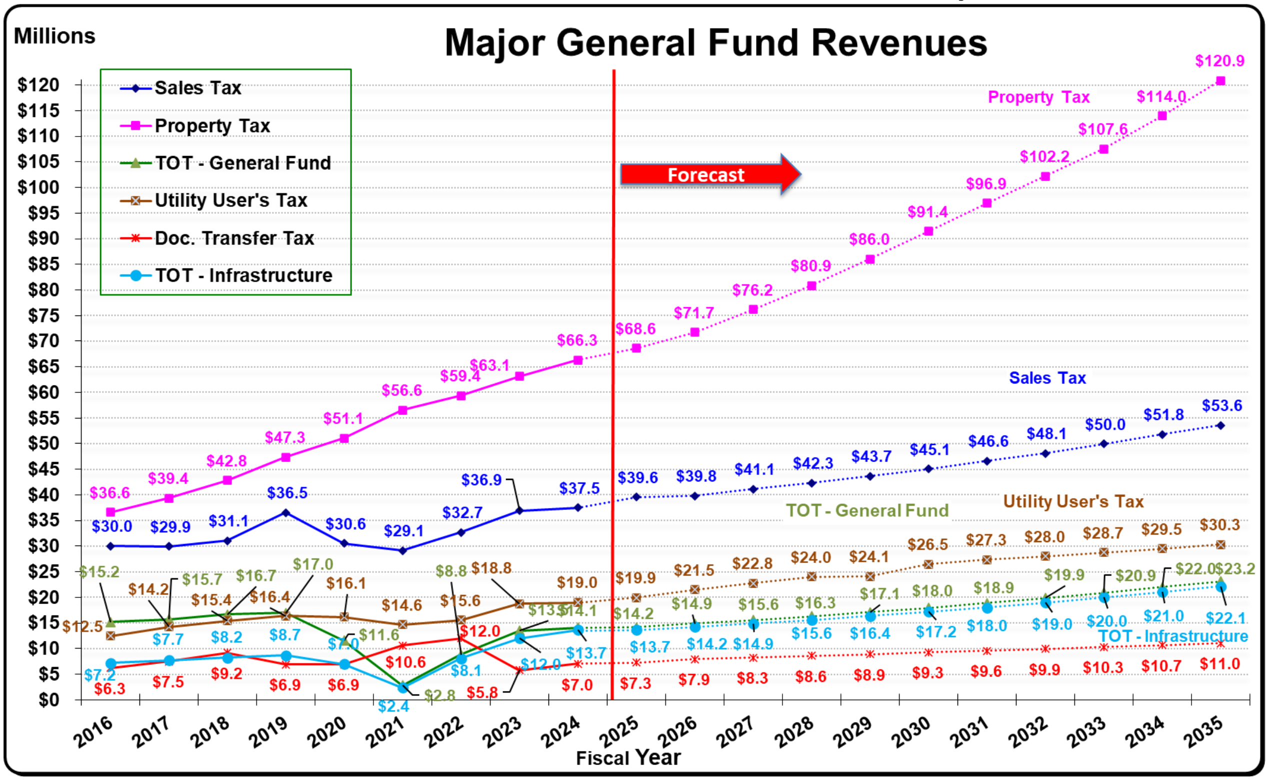
Table 1: General Fund Base Case Revenue Assumptions

