LONG RANGE

Financial Forecast

Fiscal Years 2015 to 2024

CITY OF
PALO
ALTO

Aurora, 2011
by Charles Gadeken

Temporary Artwork at
King Plaza, Civic Center
250 Hamilton Ave, Palo Alto

Photo by Ed Camaelon

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Sunflowers, 2003
by Jeffrey Reed & Jennifer Madden

440 S. California Avenue at Mimosa Lane, Palo Alto. Photo courtesy of Palo Alto Camera Club

Executive Summary

The Fiscal Year 2015-2024 General Fund Long Range Financial Forecast (LRFF), which marks the beginning of the FY 2015 budget planning process, projects a slight General Fund surplus of $1.3 million in FY 2015. Based on this analysis, staff will develop the FY 2015 Proposed Budget in alignment with the City Council priorities as approved by the City Council on February 1, 2014:

1. Comprehensive planning and action on land use and transportation: the Built Environment, Transportation, Mobility, Parking and Livability
2. Infrastructure Strategy and Funding
3. Technology and the Connected City

Concurrently, the City Council has directed staff to develop Our Palo Alto, a comprehensive and multi-faceted resident engagement process, develop a Transportation Demand Management program, and address parking within the City. Further, the City is facing major challenges to maintain its infrastructure, experiences growing unfunded liabilities for pension and retiree healthcare benefits, seeks to remain a competitive employer to keep and attract a talented workforce and has other unfunded needs. These strategic long-term efforts will require additional funding in the FY 2015 Proposed Budget and beyond.

As in past years, staff updated the City's Long Range Financial Forecast (LRFF) based on current information compiled from various sources and used available tools to project revenues and expenditures. The Long Range Financial Forecast allows staff and Council members to understand the long-term results of past decisions and identify issues that must be addressed in the near and long term, including the availability of funds. The Forecast is not a prediction or a commitment of resources; rather, it is a reasonable snapshot of the City's future financial condition based on various assumptions and currently available data.

A continuously improving economic climate is noted by the majority of national, State, regional, and local economic indicators. This Forecast assumes a continued, gradual growth of the national economy with positive impacts to the local economy, which is reflective in staff's estimates of the economically sensitive revenue estimates.

As the table below depicts, based on the FY 2015 Forecast Budget, staff anticipates a General Fund surplus of approximately $1.3 million for FY 2015 and surpluses in all out-years of the Forecast. During this Forecast Period, surpluses range between $1.3 million and $8.7 million with an approximate cumulative one-time surplus of $46.5 million. Assuming funding the General Fund Stabilization Reserve at the City Council approved target level of 18.5 percent of General Fund operating expenditures, $9.5 million would have to set aside. With this set-aside, the one-time resources projected in this Forecast would decrease by $9.4 million from $46.5 million to $37.0 million.

The table also depicts the concept of a net operating margin. The operating margin reflects the variance between the projected General Fund revenues and expenditures for each year of the forecast or the annual surplus or deficit. With the concept of the net operating margin, the year over year change in the annual surpluses and deficits, it is assumed that each shortfall is addressed completely with ongoing solutions in the year it appears and that each surplus is completely expended with ongoing expenditures. For example, if the City spends the currently projected FY 2015 surplus of $1.3 million, the available projected surplus for FY 2016 will only by approximately $3.1 million. In subsequent fiscal years, the net operating margin is estimated to range between slight deficits and slight surpluses. Based on these assumptions, the cumulative Net Operating Margin, or ongoing surplus, during the Forecast Period is approximately $7.4 million.

Base Long Range Financial Forecast

Fiscal Years 2015 to 2024

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Total Revenues	$166,306	$166,982	$175,271	$181,442	$187,164	$193,510	$199,510	$204,908	$210,898	$217,962	$225,536
Total Expenditures	$160,433	$165,671	$170,875	$176,776	$182,924	$189,291	$195,464	$201,126	$206,014	$211,330	$216,853
Net One-Time Surplus (shortfall)	$5,873	$1,310	$4,396	$4,666	$4,218	$3,900	$4,046	$3,782	$4,884	$6,632	$8,683
Cumulative One-Time Surplus (shortfall)											**$46,516**
Net Operating Margin	$0	$0	$3,085	$270	($447)	($319)	$147	($264)	$1,101	$1,748	$2,051
Cumulative Net Operating Margin											**$7,372**

Although this Forecast presents a positive fiscal outlook for the City's General Fund, it is important to note that it does not include the following potential impacts, which can increase or decrease the projected annual surpluses, to the FY 2015 Budget and the out-years of the Forecast: (1) ongoing labor negotiations (this Forecast does not assume any impacts from the contract with SEIU as approved by the City Council on March 17, 2014); (2) savings from Third Tier Pension Plan; (3) Cadillac Healthcare Federal Excise Tax; (4) dedication of increased Transient Occupancy Tax (TOT) revenue to fund a new Public Safety Building as approved by the City Council on March 3, 2014 (this additional TOT is expected to be generated starting FY 2015 as new hotels are opened); (5) additional funding and/or higher annual debt service for the Golf Course reconfiguration project; (6) the potential acquisition of the downtown Palo Alto Post Office; (7) potential termination of the Fire Services Contract with Stanford University; (8) results of ongoing negotiations for a long-term lease for the Cubberley property between the City and the Palo Alto Unified School District; and (9) changes in the local, regional, and national economy.

Consistent with the 2013-2023 Long Range Financial Forecast, the methodology for calculating changes for out-years of the Forecast (FY 2016 to FY 2024) are based on a historical analysis of increases using the Compounded Annual Growth Rate (CAGR) with adjustments factored in for known items. By using an historical average growth rate that incorporates the up and down cycles over the past 10 or 20 years, there is no single year in which a downturn is depicted. Instead, past downturns (e.g. dot-com bust and Great Recession) have been factored into the compound growth rate used to forecast future revenue streams. Staff performed a reasonableness test of the results and made appropriate changes to the CAGR analysis as discussed in the report.

Towards the end of this report, staff also presents an alternative FY 2015-2024 Long Range Financial Forecast, which assumes that the City Council dedicate a substantial portion of the estimated increase in TOT revenue towards the funding of annual debt service payments in the amount of $2.5 million. This annual debt service, over 30 years, is estimated to generate approximately $34 million in Certificates of Participation to partially fund the cost of a new Public Safety building.

In this alternative Forecast, with the dedication of the increased TOT receipts towards an annual debt service of $2.5 million, surpluses range between $1.3 million and $6.4 million with an approximate cumulative one-time surplus of $24.0 million, approximately $23 million less than the base model and the cumulative Net Operating Margin is reduced by $2.5 million, from $7.4 million to $4.9 million.

Alternative Long Range Financial Forecast

Fiscal Years 2015 to 2024

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
TOT from New Hotels	297	1,546	2,626	3,111	3,597	3,783	3,981	4,192	4,415	4,653	4,906
Total Revenues	$166,306	$166,982	$175,271	$181,442	$187,164	$193,190	$199,510	$204,908	$210,898	$217,962	$225,536
Estimated Debt Service for Public Safety Building			2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500
Total Expenditures	$160,433	$165,671	$173,375	$179,276	$185,446	$191,791	$197,964	$203,626	$208,514	$213,830	$219,353
Net One-Time Surplus (Shortfall)	$5,873	$1,310	$1,896	$2,166	$1,718	$1,400	$1,546	$1,282	$2,384	$4,132	$6,183
Cumulative One-Time Surplus (shortfall)											**$24,016**
Net Operating Margin	$0	$0	$585	$270	($447)	($319)	$147	($264)	$1,101	$1,748	$2,051
Cumulative Net Operating Margin											**$4,872**

At this time, staff projects $5.9 million in excess revenues and expenditure savings in the General Fund for FY 2014. This amount does assume forthcoming recommendations to adjust revenues and does not include expenditure increase recommendations included in the FY 2014 Midyear Budget Review as approved by the Finance Committee on March 18, 2014. Further, these projected excess revenues do not include increased costs in the current fiscal year due to approval of the contract with the Service Employees International Union.

During the next two months, staff will continue to monitor revenue sources as well as update revenues and expenditures, as applicable, based on newly available information and include these updates in the FY 2015 Proposed Budget scheduled for release on May 5, 2014.

Kaikoo V, 1988

by Betty Gold

Municipal Golf Course, 1875 Embarcadero Rd, Palo Alto. Photo courtesy of Palo Alto Camera Club

Economic Outlook

In preparing the 2015-2024 Long Range Financial Forecast, staff reviewed key economic indicators and measures available for the national, state, and local economy. Overall, as has been reported in various media outlets and economic forecast publications, on national, state, and local levels, the nation, State, and region are experiencing positive economic growth, which has accelerated after the first years following the deep recession.

National

Growth in the U.S. economy has increased in each of the four quarters of 2013, with GDP growing by a 3.2 percent annual rate in the fourth quarter of 2013, which is up from the 2.8 percent growth in the third quarter. It is anticipated that growth for the rest of 2014 will be in the 3.0 percent range[1], with growth for 2014 and 2015 between 3 and 4 percent[2]. The growth in GDP can be attributed to many factors, including rising home prices, reduced unemployment, and increasing corporate profits, however not all facets of the economy are improving at the same level, and certain pressures remain which have prevented economic indicators to fully return to pre-recession levels.

