



## FINANCE COMMITTEE

---

Special Meeting  
September 8, 2009

Chairperson Burt called the meeting to order at 7:03 p.m. in the Council Conference Room, 250 Hamilton Avenue, Palo Alto, California.

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

1. Oral Communications

None

2. Auditor's Office Review of City Telephone Rates and Charges.

City Auditor, Lynda Brouchoud stated that the City Auditor's Office requests that the Finance Committee review the City Telephone Rates and Charges report and recommend the City Council accept it. The Audit was initiated in May of 2009 when a telephone report went out to all City Departments. Based on that report the City Auditor Staff became concerned that the City might be paying higher rates than needed. Staff reviewed the charges for January through April, 2009, as well as FY 08-09. Staff reviewed calls on the internal call accounting system, called TeleMate. Staff also surveyed Redwood City, San Mateo, San Jose, Milpitas, Santa Clara, Berkeley as well as Santa Clara and Santa Cruz Counties for the months of January through April 2009. In Fiscal Year 2009 the City paid AT&T \$545,000 for landline telephone services including information lines. The City telephone system has both City-owned lines and lines that are owned by our service provider, AT&T. Together there are 2000 telephone lines and extensions serving the City. The City could have annual savings of about \$235,000 with a more competitive service. Palo Alto is paying an average of \$.028 cents for local calls per-minute, versus other jurisdictions which are paying an average of \$.011. For in-state, long-distance, Palo Alto is paying \$.182, and other jurisdictions are paying \$.022. For State-to-State, long-distance, Palo Alto is paying \$.321, versus other cities paying \$.024. Most other jurisdictions are participating in the state wide CALNET program which provides local governments with cost savings for telecommunication services. In response to our findings, ASD reported they are evaluating options to secure a competitive contract. The second finding was about oversight with the



## FINANCE COMMITTEE

---

phone bills. The billing detail is labor intensive, hindering the ability to have adequate oversight. The report details some issues, such as extensions that have been difficult to determine if they are still in use. Staff discussed these extensions with departments and they identified legitimate uses in some cases. Staff needs to make sure the City is paying only for the lines that are needed to run the business. The report also details some areas where the City could conserve money. For example, the City paid more than \$100 per month for Directory Assistance calls. Education for the Staff on various free directory assistance services might be able to bring that dollar amount down. There is also one example where the City is being billed for what appears to be a private residence, not associated with the City. Consolidated billing, in an easier format would help assure all those charges are needed. Finally, improvements can be made to the internal call accounting system, TeleMate. The City uses TeleMate to identify all calls made on each telephone line. A report is produced periodically for the employees to use so they can determine if they made any calls that were personal. They are asked to reimburse the City for these calls. When Staff reviewed these reports it was discovered that they use a rate structure that is not reflective of the actual rates the City is paying for those calls. The City Auditor's Office recommends improvements in that report to synchronize it with the actual rates. To recap, Staff has three recommendations, 1) ASD should obtain a new contract with competitive rates, 2) the contract should provide for consolidated billing, and 3) reimbursements from employees should be more accurate.

City Manager, James Keene said this Audit is very important and requires immediate action. He noticed there were problems at the same time Ms. Brouchoud did, when he received his bill. He agrees with the recommendations. He also believes there are some larger issues to be dealt with but for now, the City needs to get on the right contract. The hardware is outdated and Staff has already identified that as a problem. He said the City should rethink how they are deploying the technology.

Council Member Klein said this is a great example of why Palo Alto has an independent Auditor. He asked for clarification of the private phone line detailed in the report. He wanted to understand how long it had been being billed to the City.

Ms. Brouchoud said that they looked at four months worth of billing detail and only one month had those charges. It appeared to be a private residence, and Staff is looking for a reason. She reiterated that the bills are



## FINANCE COMMITTEE

---

difficult to sift through. In the case of this private residence, they found the long distance calls, totaling \$9.00 in charges, but Staff was not able to confirm the billing status for local calls.

Council Member Klein asked if the person involved was a City Employee.

Ms. Brouchoud said that Staff compared the phone number to Employee numbers and City Vendor phone numbers, and were not able to find a match.

Council Member Klein asked if this can be stopped immediately.

