



## CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

August 2, 2010

The Honorable City Council  
Palo Alto, California

### **City of Palo Alto Sales Tax Digest Summary First Quarter Sales (January – March 2010)**

This is an informational report and no action is required.

#### **BACKGROUND**

Sales and use tax represented 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 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 allocations<sup>1</sup> 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 first quarter sales (January through March 2010). 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 second quarter sales (April through June 2010) should be available by November 2010. ASD advises that in mid-September, it should receive information from the State on aggregate sales and use tax receipts for second quarter 2010.

<sup>1</sup> See definitions on page 4.

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

- In Palo Alto, overall sales and use tax revenue (cash receipts) for the first quarter ending March 2010 decreased 1.9% (including pool allocations) compared to the first quarter ending March 2009. However, when adjusted for a prior period correction of \$0.16 million, the City's cash receipts show a 2% increase.
- Statewide, every region in California experienced a decline in sales and use tax revenue for the year ending March 2010, compared to the prior year ending March 2009. After ten consecutive quarters of decline or no growth, statewide sales and use tax revenue has shown minimal growth of 0.5% during the first quarter ending March 2010 compared to the first quarter ending March 2009.
- Sales and use tax revenue totaled \$18.5 million for the year ending March 2010, a decrease from \$19.4 million in the prior year ending March 2009. 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**

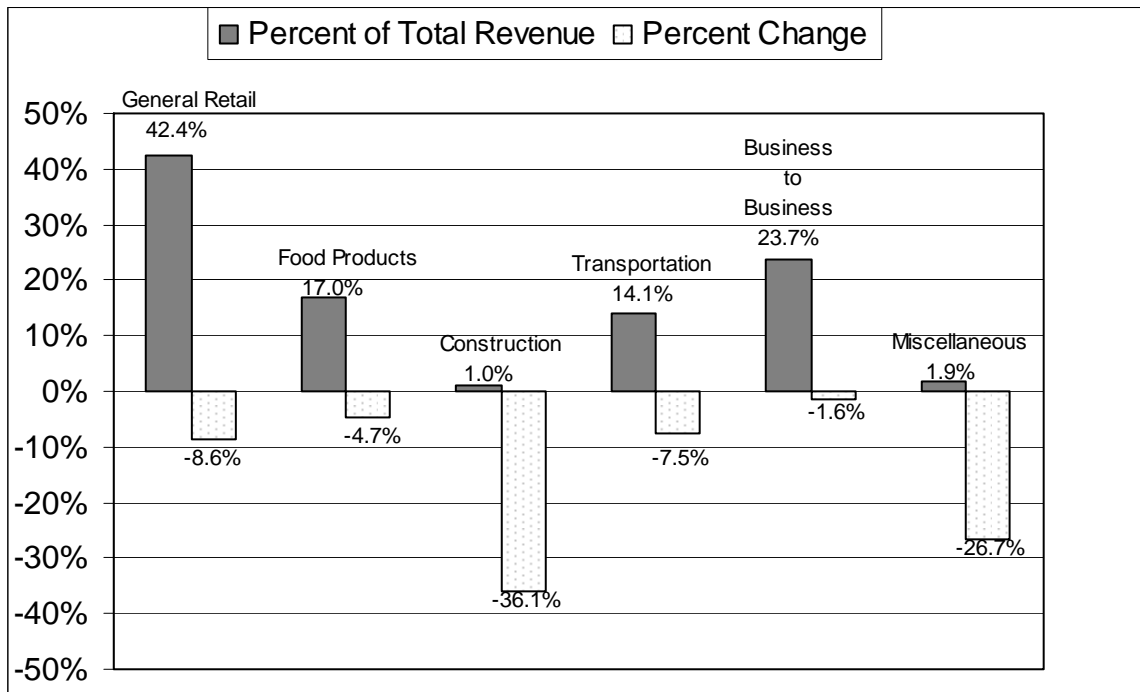
According to information from MuniServices, the following current economic influences may affect our City's sales and use tax revenue:

- In the first quarter, the government lowered its estimate of economic growth from 3% to 2.7%, noting that consumers spent less than previously anticipated.
- While the economy is strengthening, millions of jobs lost in the recession could be permanent, particularly in the retailing, manufacturing, and advertising industries.
- The overall health of the economy and consumer confidence continues to improve but remains unsteady. Middle-class consumers are spending, and sales of discretionary items are increasing.
- The California job market is expected to remain weak through the end of 2011. Preliminary estimates show the May 2010 unemployment rate in Santa Clara County at 11.0% and Palo Alto at 5.9%.

