



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

October 26, 2009

The Honorable City Council
Palo Alto, California

City of Palo Alto Sales Tax Digest Summary – Second Quarter Sales (April – June 2009)

This is an informational report and no action is required.

BACKGROUND

Sales and use tax represents about 14%, or \$19.65 million, of projected General Fund revenue in the City's Adopted Operating Budget for fiscal year 2010. This revenue includes sales and use tax for the City of Palo Alto and pool allocations¹ from the State and Santa Clara County.

The City Auditor's Office contracts with MuniServices LLC (hereafter MuniServices), the City's sales and use tax consultant, to provide sales and use tax recovery services and informational reports. The City Auditor's Office uses the recovery services and informational reports to help identify misallocation of tax revenue owed to the City, and to follow-up with the State Board of Equalization to ensure the City receives identified revenues. The City Auditor's Office includes information on sales and use tax recoveries in our quarterly reports to the Finance Committee.

The City Auditor's Office also shares the information provided by MuniServices with the Administrative Services Department (ASD) for use in revenue forecasting and budgeting, and Economic Development/Redevelopment for business outreach strategies. We coordinated this informational memo with them.

DISCUSSION

The attached report (Attachment A) was prepared by MuniServices and covers calendar year second quarter sales (April through June 2009). These funds are reported as part of the City's fiscal year 2010 revenue. Due to the timing of reporting by businesses and the State, MuniServices' detailed reports on third quarter sales (July through September 2009) should be available by February 2010. ASD advises that in mid-December, it should receive information from the State on aggregate sales and use tax receipts for third quarter 2009.

¹ See definitions on page 4.

Following are some highlights of the sales and use tax information we received:

- Second quarter 2009 sales and use tax revenue totaled \$4.8 million (down \$0.4 million from second quarter 2008 and up \$0.6 million from first quarter 2009). This revenue includes sales and use tax for the City of Palo Alto and pool allocations from the State and Santa Clara County.
- Every region in California experienced a decline in sales and use tax revenue during the second quarter ending June 2009, compared to the second quarter ending June 2008. Statewide, sales and use tax revenue has declined, or shown no growth, for eight consecutive quarters.
- Sales and use tax revenue (cash receipts) totaled \$19.0 million for the year ending June 2009, a decrease from \$21.5 million in the prior year ending June 2008. This amount includes sales and use tax for the City of Palo Alto and pool allocations from the State and Santa Clara County.

A more detailed table of information is shown on page 1 of Attachment A.

Economic Influences on Sales and Use Tax

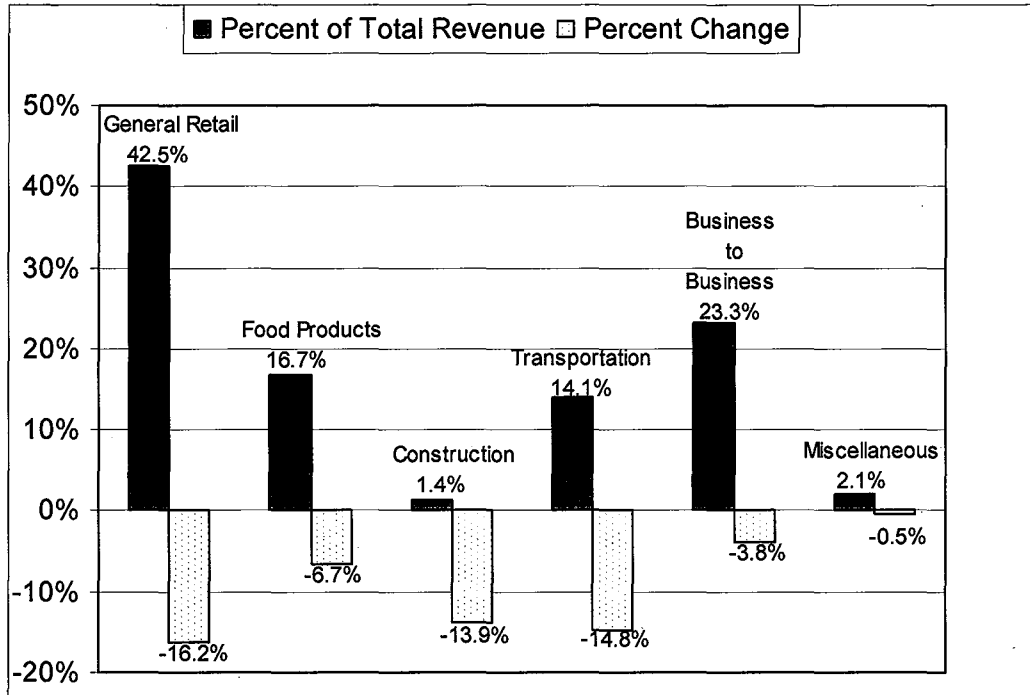
According to information from MuniServices, the following current economic influences may affect our City's sales and use tax revenue:

