



CITY OF  
**PALO  
ALTO**

**FINANCE COMMITTEE**  
Tuesday, November 29, 2022  
Special Meeting  
Community Meeting Room & Virtual  
5:30 PM

Pursuant to [AB 361](#) Palo Alto City Council and Committee meetings will be held as “hybrid” meetings with the option to attend by teleconference/video conference or in person. To maximize public safety while still maintaining transparency and public access, members of the public can choose to participate from home or attend in person. Information on how the public may observe and participate in the meeting is located at the end of the agenda.

**HOW TO PARTICIPATE**

**VIRTUAL PARTICIPATION**

**[CLICK HERE TO JOIN](https://cityofpaloalto.zoom.us/j/99227307235)** (<https://cityofpaloalto.zoom.us/j/99227307235>)  
**Meeting ID: 992 2730 7235 Phone:1(669)900-6833**

The meeting will be broadcast on Cable TV Channel 26, live on YouTube at <https://www.youtube.com/c/cityofpaloalto>, and streamed to Midpen Media Center at <https://midpenmedia.org>.

**PUBLIC COMMENTS**

Public Comments will be accepted both in person and via Zoom meeting. All requests to speak will be taken until 5 minutes after the staff’s presentation. Written public comments can be submitted in advance to [city.council@cityofpaloalto.org](mailto:city.council@cityofpaloalto.org) and will be provided to the Committee and available for inspection on the City’s website. Please clearly indicate which agenda item you are referencing in your email subject line.

**CALL TO ORDER**

**ORAL COMMUNICATIONS**

*Members of the public may speak to any item NOT on the agenda.*

**ACTION ITEMS**

**Presentation** 1. Discussion and Recommendation to the City Council Accept the Macias Gini & O’Connell’s (MGO) Audit of the City of Palo Alto’s Financial Statements as of June 30, 2022

**Presentation** 2. Approval of the FY 2022 Annual Comprehensive Financial Report (ACFR) and Year-End Budget Amendments in Various Funds

- Presentation**
3. Staff Recommends the Finance Committee Recommend the City Council Adopt a Resolution Amending Electric Rate Schedule E-HRA (Electric Hydro Rate Adjuster) Increasing the Current E-HRA Rate to \$0.050/kWh Effective January 1, 2023
  4. Discussion and Update on Sanitary Sewer Main Replacement Acceleration Alternatives
- Presentation**

FUTURE MEETINGS AND AGENDAS

ADJOURNMENT

## PUBLIC COMMENT INSTRUCTIONS

Members of the Public may provide public comments to hybrid meetings via email, in person, teleconference, or by phone.

1. **Written public comments** may be submitted by email to [city.council@cityofpaloalto.org](mailto:city.council@cityofpaloalto.org).
2. **In person public comments** please complete a speaker request card located on the table at the entrance to the Council Chambers, and deliver it to the City Clerk prior to discussion of the item.
3. **Spoken public comments using a computer or smart phone** will be accepted through the teleconference meeting. To address the Council, click on the link below to access a Zoom-based meeting. Please read the following instructions carefully.
  - You may download the Zoom client or connect to the meeting in- browser. If using your browser, make sure you are using a current, up-to-date browser: Chrome 30+, Firefox 27+, Microsoft Edge 12+, Safari 7+. Certain functionality may be disabled in older browsers including Internet Explorer. Or download the Zoom application onto your phone from the Apple App Store or Google Play Store and enter the Meeting ID below
  - You may be asked to enter an email address and name. We request that you identify yourself by name as this will be visible online and will be used to notify you that it is your turn to speak.
  - When you wish to speak on an Agenda Item, click on "raise hand." The Clerk will activate and unmute speakers in turn. Speakers will be notified shortly before they are called to speak.
  - When called, please limit your remarks to the time limit allotted.
  - A timer will be shown on the computer to help keep track of your comments.
4. **Spoken public comments using a phone** use the telephone number listed below. When you wish to speak on an agenda item hit \*9 on your phone so we know that you wish to speak. You will be asked to provide your first and last name before addressing the Council. You will be advised how long you have to speak. When called please limit your remarks to the agenda item and time limit allotted.

[Click to Join](#)   **Zoom Meeting ID: 992-2730-7235   Phone: 1(669)900-6833**

### AMERICANS WITH DISABILITY ACT (ADA)

Persons with disabilities who require auxiliary aids or services in using City facilities, services or programs or who would like information on the City's compliance with the Americans with Disabilities Act (ADA) of 1990, may contact (650) 329-2550 (Voice) 48 hours or more in advance.



# City of Palo Alto

## Finance Committee Staff Report

(ID # 14984)

---

Meeting Date: 11/29/2022

Report Type:

**Title: Discussion and Recommendation to the City Council Accept the Macias Gini & O'Connell's (MGO) Audit of the City of Palo Alto's Financial Statements as of June 30, 2022**

**From: City Manager**

**Lead Department: City Auditor**

### **Recommendation**

The City Auditor recommends that the Finance Committee review and forward to the City Council for approval the City of Palo Alto's audited financial statements for the fiscal year ended June 30, 2022 and the accompanying reports provided by Macias Gini & O'Connell LLP.

### **Discussion**

The City Charter requires that the City Council, through the City Auditor, engage an independent public accounting firm to conduct the annual financial audit. The selected firm reports the results of the audit, in writing, to the City Council. Macias Gini & O'Connell LLP, a certified public accounting firm, conducted the audits of the City's financial statements for the fiscal year ended June 30, 2022.

The City Auditor is providing copies of the following financial statements and reports as prepared by MGO:

- Auditor's Report to the City Council (the "Management Letter") – Attachment A
- Cable TV Franchise, Independent Auditor's Report and Statements of Franchise Revenues and Expenses for the Years Ended December 31, 2021 and 2020 – Attachment B
- Palo Alto Public Improvement Corporation Annual Financial Report for the Year Ended June 30, 2022 – Attachment C
- Regional Water Quality Control Plant Independent Auditor's Report and Financial Statements for the Year Ended June 30, 2022 – Attachment D
- Independent Accountant's Report on Applying Agreed-Upon Procedures Related to the Article XIII-B Appropriations Limit for the Year Ended June 30, 2022 – Attachment E



Note that the final audit report, the Single Audit, will be completed and presented at a subsequent meeting.

The Annual Comprehensive Financial Report (ACFR), a separate item on this agenda, includes the following Independent Auditor's report:

- Independent Auditor's Reports on the Financial Statements (pgs. 1-3)

Macias Gini & O'Connell LLP issued a clean opinion on each audit report and reported no findings within the Agreed-Upon Procedures report.

The City Auditor would like to express appreciation to Macias Gini & O'Connell LLC Administrative Services Department staff for their hard work and cooperation during the audit.

**Attachments:**

- Schedule A - Auditor's Report to the City Council
- Schedule B - Cable TV Franchise Auditor's Report
- Schedule C - Public Improvement Corporation Annual Financial Report
- Schedule D - Regional Water Quality Control Plant Auditor's Report
- Schedule E - GANN Limit Agreed Upon Procedures Report

**CITY OF PALO ALTO, CALIFORNIA**

Report to the City Council

For the Year Ended June 30, 2022



Certified  
Public  
Accountants

**CITY OF PALO ALTO, CALIFORNIA**  
Report to the City Council  
For the Year Ended June 30, 2022

*Table of Contents*

	<i>Page</i>
Transmittal Letter.....	i
Required Communications.....	1

Attachment: Schedule A - Auditor's Report to the City Council (14984 : MGO Audit of the Financial Statements as of June 30, 2022)



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

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, 2022, and the related notes to the financial statements, which collectively comprise the City’s basic financial statements. Professional standards require that we communicate to you the information related to our audit discussed on pages 1 through 5.

In planning and performing our audit of the basic financial statements of the City as of and for the year ended June 30, 2022, 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, we considered the City’s internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the City’s internal control.

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. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:

- *Reasonably possible.* The chance of the future event or events occurring is more than remote but less than likely.
- *Probable.* The future event or events are likely to occur.

Our consideration of internal control was for the limited purpose described in the second paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this communication, which is an integral part of our audit, is to describe, for management and those charged with governance, the scope of our testing of internal control and the results of that testing. Accordingly, this communication is not intended to be and should not be used for any other purpose. This report is a matter of public record and this does not limit the distribution of this report.

*Macias Gini & O’Connell LLP*  
Walnut Creek, California  
November 16, 2022

Attachment: Schedule A - Auditor's Report to the City Council (14984 : MGO Audit of the Financial Statements as of June 30, 2022)

**This page is left intentionally blank.**

## REQUIRED COMMUNICATIONS

We have audited the basic financial statements of the City as of and for the year ended June 30, 2022, and have issued our report thereon dated November 16, 2022. Professional standards require that we advise you of the following matters relating to our audit.

### **Our Responsibility in Relation to the Financial Statement Audit**

As communicated in our engagement letter dated April 25, 2022, our responsibility, as described by professional standards, is to form and express opinions about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, as part of our audit, we considered the internal control of the City solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

### **Planned Scope and Timing of the Audit**

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

### **Compliance with All Ethics Requirements Regarding Independence**

The engagement team, others in our firm, as appropriate, our firm, and our network firms have complied with all relevant ethical requirements regarding independence.

### **Qualitative Aspects of the City's Accounting Practices**

#### Significant Accounting Policies

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in Note 1 to the basic financial statements. As described in Note 1(n) to the City's basic financial statements, the City implemented Governmental Accounting Standards Board (GASB) Statement No. 87, Leases. The application of this statement had a material impact on the City's financial statements and footnote disclosures for the fiscal year ended June 30, 2022. The City also implemented the following GASB Statements: 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*; Statement No. 92, *Omnibus 2020*; Statement No. 93, *Replacement of Interbank Offered Rates*; Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation*

*Plans – an Amendment of GASB Statements No. 14 and No. 84, and a Supersession of GASB Statement No 32; and certain requirements of GASB Statement No. 99, Omnibus 2022.* The implementation of these statements did not have a significant impact on the City’s financial statements for the fiscal year ended June 30, 2022.

No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

### Significant Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management’s current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management’s current judgments.

The most sensitive accounting estimates affecting the City’s basic financial statements were:

- *Fair value of investments.* The City’s investments are generally carried at fair value, which is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The City’s investments are primarily classified as level 2 of the fair value hierarchy established by GASB Statement No. 72 and are valued using prices determined by the use of matrix pricing techniques maintained by the pricing vendors for these securities. The City’s investment in the money market mutual funds, California Local Agency Investment Fund and California Asset Management Program are not subject to the fair value hierarchy.
- *Estimated allowance for losses on notes and loans receivable.* The allowance for losses on notes and loans receivable is based on the types of loans (e.g. forgivable, deferred, grant, or amortizing) and management’s estimate regarding the likelihood of collectability based on loan provisions and collateral.
- *Depreciation estimates for capital assets, including depreciation methods and useful lives assigned to depreciable assets.* The estimated useful lives of capital assets were determined based on the nature of the capital assets and management’s estimate of the economic life of the assets.
- *Landfill post-closure liability.* The City has estimated, based on a study conducted by consultants, the post-closure costs of the Palo Alto landfill based on what it would cost to perform all currently mandated post-closure care. Actual post-closure care costs may be higher due to inflation variances, changes in technology, or changes in State or federal regulations.
- *Net pension and Other Postemployment Benefits (OPEB) liabilities, contributions, expenses, and other related balances.* These balances for pension and OPEB are based on actuarial valuations, which incorporate actuarial methods and assumptions adopted by the City, performed by the California Public Employees’ Retirement System’s and the City’s independent actuaries, respectively.

- *Claims loss reserve.* The City is exposed to a variety of risks of loss due to general liability, workers' compensation and other claims and records an estimate of these losses based on actuarial studies performed by third party actuaries. These studies are prepared based on the City's prior claims history, which is used as a basis for extrapolating losses for known and incurred but not reported claims. Actual loss experience may vary from these estimates.
- *Discount rate used for the calculation of lease liability and lease receivable.* The discount rate used for the calculation of the lease liability and lease receivable are based on the City's estimated incremental borrowing rate using AAA General Obligations rates.

We evaluated the key factors and assumptions used to develop the accounting estimates described above and determined that it is reasonable in relation to the basic financial statements taken as a whole and in relation to the applicable opinion units.

### Financial Statement Disclosures

Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were the disclosure of Pension Plans in Note 12, Other Post-Employment Benefits (OPEB) in Note 13, and Commitments and Contingencies in Note 17.

### **Significant Difficulties Encountered during the Audit**

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

### **Corrected and Uncorrected Misstatements**

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole and each applicable opinion unit. Management has corrected all identified misstatements.

In addition, professional standards require us to communicate to you all material, corrected misstatements that were brought to the attention of management as a result of our audit procedures. None of the misstatements identified by us as a result of our audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole or applicable opinion units.

### **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of the audit.



## **Representations Requested from Management**

We have requested certain written representations from management, which are included in the letter dated November 16, 2022.

## **Management's Consultations with Other Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

## **Other Significant Matters, Findings, or Issues**

In the normal course of our professional association with the City, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating and regulatory conditions affecting the entity, and operational plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as the City's auditors.

## **Other Information in Documents Containing Audited Financial Statements**

Pursuant to professional standards, our responsibility as auditors for other information in documents containing the City's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. However, in accordance with such standards:

### *Required Supplementary Information*

We have applied certain limited procedures to the management's discussion and analysis, the schedules of changes in net pension liability and related ratios, the schedules of pension contributions, the schedule of changes in net OPEB liability and related ratios, the schedule of employer OPEB contributions, which are required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding 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.

### *Supplementary Information and Other Sections*

We were engaged to report on the combining and individual fund financial statements and schedules, which accompany the financial statements but are not RSI. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America.

### *Other Information*

We were not engaged to report on the introductory and statistical sections, which accompany the financial statements but are not RSI or supplementary information. Our opinions on the basic financial statements do not cover the other information, and we do not express an opinion or any form of assurance thereon. In connection with our audit of the basic financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the basic financial statements, or the other information otherwise appears to be materially misstated.

Our responsibility also includes communicating to you any information which we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements.

### **Modification of the Auditor's Report**

Our report includes an emphasis of matter paragraph to reference to Note 1 to the basic financial statements for the City's implementation of GASB Statement No. 87, *Leases*. Our opinion is not modified with respect to this matter.

**CABLE TV FRANCHISE**

Independent Auditor's Report and  
Statements of Franchise Revenues and Expenses

For the Years Ended December 31, 2021 and 2020



Certified  
Public  
Accountants

**CABLE TV FRANCHISE**  
Independent Auditor’s Report and Statements of Franchise Revenues and Expenses  
For the Years Ended December 31, 2021 and 2020

*Table of Contents*

	<i>Page</i>
Independent Auditor’s Report.....	1
Financial Statements:	
Statements of Franchise Revenues and Expenses.....	3
Notes to the Financial Statements.....	4

Attachment: Schedule B - Cable TV Franchise Auditor's Report (14984 : MGO Audit of the Financial Statements as of June 30, 2022)



### Independent Auditor’s Report

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

#### **Opinion**

We have audited the Statements of Franchise Revenues and Expenses (financial statements) of the Cable TV Franchise (Franchise) for the years ended December 31, 2021 and 2020, and the related notes to the financial statements, which collectively comprise the Franchise’s financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the revenues and expenses of the Franchise for the years ended December 31, 2021 and 2020, in accordance with the financial reporting provisions of the Amended and Restated Joint Exercise of Powers Agreement signed on June 9, 2009, between the City of Palo Alto, the City of East Palo Alto, the City of Menlo Park, the County of San Mateo, the County of Santa Clara, and the Town of Atherton, as described in Note 1 to the financial statements (Agreement).

#### **Basis for Opinion**

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Franchise, and to meet our ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### **Emphasis of a Matter**

As discussed in Note 1 to the financial statements, the financial statements are prepared in accordance with the financial reporting provisions of the Agreement, which is a basis of accounting other than accounting principles generally accepted in the United States of America and are not intended to be a complete presentation of the Franchise’s financial position or results of operations. Our opinion is not modified with respect to this matter.

#### **Management’s Responsibilities for the Financial Statements**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the financial reporting provisions of the Agreement, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Attachment: Schedule B - Cable TV Franchise Auditor’s Report (14984 : MGO Audit of the Financial Statements as of June 30, 2022)

### *Auditor's Responsibilities for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Franchise's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

### *Restriction on Use*

This report is intended solely for the information and use of the governing bodies and management of the City of Palo Alto, the City of East Palo Alto, the City of Menlo Park, the County of San Mateo, the County of Santa Clara, and the Town of Atherton, and is not intended to be and should not be used by anyone other than these specified parties.

*Macias Gini É O'Connell LLP*

Walnut Creek, California  
November 16, 2022

**CABLE TV FRANCHISE**  
 Statements of Franchise Revenues and Expenses  
 For the Years Ended December 31, 2021 and 2020

	<u>2021</u>	<u>2020</u>
<b>Revenues:</b>		
Franchise fees	\$ 1,584,671	\$ 1,614,163
<b>Expenses:</b>		
Franchise administration	17,973	37,480
Consulting fees	<u>5,882</u>	<u>5,287</u>
Total expenses	<u>23,855</u>	<u>42,767</u>
<b>Net revenues</b>	<u><u>\$ 1,560,816</u></u>	<u><u>\$ 1,571,396</u></u>

	<u>2021</u>		<u>2020</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
<b>Allocated Net Revenues:</b>				
City of Palo Alto	\$ 736,062	47.2%	\$ 743,953	47.3%
City of Menlo Park	416,541	26.7%	420,485	26.7%
City of East Palo Alto	161,394	10.3%	162,894	10.4%
Town of Atherton	135,938	8.7%	133,139	8.5%
County of Santa Clara	84,596	5.4%	85,698	5.5%
County of San Mateo	<u>26,285</u>	<u>1.7%</u>	<u>25,227</u>	<u>1.6%</u>
Total allocated net revenues	<u><u>\$ 1,560,816</u></u>	<u><u>100.0%</u></u>	<u><u>\$ 1,571,396</u></u>	<u><u>100.0%</u></u>

See accompanying notes to the financial statements.

**CABLE TV FRANCHISE**  
Notes to the Financial Statements  
For the Years Ended December 31, 2021 and 2020

**NOTE 1 – JOINT OPERATING AGREEMENT AND BASIS OF ACCOUNTING**

In July 1983, a Joint Exercise of Powers Agreement was entered into by and between the Cities of Palo Alto, Menlo Park, East Palo Alto, the Counties of San Mateo and Santa Clara, and the Town of Atherton (Members) for the purpose of obtaining a state-of-the-art cable service for residents, businesses, and institutions, within each of their jurisdictions in the most efficient and economical manner possible.

In October 1988, the Members entered into a Joint Operating Agreement in which the City was granted the power and the authority to administer and coordinate the activities of the franchise and exercise the rights and responsibilities of the City pursuant to the Franchise Agreement. The activities are administered by the City and are accounted for within the City's Agency Fund. The program is accounted for using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recognized when the liability is incurred.

On August 9, 2000, the City of Palo Alto (City), acting on behalf of the Members, signed a Franchise Agreement with TCI Cablevision of California, Inc., a wholly owned subsidiary of AT&T Broadband (AT&T), a third-party contractor, which was granted a non-exclusive franchise to construct, operate, maintain and repair a cable television system within the Members jurisdictions. In 2002, the Franchise Agreement was transferred from AT&T to Comcast Corporation (Comcast).

TCI Cablevision of California, Inc. also signed an asset purchase agreement with Cable Communications Cooperative of Palo Alto, Inc. (CCCOPA), the former cable television system operator/owner, and acquired the system.

On January 1, 2007, the Digital Infrastructure and Video Competition Act (DIVCA) went into effect. Under DIVCA, cable and video service franchises are now granted exclusively by the California Public Utilities Commission (Commission) rather than by local franchising entities. On March 30, 2007, the Commission granted AT&T a statewide franchise. Comcast was allowed to seek a State franchise after January 1, 2008, when another State franchise holder (in this case AT&T) entered the local market. On January 2, 2008, the Commission granted Comcast a State franchise.

On June 9, 2009, the Members approved an Amended and Restated Joint Exercise of Powers Agreement, in substitution of the existing Joint Exercise of Powers Agreement and the Joint Operating Agreement, to reflect changes in the law due to DIVCA and to continue to allow the City to administer the cable and video franchise enforcement and monitoring process for State franchise holders.

The accompanying financial statements are prepared in accordance with the financial reporting provisions of the Amended and Restated Joint Exercise of Powers Agreement between the Members, which is a basis of accounting other than accounting principles generally accepted in the United States of America, and are not intended to be a complete presentation of the Franchise's financial position or results of operations.

As compensation for services under the State franchise agreements, AT&T and Comcast pay annual franchise fees in an amount equal to 5% of annual gross revenues, considering a reasonable adjustment for bad debts. From these fees the City is first reimbursed for out-of-pocket franchise administration costs. The remaining fees are distributed to each Member according to the percentage of revenues derived from the residents and businesses in each of the entities compared to revenues in total.



**CABLE TV FRANCHISE**  
Notes to the Financial Statements (Continued)  
For the Years Ended December 31, 2021 and 2020

**NOTE 2 – PRIOR FRANCHISE SETTLEMENTS**

A prior Franchise Agreement with CCCOPA was set to expire on March 24, 2001. On June 21, 1999, the City hired a cable communications consultant and retained the services of a law firm to assist in the franchise renewal process. On July 31, 2000, CCCOPA reimbursed the City \$185,000 toward the actual costs incurred as part of the franchise renewal efforts.

On July 24, 2000, the City reached a settlement with CCCOPA in the amount of \$220,000 to resolve outstanding claims resulting from CCCOPA's alleged failure to fully perform under the prior Franchise Agreement.

On November 22, 2004, the City reached a settlement agreement with Comcast regarding cable plant construction claims in the amount of \$175,000. This money was to be used towards the institutional network connection costs.

In 2006, the City conducted a franchise compliance audit performed by the City Auditor's Office. A settlement was reached in the amount of \$155,391. In addition, CCCOPA paid the City a \$250,000 grant to acquire, install, and/or maintain equipment to be used in connection with an institutional network defined in the Franchise Agreement.

