Preliminary FY 2023 2nd Quarter Financial Status

General Fund

Overall, the General Fund is tracking closely to adopted estimated revenues and at or below adopted expenses. Positive revenue trends continue to persist in the second quarter, with overall revenues exceeding the same period in the prior year. Although the City has experienced positive economic trends in recent periods, staff remains cautious to mixed economic indicators of potential recession. Though data continues to be uncertain, staff believe that these recommended adjustments are measured and align more closely with the current financial outlook.

General Fund: Revenues:

The FY 2023 Adopted Operating Budget approved a $215.2 million estimate for revenue sources (excluding Operating Transfers-in), of which $90.9 million has been collected to date, or 42% of the budgeted estimate. The overall tax revenue estimates in the FY 2023 Adopted Budget are higher than FY 2022 Adopted Budget levels by $23 million, from approximately $110 million to $133 million. Adjustments to realign revenue estimates such as increasing estimates for Property Tax, Sales Tax receipts, and Transient Occupancy Tax receipts were adopted in FY 2023 to align with a recovering economy. Highlights of current data on major revenue sources are included below. Overall, staff is optimistic that revenues will exceed FY 2023 Adopted Budget levels and adjustments are included in this report to align with the higher estimates.

Table 2

General Fund Revenue
FY 2023 2nd Quarter
(000's)

	2nd Quarter Actuals			Adjusted Budget			
	FY 2023	FY 2022	% change	FY 2023	%	FY 2022	%
Property Tax	$19,499	$18,085	7.8%	$59,770	32.6%	$51,228	35.3%
Sales Tax	11,674	9,485	23.1%	32,580	35.8%	28,184	33.7%
Charges for Services	15,105	11,885	27.1%	30,786	49.1%	24,515	48.5%
Transient Occupancy Tax	9,809	5,008	95.9%	18,199	53.9%	8,428	59.4%
Utility User Tax	8,011	7,261	10.3%	15,579	51.4%	14,370	50.5%
Permits and Licenses	3,121	3,019	3.4%	9,794	31.9%	8,273	36.5%
Documentary Transfer Tax	2,464	4,608	-46.5%	7,217	34.1%	7,137	64.6%
All Other Revenue Sources	21,204	22,103	-4.1%	41,851	50.7%	42,434	52.1%
Total Revenue	**$90,887**	**$81,454**	**11.6%**	**$215,776**	**42.1%**	**$184,569**	**44.1%**

Property Tax

The FY 2023 Adopted Budget is $59.8 million, a $6.5 million or 16.7% increase from the FY 2022 adjusted budgeted level of $53.2 million. Property Tax receipts of $59.4 million were received in

FY 2022 due to higher than anticipated assessed value growth and payment of disputed excess Educational Revenue Augmentation Fund (ERAF) distributions ($1.7 million) contributed to these increased receipts. Consistent with the County of Santa Clara Assessor's Office, revenues are expected to meet or exceed FY 2023 budget levels due to higher than conservatively budgeted revenues. In November 2021, the County of Santa Clara notified the cities that the California School Boards Association and its Education Legal Alliance filed a lawsuit against the Controller of the State of California arguing that the settlement reached with the counties in the excess ERAF calculation methodology is unlawful. The County estimates that 20% to 25% of excess ERAF in FY 2022, FY 2023, and beyond are at risk due to this litigation. The FY 2022 disputed amount that has been received has been reserved and the FY 2023 adopted budget excludes this amount ($1.5 million). The FY 2023 adopted budget is anticipated to be higher, therefore staff is recommending increasing this budget by $0.5 million in this report.

Sales Tax
The FY 2023 Adopted Budget is $32.6 million, an assumed growth of 15.6% from the FY 2022 adjusted budgeted of $28.2 million. Actual Sales Tax receipts of $32.7 million in FY 2022 were above year end estimated levels; however, overall receipts remained 10.4% below pre-pandemic actuals of $36.5 million in FY 2019.

