



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

November 18, 2013

The Honorable City Council
Palo Alto, California

City of Palo Alto Sales Tax Digest Summary Second Quarter Sales (April - June 2013)

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

BACKGROUND

Sales and use tax represented 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 increased to an estimated \$23.4 million for fiscal year 2013. This revenue included sales and use tax for the City of Palo Alto and pool allocations from the State and Santa Clara County.¹

The Office of the City Auditor contracts with MuniServices LLC (hereafter MuniServices), the City's sales and use tax consultant, to obtain sales and use tax recovery services and informational reports. The Office of the City Auditor 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 Office of the City Auditor 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 disclose the operations of a business. This report, including the attached Sales Tax Digest Summary includes certain modifications and omissions to maintain the confidentiality of taxpayer information.

The Office of the City Auditor 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 2013 second quarter sales (April through June 2013). These funds are reported as part of the City's fiscal year 2014 revenue. Based on the timing of reporting by businesses and the State, MuniServices' detailed reports on third quarter sales (July through September 2013) should be

available by February 2014. ASD advises that in mid-December, it should receive information from the State on aggregate sales and use tax receipts for third quarter 2013.

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 second quarter ending June 2013 increased by approximately \$2.3 million, or 40.8 percent (including pool allocations), compared to the second quarter ending June 2012.² For all jurisdictions in Santa Clara County, sales and use tax revenue for the second quarter ending June 2013 increased by \$4.9 million, or 5.5 percent, compared to the second quarter ending June 2012.
- Statewide, every region in California experienced an increase in sales and use tax revenue for the year ending June 2013, compared to the prior year ending June 2012. Statewide sales and use tax revenue has shown growth of 6.6 percent during the second quarter ending June 2013 compared to the second quarter ending June 2012.
- In Palo Alto, sales and use tax revenue totaled \$28.0 million for the year ending June 2013, an increase of 27.7 percent from \$21.9 million in the prior year ending June 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 in Attachment A.

Economic Influences on Sales and Use Tax

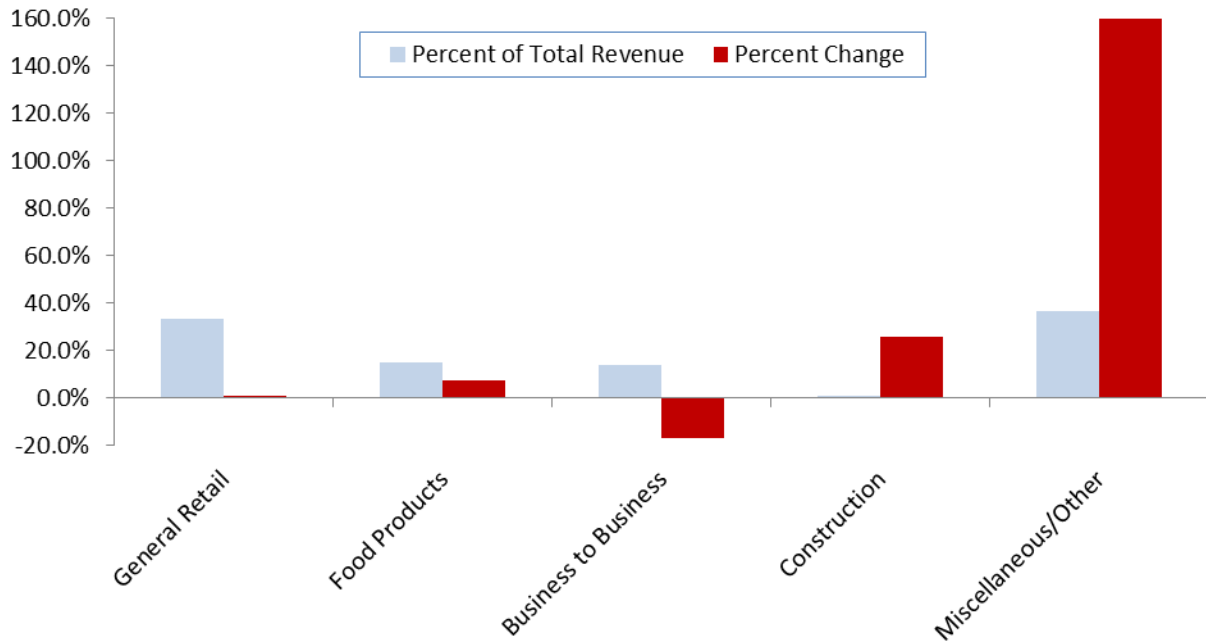
In its Economic Overview (Attachment B), MuniServices discusses economic influences including national economic trends, retail and auto trends, housing prices, and forecast information that may affect the City's sales and use tax revenue.

Preliminary estimates from the State of California Employment Development Department show the August 2013 unemployment rate in Santa Clara County at 6.7 percent and Palo Alto at 3.6 percent.

Economic Category Analysis

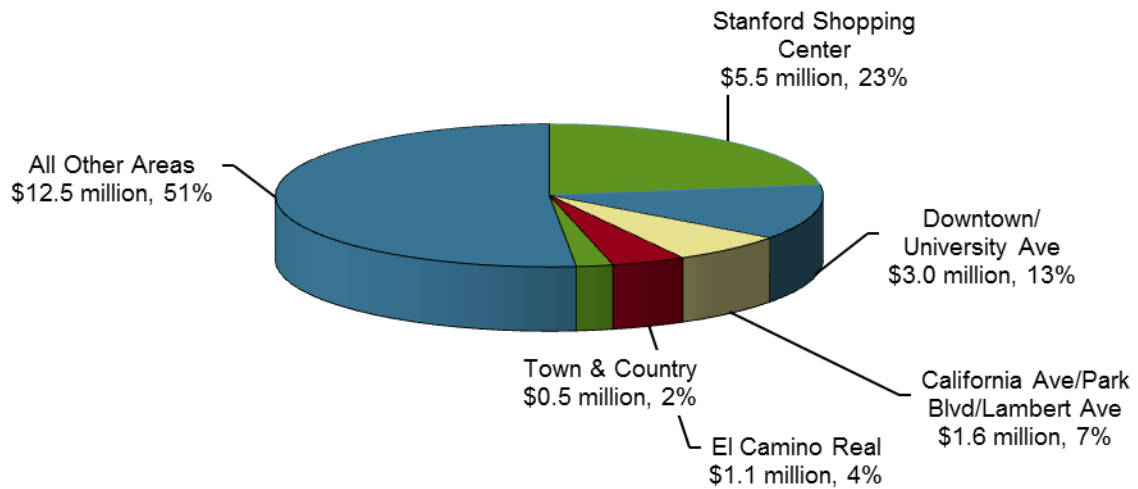
MuniServices' analysis of economic categories for the year ending June 2013 shows that General Retail comprised a large percentage of Palo Alto's sales and use tax revenue and experienced 0.9 percent growth. Food Products experienced a 7.2 percent increase and comprised 15.0 percent of total revenues. Business to Business experienced a 17.0 percent decrease and comprised 13.7 percent of total revenues.

Exhibit 1 - Comparison of Palo Alto's Sales and Use Tax Revenue and Percent Change by Economic Category for the Year Ending June 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 June 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. Effective April 1, 2013, the sales and use tax rate in Palo Alto increased to 8.75 percent from 8.625 percent in the prior quarter.

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.

¹ See definitions on page 4.

² Excluding pool allocations and adjusting for prior period and late payments, Palo Alto's sales and use tax revenue for the second quarter ending June 2013 increased by 36.7 percent compared to the second quarter ending June 2012. On a yearly basis, Palo Alto's sales and use tax revenue for the year ending June 2013 increased by 27.7 percent compared to the prior year ending June 2012.

