

**TO: FINANCE COMMITTEE**

**FROM: CITY MANAGER**

**DEPARTMENT: ADMINISTRATIVE  
SERVICES**

**DATE: SEPTEMBER 8, 2009**

**CMR: 358:09**

**SUBJECT: Review of Preliminary FY 2009 Revenue Analysis**

### **RECOMMENDATION**

Staff recommends that the Finance Committee review and discuss preliminary General Fund revenue performance for FY 2009.

### **BACKGROUND**

As a result of the current recession and consequent decline of key General Fund revenue sources, the Finance Committee requested a late summer assessment of FY 2009 revenue performance. This assessment was to include a comparison of actual revenue receipts to the FY 2009 Adjusted Budget and to prior year results. The variance analysis could lead to necessary mid year budget adjustments and allow the City to be proactive in resolving unforeseen budget gaps.

It is critical to note that the FY 2009 numbers presented in this report are unaudited and that there are potential accruals that may result in subsequent changes. Staff is not presenting a year end expense analysis at this time. Since accruals and incurred, but not reported, expenses in such areas as workers' compensation and general liability have not been fully booked and allocated to departments, staff believes an expense report is premature and could be potentially misleading.

In addition, the Committee requested an earlier review of FY 2010 quarterly revenue and expense results. Staff anticipates presenting a full analysis in late October 2009, but offers the following insights into preliminary trends in this report.

### **DISCUSSION**

The crucial backdrop to the results in this report is the dismal state of the economy. In what has come to be called the "Great Recession," the City's key and economically sensitive revenue sources have declined significantly since FY 2007-08. Rising unemployment rates, tightening credit markets, deteriorating residential and commercial property markets, and diving consumer confidence have driven down public revenue streams across the country. The City of Palo Alto has not been immune from the recession.

Attachment A shows preliminary actual revenue results for FY 2009 in comparison to the FY 2009 Adjusted Budget and to 2007-08 actual results. Attachment A reveals some notable negative revenue variances at FY 2009 year end. Variances exceeding negative 2.5 percent compared to the FY 2009 Adjusted Budget and FY 2008 actual results are discussed below. In addition, potential revenue shortfalls in the FY 2010 Budget are discussed.

### Sales Taxes

While actual sales taxes for FY 2009 were slightly above the Adjusted Budget, they were 11.2 percent or \$2.5 million below actual returns for FY 2008. Compared to prior year quarters, City cash receipts fell by 9.7 percent in the 3<sup>rd</sup> quarter 2008, 14.9 percent in the critical, holiday 4<sup>th</sup> quarter 2008, and 14.9 percent in the 1<sup>st</sup> quarter 2009. Due to the long, lag time in collecting, tallying and remitting receipts, all of the cash collections for the above periods are recognized in FY 2009.

Retrenchment in consumer spending is the principal reason for sales tax declines. New automobile, department store, and miscellaneous retail sales have been especially weak. Auto sales tax receipts have fallen from \$1.9 million in the 1<sup>st</sup> quarter of 2007 to \$1.3 million in the 1<sup>st</sup> quarter of 2009. Department store sales have dropped from \$2.7 million to \$2.4 million and miscellaneous retail from \$1.9 million to \$1.6 million during the same period. Although there are preliminary signs that the economy may have "bottomed out," economists believe a recovery will be lengthy and slow. Consumer spending, because of household debt, home price decreases, hard hit stock portfolios, and concerns about employment, is likely to remain muted for the remainder of 2009 at a minimum.

The FY 2010 budget projects \$19.7 million in sales tax revenues, 4 percent or \$0.8 million below actual FY 2009 revenues. Should the 1<sup>st</sup> quarter percentage decline of 14.9 percent repeat itself in the 2<sup>nd</sup> quarter 2009 (which represents the first quarter of receipts for FY 2010) and there is continued weakness in the 2<sup>nd</sup> quarter, it may be necessary to revise the FY 2010 budget downward at midyear by as much as \$0.4 to \$0.8 million. This is a most preliminary estimate.

### Transient Occupancy Tax (TOT)

TOT revenues were 2.5 percent or \$0.2 million under the adjusted budget. They were 11.3 percent or \$0.9 million below the prior year. It should be noted that a 2 percent TOT rate increase was approved by voters and took effect on January 1, 2008. In comparing FY 2009 to FY 2008, the first six months of FY 2008 did not include the rate increase. Therefore, had the TOT increase not passed, the gap between FY 2008 and FY 2009 revenues would have been worse.

Average occupancy and daily rates in FY 2009 were 65.2 percent and \$145.90, respectively. In FY 2008, the rates were 75.5 percent and \$149.26. TOT revenues fell nearly 30 percent lower in the period January – June 2009 compared to January – June 2008. If trends in the latter half of FY 2009 continue, it is likely a negative mid year correction may be necessary. The adjustment could range between \$0.2 and \$0.5 million. July 2009 TOT data was not available at the time of this writing.

### Documentary Transfer Tax

This important revenue source, which is based on the number and value of commercial and residential property sales, has moved down sharply during the recession. Rising to the mid \$5 million level for the past 5 years, it retreated to \$3.1 million in FY 2009. While close to the adjusted budget, this result was 42.5 percent or \$2.3 million below FY 2008 results. The poor performance is a consequence of the commercial and residential markets coming to a virtual standstill. Commercial transactions decreased due to low occupancy rates and residential transactions were minimal due to sellers holding onto their homes during a period of market softness. In addition, credit conditions were abysmal due to the collapsing credit markets for commercial and jumbo home loans.

