CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

August 19, 2013

The Honorable City Council
Palo Alto, California

City of Palo Alto Sales Tax Digest Summary First Quarter Sales (January - March 2013)

This is an informational report, and no action is required.

BACKGROUND

Sales and use tax represents about 15 percent, or $22.5 million, of projected General Fund revenue in the City's Adopted Operating Budget for fiscal year 2013. According to the Midyear Financial Report, projected sales and use tax revenue has increased and is now estimated at $23.4 million for fiscal year 2013. This revenue includes sales and use tax for the City of Palo Alto and pool allocations[1] 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 Policy and Services Committee.

The California Revenue and Taxation Code, Section 7056, requires that sales and use tax data remain confidential. As such, the City may not disclose amounts of tax paid, fluctuations in tax amounts, or any other information that would reveal the operations of a business. We have modified how we present certain data in this report to meet the requirements of this code.

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 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 2013). These funds are reported as part of the City's fiscal year 2013 revenue. Due to the timing of reporting by businesses and the State, MuniServices' detailed reports on second quarter sales (April through June 2013) should be available by November 2013. ASD advises that in mid-September, it should receive information from the State on aggregate sales and use tax receipts for second quarter 2013.

[1] 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 2013 increased by approximately $2.0 million, or 38.8 percent, (including pool allocations) compared to the first quarter ending March 2012.[2] For all jurisdictions in Santa Clara County, sales and use tax revenue for the first quarter ending March 2013 increased by $4.2 million, or 5.1 percent, compared to the first quarter ending March 2012.

- Statewide, every region in California experienced an increase in sales and use tax revenue for the year ending March 2013, compared to the prior year ending March 2012. Statewide sales and use tax revenue has shown growth of 6.7 percent during the first quarter ending March 2013 compared to the first quarter ending March 2012.

- In Palo Alto, sales and use tax revenue totaled $25.7 million for the year ending March 2013, an increase of 19.4 percent from $21.5 million in the prior year ending March 2012.[2] This amount includes sales and use tax for the City of Palo Alto and pool allocations from the State and Santa Clara County.

More detailed information is shown on Attachment A.

Economic Influences on Sales and Use Tax

In its Economic Overview (Attachment B), MuniServices discusses economic influences including national economic trends, housing prices, auto sales, and forecast information that may affect the City's sales and use tax revenue.

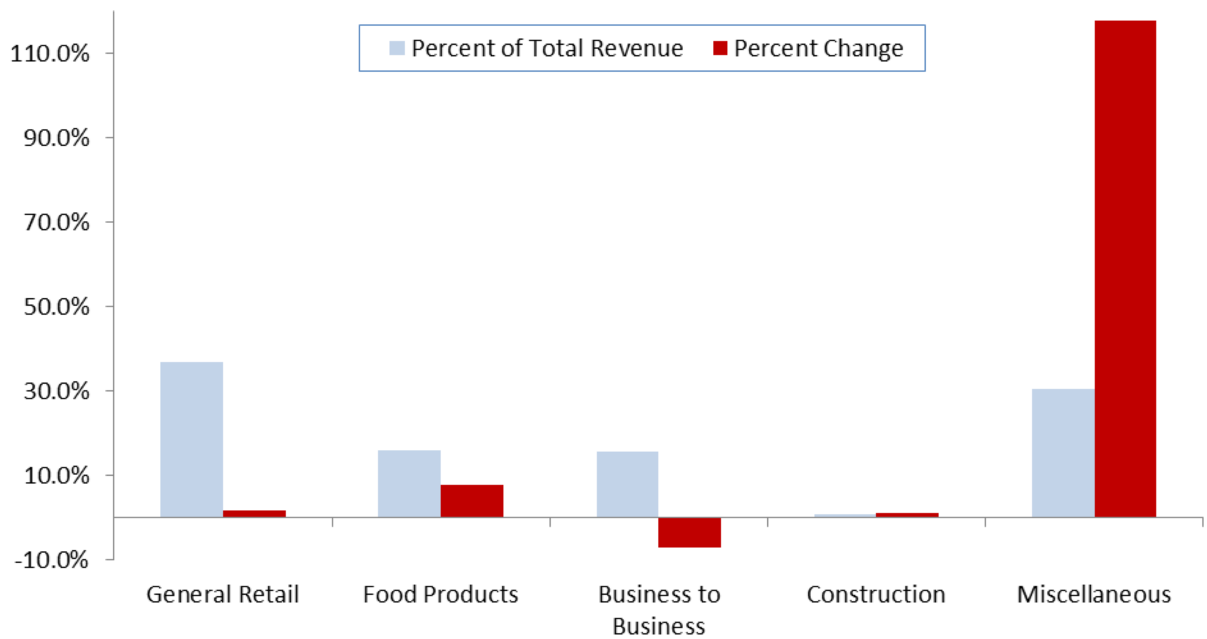
Preliminary estimates from the State of California Employment Development Department show the June 2013 unemployment rate in Santa Clara County at 6.8 percent and Palo Alto at 3.6 percent.

Economic Category Analysis

MuniServices' analysis of economic categories, for the year ending March 2013, shows that General Retail comprised the largest percentage of Palo Alto's sales and use tax revenue and experienced 1.7 percent growth. Food Products experienced an 8.0 percent increase and comprised 16.1 percent of total revenues. Business to Business experienced a 7.1 percent decrease and comprised 15.7 percent of total revenues.

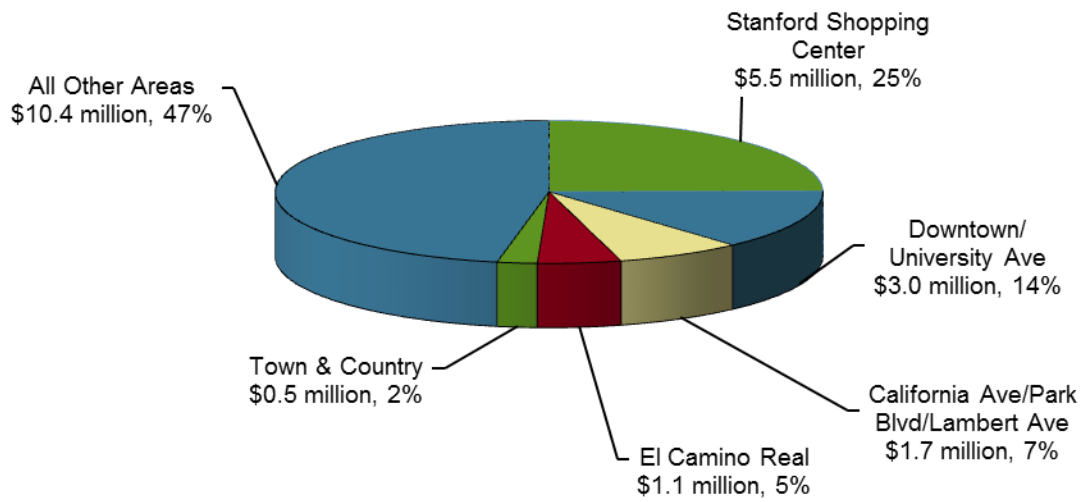
[2] Excluding pool allocations and adjusting for prior period and late payments, Palo Alto's sales and use tax revenue for the first quarter ending March 2013 increased by 34.8 percent compared to the first quarter ending March 2012. On a yearly basis, Palo Alto's sales and use tax revenue for the year ending March 2013, increased by 20.7 percent compared to the prior year ending March 2012.

Exhibit 1 - Comparison of Palo Alto's Sales and Use Tax Revenue and Percent Change by Economic Category for the Year Ending March 2013



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 2013
(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 during the first quarter 2013 was 8.625 percent, and the City should receive 1 percent of every taxable transaction. Effective April 1, 2013, the sales and use tax rate in Palo Alto increased to 8.75 percent.

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,

Jim Pelletier
City Auditor

Sources: MuniServices; California State Board of Equalization; State of California Employment Development Department; City of Palo Alto's Adopted Operating Budget Fiscal Year 2013

Audit staff: Lisa Wehara

ATTACHMENTS:

- Attachment A: City of Palo Alto Sales Tax Digest Summary (PDF)
- Attachment B: Economic Overview (July 2013) (PDF)

Department Head: Jim Pelletier, City Auditor

City of Palo Alto
Sales Tax Digest Summary
Collections through June 2013
Sales through March 2013 (2013Q1)

California Overview

The percent change in cash receipts from the prior year was 6.2% statewide, 6.2% in Northern California and 6.2% 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 increased for the year ended 1st Quarter 2013 by 5.7% statewide, 5.8% in Northern California and increased by 4.8% in Southern California.

