TO: HONORABLE CITY COUNCIL

ATTN: FINANCE COMMITTEE

FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: FEBRUARY 21, 2007 CMR: 141:07

SUBJECT: 2006-07 ADJUSTED BUDGET – SECOND QUARTER (Q2) FINANCIAL RESULTS, MIDYEAR AMENDMENTS AND CAPITAL IMPROVEMENT PROGRAM STATUS

RECOMMENDATION
Staff recommends that the Finance Committee recommend to the City Council adoption of the attached Budget Amendment Ordinance (BAO) (Attachment 1) and Resolution, which includes:

a. Proposed midyear adjustments to the 2006-07 Budget for the General Fund, Enterprise Funds, Special Revenue Funds, Internal Service Funds, and Capital Improvement Projects Fund (Exhibit A).
b. 2006-07 Midyear CIP Adjustments (Exhibit B).
c. Amendments to the 2006-07 Adopted Municipal Fee Schedule (Exhibit C).
d. Amendments to the 2006-07 Table of Organization (Exhibit D).
e. Amendments to the 2006-07 Compensation Plan (Attachment 4).

The 2006-07 midyear Capital Improvement Program (CIP) Projects Status Report is attached as an informational item (Attachment 2). A list of continuous projects follows this summary (Attachment 3). No action is required on these two items.

Staff also recommends the Finance Committee review and comment on the preliminary financial condition of the City as of December 31, 2006 (Exhibit A to BAO).

BACKGROUND
This report summarizes the changes to the 2006-07 Adopted Budget necessary as part of the normal course of business through December 2006. Where possible, adjustments are held until this midyear report is brought to Council in an effort to consolidate changes and streamline the Budget Amendment Ordinance (BAO) process. The discussion in this report is organized by fund with a primary focus on major changes in the General Fund. Details of these changes, as well as all fund summaries, are included in Exhibit A. The Midyear CIP Program Project Status Report (Attachment 2) provides the Finance Committee with information on the status of the City’s CIP projects as of December 31, 2006.

DISCUSSION
General Fund
The following is a summary of major revenue and expenditure adjustments in the General Fund as detailed in Exhibit A.

At midyear, General Fund operating revenues and expenditures are at 44 and 54 percent of budget, respectively. The difference between these numbers reflects timing issues with tax revenue collections and contract encumbrances. By year-end, total General Fund expense is projected to be less than total revenues.

In the first half of 2006-07, the City experienced steady growth in its economically sensitive revenue sources. Sales, property, transient occupancy, interest income, and documentary transfer taxes realized steady increases. Projections for these revenue sources are being adjusted upward at midyear. The weak housing market, however, is still a concern since it has the potential to slow growth in property taxes and in consumer spending.

- **Sales Tax** revenues for 2006-07 are being increased by $0.2 million to $21.3 million at midyear. Sales tax revenues in the second and third quarters of calendar year 2006 improved over the prior year by 7.0 percent and 8.6 percent, respectively. On a quarter to quarter basis, the economic segments showing particular strength within the City were auto, department store, and electronic equipment sales. Those showing decreases were furniture, appliance, and light industry.

- **Property taxes** projections are being increased by $0.7 million to $21.1 million. The local commercial and residential markets demonstrated resiliency in the face of a cooling housing market, with secured property rolls rising by 8.9 percent in 2006-07.

- **Transient occupancy** taxes (TOT) are being increased by $0.3 million to $6.7 million. In the first five months of the fiscal year, average citywide occupancy and room rates rose by 4.4 percent and 4.7 percent, respectively. The average occupancy rate went from 71.3 percent to 74.4 percent while the average daily room rate went from $128 to $134.

- **Documentary transfer taxes (DTT)** are a highly volatile revenue source, fluctuating with the volume and value of property sales and the mix of residential and commercial transactions. DTT projections are being increased by $0.3 million to $4.9 million, primarily due to high-value commercial transactions.

- **Permits and Licenses** projections are being increased by $0.3 million due to increased building permit fees associated with large construction projects.

- **Other Revenues** projections are being increased by $0.1 million due primarily to various donations and grants received. For example, the Police Department received reimbursements for public safety training and a DUI enforcement program; and the Community Services Department received grants for a number of programs or projects.

**Expense Highlights for 2006-07 Midyear Financial Results**
In many departments, expenditures are cyclical in nature; a department’s commitments in the first half of the year may include items for the entire fiscal year. Keeping these characteristics in mind, departments are within their expected expense target range.

