



2007-08
Comprehensive
Annual Financial Report
Fiscal Year Ended June 30, 2008



**City of
Palo Alto
California**

This page is intentionally left blank.



City of Palo Alto
California

Comprehensive
Annual Financial
Report

For the fiscal year ended
June 30, 2008



Prepared by: Administrative Services Department

This page is intentionally left blank.



Table of Contents.....

INTRODUCTION

Letter of Transmittal v

City Officials ix

Organizational Structure x

Administrative Services Department Organization xi

GFOA Certificate of Achievement for Excellence in Financial Reporting xii

FINANCIAL SECTION

Independent Auditor’s Report on Basic Financial Statement..... xiii

M D & A

Management’s Discussion and Analysis..... 1

BASIC FINANCIAL STATEMENTS

Citywide Financial Statements:

Statement of Net Assets 25

Statement of Activities 26

Fund Financial Statements

Major Governmental Funds:

Balance Sheet 29

Reconciliation of Fund Balances to Governmental Activities Net Assets..... 30

Statement of Revenues, Expenditures, and Changes in Fund Balance 31

Reconciliation of the Statement of Revenues, Expenditures and Changes
in Fund Balances of Governmental Funds to the Statement of Activities..... 32

Statement of Revenues, Expenditures, and Changes in Fund Balances –
Budget and Actual – General Fund 33

BASIC FINANCIAL STATEMENTS (Continued)

Major Proprietary Funds:

Statement of Net Assets	36
Statements of Revenues, Expenses and Changes in Net Assets	38
Statement of Cash Flows.....	40

Fiduciary Funds:

Statement of Fiduciary Net Assets	45
---	----

Notes to Financial Statements

Index to the Notes to the Basic Financial Statements	47
Notes to Basic Financial Statements	49

SUPPLEMENTAL INFORMATION

Non-major Governmental Funds

Combining Balance Sheets	106
Combining Statements of Revenues, Expenditures and Changes in Fund Balances.....	110
Combining Schedule of Revenues, Expenditures and Changes in Fund Balance—Budget and Actual.....	114

Internal Service Funds

Combining Statements of Net Assets	123
Combining Statements of Revenues, Expenses and Changes in Net Assets.....	124
Combining Statements of Cash Flows.....	125

Fiduciary Funds

Statement of Changes in Assets and Liabilities - All Agency Funds.....	128
--	-----



STATISTICAL SECTION

Financial Trends

Net Assets by Component	131
Changes in Net Assets	132
Fund Balances of Governmental Funds	134
Changes in Fund Balance of Governmental Funds	136

Revenue Capacity

Electric Daily Loads and Top Customers by Usage.....	138
Electric Operating Revenue by Source	139
Assessed Value of Taxable Property.....	140
Property Tax Rates, All Overlapping Governments	141
Property Tax Levies and Collections	142
Principal Property Taxpayers	143

Debt Capacity

Ratio of Outstanding Debt by Type.....	144
Computation of Direct and Overlapping Debt.....	145
Computation of Legal Bonded Debt Margin	146
Revenue Bond Coverage.....	147

Demographic and Economic Information

Taxable Transactions by Type of Business.....	148
Demographic and Economic Statistics	149
Principal Employers	150

Operating Information

Full-Time Equivalent City Government Employees by Function	151
Operating Indicators by Function/Program.....	152
Capital Asset Statistics by Function/Program	154
Insurance Coverage.....	156



SINGLE AUDIT SECTION

Schedule of Current Year Findings and Questioned Costs 161

Section I – Summary of Auditor’s Results 161

Section II – Financial Statement Findings 162

Section III – Federal Award Findings and Questioned Costs..... 162

Section IV – Status of Prior Year Findings
and Questioned Costs 162

Schedule of Expenditures of Federal Awards..... 163

Notes to the Schedule of Expenditures of Federal Awards..... 165

Report on Internal Control over Financial Reporting and On Compliance
And Other Matters Based on an Audit of Financial Statements
Performed In Accordance with Government Auditing Standards 167

Report on Compliance with Requirements Applicable To
Each Major Program and on Internal Control Over Compliance
in Accordance with OMB Circular A-133..... 169

City of Palo Alto
Office of the City Manager

Transmittal Letter.....

December 16, 2008

THE HONORABLE CITY COUNCIL
Palo Alto, California

Attention: Finance Committee

COMPREHENSIVE ANNUAL FINANCIAL REPORT
YEAR ENDED JUNE 30, 2008

Members of the Council and Citizens of Palo Alto:

Transmittal: The Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2008, is submitted for Council review in accordance with Article III, Section 16 and Article IV, Section 13 of the City of Palo Alto Charter and published as a matter of public record for interested citizens. This transmittal letter provides information regarding the economy and the governing structure in Palo Alto. An overview of the City's financial activities for the fiscal year is discussed in detail in the Management's Discussion and Analysis section of the CAFR. While the independent auditor has expressed an opinion on the financial statements contained in this report, management takes sole responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal control that it has established for this purpose. The objective of internal controls is to provide reasonable, rather than absolute, assurance that the CAFR information is accurate in all material respects.

INDEPENDENT AUDIT

The City of Palo Alto's financial statements have been audited by Maze and Associates, a firm of licensed certified public accountants. The goal of the audit is to obtain reasonable assurance that the financial statements are free of material misstatement. Maze and Associates concluded, based on the audit, that there was a reasonable basis for rendering an unqualified opinion for the fiscal year ended June 30, 2008, and that the financial statements are fairly presented in conformity with generally accepted accounting principles (GAAP). The independent auditor's report is presented as the first component of the financial section of this report.

In addition, Maze and Associates also conducts the federally mandated "Single Audit" designed to meet the special needs of federal grantor agencies. The standards governing the Single Audit require the independent auditor to report on the fair presentation of the financial statements, government's internal controls and compliance with legal requirements. These reports are available in the Single Audit section of the CAFR.



THE PALO ALTO ECONOMY

Local Trends: The City of Palo Alto, population 63,367, is a largely “built-out” community in the heart of Silicon Valley and the greater San Francisco and San Jose areas. The adjacent Stanford University, one of the premier institutions of higher education in the nation, has produced much of the talent that founded many successful high-tech companies in Palo Alto and Silicon Valley. With varied and relatively stable employers such as Stanford University, the Stanford Medical Center, the Palo Alto Medical Foundation, the Palo Alto Unified School District, the Stanford Shopping Center and businesses such as, Hewlett-Packard Company, Varian, Space Systems Loral, Palo Alto has enjoyed a diverse employment and revenue base.

Overall, revenues remained stable in 2007-08. Sales tax receipts, for example, increased by 1.9 percent over prior year levels. Transient occupancy taxes, after adjusting for a rate increase from 10 to 12 percent in January 2008, experienced organic growth of 7.6 percent over 2006-07. Similarly, property taxes rose by 7.5 percent. Somewhat shielded from the decline in the State’s economic woes, Silicon Valley held steady as technology sales and exports remained strong.

Preliminary data for 2008-09, however, is showing weakness in the economically sensitive revenue sources. Sales taxes from automobile and department stores are trending downward, hotel days are declining, and documentary transfer taxes from home and commercial sales are weakening. Credit tightening, falling stock prices, declines in corporate profits, and retrenchment in consumer spending appear to be taking a toll. The downward spiral of the national, State, and international economies are of serious concern.

As with the economic downturns in the early 1990s and 2000s, the City can be expected to take action to align expenses with its revenues. During the dot.com collapse the City closed a \$20 million structural deficit, primarily through expense reductions. On the revenue side, the City has been active in maintaining and attracting businesses that generate tax revenues. Examples include efforts to relocate a key auto dealership, participation in a regional effort to attract hotel traffic, and discussions on expanding the well regarded Stanford Shopping Center.

Employment Trends: Palo Alto is home to a strong mix of small, medium, and large firms. Employment opportunities within the City are much sought after and include: education at Stanford University, high technology at the Stanford Research Park, and health care at two medical facilities of national stature. Numerous institutions that have more than 1,000 employees include: the University, the Veterans Affairs Palo Alto Health Care facility, the Medical Foundation, Hewlett Packard, the Palo Alto Unified School District, and the City of Palo Alto. A recent study states that “Palo Alto is home to over 98,000 workers and 6,000 businesses including a mix of high technology, private equity, and investment and venture capital firms.” Currently, Palo Alto’s unemployment rate is 3.5 percent; 4.1 percent and 2.6 percent under the State’s and national rate, respectively. The Bay Area’s ties and exports to the stronger Asian economies are expected to soften impacts on employment from the State and national economic malaise

Real Estate Market: In its most recent annual report, the Santa Clara County Assessor’s Office noted that the countywide annual rate of growth in residential and commercial assessed value has declined over the past 3 years. In 2005-06 the rate of growth was 9.6 percent; in 2006-07 it was 8.3 percent in 2007-08 it was 7.0 percent; and in 2008-09 it is expected to trend lower. The City of Palo Alto’s assessed value increased by 7.5 percent in 2007-08. These figures indicate a relatively healthy local real estate market, but recent documentary or property transfer tax revenues are softening. This may indicate a future slowdown in Palo Alto’s assessment roll growth. According to the Assessor’s Office in 2007-08 “the number of transactions recorded declined 15 percent over the prior year. In addition, the number of residential properties in which market values declined below the factored base year value, more than doubled to 41,000.” The Assessor went on to say that “just as major parts of

the residential market have cooled during the last three years, the commercial and industrial market has experienced a modest resurgence. Companies like Adobe, Facebook, Oracle, Google, e-Bay and Apple are expanding, while other companies like Sun, Yahoo, and HP are consolidating their facilities.”

Overall, demand for housing in Palo Alto remained relatively strong. In past recessions, such as in the early 1990s, Palo Alto home prices either reached a plateau or dipped slightly. With its highly regarded school district, well-educated and high income population, cultural amenities, and the presence of Stanford University, the City’s real estate values have been shielded from major price swings. With the current economic downturn, this phenomenon is likely to repeat itself.

Long Range Financial Forecast: The City of Palo Alto produces a 10 year Long Range Financial Forecast (LRFF) annually. This comprehensive report analyzes, for example, local, state, and federal economic conditions; short and long-term revenue and expense trends; expense challenges such as funding retiree medical benefits; revenue opportunities such as instituting an occupancy tax increase; and infrastructure needs. The forecast is designed to highlight finance issues which the City can address proactively. Moreover, it is a tool that allows policymakers an opportunity to prioritize funding needs over time.

Delivered to Council in December, this forecast sets the tone and themes for the annual budget process that begins in January. The forecast is one of the many tools and reports the City uses for financial planning. These include, for example: quarterly revenue and expense analyses, midyear budget adjustments, a five year capital improvement plan, quarterly sales tax reports, and actuarial reports to ascertain long-term retiree liabilities. Basically, the City is conscientious and pro-active in financial planning. It is worthwhile to note that during the last two economic downturns, the City has balanced its annual budget via expenditure reductions or revenue enhancements and has not drawn down reserves, as a consequence of revenue shortfalls.

Cash and Investments: The City of Palo Alto invests its excess cash prudently and has adopted an investment policy as prescribed by State law. The policy states that investments are to be made in the following priority order: safety, liquidity, and yield. As of June 30, 2008, the City had \$371.8 million (par value) in its portfolio. Its principal investments were in agency securities, treasuries, and a State of California investment pool. The City’s investment practice is to buy securities and hold them to maturity to avoid principal loss. Staff provides a quarterly report of investments for Council review. During 2007-08, staff complied with all requirements of the City’s investment policy.

THE PALO ALTO GOVERNMENT

As a charter city delivering a full range of municipal services and public utilities under the council-manager form of government, Palo Alto offers an outstanding quality of life for its residents. The independent Palo Alto Unified School District (PAUSD) has achieved state and national recognition for the excellence of its programs. The City has dedicated 4,000 acres of open space to parks and wildlife preserves. Public facilities include five libraries, four community centers, a cultural arts center, an adult and children’s theater, a junior museum and zoo, and a golf course. The City provides a diversity of human services for seniors and youths, an extensive continuing education program, concerts, exhibits, team sports and special events.

City Council: The Council consists of nine members elected at-large for four-year, staggered terms. At the first meeting of each calendar year, the Council elects a Mayor and Vice-Mayor from its membership, with the Mayor having the duty of presiding over Council meetings. The Council is the appointing authority for which the City Manager and three other officials, the City Attorney, City Clerk, and City Auditor, report directly to.

Finance Committee: While retaining the authority to approve all actions, the City Council has established a subcommittee to review financial matters. Staff provides the CAFR, the results of external and internal audits, periodic budget-versus-actual, and investment and performance measure reports to the Finance Committee and Council to assist in their evaluation of the City’s financial performance.

City Manager: The City Manager directs administrative services, human resources, libraries, public works, planning and community environment, public safety, community services departments and also the municipal electric, water, gas, wastewater collection, wastewater treatment, storm drainage, and refuse utilities (the utilities represent almost two-thirds of the City’s revenues).

SUMMARY

Awards: During the past year, the City received an award for the prior fiscal year CAFR, from the Government Finance Officers Association (GFOA) for “excellence in financial reporting”. The 2007-08 CAFR has been submitted to the GFOA award program and management believes that, once again, it will meet the criteria for this distinguished financial reporting award.

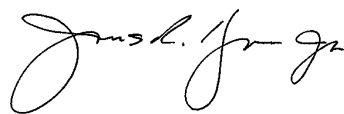
Acknowledgment: This CAFR reflects the hard work, talent and commitment of the staff members of the Administrative Services Department. This document could not have been accomplished without their efforts and each contributor deserves sincere appreciation. Management wishes to acknowledge the support of Trudy Eikenberry, Accounting Manager, and the Senior Accountants, Staff Accountants, Payroll Analysts and Accounting Specialists for the high level of professionalism and dedication they bring to the City of Palo Alto. Management would also like to express its appreciation to Maze & Associates, the City’s independent auditors, who assisted and contributed to the preparation of this Comprehensive Annual Financial Report.

Special acknowledgment must be given to the City Council Finance Committee for its support and interest in directing the financial affairs of the City in a responsible, professional and progressive manner.

Respectfully submitted,



LALO PEREZ,
Administrative Services Director



JAMES KEENE,
City Manager



City of Palo Alto City Officials

City Council

Larry Klein, *Mayor*

Peter Drekmeier, *Vice-Mayor*

John Barton

Patrick Burt

Sid Espinosa

Yoriko Kishimoto

Jack Morton

Greg Schmid

Yiaway Yeh

Finance Committee

Jack Morton, *Chair*

Patrick Burt

Greg Schmid

Yiaway Yeh

Policy and Services Committee

Yoriko Kishimoto, *Chair*

John Burton

Peter Drekmeier

Sid Espinosa

Council-Appointed Officers

City Manager

Frank Benest

City Attorney

Gary Baum

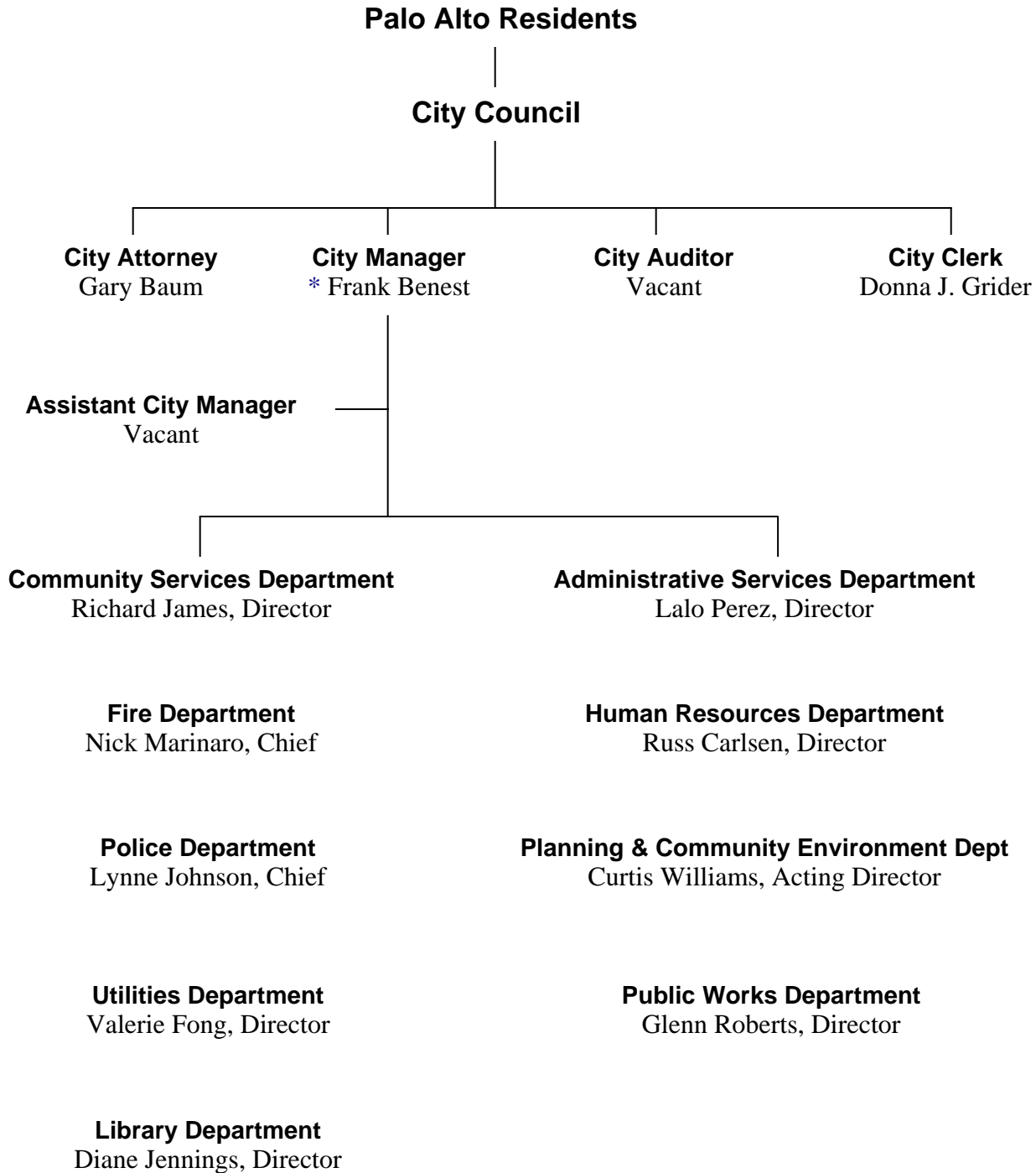
City Clerk

Donna Grider

City Auditor

Vacant

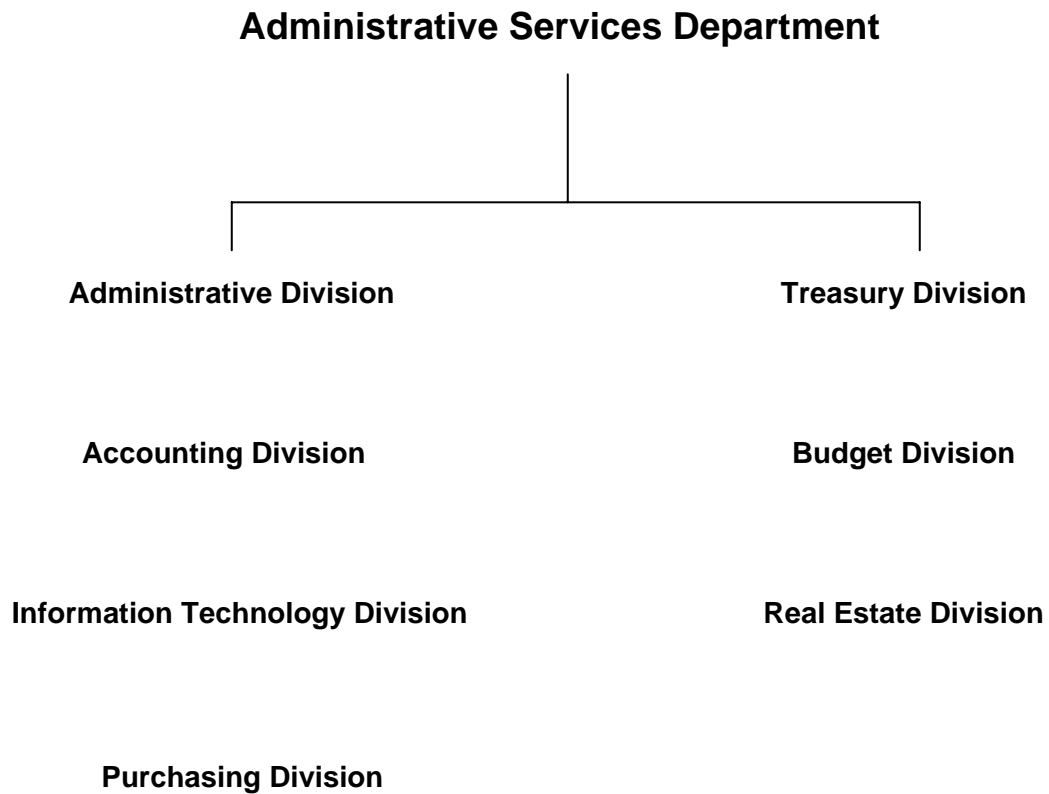
City of Palo Alto Organization



*through August 29, 2008. James Keene, effective September 2, 2008



Administrative Services Organization



Mission Statement

To provide proactive administrative and technical support to City departments and decision makers, and to safeguard and facilitate the optimal use of City resources.

Government Finance Officers Association of the United States and Canada - Award

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Palo Alto
California

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2007

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Oliver S. Cox

President

Jeffrey R. Emery

Executive Director

Independent Auditor's Report.....

MAZE & ASSOCIATES

INDEPENDENT AUDITOR'S REPORT ON BASIC FINANCIAL STATEMENTS

ACCOUNTANCY CORPORATION
3478 Buskirk Ave. - Suite 215
Pleasant Hill, California 94523
(925) 930-0902 • FAX (925) 930-0135
maze@mazeassociates.com
www.mazeassociates.com

Honorable Mayor and City Council
City of Palo Alto, California

We have audited the basic financial statements of the governmental activities, business-type activities, each major fund and the aggregate remaining fund information of the City of Palo Alto, California as of and for the year ended June 30, 2008, which collectively comprise the City's basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America and the standards for financial audits contained in *Government Auditing Standard*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining on a test basis evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Palo Alto, California as of June 30, 2008 and the respective changes in the financial position and cash flows, where applicable thereof and the respective budgetary comparisons listed as part of the basic financial statements for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Notes 7 and 12, the City implemented the provisions of Governmental Accounting Standards Board Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* and GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

In accordance with Government Auditing Standards, we have also issued our report dated October 24, 2008 on our consideration of the City of Palo Alto's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The supplemental section listed in the Table of Contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The Introductory and Statistical Sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly we express no opinion on them.

October 24, 2008

Maze + Associates

A Professional Corporation



This page is intentionally left blank.



Management's Discussion and Analysis

Management's Discussion and Analysis (MD&A) provides an overview of the City of Palo Alto's financial performance for the 2007-08 fiscal year ended June 30, 2008. To obtain a complete understanding of the City's financial condition, this document should be read in conjunction with the accompanying Transmittal Letter and Basic Financial Statements.

OVERVIEW OF THE COMPREHENSIVE ANNUAL FINANCIAL REPORT

The CAFR is presented in six sections:

- An introductory section which includes the Transmittal Letter and general information;
- Management's Discussion and Analysis;
- The Basic Financial Statements which include the Citywide and Fund Financial Statements, along with the Notes to these statements;
- Supplemental Information;
- Statistical Information; and
- Single Audit

Basic Financial Statements

The Basic Financial Statements contain the Citywide Financial Statements and the Fund Financial Statements. These statements provide long and short-term views of the City's financial activities and financial position.

The Citywide Financial Statements provide a longer-term view of the City's activities as a whole. They include the Statement of Net Assets and the Statement of Activities. The Statement of Net Assets includes the City's capital assets and long-term liabilities on a full accrual basis of accounting similar to that used by private-sector companies. The Statement of Activities provides information about the City's revenues and expenses on a full accrual basis, with an emphasis on measuring net revenues or expenses for each of the City's programs. The Statement of Activities explains in detail the change in net assets for the year. The amounts in the Statement of Net Assets and the Statement of Activities are separated into Governmental and Business-type Activities in order to provide a summary of these activities for the City.

The Fund Financial Statements display the City's operations in more detail than the Citywide statements. Their focus is primarily on the short-term activities of the City's General Fund and



other major funds such as the Capital Projects Fund, Water Services Fund, Electric Services Fund, Gas Services Fund, Wastewater Collection Fund, Wastewater Treatment Fund, Refuse Services Fund, Storm Drainage Services Fund and External Services Fund.

For certain entities and funds, the City acts solely as a depository agent. For example, the City has several Assessment Districts for which it produces fiduciary statements detailing the cash balances and activities of these districts. These statements are independent, and their balances are excluded from the City's financial statements.

Together, all these statements are called the Basic Financial Statements.

Citywide Financial Statements

Governmental Activities - All of the City's basic services are considered to be Governmental Activities. Included in basic services are the City Council, City Manager, City Attorney, City Clerk, City Auditor, Administrative Services, Human Resources, Public Works, Planning and Community Development, Police, Fire, Community Services, and Library. These services are supported by general City revenues such as taxes and by specific program revenues such as fees.

The City's governmental activities also include the activities of the Palo Alto Public Improvement Corporation and the Redevelopment Agency which are separate legal entities financially accountable to the City.

Business-type Activities - All of the City's enterprise activities are reported as Business-type Activities, including Water, Electric, Gas, Wastewater Collection, Wastewater Treatment, Refuse, Storm Drainage, and External Services. Unlike governmental services, these services are supported by charges paid by customers based on services used.

Citywide Financial Statements are prepared on the accrual basis of accounting, which means they measure the flow of all economic resources for the City as a whole.

Fund Financial Statements

The Fund Financial Statements provide detailed information about each of the City's most significant funds, called Major Funds. The concept of Major Funds, and the determination of which are Major Funds, was established by GASB 34 and replaces the concept of combining like funds and presenting them in total. Therefore, each Major Fund is presented individually, with all Non-major Funds combined in a single column on each fund statement. Subordinate schedules display these Non-major Funds in more detail. Major Funds present the major activities of the City for the year. The General Fund is always considered a Major Fund, but other funds may change from year to year as a result of changes in the pattern of City activities.

Fund Financial Statements include Governmental, Enterprise and Internal Service Funds.

Governmental Fund financial statements are prepared on the modified accrual basis of accounting, which means they measure only current financial resources and uses. Capital assets and other long-lived assets, along with long-term liabilities, are presented only in the Citywide Financial



Statements. In 2007-08, the City had two Major Governmental Funds, the General Fund and the Capital Projects Fund.

Enterprise and Internal Service Fund financial statements are prepared on the full accrual basis of accounting, similar to that used by private-sector companies. These statements, as in the past include all their assets and liabilities, current and long-term.

Since the City's Internal Service Funds provide goods and services exclusively to the City's Governmental and Business-type Activities, their activities are only reported in total at the Fund level. Internal Service Funds, such as Printing and Mailing services, can not be considered Major Funds because their revenues are derived from other City Funds. Revenues between Funds are eliminated in the Citywide Financial Statements and any related profits or losses in Internal Service Funds are returned to the activities in which they were created, along with any residual net assets of the Internal Service Funds.

Budget vs. Actual financial comparisons information are presented only for the General Fund and all Major Special Revenue Funds.

Fiduciary Statements

The City is the fiduciary agent for certain assessment districts, holding amounts collected from property owners which await transfer to these Districts' bond trustees. The City's fiduciary activities are reported in the separate Statements of Fiduciary Net Assets and the Agency Funds Statement of Changes in Assets and Liabilities. These activities are excluded from the City's other financial statements because the City cannot utilize these assets to finance its own operations.

FINANCIAL HIGHLIGHTS

Economic Background

The U.S. has and continues to deal with its worst financial crisis since the Great Depression. The economy is faced with a tight credit market, growing unemployment, imploding banks, and a severe housing downturn. The State of California continues to face budget and revenue shortfalls that have led to a request for cash flow from the federal government. Through 2007-08 the local, Silicon Valley economy turned in a steady performance and was somewhat immune from factors affecting the larger economy. The technology sector and exports, particularly to Asian markets, lessened the adverse economic impacts suffered by the rest of California and the nation.

Evidence is beginning to emerge in 2008-09, however, that consumer and business confidence is eroding and that it will lead to declines in economically sensitive revenue sources such as sales and transient occupancy taxes. Sales taxes in the City of Palo Alto and surrounding cities have weakened in recent quarters; hotel days are moving downward slowly; and growth in assessed property values has slowed. Based on these trends, 2008-09 will likely present financial challenges.

As in the past, the City continues to face and address a number of expense and revenue challenges. These include: funding existing and new infrastructure needs; warding off strong competition from neighboring city retail outlets for sales tax dollars; preventing the potential exodus of key sales tax generators; and evaluating benefit costs such as rising medical premiums.

The City is proactive in dealing with these challenges. Currently, it is working with Stanford Shopping Center to expand its retail space and to build a new hotel on its premises. In January 2008, the City increased its transient occupancy tax from 10 to 12 percent to enhance its revenue base. In addition, the City is investigating a Business License Tax since it is one of a very few California cities without one. With an underlying triple A credit rating from Standard and Poor's, the City intends to maintain its sound financial and budget practices during this period of economic distress.

Citywide

- The City's total net assets increased to \$1,100.0 million, a \$38.3 million increase.
- The City's total capital assets, net of related debt, increased to \$713.8 million, a \$44.5 million increase.
- The City's total restricted net assets decreased to \$29.2 million, a \$5.1 million decrease.
- The City's total unrestricted net assets decreased to \$357.0 million, a \$1.1 million decrease.
- Citywide revenues totaled \$402.0 million, an increase of \$30.8 million from the prior year. This total consists of \$291.1 million in program revenues and \$110.9 million in general revenues. Program revenues increased by \$20.2 million and general revenues increased by \$10.5 million.
- Total Citywide expenses were \$363.7 million, a \$40.7 million increase.
- Citywide total assets increased to \$1,223.4 million, a \$54.1 million increase.
- Citywide capital assets, increased by \$49.0 million to \$768.5 million.
- Citywide other assets increased \$5.1 million to \$454.9 million.
- Citywide total liabilities were \$123.4 million, an increase of \$15.8 million.
- Citywide long-term debt increased \$4.5 million to \$54.7 million.
- Citywide other liabilities were \$68.7 million, an increase of \$11.3 million.

Fund Level – Governmental Funds

- Governmental Fund balances decreased to \$103.9 million, a \$1.6 million decrease.
- Governmental Fund revenues increased to \$127.0 million, a \$3.8 million increase.
- Governmental Fund expenditures were \$145.2 million, a \$14.5 million increase.
- General Fund revenues came in at \$115.0 million, an increase of \$4.2 million over the prior year.
- General Fund expenditures are \$115.5 million, an increase of \$7.2 million.
- The General Fund balance of \$42.4 million at June 30, 2008 was an increase of \$3.0 million from the prior year (refer to Performance of Governmental Funds – General Fund, Page #14).



Fund Level - Enterprise Funds

- Enterprise Fund net assets increased to \$600.1 million, a \$24.1 million increase.
- Enterprise Fund operating revenues increased to \$251.7 million, a \$20.1 million increase from prior year revenues.
- Enterprise Fund operating expenses increased to \$215.8 million, a \$25.5 million increase.

FINANCIAL PERFORMANCE

Citywide Financial Statements – Governmental Activities

The following analysis focuses on the net assets and changes in net assets of the City’s Governmental Activities, presented in the Citywide Statement of Net Assets and Statement of Activities.

GOVERNMENTAL ACTIVITIES			
<i>Net Assets at June 30</i>			
(in Millions)			
	<u>2008</u>	<u>2007</u>	<u>Increase/ (Decrease) from 2007</u>
Cash and investments	\$149.9	\$173.0	(\$23.1)
Other assets	53.0	29.3	23.7
Capital assets	351.9	335.7	16.2
Total Assets	<u>554.8</u>	<u>538.0</u>	<u>16.8</u>
Long-term debt outstanding	8.4	9.3	(0.9)
Other liabilities	45.0	42.5	2.5
Total Liabilities	<u>53.4</u>	<u>51.8</u>	<u>1.6</u>
Net Assets:			
Invested in capital assets, net of debt	343.5	326.4	17.1
Restricted	27.4	32.6	(5.2)
Unrestricted	130.5	127.2	3.3
Total Net Assets	<u><u>\$501.4</u></u>	<u><u>\$486.2</u></u>	<u><u>\$15.2</u></u>

The City’s governmental total net assets increased \$15.2 million to \$501.4 million in 2007-08. This change results from the following:

- Cash and investments decreased by \$23.1 million primarily from the transfer of \$33.8 million to California Employers Retirees Benefit Trust (CERBT). The irrevocable trust provides a funding mechanism for retiree post-employment benefits. The offset to the decreased cash is the increase of other assets of \$23.8 million. (please refer to Note 12 for details of Retiree Health Benefits and implementation of GASB 45).

- Capital assets increased \$16.2 million net of depreciation; \$6.2 million for buildings and improvements, \$4.5 million is a result of roadway network and \$1.7 million for land and improvements.
- Other liabilities increased by \$2.5 million, primarily from a \$2.4 million increase in claims payable.
- Net assets invested in capital assets, net of related debt increased \$17.1 million as the City added General Fund infrastructure assets as discussed in the Capital Assets section.
- Unrestricted net assets increased \$3.3 million for a total of \$130.5 million; this represents current net assets available to finance subsequent year operations and other expenditures approved by City Council.

GOVERNMENTAL ACTIVITIES

Revenues for the Year ended June 30

(in Millions)

Revenues by Source	2008	2007	Increase/ (Decrease) from 2007
Program Revenues:			
Charges for services	\$31.9	\$31.1	\$0.8
Operating contributions & grants	4.0	5.6	(1.6)
Capital contributions & grants	1.9	1.8	0.1
Total Program Revenues	37.8	38.5	(0.7)
General Revenues:			
Property Taxes	23.1	21.5	1.6
Sales Taxes	22.6	22.2	0.4
Utility User's Taxes	10.3	9.4	0.9
Transient Occupancy Tax	8.0	6.7	1.3
Other Taxes and Fines	6.3	6.3	0.0
Investment Earnings	12.3	8.7	3.6
Rents and Miscellaneous	11.9	13.7	(1.8)
Total General Revenues	94.5	88.5	6.0
Total Revenues	\$132.3	\$127.0	\$5.3

Governmental Activities – Revenues

The table above shows that governmental revenues totaled \$132.3 million in 2007-08, an increase of \$5.3 million compared to prior year revenues of \$127.0 million.

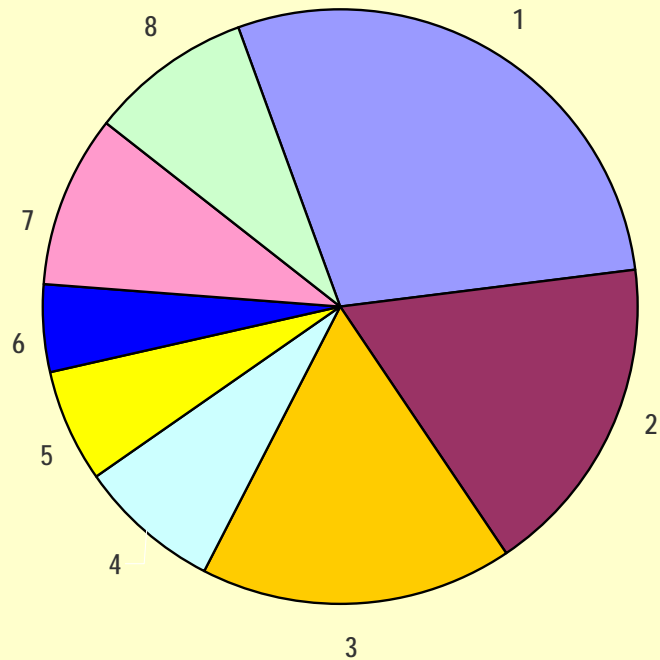
Property taxes had an increase of \$1.6 million, sales taxes increased by \$0.4 million, the utility user’s tax rose by \$0.9 million, and transient occupancy taxes by \$1.3 million. Investment earnings increased by \$3.6 million. This is a result of the year-end adjustment to carrying value for investments and reflects the year to year change in carrying value. This mark to market value is a requirement of GASB 31.

Miscellaneous revenues had a decrease of \$1.8 million from the prior year. The prior year included an accounting reclassification of inter-department revenues and charges.

Program revenues such as charges for services; operating grants and contributions; and capital grants and contributions are generated from or restricted to each activity. Program revenues include contributions from the University Avenue Off-Street Parking Assessment District as well as other recurring resources.

Sources of Revenues

- 1- Program Revenues - 29%
- 2- Property Taxes - 18%
- 3- Sales Taxes - 17%
- 4- Utility User's Taxes - 8%
- 5- Transient Occupancy Tax - 6%
- 6- Other Taxes & Fines - 5%
- 7- Investment Earnings - 9%
- 8- Rents and Miscellaneous - 8%



General revenues are composed of taxes and other revenues not specifically generated by or restricted to individual activities. All tax revenues, investment earnings, rents for governmental facilities, and fees for services are included in general revenues.

Governmental Activities – Expenses

The table below presents a comparison of 2007-08 and 2006-07 expenses (does not include encumbrances and reappropriations) by Governmental Activities and interest on long-term debt. Total Governmental Activities functional expense was \$135.7 million in 2007-08, an increase of \$14.1 million.