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

Audit staff: Lisa Wehara

ATTACHMENTS:

- Attachment A: City of Palo Alto Sales Tax Digest Summary (Q2-13) (PDF)
- Attachment B: Economic Overview (October 2013) (PDF)

Department Head: Houman Boussina, Acting City Auditor

City of Palo Alto

Sales Tax Digest Summary

Collections through September 2013

Sales through June 2013 (2013Q2)

California Overview

The percent change in cash receipts from the prior year was 6.2% statewide, 5.7% in Northern California and 6.5% 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 2nd Quarter 2013 by 4.8% statewide, 5.0% in Northern California and increased by 4.6% in Southern California.

City of Palo Alto

For the year ended 2nd Quarter 2013, sales tax cash receipts for the City grew by 27.7% from the prior year. On a quarterly basis, sales tax revenues grew by 40.8% from 2nd Quarter 2012 to 2nd 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 27.7% for the year ended 2nd Quarter 2013 from the prior year. On a quarterly basis, sales tax activity grew by 36.7% in 2nd Quarter 2013 compared to 2nd Quarter 2012.

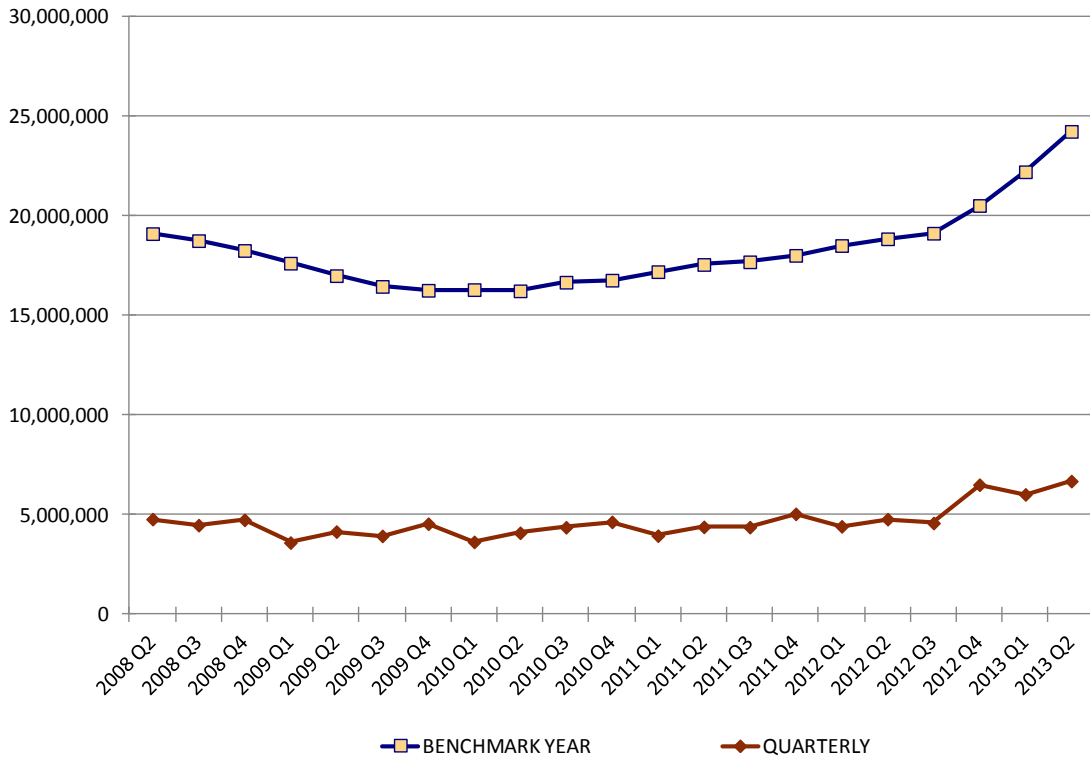
Regional Overview

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

CITY OF PALO ALTO
BENCHMARK YEAR 2013Q2 COMPARED TO BENCHMARK YEAR 2012Q2

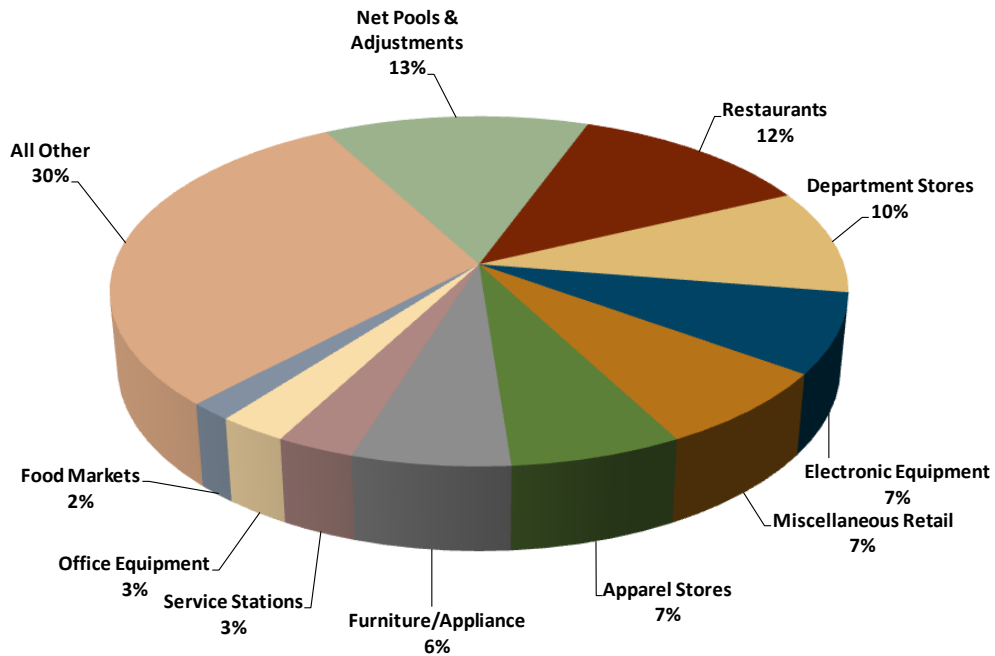
ECONOMIC CATEGORY ANALYSIS FOR YEAR ENDED 2nd QUARTER 2013									
% of Total / % Change	City of Palo Alto	California Statewide	S.F. Bay Area	Sacramento Valley	Central Valley	South Coast	Inland Empire	North Coast	Central Coast
General Retail	33.6 / 0.9	28.9 / 4.0	28.1 / 4.4	29.0 / 3.8	30.6 / 3.0	29.3 / 3.6	26.8 / 6.4	28.7 / 3.8	32.4 / 4.4
Food Products	15.0 / 7.2	19.3 / 5.4	20.1 / 6.6	16.5 / 3.1	16.1 / 2.9	20.0 / 5.2	16.4 / 7.6	18.0 / 3.0	31.4 / 3.1
Construction	1.1 / 26.0	8.9 / 8.4	8.8 / 9.0	10.4 / 10.5	10.8 / 5.2	8.0 / 5.6	11.8 / 25.0	12.3 / 7.8	9.1 / 10.7
Business to Business	13.7 / -17.0	17.0 / 1.6	19.4 / -3.0	14.2 / 5.2	14.4 / 5.9	17.1 / 1.8	15.5 / 16.1	8.9 / -2.7	5.3 / -2.3
Miscellaneous/Other	36.6 / 159.7	25.9 / 6.2	23.5 / 10.5	29.9 / 7.7	28.1 / 7.6	25.6 / 3.8	29.5 / 7.6	32.1 / 5.6	21.8 / 0.6
Total	100.0 / 27.7	100.0 / 4.8	100.0 / 5.0	100.0 / 5.7	100.0 / 4.9	100.0 / 3.8	100.0 / 10.3	100.0 / 4.1	100.0 / 3.3
ECONOMIC SEGMENT ANALYSIS FOR YEAR ENDED 2nd 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	Auto Sales - New	Department Stores	Restaurants
% of Total / % Change	*** / ***	13.3 / 5.3	14.1 / 6.5	11.9 / 3.0	14.3 / 3.6	14.2 / 5.1	11.6 / 15.2	13.6 / 1.3	20.5 / 2.3
2nd Largest Segment	Restaurants	Department Stores	Auto Sales - New	Auto Sales - New	Service Stations	Department Stores	Service Stations	Service Stations	Department Stores
% of Total / % Change	13.1 / 7.2	10.5 / 3.6	9.5 / 20.8	11.4 / 18.9	11.9 / 0.2	10.2 / 3.6	11.2 / -1.5	13.3 / -1.9	9.7 / 15.1
3rd Largest Segment	Department Stores	Auto Sales - New	Department Stores	Restaurants	Restaurants	Auto Sales - New	Department Stores	Restaurants	Misc. Retail
% of Total / % Change	10.2 / 1.4	10.1 / 14.7	9.3 / 3.9	10.4 / 4.5	9.6 / 4.2	10.2 / 11.8	10.4 / 2.7	9.6 / 4.6	9.6 / -0.3
*** Not specified to maintain confidentiality of tax information									

