



# City/School Liaison Committee Minutes



Regular Meeting  
September 18, 2014

The City School Liaison Committee met at 8:34 A.M. in the City Council Conference Room, 250 Hamilton Avenue.

Present: City of Palo Alto Representatives  
Liz Kniss, Vice Mayor, Committee Chair  
Greg Schmid, Council Member  
Khashayar Alaei, Senior Management Analyst

Palo Alto Unified School District Representatives  
Dana Tom, Board Member  
Heidi Emberling, Board Member  
Cathy Mak, District Chief Business Officer

Absent:

## ORAL COMMUNICATIONS

Mark Weiss spoke regarding his interest in the school system and their football team. He discussed rent being raised; he suggested rent control.

## APPROVAL OF MINUTES

**MOTION:** Board Member Tom moved, seconded by Council Member Schmid that the City School Liaison Committee approve the minutes of August 21, 2014.

**MOTION PASSED:** 4-0

3. PAUSD Property Tax Report.

Joe Saccio, Assistant Director of Administrative Services discussed Property Taxes and the sources of Property Tax and Secured Property Tax.

Chair Kniss noted that schools were separately funded from cities; most cities on the East Coast had combined budgets.

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Mr. Saccio answered that most residents did not know that the City received \$.09 for every Property Tax dollar. It was possible that people thought that City operations were fundamentally funded by Property Taxes. Property Taxes represented about 18 percent of the revenue in 2013; Property Taxes amounted to \$29 million.

Tarun Narayan, Senior Management Analyst mentioned that the City received a Secured Property Tax twice per year; there was the Motor Vehicle License Fee, which was the In Lieu Fee and was paid twice per year. Unsecured Property Tax was also received twice per year, but the majority of it was paid in October. The City's Property Tax budgeting forecast started in December every year, and went through to the following May. The County of Santa Clara (County) did their own forecasting, but they did not start their process until August, so the City had to complete their forecast before the County released their information. The City used a 10-20 percent average growth rate as a guideline for their Budget Forecast and received monthly assessments from the County's office, which was factored in with recent trends. This was done to ensure that the forecast was a realistic number.

Chair Kniss asked Staff for the past 20 years of fluctuation.

Mr. Narayan did not have that information.

Chair Kniss requested that Staff e-mail that information to the City School Liaison Committee (Committee).

Mr. Narayan answered yes and reiterated that Staff used the 10-20 year average of recent trends to come up with the forecast for the Long Range Forecast and Budget. The County performed a separate Budget Forecast, which was based on the Property Tax Assessment. Later, when Staff projected their median, they took the County's forecast, and then made adjustments to the City's Property Tax Budget. Regarding the Budget Performance from 1992 and 1993 to 2012 or 2013, there was an average compound growth rate of 5.5 percent, which was also used as a basis for forecasting. This allowed people to see what the actual Adopted Budget was, compared to what the performance was because there were a few percentage variants. Fiscal Year 2013 was abnormal because in that year, the County and cities within the County had a dispute about how they determined Administrative Fees. He reiterated that Property Taxes represented 18 to 19 percent of the General Fund revenue.

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Mr. Saccio remarked on the volatility of the revenue and said when recessions hit Palo Alto there was a slight dip in the revenue level, and then the revenue would continue to increase as the economy improved. The same was the case for the Sales Tax and the Transient Occupancy Tax (TOT). It was noted in Council sessions that there was a shift in Property Taxes from the Commercial to Residential sector. Since 2005 there was a shift from 66 percent residential and 34 percent commercial to 74 residential and 26 commercial and an eight percent increase in the residential contribution toward Secured Taxes.

Chair Kniss questioned the rental to homeownership ratio.

Mr. Saccio said about 45 percent were renters.

Heidi Emberling, Palo Alto Unified School District (PAUSD), Board Member requested clarification.

Mr. Saccio explained that 45 percent of the people that resided in Palo Alto were renters. Regarding the Comprehensive Financial Annual Report, Staff and Council were interested in the potential for Property Tax increase over time. Staff created a profile of the number of single-family homes within certain categories and what their values were. There were 1,700 homes that were within the \$0 to \$99,999 value. As a result of Proposition 13, a proposition proposing a decrease in Property Taxes by assessing property values at their 1975 value, restricting their annual increases of assessed value not to exceed two percent per year, there was a lot of potential for Property Tax increase as homes were turned over. The houses under \$600,000 represented 42 percent of homes in Palo Alto, and that represents only 10 percent of the assessed value.