Supporting the higher expected growth in GDP, Lynn Franco, Director of Economic Indicators at The Conference Board reports that "Consumer confidence advanced in January for the second consecutive month. Consumers' assessment of the present situation continues to improve, with both business conditions and the job market rated more favorably. Looking ahead six months, consumers expect the economy and their earnings to improve, but were somewhat mixed regarding the outlook for jobs. All in all, confidence appears to be back on track and rising expectations suggest the economy may pick up some momentum in the months ahead[3]."

The national unemployment rate in December 2013 was 6.7 percent. This is 18 percent lower than the rate of 7.9 percent in December 2012[4]. UCLA Anderson Forecast projects that the U.S. unemployment rate will decline to 6 percent by yearend 2015[5]. As the following table illustrates, unemployment rates have been lower for workers with higher levels of education, which has benefited Palo Alto.

U.S. Unemployment Rates by Education Level

Education Level	Aug. 2011	Aug. 2012	Aug. 2013
Less than High School	14.2%	12.0%	11.3%
High School	9.3%	8.7%	7.6%
Some College	8.2%	6.6%	6.1%
Bachelor's Degree or Higher	4.3%	4.1%	3.5%

Source: Bureau of Labor Statistics as sourced in Beaconomics Fall 2013

The increase in U.S. home prices is evidence of an improving economy. Prices surged by 11.0 percent in December as compared to the prior year. While Nevada led all states with growth of 23.9 percent, California was second in the nation with growth of 19.7 percent, according to analytics consulting firm CoreLogic[6]. Also of note is the fact that corporate profits are 25 percent higher than at their pre-recession peak[7].

While GDP growth, declining unemployment, and rising home prices and corporate profits indicate a rebounding economy, it should be noted that there are other economic measures that have not seen such marked improvement. Americans continue to be hampered by weak pay, tepid hiring, as well as by government spending cuts to programs such as food stamps[8]. For instance, the current national median income is lower than it was in June 2009, the ending month of the recession, and in the past twelve months median salaries have not kept up with inflation[9].

Economists and investors consider non-defense capital goods orders to be one of the most important economic indicators, as it shows the level that businesses are investing in machinery, technology, and other items, and it signals the manufacturing sector's health. Orders in this category fell by 1.3 percent from August to September. Analysts attributed this decline to business worries related to the federal government shutdown. However, 3rd quarter activity reflects a continuation of the up-and-down trend seen this year.

State

While the national economic measures indicate an economy on the rebound, tapered by sluggish improvements in a number of areas, the important economic measures for the state have shown more consistent gains. In 2013, California became the 8th largest world economy again. GDP is expected to grow by 2.9 percent in 2013, and improve even more significantly in 2014 to growth of 3.9 percent.

The unemployment rate in California fell to 8.3 percent in December 2013, down from 8.5 percent in November 2013 and 9.8 percent in December 2012. The 1.5 percent year-over-year decline outpaced the national drop of 1.2 percent[10]. July 2013 marked the 36th consecutive month of employment growth in the state[11]. UCLA Anderson Forecast predicts that the state unemployment will drop to 8.2 percent in 2014 and 7.3 percent in 2015. While these rates will still exceed the predicted national average, the pace at which California is projected to improve nearly doubles the national forecasted rates. Overall, California has added back nearly two-thirds of the jobs lost during the Great Recession. The employment recovery remains broad-based across all sectors and regions, according to Beacon Economics; however UCLA Anderson points to a continued bifurcation between fast-growing coastal regions and still-struggling inland areas.

As noted previously, the growth in California home prices is second in the nation, and by December 2013 the median home price rose to $365,000, a 22 percent increase over December 2012[12] and a more dramatic increase of 60 percent over the April 2009 low point of $221,000[13]. While home prices have been rapidly rising, the state home ownership rate of 55 percent is still well below the housing bubble high of 60.2 percent[14]. Since 2011 single-family home prices have increased by 25 percent. While continued growth is expected in 2014, the pace of growth is projected to decrease to 7 percent due to increased supply[15].

California taxable sales have expanded over 34 percent since 2009, exceeding the pre-recession peak by 4.7 percent, and hotel occupancy across the state has demonstrated consistent gains and remains above 70 percent[16].

Local

The positive impacts from an improving national and state economy, as outlined above, have been especially apparent at the local level. Silicon Valley employment is robust, with unemployment rates in the region lower than both the national and state averages. Palo Alto employment rates significantly outperform both San Jose and San Francisco.

Bay Area Non-Adjusted Unemployment Rates

Area	Oct. 2012	April 2013	Oct. 2013
San Jose	8.9%	7.2%	7.1%
San Francisco	6.8%	5.4%	5.4%
Palo Alto	4.2%	3.4%	3.4%

Source: Bureau of Labor Statistics

Between October 2012 and October 2013, the Palo Alto non-adjusted unemployment rate decreased by 24 percent from 4.2 percent to 3.4 percent. As the chart below depicts, in January 2011, the Palo Alto non-adjusted unemployment rate was at 5.7 percent.

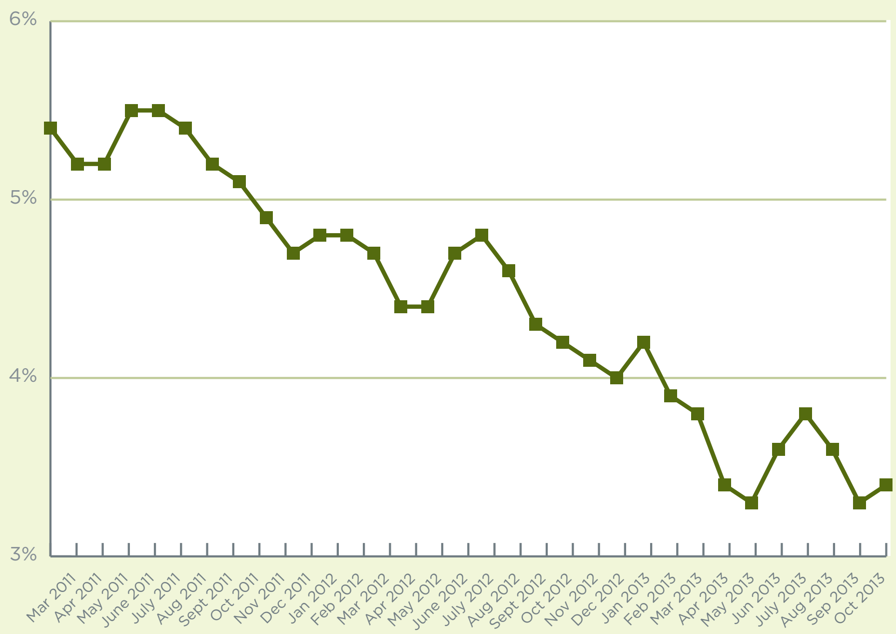
According to the UCLA Anderson Forecast, the improved employment figures in the Bay Area will be sustained and unemployment rates will continue to decline over the next two years.

As of January 2014, Zillow.com reported that the median sale price for Palo Alto homes was $1.83 million, up 20.4 percent from last year's $1.5 million median price, and Palo Alto commercial real estate spaces continue to have high occupancy rates. With improved employment and home prices, activity in Palo Alto has increased significantly.

The national, state, and local economic measures and indicators described above were all considered in the development of the 2015-2024 Long Range Financial Forecast. Staff then reviewed historical collection patterns and factors specific to Palo Alto (e.g. new hotels in development, sales tax from local businesses, and homeownership data) in preparing the Forecast revenue estimates. Overall tax revenue over the ten years in this forecast exceeds the tax revenues in the previous Long Range Financial Forecast by $106.7 million. Improvements were assumed in all tax categories (Sales, Property, Transient Occupancy, and Utility User Tax) except for the Documentary Transfer Tax.

Palo Alto Unemployment Rate (Non-Adjusted)

Jan 2011 - Oct 2013



Source: California Employment Development Department Labor Market Information Division

Cloud Forest, 2013
by Roger Stoller

Mitchel Park Library and Community Center.
image by Artist

Fiscal Year 2015-2024 General Fund Long Range Financial Forecast

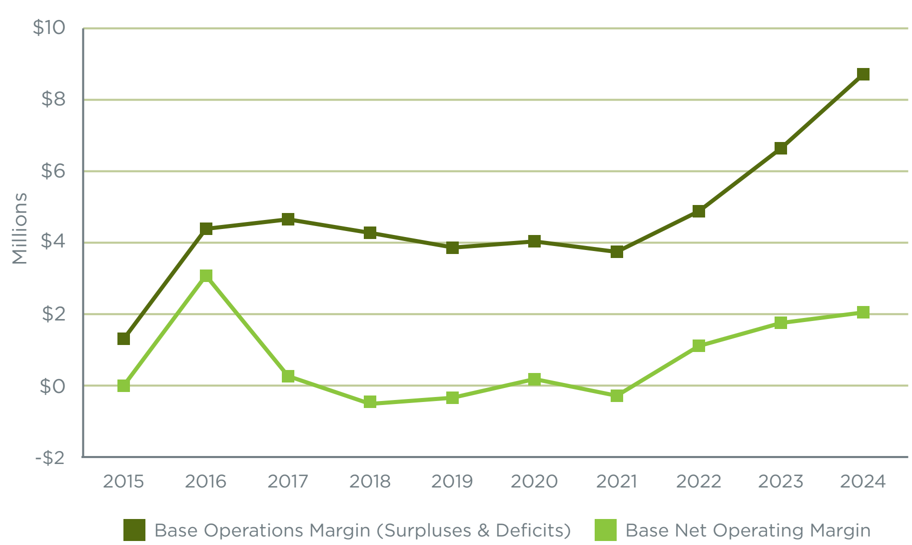
The FY 2015-2024 General Fund Long Range Financial Forecast projects a General Fund surplus in the amount of $1.3 million for FY 2015 and surpluses in all subsequent years of the Forecast. During this Forecast Period, surpluses range between $1.3 million and $8.7 million with an approximate cumulative one-time surplus of $46.5 million (see table below).