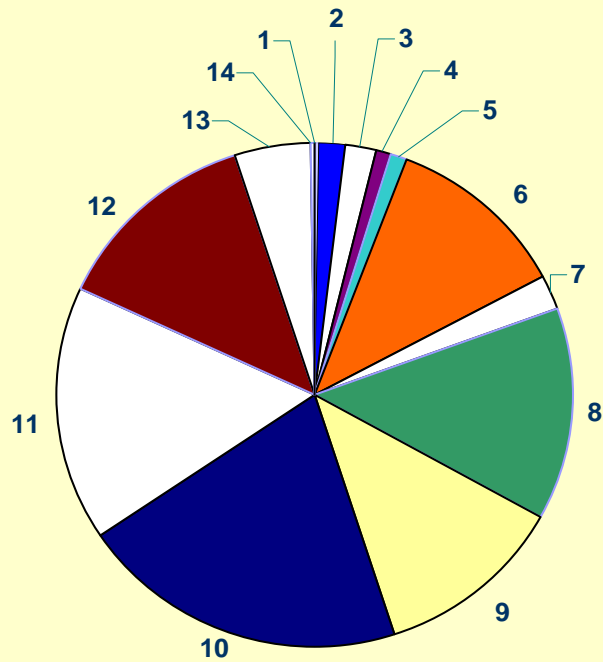
GOVERNMENTAL ACTIVITIES			
<i>Expenses for the Year ended June 30</i>			
(in Millions)			
Activities	2008	2007	Increase/ (Decrease) from 2007
City Council	\$0.3	\$0.2	\$0.1
City Manager	2.3	1.8	0.5
City Attorney	2.7	2.4	0.3
City Clerk	1.2	0.9	0.3
City Auditor	1.4	0.8	0.6
Administrative Services **	15.5	6.4	9.1
Human Resources	2.8	2.5	0.3
Public Works	18.6	16.6	2.0
Planning and Community Environment	16.4	12.9	3.5
Police	27.7	23.9	3.8
Fire	22.4	19.5	2.9
Community Services	17.7	15.7	2.0
Library	6.3	5.4	0.9
Non-Departmental **	0.0	12.1	(12.1)
Interest on long-term debt	0.4	0.5	(0.1)
Total Functional Expense	\$135.7	\$121.6	\$14.1
Increase/(Decrease) in Net Assets before Transfers	(3.5)	5.3	(8.8)
Transfers in	\$18.7	\$15.8	\$2.9
Change in Net Assets	\$15.2	\$21.1	(\$5.9)
Net Assets-Beginning	486.2	465.1	21.1
Net Assets-Ending	\$501.4	\$486.2	\$15.2

** FY 07-08 includes expenditures classified as Non-Departmental in prior years (GFOA recommendation).

The Functional Expenses Chart below includes only current year expenses. It does not include capital outlays, which are now added to the City’s capital assets. In 2007-08, the City added \$16.2 million in capital assets. The composition of 2007-08 additions is shown in detail in the Capital Asset section of the Management’s Discussion and Analysis.

Functional Expense

- 1- City Council - less than 1%
- 2.- City Manager 2%
- 3- City Attorney 2%
- 4- City Clerk 1%
- 5- City Auditor 1%
- 6- Adminstrative Services 11%
- 7- Human Resources 2%
- 8- Public Works 14%
- 9- Planning & Community Environment 12%
- 10-Police 21%
- 11-Fire 17%
- 12-Community Services 13%
- 13-Library 5%
- 14-Interest on long-term debt < 1 %



Citywide Financial Statements – Business-Type Activities

The following analysis focuses on the net assets and changes in net assets of the City’s Business-type Activities presented in the Citywide Statement of Net Assets and Statement of Activities.

BUSINESS-TYPE ACTIVITIES

Net Assets at June 30

(in Millions)

	<u>2008</u>	<u>2007</u>	<u>Increase/ (Decrease) from 2007</u>
Cash and investments	\$218.6	\$222.5	(\$3.9)
Other assets	33.3	25.0	8.3
Capital assets	416.6	383.8	32.8
Total Assets	<u>668.5</u>	<u>631.3</u>	<u>37.2</u>
Long-term debt outstanding	46.4	40.9	5.5
Other liabilities	23.6	14.9	8.7
Total Liabilities	<u>70.0</u>	<u>55.8</u>	<u>14.2</u>
Net assets:			
Invested in capital assets, net of debt	370.3	342.9	27.4
Restricted	1.7	1.7	0.0
Unrestricted	226.5	230.9	(4.4)
Total Net Assets	<u>\$598.5</u>	<u>\$575.5</u>	<u>\$23.0</u>

The City's Business-type total net assets increased \$23.0 million to \$598.5 million in 2007-08.

- Cash and investments decreased \$3.9 million as a result of capital financing operations.
- Other assets increased \$8.3 million to \$33.3 million primarily as the result of an increase of \$11.0 million in Accounts Receivable.
- Capital assets increased \$32.8 million to \$416.6 million in 2007-08. This increase is primarily a result of water, electric and gas infrastructure improvements totaling \$21.0 million and wastewater treatment infrastructure additions totaling \$10.9 million.
- Net assets invested in capital assets net of related debt increased \$27.4 million to \$370.3 million. The increase was mostly due to \$4.4 million of improvements in the Gas Fund, \$6.6 million in Electric Fund improvements, \$3.9 million in Storm Drain Fund improvements and \$7.7 million in Wastewater Treatment Fund improvements.
- Unrestricted net assets of \$226.5 million, a decrease of \$4.4 million over the prior year, represent liquid assets available to finance day-to-day operations and other expenditures approved by the City Council. This amount includes Council designated reserves such as the rate stabilization reserves of \$87.7 million, the Calaveras reserve for stranded costs of \$70.4 million and the emergency plant replacement reserve of \$9.4 million.

BUSINESS-TYPE ACTIVITIES

Revenues for the Year ended June 30

(in Millions)

Revenues by Source	2008	2007	Increase/ (Decrease) from 2007
Program Revenues:			
Water	\$27.5	\$24.0	\$3.5
Electric	103.8	102.6	1.2
Gas	49.0	42.2	6.8
Wastewater Collection	15.7	15.1	0.6
Wastewater Treatment	22.9	17.0	5.9
Refuse	28.8	25.5	3.3
Storm Drainage	5.5	5.2	0.3
External Services	0.1	0.8	(0.7)
Total Program Revenues	253.3	232.4	20.9
General Revenues:			
Investment Earnings	16.4	11.9	4.5
Total General Revenues	16.4	11.9	4.5
Total Revenues	\$269.7	\$244.3	\$25.4

The table above presents the revenues for each of the City’s Business-type Activities or Enterprise Funds. The City operates the Water, Electric, Gas, Wastewater Collection, Wastewater Treatment, Refuse, Storm Drainage and External Services Enterprise Funds, which are Major Funds and are presented in the Basic Financial Statements.

Business-type Activity revenues totaled \$269.7 million, an increase of \$25.4 million from the prior year. Revenues were significantly affected by the following events:

- Program Revenue for the Water Fund increased \$3.5 million primarily due to a 10 percent rate increase effective July 1, 2007.
- Program Revenue for the Gas Fund increased \$6.8 million primarily due to a 9.5 percent rate increase effective July 1, 2007.
- Program Revenue for the Wastewater Treatment Fund increased \$5.9 million primarily due to a \$2.9 million grant for the Water Reclamation Project and \$2.1 million due to increased revenue from the member partners.
- Program Revenue for the Refuse Fund increased \$3.3 million primarily due to a 13 percent rate increase effective July 1, 2007.
- Investment earnings increased \$4.5 million due to the year-end adjustment to the carrying value for investments.

BUSINESS-TYPE ACTIVITIES

Expenses for the Year ended June 30

(in Millions)

Activities	2008	2007	Increase/ (Decrease) from 2007
Water	\$18.9	\$16.8	\$2.1
Electric	108.0	99.2	8.8
Gas	37.2	30.7	6.5
Wastewater Collection	12.0	10.0	2.0
Wastewater Treatment	18.9	15.9	3.0
Refuse	28.8	25.4	3.4
Storm Drainage	3.2	2.6	0.6
External Services	1.0	0.8	0.2
Total Functional Expense	\$228.0	\$201.4	\$26.6
Increase in Net Assets before Transfers/Special Items	41.7	42.8	(1.1)
Transfers/Special Items			
Special Item	0.0	0.0	0.0
Transfers out	18.7	15.8	2.9
Total Transfers/Special Items	\$18.7	\$15.8	\$2.9
Change in Net Assets	\$23.0	\$27.0	(\$4.0)
Net Assets-Beginning	575.5	548.5	27.0
Net Assets-Ending	<u>\$598.5</u>	<u>\$575.5</u>	<u>\$23.0</u>

The table above presents a comparison of the 2007-08 and 2006-07 expenses for the City's Business-type Activities. Encumbrances and reappropriations are not included.

Business-type Activity expenses, transfers and special items increased \$29.5 million for a total of \$246.7 million. Changes to expenses were significantly affected by the following events:

- Functional Expense for the Electric Fund increased \$8.8 million primarily due to the net of a \$12.0 million increase in the retail purchase of utilities and a \$3.4 million decrease in Surplus Energy costs. Both costs are associated with the decrease in Surplus Energy revenue due to unfavorable weather conditions. (Further detail may be found in Note 16 to the financial statements).
- Functional Expense for the Gas Fund increased \$6.5 million, primarily due to \$5.0 million increase in commodity costs associated with declining production and increasing demand. (Further detail may be found in Note 16 to the financial statements).



Management Discussion and Analysis

- Functional Expense for the Wastewater Treatment Fund increased \$3.0 million primarily due to operational and maintenance charges which increased \$1.1 million.
- Functional Expense for the Refuse Fund increased \$3.4 million primarily due to a \$1.5 million increase from Palo Alto Sanitation Company (PASCO) charges.

FUND FINANCIAL STATEMENTS

Performance of Governmental Funds

At June 30, 2008, the City's Governmental Funds reported combined fund balances of \$103.9 million, a decrease of \$1.6 million or 1.5 percent compared with the prior year.

Governmental Fund revenues and other financing sources increased \$9.5 million for a total of \$160.4 million. Revenues and other financing sources in the General Fund increased \$5.8 million; Capital Project Fund increased \$5.2 million and Non-major Fund revenues and other financing sources decreased by \$1.5 million.

Governmental Fund expenditures and other uses increased \$15.5 million this year to \$162.1 million. General Fund expenditures and other uses increased \$8.0 million, Capital Projects Fund expenditures increased by \$4.6 million; and Non-major Fund expenditures and other uses increased by \$2.9 million.

General Fund – The General Fund ended the year with a \$3.0 million increase for a total of \$42.4 million fund balance, compared to \$5.2 million increase in the prior year.

Palo Alto's General Fund revenues totaled \$115.0 million in 2007-08. This represents an increase of \$4.2 million or 3.8 percent compared to the prior year.

Property Taxes increased by \$1.6 million or 7.5 percent from 2006-07 to 2007-08. Although Palo Alto's assessed values remains healthy for 2008-09, preliminary data indicates the growth in assessed values will be moderating. The Santa Clara Assessor recently said that the "assessment roll contains clear evidence that Silicon Valley is not immune to the national recession and economic meltdown in the residential real estate market."

Sales taxes rose by \$0.4 million or 1.9 percent over 2006-07 levels. Apparel stores, furniture and appliance, service stations, and office equipment turned in a strong performance. Department stores, automobile dealerships, electronic equipment, business services, and light industry had weak results.

The City's Utility Users Tax (UUT), which is 5 percent, is levied on telephone, water, electricity, and gas usage. This revenue source rose by \$0.9 million or 9.9 percent over the prior year. Actual revenue exceeded the budget by \$0.7 million or by 7.5 percent. Utility rates increased considerably over the prior year due to commodity costs and the building of reserve levels.

Transient Occupancy Tax (TOT) receipts rose to \$8.0 million in 2007-08, a \$1.3 million or 18.9 percent increase over the prior year. However, 59 percent or \$760 thousand of the \$1.3 million



increase is attributable to the TOT rate increasing from 10 percent to 12 percent in January 2008. Average occupancy and room rates increased over the prior year from 72.4 percent to 75.5 percent and from \$140 to \$149, respectively. This economically sensitive revenue source is anticipated to soften in 2008-09 due to the economic downturn.

Other Taxes, Fines & Penalties totaled \$7.8 million in 2007-08, a decrease of \$0.9 million from the prior year. After two years of solid results, The Documentary Transfer Tax came in at \$5.4 million, a decline of 7.8 percent from the prior year. Actual revenue results were in alignment with the 2007-08 budget. This revenue source is highly dependent on sales volume and the mix of commercial and residential sales. As with property tax projections, a softening in this sector is anticipated. Parking violations decreased by \$0.4 million from the prior year.

Charges for Services were \$19.3 million in 2007-08, a decrease of \$0.5 million from the prior year and a decrease of \$1.1 million from the adopted budget. This decrease is primarily due to decreases in plan check fees of \$0.6 million from the prior year and architect review board fees, which fell short of the prior year by \$0.3 million. Zoning plan check fees decreased by \$0.2 million from the prior year.

Permits and Licenses were \$4.8 million in 2007-08, an increase of \$0.3 million from the prior year and a decrease of \$1.2 million from the adjusted budget. The decrease is mainly due to decreases in new construction building permits and lower street cut fees.

Other Revenues totaled \$7.9 million in 2007-08, an increase of \$2.0 million from the prior year and an increase of \$3.4 million from the adjusted budget. This increase is primarily due to a \$1.5 million increase in the year-end adjustment to the carrying value of investments, partially offset by a \$0.6 million decrease in state revenues. A \$0.7 million increase was due to the sale of the Eyerly condominium property.

At June 30, 2008, the General Fund Balance totaled \$42.4 million. This represents 36.7 percent of direct General Fund expenditures providing a buffer against unexpected financial events. Of this, \$11.1 million is reserved and \$31.3 million is unreserved. Included in the reserved amount is \$2.0 million for the prepayment of Storm Drain rate increases over a three year period. A substantial portion of the unreserved balance amount is designated by the Council for budget stabilization, \$26.1 million at year-end. The designation for equity transfer stabilization designation, established in 2001-02, amounted to \$3.5 million at year-end. This reserve would be utilized in the event that the Electric or Gas Funds were not in a position to make their required equity transfer to the General Fund.

General Fund expenditures and other uses totaled \$129.1 million, an increase of \$8.0 million from the prior year. Transfers out increased by \$0.8 million from the prior year to \$13.7 million due to the transfer of the Eyerly Family Trust to a Permanent Fund for reporting purposes.

The Planning department had an increase in expenditures and encumbrances of \$0.4 million from the prior year for a total of \$10.1 million. This increase was primarily due to an increase in salaries and benefits.

Administrative departments had an increase of \$1.8 million to the adopted budget for a final budget of \$19.1 million. This increase was due to increases in legal fees of \$0.8 million, contract



Management Discussion and Analysis

expense of \$0.4 million, audit fees of \$0.1 million and salaries and benefits of \$0.6 million. Administrative departments had an increase in expenditures and encumbrances of \$2.0 million from the prior year. This increase was due to salaries and benefits of \$1.5 million and contract services expenditures of \$0.5 million.

Community Services department expenditures and encumbrances were \$0.9 million greater than the prior year. This was primarily due to an increase in salaries and benefits of \$0.7 million.

The Police department had an increase of \$1.8 million to the adopted budget for a final budget of \$29.8 million. This increase was primarily due to an increase of \$1.7 million in salary and benefits of which \$0.7 was the PAPOA contract settlement. The Police department expenditures and encumbrances were \$3.7 million greater than prior year primarily due to an increase in salaries and benefits of \$3.7 million.

The Fire department had an increase of \$1.4 million to the adopted budget for a final budget of \$24.3 million. This increase was due to increases in salaries and benefits of \$1.0 million and indirect charges of \$0.3 million. Fire department had an increase of \$2.4 million from prior year for expenditures and encumbrances mainly due to an increase in salaries and benefits of \$2.3 million.

The Library department expenditures and encumbrances were \$0.9 million greater than prior year due to salaries and benefits of \$0.6 million and supplies and materials of \$0.3 million.

Transfers out had an increase of \$4.9 million to the adopted budget for a final budget of \$15.6 million. This increase was due to a \$3.1 million increase in the transfer for infrastructure reserve to the Capital Projects Fund and a \$1.7 million increase in the transfer to the Storm Drain Fund for the water pump station.

Capital Projects Fund – Capital Projects Fund expenditures and other uses were \$21.7 million in 2007-08, which is an increase of \$4.6 million from the prior year. This increase is mainly the result of increase expenditures of capital projects of \$4.7 million and a decrease of \$0.2 million in other financing uses. This level of expenditure is consistent with the City’s effort to rehabilitate and maintain its existing infrastructure.

Non-major Funds -These funds are not presented separately in the Basic Financial statements, but are individually presented as Supplemental Information.



Performance of Enterprise Funds

At June 30, 2008, the City's Enterprise Funds reported total net assets of \$600.1 million, an increase of \$24.1 million or 4.2 percent compared with the prior year. The Water and Gas Funds net assets increased \$7.5 million and \$9.3 million, respectively. The Electric Fund net assets decreased \$4.6 million. These assets constitute 76.6 percent of the Enterprise Funds' total net assets. Unrestricted net assets for these three funds totaled \$193.6 million, a 0.6 percent decrease from 2006-07.

Water Fund – The Water Fund ended the year with net income of \$7.5 million, compared to \$6.5 million in the prior year, a \$1.0 million increase. The increase in net income is primarily due to an increase in operating revenues of \$3.0 million the result of a 10 percent rate increase effective July 1, 2007 and an increase in interest income of \$0.5 million.

Electric Fund – Operating revenues increased to \$103.8 million in 2007-08, a \$1.2 million increase from the prior year. The Electric Fund ended the year with a net loss of \$4.5 million compared to a net income of \$1.8 million in 2006-07. The net loss is due to an \$8.6 million increase in the purchase of utilities caused by the unfavorable weather conditions.

Gas Fund – A 9.5 percent rate increase effective July 1, 2007 increased revenue \$6.8 million over 2006-07. The Gas Fund ended the year with a net income of \$9.3 million, compared to a \$9.0 million in 2006-07, an increase of \$0.3 million.

Wastewater Collection Fund - Operating revenues increased to \$15.1 million, a \$0.2 million increase from 2006-07. Operating expenses decreased to \$10.0 million, a \$0.7 million decrease from 2006-07, and interest income and transfers increased to \$11.7 million, a \$1.7 million increase from 2006-07. This is due to the purchase of utilities increasing \$1.0 million. The Wastewater Collection Fund ended the year with a net income of \$4.3 million, a decrease of \$1.2 million from 2006-07.

Wastewater Treatment Fund – Revenues increased in 2007-08 by \$5.9 million due to \$2.9 million in grant funds for the Water Reclamation Project and \$2.1 million increased revenues from member partners. The Wastewater Treatment Fund ended with the year with a net income of \$5.0 million, compared to a net income of \$0.2 million in 2006-07.

Refuse Fund – Refuse Fund revenues increased to \$28.8 million in 2007-08, compared to \$25.5 million in 2006-07. Operating expenses increased \$3.5 million to \$28.6 million in 2007-08. The Refuse Fund ended the year with a net loss of \$0.2 million, compared to a \$0.6 million net income in 2006-07.

Storm Drainage Fund – The Storm Drainage Fund ended the year with a net income of \$2.7 million, the same net income as 2006-07.

External Services Fund - Created in 2001-02, this Fund provides information technology and training services to neighboring municipalities and other community organizations. The External Services Fund ended the year with a net loss of \$9.0 thousand, the same net loss in 2006-07. The Fund was discontinued in fiscal year 2007-08.

CAPITAL ASSETS

GASB 34 requires the City to record all its capital assets including infrastructure. Infrastructure includes roads, bridges, signals and similar assets used by the entire population. Although GASB 34 allowed the City four years to record all its infrastructure assets in its financial statements, as of June 30, 2002 all assets were included in the financial statements. The table below shows capital assets and the amount of accumulated depreciation for these assets for Governmental and Business-type Activities (further detail may be found in Note 6 to the financial statements).

CAPITAL ASSETS AT JUNE 30 (in Millions)

	2008	2007	Increase/ (Decrease) from 2007
Governmental Activities			
<i>Capital Assets</i>			
Land and improvements	\$73.1	\$71.4	\$1.7
Street trees	15.1	15.0	0.1
Construction in progress	37.3	29.9	7.4
Buildings and improvements	99.7	93.5	6.2
Equipment	7.8	8.2	(0.4)
Roadway network	243.7	239.2	4.5
Recreation & open space network	13.9	13.5	0.4
Less accumulated depreciation	(156.5)	(149.4)	(7.1)
<i>Internal Service Fund Assets</i>			
Construction in progress	7.2	4.4	2.8
Equipment	35.3	32.0	3.3
Less accumulated depreciation	(24.7)	(22.0)	(2.7)
Total Governmental	\$351.9	\$335.7	\$16.2
Business-type Activities			
Land	\$2.0	\$1.9	\$0.1
Construction in progress	130.0	89.0	41.0
Buildings and improvements	19.6	18.9	0.7
Transmission, Distribution & Treatment Systems	481.4	480.1	1.3
Less accumulated depreciation	(216.4)	(206.1)	(10.3)
Total Business-type	\$416.6	\$383.8	\$32.8



Governmental Activities capital assets net of depreciation, increased by \$16.2 million compared to 2006-07. This increase was primarily due to a \$6.2 million increase for building and improvements, \$4.5 million for roadway network and \$1.7 million for land and improvements.

Work on the City's infrastructure is a continuation of a ten-year plan, totaling \$100 million, developed to address the needs of the City's aging infrastructure. The ten-year plan included an assessment and prioritization of work needed on buildings, facilities, streets, sidewalks, medians, bikeways, parks and open space. Current key infrastructure projects include improvements to streets and sidewalks, refurbishing of park playgrounds and irrigation systems, upgrading athletic fields, open space and trail improvements, and facility renovations.

The City depreciates all its capital assets over their estimated useful lives, as required by GASB 34. The purpose of depreciation is to spread the cost of a capital asset over the years of its useful life so that an allocable portion of the cost of the asset is borne by all users. Additional information on capital assets and depreciable lives may be found in Note 6.

DEBT ADMINISTRATION

Each of the City's debt issues is discussed in detail in Notes 7 and 8 to the financial statements. At June 30, 2008, the City's debt was comprised of the following:

LONG-TERM DEBT AT JUNE 30

(in Millions)

	2008	2007	Increase/ (Decrease) from 2007
Governmental Activity Debt:			
General Long Term Obligations:			
1998 Golf Course Certificates of Participation	\$4.8	\$5.1	(\$0.3)
2002A Civic Center Refinancing Certificates of Participation	1.5	1.9	(0.4)
2002B Downtown Parking Improvements Certificates of Participation	2.1	2.2	(0.1)
Special Assessment Debt with City Commitment			
1987 California Avenue Parking Bonds	0.0	0.1	(0.1)
Total Governmental Activity Debt	\$8.4	\$9.3	(\$0.9)
Business-type Activity Debt:			
Enterprise Long Term Obligations:			
Utility Revenue Bonds			
1995 Series A	\$5.6	\$6.0	(\$0.4)
1999 Refunding	14.2	14.7	(0.5)
2002 Series A	20.5	21.2	(0.7)
Energy Tax Credit Bonds			
2007 Series A	1.4	0.0	1.4
State Water Resources Loan			
2007	5.6	0.0	5.6
Less: unamortized discount/issuance cost	(1.0)	(1.0)	0.0
Total Business-type Activity	\$46.3	\$40.9	\$5.4

The City issued Energy Tax Credit Bonds and a State Water Resources Loan in fiscal year 2007-08. As stated in the Statistical Section of the CAFR, the combined direct debt ratio to assessed valuation for the General Fund is a low 0.04 percent compared to the allowable, legal debt margin of 15 percent.



SPECIAL ASSESSMENT DISTRICT DEBT

Special assessment districts throughout different parts of the City have also issued debt to finance infrastructure and facilities construction exclusively in their districts. At June 30, 2008, the City had no special assessment district debt with City commitment outstanding. The final payment of \$0.1 million for the California Avenue Parking Special Assessment District was made in September 2007.

ECONOMIC OUTLOOK

The economy of the City is discussed in the accompanying Transmittal Letter and in this Discussion and Analysis.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

The CAFR is intended to provide citizens, taxpayers, investors, and creditors with a general overview of the City's finances. Questions about this report should be directed to the Administrative Services Department, at 250 Hamilton Avenue, 4th Floor, Palo Alto, California. This report and other financial reports can be viewed on the City of Palo Alto website at: www.cityofpaloalto.org. On the home page, select City Departments, select Administrative Services, and select Financial Reporting. Within Financial Reporting there are links to reports by title and reporting date.



This page is intentionally left blank.



Citywide Statement of Net Assets and Statement of Activities.....

The Citywide Statement of Net Assets and the Statement of Activities summarize all of the City’s financial activities and financial position. They are prepared on the same basis as is used by most businesses, which means they include all the City’s assets and all its liabilities, as well as all its revenues and expenses. This is known as the full accrual basis – the effect of all the City’s transactions is taken into account, regardless of whether or when cash changes hands. All material internal transactions between City funds have been eliminated.

The Statement of Net Assets reports the difference between the City’s total assets and the City’s total liabilities, including all the City’s capital assets and all its long-term debt. The Statement of Net Assets focuses the reader on the composition of the City’s net assets, by subtracting total liabilities from total assets.

The Statement of Net Assets summarizes the financial position of all the City’s Governmental Activities in a single column, and the financial position of all the City’s Business-type Activities in a single column; these columns are followed by a Total column that presents the financial position of the entire City.

The City’s Governmental and Business-type Activities include the activities of its General Fund, along with all its Special Revenue, Capital Projects, Debt Service Funds, and Enterprise Funds. Since the City’s Internal Service Funds service these Funds, their activities are consolidated with Governmental and Business-type Activities, after eliminating inter-fund transactions and balances.

The Statement of Activities reports increases and decreases in the City’s net assets. It is also prepared on the full accrual basis, which means it includes all the City’s revenues and all its expenses, regardless of when cash changes hands. This differs from the “modified accrual” basis used in the Fund financial statements, which reflect only current assets, current liabilities, available revenues and measurable expenditures.

The format of the Statement of Activities presents the City’s expenses first, listed by program, and follows these with the expenses of its Business-type Activities. Program revenues – that is, revenues which are generated directly by these programs – are then deducted from program expenses to arrive at the net expense of each governmental and Business-type program. The City’s general revenues are then listed in the Governmental Activities or Business-type Activities column, as appropriate, and the Change in Net Assets is computed and reconciled with the Statement of Net Assets.

These Statements include the financial activities of the City Public Improvement Corporation and Redevelopment Agency, which are legally separate component units of the City because they are controlled by the City, which is financially accountable for its activities.

These financial statements along with the fund financial statements and footnotes are called *Basic Financial Statements*.



This page is intentionally left blank.

City of Palo Alto - Statement of Net Assets

June 30, 2008

(In thousands of dollars)

	Governmental Activities	Business Type Activities	Totals
ASSETS			
Cash and investments (Note 3):			
Available for operations	\$147,940	\$216,729	\$364,669
Cash and investments with fiscal agent	1,924	1,908	3,832
Receivables:			
Accounts and intergovernmental	7,018	33,201	40,219
Interest receivable	2,005	2,772	4,777
Notes and loans receivable (Note 5)	6,611		6,611
Internal balances (Note 4)	2,627	(2,627)	
Assets in excess of OPEB obligation (Note 12)	29,177		29,177
Inventory of materials and supplies and prepaids	5,563		5,563
Capital assets (Note 6):			
Nondepreciable	132,846	131,997	264,843
Depreciable, net of depreciation	219,096	284,616	503,712
Total assets	<u>554,807</u>	<u>668,596</u>	<u>1,223,403</u>
LIABILITIES			
Accounts payable and accrued liabilities	8,496	15,208	23,704
Accrued salaries and benefits	1,634	597	2,231
Unearned revenue	898		898
Accrued compensated absences (Note 1):			
Due within one year	3,604		3,604
Due in more than one year	6,819		6,819
Claims payable (Note 14):			
Due within one year	7,356		7,356
Due in more than one year	16,170		16,170
Accrued landfill closure liability (Note 9):			
Due in more than one year		7,907	7,907
Long-term debt (Notes 7 and 8):			
Due within one year	800	1,690	2,490
Due in more than one year	7,605	44,620	52,225
Total liabilities	<u>53,382</u>	<u>70,022</u>	<u>123,404</u>
NET ASSETS (Note 10)			
Invested in capital assets, net of related debt	<u>343,537</u>	<u>370,303</u>	<u>713,840</u>
Restricted for:			
Special revenue programs	21,691		21,691
Capital projects			
Other capital projects	4,331		4,331
Debt service	1,406	1,732	3,138
Total Restricted	<u>27,428</u>	<u>1,732</u>	<u>29,160</u>
Unrestricted net assets	130,460	226,539	356,999
Total net assets	<u>\$501,425</u>	<u>\$598,574</u>	<u>\$1,099,999</u>

See accompanying notes to financial statements

City of Palo Alto - Statement of Activities

For the Year Ended June 30, 2008

(In thousands of dollars)

Functions/Programs	Total Expenses	Program Revenues			Net (Expense) Revenue and Change in Net Assets		Total
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	
Governmental Activities:							
City Council	\$323				(\$323)		(\$323)
City Manager	2,273				(2,273)		(2,273)
City Attorney	2,653	\$16			(2,637)		(2,637)
City Clerk	1,241				(1,241)		(1,241)
City Auditor	1,379				(1,379)		(1,379)
Administrative Services	15,477	870			(14,607)		(14,607)
Human Resources	2,806				(2,806)		(2,806)
Public Works	18,565	1,310	\$2,340	\$1,903	(13,012)		(13,012)
Planning and Community Environment	16,388	5,498	980	27	(9,883)		(9,883)
Police	27,740	4,274	285		(23,181)		(23,181)
Fire	22,386	9,418	1		(12,967)		(12,967)
Community Services	17,736	10,314	302		(7,120)		(7,120)
Library	6,321	176	121		(6,024)		(6,024)
Interest on long-term debt	438				(438)		(438)
Total Governmental Activities	135,726	31,876	4,029	1,930	(97,891)		(97,891)
Business-type Activities:							
Water	18,842	26,510		951		\$8,619	8,619
Electric	108,032	103,833				(4,199)	(4,199)
Gas	37,211	49,021				11,810	11,810
Wastewater Collection	12,023	15,102		643		3,722	3,722
Wastewater Treatment	18,902	22,889				3,987	3,987
Refuse	28,827	28,805				(22)	(22)
Storm Drainage	3,202	5,450				2,248	2,248
External Services	984	112				(872)	(872)
Total Business-type Activities	228,023	251,722		1,594		25,293	25,293
Total	\$363,749	\$283,598	\$4,029	\$3,524	(97,891)	25,293	(72,598)
General revenues:							
Taxes:							
Property taxes					23,084		23,084
Sales taxes					22,623		22,623
Utility user's taxes					10,285		10,285
Transient occupancy tax					7,976		7,976
Transfer and other taxes					6,261		6,261
Investment earnings					12,313	16,416	28,729
Miscellaneous					11,896		11,896
Transfers (Note 4)					18,701	(18,701)	
Total general revenues and transfers					113,139	(2,285)	110,854
Change in Net Assets					15,248	23,008	38,256
Net Assets-Beginning					486,177	575,566	1,061,743
Net Assets-Ending					\$501,425	\$598,574	\$1,099,999

See accompanying notes to financial statements



Fund Financial Statements.....

Introduction

The Fund Financial Statements are presented by individual major funds, while non-major funds are combined in a single column. Major funds are defined generally as having significant activities or balances in the current year.

Major Governmental Funds

The funds described below were determined to be Major Funds by the City in fiscal year 2007-08. Individual non-major funds may be found in the Supplemental section.

General Fund

The General Fund is used for all the general revenues of the City not specifically levied or collected for other City funds, and related expenditures.

Capital Projects Fund

The Capital Projects Fund is utilized to account for resources used for the acquisition and construction of capital facilities by the City, with the exception of those assets financed by proprietary funds.



This page is intentionally left blank.

City of Palo Alto - Governmental Funds

Balance Sheet - June 30, 2008

(In thousands of dollars)

	General	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
ASSETS				
Cash and investments (Note 3):				
Available for operations	\$34,726	\$38,306	\$15,970	\$89,002
Cash and investments with fiscal agent		582	1,342	1,924
Receivables:				
Accounts and intergovernmental	6,071	151	464	6,686
Interest receivable	980		176	1,156
Notes and loans receivable (Note 5)	1,155		5,456	6,611
Interfund receivables and advances (Note 4)	1,100			1,100
Prepaid items	2,032			2,032
Inventory of materials and supplies	2,999			2,999
Total Assets	\$49,063	\$39,039	\$23,408	\$111,510
LIABILITIES				
Accounts payable and accrued liabilities	\$4,504	\$726	\$226	\$5,456
Accrued salaries and benefits	1,246	35		1,281
Deferred revenue	898			898
Total Liabilities	6,648	761	226	7,635
FUND BALANCES				
Reserved for (Note 10):				
Encumbrances	3,816	4,331	210	8,357
Downtown parking structure				
Notes and loans	1,155		5,456	6,611
Interfund advances	1,100			1,100
Prepaid items	2,032			2,032
Inventory of materials and supplies	2,999			2,999
Debt service			1,406	1,406
Unreserved, designated for:				
General Fund				
Unrealized gain on investment	1,035		172	1,207
Equity transfer stabilization	3,528			3,528
Reappropriations	648			648
Budget stabilization	26,102			26,102
Capital Project Fund				
Reappropriations		16,053		16,053
Infrastructure		17,894		17,894
Unreserved, undesignated, reported in:				
Special Revenue Funds			15,207	15,207
Permanent Fund			731	731
Total Fund Balances	42,415	38,278	23,182	103,875
Total Liabilities and Fund Balances	\$49,063	\$39,039	\$23,408	\$111,510

See accompanying notes to financial statements

City of Palo Alto - Governmental Funds

**Reconciliation of Fund Balances to Governmental Activities Net Assets
June 30, 2008**

(In thousands of dollars)

Governmental Fund fund balances from prior page \$103,875

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds (Note 6) 351,942

Internal service funds are used by management to charge the costs of certain activities, such as insurance and central services and maintenance, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets. 54,154
(Excludes capital assets reported above and debt reported below)

Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds

Interest payable	(141)
Long Term debt (Note 7)	<u>(8,405)</u>

Net assets of governmental activities \$501,425

See accompanying notes to financial statements

City of Palo Alto - Governmental Funds

Statement of Revenues, Expenditures and
Changes in Fund Balance - For the Year Ended June 30, 2008
(In thousands of dollars)

	General	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
REVENUES				
Property taxes	\$23,084			\$23,084
Special assessments			\$136	136
Sales taxes	22,623			22,623
Utility users' tax	10,285			10,285
Transient occupancy tax	7,976			7,976
Other taxes and fines	7,871		1,117	8,988
Charges for services	19,294		316	19,610
From other agencies	370	\$3,266	664	4,300
Permits and licenses	4,581		180	4,761
Investment earnings	4,563	1,028	1,318	6,909
Rental income	13,592		6	13,598
Other revenue	761	245	3,707	4,713
Total Revenues	<u>115,000</u>	<u>4,539</u>	<u>7,444</u>	<u>126,983</u>
EXPENDITURES				
Current operations:				
City Council	234			234
City Manager	2,149			2,149
City Attorney	2,570			2,570
City Clerk	1,239			1,239
City Auditor	828			828
Administrative Services	6,728			6,728
Human Resources	2,502			2,502
Public Works	10,072			10,072
Planning and Community Environment	8,953		6,399	15,352
Police	26,835		171	27,006
Fire	21,644			21,644
Community Services	17,138			17,138
Library	6,219			6,219
Non-Departmental	8,360		238	8,598
Capital outlay		21,626		21,626
Debt service:				
Principal payments			885	885
Interest and fiscal fees			451	451
Total Expenditures	<u>115,471</u>	<u>21,626</u>	<u>8,144</u>	<u>145,241</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(471)</u>	<u>(17,087)</u>	<u>(700)</u>	<u>(18,258)</u>
OTHER FINANCING SOURCES (USES)				
Transfers in (Note 4)	17,133	14,409	1,895	33,437
Transfers (out) (Note 4)	(13,655)	(118)	(3,046)	(16,819)
Total Other Financing Sources (Uses)	<u>3,478</u>	<u>14,291</u>	<u>(1,151)</u>	<u>16,618</u>
Net change in fund balances	3,007	(2,796)	(1,851)	(1,640)
Fund balances at beginning of year	<u>39,408</u>	<u>41,074</u>	<u>25,033</u>	<u>105,515</u>
Fund balances at end of year	<u>\$42,415</u>	<u>\$38,278</u>	<u>\$23,182</u>	<u>\$103,875</u>

See accompanying notes to financial statements

**City of Palo Alto - Reconciliation of the
Statement of Revenues, Expenditures and
Changes in Fund Balances of
Governmental Funds to the Statement of Activities.....**

For the Year Ended June 30, 2008
(In thousands of dollars)

Net change in fund balances-total governmental funds (\$1,640)

Amounts reported for Governmental Activities in the Statement of Activities are different because:

Governmental Funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. The capital outlay expenditures are therefore added back to fund balance.

The capital outlay, net of retirements, are therefore deducted from fund balance. 21,509

Depreciation expense is deducted from fund balance (Depreciation expense is net of Internal Service Fund depreciation \$3,083 million which has already been allocated to serviced funds.) (8,597)

Bond proceeds provide current financial resources to Governmental Funds, but issuing debt increases long-term liabilities in the Statement of Net Assets. Repayment of bond principal is an expenditure in the Governmental Funds, but in the Statement of Net Assets the repayment reduces long-term liabilities.

Fund balance is increased by the amount of debt repayment. 885

Some amounts reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in Governmental Funds.

