



# CITY *of* PALO ALTO

**LONG RANGE**

**FINANCIAL FORECAST**

Fiscal Years 2010 to 2020

# TABLE OF CONTENTS

---



<b>I. INTRODUCTION</b>	<b><i>1</i></b>
<b>II. EXECUTIVE SUMMARY</b>	<b><i>1</i></b>
<b>III. ECONOMIC OUTLOOK</b>	<b><i>3</i></b>
<i>National Economic Outlook</i>	<i>3</i>
<i>Local Economic Outlook</i>	<i>4</i>
<i>Competing Forecasts</i>	<i>6</i>
<b>IV. UPDATED MODEL</b>	<b><i>6</i></b>
<i>Revenues</i>	<i>9</i>
<i>Expenditures</i>	<i>10</i>
<i>Other Large Expenditures on the Horizon</i>	<i>11</i>
<i>Optimistic and Pessimistic Scenarios</i>	<i>12</i>
<b>V. CONCLUSION AND NEXT STEPS</b>	<b><i>14</i></b>
<b>VI. APPENDICES</b>	<b><i>16</i></b>

## I. INTRODUCTION

The report that follows describes the latest economic outlook, changes in the revenue and expenditure outlook since the adoption of the FY 2010 budget, and implications of those changes. It is intended to be more concise than previous Long Range Financial Forecasts. Staff has reserved for the Appendices a range of background information that will be useful to readers looking for trends that shed light on the City's current fiscal situation.

## II. EXECUTIVE SUMMARY

Although the worst of the recession may be behind us, the pace, if not the fact, of the recovery is in question, particularly in California. Nationally, economists point to increased Gross Domestic Product, some increase in consumer and business optimism, and increasing manufacturing orders as evidence of a nascent recovery. However, California's unending fiscal quagmire and high unemployment rate continue to negatively impact the City's finances. Until job creation picks up considerably, consumer spending resumes, and property values grow at something like their prior rate of increase, the City's fiscal position will continue to deteriorate.

Furthermore, even when that local recovery takes hold, the traditional revenue sources will not sustain the current array of City services, employee salaries and benefits, and extensive infrastructure. As Stephen Levy, senior economist at the Center for the Continuing Study of the California Economy, commented during a recent discussion with staff, the traditional revenue sources for local governments are increasingly inadequate for sustaining the services those governments offer. "The arithmetic doesn't work. Something's gotta change." Either the City will need to trim its service offerings, find new sources of revenue, or continue to prune the benefits packages offered to its employees in an equitable manner- or, more likely, implement a combination of the three.

*The U.S. Economy has begun a tentative upturn; the local economy has hit bottom but has yet to show convincing signs of recovery.*

# 2010

## EXECUTIVE SUMMARY

*Even when the local economic recovery takes hold, the traditional revenue sources for local governments are increasingly inadequate for sustaining services those governments offer.*

***“The arithmetic doesn’t work. Something’s gotta change.”***  
***-- Stephen Levy, CCSCE***

For FY 2010, the updated LRFF analysis projects an initial gap of \$6.3 million. This is an increase of \$0.9 million from the \$5.4 million gap projected in December 2009, due primarily to a further decline in sales tax revenue. The \$6.3 million can be reduced by a net \$4.5 million through the following measures:

- Salary savings from vacant positions – \$1.2 million
- Savings from non-salary one-time reductions – \$1.8 million
- Savings from Public Safety Building funds that were budgeted but not spent – \$2.7 million
- Repayment of Technology Fund – (\$1.2 million)

These measures leave a net operating gap of \$1.8 million in FY 2010, which can be offset by drawing on the General Fund’s Budget Stabilization Reserve (BSR), leaving a balance of \$22.9 million, or 16.4% of total General Fund expenditures. The \$1.8 million draw on the BSR includes: (a) the \$0.8 million transfer to the Technology Fund at Council’s direction in January 2010; (b) the \$0.4 million transfer needed to complete the Technology Fund repayment; and (c) \$0.6 million needed to close the expected FY 2010 gap.

In years 2011 to 2020, structural solutions will need to be found to address projected annual funding gaps ranging from \$6.4 to \$19.6 million. These operating funding gaps include only a partial solution to the esti-

### SUMMARY LONG RANGE FINANCIAL FORECAST MODEL 2010 (\$000)

	FY 2009	FY 2010	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
		Adopted	Projected										
	Actual	Budget	Budget										
<b>Revenues</b>													
Taxes	\$ 69,102	\$ 69,285	\$ 66,648	\$ 68,806	\$ 71,082	\$ 73,707	\$ 76,635	\$ 80,250	\$ 84,115	\$ 87,781	\$ 91,236	\$ 93,980	\$ 97,245
Total other revenues	43,260	42,546	40,827	42,190	44,301	43,276	44,646	46,288	47,998	49,786	51,616	53,587	55,662
Reimbursements from Other Funds	11,483	10,643	10,559	10,790	11,158	11,456	11,852	12,329	12,827	13,348	13,892	14,463	15,014
Transfers from Other Funds	17,614	19,664	20,207	18,709	19,347	19,865	20,550	21,378	22,242	23,145	24,089	25,078	26,034
<b>TOTAL REVENUES</b>	<b>141,459</b>	<b>142,138</b>	<b>138,241</b>	<b>140,495</b>	<b>145,888</b>	<b>148,304</b>	<b>153,683</b>	<b>160,245</b>	<b>167,182</b>	<b>174,060</b>	<b>180,833</b>	<b>187,108</b>	<b>193,955</b>
<b>Expenditures</b>													
Salaries and Benefits	91,581	92,717	91,787	95,272	101,335	106,128	112,179	117,330	122,647	128,217	134,045	140,163	146,123
Non-Salary Expenditures	33,432	38,344	38,734	38,980	39,918	41,434	42,482	43,726	45,006	46,326	47,686	49,087	50,442
Infrastructure Fund and Capital Projects	14,648	9,900	7,200	10,248	11,480	12,896	13,339	13,810	14,312	14,847	15,417	16,024	16,673
Debt Service, Tech Fund Repayment, Other	1,166	1,128	2,353	2,347	2,197	2,022	796	803	803	804	803	805	285
<b>TOTAL EXPENDITURES</b>	<b>140,827</b>	<b>142,089</b>	<b>140,074</b>	<b>146,846</b>	<b>154,930</b>	<b>162,480</b>	<b>168,795</b>	<b>175,669</b>	<b>182,767</b>	<b>190,194</b>	<b>197,951</b>	<b>206,079</b>	<b>213,524</b>
Draw down on Budget Stabilization Reserve	-	-	1,833	-	-	-	-	-	-	-	-	-	-
Comprehensive Annual													
Financial Rpt. Recon.	177												
<b>GRAND NET SURPLUS (GAP)</b>	<b>\$ 809</b>	<b>\$ 49</b>	<b>\$ -</b>	<b>\$ (6,351)</b>	<b>\$ (9,042)</b>	<b>\$ (14,176)</b>	<b>\$ (15,113)</b>	<b>\$ (15,424)</b>	<b>\$ (15,585)</b>	<b>\$ (16,134)</b>	<b>\$ (17,119)</b>	<b>\$ (18,970)</b>	<b>\$ (19,569)</b>



mated \$510 million infrastructure liability. This liability comprises \$302 million in estimated backlogged maintenance of existing infrastructure over twenty years, plus \$208 million required to replace or update existing facilities. The Forecast's planned infrastructure funding is just under 41% of the required funding in the first five years. In light of the magnitude of these projected shortfalls, more comprehensive, structural solutions will need to be put into place.

The City is far from alone in facing this situation. In a December report by the Public Policy Institute of California, cities statewide were surveyed about their responses to recent fiscal difficulties. As the report described:

"The surveys show that even before the state's budget crisis deepened in 2009-10, many jurisdictions had already imposed a variety of cost-cutting actions associated with managing fiscal stress, including furloughs, layoffs, service cutbacks, and concessions from public employee labor groups. Thus, many are on the brink of having to make cuts that respondents report are likely to cause significant deterioration in services and community conditions.

"... cities and counties are caught between a rock and a hard place. As with the state, they have suffered from declining economic conditions that have eroded their revenue bases. But they must also contend with attempts by the state itself to cure its fiscal infirmities with program shifts, cuts, adjustments, and deferments, as well as the devolution of responsibilities down to the local level." <sup>1</sup>

The state's fiscal mess has a continuing oppressive effect on local economies. Moreover, the effects of the budget cuts being made in education and infrastructure will be felt for decades to come via the degradation of the social and business climate – including the work force job-readiness.

California cities in general are faced with a narrowing revenue base. With the departure of auto dealerships, competition from large retailers in neighboring jurisdictions, and lack of space to grow, Palo Alto in particular stands on shrinking fiscal ground. As Stephen Levy suggested, trying to prevent raids by the state is not enough; the City's revenue base must be broadened. Even though he expects Silicon Valley to do reasonably well over the next two to three years, the City will only partially benefit from that recovery, because of its narrow tax base and the delayed response of the housing market.

Therefore, staff needs to continue working with the community, the Council, and its own labor groups on three fronts: curbing benefit costs, pruning City service offerings, and increasing revenues. In efforts to generate additional revenues, fees could be raised where cost recovery levels are not being reached and new revenue sources pursued, including those requiring voter approval. Finally, the City must revise its Economic Development strategy and plan.

*Staff needs to continue working with the community, the Council, and its own labor groups on three fronts: continuing to curb benefit costs, pruning City service offerings, and finding new revenues.*

*Even if the Silicon Valley economy does reasonably well over the next two to three years, the City will only partially benefit from that recovery...*

### III. ECONOMIC OUTLOOK

Economists and other observers of the local economy see signs of stabilization, but retail spending and new jobs have yet to show much improvement. If the national stage is a sign of things to come, there is some cause for hope, as indicators such as Gross Domestic Product (GDP), manufacturing orders, and jobs created are trending slowly upwards. Economists disagree about what to expect in the coming months for the country as a whole, with several economists predicting a faltering, fragile recovery, and others expecting a more steady recovery. None of the widely reported forecasts have predicted growth beyond the 3.0% range for the coming year.

