



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

February 8, 2010

The Honorable City Council
Palo Alto, California

City of Palo Alto Sales Tax Digest Summary Third Quarter Sales (July – September 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. According to the Administrative Services Department (ASD), projected sales and use tax revenue has declined significantly and is now estimated at \$17.2 million 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 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 third quarter sales (July through September 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 fourth quarter sales (October through December 2009) should be available by May 2010. ASD advises that in mid-March, it should receive information from the State on aggregate sales and use tax receipts for fourth quarter 2009.

¹ See definitions on page 4.

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

- Third quarter 2009 sales and use tax revenue totaled \$4.6 million (down \$0.5 million from third quarter 2008 and down \$0.2 million from second 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 third quarter ending September 2009, compared to the third quarter ending September 2008. Statewide, sales and use tax revenue has declined, or shown no growth, for nine consecutive quarters.
- Sales and use tax revenue (cash receipts) totaled \$18.6 million for the year ending September 2009, a decrease from \$21.0 million in the prior year ending September 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

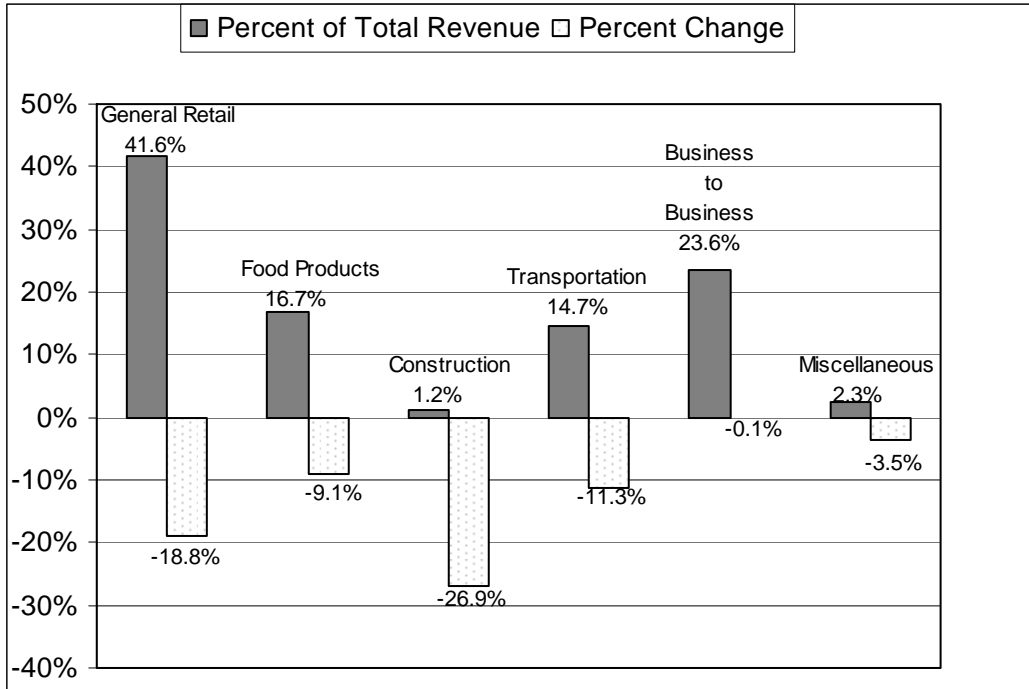
According to information from MuniServices, the following current economic influences may affect our City's sales and use tax revenue:

- As of December 2009, some economists believe that the deepest and longest national recession since the 1930's has ended, and the economy has entered a new fragile phase of recovery. However, the economy may struggle even as it recovers from the recession amidst a weak job market, cautious consumers, and tight credit.
- It is predicted that California's economy won't pick up until at least early 2011, and job losses will continue into next year.
- In the next six months, 19 percent of employers in Santa Clara County plan to reduce jobs, and 24 percent plan to add jobs. Preliminary estimates show the December 2009 unemployment rate in Santa Clara County at 11.2 percent and Palo Alto at 6.1 percent.
- Based on an analysis of the City's economic base and buying income, sales tax "leakage" or areas where the City could potentially earn more sales tax, occurs in the area of general stores (with sales tax leakage estimated around \$450,000 per year), and supermarkets (with leakage estimated around \$260,000 per year).