### **Economic Category Analysis**

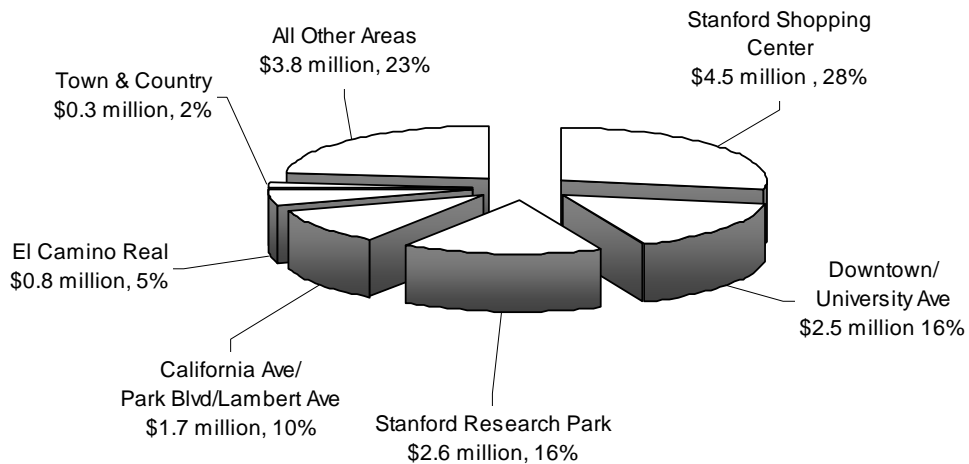
Analysis of six economic categories, for the year ending March 2010, shows that General Retail comprised the largest percentage of Palo Alto's sales and use tax revenue and experienced an 8.6% decline. Transportation experienced a 7.5% decline and comprised 14.1% of total revenues. Construction experienced a 36.1% decline, but it also represented only 1.0% 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 March 2010**



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 March 2010  
(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

### 2<sup>nd</sup> Quarter 2010 Collection of 1<sup>st</sup> Quarter Sales Quarter 1, 2010

#### California Overview

The percent change in cash receipts from the prior year was (11.0%) statewide, (11.2%) in Northern California and (10.9%) 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 1st Quarter 2010 by (10.9%) statewide, (10.7%) in Northern California and (11.0%) in Southern California.

#### City of Palo Alto

For the year ended 1st Quarter 2010, sales tax cash receipts for the City fell (4.4%) from the prior year. On a quarterly basis, sales tax revenues declined (1.9%) from 1st Quarter 2009 to 1st Quarter 2010. 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 (7.1%) for the year ended 1st Quarter 2010 from the prior year. On a quarterly basis, sales tax activity fell (0.8%) in 1st Quarter 2010 compared to 1st Quarter 2009.

