



City of Palo Alto, California
2006-07
Comprehensive
Annual Financial Report
FISCAL YEAR ENDED JUNE 30, 2007



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City of Palo Alto
California

**Comprehensive
Annual Financial
Report**

**For the fiscal year ended
June 30, 2007**



Prepared by: Administrative Services Department

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City of Palo Alto
Office of the City Manager

Transmittal Letter.....

December 11, 2007

THE HONORABLE CITY COUNCIL
Palo Alto, California

Attention: Finance Committee

COMPREHENSIVE ANNUAL FINANCIAL REPORT
YEAR ENDED JUNE 30, 2007

Members of the Council and Citizens of Palo Alto:

Transmittal: The Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007, is submitted for Council review in accordance with Article III, Section 16 and Article IV, Section 13 of the City of Palo Alto Charter and published as a matter of public record for interested citizens. This transmittal letter provides information regarding the economy and the governing structure in Palo Alto. An overview of the City's financial activities for the fiscal year is discussed in detail in the Management's Discussion and Analysis section of the CAFR. While the independent auditor has expressed an opinion on the financial statements contained in this report, management takes sole responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal control that it has established for this purpose. The objective of internal controls is to provide reasonable, rather than absolute, assurance that the CAFR information is accurate in all material respects.

INDEPENDENT AUDIT

The City of Palo Alto's financial statements have been audited by Maze and Associates, a firm of licensed certified public accountants. The goal of the audit is to obtain reasonable assurance that the financial statements are free of material misstatement. Maze and Associates concluded, based on the audit, that there was a reasonable basis for rendering an unqualified opinion for the fiscal year ended June 30, 2007, and that the financial statements are fairly presented in conformity with generally accepted accounting principles (GAAP). The independent auditor's report is presented as the first component of the financial section of this report.

In addition, Maze and Associates also conducts the federally mandated "Single Audit" designed to meet the special needs of federal grantor agencies. The standards governing the Single Audit require the independent auditor to report on the fair presentation of the financial statements, government's internal controls and compliance with legal requirements. These reports are available in the Single Audit section of the CAFR.



THE PALO ALTO ECONOMY

Local Trends The City of Palo Alto, population 62,615, is a largely “built-out” community in the heart of Silicon Valley and the greater San Francisco and San Jose areas. The adjacent Stanford University, one of the premier institutions of higher education in the nation, has produced much of the talent that founded many successful high-tech companies in Palo Alto and Silicon Valley. With varied and relatively stable employers such as Stanford University, the Stanford Medical Center, the Palo Alto Medical Foundation, the Palo Alto Unified School District, the Stanford Shopping Center and businesses such as, Hewlett-Packard/Compaq, Varian, and Roche Pharmaceuticals, Palo Alto has enjoyed a diverse employment and revenue base.

In recent years, the economy has slowly but steadily recovered from the dot-com bust of 2001-2004. During the downturn the City implemented \$20.0 million in cost reductions to align General Fund expenditures and revenues. The City did not draw on reserves to solve the numerous financial tests it faced. Economically sensitive revenue sources such as sales, transient occupancy, and documentary transfer tax revenues have rebounded since the slump. Sales taxes, for example, have risen from a low of \$18.0 million in 2002-03 to \$22.2 million in 2006-07. Similarly, transient occupancy taxes have increased from \$5.3 million in 2002-03 to \$6.7 million in 2006-07 due to stronger occupancy and per diem rates. Preliminary revenue information for 2007-08 indicates that the City is meeting its budgeted revenue targets.

To date the economy of Silicon Valley and the Bay region remains vibrant as technology sales and exports continue to grow. Recent trends and events in the national and State economies, however, are of concern. The deep seated problems in the housing and credit markets appear to be taking a toll. Generally, construction activity in the nation and California has fallen and unemployment has moved upward. Sales of new and existing homes have plummeted and layoffs in the construction and mortgage financing sectors are proliferating. Should these trends have an adverse impact on consumer spending, local jurisdictions could experience a leveling or falling off in key revenue sources such as sales and property taxes.

The City continues to face and address a number of potential expense and revenue challenges in the future. These include: funding rising employee health care costs and existing and new infrastructure needs; meeting GASB 45 provisions; warding off strong competition from neighboring city retail outlets for sales tax dollars; changing technology which threatens our future UUT revenues; and preventing the potential exodus of automobile dealerships generating high sales tax receipts. Steps have been taken to deal with many of these challenges. For example, the City has changed vesting requirements for retiree medical benefits and capped funding for employee medical plans. To meet GASB 45 provisions the City has completed its first actuarial study; identified \$30.0 million to be placed into a Trust Fund to meet its retiree medical liability; and budgeted funding in 2007-08 to meet the Annual Required Contribution. To counter threats to its revenue sources, the City is working with Stanford University to expand its Shopping Center and identifying land on which automobile dealerships can relocate. Based on its efforts to date, the City is in a favorable position to meet future economic challenges.

Employment Trends Palo Alto is home to a strong mix of small, medium, and large firms. Employment opportunities within the City are much sought after and include: education at Stanford University, high technology at the Stanford Research Park, and health care at two medical facilities of national stature. Numerous institutions that have more than 1,000 employees include: the University, the Veterans Affairs Palo Alto Health Care facility, the Medical Foundation, Hewlett Packard/Compaq, the Palo Alto Unified School District, and the City of Palo Alto.

Local employment levels in the past two years have stabilized and risen modestly but steadily. Regional economists expect that Silicon Valley employment will rise by 1-2 percent in the coming year. This growth is mainly centered in the technology sector and is contributing to a low local

unemployment rate. In 2007, the City of Palo Alto's rate was 2.6 percent while Santa Clara County's stood at 4.7 percent and the State's at 5.3 percent. The State's unemployment rate is 0.7 percentage points higher than the national average and this is a result of California's exposure in the residential building sector. This situation could lead to State budget issues that have, in the past, trickled down to negatively affect local revenue sources.

Real Estate Market The Santa Clara County Assessor's Office reported in 2007-08 that, "For the third consecutive year, the growth of the assessed value of all real property and business property remained relatively constant between eight and nine percent." Palo Alto's assessments roll growth increased by 8.3 percent in 2006-07 and by 7.5 percent in 2007-08. These figures indicate a healthy local real estate market. Moreover, the City's documentary transfer tax revenue from property sales have reached their highest levels in the past two years. This is a consequence of robust transactions in the commercial and industrial property sectors. Confirmation for this activity comes in 2006-07 when the Assessor's Office "recorded a 13.0 percent increase in the number of commercial and industrial building permits." The Assessor went on to say that this increase "is likely indicator that local companies have confidence in the direction of Silicon Valley's economy, and are choosing to expand or improve their facilities. It also demonstrates the continued realignment of the local economy from high-tech manufacturing to an internet and software based economy. Companies like Adobe, Yahoo, Google, e-Bay, and Apple are expanding, while other companies like Sun and HP are consolidating their facilities."

At this time, there is no evidence that the Palo Alto residential market is in any distress. Demand for housing remains strong. In past recessions, such as in the early 1990s, Palo Alto home prices either reach a plateau or dip slightly. With its highly regarded school district, well-educated and high income population, cultural amenities, and the presence of Stanford University, the City's real estate values have been shielded from major price swings. Should another recession occur, this phenomenon is likely to repeat itself.

Cash and Investments The City of Palo Alto invests its excess cash prudently and has adopted an investment policy as prescribed by State law. The policy states that investments are to be made in the following priority order: safety, liquidity, and yield. As of June 30, 2007, the City had \$398.4 million (par value) in its portfolio. Its principal investments were in agency securities, treasuries, and a State of California investment pool. The City's investment practice is to buy securities and hold them to maturity to avoid principal loss. Staff provides a quarterly report of investments for Council review. During 2006-07, staff complied with all requirements of the City's investment policy.

THE PALO ALTO GOVERNMENT

As a charter city delivering a full range of municipal services and public utilities under the council-manager form of government, Palo Alto offers an outstanding quality of life for its residents. The independent Palo Alto Unified School District (PAUSD) has achieved state and national recognition for the excellence of its programs. The City has dedicated 4,000 acres of open space to parks and wildlife preserves. Public facilities include five libraries, four community centers, a cultural arts center, an adult and children's theater, a junior museum and zoo, and a golf course. The City provides a diversity of human services for seniors and youths, an extensive continuing education program, concerts, exhibits, team sports and special events.

City Council: The Council consists of nine members elected at-large for four-year, staggered terms. At the first meeting of each calendar year, the Council elects a Mayor and Vice-Mayor from its membership, with the Mayor having the duty of presiding over Council meetings. The Council is the appointing authority for which the City Manager and three other officials, the City Attorney, City Clerk, and City Auditor, report directly to.

Finance Committee: While retaining the authority to approve all actions, the City Council has established a subcommittee to review financial matters. Staff provides the CAFR, the results of external and internal audits, periodic budget-versus-actual, and investment and performance measure reports to the Finance Committee and Council to assist in their evaluation of the City’s financial performance.

City Manager: The City Manager directs administrative services, human resources, libraries, public works, planning and community environment, public safety, community services departments and also the municipal electric, water, gas, wastewater collection, wastewater treatment, storm drainage, and refuse utilities (the utilities represent almost two-thirds of the City’s revenues).

SUMMARY

Awards: During the past year, the City received an award for the prior fiscal year CAFR, from the Government Finance Officers Association (GFOA) for “excellence in financial reporting”. The 2006-07 CAFR has been submitted to the GFOA award program and management believes that, once again, it will meet the criteria for this distinguished financial reporting award.

Acknowledgment: This CAFR reflects the hard work, talent and commitment of the staff members of the Administrative Services Department. This document could not have been accomplished without their efforts and each contributor deserves sincere appreciation. Management wishes to acknowledge the support of Trudy Eikenberry, Accounting Manager, and the Senior Accountants, Staff Accountants, Payroll Analysts and Accounting Specialists for the high level of professionalism and dedication they bring to the City of Palo Alto. Management would also like to express its appreciation to Maze & Associates, the City’s independent auditors, who assisted and contributed to the preparation of this Comprehensive Annual Financial Report.

Special acknowledgment must be given to the City Council Finance Committee for its support and interest in directing the financial affairs of the City in a responsible, professional and progressive manner.

Respectfully submitted,



CARL YEATS,
Administrative Services Director



FRANK BENEST,
City Manager



City of Palo Alto City Officials

City Council

Yoriko Kishimoto, *Mayor*

Larry Klein, *Vice-Mayor*

John Barton	Bern Beecham
LaDoris Cordell	Peter Drekmeier
Judy Kleinberg	Jack Morton
Dena Mossar	

Finance Committee

Jack Morton, *Chair*
Bern Beecham
Larry Klein
Dena Mossar

Policy and Services Committee

John Barton, *Chair*
LaDoris Cordell
Peter Drekmeier
Judy Kleinberg

Council-Appointed Officers

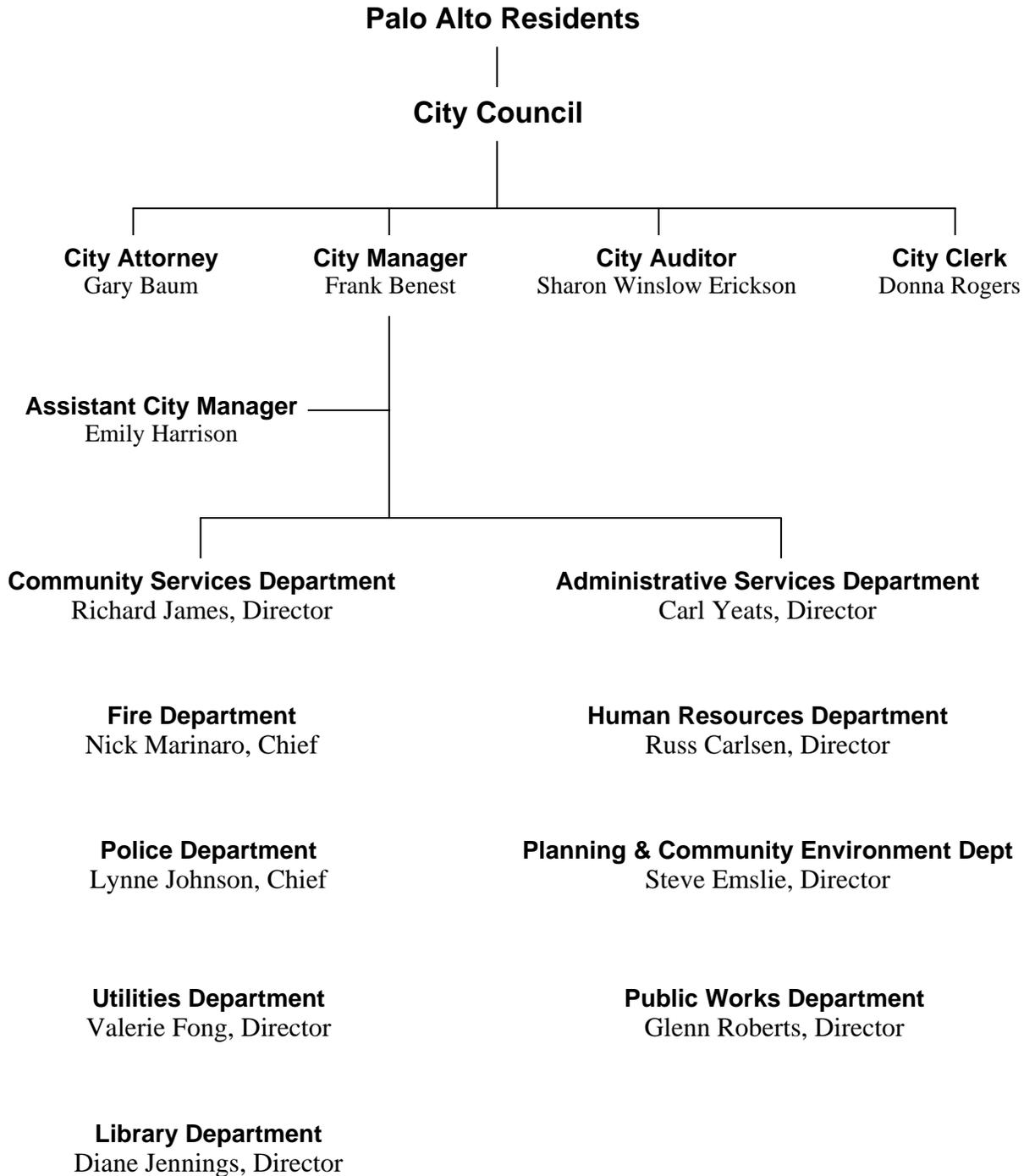
City Manager
Frank Benest

City Attorney
Gary Baum

City Clerk
Donna Rogers

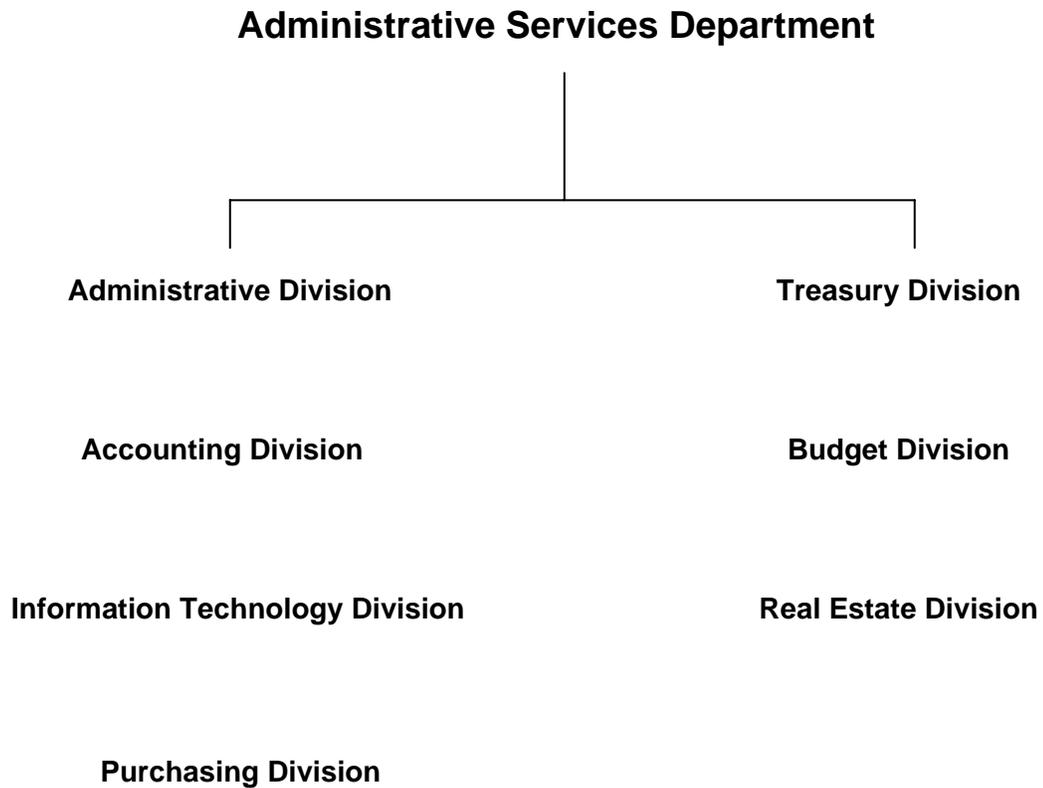
City Auditor
Sharon Winslow Erickson

City of Palo Alto Organization





Administrative Services Organization



Mission Statement

To provide proactive administrative and technical support to City departments and decision makers, and to safeguard and facilitate the optimal use of City resources.

Government Finance Officers Association of the United States and Canada – Award

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Palo Alto
California

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2006

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

Independent Auditor's Report.....

MAZE & ASSOCIATES

**INDEPENDENT AUDITOR'S REPORT
ON BASIC FINANCIAL STATEMENTS**

ACCOUNTANCY CORPORATION
3478 Buskirk Ave. - Suite 215
Pleasant Hill, California 94523
(925) 930-0902 · FAX (925) 930-0135
maze@mazeassociates.com
www.mazeassociates.com

Honorable Mayor and City Council
City of Palo Alto, California

We have audited the basic financial statements of the governmental activities, business-type activities, each major fund and the aggregate remaining fund information of the City of Palo Alto, California as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America and the standards for financial audits contained in *Government Auditing Standard*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining on a test basis evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

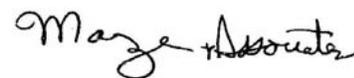
In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Palo Alto, California as of June 30, 2007 and the respective changes in the financial position and cash flows, where applicable thereof and the respective budgetary comparisons listed as part of the basic financial statements for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued reports dated October 12, 2007 on our consideration of the City of Palo Alto's internal control structure and on its compliance with laws and regulations.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The supplemental section listed in the Table of Contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The Introductory and Statistical Sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly we express no opinion on them.



October 12, 2007

A Professional Corporation



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Management's Discussion and Analysis

Management's Discussion and Analysis (MD&A) provides an overview of the City of Palo Alto's financial performance for the 2006-07 fiscal year ended June 30, 2007. To obtain a complete understanding of the City's financial condition, this document should be read in conjunction with the accompanying Transmittal Letter and Basic Financial Statements.

OVERVIEW OF THE COMPREHENSIVE ANNUAL FINANCIAL REPORT

The CAFR is presented in six sections:

- An introductory section which includes the Transmittal Letter and general information;
- Management's Discussion and Analysis;
- The Basic Financial Statements which include the Citywide and Fund Financial Statements, along with the Notes to these statements;
- Supplemental Information;
- Statistical Information; and
- Single Audit

Basic Financial Statements

The Basic Financial Statements contain the Citywide Financial Statements and the Fund Financial Statements. These statements provide long and short-term views of the City's financial activities and financial position.

The Citywide Financial Statements provide a longer-term view of the City's activities as a whole. They include the Statement of Net Assets and the Statement of Activities. The Statement of Net Assets includes the City's capital assets and long-term liabilities on a full accrual basis of accounting similar to that used by private-sector companies. The Statement of Activities provides information about the City's revenues and expenses on a full accrual basis, with an emphasis on measuring net revenues or expenses for each of the City's programs. The Statement of Activities explains in detail the change in net assets for the year. The amounts in the Statement of Net Assets and the Statement of Activities are separated into Governmental and Business-type Activities in order to provide a summary of these activities for the City.

The Fund Financial Statements display the City's operations in more detail than the Citywide statements. Their focus is primarily on the short-term activities of the City's General Fund and



other major funds such as the Capital Projects Fund, Water Services Fund, Electric Services Fund, Gas Services Fund, Wastewater Collection Fund, Wastewater Treatment Fund, Refuse Services Fund, Storm Drainage Services Fund and External Services Fund.

For certain entities and funds, the City acts solely as a depository agent. For example, the City has several Assessment Districts for which it produces fiduciary statements detailing the cash balances and activities of these districts. These statements are independent, and their balances are excluded from the City's financial statements.

Together, all these statements are called the Basic Financial Statements.

Citywide Financial Statements

Governmental Activities - All of the City's basic services are considered to be Governmental Activities. Included in basic services are the City Council, City Manager, City Attorney, City Clerk, City Auditor, Administrative Services, Human Resources, Public Works, Planning and Community Development, Police, Fire, Community Services, Library and non-departmental services. These services are supported by general City revenues such as taxes and by specific program revenues such as fees.

The City's governmental activities also include the activities of the Palo Alto Public Improvement Corporation and the Redevelopment Agency which are separate legal entities financially accountable to the City.

Business-type Activities - All of the City's enterprise activities are reported as Business-type Activities, including Water, Electric, Gas, Wastewater Collection, Wastewater Treatment, Refuse, Storm Drainage, and External Services. Unlike governmental services, these services are supported by charges paid by customers based on services used.

Citywide Financial Statements are prepared on the accrual basis of accounting, which means they measure the flow of all economic resources for the City as a whole.

Fund Financial Statements

The Fund Financial Statements provide detailed information about each of the City's most significant funds, called Major Funds. The concept of Major Funds, and the determination of which are Major Funds, was established by GASB 34 and replaces the concept of combining like funds and presenting them in total. Therefore, each Major Fund is presented individually, with all Non-major Funds combined in a single column on each fund statement. Subordinate schedules display these Non-major Funds in more detail. Major Funds present the major activities of the City for the year. The General Fund is always considered a Major Fund, but other funds may change from year to year as a result of changes in the pattern of City activities.

Fund Financial Statements include Governmental, Enterprise and Internal Service Funds.

Governmental Fund financial statements are prepared on the modified accrual basis of accounting, which means they measure only current financial resources and uses. Capital assets and other long-



lived assets, along with long-term liabilities, are presented only in the Citywide Financial Statements. In 2006-07, the City had two Major Governmental Funds, the General Fund and the Capital Projects Fund.

Enterprise and Internal Service Fund financial statements are prepared on the full accrual basis of accounting, similar to that used by private-sector companies. These statements, as in the past include all their assets and liabilities, current and long-term.

Since the City's Internal Service Funds provide goods and services exclusively to the City's Governmental and Business-type Activities, their activities are only reported in total at the Fund level. Internal Service Funds, such as Printing and Mailing services, can not be considered Major Funds because their revenues are derived from other City Funds. Revenues between Funds are eliminated in the Citywide Financial Statements and any related profits or losses in Internal Service Funds are returned to the activities in which they were created, along with any residual net assets of the Internal Service Funds.

Budget vs. Actual financial comparisons information are presented only for the General Fund and all Major Special Revenue Funds.

Fiduciary Statements

The City is the fiduciary agent for certain assessment districts, holding amounts collected from property owners which await transfer to these Districts' bond trustees. The City's fiduciary activities are reported in the separate Statements of Fiduciary Net Assets and the Agency Funds Statement of Changes in Assets and Liabilities. These activities are excluded from the City's other financial statements because the City cannot utilize these assets to finance its own operations.

FINANCIAL HIGHLIGHTS

Economic Background

The local economy has slowly but steadily recovered from the dot-com bust of 2001-2004. During the downturn, the City implemented \$20.0 million in cost reductions to align General Fund expenditures and revenues. Economically sensitive revenue sources such as sales, transient occupancy, and documentary transfer tax revenues have rebounded gradually since the slump. Sales taxes, for example, have risen from a low of \$18.0 million in 2002-03 to \$22.2 million. Preliminary revenue information for 2007-08 indicates that the City is meeting its budgeted revenue targets.

To date, the economy of Silicon Valley and the Bay region remains vibrant as technology sales and exports continue to grow. Local employment levels in the past two years have stabilized and risen modestly. Regional economists expect that Silicon Valley employment will rise by 1-2 percent in the coming year. This growth is mainly centered in the technology sector and is contributing to a low local unemployment rate. In 2007, the City of Palo Alto's rate was 2.6 percent while Santa Clara County's stood at 4.7 percent and the State's at 5.3 percent. The State's unemployment rate is 0.7 percentage points higher than the national average and this is a result of California's high exposure in the residential building sector.

Recent trends and events in the national and state economies, however, are of concern. The deep seated problems in the housing and credit markets appear to be taking a toll. Generally, construction activity in the nation and California has fallen and unemployment has moved upward. Sales of new and existing homes have plummeted and layoffs in the construction and mortgage financing sectors are proliferating. Should these trends have an adverse impact on consumer spending, local jurisdictions could experience a leveling or falling off in key revenue sources such as sales and property taxes.

The City continues to face and address a number of expense and revenue challenges in the future. These include: funding rising employee health care costs and existing and new infrastructure needs; meeting GASB 45 provisions; warding off strong competition from neighboring city retail outlets for sales tax dollars; changing technology which threatens our future UUT revenues; and preventing the potential exodus of automobile dealerships generating high sales tax receipts. The City is actively dealing with many of these challenges.

It has, for example, changed vesting requirements for retiree medical benefits and capped funding for employee medical plans. To meet GASB 45 provisions the City has completed its first actuarial study; identified \$30.0 million to be placed into a Trust Fund to meet its retiree medical liability; and budgeted funding in 2007-08 to meet the Annual Required Contribution (ARC). To counter threats to its revenue sources, the City is working with Stanford University to expand its shopping center and the City is identifying land on which automobile dealerships can relocate. Based on its efforts to date, the City is in a favorable position to meet future economic challenges.

The comparisons in the discussion and analysis below are between 2006-07 and 2005-06. All increases and decreases are expressed relative to 2005-06 results. Fiscal year 2006-07 financial highlights include the following:

Citywide

- The City's total net assets increased to \$1,061.7 million, a \$48.2 million increase.
- The City's total capital assets, net of related debt, increased to \$669.3 million, a \$39.2 million increase.
- The City's total restricted net assets increased to \$34.3 million, a \$2.7 million increase.
- The City's total unrestricted net assets increased to \$358.1 million, a \$6.3 million increase.
- Citywide revenues totaled \$371.2 million, an increase of \$14.3 million from the prior year. This total consists of \$270.9 million in program revenues and \$100.3 million in general revenues. Program revenues decreased by \$8.2 million and general revenues increased by \$22.5 million.
- Total Citywide expenses were \$323.0 million, a \$9.3 million increase.
- Citywide total assets increased to \$1,169.3 million, a \$50.4 million increase.
- Citywide capital assets, increased by \$33.8 million to \$719.5 million.
- Citywide other assets increased \$16.6 million to \$449.8 million.



- Citywide total liabilities were \$107.6 million, an increase of \$2.2 million.
- Citywide long-term debt decreased \$2.3 million to \$50.2 million.
- Citywide other liabilities were \$57.4 million, an increase of \$4.5 million.

Fund Level – Governmental Funds

- Governmental Fund balances increased to \$105.5 million, a \$4.3 million increase.
- Governmental Fund revenues increased to \$123.2 million, a \$11.6 million increase.
- Governmental Fund expenditures were \$130.7 million, a \$7.8 million increase.
- General Fund revenues came in at \$110.8 million, an increase of \$8.7 million over the prior year.
- General Fund expenditures are \$108.3 million, an increase of \$1.2 million.
- The General Fund balance of \$39.4 million at June 30, 2007 was an increase of \$5.2 million from the prior year (refer to Performance of Governmental Funds – General Fund, Page #14).

Fund Level – Enterprise Funds

- Enterprise Fund net assets increased to \$576.0 million, a \$26.3 million increase.
- Enterprise Fund operating revenues decreased to \$231.6 million, a \$9.0 million decrease from prior year revenues.
- Enterprise Fund operating expenses increased to \$190.3 million, a \$6.6 million increase.

FINANCIAL PERFORMANCE

Citywide Financial Statements – Governmental Activities

The following analysis focuses on the net assets and changes in net assets of the City’s Governmental Activities, presented in the Citywide Statement of Net Assets and Statement of Activities.

GOVERNMENTAL ACTIVITIES			
<i>Net Assets at June 30</i>			
(in Millions)			
	2007	2006	Increase/ (Decrease) from 2006
Cash and investments	\$173.0	\$160.2	\$12.8
Other assets	29.3	29.9	(0.6)
Capital assets	335.7	324.8	10.9
Total Assets	538.0	514.9	23.1
Long-term debt outstanding	9.3	10.2	(0.9)
Other liabilities	42.5	39.7	2.8
Total Liabilities	51.8	49.9	1.9
Net Assets:			
Invested in capital assets, net of debt	326.4	311.3	15.1
Restricted	32.6	29.9	2.7
Unrestricted	127.2	123.8	3.4
Total Net Assets	\$486.2	\$465.0	\$21.2

The City’s governmental total net assets increased \$21.2 million to \$486.2 million in 2006-07. This change results from the following:

- Cash and investments increased by \$12.8 million primarily from an increase in the Internal Service Funds cash balance.
- Capital assets increased \$10.9 million net of depreciation; \$9.2 million is a result of roadway network and \$1.4 million of recreation and open space network.
- Other liabilities increased by \$2.8 million, primarily from a \$1.5 million increase in claims payable and \$1.0 million increase in accounts payable.

- Net assets invested in capital assets, net of related debt increased \$15.1 million as the City added General Fund infrastructure assets as discussed in the Capital Assets section.
- Unrestricted net assets increased \$3.4 million for a total of \$127.2 million; this represents current net assets available to finance subsequent year operations and other expenditures approved by City Council.

GOVERNMENTAL ACTIVITIES

Revenues for the Year ended June 30

(in Millions)

Revenues by Source	2007	2006	Increase/ (Decrease) from 2006
Program Revenues:			
Charges for services	\$31.1	\$31.1	\$0.0
Operating contributions & grants	5.6	4.0	1.6
Capital contributions & grants	1.8	3.2	(1.4)
Total Program Revenues	38.5	38.3	0.2
General Revenues:			
Property Taxes	21.5	18.7	2.8
Sales Taxes	22.2	20.3	1.9
Utility User's Taxes	9.4	8.8	0.6
Transient Occupancy Tax	6.7	6.4	0.3
Other Taxes and Fines	6.3	7.0	(0.7)
Investment Earnings	8.7	2.6	6.1
Rents and Miscellaneous	13.7	10.4	3.3
Total General Revenues	88.5	74.2	14.3
Total Revenues	\$127.0	\$112.5	\$14.5

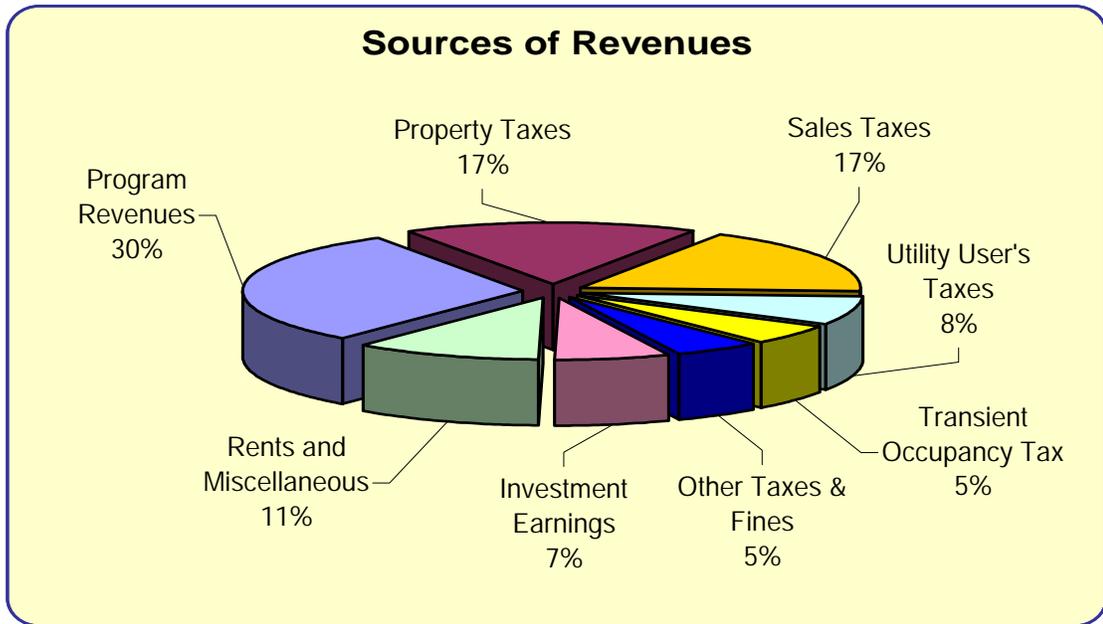
Governmental Activities – Revenues

The table above shows that governmental revenues totaled \$127.0 million in 2006-07, an increase of \$14.5 million compared to prior year revenues of \$112.5 million.

Property taxes had an increase of \$2.8 million, sales taxes increased by \$1.9 million, the utility user’s tax rose by \$0.6 million, and transient occupancy taxes by \$0.3 million. Other taxes and fines declined by \$0.7 million. Investment earnings increased by \$6.1 million. This is a result of the year-end adjustment to carrying value for investments and reflects the year to year change in carrying value. This mark to market value is a requirement of GASB 31.

Miscellaneous revenues had an increase of \$3.3 million from the prior year due to an accounting reclassification of inter-department revenues and charges.

Program revenues such as charges for services; operating grants and contributions; and capital grants and contributions are generated from or restricted to each activity. Program revenues include contributions from the University Avenue Off-Street Parking Assessment District as well as other recurring resources.



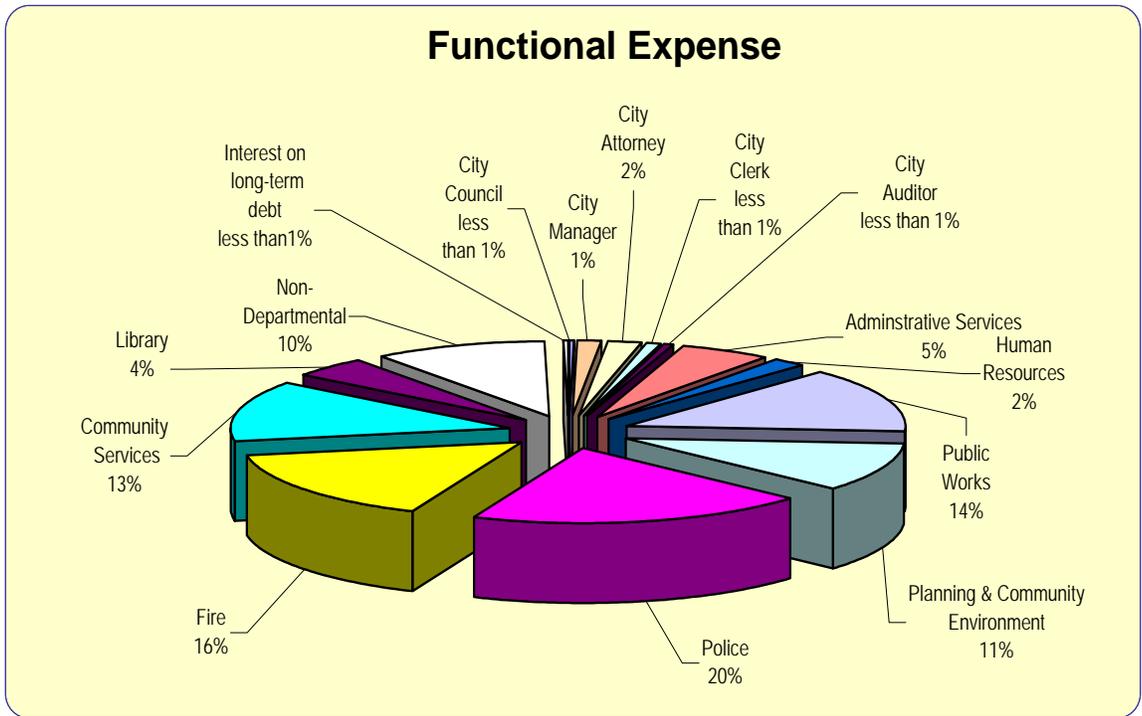
General revenues are composed of taxes and other revenues not specifically generated by or restricted to individual activities. All tax revenues, investment earnings, rents for governmental facilities, and fees for services are included in general revenues.