Interest payable 13
Deferred revenue (115)

Internal Service Funds are used by management to charge the costs of certain activities, such as equipment acquisition, maintenance, and insurance to individual funds. The net revenue (expense) of all Internal Service Funds is reported with Governmental Activities. 3,193

Change in net assets of Governmental Activities \$15,248

See accompanying notes to financial statements

City of Palo Alto - General Fund

Statement of Revenues, Expenditures and Changes in Fund Balance Budget and Actual - For the Year Ended June 30, 2008

(In thousands of dollars)

	Budgeted Amount		Actual Amount Budgetary Basis	Variance from Final Budget Positive (Negative)
	Adopted	Adjusted		
REVENUES				
Property taxes	\$22,034	\$22,735	\$23,107	\$372
Sales taxes	22,045	22,400	22,621	221
Utility users' tax	9,402	9,793	10,285	492
Transient occupancy tax	6,985	7,700	7,976	276
Other taxes, fines & penalties	8,181	8,437	7,847	(590)
Charges for services	20,383	20,383	19,311	(1,072)
Permits and licenses	6,044	6,074	4,831	(1,243)
Charges to other funds	10,650	10,650	10,913	263
Rental income	13,037	13,037	13,591	554
Other revenues	3,742	4,452	7,872	3,420
Transfers in	17,207	17,786	17,133	(653)
Prior year encumbrance and reappropriations		3,558	3,558	
Total Revenues	139,710	147,005	149,045	2,040
EXPENDITURES				
Current operations:				
Administrative Departments	17,342	19,108	19,098	10
Community Services	21,212	21,872	21,866	6
Fire	22,868	24,279	24,279	
Library	6,484	7,035	7,033	2
Planning and Community Environment	10,137	10,148	10,145	3
Police	27,981	29,787	29,784	3
Public Works	13,225	13,254	13,243	11
Non-Departmental	9,229	7,903	7,899	4
Transfers out	10,707	15,570	13,654	1,916
Total Use of Funds	139,185	148,956	147,001	1,955
EXCESS OF REVENUES OR EXPENDITURES BUDGETARY BASIS	\$525	(\$1,951)	2,044	\$3,995
Adjustments to Budgetary Basis:				
Current year encumbrance/reappropriations			4,460	
Prior year encumbrance/reappropriations			(3,558)	
Current year stores adjustment, net			(37)	
Prior year stores adjustment			98	
EXCESS OF REVENUES OVER EXPENDITURES - GAAP BASIS			3,007	
Fund balances at beginning of year			39,408	
Fund balances at end of year, GAAP basis			\$42,415	

See accompanying notes to financial statements



This page is intentionally left blank.



Proprietary Funds.....

Introduction

Proprietary Funds account for City operations financed and operated in a manner similar to a private business enterprise. The intent of the City is that the cost of providing goods and services be financed primarily through user charges.

The City has elected to treat all of its Enterprise Funds as Major Funds in fiscal year 2007-08.

Proprietary Funds do not provide for the disclosure of budget versus actual comparisons.

Water Services Fund

This fund accounts for all financial transactions relating to the City's Water service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Electric Services Fund

This fund accounts for all financial transactions relating to the City's Electric service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Gas Services Fund

This fund accounts for all financial transactions relating to the City's Gas service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Wastewater Collection Fund

This fund accounts for all financial transactions relating to the City's Wastewater Collection service. Collections are on a user charge basis to residents and business owners located in Palo Alto.

Wastewater Treatment Fund

This fund accounts for all financial transactions relating to the City's Wastewater Treatment. Services are on a user charge basis to residents and business owners located in Palo Alto.

Refuse Services Fund

This fund accounts for all financial transactions relating to the City's Refuse service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Storm Drainage Services Fund

This fund accounts for all financial transactions relating to the City's Storm Drain service. Services are on a user charge basis to residents and business owners located in Palo Alto.

External Service Fund

This fund accounts for all financial transactions relating to the City's External Services provided to surrounding communities. Service charges are established on a case-by-case basis. This fund was discontinued in fiscal year 2007-08.

City of Palo Alto - Proprietary Funds

Statement of Net Assets - June 30, 2008

(In thousands of dollars)

	Business-type Activities-Enterprise Funds			
	Water	Electric	Gas	Wastewater Collection
ASSETS				
Current Assets:				
Cash and investments (Note 3):				
Available for operations	\$23,576	\$130,276	\$20,500	\$11,704
Cash and investments with fiscal agent	848		1,034	
Accounts receivable, net	4,233	14,584	3,714	2,076
Interest receivable	272	1,736	231	139
Inventory of materials and supplies				
Prepaid items				
Total Current Assets	<u>28,929</u>	<u>146,596</u>	<u>25,479</u>	<u>13,919</u>
Noncurrent Assets:				
Capital assets, nondepreciable (Note 6)	18,054	43,984	18,846	24,666
Capital assets, depreciable (Note 6)	41,372	113,284	50,679	38,510
Total Noncurrent Assets	<u>59,426</u>	<u>157,268</u>	<u>69,525</u>	<u>63,176</u>
Total Assets	<u>88,355</u>	<u>303,864</u>	<u>95,004</u>	<u>77,095</u>
LIABILITIES				
Current Liabilities:				
Accounts payable and accrued liabilities	1,622	1,077	2,616	118
Accrued salaries and benefits	81	210	79	48
Accrued compensated absences (Note 1)				
Current portion of revenue bonds (Note 7)	351	100	429	58
Accrued claims payable (Note 14)				
Total Current Liabilities	<u>2,054</u>	<u>1,387</u>	<u>3,124</u>	<u>224</u>
Noncurrent liabilities:				
Accrued compensated absences (Note 1)				
Accrued claims payable (Note 14)				
Interfund payable (Note 4)				
Landfill closure and postclosure care (Note 9)				
Utility revenue bonds, net of unamortized issuance costs and discounts (Note 7)	9,476	1,157	10,647	1,287
Total Noncurrent Liabilities	<u>9,476</u>	<u>1,157</u>	<u>10,647</u>	<u>1,287</u>
Total Liabilities	<u>11,530</u>	<u>2,544</u>	<u>13,771</u>	<u>1,511</u>
NET ASSETS (Note 10)				
Invested in capital assets, net of related debt	49,599	156,011	58,449	61,831
Restricted for debt service	780		952	
Unrestricted	26,446	145,309	21,832	13,753
Total Net Assets	<u>\$76,825</u>	<u>\$301,320</u>	<u>\$81,233</u>	<u>\$75,584</u>

Some amounts reported for *Business-type Activities* in the Statement of Net Assets are different because certain Internal Service Fund assets and liabilities are included with Business-type Activities

Net Business-type Activities

See accompanying notes to financial statements



Business-type Activities-Enterprise Funds					Governmental Activities - Internal Service Funds
Wastewater Treatment	Refuse	Storm Drainage	External Service	TOTALS	
\$12,223	\$11,825	\$6,616	\$9	\$216,729	\$58,938
26				1,908	
5,226	2,666	702		33,201	332
176	143	75		2,772	849
					532
					29,177
<u>17,651</u>	<u>14,634</u>	<u>7,393</u>	<u>9</u>	<u>254,610</u>	<u>89,828</u>
19,629	1,962	4,856		131,997	7,151
23,580	1,908	15,283		284,616	10,550
43,209	3,870	20,139		416,613	17,701
60,860	18,504	27,532	9	671,223	107,529
6,458	332	2,976	9	15,208	2,899
110	54	15		597	353
					3,604
367		385		1,690	
					7,356
<u>6,935</u>	<u>386</u>	<u>3,376</u>	<u>9</u>	<u>17,495</u>	<u>14,212</u>
					6,819
					16,170
		1,100		1,100	
	7,907			7,907	
13,000		9,053		44,620	
13,000	7,907	10,153		53,627	22,989
19,935	8,293	13,529	9	71,122	37,201
29,842	3,870	10,701		370,303	17,701
				1,732	
11,083	6,341	3,302		228,066	52,627
<u>\$40,925</u>	<u>\$10,211</u>	<u>\$14,003</u>		<u>600,101</u>	<u>\$70,328</u>
				(1,527)	
				<u>\$598,574</u>	

City of Palo Alto - Proprietary Funds
Statements of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2008
(In thousands of dollars)

	Business-type Activities - Enterprise Funds			
	Water	Electric	Gas	Wastewater Collection
OPERATING REVENUES				
Sales of utilities:				
Customers	\$24,558	\$88,989	\$46,710	\$13,686
City departments	1,298	3,335	1,393	311
Surplus energy		1,454		
Wastewater treatment				
Service connection charges and miscellaneous	409	1,237	817	747
Charges for services				
Other operating revenues	245	8,818	101	358
Total Operating Revenues	26,510	103,833	49,021	15,102
OPERATING EXPENSES				
Purchase of utilities:				
Retail	8,363	70,302	27,220	7,056
Surplus energy		762		
Administration and general	2,741	4,909	3,309	774
Engineering (operating)	359	983	341	317
Resource management and energy efficiency programs	350	4,053	839	
Operations and maintenance	3,561	8,922	3,097	2,096
Rent	1,788	3,438	161	86
Depreciation and amortization	1,134	5,623	1,636	1,412
Claims payments and changes in estimated self-insurance liability				
Compensated absences and other benefits				
Total Operating Expenses	18,296	98,992	36,603	11,741
Operating Income	8,214	4,841	12,418	3,361
NONOPERATING REVENUES (EXPENSES)				
Return on investment	1,628	10,398	1,342	819
Interest (expense)	(437)		(535)	(74)
Joint venture debt service (Note 15)		(8,554)		
Gain (loss) on disposal of capital assets		(109)		
Capacity fees	951			643
Other				
Net Nonoperating Revenues (Expenses)	2,142	1,735	807	1,388
Income (Loss) Before Transfers and Special Item	10,356	6,576	13,225	4,749
Transfers in (Note 4)	200	33		64
Transfers (out) (Note 4)	(3,049)	(11,151)	(3,883)	(482)
Change in Net Assets	7,507	(4,542)	9,342	4,331
Total net assets at beginning of year	69,318	305,862	71,891	71,253
Total net assets at end of year	\$76,825	\$301,320	\$81,233	\$75,584

Some amounts reported for *Business-type Activities* in the Statement of Net Assets are different because certain Internal Service Fund assets and liabilities are included with Business-type Activities

Change in Net Assets of Business-type Activities

See accompanying notes to financial statements



Business-type Activities - Enterprise Funds					Governmental
Wastewater		Storm	External	TOTALS	Activities -
Treatment	Refuse	Drainage	Service		Internal Service
					Funds
	\$22,795	\$5,099		\$201,837	
\$7,128	1,301	306		15,072	
				1,454	
11,858				11,858	
				3,210	
					\$61,166
3,903	4,709	45	\$112	18,291	282
22,889	28,805	5,450	112	251,722	61,448
	9,276			122,217	
				762	
	1,521	888	26	14,168	13,539
2,179	401	298		4,878	
		189		5,431	
13,687	12,449	640	891	45,343	2,171
	4,289			9,762	
2,238	636	534		13,213	3,083
					7,029
					41,133
18,104	28,572	2,549	917	215,774	66,955
4,785	233	2,901	(805)	35,948	(5,507)
1,015	824	425	(35)	16,416	5,404
(461)	(398)	(585)		(2,490)	
				(8,554)	
				(109)	62
				1,594	
					55
554	426	(160)	(35)	6,857	5,521
5,339	659	2,741	(840)	42,805	14
	222		842	1,361	3,087
(363)	(1,053)	(70)	(11)	(20,062)	(1,004)
4,976	(172)	2,671	(9)	24,104	2,097
35,949	10,383	11,332	9		68,231
\$40,925	\$10,211	\$14,003			\$70,328
				(1,096)	
				\$23,008	

City of Palo Alto - Proprietary Funds

Statement of Cash Flows -

For the Year Ended June 30, 2008

(In thousands of dollars)

	Business-type Activities - Enterprise Funds			
	Water	Electric	Gas	Wastewater Collection
CASH FLOWS FROM OPERATING ACTIVITIES:				
Receipts from customers	\$24,224	\$94,648	\$46,597	\$14,238
Payments to suppliers	(14,457)	(86,460)	(30,371)	(9,952)
Payments to - or on behalf of employees	(2,852)	(4,891)	(3,306)	(766)
Internal activity - receipts from other funds	1,298	3,335	1,393	311
Claims paid				
Interfund receipts				
Interfund payment				
Other receipts	245		101	358
Net Cash From Operating Activities	<u>8,458</u>	<u>6,632</u>	<u>14,414</u>	<u>4,189</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:				
Transfers in	200	33		64
Transfers (out)	(3,049)	(11,151)	(3,883)	(482)
Net Cash From Noncapital Financing Activities	<u>(2,849)</u>	<u>(11,118)</u>	<u>(3,883)</u>	<u>(418)</u>
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:				
Acquisition and construction of capital assets	(3,924)	(13,562)	(5,690)	(4,373)
Proceeds from sale of capital assets				
Proceeds from debt issuance	750	1,500		
Cost of issuance paid		(143)		
Capacity fees	951			643
Principal paid on long-term debt	(333)	(100)	(405)	(54)
Interest paid on long-term debt	(437)	(8,554)	(535)	(74)
Cash Flows From Capital Financing Activities	<u>(2,993)</u>	<u>(20,859)</u>	<u>(6,630)</u>	<u>(3,858)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:				
Interest on investments	1,607	10,550	1,296	833
Net Cash Flows	4,223	(14,795)	5,197	746
Cash and cash equivalents at beginning of year	20,201	145,071	16,337	10,958
Cash and cash equivalents at end of year	<u>\$24,424</u>	<u>\$130,276</u>	<u>\$21,534</u>	<u>\$11,704</u>
FINANCIAL STATEMENT PRESENTATION:				
Cash and investments available for operations	\$23,576	\$130,276	\$20,500	\$11,704
Cash and investments with fiscal agent	848		1,034	
Cash and cash equivalents at end of year	<u>\$24,424</u>	<u>\$130,276</u>	<u>\$21,534</u>	<u>\$11,704</u>
Reconciliation of operating income (loss) to Cash Flows from Operating				
Operating income (loss)	\$8,214	\$4,841	\$12,418	\$3,361
Adjustments to reconcile operating income (loss) to cash flows				
Depreciation and amortization	1,134	5,623	1,636	1,412
Other				
Changes in assets and liabilities:				
Accounts receivable	(743)	(4,396)	(930)	(195)
Inventory of materials and supplies				
Prepaid items				
Accounts and other payables	(147)	564	1,290	(389)
Interfund receipts				
Interfund payable				
Accrued compensated absences				
Accrued claims payable and other liabilities				
Net Cash From Operating Activities	<u>\$8,458</u>	<u>\$6,632</u>	<u>\$14,414</u>	<u>\$4,189</u>

See accompanying notes to financial statements



Business-type Activities - Enterprise Funds					Governmental Activities - Internal Service Funds
Wastewater Treatment	Refuse	Storm Drainage	External Service	TOTALS	
\$7,775	\$22,686	\$5,000	\$405	\$215,573	\$60,896
(10,807)	(26,372)	469	9	(177,941)	(31,330)
(15)	(1,529)	(889)	(925)	(15,173)	(56,486)
7,128	1,301	306		15,072	(4,633)
			(281)	(281)	25
		1,100		1,100	
3,903	5,536	45		10,188	337
<u>7,984</u>	<u>1,622</u>	<u>6,031</u>	<u>(792)</u>	<u>48,538</u>	<u>(31,191)</u>
	222		842	1,361	3,087
(363)	(1,053)	(70)	(11)	(20,062)	(1,004)
<u>(363)</u>	<u>(831)</u>	<u>(70)</u>	<u>831</u>	<u>(18,701)</u>	<u>2,083</u>
(14,511)	(10)	(4,056)		(46,126)	(6,412)
4,879				7,129	62
				(143)	
				1,594	
(342)		(329)		(1,563)	
(461)	(398)	(585)		(11,044)	
<u>(10,435)</u>	<u>(408)</u>	<u>(4,970)</u>		<u>(50,153)</u>	<u>(6,350)</u>
1,038	817	404	(39)	16,506	5,472
(1,776)	1,200	1,395		(3,810)	(29,986)
14,025	10,625	5,221	9	222,447	88,924
<u>\$12,249</u>	<u>\$11,825</u>	<u>\$6,616</u>	<u>\$9</u>	<u>\$218,637</u>	<u>\$58,938</u>
\$12,223	\$11,825	\$6,616	\$9	\$216,729	\$58,938
26				1,908	
<u>\$12,249</u>	<u>\$11,825</u>	<u>\$6,616</u>	<u>\$9</u>	<u>\$218,637</u>	<u>\$58,938</u>
\$4,785	\$233	\$2,901	(\$805)	\$35,948	(\$5,507)
2,238	636	534		13,213	3,083
					55
(4,083)	(109)	(99)	293	(10,262)	(270)
					(28)
					(29,177)
5,044	35	1,595	1	7,993	(1,784)
			(281)	(281)	25
		1,100		1,100	
					16
	827			827	2,396
<u>\$7,984</u>	<u>\$1,622</u>	<u>\$6,031</u>	<u>(\$792)</u>	<u>\$48,538</u>	<u>(\$31,191)</u>



This page is intentionally left blank.



Fiduciary Funds.....

Introduction

These funds account for assets held by the City in trust or as an agent for various assessment and community facilities districts. The financial activities of these funds are excluded from the Citywide financial statements, but are presented in separate Fiduciary Fund financial statements.

This page is intentionally left blank.



City of Palo Alto - Fiduciary Funds

Statement of Fiduciary Net Assets - June 30, 2008
(In thousands of dollars)

	<u>Agency Funds</u>
ASSETS	
Cash and investments available for operations (Note 3)	\$1,067
Cash and investments with fiscal agents (Note 3)	6,099
Interest receivable	<u>45</u>
Total Assets	<u><u>\$7,211</u></u>
LIABILITIES	
Due to bondholders	\$6,388
Due to other governments	<u>823</u>
Total Liabilities	<u><u>\$7,211</u></u>

See accompanying notes to financial statements



This page is intentionally left blank.



Index.....

	Page
1. Summary of Significant Accounting Policies	49
2. Budgets and Budgetary Accounting	55
3. Cash and Investments	56
4. Interfund Transactions	61
5. Notes and Loans Receivable	63
6. Capital Assets	69
7. General Long-Term Obligations	75
8. Special Assessment Debt	81
9. Landfill Closure and Post-closure Care	83
10. Net Assets and Fund Balances	84
11. Pension Plans	87
12. Retiree Health Benefits	89
13. Deferred Compensation Plan	92
14. Risk Management	92
15. Joint Ventures	94
16. Commitments and Contingencies	97

Notes are essential to present fairly the information contained in the overview level of basic financial statements. Narrative explanations are intended to communicate information that is not readily apparent or cannot be included in the statements and schedules themselves, and to provide additional disclosures as required by the Governmental Accounting Standards Board.



This page is intentionally left blank.

Note 1.....

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Palo Alto was incorporated in 1894 and operates as a charter city, having had its first charter granted by the State of California in 1909. The City operates under the Council-Manager form of government and provides the following services: public safety (police and fire), public works, electric, water, gas, wastewater, storm drain, refuse, golf course, planning and zoning, general administration services, library, open space and science, recreational and human services.

Reporting Entity

The City is governed by a nine-member council, elected by City residents. The City is legally separate and fiscally independent which means it can issue debt, set and modify budgets and fees and sue or be sued. The accompanying Basic Financial Statements present the financial activity of the City, which is the primary government presented, along with the financial activities of its component units, which are entities for which the City is financially accountable. Although they are separate legal entities, *blended* component units are in substance, part of the City’s operations and are reported as an integral part of the City’s financial statements. This City’s component units, which are described below are blended.

The Palo Alto Public Improvement Corporation provides financing of public capital improvements for the City through the issuance of Certificates of Participation (COPs), a form of debt, which allows investors to participate in a stream of future lease payments. Proceeds from the COPs are used to construct projects which are leased to the City. The lease payments are sufficient in timing and amount to meet the debt service requirements of the COPs. The Corporation is controlled by the City, which performs all accounting and administrative functions for the Corporation. The financial activities of the Corporation are included in the Golf Course and Civic Center Debt Service Funds and the Capital Projects Fund.

The Palo Alto Redevelopment Agency is a separate government entity whose purpose is to prepare and implement plans for improvement, rehabilitation, and development of certain areas within the City. The City Council and the Redevelopment Agency Board are composed of the same individuals. Certain administrative and accounting functions are performed by City staff. The financial activities of the Agency have been included in these financial statements in the Redevelopment Agency Special Revenue Fund.

Financial statements for the Palo Alto Public Improvement Corporation and Redevelopment Agency may be obtained from the City of Palo Alto, Administrative Services Department, 4th Floor, 250 Hamilton Avenue, Palo Alto, CA 94301.

Basis of Presentation

The City’s Basic Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America. The Government Accounting Standards Board is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the United States.

These Standards require that the financial statements described below be presented.

Citywide Statements: The Statement of Net Assets and the Statement of Activities display information about the primary government (the City) and its component units. These statements include the financial activities of the overall City government, except for fiduciary activities. Eliminations have been made to minimize the double counting of internal activities. However, interfund goods and services transactions have not been eliminated in the consolidation process. These statements distinguish between the *Governmental* and *Business-type Activities* of the City. Governmental Activities generally are financed through taxes, intergovernmental revenues, and other non-exchange transactions. Business-type Activities are financed in whole or in part by fees charged to external parties.

The Statement of Activities presents a comparison between direct expenses and program revenues for each segment of the Business-type Activities of the City and for each function of the City's Governmental Activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs, (b) grants and contributions that are restricted to meeting the operational needs of a particular program and (c) fees, grants and contributions that are restricted to financing the acquisition or construction of capital assets. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements: The Fund financial statements provide information about the City's funds, including fiduciary funds and blended component units. Separate statements for each fund category—*governmental*, *proprietary*, and *fiduciary*—are presented. The emphasis of Fund financial statements is on major individual governmental and enterprise funds, each of which is displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as non-major funds.

Proprietary Fund *operating* revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. *Non-operating* revenues, such as subsidies and investment earnings, result from non-exchange transactions or ancillary activities.

Operating expenses for enterprise funds and internal service funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All expenses not meeting this definition are reported as nonoperating expenses.

Major Funds

The City's Major Governmental and Business-type Funds need to be identified and presented separately in the Fund financial statements. All other funds, called Non-major Funds, are combined and reported in a single column, regardless of their fund-type.

Major Funds are defined as funds that have either assets, liabilities, revenues or expenditures/expenses equal to 10 percent of their fund-type total and five percent of the grand total. The General Fund is always a Major Fund. The City may also select other funds it believes should be presented as Major Funds.

The City reported the following Major Governmental Funds in the accompanying financial statements:

General Fund – This is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

Capital Projects Fund – This fund accounts for resources used for the acquisition and construction of capital facilities by the City, with the exception of those assets financed by Proprietary Funds.

The City reported all its Enterprise Funds as Major Funds in the accompanying financial statements:

Water Services Fund – This fund accounts for all financial transactions relating to the City’s Water service. Services are on a user-charge basis to residents and business owners located in Palo Alto.

Electric Services Fund – This fund accounts for all financial transactions relating to the City’s Electric service. Services are on a user-charge basis to residents and business owners located in Palo Alto.

Gas Services Fund – This fund accounts for all financial transactions relating to the City’s Gas service. Services are on a user-charge basis to residents and business owners located in Palo Alto.

Wastewater Collection Services Fund – This fund accounts for all financial transactions relating to the City’s Wastewater Collection. Collections are on a user-charge basis to residents and business owners located in Palo Alto.

Wastewater Treatment Services Fund – This fund accounts for all financial transactions relating to the City’s Wastewater Treatment. Services are on a user-charge basis to residents and business owners located in Palo Alto.

Refuse Services Fund – This fund accounts for all financial transactions relating to the City’s Refuse service. Services are on a user-charge basis to residents and business owners located in Palo Alto.

Storm Drainage Services Fund – This fund accounts for all financial transactions relating to the City’s Storm Drain service. Services are on a user-charge basis to residents and business owners located in Palo Alto.

External Service Fund – This fund accounts for all financial transactions relating to the City’s external services provided to surrounding communities.

The City also reports the following fund types:

Internal Service Funds – These funds account for fleet replacement and maintenance, technology, central duplicating, printing and mailing services, administration of compensated absences and health benefits, and the City’s self-insured workers’ compensation and general liability programs, all of which are provided to other departments on a cost-reimbursement basis. Also included is the Retiree Health Benefits Internal Service Fund which accounts for benefits to retirees.

Vehicle Replacement and Maintenance – This fund accounts for the maintenance and replacement of vehicles and equipment used by all City departments. The source of revenue is an accumulation of resources.

Technology – This fund accounts for replacement and upgrade of technology, and covers four primary areas used by all City departments: desktop, infrastructure, applications, and technology research and development. The source of revenue is an accumulation of resources.

Printing and Mailing Services – This fund accounts for central duplicating, printing and mailing services provided to all City departments. Source of revenue for this fund is on reimbursement of costs for services and supplies purchased by other departments.

General Benefits and Insurance – This fund accounts for the administration of compensated absences and health benefits, and the City’s self-insured workers’ compensation and general liability programs.

Retiree Health Benefit – This fund accounts for the retiree health benefits.

Fiduciary Funds – These funds account for assets held by the City in trust or as an agent for various assessment and community facilities districts. The financial activities of these funds are excluded from the Citywide financial statements, but are presented in separate Fiduciary Fund financial statements.

Agency Funds – These funds account for assets held by the City, an agent for assessment districts and the members of the Cable Joint Powers Authority. These funds are custodial in nature and do not involve measurement of results of operations. The City maintains three agency funds. The financial activities of these funds are excluded from the Government-wide financial statements, but are presented in separate Fiduciary Fund financial statements. Agency funds apply the accrual basis of accounting but do not have a measurement focus.

California Avenue Parking Assessment District – This fund accounts for receipts and disbursements associated with the 1993 Parking District No. 92-13 Assessment Bonds.

Cable Joint Powers Authority – This fund was established to account for the activities of the cable television system on behalf of the members.

University Avenue Area Parking Assessment District – This fund accounts for the receipts and disbursements associated with the Series 2001-A University Avenue Area Off-Street Parking Assessments Bonds.

Basis of Accounting

The Citywide and Proprietary fund financial statements are reported using the *economic resources measurement focus* and the full *accrual basis* of accounting. Revenues are recorded when *earned* and expenses are recorded at the time liabilities are *incurred*, regardless of when the related cash flows take place.

Governmental Funds are reported using the *current financial resources* measurement focus and the *modified accrual* basis of accounting. Under this method, revenues are recognized when *measurable and available*. The City considers revenues susceptible to accrual reported in the Governmental Funds to be available if the revenues are collected within ninety days after year-end, except for property taxes. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as *expenditures* in Governmental Funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as *other financing sources*.

Those revenues susceptible to accrual include taxes, intergovernmental revenues, interest and charges for services.

Grant revenues are recognized in the fiscal year in which all eligibility requirements are met. Under the terms of grant agreements, the City may fund certain programs with a combination of cost-reimbursement grants, categorical block grants, and general revenues. Thus, both restricted and unrestricted net assets may be available to finance program expenditures. The City’s policy is to first apply restricted grant resources to such programs, followed by general revenues if necessary.

Certain indirect costs are included in program expenses reported for individual functions and activities. Transactions representing the exchange of interfund goods and services have also been included.

The City follows those Financial Accounting Standard Board Statements issued before November 30, 1989, which do not conflict with Governmental Accounting Standards Board Statements.

Inventory of Materials and Supplies

Materials and supplies are held for consumption and are valued at average cost. The consumption method is used to account for inventories. Under the consumption method, inventories are recorded as an expenditure at the time inventory items are used, rather than purchased.

Compensated Absences

The liability for compensated absences includes the vested portions of vacation, sick leave, and overtime compensation pay. The City’s liability for accrued compensated absences is recorded in the General Benefits and Insurance Internal Service Fund. Amounts expected to be “permanently liquidated”, such as what is due to be paid because of a realized employment action, are recorded as fund liabilities in the General Benefits and Insurance Internal Service Fund. The Fund is reimbursed through payroll charges to all other funds. Earned but unpaid vacation and overtime compensation pay is recognized as an expense or expenditure in the Proprietary and Governmental Fund types when earned because the City has provided financial resources for the full amount through its budgetary process. Vested accumulated sick pay is paid in the event of termination due to disability and under certain conditions specified in employment agreements.

During fiscal year ended June 30, 2008, changes to the compensated absences were as follows:

Beginning Balance	\$11,500
Additions	3,741
Payments	<u>(4,818)</u>
Ending Balance	<u><u>\$10,423</u></u>
Current Portion	<u><u>\$3,604</u></u>

Property Tax

Santa Clara County assesses properties and bills, collects, and distributes property taxes to the City. The County remits the entire amount levied and handles all delinquencies, retaining interest and penalties. Secured and unsecured property taxes are levied on January 1 of the preceding fiscal year.

Secured property tax is due in two installments, on November 1 and February 1, and becomes a lien on those dates. It becomes delinquent on December 10 and April 10, respectively. Unsecured property tax is due on July 1, and becomes delinquent on August 31. Collection of delinquent accounts is the responsibility of the County, which retains all penalties.

The term “unsecured” refers to taxes on personal property other than real estate, land and buildings. These taxes are secured by liens on the property being taxed. Property tax revenues are recognized by the City in the fiscal year they are assessed, provided they become available as defined above within 60 days after year end.

Rounding

All amounts included on the basic financial statements, combining statements, fiduciary statements, footnotes and schedules are presented to the nearest thousands in accordance with the City’s policy.

Estimates

The accompanying basic financial statements have been prepared on the modified accrual and/or accrual basis of accounting in accordance with generally accepted accounting principles. This requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

Note 2.....

BUDGETS AND BUDGETARY ACCOUNTING

1. The City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures and the means of financing them.
2. Public hearings are conducted to obtain public comments.
3. The Adopted budget is legally enacted through passage of a budget ordinance for all funds except for Agency Funds.
4. The City Manager is authorized to reallocate funds from a contingent account maintained in the General Fund in conformance with the adopted policies set by the City Council. Additional appropriations to departments in the General Fund, or to total appropriations for all other budgeted funds, or transfers of appropriations between funds, require approval by the City Council. These amendments are added to the Adopted budget and the resulting totals are reflected as Adjusted budget amounts.
5. Expenditures may not legally exceed budgeted appropriations at the department level for the General Fund, and at the fund level for Special Revenue and Debt Service Funds.
6. Formal budgetary integration is employed as a management control device during the year in all funds except Agency Funds and the Civic Center Refinancing and Downtown Parking Improvement Debt Service Funds.
7. Budgets for governmental funds are adopted on a basis consistent with generally accepted accounting principles (GAAP) for all funds, except that General Fund encumbrances are treated as budgetary expenditures when incurred and stores (materials, parts and supplies) transactions included in the General Fund are not budgeted.
8. Expenditures for the Capital Projects Fund are budgeted and managed on a project length basis. Budget to actual comparisons for these expenditures have been excluded from the accompanying financial statements.



Note 3.....

CASH AND INVESTMENTS

The City pools cash from all sources and all funds except Restricted Cash and Investments with Fiscal Agents so that it can be invested at the maximum yield, consistent with safety and liquidity, while individual funds can make expenditures at any time.

Policies

The City invests in individual investments and in investment pools. Individual investments are evidenced by specific identifiable *securities instruments*, or by an electronic entry registering the owner in the records of the institution issuing the security, called the *book entry* system. In order to increase security, the City employs the Trust Department of a bank as the custodian of certain City managed investments, regardless of their form.

The City’s investments are carried at fair value, as required by generally accepted accounting principles. The City adjusts the carrying value of its investments to reflect their fair value at each fiscal year end, and it includes the effects of these adjustments in income for that fiscal year.

Classification

Cash and investments are classified in the financial statements as shown below, based on whether or not their use is restricted under the terms of City debt instruments or Agency agreements (in thousands):

Cash and investments available for operations	\$364,669
Cash and investments with fiscal agents	<u>3,832</u>
City cash and investments	368,501
Cash and investments available for operations in	
Fiduciary Funds (separate Statement)	1,067
Cash and investments with fiscal agents	
Fiduciary Funds (separate Statement)	<u>6,099</u>
Total cash and investments	<u><u>\$375,667</u></u>



Investments Authorized by the City’s Investment Policy & Debt Agreements

The table below identifies the investment types that are authorized by the City’s Investment Policy. The table also identifies certain provisions of the City’s Investment Policy that address interest rate risk, credit risk and concentration of credit risk. The table addresses investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the City, rather than the general provisions of the City’s investment policy.

Authorized Investment Type	Maximum Maturity	Minimum Credit Quality	Maximum Percentage of Portfolio	Maximum Investment In One Issuer
U.S. Government Securities	10 years	N/A	No Limit	No Limit
U.S. Government Agency Securities (C)	10 years	N/A	No Limit (A)	No Limit
Certificates of Deposit	10 years	N/A	20%	10% of the par value of portfolio
Bankers Acceptances	180 days (D)	N/A (D)	30%	\$5 million
Commercial Paper	270 days	AAA	15%	\$3 million (B)
Local Agency Investment Fund	N/A	N/A	No Limit	\$40 million per account
Short-Term Repurchase Agreements	1 year	N/A	No Limit	No Limit
City of Palo Alto Bonds	N/A	N/A	No Limit	No Limit
Money Market Deposit Accounts	N/A	N/A (E)	No Limit	10%
Mutual Funds (F)	N/A	N/A	20%	10%
Negotiable Certificates of Deposit	10 years	N/A	10%	\$5 million
Medium Term Corporate Notes	5 years	AA	10%	\$5 million

(A) Callable and multi-step securities are limited to no more than twenty percent of the par value of the portfolio, provided that:

- 1) the potential call dates are known at the time of purchase.
- 2) the interest rates at which they "step-up" are known at the time of purchase.
- 3) the entire face value of the security is redeemed at the call date.

(B) The lesser of \$3 million or 10% of outstanding commercial paper of any one institution.

Debt Agreements:

(C) Utility Revenue Bonds 2002 Series A and 1999 Series A allow General Obligations of states with a Minimum Credit Quality Rating of A2/A by Moody's and S&P.

(D) Utility Revenue Bonds 2002 Series A and 1999 Series A require a Minimum Credit Quality Rating of A-1/P-1 by Moody's and S&P and maturing no more than 360 days.

Utility Revenue Bonds 1995 limit the maximum maturity to 365 days.

(E) Utility Revenue Bonds 2002 Series A and 1999 Series A require a Minimum Credit Quality Rating of AAAm or AAAm-G by S&P.

(F) Utility Revenue Bonds 2002 Series A , Golf PIC COP 1998, University Avenue Parking Bond 2001 and University Avenue Parking Bond 2002 are allowed to invest in the California Asset Management Program.

The City must maintain required amounts of cash and investments with trustees under the terms of certain debt issues. These funds are unexpended bond proceeds or are pledged as reserves to be used if the City fails to meet its obligations under these debt issues. The California Government Code requires these funds to be invested in accordance with City ordinance, bond indentures or State statute. All these funds have been invested as permitted under the Code.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates and may adversely affect the fair value of an investment. Normally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

Information about the sensitivity of the fair values of the City’s investments (including investments held by bond trustees) to market interest rate fluctuations is provided by the following table that shows the distribution to the City’s investments by maturity or earliest call date (in thousands):

Type of Investments	Less Than One Year	One to Three Years	Three to Five Years	Over Five Years	Total
U.S. Federal Agency Securities	\$53,704	\$119,068	\$57,355	\$110,471	\$340,598
Money Market Mutual Funds (government securities)	1,645				1,645
Certificates of Deposit	196	373	176		745
California Asset Management Program	3,900				3,900
Local Agency Investment Fund	26,133				26,133
Total Investments	<u>\$85,578</u>	<u>\$119,441</u>	<u>\$57,531</u>	<u>\$110,471</u>	373,021
<i>Cash in banks and on hand</i>					<u>2,646</u>
Total Cash and Investments					<u>\$375,667</u>

Local Agency Investment Fund

The City is a participant in the Local Agency Investment Fund (LAIF) that is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. LAIF management calculates the fair value and cost of the entire LAIF pool. The City adjusts its cost basis invested in LAIF to fair value based on this ratio. The balance available for withdrawal on demand is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis. Included in LAIF’s investment portfolio are collateralized mortgage obligation, mortgage-backed securities, other asset-backed securities, loans to certain state funds, and floating rate securities issued by Federal agencies, government-sponsored enterprises, and corporations. At June 30, 2008, these investments matured in an average of 212 days.

California Asset Management Program

The City is a voluntary participant in the California Asset Management Program (CAMP). CAMP is an investment pool offered by the California Asset Management Trust (the Trust). The Trust is a joint powers authority and public agency created by the Declaration of Trust and established under the provisions of the California Joint Exercise of Powers Act (California Government Code Sections 6500 et seq., or the “Act”) for the purpose of exercising the common power of its Participants to invest certain proceeds of debt issues and surplus funds. The Pool’s investments are limited to investments permitted by subdivisions (a) to (n), inclusive, of Section 53601 of the California Government Code. The City reports its investments in CAMP at the fair value amounts provided by CAMP, which is the same as the value of the pool share. At June 30, 2008 the fair value approximated is the City’s cost. At June 30, 2008, these investments have an average maturity of 49 days.

Money Market Mutual Funds are available for withdrawal on demand and at June 30, 2008 matured in an average of 17 days.



Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The City's investments (including investments held by bond trustees) include the following investments that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above):

Highly Sensitive Investments

Fair Value at Year End
(in thousands)

US Federal Agency Callable Securities. These securities are subject to early redemption in a period of declining interest rates. The resultant reduction in expected total cash flows affects the fair value of these securities and makes the values of these securities highly sensitive to changes in interest rates.