#### Regional Overview

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

#### ECONOMIC CATEGORY ANALYSIS FOR YEAR ENDED 1ST QUARTER 2010

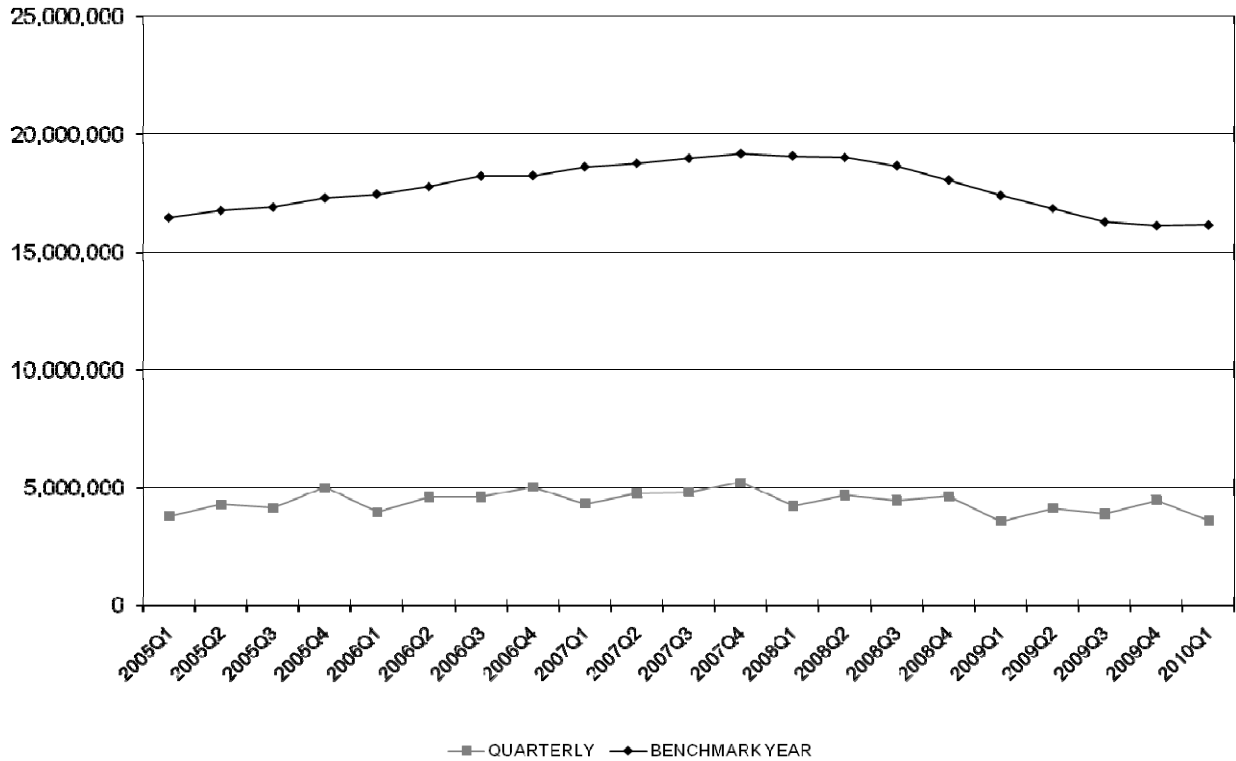
	Palo Alto	California Statewide	S.F. Bay Area	Sacramento Valley	Central Valley	South Coast	North Coast	Central Coast
<b>General Retail</b> <i>% of Total / % Change</i>	42.4 / -8.6	31.1 / -6.1	30.8 / -6.7	31.1 / -3.6	33.8 / -2.8	31.0 / -6.9	29.5 / -4.6	30.6 / -3.8
<b>Food Products</b> <i>% of Total / % Change</i>	17.0 / -4.7	19.6 / -4.9	20.1 / -4.5	17.5 / -5.4	18.1 / -4.5	20.1 / -5.2	17.8 / -4.5	19.5 / -4.5
<b>Construction</b> <i>% of Total / % Change</i>	1.0 / -36.1	8.8 / -18.5	8.4 / -17.9	10.6 / -22.4	11.0 / -21.5	8.1 / -16.8	10.4 / -21.8	13.2 / -18.4
<b>Transportation</b> <i>% of Total / % Change</i>	14.1 / -7.5	21.9 / -13.0	19.0 / -10.4	24.3 / -11.6	22.9 / -16.1	22.2 / -13.4	24.5 / -14.4	25.8 / -13.3
<b>Business to Business</b> <i>% of Total / % Change</i>	23.7 / -1.6	17.4 / -17.8	20.3 / -17.1	15.2 / -22.0	13.4 / -20.7	17.4 / -18.1	15.6 / -11.8	8.5 / -26.0
<b>Miscellaneous</b> <i>% of Total / % Change</i>	1.9 / -26.7	1.3 / -11.6	1.3 / -2.4	1.3 / -6.4	0.9 / -7.5	1.2 / -15.8	2.2 / -4.0	2.3 / 131.6
<b>Total</b>	<b>100.0 / -7.1</b>	<b>100.0 / -10.9</b>	<b>100.0 / -10.4</b>	<b>100.0 / -11.3</b>	<b>100.0 / -11.3</b>	<b>100.0 / -11.1</b>	<b>100.0 / -10.3</b>	<b>100.0 / -9.7</b>