Administrative Services Director, Lalo Perez apologized to the Committee for this problem, and thanked the Auditor's Office for the report. He said that they have not been able to locate any contracts from when they had a manager on Staff that dealt with these issues. Staff has not renegotiated since that manager left. AT&T did contact the IT group in 2008 offering to renegotiate the contract. But there was a misunderstanding with Staff and the offer was not taken. Since this problem was discovered ASD has contacted AT&T as well as the City Attorney's Office to see what can be done at this point. AT&T thinks there may be a way Palo Alto can be part of CALNET. If so, Staff will come to the Finance Committee in October with a letter to join. Staff will request that AT&T issue some credit to the City for this, but he was not hopeful that request would be fulfilled. Staff has structured oversight and management of the program utilizing an IT Manager and Senior Technologist. If Palo Alto joins CALNET existing conditions will need to be abided by, without the option to negotiate. Staff will bring back this information at the October meeting.

Council Member Klein felt that if the City doesn't have a current contract they should be able to renegotiate tomorrow morning as an interim measure to stop the bleeding now. Then the City can discuss CALNET as needed for the long term answer.

Council Member Morton said that often there are automatic renewals with this type of contract, and wondered if that is the type of contract the City has.

Mr. Perez said there is no contract.



## FINANCE COMMITTEE

---

Mr. Keene agreed that Council Member Klein's suggestion for an interim solution is valid.

Chair Burt asked if the figures for the cities used in the study were non-CALNET rates.

Ms. Brouchoud said that most of the cities they surveyed are CALNET cities.

Chair Burt said that it will be difficult to judge interim rates when there isn't a clear comparison of CALNET versus not CALNET in the study.

Council Member Schmid asked what triggered the Audit.

Ms. Brouchoud said that the TeleMate report triggered it. The rates on the report seemed high, so ASD was asked to review the information.

Council Member Schmid asked how many oversight areas are in the City. He wanted to know how the City Council knows there aren't others. He wanted to understand the systematic way of finding them.

Ms. Brouchoud said there could be a number of other areas in need of oversight.

Council Member Schmid pointed out that in the last year and a half one other unique situation has been stumbled upon. Now this issue with telephones has been stumbled upon. He asked how the Council can be assured there aren't issues that haven't been stumbled upon yet.

Ms. Brouchoud said that she doesn't know if there can be assurances with so many programs in the City. If a significant issue comes to Staff's attention a review is initiated. Staff also has the Audit Workplan and a Citywide Risk Assessment coming up. The City Auditor's Office serves a review role in a variety of areas within the City.

Council Member Schmid said that three months ago the Finance Committee reviewed each City Department, reviewing efficiencies in an effort to determine where there were ways to save money. He asked how this was missed.

Mr. Keene said the problem became clear when Staff saw the May bills, and the investigation started immediately. In any large organization there are



## FINANCE COMMITTEE

---

lots of practices that add up to cost. The City Auditor looks at risk assessment, factoring scale and breadth of the programs to be reviewed. The City does not have a comprehensive process to identify every possible situation. Programs that have the largest return have to be considered.

Ms. Brouchoud said that the City Auditor's Office independently evaluates specific programs or departments, but those Audits are only one piece. The City Council, the City Manager, and the individual departments are also pieces. If the City Auditor's Office, as one component, is aware of a problem it is reviewed.

Council Member Schmid said there should be a systematic way to take a broader look at City programs. The Police Department Cash In Audit reported items under \$100. Yet, there is this telephone problem that would have had a much bigger return.

Ms. Brouchoud clarified that Council Member Schmid was referring to the Police Department Investigative Fund Audit.

Chair Burt asked what prompted the Telephone Rates and Charges Audit.

Ms. Brouchoud said that the TeleMate report showed significant potential issues. The Auditor's Office determined that they could handle the capacity of a limited review and proceeded.

Chair Burt agreed with Council Member Schmid that resource distribution may need to be reviewed. Staff reviewed the Police Department Cash Handling, and didn't find much. It was more work than payoff. How priorities are set should be looked at. It is easy to get consumed with things that hit unexpectedly and the regular tasks, it can be hard to look at priorities. He asked what thoughts have been given regarding lessons learned in this situation. He asked how priorities can be reconsidered.

Ms. Brouchoud said that she agreed with Council Member Burt regarding the Police Investigative Funds Audit. That Audit was required even though it was limited in scope. She said that her Staff recommended to the Finance Committee that the requirement for that Audit be removed from the workplan going forward.