- California will join the nation in its economic recovery, but the contraction of State and local governments will impact the recovery for at least the near future.
- The number of people continuing to receive unemployment benefits rose –a sign that any economic recovery will be hindered by a weak job market and flat incomes. Most economists think the recession is over, but they predict the jobless rate will keep rising until at least next summer as the economy struggles to mount a sustained recovery.
- Over the last year, retail consumers led by the newly unemployed, made a fundamental shift in the way they approach purchases. Consumers are focusing on current needs and future stability rather than wants and luxury items. Retailers will need to adapt to consumers' return to frugality. This new pattern of consumer spending is not expected to change in the near future.

Economic Category Analysis

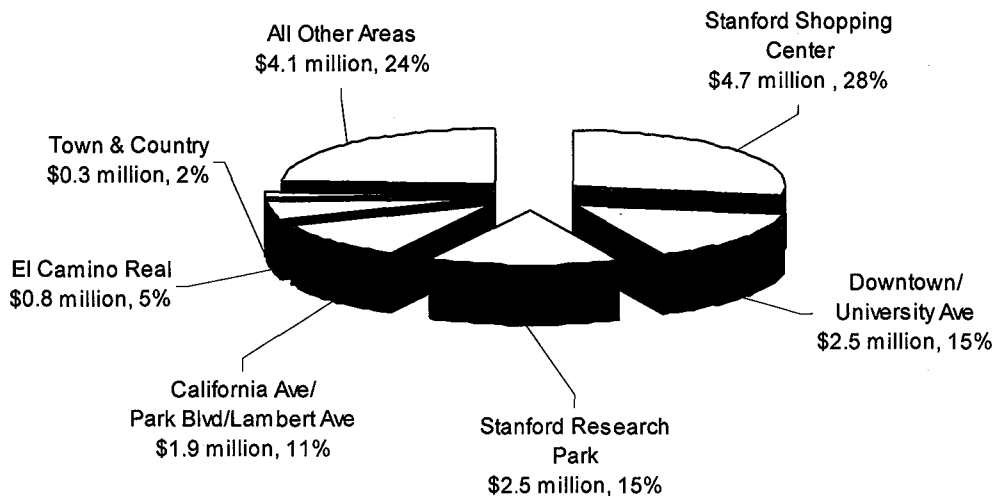
Analysis of six economic categories, for the year ending June 2009, shows that General Retail comprised the largest percentage of Palo Alto's sales and use tax revenue and experienced a 16.2% decline. Transportation experienced a 14.8% decline and comprised 14.1% of total revenues. Construction experienced a 13.9% decline, but it also represented only 1.4% of total sales and use tax revenue.

Exhibit 1 - Comparison of Palo Alto's Sales and Use Tax Revenue and Percent Change by Economic Category for the Year Ending June 2009



The following chart shows sales and use tax revenue by geographical area based on information provided by MuniServices.

Exhibit 2 – Palo Alto's Sales and Use Tax Revenue by Geographical Area For the Year Ending June 2009 (Amounts include tax estimates and exclude pool allocations)



DEFINITIONS

In California, either sales tax or use tax may apply to a transaction, but not both. The sales and use tax rate in Palo Alto is 8.25%, and the City should receive 1% of every taxable transaction. A temporary tax rate increase to 9.25% went into effect April 1, 2009.

Sales tax – imposed on all California retailers; applies to all retail sales of merchandise (tangible personal property) in the state.

Use tax – generally imposed on: consumers of merchandise (tangible personal property) that is used, consumed, or stored in this state; purchases from out-of-state retailers when the out-of-state retailer is not registered to collect California tax, or for some other reason does not collect California tax; leases of merchandise (tangible personal property).

Countywide/statewide pools – mechanisms used to allocate local tax that cannot be identified with a specific place of sale or use in California. Local tax reported to the pool is distributed to the local jurisdiction each calendar quarter using a formula that relates to the direct allocation of local tax to each jurisdiction for a given period.

Examples of taxpayers who report use tax allocated through the countywide pool include construction contractors who are consumers of materials used in the improvement of real property and whose job site is regarded as the place of business, out-of-state sellers who ship goods directly to consumers in the state from inventory located outside the state, and California sellers who ship goods directly to consumers in the state from inventory located outside the state.

Other examples of taxpayers who report use tax through the pools include auctioneers, construction contractors making sales of fixtures, catering trucks, itinerant vendors, vending machine operators and other permit holders who operate in more than one local jurisdiction, but are unable to readily identify the particular jurisdiction where the taxable transaction takes place.