#### THREE LARGEST SEGMENTS FOR YEAR ENDED 1ST QUARTER 2010

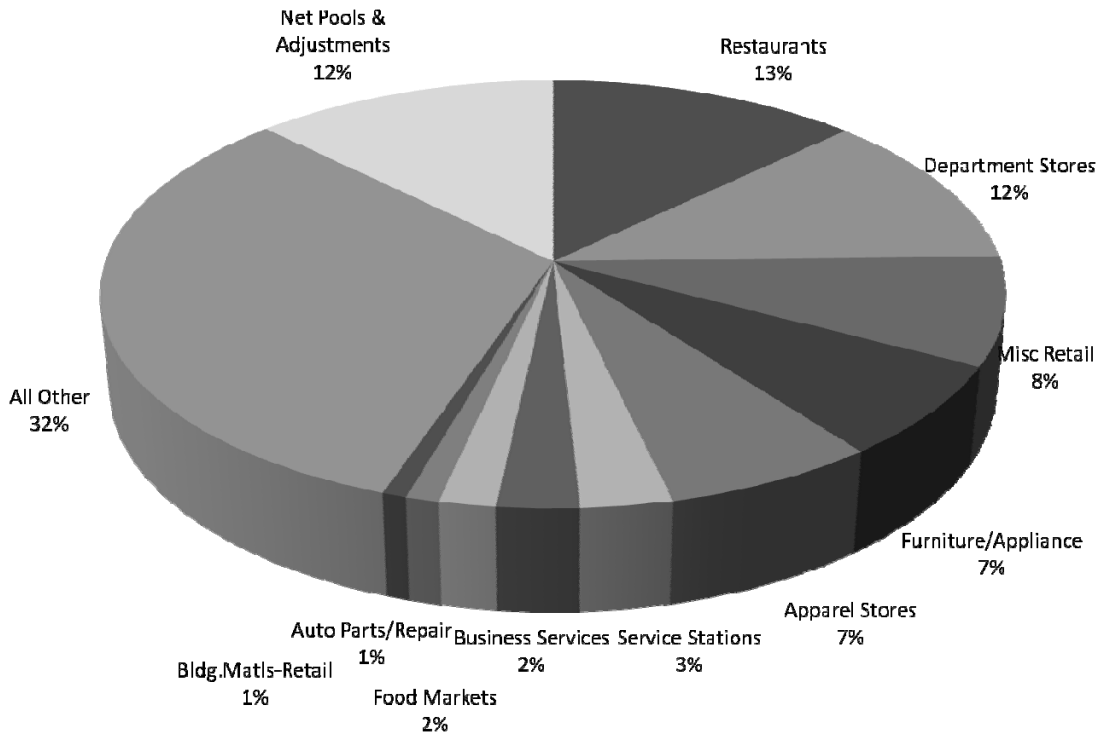
	Palo Alto	California Statewide	S.F. Bay Area	Sacramento Valley	Central Valley	South Coast	North Coast	Central Coast
<b>Largest Segment</b> <i>% of Total / % Change</i>	Restaurants 14.7 / -5.5	Restaurants 13.3 / -5.8	Restaurants 13.8 / -5.5	Department Stores 13.1 / -1.9	Department Stores 16.4 / -3.7	Restaurants 14.1 / -5.9	Department Stores 12.5 / -3.4	Department Stores 13.4 / -3.7
<b>2nd Largest Segment</b> <i>% of Total / % Change</i>	Department Stores 13.4 / -7.9	Department Stores 11.6 / -3.4	Department Stores 10.5 / -3.9	Restaurants 10.9 / -5.9	Restaurants 10.5 / -4.8	Department Stores 11.1 / -3.3	Restaurants 11.2 / -5.9	Services Stations 11.3 / -10.8
<b>3rd Largest Segment</b> <i>% of Total / % Change</i>	Electronic Equipment Confidential / 20.4	Service Stations 9.1 / -14.6	Service Stations 7.9 / -13.6	Service Stations 9.1 / -12.8	Service Stations 10.1 / -15.2	Service Stations 9.2 / -15.3	Service Stations 10.6 / -14.5	Restaurants 10.0 / -6.9

