

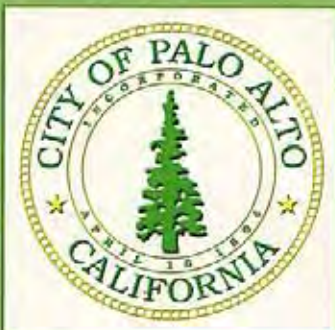
Environmental Protection



Civic Engagement for the Common Good



Economic Health of the City



CITY OF PALO ALTO, CALIFORNIA

2009-2010

**Comprehensive Annual
Financial Report**

Fiscal Year Ended June 30, 2010



City of Palo Alto
California

**Comprehensive
Annual Financial
Report**

**For the fiscal year ended
June 30, 2010**



Prepared by: Administrative Services Department



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City of Palo Alto
Office of the City Manager

Transmittal Letter.....

December 21, 2010

THE HONORABLE CITY COUNCIL
Palo Alto, California

Attention: Finance Committee

COMPREHENSIVE ANNUAL FINANCIAL REPORT

YEAR ENDED JUNE 30, 2010

Members of the Council and Citizens of Palo Alto:

Transmittal: The Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2010, 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 is 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, 2010, 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 65,408, 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, VMware, Facebook, and Space Systems Loral, Palo Alto has enjoyed a diverse employment and revenue base.

Like jurisdictions throughout the country, the City was impacted by the “Great Recession,” and is now showing signs of slow recovery. At the end of Fiscal Year (FY) 2010, the City’s unemployment rate had dropped to 6.1 percent from 6.4 percent the prior year. While Sales, Transient Occupancy, and Documentary Transfer taxes had fallen significantly in the past two years, recent Sales Tax revenues showed mixed results. Documentary Transfer Tax and Property taxes in FY 2011 were marginally higher than in FY 2010, but commercial valuation appeals have yet to be processed. These appeals could take another two years to settle, after which time a loss could be applied for the fiscal year just ended. The City believes it will take multiple years for revenue sources to fully recover from the effects of the recession.

The City also faces rising benefit costs and a significant backlog in infrastructure investment. As with past economic downturns, the City is proactively taking steps to align expenses and revenues through service and program cuts, revenue enhancements, and employee compensation savings. The City Council adopted a General Fund budget for FY 2011 that eliminated a \$7.3 million deficit and approved a health insurance cost-sharing plan for its non-Safety employees, along with a reduced retirement benefit for new employees. The City is now continuing negotiations with employees on how to address rising medical costs.

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 Palo Alto Medical Foundation, Hewlett Packard, the Palo Alto Unified School District, and the City of Palo Alto. As of June 2010, Palo Alto’s unemployment rate was 6.1 percent while the State’s was 12.2 percent and the nation’s 9.6 percent.

Real Estate Market: In its most recent annual report, the Santa Clara County Assessor’s Office noted that “Santa Clara County’s 2010 assessment roll provides a decisive account of the impact of the 21st Century’s first “Great Recession.” In total, the net assessed value of all real and business property declined by 2.43 percent or \$7.4 billion.” The Assessor’s report states, “This reduction is a direct consequence of the soaring unemployment rate in Santa Clara County.” There are, however, significant geographic differences within the County, with 6.15 percent declines in Gilroy and Morgan Hill, 3.93 percent and 2.89 percent declines in Santa Clara and Mountain View, respectively, and 0.35 percent growth in Palo Alto. Palo Alto was the only city to escape a net reduction in its assessment roll.

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 are typically shielded from major price swings. However, though Palo Alto was unique in experiencing any growth in its assessment roll, its 0.35 percent growth was significantly less than the prior year’s 3.8 percent growth, which in turn was down from 11.43 percent growth from FY 2008 to FY 2009. It has not escaped the trends of the region.

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 or early January, 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 analysis, 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, 2010, the City had \$345.6 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 FY 2010, 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, fiber optics, 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 FY 2010 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 external 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

Patrick Burt, *Mayor*

Sid Espinosa, *Vice-Mayor*

Karen Holman

Greg Scharff

Larry Klein

Greg Schmid

Gail A. Price

Nancy Shepherd

Yiaway Yeh

Finance Committee

Greg Schmid, *Chair*

Sid Espinosa

Larry Klein

Greg Scharff

Policy and Services Committee

Yiaway Yeh, *Chair*

Karen Holman

Nancy Shepherd

Gail A. Price

Council-Appointed Officers

City Manager

James Keene

City Attorney

Gary Baum

City Clerk

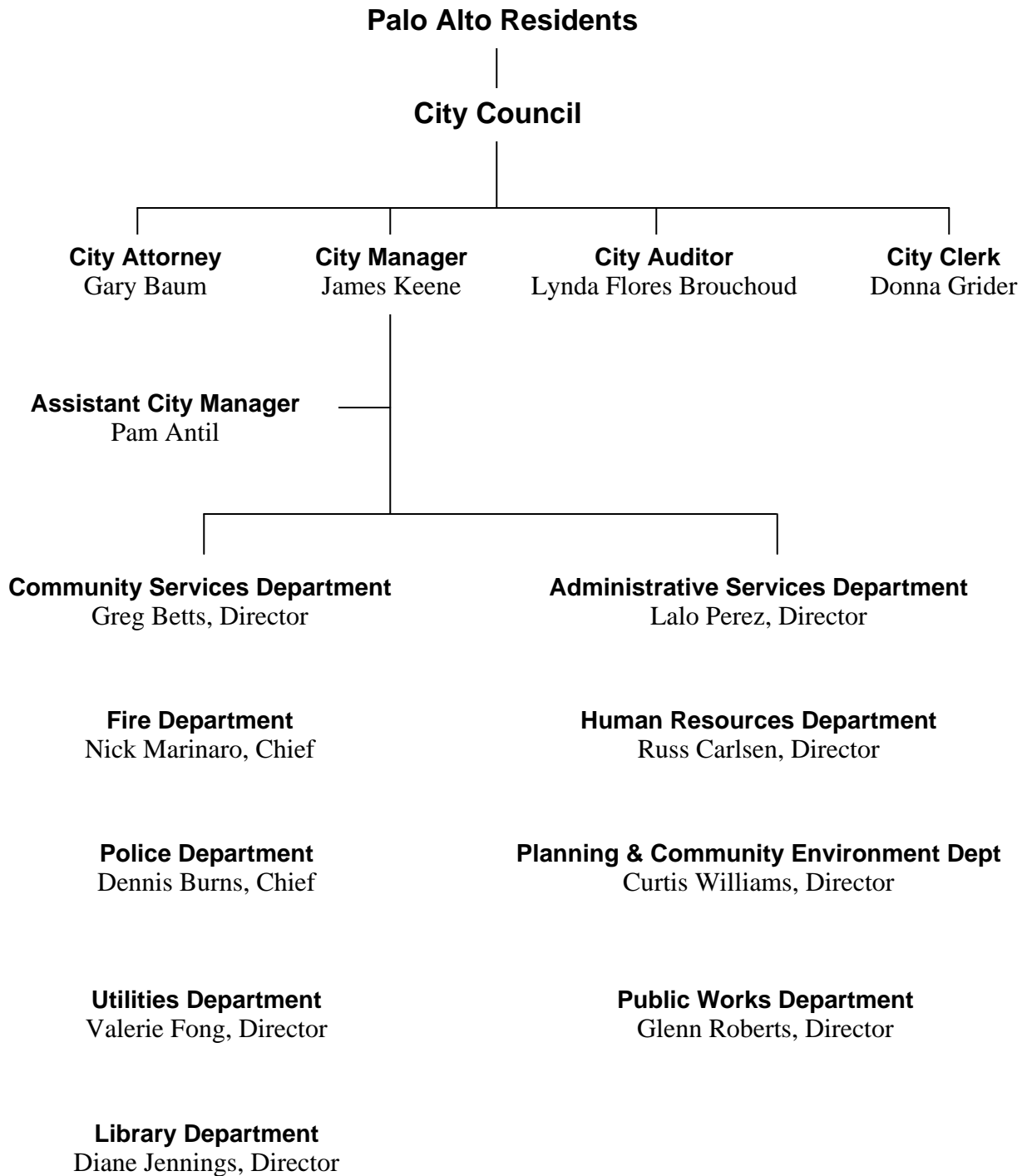
Donna Grider

City Auditor

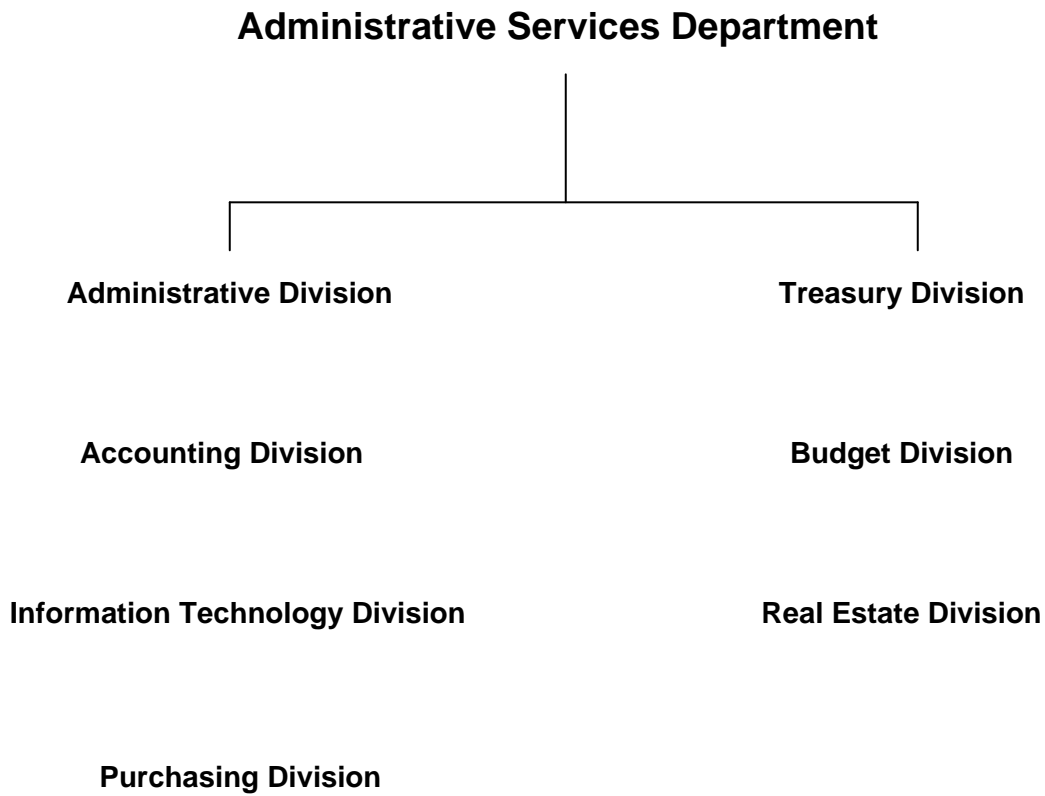
Lynda Flores Brouchoud



City of Palo Alto Organization



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, 2009

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.



President

Executive Director



Independent Auditor's Report.....



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www.mazeassociates.com

INDEPENDENT AUDITOR'S REPORT ON BASIC FINANCIAL STATEMENTS

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, 2010, 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, 2010 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 22, 2010 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.



Independent Auditor's Report

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 22, 2010



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 fiscal year ended June 30, 2010. 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 that includes the Transmittal Letter and general information
- Management's Discussion and Analysis
- The Basic Financial Statements that include the Citywide and Fund Financial Statements, along with the Notes to these statements
- Supplemental Information
- Statistical Information
- 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, Fiber Optic Fund, Gas Services Fund, Wastewater Collection Fund, Wastewater Treatment Fund, Refuse Services Fund and Storm Drainage 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 Environment, 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, Fiber Optics, Gas, Wastewater Collection, Wastewater Treatment, Refuse and Storm Drainage. 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 Government Accounting Standards Board (GASB) Statement #34 and replaced 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 Fiscal Year (FY) 2010, 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, cannot 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 comparison information is 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 that await transfer to the 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

Though the worst of the recession technically may be behind us, the pace of the recovery is in question, particularly in California. National economists point to positive but modest Gross Domestic Product levels, slight increases in consumer and business optimism, and steady manufacturing orders as evidence of a nascent recovery. California's unending fiscal quagmire, housing debacle, and high unemployment rate, however, continue to negatively impact City finances. Until job creation picks up considerably and solid consumer spending resumes, the City's fiscal position will remain uncertain. In addition to economic uncertainty, the City faces a variety of financial challenges as it copes with rising pension costs, a significant retiree medical liability, and an infrastructure backlog. The City has been proactive in balancing resources against expenses as it cut \$7.3 million in its General Fund FY 2011 operating budget. The City is committed to prudent financial practices and operational efficiencies while it continues to provide a high level of service to the community.

Sales, transient occupancy, and documentary transfer taxes have been especially sensitive to the economic downturn. Receipts in all three categories have fallen significantly in the past two years. There were indications toward the end of FY 2010 of these revenue sources reaching a "bottom." For example, documentary transfer and transient occupancy taxes have turned a corner in the number and value of transactions for the former and the daily rates and occupancy levels for the latter. The City is hopeful these trends will continue.

On the other hand, after nearly 2 years of substantial quarterly declines, fourth quarter calendar year 2009 sales tax revenues showed a slight 1.2 percent increase over the fourth quarter calendar year 2008 and then declined in the first and second quarter of 2010 by 1.9 percent and 2.6 percent, respectively. These mixed results, combined with the expectation of lower property taxes over the next two years is likely to, at best, offset any progress in transient occupancy and documentary transfer tax increases. The City believes it will take multiple years for revenue sources to fully recover from the effects of the recession. There is a concern that there are fundamental shifts in consumer spending patterns that could have an adverse impact on City resources.

Through its 10 year Long Range Financial Forecast, the City closely monitors available resources versus current and long-term expenses. This tool has enabled the City to be forewarned and forearmed as it confronts the numerous uncertainties and challenges that jurisdictions across the nation are facing.

Citywide

- The City's total net assets increased to \$1,142 million, a \$36.5 million increase. Governmental activities had a decrease of \$5.4 million and are discussed on page 6. Business-type activities had an increase of \$41.9 million and are discussed on page 12.
- The City's total capital assets, net of related debt, increased to \$768.8 million, a \$27.8 million increase. Governmental activities had an increase of \$12.8 million, primarily for roadway network, recreation and open space network, and infrastructure improvements. Business-type activities had an increase of \$14.9 million primarily from the Electric Fund transmission and distribution system.
- The City's total restricted net assets increased to \$38.6 million, a \$.2 million increase. This reflects a \$5.4 million decrease for governmental capital projects, an increase of \$3.2 million for governmental special revenue programs and an increase of \$2.4 million for debt service.
- The City's total unrestricted net assets increased to \$334.7 million, a \$8.4 million increase. Governmental activities had a decrease of \$16 million and business activities had an increase of \$24.4 million.
- Citywide revenues totaled \$395.5 million, a decrease of \$23 million from the prior year. This total consists of \$299.3 million in program revenues and \$96.2 million in general revenues. Program revenues decreased by \$13.9 million, and general revenues decreased by \$9.1 million.
- Total Citywide expenses were \$358.9 million, a \$54.1 million decrease.
- Citywide total assets increased to \$1,364.5 million, a \$134.6 million increase.
- Citywide capital assets increased by \$35.9 million to \$826.3 million.
- Citywide other assets increased \$98.7 million to \$538.2 million.
- Citywide total liabilities were \$222.4 million, an increase of \$98 million.
- Citywide long-term debt decreased \$94.8 million to \$149 million.
- Citywide other liabilities were \$73.4 million, an increase of \$3.2 million.



Fund Level – Governmental Funds

- Governmental Fund balances increased to \$153.8 million, a \$49.2 million increase.
- Governmental Fund revenues decreased to \$120 million, a \$5.6 million decrease.
- Governmental Fund expenditures were \$143.4 million, a \$1 million increase.
- General Fund revenues came in at \$109.9 million, a decrease of \$4 million over the prior year.
- General Fund expenditures are \$118.9 million, an increase of \$4.1 million.
- The General Fund balance of \$41.5 million at June 30, 2010, was a decrease of \$1.8 million from the prior year (refer to Performance of Governmental Funds – General Fund, Page 15).

Fund Level – Enterprise Funds

- Enterprise Fund net assets increased to \$635.1 million, a \$29.6 million increase.
- Enterprise Fund operating revenues decreased to \$262 million, a \$13.1 million decrease from prior year revenues.
- Enterprise Fund operating expenses decreased to \$218.6 million, a \$10.4 million decrease.

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>2010</u> | <u>2009</u> | <u>Increase/ (Decrease) from 2009</u> |
| Cash and investments | \$192.5 | \$141.0 | \$51.5 |
| Other assets | 46.5 | 59.9 | (13.4) |
| Capital assets | 376.0 | 364.3 | 11.7 |
| Total Assets | <u>615.0</u> | <u>565.2</u> | <u>49.8</u> |
| Long-term debt outstanding | 65.3 | 7.6 | 57.7 |
| Other liabilities | 43.7 | 46.2 | (2.5) |
| Total Liabilities | <u>109.0</u> | <u>53.8</u> | <u>55.2</u> |
| Net Assets: | | | |
| Invested in capital assets, net of debt | 369.5 | 356.7 | 12.8 |
| Restricted | 88.4 | 36.6 | 51.8 |
| Unrestricted | 48.1 | 118.1 | (70.0) |
| Total Net Assets | <u>\$506.0</u> | <u>\$511.4</u> | <u>(\$5.4)</u> |

The City’s governmental total net assets decreased \$5.4 million to \$506 million in FY 2010. This change results from the following:

- Cash and investments increased by \$51.5 million primarily due to the bond proceeds received from the 2010 Series A General Obligation Bond issued to fund the Mitchell Park Library and Community Center construction project as well as capital improvements for the Downtown and Main Libraries.
- Other assets decreased by \$13.4 million due to allocation of Internal Service Fund costs to the Enterprise Funds.



- Capital assets increased \$11.7 million primarily due to infrastructure improvements to the City's roadway network, curbs, gutters, sidewalks, and Civic Center infrastructure improvements.
- Long-term debt outstanding increased by \$57.7 million due to the issuance of the General Obligation Bond for construction of the Mitchell Park Library and Community Center and for capital improvements to the Downtown and Main Libraries.
- Net assets invested in capital assets, net of related debt, increased \$12.8 million as the City added General Fund infrastructure assets as discussed in the Capital Assets section (page 21).
- Restricted net assets increased \$51.8 million for a total of \$88.4 million. Unrestricted net assets decreased \$70.0 million for a total of \$48.1 million. The change in restricted and unrestricted net assets is primarily due to the Library Bond proceeds that are restricted. Unrestricted net assets represent 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 | 2010 | 2009 | Increase/ (Decrease) from 2009 |
|----------------------------------|----------------|----------------|---|
| Program Revenues: | | | |
| Charges for services | \$30.4 | \$30.0 | \$0.4 |
| Operating contributions & grants | 4.8 | 3.6 | 1.2 |
| Capital contributions & grants | 1.3 | 3.8 | (2.5) |
| Total Program Revenues | 36.5 | 37.4 | (0.9) |
| General Revenues: | | | |
| Property Taxes | 26.0 | 25.4 | 0.6 |
| Sales Taxes | 18.0 | 20.1 | (2.1) |
| Utility User's Taxes | 11.3 | 11.0 | 0.3 |
| Transient Occupancy Tax | 6.9 | 7.1 | (0.2) |
| Other Taxes | 4.1 | 3.4 | 0.7 |
| Investment Earnings | 6.5 | 8.5 | (2.0) |
| Rents and Miscellaneous | 12.7 | 15.7 | (3.0) |
| Total General Revenues | 85.5 | 91.2 | (5.7) |
| Total Revenues | \$122.0 | \$128.6 | (\$6.6) |

Governmental Activities – Revenues

The table above shows that governmental revenues totaled \$122 million in FY 2010, a decrease of \$6.6 million compared to prior year revenues of \$128.6 million.

Capital contributions and grants decreased by \$2.5 million from prior year for an ending balance of \$1.3 million. The decrease is primarily from a decrease in funds from other agencies. Capital Projects Fund, Community Development Block Grant and Housing Fund received \$1.3 million, \$873 thousand and \$924 thousand, respectively, less than the prior year.

Property taxes had an increase of \$0.6 million, sales taxes decreased by \$2.1 million, the utility user's tax rose by \$0.3 million, and transient occupancy taxes decreased by \$0.2 million. Investment earnings decreased by \$2 million. This is a result of a decrease in investment earnings of \$512 thousand and \$1.5 million for 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.

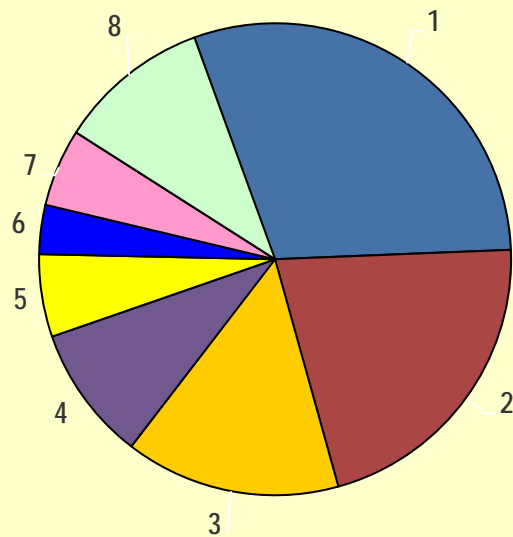
Miscellaneous revenues had a decrease of \$3 million from the prior year. Miscellaneous revenues include the net of interdepartmental revenues and charges.



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 - 30%
- 2- Property Taxes - 21%
- 3- Sales Taxes - 15%
- 4- Utility User's Taxes - 9%
- 5- Transient Occupancy Tax - 6%
- 6- Other Taxes - 3%
- 7- Investment Earnings - 5%
- 8- Rents and Miscellaneous - 11%



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 FY 2010 and FY 2009 expenses (does not include encumbrances and reappropriations) by Governmental Activities and interest on long-term debt. Total Governmental Activities functional expense was \$141.3 million in FY 2010, a decrease of \$1.3 million.

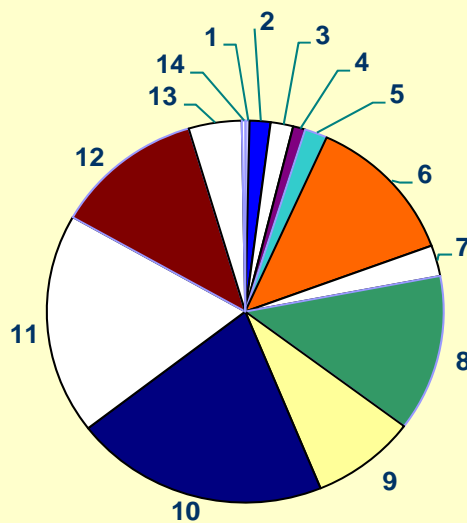
| GOVERNMENTAL ACTIVITIES | | | |
|--|----------------|----------------|---|
| <i>Expenses for the Year ended June 30</i> | | | |
| (in Millions) | | | |
| Activities | 2010 | 2009 | Increase/ (Decrease) from 2009 |
| City Council | \$0.5 | \$0.4 | \$0.1 |
| City Manager | 2.4 | 2.1 | 0.3 |
| City Attorney | 2.6 | 2.6 | 0.0 |
| City Clerk | 1.4 | 1.1 | 0.3 |
| City Auditor | 2.6 | 2.0 | 0.6 |
| Administrative Services | 17.9 | 17.8 | 0.1 |
| Human Resources | 3.7 | 3.4 | 0.3 |
| Public Works | 18.7 | 21.3 | (2.6) |
| Planning and Community Environment | 12.1 | 12.9 | (0.8) |
| Police | 29.3 | 29.3 | 0.0 |
| Fire | 26.4 | 23.2 | 3.2 |
| Community Services | 17.2 | 19.9 | (2.7) |
| Library | 6.1 | 6.2 | (0.1) |
| Interest on long-term debt | 0.4 | 0.4 | 0.0 |
| Total Functional Expense | \$141.3 | \$142.6 | (\$1.3) |
| Increase/(Decrease) in Net Assets before Transfers | (19.4) | (14.0) | (5.4) |
| Transfers in | \$14.0 | \$24.0 | (\$10.0) |
| Change in Net Assets | (\$5.4) | \$10.0 | (\$15.4) |
| Net Assets-Beginning | 511.4 | 501.4 | 10.0 |
| Net Assets-Ending | <u>\$506.0</u> | <u>\$511.4</u> | <u>(\$5.4)</u> |



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 FY 2010, the City added \$11.7 million in capital assets. The composition of FY 2010 additions is shown in detail in the Capital Asset section of 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 2%
- 6- Administrative Services 13%
- 7- Human Resources 3%
- 8- Public Works 13%
- 9- Planning & Community Environment 8%
- 10-Police 21%
- 11-Fire 19%
- 12-Community Services 12%
- 13-Library 4%
- 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 | | | |
|---|----------------|----------------|---|
| <i>Net Assets at June 30</i> | | | |
| (in Millions) | | | |
| | 2010 | 2009 | Increase/ (Decrease) from 2009 |
| Cash and investments | \$262.6 | \$205.2 | \$57.4 |
| Other assets | 36.6 | 33.4 | 3.2 |
| Capital assets | 450.3 | 426.1 | 24.2 |
| Total Assets | 749.5 | 664.7 | 84.8 |
| Long-term debt outstanding | 83.6 | 46.6 | 37.0 |
| Other liabilities | 29.8 | 24.0 | 5.8 |
| Total Liabilities | 113.4 | 70.6 | 42.8 |
| Net assets: | | | |
| Invested in capital assets, net of debt | 399.3 | 384.4 | 14.9 |
| Restricted | 4.3 | 1.7 | 2.6 |
| Unrestricted | 232.4 | 208.0 | 24.4 |
| Total Net Assets | \$636.0 | \$594.1 | \$41.9 |

The City’s Business-type total net assets increased \$41.9 million to \$636 million in FY 2010.

- Cash and investments increased \$57.4 million primarily from:
 - Water Fund received \$35 million in bond proceeds from the 2009 Water Bond.
 - Electric Fund had increase in its cash balance due to a decrease of \$11.8 in the retail purchase of utilities.
 - Wastewater Treatment Fund received \$4.5 million from the State Resources Fund (SRF) loan proceeds for the Ultra Violet Disinfection Facility Project (WQ-06014).
- Capital assets increased \$24.2 million to \$450.3 million in FY 2010. This increase is primarily a result of water, electric and wastewater collection infrastructure improvements.
- Net assets invested in capital assets net of related debt increased \$14.9 million to \$399.3 million. The increase was mostly due to \$8.7 million of capital improvements in the Water Fund and \$5.3 million of capital improvements in the Electric Fund.

- Unrestricted net assets of \$232.4 million, an increase of \$24.4 million from 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 \$87.9 million, the Calaveras reserve for stranded costs of \$59.9 million and the emergency plant replacement reserve of \$7.2 million.

BUSINESS-TYPE ACTIVITIES

Revenues for the Year ended June 30

(in Millions)

| Revenues by Source | 2010 | 2009 | Increase/ (Decrease) from 2009 |
|-------------------------------|----------------|----------------|--------------------------------------|
| Program Revenues: | | | |
| Water | \$26.2 | \$27.1 | (\$0.9) |
| Electric | 121.9 | 119.3 | 2.6 |
| Fiber Optics | 3.1 | 3.3 | (0.2) |
| Gas | 44.5 | 47.8 | (3.3) |
| Wastewater Collection | 15.1 | 14.5 | 0.6 |
| Wastewater Treatment | 16.9 | 28.5 | (11.6) |
| Refuse | 28.6 | 29.1 | (0.5) |
| Storm Drainage | 5.6 | 5.5 | 0.1 |
| Total Program Revenues | 261.9 | 275.1 | (13.2) |
| General Revenues: | | | |
| Investment Earnings | 10.8 | 14.1 | (3.3) |
| Total General Revenues | 10.8 | 14.1 | (3.3) |
| Total Revenues | \$272.7 | \$289.2 | (\$16.5) |

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

Management Discussion and Analysis

Business-type Activity revenues totaled \$272.7 million, a decrease of \$16.5 million from the prior year. Revenues were significantly affected by the following events:

- Program Revenue for the Electric Fund increased \$2.6 million primarily due to a 10 percent rate increase effective July 1, 2009.
- Program Revenue for the Gas Fund decreased \$3.3 million primarily due to a 10 percent rate decrease effective July 1, 2009.
- Program Revenue for the Wastewater Treatment Fund decreased \$11.6 million from prior year. FY 2009 included revenues for the Water Reclamation project. These revenues included grant revenues of \$2.1 million and expenditure reimbursement of \$9.8 million from City of Mountain View.
- Investment earnings decreased \$3.3 million due to a decrease in interest earnings on investments. The Electric Fund had a decrease of \$2 million, Water Fund, \$412 thousand and Refuse Fund \$404 thousand from prior year.

BUSINESS-TYPE ACTIVITIES

Expenses for the Year ended June 30
(in Millions)

| Activities | 2010 | 2009 | Increase/ (Decrease) from 2009 |
|---|----------------|----------------|--------------------------------------|
| Water | \$21.0 | \$20.3 | \$0.7 |
| Electric | 107.9 | 122.3 | (14.4) |
| Fiber Optics | 1.4 | 1.3 | 0.1 |
| Gas | 32.5 | 34.6 | (2.1) |
| Wastewater Collection | 10.7 | 14.9 | (4.2) |
| Wastewater Treatment | 13.5 | 36.9 | (23.4) |
| Refuse | 28.1 | 37.2 | (9.1) |
| Storm Drainage | 2.5 | 2.9 | (0.4) |
| Total Functional Expense | \$217.6 | \$270.4 | (\$52.8) |
| Increase in Net Assets before Transfers/Special Items | 55.5 | 19.5 | 36.0 |
| Transfers out | 14.0 | 24.0 | (10.0) |
| Total Transfers/Special Items | \$14.0 | \$24.0 | (\$10.0) |
| Change in Net Assets | \$42.0 | (\$4.5) | \$46.5 |
| Net Assets-Beginning | 594.1 | 598.6 | (4.5) |
| Net Assets-Ending | <u>\$636.1</u> | <u>\$594.1</u> | <u>\$42.0</u> |

The table above presents a comparison of the FY 2010 and FY 2009 expenses for the City's Business-type Activities. Encumbrances and reappropriations are not included.

Business-type Activity expenses, transfers and special items decreased \$62.8 million for a total of \$231.6 million. Changes to expenses were significantly affected by the following events:

- Functional Expense for the Electric Fund decreased \$14.4 million primarily due to an \$11.8 million decrease in the retail purchase of utilities and a \$1.9 million decrease in Surplus Energy costs. The decrease is due to the lower market price of electricity. (Further detail may be found in Note 17 to the financial statements.)
- Functional Expense for the Wastewater Collection Fund decreased \$4.2 million from prior year. Prior year included \$3.7 million loss on retirement of assets: 4-inch plastic polyethylene lateral pipes.
- Functional Expense for the Wastewater Treatment Fund decreased \$23.4 million from prior year. FY 2009 included expenses for Water Reclamation Project.
- Functional Expense for the Refuse Fund decreased \$9.1 million from prior year primarily due to a decrease of \$5.5 million for operations and maintenance charges.

FUND FINANCIAL STATEMENTS

Performance of Governmental Funds

As of June 30, 2010, the City's Governmental Funds reported combined fund balances of \$153.8 million, an increase of \$49.1 million or 46.9 percent compared with the prior year. The increase is primarily due to the receipt of library bond proceeds from the General Obligation Bond.

Governmental Fund revenues and other financing sources increased \$48.4 million for a total of \$213.9 million. Revenues and other financing sources in the General Fund increased \$361 thousand; Capital Projects Fund increased \$52 million, due primarily to the receipt of library bond proceeds from the General Obligation Bond; Non-major Fund revenues and other financing sources decreased by \$4 million.

Governmental Fund expenditures and other uses were the same as the prior year, \$164.8 million. General Fund expenditures and other uses increased \$3 million, Capital Projects Fund expenditures increased by \$1.9 million; and Non-major Fund expenditures and other uses decreased by \$4.9 million.

General Fund

Governmental Funds – General Fund – Balance Sheet

As of June 30, 2010, the General Fund Balance totaled \$41.5 million. This represents 34.9 percent of direct General Fund expenditures providing a buffer against unexpected financial events. Of this, \$10.4 million is reserved and \$31.1 million is unreserved. Included in the reserved amount is \$1.5 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, \$27.4 million at year-end.