\$57,333

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the actual rating as provided by Standard & Poor's investment rating system as of June 30, 2008 for each investment type (in thousands):

Investment Type	AAA	Total
U.S. Federal Agency Securities	\$340,598	\$340,598
Money Market Mutual Funds (government securities)	1,645	1,645
California Asset Management Program	3,900	3,900
Total	\$346,143	346,143
Not Rated:		
Certificates of Deposit		745
Local Agency Investment Fund		26,133
<i>Cash in banks and on hand</i>		2,646
Total Cash and Investments		\$375,667



Concentration of Credit Risk

Investments in any one issuer, other than U.S. Treasury securities, mutual funds, and external investment pools, that represent 5 percent or more of total City portfolio Entity-wide investments, are as follows at June 30, 2008 (in thousands):

<u>Investments</u>	<u>Reporting Type</u>	<u>Investment Amount</u>
Federal Agriculture Mortgage Corp.	U.S. Federal Agency Securities	\$25,920
Federal Farm Credit Bank	U.S. Federal Agency Securities	104,009
Federal Home Loan Bank	U.S. Federal Agency Securities	126,961
Federal Home Loan Mortgage Corp.	U.S. Federal Agency Securities	22,488
Federal National Mortgage Assoc.	U.S. Federal Agency Securities	40,758

Custodial Risk

California Law requires banks and savings and loan institutions to pledge government securities with a market value of 110 percent of the City's cash on deposit or first trust deed mortgage notes with a value of 150 percent of the deposit as collateral for these deposits. Under California Law this collateral is held in the City's name and places the City ahead of general creditors of the institution. The City has waived collateral requirements for the portion of deposits covered by federal deposit insurance.

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, the City will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The City's Investment Policy limits its exposure to custodial credit risk by requiring that all security transactions entered into by the City, be conducted on a delivery-versus-payment basis. Securities are to be held by a third party custodian.

Note 4.....

INTERFUND TRANSACTIONS

Transfers Between Funds

With Council approval, resources may be transferred from one City fund to another. The purpose of the majority of transfers is to subsidize a fund. Less often, a transfer may be made to open or close a fund.

Transfers between City funds during fiscal year 2007-08 were as follows (in thousands):

Fund Receiving Transfer	Fund Making Transfer	Amount Transferred	
General Fund	Street Improvement Special Revenue Fund	\$292	
	Special Districts Special Revenue Fund	794	
	Redevelopment Agency Special Revenue Fund	6	
	Capital Projects Fund	118	
	Water Enterprise Fund	2,694	A
	Electric Enterprise Fund	9,412	A
	Gas Enterprise Fund	3,208	A
	Wastewater Collection Enterprise Fund	68	A
	Refuse Enterprise Fund	271	A
	Wastewater Treatment Enterprise Fund	134	
	Storm Drainage Enterprise Fund	27	
	External Services Enterprise Fund	11	
	Vehicle Replacement and Maintenance Internal Service Fund	27	
	Technology Fund Internal Service Fund	63	
	Printing and Mailing Services Internal Service Fund	8	
	Special Revenue Funds:		
Redevelopment Agency	General Fund	6	
Debt Service Funds:			
Golf Course	General Fund	528	
Civic Center Refinancing	General Fund	329	
	Special Districts Special Revenue Fund	80	
Downtown Parking Improvement	General Fund	226	
Capital Projects Fund:			
	General Fund	11,807	B
	Street Improvement Special Revenue Fund	756	
	Developer's Impact Fee Special Revenue Fund	620	
	Transportation Mitigation Special Revenue Fund	82	
	Special Districts Special Revenue Fund	94	
	Local Law Enforcement Special Revenue Fund	100	
	Electric Enterprise Fund	270	
	Gas Enterprise Fund	40	
	Water Enterprise Fund	100	
	Refuse Enterprise Fund	390	
	Wastewater Collection Enterprise Fund	150	
Permanent Fund:			
Eyerly Trust	General Fund	726	

Fund Receiving Transfer	Fund Making Transfer	Amount Transferred
Enterprise Funds:		
Water	Gas Enterprise Fund	\$100
	Wastewater Collection Enterprise Fund	100
Electric	General Fund	33
Refuse	Special Districts Special Revenue Fund	222
Wastewater Collection Enterprise Fund	Retiree Health Benefit Internal Service Fund	64
External Services	Technology Fund Internal Service Fund	842
Internal Service Funds:		
Technology	Water Enterprise Fund	255
	Electric Enterprise Fund	1,469
	Gas Enterprise Fund	535
	Wastewater Collection Enterprise Fund	164
	Wastewater Treatment Enterprise Fund	229
	Refuse Enterprise Fund	392
	Storm Drainage Enterprise Fund	43
		<u>\$37,885</u>

The reasons for these transfers are set forth below:

- (A) Transfer to reimburse the General Fund for costs incurred for the benefit of funds making the transfer.
- (B) Allocation of funds to construct capital assets

Interfund Commitment

During fiscal year 2001-02, the City established the Palo Alto Redevelopment Agency. The Agency and the City have an agreement whereby the City will advance funds to the Agency in support of start up and formation costs. However, the interfund advances have no specific repayment date. Generally accepted accounting principals require that such amounts be treated as transfers in the year made. Advances without specified repayment terms total \$368 thousand as of June 30, 2008.

Long-Term Interfund advances

On August 6, 2007, the City authorized a loan in the amount up to \$1.7 million from the General Fund Budget Stabilization Reserve to the Storm Drainage Fund for Capital Improvement Program project San Francisquito Creek Storm Water Pump Station. The General Fund Budget Stabilization Reserve will be paid back in three years after receipt of the last payment, together with interest at an interest rate commensurate with the Reserve’s annual rate of return during the time period of the loan. The Storm Drain Fund will be charged interest on the principal borrowed (loan) from the General Fund. The interest rate will be equal to the average yield on the City’s portfolio from the time the loan is issued through the time of repayment. The loan will be repaid over a 3 year period. There shall be no pre-payment penalty. At June 30, 2008 the balance of the advance including principal and accrued interest was \$1.1 million.

Internal Balances

Internal balances represent the net interfund receivables and payables remaining after the elimination of all such balances within Governmental and Business-type Activities.



Note 5.....

NOTES AND LOANS RECEIVABLE

At June 30, 2008, the City's notes and loans receivable totaled (in thousands):

Palo Alto Housing Corporation:	
Oak Manor Townhouse	\$1,045
Emerson Street Project	375
Alma Single Room Occupancy Development	2,222
Barker Hotel	2,111
Sheridan Apartments	2,247
Oak Court Apartments, L.P.	7,834
Mid-Peninsula Housing Coalition:	
Palo Alto Gardens Apartments	574
Community Working Group, Inc	1,280
Opportunity Center Associates, L.P.	750
Home Rehabilitation Loans	96
Executive Relocation Assistance Loans	1,155
Below Market Rate Assessment Loans	74
Stevenson Housing:	
Hot Water	81
Fire Alarm	48
Oak Manor Townhouse Water System	114
Palo Alto Senior Housing Project	28
Clara-Mateo Alliance	11
Lytton Gardens Assisted Living	101
Emergency Housing Consortium	75
Alma Gardens Apartment	<u>1,150</u>
Total Loans and Notes	<u>21,371</u>
Less: valuation allowance	<u>(14,760)</u>
Net Carrying Value	<u><u>\$6,611</u></u>

Housing Loans

The City engages in programs designed to encourage construction or improvement in low-to-moderate income housing or other projects. Under these programs, grants or loans are provided under favorable terms to homeowners or developers who agree to spend these funds in accordance with the City's terms. These loans have been offset by reserved fund balances, as they are not expected to be repaid immediately.

Some of these loans contain forgiveness clauses which provide for the amount loaned to be forgiven if the third party maintain compliance with the terms of the loan and associated regulatory agreements. Since some of these loans are secured by trust deeds which are subordinated to other debt on the associated projects or are only repayable from residual cash receipts on the projects, collectibility of some of the outstanding balances may be not be realized. As a result of the forgiveness clauses and nature of these housing projects and associated cash flows, a portion of the outstanding balances of the loans has been offset by a valuation allowance.

Oak Manor Townhouse

On January 7, 1991, the City loaned \$2.1 million to assist in the acquisition of an apartment complex to be used to provide rental housing for low and very low-income households. This loan bears interest at 3 percent, is due in annual installments until 2011 and is collateralized by a subordinated deed of trust. Under the terms of the loan agreement, loan payments are forgiven if the Corporation meets the objective of this project. During the year ended June 30, 2008 the objective was met. The annual loan payment was forgiven for the calendar year ending December 31, 2007.

Emerson Street Project

On November 8, 1994, the City loaned \$375 thousand for expenses necessary to acquire an apartment complex for the preservation of rental housing for low and very low-income households in the City. This loan is collateralized by a second deed of trust. The loan bears no interest until 2009 after which the loan bears interest at three percent per year. The principal balance is due in 2034.

Alma Single Room Occupancy Development

On December 13, 1996, the City loaned \$2.7 million to the Alma Place Associates, L.P. for the development of a 107 unit single room occupancy development. This loan bears interest at 3 percent and is collateralized by a subordinated deed of trust. Loan payments are deferred until 2014. The principal balance is due in 2041.

Barker Hotel

On April 12, 1994, the City loaned a total of \$2.1 million for the preservation, rehabilitation and expansion of a low-income, single room occupancy hotel. This loan was funded by three sources: \$400 thousand from the Housing In-Lieu Special Revenue Fund, \$1.0 million from HOME Investment Partnership Program Funds, and \$670 thousand from Community Development Block Grant Funds. All three notes bear no interest and are collateralized by a deed of trust, which is subordinated to private financing. Loan repayments are deferred until 2035.



In July 2004, the City agreed to loan up to \$41 thousand to Palo Alto Housing Corporation to rehabilitate the interior of the Barker Hotel. The loan is funded entirely by Community Development Block Grant funds and is collateralized by a deed of trust on the property. Annual loan payments are deferred until certain criteria defined in the loan agreement are reached. The loan shall be forgiven if the borrower satisfactorily complies with all the terms and conditions of the loan agreement.

Sheridan Apartments

On December 8, 1998, the City loaned \$2.5 million to the Palo Alto Housing Corporation for the purchase and rehabilitation of a 57 unit apartment complex to be used for senior and low-income housing. The loan is funded by \$1.6 million in Community Development Block Grant Funds, and \$825 thousand in Housing In-Lieu funds. The note bears interest at 9 percent when available surplus cash from the project equals or exceeds 25 percent of interest calculated using 9 percent. When available surplus cash falls below this level the note bears interest at 3 percent. The note is collateralized by a second deed of trust and an Affordability Reserve Account held by the Corporation. Annual loan payments are deferred until the Corporation accumulates \$1.0 million in an Affordability Reserve Account. The principal balance is due in 2033.

Oak Court Apartments

On August 18, 2003, in connection with the loan to Oak Court Apartments, L.P. discussed below, the City loaned \$5.9 million to the Palo Alto Housing Corporation for the purchase of land on which Oak Court Apartments, L.P. constructed a 53 unit rental apartment complex for low and very low-income households with children. The note bears interest of five percent and is secured by a deed of trust. Annually accrued interest is added to the principal balance and note payments are due annually after 55 years, or beginning in 2058, unless the Corporation elects to extend the note until 2102, as define in the regulatory agreement.

Oak Court Apartments, L.P.

On August 18, 2003, the City loaned \$2.0 million to Oak Court Apartments, L.P. for the construction of a 53 unit rental apartment complex for low and very low-income households with children which was completed in April 2005. The note bears no interest until certain criteria defined in the note are satisfied, at which time the note will bear an interest rate not to exceed three percent. The note is secured by a subordinate deed of trust. The principal balance is due in 2058.

Palo Alto Gardens Apartments

On April 22, 1999, the City loaned \$1.0 million to the Mid-Peninsula Housing Coalition for the purchase and rehabilitation of a 155 unit complex for the continuation of low-income housing. This loan is funded by \$659 thousand in Community Development Block Grant funds and \$341 thousand in Housing In-Lieu funds. There are two notes that bear interest at 3 percent and are secured by second deeds of trust and a City Affordability Reserve Account held by the Coalition. Annual loan payments are deferred until certain criteria defined in the notes are reached. Principal and interest payments began in FY 2007-08. The principal balance is due in 2039.

Community Working Group, Inc.

On May 13, 2002, the City loaned \$1.3 million to the Community Working Group, Inc. for predevelopment, relocation and acquisition of land for development of an 89 unit complex and homeless service center for very low-income households. The loan is funded by \$1.3 million dollars of Community Development Block Grant funds. The note bears no interest and is secured by a first deed of trust. No repayment of the \$1.3 million will be required, provided that compliance with the City's agreement is maintained. After 89 years of compliance with the regulatory agreement, the City's loan would convert to a grant and its deed of trust would be reconveyed.

Opportunity Center Associates, L.P.

On July 19, 2004, the City loaned \$750 thousand for 55-year term to the Opportunity Center Associates, L.P. for construction of 89 units of rental housing for extremely low-income and very low-income households. The loan is funded by \$750 thousand of Residential Housing Funds. The note bears 3 percent interest and is secured by a deed of trust.

Home Rehabilitation

The City administers a closed housing rehabilitation loan program initially funded with Community Development Block Grant funds. Under this program, individuals with incomes below a certain level are eligible to receive low interest loans, for rehabilitation work on their homes. These loans are secured by deeds of trusts, which may be subordinated to subsequent encumbrances upon said real property with the prior written consent of the City. The loan repayments may be amortized over the life of the loans, deferred or a combination of both.

Executive Relocation Assistance Loans

The City Council may authorize a mortgage loan as part of a relocation assistance package to executive staff. The loans are secured by first deeds of trust and interest is adjusted annually based on the rate of return of the invested funds of the City for the year ending June 30 plus one quarter of 1 percent. Principal and interest payments are due bi-weekly. Employees must pay off any outstanding balance of their loans within a certain period after ending employment with the City. As of June 30, 2008, the City had two outstanding employee home loans due in 2030 and 2031 respectively.

Below Market Rate Assessment Loans

In December 2002, the City loaned \$53 thousand to Below Market Rate home owners with low incomes and /or very limited assets for capital repairs, special assessments and improvements of their properties. The loans bear interest at 3 percent and are secured by a deed of trust on each property. Loan payments are deferred until 2032. In 2008, the City did not accrue interest.

Stevenson Housing Hot Water Loans

In July 2004, the City agreed to loan up to \$38 thousand to Palo Alto Senior Housing Project, Inc. to refurbish the hot water piping system at the Stevenson House Senior Housing facility. In April 2005, the City agreed to increase the loan by \$45 thousand, bringing the total loan to \$83 thousand. The loan is funded entirely by Community Development Block Grant funds, and bears simple interest of 6 percent. Principal and interest payments are deferred until July 1, 2010, as long as the borrower continues to comply with all terms and conditions of the agreement.

Adolescent Counseling Services Loans (Caravan House)

In October 2003, the City agreed to loan up to \$111 thousand to Adolescent Counseling Services for rehabilitation expenses in connection with a rental housing facility for teenage girls. The loan is funded entirely by Community Development Block Grant funds, bears interest at 3 percent and is secured by a deed of trust on the property. Adolescent Counseling Services sold the property and paid the City in fiscal year 2007-08.



Palo Alto Senior Housing Project Loans

In July 2003, the City agreed to loan up to \$45 thousand to Palo Alto Senior Housing Project for home improvements in the independent living facility for low-income seniors. The loan is funded entirely by Community Development Block Grant funds, bears interest at 6 percent and is secured by a deed of trust on the property. Principal and interest payments are deferred until 2009. Principal and interest on the loan shall be forgiven if the borrower satisfactorily complies with all the terms set forth in the July 2003 agreement.

In April 2008, the City provided \$47.6 thousand for the purpose of repairing and upgrading the fire alarm system at the Senior Housing facility.

Clara-Mateo Alliance Loans

In July 2003, the City agreed to loan up to \$200 thousand to Clara-Mateo Alliance for rehabilitation of the kitchen and the Elsa Segovia Center to provide services for the homeless. The loan is funded entirely by Community Development Block Grant funds, bears interest at 6 percent and is secured by a deed of trust on the property. Repayment of the loan will not be required unless the property is sold or the program terminated; or changed to a use prior to July 1, 2009 that has not been approved by the City. Principal and interest on the loan shall be forgiven if the borrower satisfactorily complies with all the terms and conditions set forth in the July 2003 agreement.

Lytton Gardens Assisted Living

In June 2005, the City agreed to loan up to \$109 thousand to Community Housing, Inc. to upgrade and modernize the existing kitchens at the senior residential facility known as Lytton Gardens Assisted Living. The loan is funded entirely by Community Development Block Grant funds, and bears simple interest of 3 percent. Principal and interest payments are deferred until July 1, 2035, as long as the borrower continues to comply with all terms and conditions of the agreement.

Emergency Housing Consortium

In November 2005, the City agreed to loan up to \$75 thousand to Emergency Housing Consortium, to cover architectural expenses that will be incurred in rehabilitating and expanding the property. The loan is funded entirely by Community Development Block Grant funds, and bears simple interest of 3 percent. Principal and interest payments are deferred until July 1, 2035, as long as the borrower continues to comply with all terms and conditions of the agreement.

Alma Gardens Apartment

In March 2006, the City agreed to loan up to \$1.2 million to Community Working Group, Inc., to acquire a 10-unit multi-family housing complex known as Alma Garden Apartment. The loan is funded entirely by Community Development Block Grant funds. Principal and interest payments will be made as provided in the note until July 1, 2061, as long as the borrower continues to comply with all terms and conditions of the agreement.

Eden Housing

In September 2006, the City agreed to loan \$980 thousand to the Community Housing Alliance (CHA) to acquire two parcels of land for the development of a 53 unit housing complex to provide rental housing for extremely low-income residents. On September 30, 2006, the City deposited in an escrow account \$980 thousand to be used towards the purchase of the land. Of this amount, \$480 thousand was repaid back to the City.



Notes to Basic Financial Statements – Note 5

In August 2008, the City agreed to the conveyance of the Alma Substation parcel to Eden Housing and the CHA and a loan of \$3.0 million for acquisition of adjacent Ole’s Automotive Repair Shop. The City’s total loan amount for the project is \$3.5 million.



Note 6.....

CAPITAL ASSETS

Valuation

All capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Contributed capital assets are valued at their estimated fair market value on the date contributed. The City's policy is to capitalize all assets when costs are equal to/or exceed \$5,000 and the useful life exceeds three years. Infrastructure assets are capitalized when costs are equal to/or exceed \$100,000.

Proprietary Fund capital assets are recorded at cost including significant interest costs incurred under restricted tax-exempt borrowings, which finance the construction of capital assets. These interest costs, net of interest earned on investment of the proceeds of such borrowings are capitalized and added to the cost of capital assets during the construction period. Maintenance and repairs are expensed as incurred.

The City has recorded all its public domain (infrastructure) capital assets, which consists of Roadway, Recreation and Open Space, in its Citywide financial statements. GASB Statement 34 requires that all capital assets with limited useful lives be depreciated over their estimated useful lives. Alternatively, the "modified approach" may be used for certain capital assets. Depreciation is not provided under this approach, but all expenditures on these assets are expensed, unless they are additions or improvements. The City has elected to use the depreciation method for its capital assets. Capital assets with limited useful lives may/can be depreciated over their estimated useful lives. Alternatively, the "modified approach" may be used for certain capital assets. Depreciation is not provided under this approach, but all expenditures on these assets are expensed, unless they are additions or improvements. The City has elected to use the depreciation method for its capital assets.

The purpose of depreciation is to spread the cost of capital assets equitably among all users over the life of these assets. The amount charged to depreciation expense each year represents that year's pro rata share of the cost of capital assets.

Depreciation has been provided on capital assets. Depreciation of all capital assets is charged as an expense against operations each year and the total amount of depreciation taken over the years, called accumulated depreciation, is reported on the balance sheet as a reduction in the book value of capital assets.

Depreciation is provided using the straight line method which means the cost of the asset is divided by its expected useful life in years and the result is charged to expense each year until the asset is fully depreciated. The City has assigned the useful lives listed below to capital assets.



Notes to Basic Financial Statements – Note 6

	Years
GOVERNMENTAL ACTIVITIES	
Buildings & structures	10-30
Equipment:	
Computer equipment	4
Office machinery & equipment	5
Machinery & equipment	10
Roadway network includes pavement, striping & legends, curbs, gutters & sidewalks, parking lots, traffic signage and bridges	5-40
Recreation and open space network includes major park facilities, park trails, bike paths and median	25-40
 BUSINESS-TYPE ACTIVITIES	
Buildings and structures	25-60
Vehicles and heavy equipment	3-10
Machinery and equipment	10-50
Transmission and distribution systems	10-100

General Capital Assets

Changes in the City's general capital assets during the year ended June 30, 2008 were (in thousands):

	Balance June 30, 2007	Additions	Retirements	Transfers	Balance June 30, 2008
Governmental activities					
Capital assets not being depreciated					
Land and improvements	\$71,407			\$1,772	\$73,179
Street trees	15,042	\$222	(\$117)		15,147
Construction in progress	29,895	20,570		(13,096)	37,369
Total capital assets not being depreciated	116,344	20,792	(117)	(11,324)	125,695
Capital assets being depreciated					
Buildings and improvements	93,542			6,154	99,696
Equipment	8,188	329	(1,070)	344	7,791
Roadway network	239,179			4,502	243,681
Recreation & open space network	13,532			324	13,856
Total capital assets being depreciated	354,441	329	(1,070)	11,324	365,024
Less accumulated depreciation					
Buildings and improvements	(55,117)	(1,631)			(56,748)
Equipment	(6,182)	(320)	1,070		(5,432)
Roadway network	(83,396)	(5,778)			(89,174)
Recreation & open space network	(4,761)	(363)			(5,124)
Total accumulated depreciation	(149,456)	(8,092)	1,070		(156,478)
Net governmental fund program					
Capital assets being depreciated	204,985	(7,763)		11,324	208,546
Internal service fund capital assets					
Construction in progress	4,414	5,326		(2,589)	7,151
Equipment	31,967	1,163	(469)	2,589	35,250
Accumulated depreciation	(22,009)	(3,084)	393		(24,700)
Net internal service capital assets	14,372	3,405	(76)		17,701
Governmental activity capital assets, net	\$335,701	\$16,434	(\$193)		\$351,942

Business-type Capital Assets

Changes in the City’s Enterprise Fund capital assets during the year ended June 30, 2008 were (in thousands):

	Balance June 30, 2007	Additions	Retirements	Transfers	Balance June 30, 2008
<i>Business-type activities</i>					
Capital assets not being depreciated					
Land and improvements	\$1,953				\$1,953
Construction in progress	88,969	\$43,204		(\$2,129)	130,044
Total capital assets not being depreciated	90,922	43,204		(2,129)	131,997
Capital assets being depreciated					
Buildings and structures	18,915			676	19,591
Transmission, distribution, and treatment systems	480,143	2,431	(\$2,581)	1,453	481,446
Total capital assets being depreciated	499,058	2,431	(2,581)	2,129	501,037
Less accumulated depreciation					
Buildings and structures	(5,647)	(469)			(6,116)
Transmission, distribution, and treatment systems	(200,524)	(12,253)	2,472		(210,305)
Net capital assets being depreciated	(206,171)	(12,722)	2,472		(216,421)
Total depreciable assets	292,887	(10,291)	(109)	2,129	284,616
<i>Business-type activity capital assets, net</i>	<u>\$383,809</u>	<u>\$32,913</u>	<u>(\$109)</u>		<u>\$416,613</u>

Capital Asset Contributions

Some capital assets may be acquired using Federal and State grant funds, or they may be contributed by developers or other governments. Generally accepted accounting principles require that these contributions be accounted for as revenues at the time the capital assets are contributed.

Depreciation Allocation

Depreciation expense was charged to functions and programs based on their usage of the related assets. The amounts allocated to each function or program were as follows (in thousands):

<i>Governmental Activities</i>		<i>Business-Type Activities</i>	
City Manager	\$11	Water	\$1,065
Community Services	598	Electric	5,616
Fire	102	Gas	1,552
Police	25	Wastewater Collection	1,412
Public Works	7,191	Wastewater Treatment	2,093
Planning	52	Refuse	636
Non departmental (Common Use Assets)	11	Storm Drainage	348
Library Dept	102		<u>\$12,722</u>
Internal Service Funds	3,084		
	<u>\$11,176</u>		

Construction in Progress and Completed Projects

Construction in progress in fiscal year 2007-08 comprise (in thousands):

	<u>Expended to June 30, 2008</u>
Governmental Activities:	
Open Space Trails & Amenities	\$1,112
Open Space Parking Improvement	622
Park Facilities Improvement	1,518
Park Backflow Replacement & Irrigation	260
Civic Center Infrastructure	2,000
Fire Station Improvement	258
Lucie Stern Community Center Improvements	111
Community Services Lighting Enhancements	207
Library Master Plan Project	974
Children's Theater System	207
Roth Building Wings Demolition	225
Fire Communication Computer Systems	227
Park Backflow Replacement & Irrigation	259
Lot S/L Garage (Downtown Parking Structure)	497
Public Safety Building	2,555
San Mateo Drive Bridges	110
Art in Public Places	134
Police Mounted Video	196
Library Automation Service	209
Open Space Lakes/Ponds	147
Public Safety Mobile Data	164
Fire Portable Radio Replacement	245
Sand Hill Road Bridge	173
Mitchell Park Library	1,384
Fire Stations 3 & 4 Feasibility Study	188
Animal Shelter Expansion & Renovation	818
Street Maintenance	3,045
Roofing Replacement	318
Building Systems Improvement	173
Cubberley Mechanical & Electrical Upgrades	166
Stanford/Palo Alto Playing Fields	855
School Site Irrigation	270
Mitchell Park Facilities Improvements	1,132
ECR/Ventura Signal	110
San Antonio/101 Signal	234
Sidewalk Repairs	3,121
Traffic Calming Project	306
Interior Finishes Construction	288
Security Systems Improvements	203
College Terrace Library Improvement	324
Sixteen ALS Monitor/Defibrillator	133
Municipal Service Center Improvements	164
Cubberley Community Center Campus Fire Alarm System	674
Photovoltaic Designs & Installations	3,175
College Terrace Traffic Calming	143
Charleston/Arastradero Corridor Plan	781
Traffic Signal Upgrades	148
Street Lights Improvements	137
Buildings Study	175
San Antonio Road Median Improvements	340
College Terrace Parks Improvements	150
Mitchell Park Facilities Improvements	503
Tennis & Basketball Court Resurfacing	186



Notes to Basic Financial Statements – Note 6

Governmental Activities(continue):

Benches, Signage, Fencing, Walkways	\$183
Ramos Park Improvements	496
Roth Building Maintenance	159
Hoover Park Improvements	716
Library Service Model Analysis	267
Foothills Intrpt Ctr & Maint Yard Parking Lot	284
Heritage Park Playground Public/Private Partnership	158
Baylands Athletic Center Fencing Dugout	242
Peers Park Improvement	251
American with Disability	699
Foothills Park Road	225
Vehicle Replacement Fund	2,754
Technology Fund	4,397
Other construction in progress	<u>1,635</u>

Total governmental construction in progress \$44,520

Enterprise Funds:

Storm drainage structural and water quality improvements	\$4,847
Gas system extension replacements and improvements	15,832
Water system extension replacements and improvements	13,513
Electric distribution system improvements	11,473
Water quality control plant equipment replacement and lab facilities	17,201
Sewer system rehabilitation and extensions	3,685
Other construction in progress	<u>63,493</u>

Total enterprise construction in progress \$130,044

Allocations of Enterprise Fund administration and general expenses of \$5.78 million have been capitalized and included in amounts expended to June 30, 2008.

Note 7

GENERAL LONG-TERM OBLIGATIONS

The City's Long-Term Obligations

Bond discounts and issuance costs of long-term debt issues are amortized over the life of the related debt. Gains or losses between the net book value of debt and funds placed in escrow to defease that debt are amortized over the remaining life of either the refunded debt or the refunding debt, whichever is shorter.

The City's long-term debt issues and transactions, other than Special Assessment debt discussed in Note 8, were as follows (in thousands):

	Original Issue Amount	Balance June 30, 2007	Additions	Retirements	Balance June 30, 2008	Current Portion
Governmental Activity Debt:						
<i>General Long Term Obligations:</i>						
1998 Golf Course Certificates of Participation, 4.00-5.00%, due 09/01/2018	\$7,750	\$5,075		\$325	\$4,750	\$335
2002A Civic Center Refinancing Certificates of Participation, 2.00-4.00%, due 03/01/2012	3,500	1,890		350	1,540	365
2002B Downtown Parking Improvements Certificates of Participation 4.55-6.00%, due 03/01/2022	3,555	2,210		95	2,115	100
Total Governmental Activity Debt	\$14,805	\$9,175		\$770	\$8,405	\$800
Business-type Activity Debt:						
<i>Enterprise Long Term Obligations:</i>						
Utility Revenue Bonds,						
1995 Series A, 5.00-6.25%, due 06/01/2020	\$8,640	\$5,964		\$315	\$5,649	\$330
1999 Refunding, 3.25-5.25%, due 06/01/2024	17,735	14,670		455	14,215	480
2002 Series A, 3.00-5.00%, due 06/01/2026	26,055	21,225		755	20,470	780
Energy Tax Credit Bonds,						
2007 Series A, 0%, due 12/15/2021	1,500		1,500	100	1,400	100
State Water Resources Loan,						
2007, 0%, due 6/30/2029	9,000		5,629		5,629	
Less: unamortized discount/ issuance cost		(972)	(143)	(62)	(1,053)	
	\$62,930	\$40,887	\$6,986	\$1,563	\$46,310	\$1,690

Description of the City's Long-Term Debt Issues

1998 Golf Course COPs – In August 1998, the City's Public Improvement Corporation issued Golf Course Improvement COPs, Series 1998 in the amount of \$7.8 million to retire the 1978 Golf Course Lease Revenue Bonds, and to finance various improvements at the Palo Alto Public Golf Course, including upgrading five fairways and various traps, trees and greens, constructing new storm drain facilities, replacing the existing irrigation system, upgrading the driving range, and installing new cart paths. The 1998 COPs are secured by lease revenues received by the Public Improvement Corporation from golf course revenues or other unrestricted revenues of the City. Principal and interest are payable semi-annually each March 1 and September 1.

2002A Civic Center Refinancing COPs – On January 16, 2002 the City issued \$3.5 million of COPs to refund the City's 1992 COPs which were subsequently retired. Principal payments for the 2002A COPs are due annually on March 1 and interest payments semi-annually on March 1 and September 1 and are payable from lease revenues received by the Palo Alto Public Improvement Corporation from the City from available funds.

2002B Downtown Parking Improvement Project COPs – On January 16, 2002 the City issued \$3.6 million of COPs to finance the construction of certain improvements to the non-parking area contained in the City's Bryant /Florence Garage complex. Principal payments are due annually on March 1 and interest payments semi-annually on March 1 and September 1 from 4.6 percent to 6.5 percent, and are payable from lease revenues received by the Palo Alto Public Improvement Corporation from the City from available funds.

On January 25, 2005, the City defeased \$900 thousand of the 2002B Downtown Parking Improvements Certificates of Participation. Surplus cash from the Civic Center Refinancing and Downtown Parking Improvement Project Construction account were placed in an irrevocable trust to provide for future debt payments. Accordingly, the trust account assets and the liability for the defeased Bonds are not included on the financial statements. The outstanding amount of the defeased debt at June 30, 2008 is \$775 thousand. The defeasance resulted in an overall debt service savings of \$1.5 million and an economic gain of \$462 thousand.

1995 Utility Revenue Bonds, Series A – The City issued Utility Revenue Bonds on February 1, 1995 to finance certain extensions and improvements to the City's Storm Drainage and Surface Water System. The Bonds are special obligations of the City payable solely from and secured by a pledge of and lien upon the revenues derived by the City from the funds, services and facilities of all Enterprise Funds except the Refuse Fund and External Services Fund. Principal payments are payable annually on June 1 and interest payments semi-annually on June 1 and December 1. A \$2.9 million 6.3 percent term bond is due June 1, 2020. In lieu of a reserve fund, the Bonds are secured by a Surety Bond issued by AMBAC Indemnity Corporation.

The pledge of future Net Revenues for the above funds ends upon repayment of the \$5.649 million in remaining debt service on the bonds which is scheduled to occur in 2020. For fiscal year 2008, Net Revenues including operating revenues and non-operating interest earnings amounted to \$240.026 million and operating costs include operating expenses, but not interest, depreciation or amortization and amounted to \$186.287 million. Net Revenues available for debt service amounted to \$53.739 million which represented coverage of 78.57 times over the \$684 thousand in debt service.



1999 Utility Revenue and Refunding Bonds, Series A – The City issued Utility Revenue Bonds on June 1, 1999 to refund the 1990 Utility Revenue Refunding Bonds, Series A and the 1992 Utility Revenue Bonds, Series A, and to finance rehabilitation of the Wastewater Treatment System’s two sludge incinerators. The 1990 Utility Revenue Refunding Bonds, Series A and the 1992 Utility Revenue Bonds, Series A, were subsequently retired.

The 1999 Bonds are special obligations of the City payable solely from and secured by a pledge of and lien upon certain net revenues derived by the City’s Sewer System and its storm and surface water system (the “Storm Drain System”). As of June 30, 2001, the 1999 Bonds had been allocated to and were repayable from net revenues of the following enterprise funds: Wastewater Collection (10.2 percent), Wastewater Treatment (64.6 percent) and Storm Drain (25.2 percent). Principal payments are payable annually on June 1 and interest payments semi-annually on June 1 and December 1. A \$3.1 million 5.3 percent term bond, and a \$5.1 million 5.3 percent term bond are due June 1, 2021 and 2024, respectively. In lieu of a reserve fund, the Bonds are secured by a Surety Bond issued by AMBAC Indemnity Corporation.

The pledge of future Net Revenues for the above funds ends upon repayment of the \$14.215 million in remaining debt service on the bonds which is scheduled to occur in 2024. For fiscal year 2008, Net Revenues including operating revenues and non-operating interest earnings amounted to \$18.612 million and operating costs include operating expenses, but not interest, depreciation or amortization amounted to \$11.811 million. Net Revenues available for debt service amounted to \$6.801 million which represents coverage of 5.64 times over the \$1.205 million in debt service.

2002 Utility Revenue Bonds, Series A – On January 24, 2002 the City issued Utility Revenue Bonds to finance certain improvements to the City’s water utility system, and the City’s natural gas utility system. Principal payments are due annually on June 1 and interest payments are due semi-annually on June 1 and December 1 from 3.0 percent to 5.0 percent. The 2002 Revenue Bonds are secured by net revenues generated by the Water Services and Gas Services Funds.

The pledge of future Net Revenues for the above funds ends upon repayment of the \$20.47 million in remaining debt service on the bonds which is scheduled to occur in 2026. For fiscal year 2008, Net Revenues including operating revenues and non-operating interest earnings amounted to \$79.452 million and operating costs include operating expenses, but not interest, depreciation or amortization amounted to \$52.767 million. Net Revenues available for debt service amounted to \$26.685 million which represented coverage of 15.48 times over the \$1.724 million in debt service.

2007 Electric System Clean Renewable Energy Tax Credit Bonds, Series A – In October 2007, the City issued \$1.5 million of Electric Utility Clean Renewable Energy Tax Credit Bonds (CREBs), 2007 Series A, to finance the City’s photovoltaic solar panel project. The Bonds do not bear interest. In lieu of receiving periodic interest payments, bondholders are allowed annual federal income tax credits in an amount equal to a credit rate for such CREBs multiplied by the outstanding principal amount of the CREBs owned by the bondholders. The Bonds are payable solely from and secured solely by a pledge of the Net Revenues of the Electric system and the other funds pledged therefore under the Indenture.

The pledge of future Electric Fund Net Revenues ends upon repayment of the \$1.5 million in remaining debt service on the bonds which is scheduled to occur in 2021. For fiscal year 2008, Net Revenues including operating revenues and non-operating interest earnings amounted to \$114.231 million and operating costs include operating expenses, but not interest, depreciation or amortization amounted to \$93.369 million. Net Revenues available for debt service amounted to \$20.862 million which represented coverage of 208.62 times over the \$0.1 million in debt service.

State Water Resources Loan – In October 2007, the City approved the \$9.0 million loan agreement with State Water Resources Control Board (SWRCB) to finance the City’s Mountain View/Moffett Area reclaimed water pipeline project. Under the terms of the contract, the City has agreed to repay \$9.0 million to the State in exchange for receiving \$7.5 million in proceeds to be used to fund the Project. The difference between the

Notes to Basic Financial Statements – Note 7

repayment obligation and proceeds amounts to \$1.5 million and represents in-substance interest on the outstanding balance. Loan proceeds are drawn down as the project progresses and debt service payments commence on June 30, 2010. As of June 30, 2008, the City received a total loan amount of \$5.6 million.

Debt Service Requirements (in thousands):

Debt service and capitalized lease requirements are shown below for all long-term debt.

For the Year Ending June 30	Governmental Activities			Business-Type Activities		
	Principal	Interest	Total	Principal	Interest	Total
2009	\$800	\$415	\$1,215	\$1,690	\$2,025	\$3,715
2010	840	381	1,221	2,205	1,955	4,160
2011	870	345	1,215	2,280	1,880	4,160
2012	905	305	1,210	2,365	1,800	4,165
2013	530	264	794	2,455	1,713	4,168
2014-2018	3,110	857	3,967	13,754	7,052	20,806
2019-2023	1,350	148	1,498	16,800	3,906	20,706
2024-2028				8,735	571	9,306
2029				450		450
Total	\$8,405	\$2,715	\$11,120	50,734	\$20,902	\$71,636

Reconciliation of long-term debt

Residual SWRCB loan not yet received as of FY08	(3,371)
Less unamortized original issue discount	(1,053)
Net long-term debt	<u>\$46,310</u>



Debt Call Provisions

Long-term debt as of June 30, 2008 is callable on the following terms and conditions:

	<u>Initial Call Date</u>	
<i>Governmental Activities Long Term Debt</i>		
1998 Certificates of Participation	09/01/2008	(3)
2002B Certificates of Participation	03/01/2011	(2)
<i>Business-Type Activities Long Term Debt</i>		
Utility Revenue Bonds -		
1999 Refunding	06/01/2009	(1)
2002 Series A	06/01/2012	(1)

- (1) Callable in inverse numerical order of maturity at par plus a premium of 2.0 percent beginning on the initial call date. The call price declines subsequent to the initial date.
- (2) Callable in any order specified by the City at par plus a premium of 1.0 percent beginning on the initial call date. The call price declines subsequent to the initial date.
- (3) Callable in any order specified by the Trustee at par plus a premium of 1.0 percent beginning on the initial call date. The call price declines subsequent to the initial date.