#### NATIONAL ECONOMIC OUTLOOK

Nationally, the economy is expanding tentatively, although retail sales for calendar year 2009 fell 6.2% compared with 2008 to \$4.14 trillion.<sup>2</sup> GDP grew at a 2.2 percent annual pace from July to September, while industrial production rose 0.8 percent in November.<sup>3</sup>

*U.S. unemployment  
is at 10.2%;  
California unemployment  
is at 12.4% -  
its highest level  
in 69 years.*

In January, the Commerce Department's Census Bureau reported that after strong monthly gains in October and November 2009, December retail sales declined 0.3 percent. Overall, however, fourth quarter sales rose at a 7.0 percent annual rate, after a 6.4 percent gain in the third quarter. So while the trend was "in the right direction, today's retail sales data show that we have more work to do," according to U.S. Commerce Secretary Gary Locke.<sup>4</sup>

The news in the housing market was mixed at best. Sales of previously occupied homes in the U.S. rose in 2009 for the first time in four years, but prices plunged more than 12% - the sharpest fall since the Depression. According to an economist with Capital Economics, a global economic analysis firm, this "places a large question mark over whether the recovery can be sustained when the extended tax credit expires."<sup>5</sup>

The U.S. unemployment rate reached 10.2% in November, its highest level since 1983. This figure includes only people who have looked for work in the past four weeks. The underemployment rate, which also includes jobless workers who have not recently looked for work as well as part-timers who need full-time work, reached 17.5% in October. And the long-term unemployment rate - individuals unemployed for more than six months - is now 35.6%.<sup>6</sup>

Not surprisingly, unemployment is of top concern, with many fearing that even as GDP grows, employment will not keep pace. Economists point to a new "normal" among businesses now accustomed to doing more with fewer workers. Fewer jobs will limit consumer spending, which accounts for 70 percent of all economic activity, and slow the recovery.<sup>7</sup>

### STATE AND LOCAL ECONOMIC OUTLOOK

California has lost more jobs than any other state, dropping nearly 618,000 positions between November 2008 and November 2009.<sup>8</sup> California now has about the same number of jobs as it did a decade ago, when there were 3.6 million fewer working-age residents.<sup>9</sup> In November 2009 the state jobless rate reached 12.4%, and in December, the state lost another 38,800 jobs. Though the state unemployment rate did not increase in December, San Francisco and San Jose were among the regions where the unemployment rate actually increased for the month by 0.1 to 0.2 percent.<sup>10</sup>

*California has lost more jobs than any other state, dropping nearly 618,000 positions between November 2008 and November 2009. California now has about the same number of jobs as it did a decade ago.*

A recent article in the San Francisco Chronicle summed up the bleak situation:

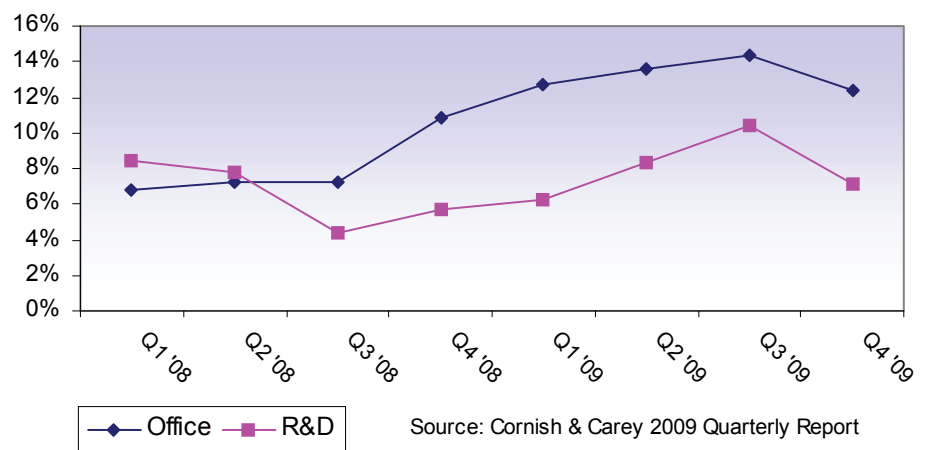
“December’s [unemployment] figure would have been even higher had not 107,000 Californians quit looking for work last month and thus fallen out of the calculations... The state estimates that 2.254 million people were unemployed in December. In addition, state officials say 1.53 million Californians were forced to work part time in December because they couldn’t find anything full time, and another 903,000 people had stopped looking but wanted jobs. These two groups are added to the unemployed to create a broader labor market measure called the underemployment rate. It registered 23.3 percent in December. One of the grimmest facts of the recession... has been the duration of unemployment. In December, 34.9 percent of jobless Californians had been out of work more than 27 weeks, which is longer than the six-month maximum for normal unemployment insurance coverage.”<sup>11</sup>

The bleak employment picture depresses retail spending, impacting one of the City’s primary revenue sources: sales tax.

On the positive side, Bay Area businesses are expressing glimmers of optimism about the future. The Business Confidence Index for the Bay Area improved to a mark of 53 out of 100 in November, up from a reading of 47 in August. An index reading that exceeds 50 signals

economic growth, while a reading below 50 signals contraction. “The job cutting is diminishing in the Bay Area,” said Scott Anderson, a Wells senior economist. “But we are forecasting another three to six months of job losses” for the nine-county region. Employers simply aren’t convinced the economy has healed enough to justify a hiring binge – or any hiring.”<sup>12</sup>

**Office and R&D Vacancy Rates, 2008 and 2009**  
**City of Palo Alto**



# 2010

## ECONOMIC OUTLOOK

*Economists forecast national GDP growth in the 2-3 percent range for 2010, and an unemployment rate settling back to 10% for most of the year. But in California, analysts predicted little or no growth in 2010 and a jobless rate of 12%.*

Lastly, the Palo Alto real estate market is beginning to show some signs of improvement, with some local real-estate agents reporting brisk sales.<sup>13</sup> In the commercial market, vacancy rates appear to at last be declining. If these trends continue, the City should see increased property tax and documentary transfer tax revenue streams in 2011 and beyond.

### COMPETING FORECASTS

No one professes that the national recession's causes have been resolved. As one economist put it, "...the core problems for the economy - bust banks and a massively overleveraged consumer - have not gone away."<sup>14</sup>

The UCLA Anderson Forecast predicted that real GDP would settle into a 2.0 percent rate for 2010, before rising to about 3.0 percent in 2011. It predicted the national unemployment rate would peak at 10.5 percent in the first quarter 2010, and then reach 10.0 percent for the rest of the year.<sup>15</sup> This forecast is matched by a prediction from Goldman Sachs that GDP will grow by 2.1 percent in 2010.

The Anderson Forecast predicted that the California economy would grow little or not at all through 2010 - with an average jobless rate of 12% -- but pick up slightly in early 2011.<sup>16</sup>

On the more optimistic side, the National Association for Business Economists predicted real GDP growth of 2.9 percent for 2010, and Economist magazine forecast 2.7 percent growth for 2010.<sup>17</sup>

Many observers are concerned that as federal stimulus programs term out, the economy will falter once again. For example, "when the [first-time homeowners] tax credit expires this spring and the government phases out programs to keep mortgage rates low, the housing market will have to stand on its own. Many economists doubt it can."<sup>18</sup>

The mixed economic signals described above set the stage for a Long Range Financial Forecast showing very modestly increasing revenues over the next four years.

## IV. UPDATED MODEL

The following tables show updated forecasts of General Fund revenues and expenditures from FY 2010 to FY 2020; the percentage changes year-over-year included in the Forecast, and Budget Stabilization Reserve balances that result. All three tables should be viewed as a Base Case — what the General Fund looks like if no structural changes are made over the next ten years.

*For fiscal years 2011 to 2020, structural solutions must be implemented to address shortfalls ranging from \$6.4 to \$19.6 million.*



