



## FINANCE COMMITTEE

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Regular Meeting  
March 10, 2009

Chairperson Burt called the meeting to order at 7:30 p.m. in the Council Chambers, 250 Hamilton Avenue, Palo Alto, California.

Present: Burt (chair), Klein, Morton, Yeh

Absent: None

1. Oral Communications

None.

2. Auditor's Office Quarterly Report as of December 31, 2008

City Auditor, Lynda Brouchoud thanked the Finance Committee for the opportunity to present the Auditor's Office Quarterly Report. She wanted to highlight a few items in the quarterly report which reflects the status of projects as of December 31, 2008. From October to December, the Auditor's Office:

- 1) Completed and issued our annual work plan with risk assessment,
- 2) Issued the status of our recommendation follow-up,
- 3) Issued the quarterly info report on sales tax for the second quarter, and
- 4) Coordinated the audit of the City's financial statements for FY 2007-08 (presented to the Committee in December).
- 5) Our sales tax monitoring uncovered an additional \$24,433 in recoveries, bringing total recoveries to over \$60,000 for the first half of the year. This figure does not include pending misallocations from 24 additional companies.

She stated the next quarterly report is scheduled to be presented to the Committee in April, which will include the status of our progress through March 31, 2009.



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Vice Mayor Morton asked for an update on the peer review.

Ms. Brouchoud stated the review went well and the Auditor's Office is scheduled to present the results to the Finance Committee in April.

Herb Borock, P.O. Box 632, Palo Alto, asked when the Citywide Cash Handling audit would be conducted and referenced that the Finance Committee had listed it as a priority in the work plan.

Ms. Brouchoud noted this was on page 5 of the report. She also stated that the Auditor's Office recently filled a vacant position and this new employee is scheduled to start the cash handling audit during this quarter.

**MOTION:** Council Member Morton moved, seconded by Council Member Yeh to recommend Council to approve the Auditors Quarterly Report as of December 31, 2008.

**PASSED:** 4-0

### 3. Business License Tax Ordinance

City Manager, James Keene stated he met with the Chamber of Commerce in discussion of the proposed Business License Tax (BLT).

Director of Administrative Services, Lalo Perez referenced an at-place item regarding a correction to the presentation located on page 6 under the miscellaneous category, which should read \$1.25 per thousand dollars of gross receipts. He gave a brief presentation on the background, methodology, tax structure, timeline and outreach efforts. He stated the Staff recommendation was for the proposed BLT's implementation to be effective July 1, 2010 after the November 2009 election, if passed. He went over the implementation costs, ongoing costs and the timelines. He commented on the economic downturn and addressed community concerns. He discussed future infrastructure needs, budget and deficit concerns. He stressed the complex issues surrounding the BLT and the need for multiple review and consideration necessary prior to final Council action.



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Mr. Keene stated there was a projected \$8 million deficit in the General Fund for the upcoming Fiscal Year. He stated the Utilities Advisory Commission (UAC) made recommendations for the upcoming budget that increased the deficit by \$2 million dollars. He stated the BLT could not be used to balance the deficit of the upcoming Fiscal Year; however, it would provide potential revenues for the 2010 Fiscal Year.

Vice Mayor Morton asked how the dollar amount for the processing fee was determined for businesses.

Mr. Perez stressed their sensitivity to small businesses in arriving at the \$35 fee.

Vice Mayor Morton asked if any neighboring communities had a base quite as low as their proposed \$35 fee.

Mr. Perez stated \$40 was the lowest area fee to date.

Vice Mayor Morton asked if revenue proposals were based on calendar year income, in effect submitting the prior year's revenue, with the '09 revenue as the basis for the first assessment.

Mr. Perez stated this was correct. He pointed out businesses will be asked to submit an estimate.

Vice Mayor Morton asked how realtors' fees would be charged and collected.

Mr. Perez stated for a \$300,000 commission the tax was \$300.00. The broker paid this if the transaction took place in Palo Alto. The broker paid this fee unless the broker was not registered in the city limits, then the agent paid this fee.

Council Member Yeh asked for clarification on the calculations of gross receipts.

Senior Financial Analyst, Josie Stokes stated, yes, each business was expected to file an application and payment form. This information was subject to verification.



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Council Member Yeh asked whether the classifications created different manners of calculations of the gross receipts.

Ms. Stokes stated each different classification brought with it a different payment rate. She gave examples of retail and professional rates with verification of categories and payments.

Council Member Yeh asked what comprises gross receipts within each classification, not so much the multiplying factor.

Assistant City Attorney, Cara Silver stated the Ordinance held a clear definition of gross receipts, with a roll-out program containing literature explaining this, answering questions and aiding in compliance.

Council Member Yeh asked how a goal for a simplified methodology and its approach reconciled with the BLT criteria.

Mr. Perez stated it was not a simplification of the methodologies. He stated taking gross receipts prior to taxes presented the opportunity for validation. This data could then be used for auditing purposes. He stated it was a common tax used throughout the state.

Vice Mayor Morton stated gross receipts had tax accountability. He asked whether this would be utilized.

Mr. Perez stated there was pending research into the tax accountability aspect.

Council Member Yeh stated there was a focus on normalizing the data. However, he stated analysis was focused more in the range of professional businesses. He asked on what basis this decision was made.

Energy Risk Manager, Karl Van Orsdol stated of all the businesses sampled, a portion of the entire population sector was taken with this sample size adjusted to match the population of the businesses in the larger sample. He stated some sectors were over-sampled with some sectors under-represented. Proportions were then equaled, representative of the entire business population.



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Council Member Yeh questioned how the gross receipts amounts were extrapolated since they ultimately affect future revenue predictions.

Mr. Van Orsdol stated there was a potentiality for errors in the population samples. He discussed under- and over-sampling of businesses. He stated standards were applied to fiscal analyses with standard deviations in order to understand how close the samples were to the actual population. He stated the standard deviation, did not report a substantially different number. He stressed the sample size was biased, but was the only sample to which they had gross sales.