Management Discussion and Analysis

Governmental Funds – General Fund – Statement of Revenues, Expenditures and Changes in Fund Balance

The General Fund ended the year with a \$1.8 million decrease for a total of \$41.5 million fund balance, compared to an \$809 thousand increase in the prior year.

Palo Alto's General Fund revenues totaled \$109.9 million in FY 2010. This represents a decrease of \$4 million or 3.5 percent compared to the prior year.

General Fund expenditures and other uses totaled \$133.6 million, an increase of \$2.9 million from the prior year. Transfers out had an increase of \$3.5 million to the adopted budget for an adjusted budget of \$14.6 million and actual expenditures of \$14.6 million. The increase in the actual expenditures and adjusted budget reflect the transfer of \$3.6 million for the Equity Transfer Stabilization Reserve, returned to the Gas and Electric Funds. Transfers out had a decrease over the prior year of \$1.2 million.

General Fund - Statement of Revenues, Expenditures and Changes in Fund Balance Budget and Actual

Sales taxes declined by \$2.1 million or 10.5 percent over FY 2009 levels for a total of \$18 million, which is \$1.7 million less than the adopted budget and \$678 thousand greater than the adjusted budget. Continued retrenchment in consumer spending is the principal reason for sales tax declines. Department, apparel and electronic stores have had noticeable declines as have auto dealers and restaurants.

Property Taxes increased by \$537 thousand or 2.1 percent from FY 2009 to FY 2010 for a total of \$26 million. The \$26 million is \$230 thousand greater than the adopted budget and \$204 thousand greater than the adjusted budget. Though Palo Alto assessed values remained healthy for FY 2010, there are troubling signs for FY 2011. The County has received a large number of appeals from commercial properties to adjust their assessed values downward. This will likely have a negative impact for the next few years.

Transient Occupancy Tax (TOT) receipts were \$6.9 million in FY 2010, a \$253 thousand or 3.6 percent decline over FY 2009. In comparison, FY 2009 had \$865 thousand or 10.8 percent decline over FY 2008. The \$6.9 million is \$142 thousand less than the adopted budget and \$219 thousand greater than the adjusted budget. Average occupancy had a modest increase over the prior year from 65.2 percent to 65.9 percent and room rates decreased from \$146 to \$139. This economically sensitive revenue source has stabilized. With a new hotel opening in May 2010, Hotel Keen, and strong receipts from existing establishments in the last two quarters of FY 2010, staff is hopeful of higher revenues next year.

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 \$266 thousand or 2.4 percent over the prior year for a total of \$11.3 million, and is in line with the adopted budget. This increase is due to the telephone levy.

Other Taxes, Fines and Penalties totaled \$5.8 million in FY 2010, an increase of \$314 thousand from the prior year, and \$121 thousand greater than the adopted budget and \$170 thousand greater than the adjusted budget. The Documentary Transfer Tax came in at \$3.7 million, an increase of \$615 thousand or 19.9 percent from the prior year. Actual revenue results were \$457 thousand above the FY 2010 adjusted budget. This revenue source is highly dependent on sales volume and the mix of commercial and residential sales. Parking violations decreased by \$266 thousand compared to the prior year.



Charges for Services were \$19.7 million in FY 2010, a decrease of \$37 thousand from the prior year and a decrease of \$506 thousand from the adopted budget and an increase of \$800 thousand from the adjusted budget.

Permits and Licenses were \$4.6 million in FY 2010, an increase of \$267 thousand from the prior year and a decrease of \$479 thousand from the adopted budget and a decrease of \$19 thousand from the adjusted budget.

Return on Investment totaled \$2.7 million, a decrease of \$750 thousand from the prior year but an increase of \$782 thousand and \$1 million from the adopted and adjusted budgets respectively. The budget does not include the year-end adjustment to the carrying value of investments. In prior CAFRs, Return on Investment was reported as part of Other Revenues.

Rental Income totaled \$14.4 million, an increase of \$751 thousand from the prior year and an increase of \$742 thousand from the adopted budget and \$611 thousand from the adjusted budget.

From Other Agencies totaled \$332 thousand, an increase of \$174 thousand from prior year and an increase of \$240 thousand from adopted budget and \$10 thousand from adjusted budget. The increase is primarily due to reimbursement for \$91 thousand of State mandated costs and \$68 thousand for fire service. In prior CAFRs, From Other Agencies was reported as part of Other Revenues.

Charges to Other Funds totaled \$11 million, a \$140 thousand decrease from prior year. Charges to Other Funds was \$385 thousand greater than the adopted budget and \$482 thousand greater than adjusted budget.

Other Revenues totaled \$2.6 million in FY 2010, an increase of \$98 thousand from the prior year. The \$2.6 million is an increase of \$951 thousand from the adopted budget and an increase of \$817 thousand from the adjusted budget. In prior CAFRs, Other Revenues also included Return on Investment and Other Agencies; in the FY 2010 CAFR, these are reported as a separate line item.

Prior CAFRs reported Administrative Departments which consist of expenditures and encumbrances for the City Attorney, City Auditor, City Clerk, City Council, City Manager, Administrative Services and Human Resources. The FY 2010 CAFR reports each as a separate line item to conform with budget reporting.

Expenditures and encumbrances for the City Attorney office were \$32 thousand less than the prior year for a total of \$3.2 million. The \$3.2 million is \$647 thousand greater than adopted budget but \$40 thousand less than adjusted budget.

City Auditor office ended the year with \$1.1 million of expenditures and encumbrances, \$132 thousand greater than the prior year, \$58 thousand greater than the adopted budget but \$18 thousand less than adjusted budget.

City Clerk office had an increase of \$313 thousand in expenditures and encumbrances from the prior year for a total of \$1.5 million. The \$1.5 million is \$38 thousand less than the adopted budget and \$69 thousand less than the adjusted budget.



Management Discussion and Analysis

City Council expenditures and encumbrances were \$28 thousand greater than prior year for a total of \$319 thousand; this is \$23 thousand greater than adopted budget but \$16 thousand less than adjusted budget.

City Manager office expenditures and encumbrances totaled \$2.3 million, \$186 thousand greater than prior year. The \$2.3 million is \$68 thousand less than adopted budget and \$59 thousand less than adjusted budget.

The Administrative Services department had an increase in expenditures and encumbrances of \$908 thousand from the prior year for a total of \$8 million. The \$8 million is \$1.3 million greater than the adopted budget but \$4 thousand less than the adjusted budget. Increase in the adopted budget and actual expenditures reflect the \$1.4 million toward the purchase of the City Manager home. The total cost of the home is \$1.9 million and the City's equity share is \$1.4 million.

The Community Services department expenditures and encumbrances were \$762 thousand less than the prior year for a total of \$20.8 million. The \$20.8 million is \$1.1 million less than adopted budget and \$105 thousand less than the adjusted budget.

The Fire department had an increase of \$4.4 million from prior year for expenditures and encumbrances, for a total of \$28.2 million. The prior year included a deferral of payment to the Technology Fund allocated charges. FY 2009 salary and benefit expenditures were \$2.5 million less than FY 2010. The \$28.2 million is \$3 million greater than the adopted budget and \$17 thousand less than the adjusted budget. The increase in budget is due to additional overtime salary, \$1.5 million and repayment of FY 2009 Technology Fund allocated charges, \$1.2 million.

Expenditures and encumbrances for the Human Resources department were \$33 thousand less than prior year for a total of \$2.8 million. The \$2.8 million is \$59 thousand less than adopted budget and \$49 thousand less than adjusted budget.

The Library department expenditures and encumbrances totaled \$6.6 million and were \$121 thousand greater than prior year. The \$6.6 million is \$238 thousand greater than the adopted budget and \$133 thousand less than the adjusted budget.

The Planning department had a decrease in expenditures and encumbrances of \$425 thousand from the prior year for a total of \$10.1 million, which was \$200 thousand greater than the adopted budget and \$63 thousand less than the adjusted budget.

The Police department had a decrease of \$845 thousand to the adopted budget for a final budget of \$29.2 million. The Police department expenditures and encumbrances totaled \$29.1 million, which is \$626 thousand less than prior year, but \$908 thousand greater than adopted budget and \$63 thousand greater than adjusted budget.

The Public Works department had a decrease in expenditures and encumbrances from prior year of \$84 thousand, for a total of \$13.4 million. Expenditures and encumbrances for the Public Works department were \$79 thousand less than adopted budget and \$90 thousand less than adjusted budget.

Non-Departmental expenditures and encumbrances totaled \$8.8 million, a decrease of \$68 thousand from the prior year and \$10 thousand less than the adjusted budget.



Capital Projects Fund – Capital Projects Fund expenditures and other uses were \$25.9 million in FY 2010, which is an increase of \$1.9 million from the prior year. 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, 2010, the City’s Enterprise Funds reported total net assets of \$635.1 million, an increase of \$29.6 million or 4.6 percent compared with the prior year. The increase was primarily from the Water, Electric and Gas Funds for \$7 million, \$9.4 million and \$7.9 million, respectively. These assets constitute 75.5 percent of the Enterprise Funds’ total net assets. Unrestricted net assets for these three funds totaled \$191.6 million, a 5.1 percent increase from FY 2009.

Water Fund – The Water Fund ended the year with net income of \$7 million, compared to \$4.9 million in the prior year, a \$2.1 million increase. The increase in net income is primarily due to decrease in other financing uses of \$2.6 million. The ending balance for the RSR is \$17 million.

Electric Fund – The Electric Fund ended the year with a net income of \$9.4 million compared to a net loss of \$7.2 million in the prior year. The net income is due to an \$11.8 million decrease in the purchase of utilities and \$1.9 million decrease in surplus energy costs caused by lower market price of electricity. The ending balance for the RSR is \$54.3 million, an increase of \$6.6 million.

Fiber Optics Fund – The Fiber Optics Fund ended the year with a net income of \$2.1 million, compared to \$2.4 million in prior year, a decrease of \$300 thousand. The ending RSR is \$8.3 million.

Gas Fund –The Gas Fund ended the year with a net income of \$7.9 million, compared to \$10.5 million in prior year, a decrease of \$2.6 million. The decrease is due to a 10 percent rate decrease effective July 1, 2009 and an increase in other financing activities of \$2.2 million. The RSR has an ending balance of \$18.5 million, an increase of \$5.4 million.

Wastewater Collection Fund - The Wastewater Collection Fund ended the year with a net income of \$4.7 million compared to a net loss of \$63 thousand from prior year. The net income is due to a decrease in non-operating expenses. The RSR had an ending balance of \$6.8 million.

Wastewater Treatment Fund – Expenditures decreased in FY 2010 by \$23.4 million compared to the prior year. FY 2009 included expenditures of \$15.3 million, for the Water Reclamation Project. The Wastewater Treatment Fund ended the year with a net loss of \$1.2 million compared to a net loss \$3.2 million in FY 2009. The net loss of \$1.2 million will draw on the Rate Stabilization Reserve (RSR), resulting in a negative balance of \$12.4 million, compared to a negative \$15.6 million for the prior year. The negative RSR balance is a result of required accounting reserves of \$14.6 million for the \$20.3 million Disinfection Facility Improvement Program. As the project progresses, the City will be reimbursed with grant and partner revenue and the RSR will move toward a positive position.



Management Discussion and Analysis

Refuse Fund – The Refuse Fund ended the year with a net loss of \$2.7 million, compared to a \$5.4 million net loss in FY 2009. The decrease in net loss is due to a decrease of \$5.5 million in operations and maintenance expenses. FY 2009 charges included additional \$3.1 million for landfill closure expenses. The net loss of \$2.7 million is a draw on the RSR, resulting in an ending balance of negative \$4.9 million, an increase from the prior year negative balance of \$2.1 million. The cash balance as of June 30, 2010 is \$8 million, which satisfies the State requirement of \$6.7 million for post-closure liabilities.

Storm Drainage Fund – The Storm Drainage Fund ended the year with a net income of \$2.5 million compared to a net income of \$3.4 million in the prior year, a decrease of \$900 thousand. Operating expenses increased to \$2.7 million, a \$1.1 million increase from FY 2009. The RSR had an ending balance of \$286 thousand compared to a negative \$1.1 million in the prior year.

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)

| | 2010 | 2009 | Increase/ (Decrease) from 2009 |
|--|----------------|----------------|--------------------------------------|
| Governmental Activities | | | |
| <i>Capital Assets</i> | | | |
| Land and improvements | \$78.5 | \$75.5 | \$3.0 |
| Street trees | 15.1 | 15.1 | 0.0 |
| Construction in progress | 32.3 | 33.5 | (1.2) |
| Buildings and improvements | 114.6 | 103.2 | 11.4 |
| Equipment | 8.2 | 7.9 | 0.3 |
| Roadway network | 260.5 | 255.2 | 5.3 |
| Recreation & open space network | 18.5 | 16.2 | 2.3 |
| Less accumulated depreciation | (174.0) | (165.0) | (9.0) |
| <i>Internal Service Fund Assets</i> | | | |
| Construction in progress | 0.6 | 3.1 | (2.5) |
| Equipment | 51.3 | 45.9 | 5.4 |
| Less accumulated depreciation | (29.6) | (26.3) | (3.3) |
| Total Governmental | \$376.0 | \$364.3 | \$11.7 |
| Business-type Activities | | | |
| Land | \$5.0 | \$2.0 | \$3.0 |
| Construction in progress | 111.8 | 103.0 | 8.8 |
| Buildings and improvements | 30.9 | 30.7 | 0.2 |
| Transmission, Distribution & Treatment Systems | 536.6 | 511.5 | 25.1 |
| Less accumulated depreciation | (234.0) | (221.1) | (12.9) |
| Total Business-type | \$450.3 | \$426.1 | \$24.2 |

Governmental Activities' capital assets net of depreciation increased by \$11.7 million compared to FY 2009. This increase was primarily due to improvements to the City's roadway network and sidewalks, park facilities' improvements, and major Civic Center infrastructure improvements.



Management Discussion and Analysis

Work on the City's infrastructure is the 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, 2010, the City's debt was comprised of the following:

LONG-TERM DEBT AT JUNE 30

(in Millions)

| | 2010 | 2009 | Increase/ (Decrease) from 2009 |
|--|---------------|---------------|--------------------------------------|
| Governmental Activity Debt: | | | |
| General Long Term Obligations: | | | |
| 1998 Golf Course Certificates of Participation | \$4.1 | \$4.4 | (\$0.3) |
| 2002A Civic Center Refinancing Certificates of Participation | 0.8 | 1.2 | (0.4) |
| 2002B Downtown Parking Improvements Certificates of Participation | 1.9 | 2.0 | (0.1) |
| General Obligation Bonds | | | |
| 2010 Series A | 55.3 | | 55.3 |
| Plus: unamortized Premium | 3.8 | | 3.8 |
| Less: unamortized discount/issuance cost | (0.6) | | (0.6) |
| Total Governmental Activity Debt | \$65.3 | \$7.6 | \$57.7 |
| Business-type Activity Debt: | | | |
| Enterprise Long Term Obligations: | | | |
| Utility Revenue Bonds | | | |
| 1995 Series A | \$5.0 | \$5.3 | (\$0.3) |
| 1999 Refunding | 13.2 | 13.7 | (0.5) |
| 2002 Series A | 18.9 | 19.7 | (0.8) |
| 2009 Series A | 35.0 | | 35.0 |
| Less: unamortized discount/issuance cost | (1.2) | (1.0) | (0.2) |
| Energy Tax Credit Bonds | | | |
| 2007 Series A | 1.2 | 1.3 | (0.1) |
| State Water Resources Loan | | | |
| 2007 | 8.5 | 9.0 | (0.5) |
| 2009 | 4.5 | | 4.5 |
| Less: unamortized discount/issuance cost | (1.5) | (1.5) | 0.0 |
| Total Business-type Activity | \$83.6 | \$46.5 | \$37.1 |

On October 16, 2009, the City issued \$35 million in 2009 Water Revenue Bonds to finance certain improvements to the City's water utility system.



On June 30, 2010, the City issued \$55.3 million in General Obligation Bonds to finance costs for construction of the new Mitchell Park Library and Community Center and to make substantial capital improvements to the Main and Downtown Libraries. The pledge of future net revenues ends upon repayment of the remaining debt service on the bonds and is scheduled to occur in 2040.

As stated in the Statistical Section of the CAFR, the combined direct debt ratio to assessed valuation for the General Fund is a low 0.28 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. As of June 30, 2010, the City had no special assessment district debt with City commitment outstanding.

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 or use the following link: www.cityofpaloalto.org/depts/asd/financial_reporting.asp



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*.

City of Palo Alto - Statement of Net Assets

June 30, 2010

(In thousands of dollars)

| | Governmental Activities | Business-type Activities | Totals |
|--|----------------------------|-----------------------------|--------------------|
| ASSETS | | | |
| Cash and investments (Note 3): | | | |
| Available for operations | \$136,170 | \$230,339 | \$366,509 |
| Cash and investments with fiscal agent | 56,286 | 32,233 | 88,519 |
| Receivables: | | | |
| Accounts and intergovernmental | 8,069 | 29,334 | 37,403 |
| Interest receivable | 1,340 | 2,117 | 3,457 |
| Notes and loans receivable (Note 5) | 8,694 | | 8,694 |
| Internal balances (Note 4) | (402) | 402 | |
| Assets in excess of OPEB obligation (Note 12) | 23,242 | | 23,242 |
| Due from other government agencies | | 4,773 | 4,773 |
| Inventory of materials and supplies and prepaids | 5,608 | | 5,608 |
| Capital assets (Note 6): | | | |
| Nondepreciable | 126,503 | 116,749 | 243,252 |
| Depreciable, net of depreciation | 249,536 | 333,509 | 583,045 |
| Total assets | 615,046 | 749,456 | 1,364,502 |
| LIABILITIES | | | |
| Accounts payable and accrued liabilities | 8,692 | 16,240 | 24,932 |
| Accrued salaries and benefits | 2,635 | 919 | 3,554 |
| Unearned revenue | 536 | 1,490 | 2,026 |
| Accrued compensated absences (Note 1): | | | |
| Due within one year | 4,095 | | 4,095 |
| Due in more than one year | 6,324 | | 6,324 |
| Claims payable (Note 14): | | | |
| Due within one year | 6,532 | | 6,532 |
| Due in more than one year | 14,946 | | 14,946 |
| Accrued landfill closure liability (Note 9): | | | |
| Due within one year | | 450 | 450 |
| Due in more than one year | | 10,673 | 10,673 |
| Long-term debt (Note 7): | | | |
| Due within one year | 870 | 3,105 | 3,975 |
| Due in more than one year | 64,395 | 80,542 | 144,937 |
| Total liabilities | 109,025 | 113,419 | 222,444 |
| NET ASSETS (Note 10) | | | |
| Invested in capital assets, net of related debt | 369,499 | 399,317 | 768,816 |
| Restricted for: | | | |
| Special revenue programs | 27,164 | | 27,164 |
| Capital projects | 5,870 | | 5,870 |
| Debt service | 1,289 | 4,300 | 5,589 |
| Total Restricted | 34,323 | 4,300 | 38,623 |
| Unrestricted net assets | 102,199 | 232,420 | 334,619 |
| Total net assets | \$506,021 | \$636,037 | \$1,142,058 |

See accompanying notes to financial statements

City of Palo Alto - Statement of Activities

For the Year Ended June 30, 2010

(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 | |
| Governmental Activities: | | | | | | |
| City Council | \$455 | | | | (\$455) | (\$455) |
| City Manager | 2,399 | | | | (2,399) | (2,399) |
| City Attorney | 2,621 | \$53 | | | (2,568) | (2,568) |
| City Clerk | 1,369 | | | | (1,369) | (1,369) |
| City Auditor | 2,601 | | | | (2,601) | (2,601) |
| Administrative Services | 17,893 | 984 | | | (16,909) | (16,909) |
| Human Resources | 3,707 | | | | (3,707) | (3,707) |
| Public Works | 18,658 | 1,258 | \$1,567 | \$1,262 | (14,571) | (14,571) |
| Planning and Community Environment | 12,114 | 4,813 | 2,664 | 18 | (4,619) | (4,619) |
| Police | 29,350 | 4,093 | 365 | | (24,892) | (24,892) |
| Fire | 26,449 | 10,244 | 3 | | (16,202) | (16,202) |
| Community Services | 17,171 | 8,729 | 110 | | (8,332) | (8,332) |
| Library | 6,143 | 199 | 120 | | (5,824) | (5,824) |
| Interest on long-term debt | 370 | | | | (370) | (370) |
| Total Governmental Activities | 141,300 | 30,373 | 4,829 | 1,280 | (104,818) | (104,818) |
| Business-type Activities: | | | | | | |
| Water | 21,037 | 26,259 | | 797 | | \$6,019 |
| Electric | 107,910 | 121,900 | | | | 13,990 |
| Fiber Optics | 1,407 | 3,105 | | | | 1,698 |
| Gas | 32,498 | 44,450 | | | | 11,952 |
| Wastewater Collection | 10,696 | 15,136 | | 39 | | 4,479 |
| Wastewater Treatment | 13,466 | 16,915 | | | | 3,449 |
| Refuse | 28,119 | 28,568 | | | | 449 |
| Storm Drainage | 2,491 | 5,647 | | | | 3,156 |
| Total Business-type Activities | 217,624 | 261,980 | | 836 | | 45,192 |
| Total | \$358,924 | \$292,353 | \$4,829 | \$2,116 | (104,818) | 45,192 |
| General revenues: | | | | | | |
| Taxes: | | | | | | |
| Property taxes | | | | | 25,981 | 25,981 |
| Sales taxes | | | | | 17,991 | 17,991 |
| Utility user's taxes | | | | | 11,295 | 11,295 |
| Transient occupancy tax | | | | | 6,858 | 6,858 |
| Transfer and other taxes | | | | | 4,055 | 4,055 |
| Investment earnings | | | | | 6,514 | 10,769 |
| Miscellaneous | | | | | 12,729 | 12,729 |
| Transfers (Note 4) | | | | | 13,994 | (13,994) |
| Total general revenues and transfers | | | | | 99,417 | (3,225) |
| Change in Net Assets | | | | | (5,401) | 41,967 |
| Net Assets-Beginning | | | | | 511,422 | 594,070 |
| Net Assets-Ending | | | | | \$506,021 | \$636,037 |

See accompanying notes to financial statements



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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 2010. 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.



City of Palo Alto - Governmental Funds

Balance Sheet - June 30, 2010

(In thousands of dollars)

| | General | Capital Projects Fund | Other Governmental Funds | Total Governmental Funds |
|---|---------------|-----------------------------|--------------------------------|--------------------------------|
| ASSETS | | | | |
| Cash and investments (Note 3): | | | | |
| Available for operations | \$33,997 | \$29,601 | \$19,202 | \$82,800 |
| Cash and investments with fiscal agent | | 55,010 | 1,276 | 56,286 |
| Receivables: | | | | |
| Accounts and intergovernmental | 7,354 | 333 | 344 | 8,031 |
| Interest receivable | 773 | | 165 | 938 |
| Notes and loans receivable (Note 5) | 880 | | 7,814 | 8,694 |
| Interfund receivables and advances (Note 4) | 550 | | | 550 |
| Prepaid items | 1,490 | | | 1,490 |
| Inventory of materials and supplies | 3,661 | | | 3,661 |
| | <u>48,705</u> | <u>84,944</u> | <u>28,801</u> | <u>162,450</u> |
| Total Assets | | | | |
| LIABILITIES | | | | |
| Accounts payable and accrued liabilities | \$4,690 | \$1,031 | \$348 | \$6,069 |
| Accrued salaries and benefits | 2,022 | 64 | | 2,086 |
| Deferred revenue | 536 | | | 536 |
| | <u>7,248</u> | <u>1,095</u> | <u>348</u> | <u>8,691</u> |
| Total Liabilities | | | | |
| FUND BALANCES | | | | |
| Reserved for (Note 10): | | | | |
| Encumbrances | 3,778 | 5,870 | 216 | 9,864 |
| Library bond project | | 53,518 | | 53,518 |
| Improvements to parking garage | | 593 | | 593 |
| Notes and loans | 880 | | 7,814 | 8,694 |
| Interfund advances | 550 | | | 550 |
| Prepaid items | 1,490 | | | 1,490 |
| Inventory of materials and supplies | 3,661 | | | 3,661 |
| Debt service | | | 1,289 | 1,289 |
| Unreserved, designated for: | | | | |
| General Fund | | | | |
| Unrealized gain on investment | 3,517 | | | 3,517 |
| Reappropriations | 185 | | | 185 |
| Budget stabilization | 27,396 | | | 27,396 |
| Capital Project Fund | | | | |
| Reappropriations | | 15,220 | | 15,220 |
| Infrastructure | | 8,648 | | 8,648 |
| Special Revenue Funds | | | | |
| Unrealized gain on investment | | | 770 | 770 |
| Unreserved, undesignated, reported in: | | | | |
| Special Revenue Funds | | | 16,962 | 16,962 |
| Permanent Fund | | | 1,402 | 1,402 |
| | <u>41,457</u> | <u>83,849</u> | <u>28,453</u> | <u>153,759</u> |
| Total Fund Balances | | | | |
| Total Liabilities and Fund Balances | <u>48,705</u> | <u>84,944</u> | <u>28,801</u> | <u>162,450</u> |

See accompanying notes to financial statements



City of Palo Alto - Governmental Funds

Reconciliation of Fund Balances to Governmental Activities Net Assets

June 30, 2010

(In thousands of dollars)

Governmental Fund fund balances from prior page \$153,759

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) 376,039

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. 41,605 (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 (117) Long Term debt (Note 7) (65,265)

Net assets of governmental activities \$506,021

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, 2010

(In thousands of dollars)

| | General | Capital Projects Fund | Other Governmental Funds | Total Governmental Funds |
|--|----------------|-----------------------------|--------------------------------|--------------------------------|
| REVENUES | | | | |
| Property taxes | \$25,981 | | | \$25,981 |
| Special assessments | | | \$14 | 14 |
| Sales taxes | 17,991 | | | 17,991 |
| Utility users' tax | 11,295 | | | 11,295 |
| Transient occupancy tax | 6,858 | | | 6,858 |
| Other taxes and fines | 5,755 | | 1,141 | 6,896 |
| Charges for services | 19,695 | | 80 | 19,775 |
| From other agencies | 430 | \$1,699 | 906 | 3,035 |
| Permits and licenses | 4,141 | | 267 | 4,408 |
| Investment earnings | 2,683 | 997 | 951 | 4,631 |
| Rental income | 14,398 | | 16 | 14,414 |
| Other revenue | 646 | 557 | 3,521 | 4,724 |
| Total Revenues | 109,873 | 3,253 | 6,896 | 120,022 |
| EXPENDITURES | | | | |
| Current operations: | | | | |
| City Council | 287 | | | 287 |
| City Manager | 2,195 | | | 2,195 |
| City Attorney | 2,510 | | | 2,510 |
| City Clerk | 1,388 | | | 1,388 |
| City Auditor | 927 | | | 927 |
| Administrative Services | 7,506 | | | 7,506 |
| Human Resources | 2,540 | | | 2,540 |
| Public Works | 9,787 | | | 9,787 |
| Planning and Community Environment | 8,559 | | 921 | 9,480 |
| Police | 26,615 | | 113 | 26,728 |
| Fire | 24,294 | | | 24,294 |
| Community Services | 16,451 | | | 16,451 |
| Library | 5,900 | | | 5,900 |
| Non-Departmental | 9,981 | | 168 | 10,149 |
| Capital outlay | | 22,006 | | 22,006 |
| Debt service: | | | | |
| Principal payments | | | 840 | 840 |
| Interest and fiscal fees | | | 382 | 382 |
| Total Expenditures | 118,940 | 22,006 | 2,424 | 143,370 |
| EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES | (9,067) | (18,753) | 4,472 | (23,348) |
| OTHER FINANCING SOURCES (USES) | | | | |
| Issuance of long-term debt (Note 7) | | 59,071 | | 59,071 |
| Transfers in (Note 4) | 21,938 | 11,450 | 1,447 | 34,835 |
| Transfers (out) (Note 4) | (14,638) | (3,926) | (2,851) | (21,415) |
| Total Other Financing Sources (Uses) | 7,300 | 66,595 | (1,404) | 72,491 |
| Net change in fund balances | (1,767) | 47,842 | 3,068 | 49,143 |
| Fund balances at beginning of year | 43,224 | 36,007 | 25,385 | 104,616 |
| Fund balances at end of year | \$41,457 | \$83,849 | \$28,453 | \$153,759 |

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, 2010**

(In thousands of dollars)

Net change in fund balances-total governmental funds \$49,143

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, is therefore deducted from fund balance. 21,223

Depreciation expense is deducted from fund balance (Depreciation expense is net of Internal Service Fund depreciation \$5,337 million (See Note 6) which has already been allocated to serviced funds.) (9,025)

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. 840
Fund balance is reduced by the issuance of long term debt (58,500)

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 12

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. (9,094)

Change in net assets of Governmental Activities (\$5,401)

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, 2010**

(In thousands of dollars)

| | Budgeted Amount | | Actual Amount Budgetary Basis | Variance from Final Budget |
|---|-----------------|------------------|----------------------------------|-------------------------------|
| | Adopted | Adjusted | | Positive (Negative) |
| REVENUES | | | | |
| Sales taxes | \$19,650 | \$17,313 | \$17,991 | \$678 |
| Property taxes | 25,752 | 25,778 | 25,982 | 204 |
| Transient occupancy tax | 7,000 | 6,639 | 6,858 | 219 |
| Utility users' tax | 11,250 | 11,417 | 11,296 | (121) |
| Other taxes, fines & penalties | 5,633 | 5,584 | 5,754 | 170 |
| Charges for services | 20,238 | 18,932 | 19,732 | 800 |
| Permits and licenses | 5,056 | 4,596 | 4,577 | (19) |
| Return on investment | 1,900 | 1,662 | 2,682 | 1,020 |
| Rental income | 13,655 | 13,786 | 14,397 | 611 |
| From other agencies | 92 | 323 | 332 | 9 |
| Charges to other funds | 10,643 | 10,546 | 11,028 | 482 |
| Other revenues | 1,605 | 1,739 | 2,556 | 817 |
| Transfers in | 19,664 | 22,908 | 21,939 | (969) |
| Prior year encumbrance and reappropriations | | 5,920 | 5,920 | |
| Total Revenues | 142,138 | 147,143 | 151,044 | 3,901 |
| EXPENDITURES | | | | |
| Current operations: | | | | |
| City Attorney | 2,569 | 3,256 | 3,216 | 40 |
| City Auditor | 999 | 1,075 | 1,057 | 18 |
| City Clerk | 1,512 | 1,543 | 1,474 | 69 |
| City Council | 296 | 335 | 319 | 16 |
| City Manager | 2,395 | 2,386 | 2,327 | 59 |
| Administrative Services | 6,761 | 8,052 | 8,048 | 4 |
| Community Services | 21,876 | 20,951 | 20,846 | 105 |
| Fire | 25,166 | 28,197 | 28,180 | 17 |
| Human Resources | 2,837 | 2,827 | 2,778 | 49 |
| Library | 6,385 | 6,756 | 6,623 | 133 |
| Planning and Community Environment | 9,858 | 10,121 | 10,058 | 63 |
| Police | 29,998 | 29,153 | 29,090 | 63 |
| Public Works | 13,484 | 13,495 | 13,405 | 90 |
| Non-Departmental | 6,925 | 8,808 | 8,798 | 10 |
| Transfers out | 11,028 | 14,565 | 14,637 | (72) |
| Total Use of Funds | 142,089 | 151,520 | 150,856 | 664 |
| EXCESS OF REVENUES OR EXPENDITURES BUDGETARY BASIS | \$49 | (\$4,377) | 188 | \$4,565 |
| Adjustments to Budgetary Basis: | | | | |
| Current year encumbrance/reappropriations | | | 3,965 | |
| Prior year encumbrance/reappropriations | | | (5,920) | |
| EXCESS OF REVENUES OVER EXPENDITURES - GAAP BASIS | | | (1,767) | |
| Fund balances at beginning of year | | | 43,224 | |
| Fund balances at end of year, GAAP basis | | | \$41,457 | |

See accompanying notes to financial statements



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 2010.

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.

Fiber Optics Fund

This fund accounts for all financial transactions relating to the City's Fiber Optics service. Services are on a user charge basis to licensees 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.