By City Council approved policy, the General Fund Budget Stabilization Reserve (BSR) is maintained in the range of 15 to 20 percent of General Fund operating expenditures, with a target of 18.5 percent. Assuming the 18.5 percent in this Forecast, the BSR would have to increase from $30.7 million in FY 2015 to $40.1 million in FY 2024. So, over the Forecast period, about $9.5 million would have to be set aside to adequately fund the BSR, reducing the one-time resources projected in this Forecast from $46.5 million to $37.0 million.

The table also depicts the concept of a net operating margin. The operating margin reflects the variance between the projected General Fund revenues and expenditures for each year of the forecast or the annual surplus or deficit. With the concept of the net operating margin, the year over year change in surpluses and deficits, it is assumed that each shortfall is addressed completely with ongoing solutions in the year it appears and that each surplus is completely expended with ongoing expenditures.

For example, as shown in the graph below, if the City spends the currently projected FY 2015 surplus of $1.3 million, the available projected surplus or net operating margin for FY 2016 will only be approximately $3.1 million. In subsequent fiscal years, the net operating margin is estimated to range between slight deficits and slight surpluses. Based on these assumptions, the cumulative Net Operating Margin, or ongoing surpluses, during the Forecast Period is approximately $7.4 million.

Operating Margin



It should be noted though, that this Forecast, as outlined in the following sections of this report does not include the following potential impacts to the FY 2015 Budget and the out-years of the Forecast:

1. Labor negotiations: After release of the Forecast to the Finance Committee, the City Council approved a contract with the Service Employees International Union (SEIU) on March 17, 2014 and is scheduled to enter in negotiation with its other bargaining units during the remainder of the current fiscal year. This Forecast assumes impacts to costs due to the approved contract with SEIU except for the health plan funding changes. These costs are dependent on the upcoming costs for health plans as provided by CalPERS and the health plan choices SEIU employees will make as part of the 2015 healthcare enrollment period. Any additional costs beyond the 2% projected increase in salary and benefits, unless offset with other benefits savings, will result in additional costs to the General Fund.
2. Third Tier Pension Plan: the CalPERS valuations as of June 30, 2012 and related rate projections do not include any pension savings from the Third Tier Pension Plan, since the third tier plan became effective January 1, 2013. The City's actuary projects only slight decreases to the City Contribution rates primarily in the out-years of the Forecast due to the Third Tier Pension Plan.
3. Cadillac Healthcare Federal Excise Tax: Beginning 2018, a 40 percent excise tax will be imposed on the value of health insurance benefits that exceed a certain threshold. It is expected that this tax will be included in the cost of the health care premiums. CalPERS plans to design healthcare premiums to stay below the threshold and discussions are in the preliminary stage. Staff will monitor this issue during the next few years.
4. Partial funding of new Public Safety Building with increased Transient Occupancy Tax (TOT) revenue from new hotels: The City Council has approved a recommendation to dedicate additional TOT receipts generated from new hotels to fund a new Public Safety Building. The Alternative Forecast Model at the end of the report depicts the impact to the Long Range Financial Forecast for dedicating this additional revenue to fund a new Public Safety Building.
5. Golf Course Reconfiguration Project: The Capital Improvement project (PG-13003) to renovate the Golf Course assumes revenues from the San Francisquito Creek Joint Powers Authority ($3 million) and from soil imports ($1.3 million). As reported to the City Council on February 3, 2014, the revenue generated from soil imports at that time amounted to $200,000. If any of these revenues are not received prior to contract award, the Infrastructure Reserve would have to advance funds. If not all planned revenues are received, the City may have to issue more debt, which will result in a higher annual debt service. The Forecast assumes an annual debt service payment of $400,000 starting in FY 2016 offset with higher estimated revenues compared to FY 2013, the last year of full operation of the Golf Course. In Fiscal Year 2014, under the modified layout, the Golf Course has received approximately $80,000 less in revenue per month.
6. Acquisition of the downtown Palo Alto Post Office: The City may acquire the downtown Palo Alto Post Office with the plan to relocate staff from leased facilities. The acquisition would be financed through issuance of debt with the annual debt service paid through lease cost savings. If the Palo Alto Post Office is acquired, it would require substantial improvements and while the City pays the annual debt service and will also have to continue paying for leasing the existing facilities. Staff is reviewing potential strategies, which would reduce the impact to the General Fund in the short term.
7. Fire Services Contract with Stanford University: The term of the Fire Response service contract between the City and Stanford is through September 30, 2026; however, at Stanford's request, the two parties have been in negotiations over the past year to restructure the contract. On October 8, 2013, the City received a Notice of Termination letter from Stanford with the intention to terminate the contract with the City no sooner than one year and no later than two years from the date of the notice. In order to plan for a possible termination of

services, the City requested that Stanford inform the City of the final termination date at least three months in advance to allow for a structured potential reduction in force in the City's Fire Department. On November 20, 2013, Stanford issued a Request for Proposal (RFP) for Delivery of Fire Department Services for the campus with a proposal submission deadline of January 31, 2014. The City submitted a proposal in response to the RFP by the due date. This Forecast assumes the continuation of the contract, because staff believes that the City of Palo Alto is best suited to provide Fire Protection Services to Stanford. For Fiscal Year 2014, the City is receiving approximately $8 million in net revenue.

8. Cubberley Lease: The City is currently in negotiation with the Palo Alto Unified School District (PAUSD) regarding the Cubberley property. If the City and PAUSD can agree on a long-term lease, and after an infrastructure condition assessment of the property, additional funds may be needed to fund capital improvements and ongoing maintenance of the site.
9. Changes in the local, regional, and national economy: This Forecast assumes a steadily growing local economy. Any changes may have positive or negative impacts on economically sensitive revenues such as Sales Tax and the Transient Occupancy Tax.

At this time, staff projects $5.9 million in excess revenues and expenditure savings in the General Fund for FY 2014. This amount does assume forthcoming recommendations to adjust revenues and does not include expenditure increase recommendations included in the FY 2014 Midyear Budget Review as approved by the Finance Committee on March 18, 2014. Further, these projected excess revenues do not include increased costs in the current fiscal year due to approval of the contract with the Service Employees International Union.

The next section of the report discusses the analysis and assumptions of major revenue and expenditure categories. Consistent with the 2013-2023 Long Range Financial Forecast, the methodology for calculating changes for out-years of the Forecast (FY 2016 to FY 2024) are based on a historical analysis of increases using the Compounded Annual Growth Rate (CAGR) with adjustments factored in for known items. Staff performed a reasonableness test of the results.

Brilliance, 2014

by Creative Machines

to be installed in 2014 at the Main Library 1213 Newell Rd, Palo Alto. photo by Creative Machines

Revenues

The tables below highlight the annual revenue estimates and year over year increases for this Forecast. Compared to FY 2014 projected, FY 2015 revenues are estimated to increase by $0.7 million, or approximately 0.4 percent. Based on the economic analysis presented in the previous section of this report, revenue estimates, which are primarily linked to the performance of the regional and local economy, are reflective of a gradually growing economy, the current increases in home prices, and the future opening of hotels.

Since FY 2010, when the Great Recession severely impacted City tax revenues, there has been a steady recovery in these resources. In fact, in such areas as transient occupancy and documentary transfer taxes gains have outpaced previous projections, reflecting a robust real estate and business environment. Some tax revenues will be adjusted upward at midyear and the Long Range Financial Forecast reflects these positive trends.

Revenues	Adopted 2014	Projected 2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Sales Taxes	$23,846	$27,352	$25,660	$26,256	$26,711	$27,269	$27,915	$28,599	$29,317	$30,091	$30,903	$31,769
Property Taxes	$29,613	$30,250	$31,835	$33,541	$35,353	$37,264	$39,297	$41,464	$43,774	$46,107	$48,503	$51,088
Transient Occupancy Tax	$11,545	$12,318	$14,156	$16,487	$17,645	$18,848,	$19,822	$20,863	$21,965	$23,137	$24,382	$25,709
Documentary Transfer Tax	$5,699	$7,395	$7,414	$6,562	$6,619	$6,685	$6,792	$6,914	$7,052	$7,222	$7,431	$7,654
Utility User Tax	$11,013	$11,386	$11,285	$11,761	$12,373	$12,584	$12,973	$13,384	$13,815	$14,264	$14,628	$15,097
Other Taxes & Fines	$2,107	$2,107	$2,206	$2,228	$2,251	$2,273	$2,296	$2,319	$2,342	$2,365	$2,389	$2,413
Subtotal: Taxes	$83,823	$90,808	$92,556	$96,835	$100,951	$104,923	$109,095	$113,543	$118,265	$123,186	$128,236	$133,730
Charges for Services	$16,203	$15,252	$14,098	$17,250	$18,005	$18,296	$18,594	$18,901	$19,216	$19,540	$19,873	$20,215
Stanford Fire and Dispatch Service	$8,176	$7,332	$7,782	$8,015	$8,256	$8,504	$8,759	$9,021	$9,292	$9,571	$9,858	$10,154
Permits & License	$8,346	$7,777	$7,355	$7,207	$7,064	$6,911	$7,153	$7,403	$7,699	$8,084	$8,489	$8,913
Return on Investment	$769	$701	$685	$699	$716	$733	$751	$770	$790	$814	$840	$869
Rental Incom	$12,891	$14,010	$14,080	$14,490	$14,852	$15,223	$15,604	$15,994	$15,151	$14,626	$14,992	$15,367
From Other Agencies	$253	$313	$253	$253	$254	$255	$256	$258	$259	$261	$262	$264
Charges to Other Funds	$10,574	$10,574	$11,081	$11,445	$11,849	$12,272	$12,705	$13,120	$13,505	$13,852	$14,212	$14,586
Other Revenues	$2,010	$2,010	$1,480	$1,510	$1,540	$1,571	$1,602	$1,634	$1,667	$1,700	$1,734	$1,769
Total Non-Tax Revenues	$59,221	$57,969	$56,813	$60,869	$62,535	$63,764	$65,424	$67,101	$67,579	$68,448	$70,260	$72,136
Operating Transfers-In	$17,529	$17,529	$17,612	$17,567	$17,956	$18,478	$18,671	$18,866	$19,064	$19,263	$19,465	$19,670
Total Source of Funds	$160,573	$166,306	$166,982	$175,271	$181,442	$187,164	$193,190	$199,510	$204,908	$210,898	$217,962	$225,536