City of Palo Alto

For the year ended 1st Quarter 2013, sales tax cash receipts for the City grew by 19.4% from the prior year. On a quarterly basis, sales tax revenues grew by 38.8% from 1st Quarter 2012 to 1st Quarter 2013. The period's cash receipts include tax from business activity during the period, payments for prior periods and other cash adjustments.

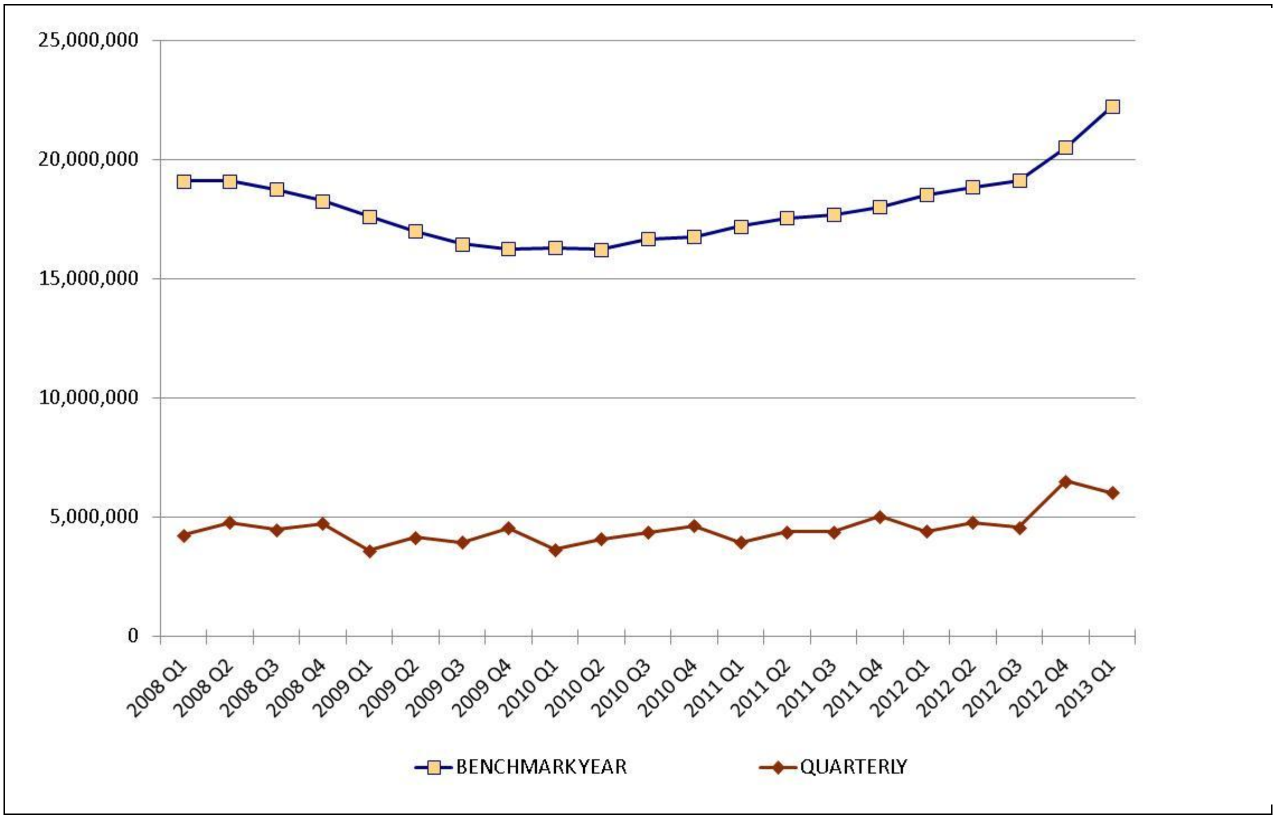
Excluding state and county pools and adjusting for anomalies (payments for prior periods) and late payments, local sales tax increased by 20.7% for the year ended 1st Quarter 2013 from the prior year. On a quarterly basis, sales tax activity grew by 34.8% in 1st Quarter 2013 compared to 1st Quarter 2012.

Regional Overview

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

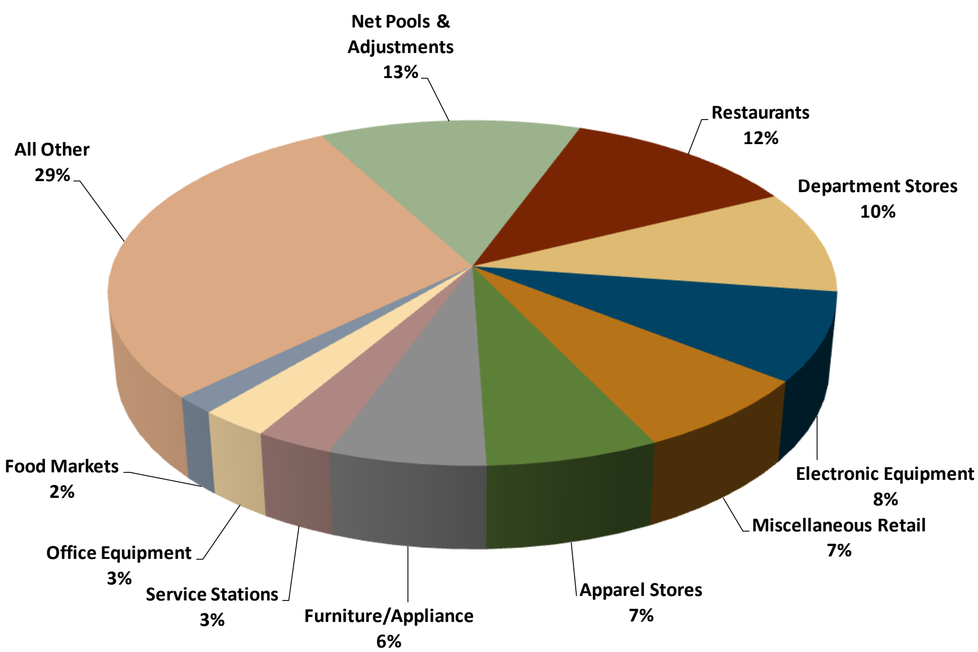
ECONOMIC CATEGORY ANALYSIS FOR YEAR ENDED 1ST QUARTER 2013									
% of Total / % Change	**City of Palo Alto**	**California Statewide**	**S.F. Bay Area**	**Sacramento Valley**	**Central Valley**	**South Coast**	**Inland Empire**	**North Coast**	**Central Coast**
General Retail	36.8 / 1.7	29 / 4.2	28.1 / 4.4	29.3 / 3.9	30.7 / 3.4	29.3 / 4	27.1 / 6.9	28.8 / 3.9	32.4 / 4.1
Food Products	16.1 / 8.0	19.2 / 5.9	19.9 / 7	16.6 / 3.2	16 / 3.4	19.9 / 5.7	16.5 / 8.1	18 / 3.8	31.7 / 6.2
Construction	0.9 / 1.3	8.7 / 7.6	8.6 / 7.8	10.1 / 5.3	10.7 / 5.3	7.9 / 6.1	11.3 / 20.9	11.8 / 4	8.6 / 3.1
Business to Business	15.7 / -7.1	17.2 / 4.2	20.1 / 3.1	14.1 / 5	14.2 / 9	17.1 / 3.1	15.5 / 13.9	8.9 / -1.9	5.4 / 1.1
Miscellaneous/Other	30.5 / 117.8	1.2 / 1.7	1.2 / 11.5	1.6 / 9.3	1.2 / 7.3	1 / -2.9	1.8 / -6.6	0.9 / -9.2	1.1 / 2.5
Total	**100.0 / 20.7**	**100 / 5.7**	**100 / 6.6**	**100 / 5.7**	**100 / 5.9**	**100 / 4.7**	**100 / 9.9**	**100 / 4.7**	**100 / 4**
ECONOMIC SEGMENT ANALYSIS FOR YEAR ENDED 1ST QUARTER 2013									
	City of Palo Alto	**California Statewide**	**S.F. Bay Area**	**Sacramento Valley**	**Central Valley**	**South Coast**	**Inland Empire**	**North Coast**	**Central Coast**
Largest Segment	***	**Restaurants**	**Restaurants**	**Department Stores**	**Department Stores**	**Restaurants**	**Service Stations**	**Service Stations**	**Restaurants**
% of Total / % Change	*** / ***	13.3 / 6.3	13.9 / 7.3	12.2 / 3.0	14.4 / 3.6	14.1 / 6.2	10.7 / 3.8	14.1 / 4.6	20.6 / 6.0
2nd Largest Segment	**Restaurants**	**Department Stores**	**Auto Sales - New**	**Auto Sales - New**	**Service Stations**	**Service Stations**	**Restaurants**	**Department Stores**	**Service Stations**
% of Total / % Change	14.0 / 8.1	10.5 / 3.6	9.4 / 3.9	11.1 / 22.9	12.2 / 4.0	10.5 / 2.2	10.1 / 3.8	13.6 / 0.1	9.9 / 5.3
3rd Largest Segment	**Department Stores**	**Service Stations**	**Service Stations**	**Service Stations**	**Restaurants**	**Department Stores**	**Auto Sales - New**	**Restaurants**	**Misc. Retail**
% of Total / % Change	11.2 / 1.6	10.3 / 3.2	9.1 / 4.8	10.8 / 4.9	9.6 / 5.4	10.2 / 3.6	9.2 / 15.2	9.5 / 4.2	9.9 / -.1
	***** Not specified to maintain confidentiality of tax information**								