Sale Tax for the first six months of FY 2023 is 23.1% higher than the same period of the prior year. During this period, business sectors with strong growth where apparel, department, and furniture/appliance stores, restaurants, food markets, auto parts/repair, service stations, health, and auto leasing. Higher prices due to the elevated inflation contributed to their sales tax performance. Sectors that didn't do as well include auto sales, office and electronic equipment, drug stores, recreation products, and business services. Should the federal reserve achieve its goal of further taming inflation, sales tax receipts are anticipated to be negatively impacted. As a result, staff is forecasting a little over 10% decrease for the remainder of FY 2023 due to the expected slowdown in the economic growth in the latter half of FY 2023. Even with the anticipated economic slowdown, Sales Tax is anticipated to generate more than the conservatively budgeted amount in FY 2023, therefore staff recommends increasing the budget by $1.5 million in this report.

Transient Occupancy Tax (TOT)
The FY 2023 Adopted Budget assumed an estimate of $18.2 million, a 6.9% increase from FY 2022 actual receipts of $16.9 million or $ 1.3 million above. FY 2022 actual receipts were higher than adopted budget levels of $8.4 million by $8.5 million but remained significantly lower than pre-pandemic actuals of $25.7 million in FY 2019. Current receipts indicate that this revenue category continues to have significant growth from the unprecedented lows seen during the pandemic. TOT is anticipated to generate more than the budgeted 18.2 million in FY 2023 and staff recommends increasing the budget by $4.0 million in this report.

Transient Occupancy Tax for the first six months of FY 2023 is 95.9% higher than the same period of the prior year. For this period, the average occupancy rate is 73.2% (prior year it was 59.7%)

and the average room rate is $270 (prior year it was $180). Staff is conservatively forecasting a 10% increase over the prior year for the remainder of FY 2023.

Charges for Services & Permits and Licenses
The FY 2023 Adopted Budget assumed an estimate of $30.8 million in Charges for Services, a $6.3 million or 25.6% increase from FY 2022 adjusted levels. The FY 2023 Adopted Budget assumed an estimate of $9.8 million in permit and license revenue, a $1.5 million or 18.4% increase from the FY 2022 adjusted level. Together, these revenue categories make up nearly half of all non-tax revenues. In total, $37.7 million was received during FY 2022, above the revised budget estimates by $4.5 million. These revenue categories consist of charges to Stanford for fire services and paramedic services, fees related to the City's golf course, arts and science classes, plan check fees, and payments to the City for issuance of Building Permits, Fire Permits, and miscellaneous health and safety-related licenses. Several adjustments to revenue in Charges for Service are recommended in this report; however, overall revenues in these categories are in line with activity levels anticipated thus far.

- Community Services (CSD): The demand for CSD programming remains at elevated levels. Total departmental revenue through the end of the second quarter is approximately $5.8 million or 46% of the FY 2023 total budgeted revenue. At this same time last year, CSD's total revenue was tracking at 41% of FY 2022 budgeted revenue levels through the second quarter. CSD is recommending adjustments to several programs with high demand. Due to the popularity of ceramics classes, the Public Art Studio has requested a strategic reorganization that is anticipated to increase the number of classes while being cost-neutral. As tennis programs have increased in popularity, the department has amended the contract in FY 2023 to accommodate additional classes. As part of the FY 2024 budget, the department is also exploring increasing subsidies for low-income youth (17 & under), seniors (60+), and/or disabled adult residents. The current policy allows a 25 percent or 50 percent fee discount through the Fee Reduction Program up to $300 annually. Income eligibility is determined using the Community Development Block Grant (CDBG) Low-Income Guidelines.

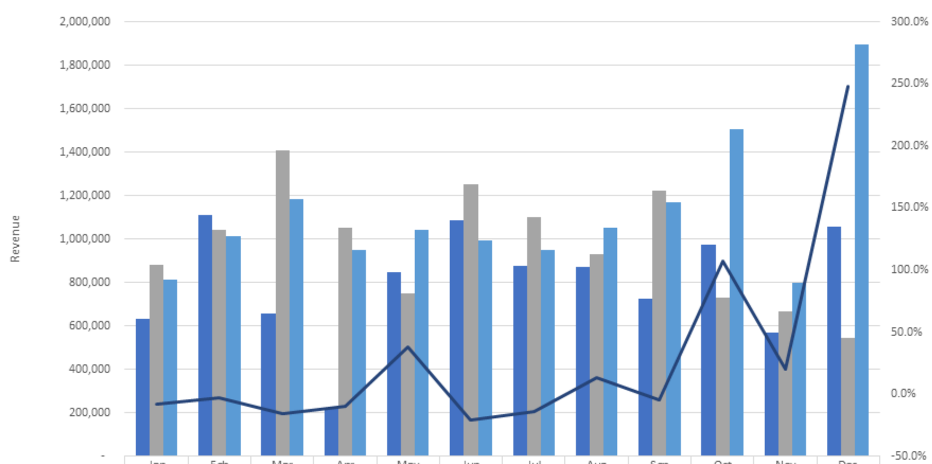
- Golf Course: Golf revenue continues to perform well in the first and second quarters of FY 2023 but is down roughly 5% from this time last year. This could be attributed to several weeks of heavy rains which would deter play both at the course and the driving range. Revenue guidance is recommended to remain at its current budgeted level due to the unpredictability of winter storms in the coming months. The proposed FY 2024 budget will reassess golf revenue and expenditures based on additional information from third-quarter results. In addition, the division is working with purchasing to draft a contract to study the feasibility of adding a second story to the driving range with the additional potential revenue as an element of the study. Once completed, those projections will be included as a part of future revenue estimates if that potential project moves forward.