General Fund department expenditures are being increased by $563,000 (less than 1 percent), of which approximately $155,000 is grant-funded spending. The Community Services Department received $80,412 in grants from the Arts Council Silicon Valley, Art Center Foundation, and from other agencies. The Fire Department received $9,000 from a Unidocs grant. The Library Department received $35,731 from the Public Library Grant from the State of California and $18,763 from the Friends of the Library “Dalal Fund.” In addition, the Planning Department is requesting $268,000 due to the increased workload associated with a number of large construction projects. These expenditures will be offset by the related permit revenue for the construction of new buildings.

**General Fund Overtime Analysis:**

The following chart shows total overtime expenditures reaching 83 percent of the adjusted budget. Although most of the General Fund departments are below their overtime budget, the Fire and Police Departments exceed their budgets for the following reasons:

- The Fire Department is at 93 percent of adopted budget for overtime. The main factors contributing to overtime usage are disability leave, vacancies, staffing of Station 8, and mandated training. Currently, there are 6 personnel on disability leave and 7 vacant positions, so overtime will be partially offset with salary savings. Approximately $170,000 of overtime was incurred at Station 8 for the entire wild fire season. In addition, a portion of overtime was spent for training, of which a majority will be reimbursable via grant funds.

- The Police Department is at 94 percent of the adopted budget for overtime. The main factors contributing to overtime usage are staffing shortages due to vacancies, disability leave, and academy and field training programs. Also, overtime was incurred for the Palo Alto Safe Neighborhoods program, a SWAT response and related investigation, and traffic control services at Stanford football games (which is partially reimbursed by the university). Overtime usage will be partially offset with salary savings.

With the Police and Fire Departments removed from the overtime analysis, General Fund overtime expense is at 38 percent of budget at midyear.
Enterprise Funds

The major utility operating fund midyear budget issues are discussed below. Please refer to the detailed fund summaries in Exhibit A for more information on these midyear changes and to the CIP section of this report for a discussion of the changes in Enterprise CIP project funding.

- Electric Fund (Net reserve reduction of $1.5 million) – The Electric Fund reserve is reduced by appropriations of $0.2 million for CIP EL-05003 Relocation of Alma Substation, $0.9 million for CIP EL-89028 Electric Customer Connections, and $0.2 million for CIP EL-99003 Electric System Improvements.

- Gas Fund (Net reserve addition of $1.1 million) – A decrease of $4.3 million in gas commodity costs is due to lower customer demand and lower-than-expected prices. A corresponding decrease of $3.2 million in customer sales is due to lower customer consumption and the movement of some large customers out of Palo Alto.

- Water Fund (Net reserve reduction of $1.0 million) – An increase of $0.8 million in water commodity purchases is due to a rate increase by the San Francisco Public Utilities Commission.
Capital Improvement Program

Adjustments to the City’s 2006-07 Capital Plan are noted in Exhibit A, with specific project adjustments described in Exhibit B. All of the CIP changes fall into three basic categories: projects requiring additional appropriations, projects necessitating reduction in appropriations, and other miscellaneous adjustments such as transfer of funding between projects. Highlights of CIP changes are as follows:

**General Fund**

- **Street Maintenance – CIP PE-86070** – Transfer funding of $175,000 to CIP VR-07800 (Scheduled Vehicle and Equipment Replacements) to purchase a grinder and possibly a vehicle to transport spoils. The grinder will allow PWD-Operations to assist PWD-Engineering in reducing the backlog of streets needing major restoration. (No additional funding required.)

- **Street Maintenance – CIP PE-86070** – Increase funding by $528,096 and increase project cost by the same amount. Adjustment is made to reflect revenue allotted from the State of California Proposition 42 Traffic Congestion Relief Fund (TCRF). (No additional funding required.)

- **Mobile Command Vehicle – CIP PD-07000** – Provide funding of $100,000 to start the design phase of the project. This project was originally budgeted for $400,000 in fiscal year 2007-08. This proposed change will reduce the funding to $300,000 in 2007-08. (General Fund: $100,000 reserve funding).

- **Stanford/Palo Alto Playing Field – CIP PG-04010** – Provide additional funding of $66,329 to cover the cost of the City’s share in property taxes and contingency funding for the project. (Development Impact Fees - Park Fund: $60,000 reserve funding; Stanford: $6,329.)