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

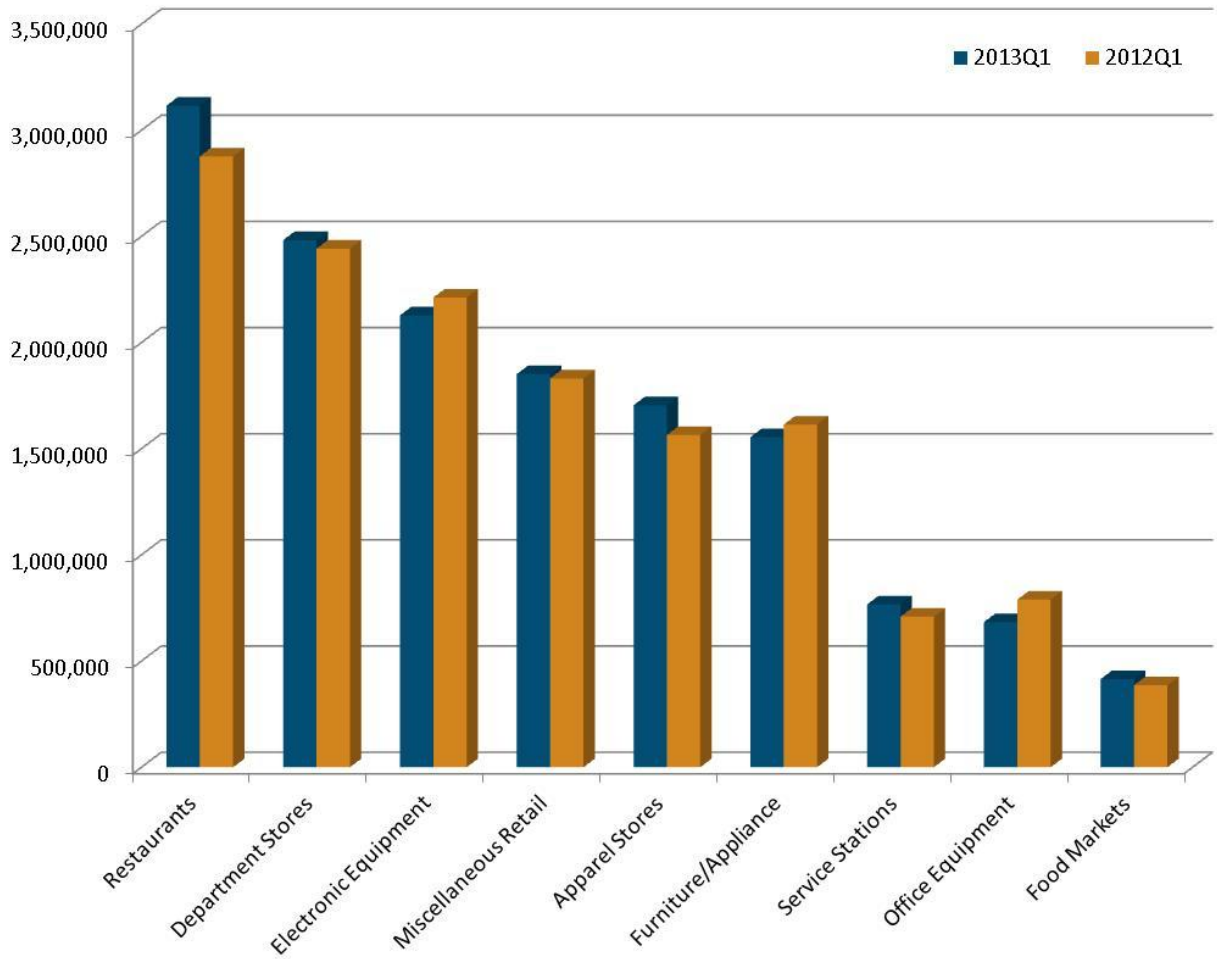


Net Cash Receipts for Benchmark Year 1st Quarter 2013: $25,694,375

**Benchmark year (BMY) is the sum of the current and 3 previous quarters (2013Q1 BMY is sum of 2013 Q1, 2012 Q4, Q3 & Q2)*



Sales Tax from Largest Non-confidential Economic Segments



Historical Analysis by Calendar Quarter

Economic Category	%	2013Q1	2012Q4	2012Q3	2012Q2	2012Q1	2011Q4	2011Q3	2011Q2	2011Q1	2010Q4
General Retail	24.5%	1,759,098	2,444,528	1,913,125	2,009,452	1,701,757	2,440,953	1,886,520	1,984,860	1,573,474	2,275,627
Business To Business	8.2%	592,136	1,101,068	843,770	993,147	1,064,996	932,723	842,771	842,709	925,263	887,037
Food Products	12.3%	882,949	905,156	877,520	886,852	816,336	838,138	799,167	806,987	740,594	769,253
Miscellaneous/Other	38.4%	2,759,713	2,004,507	905,479	848,911	797,436	781,336	812,130	720,550	680,987	665,286
Construction	0.5%	37,150	62,618	53,420	50,544	47,432	62,282	46,843	44,589	38,765	54,645
Net Pools & Adjustmei	16.2%	1,162,968	1,155,841	603,635	840,789	754,099	725,000	933,424	845,214	769,789	508,973
Total	100.0%	7,194,014	7,673,718	5,196,949	5,629,695	5,182,056	5,780,432	5,320,855	5,244,909	4,728,872	5,160,821

Economic Segments	%	2013Q1	2012Q4	2012Q3	2012Q2	2012Q1	2011Q4	2011Q3	2011Q2	2011Q1	2010Q4
Restaurants	10.7%	771,596	782,184	760,929	780,314	714,487	783,595	689,568	705,459	639,353	651,614
Electronic Equipment	4.0%	284,607	695,663	516,554	651,686	488,132	724,274	563,373	608,784	474,566	748,885
Department Stores	7.1%	509,699	779,973	584,178	608,894	382,336	573,750	455,335	482,723	399,243	584,895
Miscellaneous Retail	5.5%	393,506	584,169	429,989	456,771	347,112	488,492	385,236	392,126	301,427	421,877
Apparel Stores	5.2%	372,909	496,073	383,337	402,471	178,409	171,472	160,037	181,065	158,421	147,520
Furniture/Appliance	4.9%	350,375	444,725	345,043	365,585	99,210	104,348	104,234	105,507	100,241	146,732
Service Stations	2.6%	187,333	182,060	198,973	198,604	90,636	101,023	98,054	89,530	91,274	105,573
Office Equipment	1.8%	131,629	223,538	162,015	188,369	46,718	48,340	49,977	51,743	47,157	43,537
Food Markets	1.4%	99,711	110,625	106,652	95,807	37,116	38,854	42,654	35,131	34,857	36,962
Health & Government	1.2%	86,330	88,669	94,969	92,612	31,168	44,402	41,338	38,236	34,016	48,591
Recreation Products	0.7%	48,148	57,916	92,186	82,846	11,199	12,838	11,321	11,319	9,967	12,060
Business Services	0.9%	63,791	73,619	69,722	71,828	6,634	9,046	9,857	8,724	6,458	8,714
Drug Stores	0.9%	64,492	65,440	62,624	65,943	7,110	22,227	8,349	8,029	3,833	3,580
Misc. Vehicle Sales	0.6%	45,719	45,656	45,325	57,680	16,264	17,880	5,505	6,353	4,749	6,054
All Other	36.4%	2,621,201	1,887,567	740,818	669,496	1,971,426	1,914,891	1,762,593	1,674,966	1,653,521	1,685,254
Net Pools & Adjustmei	16.2%	1,162,968	1,155,841	603,635	840,789	754,099	725,000	933,424	845,214	769,789	508,973
Total	100.0%	7,194,014	7,673,718	5,196,949	5,629,695	5,182,056	5,780,432	5,320,855	5,244,909	4,728,872	5,160,821

*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.