Respectfully submitted,



Lynda Flores Brouchoud
City Auditor

Sources: MuniServices; the State Board of Equalization; the City's Adopted Operating Budget Fiscal Years 2010 and 2011

Audit staff: Lisa Wehara

Attachment A: City of Palo Alto Sales Tax Digest Summary

City of Palo Alto
Sales Tax Digest Summary
Third Quarter Receipts for Second Quarter Sales



2nd Quarter 2009

California Overview

The percent change in cash receipts from the prior year was (12.7%) statewide, (12.4%) in Northern California and (12.9%) in Southern California. The period's cash receipts include tax from business activity during the period, payments for prior periods and other cash adjustments. When we adjust for non-period related payments, we determine the overall business activity declined for the year ended 2nd Quarter 2009 by (13.6%) statewide, (12.8%) in Northern California, and (14.0%) in Southern California.

City of Palo Alto Overview

For the year ended 2nd Quarter 2009, sales tax cash receipts for the City fell (11.7%) from the prior year. On a quarterly basis, sales tax revenues dropped (7.2%) from 2nd Quarter 2008 to 2nd Quarter 2009. The period's cash receipts include tax from business activity during the period, payments for prior periods and other cash adjustments.

Excluding state and county pools and adjusting for anomalies (payments to prior periods) and late payments, sales tax from businesses within the City boundaries declined (11.5%) for the year ended 2nd Quarter 2009 over the prior year. On a quarterly basis, sales tax from business activity fell (9.9%) from 2nd Quarter 2008 to 2nd Quarter 2009.

Regional Overview

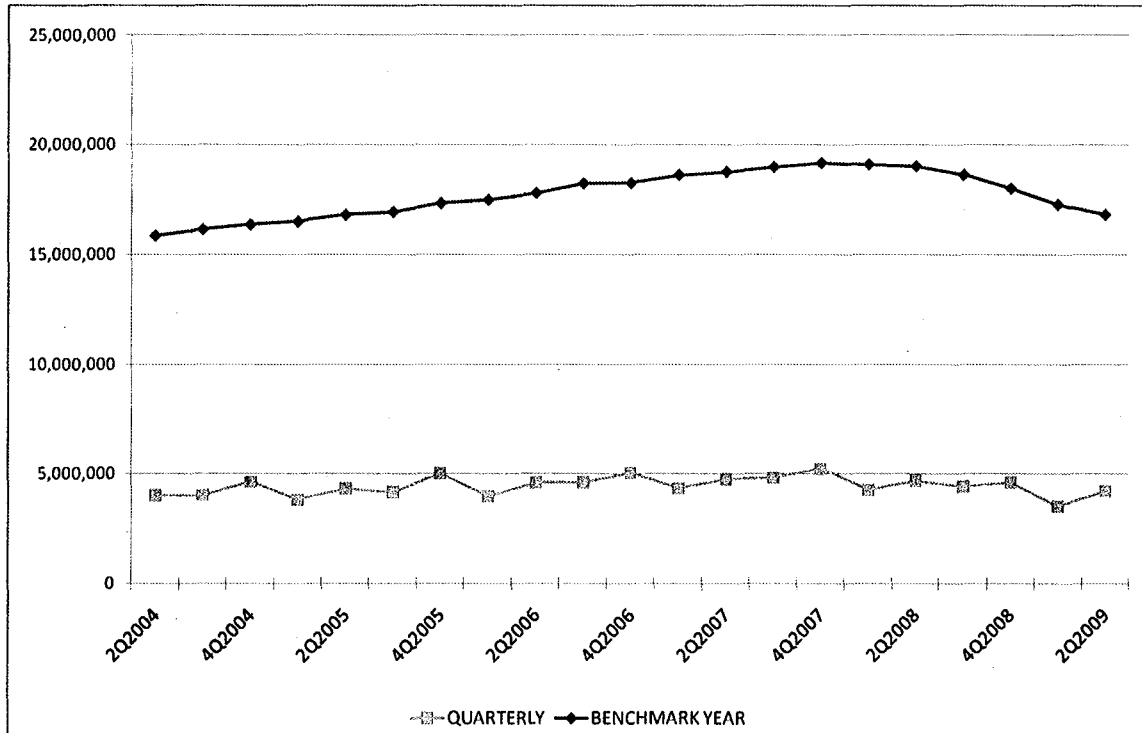
This seven-region comparison includes estimated payments and excludes net pools and adjustments.