In 2016, the City Auditor discovered that AT&T and Comcast did not consistently calculate the fees due in accordance with DIVCA and the municipal code of each of the cable joint powers members. As a result of the audit, the City received a settlement from AT&T in the amount of \$75,647 in 2016. Additionally, the City received a settlement from Comcast in the amount of \$25,000 in 2019.

The settlements and grant have been deposited and are being held by the City and earning interest. The City has since spent a part of the balance on various projects including installing and maintaining the institutional network equipment. As of December 31, 2021 and 2020, the remaining balances on deposit with the City, including balances from other funding sources, were \$1,329,242, and \$1,067,151, respectively. These balances include interest receivable of \$4,881 and \$4,211 at December 31, 2021 and 2020, respectively.

**PALO ALTO PUBLIC IMPROVEMENT  
CORPORATION**  
**(A Component Unit of the  
City of Palo Alto, California)**

Annual Financial Report  
For the Year Ended June 30, 2022



Certified  
Public  
Accountants

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto, California)**  
Annual Financial Report  
For the Year Ended June 30, 2022

*Table of Contents*

	<i>Page</i>
<b>Independent Auditor’s Report</b> .....	1
<b>Management’s Discussion and Analysis (Unaudited)</b> .....	3
<b>Basic Financial Statements</b>	
Government-wide Financial Statements:	
Statement of Net Position.....	5
Statement of Activities .....	6
Debt Service Fund Financial Statements:	
Balance Sheet .....	7
Statement of Revenues, Expenditures and Changes in Fund Balance.....	8
Notes to the Basic Financial Statements.....	9



## Independent Auditor's Report

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

### *Opinions*

We have audited the financial statements of the governmental activities and the major fund of the Palo Alto Public Improvement Corporation (Corporation), a component unit of the City of Palo Alto, California (City), as of and for the year ended June 30, 2022, and the related notes to the financial statements, which collectively comprise the Corporation's basic financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the major fund of the Corporation as of June 30, 2022, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### *Basis for Opinions*

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Corporation and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

### *Responsibilities of Management for the Financial Statements*

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Corporation's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- exercise professional judgment and maintain professional skepticism throughout the audit.
- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. Accordingly, no such opinion is expressed.
- evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Corporation's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information is the responsibility of management and, 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.

*Macias Gini & O'Connell LLP*

Walnut Creek, California  
November 16, 2022

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto, California)**  
**Management's Discussion & Analysis (Unaudited)**  
**For the Year Ended June 30, 2022**

The Palo Alto Public Improvement Corporation (Corporation), a component unit of the City of Palo Alto (City), follows the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. The Corporation is controlled by the City and was organized to assist the City in financing public improvements. The Corporation issues debt and turns the proceeds of the debt over to the City under lease agreements that provide a revenue source for the repayment of this debt. The Corporation has three outstanding debts and has turned over the proceeds to the City, which pledged certain lease payments as collateral for this debt as discussed in Note 4 to the financial statements.

**FINANCIAL HIGHLIGHTS**

GASB Statement No. 34 requires the issuance of government-wide financial statements as well as fund financial statements. The government-wide financial statements report the balance of the Corporation's long-term debt while the individual fund statements do not.

In fiscal year 2018, the City issued 2018 Capital Improvement Project and Refinancing Certificates of Participation (2018 COPs) in the amount of \$9.0 million to refinance the 2002B Downtown Parking Improvements Certificates of Participation remaining balance of \$805 thousand, and also to fund the Palo Alto Municipal Golf Course renovations.

In fiscal year 2019, the City issued the 2019 California Avenue Parking Garage tax exempt Series A and taxable Series B Certificates of Participation (2019A and 2019B COPs) in the amount of \$26.8 million plus \$4.9 million premium, and \$10.6 million, respectively. The 2019A and 2019B COPs are issued to fund the construction of the new California Avenue parking garage.

In fiscal year 2021, the City issued the 2021 Public Safety Building Certificates of Participation (2021 COPs) in the amount of \$101.5 million plus \$6.5 million premium. The 2021 COPs are issued to fund the construction of the new public safety building.

As of June 30, 2022, the Corporation has the following outstanding debt: the 2018 COPs, 2019A and 2019B COPs, and 2021 COPs.

At the government-wide level, the interest and fiscal agent charges were \$4.8 million for fiscal year 2022, an increase of \$0.8 million from the prior year. The interest on leases from the City of Palo Alto was \$1.7 million, a decrease of \$6.9 million from the prior year. The increases of interest and fiscal charges and decrease of interest on leases are due to the issuance of the 2021 COPs during the prior year which lead to the increase of outstanding bonds and incurrence of one-time costs of issuance.

The Corporation ended fiscal year 2022 with total assets of \$158.8 million, a decrease of \$4.4 million from the prior year. Total assets consisted of \$1.5 million in cash and investments, \$1.1 million of lease interest receivable from the City of Palo Alto, and \$156.2 million of investment in leases to the City of Palo Alto. The total liabilities were \$157.2 million, a decrease of \$1.2 million from the prior year. The decrease of assets and liabilities resulted from scheduled principal and interest payments of the 2018 COPS's, the 2019A and 2019B COPSs and interest payments of the 2021 COPs.

At the fund level, the Corporation's expenditures exceeded revenues by \$3.1 million due to interest payments of the 2021 COPs. As of June 30, 2022, the Corporation had one fund, the Debt Service Fund, which reported a \$1.5 million restricted fund balance.

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto, California)**  
 Management's Discussion & Analysis (Unaudited) (Continued)  
 For the Year Ended June 30, 2022

**OVERVIEW OF THE CORPORATION'S BASIC FINANCIAL STATEMENTS**

The annual financial report is comprised of two parts:

- 1) Management's discussion and analysis (this part),
- 2) The basic financial statements, which include the government-wide and the fund financial statements, along with the notes to these financial statements.

The basic financial statements comprise the government-wide financial statements and the fund financial statements. These two sets of financial statements provide two different views of the Corporation's financial activities and financial positions, both short-term and long-term.

The government-wide financial statements provide a long-term view of the Corporation's activities as a whole, and comprise the statement of net position and the statement of activities. The statement of net position provides information about the financial position of the Corporation as a whole, including all its long-term liabilities on the full accrual basis, similar to that used by corporations. The statement of activities provides information about all the Corporation's revenues and expenses on the full accrual basis, with the emphasis on measuring net revenues or expenses of the Corporation's program. The statement of activities explains in detail the change in net position for the year.

The fund financial statements report the Corporation's operations in more detail than the corporate-wide statements and focus primarily on the short-term activities of the debt service fund. Fund financial statements measure only current revenues and expenditures; current assets, liabilities and fund balances; and they exclude capital assets and long-term debt.

Together, these statements along with the notes to the financial statements are called the basic financial statements.

**DEBT ADMINISTRATION**

The Corporation issues debt in the form of Certificates of Participation (COPs) to be repaid from future lease receipts from the City. Legally, these COPs issues are the Corporation's debt only; the City is liable only for the payment of the amounts set forth in the lease securing each debt issue.

As of June 30, 2022, the Corporation has the following outstanding debt: 2018 COPs, 2019A and 2019B COPs, and 2021 COPs with outstanding principal balances of \$8.4 million, 35.7 million and \$101.5 million, respectively.

**ECONOMIC OUTLOOK AND MAJOR INITIATIVES**

The economy of the City and its major initiatives for the coming year are discussed in detail in the City's Annual Comprehensive Financial Report.

**CONTACTING THE CORPORATION'S FINANCIAL MANAGEMENT**

These Basic Financial Statements are intended to provide citizens, taxpayers, investors, and creditors with a general overview of the Corporation's finances. Questions about these financial statements should be directed to the Finance Department of the City of Palo Alto, 250 Hamilton Avenue, Palo Alto, CA 94301.

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
Statement of Net Position  
June 30, 2022

**Assets**

Cash held for operations	\$ 43,376
Cash and investments held by trustee	1,488,794
Lease interest receivable	1,070,654
Investment in leases to the City of Palo Alto	<u>156,160,520</u>
Total assets	<u>158,763,344</u>

**Liabilities**

Interest payable	1,070,654
Long-term debt:	
Due in one year	1,268,253
Due in more than one year	<u>154,892,267</u>
Total liabilities	<u>157,231,174</u>

**Net Position**

Restricted for debt service	<u><u>\$ 1,532,170</u></u>
-----------------------------	----------------------------

See accompanying notes to financial statements.



**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
Statement of Activities  
For the Year Ended June 30, 2022

<b>Expenses</b>	
Interest and fiscal agent charges	\$ 4,808,310
<b>Program revenues</b>	
Interest on leases from the City of Palo Alto	<u>1,679,174</u>
Net program revenues	(3,129,136)
<b>General revenues</b>	
Investment earnings	<u>424</u>
Change in net position	(3,128,712)
Net position, beginning of the year	<u>4,660,882</u>
Net position, end of the year	<u><u>\$ 1,532,170</u></u>

See accompanying notes to financial statements.

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**

Balance Sheet  
Debt Service Fund  
June 30, 2022

**Assets**

Cash held for operations	\$ 43,376
Cash and investments held by trustee	1,488,794
Lease interest receivable	1,070,654
Investment in leases to City of Palo Alto	156,160,520
Total assets	\$ 158,763,344

**Deferred Inflows of Resources**

Unavailable lease receipts from the City of Palo Alto	\$ 157,231,174
---	----------------

**Fund balance**

Restricted for debt service	1,532,170
Total deferred inflows of resources and fund balance	\$ 158,763,344

**Reconciliation of fund balance to net position**

Fund balance restricted for debt service	\$ 1,532,170
Long-term receivables are not available to pay for current period expenditures and are considered unavailable on the governmental fund balance sheet	157,231,174
Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the Fund:	
Interest payable	(1,070,654)
Long-term debt due within one year	(1,268,253)
Long-term debt due in more than one year	(154,892,267)
Net position of governmental activities	\$ 1,532,170

See accompanying notes to financial statements.

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
Statement of Revenues, Expenditures and Changes in Fund Balance  
Debt Service Fund  
For the Year Ended June 30, 2022

Revenues:	
Lease receipts from the City of Palo Alto:	
Principal	\$ 835,000
Interest	2,070,960
Other	3,691
Investments earnings	424
Total revenues	<u>2,910,075</u>
Expenditures:	
Debt service:	
Principal repayment	835,000
Interest and fiscal agent charges	5,192,787
Costs of issuance	11,000
Total expenditures	<u>6,038,787</u>
Deficiency of revenues under expenditures	(3,128,712)
Net change in fund balance	(3,128,712)
Fund balance, beginning of the year	4,660,882
Fund balance, end of the year	<u>\$ 1,532,170</u>
<b>Reconciliation of net change in fund balance to change in net position</b>	
Net change in fund balance - debt service fund	\$ (3,128,712)
Amounts reported for governmental activities in the statement of activities are different because:	
Repayment of bond principal is an expenditure in the governmental funds, but in the statement of net position the repayment reduces long-term liabilities.	835,000
Interest accrued on long-term debt and amortization of bond premium do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.	
Change in interest payable	(12,776)
Amortization of bond premium	408,253
Some amounts reported in the statement of revenues, expenditures and changes in fund balances reflect the timing of collection of assets which are not includable as revenues on the statement of activities.	
Lease receipt for bond principal repayment	(835,000)
Lease receipt for interest payment	12,776
Impact of bond premium amortization on lease receipt	(408,253)
Change in net position of governmental activities	<u>\$ (3,128,712)</u>

See accompanying notes to financial statements.

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto, California)**  
 Notes to the Basic Financial Statements  
 For the Year Ended June 30, 2022

**NOTE 1 – DESCRIPTION OF REPORTING ENTITY**

The Palo Alto Public Improvement Corporation (the Corporation) was incorporated in September 1983 under the General Nonprofit Corporation Law of the State of California to acquire, construct and lease capital improvement projects. The Corporation is exempt from federal income taxes under Section 501(c)(4) of the Internal Revenue Code. The Corporation provides financing of public capital improvements for the City through the issuance of Certificates of Participation (COPs), a form of debt which allows investors to participate in a stream of future lease payments. Proceeds from the COPs are used to construct projects which are leased to the City for lease payments which are sufficient in timing and amount to meet the debt service requirements of the COPs.

The Corporation is an integral part of the City of Palo Alto, California (City). It primarily services the City and its governing body is composed of the City Council. Therefore, the financial data of the Corporation has also been included as a blended component unit within the City's annual comprehensive financial report for the year ended June 30, 2022.

**NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES**

**(a) Basis of Presentation**

**Government-wide Statements:** The statement of net position and the statement of activities include the financial activities of the Corporation. Eliminations have been made to minimize the double counting of internal activities.

The statement of activities presents a comparison between direct expenses and program revenues for each function of the Corporation's activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs, and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including investment earnings, are presented as general revenues.

**Fund Financial Statements:** The fund financial statements provide information about the Corporation's funds. The emphasis of fund financial statements is on major individual funds, of which the Corporation only reports one debt service fund.

**(b) Major Fund**

Major funds are defined as funds that have either assets, liabilities, revenues or expenditures equal to ten percent of their fund-type total and five percent of the grand total. The Corporation has one fund which is reported as a major governmental fund in the accompanying financial statements as follows:

**Debt Service Fund** – This fund accounts for debt service payments on the Corporation's long-term debt.

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto, California)**  
 Notes to the Basic Financial Statements (Continued)  
 For the Year Ended June 30, 2022

**NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**(c) Basis of Accounting**

The government-wide 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 to be available if the revenues are collected within ninety days after year-end. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures to the extent they have matured.

**(d) Investment in Leases**

Improvements financed by the Corporation are leased to the City for their entire estimated useful life and will become the City property at the conclusion of the lease on November 1, 2050. The Corporation therefore records the present value of the lease and considers the leased improvement to have been sold for this amount when leased.

**(e) Net Position**

The government-wide financial statements utilize a net position presentation. Net position is further categorized as net investment in capital assets, restricted and/or unrestricted. As of June 30, 2022, the entire net position was considered restricted.

*Restricted Net Position* – This category presents external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

**(f) Deferred Inflows of Resources**

A deferred inflow of resources is defined as an acquisition of net asset or fund balances applicable to a future reporting period and will not be recognized as an inflow of resources (revenue) until that time. On the governmental fund balance sheet, the lease receipts from the City corresponding to the debt are recorded as deferred inflows of resources since the balances are not current financial resources.

**(g) Fund Balances**

At June 30, 2022, the Corporation's governmental fund's fund balances include the following classification:

*Restricted Fund Balance* – includes 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.

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto, California)**  
 Notes to the Basic Financial Statements (Continued)  
 For the Year Ended June 30, 2022

**NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**(h) Effects of New Pronouncements**

As of July 1, 2021, the Corporation implemented the following Governmental Accounting Standards Board (GASB) Statement:

In June 2017, the GASB issued Statement No. 87, *Leases*. The objective of this statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The application of this statement did not have a material impact on the financial statements of the Corporation for the fiscal year ended June 30, 2022.

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

In June 2022, the GASB issued Statement No. 100, *Accounting Changes and Error Corrections – An Amendment of GASB Statement No. 62*. The primary objective of this statement is to enhance accounting and financial reporting requirements for accounting changes and error corrections to provide more understandable, reliable, relevant consistent, and comparable information for making decisions or assessing accountability. The requirements of this statement are effective for the Corporation's fiscal year ending June 30, 2024.

**(i) Estimates**

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**NOTE 3 – CASH AND INVESTMENTS HELD BY TRUSTEE**

**(a) Interest Rate Risk**

Interest rate risk is the risk that a change in market interest rates will adversely affect the fair value of an investment. Normally, the longer it takes an investment to reach maturity, the greater will be that investment's sensitivity to changes in market rates. Information about the sensitivity of the fair values of the Corporation's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the Corporation's investments by maturity:

<u>Investment Type</u>	<u>Amount</u>	<u>Maturity Date</u>
Money Market Mutual Fund	\$ 1,488,794	19 days

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto, California)**  
 Notes to the Basic Financial Statements (Continued)  
 For the Year Ended June 30, 2022

**NOTE 3 – CASH AND INVESTMENTS HELD BY TRUSTEE (Continued)**

**Credit Risk**

Generally, 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. As of June 30, 2022, the Corporation's investments in money market mutual funds are rated AAAM by Standard & Poor's.

**(b) Fair Value Hierarchy**

The City categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure fair value of the assets. Level 1 inputs are quoted prices in an active market for identical assets; Level 2 inputs are significant other observable inputs; and Level 3 inputs are significant unobservable inputs. The Corporation's investments in money market mutual funds are not subject to the fair value hierarchy.

**(c) Investment Policy**

The Corporation must maintain required amounts of cash and investments by trustee under the terms of certain debt issues. These funds are unexpended bond proceeds or are pledged as reserves to be used if the Corporation fails to meet its obligation under these debt issues. The California Government Code (Code) requires these funds to be invested in accordance with bond indentures or State statutes. All these funds have been invested as permitted under the Code. The Investment Policy is described in detail in the City's Annual Comprehensive Financial Report.

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto, California)**  
Notes to the Basic Financial Statements (Continued)  
For the Year Ended June 30, 2022

**NOTE 3 – CASH AND INVESTMENTS HELD BY TRUSTEE (Continued)**

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.

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	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	N/A	30%	\$5 million
Commercial Paper	270 days	A-1	15%	\$3 million (B)
Local Agency Investment Fund	N/A	N/A	No Limit	\$75 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	No Limit	No Limit
Mutual Funds	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 & Other U.S. States	10 years (*)	AA/AA2	30%	No Limit
Supranational	5 years	AA/AA2	20%	10% of the par value of portfolio

(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, and 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.

(\*) The maximum maturity is based on the Investment Policy that is approved by the City Council and is less restrictive than the California Governmental Code.



**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto, California)**  
Notes to the Basic Financial Statements (Continued)  
For the Year Ended June 30, 2022

**NOTE 4 – CERTIFICATES OF PARTICIPATION**

The Corporation's long-term debt activities are presented below:

	Balance July 1, 2021	Additions	Retirements	Balance June 30, 2022	Amount due in one year
<b>Certificates of Participation</b>					
2018 Capital Improvement Project 2.20-4.22%, due 11/1/2047	\$ 8,570,000	\$ -	\$ 190,000	\$ 8,380,000	\$ 195,000
2019 California Ave. Parking Garage Series A & B 2.5%-5%, due 11/1/2048	36,365,000	-	645,000	35,720,000	665,000
2021 Public Safety Building 2%-5%, due 11/1/2050	101,505,000	-	-	101,505,000	-
Add: Unamortized Premium	10,963,773	-	408,253	10,555,520	408,253
<b>Total</b>	<b>\$ 157,403,773</b>	<b>\$ -</b>	<b>\$ 1,243,253</b>	<b>\$ 156,160,520</b>	<b>\$ 1,268,253</b>

On June 1, 2018, the City issued the 2018 Capital Improvement Project and Refinancing Certificates of Participation (2018 COPs) in the amount of \$9.0 million to fully refinance the 2002B COPs and to fund the renovation of the Palo Alto Municipal Golf Course. Principal payments are due annually on November 1 and interest payments semi-annually at various rates on May 1 and November 1. The 2018 COPs are secured by lease revenues received by the Corporation from any City's General Fund revenue source.

On March 21, 2019, the City issued the 2019 California Avenue Parking Garage tax exempt Series A and taxable Series B Certificates of Participation (2019A and 2019B COPs) in the amount of \$26.8 million plus \$4.9 million premium, and \$10.6 million, respectively, for the construction of the new California Avenue Parking Garage. Principal payments are due annually on November 1 and interest payments semi-annually at various rates on May 1 and November 1. The 2019A and 2019B COPs are secured by lease revenues received by the Corporation from any City's General Fund revenue source.

On March 24, 2021, the City issued the 2021 Public Safety Building Certificates of Participation (2021 COPs) in the amount of \$101.5 million plus \$6.5 million premium for the construction of the new public safety building. Principal payments are due annually on November 1 and interest payments semi-annually at various rates on May 1 and November 1. The 2021 COPs are secured by lease revenues received by the Corporation from any City's General Fund revenue source.

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto, California)**  
Notes to the Basic Financial Statements (Continued)  
For the Year Ended June 30, 2022

**NOTE 4 – CERTIFICATES OF PARTICIPATION (Continued)**

Future annual debt service on the outstanding debt is shown below:

For the Year Ending June 30,	Principal	Interest Payment	Total Payment
2023	\$ 860,000	\$ 4,970,244	\$ 5,830,244
2024	3,025,000	4,880,640	7,905,640
2025	3,170,000	4,729,196	7,899,196
2026	3,335,000	4,569,844	7,904,844
2027	3,495,000	4,402,268	7,897,268
2028-2032	20,295,000	19,309,115	39,604,115
2033-2037	24,830,000	14,769,404	39,599,404
2038-2042	28,925,000	10,665,351	39,590,351
2043-2047	33,520,000	6,059,329	39,579,329
2048-2051	24,150,000	1,179,520	25,329,520
	<u>\$ 145,605,000</u>	<u>\$ 75,534,911</u>	<u>\$ 221,139,911</u>

**Events of Default and Acceleration Clauses**

Generally, the Corporation is considered to be in default if the Corporation fails to pay the principal of and interest on the outstanding long-term debt when become due and payable. If an event of default has occurred and is continuing, the principal of the long-term debt, together with the accrued interest, may be declared due and payable immediately.

**CITY OF PALO ALTO  
REGIONAL WATER QUALITY  
CONTROL PLANT**

Independent Auditor's Report  
and Financial Statements

For the Year Ended June 30, 2022



Certified  
Public  
Accountants

**CITY OF PALO ALTO**  
**REGIONAL WATER QUALITY CONTROL PLANT**  
Independent Auditor’s Report and Financial Statements  
For the Year Ended June 30, 2022

*Table of Contents*

	<i>Page</i>
<b>Independent Auditor’s Report</b> .....	1
<b>Financial Statements:</b>	
Statement of Net Expenditures .....	3
Statement of Quarterly Billings .....	4
Notes to the Financial Statements.....	5

Attachment: Schedule D - Regional Water Quality Control Plant Auditor’s Report (14984 : MGO Audit of the Financial Statements as of June 30,



### Independent Auditor’s Report

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

#### *Opinion*

We have audited the Statements of Net Expenditures and Quarterly Billings (financial statements) of the City of Palo Alto Regional Water Quality Control Plant (Plant), an enterprise operation of the City of Palo Alto, California (City), for the year ended June 30, 2022, and the related notes to the financial statements, which collectively comprise the Plant’s financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the net expenditures and quarterly billings of the Plant for the year ended June 30, 2022, in accordance with the financial reporting provisions of the Basic Agreement between the City of Palo Alto, the City of Mountain View and the City of Los Altos for the Acquisition, Construction and Maintenance of a Joint Sewer System, dated October 10, 1968, as amended by addenda dated December 5, 1977, January 14, 1980, April 9, 1985, May 30, 1991, July 31, 1992, March 16, 1998, April 15, 2009, October 17, 2016, March 4, 2019, and May 17, 2021 (Basic Agreement), as described in Note 2 to the financial statements.