As with sales tax and TOT, documentary transfer tax revenue estimates for 2010 may require a midyear adjustment. Results for the month of July 2009 were nearly 40 percent under those for July 2008. Currently, the adopted budget for FY 2010 projects \$2.8 million in transfer taxes, \$0.3 million below actual FY 2009 revenues. With credit markets slowly returning to more normal activity, staff hopes this revenue source will rebound and obviate the need for a midyear adjustment.

### Fines & Penalties

This revenue category consists primarily of parking violations and library fines. Revenues are below the FY 2009 Adjusted Budget by 16.6 percent or \$0.5 million, and 4.7 percent or \$0.1 million below prior year results. The negative variance is primarily due to parking violations, which came in 28 percent or \$0.6 million below the adjusted budget. The combination of industrial injuries to Community Service Officers and fewer cars in violation of parking regulations have led to this drop. Should vacancies continue, an adjustment to adopted budget revenues may be necessary.

### Permits & Licenses

The downturn in the economy has heavily and negatively impacted building related fees. Permit and license fees were 16.5 percent or \$0.9 million below the adjusted budget and 17.4 percent or \$0.9 million below the prior year. Compared to the budget, new construction permit fees are down 13.7 percent or \$0.4 million while plan check fees were down \$0.1 million.

In the new fiscal year, July 2009 building fee revenues are up by \$0.1 million in comparison to July 2008. This may signal an upturn in this revenue category, which would preclude a midyear adjustment.

### Return on Investment

Interest income came in higher than the adjusted budget for 2009, but was under prior year results by 6.9 percent or \$0.2 million. With the Federal Reserve keeping interest rates low to stimulate the economy, the City's portfolio yield has declined to the low 4 percent range over the past two years. It is expected that yields will continue to decline as higher yielding instruments mature and the City continues to buy securities in the 3 to 4 percent range. An adjustment at midyear may be necessary if interest rates do not trend upward.

### Conclusions

In summary, the "Great Recession" continues to take a toll on City revenues. The general consensus among economists is that the remainder of 2009 will be weak, but that a slow and mild recovery will begin in 2010. Unemployment is expected to remain stubbornly high and personal income growth muted. Under such conditions, sales, transient occupancy, and documentary transfer taxes will remain under pressure in the months to come. Consequently, additional adjustments to these revenue sources may be required at mid year.

### RESOURCE IMPACT

Based on the findings above, no adjustments to the FY 2010 budget are recommended at this time. Depending upon revenue results from July through January, revenue and expense adjustments may be necessary at midyear.

### POLICY IMPLICATIONS

This report does not contain information requiring a change to existing City policies.

### ENVIRONMENTAL REVIEW

The actions described in this report do not constitute a project under section 21065 of the California Environmental Quality Act.

### ATTACHMENTS

Attachment A: Preliminary Revenue Analysis for FY 2008-09

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ATTACHMENT A

Preliminary Revenue Analysis for FY 2008-09  
Actual Performance Compared to FY 2009 Adjusted Budget and to FY 2008

Revenues	FY 2007 Actual	FY 2008 Actual	2008-09				\$ Variance from FY 2008	% Variance from FY 2008
			Adjusted Budget	Actual	\$ Variance from Budget	% Variance from Budget		
Property Taxes	21,489	23,107	25,098	25,382	284	1.1%	2,275	9.8%
Sales Taxes	22,195	22,622	20,015	20,089	74	0.4%	(2,533)	-11.2%
Utility Users Tax	9,356	10,285	11,024	11,030	6	0.1%	745	7.2%
Transient Occupancy Tax	6,708	7,976	7,250	7,071	(179)	-2.5%	(905)	-11.3%
Documentary Transfer Tax	5,837	5,382	3,000	3,092	92	3.1%	(2,290)	-42.5%
Other Taxes, Fines & Penalties	2,897	2,465	2,816	2,348	(468)	-16.6%	(117)	-4.7%
Charges for Services	19,484	18,922	19,938	19,769	(169)	-0.8%	847	4.5%
Permits & Licenses	5,320	5,221	5,160	4,310	(850)	-16.5%	(911)	-17.4%
Return On Investment	2,355	2,204	1,900	2,053	153	8.1%	(151)	-6.9%
Rental Income	13,105	13,591	13,121	13,646	525	4.0%	55	0.4%
From Other agencies	752	229	144	158	14	9.7%	(71)	-31.0%
Charges to Other Funds	9,800	10,914	10,999	11,168	169	1.5%	254	2.3%
Other Revenues	1,775	2,316	2,207	2,442	235	10.6%	126	5.4%
Transfers In	15,644	17,228	17,677	17,602	(75)	-0.4%	374	2.2%
<b>Total Revenues</b>	<b>136,717</b>	<b>142,462</b>	<b>140,349</b>	<b>140,160</b>	<b>(189)</b>	<b>-0.1%</b>	<b>(2,302)</b>	<b>-1.6%</b>

Note: This spreadsheet excludes the Unrealized Gain (Loss) on Investments which must be reported in the City's financial statements.