



CITY OF
**PALO
ALTO**

City Council Staff Report

From: City Manager

Report Type: INFORMATIONAL REPORT

Lead Department: Administrative Services

Meeting Date: January 22, 2024

Report #:2307-1774

TITLE

First Quarter Fiscal Year 2024 Financial Status Report

RECOMMENDATION

This report is informational and does not require an action by the City Council.

EXECUTIVE SUMMARY

The purpose of this report is to provide the City Council with information on the financial status of the City's General Fund and Enterprise Funds as of the end of the First (1st) Quarter of Fiscal Year (FY) 2024 (July 1, 2023 through September 30, 2023). The figures presented here are unaudited.

For the 1st quarter, General Fund revenues totaled \$28.4 million, 8.2% lower than the same period of the prior year. Expenditures totaled \$54.5 million, 14.9% higher than prior year and are tracking at 19.4% of Adjusted Budget, comparable to prior year trend.

All Enterprise Funds, except Gas Fund, resulted to a positive change in net position. The total change in position increased by \$4.6 million, or 26.1%, higher than the same period of the prior year.

BACKGROUND

This report summarizes the financial information of the General and Enterprise Funds for First(1st) quarter ending September 30, 2023 of Fiscal Year (FY) 2024 and compares those amounts to the same period of the prior year and to the FY 2024 Adjusted Budget.

Attachment A provides a breakdown of revenues by source and expenses by function, with separate columns for Adopted Budget and Adjusted Budget. The Adjusted Budget column includes prior year commitments that were carried forward into this fiscal year and amendments to the FY 2024 Adopted Budget through September 30. Encumbrances and actual expenses for the three-month period are also reported.

ANALYSIS

GENERAL FUND

As of September 30, 2023, General Fund expenditures (\$54.5 million) exceeds the revenue receipts (\$28.4 million). First quarter General Fund receipts are not indicative of the annual expected receipts in FY 2024 due to timing of major revenues received over the fiscal year. Revenues and expenditures are tracking within the FY2024 adjusted budget.

General Fund revenues (excluding operating transfers) for the 1st quarter are \$28.4 million, or 11.7% of the current year Adjusted Budget. Actual revenues totaled \$28.4 million, 8.2% or \$2.5 million lower than the same period of the prior year. Major taxes increased slightly compared to the same period of prior fiscal year driven primarily by Utility Users Tax revenue. As discussed in the Long-Range Financial Forecast¹, while the economy is currently not trending into recessionary period that was predicted for the past several quarters, first quarterly results indicate a stagnant economy or modest growth.

For the 1st quarter, General Fund expenses totaled \$54.5 million, \$7.1million or 14.9% higher than the prior year and tracking at 19.4% of Adjusted Budget, comparable to the prior year trend.

The following is a detailed discussion of the most significant revenue and expense items.

Revenue Highlights for 1st Quarter FY 2024

The following highlights the City's major revenue sources for the 1st Quarter, compared to 1st Quarter YTD, compared to the same period of the prior year. Revenue for each period is expressed as a percentage of the Adjusted Budget.

¹ Finance Committee, December 5, 2023, Item #1:
<https://portal.laserfiche.com/Portal/DocView.aspx?id=69141&repo=r-704298fc>

Table 1

General Fund Revenue
FY 2024 1st Quarter YTD
(000's)

Revenues	1st Quarter Actuals				Adjusted Budget			
	FY 2024	FY 2023	Inc / (Dec)	% change	FY 2024	%	FY 2023	%
Property Tax	\$85	\$174	(\$89)	-51.1%	\$63,785	0.1%	\$59,770	0.3%
Sales Tax	2,548	2,551	(3)	-0.1%	36,272	7.0%	32,580	7.8%
Charges for Services	6,462	6,427	35	0.5%	35,131	18.4%	30,786	20.9%
Transient Occupancy Tax	2,723	2,663	60	2.3%	26,834	10.1%	18,199	14.6%
Utility User Tax	3,876	3,495	381	10.9%	18,457	21.0%	15,579	22.4%
Permits and Licenses	2,597	1,781	816	45.8%	10,256	25.3%	9,499	18.7%
Documentary Transfer Tax	1,368	1,207	161	13.3%	5,920	23.1%	7,217	16.7%
All Other Revenue Sources	8,741	12,644	(3,903)	-30.9%	46,462	18.8%	41,851	30.2%
Total Revenue	\$28,400	\$30,942	(2,542)	-8.2%	\$243,117	11.7%	\$215,481	14.4%

