

# 2

## **SECTION – 2**

# **PROPOSED BUDGET OVERVIEW**

**PROPOSED BUDGET OVERVIEW**

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## PROPOSED BUDGET OVERVIEW

### INTRODUCTION

The FY2007/08 Proposed Budget totals \$964.6 million from all funding sources. Proposed staffing for FY2007/08 includes 5,222 full time equivalent (FTE) positions citywide, with 3,906 FTE positions funded by the General Fund. The General Fund portion of the Proposed Budget is \$428.6 million, an increase of \$27.9 million over the FY2006/07 Approved Budget.

The FY2007/08 Proposed Budget reflects the Mayor and City Council's Strategic Planning – Strategic Budgeting process, whereby the Mayor and City Council's identified priorities are incorporated into the budgeting process. The FY2007/08 Proposed Budget reflects expenditures necessary to maintain staffing levels and fund prior commitments in the upcoming fiscal year, including the addition of four major Council initiatives which will be discussed in the Base Budget Recommendations section on page 12.

### BUDGET POLICIES

The City Council has adopted the following objectives and principles to support the budget development process:

#### Budget Objectives

- Develop a fiscally sustainable spending plan by July 1<sup>st</sup>
- Align the City Council's strategic plan with the budget
- Provide funding to deliver services and infrastructure to the community
- Communicate Council's vision to the community

#### Budget Principles

- Maintain a fiscally sustainable, balanced budget
- Use one-time resources strategically
- Identify return on investment and impacts; fiscal and social benefits
- Maintain a Reserve for Economic Uncertainties
- Keep the City Council informed on the fiscal condition of the City
- Focus on incremental changes to staffing and spending
- Identify resources for top priorities and initiatives
- Continuous evaluation for efficiencies and effectiveness

### GENERAL FUND EXPENDITURES AND FINANCING

The General Fund budget and staffing levels have grown significantly in recent years due to strong growth in local tax revenues. This growth has allowed the Mayor and City Council to invest in their highest service priorities. The following is a list of previously approved augmentations to address growth:

- 67 police officers with initial and partial grant funding, replaced with full General Fund support over time
  - Two fire companies for Station 30 in North Natomas (30 FTE)
  - Staffing for Development Services and the MATRIX customer service model (32 FTE)
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FY2007/08 Proposed Budget

In addition to this growth, there are significant expenditure increases in the base budget as a result of the City's multi-year contracts with the employee unions. These contracts, on average, call for compensation increases at a rate greater than inflation and population growth. Fully funding the contracts in FY2007/08 will require \$17 million in additional financing. There are also increases in the service and supply and debt service expenditures related to growth and the acquisition of new City facilities.

The following table summarizes the FY2007/08 Proposed General Fund Budget by expenditures, revenues, net cost and FTE positions by department.

| Department                | Gross GF          |                    | Net GF Expenditures | Department       |                   | FTE             |
|---------------------------|-------------------|--------------------|---------------------|------------------|-------------------|-----------------|
|                           | Expenditures      | Reimbursements     |                     | Revenues         | Net Cost          |                 |
| Charter Officers          | \$ 18,057         | \$ (3,995)         | \$ 14,062           | \$ 2,997         | \$ 11,065         | 137.00          |
| Finance                   | 10,958            | (3,557)            | 7,401               | 738              | 6,663             | 121.50          |
| Human Resources           | 4,391             | (1,191)            | 3,200               | 139              | 3,061             | 36.00           |
| Information Technology    | 11,744            | (2,997)            | 8,747               | -                | 8,747             | 70.00           |
| Labor Relations           | 1,162             | (295)              | 867                 | 64               | 803               | 9.00            |
| Support Services          | 28,255            | (8,040)            | 20,215              | 941              | 19,274            | 236.50          |
| Code Enforcement          | 9,917             | (584)              | 9,333               | 3,097            | 6,236             | 94.00           |
| CCL                       | 10,380            | (4,142)            | 6,238               | 1,912            | 4,326             | 109.62          |
| Debt Service              | 27,216            | (1,071)            | 26,145              | -                | 26,145            | -               |
| Development Services      | 26,646            | (4,641)            | 22,005              | 18,067           | 3,938             | 245.50          |
| Economic Development      | 2,891             | (52)               | 2,839               | 2,591            | 248               | 17.00           |
| Fire                      | 92,419            | (793)              | 91,626              | 19,199           | 72,427            | 651.00          |
| General Services          | 21,750            | (7,294)            | 14,456              | 625              | 13,831            | 180.50          |
| Neighborhood Services     | 1,539             | -                  | 1,539               | -                | 1,539             | 16.00           |
| Non-Departmental          | 40,878            | 1,503              | 42,381              | -                | 42,381            | -               |
| Parks & Recreation        | 44,221            | (12,514)           | 31,707              | 855              | 30,852            | 615.64          |
| Planning Department       | 3,856             | (1,066)            | 2,790               | 223              | 2,567             | 34.00           |
| Police                    | 141,483           | (11,679)           | 129,804             | 3,767            | 126,037           | 1,263.66        |
| Transportation            | 42,203            | (33,465)           | 8,738               | 12,591           | (3,853)           | 305.50          |
| Utilities                 | -                 | 84                 | 84                  | -                | 84                | -               |
| CIP                       | 4,502             | -                  | 4,502               | -                | 4,502             | -               |
| <b>General Fund Total</b> | <b>\$ 516,213</b> | <b>\$ (87,749)</b> | <b>\$ 428,464</b>   | <b>\$ 66,865</b> | <b>\$ 361,599</b> | <b>3,905.92</b> |

Net GF Expenditures do not include \$200k Ending Fund Balance

Overall expenditures total \$516.2 million. These expenditures are funded with reimbursements from other funds (grants, work on capital improvement projects, overhead recovery), departmental revenues, discretionary taxes, and other revenues. Overall, 70 percent of the total financing consists of discretionary sources; departments directly recover 30 percent of spending. The potential for departments to generate financing varies. For example, the Transportation Department receives on-street parking revenue and recovers costs associated with conducting and managing capital projects. Furthermore, much of the activity in Development Services is funded through fees and charges. Other services such as police and fire protection services are funded with discretionary tax revenues.

The budget reflects the Mayor and City Council's priority on public safety services. This is particularly the case in the allocation of tax revenues. Though the Police and Fire Departments make up 51.7 percent of net General Fund expenditures, 61.2 percent of the discretionary

resources are allocated to these two departments. This is a clear expression of the Mayor and City Council's public safety priorities.

The following table summarizes the estimated General Fund tax revenues and other discretionary resources (dollars in thousands):

| <u>RevenueSources</u>                | <u>Revenues</u>  | <u>Percentage</u> |
|--------------------------------------|------------------|-------------------|
| Property Taxes                       | \$137,898        | 38.1%             |
| Sales & Use Taxes                    | 71,500           | 19.8%             |
| Utility Users Tax                    | 59,740           | 16.5%             |
| Transient Occupancy Tax              | 3,300            | 0.9%              |
| Other Taxes                          | 38,330           | 10.6%             |
| Transfers from Other Funds           | 21,287           | 5.9%              |
| <b>Discretionary Revenue</b>         | <b>\$332,055</b> | <b>91.8%</b>      |
| Beginning Fund Balance               | 2,000            | 0.6%              |
| Use of Reserves                      | 27,743           | 7.7%              |
| <b>Total Available Net Financing</b> | <b>\$361,798</b> | <b>100.0%</b>     |
| Less Net Operating Costs             | 361,598          |                   |
| <b>Ending Fund Balance</b>           | <b>\$200</b>     |                   |

The three major tax revenues are property taxes, sales tax, and utility users' tax. These taxes are derived from different types of economic activity within the City such as the real estate market, taxable sales, and utility use. A budget is a plan based on many assumptions. Revenues are derived from economically sensitive sources and while assumptions and estimates can be made at a point in time, the reality is that actual revenues are subject to change as a result of national, state and local economic developments.

#### Local Economic Issues

The current state of the local economy makes it difficult to project tax revenues accurately. The slowing real estate market is a salient reality. There have been, in the last year and a half, significant reductions in the sale of new homes and the resale of existing homes. The market value of residential properties has declined, but not by an alarming degree. Overall, the decline in the real estate market has neither resulted from, nor led to a recession.

There is, however, continuing good news in the area of employment and payrolls. There is positive job growth in the region, though the rate of growth is down. Payrolls are also increasing and there are more employed people earning more money.

National and state economic forecasts, overall, and real estate market forecasts, in particular, are mixed. Some predict the problems in the real estate market, coupled with higher fuel prices will lead to a recession, while others predict lower growth in the economy well short of a recession. In the real estate market, under the "soft-landing" scenario, market prices will decline slightly, and then stabilize, and sales activity will gradually increase. Worst case scenarios call for declining market prices and activity. At the end of summer 2007, actual results will replace predictions.

#### Financing Estimates

The overall net financing estimates are based on the fact that overall revenue growth is significantly lower than in recent years. In order to balance the budget, a large reserve release is included in the financing for the FY2007/08 Proposed Budget.

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Revenue results clearly indicate slowing activity in critical sectors of the local economy, particularly the real estate market. Just as very high levels of new construction and a large increase in the market values of land, residences, and commercial development resulted in record levels of property tax growth, lower levels of new construction and flat market values of real estate are resulting in lower levels of property tax growth. Based on recent data from the Sacramento County Assessor, property tax growth will be around 10 percent for FY2007/08, down from 14 percent in FY2006/07. The transfer tax and supplemental property taxes are in actual decline, a trend likely to extend for the next couple of years.

The slowing real estate market has clearly impacted sales tax revenue. In the second half of calendar 2006, taxable sales and City sales tax revenue declined by five percent from 2005 levels. This actual decline was not anticipated. The biggest sectors in decline were wholesale construction supplies and electronic equipment. The retail sectors have been flat year-to-year. This reduction in sales tax is both a regional and a statewide phenomenon.

Current year Utility Users' Tax (UUT) collections are also below prior year levels. This is apparently due to:

- Higher than anticipated exemptions for low-income rate payers under the new direct exemption program established with the assistance of SMUD and PG&E;
- Lower unit prices for natural gas;
- Overall lower commodity usage due to milder weather; and
- Cable television market share changes.

These reductions in sales tax and UUT in the current year have required related reductions in the Proposed Budget as the base has declined. Other revenues are, overall, tracking close to estimates with little significant variance in either a positive or negative direction.

#### Increase Use of Reserves

Overall, revenue estimates for the FY2007/08 Proposed Budget are lower than those included in previous forecasts. Slowing growth in major tax revenues had been forecast, but not actual reductions in sales tax and UUT. This weakness in revenues requires more extensive use of budgetary reserves than had previously been planned.

In recent years the Mayor and City Council set aside funds in addition to the \$30 million Economic Uncertainty Reserve to address increases in labor and other operating costs. There is currently \$22.8 million of planned set asides that will be used to balance the FY2007/08 budget. While previous forecasts had expected to release these funds over a period of time to bridge the gap until revenues catch up with expenses, increased operating costs have caused the need to accelerate the use of. In addition, the budget proposes the use of \$4.5 million from the Economic Uncertainty Reserve to cover projected decreases in both sales tax and UUT revenues. Should actual revenue results be higher than estimated, the use of the Economic Uncertainty Reserve will be reduced accordingly.

The use of budgetary reserves to balance the budget is not sustainable. Should the financing picture not improve over the next six months, measures to curtail the growth in expenditures will be necessary.

## BASE BUDGET RECOMMENDATIONS

The FY2007/08 Proposed Budget reflects expenditures necessary to maintain staffing levels and fund prior year commitments. The largest single impact to the growth of the base budget has been the implementation of long-term labor agreements which will result in significant expenditure growth over the remaining two years of the contracts. Other obligatory labor impacts include: employee salary adjustments, full-year costs of reclassified positions, pension and retirement contributions to both the Public Employee Retirement System (PERS) and the Sacramento City Employee Retirement System (SCERS) and employee health plans.

In addition to the growth detailed above, the Proposed Budget also includes funding for four priority initiatives identified by the City Council since the completion of the FY2006/07 budget planning cycle and prioritized for inclusion in the Proposed Budget through the Strategic Planning – Strategic Budgeting process:

- **Additional 911 Dispatchers (\$1.1 million)** – Funding for 15 FTE of the 47 approved FTE is included in the budget to address workload growth and relieve overtime and related workplace morale issues.
- **Eliminate Park Maintenance Contracting/Living Wages (\$1.3 million)** – Funding is included for FTE and service and supplies to begin the transition from contracted services to City staff. In addition, the positions included in the proposed budget convert staff to positions that pay at least the wages and benefits provided for in the City's Living Wage Ordinance.
- **Implement City of Sacramento 311 Program (\$1.2 million)** – Funding for 15 FTE and service and supplies necessary to implement a citywide 311 program in order to provide 24/7 easy access to City services and information. 311 will provide the potential to relieve current call volume to a number of operational areas including: 911, Code Enforcement, Utilities Department, Animal Care, Parks Department and Parking Enforcement.
- **Police Civilian Labor Adjustments (\$1.2 million)** – Funding is provided for salary increases in order to recruit and retain qualified employees in the Communications Center, Records Division and Forensic Identification Sections of the Police Department.

These priority initiatives are consistent with the Mayor and Council's identified strategic planning focus areas of Public Safety, and Sustainability and Livability. As directed by Council, the 911 Dispatchers, Park Maintenance and 311 programs are proposed to be phased in over three years, with continual evaluation each year to determine whether continued expansion remains the most appropriate next step, and whether the City can continue to fund the expansion given overall budget considerations at that time. The adjustments to Police civilian labor budgets are ongoing and are necessary to address recruitment and retention issues.