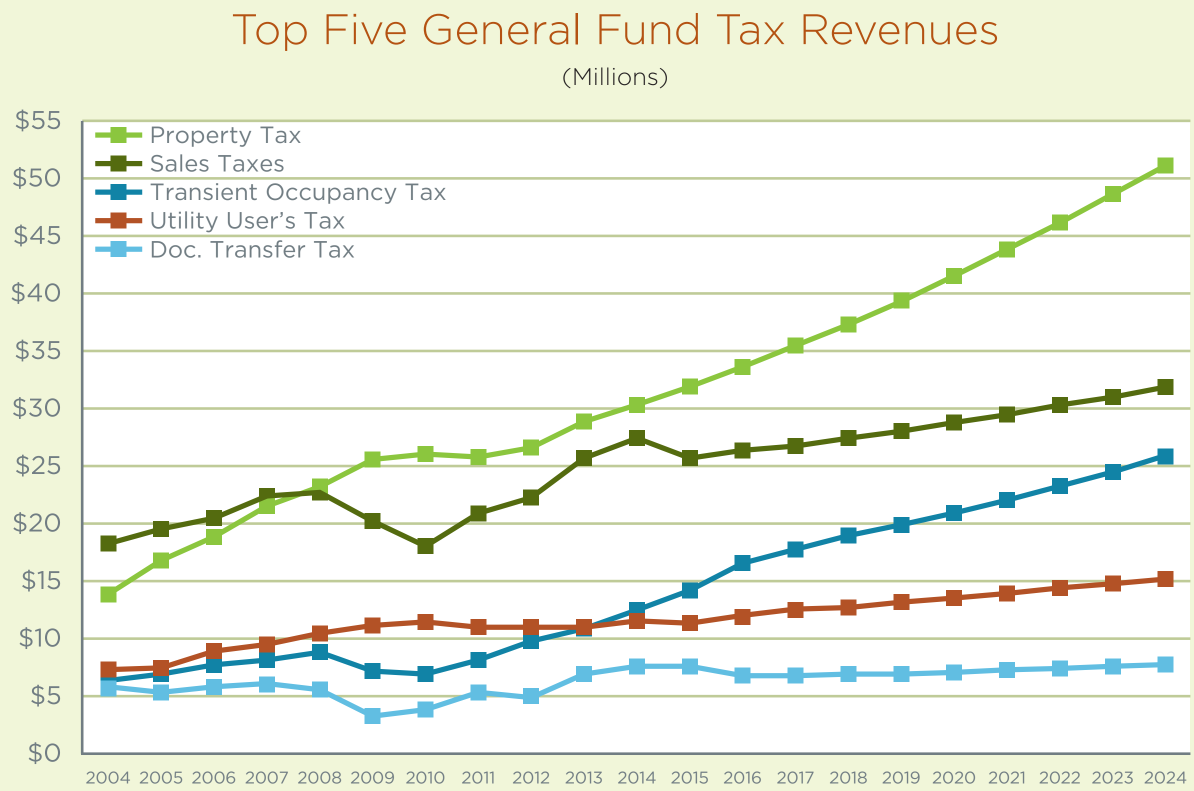
The upward trend of the City's tax revenues is expected to continue over the next 10 years. These tax revenues have significantly improved since the beginning of the Great Recession. The table below illustrates the steady growth projected for the General Fund's revenue streams, by percentage, from FY 2015 through FY 2024.

Revenues	Adopted 2014	Projected 2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Sales Taxes	-6.87%	6.82%	-6.19%	2.32%	1.73%	2.09%	2.37%	2.45%	2.51%	2.64%	2.70%	2.80%
Property Taxes	3.03%	5.25%	5.24%	5.36%	5.40%	5.41%	5.46%	5.51%	5.57%	5.33%	5.20%	5.33%
Transient Occupancy Tax	6.96%	14.13%	14.92%	16.47%	7.02%	6.82%	5.17%	5.25%	5.28%	5.34%	5.38%	5.44%
Documentary Transfer Tax	-16.31%	8.60%	0.26%	-11.50%	0.87%	1.00%	1.60%	1.80%	2.00%	2.40%	2.90%	3.00%
Utility User Tax	1.40%	4.84%	-0.89%	4.22%	5.20%	1.71%	3.09%	3.17%	3.22%	3.25%	2.55%	3.21%
Other Taxes & Fines	-2.11%	-2.11%	4.72%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%
Subtotal: Taxes	-1.34%	6.88%	1.93%	4.62%	4.25%	3.93%	3.98%	4.08%	4.16%	4.16%	4.10%	4.28%
Charges for Services	-9.24%	-14.57%	-7.56%	22.36%	4.38%	1.61%	1.63%	1.65%	1.67%	1.69%	1.70%	1.72%
Stanford Fire and Dispatch Service	2.89%	-7.73%	6.14%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Permits & License	-3.42%	-10.00%	-5.43%	-2.01%	-1.99%	-2.16%	3.50%	3.50%	4.00%	5.00%	5.00%	5.00%
Return on Investment	-18.89%	-26.10%	-2.20%	2.00%	2.38%	2.41%	2.46%	2.51%	2.66%	3.01%	3.26%	3.36%
Rental Incom	0.09%	8.78%	0.50%	2.91%	2.50%	2.50%	2.50%	2.50%	-5.27%	-3.47%	2.50%	2.50%
From Other Agencies	6.31%	31.88%	-19.39%	0.30%	0.35%	0.40%	0.45%	0.50%	0.55%	0.60%	0.65%	0.70%
Charges to Other Funds	-9.51%	-9.51%	4.79%	3.29%	3.53%	3.57%	3.53%	3.26%	2.93%	2.57%	2.60%	2.63%
Other Revenues	29.29%	29.29%	-26.37%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
Total Non-Tax Revenues	-4.09%	-6.11%	-1.99%	7.14%	2.74%	1.96%	2.60%	2.56%	0.71%	1.29%	2.65%	2.67%
Operating Trans-fers-In	-12.06%	-12.03%	0.48%	-0.26%	2.21%	2.91%	1.05%	1.05%	1.05%	1.05%	1.05%	1.05%
Total Source of Funds	**-3.64%**	**-0.20%**	**0.41%**	**4.96%**	**3.52%**	**3.15%**	**3.22%**	**3.27%**	**2.71%**	**2.92%**	**3.35%**	**3.47%**

During last year's Finance Committee discussions, it was recommended that staff consider use of a historical annual growth rate derived for each tax revenue source to project future revenue streams. This methodology was used in the final forecast presented for Fiscal Years 2013 to 2023 and has been used in this forecast as well. The Compound Annual Growth Rates (CAGR) utilized in this forecast are cited in each revenue section.

It is worth noting that in past forecasts a recession and falloff in economically sensitive revenues was assumed once every nine years. While staff did not pretend to predict the exact timing of the recession, its inclusion in the forecast was to send a signal that a cyclical event, whereby revenues can drop dramatically, will inevitably occur. By using an historical average growth rate that incorporates the up and down cycles over the past 10 or 20 years, there is no single year in which a downturn is depicted. Instead, past downturns (e.g. dot-com bust and Great Recession) have been factored into the compound growth rate used to forecast future revenue streams.

The graph below depicts a historical and projected view of the five major General Fund tax revenues. It includes 10 years of actual revenue history; the projections for the remainder of FY 2014 based on actual data available for the first six months of the fiscal year; as well as the projections for FY 2015 and the subsequent years of the Forecast, based on current available data and application of the CAGR methodology. The following section is a detailed discussion of General Fund Tax revenue and other major revenue sources by category.



Sales Tax

The table below shows that sales taxes have improved markedly since FY 2010. Between FY 2010 and FY 2014, the Sales Tax receipts are projected to increase by nearly $10 million or 53 percent, with significant increases in FY 2013 and the estimate for FY 2014. Results for FY 2013 were $3.6 million over those in FY 2012. This growth was primarily due to unexpected receipts from a single vendor in the last two quarters of FY 2013. Staff was able to meet with the vendor and gain a better understanding of their sales model, the basis of receipts for the last two quarters of FY 2013, the first two quarters of FY 2014, the last two quarters of FY 2014, and on a go forward basis. A FY 2014 midyear, upward adjustment in sales tax will be recommended for City Council consideration.