City of Palo Alto - Proprietary Funds

Statement of Net Assets - June 30, 2010

(In thousands of dollars)

| | Business-type Activities-Enterprise Funds | | | | |
|---|---|------------------|-----------------|-----------------|-----------------------|
| | Water | Electric | Fiber Optics | Gas | Wastewater Collection |
| ASSETS | | | | | |
| Current Assets: | | | | | |
| Cash and investments (Note 3): | | | | | |
| Available for operations | \$28,021 | \$123,346 | \$9,636 | \$27,982 | \$14,920 |
| Cash and investments with fiscal agent | 31,210 | | | 1,023 | |
| Accounts receivable, net | 3,610 | 15,323 | 513 | 3,059 | 1,759 |
| Interest receivable | 389 | 1,063 | 78 | 242 | 118 |
| Due from other government agencies | | | | | |
| Inventory of materials and supplies | | | | | |
| Prepaid items | | | | | |
| Total Current Assets | 63,230 | 139,732 | 10,227 | 32,306 | 16,797 |
| Noncurrent Assets: | | | | | |
| Due from other government agencies | | | | | |
| Capital assets, nondepreciable (Note 6) | 20,517 | 32,766 | 462 | 24,174 | 18,997 |
| Capital assets, depreciable (Note 6) | 52,104 | 126,174 | 6,158 | 55,072 | 45,853 |
| Total Noncurrent Assets | 72,621 | 158,940 | 6,620 | 79,246 | 64,850 |
| Total Assets | 135,851 | 298,672 | 16,847 | 111,552 | 81,647 |
| LIABILITIES | | | | | |
| Current Liabilities: | | | | | |
| Accounts payable and accrued liabilities | 3,226 | 6,056 | 18 | 1,574 | 162 |
| Accrued salaries and benefits | 120 | 292 | 19 | 122 | 74 |
| Unearned revenue | | | | | |
| Accrued compensated absences (Note 1) | | | | | |
| Landfill closure and postclosure care (Note 9) | | | | | |
| Current portion of revenue bonds (Note 7) | 1,251 | 100 | | 459 | 65 |
| Accrued claims payable (Note 14) | | | | | |
| Total Current Liabilities | 4,597 | 6,448 | 37 | 2,155 | 301 |
| 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) | 42,527 | 977 | | 9,766 | 1,166 |
| Total Noncurrent Liabilities | 42,527 | 977 | | 9,766 | 1,166 |
| Total Liabilities | 47,124 | 7,425 | 37 | 11,921 | 1,467 |
| NET ASSETS | | | | | |
| Invested in capital assets, net of related debt | 56,705 | 157,863 | 6,620 | 69,092 | 63,619 |
| Restricted for debt service | 3,348 | | | 952 | |
| Unrestricted | 28,674 | 133,384 | 10,190 | 29,587 | 16,561 |
| Total Net Assets | \$88,727 | \$291,247 | \$16,810 | \$99,631 | \$80,180 |

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 |
|---|----------------|-----------------|------------------|------------------|
| Wastewater | Refuse | Storm | TOTALS | Activities - |
| Treatment | | Drainage | | Internal Service |
| | | | | Funds |
| \$13,793 | \$8,024 | \$4,617 | \$230,339 | \$53,370 |
| | | | 32,233 | |
| 1,220 | 3,242 | 608 | 29,334 | 38 |
| 110 | 78 | 39 | 2,117 | 402 |
| 273 | | | 273 | |
| | | | | 457 |
| | | | | 23,242 |
| <u>15,396</u> | <u>11,344</u> | <u>5,264</u> | <u>294,296</u> | <u>77,509</u> |
| 4,500 | | | 4,500 | |
| 15,039 | 2,450 | 2,344 | 116,749 | 637 |
| 23,537 | 1,073 | 23,538 | 333,509 | 21,708 |
| <u>43,076</u> | <u>3,523</u> | <u>25,882</u> | <u>454,758</u> | <u>22,345</u> |
| <u>58,472</u> | <u>14,867</u> | <u>31,146</u> | <u>749,054</u> | <u>99,854</u> |
| 3,129 | 1,574 | 501 | 16,240 | 2,506 |
| 177 | 87 | 28 | 919 | 549 |
| | | 1,490 | 1,490 | |
| | | | | 4,095 |
| | 450 | | 450 | |
| 800 | | 430 | 3,105 | |
| | | | | 6,532 |
| <u>4,106</u> | <u>2,111</u> | <u>2,449</u> | <u>22,204</u> | <u>13,682</u> |
| | | | | 6,324 |
| | | | | 14,946 |
| | | 550 | 550 | |
| | 10,673 | | 10,673 | |
| <u>17,825</u> | | <u>8,281</u> | <u>80,542</u> | |
| <u>17,825</u> | <u>10,673</u> | <u>8,831</u> | <u>91,765</u> | <u>21,270</u> |
| <u>21,931</u> | <u>12,784</u> | <u>11,280</u> | <u>113,969</u> | <u>34,952</u> |
| 24,724 | 3,523 | 17,171 | 399,317 | 22,345 |
| | | | 4,300 | |
| 11,817 | (1,440) | 2,695 | 231,468 | 42,557 |
| <u>\$36,541</u> | <u>\$2,083</u> | <u>\$19,866</u> | <u>635,085</u> | <u>\$64,902</u> |
| | | | 952 | |
| | | | <u>\$636,037</u> | |

City of Palo Alto - Proprietary Funds
Statements of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2010
(In thousands of dollars)

| | Business-type Activities - Enterprise Funds | | | | |
|---|---|------------------|-----------------|-----------------|-----------------------|
| | Water | Electric | Fiber Optics | Gas | Wastewater Collection |
| OPERATING REVENUES | | | | | |
| Sales of utilities: | | | | | |
| Customers | \$24,434 | \$109,176 | \$74 | \$41,754 | \$14,274 |
| City departments | 1,311 | 3,104 | 787 | 1,490 | 217 |
| Surplus energy | | 1,354 | | | |
| Service connection charges and miscellaneous | 270 | 1,040 | | 434 | 430 |
| Charges for services | | | | | |
| Other operating revenues | 244 | 7,226 | 2,244 | 772 | 215 |
| Total Operating Revenues | 26,259 | 121,900 | 3,105 | 44,450 | 15,136 |
| OPERATING EXPENSES | | | | | |
| Purchase of utilities: | | | | | |
| Retail | 9,061 | 67,277 | | 22,529 | 6,518 |
| Surplus energy | | 1,439 | | | |
| Administration and general | 2,953 | 4,563 | 437 | 2,690 | 611 |
| Engineering (operating) | 263 | 1,245 | | 266 | 220 |
| Resource management and energy efficiency programs | 486 | 7,078 | | 1,124 | |
| Operations and maintenance | 4,257 | 8,892 | 741 | 3,943 | 1,997 |
| Rent | 2,107 | 3,813 | 14 | 320 | 115 |
| Depreciation and amortization | 1,411 | 7,095 | 251 | 1,728 | 1,439 |
| Claims payments and changes in estimated self-insurance liability | | | | | |
| Refund of charges for services | | | | | |
| Compensated absences and other benefits | | | | | |
| Total Operating Expenses | 20,538 | 101,402 | 1,443 | 32,600 | 10,900 |
| Operating Income (loss) | 5,721 | 20,498 | 1,662 | 11,850 | 4,236 |
| NONOPERATING REVENUES (EXPENSES) | | | | | |
| Return on investment | 1,375 | 5,751 | 487 | 1,343 | 674 |
| Interest (expense) | (774) | (7,824) | | (506) | (67) |
| Gain (loss) on disposal of capital assets | (189) | (173) | | (16) | (120) |
| Other | | | | | |
| Net Nonoperating Revenues (Expenses) | 412 | (2,246) | 487 | 821 | 487 |
| Income (Loss) Before Transfers and Contributions | 6,133 | 18,252 | 2,149 | 12,671 | 4,723 |
| Capital grants and contributions | 797 | | | | 39 |
| Transfers in (Note 4) | 325 | 3,026 | | 956 | 64 |
| Transfers (out) (Note 4) | (282) | (11,904) | (13) | (5,707) | (168) |
| Change in Net Assets | 6,973 | 9,374 | 2,136 | 7,920 | 4,658 |
| Total net assets at beginning of year | 81,754 | 281,873 | 14,674 | 91,711 | 75,522 |
| Total net assets at end of year | \$88,727 | \$291,247 | \$16,810 | \$99,631 | \$80,180 |

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 Activities - Internal Service Funds |
|---|----------|-------------------|-----------|---|
| Wastewater Treatment | Refuse | Storm Drainage | TOTALS | |
| \$10,087 | \$24,924 | \$5,284 | \$230,007 | |
| 6,582 | 1,323 | 329 | 15,143 | |
| | | | 1,354 | |
| | | | 2,174 | |
| | | | | \$66,547 |
| 246 | 2,321 | 34 | 13,302 | |
| 16,915 | 28,568 | 5,647 | 261,980 | 66,547 |
| | 12,476 | | 117,861 | |
| | | | 1,439 | |
| 8 | 1,499 | 337 | 13,098 | 12,174 |
| 1,902 | 345 | 341 | 4,582 | |
| | | 333 | 9,021 | |
| 13,854 | 11,673 | 778 | 46,135 | 696 |
| | 4,289 | | 10,658 | |
| 2,356 | 638 | 867 | 15,785 | 5,626 |
| | | | | 4,479 |
| | | | | 1,134 |
| | | | | 42,402 |
| 18,120 | 30,920 | 2,656 | 218,579 | 66,511 |
| (1,205) | (2,352) | 2,991 | 43,401 | 36 |
| 635 | 337 | 167 | 10,769 | 1,883 |
| (478) | (608) | (639) | (10,896) | |
| | | | (498) | (95) |
| | | | | 857 |
| 157 | (271) | (472) | (625) | 2,645 |
| (1,048) | (2,623) | 2,519 | 42,776 | 2,681 |
| | | | 836 | |
| | 257 | | 4,628 | 748 |
| (153) | (353) | (42) | (18,622) | (174) |
| (1,201) | (2,719) | 2,477 | 29,618 | 3,255 |
| 37,742 | 4,802 | 17,389 | | 61,647 |
| \$36,541 | \$2,083 | \$19,866 | | \$64,902 |
| | | | 12,349 | |
| | | | \$41,967 | |

City of Palo Alto - Proprietary Funds

Statement of Cash Flows -

For the Year Ended June 30, 2010

(In thousands of dollars)

| | Business-type Activities - Enterprise Funds | | | | Wastewater Collection |
|---|---|-----------|--------------|----------|--------------------------|
| | Water | Electric | Fiber Optics | Gas | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | | | |
| Receipts from customers | \$24,980 | \$120,143 | \$2,194 | \$43,023 | \$14,901 |
| Refunds to customers | | | | | |
| Payments to suppliers | (14,456) | (84,598) | (790) | (28,436) | (9,298) |
| Payments to employees | (2,930) | (4,517) | (433) | (2,672) | (596) |
| Internal activity - receipts from other funds | 1,311 | 3,104 | 787 | 1,490 | 217 |
| Interfund payment | | | | | |
| Other receipts | 244 | | | 772 | 215 |
| Net Cash From Operating Activities | 9,149 | 34,132 | 1,758 | 14,177 | 5,439 |
| CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES: | | | | | |
| Transfers in | 325 | 3,026 | | 956 | 64 |
| Transfers (out) | (282) | (11,904) | (13) | (5,707) | (168) |
| Net Cash From Noncapital Financing Activities | 43 | (8,878) | (13) | (4,751) | (104) |
| CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES: | | | | | |
| Acquisition and construction of capital assets | (10,300) | (12,536) | (240) | (5,952) | (3,721) |
| Capital grants and contributions | 797 | | | | 39 |
| Proceeds from debt issuance | 35,015 | | | | |
| Cost of issuance paid | (228) | | | | |
| Principal paid on long-term debt | (575) | (90) | | (432) | (58) |
| Interest paid on long-term debt | (774) | (7,824) | | (506) | (67) |
| Cash Flows From Capital Financing Activities | 23,935 | (20,450) | (240) | (6,890) | (3,807) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | | | |
| Interest on investments | 1,258 | 6,016 | 485 | 1,361 | 686 |
| Net Cash Flows | 34,385 | 10,820 | 1,990 | 3,897 | 2,214 |
| Cash and cash equivalents at beginning of year | 24,846 | 112,526 | 7,646 | 25,108 | 12,706 |
| Cash and cash equivalents at end of year | \$59,231 | \$123,346 | \$9,636 | \$29,005 | \$14,920 |
| FINANCIAL STATEMENT PRESENTATION: | | | | | |
| Cash and investments available for operations | \$28,021 | \$123,346 | \$9,636 | \$27,982 | \$14,920 |
| Cash and investments with fiscal agent | 31,210 | | | 1,023 | |
| Cash and cash equivalents at end of year | \$59,231 | \$123,346 | \$9,636 | \$29,005 | \$14,920 |
| Reconciliation of operating income (loss) to Cash Flows from Operating | | | | | |
| Operating income (loss) | \$5,721 | \$20,498 | \$1,662 | \$11,850 | \$4,236 |
| Adjustments to reconcile operating income (loss) to cash flows | | | | | |
| Depreciation and amortization | 1,411 | 7,095 | 251 | 1,728 | 1,439 |
| Other | | | | | |
| Changes in assets and liabilities: | | | | | |
| Accounts receivable | 276 | 2,701 | (124) | 835 | 197 |
| Inventory of materials and supplies | | | | | |
| Prepaid items | | | | | |
| Accounts and other payables | 1,741 | 3,838 | (31) | (236) | (433) |
| Interfund payable | | | | | |
| Accrued compensated absences | | | | | |
| Accrued claims payable and other liabilities | | | | | |
| Net Cash From Operating Activities | \$9,149 | \$34,132 | \$1,758 | \$14,177 | \$5,439 |

See accompanying notes to financial statements



| Business-type Activities - Enterprise Funds | | | | Governmental Activities - Internal Service Funds |
|---|----------------|-------------------|------------------|---|
| Wastewater Treatment | Refuse | Storm Drainage | TOTALS | |
| \$13,900 | \$24,682 | \$5,317 | \$249,140 | \$66,537 |
| | | | | (1,134) |
| (15,820) | (27,950) | (1,815) | (183,163) | (1,855) |
| 22 | (1,474) | (1,610) | (14,210) | (53,273) |
| 6,582 | 1,323 | 329 | 15,143 | (4,439) |
| | | (550) | (550) | |
| 246 | 2,453 | 1,524 | 5,454 | 857 |
| <u>4,930</u> | <u>(966)</u> | <u>3,195</u> | <u>71,814</u> | <u>6,693</u> |
| | 257 | | 4,628 | 748 |
| <u>(153)</u> | <u>(353)</u> | <u>(42)</u> | <u>(18,622)</u> | <u>(174)</u> |
| <u>(153)</u> | <u>(96)</u> | <u>(42)</u> | <u>(13,994)</u> | <u>574</u> |
| (4,114) | (186) | (1,485) | (38,534) | (5,300) |
| | | | 836 | |
| 4,530 | | | 39,545 | |
| | | | (228) | |
| (707) | | (373) | (2,235) | |
| (478) | (608) | (639) | (10,896) | |
| <u>(769)</u> | <u>(794)</u> | <u>(2,497)</u> | <u>(11,512)</u> | <u>(5,300)</u> |
| 652 | 381 | 189 | 11,028 | 2,071 |
| 4,660 | (1,475) | 845 | 57,336 | 4,038 |
| 9,133 | 9,499 | 3,772 | 205,236 | 49,332 |
| <u>\$13,793</u> | <u>\$8,024</u> | <u>\$4,617</u> | <u>\$262,572</u> | <u>\$53,370</u> |
| \$13,793 | \$8,024 | \$4,617 | \$230,339 | \$53,370 |
| | | | 32,233 | |
| <u>\$13,793</u> | <u>\$8,024</u> | <u>\$4,617</u> | <u>\$262,572</u> | <u>\$53,370</u> |
| (\$1,205) | (\$2,352) | \$2,991 | \$43,401 | \$36 |
| 2,356 | 638 | 867 | 15,785 | 5,626 |
| | | | | 857 |
| 3,813 | (242) | 33 | 7,489 | (10) |
| | | | | 10 |
| | | | | 3,110 |
| (34) | 858 | (1,636) | 4,067 | (3,017) |
| | | (550) | (550) | |
| | | | | 41 |
| | 132 | 1,490 | 1,622 | 40 |
| <u>\$4,930</u> | <u>(\$966)</u> | <u>\$3,195</u> | <u>\$71,814</u> | <u>\$6,693</u> |



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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.



City of Palo Alto - Fiduciary Funds

Statement of Fiduciary Net Assets - June 30, 2010

(In thousands of dollars)

| | <u>Agency Funds</u> |
|--|-------------------------|
| ASSETS | |
| Cash and investments available for operations (Note 3) | \$3,435 |
| Cash and investments with fiscal agents (Note 3) | 3,902 |
| Interest receivable | <u>37</u> |
| Total Assets | <u><u>\$7,374</u></u> |
| | |
| LIABILITIES | |
| Due to bondholders | \$6,481 |
| Due to other governments | <u>893</u> |
| Total Liabilities | <u><u>\$7,374</u></u> |

See accompanying notes to financial statements

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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.



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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, fiber optics, 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 for 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 non-operating 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.

Fiber Optics Fund – This fund accounts for all financial transactions relating to the City’s Fiber Optic Service. Services are on a user-charge basis to licensees 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.

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 – This fund accounts for the administration of compensated absences and health benefits.

Workers’ Compensation Insurance Program – This fund accounts for the administration of the City’s self-insured workers’ compensation programs.

General Liability Insurance Program – This fund accounts for the administration of the City’s self-insured 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 Standards 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 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 Internal Service Fund. The Fund is reimbursed through payroll charges to all other funds. Earned but unpaid vacation and overtime compensation pay are 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, 2010, changes to the compensated absences were as follows (in thousands):

| | |
|-------------------|------------------------|
| Beginning Balance | \$12,668 |
| Additions | 5,534 |
| Payments | <u>(7,783)</u> |
| Ending Balance | <u><u>\$10,419</u></u> |
| Current Portion | <u><u>\$4,095</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.
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.
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 | \$366,509 |
| Cash and investments with fiscal agents | <u>88,519</u> |
| City cash and investments | 455,028 |
| Cash and investments available for operations in | |
| Fiduciary Funds (separate Statement) | 3,435 |
| Cash and investments with fiscal agents | |
| Fiduciary Funds (separate Statement) | <u>3,902</u> |
| Total cash and investments | <u><u>\$462,365</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 | Credit Minimum 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 |
| Bonds of State of California Municipal Agencies | 10 years | AA | 10% | No Limit |

(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 after no more than 360 days.

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

(E) Water Revenue Bonds 2009 Series A, 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 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 of 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 | \$53,180 | \$82,705 | \$110,259 | \$92,304 | \$338,448 |
| U.S. Treasury Notes | | 8,167 | | | 8,167 |
| Money Market Mutual Funds (government securities) | 33,876 | | | | 33,876 |
| Certificates of Deposit | 174 | 167 | | | 341 |
| California Asset Management Program | 55,553 | | | | 55,553 |
| Local Agency Investment Fund | 22,624 | | | | 22,624 |
| Total Investments | <u>\$165,407</u> | <u>\$91,039</u> | <u>\$110,259</u> | <u>\$92,304</u> | 459,009 |
| <i>Cash in banks and on hand</i> | | | | | <u>3,356</u> |
| Total Cash and Investments | | | | | <u>\$462,365</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 obligations, 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, 2010, these investments matured in an average of 203 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, 2010, the fair value approximated is the City’s cost. At June 30, 2010, these investments have an average maturity of 57 days.

Money Market Mutual Funds are available for withdrawal on demand and at June 30, 2010, matured in an average of 28 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.

\$62,091

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, 2010, for each investment type (in thousands):

| Investment Type | AAA/AAAm | Total |
|---|-----------|-----------|
| U.S. Federal Agency Securities | \$338,448 | \$338,448 |
| U.S. Treasury Notes | 8,167 | 8,167 |
| Money Market Mutual Funds (government securities) | 33,876 | 33,876 |
| California Asset Management Program | 55,553 | 55,553 |
| Total | \$436,044 | 436,044 |
| Not Rated: | | |
| Certificates of Deposit | | 341 |
| Local Agency Investment Fund | | 22,624 |
| Cash in banks and on hand | | 3,356 |
| Total Cash and Investments | | \$462,365 |

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, 2010 (in thousands):

| Investments | Reporting Type | Investment Amount |
|----------------------------------|--------------------------------|-------------------|
| Federal Farm Credit Bank | U.S. Federal Agency Securities | \$47,062 |
| Federal Farm Credit S&P | U.S. Federal Agency Securities | 52,885 |
| Federal Home Loan Bank | U.S. Federal Agency Securities | 103,184 |
| Federal Home Loan Mortgage Corp. | U.S. Federal Agency Securities | 29,496 |
| Federal National Mortgage Assoc. | U.S. Federal Agency Securities | 22,916 |
| Federal Agriculture Mortgage | U.S. Federal Agency Securities | 24,472 |

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.

Classification

The City changed the classification of certain amounts in the current year financial statements to improve their presentation. Amounts for the prior fiscal year have been reclassified to conform to the current year presentation.

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 2010 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 | 752 | |
| | Redevelopment Agency Special Revenue Fund | 6 | |
| | Capital Projects Fund | 3,243 | C |
| | Water Enterprise Fund | 105 | A |
| | Electric Enterprise Fund | 11,485 | A |
| | Gas Enterprise Fund | 5,446 | A |
| | Wastewater Collection Enterprise Fund | 64 | A |
| | Refuse Enterprise Fund | 271 | A |
| | Wastewater Treatment Enterprise Fund | 134 | A |
| | Storm Drainage Enterprise Fund | 27 | A |
| | Fiber Optics Enterprise Fund | 3 | A |
| | Vehicle Replacement and Maintenance Internal Service Fund | 27 | |
| | Technology Fund Internal Service Fund | 75 | |
| | Printing and Mailing Services Internal Service Fund | 8 | |
| Special Revenue Funds: | Street Improvement Capital Projects Fund | 50 | C |
| | Special Districts Capital Projects Fund | 53 | C |
| | Developer's Impact Fee Capital Projects Fund | 249 | C |
| | Redevelopment Agency Capital Projects Fund | 6 | |
| Debt Service Funds: | Golf Course Improvements General Fund | 449 | |
| | Civic Center Refinancing General Fund | 333 | |
| | Downtown Parking Improvement Special Districts Special Revenue Fund | 80 | |
| Downtown Parking Improvement General Fund | 227 | | |
| Capital Projects Fund: | General Fund | 9,900 | B |
| | Street Improvement Special Revenue Fund | 1,315 | B |
| | Transportation Mitigation Special Revenue Fund | 82 | B |
| | Special Districts Special Revenue Fund | 67 | B |
| | Electric Enterprise Fund | 65 | B |
| | Gas Enterprise Fund | 9 | B |
| | Water Enterprise Fund | 4 | B |
| | Wastewater Collection Enterprise Fund | 4 | B |
| Fiber Optics Enterprise Fund | 4 | B | |



Notes to Basic Financial Statements – Note 4

| Fund Receiving Transfer | Fund Making Transfer | Amount Transferred |
|--------------------------------|--|--------------------|
| Enterprise Funds: | | |
| Water | Capital Projects Fund | \$259 |
| | Gas Enterprise Fund | 33 |
| | Wastewater Collection Enterprise Fund | 33 |
| Electric | General Fund | 2,760 |
| | Capital Projects Fund | 125 |
| | Water Enterprise Fund | 70 |
| | Gas Enterprise Fund | 70 |
| Gas | General Fund | 909 |
| | Gas Enterprise Fund | 16 |
| | Electric Enterprise Fund | 16 |
| | Wastewater Collection Enterprise Fund | 16 |
| Refuse | Special Districts Special Revenue Fund | 257 |
| Wastewater Collection | Retiree Health Benefit Internal Service Fund | 64 |
| Internal Service Funds: | | |
| Technology | Water Enterprise Fund | 87 |
| | Electric Enterprise Fund | 339 |
| | Gas Enterprise Fund | 149 |
| | Wastewater Collection Enterprise Fund | 51 |
| | Wastewater Treatment Enterprise Fund | 19 |
| | Refuse Enterprise Fund | 82 |
| | Storm Drainage Enterprise Fund | 15 |
| | Fiber Optics Enterprise Fund | 6 |
| | | \$40,211 |

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.
- (C) Transfer to return unspent construction funds.

Interfund Commitment

During fiscal year 2002, 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 principles require that such amounts be treated as transfers in the year made. Advances without specified repayment terms total \$379 thousand as of June 30, 2010.



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 three-year period. There shall be no pre-payment penalty. At June 30, 2010, the balance of the advance, including principal and accrued interest, was \$550 thousand. The balance will be paid off in FY 2011.

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, 2010, the City's notes and loans receivable totaled (in thousands):

| | |
|--|-----------------------|
| Palo Alto Housing Corporation: | |
| Oak Manor Townhouse | \$822 |
| Tree House Apartments | 2,838 |
| Emerson Street Project | 375 |
| Alma Single Room Occupancy Development | 2,222 |
| Barker Hotel | 2,111 |
| Sheridan Apartments | 2,247 |
| Oak Court Apartments, L.P. | 7,835 |
| Mid-Peninsula Housing Coalition: | |
| Palo Alto Gardens Apartments | 374 |
| Community Working Group, Inc | 1,280 |
| Opportunity Center Associates, L.P. | 750 |
| Home Rehabilitation Loans | 83 |
| Executive Relocation Assistance Loans | 880 |
| 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 Apartments | <u>1,150</u> |
| | |
| Total Loans and Notes | <u>23,499</u> |
| | |
| Less: valuation allowance | <u>(14,805)</u> |
| | |
| Net Carrying Value | <u><u>\$8,694</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 maintains 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, collectability of some of the outstanding balances may 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, 2010, the objective was met. The annual loan payment was forgiven for the calendar year ending December 31, 2009.

Tree House Apartments

In March 2009, the City agreed to loan \$2.8 million to the Tree House Apartments, L.P. for the purchase of the real property located at 488 West Charleston Road. On March 23, 2010, the City wired the full loan amount to an escrow account. The loan consisted of \$1.8 million funded by Community Development Block Grant funds; the remaining \$1 million was funded by Residential funds. Principal and interest payments will be deferred for 55 years. However if the borrower has earned extra income, and if acceptable to the other entities providing final permanent sources of funds, payment of interest and principal based on the City's proportionate share of the project's residual receipts from net operating income shall be made by borrower. In no event shall full payment be made by the borrower later than concurrently with the expiration or earlier termination of the loan agreement which is March 23, 2064.

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 2010 after which the loan bears interest at 3 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 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 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 5 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 defined in the regulatory agreement.

Oak Court Apartments, L.P.

On August 18, 2003, the City loaned \$2 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 3 percent. The note is secured by a subordinate deed of trust. The principal balance is due in 2060.

Palo Alto Gardens Apartments

On April 22, 1999, the City loaned \$1 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 2008. 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 a 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, 2010, the City had two outstanding employee home loans, the previous City Manager and the current City Manager. The original purchase cost for the previous City Manager's home was \$1.4 million and the City holds a 60 percent equity share. The loan balance owed as of June 30, 2010 was \$414 thousand. The original purchase cost for the current City Manager's home was \$1.9 million and the City holds a 75 percent equity share. The loan balance owed as of June 30, 2010 is \$467 thousand.

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 2010, the City did not receive interest payments.

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.

Stevenson Housing Fire Alarm

In December 2006, the City agreed to loan up to \$48 thousand to Palo Alto Senior Housing Project, Inc. to repair and upgrade the existing fire alarm system at the Stevenson House Senior Housing facility. 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, 2012, as long as the borrower continues to comply with all terms and conditions of the agreement.

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 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. 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 Garden Apartments

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 Apartments. 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.

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. 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 medians | 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, 2010, were (in thousands):

| | Balance June 30, 2009 | Additions | Retirements | Transfers | Balance June 30, 2010 |
|--|-----------------------------|-----------------|----------------|-----------|-----------------------------|
| <i>Governmental activities</i> | | | | | |
| Capital assets not being depreciated | | | | | |
| Land and improvements | \$75,450 | \$724 | | \$2,306 | \$78,480 |
| Street trees | 15,052 | | | | 15,052 |
| Construction in progress | 33,475 | 19,890 | | (21,031) | 32,334 |
| Total capital assets not being depreciated | 123,977 | 20,614 | | (18,725) | 125,866 |
| Capital assets being depreciated | | | | | |
| Buildings and improvements | 103,208 | 518 | | 10,879 | 114,605 |
| Equipment | 7,901 | 91 | (\$34) | 242 | 8,200 |
| Roadway network | 255,225 | | | 5,264 | 260,489 |
| Recreation & open space network | 16,212 | | | 2,340 | 18,552 |
| Total capital assets being depreciated | 382,546 | 609 | (34) | 18,725 | 401,846 |
| Less accumulated depreciation | | | | | |
| Buildings and improvements | (58,641) | (2,147) | 34 | | (60,754) |
| Equipment | (5,830) | (259) | | | (6,089) |
| Roadway network | (95,053) | (6,144) | | | (101,197) |
| Recreation & open space network | (5,503) | (475) | | | (5,978) |
| Total accumulated depreciation | (165,027) | (9,025) | 34 | | (174,018) |
| Net governmental fund program | | | | | |
| Capital assets being depreciated | 217,519 | (8,416) | | 18,725 | 227,828 |
| <i>Internal service fund capital assets</i> | | | | | |
| Construction in progress | 3,122 | 3,772 | | (6,257) | 637 |
| Equipment | 45,926 | 1,474 | (2,346) | 6,257 | 51,311 |
| Accumulated depreciation | (26,282) | (5,337) | 2,016 | | (29,603) |
| Net internal service capital assets | 22,766 | (91) | (330) | | 22,345 |
| Governmental activity capital assets, net | \$364,262 | \$12,107 | (\$330) | | \$376,039 |

Business-type Capital Assets

Changes in the City’s Enterprise Fund capital assets during the year ended June 30, 2010, were (in thousands):

| | Balance June 30, 2009 | Additions | Retirements | Transfers | Balance June 30, 2010 |
|---|--------------------------|-----------------|----------------|------------|--------------------------|
| <i>Business-type activities</i> | | | | | |
| Capital assets not being depreciated | | | | | |
| Land and improvements | \$1,953 | \$3,018 | | | \$4,971 |
| Construction in progress | 103,089 | 36,395 | | (\$27,706) | 111,778 |
| Total capital assets not being depreciated | 105,042 | 39,413 | | (27,706) | 116,749 |
| Capital assets being depreciated | | | | | |
| Buildings and structures | 30,707 | | | 193 | 30,900 |
| Transmission, distribution, and treatment systems | 511,497 | 473 | (\$2,890) | 27,513 | 536,593 |
| Total capital assets being depreciated | 542,204 | 473 | (2,890) | 27,706 | 567,493 |
| Less accumulated depreciation | | | | | |
| Buildings and structures | (6,577) | (704) | | | (7,281) |
| Transmission, distribution, and treatment systems | (214,541) | (14,551) | 2,389 | | (226,703) |
| Net capital assets being depreciated | (221,118) | (15,255) | 2,389 | | (233,984) |
| Total depreciable assets | 321,086 | (14,782) | (501) | 27,706 | 333,509 |
| <i>Business-type activity capital assets, net</i> | <u>\$426,128</u> | <u>\$24,631</u> | <u>(\$501)</u> | | <u>\$450,258</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> | |
|--------------------------------------|-----------------|---------------------------------|-----------------|
| Community Services | \$805 | Water | \$1,323 |
| Fire | 116 | Electric | 7,083 |
| Police | 59 | Fiber Optics | 251 |
| Public Works | 7,726 | Gas | 1,644 |
| Planning | 52 | Wastewater Collection | 1,440 |
| Non departmental (Common Use Assets) | 24 | Wastewater Treatment | 2,195 |
| Library Dept | 243 | Refuse | 638 |
| Internal Service Funds | 5,337 | Storm Drainage | 681 |
| | <u>\$14,362</u> | | <u>\$15,255</u> |

Construction in Progress and Completed Projects

Construction in progress during fiscal year 2010 is comprised of the following (in thousands):

| | <u>Expended to June 30, 2010</u> |
|--|--------------------------------------|
| Governmental Activities: | |
| American with Disabilities – Cubberley Wing I Elevator Upgrade | \$257 |
| American with Disabilities – Others | 1,056 |
| Animal Shelter Expansion & Renovation | 1,642 |
| Art Center Electrical & Mechanical Upgrades | 419 |
| Baylands Athletic Center Fencing Dugout | 288 |
| Bridge Rail, Abutment, and Deck Repair | 167 |
| California Avenue Improvements | 465 |
| Charleston/Arastradero Corridor Plan | 781 |
| College Terrace Library Improvements | 2,207 |
| College Terrace Parks Improvements | 305 |
| College Terrace Traffic Calming | 143 |
| CPA Municipal Airport Transition Project | 107 |
| Cubberley Mechanical & Electrical Upgrades | 181 |
| Cubberley Turf Renovation | 1,161 |
| Downtown Library Improvements | 641 |
| Downtown Parking Structure | 497 |
| ECR/Ventura Signal | 110 |
| Fire Apparatus Equipment Replacement | 261 |
| Fire Station Improvements | 1,071 |
| Greer Park Phase IV | 684 |
| Junior Museum & Zoo New Bobcat Habitat | 102 |
| LATP Master Plan Study | 151 |
| Library & Community Center Temporary Facilities | 547 |
| Lytton Plaza Renovation | 749 |
| Mitchell Park Facilities Improvements | 1,132 |
| Mitchell Park Library & Community Center | 5,352 |
| Municipal Service Center Improvements | 179 |
| Municipal Service Center Resurfacing | 327 |
| Other construction in progress | 672 |
| Park Restroom Installation | 154 |
| Park Trails | 1,333 |
| Park Facilities Improvements | 124 |
| Public Safety Building | 3,730 |
| Public Safety Mobile Data | 164 |
| Rinconada Pool Plaster Construction | 118 |
| Roofing Replacement | 590 |



Notes to Basic Financial Statements – Note 6

Governmental Activities (continued):

| | |
|---------------------------------------|-------|
| Roth Building Maintenance | \$165 |
| San Antonio Road Median Improvements | 1322 |
| San Mateo Drive Bridges 110 | 110 |
| Sand Hill Road Bridge | 173 |
| School Site Irrigation | 436 |
| Security Systems Improvements | 212 |
| Sixteen ALS Monitor/Defibrillator | 140 |
| Stanford/Palo Alto Playing Fields | 855 |
| Street Lights Improvements | 193 |
| Tennis & Basketball Court Resurfacing | 393 |
| Traffic Signal Upgrades | 468 |
| Vehicle Replacement Fund | 637 |

Total governmental construction in progress \$32,971

Enterprise Funds:

| | |
|--|----------|
| Electric distribution system improvements | \$11,586 |
| Gas system extension replacements and improvements | 20,257 |
| Other construction in progress | 55,028 |
| Other electrical improvements projects | 203 |
| Sewer system rehabilitation and extensions | 3,853 |
| Storm drainage structural and water quality improvements | 2,295 |
| Water quality control plant equipment replacement and lab facilities | 6,896 |
| Water system extension replacements and improvements | 11,660 |

Total enterprise construction in progress \$111,778

Allocations of Enterprise Fund administration and general expenses of \$9.05 million have been capitalized and included in amounts expended to June 30, 2010.