Mr. Keene said that having an independent auditor is important as it provides for checks and balances, but a high performing organization can



## FINANCE COMMITTEE

---

not be created from audits. There needs to be a culture of responsibility distributed across the front lines so the people doing the work can determine what work is a good value and then work on self-benchmarking. He recognized that there are benchmarking processes now, where problems get fixed. A lot of time problems aren't as cut and dry as this issue is. Sometimes things are more fragmented and if there was a way to quantify that they might have bigger returns as well.

Council Member Morton said that this is not unique to Palo Alto as the utilities code does not require periodic review, allowing AT&T to continue with whatever rate they are charging. One of the findings might include the vendor relationship being reviewed every few years. It should be a contract that has to go out to bid every few years.

Mr. Keene said that the City does have a lot of policies in place to assure competitive quotes. Some vendors have complained that even though they are the only vendor in the market Palo Alto still puts them through that regular review. One of the take-a-ways from the phone bill problem is that Staff is now questioning how much business is being done without contracts. Some of the systems we have out there are triggered by the contract cycle and if we don't have a contract we don't have a trigger.

Council Member Morton said that would create a vendor relationship issue.

Mr. Perez said that perhaps Staff can tie purchase orders to a contract to help match data.

Council Member Schmid asked about the group of cities that were contacted in the Audit comparison. He stated that the public sector is the last place in the world where traditional margins hold. He asked why Staff doesn't include private or non-profit businesses in their comparisons.

Ms. Brouchoud said that for this review Staff was trying to find a relevant comparison that the City would be able to achieve.

Council Member Schmid asked if the City couldn't achieve what a private business does.

Ms. Brouchoud said that it's possible. She said that it's an ongoing debate about what is relevant for these comparisons. Public sector records are



## FINANCE COMMITTEE

---

accessible. Private organizations don't necessarily allow access to their records.

Council Member Schmid said that landlines are landlines. He said that any customer would be happy to share data.

Council Member Klein agreed there was a problem. There has to be accountability. He asked how long this has been going on. When Staff says that they thought it was against procurement rules to look at a new contract they should have spoken with the City Attorney. He then asked how Staff can be sure the City has an efficient cell phone contract.

Mr. Perez said that the City switched to Verizon in 2006 and pays \$167,000 for cell phones. Before switching, the bill was over \$200,000. A lot of employees use their personal cell phones just because it's easier, and that has helped drop the bill.

Herb Borock, Palo Alto spoke regarding the non-business related phone number listed on the Audit. He said that the City should invest the labor to look at all the bills, not just a few months. He then appealed to the Committee to remember, while searching for a "triage" solution, that a competitive price isn't the same as competition. He stated that he believes taking advantage of the CALNET contract is against City Code. He stated that the current RFP (129375) on the Telecommunications Current State and Future Needs Analysis response date was 12/9/08. That would have been a 3 month study. Staff now says that the contract was first being done in November. When the bidders asked if the City was on the CALNET contract, the response was that the City will provide that information on the study results. He said that in recent years there has been an increase in the threshold that gets the City Council involved with a contract, and additional categories of contracts mean certain contracts never get to Council regardless of size. He recommended the Finance Committee revisit that. At some point there might have been a contract for the phones but due some change the Council could no longer look at these contracts. When the City was asked if a formal assessment has ever been done to determine if the current infrastructure will support voice over internet solutions, the response was they have not.

Chair Burt asked for clarification about the time frame of the bills that were reviewed.



## FINANCE COMMITTEE

---

Ms. Brouchoud said it was all bills from January through April 2009.

Mr. Perez said that the State reviewed a competitive process for the CALNET Program. It met Palo Alto's criteria so Staff believes the City can piggy back onto the contract.

Chair Burt asked if the comparison cities were on CALNET.

Ms. Brouchoud said that most of the cities surveyed were on CALNET, but several of them didn't confirm one way or the other.

Chair Burt said he would like to know how the CALNET rates compared with the non-CALNET rates. He said the report referred to 1400 telephone extensions and 550 business lines. He asked how that compares to the number of employees that have phones, or are at desks and require landlines.

Mr. Perez said that the City has 550 Business Access Lines which are used for faxes, alarms, and sprinklers. He said that a more thorough review needs to be done to determine if the 1400 lines used for telephones are necessary.

Chair Burt said the Audit report referred to the over-reimbursement from City Employees. Thirteen reimbursements were submitted from employees during the period reviewed, he asked how many should have been submitted.

