REPORT TO COUNCIL
City of Sacramento

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Consent
April 27, 2010

Honorable Mayor and
Members of the City Council

Title: City Treasurer's Report on Investments, Cash and Debt

Location/Council District: Citywide

Recommendation: Receive and File.

Contact: Russell T. Fehr, City Treasurer (916) 808-5168

Presenters: Not Applicable

Departments: City Treasurer

Division: City Treasurer

Organization No: 05001011

Description/Analysis:

Policy Considerations: Attached is a report from the Office of the City Treasurer regarding the current status of investments, cash flow, and debt. As an overarching policy directive, the Mayor and City Council require timely information regarding the City's financial affairs. While the focus of the City's financial affairs is on the budget and the economic downturns impacts on service and staffing levels, other areas of the City's financial affairs are also heavily impacted, particularly cash and debt. Budget, cash, and debt are interrelated, and decisions in one area impact the other areas.

This information is intended to complement the City Manager's budget recommendations so that the Mayor and City Council will have a complete view of the City's financial status. As the major decisions regarding City financial affairs, the setting of the course for a year with an adoption of a budget at the conclusion of the public hearings, will be made over the next two months, it is appropriate and timely to provide this report.

Environmental Considerations: California Environmental Quality Act (CEQA):
This action is not subject to the CEQA because it is not a "project" as defined in section

15378 of the CEQA Guidelines. Even if it were a project, it would be exempt under section 15061(b)(3) of the CEQA guidelines, which provides as follows: "Where it can be seen with certainty that there is no possibility that the activity in question may have a significant effect on the environment, the activity is not subject to CEQA."

Sustainability Considerations: None

Commission/Committee Action: None

Rationale for Recommendation: No specific course of action is being recommended with this report. The information on the status of the investment of the City's cash, cash flow challenges, and the feasibility of issuing long term debt is intended to provide background information is the Mayor and City Councils decision making for the annual budget and other projects.

Financial Considerations: The economic downturn and the City's budgetary reaction to the ever increasing fiscal constraints have had significant negative impacts on interest income revenue, cash flow, and the ability to issue long term debt. Interest earnings are declining due to lower cash balances being invested and due to low earnings on the safe and short term investments of the Treasury Pools. The General Fund must now borrow at certain points in the year to maintain a positive cash balance. The state of the regional economy, past budget actions, and future budget challenges make issuing new long term debt problematic.

Emerging Small Business Development (ESBD): Not Applicable

Respectfully Submitted by: ______________________
Russell T. Fehr
City Treasurer

Recommendation Approved:

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Russell T. Fehr
City Treasurer

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Attachments

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Attachment 1

Executive Summary

Investment Performance

- Interest income derived from investment of City cash in the Treasury Pool is at a historic low level due to low rates of return on smaller overall cash balances.
- The performance of the City Treasury Pool is better than the State and County Pools.

Cash Flow Challenges

- The extensive use of reserves and other one-time financing sources and the reductions in General Fund revenues in recent years has had significant negative impacts on General Fund cash flow,
- As reserves have been depleted, **there are large (up to $50 million) cash deficits in the General Fund at certain points during the fiscal year.**
- Covering these cash deficits requires borrowing, either from other City funds or by issuing short term debt.

New Long-Term Debt

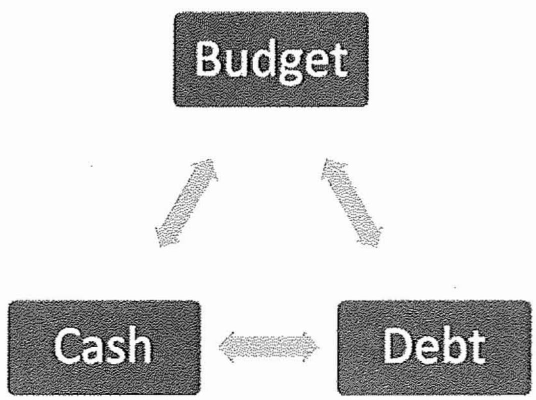
- Due to multi-year budget gaps in the General Fund, declining credit ratings, a high and increasing debt ratio, and current General Fund backing of all City debt issues, **it is unadvisable to issue City-backed, long term debt over the next several years.**
- The budgets approved for the next three years will include further use of reserves and one-time financing to defer service and staffing reductions. This will increase annual cash deficits in the General Fund and further impair the City's ability to issue long-term debt.
- It is critical that multi-year financial planning for the City include rebuilding General Fund reserves.

INTRODUCTION: FINANCIAL RELATIONSHIPS

The financial focus of the City and of the public discussion of municipal financial affairs is on the budget and the actual annual performance as compared to the budget. This is particularly true in this era of diminished resources and increasingly difficult and complex budget decisions. The budget is the fundamental service delivery and capital project plan for the City; the focus on the budget is certainly appropriate.

Yet there are other important aspects of City finance: cash position, cash flow, and the ability to issue long term debt. Budget, cash, and debt are interrelated.

FINANCIAL RELATIONSHIPS



As the budget situation has deteriorated so has the City's cash position and cash flow. Circumstances have emerged that strongly argue against issuing new long term debt over the next several years. The impacts of the Great Recession and the budgetary actions made in this context have had, and will continue to have, significant negative impacts on the City's cash position and ability to issue long term debt.

It is important to provide the Mayor and City Council with this information prior to the annual budget hearings. The critical budget decisions will be based on service needs, staffing levels, and the availability of resources both on-going and on-time. But budgetary decisions, particularly those regarding the use of one-time resources to balance the budget and the timeliness of budget decisions will have further impact on cash position, cash flow, and the ability to issue long term debt.
The greater the use of one-time resources, the deeper the General Fund cash deficit will be during the year. The use of remaining reserves and other one-time funding sources and deferrals in making necessary budget decisions will be viewed negatively by investors and credit rating agencies.