Council Member Yeh asked how predictable the revenue sources were in terms of incorporating them into the budget process.

Mr. Perez stressed the best guess nature of the predictions due to the variability of gross receipts. He stated a time period of three years was necessary before there was a true base, per se, with any level of confidence. He stated this presented many challenges. He defined the methodology regarding the tax rate comparison versus gross receipts comparisons with surrounding cities. He stressed the importance of a competitive tax rate.

Council Member Yeh asked how the analysis was done in measuring relative tax burdens across jurisdictions in the aggregate of all taxes faced by businesses.

Doug Jensen, MuniServices asked if the question pertained to total tax burden for all local taxes and not just business licenses.

Council Member Yeh stated, yes as this was an impacting factor on businesses.

Mr. Jensen stated they did not look at this in particular in that it required a much larger study of utility tax, franchise fees, hotel taxes and sales tax. He stated they looked at gross receipts in their recommendation due to the economic benefits this type of tax brought with it in terms of total revenue. He stressed it was up to the voters and policymakers to decide on the economic benefits. He stated there was an ease in administrative ability with the gross receipt practice, which also broadens the tax base, stabilizing the revenue sources.



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Mr. Perez stated the City Manager asked for a comprehensive study on the tax and fee impacts to the businesses within the City in comparison to surrounding areas. He stated this was done specifically within their office and not by outside consultants. He stressed the time necessary and the importance of this comprehensive cross-jurisdiction study.

Council Member Klein spoke to the wide response from area realtors. He went over the demographics of the emails received. He asked for clarification on Table 1 and the average gross sales of professional organizations versus the comparative city business taxes.

Mr. Perez stated these were two different sets of numbers. Table 1 listed the average number while the other chart listed the median number. He stressed the importance of the median number versus the average number which was skewed by some of the larger businesses involved.

Council Member Klein stated there was a huge difference between the median and the mean numbers.

Mr. Perez stated based on their sampled data, approximately 14 businesses would pay the \$20,000 ceiling amount. He pointed out there were large gross receipt-producing businesses which skewed these averages which made it important to focus on the median numbers.

Council Member Klein with regard to Professional Services, stressed that a firm which generated only \$2 million in gross revenue, made for a small organization. He stated there were firms in Palo Alto that were much larger than this median.

Mr. Perez stated this was one group which did not provide good data due to the fact that they do not produce sales tax. He stressed this remained the challenge.

Council Member Klein stated concern regarding the definition of Gross Receipts. He pointed out the issue of Venture Capital Firms who had no Utility Users Tax or tax revenue. He asked how they would arrive



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at gross revenues for the Venture Capital Firms which did work throughout the country from an office based within the City.

Mr. Jensen stated businesses doing so in multiple jurisdictions can apportion their receipts to the jurisdiction where the Gross Receipts are earned.

Council Member Klein asked what the standard was for configuration of these Gross Receipts.

Mr. Jensen stated the Ordinance did not cover the capture of regular commerce in another state. Palo Alto can only capture what is going on within the state of California. Any services out of state, or out of the country, are not part of the configuration.

Council Member Klein asked which services would fall in this range if they occurred in Palo Alto.

Mr. Jensen stressed this was a heavily litigated issue in the country in terms of apportionment. He deferred to the City Attorney for definition of the Gross Receipts. He stated he could offer what other cities in the area are doing for apportionment.

Josh Davis, MuniServices stated the definition of Gross Receipts was the top line number of the gross revenues. He stressed most city ordinances take this number and allow for certain deductions from this. These are itemized and can be implemented within an Ordinance in order to detail the definite terms of Gross Receipts. In the situations with a substantial number of businesses conducting taxable activities within multiple jurisdictions, Palo Alto's jurisdiction had the ability to tax only the taxable activity occurring within the jurisdiction. Apportionment, which must be done, falls to the taxpayer and then is regulated and checked by the City. He stressed the Courts have refused to allocate any percentages, formulas or apportionment schematics. It is left to the taxpayers and the jurisdictions in levying the different activities.

Vice Mayor Morton asked for clarification on Gross Receipts and how they translate out as cash flow. He asked if the figuring began with the earned portion of the cash flow generated.



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Mr. Perez stated this was correct.

Council Member Klein spoke to the calculated 8-9 percent administrative costs. He asked how these compared to the cost of raising funds through other taxation.

Mr. Perez stated Staff would return with a definitive answer on this.

Council Member Klein questioned whether there were guidelines they could use in comparison.

Mr. Perez stated they were not excluding contracting out in terms of administration. He stressed this was under analysis. He stated the challenge was not knowing how many businesses were involved, which lent to only best guess scenarios versus set numbers.

Council Member Klein pointed to Page 58 of the Consultants' report which cited the integration of their work included the address ranges for the City of Palo Alto's boundaries, including and removing any County pockets. It was his understanding that the last County pocket had been removed in prior years.

Mr. Perez stated the use of a shared zip code was the issue. If a business was not designated as East Palo Alto on an address, citing only Palo Alto as the addressed City, this required validation. Other than that, he stated the boundaries were known.

Council Member Klein asked about taxes and fees collected in Santa Clara at \$800,000 for regulatory purposes and were not revenue-generating. He asked if there were serious regulatory needs in Santa Clara that required this amount.

Mr. Perez stated there was a need to raise the revenue flat rate, per employee, since some areas have had the same structure for numerous years with no current updates. He stated administrative fees were added on top of the licensing tax. Using Santa Clara as an example, he stated their sale-generating business base was different than Palo Alto in size with a generation of \$40 million in sale tax. His interpretation was their process counted on the sales tax more so than the business licensing tax for increased revenue.



