



City of Palo Alto, California



CITY OF
**PALO
ALTO**

**2011-2012
Comprehensive Annual
Financial Report**

Fiscal Year Ended
June 30, 2012



City of Palo Alto, California



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ALTO

**2011-2012
Comprehensive Annual
Financial Report**

Fiscal Year Ended
June 30, 2012

Prepared by:
Administrative Services Department

CITY OF PALO ALTO
For the Year Ended June 30, 2012

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City of Palo Alto
Office of the City Manager

Transmittal Letter.....

November 26, 2012

THE HONORABLE CITY COUNCIL

Palo Alto, California

Attention: Finance Committee

COMPREHENSIVE ANNUAL FINANCIAL REPORT

YEAR ENDED JUNE 30, 2012

Members of the Council and Citizens of Palo Alto:

The Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2012, is submitted for Council’s 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. 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.

The City of Palo Alto’s financial statements have been audited by Macias Gini & O’Connell LLP, Certified Public Accountants. The goal of the audit is to obtain reasonable assurance that the financial statements are free of material misstatement and are fairly presented in conformity with generally accepted accounting principles (GAAP). Macias Gini & O’Connell issued an unqualified opinion for the fiscal year ended June 30, 2012. Their report is presented as the first component of the financial section of this report.

In addition, Macias Gini & O’Connell conducted 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 included in the Single Audit section of the CAFR.

An overview of the City’s financial activities for the fiscal year is discussed in detail in the Management’s Discussion and Analysis (MD&A) section of the CAFR. MD&A complements this transmittal letter and should be read in conjunction with it.

THE PALO ALTO GOVERNMENT

As a charter city serving a population of 65,544, Palo Alto delivers a full range of municipal services and public utilities under the council-manager form of government, and offers an outstanding quality of life for its residents. The City has dedicated almost 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 diverse array of human services for seniors and youths, an extensive continuing education program, concerts, exhibits, team sports and special events. The independent Palo Alto Unified School District (PAUSD) has achieved state and national recognition for the excellence of its programs.

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. Council is the appointing authority for the positions of City Manager and three other officials, the City Attorney, City Clerk, and City Auditor, all of whom report to the Council.

Finance Committee: While retaining the authority to approve all actions, the City Council has established a subcommittee to review financial matters. Staff provides the Finance Committee and Council with reports such as the CAFR, quarterly budget-versus-actual results, and investment and performance measure reports, which are utilized in their evaluation of the City’s financial position.

THE PALO ALTO ECONOMY

Employment Trends: The City of Palo Alto is a largely built-out community in the heart of Silicon Valley, in between 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, Stanford Medical Center, Palo Alto Medical Foundation, Palo Alto Unified School District, Stanford Shopping Center and businesses such as Hewlett-Packard Company, VMware, and Space Systems Loral, Palo Alto has enjoyed diverse employment and revenue bases. At the end of Fiscal Year (FY) 2012, the City’s unemployment rate had dropped to 4.7 percent from 5.3 percent the prior year, as compared to Santa Clara County’s unemployment rate of 8.7 percent, and the state’s unemployment rate of 10.7 percent.

Real Estate Market: In its most recent annual report, the Santa Clara County Assessor’s Office noted that Santa Clara County’s 2012/2013 assessment roll increased a modest 3.25%, from \$299 billion to \$309 billion, and “this year’s increase in property assessments reflects an encouraging trend and concrete evidence that the Silicon Valley economy is heading in a positive direction.” There are, however, significant geographic differences within the County. For example, Cupertino and Mountain View had increases of 6.35 and 6.56 percent, respectively; Palo Alto’s roll increased by 5.32 percent; but Gilroy experienced a .43 percent decline.

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. Palo Alto experienced 2.42 percent growth in 2012 after .35 percent growth in 2011, which in turn was down from its 11.43 percent growth in FY 2008.

Local Trends: Like jurisdictions throughout the country, the City was impacted by the Great Recession, but is now starting to show some signs of stabilization and recovery. In the past year, we



have witnessed a rebound in economically sensitive revenue sources such as sales tax, which is being driven by department store and electronics sales. Increased business activities within the City are resulting in higher transient occupancy tax revenues and development plan fees.

While these revenue sources are showing solid gains, other key revenue sources have been slow to grow. Property taxes have remained fairly stable in FY 2012 and are expected to increase modestly in FY 2013. Documentary transfer tax revenue has decreased this year compared to FY 2011, but is forecasted to start rising again in FY 2013 as the residential and commercial property markets improve.

Overall, the anticipated increase in funding sources is expected to be sufficient to cover projected FY 2013 expenses, as forecasted in the City’s Adopted Budget. The City faces rising benefit costs and a significant backlog in infrastructure investment. Staff has identified approximately \$305 million in infrastructure needs, including ongoing maintenance and new facilities such as a Public Safety building. The City Council plans to go through a prioritization process with the Community to determine possible funding sources for projects identified as priorities.

As with past economic downturns, the City is proactively taking steps to align expenses and revenues through employee compensation savings, service and program cuts, and revenue enhancements. The City Council adopted a General Fund budget with funding sources of \$151 million for FY 2013, an increase of 3.1 percent from the prior year Adopted Budget. The primary drivers of the increase are rising pension and health care costs as well as \$2.2 million to alleviate the City’s infrastructure maintenance backlog. Beginning in FY 2010, the City of Palo Alto negotiated significant compensation and benefit changes with its labor units. These changes include an increase in employee contributions to the PERS retirement plan and to health care premiums, as well as implementation of two-tier retirement plans. Negotiations with labor groups such as management, SEIU, firefighters and police will save the City almost \$9 million on an ongoing annual basis.

Long Range Financial Forecast: The City of Palo Alto produces a 10 year Long Range Financial Forecast (LRFF) annually. This comprehensive report analyzes 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 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.

The City is conscientious and proactive in its financial planning. During the last two economic downturns, the City has balanced its annual budget via expenditure reductions and revenue enhancements and has not materially drawn down reserves. Both Moody’s and Standard and Poor’s (S&P) awarded their highest credit rating of Triple A to the City’s general obligation debt. This rating has been awarded to only a few cities in California.

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, 2012, the City had \$428 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 2012, staff complied with all requirements of the City’s investment policy.

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 2012 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.

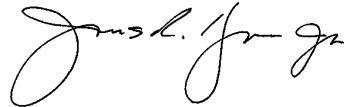
Acknowledgment: This CAFR reflects the hard work, talent and commitment of the staff members of the Administrative Services Department. This document could not have been accomplished without their efforts and each contributor deserves sincere appreciation. Management wishes to acknowledge the support of Laura Kuryk, 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 Macias Gini & O’Connell, 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

Yiaway Yeh, **Mayor**

Greg Scharff, **Vice-Mayor**

Pat Burt	Larry Klein
Sid Espinosa	Gail A. Price
Karen Holman	Greg Schmid
Nancy Shepherd	

Finance Committee

Nancy Shepherd, **Chair**
 Pat Burt
 Gail A. Price
 Greg Scharff

Policy and Services Committee

Karen Holman, **Chair**
 Sid Espinosa
 Larry Klein
 Greg Schmid

Council-Appointed Officers

City Manager

James Keene

City Attorney

Molly Stump

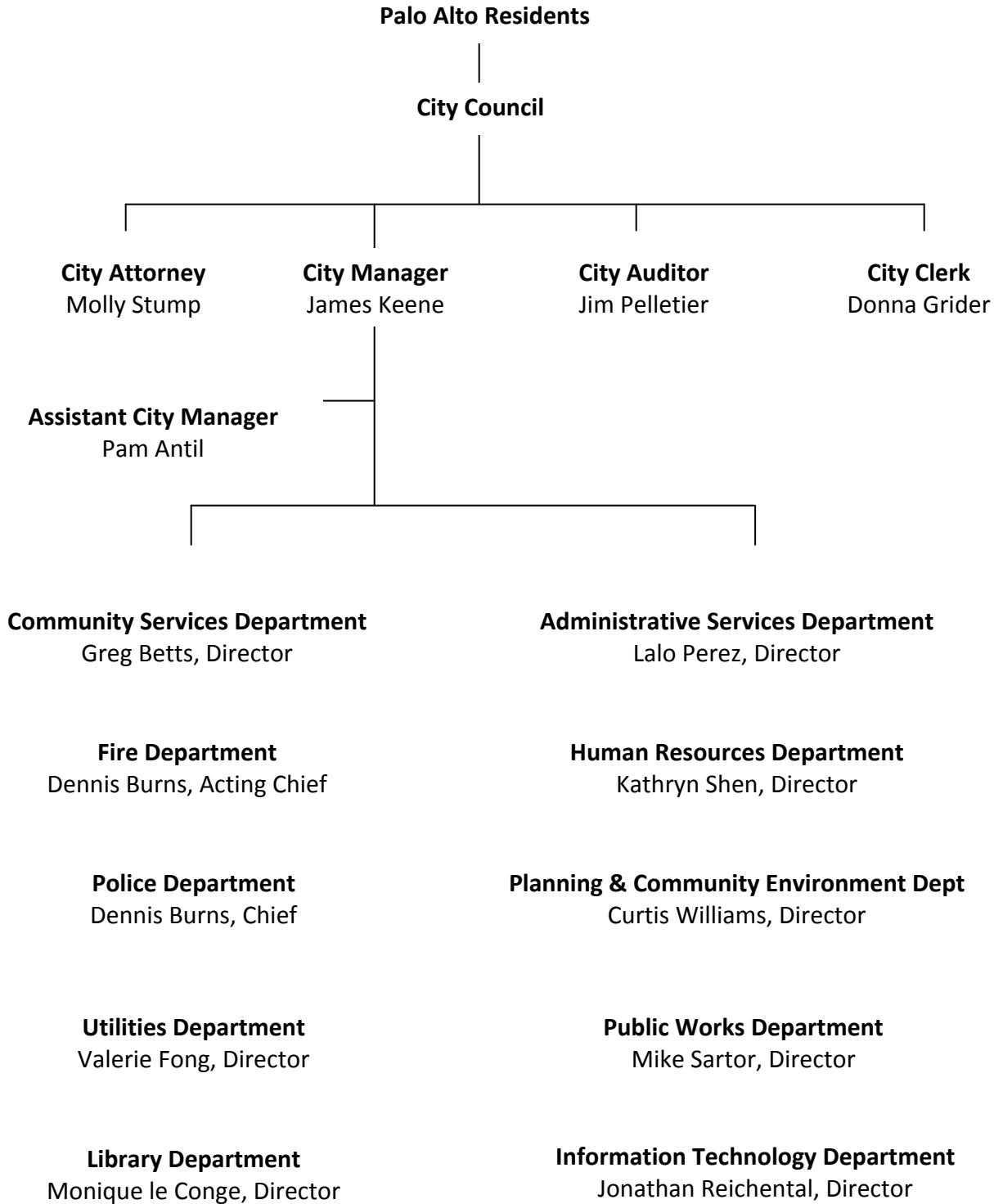
City Clerk

Donna Grider

City Auditor

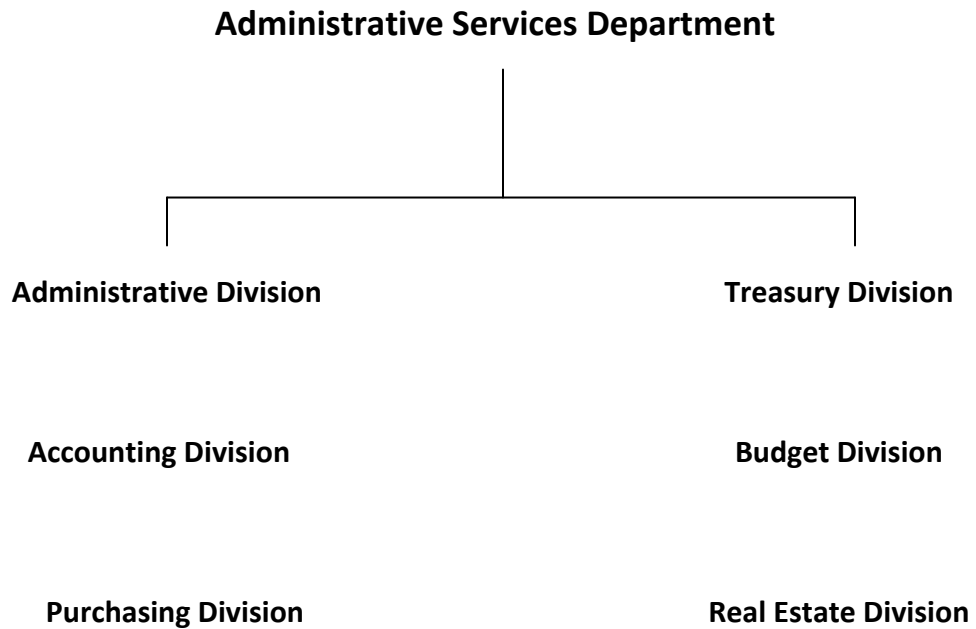
Jim Pelletier

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, 2011

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.



Christopher P. Morinell

President

Jeffrey R. Emer

Executive Director

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

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Palo Alto, California (City), as of and for the year ended June 30, 2012, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about 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 the 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 opinions.

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, as of June 30, 2012, and the respective changes in financial position, and, where applicable, cash flows thereof and the respective budgetary comparison for the General Fund 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 November 26, 2012, on our consideration of the City'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 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's financial statements as a whole. The introductory section, combining and individual nonmajor fund financial statements and schedules, and statistical section are presented for purposes of additional analysis and are not a required part of the financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the financial statements. The combining and individual nonmajor fund financial statements and schedules and the schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements 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 do not express an opinion or provide any assurance on them.

Macias Gini & Connell LLP

Walnut Creek, California
November 26, 2012



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, 2012. 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.

Financial Highlights

- The assets of City of Palo Alto exceeded its liabilities at the close of Fiscal Year (FY) 2012 by \$1,264.9 million. Of this amount, \$404.7 million represents unrestricted net assets, which may be used to meet the government's ongoing obligations to citizens and creditors.
- The City's total net assets increased by \$78.8 million primarily due to the receipt of \$20.8 million under the terms of a Development Agreement with Stanford Hospital and Clinics, Lucile Salter Packard Children's Hospital at Stanford and the Board of Trustees of the Leland Stanford Junior University (SUMC Parties).
- At the close of FY 2012, the City's governmental funds reported combined fund balances of \$162.0 million, an increase of \$20.9 million from prior year. Approximately 18.3 percent of this amount, or \$29.6 million, is unassigned fund balance and available for spending at the government's discretion.
- At the end of the current fiscal year, unrestricted fund balance (the total of the committed, assigned and unassigned components of fund balance) for the General Fund was \$36.0 million, or 23.9 percent of total general fund expenditures, including transfers.
- The City's total outstanding long-term debt decreased by \$6.0 million during the current fiscal year due to loan repayments, refinancing of Golf Course Certificates of Participation (COPs), and the refunding of a Utility Revenue Bond.

OVERVIEW OF THE COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)

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 Government-wide 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 Government-wide Financial Statements, the Fund Financial Statements and the Notes to these financial statements. This report also includes supplementary information intended to furnish additional detail to support the Basic Financial Statements.

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 entities are independent, and their balances are excluded from the City's financial statements.

Government-wide Financial Statements

The Government-wide 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. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

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. These changes are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

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 each type of activity.

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 and grants.

The City's governmental activities also include the activities of the Palo Alto Public Improvement Corporation and the Palo Alto Redevelopment Agency, which are separate legal entities financially accountable to the City. The Redevelopment Agency was dissolved effective October 7, 2011.

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, Storm Drainage and Airport. Unlike governmental services, these services are intended to recover all or a significant portion of their costs through user fees and charges, except for Airport which is currently supported by a long-term advance from the General Fund, as discussed in Note 4.

The Government-wide Financial Statements can be found on pages 29-31 of this report.



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 Governmental Accounting Standards Board (GASB) Statement No. 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.

The Fund Financial Statements display the City's operations in more detail than the Government-wide Financial Statements. Their focus is primarily on the short-term activities of the City's General Fund and other major funds such as Capital Projects, Water Services, Electric Services, Fiber Optics, Gas Services, Wastewater Collection Services, Wastewater Treatment Services, Refuse Services, Storm Drainage Services and Airport.

Budget and actual financial comparison information is presented only for the General Fund and all major Special Revenue Funds.

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

Governmental 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 Government-wide Financial Statements. In FY 2012, the City had two major governmental funds, the General Fund and the Capital Projects Fund. Data from the other governmental funds are combined into a single aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the Supplemental section of this report.

Because the focus of governmental funds is narrower than that of the Government-wide Financial Statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the Government-wide Financial Statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the Governmental Fund Balance Sheet and the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The Governmental Fund Financial Statements can be found on pages 33-37 of this report.

Proprietary Funds

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 include all of their assets and liabilities, both 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 Technology and General Benefits, cannot be considered major funds because their revenues are derived from other City funds. Revenues between funds are eliminated in the Government-wide Financial



Management's Discussion and Analysis

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.

The Proprietary Fund Financial Statements can be found on pages 38-43 of this report.

Fiduciary Funds

The City is the fiduciary agent for certain assessment districts such as the University Avenue Area Parking Assessment District, and holds amounts collected from property owners that await transfer to the districts' bond trustees. The City's fiduciary activities are reported in the separate Statement of Fiduciary Assets and Liabilities and the supplemental 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.

The Fiduciary Fund Financial Statements can be found on page 44 of this report.

Notes to the Financial Statements

The Notes provide additional information that is necessary to acquire a full understanding of the data provided in the Government-wide and Fund Financial Statements. The Notes to the financial statements can be found on pages 45-104 of this report.

Other Information

The combining statements referred to earlier in connection with non-major Governmental Funds and Internal Service Funds are presented immediately following the Notes to the financial statements. Combining statements and individual fund statements and schedules can be found on pages 105-130 of this report.

Financial Analysis of Government-wide Financial Statements

This section focuses on the City's net assets and changes in net assets of its governmental and business-type activities for the fiscal year ending June 30, 2012. As noted earlier, the City's total assets exceed total liabilities by \$1,264.9 million at the end of the fiscal year, an improvement in net position of \$78.8 million.

STATEMENT OF NET ASSETS

As of June 30, 2012

(in millions)

	Governmental Activities		Business-type Activities		Government-wide Totals	
	2012	2011	2012	2011	2012	2011
Cash and investments	\$ 215.9	\$ 190.6	\$ 281.0	\$ 274.0	\$ 496.9	\$ 464.6
Other assets	49.8	47.5	39.2	40.8	89.0	88.3
Capital assets	413.2	393.4	490.0	465.7	903.2	859.1
Total Assets	678.9	631.5	810.2	780.5	1,489.1	1,412.0
Long-term debt	62.5	64.8	83.4	87.1	145.9	151.9
Other liabilities	51.3	50.8	27.0	23.2	78.3	74.0
Total Liabilities	113.8	115.6	110.4	110.3	224.2	225.9
Net Assets						
Invested in capital assets, net of related debt	370.1	364.8	437.2	416.4	807.3	781.2
Restricted	52.9	16.4	-	-	52.9	16.4
Unrestricted	142.1	134.7	262.6	253.8	404.7	388.5
Total Net Assets	\$ 565.1	\$ 515.9	\$ 699.8	\$ 670.2	\$ 1,264.9	\$ 1,186.1

The largest portion of the City's net asset position (63.8 percent) is its investment in capital assets such as land, buildings, infrastructure and vehicles, less any related outstanding debt that was used to acquire those assets. The City uses these capital assets to provide a variety of services to its citizens. Accordingly, these assets are not available for future spending. Although the City's investment in capital assets is reported net of related debt, it should be noted that the resources used to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The restricted portion of the City's net asset position (4.2 percent) represents resources that are subject to external restrictions on how they may be used. The remaining balance of \$404.7 million, representing 32.0 percent of the City's net assets, is unrestricted and may be used to meet the government's ongoing obligations to its citizens and creditors.

At the end of the current fiscal year, the City is able to report positive balances in all reported categories of net assets, both for the government as a whole, and for its separate governmental and business-type activities. The same situation held true for the prior fiscal year.

Reasons for the \$78.8 million increase in total net assets are discussed in the following sections for governmental activities and business-type activities.

Governmental Activities – Net Assets

The following analysis focuses on the net assets and changes in net assets of the City's Governmental Activities, presented in the Government-wide Statement of Net Assets and Statement of Activities.

GOVERNMENTAL ACTIVITIES

Net Assets at June 30

(in millions)

	<u>2012</u>	<u>2011</u>	<u>Increase/ (Decrease)</u>
Cash and investments	\$ 215.9	\$ 190.6	\$ 25.3
Other assets	49.8	47.5	2.3
Capital assets	413.2	393.4	19.8
Total Assets	<u>678.9</u>	<u>631.5</u>	<u>47.4</u>
Long-term debt	62.5	64.8	(2.3)
Other liabilities	51.3	50.8	0.5
Total Liabilities	<u>113.8</u>	<u>115.6</u>	<u>(1.8)</u>
Net Assets			
Invested in capital assets, net of related debt	370.1	364.8	5.3
Restricted	52.9	16.4	36.5
Unrestricted	142.1	134.7	7.4
Total Net Assets	<u>\$ 565.1</u>	<u>\$ 515.9</u>	<u>\$ 49.2</u>

The City's Governmental activities total net assets increased \$49.2 million to \$565.1 million as of June 30, 2012. This increase was a result of the following:

- Cash and investments increased \$25.3 million primarily due to the receipt of \$20.8 million for the Development Agreement with SUMC Parties that was signed in June, 2011.
- Capital assets net of depreciation increased \$19.8 million due to improvements to the Downtown Library, Art Center electrical and mechanical upgrades, construction of the Mitchell Park Library and Community Center, and additions to the City's network of roadways and sidewalks.

- Net assets invested in capital assets, net of related debt, increased \$5.3 million to \$370.1 million. Restricted net assets increased \$36.5 million to \$52.9 million. Unrestricted net assets increased \$7.4 million to \$142.1 million. Unrestricted net assets represent current net assets available to finance subsequent year operations and other expenditures approved by City Council.

Governmental Activities – Revenues

The table below shows that Governmental activities revenues totaled \$169.4 million in FY 2012, an increase of \$35.7 million over prior year revenues of \$133.7 million.

GOVERNMENTAL ACTIVITIES
Revenues for the Year Ended June 30
(in millions)

<u>Revenues by Source</u>	<u>2012</u>	<u>2011</u>	<u>Increase/ (Decrease)</u>
Program Revenues:			
Charges for services	\$ 62.8	\$ 36.0	\$ 26.8
Operating grants and contributions	3.4	2.9	0.5
Capital grants and contributions	1.1	1.9	(0.8)
Total Program Revenues	<u>\$ 67.3</u>	<u>\$ 40.8</u>	<u>\$ 26.5</u>
General Revenues:			
Property tax	30.1	29.2	0.9
Sales tax	22.1	20.7	1.4
Utility user tax	10.8	10.8	-
Transient occupancy tax	9.7	8.1	1.6
Documentary transfer tax	4.8	5.2	(0.4)
Other tax	3.4	3.0	0.4
Investment earnings	6.2	3.5	2.7
Rents and miscellaneous	15.0	12.4	2.6
Total General Revenues	<u>102.1</u>	<u>92.9</u>	<u>9.2</u>
Total Revenues	<u>\$ 169.4</u>	<u>\$ 133.7</u>	<u>\$ 35.7</u>

Total Program Revenues increased \$26.5 million from the prior year, primarily due to increased charges for services. The majority of the increase is due to the following:

- \$20.8 million received from the SUMC Parties Development Agreement;
- \$2.3 million increase in building and zone plan check fees due to increased building activity;
- \$1.5 million due to an increase in new construction permits.



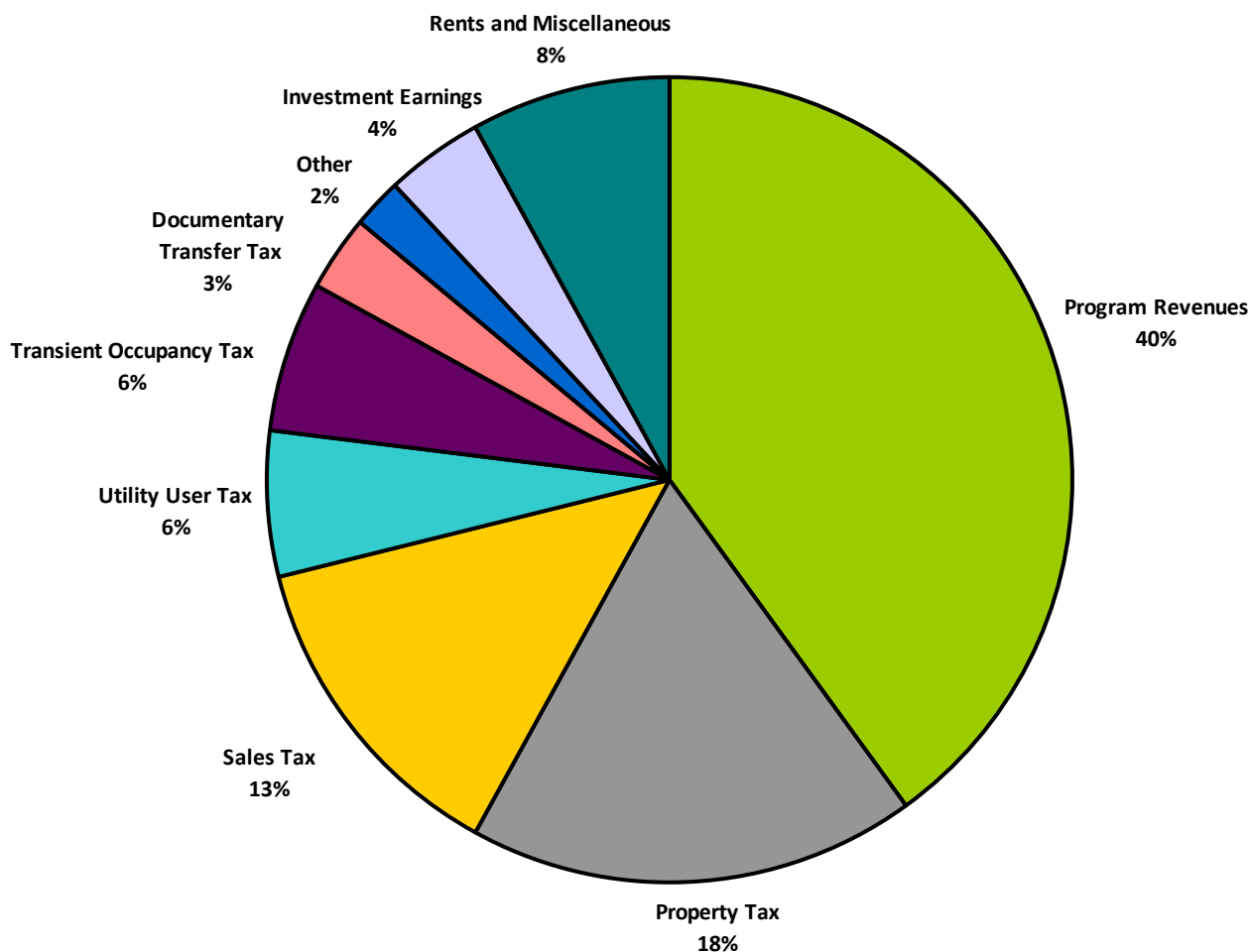
A donation of \$1.4 million was received from the Palo Alto Library Foundation.

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 sources.

General revenues increased \$9.2 million, or 9.9 percent, over the prior year. Further analysis of general revenues can be found in the Financial Analysis of Governmental Funds section of the MD&A.

Governmental Activities – Revenues by Source

The chart below presents revenues by source for Governmental Activities. General revenues are composed of taxes and other revenues not specifically generated by, or restricted to, individual activities. All tax revenues and investment earnings are included in general revenues.



Governmental Activities – Expenses

The table below presents a comparison of FY 2012 and FY 2011 expenses by function, and interest on long-term debt. Encumbrances and reappropriations are not included. Total Governmental Activities functional expense was \$137.5 million in FY 2012, a decrease of \$3.4 million, or 2.4 percent.



GOVERNMENTAL ACTIVITIES
Expenses and Change in Net Assets for the Year Ended June 30
(in millions)

<u>Activities</u>	<u>2012</u>	<u>2011</u>	<u>Increase/ (Decrease)</u>
City Council	\$ 0.3	\$ 0.1	\$ 0.2
City Manager	1.9	1.8	0.1
City Attorney	1.7	1.0	0.7
City Clerk	0.9	0.8	0.1
City Auditor	0.2	0.1	0.1
Administrative Services	10.1	9.9	0.2
Human Resources	1.1	1.3	(0.2)
Public Works	14.6	19.4	(4.8)
Planning and Community Environment	12.1	15.0	(2.9)
Police	33.5	30.5	3.0
Fire	29.3	28.5	0.8
Community Services	21.9	22.9	(1.0)
Library	7.3	6.9	0.4
Interest on long-term debt	2.6	2.7	(0.1)
Total Functional Expense	<u>137.5</u>	<u>140.9</u>	<u>(3.4)</u>
Increase/(Decrease) in Net Assets			
before Transfers	31.8	(7.2)	39.0
Transfers in	<u>17.4</u>	<u>17.1</u>	<u>0.3</u>
Change in net Assets	49.2	9.9	39.3
Net Assets, Beginning	<u>515.9</u>	<u>506.0</u>	<u>9.9</u>
Net Assets, Ending	<u>\$ 565.1</u>	<u>\$ 515.9</u>	<u>\$ 49.2</u>



Changes in year-over-year balances are described at the fund level in the Financial Analysis of Governmental Funds section of the MD&A.

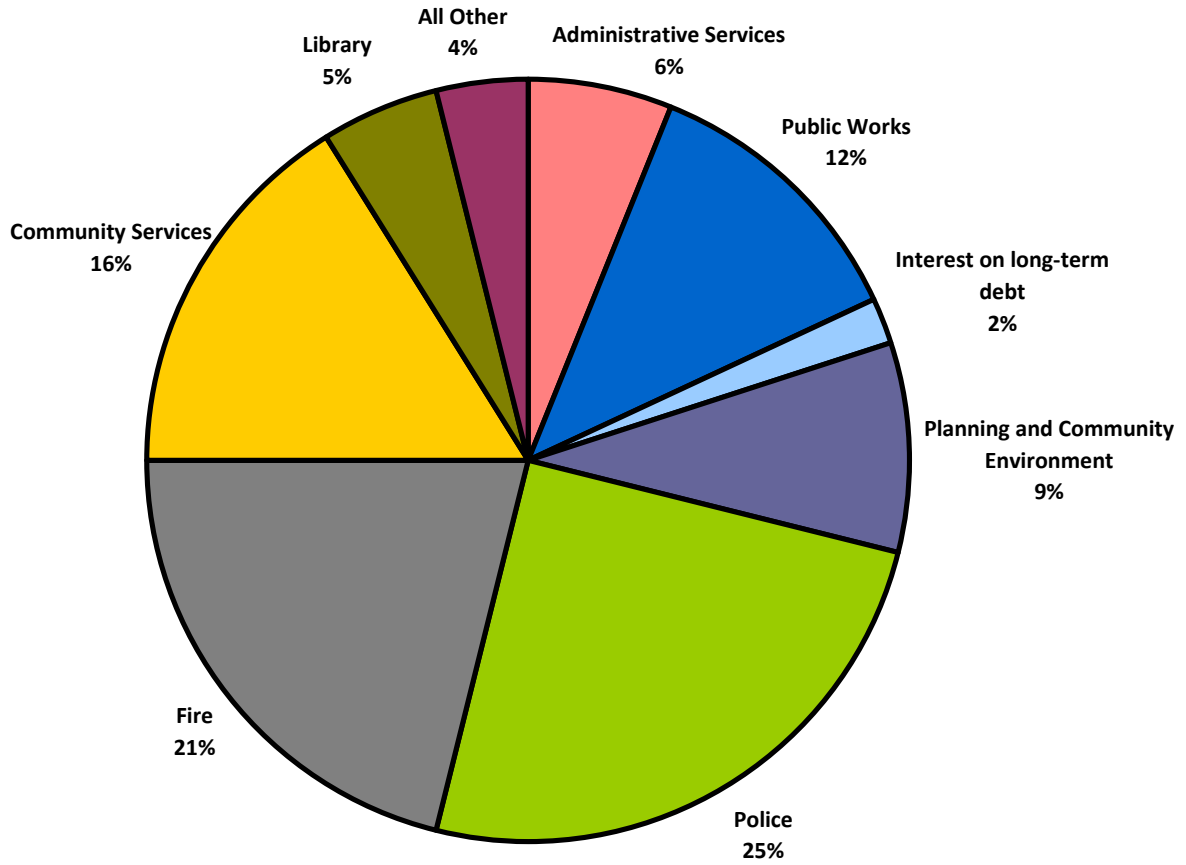
Governmental Activities – Functional Expenses

The functional expenses chart below includes only current year expenses. It does not include capital outlays, as those are added to the City's capital assets. Functions which comprise 1% or less of total expenses are



Management's Discussion and Analysis

combined into the All Other category in the chart below. All Other includes City Council, City Manager, City Attorney, City Clerk, City Auditor and Human Resources.



Business-type Activities – Net Assets

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

BUSINESS-TYPE ACTIVITIES			
Net Assets at June 30			
(in millions)			
	2012	2011	Increase/ (Decrease)
Cash and investments	\$ 281.0	\$ 274.0	\$ 7.0
Other assets	39.2	40.8	(1.6)
Capital assets	490.0	465.7	24.3
Total Assets	810.2	780.5	29.7
Long-term debt	83.4	87.1	(3.7)
Other liabilities	27.0	23.2	3.8
Total Liabilities	110.4	110.3	0.1
Net Assets			
Invested in capital assets, net of related debt	437.2	416.4	20.8
Unrestricted	262.6	253.8	8.8
Total Net Assets	\$ 699.8	\$ 670.2	\$ 29.6

The City's Business-type activities total net assets increased \$29.6 million to \$699.8 million as of June 30, 2012.

Capital assets increased \$24.3 million to \$490.0 million in FY 2012 as a result of Water, Electric and Gas infrastructure improvements. Additions include \$9.7 million of capital improvements in Water, \$6.4 million of capital improvements in Electric, and \$5.1 million of capital improvements in Gas.

Other liabilities increased \$3.8 million primarily due to Water engineering services.

Net assets invested in capital assets, net of related debt, increased \$20.8 million to \$437.2 million.

Unrestricted net assets of \$262.6 million, an increase of \$8.8 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 \$121.7 million, the Electric special projects (Calaveras) reserve for stranded costs of \$50.3 million, and the emergency plant replacement reserve of \$6.9 million.

Business-type Activities – Revenues

The table below 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, Storm Drainage and Airport Funds, which are major funds and are presented in the Basic Financial Statements.

BUSINESS-TYPE ACTIVITIES
Revenues for the Year Ended June 30
(in millions)

Revenues by Source	2012	2011	Increase/ (Decrease)
Program Revenues:			
Charges for services	\$ 269.5	\$ 265.8	\$ 3.7
Operating grants and contributions	0.6	0.6	-
Capital grants and contributions	1.5	3.0	(1.5)
Total Program Revenues	<u>\$ 271.6</u>	<u>\$ 269.4</u>	<u>\$ 2.2</u>
General Revenues:			
Investment earnings	7.6	5.7	1.9
Total General Revenues	<u>7.6</u>	<u>5.7</u>	<u>1.9</u>
Total Revenues	<u><u>\$ 279.2</u></u>	<u><u>\$ 275.1</u></u>	<u><u>\$ 4.1</u></u>

Business-type Activities revenues totaled \$279.2 million, an increase of \$4.1 million, or 1.5 percent, from the prior year. Revenues were affected by the following events:

- Charges for services increased by \$3.7 million from the prior year due to a Water Fund rate increase in October 2011.
- Capital grants and contributions decreased by \$1.5 million from the prior year due to the decrease of grant revenues for Wastewater Treatment Fund.

Business-type Activities – Expenses

The table below presents a comparison of the FY 2012 and FY 2011 expenses for the City's Business-type Activities. Encumbrances and reappropriations are not included.