Investment Performance

Interest earnings on the City's cash holdings are at lower levels than in recent years for two reasons:

1. The cash balances are much lower; and
2. In the current economic environment interest rates are very low for the safe, short term investments making up the Treasury Pool.

Economic Backdrop

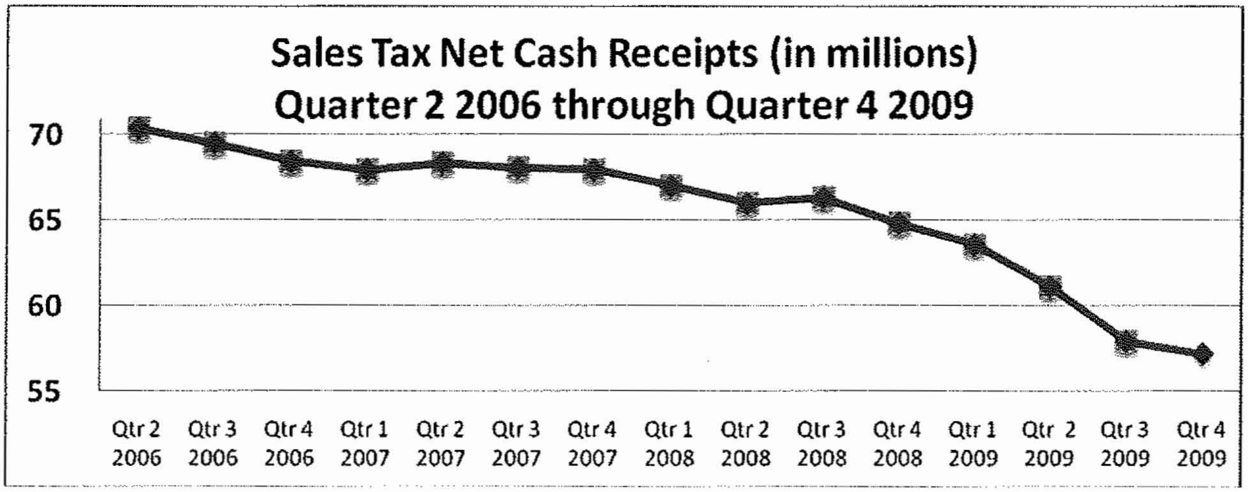
In early March, 2009, the U.S. equity markets hit a 12-year low when the Dow Jones industrial average bottomed out at 6,547. At the same time the Gross Domestic Product declined at an annual 6.5 percent rate. At that time, investors were stunned by equity losses of more than a third. Economic news worsened: labor markets were continuing to shed hundreds of thousands of jobs monthly; financial institutions were struggling to remain solvent; homeowners were walking away from obligations; and car manufacturers were soliciting the government for bailout packages. The new administration acted to pull the U.S. economy back from the abyss by restoring order within financial markets and putting people back to work. To date, financial markets have recovered, but employment has not.

Fiscal and monetary policies were implemented by the Federal Reserve and federal agencies to stop the economic blood-letting and to reverse the decline in employment and rejuvenate economic activity. A wide variety of stimulus programs increased the federal deficit to record levels, thereby transferring much of the concern over the solvency from the private sector to the public sector.

Prompted by assurances of the government to backstop the economy, including the reduction of borrowing rates to historic low levels, the equity markets have recovered more than 60% of their losses as economists and investors began to see an end to the downturn in the economy. While financial sector policies have worked, labor market and housing policies have not. The unemployment rate continues to hover just below 10 percent and more than 2.8 million homes were lost to foreclosure last year alone. Only time will tell if the major stimulus programs implemented in 2009 will have a lagging effect and allow Main Street to join in the recovery.

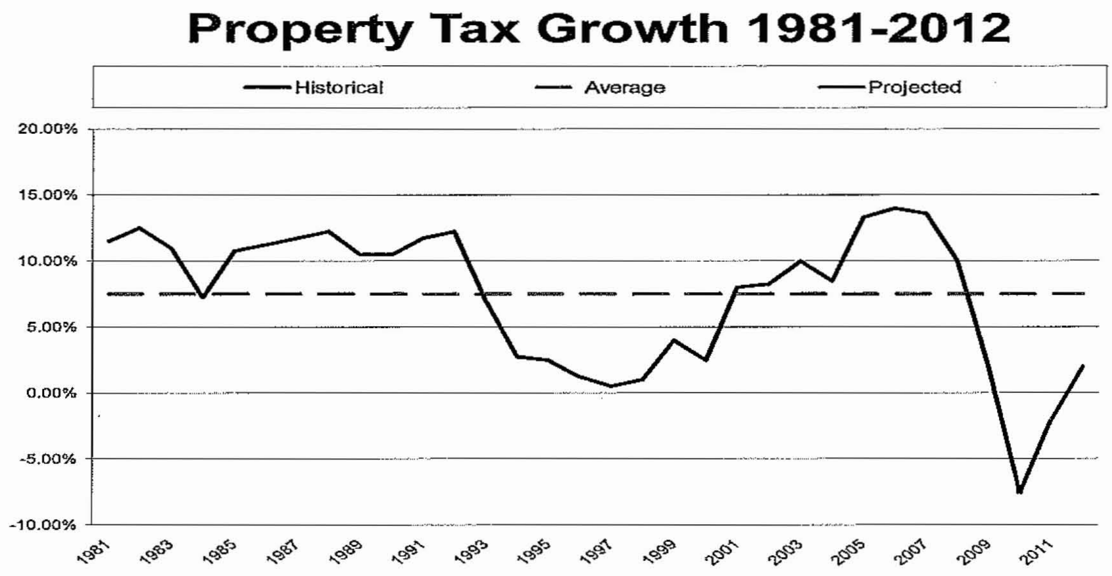
The prolonged global recession did not escape the state of California and particularly Sacramento; in fact it has been magnified by the state's budgetary issues and vast real estate exposure. According to the Sacramento State Business Review, the unemployment rate for the Sacramento region has steadily climbed to 12.4% (as of November 2009) with a loss of nearly 83,000 wage and salary jobs since June 2007 and a loss of 43,800 jobs over the last year. The report states that there will not be an improvement in employment before the fourth quarter of 2010, with the unemployment rate for the region peaking at 13.5 percent. Given that the government sector accounts for 3 out of 10 jobs in the area; the absence of change in the state's fiscal standing could prolong the recovery further. In addition, the second largest employer in the region, Sacramento County, is making large staffing reductions.