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, 2009 | Additions | Retirements | Balance June 30, 2010 | 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 | \$4,415 | | \$355 | \$4,060 | \$370 |
| 2002A Civic Center Refinancing Certificates of Participation, | | | | | | |
| 2.00-4.00%, due 03/01/2012 | 3,500 | 1,175 | | 380 | 795 | 390 |
| 2002B Downtown Parking Improvements Certificates of Participation | | | | | | |
| 4.55-6.00% due on 03/01/2022 | 3,555 | 2,015 | | 105 | 1,910 | 110 |
| General Obligation Bonds | | | | | | |
| 2010 Series A, 2.00-5.00%, due 08/01/2040 | 55,305 | | \$55,305 | | 55,305 | |
| Add: Unamortized Premium | | | 3,766 | | 3,766 | |
| Less: Unamortized Discount/Issuance Costs | | | (571) | | (571) | |
| Total Governmental Activity Debt | \$70,110 | \$7,605 | \$58,500 | \$840 | \$65,265 | \$870 |

Notes to Basic Financial Statements – Note 7

| | Original Issue Amount | Balance June 30, 2009 | Additions | Retirements | Balance June 30, 2010 | Current Portion |
|---|-----------------------------|-----------------------------|-----------------|----------------|-----------------------------|--------------------|
| 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 | \$5,319 | | \$350 | \$4,969 | \$375 |
| 1999 Refunding, 3.25-5.25%, due 06/01/2024 | 17,735 | 13,735 | | 500 | 13,235 | 520 |
| 2002 Series A, 3.00-5.00%, due 06/01/2026 | 26,055 | 19,690 | | 805 | 18,885 | 835 |
| 2009 Series A, 1.80-5.95%, due 06/01/2035 | 35,015 | | \$35,015 | | 35,015 | 825 |
| Less: unamortized discount/ issuance cost | | (979) | (418) | (110) | (1,287) | |
| Energy Tax Credit Bonds, | | | | | | |
| 2007 Series A, 0%, due 12/15/2021 | 1,500 | 1,300 | | 100 | 1,200 | 100 |
| State Water Resources Loan, | | | | | | |
| 2007, 0%, due 6/30/2029 | 9,000 | 9,000 | | 450 | 8,550 | 450 |
| 2009, 2.6%, due 11/30/2030 | 8,500 | | 4,530 | | 4,530 | |
| Less: unamortized discount/ issuance cost | | (1,500) | | (50) | (1,450) | |
| | <u>\$106,445</u> | <u>\$46,565</u> | <u>\$39,127</u> | <u>\$2,045</u> | <u>\$83,647</u> | <u>\$3,105</u> |

Description of the City's Long-Term Debt Issues

1998 Golf Course Certificates of Participation (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's 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's 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, 2010, is \$700 thousand. The defeasance resulted in an overall debt service savings of \$1.5 million and an economic gain of \$462 thousand.

2010 General Obligation Bonds (GO)– On June 30, 2010, the City issued \$55.3 million of GO bonds to finance costs for constructing a new Mitchell Park Library and Community Center, as well as substantial improvements to the Main Library and the Downtown Library. Principal payments are due annually on August 1 and interest payments semi-annually on February 1 and August 1 from 2.0 percent to 5.0 percent, and are payable from property tax revenues.

The pledge of future Net Revenues for the above funds ends upon repayment of the \$58.5 million in remaining debt service on the bonds which is scheduled to occur in 2041. In FY 2010 there were no debt service payments due.

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 Fiber Optic 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 \$4.969 million in remaining debt service on the bonds which is scheduled to occur in 2020. For fiscal year 2010, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$244.681 million, and operating costs include operating expenses but not interest, depreciation or amortization and amounted to \$190.782 million. Net Revenues available for debt service amounted to \$53.899 million which represented coverage of 79.15 times over the \$681 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 \$13.235 million in remaining debt service on the bonds which is scheduled to occur in 2024. For fiscal year 2010, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$39.214 million; and operating costs include operating expenses but not interest, depreciation or amortization and amounted to \$27.378 million. Net Revenues available for debt service amounted to \$11.836 million which represents coverage of 9.78 times over the \$1.21 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 \$18.89 million in remaining debt service on the bonds which is scheduled to occur in 2026. For fiscal year 2010, Net Revenues, including operating revenues and non-operating interest earnings amounted to \$74.224 million; and operating costs include operating expenses but not interest, depreciation or amortization and amounted to \$55.988 million. Net Revenues available for debt service amounted to \$18.236 million which represented coverage of 10.57 times over the \$1.725 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 \$1.2 million in remaining debt service on the bonds which is scheduled to occur in 2021. For FY 2010, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$127.651 million; and operating costs include operating expenses but not interest, depreciation or amortization and amounted to \$106.211 million. Net Revenues available for debt service amounted to \$21.44 million which represented coverage of 214.4 times over the \$0.1 million in debt service.

2009 Water Revenue Bonds, Series A – On October 6, 2009, the City issued Water Revenue Bonds to finance certain improvements to the City’s water utility system. Principal payments are due annually on June 1, and interest payments are due semi-annually on June 1 and December 1 from 1.80 percent to 5.95 percent. The 2009 Revenue Bonds are secured by net revenues generated by the Water Fund. The 2009 Bonds were issued as bonds designated as “Direct Payment Build America Bonds” under the provisions of the American Recovery and Reinvestment Act of 2009 (“Build America Bonds”). The City expects to receive a cash subsidy payment from the United States Treasury equal to 35 percent of the interest payable on the 2009 Bonds. The lien of the 1995 Bonds on the Net Revenues is senior to the lien on Net Revenues securing the 2009 Bonds and the 2002 Bonds. The City received the first cash subsidy payment amounting to \$360,797, which is 35 percent of the first interest payment due on June 1, 2010.

The pledge of future Net Revenues for the above funds ends upon repayment of the \$35 million in remaining debt service on the bonds which is scheduled to occur in 2035. For FY 2010, Net Revenues, including operating revenues and non-operating interest earnings amounted to \$28 million; and operating costs include operating expenses but not interest, depreciation or amortization and amounted to \$19.4 million. Net Revenues available for debt service amounted to \$8.6 million which represented coverage of 8.33 times over the \$1 million in debt service.

2007 State Water Resources Loan – In October 2007, the City approved the \$9 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 million to the State in exchange for receiving \$7.5 million in proceeds to be used to fund the Project. The difference between the 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. Concurrently with the loan, the City entered into various other agreements including a cost sharing arrangement with the City of Mountain View. Pursuant to that agreement, City of Mountain View agreed to finance a portion of the project with a \$5 million loan repayable to the City. This loan has been recorded as “Due from other government agencies” in the accompanying financial statements.

2009 State Water Resources Loan – In October 2009, the City approved an \$8.5 million loan agreement with State Water Resources Control Board (SWRCB) to finance the City’s Ultraviolet Disinfection project. Loan proceeds are drawn down as the project progresses and annual debt service payments commence on November 30, 2010.

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 |
| 2011 | \$870 | \$1,816 | \$2,686 | \$3,105 | \$3,622 | \$6,727 |
| 2012 | 1,670 | 2,808 | 4,478 | 3,399 | 3,888 | 7,287 |
| 2013 | 1,530 | 2,750 | 4,280 | 3,653 | 3,636 | 7,289 |
| 2014 | 1,575 | 2,694 | 4,269 | 3,777 | 3,507 | 7,284 |
| 2015 | 1,640 | 2,640 | 4,280 | 3,916 | 3,367 | 7,283 |
| 2016 -2020 | 8,755 | 11,994 | 20,749 | 22,048 | 14,379 | 36,427 |
| 2021 -2025 | 7,700 | 10,134 | 17,834 | 24,921 | 9,319 | 34,240 |
| 2026 -2030 | 9,120 | 8,026 | 17,146 | 14,175 | 4,949 | 19,124 |
| 2031 -2035 | 11,485 | 5,679 | 17,164 | 11,360 | 2,018 | 13,378 |
| 2036 -2040 | 14,400 | 2,702 | 17,102 | | | |
| 2041 -2045 | 6,520 | 83 | 6,603 | | | |
| Total | \$65,265 | \$51,326 | \$116,591 | 90,354 | \$48,685 | \$139,039 |

Reconciliation of long-term debt

| | |
|---|------------------------|
| 2009 SWRCB loan proceeds not yet received | (3,970) |
| Less unamortized original issue discount | <u>(2,737)</u> |
| Net long-term debt | <u>\$83,647</u> |



Debt Call Provisions

Long-term debt as of June 30, 2010, 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>2010A General Obligation Bonds</i> | | |
| \$6.595mil due 08/01/2032 | 08/01/2031 | (4) |
| \$4.890mil due 08/01/2034 | 08/01/2033 | (4) |
| \$17.725mil due 08/01/2040 | 08/01/2035 | (4) |
| <i>Business-Type Activities Long-term Debt</i> | | |
| <i>Utility Revenue Bonds -</i> | | |
| 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.
- (4) Callable in any order specified by the City at par value plus any accrued interest beginning on the initial call 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, 2010, the amount of Bonds outstanding was \$5.9 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 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, 2010, the District's outstanding debt amounted to \$870 thousand.

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, 2010, the District's outstanding debt amounted to \$7.92 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, 2010, \$0.8 million of the bonds were called and the remaining outstanding debt amounted to \$27.8 million.

Note 9

LANDFILL CLOSURE AND POST-CLOSURE CARE

State and Federal laws and regulations require the City to properly close the Palo Alto Refuse Disposal Site (Palo Alto Landfill) after it stops accepting waste by constructing a final cover on top of the approximately 126 acre landfill to cap the wastes and to perform certain maintenance and monitoring activities at the site for a minimum of thirty years after closure. The first section of the landfill closed in 1991 was a 29-acre section designated “Phase I” costing \$1.6 million. Phase I was subsequently converted to a pastoral park (Byxbee Park) and opened to the public. The remaining sections of the landfill are designated as Phase IIA (22.5 acres closed in 1992 for \$904 thousand), Phase IIB (23.2 acres closed in 2000 for \$1.2 million) and Phase IIC a 51.2 acre active area currently being filled. Phase IIC is currently expected to be filled by 2011 and is projected for closure in 2012. The 30 years of post-closure maintenance costs will be paid after the State certifies the Phase IIC closure (expected in early 2013).

In accordance with State regulations, a final closure and post-closure maintenance plan was produced by a consultant and submitted to State and local regulatory agencies in 2009. As part of this plan the City’s consultant updated cost forecasts for both the remaining Phase IIC closure and for the 30 year post-closure maintenance activities.

Landfill closure and post-closure liabilities for fiscal years 2010 and 2009 were \$11.1 million and \$11 million, respectively. Currently 98.3 percent of the landfill capacity has been used to date. Based on estimated costs to be incurred in FY 2011, \$10.7 million is expected to be recorded as future landfill closure and post-closure liability and \$450 thousand as the current portion.

During fiscal year ended June 30, 2010, changes to the Landfill Closure were as follows (in thousands):

| | |
|-------------------|------------------------|
| Beginning Balance | \$10,991 |
| Additions | <u>132</u> |
| Ending Balance | <u><u>\$11,123</u></u> |
| Current Portion | <u><u>\$450</u></u> |

The City is required by State and Federal laws and regulations to make annual funding contributions to finance closure and post-closure care. In FY 2009 for post-closure maintenance, \$5.1 million, the City changed its financial assurance mechanism from an enterprise fund mechanism to a pledge of revenue agreement with the California Integrated Waste Management Board. The \$6 million closure liability remains under the enterprise fund mechanism. The City is in compliance with these requirements for the year ended June 30, 2010.

The Landfill closure balance as of June 30, 2010 comprised the following (in thousands):

| | | |
|-------------------|------------------------|--------------------------|
| | | <u>Funding Mechanism</u> |
| Closure | \$6,003 | Cash on hand |
| Post-closure care | <u>5,120</u> | Future Revenue |
| | <u><u>\$11,123</u></u> | |



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, 2010, Governmental Funds reservations and designations included (in thousands):

| | Major Funds | | |
|--|-----------------|-----------------------|-----------------|
| | General Fund | Capital Projects Fund | Non-Major Funds |
| Reserved for: | | | |
| Encumbrances | \$3,778 | \$5,870 | \$216 |
| Library bond projects | | 53,518 | |
| Improvements to parking garage | | 593 | |
| Notes and loans | 880 | | 7,814 |
| Interfund advances | 550 | | |
| Prepaid Items | 1,490 | | |
| Inventory of materials and supplies | 3,661 | | |
| Debt service | | | 1,289 |
| Total Reserved Fund Balance | \$10,359 | \$59,981 | \$9,319 |
| Unreserved, designated for: | | | |
| Unrealized gain on investment | \$3,517 | | \$770 |
| Reappropriations | 185 | \$15,220 | |
| Budget stabilization | 27,396 | | |
| Infrastructure | | 8,648 | |
| Total Unreserved/Designated Fund Balances | \$31,098 | \$23,868 | \$770 |



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

Reserve for **library bond projects** represents the proceeds from the 2010 Series A General Obligation Bond that was issued to fund construction of the Mitchell Park Library and Community Center as well as to provide for capital improvements to the Downtown Library and the Main Library.

Reserve for **improvements to parking garage** represents remaining 2002 bond funds restricted for capital improvements to the University Avenue off-street parking garage.

Reserves for **notes and 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 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 **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, 2010, internal service fund net assets designations included (in thousands):

| | Vehicle Replacement and Maintenance | Technology | Printing and Mailing Services | General Benefits | Workers' Compensation Insurance Program | General Liability Insurance Program | Retiree Health Benefit | Total |
|--|-------------------------------------|-----------------|-------------------------------|------------------|---|-------------------------------------|------------------------|-----------------|
| Reserved net assets | | | | | | | | |
| Commitments | \$1,202 | \$1,072 | \$23 | \$635 | | \$26 | | \$2,958 |
| Unreserved: | | | | | | | | |
| Designated for: | | | | | | | | |
| Future catastrophic losses | | | | | \$100 | 74 | | 174 |
| Retiree health care | | | | | | | \$25,504 | 25,504 |
| Operating software & hardware replacements | | 194 | | | | | | 194 |
| Capital projects | 1,838 | 6,022 | | | | | | 7,860 |
| Undesignated | 3,208 | 3,101 | (7) | (435) | | | | 5,867 |
| | <u>\$6,248</u> | <u>\$10,389</u> | <u>\$16</u> | <u>\$200</u> | <u>\$100</u> | <u>\$100</u> | <u>\$25,504</u> | <u>\$42,557</u> |

Notes to Basic Financial Statements – Note 10

Reserve for **commitments** 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.

Designated for **operating software and hardware replacement** represents the portion of net assets set aside to defer future costs for operating software replacement.

Designated for **capital projects** represents the portion of net assets set aside for adopted capital projects.

As of July 1, 2009, the City split out into separate internal service funds the General Benefits, General Liability Insurance and Workers Compensation Insurance Programs which were formerly reported as a single fund. There was no change in total beginning internal service fund net assets.

Enterprise Funds

At June 30, 2010, Enterprise Fund net assets (in thousands):

| | Water | Electric | Fiber Optics | Gas | Wastewater Collection | Wastewater Treatment | Refuse | Storm Drainage | Total |
|-----------------------------|-----------------|------------------|-----------------|-----------------|--------------------------|-------------------------|------------------|-------------------|------------------|
| Unrestricted | | | | | | | | | |
| Rate stabilization | | | | | | | | | |
| Supply | | \$44,855 | | \$12,339 | | | | | \$57,194 |
| Distribution | | 9,484 | | 6,209 | | | | | 15,693 |
| Operations | \$17,037 | | \$8,270 | | \$6,772 | (\$12,386) | (\$4,935) | \$286 | 15,044 |
| | 17,037 | 54,339 | 8,270 | 18,548 | 6,772 | (12,386) | (4,935) | 286 | 87,931 |
| Emergency plant replacement | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 2,160 | | | 7,160 |
| Calaveras | | 59,865 | | | | | | | 59,865 |
| Reappropriations | 7,947 | 9,663 | 607 | 9,166 | 6,481 | 17,180 | 1,888 | 2,182 | 55,114 |
| Commitments | 2,690 | 3,730 | 313 | 873 | 2,308 | 4,863 | 949 | 227 | 15,953 |
| Underground loan | | 731 | | | | | | | 731 |
| Landfill Corrective Action | | | | | | | 658 | | 658 |
| Public benefit program | | 3,750 | | | | | | | 3,750 |
| Central Valley Project | | 306 | | | | | | | 306 |
| | <u>\$28,674</u> | <u>\$133,384</u> | <u>\$10,190</u> | <u>\$29,587</u> | <u>\$16,561</u> | <u>\$11,817</u> | <u>(\$1,440)</u> | <u>\$2,695</u> | <u>\$231,468</u> |

Additional Resources – Restricted Cash and Investments:

| | Water | Electric | Fiber Optics | Gas | Wastewater Collection | Wastewater Treatment | Refuse | Storm Drainage | Total |
|--|-----------------|----------|-----------------|----------------|--------------------------|-------------------------|--------|-------------------|-----------------|
| Restricted for : | | | | | | | | | |
| Debt services | \$3,348 | | | \$952 | | | | | \$4,300 |
| Capital projects | 27,862 | | | 71 | | | | | 27,933 |
| Total restricted cash and investments: | <u>\$31,210</u> | | | <u>\$1,023</u> | | | | | <u>\$32,233</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 year of full-time employment. Funding contributions for both Plans are determined annually on an actuarial basis as of June 30 by CalPERS.

The Plans' provisions and benefits in effect at June 30, 2010, are summarized as follows:

| | <u>Safety</u> | <u>Miscellaneous</u> |
|---|------------------|----------------------|
| 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% | 1.092-3% |
| Required employee contribution rates | 9% | 8% |
| Required employer contribution rates | 23.938% | 17.063% |

Effective July 1, 2010, the City has adopted a 2 percent at 60 retirement plan for Miscellaneous employees.

The City's current labor contracts with Safety Police and Safety Management employees require it to pay employee contributions as well as its own, this is also true for Safety Fire through January 1, 2010. As of January 2, 2010, Safety Fire employees paid the entire employee contribution of 9 percent and the City paid the employer contributions. Within the Miscellaneous group, SEIU employees contribute 5.75 percent of the employee contributions with the City paying the balance. Within the Miscellaneous group, the management employees contribute 2 percent of the employee contributions with the City paying the balance. Contributions are collected through payroll deductions and the City remits those contributions to CalPERS.

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.

Notes to Basic Financial Statements – Note 11

The City uses the actuarially determined percentages of payroll to calculate and pay contributions to CalPERS. This results in no net pension obligations or unpaid contributions. Annual Pension Costs representing the payment of all contributions required by CalPERS for the last three fiscal years were as follows (in thousands):

| Fiscal Year Ending | Annual Pension Cost (APC) | Percent of APC Contributed | Net Pension Obligation |
|-------------------------------|--|---|---------------------------------------|
| Safety Plan | | | |
| June 30, 2008 | \$5,271 | 100% | \$0 |
| June 30, 2009 | 5,437 | 100% | 0 |
| June 30, 2010 | 5,441 | 100% | 0 |
| Miscellaneous Plan | | | |
| June 30, 2008 | 10,562 | 100% | 0 |
| June 30, 2009 | 10,963 | 100% | 0 |
| June 30, 2010 | 10,891 | 100% | 0 |

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, 2008 (in thousands):

Safety Plan:

| Actuarial | | | | | | |
|----------------|-----------------------------|-----------------|--------------------|--------------|------------------------|--------------------------------------|
| Valuation Date | Entry Age Accrued Liability | Value of Assets | Unfunded Liability | Funded Ratio | Annual Covered Payroll | Unfunded Liability as a % of Payroll |
| 2006 | \$230,186 | \$202,408 | \$27,778 | 87.9% | \$20,469 | 135.7% |
| 2007 | 242,952 | 216,499 | 26,453 | 89.1% | 20,907 | 126.5% |
| 2008 | 258,964 | 228,883 | 30,081 | 88.4% | 22,181 | 135.6% |

Miscellaneous Plan:

| Actuarial | | | | | | |
|----------------|-----------------------------|-----------------|--------------------|--------------|------------------------|--------------------------------------|
| Valuation Date | Entry Age Accrued Liability | Value of Assets | Unfunded Liability | Funded Ratio | Annual Covered Payroll | Unfunded Liability as a % of Payroll |
| 2006 | \$363,774 | \$311,105 | \$52,669 | 85.5% | \$61,265 | 86.0% |
| 2007 | 408,625 | 350,543 | 58,082 | 85.8% | 61,883 | 93.9% |
| 2008 | 443,337 | 379,837 | 63,500 | 85.7% | 63,934 | 99.3% |

* 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 2010, 2009 and 2008 were \$24 million, \$24 million and \$25.5 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 dependents of retirees equal to 85 percent of the premiums for 2010 and increasing 5 percent per year until the City's share reaches 100 percent of dependent 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 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. For management, fire fighter and fire chief association members who retire on or after January 1, 2006, and for service employees who retire on or after January 1, 2007, the maximum premium amount the City will pay toward health insurance will be equal to the second highest CalPERS Bay Area Basic plan premium (currently the Blue Shield HMO premium).

During FY 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 to apply the provisions of the statement on a prospective basis. The Trust, 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 of 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, 2009, 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 increase. 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. The calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing costs between the City and plan members to that point. 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 open 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, 2010, the City made contributions and drew funds from the Net OPEB asset to fund the current year ARC. 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 (in thousands):

| | |
|--|-------------------------------|
| Annual required contribution | \$9,786 |
| Amortization on the Net OPEB Asset | 2,585 |
| Interest on the Net OPEB Asset | (2,042) |
| Adjustment to annual required contribution | <u>543</u> |
| Annual OPEB Cost | <u>10,329</u> |
| Contributions made: | |
| Contributions to OPEB Trust | 1,700 |
| City portion of current year premiums paid * | 5,519 |
| Contributions less than the ARC | <u>3,110</u> |
| Net OPEB Asset June 30, 2009 | <u>26,352</u> |
| Net OPEB Asset June 30, 2010 | <u><u>\$23,242</u></u> |

Shortly after year end, the City contributed another \$1.8 million to the Trust.

* FY 2010 premiums for 795 retirees.

The Plan's annual required contributions and actual contributions for fiscal years ended June 30, 2008, 2009 and 2010 are set forth below (in thousands):

| Fiscal Year | Annual OPEB Cost | Actual Contribution | Percentage of OPEB Cost | Net OPEB Obligation (Asset) |
|---------------|---------------------|------------------------|-------------------------------|-----------------------------------|
| June 30, 2008 | \$9,313 | \$38,490 | 413% | (\$29,177) |
| June 30, 2009 | 8,729 | 5,904 | 67% | (26,352) |
| June 30, 2010 | 10,329 | 7,219 | 70% | (23,242) |

Notes to Basic Financial Statements – Note 12

The Schedule of Funding Progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. Trend data from the actuarial studies is presented below (in thousands):

| Actuarial Valuation Date | Entry Age Actuarial Accrued Liability | Actuarial Value of Assets | Unfunded Actuarial Accrued Liability | Funded Ratio | Covered Payroll | Unfunded Actuarial Liability as Percentage of Covered Payroll |
|--------------------------|---------------------------------------|---------------------------|--------------------------------------|--------------|-----------------|---|
| January 1, 2007 | \$102,237 | | \$102,237 | 0% | \$97,600 | 104.8% |
| January 1, 2009 | 129,661 | \$24,616 | 105,045 | 18.98% | 98,940 | 106.2% |

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 (in thousands):

| Retiree Health Benefits | 2010 | 2009 |
|---------------------------------------|-----------------|-----------------|
| Net assets, beginning of year | \$26,362 | \$29,756 |
| Interest earnings | 73 | 50 |
| Unrealized gain (loss) on investments | 49 | (202) |
| Interdepartmental charges | 9,698 | 5,785 |
| Compensated benefits | (10,614) | (8,963) |
| Transfers in | (64) | (64) |
| Net assets, end of year | <u>\$25,504</u> | <u>\$26,362</u> |



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 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 \$74 million per occurrence. The City retains the risk for the first \$1 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, 2010, the City contributed \$771 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

Notes to Basic Financial Statements – Note 14

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):

| | Year Ended June 30 | |
|---|--------------------|-----------------|
| | 2010 | 2009 |
| Beginning Balance | \$21,438 | \$23,526 |
| Liability for current and prior fiscal year claims and claims incurred but not reported (IBNR) | 4,385 | 1,987 |
| Claims paid | (4,345) | (4,075) |
| Ending Balance | <u>\$21,478</u> | <u>\$21,438</u> |
| Current Portion | <u>\$6,532</u> | <u>\$5,855</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, 2010, the City incurred expenses totaling \$65.5 million for purchased power and assessments earned by NCPA.

The City's interest in NCPA projects and reserves, as computed by NCPA, was \$3.9 million at June 30, 2010. 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, 2010, is \$101.3 million. The City's participation in this project was 6.2 percent, or \$6.3 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, 2010, the book value of this Project's plant, equipment and other assets was \$426 million, while its long-term debt totaled \$372.7 million and other liabilities totaled \$3.8 million. The City's share of the Project's long-term debt amounted to \$110.7 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 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, 2010, the book value of this Project’s plant, equipment and other assets was \$885 thousand, while its long-term debt totaled zero. The City’s share of the Project’s long-term debt amounted to zero 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 was obligated to pay 4 percent of TANC’s debt-service and operating costs. However, a Resolution was approved authorizing the execution of a Long-Term Layoff Agreement (LTLA) between the Cities of Palo Alto and Roseville. These two agencies desired to “layoff” their entitlement rights to the California-Oregon Transmission Project (COTP) (and Roseville’s South of Tesla entitlement rights) for a period of 15 years to those acquiring Members (Sacramento Municipal Utility District, Turlock Irrigation District, and Modesto Irrigation District). The effective date of this Agreement was February 1, 2009. As a result, the City is obligated to pay zero percent of TANC’s debt-service and operating costs starting February 1, 2009, for a period of fifteen years.

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 \$421.4 million as of June 30, 2010. The City’s share of this debt is zero due to the LTLA mentioned above.

Construction of the COTP was complete as of June 30, 1993. The transmission line was energized March 24, 1993. Because funding of certain 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 zero at June 30, 2010, due to the LTLA mentioned above.

TANC Financial Information

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

Note 16.....

PROPOSITION 1A BORROWING BY THE STATE OF CALIFORNIA AND SECURITIZATION

Under the provisions of Proposition 1A and as part of the fiscal year 2009-10 budget package passed by the California State legislature on July 28, 2009, the State of California borrowed 8 percent of property tax revenue, including those property taxes associated with the in-lieu motor vehicle license fees, triple flip in lieu sales taxes, and supplemental property taxes, apportioned to the City. The State is required to repay the \$2,475,550 it borrowed from the City, plus interest, by June 30, 2013.

Authorized with the 2009-10 State budget package was the Proposition 1A Securitization Program (Program), administered by the California Statewide Communities Development Authority (“California Communities”), a joint powers authority sponsored by the California State Association of Counties and the League of California Cities. Under the Program, the participating cities receive cash equal to their share of State borrowings and forgoes interest they otherwise would have received from the State on the unpaid borrowings. The City is a participant in the Program.

California Communities simultaneously purchased the Proposition 1A receivables from the City and other participants and issued bonds to provide participants with proceeds to be remitted in two equal installments due on January 15, 2010, and May 3, 2010. All costs of issuance and interest were paid by the State of California. Participating local agencies have no obligation on the bonds and no credit exposure to the State. As of June 30, 2010, the City received both installments due under the Program and recorded them as property taxes in the same manner as if the State had not exercised its rights under Proposition 1A. Since sales proceeds to the City equal the book value of State borrowings, no gain or loss was incurred.

Note 17.....

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 on December 31, 2004, upon which the City exercised its first option to extend for 10 years, for a new expiration date of 12/31/2014. The lease provides for two more five-year options to extend, 1/1/2015 to 12/31/2019, and 1/1/2020 to 12/31/2024. The City’s rent for the facilities is \$6.6 million per year plus insurance, repairs and maintenance. Should any new law or regulation require the expenditure of work in excess of \$250,000, per the terms of the lease, the City and PAUSD may renegotiate the lease. 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, 2010, amounted to \$6.6 million.

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

| <u>Year ending June 30:</u> | <u>Payments</u> |
|-----------------------------|-----------------|
| 2011 | \$6,878 |
| 2012 | 7,061 |
| 2013 | 7,273 |
| 2014 | 7,491 |
| 2015 | 7,716 |
| 2016-2020 | 42,183 |
| | <u>\$78,602</u> |

GreenWaste of Palo Alto – As of July 1, 2009, GreenWaste of Palo Alto is the new contractor for waste collection, transportation, and processing services. The new agreement has a term of eight years, until June 30, 2017, with the potential to extend the contract to 2021. Base compensation for GreenWaste is a set amount for the first two years of the contract, and is adjusted annually thereafter based on CPI indicators stipulated in their contract. In FY 2010 this resulted in payments to GreenWaste of \$11.5 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, 2010. 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, 2010, is \$2.6 million. During the year ended June 30, 2010, the City paid \$413.7 thousand as its portion of current debt service.

In FY 2008, the members agreed to finance an Equipment Replacement Project from existing reserves and proceeds from the Solid Waste Revenue Bond, Series 2007. The City has committed to repay 27.8 percent of the remaining debt service on the Bonds. The City’s portion of the Bonds amounts to \$2 million as of June 30, 2010. During the year ended June 30, 2010, the City paid \$127.8 thousand as its portion of current debt service.