Finally, the FY2007/08 Proposed Budget includes the shift of all costs previously funded by the Development Services Fund (Fund 258) to the General Fund. Fund 258 was established as a stabilization fund to retain excess resources in times when development related revenues exceeded costs, and to provide financing for development services when revenues declined. Over the course of fiscal years 2003/04 and 2004/05, Fund 258 took on approximately \$1.3

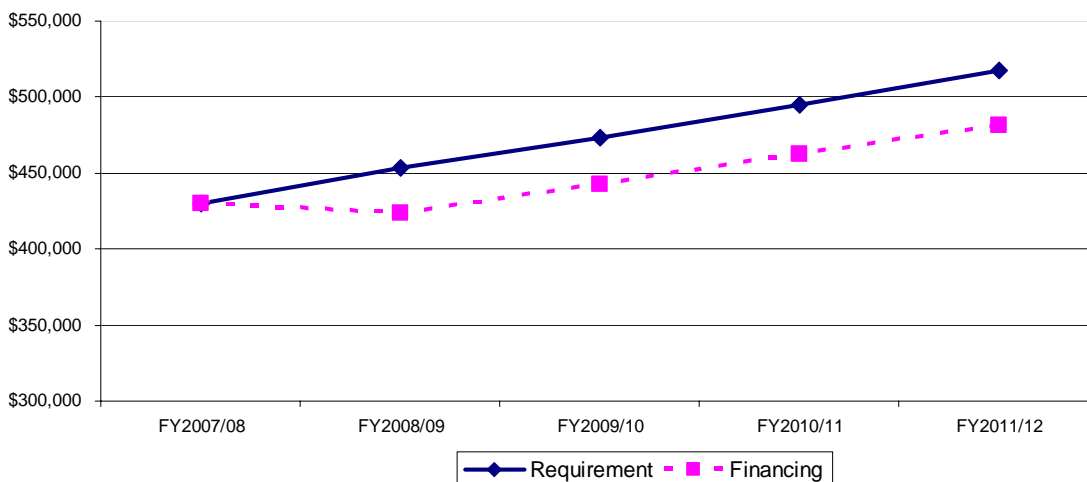
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million in ongoing General Fund operating costs. This level of ongoing funding was not sustainable, and in fact, the fund is currently overspent. Thus, funding for ongoing positions was reabsorbed by the General Fund. Staff is currently working on a plan to bring Fund 258 to a zero balance and close the fund.

**GENERAL FUND FIVE-YEAR FORECAST**

The budget forecast indicates budget challenges ahead in the General Fund. The cost of providing services is greater than the current revenues, and this gap does not close over the next several years. Previous forecasts had anticipated growth in revenues that would eventually exceed expenditures and ultimately close the gap in the out years of the five-year period; however, these earlier forecasts did not include actual year-to-year reductions in sales tax and UUT. These unanticipated declines in both sales tax and UUT have limited revenue growth such that current projected revenue growth does not catch up with projected expenditure growth over the five-year period. The projected expenditure growth is a reality, particularly through the term of the current labor contracts. Revenue estimates are less certain, and actual results over the term of the forecast may be much better or worse than currently anticipated.

The five-year General Fund budget forecast has been updated to reflect the FY2007/08 Proposed Budget and the following graph depicts the General Fund forecast.



The Proposed Budget is in balance. In order to address Council’s priorities with limited resources, the proposed budget includes the release of reserves to close the gap between expenses and revenues.

This forecast does not include the use of reserves in FY2008/09 and beyond, though reserves will be available. Over time the gap between ongoing expenditures and revenues will need to be closed. Revenue performance may or may not improve in the next several months. The five-year forecast demonstrates that, absent an upturn in revenues, the City will need to develop a multi-year plan to regain sustainability including full examination of potential funding sources and potentially limiting future growth in expenditures.

**ENTERPRISE FUNDS**

Revenues and expenses in the Enterprise Funds are consistent with ongoing Council direction relative to operational and capital plans. Rate adjustments for the Water, Sewer and Solid Waste Funds are proposed as part of the FY2007/08 Proposed Budget in order to ensure continued program delivery and to address service level costs, including the cost of Council approved labor agreements. A noticed rate hearing will be held during budget hearings.

The Proposed Budget for the Enterprise Funds includes expenditure and staffing adjustments to address base budget issues such as increasing chemical, electrical, and gas costs related to growth of the City and its infrastructure. Enterprise Fund augmentations are identified below totaling \$4.95 million and 15.5 FTE.

Updates of each of the City's Enterprise Funds, including a five-year forecast reflecting proposed rate and expenditure changes, are included at the end of the Overview.

**AUGMENTATIONS**

Consistent with the Strategic Planning – Strategic Budgeting process, the FY2007/08 Proposed Budget reflects only those expenditures necessary to maintain current staffing levels, fund prior commitments and implement Council's high priority initiatives. However, Departments have identified program and service needs for the benefit of City residents and customers, which result in no impact on the General Fund. These are identified in the charts below.

**General Fund, Fee Supported or Cost Offset** – These augmentations will be funded with reallocation of funding within the budget:

| <b>Department</b>      | <b>Net Cost</b>    | <b>FTE</b>  | <b>Description</b>  |
|------------------------|--------------------|-------------|---|
| Information Technology | \$ -               | 3.00        | 3.0 FTE positions funded through a permanent reduction in service and supply budget; and a technical adjustment to combine four (0.5) FTE to two (1.0) FTE.   |
| General Services       | -                  | 5.00        | 4.0 FTE maintenance positions to address facility growth, to be funded by reallocating resources from the existing service and supply budget; add four (0.25) FTE for facilities, paid for through the reclassification of existing positions; and increase Animal Care revenue and expenditure budgets to reflect program cost increases which are offset by increased revenues.         |
| Economic Development   | -                  | 1.00        | 1.0 FTE position funded by Thomas Enterprises for the Railyard development. Establish a \$1.16 million revenue and expenditure budget for Army Depot activity.  |
| Parks and Recreation   | (48,081)           | (0.70)      | 1.0 FTE position for IT improvements funded with approved fee increases; add 1.0 FTE position for Access Leisure funded with program revenues; add (0.25) FTE for Landscape Design funded by CIP offset; decrease 1.76 FTE due to loss of SHRA grant funding for Workreation Summer Hire Program; and a technical adjustment to combine 2.19 FTE into 1.0 FTE that is being reclassified. |
| <b>Total</b>           | <b>\$ (48,081)</b> | <b>8.30</b> |   |

**Special Revenue and Internal Service Funds, Fee Supported or Cost Offset** – These augmentations would be funded with either the recognition of new revenues or the reallocation of funding within the budget:

| Department                   | Net Cost            | FTE         | Description   |
|------------------------------|---------------------|-------------|---|
| Parks and Recreation - START | \$ 215,000          | 4.00        | 4.0 FTE positions for START program funded with increased State Proposition 49 grant revenue.                           |
| Planning - North Natomas     | 742,000             | -           | Technical adjustment to adjust multiyear budgets to reflect current costs.  |
| General Services - Fleet     | \$ 367,188          | 5.00        | 5.0 FTE positions to address fleet growth and improve turn around on fleet replacements and operations and maintenance. |
| <b>Total</b>                 | <b>\$ 1,324,188</b> | <b>9.00</b> |   |

**Enterprise Funds, Fee Supported or Cost Offset** – These augmentations would be funded with either the recognition of new revenues or the reallocation of funding within the budget:

| Department                                       | Net Cost           | FTE          | Description   |
|--|--------------------|--------------|---|
| Transportation - Parking                         | 276,612            | 5.50         | 5.50 FTE positions for Off-Street Parking, which will be offset by increased revenues.  |
| Utilities - Water                                | 1,648,480          | 9.00         | 2.0 FTE positions to reduce overtime costs resulting from swing shift; add 3.0 limited term FTE positions to implement efficiencies; add 1.0 limited term FTE position for eCAPS backfill; and transfer 3.0 FTE positions from Solid Waste division. Increase service and supply budgets for sludge removal program and cost of living adjustments. |
| Utilities - Sewer                                | 249,000            | -            | Increase service and supply budget for cost of living adjustments.  |
| Utilities - Solid Waste                          | 2,016,074          | (3.00)       | Increase service and supply budgets for garbage containers, vehicles and cost of living adjustments. Transfer 3.0 FTE positions to Water Fund.  |
| Utilities - Storm Drainage                       | 464,000            | -            | Increase service and supply budget for cost of living adjustments and one vehicle.  |
| Convention, Culture & Leisure - Marina           | 4,300              | -            | Increase service and supply budget for cost of living adjustments.  |
| Convention, Culture & Leisure - Community Center | 294,200            | 4.00         | 4.0 FTE positions funded through conversion of funding approved at Midyear 2007. Increase to service and supply budget for cost of living adjustments.  |
| <b>Total</b>                                     | <b>\$4,952,666</b> | <b>15.50</b> |   |

Departmental budgets have not been adjusted to include these augmentations. Any budget changes will be included in the City Budget only after Mayor and City Council approval in the budget hearings.

## **2007/2012 CAPITAL IMPROVEMENT PROGRAM (CIP)**

The Proposed FY2007/08 CIP Budget totals \$112.9 million, funding 250 projects in all program areas in various geographic areas of the City. The General Fund total for capital expenditures in FY2007/08 is \$4.5 million. The five-year program totals \$331.9 million from all funding sources. The General Fund portion of the five-year program is \$22.9 million.

### **SUMMARY**

The City will face a number of challenges over the next several years. The FY2007/08 Proposed Budget is balanced using a significant amount of one-time fund reserves to close the gap between estimated revenues and expenses. Should revenue projections continue to decline in the long-term, the gap between resources and expenditures will continue to grow. As a result, revenues will be carefully monitored and staff will return to Council, if necessary, to recommend a multi-year plan to regain sustainability, including expenditure reductions to bring expenses in line with revenues.

### **ENTERPRISE FUND FIVE-YEAR FORECAST**

Updates of each of the City's Enterprise Funds are shown on the following pages, including a five-year forecast reflecting proposed rate and expenditure changes.

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**Parking Fund (412)**

The City of Sacramento operates eight parking garages and seven surface parking lots, including two surface lots operated on behalf of the Crocker Art Museum, two surface lots managed for Thomas Enterprises, and one Depot lot recently acquired by the City, with a total of over 9,424 parking spaces. The Parking Facilities Division also manages over 60,000 square feet of retail space at various City parking structures.

Based on FY2005/06 actual revenues, parking fee revenues are projected to increase an average of 1 percent for FY2007/08 and 2 percent from FY2008/09 through FY2011/12. Rental income is based on current and anticipated leases. Labor expenses are projected to grow at 4 percent annually and non-labor costs at 1 percent. The increase in revenue and service and supply expenditures is due to four Parking Enforcement Officers added during the FY2006/07 Midyear process. The vehicles for these officers will be purchased during FY2007/08 and are offset by additional revenue.

**Parking Fund (412)  
Revenue and Expenditure Forecast  
Dollars in Thousands**

|                                     | <b>2007/08<br/>Proposed</b> | <b>2008/09<br/>Estimate</b> | <b>2009/10<br/>Estimate</b> | <b>2010/11<br/>Estimate</b> | <b>2011/12<br/>Estimate</b> |
|-------------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| <b>REVENUES</b>                     |                             |                             |                             |                             |                             |
| Parking Fees                        | 15,695                      | 16,009                      | 16,329                      | 16,656                      | 16,989                      |
| Interest--Operating Funds           | 306                         | 306                         | 306                         | 306                         | 306                         |
| Real Property Rental                | 1,590                       | 1,649                       | 1,761                       | 1,796                       | 1,836                       |
| <b>TOTAL REVENUES</b>               | <b>17,591</b>               | <b>17,964</b>               | <b>18,396</b>               | <b>18,758</b>               | <b>19,131</b>               |
| <b>EXPENDITURES</b>                 |                             |                             |                             |                             |                             |
| Employee Services                   | 3,789                       | 3,945                       | 4,106                       | 4,271                       | 4,442                       |
| Other Services & Supplies           | 7,309                       | 7,382                       | 7,456                       | 7,530                       | 7,606                       |
| Operating Transfer Out/(In)         | 1,373                       | 593                         | 592                         | 590                         | 583                         |
| <b>Subtotal--Operating Expenses</b> | <b>12,471</b>               | <b>11,920</b>               | <b>12,153</b>               | <b>12,392</b>               | <b>12,630</b>               |
| Debt Service                        | 2,936                       | 2,936                       | 2,936                       | 2,936                       | 2,936                       |
| OTHER USES/CIP                      | 2,878                       | 2,878                       | 2,878                       | 2,878                       | 2,878                       |
| <b>Subtotal--Other Uses</b>         | <b>5,814</b>                | <b>5,814</b>                | <b>5,814</b>                | <b>5,814</b>                | <b>5,814</b>                |
| <b>TOTAL EXPENDITURES</b>           | <b>18,285</b>               | <b>17,734</b>               | <b>17,967</b>               | <b>18,206</b>               | <b>18,444</b>               |
| <b>CURRENT SURPLUS/(DEFICIT)</b>    | <b>(694)</b>                | <b>230</b>                  | <b>429</b>                  | <b>552</b>                  | <b>686</b>                  |
| Beginning Fund Balance              | 1,800                       | 1,106                       | 1,336                       | 1,765                       | 2,317                       |
| <b>ENDING FUND BALANCE</b>          | <b>1,106</b>                | <b>1,336</b>                | <b>1,765</b>                | <b>2,317</b>                | <b>3,003</b>                |

### **Water Fund (413)**

Revenue earned by the City for the purpose of providing water service to its customers is deposited in the Water Enterprise Fund. Revenues are derived from customer fees, interest earnings, development fees, tap sales, and reimbursements from other entities for services performed by or paid by the Fund. Water Fund revenues are structured to cover the costs of providing water service to its customers which includes costs for water treatment, plant maintenance, water distribution system repair and maintenance, water conservation and education programs, water quality monitoring, related engineering services, customer service, the City-County Office of Metropolitan Water Planning, and the Water Fund capital improvement program. Expenses of the Fund are summarized and reflected as operating costs, debt service, and capital improvement costs. While the Water Fund faces some significant challenges over the next five years, it is anticipated that the fund will remain financially sound and able to meet those challenges with moderate rate increases over the next several years. Key issues for the Water Fund over the next five years include:

- Ongoing replacement and maintenance of aging infrastructure to provide a safe and reliable drinking water supply to the community, and meet state and federal standards.
- Continued compliance with the state mandate requiring installation of 100,000 water meters by the year 2025.
- Maintaining state and federal regulatory compliance.
- Development of an aggressive water conservation program consistent with the Water Forum Agreement (WFA). The WFA consists of integrated actions necessary for providing a regional solution to water shortages, environmental damage, groundwater contamination, and limited economic prosperity.
- Support of regional, long-term water supply planning.
- Development of wholesale and wheeling agreements in support of effective regional water management.
- Meeting future debt service requirements related to the rehabilitation and improvement of intake structures and treatment plants.