Leasing Arrangements

COPs and Capital Leases are issued for the purpose of financing the construction or acquisition of projects defined in each leasing arrangement. Projects are leased to the City for lease payments which, together with unspent proceeds of the leasing arrangement, will be sufficient to meet the debt service obligations of the leasing arrangement. At the termination of the leasing arrangement, title to the project will pass to the City.

Leasing arrangements are similar to debt; they allow investors to participate in a share of guaranteed payments which are made by the City. Because they are similar to debt, the present value of the total of the payments to be made by the City is recorded as long-term debt. The City's leasing arrangements are included in long-term obligations discussed above.

Conduit Financing

On December 15, 1996, the City acted as a financial intermediary in order to assist Lytton Gardens Health Care Center in issuing Insured Revenue Refunding Bonds. The Bonds are payable solely from revenues collected by Lytton Gardens Health Care Center. The City has not included these Bonds in its basic financial statements since it is not legally or morally obligated for the repayment of the Bonds. At June 30, 2008 the amount of Bonds outstanding was \$8.1 million.



Long-term Debt without City Commitment

On July 23, 2007, the City approved the issuance of two variable rate demand Tax-Exempt Revenue Bonds by the ABAG Finance Authority in the amounts of \$160 million and \$180 million for the construction of Albert L. Schultz Jewish Community Center and a new continuing care retirement community, respectively. The Debt is payable by the borrowers, Albert L. Schultz Jewish Community Center and 899 Charleston, LLC, the City has no legal or moral liability with respect to the payment of these debts.



Note 8.....

SPECIAL ASSESSMENT DEBT

Special Assessment Debt with City Commitment

Special assessment districts exist in the City to provide improvements to properties located in those districts. Properties are assessed for the cost of improvements. These assessments are payable over the term of the debt issued to finance the improvements. The total amount of the assessment is recorded as receivable and deferred revenue at the time the related debt is issued, and reduced as assessments are collected. The City is obligated to be the purchaser of last resort or to advance available City funds to repay this debt in the event of default by any of these districts. At June 30, 2008, the district was in compliance with the repayment and other requirements of its respective debt issue. The City accounts for resources available to pay special assessment debt in a Debt Service Fund. The special assessment debt is included in the City’s Governmental Activities long-term debt.

Special assessment debt with City commitment comprises the following issues (in thousands):

	Original Issue Amount	Balance June 30, 2007	Retirements	Balance June 30, 2008
<i>Governmental Activity Debt</i>				
1987 California Avenue Parking,				
6.70-9.25%, repaid				
09/02/2007	\$1,325	\$115	\$115	\$0

The final debt service payment for the principal \$115 thousand was made in September 2007.

Description of Special Assessment Debt with City’s Commitment

1987 California Avenue Parking Assessment District Assessment Bonds – The City issued Special Assessment Bonds on April 13, 1987 to finance the acquisition of land and related improvements for the purpose of providing public parking in the City. Principal payments are payable annually on September 2 and interest payments semi-annually on March 2 and September 2.

Special Assessment Debt with no City Commitment

The California Avenue Parking Assessment District No. 92-13 issued Assessment Bonds of 1993, but the City has no legal or moral liability with respect to the payment of this debt, which is secured only by assessments on the properties in this District. Therefore, this debt is not included in Governmental Activities long-term debt of the City. At June 30, 2008, the District’s outstanding debt amounted to \$1.1 million.

The University Avenue Area Off-Street Parking Assessment District issued Assessment Bonds of Series 2001-A, but the City has no legal or moral liability with respect to the payment of this debt, which is secured only by assessments on the properties in the District. Therefore, this debt is not included in Governmental Activities long-term debt of the City. At June 30, 2008, the District’s outstanding debt amounted to \$8.35 million. A portion of the proceeds from the 2001 Bonds amounting to \$3.2 million was used to defease the 1977 University Avenue Area Off-Street Parking Assessment District Bonds and the 1989 University Avenue Area Off-street Parking Assessment District Refunding and Improvement Bonds.

The University Avenue Area Off-Street Parking Assessment District issued Assessment Bonds of Series 2002-A, but the City has no legal or moral liability with respect to the payment of this debt, which is secured only by assessments on the properties in the District. Therefore, this debt is not included in Governmental Activities long-term debt of the City. As of June 30, 2008, \$3.75 million of the bonds were called and the remaining outstanding debt amounted to \$29 million.



Note 9.....

LANDFILL CLOSURE AND POST-CLOSURE CARE

State and Federal laws and regulations require the City to place a final cover on the remaining open areas of the Palo Alto Refuse Disposal Site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for thirty years after closure. Closure costs of \$1.6 million were reported in fiscal 1991-92, when a section of the refuse area was capped with a final cover and Byxbee Park was constructed on top of that section. A second section of the refuse area was capped with a final cover during fiscal year 1992-93, with closure costs of \$904 thousand. The remaining closure and post-closure care costs are expected to be paid only near and after the date that the refuse site stops accepting waste.

An updated cost estimate for the landfill closure and post-closure, based on landfill capacity, was performed during 2001. The estimates of these costs were based upon 2001 cost and are adjusted annually for inflation (\$191 thousand in fiscal 2007-08) as mandated by the State of California. Landfill closure and post-closure liability for fiscal years 2008 and 2007 were \$7.9 million and \$7.1 million, respectively. Currently, 91.8 percent of the landfill capacity has been used to date. Based on this percentage, \$7.3 million is expected to be recorded as future landfill closure and post-closure liability.

Total cost estimates are based on what it would cost to perform all currently mandated closure and post-closure care in 2001. The City expects to close the refuse area in the year 2011. Actual closure and post-closure care costs may be higher due to inflation variances, changes in technology, or changes in State or Federal regulations.

The City is required by State and Federal laws and regulations to make annual funding contributions to finance closure and post-closure care. The City is in compliance with these requirements for the year ended June 30, 2008 with the establishment of the fully-funded liability for this purpose.

Note 10.....

NET ASSETS AND FUND BALANCES

Net Assets

Net assets are the excess of all the City’s assets over all its liabilities, regardless of fund. Net assets are divided into three categories and are described below:

Invested in Capital Assets, net of related debt describes the portion of net assets which is represented by the current net book value of the City’s capital assets, less the outstanding balance of any debt issued to finance these assets.

Restricted describes the portion of net assets which is restricted as to use by the terms and conditions of agreements with outside parties, governmental regulations, laws, or other restrictions which the City cannot unilaterally alter. These principally include bond proceeds received for use on capital projects, debt service requirements, and special revenue programs subject to limitations defined regulations and laws underlying such programs.

Unrestricted describes the portion of net assets which is not restricted as to use.

Fund Balances, Reserves and Designations

In the Fund financial statements, fund balances represent the net current assets of each fund. Net current assets generally represent a fund’s cash and receivables, less its liabilities. Portions of a fund’s balance may be reserved or designated for future expenditure.

At June 30, 2008, Governmental Funds reservations and designations included (in thousands):

	Major Funds		
	General Fund	Capital Projects Fund	Non-Major Funds
Reserved for:			
Encumbrances	\$3,816	\$4,331	\$210
Notes and loans	1,155		5,456
Interfund advances	1,100		
Inventory of materials and supplies	2,999		
Prepaid items	2,032		
Debt service			1,406
Total Reserved Fund Balance	<u>\$11,102</u>	<u>\$4,331</u>	<u>\$7,072</u>
Unreserved, designated for:			
Unrealized gain on investments	\$1,035		\$172
Equity transfer stabilization	3,528		
Reappropriations	648	\$16,053	
Budget stabilization	26,102		
Infrastructure		17,894	
Total Unreserved/Designated Fund Balances	<u>\$31,313</u>	<u>\$33,947</u>	<u>\$172</u>



Reserve for **encumbrances** represents the portion of fund balance set aside for open purchase orders.

Reserves for **notes, loans, interfund advances, inventory of materials and supplies, and prepaid items** are the portions of fund balance set aside to indicate these items do not represent available, spendable resources even though they are a component of assets.

Reserve for **debt service** is the portion of fund balance for legally restricted for the payment of principal and interest on long-term liabilities.

Designated for **unrealized gain on investment** is the portion of fund balance set aside for unrealized gains on investment.

Designated for **infrastructure** is the portion of fund balance set aside for use on infrastructure.

Designated for **equity transfer stabilization** is the portion of fund balance to replace required equity transfer by Gas, or Electric Enterprise Funds in the event the fund was unable to make its required equity transfer.

Designated for **reappropriations** is the portion of fund balance set aside for subsequent years' appropriations.

Designated for **budget stabilization** is the portion of fund balance to be used to supplement the regular budget when unexpected events such as state government action, a downturn in the economy or a natural disaster reduces revenue or creates obligations that significantly impact the current year budget.

Internal Service Funds

At June 30, 2008, internal service fund net assets designations included (in thousands):

Reserved net assets-	
Commitments and reappropriations	\$6,771
Unreserved:	
Designated for:	
Future catastrophic losses	3,285
Retiree health care	29,756
Undesignated	<u>12,815</u>
Net assets unrestricted	<u><u>\$52,627</u></u>

Reserve for **commitments and reappropriations** represents the portion of net assets set aside for open purchase orders.

Designated for **future catastrophic losses** is the portion of net assets to be used for unforeseen future losses.

Designated for **retiree health care** represents the portion of net assets set aside to defer future costs of retiree health care coverage.

Enterprise Funds

At June 30, 2008, Enterprise Fund net assets (in thousands):

	Water	Electric	Gas	Wastewater Collection	Wastewater Treatment	Refuse	Storm Drainage	Total
Unrestricted								
Rate stabilization								
Supply		\$47,309	\$7,399					\$54,708
Distribution		8109	4,734					12,843
Operations	\$13,111	5,859		\$6,027	(\$7,285)	\$3,832	(\$1,384)	20,160
	13,111	61,277	12,133	6,027	(7,285)	3,832	(1,384)	87,711
Emergency plant replacement	1,595	3,057	1,328	881	2,583			9,444
Calaveras		70,397						70,397
Reappropriations	10,306	4,731	6,755	6,082	2,647	990	996	32,507
Commitments	1,367	3,007	1,532	763	13,103	883	3,690	24,345
Restricted bond proceeds					9			9
Underground loan		709						709
Landfill								
Corrective Action Public benefit program		2,109				636		2,745
Central Valley Project		22						22
Other/Unexpended debt portion	67		84		26			177
	<u>\$26,446</u>	<u>\$145,309</u>	<u>\$21,832</u>	<u>\$13,753</u>	<u>\$11,083</u>	<u>\$6,341</u>	<u>\$3,302</u>	<u>\$228,066</u>
Restricted for Debt Service	<u>\$780</u>		<u>\$952</u>					<u>\$1,732</u>

The City Council has committed unreserved net assets for general contingencies, future capital and debt service expenditures including operating and capital contingencies for unusual or emergency expenditures.



Note 11.....

PENSION PLANS

CALPERS Safety and Miscellaneous Employees Plans

Substantially all permanent City employees are eligible to participate in pension plans offered by California Public Employees Retirement System (CALPERS) an agent for multiple employer defined benefit pension plans which acts as a common investment and administrative agent for its participating member employers. CALPERS provides retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. The City's employees participate in the Safety (police and fire) and Miscellaneous (all other) Employee Plans. Benefit provisions under both Plans are established by State statute and City resolution. Benefits are based on years of credited service, equal to one years of full time employment. Funding contributions for both Plans are determined annually on an actuarial basis as of June 30 by CALPERS.

Effective July 1, 2004, the separate Police and Fire Plans were combined into one Safety Plan. Prior actuarial valuation information for Safety is not available, since the plans were combined.

The Plans' provisions and benefits in effect at June 30, 2008, are summarized as follows:

	Safety	Miscellaneous
Benefit vesting schedule	5 years service	5 years service
Benefit payments	monthly for life	monthly for life
Retirement age	50	50
Monthly benefits, as a % of annual salary	3%	1.426-2.418%
Required employee contribution rates	9%	8%
Required employer contribution rates	24.512%	17.005%

The City's current labor contracts require it to pay employee contributions as well as its own.

CALPERS determines contribution requirements using a modification of the Entry Age Normal Method. Under this method, the City's total normal benefit cost for each employee from date of hire to date of retirement is expressed as a level percentage of the related total payroll cost. Normal benefit cost under this Method is the level amount the employer must pay annually to fund an employee's projected retirement benefit. This level percentage of payroll method is used to amortize any unfunded actuarial liabilities. The actuarial assumptions used to compute contribution requirements are also used to compute the actuarial accrued liability. The City does not have a net pension obligation since it pays these actuarially required contributions monthly.

CALPERS uses the market related value method of valuing the Plan’s assets. An investment rate of return of 7.75 percent is assumed, including inflation at 3 percent. Annual salary increases are assumed to vary by duration of service. Changes in liability due to plan amendments, changes in actuarial assumptions, or changes in actuarial methods are amortized as a level percentage of payroll on a closed basis over twenty years. Investment gains and losses are tracked and amortized over 30 years.

The Plans’ actuarial value (which differs from market value) and funding progress over the most recently available three years is set forth below at their actuarial valuation date of June 30, 2006 (in thousands):

Safety Plan:

Actuarial						Unfunded
Valuation Date	Entry Age Accrued Liability	Value of Assets	Unfunded (Overfunded) Liability	Funded Ratio	Annual Covered Payroll	(Overfunded) Liability as a % of Payroll
2004	\$201,972	\$175,239	\$26,733	86.8%	\$17,458	153.1%
2005	213,683	195,866	17,817	91.7%	18,953	94.0%
2006	230,186	215,471	14,715	93.6%	20,469	71.9%

Miscellaneous Plan:

Actuarial						Unfunded
Valuation Date	Entry Age Accrued Liability	Value of Assets	Unfunded (Overfunded) Liability	Funded Ratio	Annual Covered Payroll	(Overfunded) Liability as a % of Payroll
2004	\$290,552	\$267,794	\$22,758	92.2%	\$60,316	37.7%
2005	339,641	287,139	52,502	84.5%	60,954	86.1%
2006	363,774	311,105	52,669	85.5%	61,265	86.0%

* On November 13, 2006, the City Council voted to increase the pension benefit for miscellaneous employees from 1.426-2.418 % to 2.0-2.7% effective the pay period inclusive of January 06, 2007. CALPERS revised the fiscal 2004-05 actuarial data for the impacts of this benefit enhancement.

Audited annual financial statements and ten-year trend information are available from CALPERS at P.O. Box 942709, Sacramento, CA 94229-2709.

Actuarially required contributions for all plans for fiscal years 2008, 2007 and 2006 were \$25.5, \$19.2 and \$15.8, million, respectively. The City made these contributions as required, together with certain immaterial amounts required as the result of the payment of overtime and other additional employee compensation.



Note 12.....

RETIREE HEALTH BENEFITS

In addition to providing pension benefits, the City participates in the California Public Employees Medical and Health Care Act program to provide certain health care benefits for retired employees. Employees who retire directly from the City are eligible for retiree health benefits if they retire on or after age 50 with 5 years of service and are receiving a monthly pension from CalPERS.

For employees hired before January 1, 2004, and all management employees, the City pays for the entire cost of retiree health benefits for retirees for their lifetimes. The City also pays a portion of medical costs for spouses of retirees equal to 70 percent of the premiums for 2007 and increasing 5 percent per year until the City's share reaches 100 percent of spouse premiums for 2013 and beyond.

For management employees, fire fighter and fire chief association members hired on or after January 1, 2004, and service employees hired on or after January 1, 2005, the City pays for the 50 percent of the above described benefits after 10 years of service, and the city's portion increases by 5 percent for each additional year of service up to 20 years.

During fiscal year 2008, the City implemented the provisions of Governmental Accounting Standards Board Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions. This Statement establishes uniform financial reporting standards for employers providing postemployment benefits (OPEB). As part of the implementation, the City elected to participate in an irrevocable trust to provide a funding mechanism for the OPEB and applied the provisions of the statement on a prospective basis. The California Employers Retirees Benefit Trust, is administrated by CalPERS and managed by a separately appointed board which is not under the control of City Council. This Trust is not considered a component unit by the City.

Funding Policy and Actuarial Assumptions

The City’s policy is to prefund these benefits by accumulating assets in the Trust Fund discussed above pursuant to City Council Resolution. The annual required contribution (ARC) was determined as part of a January 1, 2007 actuarial valuation using the entry age normal actuarial cost method. This is a projected benefit cost method, which takes into account those benefits that are expected to be earned in the future as well as those already accrued. The actuarial assumptions included (a) 7.75 percent investment rate of return, (b) 3.25 percent projected annual salary increase, and (c) 5 percent health inflation increases. The actuarial methods and assumptions used include techniques that smooth the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets. Actuarial calculations reflect a long-term perspective and actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to revision at least biannually as results are compared to past expectations and new estimates are made about the future. The City’s OPEB unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll using a 30 year amortization period.

Generally accepted accounting principles permit assets to be treated as OPEB assets and deducted from the Actuarial Accrued Liability when such assets are placed in an irrevocable trust or equivalent arrangement. During the fiscal year ended June 30, 2008, the City made contributions in excess of the ARC to prefund benefits. As a result, the City has calculated and recorded the Net OPEB Asset, representing the difference between the ARC, amortization and contributions, as presented below:

Annual required contribution	<u>\$9,313</u>
Annual OPEB cost	9,313
Contributions made:	
Funds Transferred CERBT	(33,844)
Premiums paid	<u>(4,646)</u>
(Decrease) increase in net OPEB obligations	(29,177)
Net OPEB obligation (asset) June 30, 2007	<u> </u>
Net OPEB obligation (asset) June 30, 2008	<u><u>(\$29,177)</u></u>

(A) The actuarial study was completed as of 1/29/2008 with a valuation date of January, 2007. After consideration of contributions made to CERBT, the study estimated a reduced ARC of \$7.686 million for future years.



In the fiscal year ended June 30, 1993, the City received a \$6.1 million refund from the California Public Retirement System (“CALPERS”) through the passage of Assembly Bill (AB) 702. This amount was placed in a separate fund to defer future costs of retiree health care coverage. During the fiscal year ended June 30, 1995, the City established and transferred the amount to a separate fund which is now accounted for as an Internal Service Fund.

The Retiree Fund’s net assets consist of the following for the fiscal year ended June 30, 2008 (in thousands):

Retiree Health Benefits	2008	2007
Net assets, beginning of year	\$30,719	\$26,505
Interest earnings	970	1,202
Unrealized gain (loss) on investments	567	114
Interdepartmental charges	7,133	4,238
Compensated benefits	(9,569)	(4,240)
Transfers in		2,900
Transfers out	(64)	
	\$29,756	\$30,719



Note 13.....

DEFERRED COMPENSATION PLAN

City employees may defer a portion of their compensation under City sponsored Deferred Compensation Plans created in accordance with Internal Revenue Code Section 457. Under these Plans, participants are not taxed on the deferred portion of their compensation until distributed to them; distributions may be made only at termination, retirement, death or in an emergency as defined by the Plans.

The laws governing deferred compensation plan assets now require plan assets to be held by a Trust for the exclusive benefit of plan participants and their beneficiaries. Since the assets held under these plans are not the City’s property and are not subject to City control, they have been excluded from these financial statements.

Note 14.....

RISK MANAGEMENT

Coverage

The City provides dental coverage to employees through programs which are administered by a service agent. The City is self-insured for the dental coverage.

The City has a workers’ compensation insurance policy with coverage up to the statutory limit set by the State of California. The City retains the risk for the first \$500 thousand in losses for each accident and employee under this policy.

The City also has public employee dishonesty insurance with a \$5 thousand deductible and coverage up to \$1.0 million per loss. The City’s property and machinery insurance policy has various deductibles and various coverages based on the kind of machinery.

The City is a member of the Authority for California Cities Excess Liability (ACCEL) which provides general liability, including auto liability, insurance coverage up to \$49.0 million per occurrence. The City retains the risk for the first \$1.0 million in losses for each occurrence under this policy.

ACCEL was established for the purpose of creating a risk management pool for central California municipalities. ACCEL is governed by a Board of Directors consisting of representatives of its member cities. The board controls the operations of ACCEL, including selection of management and approval of the annual budget.

The City’s deposits with ACCEL equal the ratio of the City’s payroll to the total payrolls of all entities. Actual surpluses or losses are shared according to a formula developed from overall loss costs and spread to member entities on a percentage basis after a retrospective rating.



During the fiscal year ended June 30, 2008, the City contributed \$714 thousand to ACCEL for current year coverage.

Audited financial statements are available from ACCEL at 160 Spear Street, San Francisco, California 94105-2709.

Claims Liability

The City provides for the uninsured portion of claims and judgments in the General Benefits and Insurance Internal Service Fund. Claims and judgments, including a provision for claims incurred but not reported, are recorded when a loss is deemed probable of assertion and the amount of the loss is reasonably determinable. As discussed, above, the City has a coverage for such claims, but it has retained the risk for the deductible, or uninsured portion of these claims.

The City’s liability for uninsured claims is limited to dental, general liability, and workers’ compensation claims, as discussed above, and was estimated by management based on prior years claims experience as follows as of June 30 (in thousands):

	<u>Year Ended June 30</u>	
	<u>2008</u>	<u>2007</u>
Beginning Balance	\$21,130	\$19,545
Liability for current and prior fiscal year claims and claims incurred but not reported (IBNR)	6,466	5,636
Claims paid	<u>(4,070)</u>	<u>(4,051)</u>
Ending Balance	<u>\$23,526</u>	<u>\$21,130</u>
Current Portion	<u>\$7,356</u>	<u>\$5,939</u>

Note 15.....

JOINT VENTURES

General

The City participates in joint ventures through Joint Powers Authorities (JPAs) established under the Joint Exercise of Powers Act of the State of California. As separate legal entities, these JPAs exercise full powers and authorities within the scope of the related Joint Powers Agreement, including the preparation of annual budgets, accountability for all funds, the power to make and execute contracts and the right to sue and be sued. Obligations and liabilities of the JPAs are not those of the City.

Each JPA is governed by a board consisting of representatives from each member agency. Each board controls the operations of its respective JPA, including selection of management and approval of operating budgets, independent of any influence by member agencies beyond their representation on the Board.

Northern California Power Agency

The City is a member of Northern California Power Agency (NCPA), a joint powers agency which operates under a joint powers agreement among fifteen public agencies. The purpose of NCPA is to use the combined strength of its members to purchase, generate, sell and interchange electric energy and capacity through the acquisition and use of electrical generation and transmission facilities. Each agency member has agreed to fund a pro rata share of certain assessments by NCPA and enter into take-or-pay power supply contracts with NCPA. While NCPA is governed by its members, none of its obligations are those of its members unless expressly assumed by them.

During the year ended June 30, 2008, the City incurred expenses totaling \$72.6 million for purchased power and assessments earned by NCPA.

The City's interest in NCPA projects and reserves, as computed by NCPA, was \$3.8 million at June 30, 2008. This amount represents the City's portion of funds which resulted from the settlement with third parties of issues with financial consequences and reconciliations of several prior years' budgets for programs. It is recognized that all the funds credited to the City are linked to the collection of revenue from the City's ratepayers, or to the settlement of disputes relating to electric power supply and that the money was collected from the City's ratepayers to pay power bills. Additionally, the NCPA Commission identified and approved the funding of specific reserves for working capital, accumulated employees post-retirement medical benefits, and billed property taxes for the geothermal project. The Commission also identified a number of contingent liabilities that may or may not be realized, the cost of which in most cases is difficult to estimate at this time. One such contingent liability is the steam field depletion which will require funding to cover debt service and operational costs in excess of the expected value of the electric power. The General Operating Reserve is intended to minimize the number and amount of individual reserves needed for each project, protect NCPA's financial condition and maintain its credit worthiness. These funds are available on demand, but the City has left them with NCPA as a reserve against these contingencies identified by NCPA.

Members of NCPA may participate in an individual project of NCPA without obligation for any other project. Member assessments collected for one project may not be used to finance other projects of NCPA without the member's permission.



Geothermal Projects

A purchased power agreement with NCPA obligated the City for 6.2 percent and 6.2 percent, respectively, of the operating costs and debt service of the two NCPA 110-megawatt geothermal steam powered generating plants, Project Number 2 and Project Number 3.

The City's participation in the Geothermal Project was sold to Turlock Irrigation District in October 1984. Accordingly, the City is liable for payment of outstanding geothermal related debt only in the event that Turlock fails to make specified payments. Total outstanding debt of the NCPA Geothermal Project at June 30, 2008 is \$117 million. The City's participation in this project was 6.2 percent, or \$7.3 million.

NCPA's Geothermal Project has experienced a greater than originally anticipated decline in steam production from geothermal wells on its leasehold property. Results of the continuing well analysis program indicate that the potential productive capacity of the geothermal steam reservoir is less than originally estimated. Therefore, NCPA has modified the operations of the Geothermal Project to reduce the average annual output from past levels. As a result, the per unit cost of energy generated by the projects will be higher than anticipated.

NCPA will continue to monitor the wells while pursuing alternatives for improving and extending reservoir performance, including supplemental water re-injection, plant equipment modifications, and changes in operating methodology. NCPA, along with other steam field operators, has observed a substantial increase in steam production in the vicinity of re-injection wells and is attempting to increase water re-injection at strategic locations. NCPA, other steam developers, and the Lake County Sanitation District are constructing a wastewater pipeline project that will greatly increase the amount of water available for re-injection.

Calaveras Hydroelectric Project

In July 1981, NCPA agreed with Calaveras County Water District to purchase the output of the North Fork Stanislaus River Hydroelectric Development Project and to finance its construction. Debt service payments to NCPA began in February 1990 when the project was declared substantially complete and power was delivered to the participants. Under its power purchase agreement with NCPA, the City is obligated to pay 22.9 percent of this Project's debt service and operating costs. At June 30, 2008, the book value of this Project's plant, equipment and other assets was \$505.1 million, while its long-term debt totaled \$495.2 million and other liabilities totaled \$4.1 million. The City's share of the Project's long term-debt amounted to \$114.2 million at that date.

Geothermal Public Power Line

In 1983, NCPA, Sacramento Municipal Utility District, the City of Santa Clara and the Modesto Irrigation District (joint owners) initiated studies for a Geothermal Public Power Line (GPPL) which would carry power generated at several existing and planned geothermal plants in the Geysers area to a location where the joint owners could receive it for transmission to their load centers. NCPA has an 18.5 percent share of this Project and the City has an 11.1 percent participation in NCPA's share. In 1989, the development of the proposed Geothermal Public Power Line was discontinued because NCPA was able to contract for sufficient transmission capacity to meet its needs in the Geysers. However, because the project financing provided funding for an ownership interest in a PG&E transmission line, a central dispatch facility and a performance bond pursuant to the Interconnection Agreement with PG&E, as well as an ownership interest in the proposed GPPL, NCPA issued \$16.0 million in long-term, fixed-rate revenue bonds in November 1989 to defease the remaining variable rate refunding bonds used to refinance this project. The City is obligated to pay its 11.1 percent share of the related debt service, but debt service costs are covered through NCPA billing mechanisms that allocate the costs to members based on use of the facilities and services.

At June 30, 2008, the book value of this Project's plant, equipment and other assets was \$2.6 million, while its long term debt totaled \$1.7 million. The City's share of the Project's long-term debt amounted to \$189 thousand at that date.

NCPA Financial Information

NCPA's financial statements can be obtained from NCPA, 180 Cirby Way, Roseville, CA 95678.

Transmission Agency of Northern California (TANC)

The City is a member of a joint powers agreement with 14 other entities in the Transmission Agency of Northern California (TANC). TANC's purpose is to provide electrical transmission or other facilities for the use of its members. While governed by its members, none of TANC's obligations are those of its members unless expressly assumed by them. The City is obligated to pay 4.0 percent of TANC's debt-service and operating costs.

According to the 1985 Project Agreement with TANC for the development of the California-Oregon Transmission Project (COTP) and subsequent related project agreements, the City is obligated to pay its share of the project's costs, including debt service and is entitled to the use of a percentage of the project's transmission or transfer capacity. TANC has issued four series of Revenue Bonds and Commercial Paper Notes totaling \$443.6 million as of June 30, 2008. The City's share of this debt is \$15.9 million.

Construction of the COTP was complete as of June 30, 1993. The transmission line was energized March 24, 1993. Because funding of certain project participants' shares in the project was needed pending approval of their applications for participation, TANC issued \$93.8 million of Commercial Paper debt backed by a Letter of Credit. The City's share of the Commercial Paper was \$3 million at June 30, 2008, which is included in the share of debt discussed above. Shares and obligations of the existing participants could increase pending final project subscription.

TANC Financial Information

TANC's financial statements can be obtained from TANC, P.O. Box 15129, Sacramento, CA 95851.

Note 16.....

COMMITMENTS AND CONTINGENCIES

Palo Alto Unified School District – The City leases a portion of the former Cubberley School site and eleven extended day care sites from the Palo Alto Unified School District (PAUSD). The lease is part of a larger agreement which includes a covenant not to develop certain properties owned by the PAUSD. The lease term expired in December 2004, with an option for an additional ten-year term. The City renewed the lease for 10 years in 2005, with the lease expiring in 12/31/2014. The City’s rent for the facilities is \$5.0 million per year plus insurance, repairs and maintenance work to be completed, which are not to exceed \$250 thousand per year. This lease is cancelable upon 90 days’ written notice in the event funds are not appropriated by the City. In addition, the lease is contingent upon authorization by the Palo Alto electorate if it exceeds the City’s Proposition 4 (Gann) appropriations limitation in any fiscal year. Lease expenditures for the year ended June 30, 2008 amounted to \$6.4 million.

Future minimum annual lease and covenant payments are as follows (in thousands):

<u>Year ending June 30:</u>	<u>Payments</u>
2009	\$6,654
2010	6,854
2011	7,060
2012	7,271
2013	7,490
2014-2017	<u>40,952</u>
	<u>\$76,281</u>

Palo Alto Sanitation Company – In 1999 the City, under the provisions of a new agreement, contracted with the Palo Alto Sanitation Company (PASCO) for services related to residential and commercial refuse collection, curbside recycling, and other operation special programs. The new agreement has a term of seven years and ten months from the effective date of September 1, 1999. The new contract revised the method by which compensation is paid to PASCO to be more in-line with the industry standard. The method establishes compensation based on the relationship between costs and profits and includes periodic performance reviews. In 2007-08 this resulted in payments to PASCO of \$9.3 million.

City of Palo Alto Regional Water Quality Control Plant – The cities of Palo Alto, Mountain View and Los Altos (the Partners) participate jointly in the cost of maintaining and operating the City of Palo Alto Regional Water Quality Control Plant and related system (the Plant). The City is the owner and administrator of the Plant which provides the transmission, treatment and disposal of sewage for the Partners. The cities of Mountain View and Los Altos are entitled to use a portion of the capacity of the Plant for a specified period of time. Each partner has the right to rent unused capacity from/to the other partners. The expenses of operations and maintenance are paid quarterly by each partner based on its pro rata share of treatment costs. Additionally, joint system revenues are shared by the partners in the same ratio as expenses are paid. The amended agreement has a term of fifty years beginning from the original signing in October 1968, but may be terminated by any partner upon ten years’ notice to the other partners. All sewage treatment property, plant and equipment are included in the Wastewater Treatment Enterprise Fund’s capital assets balance at June 30, 2008. If the City initiates the termination of the contracts, it is required to pay the other partners their unamortized contribution towards the capital assets.

Solid Waste Materials Recovery and Transfer Station (SMaRT Station) – On June 9, 1992, the City, along with the City of Mountain View, signed a Memorandum of Understanding (MOU) with the City of Sunnyvale (Sunnyvale) to participate in the construction and operation of the SMaRT station which recovers recyclable materials from the municipal solid waste delivered from participating cities. Per the MOU, the City has capacity share of 21.3 percent of this facility and reimburses its proportionate capacity share of design, construction, and operation costs to Sunnyvale.

On December 1, 1992, the Sunnyvale Financing Authority issued \$24.6 million in revenue bonds to finance the design and construction costs of the SMaRT Station. During the fiscal year ending June 30, 2003, the 1992 bonds were refunded by issuing the 2003 Solid Waste Revenue Bonds in the amount of \$20.6 million. Even though these bonds are payable from and secured by the net revenues of Sunnyvale’s Utilities Enterprise, the City is obligated to reimburse Sunnyvale 21.3 percent of total debt service payments related to these bonds. The City’s portion of remaining principal balance for SMaRT revenue bonds as of June 30, 2008 is \$3.2 million. During the year ended June 30, 2008, the City paid \$443.7 thousand as its portion of current debt service.

In fiscal 2007-08, the members agreed to finance an Equipment Replacement Project estimated to cost \$14.7 million. \$5.2 million of these costs are to be funded with existing reserves and the remaining \$9.5 million is to be funded by a proposed bond issue. The City’s portion of the proposed bond issue is \$2.0 million.

UTILITIES ENERGY RESOURCE MANAGEMENT

Energy Markets in the United States and California

U.S. and California electric and gas prices continued to be volatile during the year. The City purchased electricity in fiscal year 2007-08 in conformance with the Council-approved Long-term Electric Acquisition Plan (LEAP) established in 2001 and modified in April 2007. Due to the City’s commodity purchase strategy, whereby purchases are made on a 3-year forward basis in a ladder fashion, the City’s electric and gas utility customers enjoyed stable rates in fiscal year 2007-08 compared to what they would have paid if exposed to volatile market prices during the year. The City’s average wholesale electric commodity purchase cost during the fiscal year was approximately 6.4 ¢/kWh while the average spot market prices were close to 7.0 ¢/kWh. The primary reason the electric costs were lower than market prices is the availability of low-cost hydroelectric power. The average natural gas commodity cost for the gas pool customers was \$7.80/MMBtu compared to a spot market price of \$7.60 /MMBtu.

Hydro-electric production accounted for 36 percent of the City’s electric supply. These hydroelectric supplies derive from two sources – from contract with the Western Area Power Administration and from the City’s partial ownership of the Calaveras Hydroelectric Project. Wind and landfill gas resources accounted for 13 percent of the electric supply, with the balance purchased from the wholesale electric market. The city transacts with qualified suppliers for the market purchases and the Northern California Power Agency (NCPA), which provides scheduling services for the City, buys and sells electricity within the month as needed to meet the City’s demands.

Due to the dry hydrologic conditions in 2007 and 2008, the hydroelectric supplies were at low levels during the year and resulted in the need for the City to purchase high-cost power during the year from the market. Incidental sales of surplus energy resulted in revenues of \$1.45 million during the year. (The inputted expense associated with the surplus energy sold from the overall electric supply portfolio was calculated at \$0.76 million during the year, and is shown separately on the Statement of Revenues, Expenses and Changes in Net Assets.)

The California Independent System Operation (CAISO) now has the authority to allocate to all electric load serving entities, including publicly owned utilities such as the City, the cost responsibility for the local

generation capacity required to maintain transmission reliability on the CAISO-controlled electric grid. This is expected to result in higher costs to Palo Alto’s electric utility customers.

The City has executed Electric and Gas Master Agreements with suppliers to procure electricity and natural gas supplies. The table below outlines the electric and natural gas commodity supply commitments made by the City with these suppliers as of June 30, 2008. Monthly payments are made to suppliers upon delivery of supplies for the month. The City’s procurement plans conform to the Council-approved Energy Risk Management Policies. These include a formal oversight role (Middle Office) within the Administrative Services Department. A quarterly energy risk management report is provided to the Council as part of this oversight role.

Forward Electricity Commodity Supply Commitments as of June 30, 2008

Supplier	FY08/09	FY09/10	FY10/11	Total
JP Morgan Chase	\$ 2,388,240		\$ -	\$ 2,388,240
Powerex	1,956,420			\$ 1,956,420
Sempra	2,849,610			\$ 2,849,610
SENA	13,394,411	5,879,730		\$ 19,274,141
	\$ 20,588,681	\$ 5,879,730	\$ -	\$ 26,468,411
Average Cost (cents/kWh)	6.58 ¢	5.37 ¢		6.26 ¢

Forward Natural Gas Commodity Supply Commitments as of June 30, 2008

Supplier	FY08/09	FY09/10	FY10/11	Total
BP	\$ 1,079,000	\$ 1,761,750	\$ 2,531,328	\$ 5,372,078
Powerex	\$ 1,347,260	\$ 3,425,610		\$ 4,772,870
Sempra	\$ 4,603,736	\$ 1,662,210	\$ 1,080,832	\$ 7,346,778
SENA	\$ 8,859,080	\$ 4,164,430	\$ 2,663,665	\$ 15,687,175
	\$ 15,889,076	\$ 11,014,000	\$ 6,275,825	\$ 33,178,901
Average Cost (\$/MMBtu)	\$8.26	\$8.16	\$8.75	\$8.32

The City’s natural gas transportation contract entered into in 2005 with Pacific Gas and Electric Company (PG&E) was in place until the end of 2007. This contract, commonly known as Gas Accord III, between PG&E and its transportation customers provides the City’s retail customers stable transportation costs. Gas Accord IV went into effect starting January 1, 2008 for three years. This contract is not substantially different from our current agreement.

Future Outlook

Electric

Market price for fossil fuel based electricity is expected to remain high at between 7 to 8¢/kWh. The price premium commanded by renewable energy projects has increased considerably in the last year and is expected to remain high in the foreseeable future. The higher prices will result in higher costs to meet the City’s renewable energy supply targets.

The Council increased the renewable resource supply targets in March 2007. The new target is to meet 20 percent of the citywide load with renewable resource supplies by 2008, 30 percent by 2012 and 33 percent by 2015. Though the City has made considerable progress in securing renewable energy supplies, due to the



unavailability of short term renewable energy supplies, the delay in start date for projects for which commitments have already been made, and a large demand for renewable energy supplies in the Western U.S., the City expects to fall short of meeting the 20 percent target for 2008. Renewable supplies are expected to account for approximately 17 percent of supplies during calendar year 2008.