# City of Palo Alto

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



## Net Cash Receipts for Benchmark Year 1st Quarter 2010: \$18,539,641



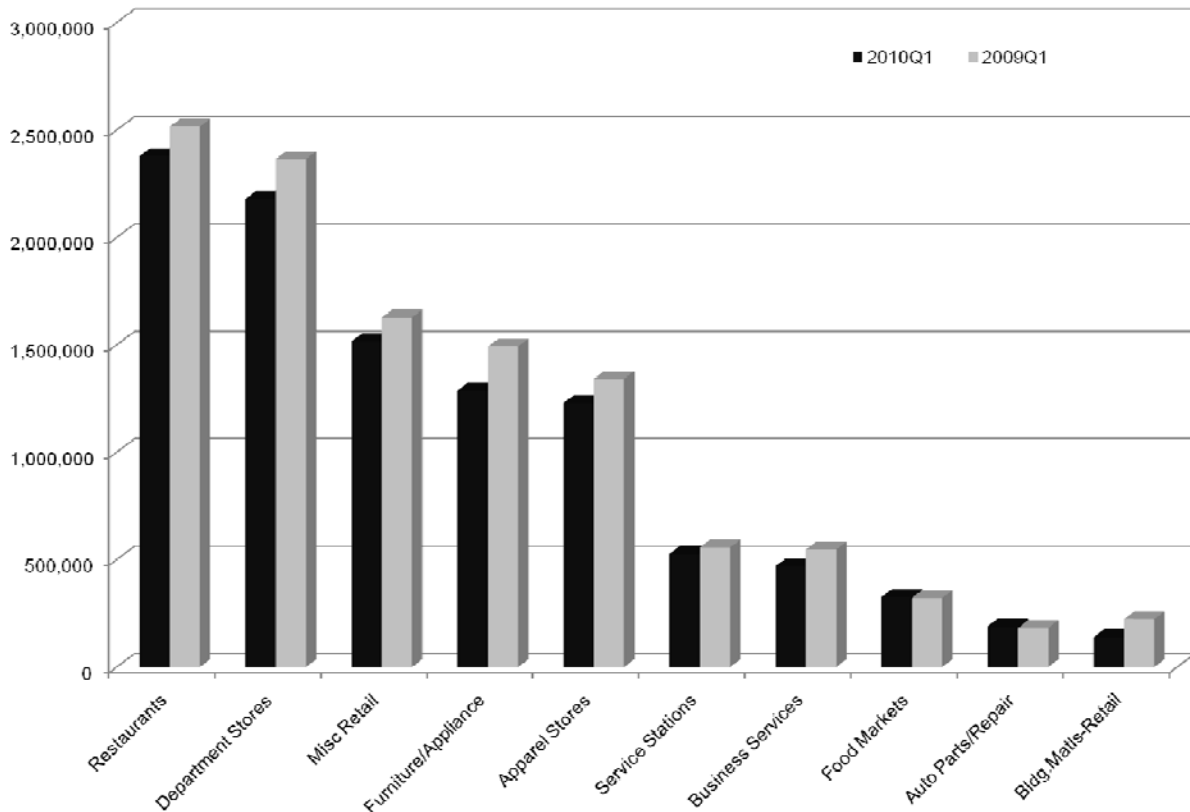
# City of Palo Alto

## 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 1st Quarter 2010. The Top 25 Sales/Use Tax contributors generate 52.4% 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 Department Store	Varian Medical Systems
Dow Jones & Company	Nordstrom Department Store	
Fry's Electronics	Pottery Barn	