The following chart provides a five-year budget and rate forecast for the Water Fund, including the following assumptions:

- System growth will approximate 1.5 percent annually with modest adjustments over future years.
- Annual operating costs will continue to rise above inflation as a result of rising labor, chemical, fleet, and sludge removal costs, and implementation of Water Forum programs.
- Future capital spending will reflect a balance between modest future rate increases and a reasonable level of infrastructure repair and rehabilitation spending.

**Water Fund (413)  
Revenue and Expenditure Forecast  
Dollars in Thousands**

|                                  | 2007/08<br>Proposed | 2008/09<br>Estimate | 2009/10<br>Estimate | 2010/11<br>Estimate | 2011/12<br>Estimate |
|----------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Projected Rate Increase          | 9%                  | 9%                  | 3%                  | 3%                  | 3%                  |
| <b>REVENUES</b>                  |                     |                     |                     |                     |                     |
| User Fees                        | 60,735              | 67,112              | 70,132              | 73,288              | 76,586              |
| Interest                         | 1,250               | 1,250               | 1,250               | 1,250               | 1,250               |
| Other                            | 4,732               | 4,779               | 4,826               | 4,874               | 4,923               |
| Development Fees                 | 4,876               | 4,876               | 3,876               | 3,876               | 2,876               |
| <b>TOTAL REVENUES</b>            | <b>71,593</b>       | <b>78,017</b>       | <b>80,084</b>       | <b>83,288</b>       | <b>85,635</b>       |
| <b>EXPENDITURES</b>              |                     |                     |                     |                     |                     |
| Operating                        | 42,647              | 47,156              | 49,481              | 51,932              | 54,515              |
| Debt Service                     | 10,286              | 11,219              | 11,195              | 11,177              | 11,170              |
| CIP                              | 14,816              | 14,918              | 13,982              | 14,412              | 14,859              |
| Augmentations                    | 1,648               | -                   | -                   | -                   | -                   |
| <b>TOTAL EXPENDITURES</b>        | <b>69,397</b>       | <b>73,293</b>       | <b>74,658</b>       | <b>77,521</b>       | <b>80,544</b>       |
| <b>CURRENT SURPLUS/(DEFICIT)</b> | 2,196               | 4,724               | 5,426               | 5,767               | 5,091               |
| Beginning Fund Balance           | 15,072              | 17,268              | 21,992              | 27,418              | 33,185              |
| <b>ENDING FUND BALANCE</b>       | <b>17,268</b>       | <b>21,992</b>       | <b>27,418</b>       | <b>33,185</b>       | <b>38,276</b>       |

### **Sewer Fund (414)**

Revenue earned by the City for the purpose of providing sewer collection service to its customers is deposited in the Sewer Fund. Revenues are derived from customer service fees, recovery of Sacramento Regional County Sanitation District (SRCSD)-related operation and maintenance costs paid for by the Fund, interest earnings, and connection charges. Sewer Fund revenues cover the cost of wastewater collection and maintenance, storage and treatment of wet weather combined sewage, installation of new services, the operation of 44 sanitary pumping stations, related engineering services, customer service, and the monitoring of discharge into the sewer collection system. Expenses of the Fund are generally divided among operating costs, debt service, and capital improvement costs.

The sewer system is a “contained system” in that very little expansion, other than in-fill projects, is possible. The City-operated sewer collection system serves approximately 60 percent of the City, primarily the central and older sections of the City. The SRCSD, through its County Sanitation District (CSD-1), serves the other areas of the City. The City’s sewage is treated by the SRCSD, while the City provides the SRCSD with billing and collection services for properties within the City service area.

The Sewer Fund presents unique challenges due to the system’s minimal growth potential and the age and nature of the system’s infrastructure. Issues facing the Sewer Fund include:

- Compliance with state and federal regulations.
- Rehabilitation of the central City’s combined sewer and storm drainage system (CSS). A combined drainage system collects wastewater from homes and businesses, plus storm water and urban runoff for treatment at a regional sewage treatment facility.
- Continued rehabilitation of the City’s separated sewer service area. A separated sewer system collects wastewater from homes and businesses and does not collect storm water.
- Limited growth in new services and the increasing costs for repair and reconstruction of the aging system.
- Maintaining the financial strength of the Fund for the purpose of raising sufficient capital to finance rehabilitation of the Combined Sewer System.

The following chart provides a five-year budget and rate forecast including the following assumptions:

- Future growth in the system will approximate 1.5 percent annually.
- Annual operating costs will continue to rise substantially more than inflation as a result of increases in labor, inflation and fleet costs.
- Future capital spending will reflect a balance between modest future rate increases and a reasonable level of infrastructure repair and rehabilitation spending.

**Sewer Fund (414)**  
**Revenue and Expenditure Forecast**  
**Dollars in Thousands**

|                                  | 2007/08<br>Proposed | 2008/09<br>Estimate | 2009/10<br>Estimate | 2010/11<br>Estimate | 2011/12<br>Estimate |
|----------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Projected Rate Increase          | 8.5%                | 7%                  | 3%                  | 3%                  | 3%                  |
| <b>REVENUE</b>                   |                     |                     |                     |                     |                     |
| User Fees                        | 19,015              | 20,632              | 21,560              | 22,531              | 23,545              |
| Interest                         | 300                 | 300                 | 300                 | 300                 | 300                 |
| Other                            | 1,181               | 1,199               | 1,217               | 1,235               | 1,253               |
| Development Fees                 | 616                 | 624                 | 632                 | 641                 | 650                 |
| <b>TOTAL REVENUES</b>            | <b>21,112</b>       | <b>22,755</b>       | <b>23,709</b>       | <b>24,707</b>       | <b>25,748</b>       |
| <b>EXPENDITURES</b>              |                     |                     |                     |                     |                     |
| Operating                        | 16,310              | 17,489              | 18,101              | 19,189              | 20,038              |
| Debt Service                     | 859                 | 859                 | 859                 | 859                 | 859                 |
| CIP                              | 3,702               | 4,156               | 3,626               | 3,771               | 3,921               |
| Augmentations                    | 249                 | -                   | -                   | -                   | -                   |
| <b>TOTAL EXPENDITURES</b>        | <b>21,120</b>       | <b>22,504</b>       | <b>22,586</b>       | <b>23,819</b>       | <b>24,818</b>       |
| <b>CURRENT SURPLUS/(DEFICIT)</b> | <b>(8)</b>          | <b>251</b>          | <b>1,123</b>        | <b>888</b>          | <b>930</b>          |
| Beginning Fund Balance           | 1,534               | 1,526               | 1,777               | 2,900               | 3,788               |
| <b>ENDING FUND BALANCE</b>       | <b>1,526</b>        | <b>1,777</b>        | <b>2,900</b>        | <b>3,788</b>        | <b>4,718</b>        |

**Solid Waste Fund (415)**

The Solid Waste Fund is financially responsible for the activities of collecting garbage, recyclables and garden refuse; sweeping streets; removing illegally dumped materials from throughout the City; and waste reduction. These solid waste activities serve three types of customers - residential, commercial and City facilities. Issues facing the Solid Waste Fund include:

- Increasing need to develop a facility north of the American River to address existing routes and new growth in the north area of the City.
- Funding increasing costs for new equipment.
- Meeting state mandated diversion goals.

The following chart provides a five-year budget and rate forecast including the following assumptions:

- Future growth in the system will approximate 1.5 percent annually with modest adjustments over future years.
- Operating costs will rise substantially more than inflation as a result of cost of living increases, inflation, and increased fleet and tipping costs.

**Solid Waste Fund (415)  
Revenue and Expenditure Forecast  
Dollars in Thousands**

|                                  | 2007/08<br>Proposed | 2008/09<br>Estimate | 2009/10<br>Estimate | 2010/11<br>Estimate | 2011/12<br>Estimate |
|----------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Projected Rate Increase          | 8.5%                | 7%                  | 3%                  | 3%                  | 3%                  |
| <b>REVENUE</b>                   |                     |                     |                     |                     |                     |
| User Fees                        | 50,166              | 54,430              | 57,151              | 60,009              | 63,009              |
| Interest                         | 59                  | 59                  | 59                  | 59                  | 59                  |
| Other/Misc.                      | 1,108               | 1,125               | 1,142               | 1,159               | 1,176               |
| <b>TOTAL REVENUES</b>            | <b>51,333</b>       | <b>55,614</b>       | <b>58,352</b>       | <b>61,227</b>       | <b>64,244</b>       |
| <b>EXPENDITURES</b>              |                     |                     |                     |                     |                     |
| Operating                        | 46,000              | 51,257              | 53,734              | 56,341              | 59,087              |
| Debt Service                     | 2,250               | 2,765               | 2,728               | 2,360               | 2,192               |
| CIP                              | 217                 | 417                 | 417                 | 417                 | 417                 |
| Augmentations                    | 2,016               |                     |                     |                     |                     |
| <b>TOTAL EXPENDITURES</b>        | <b>50,483</b>       | <b>54,439</b>       | <b>56,879</b>       | <b>59,118</b>       | <b>61,696</b>       |
| <b>CURRENT SURPLUS/(DEFICIT)</b> | <b>850</b>          | <b>1,175</b>        | <b>1,473</b>        | <b>2,109</b>        | <b>2,548</b>        |
| Beginning Fund Balance           | 88                  | 938                 | 2,113               | 3,586               | 5,695               |
| <b>ENDING FUND BALANCE</b>       | <b>938</b>          | <b>2,113</b>        | <b>3,586</b>        | <b>5,695</b>        | <b>8,243</b>        |

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**Marina Fund (417)**

The Sacramento Marina is a 547-berth marina located on the Sacramento River at Miller Park. The Marina is a full service, 7-day-a-week operation that includes a fuel dock, security gates, and parking. Revenues from berth rentals and fuel sales offset costs of operation, debt service and capital improvements.

The Marina's average occupancy rate (percentage of berths occupied) for the first six months of FY2006/07 (July-December 2006) is 92 percent. Over the past three years, occupancy has averaged over 95 percent annually and is typically higher in the summer months.

A Marina Business Plan was approved by the City Council in FY2001/02. Two key policy decisions were implemented. The first was annual adjustments in berthing fees to reflect operational cost increases, finance the planned renovations, and reflect market conditions. The second is a major capital improvement initiative to replace the 45-year old deteriorating South Basin docks. This would involve reconfiguring the berth sizes to reflect market demand and ensure higher annual occupancy rates. Total project costs are estimated at \$10.5 million and will be funded primarily from a loan from the State Department of Boating & Waterways (DBAW). Construction is expected to begin in late-spring 2007 with completion by the end of calendar year 2007. FY2007/08 expenses and revenues are expected to perform at budgeted levels.

The five-year expense and revenue forecast reflects the financial analysis prepared for the State loan acceptance. Revenues reflect expected berth occupancy levels before and during the South Basin reconfiguration (85-95 percent) and after construction (95 percent). The South Basin will remain open during construction operations, expected for the second half of calendar year 2007. The revenue projections anticipate a berth fee revenue loss of up to 15 percent during that time. Berth fees are expected to increase 6 percent annually through FY2009/10 and 3 percent annually in the years thereafter. Operating expenses are expected to increase annually by 5 percent for labor and 1 percent for non-labor costs. Interest-only payments for the South Basin loan will begin in FY2007/08 with full payments implemented in FY2009/10.