ECONOMIC CATEGORY ANALYSIS FOR YEAR ENDED 2ND QUARTER 2009								
	Palo Alto	California Statewide	S.F. Bay Area	Sacramento Valley	Central Valley	South Coast	North Coast	Central Coast
General Retail % of Total / % Change	42.5/-16.2	30.4/-9.3	30.3/-9.8	30.0/-6.7	32.4/-3.3	30.3/-10.2	30.0/-7.3	35.4/-8.6
Food Products % of Total / % Change	16.7/-6.7	19.1/-5.1	19.6/-4.5	17.1/-4.6	17.4/-3.7	19.5/-5.3	19.2/-4.9	28.8/-5.2
Construction % of Total / % Change	1.4/-13.9	9.3/-18.3	8.9/-17.4	11.6/-19.5	11.8/-16.6	8.4/-17.4	14.3/-17.4	9.6/-14.4
Transportation % of Total / % Change	14.1/-14.8	21.4/-23.7	18.3/-23.7	23.5/-22.4	22.9/-23.8	21.8/-22.9	25.8/-23.2	17.7/-24.0
Business to Business % of Total / % Change	23.3/-3.8	18.5/-12.7	21.6/-14.0	16.6/-9.4	14.5/-10.1	18.7/-12.7	9.8/-13.8	7.2/-16.4
Miscellaneous % of Total / % Change	2.1/-0.5	1.3/-7.5	1.3/-5.2	1.2/-8.3	0.9/-9.5	1.3/-8.9	0.9/-7.4	1.2/13.5
Total	100.0/-11.5	100.0/-13.6	100.0/-13.3	100.0/-12.6	100.0/-11.5	100.0/-13.5	100.0/-13.6	100.0/-11.8
THREE LARGEST SEGMENTS FOR YEAR ENDED 2ND QUARTER 2009								
	Palo Alto	California Statewide	S.F. Bay Area	Sacramento Valley	Central Valley	South Coast	North Coast	Central Coast
Largest Segment	Restaurants	Restaurants	Restaurants	Department Stores	Department Stores	Restaurants	Department Stores	Restaurants
% of Total / % Change	14.5/-6.4	13.0/-5.0	13.5/-4.8	12.5/-3.1	16.0/-2.6	13.8/-5.4	13.2/-5.9	19.7/-6.4
2nd Largest Segment	Department Stores	Department Stores	Department Stores	Restaurants	Restaurants	Department Stores	Services Stations	Miscellaneous Retail
% of Total / % Change	13.4/-16.2	11.2/-6.3	10.1/-7.6	10.8/-3.3	10.3/-0.6	10.6/-6.6	11.0/-17.4	11.1/-7.2
3rd Largest Segment	Electronic Equipment	Service Stations	Service Stations	Service Stations	Service Stations	service Stations	Restaurants	Department Stores
% of Total / % Change	***/11.4	8.9/-19.2	7.8/-19.7	8.8/-17.8	9.9/-16.6	9.0/-19.2	10.2/-4.6	10.6/-13.2

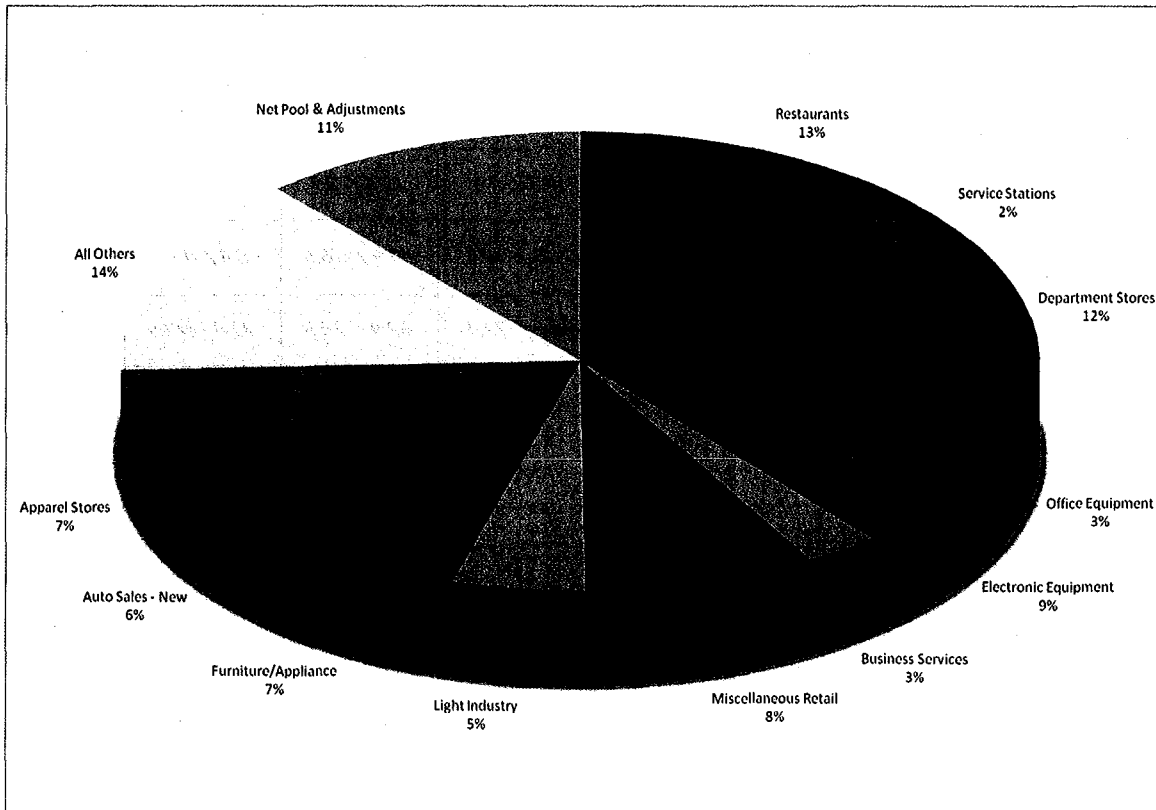
*** Confidential business information.