Quarterly Analysis by Economic Category, Total and Segments: Change from 2012Q1 to 2013Q1

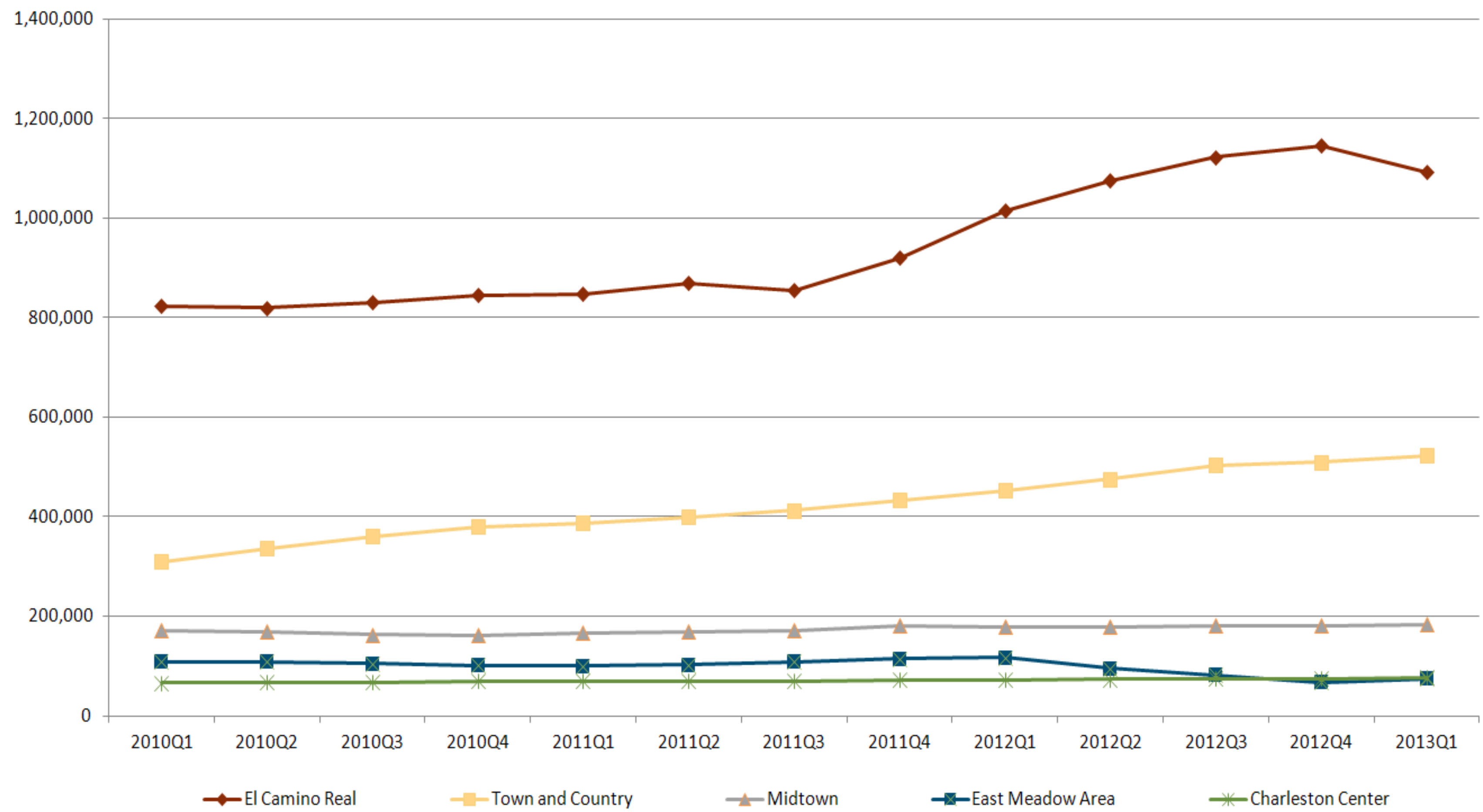
	General Retail	Food Products	Construction	Business to Business	Misc/Other	2013/1 Total	2012/1 Total	% Chg	Largest Gain	Second Largest Gain	Largest Decline	Second Largest Decline
Campbell	2.2%	4.2%	-3.0%	3.2%	-0.1%	1,961,714	1,936,182	1.3%	Restaurants	Bldg.Matls-Retail	Office Equipment	Furniture/Appliance
Cupertino	8.8%	8.0%	2.6%	3.1%	-9.2%	4,539,139	4,786,709	-5.2%	Food Processing Eqp	Apparel Stores	Business Services	Light Industry
Gilroy	5.3%	-10.8%	2.7%	4.9%	2.0%	2,734,800	2,675,011	2.2%	Apparel Stores	Auto Sales - New	Food Processing Eqp	Service Stations
Los Altos	-5.6%	2.6%	-1.2%	-15.4%	33.7%	481,716	484,187	-0.5%	Miscellaneous Retail	Food Markets	Florist/Nursery	Service Stations
Los Gatos	-20.5%	5.2%	5.5%	5.9%	3.7%	1,601,578	1,747,819	-8.4%	Auto Sales - New	Apparel Stores	Miscellaneous Retail	Service Stations
Milpitas	7.6%	2.9%	2.0%	30.6%	-26.2%	4,130,724	4,327,693	-4.6%	Bldg.Matls-Whsle	Office Equipment	Electronic Equipment	Service Stations
Morgan Hill	20.7%	8.0%	18.5%	3.9%	-15.0%	1,607,686	1,470,261	9.3%	Auto Sales - New	Auto Parts/Repair	Electronic Equipment	Auto Sales - Used
Mountain View	4.8%	29.1%	2.6%	-18.0%	-17.5%	3,223,121	3,150,202	2.3%	Restaurants	Furniture/Appliance	Office Equipment	Business Services
Palo Alto	2.6%	6.7%	254.7%	-13.2%	-43.3%	6,031,044	4,474,417	34.8%	***	Restaurants	Electronic Equipment	Office Equipment
San Jose	4.6%	2.4%	0.4%	8.5%	0.8%	31,190,485	30,367,107	2.7%	Bldg.Matls-Whsle	Department Stores	Electronic Equipment	Service Stations
Santa Clara	6.3%	4.9%	2.6%	32.1%	2.5%	8,540,922	8,080,458	5.7%	Bldg.Matls-Whsle	Electronic Equipment	Office Equipment	Health & Government
Santa Clara Co.	19.3%	7.7%	2.1%	20.2%	7.4%	849,462	804,036	5.6%	Bldg.Matls-Retail	Food Processing Eqp	Health & Government	Business Services
Saratoga	15.3%	-1.0%	-3.6%	-73.5%	-22.1%	197,517	200,966	-1.7%	Furniture/Appliance	Food Processing Eqp	Food Markets	Bldg.Matls-Retail
Sunnyvale	-33.2%	3.7%	1.7%	-9.9%	-14.1%	6,310,763	7,244,593	-12.9%	Auto Sales - New	Department Stores	Miscellaneous Retail	Electronic Equipment

*** Not specified to maintain confidentiality of tax information

City of Palo Alto - Selected Geographic Areas of the City

Benchmark Year 1st Quarter 2013

	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
El Camino Real	822,245	818,947	830,152	843,626	846,897	867,868	854,828	920,020	1,014,867	1,074,079	1,122,001	1,143,951	1,090,870
Town and Country	309,848	336,444	360,254	379,066	386,944	399,378	412,361	433,313	451,982	475,054	502,127	509,180	522,374
Midtown	170,517	169,297	162,869	162,122	166,440	168,537	171,719	180,415	178,344	179,250	181,352	181,654	183,780
East Meadow Area	107,931	108,922	104,777	100,155	100,032	102,028	108,176	114,083	116,558	94,868	81,598	67,124	74,680
Charleston Center	65,642	66,446	67,447	68,693	69,150	69,606	70,301	71,555	72,602	73,408	74,213	74,683	76,315