#### *Basis for Opinion*

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the City and the Plant, and to meet our ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### *Emphasis of a Matter*

As discussed in Note 2 to the financial statements, the financial statements are prepared in accordance with the financial reporting provisions of the Basic Agreement, which is a basis of accounting other than accounting principles generally accepted in the United States of America and are not intended to be a complete presentation of the Plant’s financial position or results of operations. Our opinion is not modified with respect to this matter.

#### *Management’s Responsibilities for the Financial Statements*

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the financial reporting provisions of the Basic Agreement, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibilities for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plant's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

### *Restriction on Use*

This report is intended solely for the information and use of the governing bodies and management of the Cities of Palo Alto, Mountain View and Los Altos, and is not intended to be and should not be used by anyone other than these specified parties.

*Macias Gini & O'Connell LLP*

Walnut Creek, California  
November 16, 2022

**CITY OF PALO ALTO**  
**REGIONAL WATER QUALITY CONTROL PLANT**  
Statement of Net Expenditures  
For the Year Ended June 30, 2022

	Total	City of Mountain View	City of Los Altos	City of Palo Alto
Direct Expenditures:				
Source control program	\$ 1,257,280	\$ 505,678	\$ 145,593	\$ 606,009
Public outreach	148,393	59,684	17,184	71,525
Permitting and enforcement	1,175,730	474,301	27,891	673,538
Operations and maintenance	16,647,869	6,696,063	1,927,727	8,024,079
System improvement CIP (Note 3)	1,429,663	575,011	165,555	689,097
Total Direct Expenditures	<u>20,658,935</u>	<u>8,310,737</u>	<u>2,283,950</u>	<u>10,064,248</u>
Indirect Administrative Expenditures (Note 4):				
Source control program	494,983	199,082	57,319	238,582
Public outreach	1,696	682	196	818
Permitting and enforcement	244,453	98,615	5,798	140,040
Operations and maintenance	4,840,882	1,947,003	560,574	2,333,305
Total Indirect Administrative Expenditures	<u>5,582,014</u>	<u>2,245,382</u>	<u>623,887</u>	<u>2,712,745</u>
Debt Service Expenditures (Note 5):				
Refunding 1990 Series A Bonds	282,780	144,218	22,057	116,505
1999 Wastewater Treatment New Project	540,491	204,792	51,185	284,514
2009 State Water Resource Loan	549,206	208,094	52,010	289,102
2017 State Water Resource Loan	1,110,743	420,861	105,187	584,695
Total Debt Service Expenditures	<u>2,483,220</u>	<u>977,965</u>	<u>230,439</u>	<u>1,274,816</u>
OPERATIONAL TRANSFER				
Operational Transfer to Technology Fund	14,000	5,631	1,621	6,748
Total Expenditures	28,738,169	11,539,715	3,139,897	14,058,557
Deduct Joint Systems Revenues (Note 6)	<u>(587,262)</u>	<u>(204,249)</u>	<u>(148,652)</u>	<u>(234,361)</u>
Net Expenditures	<u>\$ 28,150,907</u>	<u>\$ 11,335,466</u>	<u>\$ 2,991,245</u>	<u>\$ 13,824,196</u>

See accompanying notes to the financial statements.

**CITY OF PALO ALTO**  
**REGIONAL WATER QUALITY CONTROL PLANT**  
Statement of Quarterly Billings  
For the Year Ended June 30, 2022

	<u>City of Mountain View</u>	<u>City of Los Altos</u>
Billings by Quarter, Beginning:		
July 1, 2020	\$ 2,976,171	\$ 735,696
October 1, 2020	3,211,239	793,460
January 1, 2021	2,555,371	627,296
April 1, 2021	<u>3,714,465</u>	<u>907,169</u>
Total billings	12,457,246	3,063,621
Net expenditures	<u>11,335,466</u>	<u>2,991,245</u>
Excess of total billings over net expenditures	<u>\$ 1,121,780</u>	<u>\$ 72,376</u>

See accompanying notes to the financial statements.



**CITY OF PALO ALTO**  
**REGIONAL WATER QUALITY CONTROL PLANT**  
 Notes to the Financial Statements  
 For the Year Ended June 30, 2022

**NOTE 1 – THE REPORTING ENTITY**

The Cities of Palo Alto, Mountain View and Los Altos (the Members) participate jointly in the cost of maintaining and operating the Regional Water Quality Control Plant and related system (the Plant). The Members share the original costs of acquisition and construction of the Plant in the same proportions as the allocation of capacity rights to them. The City of Palo Alto (the City) is the owner and administrator of the Plant. The Cities of Mountain View and Los Altos are entitled to use a portion of the capacity of the Plant, as set forth in the Basic Agreement between the City of Palo Alto, the City of Mountain View and the City of Los Altos for the Acquisition, Construction and Maintenance of a Joint Sewer System dated October 10, 1968, as amended by addenda dated December 5, 1977, January 14, 1980, April 9, 1985, May 30, 1991, July 31, 1992, March 16, 1998, April 15, 2009, October 17, 2016, March 4, 2019, and May 17, 2021 (collectively, the “Basic Agreement”). The Basic Agreement will terminate on December 31, 2060, unless a written notice of withdrawal is tendered ten years preceding the date of withdrawal.

On May 17, 2021, the Members approved the construction of a new outfall and related improvements to existing discharge infrastructure and the rehabilitation of the primary sedimentation tanks including electrical upgrades. Each Member agreed to pay its share of the project costs, in proportion to the capacity it owns in the Joint Sewer System. The Members also authorized the City to receive State Revolving Fund Loan from the State Water Resources Control Board (SWRCB) or pursue other project financing to fund the costs of the projects.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The Plant is an enterprise that is operated by the City and its operations are accounted for as an enterprise fund in the City’s basic financial statements. The financial statements are prepared in accordance with the financial reporting provisions of the Basic Agreement, which is a basis of accounting other than accounting principles generally accepted in the United States of America. The accompanying financial statements are intended to present the Plant’s net expenditures and quarterly billings by the Plant to the Cities of Mountain View and Los Altos pursuant to the agreement of the Members as described above and are not intended to be a complete presentation of the Plant’s financial position or results of operations. Additionally, the capital cost and the outstanding debt of the Plant are not presented in these statements but are presented in the basic financial statements of the City.

Plant expenditures, joint system revenues, debt service and industrial waste compliance expenditures are shared by the Members based on agreed upon allocation percentages. The expenditures, including indirect administrative expenditures (see Note 4), are allocated to each of the Members based primarily on their respective percentages of the annual sewage flow and treatment needed for suspended solids, chemical oxygen demand and ammonia. Revenues from services, fines and penalties are allocated to each of the Members in the same proportions as those of expenditures. Debt service payments are allocated based on percentages established at the time of bond issuance. Industrial waste compliance (public outreach and permitting and enforcement) charges are allocated to Members primarily based on upon the number of industries and efforts required to maintain compliance with sewage use ordinances and other regulations from Environmental Protection Agency.

**CITY OF PALO ALTO**  
**REGIONAL WATER QUALITY CONTROL PLANT**  
Notes to the Financial Statements  
For the Year Ended June 30, 2022

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

The percentages used for the year ended June 30, 2022, to allocate expenditures and revenues were as follows:

	<u>City of Mountain View</u>	<u>City of Los Altos</u>	<u>City of Palo Alto</u>
Public outreach, source control program, operations and maintenance, system improvement CIP and joint system revenues	40.22%	11.58%	48.20%
Permitting and enforcement	40.34%	2.37%	57.29%
Debt services expenditures:			
Refunding 1990 Series A Bonds	51.00%	7.80%	41.20%
1999 Wastewater Treatment New Project	37.89%	9.47%	52.64%
2009 State Water Resources Loan	37.89%	9.47%	52.64%
2017 State Water Resources Loan	37.89%	9.47%	52.64%

The City is allocated 48.20% of total usage of the treatment plant. The City does not fully utilize its percentage allocation. Therefore, the City has entered into separate contracts to allocate portions of its excess to other entities. Fiscal year 2022 allocations are as follows:

East Palo Alto Sanitary District	7.29%
Stanford University	6.19%
Town of Los Altos Hills	2.35%
Remaining City percentages	<u>32.37%</u>
Total	<u><u>48.20%</u></u>

The agreement the City has with the above entities has no effect on the partnership agreement between the Members.

Billings are made in advance and are based on the adopted budget for the plant and estimated sewage flow. Excess (deficit) billings over (under) net expenditures are offset against the payments during the second quarter of the subsequent fiscal year.

**NOTE 3 – SYSTEM IMPROVEMENT CAPITAL IMPROVEMENTS PROGRAM (CIP)**

The basic agreement between the Members, dated October 10, 1968, provides that the administrator of the Plant is responsible for capital additions. These capital additions should be for the replacement of obsolete or worn-out units, or minor capital additions to improve the efficiency of the Plant's operations. Per the addendum to the agreement dated March 16, 1998, the Members agreed that capital additions should not exceed \$1.9 million in 1998-99 (base year). For future years, the base year amount will be adjusted annually based on increases to the Consumer Price Index-Urban Wage Earners and Clerical Workers for the San Francisco-Oakland-San Jose area. For fiscal year 2022, the adjusted capital additions limit is \$3,704,458. Actual minor System Improvement CIP expenditures amounted to \$886,540 for fiscal year 2022. As of June 30, 2022, the commitments for minor capital additions, including unspent capital additions, is \$10,212,274 which have been carried forward to fiscal year 2023.

**CITY OF PALO ALTO**  
**REGIONAL WATER QUALITY CONTROL PLANT**  
 Notes to the Financial Statements  
 For the Year Ended June 30, 2022

**NOTE 4 – INDIRECT ADMINISTRATIVE EXPENDITURES**

Indirect expenditures include those costs allocated from the City’s General Fund administrative services, which supports all operating departments of the City. Other indirect expenses are administrative charges from the City’s Internal Services Funds. These allocations are applied on a uniform basis throughout the City. The allocations are applied in accordance with the subsequent letter of agreement dated April 9, 1985.

**NOTE 5 – DEBT SERVICE EXPENDITURES**

Debt service expenditures include principal repayments, interest expense and amortization of bond discount reduced by any interest income earned from investments with the fiscal agent, related to the 1999 Series A Bonds (split for the portions used for the “New Project” and refunding of the 1990 Series A Bonds) and the 2009 and 2017 State Water Resources loans.

In June 1999, the City, City of Mountain View, City of Los Altos, Town of Los Altos Hills, East Palo Alto Sanitary District, and Stanford University agreed to issue bonds (1999 Series A Bonds) to finance the rehabilitation of the Wastewater Treatment System’s two sludge incinerators and to refund the 1990 Series A Bonds.

In October 2009, the City and the SWRCB executed an agreement for the 2009 State Water Resources Loan to finance the Ultraviolet Disinfection Project.

In June 2017, the City and the SWRCB executed an agreement for State Water Resources Loan for an award up to \$30 million, 30 years at 1.8% to finance the project replacing the sewage sludge “bio-solids” incinerators at the Plant. On September 13, 2017, the City and the SWRCB amended the original agreement of the 2017 SRF loan to lower the total amount to \$29.7 million and the due date of the last debt service payment be May 31, 2049. Under the terms of the amended agreement, a portion of the loan amount, \$4.0 million, is federally funded and the obligation balance was adjusted.

The new facility will dewater the bio-solids and allow it to be loaded onto trucks and taken offsite for further treatment until further treatment units can be built onsite. The Plant provides treatment and disposal for wastewater for the City, City of Mountain View, City of Los Altos, Town of Los Altos Hills, East Palo Alto Sanitary District, and Stanford University. Though the City is the recipient of the loan, the City’s agreement with the partner agencies oblige them to pay their proportionate share of the principal and interest of this loan. The City’s share of the loan payment is 38.2% with the partner agencies paying 61.8%.

In July 2021, the SWRCB and the City executed a direct loan agreement for an award up to \$17.5 million to finance the rehabilitate and upgrade the Plant’s primary sedimentation tanks and ancillary systems. Per the SWRCB agreement, the first debt service payment of this loan is due on February 15, 2024.

In May 2022, the City approved a \$168.7 million direct loan agreement with SWRCB to finance the Secondary Treatment Upgrades project to produce treated effluent with reduced total nitrogen content, increase treatment capacity, and rehabilitate aging infrastructure. Per the SWRCB agreement, the first debt service payment of this loan is due on December 31, 2027.

**CITY OF PALO ALTO**  
**REGIONAL WATER QUALITY CONTROL PLANT**  
Notes to the Financial Statements  
For the Year Ended June 30, 2022

**NOTE 5 – DEBT SERVICE EXPENDITURES (Continued)**

The principal amount of the debt outstanding as of June 30, 2022 are allocated as follows:

	1999 Utility Revenue Refunding Bonds		2009 State Water Resources Loan	2017 State Water Resources Loan	Total				
	1999 Wastewater Treatment New Project	Refunding of 1990 Series A Bonds							
	City of Palo Alto	\$ 375,875				\$ 190,000	\$ 1,682,396	\$ 8,848,210	\$ 11,096,481
	City of Mountain View	373,217				387,600	1,670,492	8,785,605	11,216,914
City of Los Altos	93,280	59,280	417,513	2,195,822	2,765,895				
East Palo Alto Sanitary District	75,254	90,440	336,832	1,771,497	2,274,023				
Stanford University	51,811	31,160	231,903	1,219,643	1,534,517				
Town of Los Altos Hills	15,563	1,520	69,659	366,357	453,099				
Total	<u>\$ 985,000</u>	<u>\$ 760,000</u>	<u>\$ 4,408,795</u>	<u>\$ 23,187,134</u>	<u>\$ 29,340,929</u>				

**NOTE 6 – JOINT SYSTEM REVENUES**

The Plant's joint system revenues for the year ended June 30, 2022 total \$587,262 which consisted of the following:

Septic hauling services	\$ 298,411
Valley Water	209,909
Other miscellaneous revenues	14,112
Salt water marsh services	7,500
Interdepartment services	15,040
Utility service to other utility funds	42,301
Bad debt expense	(11)
	<u>\$ 587,262</u>

**NOTE 7 – RELATED PARTY TRANSACTIONS**

During fiscal year 2022, the Plant paid the City \$2,030,324 for utility costs. Such costs are included in the Statement of Net Expenditures as source control program, permitting and enforcement, and operations and maintenance expenditures. Vehicle replacement charges of \$22,293 were paid to the City's Vehicle Replacement and Maintenance Internal Services Fund, which is included in the Statement of Net Expenditures as operations and maintenance expenditures.

**CITY OF PALO ALTO, CALIFORNIA**

Independent Accountant's Report on  
Applying Agreed-Upon Procedures Related to  
the Article XIII-B Appropriations Limit

For the Year Ended June 30, 2022



Certified  
Public  
Accountants



**Independent Accountant’s Report on  
Applying Agreed-Upon Procedures Related to  
the Article XIII-B Appropriations Limit**

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

We have performed the procedures enumerated below to the accompanying Appropriations Limit Worksheet of the City of Palo Alto, California (City) for the year ended June 30, 2022. The City’s management is responsible for the appropriations limit calculation for the year ended June 30, 2022.

The City has agreed to and acknowledged that the procedures performed are appropriate to meet the intended purpose of assisting the City in evaluating the appropriations limit calculation in accordance with the requirements of Section 1.5 of Article XIIB of the California Constitution. The procedures are recommended by the California Committee on Municipal Accounting (as presented in the CCMA White Paper titled *Agreed-upon Procedures Applied to the Appropriations Limit Prescribed by Article XIII-B of the California Constitution*). This report may not be suitable for any other purpose. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

The procedures and associated findings are as follows:

1. We obtained the completed worksheets setting forth the calculations necessary to establish the City’s appropriations limit and compared the limit and annual adjustment factors included in those worksheets to the limit and annual adjustment factors that were adopted by resolution of the City Council. We also compared the population and inflation options included in the aforementioned worksheets to those that were selected by a recorded vote of the City Council.

**Finding:** The City applied an incorrect population adjustment factor for the calculation of the current year appropriations limit. The population factor used by the City for the calculation was 0.9999. The change in population of the County of Santa Clara, as provided by the State of California’s Department of Finance was -0.56% and thus the population adjustment factor should be 0.9944. Total adjustment factors should be 1.0514 and the total adjustment amount should be \$9,240,000.

2. For the accompanying Appropriations Limit Worksheet, we added the prior year appropriations limit to the total adjustments and compared the resulting amount to the current year appropriations limit.

**Finding:** As discussed in the finding of procedure 1 above, the City applied an incorrect population adjustment factor for the calculation of the current year appropriations limit. If the City applied the correct population adjustment factor, the total adjustment amount should be \$9,240,000 and the current year appropriations limit should be \$189,100,000, which is \$1,060,000 lower than the current year adopted appropriations limit. The City’s actual revenue did not exceed the proper appropriation limit of \$189,100,000.

3. We agreed the current year information presented in the accompanying Appropriations Limit Worksheet to the appropriate supporting worksheets described in No. 1 above.

**Finding:** See findings of procedures 1 and 2 above.

4. We agreed the prior year appropriations limit presented in the accompanying Appropriations Limit Worksheet to the prior year appropriations limit adopted by the City Council.

**Finding:** No exceptions were noted as a result of our procedures.

We were engaged by the City to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively, on the appropriations limit calculation for the year ended June 30, 2022. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. No procedures have been performed with respect to the determination of the appropriations limit for the base year, as defined by Article XIII-B of the California Constitution.

We are required to be independent of the City and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our agreed-upon procedures engagement.

This report is intended solely for the information and use of City Council and the City's management, and is not intended to be and should not be used by anyone other than these specified parties.

*Macias Gini & O'Connell LLP*

Walnut Creek, California  
November 16, 2022



**CITY OF PALO ALTO, CALIFORNIA**  
Appropriations Limit Worksheet  
For the Year Ended June 30, 2022

2020-2021 appropriation limit, as adopted	\$ 179,860,000
Adjustment factors:	
Population <sup>(1)</sup>	0.9999
Inflation <sup>(2)</sup>	<u>1.0573</u>
Total adjustment factors (rounded) <sup>(3)</sup>	1.0572
 Total adjustments (rounded)	 <u>10,300,000</u>
 2021-2022 appropriation limit, as adopted	 <u><u>\$ 190,160,000</u></u>

- (1) The population factor may be based on the change in population of 1) the City or 2) the County of Santa Clara, as provided by the State of California’s Department of Finance. The population factor adopted by the City for the current year appropriation limit represents the change in population of the County of Santa Clara. However, the City applied an incorrect population adjustment factor for the calculation of the current year appropriations limit. See findings in the Independent Accountant’s Report.
- (2) The inflation factor may be based on 1) the change in per capita personal income for the State of California, as provided by the State of California’s Department of Finance; or 2) the change in the assessed valuation due to new non-residential construction within the City. The inflation factor adopted by the City for the current year appropriation limit represents the change in per capita personal income.
- (3) The total adjustment factor is calculated by multiplying the population factor by the inflation factor.





# City of Palo Alto

## Finance Committee Staff Report

(ID # 14632)

**Meeting Date: 11/29/2022**

**Report Type: Action Items**

**Title: Approval of the FY 2022 Annual Comprehensive Financial Report (ACFR) and Year-End Budget Amendments in Various Funds**

**From: City Manager**

**Lead Department: Administrative Services**

### RECOMMENDATION

Staff recommends that the Finance Committee forward to the City Council for its approval:

1. The City's Fiscal Year (FY) 2022 Annual Comprehensive Financial Report (ACFR); and
2. Amend the FY 2022 Budget Appropriation Ordinance for various funds as identified in the attached Recommended Amendments to the City Manager's FY 2022 Budget (Operating Budget: **Attachment B – Exhibit 1**; Capital Budget: **Attachment B – Exhibit 2**).

### EXECUTIVE SUMMARY

The City's fiscal year ended on June 30, 2022, financial records closed, and financial reports summarizing the fiscal year were prepared. The reports, along with the City's financial data, were audited by Macias Gini & O'Connell LLP (MGO), Certified Public Accountants, a firm hired by the City Auditor. MGO issued an unmodified (clean) audit opinion on the financial position of the City's activities and, together with the City's financial statements and other information, comprises the City's Annual Comprehensive Financial Report (ACFR). The full report can be found in Attachment C.

In addition to the ACFR, this report includes recommended budget adjustment actions to close the fiscal year. These technical actions reallocate and realign the budget to appropriate funds in alignment with actual operating and capital expenditures and revenue collected as well as adjust transfers between funds.

### Financial Highlights for FY 2022

#### ***Government-wide***

At the close of FY 2022, the City's total Net Position is \$1.27 billion, an increase of \$40.6 million or 3.2% over the prior fiscal year. The Statement of Net Position (p. 31 of the ACFR) reports Governmental Activities Net Position (the City's basic services which are generally funded by taxes, and by specific program revenues such as fees and grants) at \$474.1 million, a \$51.0

million increase from the prior year, and Business-Type Activities Net Position (the City's enterprise activities which are funded in whole or in part by fees charged to external parties) at \$796.8 million, a \$10.4 million decrease. Various factors contributed to these changes, including accounting adjustments required by the Governmental Accounting Standards Board (GASB).