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

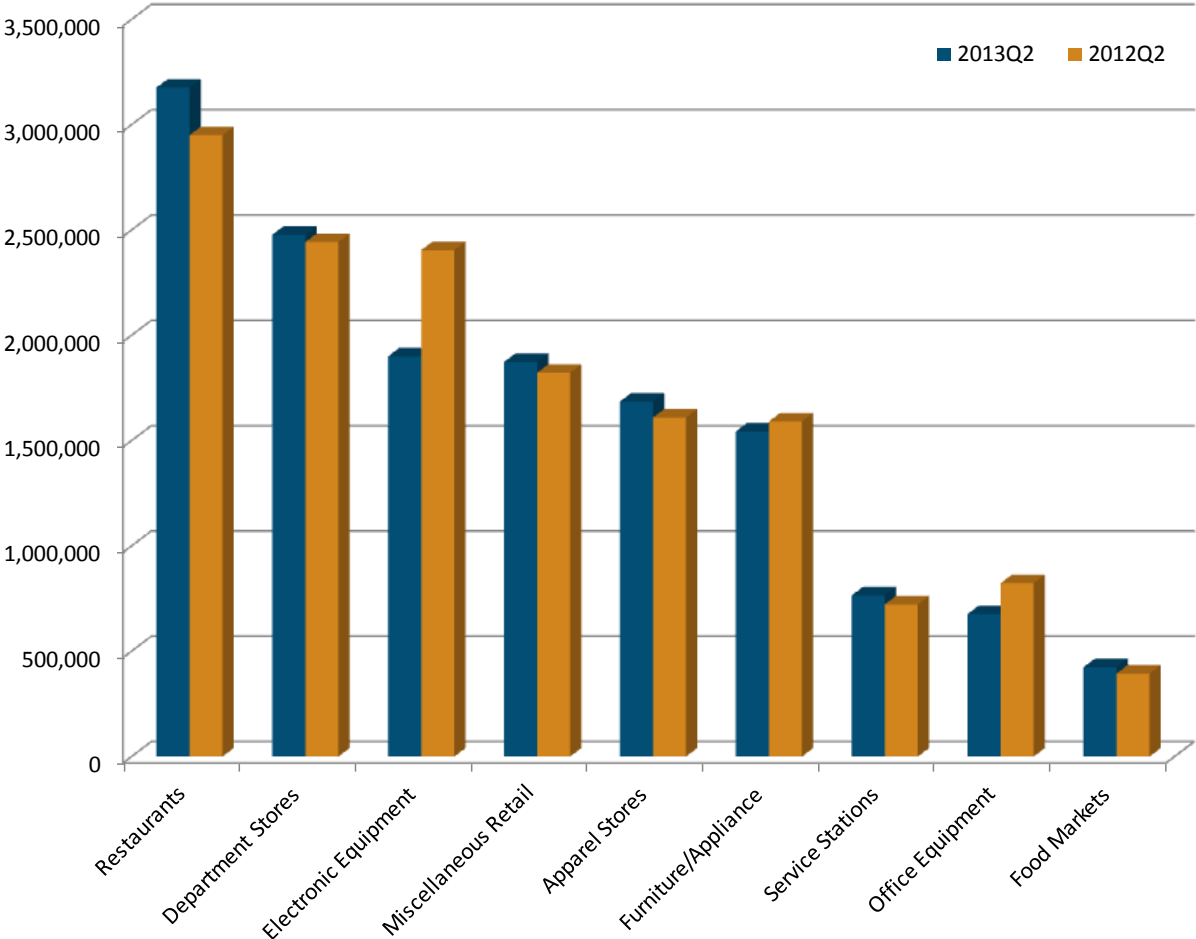


Net Cash Receipts for Benchmark Year 2nd Quarter 2013: \$27,992,276

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



Sales Tax from Largest Non-confidential Economic Segments



Historical Analysis by Calendar Quarter

Economic Category	%	2013Q2	2013Q1	2012Q4	2012Q3	2012Q2	2012Q1	2011Q4	2011Q3	2011Q2	2011Q1
General Retail	24.7%	1,959,201	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
Food Products	12.2%	966,208	882,949	905,156	877,520	886,852	816,336	838,138	799,167	806,987	740,594
Business To Business	10.1%	800,341	592,136	1,101,068	843,770	993,147	1,064,996	932,723	842,771	842,709	925,263
Construction	1.3%	106,362	37,150	62,618	53,420	50,544	47,432	62,282	46,843	44,589	38,765
Miscellaneous/Other	36.2%	2,867,931	2,759,713	2,004,507	905,479	848,911	797,436	781,336	812,130	720,550	680,987
Net Pools & Adjustments	15.5%	1,227,552	1,162,968	1,155,841	603,635	840,789	754,099	725,000	933,424	845,214	769,789
Total	100.0%	7,927,595	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

Economic Segments	%	2013Q2	2013Q1	2012Q4	2012Q3	2012Q2	2012Q1	2011Q4	2011Q3	2011Q2	2011Q1
Restaurants	10.7%	845,107	771,596	782,184	760,929	780,314	714,487	783,595	689,568	705,459	639,353
Department Stores	7.6%	603,773	509,699	779,973	584,178	608,894	382,336	573,750	455,335	482,723	399,243
Miscellaneous Retail	6.0%	471,954	393,506	584,169	429,989	456,771	347,112	488,492	385,236	392,126	301,427
Electronic Equipment	5.3%	421,200	284,607	695,663	516,554	651,686	488,132	724,274	563,373	608,784	474,566
Apparel Stores	5.1%	404,202	372,909	496,073	383,337	402,471	178,409	171,472	160,037	181,065	158,421
Furniture/Appliance	4.1%	325,112	350,375	444,725	345,043	365,585	99,210	104,348	104,234	105,507	100,241
Service Stations	2.5%	196,568	187,333	182,060	198,973	198,604	90,636	101,023	98,054	89,530	91,274
Office Equipment	2.2%	172,585	131,629	223,538	162,015	188,369	46,718	48,340	49,977	51,743	47,157
Food Markets	1.3%	106,760	99,711	110,625	106,652	95,807	37,116	38,854	42,654	35,131	34,857
Health & Government	1.3%	100,829	86,330	88,669	94,969	92,612	31,168	44,402	41,338	38,236	34,016
Business Services	0.9%	67,759	63,791	73,619	69,722	71,828	6,634	9,046	9,857	8,724	6,458
Drug Stores	0.8%	66,722	64,492	65,440	62,624	65,943	7,110	22,227	8,349	8,029	3,833
Recreation Products	0.8%	60,260	48,148	57,916	92,186	82,846	11,199	12,838	11,321	11,319	9,967
Misc. Vehicle Sales	0.6%	44,711	45,719	45,656	45,325	57,680	16,264	17,880	5,505	6,353	4,749
Miscellaneous/Other	35.5%	2,812,501	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
Net Pools & Adjustments	15.5%	1,227,552	1,162,968	1,155,841	603,635	840,789	754,099	725,000	933,424	845,214	769,789
Total	100.0%	7,927,595	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

*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.