Faced with double digit unemployment, consumers are holding off spending their disposable income on non-essentials. Consequently, municipalities are realizing a significant reduction in sales tax receipts. The City alone has experienced a nearly 20% reduction in tax receipts since the second quarter of 2006.



The problems with the regional housing market are well documented. A sharp recovery is not anticipated; rather, the housing market will experience a long bottoming process before there is marked improvement.

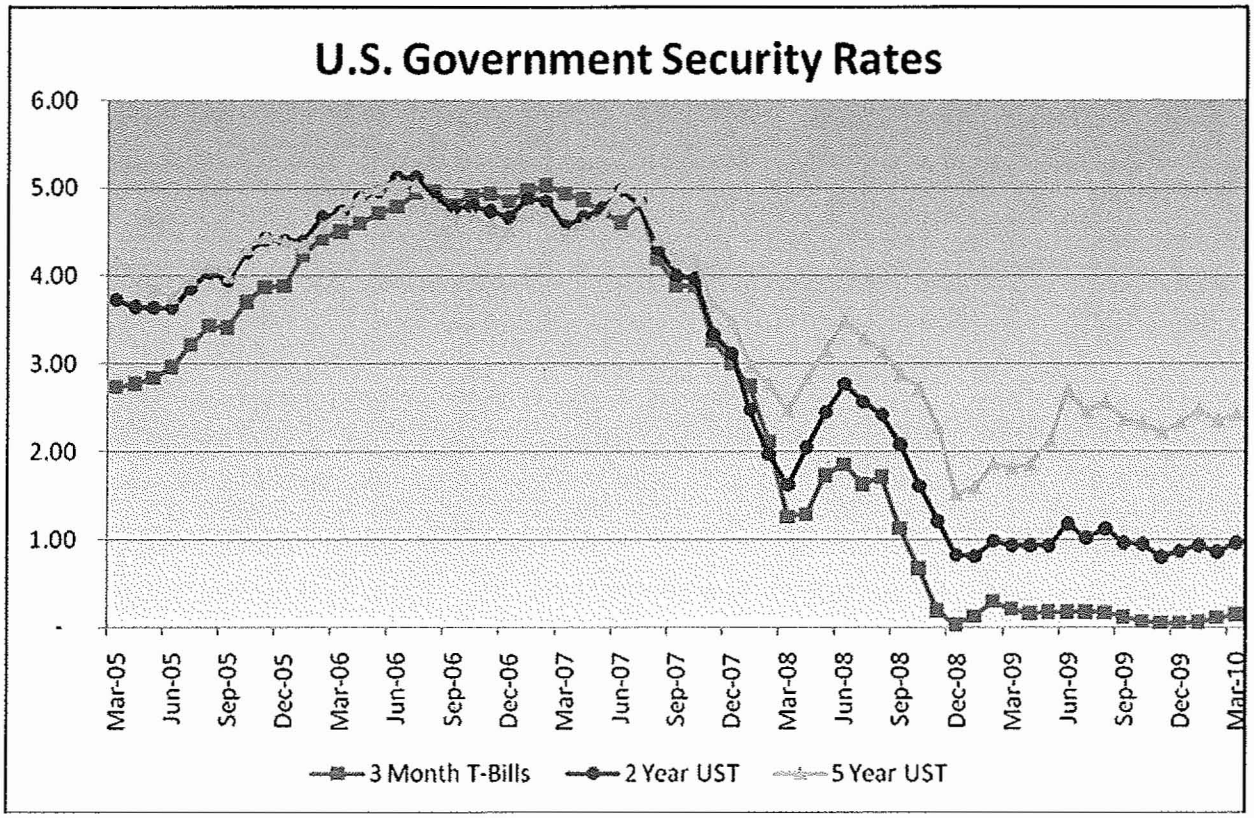
The substantial number of foreclosures in the local market has driven down market prices and assessed values. In some heavily impacted neighborhoods, the secondary effects of foreclosures and bank-owned property has contributed to further declines in value. Petitions requesting lowered assessed valuations under Proposition 8 have been filed at high rate. At present, there are pending petitions requesting an aggregate reduction in assessed valuation of over $3 billion in City of Sacramento. Accordingly, property tax revenue, calculated against a declining assessed value base, has been falling and with it a major source of revenue has suffered. As reflected in the chart below, the rate of decline is lessening, but it will take additional time for property tax revenues to grow rather than shrink.