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Council Member Klein stated the City of Palo Alto, too, looked to their sales tax for increased revenue. However, he did not think that the \$800,000 was purely for regulatory purposes. He stressed it seemed Santa Clara raised for more than they ever spent on regulatory purposes.

Mr. Keene stated there were a significantly larger number of businesses on Santa Clara County. In division and averages, he stated, this was about \$66.00.

Council Member Klein pointed to Page 8 of the report regarding professional businesses and their representation of 4.6 percent of the sampled population of businesses. He stated this sector actually represented 30 percent of business in the full population of businesses. He asked why the sample holds such an under-counting of the true numbers.

Mr. Van Orsdol stated they were under-counted in the current sample because this was the number of businesses for which they had the gross revenue data.

Council Member Klein asked, since there was no gross data on accountants, lawyers and venture capitalists, and the like, if these were excluded.

Mr. Van Orsdol stressed there are 2500 businesses in the sample, and an effort was made in being as representative of the whole as possible. Availability of data limited this representation.

Mr. Perez reiterated if there was no sales tax generation no data was reflected.

Council Member Klein asked for clarification of the professionals for which they have adequate data, as in what type of qualitative description encompasses them in the sample.

Mr. Perez stated they would return with an answer to this.

Chair Burt pointed to Table 1, Page 5 of the City Manager Report (CMR) which listed five major categories, with the last category listed as miscellaneous. He stated this was the summary of their sample,



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but asked if it was not also the basis used to arrive at anticipated revenue.

Mr. Perez stated this was correct.

Chair Burt asked if this data was then extrapolated.

Mr. Perez stated this was correct.

Chair Burt asked what total gross revenue was represented in the gross sales summarized in Table 1.

Mr. Van Orsdol expected this figure to be approximately 25 percent.

Chair Burt asked where software and pharmaceutical companies appeared in the report.

Ms. Stokes stated pharmacies fell under the retail category.

Chair Burt questioned why pharmaceuticals fell under retail if they do not do any taxable sales. He stressed he was not speaking of pharmacies but pharmaceutical manufactures.

Ms. Stokes stated pharmacies fell under retail but pharmaceuticals fell under the classification of manufacturers.

Chair Burt asked where software companies fell in the report.

Mr. Perez stated these needed further definition within the Ordinance, and this was something Staff continued working on. He stressed the discovery stage of these issues was during the current discussions. He stated there was the flexibility to classify businesses in categories they felt best fit the structure they planned to put in place. By example, he stated a company developing software likely fell in the manufacturing category, although they would need to look into it further.

Chair Burt stressed that today's software companies generally are not selling products which are sales taxable, by retail or business-to-business. He asked, out of the business-to-business tax, how much of this was reflected in software sales.



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Mr. Perez stated this information was in their sales tax report to which they would return with that figure. He stated it was also dependent on the physical delivery of the product as well as maintenance factors of the product. He stated there was data available on this and they would continue to review this tupe of business.

Chair Burt asked given the amount of software transferred over the internet currently, how is it possible to define the location of physical delivery.

Mr. Perez stated this was obviously something which required reworking within the Ordinance. He stressed that a great deal of this reporting was on an honesty basis via the corporation or individual.

Chair Burt stressed he pursued this in-depth due to the fact that software companies in Palo Alto employ a great number of people with the bulk of their operations done within the City. He stated this represented a substantial amount of revenue to which he saw a comparatively small number of this revenue represented on the chart. He gave the example of extremely large law firms, as well, who generated large revenue within the City. He looked for some sense of what revenue amounts were actualities within the City of Palo Alto along with a better understanding of the business-to-business task within the City.

Mr. Perez stated an initial review was done with information available by public access. Business-to-business was looked at in terms of sales tax categories (business services, light industry and leasing). The tax structure currently in place was a recommendation based on this methodology and the difference in tiers. He stressed there was also flexibility for a hybrid tax for any type of business category not generating gross receipt but needed implementation of a different methodology or category.

Chair Burt stated Santa Clara had a greater number of businesses cited. He did not believe their employee base, however, was higher than Palo Alto, even though their resident population was higher. He asked what accounted for the difference in the number of businesses and what sales tax proportion was business-to-business versus that of Palo Alto.



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Mr. Perez stated Staff would look into this.

Chair Burt asked about financial service companies (the venture capitalists, private equity firms, etc.). He stated this made up a large sector of the economic base. He asked for clarification on what fell under taxable activity and what ultimately was captured under this umbrella.

Mr. Perez stated it was up to Staff to define this. In looking at each category, there was some gray area which would need further identification. He stressed looking at other jurisdictions' practices would help identify some of the logistics of this.

Mr. Keene stated more data could be captured on this in order to gain some information in which to apply and make their determinations.

Chair Burt asked for clarification of taxable activity occurring in the City versus the location at which the revenue was realized.

Ms. Silver stated business tax was geared at the business activity which occurred within the City boundaries. She stressed there was a series of apportionment rules derived from this general principle. With regard to the venture capitalist issue, she suggested looking at whether Los Angeles, by example, revealed any specifics for dealing with the venture capitalist and other types of companies. She stated they would return on this issue but apportionment was regulated with standard rules adopted which typically are not in the Ordinance, itself, but generally arise as administrative guidelines for apportionment.

Chair Burt stressed the composition of Palo Alto was not typical of general cities in their type of businesses.

Vice Mayor Morton stated the Federal Government required on tax forms that business identify their business codes. He stated within this elaborate structure, these business codes would be a way to identify and make classifications. He asked if Palo Alto was using these Federal tax form business codes as a set of modifiers.

Mr. Perez stated this was correct, but challenges arose if a particular business dealt with services and retail, combined.



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Vice Mayor Morton stated, despite the gray areas, work was focused on better classification in types of businesses.

Ms. Silver stated the Federal Government categories marked the starting point where on Cities then typically created their own categories in supplementation to the existing categories.