### **General Fund**

The General Fund ended with a net Budget Stabilization Reserve (BSR) surplus of \$14.2 million, compared to estimates used in the development of the FY 2023 Adopted Budget and the Council's target reserve level of 18.5% of budgeted expenses. Overall, a total \$100.1 million fund balance of both restricted and unrestricted balances is \$24.4 million higher than the prior year balance of \$75.6 million. The BSR is \$72.8 million, a \$23.7 million or 48.3% increase from FY 2021. This increase is driven by both higher than budgeted revenues and lower than budgeted expenditures. Much of this variance was forecasted, discussed, and a core component of the FY 2023 Adopted Budget and two-year budget balancing strategy to ensure continued stability for the organization and community through uncertain times. Once the BSR is adjusted for Council approved uses to balance the FY 2023 Adopted Budget<sup>1</sup> and other needs through the first quarter of FY 2023, the City's actual \$59.8 million BSR balance is above the Council's 18.5% target (\$45.6 million) for FY 2023 by \$14.2 million.

Major tax revenues such as sales tax, property tax, transient occupancy tax, utility user tax, and documentary transfer tax were higher than budgeted while expense savings were realized across many of the departments (detailed in Attachment A). Although all the major taxes are higher than the Adjusted Budget, the pandemic continues to impact the City's revenue with sales tax, transient occupancy tax, and utility user tax, remaining lower compared to pre-pandemic revenues.

### **Business Type Activities (Enterprise Funds & Internal Service Funds)**

As of June 30, 2022, the City's Enterprise Funds reported a total net position of \$796.8 million, a decrease of \$10.4 million or 1.3% from the prior year. All funds showed positive balances: Net Investment in Capital Assets (\$670.8 million), Restricted for Debt Service (\$3.3 million), and Unrestricted (\$122.7 million).

Internal Service Funds ended the fiscal year with \$86.0 million net position balance. All funds showed positive balances except the Printing and Mailing and Workers Compensation Insurance Program Funds. The Printing and Mailing Fund reported a \$0.2 million negative balance due to the pension liability per GASB 68 and Other Post-Employment Benefits (OPEB) liability per GASB 75. Workers Compensation Insurance Program Fund showed a \$0.6 million negative balance due to unrealized market losses on investments. Once adjusted for these noncash transactions, both funds remain with a positive fund balance.

---

<sup>1</sup> City Council June 30, 2022, Agenda Item #28; CMR #14352;  
<https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/city-council-agendas-minutes/2022/20220620/20220620pccsm-amended-final-final.pdf#page=557>

## BACKGROUND

The City's fiscal year ends on June 30, at which time its financial records are closed for the year and financial reports are prepared. The reports, along with the City's financial data, are audited by Macias Gini & O'Connell LLP (MGO), Certified Public Accountants, a firm hired by the City Auditor. MGO issues an audit opinion on the financial position of the City's activities and, together with the City's financial statements and other information, comprises the City's Annual Comprehensive Financial Report (ACFR) that can be found in **Attachment C**.

**Attachment B** outlines technical recommended amendments to the FY 2022 Budget. These recommended actions close the fiscal year by reallocating and realigning budget to appropriate funds for actual operating and capital expenditures and revenue collected as well as adjust transfers between funds. The General Fund Summary found in **Attachment A**, provides detailed information of revenue and expenditures by department. The Discussion section of this staff report includes Results by Fund which discusses position of fund balances, major revenue sources, and expense highlights.

The ACFR includes government-wide statements and fund level financial statements that provide a snapshot of fund balances and activity for the year. An overview of financial results, information on how to navigate the ACFR document, and highlights of key fiscal issues affecting the City can be found in the Management's Discussion and Analysis (MD&A) section (ACFR p. 5). The MD&A also provides a discussion and analysis of the City's current fiscal health and includes financial statements and analysis compared to the prior year, along with capital asset and debt administration data.

Throughout this report, pronouncements released by GASB are referred to by issuance number. For example, GASB Pronouncement No. 68 is referenced in this report as GASB 68. A full list of pronouncements can be found on [GASB's website](#).

## DISCUSSION & ANALYSIS

There are two methods of displaying the City's financials that are included in the FY 2022 ACFR, 1) Government Wide Statements and 2) Fund Financial Statements. The discussion below is organized by these two reporting standards and the results contained within. To assist in the terminology below is a brief overview of these; each of these displays of the City's financial statements are governed by Generally Accepted Accounting Principles (GAAP) as modified regularly by the Governmental Accounting Standards Board (GASB). Neither of these views are the same as the City's annual budget; however, Fund Financial Statements is most closely aligned.

### Government Wide Financial Statements

- *Governmental Activities* – City’s basic services generally funded by taxes, and/or by specific program revenues such as fees and grants (full accrual) + includes portion of internal service funds
- *Business Type Activities* – City’s enterprise activities which are funded in whole or in part by fees charged to external parties (full accrual) + includes portion of internal service funds

### Fund Financial Statements

- *Governmental Funds* – similar to “governmental activities” EXCEPT on a modified accrual basis of accounting + excludes internal service funds.
- *Proprietary Funds* – same as “business type activities” EXCEPT includes internal service funds. Includes what we refer to as “enterprise funds” (full accrual)

## Government-wide Statements

### ***Statement of Net Position***

The Statement of Net Position presents information of all the City’s assets plus deferred outflows of resources, and liabilities plus deferred inflows of resources, with the reported net position.

The City’s net position was \$1.271 billion on June 30, 2022, compared to a balance of \$1.230 billion on June 30, 2021. The total increase of \$40.6 million, or 3.2%, consists of \$51.0 million from governmental activities partially offset by a decrease of \$10.4 million from business-type activities.

The largest portion of the City’s net position (\$1.175 billion or 92.4%) is its net investment in capital assets such as land, buildings, infrastructure, vehicles, and intangible assets – right to use leased assets less any related outstanding debt that was used to acquire these assets. The restricted portion of the City’s net position (\$76.2 million or 6.0%) represents resources that are subject to external restrictions on how they may be used. The remaining balance of \$20.0 million, across all funds, representing 1.6% of the City’s net position, is unrestricted and may be used to meet the City’s ongoing obligations to its citizens and creditors.

The unrestricted net position for the governmental activities portion is negative mainly due to the recognition of the net pension liabilities required by GASB Statement No. 68 and net OPEB liabilities required by GASB Statement No. 75. The \$102.7 million deficits for governmental activities include the \$286.6 million impact of net pension liabilities and its related deferred outflows of resources (GASB 68) and \$78.3 million impact of net OPEB liabilities and its related deferred outflows of resources and deferred inflows of resources (GASB 75). Excluding these impacts, the Governmental Activities’ unrestricted net position is \$262.2 million.

The net position of both governmental and business type activities reduced by \$50.6 million due to unrealized market losses on the City’s investment. Actual investment earnings on the City’s portfolio are \$9.0 million; however, the net interest earnings reported in the financial

statement have a negative balance of \$41.6 million due to accounting for unrealized losses on the City's investments. Per GASB 31, public agencies are required to report the change in the valuation of City's portfolio, and due to the rising interest rates, the portfolio's fixed income securities have a "paper" loss as of June 30. The City's long-standing practice is to hold investments to maturity and due to this practice, there will likely be no actual losses incurred on these investments.

**TABLE 1**  
**STATEMENT OF NET POSITION**  
*As of June 30, 2022*  
(in millions)

	Governmental Activities		Business-type Activities		Government-wide Totals	
	2022	2021	2022	2021	2022	2021
Cash and investments	\$ 400.7	\$ 443.4	\$ 241.3	\$ 285.6	\$ 642.0	\$ 729.0
Other assets	82.4	76.6	50.7	47.7	133.1	124.3
Capital assets	674.2	602.0	735.2	693.2	1,409.4	1,295.2
Deferred outflows	59.2	60.8	24.7	21.1	83.9	81.9
<b>Total assets and deferred outflows</b>	<b>1,216.5</b>	<b>1,182.8</b>	<b>1,051.9</b>	<b>1,047.6</b>	<b>2,268.4</b>	<b>2,230.4</b>
Net pension and OPEB liabilities	316.5	438.2	109.5	159.7	426.0	597.9
Long-term debt	210.2	217.5	64.3	68.9	274.5	286.4
Other liabilities	102.9	87.6	33.1	23.8	136.0	111.4
Deferred inflows	112.8	16.3	48.2	6.4	161.0	22.7
<b>Total Liabilities</b>	<b>742.4</b>	<b>759.6</b>	<b>255.1</b>	<b>258.8</b>	<b>997.5</b>	<b>1,018.4</b>
<b>Net Position</b>						
Net investment in capital assets	503.9	480.6	670.8	642.0	1,174.7	1,122.6
Restricted	72.9	80.3	3.3	3.4	76.2	83.7
Unrestricted	(102.7)	(137.7)	122.7	161.8	20.0	24.1
<b>Total Net Position</b>	<b>\$ 474.1</b>	<b>\$ 423.2</b>	<b>\$ 796.8</b>	<b>\$ 807.2</b>	<b>\$ 1,270.9</b>	<b>\$ 1,230.4</b>

### ***Statement of Activities***

The major sources of the City's revenues are Program Revenues and General Revenues. Program Revenues consist of charges for services (both governmental and business type activities) as well as operating and capital grants and contributions. General Revenues include property tax, sales tax, utility user tax, transient occupancy tax, documentary transfer tax, other taxes and miscellaneous revenue.

Revenues for the City in FY 2022 were \$565.4 million, an increase of \$11.7 million or 2.1% above FY 2021, due to a \$21.6 million increases in Governmental Activities partially offset by a \$9.9 million decrease from Business Activities. Governmental Activities increased \$21.6 million due to program and general revenues. The increases in program revenues are due to resumption and increase of in-person classes, paramedic revenues, ARPA funding totaling \$8.2 million, and \$25.7 million donation from Friends of the Junior Museum & Zoo (JMZ). The increases in general revenues are from major taxes partially offset by decreases in investment earnings from the negative impact of fair market value adjustments. Business Activities revenue decreased \$9.9 million mainly due to decreases in Water Fund revenues resulting from conservation efforts in response to the drought. This was partially offset by an increase in Gas Fund revenues driven by a 3% rate increase and portion of the commodity price increases is passed through to customers. Another factor driving the decrease of the revenue is the decrease of investment earnings resulting from negative fair market value adjustments.

Expenses for the City in FY 2022 were \$524.8 million, a decrease of \$24.1 million or 4.4% below FY 2021, due to a \$45.6 million decrease from Governmental Activities that is partially offset by a \$21.6 million increase from Business-type expenses.

The decrease in Governmental Activities expenses is mainly due to the decrease in pension and OPEB related adjustments for GASB 68 and GASB 75, primarily due to higher actual than expected interest earnings of City's pension and OPEB plan.

Administrative Services expenses decreased \$8.0 million, primarily due to the \$12.6 million set aside established in FY 2021 for *Green v. City of Palo Alto*. Additional expenses of \$4.9 million were set aside in 2022 to settle the case. The City has a total claim payable of \$17.5 million for the Green case on its governmental activities' financial statements

Public Works expenses, which decreased \$21.5 million mainly due to review and reclassification of construction in progress balances and determined that certain expenses, specifically various repairs and maintenance of streets, sidewalks, facilities, and parks, should not have been capitalized per Generally Accepted Accounting Principles (GAAP). The expense to correct these construction progress balances was recorded as part Public Works functional expenses in FY 2021. These actions are consistent with recent staff review, affirmed by an audit completed by BakerTilly (the City Auditor), to more accurately account for capitalized assets.

The increase of Business Type Activities is driven by several cost categories and resulted in higher costs compared to prior year, including energy purchase cost, operations and maintenance in Electric Fund, and commodity purchases in Gas Fund. These increases were partially offset by the decrease in pension and OPEB related adjustments for GASB 68 and GASB 75, primarily due to higher actual than expected interest earnings of City's pension and OPEB plan.

**TABLE 2**  
**Statement of Activities for the Year Ended June 30**  
**(in millions)**

	<u>2022</u>	<u>2021</u>	<u>Increase / (Decrease)</u>
<b>Revenues</b>			
Program Revenues	\$ 462.7	\$ 423.2	\$ 39.5
General Revenues	102.7	130.5	(27.8)
<b>Total Revenues</b>	<u>\$ 565.4</u>	<u>\$ 553.7</u>	<u>\$ 11.7</u>
<b>Expenses</b>			
<b>Governmental Activities</b>			
City Council	\$ (0.1)	\$ 0.2	(0.3)
City Manager	1.6	2.5	(0.9)
City Attorney	2.0	2.3	(0.3)
City Clerk	0.4	0.7	(0.3)
City Auditor	0.5	0.6	(0.1)
Administrative Services	15.0	23.0	(8.0)
Human Resources	1.6	2.5	(0.9)
Public Works	31.2	52.7	(21.5)
Planning and Development Services	15.7	18.1	(2.4)
Office Of Transportation	4.4	3.6	0.8
Police	35.1	43.6	(8.5)
Fire	31.2	37.1	(5.9)
Community Services	31.9	30.3	1.6
Library	9.5	11.1	(1.6)
Interest and Other Expense	9.0	6.3	2.7
<b>Business Type Activities</b>			
Water	41.9	43.6	(1.7)
Electric	169.1	156.1	13.0
Fiber Optics	2.2	2.5	(0.3)
Gas	40.7	28.6	12.1
Wastewater Collection	18.3	19.6	(1.3)
Wastewater Treatment	27.1	28.4	(1.3)
Refuse	30.0	29.1	0.9
Storm Drainage	4.6	4.9	(0.3)
Airport	1.9	1.5	0.4
<b>Total Expenses</b>	<u>\$ 524.8</u>	<u>\$ 548.9</u>	<u>\$ (24.1)</u>
Change in Net Position	<u>\$ 40.6</u>	<u>\$ 4.8</u>	<u>\$ 35.8</u>

### Capital Assets

The City's capital assets for its governmental and business-type activities as of June 30, 2022 amounts to \$1.409 billion (net of accumulated depreciation), which is a \$98.9 million or 7.5% increase over FY 2021. The increase was primarily due to various projects such as the Charleston Arastradero Corridor, Public Safety Building, Highway 101 Bicycle and Pedestrian Bridge, Water Main Replacement, Smart Grid Technology Installation, Electric System Improvements, and Primary Sedimentation Tank Rehabilitation. In addition, due to the \$29.2 renovated Junior Museum and Zoo (JMZ) of which \$25.7 million was a donation from the Friends of JMZ

City implemented GASB 87 – Leases which resulted in an increase of Intangible Asset – right to use leased assets amounting to \$9.1 million, net of amortization.

**TABLE 3**  
**Capital Assets**

	<u>2022</u>	<u>2021</u>	<u>(Decrease)</u>
<b>Governmental activities</b>			
Land and improvements	\$ 82.1	\$ 82.1	\$ -
Street trees	15.0	14.8	0.2
Construction in progress	121.9	143.4	(21.5)
Building and improvements	350.6	272.1	78.5
Intangible assets	3.8	3.8	-
Equipment	82.9	80.3	2.6
Roadway network	359.1	335.3	23.8
Recreation and open space network	37.0	35.2	1.8
Less accumulated depreciation	(385.2)	(365.0)	(20.2)
Intangible assets-right to use leased assets	9.8	-	9.8
Less accumulated amortization	(2.8)	-	(2.8)
Total Governmental Activities	<u>674.2</u>	<u>602.0</u>	<u>\$ 72.2</u>
<b>Business-Type Activities</b>			
Land	\$ 5.0	\$ 5	\$ -
Construction in progress	136.9	129.0	7.9
Buildings and improvements	80.5	74.5	6.0
Infrastructure	0.6	0.6	-
Transmission, distribution and treatment systems	948.9	914.8	34.1
Less accumulated depreciation	(438.8)	(415.4)	(23.4)
Intangible assets-right to use leased assets	2.9	-	2.9
Less accumulated amortization	(0.8)	-	(0.8)
Total Business-Type Activities	<u>\$ 735.2</u>	<u>\$ 708.5</u>	<u>\$ 26.7</u>
<b>Total Capital Assets</b>	<u>\$ 1,409.4</u>	<u>\$ 1,310.5</u>	<u>\$ 98.9</u>



### ***Liabilities***

As of June 30, 2022, the City's liabilities totaled \$831.6 million, which is a \$164.1 million or 16.5% decrease below FY 2021. The decrease was due City's Net Pension Liabilities and Net Other Post-Employment Benefit (OPEB) Liabilities decreasing by \$171.9 million, driven primarily due to investment earnings that increased the OPEB Plan's Net Position, scheduled debt service payments, and refinancing activities. The decrease was partially offset by an increase of lease liabilities amounting to \$10.0 million due to GASB 87 – Leases implementation.

### **Fund Financial Statements**

#### **General Fund**

##### ***General Fund Reserves***

The General Fund ended with a net Budget Stabilization Reserve (BSR) surplus of \$14.2 million, when compared to estimates used in the development of the FY 2023 Adopted Budget and the Councils target reserve level of 18.5% of budgeted expenses. Overall, at the end of the current fiscal year, the General Fund's fund balance was \$100.1 million of both restricted and unrestricted balances. This fund balance is comprised of several reserves: the Budget Stabilization Reserve (BSR or City's general reserve), reappropriations, notes and loans, inventory, prepaid items, and other general government special purpose reserves (this includes reserves for encumbrances and donations). In FY 2022, \$1.7 million was set aside for the Reserve for Excess Educational Revenue Augmentation Fund (ERAF) for the at-risk amount related to the lawsuit filed in November 2021 by the California School Boards of Association and its Education Legal Alliance against the Controller of the State of California for over the calculation methodology of the Excess ERAF.

As described in the BSR reserve policy approved by the Council, the reserve is to remain 15-20% of the General Fund operating budget, with a target goal of 18.5%. Any reserve balance in excess of the 18.5% target may be transferred to the Infrastructure Reserve (IR) in the Capital Improvement Fund, and/or the City's Section 115 Pension Trust, as outlined in the Pension Funding Policy at the discretion of the City Manager.

The FY 2023 Adopted Operating Budget projected a \$54.7 million BSR balance as of June 30, 2022, compared to the actual balance of \$72.8 million (this is a component of the General Fund, fund balance noted above). The BSR is above projected levels due to higher major taxes and program revenues, and lower expenses due to higher vacancy savings and lower expenses across departments for internal costs to run the City such as utilities, printing and mailing, and vehicle maintenance.

Much of this variance was forecasted, discussed, and a core component of the FY 2023 Adopted Budget and two-year budget balancing strategy. The Council recognized these higher than budgeted estimate and used these funds to bridge the transition as the City and community emerged from the pandemic while ensuring stability for the organization. The chart below outlines the already approved uses of the BSR in FY 2023. These adjustments, totaling \$13.0

million, results in a BSR balance of \$59.8 million; approximately 24.2% of the FY 2022 Adopted expenses of \$247.4 million. This level is approximately \$14.2 million above the target level of 18.5% (\$45.6 million). Micro and macro-economic conditions are adjusting daily, with rising inflation, changes in jobs, and recessionary trends creating significant uncertainty. As the State of California Legislative Analyst Office (LAO) wrote in their annual Fiscal Outlooks for California “Economic Conditions Weigh on Revenues, [the] booming economy has led to high inflation...efforts to tame inflation are slowing the economy...inflation pressures remain, raising risk of recession...fiscal outlooks revenues balance competing risks.”<sup>2</sup> Therefore, below are recommended adjustments in line with the City Manager’s authority for transfer of excess BSR, adjusted for a recommendation to reserve funds to safeguard the stability the City has strived to achieve in the recent year by re-establishing an economic uncertainty reserve. Staff anticipates returning to Council in February 2023 with the FY 2023 Mid-Year Review and recommendations in alignment with the allocation below for the appropriation of BSR funds above the 18.5% level. Staff do recommend a transfer to the Infrastructure Reserve as inflationary costs are impacting capital project needs including anticipated significant price increases in the Automated Parking Guidance Project, as well as a need to provide safety improvements to critical assets such as the artificial turf playing fields.

---

<sup>2</sup> The 2023-24 Budget California’s Fiscal Outlook, California Legislative Analyst’s Office (LAO), November 16, 2022, <https://lao.ca.gov/Publications/Report/4646>

<b>TABLE 4</b> <b>Year-End Budget Stabilization Reserve (BSR) Summary</b> (in millions)	
<b>General Fund BSR Balance, June 30, 2022</b>	<b>\$72,835</b>
<b>Uses of the FY 2022 Surplus</b>	
<i>FY 2023 Approved Adjustments to the BSR Balance</i>	
FY 2023 Adopted Budget	(\$9,072)
FY 2023 Services Reinvestment	(\$3,700)
Downtown Streets Team (CMR 14526)	(\$167)
Reappropriations (CMR 14728)	(\$100)
<b>Subtotal: Approved Adjustments to the BSR Balance</b>	<b>(\$13,039)</b>
<b>Subtotal: BSR Balance, After Approved Adjustments</b>	<b>\$59,796</b>
<i>FY 2023 RECOMMENDED Adjustments to the BSR Balance</i> <i>(to be considered in FY 2023 Mid-Year Budget)</i>	
Reserve for Economic Uncertainty	(\$5,000)
Transfer to Section 115 Pension Trust Fund	(\$5,000)
Transfer to Infrastructure Reserve (IR) in the Capital Improvement Fund	(\$4,000)
<b>Subtotal: RECOMMENDED Adjustments to the BSR Balance</b>	<b>(\$14,000)</b>
<b>Current Projected FY 2022 BSR Level, (June 30, 2023)</b>	<b>\$45,796</b>

### **General Fund Revenues**

General Fund revenues for FY 2022 were \$190.4 million, which is \$23.6 million or 14.1% higher than the prior year. Year-over-year changes in each of the major tax revenue categories are summarized in the following table. The majority of these higher than budgeted revenues were forecasted and discussed as part of the FY 2023 Adopted Budget, in May 2022, staff and the Finance Committee discussed use of a projected \$14 million excess revenues to develop a two-year budget strategy and begin reinvestments.

<b>TABLE 5</b> <b>General Fund Major Tax Revenues</b> (in millions)			
Category	FY 2022	FY 2021	% Change Increase (Decrease)
Property tax	\$ 59,353	\$ 56,572	4.9%
Sales tax	32,705	29,127	12.3%
Utility user tax	15,599	14,642	6.5%
Transient occupancy tax	16,946	5,179	227.2%
Documentary transfer tax	11,990	10,627	12.8%

**Property tax** revenue increased \$2.8 million or 4.9% due to property assessed value growth that was driven by the change of ownership, and an increase of \$1.1 million in the Excess Educational Revenue Augmentation Fund (ERAF) distribution.