Mr. Perez explained that more people are using their personal cell phones, which could account for the limited number of reimbursements.

Chair Burt asked how many landlines had reimbursable charges.

Ms. Brouchoud said it was difficult to give an exact number because the detail was not on the bills. Another factor was that some departments submitted reimbursements from individual employees, and one department rolled them all into one reimbursement.

Chair Burt confirmed that all of the reimbursements were overpaid but there is no indication of what should have been paid.



## FINANCE COMMITTEE

---

Mr. Perez said this process is just coming back in use and it will take time for Staff to get back on board. The goal was not to have people standing in the lobby to pay a 48 cent phone bill, rather to let it accumulate a few months. So it's a skewed number since it was stopped and started so abruptly

Chair Burt said that at some point a threshold will have to be determined otherwise it may cost more to get a reimbursement than to pay the charge.

Mr. Perez agreed that employee time, and the processing costs should be considered.

Chair Burt said there is a reference in the report about a combination of the lines that Palo Alto owns and lines that AT&T owns.

Chief Information Officer, Glen Loo said that Palo Alto leases some lines from AT&T to extend the number of extensions.

Chair Burt asked if Staff has reviewed whether the lease agreement is a good deal.

Mr. Loo said the Staff has not yet reviewed that lease.

Chair Burt said Staff should review the lease.

Mr. Perez said that is another component to reviewing the CALNET contract. It will have to be determined if Palo Alto would get a better deal with CALNET or without, because whatever the State accepted as the general terms would be what the City would have to accept.

**MOTION:** Council Member Morton moved, seconded by Council Member Schmid, that the Finance Committee recommends that the City Council receive the Audit of the City Telephone Rates and Charges.

Council Member Morton said he appreciates the Audit and corrective action will be taken.

Council Member Klein said the Committee doesn't have to accept standard reports. The Auditor has three recommendations listed and those need to be discussed. It is premature to vote on them. He said the Committee should retain this item in Committee and request that Staff report back to the Committee on action taken. After that the complete package, the Audit



## FINANCE COMMITTEE

---

Report and Actions Taken, can be brought to the full Council. These items deserve more attention and the Committee will want to see in more depth how they work out. It is not appropriate to just pass on to the Council.

Council Member Morton said the Council can not instruct the Auditor to tell the Manager what to do. The Committee should accept the Audit, pass it on to the City Council and then direct Staff to make a response in a second report. He said that is the normal process for Audits in government and non profit organizations.

Mr. Keene asked if there is a time requirement between when the Finance Committee accepts the Audit, when it goes to Council, and when Staff comes back with a second report. He said it might be confusing to bring it to Council without that second report from Staff. He suggested the report might be accepted on the condition it will only go to Council when Staff comes back with a second report.

Council Member Morton says the Finance Committee can't accept the report at all; they can only recommend it to Council, and then direct Staff to take actions on the Auditor's findings.

Council Member Klein said that Staff doesn't need direction as the City Manager has already said he's going to respond to these three recommendations.

Council Member Morton said the Committee still has to recommend the report to the City Council.

Chair Burt suggested making it part of the Motion to accept the Auditor's report and that the Committee holds forwarding it to Council until October pending an action plan update from Staff.

Council Member Klein agreed the Motion could be changed to reflect Chair Burt's suggestion, and agreed that a complete package should be submitted to the City Council.

Chair Burt asked if the Committee feels this should be an Amendment to the Motion.

Council Member Klein agreed it should be an Amendment.



## FINANCE COMMITTEE

---

Chair Burt asked if an Amendment would be accepted by the Maker.

Council Member Morton said that he would not accept an Amendment. He said that it is not appropriate to intentionally withhold an Audit from the Council.

Chair Burt said they were not intentionally withholding an Audit from the Council. The Committee is requiring actions to be taken as immediately as possible. Those actions would be presented to the Council at the same time as the Auditor's Report

Council Member Klein said they are attempting to improve efficiency in presenting a complete package.

Council Member Schmid asked if Staff agrees with each recommendation. He also asked if all actions would be able to be completed by October or if they would be setting interim goals in October.

Mr. Perez said Staff would take as much action as they have authority to. They won't, however, bring a contract to Council until it is reviewed by the Finance Committee.

Chair Burt asked if they would get a report in October detailing concrete actions that were accomplished as well as an Action Plan.