**Marina Fund (417)**  
**Revenue and Expenditure Forecast**  
**Dollars in Thousands**

|                                     | 2007/08        | 2008/09      | 2009/10      | 2010/11      | 2011/12      |
|-------------------------------------|----------------|--------------|--------------|--------------|--------------|
|                                     | Proposed       | Estimate     | Estimate     | Estimate     | Estimate     |
| <b>REVENUES</b>                     |                |              |              |              |              |
| Berth Rentals                       | 1,603          | 1,905        | 2,020        | 2,082        | 2,146        |
| Interest                            | 18             | 16           | 25           | 24           | 23           |
| Utilities                           | 32             | 32           | 32           | 32           | 32           |
| Real Property Rental                | -              | -            | -            | -            | -            |
| Gas and Oil Sales                   | 275            | 300          | 300          | 300          | 300          |
| Miscellaneous                       | 26             | 26           | 26           | 26           | 26           |
| <b>TOTAL REVENUES</b>               | <b>1,954</b>   | <b>2,279</b> | <b>2,403</b> | <b>2,464</b> | <b>2,527</b> |
| <b>EXPENDITURES</b>                 |                |              |              |              |              |
| Employee Services                   | 440            | 478          | 502          | 528          | 554          |
| Services & Supplies                 | 755            | 790          | 812          | 829          | 847          |
| Operating Transfer Out/(In)         | -              | -            | -            | -            | -            |
| <b>Subtotal--Operating Expenses</b> | <b>1,195</b>   | <b>1,269</b> | <b>1,314</b> | <b>1,357</b> | <b>1,401</b> |
| Current Debt Service                |                | 465          | 465          | 465          | 465          |
| SB Debt Service (SDBW/B of A loans) | 466            | 312          | 738          | 738          | 738          |
| Capital Improvement Projects        | 1,540          | 65           | 65           | 65           | 100          |
| Other                               | -              | -            | -            | -            | -            |
| <b>TOTAL EXPENDITURES</b>           | <b>3,201</b>   | <b>2,111</b> | <b>2,582</b> | <b>2,625</b> | <b>2,704</b> |
| <b>CURRENT SURPLUS/(DEFICIT)</b>    | <b>(1,247)</b> | 169          | (180)        | (161)        | (177)        |
| Other Fund Sources/(Uses)           | 1,475          | -            | -            | -            | -            |
| Beginning Fund Balance              | 817            | 1,045        | 1,213        | 1,034        | 873          |
| <b>ENDING FUND BALANCE</b>          | <b>1,045</b>   | <b>1,213</b> | <b>1,034</b> | <b>873</b>   | <b>696</b>   |

**Community Center Fund (419)**

The Community Center Fund finances the operation, debt service requirements and capital improvement program for the Sacramento Convention Center, Memorial Auditorium, and Community Center Theater. The Center's goals include maintaining successful financial performance as an enterprise fund, optimizing facility utilization through aggressive marketing, maintaining the facility to industry standards, stimulating hotel market demand to generate Transient Occupancy Tax (TOT) revenues, and offering a premier venue to contribute to the economic vitality of the Downtown and Sacramento region.

The significant increase in the beginning balance in the Community Center Fund reflects a combination of better than expected actual TOT and user fee collections. The Community Center Fund is expected to end the year with a positive fund balance.

In 1997, to maintain the financial integrity of the Community Center Fund, the City Council approved the use of inter-fund loans, if needed, to offset any year-end deficit. Since 1997, total borrowing has been just over \$7.5 million – approximately \$4.5 million less than originally authorized. Repayment of the inter-fund loan began in fiscal year 2006 and will continue this year with a payment of \$1 million.

TOT revenues are expected to grow by approximately 3 percent annually over the next five years. During that same time, user fees will grow from 2-4 percent annually. Labor costs will grow by 5 percent during this time and non-labor costs by 1 percent. Repayment of the inter-fund loan will continue throughout the next five years with total repayment completed by FY2012/13.

Community Center Fund (419)

**Revenue and Expenditure Forecast**  
**Dollars in Thousands**

|                                     | <b>2007/08<br/>Proposed</b> | <b>2008/09<br/>Estimate</b> | <b>2009/10<br/>Estimate</b> | <b>2010/11<br/>Estimate</b> | <b>2011/12<br/>Estimate</b> |
|-------------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| <b>REVENUES</b>                     |                             |                             |                             |                             |                             |
| Transient Occupancy Tax             | 16,500                      | 17,510                      | 18,035                      | 18,576                      | 19,134                      |
| Interest Income                     | 102                         | 740                         | 750                         | 750                         | 750                         |
| User Fees                           | 6,236                       | 6,957                       | 7,095                       | 7,273                       | 7,448                       |
| Other Revenue                       | 560                         | -                           | -                           | -                           | -                           |
| <b>TOTAL REVENUES</b>               | <b>23,398</b>               | <b>25,207</b>               | <b>25,880</b>               | <b>26,599</b>               | <b>27,332</b>               |
| <b>EXPENDITURES</b>                 |                             |                             |                             |                             |                             |
| Employee Services                   | 6,005                       | 6,664                       | 6,997                       | 7,347                       | 7,714                       |
| Services & Supplies                 | 6,731                       | 6,740                       | 6,779                       | 6,825                       | 6,867                       |
| Equipment                           | 90                          | 90                          | 90                          | 90                          | 90                          |
| Operating Transfer Out/(In)         | (1,521)                     | (1,627)                     | (1,680)                     | (1,734)                     | (1,789)                     |
| <b>Subtotal--Operating Expenses</b> | <b>11,305</b>               | <b>11,866</b>               | <b>12,186</b>               | <b>12,528</b>               | <b>12,882</b>               |
| Debt Service                        | 10,426                      | 10,431                      | 10,431                      | 10,431                      | 10,431                      |
| Capital Improvements                | 1,105                       | 925                         | 900                         | 925                         | 1,045                       |
| Other Fund Uses                     | -                           | -                           | -                           | -                           | -                           |
| <b>TOTAL EXPENDITURES</b>           | <b>22,836</b>               | <b>23,222</b>               | <b>23,517</b>               | <b>23,884</b>               | <b>24,358</b>               |
| <b>CURRENT SURPLUS/(DEFICIT)</b>    | <b>1,395</b>                | <b>1,985</b>                | <b>2,363</b>                | <b>2,715</b>                | <b>2,974</b>                |
| Interfund Transfer (Loan Repay)     |                             | (1,000)                     | (1,500)                     | (1,500)                     | (1,500)                     |
| Beginning Fund Balance              | 577                         | 139                         | 1,124                       | 1,986                       | 3,201                       |
| <b>ENDING FUND BALANCE</b>          | <b>139</b>                  | <b>1,124</b>                | <b>1,986</b>                | <b>3,201</b>                | <b>4,676</b>                |

### **Storm Drainage Fund (425)**

Revenue earned by the City for the purpose of providing storm drainage service to its customers is deposited in the Storm Drainage Fund. Revenues are generated primarily from customer service charges and interest earnings. Storm Drainage Fund revenues cover the cost of storm drainage pumping operations, wet weather treatment and storage, collection system maintenance, related engineering services, flood plain management, customer service, and the Storm Drainage Fund capital improvement program. Expenses are divided among operating costs, debt service, and capital improvements. Current issues for the Storm Drainage Fund include:

- Upgrading drainage service to areas outside of the City's combined sewer and storm drainage system (CSS) to meet citywide standards.
- Supporting regional flood control efforts.
- Improving drainage system reliability.
- Operating under Proposition 218 restrictions.

The following chart provides a five-year budget and rate forecast including the following assumptions:

- System growth will approximate 1.5 percent annually with modest adjustments over future years.
- Annual operating costs will rise substantially more than inflation as the result of increased labor, fleet and utility costs.
- Projections of future capital improvement projects in the Storm Drainage Fund reflect decreased spending due to insufficient available funding.

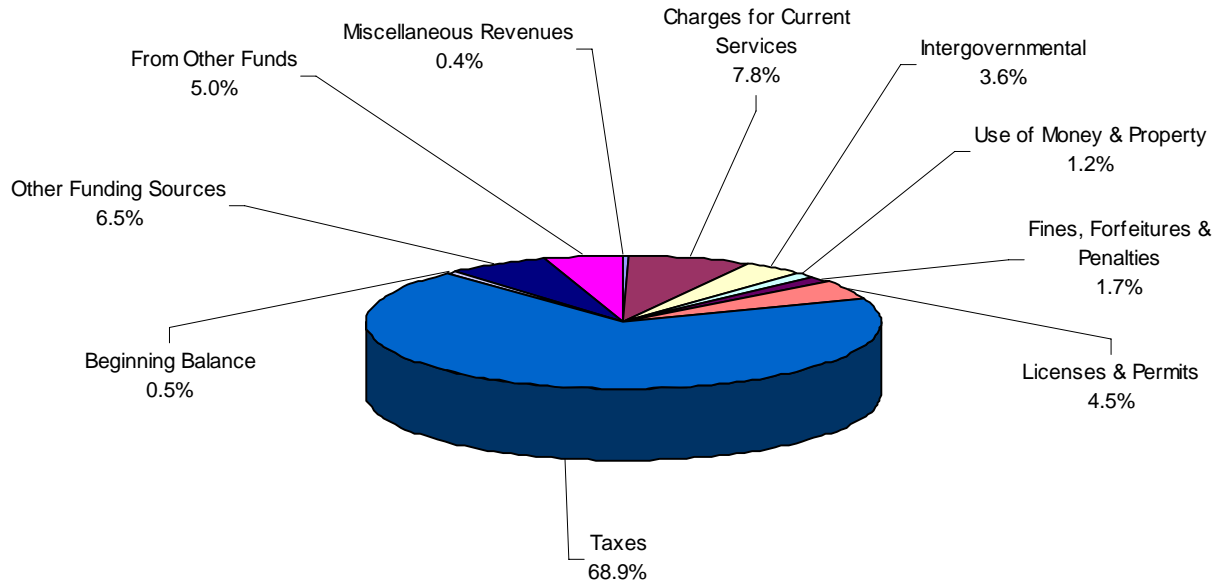
**Storm Drainage Fund (425)  
Revenue and Expenditure Forecast  
Dollars in Thousands**

|                                  | <b>2007/08<br/>Proposed</b> | <b>2008/09<br/>Estimate</b> | <b>2009/10<br/>Estimate</b> | <b>2010/11<br/>Estimate</b> | <b>2011/12<br/>Estimate</b> |
|----------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| Projected Rate Increase          | 0%                          | 0%                          | 0%                          | 0%                          | 0%                          |
| <b>REVENUE</b>                   |                             |                             |                             |                             |                             |
| User Fees                        | 31,716                      | 32,191                      | 32,674                      | 33,164                      | 33,662                      |
| Interest                         | 1,130                       | 1,130                       | 1,130                       | 1,130                       | 1,130                       |
| Other                            | 507                         | 515                         | 522                         | 530                         | 537                         |
| Compliance fee                   | 181                         | 183                         | 186                         | 189                         | 192                         |
| <b>TOTAL REVENUES</b>            | <b>33,534</b>               | <b>34,019</b>               | <b>34,512</b>               | <b>35,013</b>               | <b>35,521</b>               |
| <b>EXPENDITURES</b>              |                             |                             |                             |                             |                             |
| Operating                        | 28,985                      | 32,555                      | 33,971                      | 35,454                      | 37,008                      |
| Debt Service                     | 3,398                       | 3,398                       | 3,398                       | 3,398                       | 3,398                       |
| CIP                              | 4,959                       | 1,000                       | 1,000                       | 1,000                       | 1,000                       |
| Augmentations                    | 464                         | -                           | -                           | -                           | -                           |
| <b>TOTAL EXPENDITURES</b>        | <b>37,806</b>               | <b>36,953</b>               | <b>38,369</b>               | <b>39,852</b>               | <b>41,406</b>               |
| <b>CURRENT SURPLUS/(DEFICIT)</b> | <b>(4,272)</b>              | <b>(2,934)</b>              | <b>(3,857)</b>              | <b>(4,839)</b>              | <b>(5,885)</b>              |
| Beginning Fund Balance           | 8,024                       | 3,752                       | 818                         | (3,039)                     | (7,878)                     |
| <b>ENDING FUND BALANCE</b>       | <b>3,752</b>                | <b>818</b>                  | <b>(3,039)</b>              | <b>(7,878)</b>              | <b>(13,763)</b>             |

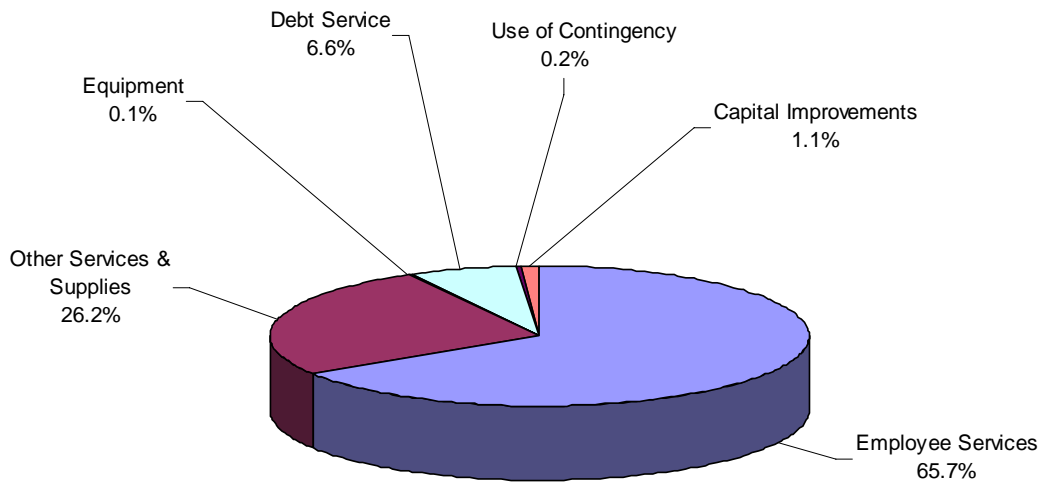
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**Total General Fund Budget: \$428.6 Million**