Governmental Activities – Expenses

The table below presents a comparison of 2006-07 and 2005-06 expenses (does not include encumbrances and reappropriations) by Governmental Activities and interest on long-term debt. Total Governmental Activities functional expense was \$121.6 million in 2006-07, an increase of \$2.7 million.

GOVERNMENTAL ACTIVITIES			
<i>Expenses for the Year ended June 30</i>			
(in Millions)			
Activities	2007	2006	Increase/ (Decrease) from 2006
City Council	\$0.2	\$0.1	\$0.1
City Manager	1.8	1.6	0.2
City Attorney	2.4	2.6	(0.2)
City Clerk	0.9	0.9	0.0
City Auditor	0.8	0.8	0.0
Administrative Services	6.4	7.0	(0.6)
Human Resources	2.5	2.6	(0.1)
Public Works	16.6	17.6	(1.0)
Planning and Community Environment	12.9	9.9	3.0
Police	23.9	23.4	0.5
Fire	19.5	18.8	0.7
Community Services	15.7	17.3	(1.6)
Library	5.4	5.4	0.0
Non-Departmental	12.1	10.4	1.7
Interest on long-term debt	0.5	0.5	0.0
Total Functional Expense	\$121.6	\$118.9	\$2.7
Increase/(Decrease) in Net Assets before Transfers	5.3	(6.3)	11.6
Transfers in	\$15.8	\$21.5	(\$5.7)
Change in Net Assets	\$21.1	\$15.2	\$5.9
Net Assets-Beginning	465.1	449.8	15.3
Net Assets-Ending	\$486.2	\$465.0	\$21.2

The Functional Expenses Chart below includes only current year expenses. It does not include capital outlays, which are now added to the City's capital assets. In 2006-07, the City added \$10.9 million in capital assets. The composition of 2006-07 additions is shown in detail in the Capital Asset section of the Management's Discussion and Analysis.



Citywide Financial Statements – Business-Type Activities

The following analysis focuses on the net assets and changes in net assets of the City's Business-type Activities presented in the Citywide Statement of Net Assets and Statement of Activities.

BUSINESS-TYPE ACTIVITIES			
<i>Net Assets at June 30</i>			
(in Millions)			
	2007	2006	Increase/ (Decrease) from 2006
Cash and investments	\$222.5	\$209.0	\$13.5
Other assets	25.0	34.1	(9.1)
Capital assets	383.8	360.9	22.9
Total Assets	631.3	604.0	27.3
Long-term debt outstanding	40.9	42.3	(1.4)
Other liabilities	14.9	13.2	1.7
Total Liabilities	55.8	55.5	0.3
Net assets:			
Invested in capital assets, net of debt	342.9	318.8	24.1
Restricted	1.7	1.7	0.0
Unrestricted	230.9	228.0	2.9
Total Net Assets	\$575.5	\$548.5	\$27.0

The City's Business-type total net assets increased \$27.0 million to \$575.5 million in 2006-07.

- Cash and investments increased \$13.5 million as a result of operations.
- Other assets decreased \$9.1 million to \$25.0 million primarily as the result of a decrease of \$10.0 million in Accounts Receivable.
- Capital assets increased \$22.9 million to \$383.8 million in 2006-07. This increase is primarily a result of water, electric and gas infrastructure improvements totaling \$14.6 million.
- Net assets invested in capital assets net of related debt increased \$24.1 million to \$342.9 million. The increase was mostly due to \$4.0 million of improvements in the Water Fund, \$6.6 million in Electric Fund improvements, \$4.7 million in Gas Fund improvements and \$7.6 million in Wastewater Collection Fund improvements.
- Unrestricted net assets of \$230.9 million, an increase of \$2.9 million over the prior year, represent liquid assets available to finance day-to-day operations and other expenditures approved by the City Council. This amount includes Council designated reserves such as the rate stabilization reserves of \$95.6 million, the Calaveras reserve for stranded costs of \$71.8 million and the emergency plant replacement reserve of \$8.2 million.

BUSINESS-TYPE ACTIVITIES

Revenues for the Year ended June 30
(in Millions)

Revenues by Source	2007	2006	Increase/ (Decrease) from 2006
Program Revenues:			
Water	\$24.0	\$21.1	\$2.9
Electric	102.6	119.4	(16.8)
Gas	42.2	37.0	5.2
Wastewater Collection	15.1	13.8	1.3
Wastewater Treatment	17.0	18.8	(1.8)
Refuse	25.5	24.8	0.7
Storm Drainage	5.2	5.2	0.0
External Services	0.8	0.8	0.0
Total Program Revenues	232.4	240.9	(8.5)
General Revenues:			
Investment Earnings	11.9	3.6	8.3
Total General Revenues	11.9	3.6	8.3
Total Revenues	\$244.3	\$244.5	(\$0.2)

The table above presents the revenues for each of the City’s Business-type Activities or Enterprise Funds. The City operates the Water, Electric, Gas, Wastewater Collection, Wastewater Treatment, Refuse, Storm Drainage and External Services Enterprise Funds, which are Major Funds and are presented in the Basic Financial Statements.

Business-type Activity revenues totaled \$244.3 million, a decrease of \$0.2 million from the prior year. Revenues were significantly affected by the following events:

- Program Revenue for the Water Fund increased \$2.9 million primarily due to a 7 percent rate increase effective July 1, 2006 and 5 percent increased consumption.
- Surplus Energy Revenue for the Electric Fund decreased \$16.8 million due to volatile drought conditions and a low hydro year. The City also made a policy decision not to raise rates. (Further detail may be found in Note 16 to the financial statements).
- Program Revenue for the Gas Fund increased \$5.2 million primarily due to a 20 percent rate increase effective July 1, 2006.
- Investment earnings increased \$8.3 million due to the year-end adjustment to the carrying value for investments.

BUSINESS-TYPE ACTIVITIES

Expenses for the Year ended June 30
(in Millions)

Activities	2007	2006	Increase/ (Decrease) from 2006
Water	\$16.8	\$15.9	\$0.9
Electric	99.2	91.6	7.6
Gas	30.7	29.1	1.6
Wastewater Collection	10.0	11.0	(1.0)
Wastewater Treatment	15.9	16.7	(0.8)
Refuse	25.4	27.0	(1.6)
Storm Drainage	2.6	2.7	(0.1)
External Services	0.8	0.8	0.0
Total Functional Expense	\$201.4	\$194.8	\$6.6
Increase in Net Assets before Transfers/Special Items	42.8	49.6	(6.8)
Transfers/Special Items			
Special Item	0.0	0.0	0.0
Transfers out	15.8	21.5	(5.7)
Total Transfers/Special Items	\$15.8	\$21.5	(\$5.7)
Change in Net Assets	\$27.0	\$28.1	(\$1.1)
Net Assets-Beginning	548.5	520.4	28.1
Net Assets-Ending	\$575.5	\$548.5	\$27.0

The table above presents a comparison of the 2006-07 and 2005-06 expenses for the City’s Business-type Activities. Encumbrances and reappropriations are not included.

Business-type Activity expenses, transfers and special items increased \$1.1 million for a total of \$217.2 million. Changes to expenses were significantly affected by the following events:

- Functional Expense for the Electric Fund increased \$7.6 million primarily due to the net of a \$17.4 million increase in the retail purchase of utilities and a \$10.5 million decrease in Surplus Energy costs. Both costs are associated with the decrease in Surplus Energy revenue due to unfavorable weather conditions. This was a planned drawdown of the rate stabilization reserve. (Further detail may be found in Note 16 to the financial statements).
- Functional Expense for the Gas Fund increased \$1.6 million, primarily due to \$0.9 million increase in commodity costs associated with declining production and increasing demand. (Further detail may be found in Note 16 to the financial statements).

- Transfers In/Out decreased \$5.7 million. The prior year included transfers to the Retiree Health Benefit Internal Service Fund as a partial payment toward the unfunded retiree medical liability.

FUND FINANCIAL STATEMENTS

Performance of Governmental Funds

At June 30, 2007, the City's Governmental Funds reported combined fund balances of \$105.5 million, an increase of \$4.3 million or 4.3 percent compared with the prior year.

Governmental Fund revenues and other financing sources increased \$12.6 million for a total of \$150.9 million. Revenues and other financing sources in the General Fund increased \$8.9 million; Capital Project Fund decreased \$0.4 million and Non-major Fund revenues and other financing sources increased by \$4.2 million.

Governmental Fund expenditures and other uses increased \$11.3 million this year to \$146.6 million. General Fund expenditures and other uses increased \$6.1 million, Capital Projects Fund expenditures increased by \$3.3 million; and Non-major Fund expenditures and other uses increased by \$1.9 million.

General Fund – The General Fund ended the year with a \$5.2 million increase for a total of \$39.4 million fund balance, compared to \$2.4 million increase in the prior year.

Palo Alto's General Fund revenues totaled \$110.8 million in 2006-07. This represents an increase of \$8.7 million or 8.5 percent compared to the prior year.

Property taxes increased by \$2.8 million or 14.6 percent from 2005-06 to 2006-07. More than half or \$1.5 million of this variance was a consequence of a State "takeaway" of local revenue in 2005-06 that was restored in 2006-07. The remaining difference is a result of a more resilient real estate market than anticipated. Actual revenues exceeded the adopted budget by \$1.1 million and the final budget by \$0.4 million or 1.9 percent. In particular, the City's commercial sector has been active in terms of sales and subsequent higher valuations. The adopted budget of \$20.4 million was increased at midyear by \$0.7 million or 3.5 percent for a final budget of \$21.1 million. The residential market and assessed values have grown and remain healthy.

Sales taxes rose by \$1.9 million or 9.2 percent over 2005-06 levels. Nearly \$1.0 million of the increase was a result of the State's increased "triple-flip" payment to the City. The higher payment is based on timing of payments in 2005-06 and 2006-07 and on higher sales tax receipts. Overall there was an increase in City sales taxes and they exceeded the final budget by \$0.9 million and the adopted budget by \$1.1 million. Sales in the technology/electronic sector rose substantially. This is a particularly volatile economic segment that can vary significantly from year to year. Department stores, restaurants, automobile dealerships and apparel stores also turned in a strong performance.

The City's Utility Users Tax (UUT) at 5.0 percent is levied on telephone, water, electricity, and gas usage. This revenue source rose by \$0.6 million or 6.8 percent over the prior year. Actual revenue



exceeded the budget by \$0.3 million or by 3.7 percent. Utility rates increased considerably over the prior year due to commodity costs and the building of reserves. In addition, a telephone provider changed a billing practice to coincide with the City's ordinance and this resulted in higher receipts.

Transient Occupancy Tax (TOT) receipts rose to \$6.7 million in 2006-07, equaling a \$0.3 million or 4.9 percent increase over the prior year. Actual revenue results were on target with the final budget of \$6.7 million and were \$0.3 million higher than the adopted budget. The adopted budget of \$6.4 million was increased at mid-year by \$0.3 million or 5.4 percent as a result of higher demand. Average occupancy rates increased from 70.5 percent in 2005-06 to 72.4 percent in 2006-07. Average daily room rates increased from \$131 to \$137 and occupancy rates increased as well. This economically sensitive revenue, as is sales tax, has rebounded due to a solid local economy.

Other Taxes, Fines & Penalties had a mid-year budget increase of \$0.3 million from \$7.4 million to \$7.7 million. This category includes the Documentary Transfer Tax. The Documentary Transfer Tax turned in a second year of solid results at \$5.8 million. It exceeded the final budget by nearly \$1.0 million and the adopted budget by \$1.3 million. This revenue source is highly dependent on the volume of sales and the mix of commercial and residential sales. The budget is projected based on historical performance and a judgment on future real estate activity. As with property tax projections, a softening in this sector was anticipated. The volume of sales in the commercial sector outpaced expectations and residential market transactions remained firm.

Charges for Services reached \$19.8 million in 2006-07 an increase of \$1.1 million from the prior year and an increase of \$0.7 million from the adopted budget. This increase is primarily due to an increase in charges to Stanford for fire and communication support of \$0.5 million from prior year, paramedic service fees which exceeded prior year by \$0.2 million and Architect Review Board fees which exceeded prior year by \$0.2 million. Zoning plan check fees saw an increase of \$0.3 million from the adopted budget.

Other Revenues totaled \$5.9 million in 2006-07, an increase of \$0.3 million from the prior year and an increase of \$2.1 million from the adjusted budget. This increase is primarily due to a \$2.8 million increase in the year end adjustment to the carrying value of investments, partially offset by a \$2.5 million decrease in local revenues. In 2005-06, \$2.5 million in grant revenue was received for the purchase of the Bressler property.

At June 30, 2007, the General Fund Balance totaled \$39.4 million. This represents 36.4 percent of direct General Fund expenditures providing a buffer against unexpected financial events. Of this, \$8.4 million is reserved and \$31.0 million is unreserved. Included in the reserved amount is \$1.3 million for the prepayment of Storm Drain rate increases over a three year period. A substantial portion of the unreserved balance amount is designated by the Council for budget stabilization, \$27.5 million at year-end. The designation for equity transfer stabilization designation, established in 2001-02, amounted to \$3.4 million at year-end. This reserve would be utilized in the event that the Electric or Gas Funds were not in a position to make their required equity transfer to the General Fund.

General Fund expenditures and other uses totaled \$121.1 million, an increase of \$6.0 million from the prior year. This increase was due to a \$2.6 million increase in the operating transfer for infrastructure reserve to the Capital Projects Fund and a \$2.9 million increase in the operating transfer to the Retiree Health Benefit Internal Service Fund.



The Planning department had an increase of \$1.1 million to the adopted budget for an ending budget of \$9.9 million. This increase was required to offset salary expenditures needed for increased workloads due an increased volume of permit processing, as a result of new construction as mentioned above. Planning department expenditures and encumbrances were \$0.1 million less than final budget and \$1.0 million more than the prior year.

Administrative departments had an increase of \$2.1 million to the adopted budget for a final budget of \$17.8 million. This increase was due to increases in legal fees of \$0.7 million, contract expenditures of \$0.3 million and increases in audit fees of \$0.2 million.

Community Services department adopted budget was increased by \$1.2 million for an ending balance of \$21.0 million. This increase was required for contract expenditures \$0.5 million and \$0.5 million for expenditures related to grants and subsidies of \$0.5 million. Community Services department expenditures and encumbrances were \$3.2 million less than the prior year. The prior year included the purchase of the Bressler property for \$3.6 million.

The Police department had an increase in expenditures and encumbrances of \$1.4 million from the prior year for a total of \$26.1 million. This increase was primarily due to increases for salaries and benefits of \$1.1 million and information technology support of \$0.7 million.

The Fire department had an increase in expenditures and encumbrances of \$1.4 million from the prior year for a total of \$21.8 million. This increase was primarily due to increases in salaries and benefits.

The Public Works department had an increase of \$0.7 million to the adopted budget for a final budget of \$13.2 million. Actual expenditures and encumbrances were \$12.9 million, an increase of \$1.0 million from the prior year. This was due to \$0.6 million increase for salaries and benefits, \$0.2 million for facilities maintenance and \$0.2 million for information technology support.

Non-departmental adopted budget was decreased by \$1.4 million for an ending balance of \$8.3 million. Actual expenditures were \$8.5 million, a decrease of \$1.6 million from the prior year. This decrease in budget and actual expenditures reflect lower estimates on non-departmental allocated costs.

Capital Projects Fund – Capital Projects Fund expenditures and other uses were \$17.2 million in 2006-07, which is an increase of \$3.3 million from the prior year. This increase is mainly the result of increase expenditures of capital projects of \$3.7 million and a decrease of \$0.4 million in other financing uses. This level of expenditure is consistent with the City’s effort to rehabilitate and maintain its existing infrastructure.

Non-major Funds -These funds are not presented separately in the Basic Financial statements, but are individually presented as Supplemental Information.



Performance of Enterprise Funds

At June 30, 2007, the City's Enterprise Funds reported total net assets of \$576.0 million, an increase of \$26.3 million or 4.8 percent compared with the prior year. The Water, Electric and Gas Funds contributed net assets of \$6.5 million, \$1.8 million and \$9.0 million, respectively, to total net assets. These assets constitute 65.8 percent of the Enterprise Funds' total net assets. Unrestricted net assets for these three funds totaled \$194.7 million, a 1.4 percent increase from 2005-06.

Water Fund – The Water Fund ended the year with net income of \$6.5 million, compared to \$1.7 million in the prior year, a \$4.8 million increase. The increase in net income is primarily due to an increase in operating revenues of \$2.9 million the result of a 7 percent rate increase effective July 1, 2006, an increase in interest income and transfers in of \$1.6 million.

Electric Fund – Operating revenues decreased to \$102.6 million in 2006-07, a \$16.8 million decrease from the prior year. This decrease is primarily due to a decrease of \$16.6 million in Surplus Energy Revenue, the result of weather conditions and a planned drawdown of the rate stabilization reserve. The Electric Fund ended the year with a net income of \$1.8 million compared to a net income of \$18.2 million in 2005-06.

Gas Fund – A 20 percent rate increase effective July 1, 2006 increased revenue \$5.2 million over 2005-06. The Gas Fund ended the year with a net income of \$9.0 million, compared to a \$3.8 million in 2005-06, an increase of \$5.2 million.

Wastewater Collection Fund - Operating revenues increased to \$14.9 million, a \$1.1 million increase from 2005-06. An increase in service connection charges contributed to the revenue increase. Operating expenses decreased to \$10.0 million, a \$0.7 million decrease from 2005-06, and interest income and transfers increased by \$1.1 million. The Wastewater Collection Fund ended the year with a net income of \$5.5 million, an increase of \$2.9 million from 2005-06.

Wastewater Treatment Fund – Revenues decreased in 2006-07 by \$1.8 million due to decreased partner billings for the Water Reclamation and Flow Meter projects. The Wastewater Treatment Fund ended the year with a net income of \$.2 million, compared to a net income of \$1.3 million in 2005-06.

Refuse Fund – Refuse Fund revenues increased to \$25.5 million in 2006-07, compared to \$24.8 million in 2005-06. Operating expenses decreased \$1.3 million to \$25.1 million in 2006-07. The Refuse Fund ended the year with a net income of \$0.6 million, compared to a \$2.6 million net loss in 2005-06.

Storm Drainage Fund – The Storm Drainage Fund ended the year with a net income of \$2.7 million, as compared to a net income of \$2.9 million in 2005-06.

External Services Fund - Created in 2001-02, this Fund provides information technology and training services to neighboring municipalities and other community organizations. The External Services Fund ended the year with a net loss of \$9.0 thousand as compared to a net loss of \$12.0 thousand in 2005-06.

CAPITAL ASSETS

GASB 34 requires the City to record all its capital assets including infrastructure. Infrastructure includes roads, bridges, signals and similar assets used by the entire population. Although GASB 34 allowed the City four years to record all its infrastructure assets in its financial statements, as of June 30, 2002 all assets were included in the financial statements. The table below shows capital assets and the amount of accumulated depreciation for these assets for Governmental and Business-type Activities (further detail may be found in Note 6 to the financial statements).

CAPITAL ASSETS AT JUNE 30 (in Millions)

	2007	2006	Increase/ (Decrease) from 2006
Governmental Activities			
<i>Capital Assets</i>			
Land and improvements	\$71.4	\$71.4	\$0.0
Street trees	15.0	15.3	(0.3)
Construction in progress	29.9	24.4	5.5
Buildings and improvements	93.5	91.2	2.3
Equipment	8.2	8.6	(0.4)
Roadway network	239.2	230.0	9.2
Recreation & open space network	13.5	12.1	1.4
Less accumulated depreciation	(149.4)	(142.2)	(7.2)
<i>Internal Service Fund Assets</i>			
Construction in progress	4.4	3.2	1.2
Equipment	32.0	32.0	(0.0)
Less accumulated depreciation	(22.0)	(21.2)	(0.8)
Total Governmental	\$335.7	\$324.8	\$10.9
Business-type Activities			
Land	\$1.9	\$1.9	\$0.0
Construction in progress	89.0	63.1	25.9
Buildings and improvements	18.9	18.1	0.8
Transmission, Distribution & Treatment Systems	480.1	471.5	8.6
Less accumulated depreciation	(206.1)	(193.8)	(12.3)
Total Business-type	\$383.8	\$360.8	\$23.0



Governmental Activities capital assets net of depreciation, increased by \$10.9 million compared to 2005-06. This increase was primarily due to a \$9.2 million increase for the roadway network and \$1.4 million of recreation and open space network.

Work on the City's infrastructure is a continuation of a ten-year plan, totaling \$100 million, developed to address the needs of the City's aging infrastructure. The ten-year plan included an assessment and prioritization of work needed on buildings, facilities, streets, sidewalks, medians, bikeways, parks and open space. Current key infrastructure projects include improvements to streets and sidewalks, refurbishing of park playgrounds and irrigation systems, upgrading athletic fields, open space and trail improvements, and facility renovations.

The City depreciates all its capital assets over their estimated useful lives, as required by GASB 34. The purpose of depreciation is to spread the cost of a capital asset over the years of its useful life so that an allocable portion of the cost of the asset is borne by all users. Additional information on capital assets and depreciable lives may be found in Note 6.

DEBT ADMINISTRATION

Each of the City's debt issues is discussed in detail in Notes 7 and 8 to the financial statements. At June 30, 2007, the City's debt was comprised of the following:

LONG-TERM DEBT AT JUNE 30

(in Millions)

	2007	2006	Increase/ (Decrease) from 2006
Governmental Activity Debt:			
General Long Term Obligations:			
1998 Golf Course Certificates of Participation	\$5.1	\$5.4	(\$0.3)
2002A Civic Center Refinancing Certificates of Participation	1.9	2.2	(0.3)
2002B Downtown Parking Improvements Certificates of Participation	2.2	2.3	(0.1)
Special Assessment Debt with City Commitment			
1987 California Avenue Parking Bonds	0.1	0.2	(0.1)
Total Governmental Activity Debt	\$9.3	\$10.1	(\$0.8)
Business-type Activity Debt:			
Enterprise Long Term Obligations:			
Utility Revenue Bonds			
1995 Series A	\$6.0	\$6.3	(\$0.3)
1999 Refunding	14.7	15.1	(0.4)
2002 Series A	21.2	21.9	(0.7)
Less: unamortized discount/issuance cost	(1.0)	(1.0)	0.0
Total Business-type Activity	\$40.9	\$42.3	(\$1.4)

The City did not issue any new debt in 2006-07. As stated in the Statistical Section of the CAFR, the combined direct debt ratio to assessed valuation for the General Fund is a low 0.05 percent compared to the allowable, legal debt margin of 15 percent.



SPECIAL ASSESSMENT DISTRICT DEBT

Special assessment districts throughout different parts of the City have also issued debt to finance infrastructure and facilities construction exclusively in their districts. At June 30, 2007, a total of \$0.1 million in special assessment district debt was outstanding, issued by the California Avenue Parking Special Assessment District. The City is contingently obligated for this debt, therefore it has been included as part of the City's governmental long-term debt.

ECONOMIC OUTLOOK

The economy of the City is discussed in the accompanying Transmittal Letter and in this Discussion and Analysis.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

The CAFR is intended to provide citizens, taxpayers, investors, and creditors with a general overview of the City's finances. Questions about this report should be directed to the Administrative Services Department, at 250 Hamilton Avenue, 4th Floor, Palo Alto, California. This report and other financial reports can be viewed on the City of Palo Alto website at: www.cityofpaloalto.org. On the home page, select City Departments, select Administrative Services, and select Financial Reporting. Within Financial Reporting there are links to reports by title and reporting date.



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Citywide Statement of Net Assets and Statement of Activities.....

The Citywide Statement of Net Assets and the Statement of Activities summarize all of the City’s financial activities and financial position. They are prepared on the same basis as is used by most businesses, which means they include all the City’s assets and all its liabilities, as well as all its revenues and expenses. This is known as the full accrual basis – the effect of all the City’s transactions is taken into account, regardless of whether or when cash changes hands. All material internal transactions between City funds have been eliminated.

The Statement of Net Assets reports the difference between the City’s total assets and the City’s total liabilities, including all the City’s capital assets and all its long-term debt. The Statement of Net Assets focuses the reader on the composition of the City’s net assets, by subtracting total liabilities from total assets.

The Statement of Net Assets summarizes the financial position of all the City’s Governmental Activities in a single column, and the financial position of all the City’s Business-type Activities in a single column; these columns are followed by a Total column that presents the financial position of the entire City.

The City’s Governmental and Business-type Activities include the activities of its General Fund, along with all its Special Revenue, Capital Projects, Debt Service Funds, and Enterprise Funds. Since the City’s Internal Service Funds service these Funds, their activities are consolidated with Governmental and Business-type Activities, after eliminating inter-fund transactions and balances.

The Statement of Activities reports increases and decreases in the City’s net assets. It is also prepared on the full accrual basis, which means it includes all the City’s revenues and all its expenses, regardless of when cash changes hands. This differs from the “modified accrual” basis used in the Fund financial statements, which reflect only current assets, current liabilities, available revenues and measurable expenditures.

The format of the Statement of Activities presents the City’s expenses first, listed by program, and follows these with the expenses of its Business-type Activities. Program revenues – that is, revenues which are generated directly by these programs – are then deducted from program expenses to arrive at the net expense of each governmental and Business-type program. The City’s general revenues are then listed in the Governmental Activities or Business-type Activities column, as appropriate, and the Change in Net Assets is computed and reconciled with the Statement of Net Assets.

These Statements include the financial activities of the City Public Improvement Corporation and Redevelopment Agency, which are legally separate component units of the City because they are controlled by the City, which is financially accountable for its activities.

These financial statements along with the fund financial statements and footnotes are called *Basic Financial Statements*.



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City of Palo Alto - Statement of Net Assets

June 30, 2007

(In thousands of dollars)

	Governmental Activities	Business-type Activities	Totals
ASSETS			
Cash and investments (Note 3):			
Available for operations	\$170,789	\$220,659	\$391,448
Cash and investments with fiscal agent	2,235	1,788	4,023
Receivables:			
Accounts and intergovernmental	8,875	22,939	31,814
Interest receivable	2,172	2,862	5,034
Notes and loans receivable (Note 5)	13,218		13,218
Internal balances (Note 4)	712	(712)	
Prepaid items	1,253		1,253
Inventory of materials and supplies (Note 1)	3,071		3,071
Capital assets (Note 6):			
Nondepreciable	120,758	90,922	211,680
Depreciable, net of depreciation	214,943	292,887	507,830
	<u>538,026</u>	<u>631,345</u>	<u>1,169,371</u>
Total assets			
LIABILITIES			
Accounts payable and accrued liabilities	7,383	7,101	14,484
Accrued salaries and benefits	1,526	711	2,237
Unearned revenue	1,020		1,020
Accrued compensated absences (Note 1):			
Due within one year	3,482		3,482
Due in more than one year	8,018		8,018
Claims payable (Note 14):			
Due within one year	5,939		5,939
Due in more than one year	15,191		15,191
Accrued landfill closure liability (Note 9):			
Due in more than one year		7,080	7,080
Long-term debt (Notes 7 and 8):			
Due within one year	885	1,525	2,410
Due in more than one year	8,405	39,362	47,767
	<u>51,849</u>	<u>55,779</u>	<u>107,628</u>
Total liabilities			
NET ASSETS (Note 10)			
Invested in capital assets, net of related debt	326,411	342,922	669,333
Restricted for:			
Special revenue programs	23,549		23,549
Capital projects			
Downtown parking structure	56		56
Other capital projects	7,372		7,372
Debt service	1,599	1,732	3,331
	<u>32,576</u>	<u>1,732</u>	<u>34,308</u>
Total Restricted			
Unrestricted net assets	127,190	230,912	358,102
	<u>\$486,177</u>	<u>\$575,566</u>	<u>\$1,061,743</u>
Total net assets			

See accompanying notes to financial statements

City of Palo Alto - Statement of Activities

For the Year Ended June 30, 2007

(In thousands of dollars)

Functions/Programs	Total Expenses	Program Revenues			Net (Expense) Revenue and Change in Net Assets		Total
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	
Governmental Activities:							
City Council	\$180				(\$180)		(\$180)
City Manager	1,760				(1,760)		(1,760)
City Attorney	2,390	\$13			(2,377)		(2,377)
City Clerk	900				(900)		(900)
City Auditor	838				(838)		(838)
Administrative Services	6,419	835			(5,584)		(5,584)
Human Resources	2,472	11			(2,461)		(2,461)
Public Works	16,645	968	\$1,610	\$1,740	(12,327)		(12,327)
Planning and Community Environment	12,929	6,267	3,428	16	(3,218)		(3,218)
Police	23,861	4,179	336		(19,346)		(19,346)
Fire	19,530	9,610	54		(9,866)		(9,866)
Community Services	15,729	9,128	132		(6,469)		(6,469)
Library	5,347	146	82		(5,119)		(5,119)
Non-Departmental	12,133				(12,133)		(12,133)
Interest on long-term debt	477				(477)		(477)
Total Governmental Activities	121,610	31,157	5,642	1,756	(83,055)		(83,055)
Business-type Activities:							
Water	16,794	23,495		542		\$7,243	7,243
Electric	99,294	102,549				3,255	3,255
Gas	30,690	42,221		1		11,532	11,532
Wastewater Collection	10,085	14,848		213		4,976	4,976
Wastewater Treatment	15,901	16,957				1,056	1,056
Refuse	25,372	25,532				160	160
Storm Drainage	2,517	5,181				2,664	2,664
External Services	767	789				22	22
Total Business-type Activities	201,420	231,572		756		30,908	30,908
Total	\$323,030	\$262,729	\$5,642	\$2,512	(83,055)	30,908	(52,147)
General revenues:							
Taxes:							
Property taxes					21,466		21,466
Sales taxes					22,194		22,194
Utility user's taxes					9,356		9,356
Transient occupancy tax					6,709		6,709
Other taxes					6,293		6,293
Investment earnings					8,747	11,910	20,657
Miscellaneous					13,670		13,670
Transfers (Note 4)					15,754	(15,754)	
Total general revenues and transfers					104,189	(3,844)	100,345
Change in Net Assets					21,134	27,064	48,198
Net Assets-Beginning					465,043	548,502	1,013,545
Net Assets-Ending					\$486,177	\$575,566	\$1,061,743

See accompanying notes to financial statements



Fund Financial Statements.....

Introduction

The Fund Financial Statements are presented by individual major funds, while non-major funds are combined in a single column. Major funds are defined generally as having significant activities or balances in the current year.

Major Governmental Funds

The funds described below were determined to be Major Funds by the City in fiscal year 2006-07. Individual non-major funds may be found in the Supplemental section.

General Fund

The General Fund is used for all the general revenues of the City not specifically levied or collected for other City funds, and related expenditures.

Capital Projects Fund

The Capital Projects Fund is utilized to account for resources used for the acquisition and construction of capital facilities by the City, with the exception of those assets financed by proprietary funds.



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City of Palo Alto - Governmental Funds

Balance Sheet - June 30, 2007

(In thousands of dollars)

	General	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
ASSETS				
Cash and investments (Note 3):				
Available for operations	\$30,737	\$39,833	\$ 11,295	\$81,865
Cash and investments with fiscal agent		915	1,320	2,235
Receivables:				
Accounts and intergovernmental	7,166	986	546	8,698
Special assessment			115	115
Interest receivable	1,115		140	1,255
Notes and loans receivable (Note 5)	1,182		12,036	13,218
Interfund receivables and advances (Note 4)	326			326
Prepaid items	1,253			1,253
Inventory of materials and supplies	2,567			2,567
	<u>\$44,346</u>	<u>\$41,734</u>	<u>\$25,452</u>	<u>\$111,532</u>
LIABILITIES				
Accounts payable and accrued liabilities	\$2,837	\$621	\$234	\$3,692
Accrued salaries and benefits	1,081	39		1,120
Deferred revenue	1,020		115	1,135
Interfund payable and advances (Note 4)			70	70
	<u>4,938</u>	<u>660</u>	<u>419</u>	<u>6,017</u>
FUND BALANCES				
Reserved for (Note 10):				
Encumbrances	3,390	7,372	666	11,428
Down to wn parking structure		56		56
Notes and loans	1,182		12,036	13,218
Inventory of materials and supplies	2,567			2,567
Prepaid items	1,253			1,253
Debt service			1,484	1,484
Unreserved, designated for:				
General Fund				
Equity transfer stabilization	3,465			3,465
Reappropriations	71			71
Budget stabilization	27,480			27,480
Capital Project Fund				
Reappropriations		17,831		17,831
Infrastructure		15,815		15,815
Unreserved, undesignated, reported in:				
Special Revenue Funds			10,847	10,847
	<u>39,408</u>	<u>41,074</u>	<u>25,033</u>	<u>105,515</u>
Total Fund Balances	<u>\$44,346</u>	<u>\$41,734</u>	<u>\$25,452</u>	<u>\$111,532</u>
Total Liabilities and Fund Balances	<u>\$44,346</u>	<u>\$41,734</u>	<u>\$25,452</u>	<u>\$111,532</u>

See accompanying notes to financial statements

City of Palo Alto - Governmental Funds
Reconciliation of Fund Balances to Governmental Activities Net Assets
June 30, 2007

(In thousands of dollars)

Governmental Fund fund balances from prior page \$105,515

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds (Note 6) 335,701

Internal service funds are used by management to charge the costs of certain activities, such as insurance and central services and maintenance, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets. (Excludes capital assets reported above and debt reported below) 54,290

Accrual adjustment to remove deferred revenue from the balance sheet 115

Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds (Notes 7 & 8) (9,444)

Net assets of governmental activities \$486,177

See accompanying notes to financial statements

City of Palo Alto - Governmental Funds

Statement of Revenues, Expenditures and

Changes in Fund Balance - For the Year Ended June 30, 2007

(In thousands of dollars)

	General	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
REVENUES				
Property taxes	\$21,466			\$21,466
Special assessments			\$266	266
Sales taxes	22,194			22,194
Utility users' tax	9,356			9,356
Transient occupancy tax	6,709			6,709
Other taxes and fines	8,748		1,136	9,884
Charges for services	19,746		183	19,929
From other agencies	836	\$1,935	677	3,448
Permits and licenses	4,578		133	4,711
Investment earnings	3,186	1,057	469	4,712
Rental income	13,032		6	13,038
Other revenue	929	60	6,514	7,503
Total Revenues	110,780	3,052	9,384	123,216
EXPENDITURES				
Current operations:				
City Council	169			169
City Manager	1,727			1,727
City Attorney	2,338			2,338
City Clerk	860			860
City Auditor	836			836
Administrative Services	6,107			6,107
Human Resources	2,362			2,362
Public Works	9,256			9,256
Planning and Community Environment	8,632		3,242	11,874
Police	23,246		59	23,305
Fire	19,146			19,146
Community Services	16,533			16,533
Library	5,260			5,260
Non-Departmental	11,303		819	12,122
Capital outlay	568	16,910		17,478
Debt service:				
Principal payments			850	850
Interest and fiscal fees			489	489
Total Expenditures	108,343	16,910	5,459	130,712
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	2,437	(13,858)	3,925	(7,496)
OTHER FINANCING SOURCES (USES)				
Transfers in (Note 4)	15,557	10,715	1,429	27,701
Transfers (out) (Note 4)	(12,803)	(250)	(2,829)	(15,882)
Total Other Financing Sources (Uses)	2,754	10,465	(1,400)	11,819
Net change in fund balances	5,191	(3,393)	2,525	4,323
Fund balances at beginning of year	34,217	44,467	22,508	101,192
Fund balances at end of year	\$39,408	\$41,074	\$25,033	\$105,515

See accompanying notes to financial statements

**City of Palo Alto - Reconciliation of the
Statement of Revenues, Expenditures and
Changes in Fund Balances of
Governmental Funds to the Statement of Activities.....**

**For the Year Ended June 30, 2007
(In thousands of dollars)**

Net change in fund balances-total governmental funds \$4,323

Amounts reported for Governmental Activities in the Statement of
Activities are different because:

Governmental Funds report capital outlays as expenditures.
However, in the Statement of Activities the cost of those assets is
allocated over their estimated useful lives and reported as
depreciation expense. The capital outlay expenditures are therefore
added back to fund balance.

The capital outlay, net of retirements, are therefore deducted from
fund balance. 18,285

Depreciation expense is deducted from fund balance
(Depreciation expense is net of Internal Service Fund depreciation
\$3,201 million which has already been allocated to serviced
funds.) (7,751)

Bond proceeds provide current financial resources to Governmental
Funds, but issuing debt increases long-term liabilities in the
Statement of Net Assets. Repayment of bond principal is an
expenditure in the Governmental Funds, but in the Statement of Net
Assets the repayment reduces long-term liabilities.

