



Finance Committee Staff Report

From: City Manager

Report Type: INFORMATION REPORT

Lead Department: Administrative Services

Meeting Date: December 3, 2024

Report #:2405-3096

TITLE

Informational Item: First Quarter Fiscal Year 2025 Financial Status Report

RECOMMENDATION

This report transmits the City of Palo Alto's Fiscal Year 2025 First Quarter Financial Status Report. Staff recommends the Committee review and accept this report.

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) 2025 (July 1, 2024 through September 30, 2024). The figures presented in this report are unaudited.

For the 1st quarter, General Fund revenues totaled \$31.0 million, or 9.2% higher than the same period of the prior fiscal year. Expenditures totaled \$64.3 million, 17.9% higher than prior year and are tracking at 22.9% of Adjusted Budget.

All Enterprise Funds, except Gas and Airport Funds, resulted in a positive change in net position. The total change in position increased by \$11.3 million, or 51.0%, 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, 2024 of Fiscal Year (FY) 2025 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 2025 Adopted Budget through September 30, if any. Encumbrances and actual expenditures for the three-month period are also reported.

ANALYSIS

GENERAL FUND

As of September 30, 2024, General Fund expenditures (\$64.3 million) exceeds the revenue receipts (\$31.0 million). First quarter General Fund receipts are not indicative of the annual expected receipts in FY 2025 due to timing of major revenues received over the fiscal year. Revenues and expenditures are tracking within the FY2025 adjusted budget, comparable to prior fiscal year trend.

General Fund revenues (excluding operating transfers) for the 1st quarter are \$31.0 million, or 12.0%, of the current year Adjusted Budget. Actual revenues totaled \$31.0 million, 9.2% or \$2.6 million higher than the same period of the prior fiscal year. Major taxes increased by \$1.9 million compared to the same period of prior fiscal year driven primarily by Transient Occupancy Tax (TOT) and Utility Users Tax revenue. Sales and documentary transfer taxes are nearly identical to the same period in prior fiscal year. This reflects ongoing economic conditions and reinforces the forecast of a gradual return to moderate growth beginning in 2026.

For the 1st quarter, General Fund expenditures totaled \$64.3 million, \$9.8 million or 17.9% higher than the prior fiscal year and tracking at 22.9% of adjusted budget, slightly higher compared to prior budget versus actual at 19.4%. The City is making significant efforts to fill vacant positions while this budget to actual variance also reflects the change in budget assumptions between FY 2024 and FY 2025 which reflected a 2% increase for a total presumed vacancy factor of 5% instead of 3% in assumed vacancies.

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

Revenue Highlights for 1st Quarter FY 2025

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 fiscal year. Revenue for each period is expressed as a percentage of the Adjusted Budget.

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the same period in prior fiscal year. This reflects ongoing economic resilience despite elevated inflationary pressures, consistent with a forecasted modestly weak economy in FY 2025 and a gradual return to moderate growth starting in 2026.

For the 1st quarter, General Fund expenditures totaled \$64.3 million, \$9.8 million or 17.9% higher than the prior fiscal year and tracking at 22.9% of Adjusted Budget, slightly higher compared to prior budget versus actual at 19.4%.

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Revenue Highlights for 1st Quarter FY 2025

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 fiscal year. Revenue for each period is expressed as a percentage of the Adjusted Budget.

Table 1
General Fund Revenue
FY 2025 1st Quarter YTD
(000's)

Revenues	1st Quarter Actuals				Adjusted Budget			
	FY2025	FY 2024	Inc / (Dec)	% change	FY 2025	%	FY 2024	%
Property Tax	\$94	\$85	\$9	10.6%	\$68,623	0.1%	\$63,785	0.1%
Sales Tax	2,585	\$2,548	37.0	1.5%	39,577	6.5%	36,272	7.0%
Charges for Services	6,169	\$6,462	(293.0)	-4.5%	38,637	16.0%	35,131	18.4%
Transient Occupancy Tax	3,950	\$2,723	1,227.0	45.1%	27,857	14.2%	26,834	10.1%
Utility User Tax	4,486	\$3,876	610.0	15.7%	19,943	22.5%	18,547	20.9%
Business Tax	21	-	21.0	0.0%	4,763	0.4%	1,660	0.0%
Permits and Licenses	2,803	\$2,597	206.0	7.9%	10,813	25.9%	10,256	25.3%
Documentary Transfer Tax	1,499	\$1,368	131.0	9.6%	7,260	20.6%	5,920	23.1%
All Other Revenue Sources	9,402	\$8,741	661.0	7.6%	41,139	22.9%	44,856	19.5%
Total Revenue	\$31,009	\$28,400	\$2,609	9.2%	\$258,612	12.0%	\$243,261	11.7%