Ms. Brouchoud recalled that in the Ambulance Billing Audit the Committee also had some directions for Staff. Using that Audit as an example, the Committee should accept this Audit as it stands alone, and then direct Staff to take action.

Chair Burt said that it would clarify what the intention of the Amendment is. He asked if Council Member Klein would like to restate his Amendment.

Council Member Klein said he didn't know what it meant to accept the report. The Committee is taking the Auditor's recommendations and telling Staff we need more specifics and directing them to act on it immediately. His goal was to accept the recommendations and forward them to Council when they are complete.



## FINANCE COMMITTEE

---

**SUBSTITUTE MOTION:** Council Member Klein moved, seconded by Chair Burt to accept the recommendations made in the Audit Report and forward them to the Council at a later date, with a complete response from Staff.

Mr. Keene asked if there was an Auditor protocol so Ms. Brouchoud can discharge her responsibility in relation to this Audit, allowing the requested functions to move from the Auditor's responsibility to that of Staff.

Ms. Brouchoud said that the Auditor's Office would request the Finance Committee accept the report and agendaize it on the Council Consent Calendar. The recommendations will still be followed up on by the Auditor's Office and can be reported to the Committee.

Chair Burt said that Staff has given a partial response to the Audit recommendations. The Committee is saying this issue is serious enough to require a more complete response and a more concrete plan when the Audit goes before Council. He said it is not intended to be a full hand off right now from Auditor to Staff. The Committee would expect the full hand off in October after Staff's response.

Council Member Morton said that this action would compromise the independence of the Auditor. Her report can not be dependent on what Staff does. She reports to the Council. The Committee should make a recommendation to Council to accept the Audit as it was prepared.

Council Member Schmid asked if they could break it up into two parts and accept the report, and then direct Staff to come back to Finance Committee

Chair Burt asked if that meant the report goes forward to Council absent of adequate and concrete response from Staff.

Council Member Schmid said that could be added to the second part of the Motion.

Council Member Burt agreed that was what Council Member Klein wanted.

Council Member Morton said that there are often Audit recommendations that take years to fulfill and setting a precedent that holds the Audit reports until the actions have been implemented is a bad one.



## FINANCE COMMITTEE

---

Chair Burt said this is not a request to hold the report for full implementation, rather to hear back in October, a more concrete implementation plan, along with actions that will have been taken by that time.

Council Member Klein said that an implementation plan wouldn't compromise the Auditor's professional integrity when she isn't responsible for the implementation.

Council Member Schmid said the Substitute Motion states that the Finance Committee will accept the Audit report and refer it to Council.

Council Member Burt said that it will include actions that have been taken by that time.

Mr. Keene said that it will at least identify a path to take.

Council Member Morton said the Substitute Motion makes the Auditor's report accepted based on Staff performance. The Auditor's role is to define the problem, get Staffs comment and report to Council. It is not to manage implementation.

Council Member Schmid said he thought they were accepting the report along with the Staff action.

Council Member Morton said tying the Auditor's report to Staff action is not appropriate.

Ms. Brouchoud said that the Auditor's report is considered complete. Auditing standards require that they seek a response but it is considered complete.

Chair Burt said there is no request in the Motion for the Auditor to add to the report after the Staff takes action. It only concerns when the Finance Committee forwards the report to Council.

Council Member Klein said that it comes back to the Committee again.

Mr. Keene asked if the Auditor's goal was to get the report to the Council or was it to have the Council accept the report.



## FINANCE COMMITTEE

---

Ms. Brouchoud said typically the report is accepted in its totality. She said she understood that the Finance Committees intent is for Staff to hold off bringing the report to Council.

Council Member Klein said his goal is to have an efficient process.

Council Member Burt said that it would prevent the full Council from going through this same discussion only to forward it back to the Finance Committee.

Council Member Morton said the Finance Committee doesn't have the legal authority to withhold an Audit. They don't have the authority to approve it. The Council approves it. Through Audit courtesy it comes through the Finance Committee, but the full Council approves. This is a bad precedent because it means the Auditor can't issue her reports until conditions are tied to them. The whole importance of independence is that she issues reports and then Staff acts independently. If the Committee has the votes to do this, then it will be done. But it is illegal and not within our powers. And if there aren't enough votes it's split and it goes to Council anyway.

Mr. Keene said that he thinks the City Auditor could have the discretion to choose what she would do on her own.

Council Member Morton said she wouldn't have a choice; she would have to send it to Council.