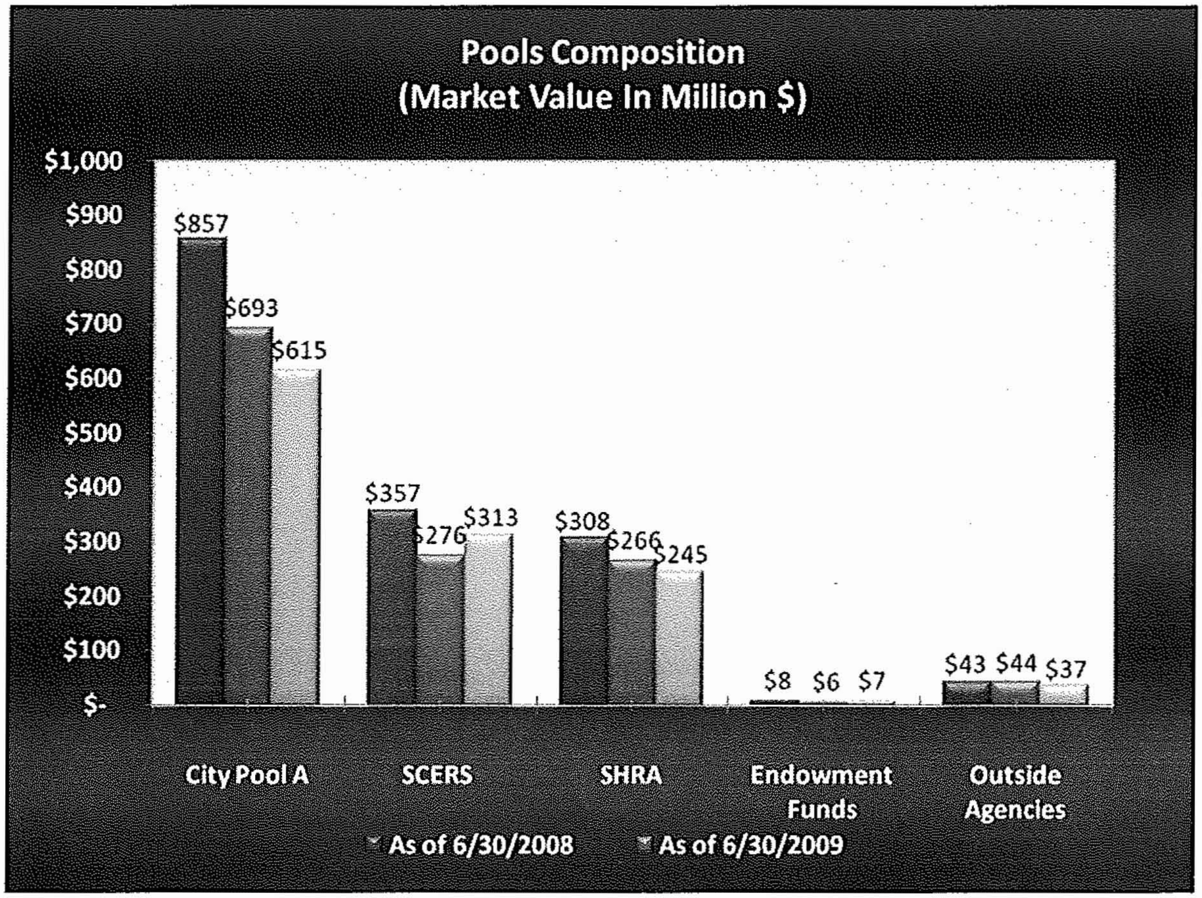
Values on the tax roll have fallen for the first time in decades. The reduction for the current fiscal year is 7.5 percent, and an additional 2 percent reduction is forecast for FY 2011.

City Treasury Pool Performance

The continuing problems with persistent high unemployment, low levels of capacity utilization and low inflation has caused the Federal Reserve to maintain the federal funds rate, in the Fed's own words, at "exceptionally low levels... for an extended period." As noted in the accompanying graphs, taking the lead from the federal funds rate, yields on AAA government debt that forms the major body of investments of the City's treasury pools are at very low yields thereby reducing interest earning contributions to the City's general fund over the past three years. Those yields include 0.15 percent points for three-month maturities, 0.95 percent points for two-year maturities and 2.4 percent for five-year maturities. While yields are likely to increase over time, it is anticipated that given the high unemployment rates and continuing problems in the residential and commercial real estate markets the federal government will continue monetary policies that will maintain low borrowing rates.



Interest earnings are also impacted by lower cash balances in the Treasury Pool. The lower balances are the result of reserve and fund balance usage the planned expenditure of bond funds and other capital funding. The following table illustrates the holdings of the City and other agencies in the Treasury Pools from June 30, 2008 to estimated levels on June 30, 2010.