- **College Terrace Parks Improvements – CIP PE-00110** – Provide additional funding of $185,000 for the construction of Cameron & Weissah Park. The original funding for this project was returned to the infrastructure reserve in line with the “just-in-time” funding initiative in fiscal year 2002-03. (Infrastructure Reserve: $185,000 reserve funding.)

- **Open Space Trails and Amenities – CIP OS-00001** – Increase funding by $75,000 and increase project cost by the same amount. Adjustment is made to reflect grants from the U.S. Fish and Wildlife Service, and from the State of California Coastal Conservancy. (No additional funding required.)

- **Open Space Trails and Amenities – CIP OS-00001** – Increase funding by $48,000 for the earlier-than-expected replacement of wooden footbridges at Foothills Park. A portion of the funding for this project was returned to the infrastructure reserve in line with the “just-in-time” funding initiative in fiscal year 2002-03. (Infrastructure Reserve: $48,000 reserve funding.)

- **Cubberley Fire Alarm System – CIP PF-06003** – Increase funding by $120,000 to cover consultant’s estimated cost of the project. (Infrastructure Reserve: $120,000 reserve funding.)
• **Library Service Model – CIP PE-07011** – Return funding of $200,000 to the infrastructure reserve. There is currently $1.4 million in PE-04012 and this is sufficient to pay for the change in scope.

• **Cubberley Landscaping Improvements – CIP PE-06012** – Transfer the funding of $50,000 to Cubberley Improvements – CIP CA-01014. This transfer will provide additional funding for the lighting improvements in Cubberley. (No additional funding required.)

• **Heritage Park Playground Public/Private Partnership CIP– PG-07000** – To create a new project and provide funding of $75,000. This project is a partnership, between the City and the Heritage Park Partnership neighborhood association to construct a playground in the park. The project is estimated to cost $210,000 of which the City is committed to provide $75,000 and the Partnership is to pay for the balance.

• **Photovoltaic Design and Installation – CIP PE-05001** – Increase funding by $340,000 in conjunction with the award of contract to install photovoltaic panels, trackers and carports at the Baylands Interpretive Center, Municipal Service Center and Cubberley Community Center (CMR:445:06). Funding will come from the Green Program of the Electric Fund. (Electric Fund Distribution: $340,000 Green Program funding.)

• **Roofing Replacement – CIP PF-00006** – Increase funding by $96,000 to align timing of roof replacement of the Municipal Services Center with Photovoltaic Design and Installation CIP–PE-05001 (CMR:445:06). (Infrastructure Reserve: $96,000 reserve funding.)

• **Downtown North Traffic Calming – CIP PL-07000** – To create a new project, with $60,000 in funding to install hardscape in traffic circles in Downtown North. This project will complete the Downtown North traffic calming project. (General Fund: $60,000 reserve funding.)

• **Safe Routes to School – CIP PL-00026** – Increase funding by $50,000 and increase project cost by the same amount. Adjustment is made to reflect Transportation Development Act (TDA) grant from the Metropolitan Transportation Commission. (No additional funding required.)

• **Mitchell Park Library and Community Center Improvements – CIP PE-04012** – Change in project scope. The new scope will replace the original plan to provide seismic retrofit, painting, new flooring, electrical and mechanical upgrades to the Library and the Community Center. The new scope will provide for the environmental analysis, preliminary design, community outreach and construction cost estimates for two different scenarios: 1) a new Mitchell Park Library only, and 2) a new Mitchell Park Library and a new Community Center. The change is initiated in response to City Council’s direction to proceed with the Mitchell Park Library Space Study. (No additional funding required.)
Internal Service Funds/Enterprise Funds

- **Archive and Purge Record Management – CIP TE-07005** – To create a new technology project and provide funding of $100,000. This project is created to respond to the business needs of the Enterprise Fund utilities operations. Funding will come from existing Electric Fund CIP EL-99005 (Utility Print Design). (No additional funding required.)

- **Utility Print Design – CIP EL-99005** – Transfer funding of $70,000 to Automated Meter Reading – CIP EL-04014. Funding will be used to cover the costs of purchasing meter reading handheld and cradles. CIP EL-99005 will be closed at the end of fiscal year 2006-07. (No additional funding required.)