Economic Category Analysis

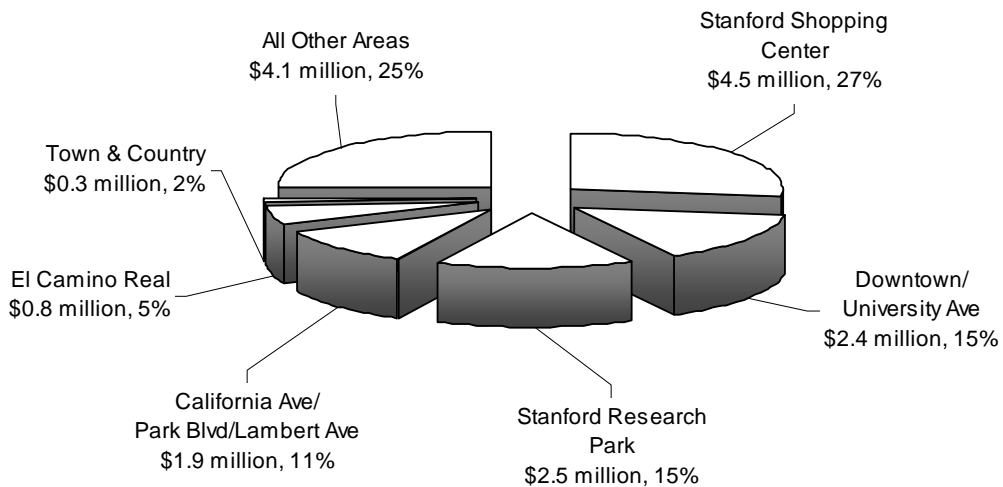
Analysis of six economic categories, for the year ending September 2009, shows that General Retail comprised the largest percentage of Palo Alto's sales and use tax revenue and experienced an 18.8% decline. Transportation experienced a 11.3% decline and comprised 14.7% of total revenues. Construction experienced a 26.9% decline, but it also represented only 1.2% 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 September 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 September 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 and is scheduled to expire on July 1, 2011.

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

Fourth Quarter Collection of Third Quarter Sales Quarter 3, 2009

California Overview

The percent change in cash receipts from the prior year was (15.7%) statewide, (15.4%) in Northern California and (15.8%) 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 3rd Quarter 2009 by (16.2%) statewide, (15.5%) in Northern California and (16.6%) in Southern California.

City of Palo Alto

For the year ended 3rd Quarter 2009, sales tax cash receipts for the City fell (11.6%) from the prior year. On a quarterly basis, sales tax revenues dropped (9.0%) from 3rd Quarter 2008 to 3rd 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 for prior periods) and late payments, local sales tax declined (12.1%) for the year ended 3rd Quarter 2009 from the prior year. On a quarterly basis, sales tax activity fell (13.1%) in 3rd Quarter 2009 compared to 3rd Quarter 2008.