Fund balance is increased by the amount of debt repayment. 850

Some amounts reported in the Statement of Activities do not require
the use of current financial resources and therefore are not reported
as expenditures in Governmental Funds.

Interest payable 12
Deferred revenue (261)

Internal Service Funds are used by management to charge the costs
of certain activities, such as equipment acquisition, maintenance,
and insurance to individual funds. The net revenue (expense) of all
Internal Service Funds is reported with Governmental Activities. 5,676

Change in net assets of Governmental Activities \$21,134

See accompanying notes to financial statements

City of Palo Alto - General Fund

Statement of Revenues, Expenditures and Changes in Fund Balance

Budget and Actual - For the Year Ended June 30, 2007

(In thousands of dollars)

	Budgeted Amount		Actual Amount Budgetary Basis	Variance from Final Budget
	Adopted	Adjusted		Positive (Negative)
REVENUES				
Property taxes	\$20,368	\$21,084	\$21,489	\$405
Sales taxes	21,133	21,283	22,195	912
Utility users' tax	9,151	9,025	9,356	331
Transient occupancy tax	6,400	6,743	6,708	(35)
Other taxes, fines & penalties	7,438	7,757	8,734	977
Charges for services	19,053	19,062	19,750	688
Permits and licenses	4,218	4,487	4,573	86
Charges to other funds	9,084	9,084	10,277	1,193
Rental income	12,951	12,951	13,105	154
Other revenues	3,421	3,781	5,889	2,108
Transfers in	15,781	15,781	15,644	(137)
Prior year encumbrance and reappropriations		4,026	4,026	
Total Revenues	128,998	135,064	141,746	6,682
EXPENDITURES				
Current operations:				
Administrative Departments	15,758	17,796	17,116	680
Community Services	19,881	21,033	20,879	154
Fire	22,201	21,892	21,868	24
Library	5,800	6,206	6,158	48
Planning and Community Environment	8,762	9,858	9,744	114
Police	25,686	26,125	26,077	48
Public Works	12,412	13,160	12,863	297
Non-Departmental	9,770	8,311	8,497	(186)
Transfers out	7,439	7,831	12,801	(4,970)
Total Use of Funds	127,709	132,212	136,003	(3,791)
EXCESS OF REVENUES OR EXPENDITURES BUDGETARY BASIS	\$1,289	\$2,852	5,743	\$2,891
Adjustments to Budgetary Basis:				
Current year encumbrance/reappropriations			3,558	
Prior year encumbrance/reappropriations			(4,026)	
Current year stores adjustment, net			(98)	
Prior year stores adjustment			14	
EXCESS OF REVENUES OVER EXPENDITURES - GAAP BASIS			5,191	
Fund balances at beginning of year			34,217	
Fund balances at end of year, GAAP basis			\$39,408	

See accompanying notes to financial statements



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Proprietary Funds.....

Introduction

Proprietary Funds account for City operations financed and operated in a manner similar to a private business enterprise. The intent of the City is that the cost of providing goods and services be financed primarily through user charges.

The City has elected to treat all of its Enterprise Funds as Major Funds in fiscal year 2006-07.

Proprietary Funds do not provide for the disclosure of budget versus actual comparisons.

Water Services Fund

This fund accounts for all financial transactions relating to the City's Water service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Electric Services Fund

This fund accounts for all financial transactions relating to the City's Electric service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Gas Services Fund

This fund accounts for all financial transactions relating to the City's Gas service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Wastewater Collection Fund

This fund accounts for all financial transactions relating to the City's Wastewater Collection service. Collections are on a user charge basis to residents and business owners located in Palo Alto.

Wastewater Treatment Fund

This fund accounts for all financial transactions relating to the City's Wastewater Treatment. Services are on a user charge basis to residents and business owners located in Palo Alto.

Refuse Services Fund

This fund accounts for all financial transactions relating to the City's Refuse service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Storm Drainage Services Fund

This fund accounts for all financial transactions relating to the City's Storm Drain service. Services are on a user charge basis to residents and business owners located in Palo Alto.

External Service Fund

This fund accounts for all financial transactions relating to the City's External Services provided to surrounding communities. Service charges are established on a case-by-case basis.

City of Palo Alto - Proprietary Funds

Statement of Net Assets - June 30, 2007

(In thousands of dollars)

	Business-type Activities-Enterprise Funds			
	Water	Electric	Gas	Wastewater Collection
ASSETS				
Current Assets:				
Cash and investments (Note 3):				
Available for operations	\$19,407	\$145,071	\$15,369	\$10,958
Cash and investments with fiscal agent	794		968	
Accounts receivable, net	3,490	10,188	2,784	1,881
Interest receivable	251	1,888	185	153
Interfund receivables				
Inventory of materials and supplies				
Total Current Assets	<u>23,942</u>	<u>157,147</u>	<u>19,306</u>	<u>12,992</u>
Noncurrent Assets:				
Capital assets, nondepreciable (Note 6)	14,459	31,793	14,051	22,027
Capital assets, depreciable (Note 6)	42,177	117,645	51,420	38,188
Total Noncurrent Assets	<u>56,636</u>	<u>149,438</u>	<u>65,471</u>	<u>60,215</u>
Total Assets	<u>80,578</u>	<u>306,585</u>	<u>84,777</u>	<u>73,207</u>
LIABILITIES				
Current Liabilities:				
Accounts payable and accrued liabilities	1,658	531	1,329	515
Accrued salaries and benefits	192	192	76	40
Accrued compensated absences (Note 1)				
Interfund payable (Note 4)				
Current portion of revenue bonds (Note 7)	340		415	55
Accrued claims payable - current (Note 14)				
Total Current Liabilities	<u>2,190</u>	<u>723</u>	<u>1,820</u>	<u>610</u>
Noncurrent liabilities:				
Accrued compensated absences - noncurrent (Note 1)				
Accrued claims payable - noncurrent (Note 14)				
Landfill closure and postclosure care (Note 9)				
Utility revenue bonds, net of unamortized issuance costs and discounts (Note 7)	9,070		11,066	1,344
Total Noncurrent Liabilities	<u>9,070</u>	<u></u>	<u>11,066</u>	<u>1,344</u>
Total Liabilities	<u>11,260</u>	<u>723</u>	<u>12,886</u>	<u>1,954</u>
NET ASSETS				
Invested in capital assets, net of related debt	47,226	149,438	53,990	58,816
Restricted for debt service	780		952	
Unrestricted	21,312	156,424	16,949	12,437
Total Net Assets	<u>\$69,318</u>	<u>\$305,862</u>	<u>\$71,891</u>	<u>\$71,253</u>

Some amounts reported for *Business-type Activities* in the Statement of Net Assets are different because certain Internal Service Fund assets and liabilities are included with Business-type Activities

Net Business-type Activities

See accompanying notes to financial statements



Business-type Activities-Enterprise funds					Governmental
Wastewater Treatment	Refuse	Storm Drainage	External Service	TOTALS	Activities - Internal Service Funds
\$ 13,999	\$10,625	\$5,221	\$9	\$220,659	\$88,924
26				1,788	
1,143	2,557	603	293	22,939	62
199	136	54	(4)	2,862	917
					25
					504
<u>15,367</u>	<u>13,318</u>	<u>5,878</u>	<u>298</u>	<u>248,248</u>	<u>90,432</u>
5,131	1,953	1,508		90,922	4,414
25,805	2,543	15,109		292,887	9,958
<u>30,936</u>	<u>4,496</u>	<u>16,617</u>		<u>383,809</u>	<u>14,372</u>
<u>46,303</u>	<u>17,814</u>	<u>22,495</u>	<u>298</u>	<u>632,057</u>	<u>104,804</u>
1,399	289	1,380		7,101	3,537
125	62	16	8	711	406
					3,482
			281	281	
355		360		1,525	
					5,939
<u>1,879</u>	<u>351</u>	<u>1,756</u>	<u>289</u>	<u>9,618</u>	<u>13,364</u>
					8,018
	7,080			7,080	15,191
<u>8,475</u>		<u>9,407</u>		<u>39,362</u>	
<u>8,475</u>	<u>7,080</u>	<u>9,407</u>		<u>46,442</u>	<u>23,209</u>
<u>10,354</u>	<u>7,431</u>	<u>11,163</u>	<u>289</u>	<u>56,060</u>	<u>36,573</u>
22,106	4,496	6,850		342,922	14,372
				1,732	
<u>13,843</u>	<u>5,887</u>	<u>4,482</u>	<u>9</u>	<u>231,343</u>	<u>53,859</u>
<u>\$35,949</u>	<u>\$10,383</u>	<u>\$11,332</u>	<u>\$9</u>	<u>575,997</u>	<u>\$68,231</u>
				(431)	
				<u>\$575,566</u>	

City of Palo Alto - Proprietary Funds
Statements of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2007
(In thousands of dollars)

	Business-type Activities - Enterprise Funds			
	Water	Electric	Gas	Wastewater Collection
OPERATING REVENUES				
Sales of utilities:				
Customers	\$21,826	\$83,620	\$40,474	\$13,555
City departments	1,088	2,973	863	265
Surplus energy		5,945		
Wastewater treatment				
Service connection charges and miscellaneous	315	1,889	756	599
Charges for services				
Other operating revenues	266	8,122	129	429
Total Operating Revenues	23,495	102,549	42,222	14,848
OPERATING EXPENSES				
Purchase of utilities:				
Retail	7,805	58,282	22,250	6,142
Surplus energy		4,196		
Administration and general	2,247	5,651	2,472	589
Engineering (operating)	262	1,054	295	237
Resource management and energy efficiency programs	396	3,368	878	
Operations and maintenance	2,702	7,880	2,467	1,569
Rent	1,781	3,521	148	78
Depreciation and amortization	1,132	5,655	1,623	1,401
Claims payments and changes in estimated self-insurance liability				
Compensated absences and other benefits				
Total Operating Expenses	16,325	89,607	30,133	10,016
Operating Income	7,170	12,942	12,089	4,832
NONOPERATING REVENUES (EXPENSES)				
Return on investment	1,081	7,975	724	665
Interest (expense)	(455)		(546)	(75)
Joint venture debt service (Note 15)		(8,443)		
Gain (loss) on disposal of fixed assets		(1,193)	(14)	(7)
Capacity fees	542		1	213
Other				
Net Nonoperating Revenues (Expenses)	1,168	(1,661)	165	796
Income (Loss) Before Transfers and Special Item	8,338	11,281	12,254	5,628
Transfers in (Note 4)	1,153	471		
Transfers (out) (Note 4)	(2,977)	(9,943)	(3,297)	(135)
Change in Net Assets	6,514	1,809	8,957	5,493
Total net assets at beginning of year	62,804	304,053	62,934	65,760
Total net assets at end of year	\$69,318	\$305,862	\$71,891	\$71,253

Some amounts reported for *Business-type Activities* in the Statement of Net Assets are different because certain Internal Service Fund assets and liabilities are included with Business-type Activities

Change in Net Assets of Business-type Activities

See accompanying notes to financial statements



Business-type Activities - Enterprise Funds					Governmental
Wastewater Treatment	Refuse	Storm Drainage	External Service	TOTALS	Activities - Internal Service Funds
	\$20,122	\$4,863		\$184,460	
\$6,199	1,107	299		12,794	
				5,945	
10,593				10,593	
				3,559	
					\$56,542
165	4,303	19	\$789	14,222	
16,957	25,532	5,181	789	231,573	56,542
	7,825			102,304	
				4,196	
	1,520	167	2	12,648	11,323
1,917	372	354		4,491	
		227		4,869	
12,227	10,496	715	799	38,855	2,889
	4,289			9,817	
2,127	636	524		13,098	3,201
					6,618
					34,146
16,271	25,138	1,987	801	190,278	58,177
686	394	3,194	(12)	41,295	(1,635)
757	563	165	(20)	11,910	4,035
(186)	(377)	(605)		(2,244)	
				(8,443)	
				(1,214)	210
				756	
					(111)
571	186	(440)	(20)	765	4,134
1,257	580	2,754	(32)	42,060	2,499
	246		23	1,893	3,958
(1,021)	(263)	(11)		(17,647)	(23)
236	563	2,743	(9)	26,306	6,434
35,713	9,820	8,589	18		61,797
\$35,949	\$10,383	\$11,332	\$9		\$68,231
				758	
				\$27,064	

City of Palo Alto - Proprietary Funds

Statement of Cash Flows -

For the Year Ended June 30, 2007

(In thousands of dollars)

	Business-type Activities - Enterprise Funds			
	Water	Electric	Gas	Wastewater Collection
CASH FLOWS FROM OPERATING ACTIVITIES:				
Receipts from customers	\$21,842	\$110,146	\$40,884	\$14,081
Payments to suppliers	(13,159)	(79,406)	(25,867)	(7,714)
Payments to employees	(2,113)	(5,639)	(2,464)	(584)
Internal activity - receipts from other funds	1,088	2,973	863	265
Claims paid				
Other receipts	266		129	429
Net Cash From Operating Activities	<u>7,924</u>	<u>28,074</u>	<u>13,545</u>	<u>6,477</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:				
Interfund receipts				
Transfers in	1,153	471		
Transfers (out)	(2,977)	(9,943)	(3,297)	(135)
Net Cash From Noncapital Financing Activities	<u>(1,824)</u>	<u>(9,472)</u>	<u>(3,297)</u>	<u>(135)</u>
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:				
Acquisition and construction of fixed assets	(4,808)	(13,501)	(5,917)	(8,975)
Proceeds from sale of capital assets				
Capacity fees	542		1	213
Principal paid on long-term debt	(320)		(392)	(52)
Interest paid on long-term debt	(455)	(8,443)	(546)	(75)
Cash Flows From Capital Financing Activities	<u>(5,041)</u>	<u>(21,944)</u>	<u>(6,854)</u>	<u>(8,889)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:				
Interest on investments	1,050	7,834	692	672
Net Cash Flows	<u>2,109</u>	<u>4,492</u>	<u>4,086</u>	<u>(1,875)</u>
Cash and cash equivalents at beginning of year	<u>18,092</u>	<u>140,579</u>	<u>12,251</u>	<u>12,833</u>
Cash and cash equivalents at end of year	<u>\$20,201</u>	<u>\$145,071</u>	<u>\$16,337</u>	<u>\$10,958</u>
FINANCIAL STATEMENT PRESENTATION:				
Cash and investments available for operations	\$19,407	\$145,071	\$15,369	\$10,958
Cash and investments with fiscal agent	794		968	
Cash and cash equivalents at end of year	<u>\$20,201</u>	<u>\$145,071</u>	<u>\$16,337</u>	<u>\$10,958</u>
Reconciliation of operating income (loss) to Cash Flows from				
Operating income (loss)	\$7,170	\$12,942	\$12,089	\$4,832
Adjustments to reconcile operating income (loss) to cash				
Depreciation and amortization	1,132	5,655	1,623	1,401
Other				
Changes in assets and liabilities:				
Accounts receivable	(299)	10,570	(346)	(73)
Inventory of materials and supplies				
Accounts and other payables	(79)	(1,093)	179	317
Accrued claims payable and other liabilities				
Net Cash From Operating Activities	<u>\$7,924</u>	<u>\$28,074</u>	<u>\$13,545</u>	<u>\$6,477</u>

See accompanying notes to financial statements



Business-type Activities - Enterprise Funds					Governmental Activities - Internal Service Funds
Wastewater Treatment	Refuse	Storm Drainage	External Service	TOTALS	
\$10,741	\$20,196	\$4,845	\$782	\$223,517	\$56,554
(12,994)	(23,022)	(309)		(162,471)	(2,758)
30	(1,503)	(163)	(800)	(13,236)	(44,699)
6,199	1,107	299		12,794	
					(5,033)
165	4,503	19		5,511	(111)
4,141	1,281	4,691	(18)	66,115	3,953
			20	20	25
	246		23	1,893	3,958
(1,021)	(263)	(11)		(17,647)	(23)
(1,021)	(17)	(11)	43	(15,734)	3,960
(2,127)		(1,916)		(37,244)	(3,541)
					210
				756	
(328)		(309)		(1,401)	
(186)	(377)	(605)		(10,687)	
(2,641)	(377)	(2,830)		(48,576)	(3,331)
733	549	152	(16)	11,666	3,894
1,212	1,436	2,002	9	13,471	8,476
12,813	9,189	3,219		208,976	80,448
\$14,025	\$10,625	\$5,221	\$9	\$222,447	\$88,924
\$13,999	\$10,625	\$5,221	\$9	\$220,659	\$88,924
26				1,788	
\$14,025	\$10,625	\$5,221	\$9	\$222,447	\$88,924
\$686	\$394	\$3,194	(\$12)	\$41,295	(\$1,635)
2,127	636	524		13,098	3,201
					(111)
148	74	(18)	(7)	10,049	12
					(28)
1,180	(23)	991	1	1,473	929
	200			200	1,585
\$4,141	\$1,281	\$4,691	(\$18)	\$66,115	\$3,953



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Fiduciary Funds.....

Introduction

These funds account for assets held by the City in trust or as an agent for various assessment and community facilities districts. The financial activities of these funds are excluded from the Citywide financial statements, but are presented in separate Fiduciary Fund financial statements.



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**City of Palo Alto - Fiduciary Funds****Statement of Fiduciary Net Assets - June 30, 2007***(In thousands of dollars)*

	<u>Agency Funds</u>
ASSETS	
Cash and investments available for operations (Note 3)	\$1,033
Cash and investments with fiscal agents (Note 3)	6,097
Interest receivable	<u>44</u>
Total Assets	<u><u>\$7,174</u></u>
LIABILITIES	
Due to bondholders	\$6,395
Due to other governments	<u>779</u>
Total Liabilities	<u><u>\$7,174</u></u>

See accompanying notes to financial statements

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Notes are essential to present fairly the information contained in the overview level of basic financial statements. Narrative explanations are intended to communicate information that is not readily apparent or cannot be included in the statements and schedules themselves, and to provide additional disclosures as required by the Governmental Accounting Standards Board.



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Note 1.....

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Palo Alto was incorporated in 1894 and operates as a charter city, having had its first charter granted by the State of California in 1909. The City operates under the Council-Manager form of government and provides the following services: public safety (police and fire), public works, electric, water, gas, wastewater, storm drain, refuse, golf course, planning and zoning, general administration services, library, open space and science, recreational and human services.

Reporting Entity

The City is governed by a nine-member council, elected by City residents. The City is legally separate and fiscally independent which means it can issue debt, set and modify budgets and fees and sue or be sued. The accompanying Basic Financial Statements present the financial activity of the City, which is the primary government presented, along with the financial activities of its component units, which are entities for which the City is financially accountable. Although they are separate legal entities, *blended* component units are in substance, part of the City's operations and are reported as an integral part of the City's financial statements. This City's component units, which are described below are blended.

The Palo Alto Public Improvement Corporation provides financing of public capital improvements for the City through the issuance of Certificates of Participation (COPs), a form of debt, which allows investors to participate in a stream of future lease payments. Proceeds from the COPs are used to construct projects which are leased to the City. The lease payments are sufficient in timing and amount to meet the debt service requirements of the COPs. The Corporation is controlled by the City, which performs all accounting and administrative functions for the Corporation. The financial activities of the Corporation are included in the Golf Course and Civic Center Debt Service Funds and the Capital Projects Fund.

The Palo Alto Redevelopment Agency is a separate government entity whose purpose is to prepare and implement plans for improvement, rehabilitation, and development of certain areas within the City. The City Council and the Redevelopment Agency Board are composed of the same individuals. Certain administrative and accounting functions are performed by City staff. The financial activities of the Agency have been included in these financial statements in the Redevelopment Agency Special Revenue Fund.

Financial statements for the Palo Alto Public Improvement Corporation and Redevelopment Agency may be obtained from the City of Palo Alto, Administrative Services Department, 4th Floor, 250 Hamilton Avenue, Palo Alto, CA 94301.

Basis of Presentation

The City's Basic Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America. The Government Accounting Standards Board is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the United States.

These Standards require that the financial statements described below be presented.

Citywide Statements: The Statement of Net Assets and the Statement of Activities display information about the primary government (the City) and its component units. These statements include the financial activities of the overall City government, except for fiduciary activities. Eliminations have been made to minimize the double counting of internal activities. These statements distinguish between the *Governmental* and *Business-type Activities* of the City. Governmental Activities generally are financed through taxes, intergovernmental revenues, and other non-exchange transactions. Business-type Activities are financed in whole or in part by fees charged to external parties.

The Statement of Activities presents a comparison between direct expenses and program revenues for each segment of the Business-type Activities of the City and for each function of the City's Governmental Activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs, (b) grants and contributions that are restricted to meeting the operational needs of a particular program and (c) fees, grants and contributions that are restricted to financing the acquisition or construction of capital assets. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements: The Fund financial statements provide information about the City's funds, including fiduciary funds and blended component units. Separate statements for each fund category—*governmental*, *proprietary*, and *fiduciary*—are presented. The emphasis of Fund financial statements is on major individual governmental and enterprise funds, each of which is displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as non-major funds.

Proprietary Fund *operating* revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. *Non-operating* revenues, such as subsidies and investment earnings, result from non-exchange transactions or ancillary activities.

Operating expenses for enterprise funds and internal service funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All expenses not meeting this definition are reported as nonoperating expenses.

Major Funds

The City's Major Governmental and Business-type Funds need to be identified and presented separately in the Fund financial statements. All other funds, called Non-major Funds, are combined and reported in a single column, regardless of their fund-type.

Major Funds are defined as funds that have either assets, liabilities, revenues or expenditures/expenses equal to 10 percent of their fund-type total and five percent of the grand total. The General Fund is always a Major Fund. The City may also select other funds it believes should be presented as Major Funds.

The City reported the following Major Governmental Funds in the accompanying financial statements:

General Fund – This is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

Capital Projects Fund – This fund accounts for resources used for the acquisition and construction of capital facilities by the City, with the exception of those assets financed by Proprietary Funds.

The City reported all its Enterprise Funds as Major Funds in the accompanying financial statements:

Water Services Fund – This fund accounts for all financial transactions relating to the City’s Water service. Services are on a user-charge basis to residents and business owners located in Palo Alto.

Electric Services Fund – This fund accounts for all financial transactions relating to the City’s Electric service. Services are on a user-charge basis to residents and business owners located in Palo Alto.

Gas Services Fund – This fund accounts for all financial transactions relating to the City’s Gas service. Services are on a user-charge basis to residents and business owners located in Palo Alto.

Wastewater Collection Services Fund – This fund accounts for all financial transactions relating to the City’s Wastewater Collection. Collections are on a user-charge basis to residents and business owners located in Palo Alto.

Wastewater Treatment Services Fund – This fund accounts for all financial transactions relating to the City’s Wastewater Treatment. Services are on a user-charge basis to residents and business owners located in Palo Alto.

Refuse Services Fund – This fund accounts for all financial transactions relating to the City’s Refuse service. Services are on a user-charge basis to residents and business owners located in Palo Alto.

Storm Drainage Services Fund – This fund accounts for all financial transactions relating to the City’s Storm Drain service. Services are on a user-charge basis to residents and business owners located in Palo Alto.

External Service Fund – This fund accounts for all financial transactions relating to the City’s external services provided to surrounding communities.

The City also reports the following fund types:

Internal Service Funds – These funds account for fleet replacement and maintenance, technology, central duplicating, printing and mailing services, administration of compensated absences and health benefits, and the City’s self-insured workers’ compensation and general liability programs, all of which are provided to other departments on a cost-reimbursement basis. Also included is the Retiree Health Benefits Internal Service Fund which accounts for benefits to retirees.

Vehicle Replacement and Maintenance – This fund accounts for the maintenance and replacement of vehicles and equipment used by all City departments. The source of revenue is an accumulation of resources.

Technology – This fund accounts for replacement and upgrade of technology, and covers four primary areas used by all City departments: desktop, infrastructure, applications, and technology research and development. The source of revenue is an accumulation of resources.

Printing and Mailing Services – This fund accounts for central duplicating, printing and mailing services provided to all City departments. Source of revenue for this fund is on reimbursement of costs for services and supplies purchased by other departments.

General Benefits and Insurance – This fund accounts for the administration of compensated absences and health benefits, and the City’s self-insured workers’ compensation and general liability programs.

Retiree Health Benefit – This fund accounts for the retiree health benefits.

Fiduciary Funds – These funds account for assets held by the City in trust or as an agent for various assessment and community facilities districts. The financial activities of these funds are excluded from the Citywide financial statements, but are presented in separate Fiduciary Fund financial statements.

Agency Funds – These funds account for assets held by the City, an agent for assessment districts and the members of the Cable Joint Powers Authority. These funds are custodial in nature and do not involve measurement of results of operations. The City maintains three agency funds. The financial activities of these funds are excluded from the Government-wide financial statements, but are presented in separate Fiduciary Fund financial statements. Agency funds apply the accrual basis of accounting but do not have a measurement focus.

California Avenue Parking Assessment District – This fund accounts for receipts and disbursements associated with the 1993 Parking District No. 92-13 Assessment Bonds.

Cable Joint Powers Authority – This fund was established to account for the activities of the cable television system on behalf of the members.

University Avenue Area Parking Assessment District – This fund accounts for the receipts and disbursements associated with the Series 2001-A University Avenue Area Off-Street Parking Assessments Bonds.

Basis of Accounting

The Citywide and Proprietary fund financial statements are reported using the *economic resources measurement focus* and the full *accrual basis* of accounting. Revenues are recorded when *earned* and expenses are recorded at the time liabilities are *incurred*, regardless of when the related cash flows take place.

Governmental Funds are reported using the *current financial resources* measurement focus and the *modified accrual* basis of accounting. Under this method, revenues are recognized when *measurable and available*. The City considers all revenues reported in the Governmental Funds to be available if the revenues are collected within ninety days after year-end. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as *expenditures* in Governmental Funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as *other financing sources*.

Those revenues susceptible to accrual include taxes, intergovernmental revenues, interest and charges for services.

Grant revenues are recognized in the fiscal year in which all eligibility requirements are met. Under the terms of grant agreements, the City may fund certain programs with a combination of cost-reimbursement grants, categorical block grants, and general revenues. Thus, both restricted and unrestricted net assets may be available to finance program expenditures. The City’s policy is to first apply restricted grant resources to such programs, followed by general revenues if necessary.

Certain indirect costs are included in program expenses reported for individual functions and activities. Transactions representing the exchange of interfund goods and services have also been included.

The City follows those Financial Accounting Standard Board Statements issued before November 30, 1989, which do not conflict with Governmental Accounting Standards Board Statements.

Inventory of Materials and Supplies

Materials and supplies are held for consumption and are valued at average cost. The consumption method is used to account for inventories. Under the consumption method, inventories are recorded as an expenditure at the time inventory items are used, rather than purchased.

Compensated Absences

The liability for compensated absences includes the vested portions of vacation, sick leave, and overtime compensation pay. The City’s liability for accrued compensated absences is recorded in the General Benefits and Insurance Internal Service Fund. Amounts expected to be “permanently liquidated”, such as what is due to be paid because of a realized employment action, are recorded as fund liabilities in the General Benefits and Insurance Internal Service Fund. The Fund is reimbursed through payroll charges to all other funds. Earned but unpaid vacation and overtime compensation pay is recognized as an expense or expenditure in the Proprietary and Governmental Fund types when earned because the City has provided financial resources for the full amount through its budgetary process. Vested accumulated sick pay is paid in the event of termination due to disability and under certain conditions specified in employment agreements.

During fiscal year ended June 30, 2007, changes to the compensated absences were as follows:

Beginning Balance	\$12,334
Additions	3,902
Payments	<u>(4,736)</u>
Ending Balance	<u>\$11,500</u>
Current Portion	<u>\$3,482</u>

Property Tax

Santa Clara County assesses properties and bills, collects, and distributes property taxes to the City. The County remits the entire amount levied and handles all delinquencies, retaining interest and penalties. Secured and unsecured property taxes are levied on January 1 of the preceding fiscal year.

Secured property tax is due in two installments, on November 1 and February 1, and becomes a lien on those dates. It becomes delinquent on December 10 and April 10, respectively. Unsecured property tax is due on July 1, and becomes delinquent on August 31. Collection of delinquent accounts is the responsibility of the County, which retains all penalties.

The term “unsecured” refers to taxes on personal property other than real estate, land and buildings. These taxes are secured by liens on the property being taxed. Property tax revenues are recognized by the City in the fiscal year they are assessed, provided they become available as defined above within 60 days after year end.

Rounding

All amounts included on the basic financial statements, combining statements, fiduciary statements, footnotes and schedules are presented to the nearest thousands in accordance with the City’s policy.

Note 2.....

BUDGETS AND BUDGETARY ACCOUNTING

1. The City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures and the means of financing them.
2. Public hearings are conducted to obtain public comments.
3. The Adopted budget is legally enacted through passage of a budget ordinance for all funds except for Agency Funds.
4. The City Manager is authorized to reallocate funds from a contingent account maintained in the General Fund in conformance with the adopted policies set by the City Council. Additional appropriations to departments in the General Fund, or to total appropriations for all other budgeted funds, or transfers of appropriations between funds, require approval by the City Council. These amendments are added to the Adopted budget and the resulting totals are reflected as Adjusted budget amounts.
5. Expenditures may not legally exceed budgeted appropriations at the department level for the General Fund, and at the fund level for Special Revenue and Debt Service Funds.
6. Formal budgetary integration is employed as a management control device during the year in all funds except Agency Funds and the Civic Center Refinancing and Downtown Parking Improvement Debt Service Funds.
7. Budgets for governmental funds are adopted on a basis consistent with generally accepted accounting principles (GAAP) for all funds, except that General Fund encumbrances are treated as budgetary expenditures when incurred and stores (materials, parts and supplies) transactions included in the General Fund are not budgeted.
8. Expenditures for the Capital Projects Fund are budgeted and managed on a project length basis. Budget to actual comparisons for these expenditures have been excluded from the accompanying financial statements.

Excess of Expenditures over Appropriations

The funds below incurred expenditures and operating transfers in excess of their budgets in the amounts indicated as the results of unanticipated expenses. Sufficient resources were available within each fund to finance these excesses.

The General Fund's actual expenditures and operating transfers out, exceeded budget in the amounts of \$3.8 million in fiscal year 2006-07. This was offset by revenues exceeding budget by \$6.7 million for a net of \$2.9 million. Additional operating transfers made as year-end adjustments consisted of; 1) \$2.9 million to the Retiree Medical Benefits Internal Service Fund and 2) \$3.0 million to the Capital Projects Fund infrastructure reserve, based on reserve policy and Council goals to fund the infrastructure.



Note 3.....

CASH AND INVESTMENTS

The City pools cash from all sources and all funds except Restricted Cash and Investments with Fiscal Agents so that it can be invested at the maximum yield, consistent with safety and liquidity, while individual funds can make expenditures at any time.

Policies

The City invests in individual investments and in investment pools. Individual investments are evidenced by specific identifiable securities instruments, or by an electronic entry registering the owner in the records of the institution issuing the security, called the book entry system. In order to increase security, the City employs the Trust Department of a bank as the custodian of certain City managed investments, regardless of their form.

The City’s investments are carried at fair value, as required by generally accepted accounting principles. The City adjusts the carrying value of its investments to reflect their fair value at each fiscal year end, and it includes the effects of these adjustments in income for that fiscal year.

Classification

Cash and investments are classified in the financial statements as shown below, based on whether or not their use is restricted under the terms of City debt instruments or Agency agreements (in thousands):

Cash and investments available for operations	\$391,448
Cash and investments with fiscal agents	<u>4,023</u>
City cash and investments	395,471
Cash and investments available for operations in	
Fiduciary Funds (separate Statement)	1,033
Cash and investments with fiscal agents	
Fiduciary Funds (separate Statement)	<u>6,097</u>
Total cash and investments	<u><u>\$402,601</u></u>



Investments Authorized by the City's Investment Policy & Debt Agreements

The table below identifies the investment types that are authorized by the City's Investment Policy. The table also identifies certain provisions of the City's Investment Policy that address interest rate risk, credit risk and concentration of credit risk. The table addresses investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the City, rather than the general provisions of the City's investment policy.

Authorized Investment Type	Maximum Maturity	Minimum Credit Quality	Maximum Percentage of Portfolio	Maximum Investment In One Issuer
U.S. Government Securities	10 years	N/A	No Limit	No Limit
U.S. Government Agency Securities (C)	10 years	N/A	No Limit (A)	No Limit
Certificates of Deposit	10 years	N/A	20%	10% of the par value of portfolio
Bankers Acceptances	180 days (D)	N/A (D)	30%	\$5 million
Commercial Paper	270 days	AAA	15%	\$3 million (B)
Local Agency Investment Fund	N/A	N/A	No Limit	\$40 million per account
Short-Term Repurchase Agreements	1 year	N/A	No Limit	No Limit
City of Palo Alto Bonds	N/A	N/A	No Limit	No Limit
Money Market Deposit Accounts	N/A	N/A (E)	No Limit	10%
Mutual Funds (F)	N/A	N/A	20%	10%
Negotiable Certificates of Deposit	10 years	N/A	10%	\$5 million
Medium Term Corporate Notes	5 years	AA	10%	\$5 million

(A) Callable and multi-step securities are limited to no more than twenty percent of the par value of the portfolio, provided that:

- 1) the potential call dates are known at the time of purchase.
- 2) the interest rates at which they "step-up" are known at the time of purchase.
- 3) the entire face value of the security is redeemed at the call date.

(B) The lesser of \$3 million or 10% of outstanding commercial paper of any one institution.

Debt Agreements:

(C) Utility Revenue Bonds 2002 Series A and 1999 Series A allow General Obligations of states with a Minimum Credit Quality Rating of A2/A by Moody's and S&P.

(D) Utility Revenue Bonds 2002 Series A and 1999 Series A require a Minimum Credit Quality Rating of A-1/P-1 by Moody's and S&P and maturing no more than 360 days.

Utility Revenue Bonds 1995 limit the maximum maturity to 365 days.

(E) Utility Revenue Bonds 2002 Series A and 1999 Series A require a Minimum Credit Quality Rating of AAAm or AAAm-G by S&P.

(F) Utility Revenue Bonds 2002 Series A, Golf PIC COP 1998, University Avenue Parking Bond 2001 and University Avenue Parking Bond 2002 are allowed to invest in the California Asset Management Program.

The City must maintain required amounts of cash and investments with trustees under the terms of certain debt issues. These funds are unexpended bond proceeds or are pledged as reserves to be used if the City fails to meet its obligations under these debt issues. The California Government Code requires these funds to be invested in accordance with City ordinance, bond indentures or State statute. All these funds have been invested as permitted under the Code.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates and may adversely affect the fair value of an investment. Normally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

Information about the sensitivity of the fair values of the City’s investments (including investments held by bond trustees) to market interest rate fluctuations is provided by the following table that shows the distribution to the City’s investments by maturity or earliest call date (in thousands):

Type of Investments	Less Than One Year	One to Three Years	Three to Five years	Over Five Years	Total
U.S. Treasury Notes	\$8,412				\$8,412
U.S. Federal Agency Securities	72,379	\$154,099	\$86,536	\$63,584	376,598
U.S. Federal Agency Mortgage Backed Securities		2			2
Money Market Mutual Funds (government securities)	1,131				1,131
Certificates of Deposit	198	374	344		916
California Asset Management Program	4,193				4,193
Local Agency Investment Fund	11,465				11,465
Total Investments	<u>\$97,778</u>	<u>\$154,475</u>	<u>\$86,880</u>	<u>\$63,584</u>	402,717
Cash in banks (overdraft) and on hand					(116)
Total Cash and Investments					<u>\$402,601</u>

Local Agency Investment Fund

The City is a participant in the Local Agency Investment Fund (LAIF) that is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. LAIF management calculates the fair value and cost of the entire LAIF pool. The City adjusts its cost basis invested in LAIF to fair value based on this ratio. The balance available for withdrawal on demand is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis. Included in LAIF’s investment portfolio are collateralized mortgage obligation, mortgage-backed securities, other asset-backed securities, loans to certain state funds, and floating rate securities issued by Federal agencies, government-sponsored enterprises, and corporations. At June 30, 2007, these investments matured in an average of 176 days.

Money Market Mutual Funds are available for withdrawal on demand and at June 30, 2007 matured in an average of 37 days.



Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The City's investments (including investments held by bond trustees) include the following investments that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above):

Highly Sensitive Investments

Fair Value at Year End (in thousands)

US Federal Agency Mortgage Backed Securities. These securities are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows affects the fair value of these securities and makes the values of these securities highly sensitive to changes in interest rates.