### LONG RANGE FINANCIAL FORECAST MODEL 2010 (\$000)

	FY 2009	FY 2010	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
	Actual	Adopted Budget	Projected Budget										
<b>Revenues</b>													
Sales Taxes	\$ 20,089	\$ 19,650	\$ 17,190	\$ 17,868	\$ 18,577	\$ 19,335	\$ 20,175	\$ 21,067	\$ 22,014	\$ 22,784	\$ 23,467	\$ 24,137	\$ 25,056
Property Taxes	25,432	25,752	25,778	25,907	26,553	27,546	28,852	30,293	31,861	33,410	34,954	35,787	36,822
Utility User Tax	11,030	11,250	11,417	12,513	13,156	13,676	13,973	14,703	15,486	16,328	17,200	18,071	18,966
Transient Occupancy Tax	7,111	7,000	6,639	6,771	6,920	7,118	7,420	7,773	8,161	8,528	8,806	9,057	9,336
Documentary Transfer Tax	3,092	2,800	3,250	3,313	3,394	3,485	3,588	3,693	3,774	3,809	3,788	3,804	3,836
Other Taxes, Fines & Penalties	2,348	2,833	2,374	2,434	2,482	2,547	2,627	2,721	2,819	2,922	3,021	3,124	3,229
<b>Subtotal: Taxes</b>	<b>69,102</b>	<b>69,285</b>	<b>66,648</b>	<b>68,806</b>	<b>71,082</b>	<b>73,707</b>	<b>76,635</b>	<b>80,250</b>	<b>84,115</b>	<b>87,781</b>	<b>91,236</b>	<b>93,980</b>	<b>97,245</b>
Service Fees & Permits	16,210	17,437	15,814	16,575	17,799	18,131	18,660	19,395	20,160	20,956	21,783	22,717	23,688
Joint Service Agreements (Stanford Univ)	7,796	7,857	7,632	7,991	8,556	8,923	9,334	9,793	10,276	10,786	11,322	11,889	12,484
Interest Earnings	2,008	1,900	1,662	1,646	1,676	1,724	1,785	1,852	1,923	2,002	2,053	2,095	2,163
Other revenues	17,246	15,352	15,719	15,978	16,270	14,498	14,867	15,248	15,639	16,042	16,458	16,886	17,327
Reimbursements from Other Funds	11,483	10,643	10,559	10,790	11,158	11,456	11,852	12,329	12,827	13,348	13,892	14,463	15,014
<b>Total Revenues Before Transfers</b>	<b>123,845</b>	<b>122,474</b>	<b>118,034</b>	<b>121,786</b>	<b>126,541</b>	<b>128,439</b>	<b>133,133</b>	<b>138,867</b>	<b>144,940</b>	<b>150,915</b>	<b>156,744</b>	<b>162,030</b>	<b>167,921</b>
Transfers from Other Funds	17,614	19,664	20,207	18,709	19,347	19,865	20,550	21,378	22,242	23,145	24,089	25,078	26,034
<b>TOTAL REVENUES</b>	<b>141,459</b>	<b>142,138</b>	<b>138,241</b>	<b>140,495</b>	<b>145,888</b>	<b>148,304</b>	<b>153,683</b>	<b>160,245</b>	<b>167,182</b>	<b>174,060</b>	<b>180,833</b>	<b>187,108</b>	<b>193,955</b>
<b>Expenditures</b>													
Base Salaries	62,104	63,512	63,669	64,164	66,233	67,470	69,437	72,174	75,020	77,978	81,054	84,251	87,575
Salary & Benefit Reductions to be Negotiated <sup>(1)</sup>		(3,000)											
PAPOA Salary Increase Deferral <sup>(2)</sup>			(759)										
Savings from SEIU		(1,222)		(1,222)	(1,246)	(1,271)	(1,310)	(1,362)	(1,416)	(1,473)	(1,532)	(1,593)	(1,657)
Savings from Mgmt./Prof.			(806)	(806)	(822)	(839)	(864)	(898)	(934)	(972)	(1,010)	(1,051)	(1,093)
Benefits	29,477	32,205	32,205	33,373	36,396	38,270	40,259	42,375	44,613	46,980	49,475	52,125	54,918
<b>Other Activities</b>													
Additional Retirement Contribution Increase <sup>(3)</sup>					1,031	2,774	4,963	5,389	5,756	6,140	6,542	6,963	6,963
Retiree Medical Cost Increase				735	735	735	735	735	735	735	735	735	735
Salary & Benefit Reductions to be Negotiated			-	(972)	(991)	(1,011)	(1,042)	(1,083)	(1,127)	(1,172)	(1,219)	(1,267)	(1,318)
Vacant Positions Salary Savings			(1,300)										
<b>Subtotal: Salaries and Benefits</b>	<b>91,581</b>	<b>92,717</b>	<b>91,787</b>	<b>95,272</b>	<b>101,335</b>	<b>106,128</b>	<b>112,179</b>	<b>117,330</b>	<b>122,647</b>	<b>128,217</b>	<b>134,045</b>	<b>140,163</b>	<b>146,123</b>
Contract Services	10,100	9,076	9,562	9,804	9,951	10,120	10,373	10,684	11,005	11,335	11,675	12,025	12,386
Supplies & Materials	3,023	3,547	3,391	3,480	3,532	3,592	3,682	3,793	3,906	4,023	4,144	4,269	4,397
General Expense	9,008	10,193	10,285	9,870	10,121	10,385	10,681	11,002	11,330	11,670	12,020	12,381	12,665
Rents, Leases, & Equipment	1,014	1,212	1,180	1,213	1,231	1,252	1,283	1,322	1,362	1,402	1,445	1,488	1,532
Allocated Expenses	10,287	14,316	14,316	14,613	14,832	15,084	15,462	15,925	16,403	16,895	17,402	17,924	18,462
<b>Other Activities</b>													
Library Operating Cost Increase				250	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
<b>Total Expenditures Before Transfers</b>	<b>125,013</b>	<b>131,061</b>	<b>130,521</b>	<b>134,252</b>	<b>141,253</b>	<b>147,562</b>	<b>154,661</b>	<b>161,056</b>	<b>167,653</b>	<b>174,543</b>	<b>181,731</b>	<b>189,249</b>	<b>196,566</b>
<b>Transfers to Other Funds</b>													
GF Transfer for Infrastructure CIP	8,062	6,180	6,180	8,501	8,844	9,211	9,604	10,024	10,474	10,955	11,470	12,021	12,610
<b>Other Activities</b>													
Infrastructure Contribution Increase					1,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Technology Fund Repayment			1,225	1,225	1,225								
Public Safety Bldg. Budget Savings			(2,700)										
GF Transfer for Other Capital Projects	6,586	3,720	3,720	1,747	1,636	1,685	1,735	1,786	1,838	1,892	1,947	2,003	2,063
Debt Service	1,082	1,086	1,086	1,080	929	752	749	754	751	753	752	754	234
Other	84	42	42	42	44	45	47	49	51	51	51	51	51
<b>TOTAL EXPENDITURES</b>	<b>140,827</b>	<b>142,089</b>	<b>140,074</b>	<b>146,846</b>	<b>154,930</b>	<b>162,480</b>	<b>168,795</b>	<b>175,669</b>	<b>182,767</b>	<b>190,194</b>	<b>197,951</b>	<b>206,079</b>	<b>213,524</b>
<b>Net Operating Surplus/(Gap)</b>	<b>632</b>	<b>49</b>	<b>(1,833)</b>	<b>(6,351)</b>	<b>(9,042)</b>	<b>(14,176)</b>	<b>(15,113)</b>	<b>(15,424)</b>	<b>(15,585)</b>	<b>(16,134)</b>	<b>(17,119)</b>	<b>(18,970)</b>	<b>(19,569)</b>
Draw down on Budget Stabilization Reserve			1,833										
Comprehensive Annual Fin. Rpt. Recon.	177												
<b>Subtotal</b>	<b>177</b>	<b>-</b>	<b>1,833</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>GRAND NET SURPLUS (GAP)</b>	<b>\$ 809</b>	<b>\$ 49</b>	<b>\$ -</b>	<b>\$ (6,351)</b>	<b>\$ (9,042)</b>	<b>\$ (14,176)</b>	<b>\$ (15,113)</b>	<b>\$ (15,424)</b>	<b>\$ (15,585)</b>	<b>\$ (16,134)</b>	<b>\$ (17,119)</b>	<b>\$ (18,970)</b>	<b>\$ (19,569)</b>

(1) In FY 2010, \$2.8 million in permanent budgeted compensation savings has been realized.

(2) Police union (PAPOA) deferred their FY 2010 negotiated salary increase of \$0.8 million to FY 2011

(3) Based on current 2.7% @ 55 formula; employee contribution towards health care premiums not included.

Note: Assumption of no salary increase for SEIU and Mgmt./Prof. in FY 2010 and FY 2011 and no salary increase for Firefighters (IAFF) in FY 2011

# 2010

## UPDATED MODEL

### PERCENTAGE CHANGES IN FORECAST FOR REVENUES AND EXPENSES

	FY 2009	FY 2010 ABFY 2010 PB	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	Cumulative %
	% Change	% Change	% Change	% Change	% Change	% Change	% Change	% Change	% Change	% Change	% Change	% Change	Change, 2010-
<b>Revenues</b>													
Sales Taxes	(11.20%)	(2.19%)	(14.43%)	3.94%	3.97%	4.08%	4.34%	4.42%	4.50%	3.50%	3.00%	2.86%	3.81%
Property Taxes	10.17%	1.26%	1.36%	0.50%	2.49%	3.74%	4.74%	4.99%	5.18%	4.86%	4.62%	2.38%	2.89%
Utility User Tax	7.24%	1.99%	3.51%	9.60%	5.14%	3.95%	2.17%	5.22%	5.33%	5.44%	5.34%	5.06%	4.95%
Transient Occupancy Tax	(10.85%)	(1.56%)	(6.64%)	1.99%	2.20%	2.86%	4.24%	4.76%	4.99%	4.50%	3.26%	2.85%	3.08%
Documentary Transfer Tax	(42.54%)	(9.45%)	5.10%	1.94%	2.44%	2.69%	2.94%	2.94%	2.19%	0.94%	(0.57%)	0.44%	0.83%
Other Taxes, Fines & Penalties	(5.63%)	20.66%	1.11%	2.53%	1.97%	2.62%	3.14%	3.58%	3.60%	3.65%	3.39%	3.41%	3.36%
<b>Subtotal: Taxes</b>	<b>(3.81%)</b>	<b>0.26%</b>	<b>(3.55%)</b>	<b>3.24%</b>	<b>3.31%</b>	<b>3.69%</b>	<b>3.97%</b>	<b>4.72%</b>	<b>4.82%</b>	<b>4.36%</b>	<b>3.94%</b>	<b>3.01%</b>	<b>3.47%</b>
Service Fees & Permits	(5.43%)	7.57%	(2.44%)	4.81%	7.38%	1.87%	2.92%	3.94%	3.95%	3.95%	4.29%	4.27%	
Joint Service Agreements (Stanfor	12.40%	0.78%	(2.10%)	4.70%	7.07%	4.29%	4.61%	4.92%	4.93%	4.96%	4.97%	5.01%	5.00%
Interest Earnings	(10.04%)	(5.38%)	(17.23%)	(0.96%)	1.82%	2.86%	3.54%	3.75%	3.83%	4.11%	2.55%	2.05%	3.25%
Other revenues	(4.36%)	(10.98%)	(8.85%)	1.65%	1.83%	(10.89%)	2.55%	2.56%	2.56%	2.58%	2.59%	2.60%	2.61%
Reimbursements from Other	1.32%	(7.32%)	(8.05%)	2.19%	3.41%	2.67%	3.46%	4.02%	4.04%	4.06%	4.08%	4.11%	3.81%
<b>Total Revenues Before Tran</b>	<b>(2.87%)</b>	<b>(1.11%)</b>	<b>(4.69%)</b>	<b>3.18%</b>	<b>3.90%</b>	<b>1.50%</b>	<b>3.65%</b>	<b>4.31%</b>	<b>4.37%</b>	<b>4.12%</b>	<b>3.86%</b>	<b>3.37%</b>	<b>3.64%</b>
Transfers from Other Funds	2.24%	11.64%	14.72%	(7.41%)	3.41%	2.68%	3.45%	4.03%	4.04%	4.06%	4.08%	4.11%	3.81%
<b>TOTAL REVENUES</b>	<b>(2.27%)</b>	<b>0.48%</b>	<b>(2.28%)</b>	<b>1.63%</b>	<b>3.84%</b>	<b>1.66%</b>	<b>3.63%</b>	<b>4.27%</b>	<b>4.33%</b>	<b>4.11%</b>	<b>3.89%</b>	<b>3.47%</b>	<b>3.66%</b>
<b>Expenditures</b>													
Base Salaries	2.77%	2.27%	1.30%	1.99%	3.22%	1.87%	2.92%	3.94%	3.94%	3.94%	3.94%	3.94%	3.95%
Salary & Benefit Reductions to be Negotiated (1	N/A	N/A	N/A										
PAPOA Salary Increase Deferral (2)													
Savings from SEIU			N/A	0.00%	2.00%	2.00%	3.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Savings from Mgmt./Prof.			N/A	0.00%	2.00%	2.00%	3.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Benefits	(4.54%)	9.25%	9.25%	3.63%	9.06%	5.15%	5.20%	5.26%	5.28%	5.31%	5.31%	5.36%	5.36%
<b>Subtotal: Salaries and Bene</b>	<b>0.30%</b>	<b>1.24%</b>	<b>0.23%</b>	<b>3.80%</b>	<b>6.36%</b>	<b>4.73%</b>	<b>5.70%</b>	<b>4.59%</b>	<b>4.53%</b>	<b>4.54%</b>	<b>4.55%</b>	<b>4.56%</b>	<b>4.25%</b>
Contract Services	7.37%	(10.14%)	(5.33%)	2.53%	1.50%	1.70%	2.50%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Supplies & Materials	(0.10%)	17.33%	12.17%	2.62%	1.50%	1.70%	2.50%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
General Expense	(1.83%)	13.15%	14.18%	(4.04%)	2.55%	2.61%	2.85%	3.00%	2.99%	3.00%	3.00%	3.00%	2.30%
Rents, Leases, & Equipment	(10.58%)	19.53%	16.33%	2.83%	1.50%	1.70%	2.50%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Allocated Expenses	(30.39%)	39.17%	39.17%	2.07%	1.50%	1.70%	2.50%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
<b>Total Expenditures Before 1</b>	<b>(43.21%)</b>	<b>4.84%</b>	<b>4.41%</b>	<b>2.86%</b>	<b>5.21%</b>	<b>4.47%</b>	<b>4.81%</b>	<b>4.13%</b>	<b>4.10%</b>	<b>4.11%</b>	<b>4.12%</b>	<b>4.14%</b>	<b>3.87%</b>
<b>Transfers to Other Funds</b>													
GF Transfer for Infrastructure CIP	13.77%	(23.34%)	(23.34%)	37.55%	4.04%	4.15%	4.26%	4.38%	4.48%	4.60%	4.70%	4.80%	4.90%
GF Transfer for Other Capital	39.50%	(43.52%)	(43.52%)	(53.04%)	(6.35%)	3.00%	2.97%	2.94%	2.91%	2.94%	2.91%	2.88%	3.00%
Debt Service	(0.01%)	0.38%	0.36%	(0.54%)	(13.99%)	(19.07%)	(0.40%)	0.68%	(0.31%)	0.15%	(0.10%)	0.31%	(69.04%)
Other	115.38%	(50.00%)	(50.00%)	0.00%	4.00%	4.00%	4.00%	4.00%	4.00%	0.00%	0.00%	0.00%	0.00%
<b>TOTAL EXPENDITURES</b>	<b>(39.58%)</b>	<b>0.90%</b>	<b>(0.53%)</b>	<b>4.84%</b>	<b>5.51%</b>	<b>4.87%</b>	<b>3.89%</b>	<b>4.07%</b>	<b>4.04%</b>	<b>4.06%</b>	<b>4.08%</b>	<b>4.11%</b>	<b>3.61%</b>