Regional Overview

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

ECONOMIC CATEGORY ANALYSIS FOR YEAR ENDED 3RD QUARTER 2009

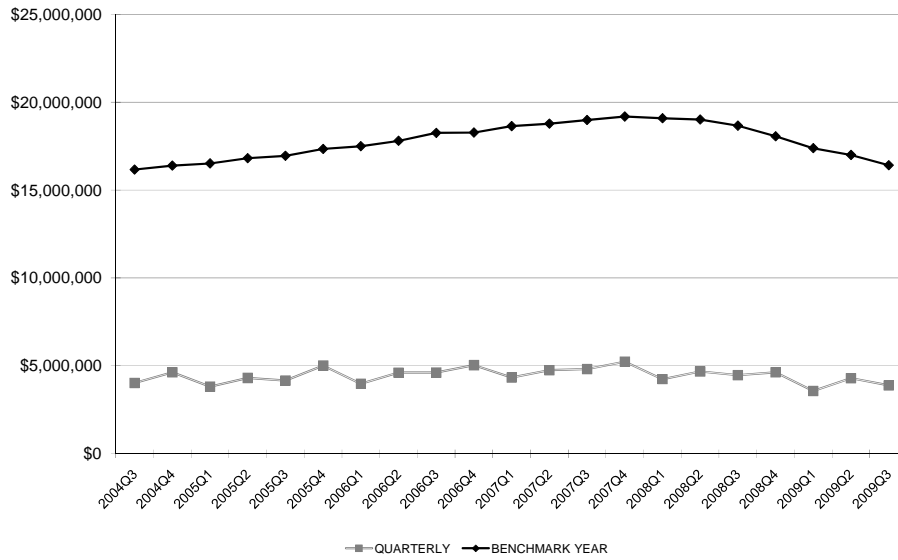
	Palo Alto	California Statewide	S.F. Bay Area	Sacramento Valley	Central Valley	South Coast	North Coast	Central Coast
General Retail <i>% of Total / % Change</i>	41.6 / -18.8	30.8 / -10.6	30.8 / -11.7	30.6 / -7.4	33.1 / -3.9	30.7 / -11.5	29.2 / -10.6	30.9 / -7.9
Food Products <i>% of Total / % Change</i>	16.7 / -9.1	19.5 / -6.6	20.0 / -6.5	17.4 / -6.4	17.8 / -5.1	19.9 / -6.8	17.9 / -7.8	19.6 / -7.3
Construction <i>% of Total / % Change</i>	1.2 / -26.9	9.2 / -20.2	8.8 / -20.6	11.3 / -22.4	11.7 / -19.7	8.5 / -18.7	11.2 / -25.6	14.2 / -20.1
Transportation <i>% of Total / % Change</i>	14.7 / -11.3	20.9 / -27.5	17.8 / -27.6	23.2 / -24.5	22.1 / -28.2	21.3 / -27.0	23.5 / -31.6	25.3 / -27.3
Business to Business <i>% of Total / % Change</i>	23.6 / -0.1	18.2 / -17.4	21.4 / -17.1	16.2 / -16.6	14.3 / -16.9	18.3 / -18.0	16.0 / -13.6	9.2 / -26.5
Miscellaneous <i>% of Total / % Change</i>	2.3 / -3.5	1.3 / -9.7	1.4 / -6.3	1.3 / -4.9	0.9 / -8.7	1.2 / -13.1	2.2 / -5.0	0.9 / -7.9
Total	100.0 / -12.1	100.0 / -16.2	100.0 / -16.0	100.0 / -15.1	100.0 / -14.4	100.0 / -16.3	100.0 / -18.3	100.0 / -17.1