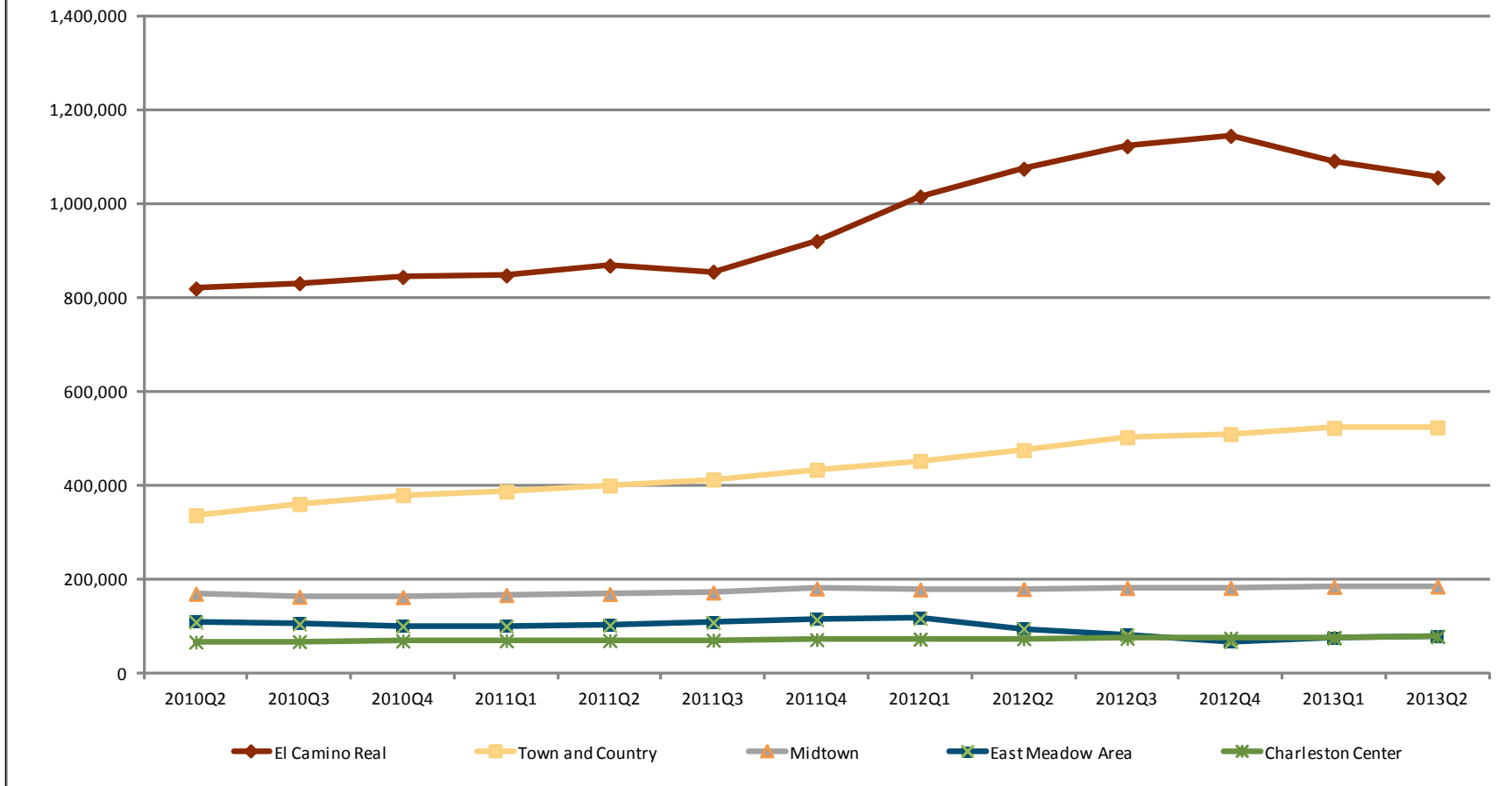
Quarterly Analysis by Economic Category, Total and Segments: Change from 2012Q2 to 2013Q2

	General Retail	Food Products	Construction	Business to Business	Misc/Other	2013/2 Total	2012/2 Total	% Chg	Largest Gain	Second Largest Gain	Largest Decline	Second Largest Decline
Campbell	-2.3%	6.4%	5.6%	16.0%	3.1%	2,218,602	2,126,740	4.3%	Bldg.Matls-Whsle	Recreation Products	Miscellaneous Retail	Furniture/Appliance
Cupertino	-0.4%	5.3%	19.2%	-12.6%	-2.6%	4,595,781	5,039,048	-8.8%	Food Processing Eqp	Bldg.Matls-Whsle	Electronic Equipment	Business Services
Gilroy	-3.2%	2.0%	2.5%	8.8%	3.0%	3,048,632	3,039,796	0.3%	Auto Sales - New	Misc. Vehicle Sales	Apparel Stores	Service Stations
Los Altos	-10.6%	-0.2%	1.0%	23.2%	-5.7%	519,082	541,602	-4.2%	Miscellaneous Retail	Apparel Stores	Florist/Nursery	Service Stations
Los Gatos	-10.9%	3.8%	3.0%	3.3%	2.0%	1,698,831	1,762,911	-3.6%	Auto Sales - New	Business Services	Miscellaneous Retail	Service Stations
Milpitas	7.3%	8.5%	21.3%	-18.2%	-6.1%	4,387,349	4,442,062	-1.2%	Bldg.Matls-Whsle	Furniture/Appliance	Office Equipment	Auto Sales - New
Morgan Hill	11.1%	11.8%	12.7%	-18.8%	16.9%	1,821,167	1,695,874	7.4%	Auto Sales - New	Auto Parts/Repair	Electronic Equipment	Heavy Industry
Mountain View	-2.0%	23.3%	11.0%	4.1%	-1.4%	3,459,130	3,293,648	5.0%	Restaurants	Business Services	Office Equipment	Service Stations
Palo Alto	-3.0%	7.7%	110.0%	-21.5%	214.0%	6,700,045	4,900,839	36.7%	***	Heavy Industry	Electronic Equipment	Office Equipment
San Jose	2.5%	6.0%	9.6%	-11.1%	-2.7%	33,787,269	34,105,579	-0.9%	Restaurants	Bldg.Matls-Whsle	Office Equipment	Service Stations
Santa Clara	25.9%	4.1%	19.4%	-4.0%	-3.6%	9,706,387	9,400,067	3.3%	Furniture/Appliance	Bldg.Matls-Whsle	Office Equipment	Heavy Industry
Santa Clara Co.	2.7%	5.6%	1.6%	39.7%	-17.0%	971,517	953,258	1.9%	Office Equipment	Food Processing Eqp	Service Stations	Apparel Stores
Saratoga	31.8%	-5.2%	129.1%	-47.4%	-17.1%	221,317	234,151	-5.5%	Furniture/Appliance	Miscellaneous Retail	Office Equipment	Restaurants
Sunnyvale	-11.4%	4.7%	-7.3%	0.1%	1.7%	6,770,348	6,868,708	-1.4%	Light Industry	Restaurants	Miscellaneous Retail	Office Equipment