Chair Kniss clarified what capacity meant and said that meant if the houses were sold.

Mr. Saccio agreed and said that was if there was turnover. For example, he assumed there was an annual turn-over rate at five percent of the properties that were under \$600,000. If those houses sold for \$1,500,000, there would be about 7,000 properties in that category. The average assessed value for those properties were around \$245,000, which was extremely low.

Chair Kniss predicted that as a result of Proposition 13, many people would feel like they were in a difficult situation because it was hard to leave a house that had low taxes.

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Mr. Saccio mentioned the one percent Tax Increment, which was related to the Secured and the Unsecured Tax. He illustrated that if the City received \$.09 for every Property Tax dollar, and if these properties appreciated and were turned over at a rate of five percent, there was going to be an increase of \$397,000 in Property Taxes. The School District received more than that; his presentation illustrated there was a capacity for increase in the future.

Chair Kniss questioned whether that was the average turnover.

Mr. Saccio said yes, roughly.

Mr. Narayan remarked that the residential turnover was about three percent. This number fluctuated on any given year, but the average was three percent. When property was turned over from its assessed value to the properties new market value, this equaled about 63 percent of a value increase on the Assessor's Role. Many of the properties had a low assessed value; when they changed market value, there was significant uptake on the three percent of the properties that were turned over.

Chair Kniss thought this conversation illustrated what the City received and what the School District received. She wanted to discuss Basic Aid and how that changed the profile for the School District.

Cathy Mak, District Chief Business Officer noted that the unique characteristic of Basic Aid was that the Property Tax revenue was higher than what the State's calculation was.

Chair Kniss remarked that was connected to the average daily attendance.

Ms. Mak said the Property Taxes were higher, so the School District was able keep that funding. The School Districts share of the formula of calculated funding was higher than what a State funded District would be.

Chair Kniss stated that there were about 1,100 school districts in that range; she questioned how many of the 1,100 were Basic Aid districts.

Ms. Mak said that changed every year. When the recession hit, the number increased to about 140. Now, with the State's Local Control Funding Formula, the State planned on incrementally, for the next six or seven years, increasing the funding for all the other State funded districts. There was an anticipated drop over the next couple of years.

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Chair Kniss wanted to make clear that was the number of Basic Aid districts.

Ms. Mak said yes.

Chair Kniss questioned whether there were 140 Basic Aid districts now.

Dana Tom, Palo Alto Unified School District, Board Member said recently there were 60 Basic Aid districts. State funding dropped so much that school districts fell into Basic Aid status.

Chair Kniss thought it was good to be reminded that the City received less than 10 percent of the revenue and PAUSD received close to 20 percent. The revenue was fairly level and predictable over the last 20 to 30 years.

Chair Kniss left the meeting at 8:57 A.M.

Ms. Emberling wanted to know what factors influenced the budgeting process in terms of assuming the annual growth rate because the City's growth rate was close to the actual rate and PAUSD's was close to two percent.

Mr. Saccio noted that when the City wanted to look at the Long Range Financial Forecast for the next 10 years, they wanted know what the actual revenues were in the coming fiscal year (FY). The City used the actual Compounded Annual Growth Rate when they looked at the following FY revenues, then, as information came in, the City modified the Forecast in terms of what the Budget was. The City also modified the following year's Budget based off what came in during the FY. He understood PAUSD started off with two percent, which was conservative given the historical situation, and then they modified it throughout the year when better information from the County came in. The City took more of an aggressive stab at what was going to happen. They were different approaches, but in the end, the City and PAUSD should see similar growth.

Ms. Emberling wanted to know if that was problematic in the past few years when there was economic downturn below two percent.

Mr. Saccio relayed that the City used to factor in recessions every eight or nine years, but the Finance Committee felt it was conjecture to factor in recessions. When recessions happened, Staff adjusted the Budget

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accordingly. This was even more of a factor with the more economically sensitive revenue, such as TOT and Sales Tax.

Ms. Emberling questioned what TOT was.