### GENERAL FUND RESERVE SUMMARY (\$000)

	FY 2009	Adopted FY 2010	Projected FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
<b>Budget Stabilization Reserve</b>													
Beginning Balance	\$ 26,102	\$ 24,747	\$ 24,747	\$ 22,914	\$ 16,563	\$ 7,521	\$ (6,655)	\$ (21,768)	\$ (37,192)	\$ (52,777)	\$ (68,911)	\$ (86,030)	\$ (105,000)
To/(From) Reserves	809	49	(1,833)	(6,351)	(9,042)	(14,176)	(15,113)	(15,424)	(15,585)	(16,134)	(17,119)	(18,970)	(19,569)
CAFR adjustments	1,527	0	0	0	0	0	0	0	0	0	0	0	0
One-time Only Increases/(Decreases)	(3,691)	0	0	0	0	0	0	0	0	0	0	0	0
<b>Ending Balance</b>	<b>\$ 24,747</b>	<b>\$ 24,796</b>	<b>\$ 22,914</b>	<b>\$ 16,563</b>	<b>\$ 7,521</b>	<b>\$ (6,655)</b>	<b>\$ (21,768)</b>	<b>\$ (37,192)</b>	<b>\$ (52,777)</b>	<b>\$ (68,911)</b>	<b>\$ (86,030)</b>	<b>\$ (105,000)</b>	<b>\$ (124,569)</b>
% of Total Expenditures	17.6%	17.5%	16.4%	11.3%	4.9%	(4.1%)	(12.9%)	(21.2%)	(28.9%)	(36.2%)	(43.5%)	(51.0%)	(58.3%)

The discussion on page 9, highlights changes in revenues and expenditures from budgeted values, as well as comparisons to FY 2009 actual results.

The updated Forecast shows a Net Operating Deficit line of \$1.8 million in FY 2010, after implementing measures to reduce a net \$4.5 million from the initial \$6.3 million gap. Staff suggests balancing the remaining funding gap using the Budget Stabilization Reserve (BSR) for this year, leaving the BSR at \$22.9 million or 16.4% of General Fund expenditures. But with forecasted gaps of \$6.4 million to \$19.6 million from 2011 to 2020, if the BSR were used as the only tool to balance those budgets, it would be depleted some time in the middle of FY 2013. (See General Reserve Summary above.) In this Base Case Forecast, revenues increase 40.3% over the ten years, while expenses increase 52.4%.

As in earlier versions, the Forecast assumes a slow rate of growth for the overall economy and for City revenues. The Forecast does not include expected new revenue sources, such as new hotels planned for construction.

*Since the FY 2010 budget was adopted, sales tax revenue projections have decreased by \$2.5 million (13%), while property tax projections have held steady.*

Staff has added an Optimistic and a Pessimistic Scenario, which are discussed following the base forecast.

## REVENUES

### Sales Tax

FY 2010 sales tax revenue is now estimated at \$17.2 million, compared to \$19.7 million assumed in the FY 2010 adopted budget – a \$2.5 million or 13% drop. This estimate is \$0.4 million lower than in the December 1 report due to the lower-than-anticipated 3rd quarter 2009 results. The new figure represents a 14% drop in sales tax since FY 2009. Note that Fourth Quarter results, which include the Holiday season, are unknown as of the printing of this report.

# 2010

## UPDATED MODEL

### *Property Tax*

The property tax projection for 2010 is \$25.8 million, just 0.1% above FY 2010 adopted budget, and 1.3% above FY 2009 receipts. In FY 2011, revenues are projected to remain at FY 2010 levels, or \$0.5 million less than was projected in December 2009. The source of decrease in FY 2011 projected revenues is information from the County that the CPI used to calculate changes in assessed value will be negative 0.237% for FY 2011.

### *Transient Occupancy Tax (TOT)*

The FY 2010 estimate for TOT is now \$6.6 million, down 5% from the FY 2010 budgeted amount of \$7.0 million and 7% less than actual FY 2009 revenues. FY 2011 revenues are projected to increase by just 2.0%. These estimates reflect the recent reports of dismal October and November 2009 TOT revenues, with declines of 20.7 and 7.2 percent, respectively, from one year prior.

### *Documentary Transfer Tax*

Forecasted Documentary Transfer Tax revenue is \$3.25 million in 2010, a 5% increase over last year's actual revenues and a 16% increase over the 2010 budgeted amount. This increase results from signs that these revenues have bottomed out and are beginning to show signs of an upturn.

### *Joint Service Agreements*

The Stanford contract – the Joint Service Agreements' primary element – declined by \$0.2 million for 2010, compared to the FY 2010 budgeted amount, due to reversed Technology Fund charges to the Fire Department and other midyear Fire department reductions.

## EXPENDITURES

### *Salaries and Benefits*

Salaries and benefits for FY 2010 are now estimated at \$91.8 million, compared to \$92.7 million originally budgeted for this fiscal year. This represents a 0.2% increase over FY 2009 actual expenditures. The savings from SEIU and the Management and Professional groups, along with a Palo Alto Police Officers' Association (PAPOA) salary deferral, contributed to this reduction. The cost savings were partially offset by health insurance premium increases and CalPERS (pension) rate increases:

- Health care premiums for current and retired General Fund employees (not including retiree medical liability) in FY 2010 are \$1.4 million (12%) above FY 2009 levels. This is a continuation of a long-time trend in health care costs, which increased 159% between 1999 and 2009, and another 11% from FY 2009 to FY 2010.
- CalPERS implemented a recent increase for 2011 and 2012 which will cause General Fund cost increases of \$0.4 million and \$1.7 million respectively. In addition to this rate increase, CalPERS announced a future increase in retirement contributions from participating jurisdictions effective FY 2012, due to the loss in its investment portfolio. The City's estimated additional increases will range from \$1.0 million in FY 2012 to \$5.4 million in FY 2015.

The Forecast does not include benefit savings from a two-tier pension formula of 2.0% at 60 for new employees, expected to be presented to Council for implementation in the spring of 2010. Nor does it include future employee contributions to health care premiums.

### *Non-salary Expense*

Estimated non-salary expense increased 1% for 2010 compared to budget, and 16% over FY 2009 actual expenditures. The primary reason for the increase is the “skipping” of the Tech Fund allocation in FY 2009 and the planned repayment to the Fund over four years, beginning this fiscal year.

### *Infrastructure*

The 2010 General Fund transfer to the Infrastructure Fund was reduced by \$2.0 million, leaving that contribution at \$6.18 million, and General Fund funding for other capital projects was cut to \$3.72 million from \$6.6 million in FY 2009. In addition this forecast shows an expected savings of \$2.7 million in FY 2010 funds from Public Safety Building design work that was budgeted but not spent.

For 2011, the Infrastructure Fund transfer returns to \$8.5 million, and the funding for other capital projects decreases by \$2.0 million to \$1.7 million.