- **Relocation of Alma Substation – CIP EL-05003** – Increase funding by $200,000 due to increase in cost above the original estimate. (Electric Fund Distribution RSR: $200,000 reserve funding.)

- **Electric Customer Connections – CIP EL-89028** – Increase funding by $900,000 to cover increase both in costs of transformers and in volume of customers. (Electric Fund Distribution RSR: $900,000 reserve funding.)

- **Electric System Improvements – CIP EL-98003** – Increase funding by $200,000 to cover additional encumbrance. (Electric Fund Distribution RSR: $200,000 reserve funding.)

Amendments to the 2006-07 Adopted Municipal Fee Schedule

Staff is proposing to amend the 2006-07 Municipal Fee Schedule as shown in Exhibit C.

Future year annual revenue increases due to these changes are not significant. The new or increased fees are pool passes, facility card replacement, facility use, fire compliance, paramedic transport and treatment, development impact, and planning legal review fees as well as a transferable permit.

Table of Organization Changes

The proposed adjustments to the Table of Organization (Exhibit D) include seven additions, five eliminations, four reclassifications, and one transfer.

- City Attorney: Addition of 1.0 Full Time Equivalent (FTE) Assistant City Attorney and elimination of 0.80 FTE Senior Assistant City Attorney due to restructuring of duties. Some of the Senior Assistant City Attorney’s work can be performed at the Assistant City Attorney level.

- City Manager: Transfer of 1.0 FTE Manager Economic Resources to the Planning Department. The transfer will enhance the economic development capabilities and is the result of the Finance Committee’s recommendation that the City Manager review the Economic Development activities.

- Human Resources: Reclassification of 1.0 FTE HR Assistant to HR Representative due to additional responsibilities required. The HR Representative will streamline duties performed in Risk Management and Benefits.
• **Human Resources:** Addition of 0.25 FTE Senior Administrator due to departmental restructuring. The Senior Administrator will manage the consolidation of the Employment and Training divisions and seek opportunities to streamline and restructure the new division.

• **Library:** Reclassification of 1.0 FTE Supervisor, Librarian to Division Head, Library Services due to departmental restructuring. The Division Head, Library Services will manage Collection and Technical Services. This will allow the Library Director, who is currently handling these duties, in addition to those of the department head to focus on working with the community and other departments.

• **Library:** Reclassification of 1.0 FTE Manager, Main Library Services to Assistant Director, Library Services due to departmental restructuring. The Assistant Director will be responsible for all Public Services, including supervision of all Supervising Librarians and library operations. The Director will primarily be responsible for policy development and assessing community priorities.

• **Police:** Addition of 1.0 FTE Public Safety Dispatcher - Lead and elimination of 1.0 FTE Supervisor, Police Services due to a business process change. In the past few years, the Department has acquired new mobile audio video technology and other public safety systems that necessitate having someone to manage them on a full-time basis. The supervisory responsibilities of the vacant Supervisor, Police Services have been transferred to other technical services management personnel.

• **Utilities Department:** Addition of 1.0 FTE Engineering Tech III and elimination of 1.0 FTE Resource Planner due to departmental reorganization. Due to an increasing volume of capital and maintenance work, an Engineering Tech III is needed for mapping and database management. The remaining responsibilities of the Resource Planner have been transferred to other staff.

• **Utilities Department:** Reclassification of 1.0 FTE Senior Electric Project Engineer to 1.0 FTE Power Engineer to align the position with the required level of experience. A Power Engineer has been underfilling the Senior Electric Project Engineer position.

• **Utilities Department:** Addition of 1.0 FTE Heavy Equipment Operator and elimination of 1.0 FTE Utility Field Service Representative due to an arbitration ruling and a departmental reorganization. The Heavy Equipment Operator will support the maintenance, repair, and emergency response for Utilities Water, Gas, and Wastewater. The Utility Field Service Representative position was recently vacated due to a promotion.

• **Utilities Department:** Addition of 1.0 FTE Senior Water System Operator due to an arbitration ruling. The Senior Water System Operator will support the maintenance, repair, and emergency response for Utilities Water, Gas, and Wastewater.
Technology Fund: Addition of 1.0 FTE Senior Business Analyst and elimination of 1.0 FTE Senior Technologist due to SAP staffing needs. The Senior Business Analyst will support SAP projects including the ERP 2005 upgrade and Utilities CIS implementation.