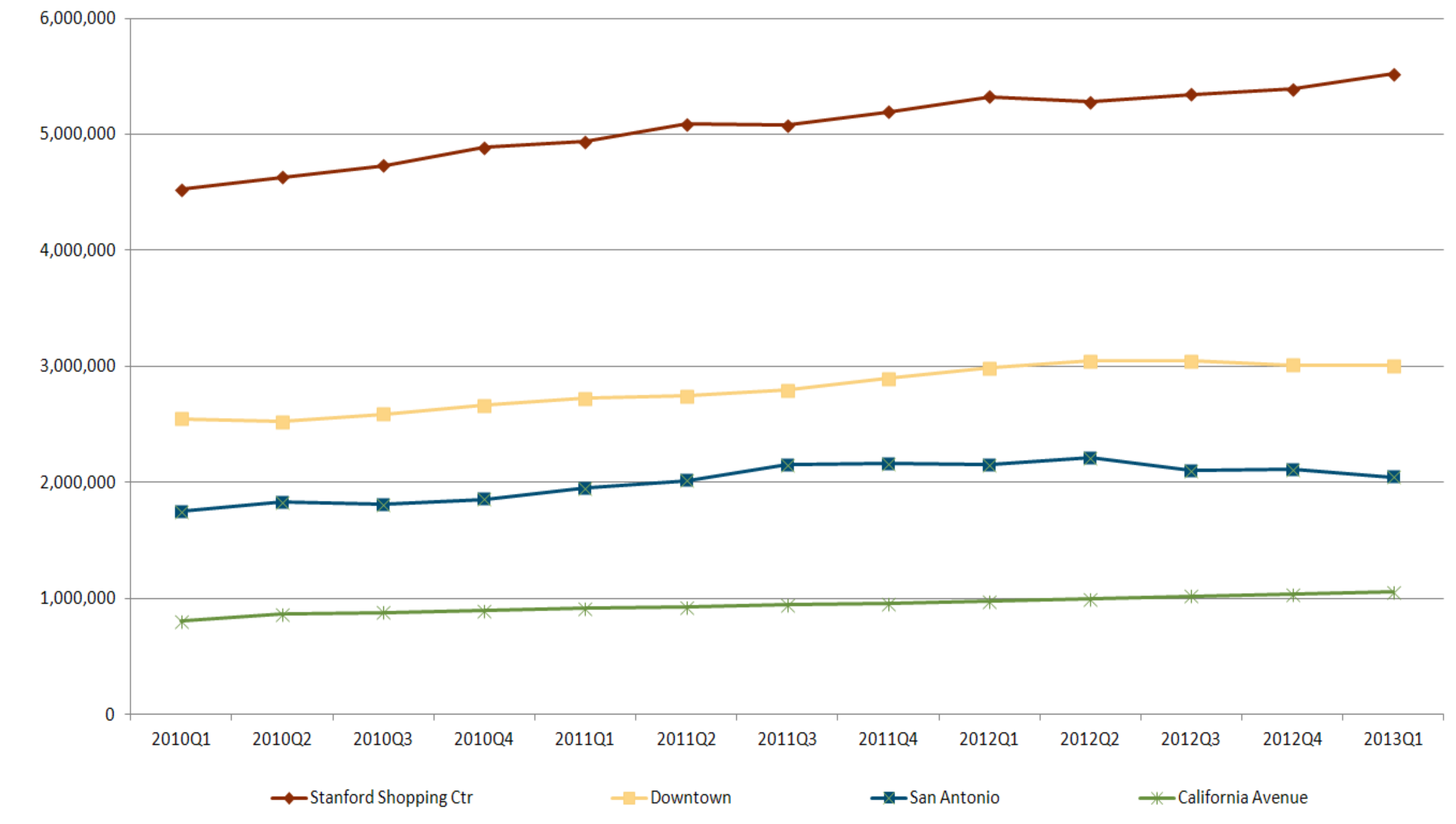


**Benchmark year (BMY) is the sum of the current and 3 previous quarters (2013Q1 BMY is sum of 2013 Q1, 2012 Q4, Q3 & Q2)*

City of Palo Alto - Selected Geographic Areas of the City

Benchmark Year 1st Quarter 2013

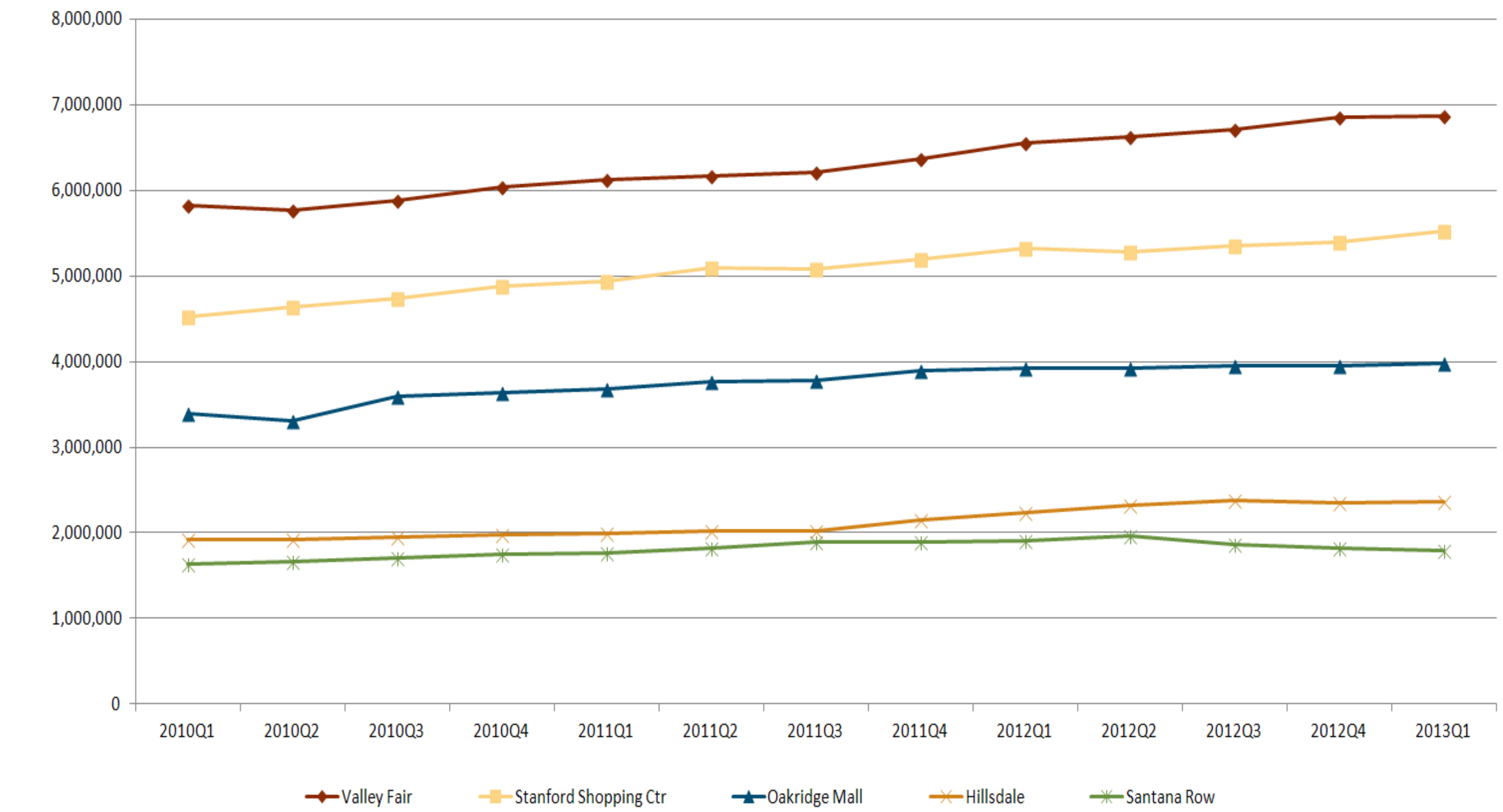
	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Stanford Shopping Ctr	4,524,318	4,631,095	4,731,800	4,884,843	4,941,127	5,087,834	5,079,526	5,194,491	5,325,435	5,281,772	5,345,618	5,388,747	5,519,326
Downtown	2,549,106	2,528,095	2,589,660	2,663,500	2,723,552	2,748,925	2,793,987	2,897,003	2,986,093	3,044,755	3,047,356	3,013,183	3,007,123
San Antonio	1,752,653	1,831,894	1,811,722	1,856,817	1,954,526	2,017,259	2,156,535	2,164,335	2,155,721	2,212,977	2,103,881	2,114,306	2,047,925
California Avenue	807,490	863,730	879,364	895,989	917,851	928,031	945,340	952,300	976,897	999,421	1,020,704	1,034,151	1,058,098



**Benchmark year (BMY) is the sum of the current and 3 previous quarters (2013Q1 BMY is sum of 2013 Q1, 2012 Q4, Q3 & Q2)*

City of Palo Alto - Regional Shopping Mall Comparison
Benchmark Year 1st Quarter 2013

	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Valley Fair	5,829,695	5,769,507	5,887,510	6,031,602	6,119,960	6,166,420	6,204,976	6,370,656	6,559,394	6,621,598	6,708,343	6,855,987	6,865,443
Stanford Shopping Ctr	4,524,318	4,631,095	4,731,800	4,884,843	4,941,127	5,087,834	5,079,526	5,194,491	5,325,435	5,281,772	5,345,618	5,388,747	5,519,326
Oakridge Mall	3,395,994	3,308,231	3,589,119	3,630,341	3,679,073	3,768,899	3,782,531	3,888,402	3,928,855	3,925,454	3,947,751	3,957,195	3,972,739
Hillsdale	1,915,711	1,917,510	1,943,391	1,982,532	1,989,259	2,015,790	2,019,678	2,145,957	2,241,553	2,315,120	2,381,548	2,348,668	2,367,315
Santana Row	1637476	1667967	1711667	1749506	1770255	1821843	1897528	1892070	1900328	1961561	1867513	1819616	1795942



Attachment B

Economic Overview

2Q2013 News

Analysts find fiscal picture brightening

Economists see financial growth around the corner

For more than a decade, the economy has failed to grow the way it once did. Unemployment has not stayed this high, this long, since the 1930s. But could the New Normal, as this long economic slog has been called, be growing old? That is the surprising new view of a number of economists in academia and on Wall Street, who are now predicting something the United States has not experienced in years: healthier, more lasting growth. The improving outlook is one reason the stock market has risen so sharply this year, even if street-level evidence for a turnaround, such strong job growth and income gains, has been scant so far.