Mr. Saccio replied it was the Transient Occupancy Tax for the Hotel Tax. This presented an issue when Staff budgeted 5.5 percent for the growth rate and they only received one percent.

Ms. Emberling explained that PAUSD's concern dealt with laying off teachers.

Ms. Mak explained that Property Tax accounted for about 72 percent of PAUSD's total revenue. They received about nine percent in revenue from the State and the Federal Government, and the remaining 20 percent was from the Lease Revenue sites, donations, and other local income. Property Tax growth was cyclical, it mirrored the economy and in looking at the up-cycles, there was double digit growth, but this type of growth was not seen anymore. Right now, PAUSD was in the third year of a good cycle because Property Tax grew between six and seven percent. Regarding the Long Range Budget Projection, PAUSD used a two percent growth, which was very conservative. During the July 1, 2014 Budget, PAUSD used a three percent growth, and then in August, received the report from the County Assessor's Office and the estimated growth for the current year; this was 6.36 percent, or about \$4.4 million. Regarding the breakdown for Property Tax revenue, PAUSD received revenue for Secured and Unsecured Tax, and some from Home Owners Exemption. There was a budgeted three percent increase in all three categories but the County's estimates were all very different. This showed how unpredictable Property Tax Revenue was. The terms of distribution were estimated at: Secured Tax \$125 million, or 92 percent; seven percent Unsecured Tax, or \$9 million; and less than one percent in Homeowners Exemption, or \$700,000. Some problems in projecting Property Tax growth were no projections were provided by the County Assessor, there was a high level of uncertainty, and there was delayed information. Due to the delay in information, PAUSD did not assume what the Property Tax was going to be when they built their Budget, whereas the City used a 10-20 year average when planning their forecast. The recession that just passed illustrated why averages for an extended amount of time were not a good index when building a Long Range Budget. She noted that a lot of school districts got into trouble for issuing bonds after the 2008 recession. She added that typically consultants used a five to seven year rolling average. The reason why PAUSD used a two percent growth in the Property Tax assumption was: 1) two percent was what was needed to cover or rollover the previous year's budget; and 2) Proposition 13 capped the

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increase in Property Tax to two percent. In August, when PAUSD received their numbers from the County, they updated their Budget but recently they started to use a three percent growth rate, which she was going to explain later, as the School District just started the process of allocating additional funding. Another reason three percent was used was due to program needs and increased pension costs; two percent was not enough to cover all the costs that rolled over from the previous year to the current year. In June, 2014 the State Legislature passed a State Pension Funding Plan which called for an increase in pension for the next seven years, which was going to be a substantial amount. The School District expected that two percent was not enough now and that three or four percent was needed to cover the rollover Budget. The pension cost increase was about \$2.1 million every year for the next six years, which equated to about 1.5 percent of the Property Tax growth; 3.5 percent was going to be needed over the next six years to cover the rollover Budget. Throughout the year when updates were received from the County Assessor's Office and the County Controller's Office, August was the time when the first set of numbers were received, then there were quarterly meetings with the County Assessor's Office and the County Controller's office. During those times, PAUSD staff provided updates to the City School Board and revised their Budget. In recent years, the change from August to the end of the year was less than one percent. There was information PAUSD monitored throughout the year, but because there was no projection from the County, the quarterly updates were able to provide information about building permits that were coming in that were related to appeals or refunds. The Consumer Price Index (CPI) cycle was from October to October; beginning with the summer; PAUSD tracked CPI and were able to see whether it would be below two percent. The School Districts' presentation was focused on Property Tax growth, as well as having information put together about PAUSD's overall financial condition. She discussed PAUSD being a Basic Aid District and said that meant more money was received from Property Tax revenue but PAUSD still had budget problems. Being a Basic Aid District and also enduring a recent change in the State funding formula, compared to the recent recession, the State revenue dropped significantly; State revenue used to be 10 or 11 percent, it was now about six percent. This meant a \$7.5 million cut in State funding, beginning in 2008 and continuing until now. This funding was lost forever due to the new funding formula. The State funding increase was going to have a significant impact on the Budget, which would deal with about 1.5 percent of the Property Tax growth. Being Basic Aid, PAUSD no longer received funding for each student and enrollment was growing about two percent over the past 10 to 12 years.