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014*
Revenue (in millions)	$17.9	$20.6	$22.0	$25.6	$27.4

*projected revenue based on currently available information

However, staff believes that such marked year over year sales tax increases are not sustainable. After controlling for the new revenue discussed above, the sales tax picture is of some concern. In the past several quarters, revenues from a few key electronics firms and an auto dealer have fallen significantly. Unlike TOT, documentary, and property taxes, this revenue source is not demonstrating significant growth. Historically, the top ten vendors within Palo Alto have generated nearly 38-40 percent of sales tax revenues (excludes county pool revenue). This shows that the City is vulnerable to swings in the performance of crucial firms. Further trend data is needed before a determination can be made as to whether the falloffs in electronic sales are cyclical or ongoing. Additionally, consumers continue to shift their purchases from brick and mortar to online retailers. On a positive note, restaurants and apparel stores have shown increases. The Sales Tax generated by Palo Alto consumers, who may purchase goods from online retailers, may only partially benefit the City of Palo Alto. Unless the point of sale for online retailers is within Palo Alto, the City will not receive the full sales tax amounts generated through the online purchases.

The CAGR applied to the period FY 2015 through FY 2024 is 2.5 percent which is in line with last year's forecast and with historical growth rates.

Property Tax

Following a historical pattern during recessions, property tax revenues decreased ever so slightly between FY 2010 and FY 2011. Unlike many hard-hit jurisdictions, the City's property values did not fall precipitously and maintained their worth. Since FY 2011, revenues have solidly increased due to short supply and strong demand. Between FY 2010 and FY 2014, the Property Tax receipts are projected to increase by over $4 million or 16.5 percent, with marked increases in FY 2013 and the estimate for FY 2014. Residential properties for sale continue to receive multiple offers with bids and final sale prices exceeding list prices. According to one Real Estate Web Site, home sale values surged from $1.23 million in 2009 to $1.8 million in 2013. A recent article in the Silicon Valley Business Journal indicated that a commercial property on Lytton Avenue probably sold for more than $1,000 per square foot, a noteworthy amount. Results below demonstrate the resiliency of the residential and commercial market in Palo Alto. A FY 2014 midyear, upward adjustment in property tax will be recommended for City Council consideration.

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Revenue (in millions)	$26.0	$25.7	$26.5	$28.7	$30.3*

*projected revenue based on currently available information

The City's forecast for FY 2014 is based on historical trends and information garnered quarterly from the County on appeals, additions to the roll, and movement in assessed values. Staff does contact the School District for their assumptions in property tax growth. Last year, however, PAUSD's expected growth rate for FY 2014 was well below the City's assumed growth rate.

The CAGR applied to the period FY 2015 through FY 2024 is 5.4 percent which is higher than the 5.0 percent utilized in last year's forecast. A buoyant residential and commercial property market that is borne out by the number and value of documentary transfer tax transactions indicates that a higher growth rate is warranted at this time. In January, staff hired a consultant who can provide historical data on the number and value of transactions and the "hidden" value that can be realized in the upcoming years due to Proposition 13. As staff engages with the consultant, a better understanding of the assessed valuations can be achieved, which will result in a refinement of the property tax revenue estimate analysis for future long-range financial plans.

Transient Occupancy Tax

Despite the recessionary period, as outlined in the table below, during the last five years the City's Transient Occupancy Tax (TOT) receipts performed very well. Between FY 2010 and FY 2014, TOT receipts are projected to increase by over $5 million or 78 percent, with an annual growth rate of 11 percent to 19 percent. Occupancy levels have risen considerably since FY 2010 continuing an approach toward full capacity in FY 2014. Anecdotal information indicates that bookings are increasing in the customarily weak weekend period. With demand increasing due to a vibrant business environment, both in Palo Alto and on the Peninsula, average daily room rates have increased as well, contributing to higher tax receipts. A FY 2014 midyear, upward adjustment in TOT receipts will be recommended for City Council consideration.

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Revenue (in millions)	$6.9	$8.1	$9.7	$10.8	$12.3*
Avg. Daily Room Rate	$139	$147	$165	$182	$198 YTD
Occupancy Percentage	66%	73%	79%	80%	82% YTD

*projected revenue based on currently available information

The Forecast includes estimated revenues for all of the new hotels the City anticipates opening through FY 2018. These include: The Epiphany, Hilton Garden Inn, Hilton Homewood Suites, Staybridge Suites, and a Westin Annex. It is important that the City Council has approved an infrastructure funding plan which dedicates revenue from the new hotels to fund the construction of a new Public Safety building. Although, the recent annual growth rate has been between 11 percent and 19 percent, the underlying CAGR used in last year's forecast was 4.9 percent and staff has used the same percentage growth rate in this forecast, primarily due to the economic sensitivity of this revenue source.

Documentary Transfer Tax

This economically sensitive revenue source has experienced ups and downs tied to the City's housing market. Between FY 2010 and FY 2014, Documentary Transfer Tax receipts are projected to double from $3.7 million to $7.4 million, with an annual growth rate ranging from -8 percent to 42 percent. Expecting this somewhat unpredictable revenue to revert more toward the mean annual increases in FY 2014 staff budgeted $5.7 million. It now appears reasonable to assume collections will exceed the prior year and yield approximately $7.4 million. Through November 2013, transactions and transaction value exceeded the same prior year period by 9.4 and 52.7 percent, respectively. A FY 2014 midyear, upward adjustment in Documentary Transfer Tax receipts will be recommended for City Council consideration. At this time, given activity in the market, staff anticipates FY 2015 revenues of $7.4 million.

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Revenue (in millions)	$3.7	$5.2	$4.8	$6.8	$7.4*

*projected revenue based on currently available information

The CAGR applied in the FY 2013 LRFF was 7.4 percent. Staff has not replicated this growth rate in projecting revenues through FY 2023, but has projected higher revenue levels that range from $6.5 to $7.6 million. These levels are appreciably higher than those experienced from FY 2010 to FY 2012 and will be dependent on high transaction values and volume in the local housing market.

Utility Users Tax

The City's utility tax revenue is based on a 5 percent tax on electric, water, gas and telephone usage. The revenue anticipated from utility usage is based on the Utilities Department's 5 year revenue and rate projections. These numbers could change as the department discusses its proposed rate plan with the Utilities Advisory Commission and the Council during the annual budget process. UUT from utility usage will be adjusted slightly upward at midyear to $8.2 million and is anticipated to remain relatively flat at $8.3 million in FY 2015.

Telephone receipts showed an uptick in FY 2013 which will result in an adjustment at midyear from $2.8 million to $3.1 million. Unfortunately, there is little data available from telecommunications providers that can provide more informed projections so a similar level of revenue is anticipated in FY 2015.

A FY 2014 midyear, upward adjustment in this tax category of less than $0.4 million will be recommended for City Council consideration.

Other Taxes & Fines

Staff anticipates that revenue in this category will increase slightly in FY 2015 to $2.2 million. The largest source of revenue in this category is derived from parking violations revenue, which staff is estimating to be $1.7 million in FY 2015, a slight increase from the FY 2014 estimate of $1.6 million. Other revenue items in this category, such as traffic violations, administrative citations, and library fines and fees, also continue to grow, contributing to a 1.0 percent annual growth in this category over the 10 year forecast.

Charges for Services

In FY 2014, total revenues in this category are projected to decrease by $1.0 million. In the forthcoming FY 2014 Midyear Budget Review, staff will bring forward recommendations to decrease the revenue estimate for this revenue categories for the reasons outlined below. First, $0.5 million of the revenue estimate decrease is attributed to staff vacancies and the temporary closure of the Palo Alto Animal Services spay and neuter clinic. More information regarding the status of filling these positions and timing of the clinic's reopening will be included in the midyear budget report.

The second contributing factor to the decrease in the FY 2014 projected revenue estimate in this category is due to planning and development services charges. This revenue stream is expected to decrease by $0.5 million and is based on the first and second quarter actual receipts and reflects a decline in development activity in comparison with the previous year.

A continued revenue decrease is included in the FY 2015 Forecast Budget. Compared to the FY 2014 Projected revenue estimate, the FY 2015 Forecast revenue estimate is net decreased by an additional $1.2 million. The $1.2 million decrease includes a downward projection of planning and development services charges (decrease of an additional $0.5 million) and a downward projection of golf course revenue estimate (decrease of $1.5 million) due to the Golf Course Reconfiguration Project (decrease of $1.5 million). The revenue decreases total $2.0 million and is offset primarily with assumed revenue from spay and neuter clinic (increase of $0.5 million assumes a reopening of the clinic) and Fire Plan Inspection Services (increase of $0.1 million to align the budgeted revenue with historical trends).

In the outer years, the forecast assumes roughly a 1.7 percent annual increase in this revenue category beginning FY 2018 through 2024. This assumes that the Golf Course Reconfiguration project is completed in FY 2016 and golf related revenue is equivalent to previous levels.

Stanford Fire and Dispatch Services

The City has two separate agreements with Stanford University to provide Fire Response services and Dispatch services. As part of these agreements to reimburse the City for Stanford's proportional share of these services, Stanford is charged 30.3 percent of the Fire Department's net cost and 16 percent of the Police Department's Communication and Dispatch Division. The FY 2015 base assumes a reimbursement of $7.8 million, which is a 4.8 percent decrease from the FY 2014 adopted amount of $8.2 million.