**Revenues**

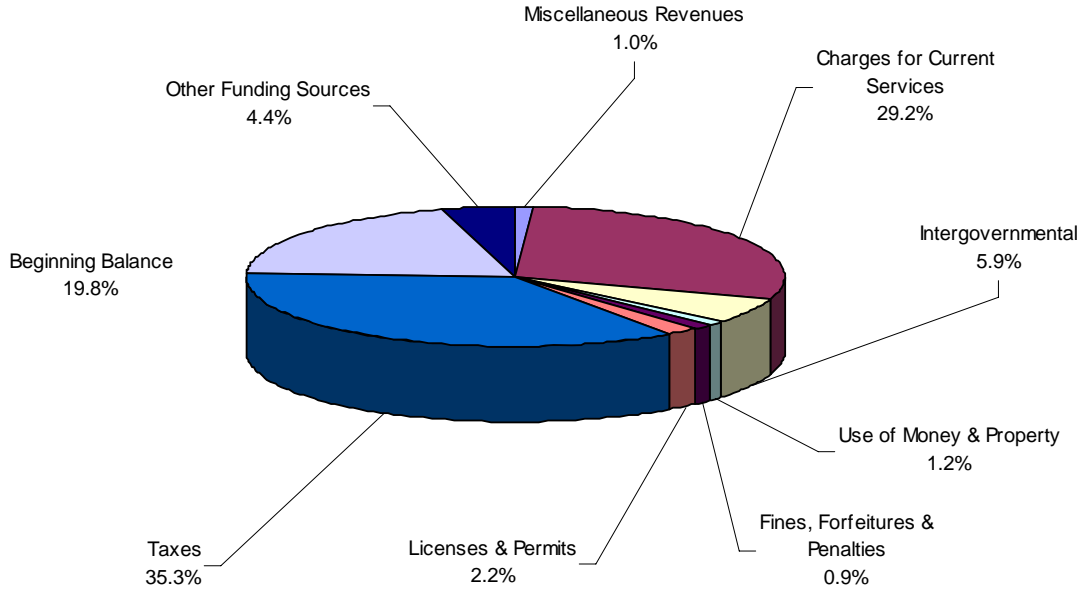


**Expenditures**

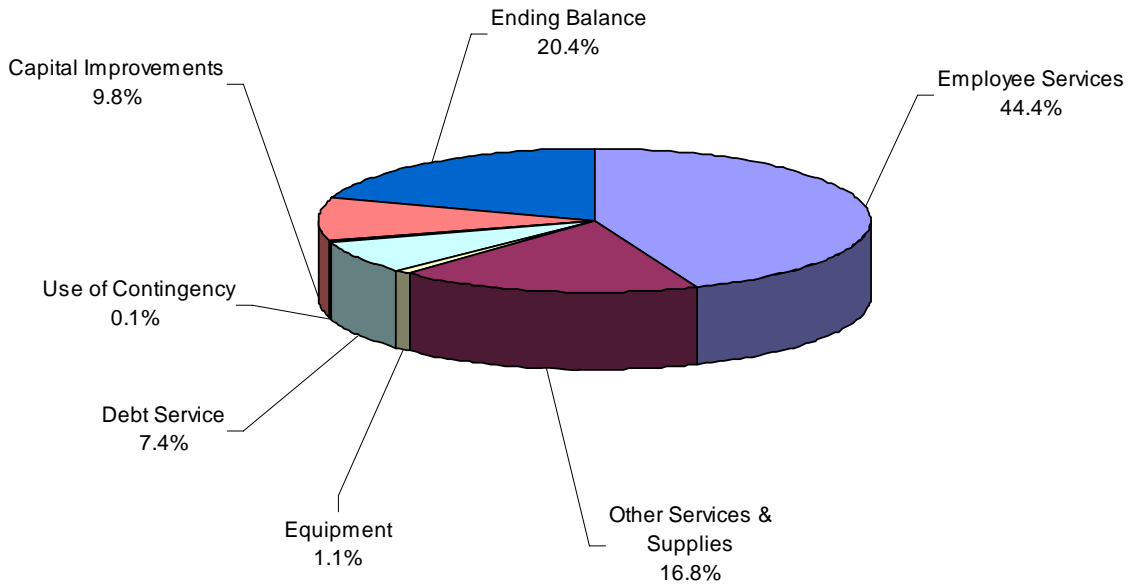


**Total City Budget: \$964.6 Million**

**Revenues**



**Expenditures**



## **BUDGET STATEMENT**

### **General Information**

The City of Sacramento was established in 1849 and in 1854 became the capital for the State of California. Sacramento also serves as the seat of Sacramento County government. It is the seventh largest populated city in California. The State of California, Department of Finance, estimates the population on January 1, 2006, of 461,000 for the City and 1,385,607 for the County of Sacramento. Sacramento encompasses 99 square miles and is located in the northern section of California's burgeoning Central Valley.

Sacramento is a charter city and operates under a Council-Manager form of government that currently provides for a nine-member elected City Council including an elected Mayor. There are no other elected City officials. The City Council appoints the City Manager, City Attorney, City Clerk and the City Treasurer to carry out its adopted policies. Members of the City Council serve alternating terms of four years, with the Mayor and four Council Members up for reelection in calendar year 2008, and the remaining Council Members up for reelection in calendar year 2010. The Mayor is chairperson of the City Council and is elected in at-large City elections. City Council members are elected by eight individual districts.

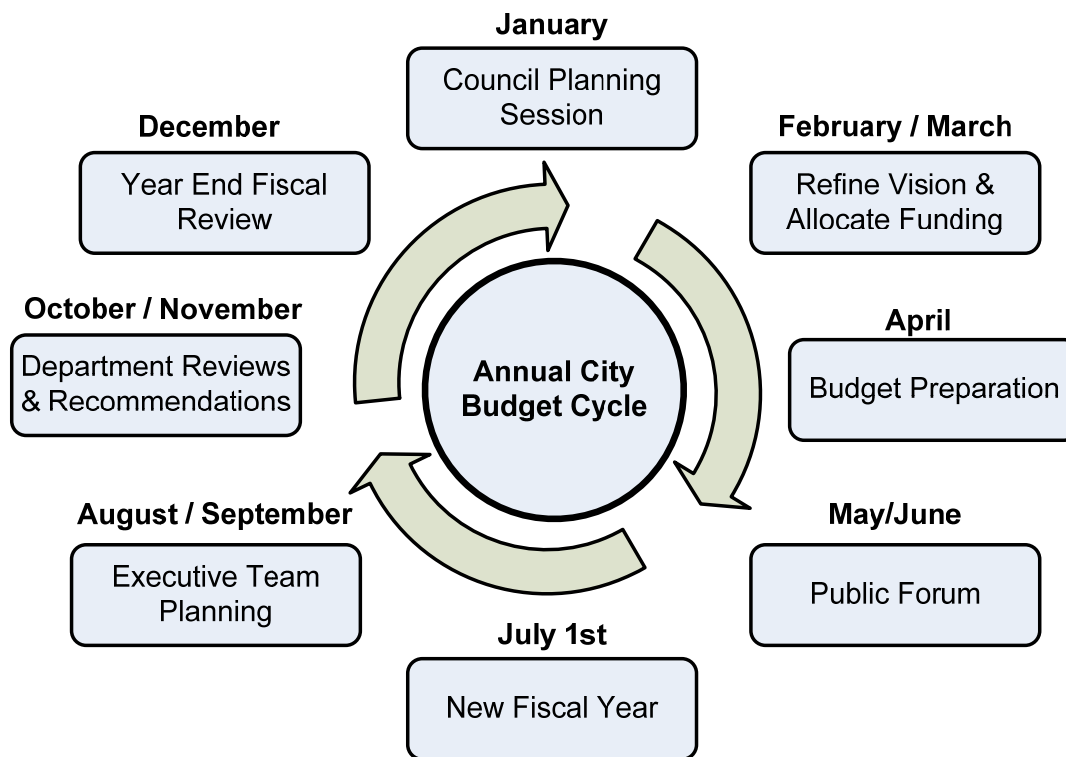
The City provides a full range of municipal services including police, fire, water, sewer, storm drainage, solid waste, code enforcement, construction and maintenance of parks and streets, planning and development, recreation and cultural activities, and general administration.

The Sacramento City Charter requires that the City Manager submit a proposed budget to the City Council at least 60 days prior to the commencement of each fiscal year. Once approved by City Council, this annual budget serves as the foundation for the City of Sacramento's financial planning and control. Budgetary control is maintained at the department level, by fund. Budgetary control for capital improvement projects is maintained at the individual project level, by fund.

### **Budget Process**

The Mayor and City Council formally adopted the Strategic Planning – Strategic Budgeting process in June 2006 which allows the Mayor and City Council to incorporate priorities as identified in their strategic plan into the budget process. Strategic Planning – Strategic Budgeting allows the Mayor and City Council to focus funding on specific, priority programs and services. This planning model allows the integration of short and long-term budget planning into the annual budget cycle and is used for both financial expansion in good economic times or for balancing and budget reductions in the case of a declining economy.

The figure below represents the City's budget/program planning cycle:



The City's fiscal year is July 1<sup>st</sup> through June 30<sup>th</sup>. As such, the City Council annually adopts the City's operating and capital budgets for a single fiscal year beginning July 1 and ending June 30 in the subsequent calendar year.

To establish the annual budget, the Budget Division of the Finance Department develops a plan for expenditure of projected available resources for the coming Fiscal Year. Labor costs are updated to reflect salary and benefit changes called for in union contracts and estimates for unrepresented employees are also updated. A five year revenue model is developed based on prior year actual revenue receipts and economic and revenue forecasts to determine what resources, tax revenues and other discretionary revenues will be available to support operating requirements. Similarly, Capital Improvement Program priorities are married with available funds from over 22 different funding sources.

A base budget is prepared from this information. This base budget updates the costs of maintaining service and staffing levels into the new budget year. The base budget also includes the updated estimates of revenues and other financing sources. The base budget contains the operating and capital budgets.

Proposed operating and capital budget documents are prepared and are transmitted to the Mayor and City Council as required by City Charter on or before May 1 of each year. The Mayor and Council review the proposed operating and capital improvement budget in public hearings. The budget is formally adopted by the vote of City Council on or before June 30 of each year. Any changes to the proposed budget as considered and approved by the City Council during budget hearings are included in the Approved Budget document.

The Council adopted Strategic Planning – Strategic Budgeting process is reflected in the following timeline:

January – Council Planning Session

- Establish budget objectives and principles
- Provide policy direction for year end results
- Consider policy direction for marginal budget adjustments

February/March – Refine Vision & Allocate Funding

- Integrate budget with strategic plan
- Refine policy direction for marginal budget adjustments

April – Budget Preparation

- Staff develops base budget and Council vision document

May/June – Public Forum

- City Council hearings on the proposed budget documents

July 1<sup>st</sup> – New Fiscal Year

August/September – Executive Team Planning

- Staff planning for budget implementation
- Identification of issues to be considered for future budget development

October/November – Department Reviews and Recommendations

- Administrative work related to close of prior fiscal year
- Staff briefs Council on critical fiscal issues for future budget development

December – Year End Fiscal Review

- Completion of year end review
- Staff briefs Council on prior fiscal year end results

### **Budget Policies**

The City of Sacramento develops its annual budget according to Council-adopted sustainable budget policies. These policies call for one-time funding sources to be used for only one-time operating and capital expenditures. Ongoing expenditures are to be matched with ongoing financing sources. Reserves are to be used in a planned and strategic manner only. Five-year forecasts of the General Fund are to be constantly updated as new information becomes available. Full reviews of revenue receipts in comparison to the budgetary estimates are to be performed and corrective actions recommended if necessary. Adherence to these budget policies has enabled the City to avoid service level and staffing reductions during the economic slowdown in the early years of this decade and to provide for significant service augmentations in the past two years.

The ongoing core of the Mayor and Council's budget philosophy continues to be sustainability. The City Council has adopted the following objectives and principles to support this philosophy:

**Budget Objectives**

- Develop a fiscally sustainable spending plan by July 1<sup>st</sup>
- Align the City Council's strategic plan with the budget
- Provide funding to deliver services and infrastructure to the community
- Communicate Council's vision to the community

**Budget Principles**

- Maintain a fiscally sustainable, balanced budget
- Use one-time resources strategically
- Identify return on investment and impacts; fiscal and social benefits
- Maintain a reserve for economic uncertainties
- Keep the City Council informed on the fiscal condition of the City
- Focus on incremental changes to staffing and spending
- Identify resources for top priorities and initiatives
- Continuous evaluation for efficiencies and effectiveness

**General Fund Reserve**

The City Council set a goal of 10 percent of revenues as a reserve for the General Fund. Currently the General Fund has a reserve of \$30 million, or 7.5 percent of the City's estimated FY2007/08 General Fund revenues. The Proposed Budget includes a release of \$4.5 million from this reserve. This reserve was established to provide resources for the Mayor and Council to manage the impact of economic fluctuations that negatively impact the City's revenues.