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 FY 2010 in conformance with the Council-approved Long-term Electric Acquisition Plan (LEAP) established in 2001 and last modified in March 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 gas utility has a higher average cost of gas for its pool customers in FY 2010 compared to the average market price during the year. The City’s average natural gas commodity cost for the gas pool customers was \$6.72/MMBtu compared to a spot market price of \$4.62/MMBtu. The primary reason the City’s natural gas costs were higher than market was due to a dramatic drop in spot market prices in FY 2009 after gas had been purchased and costs were locked in. The City’s average wholesale electric commodity purchase cost during the fiscal year was approximately 5.1 ¢/kWh while the average spot market prices were approximately 4.1¢/kWh.

Due to the dry hydrologic conditions since 2007, the hydroelectric supplies were at low levels during the year and resulted in the need for the City to purchase replacement power during the year from the market. Hydroelectric production accounted for only 37 percent of the City’s electric supply in FY 2010 instead of 50 percent in a normal hydrologic year. 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 17 percent of the electric supply in FY 2010, 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, and buys and sells electricity within the month as needed to meet the City’s demands.

Incidental sales of surplus energy resulted in revenues of \$1.35 million during the year. (The expense associated with the surplus energy sold from the overall electric supply portfolio was calculated at \$1.44 million during the year, and is shown separately on the Statement of Revenues, Expenses and Changes in Net Assets.)

During FY 2009, the City executed a 15-year assignment of its full share of ownership and obligations in the California Oregon Transmission Project (COTP). The assignment resulted in lower cost to serve the City's electric rate payers in FY 2010 and is projected to continue saving the City throughout the term of the assignment.

The California Independent System Operation (CAISO) is authorized 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, 2010. 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, 2010

| Supplier | FY 2011 | FY 2012 | FY 2013 | Total |
|-----------------------------|---------------|--------------|---------|---------------|
| BP | \$ 2,378,330 | \$ 1,416,800 | \$ - | \$ 3,795,130 |
| Powerex | \$ 4,102,111 | \$ 5,832,103 | \$ - | \$ 9,934,214 |
| Sempra | \$ 2,595,575 | \$ - | \$ - | \$ 2,595,575 |
| SENA | \$ 6,927,618 | \$ 2,635,200 | \$ - | \$ 9,562,818 |
| | \$ 16,003,634 | \$ 9,884,103 | \$ - | \$ 25,887,737 |
| Average Cost (cents/kWh) | 5.49 ¢ | 5.54 ¢ | ¢ | 5.51 ¢ |

Forward Natural Gas Commodity Supply Commitments as of June 30, 2010

| Supplier | FY 2011 | FY 2012 | FY 2013 | Total |
|----------------------------|--------------|--------------|--------------|---------------|
| BP | \$ 2,354,493 | \$ 2,004,405 | \$ - | \$ 4,358,898 |
| Powerex | \$ 568,295 | \$ 768,135 | \$ 774,900 | \$ 2,111,330 |
| Sempra | \$ 1,080,832 | \$ 645,190 | \$ 967,910 | \$ 2,693,932 |
| SENA | \$ 5,832,912 | \$ 4,778,533 | \$ 822,870 | \$ 11,434,315 |
| | \$ 9,836,532 | \$ 8,196,263 | \$ 2,565,680 | \$ 20,598,475 |
| Average Cost (\$/MMBtu) | \$8.14 | \$7.01 | \$6.46 | \$7.42 |

The City's natural gas transportation contract with the Pacific Gas and Electric Company (PG&E) went into effect starting January 1, 2008, and will be in place until the end of 2010. This contract, commonly known as Gas Accord IV, between PG&E and its transportation customers provides the City's retail customers stable transportation costs. This contract is not substantially different from the last agreement that went into effect in 2005. During calendar year 2010, staff has been actively involved with the replacement transportation agreement. As a result of this agreement, the City's backbone transportation cost is projected to increase by about 40 percent beginning on January 1, 2011. Despite this projected cost increase, the City will continue to benefit from its transportation contract with PG&E.

Future Outlook

Electric

The market price for fossil fuel based electricity is projected to be relatively low for the next 12 months – at 4 to 5¢/kWh – but in the longer term it is expected to return to a higher level of 6 to 8¢/kWh. The price premium commanded by renewable energy projects remains significantly higher than “brown” market power. Costs for renewable energy are 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-approved renewable resource supply targets, last updated in March 2007, are to meet 30 percent of the Citywide load with renewable resource supplies by 2012 and 33 percent by 2015. Renewable supplies accounted for approximately 15 percent of supplies during calendar year 2009. Part of the reason that the renewable supplies were lower in 2009 was that the wind supplies were not available for a period of time in 2009. Going forward, the portion of the City’s electricity demand met by renewable supplies is expected to be 19 percent in calendar year 2010 before rising to 20 percent in 2011 and 22 percent in 2012. Council approved two additional renewable energy contracts in FY 2010, which will bring the renewable supply fraction to about 27 percent by 2013, when the two new projects are expected to begin operation. In FY 2010, Council also directed staff to return with a review of the plans and policies regarding the acquisition of energy efficiency and renewable energy.

Energy efficiency is the most cost-effective electric resource available to the City. It is considered a primary resource for the electric utility. Reducing the need for energy and renewable energy supplies are two of the main methods the City plans to employ to achieve the greenhouse gas reduction targets established in the City’s Climate Protection Plan. The City’s first 10-year Electric Energy Efficiency Plan, adopted by Council in 2007, had a goal of reducing the City’s electric needs by 3.5 percent by 2016 by employing energy efficiency measures. For the first three years of the 2007 Plan’s implementation, actual energy savings exceeded the annual goals set in the plan. In May 2010, Council adopted the updated 2010 10-year Electric Energy Efficiency Plan, which more than doubled the energy efficiency goals of the 2007 Plan. The goal for the 2010 Plan is to reduce the City’s electric needs by 7.2 percent by 2020 by employing energy efficiency measures.

PaloAltoGreen, the City’s volunteer green power program, currently accounts for an additional 6 percent of the City’s energy needs from renewable resources. The City also has a program to encourage small-scale ultra-clean distributed generation and co-generation applications within the city, but there have been no applicants for this program. The City is planning to re-evaluate this program to make sure that it provides the proper incentive for customers to build such clean and efficient units at their premises

The CAISO implemented its Market Redesign and Technology Update (MRTU) in April 2009. An underlying component of MRTU is the use of location-specific prices for the scheduling of energy transactions. These locational prices are determined hourly and reflect the marginal costs of meeting demand and resolving congestion on the transmission grid, which adds more uncertainty and volatility to the cost of transmission services for the City.

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 December 2008, the California Air Resources Board (CARB) approved the 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 has a range of GHG reduction actions which include direct regulations, alternative compliance mechanisms, monetary and non-monetary incentives, voluntary actions, market-based mechanisms such as a cap-and-trade system, and an AB 32 cost of implementation fee regulation to fund the program. CARB is tasked with completing the majority of the work in designing the implementation details by December 31, 2010, with most regulations and other initiatives adopted by the start of 2011. One of the first measures to be implemented will be the implementation fee, which is anticipated to start early in FY 2011.

Natural Gas

Long-term market prices for natural gas have fallen to just under \$0.60 per therm from the high prices experienced in the summer of 2008. Increasing U.S. and international demand resulting from economic recovery may put pressure on gas prices in the long term; however, low to moderate gas prices are forecasted for the next year or two. While the gas laddering strategy allows for the use of both fixed-price and capped-price products to hedge the gas utility supply portfolio for deliveries up to 5 years in the future, no supplies to be delivered beyond three years in the future have been purchased. The City also employs asset management strategies to lower overall commodity costs.

In February 2008, Council approved a new plan to implement a voluntary customer program similar to PaloAltoGreen for non-fossil fuel gas supplies. The City continues to search for potential supplies that are priced in a reasonable range for program marketability.

Water

The City's water use during FY 2010 decreased about 5.9 percent from 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 65 percent of what it was in 1975. The drop in usage in FY 2010 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 FY 2010 increased by 8 percent from FY 2009, primarily due to a 15 percent increase in the wholesale water rate in FY 2010.

Water supply costs are expected to continue to trend upward as the SFPUC implements its upgrade to the regional water system facilities, the Water System Improvement Program (WSIP). Costs for the WSIP are expected to be about \$4.6 billion. Estimates for these increased costs have been factored into the City's long-term water supply cost projections.

Palo Alto is a member of the Bay Area Water Supply and Conservation Agency (BAWSCA), which represents all the agencies that buy water on a wholesale basis from San Francisco. 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 expired on June 30, 2009. Each agency, including Palo Alto, has approved a new 25-year Water Supply Agreement with San Francisco effective on July 1, 2009. The new contract contains the same mechanism for cost allocation as in the old contract and the contract has other improvements regarding water quality and fair treatment in water supply emergencies. However, a new supply limitation will require that the BAWSCA agencies work together to reduce long-term demand so that additional diversions from the Tuolumne River are minimized or eliminated.

During FY 2009, the City completed a Recycled Water Facility Plan, which provides more detailed design information on the project to expand the recycled water distribution. After circulating a Draft Mitigated Negative Declaration document for comments, it was determined that additional study would be required to address the water quality of the recycled water, particularly the salinity levels, which would negatively impact plant materials. The City embarked on a single-issue Environmental Impact Report in FY 2010 to address this issue. The environmental documents, which are necessary to compete for grant funding opportunities, are expected to be completed in FY 2011.

Contingent Liabilities

Many of the uncertainties faced by the Utilities Department as an aftermath of the 2000-01 energy crisis have been resolved. The Ninth Circuit Court 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”) 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 Superior Court of Los Angeles in April 2007. In March 2010, the issue was resolved in a settlement agreement and the City made a payment to the California Parties and no further claims are expected. On April 29, 2010 the FERC issued an order approving the settlement between NCPA and the California Parties. Another dispute between the Western Area Power Administration and PG&E regarding PG&E’s claim to recover certain CAISO related costs has 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, 2010, 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 administering 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.



Non-Major Governmental Funds

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.

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.

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.

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City of Palo Alto - Non- Major Governmental Funds

Combining Balance Sheets- June 30, 2010

(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 | \$945 | \$205 | \$5,902 | \$1,034 | \$4,402 | \$202 |
| Cash and investments with fiscal agent | | | | | | |
| Receivables: | | | | | | |
| Accounts | 100 | 219 | | | | 25 |
| Interest | 13 | | 45 | 7 | 36 | 1 |
| Notes | | 4,383 | 3,431 | | | |
| | | | | | | |
| Total Assets | <u>\$1,058</u> | <u>\$4,807</u> | <u>\$9,378</u> | <u>\$1,041</u> | <u>\$4,438</u> | <u>\$228</u> |
| LIABILITIES | | | | | | |
| Accounts payable | | \$104 | \$218 | | | \$11 |
| | | | | | | |
| Total Liabilities | | <u>104</u> | <u>218</u> | | | <u>11</u> |
| FUND EQUITY | | | | | | |
| Reserved for: | | | | | | |
| Encumbrances | | 142 | 35 | \$6 | | 23 |
| Notes receivable | | 4,383 | 3,431 | | | |
| Debt service | | | | | | |
| Unreserved, designated for: | | | | | | |
| Special Revenue Funds | | | | | | |
| Unrealized gain on investments | \$68 | | 244 | 39 | \$193 | 9 |
| Special revenue projects | | | 5,450 | 996 | 4,245 | 185 |
| Special revenue reappropriations | 460 | | | | | |
| Unreserved, undesignated: | | | | | | |
| Permanent Fund | | | | | | |
| Special Revenue Funds | 530 | 178 | | | | |
| | | | | | | |
| Total Fund Balances | <u>1,058</u> | <u>4,703</u> | <u>9,160</u> | <u>1,041</u> | <u>4,438</u> | <u>217</u> |
| | | | | | | |
| Total Liabilities and Fund Balances | <u>\$1,058</u> | <u>\$4,807</u> | <u>\$9,378</u> | <u>\$1,041</u> | <u>\$4,438</u> | <u>\$228</u> |



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| 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 |
| | \$5,072 | | \$32 | \$688 | \$3 350 | \$238 |
| | 41 | | | 10 | | |
| | <u>\$5,113</u> | | <u>\$32</u> | <u>\$698</u> | <u>\$353</u> | <u>\$238</u> |
| | | | | | | |
| | | | \$10 | \$698 | \$353 | \$238 |
| | \$217 | | | | | |
| | 4,896 | | 22 | | | |
| | 5,113 | | 32 | 698 | 353 | 238 |
| | <u>\$5,113</u> | | <u>\$32</u> | <u>\$698</u> | <u>\$353</u> | <u>\$238</u> |

(Continued)

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City of Palo Alto - Non- Major Governmental Funds

Combining Balance Sheets- June 30, 2010

(In thousands of dollars)

| | PERMANENT FUND | |
|--|-------------------|---|
| | Eyerly Family | Total Non-major Governmental Funds |
| ASSETS | | |
| Cash and investments: | | |
| Available for operations | \$1,405 | \$19,202 |
| Cash and investments with fiscal agent | | 1,276 |
| Receivables: | | |
| Accounts | | 344 |
| Interest | 12 | 165 |
| Notes | | 7,814 |
| | <u>1,417</u> | <u>28,801</u> |
| Total Assets | <u>\$1,417</u> | <u>\$28,801</u> |
| LIABILITIES | | |
| Accounts payable | <u>\$15</u> | <u>\$348</u> |
| Total Liabilities | <u>15</u> | <u>348</u> |
| FUND EQUITY | | |
| Reserved for: | | |
| Encumbrances | | 216 |
| Notes receivable | | 7,814 |
| Debt service | | 1,289 |
| Unreserved, designated for: | | |
| Special Revenue Funds | | |
| Unrealized gain on investments | | 770 |
| Special revenue projects | | 10,876 |
| Special revenue reappropriations | | 460 |
| Unreserved, undesignated: | | |
| Permanent Fund | 1,402 | 1,402 |
| Special Revenue Funds | | 5,626 |
| | <u>1,402</u> | <u>28,453</u> |
| | <u>\$1,417</u> | <u>\$28,801</u> |



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City of Palo Alto - Non- Major Governmental Funds

Combining Statement of Revenues, Expenditures and

Changes in Fund Balances -

For the Year Ended June 30, 2010

(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 | \$1,062 | | | \$32 | \$47 | |
| Charges for services | | | | | 80 | |
| From other agencies: | | | | | | |
| Community Development Block Grant | | \$621 | | | | |
| State of California | | | | | | \$138 |
| Other revenue from other agencies | | 143 | \$4 | | | |
| Permits and licenses | | | | 267 | | |
| Return on investment | 81 | 12 | 263 | 40 | 232 | 11 |
| Rental income | | | 16 | | | |
| Other: | | | | | | |
| Housing In-Lieu - residential | | | 1,900 | | | |
| University Avenue Parking | | | | 885 | | |
| California Avenue Parking | | | | 104 | | |
| Other fees | | | 21 | | | |
| Total Revenues | 1,143 | 776 | 2,204 | 1,328 | 359 | 149 |
| EXPENDITURES | | | | | | |
| Current: | | | | | | |
| Planning and Community Environment | | 509 | 368 | 44 | | |
| Public Safety - Police | | | | | | 113 |
| Non Departmental | | 27 | 31 | | | |
| Debt service: | | | | | | |
| Principal retirement | | | | | | |
| Interest and fiscal charges | | | | | | |
| Total Expenditures | | 536 | 399 | 44 | | 113 |
| EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES | | | | | | |
| | 1,143 | 240 | 1,805 | 1,284 | 359 | 36 |
| OTHER FINANCING SOURCES (USES) | | | | | | |
| Transfers in | 50 | | | 53 | | |
| Transfers (out) | (1,607) | | | (1,156) | (82) | |
| Total Other Financing Sources (Uses) | (1,557) | | | (1,103) | (82) | |
| Net Change in Fund Balance | (414) | 240 | 1,805 | 181 | 277 | 36 |
| Fund balances at the beginning of year | 1,472 | 4,463 | 7,355 | 860 | 4,161 | 181 |
| Fund balances at end of year | \$1,058 | \$4,703 | \$9,160 | \$1,041 | \$4,438 | \$217 |



| 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 |
| | | | \$14 | | | |
| | \$222 | | 4 | \$10 | | |
| | 577 | | | | | |
| | 799 | | 18 | 10 | | |
| | | | 94 | | | |
| | | | | 355 207 | \$380 46 | \$105 129 |
| | | | 94 | 562 | 426 | 234 |
| | 799 | | (76) | (552) | (426) | (234) |
| | 249 | \$6 (6) | | 449 | 413 | 227 |
| | 249 | | | 449 | 413 | 227 |
| | 1,048 | | (76) | (103) | (13) | (7) |
| | 4,065 | | 108 | 801 | 366 | 245 |
| | \$5,113 | | \$32 | \$698 | \$353 | \$238 |

(Continued)

City of Palo Alto - Non- Major Governmental Funds

Combining Statement of Revenues, Expenditures and

Changes in Fund Balances -

For the Year Ended June 30, 2010

(In thousands of dollars)

| | PERMANENT FUND | |
|--|-------------------|---|
| | Eyerly Family | Total Non-major Governmental Funds |
| REVENUES | | |
| Special assessments | | \$14 |
| Other taxes and fines | | 1,141 |
| Charges for services | | 80 |
| From other agencies: | | |
| Community Development Block Grant | | 621 |
| State of California | | 138 |
| Other revenue from other agencies | | 147 |
| Permits and licenses | | 267 |
| Return on investment | \$76 | 951 |
| Rental income | | 16 |
| Other: | | |
| Housing In-Lieu - residential | | 1,900 |
| University Avenue Parking | | 885 |
| California Avenue Parking | | 104 |
| Other fees | 34 | 632 |
| | <u>110</u> | <u>6,896</u> |
| Total Revenues | | |
| EXPENDITURES | | |
| Current: | | |
| Planning and Community Environment | | 921 |
| Public Safety - Police | | 113 |
| Non Departmental | 16 | 168 |
| Debt service: | | |
| Principal retirement | | 840 |
| Interest and fiscal charges | | 382 |
| | <u>16</u> | <u>2,424</u> |
| Total Expenditures | | |
| EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES | <u>94</u> | <u>4,472</u> |
| OTHER FINANCING SOURCES (USES) | | |
| Transfers in | | 1,447 |
| Transfers (out) | | (2,851) |
| | | <u>(1,404)</u> |
| Total Other Financing Sources (Uses) | | |
| Net Change in Fund Balance | 94 | 3,068 |
| Fund balances at the beginning of year | 1,308 | 25,385 |
| Fund balances at end of year | <u>\$1,402</u> | <u>\$28,453</u> |

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City of Palo Alto - Non- major Governmental Funds
Combining Statement of Revenues, Expenditures and
Changes in Fund Balances - Budget and Actual

For the Year Ended June 30, 2010

(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 | \$1,128 | \$1,062 | (\$66) | | | |
| Charges for services | | | | | | |
| From other agencies: | | | | | | |
| Community Development Block Grant | | | | \$656 | \$621 | (\$35) |
| State of California | | | | | | |
| Other revenue from other agencies | | | | 140 | 143 | 3 |
| Permits and licenses | | | | | | |
| Return on investment | 5 | 81 | 76 | | 12 | 12 |
| Rental income | | | | | | |
| Other: | | | | | | |
| Housing In-Lieu - residential | | | | | | |
| Housing In-Lieu - commercial | | | | | | |
| University Avenue Parking | | | | | | |
| California Avenue Parking | | | | | | |
| Other fees | | | | 7 | | (7) |
| Total Revenues | <u>1,133</u> | <u>1,143</u> | <u>10</u> | <u>803</u> | <u>776</u> | <u>(27)</u> |
| EXPENDITURES | | | | | | |
| Current operations: | | | | | | |
| Planning and Community Environment | | | | 1,877 | 509 | 1,368 |
| Public Safety - Police | | | | | | |
| Non Departmental | | | | | 27 | (27) |
| Debt service: | | | | | | |
| Principal retirement | | | | | | |
| Interest and fiscal charges | | | | | | |
| Total Expenditures | | | | <u>1,877</u> | <u>536</u> | <u>1,341</u> |
| EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES | <u>1,133</u> | <u>1,143</u> | <u>10</u> | <u>(1,074)</u> | <u>240</u> | <u>1,314</u> |
| OTHER FINANCING SOURCES (USES) | | | | | | |
| Transfers in | 50 | 50 | | 5 | | (5) |
| Transfers (out) | (1,042) | (1,607) | (565) | (5) | | 5 |
| Total Other Financing Sources (Uses) | <u>(992)</u> | <u>(1,557)</u> | <u>(565)</u> | | | |
| Net Change in Fund Balance | <u>\$141</u> | <u>(414)</u> | <u>(\$555)</u> | <u>(\$1,074)</u> | <u>240</u> | <u>\$1,314</u> |
| Fund balances at the beginning of year | | <u>1,472</u> | | | <u>4,463</u> | |
| Fund balances at end of year | | <u>\$1,058</u> | | | <u>\$4,703</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) |
| | | | \$32 | \$32 | | \$82 | \$47 80 | \$47 (2) |
| \$1,000 | \$4 | (\$1,000) 4 | 226 | 267 | \$41 | | | |
| 165 | 263 | 98 | 28 | 40 | 12 | 90 | 232 | 142 |
| 5 | 16 | 11 | | | | | | |
| 450 | 1,900 | 1,450 | 817 | 885 | 68 | 480 | | (480) |
| 300 | | (300) | 94 | 104 | 10 | | | |
| 542 | 21 | (521) | | | | | | |
| 2,462 | 2,204 | (258) | 1,197 | 1,328 | 131 | 652 | 359 | (293) |
| 2,115 | 368 | 1,747 | 47 | 44 | 3 | | | |
| 633 | 31 | 602 | | | | | | |
| 2,748 | 399 | 2,349 | 47 | 44 | 3 | | | |
| (286) | 1,805 | 2,091 | 1,150 | 1,284 | 134 | 652 | 359 | (293) |
| | | | 53 | 53 | | (82) | (82) | |
| | | | (1,331) | (1,156) | 175 | | | |
| | | | (1,278) | (1,103) | 175 | (82) | (82) | |
| (\$286) | 1,805 | \$2,091 | (\$128) | 181 | \$309 | \$570 | 277 | (\$293) |
| | 7,355 | | | 860 | | | 4,161 | |
| | \$9,160 | | | \$1,041 | | | \$4,438 | |

(Continued)

City of Palo Alto - Non- major Governmental Funds
Combining Statement of Revenues, Expenditures and
Changes in Fund Balances - Budget and Actual
For the Year Ended June 30, 2010
(In thousands of dollars)

| | SPECIAL REVENUE FUNDS | | | | | |
|--|-----------------------|--------|------------------------------------|------------------------|---------|------------------------------------|
| | Local Law Enforcement | | | Developer's Impact Fee | | |
| | 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 | \$100 | \$138 | \$38 | | | |
| Other revenue from other agencies | | | | | | |
| Permits and licenses | | | | | | |
| Return on investment | 6 | 11 | 5 | \$195 | \$222 | \$27 |
| Rental income | | | | | | |
| Other: | | | | | | |
| Housing In-Lieu - residential | | | | | | |
| Housing In-Lieu - commercial | | | | | | |
| University Avenue Parking | | | | | | |
| California Avenue Parking | | | | | | |
| Other fees | | | | 553 | 577 | 24 |
| Total Revenues | 106 | 149 | 43 | 748 | 799 | 51 |
| EXPENDITURES | | | | | | |
| Current operations: | | | | | | |
| Planning and Community Environment | | | | | | |
| Public Safety - Police | 132 | 113 | 19 | | | |
| Non Departmental | | | | | | |
| Debt service: | | | | | | |
| Principal retirement | | | | | | |
| Interest and fiscal charges | | | | | | |
| Total Expenditures | 132 | 113 | 19 | | | |
| EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES | (26) | 36 | 62 | 748 | 799 | 51 |
| OTHER FINANCING SOURCES (USES) | | | | | | |
| Transfers in | | | | 249 | 249 | |
| Transfers (out) | | | | | | |
| Total Other Financing Sources (Uses) | | | | 249 | 249 | |
| Net Change in Fund Balance | (\$26) | 36 | \$62 | \$997 | 1,048 | \$51 |
| Fund balances at the beginning of year | | 181 | | | 4,065 | |
| Fund balances at end of year | | \$217 | | | \$5,113 | |



| SPECIAL REVENUE FUNDS | | | | | | DEBT SERVICE FUNDS | | |
|-----------------------|--------|------------------------------|--|--------|------------------------------|--------------------|--------|------------------------------|
| Redevelopment Agency | | | Downtown Business Improvement District | | | Golf Course | | |
| Budget | Actual | Variance Positive (Negative) | Budget | Actual | Variance Positive (Negative) | Budget | Actual | Variance Positive (Negative) |
| | | | \$160 | \$14 | (\$146) | | | |
| | | | 2 | 4 | 2 | \$32 | \$10 | (\$22) |
| | | | 162 | 18 | (144) | 32 | 10 | (22) |
| | | | 165 | 94 | 71 | | | |
| | | | | | | 355 | 355 | |
| | | | | | | 206 | 207 | (1) |
| | | | 165 | 94 | 71 | 561 | 562 | (1) |
| | | | (3) | (76) | (73) | (529) | (552) | (23) |
| \$9 | \$6 | (\$3) | | | | 430 | 449 | 19 |
| (9) | (6) | 3 | | | | | | |
| | | | | | | 430 | 449 | 19 |
| | | | (\$3) | (76) | (\$73) | (\$99) | (103) | (\$4) |
| | | | | 108 | | | 801 | |
| | | | | \$32 | | | \$698 | |

(Continued)

City of Palo Alto - Non- major Governmental Funds
Combining Statement of Revenues, Expenditures and
Changes in Fund Balances - Budget and Actual
For the Year Ended June 30, 2010
(In thousands of dollars)

| | DEBT SERVICE FUNDS | | | | | |
|--|------------------------|--------|------------------------------------|------------------------------|--------|------------------------------------|
| | Civic Center Refinance | | | Downtown Parking Improvement | | |
| | 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 | | | | | | |
| Permits and licenses | | | | | | |
| Return on investment | \$13 | | (\$13) | \$9 | | (\$9) |
| Rental income | | | | | | |
| Other: | | | | | | |
| Housing In-Lieu - residential | | | | | | |
| Housing In-Lieu - commercial | | | | | | |
| University Avenue Parking | | | | | | |
| California Avenue Parking | | | | | | |
| Other fees | | | | | | |
| Total Revenues | 13 | | (13) | 9 | | (9) |
| EXPENDITURES | | | | | | |
| Current operations: | | | | | | |
| Planning and Community Environment | | | | | | |
| Public Safety - Police | | | | | | |
| Non Departmental | | | | | | |
| Debt service: | | | | | | |
| Principal retirement | 380 | \$380 | | 105 | \$105 | |
| Interest and fiscal charges | 46 | 46 | | 129 | 129 | |
| Total Expenditures | 426 | 426 | | 234 | 234 | |
| EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES | (413) | (426) | (13) | (225) | (234) | (9) |
| OTHER FINANCING SOURCES (USES) | | | | | | |
| Transfers in | 413 | 413 | | 225 | 227 | 2 |
| Transfers (out) | | | | | | |
| Total Other Financing Sources (Uses) | 413 | 413 | | 225 | 227 | 2 |
| Net Change in Fund Balance | | (13) | (\$13) | | (7) | (\$7) |
| Fund balances at the beginning of year | | 366 | | | 245 | |
| Fund balances at end of year | | \$353 | | | \$238 | |



| PERMANENT FUND | | | TOTAL | | |
|----------------|---------|------------------------------|------------------------------|----------|------------------------------|
| Eyerly Family | | | Non-major Governmental Funds | | |
| Budget | Actual | Variance Positive (Negative) | Budget | Actual | Variance Positive (Negative) |
| | | | \$160 | \$14 | (\$146) |
| | | | 1,160 | 1,141 | (19) |
| | | | 82 | 80 | (2) |
| | | | 656 | 621 | (35) |
| | | | 1,100 | 138 | (962) |
| | | | 140 | 147 | 7 |
| | | | 226 | 267 | 41 |
| \$33 | \$76 | \$43 | 578 | 951 | 373 |
| | | | 5 | 16 | 11 |
| | | | 450 | 1,900 | 1,450 |
| | | | 300 | | (300) |
| | | | 1,297 | 885 | (412) |
| | | | 94 | 104 | 10 |
| | 34 | 34 | 1,102 | 632 | (470) |
| 33 | 110 | 77 | 7,350 | 6,896 | (454) |
| | | | 4,039 | 921 | 3,118 |
| | | | 132 | 113 | 19 |
| | 16 | (16) | 798 | 168 | 630 |
| | | | 840 | 840 | |
| | | | 381 | 382 | (1) |
| | 16 | (16) | 6,190 | 2,424 | 3,766 |
| 33 | 94 | 61 | 1,160 | 4,472 | 3,312 |
| | | | 1,434 | 1,447 | 13 |
| | | | (2,469) | (2,851) | (382) |
| | | | (1,035) | (1,404) | (369) |
| \$33 | 94 | \$61 | \$125 | 3,068 | \$2,943 |
| | 1,308 | | | 25,385 | |
| | \$1,402 | | | \$28,453 | |

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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

This fund accounts for the administration of compensated absences and health benefits.

WORKERS' COMPENSATION INSURANCE PROGRAM

This fund accounts for the administration of the City's self-insured workers' compensation programs.

GENERAL LIABILITIES INSURANCE PROGRAM

This fund accounts for the administration of the City's self-insured general liability programs.

RETIREE HEALTH BENEFIT

This fund accounts for the retiree health benefits.

City of Palo Alto - Internal Service Funds

Combining Statements of Net Assets - June 30, 2010
(In thousands of dollars)

| | Vehicle Replacement and Maintenance | Technology | Printing and Mailing Services | General Benefits | Workers' Compensation Insurance Program |
|---|--|------------|--|---------------------|--|
| ASSETS | | | | | |
| Current Assets: | | | | | |
| Cash and investments available for operations | \$5,775 | \$10,969 | \$21 | \$12,941 | \$15,506 |
| Accounts receivable, net | 38 | | | | |
| Interest receivable | 46 | 90 | | 256 | |
| Inventory of materials and supplies | 457 | | | | |
| Net OPEB assets | | | | | |
| Total Current Assets | 6,316 | 11,059 | 21 | 13,197 | 15,506 |
| Noncurrent Assets: | | | | | |
| Capital assets, nondepreciable | 637 | | | | |
| Capital assets, net of depreciation | 12,654 | 9,039 | 15 | | |
| Total Noncurrent Assets | 13,291 | 9,039 | 15 | | |
| Total Assets | 19,607 | 20,098 | 36 | 13,197 | 15,506 |
| LIABILITIES | | | | | |
| Current Liabilities: | | | | | |
| Accounts payable and accrued liabilities | 35 | 564 | | 1,841 | 59 |
| Accrued salaries and benefits | 33 | 106 | 5 | 405 | |
| Accrued compensated absences | | | | 4,095 | |
| Accrued claims payable - current | | | | 332 | 3,524 |
| Total Current Liabilities | 68 | 670 | 5 | 6,673 | 3,583 |
| Long-term Liabilities: | | | | | |
| Accrued compensated absences | | | | 6,324 | |
| Accrued claims payable | | | | | 11,823 |
| Total Long-term Liabilities | | | | 6,324 | 11,823 |
| Total Liabilities | 68 | 670 | 5 | 12,997 | 15,406 |
| NET ASSETS | | | | | |
| Investment in capital assets | 13,291 | 9,039 | 15 | | |
| Unrestricted | 6,248 | 10,389 | 16 | 200 | 100 |
| Total Net Assets | \$19,539 | \$19,428 | \$31 | \$200 | \$100 |

.....

| General Liabilities Insurance Program | Retiree Health Benefit | Total |
|--|------------------------------|-----------------|
| \$5,906 | \$2,252 | \$53,370 |
| | | 38 |
| | 10 | 402 |
| | | 457 |
| | 23,242 | 23,242 |
| <u>5,906</u> | <u>25,504</u> | <u>77,509</u> |
| | | 637 |
| | | <u>21,708</u> |
| | | 22,345 |
| <u>5,906</u> | <u>25,504</u> | <u>99,854</u> |
| | | 7 |
| | | 2,506 |
| | | 549 |
| | | 4,095 |
| <u>2,676</u> | | <u>6,532</u> |
| <u>2,683</u> | | <u>13,682</u> |
| | | 6,324 |
| <u>3,123</u> | | <u>14,946</u> |
| <u>3,123</u> | | <u>21,270</u> |
| <u>5,806</u> | | <u>34,952</u> |
| | | 22,345 |
| <u>100</u> | <u>25,504</u> | <u>42,557</u> |
| <u>\$100</u> | <u>\$25,504</u> | <u>\$64,902</u> |

.....