## Sales Tax from Largest 10 Non-confidential Economic Segments



# City of Palo Alto

## Historical Analysis by Calendar Quarter

Economic Category	%	2010Q1	2009Q4	2009Q3	2009Q2	2009Q1	2008Q4	2008Q3	2008Q2	2008Q1
General Retail	35.8	1,473,821	2,064,636	1,615,455	1,671,676	1,401,746	2,134,924	1,942,546	2,025,574	1,799,048
Business To Business	20.6	849,181	993,411	894,386	1,096,153	871,861	1,003,360	949,417	1,044,467	927,270
Food Products	16.2	666,388	699,788	665,680	694,271	649,563	730,351	733,080	771,761	730,827
Transportation	13.0	534,793	516,345	594,725	726,213	495,640	596,634	665,857	700,718	638,476
Miscellaneous	1.6	67,673	70,822	79,799	79,758	101,377	111,476	115,678	81,252	89,266
Construction	0.9	37,914	48,862	44,182	38,589	56,568	59,367	72,868	67,136	64,984
Net Pools & Adjustments	11.8	487,801	634,071	684,537	508,710	619,790	331,300	550,414	499,562	678,938
<b>Total</b>	<b>100.0</b>	<b>4,117,571</b>	<b>5,027,935</b>	<b>4,578,764</b>	<b>4,815,370</b>	<b>4,196,545</b>	<b>4,967,412</b>	<b>5,029,860</b>	<b>5,190,470</b>	<b>4,928,809</b>

Economic Segments	%	2010Q1	2009Q4	2009Q3	2009Q2	2009Q1	2008Q4	2008Q3	2008Q2	2008Q1
Restaurants	13.8	568,305	597,762	580,829	604,861	565,461	627,710	641,492	676,150	636,670
Department Stores	11.1	455,378	714,431	480,038	529,267	426,855	723,247	571,259	643,944	515,250
Miscellaneous Retail	7.9	325,512	459,998	341,947	360,311	304,199	474,090	412,826	432,541	405,110
Furniture/Appliance	6.9	282,989	345,141	352,050	302,007	292,437	378,643	449,934	370,034	397,555
Apparel Stores	6.5	267,315	375,133	286,511	299,896	243,222	385,510	335,428	377,457	317,459
Service Stations	3.4	139,906	128,317	134,369	119,637	95,957	111,830	173,307	177,430	154,558
Business Services	2.7	110,989	113,481	124,575	116,394	109,472	143,531	132,365	153,478	131,275
Food Markets	2.1	86,892	88,469	74,317	75,997	72,517	88,559	78,856	81,678	78,860
Auto Parts/Repair	1.0	39,150	39,592	40,669	65,174	37,341	39,787	49,199	48,145	37,605
Leasing	0.8	34,760	37,222	41,697	34,892	36,308	37,049	45,324	42,611	45,332
Bldg.Matls-Retail	0.8	33,297	38,766	39,314	33,879	50,548	53,188	61,367	58,082	56,037
Liquor Stores	0.3	11,162	13,297	10,534	13,313	11,585	14,075	12,707	13,933	15,297
Miscellaneous Other	0.2	6,550	9,061	7,637	6,730	6,092	9,847	7,223	8,775	6,398
Heavy Industry	0.1	4,782	5,944	5,090	5,369	5,596	9,069	5,829	7,406	6,451
Bldg.Matls-Whsle	0.1	4,617	10,096	4,868	4,710	6,020	6,179	11,501	9,054	8,947
All Other	30.6	1,258,166	1,417,154	1,369,782	1,734,223	1,313,145	1,533,798	1,490,829	1,590,190	1,437,067
Net Pools & Adjustments	11.8	487,801	634,071	684,537	508,710	619,790	331,300	550,414	499,562	678,938
<b>Total</b>	<b>100</b>	<b>4,117,571</b>	<b>5,027,935</b>	<b>4,578,764</b>	<b>4,815,370</b>	<b>4,196,545</b>	<b>4,967,412</b>	<b>5,029,860</b>	<b>5,190,470</b>	<b>4,928,809</b>

\*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.