**Sales tax** receipts were \$3.6 million or 12.3% higher than the prior year. The increase is due to the strong performance of apparel and department stores, furniture/appliance, and food products categories which include restaurants, and transportation such as new auto sales. The City’s revenue base also benefits from many high-end goods and dining options at regional destinations, such as Stanford Shopping Center.

**Utility user tax** revenues are \$1.0 million or 6.5%, higher compared to prior year. The economic recovery resulted in increased business activity and workers returning to the office/business site resulting an increased use of services subject to UUT.

**Transient occupancy tax (TOT)** ended the year \$11.8 million or 227% higher than prior year. The increase is exceptionally high because this is compared to a time when there was a high-level of health, safety and travel restrictions however remains lower than the pre-pandemic levels. In FY 2022, the average occupancy rate was 63.5%, a 57.4% increase and the average room rate was \$194.89, a 68.6% increase over the prior year. The entire 15.5% TOT rate from new hotels, plus 3.5% from all other hotels, has been allocated to the Infrastructure Plan pursuant to City Council direction. This results in additional TOT for the Infrastructure plan of \$2.2 million. These additional funds, coupled with the recommended excess BSR funds will assist in ensuring capital projects may continue as planned, adjusting for the rising costs due to the current inflationary economic conditions. The following is a comparative breakdown of the allocation of transient occupancy tax receipts:

TABLE 6 Allocation of Transient Occupancy Tax			
	FY 2022	FY 2021	% Change Increase (Decrease)
<b>General Fund</b>	\$ 8,828	\$ 2,796	215.7 %
<b>Infrastructure Plan</b>			
New hotels – 12%	4,292	1,214	253.5 %
All hotels – 3.5%	3,826	1,169	227.3 %
<i>Subtotal Infrastructure</i>	<i>8,118</i>	<i>2,383</i>	<i>240.7 %</i>
<b>Total TOT Receipts</b>	<b><u>\$ 16,946</u></b>	<b><u>\$ 5,179</u></b>	<b>227.2 %</b>

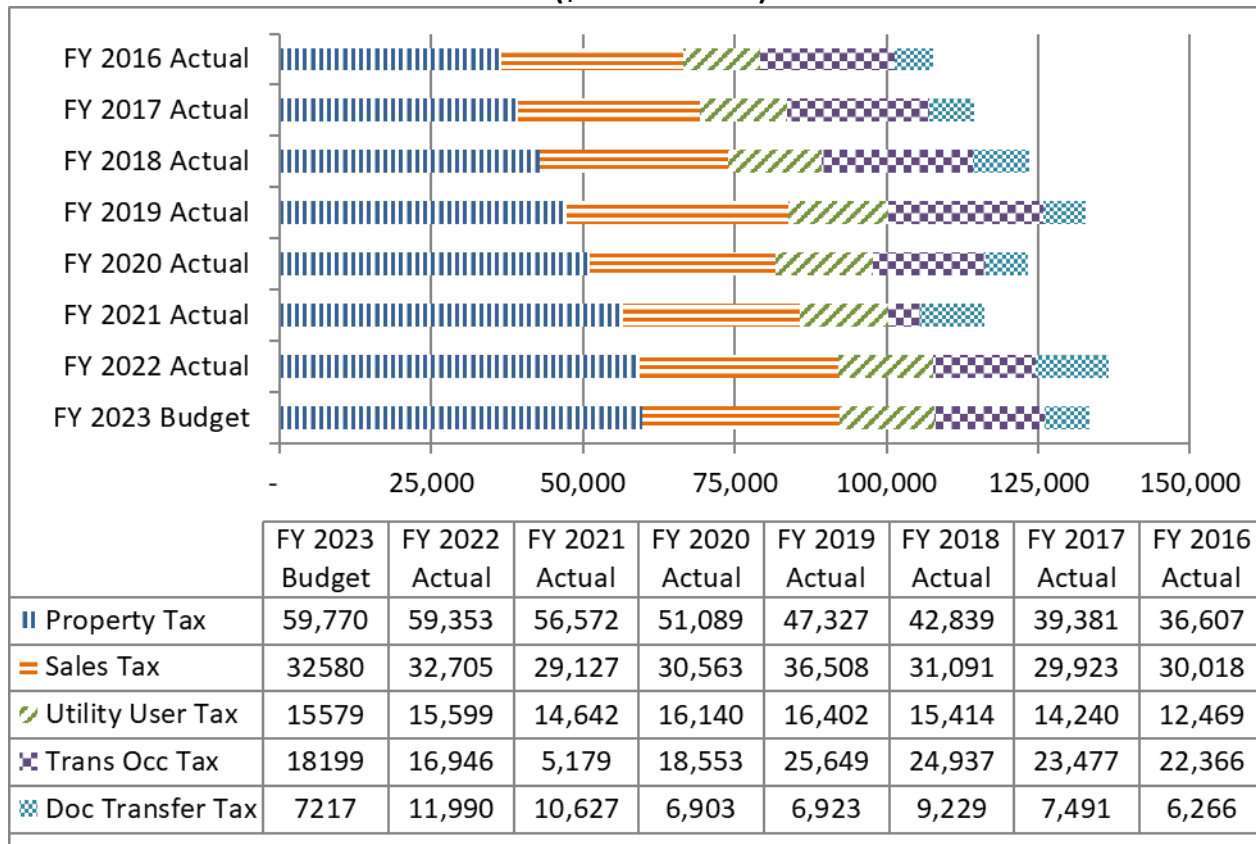
**Documentary transfer tax** increased \$1.4 million or 12.8% compared to prior year due to nine large commercial property transactions that occurred in FY2022. The number of transactions was comparable to the prior year This revenue source is volatile since it is highly dependent on sales volume and property values and the mix of commercial and residential sales.

**Charges for services** increased \$4.2 million or 16.7% compared to prior year mainly due to resumption of program and classes and offered both virtually and in-person with the lifting of many State and County Public Health restrictions.

**Other revenues** decreased \$2.8 million or 56.0% compared to prior year, due to decrease of investment earnings, mainly from unrealized market losses on investments, partially offset by the American Rescue Plan Act distribution of \$8.2 million recognized as revenue in FY 2022.

The following is a chart which depicts the relative contribution of each tax category over the past seven years (2016 through 2022), as well as the current budgeted year (2022).

**CHART 1**  
**General Fund Tax Revenues**  
**Actual Fiscal Years 2016 – 2022**  
**Budget Fiscal Year 2022**  
**(\$ in thousands)**



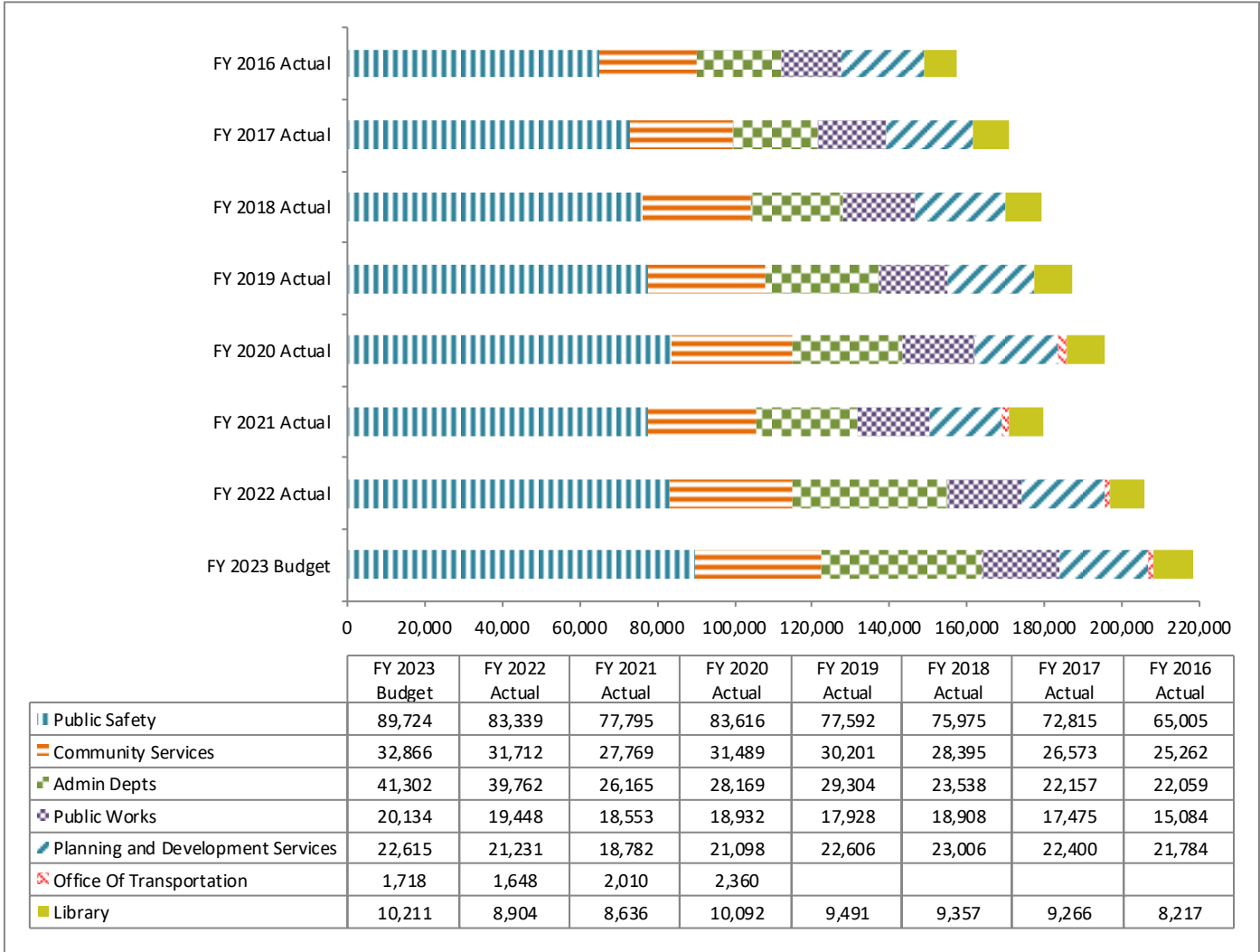
**General Fund Expenditures**

General Fund expenditures for FY 2022, including encumbrances and reappropriations, totaled \$209.5; an increase of 14.0% from the prior year, primarily due to the increase in salary and benefit costs, and indirect charges. The increase in salaries and benefits are due to overtime, specifically police and fire, paid leave, and pension. The indirect charges were higher in the

current year primarily due to liability insurance charges, vehicle equipment maintenance service and information technology (IT) support. The increase in liability insurance charges is based on actuarial analysis of the City's liabilities costs over the past few years and provides an 85 percent confidence level. Another factor driving the increase was due to reappropriations of \$12.4 million claims for a class action lawsuit.

The Adopted Budget of \$194.4 million was increased to the Final Adjusted Budget amount of \$215.1 million, primarily due to increased funding from prior year encumbered and reappropriated balances and increases for several departments throughout the year also occurred based on City Council direction per recommendations contained in City Manager Reports. The following is a chart which compares actual departmental costs, including encumbrances and reappropriations, excluding Cubberley lease over the past seven years and budgeted costs for FY 2023.

**CHART 2**  
**General Fund Departments**  
**Actual Expenditures Fiscal Years 2016– 2022 (including reappropriations and encumbrances)**  
**Budgeted Expenditures Fiscal Year 2023**  
**(\$ in thousands)**



*The Development Services Department was combined with the Planning and Community Environment in FY 2020 and renamed to the Planning and Development Services Department.*  
*The Office of Transportation Department, which previously was a division of the Planning and Community Environment Department was established in FY 2020.*

**Capital Projects Fund**

The Capital Projects Fund ended the year with a fund balance of \$117.9 million, comprised of the following:

<b>TABLE 7 Capital Projects Fund – Fund Balance</b>	
<b>Fund Balance Component</b>	<b>Amount (\$ in millions)</b>
Restricted for Library projects	\$ 251
Reserved for Roth Building rehabilitation	5,184
Reserved for Cubberley expenditures	5,720
Restricted for Public Safety Building	48,216
Assigned for all other Capital projects	58,567
<b>Total Capital Projects Fund Balance</b>	<b>\$ 117,938</b>

**Restricted for Library projects** \$0.3 million is the portion of fund balance dedicated to the remaining Mitchell Park Library expenditures which, if considered bond expenses will be paid for with cash from bond proceeds. Non-bondable expenditures such as salaries and benefits are funded from the Infrastructure Reserve (ending fund balance in the Capital Projects Fund), as established at the time of the bond issuance. The Mitchell Park Library project is already completed but the roof defects need to be fixed using this reserve.

**Restricted for Public Safety Building** \$48.2 million represents the remaining bond funding dedicated to the construction of the public safety building. This project is currently under construction with estimated completion in Fall 2023.

**Assigned for all other Capital projects** \$58.6 million represents the amount of unspent funds associated with Adopted Capital projects and other noted items. Outside funding sources such as grants, donations and future debt issues are not factored into this component of the fund balance until they are received.

### ***Enterprise Funds***

The City's Enterprise Funds reported a total Net Position of \$790.7 million, a \$12.6 million, or 1.6% decrease from the prior year. The table below summarizes the overall change in Net Position for each Enterprise Fund. Compared to FY 2021, the Change in Net Position for Enterprise funds decreased \$34.8 million driven primarily by the Electric Fund, Water, Fiber Optics and Gas Funds – details of these funds are summarized following this table.



**TABLE 8**  
**ENTERPRISE FUNDS**  
*Change in Net Position for the Year Ended June 30*  
(in millions)

<b>Fund Name</b>	<b>2022</b>	<b>2021</b>	<b>Increase/ (Decrease)</b>
Water	\$ 0.7	\$ 6.6	\$ (5.9)
Electric	(24.2)	(4.8)	(19.4)
Fiber Optics	(1.2)	1.5	(2.7)
Gas	(0.6)	3.5	(4.1)
Wastewater Collection	1.2	0.7	0.5
Wastewater Treatment	1.4	3.1	(1.7)
Refuse	(0.2)	1.9	(2.1)
Storm Drainage	2.6	3.0	(0.4)
Airport	7.7	6.7	1.0
<b>Total Change in Net Position</b>	<b>\$ (12.6)</b>	<b>\$ 22.2</b>	<b>\$ (34.8)</b>

Overall, Changes in Net Position decreased \$34.8 million for Enterprise Funds, mainly due to accounting adjustments that resulted in over \$21.5 million net unrealized market loss. In addition, the Water Fund experienced lower revenue due to residential conservation efforts. The Electric Fund also reported negative net change from the prior year due to increases in purchases of electricity which were primarily driven by higher than historical forward energy prices (future delivery), increased resource adequacy costs (capacity supply and demand), and lower hydroelectric supply. The Gas Fund showed a \$4.1 million negative change due to higher commodity prices partially offset by a 3% rate increase and increased revenue from a portion of the commodity price increases being passed directly to customers. The Airport Fund reported a \$1.0 million positive net change due to federal grants received for the Apron Reconstruction project.

The table below details the Change in Unrestricted Net Position in the Enterprise Funds. Enterprise Fund Rate Stabilization, Operations and other reserve balances are shown in detail in the ACFR (p. 96). Overall, except for the Wastewater Treatment Fund and the Airport Fund, each Enterprise Funds maintained a positive unrestricted net position balance as of June 30, 2022. Adjustments for the Pension Reserve (as required by GASB 68) and OPEB Reserve (as required by GASB 75) total \$130.2 million and unrealized market losses on investments total \$21.5 million (as required by GASB 31) for all Enterprise Funds and reduce each fund's unrestricted net position.

The Wastewater Treatment Fund reflects a \$14.8 million Unrestricted Reserve deficit and is mainly driven by \$ 26.1 million in Pension Reserves and OPEB Reserves adjustments.

The Airport Fund reports a \$3.0 million Unrestricted Reserve deficit which is attributed to the

\$1.1 million Pension Reserve and OPEB Reserve adjustments. Second, the fund deficit in the Airport Fund is also a result of cumulative fund deficits over the life of the fund as fiscal operations at the airport stabilize and capital projects near completion. The \$7.7 million change in net position of Airport Fund in current year is \$0.6 million from operations and \$7.1 million grants received in current year.

**TABLE 8**  
**Enterprise Funds**  
**Changes in Unrestricted (Deficit) Net Position**  
**(In Million)**

Fund Name	2022	2021	Increase/ (Decrease)
Water	\$ 27.8	\$ 33.0	\$ (5.2)
Electric	46.5	74.5	(28.0)
Fiber Optics	32.1	34.5	(2.4)
Gas	6.4	11.6	(5.2)
Wastewater Collection	2.1	0.7	1.4
Wastewater Treatment	(14.8)	(10.8)	(4.0)
Refuse	13.9	14.1	(0.2)
Storm Drainage	5.5	4.0	1.5
Aiport	(3.0)	(3.7)	0.7
<b>Total Changes in Reserves (Unrestricted)</b>	<b>\$ 116.5</b>	<b>\$ 157.9</b>	<b>\$ (41.4)</b>

### RESOURCE IMPACT

Recommended actions in the report will align the FY 2022 appropriations with final financial activities as outlined in **Attachment B**. Overall, the City ended the FY 2022 in a positive net position.

### STAKEHOLDER ENGAGEMENT

The review and writing of this report was coordinated among various divisions within the Administrative Services Department, along with Departments who assisted in staff's analysis. The actions recommended in this report were discussed and communicated to the impacted departments.

### ENVIRONMENTAL REVIEW

This is not a project for purposes of the California Environmental Quality Act.

### Attachments:

- Attachment A: General Fund Summary (Budget and Actuals)
- Attachment B: Recommended FY 2022 Year-End Budget Actions
- Attachment C: FY2022 Annual Comprehensive Financial Report

**Attachment A**  
**Statement of Revenues, Expenditures and Change in Fund Balance - Budget and Actual**

	GENERAL FUND SUMMARY (\$000s)						
	FY 2022 Adopted Budget	FY 2022 Adjusted Budget	FY 2022 Rev/Exp Actuals	FY 2022 Allocated Charges	FY 2022 Encum / Reappropriation	FY 2022 Actual Rev/Exp	FY 2022 Actual to Adj Budget Variance
<b>Revenues</b>							
Sales Tax	28,184	28,184	32,705			32,705	4,521
Property Tax	51,228	53,228	59,353			59,353	6,125
Transient Occupancy Tax	8,428	10,647	16,946			16,946	6,299
Documentary Transfer Tax	7,137	7,137	11,990			11,990	4,853
Utility User Tax	14,370	14,370	15,599			15,599	1,229
Other Taxes, Fines and penalties	1,434	1,434	893			893	(541)
Charges for Services	24,515	25,532	29,252		295	29,547	4,015
Permits and Licenses	7,761	8,273	8,529			8,529	256
Investment Earnings	898	898	1,366			1,366	469
Rental Income	14,403	14,403	13,863			13,863	(540)
From Other Agencies	10,277	11,044	10,817			10,817	(226)
Charges to Other Funds	14,165	14,165		13,980		13,980	(185)
Other Revenues	504	526	864	-		864	338
<b>Total Revenues</b>	<b>183,304</b>	<b>189,840</b>	<b>202,178</b>	<b>13,980</b>	<b>295</b>	<b>216,453</b>	<b>26,613</b>
Add: Operating Transfers In	22,546	22,197	22,197			22,197	-
Prior Year Encum / Reappropriation	150	11,101	11,101			11,101	-
<b>Total Source of Funds</b>	<b>206,000</b>	<b>223,138</b>	<b>235,476</b>	<b>13,980</b>	<b>295</b>	<b>249,751</b>	<b>26,613</b>
<b>Expenditures</b>							
City Attorney	3,945	4,466	2,585	1,493	388	4,466	0
City Auditor	972	1,026	489	341	196	1,027	(0)
City Clerk	1,327	1,383	713	375	73	1,161	221
City Council	433	475	219	135	50	404	71
City Manager	3,319	3,833	2,018	1,099	352	3,469	364
Administrative Services	8,923	9,684	5,784	3,193	362	9,338	346
Community Services	31,052	32,789	29,663	230	1,819	31,712	1,077
Fire	35,677	38,566	38,004	163	398	38,565	2
Human Resources	3,878	4,229	2,295	1,308	239	3,843	386
Library	8,903	9,145	8,591	-	313	8,904	241
Office of Transportation	1,747	1,892	1,629	-	19	1,648	244
Planning and Development Services	17,673	21,554	17,770	69	3,393	21,231	322
Police	44,353	45,755	43,557	737	479	44,774	982
Public Works	18,755	20,000	12,037	4,837	2,575	19,448	552
Non-Departmental	13,482	20,253	4,361	-	15,146	19,507	746
<b>Total Expenditures</b>	<b>194,439</b>	<b>215,052</b>	<b>169,714</b>	<b>13,980</b>	<b>25,802</b>	<b>209,497</b>	<b>5,555</b>
Add: Operating Trans Out	4,296	5,498	5,498	-		5,498	-
Transfer to Infrastructure	10,406	12,625	12,625	-		12,625	-
<b>Total Use of Funds</b>	<b>209,141</b>	<b>233,175</b>	<b>187,837</b>	<b>13,980</b>	<b>25,802</b>	<b>227,620</b>	<b>5,555</b>
<b>Net Surplus/(Deficit)</b>	<b>(3,141)</b>	<b>(10,037)</b>	<b>47,638</b>	<b>-</b>	<b>(25,507)</b>	<b>22,131</b>	<b>32,168</b>

## Adjustment to Budgetary Basis:

Unrealized gain/loss on investments	(11,960)
Changes in Advances to Other Funds	(202)
GASB 87 impact on net income	89
Current year encumbrance / reappropriations	25,507
Prior Year encumbrances / reappropriations	(11,101)
<b>Change in Fund Balance, GAAP Basis</b>	<b>24,464</b>

Attachment: Attachment A: General Fund Summary (Budget and Actuals) (14632 : Approval of FY 2022 ACFR and Budget YE Adjustments)