Property tax revenue in the 1st quarter of the fiscal year is only a nominal amount as property tax receipts are paid by the County over three months beginning in the month of November and then again beginning in March. FY 2023 actual property tax revenue was \$63.1 million, \$2.9 million or 4.7% higher than the FY 2023 adjusted budget and \$3.8 million or 6.4% over the prior fiscal year. The increase is primarily driven by change in assessed values due to ownership change in FY 2022 and FY 2023 plus the 2% Proposition 13 overall annual increase.

Excess Educational Revenue Augmentation Fund (ERAF) distributions from the County of Santa Clara in fiscal years 2021, 2022, and 2023 receipts were \$5.6 million, \$6.6 million, and \$6.4 million, respectively. In FY 2023, the reserve for Excess ERAF, representing the at-risk amount related to the State Controller's Office auditing finding on Marin County, totaled \$4.1 million. The state's assertion is former Redevelopment Agency funds which are now part of the regular property taxes should be excluded from the excess ERAF calculation. Marin County is challenging this finding and it is not known if this will be elevated to a court case. The estimate is, if this audit finding is sustained, 22% of excess ERAF is at risk for fiscal years 2021, 2022, and 2023. If the finding holds, the County of Santa Clara, as well as other Excess ERAF counties, could face similar audit findings likely starting in FY 2025. This reserve is consistent with prior year methodology of assumptions for this challenge.

The FY 2024 updated forecast is \$64.7 million, \$1.6 million or 2.5% higher than the prior year's actual revenue. This is \$0.9 million higher than the budgeted amount of \$63.8 million and has been reduced by \$1.5 million for the on-going FY 2024 Excess ERAF audit at-risk .9amount.

Without this reduction the forecasted amount would have been a \$3.1 million, or 4.9%, increase compared to prior year's actual revenue.

Sales tax revenue cash receipts totaled \$2.5 million for the 1st quarter. This represents one month's sales tax activity due to the two-month delay between sales tax collection by the State and remittance to the City. The FY 2023 actual sales tax revenue was \$36.9 million, \$4.2 million or 12.9% higher than FY 2022, due to a combination of continued pandemic recovery, robust consumer spending and inflation.

The FY2024 budget amount is \$36.3 million, 1.8% lower than the prior year's actual revenue, and is based on conservative estimate that considered a combination of recovery and higher price of goods and services resulting from inflation. Since then, the inflation is still elevated but declining and consumer spending has remained resilient. As of December 2023, the cash receipts for three months in FY2024 is \$9.6 million, or 10.4% higher from the same period of last year. However, this recovery growth has slowed compared to 12.3% and 12.9% in FY2022 and FY2023, respectively. Staff and the City's sales tax consultant are forecasting a modest increase over the prior year's actual receipts.

Transient occupancy tax (TOT) revenue of \$2.7 million represents about one and half month of collections which about equal the same period for last fiscal year. As of writing of this report, 1st quarter revenue is \$6.8 million, similar to the prior year trend. Data for October 2023 (as of the writing of this report) indicates an upward trend of approximately 15% compared to the same period of last fiscal year. The FY 2024 adopted budget of \$26.8 million is a higher than the FY 2019 pre-pandemic actuals of \$25.6 million. With TOT revenue remaining stagnant in the 1st quarter, then experiencing 15% growth in October 2023, staff is continuing to monitor 2nd quarter results to determine whether or not this growth trend will continue or flatten.

During the 1st quarter of FY2024, hotels average daily room and occupancy rates are \$234.50 per day and 68.9%, respectively. A 11.2% increase in average daily room and 9% increase in occupancy rates over the same period of the prior fiscal year. As of October 2023, the average daily room and occupancy rates percentage of individual hotels are averaging approximately \$244.59 and 70.3%, respectively.