BUSINESS-TYPE ACTIVITIES			
Expenses and Change in Net Assets for the Year Ended June 30			
(in millions)			
Business-type Activities	2012	2011	Increase/ (Decrease)
Water	\$ 29.1	\$ 24.3	\$ 4.8
Electric	102.0	100.1	1.9
Fiber optics	1.5	1.6	(0.1)
Gas	28.9	32.0	(3.1)
Wastewater collection	14.8	12.3	2.5
Wastewater treatment	20.7	19.7	1.0
Refuse	31.9	30.7	1.2
Storm drainage	3.1	3.2	(0.1)
Airport	0.2	0.1	0.1
Total Functional Expense	232.2	224.0	8.2
Increase/(Decrease) in Net Assets before Transfers	47.0	51.3	(4.3)
Transfers out	17.4	17.1	0.3
Change in net Assets	29.6	34.2	(4.6)
Net Assets, Beginning	670.2	636.0	34.2
Net Assets, Ending	\$ 699.8	\$ 670.2	\$ 29.6

Business-type Activities expenses increased \$8.2 million for a total of \$232.2 million. Year over year expenses were significantly affected by the following events:

- Water Fund expenses increased \$4.8 million from prior year primarily due to an increase in retail purchase of utilities. Further detail can be found in Note 16 to the financial statements.
- Electric Fund expenses increased \$1.9 million primarily due to a \$1.5 million increase in interest expense charged by the NCPA joint agency and increased administrative and general expenses.
- Gas Fund expenses decreased \$3.1 million due to a decrease in retail purchase of utilities. Further detail can be found in Note 16 to the financial statements.
- Wastewater Collection Fund expenses increased by \$2.5 million due to a \$1.5 million increase in retail purchase of utilities and a \$.8 million increase in depreciation expense.

FUND FINANCIAL STATEMENTS

Financial Analysis of Governmental Funds

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, the unassigned fund balance may serve as a useful measure of a government's net resources available for discretionary use as they represent the portion of fund balance which has not yet been limited to use for a particular purpose by either an external party, the City itself, or a group or individual that has been delegated authority to assign resources for use for particular purposes by the City's Council.

As of June 30, 2012, the City's Governmental Funds reported combined fund balances of \$162.0 million, an increase of \$20.9 million from the prior year. Approximately 18.3 percent, or \$29.6 million, constitutes unassigned fund balance, which is available for spending at the government's discretion. The remainder of the fund balance is either nonspendable, restricted, committed, or assigned to indicate that it is 1) not in spendable form (\$17.1 million), 2) restricted for particular purposes (\$61.3 million), 3) committed for particular purposes (\$14.3 million), or 4) assigned for particular purposes (\$39.7 million).

Governmental Fund revenues increased \$35.0 million, or 26.4 percent, from prior year to \$167.4 million. Revenues in the General Fund increased \$8.3 million and Capital Projects Fund revenue decreased \$1.0 million. Other Governmental Funds revenue increased by \$27.8 million primarily due to the receipt of \$20.8 million from the SUMC Parties Development Agreement and a \$2.8 million increase in Housing-In-Lieu residential funds.

Governmental Fund expenditures were \$164.1 million, an increase of \$3.2 million from the prior year. General Fund expenditures increased \$6.8 million, Capital Projects Fund expenditures decreased by \$6.3 million, and Non-major Fund expenditures increased by \$2.8 million.

General Fund Balance Sheet

The General Fund is the chief operating fund of the City. At the end of the current fiscal year, fund balance of the General Fund was \$42.0 million, compared to \$44.2 million in the prior year. The fund balance has been classified as \$6.0 million nonspendable, \$6.4 million assigned, and \$29.6 million unassigned. Of the unassigned amount, \$28.1 million is designated by the Council for budget stabilization. That amount represents 18.5 percent of the FY 2013 budgeted expenditures and operating transfers, and is the target balance intended to fund unbudgeted, unanticipated one-time costs. Funds in excess of the target balance were transferred to the Infrastructure Reserve in the Capital Projects Fund, as allowed by the General Fund Reserve Policy.

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

The City's General Fund revenues totaled \$125.6 million in FY 2012. This represents an increase of \$8.3 million, or 7.1 percent, compared to the prior year. The year over year change in significant revenue sources is noted in the following table.

GENERAL FUND
Revenues for the Year Ended June 30
(in millions)

Revenues by Source	2012	2011	Increase/ (Decrease)
Property tax	\$ 26.5	\$ 25.7	\$ 0.8
Sales tax	22.1	20.7	1.4
Utility user tax	10.8	10.9	(0.1)
Transient occupancy tax	9.7	8.1	1.6
Documentary transfer tax	4.8	5.2	(0.4)
Charges for services	24.9	22.3	2.6
Permits and licences	6.6	5.1	1.5
Rental income	14.3	14.3	-
All other	5.9	5.0	0.9
Total Revenues	\$ 125.6	\$ 117.3	\$ 8.3

Property tax revenue increased by \$0.8 million, or 3.1 percent, over FY 2011 for a total of \$26.5 million, which was in line with County growth expectations. The recent rise in median home sale prices in Palo Alto will be reflected in FY 2013 property tax revenues.

Sales tax revenue increased by \$1.4 million, or 6.7 percent, over FY 2011 levels for a total of \$22.1 million. The increase was driven by strong retail sales in the department store and electronics sales categories.

Utility user tax remained flat year over year. Higher utility-generated revenues were offset by lower telephone-generated revenues, which are declining due to fewer land lines and changes in the billing practices of the providers.

Transient occupancy tax continued to improve, and increased by \$1.6 million, or 19.8 percent, due to increased business activity and improving occupancy and room rates. Both occupancy and room rates have been steadily increasing through FY 2012.

Documentary transfer tax declined \$0.4 million to \$4.8 million. This tax source was particularly lucrative in FY 2011 due to a small number of high dollar commercial transactions. In FY 2012 the revenue declined due to a shift in the mix of commercial and residential transactions.

Charges for services totaled \$24.9 million in FY 2012, an increase of \$2.6 million from the prior year. The increase was primarily due to an increase in building and zone plan check fees as a result of increased building activity within the City. The City also implemented a Development Center Blue Print Process which streamlined and modernized the City's permit process.

Permits and licenses revenue increased over prior year by \$1.5 million, most of which is attributed to an increase in new construction permits.

Expenditures

General Fund expenditures totaled \$128.3 million for FY 2012 compared to \$121.5 in the prior year. This amount excludes encumbrances and reappropriations. The year over year change for major functions is noted in the following table:

GENERAL FUND
Expenditures for the Year Ended June 30
(in millions)

<u>Expenditures by Function</u>	<u>2012</u>	<u>2011</u>	<u>Increase/ (Decrease)</u>
Administrative Services	\$ 3.3	\$ 3.3	\$ -
Public Works	11.3	11.3	-
Planning and Community Environment	10.3	9.4	0.9
Police	33.2	30.5	2.7
Fire	29.1	28.4	0.7
Community Services	20.8	20.0	0.8
Library	7.1	6.5	0.6
Non-Departmental	6.6	7.1	(0.5)
All other	6.6	5.0	1.6
Total Expenditures	<u>\$ 128.3</u>	<u>\$ 121.5</u>	<u>\$ 6.8</u>

The increase from prior year of \$6.8 million, or 5.6 percent, includes the following costs which are spread across all functions:

- \$1.6 million increase in retiree medical costs;
- \$1.9 million increase in benefit allocation costs, primarily pension, and
- \$1.0 million increase for liability insurance.

In addition to the above, the following cost increases are specific to the named function:

- Library increased by \$0.6 million due to increased book purchases;
- Community Services increased due to increased contract services costs, and

- Planning and Community Environment increased due to technology enhancements for the Development Center.

Transfers out for FY 2012 were \$22.1 million compared to \$11.0 million in the prior year. Of the \$11.1 million increase, \$7.6 million was due to the transfer of funds in excess of the 18.5 percent target for General Fund Budget Stabilization Reserve (BSR) to the Infrastructure Reserve in the Capital Projects Fund.

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

Original budget compared to final budget:

Revenues were originally budgeted at \$126.9 million and were revised upward by \$10.9 million, which included \$3.9 million for the prior year encumbrance reserve. Significant items contributing to the difference between original budget amounts and final budget amounts for revenue categories were as follows:



GENERAL FUND
Budgeted Revenues for the Year Ended June 30
(in millions)

<u>Budgeted Revenues</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Increase/ (Decrease)</u>
Sales tax	\$ 20.2	\$ 21.6	\$ 1.4
Transient occupancy tax	8.2	8.7	0.5
Documentary transfer tax	4.3	4.8	0.5
Charges for services	21.8	22.6	0.8
Permits and licences	5.8	6.5	0.7
All other	56.1	56.0	(0.1)
	<u>116.4</u>	<u>120.2</u>	<u>3.8</u>
Charges to other funds	10.5	10.5	-
Lease proceeds	-	3.2	3.2
Prior year encumbrances and appropriations	-	3.9	3.9
Total Budgeted Revenues	<u>\$ 126.9</u>	<u>\$ 137.8</u>	<u>\$ 10.9</u>



Adjustments to the original budget were based on the following:

- Sales tax was increased by \$1.4 million from the original budget due to stronger sales tax performance in the calendar year third quarter and indications of strong retail sales in the fourth quarter. The projected target was in line with the sales tax consultant's estimate.
- Transient occupancy tax budgeted amount of \$8.2 million was increased by \$0.5 million due to higher trending receipts from existing establishments.
- Documentary transfer tax budgeted amount was increased by \$0.5 million based on recent revenue trends and the real estate market outlook.



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- Charges for services budget was increased by \$0.8 million to \$22.6 million due to implementation of the Development Center Blueprint Process Plan which streamlined and modernized the City's permit process.
- Permits and licenses budget was increased by \$0.7 million due to an increase in development activity in the City.
- The budget for other revenue was increased by \$0.8 million, primarily due to the receipt of Library donations.
- Revenue from lease proceeds was increased by \$3.2 million due to the receipt of proceeds resulting from execution of a master lease agreement with JP Morgan Chase N.A.

Significant differences between final budgeted revenues of \$137.8 million and actual revenues of \$144.4 million, a difference of \$6.6 million, are explained by the following:

- Sales and transient occupancy taxes were \$1.5 million higher than the final budget due to the continued upward trend in sales and business activity.
- Charges for services actual revenue for the year was \$25.1 million, or \$2.6 million more than the final budgeted amount, as a result of increased paramedic fees and building and zone plan check fees.
- Charges to other funds actual revenue was \$11.6 million, or \$1.1 million higher than the final budget amount, due to the true-up of cost plan charges at the end of the year.

Expenditures were originally budgeted at \$134.5 million and were revised upward by \$11.5 million for a final budgeted amount of \$146.0 million. Significant items contributing to the difference between original budget amounts and final budget amounts for expenditure categories were as follows:



GENERAL FUND
Budgeted Expenditures for the Year Ended June 30
(in millions)

<u>Budgeted Expenditures</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Increase/ (Decrease)</u>	<u>Actuals, plus Encumbrances</u>
Administrative Services	\$ 6.5	\$ 7.2	\$ 0.7	\$ 7.2
Community Services	20.7	21.6	0.9	21.4
Fire	29.8	30.2	0.4	30.1
Library	6.9	7.8	0.9	7.7
Planning and Community Environment	10.0	12.1	2.1	11.2
Police	31.9	33.8	1.9	33.8
Public Works	13.0	14.0	1.0	13.8
Non-Departmental	5.0	7.4	2.4	8.2
All other	10.7	11.9	1.2	11.5
Total Budgeted Expenditures	<u>\$ 134.5</u>	<u>\$ 146.0</u>	<u>\$ 11.5</u>	144.9
Less: Charges to Other Funds				(11.7)
Less: Encumbrances				<u>(4.9)</u>
Net General Fund Expenditures				<u>\$ 128.3</u>



Adjustments of \$11.5 million to the original budget were based on the following:

- \$2.3 million for increased retiree medical costs;
- \$3.4 million for Public Safety labor concessions which were not achieved;
- \$1.5 million for expenses related to implementation of the Blueprint Process Plan for the Development Center, and
- \$3.8 million for carry-forward of encumbrances from prior year.

The final budgeted expenditure amount of \$146.0 million compares to the actual expenditures plus encumbrances of \$144.9 million, a difference of \$1.1 million. The lower than budgeted expenditures were primarily due to the delay in completion of the Development Center expansion project.

Transfers out were originally budgeted at \$11.8 million, with the final budget number at \$15.1 million, an increase of \$3.3 million which was the result of a \$2.6 million transfer to the Debt Service Fund for refinancing of Golf Course COPs and \$0.6 million that was budgeted for a loan to the Refuse Fund. The actual transfers out for the year were \$22.1 million, or \$7.0 million greater than final budget due to the end of year transfer

from the General Fund BSR to the Capital Projects Infrastructure Reserve of \$7.6 million, offset by a reduction of \$0.6 million as the Refuse Fund loan was not required.

Capital Projects Fund

Capital Projects Fund expenditures and other uses were \$32.6 million in FY 2012, which is a decrease of \$3.7 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.

Financial Analysis of Enterprise Funds

At June 30, 2012, the City's Enterprise Funds reported total net assets of \$697.5 million, an increase of \$29.3 million or 4.4 percent over the prior year. The increase was primarily from the Water, Electric and Gas Funds for \$4.5 million, \$9.0 million and \$7.8 million, respectively. Unrestricted net assets for the Enterprise Funds totaled \$260.3 million, a 3.4 percent increase from FY 2011.

Following is a table which compares the year over year change in net assets for each of the Enterprise Funds:

ENTERPRISE FUNDS
Change in Net Assets for the Year Ended June 30
(in millions)

Fund Name	2012	2011	Increase/ (Decrease)
Water	\$ 4.5	\$ 3.5	\$ 1.0
Electric	9.0	13.1	(4.1)
Fiber Optics	2.6	2.1	0.5
Gas	7.8	6.2	1.6
Wastewater Collection	0.9	3.4	(2.5)
Wastewater Treatment	2.1	1.4	0.7
Refuse	(0.5)	0.3	(0.8)
Storm Drainage	3.0	3.0	-
Airport	(0.1)	-	(0.1)
Total Change in Net Assets	\$ 29.3	\$ 33.0	\$ (3.7)



The most significant factors in the year over year change in net assets for Enterprise Funds are as follows:

- Electric change in net assets for the year was \$9.0 million, a decrease of \$4.1 million from the prior year. The decrease was a combination of a \$3.2 million decrease in operating revenues, primarily commercial revenue, and a \$0.8 million increase in non-operating expenses. The ending RSR balance is \$74.6 million, an increase of \$8.3 million from prior year.
- Gas ended the year with change in net assets of \$7.8 million, compared to \$6.2 million in the prior year, an increase of \$1.6 million. The increase is due to a \$3.3 million decrease in operating expenses, offset by a \$1.8 million decrease in operating revenue. The ending RSR balance is \$16.0 million, a decrease of \$0.2 million from prior year.
- Wastewater Collection ended the year with change in net assets of \$0.9 million compared to \$3.4 million in the prior year. The decreased change in net assets is primarily due to a \$1.5 million increase in purchase of utilities expense and a \$1.0 million increase in operating expenses. The ending RSR balance is \$4.8 million, a decrease of \$1.1 million from prior year.
- Refuse ended the year with a change in net assets of negative \$0.5 million, compared to a \$0.3 million change in net assets in FY 2011. The decrease of \$0.8 million is due to increased operations and maintenance expense. The ending RSR balance is negative \$4.1 million, compared to a negative \$5.0 million the prior year, an improvement of \$0.9 million. Compliance requirements for the landfill closure and post-closure maintenance plan are discussed in detail in Note 9.

CAPITAL ASSETS

GASB 34 requires that the City record all its capital assets, including infrastructure and intangible assets. Infrastructure includes roads, bridges, signals and similar assets used by the entire population. The table below shows capital assets and the amount of accumulated depreciation for these assets for Governmental and Business-type Activities. Further detail can be found in Note 6 to the financial statements.

CAPITAL ASSETS AT JUNE 30			
(in millions)			
	<u>2012</u>	<u>2011</u>	<u>Increase/ (Decrease)</u>
Governmental Activities			
Capital Assets			
Land and improvements	\$ 78.6	\$ 78.6	\$ -
Street trees	15.4	15.4	-
Construction in progress	55.3	36.2	19.1
Buildings and improvements	132.9	124.0	8.9
Intangible assets - Easement	3.8	3.8	-
Equipment	10.1	9.7	0.4
Roadway network	272.4	267.5	4.9
Recreation and open space network	23.1	21.8	1.3
Less accumulated depreciation	(194.2)	(183.7)	(10.5)
Internal Service Fund Assets			
Construction in progress	0.2	0.2	-
Equipment	51.5	51.7	(0.2)
Less accumulated depreciation	(35.9)	(31.8)	(4.1)
Total Governmental	<u>\$ 413.2</u>	<u>\$ 393.4</u>	<u>\$ 19.8</u>
Business-type Activities			
Land	\$ 5.0	\$ 5.0	\$ -
Construction in progress	99.3	132.4	(33.1)
Buildings and improvements	32.7	31.9	0.8
Transmission, distribution and treatment systems	616.0	545.6	70.4
Less accumulated depreciation	(263.0)	(249.2)	(13.8)
Total Business-type	<u>\$ 490.0</u>	<u>\$ 465.7</u>	<u>\$ 24.3</u>

Governmental Activities' capital assets net of depreciation increased by \$19.8 million from the prior year. The increase was primarily due to improvements for the Downtown Library, Art Center electrical and mechanical upgrades, construction of the Mitchell Park Library and Community Center, and street and sidewalk improvements.



In early 2010, the Palo Alto City Council established an Infrastructure Blue Ribbon Commission (IBRC) to review the City's General Fund infrastructure needs and to recommend resources to fill any funding gaps identified. The Commission issued their report dated December 22, 2011 in which they identified a deferred maintenance backlog of \$41.5 million for "keep up" needs, and major capital expenditures of \$210.7 million for "new and replacement" needs, including replacement of the Public Safety Building and the Municipal Services Center. Funding sources include an increase in the annual capital transfer from the General Fund for "keep up" needs, and potentially placing an infrastructure financing measure on a future ballot to finance "new and replacement" needs.

Major governmental activities' capital projects that are currently in progress, and the remaining capital commitment of each, are as follows:

- Mitchell Park Library and Community Center - \$21.0 million
- Main Library - \$16.2 million
- Art Center electrical and mechanical upgrades - \$2.7 million

Business-type Activities' capital assets net of depreciation increased by \$24.3 million over FY 2011. The increase is due to Water, Electric and Gas infrastructure improvements.

Major business-type activities' capital projects that are currently in progress, and the remaining capital commitment of each, are as follows:

- Emergency water supply improvement for Water Fund - \$17.6 million
- Gas main replacement project for Gas Fund - \$6.6 million
- Plant equipment replacement for Wastewater Treatment Fund - \$3.9 million
- Wastewater Collection Fund rehabilitation/augmentation project - \$3.1 million

The City depreciates 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 are in Note 6.

DEBT ADMINISTRATION

Each of the City's debt issues is discussed in detail in Note 7 to the financial statements. At June 30, 2012, the City's debt was comprised of the following:

LONG-TERM DEBT AT JUNE 30 (in millions)

	<u>2012</u>	<u>2011</u>	<u>Increase/ (Decrease)</u>
Governmental Activities			
General Long-Term Obligations			
Certificates of Participation			
1998 Golf Course	\$ -	\$ 3.7	\$ (3.7)
2002A Civic Center Refinancing	-	0.4	(0.4)
2002B Downtown Parking Improvements	1.7	1.8	(0.1)
General Obligation Bonds			
2010 Series A	54.5	55.3	(0.8)
2011 Lease Purchase Agreement	2.8	-	2.8
Add: unamortized premium	3.5	3.6	(0.1)
Total Governmental	<u>\$ 62.5</u>	<u>\$ 64.8</u>	<u>\$ (2.3)</u>
Business-type Activities			
Enterprise Long-Term Obligations			
Utility Revenue Bonds			
1995 Series A	\$ 4.2	\$ 4.6	(0.4)
1999 Refunding	12.2	12.7	(0.5)
2002 Series A	-	18.1	(18.1)
2009 Series A	33.4	34.2	(0.8)
2011 Series A	16.2	-	16.2
Less: unamortized premium (discount) and loss on refunding	0.6	(0.2)	0.8
Energy Tax Credit Bonds			
2007 Series A	1.0	1.1	(0.1)
Less: unamortized premium (discount)	(0.1)	(0.1)	-
State Water Resources Loan			
2007	7.7	8.1	(0.4)
2009	8.2	8.6	(0.4)
Total Business-type	<u>\$ 83.4</u>	<u>\$ 87.1</u>	<u>\$ (3.7)</u>



On August 2, 2011, the City entered into a master lease-purchase agreement with JP Morgan Chase Bank, N.A. and the proceeds, together with the reserve fund, were used to pay off the 1998 Golf Course Certificates of Participation.

As noted in the Statistical Section of the CAFR, the combined direct debt ratio to assessed valuation for the General Fund is a low 0.24 percent compared to the allowable legal debt margin of 15 percent.

On September 8, 2011, the City issued a \$17.2 million 2011 Series A Utility Revenue Bond to refund the outstanding 2002 Series A Utility Revenue Bond. The 2002 Bond was issued to finance improvements to the City's municipal water utility system and the natural gas utility system. The pledge of future revenues ends upon repayment of the remaining debt service on the bond in 2026.

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, 2012, 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.

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 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/gov/depts/asd/reporting.asp

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CITY OF PALO ALTO
Statement of Net Assets
June 30, 2012
(Amounts in thousands)

	Governmental Activities	Business-Type Activities	Total
ASSETS:			
Cash and investments available for operations (Note 3)	\$ 193,697	\$ 251,226	\$ 444,923
Receivables, net:			
Accounts and intergovernmental	8,566	29,003	37,569
Interest receivable	1,179	1,657	2,836
Notes and loans receivable (Note 5)	14,831	-	14,831
Internal balances (Note 4)	(1,998)	1,998	-
Net OPEB asset (Note 12)	21,271	-	21,271
Due from other government agencies	-	4,250	4,250
Inventory of materials and supplies and prepaids	5,416	27	5,443
Deferred charges	533	2,131	2,664
Restricted cash and investments with fiscal agents (Note 3)	22,207	24,085	46,292
Restricted cash for post-closure landfill (Note 3)	-	5,717	5,717
Capital assets (Note 6):			
Nondepreciable	149,529	104,304	253,833
Depreciable, net of accumulated depreciation	263,709	385,740	649,449
Total assets	<u>678,940</u>	<u>810,138</u>	<u>1,489,078</u>
LIABILITIES:			
Accounts payable and accruals	11,945	13,825	25,770
Accrued salaries and benefits	2,719	1,272	3,991
Unearned revenue	198	932	1,130
Accrued compensated absences (Note 1):			
Due in one year	2,879	-	2,879
Due in more than one year	6,083	-	6,083
Claims payable (Note 14):			
Due in one year	7,043	-	7,043
Due in more than one year	20,423	-	20,423
Accrued landfill closure liability and post-closure care (Note 9):			
Due in more than one year	-	10,997	10,997
Long-term debt (Note 7):			
Due in one year	1,614	3,666	5,280
Due in more than one year	60,889	79,693	140,582
Total liabilities	<u>113,793</u>	<u>110,385</u>	<u>224,178</u>
NET ASSETS (NOTE 10):			
Invested in capital assets, net of related debt	370,111	437,151	807,262
Restricted for:			
Special revenue programs	43,410	-	43,410
Capital projects	1,609	-	1,609
Debt service	6,468	-	6,468
Eyerly Family	1,447	-	1,447
Total restricted net assets	<u>52,934</u>	<u>-</u>	<u>52,934</u>
Unrestricted	<u>142,102</u>	<u>262,602</u>	<u>404,704</u>
Total net assets	<u>\$ 565,147</u>	<u>\$ 699,753</u>	<u>\$ 1,264,900</u>

See accompanying notes to basic financial statements.

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CITY OF PALO ALTO
Statement of Activities
For the Year Ended June 30, 2012
(Amounts in thousands)

Functions/Programs	Program Revenues				Net (Expense) Revenue and Changes in Net Assets		Total
	Expenses	Charges for Services	Operating	Capital	Governmental Activities	Business-Type Activities	
			Grants and Contributions	Grants and Contributions			
Governmental Activities:							
City Council	\$ 345	\$ -	\$ -	\$ -	\$ (345)	\$ -	\$ (345)
City Manager	1,960	-	-	-	(1,960)	-	(1,960)
City Attorney	1,656	-	-	-	(1,656)	-	(1,656)
City Clerk	908	-	-	-	(908)	-	(908)
City Auditor	235	-	-	-	(235)	-	(235)
Administrative Services	10,100	1,647	-	880	(7,573)	-	(7,573)
Human Resources	1,071	-	-	-	(1,071)	-	(1,071)
Public Works	14,568	1,008	5	11	(13,544)	-	(13,544)
Planning and Community Environment	12,074	31,491	3,291	173	22,881	-	22,881
Police	33,533	2,160	110	-	(31,263)	-	(31,263)
Fire	29,284	13,498	-	-	(15,786)	-	(15,786)
Community Services	21,915	11,365	24	-	(10,526)	-	(10,526)
Library	7,323	1,600	11	-	(5,712)	-	(5,712)
Interest on long-term debt	2,575	-	-	-	(2,575)	-	(2,575)
Total Governmental Activities	137,547	62,769	3,441	1,064	(70,273)	-	(70,273)
Business-Type Activities:							
Water	29,093	31,467	605	1,121	-	4,100	4,100
Electric	102,030	118,886	-	-	-	16,856	16,856
Fiber Optics	1,489	3,662	-	-	-	2,173	2,173
Gas	28,878	41,774	-	-	-	12,896	12,896
Wastewater Collection	14,825	14,942	-	405	-	522	522
Wastewater Treatment	20,712	22,200	-	-	-	1,488	1,488
Refuse	31,900	30,645	-	-	-	(1,255)	(1,255)
Storm Drainage	3,103	5,892	-	-	-	2,789	2,789
Airport	153	-	-	-	-	(153)	(153)
Total Business-Type Activities	232,183	269,468	605	1,526	-	39,416	39,416
Total	\$ 369,730	\$ 332,237	\$ 4,046	\$ 2,590	(70,273)	39,416	(30,857)
General Revenues:							
Taxes:							
Property tax					30,104	-	30,104
Sales tax					22,132	-	22,132
Utility user tax					10,834	-	10,834
Transient occupancy tax					9,664	-	9,664
Documentary transfer tax					4,821	-	4,821
Other taxes					3,352	-	3,352
Investment earnings					6,238	7,605	13,843
Rents and miscellaneous					14,943	-	14,943
Transfers (Note 4)					17,426	(17,426)	-
Total general revenues and transfers					119,514	(9,821)	109,693
Change in net assets					49,241	29,595	78,836
Net assets, beginning of year					515,906	670,158	1,186,064
Net assets, end of year					\$ 565,147	\$ 699,753	\$ 1,264,900

See accompanying notes to basic financial statements.

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CITY OF PALO ALTO
Governmental Funds
Balance Sheet
June 30, 2012
(Amounts in thousands)

	General Fund	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
ASSETS:				
Cash and investments available for operations (Note 3)	\$ 36,151	\$ 33,967	\$ 51,858	\$ 121,976
Receivables, net:				
Accounts and intergovernmental	7,804	191	317	8,312
Interest receivable	510	-	300	810
Notes and loans receivable (Note 5)	959	-	13,872	14,831
Prepaid items	932	-	-	932
Advance to other fund (Note 4)	300	-	-	300
Inventory of materials and supplies	3,816	-	-	3,816
Restricted cash and investments with fiscal agents (Note 3)	-	21,968	239	22,207
Total assets	\$ 50,472	\$ 56,126	\$ 66,586	\$ 173,184
LIABILITIES AND FUND BALANCES:				
Liabilities:				
Accounts payable and accruals	\$ 5,823	\$ 2,227	\$ 391	\$ 8,441
Accrued salaries and benefits	2,428	101	9	2,538
Deferred revenue	198	-	-	198
Total liabilities	8,449	2,328	400	11,177
Fund balances (Note 10):				
Nonspendable:				
Notes and loans receivable	959	-	9,665	10,624
Prepaid items	932	-	-	932
Inventories	3,816	-	-	3,816
Advance to other fund	300	-	-	300
Eyerly family	-	-	1,447	1,447
Restricted for:				
Transportation mitigation	-	-	6,095	6,095
Federal revenue	-	-	4,519	4,519
Street improvement	-	-	1,015	1,015
Local law enforcement	-	-	251	251
Library bond project	-	21,350	-	21,350
Public benefits	-	-	21,865	21,865
Debt service	-	-	6,229	6,229
Committed to:				
Developer's impact fees	-	-	5,935	5,935
Housing in-lieu	-	-	7,322	7,322
Special districts	-	-	934	934
Downtown business	-	-	93	93
Assigned to:				
Unrealized gains on investments	3,031	-	816	3,847
Infrastructure	-	12,055	-	12,055
Capital projects	-	20,393	-	20,393
Other general government purposes	3,369	-	-	3,369
Unassigned to:				
Budget Stabilization	28,122	-	-	28,122
Reappropriations	1,494	-	-	1,494
Total fund balances	42,023	53,798	66,186	162,007
Total liabilities and fund balances	\$ 50,472	\$ 56,126	\$ 66,586	\$ 173,184

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
Reconciliation of the Balance Sheet of Governmental Funds to
the Statement of Net Assets - Governmental Activities
June 30, 2012
(Amounts in thousands)

Total fund balances reported on the governmental funds balance sheet	\$ 162,007
<p>Amounts reported for governmental activities in the statement of net assets are different from those reported in the governmental funds above because of the following:</p>	
Costs of issuance related to the bonds are capitalized and amortized over the life of the bonds in the government-wide financial statements	533
Capital assets used in governmental activities are not current assets or financial resources and therefore are not reported in the governmental funds (Note 6)	413,238
Internal service funds are used by management to charge the costs of activities such as insurance, equipment acquisition and maintenance, and certain employee benefits to individual funds. The assets and liabilities of the internal service funds are therefore included in governmental activities in the statement of net assets (excludes capital assets reported above)	52,948
Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the governmental funds:	
Interest payable	(1,076)
Long-term debt (Note 7)	(62,503)
	(63,579)
Net assets of governmental activities	\$ 565,147

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
Governmental Funds
Statement of Revenues, Expenditures and Changes in Fund Balances
For the Year Ended June 30, 2012
(Amounts in thousands)

	General Fund	Capital Projects Fund	Other Governmental Funds	Total
REVENUES:				
Property tax	\$ 26,494	\$ -	\$ 3,610	\$ 30,104
Special assessments	-	-	112	112
Sales tax	22,132	-	-	22,132
Utility user tax	10,834	-	-	10,834
Transient occupancy tax	9,664	-	-	9,664
Documentary transfer tax	4,821	-	-	4,821
Other taxes and fines	2,033	-	1,879	3,912
Charges for services	24,912	10	21,351	46,273
From other agencies	82	262	772	1,116
Permits and licenses	6,633	-	503	7,136
Investment earnings	1,055	1,057	2,173	4,285
Rental income	14,294	-	4	14,298
Other revenue	2,599	1,573	8,567	12,739
Total revenues	125,553	2,902	38,971	167,426
EXPENDITURES:				
Current:				
City Council	344	-	-	344
City Manager	1,926	-	-	1,926
City Attorney	1,654	-	-	1,654
City Clerk	909	-	-	909
City Auditor	236	-	-	236
Administrative Services	3,275	-	-	3,275
Human Resources	1,068	-	-	1,068
Public Works	11,304	-	-	11,304
Planning and Community Environment	10,276	-	1,690	11,966
Police	33,178	-	132	33,310
Fire	29,108	-	-	29,108
Community Services	20,832	-	28	20,860
Library	7,072	-	-	7,072
Non-Departmental	6,573	-	246	6,819
Capital outlay	-	29,154	-	29,154
Debt service:				
Principal	458	-	1,285	1,743
Interest and fiscal charges	41	-	2,716	2,757
Payment to bond refunding escrow	-	-	586	586
Total expenditures	128,254	29,154	6,683	164,091
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	(2,701)	(26,252)	32,288	3,335
OTHER FINANCING SOURCES (USES):				
Issuance of debt	3,222	-	-	3,222
Payment to bond refunding escrow	-	-	(3,104)	(3,104)
Transfers in (Note 4)	19,459	20,841	6,900	47,200
Transfers out (Note 4)	(22,136)	(3,456)	(4,190)	(29,782)
Total other financing sources (uses)	545	17,385	(394)	17,536
Change in fund balances	(2,156)	(8,867)	31,894	20,871
FUND BALANCES, BEGINNING OF YEAR	44,179	62,665	34,292	141,136
FUND BALANCES, END OF YEAR	\$ 42,023	\$ 53,798	\$ 66,186	\$ 162,007

See accompanying notes to basic 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 - Governmental Activities
For the Year Ended June 30, 2012
(Amounts in thousands)

Net change in fund balances - total governmental funds \$ 20,871

Amounts reported for governmental activities in the statement of activities are different from those reported in the governmental funds above because of the following:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the costs of these assets are capitalized and allocated over their estimated useful lives and reported as depreciation expense. Therefore, the activities associated with capital assets are as follows:

Capital outlay added back to fund balance for current year additions	34,741
Depreciation expense is deducted from fund balance (depreciation expense is net of internal service fund depreciation of \$4,695 (Note 6), which has already been allocated through the internal service fund activities below	(10,547)
Disposal and impairment of capital assets	(140)

Principal payments on long-term liabilities are reported as expenditures in governmental funds when paid. The governmental activities, however, report principal payments as a reduction of long-term debt on the statement of net assets. Interest accrued on long-term debt and amortization of bond issuance costs and premiums do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. Therefore, the activities associated with long-term debt are as follows:

Principal paid during the year	1,743
Proceeds from debt issuance	(3,222)
Payment to bond refunding escrow	3,690
Change in interest payable	75
Amortization of deferred costs of issuance	(19)
Amortization of bond premium	126

Internal service funds are used by management to charge the costs of activities, such as insurance, equipment acquisition and maintenance, and employees benefits to individual funds. The portion of the net revenue (expense) of these internal service funds arising out of their transactions with governmental funds is reported with governmental activities.

	<u>1,923</u>
Change in net assets of governmental activities	<u>\$ 49,241</u>

CITY OF PALO ALTO
General Fund
Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
For the Year Ended June 30, 2012
(Amounts in thousands)

	Budgeted Amounts		Actual, plus Encumbrances	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES:				
Sales tax	\$ 20,246	\$ 21,594	\$ 22,132	\$ 538
Property tax	26,052	25,989	26,494	505
Transient occupancy tax	8,204	8,674	9,664	990
Documentary transfer tax	4,269	4,769	4,821	52
Utility user tax	10,859	10,677	10,834	157
Other taxes, fines and penalties	2,330	2,156	2,033	(123)
Charges for services	21,841	22,566	25,143	2,577
Permits and licenses	5,778	6,486	6,534	48
Investment earnings	1,318	974	1,055	81
Rental income	13,914	13,914	14,294	380
From other agencies	155	174	81	(93)
Other revenues	<u>1,428</u>	<u>2,206</u>	<u>2,602</u>	<u>396</u>
	116,394	120,179	125,687	5,508
Charges to other funds	10,505	10,505	11,639	1,134
Lease proceeds	-	3,222	3,222	-
Prior year encumbrances and reappropriations	<u>-</u>	<u>3,887</u>	<u>3,888</u>	<u>1</u>
Total revenues	<u>126,899</u>	<u>137,793</u>	<u>144,436</u>	<u>6,643</u>
EXPENDITURES:				
Current:				
City Attorney	2,355	3,141	3,106	35
City Auditor	1,006	1,109	961	148
City Clerk	1,479	1,542	1,526	16
City Council	319	463	436	27
City Manager	2,512	2,885	2,747	138
Administrative Services	6,514	7,207	7,203	4
Community Services	20,711	21,623	21,399	224
Fire	29,780	30,180	30,117	63
Human Resources	2,919	2,779	2,714	65
Library	6,944	7,814	7,714	100
Planning and Community Environment	10,021	12,075	11,186	889
Police	31,918	33,811	33,762	49
Public Works	13,007	13,970	13,789	181
Non-Departmental	<u>5,038</u>	<u>7,412</u>	<u>8,230</u>	<u>(818)</u>
Total expenditures	<u>134,523</u>	<u>146,011</u>	<u>144,890</u>	<u>1,121</u>
(DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	<u>(7,624)</u>	<u>(8,218)</u>	<u>(454)</u>	<u>7,764</u>
OTHER FINANCING SOURCES (USES):				
Transfers in	19,606	19,651	19,459	(192)
Transfers out	<u>(11,837)</u>	<u>(15,096)</u>	<u>(22,136)</u>	<u>(7,040)</u>
Total other financing sources (uses)	<u>7,769</u>	<u>4,555</u>	<u>(2,677)</u>	<u>(7,232)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, BUDGETARY BASIS	<u>\$ 145</u>	<u>\$ (3,663)</u>	<u>(3,131)</u>	<u>\$ 532</u>
Adjustment to Budgetary Basis:				
Current year encumbrances/reappropriations			4,863	
Prior year encumbrances/reappropriations			<u>(3,888)</u>	
EXCESS OF REVENUES OVER EXPENDITURES, GAAP BASIS			(2,156)	
FUND BALANCES AT BEGINNING OF YEAR, GAAP BASIS			<u>44,179</u>	
FUND BALANCES AT END OF YEAR, GAAP BASIS			<u>\$ 42,023</u>	

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
Proprietary Funds
Statement of Fund Net Assets
June 30, 2012
(Amounts in thousands)

	Business-Type Activities-Enterprise Funds			
	Water	Electric	Fiber Optics	Gas
ASSETS:				
Current assets:				
Cash and investments available for operations (Note 3)	\$ 23,712	\$ 135,946	\$ 13,715	\$ 36,263
Accounts receivable, net	5,245	13,148	535	2,546
Interest receivable	171	871	82	227
Due from other government agencies	-	-	-	-
Inventory of materials and supplies	-	-	-	-
Restricted cash and investments with fiscal agents (Note 3)	23,268	-	-	817
Restricted cash for landfill closure (Note 3)	-	-	-	-
Total current assets	<u>52,396</u>	<u>149,965</u>	<u>14,332</u>	<u>39,853</u>
Noncurrent assets:				
Due from other government agencies	-	-	-	-
Deferred bond issuance costs	558	48	-	113
Deposit	-	27	-	-
Capital assets (Note 6):				
Nondepreciable	30,782	24,048	1,090	18,199
Depreciable, net	60,871	142,935	6,135	67,611
Net OPEB asset (Note 12)	-	-	-	-
Total noncurrent assets	<u>92,211</u>	<u>167,058</u>	<u>7,225</u>	<u>85,923</u>
Total assets	<u>144,607</u>	<u>317,023</u>	<u>21,557</u>	<u>125,776</u>
LIABILITIES:				
Current liabilities:				
Accounts payable and accruals	5,865	2,260	50	2,637
Accrued salaries and benefits	170	429	31	196
Unearned revenue	-	-	-	-
Accrued compensated absences (Note 1)	-	-	-	-
Current portion of revenue bonds (Note 7)	1,319	100	-	506
Accrued claims payable (Note 14)	-	-	-	-
Total current liabilities	<u>7,354</u>	<u>2,789</u>	<u>81</u>	<u>3,339</u>
Noncurrent liabilities:				
Accrued compensated absences (Note 1)	-	-	-	-
Accrued claims payable (Note 14)	-	-	-	-
Advance from other fund (Note 4)	-	-	-	-
Landfill closure and post-closure care (Note 9)	-	-	-	-
Utility revenue bonds, net of unamortized discounts/premiums (Note 7)	40,480	846	-	8,823
Total noncurrent liabilities	<u>40,480</u>	<u>846</u>	<u>-</u>	<u>8,823</u>
Total liabilities	<u>47,834</u>	<u>3,635</u>	<u>81</u>	<u>12,162</u>
NET ASSETS:				
Invested in capital assets, net of related debt	73,680	166,085	7,225	77,411
Unrestricted (deficit)	23,093	147,303	14,251	36,203
Total net assets	<u>\$ 96,773</u>	<u>\$ 313,388</u>	<u>\$ 21,476</u>	<u>\$ 113,614</u>

Some amounts reported for Business-type Activities in the statement of net assets are different because certain Internal Service Fund net assets are included with Business-type Activities
Net assets reported in Business-type Activities

See accompanying notes to basic financial statements.