## OTHER LARGE EXPENDITURES ON THE HORIZON

Among the City’s other Big-Ticket expense-related challenges are:

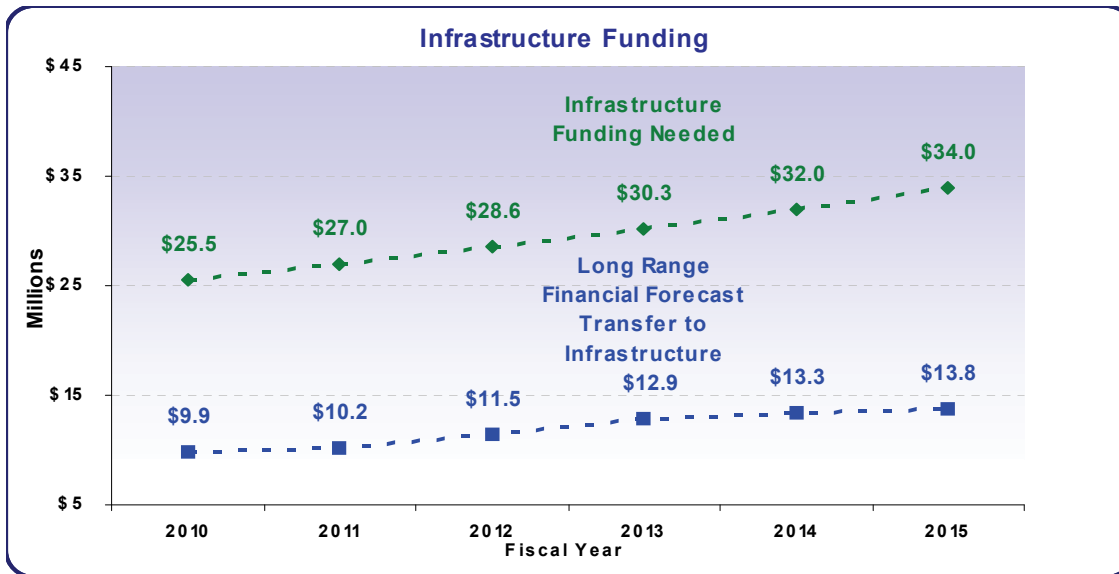
- The City’s most recent actuarial analysis dated January 1, 2009 indicated that the annual required contribution towards the citywide employee retiree medical liability will rise by \$1.4 million per year, with the General Fund’s share at \$0.7 million. Actuarial analyses are required every two years.
- The new library and community center expansions and rehabilitations require approximately \$1.0 million in incremental annual operating expenses beginning in FY 2013.
- The Forecast assumes funding from the General Fund and Infrastructure Reserve of, on average, \$11.9 million per year over the next five years, which is about \$17.7 million (60%) less than what is required over the next five years to fund the \$302 million 20-year infrastructure liability. This twenty-year amount includes backlogged work carried over from prior years as well as future needed work, and required work to maintain the City’s streets, sidewalks, parks, open space, buildings, and other facilities. In addition, staff identified another \$208 million to replace existing facilities that have exceeded their useful life or need substantial improvements. These include the replacement or improvement of: the Municipal Services Center, two Fire Stations, the Animal Shelter, the Public Safety Building and the Junior Museum, among others. The addition of the Public Safety Building to this list increased its total from \$148 million to \$208 million. The staggering estimate of \$510 million in infrastructure rehabilitation and replacement needs amplifies the severity of the City’s “structural” funding gap.

*Additional anticipated expenses include \$0.7 million per year for retiree medical liability, \$1.3 million per year in health care premiums, and \$1.0 million per year for upgraded libraries and community centers.*



# 2010 CONCLUSION

The following graph shows the growing gap between planned funding and needed funding over the next five years. Cumulative spending over those five years would be \$61.7 million, or 40.6% of the estimated \$151.9 million needed. The staggering estimate of \$510 million in infrastructure rehabilitation and replacement needs amplifies the severity of the City's "structural" funding gap.



The following graph shows the growing gap between planned funding and needed funding over the next five years. Cumulative spending over those five years would be \$61.7 million, or 40.6% of the estimated \$151.9 million needed.

## OPTIMISTIC AND PESSIMISTIC SCENARIOS

For the Optimistic Scenario, staff assumed the local economy would bounce back somewhat more quickly, lowering the unemployment rate and increasing consumer income at a quickened pace compared to the base forecast. As a result, sales tax revenues would pick up more strongly in 2011 and out years, as would Property Tax and Transient Occupancy Tax revenues. The net result is that funding gaps in years 2011 through 2020 would decline to a range of \$4.4 to \$10.1 million. In other words, the structural problem would remain, even with a stronger recovery, albeit slightly less dramatically.

In the Pessimistic Scenario, staff assumed the recovery would be hampered by unemployment lingering at 12% through 2012, with a resulting negative impact on retail spending. In this scenario, the funding gaps would rise to a range of \$8.0 million to \$31.4 million, and more draconian measures would need to be enacted in the short run to confront the larger anticipated 2011 gap.

All three scenarios show continued General Fund funding gaps for years 2011 to 2020. The base Forecast shows that the City must make \$6.4 million of permanent net changes in expenditure and/or revenue levels to avoid a funding gap in 2011, and those changes must grow in magnitude to head off funding gaps that would otherwise grow 200%

# 2010

## CONCLUSION

### LONG RANGE FINANCIAL FORECAST MODEL 2010 (\$000) - OPTIMISTIC SCENARIO

	FY 2009	FY 2010	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
	Actual	Adopted Budget	Projected Budget										
<b>Revenues</b>													
Taxes	\$ 69,102	\$ 69,285	\$ 67,233	\$ 70,182	\$ 73,475	\$ 77,123	\$ 81,028	\$ 85,389	\$ 90,491	\$ 94,553	\$ 98,271	\$ 102,512	\$ 107,651
Total other revenues	43,260	42,546	40,860	42,736	44,898	43,901	45,309	46,997	48,755	50,577	52,447	54,483	56,611
Reimbursements from Other Funds	11,483	10,643	10,559	10,790	11,158	11,456	11,852	12,329	12,827	13,348	13,892	14,463	15,014
Transfers from Other Funds	17,614	19,664	20,207	18,709	19,347	19,865	20,550	21,378	22,242	23,145	24,089	25,078	26,034
<b>TOTAL REVENUES</b>	<b>141,459</b>	<b>142,138</b>	<b>138,859</b>	<b>142,417</b>	<b>148,878</b>	<b>152,345</b>	<b>158,739</b>	<b>166,093</b>	<b>174,315</b>	<b>181,623</b>	<b>188,699</b>	<b>196,536</b>	<b>205,310</b>
<b>Expenditures</b>													
Salaries and Benefits	91,581	92,717	91,787	95,272	101,335	106,128	112,179	117,330	122,647	128,217	134,045	140,163	146,123
Non-Salary Expenditures	33,432	38,344	38,734	38,980	39,918	41,434	42,482	43,726	45,006	46,326	47,686	49,087	50,442
Infrastructure Fund and Capital Projects	14,648	9,900	8,425	11,473	12,705	14,121	13,339	13,810	14,312	14,847	15,417	16,024	16,673
Debt Service, Other	1,166	1,128	1,128	1,122	972	797	796	803	803	804	803	805	285
<b>TOTAL EXPENDITURES</b>	<b>140,827</b>	<b>142,089</b>	<b>140,074</b>	<b>146,846</b>	<b>154,930</b>	<b>162,480</b>	<b>168,795</b>	<b>175,669</b>	<b>182,767</b>	<b>190,194</b>	<b>197,951</b>	<b>206,079</b>	<b>213,524</b>
Drawdown on Budget Stabilization Reserve	-	-	1,215	-	-	-	-	-	-	-	-	-	-
Comprehensive Annual Financial Rpt. Recon.	177												
<b>GRAND NET SURPLUS (GAP)</b>	<b>\$ 809</b>	<b>\$ 49</b>	<b>\$ -</b>	<b>\$ (4,429)</b>	<b>\$ (6,052)</b>	<b>\$ (10,135)</b>	<b>\$ (10,056)</b>	<b>\$ (9,576)</b>	<b>\$ (8,452)</b>	<b>\$ (8,571)</b>	<b>\$ (9,252)</b>	<b>\$ (9,543)</b>	<b>\$ (8,214)</b>

### LONG RANGE FINANCIAL FORECAST MODEL 2010 (\$000) - PESSIMISTIC SCENARIO

	FY 2009	FY 2010	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
	Actual	Adopted Budget	Projected Budget										
<b>Revenues</b>													
Taxes	\$ 69,102	\$ 69,285	\$ 66,296	\$ 67,669	\$ 69,289	\$ 71,136	\$ 73,158	\$ 75,832	\$ 78,679	\$ 80,785	\$ 82,547	\$ 84,212	\$ 86,400
Total other revenues	43,260	42,546	40,320	41,645	43,703	42,649	43,984	45,584	47,251	48,978	50,746	52,678	54,714
Reimbursements from Other Funds	11,483	10,643	10,559	10,790	11,158	11,456	11,852	12,329	12,827	13,348	13,892	14,463	15,014
Transfers from Other Funds	17,614	19,664	20,207	18,709	19,347	19,865	20,550	21,378	22,242	23,145	24,089	25,078	26,034
<b>TOTAL REVENUES</b>	<b>141,459</b>	<b>142,138</b>	<b>137,382</b>	<b>138,813</b>	<b>143,497</b>	<b>145,106</b>	<b>149,544</b>	<b>155,123</b>	<b>160,999</b>	<b>166,256</b>	<b>171,274</b>	<b>176,431</b>	<b>182,162</b>
<b>Expenditures</b>													
Salaries and Benefits	91,581	92,717	91,787	95,272	101,335	106,128	112,179	117,330	122,647	128,217	134,045	140,163	146,123
Non-Salary Expenditures	33,432	38,344	38,734	38,980	39,918	41,434	42,482	43,726	45,006	46,326	47,686	49,087	50,442
Infrastructure Fund and Capital Projects	14,648	9,900	8,425	11,473	12,705	14,121	13,339	13,810	14,312	14,847	15,417	16,024	16,673
Debt Service, Other	1,166	1,128	1,128	1,122	972	797	796	803	803	804	803	805	285
<b>TOTAL EXPENDITURES</b>	<b>140,827</b>	<b>142,089</b>	<b>140,074</b>	<b>146,846</b>	<b>154,930</b>	<b>162,480</b>	<b>168,795</b>	<b>175,669</b>	<b>182,767</b>	<b>190,194</b>	<b>197,951</b>	<b>206,079</b>	<b>213,524</b>
Drawdown on Budget Stabilization Reserve	-	-	2,692	-	-	-	-	-	-	-	-	-	-
Comprehensive Annual Financial Rpt. Recon.	177												
<b>GRAND NET SURPLUS (GAP)</b>	<b>\$ 809</b>	<b>\$ 49</b>	<b>\$ -</b>	<b>\$ (8,033)</b>	<b>\$ (11,433)</b>	<b>\$ (17,374)</b>	<b>\$ (19,251)</b>	<b>\$ (20,546)</b>	<b>\$ (21,768)</b>	<b>\$ (23,938)</b>	<b>\$ (26,677)</b>	<b>\$ (29,648)</b>	<b>\$ (31,362)</b>

# 2010

## CONCLUSION

over ten years. In the optimistic scenario, the 2011 picture is 30% - or \$2 million - better, but still the gaps grow by 130% over ten years. In the pessimistic scenario, an additional \$1.7 million in cuts or new revenues must be found in 2011, and funding gaps quadruple in the next four years. Moreover, none of the three scenarios incorporates a full solution to the \$302 million, twenty-year Infrastructure backlog.