Mr. Keene said the intent isn't to undermine the Auditor's independence but trying to accommodate both things without compromising her independence is harmless.

Chair Burt said he doesn't see the difference. This is an agenda item being carried to October. The agenda item is being extended into two Finance Committee meetings. At this point a Motion that accepts the Audit and action to hold off presenting it to Council until it has a more meaningful response from Staff is being made. He said the action is not illegal.

Council Member Schmid asked if the workplan comes back to the Finance Committee, and is discussed, does that end up modifying the changes and extending this process.



## FINANCE COMMITTEE

---

Chair Burt said the Committee will make a decision in the workplan to move the Audit to Council after the October meeting. If there are disagreements the Committee will vote on them. This Motion says that the Committee will make a decision on the workplan and move the Audit forward to Council after the October meeting with whatever workplan is agreed upon.

Council Member Schmid asked if it was part of the Motion that the Committee will forward it in October.

Council Member Klein said he would add it.

Chair Burt clarified that as part of the Motion.

**SUBSTITUTE MOTION RESTATED:** Council Member Klein moved, seconded by Chair Burt to accept the audit and forward the audit report to the Council after the October Finance Committee meeting, with an agreed upon workplan from the City Manager.

Mr. Keene said that Staff won't have a complete plan in October. He said the real issue is getting a better price as soon as possible. The ancillary issues are secondary. This whole conversation started with trying to determine how quickly improvements can be made. He reminded the Committee that Mr. Perez reported that Staff could get the CALNET option to Council in October. The Committee also asked for other competitive possibilities.

Chair Burt said the Committee is not looking for Staff to complete the implementation of the workplan at this point. The Committee will be looking for a more complete workplan, along with any actions Staff will have completed by that time.

**SUBSTITUTE MOTION PASSED:** 3-1 Morton no

Council Member Morton said he was voting "no" with all due respect to the position it puts the City Auditor in.

Chair Burt said the City Manager was hired to reform and create a cultural change within City Administration, a change the City Council thought was required. This report reaffirms that things need to change. He felt progress was being made in the right direction. He acknowledged change can be painful, but problems don't get solved until they are discovered, admitted to,



## FINANCE COMMITTEE

---

and then acted on. When a task can't get covered it must be brought into the open. During budget review, issues like this were discussed in an effort to plan for them. If Staff determines they will no longer be able to accomplish tasks such as oversight of phone bills, it must come before Council. Council must determine if the cost of giving up a priority is worth it. For example, Staff is saying that there will now be oversight with the phone bills, but they haven't said what it's going to cost. Council should know what priorities Staff is going to set aside in order to find time to review the phone bills. Council should know how many hours this oversight will cost Staff. If it is only five hours a month then the priority should never have been given up in the first place. If it's going to be hundreds of hours we need to work to find a solution. He stated that he also wants Staff to work with AT&T to get a retroactive credit for these charges.

Council Member Klein agreed that the City Manager inherited some problems. He didn't agree about the trade offs with Staff production. He said the problems were not caused by one person retiring. He said it was difficult to understand why rates have gone up after this person left. He agreed that Staff must negotiate with AT&T. It's a delicate balance between maintaining loyal customers and profiting. They may have had a legal obligation to provide for us better than they did.

### 3. Review of Preliminary FY 2009 Revenue Analysis.

Deputy Director Administrative Services, Joe Saccio said that the Finance Committee requested early information on year-end revenue performance. The Revenue Tax Sales, Transient Occupancy Tax (TOT), Documentary Transfer Tax, were very close to projected budget. Other non-tax sources were below projected budget such as Fines and Permits. The variances in revenue for 2008-2009 were below those in 2007-2008. For example, sales tax was 2.5 million below the prior year. TOT was \$900,000 below and Documentary Transfer Tax was \$2.3 million below last years actual returns. Attachment A has variances from the Adjusted to the Actual Budget. The variances in the last two columns are what we received in 2008-2009 compared to 2007-2008. All of these areas that were short are all economically sensitive areas where issues such as the credit crisis and the drop in portfolio prices affect them. Palo Alto's neighbors are experiencing the same down turns. Mountain View's sales tax is 6.5 percent below budget and prior year TOT was 25 percent below. In Sunnyvale they were on target with sales tax for this year, but they are 14 percent below last year and TOT was 22 percent below. Staff is cautious about 2009-2010.