A prominent convert to this emerging belief is Tyler Cowen, an economics professor at George Mason University near Washington and author of "The Great Stagnation," a 2011 best seller, who has gone from doomsayer to a decidedly more optimistic perspective. He is not predicting an imminent resurgence. Like most academic economists, Mr. Cowen focuses on the next quarter-century rather than the next quarter. But new technologies like artificial intelligence and online education, increased domestic energy production and slowing growth in the cost of health care have prompted Mr. Cowen to reappraise the country's prospects.

"It's better than it looked," Mr. Cowen said. "Technological progress comes in batches and it's just a little more rapid than it looked two years ago." His next book, "Average Is Over: Powering America Beyond the Age of the Great Stagnation," is due out in September.

Certainly, there are significant headwinds that will not abate anytime soon, including an aging population, government austerity, the worst income inequality in nearly a century and more than four million long-term unemployed workers. These and other forces prompted some leading economists, led by Robert J. Gordon of Northwestern, to conclude not long ago that the arc of American economic growth for centuries was over, to be replaced by decades of stagnation. Productivity might grow steadily, Professor Gordon argued, but the benefits will not flow to most Americans.

Other analysts are challenging that perspective, which they said was colored, in part, by the severe downturn that hit the global economy more than five years ago. And some of them now see a brighter outlook right around the corner. Two widely followed economic forecasters, Morgan Stanley and IHS Global Insight, have both increased their estimates for growth in recent days. "It's been a long time coming," said Nariman Behravesh, chief economist at IHS. "There is more optimism about the U.S. and in particular about the second half of this year and 2014. Three months ago, we wouldn't have come to that same conclusion."

Indeed, a number of forecasters are now predicting that the expansion, which began in 2009 and has remained subpar ever since, might prove to be far more durable than the typical five-to-six-year growth cycle, in part because of the absence of the traditional boom, then bust pattern.

In particular, Mr. Behravesh and other economists said, the economy has shown greater resilience than expected in the face of tax increases and spending cuts in Washington. As the impact from this fiscal tightening eases, the overall growth rate should pick up.

Mr. Behravesh now expects the annual growth rate to rise to 2.9 percent in 2014 and 3.5 percent in 2015. If he's right it would mark the fastest annual growth since 2005 when the economy expanded by 3.1 percent. It is also well above the 2 percent rise in output the economy has averaged over the last three years.

Economy slows with consumer spending

Americans cut back on spending in April after their income failed to grow, a sign that economic growth may be slowing. Consumer spending dropped a seasonally adjusted 0.2 percent in April, the Commerce Department said recently. That was the first decline since last May. It followed a 0.1 percent increase in March and a 0.8 percent jump in February. A drop in gas prices likely lowered overall spending. Adjusted for inflation, spending ticked up 0.1 percent last month, Still, that was the smallest gain since October.

Income was unchanged in April, after a 0.3 percent rise in March and 1.2 percent gain in February. Wages and salaries barely grew, while government benefit payments fell. The retrenchment in spending indicates consumers may be starting to feel the impact of higher taxes. But a separate report recently showed consumer confidence rose to a six-year high in May, suggesting the decline in spending may be temporary.

Americans are taking home less pay this year because of a 2 percentage point increase in Social Security taxes. A person earning $50,000 a year has about $1,000 less to spend this year. A household with two high-paid workers has up to $4,500 less. Income taxes on the wealthiest Americans also increased.

Consumer spending drives 70 percent of economic activity. It grew at the fastest pace in more than two years from January through March, helping the economy expand at a 2.4 annual rate during that quarter. Economists said the latest spending figures suggest growth may be slowing in the April-June quarter to around a 2 percent rate.

Consumer commerce at 5-year high

U.S. home prices show biggest year –over-year increase since April ‘06

Home prices are surging. Job growth is strengthening and stocks are setting record highs. All of which explains why Americans are more hopeful about the economy than at any other point in five years. Greater confidence could spur people to spend more and help offset tax increases and federal spending cuts. And the fastest rise in home prices in seven years might lead more Americans to put houses on the market, easing supply shortages that have kept the housing recovery from taking off.

The report from the Conference Board, a private research group, showed that consumer confidence jumped in May to a reading of 76.2, up from 69 in April. That's the highest level since February 2008, two months after the Great Recession officially began.

A separate report showed that U.S. home prices jumped nearly 11 percent in March compared with a year ago, the sharpest 12-month increase since April 2006. Prices rose year over year in all 20 cities in the Standard & Poor's/Case-Shiller home price index.

Surging stock prices and steady home-price increases have allowed Americans to regain the $16 trillion in wealth they lost to the Great Recession. Higher wealth tends to embolden people to spend more. Some economists have said the increase in home prices alone could boost consumer spending enough to offset a Social Security tax increase that has reduced paychecks for most Americans this year.

The Conference Board survey said consumers are also more optimistic about the next six months. That should translate into greater consumer spending, substantial growth in hiring and faster economic growth in the second half of 2013, says Thomas Feltmate, an economist with TD Economics. The Conference Board found that optimism is growing mostly among those earning more than the median household income of roughly $50,000. For those households, the confidence index jumped to 95.1 from 85.3.

Among most other income groups, confidence either rose more slowly or fell. For those earning $15,000 to $24,999, for example, the confidence index rose modestly, from 52.6 to 55.9. And for those earning $25,000 to $34,999, it slipped from 59.8 to 57.9. Economists say the disparity points to the gain in stock prices, which mostly benefits more affluent Americans. Consumers’ outlook on the job market also improved in April. The percentage who said jobs are plentiful rose, and the percentage who said they’re hard to find declined.

Carmakers hope lease cuts will rev EV sales

Auto companies are hoping lower lease prices can put a charge into sluggish electric car sales.

Honda announced recently that it's slashing the monthly lease cost of its tiny Fit EV by one third, following similar moves by other automakers. Honda is also throwing in other goodies, such as a free home charging station and unlimited mileage.

Electric vehicles once were billed as the answer to high gas prices and dependence on foreign oil. But U.S. oil production is rising and gasoline supplies are abundant. Pump prices have remained relatively stable the past three years, while gas-powered cars have gotten more efficient, making consumers reluctant to give them up. There's also the worry that an electric car could run out of juice on longer trips.

As a result, electric car sales are only a tiny fraction of overall U.S. auto sales. Automakers sold just over 12,000 pure-electric vehicles in the U.S. through April, according to Ward's AutoInfoBank and Tesla Motors. That's less than 1 percent of the 4.97 million cars and trucks sold during the same period. Even a $7,500 tax credit from the U.S. government that effectively lowers prices couldn't persuade most car buyers.

Automakers need to create a market for the cars among buyers who won't ordinarily go for the latest technology, said Larry Dominique, a former Nissan Motor Co. product chief. "The early adopters are kind of phased out of the EV market. To get that broader appeal to the EV, they're doing some pretty aggressive lease deals," said Dominique, now an executive with the TrueCar.com auto pricing website.

The sluggish sales have dampened high expectations for electric car use. President Barack Obama has said he wants to put 1 million plug-in electric vehicles on the road by 2015, but with two years left, the nation is far short of that goal. Still, the cheap leases and a broader selection of models are giving electric vehicles a boost. Sales for the first four months of this year already are 80 percent of last year's total sales of about 15,000.

The added models, though, have multiple automakers competing for a small number of buyers. Automakers generally lose money on electric cars because the technology is so new and the batteries are costly. But they have been subsidizing sales by lowering prices. Chrysler CEO Sergio Marchionne said earlier this year that his company will lose $10,000 on every Fiat 500 electric vehicle it sells. Others have reported similar losses.

With the Fit EV, Honda is offering a $259 per month lease, down $130 from the initial $389 per month offer when the car went on sale in July of last year. The reduced price starts June 1 and will apply to existing Fit EV leases, Honda said. The three-year lease requires no money down and comes with unlimited mileage, free routine maintenance, collision insurance coverage and a free 240-volt home charging station.