*The process of making the difficult choices required to balance the City's budgets going forward must begin now, for implementation in FY 2011.*

If there is one thing the economic optimists, pessimists and “realists” can agree on, it is that the City has a structural funding gap problem: given the general fiscal and expense structure of this service-based organization, the numbers do not add up to a sustainable budget.

## V. CONCLUSION AND NEXT STEPS

This Long Range Financial Forecast and analysis demonstrate the irrefutable reality of the City's structural funding gap, which will only get worse with each passing year. The City cannot continue to maintain the same portfolio of services at current levels given its shrinking revenue base. As Mr. Levy pointed out, “the arithmetic doesn't work.”

The presentation of this Forecast is the first step of a process of ongoing discussions to formulate plans for balancing the City's budget. The chart on page 15 illustrates the one-time adjustments needed to achieve a balanced budget this fiscal year, as well as the magnitude of structural adjustments that will be required to balance the FY 2011 and FY 2012 budgets. The particulars of those \$9.2 million in cuts will need to be determined by all stakeholders, including community members, Council, businesses, staff, and others.

Given the drop in City revenues over the course of the fiscal year, departments will need to close an expected \$6.4 million gap in FY 2010. Staff will present a detailed Budget Balancing Plan for FY 2010 during the Mid-year Report to the Finance Committee on March 2, 2010, and will return in late March with a big-picture view and outreach plans for engaging stakeholders in closing the \$6.4 million projected gap in FY 2011.

Staff recommends embarking immediately on this multi-step process of reaching sustainable budgets for the future, including a clear timeline for presenting recommendations to Council.

Initial revenue sources that should be pursued include adjusting cost recovery levels to 100% and reviewing subsidized facility rents. In addition, new revenue opportunities should be developed, including those that require voter approval. The opportunity to issue debt for financing infrastructure needs will also need to be explored, as will pursuing development strategies in the Comprehensive Plan.

### ADJUSTMENTS REQUIRED TO ADDRESS FY 2010 - FY 2012 DEFICITS

\$ (millions)	FY 2009	FY 2010 (adopted)	FY 2010 (projected)*	FY 2011 (projected)*	FY 2012 (projected)
Funding Gap	\$8.0	\$10.0	\$6.3	\$6.4 (additional gap)	\$2.8 (additional gap)
One-time adjustments	\$8.8	\$3.0	\$6.3		
Structural adjustments		\$7.0		\$6.4	\$2.8
Final 09 CAFR adjustments	\$0.8				
<b>Bottom line</b>	<b>\$0.8</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

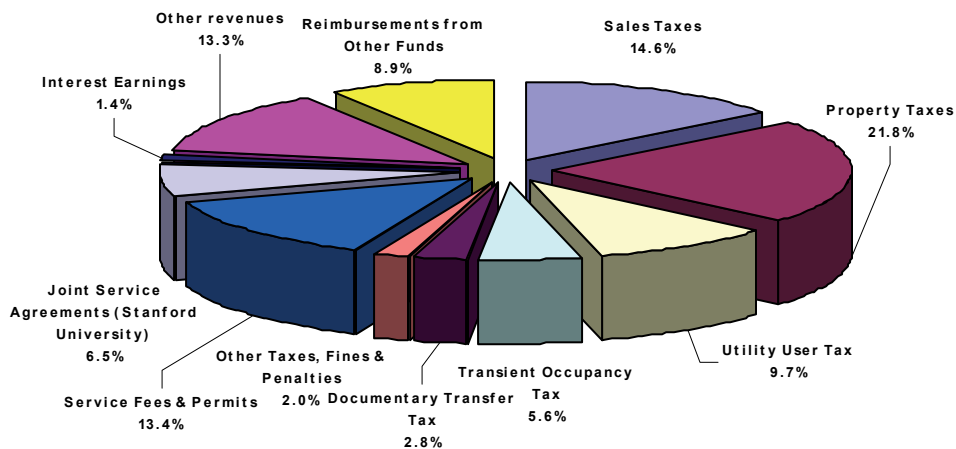
\*Subject to revision pending upcoming revenue data

Staff will soon begin implementing a “Change by Design” effort by which interdepartmental Design Teams will be created to work on specific problems the City faces as an organization, including balancing the budget, streamlining operations, revenue generation, and others.

In addition, efforts will be made in upcoming negotiations with Fire and Police units to seek salary and benefit concessions conceptually similar to those imposed on SEIU and acceded to by the Management and Professional group. While PAPOA already postponed a contracted salary increase, equity will be sought in discussions with the Fire union and Fire Chiefs unit. These benefits concessions are a necessity in balancing the long-term structural gap problem the City faces, along with nearly every other city in California..

### VI. APPENDICES

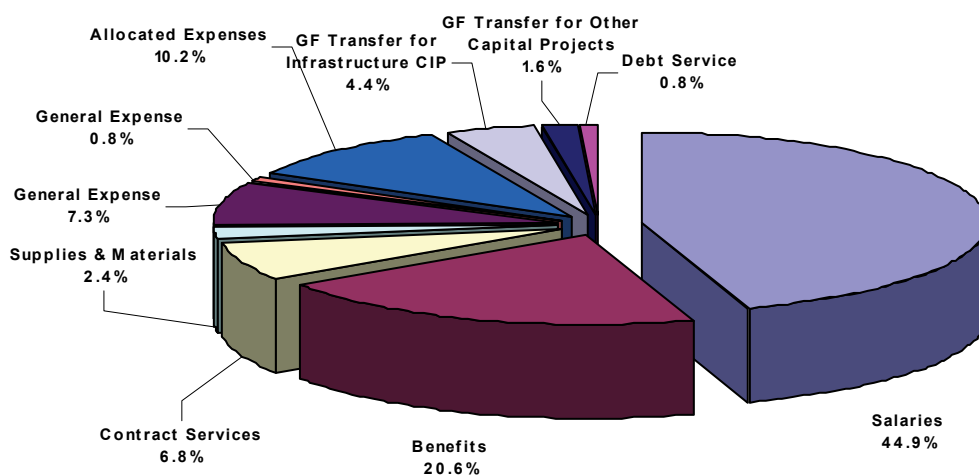
**General Fund LRFF Revenue by Type  
Fiscal Year 2010**



Total Budgeted Revenues = \$138.2 million

*Due to rounding error % may not equal 100%*

**Fiscal Year 2010 General Fund Long Range Financial  
Forecast Expenditure by Type**

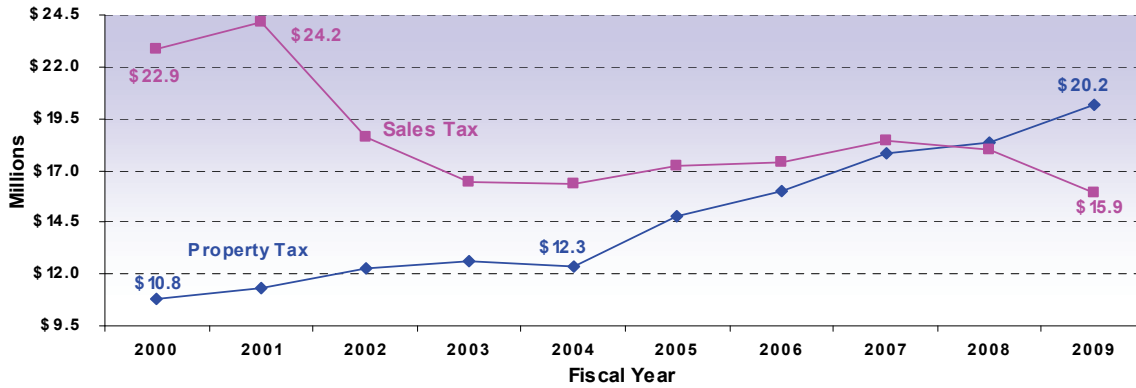


Total Budgeted Expenditures = \$140.1 million

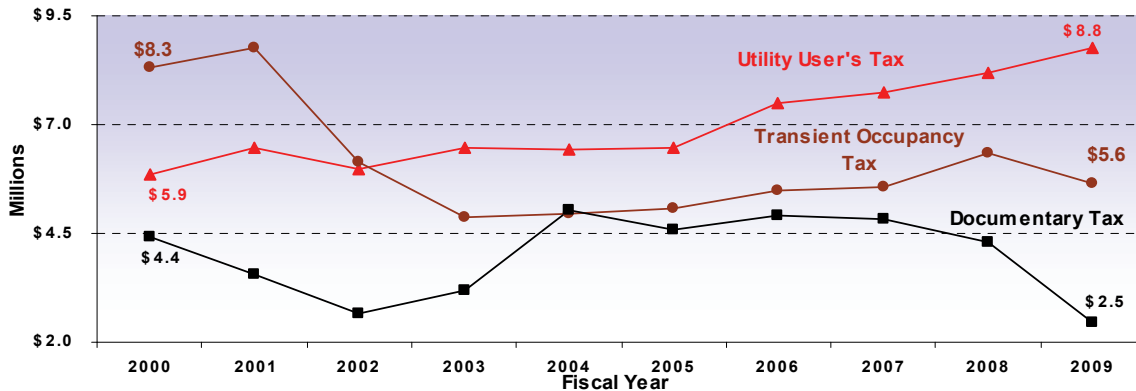
*Due to rounding error % may not equal 100%*