- Junior Museum & Zoo (JMZ): Through the first two quarters of FY 2023, revenue is roughly at 35% of budgeted levels (approximately $0.9 million in actual revenue vs. $2.5 million in budgeted revenue). FY 2023 revenues should easily exceed the FY 2022 total of $1.48 million, however, FY 2023 represents the first full year of operations, as the JMZ opened its doors in October 2021. Memberships remain the best-performing revenue category (60% of FY 23 target), while facilities rentals are the lowest performing (19% of FY 23 target), reflecting similar trends as the prior year.

  Staff has requested funding for a comprehensive operational analysis of the newly opened Palo Alto Junior Museum and Zoo and to prepare a business plan to inform ongoing operational and budgetary decisions as a part of Mid-Year recommendations ($50,000). The study will examine financial, operational, and programmatic status and make recommendations for future operations to include ticket and membership prices, and how pricing will impact consumer demand. Once the study is completed, staff will review the results and present recommendations for financial and operational efficiencies to Council. In addition, Staff is currently working with purchasing for a new reservation and ticketing platform for the JMZ. Funding this technology initiative was a part of the Community Services Department FY 2023 Adopted Operating Budget ($50,000).

- Development Services: Preliminary FY 2023 Development Services revenue is up 42.0% compared to last year and is currently at 54.7% of the FY 2023 revenue target. This is mainly driven by increased permit activity in the last quarter of 2022 due to a code change year. Department-managed expenses are currently under or on pace to meet the budget. The table below articulates Development Services revenues from January through December from 2020 to 2022.

Table 3: Development Services Revenue – 2021 vs 2022



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2020	634,160	1,112,821	655,069	217,418	845,241	1,084,075	878,166	871,916	724,605	975,046	571,138	1,057,941
2021	883,186	1,044,157	1,405,828	1,050,596	751,803	1,253,554	1,099,728	931,323	1,223,176	728,200	665,534	544,456
2022	811,689	1,014,408	1,182,285	949,867	1,040,580	991,220	948,050	1,052,457	1,171,003	1,507,781	798,073	1,894,874
YoY '22 vs '21	-8.1%	-2.8%	-15.9%	-9.6%	38.4%	-20.9%	-13.8%	13.0%	-4.3%	107.1%	19.9%	248.0%

General Fund: Expenses

Overall General Fund expenses are currently expected to remain within the FY 2022 Adjusted budget levels of $248.4 million. General Fund expenses (excluding operating transfers) for second quarter are 11.2% higher than the prior year and are tracking at 38.0% of the Adjusted Budget (excluding encumbrances). This is slightly lower than the percent expended through the second quarter in FY 2022 and can be attributed to the continued vacancies across the City in particular in the Community Services, Planning and Development Services, and Library Departments.