Business-Type Activities-Enterprise Funds						Governmental Activities - Internal Service Funds
Wastewater Collection	Wastewater Treatment	Refuse	Storm Drainage	Airport	Totals	
\$ 15,513	\$ 16,699	\$ 2,398	\$ 6,842	\$ 138	\$ 251,226	\$ 71,721
1,718	2,090	3,098	623	-	29,003	254
106	101	56	42	1	1,657	369
-	250	-	-	-	250	-
-	-	-	-	-	-	668
-	-	-	-	-	24,085	-
-	-	5,717	-	-	5,717	-
<u>17,337</u>	<u>19,140</u>	<u>11,269</u>	<u>7,507</u>	<u>139</u>	<u>311,938</u>	<u>73,012</u>
-	4,000	-	-	-	4,000	-
20	1,262	-	130	-	2,131	-
-	-	-	-	-	27	-
12,603	10,241	3,540	3,801	-	104,304	204
56,176	28,480	12	23,520	-	385,740	15,662
-	-	-	-	-	-	21,271
<u>68,799</u>	<u>43,983</u>	<u>3,552</u>	<u>27,451</u>	<u>-</u>	<u>496,202</u>	<u>37,137</u>
<u>86,136</u>	<u>63,123</u>	<u>14,821</u>	<u>34,958</u>	<u>139</u>	<u>808,140</u>	<u>110,149</u>
439	684	1,781	95	14	13,825	2,428
103	215	96	32	-	1,272	181
-	-	-	932	-	932	-
-	-	-	-	-	-	2,879
71	1,190	-	480	-	3,666	-
-	-	-	-	-	-	7,043
<u>613</u>	<u>2,089</u>	<u>1,877</u>	<u>1,539</u>	<u>14</u>	<u>19,695</u>	<u>12,531</u>
-	-	-	-	-	-	6,083
-	-	-	-	-	-	20,423
-	-	-	-	300	300	-
-	-	10,997	-	-	10,997	-
<u>1,051</u>	<u>20,955</u>	<u>-</u>	<u>7,538</u>	<u>-</u>	<u>79,693</u>	<u>-</u>
<u>1,051</u>	<u>20,955</u>	<u>10,997</u>	<u>7,538</u>	<u>300</u>	<u>90,990</u>	<u>26,506</u>
<u>1,664</u>	<u>23,044</u>	<u>12,874</u>	<u>9,077</u>	<u>314</u>	<u>110,685</u>	<u>39,037</u>
67,677	22,088	3,552	19,433	-	437,151	15,866
16,795	17,991	(1,605)	6,448	(175)	260,304	55,246
<u>\$ 84,472</u>	<u>\$ 40,079</u>	<u>\$ 1,947</u>	<u>\$ 25,881</u>	<u>\$ (175)</u>	<u>697,455</u>	<u>\$ 71,112</u>
					<u>2,298</u>	
					<u>\$ 699,753</u>	

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
Proprietary Funds
Statement of Revenues, Expenses and Changes in Fund Net Assets
For the Year Ended June 30, 2012
(Amounts in thousands)

	Business-Type Activities-Enterprise Funds			
	Water	Electric	Fiber Optics	Gas
OPERATING REVENUES:				
Sales of utilities:				
Customers	\$ 29,115	\$ 105,225	\$ -	\$ 40,265
City departments	1,380	3,352	710	769
Surplus energy	-	2,323	-	-
Service connection charges and miscellaneous	534	1,468	-	592
Charges for services	-	-	-	-
Other	438	6,518	2,952	148
Total operating revenues	<u>31,467</u>	<u>118,886</u>	<u>3,662</u>	<u>41,774</u>
OPERATING EXPENSES:				
Purchase of utilities:				
Retail	14,889	55,526	-	16,235
Surplus energy	-	3,198	-	-
Administrative and general	3,548	5,323	375	3,451
Engineering (operating)	301	1,204	-	333
Resource management and energy efficiency	553	7,196	-	1,343
Operations and maintenance	4,901	9,288	817	5,032
Rent	2,157	3,688	25	230
Depreciation and amortization	1,481	7,761	275	1,881
Claims payments and changes in estimated self-insurance liability	-	-	-	-
Refund of charges for services	-	-	-	-
Compensated absences and other benefits	-	-	-	-
Total operating expenses	<u>27,830</u>	<u>93,184</u>	<u>1,492</u>	<u>28,505</u>
Operating income (loss)	3,637	25,702	2,170	13,269
NONOPERATING REVENUES (EXPENSES):				
Investment earnings	520	4,100	436	1,119
Interest expense	(943)	(8,803)	-	(406)
Gain (loss) on disposal of capital assets	(361)	(180)	-	(44)
Other nonoperating revenues	605	-	-	-
Total nonoperating revenues (expenses)	<u>(179)</u>	<u>(4,883)</u>	<u>436</u>	<u>669</u>
Income (loss) before transfers and capital contributions	3,458	20,819	2,606	13,938
Capital contributions	1,121	-	-	-
Transfers in	75	103	-	-
Transfers out	(104)	(11,886)	(9)	(6,176)
Change in net assets	4,550	9,036	2,597	7,762
NET ASSETS, BEGINNING OF YEAR	<u>92,223</u>	<u>304,352</u>	<u>18,879</u>	<u>105,852</u>
NET ASSETS (DEFICIT), END OF YEAR	<u>\$ 96,773</u>	<u>\$ 313,388</u>	<u>\$ 21,476</u>	<u>\$ 113,614</u>

Some amounts reported for Business-type Activities in the Statement of Activities are different because certain Internal Service Fund activities are included with Business-type Activities

Change in net assets reported in Business-type Activities

See accompanying notes to basic financial statements.

Business-Type Activities-Enterprise Funds						Governmental
Wastewater	Wastewater		Storm		Totals	Activities- Internal Service Funds
Collection	Treatment	Refuse	Drainage	Airport		
\$ 13,983	\$ 13,006	\$ 25,870	\$ 5,465	\$ -	232,929	\$ -
111	8,947	1,131	331	-	16,731	-
-	-	-	-	-	2,323	-
584	-	-	-	-	3,178	-
-	-	-	-	-	-	79,605
264	247	3,342	96	-	14,005	-
<u>14,942</u>	<u>22,200</u>	<u>30,343</u>	<u>5,892</u>	<u>-</u>	<u>269,166</u>	<u>79,605</u>
8,895	-	12,882	-	-	108,427	-
-	-	-	-	-	3,198	-
826	-	1,901	339	153	15,916	8,368
258	2,343	261	349	-	5,049	-
-	-	-	202	-	9,294	-
2,466	15,498	11,617	847	-	50,466	8,896
106	-	4,289	-	-	10,495	-
2,282	2,163	-	877	-	16,720	5,884
-	-	-	-	-	-	7,603
-	-	-	-	-	-	65
-	-	-	-	-	-	48,542
<u>14,833</u>	<u>20,004</u>	<u>30,950</u>	<u>2,614</u>	<u>153</u>	<u>219,565</u>	<u>79,358</u>
109	2,196	(607)	3,278	(153)	49,601	247
494	490	222	219	5	7,605	1,904
(36)	(604)	(605)	(493)	-	(11,890)	-
(10)	-	(404)	-	-	(999)	3
-	-	302	-	-	907	32
<u>448</u>	<u>(114)</u>	<u>(485)</u>	<u>(274)</u>	<u>5</u>	<u>(4,377)</u>	<u>1,939</u>
557	2,082	(1,092)	3,004	(148)	45,224	2,186
405	-	-	-	-	1,526	-
-	145	692	19	-	1,034	858
<u>(88)</u>	<u>(105)</u>	<u>(74)</u>	<u>(18)</u>	<u>-</u>	<u>(18,460)</u>	<u>(850)</u>
874	2,122	(474)	3,005	(148)	29,324	2,194
<u>83,598</u>	<u>37,957</u>	<u>2,421</u>	<u>22,876</u>	<u>(27)</u>		<u>68,918</u>
<u>\$ 84,472</u>	<u>\$ 40,079</u>	<u>\$ 1,947</u>	<u>\$ 25,881</u>	<u>\$ (175)</u>		<u>\$ 71,112</u>

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\$ 29,595

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
Proprietary Funds
Statement of Cash Flows
For the Year Ended June 30, 2012
(Amounts in thousands)

	Business-Type Activities-Enterprise Funds			
	Water	Electric	Fiber Optics	Gas
Cash flows from operating activities:				
Cash received from customers	\$ 27,911	\$ 111,440	\$ (1)	\$ 41,308
Cash refunds to customers	-	-	-	-
Cash payments to suppliers for goods and services	(19,440)	(80,517)	(832)	(21,771)
Cash payments to employees	(3,529)	(5,241)	(369)	(3,423)
Internal activity- receipts (payment) from (to) other funds	1,380	3,352	710	769
Other receipts	438	6,518	2,952	148
Net cash provided by (used in) operating activities	<u>6,760</u>	<u>35,552</u>	<u>2,460</u>	<u>17,031</u>
Cash flows from noncapital financing activities:				
Transfers in	75	103	-	-
Transfers out	(104)	(11,886)	(9)	(6,176)
Cash flows provided by (used in) noncapital financing activities	<u>(29)</u>	<u>(11,783)</u>	<u>(9)</u>	<u>(6,176)</u>
Cash flows from capital and related financing activities:				
Acquisition and construction of capital assets	(14,203)	(12,227)	(560)	(7,462)
Proceeds from sale of capital assets	-	-	-	-
Capital grants and contributions	1,330	-	-	-
Interest subsidy received from Build America Bond	396	-	-	-
Proceeds from debt issuance	131	-	-	160
Cost of issuance paid	(98)	-	-	(119)
Principal paid on long-term debt	(1,331)	(100)	-	(628)
Interest paid on long-term debt	(977)	(8,803)	-	(364)
Cash flows used in capital and related financing activities	<u>(14,752)</u>	<u>(21,130)</u>	<u>(560)</u>	<u>(8,413)</u>
Cash flows from investing activities:				
Interest received	645	4,170	432	1,116
Net change in cash and cash equivalents	<u>(7,376)</u>	<u>6,809</u>	<u>2,323</u>	<u>3,558</u>
Cash and cash equivalents, beginning of year	54,356	129,137	11,392	33,522
Cash and cash equivalents, end of year	<u>\$ 46,980</u>	<u>\$ 135,946</u>	<u>\$ 13,715</u>	<u>\$ 37,080</u>
Financial statement presentation:				
Cash and investments available for operations	\$ 23,712	\$ 135,946	\$ 13,715	\$ 36,263
Cash and investments with fiscal agent	23,268	-	-	817
Cash and cash equivalents, end of year	<u>\$ 46,980</u>	<u>\$ 135,946</u>	<u>\$ 13,715</u>	<u>\$ 37,080</u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:				
Operating income (loss)	\$ 3,637	\$ 25,702	\$ 2,170	\$ 13,269
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:				
Depreciation and amortization	1,481	7,761	275	1,881
Other	-	-	-	-
Change in assets and liabilities:				
Accounts receivable	(1,738)	2,424	(1)	451
Inventory of materials and supplies	-	-	-	-
Deposits	-	(18)	-	-
Net OPEB asset	-	-	-	-
Accounts payable and accruals	3,361	(399)	10	1,402
Accrued salaries and benefits	19	82	6	28
Accrued compensated absences	-	-	-	-
Unearned revenue	-	-	-	-
Landfill closure and post-closure care	-	-	-	-
Accrued claims payable and other liabilities	-	-	-	-
Net cash provided by (used in) operating activities	<u>\$ 6,760</u>	<u>\$ 35,552</u>	<u>\$ 2,460</u>	<u>\$ 17,031</u>
Noncash capital and related financing activities:				
Payment to refunded bond escrow from refunding bond proceeds	\$ 8,204	\$ -	\$ -	\$ 10,027

See accompanying notes to basic financial statements.

Business-Type Activities-Enterprise Funds						Governmental Activities- Internal Service Funds
Wastewater Collection	Wastewater Treatment	Refuse	Storm Drainage	Airport	Totals	
\$ 14,532	\$ 13,160	\$ 25,981	\$ 5,147	\$ -	\$ 239,478	\$ 79,411
-	-	-	-	-	-	(65)
(11,617)	(18,446)	(29,004)	(1,593)	-	(183,220)	(9,168)
(815)	8	(1,908)	(339)	(145)	(15,761)	(53,702)
111	8,947	1,131	331	-	16,731	(4,040)
264	247	3,568	96	-	14,231	32
<u>2,475</u>	<u>3,916</u>	<u>(232)</u>	<u>3,642</u>	<u>(145)</u>	<u>71,459</u>	<u>12,468</u>
-	145	692	19	-	1,034	858
(88)	(105)	(74)	(18)	-	(18,460)	(850)
<u>(88)</u>	<u>40</u>	<u>618</u>	<u>1</u>	<u>-</u>	<u>(17,426)</u>	<u>8</u>
(3,452)	(1,254)	(806)	(2,006)	-	(41,970)	(1,707)
-	-	-	-	-	-	46
405	250	302	-	-	2,287	-
-	-	-	-	-	396	-
-	-	-	-	-	291	-
-	-	-	-	-	(217)	-
(68)	(1,169)	-	(455)	-	(3,751)	-
(34)	(553)	(605)	(494)	-	(11,830)	-
<u>(3,149)</u>	<u>(2,726)</u>	<u>(1,109)</u>	<u>(2,955)</u>	<u>-</u>	<u>(54,794)</u>	<u>(1,661)</u>
501	495	230	217	5	7,811	1,896
(261)	1,725	(493)	905	(140)	7,050	12,711
<u>15,774</u>	<u>14,974</u>	<u>8,608</u>	<u>5,937</u>	<u>278</u>	<u>273,978</u>	<u>60,738</u>
<u>\$ 15,513</u>	<u>\$ 16,699</u>	<u>\$ 8,115</u>	<u>\$ 6,842</u>	<u>\$ 138</u>	<u>\$ 281,028</u>	<u>\$ 73,449</u>
\$ 15,513	\$ 16,699	\$ 2,398	\$ 6,842	\$ 138	\$ 251,226	\$ 71,721
-	-	5,717	-	-	29,802	-
<u>\$ 15,513</u>	<u>\$ 16,699</u>	<u>\$ 8,115</u>	<u>\$ 6,842</u>	<u>\$ 138</u>	<u>\$ 281,028</u>	<u>\$ 71,721</u>
\$ 109	\$ 2,196	\$ (607)	\$ 3,278	\$ (153)	\$ 49,601	\$ 247
2,282	2,163	-	877	-	16,720	5,884
-	-	-	-	-	-	32
(35)	154	111	(37)	-	1,329	(194)
-	-	-	-	-	-	(55)
-	-	-	-	-	(18)	-
-	-	-	-	-	-	1,735
108	(605)	45	(195)	9	3,736	(95)
11	8	(7)	-	(1)	146	47
-	-	-	-	-	-	(424)
-	-	-	(281)	-	(281)	-
-	-	226	-	-	226	-
-	-	-	-	-	-	3,563
<u>\$ 2,475</u>	<u>\$ 3,916</u>	<u>\$ (232)</u>	<u>\$ 3,642</u>	<u>\$ (145)</u>	<u>\$ 71,459</u>	<u>\$ 10,740</u>
\$ -	\$ -	\$ -	\$ -	\$ -	\$ 18,231	\$ -

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
Statement of Fiduciary Net Assets
June 30, 2012
(Amounts in thousands)

	Agency Funds
ASSETS:	
Cash and investments available for operations (Note 3)	\$ 2,816
Restricted cash and investments with fiscal agents (Note 3)	2,538
Interest receivable	18
Total assets	\$ 5,372
 LIABILITIES:	
Due to bondholders	\$ 4,456
Due to other governments	916
Total liabilities	\$ 5,372

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
Index to the Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

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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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CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Palo Alto (the City) 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.

(a) 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 activities 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 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. The City's component units, which are described below, are blended.

The Palo Alto Public Improvement Corporation (the Corporation) provides financing of public capital improvements for the City through the issuance of Certificates of Participation (COPs), a form of debt that allows investors to participate in a stream of future lease payments. Proceeds from the COPs are used to construct projects that are leased to the City. The lease payments are sufficient in timing and amount to meet the debt service requirements of the COPs. The Board of Directors of the Corporation is composed of the same members as the City Council. 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 Refinancing Debt Service Funds and the Capital Projects Fund.

The Palo Alto Redevelopment Agency (the Agency) was a separate government entity whose purpose was to prepare and implement plans for improvement, rehabilitation, and development of certain areas within the City. The City Council and the Redevelopment Agency Board were composed of the same individuals. Certain administrative and accounting functions were performed by City staff. The financial activities of the Agency have been included in these financial statements in the Redevelopment Agency Special Revenue Fund. As of June 29, 2011, changes to the California Redevelopment Law have terminated the authority of redevelopment agencies to undertake new obligations to redevelop property. On September 6, 2011, the City filed Ordinance No. 5126 dissolving the operations of the Agency effective October 7, 2011.

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

(b) 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 Governmental Accounting Standards Board (GASB) is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the United States.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Basis of Presentation (Continued)

These standards require that the financial statements described below be presented:

Government-wide Statements: The Statement of Net Assets and the Statement of Activities display information about the primary government 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 and 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, enterprise and internal service 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.

(c) Major Funds

The City's major governmental and enterprise 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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Major Funds (Continued)

Major funds are defined as funds that have either assets, liabilities, revenues or expenditures/expenses equal to at least 10 percent of their fund type total and at least 5 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 on a qualitative basis.

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 of its enterprise funds as major funds in the accompanying financial statements. These funds are:

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 the City.

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 the City.

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 the City.

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 in the City.

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

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 the City.

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 the City.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Major Funds (Continued)

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 the City.

Airport Fund – This fund accounts for all financial transactions relating to the Palo Alto Airport. The City will be taking over operation of the airport from Santa Clara County no later than 2017.

The City also reports the following funds:

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 from reimbursement of fleet replacement and maintenance costs allocated to each department by usage of vehicle.

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 from reimbursement of costs for support provided to other departments.

Printing and Mailing Services – This fund accounts for central duplicating, printing and mailing services provided to all City departments. The source of revenue for this fund is from 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 program.

General Liability Insurance Program – This fund accounts for the administration of the City's self-insured general liability program.

Retiree Health Benefits – This fund accounts for retiree health benefits.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Major Funds (Continued)

Fiduciary Funds – These funds account for assets held by the City, an agent for assessment districts, and 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 the receipts and disbursements associated with the 1993 Parking District No. 92-13 Assessment Bonds.

Cable Joint Powers Authority – This fund accounts for the activities of the cable television system on behalf of the members.

University Avenue Area Off-Street Parking Assessment District – This fund accounts for the receipts and disbursements associated with the Series 2001-A and Series 2002-A University Avenue Area Off-Street Parking Assessments Bonds, and the 2012 Limited Obligation Refunding Improvement Bonds.

(d) Basis of Accounting

The government-wide 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, which are collected within sixty days after year-end.

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*.

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

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Basis of Accounting (Continued)

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 (FASB) Statements and predecessor pronouncements issued before November 30, 1989, which do not conflict with GASB Statements, in both the government-wide financial statements for business-type activities and the proprietary fund financial statements. The City has elected not to apply FASB pronouncements issued after November 30, 1989 to business-type activities and enterprise funds.

(e) Cash and Cash Equivalents

Restricted and unrestricted pooled cash and investments held in the City Treasury, and other unrestricted investments invested by the City Treasurer, are considered cash equivalents for purposes of the statement of cash flows because the City's cash management pool and funds invested by the City Treasurer possess the characteristics of demand deposit accounts. Other restricted and unrestricted investments with maturities of less than three months at the time of purchase are considered cash equivalents for purposes of the statement of cash flows.

(f) Deposits and Investments

The City's investments are carried at fair value, as required by GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. 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.

(g) 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 expenditures at the time inventory items are used, rather than purchased.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) Compensated Absences

The liability for compensated absences includes the vested portion 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 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 the fiscal year ended June 30, 2012, changes to the compensated absences were as follows (in thousands):

Beginning balance	\$	9,386
Additions		6,729
Payments		<u>(7,153)</u>
Ending balance	\$	<u>8,962</u>
Current portion	\$	<u>2,879</u>

(i) Property Tax

Santa Clara County (the 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.

The County assesses property values, levies bills and collects taxes as follows:

	<u>Secured</u>	<u>Unsecured</u>
Lien Dates	January 01	January 01
Levy Dates	October 01	July 01
Due Dates	50% on November 01 50% on February 01	Upon receipt of billing
Delinquent after	December 10 (for November) April 10 (for February)	August 31

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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(j) Rounding

All amounts included in the basic financial statements and footnotes are presented to the nearest thousand.

(k) Effects of New Pronouncements

During the year ended June 30, 2012, the City implemented the following GASB Statement:

In June 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*. This Statement sets forth criteria to establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The requirements of this Statement enhance comparability and improve financial reporting by clarifying the circumstances in which hedge accounting should continue when swap counterparty, or swap counterparty's credit support provider, is replaced. The requirements of this Statement are effective for the City's fiscal year ending June 30, 2012.

The City is currently analyzing its accounting practices to determine the potential impact on the financial statements for the following GASB Statements:

GASB Statement No. 60 issued November 2010, *Accounting and Financial Reporting for Service Concession Arrangements*, addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. Common examples of SCAs include long-term arrangements between a transferor (a government) and an operator (governmental or nongovernmental entity) in which the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset in exchange for significant consideration, and the operator collects and is compensated by fees from third parties. Application of this Statement is effective for the City's fiscal year ending June 30, 2013.

GASB Statement No. 61 issued November 2010, *The Financial Reporting Entity: Omnibus*, is designed to improve financial reporting for governmental entities by amending the requirements of GASB Statement No. 14, *The Financial Reporting Entity*, and GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet the needs of users and address reporting entity issues that have come to light since these statements were issued in 1991 and 1999, respectively. GASB Statement No. 61 improves the information presented about the financial reporting entity, which is comprised of a primary government and related entities (component units) and amends the criteria for blending – that is, reporting component units as if they were part of the primary government – in certain circumstances. Application of this Statement is effective for the City's fiscal year ending June 30, 2013.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Effects of New Pronouncements (Continued)

GASB Statement No. 62 issued December 2010, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, is incorporating into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the FASB and AICPA pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. The requirements of this Statement are effective for the City's fiscal year ending June 30, 2013.

GASB Statement No. 63 issued June 2011, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. This Statement also amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The requirements of this Statement are effective for the City's fiscal year ending June 30, 2013.

GASB Statement No. 65 issued March 2012, *Items Previously Reported as Assets and Liabilities*, establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This Statement amends the financial statement element classification of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statements No. 6, *Elements of Financial Statements*. It also provides other financial reporting guidance related to the impact of the financial statements elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term *deferred* in financial statement presentations. The requirements of this Statement are effective for the City's fiscal year ending June 30, 2014.

GASB Statement No. 68 issued June 2012, *Accounting and Financial Reporting for Pensions*, establishes accounting and financial reporting requirements for pension plans that are administered through trusts. Statement No. 68 requires governments participating in the single and agent for multiple employer defined benefit plans to recognize a liability equal to the net pension liability. The net pension liability is required to be measured as of a date no later than the end of the employer's prior fiscal year (the measurement date), consistently applied from period to period. The pension expense and deferred outflows of resources and deferred inflows of resources related to pensions that are required to be recognized by an employer primarily result from changes in the components of the net pension liability—that is, changes in the total pension liability and in the pension plan's fiduciary net position. It requires that most changes in

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) *Effects of New Pronouncements (Continued)*

the net pension liability be included in pension expense in the period of the change. The effects of certain other changes in the net pension liability are required to be included in pension expense over the current and future periods. It also requires that notes to financial statements of single and agent employers include descriptive information, such as the types of benefits provided and the number and classes of employees covered by the benefit terms, sources of changes in the net pension liability for current year, significant assumptions and other inputs used in the valuations and the valuation date. The Statement also requires the government to present required supplementary information for each of the ten most recent fiscal years. The requirements of this Statement are effective for the City's fiscal year ending June 30, 2015.

(l) *Use of Estimates*

The accompanying basic financial statements have been prepared on the modified accrual and accrual basis of accounting in accordance with generally accepted accounting principles. This requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. 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 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 Adopted Budget amounts.
5. As defined in the municipal code, expenditures may not 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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 2 – BUDGETS AND BUDGETARY ACCOUNTING (Continued)

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 maintained 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 bond proceeds with fiscal agents, and invests its pooled idle cash according to State of California law and the City’s Investment Policy. The basic principles underlying the City’s investment philosophy are to ensure the safety of public funds, ensure that sufficient funds are available to meet current expenditures, and achieve a reasonable rate of return on investments.

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.

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):

	Governmental Activities	Business-Type Activities	Fiduciary Funds	Total
Cash and investments:				
Available for operations	\$ 193,697	\$ 251,226	\$ 2,816	\$ 447,739
Restricted for post-closure landfill	-	5,717	-	5,717
Held with fiscal agents	22,207	24,085	2,538	48,830
Total cash and investments	<u>\$ 215,904</u>	<u>\$ 281,028</u>	<u>\$ 5,354</u>	<u>\$ 502,286</u>

Investments Authorized by the City’s Investment Policy and 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 trustees that are governed by the provisions of debt agreements of the City, rather than the general provisions of the City’s Investment Policy.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 3 – CASH AND INVESTMENTS (Continued)

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.

Authorized Investment Type	Maximum Maturity	Minimum Credit Quality	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
U.S. Government Securities	10 years	N/A	No Limit	No Limit
U.S. Government Agency Securities (C)	10 years	N/A	No Limit (A)	No Limit
Certificates of Deposit	10 years	N/A	20%	10% of the par value of portfolio
Bankers Acceptances	180 days (D)	N/A (D)	30%	\$5 million
Commercial Paper	270 days	AAA	15%	\$3 million (B)
Local Agency Investment Fund	N/A	N/A	No Limit	\$50 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	No Limit
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/AA2	10%	No Limit

(A) Callable and multi-step securities are limited to no more than 25% 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 2011 Series A and 1999 Series A allow general obligations of states with a minimum credit quality rating of A2/A by Moody's and Standard & Poor's.

(D) Utility Revenue Bonds 2011 Series A and 1999 Series A require a minimum credit quality rating of A-1/P-1 by Moody's and Standard & Poor's 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 2011 Series A and 1999 Series A require a minimum credit quality rating of AAAM or AAAM-G by Standard & Poor's.

(F) Utility Revenue Bonds 2011 Series A and University Avenue Parking Bond 2012 are allowed to invest in the California Asset Management Program.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 3 – CASH AND INVESTMENTS (Continued)

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 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 Investment	Maturities				Total
	Less Than One Year	One to Three Years	Three to Five Years	Over Five Years	
U.S. Federal Agency Securities	\$ 38,311	\$ 114,290	\$ 149,474	\$ 116,339	\$ 418,414
U.S. Treasury Notes	4,062	-	-	-	4,062
Local Government Bond	4,682	3,329	-	4,974	12,985
Money Market Mutual Funds	23,351	-	-	-	23,351
California Asset Management	24,489	-	-	-	24,489
Local Agency Investment Fund	17,167	-	-	-	17,167
Total Investments	\$ 112,062	\$ 117,619	\$ 149,474	\$ 121,313	500,468
Cash in bank and on hand					1,818
Total Cash and Investments					\$ 502,286

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 accounting records maintained by LAIF, which are recorded on an amortized cost basis. 3.47% of 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, 2012, these investments matured in an average of 268 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, 2012, the fair value approximated the City's cost. These investments have an average maturity of 53 days.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 3 – CASH AND INVESTMENTS (Continued)

Money market mutual funds are available for withdrawal on demand and at June 30, 2012, matured in an average of 50 days.

Investment with Fair Values Highly Sensitive to Interest Rate Fluctuations

At June 30, 2012, the City's investments (including investments held by bond trustees) include U.S. Federal Agency Callable Securities in the amount of \$99.2 million that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above). 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.

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, 2012, for each investment type (in thousands):

<u>Type of Investment</u>	<u>Rating</u>	<u>Total</u>
U.S. Federal Agency Securities	AA+	\$ 418,414
Local Government Bond	AAA/AAAm	12,985
Money Market Mutual Funds	AAA/AAAm	23,351
California Asset Management Program	AAA/AAAm	<u>24,489</u>
Total Investments		479,239
Not Applicable:		
U.S. Treasury Notes		4,062
Not Rated:		
Local Agency Investment Fund		17,167
Cash in bank and on hand		<u>1,818</u>
Total Cash and Investments		<u><u>\$ 502,286</u></u>

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 investments are as follows at June 30, 2012 (in thousands):

<u>Investments</u>	<u>Reporting Type</u>	<u>Fair Value at Year-End</u>
Federal Home Loan Bank	U.S. Federal Agency Securities	\$ 159,773
Federal Farm Credit Bank	U.S. Federal Agency Securities	96,446
Federal National Mortgage Corporation	U.S. Federal Agency Securities	80,681
Federal Home Loan Mortgage Corporation	U.S. Federal Agency Securities	41,882
Federal Agricultural Mortgage Corporation	U.S. Federal Agency Securities	35,545

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 3 – CASH AND INVESTMENTS (Continued)

Custodial Credit 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 considered 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 to a transaction, the City will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The City’s Investment Policy limits its exposure to custodial credit risk by requiring that all security transactions entered into by the City be conducted on a delivery-versus-payment basis. Securities are to be held by a third-party custodian.

NOTE 4 – INTERFUND TRANSACTIONS

Transfers Between Funds

With Council approval, resources may be transferred from one City fund to another. The purpose of the majority of transfers is to subsidize a fund. Less often, a transfer may be made to open or close a fund. Transfers between City funds during FY 2012 were as follows (in thousands):

<u>Fund Receiving Transfer</u>	<u>Fund Making Transfer</u>	<u>Amount Transferred</u>
General Fund	Nonmajor Governmental Funds	\$ 1,258 A
	Electric Services Fund	11,587 A
	Gas Services Fund	6,007 A
	Internal Service Funds	607 A
Capital Projects Fund	General Fund	18,644 B
	Nonmajor Governmental Funds	2,197 B
Nonmajor Governmental Funds	General Fund	3,401 A
	Capital Projects Fund	3,456 C
	Nonmajor Governmental Funds	43 A
	Subtotal	<u>\$ 47,200</u>

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 4 – INTERFUND TRANSACTIONS (Continued)

(Continued)

Fund Receiving Transfer	Fund Making Transfer	Amount Transferred
Water Services Fund	Gas Services Fund	33 B
	Wastewater Collection Fund	33 B
	Internal Service Funds	9 D
Electric Services Fund	General Fund	33 E
	Internal Service Funds	70 D
Refuse Services Fund	Nonmajor Governmental Funds	692 E
Wastewater Treatment Fund	Internal Service Funds	145 D
Storm Drainage Services Fund	Internal Service Funds	19 D
Internal Service Funds	General Fund	58 F
	Water Services Fund	104 B
	Electric Services Fund	299 B
	Gas Services Fund	136 B
	Wastewater Collection Fund	55 B
	Wastewater Treatment Fund	105 B
	Refuse Services Fund	74 B
	Storm Drainage Services Fund	18 B
	Fiber Optics Fund	9 B
	Subtotal	<u>1,892</u>
	Total	<u>\$ 49,092</u>

The reasons for these transfers are set forth below:

- (A) Transfer to reimburse the Governmental Fund for costs incurred for the benefit of funds making the transfer.
- (B) Allocation of funds to construct capital assets.
- (C) Transfer to allocate bond premium from Debt Service Fund to Capital Projects Fund.
- (D) Transfer to refund replacement charges.
- (E) Transfer to reimburse the Utility Funds for costs incurred for the benefit of funds making the transfer.
- (F) Transfer to reimburse Internal Service Funds for costs incurred for the benefit of funds making the transfer.

Interfund Commitment

During FY 2002, the City established the Palo Alto Redevelopment Agency (the Agency). The Agency and the City have an agreement whereby the City advanced 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 approximately \$399,000 as of June 30, 2012. On September 6, 2011, the City filed Ordinance No. 5126 dissolving the operations of the Agency and, accordingly, this advance will not be repaid to the City.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 4 – INTERFUND TRANSACTIONS (Continued)

Long-Term Interfund Advance

On December 6, 2010, the City Council accepted an Airport Business Plan of the Palo Alto Airport (PAO) and approved creation of a new Airport Enterprise Fund to facilitate the transition of PAO control from the Santa Clara County to the City. The Council approved the General Fund to fund the new Airport Enterprise Fund in the amount of \$300,000 for environmental analysis, legal and personnel costs related to the transition. According to the agreement, the Airport Fund will repay the \$300,000 with interest equal to the average return yield on the City's investment portfolio in 6 years to the General Fund. As of June 30, 2012, the outstanding amount is \$300,000.

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, 2012, the City's notes and loans receivable totaled (in thousands):

Palo Alto Housing Corporation:	
Oak Manor Townhouse	\$ 585
Tree House Apartments	5,344
Emerson Street Project	375
Alma Single Room Occupancy Development	2,222
Barker Hotel	2,111
Sheridan Apartments	2,248
Oak Court Apartments, L.P.	7,835
Mid-Peninsula Housing Coalition:	
Palo Alto Gardens Apartments	100
Community Working Group, Inc.	1,280
Opportunity Center Associates, L.P.	750
Home Rehabilitation Loans	76
Executive Relocation Assistance Loans	959
Below Market Rate Assessment Loans	53
Stevenson Housing 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	1,150
2811-2825 Alma Street Acquisition	1,290
Palo Alto Family Housing, 801 Alma Street	<u>2,800</u>
Total Notes and Loans	29,555
Less: Valuation Allowance	<u>(14,724)</u>
Total Notes and Loans, Net	<u>\$ 14,831</u>

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 5 – NOTES AND LOANS RECEIVABLE (Continued)

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 nonspendable, restricted or committed fund balances, as they are not expected to be repaid immediately.