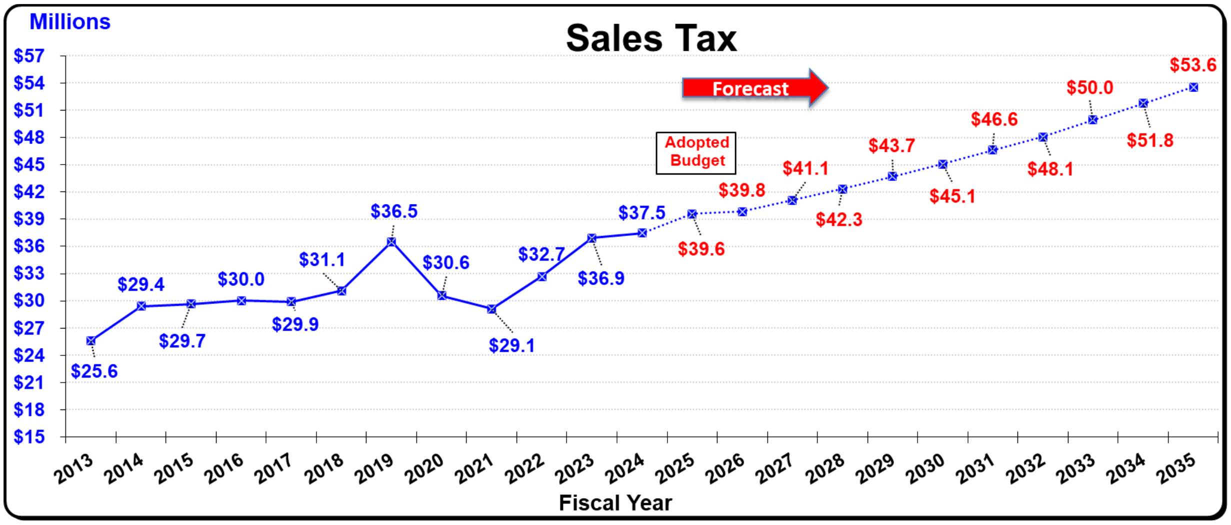


Sales Tax

Compared to FY 2019 pre-pandemic actuals of $36.5 million, sales tax revenue declined by $7.4 million, or 20.2%, during the pandemic in FY 2021. The recovery, which began in the last quarter of FY 2021, resulted in the FY 2022 and FY 2023 receipts increasing by $3.6 million or 12.3% and $4.2 million or 12.9%, respectively. The FY 2024 receipts increased by $0.6 million or 1.5%. With the economic “soft-landing”, the FY 2025 receipts is expected to be relatively flat; however, with the expected opening of a new car dealership at the end of this calendar year, a modest increase may develop compared to FY 2024. The general retail, food products (includes restaurants), transportation, and business to business (includes car leasing) categories experienced increases. This economic trend was mixed in the San Francisco Bay Area and in California. A few municipalities had single digit increases in FY 2024 while most had single or double digit decreases.

The FY 2025 Adopted Budget for Sales Tax is $39.6 million, a $2.1 million or 5.6% increase from FY 2024 actuals of $37.5 million. Staff continues to monitor the FY 2025 sales tax trends. Revenue for FY 2026 is projected at $39.8 million, a slight $0.2 million or 0.6% increase over the FY 2025 Adopted Budget due to many uncertainties surrounding the economy. The Base Case assumes 2.3% to 4% growth over the length of the forecast with a 10-year compound annual growth rate (CAGR) of 3.4%.