2006-07 Midyear Capital Improvement Program Projects Status Report:
This report provides the Finance Committee with information on the status of the City's Capital Improvement Program (CIP) projects as of December 31, 2006. In the attached matrix (Attachment 2), all City departments have submitted information on their projects and commented on any issues that might cause a change in the scope or timing of the projects. Information in this report is intended to keep Council abreast of progress on all CIP projects that were open at the beginning of the 2006-07 fiscal year and on those projects which were added or completed during the current year.

The matrix categorizes CIP projects into minor projects (projects which can be completed within a one-year period) and multi-year projects (projects which have multi-year budgets and/or complex implementation schedules with identifiable phases). The projects status portion of the matrix identifies the phase the project was in as of December 31, 2006, to give Council a perspective on how much progress was made on a project. Three distinct phases are defined, as follows:

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<thead>
<tr>
<th>Phase</th>
<th>Activities</th>
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</thead>
<tbody>
<tr>
<td>Pre-Design</td>
<td>• Preparation of a feasibility study</td>
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<tr>
<td></td>
<td>• Development of a master plan</td>
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<tr>
<td></td>
<td>• Definition of a project scope</td>
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<tr>
<td></td>
<td>• Preparation of an Environmental Impact Report</td>
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<tr>
<td>Design</td>
<td>• Hiring a design consultant</td>
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<tr>
<td></td>
<td>• Completion of project design</td>
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<tr>
<td></td>
<td>• Soliciting bids or proposals</td>
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<tr>
<td>Construction</td>
<td>• Acquisition of major equipment</td>
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<tr>
<td></td>
<td>• Installation</td>
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<tr>
<td></td>
<td>• Implementation of a project</td>
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</tbody>
</table>

Projects are listed by department for the General Fund and by fund for the Enterprise and Internal Service Funds. The matrix also includes information on the total budget from inception for each project, the available budget as of the beginning of the fiscal year, the fiscal year expenditures through December 2006, including commitments (encumbrances), and the remaining balance in the project budget as of midyear. The comment section of the matrix clarifies the status of certain projects. At the inception of the 2006-07 Adopted CIP Budget, the General Fund labor costs associated with the projects are budgeted at a fund level and will be allocated to individual projects as part of the year-end close process. For midyear reporting, the actual labor costs incurred by each project as of the date of the report, are removed from total current expenditures to make expenses align with the budget amount.

The matrix does not include "continuous" projects. These projects, such as water meter replacement, have no definitive beginning or end dates and receive ongoing funding to reflect the continuing replacement cycles or commitments. During the first half of 2006-07, progress was made on all of
the "continuous" projects (Attachment 3).

**RESOURCE IMPACT**
Adoption of the attached ordinance will allow for adjustments to the fiscal year 2006-07 budget, along with amendments to the Table of Organization, the Municipal Fee Schedule and 19 General Fund CIP projects. With the approval of this ordinance, the projected ending balance of the General Fund Budget Stabilization Reserve is $25.2 million, an increase of $1.4 million. The Capital Fund Infrastructure Reserve is projected to end with a balance of $12.8 million, a reduction of $0.1 million. The projected ending Rate Stabilization Reserve total for all Enterprise funds decreases by $1.4 million mainly due to additional appropriations for various capital improvement projects.

**POLICY IMPLICATIONS**
These recommendations are consistent with existing City policies.

**ENVIRONMENTAL ASSESSMENT**
This is not a project for purposes of the California Environmental Quality Act (CEQA).

PREPARED BY:

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**ATTACHMENTS**
Attachment 1: Budget Amendment Ordinance with the following exhibits:

- **Exhibit A** Fund Summaries and detail changes to the General Fund, Enterprise Funds, Special Revenue Funds, Internal Service Funds, and Capital Improvement Fund
- **Exhibit B** 2006-07 Midyear CIP Adjustments
- **Exhibit C** Amendments to the 2006-07 Adopted Municipal Fee Schedule
- **Exhibit D** Amendments to the 2006-07 Table of Organization

Attachment 2: 2006-07 Midyear Capital Improvement Program Projects Status
Attachment 3: List of Continuous Capital Projects
Attachment 4: Resolution of the Council of the City of Palo Alto amending the Compensation Plan for Management and Professional Personnel and Council Appointees Adopted by Resolution No. 8678 to add two new classifications

- **Exhibit A** 2006-07 Compensation Plan Changes for Management/Professional Personnel