Council Member Yeh asked about potential impacts of the different classifications. In businesses assuming the tax burden, he questioned how many of those classifications had the potential for a pass-through cost to the end-user, the customer and/or the resident ultimately assumed the cost.

Mr. Perez stated based on ongoing meetings in this arena, the concern of the business community was that this eventually passed on to the consumer, or the renter. With no affront to the business community, he added that sales tax and hotel taxes are pass-through costs. He stated the businesses do not pay these directly in that the consumers paid these taxes, so to speak.

Council Yeh asked what unintended impacts might arise, specifically with regard to non-profits.

Mr. Perez stated non-profits were exempt but they could be renting private or commercial space which would be subject to a pass-on.

Council Member Yeh suggested, in structuring the Ordinance, to look at what has happened in other jurisdictions. He asked if there was an opportunity to look at impacts on local cost of living adjustments that resulted from this. He asked for the reasoning behind Staff asking for a CPI adjustment on the floor and ceiling figures.

Mr. Perez stated this was based on discussions with surrounding jurisdictions that did not have such mechanisms in place. He stressed nothing stood in the way of the City having a different structure or timeframe at all.

Council Member Yeh asked about the Business Registry, itself, and the creation of this registry. He asked what information would be included in this registry in terms of categories of information.



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Ms. Stokes stated Staff developed an information-gathering form which included business address, emergency contact, number of employees, square footage, hazardous materials as well as some confidential information which would not be released to the public.

Council Member Yeh asked whether the registration was required versus voluntary.

Mr. Perez stated Staff was reviewing the elements of mandatory versus voluntary registration.

Council Member Yeh asked to what extent this registration would be enforced if it were made mandatory versus voluntary. He asked if this enforcement, in either case, was factored into Staff costs.

Mr. Perez stated the assumption was there was an application filled out and then submitted with the returns. If it became too complex, he stated the impacts would be looked at. He stated it was difficult to really assess this as an exact number without the exact data available at this time.

Council Member Yeh asked about home-based businesses versus commercial-based businesses. He asked if this was also a challenging area in an effort to assess these home businesses.

Mr. Perez stated there is no good grasp, as of yet, as to what is out there in the home business realm in exact numbers. Ongoing data would prove useful in understanding the types of home-based businesses and the demands this would create for Staff.

Council Member Klein, regarding the proposed rate structure, asked for further thought on what went into the current distinctions between retail, service and professional business rates.

Mr. Perez stated the rate structure modeled what is typically used in the surrounding area. The proposed rate structure took into account the margin of profit.

Vice Mayor Morton stated the community still held confusion over the concept of the pass-through tax. For the public's benefit he asked for



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clarification of this as it pertained to realtors and the discouragement of housing sales within the City.

Mr. Perez stated in rental units, with an imposed tax on the landscape company (or an imposed tax on the plumbing service provider), those cumulative dollars paid by the business entity would then be put in as their cost of business back to the recipient of the services. He stated, in this example, the one particular renter in this dwelling could then see an increase in these service and/or in the rent being paid.

Vice Mayor Morton asked if they thought they would really lose renters if there was a pass-through allocation of service costs.

Mr. Perez gave an another example, in that what was proposed was that multi-unit rentals (four or more holdings) pay 75 cents/one thousand dollars in income. In this regard, a monthly rent of \$4500.00 x 4 for the year would result in the generation of \$216,000 annually. He mentioned the owner or company would pay the annual tax of \$162.00.

Vice Mayor Morton expressed concern that there was worry over this pass-through, but also wanted to be sure he was correct in the calculations.

Chair Burt asked if the proportion of revenue derived from small, medium and large businesses had been looked at in any general sense.

Mr. Perez deferred to Mr. Vanorsdol but stated any figures cited were based on the data available.

Mr. Van Orsdol stated businesses which had a gross revenue of \$100,000 represented less than 5 percent of the total expected revenue to the City. Small businesses presented a small fraction of this total revenue.

Chair Burt asked what the revenue caps were for each sector, from small business up to the \$20,000 maximum.

Mr. Perez stated for retail this was \$40 million and for services was \$26,666,000.



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Chair Burt stated, based on the rate structure, manufacturing was comparable to retail at \$40 million. He stated they tried to have virtually zero revenue generation from small businesses. This appeared as cost recovery, or in the case of very small businesses, below cost recovery as a business registry. Beyond that, there are small to medium, and medium to large businesses, on to the very large. He stated the highest number of businesses fell in the small business range which did not generate revenue for the City. He asked then about the cap for the large businesses. If companies made a billion dollars a year in revenue with the City, but a cap is placed on their gross taxable revenues, he stated the result is they pay 1/25<sup>th</sup> of the rate of a medium sized business in the same sector. He asked if this was a correct assumption.

Mr. Perez stated there was concern over losing the large business. He stressed some businesses were difficult to move; however, other businesses could decide to move their point-of-sale activity outside the confines of Palo Alto. He stated this was the reason for the cap, in prevention of this large business loss.

Chair Burt shared the concern over the loss of large retailers. However, this concern was reflected in the lower rates for retailers in various sectors. He was more interested in a structure which would credit-back toward the retailers and hotel operators who generated significant revenue to the City. He stated the credit-back lessened the financial impact on retailers, whether they were small or large. He pointed out the many large, high-revenue businesses in Palo Alto that do not fall in the retailing category. He stated the scenario existed where a large retailer could be paying the same amount of tax, or half as much as a software company that was generating a billion a year in revenue out of the City. He stated the cap, as structured and explained, was intended to protect the large retailers, which he supported, but he did not support this protection for the large law firms, software and other companies.

Mr. Perez stated work could be done in this realm by direction of the Finance Committee. He stressed, however, the administrative burden on both Staff and the businesses end in order administer to this.

Committee took a break at 9:15 p.m. and returned at 9:25 p.m.