\$2

US Federal Agency Callable Securities. These securities are subject to early redemption in a period of declining interest rates. The resultant reduction in expected total cash flows affects the fair value of these securities and makes the values of these securities highly sensitive to changes in interest rates.

77,442

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the actual rating as provided by Standard & Poor's investment rating system as of June 30, 2007 for each investment type (in thousands):

Investment Type	AAA	A-1+	Total
U.S. Federal Agency Securities	\$376,122	\$476	\$376,598
U.S. Federal Agency Mortgage Backed Securities	2		2
Money Market Mutual Funds (government securities)	1,131		1,131
Total	\$377,255	\$476	377,731
Not Rated:			
Certificates of Deposit			916
California Asset Management Program			4,193
Local Agency Investment Fund			11,465
Exempt from Credit Rating Disclosure:			
U.S. Treasury Notes			8,412
<i>Cash in banks (overdraft) and on hand</i>			(116)
Total Cash and Investments			\$402,601



Concentration of Credit Risk

Investments in any one issuer, other than U.S. Treasury securities, mutual funds, and external investment pools, that represent 5 percent or more of total City portfolio Entity-wide investments, are as follows at June 30, 2007 (in thousands):

<u>Investments</u>	<u>Reporting Type</u>	<u>Investment Amount</u>
Federal Farm Credit Bank	U.S. Federal Agency Securities	\$90,503
Federal Home Loan Bank	U.S. Federal Agency Securities	126,717
Federal Home Loan Mortgage Corp.	U.S. Federal Agency Securities	35,484
Federal National Mortgage Assoc.	U.S. Federal Agency Securities	62,637

Custodial Risk

California Law requires banks and savings and loan institutions to pledge government securities with a market value of 110 percent of the City's cash on deposit or first trust deed mortgage notes with a value of 150 percent of the deposit as collateral for these deposits. Under California Law this collateral is held in the City's name and places the City ahead of general creditors of the institution. The City has waived collateral requirements for the portion of deposits covered by federal deposit insurance.

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, the City will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The City's Investment Policy limits its exposure to custodial credit risk by requiring that all security transactions entered into by the City, be conducted on a delivery-versus-payment basis. Securities are to be held by a third party custodian.



Note 4.....

INTERFUND TRANSACTIONS

Transfers Between Funds

With Council approval, resources may be transferred from one City fund to another. The purpose of the majority of transfers is to subsidize a fund. Less often, a transfer may be made to open or close a fund.

Transfers between City funds during fiscal year 2006-07 were as follows (in thousands):

Fund Receiving Transfer	Fund Making Transfer	Amount Transferred
General Fund	Street Improvement Special Revenue Fund	\$292
	Special Districts Special Revenue Fund	703
	Redevelopment Agency Special Revenue Fund	6
	Capital Projects Fund	75
	Water Enterprise Fund	2,519 A
	Electric Enterprise Fund	8,812 A
	Gas Enterprise Fund	2,980 A
	Wastewater Collection Enterprise Fund	4 A
	Refuse Enterprise Fund	166 A
Special Revenue Funds:		
Housing In-Lieu Special Revenue Fund	Federal Revenue	250
Redevelopment Agency	General Fund	6
Debt Service Funds:		
Golf Course Improvements	General Fund	525
Civic Center Financing	General Fund	338
	Special Districts Special Revenue Fund	80
Downtown Parking Improvement	General Fund	230
Capital Projects Fund	General Fund	8,791 B
	Street Improvement Special Revenue Fund	899 C
	Special Districts Special Revenue Fund	200
	Developer's Impact Fee Special Revenue Fund	135
	Electric Enterprise Fund	672 B
	Asset Seizure Special Revenue Fund	18

Fund Receiving Transfer	Fund Making Transfer	Amount Transferred
Enterprise Funds:		
Water Fund	Gas Enterprise Fund	\$77
	Wastewater Collection Enterprise Fund	76
	Wastewater Treatment Enterprise Fund	1,000
Electric	Water Enterprise Fund	368
	Gas Enterprise Fund	103
Refuse	Special Districts Special Revenue Fund	246
External Services	Technology Fund	23
Internal Service Funds:		
Vehicle Replacement and Maintenance	General Fund	13
	Capital Projects Fund	175
Technology	Water Enterprise Fund	90
	Electric Enterprise Fund	459
	Gas Enterprise Fund	137
	Wastewater Collection Enterprise Fund	55
	Wastewater Treatment Enterprise Fund	21
	Refuse Enterprise Fund	97
	Storm Drainage Enterprise Fund	11
Retiree Health Benefits	General Fund	2,900 D
		\$33,552

The reasons for these transfers are set forth below:

- (A) Transfer to reimburse the General Fund for costs incurred for the benefit of funds making the transfer.
- (B) Allocation of funds to construct capital assets.
- (C) Transfer to return unspent construction funds.
- (D) Transfer to fund the retiree medical benefits.

Current Interfund Balance

Current interfund balances arise in the normal course of business and are expected to be repaid shortly after the end of the fiscal year. At June 30, 2007, the Federal Revenue Special Revenue Fund owed the General Fund \$70 thousand. The External Service Business-type Fund owed \$256 thousand and \$25 thousand to the General Fund and the Technology Internal Service Fund, respectively.

Interfund Commitment

During fiscal year 2001-02, the City established the Palo Alto Redevelopment Agency. The Agency and the City have an agreement whereby the City will advance funds to the Agency in support of start up and formation costs. However, the interfund advances have no specific repayment date. Generally accepted accounting principals require that such amounts be treated as transfers in the year made. Advances without specified repayment terms total \$362 thousand as of June 30, 2007.

Internal Balances

Internal balances represent the net interfund receivables and payables remaining after the elimination of all such balances within Governmental and Business-type Activities.



Note 5.....

NOTES AND LOANS RECEIVABLE

At June 30, 2007, the City's notes and loans receivable totaled (in thousands):

Palo Alto Housing Corporation:	
Oak Manor Townhouse	\$1,151
Emerson Street Project	375
Alma Single Room Occupancy Development	2,222
Barker Hotel	2,111
Sheridan Apartments	2,248
Oak Court Apartments, L.P.	7,834
Mid-Peninsula Housing Coalition:	
Palo Alto Gardens Apartments	1,000
Community Working Group, Inc	1,280
Opportunity Center Associates, L.P.	750
Home Rehabilitation Loans	113
Executive Relocation Assistance Loans	1,182
Below Market Rate Assessment Loans	74
Stevenson Housing:	
Hot Water	81
Fire Alarm	3
Oak Manor Townhouse Water System	114
Adolescent Counseling	104
Palo Alto Senior Housing Project	28
Clara-Mateo Alliance	11
Lytton Gardens Assisted Living	101
Emergency Housing Consortium	75
Alma Gardens Apartment	1,150
Eden Housing	480
	<hr/>
Total Loans and notes	22,487
	<hr/>
Less: valuation allowance	(9,269)
	<hr/>
Net Carrying Value	\$13,218
	<hr/> <hr/>

Housing Loans

The City engages in programs designed to encourage construction or improvement in low-to-moderate income housing or other projects. Under these programs, grants or loans are provided under favorable terms to homeowners or developers who agree to spend these funds in accordance with the City's terms. These loans have been offset by reserved fund balances, as they are not expected to be repaid immediately.

Some of these loans contain forgiveness clauses which provide for the amount loaned to be forgiven if the third party maintain compliance with the terms of the loan and associated regulatory agreements. Since some of these loans are secured by trust deeds which are subordinated to other debt on the associated projects or are only repayable from residual cash receipts on the projects, collectibility of some of the outstanding balances may be not be realized. As a result of the forgiveness clauses and nature of these housing projects and associated cash flows, a portion of the outstanding balances of the loans has been offset by a valuation allowance.

Oak Manor Townhouse

On January 7, 1991, the City loaned \$2.1 million to assist in the acquisition of an apartment complex to be used to provide rental housing for low and very low-income households. This loan bears interest at 3 percent, is due in annual installments until 2011 and is collateralized by a subordinated deed of trust. Under the terms of the loan agreement, loan payments are forgiven if the Corporation meets the objective of this project. During the year ended June 30, 2007 the objective was met. The annual loan payment was forgiven for the calendar year ending December 31, 2006.

Emerson Street Project

On November 8, 1994, the City loaned \$375 thousand for expenses necessary to acquire an apartment complex for the preservation of rental housing for low and very low-income households in the City. This loan is collateralized by a second deed of trust. The loan bears no interest until 2009 after which the loan bears interest at three percent per year. The principal balance is due in 2034.

Alma Single Room Occupancy Development

On December 13, 1996, the City loaned \$2.7 million to the Alma Place Associates, L.P. for the development of a 107 unit single room occupancy development. This loan bears interest at 3 percent and is collateralized by a subordinated deed of trust. Loan payments are deferred until 2014. The principal balance is due in 2041.

Barker Hotel

On April 12, 1994, the City loaned a total of \$2.1 million for the preservation, rehabilitation and expansion of a low-income, single room occupancy hotel. This loan was funded by three sources: \$400 thousand from the Housing In-Lieu Special Revenue Fund, \$1.0 million from HOME Investment Partnership Program Funds, and \$670 thousand from Community Development Block Grant Funds. All three notes bear no interest and are collateralized by a deed of trust, which is subordinated to private financing. Loan repayments are deferred until 2035.



In July 2004, the City agreed to loan up to \$41 thousand to Palo Alto Housing Corporation to rehabilitate the interior of the Barker Hotel. The loan is funded entirely by Community Development Block Grant funds and is collateralized by a deed of trust on the property. Annual loan payments are deferred until certain criteria defined in the loan agreement are reached. The loan shall be forgiven if the borrower satisfactorily complies with all the terms and conditions of the loan agreement.

Sheridan Apartments

On December 8, 1998, the City loaned \$2.5 million to the Palo Alto Housing Corporation for the purchase and rehabilitation of a 57 unit apartment complex to be used for senior and low-income housing. The loan is funded by \$1.6 million in Community Development Block Grant Funds, and \$825 thousand in Housing In-Lieu funds. The note bears interest at 9 percent when available surplus cash from the project equals or exceeds 25 percent of interest calculated using 9 percent. When available surplus cash falls below this level the note bears interest at 3 percent. The note is collateralized by a second deed of trust and an Affordability Reserve Account held by the Corporation. Annual loan payments are deferred until the Corporation accumulates \$1.0 million in an Affordability Reserve Account. The principal balance is due in 2033.

Oak Court Apartments

On August 18, 2003, in connection with the loan to Oak Court Apartments, L.P. discussed below, the City loaned \$5.9 million to the Palo Alto Housing Corporation for the purchase of land on which Oak Court Apartments, L.P. constructed a 53 unit rental apartment complex for low and very low-income households with children. The note bears interest of five percent and is secured by a deed of trust. Annually accrued interest is added to the principal balance and note payments are due annually after 55 years, or beginning in 2058, unless the Corporation elects to extend the note until 2102, as define in the regulatory agreement.

Oak Court Apartments, L.P.

On August 18, 2003, the City loaned \$2.0 million to Oak Court Apartments, L.P. for the construction of a 53 unit rental apartment complex for low and very low-income households with children which was completed in April 2005. The note bears no interest until certain criteria defined in the note are satisfied, at which time the note will bear an interest rate not to exceed three percent. The note is secured by a subordinate deed of trust. The principal balance is due in 2058.

Palo Alto Gardens Apartments

On April 22, 1999, the City loaned \$1.0 million to the Mid-Peninsula Housing Coalition for the purchase and rehabilitation of a 155 unit complex for the continuation of low-income housing. This loan is funded by \$659 thousand in Community Development Block Grant funds and \$341 thousand in Housing In-Lieu funds. There are two notes that bear interest at 3 percent and are secured by second deeds of trust and a City Affordability Reserve Account held by the Coalition. Annual loan payments are deferred until certain criteria defined in the notes are reached. The principal balance is due in 2039.

Community Working Group, Inc.

On May 13, 2002, the City loaned \$1.3 million to the Community Working Group, Inc. for predevelopment, relocation and acquisition of land for development of an 89 unit complex and homeless service center for very low-income households. The loan is funded by \$1.3 million dollars of Community Development Block Grant funds. The note bears no interest and is secured by a first deed of trust. No repayment of the \$1.3 million will be required, provided that compliance with the City's agreement is maintained. After 89 years of compliance with the regulatory agreement, the City's loan would convert to a grant and its deed of trust would be reconveyed.

Opportunity Center Associates, L.P.

On July 19, 2004, the City loaned \$750 thousand to the Opportunity Center Associates, L.P. for construction of 89 units of rental housing for extremely low-income and very low-income households. The loan is funded by \$750 thousand of Residential Housing Funds. The note bears 3 percent interest and is secured by a deed of trust. The principal balance is due September 1, 2007 but can be extended an additional 55 years if certain conditions in the loan agreement are met.

Home Rehabilitation

The City administers a closed housing rehabilitation loan program initially funded with Community Development Block Grant funds. Under this program, individuals with incomes below a certain level are eligible to receive low interest loans, for rehabilitation work on their homes. These loans are secured by deeds of trusts, which may be subordinated to subsequent encumbrances upon said real property with the prior written consent of the City. The loan repayments may be amortized over the life of the loans, deferred or a combination of both.

Executive Relocation Assistance Loans

The City Council may authorize a mortgage loan as part of a relocation assistance package to executive staff. The loans are secured by first deeds of trust and interest is adjusted annually based on the rate of return of the invested funds of the City for the year ending June 30 plus one quarter of 1 percent. Principal and interest payments are due bi-weekly. Employees must pay off any outstanding balance of their loans within a certain period after ending employment with the City. As of June 30, 2007, the City had two outstanding employee home loans due in 2030 and 2031 respectively.

Below Market Rate Assessment Loans

In December 2002, the City loaned \$53 thousand to Below Market Rate home owners with low incomes and /or very limited assets for capital repairs, special assessments and improvements of their properties. The loans bear interest at 3 percent and are secured by a deed of trust on each property. Loan payments are deferred until 2032. In 2007, the City did not accrue interest.

Stevenson Housing Hot Water Loans

In July 2004, the City agreed to loan up to \$38 thousand to Palo Alto Senior Housing Project, Inc. to refurbish the hot water piping system at the Stevenson House Senior Housing facility. In April 2005, the City agreed to increase the loan by \$45 thousand, bringing the total loan to \$83 thousand. The loan is funded entirely by Community Development Block Grant funds, and bears simple interest of 6 percent. Principal and interest payments are deferred until July 1, 2010, as long as the borrower continues to comply with all terms and conditions of the agreement.

Adolescent Counseling Services Loans

In October 2003, the City agreed to loan up to \$111 thousand to Adolescent Counseling Services for rehabilitation expenses in connection with a rental housing facility for teenage girls. The loan is funded entirely by Community Development Block Grant funds, bears interest at 3 percent and is secured by a deed of trust on the property.



Palo Alto Senior Housing Project Loans

In July 2003, the City agreed to loan up to \$45 thousand to Palo Alto Senior Housing Project for home improvements in the independent living facility for low-income seniors. The loan is funded entirely by Community Development Block Grant funds, bears interest at 6 percent and is secured by a deed of trust on the property. Principal and interest payments are deferred until 2009. Principal and interest on the loan shall be forgiven if the borrower satisfactorily complies with all the terms set forth in the July 2003 agreement.

In April 2007, the City agreed to provide funds for the purpose of repairing and upgrading the fire alarm system at the Senior Housing facility.

Clara-Mateo Alliance Loans

In July 2003, the City agreed to loan up to \$200 thousand to Clara-Mateo Alliance for rehabilitation of the kitchen and the Elsa Segovia Center to provide services for the homeless. The loan is funded entirely by Community Development Block Grant funds, bears interest at 6 percent and is secured by a deed of trust on the property. Principal and interest payments are deferred until 2009. Principal and interest on the loan shall be forgiven if the borrower satisfactorily complies with all the terms and conditions set forth in the July 2003 agreement.

Lytton Gardens Assisted Living

In June 2005, the City agreed to loan up to \$109 thousand to Community Housing, Inc. to upgrade and modernize the existing kitchens at the senior residential facility known as Lytton Gardens Assisted Living. The loan is funded entirely by Community Development Block Grant funds, and bears simple interest of 3 percent. Principal and interest payments are deferred until July 1, 2035, as long as the borrower continues to comply with all terms and conditions of the agreement.

Emergency Housing Consortium

In November 2005, the City agreed to loan up to \$75 thousand to Emergency Housing Consortium, to cover architectural expenses that will be incurred in rehabilitating and expanding the property. The loan is funded entirely by Community Development Block Grant funds, and bears simple interest of 3 percent. Principal and interest payments are deferred until July 1, 2035, as long as the borrower continues to comply with all terms and conditions of the agreement.

Alma Gardens Apartment

In March 2006, the City agreed to loan up to \$1.2 million to Community Working Group, Inc., to acquire a 10-unit multi-family housing complex known as Alma Garden Apartment. The loan is funded entirely by Community Development Block Grant funds. Principal and interest payments will be made as provided in the note until July 1, 2061, as long as the borrower continues to comply with all terms and conditions of the agreement.

Eden Housing

In September 2006, the City agreed to loan \$480 thousand to the Community Housing Alliance (CHA) to acquire two parcels of land. The CHA will develop a 53 unit housing complex to provide rental housing for extremely low-income residents. On September 30, 2006, the City deposited in an escrow account \$980 thousand to be used towards the purchase of the land. The loan amount was collected on September 18, 2007.

In August 2007, the City agreed to the conveyance of the Alma Substation parcel to Eden Housing and the CHA and a loan of \$3.0 million for acquisition of adjacent Ole's Automotive Repair Shop.



Note 6.....

CAPITAL ASSETS

Valuation

All capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Contributed capital assets are valued at their estimated fair market value on the date contributed. The City’s policy is to capitalize all assets when costs are equal to/or exceed \$5,000 and the useful life exceeds three years. Infrastructure assets are capitalized when costs are equal to/or exceed \$100,000.

Proprietary Fund capital assets are recorded at cost including significant interest costs incurred under restricted tax-exempt borrowings, which finance the construction of capital assets. These interest costs, net of interest earned on investment of the proceeds of such borrowings are capitalized and added to the cost of capital assets during the construction period. Maintenance and repairs are expensed as incurred.

The City has recorded all its public domain (infrastructure) capital assets, which consists of Roadway, Recreation and Open Space, in its Citywide financial statements. GASB Statement 34 requires that all capital assets with limited useful lives be depreciated over their estimated useful lives. Alternatively, the “modified approach” may be used for certain capital assets. Depreciation is not provided under this approach, but all expenditures on these assets are expensed, unless they are additions or improvements. The City has elected to use the depreciation method for its capital assets. Capital assets with limited useful lives may/can be depreciated over their estimated useful lives. Alternatively, the “modified approach” may be used for certain capital assets. Depreciation is not provided under this approach, but all expenditures on these assets are expensed, unless they are additions or improvements. The City has elected to use the depreciation method for its capital assets.

The purpose of depreciation is to spread the cost of capital assets equitably among all users over the life of these assets. The amount charged to depreciation expense each year represents that year’s pro rata share of the cost of capital assets.

Depreciation has been provided on capital assets. Depreciation of all capital assets is charged as an expense against operations each year and the total amount of depreciation taken over the years, called accumulated depreciation, is reported on the balance sheet as a reduction in the book value of capital assets.

Depreciation is provided using the straight line method which means the cost of the asset is divided by its expected useful life in years and the result is charged to expense each year until the asset is fully depreciated. The City has assigned the useful lives listed below to capital assets.



GOVERNMENTAL ACTIVITIES	Years
Buildings & structures	10-30
Equipment:	
Computer equipment	4
Office machinery & equipment	5
Machinery & equipment	10
Roadway network includes pavement, striping & legends, curbs, gutters & sidewalks, parking lots, traffic signage and bridges	5-40
Recreation and open space network includes major park facilities, park trails, bike paths and median	25-40
 BUSINESS-TYPE ACTIVITIES	
Buildings and structures	25-60
Vehicles and heavy equipment	3-10
Machinery and equipment	10-50
Transmission and distribution systems	10-100

General Capital Assets

Changes in the City’s general capital assets during the year ended June 30, 2007 were (in thousands):

	Balance June 30, 2006	Additions	Retirements	Transfers	Balance June 30, 2007
<i>Governmental activities</i>					
Capital assets not being depreciated					
Land and improvements	\$71,407				\$71,407
Street trees	15,308		(\$266)		15,042
Construction in progress	24,457	\$17,982		(\$12,544)	29,895
Total capital assets not being depreciated	111,172	17,982	(266)	(12,544)	116,344
Capital assets being depreciated					
Buildings and improvements	91,186			2,356	93,542
Equipment	8,659	23	(519)	25	8,188
Roadway network	229,917	545		8,717	239,179
Recreation & open space network	12,086			1,446	13,532
Total capital assets being depreciated	341,848	568	(519)	12,544	354,441
Less accumulated depreciation					
Buildings and improvements	(53,578)	(1,539)			(55,117)
Equipment	(6,394)	(307)	519		(6,182)
Roadway network	(77,805)	(5,591)			(83,396)
Recreation & open space network	(4,447)	(314)			(4,761)
Total accumulated depreciation	(142,224)	(7,751)	519		(149,456)
Net governmental fund program					
Capital assets being depreciated	199,624	(7,183)		12,544	204,985
<i>Internal service fund capital assets</i>					
Construction in progress	3,186	2,092		(864)	4,414
Equipment	32,014	1,489	(2,400)	864	31,967
Accumulated depreciation	(21,169)	(3,201)	2,361		(22,009)
Net internal service capital assets	14,031	380	(39)		14,372
Governmental activity capital assets, net	\$324,827	\$11,179	(\$305)		\$335,701



Business-type Capital Assets

Changes in the City's Enterprise Fund capital assets during the year ended June 30, 2007 were (in thousands):

	Balance June 30, 2006	Additions	Retirements	Transfers	Balance June 30, 2007
<i>Business-type activities</i>					
Capital assets not being depreciated					
Land and improvements	\$1,953				\$1,953
Construction in progress	63,076	\$34,566		(\$8,673)	88,969
Total capital assets not being depreciated	65,029	34,566		(8,673)	90,922
Capital assets being depreciated					
Buildings and structures	18,111			804	18,915
Transmission, distribution, and treatment systems	471,525	2,383	(\$1,634)	7,869	480,143
Total capital assets being depreciated	489,636	2,383	(1,634)	8,673	499,058
Less accumulated depreciation					
Buildings and structures	(5,193)	(454)			(5,647)
Transmission, distribution, and treatment systems	(188,595)	(12,294)	365		(200,524)
Net capital assets being depreciated	(193,788)	(12,748)	365		(206,171)
Total depreciable assets	295,848	(10,365)	(1,269)	8,673	292,887
<i>Business-type activity capital assets, net</i>	<u>\$360,877</u>	<u>\$24,201</u>	<u>(\$1,269)</u>		<u>\$383,809</u>

Capital Asset Contributions

Some capital assets may be acquired using Federal and State grant funds, or they may be contributed by developers or other governments. Generally accepted accounting principles require that these contributions be accounted for as revenues at the time the capital assets are contributed.

Depreciation Allocation

Depreciation expense was charged to functions and programs based on their usage of the related assets. The amounts allocated to each function or program were as follows (in thousands):

<i>Governmental Activities</i>		<i>Business-Type Activities</i>	
City Manager	\$11	Water	\$1,063
Community Services	523	Electric	5,655
Fire	88	Gas	1,539
Police	26	Wastewater Collection	1,401
Public Works	6,986	Wastewater Treatment	2,118
Planning	19	Refuse	635
Non departmental (Common Use Assets)	11	Storm Drainage	337
Library Dept	87		<u>\$12,748</u>
Internal Service Funds	3,201		
	<u>\$10,952</u>		

Construction in Progress and Completed Projects

Construction in progress in fiscal year 2006-07 comprise (in thousands):

	Expended to June 30, 2007
	<hr/>
Governmental Activities:	
Open Space Trails & Amenities	\$855
Open Space Parking Improvement	622
Park Facilities Improvement	1,518
Park Backflow Replacement & Irrigation	519
Civic Center Infrastructure Improvements	1,892
Lucie Stern Community Center Improvements	110
Community Services Lighting Enhancements	176
Library Master Plan Project	974
Children's Theater System Upgrade	207
Roth Building Wings	225
Fire Communication Computer System	227
Lot S/L Garage (Downtown Parking Structure)	405
Police Building Project	1,462
San Mateo Drive Bridges	110
Library Automation Service	204
Open Space Lakes/Ponds	106
Public Safety Mobile Data	164
Fire Portable Radio Replacement	132
Sand Hill Road Bridge	173
Children's Library Improvement	3,512
Cambridge Parking Structure	184
Mitchell Park Library & Community Center	222
Fire Stations 3 & 4 Feasibility Study	188
Animal Shelter Expansion & Renovation	672
Street Maintenance	3,073
Roofing Replacement	153
Building Systems Improvements	155
American w/ Disabilities Act Compliance	649
Stanford/Palo Alto Playing Fields	853
School Site Irrigation	212
Mitchell Park Facilities Improvements	1,439
ECR/Ventura Signal	110
San Antonio/101 Signal	234
Sidewalk Repairs	2,196
Interior Finishes Construction	222
Traffic Calming Project	200
Security Systems Improvement	197
Municipal Service Center Improvement	145
Photovoltaic Design & Installations	990
College Terrace Traffic Calming	126
Charleston/Arastradero Corridor Plan	749
Traffic Signal Upgrades	112
Street Lights Improvements	125
San Antonio Road Median Improvements	186
Police Vehicle-Mounted Video Recording	196
Main Library Configuration	573
Tennis & Basketball Court Resurfacing	139
Benches, Signage, Fencing, Walkways	106
Roth Building Maintenance	141
Library Service Model Analysis	267
Vehicle Replacement Fund	2,095
Technology Fund	2,320
Other construction in progress	1,487
	<hr/>
Total governmental construction in progress	\$34,309
	<hr/> <hr/>



Enterprise Funds:

Storm drainage structural and water quality improvements	\$1,495
Gas system extension replacements and improvements	1
Water system extension replacements and improvements	839
Electric distribution system improvements	10,225
Other electrical improvement projects	5,865
Water quality control plant equipment replacement and lab facilities	2,391
Sewer system rehabilitation and extensions	11,718
Other construction in progress	<u>56,435</u>
Total enterprise construction in progress	<u><u>\$88,969</u></u>

Allocations of Enterprise Fund administration and general expenses of \$7.5 million have been capitalized and included in amounts expended to June 30, 2007.

Note 7.....

GENERAL LONG-TERM OBLIGATIONS

The City’s Long-Term Obligations

Bond discounts and issuance costs of long-term debt issues are amortized over the life of the related debt. Gains or losses between the net book value of debt and funds placed in escrow to defease that debt are amortized over the remaining life of either the refunded debt or the refunding debt, whichever is shorter.

The City’s long-term debt issues and transactions, other than Special Assessment debt discussed in Note 8, were as follows (in thousands):

	Original Issue Amount	Balance June 30, 2006	Retirements	Balance June 30, 2007	Current Portion
Governmental Activity Debt:					
<i>General Long Term Obligations:</i>					
1998 Golf Course Certificates of Participation,					
4.00-5.00%, due 09/01/2018	\$7,750	\$5,385	\$310	\$5,075	\$325
2002A Civic Center Refinancing					
Certificates of Participation,					
2.00-4.00%, due 03/01/2012	3,500	2,230	340	1,890	350
2002B Downtown Parking Improvements					
Certificates of Participation					
4.55-6.00%, due 03/01/2022	3,555	2,300	90	2,210	95
Total Governmental Activity Debt	<u>\$14,805</u>	<u>\$9,915</u>	<u>\$740</u>	<u>\$9,175</u>	<u>\$770</u>
Business-type Activity Debt:					
<i>Enterprise Long Term Obligations:</i>					
Utility Revenue Bonds,					
1995 Series A, 5.00-6.25%, due 06/01/2020	\$8,640	\$6,260	\$296	\$5,964	\$315
1999 Refunding, 3.25-5.25%, due 06/01/2024	17,735	15,110	440	14,670	455
2002 Series A, 3.00-5.00%, due 06/01/2026	26,055	21,955	730	21,225	755
Less: unamortized discount/ issuance cost		(1,037)	(65)	(972)	
	<u>\$52,430</u>	<u>\$42,288</u>	<u>\$1,401</u>	<u>\$40,887</u>	<u>\$1,525</u>

Description of the City's Long-Term Debt Issues

1998 Golf Course COPs – In August 1998, the City's Public Improvement Corporation issued Golf Course Improvement COPs, Series 1998 in the amount of \$7.8 million to retire the 1978 Golf Course Lease Revenue Bonds, and to finance various improvements at the Palo Alto Public Golf Course, including upgrading five fairways and various traps, trees and greens, constructing new storm drain facilities, replacing the existing irrigation system, upgrading the driving range, and installing new cart paths. The 1998 COPs are secured by lease revenues received by the Public Improvement Corporation from golf course revenues or other unrestricted revenues of the City. Principal and interest are payable semi-annually each March 1 and September 1.

2002A Civic Center Refinancing COPs – On January 16, 2002 the City issued \$3.5 million of COPs to refund the City's 1992 COPs which were subsequently retired. Principal payments for the 2002A COPs are due annually on March 1 and interest payments semi-annually on March 1 and September 1 and are payable from lease revenues received by the Palo Alto Public Improvement Corporation from the City from available funds.

2002B Downtown Parking Improvement Project COPs – On January 16, 2002 the City issued \$3.6 million of COPs to finance the construction of certain improvements to the non-parking area contained in the City's Bryant /Florence Garage complex. Principal payments are due annually on March 1 and interest payments semi-annually on March 1 and September 1 from 4.6 percent to 6.5 percent, and are payable from lease revenues received by the Palo Alto Public Improvement Corporation from the City from available funds.

On January 25, 2005, the City defeased \$900 thousand of the 2002B Downtown Parking Improvements Certificates of Participation. Surplus cash from the Civic Center Refinancing and Downtown Parking Improvement Project Construction account were placed in an irrevocable trust to provide for future debt payments. Accordingly, the trust account assets and the liability for the defeased Bonds are not included on the financial statements. The outstanding amount of the defeased debt at June 30, 2007 is \$810 thousand. The defeasance resulted in an overall debt service savings of \$1.5 million and an economic gain of \$462 thousand.

1995 Utility Revenue Bonds, Series A – The City issued Utility Revenue Bonds on February 1, 1995 to finance certain extensions and improvements to the City's Storm Drainage and Surface Water System. The Bonds are special obligations of the City payable solely from and secured by a pledge of and lien upon the revenues derived by the City from the funds, services and facilities of all Enterprise Funds except the Refuse Fund and External Services Fund. Principal payments are payable annually on June 1 and interest payments semi-annually on June 1 and December 1. A \$2.9 million 6.3 percent term bond is due June 1, 2020. In lieu of a reserve fund, the Bonds are secured by a Surety Bond issued by AMBAC Indemnity Corporation.

1999 Utility Revenue and Refunding Bonds, Series A – The City issued Utility Revenue Bonds on June 1, 1999 to refund the 1990 Utility Revenue Refunding Bonds, Series A and the 1992 Utility Revenue Bonds, Series A, and to finance rehabilitation of the Wastewater Treatment System's two sludge incinerators. The 1990 Utility Revenue Refunding Bonds, Series A and the 1992 Utility Revenue Bonds, Series A, were subsequently retired.

The 1999 Bonds are special obligations of the City payable solely from and secured by a pledge of and lien upon certain net revenues derived by the City’s Sewer System and its storm and surface water system (the “Storm Drain System”). As of June 30, 2001, the 1999 Bonds had been allocated to and were repayable from net revenues of the following enterprise funds: Wastewater Collection (10.2 percent), Wastewater Treatment (64.6 percent) and Storm Drain (25.2 percent). Principal payments are payable annually on June 1 and interest payments semi-annually on June 1 and December 1. A \$3.1 million 5.3 percent term bond, and a \$5.1 million 5.3 percent term bond are due June 1, 2021 and 2024, respectively. In lieu of a reserve fund, the Bonds are secured by a Surety Bond issued by AMBAC Indemnity Corporation.

2002 Utility Revenue Bonds, Series A – On January 24, 2002 the City issued Utility Revenue Bonds to finance certain improvements to the City’s water utility system, and the City’s natural gas utility system. Principal payments are due annually on June 1 and interest payments are due semi-annually on June 1 and December 1 from 3.0 percent to 5.0 percent. The 2002 Revenue Bonds are secured by net revenues generated by the Water Services and Gas Services Funds.

Debt Service Requirements (in thousands):

Debt service and capitalized lease requirements are shown below for all long-term debt.

For the Year Ending June 30	<u>Governmental Activities</u>		<u>Business-Type Activities</u>	
	Principal	Interest	Principal	Interest
2008	\$770	\$446	\$1,525	\$2,088
2009	800	415	1,590	2,025
2010	840	381	1,655	1,955
2011	870	345	1,730	1,880
2012	905	305	1,815	1,800
2013-2017	2,950	1,018	10,484	7,577
2018-2022	2,040	251	13,450	4,604
2023-2026			9,610	1,061
Total	<u>\$9,175</u>	<u>\$3,161</u>	41,859	<u>\$22,990</u>

Reconciliation of long-term debt

Less unamortized original issue discount (972)

Net long-term debt \$40,887



Debt Call Provisions

Long-term debt as of June 30, 2007 is callable on the following terms and conditions:

	<u>Initial Call Date</u>	
<i>Governmental Activities Long Term Debt</i>		
1998 Certificates of Participation	09/01/2008	(3)
2002B Certificates of Participation	03/01/2011	(2)
<i>Business-Type Activities Long Term Debt</i>		
Utility Revenue Bonds -		
1999 Refunding	06/01/2009	(1)
2002 Series A	06/01/2012	(1)

- (1) Callable in inverse numerical order of maturity at par plus a premium of 2.0 percent beginning on the initial call date. The call price declines subsequent to the initial date.
- (2) Callable in any order specified by the City at par plus a premium of 1.0 percent beginning on the initial call date. The call price declines subsequent to the initial date.
- (3) Callable in any order specified by the Trustee at par plus a premium of 1.0 percent beginning on the initial call date. The call price declines subsequent to the initial date.

Leasing Arrangements

COPs and Capital Leases are issued for the purpose of financing the construction or acquisition of projects defined in each leasing arrangement. Projects are leased to the City for lease payments which, together with unspent proceeds of the leasing arrangement, will be sufficient to meet the debt service obligations of the leasing arrangement. At the termination of the leasing arrangement, title to the project will pass to the City.

Leasing arrangements are similar to debt; they allow investors to participate in a share of guaranteed payments which are made by the City. Because they are similar to debt, the present value of the total of the payments to be made by the City is recorded as long-term debt. The City's leasing arrangements are included in long-term obligations discussed above.

Conduit Financing

On December 15, 1996, the City acted as a financial intermediary in order to assist Lytton Gardens Health Care Center in issuing Insured Revenue Refunding Bonds. The Bonds are payable solely from revenues collected by Lytton Gardens Health Care Center. The City has not included these Bonds in its basic financial statements since it is not legally or morally obligated for the repayment of the Bonds. At June 30, 2007 the amount of Bonds outstanding was \$8.8 million.

Authorized but Unissued Debt

On June 4, 2007, the City approved the issuance of \$1.5 million of Electric Utility Clean Renewable Energy Tax Credit Bonds (CREBs), 2007 Series A to finance the City’s photovoltaic solar panel project. The Bonds do not bear interest. In lieu of receiving periodic interest payments, bondholders are allowed annual federal income tax credits in an amount equal to a credit rate for such CREBs multiplied by the outstanding principal amount of the CREBs owned by the bondholders. The Bonds are payable solely from and secured solely by a pledge of the Net Revenues of the Electric system and the other funds pledged therefore under the Indenture. As of June 30, 2007, the debt has not been issued.

On November 6, 2006, the City approved requesting a loan up to \$19 million from the State Water Resources Control Board to finance the design and construction of the Mountain View/Moffett Area reclaimed water pipeline project. As of June 30, 2007, no proceeds had been received or requested.

Long-term Debt without City Commitment

On July 23, 2007, the City approved the issuance of two variable rate demand Tax-Exempt Revenue Bonds by the ABAG Finance Authority in the amounts of \$160 million and \$180 million for the construction of Albert L. Schultz Jewish Community Center and a new continuing care retirement community, respectively. The Debt is payable by the borrowers, Albert L. Schultz Jewish Community Center and 899 Charleston, LLC, the City has no legal or moral liability with respect to the payment of these debts.

Note 8.....