Property tax revenue in the 1st quarter of the fiscal year is the typical nominal amount as property tax receipts are mostly paid by the County over three months beginning in the month of November and then again beginning in March. FY2024 actuals are \$3.2 million or 5.1% over the prior fiscal year primarily driven by change in assessed values due to ownership change in FY 2024 plus the expected 2% Proposition 13 overall annual increase in FY 2025

The FY 2025 updated forecast is \$68.3 million, \$2.0 million or 3.0% higher than the prior year's actual revenue and \$0.3 million lower than the FY 2025 adjusted budgeted. The updated forecast has been reduced by \$1.5 million for the on-going FY 2025 Excess ERAF audit at-risk amount. Without this reduction the updated forecasted amount would have been a \$3.5 million, or 5.3%, increase compared to prior year's actual revenue. In comparison, the five-year compound annual growth rate on actual receipts was 7.0% with the FY 2024 actual growth rate being 5.1%.

ERAF distributions from the County of Santa Clara in fiscal years 2021, 2022, 2023, and 2024 receipts were \$5.6 million, \$6.6 million, \$6.4 million, and \$7.0 million respectively. In FY 2024, the reserve for Excess ERAF, representing the at-risk amount related to the State Controller's Office auditing finding on Marin County, totaled \$5.6 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 the County of Santa Clara has filed a lawsuit. The estimate is, if this audit finding is sustained, 20% to 22% of excess ERAF is at risk for fiscal years 2021 to 2025. If the finding holds, the County of Santa Clara, as well as other Excess ERAF counties, may be negatively impacted for future fiscal years as well. This reserve, as of FY 2024, is consistent with prior year methodology of assumptions for this challenge. Also, consistent with prior year, the FY 2025 budget has been reduced by this at-risk amount.

Sales tax revenue cash receipts totaled \$2.6 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 2024 actual sales tax revenue was \$37.5 million, \$0.6 million or 1.5% higher than FY 2023.

The FY 2025 budget amount is \$39.6 million, 5.6% higher than the prior year's actual revenue, and is based on conservative estimate that considered a combination of recovery phase of the pandemic and higher price of goods. Since then, an economic soft landing, consumer spending is still resilient but expected to moderate further. The recovery growth has slowed compared to 12.3% and 12.9% in FY 2022 and FY 2023, respectively with FY 2024 being 1.5%. Staff is forecasting slightly over 2% growth in FY 2025 which is a combination of expected modest growth and expected opening of a new car dealership in mid FY 2025. In comparison, the five- and ten-year annual compound annual growth rate on actual receipts was 0.5% and 2.5%, respectively.

Transient occupancy tax (TOT) cash receipts for about one and half months totaled \$3.9 million, or 14.2% of the FY 2025 adjusted budget and is \$1.2 million, or 45.1%, increase than prior fiscal year receipts for the same period. The 45.1% increase is due to timing of individual hotel receipts and does not reflect the true economic performance. This revenue is at an economic crossroad. In July and September, there were growth of 8.6% and 5.3%, respectively, but in August, receipts declined by 2.5%: over the prior fiscal year's actual receipts. As of writing of this report, 1st quarter revenue is \$7.1 million, an increase of \$0.3 million, or 3.8%, higher the prior fiscal year. Without considering inflation, the FY 2025 adopted budget of \$27.9 million is higher than the FY 2019 pre-pandemic actuals of \$25.6 million by \$2.2 million or 8.6%. The FY 2024 had similar level or \$2.3 million or 9% growth over the prior years. The revised forecast is expecting a flattening of this revenue.