THREE LARGEST SEGMENTS FOR YEAR ENDED 3RD QUARTER 2009

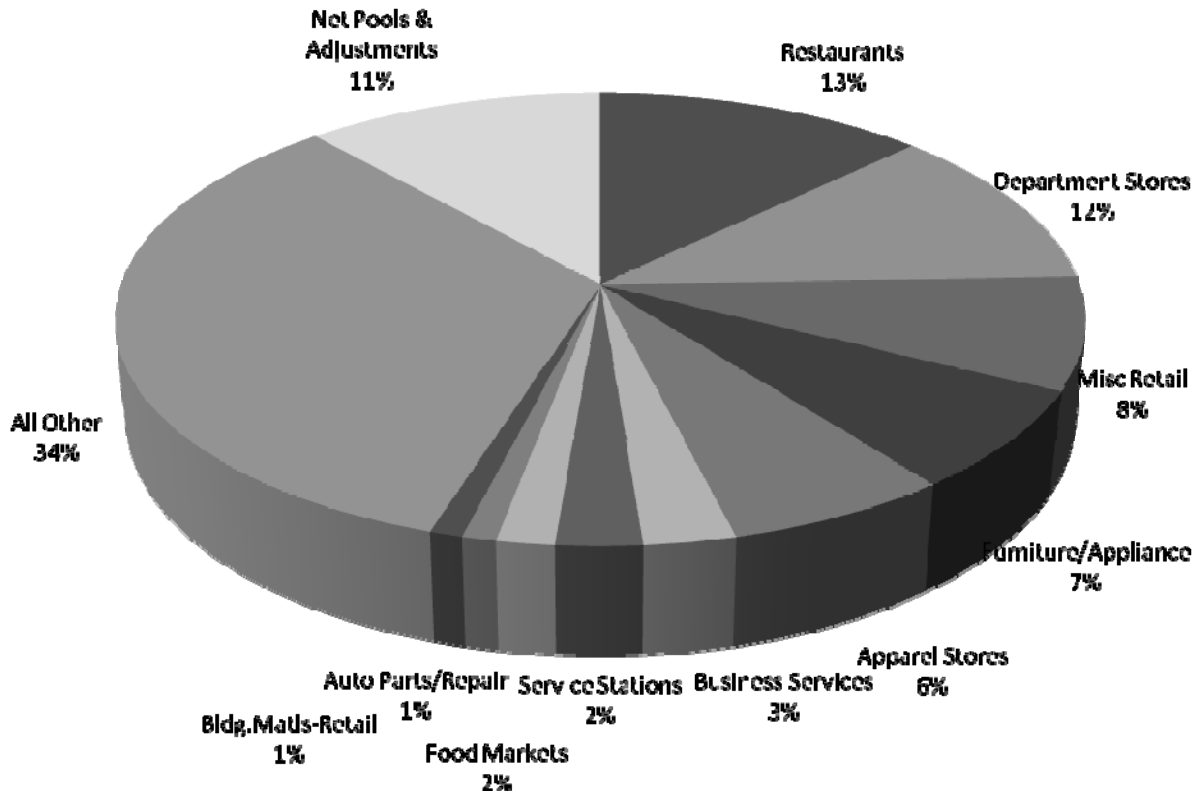
	Palo Alto	California Statewide	S.F. Bay Area	Sacramento Valley	Central Valley	South Coast	North Coast	Central Coast
Largest Segment <i>% of Total / % Change</i>	Restaurants 14.5 / -9.2	Restaurants 13.3 / -7.0	Restaurants 13.7 / -7.2	Department Stores 12.8 / -4.6	Department Stores 16.1 / -4.2	Restaurants 14.0 / -7.4	Department Stores 12.4 / -8.2	Department Stores 13.5 / -7.1
2nd Largest Segment <i>% of Total / % Change</i>	Department Stores 13.2 / -16.8	Department Stores 11.4 / -7.6	Department Stores 10.4 / -9.2	Restaurants 10.9 / -5.4	Restaurants 10.5 / -2.4	Department Stores 10.9 / -7.9	Restaurants 11.3 / -7.7	Services Stations 10.4 / -29.2
3rd Largest Segment <i>% of Total / % Change</i>	Electronic Equipment <i>Confidential / 16.9</i>	Service Stations 8.2 / -32.2	Misc. Retail 7.6 / -13.4	Auto Sales - New 8.6 / -24.3	Service Stations 9.2 / -30.2	Auto Sales - New 8.5 / -25.2	Service Stations 9.8 / -32.7	Restaurants 10.3 / -7.3