**Budget Basis**

The City's annual budget is prepared on a modified cash basis of accounting. Revenues are recognized when cash is received, and expenditures include both cash payments and encumbrances for purchase orders and contractual services. Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

Property taxes, franchise taxes, licenses, intergovernmental revenue, special assessments, charges for services, and interest associated with the current fiscal period are all considered to be susceptible to accrual, and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the government.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

**Budget Presentation**

The presentation of the FY2007/08 Proposed Budget is included in three documents: Proposed Operating Budget, Proposed Capital Improvement Budget and the Blueprint for Strategic Budgeting. The Blueprint is designed to provide highlights and general information relative to the Proposed

Operating and CIP Budgets. Both the Proposed and Approved budget documents are available on the City's web site at the following web address: [www.cityofsacramento.org/finance/budget](http://www.cityofsacramento.org/finance/budget).

The Proposed Operating Budget includes the technical information concerning operating departments, and estimated citywide revenues and expenses. The Overview section provides an outline of anticipated revenue, including an explanation of assumptions and a five-year General Fund forecast (revenues and expenditures). The department sections provide a summary of appropriations and source of funds including change to the prior year budget, as well as a summary of full time equivalent (FTE) by department division. The Budget Schedules include a detailed estimate of staffing, revenues and expenditures for the General Fund, the Enterprise Funds and other special revenue funds. The Staffing section provides a list of authorized positions for each department, by division, including the additions and/or deletions of FTE.

### **Capital Improvement Program**

The Capital Improvement Program (CIP) includes a one-year capital budget (FY2007/08) and a five-year program (2007-2012) of capital expenditures. The capital budget includes the establishment of capital projects, funding appropriations and authorization of expenditures for projects receiving funding in year one of the CIP.

The Proposed CIP includes the Capital Budget for Fiscal Year (FY) 2007/08 and a five-year expenditure plan. The Proposed FY2007/08 CIP Budget totals \$112.9 million, funding 250 projects in all program areas in various geographic areas of the City of Sacramento. The General Fund total for capital expenditures in FY2007/08 is \$4.5 million. The five-year program totals \$331.9 million from all funding sources, including State and Federal grant funding and funding from the Enterprise Funds. The General Fund portion of the five-year program is \$22.9 million.

The Proposed 2007-2012 CIP incorporates projects supportive of Council adopted policies and plans, which include the City's Transportation Programming Guide, Utility Master Plans, Parks and Recreation Master Plan, and the Parks and Recreation Programming Guide. The 2006 Community Reinvestment Capital Improvement Program (CRCIP) projects funded by bonds authorized by the City Council in 2006 are also reflected in the CIP. These projects will ultimately result in additional operating costs, including additional staff for the new facilities. These future costs have been included in the five-year forecast and will be added to the operating budget on an as needed basis as projects are completed.

**Budget Hearing Calendar**  
**PROPOSED FY2007/08 BUDGET - CITY COUNCIL HEARING SCHEDULE**

| <b>Date</b>      | <b>Afternoon Meeting</b>   | <b>Evening Meeting</b>  |
|------------------|--|---|
| Tuesday, May 15  | <b>Budget Hearing</b><br><b>FY2007/08 Proposed Operating and CIP Budget Overview</b><br>Base Budget - General Fund Overview<br>Additions to Base<br>Finance Issues<br><b>Intent Motion to Adopt Base Operating and CIP Budgets</b> | <b>Budget Hearing</b><br><b>CRCIP Status Update</b>   |
| Tuesday, May 22  | <b>Budget Hearings</b><br>Hold for Hearing if Necessary  | <b>Budget Hearing</b><br>Police Department Masterplan   |
| Tuesday, May 29  | <b>Budget Hearing</b><br>General Plan/Economic Development Strategy<br>Organizational Restructuring<br>Youth Coordinator   | <b>Budget Hearing</b><br>Fire Department Masterplan   |
| Tuesday, June 5  | <b>Budget Hearings</b><br>Report Back on Assessments   | <b>Budget Hearings</b><br>Enterprise Funds Overview<br>Big Picture - High level assumptions<br>Rate Hearing<br>Utilities Department Initiatives<br>Reports Back |
| Tuesday, June 12 | <b>Budget Hearings</b><br>Reports Back (if necessary)<br>Budget Summary  | <b>Budget Hearing</b><br>FY2007/08 Operating and CIP Budget Adoption  |

**Fund Structure**

The City uses fund accounting to assure and demonstrate compliance with finance-related legal requirements. A fund is defined as a separate accounting entity with a self-balancing set of accounts recording cash and other financial resources together with related liabilities. Each fund was established for the purpose of accounting for specific activities in accordance with applicable regulations, restrictions or limitations. The City has three types of funds:

- *Governmental Funds* — Account for activities which are primarily supported by taxes or other mandatory payments. Most of the City's basic services are included in governmental funds.

- *Proprietary Funds* — Account for services for which customer fees are intended to finance the costs of operations. There are two types of Proprietary Funds:
  - Enterprise Funds account for programs and services financed and operated similar to business-type activities which include services rendered to the general public on a fee basis.
  - Internal Service Funds account for the activities that provide services provided by one department to another department on a cost reimbursement basis, such as the City's Fleet Fund and Risk Management Fund.
- *Fiduciary Funds* — Account for activities that most closely resemble not-for-profit organizations including trusts and agency activities. The City is the trustee, or *fiduciary*, for its employees' pension plan (SCERS). It is also responsible for other assets, reported in an investment trust fund, which because of trust agreements, can be used only for the trust beneficiaries. The City is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

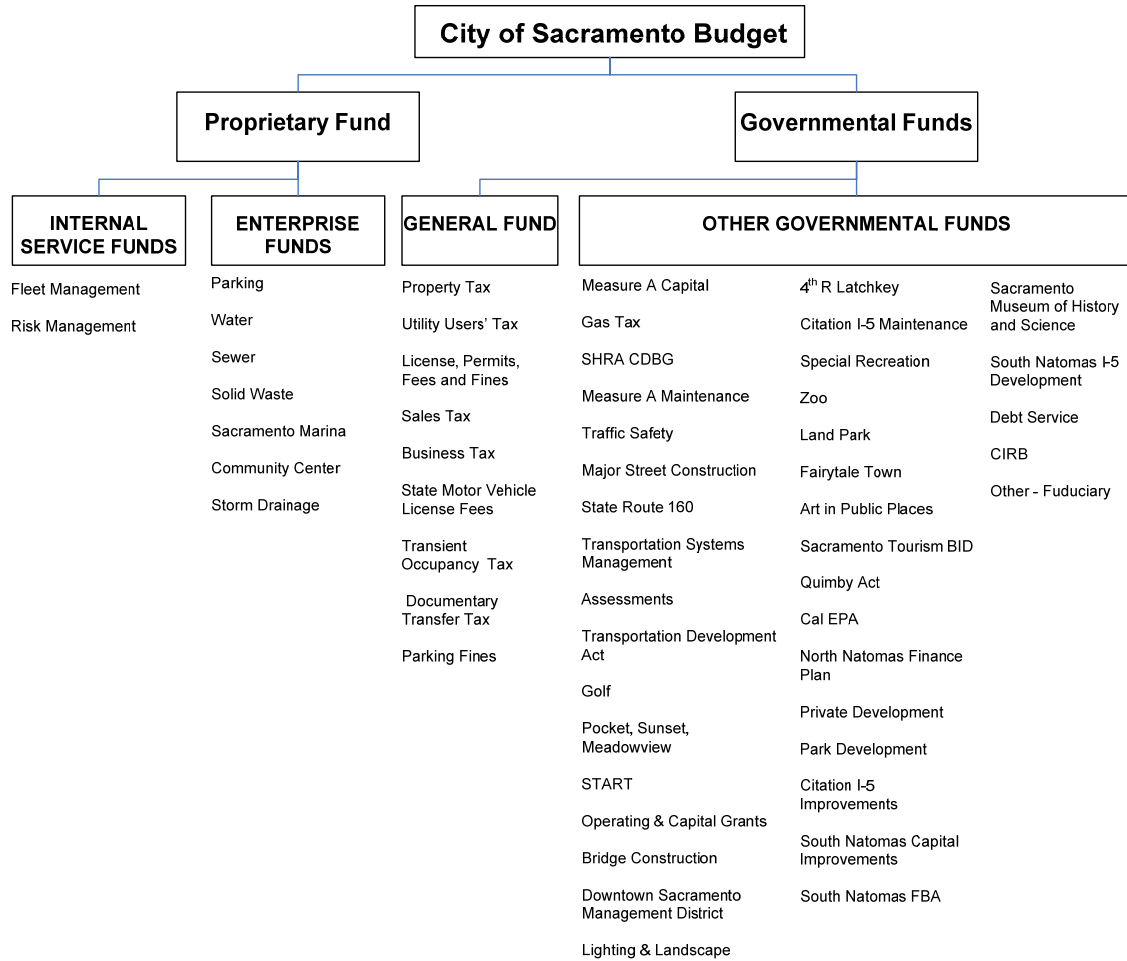
The General Fund is the primary operating fund of the City and accounts for all financial resources except for those that are required to be accounted for in separate funds. Sources of General Fund revenues include taxes, licenses, permits, fees, fines, intergovernmental revenues, and charges for services, special assessments, interest income and other resources available for discretionary funding.

Enterprise Funds are used to account for revenues generated by specific taxes, fees or other sources that are designated to finance specified functions, programs or activities.

Special Revenue Funds are used to account for revenues generated by specific fees, most often charges to customers for services provided, that are designated to finance specified functions, programs or activities.

Annual budgets are adopted for the General Fund, Enterprise Funds and Special Revenue funds and Internal Service Funds. Expenditures are appropriated on a modified accrual basis, except that commitments related to purchase orders and contracts are treated as expenditures in the year of commitment.

Budgets are modified throughout the year when the tax base changes, fees are modified, new revenue sources are identified, or programs are changed. The City Manager is authorized to administratively amend the budget during the year for transactions up to \$100,000 without City Council approval. All other appropriation adjustments during the year require City Council approval. Unencumbered annual budget appropriations lapse at fiscal year-end. Multi-year budget appropriations are automatically carried over into the next fiscal year.



**FINANCIAL INFORMATION**

**General Information**

The General Fund is the City’s primary operating fund and accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The City budget includes the following major Enterprise Funds:

- ✓ The Water Fund accounts for the operation and maintenance of the City’s water treatment and water transmission and distribution systems.
- ✓ The Sewer Fund accounts for the operation and maintenance of the City’s sewer system.
- ✓ The Storm Drainage Fund accounts for the operation and maintenance of the City’s surface drainage system.
- ✓ The Solid Waste Fund accounts for the collection and disposal of refuse throughout the City and for landfill closure.
- ✓ The Marina Fund accounts for the operation and maintenance of the Sacramento Marina, a 547-berth marina located on the Sacramento River at Miller Park.

- ✓ The Community Center Fund accounts for the operation and maintenance of the City's Community Center, including the theater and exhibit halls.

Internal service funds account for the financing of fleet and risk management services to other departments on a cost reimbursement basis.

### Revenue Overview

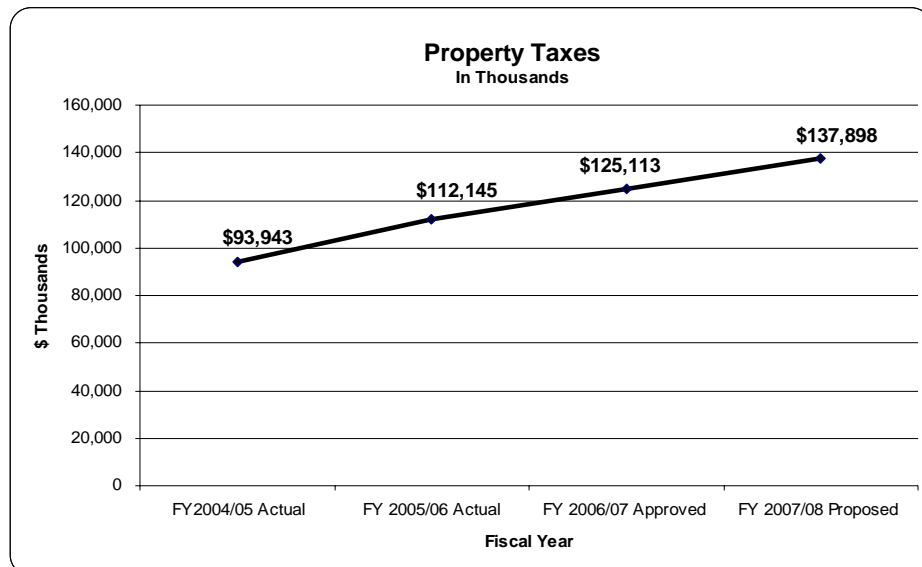
**Property Taxes.** Article XIII of the California Constitution (Proposition 13) limits ad valorem taxes on real property to one percent of value plus taxes necessary to pay indebtedness approved by voters prior to July 1, 1978. The Article also established the 1975/76 assessed valuation as the base and limits annual increases to the cost of living, not to exceed two percent, for each year thereafter. Property may also be reassessed to full market value after a sale, transfer of ownership, or completion of new construction. The State is prohibited under the Article from imposing new ad valorem, sales, or transactions taxes on real property. Local government may impose special taxes (except on real property) with the approval of two-thirds of the qualified electors.

Property taxes are levied annually by the Sacramento County Assessor on July 1 and become a lien on property on January 1. The City participates in an alternative method of distribution of property tax levies and assessments known as the "Teeter Plan." The Teeter Plan payment, which includes 95 percent of the outstanding accumulated delinquency, is included in property tax revenue. Under the Teeter Plan code, 5 percent of the delinquency must remain with the County as a reserve for Teeter Plan funding.

Property Taxes are the largest General Fund revenue source, accounting for approximately 25.5 percent of all General Fund revenues. Revenues related to property taxes are affected by fluctuations in the real estate market, levels of new construction activity and the corresponding changes to the tax rolls.