Documentary transfer tax cash receipts for two and half months total \$1.4 million, or 23.1% of the FY 2024 adjusted budget and is \$0.2 million, or 13.3%, increase than prior year receipts for the same period due to the higher total property sales value. The number of transactions is 11.6% lower compared to prior first quarter. This revenue source is volatile, it is highly dependent on sales volume and the mix of commercial and residential sales. Staff continues to monitor these receipts closely due to significant fluctuations that can occur anytime depending on the real estate sales activity. The budgeted amount of \$5.9 million, which is 2.9% higher than the actual receipts of the prior year, is still expected to be realized.

Permits and Licenses revenue increased by \$0.8 million, or 45.8%, from the same quarter last year primarily due to an increase in new construction permit revenue.

All other revenue sources cash receipts for the 1st quarter have decreased \$3.9 million or 30.9%, from the same period of last year primarily due to the American Rescue Plan Act (ARPA) allocation which was received in full in FY2023.

Beginning in FY2024, all other revenue sources, includes a new business tax (Measure K) to fund public safety, affordable housing and homeless services, and transportation and grade separation. The tax is expected to be phased-in over several years, generating initial receipts of \$2.4 million in FY 2024. There are no actual receipts for the 1st quarter.

Expense Highlights for 1st Quarter FY 2024

The following highlights the City's expenses by function for the 1st quarter, compared to the same quarter in prior year. Each quarter's expense is expressed as a percentage of the Adjusted Budget for each year.

Table 2

General Fund Expenditures
FY 2024 1st Quarter YTD
(000's)

Expenditures	1st Quarter Actuals				Adjusted Budget			
	FY 2024	FY 2023	Inc/(Dec)	% change	FY 2024	%	FY 2023	%
Police	\$ 13,309	\$ 12,333	\$ 976	7.9%	\$ 52,241	25.5%	\$ 47,723	25.8%
Fire	12,513	10,502	2,011	19.1%	47,464	26.4%	41,379	25.4%
Community Services	8,145	6,713	1,432	21.3%	40,356	20.2%	34,429	19.5%
Public Works	4,834	4,504	330	7.3%	25,763	18.8%	22,667	19.9%
Planning and Development Services	5,054	4,223	831	19.7%	30,049	16.8%	26,131	16.2%
Library	2,602	2,133	469	22.0%	12,599	20.7%	10,524	20.3%
Administrative Services	2,423	2,301	122	5.3%	11,250	21.5%	10,107	22.8%
All Other Departments	5,658	4,743	915	19.3%	61,530	9.2%	39,827	11.9%
Total Expenditures	\$ 54,538	\$ 47,452	\$ 7,086	14.9%	\$281,252	19.4%	\$232,787	20.4%

For the 1st quarter of the fiscal year, total expenses increased \$7.1 million, or 14.9%, compared to the same quarter prior year and are trending in line with total budget at 19.4%. The increase is driven by salaries and benefits increases that include pension and medical expenses; the 4.0% cost of living adjustment wage increase for all labor groups (effective July 1, 2023); management market adjustments aligned with benchmark studies (effective December 31, 2022), flexible compensation to allow employee choice in health and other benefit options, and addition of new positions. Staff continues to work on filling vacant positions while the City maintains a high vacancy level which is expected to generate savings in FY 2024.

Attachment A shows total expenses, including encumbrances for the 1st quarter are 25.8% of the adjusted budget. Some of the departments are higher than 25% due to some purchase orders that cover the entire year (i.e., landscape maintenance, contract services, consultant fees and

others). It is the City's practice in many instances to encumber budget funds for the fiscal year so that invoices are drawdown, or paid against, the encumbrances.

Police and Fire comprise 47.3% of the total General Fund expenditures for the 1st quarter, which is 13.1% higher compared to the prior year. The following highlights Police and Fire salaries and overtime for the 1st quarter.