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### PUBLIC COMMENT

Dennis Martin, National Association of Industrial Properties, a representative of commercial property business based out of San Jose with representative firms throughout California. He expressed concerns and requested involvement in the discussion prior to, and after, policy decisions.

Vice Mayor Morton asked if there were any other communities in which his organization did not pay a Business License Tax.

Mr. Martin stated no, not in his chapter, which is primarily located in Santa Clara County, but also in the southern sections of San Mateo County as their territory, and all the cities have some form of business tax.

Leon Leong, stated he was Co-Chair of the Local Government Relations Committee of the Palo Alto District of Realtors, but was speaking as a citizen of Palo Alto and as a realtor doing business within the City. He stated Council had developed a sustainable budget in 2005. He commented on the ensuing years' budget forecasts as being lower than those cited in 2005. He expressed concern over managing to meet the objectives necessary for a sustainable budget. He showed slides regarding revenue projections and economically cyclical revenues. He continued his presentation on the expenditures of the last four years with comparison to the adopted Budget. He spoke to better management of the adopted budgets to resolve any future deficit issues. He noted expenditures were growing faster than the CPI which was not a healthy financial situation.

Chair Burt stated the additional slides would be read by the Committee.

Council Member Klein stated it was difficult to believe that there was a deficit over the last four years when they have not had the need to reduce their Budget Stabilization Reserve. He stated the year-end budget reconciliations have either been at the break-even level or had surpluses over the last years.



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Mr. Leong stated he reviewed the budget documents and had seen the surpluses.

Council Member Klein stated these numbers were audited by an outside auditor for any discrepancies. He suggested that Mr. Leong speak with Mr. Perez and/or the outside auditor. He felt there were some discrepancies in the numbers Mr. Leong was using in his presentation.

Mr. Leong stated his numbers were taken from the adopted budget documents.

Council Member Klein stated he should acknowledge, then, that these adopted budgets showed a surplus.

Mr. Leong stated those surpluses could be considered in use to fight the future deficits during this period of downward turning economics. He stated his next two slides made an example as to what a business person and/or realtor had with regard to potentially being taxed twice on certain transactions. He hoped for some further work on preventing any double-tax of this nature.

Leannah Hunt, Realtor, immediate and past President of the Silicon Valley Association of Realtors, with offices in Palo Alto. She opposed the BLT Ordinance. She was mindful of the budget deficiencies faced as well as the difficult times ahead for area business owners. She stressed the shortfalls of the current process and negotiations. She requested the Mayor appoint a Committee to review the budget and other opportunities to secure the funds and services necessary to maintain the community and its businesses.

Paula Sandas, Palo Alto Chamber of Commerce, spoke in opposition of the Gross Receipt Tax. She stated the tax has been a long time in coming but now was on the fast track towards the November Ballot. The Chamber's position was in opposition of the Gross Receipt Tax (referred to as the BLT). The Chamber recommended establishment of a Blue Ribbon Taskforce of stakeholders to include members of the business community in order to study innovative alternatives to the tax.



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Ted Paulin, fifth generation community member of Palo Alto, with a family business which began in 1897. He stated he was also a second-generation Palo Alto realtor. He opposed the proposed tax in that it was overly confusing. He suggested a flat tax base, a set amount, kept simple for all involved.

Pat Sausedo, Executive Director of the National Association of Industrial and Office Properties (NAIOP) and the commercial real estate industry of Silicon Valley. She let the Committee know that in all Santa Clara County cities, none of these cities has a Gross Receipt Tax, while they do have a Business License Tax. She stated in the current presentation comments were made that the Gross Receipt Tax was reasonable and equitable to the business community. She asked if this reasonable and equitable by Staff's determinations since there had been no dialogue with the business community and stakeholders subject to this proposed tax. She agreed with the Chamber's recommendation for creation of a Task Force which would include these businesses and stakeholders in order to build a truly reasonable and equitable plan and implementation.

Herb Borock, P.O. Box 632, Palo Alto stated the formation of a Task Force would delay the election by two years. He stated the tax base should have been implemented twenty-five years ago. He suggested that Staff make use of data available from the Employment Development Division (EDD) of the State of California for more accurate analysis of the businesses involved, the number of employees and revenue numbers. He stated the exemption language used by Staff is not clear. He suggested Council look at the actual language for this particular exemptions. He stressed they also look at the language regarding the proportionality of number of employees, etc., which justify certain ends. He stated he was of the mind that there were two county pockets within the City and described these.

Robert Moss, 410 Orme Street, Palo Alto stated the proposed tax was long overdue but the current structuring of the tax remained awkward. He also stated it was not the taxes which drove business out of Palo Alto but the high rent of office space. He suggested a census of the number of business, number of employees and locations would provide additional information as an incentive for this tax. He stressed the importance of the job and housing numbers in the balance.



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John St. Clair III, Alain Pinel Realtors, Chair of the Palo Alto District Council, board member of the Silicon Valley Association of Realtors, resident and businessman. He opposed the tax, as a businessperson, especially given the current state of the economy. He stated a gross tax received does not reflect the current conditions of the market since it is based on the previous year's business activity.

Julia Keady, Alain Pinel Realtors, and 2009 President of the Silicon Valley Association of Realtors. She stated the proposed BLT was speculative. She stated the City cannot anticipate a specific dollar amount from this type of tax, year-to-year, especially considering the current economic climate. Because business activities fluctuate from year to year, the Gross Receipt Tax model was not a predictable measure to base revenues onto a fixed structure deficit. She stated community members understand the role taxes play in continued services. However, from a realty perspective, there was the risk of taxation in Palo Alto, and also where they sell their property, resulting in double-taxation or more. She stated the timeline for this decision was short, and she hoped for inclusion and continued dialogue.