Some of these loans contain forgiveness clauses that 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, that 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, 2012, the objective was met. The annual loan payment was forgiven for the calendar year ended December 31, 2011.

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 Charlton 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. An additional development loan in the amount of \$2.5 million was approved by the City on October 18, 2010. As of June 30, 2012, the outstanding balance for the Tree House Apartments in aggregate is \$5.3 million. 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 the 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 \$375,000 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. The principal balance is due in 2034.

Alma Single Room Occupancy Development

On December 13, 1996, the City authorized \$2.7 million to the Alma Place Associates, L.P. for the

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 5 – NOTES AND LOANS RECEIVABLE (Continued)

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 occupancy hotel. This loan was funded by three sources: \$400,000 from the Housing In-Lieu Fund, \$1 million from HOME Investment Partnership Program Funds, and \$670,000 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 \$41,000 to the 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 \$825,000 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 Palo Alto Housing Corporation. Annual loan payments were deferred until the Palo Alto Housing Corporation accumulated \$1 million in an affordability reserve account. Two principal payments totaling \$202,438 have been made, and interest has also been paid. The remaining 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 Palo Alto Housing 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 \$1.9 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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 5 – NOTES AND LOANS RECEIVABLE (Continued)

Palo Alto Gardens Apartments

On April 22, 1999, the City loaned \$1 million to the Mid-Peninsula Housing Coalition (the Coalition) for the purchase and rehabilitation of a 155-unit complex for the continuation of low-income housing. This loan is funded by \$659,000 in Community Development Block Grant funds and \$341,000 in Housing In-Lieu funds. The two notes 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 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 re-conveyed.

Opportunity Center Associates, L.P.

On July 19, 2004, the City loaned \$750,000 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 \$750,000 of residential housing funds. The note bears 3 percent interest and is secured by a deed of trust. The loan remains outstanding and becomes due at the end of the 55-year term.

Home Rehabilitation Loans

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 trust, 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 ended 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, 2012, the City had two outstanding home loans, one from the previous City Manager and one from 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, 2012 was approximately \$387,000. The previous City Manager can remain in the home until December 2017, or until his children have left Palo Alto public schools, whichever occurs first.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 5 – NOTES AND LOANS RECEIVABLE (Continued)

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, 2012 is approximately \$449,000. During FY 2011, the Council authorized a capital improvement loan of \$125,000. Loans for capital improvements are made on a dollar for dollar matching basis, with an equal equity contribution made by the City Manager. The loan balance owed as of June 30, 2012 was approximately \$122,000.

Below Market Rate Assessment Loans

In December 2002, the City loaned \$74,000 to below market rate homeowners 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 2012, the City did not receive interest payments.

Stevenson Housing Fire Alarm

In December 2006, the City agreed to loan up to \$48,000 to the 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.

Oak Manor Townhouse Water System

On May 12, 2003, the City Council approved an allocation of \$113,672 to Palo Alto Housing Corporation Housing Apartments, Inc (PAHCA, Inc) to replace the water pipes with an intention to provide a permanent solution to Oak Manor's plumbing needs. Repayment of the loan will not be required unless the property is sold, the program is terminated or purpose of the program is changed without City's approval prior to July 1, 2033. The loan for this project is subordinated to the existing City loan with PAHCA, Inc of January 7, 1991 for the acquisition of the project site, which is discussed earlier in this section.

Palo Alto Senior Housing Project

In July 2003, the City agreed to loan up to \$45,000 to the 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 \$47,600 for the purpose of repairing and upgrading the fire alarm system at the Senior Housing facility. As of June 30, 2012, the outstanding balance was \$28,000.

Clara-Mateo Alliance

In July 2003, the City agreed to loan up to \$200,000 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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 5 – NOTES AND LOANS RECEIVABLE (Continued)

Lytton Gardens Assisted Living

In June 2005, the City agreed to loan up to \$109,000 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 \$75,000 to the 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 the Alma Garden Apartments. The loan is funded entirely by Community Development Block Grant funds. Principal and interest payments are deferred until July 1, 2061, as long as the borrower continues to comply with all terms and conditions of the agreement.

2811-2825 Alma Street Acquisition

On October 9, 2011, the City agreed to loan \$1.3 million to PAHC Properties Corporation (PAHC) to acquire the properties on Alma Street for the purpose of developing an affordable rental housing project. The loan bears simple interest of 3 percent, with an option to forgive the loan at maturity as long as PAHC maintains the affordability restrictions. Provided PAHC is not in default of the agreement, no principal payments shall be due and interest shall not begin to accrue until the closing of the project's permanent funding. Principal and interest payments are payable during the term of the agreement on a "residual receipt" basis as described in the agreement.

Palo Alto Family Housing, 801 Alma Street

On February 14, 2011, the City agreed to loan to Palo Alto Family, LP up to \$5.8 million for the purposes of predevelopment expenses and acquiring certain real property for the Alma Street Affordable Multi-Family Rental Housing Project. The loan bears simple interest of 3 percent. Principal and interest are due and payable during the term of the agreement on a "residual receipt" basis as described in the agreement. Except in the case of a default, all remaining principal and interest shall be payable on the Restriction Termination Date as defined in the agreement. As of June 30, 2012, the outstanding amount is \$2.8 million.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

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 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 one year. 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 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 capital assets, consisting of roadway and recreation and open space, in its government-wide financial statements. GASB Statement No. 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 those 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 statement of net assets as a reduction in the book value of capital assets.

Depreciation is calculated 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.

<u>Governmental Activities</u>	<u>Years</u>
Buildings and structures	20 - 30
Equipment:	
Computer equipment	3 - 5
Office machinery and equipment	5
Machinery and equipment	5 - 30
Roadway network:	
Includes pavement, striping and legends, curbs, gutters and 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
 <u>Business-type Activities</u>	
Buildings and structures	25 - 60
Vehicles and heavy equipment	3 - 10
Machinery and equipment	10 - 50
Transmission, distribution and treatment systems	10 - 100

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 6 – CAPITAL ASSETS (Continued)

General Capital Assets

Changes in the City's general capital assets during the year ended June 30, 2012 were (in thousands):

	Balance July 1, 2011	Additions	Retirements	Transfers	Balance June 30, 2012
<i>Governmental activities</i>					
Nondepreciable capital assets:					
Land and improvements	\$ 78,561	\$ 86	\$ -	\$ -	\$ 78,647
Street trees	15,374	31	-	-	15,405
Intangible assets	3,800	-	-	(3,800)	-
Construction in progress	36,297	32,281	(140)	(13,165)	55,273
Total nondepreciable capital assets	<u>134,032</u>	<u>32,398</u>	<u>(140)</u>	<u>(16,965)</u>	<u>149,325</u>
Depreciable capital assets:					
Buildings and structures	123,916	1,575	-	7,462	132,953
Intangible assets - Easement	-	-	-	3,800	3,800
Equipment	9,710	78	-	280	10,068
Roadway network	267,575	-	-	4,844	272,419
Recreation and open space network	21,788	690	-	579	23,057
Total depreciable capital assets	<u>422,989</u>	<u>2,343</u>	<u>-</u>	<u>16,965</u>	<u>442,297</u>
Less accumulated depreciation:					
Buildings and structures	(63,236)	(2,899)	-	-	(66,135)
Intangible assets - Easement	-	(16)	-	-	(16)
Equipment	(6,435)	(483)	-	-	(6,918)
Roadway network	(107,453)	(6,408)	-	-	(113,861)
Recreation and open space network	(6,579)	(741)	-	-	(7,320)
Total accumulated depreciation	<u>(183,703)</u>	<u>(10,547)</u>	<u>-</u>	<u>-</u>	<u>(194,250)</u>
Depreciable capital assets, net	<u>239,286</u>	<u>(8,204)</u>	<u>-</u>	<u>16,965</u>	<u>248,047</u>
Internal service fund capital assets					
Construction in progress	151	1,558	-	(1,505)	204
Equipment	51,715	149	(1,792)	1,505	51,577
Less accumulated depreciation	(31,780)	(5,884)	1,749	-	(35,915)
Net internal service fund capital assets	<u>20,086</u>	<u>(4,177)</u>	<u>(43)</u>	<u>-</u>	<u>15,866</u>
Governmental activities capital assets, net	<u>\$ 393,404</u>	<u>\$ 20,017</u>	<u>\$ (183)</u>	<u>\$ -</u>	<u>\$ 413,238</u>

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 6 – CAPITAL ASSETS (Continued)

Business-type Capital Assets

Changes in the City's enterprise fund capital assets during the year ended June 30, 2012 were (in thousands):

	Balance July 1, 2011	Additions	Retirements	Transfers	Balance June 30, 2012
<i>Business-type activities</i>					
Nondepreciable capital assets:					
Land and improvements	\$ 4,971	\$ -	\$ -	\$ -	\$ 4,971
Construction in progress	132,437	40,851	-	(73,955)	99,333
Total nondepreciable capital assets	<u>137,408</u>	<u>40,851</u>	<u>-</u>	<u>(73,955)</u>	<u>104,304</u>
Depreciable capital assets:					
Buildings and structures	31,860	-	-	849	32,709
Transmission, distribution and treatment systems	545,548	1,119	(3,801)	73,106	615,972
Total depreciable capital assets	<u>577,408</u>	<u>1,119</u>	<u>(3,801)</u>	<u>73,955</u>	<u>648,681</u>
Less accumulated depreciation:					
Buildings and structures	(7,973)	(603)	-	-	(8,576)
Transmission, distribution and treatment systems	(241,119)	(16,048)	2,802	-	(254,365)
Total accumulated depreciation	<u>(249,092)</u>	<u>(16,651)</u>	<u>2,802</u>	<u>-</u>	<u>(262,941)</u>
Depreciable capital assets, net	<u>328,316</u>	<u>(15,532)</u>	<u>(999)</u>	<u>73,955</u>	<u>385,740</u>
Business-type activities capital assets, net	<u>\$ 465,724</u>	<u>\$ 25,319</u>	<u>\$ (999)</u>	<u>\$ -</u>	<u>\$ 490,044</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 are as follows (in thousands):

<i>Governmental Activities</i>		<i>Business-type Activities</i>	
City Manager	\$ 33	Water	\$ 1,468
Community Services	1,095	Electric	7,751
Fire	169	Fiber Optics	275
Police	134	Gas	1,896
Public Works	8,789	Wastewater Collection	2,282
Planning	89	Wastewater Treatment	2,134
Non-departmental	10	Storm Drainage	845
Library	228		<u>\$ 16,651</u>
Internal Service Funds	5,884		
	<u>\$ 16,431</u>		

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 6 – CAPITAL ASSETS (Continued)

Construction In Progress and Completed Projects

Construction in progress during FY 2012 is comprised of the following (in thousands):

<u>Governmental Activities</u>	<u>Expended to June 30, 2012</u>
Mitchell Park Library & Community Center	\$ 28,382
Civic Center Infrastructure Improvements	5,755
Art Center Electrical & Mechanical Upgrades	5,592
San Antonio Road Median Improvements	2,141
Main Library Construction & Improvements	1,933
Greer Park Phase IV	1,752
Americans With Disabilities - Other	1,234
Charleston/Arastradero Corridor Plan	1,001
Traffic Signal Upgrades	895
Library & Community Center Temporary Facilities	660
El Camino / Stanford Intersection	594
Park Restroom Installation	476
Highway 101 Pedestrian/Bicycle Overpass	345
Interior Finishes Construction	269
Roofing Replacement	228
Security Systems Improvements	215
Bicycle Boulevards Implementation Project	214
Furniture/Technology for Library Bond	207
Vehicle Replacement Fund	204
Public Safety Building	198
Foothills Park Interpretive Center Improvements	197
Municipal Service Center Improvements	192
Dinah SummerHill Pedestrian/Bicycle Path	188
Park Trails	179
Roth Building	166
Thermoplastic Lane Marking & Striping	158
Foothills Park Road Improvements	150
Safe Routes To Schools	138
Magical Bridge Playground	128
Rinconada Park Master Plan and Design	122
Building Systems Improvements	113
El Camino / Ventura Traffic Signal	110
Other Construction In Progress	1,341
Total Governmental Activities Construction In Progress	<u>\$ 55,477</u>

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 6 – CAPITAL ASSETS (Continued)

Construction In Progress and Completed Projects

<u>Business-type Activities</u>	<u>Expended to June 30, 2012</u>
Water system extension replacements and improvements	\$ 22,972
Electric distribution system improvements	7,401
Water quality control plant equipment replacement and lab facilities	7,222
Gas system extension replacements and improvements	6,977
Sewer system rehabilitation and extensions	4,781
Storm drainage structural and water quality improvements	1,339
Other electrical improvements projects	1,016
Other construction in progress	47,625
Total Business-type Activities Construction In Progress	<u>\$ 99,333</u>

Allocations of business-type activity administration and general expenses of \$11.6 million have been capitalized and included in amounts expended through June 30, 2012.

Major governmental capital projects that are currently in progress, and the remaining capital commitment of each, are as follows:

- Mitchell Park Library and Community Center - \$21.0 million
- Main Library - \$16.2 million
- Art Center electrical and mechanical upgrades - \$2.7 million

Major business-type capital projects that are currently in progress, and the remaining capital commitment of each, are as follows:

- Emergency water supply improvement for Water Fund - \$17.6 million
- Gas main replacement project for Gas Fund - \$6.6 million
- Plant equipment replacement for Wastewater Treatment Fund - \$3.9 million
- Wastewater Collection Fund rehabilitation/augmentation project - \$3.1 million

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS

Long-Term Obligations

Bond premiums and discounts 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):

	<u>Original Issue Amount</u>	<u>Balance July 1, 2011</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2012</u>	<u>Current Portion</u>
Governmental Activities Debt:						
<i>General Long-Term Obligations:</i>						
1998 Golf Course	\$ 7,750	\$ 3,690	\$ -	\$ 3,690	\$ -	\$ -
Certificates of Participation, 4.00-5.00%, due 09/01/2018						
2002A Civic Center Refinancing	3,500	405	-	405	-	-
Certificates of Participation, 2.00-4.00%, due 03/01/2012						
2002B Downtown Parking Improvements	3,555	1,800	-	115	1,685	125
Certificates of Participation, 2.00-4.00%, due 03/01/2022						
General Obligation Bonds 2010 Series A, 2.00-5.00%, due 08/01/2040	55,305	55,305	-	765	54,540	1,000
2011 Lease-Purchase Agreement	3,222	-	3,222	458	2,764	364
Add: unamortized premium	-	3,640	-	126	3,514	125
	<u>-\$ 73,332</u>	<u>\$ 64,840</u>	<u>\$ 3,222</u>	<u>\$ 5,559</u>	<u>\$ 62,503</u>	<u>\$ 1,614</u>
Total Governmental Activities Debt	<u>\$ 73,332</u>	<u>\$ 64,840</u>	<u>\$ 3,222</u>	<u>\$ 5,559</u>	<u>\$ 62,503</u>	<u>\$ 1,614</u>

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

	Original Issue Amount	Balance July 1, 2011	Additions	Retirements	Balance June 30, 2012	Current Portion
Business-type Activities Debt:						
<i>Enterprise Long-Term Obligations:</i>						
Utility Revenue Bonds						
1995 Series A, 5.00-6.25%, due 06/01/2020	\$ 8,640	\$ 4,594	\$ -	\$ 395	\$ 4,199	\$ 420
1999 Refunding, 3.25-5.25%, due 06/01/2024	17,735	12,715	-	550	12,165	580
2002 Series A, 3.00-5.00%, due 06/01/2026	26,055	18,052	-	18,052	-	-
2009 Series A, 1.80-5.95%, due 06/01/2035	35,015	34,190	-	835	33,355	855
2011 Series A, 1.80-5.95%, due 06/01/2035	17,225	-	17,225	1,065	16,160	920
Less: Unamortized Premium (Discount)		(170)	1,297	32	1,095	-
Less: Loss on refunding		-	(440)	22	(462)	-
Energy Tax Credit Bonds						
2007 Series A, 0%, Due 12/15/2021	1,500	1,100	-	100	1,000	100
Less: unamortized Premium (Discount)		(59)	-	(6)	(53)	-
State Water Resources Loans						
2007, 0%, due 06/30/2029	9,000	8,100	-	450	7,650	450
2009, 2.6%, due 11/30/2030	8,500	8,596	-	346	8,250	341
Total Business-type Activities Debt	<u>\$ 123,670</u>	<u>\$ 87,118</u>	<u>\$ 18,082</u>	<u>\$ 21,841</u>	<u>\$ 83,359</u>	<u>\$ 3,666</u>

Description of 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 were secured by lease revenues received by the Public Improvement Corporation from golf course revenues or other unrestricted revenues of the City. On August 2, 2011, the City entered into a master lease-purchase agreement with JP Morgan Chase Bank, N.A. Proceeds together with the COPs reserve fund were deposited into an escrow account to redeem all of the COPs in the aggregate amount of \$3.7 million. At June 30, 2012, the 1998 COPs were fully redeemed.

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 Corporation from the City’s available funds. As of June 30, 2012, the City has fully paid off the outstanding COPs.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

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, and are payable from lease revenues received by the Corporation from the City’s available funds.

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 percent to 5 percent, and are payable from property tax revenues.

The pledge of future Net Revenues for the above funds ends upon repayment of the \$54.5 million principal and \$40.6 million interest as the remaining debt service on the bonds, which is scheduled to occur in FY 2041.

2011 Lease-Purchase Agreement – On August 2, 2011, the City entered into a master lease-purchase agreement with JP Morgan Chase Bank, N.A. to finance redemption of the 1998 Golf Course COPs. The lease is secured by a first priority security interest in twenty-one Fire Department emergency vehicles. Lease proceeds were \$3.2 million. Principal payments are due annually on September 1 and interest payments are due semi-annually on September 1 and March 1 at a rate of 2.49 percent, payable from General Fund revenues.

1995 Utility Revenue Bonds, Series A – The City issued \$8.6 million of 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 Services Fund and Fiber Optics 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.

As required by the Indenture, the City established a debt service reserve fund for the Bonds (the “Reserve Account”), with a minimum funding level requirement in the Reserve Account (the “Reserve Requirement”). At the time it issued the Bonds, the City satisfied the Reserve Requirement with a deposit into the Reserve Account of a surety bond (the “Surety Bond”) in the amount of \$685,340 issued by Ambac Indemnity Corporation (renamed to Ambac Assurance Corporation in 1997).

On November 9, 2010, Ambac Financial Group Inc. (Ambac Financial) filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. Ambac Financial is a holding company whose affiliates provide financial guarantees and financial services to its customers. Ambac Indemnity Corporation, now known as Ambac Assurance Corporation, is a subsidiary of Ambac Financial. Ambac has issued a reserve fund surety bond of \$685,340 that expires on June 1, 2020 and is on deposit in the Reserve Fund account securing the Bonds. According to the Trust Agreement for these bonds, in the event that such surety bond for any reason terminates or expires, and the remaining amount on deposit in the Reserve Fund account is less

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

than the required reserve, the City is to address such shortfall by delivering to the trustee a surety bond or a letter of credit meeting the criteria of a Qualified Reserve Facility under the Trust Agreement, or depositing cash to the General Account in up to twelve equal monthly installments. Information about Ambac Financial is available on Form 10-K and Form 10-Q filed by Ambac Financial; the City refers to this information for reference only, and does not intend to incorporate any such information herein. The City is not certain about the effect of the bankruptcy proceedings, if any, on the Surety Bond.

The pledge of future Net Revenues for the above funds ends upon repayment of the \$4.2 million principal and \$1.3 million interest as the remaining debt service on the bonds, which is scheduled to occur in 2020. For FY 2012, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$242.1 million; operating costs, including operating expenses but not interest, depreciation or amortization, amounted to \$169.9 million. Net Revenues available for debt service amounted to \$72.2 million, which represented coverage of 105.83 times over the \$0.7 million in debt service.

1999 Utility Revenue and Refunding Bonds, Series A – The City issued \$17.7 million of 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 two Wastewater Treatment 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 Drainage (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.

As required by the Indenture, the City established a debt service reserve fund for the Bonds (the "Reserve Account"), with a minimum funding level requirement in the Reserve Account (the "Reserve Requirement"). At the time it issued the Bonds, the City satisfied the Reserve Requirement with a deposit into the Reserve Account of a surety bond (the "Surety Bond") in the amount of \$1,647,300 issued by Ambac Indemnity Corporation (renamed to Ambac Assurance Corporation in 1997).

On November 9, 2010, Ambac Financial Group Inc. (Ambac Financial) filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. Ambac Financial is a holding company whose affiliates provide financial guarantees and financial services to its customers. Ambac Indemnity Corporation, now known as Ambac Assurance Corporation, is a subsidiary of Ambac Financial. Ambac has issued a reserve fund surety bond of \$1,647,300 that expires on June 1, 2024 and is on deposit in the Reserve Fund account securing the Bonds. According to the Trust Agreement for these bonds, in the event that such surety bond for any reason terminates or expires, and the remaining amount on deposit in the Reserve Fund account is less than the required reserve, the City is to address such shortfall by delivering to the trustee a surety bond

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

or a letter of credit meeting the criteria of a Qualified Reserve Facility under the Trust Agreement, or depositing cash to the General Account in up to twelve equal monthly installments. Information about Ambac Financial is available on Form 10-K and Form 10-Q filed by Ambac Financial; the City refers to this information for reference only, and does not intend to incorporate any such information herein. The City is not certain about the effect of the bankruptcy proceedings, if any, on the Surety Bond.

The pledge of future Net Revenues for the above funds ends upon repayment of the \$12.2 million principal and \$5.0 million interest as the remaining debt service on the bonds, which is scheduled to occur in 2024. For FY 2012, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$44.2 million; operating costs, including operating expenses but not interest, depreciation or amortization, amounted to \$32.1 million. Net Revenues available for debt service amounted to \$12.1 million, which represents coverage of 10 times over the \$1.2 million in debt service.

2002 Utility Revenue Bonds, Series A – On January 24, 2002, the City issued \$26.1 million of Utility Revenue Bonds (2002 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 percent to 5 percent. The 2002 Revenue Bonds are secured by net revenues generated by the Water Services and Gas Services Funds.

On September 8, 2011, the City issued a \$17.2 million utility lease revenue bond 2011, Series A with an average interest rate of 3.33 percent and an original bond premium of \$1.3 million. Proceeds together with the existing 2002 bond reserve fund were used to refund on a current basis the 2002 Bonds. The money deposited in the escrow fund will be invested in U.S. Treasury Securities so that the interest thereon and the maturing principal thereof will be sufficient to redeem the outstanding 2002 Bonds in full on December 1, 2011. As of June 30, 2012, the 2002 Bonds were completely paid off.

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 under the Indenture.

The pledge of future Electric Fund Net Revenues ends upon repayment of the \$1.0 million remaining debt service on the bonds, which is scheduled to occur in 2022. For FY 2012, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$123.0 million; operating costs, including operating expenses but not interest, depreciation or amortization, amounted to \$85.4 million. Net Revenues available for debt service amounted to \$37.6 million, which represented coverage of 376 times over the \$0.1 million in debt service.

2009 Water Revenue Bonds, Series A – On October 6, 2009, the City issued \$35.0 million of 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

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

the Water Services 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 subsidy payments amounting to \$604,600, which represents 35 percent of the two interest payments due on December 1, 2011 and June 1, 2012.

The pledge of future Net Revenues for the above funds ends upon repayment of the \$33.4 million principal and \$25.6 million interest as the remaining debt service on the bonds, which is scheduled to occur in 2035. For FY 2012, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$32.0 million; operating costs, including operating expenses but not interest, depreciation or amortization, amounted to \$26.4 million. Net Revenues available for debt service amounted to \$5.6 million, which represented coverage of 2.2 times over the \$2.6 million in debt service.

2011 Utility Revenue Refunding Bonds – On September 8, 2011, the City issued \$17.2 million in Lease Revenue Bonds (2011 Bonds) to refund the outstanding 2002 Series A Utility Revenue Bonds (2002 Bonds) on a current basis. The aggregate difference in debt service between the 2002 Bonds and the 2011 Bonds was \$4.0 million. The economic gain on the bond refunding was \$3.1 million. The 2002 Bonds were issued to finance improvement to the City’s municipal water utility system and the natural gas utility system. Principal of the 2011 Bonds is payable annually on June 1, and interest on the 2011 Bonds is payable semi-annually on June 1 and December 1. The 2011 Bonds are secured by net revenues generated by the Water Services and Gas Services Funds.

The pledge of future Net Revenues of the above funds ends upon repayment of the \$16.2 million principal and \$4.2 million interest as remaining debt service on the bonds, which is scheduled to occur in 2026. For FY 2012, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$74.9 million; operating costs, including operating expenses but not interest, depreciation or amortization, amounted to \$52.2 million. Net Revenues available for debt service amounted to \$22.7 million, which represented coverage of 15.5 times over the \$1.5 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 commenced 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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

As of June 30, 2011, the full loan in the amount of \$8.5 million was drawn down and became outstanding. Interest in the amount of \$96,000 was accrued and added to the outstanding loan balance.

Debt Service Requirements (in thousands):

Debt service 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
2013	\$ 1,489	\$ 2,659	\$ 4,148	\$ 3,666	\$ 3,355	\$ 7,021
2014	1,524	2,617	4,141	3,780	3,237	7,017
2015	1,578	2,572	4,150	3,909	3,108	7,017
2016	1,615	2,522	4,137	4,049	2,972	7,021
2017	1,676	2,453	4,129	4,198	2,818	7,016
2018-2022	8,227	11,135	19,362	23,603	11,482	35,085
2023-2027	7,935	9,340	17,275	20,603	6,858	27,461
2028-2032	10,035	7,197	17,232	12,110	3,835	15,945
2033-2037	12,525	4,648	17,173	6,861	832	7,693
2038-2041	12,385	1,276	13,661	-	-	-
Total	\$ 58,989	\$ 46,419	\$ 105,408	\$ 82,779	\$ 38,497	\$ 121,276

Debt Call Provisions

Long-term debt as of June 30, 2012 is callable on the following terms and conditions:

	<u>Initial Call Date</u>	
Governmental Activities Long-Term Debt		
2002B Certificates of Participation	03/01/11	(2)
2010A General Obligation Bonds		
\$6.595 million due 08/01/2032	08/01/31	(3)
\$4.890 million due 08/01/2034	08/01/33	(3)
\$17.725 million due 08/01/2040	08/01/35	(3)
Business-Type Activities Long-Term Debt		
Utility Revenue Bonds		
1999 Refunding	06/01/09	(1)
2011 Series A	06/01/21	(1)

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

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

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 in that 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, 2012, the amount of bonds outstanding was \$5.1 million.

Long-term Debt without City Commitment

On July 23, 2007, the City approved the issuance of two variable rate demand Tax-Exempt Revenue Bonds by the Association of Bay Area Governments (ABAG) Finance Authority in the amounts of \$160 million and \$180 million for the construction of the 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, 2012, the District's outstanding debt amounted to \$620 thousand.

On February 29, 2012, the University Avenue Area Off-Street Parking Assessment District issued Limited Obligation Refunding Improvement Bonds (2012 Bonds), 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, 2012, the District's outstanding debt amounted to \$31.13 million. The proceeds from the 2012 Bonds, combined with available Assessment Funds, were used to redeem the outstanding University Avenue Area Off-Street Parking Assessment District Series 2001-A and Series 2002-A Bonds.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

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 by performing 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 at a cost of \$0.9 million), Phase IIB (23.2 acres closed in 2000 at a cost of \$1.2 million) and Phase IIC, a 51.2 acre active area that is currently filled to capacity and ceased accepting waste after July 28, 2011. Phase IIC is currently scheduled for closure in 2013. The 30 years of post-closure maintenance costs will be paid after the state certifies the Phase IIC closure (expected in early 2014).

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 FY 2012 and 2011 were \$11.0 million and \$10.8 million, respectively. 100 percent of the landfill capacity has been used to date. Based on costs incurred in FY 2012, \$11.0 million is expected to be recorded as future landfill closure and post-closure liability.

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 2012, for the \$5.3 million post-closure maintenance, 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 \$5.7 million closure liability remains under the enterprise fund mechanism. The City is in compliance with these requirements for the year ended June 30, 2012.

The landfill closure balance as of June 30, 2012 comprised the following (in thousands):

		<u>Funding Mechanism</u>
Closure	\$ 5,717	Cash on hand
Post-closure care	<u>5,280</u>	Future revenues
Balance	<u><u>\$ 10,997</u></u>	

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

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

As prescribed by GASB Statement No. 54, governmental funds report fund balances in classifications based primarily on the extent to which the City is bound to honor constraints on the specific purposes for which amounts in the funds can be spent. Fund balances for governmental funds are made up of the following:

Nonspendable Fund Balance – This fund is comprised of amounts that are: (a) not in spendable form, or (b) legally or contractually required to be maintained intact. The "not in spendable form" criterion includes items that are not expected to be converted to cash, for example: prepaid items, land held for redevelopment and long-term notes receivable. The corpus of the permanent fund is contractually required to be maintained intact.

Restricted Fund Balance – This fund is comprised of amounts that can be spent only for the specific purposes stipulated by external resource providers, constitutionally or through enabling legislation. Restrictions may effectively be changed or lifted only with the consent of resource providers.

Committed Fund Balance – This fund is comprised of amounts that can only be used for the specific purposes determined by the action that constitutes the most binding constraint (i.e. ordinance) of the City's highest level of decision-making authority, the City Council. Commitments may be changed or lifted only by the City taking the same formal action that imposed the constraint originally.

Assigned Fund Balance – This fund is comprised of amounts intended to be used by the City for specific purposes that are neither restricted nor committed. Intent is expressed by the City Council or official to which the City Council has delegated the authority to assign amounts to be used for specific purposes.

Unassigned Fund Balance – This fund is the residual classification for the General Fund and includes all amounts not contained in the other classifications. Unassigned amounts are technically available for any purpose. Other governmental funds may only report negative unassigned fund balance, which occurs when a fund has a residual deficit after allocation of fund balance to the nonspendable, restricted or committed categories.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 10 – NET ASSETS AND FUND BALANCES (Continued)

The fund balances of all governmental funds are presented by the above mentioned categories on the face of the financial statements. In circumstances when an expenditure is made for a purpose for which amounts are available in multiple fund balance categories, fund balance is depleted in the order of restricted, committed, assigned, and unassigned.

The General Fund Budget Stabilization Reserve (BSR) is established by authority of the General Fund Reserve Policy, which is approved by the City Council and included in the City's annual adopted budget. The BSR is maintained in the range of 15 to 20 percent of General Fund operating expenditures, with a target of 18.5 percent. Any reserve level below 15 percent requires City Council approval. At the discretion of the City Manager, a reserve balance above 18.5 percent may be transferred to the Infrastructure Reserve within the Capital Projects Fund. The purpose of the General Fund BSR is to fund unbudgeted, unanticipated one-time costs. The BSR is not meant to fund ongoing, recurring General Fund operating expenditures.

As of June 30, 2012 total outstanding encumbrances related to governmental activities were \$3.4 million for the General Fund, \$20.0 million for the Capital Projects Fund, and \$1.0 million for the Special Revenue Funds.

Enterprise Funds

At June 30, 2012, Enterprise Fund unrestricted net assets (in thousands) were as follows:

	Water	Electric	Fiber Optics	Gas	Wastewater Collection	Wastewater Treatment	Refuse	Storm Drainage	Airport	Total
Unrestricted										
Rate stabilization										
Supply	\$ -	\$ 65,929	\$ -	\$ 7,618	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 73,547
Distribution	-	8,680	-	8,374	-	-	-	-	-	17,054
Operations	7,997	-	12,470	-	4,751	7,461	(4,089)	2,726	(223)	31,093
	7,997	74,609	12,470	15,992	4,751	7,461	(4,089)	2,726	(223)	121,694
Emergency plant replacement	1,000	1,000	1,000	1,000	1,000	1,929	-	-	-	6,929
Electric special projects	-	50,320	-	-	-	-	-	-	-	50,320
Reappropriations	8,355	11,466	690	13,621	9,849	4,504	821	3,351	-	52,657
Commitments	5,741	7,703	91	5,590	1,195	3,538	984	371	48	25,261
Underground loan	-	742	-	-	-	-	-	-	-	742
Notes and loans	-	-	-	-	-	559	-	-	-	559
Landfill corrective action	-	-	-	-	-	-	679	-	-	679
Public benefit program	-	1,149	-	-	-	-	-	-	-	1,149
Central Valley Project	-	314	-	-	-	-	-	-	-	314
Total	\$ 23,093	\$ 147,303	\$ 14,251	\$ 36,203	\$ 16,795	\$ 17,991	\$ (1,605)	\$ 6,448	\$ (175)	\$ 260,304

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

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 10 – NET ASSETS AND FUND BALANCES (Continued)

Internal Service Funds

At June 30, 2012, Internal Service Funds unrestricted net assets (in thousands):

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits	Workers' Compensatio n Insurance Program	General Liabilities Insurance Program	Retiree Health Benefits	Total
Unrestricted net assets:								
Commitments	\$ 1,193	\$ 2,743	\$ 155	\$ 286	\$ 300	\$ 4	\$ -	\$ 4,681
Future catastrophic losses	-	-	-	-	-	96	-	96
Retiree health care	-	-	-	-	-	-	26,265	26,265
Software and hardware replacement	-	343	-	-	-	-	-	343
Capital Projects	917	8,768	-	-	-	-	-	9,685
Available	7,300	5,640	(160)	1,226	(100)	270	-	14,176
Total	<u>\$ 9,410</u>	<u>\$ 17,494</u>	<u>\$ (5)</u>	<u>\$ 1,512</u>	<u>\$ 200</u>	<u>\$ 370</u>	<u>\$ 26,265</u>	<u>\$ 55,246</u>

Commitments represent the portion of net assets set aside for open purchase orders.

Future catastrophic losses represent the portion of net assets to be used for unforeseen future losses.

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

Capital projects represent the portion of net assets set aside for adopted capital projects.

NOTE 11 – PENSION PLANS

CalPERS Safety and Miscellaneous Employees' Plans

Substantially all permanent City employees are eligible to participate in pension plans offered by the 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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 11 – PENSION PLANS (Continued)

The Plans' provisions and benefits in effect at June 30, 2012, as determined by the valuation dated June 30, 2009, are summarized as follows:

	Safety Plan Fire Fighters, Fire Chiefs Association, Police Officers, Police Management Hire Date Before 6/8/12	Safety Plan Fire Fighters Hire Date on or After 6/8/12
Benefit vesting schedule	5 years service	5 years service
Benefit payments	monthly for life	monthly for life
Full retirement age	50	55 ¹
Monthly benefits, as a % of annual salary	3%	3%
Required employee contribution rates ²	9%	9%
Required employer contribution rates	30.125%	30.125%

¹ Employees can retire at age 50 with reduced benefits of 2.4% - 2.88%.

² Effective October 22, 2011, Fire Fighters contribute 6.5% and City pays remainder. Effective March 10, 2012, Fire Chiefs Association contributes 9%. Effective May 19, 2012, Police Officers contribute 9%. Effective July 1, 2012, Fire Fighters contribute 9%.

	Miscellaneous Plan Hire Date Before 7/17/10	Miscellaneous Plan Hire Date on or After 7/17/10
Benefit vesting schedule	5 years service	5 years service
Benefit payments	monthly for life	monthly for life
Full retirement age ³	55	60
Monthly benefits, as a % of annual salary ³	2.7%	2.0% - 2.418%
Required employee contribution rates ⁴	8%	7%
Required employer contribution rates	21.725%	21.725%

³ Employees can retire at age 50 with reduced benefits of 2.0% - 2.56% if hired before 7/17/10, or 1.092% - 1.874% if hired on or after 7/17/10.

⁴ Management employees contribute 2% and City pays remainder; Service Employees International Union (SEIU) employees contribute 5.75% and City pays remainder. Effective July 1, 2012 for SEIU and October 6, 2012 for management, employees will contribute 8% if hired before 7/17/10 and 7% if hired on or after 7/17/10.

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.

Actuarially determined employer and employee contributions for all plans for fiscal years 2012, 2011 and 2010 were \$27.7, \$24.0 and \$24.0 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.

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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 11 – PENSION PLANS (Continued)

Annual Pension Costs representing the payment of annual required contributions determined by CalPERS for the last three fiscal years were as follows (in thousands):

<u>Fiscal Year Ended</u>	<u>Annual Pension Cost (APC)</u>	<u>Percent of APC Contributed</u>	<u>Net Pension Obligation</u>
<i>Safety Plan</i>			
June 30, 2010	\$ 5,441	100%	\$ -
June 30, 2011	6,029	100%	-
June 30, 2012	7,324	100%	-
<i>Miscellaneous Plan</i>			
June 30, 2010	\$ 10,891	100%	-
June 30, 2011	12,354	100%	-
June 30, 2012	15,687	100%	-

CalPERS uses the 15 year smoothed market method of valuing the Plan 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 a 30 year rolling period, except for special gains and losses in fiscal years 2009 through 2011 which are being amortized over fixed and declining 30 year periods.