City of Palo Alto

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



Net Cash Receipts for Benchmark Year 3rd Quarter 2009: \$18,558,090



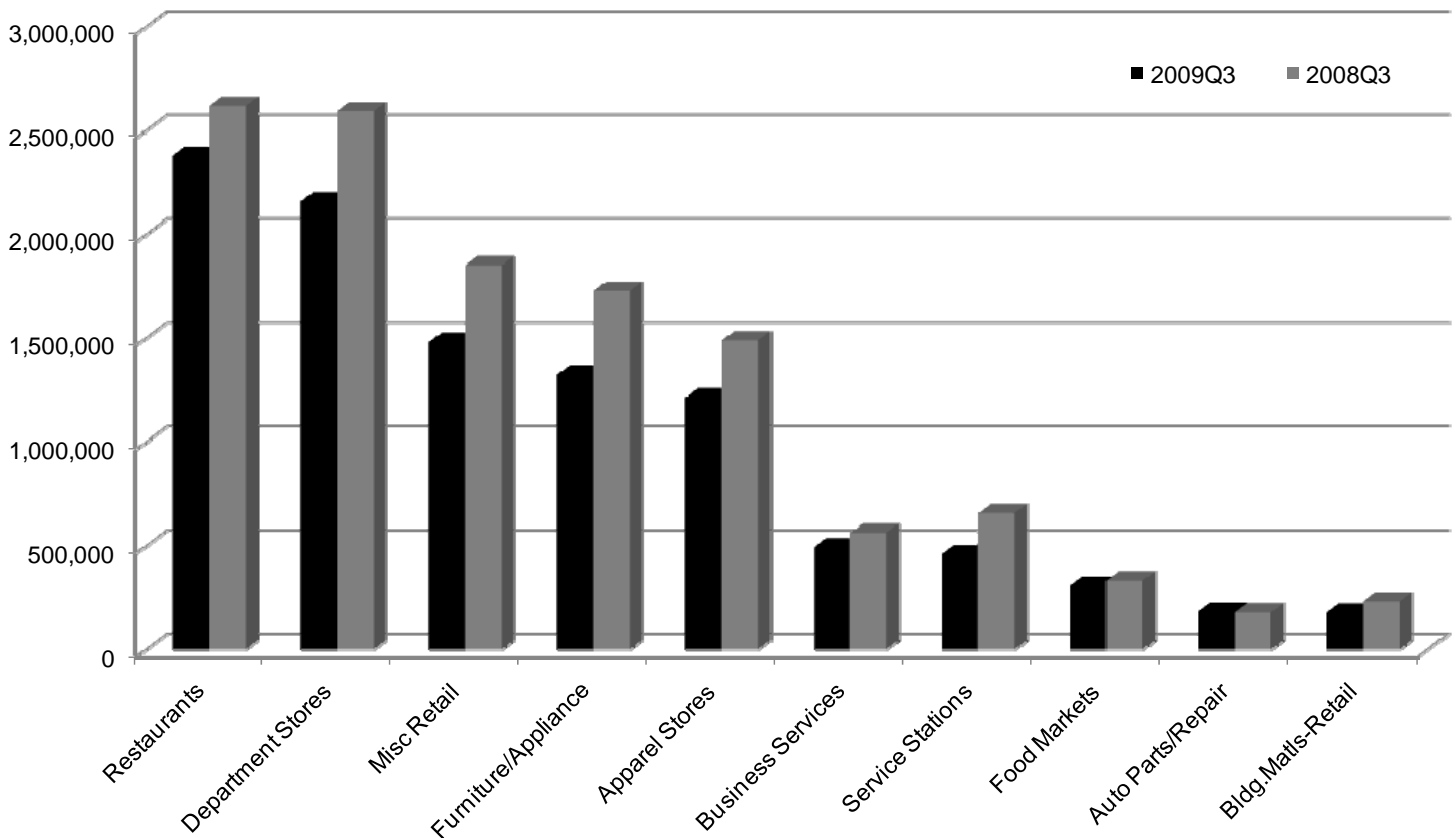
City of Palo Alto

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 3rd Quarter 2009. The Top 25 Sales/Use Tax contributors generate 51.4% of Palo Alto's total sales and use tax revenue.

Anderson Honda	Hewlett-Packard	Raytheon Company
Apple Stores	Integrated Archive Systems	Shell Service Stations
Bloomingdale's	Keeble & Shuchat Photography	Stanford University Hospital
Carlsen Motor Cars	Loral Space Systems	The Gap
Carlsen Subaru	Macy's Department Store	Tiffany & Company
Crate & Barrel	Magnussen's Toyota	Valero Service Stations
CVS/Pharmacy	Neiman Marcus	Varian Medical Systems
Dow Jones & Company	Nordstrom Department Store	
Fry's Electronics	Park Avenue Motors	