City of Palo Alto

Gross Historical Sales Tax Revenue Performance by Benchmark Year and Quarter (Before Adjustments)



Net Cash Receipts for Benchmark Year 2nd Quarter 2009: \$19,009,186

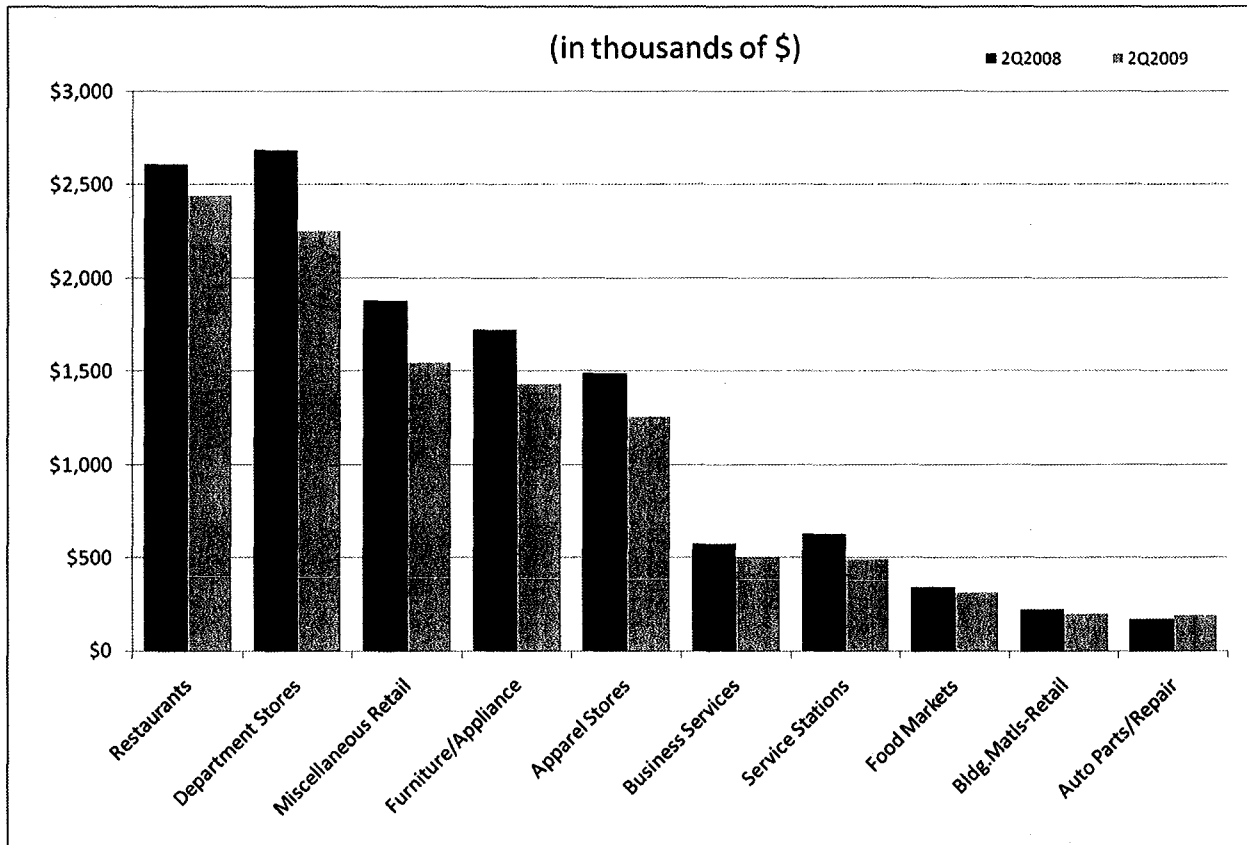


Top 25 Sales/Use Tax Contributors

The following list identifies Palo Alto's Top 25 Sales/Use Tax contributors. The list is in alphabetical order and represents the year ended 2nd Quarter 2009. The Top 25 Sales/Use Tax contributors generate 50.7% of Palo Alto's total sales and use tax revenue.