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Ms. Emberling mentioned there was a discussion at the last School Board Meeting about student growth and said in the past six years, or since 2008, the revenue for student growth was about five percent, the enrollment growth was about 11 percent, and CPI growth during that time was 13 percent. This meant that PAUSD did not get any extra money for enrollment and that the Budget was just spread thinner.

Council Member Schmid highlighted that PAUSD and the City had different financial forecasts; the City had 5.5 percent growth rate and PAUSD used two percent. He was concerned that the City was headed toward a two percent growth rate because the numbers that were given by both the School District and the City built elements of a story. Historically, the City had 5.5 percent growth rate, which accounted for 20 percent revenue, but City Tax Revenue was closer to 1/3 of the Budget, adding the Documentary Tax, which was tied to Property Tax, and the Tax Revenue, which was a large share of the Budget. This showed that continued to be the fastest growing revenues.

Mr. Tom clarified that they were the fastest growing.

Council Member Schmid reiterated that these were the most important sources of revenue for PAUSD. One concern was that the commercial share declined one percent per year in the past nine years. There was extensive commercial growth over the past four years, but it was declining as well, which was a function of Proposition 13. Commercial properties endured and there were more burdens on residential turn over. Staff indicated that the key part of residential turnover was the turnover of older homes. In PAUSD's presentation, there was good picture of Property Tax growth, which showed that Property Tax grew higher in early 2000's than it did in the last four years, but sales value of homes in the last four years was much higher than they were in the early 2000's. This indicated that less Property Taxes were received out of residential turnover then was received previously. Families understood what commercial property owners were doing, so they turned over an increased amount of their residential properties to family trusts and family trusts did not get revalued at the same rate. The rental property number was a critical early indicator that if rentals went up, there were more people with family trusts renting properties, rather than selling. Since 1987, the School District was growing about two percent per year, which was two percent points higher than the City from 1987 to 2000; from 2000 to 2013, the City started growing about one percent per year and the School District continued to grow about two percent. There were indications now that the School District was not growing.



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Ms. Mak clarified that growth slowed down, not stopped.

Council Member Schmid recalled that the twelfth day enrollment growth was listed as zero percent.

Ms. Mak clarified that there were actually 59 students.

Council Member Schmid noted that this was the first time in thirty years that the School District was growing slower than the City. This might indicate that the health in the Property Taxes and the ability to attract young families who were willing to pay a premium on housing was declining. The City was not going to see the leveraged Property Tax growth rates that were seen in the past. As a result, the City was encouraging smaller sized housing for young workers, not families. The net revenue increase that was received from Property Taxes, which was about 40 percent, came from the sale of pre-Proposition 13 housing. The numbers from the School District and the City may have had different uses, but raised profound issues that were deeply disturbing, maybe not for the next fiscal year but for the future. The City and the School District were paying increased amounts for retirees and for healthcare, and both of those numbers were growing four to five percent per year. Hearing the presentations of the City and the School District told a story that everyone should be sensitive to, considering the long-term obligations.

Mr. Saccio thought the point was well taken. Old growth rates were quite high, until 2009, but were now certainly lower.

Council Member Schmid added that property values were going up higher than they were before.

Mr. Saccio remarked that apart from the two percent growth rate from 2016 and out, Staff was seeing lower growth, but it was within the five percent range. This was expected to continue for the next four to six years. He suggested being cautious on the out years, and suggested taking a good look at the forecast. He agreed that there were a lot of trusts on the Documentary Transfer Tax list.

Mr. Narayan agreed and said there were a lot of "TR" notations on the property list, which indicated they were trusts. More and more properties were showing that activity.

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Council Member Schmid inquired whether that was part of a public record and wanted to know if the City was able to start reporting that.

Mr. Saccio said that County was good at getting data regarding the Property Tax, but the Documentary Transfer Tax was listed line by line. He said he would look into it and suggested taking samples and extrapolations beyond the list. He questioned whether Staff kept prior year reports.

Mr. Narayan said yes and said they listed all the parcel numbers and names. Putting the information into a summary format was useful to the larger audience.

Council Member Schmid thought that information was good to track as an economist, but as a publicist, the information was not so good to track.