## ATTACHMENT B, EXHIBIT 1

**CITY OF PALO ALTO**  
**RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2022 BUDGET**

Department		Revenues Adjustment	Expenses Adjustment
<b>GENERAL FUND (102)</b>			
<i>City Attorney's Office</i>	<b>Contract Services</b> This action reallocates funding as a result of higher than anticipated contract services expenses in FY 2022. These higher expenditures are primarily due to special projects including the Roth Building rehabilitation, wireless ordinance update, employee investigations, and capital project construction contract claims.	\$ -	\$ 103,000
<i>City Auditor's Office</i>	<b>Salaries &amp; Benefits and Contract Services</b> This action reallocates funding as a result of salary and benefit expenses in FY 2022 that were unbudgeted as well as higher than anticipated contract services expenses related to FY 2021 audits that were paid during FY 2022.	\$ -	\$ 25,000
<i>Community Services</i>	<b>Departmental Expense Savings</b> This action reallocates departmental cost savings within the General Fund in order to offset departments with higher than anticipated expenses in FY 2022. The Community Services Department realized a net savings, primarily in salaries and benefits, as a result of a large number of vacancies as well as savings from lower than anticipated utility charges.	\$ -	\$ (253,000)
<i>Fire</i>	<b>Charges for Services and Revenue from Other Agencies/Salaries &amp; Benefits</b> This action reallocates funding as a result of higher than anticipated salary and benefit expenses and recognizes and appropriates higher than anticipated paramedic services revenue and revenue from the State of California. The higher expenditures, specifically in overtime costs, are primarily due to an above average amounts of vacancies, employee leave, and employee turnover (voluntary and retirement) as maintaining minimum staffing levels requires the use of overtime for backfill. The higher expenditures are partially offset by increased paramedic transport services revenue as well as additional revenue from the State of California as reimbursements for participating in Strike Teams and other statewide fire services.	\$ 600,000	\$ 725,000
<i>Non-Departmental</i>	<b>Transient Occupancy Tax Revenue/Transfer to Capital Improvement Fund</b> This action increases the transfer to the Capital Improvement Fund as it relates to Transient Occupancy Tax (TOT) revenues earmarked for city-wide infrastructure improvements due to higher than anticipated TOT collections in FY 2022.	\$ 2,219,000	\$ 2,219,000
<b>GENERAL FUND (102) SUBTOTAL</b>		<b>\$ 2,819,000</b>	<b>\$ 2,819,000</b>

Attachment: Attachment B: Recommended FY 2022 Year-End Budget Actions (14632 : Approval of FY 2022 ACFR and Budget YE Adjustments)

## ATTACHMENT B, EXHIBIT 1

**CITY OF PALO ALTO**  
**RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2022 BUDGET**

Department		Revenues Adjustment	Expenses Adjustment
<b>CAPITAL IMPROVEMENT FUNDS</b>			
<b><u>GENERAL FUND CAPITAL IMPROVEMENT FUND (471)</u></b>			
<i>Capital</i>	<b>Capital Improvement Project Adjustments</b> This action reflects the combined impact from adjustments to projects as outlined in Attachment B, Exhibit 2.	\$ -	\$ 419,000
<i>Capital</i>	<b>Transfer from General Fund</b> This action increases the transfer from the General Fund related to TOT revenue Council earmarked to use for city-wide infrastructure improvements due to actual revenue collected being higher than budgeted in FY 2022.	\$ 2,219,000	\$ -
<i>Fund Balance</i>	<b>Adjustment to Fund Balance</b> This action adjusts the fund balance to offset adjustments recommended in this report.	\$ -	\$ 1,800,000
<b>GENERAL FUND CAPITAL IMPROVEMENT FUND (471) SUBTOTAL</b>		<b>\$ 2,219,000</b>	<b>\$ 2,219,000</b>
<b><u>CUBBERLEY PROPERTY INFRASTRUCTURE FUND (472)</u></b>			
<i>Public Works</i>	<b>Revenue from Other Agencies/Salaries and Benefits</b> This action appropriates funding for increased costs related to facilities maintenance work at the Cubberley Property and recognizes and appropriates increased revenue from the Palo Alto United School District (PAUSD) to reimburse the City for their share of the costs as outlined in the Cubberley lease agreement between the City and PAUSD.	\$ 22,000	\$ 22,000
<b>CUBBERLEY PROPERTY INFRASTRUCTURE FUND (472) SUBTOTAL</b>		<b>\$ 22,000</b>	<b>\$ 22,000</b>

## ATTACHMENT B, EXHIBIT 1

**CITY OF PALO ALTO**  
**RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2022 BUDGET**

Department		Revenues Adjustment	Expenses Adjustment
<b>ENTERPRISE FUNDS</b>			
<b><u>ELECTRIC FUND (513 &amp; 523)</u></b>			
<i>Capital</i>	<b>Capital Improvement Project Adjustments</b> This action reflects the combined impact from adjustments to projects as outlined in Attachment B, Exhibit 2.	\$ -	\$ 145,000
<i>Fund Balance</i>	<b>Adjustment to Fund Balance</b> This action adjusts the fund balance to offset adjustments recommended in this report.	\$ -	\$ (145,000)
<b>ELECTRIC FUND (513 &amp; 523) SUBTOTAL</b>		<b>\$ -</b>	<b>\$ -</b>
<b><u>FIBER OPTICS FUND (533)</u></b>			
<i>Capital</i>	<b>Capital Improvement Project Adjustments</b> This action reflects the combined impact from adjustments to projects as outlined in Attachment B, Exhibit 2.	\$ -	\$ 18,000
<i>Fund Balance</i>	<b>Adjustment to Fund Balance</b> This action adjusts the fund balance to offset adjustments recommended in this report.	\$ -	\$ (18,000)
<b>FIBER OPTICS FUND (533) SUBTOTAL</b>		<b>\$ -</b>	<b>\$ -</b>
<b><u>GAS FUND (514 &amp; 524)</u></b>			
<i>Capital</i>	<b>Capital Improvement Project Adjustments</b> This action reflects the combined impact from adjustments to projects as outlined in Attachment B, Exhibit 2.	\$ -	\$ 4,000
<i>Fund Balance</i>	<b>Adjustment to Fund Balance</b> This action adjusts the fund balance to offset adjustments recommended in this report.	\$ -	\$ (4,000)
<b>GAS FUND (514 &amp; 524) SUBTOTAL</b>		<b>\$ -</b>	<b>\$ -</b>
<b><u>REFUSE FUND (525)</u></b>			
<i>Public Works</i>	<b>Refuse Collection, Hauling, and Disposal</b> As described in CMR 14275, at the end of each fiscal year staff estimates the expenses needed for the next contract year for GreenWaste of Palo Alto (GWPA) and conducts a technical clean-up of expenses to ensure that any excess carryforward amount from the contract encumbrance is returned to the fund balance. An error occurred in FY 2021 and too much was returned to the fund balance, leaving insufficient funds for the contract in FY 2022. CMR 14275 approved a \$0.9 million budget adjustment but this \$1.4 million technical correction augments the adjustment made in CMR 14275 to fully align the budget with the total expenses for services provided by GWPA in FY 2022.	\$ -	\$ 1,443,000
<i>Fund Balance</i>	<b>Adjustment to Fund Balance</b> This action adjusts the fund balance to offset adjustments recommended in this report.	\$ -	\$ (1,443,000)
<b>REFUSE FUND (525) SUBTOTAL</b>		<b>\$ -</b>	<b>\$ -</b>

Attachment: Attachment B: Recommended FY 2022 Year-End Budget Actions (14632 : Approval of FY 2022 ACFR and Budget YE Adjustments)

## ATTACHMENT B, EXHIBIT 1

**CITY OF PALO ALTO**  
**RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2022 BUDGET**

Department		Revenues Adjustment	Expenses Adjustment
<b>ENTERPRISE FUNDS</b>			
<b><u>STORMWATER MANGEMENT FUND (528)</u></b>			
<i>Capital</i>	<b>Capital Improvement Project Adjustments</b> This action reflects the combined impact from adjustments to projects as outlined in Attachment B, Exhibit 2.	\$ -	\$ 5,000
<i>Fund Balance</i>	<b>Adjustment to Fund Balance</b> This action adjusts the fund balance to offset adjustments recommended in this report.	\$ -	\$ (5,000)
<b>STORMWATER MANGEMENT FUND (528) SUBTOTAL</b>		<b>\$ -</b>	<b>\$ -</b>
<b><u>WASTEWATER COLLECTION FUND (527)</u></b>			
<i>Capital</i>	<b>Capital Improvement Project Adjustments</b> This action reflects the combined impact from adjustments to projects as outlined in Attachment B, Exhibit 2.	\$ -	\$ 90,000
<i>Fund Balance</i>	<b>Adjustment to Fund Balance</b> This action adjusts the fund balance to offset adjustments recommended in this report.	\$ -	\$ (90,000)
<b>WASTEWATER COLLECTION FUND (527) SUBTOTAL</b>		<b>\$ -</b>	<b>\$ -</b>
<b><u>WATER FUND (522)</u></b>			
<i>Capital</i>	<b>Capital Improvement Project Adjustments</b> This action reflects the combined impact from adjustments to projects as outlined in Attachment B, Exhibit 2.	\$ -	\$ 145,000
<i>Fund Balance</i>	<b>Adjustment to Fund Balance</b> This action adjusts the fund balance to offset adjustments recommended in this report.	\$ -	\$ (145,000)
<b>WATER FUND (522) SUBTOTAL</b>		<b>\$ -</b>	<b>\$ -</b>

Attachment: Attachment B: Recommended FY 2022 Year-End Budget Actions (14632 : Approval of FY 2022 ACFR and Budget YE Adjustments)



## ATTACHMENT B, EXHIBIT 1

**CITY OF PALO ALTO**  
**RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2022 BUDGET**

Department		Revenues Adjustment	Expenses Adjustment
<b>INTERNAL SERVICE FUNDS</b>			
<b><u>VEHICLE REPLACEMENT &amp; MAINTENANCE FUND (681)</u></b>			
<i>Capital</i>	<b>Capital Improvement Project Adjustments</b>	\$ 140,000	\$ 140,000
	This action reflects the combined impact from adjustments to projects as outlined in Attachment B, Exhibit 2.		
<b>VEHICLE REPLACEMENT &amp; MAINTENANCE FUND (681) SUBTOTAL</b>		<b>\$ 140,000</b>	<b>\$ 140,000</b>
<b><u>WORKERS' COMPENSATION FUND (688)</u></b>			
<i>Human Resources</i>	<b>Claims Costs/Reimbursements</b>	\$ 115,000	\$ 115,000
	This net-neutral action increases the estimate for workers' compensation claims by \$115,000, from \$5.9 million to \$6.0 million, due to higher than anticipated claims costs in FY 2022. This amount is fully offset by additional revenue for excess insurance reimbursements received during the period.		
<b>WORKERS' COMPENSATION FUND (688) SUBTOTAL</b>		<b>\$ 115,000</b>	<b>\$ 115,000</b>

## ATTACHMENT B, EXHIBIT 1

**CITY OF PALO ALTO**  
**RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2022 BUDGET**

Department		Revenues Adjustment	Expenses Adjustment
<b>SPECIAL REVENUE FUNDS</b>			
<b><u>PUBLIC ART FUND (207)</u></b>			
<i>Community Services</i>	<b>Contract Services</b> This action increases the appropriation for contract services in the Public Art Fund to align with the costs associated with the City's CodeArt Festival.	\$ -	\$ 48,000
<i>Fund Balance</i>	<b>Adjustment to Fund Balance</b> This action adjusts the fund balance to offset adjustments recommended in this report.	\$ -	\$ (48,000)
<b>PUBLIC ART FUND (207) SUBTOTAL</b>		<b>\$ -</b>	<b>\$ -</b>

## ATTACHMENT B, EXHIBIT 1

**CITY OF PALO ALTO**  
**RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2022 BUDGET**

Department		Revenues Adjustment	Expenses Adjustment
<b>DEBT SERVICE &amp; AGENCY TRUST FUNDS</b>			
<b><u>2021 PUBLIC SAFETY BUILDING COP FUND (363)</u></b>			
<i>Administrative Services</i>	<b>Debt Service Payment</b> This action appropriates funding to cover the capitalized interest payment for the Certificates of Participation to fund the New Public Safety Building capital project (PE-15001). These funds were set aside as part of bond sale in this Fund in order to make this payment; however, they were not appropriated as part of the FY 2022 Budget.	\$ -	\$ 3,133,000
<i>Fund Balance</i>	<b>Adjustment to Fund Balance</b> This action adjusts the fund balance to offset adjustments recommended in this report.	\$ -	\$ (3,133,000)
<b>2021 PUBLIC SAFETY BUILDING COP FUND (363) SUBTOTAL</b>		<b>\$ -</b>	<b>\$ -</b>
<b><u>LIBRARY PROJECTS FUND (370)</u></b>			
<i>Administrative Services</i>	<b>Bond Proceeds/Debt Service Payment</b> This action recognizes and appropriates bond proceed revenue from refinancing of Library General Obligation (GO) Bonds (CMR 13438). This action also appropriates funding to pay off the previous GO Bond amount. The refinancing occurred in June 2022, so this action is needed to true up the budget with the actual amounts for the bond sales.	\$ 41,197,000	\$ 44,071,000
<i>Fund Balance</i>	<b>Adjustment to Fund Balance</b> This action adjusts the fund balance to offset adjustments recommended in this report.	\$ -	\$ (2,874,000)
<b>LIBRARY PROJECTS FUND (370) SUBTOTAL</b>		<b>\$ 41,197,000</b>	<b>\$ 44,071,000</b>
<b><u>UNIVERSITY AVENUE PARKING ASSESSMENT AGENCY FUND (775)</u></b>			
<i>Administrative Services</i>	<b>Contract Services</b> This action increases the appropriation for Contract Services within the fund to align budget levels with actual expenditures in FY 2022.	\$ -	\$ 2,000
<i>Fund Balance</i>	<b>Adjustment to Fund Balance</b> This action adjusts the fund balance to offset adjustments recommended in this report.	\$ -	\$ (2,000)
<b>UNIVERSITY AVENUE PARKING ASSESSMENT AGENCY FUND (775) SUBTOTAL</b>		<b>\$ -</b>	<b>\$ -</b>

Attachment: Attachment B: Recommended FY 2022 Year-End Budget Actions (14632 : Approval of FY 2022 ACFR and Budget YE Adjustments)

## ATTACHMENT B, EXHIBIT 2

**CITY OF PALO ALTO**  
**RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2022 CAPITAL IMPROVEMENT PROGRAM**

Project Number	Title	Revenue	Expense	Comments
<b>CAPITAL IMPROVEMENT FUND</b>				
PE-19002	Animal Shelter Renovation		\$ 74,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
FD-21000	Automated External Defibrillators		\$ (50,000)	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PE-18006	Byxbee Park Completion		\$ (500,000)	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PF-14004	Cal Avenue Parking District Parking Improvements		\$ 1,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PG-14002	Cameron Park Improvements		\$ 16,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
AS-10000	Capital Improvement Fund Administration		\$ (1,040,000)	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PE-13011	Charleston/Arastradero Corridor Project		\$ 205,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PE-20001	City Bridge Improvements		\$ (19,000)	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PE-09003	City Facility Parking Lot Maintenance		\$ (61,000)	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PE-17010	Civic Center Electrical Upgrade & EV Charger Installation		\$ 6,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PE-18016	Civic Center Fire Life Safety Upgrades		\$ 34,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PE-15020	Civic Center Waterproofing and Repairs		\$ 114,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PG-18001	Dog Park Installation		\$ 36,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PL-14000	El Camino/Churchill Enhanced Bikeway		\$ (518,000)	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
FD-14002	Fire Ringdown System Replacement		\$ 14,000	Increase to project due to higher than anticipated contract service expenditures to close out the project.
PE-15003	Fire Station No. 3 Replacement		\$ 87,000	Increase to project due to higher than anticipated contract service expenditures to close out the project.
PE-18002	High and Bryant Street Garages Waterproofing and Repairs		\$ 6,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PE-11011	Highway 101 Pedestrian/Bicycle Overpass Project		\$ 524,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures (\$315k). Increase to project due to higher than anticipated contract service expenditures to close out the project (\$209k)

Attachment: Attachment B: Recommended FY 2022 Year-End Budget Actions (14632 : Approval of FY 2022 ACFR and Budget YE Adjustments)

## ATTACHMENT B, EXHIBIT 2

**CITY OF PALO ALTO**  
**RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2022 CAPITAL IMPROVEMENT PROGRAM**

Project Number	Title	Revenue	Expense	Comments
LB-21000	Library Automated Materials Handling		\$ (50,000)	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PF-17000	Municipal Service Center A, B, & C Roof Replacement		\$ 80,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PE-18000	New California Avenue Area Parking Garage		\$ 34,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
OS-00001	Open Space Trails & Amenities		\$ 135,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
OS-09001	Off-Road Pathway Resurfacing and Repair		\$ (16,000)	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PG-09002	Park and Open Space Emergency Repairs		\$ 37,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PG-19000	Park Restroom Installation		\$ (71,000)	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PG-14000	Ramos Park Improvements		\$ 29,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PE-08001	Rinconada Park Improvements		\$ 236,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures (\$127k). Increase to project with corresponding reduction in FY23 due to project expenses for construction oversight anticipated in FY23 being completed in FY22 (\$109k). FY23 reduction action approved by Council on 10/24/22 in CMR 14728.
PO-89003	Sidewalk Repairs		\$ 533,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PE-86070	Street Maintenance		\$ 518,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
PE-21004	University Avenue Streetscape Update		\$ 25,000	Adjustment to allocate Salaries and Benefits across capital projects based on actual expenditures.
	<b>Total</b>	<b>\$ -</b>	<b>\$ 419,000</b>	

ELECTRIC FUND				
EL-06001	115 kV Electric Intertie		\$ 28,000	Increase to project due to higher than anticipated expenditures.
EL-19001	Colorado Power Station		\$ (730,000)	Decrease to project due to lower than anticipated expenditures to offset overspent projects.
EL-89028	Electric Customer Connections		\$ 1,100,000	Increase to project due to higher than anticipated expenditures, with a \$650k reduction in EL-17007, and a \$450k reduction in EL-17002, both of which had some project savings.
EL-17007	Facility Relocation for Caltrain		\$ (650,000)	Decrease to project due to lower than anticipated expenditures to offset overspent projects.
EL-11014	Smart Grid Technology Installation		\$ 18,000	Increase to project due to higher than anticipated expenditures.

Attachment: Attachment B: Recommended FY 2022 Year-End Budget Actions (14632 : Approval of FY 2022 ACFR and Budget YE Adjustments)

## ATTACHMENT B, EXHIBIT 2

**CITY OF PALO ALTO**  
**RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2022 CAPITAL IMPROVEMENT PROGRAM**

Project Number	Title	Revenue	Expense	Comments
EL-17002	Substation Breakers		\$ (450,000)	Decrease to project due to lower than anticipated expenditures to offset overspent projects.
EL-89044	Substation Facility Improvements		\$ 99,000	Increase to project due to higher than anticipated expenditures.
EL-16003	Substation Security		\$ 1,100,000	Increase to project due to higher than anticipated expenditures with a \$730k reduction in EL-19001, and a \$370k reduction in EL-19004, both of which had some project savings.
EL-19004	Wood Pole		\$ (370,000)	Decrease to project due to lower than anticipated expenditures to offset overspent projects.
	<b>Total</b>	<b>\$ -</b>	<b>\$ 145,000</b>	

**FIBER FUND**

FO-16000	Fiber Optics Network - System Rebuild		\$ 18,000	Increase to project due to higher than anticipated expenditures.
	<b>Total</b>	<b>\$ -</b>	<b>\$ 18,000</b>	

**GAS FUND**

GS-11002	Gas System Improvements		\$ 4,000	Increase to project due to higher than anticipated expenditures.
	<b>Total</b>	<b>\$ -</b>	<b>\$ 4,000</b>	

**STORMWATER MANAGEMENT FUND**

SD-22000	East Bayshore Road & East Meadow Drive Storm Drain System Upgrade		\$ 5,000	Increase to project due to higher than anticipated expenditures.
	<b>Total</b>	<b>\$ -</b>	<b>\$ 5,000</b>	

**VEHICLE FUND**

VR-22000	Scheduled Vehicle and Equipment Replacement - Fiscal Year 2022	\$ 140,000	\$ 140,000	Adjustment to align project budget with mid-year amendments to the operating budget for the purchase of a tractor (\$100K) and a code enforcement vehicle (\$40K).
	<b>Total</b>	<b>\$ 140,000</b>	<b>\$ 140,000</b>	

**WASTEWATER COLLECTION FUND**

WC-99013	Sewer Manhole Rehab/Replacement		\$ 85,000	Increase to project due to higher than anticipated expenditures.
WC-80020	Sewer System, Customer Connections		\$ 5,000	Increase to project due to higher than anticipated expenditures.
	<b>Total</b>	<b>\$ -</b>	<b>\$ 90,000</b>	

**WATER FUND**

WS-80013	Water System Customer Connections		\$ 145,000	Increase to project due to higher than anticipated expenditures.
	<b>Total</b>	<b>\$ -</b>	<b>\$ 145,000</b>	

**TOTAL CIP ADJUSTMENTS \$ - \$ 718,000**

Attachment: Attachment B: Recommended FY 2022 Year-End Budget Actions (14632 : Approval of FY 2022 ACFR and Budget YE Adjustments)



## Fiscal Year 2022 Annual Comprehensive Financial Report

This document may be viewed at the City's website:

[Financial Reporting – City of Palo Alto, CA](#)

<https://www.cityofpaloalto.org/files/assets/public/administrative-services/financial-reporting/comprehensive-annual-financial-reports-cafr/current-2011-cafrs/2022-acfr-final/city-of-palo-alto-acfr-fy2022-final.pdf>



# City of Palo Alto

## Finance Committee Staff Report

(ID # 14975)

**Meeting Date: 11/29/2022**

**Report Type: Action Items**

**Title: Staff Recommends the Finance Committee Recommend the City Council Adopt a Resolution Amending Electric Rate Schedule E-HRA (Electric Hydro Rate Adjuster) Increasing the Current E-HRA Rate to \$0.050/kWh Effective January 1, 2023**

**From: City Manager**

**Lead Department: Utilities**

### **Recommended Motion**

Staff recommends that the Finance Committee recommend the City Council adopt a Resolution of the Council of the City of Palo Alto Amending the Electric Hydro Rate Adjuster rate schedule (E-HRA), Increasing the Current E-HRA Rate to \$0.050/kWh Effective January 1, 2023, to reflect current hydrological conditions and market purchase costs. This would replace the existing E-HRA surcharges and discounts across all levels, and increase the current E-HRA rate from \$0.013/kWh to \$0.050/kWh .