TABLE 2: City of Palo Alto Sales Tax Revenues through FY 2035



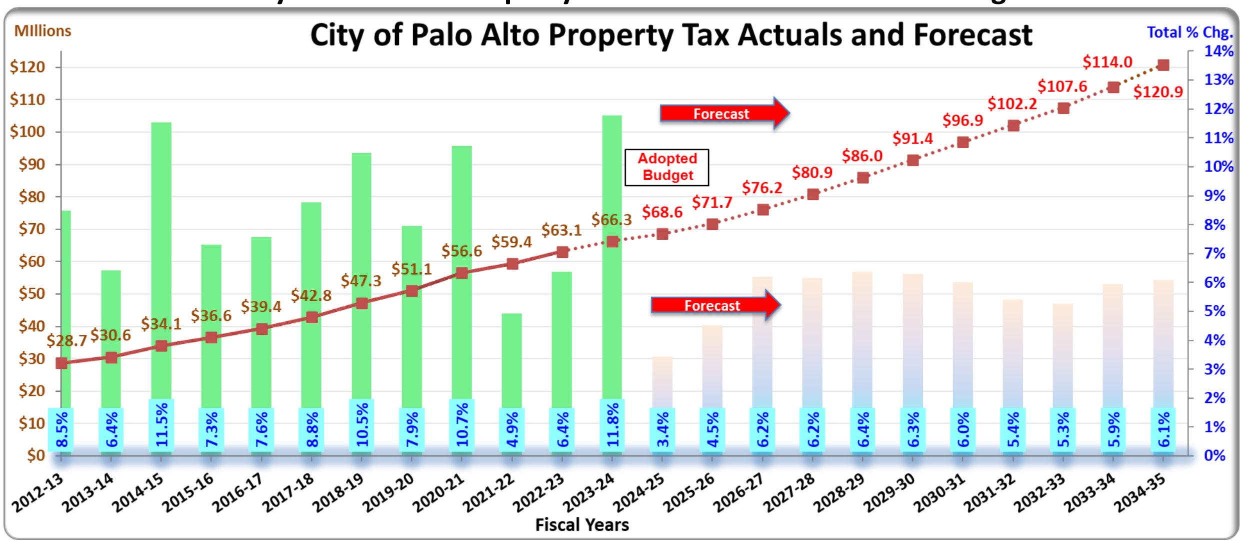
Property Tax

Property tax revenue is the General Fund's largest revenue source and represents approximately 25% of the total revenues. Historically, the 10-year compound annual growth rate (CAGR) was 8.1%, with a low of 4.9% in FY 2022 and a high of 11.5% in FY 2015. During economic downturns, impacts to property tax occur a year later, as a result, the $2.8 million or 4.9% growth in FY 2022 was the lowest in the past decade. This category also includes receipts for excess Educational Revenue Augmentation Fund (ERAF) distributions from the County of Santa Clara. ERAF is the fund used to collect and disburse property taxes that are shifted to/from cities, the County, and special districts prior to their reallocation to K-14 school agencies. When the state shifts more local property tax than required to support schools, these funds are returned and known as excess ERAF. As a result of the volatility of ERAF, it is not considered a permanent local revenue source even though it has performed strongly in the past decade.

ERAF Reserve: Since FY 2021, the City has engaged in several disputes over the calculation and disbursement of excess ERAF Funds. In response, the City established reserves for potential estimated losses at 25% of total Excess ERAF receipts. There were favorable resolutions with the State and Santa Clara County, followed by the State and California School Board Association, for two prior disputes. The associated reserves have been released to the Budget Stabilization Reserve (BSR) or consolidated for potential future at-risk amounts.

A few years ago,, the State Controller's Office issued a negative audit finding against Marin County. The state asserts that 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, 22% of excess ERAF is at risk for fiscal years 2021, 2022, 2023, and 2024. If the finding holds, the County of Santa Clara, as well as other Excess ERAF counties, would be negatively impacted in FY 2025 and beyond. In FY 2024, $5.6 million was set aside for the Reserve of excess ERAF for the at-risk amount. In addition, 22% or $1.5 million in FY 2025 budget has been reduced by this amount. Staff will continue to monitor the status of this audit finding and report on any significant developments.

TABLE 3: City of Palo Alto Property Tax Actuals and Forecast through FY 2035



Transfer of ownership has been a significant driver of past growth; however, that growth did moderate in FY 2024 which is expected to continue in FY 2025 due to the economic slowdown. For example, the median sales price of single family residential in the first (fiscal year) quarter of FY 2025 increased by 4% over the prior year.