During the 1st quarter of FY 2025, hotels average daily room and occupancy rates are \$238.76 per day and 70.2%, respectively, a 2.5% increase in average daily room and 10.8% decrease in

occupancy rates over the same period of the prior fiscal year. In comparison, the five- and ten-year annual compound annual growth rate on actual receipts was 1.6% and 8.5%, respectively.

Documentary transfer tax cash receipts for two and half month total \$1.5 million, or 20.6% of the FY 2025 adjusted budget and is \$0.1 million, or 9.6%, increase than prior year receipts for the same period due to the higher total property sales value. The number of transactions is 2.0% higher compared to prior fiscal year 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 \$7.3 million, which is 3.5% higher than the actual receipts of the prior year, is still expected to be realized.

Utility User Tax (UUT) revenue total \$4.5 million, or 22.5% of the FY 2025 adjusted budget and is \$0.9 million, or 4.9% than the prior year's actuals. This is \$0.6 million, or 15.7%, higher than the prior fiscal year's receipts due to rate increases and strong telephone UUT. This trend has led to revising the budgeted forecast to \$20.6 million, \$0.7 million or 3.5% higher than the current budget. The revised forecast is 8.4% higher than the prior year's actual receipts.

Business Tax revenue in the 1st quarter of the fiscal year is a nominal amount as business are required to file business tax quarterly but it is due the first day of the following quarter (October 1st) and is delinquent 30 days later. FY 2025 Adjusted Budget includes \$4.8 million for business tax revenue. The tax became effective in January 2023, with the rate through January 2025 being half of the full rate, or 3.75 cents per square foot per month. The full rate will be assessed starting January 2025 at 7.5 cents per square foot per month. The tax has an annual cap of \$0.5 million per business and both the rate and the cap are increased by 2.5% annually beginning FY 2027.

Expenditure Highlights for 1st Quarter FY 2025

The following highlights the City's expenditures by function for the 1st quarter, excluding encumbrances, 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 2025 1st Quarter YTD
(000's)

Expenditures	1st Quarter Actuals				Adjusted Budget			
	FY 2025	FY 2024	Inc/(Dec)	% change	FY 2025	%	FY 2024	%
Police	\$ 15,500	\$ 13,309	\$ 2,191	16.5%	\$ 56,365	27.5%	\$ 52,241	25.5%
Fire	14,550	12,513	2,037	16.3%	55,441	26.2%	47,464	26.4%
Community Services	10,136	8,145	1,991	24.4%	42,300	24.0%	40,356	20.2%
Public Works	5,977	4,834	1,143	23.6%	27,190	22.0%	25,763	18.8%
Planning and Development Services	5,425	5,054	371	7.3%	29,009	18.7%	30,049	16.8%
Library	3,230	2,602	628	24.1%	12,840	25.2%	12,599	20.7%
Administrative Services	2,843	2,423	420	17.3%	12,154	23.4%	11,250	21.5%
All Other Departments	6,649	5,658	991	17.5%	45,417	14.6%	61,530	9.2%
Total Expenditures	\$ 64,310	\$ 54,538	\$ 9,772	17.9%	\$ 280,716	22.9%	\$ 281,252	19.4%

For the 1st quarter of the fiscal year, total expenses increased by \$9.8 million, or 17.9%, compared to the same quarter prior fiscal year, aligning with total budget at 22.9%. This increase is primarily due to higher salaries and benefits costs, including pension and medical expenses; a 4.0% cost of living adjustment for all labor groups (effective July 1, 2024), flexible compensation options; rising health costs; and the addition of new positions.

Attachment A shows total expenses, including encumbrances for the 1st quarter are 33.4% of the adjusted budget. Most departments exceed 25% due to purchase orders that cover the entire year (i.e., landscape maintenance, contract services, consultant fees and others). It is the City's practice to encumber budget funds for the fiscal year, allowing invoices to be drawn down, or paid against these encumbrances.

Community Services expenditures increased \$2.0 million, or 24.4%, due mainly due to salaries and benefits (\$0.8 million increase) and contract services (\$1.1 million increase). Most of the contract services increases are as follows:

- Golf course fee contract services are higher by \$0.8 million due to the timing of invoice payments for the golf course management; prior fiscal year was delayed until the 2nd quarter.
- Landscape maintenance due to additional sites and services on weekends, increase in required minimum staffing level and higher material, and labor cost.