Staff will recommend adjusting this revenue to $7.3 million in the FY 2014 Midyear Budget Review report. There are two main drivers for this $844,000 downward adjustment. This downward adjustment is related to FY 2013 and FY 2014 activity and billing corrections. The adjustment related to FY 2013 totals $427,000 and is due to higher than anticipated revenue (paramedic and plan check) and a correction to the contract annual billing. In FY 2014, the reimbursement from Stanford was reviewed and revenue from Stanford was reduced to align revenue and expense with budgeted cost and results in a $417,000 decrease. The total $844,000 adjustment will be recommended as part of the FY 2014 Midyear Report. This will bring the FY 2014 reimbursement from Stanford for both services to $7.3 million.

Compared to the FY 2014 projected, the FY 2015 reimbursement from Stanford is projected to increase by 6.1 percent. This is a result of increases in salary and benefit costs offset by an increased revenue credit for paramedic transports and hazardous materials inspections.

The term of the Fire Response service contract between the City and Stanford is through September 30, 2026; however, at Stanford's request, the two parties have been in negotiations over the past year to restructure the contract. On October 8, 2013, the City received a Notice of Termination letter from Stanford with the intention to terminate the contract with the City no sooner than one year and no later than two years from the date of the notice. In order to plan for a possible termination of services, the City requested that Stanford inform the City of the final termination date at least three months in advance to allow for a structured potential reduction in force in the City's Fire Department. On November 20, 2013, Stanford issued a Request for Proposal (RFP) for Delivery of Fire Department Services for the campus with a proposal submission deadline of January 31, 2014. The City submitted a proposal in response to the RFP by the due date. The FY 2015 budget assumes the continuation of the contract, because staff believes that the City of Palo Alto is best suited to provide Fire Protection Services to Stanford. A modest annual increase of 3.0 percent has been built into the outer years to account for increasing salary and benefit costs based on currently available information.

Permits and Licenses

Revenue from permits and licenses has experienced consistent growth over the past several years, primarily due to increased Development Services activity. In FY 2013, Permits and Licenses revenue increased by 19.6 percent from FY 2012 levels. The increase was attributable to a heightened amount of development activity coupled with the newly established citywide Technology Enhancement Fee, which increased the majority of City fees by 5 percent. Based on year-to-date activity levels, FY 2014 revenues are projected to decrease by 5.4 percent from the adopted budget revenue estimate. The decline is attributable to lower than budgeted Development Services activity, and downward adjustments made to a number of Police and Fire Department fees in order to ensure cost-recovery. In FY 2015, revenues in this category are expected to decrease an additional $0.4 million, or 5.4 percent, from the FY 2014 projected level. It is assumed in the forecast that development related revenues will not exceed development related expenditures, and revenues will fluctuate between declines of approximately 2 percent in Fiscal Years 2016-2018, with increases ranging between 3.5-5 percent in Fiscal Years 2019 through 2024.

Return on Investment

Interest earnings continue to drop and will continue to be depressed as a consequence of the Federal Reserve's quantitative easing policy. General Fund income from this source has dropped from $1.6 million in FY 2010 to $0.9

million in FY 2012 and to an expected $0.7 million in FY 2014. As the Federal Reserve unwinds its easing (which it has begun) and rates begin to increase (which they have not as of this writing), the City expects to experience a gradual increase in this income stream.

Rental Income

The largest source of rental income comes from the City's Enterprise Funds and the Cubberley Community Center. Compared to the FY 2014 Adopted Budget, rental income will increase from $12.9 million to $14.1 million, or 9 percent. An assessment of all General Fund properties that was conducted in FY 2014 which results in an ongoing increase of approximately $1.2 million in rental income to the General Fund for FY 2014. Of this amount, $0.6 million increase is from the Utilities Funds, $60,000 from the Public Works Enterprise Funds, and $0.5 million from the Internal Service Funds. Staff will recommend a $1.2 million revenue increase as part of the FY 2014 Midyear Budget Review. Please note that the $0.5 million rent revenue increase to the General Fund from the Internal Service Funds will be recommended to be offset with an increase in allocated charges of $0.2 million which will results in an overall $1.0 million net positive impact to the General Fund.

For this forecast period, a 2.5 percent growth was assumed for all rental properties, except for the Refuse Fund rent which is assumed to remain constant until FY 2021 to account for the closing costs related to the Middlefield Well landfill site.

Revenue from Other Agencies

Included in this category is funding from Community Services Outreach theatre programs, reimbursements from the Palo Alto Unified School District (PAUSD) for various events, State of California grants for Police, and Libraries and Community Services. Many of these revenue streams are difficult to predict and are dedicated often to specific purposes. In this category revenues over the past 5 fiscal years have ranged from $80,000 to $350,000. This forecast assumes $253,000 for FY 2015 with a growth rate slightly lower than 1 percent in subsequent years due to the unpredictability of this funding source.

Charges to Other Funds

Approximately 87 percent of this category is General Fund administrative cost plan charges to the Enterprise and Internal Service Funds. The FY 2015 projected amount is $11.1 million, an increase of 4.9 percent, from the FY 2014 adopted budget level. The increase is primarily attributable to increased salary and benefit costs in the internal support departments. The forecast includes increases ranging between 2.5-3.5 percent each year based primarily on assumed increases in salary and fringe costs.

Other Revenues

Major revenue sources in this category are Animal Services charges to Los Altos and Los Altos Hills, reimbursements from PAUSD for its share of Cubberley and athletic field maintenance, donations from non-profits for City libraries, and miscellaneous revenues. The FY 2014 adopted budget includes a one-time $0.5 million donation from the Palo Alto Library Foundation, which is removed in the FY 2015 base. The FY 2015 projected revenue is $1.5 million, with a 2 percent annual increase forecasted beginning FY 2016.

Operating Transfers In

Operating Transfers include the equity transfer from the Electric and Gas Funds as well as transfers from the University Ave Parking Permit Fund. In accordance with a methodology approved by Council in June 2009, the equity transfer is calculated by applying a rate of return to the capital asset base of the Electric and Gas Funds. This rate of return is based on PG&E's rate of return on equity as approved by the California Public Utilities Commission (CPUC). The equity transfer from the Electric and Gas Funds is projected to increase from $17.0 million in FY 2014 to $17.1 million in FY 2015. Using the Utility Department's projections from the Electric and Gas Five Year Financial Forecasts as approved by the City Council in spring 2013, the equity transfer is projected to decrease slightly in FY 2016 (0.3 percent) and then increase by one to two percent over the forecast period.

Untitled, 2013

by Beth Nybeck

Hoover Park, 2901 Cowper Street, Palo Alto

Photo courtesy of Public Art Program

Expenditure Cost Elements

The General Fund expenditure categories have been adjusted with FY 2014 Adopted Budget one-time expenditures and major cost elements, including adjustments to the City's allocated charges and cost plan, library closures and reopening, rent to non-General Fund departments and funds, and the Golf Course Reconfiguration project and associated debt issuance. The tables below display the General Fund expense forecast. Compared to FY 2014 projected, FY 2015 expenditures are estimated to increase by $5.3 million, or 3.3 percent primarily due to increased salary and benefits, rents and leases, and allocated charges costs from Enterprise Funds and Internal Service Funds as well as a change in the budgeting methodology for vacant positions. The change in budgeting methodology for vacant positions, which assumes that for vacant positions as of August 2013, the full cost of benefits will be included in departmental budgets, is offset with a higher assumed vacancy savings factor for departments based on a historical analysis. As part of the FY 2015 Proposed Budget process, this information will be updated.

Expenditures	Adopted 2014	Projected 2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Salaries	$62.720	$61,899	$62,184	$63,394	$64,629	$65,888	$67,172	$68,483	$69,819	$71,182	$72,573	$73,991
Benefits	$36,927	$36,327	$42,346	$44,488	$47,661	$51,040	$54,530	$58,214	$60,901	$62,986	$65,189	$67,528
Subtotal: Salaries and Benefits	$99,647	$98,226	$104,529	$107,882	$112,290	$116,928	$121,702	$126,696	$130,720	$134,168	$137,762	$141,519
Contract Services	$13,341	$13,763	$12,522	$13,222	$13,552	$13,891	$14,238	$14,594	$14,959	$15,333	$15,717	$16,109
Supplies & Materials	$3,912	$3,924	$3,408	$3,530	$3,618	$3,709	$3,801	$3,896	$3,994	$4,094	$4,196	$4,301
General Expense	$4,869	$5,346	$4,858	$5,009	$5,135	$5,265	$5,399	$5,106	$5,236	$5,369	$5,506	$5,647
Cubberley Lease	$7,268	$7,268	$7,486	$7,711	$7,942	$8,180	$8,426	$8,678	$8,939	$9,207	$9,483	$9,768
Rents & Leases	$1,210	$1,210	$1,354	$1,395	$1,437	$1,480	$1,524	$1,570	$1,617	$1,666	$1,716	$1,767
Facilities & Equpment	$476	$553	$469	$489	$502	$514	$527	$540	$554	$568	$582	$596
Allocated Charges	$14,927	$15,075	$15,354	$15,662	$15,975	$16,294	$16,620	$16,953	$17,292	$17,637	$17,990	$18,350
Total Non-Sal/Ben Exps Before Transfers	$46,003	$47,139	$45,452	$47,017	$48,161	$49,334	$50,536	$51,338	$52,590	$53,873	$55,189	$56,538
Operating Transfers Out	$843	$1,842	$2,031	$1,976	$1,976	$1,976	$1,976	$1,976	$1,976	$1,738	$1,738	$1,738
Transfer to Infrastructure	$13,226	$13,226	$13,659	$14,000	$14,351	$14,709	$15,077	$15,454	$15,840	$16,236	$16,642	$17,058
Total Use of Funds	**$159,719**	**$160,433**	**$165,671**	**$170,875**	**$176,776**	**$182,946**	**$189,291**	**$195,464**	**$201,014**	**$206,014**	**$211,330**	**$216,853**