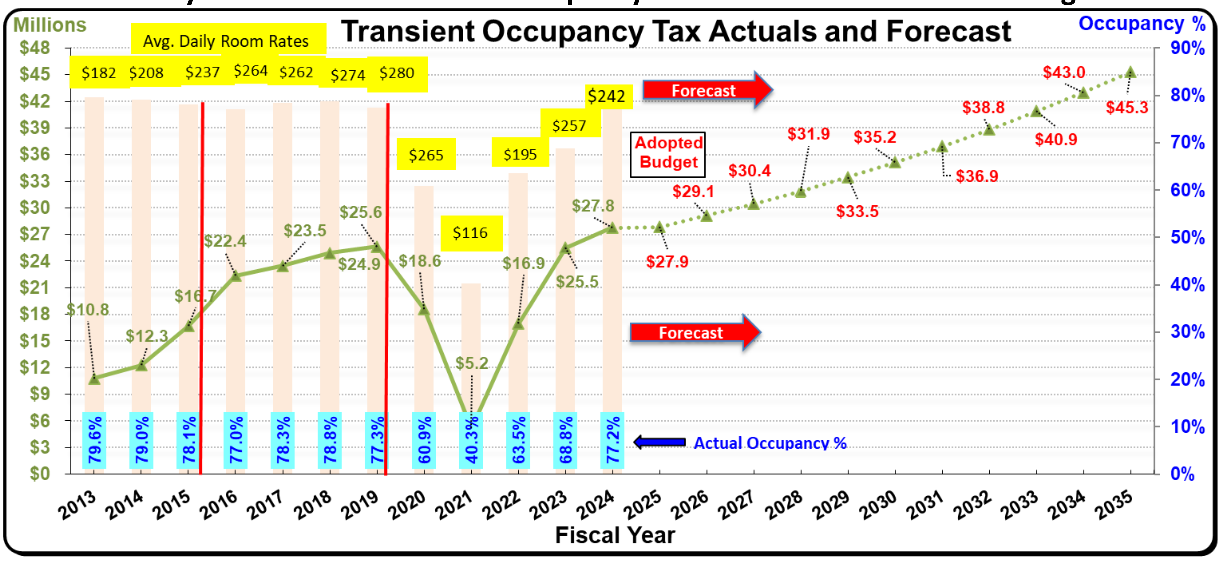
The FY 2025 Adopted Budget for Property Tax is $68.6 million, a $2.3 million or 3.5% increase over the FY 2024 actuals of $66.3 million. In FY 2026, this revenue is anticipated to increase to $71.7 million, a $3.1 million or 4.5% increase over the FY 2025 Adopted Budget amount. The Base Case assumes 5.2% to 6.4% growth over the length of the forecast with a 10-year CAGR of 5.9%.

Transient Occupancy Tax (TOT)

Revenue in this category is impacted by business and other leisure/non-leisure travel and experienced significant reductions in FY 2020 and FY 2021 due to public health orders, travel restrictions, and diminishing business and personal travel plans resulting from the pandemic. TOT revenue declined by $20.5 million or 79.8% in FY 2021, when comparing the FY 2019 pre-pandemic actuals of $25.6 million. As public health conditions improved and travel resumed, this revenue began to recover, significantly grew in FY 2022, and in FY 2023, currently, this revenue has recovered to pre-pandemic levels. The opening of the two Marriott hotels in mid and late FY 2021 and the re-opening of multiple hotels in FY 2021 and FY 2022 were positive developments that helped drive recovery for this tax revenue.

The FY 2025 Adopted Budget for TOT revenue is $27.9 million, a $0.1 million or 0.4% increase over FY 2024 actuals of $27.8 million. In FY 2026, this revenue is anticipated to increase to $29.1 million. Year-to-date (as of August 2024), daily average room rates increased by 0.5% from $220 per day to $221 per day while occupancy rate decreased by 9.9% from 76.6% to 69.0%. Revenue in this category is experiencing a near term stagnation; however, it's anticipated to grow in FY 2026 and beyond at a projected rate of 1.3% to 5.3% over the length of the forecast, or a 4.9% 10-year CAGR.

TABLE 4: City of Palo Alto Transient Occupancy Tax Actuals and Forecast through FY 2035