SPECIAL ASSESSMENT DEBT

Special Assessment Debt with City Commitment

Special assessment districts exist in the City to provide improvements to properties located in those districts. Properties are assessed for the cost of improvements. These assessments are payable over the term of the debt issued to finance the improvements. The total amount of the assessment is recorded as receivable and deferred revenue at the time the related debt is issued, and reduced as assessments are collected. The City is obligated to be the purchaser of last resort or to advance available City funds to repay this debt in the event of default by any of these districts. At June 30, 2007, the district was in compliance with the repayment and other requirements of its respective debt issue. The City accounts for resources available to pay special assessment debt in a Debt Service Fund. The special assessment debt is included in the City's Governmental Activities long-term debt.

Special assessment debt with City commitment comprises the following issues (in thousands):

	Original Issue Amount	Balance June 30, 2006	Retirements	Balance June 30, 2007	Current Portion
Governmental Activity Debt					
1987 California Avenue Parking,					
6.70-9.25%, repaid					
09/02/2007	\$1,325	\$225	\$110	\$115	\$115

The final debt service payments for principal and interest of \$115 thousand and \$5 thousand, respectively, were made in September 2007.

Description of Special Assessment Debt with City’s Commitment

1987 California Avenue Parking Assessment District Assessment Bonds – The City issued Special Assessment Bonds on April 13, 1987 to finance the acquisition of land and related improvements for the purpose of providing public parking in the City. Principal payments are payable annually on September 2 and interest payments semi-annually on March 2 and September 2.

Special Assessment Debt with no City Commitment

The California Avenue Parking Assessment District No. 92-13 issued Assessment Bonds of 1993, but the City has no legal or moral liability with respect to the payment of this debt, which is secured only by assessments on the properties in this District. Therefore, this debt is not included in Governmental Activities long-term debt of the City. At June 30, 2007, the District’s outstanding debt amounted to \$1.2 million.

The University Avenue Area Off-Street Parking Assessment District issued Assessment Bonds of Series 2001-A, but the City has no legal or moral liability with respect to the payment of this debt, which is secured only by assessments on the properties in the District. Therefore, this debt is not included in Governmental Activities long-term debt of the City. At June 30, 2007, the District’s outstanding debt amounted to \$8.6 million. A portion of the proceeds from the 2001 Bonds amounting to \$3.2 million was used to defease the 1977 University Avenue Area Off-Street Parking Assessment District Bonds and the 1989 University Avenue Area Off-street Parking Assessment District Refunding and Improvement Bonds.

The University Avenue Area Off-Street Parking Assessment District issued Assessment Bonds of Series 2002-A, but the City has no legal or moral liability with respect to the payment of this debt, which is secured only by assessments on the properties in the District. Therefore, this debt is not included in Governmental Activities long-term debt of the City. As of June 30, 2007, \$0.6 million of the bonds were called and the remaining outstanding debt amounted to \$30 million.



Note 9.....

LANDFILL CLOSURE AND POST-CLOSURE CARE

State and Federal laws and regulations require the City to place a final cover on the remaining open areas of the Palo Alto Refuse Disposal Site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for thirty years after closure. Closure costs of \$1.6 million were reported in fiscal 1991-92, when a section of the refuse area was capped with a final cover and Byxbee Park was constructed on top of that section. A second section of the refuse area was capped with a final cover during fiscal year 1992-93, with closure costs of \$904 thousand. The remaining closure and post-closure care costs are expected to be paid only near and after the date that the refuse site stops accepting waste.

An updated cost estimate for the landfill closure and post-closure, based on landfill capacity, was performed during 2001. The estimates of these costs were based upon 2001 cost and are adjusted annually for inflation (\$200 thousand in fiscal 2006-07) as mandated by the State of California. Landfill closure and post-closure liability for fiscal years 2007 and 2006 were \$7.1 million and \$6.9 million, respectively. Currently, 91.5 percent of the landfill capacity has been used to date. Based on this percentage, \$6.5 million is expected to be recorded as future landfill closure and post-closure liability.

Total cost estimates are based on what it would cost to perform all currently mandated closure and post-closure care in 2001. The City expects to close the refuse area in the year 2011. Actual closure and post-closure care costs may be higher due to inflation variances, changes in technology, or changes in State or Federal regulations.

The City is required by State and Federal laws and regulations to make annual funding contributions to finance closure and post-closure care. The City is in compliance with these requirements for the year ended June 30, 2007 with the establishment of the fully-funded liability for this purpose.



Note 10.....

NET ASSETS AND FUND BALANCES

Net Assets

Net assets are the excess of all the City’s assets over all its liabilities, regardless of fund. Net assets are divided into three categories and are described below:

Invested in Capital Assets, net of related debt describes the portion of net assets which is represented by the current net book value of the City’s capital assets, less the outstanding balance of any debt issued to finance these assets.

Restricted describes the portion of net assets which is restricted as to use by the terms and conditions of agreements with outside parties, governmental regulations, laws, or other restrictions which the City cannot unilaterally alter. These principally include bond proceeds received for use on capital projects, debt service requirements, and special revenue programs subject to limitations defined regulations and laws underlying such programs.

Unrestricted describes the portion of net assets which is not restricted as to use.

Fund Balances, Reserves and Designations

In the Fund financial statements, fund balances represent the net current assets of each fund. Net current assets generally represent a fund’s cash and receivables, less its liabilities. Portions of a fund’s balance may be reserved or designated for future expenditure.

At June 30, 2007, Governmental Funds reservations and designations included (in thousands):

	Major Funds		
	General Fund	Capital Projects Fund	Non-Major Funds
Reserved for:			
Encumbrances	\$3,390	\$7,372	\$666
Downtown parking structure		56	
Notes and loans	1,182		12,036
Inventory of materials and supplies	2,567		
Prepaid Items	1,253		
Debt service			1,484
Total Reserved Fund Balance	<u>\$8,392</u>	<u>\$7,428</u>	<u>\$14,186</u>
Unreserved, designated for:			
Special revenue projects			\$8,205
Equity transfer stabilization	\$3,465		
Reappropriations	71	\$17,831	2,881
Budget stabilization	27,480		
Infrastructure		15,815	
Total Unreserved/Designated Fund Balances	<u>\$31,016</u>	<u>\$33,646</u>	<u>\$11,086</u>



Reserve for **encumbrances** represents the portion of fund balance set aside for open purchase orders.

Reserves for **notes, loans, inventory of materials and supplies, and prepaid items** are the portions of fund balance set aside to indicate these items do not represent available, spendable resources even though they are a component of assets.

Reserve for **debt service** is the portion of fund balance legally restricted for the payment of principal and interest on long-term liabilities.

Designated for **special revenue projects** is the portion of fund balance for use on capital outlay projects.

Designated for **equity transfer stabilization** is the portion of fund balance to replace required equity transfer by Gas, or Electric Enterprise Funds in the event the fund was unable to make its required equity transfer.

Designated for **reappropriations** is the portion of fund balance set aside for subsequent years' appropriations.

Designated for **budget stabilization** is the portion of fund balance to be used to supplement the regular budget when unexpected events such as state government action, a downturn in the economy or a natural disaster reduces revenue or creates obligations that significantly impact the current year budget.

Designated for **infrastructure** is the portion of fund balance to be used for financing future capital improvements.

Internal Service Funds

At June 30, 2007, internal service fund net assets designations included (in thousands):

Reserved net assets-	
Commitments and reappropriations	\$3,645
Unreserved:	
Designated for:	
Future catastrophic losses	3,955
Retiree health care	30,719
Interfund advances/payables	25
Undesignated	<u>15,515</u>
Net assets unrestricted	<u><u>\$53,859</u></u>

Reserve for **commitments and reappropriations** represents the portion of net assets set aside for open purchase orders.

Designated for **future catastrophic losses** is the portion of net assets to be used for unforeseen future losses.

Designated for **retiree health care** represents the portion of net assets set aside to defer future costs of retiree health care coverage.

Designated for **interfund advances/payables** represents the portion of net assets set aside to indicate these items do not represent available, spendable resources even though they are a component of assets.

Enterprise Funds

At June 30, 2007, Enterprise Fund net assets (in thousands):

	Water	Electric	Gas	Wastewater Collection	Wastewater Treatment	Refuse	Storm Drainage	External Services	Total
Unrestricted									
Rate stabilization									
Supply		\$60,594	\$6,668						\$67,262
Distribution		7,787	1,738						9,525
Operations	\$16,276	2,730		\$5,803	(\$12,596)	\$4,414	\$2,186		18,813
	16,276	71,111	8,406	5,803	(12,596)	4,414	2,186		95,600
Emergency plant									
replacement	1,354	2,625	1,010	666	2,583				8,238
Calaveras		71,810							71,810
Reappropriations	1,672	4,535	6,555	4,176	2,421	60	2,137		21,556
Commitments	1,995	4,387	960	1,791	21,400	824	158	\$5	31,520
Restricted bond proceeds					9				9
Underground loan		698							698
Refuse Water									
Resources Board						590			590
Public benefit program		1,377							1,377
Central Valley Project		(116)							(116)
Other/Unexpended debt portion	15	(3)	18	1	26	(1)	1		57
External Service - Information Technology								4	4
	<u>\$21,312</u>	<u>\$156,424</u>	<u>\$16,949</u>	<u>\$12,437</u>	<u>\$13,843</u>	<u>\$5,887</u>	<u>\$4,482</u>	<u>\$9</u>	<u>\$231,343</u>
Restricted for Debt Service	<u>\$780</u>		<u>\$952</u>						<u>\$1,732</u>

The City Council has committed unreserved net assets for general contingencies, future capital and debt service expenditures including operating and capital contingencies for unusual or emergency expenditures.



Note 11.....

PENSION PLANS

CALPERS Safety and Miscellaneous Employees Plans

Substantially all permanent City employees are eligible to participate in pension plans offered by California Public Employees Retirement System (CALPERS) an agent for multiple employer defined benefit pension plans which acts as a common investment and administrative agent for its participating member employers. CALPERS provides retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. The City's employees participate in the Safety (police and fire) and Miscellaneous (all other) Employee Plans. Benefit provisions under both Plans are established by State statute and City resolution. Benefits are based on years of credited service, equal to one years of full time employment. Funding contributions for both Plans are determined annually on an actuarial basis as of June 30 by CALPERS.

Effective July 1, 2004, the separate Police and Fire Plans were combined into one Safety Plan. Prior actuarial valuation information for Safety is not available, since the plans were combined.

The Plans' provisions and benefits in effect at June 30, 2007, are summarized as follows:

	Safety	Miscellaneous
Benefit vesting schedule	5 years service	5 years service
Benefit payments	monthly for life	monthly for life
Retirement age	50	50
Monthly benefits, as a % of annual salary	3%	2.0-2.7%
Required employee contribution rates	9%	8%
Required employer contribution rates	24.208%	11.436%

The City's current labor contracts require it to pay employee contributions as well as its own.

CALPERS determines contribution requirements using a modification of the Entry Age Normal Method. Under this method, the City's total normal benefit cost for each employee from date of hire to date of retirement is expressed as a level percentage of the related total payroll cost. Normal benefit cost under this Method is the level amount the employer must pay annually to fund an employee's projected retirement benefit. This level percentage of payroll method is used to amortize any unfunded actuarial liabilities. The actuarial assumptions used to compute contribution requirements are also used to compute the actuarial accrued liability. The City does not have a net pension obligation since it pays these actuarially required contributions monthly.

CALPERS uses the market related value method of valuing the Plan’s assets. An investment rate of return of 7.75 percent is assumed, including inflation at 3 percent. Annual salary increases are assumed to vary by duration of service. Changes in liability due to plan amendments, changes in actuarial assumptions, or changes in actuarial methods are amortized as a level percentage of payroll on a closed basis over twenty years. Investment gains and losses are tracked and amortized over 30 years.

The Plans’ actuarial value (which differs from market value) and funding progress over the most recently available three years is set forth below at their actuarial valuation date of June 30, 2005 (in thousands):

Safety Plan:

Actuarial					Unfunded	
Valuation Date	Entry Age Accrued Liability	Value of Assets	Unfunded (Overfunded) Liability	Funded Ratio	Annual Covered Payroll	(Overfunded) Liability as a % of Payroll
2003	\$193,154	\$170,471	\$22,683	88.3%	\$18,855	120.3%
2004	201,972	177,827	24,145	88.0%	17,458	138.3%
2005	213,683	189,821	23,862	88.8%	18,953	125.9%

Miscellaneous Plan:

Actuarial					Unfunded	
Valuation Date	Entry Age Accrued Liability	Value of Assets	Unfunded (Overfunded) Liability	Funded Ratio	Annual Covered Payroll	(Overfunded) Liability as a % of Payroll
2003	\$272,422	\$257,123	\$15,299	94.4%	\$60,498	25.3%
2004	290,552	267,794	22,758	92.2%	60,316	37.7%
2005 *	339,641	287,139	52,503	84.5%	60,954	86.1%

* On November 13, 2006, the City Council voted to increase the pension benefit for miscellaneous employees from 1.426-2.418 % to 2.0-2.7% effective the pay period inclusive of January 06, 2007. CALPERS revised the fiscal 2004-05 actuarial data for the impacts of this benefit enhancement.

Audited annual financial statements and ten-year trend information are available from CALPERS at P.O. Box 942709, Sacramento, CA 94229-2709.

Actuarially required contributions for all plans for fiscal years 2007, 2006 and 2005 were \$19.7, \$19.2 and \$15.8, million, respectively. The City made these contributions as required, together with certain immaterial amounts required as the result of the payment of overtime and other additional employee compensation.

Note 12

RETIREE HEALTH BENEFITS

In addition to providing pension benefits, the City participates in the California Public Employees Medical and Health Care Act program to provide certain health care benefits for retired employees. Substantially all of the City's employees may become eligible for those benefits if they reach normal retirement age while working for the City. The costs of retiree health care are recognized as expenditures when premiums are paid. For fiscal year 2006-07, expenditures for retiree health care for approximately 642 eligible retired employees totaled \$4.2 million, including administrative fees. The premium is based upon an average annual cost of coverage per retiree of \$6 thousand.

In the fiscal year ended June 30, 1993, the City received a \$6.1 million refund from the California Public Retirement System (CALPERS) through the passage of Assembly Bill (AB) 702. This amount was placed in a separate fund to defer future costs of retiree health care coverage. During the fiscal year ended June 30, 1995, the City established and transferred the amount to a separate fund which is now accounted for as an Internal Service Fund.

During the current fiscal year, Milliman, Inc. performed an actuarial valuation to determine the City's retiree medical liability. The unfunded liability ranges from \$83.0 million to \$149.0 million depending on the discount rate assumption used which ranges from 4.0 percent to 7.75 percent. The lower range of the discount rate is based on the rate of return of the City's current investment portfolio and assumes staff managing the funds internally. The higher range is based on staff being able to use a trust or deposit funds with CALPERS, which has an expected rate of return of 7.75 percent on its investments. As of June 30, 2007, the City has saved \$30.7 million towards the liability.

Staff is evaluating various options for both reducing the liability and saving the required funds to meet recommended annual contribution levels. It is anticipated that funding and investment recommendations will be presented to Council for approval in the winter of 2007.

The Retiree Fund's net assets consist of the following for the fiscal year ended June 30 (in thousands):

Retiree Health Benefits	2007	2006
Net assets, beginning of year	\$26,505	\$18,265
Interest earnings	1,202	729
Unrealized gain (loss) on investments	114	(476)
Interdepartmental charges	4,238	3,599
Compensated benefits	(4,240)	(3,599)
Transfers in	2,900	7,987
Net assets, end of year	\$30,719	\$26,505



Note 13.....

DEFERRED COMPENSATION PLAN

City employees may defer a portion of their compensation under City sponsored Deferred Compensation Plans created in accordance with Internal Revenue Code Section 457. Under these Plans, participants are not taxed on the deferred portion of their compensation until distributed to them; distributions may be made only at termination, retirement, death or in an emergency as defined by the Plans.

The laws governing deferred compensation plan assets now require plan assets to be held by a Trust for the exclusive benefit of plan participants and their beneficiaries. Since the assets held under these plans are not the City's property and are not subject to City control, they have been excluded from these financial statements.

Note 14.....

RISK MANAGEMENT

Coverage

The City provides dental coverage to employees through programs which are administered by a service agent. The City is self-insured for the dental coverage.

The City has a workers' compensation insurance policy with coverage up to the statutory limit set by the State of California. The City retains the risk for the first \$500 thousand in losses for each accident and employee under this policy.

The City also has public employee dishonesty insurance with a \$5 thousand deductible and coverage up to \$1.0 million per loss. The City's property and machinery insurance policy has various deductibles and various coverages based on the kind of machinery.

The City is a member of the Authority for California Cities Excess Liability (ACCEL) which provides general liability, including auto liability, insurance coverage up to \$44.0 million per occurrence. The City retains the risk for the first \$1.0 million in losses for each occurrence under this policy.

ACCEL was established for the purpose of creating a risk management pool for central California municipalities. ACCEL is governed by a Board of Directors consisting of representatives of its member cities. The board controls the operations of ACCEL, including selection of management and approval of the annual budget.

The City's deposits with ACCEL equal the ratio of the City's payroll to the total payrolls of all entities. Actual surpluses or losses are shared according to a formula developed from overall loss costs and spread to member entities on a percentage basis after a retrospective rating.

During the fiscal year ended June 30, 2007, the City contributed \$706 thousand to ACCEL for current year coverage.



Audited financial statements are available from ACCEL at 160 Spear Street, San Francisco, California 94105-2709.

Claims Liability

The City provides for the uninsured portion of claims and judgments in the General Benefits and Insurance Internal Service Fund. Claims and judgments, including a provision for claims incurred but not reported, are recorded when a loss is deemed probable of assertion and the amount of the loss is reasonably determinable. As discussed, above, the City has a coverage for such claims, but it has retained the risk for the deductible, or uninsured portion of these claims.

The City’s liability for uninsured claims is limited to dental, general liability, and workers’ compensation claims, as discussed above, and was estimated by management based on prior years claims experience as follows as of June 30 (in thousands):

	<u>Year Ended June 30</u>	
	<u>2007</u>	<u>2006</u>
Beginning Balance	\$19,545	\$13,883
Liability for current and prior fiscal year claims and claims incurred but not reported (IBNR)	(2,466)	9,981
Claims paid	<u>4,051</u>	<u>(4,319)</u>
Ending Balance	<u>\$21,130</u>	<u>\$19,545</u>
 Current Portion	 <u>\$5,939</u>	 <u>\$6,033</u>



Note 15.....

JOINT VENTURES

General

The City participates in joint ventures through Joint Powers Authorities (JPAs) established under the Joint Exercise of Powers Act of the State of California. As separate legal entities, these JPAs exercise full powers and authorities within the scope of the related Joint Powers Agreement, including the preparation of annual budgets, accountability for all funds, the power to make and execute contracts and the right to sue and be sued. Obligations and liabilities of the JPAs are not those of the City.

Each JPA is governed by a board consisting of representatives from each member agency. Each board controls the operations of its respective JPA, including selection of management and approval of operating budgets, independent of any influence by member agencies beyond their representation on the Board.

Northern California Power Agency

The City is a member of Northern California Power Agency (NCPA), a joint powers agency which operates under a joint powers agreement among fifteen public agencies. The purpose of NCPA is to use the combined strength of its members to purchase, generate, sell and interchange electric energy and capacity through the acquisition and use of electrical generation and transmission facilities. Each agency member has agreed to fund a pro rata share of certain assessments by NCPA and enter into take-or-pay power supply contracts with NCPA. While NCPA is governed by its members, none of its obligations are those of its members unless expressly assumed by them.

During the year ended June 30, 2007, the City incurred expenses totaling \$59.2 million for purchased power and assessments earned by NCPA.

The City's interest in NCPA projects and reserves, as computed by NCPA, was \$4.4 million at June 30, 2007. This amount represents the City's portion of funds which resulted from the settlement with third parties of issues with financial consequences and reconciliations of several prior years' budgets for programs. It is recognized that all the funds credited to the City are linked to the collection of revenue from the City's ratepayers, or to the settlement of disputes relating to electric power supply and that the money was collected from the City's ratepayers to pay power bills. Additionally, the NCPA Commission identified and approved the funding of specific reserves for working capital, accumulated employees post-retirement medical benefits, and billed property taxes for the geothermal project. The Commission also identified a number of contingent liabilities that may or may not be realized, the cost of which in most cases is difficult to estimate at this time. One such contingent liability is the steam field depletion which will require funding to cover debt service and operational costs in excess of the expected value of the electric power. The General Operating Reserve is intended to minimize the number and amount of individual reserves needed for each project, protect NCPA's financial condition and maintain its credit worthiness. These funds are available on demand, but the City has left them with NCPA as a reserve against these contingencies identified by NCPA.

Members of NCPA may participate in an individual project of NCPA without obligation for any other project. Member assessments collected for one project may not be used to finance other projects of NCPA without the member's permission.



Geothermal Projects

A purchased power agreement with NCPA obligated the City for 6.2 percent and 6.2 percent, respectively, of the operating costs and debt service of the two NCPA 110-megawatt geothermal steam powered generating plants, Project Number 2 and Project Number 3.

The City's participation in the Geothermal Project was sold to Turlock Irrigation District in October 1984. Accordingly, the City is liable for payment of outstanding geothermal related debt only in the event that Turlock fails to make specified payments. Total outstanding debt of the NCPA Geothermal Project at June 30, 2007 is \$253.0 million. The City's participation in this project was 6.2 percent, or \$15.7 million.

NCPA's Geothermal Project has experienced a greater than originally anticipated decline in steam production from geothermal wells on its leasehold property. Results of the continuing well analysis program indicate that the potential productive capacity of the geothermal steam reservoir is less than originally estimated. Therefore, NCPA has modified the operations of the Geothermal Project to reduce the average annual output from past levels. As a result, the per unit cost of energy generated by the projects will be higher than anticipated.

NCPA will continue to monitor the wells while pursuing alternatives for improving and extending reservoir performance, including supplemental water re-injection, plant equipment modifications, and changes in operating methodology. NCPA, along with other steam field operators, has observed a substantial increase in steam production in the vicinity of re-injection wells and is attempting to increase water re-injection at strategic locations. NCPA, other steam developers, and the Lake County Sanitation District are constructing a wastewater pipeline project that will greatly increase the amount of water available for re-injection.

Calaveras Hydroelectric Project

In July 1981, NCPA agreed with Calaveras County Water District to purchase the output of the North Fork Stanislaus River Hydroelectric Development Project and to finance its construction. Debt service payments to NCPA began in February 1990 when the project was declared substantially complete and power was delivered to the participants. Under its power purchase agreement with NCPA, the City is obligated to pay 22.9 percent of this Project's debt service and operating costs. At June 30, 2007, the book value of this Project's plant, equipment and other assets was \$508.1 million, while its long-term debt totaled \$496.1 million and other liabilities totaled \$3.6 million. The City's share of the Project's long term-debt amounted to \$114.5 million at that date.

Geothermal Public Power Line

In 1983, NCPA, Sacramento Municipal Utility District, the City of Santa Clara and the Modesto Irrigation District (joint owners) initiated studies for a Geothermal Public Power Line (GPPL) which would carry power generated at several existing and planned geothermal plants in the Geysers area to a location where the joint owners could receive it for transmission to their load centers. NCPA has an 18.5 percent share of this Project and the City has an 11.1 percent participation in NCPA's share. In 1989, the development of the proposed Geothermal Public Power Line was discontinued because NCPA was able to contract for sufficient transmission capacity to meet its needs in the Geysers. However, because the project financing provided funding for an ownership interest in a PG&E transmission line, a central dispatch facility and a performance bond pursuant to the Interconnection Agreement with PG&E, as well as an ownership interest in the proposed GPPL, NCPA issued \$16.0 million in long-term, fixed-rate revenue bonds in November 1989 to defease the remaining variable rate refunding bonds used to refinance this project. The City is obligated to pay its 11.1 percent share of the related debt service, but debt service costs are covered through NCPA billing mechanisms that allocate the costs to members based on use of the facilities and services.

At June 30, 2007, the book value of this Project's plant, equipment and other assets was \$3.3 million, while its long term debt totaled \$2.5 million. The City's share of the Project's long-term debt amounted to \$278 thousand at that date.

NCPA Financial Information

NCPA's financial statements can be obtained from NCPA, 180 Cirby Way, Roseville, CA 95678.

Transmission Agency of Northern California (TANC)

The City is a member of a joint powers agreement with 14 other entities in the Transmission Agency of Northern California (TANC). TANC's purpose is to provide electrical transmission or other facilities for the use of its members. While governed by its members, none of TANC's obligations are those of its members unless expressly assumed by them. The City is obligated to pay 4.0 percent of TANC's debt-service and operating costs.

According to the 1985 Project Agreement with TANC for the development of the California-Oregon Transmission Project (COTP) and subsequent related project agreements, the City is obligated to pay its share of the project's costs, including debt service and is entitled to the use of a percentage of the project's transmission or transfer capacity. TANC has issued four series of Revenue Bonds and Commercial Paper Notes totaling \$408.3 million as of June 30, 2007. The City's share of this debt is \$16.4 million.

Construction of the COTP was complete as of June 30, 1993. The transmission line was energized March 24, 1993. Because funding of certain project participants' shares in the project was needed pending approval of their applications for participation, TANC issued \$93.8 million of Commercial Paper debt backed by a Letter of Credit. The City's share of the Commercial Paper was \$3.0 million at June 30, 2007, which is included in the share of debt discussed above. Shares and obligations of the existing participants could increase pending final project subscription.

TANC Financial Information

TANC's financial statements can be obtained from TANC, P.O. Box 15129, Sacramento, CA 95851.

Note 16.....

COMMITMENTS AND CONTINGENCIES

Palo Alto Unified School District – The City leases a portion of the former Cubberley School site and eleven extended day care sites from the Palo Alto Unified School District (PAUSD). The lease is part of a larger agreement which includes a covenant not to develop certain properties owned by the PAUSD. The lease term expired in December 2004, with an option for an additional ten-year term. The City renewed the lease for 10 years in 2005, with the lease expiring in 12/31/2014. The City’s rent for the facilities is \$5.0 million per year plus insurance, repairs and maintenance work to be completed, which are not to exceed \$250 thousand per year. This lease is cancelable upon 90 days’ written notice in the event funds are not appropriated by the City. In addition, the lease is contingent upon authorization by the Palo Alto electorate if it exceeds the City’s Proposition 4 (Gann) appropriations limitation in any fiscal year. Lease expenditures for the year ended June 30, 2007 amounted to \$6.3 million.

Future minimum annual lease and covenant payments are as follows (in thousands):

<u>Year ending June 30:</u>	<u>Payments</u>
2007	\$6,384
2008	6,576
2009	6,773
2010	6,976
2011	7,185
2012-2014	<u>22,874</u>
	<u>\$56,768</u>

Palo Alto Sanitation Company – In 1999 the City, under the provisions of a new agreement, contracted with the Palo Alto Sanitation Company (PASCO) for services related to residential and commercial refuse collection, curbside recycling, and other operation special programs. The new agreement has a term of seven years and ten months from the effective date of September 1, 1999. The new contract revised the method by which compensation is paid to PASCO to be more in-line with the industry standard. The method establishes compensation based on the relationship between costs and profits and includes periodic performance reviews. In 2006-07 this resulted in payments to PASCO of \$7.8 million.

City of Palo Alto Regional Water Quality Control Plant – The cities of Palo Alto, Mountain View and Los Altos (the Partners) participate jointly in the cost of maintaining and operating the City of Palo Alto Regional Water Quality Control Plant and related system (the Plant). The City is the owner and administrator of the Plant which provides the transmission, treatment and disposal of sewage for the Partners. The cities of Mountain View and Los Altos are entitled to use a portion of the capacity of the Plant for a specified period of time. Each partner has the right to rent unused capacity from/to the other partners. The expenses of operations and maintenance are paid quarterly by each partner based on its pro rata share of treatment costs. Additionally, joint system revenues are shared by the partners in the same ratio as expenses are paid. The amended agreement has a term of fifty years beginning from the original signing in October 1968, but may be terminated by any partner upon ten years’ notice to the other partners. All sewage treatment property, plant and equipment are included in the Wastewater Treatment Enterprise Fund’s capital assets balance at June 30, 2007. If the City initiates the termination of the contracts, it is required to pay the other partners their unamortized contribution towards the capital assets.

Solid Waste Materials Recovery and Transfer Station (SMaRT Station) – On June 9, 1992, the City, along with the City of Mountain View, signed a Memorandum of Understanding (MOU) with the City of

Sunnyvale (Sunnyvale) to participate in the construction and operation of the SMaRT station which recovers recyclable materials from the municipal solid waste delivered from participating cities. Per the MOU, the City has capacity share of 21.3 percent of this facility and reimburses its proportionate capacity share of design, construction, and operation costs to Sunnyvale.

On December 1, 1992, the Sunnyvale Financing Authority issued \$24.6 million in revenue bonds to finance the design and construction costs of the SMaRT Station. During the fiscal year ending June 30, 2003, the 1992 bonds were refunded by issuing the 2003 Solid Waste Revenue Bonds in the amount of \$20.6 million. Even though these bonds are payable from and secured by the net revenues of Sunnyvale's Utilities Enterprise, the City is obligated to reimburse Sunnyvale 21.3 percent of total debt service payments related to these bonds. The City's portion of remaining principal balance for SMaRT revenue bonds as of June 30, 2007 is \$3.4 million. During the year ended June 30, 2007, the City paid \$443.6 thousand as its portion of current debt service.

Subsequent to June 30, 2007, the members agreed to finance an Equipment Replacement Project estimated to cost \$14.7 million. \$5.2 million of these costs are to be funded with existing reserves and the remaining \$9.5 million is to be funded by a proposed bond issue. The City's portion of the proposed bond issue is \$2.0 million.

UTILITIES ENERGY RESOURCE MANAGEMENT

Energy Markets in the United States and California

U.S. and California electric and gas prices continued to be volatile during the year. The City purchased electricity in fiscal year 2006-07 in conformance with the Council-approved Long-term Electric Acquisition Plan (LEAP) established in 2001 and modified in April 2007. Due to the City's commodity purchase strategy, whereby purchases are made on a 3-year forward basis in a laddered fashion, the City's electric and gas utility customers enjoyed lower retail rates in fiscal year 2006-07 compared to what they would have paid if exposed to volatile market prices during the year. The City's average wholesale electric commodity purchase cost during the fiscal year was approximately 5.3 ¢/kWh while the average spot market prices were close to 5.5 ¢/kWh; the corresponding average gas commodity cost for the gas pool customers was \$6.57/MMBtu compared to a spot market price of \$6.82/MMBtu.

Hydro-electric production accounted for 47 percent of the City's electric supply. Wind and landfill gas based electric supply accounted for 13 percent of the resources, with the balance purchased from the wholesale electric market. Incidental sales of surplus energy resulted in a revenue of \$5.9 million during the year (the imputed expense associated with the surplus energy sold from the overall electric supply portfolio was calculated at \$4.2 million during the year, and is shown separately in the Statement of Revenues, Expenses, and Changes in Net Assets).

The City has executed Electric and Gas Master Agreements with suppliers to procure electricity and natural gas supplies. The table below outlines the electric and natural gas commodity supply commitments made by the City with these suppliers as of June 30, 2007. Monthly payments are made to suppliers upon delivery of supplies for the month. The City's procurement plans conform to the Council-approved Energy Risk Management Policies. These include a formal oversight role (Middle Office) within the Administrative Services Department. A quarterly energy risk management report is provided to the Council as part of this oversight role.

Forward Electricity Commodity Supply Commitments as of June 30, 2007

Supplier	FY07/08	FY08/09	FY09/10	Total
BP	\$ 4,730,396	\$ -	\$ -	\$ 4,730,396
Coral Power	9,417,615	6,128,850	2,021,235	\$ 17,567,699
Sempra	7,919,435	-	-	\$ 7,919,435
	\$ 22,067,446	\$ 6,128,850	\$ 2,021,235	\$ 30,217,531
Average Cost (cents/kWh)	5.96 ¢	4.43 ¢	3.66 ¢	5.35 ¢

Forward Natural Gas Commodity Supply Commitments as of June 30, 2007

Supplier	FY07/08	FY08/09	FY09/10	Total
Coral Energy	\$ 10,013,741	\$ 8,859,080	\$ 2,751,400	\$ 21,624,221
Powerex	\$ -	\$ 256,060	\$ 811,800	\$ 1,067,860
Sempra	\$ 5,702,350	\$ 4,603,736	\$ 1,662,210	\$ 11,968,296
	\$ 15,716,091	\$ 13,718,876	\$ 5,225,410	\$ 34,660,377
Average Cost (\$/MMBtu)	\$6.00	\$8.24	\$8.01	\$7.02

The City's natural gas transportation contract entered into in 2005 with Pacific Gas and Electric Company (PG&E) will be in place until the end of 2007. This contract, commonly known as Gas Accord III, between PG&E and its transportation customers provides the City's retail customers stable transportation costs. Gas Accord IV will be in effect starting January 1, 2008 for three years. This contract is not substantially different from our current agreement.

Significant energy bills signed into California law during the second year of the 2006-07 Legislative Session are listed below. The City has taken substantial steps to understand and comply with these laws and associated regulations.

AB 32 (Chaptered 9/27/2006) was the year's major climate change bill for the state. It requires the Air Resources Board to first determine the 1990 level of greenhouse emissions statewide and then to adopt any and all regulations it deems necessary to meet that level by 2020. The bill also includes a provision for greenhouse gas emission limits and fees. The City is participating in the regulatory stakeholder process in coordination with other municipal utility entities.

AB 2021 (Chaptered 9/29/2006) restated existing law that requires publicly owned utilities to invest in all cost effective, reliable and feasible energy efficiency, and adds additional reporting requirements for publicly owned utilities. It requires municipal utilities to prepare 10-year energy efficiency plans every 3 years. It requires annual performance reporting to customers and the California Energy Commission (CEC). The City Council approved Palo Alto's Ten-year Energy Efficiency Plan in April 2007. The plan is currently being implemented.

SB 1 (Chaptered 8/21/2006) adds requirements to the CPUC's California Solar Initiative Program and extends a similar program requirement to local publicly owned electric utilities. This bill requires that every local publicly owned electric utility serving end-use customers, on or before January 1, 2008, adopt, implement, and finance a solar initiative program for the purpose of investing in, and encouraging the increased installation of, residential and commercial solar energy systems. The bill requires a local publicly owned electric utility to make certain program information available to its customers, to the Legislature, and to the CEC on an annual basis beginning June 1, 2008. The City offers programs that comply with these provisions.



SB 1368 (Chaptered 9/29/2006) prohibits all utilities from investing in power plant projects or contracts that are not at least as clean as a combined cycle gas turbine project. It requires all electricity contracts of five years or longer to be reviewed by the CEC for compliance. The City is not expected to be directly impacted by this law at this time.

Future Outlook

Electric

The Council increased the renewable resource supply targets in April 2007. The new target is to meet 20 percent of the citywide load with renewable resource supplies by 2008, 30 percent by 2012 and 33 percent by 2015. In fiscal year 2005-06, the City met 7 percent of the load through new renewable resources and in 2006-07 the supply rose to 13 percent. PaloAltoGreen, the City's voluntary green power program currently accounts for an additional 4 percent of the City's energy needs from renewable resources. The City is also in the process of implementing a program to encourage small-scale ultra-clean distributed generation and cogeneration applications within the City.

The California Independent System Operator (CAISO) is in the process of implementing a number of initiatives with the stated goals of reliable and efficient operation of the transmission grid. Implementation of these initiatives, or the Market Redesign and Technology Update (MRTU), is anticipated to occur by April 2008. An underlying component of MRTU is the use of location-specific prices for the scheduling of energy transactions, which could lead to cost increases for transmission services for the City. Upon the implementation of MRTU, the CAISO will also have the authority to allocate to all load serving entities, including municipal utilities, the cost responsibility for the local generation capacity required to maintain transmission reliability in the CAISO Control Area. This is expected to result in higher cost for the City.

The following energy bills are pending in the State legislature and will have a direct or indirect impact on the City's Utilities operations.

AB 1103 (Saldana): This bill would require utilities to maintain records of energy consumption data of all nonresidential buildings they serve. Starting 2009, utilities would be required to upload all of the energy consumption data to the U.S. EPA's Energy Star Portfolio Manager upon authorization of the owner/operator of that building. The bill is now on the Governor's desk.

AB 1613 (Blakeslee): This bill would require a local publicly owned electric utility serving retail end-use customers to establish a program that allows retail customers to utilize combined heat and power systems "that reduce emissions of greenhouse gases by achieving improved efficiencies utilizing heat that would otherwise be wasted in separate energy applications" and that provides a market for the purchase of excess electricity generated by a combined heat and power system, at a just and reasonable rate, to be determined by the governing body of the utility. The bill is now on the Governor's desk.