- ✓ Main roll property taxes are estimated to grow by 7.6 percent.

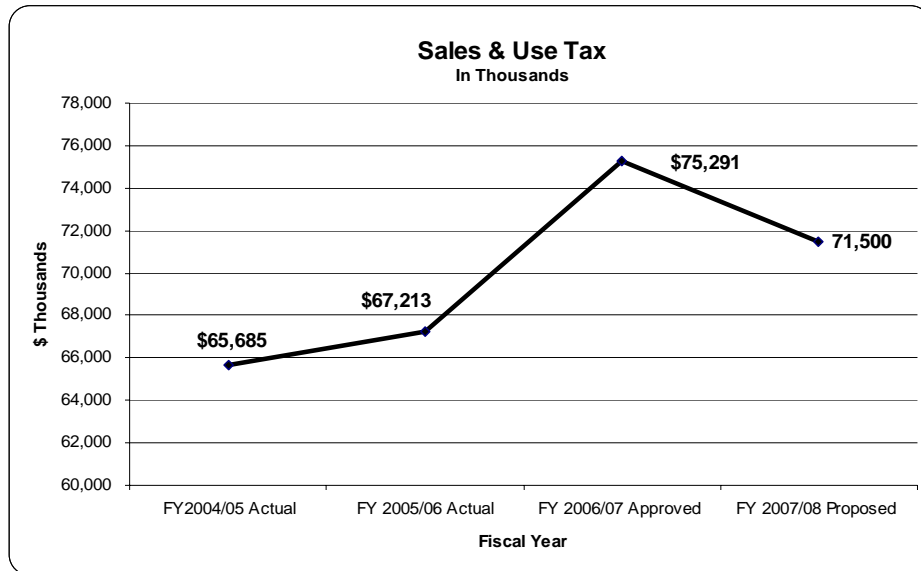
The property transfer tax, imposed on all transfers when property located in the City is sold, is estimated to decline by \$1 million or 10 percent due to a slowing real estate market.



**Sales and Use Tax.** The City of Sacramento has adopted a Bradley-Burns Sales Tax Ordinance which allows the City to be allocated one cent of the overall sales tax imposed in the City. The State Board of Equalization collects and distributes sales and use tax for the State, cities, counties, and other entities receiving sales tax revenue.

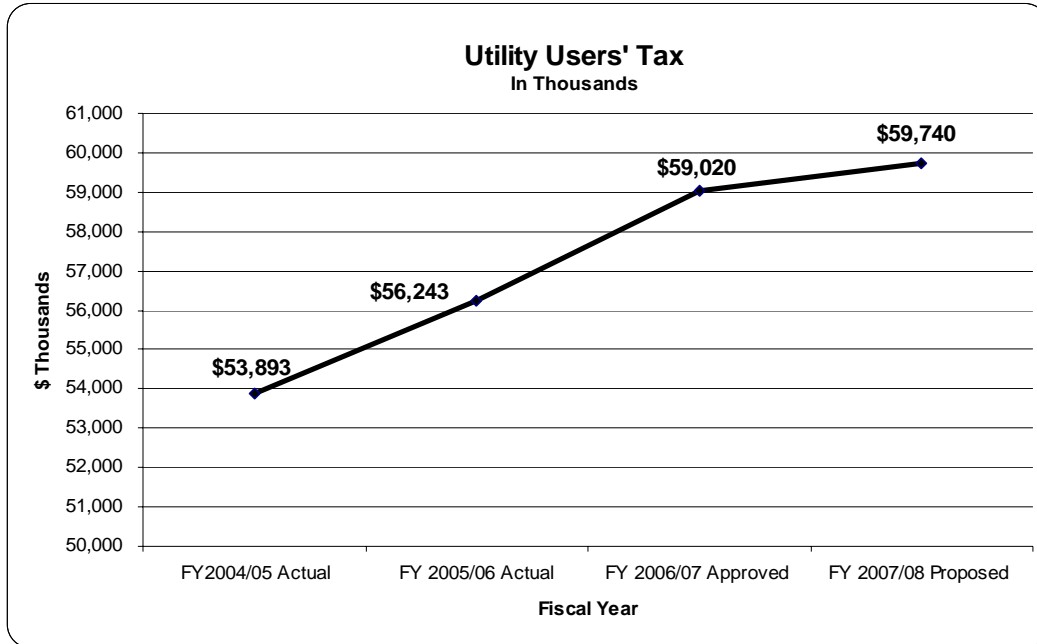
Sales and Use Taxes make up approximately 14.9 percent of General Fund revenues and are expected to decline by 6.1 percent as a result of the effects of the slowing real estate market on business to business and home improvement sales.

The 2003/04 State budget implemented what is commonly called the “triple flip” whereby \$15 billion of voter approved economic recovery bonds to finance the State’s Fiscal Year 2002/03 and Fiscal Year 2003/04 State budget deficits, would be payable from a fund established by the redirection of one-quarter of local governments’ 1% share of the sales tax imposed on taxable transactions within their jurisdiction to the State, commencing July 1, 2004. The portion of sales and use tax that otherwise would have been allocated to local governments, including the City, would be decreased by a commensurate amount. Commencing in Fiscal Year 2004/05, local governments’ share of local property tax revenues were restored by an amount equal to the one-quarter cent reduction in the local sales and use tax, creating a revenue neutral effect on local governments for the 2004/05 Fiscal Year and subsequent Fiscal Years. Since Fiscal Year 2004/05 this revenue exchange has been implemented with the City receiving less sales tax and greater property tax allocations. This will remain in effect until such time as the State’s economic recovery bonds have been retired.

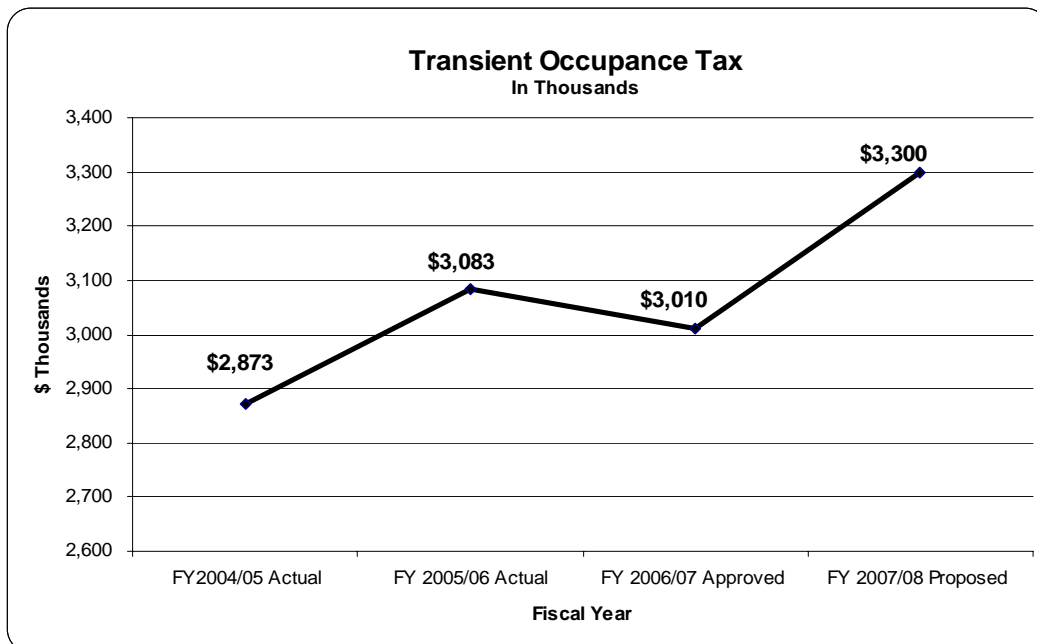


**Utility Users Tax (UUT).** Measure C was approved by the voters on November 8, 1988, and reaffirmed the 7.5 percent tax rate on the use of electricity, natural gas and telephone and cable services.

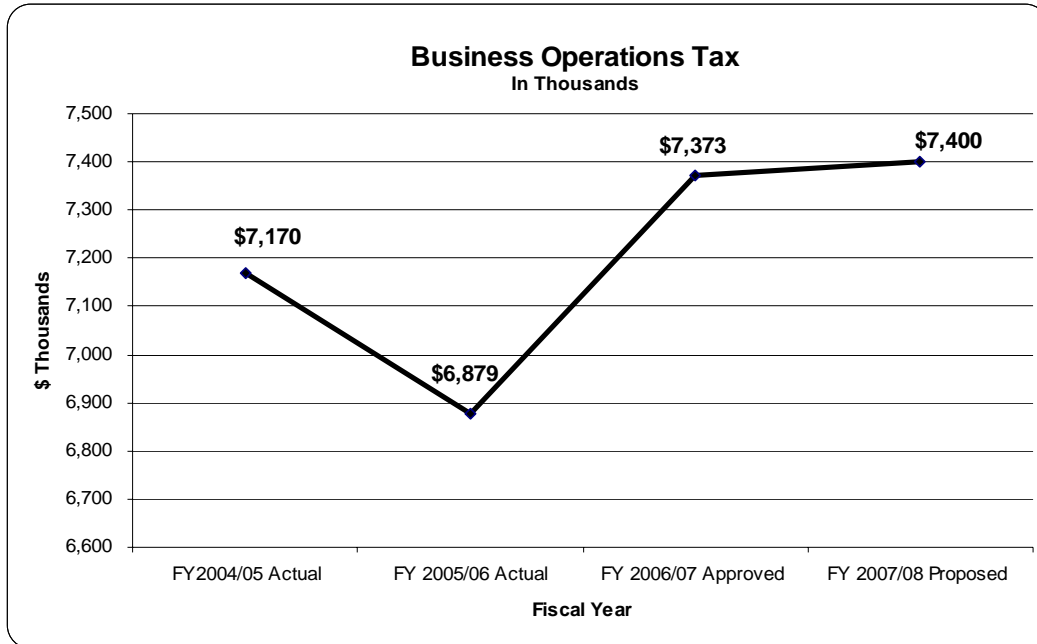
The UUT provides a significant portion of the City's General Fund revenues. Current UUT revenue is approximately 15 percent of General Fund revenues and is expected to grow by only 4.9 percent, reflecting a general decline in UUT growth relative to decreased unit prices for natural gas and a loss of market share in telephone and cable.



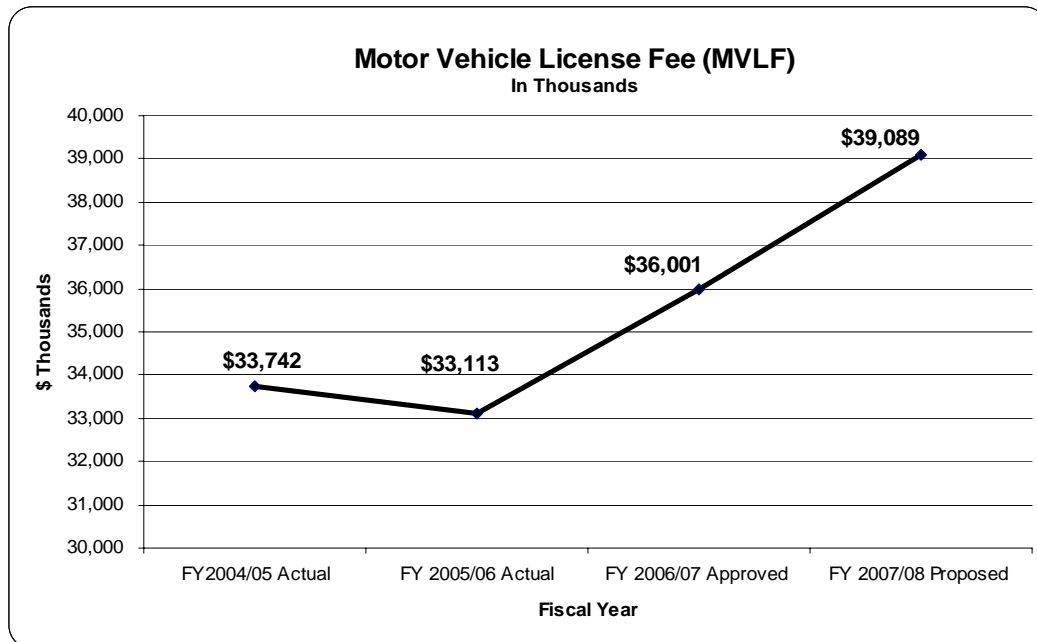
**Transient Occupancy Tax (TOT).** The current rate of 12.0 percent is charged to all transient guests of hotels, motels, inns, and bed & breakfasts within the City limits. The General Fund portion of TOT revenues is equal to 2 percent of the 12 percent rate of total TOT revenues. The remaining TOT revenues collected are for use by the Community Center Fund. TOT revenues are expected to grow by approximately 3 percent annually over the next five years.



**Business Operations Tax.** Remitted annually by individuals and businesses that commence, transact, engage in or carry on any business, trade, profession, calling, occupation or gainful activity in the City. Business Operations Taxes make up approximately 1.9 percent of General Fund revenues and are expected to grow less than 1 percent.



**Motor Vehicle License Fee (MVLFF).** An annual license fee equal to 2 percent of the market value of the vehicle as determined by the Department of Motor Vehicles is imposed on any vehicle, of a type which is subject to registration under the Vehicle Code. Monthly MVLFF apportionments are based on two percent of the market value of all vehicles licensed. The State currently backfills 67.5 percent of the total amount.