Robert Reid agreed with Ms. Keady's comments with regard to the possibility of double, tripled or even further taxation as a result of the plan. He stated the proposed tax was cumbersome and inequitable. He stated a flat tax would be more beneficial and equitable to both the community and the City.

Adam Atito, realtor, stated the initial Business Registry Fee should be completed prior to the discussion of a business tax plan. He asked that this process take its course prior to additional talks on the Business License Tax. He was in support of a flat tax rate versus a gross tax and stressed the importance of community and business members paying taxes to ensure continuation of services.

Michael Morris, Palo Alto native and commercial property owner in Downtown Palo Alto. He stated there was an inequity in business size versus the amount taxed. He stated the business license flat fee was workable alternative. He stressed the adverse effects the proposed tax plan would have on the small businesses in the community. He believed such a tax plan resulted in businesses leaving Palo Alto in response.



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Dan Dykwel, Realtor, and Co-Chair of the Local Governmental Relations (LGR) Committee for Silicon Valley and the Palo Alto Chapter of the Silicon Valley Association of Realtors, Chamber of Commerce board member and Co-Chair of the Business License Tax Taskforce. He stated the tax proposal contained incomplete data in order to achieve the proposed equitable taxability. He stated minimizing the impact on the business community was paramount since businesses are a vital aspect of Palo Alto.

Joshua Howard, Executive Director of the tri-county division of the California Apartments Association. He expressed concern over the formula proposed for the Gross Receipt Tax. He stated there was a lack of outreach to area businesses ultimately impacted by this plan, most especially commercial real estate and the multi-family rental sector. He noted a lack of transparency in the process since Staff appeared to have already decided upon a gross receipts formula. He stressed the need for exploration of ways to reduce costs, while also increasing revenue, especially in current economic times. He cited gross receipt taxing as being burdensome, intrusive and lent to pass-through costs to residents.

Adam Montgomery, Government Affairs Director of the Silicon Valley Association of Realtors. He spoke to Mr. Dykwel points and their tracking of this taxation issue with the hope that several proposals would come forth to the Finance Committee with varying options. He asked if they could move towards a proposal comprised of all the options for final decision.

Nader Essabmoy, 30-year resident of Palo Alto thanked Staff for their work, and stated he understood the pressures to provide services to a community and the resultant taxation of community members. However, he stated the tax proposal appeared unfair to the individual or small businesses. He expressed concern over the \$20,000 cap since businesses of a larger nature had the option to move, which spoke again to the unfairness of the proposal as presented. He felt the taxation of residential units of four units or more also came with some inequalities by process.

Chair Burt asked for any additional comments from Staff regarding issues raised by the public.



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Mr. Perez stated there were no further comments or questions at this time. However, he noted an email was sent to the Finance Committee with questions and answers which had been submitted to Staff prior. He stated this was an ongoing process and he urged any and all members of the community or speakers to contact Staff with further questions.

Mr. Keene added his understanding of the concern over the timeline for this tax proposal and decision. He stated, however, it was necessary to bring something to the public and to the Council, through the Finance Committee. He stated it was obvious, based on questions from the Finance Committee, as well as in speakers' comments, that the current recommendations had not exhausted all the variables and possibilities or answered all questions. However, they had also received questions and concerns over when they would finally see the Business License Tax proposal. He stated when the methodology was appropriate with due diligence, they brought this to the public realm, with also the understanding that there was the need for ongoing discussion.

Vice Mayor Morton asked Staff for clarification on what they sought from the Finance Committee at this current meeting.

Mr. Keene stated Staff's thought was to return to the Committee on April 21, 2009. In the interim, more than a month, they expected to follow up on the questions and comments from the Committee as well as any further directives. He stated there would be opportunity as well for further questions and concerns from the community.

Council Member Klein asked Staff to return with a goal to produce a revenue of \$2.5 to \$3 million. He stated he arrived at these figures by looking at the communities of San Mateo and Menlo Park as comparable to Palo Alto, although Menlo Park's numbers needed doubling since Palo Alto is twice their size. He stated a flat tax was simple method, but it was not equitable. He stressed an equitable taxation brought with it a more complex system. He suggested a plan which eliminated businesses conducted out of a personal residence, owned and/or rented by the business owner. He stated this simplified the proposal without revenue impacts. He suggested, as well, increasing the real estate exemptions up to the 8- to 12-unit level. He stated he wished to see the number of payers under the taxation



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substantially cut which does not significantly impact the proposed revenue. He went over his decision-making process for the above-mentioned suggestions. He stressed there was never a good time for a new tax; however, various economists now argue, on the State and Local level, that it was better business to have some increased revenue. He stated the National level was certainly different. Ultimately, he stated businesses experience more unhappiness with lower or no taxes due to the decline in community services. He was in support of the BLT, despite any misgivings about the timeline. He reiterated that taxation remained essential in the maintenance of community services which led to success throughout the City on all levels.

Vice Mayor Morton aligned his comments with the majority of those made by Council Member Klein, although he did not agree on excluding home-based businesses. He also addressed comments and concerns made by the public regarding the unfairness, bad timing and inequality of the tax plan. He spoke to pros and cons regarding the suggestion for the need of a Task Force to address this tax plan. He stressed the tax plan was not speculative in nature as the community comments suggested and did not agree that businesses would leave Palo Alto in response to the tax plan. He stated he was in support of the BLT as the easiest and most simple way to achieve all goals.

Council Member Yeh stated all tax implementation brought with it business impacts and look for some structuring of how these businesses are impacted. If the plan moved forward, he had concerns over the predictability of the budget. He wished to know how Staff anticipated management of a three-year period since this was a significant time period of trial and error which affected government policies and services in the community. Without that predictability, he stressed the need for a plan to mitigate any fluctuations that might occur. He focused on the Business Registry as a way to tie in multiple processes in the City including Fiber to the Premises and home-based businesses. He stressed the importance of clustering this information. He stated an alternative structure to the proposed plan was a Payroll Expense Tax as done in San Francisco. He also encouraged Staff to consider the concept of apportionment since the message was clear that businesses cutting across jurisdictions needed this coordination.