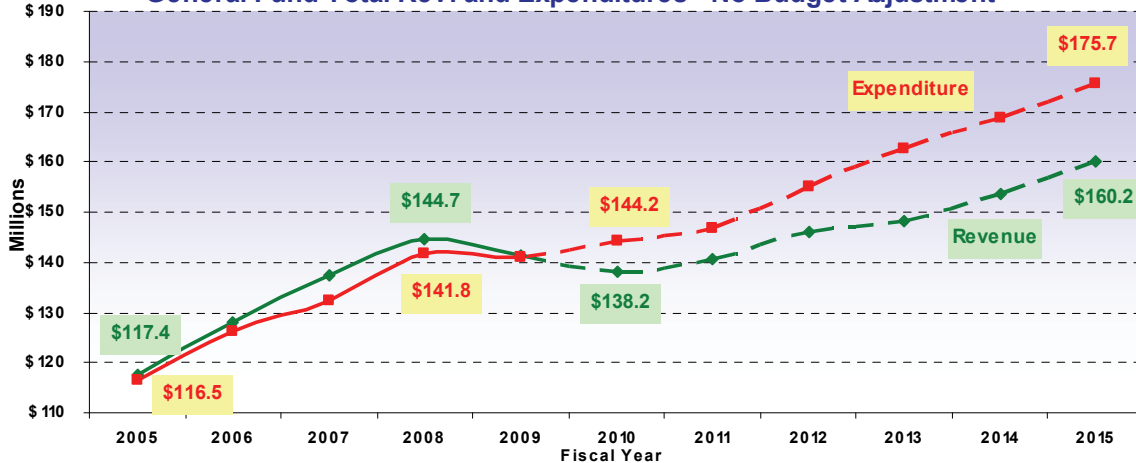
**General Fund Major Revenues**  
Last 10 Years in Fiscal Year 2000 Dollars



**General Fund Major Revenues**  
Last 10 Years in Fiscal Year 2000 Dollars



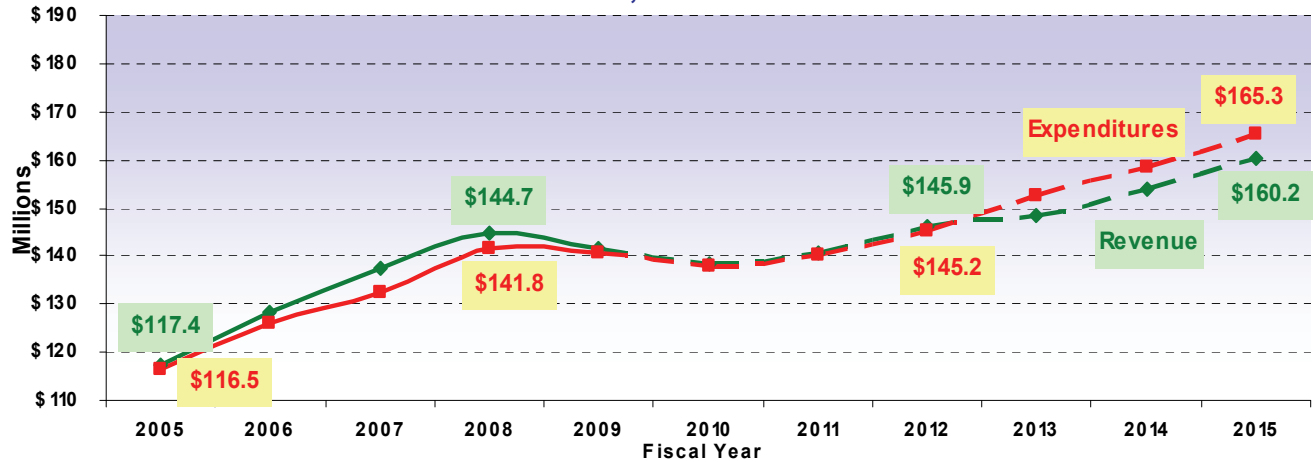
**General Fund Total Rev. and Expenditures - No Budget Adjustment**