*** Not specified to maintain confidentiality of tax information

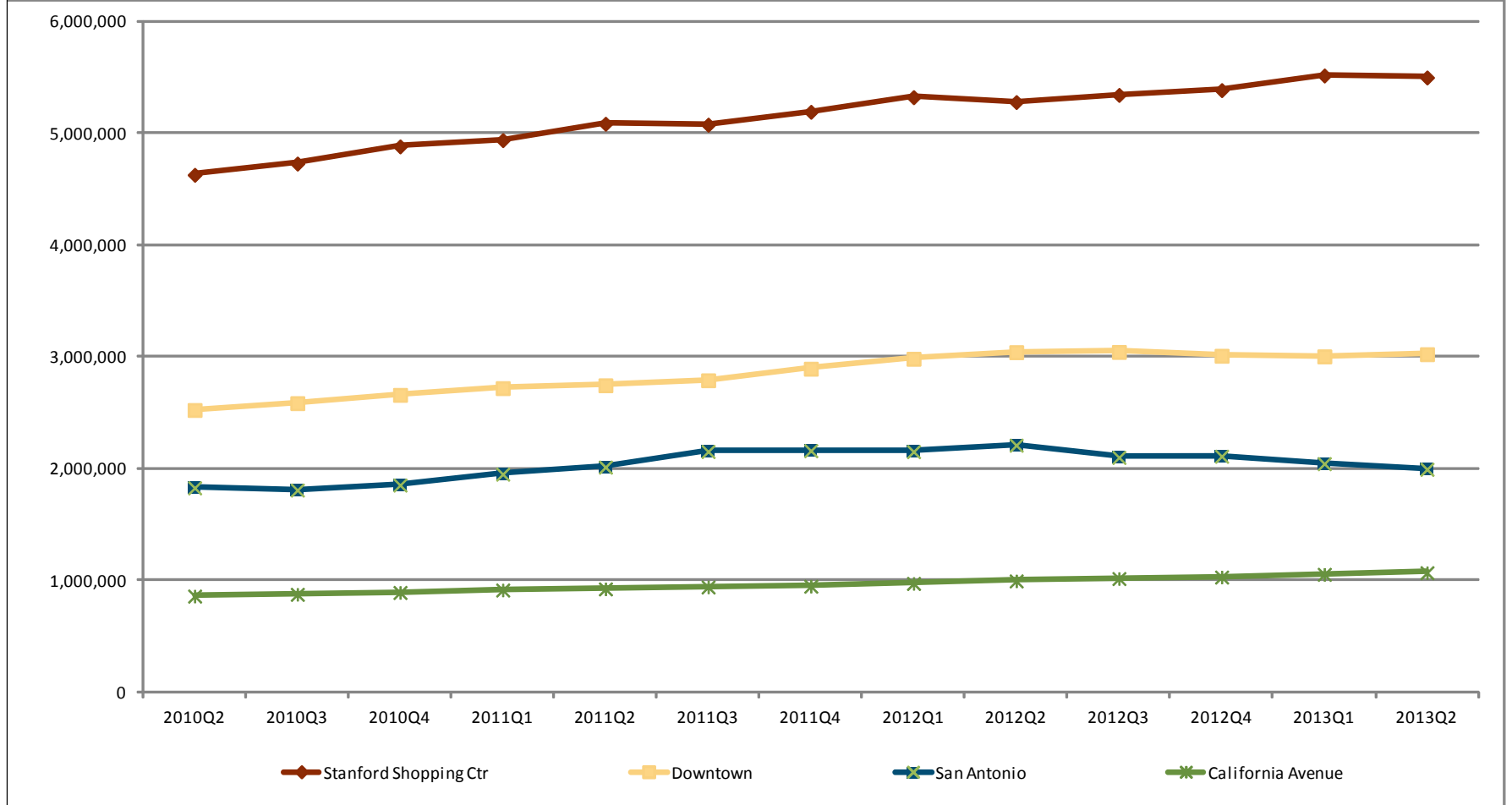
**Benchmark year (BMY) is the sum of the current and 3 previous quarters (2013Q2 BMY is sum of 2013 Q2 & Q1, 2012 Q4 & Q3)*

City of Palo Alto - Selected Geographic Areas of the City													
Benchmark Year 2nd Quarter 2013													
	2010Q2	2010Q3	2010Q4	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
El Camino Real	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	1,055,524
Town and Country	336,444	360,254	379,066	386,944	399,378	412,361	433,313	451,982	475,054	502,127	509,180	522,374	523,504
Midtown	169,297	162,869	162,122	166,440	168,537	171,719	180,415	178,344	179,250	181,352	181,654	183,780	184,646
East Meadow Area	108,922	104,777	100,155	100,032	102,028	108,176	114,083	116,558	94,868	81,598	67,124	74,680	77,869
Charleston Center	66,446	67,447	68,693	69,150	69,606	70,301	71,555	72,602	73,408	74,213	74,683	76,315	78,734

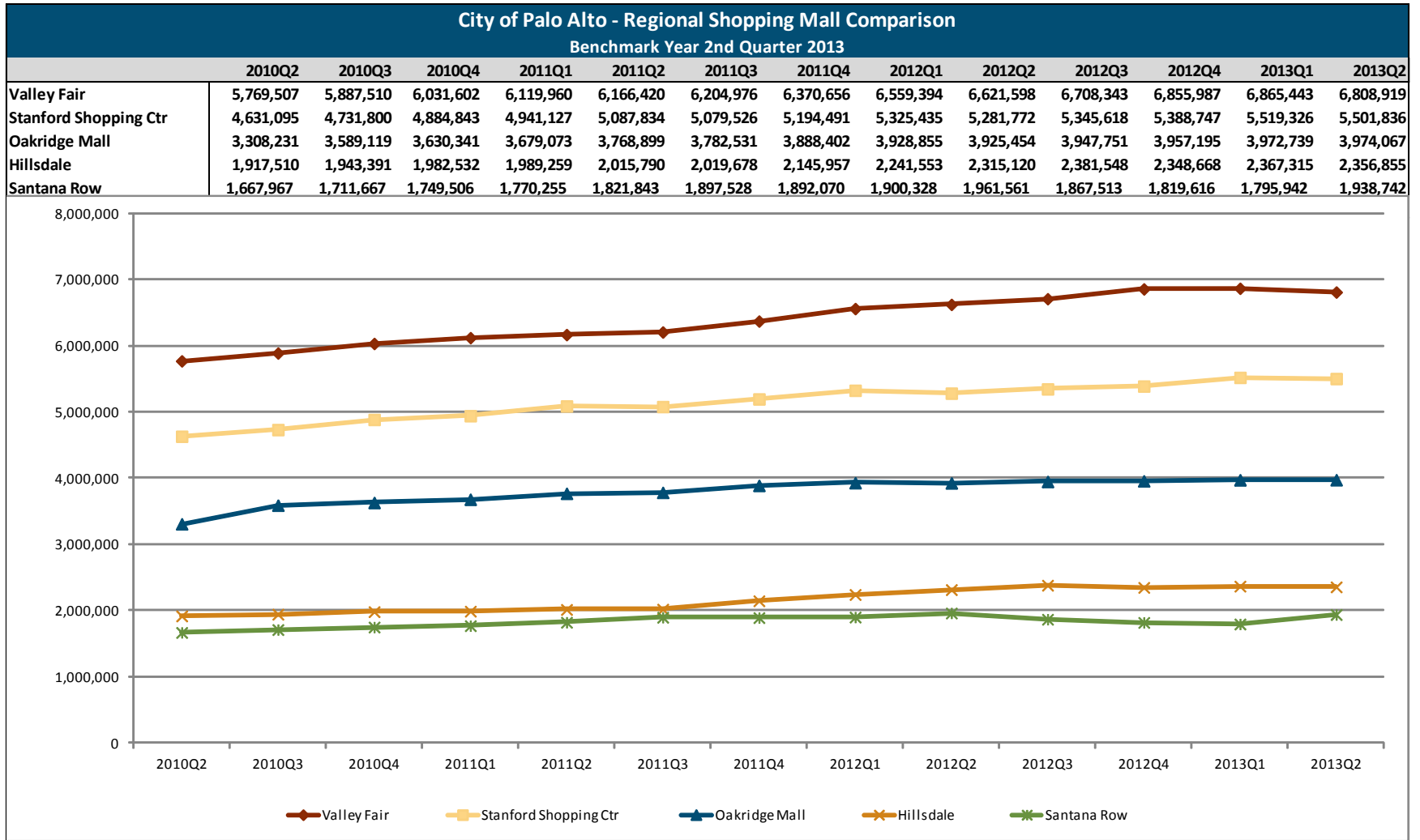


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City of Palo Alto - Selected Geographic Areas of the City													
Benchmark Year 2nd Quarter 2013													
	2010Q2	2010Q3	2010Q4	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Stanford Shopping Ctr	4,631,095	4,731,800	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	5,501,836
Downtown	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	3,027,279
San Antonio	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	1,997,654
California Avenue	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	1,072,925