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Chair Burt stated it was his sense that most speakers were willing to move forward with the BLT with certain specific considerations. He stated he struggled with the timing, the scale and the form of the proposed plan. In an effort to be fair, he stressed with any new tax, there was always the question of equitability. He stated this involved many elements and that Staff's proposal contained progressive elements to deal with inequities, which included the exception for small businesses. He stated there was, though, the regressive element of very high exceptions for the larger businesses. He expressed his opinions on payroll taxation as an alternative with regard to fairness. He encouraged Staff to accelerate the outreach program to the general community as well as the business community. He stressed the importance of the constructive comments that were made by community members. He asked if the individual taxation records would remain confidential in the same way that the current sales tax records are sealed.

Mr. Perez stated this was correct.

Chair Burt summarized the bulk of what was heard in that the Committee would like to see more than one option. He agreed with Council Member Klein that the current scale-in of this tax was high in keeping with the current economic times. He asked whether Staff had received an adequate sense from the Committee on how they should move forward.

Mr. Keene stated Staff had adequate information on which to proceed.

Council Member Klein requested that Staff include a study of the total local tax burden in the City in comparison to other cities. In this realm, he suggested eliminating sales and property taxes from this study, since these are uniform. He stated the only real variables included utility user tax or business licensing taxes. He suggested Staff also include the utility rates (including comparisons) and an analysis as to how much the tax burden was borne by the business community pre- Proposition 13 (1978) and now. He stated there was the suggestion that tax burden from business was reduced due to Proposition 13, but they have also heard the opposite. Regarding the timing issue, he stated this proposed plan would not go into effect until July 2010 under any circumstance. He stated Council would be recommending the ballot measure and the Council has the discretion



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to delay this if necessary. He stated as far as minimum fees were concerned, the information provided by a business registry was needed but hoped the record-keeping process was simplified which would also keep administration costs down.

Vice Mayor Morton asked whether Council Member Klein recommended exclude the Transient Occupancy Tax (TOT) along with exclusion of the real estate and sales tax.

Klein stated he included the TOT which applied to a relatively small segment of the business community. He would also leave in parcel taxes since they do vary significantly from community to community.

4. Consideration of Recommendation for City Council Adoption of the Fiscal Year 2009 Adjusted Budget – Second Quarter (Q2) Financial Results, Midyear Amendments, Capital Improvement Program Status, and Amendments to FY 2009 Adopted Municipal Fee Schedule

City Manager, James Keene stated current budget adjustments trended downward. In closing the \$5.8 million gap in the budget, they processed and identified departmental expenditure reductions, eliminated budgeted transfers (the Year-End Surplus and Infrastructure Reserve, which was a million-dollar figure which did not materialize), General Fund contributions to the retiree medical liability and initiation of hiring freeze for the balance of the of Fiscal Year 2009.

Budget Manager, Sharon Bozman gave a brief presentation of the Midyear Financial Report with a summary of numbers seen by Council in February for the Long-range Financial Forecast. These included the above-mentioned, one-time expenditure adjustments made to decrease the \$5.8 million gap in the budget. She stated there was ongoing monitoring of revenues in keeping with the long-range forecast. She gave an overview of departmental expenditure reductions through midyear. She continued with proposed actions in the event of further revenue decline which included elimination of the remaining General Fund contribution to the retiree medical liability, continuation of vacancy holds and expansion of the City Manager's spending reductions.



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Mr. Perez went over a meeting Staff attended with the Santa Clara County Assessor's office on property tax discussion. A 2.9 percent increase in assessment evaluations is predicted for the next fiscal year, in line with Staff's long-range forecast. He went over school district data, applied comparison to the City, which reflected eight foreclosures in calendar year 2008. He went over property valuations and the current market conditions. He stated there is a comfort level there; however, there is concern over non-secured or commercial properties which revealed wider variations in assessment values. He stated preliminary indicators from the State of California revealed fourth quarter returns from 2008 versus 2007, for the state, were down 14.9 percent. He stressed the exact impact was not known to Palo Alto, in this statewide comparison, but it revealed the fact that the number will not be positive. Advance amounts were lowered based on prior year's projections for the month of February by \$750,000. Hotel tax was slightly up versus last year's numbers. However a drop-off occurred in January '09. Average room costs are lower with a troublesome percentage in occupancy levels.

Mr. Keene reiterated that the strategies for the current Fiscal Year 2009 was to get through the year with the one-time cuts. He acknowledged the fact that more systemic decisions and choices pended the upcoming 2010 budget.

Vice Mayor Morton stressed the fact that budget cuts lend to a burden or cuts in City departments and community-based services. He stated, without work on the revenue stream coming in, bigger budget cuts remained likely for the coming year.

Council Member Klein spoke to Tom Wagner's email, on the question of what is charged in inspection services with regard to the Green Building Ordinances with dramatic fee increases. He stated the increases were very large and above what was charged prior. Staff's response was this was due to Council's mandate that fees covered expenses. He understands the policy but questioned why the expenses increased so significantly.

Mr. Keene stated he was in no position to respond to the Committee with an informed answer but would return with information on this.

Council Member Klein asked if these fees were currently charged.



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Mr. Keene stated, in looking at the revenue numbers, there were significant declines in the permit numbers. He stated reductions were made in the Staff as well.

Interim Director of Planning and Community Environment, Curtis Williams stated there was not a fee charged for green building review. There was a plan to implement a fee for the single-family home which includes the construction and demolition fee. He stated for a large home this was estimated as an approximate \$500 fee. The Utilities Department also had programs and rebate incentives to offset costs or cancel out the fee increase. Ultimately, he stated this was a Council policy determination, which they reported last year with the Green Building Ordinance also included reporting back at midyear with the fee schedule and request for additional staffing.