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

<i>Safety Plan:</i>		<u>Actuarial</u>				Annual Covered Payroll	Unfunded Liability as a % of Payroll
<u>Valuation Date</u>	<u>Entry Age Accrued Liability</u>	<u>Value of Assets</u>	<u>Unfunded Liability</u>	<u>Funded Ratio</u>			
2008	\$ 258,964	\$ 228,883	\$ 30,081	88.4%	\$ 22,181	135.6%	
2009	280,293	236,274	44,019	84.3%	22,087	199.3%	
2010	293,895	244,413	49,482	83.2%	23,030	214.9%	
<i>Miscellaneous Plan:</i>		<u>Actuarial</u>					
<u>Valuation Date</u>	<u>Entry Age Accrued Liability</u>	<u>Value of Assets</u>	<u>Unfunded Liability</u>	<u>Funded Ratio</u>			
2008	\$ 443,337	\$ 379,837	\$ 63,500	85.7%	\$ 63,934	99.3%	
2009	499,200	398,765	100,435	79.9%	65,602	153.1%	
2010	521,269	416,810	104,459	80.0%	62,496	167.1%	

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 11 – PENSION PLANS (Continued)

The significant actuarial assumptions adopted by CalPERS' Board of Administration that were used to prepare the City's actuarial valuations for both the Safety and Miscellaneous Plans are as follows:

Safety Plan

Valuation Date	6/30/2010*	6/30/2009**
Actuarial Cost Method	Entry Age Normal Cost Method	Entry Age Normal Cost Method
Amortization Method	Level percent of payroll	Level percent of payroll
Average Remaining Period	29 Years as of the Valuation Date	30 Years as of the Valuation Date
Asset Valuation Method	15 Year Smoothed Market	15 Year Smoothed Market
Actuarial Assumptions:		
Investment Rate of Return	7.75% (net of administrative expenses)	7.75% (net of administrative expenses)
Projected Salary Increases	3.55% to 13.15% depending on age, service, and type of employment	3.55% to 13.15% depending on age, service, and type of employment
Inflation	3.00%	3.00%
Payroll Growth	3.25%	3.25%
Individual Salary Growth	A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 3.00% and an annual production growth of 0.25%.	A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 3.00% and an annual production growth of 0.25%.

Miscellaneous Plan

Valuation Date	6/30/2010*	6/30/2009**
Actuarial Cost Method	Entry Age Normal Cost Method	Entry Age Normal Cost Method
Amortization Method	Level percent of payroll	Level percent of payroll
Average Remaining Period	20 Years as of the Valuation Date	21 Years as of the Valuation Date
Asset Valuation Method	15 Year Smoothed Market	15 Year Smoothed Market
Actuarial Assumptions:		
Investment Rate of Return	7.75% (net of administrative expenses)	7.75% (net of administrative expenses)
Projected Salary Increases	3.55% to 14.45% depending on age, service, and type of employment	3.55% to 14.45% depending on age, service, and type of employment
Inflation	3.00%	3.00%
Payroll Growth	3.25%	3.25%
Individual Salary Growth	A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 3.00% and an annual production growth of 0.25%.	A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 3.00% and an annual production growth of 0.25%.

* The June 30, 2010 valuations, which are the most recent valuations, were used to disclose the funded status.

** The June 30, 2009 valuations were used to determine the contribution requirements for FY 2012.

Audited annual financial statements and six-year trend information are available from CalPERS at P.O. Box 942703, Sacramento, CA 94229-2709.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

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. Details of benefits provided to retirees are noted in the following tables:

Unit	Hired Before	Retiree Coverage ¹	Dependent Coverage	Retired on or After	Retiree Contribution
Management & Professional	1/1/2004	100%	95%	4/1/2011	up to 10%
Police Management	1/1/2004	100%	95%	N/A	0%
Fire Fighters	1/1/2004	100%	95%	12/1/2011	10%
Fire Chiefs Association	1/1/2004	100%	95%	1/1/2013	10%
SEIU	1/1/2005	100%	95%	4/1/2011	up to 10%
Police Officers	1/1/2006	100%	95%	N/A	0%

¹ 100% of benefits if the employee was vested in CalPERS for five years and the employee retired from the City of Palo

Unit	Hired on or After	Retiree Coverage ²	Dependent Coverage ³	Retired on or After	Retiree Contribution
Management & Professional ⁴	1/1/2004	50%-100%	Max. 90%	4/1/2011	up to 10%
Police Management ⁴	1/1/2004	50%-100%	Max. 90%	N/A	0%
Fire Fighters ⁴	1/1/2004	50%-100%	Max. 90%	12/1/2011	10%
Fire Chiefs Association ⁴	1/1/2004	50%-100%	Max. 90%	1/1/2013	10%
SEIU ⁵	1/1/2005	50%-100%	Max. 90%	4/1/2011	up to 10%
Police Officers ⁴	1/1/2006	50%-100%	Max. 90%	N/A	0%

² Employees with ten years of CalPERS service, at least five of which are at the City of Palo Alto, receive 50% of the lifetime medical benefit, with the City portion increasing by 5% for each additional year of service.

³ Maximum of 90% once employee completes 20 years of service.

⁴ Effective 1/1/2006 plan capped at the second highest CalPERS Bay Area Basic plan premium.

⁵ Effective 1/1/2007 plan capped at the second highest CalPERS Bay Area Basic plan premium.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 12 – RETIREE HEALTH BENEFITS (Continued)

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 other 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 (CERBT), is administrated by CalPERS and managed by a separately appointed board, which is not under control of the 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, 2011, 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 include: (a) 7.75 percent investment rate of return, (b) 3.25 percent projected annual salary increase, (c) actuarial value of assets, (d) inflation rate of 3 percent, and (e) health care cost trend data as noted in the following table:

<u>Year</u>	<u>Non-Medicare</u>	<u>Medicare</u>
2013	9.0%	9.4%
2014	8.5%	8.9%
2015	8.0%	8.0%
2016	7.5%	7.8%
2017	7.0%	7.2%
2018	6.5%	6.7%
2019	6.0%	6.1%
2020	5.5%	5.6%
2021+	5.0%	5.0%

The funded status of the plan was determined as part of the June 30, 2011 actuarial valuation. The actuarial assumptions used for the June 30, 2011 actuarial valuation were the same as the actuarial assumptions used for the January 1, 2011 actuarial valuation, except for the investment rate of return, which is 7.61 percent instead of 7.75 percent.

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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 12 – RETIREE HEALTH BENEFITS (Continued)

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 year ended June 30, 2012, the City made contributions and amortized 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	\$ 12,584
Amortization on the Net OPEB Asset	2,257
Interest on the Net OPEB Asset	<u>(1,783)</u>
Annual OPEB Cost	<u>13,058</u>
Contributions made:	
Contributions to OPEB Trust	3,158
Contributions to Retirees	5,665
City portion of current year premiums paid*	<u>2,500</u>
Total contributions made	<u>11,323</u>
Change in Net OPEB Asset	(1,735)
Net OPEB Asset, beginning of year	<u>23,006</u>
Net OPEB Asset, end of year	<u><u>\$ 21,271</u></u>

* FY 2012 premiums for 921 retirees.

Shortly after year-end, the City contributed an additional \$3.7 million to the Trust.

The Plan's annual required contributions and actual contributions for the past three years ended June 30 are set forth below (in thousands):

Fiscal Year	Annual OPEB Cost	Actual Contribution	Percentage of OPEB Cost	Net OPEB Obligation (Asset)
June 30, 2010	\$ 10,329	\$ 7,219	70%	\$ (23,242)
June 30, 2011	10,265	10,029	98%	(23,006)
June 30, 2012	13,058	11,323	87%	(21,271)

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 12 – RETIREE HEALTH BENEFITS (Continued)

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):

Valuation Date	Entry Age Accrued Liability	Value of Assets	Unfunded Liability	Funded Ratio	Annual Covered Payroll	Unfunded Liability as a % of Payroll
January 1, 2007	\$ 102,237	\$ -	\$ 102,237	0.0%	\$ 97,600	104.8%
January 1, 2009	129,661	24,616	105,045	19.0%	98,940	106.2%
January 1, 2011	165,660	40,213	125,447	24.3%	80,664	155.5%
June 30, 2011 *	168,053	44,774	123,279	26.6%	83,285	148.0%

* In accordance with GASB Statement No. 57, the CERBT required all trust participants to use a common valuation date. Therefore, the City is required to conduct its biennial valuation on June 30, rather than January 1, effective for 2011.

The retiree activities in the City’s Retiree Health Benefit Internal Service Fund consist of the following for the year ended June 30 (in thousands):

Retiree Health Benefits	2012	2011
Net assets, beginning of year	\$ 26,285	\$ 25,504
Interest earnings	81	60
Unrealized gain (loss) on investments	74	35
Interdepartmental charges	12,238	10,980
Compensated benefits	(12,413)	(10,294)
Net assets, end of year	<u>\$ 26,265</u>	<u>\$ 26,285</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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 14 – RISK MANAGEMENT

Coverage

The City provides dental coverage to employees through a City plan, which is administered by a third party service agent. The City is self-insured for the dental claims.

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 \$750,000 in losses for each accident and employee under this policy.

The City also has public employee dishonesty insurance with a \$5,000 deductible and coverage up to \$1 million per loss.

The City's property, boiler, and machinery insurance policy has various deductibles and various coverage based on the type of property.

The City is a member of the Authority for California Cities Excess Liability (ACCEL), which provides excess general liability, including auto liability, insurance coverage up to \$100 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 claims management, general administration 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 year ended June 30, 2012, the City contributed \$0.9 million to ACCEL for current year coverage.

Audited financial statements are available from ACCEL at 100 Pine Street, 11th Floor, San Francisco, California 94110.

Claims Liability

The City provides for the uninsured portion of claims and judgments in the General Benefits and Insurance Internal Service Funds. Claims and judgments, including a provision for claims incurred but not reported, and claim adjustment expenses 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 coverage for such claims, but it has retained the risk for the deductible or uninsured portion of these claims.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 14 – RISK MANAGEMENT (Continued)

The City’s liability for uninsured claims is limited to dental, general liability, and workers’ compensation claims, as discussed above. Dental liability is based on a percentage of current year actual expense. General and workers’ compensation liabilities are based on the results of actuarial studies, and include amounts for claims incurred but not reported as follows as of June 30 (in thousands):

	Year Ended June 30	
	2012	2011
Beginning balance	\$ 23,903	\$ 21,478
Liability for current and prior fiscal years claims and claims incurred but not reported (IBNR)	7,603	6,665
Claims paid	(4,040)	(4,240)
Ending balance	\$ 27,466	\$ 23,903
Current portion	\$ 7,043	\$ 5,873

The City has not incurred a claim that has exceeded its insurance coverage limits in any of the last three years, nor have there been any significant reductions in insurance coverage.

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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 15 – JOINT VENTURES (Continued)

During the year ended June 30, 2012, the City incurred expenses totaling \$55.5 million for purchased power and assessments earned by NCPA.

The City's interest in NCPA projects and reserves, as computed by NCPA, was \$3.5 million at June 30, 2012. 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, 2012 is \$78.1 million. The City's participation in this project was 6.2 percent, or \$4.8 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

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 15 – JOINT VENTURES (Continued)

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, 2012, the book value of this Project's plant, equipment and other assets was \$428.4 million, while its long-term debt totaled \$359.9 million and other liabilities totaled \$68.5 million. The City's share of the Project's long-term debt amounted to \$82.4 million at that date.

Geothermal Public Power Line

In 1983, NCPA, the 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 Pacific Gas & Electric (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, 2012, the book value of this Project's plant, equipment and other assets was zero, and its long-term debt totaled zero.

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

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 15 – JOINT VENTURES (Continued)

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, 2011, 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 – COMMITMENTS AND CONTINGENCIES

Palo Alto Unified School District – The City leases a portion of the former Cubberley School site and twelve 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 \$7.1 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, 2012, amounted to \$7.1 million.

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

<u>Year ending June 30</u>	<u>Payments</u>
2013	\$ 7,133
2014	7,347
2015	7,567
2016	7,795
2017	8,028
2018-2020	25,559
	<u>\$ 63,429</u>

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 16 – COMMITMENTS AND CONTINGENCIES (Continued)

GreenWaste of Palo Alto –GreenWaste of Palo Alto continues as the City’s contractor for waste collection, transportation, and processing services. The agreement has a term of eight years, expiring June 30, 2017, with an option to extend the contract to 2021. The base compensation for GreenWaste is adjusted annually based on CPI indicators stipulated in the contract. In FY 2012 payments to GreenWaste were \$10.6 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, 2012. 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 a 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 ended 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, 2012, is \$2.1 million. During the year ended June 30, 2012, the City paid \$0.3 million 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 \$1.7 million as of June 30, 2012. During the year ended June 30, 2012, the City paid \$0.1 million as its portion of current debt service.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 16 – COMMITMENTS AND CONTINGENCIES (Continued)

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 2012 in conformance with the Council-approved Long-term Electric Acquisition Plan (LEAP) established in 2001 and last modified in April 2012 and Council approved Energy Risk Management Policy. In April 2012, Council updated the Gas Utility Long-Term Plan (GULP) and changed the natural gas purchasing strategy so no new fixed-priced purchases will be made and all gas will be purchased on the spot market. Prior to that, natural gas purchases were made on a 3-year forward basis in a laddered fashion and forward purchases for delivery through October 2013 exist. Due to the forward purchases done prior to April 2012 and since the price of natural gas has declined since those purchases were made, the City's gas utility had a higher average cost of gas for its pool customers in FY 2012 compared to the average market price during the year. The City's average natural gas commodity cost for the gas pool customers was \$5.20/MMBtu compared to a spot market price of \$3.46/MMBtu. The primary reason the City's natural gas costs were higher than market was due to a dramatic drop in spot market prices after gas had been purchased and costs were locked in. The City's average purchase cost for bilateral forward market purchases for electricity during FY 2012 was approximately 5.1¢/kWh while the average spot market prices were approximately 3.0¢/kWh.

Hydroelectric supplies were at high levels in FY 2012, which resulted in less energy purchased from the market. Hydroelectric production accounted for 52 percent of the City's electric supply in FY 2012 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 21 percent of the electric supply in FY 2012, with the balance purchased from the wholesale electric market. The City transacts with qualified suppliers for the market purchases, and the Northern California Power Agency (NCPA), which provides scheduling services for the City, buys and sells electricity within the month as needed to meet the City's demands.

Incidental sales of surplus energy resulted in revenues of \$2.3 million during the year. The expense associated with the surplus energy sold from the overall electric supply portfolio was calculated at \$3.2 million for the year, and is shown separately on the Statement of Revenues, Expenses and Changes in Fund 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 and is projected to continue saving the City throughout the term of the assignment.

The City has executed Electric and Gas Master Agreements with suppliers to procure wholesale 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, 2012. 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 Policy. These include a formal oversight role (Middle Office)

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 16 – COMMITMENTS AND CONTINGENCIES (Continued)

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, 2012

Supplier	FY 2013	FY 2014	Total
BP	\$ 3,204,120	\$ -	\$ 3,204,120
Powerex	7,437,483	2,693,876	10,131,359
SENA	201,520	-	201,520
	10,843,123	2,693,876	13,536,999
Average Cost (\$/MWh)	36.28	40.65	37.08

Forward Natural Gas Commodity Supply Commitments as of June 30, 2012

Supplier	FY 2013	FY 2014	Total
JP Morgan	\$ 967,910	\$ -	\$ 967,910
Powerex	1,227,170	611,310	1,838,480
SENA	1,582,064	-	1,582,064
	3,777,144	611,310	4,388,454
Average Cost (\$/MMBtu)	4.99	4.97	4.99

The City's natural gas transportation contract with the Pacific Gas and Electric Company (PG&E) went into effect starting January 1, 2011, and will be in place until the end of 2014. This contract, commonly known as Gas Accord V, between PG&E and its transportation customers provides the City's retail customers stable transportation costs. Palo Alto retains access to transmission capacity on par with PG&E's core customers although rates increased for all shippers. Palo Alto's backbone transmission rate increased by approximately 40 percent or \$150,000 per year. This is due to a shifting of costs from the pipeline in the south to the northern pipeline. 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 3 to 4¢/kWh – but in the longer term it is expected to return to a higher level of 5 to 7¢/kWh. The price premium commanded by renewable energy projects remains significantly higher than “brown” market power. Costs for renewable energy are expected to remain relatively high in the foreseeable future resulting in higher costs to meet the City's renewable energy supply targets. However, recently the price of solar photovoltaic projects has declined dramatically, resulting in lower projected renewable energy costs than in past years.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 16 – COMMITMENTS AND CONTINGENCIES (continued)

The Council-approved Renewable Portfolio Standard (RPS), last updated in April 2012, is to meet 33 percent of the City’s retail electric sales with renewable resource supplies by 2015. On April 12, 2011 California adopted legislation (SB X12) requiring an RPS for all load serving entities including public owned utilities. The law requires utilities to procure renewable energy supplies to meet 20 percent of their retail sales by December 31, 2013, 25 percent of their retail sales by December 31, 2016 and 33 percent of their retail sales by December 31, 2020. For calendar year 2011, renewable supplies accounted for approximately 20.7 percent of retail sales. Going forward, the City continues to be on track to meet the City’s RPS as well as the state mandated RPS. Based on existing and committed renewable supplies – which are detailed in the table below – the City expects to have a renewable energy supply level as a percentage of retail sales of 23.3 percent in calendar year 2013, 28.0 percent in calendar year 2016, and 27.7 percent in calendar year 2020. In order to help procure the remaining renewable energy to achieve RPS level of 33 percent of retail sales, Council adopted a feed-in-tariff program (Palo Alto CLEAN) to buy energy from projects developed in Palo Alto. The City also plans to pursue additional long-term renewable energy purchase contracts from projects located throughout the western United States through competitive solicitation.

Long-term Renewable Energy Contracts:

Project Name	Technology	Nameplate Capacity (MW)	Nominal Generation (MWh/yr)	Currently Online	Actual or Expected Contract Start Date	Location (state)	Contracting Date	Contract Term (years)
Shiloh	Wind	25	74,400	Yes	2006	California	2005	15
High Winds	Wind	20	51,800	Yes	2004	California	2004	23.5
Santa Cruz Landfill	LFG	1.6	11,200	Yes	2006	California	2004	20
Ox Mountain Landfill	LFG	5.7	40,800	Yes	2009	California	2005	20
Keller Canyon Landfill	LFG	2	11,800	Yes	2009	California	2005	20
Johnson Canyon Landfill	LFG	1.4	11,400	No	2012	California	2009	20
San Joaquin Landfill	LFG	4.1	30,300	No	2013	California	2010	20
Crazy Horse Canyon Landfill	LFG	2.9	21,600	No	2013	California	2010	20
Western GeoPower	Geothermal	3.9	33,100	No	2014	California	2011	25

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 the Council in 2007, had a goal of reducing the City’s electric and gas 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 electric 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. In April 2011, Council updated the energy efficiency goals for natural gas, increasing the goal to reduce the City’s natural gas needs by 5.5 percent by 2020. The potential for future savings in both the electric and natural gas utilities is currently being modeled, and revised goals will be developed at the end of calendar year 2012.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 16 – COMMITMENTS AND CONTINGENCIES (continued)

PaloAltoGreen, the City's volunteer green power program, currently accounts for an additional 8 percent of the City's energy needs from renewable resources. The City also has several programs to encourage renewable distributed generation and small scale ultra-clean co-generation within the City.

The California Independent System Operator (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. In October 2011, CARB adopted the California Cap-and-Trade Regulation which creates an aggregate GHG emission limit on the sources responsible for 85 percent of California's GHG emissions. The GHG cap will decline 2-3 percent a year resulting in a 15 percent reduction in 2020. CARB will distribute allowances (defined as the authorization to emit up to one metric ton of carbon dioxide equivalent per allowance), which are tradable permits, equal to the emission allowed under the cap. The City's electric utility operations will fall under the cap starting 2013. As an electric distribution company, the City will be allocated GHG emission allowances through 2020, with an estimated value of \$5 million per year. The regulation requires that the City utilize the value of these allocated allowances "exclusively for the benefit of retail (electric) ratepayers", consistent with the State's GHG reduction goals. At this time it is anticipated that the first auction of allowances will take place in November 2012 and the cap-and-trade system will go into full effect in 2013.

Natural Gas

Long-term market prices for natural gas have remained depressed since the market price peak in July 2008. Increasing U.S. and international demand resulting from economic recovery and potential clean energy legislation may put pressure on gas prices in the long term, however low to moderate gas prices are forecasted for the next year or two. The gas laddering strategy that was used since 2002 to hedge gas portfolio costs was changed by Council in April 2012 when a new strategy to purchase gas on the short-term (spot) market was adopted. In June 2012, Council adopted a change in gas retail rates so that the spot market gas price is passed on to customers on a monthly basis. The City also employs asset management strategies to lower overall commodity costs.

In March 2011, the Council approved a plan to implement a voluntary customer program similar to PaloAltoGreen if reasonably priced non-fossil gas supplies could be found. While the City continues to search for potential supplies that are priced in a reasonable range for program marketability, such supplies have not yet been found.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 16 – COMMITMENTS AND CONTINGENCIES (continued)

Water

The City's water use during FY 2012 increased about 2.0 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 small increase in usage in FY 2012 compared to FY 2011 may be attributed to some level of economic recovery and increased rainfall. Water supply costs for FY 2012 increased by 38.2 percent from FY 2011, primarily due to a 38.0 percent increase in the San Francisco Public Utilities Commission (SFPUC) wholesale water rate in FY 2012. The increase was related in part to extensive capital improvements on the Hetch Hetchy Water System and in part decreased consumption in San Francisco and other Bay Area Water Supply & Conservation Agency (BAWSCA) agencies, which required a higher per unit wholesale rate in order to recover fixed costs.

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 BAWSCA, which represents all the agencies that buy water on a wholesale basis from the City and County of San Francisco (San Francisco.) The relationship between each of the BAWSCA agencies and 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 2013.

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 the Superior Court in 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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2012

NOTE 16 – COMMITMENTS AND CONTINGENCIES (continued)

On April 29, 2010, 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 materially 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 \$0.6 million sales 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, 2012, 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 costs were questioned 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.

CITY OF PALO ALTO
Non-major Governmental Funds
Combining Balance Sheet
June 30, 2012
(Amounts in thousands)

	Special Revenue Funds	Debt Service Funds	Permanent Fund	Total
ASSETS:				
Cash and investments:				
Available for operations	\$ 44,455	\$ 5,959	\$ 1,444	\$ 51,858
Cash and investments with fiscal agents	-	239	-	239
Receivables, net:				
Accounts	305	12	-	317
Interest	272	19	9	300
Notes	13,872	-	-	13,872
Total assets	<u>\$ 58,904</u>	<u>\$ 6,229</u>	<u>\$ 1,453</u>	<u>\$ 66,586</u>
LIABILITIES AND FUND BALANCES:				
Liabilities:				
Accounts payable and accruals	\$ 385	\$ -	\$ 6	\$ 391
Accrued salaries and benefits	9	-	-	9
Total liabilities	<u>394</u>	<u>-</u>	<u>6</u>	<u>400</u>
Fund balances:				
Nonspendable				
Notes and loans receivable	9,665	-	-	9,665
Eyerly family	-	-	1,447	1,447
Restricted				
Transportation mitigation	6,095	-	-	6,095
Federal revenue	4,519	-	-	4,519
Street improvement	1,015	-	-	1,015
Local law enforcement	251	-	-	251
Debt service	-	6,229	-	6,229
Public benefits	21,865	-	-	21,865
Committed				
Developer's impact fee	5,935	-	-	5,935
Housing In-Lieu	7,322	-	-	7,322
Special districts	934	-	-	934
Downtown business	93	-	-	93
Assigned				
Unrealized gain on investment	816	-	-	816
Total fund balances	<u>58,510</u>	<u>6,229</u>	<u>1,447</u>	<u>66,186</u>
Total liabilities and fund balances	<u>\$ 58,904</u>	<u>\$ 6,229</u>	<u>\$ 1,453</u>	<u>\$ 66,586</u>

CITY OF PALO ALTO
Non-major Governmental Funds
Combining Statement of Revenues, Expenditures and Changes in Fund Balances
For the Year Ended June 30, 2012
(Amounts in thousands)

	Special Revenue Funds	Debt Service Funds	Permanent Fund	Total
REVENUES:				
Property tax	\$ -	\$ 3,610	\$ -	\$ 3,610
Special assessments	112	-	-	112
Other taxes and fines	1,879	-	-	1,879
Charges for services	21,351	-	-	21,351
From other agencies:				
Community Development Block Grants	662	-	-	662
State of California	114	-	-	114
Other revenue from other agencies	(4)	-	-	(4)
Permits and licenses	503	-	-	503
Investment earnings	1,949	183	41	2,173
Rental income	4	-	-	4
Other:				
Housing In-Lieu - residential	5,367	-	-	5,367
University Avenue Parking	1,002	-	-	1,002
California Avenue Parking	97	-	-	97
Other fees	2,101	-	-	2,101
Total revenues	<u>35,137</u>	<u>3,793</u>	<u>41</u>	<u>38,971</u>
EXPENDITURES:				
Current:				
Planning and Community Environment	1,690	-	-	1,690
Public safety - Police	132	-	-	132
Community Services	28	-	-	28
Non-Departmental	230	-	16	246
Debt service:				
Principal retirement	-	1,285	-	1,285
Interest and fiscal charges	-	2,716	-	2,716
Payment to bond refunding escrow	-	586	-	586
Total expenditures	<u>2,080</u>	<u>4,587</u>	<u>16</u>	<u>6,683</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	<u>33,057</u>	<u>(794)</u>	<u>25</u>	<u>32,288</u>
OTHER FINANCING SOURCES (USES):				
Payment to bond refunding escrow	-	(3,104)	-	(3,104)
Transfers in	38	6,862	-	6,900
Transfers out	(4,190)	-	-	(4,190)
Total other financing sources (uses)	<u>(4,152)</u>	<u>3,758</u>	<u>-</u>	<u>(394)</u>
Change in fund balances	28,905	2,964	25	31,894
FUND BALANCES, BEGINNING OF YEAR	<u>29,605</u>	<u>3,265</u>	<u>1,422</u>	<u>34,292</u>
FUND BALANCES, END OF YEAR	<u>\$ 58,510</u>	<u>\$ 6,229</u>	<u>\$ 1,447</u>	<u>\$ 66,186</u>

NON-MAJOR GOVERNMENTAL FUNDS

SPECIAL REVENUE 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

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

Downtown Business Development District

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

Public Benefits

This fund accounts for the activities of the SUMC Parties Development Agreement (DA) whereby SUMC will enhance and expand their facilities and the City will grant SUMC the right to develop the facilities in accordance with the DA.

CITY OF PALO ALTO
Non-major Special Revenue Funds
Combining Balance Sheet
June 30, 2012
(Amounts in thousands)

	Street Improvement	Federal Revenue	Housing In-Lieu	Special Districts	Transportation Mitigation
ASSETS:					
Cash and investments:					
Available for operations	\$ 868	\$ 289	\$ 7,605	\$ 971	\$ 6,390
Receivables:					
Accounts	185	81	-	-	-
Interest	8	-	46	7	34
Notes	-	4,207	9,665	-	-
Total assets	<u>\$ 1,061</u>	<u>\$ 4,577</u>	<u>\$ 17,316</u>	<u>\$ 978</u>	<u>\$ 6,424</u>
LIABILITIES AND FUND BALANCES:					
Liabilities:					
Accounts payable and accruals	\$ -	\$ 55	\$ 49	\$ -	\$ 122
Accrued salaries and benefits	-	3	-	2	-
Total liabilities	<u>-</u>	<u>58</u>	<u>49</u>	<u>2</u>	<u>122</u>
Fund balances:					
Nonspendable					
Notes and loans receivables	-	-	9,665	-	-
Prepaid costs	-	-	-	-	-
Inventories	-	-	-	-	-
Advance to other funds	-	-	-	-	-
Eyerly family	-	-	-	-	-
Restricted					
Transportation mitigation	-	-	-	-	6,095
Federal revenue	-	4,519	-	-	-
Street improvement	1,015	-	-	-	-
Local law enforcement	-	-	-	-	-
Public benefits	-	-	-	-	-
Library bond project	-	-	-	-	-
Improvement to parking garage	-	-	-	-	-
Debt Service	-	-	-	-	-
Committed					
Capital projects	-	-	-	-	-
Developer's impact fee	-	-	-	-	-
Housing In-Lieu	-	-	7,322	-	-
Special districts	-	-	-	934	-
Downtown business	-	-	-	-	-
Assigned					
Unrealized gain on investment	46	-	280	42	207
Total fund balances	<u>1,061</u>	<u>4,519</u>	<u>17,267</u>	<u>976</u>	<u>6,302</u>
Total liabilities and fund balances	<u>\$ 1,061</u>	<u>\$ 4,577</u>	<u>\$ 17,316</u>	<u>\$ 978</u>	<u>\$ 6,424</u>

Local Law Enforcement	Assets Seizure	Developer's Impact Fee	Redevelopment Agency	Downtown Business Development District	Public Benefits	Total
\$ 217	\$ 2	\$ 6,158	\$ -	\$ 96	\$ 21,859	\$ 44,455
39	-	-	-	-	-	305
1	-	38	-	1	137	272
-	-	-	-	-	-	13,872
<u>\$ 257</u>	<u>\$ 2</u>	<u>\$ 6,196</u>	<u>\$ -</u>	<u>\$ 97</u>	<u>\$ 21,996</u>	<u>\$ 58,904</u>
\$ -	\$ -	\$ 32	\$ -	\$ -	\$ 127	\$ 385
-	-	-	-	-	4	9
-	-	32	-	-	131	394
-	-	-	-	-	-	9,665
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	6,095
-	-	-	-	-	-	4,519
-	-	-	-	-	-	1,015
249	2	-	-	-	-	251
-	-	-	-	-	21,865	21,865
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	5,935	-	-	-	5,935
-	-	-	-	-	-	7,322
-	-	-	-	-	-	934
-	-	-	-	93	-	93
8	-	229	-	4	-	816
<u>257</u>	<u>2</u>	<u>6,164</u>	<u>-</u>	<u>97</u>	<u>21,865</u>	<u>58,510</u>
<u>\$ 257</u>	<u>\$ 2</u>	<u>\$ 6,196</u>	<u>\$ -</u>	<u>\$ 97</u>	<u>\$ 21,996</u>	<u>\$ 58,904</u>

CITY OF PALO ALTO
Non-major Special Revenue Funds
Combining Statement of Revenues, Expenditures and Changes in Fund Balances
For the Year Ended June 30, 2012
(Amounts in thousands)

	Street Improvement	Federal Revenue	Housing In-Lieu	Special Districts	Transportation Mitigation
REVENUES:					
Special assessments	\$ -	\$ -	\$ -	\$ -	\$ -
Other taxes and fines	1,830	-	-	49	-
Charges for services	-	-	-	-	551
From other agencies:					
Community Development Block Grants	-	662	-	-	-
State of California	-	-	-	-	-
Other revenue from other agencies	-	-	-	-	-
Permits and licenses	-	-	-	503	-
Investment earnings	29	(78)	249	31	183
Rental income	-	-	4	-	-
Other					
Housing In-Lieu - residential	-	-	5,367	-	-
University Avenue Parking	-	-	-	1,002	-
California Avenue Parking	-	-	-	97	-
Other fees	-	220	279	-	1,109
Total revenues	1,859	804	5,899	1,682	1,843
EXPENDITURES:					
Current:					
Planning and Community Environment	-	890	481	72	-
Public safety - Police	-	-	-	-	-
Community Services	-	-	-	-	-
Non-Departmental	-	14	53	84	-
Total expenditures	-	904	534	156	-
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	1,859	(100)	5,365	1,526	1,843
OTHER FINANCING SOURCES (USES):					
Transfers in	-	-	-	29	-
Transfers out	(2,442)	-	-	(1,692)	(47)
Total other financing sources (uses)	(2,442)	-	-	(1,663)	(47)
Change in fund balances	(583)	(100)	5,365	(137)	1,796
FUND BALANCES, BEGINNING OF YEAR	1,644	4,619	11,902	1,113	4,506
FUND BALANCES, END OF YEAR	\$ 1,061	\$ 4,519	\$ 17,267	\$ 976	\$ 6,302

Local Law Enforcement	Assets Seizure	Developer's Impact Fee	Redevelopment Agency	Downtown Business Development District	Public Benefits	Total
\$ -	\$ -	\$ -	\$ -	\$ 112	\$ -	\$ 112
-	-	-	-	-	-	1,879
-	-	-	-	-	20,800	21,351
-	-	-	-	-	-	662
114	-	-	-	-	-	114
(4)	-	-	-	-	-	(4)
-	-	-	-	-	-	503
7	-	183	-	5	1,340	1,949
-	-	-	-	-	-	4
-	-	-	-	-	-	5,367
-	-	-	-	-	-	1,002
-	-	-	-	-	-	97
1	-	492	-	-	-	2,101
118	-	675	-	117	22,140	35,137
-	-	-	-	-	247	1,690
132	-	-	-	-	-	132
-	-	-	-	-	28	28
-	-	-	-	79	-	230
132	-	-	-	79	275	2,080
(14)	-	675	-	38	21,865	33,057
-	-	-	9	-	-	38
-	-	-	(9)	-	-	(4,190)
-	-	-	-	-	-	(4,152)
(14)	-	675	-	38	21,865	28,905
271	2	5,489	-	59	-	29,605
\$ 257	\$ 2	\$ 6,164	\$ -	\$ 97	\$ 21,865	\$ 58,510

CITY OF PALO ALTO
Non-major Special Revenue Funds
Combining Schedule of Revenues, Expenditures and Changes in Fund Balances -
Budget and Actual
For the Year Ended June 30, 2012
(Amounts in thousands)

	Street Improvement			Federal Revenue		
	Budget	Actual, plus Encumbrances	Variance Positive (Negative)	Budget	Actual, plus Encumbrances	Variance Positive (Negative)
REVENUES:						
Special assessments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other taxes and fines	1,764	1,830	66	-	-	-
Charges for services	-	-	-	-	-	-
From other agencies:						
Community Development Block Grants	-	-	-	663	662	(1)
State of California	-	-	-	-	-	-
Other revenue from other agencies	-	-	-	276	-	(276)
Permits and licenses	-	-	-	-	-	-
Investment earnings	14	29	15	-	(78)	(78)
Rental income	-	-	-	-	-	-
Other:						
Housing In-Lieu - residential	-	-	-	-	-	-
University Avenue Parking	-	-	-	-	-	-
California Avenue Parking	-	-	-	-	-	-
Other fees	-	-	-	-	220	220
Total revenues	1,778	1,859	81	939	804	(135)
EXPENDITURES:						
Current:						
Planning and Community Environment	-	-	-	1,698	890	808
Public safety - Police	-	-	-	-	-	-
Community Services	-	-	-	-	-	-
Non-Departmental	664	-	664	-	14	(14)
Total expenditures	664	-	664	1,698	904	794
Excess (deficiency) of revenues over (under) expenditures	1,114	1,859	745	(759)	(100)	659
OTHER FINANCING SOURCES (USES):						
Transfers in	-	-	-	5	-	(5)
Transfers out	(2,442)	(2,442)	-	-	-	-
Total other financing sources (uses)	(2,442)	(2,442)	-	5	-	(5)
Change in fund balances	\$ (1,328)	(583)	\$ 745	\$ (754)	(100)	\$ 654
FUND BALANCES, BEGINNING OF YEAR		1,644			4,619	
FUND BALANCES, END OF YEAR		\$ 1,061			\$ 4,519	

Housing In-Lieu			Special Districts			Transportation Mitigation		
Budget	Actual, plus Encumbrances	Variance Positive (Negative)	Budget	Actual, plus Encumbrances	Variance Positive (Negative)	Budget	Actual, plus Encumbrances	Variance Positive (Negative)
\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
-	-	-	43	49	6	-	-	-
-	-	-	-	-	-	282	551	269
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	288	503	215	-	-	-
188	249	61	30	31	1	135	183	48
9	4	(5)	-	-	-	-	-	-
3,500	5,367	1,867	-	-	-	-	-	-
-	-	-	885	1,002	117	-	-	-
-	-	-	104	97	(7)	-	-	-
222	279	57	-	-	-	280	1,109	829
<u>3,919</u>	<u>5,899</u>	<u>1,980</u>	<u>1,350</u>	<u>1,682</u>	<u>332</u>	<u>697</u>	<u>1,843</u>	<u>1,146</u>
4,859	481	4,378	96	72	24	410	-	410
-	-	-	-	-	-	-	-	-
<u>2,183</u>	<u>53</u>	<u>2,130</u>	<u>34</u>	<u>84</u>	<u>(50)</u>	<u>-</u>	<u>-</u>	<u>-</u>
<u>7,042</u>	<u>534</u>	<u>6,508</u>	<u>130</u>	<u>156</u>	<u>(26)</u>	<u>410</u>	<u>-</u>	<u>410</u>
<u>(3,123)</u>	<u>5,365</u>	<u>8,488</u>	<u>1,220</u>	<u>1,526</u>	<u>306</u>	<u>287</u>	<u>1,843</u>	<u>1,556</u>
-	-	-	-	29	29	-	-	-
-	-	-	(1,526)	(1,692)	(166)	(47)	(47)	-
-	-	-	(1,526)	(1,663)	(137)	(47)	(47)	-
<u>\$ (3,123)</u>	<u>5,365</u>	<u>\$ 8,488</u>	<u>\$ (306)</u>	<u>(137)</u>	<u>\$ 169</u>	<u>\$ 240</u>	<u>1,796</u>	<u>\$ 1,556</u>
	<u>11,902</u>			<u>1,113</u>			<u>4,506</u>	
	<u>\$ 17,267</u>			<u>\$ 976</u>			<u>\$ 6,302</u>	