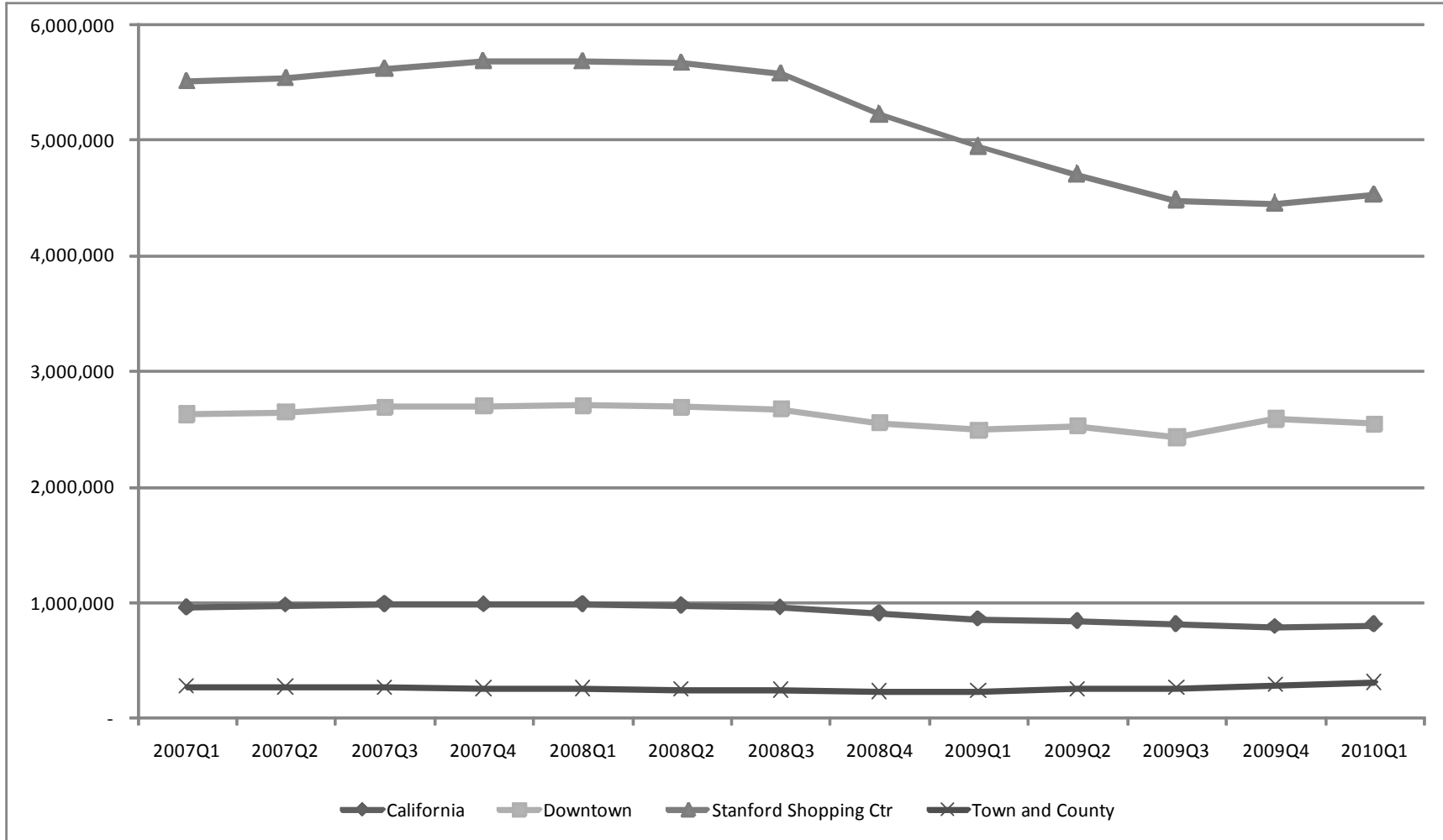
# City of Palo Alto

	General Retail	Food Products	Transportation	Construction	Business to Business	Miscellaneous	2010/1 Total	2009/1 Total	% Chg	Largest Gain	Second Largest Gain	Largest Decline	Second Largest Decline
Campbell	4.4%	-3.9%	13.9%	-16.8%	-21.5%	-43.3%	1,600,126	1,673,757	-4.4%	Service Stations	Department Stores	Bldg.Matls-Whsle	Electronic Equipment
Cupertino	0.3%	5.6%	31.7%	-27.9%	12.2%	-17.3%	3,011,367	2,753,976	9.3%	Office Equipment	Electronic Equipment	Department Stores	Bldg.Matls-Retail
Gilroy	3.8%	-6.3%	20.6%	-8.7%	-1.3%	-11.3%	2,263,467	2,176,911	4.0%	Service Stations	Apparel Stores	Restaurants	Bldg.Matls-Retail
Los Altos	-6.9%	0.2%	30.8%	-18.9%	-8.7%	-5.7%	412,022	402,642	2.3%	Service Stations	Food Markets	Miscellaneous Retail	Florist/Nursery
Los Gatos	16.0%	1.1%	-3.8%	5.2%	-14.4%	6.8%	1,801,880	1,675,770	7.5%	Miscellaneous Retail	Service Stations	Auto Sales - New	Leasing
Milpitas	13.5%	2.3%	47.8%	2.1%	2.9%	41.9%	3,226,795	2,903,685	11.1%	Auto Sales - New	Office Equipment	Heavy Industry	Chemical Products
Monte Sereno	86.8%	-100.0%	35.1%	-100.0%	23.6%	-79.8%	3,268	2,264	44.3%	Auto Parts/Repair	Miscellaneous Retail	Miscellaneous Other	Chemical Products
Morgan Hill	15.3%	-0.7%	4.8%	-15.7%	22.1%	-29.6%	1,016,253	958,077	6.1%	Service Stations	Department Stores	Misc. Vehicle Sales	Bldg.Matls-Whsle
Mountain View	-1.2%	1.7%	45.1%	93.6%	21.7%	-86.6%	3,219,305	2,978,973	8.1%	Office Equipment	Service Stations	Health & Government	Furniture/Appliance
Palo Alto	4.9%	2.1%	6.2%	-33.0%	-3.9%	-32.9%	3,629,773	3,601,586	0.8%	Service Stations	Department Stores	Electronic Equipment	Health & Government
San Jose	0.8%	-2.4%	18.2%	6.0%	11.6%	1.0%	25,224,710	23,634,276	6.7%	Office Equipment	Service Stations	Electronic Equipment	Furniture/Appliance