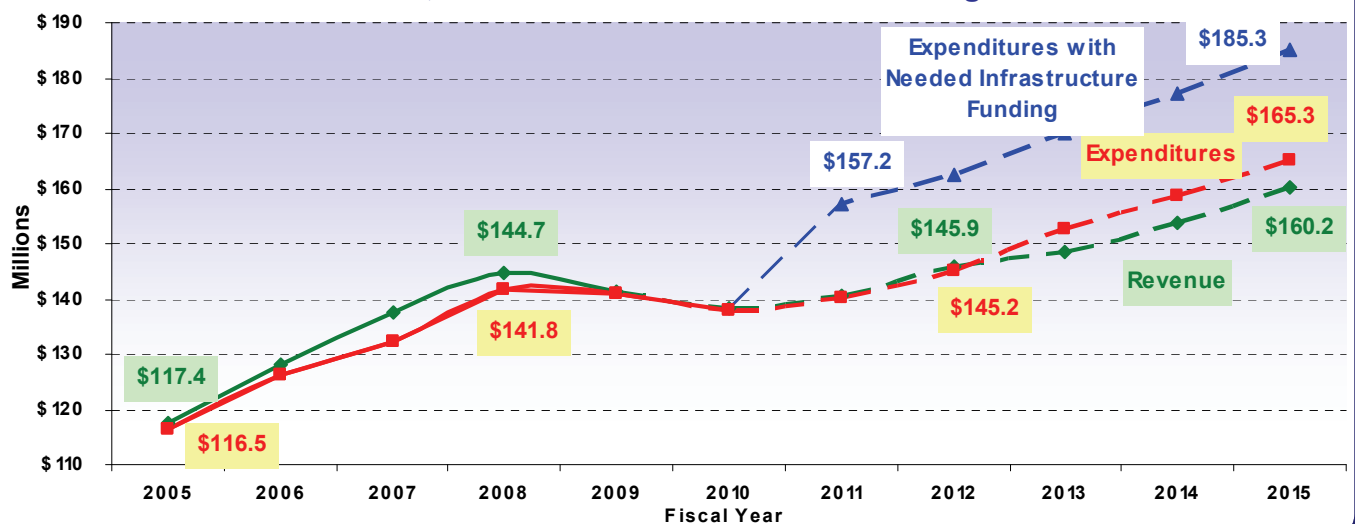
# 2010

## APPENDICES

**General Fund Total Rev. and Expenditures - Balancing Fiscal Years 2010, 2011, and 2012**

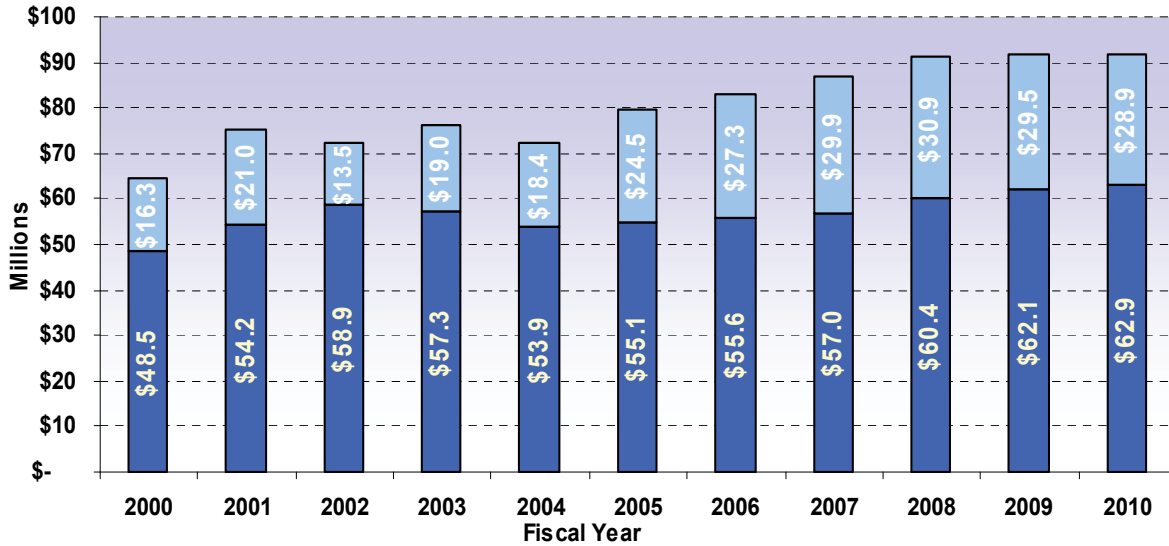


**General Fund Total Rev. and Expenditures - Balancing Fiscal Year 2010, 2011, and 2012 with Infrastructure Funding**

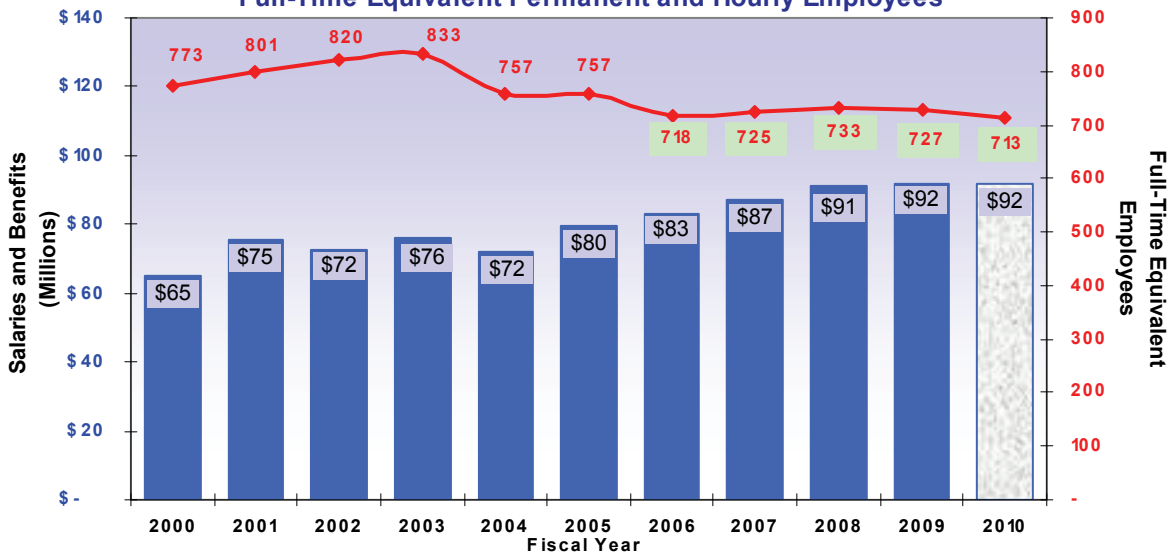


**General Fund Salaries and Benefits (Millions)**

■ Salaries ■ Benefits



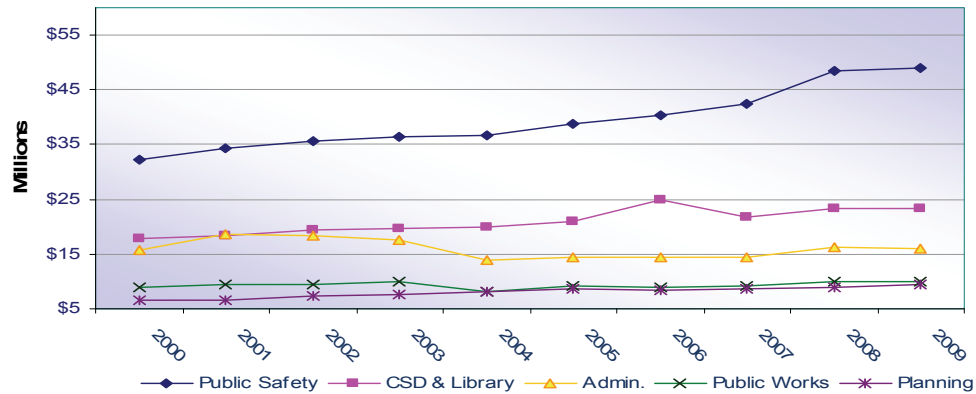
**General Fund Salaries and Benefits (Millions) with Full-Time Equivalent Permanent and Hourly Employees**



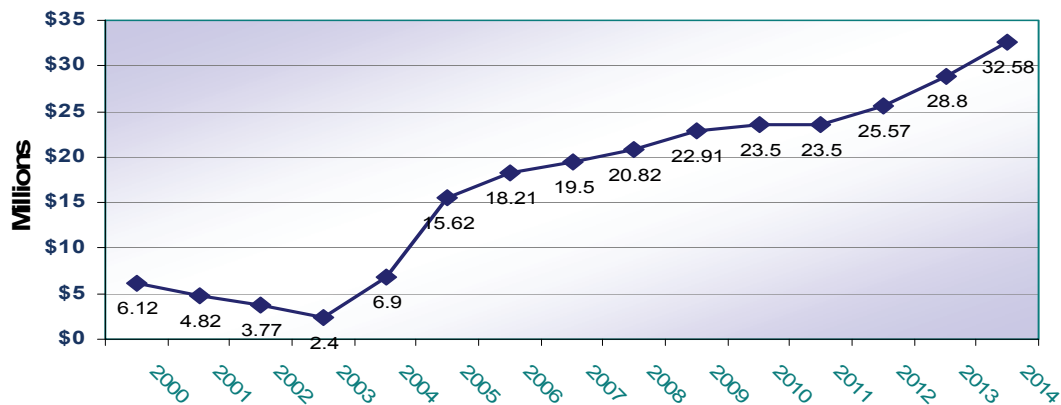
# 2010

## APPENDICES

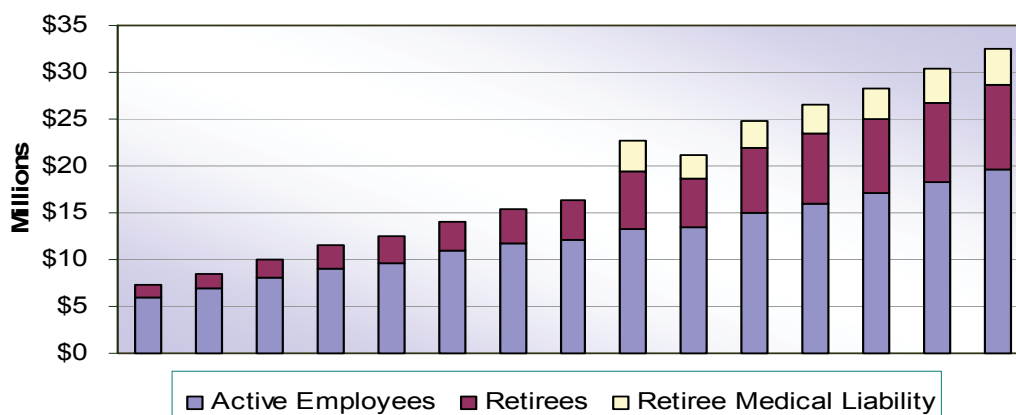
**General Fund Operating Expenditures:  
Last 10 Years in Nominal Dollars (in \$000s)**



**Citywide Pension Expense**



**Citywide Healthcare Expenses**



### **CITIES' ACTIONS TAKEN TO DEAL WITH FISCAL STRESS 2008-09**

<b>ACTIONS TAKEN</b>	<b>PERCENTAGE OF CITIES</b>
Cut spending for various services	81%
Eliminated unfilled positions	60%
Raised fees (any fee)	53%
Imposed hiring freeze	71%
Laid off employees	30%
Used reserves to cover shortfalls	60%
Reclassified open positions to lower levels	24%
Reduced/eliminated allocation to reserve account	42%
Implemented general, uniform cross-board cuts	37%
Used work furloughs	14%
Reduced benefits for new employees	15%
Encouraged/provided incentives for early retirement	20%
Raised taxes (any tax)	10%
Reduced employee benefits for current employees	10%
Reduced wages	13%

**Source:** Max Neiman and Daniel Krimm, "Perceptions of Local Fiscal stress During a State Budget Crisis," Public Policy Institute of California, December 2009  
(Average number of Cities responding = 220)



# 2010

## APPENDICES

### **AVERAGE PERCENT MID-YEAR REDUCTION FOR LINE ITEMS IN RESPONDING CITIES, 2008-09**

<b>BUDGET LINE ITEM</b>	<b>AVERAGE PERCENT OF REDUCTIONS</b>	<b>NUMBER OF RESPONDING CITIES</b>
Contribution to Reserve Fund	48.1%	29
Senior programs	16.8%	52
Streets and roads	13.9%	88
Planning	12.5%	106
Library	12.1%	42
Homeless	11.5%	9
Management and Admin. Services	10.8%	117
Animal Control	10.6%	69
Parks	10.2%	90
Fire & Emergency medical	9.9%	76
Economic development (not redevelopment)	9.1%	49
Adult & youth recreation	8.8%	84
Police services	8.5%	116
Public works	7.9%	95
Water & sewer utilities	7.3%	49

**Source:** Max Neiman and Daniel Krimm, "Perceptions of Local Fiscal stress During a State Budget Crisis," Public Policy Institute of California, December 2009

## NOTES

<sup>1</sup> Max Neiman, Daniel Krimm, “Perceptions of Local Fiscal Stress During a State Budget Crisis,” Public Policy Institute, December 2009.

<sup>2</sup> Rex Nutting, “for 2009, sales sank a record 6.2% to \$4.14 trillion,” *MarketWatch*, Jan. 14, 2010

<sup>3</sup> MuniServices, Economic Outlook, 4<sup>th</sup> Quarter 2009 News

<sup>4</sup> US Commerce Department press release, January 14, 2010

<sup>5</sup> Alan Zibel: “Sales rise, prices drop so recovery still on hold,” *San Jose Mercury News*, January 26, 2010

<sup>6</sup> *New York Times* Editorial, November 8, 2009

<sup>7</sup> Tom Abate: “Smaller GDP growth might mean slower recovery,” quoting Bart van Ark, economist with the Conference Board, *San Francisco Chronicle*, December 23, 2009

<sup>8</sup> “The Beacon Employment Report,” Beacon Economics, December 2009

<sup>9</sup> Marisa Lagos, “Cuts hurt economy, group warns,” *San Francisco Chronicle*, February 3, 2010

<sup>10</sup> “The Beacon Employment Report,” Beacon Economics, January 2010

<sup>11</sup> Tom Abate: “State jobless rate flat at 12.4%,” *San Francisco Chronicle*, January 23, 2010

<sup>12</sup> MuniServices Economic Outlook, 4<sup>th</sup> Quarter 2009 News

<sup>13</sup> Jim Carlton, “Bay Area Housing Market Starts to Pick Up,” *The Wall Street Journal*, January 21, 2010

<sup>14</sup> Ian Shepherdson of High Frequency Economics, as quoted in MuniServices, Economic Outlook, 4<sup>th</sup> Quarter 2009 News

<sup>15</sup> UCLA Anderson Forecast, December 9, 2009

<sup>16</sup> Tom Abate: “Recovery will be slow, forecasts say,” *San Francisco Chronicle*, December 9, 2009

<sup>17</sup> MuniServices Economic Outlook 4<sup>th</sup> Quarter 2009 News

<sup>18</sup> Alan Zibel: “Cold winter for home sales,” *San Francisco Chronicle*, January 6, 2010



THIS PAGE IS INTENTIONALLY LEFT BLANK



## 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:*

ADA Coordinator  
City of Palo Alto  
285 Hamilton Avenue  
(650) 329-2550

---

### *Acknowledgements*

*Staff thanks Stephen Levy,  
senior economist at the Center for the  
Continuing Study of the California Economy,  
for his contributions*

#### **Contributors**

Lalo Perez  
David Ramberg  
Joe Saccio  
Nancy Nagel  
Tarun Narayan  
Christine Paras  
Dale Wong

#### **Graphics Printing**

Cherie McFadden  
Palo Alto Print Shop

---

*Visit our website at: [www.CityofPaloAlto.org](http://www.CityofPaloAlto.org)*

---

*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.*

*It is home to Stanford University and numerous innovative and world-famous businesses.*

---



30% post-consumer recycled

**CITY OF PALO ALTO**  
**250 HAMILTON AVE**  
**PALO ALTO, CA 94301**  
**[www.cityofpaloalto.org](http://www.cityofpaloalto.org)**

Phone: 650-329-2100 Fax: 650-325-5025

---