(Continued)

CITY OF PALO ALTO
 Non-major Special Revenue Funds
 Combining Schedule of Revenues, Expenditures and Changes in Fund Balances -
 Budget and Actual
 For the Year Ended June 30, 2012
 (Amounts in Thousands)

	Local Law Enforcement			Asset Seizure			Developer's Impact Fee		
	Budget	Actual, plus Encumbrances	Variance Positive (Negative)	Budget	Actual, plus Encumbrances	Variance Positive (Negative)	Budget	Actual, plus Encumbrances	Variance Positive (Negative)
Revenues:									
Special assessments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other taxes and fines	-	-	-	-	-	-	-	-	-
Charges for services	-	-	-	-	-	-	-	-	-
From other agencies:									
Community Development Block Grants	-	-	-	-	-	-	-	-	-
State of California	105	114	9	-	-	-	-	-	-
Other revenue from other agencies	-	(4)	(4)	-	-	-	-	-	-
Permits and licenses	-	-	-	-	-	-	-	-	-
Return on investments	6	7	1	-	-	-	161	183	22
Rental income	-	-	-	-	-	-	-	-	-
Other:									
Housing In-Lieu - residential	-	-	-	-	-	-	-	-	-
University Avenue Parking	-	-	-	-	-	-	-	-	-
California Avenue Parking	-	-	-	-	-	-	-	-	-
Other fees	-	1	1	-	-	-	553	492	(61)
Total revenues	<u>111</u>	<u>118</u>	<u>7</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>714</u>	<u>675</u>	<u>(39)</u>
Expenditures:									
Current:									
Planning and Community Environment	-	-	-	-	-	-	-	-	-
Public safety - Police	152	132	20	-	-	-	-	-	-
Community Services	-	-	-	-	-	-	-	-	-
Non-Departmental	-	-	-	-	-	-	-	-	-
Total expenditures	<u>152</u>	<u>132</u>	<u>20</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(41)</u>	<u>(14)</u>	<u>27</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>714</u>	<u>675</u>	<u>(39)</u>
Other financing sources (uses):									
Transfers in	-	-	-	-	-	-	-	-	-
Transfers out	-	-	-	-	-	-	-	-	-
Total other financing sources (uses)	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Change in fund balances	<u>\$ (41)</u>	<u>(14)</u>	<u>\$ 27</u>	<u>\$ -</u>	<u>-</u>	<u>\$ -</u>	<u>\$ 714</u>	<u>675</u>	<u>\$ (39)</u>
Fund balances, beginning of year		271			2			5,489	
Fund balances, end of year		<u>\$ 257</u>			<u>\$ 2</u>			<u>\$ 6,164</u>	

Redevelopment Agency			Downtown Business Improvement District			Public Benefits			Total Non-major Special Revenue Funds		
Budget	Actual, plus Encumbrances	Variance Positive (Negative)	Budget	Actual, plus Encumbrances	Variance Positive (Negative)	Budget	Actual, plus Encumbrances	Variance Positive (Negative)	Budget	Actual, plus Encumbrances	Variance Positive (Negative)
\$ -	\$ -	\$ -	\$ 160	\$ 112	\$ (48)	\$ -	\$ -	\$ -	\$ 160	\$ 112	\$ (48)
-	-	-	-	-	-	-	-	-	1,807	1,879	72
-	-	-	-	-	-	20,800	20,800	-	21,082	21,351	269
-	-	-	-	-	-	-	-	-	663	662	(1)
-	-	-	-	-	-	-	-	-	105	114	9
-	-	-	-	-	-	-	-	-	276	(4)	(280)
-	-	-	-	-	-	-	-	-	288	503	215
-	-	-	2	5	3	460	1,340	880	996	1,949	953
-	-	-	-	-	-	-	-	-	9	4	(5)
-	-	-	-	-	-	-	-	-	3,500	5,367	1,867
-	-	-	-	-	-	-	-	-	885	1,002	117
-	-	-	-	-	-	-	-	-	104	97	(7)
-	-	-	-	-	-	-	-	-	1,055	2,101	1,046
-	-	-	162	117	(45)	21,260	22,140	880	30,930	35,137	4,207
-	-	-	-	-	-	250	247	3	7,313	1,690	5,623
-	-	-	-	-	-	-	-	-	152	132	20
-	-	-	-	-	-	65	28	-	65	28	-
-	-	-	194	79	115	-	-	-	3,075	230	2,845
-	-	-	194	79	115	315	275	3	10,605	2,080	8,488
-	-	-	(32)	38	70	20,945	21,865	920	20,325	33,057	12,732
9	9	-	-	-	-	-	-	-	14	38	24
-	(9)	(9)	-	-	-	-	-	-	(4,015)	(4,190)	(175)
9	-	(9)	-	-	-	-	-	-	(4,001)	(4,152)	(151)
<u>\$ 9</u>	<u>-</u>	<u>\$ (9)</u>	<u>\$ (32)</u>	<u>38</u>	<u>\$ 70</u>	<u>\$ 20,945</u>	<u>21,865</u>	<u>\$ 920</u>	<u>\$ 16,324</u>	<u>28,905</u>	<u>\$ 12,581</u>
-	-	-	-	59	-	-	-	-	-	29,605	-
<u>\$ -</u>	<u>-</u>	<u>-</u>	<u>\$ 97</u>	<u>\$ 97</u>	<u>-</u>	<u>\$ 21,865</u>	<u>-</u>	<u>-</u>	<u>\$ 58,510</u>	<u>-</u>	<u>-</u>

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NON-MAJOR GOVERNMENTAL FUNDS

DEBT SERVICE 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.

Library Project

This fund accounts for revenues received from property taxes to provide payment of principal and interest associated with the 2010 General Obligation Bonds as they become due.

CITY OF PALO ALTO
Non-major Debt Service Funds
Combining Balance Sheet
June 30, 2012
(Amounts in thousands)

	Golf Course	Civic Center Refinancing	Downtown Parking Improvement	Library Projects	Total
ASSETS:					
Cash and investments :					
Available for operations	\$ -	\$ -	\$ 12	\$ 5,947	\$ 5,959
Cash and investments with fiscal agents	-	-	239	-	239
Receivables:					
Accounts	-	-	-	12	12
Interest	-	-	-	19	19
Total assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 251</u>	<u>\$ 5,978</u>	<u>\$ 6,229</u>
Fund balances:					
Restricted:					
Debt service	-	-	251	5,978	6,229
Total fund balances	<u>-</u>	<u>-</u>	<u>251</u>	<u>5,978</u>	<u>6,229</u>
Total liabilities and fund balances	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 251</u>	<u>\$ 5,978</u>	<u>\$ 6,229</u>

CITY OF PALO ALTO
Non-major Debt Service Funds
Combining Statement of Revenues, Expenditures and Changes in Fund Balances
For the Year Ended June 30, 2012
(Amounts in thousands)

	Golf Course	Civic Center Refinancing	Downtown Parking Improvement	Library Project	Total
REVENUES:					
Property tax	\$ -	\$ -	\$ -	\$ 3,610	\$ 3,610
Investment earnings	-	-	1	182	183
Total revenues	-	-	1	3,792	3,793
EXPENDITURES:					
Debt service:					
Principal retirement	-	405	115	765	1,285
Interest and fiscal charges	81	16	117	2,502	2,716
Payment to bond refunding escrow	586	-	-	-	586
Total expenditures	667	421	232	3,267	4,587
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	(667)	(421)	(231)	525	(794)
OTHER FINANCING SOURCES (USES):					
Payment to bond refunding escrow	(3,104)	-	-	-	(3,104)
Transfers in	3,104	70	232	3,456	6,862
Total other financing sources (uses)	-	70	232	3,456	3,758
Change in fund balances	(667)	(351)	1	3,981	2,964
FUND BALANCES, BEGINNING OF YEAR	667	351	250	1,997	3,265
FUND BALANCES, END OF YEAR	\$ -	\$ -	\$ 251	\$ 5,978	\$ 6,229

CITY OF PALO ALTO
Non-major Debt Service Funds
Combining Schedule of Revenues, Expenditures and Changes in Fund Balances -
Budget and Actual
For the Year Ended June 30, 2012
(Amounts in thousands)

	Golf Course			Civic Center Refinancing		
	Budget	Actual, plus Encumbrances	Variance Positive (Negative)	Budget	Actual, plus Encumbrances	Variance Positive (Negative)
REVENUES:						
Special assessments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Investment earnings	-	-	-	-	-	-
Total revenues	-	-	-	-	-	-
EXPENDITURES:						
Debt service:						
Principal retirement		-	-	405	405	-
Interest and fiscal charges	172	81	(91)	16	16	-
Payment to bond refunding escrow	-	586	586	-	-	-
Total expenditures	172	667	495	421	421	-
Excess (deficiency) of revenues over (under) expenditures	(172)	(667)	(495)	(421)	(421)	-
OTHER FINANCING SOURCES (USES):						
Payment to bond refunding escrow	(3,599)	(3,104)	495	-	-	-
Transfers in	3,104	3,104	-	72	70	(2)
Total other financing sources (uses)	(495)	-	495	72	70	(2)
Change in fund balances	<u>\$ (667)</u>	<u>(667)</u>	<u>\$ -</u>	<u>\$ (349)</u>	<u>(351)</u>	<u>\$ (2)</u>
FUND BALANCES, BEGINNING OF YEAR		667			351	
FUND BALANCES, END OF YEAR		<u>\$ -</u>			<u>\$ -</u>	

Downtown Parking Improvement			Library Project			Total Non-major Debt Service Funds		
Budget	Actual, plus Encumbrances	Variance Positive (Negative)	Budget	Actual, plus Encumbrances	Variance Positive (Negative)	Budget	Actual, plus Encumbrances	Variance Positive (Negative)
\$ -	\$ -	\$ -	\$ 3,495	\$ 3,610	\$ 115	\$ 3,495	\$ 3,610	\$ 115
	1	1		182	182	-	183	183
-	1	1	3,495	3,792	297	3,495	3,793	298
115	115	-	765	765	-	1,285	1,285	-
117	117	-	2,502	2,502	-	2,807	2,716	(91)
-	-	-	-	-	-	-	586	586
232	232	-	3,267	3,267	-	4,092	4,587	495
(232)	(231)	1	228	525	297	(597)	(794)	(197)
-	-	-	-	-	-	(3,599)	(3,104)	495
232	232	-	3,456	3,456	-	6,864	6,862	(2)
232	232	-	3,456	3,456	-	3,265	3,758	493
\$ -	1	\$ 1	\$ 3,684	3,981	\$ 297	\$ 2,668	2,964	\$ 296
	250			1,997			3,265	
	\$ 251			\$ 5,978			\$ 6,229	

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NON-MAJOR GOVERNMENTAL FUNDS

PERMANENT FUND

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.

CITY OF PALO ALTO
Non-major Permanent Fund
Schedule of Revenues, Expenditures and Changes in Fund Balances -
Budget and Actual
For the Year Ended June 30, 2012
(Amounts in thousands)

	<u>Eyerly Permanent Fund</u>		
	<u>Budget</u>	<u>Actual, plus Encumbrances</u>	<u>Variance Positive (Negative)</u>
REVENUES:			
Investment earnings	\$ 43	\$ 41	\$ (2)
Other fees	-	-	-
Total revenues	<u>43</u>	<u>41</u>	<u>(2)</u>
EXPENDITURES:			
Current:			
Non-Departmental	<u>1</u>	<u>16</u>	<u>(15)</u>
Total expenditures	<u>1</u>	<u>16</u>	<u>(15)</u>
Excess (deficiency) of revenues over (under) expenditures	<u>42</u>	<u>25</u>	<u>(17)</u>
Change in fund balances	<u>\$ 42</u>	<u>25</u>	<u>\$ (17)</u>
FUND BALANCES, BEGINNING OF YEAR		<u>1,422</u>	
FUND BALANCES, END OF YEAR		<u>\$ 1,447</u>	

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 on reimbursement of fleet replacement and maintenance costs allocated to each department by usage of vehicle.

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 on reimbursement of costs for support provided to other departments.

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 Benefits

This fund accounts for the retiree health benefits.

CITY OF PALO ALTO
Internal Service Funds
Combining Statement of Fund Net Assets
June 30, 2012
(Amounts in thousands)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits	Workers' Compensation Insurance Program	General Liabilities Insurance Program	Retiree Health Benefits	Total
ASSETS:								
Current Assets:								
Cash and investments:								
Available for operations	\$ 8,530	\$ 17,786	\$ -	\$ 12,837	\$ 19,877	\$ 7,722	\$ 4,969	\$ 71,721
Accounts receivable, net	230	-	-	24	-	-	-	254
Interest receivable	52	103	-	63	97	27	27	369
Inventory of materials and supplies	668	-	-	-	-	-	-	668
Total current assets	9,480	17,889	-	12,924	19,974	7,749	4,996	73,012
Noncurrent Assets:								
Capital assets:								
Non-Depreciable	204	-	-	-	-	-	-	204
Depreciable, net	12,637	3,016	9	-	-	-	-	15,662
Net OPEB asset	-	-	-	-	-	-	21,271	21,271
Total noncurrent assets	12,841	3,016	9	-	-	-	21,271	37,137
Total assets	22,321	20,905	9	12,924	19,974	7,749	26,267	110,149
LIABILITIES:								
Current Liabilities:								
Accounts payable and accruals	26	259	-	2,105	30	6	2	2,428
Accrued salaries and benefits	41	131	4	5	-	-	-	181
Accrued compensated absences	3	5	1	2,870	-	-	-	2,879
Accrued claims payable - current	-	-	-	349	4,263	2,431	-	7,043
Total current liabilities	70	395	5	5,329	4,293	2,437	2	12,531
Noncurrent liabilities:								
Accrued compensated absences	-	-	-	6,083	-	-	-	6,083
Accrued claims payable	-	-	-	-	15,481	4,942	-	20,423
Total noncurrent liabilities	-	-	-	6,083	15,481	4,942	-	26,506
Total liabilities	70	395	5	11,412	19,774	7,379	2	39,037
NET ASSETS:								
Invested in capital assets	12,841	3,016	9	-	-	-	-	15,866
Unrestricted (deficit)	9,410	17,494	(5)	1,512	200	370	26,265	55,246
Total net assets	\$ 22,251	\$ 20,510	\$ 4	\$ 1,512	\$ 200	\$ 370	\$ 26,265	\$ 71,112

CITY OF PALO ALTO
Internal Service Funds
Combining Statement of Revenues, Expenses and Changes in Fund Net Assets
For the Year Ended June 30, 2012
(Amounts in thousands)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits	Workers' Compensation Insurance Program	General Liabilities Insurance Program	Retiree Health Benefits	Total
OPERATING REVENUES:								
Charges for services	\$ 7,713	\$ 12,187	\$ 1,134	\$ 38,850	\$ 4,109	\$ 3,374	\$ 12,238	\$ 79,605
Other	-	-	-	-	-	-	-	-
Total operating revenues	7,713	12,187	1,134	38,850	4,109	3,374	12,238	79,605
OPERATING EXPENSES:								
Administrative and general	744	4,063	1,081	213	615	1,113	539	8,368
Operations and maintenance	3,262	5,524	-	110	-	-	-	8,896
Depreciation and amortization	2,788	3,093	3	-	-	-	-	5,884
Claim payments and change in estimated self-insured liability	-	-	-	1,624	3,883	2,096	-	7,603
Refund of charges for services	57	8	-	-	-	-	-	65
Compensated absences and other benefits	-	-	-	36,668	-	-	11,874	48,542
Total operating expenses	6,851	12,688	1,084	38,615	4,498	3,209	12,413	79,358
Operating income (loss)	862	(501)	50	235	(389)	165	(175)	247
NONOPERATING REVENUES (EXPENSES):								
Investment earnings	273	576	(6)	312	489	105	155	1,904
Gain on disposal of capital assets	3	-	-	-	-	-	-	3
Other nonoperating revenues	32	-	-	-	-	-	-	32
Total nonoperating revenues (expenses)	308	576	(6)	312	489	105	155	1,939
Income (loss) before transfers	1,170	75	44	547	100	270	(20)	2,186
Transfers in	35	823	-	-	-	-	-	858
Transfers out	(825)	(25)	-	-	-	-	-	(850)
Change in net assets	380	873	44	547	100	270	(20)	2,194
NET ASSETS (DEFICIT), BEGINNING OF YEAR	21,871	19,637	(40)	965	100	100	26,285	68,918
NET ASSETS, END OF YEAR	\$ 22,251	\$ 20,510	\$ 4	\$ 1,512	\$ 200	\$ 370	\$ 26,265	\$ 71,112

CITY OF PALO ALTO
Internal Service Funds
Combining Statement of Cash Flows
For the Year Ended June 30, 2012
(Amounts in thousands)

	Vehicle Replacement and		Printing and Mailing	General Benefits	Workers' Compensation Insurance Program	General Liabilities Insurance Program	Retiree Health Benefits	Total
	Maintenance	Technology	Services					
Cash flows from operating activities:								
Cash received from customers	\$ 7,543	\$ 12,187	\$ 1,134	\$ 38,826	\$ 4,109	\$ 3,374	\$ 12,238	\$ 79,411
Cash refunds to customers	(57)	(8)	-	-	-	-	-	(65)
Cash payments to suppliers for goods and services	(3,412)	(5,611)	(49)	(96)	-	-	-	(9,168)
Cash payments to employees	(733)	(4,039)	(1,079)	(37,178)	(618)	621	(10,676)	(53,702)
Cash payments for judgments and claims	-	-	-	(1,603)	(2,069)	(368)	-	(4,040)
Other cash receipts	32	-	-	-	-	-	-	32
Cash flows provided by (used in) operating activities	<u>3,373</u>	<u>2,529</u>	<u>6</u>	<u>(51)</u>	<u>1,422</u>	<u>3,627</u>	<u>1,562</u>	<u>12,468</u>
Cash flows from noncapital financing activities:								
Transfers in	35	823	-	-	-	-	-	858
Transfers out	(825)	(25)	-	-	-	-	-	(850)
Cash flows provided by (used in) noncapital financing activities	<u>(790)</u>	<u>798</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8</u>
Cash flows from capital and related financing activities:								
Acquisition of capital assets	(1,611)	(96)	-	-	-	-	-	(1,707)
Proceeds from sale of capital assets	46	-	-	-	-	-	-	46
Cash flows provided by (used in) capital and related financing activities	<u>(1,565)</u>	<u>(96)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,661)</u>
Cash flows from investing activities:								
Interest received (paid)	271	565	(6)	318	494	109	145	1,896
Net change in cash and cash equivalents	1,289	3,796	-	267	1,916	3,736	1,707	12,711
Cash and cash equivalents, beginning of year	7,241	13,990	-	12,570	17,961	5,714	3,262	60,738
Cash and cash equivalents, end of year	<u>\$ 8,530</u>	<u>\$ 17,786</u>	<u>\$ -</u>	<u>\$ 12,837</u>	<u>\$ 19,877</u>	<u>\$ 9,450</u>	<u>\$ 4,969</u>	<u>\$ 73,449</u>
Reconciliation of operating income (loss) to net cash flows provided by (used in) operating activities:								
Operating income (loss)	\$ 862	\$ (501)	\$ 50	\$ 235	\$ (389)	\$ 165	\$ (175)	\$ 247
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:								
Depreciation	2,788	3,093	3	-	-	-	-	5,884
Other	32	-	-	-	-	-	-	32
Change in assets and liabilities:								
Accounts receivable	(170)	-	-	(24)	-	-	-	(194)
Inventory of materials and supplies	(55)	-	-	-	-	-	-	(55)
Net OPEB asset	-	-	-	-	-	-	1,735	1,735
Accounts payable and accruals	(95)	(87)	(49)	131	(3)	6	2	(95)
Accrued salaries and benefits	12	29	1	5	-	-	-	47
Accrued compensated absences	(1)	(5)	1	(419)	-	-	-	(424)
Accrued claims payable	-	-	-	21	1,814	1,728	-	3,563
Cash flows provided by (used in) operating activities	<u>\$ 3,373</u>	<u>\$ 2,529</u>	<u>\$ 6</u>	<u>\$ (51)</u>	<u>\$ 1,422</u>	<u>\$ 1,899</u>	<u>\$ 1,562</u>	<u>\$ 10,740</u>

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 Off-Street 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
All Agency Funds
Statement of Changes in Assets and Liabilities
For the Year Ended June 30, 2012
(Amounts in thousands)

California Avenue Parking Assessment District	Balance June 30, 2011	Additions	Deletions	Balance June 30, 2012
ASSETS:				
Cash and investments available for operations	\$ 208	\$ -	\$ 10	\$ 198
Total Assets	<u>\$ 208</u>	<u>\$ -</u>	<u>\$ 10</u>	<u>\$ 198</u>
LIABILITIES:				
Due to bondholders	<u>\$ 208</u>	<u>\$ (10)</u>	<u>\$ -</u>	<u>\$ 198</u>
<hr/>				
Cable Joint Powers Authority				
ASSETS:				
Cash and investments available for operations	\$ 904	\$ 6	\$ -	\$ 910
Interest receivable	7	-	1	6
Total assets	<u>\$ 911</u>	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 916</u>
LIABILITIES:				
Due to other governments	<u>\$ 911</u>	<u>\$ 5</u>	<u>\$ -</u>	<u>\$ 916</u>
<hr/>				
University Avenue Parking Assessment District				
ASSETS:				
Cash and investments available for operations	\$ 2,006	\$ (298)	\$ -	\$ 1,708
Cash and investments with fiscal agents	3,906	-	1,368	2,538
Interest receivable	25	-	13	12
Total assets	<u>\$ 5,937</u>	<u>\$ (298)</u>	<u>\$ 1,381</u>	<u>\$ 4,258</u>
LIABILITIES:				
Due to bondholders	<u>\$ 5,937</u>	<u>\$ (1,679)</u>	<u>\$ -</u>	<u>\$ 4,258</u>
<hr/>				
Total Agency Funds				
ASSETS:				
Cash and investments available for operations	\$ 3,118	\$ (292)	\$ 10	\$ 2,816
Cash and investments with fiscal agents	3,906	-	1,368	2,538
Interest receivable	32	-	14	18
Total assets	<u>\$ 7,056</u>	<u>\$ (292)</u>	<u>\$ 1,392</u>	<u>\$ 5,372</u>
LIABILITIES:				
Due to bondholders	\$ 6,145	\$ (1,689)	\$ -	\$ 4,456
Due to other governments	911	5	-	916
Total liabilities	<u>\$ 7,056</u>	<u>\$ (1,684)</u>	<u>\$ -</u>	<u>\$ 5,372</u>

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. 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:

- Net Assets by Component
- Changes in Net Assets
- Fund Balances of Governmental Funds
- Changes in Fund Balances 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:

- Electric Operating Revenue by Source
- Supplemental Disclosure for Water Utilities
- Assessed Value of Taxable Property
- Property Tax Rates, All Overlapping Governments
- Property Tax Levies and Collections
- Principal Property Taxpayers
- Assessed Valuation and Parcels by Land Use
- Per Parcel Assessed Valuation of Single Family Residential

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:

- Ratio of Outstanding Debt by Type
- Computation of Direct and Overlapping Debt
- Computation of Legal Bonded Debt Margin
- Revenue Bond Coverage

STATISTICAL SECTION

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:

- Taxable Transactions by Type of Business
- Demographic and Economic Statistics
- Principal Employers

Operating Information

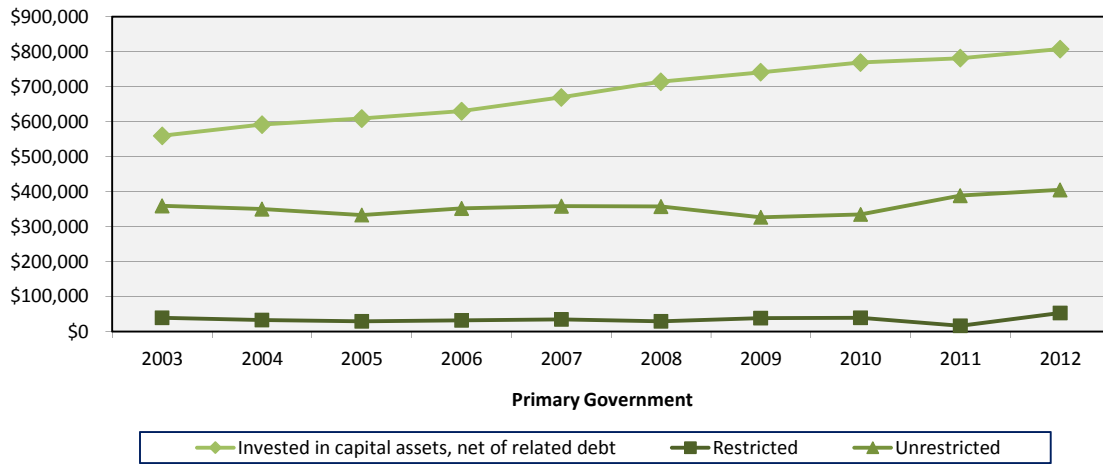
These schedules contain service and infrastructure data to help the reader understand how the information in the City's financial report relates to the services the City provides and the activities it performs:

- Operating Indicators by Function/Program
- Capital Asset Statistics by Function/Program
- Full-Time Equivalent City Government Employees by Function

Sources

Unless otherwise noted, the information in these schedules is derived from the Comprehensive Annual Financial Reports for the relevant year.

CITY OF PALO ALTO
Net Assets by Component
Last Ten Fiscal Years
(Accrual basis of accounting)
(Amounts in thousands)



	Fiscal Year Ended June 30									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Governmental Activities										
Invested in capital assets,										
net of related debt	\$ 279,306	\$ 297,125	\$ 305,225	\$ 311,335	\$ 326,411	\$ 343,537	\$ 356,657	\$ 369,499	\$ 364,747	\$ 370,111
Restricted	37,112	30,417	27,273	29,885	32,576	27,428	36,632	34,323	16,437	52,934
Unrestricted	130,463	123,762	117,301	123,823	127,190	130,460	118,133	102,199	134,722	142,102
Total Governmental Activities Net Assets	\$ 446,881	\$ 451,304	\$ 449,799	\$ 465,043	\$ 486,177	\$ 501,425	\$ 511,422	\$ 506,021	\$ 515,906	\$ 565,147
Business-type Activities										
Invested in capital assets,										
net of related debt	\$ 279,885	\$ 294,197	\$ 303,473	\$ 318,738	\$ 342,922	\$ 370,303	\$ 384,313	\$ 399,317	\$ 416,418	\$ 437,151
Restricted	1,728	1,798	1,750	1,732	1,732	1,732	1,732	4,300	-	-
Unrestricted	228,308	226,278	215,128	228,032	230,912	226,539	208,025	232,420	253,740	262,602
Total Business-type Activities Net Assets	\$ 509,921	\$ 522,273	\$ 520,351	\$ 548,502	\$ 575,566	\$ 598,574	\$ 594,070	\$ 636,037	\$ 670,158	\$ 699,753
Primary Government										
Invested in capital assets,										
net of related debt	\$ 559,191	\$ 591,322	\$ 608,698	\$ 630,073	\$ 669,333	\$ 713,840	\$ 740,970	\$ 768,816	\$ 781,165	\$ 807,262
Restricted	38,840	32,215	29,023	31,617	34,308	29,160	38,364	38,623	16,437	52,934
Unrestricted	358,771	350,040	332,429	351,855	358,102	356,999	326,158	334,619	388,462	404,704
Total Primary Government Net Assets	\$ 956,802	\$ 973,577	\$ 970,150	\$ 1,013,545	\$ 1,061,743	\$ 1,099,999	\$ 1,105,492	\$ 1,142,058	\$ 1,186,064	\$ 1,264,900

Source: Annual Financial Statements, Statement of Net Assets

CITY OF PALO ALTO
Changes in Net Assets
Last Ten Fiscal Years
(Accrual basis of accounting)
(Amounts in thousands)

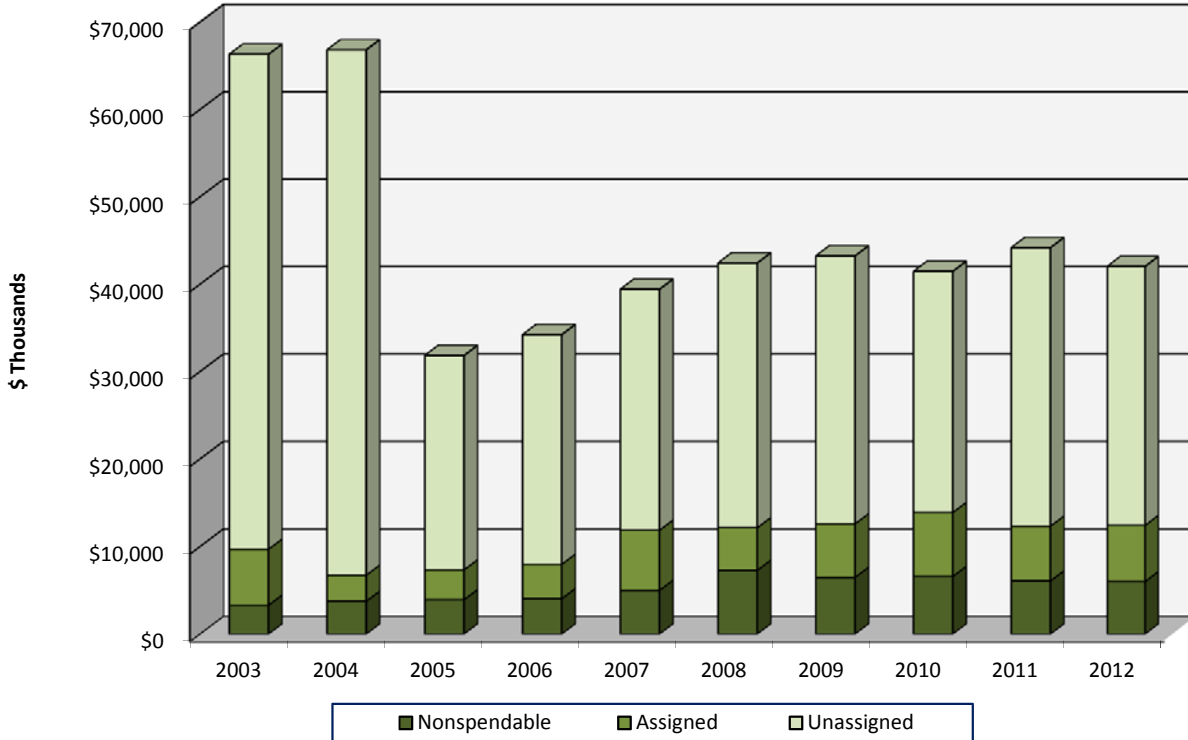
	Fiscal Year Ended June 30									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
PROGRAM REVENUES										
Governmental Activities										
Charges for services										
City Attorney	\$ 92	\$ 64	\$ 22	\$ 22	\$ 13	\$ 16	\$ 12	\$ 53	\$ -	\$ -
City Clerk	1	1	-	2	-	-	-	-	-	-
City Auditor	1	-	-	-	-	-	-	-	-	-
Administrative Services	406	815	480	627	835	870	726	984	2,889	1,647
Human Resources	-	-	-	-	11	-	-	-	-	-
Public Works	1,058	260	573	805	968	1,310	1,169	1,258	2,419	1,008
Planning & Community Environment	5,119	3,074	4,090	5,509	6,267	5,498	4,704	4,813	7,237	31,491
Police	3,396	4,415	3,801	4,178	4,179	4,274	3,947	4,093	3,237	2,160
Fire	7,811	7,565	8,555	9,078	9,610	9,418	10,723	10,244	12,037	13,498
Community Services	7,537	7,846	7,592	10,803	9,128	10,314	8,522	8,729	7,724	11,365
Library	-	-	133	129	146	176	177	199	480	1,600
Operating grants and contributions	4,468	4,213	3,677	3,976	5,642	4,029	3,599	4,829	2,884	3,441
Capital grants and contributions	635	1,990	804	3,156	1,756	1,930	3,810	1,280	1,903	1,064
Total Governmental Activities										
Program Revenues	<u>30,524</u>	<u>30,243</u>	<u>29,727</u>	<u>38,285</u>	<u>38,555</u>	<u>37,835</u>	<u>37,389</u>	<u>36,482</u>	<u>40,810</u>	<u>67,274</u>
Business-type Activities										
Charges for services										
Water	17,654	21,993	21,041	21,108	23,495	26,510	27,120	26,259	26,624	31,467
Electric	91,622	92,617	88,737	119,418	102,549	103,833	119,320	121,900	122,109	118,886
Fiber Optics ¹	-	-	-	-	-	-	3,336	3,105	3,322	3,662
Gas	29,714	24,839	31,206	36,977	42,221	49,021	47,838	44,450	43,584	41,774
Wastewater Collection	10,676	12,647	12,041	13,801	14,848	15,102	14,486	15,136	15,094	14,942
Wastewater Treatment	13,556	14,744	15,982	18,778	16,957	22,889	28,425	16,915	18,830	22,200
Refuse	21,691	21,923	23,387	24,795	25,532	28,805	29,101	28,568	30,469	30,645
Storm Drainage	2,192	2,170	2,484	5,174	5,181	5,450	5,505	5,647	5,796	5,892
External Services	605	585	766	854	789	112	-	-	-	-
Operating grants and contributions	-	-	-	-	-	-	-	361	610	605
Capital grants and contributions	-	-	-	-	756	1,594	639	475	3,004	1,526
Total Business-type Activities										
Program Revenues	<u>187,710</u>	<u>191,518</u>	<u>195,644</u>	<u>240,905</u>	<u>232,328</u>	<u>253,316</u>	<u>275,770</u>	<u>262,816</u>	<u>269,442</u>	<u>271,599</u>
Total Primary Government										
Program Revenues	<u>\$ 218,234</u>	<u>\$ 221,761</u>	<u>\$ 225,371</u>	<u>\$ 279,190</u>	<u>\$ 270,883</u>	<u>\$ 291,151</u>	<u>\$ 313,159</u>	<u>\$ 299,298</u>	<u>\$ 310,252</u>	<u>\$ 338,873</u>
EXPENSES										
Governmental Activities										
City Council	\$ 234	\$ 269	\$ 130	\$ 141	\$ 180	\$ 323	\$ 394	\$ 455	\$ 15	\$ 345
City Manager	1,565	1,663	1,725	1,563	1,760	2,273	2,085	2,399	1,842	1,960
City Attorney	2,028	2,300	2,653	2,598	2,390	2,653	2,575	2,621	953	1,656
City Clerk	598	808	770	945	900	1,241	1,098	1,369	803	908
City Auditor	646	668	764	843	838	1,379	2,053	2,601	138	235
Administrative Services ²	9,723	6,271	6,982	6,972	6,419	15,477	17,784	17,893	9,888	10,100
Human Resources	1,728	2,078	2,410	2,546	2,472	2,806	3,448	3,707	1,346	1,071
Public Works	13,702	14,460	16,400	17,596	16,645	18,565	21,270	18,658	19,357	14,568
Planning & Community Environment	7,485	8,898	10,162	9,931	12,929	16,388	12,940	12,114	15,031	12,074
Police	19,273	20,414	22,416	23,411	23,861	27,740	29,288	29,351	30,465	33,533
Fire	16,859	17,308	18,127	18,747	19,530	22,386	23,199	26,448	28,531	29,284
Community Services	19,633	20,864	17,240	17,296	15,729	17,736	19,862	17,171	22,845	21,915
Library	-	-	4,835	5,323	5,347	6,321	6,244	6,143	6,920	7,323
Non-departmental ²	7,449	7,618	12,474	10,400	12,133	-	-	-	-	-
Interest on long term debt	675	635	693	512	477	438	404	370	2,742	2,575
Total Governmental										
Activities Expenses	<u>101,598</u>	<u>104,254</u>	<u>117,781</u>	<u>118,824</u>	<u>121,610</u>	<u>135,726</u>	<u>142,644</u>	<u>141,300</u>	<u>140,876</u>	<u>137,547</u>
Business-type Activities										
Water	13,237	16,047	14,969	15,881	16,794	18,842	20,271	21,037	24,268	29,093
Electric	73,744	73,545	73,051	91,570	99,294	108,032	122,268	107,910	100,130	102,030
Fiber Optics ¹	-	-	-	-	-	-	1,284	1,407	1,561	1,489
Gas	22,270	22,994	26,656	29,107	30,690	37,211	34,603	32,498	32,051	28,878
Wastewater Collection	8,712	9,203	8,907	11,005	10,085	12,023	14,875	10,696	12,275	14,825
Wastewater Treatment	14,312	14,868	17,457	16,747	15,901	18,902	36,896	13,466	19,731	20,712
Refuse	24,635	24,282	24,959	26,989	25,372	28,827	37,217	28,119	30,684	31,900
Storm Drainage	2,489	2,975	3,336	2,673	2,517	3,202	2,943	2,491	3,229	3,103
Airport	-	-	-	-	-	-	-	-	31	153
External Services	583	688	760	868	767	984	-	-	-	-
Total Business-type										
Activities Expenses	<u>159,982</u>	<u>164,602</u>	<u>170,095</u>	<u>194,840</u>	<u>201,420</u>	<u>228,023</u>	<u>270,357</u>	<u>217,624</u>	<u>223,960</u>	<u>232,183</u>
Total Primary										
Government Expenses	<u>\$ 261,580</u>	<u>\$ 268,856</u>	<u>\$ 287,876</u>	<u>\$ 313,664</u>	<u>\$ 323,030</u>	<u>\$ 363,749</u>	<u>\$ 413,001</u>	<u>\$ 358,924</u>	<u>\$ 364,836</u>	<u>\$ 369,730</u>