### **Executive Summary**

Power available to the City of Palo Alto (City or Palo Alto) from hydroelectric resources is reduced due to the ongoing drought. Reduced hydro output has resulted in increased demand for market power resources which is largely comprised of gas-fired generation. The increase in demand combined with high fossil fuel prices caused by unstable socio-political conditions has resulted in power prices that are greater than the values used to calculate the existing E-HRA surcharge. Hydro Stabilization Reserves (HSR) have been exhausted and Operations Reserves are being negatively impacted by higher ongoing costs.

On November 2, 2022, staff recommended, and the Utilities Advisory Commission approved, increasing the E-HRA from \$0.013/kWh to \$0.026/kWh ([ID# 14837](#)). However, further increases to electric purchase cost from September projections are prompting staff to revise their recommendation.

Staff has provided two E-HRA alternatives for Finance Committee consideration. Both alternatives aim to keep the Electric Supply Operations Reserve (E-SOR) above minimum guideline levels at the end of FY 2023. Alternative #1 results in a projected E-SOR slightly higher than the minimum guideline, while Alternative #2 adds additional supporting funds to the E-SOR.



Staff recommends Alternative #2 to the Finance Committee, increasing the current \$0.013/kwh surcharge to \$0.05/kwh forecasted to end June 30, 2023. This change will preserve reserve levels above the minimum guidelines if market prices remain in the forecasted range during the fiscal year. Activation of the E-HRA surcharge creates a temporary rate increase. When triggered, the proposed E-HRA increase is approximately a 21% or \$18.13 monthly increase for a median electric residential customer, which remains 38% below a comparable PG&E customer.

Staff expects that the E-HRA will have to be modified again in July. If market costs continue to be high, staff will likely increase base electric rates to reflect the new commodity cost environment, and the E-HRA would be reduced. As part of the FY 2023 rate setting the Utilities department will evaluate and recalibrate electric rates and adapt to the changing market.

### **Background**

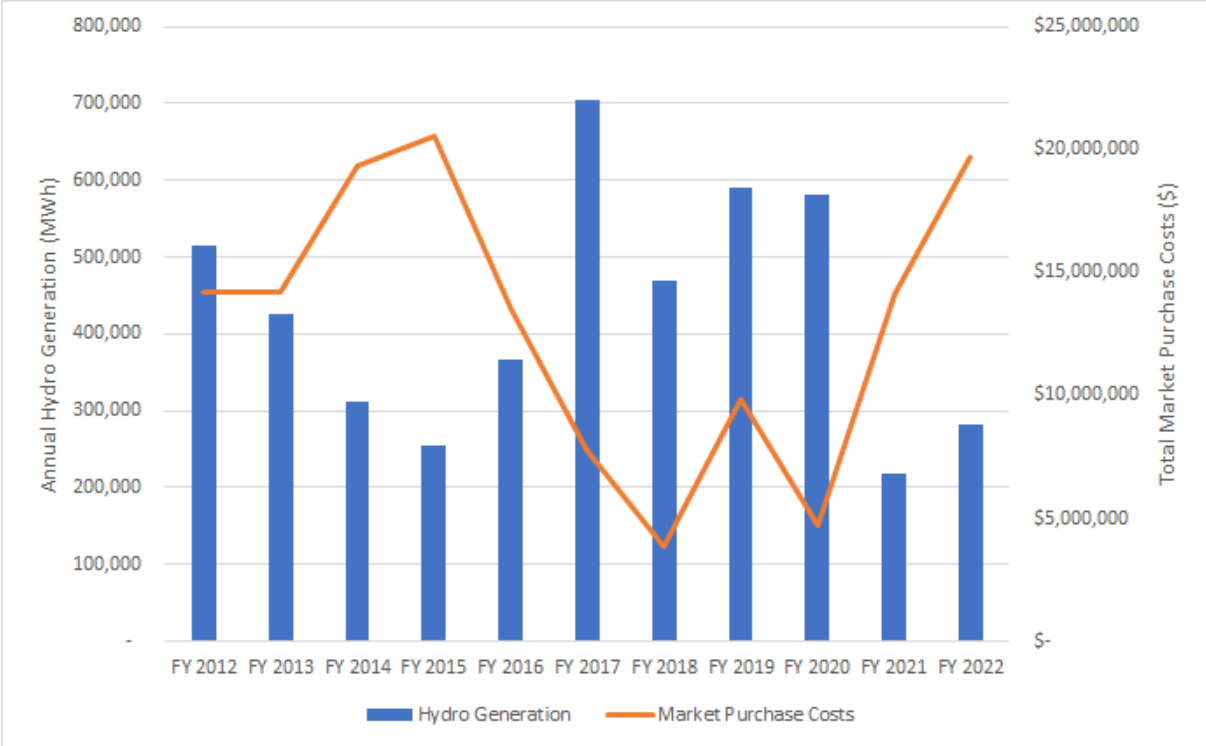
The City has access to a large amount of relatively low-cost, carbon free hydroelectric generation to meet its electric supply needs. Whereas hydroelectric generation supplies about 10% of the overall electric supply for California, the City meets about 50% of its electric supply needs with hydro generation in an average year.

The drawback to maintaining such a heavy reliance on hydroelectric generation is that the output of these resources is highly sensitive to weather conditions. Although the City receives about 50% of its electric supplies from its hydroelectric resources in a “normal” weather year, that amount can fall to as low as 20% in extremely dry years. And unlike many of the City’s supply contracts, where the cost of the resource is proportional to the amount of generation delivered, the City essentially pays a fixed amount every year for the output of its two hydroelectric resources (Western Base Resource and the Calaveras project) regardless of the amount of electricity they produce.

The City purchases additional supply resources (generic market power and, to comply with the Carbon Neutral Plan, renewable energy certificates, or RECs) to make up for the reduced hydroelectric output during dry years. Compounding the problem, market power prices are often higher in dry years when the City must purchase more because the entire state is experiencing reduced hydro supply conditions. Market prices are influenced by inflation, weather, alternative fuel costs, and global supply and demand.

Figure 1 below illustrates this relationship between the City’s annual market purchase costs and the amount of hydroelectric generation it receives.

### **Figure 1: Annual Hydro Generation vs. Market Purchase Costs (2012-2022)**



In 2005, when a new “Contract for Electric Service - Base Resource” with the Western Area Power Administration (WAPA) increased the City’s exposure to hydro variability, Council adopted a policy of maintaining reserves, combined with “laddered” market purchases, to manage this variability<sup>1</sup>.

In 2018, Council adopted the E-HRA mechanism ([ID 8962](#)) to manage the financial impacts of the annual variability in production of the City’s hydroelectric resource. The E-HRA and the HS Reserve are used to stabilize electric rates when hydrological conditions are either poor, as is currently the case, or exceptionally good. Activation of the E-HRA is based on staff’s evaluation of hydro generation availability and the HS Reserve level. When the HS Reserve falls below 25% of its maximum (\$11 million) and hydro generation is projected to be below normal through the end of the current fiscal year, the E-HRA surcharge is applied. The resulting revenues are used to fund the additional short-term costs of providing electric service. When drought conditions subside and/or HS Reserves are within guideline ranges, the surcharge can be de-activated and standard rates can resume.

In 2018, staff developed the E-HRA mechanism utilizing a 20-year simulation model, estimating reserve needs under periods of both above average hydro generation as well as periods of extended drought. The model estimated high market prices during periods of drought using generation prices that were high at the time, about \$47/MWh. As market costs have increased

<sup>1</sup> As described in Palo Alto’s current Long-term Electric Acquisition Plan (LEAP) Objectives and Strategies: <https://www.cityofpaloalto.org/files/assets/public/environment-in-palo-alto/energy-compost-facility-consideration/leap-objectives-and-strategies-april-2012.pdf>

above this level, staff recommends amending the E-HRA structure to update energy prices to reflect current conditions. The model's generation levels remain valid.

The E-HRA rate structure in effect now can result in either a 4% rate increase (at the \$0.0065/kWh level) or an 8% increase (at the \$0.013/kWh level)<sup>2</sup>. The proposed E-HRA increase of \$0.037/kWh (from \$0.013 to \$0.050) is approximately a 21% or \$18.13/month increase for a median electric residential customer and 38% below a comparable PG&E customer.

In March 2022, in response to rapidly worsening drought conditions in California, Council adopted changes to the E-HRA surcharge ([ID 13905](#)), broadening the conditions under which the rate could be utilized and activating the rate effective April 1, 2022. This was done to help lower longer-term average rates, as well as help maintain general reserve health.

### **Discussion**

The City receives power from two hydroelectric projects, the Calaveras project and the Western Base Resource contract for Federal hydropower from the Central Valley Project.<sup>3</sup> The watershed for Western hydropower is primarily in the northern end of California, while the watershed for the Calaveras project is in the Central Sierras.

Power from these sources is reduced under continued drought conditions. For water year 2020-2021 (October 2020 to September 2021), total precipitation was just below 50% of average in both watersheds. For water year 2021-2022, total precipitation was below 80% of average in Northern California and about 63% of average in the Central Sierras. As shown in Table 1, total actual hydropower for FY 2021 was 295 GWh, which is 183 GWh (38%) below the long-term average, and total actual hydropower for FY 2022 was 230 GWh, which is 250 GWh (52%) below the long-term average.<sup>4</sup>

**Table 1: Hydro Generation FY 2021-22 Actuals (GWh)**

<b>Hydro Generation</b>	<b>FY 2021</b>	<b>FY 2022</b>
Calaveras Actuals	49	61
Western Actuals	246	169
<b>Total Hydro Generation</b>	<b>295</b>	<b>230</b>
Long-term Average Total (%)	61%	48%

<sup>2</sup> For the median Palo Alto household, which consumes approximately 490 kWh/month, rate adjustments of 0.65 ¢/kWh, 1.3 ¢/kWh, and 1.8 ¢/kWh equate to monthly bill impacts of \$3.19, \$6.37, and \$8.82, respectively.

<sup>3</sup> The Calaveras project is a hydropower project located in Calaveras County that is maintained and operated by the Northern California Power Agency on behalf of the City and other project participants. The City is also one of several public entities with contracts with the Western Area Power Administration for "Base Resource" electricity, which is the hydroelectric power available from the Federal Government's Central Valley Project (operated by the Bureau of Reclamation) after accounting for power used for Central Valley Project operations and power delivered to certain "preference" customers.

<sup>4</sup>The long-term average forecast levels for both Western and Calaveras have been revised downward (about 10% each) in recent years to reflect the impact of climate change. These values may need to be revisited again in the coming years.

Long-term Average Total Hydro	481	481
-------------------------------	-----	-----

Reservoir levels remain very low across Northern and Central California. Most reservoirs are 30 to 50% below their average levels for this time of year. As a result, Palo Alto’s hydroelectric projections are approximately 275 GWh for this fiscal year, which is about 57% of the long-term average level of hydro output, and 377 GWh for FY 2024, which is 78% of the long-term average level.

When Council activated the E-HRA at the \$0.013/kwh level effective April 1, 2022, projected hydro output was about 310 GWh/year and HSR funds were projected to be drawn below \$11 million<sup>5</sup> by the end of FY 2022. Market prices are now more than double the price used to estimate the existing E-HRA rate. Actual power supply costs for FY 2022 were about \$16 million more than adopted budget levels, and FY 2023 costs are projected to be similarly high. As a result, staff requested a transfer of all \$15 million of HSR funds to the Operations Reserve to offset costs in FY 2022. Council’s activation of the E-HRA rate offset \$1.5 million of higher costs that remained after the \$15 million HS Reserve transfer. \$400,000 remains in the Hydro Stabilization Reserves.

While the FY 2022 Annual Comprehensive Financial Report is still being reviewed, the unaudited ending balance for the Supply Operations Reserve is approximately \$22.2 million. This is about \$3.3 million above the Council-adopted minimum guideline levels for FY 2023<sup>6</sup>.

Updated November estimates for FY 2023 electric purchase costs are now \$16.1 million more than budget, compared to the \$9 million previously estimated and cited in the November 2 UAC staff report (which was based on September data). The proposal provided to the UAC was to increase the E-HRA to \$0.026/kwh, resulting in about \$5 million in additional revenue (over the last 6 months of FY 2023). Based upon updated purchase cost estimates, this would still leave the Supply Operations Reserve roughly \$6.8 million below minimum guideline levels at the end of FY 2023, as shown in Table 2 below:

**Table 2: Projected FY 2023 Supply Operations Reserve Balances (Million \$’s)**

(\$’s in millions)	FY 2023 Financial Plan (Adptd Budget)	UAC Projections (Nov 2022)	Updated Projections (\$0.026/kwh surcharge)
<b>Beginning Supply Operations Reserve Balance</b>	<b>\$33,046</b>	<b>\$22,197</b>	<b>\$22,197</b>
Net Fund Revenues/(Expenses)	927	927	927
Revenue: Proposed Additional E-HRA	N/A	5,000	5,000

<sup>5</sup> When the HS Reserve level falls below 25% of its maximum, or \$11 million, the E-HRA can be activated if projected hydro generation is also below 480 GWh/yr.

<sup>6</sup> FY 2023 Electric Financial Plan, adopted June 13, 2022, Staff Report ID# 13661:  
<https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/city-councilagendas-minutes/2022/20220613/20220613pccsm-final-amended-linked.pdf>

Expense: Additional Purchase Cost	N/A	(9,000)	(16,100)
<b>Ending Supply Operations Reserve Balance</b>	<b>\$34,973</b>	<b>\$19,124</b>	<b>\$12,024</b>
<b><i>Supply Operations Reserve Minimum Guideline</i></b>	<b>\$18,843</b>		

Based on the current sales trends for FY 2023, staff estimates the existing \$0.013/kwh adjuster will generate \$10.25 million in the Electric Fund over all of FY 2023, as projected in the FY 2023 Financial Plan.

In November 2022, staff proposed the UAC recommend doubling of the E-HRA rate, as shown in Table 6, which is projected to bring the Electric Fund approximately \$5 million in additional revenues in FY 2023 assuming an effective date of January 1, 2023.

Staff has determined that meeting the revised supply cost increases and keeping reserves at or above minimum guideline levels, would require increasing the E-HRA surcharge to at least \$0.044/kwh. However, even this would result in an ending Supply Operations Reserve lower than the original UAC proposal.

To keep the Supply Operations Reserve from eroding further, staff has provided two alternatives in Table 3 below: Alternative #1 which provides for \$1.6 million above minimum guideline levels by the end of FY 2023, and Alternative #2, which provides for \$2.4 million above minimum levels by the end of FY 2023.

**Table 3: Projected FY 2023 Supply Operations Reserve Balances (Million \$'s)**

	FY 2023 Financial Plan	UAC Proposal (\$0.026/kwh surcharge)	Alternative #1 (\$0.048/kwh surcharge)	Alternative #2 (\$0.050/kwh surcharge)
<b>Beginning Supply Operations Reserve Balance</b>	<b>\$33,046</b>	<b>\$22,197</b>	<b>\$22,197</b>	<b>\$22,197</b>
Net Fund Revenue (Expense)	927	927	927	927
Revenue: New E-HRA Revenue	N/A	5,000	13,462	14,231
Expense: Additional Purchase Cost	N/A	(9,000)	(16,100)	(16,100)
<b>Ending Supply Operations Reserve Balance</b>	<b>\$34,973</b>	<b>\$19,124</b>	<b>\$20,486</b>	<b>\$21,255</b>
<b><i>Supply Operations Reserve Minimum Guideline</i></b>	<b>\$18,843</b>			

For reference, each additional \$0.001/kwh would add about \$380,000 to FY 2023 revenues, based on current sales estimates.

Table 4 shows the relative bill impacts of these proposals on a median electric customer, as well as how far below comparable PG&E bills the new rates would be:

**Table 4: Bill Impacts**

	Current (\$0.013/kwh surcharge)	UAC Proposal (\$0.026/kwh surcharge)	Alternative #1 (\$0.048/kwh surcharge)	Alternative #2 (\$0.050/kwh surcharge)
Monthly bill	\$86.57	\$92.94	\$103.72	\$104.70
Bill Impact (\$)	-	6.37	17.15	18.13
Bill Impact (%)	-	7%	20%	21%
% Below PG&E	49%	45%	39%	35%

The current E-HRA levels are shown in Table 5:

**Table 5: Current Hydro Rate Adjustments (\$/kWh)**

Hydro Stabilization Reserve Level	Projected Hydro Generation vs. Average Hydro Generation (GWh/year)			
	Less than 319	319 to 480	480 to 642	Over 642
Above Maximum (>\$35 million)	\$-	\$(0.0065)	\$(0.0065)	\$(0.018)
75% to 100% (\$27 to \$35 million)	\$-	\$-	\$(0.0065)	\$(0.013)
25% to 75% (\$11 to \$27 million)	\$-	\$-	\$-	\$-
25% and below (<\$11 million)	\$0.013	\$0.0065	\$-	\$-

The proposed E-HRA as presented to the UAC on November 2, 2022 is shown in Table 6:

**Table 6: Proposed Hydro Rate Adjustments at November 2022 UAC meeting (\$/kWh)**

Hydro Stabilization Reserve Level	Projected Hydro Generation vs. Average Hydro Generation (GWh/year)			
	Less than 319	319 to 480	480 to 642	Over 642
Above Maximum (>\$35 million)	\$-	\$(0.013)	\$(0.013)	\$(0.036)
75% to 100% (\$27 to \$35 million)	\$-	\$-	\$(0.013)	\$(0.026)
25% to 75%	\$-	\$-	\$-	\$-

(\$11 to \$27 million)				
25% and below (<\$11 million)	\$0.026	\$0.013	\$-	\$-

Table 7 shows the overall revised rates under Alternative #1:

**Table 7: Proposed Hydro Rate Adjustments (\$/kWh) – Alternative #1**

Hydro Stabilization Reserve Level	Projected Hydro Generation vs. Average Hydro Generation (GWh/year)			
	Less than 319	319 to 480	480 to 642	Over 642
Above Maximum (>\$35 million)	\$-	\$(0.024)	\$(0.024)	\$(0.066)
75% to 100% (\$27 to \$35 million)	\$-	\$-	\$(0.024)	\$(0.048)
25% to 75% (\$11 to \$27 million)	\$-	\$-	\$-	\$-
25% and below (<\$11 million)	\$0.048	\$0.024	\$-	\$-

Table 8 shows the overall revised rates under Alternative #2:

**Table 8: Proposed Hydro Rate Adjustments (\$/kWh) -Alternative #2**

Hydro Stabilization Reserve Level	Projected Hydro Generation vs. Average Hydro Generation (GWh/year)			
	Less than 319	319 to 480	480 to 642	Over 642
Above Maximum (>\$35 million)	\$-	\$(0.029)	\$(0.029)	\$(0.069)
75% to 100% (\$27 to \$35 million)	\$-	\$-	\$(0.029)	\$(0.050)
25% to 75% (\$11 to \$27 million)	\$-	\$-	\$-	\$-
25% and below (<\$11 million)	\$0.050	\$0.029	\$-	\$-

While either of the alternative increases shown would keep the Supply Operations Reserve above minimum if all other revenue and expense conditions hold, it is still possible that external factors (higher/lower market prices, reduced/increased sales, etc.) could positively or negatively impact the Operations Reserve by fiscal year end.

E-HRA going forward

Staff expects that the E-HRA will have to be modified again in July. If market costs continue to be high, staff will likely increase base electric rates to reflect the new commodity cost environment, and the E-HRA would be reduced. Staff is also investigating an alternative mechanism for passing through cost variations from budget, to be provided and reviewed during the upcoming FY 2024 budget cycle.

#### Staff Proposed Alternative

Staff recommends that the Finance Committee recommend that City Council adopt the rates shown in Table 8 (Alternative #2).

While this proposal is different from what the Utilities Advisory Commission reviewed in November, staff feels that the projected continued increases to electricity costs from what was seen back in September warrant the change. Further, given the burgeoning electricity costs and the relatively low level of current Operations Reserves, staff believes the higher Alternative #2 rate would place the Electric Utility in a better financial position for FY 2023 and beyond.

The alternative to increasing the E-HRA surcharge is implementing a general rate increase. Utilizing the E-HRA is a targeted way to mitigate the impacts of hydro generation and supply cost fluctuations. If higher market prices persist or appear to be a 'new normal,' or larger long-term reserves are needed, general rates can be increased at the next fiscal year and the E-HRA brought to zero as additional revenue recovery is not needed.

#### **Resource Impact**

Based on the current sales trends for FY 2023, the estimated revenue impacts for the existing \$0.013/kwh adjuster is an increase of \$10.25 million in the Electric Fund in FY 2023, which has already been included in the adopted budget.

If, in December 2022, Council additionally adopts:

- UAC proposal (\$0.026/kWh), FY 2023 revenues would increase by \$5 million;
- Alternative #1 (\$0.048/kWh), FY 2023 revenues would increase by \$13.5 million; and
- Alternative #2 (\$0.050/kWh), FY 2023 revenues would increase by \$14.2 million.

Staff's recommendation is Alternative #2. The City is a utility customer so rate increases will also result in City expense increases. Resource impacts to City departments and funds of the recommended rate adjustments will be reflected in the mid-year budget process.

#### **Policy Implications**

The proposed Electric Hydro Rate Adjuster (E-HRA) rate amendment is consistent with Council-adopted Reserve Management Practices that are part of the adopted 2023 Electric Financial Plans.

#### **Stakeholder Engagement**

The UAC considered staff's request (Table 6) at its November 2, 2022 meeting. At that meeting,



the UAC agreed that, given the escalating costs of purchasing electricity, that the rate increase was prudent. The UAC approved Staff's motion unanimously.

Staff will provide a subsequent memo the UAC informing of them of staff's modified recommendation, as well as the Finance Committee's actions on that recommendation.

**Environmental Review**

The Finance Committee's recommendation that Council amend the E-HRA rate does not meet the California Environmental Quality Act's definition of a project, pursuant to Public Resources Code 21065 and CEQA Guidelines Section 15378(b)(4) and (5), because it is a governmental fiscal and administrative activity which will not cause a direct or indirect physical change in the environment.