Sales of the subcompact Fit EV have been particularly slow. Through April, Honda has sold or leased only 68 in the U.S. Last year it sold or leased only 93, according to Ward's. "Although we feel the Fit EV offers significant product benefits over other electric vehicles, in order to effectively compete in the EV market, we need a more competitive price," Honda Motor Co. spokeswoman Robyn Eagles said in a statement.

Earlier this month, General Motors Co. said that it would lease the subcompact Spark EV for $199 per month with $999 due at signing as it goes on sale in California and Oregon. Nissan is offering a $199-per-month lease on its Leaf electric car with $1,999 down.

Pickup trucks drive surge in auto sales in May auto sales

Full-size pickups once again dominated U.S. auto sales in May, as small businesses -- increasingly confident in the economy -- raced to replace the aging pickups they held on to during the recession. Car buyers, too, were lured by low interest rates and Memorial Day sales. Overall, U.S. consumers bought 1.4 million vehicles in May, up 8 percent from the same month a year ago, according to Autodata Corp. The results suggest the auto industry will remain a bright spot in an economy that's been slowed by weak manufacturing. And the boost from the industry will help sustain the economy's steady job growth.

Most automakers topped analysts' expectations in May, with Nissan reporting its highest May sales ever after cutting prices on seven popular models. Chrysler, Ford, Honda and Toyota also reported increases. Only Volkswagen's sales were down from last May.

Automakers sold 173,972 full-size pickups in May, the highest total since a year-end rush last December, according to Ward's AutoInfoBank. Sales of Ford's F-Series pickup, which is the country's best-selling vehicle, rose 31 percent to a six-year high of 71,604. General Motors and Chrysler also posted full-size truck sales gains of more than 20 percent. Those sales have reverberated in the job market. Ford said in early May that it's adding 2,000 workers to the Missouri plant that makes the F-150. From January through April, automakers and parts companies hired 14,600 workers, and the Center for Automotive Research expects them to add 35,000 over the full year. Car dealers are also hiring, with the average number of employees rising from 53 to 55 last year, said the National Auto Dealers Association. More are expected to be hired this year.

The Federal Reserve's low interest rate policies have helped nurture sales by keeping loan rates low. Despite the weak manufacturing numbers, other bright spots -- like home building and oil and gas drilling -- are fueling the auto sales boom.

Home construction rose 12 percent in the first three months of this year, and builders -- along with plumbers, landscapers and painters -- need work vehicles. GM said sales of vans to small commercial buyers, or those with fleets of one to four vehicles, rose 17 percent in May.

Automakers are also selling more trucks in Texas, the Dakotas, Montana and elsewhere thanks to increased drilling. Strong sales of pickups in May – not typically a blowout month for trucks – signal that businesses feel more certain about the future, said Jesse Toprak, senior analyst for the TrueCar.com auto pricing site. “Businesses tend to make better financial decisions because they have to,” he said. “They tend to wait longer. But when they do come back, they come back in large numbers.”

May sales wiped away a disappointing April, when the annualized rate for U.S. auto sales dropped below 15 million for the first time in six months. In May, the rate hit 15.3 million. Toprak said he’s now considering raising his forecast for full-year U.S. auto sales above 15.5 million. The industry sold 14.5 million vehicles in 2012.

Big Three sales pick up in June, getting a boost from lower interest rates, credit availability, rising home construction

U.S. buyers snapped up new cars and trucks in June at a pace not seen since before the recession. Continuing demand for big pickups helped boost sales for Detroit’s automakers. Ford said Tuesday that its sales rose 14 percent, while Chrysler’s gained 8 percent and General Motors’ rose 6.5 percent. Japanese automakers reported solid gains as well. Nissan’s sales jumped 13 percent, while Toyota’s and Honda’s each rose 10 percent. South Korea’s Hyundai reported a record June, with sales up 2 percent. Only Volkswagen’s sales dropped 3 percent, the third straight monthly decline for the German car company as some products like the Jetta start to age.

Analysts say they don’t see much that could slow the sales momentum of the first six months. The factors that juiced sales — low interest rates, wider credit availability, rising home construction and hot new vehicles — are likely to remain in place. So far, hiccups in the stock market, higher taxes and fluctuating gas prices haven’t dampened demand.“I think the fundamentals for continued growth in the new vehicle sales industry are intact,” Chrysler’s U.S. sales chief, Reid Bigland, said last week.

Analyst estimate that U.S. auto sales rose 6 percent to 8 percent in June compared with the same month last year. The auto pricing site TrueCar.com predicts that dealers sold cars and trucks at an annualized rate of 15.7 million last month, the best rate since December 2007. Sales of pickups — which have been selling at a rate three times faster than the rest of the industry has — continued at a strong pace in June. Ford sold just over 68,000 F-Series trucks, up 24 percent from last June and its best June for trucks since 2005. GM said sales of the Chevrolet Silverado jumped 29 percent to 43,259, while Chrysler Group sold nearly 30,000 full-size Ram pickups, up 24 percent from last June. Small businesses have been replacing their aging trucks as home construction has picked up.

Young graduates may have contributed to a rise in small-car sales, said Kelley Blue Book analyst Alec Gutierrez. Gas prices, which averaged $3.60 a gallon nationwide in June and were higher than a year ago, may have steered some buyers to more fuel-efficient models, Gutierrez said. Sales of Ford's recently updated Fiesta subcompact more than doubled to 9,368, while sales of the subcompact Honda Fit were up 10 percent. Sales of the Hyundai Elantra small car jumped 26 percent to more than 22,000. Consumer's confidence hit a six-year high in June. At the same time, auto loan rates remained near historic lows in June. The rate on a four-year new car loan is averaging 2.7 percent, according to Bankrate.com.

Job gains hold steady pace in May

Jobless rate rises to 7.6% as more begin looking for work

The U.S. economy added 175,000 jobs in May — a steady pace that shows strength in the face of tax increases and government spending cuts, if not enough to reduce still-high unemployment. The unemployment rate rose to 7.6 percent from 7.5 percent in April, the Labor Department said recently. The rate rose because more people began looking for work, a healthy sign, but only about three-quarters found jobs.

Analysts said the less-than-robust job growth would likely lead the Federal Reserve to maintain the pace of its monthly bond purchases for a few more months. The bond purchases have been intended to ease long-term borrowing costs and lift stock prices. The recent job figures provided further evidence of the U.S. economy's resilience. The housing market is strengthening, auto sales are up and consumer confidence has reached a five-year peak. Stock prices are near record highs, and the budget deficit has shrunk.

The U.S. economy's relative strength contrasts with Europe, which is gripped by recession, and Asia, where once-explosive economies are now struggling. Many analysts expect the U.S. economy to strengthen later this year. Employers have added an average of 155,000 jobs the past three months. But the May gain almost exactly matched the average increase of the previous 12 months: 172,000.

Reflecting a trend in recent months, many of the jobs added in May were lower-paying ones. That means they aren't likely to fuel as much consumer spending and economic growth as higher- paying jobs that have disappeared. Yet Americans appear to be more optimistic about their job prospects: 420,000 people started looking for work in May. As a result, the percentage of Americans 16 and older either working or looking for work rose to 63.4 percent from a 34-year low of 63.3 percent in April. This is called the labor force participation rate. Higher participation can boost the unemployment rate. That's because once people without a job start looking for one, they're counted as unemployed.

Labor force participation has been falling since peaking at 67.3 percent in 2000. That's partly the result of baby boomers retiring and dropping out of the work force. Joseph LaVorgna, chief U.S. economist at Deutsche Bank Securities, thinks an improving job market will encourage more Americans to look for jobs. He predicts that the participation rate will level off at around 63.5 percent.

Amazon to roll out online grocery sales

Amazon.com Inc is planning a major roll-out of an online grocery business that it has been quietly developing for years, targeting one of the largest retail sectors yet to be upended by e-commerce, according to two people familiar with the situation. The company has been testing AmazonFresh in its hometown of Seattle for at least five years, delivering fresh produce such as eggs, strawberries and meat with its own fleet of trucks.

Amazon is now planning to expand its grocery business outside Seattle for the first time, starting with Los Angeles this month and the San Francisco Bay Area later this year, according to the two people who were not authorized to speak publicly. If those new locations go well, the company may launch AmazonFresh in 20 other urban areas in 2014, including some outside the United States, said one of the people. Bill Bishop, a prominent supermarket analyst and consultant, said the company was targeting as many as 40 markets, without divulging how he knew of Amazon's plans. Amazon is searching for new, large markets to enter as the company tries to maintain a growth rate that has fueled a 220 percent surge in its shares over the past five years. The grocery business in the United States, which generated $568 billion in retail sales last year, may be a ripe target.