Expenditures	Adopted 2014	Projected 2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Salaries	9.64%	8.21%	-0.86%	1.95%	1.95%	1.95%	1.95%	1.95%	1.95%	1.95%	1.95%	1.95%
Benefits	-2.08%	-3.67%	14.67%	5.06%	7.13%	7.09%	6.84%	6.76%	4.62%	3.42%	3.50%	3.59%
Subtotal: Salaries and Benefits	4.99%	3.49%	4.90%	3.21%	4.09%	4.13%	4.08%	4.10%	3.18%	2.64%	2.68%	2.73%
Contract Services	16.89%	20.59%	-6.14%	5.59%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Supplies & Materials	34.74%	35.13%	-12.90%	3.59%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
General Expense	47.15%	61.56%	-0.22%	3.10%	2.52%	2.53%	2.54%	-5.43%	2.53%	2.54%	2.55%	2.56%
Cubberley Lease	245%	2.45%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Rents & Leases	5.00%	5.00%	11.94%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Facilities & Equpment	-35.71%	-25.30%	-1.41%	4.25%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Allocated Charges	-14.57%	-13.72%	2.87%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
Total Non-Sal/Ben Exps Before Transfers	4.35%	6.93%	-1.20%	3.44%	2.43%	2.44%	1.59%	1.59%	2.44%	2.44%	2.44%	2.44%
Operating Transfers Out	-70.25%	34.95%	141.02%	-2.71%	0.00%	0.00%	0.00%	0.00%	0.00%	-12.05%	0.00%	0.00%
Transfer to Infrastructure	-40.58%	40.58%	3.27%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Total Use of Funds	**-2.66%**	**-2.23%**	**3.73%**	**3.14%**	**3.45%**	**3.49%**	**3.26%**	**3.26%**	**2.90%**	**2.43%**	**2.58%**	**2.61%**

Salary and Benefits

SALARY

The Forecast is consistent with the City's change in salary budget methodology that was implemented as part of the FY 2014 Adopted Budget. As such, positions are budgeted at actual rate of pay including benefits as of fall 2013. Then, by position, salary costs are updated in accordance with applicable Memoranda of Understanding between the City and its bargaining groups. The Forecast also assumes a pay-for-performance increase for Management and Professional employees.

Consistent with the previous forecast, this Forecast includes a salary reserve that accounts for a potential employee salary increases. This salary reserve is set aside for planning purposes only and does not reflect a commitment from the City to increase employees' salaries and associated benefits. Any changes to employees' salaries and benefits are part of the meet and confer process with the City's employee groups, as applicable. The pending negotiations with labor groups may impact the salary costs for FY 2015 Budget. Any such impacts will be included, as necessary, in the development of the FY 2015 Proposed Budget, which is scheduled for release to the City Council early May 2014.

BENEFITS

Pension

The forecast includes the most recent pension rates from CalPERS which, compared to the FY 2014 rates, represent a 1.5 percentage point increase in pension contribution rate for miscellaneous groups (from 24.60 percent to 26.12 percent) and 6.1 percentage point increase in the pension contribution rate for safety groups (from 33.44 percent to 39.52 percent) for FY 2015.

As presented to the Finance Committee at the December 3, 2013 Finance Committee Meeting (Item 3), the primary reasons for the increase in the City's contribution rates for FY 2015 was the 0.1 percent investment earnings for FY 2012 partially offset with the 12 percent investment earnings for FY 2013. Starting with FY 2016, increases to the City contribution rate are primarily due to actuarial assumption and valuation policy changes.

In March 2012 the CalPERS Board reduced the earnings interest assumption rate or discount rate from 7.75 percent to 7.5 percent, and subsequently approved a two-year optional phase-in of the associated rate increases. Further, at the March 18, 2013 CalPERS Board Meeting, the Board approved new demographic assumptions, which will increase the City's Pension Contribution rates starting FY 2017. The City's pension contribution rates in this Forecast include the CalPERS Board approval of the demographic assumption changes. Specifically, with FY 2017 and FY 2020, the pension contribution rate will increase by 1.0 percentage point annually for the miscellaneous groups and 1.4 percentage points annually for the safety groups.

The below table outlines the City's pension contribution rates used in the forecast where rates for FY 2021 and beyond assume a 5 percent point increase for miscellaneous and a 7 percent point increase for safety.

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Miscellaneous Employees	24.6%	26.12%	27.6%	29%	30.5%	31.9%	33.4%	33.4%	33.4%	33.4%
Demographic Assumptions (5% Smoothed over 5 years starting FY 2017)				1%	2%	3%	4%	5%	5%	5%
Total Rate for Miscellaneous Employees	24.6%	26.12%	27.6%	30%	32.5%	34.9%	37.4%	38.4%	38.4%	38.4%
Safety Employees	33.44%	39.53%	42.1%	44.6%	47.2%	49.7%	52.2%	52.2%	52.2%	52.2%
Demographic Assumptions (7% Smoothed over 5 years starting FY 2017)				1.4%	2.8%	4.2%	5.6%	7%	7%	7%
Total Rate for Safety Employees	33.44%	39.53%	42.1%	46%	50%	35.9%	57.8%	59.2%	59.2%	59.2%

During the last year, CalPERS closed the 30-year amortization period and changed the smoothing period from fifteen to five years. By closing the 30-year amortization period, given today's actuarial assumptions and valuation policies, CalPERS requires that the annual required contribution be set at a level which ensures that the unfunded liability will be paid off at the end of the amortization period. By reducing the smoothing period from fifteen to five years, any actuarial and discount rate assumptions as well as gains and losses are accounted for in the pension contribution rates within five years. CalPERS believes that these new policies will provide less volatility in extreme years where significant gains or losses are realized, helps improve the funded status, adds additional transparency to member agencies' future contribution requirements, and suppresses assumption changes through automatic smoothing.

These rates do not assume any potential rate increases from likely future assumption changes, any positive impacts of the California Public Employees' Pension Reform Act (PEPRA) of 2013, or any changes to participant demographics. The PEPRA mandated third pension tier (2 percent at 62) for new employees went into effect on January 1, 2013. The pension rates included in this forecast represents actuarial data as of June 30, 2012 and the rates that incorporate this savings will not be available until the valuation that will set the FY 2016 rates (available sometime early winter 2014).

Healthcare

In previous Forecasts, a 10 percent annual increase for health care costs was assumed. A 10-year historical trend analysis indicated that an 8 percent inflation factor is more in line with actual trends experienced by the City. Therefore, this Forecast assumes an annual health care cost inflator of 8 percent. Consistent with the previous forecast and with historical trends, the 2015-2024 Long Range Financial Forecast assumes a 4 percent increase for dental and vision costs for outer years.

This Forecast includes the Annual Required Contribution from the May 2012 actuarial valuation for the City's retiree healthcare plans. The data used in this valuation is based on information as of June 30, 2011. An updated valuation report is scheduled for release in May 2014. Any changes in costs due to the new valuation will be incorporated in the FY 2015 Proposed Budget.

The Affordable Care Act includes provisions which stipulate that the City offers healthcare benefits for specific hourly staff meeting certain work-schedule requirements. At this time, staff has identified six employees eligible for this program with a cost to the City of approximately $60,000 per year. As part of the development of the FY 2015 Proposed Budget, this cost will be further analyzed.

The FY 2014 projected budget includes an additional $1.5 million in salary and benefits savings offset with higher than anticipated expenditures in the non-salary expenditure categories. Staff will provide an update to this amount in the midyear report.

Contract Services

The FY 2014 Adopted Budget included $13.7 million to fund contract services. The FY 2015 Forecast budget for Contract Services is adjusted for one-time expenditures as included in the FY 2014 Adopted Budget (e.g.: $0.8 million for projects in the Planning and Community Environment Department such as a community engagement process for the Arts and Innovation District Area (27 University Avenue), downtown parking study, Comprehensive Plan update, and Climate Protection Plan update) or ongoing expenditures approved by the City Council after the adoption of the budget (e.g.: $0.4 million for landscape services at parks and City facilities). These adjustments result in a net decrease of $1.2 million in contract expenses to $12.5 million for the FY 2015 Forecast Budget.

In the out-years of the Forecast, 2.5 percent of annual growth for contract services is assumed. This is aligned to the 20 year historical average of the San Francisco Metropolitan Statistical Area Consumer Price Index – All Urban Consumers of 2.6 percent.

Supplies & Materials

This category remains at $3.9 million in the FY 2014 Adopted budget and the projection for the current year. Compared to the FY 2014 Adopted, the FY 2015 Forecast Budget is decreased by $0.5 million primarily due to the removal of the purchase of library materials funded through a donation from the Palo Alto Library Foundation. For the out-years of the Forecast, it is assumed that costs will increase based on the 2.5 percent annual increase.

General Expense

This category includes costs for travel and meetings, telephone and non-city utilities, contingency accounts, subsidies and grants provided through the Human Resource Allocation Process, and debt service payments for the Master Lease-Purchase Agreement related to the golf course. Projected FY 2014 expenses are $5.3 million, which are primarily due to a one-time $0.6 million increase for the November 2013 Measure D election costs. This amount was removed from the FY 2015 Forecast budget. Beginning FY 2016, this category assumes an annual 2.5 percent increase.