## FINANCE COMMITTEE

---

This fiscal year revenue will be monitored carefully, but there isn't enough evidence to indicate a trend yet. Recovery is expected to be very slow. The first three Documentary Transfer Tax returns are 50 percent below where they were last year. TOT for July was 20 percent below last year July. Sales Tax reports for the second quarter comes in mid September, it is estimated to be about 15 percent below last year's first quarter.

Council Member Klein asked Mr. Saccio if he was giving information not in the Staff Report.

Mr. Saccio confirmed that some of the information was not available yet when the Staff Report was written. He said that 4<sup>th</sup> quarter this year was 15 percent below 4<sup>th</sup> quarter last year. The 1<sup>st</sup> quarter of this year was 15 percent below the 1<sup>st</sup> quarter last year. And the outside consultant the City uses thinks the 2<sup>nd</sup> quarter of this year may be 15 percent below again. Sales Tax has been on target with budget.

Council Member Klein said the only number he has seen so far was for the Documentary Transfer Tax. He asked how that compares to the budget.

Mr. Saccio said Documentary Transfer Taxes are down 50 percent for the first three remittances this year compared to last year. A lot of these remittances are seasonal and vary depending on a mix of transactions. Therefore it's difficult to give exact numbers, as they don't match directly.

Council Member Klein said that using last years numbers as a comparison doesn't work in that case.

Mr. Saccio said that they use that as a standard by which to judge what may be happening this year. He reiterated that it was his opinion that it was premature to make a prediction.

Administrative Services Director, Lalo Perez said that they were looking at a report from a local realtor today and noticed a trend that inventory is going down rapidly. That's a concern for October.

Chair Burt said inventory should be referred to in terms of gross number of sales.

Mr. Perez agreed and added that inventory is going down and prices are going up.



## FINANCE COMMITTEE

---

Chair Burt asked what the number is on the trend on transactions.

Mr. Perez said that August figures are not available yet.

Chair Burt said he would interpret that differently. He said it is not a warning sign, rather an indicator that the market will respond by placing more properties on the market. There are indicators of an increased demand and the market will respond.

Mr. Perez said that is what Staff will monitor.

Chair Burt said he would still say that in this market there may be some financing issues but sales indicate there is still adequate liquidity.

Mr. Perez said the reports say that Palo Alto is ahead in terms of that indicator.

Mr. Saccio said that Palo Alto received \$437,000 in the first three remittances for Documentary Transfer Tax and last year at this time there was \$775,000. The budget for 2009-2010 is \$2.8 million for the Documentary Transfer Tax. It is \$200,000 lower than what was actually received as we expected the weakness to continue. July-August traditionally are positive months for this tax, so there could be weak periods ahead. The seasonality of the receipts has to be considered. It would be a mistake to take the \$437,000 and multiply it by the number of months remaining in the year as a predictor. If the sales tax continues the trend at 15 percent below where it was last year we will have to make some downward adjustments at mid-year, perhaps as much as \$400,000-\$800,000 just for sales tax. The Transient Occupancy Tax may have to be revised down between \$200,000 and \$500,000. More data is needed to assess this year. There are some positive signs but there are also other external factors such as the reliance on consumer spending.

Chair Burt said a year by year comparison is less valid in years like this than in other years. There is a mixture of issues going on in different sectors. Some hotels looked like they were closed last year and they don't now. Yet Stanford Shopping Center doesn't look as busy as it used to. The City needs to graph against a baseline period that is reflective of a normal year, not an unusually successful year.



## FINANCE COMMITTEE

---

Mr. Perez agreed with Chair Burt. The City Manager has asked Staff to report revenue to him on a monthly basis. Staff will share the information each month either with Council via the Finance Committee meetings or in the regular Council meetings during the City Manager Comments.

Council Member Morton said there is potential for a \$2 million downward adjustment to budget. He said if salary concessions don't materialize it will be a tough road. He said that until the end of the 1<sup>st</sup> quarter in November it will be impossible to tell where the situation stands.

Council Member Schmid agreed that it is hard to make accurate predictions based off of one month's data. He was concerned with functional issues regarding the "normal" period. The City is dependent on consumer purchasing, making the situation susceptible to competition with all the cities around us. Property taxes have been the fastest growing element in the past but it's hard to judge now. Looking at the low point in the dot com industry, Palo Alto property taxes took the hit two years later. This might indicate that 2010, 2011 or 2012 might be the worst years for this revenue. Transient Occupancy Tax is also dangerous as our neighbors are building hotels while Palo Alto talks a lot about building hotels. It's going to be tough to increase the Transient Occupancy Tax revenue without building hotels. The Documentary Transfer Tax also depends on commercial growth and Palo Alto has so many delays in this area. More than a month to month or even year to year comparison is needed. What will constitute a normal year will need to be determined.