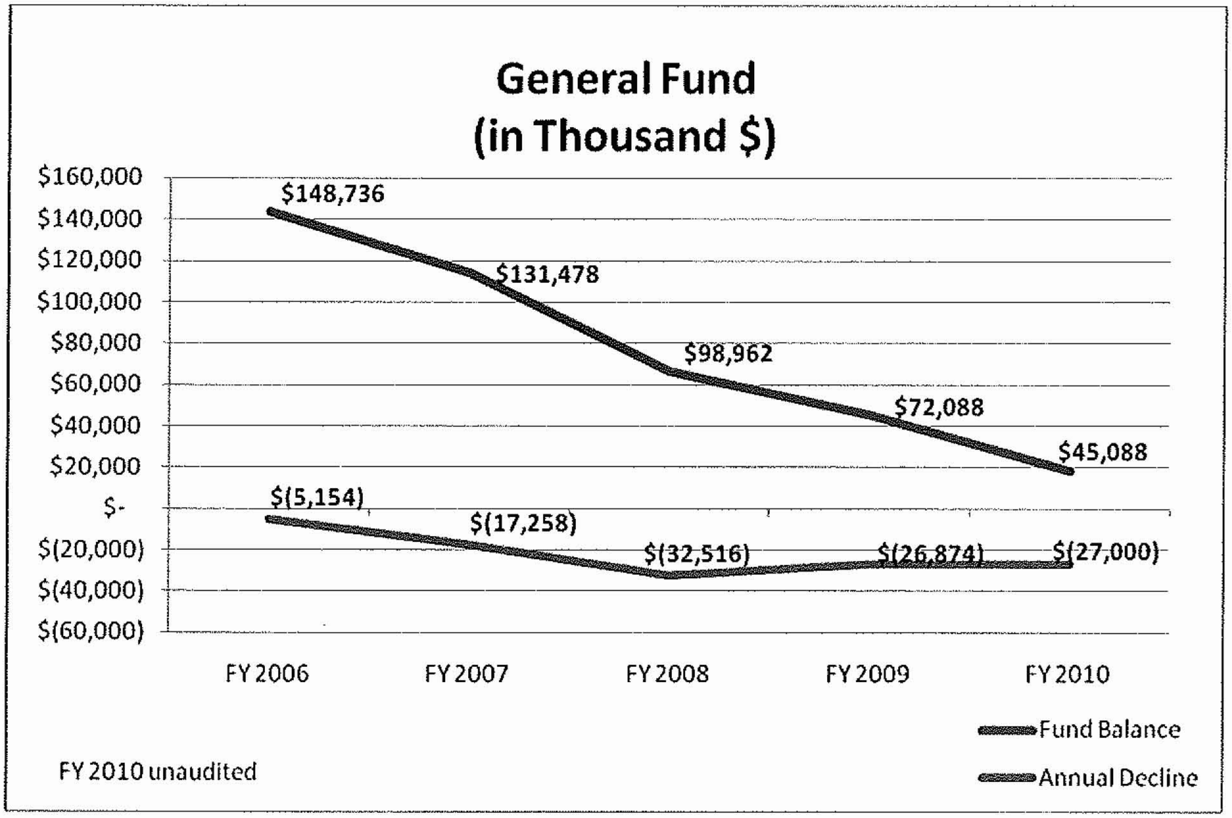
In two years, total City cash balances have declined by $245 million. The reduction in the cash position of the General Fund now poses a significant cash flow problem and the need to borrow on an annual basis to resolve the cash flow problem.

CASH POSITION

Since FY 2009 there has been, and will continue to be, periods where the cash balance in the General Fund is negative. The General Fund has to borrow to cover these cash deficits. This is occurring even though the General Fund begins and ends a fiscal year with a positive cash balance. The problem is likely to grow over the next three fiscal years. Rebuilding General Fund reserves will reverse the trend, and ultimately, eliminate the need for borrowing.

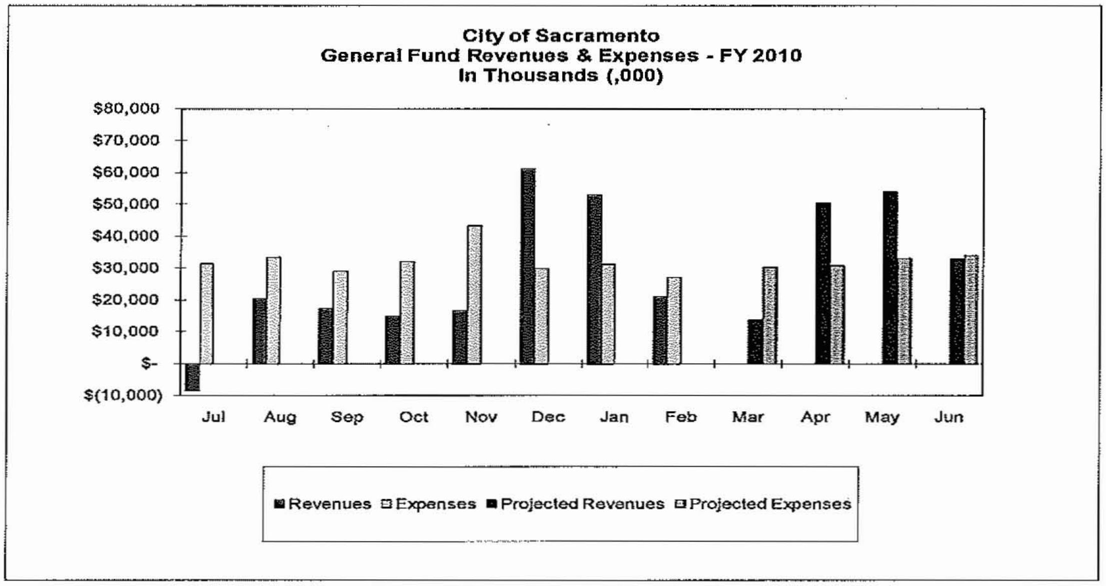
This situation has arisen due to the extensive use of one-time financing sources (reserves and other sources) over a five year period. The following graph illustrates the reductions in fund balance over the past five years:

DECLINE IN FUND BALANCE OF GENERAL FUND



There has been a reduction in fund balance of over $103 million. The upper line represents fund balance totals at the end of a fiscal year. The lower line represents the annual reductions in fund balance which have ranged from $5.1 million to $32.5 million. Overall cash balances during a fiscal year have declined by a similar amount. Compared to five years ago, the cash holding in the General Fund, at any point in the year, was approximately $100 million more than now.