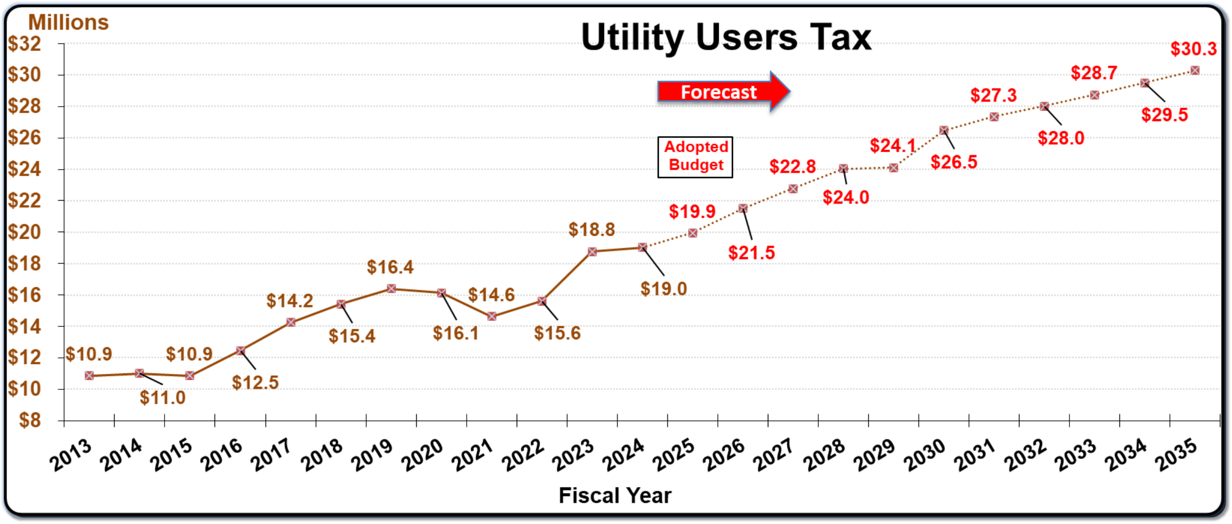


Note: January 2015, TOT Rate went from 12% to 14%
April 2019, TOT Rate went from 14% to 15.5%

Utility User's Tax (UUT)

The UUT is levied on electric, gas, and water consumption, as well as on telephone usage. Revenue in this category is impacted by consumption levels and has experienced reductions in prior periods due to water conservation programs and reduced workforces and business closures during the pandemic. This revenue has recovered as the local economy recovered and workers returned to the office in FY 2023. In addition, higher utility commodity costs resulted in sizable utility rate increases and higher UUT revenues. The FY 2025 Adopted Budget for UUT is $19.9 million, $0.9 million or 4.7% higher than the FY 2024 actuals of $19.0 million. In FY 2026, this revenue is anticipated to increase to $21.5 million, a $1.6 million or 7.9% increase over the FY 2025 budgeted amount. Revenue in this category is expected togrow at 2.5% to 9.8% over the length of the forecast, or a 10-year CAGR of 4.0%.

TABLE 5: City of Palo Alto Utility Users Tax Actuals and Forecast through FY 2035

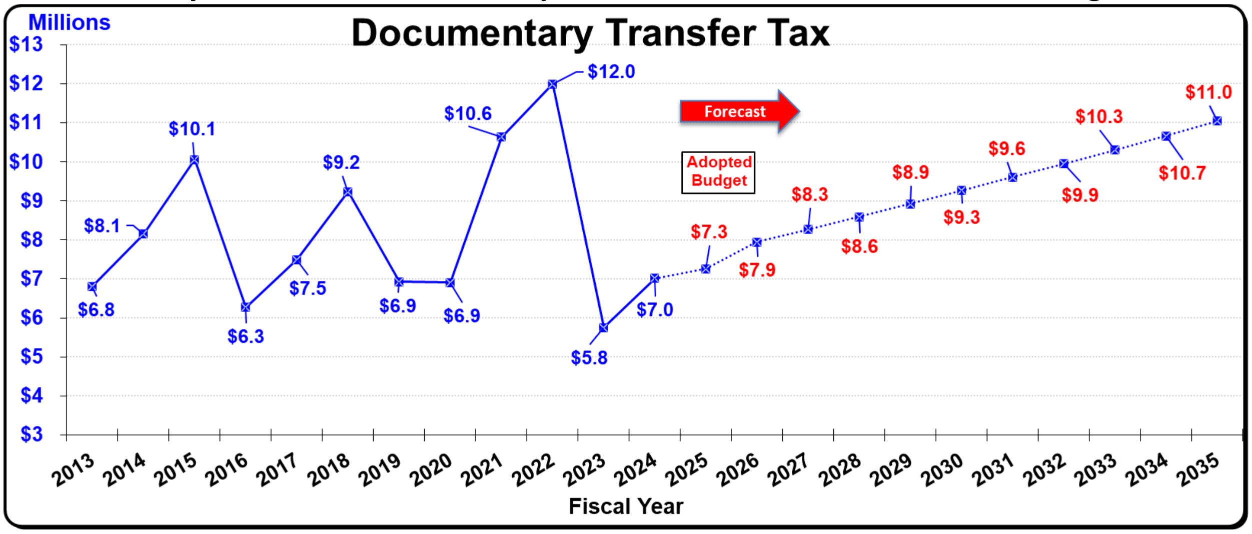


Documentary Transfer Tax (DTT)