- | | |
|--|--|
| <ul style="list-style-type: none"> Anderson Honda Apple Stores Bloomingdale's Carlsen Motor Cars Carlsen Subaru Crate & Barrel Dow Jones & Company Fry's Electronics Hewlett-Packard Integrated Archive Systems Keeble & Shuchat Photography Longs Drugs Stores Loral Space Systems | <ul style="list-style-type: none"> Macy's Department Store Magnussen Toyota Neiman Marcus Department Store Nordstrom Department Store Park Avenue Motors Raytheon Company Shell Service Stations Stanford University Hospital The Gap Tiffany & Company Varian Medical Systems Williams-Sonoma |
|--|--|

Sales Tax from Largest 10 Non-confidential Economic Segments



City of Palo Alto

Historical Analysis by Calendar Quarter

Economic Category	%	2009/2	2009/1	2008/4	2008/3	2008/2	2008/1	2007/4	2007/3	2007/2
General Retail	35.1	1,689,278	1,396,939	2,123,927	1,938,787	2,025,290	1,798,864	2,633,887	2,075,292	2,095,792
Business To Business	22.8	1,095,521	868,477	999,528	948,280	1,043,626	950,183	942,209	1,130,809	1,004,892
Food Products	14.6	702,435	646,443	728,944	731,901	771,256	730,224	778,658	731,790	745,953
Transportation	13.0	624,129	489,420	597,076	665,857	700,718	638,476	714,975	734,065	731,732
Miscellaneous	1.5	73,913	91,452	104,521	80,415	79,757	89,266	97,754	85,426	118,443
Construction	0.8	38,468	56,568	59,367	73,072	67,136	64,984	66,861	65,158	68,613
Net Pools & Adjustments	12.3	591,626	647,246	354,049	591,548	502,687	656,812	606,216	750,044	164,093
Total	100.0	4,815,370	4,196,545	4,967,412	5,029,860	5,190,470	4,928,809	5,840,560	5,572,584	4,929,518

Economic Segment	%	2009/2	2009/1	2008/4	2008/3	2008/2	2008/1	2007/4	2007/3	2007/2
Restaurants	12.8	614,330	562,341	626,303	640,499	675,646	636,067	665,483	632,432	647,325
Department Stores	11.0	529,267	426,855	723,247	571,259	643,944	515,250	864,092	662,364	674,021
Miscellaneous Retail	7.5	362,557	301,033	470,722	411,741	432,427	405,110	601,270	440,535	475,418
Furniture/Appliance	6.4	310,061	292,044	378,626	449,922	369,954	397,380	510,854	442,337	358,226
Apparel Stores	6.3	305,215	241,891	377,969	332,766	377,367	317,450	458,596	337,305	367,854
Service Stations	2.4	116,746	90,066	112,489	173,307	177,430	154,558	152,871	140,370	163,574
Business Services	2.4	115,808	108,951	142,360	132,139	152,818	131,275	146,470	143,928	138,639
Food Markets	1.6	75,754	72,517	88,559	78,670	81,677	78,860	95,596	86,112	85,430
Auto Parts/Repair	1.4	65,036	37,012	39,570	49,199	48,145	37,605	43,424	44,163	46,603
Leasing	0.7	35,169	37,011	37,035	45,313	42,537	45,320	45,215	54,710	46,465
Bldg.Matls-Retail	0.7	33,940	50,548	53,188	61,571	58,082	56,037	56,136	55,105	57,584
Liquor Stores	0.3	12,251	11,585	14,075	12,707	13,933	15,297	17,579	13,246	13,198
Miscellaneous Other	0.1	6,677	6,096	9,834	7,223	8,682	6,398	11,383	7,953	14,375
Heavy Industry	0.1	5,215	5,596	9,060	5,829	7,406	6,451	8,810	13,321	7,119
Bldg.Matls-Whsle	0.1	4,528	6,020	6,179	11,501	9,054	8,947	10,725	10,053	11,029
All Other	33.9	1,631,190	1,299,733	1,524,147	1,454,666	1,588,681	1,459,992	1,545,840	1,738,606	1,658,565
Net Pools & Adjustments	12.3	591,626	647,246	354,049	591,548	502,687	656,812	606,216	750,044	164,093
Total	100.0	4,815,370	4,196,545	4,967,412	5,029,860	5,190,470	4,928,809	5,840,560	5,572,584	4,929,518

*Net Pools & Adjustments reconciles economic performance to periods' net cash receipts. The historical amounts by calendar quarter: (1) include any prior period adjustments and payments in the appropriate category/segment and (2) exclude businesses no longer active in the current period.