	Fiscal Year Ended June 30									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
NET (EXPENSE)/REVENUE										
Governmental Activities	\$ (71,074)	\$ (74,011)	\$ (88,054)	\$ (80,539)	\$ (83,055)	\$ (97,891)	\$ (105,255)	\$ (104,818)	\$ (100,066)	\$ (70,273)
Business-type Activities	27,728	26,916	25,549	46,065	30,908	25,293	5,413	45,192	45,482	39,416
Total Primary Government										
Net (Expense)/Revenue	<u>\$ (43,346)</u>	<u>\$ (47,095)</u>	<u>\$ (62,505)</u>	<u>\$ (34,474)</u>	<u>\$ (52,147)</u>	<u>\$ (72,598)</u>	<u>\$ (99,842)</u>	<u>\$ (59,626)</u>	<u>\$ (54,584)</u>	<u>\$ (30,857)</u>
GENERAL REVENUES AND OTHER CHANGES IN NET ASSETS										
<u>Governmental Activities</u>										
Taxes										
Property tax	\$ 13,882	\$ 13,707	\$ 16,657	\$ 18,731	\$ 21,466	\$ 23,084	\$ 25,432	\$ 25,981	\$ 29,156	\$ 30,104
Sales tax	18,041	18,151	19,308	20,315	22,194	22,623	20,089	17,991	20,746	22,132
Utility user tax	7,067	7,152	7,269	8,759	9,356	10,285	11,030	11,295	10,851	10,834
Transient occupancy tax	5,333	5,489	5,686	6,393	6,709	7,976	7,111	6,858	8,082	9,664
Other taxes	7,275	8,493	5,580	7,033	6,293	6,261	3,364	4,055	8,156	8,173
Investment earnings	10,213	326	4,988	2,567	8,747	12,313	8,525	6,514	3,500	6,238
Rents and miscellaneous	15,333	10,165	12,997	10,440	13,670	11,896	15,682	12,729	12,377	14,943
Transfers	14,730	14,951	14,064	21,545	15,754	18,701	24,020	13,994	17,083	17,426
Total Governmental Activities	<u>91,874</u>	<u>78,434</u>	<u>86,549</u>	<u>95,783</u>	<u>104,189</u>	<u>113,139</u>	<u>115,253</u>	<u>99,417</u>	<u>109,951</u>	<u>119,514</u>
<u>Business-type Activities</u>										
Investment earnings	13,583	387	8,093	3,631	11,910	16,416	14,103	10,769	5,722	7,605
Special item	-	-	(21,500)	-	-	-	-	-	-	-
Transfers	(14,730)	(14,951)	(14,064)	(21,545)	(15,754)	(18,701)	(24,020)	(13,994)	(17,083)	(17,426)
Total Business-type Activities	<u>(1,147)</u>	<u>(14,564)</u>	<u>(27,471)</u>	<u>(17,914)</u>	<u>(3,844)</u>	<u>(2,285)</u>	<u>(9,917)</u>	<u>(3,225)</u>	<u>(11,361)</u>	<u>(9,821)</u>
Total Primary Government	<u>\$ 90,727</u>	<u>\$ 63,870</u>	<u>\$ 59,078</u>	<u>\$ 77,869</u>	<u>\$ 100,345</u>	<u>\$ 110,854</u>	<u>\$ 105,336</u>	<u>\$ 96,192</u>	<u>\$ 98,590</u>	<u>\$ 109,693</u>
CHANGE IN NET ASSETS										
Governmental Activities	\$ 20,800	\$ 4,423	\$ (1,505)	\$ 15,244	\$ 21,134	\$ 15,248	\$ 9,998	\$ (5,401)	\$ 9,885	\$ 49,241
Business-type Activities	26,581	12,352	(1,922)	28,151	27,064	23,008	(4,504)	41,967	34,121	29,595
Total Primary Government										
Change in Net Assets	<u>\$ 47,381</u>	<u>\$ 16,775</u>	<u>\$ (3,427)</u>	<u>\$ 43,395</u>	<u>\$ 48,198</u>	<u>\$ 38,256</u>	<u>\$ 5,494</u>	<u>\$ 36,566</u>	<u>\$ 44,006</u>	<u>\$ 78,836</u>

Notes: ¹Prior to 2009, Fiber Optics was included in Electric.
²Beginning in 2008, includes Non-departmental expenses.

Source: Annual Financial Statements, Statement of Activities

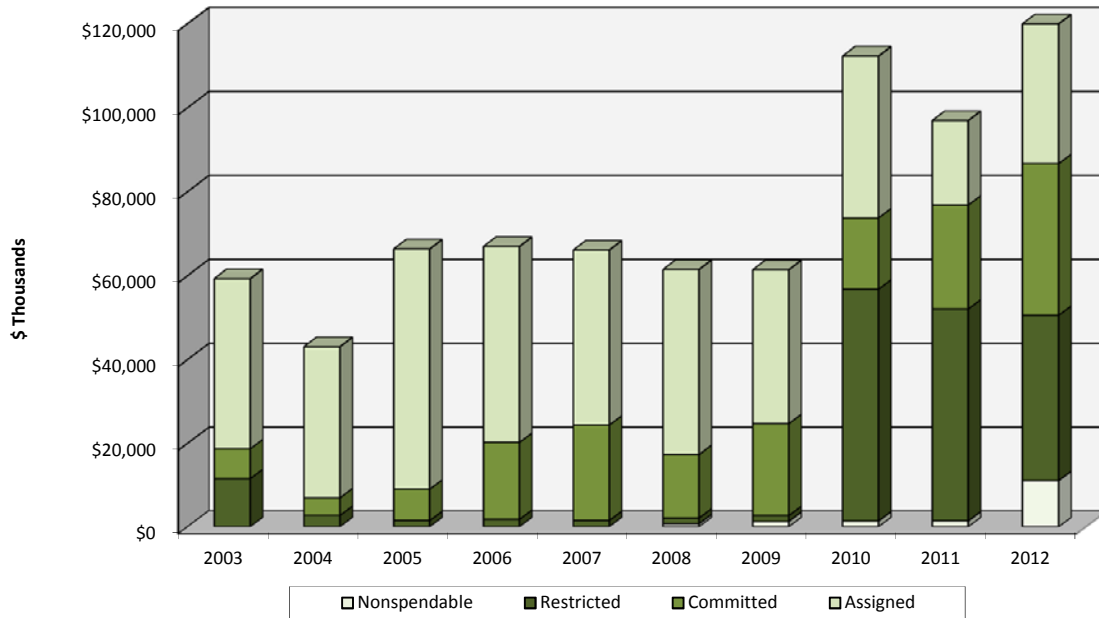
CITY OF PALO ALTO
Fund Balances of Governmental Funds (General Fund)
Last Ten Fiscal Years
(Modified accrual basis of accounting)
(Amounts in thousands)



	Fiscal Year Ended June 30									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
General Fund										
Nonspendable	\$ 3,303	\$ 3,762	\$ 3,931	\$ 4,052	\$ 5,002	\$ 7,286	\$ 6,476	\$ 6,581	\$ 6,085	\$ 6,007
Restricted	-	-	-	-	-	-	-	-	-	-
Committed	-	-	-	-	-	-	-	-	-	-
Assigned	6,386	2,973	3,401	3,914	6,855	4,851	6,100	7,295	6,235	6,400
Unassigned	56,618	60,087	24,498	26,251	27,551	30,278	30,648	27,581	31,859	29,616
Total General Fund	\$ 66,307	\$ 66,822	\$ 31,830	\$ 34,217	\$ 39,408	\$ 42,415	\$ 43,224	\$ 41,457	\$ 44,179	\$ 42,023

Source: Annual Financial Statements, Balance Sheet

CITY OF PALO ALTO
Fund Balances of Governmental Funds (All Other Governmental Funds)
Last Ten Fiscal Years
(Modified accrual basis of accounting)
(Amounts in thousands)



	Fiscal Year Ended June 30									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
All Other Governmental Funds										
Nonspendable	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 731	\$ 1,308	\$ 1,402	\$ 1,422	\$ 11,112
Restricted	11,574	2,761	1,522	1,822	1,540	1,406	1,412	55,400	50,646	61,324
Committed	7,127	4,206	7,521	18,430	22,883	15,207	22,043	16,962	24,775	14,284
Assigned	40,606	36,117	57,336	46,723	41,684	44,116	36,629	38,538	20,114	33,264
Unassigned	-	-	-	-	-	-	-	-	-	-
Total All Other Governmental Funds	<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>	<u>\$ 96,957</u>	<u>\$ 119,984</u>

Source: Annual Financial Statements, Balance Sheet

CITY OF PALO ALTO
Change in Fund Balances of Governmental Funds
Last Ten Fiscal Years
(Modified accrual basis of accounting)
(Amounts in thousands)

	Fiscal Year Ended June 30									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Revenues										
Property tax	\$ 13,821	\$ 13,707	\$ 16,657	\$ 18,731	\$ 21,466	\$ 23,084	\$ 25,432	\$ 25,981	\$ 29,248	\$ 30,216
Sales tax	18,041	18,151	19,308	20,315	22,194	22,623	20,089	17,991	20,746	22,132
Other taxes and fines	23,194	25,311	22,037	25,840	26,215	27,385	24,843	25,063	27,890	29,231
Charges for services	16,798	16,018	17,159	18,672	19,929	19,610	19,837	19,775	22,311	46,273
From other agencies	3,776	4,661	2,757	5,931	3,448	4,300	5,984	3,035	1,614	1,116
Permits and licenses	3,161	2,563	3,183	4,305	4,711	4,761	4,033	4,408	5,433	7,136
Interest and rentals	19,981	11,480	14,968	13,776	17,750	20,507	19,183	19,045	16,553	18,583
Other revenue	5,095	1,681	4,269	4,058	7,503	4,713	6,223	4,724	8,624	12,739
Total Revenues	103,867	93,572	100,338	111,628	123,216	126,983	125,624	120,022	132,419	167,426
Expenditures										
Administration ¹	17,521	13,862	14,509	14,299	14,399	16,250	16,002	17,353	8,351	9,412
Public Works	9,858	8,031	9,060	9,036	9,256	10,072	10,064	9,787	11,317	11,304
Planning and Community Environment	7,721	8,793	9,692	9,292	11,874	9,861	10,462	9,480	10,309	11,966
Police	19,719	19,962	21,117	22,279	23,305	27,006	27,053	26,728	30,519	33,310
Fire	16,841	16,891	17,615	18,114	19,146	21,644	21,904	24,294	28,355	29,108
Community Services ²	19,793	19,934	16,298	19,740	16,533	17,138	17,451	16,451	20,029	20,860
Library ²	-	-	4,800	5,170	5,260	6,219	5,985	5,900	6,509	7,072
Non-departmental	7,442	7,598	9,028	10,389	12,122	14,089	10,765	10,149	7,352	6,819
Special revenue and capital projects	33,584	22,289	21,317	13,243	17,478	21,626	21,485	22,006	35,486	29,154
Debt service - principal payments	875	780	785	810	850	885	800	840	870	1,743
Debt service -interest and fiscal fees	696	639	583	523	489	451	416	382	1,815	2,757
Payment to bond refunding escrow	-	-	-	-	-	-	-	-	-	586
Total Expenditures	134,050	118,779	124,804	122,895	130,712	145,241	142,387	143,370	160,912	164,091
Excess (Deficiency) of Revenues Over (Under) Expenditures	(30,183)	(25,207)	(24,466)	(11,267)	(7,496)	(18,258)	(16,763)	(23,348)	(28,493)	3,335
Other Financing Sources (Uses)										
Transfers in	31,402	28,632	60,429	26,640	27,701	33,437	39,903	34,835	30,323	47,200
Transfers out	(16,603)	(19,133)	(46,622)	(12,390)	(15,882)	(16,819)	(22,399)	(21,415)	(14,352)	(29,782)
Other	-	-	-	-	-	-	-	-	(101)	-
Contribution from assessment district	425	-	-	-	-	-	-	-	-	-
Proceeds from long term debt	-	-	-	-	-	-	-	59,071	-	3,222
Payments to refund bond escrow	-	-	(1,038)	-	-	-	-	-	-	(3,104)
Total Other Financing Sources (Uses)	15,224	9,499	12,769	14,250	11,819	16,618	17,504	72,491	15,870	17,536
Net Change in Fund Balances	\$ (14,959)	\$ (15,708)	\$ (11,697)	\$ 2,983	\$ 4,323	\$ (1,640)	\$ 741	\$ 49,143	\$ (12,623)	\$ 20,871
Debt Service as a Percentage of Non-Capital Expenditures	1.6%	1.5%	1.3%	1.2%	1.2%	1.1%	1.0%	1.0%	2.1%	3.3%

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

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

Source: Annual Financial Statements, Governmental Funds, Statement of Revenues, Expenditures and Changes in Fund Balances

CITY OF PALO ALTO
Electric Operating Revenue by Source
Last Ten Fiscal Years
(Amounts in thousands)

Fiscal Year	Commercial and			City of Palo Alto	Total
	Residential	Industrial			
2003	\$ 11,657	\$ 55,353		\$ 2,028	\$ 69,038
2004	12,245	54,881		2,113	69,239
2005	13,009	56,683		2,289	71,981
2006	14,973	67,389		2,492	84,854
2007	15,150	68,214		2,466	85,830
2008	16,109	72,632		2,571	91,312
2009	17,939	83,710		2,823	104,472
2010	19,898	89,315		2,890	112,103
2011	19,848	88,076		2,991	110,915
2012	20,328	85,895		3,352	109,575

Top Ten Electric Customers by Revenue*

Customer (alphabetical order)	Type of Business
529 Bryant Street LLC	Technology
City of Palo Alto	Municipal
Communications & Power Industries (CPI)	Research
Hewlett-Packard Company	Computer
Space Systems/Loral	Satellite & Satellite Systems
Stanford	Property Management
Stanford Hospital & Clinics	Hospital
Varian Medical Systems, Inc.	Manufacturing
Veterans Admin Hospital	Hospital
VMware, Inc.	Computer

*The top ten customers accounted for approximately 37.45% of total kWh consumption (352,980,717 kWh) and 33.79% of revenue (\$37,064,825). The largest customer accounted for 8.83% of total kWh consumption and 7.62% of revenue. The smallest customer accounted for 1% of total kWh consumption and 1% of revenue.

	Number of Customers	Kilowatt-hour Sales (kWh)	Revenue
Residential	26,713	191,635,563	\$ 20,328
Commercial	2,449	428,810,305	60,443
Industrial	150	236,814,330	25,452
CPA/Other	215	85,303,689	3,352
Total	29,527	942,563,887	\$ 109,575

City of Palo Alto Power Purchase

Western Area Power Administration	42%
Forward Market Purchases	24%
Wind Energy contracts with PPM Energy, Inc.	12%
Northern California Power Agency	11%
Landfill Gas Energy	7%
Short-Term Market	4%

Note: Revenue includes all utilities (metered and non-metered), revenue adjustments, and Primary Voltage discount. Revenue does not include CEC surcharge, UUT, Solar and Rap discounts and deposits. Parts of this schedule are provided as required by the Continuing Disclosure Agreement for the City's Utility Revenue Bond and are not required by Governmental Accounting Standards Board (GASB).

Source: City of Palo Alto, Utilities and Accounting Departments

CITY OF PALO ALTO
Supplemental Disclosure for Water Utilities
Fiscal Year 2012

Top Ten Largest Water Utility Customers (alphabetical order)

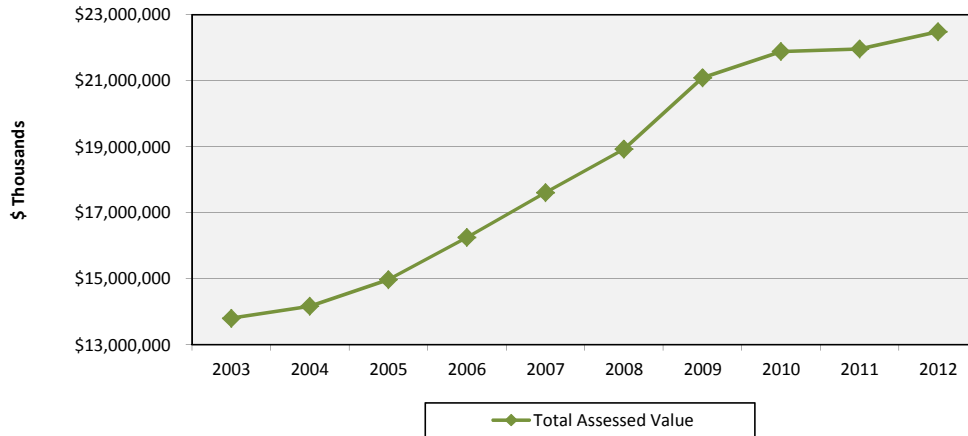
City of Palo Alto
Hewlett-Packard Company
Palo Alto Hills Golf & Country Club
Palo Alto Unified School District
Oak Creek Apartments
Stanford Hospital & Clinics
Stanford West Management
Veterans Admin Hospital
VMware Inc.
VI at Palo Alto

The top ten customers total consumption is 850,951 CCF with revenue of \$4,830,969. This amount accounts for approximately 16.81% of total consumption and 16.18% of revenue. The largest customer (other than the City of Palo Alto) accounted for 3% of consumption and 3% of revenue. The smallest customer accounted for 1% of consumption and 1% of revenue.

Note: This schedule is provided as required by the Continuing Disclosure Agreement for the City's Utility Revenue Bond and is not required by Governmental Accounting Standards Board (GASB).

Source: City of Palo Alto, Utilities Department

CITY OF PALO ALTO
Assessed Value of Taxable Property
Last Ten Fiscal Years
(Amounts in thousands)

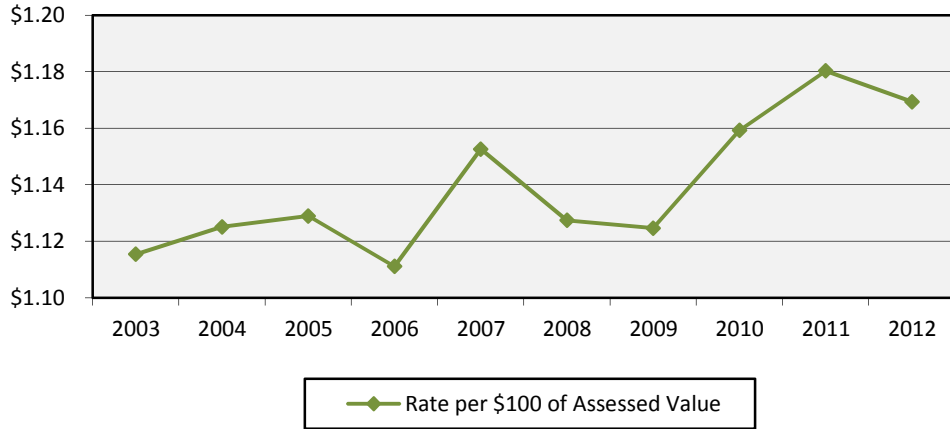


	Fiscal Year Ended June 30									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Net Local Secured Roll										
Land	\$ 6,140,438	\$ 6,588,474	\$ 7,075,300	\$ 7,941,482	\$ 8,725,485	\$ 9,497,746	\$ 10,420,139	\$ 11,007,650	\$ 11,011,160	\$ 11,352,993
Improvements	6,692,162	6,996,106	7,722,660	8,364,668	8,915,623	9,453,436	10,527,617	10,752,671	10,962,928	11,703,597
Personal property	309,386	195,859	220,585	174,666	213,154	228,875	303,688	288,148	241,280	257,436
	<u>13,141,986</u>	<u>13,780,439</u>	<u>15,018,545</u>	<u>16,480,816</u>	<u>17,854,262</u>	<u>19,180,057</u>	<u>21,251,444</u>	<u>22,048,469</u>	<u>22,215,368</u>	<u>23,314,026</u>
Less:										
Exemptions net of state aid	(951,807)	(1,196,546)	(1,402,039)	(1,595,871)	(1,639,856)	(1,797,327)	(1,871,292)	(1,809,119)	(1,757,241)	(2,346,728)
Total Net Local Secured Roll	<u>12,190,179</u>	<u>12,583,893</u>	<u>13,616,506</u>	<u>14,884,945</u>	<u>16,214,406</u>	<u>17,382,730</u>	<u>19,380,152</u>	<u>20,239,350</u>	<u>20,458,127</u>	<u>20,967,298</u>
Public utilities	3,859	3,956	4,150	4,084	3,923	3,174	2,573	2,573	2,573	2,573
Unsecured property	<u>1,612,179</u>	<u>1,582,368</u>	<u>1,354,310</u>	<u>1,361,117</u>	<u>1,391,284</u>	<u>1,536,584</u>	<u>1,702,884</u>	<u>1,638,436</u>	<u>1,495,574</u>	<u>1,516,837</u>
Total Assessed Value	<u>\$ 13,806,217</u>	<u>\$ 14,170,217</u>	<u>\$ 14,974,966</u>	<u>\$ 16,250,146</u>	<u>\$ 17,609,613</u>	<u>\$ 18,922,488</u>	<u>\$ 21,085,609</u>	<u>\$ 21,880,359</u>	<u>\$ 21,956,274</u>	<u>\$ 22,486,708</u>
Total Direct Tax Rate	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%

Note: The State Constitution requires property to be assessed at 100% of the most recent purchase price, plus an increment of no more than 2% annually, plus any local over-rides. These values are considered to be full market values.

Source: County of Santa Clara Assessor's Office

**CITY OF PALO ALTO
Property Tax Rates
All Overlapping Governments
Last Ten Fiscal Years**



Fiscal Year	Basic County Wide Levy	County Retirement Levy	County Hospital G.O. Bond (Measure A) ¹	City Library G.O. Bond (Measure N) ²	Santa Clara Valley Water District	School District	Community College	Total Direct and Overlapping Rates
2003	1.00	0.0388	-	-	0.0072	0.0586	0.0108	1.12
2004	1.00	0.0388	-	-	0.0087	0.0666	0.0110	1.13
2005	1.00	0.0388	-	-	0.0092	0.0680	0.0129	1.13
2006	1.00	0.0388	-	-	0.0078	0.0526	0.0119	1.11
2007	1.00	0.0388	-	-	0.0072	0.0720	0.0346	1.15
2008	1.00	0.0388	-	-	0.0071	0.0702	0.0113	1.13
2009	1.00	0.0388	-	-	0.0061	0.0674	0.0123	1.12
2010	1.00	0.0388	0.0122	-	0.0074	0.0686	0.0322	1.16
2011	1.00	0.0388	0.0095	0.0171	0.0072	0.0751	0.0326	1.18
2012	1.00	0.0388	0.0047	0.0155	0.0064	0.0742	0.0297	1.17

Notes: ¹The County General Obligation Bond (Measure A) was passed in 2008 to fund the seismic upgrade of the Santa Clara Valley Medical Center. Rates were first levied for the 2009-10 fiscal year.

²The City of Palo Alto General Obligation Bond (Measure N) was passed in 2008 to fund the construction and renovation of three of the City's libraries. Rates were first levied for the 2010-11 fiscal year.

Source: County of Santa Clara, Tax Rates and Information

CITY OF PALO ALTO
Property Tax Levies and Collections
Last Ten Fiscal Years
(Amounts in thousands)

Fiscal Year Ended June 30	Total Tax Levy ¹ for FY	Collected within the Fiscal Year of the Levy			Total Collections to Date	
		Amount	Percentage of Levy	Collections in Subsequent Years ²	Amount	Percentage of Levy
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%
2011	25,688	25,688	100%	-	25,688	100%
2012	26,494	26,494	100%	-	26,494	100%

Notes: ¹During fiscal year 1995, the County of Santa Clara began providing the City 100% of its tax levy under an agreement which allows the county to keep all interest and delinquency charges collected.

²Effective fiscal year 1994, 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.

Source: Annual Financial Statements, Government Funds, Statement of Revenues, Expenditures and Changes in Fund Balances.

CITY OF PALO ALTO
Principal Property Taxpayers
Current Year and Nine Years Ago
(Amounts in thousands)

Taxpayer	Fiscal Year 2012			Fiscal Year 2003		
	Taxable Assessed Value	Rank	Percentage of Total Taxable Assessed Value	Taxable Assessed Value	Rank	Percentage of Total Taxable Assessed Value
Leland Stanford Jr. University	\$ 3,035,075	1	13.5%	\$ 2,034,196	1	15.5%
Space Systems/Loral, Inc.	226,246	2	1.0%	255,731	2	1.9%
Arden Realty Limited Partnership	112,472	3	0.5%			
Whisman Ventures, LLC	105,066	4	0.5%			
ECI 2 Bayshore, LLC / ECI Hamilton, LLC	73,901	5	0.3%			
Ronald & Ann Williams Charitable Foundation	58,804	6	0.3%			
Blackhawk Parent, LLC	50,196	7	0.2%			
300 / 400 Hamilton Associates	41,433	8	0.2%			
Thoit Bros., Inc.	31,740	9	0.1%			
529 Bryant St.	31,737	10	0.1%			
Agilent Technologies				82,038	3	0.6%
Sun Microsystems, Inc.				78,072	4	0.6%
Harbor Investment Partners				59,186	5	0.5%
Embarcadero Place Associates				49,250	6	0.4%
Cowper-Hamilton Associates				41,168	7	0.3%
California Pacific Commercial Corp.				34,226	8	0.3%
Pacific Hotel Development Venture LP				31,131	9	0.2%
Embarcadero Bayshore Investors				31,093	10	0.2%
Total	\$ 3,766,670		16.7%	\$ 2,696,091		20.5%

Total City Taxable Assessed Value:

FY 2012	\$ 22,486,708
FY 2003	\$ 13,141,986

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

CITY OF PALO ALTO
Assessed Valuation and Parcels by Land Use
As of June 30, 2012

	2011-2012						
	Assessed	% of	No. of	% of	No. of	% of	
	Valuation¹	Total	Parcels	Total	Taxable	% of	
					Parcels	Total	
<u>Non-Residential:</u>							
Agricultural/forest	\$ 35,335,945	0.17 %	50	0.25 %	34	0.17 %	
Commercial	1,130,031,385	5.39	471	2.32	465	2.31	
Professional/office	2,516,156,240	12.00	496	2.44	474	2.35	
Industrial/research & development	1,961,860,451	9.36	192	0.95	187	0.93	
Recreational	32,558,018	0.16	15	0.07	12	0.06	
Government/social/institutional	230,486,654	1.10	103	0.51	40	0.20	
Miscellaneous	<u>9,790,872</u>	<u>0.05</u>	<u>21</u>	<u>0.10</u>	<u>20</u>	<u>0.10</u>	
Subtotal Non-Residential	\$ 5,916,219,565	28.22 %	1,348	6.64 %	1,232	6.12 %	
<u>Residential:</u>							
Single family residence	\$ 11,969,379,972	57.09 %	14,916	73.50 %	14,889	73.95 %	
Condominium/townhouse	1,542,232,765	7.36	2,764	13.62	2,759	13.70	
2-4 Residential units	340,348,321	1.62	523	2.58	523	2.60	
5+ Residential units	1,050,912,445	5.01	332	1.64	307	1.52	
Mobile home	<u>69,416</u>	<u>0.00</u>	<u>7</u>	<u>0.03</u>	<u>7</u>	<u>0.03</u>	
Subtotal Residential	\$ 14,902,942,919	71.08 %	18,542	91.37 %	18,485	91.81 %	
Vacant Parcels	\$ 148,135,184	0.71 %	403	1.99 %	417	2.07 %	
Total	\$ 20,967,297,668	100 %	20,293	100 %	20,134	100 %	

Notes: 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 Governmental Accounting Standards Board (GASB). Therefore, ten years of comparison data is not presented.

¹Local secured assessed valuation, excluding tax-exempt property.

Source: California Municipal Statistics, Inc.

CITY OF PALO ALTO
Per Parcel Assessed Valuation of Single Family Residential
As of June 30, 2012

	No. of Taxable Parcels ¹	2011-2012 Assessed Valuation	Average Assessed Valuation	Median Assessed Valuation
Single Family Residential	14,889	\$11,969,379,972	\$803,908	\$601,768

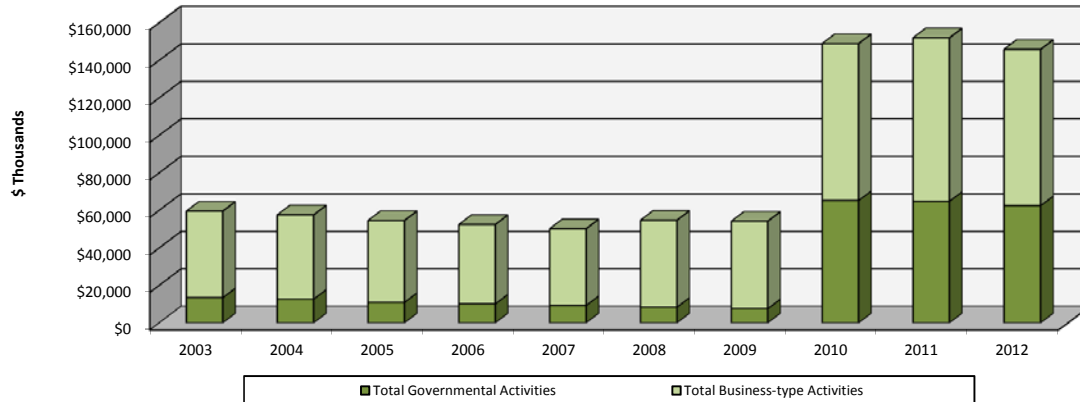
2011-2012 Assessed Valuation	No. of Taxable Parcels ¹	% of Total Parcels	Cumulative % of Total Parcels	Total Valuation	% of Total Valuation	Cumulative % of Total Valuation
\$0-99,999	1,950	13.10	13.10	\$ 148,603,010	1.24	1.24
\$100,000-199,999	1,957	13.14	26.24	269,755,993	2.25	3.50
\$200,000-299,999	998	6.70	32.94	249,756,101	2.09	5.58
\$300,000-399,999	829	5.57	38.51	290,578,648	2.43	8.01
\$400,000-499,999	846	5.68	44.19	382,411,765	3.19	11.20
\$500,000-599,999	843	5.66	49.86	464,061,669	3.88	15.08
\$600,000-699,999	737	4.95	54.81	479,782,639	4.01	19.09
\$700,000-799,999	679	4.56	59.37	509,862,657	4.26	23.35
\$800,000-899,999	792	5.32	64.69	673,658,430	5.63	28.98
\$900,000-999,999	783	5.26	69.94	744,073,696	6.22	35.19
\$1,000,000-1,099,999	700	4.70	74.65	733,320,880	6.13	41.32
\$1,100,000-1,199,999	510	3.43	78.07	586,775,917	4.90	46.22
\$1,200,000-1,299,999	467	3.14	81.21	582,154,595	4.86	51.09
\$1,300,000-1,399,999	382	2.57	83.77	514,563,580	4.30	55.39
\$1,400,000-1,499,999	356	2.39	86.16	514,840,345	4.30	59.69
\$1,500,000-1,599,999	285	1.91	88.08	440,908,304	3.68	63.37
\$1,600,000-1,699,999	276	1.85	89.93	455,100,960	3.80	67.17
\$1,700,000-1,799,999	198	1.33	91.26	346,158,183	2.89	70.07
\$1,800,000-1,899,999	168	1.13	92.39	310,346,564	2.59	72.66
\$1,900,000-1,999,999	160	1.07	93.46	311,367,708	2.60	75.26
\$2,000,000 and greater	973	6.54	100.00	2,961,298,328	24.74	100.00
Total	14,889	100.00		\$ 11,969,379,972	100.00	

Notes: 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 Governmental Accounting Standards Board (GASB). Therefore, ten years of comparison data is not presented.

¹Improved single family residential parcels. Excludes condominiums and parcels with multiple family units.

Source: California Municipal Statistics, Inc.

CITY OF PALO ALTO
Ratio of Outstanding Debt by Type
Last Ten Fiscal Years
(Amounts in thousands)



	Fiscal Year Ended June 30									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Governmental Activities										
Certificates of Participation	\$ 12,905	\$ 12,215	\$ 10,625	\$ 9,915	\$ 9,175	\$ 8,405	\$ 7,605	\$ 6,765	\$ 5,895	\$ 1,685
General Obligation Bonds	-	-	-	-	-	-	-	55,305	55,305	54,540
Special Assessment Debt	510	420	325	225	115	-	-	-	-	-
Capital Lease Obligations	57	25	-	-	-	-	-	-	-	-
2011 Lease-Purchase Agreement	-	-	-	-	-	-	-	-	-	2,764
Add: unamortized premium	-	-	-	-	-	-	-	3,766	3,640	3,514
Less: unamortized discount/ issuance costs	-	-	-	-	-	-	-	(571)	-	-
Total Governmental Activities	13,472	12,660	10,950	10,140	9,290	8,405	7,605	65,265	64,840	62,503
Business-type Activities										
Utility Revenue Bonds	47,410	46,100	44,735	43,325	41,859	40,334	38,744	72,104	69,551	65,879
Energy Tax Credits	-	-	-	-	-	1,400	1,300	1,200	1,100	1,000
State Water Resources Loan	-	-	-	-	-	5,629	9,000	13,080	16,696	15,900
Less: unamortized discount/ issuance costs	(1,341)	(1,238)	(1,137)	(1,037)	(972)	(1,053)	(2,479)	(2,737)	(229)	580
Total Business-type Activities	46,069	44,862	43,598	42,288	40,887	46,310	46,565	83,647	87,118	83,359
Total Primary Government Outstanding Debt	\$ 59,541	\$ 57,522	\$ 54,548	\$ 52,428	\$ 50,177	\$ 54,715	\$ 54,170	\$ 148,912	\$ 151,958	\$ 145,862
Percentage of Personal Income ¹	2.19%	2.11%	1.89%	1.69%	1.51%	1.53%	1.50%	4.30%	4.00%	3.57%
Population	60,465	60,246	61,674	62,148	62,615	63,367	64,484	65,408	64,417	65,544
Debt Per Capita	\$ 0.98	\$ 0.95	\$ 0.88	\$ 0.84	\$ 0.80	\$ 0.86	\$ 0.84	\$ 2.28	\$ 2.36	\$ 2.23

Notes: ¹See the schedule of Demographic and Economic Statistics for personal income data. Per capita personal income is only available for Santa Clara County, therefore personal income is the product of the countywide per capita amount and the City's population.