Natural Gas

Long term market prices for natural gas remain at about \$8 per MMBtu. Declining production in the U.S. and Canada, increasing U.S. and international demand, and uncertainty in the Middle East are expected to keep natural gas prices strong. A projected increase in Liquefied Natural Gas (LNG) imports is expected to have a slight impact on prices by 2009. Market price volatility is expected to remain high in the short term. The City plans to continue implementing its 3-year laddering strategy using both fixed-price and capped-price products to hedge the gas utility supply portfolio. The City will also examine additional strategies to control commodity cost.



A new bill on the Governor’s desk (AB 1470) would require the governing body of each publicly owned utility providing gas service to retail end-use gas customers to adopt, implement, and finance a solar water heating system incentive program meeting certain requirements established by the Governing Board. The program must, however, have an element that addresses low-income and affordable housing projects, pursuant to existing sections of the California Health and Safety code. Development of a solar water heating program is included in the Council-approved Ten-year Energy Efficiency Plan.

Water

The City’s water use during fiscal year 2006-07 increased about 10 percent over the prior year. Usage is highly dependent on weather conditions, but has remained essentially flat for the past 10 years. Current water usage is only two-thirds of what it was in 1976. Water supply costs for fiscal year 2006-07 increased almost 30 percent from fiscal year 2005-06, consistent with the increased water purchases from the City’s water supplier, the San Francisco Public Utilities Commission (SFPUC), and an almost 20 percent increase in the wholesale water rate in fiscal year 2006-07.

Water supply costs are expected to trend upward as the SFPUC implements a much delayed, but essential, upgrade to the regional water system facilities. In the November 2002 elections, the San Francisco electorate approved a bond measure to pay for San Francisco’s one-third share of the cost of the Water System Improvement Program (WSIP) that was estimated to be about \$3.0 billion at the time. Costs for the WSIP are now expected to be about \$4.3 billion. When other planned projects are factored in, the total cost to upgrade and improve the regional water system is about \$5.0 billion. The Bay Area Water Supply and Conservation Agency (BAWSCA) and the San Francisco Bay Area Regional Financing Authority were created in 2003 to provide funding for the two-thirds share of the WSIP costs allocated to the agencies that purchase water from the SFPUC, including Palo Alto. Estimates for these increased costs have been factored into the City’s long-term water rate projections. However, the wholesale agencies (including the City) may be asked to make an up-front capital commitment, rather than pay for their share of the improvements over time through increased SFPUC wholesale water rates.

The relationship between each of the BAWSCA agencies and the City and County of San Francisco is specified in a 25-year water service contract, which expires on June 30, 2009. Each agency, including Palo Alto, has given BAWSCA the authority to negotiate a new contract on its behalf. At this time, it is unknown whether the mechanism for cost allocation or wholesale rate structure will change from the current contract.

During fiscal year 2005-06, the City completed the 2006 Recycled Water Market Survey to update the estimates of cost and potential for expanding the recycled water distribution system. The market survey found that the cost of recycled water is still more costly than the current estimate of future water cost from the SFPUC. In fiscal year 2006-07, the City embarked on the next planning phase for expanding the recycled water distribution system in Palo Alto by starting the Recycled Water Facility Plan. The City received a \$75,000 grant from the state to complete the facility plan, which is scheduled to be complete in fiscal year 2007-08. This plan provides more detailed design information and includes the preparation of environmental documents for the project. At this time, the estimated cost for the project indicates that outside funding will be needed for the project to be feasible. Completion of the facility plan and environmental documents is necessary to compete for available grant funding opportunities.

Contingent Liabilities

Many of the uncertainties faced by the Utilities Department as an aftermath of the 2000-01 energy crisis have been resolved, however, a number of uncertainties remain. Following a Ninth Circuit Court determination that the Federal Energy Regulatory Commission (FERC) lacked authority under the Federal Power Act to grant refund relief against governmental agencies, a number of California Parties have filed suit against the Northern California Power Agency (NCPA) and other municipal utilities seeking refunds for sales made to the CAISO and Power Exchange during the energy crisis. The suit was filed in the Superior Court in Los Angeles in April 2007. Another dispute between the Western Area Power Administration and PG&E regarding PG&E's claim to recover certain CAISO related costs has also not been resolved. The potential exposure to liability under the California Parties lawsuit or PG&E's CAISO-related claim is not likely to have a material adverse effect on the City's financial condition.

Litigation – The City is subject to litigation arising in the normal course of business. In the opinion of the City Attorney, there is no pending litigation, claims or assessments that are likely to have a material adverse effect on the City's financial condition.

Sales Tax Adjustment – On April 14, 1999, the State Board of Equalization informed the City that it had been allocated and paid \$594 thousand in sales and taxes in error and that the City was obligated to refund these taxes from future sales tax revenues. The City is in process of challenging the Board's findings. However, as of June 30, 2007, the issue had not been settled and the refund had not been returned.

Grant Programs – The City participates in Federal and State grant programs. These programs have been audited by the City's independent accountants in accordance with the provisions of the Federal Single Audit Act amendments of 1996 and applicable State requirements. No cost disallowances were proposed as a result of these audits; however, these programs are still subject to further examination by the grantors and the amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time. The City such amounts, if any, to be immaterial.



Non-major Governmental Funds.....

STREET IMPROVEMENT

This fund accounts for revenues received from state gas tax, allocations must be spent on the construction and maintenance of the road network system of the City.

FEDERAL REVENUE

This fund accounts for grant funds received under the Community Development Act of 1974 and HOME Investment Grant Programs, for activities approved and subject to federal regulations.

HOUSING IN-LIEU

This fund accounts for revenues from commercial and residential developers to provide housing under the City’s Below Market Rate program.

SPECIAL DISTRICTS

This fund accounts for revenues from parking permits and for maintenance of various parking lots within the City’s parking districts.

TRANSPORTATION MITIGATION

This fund accounts for revenues from fees or contributions required for transportation mitigation issues encountered as a result of City development.

LOCAL LAW ENFORCEMENT

This fund accounts for revenues received in support of City’s law enforcement program.

ASSETS SEIZURE

This fund accounts for seized property and funds associated with drug trafficking. Under California Assembly Bill No. 4162, the monies are released to the City for specific expenditures related to law enforcement activities.

DEVELOPER’S IMPACT FEE

This fund accounts for fees imposed on new developments to be used for parks, community centers and libraries.

REDEVELOPMENT AGENCY ADMINISTRATION

This fund accounts for the activities of administrating the Redevelopment Agency.

DOWNTOWN BUSINESS IMPROVEMENT DISTRICT

The Downtown Business Improvement District Fund was established to account for the activities of the Palo Alto Downtown Business Improvement District, which was established to enhance the viability of the downtown business district.

GOLF COURSE

This fund accounts for revenues received from the General Fund to provide payment of principal and interest associated with general obligation debt issued for the City’s golf course.

CIVIC CENTER REFINANCING

This fund accounts for revenues received from the General Fund to provide payment of principal and interest associated with the 2002A Civic Center Refinancing Certificates of Participation as they become due.



Non-major Governmental Funds

DOWNTOWN PARKING IMPROVEMENT

This fund accounts for revenues received from the General Fund to provide payment of principal and interest associated with the 2002B Downtown Parking Improvement Certificate of Participation as they become due.

SPECIAL ASSESSMENT DEBT

This fund accumulates monies for payments of special assessment improvement bonds which are financed by assessments placed on property owners within the University Avenue and California Avenue Parking district.



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City of Palo Alto - Non-Major Governmental Funds

Combining Balance Sheets- June 30, 2007

(In thousands of dollars)

	SPECIAL REVENUE FUNDS					
	Street Improvement	Federal Revenue	Housing In-Lieu	Special Districts	Transportation Mitigation	Local Law Enforcement
ASSETS						
Cash and investments :						
Available for operations	\$178	\$35	\$5,497	\$701	\$1,758	\$280
Cash and investments with fiscal agent						
Receivables:						
Accounts	107	68	306			
Special assessments						
Interest	8		54	10	19	3
Notes		5,303	6,733			
Total Assets	<u>\$293</u>	<u>\$5,406</u>	<u>\$12,590</u>	<u>\$711</u>	<u>\$1,777</u>	<u>\$283</u>
LIABILITIES						
Accounts payable		32	200			2
Deferred revenue						
Interfund payable and advances		70				
Total Liabilities		<u>102</u>	<u>200</u>			<u>2</u>
FUND EQUITY						
Reserved for:						
Encumbrances	334	107	75			146
Notes receivable		5,303	6,733			
Debt service						
Unreserved, designated for:						
Special Revenue Funds						
Special revenue projects			5,582	711	1,777	135
Special revenue reappropriations	1,753	1,128				
Unreserved, undesignated:						
Special Revenue Funds	(1,794)	(1,234)				
Total Equity	<u>293</u>	<u>5,304</u>	<u>12,390</u>	<u>711</u>	<u>1,777</u>	<u>281</u>
Total Equity	<u>\$293</u>	<u>\$5,406</u>	<u>\$12,590</u>	<u>\$711</u>	<u>\$1,777</u>	<u>\$283</u>



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SPECIAL REVENUE FUNDS				DEBT SERVICE FUNDS		
<u>Assets Seizure</u>	<u>Developer's Impact Fee</u>	<u>Redevelopment Agency</u>	<u>Downtown Business Improvement District</u>	<u>Golf Course</u>	<u>Civic Center Refinancing</u>	<u>Downtown Parking Improvement</u>
	\$2,687		\$15	\$13	\$9	\$4
				717	359	244
			65			
	26			12	5	3
	<u>\$2,713</u>		<u>\$80</u>	<u>\$742</u>	<u>\$373</u>	<u>\$251</u>
			4			
				742	373	251
	<u>2,713</u>		<u>76</u>			
	<u>2,713</u>		<u>80</u>	<u>742</u>	<u>373</u>	<u>251</u>
	<u>\$2,713</u>		<u>\$80</u>	<u>\$742</u>	<u>\$373</u>	<u>\$251</u>

(Continued)

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City of Palo Alto - Non-Major Governmental Funds

Combining Balance Sheets- June 30, 2007

(In thousands of dollars)

	DEBT SERVICE	
	<u>FUND</u>	
	Special Assessment Debt	Total Non-major Governmental Funds
	<u> </u>	<u> </u>
ASSETS		
Cash and investments :		
Available for operations	\$118	\$ 11,295
Cash and investments with fiscal agent		1,320
Receivables:		
Accounts		546
Special assessments	115	115
Interest		140
Notes		12,036
	<u> </u>	<u> </u>
Total Assets	<u><u>\$233</u></u>	<u><u>\$25,452</u></u>
LIABILITIES		
Accounts payable		234
Deferred revenue	115	115
Interfund payable and advances		70
	<u> </u>	<u> </u>
Total Liabilities	<u><u>115</u></u>	<u><u>419</u></u>
FUND EQUITY		
Reserved for:		
Encumbrances		666
Notes receivable		12,036
Debt service	118	1,484
Unreserved, designated for:		
Special Revenue Funds		
Special revenue projects		8,205
Special revenue reappropriations		2,881
Unreserved, undesignated:		
Special Revenue Funds		(239)
	<u> </u>	<u> </u>
	<u>118</u>	<u>25,033</u>
	<u><u>\$233</u></u>	<u><u>\$25,452</u></u>



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City of Palo Alto - Non-Major Governmental Funds
Combining Statements of Revenues, Expenditures and
Changes in Fund Balances -
For the Year Ended June 30, 2007
(In thousands of dollars)

	<u>SPECIAL REVENUE FUNDS</u>					
	<u>Street Improvement</u>	<u>Federal Revenue</u>	<u>Housing In-Lieu</u>	<u>Special Districts</u>	<u>Transportation Mitigation</u>	<u>Local Law Enforcement</u>
REVENUES						
Special assessments						
Other taxes and fines	\$1,136					
Charges for services					\$183	
From other agencies:						
Community Development Block Grant		\$448				
State of California						\$121
Other revenue from other agencies		108				
Permit and licenses				\$133		
Return on investment	25	1	\$184	45	84	10
Rental income			6			
Other:						
Housing In-Lieu - residential			2,135			
Housing In-Lieu - commercial			664			
University Avenue Parking				766		
California Avenue Parking				103		
Other fees		411	976		40	
Total Revenues	1,161	968	3,965	1,047	307	131
EXPENDITURES						
Current:						
Planning and Community Environment		1,255	1,987			
Public Safety - Police						59
Non Departmental		(4)	687			
Debt service:						
Principal retirement						
Interest and fiscal charges						
Total Expenditures		1,251	2,674			59
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	1,161	(283)	1,291	1,047	307	72
OTHER FINANCING SOURCES (USES)						
Transfers in			250			
Transfers (out)	(1,191)	(250)		(1,229)		
Total Other Financing Sources (Uses)	(1,191)	(250)	250	(1,229)		
Net Change in Fund Balance	(30)	(533)	1,541	(182)	307	72
Fund balances at the beginning of year	323	5,837	10,849	893	1,470	209
Fund balances at end of year	<u>\$293</u>	<u>\$5,304</u>	<u>\$12,390</u>	<u>\$711</u>	<u>\$1,777</u>	<u>\$281</u>



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SPECIAL REVENUE FUNDS				DEBT SERVICE FUNDS		
Assets Seizure	Developer's Impact Fee	Redevelopment Agency	Downtown Business Improvement District	Golf Course	Civic Center Refinancing	Downtown Parking Improvement
			\$141			
	\$98		4	(\$7)	\$14	\$11
	1,419					
	1,517		145	(7)	14	11
			136			
				310	340	90
				249	82	145
			136	559	422	235
	1,517		9	(566)	(408)	(224)
(18)	(135)	6		525	418	230
(18)	(135)	(6)		525	418	230
(18)	1,382		9	(41)	10	6
18	1,331		71	783	363	245
	\$2,713		\$80	\$742	\$373	\$251

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City of Palo Alto - Non-Major Governmental Funds
Combining Statements of Revenues, Expenditures and
Changes in Fund Balances -
For the Year Ended June 30, 2007
(In thousands of dollars)

	DEBT SERVICE	
	<u>FUND</u>	
	Special Assessment District	Total Non-major Governmental Funds
	<u> </u>	<u> </u>
REVENUES		
Special assessments	\$125	\$266
Other taxes and fines		1,136
Charges for services		183
From other agencies:		
Community Development Block Grant		448
State of California		121
Other revenue from other agencies		108
Permit and licenses		133
Return on investment		469
Rental income		6
Other:		
Housing In-Lieu - residential		2,135
Housing In-Lieu - commercial		664
University Avenue Parking		766
California Avenue Parking		103
Other fees		2,846
Total Revenues	<u>125</u>	<u>9,384</u>
EXPENDITURES		
Current:		
Planning and Community Environment		3,242
Public Safety - Police		59
Non Departmental		819
Debt service:		
Principal retirement	110	850
Interest and fiscal charges	13	489
Total Expenditures	<u>123</u>	<u>5,459</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>2</u>	<u>3,925</u>
OTHER FINANCING SOURCES (USES)		
Transfers in		1,429
Transfers (out)		(2,829)
Total Other Financing Sources (Uses)		<u>(1,400)</u>
Net Change in Fund Balance	2	2,525
Fund balances at the beginning of year	116	22,508
Fund balances at end of year	<u>\$118</u>	<u>\$25,033</u>



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City of Palo Alto - Non-major Governmental Funds
Combining Schedule of Revenues, Expenditures and
Changes in Fund Balances -Budget and Actual
For the Year Ended June 30, 2007
(In thousands of dollars)

	SPECIAL REVENUE FUNDS					
	Street Improvement			Federal Revenue		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
REVENUES						
Special assessments						
Other taxes and fines	\$1,126	\$1,136	\$10			
Charges for services						
From other agencies:						
Community Development Block Grant				\$821	\$448	(\$373)
State of California						
Other revenue from other agencies				10	108	98
Permit and licenses						
Return on investment	19	25	6	5	1	(4)
Rental income						
Other:						
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees				7	411	404
Total Revenues	<u>1,145</u>	<u>1,161</u>	<u>16</u>	<u>843</u>	<u>968</u>	<u>125</u>
EXPENDITURES						
Current operations:						
Planning and Community Environment				1,753	307	1,446
Public Safety - Police						
Non Departmental					(4)	4
Debt service:						
Principal retirement						
Interest and fiscal charges						
Total Expenditures				<u>1,753</u>	<u>303</u>	<u>1,450</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>1,145</u>	<u>1,161</u>	<u>16</u>	<u>(910)</u>	<u>665</u>	<u>1,575</u>
OTHER FINANCING SOURCES (USES)						
Transfers in				35		(35)
Transfers (out)	(1,462)	(1,191)	271	(285)	(250)	35
Total Other Financing Sources (Uses)	<u>(1,462)</u>	<u>(1,191)</u>	<u>271</u>	<u>(250)</u>	<u>(250)</u>	
Net Change in Fund Balance - Budget Basis	<u>(\$317)</u>	<u>(30)</u>	<u>\$287</u>	<u>(\$1,160)</u>	<u>415</u>	<u>\$1,575</u>
Non budgeted transactions - Valuation Allowance					(948)	
Fund balances at the beginning of year - (GAAP Basis)		<u>323</u>			<u>5,837</u>	
Fund balances at end of year - (GAAP Basis)		<u>\$293</u>			<u>\$5,304</u>	



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SPECIAL REVENUE FUNDS

Housing In-Lieu			Special Districts			Transportation Mitigation		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
							\$183	\$183
\$250		(\$250)						
135	\$184	49	\$48	\$133	\$133	\$83	84	1
9	6	(3)		45	(3)			
200	2,135	1,935						
200	664	464	759	766	7	480		(480)
			115	103	(12)			
875	976	101					40	40
<u>1,669</u>	<u>3,965</u>	<u>2,296</u>	<u>922</u>	<u>1,047</u>	<u>125</u>	<u>563</u>	<u>307</u>	<u>(256)</u>
298	210	88						
1,663	687	976						
<u>1,961</u>	<u>897</u>	<u>1,064</u>						
(292)	3,068	3,360	922	1,047	125	563	307	(256)
250	250		(1,301)	(1,229)	72			
250	250		(1,301)	(1,229)	72			
<u>(\$42)</u>	<u>3,318</u>	<u>\$3,360</u>	<u>(\$379)</u>	<u>(182)</u>	<u>\$197</u>	<u>\$563</u>	<u>307</u>	<u>(\$256)</u>
	(1,777)							
	<u>10,849</u>			<u>893</u>			<u>1,470</u>	
	<u>\$12,390</u>			<u>\$711</u>			<u>\$1,777</u>	

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City of Palo Alto - Non-major Governmental Funds
Combining Schedule of Revenues, Expenditures and
Changes in Fund Balances - Budget and Actual
For the Year Ended June 30, 2007

(In thousands of dollars)

	SPECIAL REVENUE FUNDS					
	Local Law Enforcement			Asset Seizure		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
REVENUES						
Special assessments						
Other taxes and fines						
Charges for services						
From other agencies:						
Community Development Block Grant						
State of California	\$121	\$121				
Other revenue from other agencies						
Permit and licenses						
Return on investment	9	10	\$1	\$1		(\$1)
Rental income						
Other:						
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees						
Total Revenues	<u>130</u>	<u>131</u>	<u>1</u>	<u>1</u>		<u>(1)</u>
EXPENDITURES						
Current operations:						
Planning and Community Environment						
Public Safety - Police	287	59	228			
Non Departmental						
Debt service:						
Principal retirement						
Interest and fiscal charges						
Total Expenditures	<u>287</u>	<u>59</u>	<u>228</u>			
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(157)</u>	<u>72</u>	<u>229</u>	<u>1</u>		<u>(1)</u>
OTHER FINANCING SOURCES (USES)						
Transfers in						
Transfers (out)				(18)	(\$18)	
Total Other Financing Sources (Uses)				<u>(18)</u>	<u>(18)</u>	
Net Change in Fund Balance - Budget Basis	<u>(\$157)</u>	<u>72</u>	<u>\$229</u>	<u>(\$17)</u>	<u>(18)</u>	<u>(\$1)</u>
Non budgeted transactions - Valuation Allowance						
Fund balances at the beginning of year - (GAAP Basis)		<u>209</u>			<u>18</u>	
Fund balances at end of year - (GAAP Basis)		<u>\$281</u>			<u>18</u>	



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SPECIAL REVENUE FUNDS

Developer's Impact Fee			Redevelopment Agency			Downtown Business Improvement District		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
						\$154	\$141	(\$13)
\$44	\$98	\$54				4	4	
553	1,419	866						
597	1,517	920				158	145	(13)
						158	136	22
						158	136	22
597	1,517	920					9	9
(135)	(135)		\$9 (9)	\$6 (6)	(3) 3			
(135)	(135)							
<u>\$462</u>	<u>1,382</u>	<u>\$920</u>					<u>9</u>	<u>\$9</u>
	<u>1,331</u>						<u>71</u>	
	<u>\$2,713</u>						<u>\$80</u>	

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City of Palo Alto - Non-major Governmental Funds
Combining Schedule of Revenues, Expenditures and
Changes in Fund Balances - Budget and Actual
For the Year Ended June 30, 2007

(In thousands of dollars)

	DEBT SERVICE FUNDS					
	Golf Course			Civic Center Refinance		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
REVENUES						
Special assessments						
Other taxes and fines						
Charges for services						
From other agencies:						
Community Development Block Grant						
State of California						
Other revenue from other agencies						
Permit and licenses						
Return on investment	\$33	(\$7)	(\$40)	\$5	\$14	\$9
Rental income						
Other:						
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees						
Total Revenues	<u>33</u>	<u>(7)</u>	<u>(40)</u>	<u>5</u>	<u>14</u>	<u>9</u>
EXPENDITURES						
Current operations:						
Planning and Community Environment						
Public Safety - Police						
Non Departmental						
Debt service:						
Principal retirement	310	310		340	340	
Interest and fiscal charges	248	249	(1)	82	82	
Total Expenditures	<u>558</u>	<u>559</u>	<u>(1)</u>	<u>422</u>	<u>422</u>	
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(525)</u>	<u>(566)</u>	<u>(41)</u>	<u>(417)</u>	<u>(408)</u>	<u>9</u>
OTHER FINANCING SOURCES (USES)						
Transfers in	525	525		418	418	
Transfers (out)						
Total Other Financing Sources (Uses)	<u>525</u>	<u>525</u>		<u>418</u>	<u>418</u>	
Net Change in Fund Balance - Budget Basis	<u></u>	<u>(41)</u>	<u>(\$41)</u>	<u>\$1</u>	<u>10</u>	<u>\$9</u>
Non budgeted transactions - Valuation Allowance						
Fund balances at the beginning of year - (GAAP Basis)	<u>783</u>			<u>363</u>		
Fund balances at end of year - (GAAP Basis)	<u>\$742</u>			<u>\$373</u>		



DEBT SERVICE FUNDS						TOTAL		
Downtown Parking Improvement			Special Assessment District			Non-major Governmental Funds		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
			\$123	\$125	\$2	\$277	\$266	(\$11)
						1,126	1,136	10
							183	183
						821	448	(373)
						371	121	(250)
						10	108	98
							133	133
\$6	\$11	\$5				392	469	77
						9	6	(3)
						200	2,135	1,935
						200	664	464
						1,239	766	(473)
						115	103	(12)
						1,435	2,846	1,411
6	11	5	123	125	2	6,195	9,384	3,189
						2,051	517	1,534
						287	59	228
						1,821	819	1,002
90	90		110	110		850	850	
145	145		13	13		488	489	(1)
235	235		123	123		5,497	2,734	2,763
(229)	(224)	5		2	2	698	6,650	5,952
230	230					1,467	1,429	(38)
						(3,210)	(2,829)	381
230	230					(1,743)	(1,400)	343
\$1	6	\$5		2	\$2	(\$1,045)	5,250	\$6,295
							(2,725)	
	245			116			22,508	
	\$251			\$118			\$25,033	



Non-major Governmental Funds

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Internal Service Funds

Introduction

Internal Service Funds are used to finance and account for special activities and services performed by a designated department for other departments in the City on a cost reimbursement basis.

VEHICLE REPLACEMENT AND MAINTENANCE

This fund accounts for the maintenance and replacement of vehicles and equipment used by all City departments. The source of revenue is an accumulation of resources.

TECHNOLOGY

This fund accounts for replacement and upgrade of technology, and covers four primary areas used by all City departments: desktop, infrastructure, applications, and technology research and development. The source of revenue is an accumulation of resources.

PRINTING AND MAILING SERVICES

This fund accounts for central duplicating, printing and mailing services provided to all City departments. Source of revenue for this fund is on reimbursement of costs for services and supplies purchased by other departments.

GENERAL BENEFITS AND INSURANCE

This fund accounts for the administration of compensated absences and health benefits, and the City's self-insured workers' compensation and general liability programs.

RETIREE HEALTH BENEFIT

This fund accounts for the retiree health benefits.



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City of Palo Alto - Internal Service Funds

Combining Statements of Net Assets - June 30, 2007

(In thousands of dollars)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits and Insurance	Retiree Health Benefit	Total
ASSETS						
Current Assets:						
Cash and investments available for operations	\$4,452	\$13,951	\$348	\$39,753	\$30,420	\$88,924
Accounts receivable, net	50			12		62
Interest receivable	63	176	6	373	299	917
Interfund receivables		25				25
Inventory of materials and supplies	504					504
Total Current Assets	<u>5,069</u>	<u>14,152</u>	<u>354</u>	<u>40,138</u>	<u>30,719</u>	<u>90,432</u>
Noncurrent Assets:						
Capital assets, nondepreciable	2,094	2,320				4,414
Capital assets, net of depreciation	8,799	1,135	24			9,958
Total Noncurrent Assets	<u>10,893</u>	<u>3,455</u>	<u>24</u>			<u>14,372</u>
Total Assets	<u>15,962</u>	<u>17,607</u>	<u>378</u>	<u>40,138</u>	<u>30,719</u>	<u>104,804</u>
LIABILITIES						
Current Liabilities:						
Accounts payable and accrued liabilities	208	98		3,231		3,537
Accrued salaries and benefits	20	59	5	322		406
Accrued compensated absences				3,482		3,482
Accrued claims payable - current				5,939		5,939
Total Current Liabilities	<u>228</u>	<u>157</u>	<u>5</u>	<u>12,974</u>		<u>13,364</u>
Long-term Liabilities:						
Accrued compensated absences				8,018		8,018
Accrued claims payable				15,191		15,191
Total Long-term Liabilities				<u>23,209</u>		<u>23,209</u>
Total Liabilities	<u>228</u>	<u>157</u>	<u>5</u>	<u>36,183</u>		<u>36,573</u>
NET ASSETS						
Investment in capital assets	10,893	3,455	24			14,372
Unrestricted	4,841	13,995	349	3,955	30,719	53,859
Total Net Assets	<u>\$15,734</u>	<u>\$17,450</u>	<u>\$373</u>	<u>\$3,955</u>	<u>\$30,719</u>	<u>\$68,231</u>



City of Palo Alto - Internal Service Funds
Combining Statements of Revenues, Expenses and
Changes in Net Assets - For the Year Ended June 30, 2007
(In thousands of dollars)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits and Insurance	Retiree Health Benefit	Total
OPERATING REVENUES						
Charges for services	\$5,929	\$8,718	\$1,193	\$36,464	\$4,238	\$56,542
OPERATING EXPENSES						
Administration and general	623	7,866	1,343	1,471	20	11,323
Operations and maintenance	2,889					2,889
Depreciation and amortization	2,067	1,131	3			3,201
Claim payments and change in estimated self-insured liability				6,618		6,618
Compensated absences and other benefits	58			29,868	4,220	34,146
Total Operating Expenses	5,637	8,997	1,346	37,957	4,240	58,177
Total Operating Income (Loss)	292	(279)	(153)	(1,493)	(2)	(1,635)
NONOPERATING REVENUES (EXPENSES)						
Return on investment	266	720	29	1,704	1,316	4,035
Gain (loss) on disposal of fixed assets	210					210
Other nonoperating revenues (expense)	(152)	35	6			(111)
Total Non operating Revenues	324	755	35	1,704	1,316	4,134
Income (Loss) Before Transfers	616	476	(118)	211	1,314	2,499
Transfers in	188	870			2,900	3,958
Transfers (out)		(23)				(23)
Change in Net Assets	804	1,323	(118)	211	4,214	6,434
Net assets at beginning of year	14,930	16,127	491	3,744	26,505	61,797
Net assets at end of year	\$15,734	\$17,450	\$373	\$3,955	\$30,719	\$68,231

City of Palo Alto - Internal Service Funds

Combining Statements of Cash Flows - For the Fiscal Year Ended June 30, 2007

(In thousands of dollars)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits and Insurance	Retiree Health Benefit	Total
CASH FLOW FROM OPERATING ACTIVITIES						
Receipts from customers	\$5,888	\$8,718	\$1,193	\$36,517	\$4,238	\$56,554
Payments to suppliers	(2,757)				(1)	(2,758)
Payments to employees	(681)	(7,937)	(1,343)	(30,499)	(4,239)	(44,699)
Claims paid				(5,033)		(5,033)
Other receipts	(152)	35	6			(111)
Net cash provided by operating activities	2,298	816	(144)	985	(2)	3,953
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Interfund payments		25				25
Transfers in	188	870			2,900	3,958
Transfers (out)		(23)				(23)
Cash flows from noncapital financing activities	188	872			2,900	3,960
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES						
Acquisition and construction of fixed assets	(3,156)	(385)				(3,541)
Proceeds from sale of capital assets	210					210
Cash flows from capital financing activities	(2,946)	(385)				(3,331)
CASH FLOWS FROM INVESTING ACTIVITIES						
Interest and dividends on pooled investments	265	699	30	1,660	1,240	3,894
Net Cash Flows	(195)	2,002	(114)	2,645	4,138	8,476
Cash and investments at beginning of year	4,647	11,949	462	37,108	26,282	80,448
Cash and investments at end of year	\$4,452	\$13,951	\$348	\$39,753	\$30,420	\$88,924
CASH FLOWS FROM OPERATING ACTIVITIES						
Operating income (loss)	\$292	(\$279)	(\$153)	(\$1,493)	(\$2)	(\$1,635)
Adjustments to reconcile operating income (loss) to cash flows from operating activities:						
Depreciation and amortization	2,067	1,131	3			3,201
Other	(152)	35	6			(111)
Changes in assets and liabilities:						
Accounts receivable	(41)			53		12
Inventory of materials and supplies	(28)					(28)
Accounts and other payables	160	(71)		840		929
Accrued claims payable				1,585		1,585
Net cash provided by operating activities	\$2,298	\$816	(\$144)	\$985	(\$2)	\$3,953



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Fiduciary Funds.....

Introduction

Fiduciary Funds are used to account for assets held by the City acting in a fiduciary capacity for other entities and individuals. The funds are operated to carry out the specific actions required by the trust agreements, ordinances and other governing regulations.

Fiduciary Funds are presented separately from the Citywide and Fund financial statements.

Agency Funds are custodial in nature and do not involve measurement of results of operations. The City maintains three agency funds, as follows:

CALIFORNIA AVENUE PARKING ASSESSMENT DISTRICT

This fund accounts for receipts and disbursements associated with the 1993 Parking District No. 92-13 Assessment Bonds.

CABLE JOINT POWERS AUTHORITY

The fund was established to account for the activities of the cable television system on behalf of the members.

UNIVERSITY AVENUE AREA PARKING ASSESSMENT DISTRICT

The fund accounts for the receipts and disbursements associated with the Series 2001-A University Avenue Area Off-Street Parking Assessments Bonds.

City of Palo Alto - Agency Funds
Statement of Changes in Assets and Liabilities -
For the Fiscal Year Ended June 30, 2007
(In thousands of dollars)

	Balance June 30, 2006	Additions	Reductions	Balance June 30, 2007
<hr/> California Avenue Parking Assessment District <hr/>				
ASSETS				
Cash and investments available for operations	\$280	\$146	\$162	\$264
LIABILITIES				
Due to bondholders	\$280	\$146	\$162	\$264
<hr/> Cable Joint Powers Authority <hr/>				
ASSETS				
Cash and investments available for operations	\$735	\$56	\$22	\$769
Interest receivable	9	10	9	10
Total assets	<u>\$744</u>	<u>\$66</u>	<u>\$31</u>	<u>\$779</u>
LIABILITIES				
Due to other governments	<u>\$744</u>	<u>\$66</u>	<u>\$31</u>	<u>\$779</u>
<hr/> University Avenue Area Parking Assessment District <hr/>				
ASSETS				
Cash and investments with fiscal agents	\$6,046	\$3,050	\$2,999	\$6,097
Interest receivable	63	34	63	34
Total assets	<u>\$6,109</u>	<u>\$3,084</u>	<u>\$3,062</u>	<u>\$6,131</u>
LIABILITIES				
Due to bondholders	<u>\$6,109</u>	<u>\$3,084</u>	<u>\$3,062</u>	<u>\$6,131</u>
<hr/> Total Agency Funds <hr/>				
ASSETS				
Cash and investments available for operations	\$1,015	\$202	\$184	\$1,033
Cash and investments with fiscal agents	6,046	3,050	2,999	6,097
Interest receivable	72	44	72	44
Total assets	<u>\$7,133</u>	<u>\$3,296</u>	<u>\$3,255</u>	<u>\$7,174</u>
LIABILITIES				
Due to bondholders	\$6,389	\$3,230	\$3,224	\$6,395
Due to other governments	744	66	31	779
Total liabilities	<u>\$7,133</u>	<u>\$3,296</u>	<u>\$3,255</u>	<u>\$7,174</u>



Statistical Section.....

The statistical section contains comprehensive statistical data which relates to physical, economic, social and political characteristics of the City. It is intended to provide users with a broader and more complete understanding of the City and its financial affairs than is possible from the financial statements and supporting schedules included in the financial section.

In this section, readers will find comparative information related to the City's revenue sources, expenditures, property tax valuations, levies and collections, general obligation bonded debt, utility revenue debt service, demographics and pension plan funding. Where available, the comparative information is presented for the last ten fiscal years.

In addition, this section presents information related to the City's legal debt margin computation, principal taxpayers, notary and security bond coverages, and other miscellaneous statistics pertaining to services provided by the City.

In contrast to the financial section, the statistical section information is not usually subject to independent audit.

Financial Trends

These schedules contain trend information to help the reader understand how the City's financial performance and well being have changed over time:

1. Net Assets by Component
2. Changes in Net Assets
3. Fund Balances of Governmental Funds
4. Changes in Fund Balance of Governmental Funds

Revenue Capacity

These schedules contain information to help the reader assess the City's most significant local revenue sources, property tax and electric charges:

1. Electric Daily Loads and Top Customers by Usage
2. Electric Operating Revenue by Source
3. Assessed Value of Taxable Property
4. Property Tax Rates, All Overlapping Governments
5. Property Tax Levies and Collections
6. Principal Property Taxpayers

Debt Capacity

These schedules present information to help the reader assess the affordability of the City's current levels of outstanding debt and the City's ability to issue additional debt in the future:

1. Ratio of Outstanding Debt by Type
2. Computation of Direct and Overlapping Debt
3. Computation of Legal Bonded Debt Margin
4. Revenue Bond Coverage



Demographic and Economic Information

These schedules offer demographic and economic indicators to help the reader understand the environment within which the City's financial activities take place:

1. Taxable Transaction by Type of Business
2. Demographic and Economic Statistics
3. Principal Employers

Operating Information

These schedules contain service and infrastructure data to help the reader understand how the information in the City's financial report relates to the services the City provides and the activities it performs:

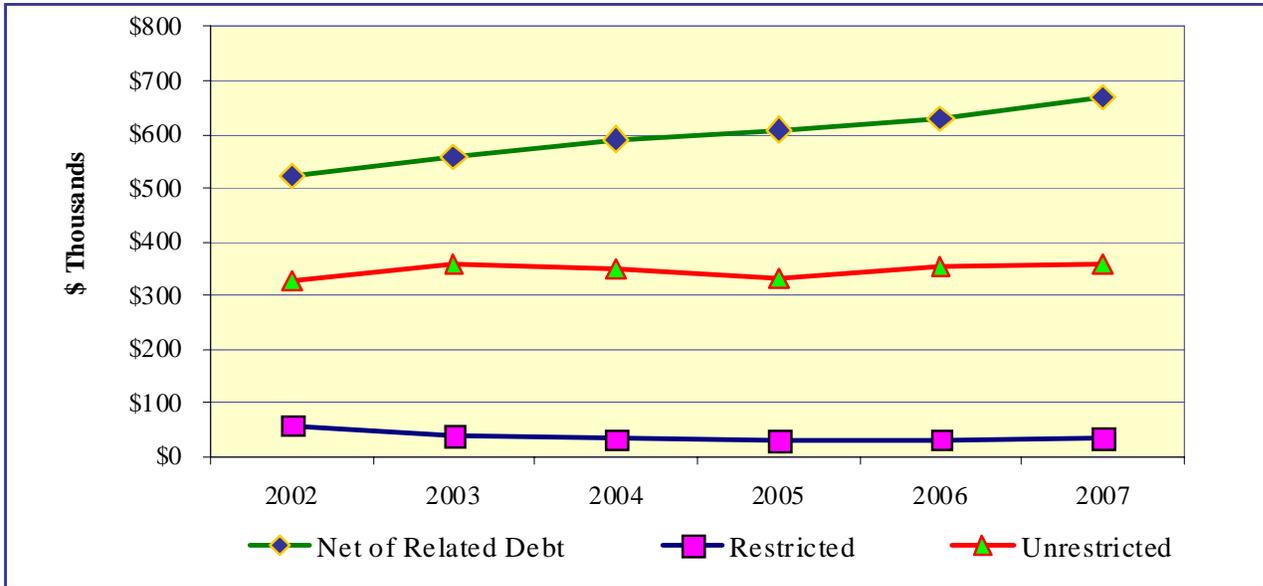
1. Full-Time Equivalent City Government Employees by Function
2. Operating Indicators by Function/Program
3. Capital Asset Statistics by Function/Program
4. Insurance Coverage

Sources

Unless otherwise noted, the information in these schedules is derived from the Comprehensive Annual Financial Reports for the relevant year. The City implemented GASB Statement 34 in 2002; schedules presenting government-wide information include information beginning in that year.