**Attachments:**

- Attachment A: Resolution

Resolution No. \_\_\_\_  
 Resolution of the Council of the City of Palo Alto Amending Electric  
 Rate Schedule E-HRA (Electric Hydro Rate Adjuster), Increasing the  
 Current E-HRA Rate to \$0.050/kWh Effective January 1, 2023

R E C I T A L S

- A. Hydroelectric Rate Adjustment mechanisms are designed to modify customer rates, either up or down, such that overall sales revenue is aligned with supply costs for the electric utility.
- B. Hydroelectric Rate Adjustment mechanisms are intended to enable the electric utility to maintain a reasonably stable level of financial reserves, and maintain base electric rates at lower levels over the long term.
- C. In 2018, staff developed the E-HRA rate mechanism utilizing a 20-year simulation model, estimating reserve needs under periods of both above average hydro generation as well as periods of extended drought. The original model inputs have changed since then, with multi-year drought conditions, rising inflation, increased market costs for alternative fuels, and uncertainty in natural gas markets greatly increasing the market costs for electricity. The existing E-HRA rate is no longer collecting enough revenue to adequately offset required market purchases.
- D. Section D(2)(a) of the Council-adopted E-HRA Rate Schedule directs staff to calculate the Hydro Rate Adjustment annually in May. E-HRA activation may also occur at other times throughout the year, such as when hydrologic conditions are poor and Hydroelectric Stabilization Reserve levels are projected to fall below the 25% level within the current fiscal year.
- E. Therefore, staff recommends the Council modify the E-HRA rate schedule to reflect updated market supply costs and hydrologic conditions, and mitigate Operations Reserve impacts.
- F. Pursuant to Chapter 12.20.010 of the Palo Alto Municipal Code, the Council of the City of Palo Alto may by resolution adopt rules and regulations governing utility services, fees and charges.

The Council of the City of Palo Alto hereby RESOLVES as follows:

SECTION 1. Pursuant to Section 12.20.010 of the Palo Alto Municipal Code, Utility Rate Schedule E-HRA (Electric Hydro Rate Adjuster) is added as attached and incorporated. Utility Rate Schedule E-HRA, as amended, shall become effective January 1, 2023.

SECTION 2. As a result, on January 1, 2023 the \$0.013/kWh E-HRA rate activated by Council on March 14, 2022, and effective April 1, 2022, will increase to \$0.050/kWh.

SECTION 3. The Council finds that the revenue derived from the adoption of this resolution shall be used only for the purpose set forth in Article VII, Section 2, of the Charter of the City of Palo Alto.

SECTION 4. The Council finds that the fees and charges adopted by this resolution are charges imposed for a specific government service or product provided directly to the payor that are not provided to those not charged, and do not exceed the reasonable costs to the City of providing the service or product.

//

//

//

//

//

//

//

//

//

//

//

//

//

//

//

//

SECTION 5. The Council finds that the adoption of this resolution changing electric rates to meet operating expenses and meet financial reserve needs is not subject to the California Environmental Quality Act (CEQA), pursuant to California Public Resources Code Sec. 21080(b)(8) and Title 14 of the California Code of Regulations Sec. 15273(a). After reviewing the staff report and all attachments presented to Council, the Council incorporates these documents herein and finds that sufficient evidence has been presented setting forth with specificity the basis for this claim of CEQA exemption.

INTRODUCED AND PASSED:

AYES:

NOES:

ABSENT:

ABSTENTIONS:

ATTEST:

\_\_\_\_\_  
City Clerk

\_\_\_\_\_  
Mayor

APPROVED AS TO FORM:

APPROVED:

\_\_\_\_\_  
Assistant City Attorney

\_\_\_\_\_  
City Manager

\_\_\_\_\_  
Director of Utilities

\_\_\_\_\_  
Director of Administrative Services

Attachment: Attachment A: Resolution (14975 : Hydro Rate Adjuster Amendment)



# City of Palo Alto

## Finance Committee Staff Report

(ID # 14611)

**Meeting Date: 11/29/2022**

**Report Type: Action Items**

### **Title: Discussion and Update on Sanitary Sewer Main Replacement Acceleration Alternatives**

**From: City Manager**

**Lead Department: Utilities**

#### **Recommendation**

This item is for the Finance Committee's discussion and feedback; no action is requested.

#### **Discussion**

There are 138 miles of remaining clay sanitary sewer mains that need to be replaced before they exceed their approximately 100-year life expectancy, which would require an annual replacement of around 2.5 miles per year. Current wastewater rates support an annual rate of replacement of around 1 mile per year. Staff seeks input from the Finance Committee on how quickly to move to a 2.5 mile per year rate of sanitary sewer main replacement given the associated increase of customer wastewater collection rates necessary to fund the improvements.

The brief summary below describes three alternative approaches to accelerate the sanitary sewer main replacement and illustrate the preliminary rate increase projections needed to achieve the proposed 2.5 mile per year main replacement for each alternative based on a pay-go financial model and a debt financing model. Staff will continue to update and refine these estimates based on changing economic conditions and the availability of updated financial information from the Fiscal Year 2022 Year-End process.

- Alternative #1: immediately move to 2.5 miles per year of sanitary sewer main replacement starting in FY 2024
- Alternative #2: transition to 2.5 miles per year of sanitary sewer main replacement over four years and begin the program in FY 2026
- Alternative #3: transition to 2.5 miles per year of sanitary sewer main replacement to keep rate increases below 5%; program estimated to start in FY 2034

Once equipment reaches the approximate 100-year life expectancy, the risks or maintenance the City may experience include:

- Increased maintenance to clear blockages and perform spot repairs

- Increased frequency of sanitary sewer overflows
- Increased volume of sewage discharged per sanitary sewer overflow event
- Increased cost to replace failed infrastructure
- Increased potential for sinkholes at locations of failed infrastructure
- Potential additional liability associated with sanitary sewer overflows

While reviewing and receive feedback on this important maintenance schedule, the City's Regional Water Quality Control Plant is going through significant capital investment in parallel that will also impact rates during this same period. A key project to upgrade the secondary stage of the wastewater treatment system for the City's Regional Water Quality Control Plant of which the City is responsible for 38.16% of the capital investment (\$169 million, financing at \$193 million). The Secondary Treatment Upgrades (STU) project will be financed by the state low-interest SRF loan program and be repaid by Palo Alto and its five partner agencies. The project was identified in the 2012 Long Range Facilities Plan (LRFP). Construction is expected to start in early 2023 and the improvement is expected to be completed around November 2027. Loan payments on the debt service will begin in 2028. This timing is important for the discussion on impact to the rates. Further details on rates follows the alternative approaches to accelerate the sanitary sewer main replacement

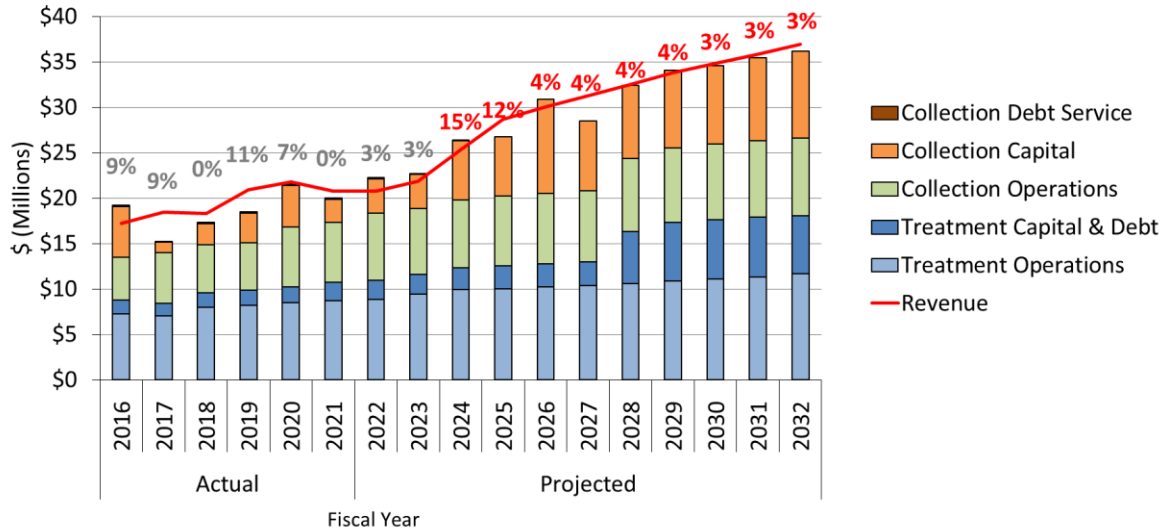
### **Three alternative approaches to accelerate the sanitary sewer main replacement**

#### **Alternative 1**

The first alternative is to immediately move to 2.5 miles per year of sanitary sewer main replacement starting in FY 2024. Subsequent projects will replace 5 miles of sewer mains every two years. At this replacement rate, the last clay sewer mains would be replaced when they are 107 years old. This alternative could be financed either using pay-as-you-go financing with funds collected from rates (Alternative 1a), or using a utility revenue bond of an estimated \$12.6 million to fund the sewer main replacement work planned for FY 2024 and FY 2025 (Alternative 1b).

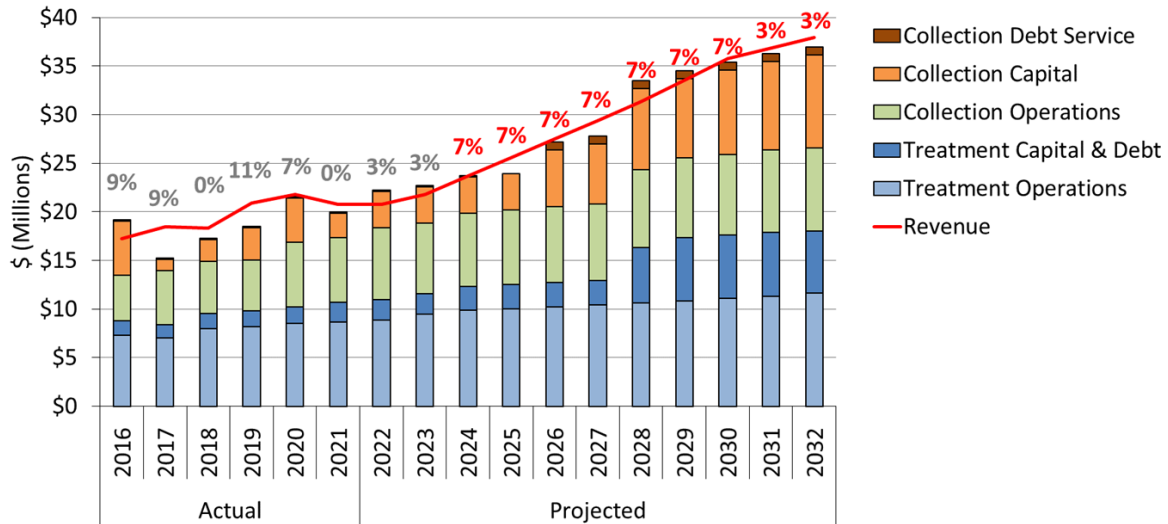
Under Alternative 1a, staff estimates rate increases of 15% and 12% in FY 2024 and FY 2025 would be needed followed by 3% to 4% annual rate increases throughout the forecast period.

**Figure 1: Alternative 1a – Immediate Move to 2.5 miles/year Pay-Go Finance 5-mile Project in FY 2024**



Under Alternative 1b, staff estimates rate increases of 7% annually over the next seven years followed by 3% annual rate increases throughout the forecast period.

**Figure 2: Alternative 1b – Immediate Move to 2.5 Miles/Year, Debt Finance 5-mile Project in FY 2024**

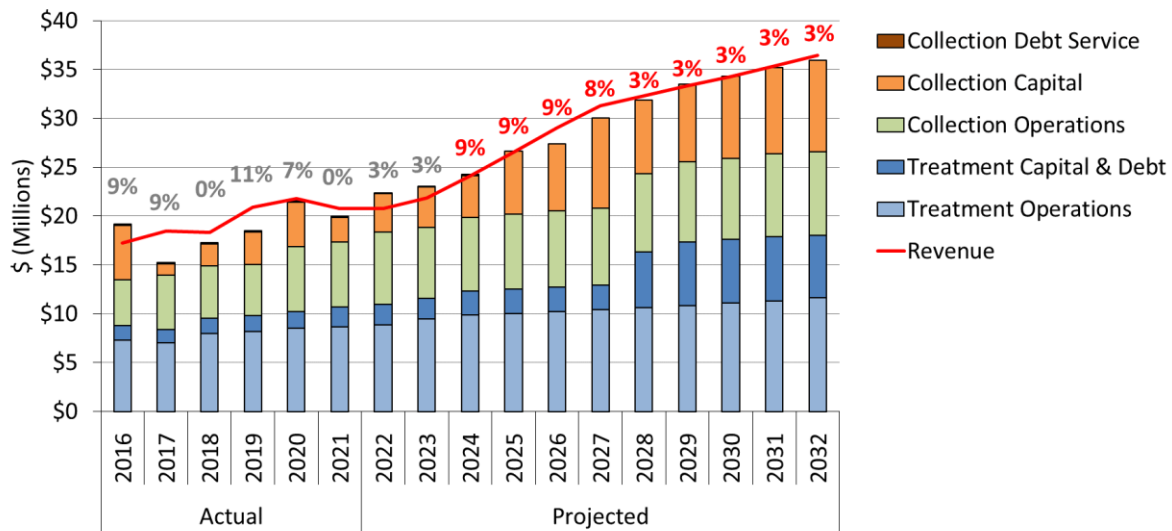


However, when compared to the other alternatives, Alternative 1b is expected to cost the City approximately \$11,000,000 extra for bond financing and \$3,400,000 for loan financing from the California State Revolving Loan (SRF) Fund over the duration of the financing period. Given the competitive nature of SRF loans, there is no guarantee the City’s SRF application would be funded.

Alternative 2

The second alternative is to transition to 2.5 miles per year of sanitary sewer main replacement over four years and begin the program in FY 2026. Subsequent projects will replace 5 miles of sewer mains every two years. At this replacement rate, the last clay sewer mains would be replaced when they are 109 years old. Under Alternative 2, staff estimates rate increases of 9% annually for the next three years (FY 2024 through FY 2026), and 8% in FY 2027, followed by annual 3% rate increases throughout the forecast period.

Figure 3: Alternative 2 – Transition to 2.5 Miles/Year Over Four Years, 5-Mile Project in FY 2026

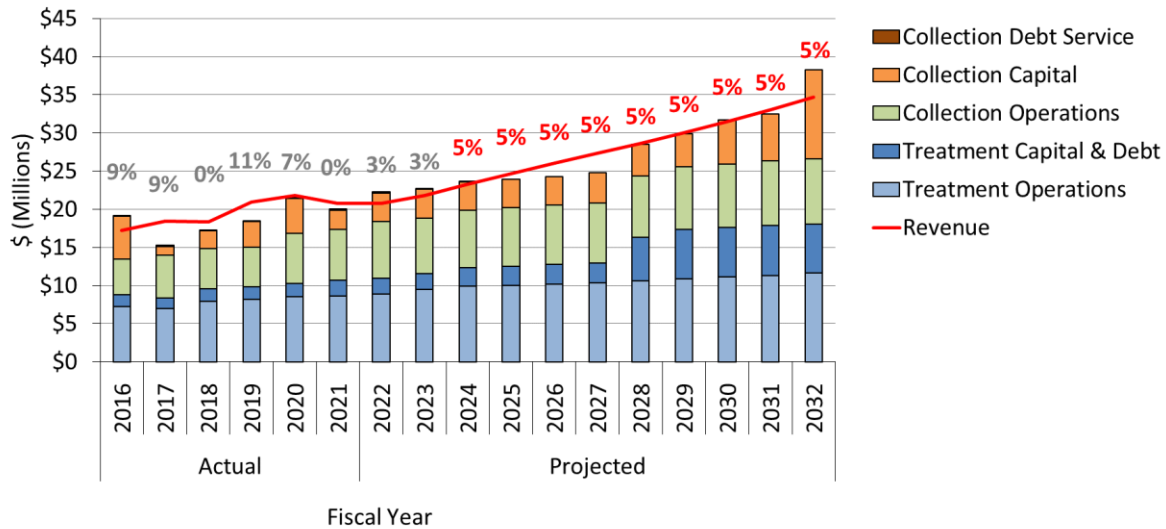


Alternative 3

The third alternative is to transition to 2.5 miles per year of sanitary sewer main replacement slowly to keep rate increases below 5%. Staff anticipates that the 2.5 miles per year replacement program would start in FY 2034. Subsequent projects will replace 5 miles of sewer mains every two years. At this replacement rate, the last clay sewer mains would be replaced when they are 113 years old. Under Alternative 3, rate increases are limited to 5% annually.



Figure 4: Alternative 3 – Transition to 2.5 Miles/Year Slowly To Keep Rate Increases Low, 5-Mile Project in FY 2034



**Waste Water Collection Rates**

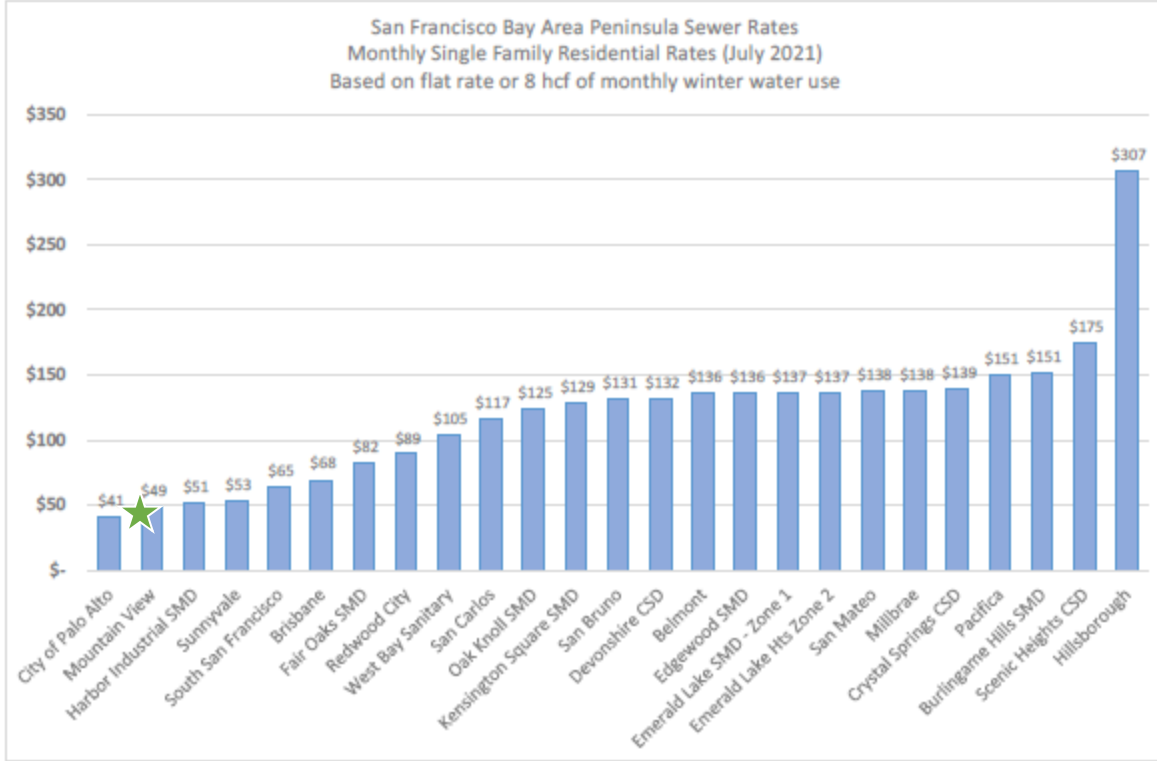
Staff plans to return to the Finance Committee with Preliminary Financial Forecasts in February 2023 and with proposed Financial Plans and rates in April 2023. However, for context to assist the committee in the review of these alternatives, below is a graph from Silicon Valley Clean Water’s Proposed 2021-22

**WASTEWATER MONTHLY RESIDENTIAL BILL (\$) NOVEMBER 2022**

Palo Alto is 28% below comparison city average

Palo Alto	Neighboring Communities					
	Menlo Park	Redwood City	Santa Clara	Mountain View	Los Altos	Hayward
44.62	106.67	89.28	46.82	50.10	42.05	38.58

Operating Budget representing the City’s current residential rate of \$ 44.62 compared of neighboring agencies. The City has historically enjoyed low residential wastewater rates compared to neighboring agencies. Rate increases are expected to support inflation, the cashflow needs of the capital investments being made at the RWQCP, and the debt payment for the significant capital investments, along with the alternative scenarios for discussion above. The scenarios above do have some modeling for the RWQCP capital needs in the “Treatment Capital & Debt” section of the alternative forecasts above, though cost of these capital improvements continue to exceed engineer estimates in this environment.



### Stakeholder Engagement

At the Utilities Advisory Commission (UAC) April 2022 meeting, staff presented the need to increase the rate of sewer main replacement from 1 mile per year to 2.5 miles per year in order to replace the remaining 138 miles of sewer mains scheduled for replacement before they exceed their expected life. UAC Commissioners expressed support for increasing the rate of sewer main replacement to 2.5 miles per year. At the UAC’s October 12, 2022 meeting, staff presented the same attached three alternative approaches to accelerate the sanitary sewer main replacement ([Staff Report #14610](#)). UAC Commissioners asked questions about the causes of sanitary sewer overflows, and asked whether pipes are prioritized based upon condition. Staff responded that sanitary sewer overflows can be caused by leaks or blockages and that pipes are targeted for cleaning and prioritized for replacement. A UAC Commissioner asked a question about climate change and sea level rise impacts on the sewer mains. Staff responded that as part of the upcoming sewer master plan study, staff will work with the consultant on examining these impacts. One Commissioner stated that Alternative 1a or 1b (only with SRF loan) is reasonable while two Commissioners opposed Alternative 1a and 1b. Three Commissioners supported Alternative 2 while one Commissioner questioned whether Alternative 3 may also be acceptable. Staff responded that Alternative 3 would not allow the City to manage sewer infrastructure on a life-cycle basis.