Mr. Saccio agreed with the information about trusts but said there was a lot of money people earned by renting out the houses. It was good to get a handle on that because people were deciding not to sell, and instead having an income stream.

Council Member Schmid remarked that the volatility of a rental was very different from a family that bought into the community and was committed to it.

Mr. Saccio mentioned that the two percent of reserve for rollover seemed low, even though he knew it was adjusted during the year. He recalled that PAUSD allocated the additional monies for raises, but he thought the original projection seemed low. Staff was aware of the pension increases and they factored that into their Budget. The figures looked good for the next few years, as the result of the stock market, but he thought it was necessary to plan based off what those figures showed.

Walter Rossmann, Budget Director noted that last year there was a change with CalPERS, the City retirement plan; it was now facing the five year projection as opposed to a seven year projection. Last year Staff was able to see the impact right away, but with next year's Budget, Staff thought they would see the smoothing right away; they expected to see the adjusted increases in the interest rate performance, or decreases in the performance versus an immediate change in the place of a five year period projection.

Council Member Schmid confirmed that information was going to be available in October.

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Mr. Rossmann said yes, Staff expected to get the information at the end of October, and thought they would relay the information to the Finance Committee in early December.

Mr. Narayan added that although the County did a good job in providing basic information, it was difficult to get the detailed information. Last year was the first year Staff engaged the services of an outside source to provide more details on how many parcels were in different price ranges, how often they turned over, and other related information. Staff wanted to get a deeper understanding to be better prepared to incorporate that information in their forecast so there were no surprises as the long-term projection changed. Beyond three to seven years in the forecast, there were a lot of assumptions but Staff was trying to gather as much information as possible.

Council Member Schmid reminded Staff that the parcels that were still under Proposition 13 had a growing incentive to move into a trust.

Mr. Saccio thought it would be interesting to see the data on the commercial properties because there were a lot of commercial properties that were in the same situation and that have benefitted from Proposition 13. He recalled that there was some effort on the part of the State Legislature to take away some of the loopholes on commercial properties.

Council Member Schmid inquired whether that was recent because he recalled a Bill that required a 90 percent turnover instead of a 100 percent turnover in properties.

Mr. Saccio thought the data would be interesting to look at.

Ms. Emberling inquired whether it was mentioned that commercial Property Tax declined about one percent.

Council Member Schmid clarified that the share declined about one percent.

Mr. Saccio conveyed that share shifted by eight or nine percent, about one percent per year toward residential property.

Mr. Tom noted that could also be thought of as Residential Property Tax increasing by one percent per year.

Council Member Schmid agreed and said that was where the growth was.

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Mr. Tom remarked that was where the turnover was because commercial properties had almost zero turnover. He added that Property Tax Revenue growth and taking into account the enrollment growth rate were the two biggest Budget draws PAUSD had. Property Tax was the largest revenue, and enrollment growth drove the Budget changes. When the two factors were divided out, the PAUSD Budget was negative because their Revenue growth was very modest and there was continued enrollment growth. Enrollment growth did not affect the City Budget at all, but it was the main driver for PAUSD's Budget; they had a much less diverse source of revenue than the City, which also made the two Budgets' different.

Mr. Saccio remarked that there could be a lot of volatility between the two revenue sources. The City's Budget was very diverse, even compared with other Cities, which was a benefit. In each recession there was in the past, there was a severe fall off in the TOT, the Hotel Tax, and the Sales Tax; the Documentary Transfer Tax fell off too because people were not selling their homes. Palo Alto did not see much of the effects of a recession; values of homes plateaued but there was a stable revenue stream; Palo Alto was much more stable than other cities in this district.

Mr. Tom mentioned that San Carlos was a good example because their ratio of commercial property compared to residential property was very different from Palo Alto. In 2003, San Carlos' revenue dropped about 20 percent in one year.

Ms. Mak remarked that was in their unsecured role.

Mr. Tom said yes because they had such a high proportion of commercial Property Tax revenue and their unsecured Property Taxes were reassessed at a much lower rate.

Mr. Saccio recalled that San Carlos was very quick to approach the County and change their valuations on regular Property and Unsecured Tax.