Table 3
Police and Fire
Salaries and Overtime Expense
FY 2024 1st Quarter YTD
(000's)

Department	1st Quarter Actuals				Adjusted Budget			
	FY 2024	FY 2023	Inc (Dec)	% change	FY 2024	%	FY 2023	%
Police - Salaries	\$ 4,787	\$ 4,476	\$ 311	6.9%	\$ 22,512	21.3%	\$ 20,026	22.4%
Police - Overtime	754	740	14	1.9%	1,029	73.3%	973	76.1%
Total Police	5,541	5,216	325	6.2%	23,541	23.5%	20,999	24.8%
Fire - Salaries	4,210	3,553	657	18.5%	18,417	22.9%	15,997	22.2%
Fire - Overtime	1,276	1,070	206	19.3%	2,146	59.5%	2,124	50.4%
Total Fire	5,486	4,623	863	18.7%	20,563	26.7%	18,121	25.5%
Total Police and Fire								
Salaries and Overtime	\$ 11,027	\$ 9,839	\$ 1,188	12.1%	\$ 44,104	25.0%	\$ 39,120	25.2%

Police overtime is 1.9% higher than the prior year and 73.3% of adjusted budget due to the following:

- Backfilling 13% vacancies: 12 police officers, 1 community service officer, 4 dispatchers and 1 administrative associate.
- 6% of staff are unavailable to work due to benefited leaves or industrial injuries.
- 13% of filled recruits are in training, in-house or at the police academy.

Although salaries and overtime are tracking higher, overall, the Department is trending 23.5% within the budget for the total salary and benefits and anticipates doing so through the remainder of the FY2024. The Department's net overtime cost is \$0.4 million after deducting the reimbursements and salary savings due to vacancies. Analysis is included in Attachment B.

Fire salaries is 18.5% higher than the same period in prior year due to management market rate adjustment, 4.0% cost of living adjustment wage increase effective July 1, 2023, and training a significant number of entry level firefighters to fill vacancies on shift.

Fire overtime is 19.3% higher than the same period in prior year and 59.5% of adjusted budget due to backfilling entry level firefighters while completing Joint Fire Academy and vacancies. In the spring of 2023, the Department hired total of 13 entry level firefighters which accounts for 16% of all on-shift personnel positions. Although the positions are filled, those 13 recruits must complete a 6-month academy before being able to work on shift. In August 2023, the 13-entry level firefighters graduated from the academy and are now working on shift.

The Department continuous to struggle to fill vacancies, as of writing of this report, the Department is still carrying 12 vacancies among the International Association of Fire Fighters (IAFF) ranks. The overtime hours will remain high as backfill is required to maintain daily operations with a high vacancy rate.

On a combined basis, salaries and overtime are 26.7 % of the budget through the 1st quarter of the fiscal year. The Department's net overtime cost is \$1.0 million after deducting the reimbursements and salary savings due to vacancies. Analysis is included in Attachment B.

General Fund Budget Stabilization Reserve (BSR) Balance

Based on information reported in the FY 2023 Annual Comprehensive Financial Report (ACFR)², the City's current General Fund Budget BSR ended FY 2023 at \$61.5 million; after adjusting the BSR for FY 2024 uses approved by Council through September 2023, the net BSR balance was \$57.9 million. When accounting for uses through December 2023, the net BSR balance is \$57.3 million, \$3.4 million above Council's 20% BSR target level. By policy, the City maintains a BSR balance of 15-20% of the annual operating expense, with a target level of 18.5%. However, in development of the FY 2024 budget, the Council adopted the BSR at the 20% level (\$53.9 million) to mitigate risk due to economic uncertainty. In alignment with Council policy, staff recommends that the \$3.4 million excess is split between the Capital Fund Infrastructure Reserve (IR) and the Section 114 Pension Trust fund (\$1.7 million each). Staff anticipates returning to Council in February 2024 with the FY 2024 Mid-Year Review and recommendations in alignment with the allocation below for the appropriation of BSR funds above the 20.0% level.

Enterprise Funds

Following is a summary of changes in net position for each of the Enterprise Funds for the three months ending September 30, 2023, including a comparison of results from the same period last year.