Cubberley Lease

The forecast assumes a 3.0 percent annual CPI increase for the lease payments to the Palo Alto Unified School District (PAUSD) for the Cubberley facility. This results in a $0.2 million increase from $7.3 million to $7.5 million in the Cubberley lease expense in FY 2015.

Rents & Leases

Rent and Lease expenses for FY 2015 are estimated to increase by $144,000 from the FY 2014 level of $1.2 million to account for higher lease costs for the Development Center. From FY 2016 onwards, this expense is expected to increase by 3.0 percent per year.

Facilities & Equipment

Facilities and equipment expenses for FY 2014 is projected to be $0.5 million and will remain consistent in FY 2015 onward. The base model assumes a 3.0 percent annual increase starting in FY 2016.

Allocated Charges

Allocated charges represent expense allocations by the City's enterprise and internal services funds for services and products they provide to General Fund departments. In FY 2015, these charges are estimated at $15.3 million including utilities usage (28.1 percent or $4.3 million), liability insurance (4.6 percent or $0.7 million), technology costs (35.9 percent, or $5.5 million), vehicle equipment and replacement costs (24.8 percent or $3.8 million), and other costs (6.5 percent, or $1.0 million). The FY 2015 charges of the forecast updates the revenue and expense for these cost plans based on the most current information available at the time of Forecast development. Growth of 2.0 percent is anticipated in the outer years, which is based on the average annual expense growth over the forecast period.

Operating Transfers Out

Operating Transfers Out include transfers from the General Fund to the Debt Service Fund, Technology Fund, and Airport Fund. FY 2014 projected transfers out total $1.8 million which is an increase of $1.0 million compared to the FY 2014 adopted budget amount. This increase represents the estimated technology fee proceeds generated from the majority of Municipal Fees and collected in the General Fund. As part of the FY 2014 Midyear Budget Review, staff will bring forward recommendations to transfer this estimated amount from the General Fund to the Technology Fund for citywide technology initiatives.

A $0.3 million transfer to the Airport Fund from the General Fund is included in FY 2014 projected amounts and it is unknown when the Airport Fund will be self-sustaining; therefore, this transfer continues in FY 2015 with an increase of $0.26 million to a total of $560,000 assuming that the City will assume of control of the Airport in FY 2015. In the out-years of this Forecast, an annual transfer amount of $0.3 million is assumed. With the increase in the loan amount to the Airport Fund, for FY 2015, this expense category total amounts to $2.0 million.

Projected FY 2014 and FY 2015 transfers out include a $0.1 million annual transfer to the Technology Fund for the Library Virtual Branch. This transfer is projected to end in FY 2016 lowering the transfers out to $2.0 million.

In order to partially finance the golf course reconfiguration project, the City Council approved the issuance of debt. It is assumed that the debt will be issued in FY 2015 resulting in an increase in the annual debt service in the estimated amount of $0.3 million starting FY 2016. Debt service payments for the 2002 issuance of certificates of participation for the Downtown Parking Improvement Project end in FY 2022. As a result, transfers to the Debt Service Fund decrease by $0.2 million and overall transfers out decrease to $1.8 million.

Transfer to Infrastructure

In FY 2014, adopted and projected transfers to the capital project fund remain at $13.2 million and increase by $0.4 million, or 3.3 percent, in FY 2015. Future year projections are based on anticipated 2.5 percent CPI increases.

Tilted Donut #5, 2005

by Fletcher Benton

Corner of El Camino Real and Page Mill Road, Palo Alto

Photo by Bill Jackson

Alternative FY 2015-2024 Long Range Financial Forecast

Additional Transient Occupancy Tax Receipts – Public Safety Building

During the last year, the City's Infrastructure Committee discussed the City's infrastructure needs and potential funding sources. One of the potential funding sources identified is a projected increase in Transient Occupancy Tax (TOT) receipts due to several new hotels scheduled to open during the next few years. The table below provides an alternative FY 2015-2024 Long Range Financial Forecast view which identifies the estimated additional TOT receipts starting in the current fiscal year escalated by the Compound Annual Growth Rate assumed in this Forecast as well as the annual debt service of $2.5 million. With a conservative approach, staff estimates that the issuance of approximately $34.0 million in Certificates of Participation to fund a Public Safety building will require an annual debt service of $2.5 million for 30 years.

In this alternative Forecast, with the dedication of the increased TOT receipts towards an annual debt service of $2.5 million, surpluses range between $1.3 million and $6.2 million with an approximate cumulative one-time surplus of $24.0 million, approximately $23 million less than the base model. The cumulative Net Operating Margin is reduced by $2.5 million to $4.9 million from $7.4 million.

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
TOT from New Hotels	$297	$1,546	$2,626	$3,111	$3,597	$3,783	$3,981	$4,192	$4,415	$4,653	$4,906
Total Revenues	$166,306	$166,982	$175,271	$181,442	$187,164	$193,190	$199,510	$204,908	$210,898	$217,962	$225,536
Estimated Debt Service for Public Safety Building			$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500
Total Expenditures	$160,433	$165,671	$173,375	$179,276	$185,446	$191,791	$197,964	$203,626	$208,514	$213,830	$219,353
Net One-Time Surplus (Shortftall)	$5,873	$1,310	$1,896	$2,166	$1,718	$1,400	$1,546	$1,282	$2,384	$4,132	$6,183
Cumulative One-Time Surplus (Shortfall)											**$24,016**
Net Operating Margin	**$0**	**$0**	**$585**	**$270**	**($447)**	**($319)**	**$147**	**($264)**	**$1,101**	**$1,748**	**$2,051**
Cumulative Net Operating Margin											**$4.872**

Higher Pension Contributions

This Forecast assumes the higher pension contributions due to the updated demographic assumptions as approved by the CalPERS Board on February 18, 2014 and a discount rate (interest earnings assumption of the CalPERS investment portfolio) of 7.5%. A lowering of the discount rate to 7.25% would increase the City's unfunded liability and result in an increased annual required contribution. Based on the CalPERS issued Valuations for Miscellaneous and Safety employees as of June 30, 2012 and the provided sensitivity analysis, the annual required contributions would increase by approximately $2.1 million from $17.3 million to $19.4 million in FY 2015.

Major Tax Revenue Sensitivity Analysis

As discussed in this Forecast, the FY 2015 total tax receipts are estimated to generate approximately $92.6 million. This assumes an average tax receipts annual growth of 1.93% from FY 2014 Year-End projections to FY 2015. The year over year assumed growth in total tax revenues is between 1.93% and 4.62% for the Forecast period. All other assumptions remaining the same, if tax revenue receipts growth falls short by one percentage point from 1.93% to 0.93% in FY 2015, the loss in revenue would be approximately $0.9 million. However, a year over year loss of one percentage point in annual revenue growth would result in a cumulative revenue loss of approximately $61 million. Such a loss in revenue growth would erase the cumulative one-time surpluses of $46.5 million as depicted in this Forecast and result in cumulative one-time deficits of $14.5 million.

Arch Cradle, 2008
by Michal Szabo

Mitchell Park, 600 East Meadow Avenue, Palo Alto.
photo by Caroline Lambert

Wetlands Musings, 2007

by Linda Gass

Portable Collection
Photo by Artist

Conclusion

Although this Forecast projects a slight General Fund surplus of $1.3 million for FY 2015 and overall a positive financial outlook for the City, a cautionary note needs to be struck. The City Council has directed staff to develop Our Palo Alto, a comprehensive and multi-faceted resident engagement process, develop a Transportation Demand Management program, and address parking within the City.

These directions are aligned with the City Council priorities as approved during the City Council retreat on February 1. 2014:

1. Comprehensive planning and action on land use and transportation: The Built Environment, Transportation, Mobility, Parking and Livability
2. Infrastructure Strategy and Funding
3. Technology and the Connected City

Further, the City is facing major challenges to maintain its infrastructure, experiences growing unfunded liabilities for pension and retiree healthcare benefits, seeks to remain a competitive employer to keep and attract a talented workforce, and address other needs. These strategic long-term efforts will require additional funding in the FY 2015 Proposed Budget and beyond.

During the next two months, staff will continue to monitor revenue sources as well as update revenues and expenditures, as applicable, based on newly available information. This updated information will be reflected in the FY 2015 Proposed Budget, which is scheduled to be released to the City Council early May 2014.

Under the Sun, 2004
by Mohamed Soumah

440 S. California Ave. at Mimosa Lane, Palo Alto

Photo courtesy of Palo Alto Camera Club

Endnotes

1. UCLA Anderson Forecast, News Release of December 5, 2013
2. UCLA Anderson Forecast, News Release of September 12, 2013
3. The Conference Board, Consumer Confidence Survey, January 28, 2014, http://www.conference-board.org/data/consumerconfidence.cfm
4. Bureau of Labor Statistics, January 28, 2014
5. UCLA Anderson Forecast, News Release of December 5, 2013
6. CoreLogic Home Price Index Report, December 2013
7. Beaconomics, Fall 2013
8. MuniServices Economic Overview, 3Q2013 News
9. Ibid.
10. The Weekly Briefing, CA State Treasurer's Office, Jan. 27, 2014
11. The Weekly Briefing, CA State Treasurer's Office, Nov. 4, 2013
12. The Weekly Briefing, CA State Treasurer's Office, Jan. 27, 2014
13. Beaconomics, Fall 2013
14. Ibid.
15. The 2014-15 Budget: California's Fiscal Outlook. California Legislative Analyst's Office, November 20, 2013
16. Beaconomics, Fall 2013

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Americans with disabilities act statement

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

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Untitled, 2006
by David Huffman

California Ave. Palo Alto.
Photo by Public Art Project

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.