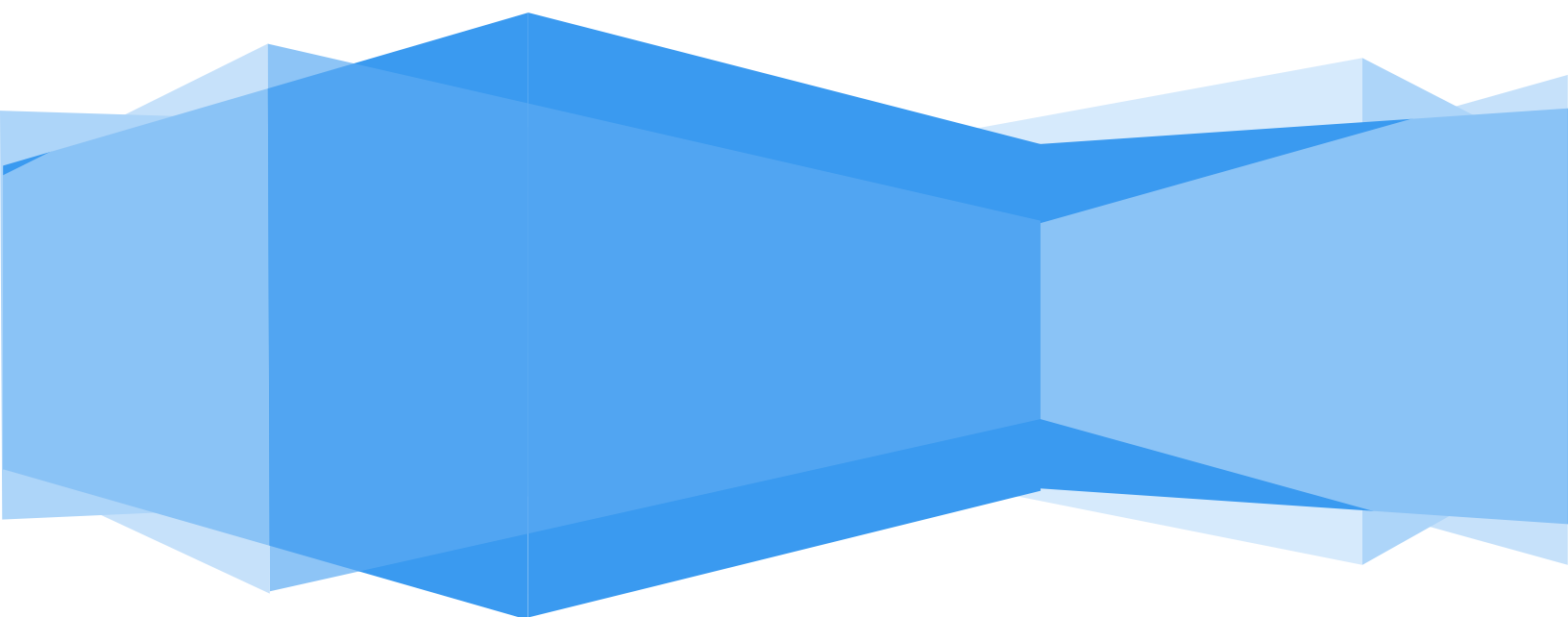
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Economic Overview

3Q2013 News



GDP UP 2.5 PERCENT

Rise in economy beats estimates

Boost will help as Fed decides whether to cut back bond purchases

A stronger-than-expected rise in U.S. economic growth last quarter will likely strengthen the hand of Federal Reserve officials who want to slow the Fed's bond purchases. The economy grew at a 2.5 percent annual rate from April through June, the government estimated recently. That was more than twice the growth rate in the first quarter and far above an initial estimate of a 1.7 percent rate for April through June.

The Fed is weighing key measures of the economy's health before it meets to decide whether to scale back its \$85 billion in monthly bond purchases. The Fed's bond buying has helped keep long-term borrowing rates near record lows. A stronger economy would need less support from the Fed. Global financial markets have been under pressure over speculation that the Fed will slow its purchases and send interest rates in the United States higher. U.S. rates have already been rising in anticipation of a pullback in Fed bond buying. But the Fed may decide the economy is strengthening enough to withstand higher rates.

Last quarter's faster growth "should give Fed officials more confidence that the recovery is gathering steam," said Paul Ashworth, chief U.S. economist at Capital Economics. Other analysts think the Fed might decide to maintain the pace of its bond buying to help fuel the economy. They think Fed officials may conclude that the still-subpar U.S. economy could falter under the weight of higher interest rates, a slower housing rebound or a messy resolution to a fight over the federal budget.

Recently, the government upgraded its estimate of growth for last quarter mainly because the U.S. trade deficit narrowed in June. That occurred because U.S. companies exported more goods than previously thought and imported fewer. The narrower trade gap offset weaker spending by the U.S. government.

For the second half of the year, analysts generally think the economy will grow at an annual rate of around 2.5 percent, fueled by steady job gains and a diminished impact from federal spending cuts. That growth rate, though, would be too weak to meet the Fed's own forecasts for 2013.

Retail sales slow even as the economy grows

Bleaker outlooks at retailers like Wal-Mart and Macy's are raising doubts that consumers will spend enough in coming months to lift the still-subpar U.S. economy. Though the economy is growing steadily, Americans are being hampered by weak pay, higher taxes and tepid hiring.

Sluggish overseas economies are also slowing sales for U.S. retailers. It's a picture the Federal Reserve will weigh in deciding whether to scale back its bond purchases as soon.

"Consumers aren't going to start spending with abandon until we see much stronger job and wage growth," says Mark Vitner, an economist at Wells Fargo. Average weekly paychecks have grown just 1.3 percent since the recession ended more than four years ago. Over the past 12 months, pay has trailed even low inflation. That's partly why spending has remained lackluster and why many Americans may be postponing purchases at department stores so they can buy cars, homes and other costly necessities.

Americans increased their spending at an annual rate of just 1.8 percent in the April-June quarter — down from a 2.3 percent rate in the January-March period. Consumer spending is expected to improve in the second half of the year. But most economists foresee only a slight acceleration to an annual rate of 2 percent to 2.5 percent.

Those spending rates are historically weak. And they're too meager to significantly boost the economy, which grew at an annual rate of just 1.4 percent in the first half of the year. Consumer spending fuels about 70 percent of the U.S. economy. For much of this year, many Americans have made major purchases that they had postponed during the recession and the weak recovery. Auto and home sales have strengthened, leaving less spending money for discretionary purchases such as electronic goods, clothes and eating out.

"Consumers are very much need-based," said Ken Perkins, president of RetailMetrics, a retail research firm. "If they're buying a new car, that leaves less money for a child's wardrobe." That trend has weakened sales and profits of retailers like Macy's, which reported a disappointing profit second-quarter profit recently and cut its outlook for the year.

Wal-Mart, the world's biggest retailer, issued a quarterly earnings report recently that intensified worries about the strength of U.S. consumers, long a driving force for the global economy. The Bentonville, Ark.-based discounter cut its annual profit and revenue forecasts. Wal-Mart said it expects economic strains in the United States and abroad to squeeze its low-income shoppers the rest of the year. Wal-Mart is considered an economic bellwether: It accounts for nearly 10 percent of nonautomotive retail spending in the United States. The company attributed its gloomier report in part to a Social Security tax increase that's reduced most Americans' paychecks earlier this year.