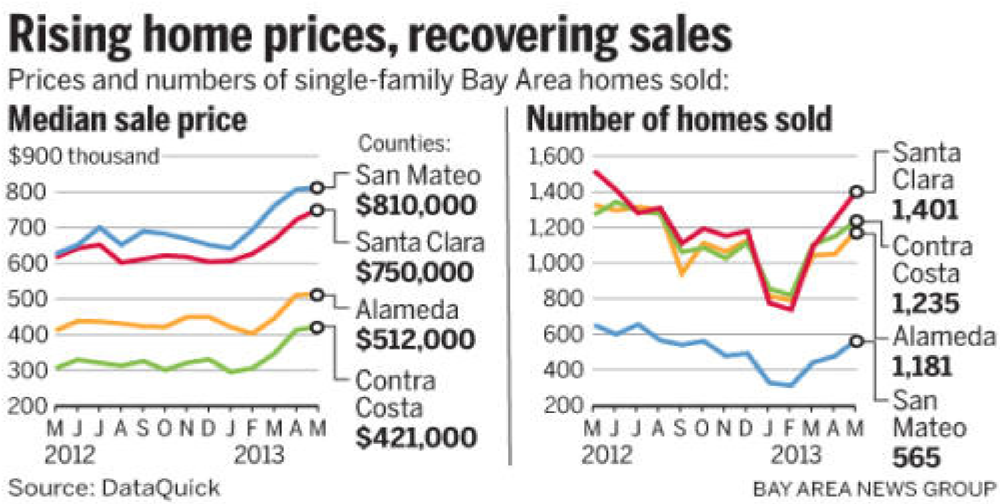
Cost of housing continues to climb

Sales in May down from year ago, but average prices hit-five-year high

Bay Area single family home prices continued a skyward climb in May, reaching their highest level in more than five years, according to a recent report. Median sales prices in the sizzling market were given an upward nudge in the East Bay, Peninsula and South Bay by multiple offers for a scant supply of houses for sale and by a change in the market mix to favor higher-priced homes, said real estate information company DataQuick.

Sales still are well below their year-ago levels, although they rose by double digits from April to May in Alameda, San Mateo and Santa Clara counties, and 8 percent in Contra Costa County, the San Diego company reported.

Inventory is up a bit in Santa Clara County, according to Carl San Miguel, president of the Santa Clara County Association of Realtors. But in the most desired pockets of the county, it's still painfully tight.



Alameda County's single-family home sales had a median sales price in May of $512,000, a 24.7 percent gain from May 2012. That's the highest since February 2008. Sales were down 10.6 percent from a year earlier.

Contra Costa County's median sales price of $421,000 was up 38 percent from a year earlier, also the highest since February 2008. Sales were down 2.5 percent from a year earlier.

Santa Clara County's median price was $750,000, a 22 percent yearly gain and the highest since November 2007. Sales were down 7.3 percent from a year ago.

San Mateo County's median price was $810,000, a 29.6 percent gain over the year, the highest since November 2007. Sales were down 12.7 percent.

The total of 4,382 sales of single-family homes in the East Bay, Peninsula and South Bay in May was down 7 percent from a year ago, but up about 12 percent from April.

In a sign of a strengthening economy, foreclosures and sales of properties worth less than their mortgages were at their lowest — 21 percent of all sales — since December 2007, the San Diego company said.

DAY AFTER BIGGEST DROP IN 20 YEARS

Sales data sink PC-makers shares

Drop in demand for personal computers punishing the industry

If fewer people are interested in buying a new personal computer, then fewer investors want to own stakes in companies whose fortunes are tied to the sales of laptop and desktop machines. That logic ruled recently as Wall Street reacted to fresh evidence that PCs are turning into a dying breed of technology as consumers and businesses embrace smartphones and tablet computers as their preferred computing devices.

The stocks of PC software maker Microsoft Corp. and PC maker Hewlett-Packard Co. absorbed significant hits on the news that PCs suffered an unprecedented sales decline during the first three months of the year. Other companies connected to the PC industry, such as Intel Corp., also were affected, although not to the same degree as the industry bellwethers.

First-quarter shipments of PCs plummeted by 11 percent to 14 percent from a year earlier, according to separate estimates issued late Wednesday by Gartner Inc. and International Data Corp. By either measure, it was the biggest decrease recorded by either research firm since they began tracking PCs sales. For IDC, the data goes back to 1994 — just before Microsoft released a revamped PC operating system called Windows 95, which played a major role in triggering a sales boom that turned laptop and desktop machines into a household staple.

Microsoft hoped to revive PC demand last year with the debut of the most dramatic makeover of Windows since the 1995 redesign. The changes imbued Windows with some of the qualities of mobile software, including touch-screen controls and a display of applications in a mosaic of interactive tiles. Although Microsoft says it's happy with the more than 60 million copies of Windows 8 that have been sold since its October release, analysts have been disappointed.

In its report, IDC blamed Windows 8 for accelerating the sales decline by confusing too many people who had become accustomed to using the old operating system. Another problem: The PCs designed to run on Windows 8 are coming in a befuddling array of styles and are demanding significantly higher prices than older models, at a time when the initial out-of-pocket expense for a smartphone is as low as $99 and tablet computers go for less than $200. In a sign of how sensitive consumers have become to prices, Amazon.com Inc.'s top-selling laptop is a $249 Samsung laptop running a new operating system based on Google's Chrome Web browser.

Count Sterne Agee's Shaw Wu among the analysts worried about the future of Microsoft and its partners in the PC industry. "We frankly believe (Microsoft's) strategy of forcing user interface changes that nobody wants has proven to be a disaster," Wu wrote in a recent research note.

HP, the world's largest PC maker, has been suffering sales declines with the rest of the market. Its PC shipments plunged by 24 percent in the first quarter. The company, which is based in Palo Alto, Calif., had been hoping to bounce back with the release of Windows 8. With those hopes dashed, HP is now making a laptop that runs on the Chrome operating system. CEO Meg Whitman is also trying to expand the company's more profitable businesses, such as business software, data analysis and consulting.

Intel, whose chips are in 80 percent of the world's personal computers but a laggard in mobile devices, is hoping to boost its revenue with a new line of microprocessors better suited for tablets and lightweight laptops.

UCLA Anderson School Forecast

BAY AREA ECONOMY

Region seen as growth engine

The Bay Area economy will remain robust despite a sluggish nationwide recovery, according to the latest projection by the UCLA Anderson Forecast. "The Bay Area is leading the state, and the state is leading the nation in terms of its recovery," said Jerry Nickelsburg, a senior economist with the Anderson Forecast, which on recently issued a closely watched quarterly outlook for the California and U.S. economy.

The national economy, in contrast, is experiencing a recovery in name only, said Edward Leamer, director of the Anderson Forecast. "It's not a recovery," Leamer wrote. "It's not even normal growth. It's bad." The U.S. economy, the world's largest, historically has expanded by an average of 3 percent a year. But in recent years, growth has been in the 1 percent to 2 percent range. That means the economy would have to grow at 5 percent for eight straight years to regain the typical trend line, Leamer estimated. "The economy in the United States is not growing strongly enough to provide jobs for all the people who were laid off," Leamer said in an interview. "If you have a job, you are in good shape. If you don't have a job, you are in bad shape. This is the weakest recovery since World War II."

The halting pace of expansion nationwide has raised the question of whether the Bay Area can sustain its recent robust job growth. But many economists say the nine-county region will continue as a top performer. "The Bay Area ought to remain one of the fastest-growing regions of California," Nickelsburg said. "It is possible some areas of Southern California will supersede the Bay Area in job growth, but the Bay Area will continue its rapid growth."

Scott Anderson, chief economist with San Francisco-based Bank of the West, agreed. "We are seeing some softening in the Bay Area labor market, but the Bay Area is still in a leadership position nationwide," he said. "And the housing market is strong and staying strong." Still, if the U.S. economy were to suffer a sharp slowdown due to a recession in Europe and a downturn in China and Brazil, that could pose hazards for the Bay Area economy.

Anderson, the Bank of the West economist, predicts the U.S. gross domestic product will post 1.5 percent annual growth in the second quarter of this year, down from the 2.4 percent annualized growth for the first quarter. But he expects economic growth to reach 2.5 percent to 3 percent a year in the latter half of 2014.

The tech sector continues to shine in the Bay Area, economists said, and the housing market has begun to sparkle as well, both in this region and statewide. Even some sectors that had been left for dead by the recession are looking better. "Construction is now a growth sector for California," Nickelsburg wrote in the forecast. "The depression in construction employment is over."

The Anderson Forecast predicted that nonfarm payroll jobs statewide will expand by 2 percent both this year and next. The state's jobless rate will average 9.1 percent this year and 8.1 percent in 2014, the forecast predicted. "Our view of the California economy is slightly more optimistic now than it was in the prior quarter," Nickelsburg said.

Sources:
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