Santa Clara	10.5%	-0.5%	15.3%	-9.3%	-5.0%	-17.8%	6,659,831	6,579,277	1.2%	Auto Sales - New	Service Stations	Office Equipment	Health & Government
Santa Clara Co.	-14.7%	-7.4%	16.7%	1.3%	-11.3%	7.8%	703,278	723,205	-2.8%	Misc. Vehicle Sales	Leasing	Light Industry	Miscellaneous Retail
Saratoga	-12.9%	7.9%	17.3%	70.4%	-3.4%	19.5%	194,185	183,591	5.8%	Restaurants	Bldg.Matls-Whsle	Miscellaneous Retail	Electronic Equipment
Sunnyvale	9.3%	-1.8%	4.8%	12.4%	16.4%	-13.5%	5,133,202	4,694,103	9.4%	Electronic Equipment	Office Equipment	Light Industry	Furniture/Appliance

# City of Palo Alto

City of Palo Alto - Selected Geographic Areas of the City  
Benchmark Year 1st Quarter 2010

	2007Q1	2007Q2	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1
California	956,133	979,260	991,900	984,263	990,771	978,463	960,772	908,095	858,391	839,591	812,294	790,954	807,490
Downtown	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	2,591,213	2,549,106
Stanford Shopping Ctr	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	4,451,986	4,524,318
Town and County	276,364	269,829	266,728	256,553	256,612	248,359	243,683	233,208	237,307	251,608	261,294	288,103	309,848



# City of Palo Alto

City of Palo Alto - Regional Shopping Mall Comparison  
Benchmark Year 1st Quarter 2010

	2007Q1	2007Q2	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1
Valley Fair	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	5,761,442	5,829,695
Santana Row	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	1,615,462	1,637,476
Hillsdale	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	1,895,456	1,915,711
Stanford Shopping Ctr	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	4,451,986	4,524,318
Oakridge Mall	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	3,380,772	3,395,994