Sources: County of Santa Clara (assessed valuation)
State of California, Department of Finance (population)
California Department of Transportation Long-Term Socio-Economic Forecasts (personal income)
Annual Financial Statements, Note 7 General Long-Term Obligations and Note 8 Special Assessment Debt

CITY OF PALO ALTO
Computation of Direct and Overlapping Debt
As of June 30, 2012

2011-2012 Assessed Valuation

\$ 22,486,707,664

	Total Debt	Percentage	Amount
	Outstanding	Applicable	Applicable
<u>Direct and Overlapping Tax and Assessment Debt</u>		to City of	to City of
		Palo Alto¹	Palo Alto
Santa Clara County	\$ 316,800,000	8.38%	\$ 26,544,672
Foothill-DeAnza Community College District	628,424,288	23.61%	148,352,122
Palo Alto Unified School District	221,669,249	89.17%	197,662,469
Fremont Union High School District	260,605,108	0.02%	62,545
Los Gatos Joint Union High School District	51,160,000	0.01%	5,628
Mountain View-Los Altos Union High School District	47,971,663	1.02%	488,831
Cupertino Union School District	120,672,535	0.04%	48,269
Los Altos School District	83,603,480	1.04%	871,148
Saratoga Union School District	45,413,558	0.02%	10,445
Whisman School District	17,964,376	3.59%	645,280
City of Palo Alto	54,540,000	100%	54,540,000
El Camino Hospital District	142,280,000	0.10%	138,012
City of Palo Alto Special Assessment Bonds	31,750,000	100%	31,750,000
Santa Clara Valley Water District Benefit Assessment District	133,440,000	8.38%	11,180,938
Total Direct and Overlapping Tax and Assessment Debt			<u>472,300,359</u>
<u>Direct and Overlapping General Fund Debt</u>			
Santa Clara County General Fund Obligations	786,980,000	8.208%	64,597,649
Santa Clara County Pension Obligations	386,024,822	8.31%	32,094,488
Santa Clara County Board of Education Certificates of Participation	12,580,000	7.69%	966,937
Foothill-DeAnza Community College District Certificates of Participation	21,215,000	21.02%	4,459,362
Los Gatos-Saratoga Joint Union High School District Certificates of Participation	9,650,000	0.01%	998
Mountain View-Los Altos Union High School District Certificates of Participation	6,115,000	0.95%	58,185
Saratoga Union High School District Certificates of Participation	6,110,000	0.02%	1,341
City of Palo Alto Certificates of Participation	1,685,000	100%	1,685,000
Santa Clara County Vector Control District Certificates of Participation	3,800,000	8.00%	304,158
Midpeninsula Regional Open Space Park District General Fund Obligations	131,003,031	14.65%	19,191,211
Total Direct and Overlapping General Fund Debt			<u>123,359,329</u>
Total Combined Debt			<u>\$ 595,659,688</u>
	Ratio to		
	Assessed Valuation		
Total Direct Debt	0.25%		\$ 56,225,000
Total Overlapping Debt	<u>2.40%</u>		<u>539,434,688</u>
Total Direct and Overlapping Debt	<u>2.65%</u>		<u>\$ 595,659,688</u> ²

Notes: ¹Percentage of overlapping agency's assessed valuation located within boundaries of the city

²Excludes tax and revenue anticipation notes, enterprise revenue, mortgage revenue and tax allocation bonds and non-bonded capital lease obligations.

Source: California Municipal Statistics, Inc.

CITY OF PALO ALTO
Computation of Legal Bonded Debt Margin
As of June 30, 2012
(Amounts in thousands)

Assessed Valuation:

Secured property assessed value,
net of exempt real property \$ 22,486,708

Bonded Debt Limit (3.75% of Assessed Value) ¹ 843,252

Direct Debt:

Certificates of Participation 1,685
General Obligation bonds 54,540

Total Direct Debt 56,225

Less: Amount of Debt Not Subject to Limit ² 1,685

Total Net Debt Applicable to Limit 54,540

Legal Bonded Debt Margin \$ 788,712

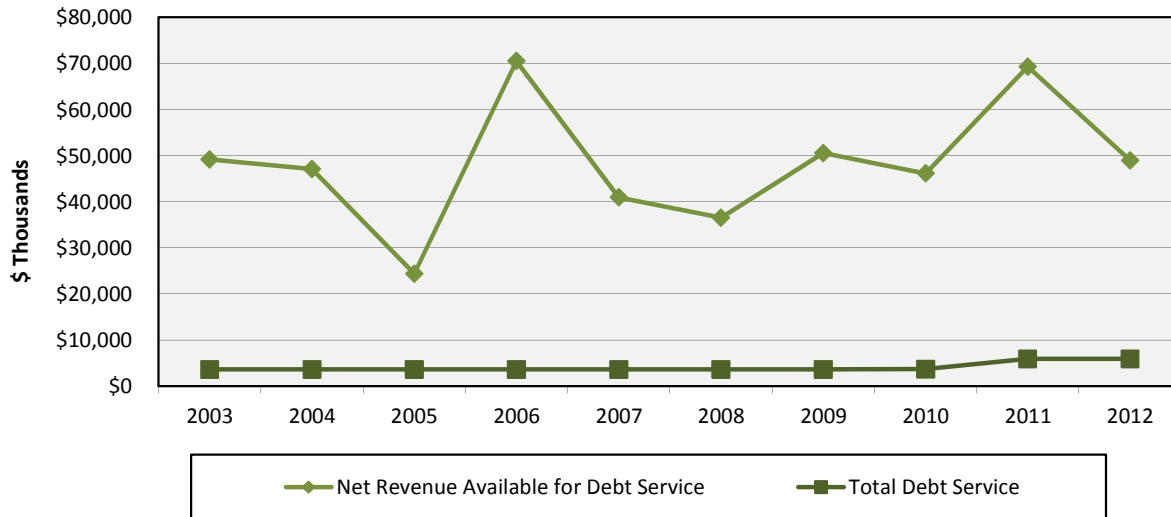
Fiscal Year	Total Assessed Value (AV)	Bonded Debt Limit (3.75% of AV)	Total Net Debt Applicable to Limit	Legal Bonded Debt Margin	Total Net Debt Applicable to the Debt as a %	Ratio of Net Debt to Assessed Value of Taxable Property
2003	\$ 13,776,406	\$ 516,615	\$ -	\$ 516,615	0.00%	-
2004	14,974,966	561,561	-	561,561	0.00%	-
2005	16,250,066	609,378	-	609,378	0.00%	-
2006	16,250,066	609,377	-	609,377	0.00%	-
2007	17,609,613	660,360	-	660,360	0.00%	-
2008	18,922,488	709,593	-	709,593	0.00%	-
2009	21,085,609	790,710	-	790,710	0.00%	-
2010	21,880,359	820,513	55,305	765,208	6.74%	0.0025
2011	21,956,274	823,360	55,305	768,055	6.72%	0.0025
2012	22,486,708	843,252	54,540	788,712	6.47%	0.0024

Notes: ¹California Government Code, Section 43605 sets the debt limit at 15% of the assessed value of all real and personal property of the City. Because this Code section was enacted when assessed value was 25% of market value, the limit is calculated at one-fourth, or 3.75%. This legal debt margin applies to General Obligation debt. Prior year limits have been adjusted to conform to the current year methodology.

²In accordance with California Government Code Section 43605, only the City's General Obligation bonds are subject to the legal debt limit of 15%. Enterprise Fund debt is not subject to legal debt margin.

Source: Annual Financial Statements, Assessed Value of Taxable Property and Note 7 General Long-Term Obligations

CITY OF PALO ALTO
Revenue Bond Coverage
Business-type Activities¹
Last Ten Fiscal Years
(Amounts in thousands)



Fiscal Year	Gross Revenue	Less: Direct Operating Expenses ²	Net Revenue Available for Debt Service	Debt Service			Coverage Ratio
				Principal	Interest	Total	
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
2011	237,600	168,328	69,272	2,655	3,261	5,916	11.71
2012	235,160	170,525	64,635	2,945	2,959	5,904	10.95

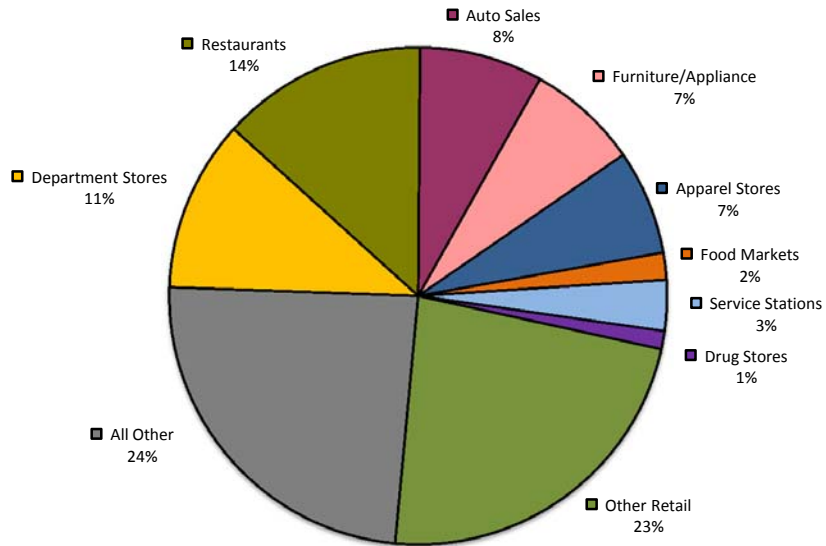
Notes: ¹Airport, Refuse and Fiber Optics funds have no debt and are therefore excluded from this schedule.

²Excludes depreciation and amortization expense.

Source: City of Palo Alto, Accounting Department

CITY OF PALO ALTO
Taxable Transactions by Type of Business
Last Ten Fiscal Years
(Amounts in thousands)

Fiscal Year 2012



ECONOMIC SEGMENT

Fiscal Year	Department Stores		Auto Sales	Furniture/ Appliance	Apparel Stores	Food Markets	Service Stations	Drug Stores	Other Retail		Total
	Stores	Restaurants							All Other		
2003	\$ 2,316	\$ 2,172	\$ 2,094	\$ 1,455	\$ 1,114	\$ 375	\$ 388	\$ 171	\$ 2,811	\$ 4,834	\$ 17,730
2004	2,425	2,168	1,958	1,479	1,186	351	437	168	3,698	3,997	17,867
2005	2,621	2,206	1,966	1,176	1,310	356	533	317	3,590	5,139	19,214
2006	2,664	2,306	2,062	1,168	1,346	370	595	392	4,244	5,042	20,189
2007	2,751	2,486	1,954	1,109	1,485	374	602	203	5,075	5,185	21,224
2008	2,685	2,566	1,731	1,685	1,497	349	622	405	4,682	5,066	21,288
2009	2,251	2,443	1,358	1,431	1,258	315	493	214	4,284	5,277	19,324
2010	2,215	2,418	1,288	1,402	1,254	343	549	219	4,458	4,268	18,414
2011	2,374	2,621	1,474	1,564	1,292	381	630	242	4,873	4,848	20,299
2012	2,445	2,937	1,758	1,590	1,492	387	722	257	5,049	5,276	21,913

Source: California State Board of Equalization, compiled by MuniServices LLC

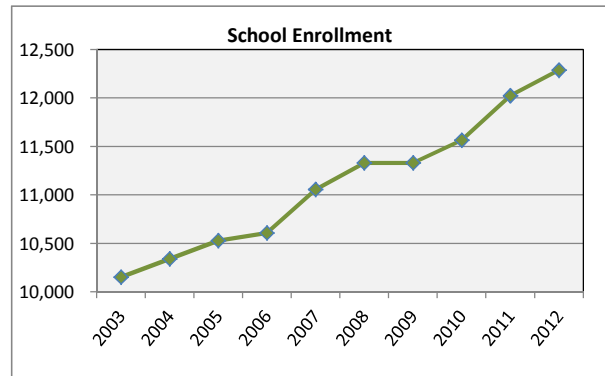
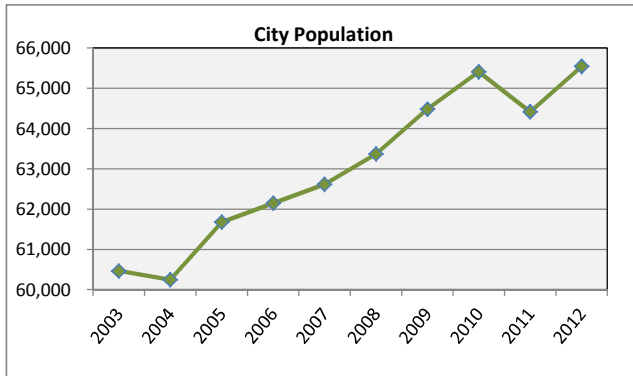
Sales Tax Rates for the Fiscal Year ended June 30, 2012

State Funds	6.00%
Local (County/City):	
County Transportation Funds	0.25%
City Operations (Palo Alto)	1.00%
Special District Tax Rate:	
Santa Clara County Transit District (SCCT)	0.50%
Santa Clara County Valley Transportation Authority (SCVT)	0.50%
	8.25%

Source: California State Board of Equalization

Note: Effective July 1, 2012, the sales tax rate increased to 8.375% as a result of the Santa Clara VTA BART Operating and Maintenance Transactions and Use Tax (.125%).

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 Enrollment	Santa Clara County Population	City Population as a Percentage of County Population	Santa Clara County Total Personal Income (in thousands)	Santa Clara County Per Capita Personal Income (in thousands)
2003	60,465	4.1%	10,151	1,729,917	3.50%	\$ 77,900,000	\$ 45,031
2004	60,246	3.2%	10,341	1,731,422	3.48%	78,500,000	45,338
2005	61,674	2.8%	10,527	1,759,585	3.51%	82,300,000	46,772
2006	62,148	2.5%	10,607	1,773,258	3.50%	88,300,000	49,795
2007	62,615	2.6%	11,056	1,808,056	3.46%	96,100,000	53,151
2008	63,367	3.5%	11,329	1,837,075	3.45%	103,500,000	56,340
2009	64,484	6.5%	11,329	1,857,621	3.47%	103,700,000	55,824
2010	65,408	6.2%	11,565	1,880,876	3.48%	99,500,000	52,901
2011	64,417	5.3%	12,024	1,781,427	3.62%	105,000,000	58,942
2012	65,544	4.7%	12,286	1,816,486	3.61%	113,200,000	62,318 *

Note: Data on personal income and per capita personal income is only available for Santa Clara County.

Source: California State Department of Finance (population)
 State Employment Development Office (unemployment rate)
 Palo Alto Unified School District (school enrollment)
 * California Department of Transportation Long-Term Socio-Economic Forecasts (personal income)

CITY OF PALO ALTO
Principal Employers
Current Year and Four Years Ago

Employer	FY 2012			FY 2008¹		
	Number of Employees	Rank	Percentage of Total City Employment	Number of Employees	Rank	Percentage of Total City Employment
Stanford University	10,680	1	9.7%	9,821	1	7.0%
Stanford University Medical Center/Hospital	5,059	2	4.6%	5,025	2	3.6%
Lucile Packard Children's Hospital	4,750	3	4.3%	3,326	4	2.4%
Veteran's Affairs Palo Alto Health Care System	3,500	4	3.2%	3,500	3	2.5%
Hewlett-Packard Company	2,201	5	2.0%	2,001	5	1.4%
Palo Alto Medical Foundation	2,200	6	2.0%	2,000	6	1.4%
Space Systems/Loral	1,870	7	1.7%	1,700	7	1.2%
Wilson Sonsini Goodrich & Rosati	1,650	8	1.5%	1,500	8	1.1%
Palo Alto Unified School District	1,362	9	1.2%	1,304	9	0.9%
City of Palo Alto	<u>1,017</u>	10	<u>0.7%</u>	<u>1,074</u>	10	<u>0.8%</u>
Total	<u>34,289</u>		<u>31.0%</u>	<u>31,251</u>		<u>22.3%</u>

Total City Day Population:

FY 2012	110,000
FY 2008	140,000

Notes: While unable to confirm the number of Palo Alto-based employees at SAP and VMware, Inc., Business Journal's Book of Lists dated December 2011, reports 2,100 employees at SAP and 2,806 employees at VMware, Inc. in Silicon Valley. SAP North America's headquarters is in Newton Square, PA while VMware's world headquarters is in Palo Alto.

¹Comparable data was not available until FY 2008.

Source: AtoZdatabases, <http://facts.stanford.edu/governance.html>, <http://facts.stanford.edu/hospital.html>, www.lpch.org/aboutus/, Palo Alto Unified School District 2011-12 Budget, The City of Palo Alto, A Report to Our Citizens, Business Journal Annual Book of Lists.

CITY OF PALO ALTO
Operating Indicators by Function/Program
Last Ten Fiscal Years¹

FUNCTIONS/PROGRAMS	Fiscal Year Ended June 30			
	2002	2003	2004	2005
<u>Governmental activities</u>				
Community Services				
Number of theater performances	187	173	175	172
Total hours of athletic field usage ²	-	-	-	65,748
Number of rounds of golf	89,450	87,892	83,728	78,410
Enrollment in recreation classes ²	-	16,281	16,435	15,127
Planning and Community Environment				
Planning applications completed	272	324	409	327
Building permits issued	3,241	3,151	3,236	3,081
Green Building permit applications processed ³	-	-	-	-
Caltrain average weekday boarding	3,241	2,906	2,825	3,264
Police				
Calls for service	57,292	53,143	52,489	52,233
Total arrests	3,153	2,851	2,577	2,134
Parking citations issued	55,437	52,422	47,860	52,235
Animal Services				
Number of service calls	2,803	3,545	3,575	4,994
Number of sheltered animals	3,614	3,849	3,780	3,514
Fire				
Calls for service	7,071	6,636	6,675	6,414
Number of fire incidents	285	260	248	224
Number of fire inspections	1,465	1,349	793	1,488
Library				
Total number of cardholders	45,112	49,448	50,171	52,001
Total number of items in collection	284,071	267,356	267,693	264,511
Total circulation	1,117,795	1,240,099	1,314,790	1,282,888
Public Works				
Street resurfacing (lane miles)	17	17	17	20
Number of potholes repaired	2,220	2,943	2,907	3,221
Sq. ft. of sidewalk replaced or permanently repaired	94,487	101,410	115,352	132,430
Number of trees planted	295	322	242	164
Total tons of waste landfilled	67,664	65,170	61,266	60,777
Tons of materials recycled	43,311	48,062	49,268	50,311
<u>Business-type activities</u>				
Electric				
Number of customer accounts	28,348	28,408	28,482	28,556
Residential MWH consumed	150,525	153,783	158,099	161,440
Gas				
Number of customer accounts	23,116	23,169	23,216	23,301
Residential therms consumed	12,497,401	11,875,753	11,700,335	12,299,158
Water				
Number of customer accounts	19,437	19,487	19,557	19,605
Residential water consumption (CCF)	2,915,487	2,844,916	3,000,645	2,686,507
Wastewater collection				
Number of customer accounts	21,772	21,819	21,830	21,763
Millions of gallons processed	8,699	8,704	8,238	8,497

Notes: ¹Ten most recent years available.

²Some data not available.

³In FY 2009, a new Green Building Program was established under the City's Green Building Ordinance to build a new generation of efficient buildings in Palo Alto that are environmentally responsible and healthy places in which to live and work.

Source: City of Palo Alto Service Efforts and Accomplishments Report

Fiscal Year Ended June 30

2006	2007	2008	2009	2010	2011
183	171	166	159	174	175
65,791	70,769	63,212	45,762	41,705	42,687
76,000	76,241	74,630	72,170	69,791	67,381
14,768	14,460	13,851	13,091	12,880	12,310
390	299	257	273	226	238
3,081	3,136	3,046	2,543	2,847	3,559
-	-	-	341	556	961
3,882	4,132	4,589	4,863	4,796	5,501
57,017	60,079	58,742	53,275	55,860	52,159
2,530	3,059	3,253	2,612	2,451	2,288
56,502	57,222	50,706	49,996	42,591	40,426
2,861	2,990	3,059	2,873	2,692	2,804
3,839	3,578	3,532	3,422	3,147	3,323
6,897	7,236	7,723	7,549	7,468	7,555
211	221	192	239	182	165
899	1,021	1,277	1,028	1,526	1,807
55,909	53,099	53,740	54,878	51,969	53,246
260,468	270,755	279,403	293,735	298,667	314,154
1,280,547	1,414,509	1,542,116	1,633,955	1,624,785	1,476,648
20	32	27	23	32	29
2,311	1,188	1,977	3,727	3,149	2,986
126,574	94,620	83,827	56,909	54,602	71,174
263	164	188	250	201	150
59,276	59,938	61,866	68,228	48,955	38,524
56,013	56,837	52,196	49,911	48,811	56,586
28,653	28,684	29,024	28,527	29,430	29,708
161,202	162,405	162,680	159,899	163,098	160,318
23,353	23,357	23,502	23,090	23,724	23,816
11,745,883	11,759,842	11,969,151	11,003,088	11,394,712	11,476,609
19,645	19,726	19,942	19,442	20,134	20,248
2,647,758	2,807,477	2,746,980	2,566,962	2,415,467	2,442,415
21,784	21,789	21,970	21,210	22,231	22,320
8,972	8,853	8,510	7,958	8,184	8,652

CITY OF PALO ALTO
Capital Asset Statistics by Function/Program
Last Ten Fiscal Years

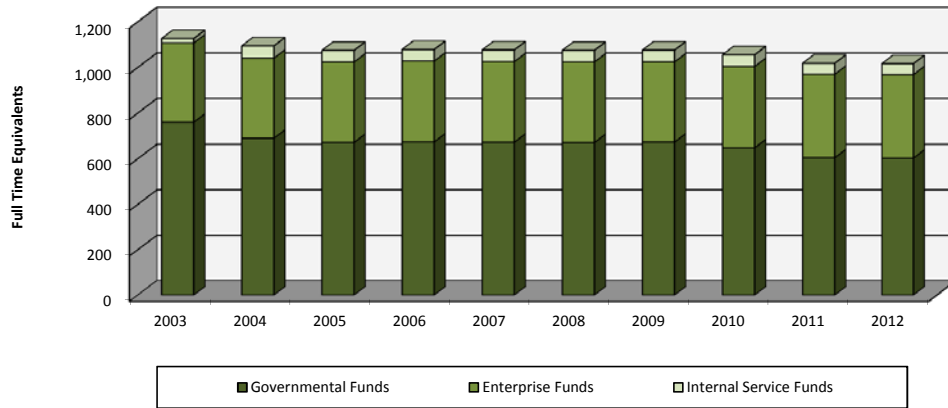
FUNCTION/PROGRAM	Fiscal Year Ended June 30			
	2003	2004	2005	2006
Public Safety				
Fire:				
Fire Stations	8	8	8	8
Fire Apparatus	22	23	25	25
Police:				
Police Stations	1	1	1	1
Police Patrol Vehicles	33	30	30	30
Community Services				
Acres - Downtown/Urban Parks	170	170	170	170
Acres - Open Space	3,731	3,731	3,731	3,731
Parks and Preserves	34	34	35	35
Golf Course	1	1	1	1
Tennis Courts	52	52	52	52
Athletic Center	1	1	1	1
Community Centers	4	4	4	4
Theaters	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	5	5	5
Public Works:				
Number of Trees Maintained	34,939	35,440	35,096	34,841
Electric Utility¹				
Miles of Overhead Lines	227	227	225	217
Miles of Underground Lines	186	186	188	210
Water Utility				
Miles of Water Mains	226	226	226	217
Gas Utility				
Miles of Gas Mains	207	207	207	207
Waste Water				
Miles of Sanitary Sewer Lines	202	202	202	202

Note: ¹The City of Palo Alto Utilities Department recently completed the conversion of its electric system maps to a GIS mapping system database. Therefore, the distances reported in FY 11/12 are more accurate than the distances reported in previous years.

Source: City of Palo Alto

Fiscal Year Ended June 30					
2007	2008	2009	2010	2011	2012
8	8	8	8	8	7
25	23	28	28	27	29
1	1	1	1	1	1
30	30	30	30	30	30
157	157	157	157	157	157
3,744	3,744	3,744	3,744	3,744	3,744
36	36	36	36	36	36
1	1	1	1	1	1
51	51	51	51	51	51
4	4	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
3	3	3	3	3	3
5	5	5	5	5	5
34,556	35,322	35,255	35,289	35,241	35,138
194	193	193	193	193	223
252	253	253	253	253	245
217	217	214	214	214	234
207	207	207	205	205	210
202	202	207	207	207	217

CITY OF PALO ALTO
Full-Time Equivalent City Government Employees by Function
Last Ten Fiscal Years



Full Time Equivalent Employees as of June 30

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
<u>Governmental Funds</u>										
General Fund:										
Administrative	145	101	96	97	99	99	98	89	83	83
Community Services	153	145	98	99	97	96	97	94	75	74
Fire	133	129	126	127	127	127	127	123	121	122
Library ¹	-	-	44	44	44	44	44	42	41	41
Planning and Community Environment	59	55	53	53	53	53	53	49	45	43
Police	178	171	165	164	163	163	164	162	157	157
Public Works ²	94	76	68	68	68	68	69	64	59	56
Subtotal General Fund	761	676	650	652	651	650	651	623	580	576
All Other Funds:										
Capital Projects Fund	-	13	20	20	20	20	21	25	24	24
Special Revenue Fund	-	1	1	1	1	1	1	1	2	2
Total Governmental Funds	761	690	672	674	672	671	673	648	605	603
<u>Enterprise Funds</u>										
Public Works ³	110	111	113	113	113	113	114	115	115	115
Utilities ⁴	230	234	234	236	235	235	238	242	251	251
External Services ⁵	7	6	6	6	6	6	-	-	-	-
Total Enterprise Funds	347	351	353	355	353	353	352	356	366	366
<u>Internal Service Funds</u>										
Printing and Mailing	4	4	5	5	5	4	4	4	2	2
Technology	-	33	30	30	30	30	31	31	30	30
Vehicle Replacement	15	16	16	16	16	16	16	16	16	16
Total Internal Service Funds	19	53	50	50	51	50	51	51	48	48
Total	1,127	1,094	1,074	1,079	1,076	1,074	1,076	1,055	1,019	1,017

Note: ¹Library became its own entity effective 2005. Prior to 2005, Library was part of Community Services.
²Fleet and Facilities Management
³Refuse, Storm Drainage, Wastewater Treatment
⁴Electric, Gas, Wastewater Collection, Water
⁵Effective in 2009, External Services was dissolved. 5 FTEs were eliminated and 1 FTE was transferred to the Technology Fund.

CITY OF PALO ALTO
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For the Year Ended June 30, 2012

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

INDEPENDENT AUDITOR'S 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

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Palo Alto, California (City), as of and for the year ended June 30, 2012, which collectively comprise City's basic financial statements and have issued our report thereon dated November 26, 2012. We conducted our audit in accordance with auditing standards generally accepted 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

Management of City is responsible for establishing and maintaining effective 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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity'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 previously.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether 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 or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Mayor and City Council, management, others within the entity, 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.

Macias Gini & Connell LLP

Walnut Creek, California
November 26, 2012

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

**INDEPENDENT AUDITOR'S 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**

Compliance

We have audited the compliance of the City of Palo Alto, California (City) with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on the City's major federal program for the year ended June 30, 2012. The City's major federal program is 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 its major federal program is the responsibility of City's management. Our responsibility is to express an opinion on City's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about 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 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 its major federal program for the year ended June 30, 2012. 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 2012-1.

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.

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.

Our consideration of internal control over compliance 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 compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified a certain deficiency in internal control over compliance that we consider to be a significant deficiency as described in the accompanying schedule of findings and questioned costs as item 2012-1. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

The City's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the City's response and, accordingly, we express no opinion on the response.

This report is intended solely for the information and use of the Mayor and City Council, management, others within the entity, 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.

Macias Gini & Cunnell LLP

Walnut Creek, California
November 26, 2012

CITY OF PALO ALTO
Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2012

Grantor/Pass-Through Grantor/Program Title	Grantor Identifying Number	Federal CFDA Number	Expenditures	Subrecipients Expenditures
U.S. Department of Housing and Urban Development				
<i>Direct</i>				
CDBG - Entitlement Grants Cluster Community Development Block Grants/Entitlement Grants	B-10-MC-06-0020	14.218	\$ 882,196	\$ 748,885
U.S. Department of Interior				
<i>Direct</i>				
ARRA - Water Reclamation and Reuse Program	R10AP20003	15.504	209,547	-
U.S. Department of Justice				
<i>Direct</i>				
ARRA - Edward Byrne Memorial Justices Assistance Grant (JAG) To Units of Local Government	2009-FY118-CA-SB	16.804	6,807	-
U.S. Department of Transportation				
<i>Pass-through from State of California Department of Transportation</i>				
ARRA - Highway Planning and Construction	HSIPL 5100015	20.205	138,033	-
ARRA - Highway Planning and Construction	5100-017	20.205	2,004	-
Total Highway Planning and Construction			140,037	-
Institute of Museum and Library Services				
<i>Direct</i>				
Conservation Project Support	IC-21-11-0124-11	45.303	3,000	-
<i>Pass-through from California State Library</i>				
Grants to States	LS-00-11-0005-11	45.310	1,000	-
Total Institute of Museum and Library Services			4,000	-
U.S. Department of Energy				
<i>Direct</i>				
ARRA - Energy Efficiency and Conservation Block Grant	DE-SC0002146	81.128	35,644	-
U.S. Department of Homeland Security				
<i>Pass-through from City and County of San Francisco</i>				
Homeland Security Grant Program	None	97.067	13,500	-
<i>Pass-through from County of Santa Clara</i>				
State Homeland Security Grant	2008-0006	97.073	25,000	-
Total U.S. Department of Homeland Security			38,500	-
TOTAL FEDERAL FINANCIAL AWARDS			\$ 1,316,731	\$ 748,885

CITY OF PALO ALTO
Notes to the Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2012

NOTE 1 – REPORTING ENTITY

The Schedule of Expenditures 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 measurement focus applied. All governmental funds are accounted for using the modified accrual basis of accounting. All proprietary funds are accounted for using the basis of accounting. Expenditures of federal awards reported on the Schedule are recognized when incurred.

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.

NOTE 4 – RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Amounts reported in the Schedule agree to or can be reconciled with the amounts reported in the related federal financial reports.

NOTE 5 – RELATIONSHIP TO BASIC FINANCIAL STATEMENTS

Federal awards and expenditures agree to or can be reconciled with the amounts reported in the City's basic financial statements.

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2012

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued on the basic financial statements of the City:	Unqualified
Internal control over financial reporting:	
◆ Material weakness(es) identified?	No
◆ Significant deficiency(ies) identified that are not considered to be material weaknesses?	None reported
Noncompliance material to the financial statements noted?	No

Federal Awards

Internal control over major programs:	
◆ Material weakness(es) identified?	No
◆ Significant deficiency(ies) identified that are not considered to be material weaknesses?	yes
Type of auditor's report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?	Yes
Identification of Major Program:	14.218 CDBG – Entitlement Grants Cluster
Dollar threshold used to distinguish between type A and type B programs:	\$300,000
Auditee qualified as a low-risk auditee?	No

Section II – Financial Statement Findings

None noted in current year.

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2012

Section III - Federal Award Findings and Questioned Costs

Reference Number: 2012-1
Federal Program Title: CDBG – Entitlement Grants Cluster
Federal Catalog Number: 14.218
Federal Agency: U.S. Department of Housing and Urban Development
Pass-Through Entity: N/A
Federal Award Number and Year: B-11-MC-06-0020 and 2011-2012
Category of Finding: Reporting

Criteria:

Under the Federal Funding Accountability and Transparency Act (FFATA), all prime grant recipients awarded a new federal grant greater than or equal to \$25,000 as of October 1, 2010, are subject to FFATA sub-award reporting requirements, as outlined in the Office of Management and Budget guidance issued August 27, 2010. The prime grant recipient is required to file a FFATA sub-award report by the end of the month following the month in which the prime grant recipient awards any sub-grant greater than or equal \$25,000. During the FY2012, the City, as prime grant recipient of the CDBG entitlement grant from HUD, sub-granted funding to various subrecipients with a total contract amount of \$1.2 million. Actual allowable costs reimbursed to subrecipients were \$748,885 for eight sub-grantees. Out of the eight sub-awards with federal expenditures, six of them were in amounts individually greater than \$25,000 and, accordingly, subject to the reporting requirements under the FFATA. The total expenditures of the six sub-awards not reported under the FFATA were in the amount of \$733,885.

Condition:

The City did not report the sub-award information related to the 6 sub-grantees to the FFATA Sub-award Reporting System (FSRS) during FY2012.

Cause:

The City was unaware of the FFATA reporting requirement, which became applicable to the sub-grants awarded during FY2012.

Effect:

The City is not in compliance with the FFATA reporting requirements.

Questioned Costs:

N/A – although the sub-grants were not reported, they are expenditures passed to the sub-grants for allowable activities.

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2012

Section III - Federal Award Findings and Questioned Costs (Continued)

Recommendation:

We recommend the City to review the compliance supplements updates annually to ensure all new compliance requirements are considered and performed. The information is available to the public on the website of Office of Management and Budget, which is updated annually. The supplements detail the existing and new compliance requirements by federal grant program. The City should review the supplements prior to the new fiscal year starts and discuss with HUD contact for any questions.

Management Response and Corrective Action Plan:

Due to Staff changes, the City was not aware that the FFATA reporting was required. Staff has obtained the necessary approvals for the FFATA Sub-award Reporting System and will begin to enter information for the applicable sub-grants awarded. In addition, City Staff will continue to closely monitor changes in compliance requirements and review the supplements prior to the start of the new fiscal year.

CITY OF PALO ALTO
Schedule of Prior Audit Findings and Questioned Costs
For the Year Ended June 30, 2012

Schedule of Prior Year Findings and Questioned Costs

Finding #SA 2011-1

Reporting

Federal Program Title: ARRA – Energy Efficiency and Conservation Block Grant Program

Federal Catalog Number: 81.128

Condition: Under Appendix 6 of the grant agreement and per discussion with the Contract Specialist from the Department of Energy, the Itemized Cost Report is due quarterly along with the SF-425 Reports. The City did not submit the required itemized costs reports on a quarterly basis during the fiscal year. As corrective action, City Staff has already emailed the quarterly itemized cost reports dating back to Q1, 2010 to the EECBG Contract Specialist at the DOE on November 17, 2011. In the future, when staff submits the quarterly ARRA reports, staff will continue to email the itemized cost reports to the EECBG Contract Specialist.

Status of Corrective Action Plan: Corrected.

Finding #SA 2011-2

Reporting

Federal Program Title: ARRA – Energy Efficiency and Conservation Block Grant Program

Federal Catalog Number: 81.128

Condition: There is no evidence that shows the management review and approval on the required reports. The lack of documentation prevents management from demonstrating that the internal control is operating as designed to ensure the reports were prepared accurately in accordance to the program requirements. In addition, while the Utility Marketing Service Manager is familiar with the Home Energy Program only, the information related to LED Street Light program were not adequately reviewed. As part of the corrective action plan, the draft report will be emailed to the Supervising Electric Engineer who oversees the LED Streetlight project for approval; the email correspondence with the Supervising Electric Engineer will be printed and filed with the paper approval as back-up documentation of management review.

Status of Corrective Action Plan: Corrected.

CITY OF PALO ALTO
Schedule of Prior Audit Findings and Questioned Costs
For the Year Ended June 30, 2012

Finding #SA 2011-3

Schedule of Expenditures of Federal Awards Reporting

Federal Program Title: ARRA – Energy Efficiency and Conservation Block Grant Program

Federal Catalog Number: 81.128

Condition: 2 invoices were not included in the preliminary SEFA provided by the Administrative Services Department of the City due to a coding error in the general ledger. The related expenditures were for allowable costs under the program guidelines incurred in the current fiscal year. Therefore, the expenditures should be reported as part of the program expenditures on the SEFA for the current fiscal year.

In the future, staff will keep a hard copy of the financial reports reflecting both federal and city expenditures.

Status of Corrective Action Plan: Not applicable as the City did not have any expenditures incurred in current year under this program.

Finding #SA 2011-4

Subrecipient Monitoring

Federal Program Title: CDBG – Entitlement Grants Cluster

Federal Catalog Number: 14.218

Condition: The City did not communicate the CFDA and Federal Award numbers to the subrecipients at the time of the sub-awards. The finding in the FY 2010 single audit occurred after the FY 2011 subrecipient awards and subsequent contracts had been issued. As such, the information was not communicated to the subrecipients nor was it included on the CDBG subrecipient contracts. For FY 2012, the CFDA title and number has been provided on all CDBG subrecipients contracts.

Status of Corrective Action Plan: Corrected.

CITY OF PALO ALTO
Schedule of Prior Audit Findings and Questioned Costs
For the Year Ended June 30, 2012

Finding #SA 2011-5

Suspension and Debarment

Federal Program Title:

CDBG – Entitlement Grants Cluster

Federal Catalog Number:

14.218

Condition:

The City did not perform a debarment and suspension check on the sub-grantees when awarding sub-grants in FY 2011. Six sub-grantees were selected for testing, and all of them did not have documentation that their status was verified in EPLS, although based on our testing, none of them were noted as debarred or suspended in the EPLS. In the future, prior to awarding a CDBG Allocation, the City will perform a debarment and suspension check for all subrecipients.

Status of Corrective Action Plan:

Corrected.

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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.

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AMERICANS WITH DISABILITIES ACT STATEMENT

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

For information contact:
ADA Coordinator
250 Hamilton Avenue
(650) 329-2550
ADA@cityofpaloalto.org

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