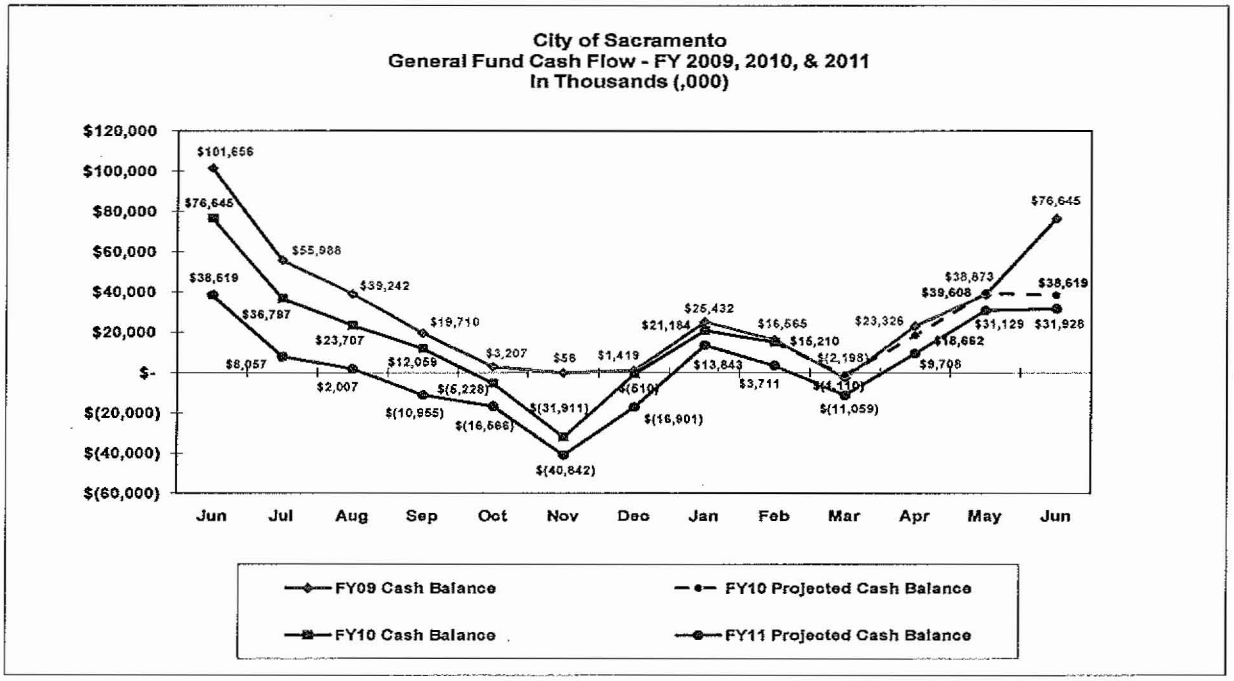
The reduction in cash balances has become a serious problem due to the uneven cash flow in the General Fund during a fiscal year. The following graph illustrates the actual and projected General Fund cash flow for the current fiscal year and illustrates the "dry period" cash flow challenge:



Monthly expenditures are fairly even with peaks coming in the months when debt service payments are made. Monthly receipts of revenues are much more uneven. Property taxes are the largest source of General Fund revenue and are allocated at mid-year and in the final quarter of the year. The result is expenditures being greater than revenues from July through November and again in February and March.

If the cash balance is not high enough at the start of the fiscal year, then the General Fund runs out of cash during the dry periods. Due to the large reductions in beginning cash balances, this is occurring even though there is a positive cash balance in the General Fund at the start and end of the fiscal year.

The next graph illustrates how the reduction in beginning cash balance in the General Fund now results in growing cash deficits in dry period months and the cumulative cash flow for the General Fund for last year, the current year, and the coming year.



In Fiscal Year 2009 there was a relative small cash deficit of approximately $2.2 million in March. In the current year, the cash deficit in November was approximately $32 million and will increase to between $45 and $50 million in Fiscal Year 2011.

General Fund Borrowing

The General Fund must now borrow to have the cash necessary to meet obligations. For FY 2009 and FY 2010 borrowing was from other City funds.

For FY 2011, the City Treasurer will seek City Council authority to attempt a short-term, cash flow borrowing, to supplement internal cash resources. The cash flow notes are known as TRANS (Tax Revenue Anticipation Notes). The last time the City issued TRANS was 1995.

The emergence of the cash deficits should come as no surprise. The City Council was informed of a deteriorating cash position in October 2008 and January 2009. In June 2009 the City Council authorized the Treasurer and Finance Director to make and record internal loans to maintain General Fund liquidity during the current Fiscal Year 2010.

Many local governments in California borrow internally or routinely issue short-term, cash flow notes. For some it is a standard part of the annual fiscal cycle. This has now become the case for the City.

Risks

The cash position of the General Fund will further deteriorate as reserves and other one-time resources are used to defer service, staffing, and employee compensation changes. The dry period problem will deepen requiring greater short term borrowing. The plan is to use a mix of internal resources and short term borrowing. The ultimate risk is running out of internal funds from which to borrow and then being unable to access the financial markets or only at great cost.

Reserve: Long Term Solution

The cash flow challenge will not soon be resolved. The problem will continue to grow as one-time resources are used to balance the budget. The negative trend can only be reversed by rebuilding General Fund reserves.

Debt Profile

In June 2009, the City's issuer credit rating was downgraded by both Moody's and Standard & Poor's. The downgrades were a result of:

- underlying economics of the region,
- the use of reserves,
- the strain on the City's ability to maintain contingency reserves given further declines in revenues, and
- high General Fund debt ratio.

Moody's	Standard & Poor's
Aa2 → Aa3	AA → A+

As we approach the new fiscal year with continuing declines in revenues, it is important to be aware of how actions we take now will affect the City's financial standing and ability to issue debt for critical facilities. The following summary observations and recommendations related to the City's debt position are offered.

- The City should develop a financial strategy to regain a solid AA category rating and;
- The City should refrain from issuing any long-term City backed debt over the next several years

Debt – Purpose

Debt financing of City projects can be a cost-effective means of providing key facilities and services. Debt financing may be used to fairly distribute the cost of land, improvements, and equipment over time to future users of the improvements as opposed to the full burden of a future facility being borne by the current residents. Additionally, the use of short-term borrowing to meet critical cash flow must be an option available to the City.

It is also very important to consider the debt burden on future City Budgets must not be so great that it impedes the ability to finance additional needed facilities at that time. **Further, the City must have sufficient revenues to meet its on-going operating needs and debt obligations, failure to meet a debt obligation would have significant repercussions to market reputation, credit rating, and ultimately to the cost of future borrowing (increased interest rates.)** A City that cannot borrow cannot grow and develop.