Sales Tax from Largest 10 Non-confidential Economic Segments



City of Palo Alto

Historical Analysis by Calendar Quarter

Economic Category	%	2009/3	2009/2	2009/1	2008/4	2008/3	2008/2	2008/1	2007/4	2007/3
General Retail	35.3	1,615,455	1,671,676	1,401,746	2,134,924	1,942,546	2,025,574	1,799,048	2,633,975	2,075,608
Business To Business	19.5	894,386	1,096,153	871,861	1,003,360	949,417	1,044,467	927,270	948,200	1,135,985
Food Products	14.5	665,680	694,271	649,563	730,351	733,080	771,761	730,827	779,279	731,790
Transportation	13.0	594,725	726,213	495,640	596,634	665,857	700,718	638,476	714,975	734,065
Miscellaneous	1.7	79,799	79,758	101,377	111,476	115,678	81,252	89,266	99,538	85,426
Construction	1.0	44,182	38,589	56,568	59,367	72,868	67,136	64,984	66,861	65,158
Net Pools & Adjustments	15.0	684,537	508,710	619,790	331,300	550,414	499,562	678,938	597,732	744,552
Total	100.0	4,578,764	4,815,370	4,196,545	4,967,412	5,029,860	5,190,470	4,928,809	5,840,560	5,572,584

Economic Segments	%	2009/3	2009/2	2009/1	2008/4	2008/3	2008/2	2008/1	2007/4	2007/3
Restaurants	12.7	580,829	604,861	565,461	627,710	641,492	676,150	636,670	665,505	632,432
Department Stores	10.5	480,038	529,267	426,855	723,247	571,259	643,944	515,250	864,092	662,364
Furniture/Appliance	7.7	352,050	302,007	292,437	378,643	449,934	370,034	397,555	510,854	442,549
Miscellaneous Retail	7.5	341,947	360,311	304,199	474,090	412,826	432,541	405,110	601,294	440,568
Apparel Stores	6.3	286,511	299,896	243,222	385,510	335,428	377,457	317,459	458,660	337,376
Service Stations	2.9	134,369	119,637	95,957	111,830	173,307	177,430	154,558	152,871	140,370
Business Services	2.7	124,575	116,394	109,472	143,531	132,365	153,478	131,275	146,607	143,888
Food Markets	1.6	74,317	75,997	72,517	88,559	78,856	81,678	78,860	96,195	86,112
Leasing	0.9	41,697	34,892	36,308	37,049	45,324	42,611	45,332	45,869	54,710
Auto Parts/Repair	0.9	40,669	65,174	37,341	39,787	49,199	48,145	37,605	43,424	44,163
Bldg.Matls-Retail	0.9	39,314	33,879	50,548	53,188	61,367	58,082	56,037	56,136	55,105
Liquor Stores	0.2	10,534	13,313	11,585	14,075	12,707	13,933	15,297	17,579	13,246
Miscellaneous Other	0.2	7,637	6,730	6,092	9,847	7,223	8,775	6,398	11,383	7,953
Heavy Industry	0.1	5,090	5,369	5,596	9,069	5,829	7,406	6,451	8,810	13,321
Bldg.Matls-Whsle	0.1	4,868	4,710	6,020	6,179	11,501	9,054	8,947	10,725	10,053
All Other	29.9	1,369,782	1,734,223	1,313,145	1,533,798	1,490,829	1,590,190	1,437,067	1,552,824	1,743,822
Net Pools & Adjustments	15.0	684,537	508,710	619,790	331,300	550,414	499,562	678,938	597,732	744,552
Total	100	4,578,764	4,815,370	4,196,545	4,967,412	5,029,860	5,190,470	4,928,809	5,840,560	5,572,584

*Net Pools & Adjustments reconcile 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.