Revenue in this category is highly volatile and dependent on sales volume and the mix of commercial and residential sales. DTT experienced record receipts in FY 2021 and FY 2022 at $10.6 million and $12.0 million, respectively,which was followed by a sharp decline in FY 2023 at $5.8 million. In both record years, the primary drivers werelarge commercial transactions, six in FY 2021 and nine in FY 2022, and robust residential sales. In FY 2023, sales activities normalized, dropping revenue to $5.8 million, but the FY 2024 receipts were $7 million, a 10.1% increase in transactions. The FY 2025 Adopted Budget for DTT is $7.3 million, $0.3 million or 3.5% higher than FY 2024 actuals. In FY 2026, this revenue is projected to increase to $7.9 million, a $0.6 million or 9.4% increase, from the FY 2025 budgeted amount of $7.3 million.

As in past years, this revenue source is challenging to forecast and can fluctuate month to month depending on real estate transactions. The number of transactions through October 2024 (217) is 14.2% higher than October 2023, with the total revenue from these transactions increasing by 14.2%. The Palo Alto housing market remains strong, as discussed in the Property Taxes section, single family residential median sales price in Palo Alto has increased, which is an expected occurrence as the predicated economic soft landing and lower mortgage rate will impact property sales activity in FY 2025.

TABLE 6: City of Palo Alto Documentary Transfer Tax Actuals and Forecast through FY 2035



Business Tax (BT)

In November 2022, voters approved Measure K (Business Tax) to provide additional funding for critical public safety needs, transportation safety improvements and grade separations, and affordable housing and unhoused services. The first BT payment was due on January 1, 2024, for calendar year 2023. As a result, the FY 2024 receipt of $5.3 million represents a year and half of collection. However, the initial collection was based on a BT rate of 3.75 cents per square foot which will increase to 7.5 per square foot starting on January 1, 2025. The tax applies to non-exempt businesses above 10,000 square feet with an annual single business cap of $500,000. Both the rate and the cap will be increased annually by 2.5% beginning in FY 2027. A limited number of businesses have the option to offset this tax by their sales/use tax collection. After the initial first payment, filings will be submitted on a quarterly basis.