City of Palo Alto - Internal Service Funds

Combining Statement of Revenues, Expenses and

Changes in Net Assets - For the Year Ended June 30, 2010

(In thousands of dollars)

| | Vehicle Replacement and Maintenance | Technology | Printing and Mailing Services | General Benefits | Workers' Compensation Insurance Program |
|--|--|------------|--|---------------------|--|
| OPERATING REVENUES | | | | | |
| Charges for services | \$6,847 | \$10,093 | \$1,401 | \$37,935 | \$573 |
| Total Operating Revenues | 6,847 | 10,093 | 1,401 | 37,935 | 573 |
| OPERATING EXPENSES | | | | | |
| Administration and general | 816 | 7,483 | 1,455 | 320 | 521 |
| Operations and maintenance | 524 | 113 | | 14 | |
| Depreciation and amortization | 2,652 | 2,971 | 3 | | |
| Claim payments and change in estimated self-insured liability | | | | 1,695 | 3,207 |
| Refund of charges for services | | | | | |
| Compensated absences and other benefits | 38 | | | 32,319 | |
| Total Operating Expenses | 4,030 | 10,567 | 1,458 | 34,348 | 3,728 |
| Total Operating Income (Loss) | 2,817 | (474) | (57) | 3,587 | (3,155) |
| NONOPERATING REVENUES (EXPENSES) | | | | | |
| Return on investment | 236 | 278 | (6) | 1,253 | |
| Gain (loss) on disposal of capital assets | (95) | | | | |
| Other nonoperating revenues (expense) | 808 | 49 | | | |
| Total Nonoperating Revenues | 949 | 327 | (6) | 1,253 | |
| Income (Loss) Before Transfers | 3,766 | (147) | (63) | 4,840 | (3,155) |
| Transfers in | | 748 | | | |
| Transfers (out) | (27) | (75) | (8) | | |
| Change in Net Assets | 3,739 | 526 | (71) | 4,840 | (3,155) |
| Net assets at beginning of year, as restated | 15,800 | 18,902 | 102 | (4,640) | 3,255 |
| Net assets at end of year | \$19,539 | \$19,428 | \$31 | \$200 | \$100 |



.....

| General Liabilities Insurance Program | Retiree Health Benefit | Total |
|--|------------------------------|----------|
| | \$9,698 | \$66,547 |
| | 9,698 | 66,547 |
| \$1,010 | 569 | 12,174 |
| 45 | | 696 |
| | | 5,626 |
| (423) | | 4,479 |
| 1,134 | | 1,134 |
| | 10,045 | 42,402 |
| 1,766 | 10,614 | 66,511 |
| (1,766) | (916) | 36 |
| | 122 | 1,883 |
| | | (95) |
| | | 857 |
| | 122 | 2,645 |
| (1,766) | (794) | 2,681 |
| | | 748 |
| | (64) | (174) |
| (1,766) | (858) | 3,255 |
| 1,866 | 26,362 | 61,647 |
| \$100 | \$25,504 | \$64,902 |

.....

City of Palo Alto - Internal Service Funds

Combining Statement of Cash Flows - For the Fiscal Year Ended June 30, 2010

(In thousands of dollars)

| | Vehicle Replacement and Maintenance | Technology | Printing and Mailing Services | General Benefits | Workers' Compensation Insurance Program |
|---|--|------------|--|---------------------|--|
| CASH FLOW FROM OPERATING ACTIVITIES | | | | | |
| Receipts from customers | \$6,837 | \$10,093 | \$1,401 | \$37,935 | \$573 |
| Refunds to customers | | | | | |
| Payments to suppliers | (1,855) | | | | |
| Payments to employees | (848) | (7,835) | (1,459) | (34,047) | (526) |
| Claims paid | | | | (1,701) | (2,389) |
| Other receipts | 808 | 49 | | | |
| Net cash provided by operating activities | 4,942 | 2,307 | (58) | 2,187 | (2,342) |
| CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES | | | | | |
| Transfers in | | 748 | | | |
| Transfers (out) | (27) | (75) | (8) | | |
| Cash flows from noncapital financing activities | (27) | 673 | (8) | | |
| CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES | | | | | |
| Acquisition and construction of capital assets | (3,826) | (1,474) | | | |
| Cash flows from capital financing activities | (3,826) | (1,474) | | | |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | | |
| Interest and dividends on pooled investments | 244 | 350 | (6) | 1,370 | |
| Net Cash Flows | 1,333 | 1,856 | (72) | 3,557 | (2,342) |
| Cash and investments at beginning of year, as restated | 4,442 | 9,113 | 93 | 9,384 | 17,848 |
| Cash and investments at end of year | \$5,775 | \$10,969 | \$21 | \$12,941 | \$15,506 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | | |
| Operating income (loss) | \$2,817 | (\$474) | (\$57) | \$3,587 | (\$3,155) |
| Adjustments to reconcile operating income (loss) to cash flows from operating activities: | | | | | |
| Depreciation and amortization | 2,652 | 2,971 | 3 | | |
| Other | 808 | 49 | | | |
| Changes in assets and liabilities: | | | | | |
| Accounts receivable | (10) | | | | |
| Inventory of materials and supplies | 10 | | | | |
| Prepaid items | | | | | |
| Accounts and other payables | (1,335) | (239) | (4) | (1,435) | (5) |
| Accrued compensated absences | | | | 41 | |
| Accrued claims payable | | | | (6) | 818 |
| Net cash provided by operating activities | \$4,942 | \$2,307 | (\$58) | \$2,187 | (\$2,342) |

.....

| General Liabilities Insurance Program | Retiree Health Benefit | Total |
|--|------------------------------|-----------------|
| | \$9,698 | \$66,537 |
| (\$1,134) | | (1,134) |
| | | (1,855) |
| (1,054) | (7,504) | (53,273) |
| (349) | | (4,439) |
| | | 857 |
| <u>(2,537)</u> | <u>2,194</u> | <u>6,693</u> |
| | | 748 |
| | (64) | (174) |
| | (64) | 574 |
| | | (5,300) |
| | | (5,300) |
| | 113 | 2,071 |
| (2,537) | 2,243 | 4,038 |
| 8,443 | 9 | 49,332 |
| <u>\$5,906</u> | <u>\$2,252</u> | <u>\$53,370</u> |
| | | \$36 |
| | (\$916) | 5,626 |
| | | 857 |
| | | (10) |
| | | 10 |
| | 3,110 | 3,110 |
| 1 | | (3,017) |
| | | 41 |
| (772) | | 40 |
| <u>(\$2,537)</u> | <u>\$2,194</u> | <u>\$6,693</u> |

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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, 2010
(In thousands of dollars)

| | Balance June 30, 2009 | Additions | Reductions | Balance June 30, 2010 |
|---|--------------------------|-----------|------------|--------------------------|
| <hr/> California Avenue Parking Assessment District <hr/> | | | | |
| ASSETS | | | | |
| Cash and investments available for operations | \$238 | | \$18 | \$220 |
| LIABILITIES | | | | |
| Due to bondholders | \$238 | | \$18 | \$220 |
| <hr/> Cable Joint Powers Authority <hr/> | | | | |
| ASSETS | | | | |
| Cash and investments available for operations | \$868 | \$17 | | \$885 |
| Interest receivable | 9 | | \$1 | 8 |
| Total assets | \$877 | \$17 | \$1 | \$893 |
| LIABILITIES | | | | |
| Due to other governments | \$877 | \$17 | \$1 | \$893 |
| <hr/> University Avenue Area Parking Assessment District <hr/> | | | | |
| ASSETS | | | | |
| Cash and investments available for operations | \$2,096 | \$234 | | \$2,330 |
| Cash and investments with fiscal agents | 3,966 | | \$64 | 3,902 |
| Interest receivable | 33 | | 4 | 29 |
| Total assets | \$6,095 | \$234 | \$68 | \$6,261 |
| LIABILITIES | | | | |
| Due to bondholders | \$6,095 | \$234 | \$68 | \$6,261 |
| <hr/> Total Agency Funds <hr/> | | | | |
| ASSETS | | | | |
| Cash and investments available for operations | \$3,202 | \$251 | \$18 | \$3,435 |
| Cash and investments with fiscal agents | 3,966 | | 64 | 3,902 |
| Interest receivable | 42 | | 5 | 37 |
| Total assets | \$7,210 | \$251 | \$87 | \$7,374 |
| LIABILITIES | | | | |
| Due to bondholders | \$6,333 | \$234 | \$86 | \$6,481 |
| Due to other governments | 877 | 17 | 1 | 893 |
| Total liabilities | \$7,210 | \$251 | \$87 | \$7,374 |

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
7. Assessed Valuation and Parcels by Land Use
8. Assessed Valuation of Single Family Residential Parcels

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:

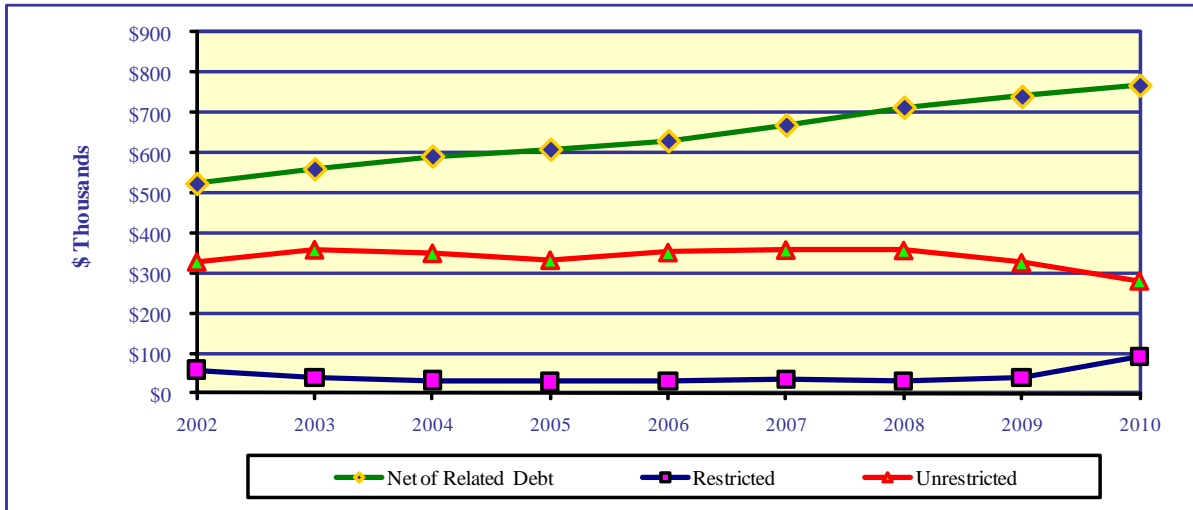
1. Full-Time Equivalent City Government Employees by Function
2. Operating Indicators by Function/Program
3. Capital Asset Statistics by Function/Program
4. Insurance Coverage

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 Nine Fiscal Years (\$000)
(Accrual Basis of Accounting)



| | Fiscal Year Ended June 30, | | | | | | | | |
|--|-----------------------------------|------------------|------------------|------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
| Governmental activities | | | | | | | | | |
| Invested in capital assets, net of related debt | \$252,183 | \$279,306 | \$297,125 | \$305,225 | \$311,335 | \$326,411 | \$343,537 | \$356,657 | \$369,499 |
| Restricted | 56,785 | 37,112 | 30,417 | 27,273 | 29,885 | 32,576 | 27,428 | 36,632 | 88,434 |
| Unrestricted | 117,113 | 130,463 | 123,762 | 117,301 | 123,823 | 127,190 | 130,460 | 118,133 | 48,087 |
| Total governmental activities net assets | \$426,081 | \$446,881 | \$451,304 | \$449,799 | \$465,043 | \$486,177 | \$501,425 | \$511,422 | \$506,020 |
| 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 | \$384,313 | \$399,317 |
| Restricted | 1,728 | 1,728 | 1,798 | 1,750 | 1,732 | 1,732 | 1,732 | 1,732 | 4,300 |
| Unrestricted | 210,990 | 228,308 | 226,278 | 215,128 | 228,032 | 230,912 | 226,539 | 208,025 | 232,417 |
| Total business-type activities net assets | \$483,340 | \$509,921 | \$522,273 | \$520,351 | \$548,502 | \$575,566 | \$598,574 | \$594,070 | \$636,034 |
| Primary government | | | | | | | | | |
| Invested in capital assets, net of related debt | \$522,805 | \$559,191 | \$591,322 | \$608,698 | \$630,073 | \$669,333 | \$713,840 | \$740,970 | \$768,816 |
| Restricted | 58,513 | 38,840 | 32,215 | 29,023 | 31,617 | 34,308 | 29,160 | 38,364 | 92,734 |
| Unrestricted | 328,103 | 358,771 | 350,040 | 332,429 | 351,855 | 358,102 | 356,999 | 326,158 | 280,504 |
| Total primary government net assets | \$909,421 | \$956,802 | \$973,577 | \$970,150 | \$1,013,545 | \$1,061,743 | \$1,099,999 | \$1,105,492 | \$1,142,054 |

Source: Annual Financial Statements

Note: 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 Nine Fiscal Years (\$000)
(Accrual Basis of Accounting)**

| | Fiscal Year Ended June 30, | | | | | | | | |
|--|-----------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
| Expenses | | | | | | | | | |
| Governmental Activities: | | | | | | | | | |
| City Council | \$238 | \$234 | \$269 | \$130 | \$141 | \$180 | \$323 | \$394 | \$455 |
| City Manager | 1,765 | 1,565 | 1,663 | 1,725 | 1,563 | 1,760 | 2,273 | 2,085 | 2,399 |
| City Attorney | 2,410 | 2,028 | 2,300 | 2,653 | 2,598 | 2,390 | 2,653 | 2,575 | 2,621 |
| City Clerk | 633 | 598 | 808 | 770 | 945 | 900 | 1,241 | 1,098 | 1,369 |
| City Auditor | 583 | 646 | 668 | 764 | 843 | 838 | 1,379 | 2,053 | 2,601 |
| Administrative Services ** | 10,138 | 9,723 | 6,271 | 6,982 | 6,972 | 6,419 | 15,477 | 17,784 | 17,893 |
| Human Resources | 2,166 | 1,728 | 2,078 | 2,410 | 2,546 | 2,472 | 2,806 | 3,448 | 3,707 |
| Public Works | 15,656 | 13,702 | 14,460 | 16,400 | 17,596 | 16,645 | 18,565 | 21,270 | 18,659 |
| Planning and Community Environment | 7,311 | 7,485 | 8,898 | 10,162 | 9,931 | 12,929 | 16,388 | 12,940 | 12,114 |
| Police | 19,049 | 19,273 | 20,414 | 22,416 | 23,411 | 23,861 | 27,740 | 29,288 | 29,351 |
| Fire | 16,870 | 16,859 | 17,308 | 18,127 | 18,747 | 19,530 | 22,386 | 23,199 | 26,448 |
| Community Services | 19,850 | 19,633 | 20,864 | 17,240 | 17,296 | 15,729 | 17,736 | 19,862 | 17,171 |
| Library | | | | 4,835 | 5,323 | 5,347 | 6,321 | 6,244 | 6,143 |
| Non-Departmental ** | 8,412 | 7,449 | 7,618 | 12,474 | 10,400 | 12,133 | 0 | 0 | 0 |
| Interest on Long Term Debt | 1,094 | 675 | 635 | 693 | 512 | 477 | 438 | 404 | 370 |
| Total Governmental Activities Expenses | \$106,175 | \$101,598 | \$104,254 | \$117,781 | \$118,824 | \$121,610 | \$135,726 | \$142,644 | \$141,301 |
| Business-Type Activities: | | | | | | | | | |
| Water | \$12,722 | \$13,237 | \$16,047 | \$14,969 | \$15,881 | \$16,794 | \$18,842 | \$20,271 | \$21,038 |
| Electric | 98,405 | 73,744 | 73,545 | 73,051 | 91,570 | 99,294 | 108,032 | 122,268 | 107,910 |
| Fiber Optics * | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1,284 | 1,407 |
| Gas | 28,778 | 22,270 | 22,994 | 26,656 | 29,107 | 30,690 | 37,211 | 34,603 | 32,498 |
| Wastewater Collection | 8,489 | 8,712 | 9,203 | 8,907 | 11,005 | 10,085 | 12,023 | 14,875 | 10,697 |
| Wastewater Treatment | 13,287 | 14,312 | 14,868 | 17,457 | 16,747 | 15,901 | 18,902 | 36,896 | 13,466 |
| Refuse | 23,750 | 24,635 | 24,282 | 24,959 | 26,989 | 25,372 | 28,827 | 37,217 | 28,120 |
| Storm Drainage | 2,188 | 2,489 | 2,975 | 3,336 | 2,673 | 2,517 | 3,202 | 2,943 | 2,491 |
| External Services | 349 | 583 | 688 | 760 | 868 | 767 | 984 | 0 | 0 |
| Total Business-Type Activities Expenses | 187,968 | 159,982 | 164,602 | 170,095 | 194,840 | 201,420 | 228,023 | 270,357 | 217,627 |
| Total Primary Government Expenses | \$294,143 | \$261,580 | \$268,856 | \$287,876 | \$313,664 | \$323,030 | \$363,749 | \$413,001 | \$358,928 |
| Program Revenues | | | | | | | | | |
| Governmental Activities: | | | | | | | | | |
| Charges for Services: | | | | | | | | | |
| City Council | | | | | | | | | |
| City Manager | | | | | | | | | |
| City Attorney | | \$92 | \$64 | \$22 | \$22 | \$13 | \$16 | \$12 | \$53 |
| City Clerk | \$1 | 1 | 1 | | 2 | | | | |
| City Auditor | | 1 | | | | | | | |
| Administrative Services | 12 | 406 | 815 | 480 | 627 | 835 | 870 | 726 | 984 |
| Human Resources | | | | | | 11 | | | |
| Public Works | 320 | 1,058 | 260 | 573 | 805 | 968 | 1,310 | 1,169 | 1,258 |
| Planning and Community Environment | 4,062 | 5,119 | 3,074 | 4,090 | 5,509 | 6,267 | 5,498 | 4,704 | 4,813 |
| Police | 3,966 | 3,396 | 4,415 | 3,801 | 4,178 | 4,179 | 4,274 | 3,947 | 4,093 |
| Fire | 7,976 | 7,811 | 7,565 | 8,555 | 9,078 | 9,610 | 9,418 | 10,723 | 10,244 |
| Community Services | 7,793 | 7,537 | 7,846 | 7,592 | 10,803 | 9,128 | 10,314 | 8,522 | 8,729 |
| Library | | | | 133 | 129 | 146 | 176 | 177 | 199 |
| Operating Grants and Contributions | 5,568 | 4,468 | 4,213 | 3,677 | 3,976 | 5,642 | 4,029 | 3,599 | 4,829 |

* Prior to 2009, Fiber Optics was included in Electric

** Beginning in 2008, includes expenditures classified as Non-departmental in prior years (GFOA recommendation)

City of Palo Alto - Changes in Net Assets

Last Eight Fiscal Years (\$000)

(Accrual Basis of Accounting)

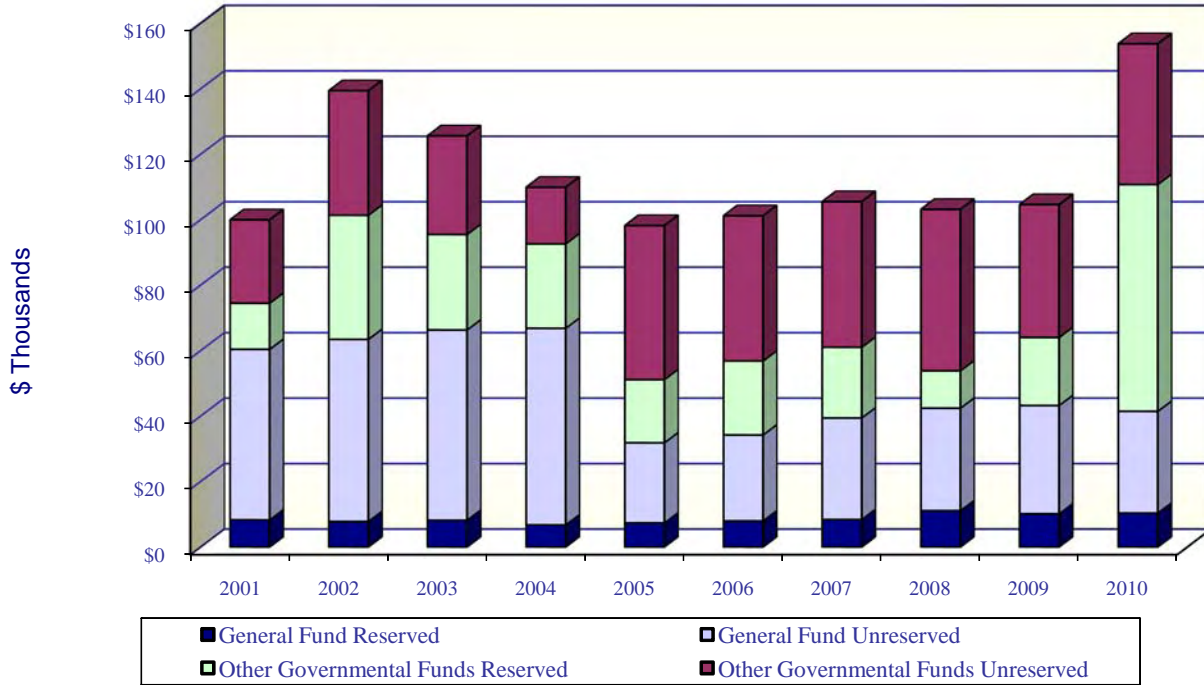
| | Fiscal Year Ended June 30, | | | | | | | | |
|---|-----------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
| Capital Grants and Contributions | 32,380 | 635 | 1,990 | 804 | 3,156 | 1,756 | 1,930 | 3,810 | 1,280 |
| Total Government Activities Program Revenues | 62,078 | 30,524 | 30,243 | 29,727 | 38,285 | 38,555 | 37,835 | 37,389 | 36,482 |
| Business-Type Activities: | | | | | | | | | |
| Charges for Services: | | | | | | | | | |
| Water | 16,034 | 17,654 | 21,993 | 21,041 | 21,108 | 23,495 | 26,510 | 27,120 | 26,259 |
| Electric | 93,755 | 91,622 | 92,617 | 88,737 | 119,418 | 102,549 | 103,833 | 119,320 | 121,900 |
| Fiber Optics * | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 3,336 | 3,105 |
| Gas | 41,658 | 29,714 | 24,839 | 31,206 | 36,977 | 42,221 | 49,021 | 47,838 | 44,450 |
| Wastewater Collection | 9,292 | 10,676 | 12,647 | 12,041 | 13,801 | 14,848 | 15,102 | 14,486 | 15,136 |
| Wastewater Treatment | 13,987 | 13,556 | 14,744 | 15,982 | 18,778 | 16,957 | 22,889 | 28,425 | 16,915 |
| Refuse | 21,777 | 21,691 | 21,923 | 23,387 | 24,795 | 25,532 | 28,805 | 29,101 | 28,568 |
| Storm Drainage | 2,221 | 2,192 | 2,170 | 2,484 | 5,174 | 5,181 | 5,450 | 5,505 | 5,647 |
| External Services | 380 | 605 | 585 | 766 | 854 | 789 | 112 | 0 | 0 |
| Operating Grants and Contributions | | | | | | | | | 0 |
| Capital Grants and Contributions | 185 | | | | | 756 | 1,594 | 639 | 836 |
| Total Business-Type Activities Program Revenue | 199,289 | 187,710 | 191,518 | 195,644 | 240,905 | 232,328 | 253,316 | 275,770 | 262,816 |
| Total Primary Government Program Revenues | ##### | ##### | ##### | ##### | ##### | ##### | ##### | \$313,159 | \$299,298 |
| Net (Expense)/Revenue | | | | | | | | | |
| Governmental Activities | (\$44,097) | (\$71,074) | (\$74,011) | (\$88,054) | (\$80,539) | (\$83,055) | (\$97,891) | (\$105,255) | (\$104,818) |
| Business-Type Activities | 11,321 | 27,728 | 26,916 | 25,549 | 46,065 | 30,908 | 25,293 | 5,413 | 45,192 |
| Total Primary Government Net Expense | (\$32,776) | (\$43,346) | (\$47,095) | (\$62,505) | (\$34,474) | (\$52,147) | (\$72,598) | (\$99,842) | (\$59,626) |
| 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 | \$25,432 | \$25,981 |
| Sales Taxes | 20,085 | 18,041 | 18,151 | 19,308 | 20,315 | 22,194 | 22,623 | 20,089 | 17,991 |
| Utilities Users Taxes | 6,457 | 7,067 | 7,152 | 7,269 | 8,759 | 9,356 | 10,285 | 11,030 | 11,295 |
| Transient Occupancy Tax | 6,615 | 5,333 | 5,489 | 5,686 | 6,393 | 6,709 | 7,976 | 7,111 | 6,858 |
| Other taxes | 6,284 | 7,275 | 8,493 | 5,580 | 7,033 | 6,293 | 6,261 | 3,364 | 4,055 |
| Investment Earnings | 10,589 | 10,213 | 326 | 4,988 | 2,567 | 8,747 | 12,313 | 8,525 | 6,514 |
| Rents and Miscellaneous | 18,524 | 15,333 | 10,165 | 12,997 | 10,440 | 13,670 | 11,896 | 15,682 | 12,729 |
| Transfers | 13,334 | 14,730 | 14,951 | 14,064 | 21,545 | 15,754 | 18,701 | 24,020 | 13,994 |
| Total Government Activities | 95,158 | 91,874 | 78,434 | 86,549 | 95,783 | 104,189 | 113,139 | 115,253 | 99,417 |
| Business-Type Activities: | | | | | | | | | |
| Investment Earnings | 15,620 | 13,583 | 387 | 8,093 | 3,631 | 11,910 | 16,416 | 14,103 | 10,769 |
| Special Item | | | | (21,500) | | | | | |
| Transfers | (13,334) | (14,730) | (14,951) | (14,064) | (21,545) | (15,754) | (18,701) | (24,020) | (13,994) |
| Total Business-Type Activities | 2,286 | (1,147) | (14,564) | (27,471) | (17,914) | (3,844) | (2,285) | (9,917) | (3,225) |
| Total Primary Government | \$97,444 | \$90,727 | \$63,870 | \$59,078 | \$77,869 | ##### | ##### | \$105,336 | \$96,192 |
| Change in Net Assets | | | | | | | | | |
| Governmental Activities | \$51,061 | \$20,800 | \$4,423 | (\$1,505) | \$15,244 | \$21,134 | \$15,248 | \$9,998 | (\$5,401) |
| Business-Type Activities | 13,607 | 26,581 | 12,352 | (1,922) | 28,151 | 27,064 | 23,008 | (4,504) | 41,967 |
| Total Primary Government | \$64,668 | \$47,381 | \$16,775 | (\$3,427) | \$43,395 | \$48,198 | \$38,256 | \$5,494 | \$36,566 |

Source: Annual Financial Statements

* Prior to 2009, Fiber Optics was included in Electric

Note: 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, | | | | | | | | | | |
|---|----------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|------------------|-----|
| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | |
| General Fund | | | | | | | | | | | |
| Reserved | \$8,282 | \$7,780 | \$8,156 | \$6,735 | \$7,332 | \$7,966 | \$8,392 | \$11,102 | \$10,135 | \$10,359 | |
| Unreserved | 52,114 | 55,653 | 58,151 | 60,087 | 24,498 | 26,251 | 31,016 | 31,313 | 33,089 | 31,098 | |
| Total General Fund | <u>\$60,396</u> | <u>\$63,433</u> | <u>\$66,307</u> | <u>\$66,822</u> | <u>\$31,830</u> | <u>\$34,217</u> | <u>\$39,408</u> | <u>\$42,415</u> | <u>\$43,224</u> | <u>\$41,457</u> | (a) |
| All Other Governmental Funds | | | | | | | | | | | |
| Reserved | \$14,086 | \$37,924 | \$29,174 | \$25,790 | \$19,305 | \$22,597 | \$21,614 | \$11,403 | \$20,791 | \$69,300 | |
| Unreserved, reported in: | | | | | | | | | | | |
| Special revenue funds | 7,466 | 18,263 | 7,428 | 6,875 | 7,643 | 7,063 | 10,847 | 15,379 | 14,533 | 17,732 | |
| Capital project funds | 18,005 | 19,772 | 22,705 | 10,419 | 39,431 | 37,315 | 33,646 | 33,947 | 24,760 | 23,868 | |
| Permanent funds | | | | | | | | 731 | 1,308 | 1,402 | |
| Total all other governmental funds | <u>\$39,557</u> | <u>\$75,959</u> | <u>\$59,307</u> | <u>\$43,084</u> | <u>\$66,379</u> | <u>\$66,975</u> | <u>\$66,107</u> | <u>\$61,460</u> | <u>\$61,392</u> | <u>\$112,302</u> | |

Source: Annual Financial Statements

Note: (a) The change in total fund balance for the General fund is explained in the "Management's Discussion and Analysis."