RETAIL TRENDS

Online retailers set up shop in real world

Balsam Hill has enjoyed seven years as a booming online retailer and one of Silicon Valley's fastest-growing Internet companies. But recently, the high-end artificial Christmas tree manufacturer will open a brick-and-mortar store just off the highway in Burlingame. In this

part-warehouse, part-showroom, part-discount outlet space within earshot of San Francisco International Airport city, Balsam Hill will display its towering and bejeweled artificial trees, which have, until now, mostly been confined to cyberspace.

Redwood City-based Balsam Hill becomes the latest successful online retailer -- it has been profitable since its inception, growing more than 200 percent some years -- to venture offline and into the physical retail world in a role reversal that seems to defy the booming e-commerce industry. While traditional brick-and-mortar merchants struggle to capture consumers who increasingly shop from their smart phones and tablets, some online-only retailers are adding physical stores to improve sales and attract new customers who may discover the street address before the Web address, say retail industry experts.

"You can't just stick an ad on Google and hope that you're showing up first in search results," said Kelly Pedersen, retail and consumer director with global consulting firm PwC. "They need to differentiate themselves."

From eyeglass designer Warby Parker to baby gear retailer Our Baby Our World, fashion site Bauble Bar and Gap subsidiary Piperlime, online companies are expanding their businesses through brick-and-mortar stores. These are not your average strip mall stores -- they are, in most cases, ornate showrooms or intimate retail sites to try on clothes and test out tech gadgets before making the purchase online.

Balsam Hill's new outlet and showroom, open now through January and likely weekends in the summer, will be a feast for the senses -- Christmas carols will play on the loudspeaker, blinking lights and ornaments will be shown and a children's choir will perform. That holiday experience doesn't come with a quick online purchase. Each tree will be done up "in all its glory with all the decorations" and customers can buy them for next-day delivery, said founder and CEO Thomas Harman.

"Picking a Christmas tree is actually an emotional decision," he said. "That's the tree that you're going to decorate every year with your family. That's the tree that's going to be the centerpiece in your house." Harman said he wanted to create a destination shopping experience and attract new customers who want to pick out their Christmas tree with family and spend time mulling over a purchase that will be used for many years. "This is an opportunity for everyone to actually touch and feel and see the trees that they see online," Harman said. The company is in a good place to open a store because it has built up its brand -- it's well known all over the country -- and the demand for artificial trees is so much higher than it used to be. More than 80 percent of households in the U.S. that celebrate Christmas put up an artificial tree.

In addition, the outlet part of the store gives Balsam Hill a place to sell trees at a discount that have been returned or are from a previous season, which it couldn't do easily online. Balsam Hill trees range from a few hundred dollars to about \$20,000 for a commercial tree for a mall or

business, and are anywhere from four feet to 30 feet. They are made from plastic but are designed to look and feel identical to trees in nature though most come with lights.

Malls turn to fine dining for food courts

The Fig & Olive restaurant chain drips with foodie cred.

The eateries, which started in Manhattan, feature fancy olive oils and celebrity sightings. An average diner's check easily breaches \$50. The Mediterranean-inspired cuisine is the antithesis of quick-stop mall chow. But come November, a Fig & Olive will open in a 12,000-square-foot space at Fashion Island in Newport Beach, beating out 50 others for the prime spot away from the main shopping plaza.

There will be ocean views, a garden with a fireplace, wine shelves and a white room inspired by the Cote d'Azur. Each of the 60 olive trees ringing the site costs \$15,000, only a small part of the multimillion-dollar investment by the restaurant chain and the Irvine Co., which owns the property. "The stigma of opening in a mall is going away," Fig & Olive founder Laurent Halasz said of his first foray into a shopping center. "There's been a huge change."

U.S. shopping centers are moving from fast food to fancy food. It started a few years ago as tired food courts began transforming into slick dining terraces. Now, upscale restaurants are making an appearance, even replacing department stores as mall anchors.

At Irvine Co. which owns Fashion Island and Crystal Cove Shopping Center, also in Newport Beach, an increasing portion of mall revenue is coming from food. Two staffers are dedicated to finding dining tenants. "We view these restaurants as being traffic draws," said Dan Sheridan, the company's president.

At San Jose's Westfield Valley Fair, construction is underway on a new multimillion-dollar restaurant and bar area to offer shoppers upscale dining. The 23,000-square-foot dining area is part of the mall's luxury wing project. The dining terrace will be completed in November and will include 10 new restaurants, a fire pit, wine bar, entertainment and a lounge.

Stanford Shopping Center has added Yucca de Lac, which has as its roots the high-end Hong Kong restaurant of the same name. Drawing visitors has become a big concern for mall operators, who figure they need more than apparel and shoe stores and the occasional movie theater. They're battling growing online shopping options and free shipping offers.

At the same time, shopping center owners are losing interest in multi-unit budget eateries and are courting elite foodie favorites with the lure of prominent plots of land. They're targeting the growing ranks of diners who shun cookie-cutter chain menus for meals they can brag about on blogs and social media. Industry statistics show that restaurants at malls are outperforming those centers' fast-food outlets. Sales at mall restaurants grew 4.3% in the year that ended in

May, while mall fast food purveyors posted a 0.3% decline, according to data from the International Council of Shopping Centers. The Irvine Spectrum shopping center in Irvine, closed its food court late last year and will add an Umami Burger next year. It also plans to sprinkle new culinary options such as Cucina Enoteca, Wood Ranch and Tender Greens.

AUTO TRENDS

Ford gaining ground on Toyota and Honda

Automaker's market share in California up more than 2% since '06

In a Bay Area car landscape dominated by Toyota and Honda, the iconic faces of U.S. car manufacturing -- Ford and GM -- are fighting their way back into contention. It's been a long climb back. Ford's share of the California market has risen more than 2 percentage points -- from 9.5 percent in 2006 to 11.9 percent in the second quarter of this year, putting Ford in third place, behind Honda and top dog Toyota. GM remains in fourth, with 10.6 percent of the market.

Both Ford and GM have cars that are among the top five bestsellers in their categories in the state. Ford's Mustang is No. 1 in the sporty compact category and Chevy's Impala takes the top spot in the large mid-size category. At The Ford Store in Morgan Hill, the Bay Area's No. 1 seller of Fords, Jo Babcock of San Francisco gave up his Toyota Scion and bought a 2013 Ford Transit Connect cargo van. "Ford's a lot better than it used to be," Babcock said. "I've been driving Japanese cars for the last eight years. But things change and now Ford is up for the competition."

Fans of GM's Chevrolet brand feel just as strongly. Ben Guill went shopping for a new SUV recently that would be both spacious and fuel efficient for his son, Mark, and ended up on the lot of Capitol Chevrolet in San Jose. "Five years ago or so, for one reason or another, Chevrolet wasn't trying that hard," Guill, of San Jose, said. "Chevrolet has since made a major turnaround in quality."

While Toyota continues to dominate, its overall share of the California market slipped by more than 2 percentage points in the second quarter of 2013 -- from 23.4 percent in 2006 to 21.2 percent, according to the California New Car Dealers Association. Honda remained a distant second, with 13.1 percent of the market, up from 12 percent in 2006. "It's still a market very heavily dominated by Toyota and Honda," said Stephen Smith, president of the Silicon Valley Auto Dealers Association. "But Ford has come a long way and lately it's been putting out a fantastic product."

The GM picture is more difficult to measure because of GM's changing brands. In 2006, the automaker had the second largest share of the California market, at 15.2 percent. But GM's fleet was much larger than today and included Hummers, Pontiacs, Saturns and Saabs. In the

latest numbers released by the California New Car Dealers Association, the GM brands that were measured were down to Buick, Cadillac, Chevrolet and GMC.

Chrysler's fleet also has changed as Chrysler's share of the California vehicle market has risen and fallen. In 2006, Chrysler had 2 percent of the market but jumped to 7.5 percent in 2008 when its brands included Chrysler, Dodge and Jeep. Although the Chrysler brand grew to include Fiat in 2012, its market share fell to 6.5 percent. This year, Chrysler's market share has dropped to 5.4 percent.