- Animal service provider cost.

Public Works expenditures increased \$1.1 million, or 23.6%, primarily due to salaries and benefits (\$0.4 million increase) and contract services (\$0.6 million). The increases of contract services are due to higher janitorial service contract and consultant fees. The increase in janitorial service contract, effective December 2023, was due to new higher wage and benefits standards, and additional City facilities and service frequency at some facilities. Consultant fees increase is due to the Sustainability Climate Action Plan (S/CAP) Funding Study.

Police and Fire accounted for 46.7% of total General Fund expenditures in the 1st quarter, consistent with 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 2025 1st Quarter YTD
(000's)

Department	1st Quarter Actuals					Adjusted Budget			
	FY 2025	FY 2024	Inc (Dec)	% change		FY 2025	%	FY 2024	%
Police - Salaries	\$ 5,477	\$ 4,787	\$ 690	14.4%		\$ 23,793	23.0%	\$ 22,512	21.3%
Police - Overtime	1,057	754	303	40.2%		1,099	96.2%	1,029	73.3%
Total Police	6,534	5,541	993	17.9%		24,892	26.2%	23,541	23.5%
Fire - Salaries	4,840	3,553	1,287	36.2%		21,628	22.4%	15,997	22.2%
Fire - Overtime	1,716	1,070	646	60.4%		2,721	63.1%	2,124	50.4%
Total Fire	6,556	4,623	1,933	41.8%		24,349	26.9%	18,121	25.5%
Total Police and Fire Salaries and Overtime	\$ 13,090	\$ 10,164	\$ 2,926	28.8%		\$ 49,241	26.6%	\$ 41,662	24.4%

Police overtime is 40.2% higher than the prior fiscal year and 96.2% of adjusted budget. In the first quarter of FY 2025, the Department had 7 vacancies out of 142 full-time positions: one Lieutenant, three Dispatchers, one Records staff, and two Police Officers. Of the 76 filled PAPOA positions, 10 (13%) were in training, 10 (13%) were on long-term leave and 56 (74%) were available for duty.

Currently, eight officers focus to investigations, three to traffic enforcement, two to personnel and training, two to special problems and one on Psychiatric Emergency Response Team, leaving 40 police officers available for patrol. These officers respond to approximately 110 calls daily, conduct enforcement stops and participate in community outreach. The Department

operates five patrol teams, each with four to five members. Most overtime is attributed to filling police positions to address staffing gaps from vacancies or absences and to respond to sporadic increases in demand such as major accidents. The Department will continue to monitor overtime and any impact on budget appropriation including additional overtime incurred in alignment with the recent retail theft grant activities. An analysis is included in Attachment B.

Fire overtime is 60.4% higher than the same period in prior year and 63.1% of the adjusted budget. Department overtime were incurred due to backfilling vacancies on shift. The department current deployment model requires 24 positions daily for Fire Engines and Ambulances to operate fully. Any vacancy must be backfilled to maintain operational readiness. Vacancies can arise from several factors, including unfilled positions, employees on injury leave, new hires still in training and not yet off probation, or those on vacation or other leaves of absence. In FY 2025 Q1, with 10 vacant positions and three employees on injury leave, overtime levels remained high as we needed to fill these positions daily. An analysis is included in Attachment B.

General Fund Budget Stabilization Reserve (BSR) Balance

Based on information reported in the FY 2024 Annual Comprehensive Financial Report (ACFR), the City's current General Fund Budget BSR ended FY 2024 at \$65.9 million; after adjusting the BSR for FY 2025 uses approved by Council¹ in the amount of \$2.6 million, the net BSR balance was \$63.3 million, or \$8.9 million above Council's 18.5% 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%. The \$8.9 million is comprised of \$7.9 million or 1.5% budget variance in comparison to total FY 2024 actual General Fund revenues and expenditures, which is well within acceptable standard deviation given the complexity, size and fluctuation of the General Fund, and an additional \$1 million due to an isolated misclassification of prior reappropriation, which staff discovered in the year-end close reconciliation. Staff recommends that the \$8.9 million above the 18.5% BSR target level be allocated between the Capital Fund Infrastructure Reserve (IR) (\$3.0 million) and Budget Uncertainty Reserve (\$5.9 million). The budget actions to allocate the BSR funds above the 18.5% target level will be included in the FY 2025 Mid-Year Review (February 2025).