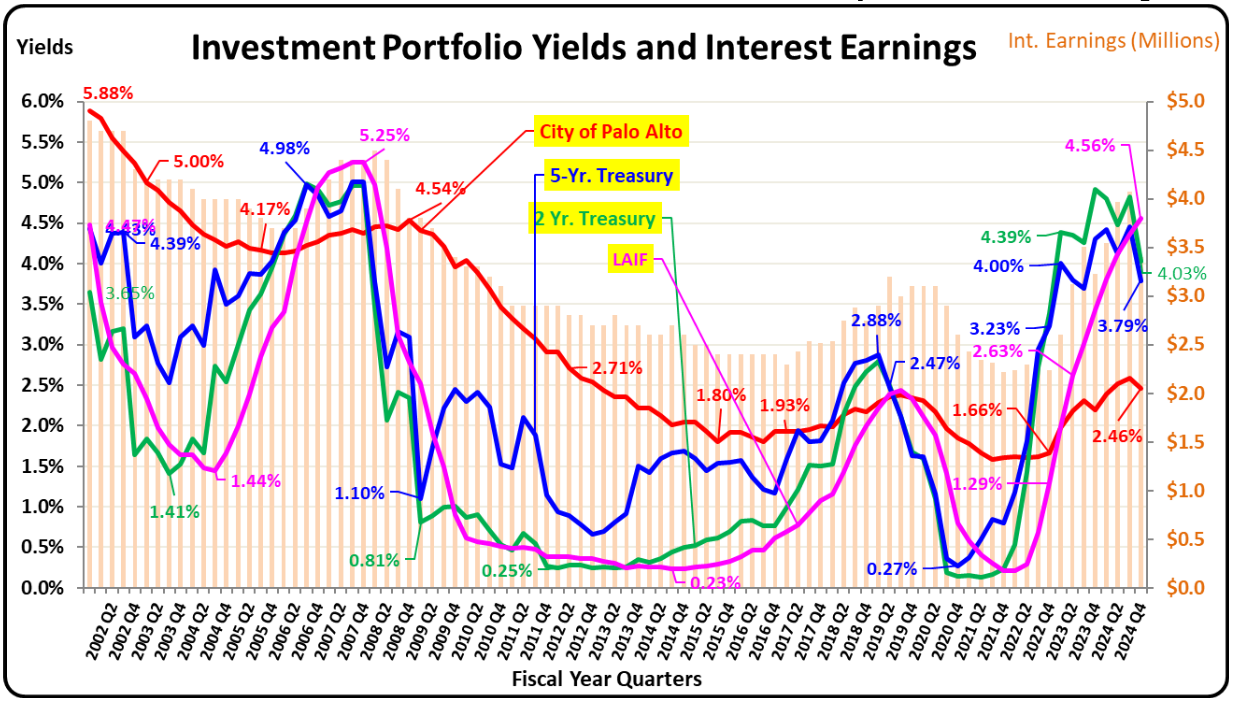
The FY 2025 Adopted Budget for BT is $4.8 million, a $0.5 million or 9.9% lower than the FY 2024 actuals of $5.3 million. In FY 2026, this revenue is anticipated to increase to $6.5 million. Revenue in this category, after an initial double-digit growth due to the rate increase, is expected to experience growth at 3% to 3.8% over the length of the forecast, with a 10-year CAGR of 5.6%. Since this is a relatively new revenue source, staff continues to monitor collections and will make revisions if needed as part of FY 2026 budget process.

Return on Investment

The return-on-investment category reflects the interest earnings on the City's investment portfolio. This category is a combination of past investments, new investments at current market rates, and available investable cash which fluctuates seasonally and annually. As of the timing of this LRFF, the Federal Open Market Committee (FOMC) has cut the federal funds rate twice totaling 0.75% to 4.75% (75 basis points). It is expected that further interest rates cuts will occur.

The actual FY 2024 interest earning was $3.7 million, higher than expected due an increasing interest rate environment. The average portfolio rate of return for the first quarter of FY 2025 was 2.46%, and a 2.59% average yield as of the fourth quarter of FY 2024. The adopted General Fund FY 2025 budget for interest earning is $3.3 million, and is projected at $3.8 million for FY 2026, with a 4.2% CAGR over the ten-year period.

TABLE 7: Palo Alto Historical Investment Portfolio Yields and Citywide Interest Earnings



Rental Income

Rental Income of $16.4 million in FY 2026 primarily reflects rent paid to the General Fund from the City's Enterprise Funds and tenants at the Cubberley Community Center. Rental income is projected to remain flat compared to the FY 2025 Adopted Budget. This revenue category will be further reviewed and revised subsequent to this forecast, typically based on the December-to-December California Consumer Price Index (CCPI) in the San Francisco Bay Area.

Charges for Services and Permits and Licenses

Revenues in the Charges for Services and the Permits and Licenses categories are anticipated to be $41.3 million and $11.6 million, respectively, in FY 2026. Together, these amounts total $52.9 million and are approximately $3.6 million higher than the FY 2025 Adopted Budget of $49.3 million. Increases in these categories are primarily due to revenue adjustments for the agreement with Stanford to provide Fire and Dispatch services, and higher forecasts for permit and plan review services processed through the Development Center.

The revenue estimates in these categories are based on current activity levels, and these revenue sources are primarily driven by the cost of staff to provide services to the community. To ensure alignment with target cost recovery levels, the City has engaged a consulting firm to assist with a comprehensive cost allocation plan and municipal fee study during FY 2025, with implementation anticipated in FY 2026. Staff will evaluate and bring forward recommendations to align fees with target cost recovery levels to cover general salary and benefits increases and CPI trends. These efforts aim to improve fee transparency and ensure equitable cost distribution across City services. One exception to this is Development Services activities and related revenue. Development Services fees are fully cost-recoverable, and the department has been modeled as cost-neutral in this forecast.