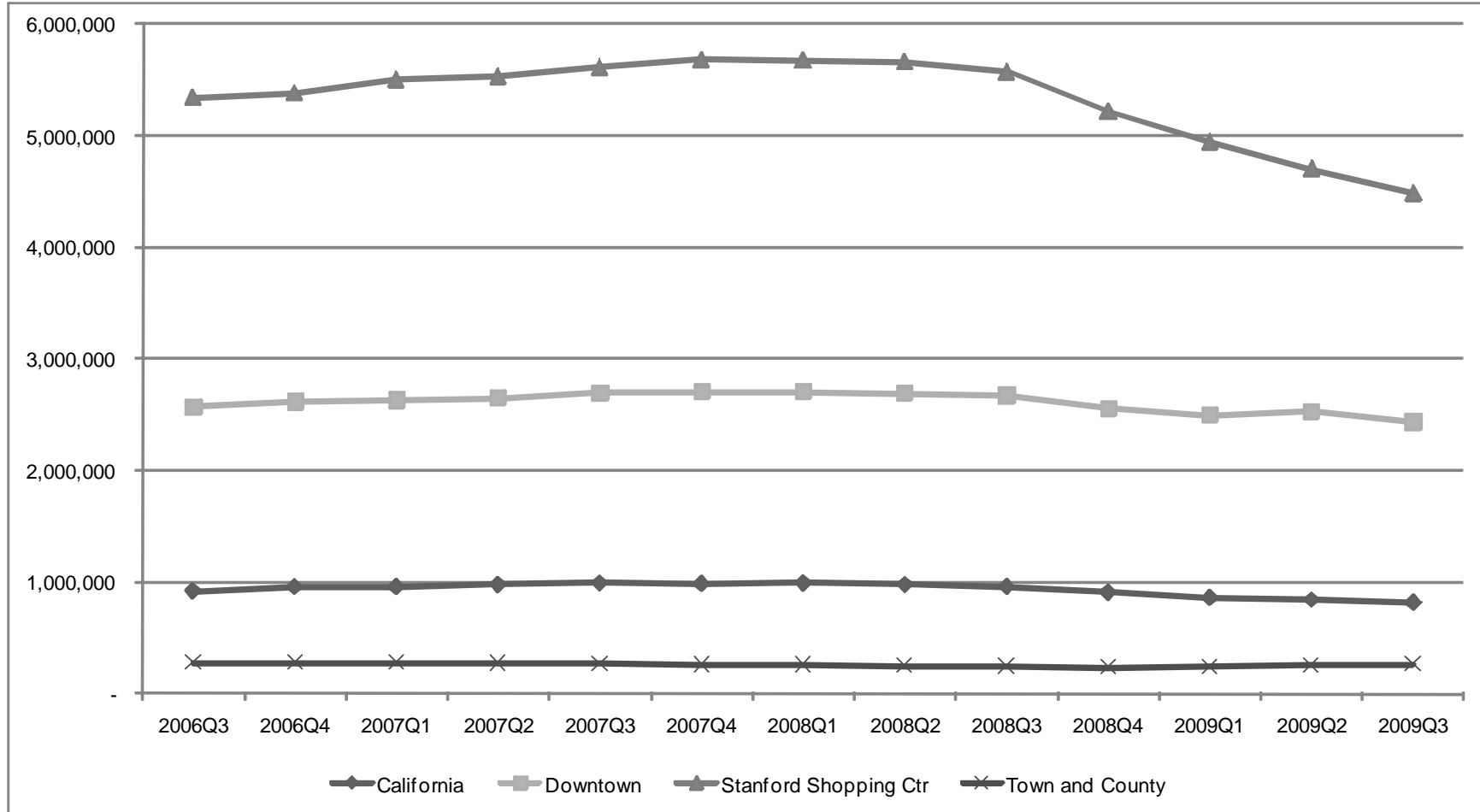
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	General Retail	Food Products	Transportation	Construction	Business to Business	Miscellaneous	2009/3 Total	2008/3 Total	% Chg	Largest Gain	Second Largest Gain	Largest Decline	Second Largest Decline
Campbell	-11.3%	-11.8%	-21.6%	-17.8%	-34.0%	-45.7%	1,773,045	2,173,228	-18.4%	Leasing	Drug Stores	Business Services	Service Stations
Cupertino	-6.7%	-12.1%	-24.1%	-37.6%	16.4%	-8.2%	3,323,261	3,168,994	4.9%	Office Equipment	Furniture / Appliance	Electronic Equipment	Business Services
Gilroy	-2.5%	-1.4%	-23.3%	-16.6%	-23.1%	-8.6%	2,627,987	2,938,000	-10.6%	Department Stores	Apparel Stores	Service Stations	Auto Sales - New
Los Altos	-24.4%	-9.5%	-19.3%	-36.0%	-23.0%	-11.0%	456,267	560,621	-18.6%	Light Industry	Auto Parts/Repair	Service Stations	Florist / Nursery
Los Gatos	4.2%	-5.2%	-24.9%	-21.8%	-18.1%	-15.6%	1,842,242	1,964,196	-6.2%	Miscellaneous Retail	Department Stores	Auto Sales - New	Service Stations
Milpitas	-7.8%	-8.4%	-28.0%	-31.1%	-22.3%	26.4%	3,011,235	3,612,377	-16.6%	Health & Government	Miscellaneous Retail	Auto Sales - New	Electronic Equipment
Monte Sereno	-16.5%	-100.0%	38.1%	-100.0%	34.3%	-10.5%	3,084	2,582	19.4%	Auto Parts/Repair	Department Stores	Miscellaneous Retail	Furniture / Appliance
Morgan Hill	-10.9%	-4.9%	-27.6%	-24.1%	-38.0%	52.6%	1,082,564	1,372,629	-21.1%	Leasing	Health & Government	Service Stations	Electronic Equipment
Mountain View	-1.3%	-2.8%	-25.7%	-9.1%	-14.5%	-39.1%	3,202,495	3,599,847	-11.0%	Department Stores	Bldg.Matls-Whsle	Service Stations	Office Equipment
Palo Alto	-16.8%	-9.2%	-10.7%	-39.4%	-5.8%	-31.0%	3,894,226	4,479,449	-13.1%	Electronic Equipment	Chemical Products	Furniture / Appliance	Department Stores
San Jose	-10.3%	-9.6%	-21.2%	-26.1%	-23.9%	-17.4%	26,203,941	31,934,392	-17.9%	Liquor Stores		Service Stations	Bldg.Matls-Whsle