City of Palo Alto - Net Assets by Component
Last Six Fiscal Years (\$000)
(Accrual Basis of Accounting)



	Fiscal Year Ended June 30,					
	2002	2003	2004	2005	2006	2007
Governmental activities						
Invested in capital assets, net of related debt	\$252,183	\$279,306	\$297,125	\$305,225	\$311,335	\$326,411
Restricted	56,785	37,112	30,417	27,273	29,885	32,576
Unrestricted	117,113	130,463	123,762	117,301	123,823	127,190
Total governmental activities net assets	\$426,081	\$446,881	\$451,304	\$449,799	\$465,043	\$486,177
Business-type activities						
Invested in capital assets, net of related debt	\$270,622	\$279,885	\$294,197	\$303,473	\$318,738	\$342,922
Restricted	1,728	1,728	1,798	1,750	1,732	1,732
Unrestricted	210,990	228,308	226,278	215,128	228,032	230,912
Total business-type activities net assets	\$483,340	\$509,921	\$522,273	\$520,351	\$548,502	\$575,566
Primary government						
Invested in capital assets, net of related debt	\$522,805	\$559,191	\$591,322	\$608,698	\$630,073	\$669,333
Restricted	58,513	38,840	32,215	29,023	31,617	34,308
Unrestricted	328,103	358,771	350,040	332,429	351,855	358,102
Total primary government net assets	\$909,421	\$956,802	\$973,577	\$970,150	\$1,013,545	\$1,061,743

Source: Annual Financial Statements

Note:

(a) The City implemented GASB Statement 34 in fiscal year 2002. Therefore this calculation is included only for fiscal years subsequent to that date.

City of Palo Alto - Changes in Net Assets
**Last Six Fiscal Years (\$000)
(Accrual Basis of Accounting)**

	Fiscal Year Ended June 30,					
	2002	2003	2004	2005	2006	2007
<u>Expenses</u>						
Governmental Activities:						
City Council	\$238	\$234	\$269	\$130	\$141	\$180
City Manager	1,765	1,565	1,663	1,725	1,563	1,760
City Attorney	2,410	2,028	2,300	2,653	2,598	2,390
City Clerk	633	598	808	770	945	900
City Auditor	583	646	668	764	843	838
Administrative Services	10,138	9,723	6,271	6,982	6,972	6,419
Human Resources	2,166	1,728	2,078	2,410	2,546	2,472
Public Works	15,656	13,702	14,460	16,400	17,596	16,645
Planning and Community Environment	7,311	7,485	8,898	10,162	9,931	12,929
Police	19,049	19,273	20,414	22,416	23,411	23,861
Fire	16,870	16,859	17,308	18,127	18,747	19,530
Community Services	19,850	19,633	20,864	17,240	17,296	15,729
Library				4,835	5,323	5,347
Non-Departmental	8,412	7,449	7,618	12,474	10,400	12,133
Interest on Long Term Debt	1,094	675	635	693	512	477
Total Governmental Activities Expenses	\$106,175	\$101,598	\$104,254	\$117,781	\$118,824	\$121,610
Business-Type Activities:						
Water	\$12,722	\$13,237	\$16,047	\$14,969	\$15,881	\$16,794
Electric	98,405	73,744	73,545	73,051	91,570	99,294
Gas	28,778	22,270	22,994	26,656	29,107	30,690
Wastewater Collection	8,489	8,712	9,203	8,907	11,005	10,085
Wastewater Treatment	13,287	14,312	14,868	17,457	16,747	15,901
Refuse	23,750	24,635	24,282	24,959	26,989	25,372
Storm Drainage	2,188	2,489	2,975	3,336	2,673	2,517
External Services	349	583	688	760	868	767
Total Business-Type Activities Expenses	187,968	159,982	164,602	170,095	194,840	201,420
Total Primary Government Expenses	\$294,143	\$261,580	\$268,856	\$287,876	\$313,664	\$323,030

Program Revenues

Governmental Activities						
Charges for Services:						
City Council						
City Manager						
City Attorney		\$92	\$64	\$22	\$22	\$13
City Clerk	1	1	1		2	
City Auditor		1				
Administrative Services	12	406	815	480	627	835
Human Resources						11
Public Works	320	1,058	260	573	805	968
Planning and Community Environment	4,062	5,119	3,074	4,090	5,509	6,267
Police	3,966	3,396	4,415	3,801	4,178	4,179
Fire	7,976	7,811	7,565	8,555	9,078	9,610
Community Services	7,793	7,537	7,846	7,592	10,803	9,128
Library				133	129	146
Operating Grants and Contributions	5,568	4,468	4,213	3,677	3,976	5,642



City of Palo Alto - Changes in Net Assets

Last Six Fiscal Years (\$000)
(Accrual Basis of Accounting)

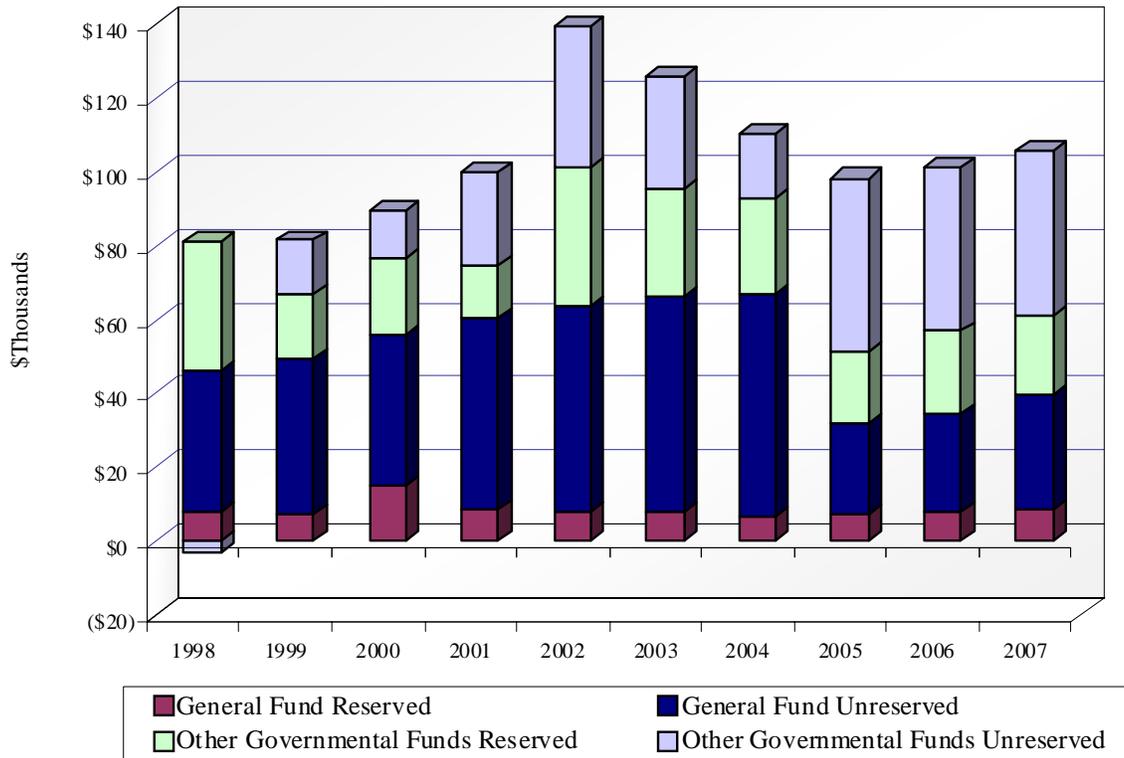
	Fiscal Year Ended June 30,					
	2002	2003	2004	2005	2006	2007
Capital Grants and Contributions	32,380	635	1,990	804	3,156	1,756
Total Government Activities Program Revenues	62,078	30,524	30,243	29,727	38,285	38,555
Business-Type Activities:						
Charges for Services:						
Water	16,034	17,654	21,993	21,041	21,108	23,495
Electric	93,755	91,622	92,617	88,737	119,418	102,549
Gas	41,658	29,714	24,839	31,206	36,977	42,221
Wastewater Collection	9,292	10,676	12,647	12,041	13,801	14,848
Wastewater Treatment	13,987	13,556	14,744	15,982	18,778	16,957
Refuse	21,777	21,691	21,923	23,387	24,795	25,532
Storm Drainage	2,221	2,192	2,170	2,484	5,174	5,181
External Services	380	605	585	766	854	789
Operating Grants and Contributions						
Capital Grants and Contributions	185					756
Total Business-Type Activities Program Revenue	199,289	187,710	191,518	195,644	240,905	232,328
Total Primary Government Program Revenues	\$261,367	\$218,234	\$221,761	\$225,371	\$279,190	\$270,883
Net (Expense)/Revenue						
Governmental Activities	(\$44,097)	(\$71,074)	(\$74,011)	(\$88,054)	(\$80,539)	(\$83,055)
Business-Type Activities	11,321	27,728	26,916	25,549	46,065	30,908
Total Primary Government Net Expense	(\$32,776)	(\$43,346)	(\$47,095)	(\$62,505)	(\$34,474)	(\$52,147)
General Revenues and Other Changes in Net Assets						
Governmental Activities:						
Taxes:						
Property Taxes	\$13,270	\$13,882	\$13,707	\$16,657	\$18,731	\$21,466
Sales Taxes	20,085	18,041	18,151	19,308	20,315	22,194
Utilities Users Taxes	6,457	7,067	7,152	7,269	8,759	9,356
Transient Occupancy Tax	6,615	5,333	5,489	5,686	6,393	6,709
Other taxes	6,284	7,275	8,493	5,580	7,033	6,293
Investment Earnings	10,589	10,213	326	4,988	2,567	8,747
Rents and Miscellaneous	18,524	15,333	10,165	12,997	10,440	13,670
Transfers	13,334	14,730	14,951	14,064	21,545	15,754
Total Government Activities	95,158	91,874	78,434	86,549	95,783	104,189
Business-Type Activities:						
Investment Earnings	15,620	13,583	387	8,093	3,631	11,910
Special Item				(21,500)	0	
Transfers	(13,334)	(14,730)	(14,951)	(14,064)	(21,545)	(15,754)
Total Business-Type Activities	2,286	(1,147)	(14,564)	(27,471)	(17,914)	(3,844)
Total Primary Government	\$97,444	\$90,727	\$63,870	\$59,078	\$77,869	\$100,345
Change in Net Assets						
Governmental Activities	\$51,061	\$20,800	\$4,423	(\$1,505)	\$15,244	\$21,134
Business-Type Activities	13,607	26,581	12,352	(1,922)	28,151	27,064
Total Primary Government	\$64,668	\$47,381	\$16,775	(\$3,427)	\$43,395	\$48,198

Source: Annual Financial Statements

Note:

(a) The City implemented GASB Statement 34 in fiscal year 2002. Therefore this calculation is included only for fiscal years subsequent to that date.

**City of Palo Alto - Fund Balances of Governmental Funds
Last Ten Fiscal Years (\$000)
(Modified Accrual Basis of Accounting)**



	Fiscal Year Ended June 30,									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
General Fund										
Reserved	\$7,678	\$7,237	\$14,838	\$8,282	\$7,780	\$8,156	\$6,735	\$7,332	\$7,966	\$8,392
Unreserved	38,226	41,900	40,927	52,114	55,653	58,151	60,087	24,498	26,251	31,016
Total General Fund	\$45,904	\$49,137	\$55,765	\$60,396	\$63,433	\$66,307	\$66,822	\$31,830	\$34,217	\$39,408 (a)
All Other Governmental Funds										
Reserved	\$35,241	\$17,796	\$20,717	\$14,086	\$37,924	\$29,174	\$25,790	\$19,305	\$22,597	\$21,614
Unreserved, reported in:										
Special revenue funds	2,933	5,273	4,908	7,466	18,263	7,428	6,875	7,643	7,063	10,847
Capital project funds	(5,991)	9,195	7,987	18,005	19,772	22,705	10,419	39,431	37,315	33,646
Total all other governmental funds	\$32,183	\$32,264	\$33,612	\$39,557	\$75,959	\$59,307	\$43,084	\$66,379	\$66,975	\$66,107

Source: Annual Financial Statements

Note:

(a) The change in total fund balance for the General fund and other governmental funds is explained in Management's discussion and Analysis.

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City of Palo Alto - Changes in Fund Balance of Governmental Funds Last Ten Fiscal Years (\$000)

(Modified Accrual Basis of Accounting)

	Fiscal Year Ended June 30,				
	1998	1999	2000	2001	2002
Revenues					
Sales tax	\$20,011	\$20,225	\$22,867	\$25,786	\$20,085
Property tax	8,903	9,521	10,770	12,110	13,231
Other taxes	19,150	20,393	23,582	26,160	20,485
Permits and licenses	8,984	8,810	12,408	12,743	2,901
Fines, forfeits and penalties	1,161	1,475	1,703	1,873	2,181
Interest and rentals	14,525	13,992	13,874	17,432	19,547
From other agencies	1,732	3,374	3,282	2,208	3,860
Charges for services	4,507	4,751	5,053	5,466	16,667
Other	6,354	4,376	6,213	7,590	8,580
Total Revenues	85,327	86,917	99,752	111,368	107,537
Expenditures					
Administration (1)	12,987	15,066	15,772	18,557	18,235
Public works	8,172	9,202	8,827	9,522	9,549
Planning and community environment	4,832	5,674	6,639	6,652	7,378
Police	16,093	16,705	17,666	18,306	19,047
Fire	13,100	13,949	14,512	15,973	16,722
Community services	15,050	16,820	17,858	18,469	19,499
Library (2)					
Non-departmental	6,298	6,520	6,927	14,487	8,259
Special revenue and capital projects	6,749	16,605	13,151	11,089	16,960
Debt service - Principal payments	1,405	1,553	1,775	1,895	465
Debt Service - Interest and fiscal fees	888	956	1,026	922	686
Total Expenditures	85,574	103,050	104,153	115,872	116,800
Excess (deficiency) of revenues over (under) expenditures	(247)	(16,133)	(4,401)	(4,504)	(9,263)
Other Financing Sources (Uses)					
Transfers in	23,825	24,715	27,795	26,150	27,389
Transfers (out)	(11,097)	(649)	(15,418)	(14,487)	(14,444)
Contribution from assessment district				4,112	31,823
Proceeds from long term debt					7,055
Bond proceeds		7,750			
Payments to refunded bond escrow		(649)		(705)	(3,820)
Total other financing sources (uses)	12,728	31,167	12,377	15,070	48,003
Net Change in fund balances	\$12,481	\$15,034	\$7,976	\$10,566	\$38,740
Debt service as a percentage of noncapital expenditures	(a)	(a)	(a)	(a)	1.1%

Source: Annual Financial Statements

Note: (a) The City implemented GASB Statement 34 in fiscal year 2002. Therefore this calculation is included only for fiscal years subsequent to that date.

(1) Comprised of the following departments: City Council, City Manager, City Attorney, City Clerk, City Auditor, Administrative Services and Human Resources.

(2) Prior to 2005, Library was included in Community Services.



Fiscal Year Ended June 30,

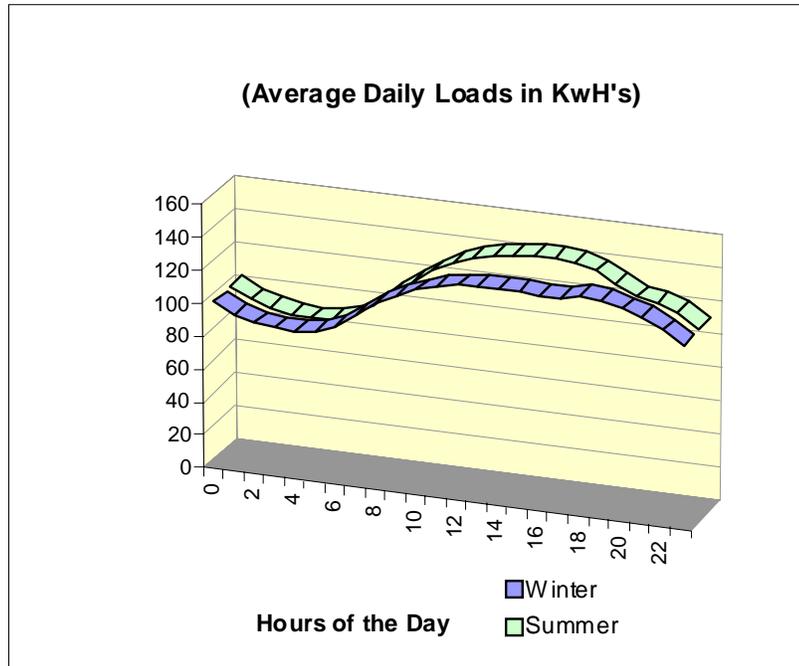
2003	2004	2005	2006	2007
\$18,041	\$18,151	\$19,308	\$20,315	\$22,194
13,821	13,707	16,657	18,731	21,466
21,070	22,427	19,941	23,712	23,698
3,161	2,563	3,183	4,305	4,711
2,124	2,884	2,096	2,128	2,517
19,981	11,480	14,968	13,776	17,750
3,776	4,661	2,757	5,931	3,448
16,798	16,018	17,159	18,672	19,929
5,095	1,681	4,269	4,058	7,503
<u>103,867</u>	<u>93,572</u>	<u>100,338</u>	<u>111,628</u>	<u>123,216</u>
17,521	13,862	14,509	14,299	14,399
9,858	8,031	9,060	9,036	9,256
7,721	8,793	9,692	9,292	11,874
19,719	19,962	21,117	22,279	23,305
16,841	16,891	17,615	18,114	19,146
19,793	19,934	16,298	19,740	16,533
		4,800	5,170	5,260
7,442	7,598	9,028	10,389	12,122
33,584	22,289	21,317	13,243	17,478
875	780	785	810	850
696	639	583	523	489
<u>134,050</u>	<u>118,779</u>	<u>124,804</u>	<u>122,895</u>	<u>130,712</u>
<u>(30,183)</u>	<u>(25,207)</u>	<u>(24,466)</u>	<u>(11,267)</u>	<u>(7,496)</u>
31,402	28,632	60,429	26,640	27,701
(16,603)	(19,133)	(46,622)	(12,390)	(15,882)
425				
		(1,038)		
<u>15,224</u>	<u>9,499</u>	<u>12,769</u>	<u>14,250</u>	<u>11,819</u>
<u>(\$14,959)</u>	<u>(\$15,708)</u>	<u>(\$11,697)</u>	<u>\$2,983</u>	<u>\$4,323</u>
1.6%	1.5%	1.3%	1.2%	1.2%

City of Palo Alto - Electric Daily Loads and Top Customers by Usage

June 30, 2007

(in thousands of KWh)

Daily Hours	# Kilowatt Hours	
	(Oct-Mar) Winter	(Apr-Sep) Summer
0	100,438	101,517
1	94,790	94,880
2	90,892	91,072
3	89,281	88,975
4	88,941	88,093
5	90,450	88,912
6	95,004	92,613
7	103,757	99,614
8	112,440	109,194
9	118,321	118,040
10	123,162	125,536
11	126,847	132,467
12	128,866	137,040
13	129,496	139,515
14	129,665	141,393
15	129,418	142,619
16	128,469	142,347
17	128,189	140,814
18	131,029	137,615
19	130,573	131,037
20	126,713	124,882
21	123,062	123,045
22	117,056	118,421
23	108,758	109,992



Source: City of Palo Alto, Utilities Resource Management

Top Ten Electric Customers by Usage

Rank No.	Customer	Type of Business	Kwh's	% of System Total
1	Stanford Hospital	Hospital	76,787,377	7.85 %
2	Vet Admin Hospital	Hospital	38,963,744	3.98
3	Space System Loral	Satellite & Satellite Systems	36,630,943	3.74
4	CPI-David Morman	Research in Physical Science	34,897,184	3.57
5	Syntex/J Meek	Technology in Occupational Risk Mgmt	33,612,000	3.44
6	Hewlett Packard	Computer	31,332,677	3.20
7	City of Palo Alto	Municipal	30,131,948	3.08
8	Varian Medical Systems	Manufacturing in Cancer Therapy Systems	27,902,945	2.85
9	Stanford Hines Interests	Property Management	13,741,055	1.40
10	Varian, Inc.	Technology in Medical Life Science	12,449,361	1.27
Total			336,449,234	34.39 %

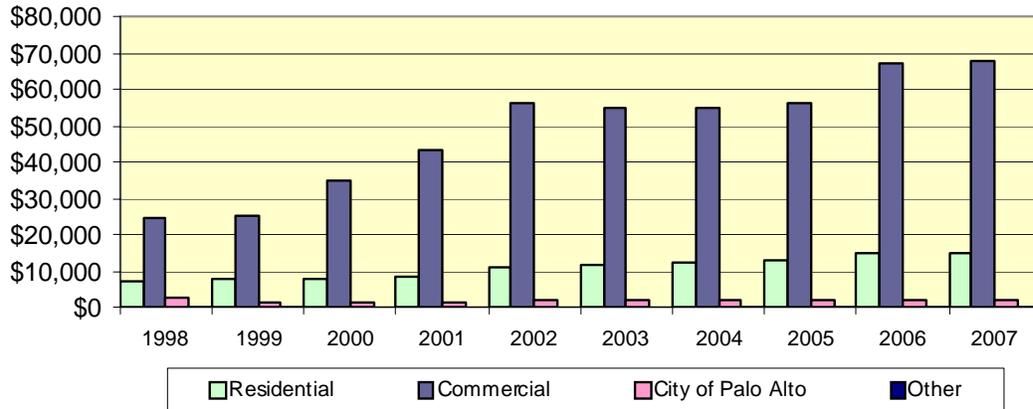
Source: City of Palo Alto, Utilities Department



City of Palo Alto - Electric Operating Revenue by Source

June 30, 2007

(in thousands of dollars)



Fiscal Year	Residential	Commercial	City of Palo Alto	Other	Total
1998	7,421	25,098	2,804	51	35,374
1999	7,758	25,318	1,685	65	34,826
2000	7,987	34,826	1,415	29	44,256
2001	8,489	43,460	1,545	5	53,499
2002	11,377	56,214	1,925	6	69,521
2003	11,657	55,353	2,004	24	69,039
2004	12,245	54,881	2,047	66	69,240
2005	13,009	56,683	2,222	67	71,981
2006	14,973	67,389	2,395	97	84,854
2007	15,150	68,214	2,397	69	85,829

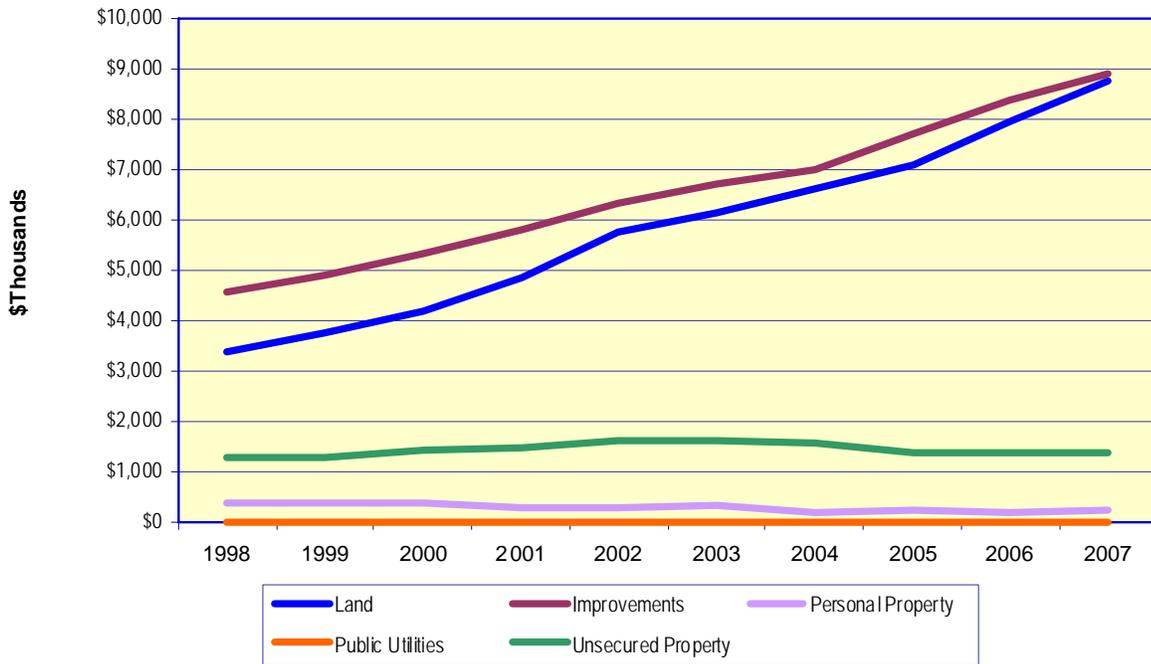
Top Ten Electric Revenue

Rank No.	Customer	Type of Business	Net Charges	% of System Total
1	Stanford Hospital	Hospital	9,073,416	4.72%
2	City of Palo Alto	Municipal	5,957,021	3.10%
3	Vet Admin Hospital	Hospital	5,425,693	2.82%
4	Syntex/J Meek-MS#SS-200	Technology	4,689,012	2.44%
5	Space System Loral/MS-AC-1	Satellite System	4,300,389	2.24%
6	CPI-David Morman-M/SB500	Research	3,915,982	2.04%
7	Hewlett Packard	Computer	3,611,540	1.88%
8	Varian Medical Systems	Manufacturing	3,065,726	1.60%
9	Palo Alto Schools	Education	2,443,768	1.27%
10	Stanford % Hines Interests	Property Mgmt	2,271,170	1.18%
Total			\$ 44,753,718	23.28%

Source: City of Palo Alto, Utilities Department

Note: Revenue includes all utilities (metered and non-metered), revenue adjustments, and Primary Voltage discount. Does not include CEC surcharge, UUT, Solar and Rap discounts, and deposits.

**City of Palo Alto - Assessed Value of Taxable Property.....
Last Ten Fiscal Years (\$000)**



Fiscal Year	Net Local Secured Roll			Subtotal	Less			Total Assessed Value	Total Direct Tax Rate
	Land	Improvements	Personal Property	Net Local Secured Roll	Public Utilities	Unsecured Property	Exemptions Net of State Aid		
1998	3,353,027	4,585,725	381,091	\$8,319,843	2,652	1,265,100	701,972	\$8,885,623	1%
1999	3,729,475	4,920,111	394,610	9,044,196	2,842	1,279,315	702,485	9,623,868	1%
2000	4,187,357	5,335,026	394,198	9,916,581	3,362	1,415,999	802,164	10,533,778	1%
2001	4,849,233	5,816,633	280,958	10,946,824	3,309	1,473,678	813,896	11,609,915	1%
2002	5,744,675	6,347,719	292,812	12,385,206	3,371	1,627,594	913,475	13,102,696	1%
2003	6,140,438	6,692,162	309,386	13,141,986	3,859	1,612,179	951,807	13,806,217	1%
2004	6,588,474	6,996,106	195,859	13,780,439	3,956	1,582,368	1,196,546	14,170,217	1%
2005	7,075,300	7,722,660	220,585	15,018,545	4,150	1,354,310	1,402,039	14,974,966	1%
2006	7,941,482	8,364,668	174,666	16,480,816	4,084	1,361,117	1,595,871	16,250,146	1%
2007	8,725,485	8,915,623	213,154	17,854,262	3,923	1,391,284	1,639,856	17,609,613	1%

Source: County of Santa Clara Assessor's Office

Note: Beginning in fiscal year 1988-89, Chapter 921 of the Statutes of 1987 requires the establishment of a single county-wide tax rate area for the assignment of the assessed value of certain types of state-assessed utility property and sets forth formulas for the determination of county-wide tax rates for this particular type of property.

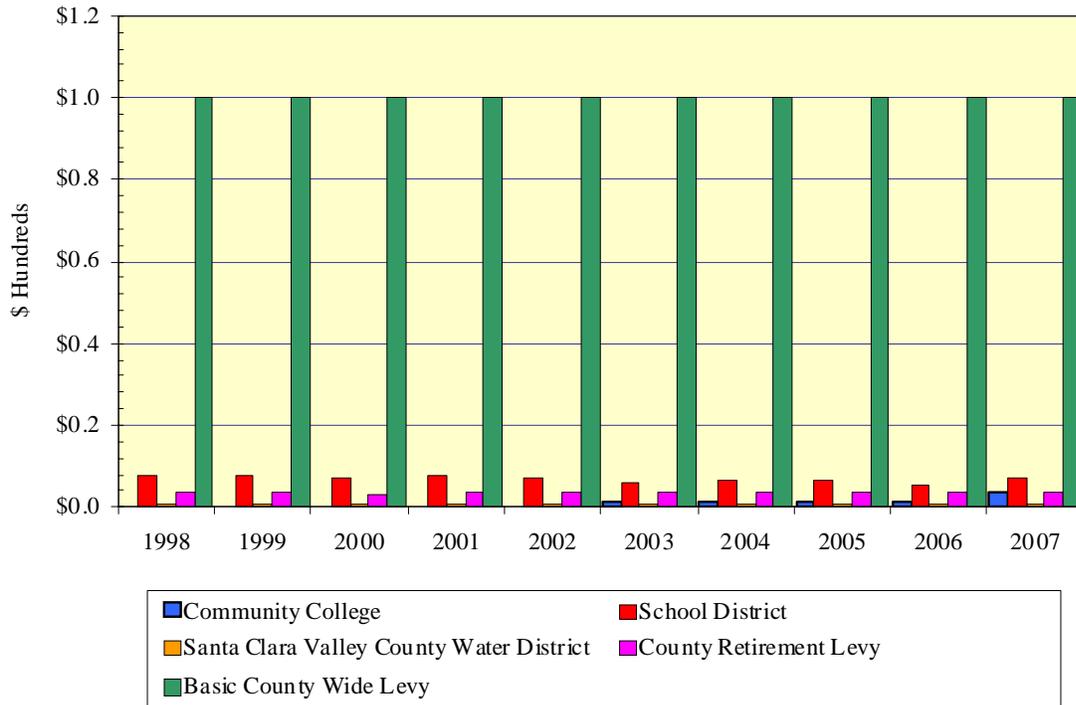
The State Constitution requires property to be assessed at one hundred percent of the most recent purchase price, plus an increment of no more than two percent annually, plus any local over-rides. These values are considered to be full market values.



City of Palo Alto - Property Tax Rates.....

All Overlapping Governments

Last Ten Fiscal Years



<u>Fiscal Year</u>	<u>Basic County Wide Levy</u>	<u>County Retirement Levy</u>	<u>Santa Clara Valley Water District</u>	<u>School District</u>	<u>Community College</u>	<u>Total</u>
1998	1.0000	0.0388	0.0076	0.0764	0.0000	\$1.1228
1999	1.0000	0.0388	0.0082	0.0757	0.0000	1.1227
2000	1.0000	0.0319	0.0085	0.0740	0.0000	1.1144
2001	1.0000	0.0356	0.0075	0.0771	0.0000	1.1202
2002	1.0000	0.0364	0.0062	0.0727	0.0000	1.1153
2003	1.0000	0.0388	0.0072	0.0586	0.0108	1.1154
2004	1.0000	0.0388	0.0087	0.0666	0.0110	1.1251
2005	1.0000	0.0388	0.0092	0.0680	0.0129	1.1289
2006	1.0000	0.0388	0.0078	0.0526	0.0119	1.1111
2007	1.0000	0.0388	0.0072	0.0720	0.0346	1.1526

Source: County of Santa Clara, Tax Rates and Information

City of Palo Alto - Property Tax Levies and Collections
Last Ten Fiscal Years (\$000)

<u>Fiscal Year</u>	<u>Total Tax Levy (a)</u>	<u>Current Tax Collections</u>	<u>Percent of Levy Collected</u>	<u>Delinquent Tax Collections (b)</u>	<u>Total Tax Collections</u>	<u>Percent of Total Tax Collections to Tax Levy</u>
1998	7,660	7,660	100%		7,660	100%
1999	9,521	9,521	100%		9,521	100%
2000	10,770	10,770	100%		10,770	100%
2001	12,110	12,110	100%		12,110	100%
2002	13,231	13,231	100%		13,231	100%
2003	13,821	13,821	100%		13,821	100%
2004	13,707	13,707	100%		13,707	100%
2005	16,657	16,657	100%		16,657	100%
2006	18,731	18,731	100%		18,731	100%
2007	21,466	21,466	100%		21,466	100%

Source: County of Santa Clara Assessor's Office

Note: Current tax collections beginning in 1993 have been reduced by a mandatory tax reallocation imposed by the State of California.

- (a) During fiscal year 1995, the County began providing the City 100% of its tax levy under an agreement which allows the County to keep all interest and delinquency charges collected.
- (b) Effective with the fiscal year 1993-94, the City is on the Teeter Plan, under which the County of Santa Clara pays the full tax levy due. All prior delinquent taxes were also received in that fiscal year.