¹ City Council Meeting, June 17 2024, Staff Report 2406-3140: <https://portal.laserfiche.com/Portal/DocView.aspx?id=73983&repo=-704298fc&searchid=fe0b0b3a-a510-4161-b80b-7f2c52881023>

Enterprise Funds

The following is a summary of changes in net position for each of the Enterprise Funds for the three months ending September 30, 2024, along with a comparison to the same period last fiscal year.

Table 4
Enterprise Funds Change in Net Position
FY 2025 1st Quarter YTD
(000's)

Funds	1st Quarter Actuals		Increase	
	FY 2025	FY 2024	(Decrease)	% Change
Water	\$ 4,918	\$ 3,572	\$ 1,346	37.7%
Electric	18,077	8,105	9,972	123.0%
Fiber Optic	316	684	(368)	-53.8%
Gas	(776)	(431)	(345)	80.0%
Wastewater Collection	998	55	943	1714.5%
Wastewater Treatment	6,779	5,458	1,321	24.2%
Refuse	2,926	3,496	(570)	-16.3%
Storm Drainage	429	472	(43)	-9.1%
Airport	(183)	766	(949)	-123.9%
Total Change in Net Position	\$ 33,484	\$ 22,177	\$ 11,307	51.0%

Water Fund increased \$1.3 million, or 37.7%, from prior year fiscal year, due to an increase in operating revenues primarily from customer sales, which was partially offset by an increase in operating expenses. The increase in customer sales resulted from 9.5% overall rate increase for residential and commercial customers, effective July 1, 2024, and higher consumption. Operating expenses have increased, driven by higher commodity costs. The wholesale commodity rate from San Francisco Public Utilities Commission (SFPUC) increased from \$5.21 to \$5.67 per CCF, reflecting a 9.0% increase.

Electric Fund increased by \$10.0 million, or 123.0%, from prior fiscal year, due to increase in operating revenues, from a new data center, customer sales and resource adequacy sales, and decrease in operating. The expense decrease is driven by lower joint agency service payment to Northern California Power Agency (NCPA) due to lower debt service costs of the Calaveras hydroelectric project, and lower transmission costs and commodity expense due to higher-than-expected hydro generation. The increase in customer sales revenue is due to rate increases effective July 1, 2024, and higher commercial usage. The rate changes were based on the electric cost of service study including higher demand rates due to rising local capacity costs. While the increase in resource adequacy capacity sales is due to favorable market conditions.

Wastewater Collection Fund increased by \$0.9 million, or 1714.5% from prior year due to an increase in operating revenue primarily from customer sales and from connection fees. The increase in customer sales resulted primarily from 15.0% overall rate increase for residential and commercial customers, effective July 1, 2024. The rate increase allows the highest priority sewer mains to be replaced while allowing the reserves to gradually replenish before the next major project.

Wastewater Treatment Fund increased \$1.3 million, or 24.2%, from the prior fiscal year primarily due to revenue increase from the partner agencies. The revenue increases can be attributed to various factors, including higher operating and maintenance expenses, increased salary and benefit costs, elevated permitting fees, and rising contract costs. This fund recovers its increased expenses from partner agencies including the Wastewater Collection Fund. The partner agencies cover these expenses either quarterly or annually, depending on the specific agency per the agreement terms. The billing is based on the FY2025 adopted budget, the previous year's sewage flow, and the existing partner debt service. Any excess or underbilling (adopted budget vs. actual expenses) is calculated at the end of the fiscal year, and then an additional cost or credit is provided based on the results of this calculation.

Airport Fund decreased \$0.9 million, or 123.9%, mainly due to decrease in federal grants. Federal grants from the Federal Aviation Administration for the Apron Reconstruction (AP-16000) have been fully utilized in FY 2024 and for the Airport Layout Plan (AP-21000) is nearing to its end, remaining 20% of the grant is to be received in current fiscal year.

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: FY2025 First Quarter Financial Report

Attachment B: Public Safety Overtime Analysis Q1 2025

APPROVED BY:

Lauren Lai, CFO/ Administrative Services Director