City of Palo Alto

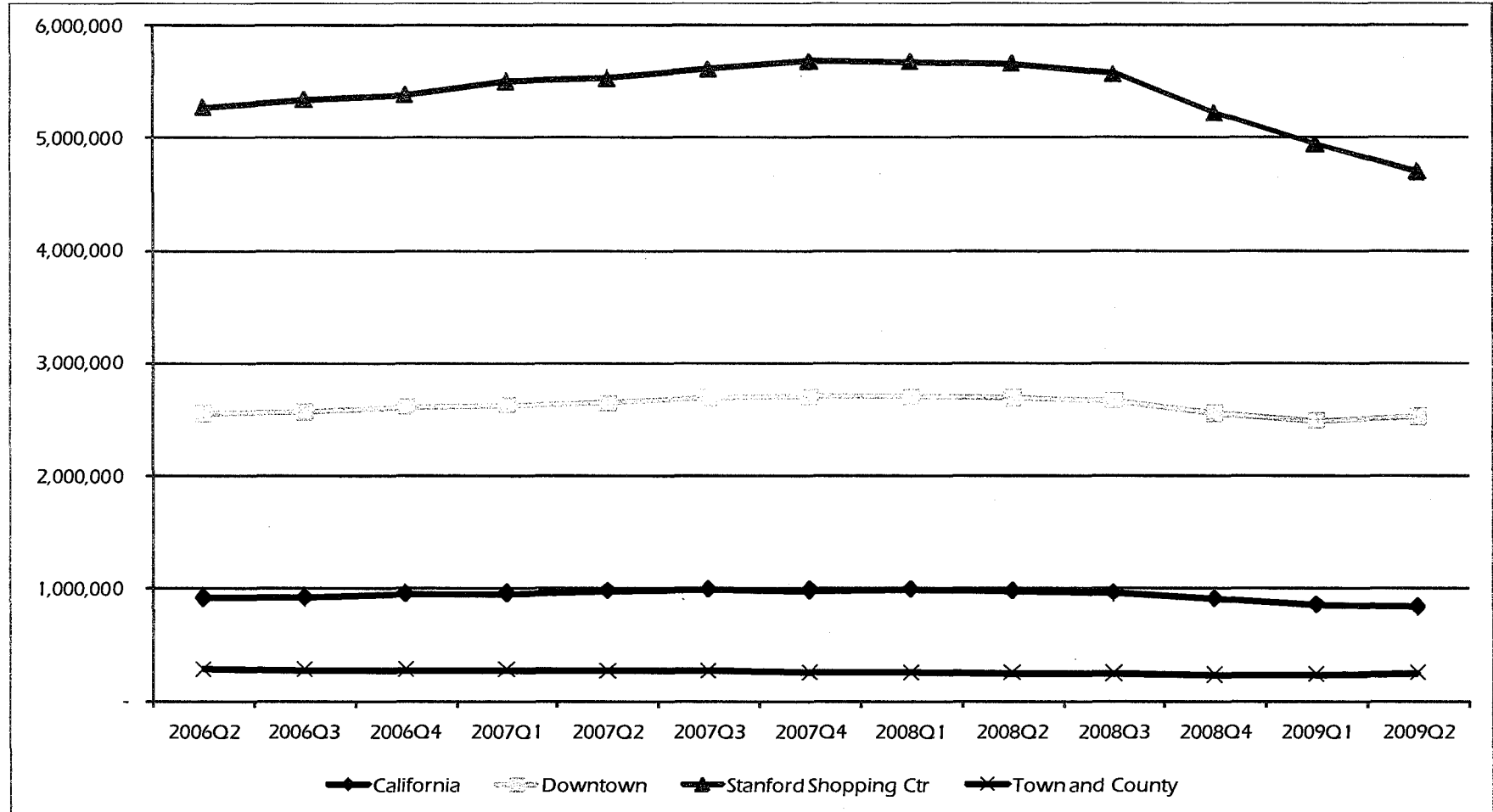
Percent Change to 2nd Quarter 2009 from 2nd Quarter 2008