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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, | | | |
|--|----------------------------|-----------------|-------------------|-------------------|
| | 2001 | 2002 | 2003 | 2004 |
| Revenues | | | | |
| Sales tax | \$25,786 | \$20,085 | \$18,041 | \$18,151 |
| Property tax | 12,110 | 13,231 | 13,821 | 13,707 |
| Other taxes | 26,160 | 20,485 | 21,070 | 22,427 |
| Permits and licenses | 12,743 | 2,901 | 3,161 | 2,563 |
| Fines, forfeits and penalties | 1,873 | 2,181 | 2,124 | 2,884 |
| Interest and rentals | 17,432 | 19,547 | 19,981 | 11,480 |
| From other agencies | 2,208 | 3,860 | 3,776 | 4,661 |
| Charges for services | 5,466 | 16,667 | 16,798 | 16,018 |
| Other | 7,590 | 8,580 | 5,095 | 1,681 |
| Total Revenues | 111,368 | 107,537 | 103,867 | 93,572 |
| Expenditures | | | | |
| Administration (1) | 18,557 | 18,235 | 17,521 | 13,862 |
| Public works | 9,522 | 9,549 | 9,858 | 8,031 |
| Planning and community environment | 6,652 | 7,378 | 7,721 | 8,793 |
| Police | 18,306 | 19,047 | 19,719 | 19,962 |
| Fire | 15,973 | 16,722 | 16,841 | 16,891 |
| Community services | 18,469 | 19,499 | 19,793 | 19,934 |
| Library (2) | | | | |
| Non-departmental | 14,487 | 8,259 | 7,442 | 7,598 |
| Special revenue and capital projects | 11,089 | 16,960 | 33,584 | 22,289 |
| Debt service - Principal payments | 1,895 | 465 | 875 | 780 |
| Debt Service - Interest and fiscal fees | 922 | 686 | 696 | 639 |
| Total Expenditures | 115,872 | 116,800 | 134,050 | 118,779 |
| Excess (deficiency) of revenues over (under) expenditures | (4,504) | (9,263) | (30,183) | (25,207) |
| Other Financing Sources (Uses) | | | | |
| Transfers in | 26,150 | 27,389 | 31,402 | 28,632 |
| Transfers (out) | (14,487) | (14,444) | (16,603) | (19,133) |
| Contribution from assessment district | 4,112 | 31,823 | 425 | |
| Proceeds from long term debt | | 7,055 | | |
| Payments to refunded bond escrow | (705) | (3,820) | | |
| Total other financing sources (uses) | 15,070 | 48,003 | 15,224 | 9,499 |
| Net Change in fund balances | \$10,566 | \$38,740 | (\$14,959) | (\$15,708) |

Debt service as a percentage of noncapital expenditures (a) 1.1% 1.6% 1.5%

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,

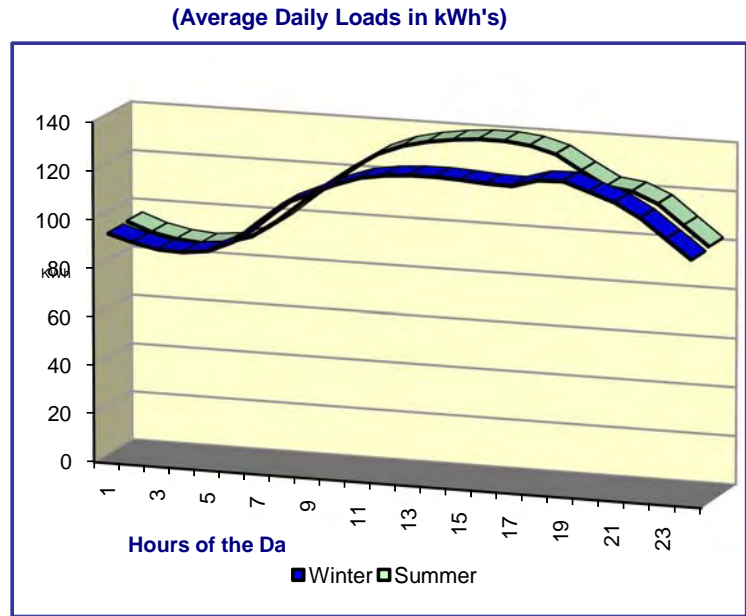
| 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|-------------------|----------------|----------------|------------------|----------------|-----------------|
| \$19,308 | \$20,315 | \$22,194 | \$22,623 | \$20,089 | \$17,991 |
| 16,657 | 18,731 | 21,466 | 23,084 | 25,432 | 25,981 |
| 19,941 | 23,712 | 23,698 | 25,202 | 22,712 | 23,206 |
| 3,183 | 4,305 | 4,711 | 4,761 | 4,033 | 4,408 |
| 2,096 | 2,128 | 2,517 | 2,183 | 2,131 | 1,857 |
| 14,968 | 13,776 | 17,750 | 20,507 | 19,183 | 19,045 |
| 2,757 | 5,931 | 3,448 | 4,300 | 5,984 | 3,035 |
| 17,159 | 18,672 | 19,929 | 19,610 | 19,837 | 19,775 |
| 4,269 | 4,058 | 7,503 | 4,713 | 6,223 | 4,724 |
| 100,338 | 111,628 | 123,216 | 126,983 | 125,624 | 120,022 |
| 14,509 | 14,299 | 14,399 | 16,250 | 16,002 | 17,353 |
| 9,060 | 9,036 | 9,256 | 10,072 | 10,064 | 9,787 |
| 9,692 | 9,292 | 11,874 | 9,861 | 10,462 | 9,480 |
| 21,117 | 22,279 | 23,305 | 27,006 | 27,053 | 26,728 |
| 17,615 | 18,114 | 19,146 | 21,644 | 21,904 | 24,294 |
| 16,298 | 19,740 | 16,533 | 17,138 | 17,451 | 16,451 |
| 4,800 | 5,170 | 5,260 | 6,219 | 5,985 | 5,900 |
| 9,028 | 10,389 | 12,122 | 14,089 | 10,765 | 10,149 |
| 21,317 | 13,243 | 17,478 | 21,626 | 21,485 | 22,006 |
| 785 | 810 | 850 | 885 | 800 | 840 |
| 583 | 523 | 489 | 451 | 416 | 382 |
| 124,804 | 122,895 | 130,712 | 145,241 | 142,387 | 143,370 |
| (24,466) | (11,267) | (7,496) | (18,258) | (16,763) | (23,348) |
| 60,429 | 26,640 | 27,701 | 33,437 | 39,903 | 34,835 |
| (46,622) | (12,390) | (15,882) | (16,819) | (22,399) | (21,415) |
| (1,038) | | | | | 59,071 |
| 12,769 | 14,250 | 11,819 | 16,618 | 17,504 | 72,491 |
| (\$11,697) | \$2,983 | \$4,323 | (\$1,640) | \$741 | \$49,143 |
| 1.3% | 1.2% | 1.2% | 1.1% | 1.0% | 1.0% |

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

June 30, 2010

(in thousands of kWh)

| # Kilowatt Hours | | |
|------------------|---------------------|---------------------|
| Daily Hours | (Oct-Mar) Winter | (Apr-Sep) Summer |
| 0 | 94,061 | 94,673 |
| 1 | 91,123 | 90,921 |
| 2 | 88,894 | 88,791 |
| 3 | 88,480 | 87,886 |
| 4 | 89,737 | 88,884 |
| 5 | 94,267 | 92,089 |
| 6 | 103,073 | 99,145 |
| 7 | 111,294 | 107,631 |
| 8 | 115,818 | 115,709 |
| 9 | 120,433 | 123,102 |
| 10 | 124,032 | 129,577 |
| 11 | 125,730 | 133,615 |
| 12 | 126,467 | 135,983 |
| 13 | 126,562 | 137,504 |
| 14 | 126,051 | 138,366 |
| 15 | 125,243 | 138,324 |
| 16 | 124,969 | 137,180 |
| 17 | 127,994 | 134,346 |
| 18 | 128,297 | 128,327 |
| 19 | 124,746 | 122,679 |
| 20 | 121,154 | 121,320 |
| 21 | 115,509 | 116,950 |
| 22 | 107,716 | 108,917 |
| 23 | 99,972 | 100,931 |



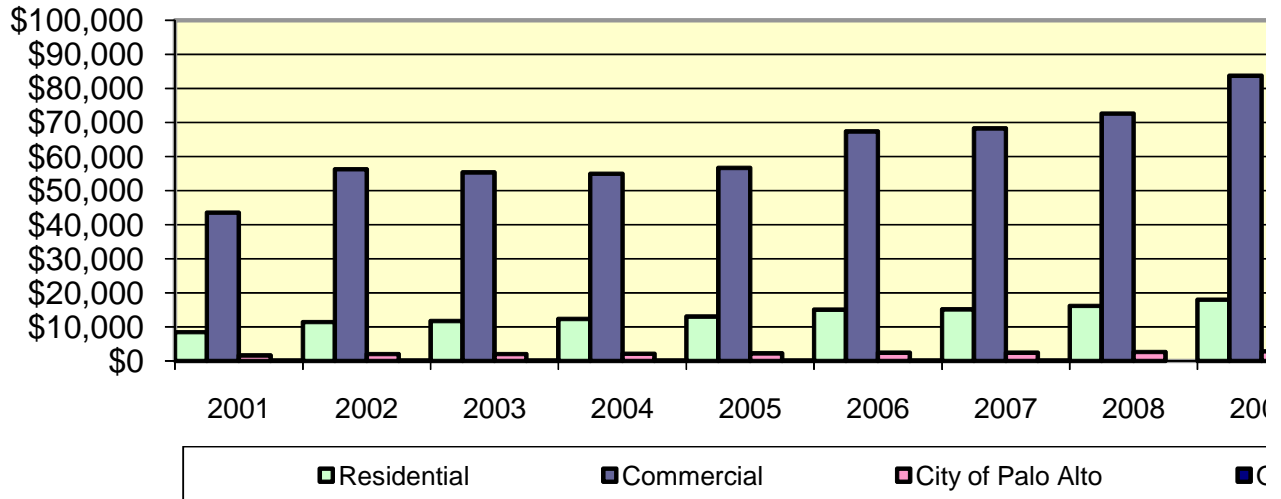
Source: City of Palo Alto, Utilities Resource Management

Top Ten Electric Customers by Usage

| Customer (alphabetical order) | Type of Business | kWh's | % of System Total |
|-------------------------------|------------------------------------|--------------------|-------------------|
| City of Palo Alto | Municipal | | |
| CPI-David Morman | Research | | |
| Hewlett Packard | Computer | | |
| Space System Loral | Satellite & Satellite Systems | | |
| Stanford Hines Interests | Property Management | | |
| Stanford Hospital | Hospital | | |
| Syntex | Technology | | |
| Varian Medical Systems | Manufacturing of Medical Equipment | | |
| Veterans Admin Hospital | Hospital | | |
| VMWare Inc. | Computer | | |
| Total | | 351,040,113 | 36.38 % |

Source: City of Palo Alto, Utilities Department

City of Palo Alto - Electric Operating Revenue by Source Last Ten Fiscal Years (\$000)



F
2
2

| | | | | | |
|------|--------|--------|-------|----|---------|
| 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 |
| 2009 | 17,939 | 83,710 | 2,823 | 0 | 104,472 |
| 2010 | 19,898 | 89,315 | 2,890 | 0 | 112,103 |

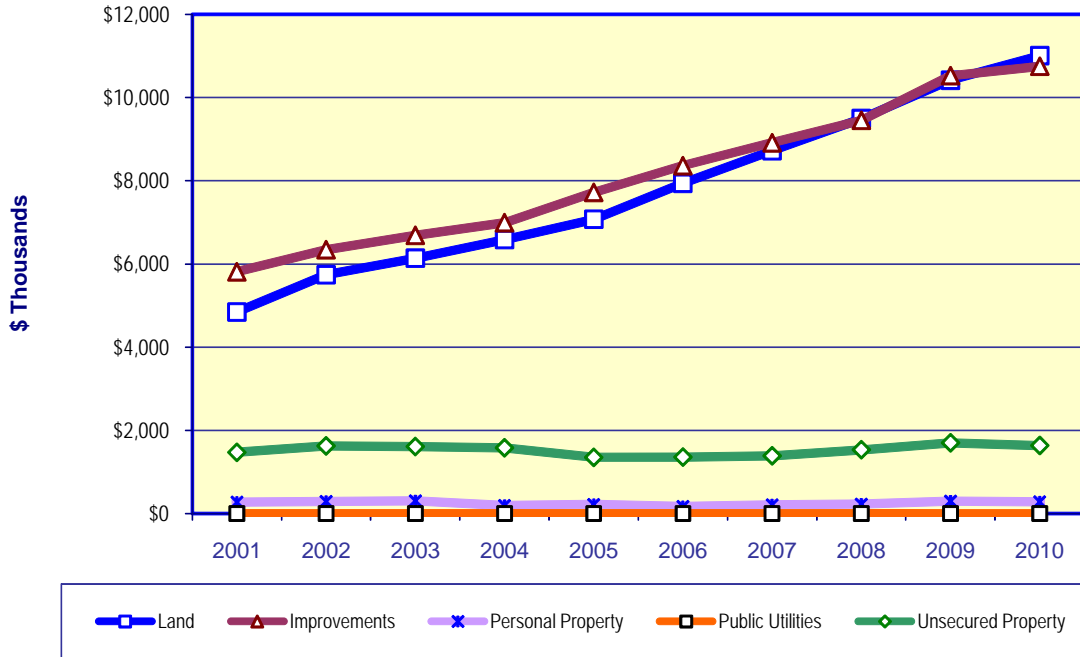
Top Ten Electric Revenue

| Customer (alphabetical order) | Type of Business | Net Charges | % of System Total |
|-------------------------------|------------------|----------------------|-------------------|
| City of Palo Alto | Municipal | | |
| CPI-David Morman | Research | | |
| Hewlett Packard | Computer | | |
| Space System Loral | Satellite System | | |
| Stanford Hines Interests | Property Mgmt | | |
| Stanford Hospital | Hospital | | |
| Syntex | Technology | | |
| Varian Medical Systems | Manufacturing | | |
| Veterans Admin Hospital | Hospital | | |
| VMWare Inc. | Computer | | |
| Total | | \$ 37,921,587 | 16.75% |

Source: City of Palo Alto, Utilities Department

Notes: 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 | | |
| 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% |
| 2009 | 10,420,139 | 10,527,617 | 303,688 | 21,251,444 | 2,573 | 1,702,884 | 1,871,292 | 21,085,609 | 1% |
| 2010 | 11,007,650 | 10,752,671 | 288,148 | 22,048,469 | 2,573 | 1,638,436 | 1,809,119 | 21,880,359 | 1% |

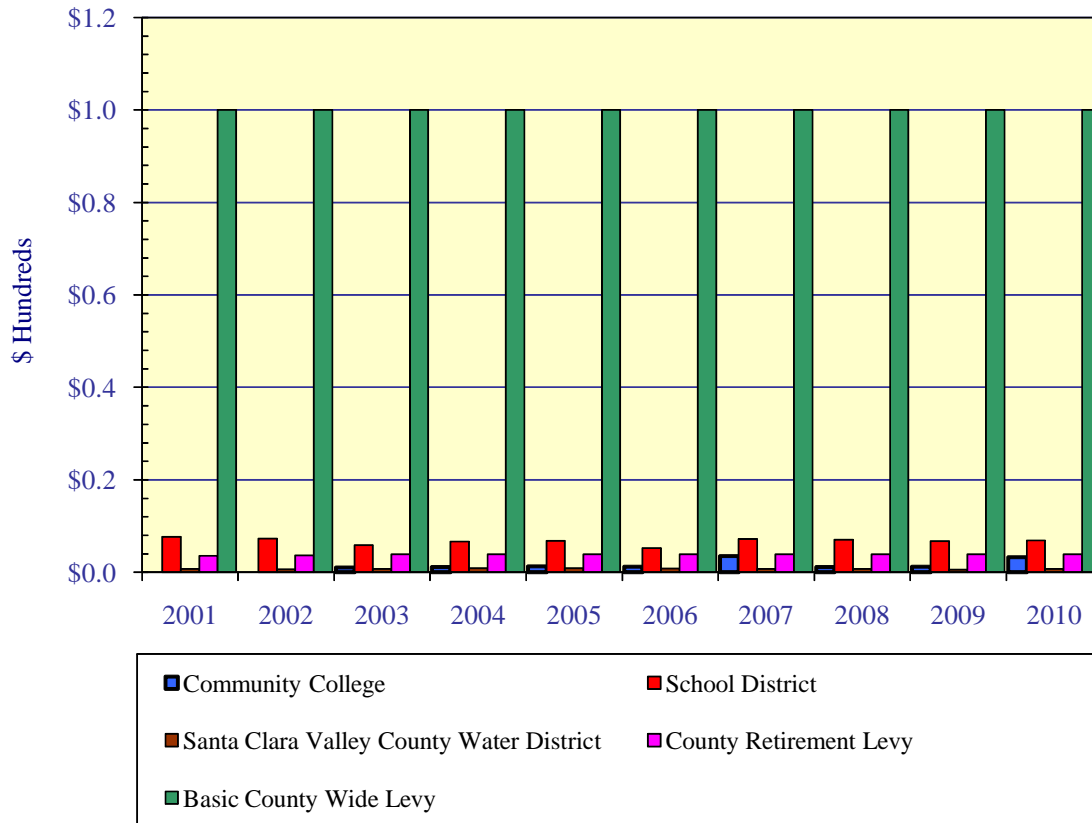
Source: County of Santa Clara Assessor's Office

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 |
|-------------|------------------------|------------------------|-----------------------------------|-----------------|-------------------|--------|
| 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 |
| 2009 | 1.0000 | 0.0388 | 0.0061 | 0.0674 | 0.0123 | 1.1246 |
| 2010 | 1.0000 | 0.0388 | 0.0074 | 0.0686 | 0.0322 | 1.1470 |

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> |
|--------------------|---------------------------|--------------------------------|----------------------------------|---------------------------------------|------------------------------|---|
| 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% |
| 2009 | 25,432 | 25,432 | 100% | - | 25,432 | 100% |
| 2010 | 25,981 | 25,981 | 100% | - | 25,981 | 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 Taxpayers

Current Year and Nine Years Ago (\$000)

| Taxpayer | FY 2010 | | | FY 2001 | | |
|---|------------------------|------|---|------------------------|------|---|
| | 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 | \$3,339,922 | 1 | 15.3% | \$1,892,481 | 1 | 16.3% |
| Space System /Loral, Inc. | 210,132 | 2 | 1.0% | 196,873 | 2 | 1.7% |
| Arden Realty Limited Partnership | 111,897 | 3 | 0.5% | | | 0.0% |
| Whisman Ventures, LLC | 104,529 | 4 | 0.5% | | | 0.0% |
| ECI 2 Bayshore LLC / ECI Hamilton LLC | 73,523 | 5 | 0.3% | | | 0.0% |
| Blackhawk Parent LLC | 49,939 | 6 | 0.2% | | | 0.0% |
| Pacific Hotel Dev Venture LP | 43,686 | 7 | 0.2% | | | 0.0% |
| 300 / 400 Hamilton Associates | 41,221 | 8 | 0.2% | | | 0.0% |
| Ronald & Ann Williams Charitable Foundation | 40,346 | 9 | 0.2% | | | 0.0% |
| 505 Hamilton Avenue Partners LP | 40,142 | 10 | 0.2% | | | 0.0% |
| Embarcadero Place Associates | | | 0.0% | 63,240 | 3 | 0.5% |
| Sun Microsystems, Inc. | | | 0.0% | 61,923 | 4 | 0.5% |
| Harbor Investment Partners | | | 0.0% | 56,349 | 5 | 0.5% |
| Cowper-Hamilton Associates | | | 0.0% | 39,165 | 6 | 0.3% |
| Embarcadero Bayshore Investors, et al | | | 0.0% | 30,050 | 7 | 0.3% |
| Hyatt Equities LLC | | | 0.0% | 24,000 | 8 | 0.2% |
| Seabiscuit LLC, et al | | | 0.0% | 23,482 | 9 | 0.2% |
| Agilent Technologies | | | 0.0% | 22,755 | 10 | 0.2% |
| Subtotal | \$4,055,337 | | 18.5% | \$2,410,318 | | 20.8% |
| Total City Taxable Assessed Value | | | | | | |
| FY 2010 | \$21,880,359 | | | | | |
| FY 2001 | \$11,609,915 | | | | | |

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

City of Palo Alto - Assessed Valuation and Parcels By Land Use

As Of June 30, 2010

| | 2009-10 Assessed Valuation (a) | % of Total | No. of Parcels | % of Total | No. of Taxable Parcels | % of Total |
|-----------------------------------|---|-----------------------|---------------------------|-----------------------|---------------------------------------|-----------------------|
| Non-Residential: | | | | | | |
| Agricultural/Forest | \$ 25,840,436 | 0.13 | 51 | 0.25 | 33 | 0.17 |
| Commercial | 1,110,017,755 | 5.48 | 461 | 2.26 | 455 | 2.28 |
| Professional/Office | 2,400,760,506 | 11.86 | 479 | 2.34 | 459 | 2.28 |
| Industrial/Research & Development | 2,014,916,558 | 9.96 | 189 | 0.92 | 184 | 0.92 |
| Recreational | 21,740,043 | 0.11 | 14 | 0.07 | 11 | 0.06 |
| Government/Social/Institutional | 420,964,393 | 2.08 | 106 | 0.52 | 39 | 0.20 |
| Miscellaneous | 10,874,738 | 0.05 | 25 | 0.12 | 23 | 0.12 |
| Subtotal Non-Residential | <u>\$ 6,005,114,429</u> | <u>29.67</u> | <u>1,325</u> | <u>6.48</u> | <u>1,204</u> | <u>6.03</u> |
| Residential: | | | | | | |
| Single Family Residence | \$ 11,513,811,943 | 56.89 | 14,879 | 72.82 | 14,834 | 74.30 |
| Condominium/Townhouse | 1,386,493,446 | 6.85 | 2,630 | 12.87 | 2,627 | 13.16 |
| 2-4 Residential Units | 344,216,870 | 1.70 | 535 | 2.62 | 535 | 2.68 |
| 5+ Residential Units/Apartments | 697,779,476 | 3.45 | 330 | 1.62 | 305 | 1.53 |
| Mobile Home | 77,840 | 0.00 | 7 | 0.03 | 7 | 0.04 |
| Subtotal Residential | <u>\$ 13,942,379,575</u> | <u>68.89</u> | <u>18,381</u> | <u>89.96</u> | <u>18,308</u> | <u>91.71</u> |
| Vacant Parcels | \$ 288,017,714 | 1.42 | 468 | 2.29 | 441 | 2.21 |
| Unknown | 3,837,714 | 0.02 | 259 | 1.27 | 10 | 0.05 |
| Total | <u><u>\$ 20,239,349,432</u></u> | <u><u>100.00</u></u> | <u><u>20,433</u></u> | <u><u>100.00</u></u> | <u><u>19,963</u></u> | <u><u>100.00</u></u> |

Source: California Municipal Statistics, Inc.

Note:

This schedule is provided as required by the Continuing Disclosure Agreement for the City's Series 2010A General Obligation Bond and is not required by Government Accounting Standards Board (GASB). Therefore, ten years of comparison data is not presented.

(a) Local Secured Assessed Valuation, Excluding Tax-Exempt Property

City of Palo Alto - Per Parcel Assessed Valuation of Single Family Homes

June 30, 2010

| | No. of Parcels | 2009-10 Assessed Valuation | Average Assessed Valuation | Median Assessed Valuation |
|---------------------------|---------------------------|---|---|--------------------------------------|
| Single Family Residential | 14,879 | \$11,513,811,943 | \$773,830 | \$546,815 |

| 2009-10 Assessed Valuation | No. of Parcels (a) | % of Total | Cumulative % of Total | Total Valuation | No. of % of Total | Cumulative % of Total |
|---------------------------------------|-------------------------------|-----------------------|----------------------------------|----------------------------|----------------------------------|----------------------------------|
| \$0 - \$99,999 | 2,156 | 14.490 | 14.490 | \$ 161,737,351 | 1.405 | 1.405 |
| \$100,000 - \$199,999 | 2,057 | 13.825 | 28.315 | 283,300,864 | 2.461 | 3.865 |
| \$200,000 - \$299,999 | 1,046 | 7.030 | 35.345 | 261,725,467 | 2.273 | 6.138 |
| \$300,000 - \$399,999 | 869 | 5.840 | 41.185 | 304,494,839 | 2.645 | 8.783 |
| \$400,000 - \$499,999 | 886 | 5.955 | 47.140 | 400,511,772 | 3.479 | 12.262 |
| \$500,000 - \$599,999 | 897 | 6.029 | 53.169 | 493,169,146 | 4.283 | 16.545 |
| \$600,000 - \$699,999 | 777 | 5.222 | 58.391 | 506,134,743 | 4.396 | 20.941 |
| \$700,000 - \$799,999 | 680 | 4.570 | 62.961 | 510,717,462 | 4.436 | 25.377 |
| \$800,000 - \$899,999 | 769 | 5.168 | 68.129 | 653,757,883 | 5.678 | 31.055 |
| \$900,000 - \$999,999 | 687 | 4.617 | 72.746 | 652,899,151 | 5.671 | 36.726 |
| \$1,000,000 - \$1,099,999 | 554 | 3.723 | 76.469 | 580,118,272 | 5.038 | 41.764 |
| \$1,100,000 - \$1,199,999 | 465 | 3.125 | 79.594 | 535,661,205 | 4.652 | 46.416 |
| \$1,200,000 - \$1,299,999 | 375 | 2.520 | 82.114 | 468,884,496 | 4.072 | 50.488 |
| \$1,300,000 - \$1,399,999 | 351 | 2.359 | 84.473 | 473,151,558 | 4.109 | 54.597 |
| \$1,400,000 - \$1,499,999 | 330 | 2.218 | 86.691 | 477,882,824 | 4.151 | 58.748 |
| \$1,500,000 - \$1,599,999 | 269 | 1.808 | 88.499 | 416,158,588 | 3.614 | 62.362 |
| \$1,600,000 - \$1,699,999 | 234 | 1.573 | 90.072 | 386,650,544 | 3.358 | 65.720 |
| \$1,700,000 - \$1,799,999 | 191 | 1.284 | 91.356 | 334,053,898 | 2.901 | 68.621 |
| \$1,800,000 - \$1,899,999 | 167 | 1.122 | 92.478 | 308,308,875 | 2.678 | 71.299 |
| \$1,900,000 - \$1,999,999 | 128 | 0.860 | 93.338 | 249,337,765 | 2.166 | 73.465 |
| \$2,000,000 and Greater | 991 | 6.660 | 100.000 | 3,055,155,240 | 26.535 | 100.000 |
| Total | 14,879 | 100.000 | | \$ 11,513,811,943 | 100.000 | |

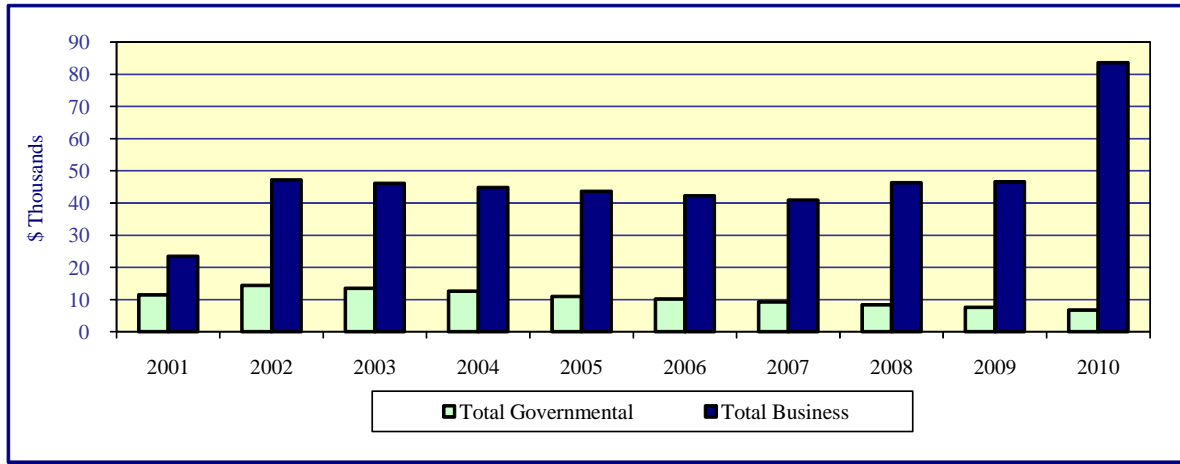
Source: California Municipal Statistics, Inc.

Note:

This schedule is provided as required by the Continuing Disclosure Agreement for the City's Series 2010A General Obligation Bond and is not required by Government Accounting Standards Board (GASB). Therefore, ten years of comparison data is not presented.

(a) Improved single family residential parcels. Excludes condominiums and parcels with multiple family units.

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 |
|-------------|-------------------------------|-------------------------|---------------------------|--------|
| 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 | 0 | 10,950 |
| 2006 | 9,915 | 225 | 0 | 10,140 |
| 2007 | 9,175 | 115 | 0 | 9,290 |
| 2008 | 8,405 | 0 | 0 | 8,405 |
| 2009 | 7,605 | 0 | 0 | 7,605 |
| 2010 | 6,765 | 0 | 0 | 6,765 |

Business-Type Activities

| Fiscal Year | Utility Revenue Bonds | Total | Total Primary Government | Percentage of Assessed Value (a) | Percentage of Personal Income (b) | Per Capita (c) |
|-------------|-----------------------|--------|--------------------------|----------------------------------|-----------------------------------|----------------|
| 2001 | 23,465 | 23,465 | 34,948 | 0.30 % | 1.03% | \$0.57 |
| 2002 | 47,210 | 47,210 | 61,584 | 0.47 % | 2.04% | \$1.02 |
| 2003 | 46,069 | 46,069 | 59,541 | 0.43 % | 1.97% | \$0.98 |
| 2004 | 44,862 | 44,862 | 57,522 | 0.38 % | 1.87% | \$0.95 |
| 2005 | 43,598 | 43,598 | 54,548 | 0.34 % | 1.67% | \$0.88 |
| 2006 | 42,288 | 42,288 | 52,428 | 0.32 % | 1.53% | \$0.84 |
| 2007 | 40,887 | 40,887 | 50,177 | 0.28 % | 1.46% | \$0.80 |
| 2008 | 46,310 | 46,310 | 54,715 | 0.29 % | 1.54% | \$0.86 |
| 2009 | 46,565 | 46,565 | 54,170 | 0.26 % | 1.47% | \$0.84 |
| 2010 | 83,647 | 83,647 | 90,412 | 0.41 % | 2.71% | \$1.38 |

Sources: City of Palo Alto

(a) County of Santa Clara (assessed value)

(b) Per capita personal income are only available for Santa Clara County.

Personal income is the product of the countywide per capita amount and the City's population.

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

California State Department of Transportation Forecasts

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, 2010

FY 2010 Assessed Valuation

\$21,880,358,093

| | Total Debt Outstanding | Percentage Applicable To City of Palo Alto (a) | Amount Applicable To City of Palo Alto |
|---|------------------------|--|--|
| <u>OVERLAPPING TAX AND ASSESSMENT DEBT:</u> | | | |
| Santa Clara County | \$350,000,000 | 8.104% | \$28,364,000 |
| Santa Clara Valley Water District, Zone W-1 | 910,000 | 0.484% | 4,404 |
| Foothill-DeAnza Community College District | 479,279,288 | 23.342% | 111,873,371 |
| Palo Alto Unified School District | 210,379,249 | 89.328% | 187,927,576 |
| Fremont Union High School District | 202,415,000 | 0.007% | 14,169 |
| Mountain View-Los Altos Union High School District | 32,648,569 | 1.040% | 339,545 |
| Cupertino Union School District | 127,264,911 | 0.004% | 5,091 |
| Los Altos School District | 90,819,000 | 1.038% | 942,701 |
| Whisman School District | 20,283,121 | 3.768% | 764,268 |
| City of Palo Alto | 55,305,000 | 100.000% | 55,305,000 |
| El Camino Hospital District | 144,975,000 | 0.093% | 134,827 |
| City of Palo Alto Special Assessment Bonds | 36,575,000 | 100.000% | 36,575,000 |
| Santa Clara Valley Water District Benefit Assessment District | 152,440,000 | 8.104% | 12,353,738 |
| TOTAL OVERLAPPING TAX AND ASSESSMENT DEBT | \$1,903,294,138 | | \$434,603,690 |

DIRECT AND OVERLAPPING GENERAL FUND DEBT:

| | | | |
|--|------------------------|----------|----------------------|
| Santa Clara County General Fund Obligations | \$825,070,000 | 8.104% | \$66,863,673 |
| Santa Clara County Pension Obligations | 388,044,822 | 8.104% | 31,447,152 |
| Santa Clara County Board of Education Certificates of Participation | 13,580,000 | 8.104% | 1,100,523 |
| Foothill-DeAnza Community College District Certificates of Participation | 23,450,000 | 23.342% | 5,473,699 |
| Mountain View-Los Altos Union High School District Certificates of Participation | 6,505,000 | 1.040% | 67,652 |
| City of Palo Alto General Fund Obligations | 6,765,000 | 100.000% | 6,765,000 |
| Santa Clara County Vector Control District Certificates of Participation | 3,965,000 | 8.104% | 321,324 |
| Midpeninsula Regional Open Space Park District General Fund Obligations | 113,788,031 | 13.643% | 15,524,101 |
| TOTAL DIRECT AND OVERLAPPING GENERAL FUND DEBT | \$1,381,167,853 | | \$127,563,124 |

COMBINED TOTAL DEBT

\$3,284,461,991

\$562,166,814 (b)

Note: (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

| | |
|---|-------|
| Direct Debt (\$55,305,000) | 0.25% |
| Combined Direct Debt (\$62,070,000) | 0.28% |
| Total Overlapping Tax and Assessment Debt | 1.99% |
| Combined Total Debt | 2.57% |

STATE SCHOOL BUILDING AID REPAYABLE AS OF 06/30/10: \$0

Source: California Municipal Statistics, Inc.