PaloAltoGreen, the City's volunteer green power program currently accounts for an additional 5 percent of the City's energy needs from renewable resources. The City is also in the process of implementing a program to encourage small-scale ultra-clean distributed generation and cogeneration applications within the city. The City is also in the process of reviewing all utility programs, including PaloAltoGreen, to ensure that programs are aligned to reduce greenhouse gas emissions associated with the City's energy supplies.

The California Independent System Operator (CAISO) is in the process of implementing a number of initiatives with the stated goals of reliable and efficient operation of the transmission grid. Implementation of these initiatives, or the Market Redesign and Technology Update (MRTU), is anticipated to occur by February 2009. An underlying component of MRTU is the use of location-specific prices for the scheduling of energy transactions, which could lead to cost increases for transmission services for the City.

The following energy bills were signed into California law September 2008 (the second year of the two-year, 2007-2008, Session):

AB 1763 (Chaptered 9/28/2008): This bill requires investor-owned utilities (IOUs) to disclose specified information on usage and cost on residential customer's billing statements, and to make available online to residential customers specified information on usage and energy conservation measures. Publicly owned utilities, such as the City's, are not included under AB 1763.

AB 844 (Chaptered 9/30/2008), SB 447 (Chaptered 9/30/2008), and; SB 691 (Chaptered 9/30/2008): These three bills address the issue of metal theft by setting new regulations for junk dealers and recyclers.

The City continues to follow the development of laws and associated regulations related to implementation of AB 32 (California Global Warming Solutions Act of 2006, Chaptered 9/27/2006). In October 2008, the California Air Resources Board (CARB) will release a revised Scoping Plan, which is the primary guidance document for shaping how California will reduce its greenhouse gas (GHG) emissions to 1990 levels by 2020 as called for by AB 32. The Scoping Plan is due to be formally adopted by the CARB board by the end of November 2008. A key input to the Scoping Plan is the GHG policy decision released by the California Public Utilities Commission (CPUC) and the California Energy Commission (CEC) in proposal, about the need to protect consumers from flawed market designs, and highlighting problems regarding certain allowance distribution approaches.

The Emergency Economic Stabilization Act of 2008 (H.R. 1424), signed into law by President Bush in October, contained key tax extender provisions that the City have advocated for throughout the year. The \$17 billion energy tax provisions extend: the Production Tax Credit (PTC), a tax credit for the first 10 year of output from qualifying renewable projects such as wind, for one year; and the solar investment tax extension, commercial buildings for five years, and appliances for two years. In addition, the legislation also authorizes \$800 million for Clean Renewable Energy Bonds (CREBs) to be divided among state, local, and tribal governments, public power, and rural electric cooperatives.

Significant California state legislation that failed to pass this year included a number of bills that would have increased the statewide Renewable Portfolio Standard (RPS) to 33% and included publicly owned utilities in the regulations. Although these bills failed to pass the year they are expected to be back in some form in the next California legislative session of 2009. Also pending on the November California ballot this year is Proposition 7 (the Solar & Clean Energy Act of 2008), which calls for 40% RPS by 2020 and 50% by 2025.



Natural Gas

Long term market prices for natural gas remain at about \$0.80 per therm. Declining production in the U.S. and Canada and increasing U.S. and international demand will put pressure on the prices in the long-term. Market price volatility is expected to remain high in the short term due to the uncertainty in the financial markets. The City plans to continue implementing its 3-year laddering strategy using both fixed-price and capped-price products to hedge the gas utility supply portfolio. The City will also examine additional strategies to control commodity cost.

In February 2008, Council approved a new plan to implement a voluntary customer program similar to Palo Alto Green for non-fossil fuel gas supplies. The program may be supplied via biomethane sources or carbon offset credits. The cost of the new program has not yet been determined.

Water

The City's water use during fiscal year 2007-08 increased about 2.5 percent over the prior year. Usage is highly dependent on weather conditions, but has remained essentially flat for the past 10 years. Current water usage is only 70 percent of what it was in 1975. The slight drop in usage in FY 2007-08 may be attributed to customer response to the call for water conservation due to dry conditions that was issued in April 2008 by the San Francisco Public Utilities Commission (SFPUC). Water supply costs for fiscal year 2007-08 increased almost 3.8 percent from fiscal year 2006-07, consistent with a 6.6 percent increase in the wholesale water rate in fiscal year 2007-08.

Water supply costs are expected to trend upward as the SFPUC implements a much delayed, but essential, upgrade to the regional water system facilities. In the November 2002 elections, the San Francisco electorate approved a bond measure to pay for San Francisco's one-third share of the cost of the Water System Improvement Program (WSIP) that was estimated to be about \$3.0 billion at the time. Costs for the WSIP are now expected to be about \$4.4 billion. When other planned projects are factored in, the total cost to upgrade and improve the regional water system is about \$5.0 billion. The Bay Area Water Supply and Conservation Agency (BAWSCA) and the San Francisco Bay Area Regional Financing Authority were created in 2003 to provide funding for the two-thirds share of the WSIP costs allocated to the agencies that purchase water from the SFPUC, including Palo Alto. Estimates for these increased costs have been factored into the City's long-term water rate projections.

The relationship between each of the BAWSCA agencies and the City and County of San Francisco is specified in a 25-year water service contract, which expires on June 30, 2009. Each agency, including Palo Alto, has given BAWSCA the authority to negotiate a new contract on its behalf. At this time, it is unknown whether the mechanism for cost allocation or wholesale rate structure will change from the current contract.

During fiscal year 2007-08, the City continued the planning phase for expanding the recycled water distribution system in Palo Alto by preparing a Recycled Water Facility Plan. The plan is expected to be complete in fiscal year 2008-09. This plan provides more detailed design information and includes the preparation of environmental documents for the project. Completion of the facility plan and environmental documents is necessary to compete for grant funding opportunities.



Contingent Liabilities

Many of the uncertainties faced by the Utilities Department as an aftermath of the 2000-01 energy crisis have been resolved, however, a number of uncertainties remain. The Ninth Circuit Court has determined that the Federal Energy Regulatory Commission (FERC) lacked authority under the Federal Power Act to grant refund relief against governmental agencies, and the United States Supreme Court declined to review that decision. Nonetheless a number of entities (“the California Parties”) have filed suit against the NCPA and other municipal utilities seeking refunds for sales made to the CAISO and Power Exchange during the energy crisis. The suit was filed in the Superior Court in Los Angeles in April 2007. Another dispute between the Western Area Power Administration and PG&E regarding PG&E’s claim to recover certain CAISO related costs has also not been resolved.

Litigation – The City is subject to litigation arising in the normal course of business. In the opinion of the City Attorney, there is no pending litigation, claims or assessments that are likely to have a material adverse effect on the City’s financial condition.

Sales Tax Adjustment – On April 14, 1999, the State Board of Equalization informed the City that it had been allocated and paid \$594 thousand in sales and taxes in error and that the City was obligated to refund these taxes from future sales tax revenues. The City is in process of challenging the Board’s findings. However, as of June 30, 2008, the issue had not been settled and the refund had not been returned.

Grant Programs – The City participates in Federal and State grant programs. These programs have been audited by the City’s independent accountants in accordance with the provisions of the Federal Single Audit Act amendments of 1996 and applicable State requirements. No cost disallowances were proposed as a result of these audits; however, these programs are still subject to further examination by the grantors and the amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time. The City expects such amounts, if any, to be immaterial.



Non-major Governmental Funds.....

STREET IMPROVEMENT

This fund accounts for revenues received from state gas tax, allocations must be spent on the construction and maintenance of the road network system of the City.

FEDERAL REVENUE

This fund accounts for grant funds received under the Community Development Act of 1974 and HOME Investment Grant Programs, for activities approved and subject to federal regulations.

HOUSING IN-LIEU

This fund accounts for revenues from commercial and residential developers to provide housing under the City’s Below Market Rate program.

SPECIAL DISTRICTS

This fund accounts for revenues from parking permits and for maintenance of various parking lots within the City’s parking districts.

TRANSPORTATION MITIGATION

This fund accounts for revenues from fees or contributions required for transportation mitigation issues encountered as a result of City development.

LOCAL LAW ENFORCEMENT

This fund accounts for revenues received in support of City’s law enforcement program.

ASSETS SEIZURE

This fund accounts for seized property and funds associated with drug trafficking. Under California Assembly Bill No. 4162, the monies are released to the City for specific expenditures related to law enforcement activities.

DEVELOPER’S IMPACT FEE

This fund accounts for fees imposed on new developments to be used for parks, community centers and libraries.

REDEVELOPMENT AGENCY ADMINISTRATION

This fund accounts for the activities of administrating the Redevelopment Agency.

DOWNTOWN BUSINESS IMPROVEMENT DISTRICT

The Downtown Business Improvement District Fund was established to account for the activities of the Palo Alto Downtown Business Improvement District, which was established to enhance the viability of the downtown business district.

GOLF COURSE

This fund accounts for revenues received from the General Fund to provide payment of principal and interest associated with Certificates of Participation issued for the City’s golf course.

CIVIC CENTER REFINANCING

This fund accounts for revenues received from the General Fund to provide payment of principal and interest associated with the 2002A Civic Center Refinancing Certificates of Participation as they become due.





Non-major Governmental Funds

DOWNTOWN PARKING IMPROVEMENT

This fund accounts for revenues received from the General Fund to provide payment of principal and interest associated with the 2002B Downtown Parking Improvement Certificate of Participation as they become due.

SPECIAL ASSESSMENT DEBT

This fund accumulates monies for payments of special assessment improvement bonds which are financed by assessments placed on property owners within the University Avenue and California Avenue Parking District.

EYERLY FAMILY

This fund accounts for the revenues received from assets donated by Mr. and Mrs. Fred Eyerly for the City and or its citizenry.



This page is intentionally left blank.



City of Palo Alto - Non-Major Governmental Funds

Combining Balance Sheets- June 30, 2008

(In thousands of dollars)

	SPECIAL REVENUE FUNDS					
	Street Improvement	Federal Revenue	Housing In-Lieu	Special Districts	Transportation Mitigation	Local Law Enforcement
ASSETS						
Cash and investments :						
Available for operations	\$9	\$452	\$7,267	\$742	\$2,204	\$152
Cash and investments with fiscal agent						
Receivables:						
Accounts	371					
Interest	1		79	9	23	3
Notes		3,026	2,430			
Total Assets	<u>\$381</u>	<u>\$3,478</u>	<u>\$9,776</u>	<u>\$751</u>	<u>\$2,227</u>	<u>\$155</u>
LIABILITIES						
Accounts payable		38	176			9
Total Liabilities		<u>38</u>	<u>176</u>			<u>9</u>
FUND EQUITY						
Reserved for:						
Encumbrances		134	59			13
Notes receivable		3,026	2,430			
Debt service						
Unreserved, designated for:						
Special Revenue Funds						
Unrealized gain on investments	2		85	10	24	3
Special revenue projects			7,026	741	2,203	130
Special revenue reappropriations	2,502	682				
Unreserved, undesignated:						
Permanent Fund						
Special Revenue Funds	(2,123)	(402)				
Total Fund Balances	<u>381</u>	<u>3,440</u>	<u>9,600</u>	<u>751</u>	<u>2,227</u>	<u>146</u>
Total Liabilities and Fund Balances	<u>\$381</u>	<u>\$3,478</u>	<u>\$9,776</u>	<u>\$751</u>	<u>\$2,227</u>	<u>\$155</u>



.....

SPECIAL REVENUE FUNDS				DEBT SERVICE FUNDS		
Assets Seizure	Developer's Impact Fee	Redevelopment Agency	Downtown Business Improvement District	Golf Course	Civic Center Refinancing	Downtown Parking Improvement
	\$4,344		\$19	\$17 749	\$22 353	\$13 240
	44		93	12		
	<u>\$4,388</u>		<u>\$112</u>	<u>\$778</u>	<u>\$375</u>	<u>\$253</u>
			4	778	375	253
	48					
	<u>4,340</u>		<u>108</u>			
	<u>4,388</u>		<u>112</u>	<u>778</u>	<u>375</u>	<u>253</u>
	<u>\$4,388</u>		<u>\$112</u>	<u>\$778</u>	<u>\$375</u>	<u>\$253</u>

(Continued)

.....



City of Palo Alto - Non-Major Governmental Funds

Combining Balance Sheets- June 30, 2008

(In thousands of dollars)

	DEBT SERVICE FUND	PERMANENT FUND	Total Non-major Governmental Funds
	Special Assessment Debt	Eyerly Family	
ASSETS			
Cash and investments :			
Available for operations		\$729	\$15,970
Cash and investments with fiscal agent			1,342
Receivables:			
Accounts			464
Interest		5	176
Notes			5,456
Total Assets		\$734	\$23,408
LIABILITIES			
Accounts payable		3	226
Total Liabilities		3	226
FUND EQUITY			
Reserved for:			
Encumbrances			210
Notes receivable			5,456
Debt service			1,406
Unreserved, designated for:			
Special Revenue Funds			
Unrealized gain on investments			172
Special revenue projects			10,100
Special revenue reappropriations			3,184
Unreserved, undesignated:			
Permanent Fund		731	731
Special Revenue Funds			1,923
Total Fund Balances		731	23,182
Total Liabilities and Fund Balances		\$734	\$23,408



This page is intentionally left blank.

City of Palo Alto - Non-Major Governmental Funds

Combining Statements of Revenues, Expenditures and

Changes in Fund Balances -

For the Year Ended June 30, 2008

(In thousands of dollars)

	SPECIAL REVENUE FUNDS					
	Street Improvement	Federal Revenue	Housing In-Lieu	Special Districts	Transportation Mitigation	Local Law Enforcement
REVENUES						
Special assessments						
Other taxes and fines	\$1,113				\$4	
Charges for services					316	
From other agencies:						
Community Development Block Grant		\$386				
State of California						\$122
Other revenue from other agencies		156				
Permit and licenses				\$180		
Return on investment	23	159	\$586	50	134	14
Rental income			6			
Other:						
Housing In-Lieu - residential			17			
Housing In-Lieu - commercial			421			
University Avenue Parking				902	53	
California Avenue Parking				98		
Other fees			146		25	
Total Revenues	1,136	701	1,176	1,230	532	136
EXPENDITURES						
Current:						
Planning and Community Environment		2,589	3,810			
Public Safety - Police						171
Non Departmental		(24)	156			
Debt service:						
Principal retirement						
Interest and fiscal charges						
Total Expenditures		2,565	3,966			171
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	1,136	(1,864)	(2,790)	1,230	532	(35)
OTHER FINANCING SOURCES (USES)						
Transfers in						
Transfers (out)	(1,048)			(1,190)	(82)	(100)
Total Other Financing Sources (Uses)	(1,048)			(1,190)	(82)	(100)
Net Change in Fund Balance	88	(1,864)	(2,790)	40	450	(135)
Fund balances at the beginning of year	293	5,304	12,390	711	1,777	281
Fund balances at end of year	<u>\$381</u>	<u>\$3,440</u>	<u>\$9,600</u>	<u>\$751</u>	<u>\$2,227</u>	<u>\$146</u>



SPECIAL REVENUE FUNDS				DEBT SERVICE FUNDS		
Assets Seizure	Developer's Impact Fee	Redevelopment Agency	Downtown Business Improvement District	Golf Course	Civic Center Refinancing	Downtown Parking Improvement
			\$135			
	\$250		3	\$69	\$14	\$11
	2,045					
	2,295		138	69	14	11
			106			
				325	350	95
				236	71	140
			106	561	421	235
	2,295		32	(492)	(407)	(224)
	(620)	\$6 (6)		528	409	226
	(620)			528	409	226
	1,675		32	36	2	2
	2,713		80	742	373	251
	\$4,388		\$112	\$778	\$375	\$253

(Continued)

City of Palo Alto - Non-Major Governmental Funds

Combining Statements of Revenues, Expenditures and

Changes in Fund Balances -

For the Year Ended June 30, 2008

(In thousands of dollars)

	DEBT SERVICE FUND	PERMANENT FUND	Total
	Special Assessment District	Eyerly Family	Non-major Governmental Funds
REVENUES			
Special assessments	\$1		\$136
Other taxes and fines			1,117
Charges for services			316
From other agencies:			
Community Development Block Grant			386
State of California			122
Other revenue from other agencies			156
Permit and licenses			180
Return on investment		\$5	1,318
Rental income			6
Other:			
Housing In-Lieu - residential			17
Housing In-Lieu - commercial			421
University Avenue Parking			955
California Avenue Parking			98
Other fees			2,216
Total Revenues	<u>1</u>	<u>5</u>	<u>7,444</u>
EXPENDITURES			
Current:			
Planning and Community Environment			6,399
Public Safety - Police			171
Non Departmental			238
Debt service:			
Principal retirement	115		885
Interest and fiscal charges	4		451
Total Expenditures	<u>119</u>		<u>8,144</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(118)</u>	<u>5</u>	<u>(700)</u>
OTHER FINANCING SOURCES (USES)			
Transfers in		726	1,895
Transfers (out)			(3,046)
Total Other Financing Sources (Uses)		<u>726</u>	<u>(1,151)</u>
Net Change in Fund Balance	<u>(118)</u>	<u>731</u>	<u>(1,851)</u>
Fund balances at the beginning of year	<u>118</u>		<u>25,033</u>
Fund balances at end of year		<u>\$731</u>	<u>\$23,182</u>



This page is intentionally left blank.

City of Palo Alto - Non-major Governmental Funds
Combining Schedule of Revenues, Expenditures and
Changes in Fund Balances -Budget and Actual
For the Year Ended June 30, 2008
(In thousands of dollars)

	SPECIAL REVENUE FUNDS					
	Street Improvement			Federal Revenue		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
REVENUES						
Special assessments						
Other taxes and fines	\$1,136	\$1,113	(\$23)			
Charges for services						
From other agencies:						
Community Development Block Grant State of California				\$712	\$386	(\$326)
Other revenue from other agencies				40	156	116
Permit and licenses						
Return on investment	18	23	5		159	159
Rental income						
Other:						
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees				7		(7)
Total Revenues	<u>1,154</u>	<u>1,136</u>	<u>(18)</u>	<u>759</u>	<u>701</u>	<u>(58)</u>
EXPENDITURES						
Current operations:						
Planning and Community Environment				2,074	653	1,421
Public Safety - Police						
Non Departmental					(24)	24
Debt service:						
Principal retirement						
Interest and fiscal charges						
Total Expenditures				<u>2,074</u>	<u>629</u>	<u>1,445</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>1,154</u>	<u>1,136</u>	<u>(18)</u>	<u>(1,315)</u>	<u>72</u>	<u>1,387</u>
OTHER FINANCING SOURCES (USES)						
Transfers in				5		(5)
Transfers (out)	(1,462)	(1,048)	414	(5)		5
Total Other Financing Sources (Uses)	<u>(1,462)</u>	<u>(1,048)</u>	<u>414</u>			
Net Change in Fund Balance - Budget Basis	<u>(\$308)</u>	88	<u>\$396</u>	<u>(\$1,315)</u>	72	<u>\$1,387</u>
Non budgeted transactions - Valuation Allowance					(1,936)	
Fund balances at the beginning of year - (GAAP Basis)		293			5,304	
Fund balances at end of year - (GAAP Basis)		<u>\$381</u>			<u>\$3,440</u>	



SPECIAL REVENUE FUNDS

Housing In-Lieu			Special Districts			Transportation Mitigation		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
						\$82	\$4 316	\$4 234
\$150	\$586	\$436	\$38	\$180 50	\$180 12	69	134	65
9	6	(3)						
200	17	(183)						
200	421	221	910	902	(8)	480	53	(427)
			134	98	(36)			
375	146	(229)					25	25
934	1,176	242	1,082	1,230	148	631	532	(99)
395	255	140						
634	156	478						
1,029	411	618						
(95)	765	860	1,082	1,230	148	631	532	(99)
			(1,290)	(1,190)	100	(82)	(82)	
			(1,290)	(1,190)	100	(82)	(82)	
(\$95)	765	\$860	(\$208)	40	\$248	\$549	450	(\$99)
	(3,555)							
	12,390			711			1,777	
	\$9,600			\$751			\$2,227	

(Continued)



City of Palo Alto - Non-major Governmental Funds
Combining Schedule of Revenues, Expenditures and
Changes in Fund Balances -Budget and Actual
For the Year Ended June 30, 2008
(In thousands of dollars)

	SPECIAL REVENUE FUNDS					
	Local Law Enforcement			Asset Seizure		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
REVENUES						
Special assessments						
Other taxes and fines						
Charges for services						
From other agencies:						
Community Development Block Grant						
State of California	\$150	\$122	(\$28)			
Other revenue from other agencies						
Permit and licenses						
Return on investment	14	14		\$1		(\$1)
Rental income						
Other:						
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees						
Total Revenues	<u>164</u>	<u>136</u>	<u>(28)</u>	<u>1</u>		<u>(1)</u>
EXPENDITURES						
Current operations:						
Planning and Community Environment						
Public Safety - Police	198	171	27			
Non Departmental						
Debt service:						
Principal retirement						
Interest and fiscal charges						
Total Expenditures	<u>198</u>	<u>171</u>	<u>27</u>			
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(34)</u>	<u>(35)</u>	<u>(1)</u>	<u>1</u>		<u>(1)</u>
OTHER FINANCING SOURCES (USES)						
Transfers in						
Transfers (out)	(100)	(100)				
Total Other Financing Sources (Uses)	<u>(100)</u>	<u>(100)</u>				
Net Change in Fund Balance - Budget Basis	<u>(\$134)</u>	<u>(135)</u>	<u>(\$1)</u>	<u>\$1</u>		<u>(\$1)</u>
Non budgeted transactions - Valuation Allowance						
Fund balances at the beginning of year - (GAAP Basis)		<u>281</u>				
Fund balances at end of year - (GAAP Basis)		<u>\$146</u>				



.....

SPECIAL REVENUE FUNDS

Developer's Impact Fee			Redevelopment Agency			Downtown Business Improvement District		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
						\$160	\$135	(\$25)
\$77	\$250	\$173				4	3	(1)
553	2,045	1,492						
630	2,295	1,665				164	138	(26)
						164	106	58
						164	106	58
630	2,295	1,665					32	32
(620)	(620)		\$9 (9)	\$6 (6)	(\$3) 3			
(620)	(620)							
\$10	1,675	\$1,665					32	\$32
	2,713						80	
	\$4,388						\$112	

(Continued)

City of Palo Alto - Non-major Governmental Funds

Combining Schedule of Revenues, Expenditures and

Changes in Fund Balances - Budget and Actual

For the Year Ended June 30, 2008

(In thousands of dollars)

	DEBT SERVICE FUNDS					
	Golf Course			Civic Center Refinance		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
REVENUES						
Special assessments						
Other taxes and fines						
Charges for services						
From other agencies:						
Community Development Block Grant						
State of California						
Other revenue from other agencies						
Permit and licenses						
Return on investment	\$32	\$69	\$37	\$12	\$14	\$2
Rental income						
Other:						
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees						
Total Revenues	<u>32</u>	<u>69</u>	<u>37</u>	<u>12</u>	<u>14</u>	<u>2</u>
EXPENDITURES						
Current operations:						
Planning and Community Environment						
Public Safety - Police						
Non Departmental						
Debt service:						
Principal retirement	325	325		350	350	
Interest and fiscal charges	235	236	(1)	71	71	
Total Expenditures	<u>560</u>	<u>561</u>	<u>(1)</u>	<u>421</u>	<u>421</u>	
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(528)	(492)	36	(409)	(407)	2
OTHER FINANCING SOURCES (USES)						
Transfers in	528	528		409	409	
Transfers (out)						
Total Other Financing Sources (Uses)	<u>528</u>	<u>528</u>		<u>409</u>	<u>409</u>	
Net Change in Fund Balance - Budget Basis	<u>36</u>	<u>\$36</u>		<u>2</u>	<u>\$2</u>	
Non budgeted transactions - Valuation Allowance						
Fund balances at the beginning of year - (GAAP Basis)	<u>742</u>			<u>373</u>		
Fund balances at end of year - (GAAP Basis)	<u>\$778</u>			<u>\$375</u>		



DEBT SERVICE FUNDS						PERMANENT FUND			TOTAL		
Downtown Parking Improvement			Special Assessment District			Eyerly Family			Non-major Governmental Funds		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
			\$119	\$1	(\$118)				\$279	\$136	(\$143)
									1,136	1,117	(19)
									82	316	234
									712	386	(326)
									150	122	(28)
									40	156	116
										180	180
\$9	\$11	\$2				\$5			424	1,318	894
									9	6	(3)
									200	17	(183)
									200	421	221
									1,390	955	(435)
									134	98	(36)
									935	2,216	1,281
9	11	2	119	1	(118)	5			5,691	7,444	1,753
									2,469	908	1,561
									198	171	27
									798	238	560
95	95		115	115					885	885	
140	140		4	4					450	451	(1)
235	235		119	119					4,800	2,653	2,147
(226)	(224)	2		(118)	(118)	5			891	4,791	3,900
226	226					726	726		1,177	1,895	(8)
									(3,568)	(3,046)	522
226	226					726	726		(2,391)	(1,151)	514
	2	\$2		(118)	(\$118)	731	\$726		(\$1,500)	3,640	\$4,414
										(5,491)	
	251			118						25,033	
	\$253					\$731				\$23,182	



Non-major Governmental Funds

This page is intentionally left blank.



Internal Service Funds

Introduction

Internal Service Funds are used to finance and account for special activities and services performed by a designated department for other departments in the City on a cost reimbursement basis.

VEHICLE REPLACEMENT AND MAINTENANCE

This fund accounts for the maintenance and replacement of vehicles and equipment used by all City departments. The source of revenue is an accumulation of resources.

TECHNOLOGY

This fund accounts for replacement and upgrade of technology, and covers four primary areas used by all City departments: desktop, infrastructure, applications, and technology research and development. The source of revenue is an accumulation of resources.

PRINTING AND MAILING SERVICES

This fund accounts for central duplicating, printing and mailing services provided to all City departments. Source of revenue for this fund is on reimbursement of costs for services and supplies purchased by other departments.

GENERAL BENEFITS AND INSURANCE

This fund accounts for the administration of compensated absences and health benefits, and the City's self-insured workers' compensation and general liability programs.

RETIREE HEALTH BENEFIT

This fund accounts for the retiree health benefits.



This page is intentionally left blank.

City of Palo Alto - Internal Service Funds

Combining Statements of Net Assets - June 30, 2008

(In thousands of dollars)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits and Insurance	Retiree Health Benefit	Total
ASSETS						
Current Assets:						
Cash and investments available for operations	\$5,123	\$14,911	\$187	\$38,333	\$384	\$58,938
Accounts receivable, net	50	282				332
Interest receivable	61	187	3	403	195	849
Inventory of materials and supplies	587	(67)	(1)	13		532
Prepaid items					29,177	29,177
Total Current Assets	5,821	15,313	189	38,749	29,756	89,828
Noncurrent Assets:						
Capital assets, nondepreciable	2,754	4,397				7,151
Capital assets, net of depreciation	9,249	1,280	21			10,550
Total Noncurrent Assets	12,003	5,677	21			17,701
Total Assets	17,824	20,990	210	38,749	29,756	107,529
LIABILITIES						
Current Liabilities:						
Accounts payable and accrued liabilities	310	1,327		1,262		2,899
Accrued salaries and benefits	19	59	6	269		353
Accrued compensated absences	3	12	1	3,588		3,604
Accrued claims payable - current				7,356		7,356
Total Current Liabilities	332	1,398	7	12,475		14,212
Long-term Liabilities:						
Accrued compensated absences				6,819		6,819
Accrued claims payable				16,170		16,170
Total Long-term Liabilities				22,989		22,989
Total Liabilities	332	1,398	7	35,464		37,201
NET ASSETS						
Investment in capital assets	12,003	5,677	21			17,701
Unrestricted	5,489	13,915	182	3,285	29,756	52,627
Total Net Assets	\$17,492	\$19,592	\$203	\$3,285	\$29,756	\$70,328

City of Palo Alto - Internal Service Funds
Combining Statements of Revenues, Expenses and
Changes in Net Assets - For the Year Ended June 30, 2008
(In thousands of dollars)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits and Insurance	Retiree Health Benefit	Total
OPERATING REVENUES						
Charges for services	\$6,383	\$9,193	\$1,250	\$37,207	\$7,133	\$61,166
Other operating revenues		282				282
Total Operating Revenues	6,383	9,475	1,250	37,207	7,133	61,448
OPERATING EXPENSES						
Administration and general	833	9,495	1,434	1,759	18	13,539
Operations and maintenance	2,171					2,171
Depreciation and amortization	1,920	1,160	3			3,083
Claim payments and change in estimated self-insured liability				7,029		7,029
Compensated absences and other benefits	74			31,508	9,551	41,133
Total Operating Expenses	4,998	10,655	1,437	40,296	9,569	66,955
Total Operating Income (Loss)	1,385	(1,180)	(187)	(3,089)	(2,436)	(5,507)
NONOPERATING REVENUES (EXPENSES)						
Return on investment	338	1,088	22	2,419	1,537	5,404
Gain (loss) on disposal of capital assets	62					62
Other nonoperating revenues (expense)		52	3			55
Total Nonoperating Revenues	400	1,140	25	2,419	1,537	5,521
Income (Loss) Before Transfers	1,785	(40)	(162)	(670)	(899)	14
Transfers in		3,087				3,087
Transfers (out)	(27)	(905)	(8)		(64)	(1,004)
Change in Net Assets	1,758	2,142	(170)	(670)	(963)	2,097
Net assets at beginning of year	15,734	17,450	373	3,955	30,719	68,231
Net assets at end of year	\$17,492	\$19,592	\$203	\$3,285	\$29,756	\$70,328

City of Palo Alto - Internal Service Funds

Combining Statements of Cash Flows - For the Fiscal Year Ended June 30, 2008

(In thousands of dollars)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits and Insurance	Retiree Health Benefit	Total
CASH FLOW FROM OPERATING ACTIVITIES						
Receipts from customers	\$6,383	\$8,911	\$1,250	\$37,219	\$7,133	\$60,896
Payments to suppliers	(2,152)				(29,178)	(31,330)
Payments to or on behalf of employees	(905)	(8,187)	(1,431)	(36,395)	(9,568)	(56,486)
Claims paid				(4,633)		(4,633)
Interfund payments		25				25
Other receipts		334	3			337
Net cash provided by operating activities	3,326	1,083	(178)	(3,809)	(31,613)	(31,191)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Transfers in		3,087				3,087
Transfers (out)	(27)	(905)	(8)		(64)	(1,004)
Cash flows from noncapital financing activities	(27)	2,182	(8)		(64)	2,083
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES						
Acquisition and construction of capital assets	(3,030)	(3,382)				(6,412)
Proceeds from sale of capital assets	62					62
Cash flows from capital financing activities	(2,968)	(3,382)				(6,350)
CASH FLOWS FROM INVESTING ACTIVITIES						
Interest and dividends on pooled investments	340	1,077	25	2,389	1,641	5,472
Net Cash Flows	671	960	(161)	(1,420)	(30,036)	(29,986)
Cash and investments at beginning of year	4,452	13,951	348	39,753	30,420	88,924
Cash and investments at end of year	\$5,123	\$14,911	\$187	\$38,333	\$384	\$58,938
CASH FLOWS FROM OPERATING ACTIVITIES						
Operating income (loss)	\$1,385	(\$1,180)	(\$187)	(\$3,089)	(\$2,436)	(\$5,507)
Adjustments to reconcile operating income (loss) to cash flows from operating activities:						
Depreciation and amortization	1,920	1,160	3			3,083
Other		52	3			55
Changes in assets and liabilities:						
Accounts receivable		(282)		12		(270)
Inventory of materials and supplies	(83)	67	1	(13)		(28)
Prepaid items					(29,177)	(29,177)
Accounts and other payables	101	1,229	1	(3,115)		(1,784)
Accrued compensated absences	3	12	1			16
Interfund payment		25				25
Accrued claims payable				2,396		2,396
Net cash provided by operating activities	\$3,326	\$1,083	(\$178)	(\$3,809)	(\$31,613)	(\$31,191)



This page is intentionally left blank.



Fiduciary Funds.....

Introduction

Fiduciary Funds are used to account for assets held by the City acting in a fiduciary capacity for other entities and individuals. The funds are operated to carry out the specific actions required by the trust agreements, ordinances and other governing regulations.

Fiduciary Funds are presented separately from the Citywide and Fund financial statements.

Agency Funds are custodial in nature and do not involve measurement of results of operations. The City maintains three agency funds, as follows:

CALIFORNIA AVENUE PARKING ASSESSMENT DISTRICT

This fund accounts for receipts and disbursements associated with the 1993 Parking District No. 92-13 Assessment Bonds.

CABLE JOINT POWERS AUTHORITY

The fund was established to account for the activities of the cable television system on behalf of the members.

UNIVERSITY AVENUE AREA PARKING ASSESSMENT DISTRICT

The fund accounts for the receipts and disbursements associated with the Series 2001-A University Avenue Area Off-Street Parking Assessments Bonds.



City of Palo Alto - Agency Funds
Statement of Changes in Assets and Liabilities -
For the Fiscal Year Ended June 30, 2008
(In thousands of dollars)

	Balance June 30, 2007	Additions	Reductions	Balance June 30, 2008
<hr/> California Avenue Parking Assessment District <hr/>				
ASSETS				
Cash and investments available for operations	\$264		\$10	\$254
LIABILITIES				
Due to bondholders	\$264		\$10	\$254
<hr/> Cable Joint Powers Authority <hr/>				
ASSETS				
Cash and investments available for operations	\$769	\$44		\$813
Interest receivable	10			10
Total assets	\$779	\$44		\$823
LIABILITIES				
Due to other governments	\$779	\$44		\$823
<hr/> University Avenue Area Parking Assessment District <hr/>				
ASSETS				
Cash and investments with fiscal agents	\$6,097	\$3	\$1	\$6,099
Interest receivable	34	1		35
Total assets	\$6,131	\$4	\$1	\$6,134
LIABILITIES				
Due to bondholders	\$6,131	\$4	\$1	\$6,134
<hr/> Total Agency Funds <hr/>				
ASSETS				
Cash and investments available for operations	\$1,033	\$44	\$10	\$1,067
Cash and investments with fiscal agents	6,097	3	1	6,099
Interest receivable	44	1		45
Total assets	\$7,174	\$48	\$11	\$7,211
LIABILITIES				
Due to bondholders	\$6,395	\$4	\$11	\$6,388
Due to other governments	779	44		823
Total liabilities	\$7,174	\$48	\$11	\$7,211



Statistical Section.....

The statistical section contains comprehensive statistical data which relates to physical, economic, social and political characteristics of the City. It is intended to provide users with a broader and more complete understanding of the City and its financial affairs than is possible from the financial statements and supporting schedules included in the financial section.

In this section, readers will find comparative information related to the City's revenue sources, expenditures, property tax valuations, levies and collections, general obligation bonded debt, utility revenue debt service, demographics and pension plan funding. Where available, the comparative information is presented for the last ten fiscal years.

In addition, this section presents information related to the City's legal debt margin computation, principal taxpayers, notary and security bond coverages, and other miscellaneous statistics pertaining to services provided by the City.

In contrast to the financial section, the statistical section information is not usually subject to independent audit.

Financial Trends

These schedules contain trend information to help the reader understand how the City's financial performance and well being have changed over time:

1. Net Assets by Component
2. Changes in Net Assets
3. Fund Balances of Governmental Funds
4. Changes in Fund Balance of Governmental Funds

Revenue Capacity

These schedules contain information to help the reader assess the City's most significant local revenue sources, property tax and electric charges:

1. Electric Daily Loads and Top Customers by Usage
2. Electric Operating Revenue by Source
3. Assessed Value of Taxable Property
4. Property Tax Rates, All Overlapping Governments
5. Property Tax Levies and Collections
6. Principal Property Taxpayers

Debt Capacity

These schedules present information to help the reader assess the affordability of the City's current levels of outstanding debt and the City's ability to issue additional debt in the future:

1. Ratio of Outstanding Debt by Type
2. Computation of Direct and Overlapping Debt
3. Computation of Legal Bonded Debt Margin
4. Revenue Bond Coverage



Demographic and Economic Information

These schedules offer demographic and economic indicators to help the reader understand the environment within which the City's financial activities take place:

1. Taxable Transaction by Type of Business
2. Demographic and Economic Statistics
3. Principal Employers

Operating Information

These schedules contain service and infrastructure data to help the reader understand how the information in the City's financial report relates to the services the City provides and the activities it performs:

1. Full-Time Equivalent City Government Employees by Function
2. Operating Indicators by Function/Program
3. Capital Asset Statistics by Function/Program
4. Insurance Coverage

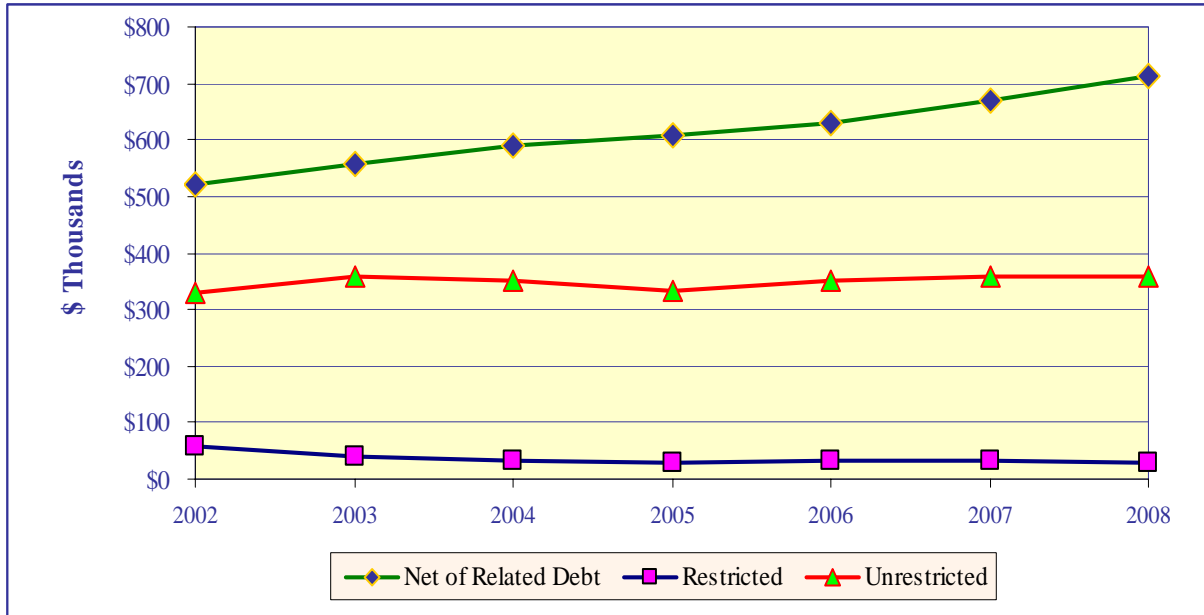
Sources

Unless otherwise noted, the information in these schedules is derived from the Comprehensive Annual Financial Reports for the relevant year. The City implemented GASB Statement 34 in 2002; schedules presenting government-wide information include information beginning in that year.