	General Retail	Food Products	Transportation	Construction	B2B	Miscellaneous	2008 Q2 Total	2009 Q2 Total	% Change	Largest Gain	2nd Largest Gain	Largest Decline	2nd Largest Decline
Campbell	-14%	-10%	-24%	-26%	-33%	-24%	2,179,337	1,747,260	-19.8%	Chemical Products	Liquor Stores	Bldg.Matls-Retail	Service Stations
Cupertino	-12%	-10%	-32%	-30%	-15%	10%	4,136,112	3,516,377	-15.0%	Electronic Equipment	Health & Government	Business Services	Office Equipment
Gilroy	-4%	-2%	-41%	-21%	-28%	-18%	2,956,216	2,443,048	-17.4%	Auto Parts/Repair	Light Industry	Auto Sales - New	Service Stations
Los Altos	-27%	-9%	-31%	-23%	-41%	-17%	584,219	453,546	-22.4%	Electronic Equipment	Auto Parts/Repair	Service Stations	Miscellaneous Retail
Los Gatos	4%	-7%	-33%	-23%	-35%	-30%	1,957,090	1,765,118	-9.8%	Miscellaneous Retail	Drug Stores	Auto Sales - New	Service Stations
Milpitas	-9%	-5%	-40%	-33%	-20%	6%	3,561,788	2,924,313	-17.9%	Office Equipment	Heavy Industry	Electronic Equipment	Auto Sales - New
Monte Sereno	-72%	-100%	23%	-100%	-64%	41%	3,558	2,385	-33.0%	Auto Parts/Repair	Department Stores	Miscellaneous Retail	Apparel Stores
Morgan Hill	-17%	-6%	-40%	-34%	-41%	8%	1,430,080	1,008,070	-29.5%	Recreation Products	Health & Government	Service Stations	Electronic Equipment
Mountain View	-4%	1%	-30%	-7%	-25%	-13%	3,549,343	3,036,429	-14.5%	Auto Parts/Repair	Food Markets	Service Stations	Electronic Equipment
Palo Alto	-17%	-9%	-11%	-43%	5%	-7%	4,687,783	4,223,744	-9.9%	Electronic Equipment	Auto Sales - Used	Auto Sales - New	Department Stores
San Jose	-12%	-10%	-35%	-27%	-34%	-25%	32,966,525	24,898,436	-24.5%	Liquor Stores	Closed Acct-Adjustmt	Service Stations	Office Equipment
Santa Clara	-12%	-13%	-28%	-28%	-29%	-27%	8,472,942	6,444,845	-23.9%	Apparel Stores	Chemical Products	Electronic Equipment	Auto Sales - New
Santa Clara Co.	-25%	-26%	-42%	-42%	-28%	-16%	1,108,597	775,962	-30.0%	Energy Sales	Leasing	Bldg.Matls-Whsle	Service Stations
Saratoga	-39%	1%	-26%	-13%	9%	61%	221,267	190,000	-14.1%	Business Services	Health & Government	Miscellaneous Retail	Furniture/ Appliance
Sunnyvale	-22%	-17%	-36%	-28%	-17%	-46%	6,351,019	4,812,383	-24.2%	Drug Stores	Liquor Stores	Auto Sales - New	Service Stations

City of Palo Alto

City of Palo Alto - Selected Geographic Areas of the City
Benchmark Year 2nd Quarter 2009

	2006Q2	2006Q3	2006Q4	2007Q1	2007Q2	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2
California	917,333	920,077	952,795	956,133	979,260	991,900	984,263	990,771	978,463	960,772	908,095	858,391	839,591
Downtown	2,555,958	2,570,964	2,614,276	2,630,376	2,649,055	2,694,704	2,703,079	2,705,829	2,692,680	2,674,057	2,557,974	2,493,666	2,528,443
Stanford Shopping Ctr	5,271,963	5,343,529	5,382,666	5,503,283	5,529,868	5,612,325	5,681,340	5,674,646	5,661,387	5,570,554	5,218,085	4,941,824	4,701,109
Town and County	281,132	276,642	277,237	276,364	269,829	266,728	256,553	256,612	248,359	243,683	233,208	237,307	251,608



City of Palo Alto

City of Palo Alto - Regional Shopping Mall Comparison Benchmark Year 2nd Quarter 2009

	2006Q2	2006Q3	2006Q4	2007Q1	2007Q2	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2
Valley Fair	6,536,476	6,818,211	6,745,612	6,860,819	6,646,498	6,719,867	6,571,449	6,520,191	6,399,179	6,367,597	6,093,294	5,941,991	5,769,466
Santana Row	1,707,638	1,734,143	1,764,508	1,821,673	1,858,037	1,913,632	1,930,733	1,892,646	1,894,799	1,919,027	1,840,846	1,755,862	1,685,331
Hillsdale	3,208,307	2,889,177	2,890,671	2,910,464	2,832,627	2,808,965	2,727,880	2,644,727	2,616,817	2,551,004	2,509,227	2,020,719	1,981,010
Stanford Shopping Ctr	5,271,963	5,343,529	5,382,666	5,503,283	5,529,868	5,612,325	5,681,340	5,674,646	5,661,387	5,570,554	5,218,085	4,941,824	4,701,109
Oakridge Mall	3,247,315	3,023,925	3,017,094	3,036,592	3,209,583	3,184,516	3,183,645	3,313,152	3,349,138	3,355,538	3,199,518	3,105,561	3,035,077

