TO: HONORABLE CITY COUNCIL
ATTENTION: FINANCE COMMITTEE
FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES
DATE: DECEMBER 6, 2005 CMR: 416:05
SUBJECT: FIRST QUARTER FISCAL YEAR 2005-06 FINANCIAL RESULTS

This is an informational report and no Council action is required. The purpose of this report is to provide the Council with insight into the financial condition of the City’s General Fund (GF) as of the first quarter of 2005-06.

DISCUSSION
In the past year, the Silicon Valley economy finally saw signs of a slow but steady recovery. Unemployment rates in the last year declined from 3.4% to 2.7% in Palo Alto and from 6.8% to 5.5% in Santa Clara County. Economically sensitive revenue sources such as sales and transient occupancy tax revenues have begun to rebound, albeit slowly, after years of significant declines.

Adverse events and trends in the recent, severe downturn such as layoffs in the technology sector, lack of capital investment, curtailed venture capital activity, and weaker consumer spending appeared to be reversing toward the end of 2004-05 and the beginning of this fiscal year. Statistics on Peninsula jobs indicated growth of a little over 1 percent over the prior year—a modest, but welcome trend. Nationally, firms that had reduced computer purchases began to reinvest in technology and boosted the bottom line of Silicon Valley companies. The gradual upward movement in sales and TOT revenues indicates that consumers and businesses have grown somewhat more confident in spending on goods and services. Recent newspaper articles indicate that venture capital investments have increased over prior years and cover a broad range of start-up companies. These emerging trends, combined with City “Strengthening the Bottom Line” efforts over the past four years, confirm that Palo Alto is on firm fiscal footing for this fiscal year.

Revenue Highlights for First Quarter Fiscal Year 2005-06 Financial Results
Attachment A shows first quarter year-to-date actual revenues as a percentage of the Adjusted Budget.

Sales Tax: Receipts for the first fiscal year quarter of 2005-06 are at 17 percent of budget. This is a consequence of the timing of the State’s “triple flip” biannual payments which are made in January and June. At this time, staff expects that sales tax performance will improve this fiscal year and exceed the adopted budget. This likely will lead to adjustments at midyear.
First quarter results, unadjusted for one-time events, showed a 9.8 percent or $0.45 million increase over the first quarter of 2004-05. The economic segments displaying strength include service stations, electronic equipment, drug stores and auto sales. While the sales tax picture is improving, recent concerns about consumer spending during the holiday season suggest caution about vigorous tax growth in 2005-06.

*Property Taxes*: Payments from the county for the first half of the fiscal year essentially begin in October and are fully paid by January. As a consequence, receipts during the first quarter are not indicative of future results. Staff projects that property tax receipts will meet or exceed the adopted budget and that positive adjustments at midyear will occur.

*Transient Occupancy Taxes (TOT)*: Revenues are expected to be close to budget at year end despite the 17 percent of budget statistic for the first quarter (Attachment A). Occupancy and per diem rates in July and August of 2005-06 have improved over those in 2004-05 and statistics toward the end of 2004-05 indicate a sustained upward trend. The strongest TOT months are in April, May and June so staff is optimistic that the $6.0 million target for 2005-06 will be met.

*Other Taxes Fines and Penalties*: Revenues well exceed the first quarter 25 percent guideline. The 41 percent variance is primarily driven by documentary transfer taxes. In the last and this fiscal year, transfer tax revenues have exceeded expectations. This can be attributed to a vigorous housing market with rising residential prices and high sale volumes due to the low interest rate environment. This is a volatile revenue category that is sensitive to transaction volume, the mix of residential and commercial transactions, and the size of individual transactions. Given the expected softening in the housing market, it is too early to predict whether adjustments at midyear will occur. If performance in the first quarter continues, adjustments at mid-year will be made.

**Expense Highlights for First Quarter Fiscal Year 2005-06**
Expenditures are often cyclical in nature and a department’s commitments could include items for the entire fiscal year. Given these facts, departments are within their expected target range.

**Excess Overtime Expenditures**

*General Fund Overtime Analysis*

Attachment B shows total overtime expenditures reaching 39 percent of the adjusted budget. Although most of the General Fund departments are below their overtime budget, the Fire, Planning and Police Departments exceed their budgets for the following reasons.

- The Fire Department is at 41 percent of adopted budget for overtime. The main factors contributing to overtime usage are disability leave, Katrina relief, and mandated training. Currently, there are eight personnel on disability leave, so overtime will be partially offset with salary savings. The Fire Department deployed two personnel for Katrina relief for over three weeks. The Federal Emergency Management agency (FEMA) will reimburse the City for a portion of the overtime. In addition, a significant amount of time was spent for training. A majority of the training will be reimbursable via grant funds.
• The Police Department is at 44 percent of the adopted budget for overtime. The main factors contributing to overtime usage are staffing shortages due to vacancies and disability leave and two major investigations. Overtime usage will be partially offset with salary savings.

• The Planning Department is at 44 percent of the adopted budget for overtime resulting from staffing shortages due to vacancies, disability and military leave. The OT usage will be offset by salary savings.

ENVIRONMENTAL REVIEW
The action recommended is not a project for the purposes of the California Environmental Quality Act.

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ATTACHMENT
Attachment B: 2005-06, First Quarter General Fund Overtime