Chair Burt said the return on investment with regards to CalPERS is looking at a 30 year 7.5 percent trend between 1978 and 2008. Objectively that is probably an anomaly. That's different than Palo Alto's investment pool but reasonable expectations need to be reviewed versus only using historical information. Palo Alto still had a loss and will typically have less gain than CalPERS with our more conservative investments.

Council Member Klein said the City's portfolio is limited to US Bonds.

Council Member Schmid said Bonds are not returning much at this time.

Council Member Klein said that they are about 12 percent and that looking at 30 year bonds is not an historical anomaly. Palo Alto should get the same rate for the next 30 years.



## FINANCE COMMITTEE

---

Mr. Saccio said the current return rate is a low 4.2 percent and can range as high as 5.5 to 6 percent. It is a narrow band.

Council Member Schmid said a Treasury Bond is 3 percent.

Mr. Saccio said that currently lower yielding maturities are being turned over for higher yielding.

Chair Burt asked what the typical terms are.

Mr. Saccio said the average is around 3 ½ years. The percentages beyond 5 years are very small.

Chair Burt asked if Staff is doing projections based on 3 year anticipated yields.

Mr. Perez said that Staff uses a laddering strategy. The ladder is built up and then advantages on the curve are sought out.

Council Member Klein said there is a huge difference between what Palo Alto does and what CalPers does. CalPers does equity adjustments and has lost on those but then made some on real estate. Palo Alto has had no losses on principal.

Mr. Perez said he just got the statement on CalPers Retirement Medical Trust. The balance was \$21.7 million for March 31 through June 30 it earned \$4 million back for a current balance of \$26.4 million including a contribution of \$700,000 that we made.

Mr. Keene said Palo Alto earned \$33 million a year before the economy went down.

Mr. Perez said that included the contributions by the City.

Chair Burt said the press said this is the worst loss Palo Alto has had. It might be important to communicate a partial recovery rather than just reporting the bad news.

Mr. Saccio said that he had a comparison between the adopted budget for 2009-2010 and the actuals. Property taxes have been raised. Palo Alto is in



## FINANCE COMMITTEE

---

line with County projections for 2010. According to the School Liaison Committee there may be a 2 percent increase in property taxes.

Council Member Klein said that is for properties that have not sold. The CPIs are 2 percent.

Mr. Saccio said the adopted budget for sales tax has been lowered. Utilities taxes are level. Transient Occupancy Tax has been lowered. Documentary Transfer Tax has been lowered when compared to the adjusted budget.

#### 4. Discussion of Future Meeting Schedules and Agendas.

City Manager James Keene said that in the context of budget updates the Fire Fighters Union is not going to accept the offer made to them and asked to go ahead and retroactively implement their 2010 pay raises. They are concerned about the few Fire Fighters that might retire this year. That means that their contract will expire at the end of this year. That is approximately \$500,000-600,000 of anticipated savings we were hoping to get.

Chair Burt said addressing this needs to be discussed.

Mr. Keene said that Staff is giving regular updates. Staff is planning on being able to have that information for the Finance Committee on October 20<sup>th</sup>, but an update was requested sooner.

Council Member Morton said that date doesn't help the community with Measure A and understanding the Tier Two cuts.

Council Member Klein said he thought they were going to have an update at the full City Council meeting on either the September 21, 2009 or October 6<sup>th</sup> at the Finance Committee meeting.

Administrative Services Director, Lalo Perez said that the Agenda doesn't have anything at the end of September, but Staff won't have a full picture until September 30, so Staff was looking at October 5 which is the City Managers review from 6:00-8:15.

Mr. Keene suggested the issue should be revisited at the September 28 Council meeting.



## **FINANCE COMMITTEE**

---

Council Member Klein said he would prefer to do it on October 6 considering the Tier Two cuts.

Council Member Morton agreed.

Mr. Keene said that Staff will be prepared to present at the October 5<sup>th</sup> City Council meeting.

ADJOURNMENT: The meeting was adjourned at 9:24 p.m.