Council Member Klein stated the fee increase for new housing rose to very high percentages. He asked if the prior fee really was too low.

Mr. Williams stated it was the construction and demolition permit process in question and the work surrounding verification of this. He stated there was never a fee associated specifically to checking things over with followup and records. He stated they could look at further reduction in these fees if so advised by the Committee, but reductions meant 100 percent of the costs would not be covered for green building reviews.

Council Member Klein requested a hold on the fee increase pending a more detailed report on how it can be done.

**MOTION:** Council Member Klein moved, seconded by Council Member Yeh to hold green building fee increase in abeyance until additional information was received by Staff.

Vice Mayor Morton clarified the Motion and stated he supported the Motion which would give more information to the public.

Mr. Perez asked whether it was appropriate to return during Council review, or was it necessary to return to the Finance Committee.



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Chair Burt stated the Motion's intention was that this return to the Finance Committee at the next regularly scheduled meeting.

### **MOTION PASSED: 4-0**

Vice Mayor Morton asked if there was any way to mitigate the impact on community services by a review of fees, or any way in which fee adjustments might lead to mitigation of some of these cuts.

Interim Director of Community Services, Greg Betts stated the fee schedule was reviewed. There was a break point in many community programs, where if fees were raised, decrease in attendance would result. He stated a number of fee suggestions were brought forward for the current budget with some adjustments in increases in rental fees. He stated the proposal also included a new fee for the lawn bowling club rentals.

Vice Mayor Morton asked, in looking at the fees for the upcoming budget, they were prepared to cut the fees.

Mr. Betts stated this was correct.

Vice Mayor Morton agreed they should move on this item.

Council Member Yeh stated he saw variations in the percentages going across departments. He asked how these numbers were arrived at.

Mr. Perez stated vacancies were a major factor in the hiring freeze. There were also limitations in several departments due to contractual obligations in minimum staffing quotients. Departments also looked at their non-salary costs.

Council Member Yeh, in terms of revenue recovery, he asked if these positions were actually removed from personnel count or were they held vacant for later consideration.

Mr. Keene stated for the current Fiscal Year 2009, the positions are held vacant. In 2010, these vacancies will be reviewed further as to whether they will be permanently eliminated. Whether or not the departmental vacancies is revenue-producing was also a factor.



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Council Member Yeh asked how these one-time cuts factor into moving forward in preparation for the two-year budget process.

Mr. Keene stated it was too early to speculate. Limitations in the current year tend to carry over the ensuing years, but this does not mean an avoidance in efforts to remove some of these limitations. He stated there is more flexibility in some areas versus others.

Council Member Yeh asked if there were pending Capital Improvement Projects (CIP) which would improve efficiency as opposed to routine maintenance type CIPs.

Mr. Keene stated it was an excellent point to tighten services in this way. Suggestions have been received at the Staff level which are in the review process for advisement to the CIPs regarding these same factors.

Chair Burt agreed a blanket decrease across the board was not the way to proceed. He wished for a better understanding of the impacts on services due to cost reductions. He questioned whether they should be looking at proactive program to move qualified people to fill positions in the enterprise fund rather than doing a new hire which may result in future layoffs in the General Fund.

Mr. Keene stated this was being done. He stressed there has not been a lot of employee turnover since they try to hold positions vacant, including in the enterprise funds. The current focus is on internal recruitment in replacement of as many positions as possible.

Chair Burt expressed appreciation for the high caliber Police and Fire Department. He stated these departments look to have had the lesser decreases since there are not opportunities for greater cuts while also meeting the City's needs. He stated, however, this is difficult to understand in just looking at the numbers what is exactly going on behind the scenes.

Mr. Keene stated the Fire Chief may want to speak to this. He drew the comparison to the revenue structure in the State of California, where there were built-in restrictions and limitations in some areas which force them to make cuts where possible, while not possible in



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other areas in keeping with public safety which has less flexibility in cuts which would affect needed services.

Chair Burt asked if there were opportunities where city departments have acknowledged that they can come forward with ways to improve efficiency or reduce costs in an effort to avoid tougher choices or cuts.

Mr. Keene stated this was the case, however, for the most part, these types of cuts or reductions would not entirely help avoiding some of the upcoming tougher decisions and budget cuts.

Mr. Perez gave an overview of the Fire Department budget. The Fire Department had contractual obligations and limitations when it came to making determinations on the amount of reductions possible.

Chair Burt stated overtime was a large factor in the Fire Department budget. He asked whether overtime was an area for possible adjustments. He stated parking violations were also down. He asked if this was a reflection of lower employment in the downtown area with fewer parking fines as a result.

Lt. Mark Venable, Palo Alto Police Department (PAPD) stated there was no economic downturn determining the lower amount of parking violations. The principle reason for the downturn stemmed from recent injuries to several parking enforcement officers, which limited their enforcement capabilities or took them off duty completely. Council also added a parking enforcement officer who is now on board working. With the injured officers returning to full duty and the additional officer, they have experienced an upward trend in the last several months.

Chair Burt stated his concern about the multiplier effect in the hotel tax where a drop in occupancy also dropped the daily rates. He stated that free-fall is noticeable at this point. He suggested an occupancy evaluation analysis was necessary.

**MOTION:** Vice Mayor Morton moved seconded by Council Member Klein to pass on to full Council for midyear adoption with the exclusion of the green building fee adjustments as per the previous Motion of the Finance Committee.



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**MOTION PASSED:** 4-0

5. Discussion of Future Meeting Schedules and Agendas.

No meeting on April 7, 2009.

April 21, 2009 to discuss BLT

May 18, 2009

July 20, 2009 BLT resolution, ballot/rebuttal arguments

ADJOURNMENT: The meeting adjourned at 11:30 p.m.