Table 4

General Fund Expenses
FY 2023 2nd Quarter
(000's)

Expenditures	2nd Quarter Actuals FY 2023	FY 2022	% change	Adjusted Budget FY 2023	%	FY 2022	%
Police	$ 23,934	$ 21,025	13.8%	$ 47,723	50.2%	$ 43,739	48.1%
Fire	20,420	18,289	11.7%	41,479	49.2%	36,446	50.2%
Community Services	13,379	13,262	0.9%	34,690	38.6%	32,508	40.8%
Public Works	9,264	7,844	18.1%	22,764	40.7%	20,124	39.0%
Planning and Development Services	8,916	7,691	15.9%	26,426	33.7%	20,447	37.6%
Library	4,272	4,073	4.9%	10,524	40.6%	9,011	45.2%
Administrative Services	4,705	4,263	10.4%	10,107	46.6%	9,401	45.3%
All Other Departments	9,609	8,522	12.8%	54,672	17.6%	38,926	21.9%
Total Expenses	**$ 94,499**	**$ 84,969**	**11.22%**	**$ 248,385**	**38.0%**	**$ 210,602**	**40.3%**

Salaries and Benefits

As a service driven organization, the largest expenses are salaries and benefits. Preliminary salary and benefits expenditures through December 2022 are approximately $71.3 million, or 48.1% of the $148.4 million FY 2023 Adopted Budget, compared to $64.3 million in the same period in the prior year. The City continues to maintain vacancies of approximately 154 positions, though this changes frequently, which reflects approximately a 15.1% vacancy rate. When comparing staff capacity to deliver services to the community beyond the authorized staffing levels, looking at December 2021 to December 2022, the City has 30 more full-time employees, however staffing is still approximately 8% below pre-pandemic benefitted employee (typically full-time) counts. If looking at all employees, including part-time staffing from March 2020 (pre-pandemic) to December 2022, the total number of City employees is down over 10%. Use of leaves[2] also impacts service capacity. Looking at the six-month period ending December 2022 versus that same period in December 2021, use of leave is nearly identical year over year but represents a 23% increase as compared to December 2020.

This year the City is engaging in labor negotiations with various bargaining groups and unrepresented management professionals to negotiate new agreements. Tentative agreements have been reached with MGMT, IAFF, and SEIU, and the remaining four labor groups (PAPOA, PMA, FCA, UMPAPA) are pending. This report recognizes $2.6 million in estimated expense increases commensurate with the status of economic proposals for all groups, including compensation adjustments and other terms of employment. This expense increase is fully offset in FY 2023 by the elimination of the Inflation and Salary Reserve ($900,000) set aside by the City Council during the FY 2023 budget process in anticipation of these agreements, and department vacancy savings ($1.7 million). Final agreements with the City's remaining labor groups are pending.

Public Safety Overtime

Table 5

Police and Fire
Salaries and Overtime Expense
FY 2023 2nd Quarter YTD
(000's)

	2nd Quarter YTD Actuals			Adjusted Budget			
	FY 2023	FY 2022	% change Inc (Dec)	FY 2023	%	FY 2022	%
Police - Salaries	$ 9,148	$ 8,192	12%	$ 20,026	46%	$ 17,586	47%
Police - Overtime	1,509	1,011	49%	973	155%	944	107%
Total Police	10,657	9,203	16%	20,999	51%	18,530	50%
Fire - Salaries	7,450	6,451	15%	15,997	47%	13,936	46%
Fire - Overtime	1,816	2,374	-24%	2,124	85%	1,931	123%
Total Fire	9,266	8,825	5%	18,121	51%	15,867	56%
Total Public Safety Salaries & Overtime	$ 19,923	$ 18,028	11%	$ 39,120	51%	$ 34,397	52%

As shown in Table 4 above, Police Department overtime is trending higher compared to FY 2022 due to a number of factors, including backfilling shifts due to vacancies, benefited leave or industrial injuries and training a higher than usual volume of new hires. As of this writing, 7% of positions are vacant, another 10% of staff are unavailable to work due to benefited leave or industrial injury, and 13% of filled positions have new staff in training (in-house or at the police academy). The Department is anticipating overtime to continue trending over FY 2022 with a leveling off if the active hiring cycle continues to stay ahead of departures. For more information on vacancy and overtime staffing, see Attachment D.

Fire Department overtime expenses are tracking lower compared to FY 2022. The Department hired nine entry level fire fighters in February 2022 but continues to experience increased turnover and employee injuries which create vacancies requiring backfill overtime. Seven sworn employees have voluntarily left the Department during FY 2023. A current job posting accepting entry level firefighters is active, and those new recruits will begin an academy in April 2023. The report includes an adjustment moving $1.5 million from salaries to overtime to help mitigate impacts, as well as recognizing income and expense offsets for the shared staffing of Fire Station 8 with the Santa Clara County during the high fire risk season. Table 4 above does not show these recommended adjustments; however, please see Attachment D for Fire Department overtime information with these recommendations included.