Mike Luner, the general manager of Capitol Chevrolet, used to rely on trucks to drive 80 percent of his sales. Now nearly 70 percent of his sales come from Chevrolet cars, especially the hybrid Chevrolet Volt, which gets an advertised 98 mpg. Capitol Chevrolet sold 420 Volts last year, more than any other Chevy dealer in the country. This year, the dealership already has sold 325 Volts through July and is on pace to break its own record. "GM used to focus on trucks," Luner said. "Now, with the Volt, Sonic and Spark, we're right where Toyota lives." Bill Fay, group vice president and general manager for Toyota Motor Sales, called the increased competition "a win-win for both the consumer and the industry."

Automakers set a torrid U.S. sales pace in August

The major U.S. and Japanese automakers all posted double-digit U.S. sales gains last month as car buyers snapped up pickup trucks and small cars to lead the industry toward its best month in six years. Honda reported the biggest gain with sales up almost 27 percent over August of last year. Toyota sales rose nearly 23 percent, while Nissan was up 22 percent. At General Motors, sales were up almost 15 percent for the company's best month since September of 2008. Chrysler and Ford each reported 12 percent gains.

Sales in August ran at an annual rate of 16.1 million cars and trucks, a pace not seen since November of 2007, a month before the start of the recession. Mustafa Mohatarem, GM's chief economist, predicted that rate of sales is here to stay. History, he said, shows that auto sales follow a trend, and that trend is now back above pre-recession levels. "With the underlying economy fairly solid and with the still very high average age of the fleet, I have full expectations that we will continue to see a fairly steady industry," Mohatarem said. The average age of a vehicle on U.S. roads today is a record 11.4 years according to the Polk research firm. That means more people have to replace cars and trucks that they kept through the recession.

While GM didn't officially raise its sales forecast for the year from 15.5 million, Mohatarem said he expects the year to end with sales closer to 15.8 million vehicles. Also, the industry is on better footing than it was in 2007. Prices are high, and automakers aren't resorting to huge discounts to pull customers into showrooms, Mohatarem said.

Consumers are spending at record levels to buy loaded-up vehicles, according to the auto pricing website TrueCar.com. The average U.S. vehicle sold for an estimated \$31,252 last month, up almost \$1,000 over August of last year and \$24 higher than the previous record in

December of 2012. Five automakers, Chrysler, Ford, Honda, Nissan and Volkswagen, all had record-high selling prices last month, according to TrueCar.

NATION

Consumer spending slows as income lags

U.S. consumers barely increased their spending in July after their income grew more slowly, held back by steep government spending cuts that reduced federal workers' salaries. The tepid gains suggest economic growth is off to a weak start in the July - September quarter.

The Commerce Department said that consumer spending rose just 0.1 percent in July from the previous month. That's slower than June's 0.6 percent increase. Consumers cut their spending on long-lasting manufactured goods, such as cars and appliances. Spending on services was unchanged. Income rose a slight 0.1 percent in July following a 0.3 percent June gain. Overall wages and salaries tumbled \$21.8 billion from June.

CALIFORNIA VALUES ROCKET 21 PERCENT

Home prices surge 11.9% in year

Data firm says pace of increases is the fastest spurt since 1977

U.S. home prices surged 11.9 percent in June from a year earlier, reflecting stronger demand amid a tight supply of homes for sale. CoreLogic, a real estate data provider, said Tuesday that home prices climbed on annual basis in 48 states. They fell only in Mississippi and Delaware. And all but one of the 100 largest cities reported price gains. Nevada led all states with an annual gain of 26.5 percent. That was followed by California (21.4 percent), Wyoming (16.7 percent), Arizona (16.2 percent) and Georgia (14.3 percent).

On a monthly basis, U.S. home prices rose 1.9 percent in June from May, the 16th straight month-over-month increase. U.S. home values increased 10 percent through the first six months of the year, the firm said. "Trend in home price gains is moving at the fastest pace since 1977," said Mark Fleming, CoreLogic's chief economist.

Steady price increases are the latest sign of a recovery in housing. Stable job gains and still-low mortgage rates have encouraged more Americans to buy homes. Greater demand, along with fewer homes for sale, has helped push up prices. One concern is that higher mortgage rates could slow home sales. But many economists say rates remain low by historical standards and would need to rise much faster to halt the momentum.

Previously occupied homes sold in June at a seasonally adjusted annual rate of 5.08 million, the National Association of Realtors reported last month. That's close to a 3 ½ -year high reached in May and 15.2 percent above year-ago levels. Despite the gains since last year, home prices are

still about 19 percent below the peaks they reached in April 2006, CoreLogic said. That's a key reason the supply of homes for sale remains low. Many homeowners are waiting to recoup their losses before putting their houses on the market.

Another factor in the recent price gains is that foreclosed homes, which often sell at a discount to other homes, are making up a smaller proportion of overall sales. Completed foreclosures, when the lender repossesses a home, are on track this year to hit a half-million, or about a quarter below last year's total, according to RealtyTrac Inc. Excluding "distressed" sales, which include foreclosures and short sales, no states posted home price declines last month, CoreLogic said. A short sale is when a home sells for less than what is owed on the mortgage.

UCLA Anderson School Forecast

STATE ECONOMY

California recovery has been uneven

Analysts: Job growth stunted by technology

The economic recovery in the Bay Area and California is gaining steam, yet the pace of job growth is being hampered by new technologies that enable employers to limit hiring. Economists with the closely watched UCLA Anderson Forecast say the Bay Area is leading the economic rebound in California, and that California is leading the nation. But the upswing is uneven. "This is a bifurcated recovery," said Anderson Forecast senior economist Jerry Nickelsburg.

Much of the Bay Area, Los Angeles, Orange County and San Diego enjoy robust employment growth, primarily because they benefit from high-tech and biotech employment growth. Yet the East Bay, Central Valley and Inland Empire continue to struggle to add jobs.

Even within regions of California, the rebound is not spread evenly. "If the kind of work you do can be replaced by a computer or a robot, you probably have a set of skills that will not take you very far into the future," Nickelsburg said.

High-tech job openings are plentiful, though many are contract jobs rather than full-time employment with benefits. In contrast, people in manufacturing, retail, logistics, leisure and hospitality and other sectors whose jobs can be automated or supplanted by technology are finding it tougher to land work. "There are huge differences in the Bay Area," said Jeffrey Michael, director of the Stockton-based Business Forecasting Center at University of the Pacific. "Santa Clara County and San Francisco have recovered much more quickly than the East Bay. And the East Bay was hit much harder than the other areas during the Great Recession, but it hasn't recovered yet."

Economists also believe the trend toward automation helps explain why the overall economic recovery is tepid. "We haven't had a solid jobs rebound, and the increased use of new technologies is one reason why," said Jordan Levine, director of economic research with Beacon Economics. "Companies can do more with less because they can use new technologies -- the Internet, software, new equipment, automated processes. If they need to meet rising demand for their products or services, they can do so without a major expansion of their payrolls." Even when they find employment, some Bay Area workers say the jobs aren't quite what they want. Many available technology openings are contract jobs that don't offer the health benefits and stability of full-time employment.

Despite the slow pace in job growth, California can expect a steadily improving economy as measured by gains in payroll jobs, an improvement in the unemployment rate and a rise in personal income, the UCLA Anderson Forecast found. "We are still seeing job growth, and we also are seeing more positive economic news from China, Japan and Europe," Nickelsburg said.

The forecast predicts that the state's payroll job growth will rise by 1.7 percent in 2013, 1.9 percent in 2014 and 2.2 percent in 2015. It says the jobless rate will average 8.9 percent this year, improve to an average of 7.9 percent in 2014 and drop to 6.9 percent by 2015. "The worst is behind us," said Levine of Beacon Economics.

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