Santa Clara	-11.0%	-11.1%	-9.0%	-31.4%	-26.4%	1.7%	6,748,728	8,274,882	-18.4%	Auto Sales - New	Chemical Products	Electronic Equipment	Office Equipment
Santa Clara Co.	-17.0%	-18.7%	-34.7%	-40.9%	-22.3%	-16.6%	842,202	1,114,612	-24.4%	Misc. Vehicle Sales	Electronic Equipment	Bldg.Matls-Whsle	Service Stations
Saratoga	-33.6%	-6.9%	-8.5%	-26.4%	-5.7%	-9.4%	215,957	251,345	-14.1%	Business Services	Office Equipment	Miscellaneous Retail	Electronic Equipment
Sunnyvale	-20.9%	-8.7%	-10.7%	10.2%	-16.1%	-34.5%	5,395,690	6,197,657	-12.9%	Bldg.Matls-Whsle	Auto Sales - Used	Office Equipment	Service Stations

City of Palo Alto

City of Palo Alto - Selected Geographic Areas of the City
Benchmark Year 3rd Quarter 2009

	2006Q3	2006Q4	2007Q1	2007Q2	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3
California	920,077	952,795	956,133	979,260	991,900	984,263	990,771	978,463	960,772	908,095	858,391	839,591	812,294
Downtown	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	2,434,567
Stanford Shopping Ctr	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	4,479,311
Town and County	276,642	277,237	276,364	269,829	266,728	256,553	256,612	248,359	243,683	233,208	237,307	251,608	261,294



City of Palo Alto

City of Palo Alto - Regional Shopping Mall Comparison
Benchmark Year 3rd Quarter 2009

	2006Q3	2006Q4	2007Q1	2007Q2	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3
Valley Fair	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	5,717,263
Santana Row	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	1,635,305
Hillsdale	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	1,961,708
Stanford Shopping Ctr	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	4,479,311
Oakridge Mall	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	3,419,383