City of Palo Alto - Computation of Legal Bonded Debt Margin

June 30, 2010

(in thousands of dollars)

Assessed Valuation:

Secured property assessed value, net of
exempt real property \$21,880,359

Bonded debt limit 3.75% of assessed value (a) \$820,513

Amount of debt subject to limit: (b)

| | |
|--|----------|
| Certificates of participation | 6,765 |
| General Obligation Bonds | 55,305 |
| Special assessment debt with government commitment | <u>0</u> |
| Total Debt | 62,070 |

Less amount of debt not subject to limit 6,765

Amount of debt subject to limit 55,305

Legal bonded debt margin \$765,208

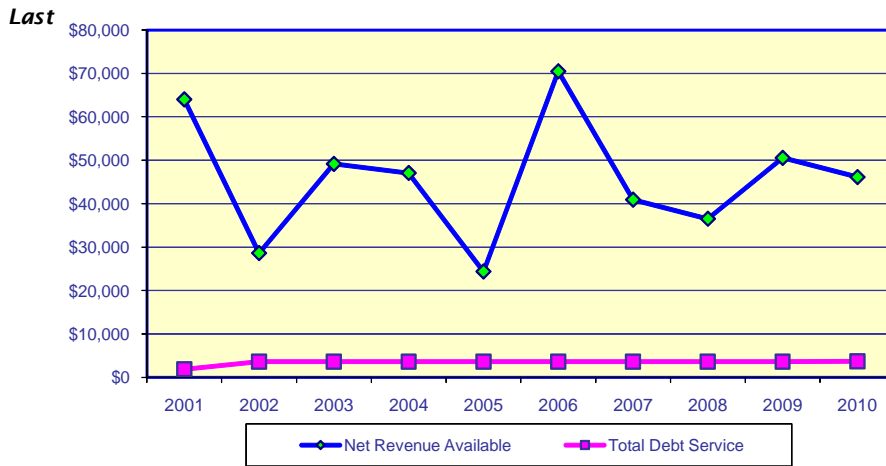
| Fiscal Year | Debt Limit | Total Net Debt Applicable to Limit | Legal Debt Margin | Total net debt applicable to the limit as a percentage of debt limit |
|----------------|---------------|--|-------------------------|--|
| 2001 | 435,372 | 0 | 435,372 | 0.00% |
| 2002 | 491,351 | 0 | 491,351 | 0.00% |
| 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% |
| 2009 | 790,710 | 0 | 790,710 | 0.00% |
| 2010 | 820,513 | 55,305 | 765,208 | 7.23% |

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%. 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



| Fiscal Year | Gross Revenue | Direct Operating Expenditures | Net Revenue Available for Debt Services (a) | Debt Service | | | Coverage |
|-------------|---------------|-------------------------------|---|--------------|----------|-------|----------|
| | | | | Principal | Interest | Total | |
| 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 | 1,525 | 2,088 | 3,613 | 10.11 |
| 2009 | 246,028 | 195,489 | 50,539 | 1,590 | 2,024 | 3,614 | 13.98 |
| 2010 | 233,774 | 187,658 | 46,116 | 1,755 | 1,954 | 3,709 | 12.43 |

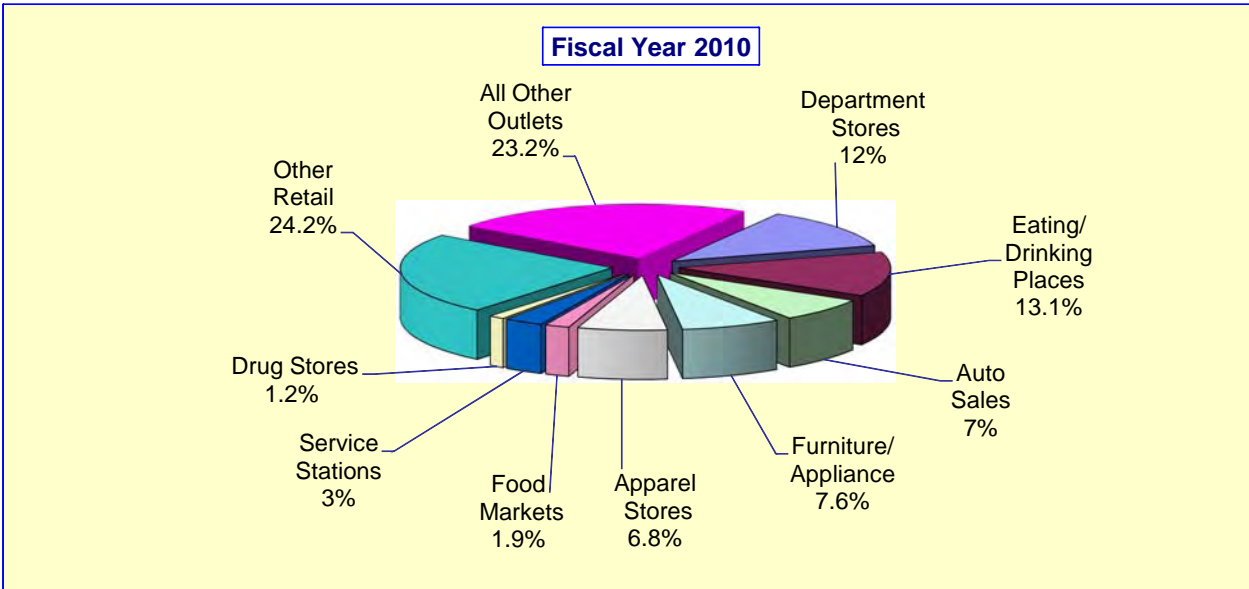
Source: Annual Financial Statements

Note: (a) Excludes depreciation and amortization expense.

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

FY 2008 Principal for Debt Service was restated due to correction of data.

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 |
|-------------|-------------------|------------------------|------------|---------------------|----------------|--------------|------------------|-------------|--------------|---------------------|-------------------|--------|
| 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 |
| 2009 | 2,251 | 2,443 | 1,358 | 1,431 | 1,258 | 315 | 493 | 214 | 4,284 | 14,047 | 5,277 | 19,324 |
| 2010 | 2,215 | 2,418 | 1,288 | 1,402 | 1,254 | 343 | 549 | 219 | 4,458 | 14,146 | 4,268 | 18,414 |

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

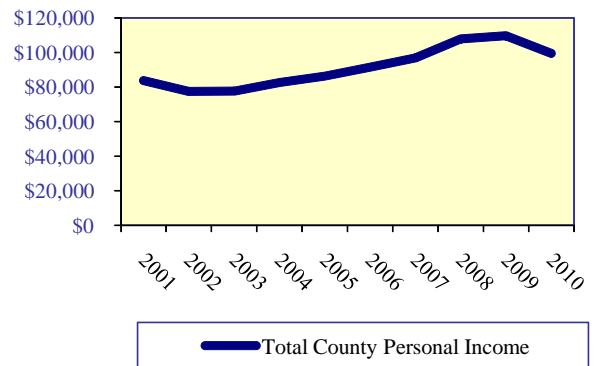
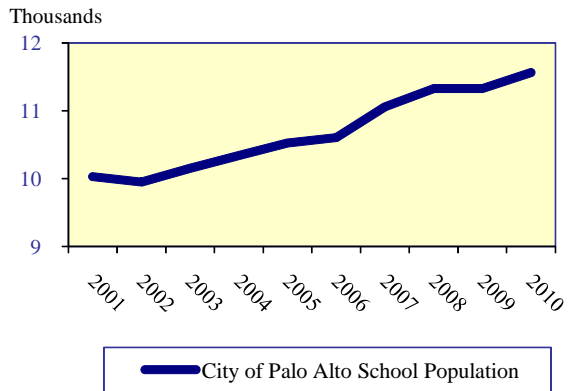
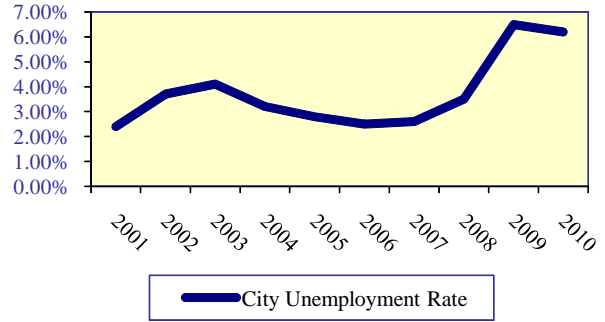
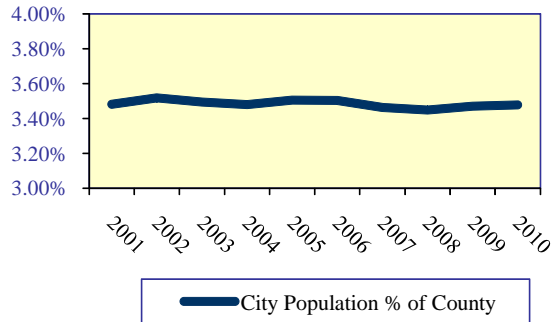
**SALES TAX RATES FOR THE
 FISCAL YEAR ENDED JUNE 30, 2010**

| | |
|---|--------------|
| State Funds | 7.00% |
| County Transportation Fund (Transportation Development Act) | 0.25% |
| County Transportation Fund | 1.00% |
| City | 1.00% |
| | 9.25% |

Source: California State Board of Equalization

City of Palo Alto - Demographic and Economic Statistics

Last Ten Fiscal Years



| 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 |
|-------------|------------------------------|---|-------------------------------------|-------------------------------|-----------------------------|--|
| 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* |
| 2009 | 64,484 | 6.5% | 11,329 | 1,857,621 | 3.47% | 109,700,000* |
| 2010 | 65,408 | 6.2% | 11,565 | 1,880,876 | 3.48% | 99,600,000* |

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

* California State Department of Transportation Forecasts

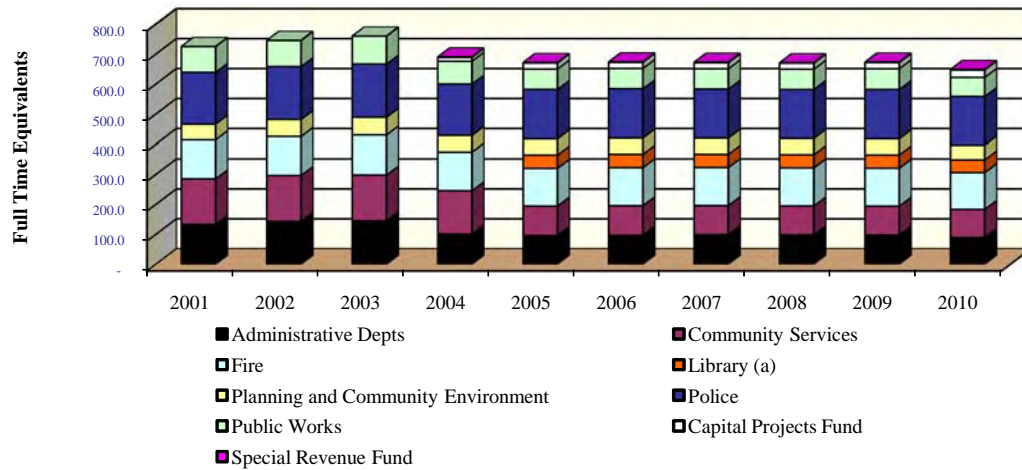
City of Palo Alto - Principal Employers
Current Year and Nine Years Ago

| Employer | FY 2010 | | | FY 2001 | |
|--|----------------------------|-------------|--|----------------------------|-------------|
| | Number of Employees | Rank | Percentage of Total City Employment | Number of Employees | Rank |
| Stanford University | 10,101 | 1 | 9.2% | 5000+ | 1 |
| Stanford University Medical Center/Hospital | 5,569 | 2 | 5.1% | 750-1000 | 10 |
| Lucile Packard Children's Hospital | 3,549 | 3 | 3.2% | | |
| Veteran's Affairs Palo Alto Health Care System | 3,500 | 4 | 3.2% | 3,000 | 3 |
| Hewlett-Packard Company | 2,001 | 5 | 1.8% | 3,400 | 2 |
| Palo Alto Medical Foundation | 2,000 | 6 | 1.8% | 1,200 | 7 |
| Space Systems Loral | 1,700 | 7 | 1.5% | 2,777 | 4 |
| Wilson Sonsini Goodrich Rosati | 1,500 | 8 | 1.4% | 1,323 | 6 |
| Palo Alto Unified School District | 1,336 | 9 | 1.2% | 1,636 | 5 |
| City of Palo Alto | 1,100 | 10 | 1.0% | 1,050 | 8 |
| Roche Bioscience | | | | 1,000 | 9 |
| Subtotal | <u>32,356</u> | | <u>29.3%</u> | | |
| Total City Day Population | <u>110,246</u> | | | | |

Source: FY 2010: www.ReferenceUSA.com, www.stanfordhospital.org, www.lpch.org, www.pausd.org
 FY 2001: Palo Alto Weekly



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



| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Governmental Funds | | | | | | | | | | |
| General Fund | | | | | | | | | | |
| Administrative Depts | 133.35 | 143.60 | 145.10 | 101.10 | 96.24 | 96.65 | 99.05 | 98.65 | 97.80 | 89.30 |
| Community Services | 152.00 | 153.00 | 153.00 | 144.75 | 98.25 | 99.25 | 97.25 | 96.25 | 96.50 | 94.25 |
| Fire | 129.00 | 129.00 | 132.50 | 128.50 | 126.00 | 127.00 | 127.00 | 127.00 | 126.69 | 122.69 |
| Library (a) | | | | | 44.00 | 44.25 | 43.75 | 43.75 | 43.75 | 42.25 |
| Planning and Community Environment | 52.00 | 56.50 | 59.00 | 54.80 | 53.30 | 53.30 | 53.30 | 53.30 | 53.30 | 48.85 |
| Police | 173.00 | 176.50 | 177.50 | 171.00 | 164.50 | 164.00 | 163.00 | 163.00 | 164.00 | 161.50 |
| Public Works | 85.98 | 87.05 | 93.05 | 76.20 | 67.90 | 67.90 | 67.90 | 67.90 | 69.23 | 63.67 |
| Capital Projects Fund | | | | 12.70 | 20.20 | 20.20 | 20.00 | 20.00 | 20.67 | 24.67 |
| Special Revenue Fund | | | | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.15 |
| Enterprise Funds | | | | | | | | | | |
| Public Works Department (Refuse, Storm Drain, Wastewater Treatment) | 109.52 | 110.45 | 110.45 | 111.35 | 112.65 | 112.65 | 112.65 | 112.65 | 113.55 | 114.63 |
| Utilities Department (Administrative, Electric, Gas, Wastewater Collection, Water) | 224.50 | 230.50 | 229.50 | 233.75 | 233.90 | 235.90 | 234.90 | 234.90 | 238.01 | 241.61 |
| CPA External Services (b) | | 4.00 | 7.00 | 5.70 | 6.00 | 6.00 | 5.80 | 5.80 | | |
| Other Funds | | | | | | | | | | |
| Printing and Mailing | 5.15 | 4.15 | 4.15 | 4.15 | 4.70 | 4.60 | 4.65 | 4.05 | 4.05 | 4.05 |
| Technology | | | | 33.15 | 29.56 | 29.60 | 29.80 | 29.80 | 30.65 | 30.65 |
| Equipment Management | 14.00 | 15.00 | 15.00 | 16.00 | 16.00 | 16.00 | 16.20 | 16.20 | 16.20 | 16.08 |
| Total | 1,078.50 | 1,109.75 | 1,126.25 | 1,094.35 | 1,074.40 | 1,078.50 | 1,076.45 | 1,074.45 | 1,075.60 | 1,055.35 |

Source: City of Palo Alto - Adopted Operating Budget

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

(b) CPA External Services of the original 5.80 FTE, .80 FTE was transferred to the Technology Fund and 5.00 FTE was eliminated.

City of Palo Alto - Operating Indicators by Function/Program
Last Ten Fiscal Years

| <u>Function / Program</u> | <u>Fiscal Year</u> | | |
|---|--------------------|-------------|-------------|
| | <u>2001</u> | <u>2002</u> | <u>2003</u> |
| Public Safety: | | | |
| Fire: | | | |
| Number of Fire Hydrants | 1,729 | 1,741 | 1,746 |
| Planning & Community Environment: | | | |
| Number of Housing Units | 26,048 | 26,841 | 26,934 |
| Commercial & Industrial Space - Million Sq Ft | 27.3 | 27.3 | 27.3 |
| Electric Utility: | | | |
| Number of Customer Accounts | 28,097 | 28,348 | 28,408 |
| Million of KWH Sold | 1,057 | 997 | 957 |
| Fiber Optics Utility: | | | |
| Number of Fiber Optic Connections | 41 | 30 | 23 |
| Water Utility: | | | |
| Number of Customer Accounts | 19,335 | 19,437 | 19,487 |
| Million CCF Sold | 5.9 | 5.9 | 5.6 |
| Gas Utility: | | | |
| Number of Customer Accounts | 23,101 | 23,116 | 23,169 |
| Million Therms Sold | 36.7 | 33.7 | 31.8 |
| Waste Water: | | | |
| Number of Customer Accounts | 21,752 | 21,772 | 21,819 |
| Millions of Gallons Processed | 9,243 | 8,699 | 8,704 |

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

Note: Fiscal Years 2004-2006, number of fire hydrants are restated due to change in source of data.
 Fiscal Years 2007 and 2008, for Water Utility - Million CCF Sold, are restated due to correction of measuring units.

Fiscal Year

| 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 1,874 | 1,873 | 1,919 | 1,944 | 1,948 | 1,949 | 1,954 |
| 27,019 | 27,522 | 27,767 | 27,763 | 27,938 | 28,291 | 28,445 |
| 27.3 | 27.3 | 27.3 | 27.3 | 27.3 | 27.3 | 27.3 |
| 28,482 | 28,539 | 28,653 | 28,684 | 29,024 | 28,527 | 28,527 |
| 958 | 959 | 966 | 978 | 977 | 996 | 965 |
| 18 | 39 | 22 | 23 | 27 | 26 | 24 |
| 19,557 | 19,605 | 19,645 | 19,726 | 19,942 | 19,442 | 19,916 |
| 6.0 | 5.3 | 5.2 | 5.4 | 5.5 | 5.7 | 5.0 |
| 23,216 | 23,300 | 23,353 | 23,357 | 23,502 | 23,090 | 23,322 |
| 31.5 | 32.0 | 31.5 | 31.3 | 32.2 | 30.6 | 30.7 |
| 21,830 | 21,825 | 21,784 | 21,835 | 21,990 | 22,210 | 22,193 |
| 8,238 | 8,395 | 8,972 | 9,220 | 8,510 | 7,958 | 8,184 |

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

Last Ten Fiscal Years

| Function/Program | Fiscal Year | | | |
|-------------------------------|-------------|--------|--------|--------|
| | 2001 | 2002 | 2003 | 2004 |
| Public Safety: | | | | |
| Fire: | | | | |
| Fire Stations | 8 | 8 | 8 | 8 |
| Fire Apparatus | 24 | 25 | 22 | 23 |
| Police: | | | | |
| Police Stations | 1 | 1 | 1 | 1 |
| Police Patrol Vehicles | 33 | 33 | 33 | 30 |
| Community Services: | | | | |
| Acres - Downtown/Urban Parks | 170 | 170 | 170 | 170 |
| Acres - Open Space | 3,731 | 3,731 | 3,731 | 3,731 |
| Parks and Preserves | 33 | 34 | 34 | 34 |
| Golf Course | 1 | 1 | 1 | 1 |
| Tennis Courts | 52 | 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 | 1 | 1 | 1 | 1 |
| Nature Center | 2 | 2 | 2 | 2 |
| Libraries: | | | | |
| Libraries | 6 | 6 | 6 | 5 |
| Public Works: | | | | |
| Number of Trees Maintained | 38,094 | 37,941 | 34,939 | 35,440 |
| Electric Utility: | | | | |
| Overhead Pole Miles | 227 | 227 | 227 | 227 |
| Underground Trench Miles | 220 | 186 | 186 | 186 |
| Water Utility: | | | | |
| Miles of Water Mains | 222 | 226 | 226 | 226 |
| Gas Utility: | | | | |
| Miles of Gas Mains | 201 | 207 | 207 | 207 |
| Waste Water: | | | | |
| Miles of Sanitary Sewer Lines | 218 | 202 | 202 | 202 |

Source: City of Palo Alto

| Fiscal Year | | | | | |
|-------------|--------|--------|--------|--------|--------|
| 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
| 8 | 8 | 8 | 8 | 8 | 8 |
| 25 | 25 | 25 | 23 | 28 | 28 |
| 1 | 1 | 1 | 1 | 1 | 1 |
| 30 | 30 | 30 | 30 | 30 | 30 |
| 170 | 170 | 157 | 157 | 157 | 157 |
| 3,731 | 3,731 | 3,744 | 3,744 | 3,744 | 3,744 |
| 35 | 35 | 36 | 36 | 36 | 36 |
| 1 | 1 | 1 | 1 | 1 | 1 |
| 52 | 52 | 51 | 51 | 51 | 51 |
| 1 | 1 | 4 | 4 | 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 | 3 | 3 | 3 | 3 |
| 5 | 5 | 5 | 5 | 5 | 5 |
| 35,096 | 34,841 | 34,556 | 35,322 | 35,255 | 35,255 |
| 225 | 217 | 194 | 193 | 193 | 193 |
| 188 | 210 | 252 | 253 | 253 | 253 |
| 226 | 217 | 217 | 217 | 214 | 214 |
| 207 | 207 | 207 | 207 | 207 | 205 |
| 202 | 202 | 202 | 202 | 207 | 207 |

City of Palo Alto - Insurance Coverage.....
June 30, 2010

| TYPE | COVERAGE (Deductible) | LIMITS | COMPANY | EXPIRATION DATE |
|-------------------------------------|---|---|--|------------------------|
| PROPERTY LOSS | | | | |
| Blanket | All real & personal property (\$10,000 deductible), Fine Arts (\$2,500 deductible) | \$353,383,251 | CA Public Entity Property Program | 07/01/11 |
| Boiler & Machinery | All real & personal property (\$25,000 deductible) | \$100,000,000 maximum all risk per occurrence limit \$1,000,000 minimum contingent business interruption | CA Public Entity Property Program | 07/01/11 |
| Flood Insurance | All real property 1305 Middlefield Road (\$1,000 deductible) | \$500,000 | Hartford Fire Insurance Co. | 04/07/11 |
| 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. | 03/22/12 |
| UMBRELLA EXCESS LIABILITY | | | | |
| | City is a member of an insurance pool participating with a number of other California cities (\$1,000,000 self-insured retention) | \$74,000,000 annual aggregate | Everest Ins. Co. Lexington Ins Co. | 07/01/11 |
| Trustees Errors and Omissions | Bodily injury and property damage liability Errors and omissions liability | | | |
| SPECIAL LIABILITY | | | | |
| | Each occurrence | | | |
| Volunteers Accident | Medical - Each person / (\$100 deductible) | \$20,000 | Life Insurance Co. of North America | 02/01/11 |
| Special Events | Bodily injury | \$1,000,000 per occurrence | Axis Surplus Insurance Company | 01/01/11 |
| EMPLOYEE | | | | |
| Travel Accident | Indemnity, based on salary | \$1,500,000 per accident | Life Insurance Co. of North America | 06/01/11 |
| 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 | | 07/01/10 |
| EXCESS WORKERS' COMPENSATION | | | | |
| | Pooled Retention | \$4,000,000 limit per occurrence - Workers Comp and Employers Liability | CA. Public Entity Insurance Authority | 07/01/11 |
| | Reinsured Layer | \$45,000,000 workers comp per occurrence, excess of pooled retention limit, includes \$5,000,000 employers liability | ACB American Insurance Co. | 07/01/11 |

Source: Human Resources Dept, City of Palo Alto



Single Audit Index.....

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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.

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Schedule of Findings.....

**CITY OF PALO ALTO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For The Year Ended June 30, 2010**

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 X No
- Significant deficiency(ies) identified that are not considered to be material weaknesses? X Yes None Reported

Noncompliance material to financial statements noted? Yes X No

Federal Awards

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

Internal control over major programs:

- Material weakness(es) identified? X Yes No
- Significant deficiency(ies) identified that are not considered to be material weaknesses? X Yes None Reported

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? X Yes No

Identification of major programs:

| CFDA #(s) | Name of Federal Program or Cluster |
|-----------------|---|
| 20.932 | U.S. Department of Transportation – Highway Planning and Construction - ARRA |
| 14.218 & 14.253 | U.S. Department of Housing and Urban Development – Community Development Block Grant/Entitlement Grants (Cluster) |
| 81.128 | U.S. Department of Energy – Energy Efficiency and Conservation Block Grant Program - ARRA |
| 14.251 | U.S. Department of Housing and Urban Development – Economic Development Initiative, Special Project, Neighborhood Initiative and Miscellaneous Grants |

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 22, 2010, 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 disclosed the following findings and questioned costs required to be reported in accordance with section 510(a) of OMB Circular A-133.

Finding #SA 2010-01 – Grant Agreement Retention

Federal Agency: Department of Energy
CFDA Number: 81.128
Program Title: ARRA – Energy Efficiency and Conservation Block Grant Program

Criteria: Recipients of federal awards are required to comply with the applicable regulations and provisions of the award agreement. Recipients must maintain a copy of the agreement on file and be familiar with it to ensure compliance is achieved.

Condition: City staff did not have a complete copy of the grant agreement on file. We were provided a copy of the complete agreement only after the staff obtained one from the grantor. Until asked about the agreement, staff had not recalled that a copy of the agreement had been posted on the website.

Effect: Without the complete agreement, City cannot maintain compliance with federal requirements.

Cause: Poor record keeping.

Recommendation: The City should ensure that all relevant grant agreements and documentation are properly maintained.

Planned Corrective Actions: City staff has downloaded a copy of the grant agreement in the EECBG grant folder along with other necessary filings. In the future, staff will keep a soft copy and hard copy of the complete agreement on file. The City has been in compliance with the grant agreement and staff has worked closely with DOE counterparts and project managers in submitting quarterly financial and status reports in a timely manner. Although staff did not have a complete copy of the grant agreement on file, it could be accessed under the FedConnect login.

Name of contact person: Dave Yuan, Sr. Administrator, Utilities



Finding #SA 2010-02 – Communicating the CFDA Number to Subrecipients

Federal Agency: Department of Housing and Urban Development
CFDA number – 14.218 / 14.253
CFDA title – Community Development Block Grant Entitlement Grants / Community Development Block Grant ARRA Entitlement Grants (CDBG-R) (Recovery Act Funded)

Criteria: OMB Circular A-133 section 400(d)(1), requires pass-through entities to identify Federal awards made by informing each subrecipient of the CFDA title and number.

Condition: We selected three subrecipient agreements under the CDBG program and one subrecipient agreement under the CDBG-R program for testing of compliance with the OMB Circular A-133 requirements and noted that none of the subrecipient agreements included the CFDA number as required by the OMB Circular.

Effect: The City is not in compliance with the requirements of OMB Circular A-133 section 400(d)(1).

Cause: We understand that the subrecipients funded by the City did not receive more than \$500,000 in federal awards and therefore the City did not include the CFDA number in the grant agreement. However, funding levels should not be used to ignore this requirement.

Recommendation: The City should include the CFDA number and title in its subrecipient agreements or communicate the CFDA number and title to subrecipients in some other formal manner.

Planned Corrective Actions: The City will ask the attorney’s office to include the CDBG CFDA number and title on all CDBG sub-recipient contracts in the future.

Name of contact person: Suzanne Bailey, Interim CDBG Coordinator

Finding #SA 2010-03 – Signed Grant Agreement Retention

Federal Agency: Department of Housing and Urban Development
CFDA number: 14.251
CFDA title: Economic Development Initiative, Special Project, Neighborhood Initiative and Miscellaneous Grants

Criteria: Federal grant documentation is required to establish arms length agreements and pertinent terms and conditions. Recipients must obtain and maintain a copy of the signed agreement on file.

Condition: City staff did not have a signed copy of grant agreement #B-05-SP-CA-0721 on file. The agreement provides the majority of funding for this program and is one of three agreements with the Department of Housing and Urban Development.

Effect: Without a signed agreement, there can be no assurance that the agreement, in final form, has been complied with.

Cause: Poor record keeping.

Recommendation: The City should ensure that all relevant signed grant agreements and documentation are properly maintained.

Planned Corrective Actions: City staff was able to obtain a copy of the signed agreement from the grantor. The City has been in compliance with federal requirements and the grant is now closed and all funds drawn down. In the future, staff will keep a hard copy and a soft copy of the complete agreement on file.

Name of contact person: Debra Jacobs, Program Manager

SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS –

Prepared by Management

Financial Statement Prior Year Findings

In our prior year audit, we noted one significant deficiency. We have also issued a separate Memorandum on Internal Control dated October 22, 2010, that includes the current status of the deficiency. Our Memorandum is an integral part of our audits and should be read in conjunction with this report.

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, 2010

| Program Name | Identifying Pass-Through/ Grantor Number | Catalog of Federal Domestic Assistance Number | Program Expenditures |
|--|---|---|-------------------------|
| Department of Housing and Urban Development | | | |
| Community Development Block Grant | B-09-MC-06-0020 | | |
| Program Expenditures | | 14.218 | \$118,943 |
| Subgrants: | | | |
| OMBUDSMAN Program | | | 5,000 |
| Palo Alto Housing Corporation-Banker Counseling | | | 31,160 |
| Clara Mateo Alliance Family Shelter | | | 36,361 |
| InnVision | | | 31,160 |
| Project Sentinel - Fair Housing | | | 30,725 |
| Palo Alto Housing Corporation-Tree House | | | 300,000 |
| Support Network | | | 8,570 |
| Avenidas | | | 11,039 |
| Lytton Gardens | | | 108,000 |
| Stevenson House | | | 83,160 |
| Total CDBG Expenditures | | 14.218 | 764,118 |
| Community Development Block Grant ARRA Entitlement Grants | B-09-MY-06-0020 | | |
| Program Expenditures | | 14.253 | 12,970 |
| Subgrants: | | | |
| Avenidas | | | 44,347 |
| Palo Alto Housing Corporation - California Park | | | 6,601 |
| Shelter Network | | | 20,625 |
| Total CDBG-R Expenditures | | | 84,543 |
| Total CDBG Cluster | | | 848,661 |
| Economic Development Initiative, Special Project, Neighborhood Initiative and Miscellaneous Grants | B-03-SP-A-0062, B-04-SP-CA-0077 & B-05-SP-CA-0721 | 14.251 | 357,217 |
| Department of Justice | | | |
| National Endowment for the Arts - The Big Read | 2009-SB-B9-0976 | 16.804 | 8,819 |
| Department of Transportation | | | |
| Highway Planning and Construction (Passed through State of California Department of Transportation) | | 20.932 | |
| ARRA - Lytton | ESPL-5100(011) | | 580,000 |
| ARRA - San Antonio | ESPL-5100(012) | | 505,000 |
| ARRA - Alma Rd. Rehabilitation | ESPL-5100(013) | | 2,250 |
| Total DOT Expenditures | | 20.932 | 1,087,250 |
| Department of Energy | | | |
| ARRA - Energy Efficiency & Conservation Block Grant | DE-SC0002146 | 81.128 | 186,764 |
| 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 | 4,528,017 |
| U.S. Department of Homeland Security | | | |
| Assistance to Firefighter Grant | EMIW-2008-FO-12589 | 97.044 | 188,216 |
| State Fire Training Systems Grant | 07-5690 | 97.043 | 12,138 |
| Emergency Management Performance Grant (EMPG) | OES #085-55282 | 97.042 | 41,906 |
| Urban Areas Security Initiative (UASI) | 075-95017 2008-0026 | 97.008 | 23,506 |
| Total DHS Expenditures | | | 265,766 |
| TOTAL FEDERAL FINANCIAL AWARDS | | | \$7,296,537 |

See Notes to Schedule of Expenditures of Federal Awards

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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. Expenditures of Federal Awards reported on the Schedule are recognized when incurred.

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 2009-10, the City expended \$5,272,761 in costs under the Office of Water, Environmental Protection Agency, Capitalization Grants for Clean Water State Revolving Funds Program (CFDA #66.458). Of this amount \$4,528,017 represents federal costs included on the schedule of expenditures of federal awards. The remaining program costs were funded with state awards and amounted to \$744,744 which has been excluded from this report.

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 of Federal award programs when they occur.

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Independent Auditor Reports.....



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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, 2010, and have issued our report thereon dated October 22, 2010. 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 deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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. However, we identified certain deficiencies in internal control over financial reporting, described in our separately issued Memorandum on Internal Control dated October 22, 2010 that we consider to be significant deficiencies in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.



Independent Auditor Reports

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*.

We have also issued a separate Memorandum on Internal Control dated October 22, 2010, 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, 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 22, 2010



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REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON 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 City of Palo Alto's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the City's major federal programs for the year ended June 30, 2010. The City's major federal programs are identified in the summary of auditor's results section of 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 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. 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 of the City's compliance with those requirements.

In our opinion, the City complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as item 2010-02.

A Professional Corporation



Internal Control Over Compliance

Management of the City is responsible for establishing and maintaining effective internal control 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 to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 the City's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2010-01 and 2010-03 to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the City as of and for the year ended June 30, 2010, and have issued our report thereon dated October 22, 2010. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such 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 City's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the City's responses and, accordingly, we express no opinion on the responses

This report is intended solely for the information and use of management, City Council, management, 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 22, 2010

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:

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