Credit Analysis

The importance of maintaining a good credit rating is as important for a City as it is for individuals.

- ***Why do we need a good credit rating?*** Maintaining a solid credit rating is an essential component of sound financial management. It ensures that the City can access or borrow funds if needed – whether for critical projects or in time of emergency. The difficult question is:
- ***What is the appropriate credit rating the City should strive for?*** This is a difficult question dependent upon the City's objective and market conditions. A lower credit rating will increase borrowing costs, placing increased financial burdens on our constituents and limiting our ability to issue debt for needed improvements and amenities in the future. While a higher credit rating will equate to lower borrowing costs, the requirements to maintain a high credit rating may far outweigh the benefits of the lower cost of borrowing.

In addition to cost, ready access to the financial market must also be considered. Many institutional investors are limited to investing in only AA or higher rated debt. Until recently, the City has maintained AA ratings and enjoyed ready and cost effective access to the market; beginning in late 2007 with the failure of Lehman Brothers, access to credit has been significantly impacted in both the public and private sectors as many of the underlying economics come under stress. To ensure the City has ready access to the financial markets the City should strive to regain and maintain a solid AA rating.

- ***How do we achieve and maintain a solid credit rating?***
  In general, the credit rating is an analysis of both quantitative and qualitative factors that affect the City's ability and demonstrated willingness to pay debt service. These factors can be grouped into four general areas listed below[1].

  - Economic Strengths
  - Financial Strengths
  - Management and Governance
  - Debt Profile

- <u>Economic Strengths</u>: These factors include a review of many of the local base economics and revenue streams that can impact the City's ability to meet its operating and debt obligations. This category includes employment, property tax, and sales tax growth and revenues.

  As discussed earlier, while the assessed value of property has doubled in the past eight years, there was significant trend since 2006 followed by actual reductions in FY2010 and FY2011, as shown in the graph earlier in this report This downward spiral has had a direct and significant impact on property tax revenues coming into the General Fund, as well as to tax increment allocated to Sacramento Housing and Redevelopment Agency (relevancy of which will be discussed in the Debt Profile section.)

It has long been viewed that one of Sacramento's strengths is being the state capital with a large stable employment base, which generally weathers economic downturns.

1 Analytics derived from Moody's Investor Service, Rating Methodology, General Obligation Bonds, October 2009

However, the protracted resolution of state budget problems has significant direct and indirect impacts on the regional economy. Furloughs have reduced the income of the large concentration of State employees in Sacramento. This declining value of our economic base is seen in the ability of our residents and businesses to pay taxes and generate revenues through consumer spending; evidenced by the sharp decline in sales tax since mid-2006 as illustrated in the graph presented earlier in this report.

- *Financial Strengths:* Second in magnitude of importance weighing into the City's credit ratings are the quantitative factors related to the City's finances. This includes reviews of budget plans to actual performance; current financial position and fund balances, as well as future projections and trends; and a general review of City operations. Additionally, for debt service supported by user fees, the level of the rates compared to peers, the amount of cash on hand (six-months desired), as well as, long-term reliability to provide the service, such as water rights. The published annual budgets and comprehensive financial reports are key elements to this review component; targeting several sub-factors including the following:

    - Liquidity/Reserves – are sufficient reserves available to fund unforeseen events?

    - Operating Flexibility – is there flexibility to modify revenues and expenditures to meet changing conditions?

    - Budgetary Operations – are budgets appropriately balanced, matching on-going expenditures with on-going revenues, avoiding reliance on one-time revenues?

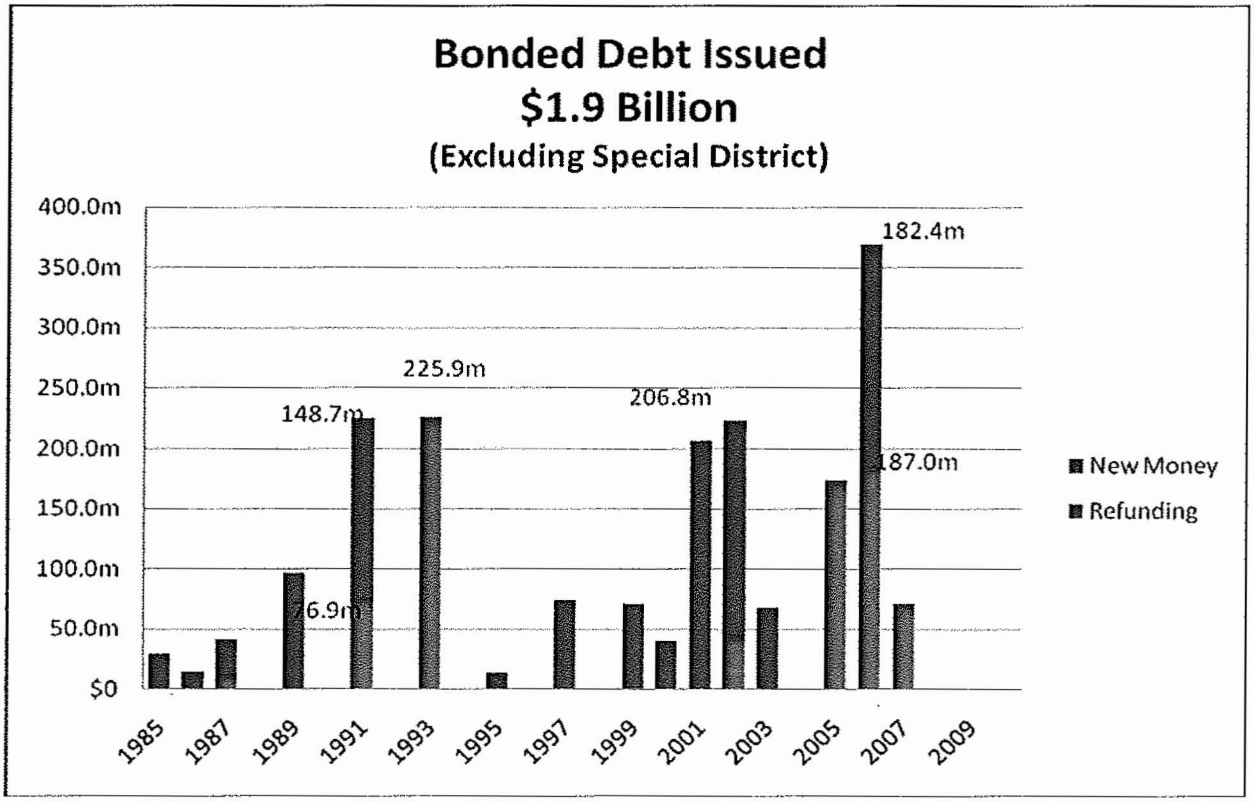
  As mentioned earlier, over the past five years the City has made extensive use of one time financing to meet on-going operations. While this allowed the city to ease the impacts to our citizens, it was noted by the ratings agencies as a contributing factor for the City's recent downgrade. This does not mean that the use of reserves for the very purpose they were intended is inherently bad, it merely indicates that we must be cognizant of our actions, weigh the current and potential future implications, and determine the best course of action for the City.