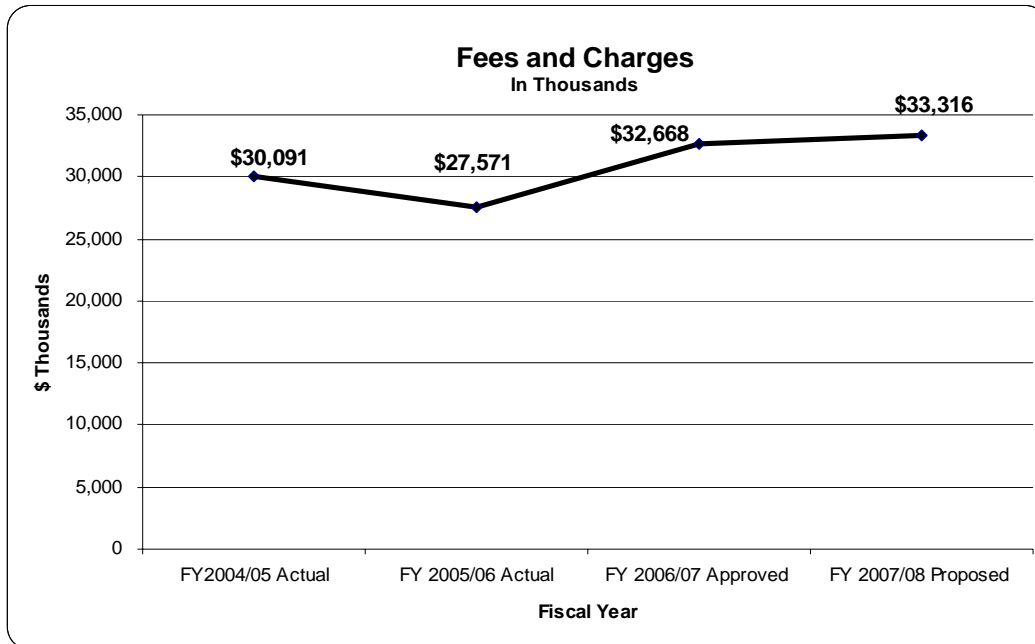


**Fees and Charges.** Local government has the ability to implement fees to fund City facilities, infrastructure and services. There are five main categories of fees that the City currently implements:

- ✓ Impact/development fees;
- ✓ Service fees;
- ✓ Regulatory fees;
- ✓ Rental fees; and
- ✓ Penalties/Fines.

The Council has an adopted fee policy which sets forth guidelines for: establishing cost recovery goals; determining the categories of cost recovery levels in which to categorize/organize fees; methods for determining which category a fee falls under; and establishment and modification of fees and charges.

Fees and Charges make up approximately 13.2 percent of General Fund revenues and are expected to grow approximately 1.6 percent.



Note: Property, sales, use, and utility user taxes related to the current fiscal year are accrued as revenue and accounts receivable and considered available if received within 60 days of year end. Federal and State grants are considered receivable and accrued as revenue when all eligibility requirements have been met under the accrual basis of accounting in the government-wide statement of net assets. The amount recognized as revenue under the modified accrual basis of accounting is limited to the amount that is deemed measurable and available.

**Debt Policy**

California State Government Code Section 43605 specifies that cities shall not incur a level of bonded indebtedness for public improvements which exceeds in the aggregate 15 percent of the assessed value of all real and personal property of the city payable from the proceeds of taxes levied upon taxable property in the city.

At June 30, 2006 and 2005, the City had \$937 and \$810 million, respectively, in long-term debt outstanding, not including \$116 million of debt for the City's discretely presented component units.

Outstanding debt of governmental activities increased approximately \$138 million primarily due to the issuance of new debt, slightly offset by principal payments on existing debt during the year. Outstanding debt of business-type activities decreased approximately \$11 million primarily due to decreases for principal payments on existing debt during the year.

**City of Sacramento  
Outstanding Debt  
June 30, 2006 (\$ in millions)**

|                               | <u>Governmental<br/>Activities</u> | <u>Business-type<br/>Activities</u> | <u>Total</u> |
|-------------------------------|------------------------------------|-------------------------------------|--------------|
| Revenue and other bonds (net) | \$530                              | \$353                               | \$883        |
| Notes payable                 | 1                                  | 49                                  | \$50         |
| Capital lease obligations     | 2                                  | 2                                   | \$4          |
| Total                         | <u>\$533</u>                       | <u>\$404</u>                        | <u>\$937</u> |

The City continues to maintain excellent credit ratings on all of its debt issues. The following are the ratings at June 30, 2006, as determined by Moody's Investors Service and Standard & Poor's. These ratings have not changed subsequent to year-end.

|  | <u>Moody's</u> | <u>S &amp; P</u> |
|--|----------------|------------------|
| Insured issues:  |                |                  |
| • 1993 Refunded Lease Revenue Bonds, Series A            | Aaa            | Aa               |
| • 1995 Gas Tax Revenue Bonds, Series A                   | Aaa            | AAA              |
| • 1996 Lighting and Landscape Bonds                      | Aaa            | AAA              |
| • 1997 Lease Revenue Bonds                               | Aaa            | AAA              |
| • 1999 Capital Improvement Revenue Bonds                 | Aaa            | AAA              |
| • 2001 Capital Improvement Revenue Bonds, Series A       | Aaa            | AAA              |
| • 2002 Capital Improvement Revenue Bonds, Series A       | Aaa            | AAA              |
| • 2003 Capital Improvement Revenue Bonds                 | Aaa            | AAA              |
| • 2005 Refunding Revenue Bonds                           | Aaa            | AAA              |
| • 2006 Capital Improvement Revenue Bonds, Series A and B | Aaa            | AAA              |
| Uninsured issues:  |                |                  |
| • 1991 Marks-Roos Revenue Bonds                          | A1             | A+p              |
| • 1993 Refunded Lease Revenue Bonds, Series B            | Aa             | A+               |
| • 2002 Refunding Revenue Bonds                           | A1             | AA-              |

### **Investment Policy**

All funds of the City are invested by the City Treasurer. The cash balances of all operating funds of the City, including the General Fund, enterprise funds, and other related entities, are invested in the City's Pool A Fund ("Pool A"). Investments in Pool A are purchased according to the current Investment Policy of the City, which is in compliance with the investment guidelines of the California Government Code (Sections 53601 & 53635). The City Investment Policy is presented quarterly to the City Council for approval and includes the approved credit standards, investment objectives, and specific constraints of Pool A. On a monthly basis, City investments are reviewed by the City's Investment Committee to review transactions and overall compliance with the Government Code and Investment Policy. The Committee also reviews the current investment strategy and guidelines in relation to the current financial and economic environments. On a quarterly basis, the City Treasurer prepares an investment activity and positions report for review by the City Council.

The primary investment strategy for Pool A is to provide adequate liquidity. This is achieved by covering the expected cash disbursements with revenues and maturities for the next rolling six-month period. After satisfying liquidity, any idle cash is used to prudently maximize yield. Longer-term strategies are developed and followed after considering long-term cash flow needs, current projected economic conditions and the prudent diversification of maturities.

## EMPLOYEE RETIREMENT PLANS

The City of Sacramento provides defined benefit retirement benefits through the California Public Employees' Retirement System (PERS) and the Sacramento City Employees' Retirement System (SCERS). PERS is an agent multiple-employer public employee defined benefit pension plan. SCERS, a closed system, is a single-employer defined benefit pension plan. There are approximately 1,150 retirees covered by SCERS and 120 active employees covered by the plan. All other retirees and active employees are covered under CalPERS.

All full-time and certain part-time City employees hired after January 28, 1977, and City safety employees, regardless of date of hire, are eligible to participate in PERS. PERS provides retirement and disability benefits, annual cost of living adjustments, and death benefits to plan members and their beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provisions and all other requirements are established by state statute and city ordinance.

All full-time, non-safety employees hired before January 29, 1977, were eligible to participate in SCERS. SCERS provides retirement and disability benefits, annual cost of living adjustments, and death benefits to plan members and beneficiaries. The City reports SCERS as a pension trust fund. The following is a summary of significant accounting policies:

### FUNDING POLICY

Participants are required to contribute a percentage of their annual covered salary, as follows:

|                                 |         |
|---------------------------------|---------|
| PERS - Miscellaneous            | 7%      |
| PERS - Safety                   | 9%      |
| SCERS - (varies with entry age) | 3 – 10% |

The City makes the following participant contributions on their behalf and for their account (percent of annual covered payroll):

|  |    |
|--|----|
| PERS - Certain miscellaneous employees | 3% |
| PERS - Safety                          | 9% |

The City is required to contribute at actuarially determined rates. Rates for the Proposed FY2007/08 Budget are (percent of annual covered payroll):

|                      |         |
|----------------------|---------|
| PERS - Miscellaneous | 11.216% |
| PERS - Safety        | 22.279% |

PERS contribution requirements are established and may be amended by PERS. SCERS contribution requirements are established by City Code.

## **ANNUAL PENSION COST**

For the fiscal year ended June 30, 2006, the City's annual PERS pension cost of \$38.5 million was equal to the City's required and actual contributions. The required contribution was determined as part of the June 30, 2003, actuarial valuation, using the entry age normal actuarial cost method. The actuarial assumptions included (a) 7.75 percent investment rate of return (net of administrative expenses), (b) projected annual salary increases that vary by duration of service ranging from 3.25 percent to 14.45 percent. Both (a) and (b) included an inflation component of 3.0 percent and an annual production growth of 0.25 percent. The actuarial value of PERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period. Unfunded actuarial accrued liabilities and excess assets as of June 30, 2004, are being amortized, using the level percentage of payroll method, over a closed period that depends on the plan's date of entry into PERS. The remaining amortization period at June 30, 2004, was 31 years for the safety employees' plan and 27 years for the miscellaneous employees' plan. Subsequent plan amendments are amortized as a level percentage of projected payrolls over a closed 20-year period. Annual gains and losses that occur in the operation of the plan are amortized over a rolling period, which results in an amortization of 6% of unamortized gains and losses each year.

The City had no required contributions or actual pension cost for SCERS for the fiscal year ended June 30, 2006. In fact, the City has not made an employer contribution to SCERS since 1992; however, active employees have been making their contribution. However, the Proposed FY2007/08 budget contains a \$3.5 million contribution to SCERS from both the General Fund and Enterprise funds, which is necessary to ensure the ability of the fund to pay the estimated benefits of current and future retirees.

The City Treasurer is responsible for investing and managing the accumulated employee and employer contributions until the funds are paid out to the retirees. Because SCERS is a closed retirement system, the investment of trust funds must be more conservative than is the case with an open system such as CalPERS.

## **Other Post Employment Benefits**

Recent changes to State and Local Government employers reporting requirements related to the cost of retiree medical benefits represent a very serious fiscal challenge to the City. The City currently provides a medical insurance subsidy to retirees who meet certain longevity standards. The City has been budgeting and reporting the cost of the retiree medical benefit on a pay-as-you-go basis. Only the regular payments to the vested retirees are included in the Budget reported in the City's Financial Statements. This contrasts with the pension benefit which is included in the Budget and the Financial Statement on a different basis. With pensions, the long-term costs of providing the benefit for vested retirees and employees is calculated and the annual cost of fully providing the benefit is determined and included in the Budget and reported in the Financial Statements.

The Governmental Accounting Standards Board (GASB) has set new standards which will go into effect for Fiscal Year 2007/08 and requires reporting of the cost of the retiree medical benefit on an accrued actuarial basis. The City will now have to report the long term costs of providing the retiree medical benefit on the same basis as the pension benefit, but the City will not necessarily have to fully fund the retiree medical benefit.

The City will also have to disclose a plan to fund the benefit. Continuing with pay-as-you-go qualifies as a plan. This is a nationwide issue, and all state and local governmental will have to conform to the new reporting standard.

The long-term dollar cost of providing the benefit will measure in the hundreds of millions. The annual cost of funding the retiree medical benefit on the same basis as pension benefit will measure in the tens of millions. The current pay-as-you-go cost in the Budget is approximately \$6.3 million and has increased from \$4.3 million over the past four years.

While the City may continue funding the retiree medical benefit on a pay-as-you-go basis, continuing with the status quo practice represents a significant fiscal risk to the City. The credit rating agencies have indicated that failing to fully fund the retiree medical benefit on an accrued actuarial basis will be an adverse factor in determining credit ratings. Should the City's credit rating be downgraded significantly, the costs of borrowing would become prohibitive and the City may find it impossible to borrow. This would bring most development with the City to a halt.

This risk is made more real by the fact that some governmental agencies are funding the benefit on an accrued actuarial basis, including agencies in California. New cities, such as Citrus Heights, Rancho Cordova, and Elk Grove do not have large numbers of retirees or long term employees, so their long term liabilities are proportionally much lower than the City's. Some agencies have borrowed to pre-fund the benefit and are including the debt service in their budgets. Other agencies have the capacity to divert operating revenues to this new need. In the case of the City, however, pre-funding the benefit presents an extraordinarily difficult fiscal challenge. And in the longer run, the City may not have a real choice.

A City working group has been formed to gather facts and explore the City's options for dealing with the new accounting standard. The working group consists of representatives of the Finance Department, Human Resources, Labor Relations, and the Treasurer. Once basic facts are gathered other stakeholders will be included in the assessment of the problem, including employee unions and retiree representatives.

The Mayor and Council will receive periodic updates on the status of the issue and the magnitude of potential fiscal impacts before any decision is required.