City of Palo Alto - Net Assets by Component

Last Seven Fiscal Years (\$000)
(Accrual Basis of Accounting)



	Fiscal Year Ended June 30,						
	2002	2003	2004	2005	2006	2007	2008
Governmental activities							
Invested in capital assets, net of related debt	\$252,183	\$279,306	\$297,125	\$305,225	\$311,335	\$326,411	\$343,537
Restricted	56,785	37,112	30,417	27,273	29,885	32,576	27,428
Unrestricted	117,113	130,463	123,762	117,301	123,823	127,190	130,460
Total governmental activities net assets	\$426,081	\$446,881	\$451,304	\$449,799	\$465,043	\$486,177	\$501,425
Business-type activities							
Invested in capital assets, net of related debt	\$270,622	\$279,885	\$294,197	\$303,473	\$318,738	\$342,922	\$370,303
Restricted	1,728	1,728	1,798	1,750	1,732	1,732	1,732
Unrestricted	210,990	228,308	226,278	215,128	228,032	230,912	226,539
Total business-type activities net assets	\$483,340	\$509,921	\$522,273	\$520,351	\$548,502	\$575,566	\$598,574
Primary government							
Invested in capital assets, net of related debt	\$522,805	\$559,191	\$591,322	\$608,698	\$630,073	\$669,333	\$713,840
Restricted	58,513	38,840	32,215	29,023	31,617	34,308	29,160
Unrestricted	328,103	358,771	350,040	332,429	351,855	358,102	356,999
Total primary government net assets	\$909,421	\$956,802	\$973,577	\$970,150	\$1,013,545	\$1,061,743	\$1,099,999

Source: Annual Financial Statements

Note: (a) The City implemented GASB Statement 34 in fiscal year 2002. Therefore this calculation is included only for fiscal years subsequent to that date.

City of Palo Alto - Changes in Net Assets

Last Seven Fiscal Years (\$000)
(Accrual Basis of Accounting)

	Fiscal Year Ended June 30,						
	2002	2003	2004	2005	2006	2007	2008
Expenses							
Governmental Activities:							
City Council	\$238	\$234	\$269	\$130	\$141	\$180	\$323
City Manager	1,765	1,565	1,663	1,725	1,563	1,760	2,273
City Attorney	2,410	2,028	2,300	2,653	2,598	2,390	2,653
City Clerk	633	598	808	770	945	900	1,241
City Auditor	583	646	668	764	843	838	1,379
Administrative Services **	10,138	9,723	6,271	6,982	6,972	6,419	15,477
Human Resources	2,166	1,728	2,078	2,410	2,546	2,472	2,806
Public Works	15,656	13,702	14,460	16,400	17,596	16,645	18,565
Planning and Community Environment	7,311	7,485	8,898	10,162	9,931	12,929	16,388
Police	19,049	19,273	20,414	22,416	23,411	23,861	27,740
Fire	16,870	16,859	17,308	18,127	18,747	19,530	22,386
Community Services	19,850	19,633	20,864	17,240	17,296	15,729	17,736
Library				4,835	5,323	5,347	6,321
Non-Departmental **	8,412	7,449	7,618	12,474	10,400	12,133	0
Interest on Long Term Debt	1,094	675	635	693	512	477	438
Total Governmental Activities Expenses	\$106,175	\$101,598	\$104,254	\$117,781	\$118,824	\$121,610	\$135,726
Business-Type Activities:							
Water	\$12,722	\$13,237	\$16,047	\$14,969	\$15,881	\$16,794	\$18,842
Electric	98,405	73,744	73,545	73,051	91,570	99,294	108,032
Gas	28,778	22,270	22,994	26,656	29,107	30,690	37,211
Wastewater Collection	8,489	8,712	9,203	8,907	11,005	10,085	12,023
Wastewater Treatment	13,287	14,312	14,868	17,457	16,747	15,901	18,902
Refuse	23,750	24,635	24,282	24,959	26,989	25,372	28,827
Storm Drainage	2,188	2,489	2,975	3,336	2,673	2,517	3,202
External Services	349	583	688	760	868	767	984
Total Business-Type Activities Expenses	187,968	159,982	164,602	170,095	194,840	201,420	228,023
Total Primary Government Expenses	\$294,143	\$261,580	\$268,856	\$287,876	\$313,664	\$323,030	\$363,749

Program Revenues

Governmental Activities

Charges for Services:

City Council							
City Manager							
City Attorney		\$92	\$64	\$22	\$22	\$13	\$16
City Clerk	1	1	1		2		
City Auditor		1					
Administrative Services	12	406	815	480	627	835	870
Human Resources						11	
Public Works	320	1,058	260	573	805	968	1,310
Planning and Community Environment	4,062	5,119	3,074	4,090	5,509	6,267	5,498
Police	3,966	3,396	4,415	3,801	4,178	4,179	4,274
Fire	7,976	7,811	7,565	8,555	9,078	9,610	9,418
Community Services	7,793	7,537	7,846	7,592	10,803	9,128	10,314
Library				133	129	146	176
Operating Grants and Contributions	5,568	4,468	4,213	3,677	3,976	5,642	4,029

** FY 07-08 includes expenditures classified as Non-departmental in prior years (GFOA recommendation)

City of Palo Alto - Changes in Net Assets

Last Seven Fiscal Years (\$000)

(Accrual Basis of Accounting)

	Fiscal Year Ended June 30,						
	2002	2003	2004	2005	2006	2007	2008
Capital Grants and Contributions	32,380	635	1,990	804	3,156	1,756	1,930
Total Government Activities Program Revenues	62,078	30,524	30,243	29,727	38,285	38,555	37,835
Business-Type Activities:							
Charges for Services:							
Water	16,034	17,654	21,993	21,041	21,108	23,495	26,510
Electric	93,755	91,622	92,617	88,737	119,418	102,549	103,833
Gas	41,658	29,714	24,839	31,206	36,977	42,221	49,021
Wastewater Collection	9,292	10,676	12,647	12,041	13,801	14,848	15,102
Wastewater Treatment	13,987	13,556	14,744	15,982	18,778	16,957	22,889
Refuse	21,777	21,691	21,923	23,387	24,795	25,532	28,805
Storm Drainage	2,221	2,192	2,170	2,484	5,174	5,181	5,450
External Services	380	605	585	766	854	789	112
Capital Grants and Contributions	185					756	1,594
Total Business-Type Activities Program Revenue	199,289	187,710	191,518	195,644	240,905	232,328	253,316
Total Primary Government Program Revenues	\$261,367	\$218,234	\$221,761	\$225,371	\$279,190	\$270,883	\$291,151
Net (Expense)/Revenue							
Governmental Activities	(\$44,097)	(\$71,074)	(\$74,011)	(\$88,054)	(\$80,539)	(\$83,055)	(\$97,891)
Business-Type Activities	11,321	27,728	26,916	25,549	46,065	30,908	25,293
Total Primary Government Net Expense	(\$32,776)	(\$43,346)	(\$47,095)	(\$62,505)	(\$34,474)	(\$52,147)	(\$72,598)
General Revenues and Other Changes in Net Assets							
Governmental Activities:							
Taxes:							
Property Taxes	\$13,270	\$13,882	\$13,707	\$16,657	\$18,731	\$21,466	\$23,084
Sales Taxes	20,085	18,041	18,151	19,308	20,315	22,194	22,623
Utilities Users Taxes	6,457	7,067	7,152	7,269	8,759	9,356	10,285
Transient Occupancy Tax	6,615	5,333	5,489	5,686	6,393	6,709	7,976
Other taxes	6,284	7,275	8,493	5,580	7,033	6,293	6,261
Investment Earnings	10,589	10,213	326	4,988	2,567	8,747	12,313
Rents and Miscellaneous	18,524	15,333	10,165	12,997	10,440	13,670	11,896
Transfers	13,334	14,730	14,951	14,064	21,545	15,754	18,701
Total Government Activities	95,158	91,874	78,434	86,549	95,783	104,189	113,139
Business-Type Activities:							
Investment Earnings	15,620	13,583	387	8,093	3,631	11,910	16,416
Special Item				(21,500)			
Transfers	(13,334)	(14,730)	(14,951)	(14,064)	(21,545)	(15,754)	(18,701)
Total Business-Type Activities	2,286	(1,147)	(14,564)	(27,471)	(17,914)	(3,844)	(2,285)
Total Primary Government	\$97,444	\$90,727	\$63,870	\$59,078	\$77,869	\$100,345	\$110,854
Change in Net Assets							
Governmental Activities	\$51,061	\$20,800	\$4,423	(\$1,505)	\$15,244	\$21,134	\$15,248
Business-Type Activities	13,607	26,581	12,352	(1,922)	28,151	27,064	23,008
Total Primary Government	\$64,668	\$47,381	\$16,775	(\$3,427)	\$43,395	\$48,198	\$38,256

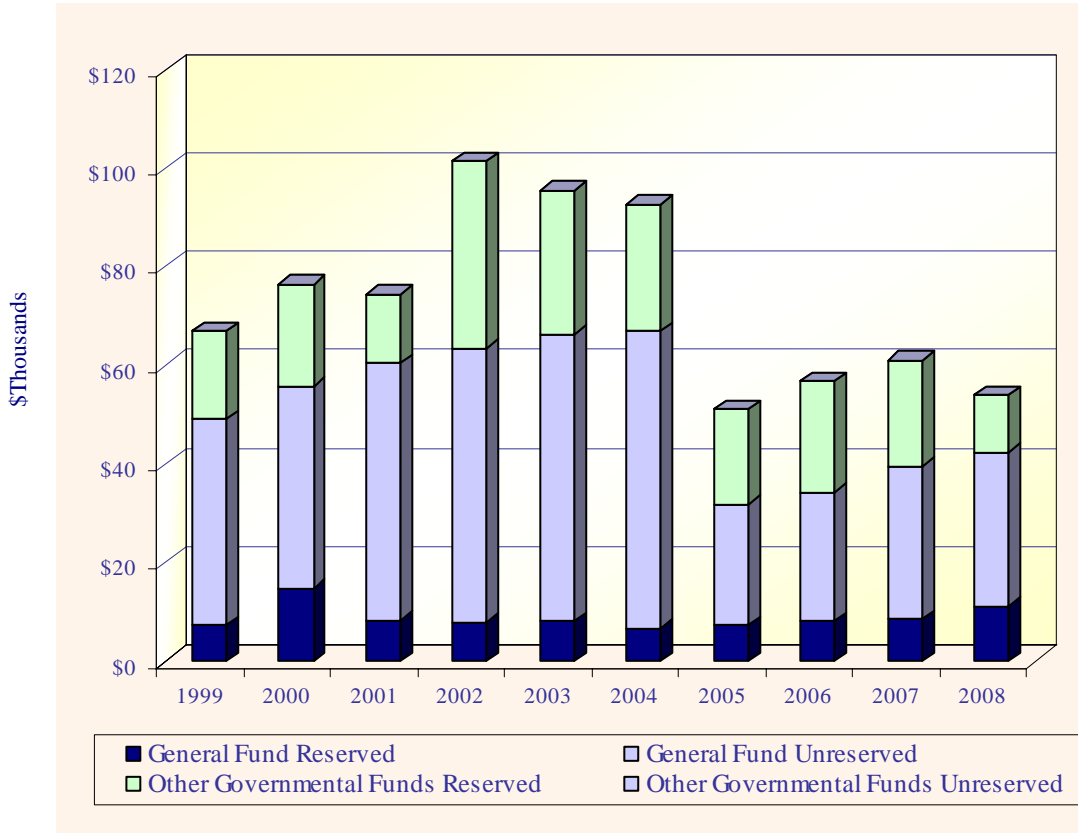
Source: Annual Financial Statements

Note: (a) The City implemented GASB Statement 34 in fiscal year 2002. Therefore this calculation is included only for fiscal years subsequent to that date.

City of Palo Alto - Fund Balances of Governmental Funds

Last Ten Fiscal Years (\$000)

(Modified Accrual Basis of Accounting)



Fiscal Year Ended June 30,

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
General Fund										
Reserved	\$7,237	\$14,838	\$8,282	\$7,780	\$8,156	\$6,735	\$7,332	\$7,966	\$8,392	\$11,102
Unreserved	41,900	40,927	52,114	55,653	58,151	60,087	24,498	26,251	31,016	31,313
Total General Fund	\$49,137	\$55,765	\$60,396	\$63,433	\$66,307	\$66,822	\$31,830	\$34,217	\$39,408	\$42,415 (a)
All Other Governmental Funds										
Reserved	\$17,796	\$20,717	\$14,086	\$37,924	\$29,174	\$25,790	\$19,305	\$22,597	\$21,614	\$11,575
Unreserved, reported in:										
Special revenue & Permanent funds	5,273	4,908	7,466	18,263	7,428	6,875	7,643	7,063	10,847	33,947
Capital project funds	9,195	7,987	18,005	19,772	22,705	10,419	39,431	37,315	33,646	15,938
Total all other governmental funds	\$32,264	\$33,612	\$39,557	\$75,959	\$59,307	\$43,084	\$66,379	\$66,975	\$66,107	\$61,460

Source: Annual Financial Statements

Note: (a) The change in total fund balance for the General fund and other governmental funds is explained in Management's discussion and Analysis.

This page is intentionally left blank.

City of Palo Alto - Changes in Fund Balance of Governmental Funds Last Ten Fiscal Years (\$000)

(Modified Accrual Basis of Accounting)

	Fiscal Year Ended June 30,				
	1999	2000	2001	2002	2003
Revenues					
Sales tax	\$20,225	\$22,867	\$25,786	\$20,085	\$18,041
Property tax	9,521	10,770	12,110	13,231	13,821
Other taxes	20,393	23,582	26,160	20,485	21,070
Permits and licenses	8,810	12,408	12,743	2,901	3,161
Fines, forfeits and penalties	1,475	1,703	1,873	2,181	2,124
Interest and rentals	13,992	13,874	17,432	19,547	19,981
From other agencies	3,374	3,282	2,208	3,860	3,776
Charges for services	4,751	5,053	5,466	16,667	16,798
Other	4,376	6,213	7,590	8,580	5,095
Total Revenues	86,917	99,752	111,368	107,537	103,867
Expenditures					
Administration (1)	15,066	15,772	18,557	18,235	17,521
Public works	9,202	8,827	9,522	9,549	9,858
Planning and community environment	5,674	6,639	6,652	7,378	7,721
Police	16,705	17,666	18,306	19,047	19,719
Fire	13,949	14,512	15,973	16,722	16,841
Community services	16,820	17,858	18,469	19,499	19,793
Library (2)					
Non-departmental	6,520	6,927	14,487	8,259	7,442
Special revenue and capital projects	16,605	13,151	11,089	16,960	33,584
Debt service - Principal payments	1,553	1,775	1,895	465	875
Debt Service - Interest and fiscal fees	956	1,026	922	686	696
Total Expenditures	103,050	104,153	115,872	116,800	134,050
Excess (deficiency) of revenues over (under) expenditures	(16,133)	(4,401)	(4,504)	(9,263)	(30,183)
Other Financing Sources (Uses)					
Transfers in	24,715	27,795	26,150	27,389	31,402
Transfers (out)	(649)	(15,418)	(14,487)	(14,444)	(16,603)
Contribution from assessment district			4,112	31,823	425
Proceeds from long term debt	7,750			7,055	
Payments to refunded bond escrow	(649)		(705)	(3,820)	
Total other financing sources (uses)	31,167	12,377	15,070	48,003	15,224
Net Change in fund balances	\$15,034	\$7,976	\$10,566	\$38,740	(\$14,959)
Debt service as a percentage of noncapital expenditures	(a)	(a)	(a)	1.1%	1.6%

Source: Annual Financial Statements

Note: (a) The City implemented GASB Statement 34 in fiscal year 2002. Therefore this calculation is included only for fiscal years subsequent to that date.

(1) Comprised of the following departments: City Council, City Manager, City Attorney, City Clerk, City Auditor, Administrative Services and Human Resources.

(2) Prior to 2005, Library was included in Community Services.



Fiscal Year Ended June 30,

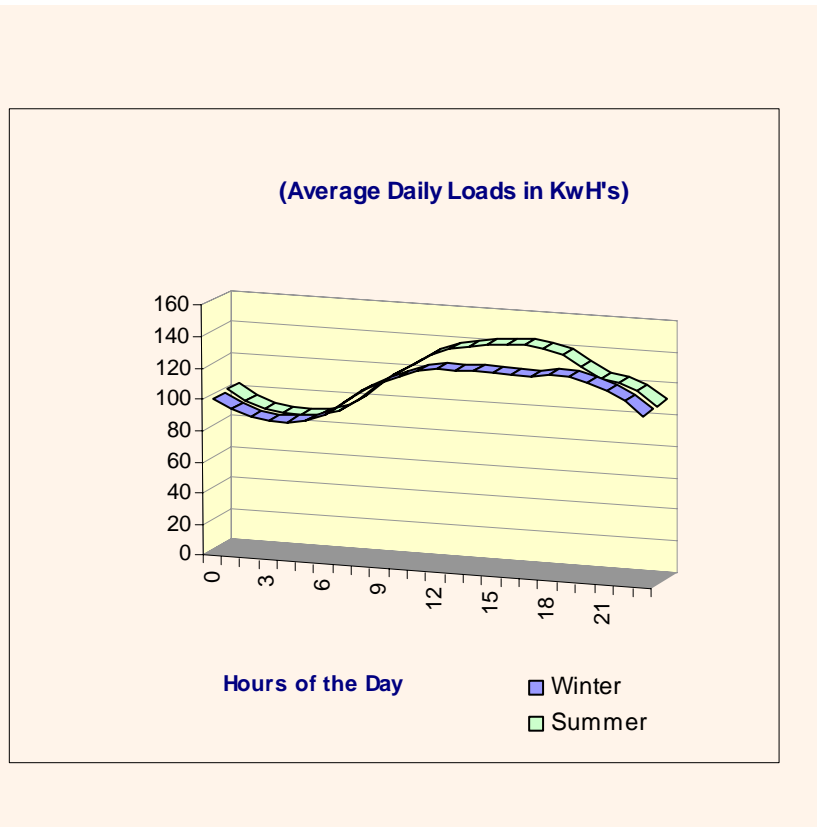
2004	2005	2006	2007	2008
\$18,151	\$19,308	\$20,315	\$22,194	\$22,623
13,707	16,657	18,731	21,466	23,084
22,427	19,941	23,712	23,698	25,202
2,563	3,183	4,305	4,711	4,761
2,884	2,096	2,128	2,517	2,183
11,480	14,968	13,776	17,750	20,507
4,661	2,757	5,931	3,448	4,300
16,018	17,159	18,672	19,929	19,610
1,681	4,269	4,058	7,503	4,713
<u>93,572</u>	<u>100,338</u>	<u>111,628</u>	<u>123,216</u>	<u>126,983</u>
13,862	14,509	14,299	14,399	16,250
8,031	9,060	9,036	9,256	10,072
8,793	9,692	9,292	11,874	9,861
19,962	21,117	22,279	23,305	27,006
16,891	17,615	18,114	19,146	21,644
19,934	16,298	19,740	16,533	17,138
	4,800	5,170	5,260	6,219
7,598	9,028	10,389	12,122	14,089
22,289	21,317	13,243	17,478	21,626
780	785	810	850	885
639	583	523	489	451
<u>118,779</u>	<u>124,804</u>	<u>122,895</u>	<u>130,712</u>	<u>145,241</u>
(25,207)	(24,466)	(11,267)	(7,496)	(18,258)
28,632	60,429	26,640	27,701	33,437
(19,133)	(46,622)	(12,390)	(15,882)	(16,819)
	(1,038)			
<u>9,499</u>	<u>12,769</u>	<u>14,250</u>	<u>11,819</u>	<u>16,618</u>
<u>(\$15,708)</u>	<u>(\$11,697)</u>	<u>\$2,983</u>	<u>\$4,323</u>	<u>(\$1,640)</u>
1.5%	1.3%	1.2%	1.2%	1.1%

City of Palo Alto - Electric Daily Loads and Top Customers by Usage

June 30, 2008

(in thousands of KWh)

Daily Hours	# Kilowatt Hours	
	(Oct-Mar) Winter	(Apr-Sep) Summer
0	103,128	103,496
1	97,059	97,157
2	93,139	93,225
3	91,909	91,508
4	91,495	90,823
5	92,562	91,698
6	97,011	95,830
7	106,586	104,078
8	115,415	113,076
9	120,913	120,351
10	125,664	126,552
11	129,417	131,883
12	131,324	135,021
13	131,926	136,543
14	132,031	137,518
15	131,652	137,847
16	130,838	137,396
17	130,400	136,502
18	132,858	136,189
19	132,210	132,559
20	128,757	127,843
21	125,328	125,264
22	119,571	120,136
23	111,357	111,782



Source: City of Palo Alto, Utilities Resource Management

Top Ten Electric Customers by Usage

Customer (alphabetical order)	Type of Business	Kw H's	% of System Total
City of Palo Alto	Municipal		%
CPI-David Morman	Research in Physical Science		
DPIX-BLDG 34	Municipal		
Hew lett Packard	Computer		
Space System Loral	Satellite & Satellite Systems		
Stanford Hines Interests	Property Management		
Stanford Hospital	Hospital		
Syntex/J Meek	Technology in Occupational Risk Mgmt		
Vet Admin Hosp	Hospital		
VMWare Inc.	Computer		
Total		330,385,588	33.77 %

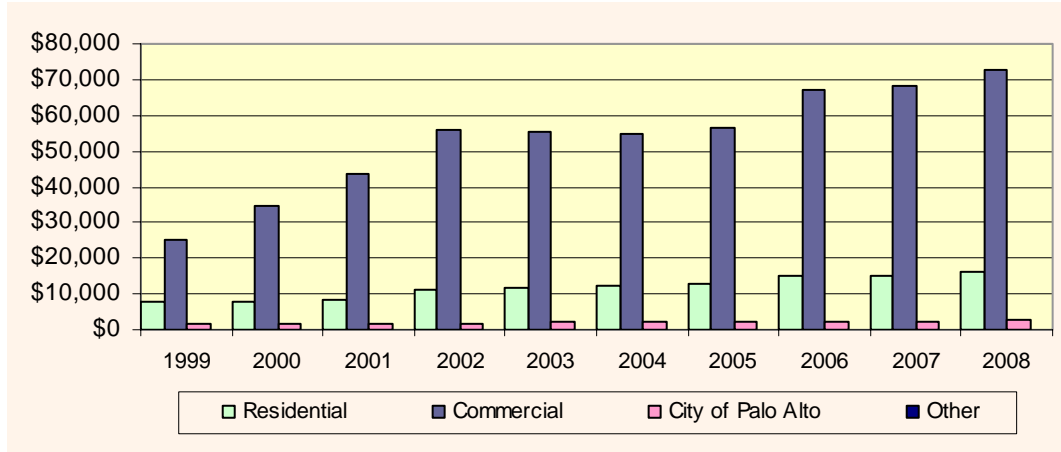
Source: City of Palo Alto, Utilities Department



City of Palo Alto - Electric Operating Revenue by Source

June 30, 2008

(in thousands of dollars)



Fiscal Year	Residential	Commercial	City of Palo Alto	Other	Total
1999	7,758	25,318	1,685	65	34,826
2000	7,987	34,826	1,415	29	44,256
2001	8,489	43,460	1,545	5	53,499
2002	11,377	56,214	1,925	6	69,521
2003	11,657	55,353	2,004	24	69,039
2004	12,245	54,881	2,047	66	69,240
2005	13,009	56,683	2,222	67	71,981
2006	14,973	67,389	2,395	97	84,854
2007	15,150	68,214	2,397	69	85,829
2008	16,109	72,632	2,571	0	91,312

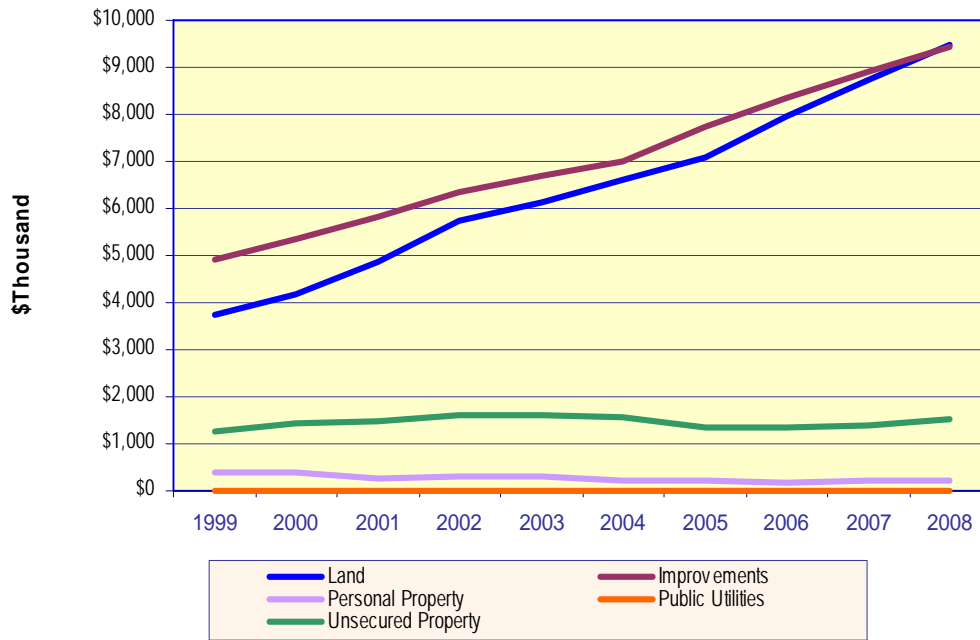
Top Ten Electric Revenue

Customer (alphabetical order)	Type of Business	Net Charges	% of System Total
City of Palo Alto	Municipal		
CPI-David Morman-MSB500	Research		
Hewlett Packard	Computer		
Palo Alto Schools	Education		
Space System Loral/MS-AC-1	Satellite System		
Stanford % Hines Interests	Property Mgmt		
Stanford Hospital	Hospital		
Syntex/J Meek-MS#SS-200	Technology		
Vet Admin Hospital	Hospital		
VMWare, Inc.	Computer		
Total		\$ 48,865,158	25.42%

Source: City of Palo Alto, Utilities Department

Note: Revenue includes all utilities (metered and non-metered), revenue adjustments, and Primary Voltage discount. Does not include CEC surcharge, UUT, Solar and Rap discounts, and deposits.

City of Palo Alto - Assessed Value of Taxable Property
Last Ten Fiscal Years (\$'000)



Fiscal Year	Net Local Secured Roll			Subtotal	Less			Total Assessed Value	Total Direct Tax Rate
	Land	Improvements	Personal Property	Net Local Secured Roll	Public Utilities	Unsecured Property	Exemptions Net of State Aid		
1999	3,729,475	4,920,111	394,610	9,044,196	2,842	1,279,315	702,485	9,623,868	1%
2000	4,187,357	5,335,026	394,198	9,916,581	3,362	1,415,999	802,164	10,533,778	1%
2001	4,849,233	5,816,633	280,958	10,946,824	3,309	1,473,678	813,896	11,609,915	1%
2002	5,744,675	6,347,719	292,812	12,385,206	3,371	1,627,594	913,475	13,102,696	1%
2003	6,140,438	6,692,162	309,386	13,141,986	3,859	1,612,179	951,807	13,806,217	1%
2004	6,588,474	6,996,106	195,859	13,780,439	3,956	1,582,368	1,196,546	14,170,217	1%
2005	7,075,300	7,722,660	220,585	15,018,545	4,150	1,354,310	1,402,039	14,974,966	1%
2006	7,941,482	8,364,668	174,666	16,480,816	4,084	1,361,117	1,595,871	16,250,146	1%
2007	8,725,485	8,915,623	213,154	17,854,262	3,923	1,391,284	1,639,856	17,609,613	1%
2008	9,497,746	9,453,436	228,875	19,180,057	3,174	1,536,584	1,797,327	18,922,488	1%

Source: County of Santa Clara Assessor's Office

Note: Beginning in fiscal year 1988-89, Chapter 921 of the Statutes of 1987 requires the establishment of a single county-wide tax rate area for the assignment of the assessed value of certain types of state-assessed utility property and sets forth formulas for the determination of county-wide tax rates for this particular type of property.

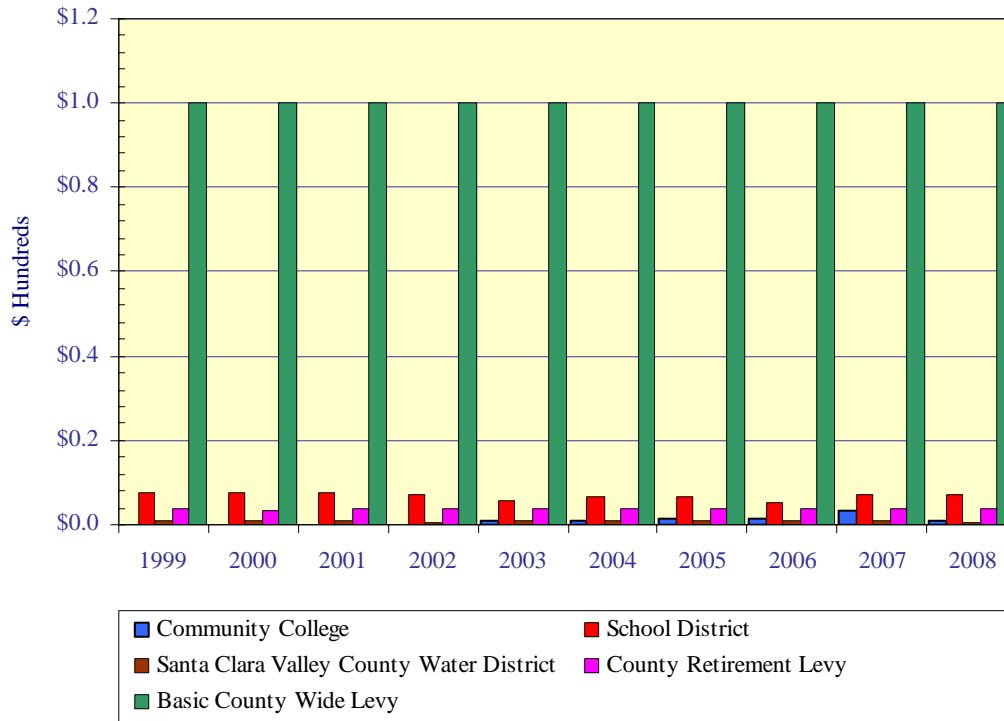
The State Constitution requires property to be assessed at one hundred percent of the most recent purchase price, plus an increment of no more than two percent annually, plus any local over-rides. These values are considered to be full market values.



City of Palo Alto - Property Tax Rates

All Overlapping Governments

Last Ten Fiscal Years



Fiscal Year	Basic County Wide Levy	County Retirement Levy	Santa Clara Valley Water District	School District	Community College	Total
1999	1.0000	0.0388	0.0082	0.0757	0.0000	1.1227
2000	1.0000	0.0319	0.0085	0.0740	0.0000	1.1144
2001	1.0000	0.0356	0.0075	0.0771	0.0000	1.1202
2002	1.0000	0.0364	0.0062	0.0727	0.0000	1.1153
2003	1.0000	0.0388	0.0072	0.0586	0.0108	1.1154
2004	1.0000	0.0388	0.0087	0.0666	0.0110	1.1251
2005	1.0000	0.0388	0.0092	0.0680	0.0129	1.1289
2006	1.0000	0.0388	0.0078	0.0526	0.0119	1.1111
2007	1.0000	0.0388	0.0072	0.0720	0.0346	1.1526
2008	1.0000	0.0388	0.0071	0.0702	0.0113	1.1274

Source: County of Santa Clara, Tax Rates and Information

City of Palo Alto - Property Tax Levies and Collections

Last Ten Fiscal Years (\$000)

<u>Fiscal Year</u>	<u>Total Tax Levy (a)</u>	<u>Current Tax Collections</u>	<u>Percent of Levy Collected</u>	<u>Delinquent Tax Collections (b)</u>	<u>Total Tax Collections</u>	<u>Percent of Total Tax Collections to Tax Levy</u>
1999	9,521	9,521	100%	-	9,521	100%
2000	10,770	10,770	100%	-	10,770	100%
2001	12,110	12,110	100%	-	12,110	100%
2002	13,231	13,231	100%	-	13,231	100%
2003	13,821	13,821	100%	-	13,821	100%
2004	13,707	13,707	100%	-	13,707	100%
2005	16,657	16,657	100%	-	16,657	100%
2006	18,731	18,731	100%	-	18,731	100%
2007	21,466	21,466	100%	-	21,466	100%
2008	23,084	23,084	100%	-	23,084	100%

Source: County of Santa Clara Assessor's Office

Note: Current tax collections beginning in 1993 have been reduced by a mandatory tax reallocation imposed by the State of California.

- (a) During fiscal year 1995, the County began providing the City 100% of its tax levy under an agreement which allows the County to keep all interest and delinquency charges collected.
- (b) Effective with the fiscal year 1993-94, the City is on the Teeter Plan, under which the County of Santa Clara pays the full tax levy due. All prior delinquent taxes were also received in that fiscal year.



City of Palo Alto - Principal Property Tax Payers

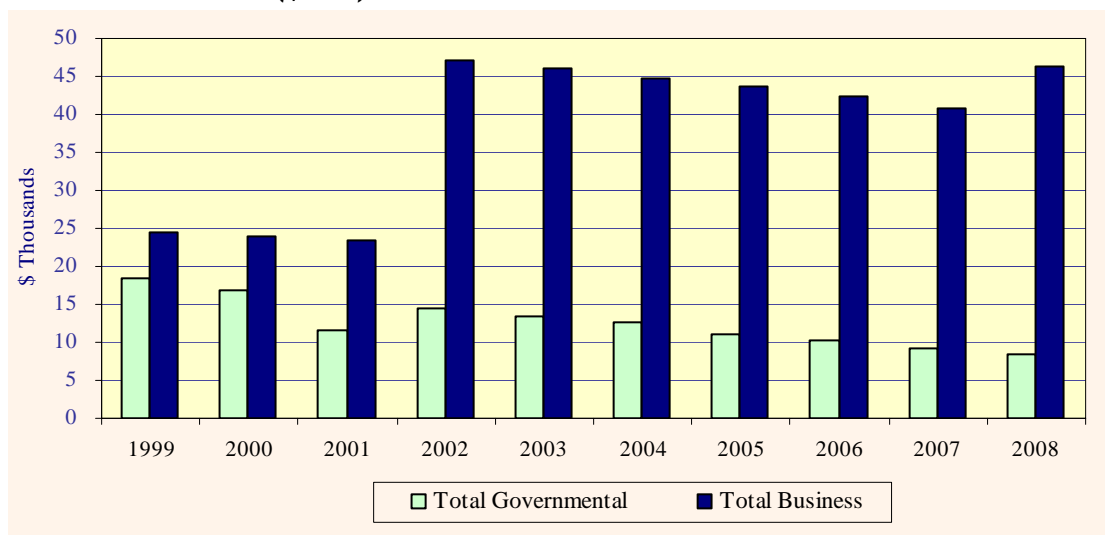
Current Year and Nine Years Ago (\$000)

Taxpayer	2007-08			1998-99		
	Taxable Assessed Value	Rank	Percentage of Total City Taxable Assessed Value	Taxable Assessed Value	Rank	Percentage of Total City Taxable Assessed Value
Leland Stanford Jr University	\$2,968,746	1	15.7%	\$1,631,031	1	16.9%
Space System /Loral Inc.	169,513	2	0.9%	193,128	2	2.0%
Sun Microsystems Inc.			0.0%	69,742	3	0.7%
Harbor Investments Partners	65,791	4	0.3%	53,705	4	0.6%
Digital Equipment Corporation			0.0%	44,422	5	0.5%
Embarcadero Place Corporation			0.0%	43,350	6	0.5%
Cowper-Hamilton Associates			0.0%	37,699	7	0.4%
Hyatt Equities, LLC			0.0%	23,101	8	0.2%
Stanford Square Limited Partners			0.0%	22,200	9	0.2%
University Ave. Partners and Associates			0.0%	21,180	10	0.2%
Whisman Ventures, LLC	100,470	3	0.5%			0.0%
Western Pacific Housing Inc	60,033	5	0.3%			0.0%
EOP-Embarcadero Place, LLC	45,000	6	0.2%			0.0%
505 Hamilton Avenue Partners L.P.	38,583	7	0.2%			0.0%
Pacific Hotel Dev Venture L P	38,143	8	0.2%			0.0%
Palo Alto Town & Country Village Inc	37,031	9	0.2%			0.0%
California Pacific Comm. Corp.	35,953	10	0.2%			0.0%
Subtotal	\$3,559,263		18.8%	\$2,139,558		22.2%
Total Net Assessed Valuation:						
Fiscal Year 2007-2008	\$18,922,488					
Fiscal Year 1998-1999	\$9,623,868					

Source: County of Santa Clara compiled by Hunt Consulting, LLC

City of Palo Alto - Ratio of Outstanding Debt by Type

Last Ten Fiscal Years (\$000)



Governmental Activities

Fiscal Year	Certificates of Participation	Special Assessment Debt	Capital Lease Obligations	Total
1999	12,480	5,195	791	18,466
2000	11,625	4,670	537	16,832
2001	10,700	670	113	11,483
2002	13,695	595	84	14,374
2003	12,905	510	57	13,472
2004	12,215	420	25	12,660
2005	10,625	325		10,950
2006	9,915	225		10,140
2007	9,175	115		9,290
2008	8,405	0		8,405

Business-Type Activities

Fiscal Year	Utility Revenue Bonds	Total	Total Primary Government	Percentage of Assessed Value (a)	Per Capita (b)
1999	24,368	24,368	42,834	0.45 %	\$0.70
2000	23,935	23,935	40,767	0.39	0.66
2001	23,465	23,465	34,948	0.30	0.57
2002	47,210	47,210	61,584	0.47	1.02
2003	46,069	46,069	59,541	0.43	0.98
2004	44,862	44,862	57,522	0.38	0.95
2005	43,598	43,598	54,548	0.34	0.88
2006	42,288	42,288	52,428	0.32	0.84
2007	40,887	40,887	50,177	0.28	0.80
2008	46,310	46,310	54,715	0.29	0.86

Sources: City of Palo Alto

(a) County of Santa Clara (assessed value)

(b) State of California, Department of Finance (population)

Note: Debt amounts exclude any premiums, discounts, or other amortization amounts.