Council Member Schmid believed one dilemma the City and the School District faced was young families moving to town because the School District needed to immediately provide more spaces and more teachers when enrollment went up. In the long run, if there were no young families moving into town, it changed the nature of the tax advantages that existed now, such as Property Taxes turning over on a regular basis. The City faced many land-use decisions and the School District had an impact on that. It

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was a question of building smaller or larger units for people that did not use the schools and were more likely to rent.

Mr. Tom wanted to confirm whether family trust ownership deferred the turnover and reassessment of the property.

Council Member Schmid replied that between 40 to 50 percent of the annual Property Tax revenue came from new families moving into Proposition 13 capped housing.

Mr. Tom remarked that Proposition 13 housing was reassessed at market value and property that was passed on through a family trust was not reassessed property.

Mr. Saccio said yes, there was no transaction, there was no sale.

Ms. Emberling questioned whether that was the same circumstance when the owner rented the property to their family.

Mr. Saccio remarked that it was the same because the ownership remained the same. There needed to be a transaction or a complete re-do of the property that added value to change the circumstance.

Mr. Narayan mentioned that the trust documents just changed.

Ms. Emberling noted that in the last Budget that passed there was a reserve cap; she wanted to know if that was just for the School Districts.

Ms. Mak said yes.

Ms. Emberling inquired whether the School Districts Reserve Budget was capped at three percent.

Mr. Tom said the system was complicated but did not take effect for a while.

Ms. Emberling wanted to discuss it with the Committee.

Mr. Tom understood it was a political act by teachers and unions working with Governor Brown to get the Rainy Day Fund passed; people wanted the money out of reserves and into the salaries.

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Council Member Schmid made clear the cap was three percent.

Ms. Mak mentioned that the cap was two times the amount that the State required the school districts to fund. The cap was six percent for PAUSD.

Council Member Schmid relayed that the City's cap was 16 percent.

Mr. Rossmann communicated that the City's policy was that the Budget Stabilization Reserve was between 15 and 20 percent, but Staff currently set it at 18.5 percent. Regarding Undesignated Reserves were able to be used for any purpose. He inquired whether the School District was allowed to have Designated Reserves, where money was set aside for a designated purpose.

Ms. Mak explained that there were two parts to the Budget Trailer Bill. School Districts had to explain why they had Reserves in excess of the State's required level; this included Designated and Undesignated Reserves. The second piece dealt with Proposition 2, a Proposition regarding reserves for school districts, if it passed in November 2014, then the school district was required to cap their Budget at two times the required level.

Council Member Schmid wanted to know if that was going to be on the ballot for November 2014.

Ms. Emberling said yes.

Mr. Tom noted that was how Governor Brown got the Teachers Union to support the Rainy Day Fund proposition.

Mr. Saccio commented that if the School District went over the cap they were able to use the funds anyway they were determined.

Mr. Tom mentioned that it was possible to request a waiver for two years.

Ms. Mak clarified that a waiver could be requested for up to two years but Proposition 2 was not going to take effect until 2017.

Mr. Tom noted that school boards and administration were pushing for a more rational cap, if there were to be a cap.

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Council Member Schmid thought sharing the City and the School Districts perception was good as there were different goals and needs; there were fundamental needs that were changing and it was good to keep up with the insights of both sides.

## FUTURE MEETINGS AND AGENDAS

Council Member Schmid inquired whether the Twelve Day Enrollment was coming to the City School Liaison Committee (Committee) for the next meeting.

Heidi Emberling, Palo Alto Unified School District, Board Member requested clarification that it was going to be on the next Agenda.

Kimberly Lunt, Office of the City Clerk said that Khashayar Alaei, Senior Management Analyst and Committee Liaison agendaized Items for upcoming Committee meetings.

Council Member Schmid mentioned there was a presentation at the last Council meeting on Emergency Preparedness.

Ms. Emberling remarked that the Superintendent sent out a universal e-mail regarding emergency preparedness.

Council Member Schmid continued that this was a major study that the City paid for to examine each type of threat.

Ms. Emberling noted that she handed out the School Board's Focus Goals that were discussed at the School Board Retreat.

Ms. Emberling relayed that the new Superintendent was doing tours at every school site called "Second Cups of Coffee".

ADJOURNMENT: The meeting was adjourned at 9:56 A.M.