Charges for Service - Stanford Fire and Dispatch Services: The City and Stanford have two separate agreements for the provision of fire response and emergency dispatch services. The fire response services agreement became effective in July 2018 and outlines service level terms and a new cost allocation methodology as the baseline for agreement costs. The term extended through June 2023, with annual renewals in effect through June 2028 unless otherwise terminated. The agreement includes a staffing deployment model for suppression and medical services, which was approved by the City Council in October 2017 and deployed in January 2018. This forecast aligns with the new staffing model; and, in accordance with the agreement, adjustments to revenue from Stanford have been aligned with the year-over-year changes to the operating expenses in the Fire Department over the forecast period. Similarly, changes to the revenue received for dispatching services have been aligned with the operating expenses in the Technical Services Division of the Police Department where the costs to provide these services are budgeted. For fire and police revenue, additional adjustments may be applicable if new labor agreements are negotiated for the forecast period. Revenues for these services are based on current anticipated changes in salary and benefits costs within the Fire Department and Police Department Dispatch Unit.

<u>Charges to Other Funds</u>

The main source of revenues in this category is General Fund administrative cost allocation plan charges to the Enterprise and Internal Service Funds. Internal support departments such as Administrative Services, Human Resources, and Council Appointed Offices provide services to Enterprise and Internal Service Funds. The costs for these services are recovered through the administrative cost allocation plan charges. The FY 2026 estimate for Charges to Other Funds of $15.1 million remains flat compared to the FY 2025 budgeted amount. To ensure alignment with target cost recovery levels, the City has engaged a consulting firm to assist with a comprehensive cost allocation plan and municipal fee study in FY 2025, with targeted implementation in FY 2026. Staff will evaluate and bring forward cost allocation recommendations.

<u>Operating Transfers-in</u>

Operating Transfers-in materialize as expenses in other funds throughout the City and as a revenue in the General Fund. This budget category includes repayment of a previous loan from the General Fund to the Airport Fund, funding for police patrol in the downtown area, and the equity transfer from the Electric and Gas funds. Overall, the Operating Transfers-in are estimated to be $29.1 million for FY 2026. While this matches the total for FY 2025, the prior year included a one-time $2.0 million transfer from the General Benefits Fund. This transfer was a refund of allocated charges paid by General Fund departments into the General Benefits Fund in prior years, which had accumulated in fund balance. Additionally, the Electric Fund equity transfer increased from $15.1 million to $18.3 million, while the Gas Fund equity transfer decreased from $10.9 million to $9.7 million, reflecting updated revenue forecasts for each fund.

In accordance with the methodology approved by the City Council in June 2009, the Electric Fund's equity transfer to the General Fund equity transfer has been calculated by applying a rate of return on the capital asset base of the Electric Fund. This rate of return is based on PG&E's rate of return on equity as approved by the California Public Utilities Commission (CPUC). The Gas Fund's equity transfer calculation was updated based on the passage of Measure L on the November 2022 ballot. As outlined in the ballot measure language, the Gas Fund equity transfer can be up to 18% of annual gross gas retail revenue. This LRFF increases the transfer to 18% in FY 2026, where it is projected to remain through 2035.

<u>Other Revenue and Revenue from Other Agencies</u>
Revenues in these two categories is projected at $3.6 million in FY 2026, $0.9 million lower than the FY 2025 adopted budget of $4.5 million. These two revenue categories mainly account for grants or reimbursements from the federal and state governments or other local jurisdictions. Other Revenue decreased slightly by $0.2 million in FY 2026 as a result of limited time funding in FY 2025 from LifeMoves, ,for reimbursement related to the Homekey Facility. Revenue from Other Agencies decreases by $0.7 million in FY 2026, because FY 2025 is the last year of the Staffing for Adequate Fire and Emergency Response (SAFER) grant funding awarded to the City in FY 2022.