City of Palo Alto - Principal Property Tax Payers
Current Year and Nine Years Ago (\$000)

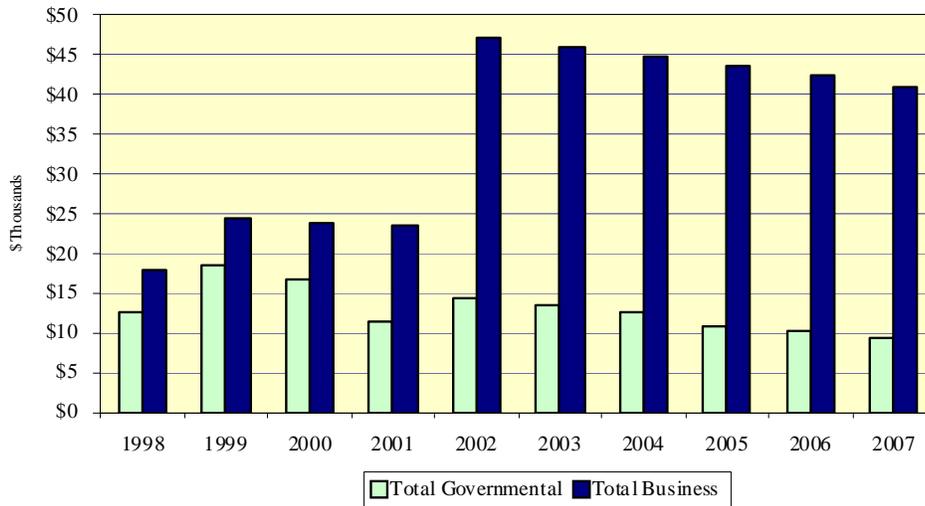
Taxpayer	2006-07			1997-98		
	Taxable Assessed Value	Rank	Percentage of Total City Taxable Assessed Value	Taxable Assessed Value	Rank	Percentage of Total City Taxable Assessed Value
Leland Stanford Jr University	\$2,632,853	1	15.0%	\$1,483,270	1	16.7%
Space System /Loral Inc.	180,779	2	1.0%	179,819	2	2.0%
Sun Microsystems Inc.			0.0%	51,332	3	0.6%
Harbor Investments Partners	52,165	4	0.3%	42,000	4	0.5%
S I Palo Alto Inc.			0.0%	41,511	5	0.5%
Digital Equipment Corporation			0.0%	37,954	6	0.4%
Cowper-Hamilton Associates			0.0%	36,403	7	0.4%
University Ave. Partners and Associates			0.0%	19,889	8	0.2%
Maytai Investments, Inc.			0.0%	15,763	9	0.2%
Stanford Square Limited Partners			0.0%	15,700	10	0.2%
Agilent Technologies Inc.	81,285	3	0.5%			0.0%
EOP-Embarcadero Place, LLC	40,000	5	0.2%			0.0%
Hamilton Associates 300	38,843	6	0.2%			0.0%
California Pacific Comm. Corp.	37,339	7	0.2%			0.0%
Palo Alto Town & Country Village Inc	36,306	8	0.2%			0.0%
Pacific Hotel Dev Venture L P	32,796	9	0.2%			0.0%
Thoits Bros Inc.	29,751	10	0.2%			0.0%
Subtotal	\$3,162,117		18.0%	\$1,923,641		21.6%

Total Net Assessed Valuation:

Fiscal Year 2006-2007	\$17,609,613
Fiscal Year 1997-1998	\$8,885,623

Source: County of Santa Clara compiled by Hunt Consulting, LLC

City of Palo Alto - Ratio of Outstanding Debt by Type
Last Ten Fiscal Years (\$'000)



Governmental Activities

Fiscal Year	General Revenue Bonds	Certificates of Participation	Special Assessment Debt	Capital Lease Obligations	Total
1998	\$625	\$5,215	\$5,685	\$1,186	\$12,711
1999		12,480	5,195	791	18,466
2000		11,625	4,670	537	16,832
2001		10,700	670	113	11,483
2002		13,695	595	84	14,374
2003		12,905	510	57	13,472
2004		12,215	420	25	12,660
2005		10,625	325		10,950
2006		9,915	225		10,140
2007		9,175	115		9,290

Business-Type Activities

Fiscal Year	Utility Revenue Bonds	Total	Total Primary Government	Percentage of Assessed Value (a)	Per Capita (b)
1998	\$17,915	\$17,915	\$30,626	0.34 %	\$0.51
1999	24,368	24,368	42,834	0.45	0.70
2000	23,935	23,935	40,767	0.39	0.66
2001	23,465	23,465	34,948	0.30	0.57
2002	47,210	47,210	61,584	0.47	1.02
2003	46,069	46,069	59,541	0.43	0.98
2004	44,862	44,862	57,522	0.38	0.95
2005	43,598	43,598	54,548	0.34	0.88
2006	42,288	42,288	52,428	0.32	0.84
2007	40,887	40,887	50,177	0.28	0.80

Sources: City of Palo Alto

(a) County of Santa Clara (assessed value)

(b) State of California, Department of Finance (population)

Note: Debt amounts exclude any premiums, discounts, or other amortization amounts.

Details regarding the City's outstanding debt can be found in the notes to the financial statements.



City of Palo Alto - Computation of Direct and Overlapping Debt
June 30, 2007

2006-07 Assessed Valuation

\$17,609,613,000

	Total Debt Outstanding	Percentage Applicable To City of Palo Alto (a)	Amount Applicable To City of Palo Alto
<u>OVERLAPPING TAX AND ASSESSMENT DEBT:</u>			
Foothill-DeAnza Community College District	\$486,686,935	22.967%	\$111,777,388
Palo Alto Unified School District	105,380,000	88.691%	93,462,576
Fremont Union High School District	135,495,000	0.007%	9,485
Mountain View-Los Altos Union High School District	41,161,332	0.979%	402,969
Cupertino Union School District	121,617,087	0.005%	6,081
Los Altos School District	99,819,000	0.927%	925,322
Whisman School District	24,024,322	3.649%	876,648
El Camino Hospital District	148,000,000	0.081%	119,880
City of Palo Alto Special Assessment Bonds	39,680,000	100.000%	39,680,000
Santa Clara Valley Water District Benefit Assessment District	<u>173,070,000</u>	7.478%	<u>12,942,175</u>
TOTAL OVERLAPPING TAX AND ASSESSMENT DEBT	<u>\$1,374,933,676</u>		<u>\$260,202,524</u>
<u>DIRECT AND OVERLAPPING GENERAL FUND DEBT:</u>			
Santa Clara County General Fund Obligations	\$831,605,000	7.471%	\$62,187,422
Santa Clara County Board of Education Certificates of Participation	16,325,000	7.471%	1,220,784
Foothill-DeAnza Community College District Certificates of Participation	29,700,000	22.967%	6,821,199
Mountain View-Los Altos Union High School District Certificates of Participation	7,600,000	0.979%	74,404
Cupertino Union School District Certificates of Participation	3,475,000	0.005%	174
City of Palo Alto General Fund Obligations	9,175,000	100.000%	9,175,000
Santa Clara County Vector Control District Certificates of Participation	4,420,000	7.478%	330,528
Midpeninsula Regional Open Space Park District General Fund Obligations	<u>108,465,193</u>	13.192%	<u>14,308,728</u>
TOTAL DIRECT AND OVERLAPPING GENERAL FUND DEBT	<u>\$1,010,765,193</u>		<u>\$94,118,239</u>
COMBINED TOTAL DEBT	<u>\$2,385,698,869</u>		<u>\$354,320,763</u> (b)

(a) Percentage of overlapping agency's assessed valuation located within boundaries of the city.

(b) Excludes tax and revenue anticipation notes, enterprise revenue, mortgage revenue and tax allocation bonds and non-bonded capital lease obligations.

Ratios to Assessed Valuation	
Combined Direct Debt (\$9,175,000)	0.05%
Total Overlapping Tax and Assessment Debt	1.48%
Combined Total Debt	2.01%

STATE SCHOOL BUILDING AID REPAYABLE AS OF 06/30/07: \$0

Source: California Municipal Statistics, Inc.

City of Palo Alto - Computation of Legal Bonded Debt Margin

June 30, 2007

(in thousands of dollars)

Assessed Valuation:

Secured property assessed value, net of exempt real property	\$17,609,613
--	--------------

Bonded debt limit 3.75% of assessed value (a)	\$660,360
--	------------------

Amount of debt subject to limit: (b)

Certificates of participation	9,175
Special assessment debt with government commitment	115
Total Debt	9,290

Less amount of debt not subject to limit	9,290
--	-------

Amount of debt subject to limit	0
---------------------------------	---

Legal bonded debt margin	\$660,360
---------------------------------	------------------

Fiscal Year	Debt Limit	Total Net Debt Applicable to Limit	Legal Debt Margin	Total net debt applicable to the limit as a percentage of debt limit
1998	\$333,211	\$0	\$333,211	0.00%
1999	360,895	0	360,895	0.00%
2000	395,017	0	395,017	0.00%
2001	435,372	0	435,372	0.00%
2002	491,351	0	491,351	0.00%
2003	516,615	0	516,615	0.00%
2004	561,561	0	561,561	0.00%
2005	609,378	0	609,378	0.00%
2006	609,377	0	609,377	0.00%
2007	660,360	0	660,360	0.00%

Source: Annual Financial Statements

Notes:

- (a) California Government Code, Section 43605 sets the debt limit at 15%. The Code section was enacted prior to the change in basing assessed value to full market value when it was previously 25% of market value. Thus, the limit shown as 3.75% is one-fourth the limit to account for the adjustment of showing assessed valuation at full cash value. Prior year limits have been adjusted to conform to the current year methodology.
- (b) In accordance with California Government Code Section 43605, only the City's general obligation bonds are subject to the legal debt limit of 15%. As of June 30, 2006, the City had no general obligation bonds outstanding.

The above does not include debt recorded in the Enterprise Funds because such debt is not subject to legal debt margin.

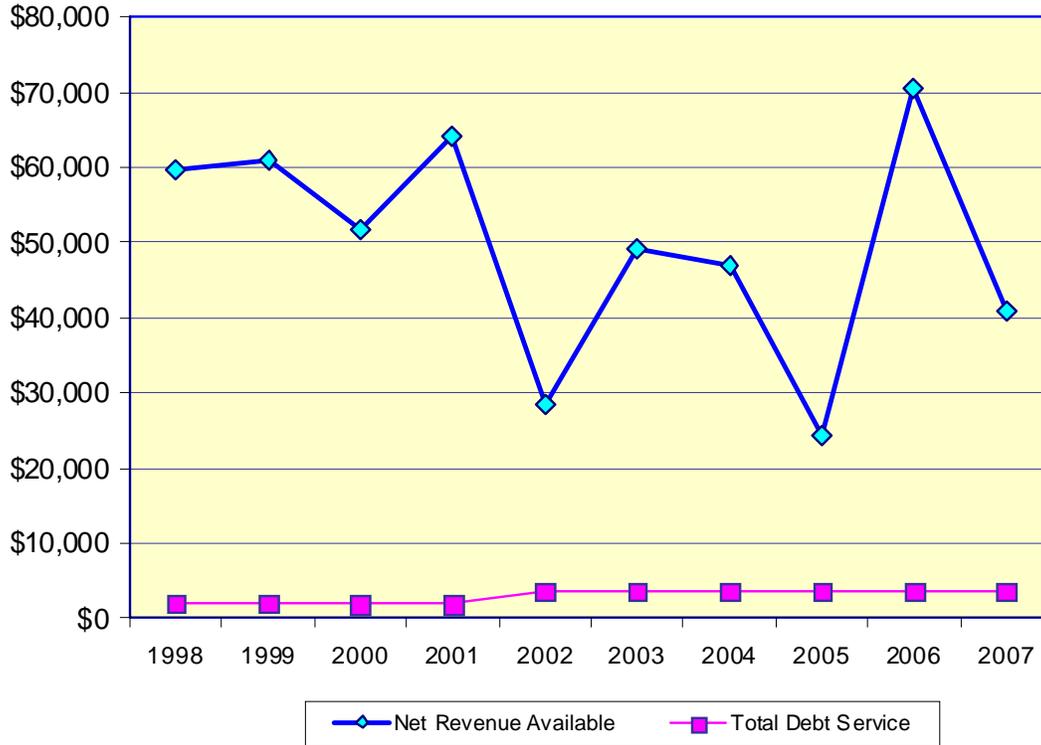
Special assessment debt excludes debt where there is no government commitment.



City of Palo Alto - Revenue Bond Coverage.....

Water, Electric, Gas, Wastewater Collection,
Wastewater Treatment and Storm Drainage Funds

Last Ten Fiscal Years (\$'000)



Fiscal Year	Gross Revenue	Direct Operating Expenditures	Net Revenue Available for Debt Services (a)	Debt Service			Coverage
				Principal	Interest	Total	
1998	\$144,195	\$84,415	\$59,780	\$840	\$1,214	\$2,054	29.10
1999	141,696	80,748	60,948	896	1,163	2,059	29.60
2000	130,550	78,880	51,670	545	1,363	1,908	27.08
2001	197,022	133,012	64,010	555	1,342	1,897	33.74
2002	176,947	148,345	28,602	1,955	1,660	3,615	7.91
2003	165,414	116,268	49,146	1,255	2,354	3,609	13.62
2004	169,047	121,988	47,059	1,310	2,307	3,617	13.01
2005	171,493	147,123	24,370	1,365	2,257	3,622	6.73
2006	214,944	144,465	70,479	1,410	2,203	3,613	19.51
2007	205,258	164,340	40,918	1,465	2,147	3,612	11.33

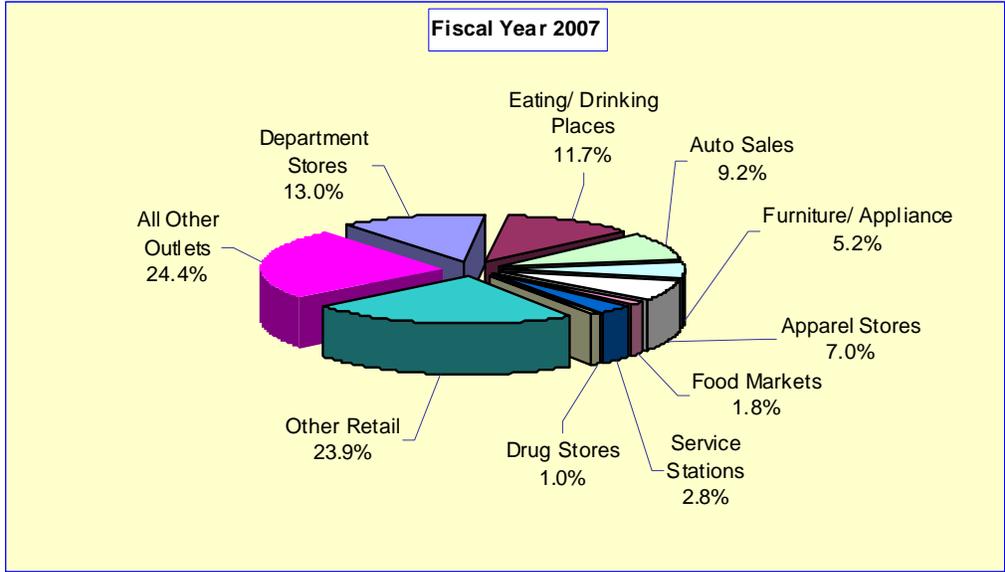
Source: Annual Financial Statements

Notes:

(a) Excludes depreciation and amortization expense.

Details regarding the City's outstanding debt can be found in the notes to the financial statements.

**City of Palo Alto- Taxable Transactions by Type of Business.....
Last Ten Fiscal Years (\$'000)**



RETAIL STORES

Fiscal Year	Department Stores	Eating/ Drinking Places	Auto Sales	Furniture/ Appliance	Apparel Stores	Food Markets	Service Stations	Drug Stores	Other Retail	Retail Stores Total	All Other Outlets	Total
1998	\$2,925	\$2,032	\$2,112	\$1,388	\$1,033	\$325	\$318	\$131	\$4,177	\$14,441	\$5,026	\$19,467
1999	2,740	2,077	2,265	1,485	1,116	344	269	143	4,079	14,518	5,128	19,646
2000	3,011	2,379	2,724	1,845	1,226	347	323	173	4,169	16,197	6,386	22,583
2001	3,112	2,551	3,118	1,824	1,343	351	417	186	4,706	17,608	7,270	24,878
2002	2,646	2,321	2,533	1,593	1,171	371	379	180	3,674	14,868	5,009	19,877
2003	2,316	2,172	2,094	1,455	1,114	375	388	171	2,811	12,896	4,834	17,730
2004	2,425	2,168	1,958	1,479	1,186	351	437	168	3,698	13,870	3,997	17,867
2005	2,621	2,206	1,966	1,176	1,310	356	533	317	3,590	14,075	5,139	19,214
2006	2,664	2,306	2,062	1,168	1,346	370	595	392	4,244	15,147	5,042	20,189
2007	2,751	2,486	1,954	1,109	1,485	374	602	203	5,075	16,039	5,185	21,224

Source: California State Board of Equalization, compiled by MBIA Muniservices Company

**SALES TAX RATES FOR THE
FISCAL YEAR ENDED JUNE 30, 2007**

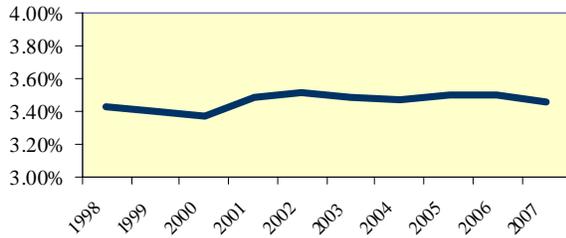
State Funds	6.00%
County Transportation Fund (Transportation Development	0.25%
County Transportation Fund	1.00%
City	1.00%
Total	8.25%

Source: California State Board of Equalization

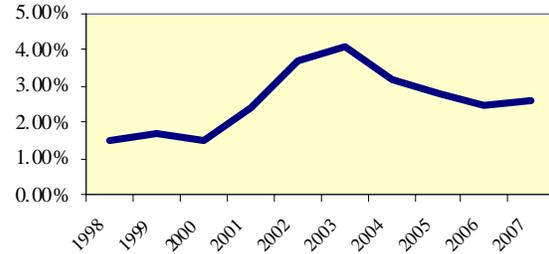


City of Palo Alto - Demographic and Economic Statistics

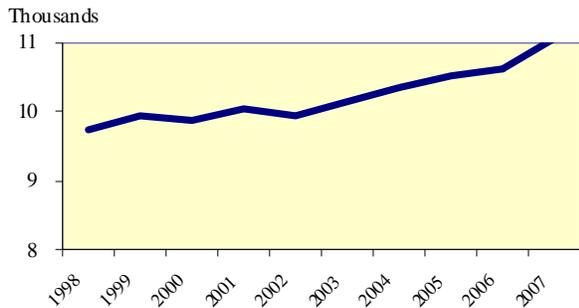
Last Ten Fiscal Years



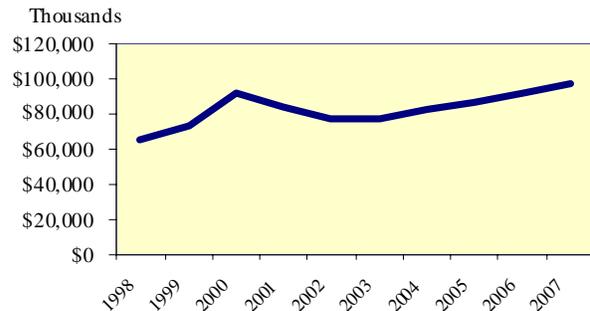
City Population as a % of County Population



City Unemployment Rate



City School Population



Total County Personal Income

Fiscal Year	City of Palo Alto Population	City of Palo Alto Unemployment Rate (%)	City of Palo Alto School Population	Santa Clara County Population	City Population % of County	Santa Clara Total County (\$000) Personal Income
1998	57,900	1.5%	9,719	1,689,900	3.43%	64,850,110
1999	58,300	1.7%	9,946	1,715,400	3.40%	73,045,821
2000	58,500	1.5%	9,881	1,736,700	3.37%	91,386,181
2001	60,200	2.4%	10,031	1,728,680	3.48%	83,838,707
2002	60,500	3.7%	9,952	1,719,565	3.52%	77,548,912
2003	60,465	4.1%	10,151	1,729,917	3.50%	77,680,349
2004	60,246	3.2%	10,341	1,731,422	3.48%	82,638,917
2005	61,674	2.8%	10,527	1,759,585	3.51%	86,400,000 *
2006	62,148	2.5%	10,607	1,773,258	3.50%	91,600,000 *
2007	62,615	2.6%	11,056	1,808,056	3.46%	96,900,000 *

Source: California State Department of Finance
 State Employment Development Office
 Palo Alto Unified School District
 * California State Department of Transportation Forecasts

City of Palo Alto - Principal Employers

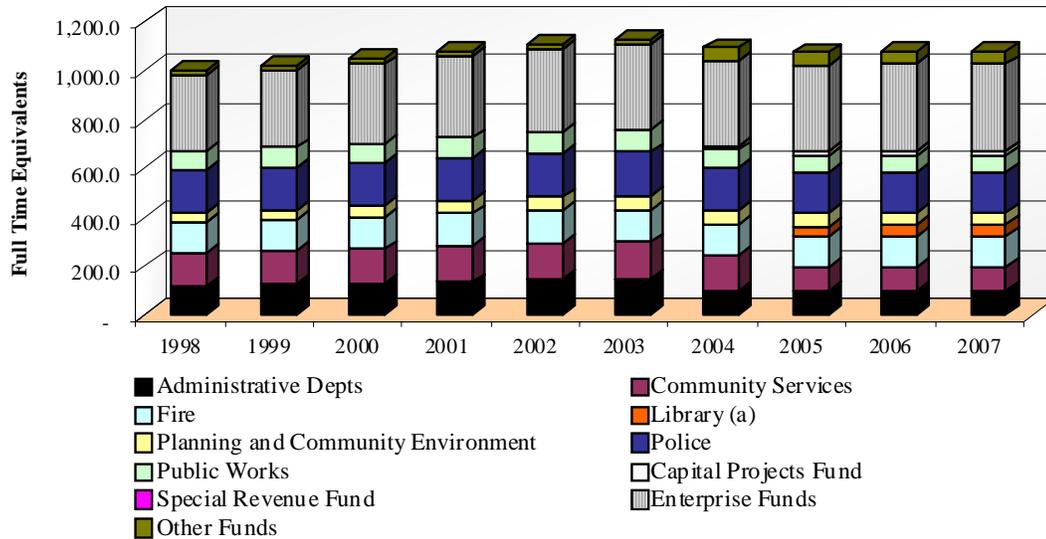
Current Year

	<u>2006-07</u>
<u>Employer</u>	<u>Number of Employees</u>
Stanford Hospital & Clinics	5,000 - 9,999
Veteran's Affairs Palo Alto Health Care System	1,000 - 4,000
Hewlett-Packard Company	1,000 - 4,000
Palo Alto Medical Foundation	1,000 - 4,000
Space Systems Loral	1,000 - 4,000
Wilson Sonsini Goodrich & Rosati	1,000 - 4,000
Varian Medical Systems, Inc.	1,000 - 4,000
Lucile Packard Children's Health	1,000 - 4,000
City of Palo Alto	1,000 - 4,000
Roche Palo Alto	1,000 - 4,000
Total City Day Population	<u><u>62,615</u></u>

Source: www.ReferenceUSA.com and Info Palo Alto Magazine



City of Palo Alto - Full-Time Equivalent City Government Employees by Function Last Ten Fiscal Years



	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Governmental Funds										
General Fund										
Administrative Depts	120.76	124.35	126.35	133.35	143.60	145.10	101.10	96.24	96.65	99.05
Community Services	134.00	139.25	142.25	152.00	153.00	153.00	144.75	98.25	99.25	97.25
Fire	123.00	124.00	128.00	129.00	129.00	132.50	128.50	126.00	127.00	127.00
Library (a)								44.00	44.25	43.75
Planning and Community Environment	45.00	46.00	51.00	52.00	56.50	59.00	54.80	53.30	53.30	53.30
Police	167.50	171.00	173.00	173.00	176.50	177.50	171.00	164.50	164.00	163.00
Public Works	80.53	82.42	83.42	85.98	87.05	93.05	76.20	67.90	67.90	67.90
Capital Projects Fund							12.70	20.20	20.20	20.00
Special Revenue Fund							1.20	1.20	1.20	1.20
Enterprise Funds										
Public Works Department (Refuse, Storm Drain, Wastewater Treatment)	105.47	106.58	107.58	109.52	110.45	110.45	111.35	112.65	112.65	112.65
Utilities Department (Administrative, Electric, Gas, Wastewater Collection, Water)	208.50	211.50	215.50	224.50	230.50	229.50	233.75	233.90	235.90	234.90
CPA External Services					4.00	7.00	5.70	6.00	6.00	5.80
Other Funds										
Printing and Mailing	5.15	5.15	5.15	5.15	4.15	4.15	4.15	4.70	4.60	4.65
Technology							33.15	29.56	29.60	29.80
Equipment Management	14.00	14.00	14.00	14.00	15.00	15.00	16.00	16.00	16.00	16.20
Total	1,003.91	1,024.25	1,046.25	1,078.50	1,109.75	1,126.25	1,094.35	1,074.40	1,078.50	1,076.45

Source: City of Palo Alto - Adopted Operating Budget

Notes: (a) Library became its own entity effective 2005, originally part of Community Services.

City of Palo Alto - Operating Indicators by Function/Program
Last Ten Fiscal Years

Function / Program	Fiscal Year		
	1998	1999	2000
Public Safety:			
Fire:			
Number of Fire Hydrants	1,500	1,699	1,708
Planning & Community Environment			
Number of Housing Units	25,701	25,708	25,732
Commercial & Industrial Space - Million Sq Ft	27.1	27.1	27.3
Electric Utility			
Number of Customer Accounts	27,641	27,674	27,533
Million of KWH Sold	1,121	1,124	1,134
Water Utility			
Number of Customer Accounts	19,298	19,322	18,921
Million CCF Sold	5.8	6.1	6.6
Gas Utility			
Number of Customer Accounts	23,327	23,322	23,154
Million Therms Sold	37.0	41.0	37.0
Waste Water			
Number of Customer Accounts	25,951	21,975	21,973
Millions of Gallons Processed	10,339	9,426	9,834

Source: City of Palo Alto
 State of California, Dept of Finance (housing units)

Note: Fiscal Years 2004-2006 is restated due to change in source of data.



Fiscal Year						
2001	2002	2003	2004	2005	2006	2007
1,729	1,741	1,746	1,874	1,873	1,919	1,944
26,048	26,841	26,934	27,019	27,522	27,767	27,763
27.3	27.3	27.3	27.3	27.3	27.3	27.3
28,097	28,348	28,408	28,482	28,539	28,653	28,684
1,057	997	957	958	959	966	978
19,335	19,437	19,487	19,557	19,605	19,645	19,726
5.9	5.9	5.6	6.0	5.3	5.2	12.0
23,101	23,116	23,169	23,216	23,300	23,353	23,357
36.7	33.7	31.8	31.5	32.0	31.5	31.3
21,752	21,772	21,819	21,830	21,825	21,784	21,835
9,243	8,699	8,704	8,238	8,395	8,972	9,220

City of Palo Alto - Capital Asset Statistics by Function/Program
Last Ten Fiscal Years

Function/Program	Fiscal Year			
	1998	1999	2000	2001
Public Safety:				
Fire:				
Fire Stations	8	8	8	8
Fire Apparatus	24	24	23	24
Police:				
Police Stations	1	1	1	1
Police Patrol Vehicles	26	27	29	33
Community Services				
Acres - Downtown/Urban Parks	142	142	170	170
Acres - Open Space	3,997	3,997	3,731	3,731
Parks and Preserves	36	36	35	33
Golf Course	1	1	1	1
Tennis Courts	51	51	52	52
Athletic Center	1	1	1	1
Community Centers	4	4	4	4
Theatres	3	3	3	3
Cultural Center/Art Center	1	1	1	1
Junior Museum and Zoo	1	1	1	1
Swimming Pools	3	3	1	1
Nature Center	2	2	2	2
Libraries				
Libraries	6	6	6	6
Public Works				
Number of Trees Maintained	39,200	39,832	39,923	38,094
Electric Utility				
Overhead Pole Miles	185	183	228	227
Underground Trench Miles	200	202	209	220
Water Utility				
Miles of Water Mains	215	220	221	222
Gas Utility				
Miles of Gas Mains	170	169	170	201
Waste Water				
Miles of Sanitary Sewer Lines	219	219	219	218

Source: City of Palo Alto



Fiscal Year					
2002	2003	2004	2005	2006	2007
8	8	8	8	8	8
25	22	23	25	25	25
1	1	1	1	1	1
33	33	30	30	30	30
170	170	170	170	170	157
3,731	3,731	3,731	3,731	3,731	3,744
34	34	34	35	35	36
1	1	1	1	1	1
52	52	52	52	52	51
1	1	1	1	1	4
4	4	4	4	4	4
3	3	3	3	3	3
1	1	1	1	1	1
1	1	1	1	1	1
1	1	1	1	1	1
2	2	2	2	2	3
6	6	5	5	5	5
37,941	34,939	35,440	35,096	34,841	34,556
227	227	227	225	217	194
186	186	186	188	210	252
226	226	226	226	217	217
207	207	207	207	207	207
202	202	202	202	202	202

City of Palo Alto - Insurance Coverage.....
June 30, 2007

TYPE	COVERAGE (Deductible)	LIMITS	COMPANY	EXPIRATION DATE
PROPERTY LOSS				
Blanket	All real & personal property (\$25,000 deductible), Fine Arts (\$2,500 deductible)	\$340,760,836	CA Public Entity Property Program	07/01/08
Boiler & Machinery	All real & personal property (\$50,000 deductible)	\$1,000,000 maximum all risk per occurrence limit \$1,000,000 minimum contingent business interruption	CA Public Entity Property Program	07/01/08
Flood Insurance	All real property 1305 Middlefield Road (\$1,000 deductible)	\$500,000	Hartford Fire Insurance Co.	04/07/08
FINANCIAL LOSS				
Employee Dishonesty	Position bond-faithful performance per loss (\$5,000 deductible)	\$1,000,000 / \$4,000,000 x \$1,000,000 per occurrence for City Mgr. & Director of ASD	Fidelity & Deposit Co.	03/22/09
UMBRELLA EXCESS LIABILITY				
	City is a member of an insurance pool participating with a number of other California cities (\$1,000,000 self-insured retention)	\$45,000,000 annual aggregate	Everest Ins. Co. Lexington Ins Co. Axis Surplus Insurance Co.	07/01/08
Trustees Errors and Omissions	Bodily injury and property damage liability Errors and omissions liability			
SPECIAL LIABILITY				
Volunteers Accident	Medical - Each person / (\$100 deductible)	\$20,000	Life Insurance Co. of North America	02/02/08
Special Events	Bodily injury	\$1,000,000 per occurrence	Axis Surplus Insurance Company	01/01/08
AUTOMOBILE LIABILITY				
City Manager Vehicle Only	Physical Damage (\$1,000 deductible comp. collision)	\$1,000,000	Progressive Com. Auto Insurance	04/11/08
EMPLOYEE BENEFIT				
Travel Accident	Indemnity, based on salary	\$1,500,000 per accident	Life Insurance Co. of North America	06/01/08
EMPLOYEE HEALTH PLAN				
	The City participates in the California Public Employees' Medical and Health Care Act (PEMHCA) program to provide medical benefits to employees and retirees			
WORKERS' COMPENSATION				
	City is self-insured for first \$500,000 liability	\$500,000 per occurrence		07/01/08
EXCESS WORKERS' COMPENSATION				
	Pooled Retention	\$5,000,000 limit per occurrence - Workers Comp and Employers Liability	CA. Public Entity Insurance Authority	07/01/08
	Reinsured Layer	\$250,000,000 workers comp per occurrence, excess of pooled retention limit, includes \$5,000,000 employers liability excess of \$5,000,000 pooled retention	National Union Fire Insurance Co.	07/01/08

Source: Human Resources Dept, City of Palo Alto



Single Audit Index.....

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Single Audit Section.....

This section provides an overview of grant awards received from the Federal government. The Single Audit Act Amendments of 1996 require local governments to report and audit Federal funds separately from their Basic Financial Statements.



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Schedule of Findings.....

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Honorable Mayor and Members of the
City Council of the City of Palo Alto, California

We are required by the Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-profit Organizations*, to present an overview of the Single Audit which is presented below.

We have audited the basic financial statements of the City of Palo Alto, California, for the year ended June 30, 2007 and have issued our unqualified report thereon dated October 12, 2007. These basic financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America; *Government Auditing Standards*, issued by the Comptroller General of the United States and the Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non profit Organizations*. We performed a Single Audit as requested by the City to comply with the provisions of the Single Audit Act as amended in 1996 and OMB A-133.

Section I—Summary of Auditor’s Results

Financial Statements

	Unqualified		
Type of auditor’s report issued:	_____		
Internal control over financial reporting:			
• Material weakness(es) identified?	_____	X	No
• Significant deficiency (ies) identified that are not considered to be material weaknesses?	X	_____	None reported
Noncompliance material to financial statements noted?	_____	X	No



Schedule of Findings

Federal Awards

Type of auditor’s report issued on compliance for major programs:

Unqualified

Internal control over major programs:

- Material weakness(es) identified?
- Significant deficiency (ies) identified that are not considered to be material weaknesses

_____ X No

_____ X none reported

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?

_____ X no

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster
20.500	Federal Transit Cluster
14.218	Department of Housing and Urban Development: Community Development Block Grant

Dollar threshold used to distinguish between Type A and type B programs:

\$300,000

Auditee qualified as low-risk auditee?

X yes _____



Section II – Financial Statement Findings

Our audit did disclose a significant deficiency and other matters communicated to City Council in our separate Memorandum on Internal Controls dated October 12, 2007.

Section III – Federal Award Findings and Questioned Costs

Current Year Findings and Questioned Costs

Our audit did not disclose any findings or questioned costs required to be reported in accordance with OMB Circular A-133.

Section IV - Status of Prior Year Findings and Questioned Costs

Prepared by Management

There were no unresolved prior year findings



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CITY OF PALO ALTO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

Program Name	Grantor/ Pass-Through Entity Grant Number	Catalog of Federal Domestic Assistance Number	Program Expenditures
Department of Housing and Urban Development			
Community Development Block Grant Program			
Program Expenditures	B-05-MC-06-0020	14.218	\$124,536
New loans in current year			
Stevenson Housing-Fire Alarm Project			3,000
Emergency Housing Consortium - Our House			33,713
CWG - Alma Gardens Apartment			250,000
Subgrants:			
Emergency Housing Consortium			7,760
OMBUDSMAN Program			5,800
Clara Mateo Alliance Shelter			18,322
Clara Mateo Alliance Family Shelter			18,725
Inn Vision			21,250
Shelter Network Haven Housing			16,375
Economic and Social Opportunities, Inc.			15,281
Project Sentinel - Fair Housing			26,800
Mid-Peninsula Alano Group			5,000
Palo Alto Senior Housing Project			
Baker Counseling			20,270
Total CDBG Expenditures		14.218	566,832
Governor's Office of Emergency Services (Passed through California Department of Transportation)	FEMA -3033 110-DR-CA, OES ID #085-55282	20.703	39,191
Valley Transportation Authority -- Intermodal Transit Center	CA-03-0635-00	20.500	124,712
Department of Energy	DE-FG36-03GO13066	81.122	43,939
U.S .Fish & Wildlife Service-Creek Restoration	81420-6-J145	15.631	1,682
TOTAL FEDERAL FINANCIAL AWARDS			\$776,356

See Notes to Schedule of Expenditures of Federal Awards



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NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Note 1.....

Reporting Entity

The Schedule of Expenditure of Federal Awards (the Schedule) includes expenditures of federal awards for the City and its component units as disclosed in the notes to the Basic Financial Statements.

Note 2.....

Basis of Accounting

Basis of accounting refers to *when* revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus applied. All governmental funds and agency funds are accounted for using the modified accrual basis of accounting. All proprietary funds are accounted for using the accrual basis of accounting. Expenditures of Federal Awards reported on the Schedule are recognized when incurred.

OMB Circular A-133 requires that certain adjustments be made to expenditures recognized when incurred. The adjustments applicable to the City are summarized below:

Loan Program with continuing Compliance Requirements - The City operates a loan program under which it must insure participants maintain compliance with program requirements on an on-going basis. OMB Circular A-133 section .205(b) requires that expenditures for the above program include the balance of loans outstanding at the beginning of the year plus cash received from the program.

Note 3.....

Direct and Pass-Through Federal Awards

Federal awards may be granted directly to the City by a federal granting agency or may be granted to other government agencies which pass-through federal awards to the City. The Schedule includes both of these types Federal award programs when they occur.



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MAZE & ASSOCIATES

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Honorable Mayor and City Council
City of Palo Alto, California

We have audited the basic financial statements of the City of Palo Alto as of and for the year ended June 30, 2007, and have issued our report thereon dated October 12, 2007. We conducted our audit in accordance with generally accepted auditing standards in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, or prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weakness. However, we believe that none of the significant deficiencies described above is a material weakness.

Our audit did disclose a significant deficiency and other matters communicated to City Council in our separate Memorandum on Internal Controls dated October 12, 2007.

A Professional Corporation



Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the audit committee, City Council and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Mage & Associates

October 12, 2007



MAZE & ASSOCIATES

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**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO
EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

Honorable Mayor and City Council
City of Palo Alto, California

Compliance

We have audited the compliance of the City of Palo Alto with the types of compliance requirements described in the U.S. Office of Management and Budget (*OMB Circular A-133 Compliance Supplement*) that are applicable to each of its major federal programs for the year ended June 30, 2007. The City's major federal programs are identified in Section I - Summary of Auditor's Results included on the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City of Example's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the City's compliance with those requirements.

In our opinion, the City complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2007.

Internal Control over Compliance

The management of the City is responsible for establishing and maintaining effective internal controls over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the City's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of City's internal control over compliance.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

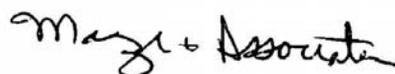
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider as material weaknesses, as defined above.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the business type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended June 30, 2007, and have issued our report thereon dated October 12, 2007. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for the purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the audit committee, management, City Council, others within the entity the City of Palo Alto and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties.



October 12, 2007

The City of Palo Alto is located in northern Santa Clara County, approximately 35 miles south of the City of San Francisco and 12 miles north of the City of San Jose. Spanish explorers named the area for the tall, twin-trunked redwood tree they camped beneath in 1769. Palo Alto incorporated in 1894 and the State of California granted its first charter in 1909.

AMERICANS WITH DISABILITIES ACT STATEMENT

In compliance with Americans with Disabilities Act (ADA) of 1990, this document may be provided in other accessible formats.

For information contact:

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(650) 329-2550
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