Details regarding the City's outstanding debt can be found in the notes to the financial statements.



City of Palo Alto - Computation of Direct and Overlapping Debt

June 30, 2008

2007-08 Assessed Valuation	<u>\$18,922,488,000</u>		
	Total Debt	Percentage Applicable To City of Palo Alto (a)	Amount Applicable To City of Palo Alto
<u>OVERLAPPING TAX AND ASSESSMENT DEBT:</u>			
Foothill-DeAnza Community College District	\$484,814,288	22.887%	\$110,959,446
Palo Alto Unified School District	100,660,000	88.994%	89,581,360
Fremont Union High School District	132,000,000	0.008%	10,560
Mountain View-Los Altos Union High School District	38,464,160	0.991%	381,180
Cupertino Union School District	128,129,883	0.004%	5,125
Los Altos School District	97,344,000	0.939%	914,060
Whisman School District	22,832,215	3.699%	844,564
El Camino Hospital District	146,365,000	0.101%	147,829
City of Palo Alto Special Assessment Bonds	37,520,000	100.000%	37,520,000
Santa Clara Valley Water District Benefit Assessment District	165,020,000	7.464%	12,317,093
TOTAL OVERLAPPING TAX AND ASSESSMENT DEBT	<u>\$1,353,149,546</u>		<u>\$252,681,217</u>
<u>DIRECT AND OVERLAPPING GENERAL FUND DEBT:</u>			
Santa Clara County General Fund Obligations	\$895,655,000	7.464%	\$66,851,689
Santa Clara County Pension Obligations	389,484,822	7.464%	\$29,071,147
Santa Clara County Board of Education Certificates of Participation	15,445,000	7.464%	1,152,815
Foothill-DeAnza Community College District Certificates of Participation	27,685,000	22.887%	6,336,266
Mountain View-Los Altos Union High School District Certificates of Participation	7,245,000	0.991%	71,798
Cupertino Union School District Certificates of Participation	2,375,000	0.004%	95
City of Palo Alto General Fund Obligations	8,405,000	100.000%	8,405,000
Santa Clara County Vector Control District Certificates of Participation	4,275,000	7.464%	319,086
Midpeninsula Regional Open Space Park District General Fund Obligations	104,840,193	13.163%	13,800,115
TOTAL DIRECT AND OVERLAPPING GENERAL FUND DEBT	<u>\$1,455,410,015</u>		<u>\$126,008,011</u>
COMBINED TOTAL DEBT	<u>\$2,808,559,561</u>		<u>\$378,689,228</u> (b)

(a) Percentage of overlapping agency's assessed valuation located within boundaries of the city.

(b) Excludes tax and revenue anticipation notes, enterprise revenue, mortgage revenue and tax allocation bonds and non-bonded capital lease obligations.

Ratios to Assessed Valuation

Combined Direct Debt (\$8,405,000)	0.04%
Total Overlapping Tax and Assessment Debt	1.34%
Combined Total Debt	2.00%

STATE SCHOOL BUILDING AID REPAYABLE AS OF 06/30/08: \$0

Source: California Municipal Statistics, Inc.

City of Palo Alto - Computation of Legal Bonded Debt Margin

June 30, 2008

(in thousands of dollars)

Assessed Valuation:

Secured property assessed value, net of
exempt real property \$18,922,488

Bonded debt limit 3.75% of assessed value (a) \$709,593

Amount of debt subject to limit: (b)

Certificates of participation 8,405
Special assessment debt with government commitment 0
Total Debt 8,405

Less amount of debt not subject to limit 8,405

Amount of debt subject to limit 0

Legal bonded debt margin \$709,593

Fiscal Year	Debt Limit	Total Net Debt Applicable to Limit	Legal Debt Margin	Total net debt applicable to the limit as a percentage of debt limit
1999	360,895	0	360,895	0.00%
2000	395,017	0	395,017	0.00%
2001	435,372	0	435,372	0.00%
2002	491,351	0	491,351	0.00%
2003	516,615	0	516,615	0.00%
2004	561,561	0	561,561	0.00%
2005	609,378	0	609,378	0.00%
2006	609,377	0	609,377	0.00%
2007	660,360	0	660,360	0.00%
2008	709,593	0	709,593	0.00%

Source: Annual Financial Statements

Notes:

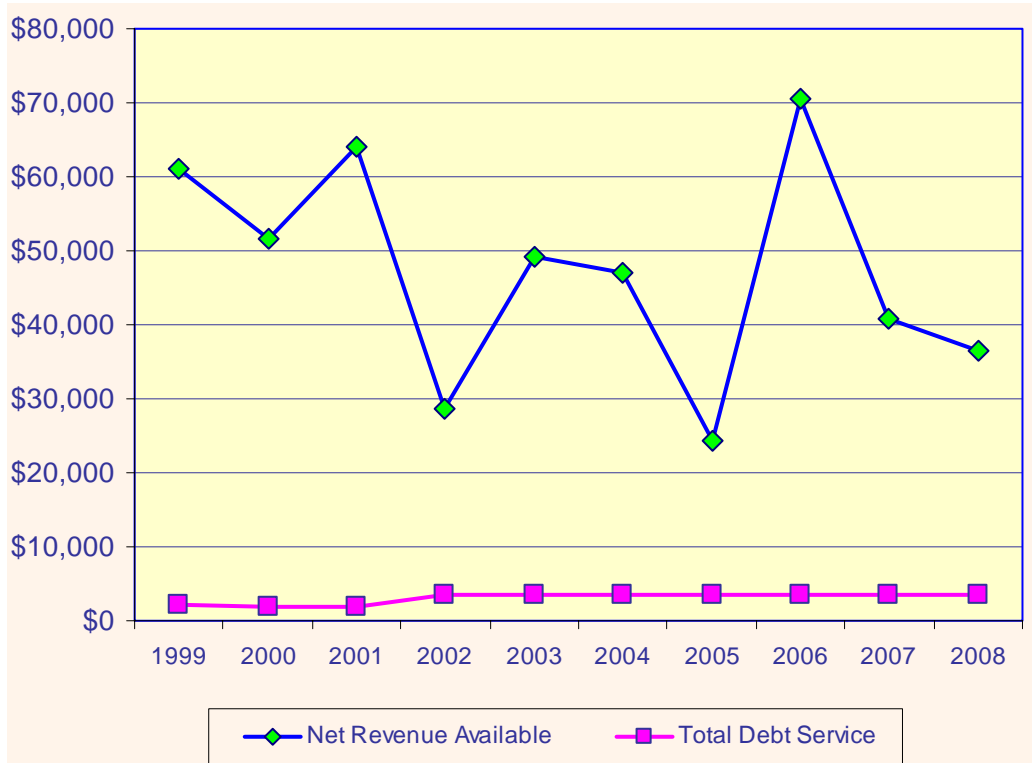
- (a) California Government Code, Section 43605 sets the debt limit at 15%. The Code section was enacted prior to the change in basing assessed value to full market value when it was previously 25% of market value. Thus, the limit shown as 3.75% is one-fourth the limit to account for the adjustment of showing assessed valuation at full cash value. Prior year limits have been adjusted to conform to the current year methodology.
- (b) In accordance with California Government Code Section 43605, only the City's general obligation bonds are subject to the legal debt limit of 15%. As of June 30, 2006, the City had no general obligation bonds outstanding. The above does not include debt recorded in the Enterprise Funds because such debt is not subject to legal debt margin.
Special assessment debt excludes debt where there is no government commitment.



City of Palo Alto - Revenue Bond Coverage

Water, Electric, Gas, Wastewater Collection,
Wastewater Treatment and Storm Drainage Funds

Last Ten Fiscal Years (\$000)



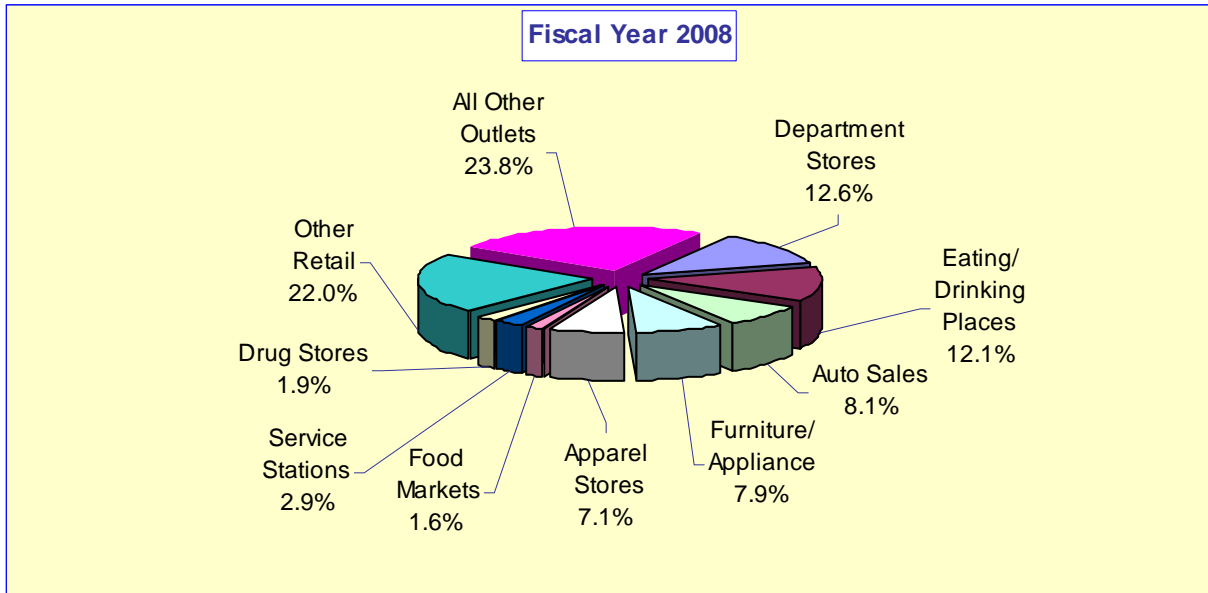
Fiscal Year	Gross Revenue	Direct Operating Expenditures	Net Revenue Available for Debt Services (a)	Debt Service			Coverage
				Principal	Interest	Total	
1999	141,696	80,748	60,948	896	1,163	2,059	29.60
2000	130,550	78,880	51,670	545	1,363	1,908	27.08
2001	197,022	133,012	64,010	555	1,342	1,897	33.74
2002	176,947	148,345	28,602	1,955	1,660	3,615	7.91
2003	165,414	116,268	49,146	1,255	2,354	3,609	13.62
2004	169,047	121,988	47,059	1,310	2,307	3,617	13.01
2005	171,493	147,123	24,370	1,365	2,257	3,622	6.73
2006	214,944	144,465	70,479	1,410	2,203	3,613	19.51
2007	205,258	164,340	40,918	1,465	2,147	3,612	11.33
2008	222,799	186,285	36,514	1,526	2,088	3,614	10.10

Source: Annual Financial Statements

Note: (a) Excludes depreciation and amortization expense.

Details regarding the City's outstanding debt can be found in the notes to the financial statements.

**City of Palo Alto- Taxable Transactions by Type of Business
Last Ten Fiscal Years (\$000)**



RETAIL STORES

Fiscal Year	Department Stores	Eating/Drinking Places	Auto Sales	Furniture/Appliance	Apparel Stores	Food Markets	Service Stations	Drug Stores	Other Retail	Retail Stores Total	All Other Outlets	Total
1999	2,740	2,077	2,265	1,485	1,116	344	269	143	4,079	14,518	5,128	19,646
2000	3,011	2,379	2,724	1,845	1,226	347	323	173	4,169	16,197	6,386	22,583
2001	3,112	2,551	3,118	1,824	1,343	351	417	186	4,706	17,608	7,270	24,878
2002	2,646	2,321	2,533	1,593	1,171	371	379	180	3,674	14,868	5,009	19,877
2003	2,316	2,172	2,094	1,455	1,114	375	388	171	2,811	12,896	4,834	17,730
2004	2,425	2,168	1,958	1,479	1,186	351	437	168	3,698	13,870	3,997	17,867
2005	2,621	2,206	1,966	1,176	1,310	356	533	317	3,590	14,075	5,139	19,214
2006	2,664	2,306	2,062	1,168	1,346	370	595	392	4,244	15,147	5,042	20,189
2007	2,751	2,486	1,954	1,109	1,485	374	602	203	5,075	16,039	5,185	21,224
2008	2,685	2,566	1,731	1,685	1,497	349	622	405	4,682	16,222	5,066	21,288

Source: California State Board of Equalization, compiled by MBIA Muniservices Company

**SALES TAX RATES FOR THE
FISCAL YEAR ENDED JUNE 30, 2008**

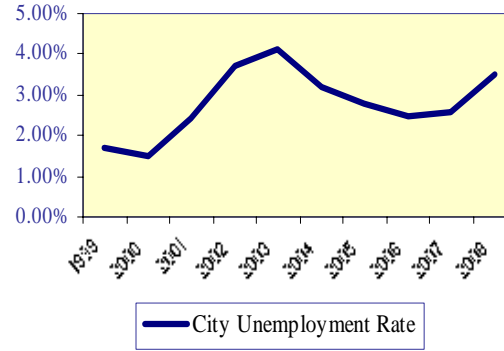
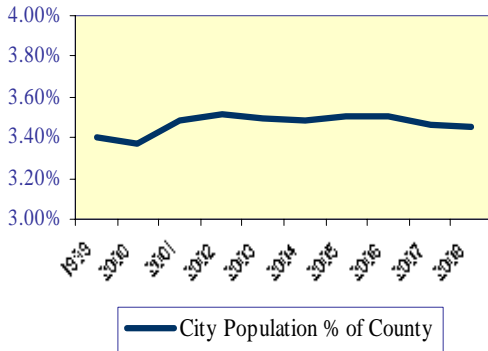
State Funds	6.00%
County Transportation Fund (Transportation Development Act)	0.25%
County Transportation Fund	1.00%
City	1.00%
	8.25%

Source: California State Board of Equalization

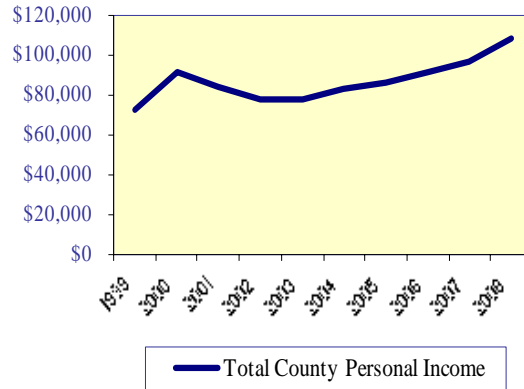
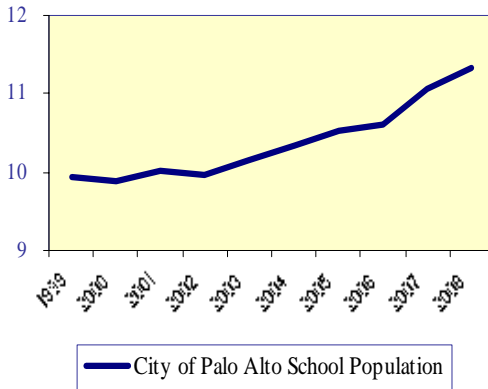


City of Palo Alto - Demographic and Economic Statistics

Last Ten Fiscal Years



Thousands



Fiscal Year	City of Palo Alto Population	City of Palo Alto Unemployment Rate (%)	City of Palo Alto School Population	Santa Clara County Population	City Population % of County	Santa Clara Total County (\$000) Personal Income
1999	58,300	1.7%	9,946	1,715,400	3.40%	73,045,821
2000	58,500	1.5%	9,881	1,736,700	3.37%	91,386,181
2001	60,200	2.4%	10,031	1,728,680	3.48%	83,838,707
2002	60,500	3.7%	9,952	1,719,565	3.52%	77,548,912
2003	60,465	4.1%	10,151	1,729,917	3.50%	77,680,349
2004	60,246	3.2%	10,341	1,731,422	3.48%	82,638,917
2005	61,674	2.8%	10,527	1,759,585	3.51%	86,400,000 *
2006	62,148	2.5%	10,607	1,773,258	3.50%	91,600,000 *
2007	62,615	2.6%	11,056	1,808,056	3.46%	96,900,000 *
2008	63,367	3.5%	11,329	1,837,075	3.45%	107,900,000 *

Source: California State Department of Finance
 State Employment Development Office
 Palo Alto Unified School District

* California State Department of Transportation Forecasts

City of Palo Alto - Principal Employers

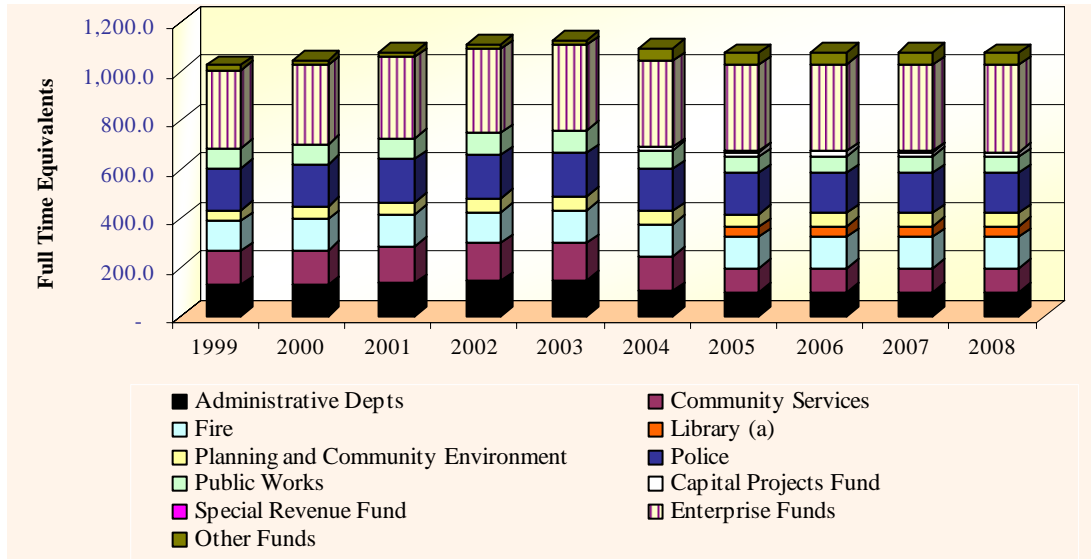
Current Year and Nine Years Ago

Employer	2007-08		1998-99	
	Number of Employees	Rank	Number of Employees	Rank
HP Labs	7,500	1		
Veteran's Affairs Palo Alto Health Care System	3,500	2	1,000 +	9
VA Palo Alto Health Care	2,900	3		
Hewlett-Packard Company	2,001	4	5000 +	2
Palo Alto Medical Foundation	2,000	5	1,500 +	6
Space Systems Loral	1,700	6	3,000 - 5,000	3
Wilson Sonsini Goodrich Rosati	1,500	7		
Packard Children's Hospital	1,300	8		
City of Palo Alto	1,100	9		
Roche Palo Alto	1,000	10		
Stanford University			5,000 +	1
Varian Associates			1,500 - 2,000	4
Palo Alto Unified School District			1,636	5
Alza Corporation			1,500 +	7
Roche Bioscience			1,000 - 1,500	8
Stanford University Medical Center/Hospital			750 - 1,000	10
Total City Day Population	63,367			

Source: www.ReferenceUSA.com & Palo Alto Weekly



City of Palo Alto - Full-Time Equivalent City Government Employees by Function Last Ten Fiscal Years



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Governmental Funds										
General Fund										
Administrative Depts	124.35	126.35	133.35	143.60	145.10	101.10	96.24	96.65	99.05	98.65
Community Services	139.25	142.25	152.00	153.00	153.00	144.75	98.25	99.25	97.25	96.25
Fire	124.00	128.00	129.00	129.00	132.50	128.50	126.00	127.00	127.00	127.00
Library (a)							44.00	44.25	43.75	43.75
Planning and Community Environment										
Police	46.00	51.00	52.00	56.50	59.00	54.80	53.30	53.30	53.30	53.30
Public Works	171.00	173.00	173.00	176.50	177.50	171.00	164.50	164.00	163.00	163.00
Special Revenue Fund	82.42	83.42	85.98	87.05	93.05	76.20	67.90	67.90	67.90	67.90
Capital Projects Fund						12.70	20.20	20.20	20.00	20.00
Enterprise Funds						1.20	1.20	1.20	1.20	1.20
Enterprise Funds										
Public Works Department (Refuse, Storm Drain, Wastewater Treatment)	106.58	107.58	109.52	110.45	110.45	111.35	112.65	112.65	112.65	112.65
Utilities Department (Administrative, Electric, Gas, Wastewater Collection, Water)	211.50	215.50	224.50	230.50	229.50	233.75	233.90	235.90	234.90	234.90
CPA External Services				4.00	7.00	5.70	6.00	6.00	5.80	5.80
Other Funds										
Printing and Mailing	5.15	5.15	5.15	4.15	4.15	4.15	4.70	4.60	4.65	4.05
Technology						33.15	29.56	29.60	29.80	29.80
Equipment Management	14.00	14.00	14.00	15.00	15.00	16.00	16.00	16.00	16.20	16.20
Total	1,024.25	1,046.25	1,078.50	1,109.75	1,126.25	1,094.35	1,074.40	1,078.50	1,076.45	1,074.45

Source: City of Palo Alto - Adopted Operating Budget

Notes: (a) Library became its own entity effective 2005, originally part of Community Services.

City of Palo Alto - Operating Indicators by Function/Program

Last Ten Fiscal Years

<u>Function / Program</u>	<u>Fiscal Year</u>		
	<u>1999</u>	<u>2000</u>	<u>2001</u>
Public Safety:			
Fire:			
Number of Fire Hydrants	1,699	1,708	1,729
Planning & Community Environment			
Number of Housing Units	25,708	25,732	26,048
Commercial & Industrial Space - Million Sq Ft	27.1	27.3	27.3
Electric Utility			
Number of Customer Accounts	27,674	27,533	28,097
Million of KWH Sold	1,124	1,134	1,057
Water Utility			
Number of Customer Accounts	19,322	18,921	19,335
Million CCF Sold	6.1	6.6	5.9
Gas Utility			
Number of Customer Accounts	23,322	23,154	23,101
Million Therms Sold	41.0	37.0	36.7
Waste Water			
Number of Customer Accounts	21,975	21,973	21,752
Millions of Gallons Processed	9,426	9,834	9,243

Source: City of Palo Alto
State of California, Dept of Finance (housing units)

Note: Fiscal Years 2004-2006 are restated due to change in source of data.



Fiscal Year

2002	2003	2004	2005	2006	2007	2008
1,741	1,746	1,874	1,873	1,919	1,944	1,948
26,841 27.3	26,934 27.3	27,019 27.3	27,522 27.3	27,767 27.3	27,763 27.3	27,938 27.3
28,348 997	28,408 957	28,482 958	28,539 959	28,653 966	28,684 978	29,024 977
19,437 5.9	19,487 5.6	19,557 6.0	19,605 5.3	19,645 5.2	19,726 12.0	19,942 12.0
23,116 33.7	23,169 31.8	23,216 31.5	23,300 32.0	23,353 31.5	23,357 31.3	23,502 32.2
21,772 8,699	21,819 8,704	21,830 8,238	21,825 8,395	21,784 8,972	21,835 9,220	21,990 8,510

City of Palo Alto - Capital Asset Statistics by Function/Program

Last Ten Fiscal Years

Function/Program	Fiscal Year			
	1999	2000	2001	2002
Public Safety:				
Fire:				
Fire Stations	8	8	8	8
Fire Apparatus	24	23	24	25
Police:				
Police Stations	1	1	1	1
Police Patrol Vehicles	27	29	33	33
Community Services				
Acres - Downtown/Urban Parks	142	170	170	170
Acres - Open Space	3,997	3,731	3,731	3,731
Parks and Preserves	36	35	33	34
Golf Course	1	1	1	1
Tennis Courts	51	52	52	52
Athletic Center	1	1	1	1
Community Centers	4	4	4	4
Theatres	3	3	3	3
Cultural Center/Art Center	1	1	1	1
Junior Museum and Zoo	1	1	1	1
Swimming Pools	3	1	1	1
Nature Center	2	2	2	2
Libraries				
Libraries	6	6	6	6
Public Works				
Number of Trees Maintained	39,832	39,923	38,094	37,941
Electric Utility				
Overhead Pole Miles	183	228	227	227
Underground Trench Miles	202	209	220	186
Water Utility				
Miles of Water Mains	220	221	222	226
Gas Utility				
Miles of Gas Mains	169	170	201	207
Waste Water				
Miles of Sanitary Sewer Lines	219	219	218	202

Source: City of Palo Alto



Fiscal Year					
2003	2004	2005	2006	2007	2008
8	8	8	8	8	8
22	23	25	25	25	23
1	1	1	1	1	1
33	30	30	30	30	30
170	170	170	170	157	157
3,731	3,731	3,731	3,731	3,744	3,744
34	34	35	35	36	36
1	1	1	1	1	1
52	52	52	52	51	51
1	1	1	1	4	4
4	4	4	4	4	4
3	3	3	3	3	3
1	1	1	1	1	1
1	1	1	1	1	1
1	1	1	1	1	1
2	2	2	2	3	3
6	5	5	5	5	5
34,939	35,440	35,096	34,841	34,556	35,322
227	227	225	217	194	193
186	186	188	210	252	253
226	226	226	217	217	217
207	207	207	207	207	207
202	202	202	202	202	202

City of Palo Alto - Insurance Coverage.....

June 30, 2008

TYPE	COVERAGE (Deductible)	LIMITS	COMPANY	EXPIRATION DATE
PROPERTY LOSS				
Blanket	All real & personal property (\$25,000 deductible), Fine Arts (\$2,500 deductible)	\$350,460,922	CA Public Entity Property Program	07/01/09
Boiler & Machinery	All real & personal property (\$50,000 deductible)	\$1,000,000 maximum all risk per occurrence limit \$1,000,000 minimum contingent business interruption	CA Public Entity Property Program	07/01/09
Flood Insurance	All real property 1305 Middlefield Road (\$1,000 deductible)	\$500,000	Hartford Fire Insurance Co.	04/07/09
FINANCIAL LOSS				
Employee Dishonesty	Position bond-faithful performance per loss (\$5,000 deductible)	\$1,000,000 / \$4,000,000 x \$1,000,000 per occurrence for City Mgr. & Director of ASD	Fidelity & Deposit Co.	03/22/09
UMBRELLA EXCESS LIABILITY				
Trustees Errors and Omissions	City is a member of an insurance pool participating with a number of other California cities (\$1,000,000 self-insured retention) Bodily injury and property damage liability Errors and omissions liability	\$45,000,000 annual aggregate	Everest Ins. Co. Lexington Ins Co.	07/01/09
SPECIAL LIABILITY				
Volunteers Accident	Each occurrence Medical - Each person / (\$100 deductible)	\$20,000	Life Insurance Co. of North America	02/02/09
Special Events	Bodily injury	\$1,000,000 per occurrence	Axis Surplus Insurance Company	01/01/09
EMPLOYEE BENEFIT				
Travel Accident	Indemnity, based on salary	\$1,500,000 per accident	Life Insurance Co. of North America	06/01/09
EMPLOYEE HEALTH PLAN				
	The City participates in the California Public Employees' Medical and Health Care Act (PEMHCA) program to provide medical benefits to employees and retirees			
WORKERS' COMPENSATION				
	City is self-insured for first \$500,000 liability	\$500,000 per occurrence		07/01/09
EXCESS WORKERS' COMPENSATION				
	Pooled Retention	\$5,000,000 limit per occurrence	CA. Public Entity Insurance Authority	07/01/09
	Reinsured Layer	\$250,000,000 workers comp per occurrence, excess of pooled retention limit, includes \$5,000,000 employers liability excess of \$5,000,000 pooled retention	National Union Fire Insurance Co.	07/01/09

Source: Human Resources Dept, City of Palo Alto



Single Audit Index.....

Schedule of Current Year Findings and Questioned Costs 161

Section I - Summary of Auditor’s Results..... 161

Section II - Financial Statement Findings 162

Section III - Federal Award Findings and Questioned Costs 162

Section IV - Status of Prior Year Findings
and Questioned Costs..... 162

Schedule of Expenditures of Federal Awards 163

Notes to Schedule of Expenditures of Federal Awards 165

Report On Internal Control over Financial Reporting and On Compliance
And Other Matters Based on an Audit of Financial Statements
Performed In Accordance With Government Auditing Standards..... 167

Report On Compliance with Requirements Applicable To
Each Major Program and On Internal Control Over Compliance
In Accordance With OMB Circular A-133 169



This page is intentionally left blank.



Single Audit Section.....

This section provides an overview of grant awards received from the Federal government. The Single Audit Act Amendments of 1996 require local governments to report and audit Federal funds separately from their Basic Financial Statements.



This page is intentionally left blank.



Schedule of Findings.....

CITY OF PALO ALTO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For The Year Ended June 30, 2008

SECTION I—SUMMARY OF AUDITOR’S RESULTS

Financial Statements

Type of auditor’s report issued:		Unqualified	

Internal control over financial reporting:			
• Material weakness(es) identified?	_____	Yes <u> X </u>	No
• Significant deficiency(ies) identified that are not considered to be material weaknesses?	_____	Yes <u> X </u>	None Reported
Noncompliance material to financial statements noted?	_____	Yes <u> X </u>	No

Federal Awards

Type of auditor’s report issued on compliance for major programs:		Unqualified	

Internal control over major programs:			
• Material weakness(es) identified?	_____	Yes <u> X </u>	No
• Significant deficiency(ies) identified that are not considered to be material weaknesses?	_____	Yes <u> X </u>	None Reported
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?	_____	Yes <u> X </u>	No

Identification of major programs:

<u>CFDA#(s)</u>	<u>Name of Federal Program or Cluster</u>
66.458	State Water Resources Control Board Loan
81.087	Renewable Energy Research and Development

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee? X Yes _____ No



SECTION II – FINANCIAL STATEMENT FINDINGS

Our audit did not disclose any material weaknesses or instances of noncompliance material to the basic financial statements. We have also issued a separate Memorandum on Internal Control dated October 24, 2008 which is an integral part of our audits and should be read in conjunction with this report.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Our audit did not disclose any findings or questioned costs required to be reported in accordance with section 510(a) of OMB Circular A-133.

**SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS –
Prepared by Management**

Financial Statement Prior Year Findings

There were no prior year Financial Statement Findings reported.

Federal Award Prior Year Findings and Questioned Costs

There were no prior year Federal Award Findings and Questioned Costs reported.



CITY OF PALO ALTO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE FISCAL YEAR ENDED JUNE 30, 2008

Program Name	Identifying Pass-Through Grant Number	Catalog of Federal Domestic Assistance Number	Program Expenditures
Department of Housing and Urban Development			
Community Development Block Grant Program	B-05-MC-06-0020		
Program Expenditures		14.218	124,536
Subgrants:			
Emergency Housing Consortium			7,500
OMBUDSMAN Program			7,500
Palo Alto Housing Corporation-Banker Counseling			25,000
New Housing Development			17,336
Clara Mateo Alliance Shelter			17,500
Clara Mateo Alliance Family Shelter			17,500
Shelter Network Haven Housing			8,500
InnVision			30,000
Project Sentinel - Fair Housing			26,800
Stevenson Housing - Fari Alarm Project			44,646
Stevenson Housing - Windows/Doors			257,952
EHC Off the Street			7,500
Lytton Gardens Nursing Facilities			86,571
Total CDBG Expenditures		14.218	<u>678,841</u>
Governor's Office of Emergency Services			
(Passed through California Department of Transportation)	FEMA-3033110-DR-CA		
Emergency Management Performance	OES ID #085-55282	20.703	8,533
(Passed through State of California through County)			
Urban Area Security (UAS)			1,150
OT/Backfill Terrorism Training			2,888
Total Expenditures from Governor's office			<u>12,571</u>
Department of Energy	DE-FG36-03GO13066	81.087	<u>1,152,332</u>
Office of Water, Environmental Protection Agency			
(Passed through California State Water Resources Control Board)	Contract # 07-814-550-0 Loan # C-06-4132-110	66.458	<u>5,629,185</u>
U.S. Fish & Wildlife Service-Baylands	81420-5-J225	15.631	24,000
U.S. Fish & Wildlife Service-Creek Restoration	81420-6-J145	15.631	4,003
TOTAL FEDERAL FINANCIAL AWARDS			<u><u>\$7,500,932</u></u>

See Notes to Schedule of Expenditures of Federal Awards



This page is intentionally left blank.



NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Note 1.....

REPORTING ENTITY

The Schedule of Expenditure of Federal Awards (the Schedule) includes expenditures of federal awards for the City of Palo Alto, California and its component units as disclosed in the notes to the Basic Financial Statements.

Note 2.....

BASIS OF ACCOUNTING

Basis of accounting refers to *when* revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus applied. All governmental funds and agency funds are accounted for using the modified accrual basis of accounting. All proprietary funds are accounted for using the accrual basis of accounting.

OMB Circular A-133 requires that certain adjustments be made to expenditures recognized when incurred. The adjustments applicable to the City are summarized below:

Expenditure of Long-Term Debt Proceeds – In this fiscal year, the City received proceeds from long-term debt funded by the federal government passed through the California State Water Resources Control Board. In accordance with OMB Circular A-133, section .205(d) the City included current year expenditures of such proceeds on the Schedule of Expenditures of Federal Awards.

During fiscal 2007-08, the City expended \$5,629,185 in costs under the Office of Water, Environmental Protection Agency, Capitalization Grants For Clean Water State Revolving Funds Program (CFDA #66.458). As of June 30, 2008, the City had received \$2,784,823 in remittances from the State with another \$2,844,362 received subsequent to June 2008 as reimbursement of the above costs.

Note 3.....

DIRECT AND INDIRECT (PASS-THROUGH) FEDERAL AWARDS

Federal awards may be granted directly to the City by a federal granting agency or may be granted to other government agencies which pass-through federal awards to the City. The Schedule includes both of these types Federal award programs when they occur.



This page is intentionally left blank.



MAZE & ASSOCIATES

ACCOUNTANCY CORPORATION
3478 Buskirk Ave. - Suite 215
Pleasant Hill, California 94523
(925) 930-0902 • FAX (925) 930-0135
maze@mazeassociates.com
www.mazeassociates.com

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Honorable Mayor and City Council
of the City of Palo Alto, California

We have audited the financial statements of the City of Palo Alto as of and for the year ended June 30, 2008, and have issued our report thereon dated October 24, 2008. We conducted our audit in accordance with generally accepted auditing standards in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

A Professional Corporation

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards*.

Our audit did not disclose any material weaknesses or instances of noncompliance material to the basic financial statements. We have also issued a separate Memorandum on Internal Control dated October 24, 2008 which is an integral part of our audits and should be read in conjunction with this report.

This report is intended solely for the information and use of City Council, City Council, its committee, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

October 24, 2008

Mage Associates



MAZE & ASSOCIATES

ACCOUNTANCY CORPORATION
3478 Buskirk Ave. - Suite 215
Pleasant Hill, California 94523
(925) 930-0902 · FAX (925) 930-0135
maze@mazeassociates.com
www.mazeassociates.com

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO
EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

Honorable Mayor and City Council
of the City of Palo Alto California

Compliance

We have audited the compliance of the City of Palo Alto with the types of compliance requirements described in the OMB Circular A-133 *Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2008. The City's major federal programs are identified in Section I - Summary of Auditor's Results included in the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the City's compliance with those requirements.

In our opinion, the City complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2008.

A Professional Corporation

Internal Control over Compliance

The management of the City is responsible for establishing and maintaining effective internal controls over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the City's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of City's internal control over compliance.

A *control deficiency* in a City's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the City's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the City's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider material weaknesses, as defined above.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the City as of and for the year ended June 30, 2008, and have issued our report thereon dated October 24, 2008. Our audit was performed for the purpose of forming opinions on the financial statements. The accompanying schedule of expenditures of federal awards is presented for the purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of City Council, its committee, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Mayer + Associates

October 24, 2008

The City of Palo Alto is located in northern Santa Clara County, approximately 35 miles south of the City of San Francisco and 12 miles north of the City of San Jose. Spanish explorers named the area for the tall, twin-trunked redwood tree they camped beneath in 1769. Palo Alto incorporated in 1894 and the State of California granted its first charter in 1909.

AMERICANS WITH DISABILITIES ACT STATEMENT

In compliance with Americans with Disabilities Act (ADA) of 1990, this document may be provided in other accessible formats.

For information contact:

ADA Coordinator
250 Hamilton Avenue
(650) 329-2550
ada@cityofpaloalto.org

This page is intentionally left blank.