² 11/28/2023 CMR# 2308-1857 *Finance Committee Staff Report, Approval of the FY 2023 ACFR YE Budget Amendments, and Resolution to Extend and Amend the Development and Services Reserve Fund Policy*
<https://portal.laserfiche.com/Portal/DocView.aspx?id=69140&repo=r-704298fc&searchid=222c8b61-ff08-4b38-ba4c-22c2a2d87b96>

Table 4

Enterprise Funds Change in Net Position
FY 2024 1st Quarter YTD
(000's)

Funds	1st Quarter Actuals		Increase (Decrease)	% Change
	FY 2024	FY 2023		
Water	3,572	3,701	(129)	-3.5%
Electric	8,105	2,245	5,860	261.0%
Fiber Optic	684	202	482	238.6%
Gas	(431)	364	(795)	-218.4%
Wastewater Collection	55	116	(61)	-52.6%
Wastewater Treatment	5,458	7,054	(1,596)	-22.6%
Refuse	3,496	3,419	77	2.3%
Storm Drainage	472	502	(30)	-6.0%
Airport	766	(11)	777	-7063.6%
Total Change in Net Position	22,177	17,592	4,585	26.1%

Electric Fund increased \$5.9 million, or 261.0%, from prior year, due to overall increase in operating revenues mainly from customer sales and surplus energy sales partially offset by increase in operating expenses. The 20% increase in base rate effective July 1, 2023 and surplus energy sales from favorable hydroelectric generation , resulted in a \$7.0 million increase in revenues despite the deactivation of the Electric Hydro Adjuster (E-HRA).The deactivation of E-HRA is made possible due to receipt of a \$23.9 million refund from the Bureau of Reclamation of overcharges associated with the Central Valley Project, where the City gets most of its hydroelectric power. The refund is a result of a successful litigation the City participated in against the Bureau. The increase in operating expenses is driven by higher transmission costs as well as salaries and benefits.

Fiber Optics Fund increased by \$0.5 million, or 238.6% from prior year due to the timing of Stanford University's projects billing.

Gas Fund decreased by \$0.8 million, or 218.4% from the same period due to decrease in revenue from customer sales and loss on disposal of fixed assets partially offset by lower commodity purchases. The customer sales decreased by \$0.7 million primarily due to decrease of natural gas price. The gas distribution rate increased 8% effective July 1, 2023 but the system average rate decreased by 10.4% due to decrease in natural gas market prices which are pass-through in nature. Gas commodity prices decreased due to milder temperatures that diminished demand for heating and an above-average level of gas storage. During the current fiscal year there are disposals or early retirement of gas meters resulting in a \$0.4 million

loss. Majority of the retired gas meters were due to incompatibility with the new advanced metering infrastructure or smart meter endpoints.

Wastewater Treatment Fund decreased by \$1.6 million, or 22.6 % from the same period mainly due to the timing of the CA State Water Resources Control Board reimbursements for the Primary Sedimentation Tanks (PST) and Secondary Treatment Upgrades (STU) projects. These reimbursements will be subsequently adjusted to a liability as the City is expected to repay the loans following the completion of each project.

Airport Fund increased by \$0.8 million mainly due to a \$0.7 million increase in federal grants for Federal Aviation Administration for projects Apron Reconstruction (AP-16000) and Airport Layout Plan (AP-21000).

FISCAL/RESOURCE IMPACT

At this time, this report does not recommend an action amending the City's financials, however, depending on trends and further input from Council, actions may be necessary later in the year to better align revenues with expected collections. Staff continues to monitor activities closely.

STAKEHOLDER ENGAGEMENT

This effort to manage and monitor the financial status of City funds continues to be a citywide effort coordinated among all departments. Outside consultants for expertise on major revenues categories including Sales Tax and Property Tax are consulted regularly to provide updates to the forecasted revenue collections.

ENVIRONMENTAL REVIEW

Finance Committee action on this item is not a project as defined by CEQA because financial reports does not involve any commitments to any specific project which may result in a potentially impact on the environment, CEQA Guidelines section 15378(b)(4).

ATTACHMENTS

Attachment A: FY2024 First Quarter Financial Report

Attachment B: Public Safety Overtime Analysis Q1 2024

APPROVED BY:

Kiely Nose, Assistant City Manager