- Management and Governance Practices: This review centers on the qualitative component of management practices. Is there the willingness and commitment of management and elected/appointed officials to set financial targets and make the difficult decisions to achieve those targets?

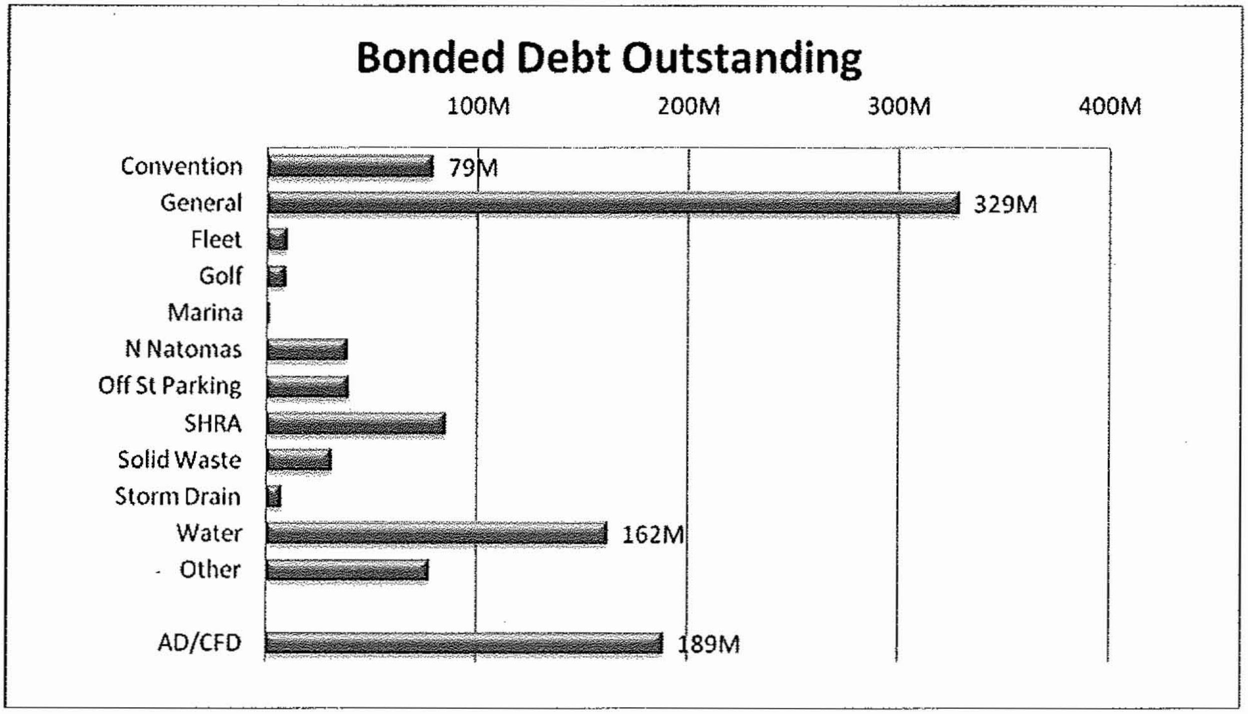
- Debt Profile: The final factor in a credit analysis is the management of the City's debt. Dependent upon the repayment revenue, different credit metrics will come into play when evaluating either issuer credit rating or the underlying credit rating for a particular bond issue. These may include several benchmarks that evaluate whether the City is maintaining a prudent level of debt, such as the ratio of net general fund debt service to general fund revenues the debt per capita, or debt to assessed valuation. Other key metrics for a bond issue are debt service coverage ratios, debt to asset value, operating reserves, a customer concentration or diversification of risk. This area also includes evaluation of debt management practices of existing debt, and adherence and compliance with federal and state regulations.

Debt Background

For a 25 year period, beginning in 1960 up to 1985, the City of Sacramento issued $362 million of bond debt obligations; primarily supported by enterprise funds to include the Convention Center, Water, and Sewer funds. The following 15 years saw a light flurry of debt issuance associated with revitalization of downtown including the introduction of a light rail system, Convention Center expansion, and other public amenities enhancements including golf and library facilities. These bond issues culminated in the 1993 refunding issue that refinanced and consolidated the earlier bond issues of this period.

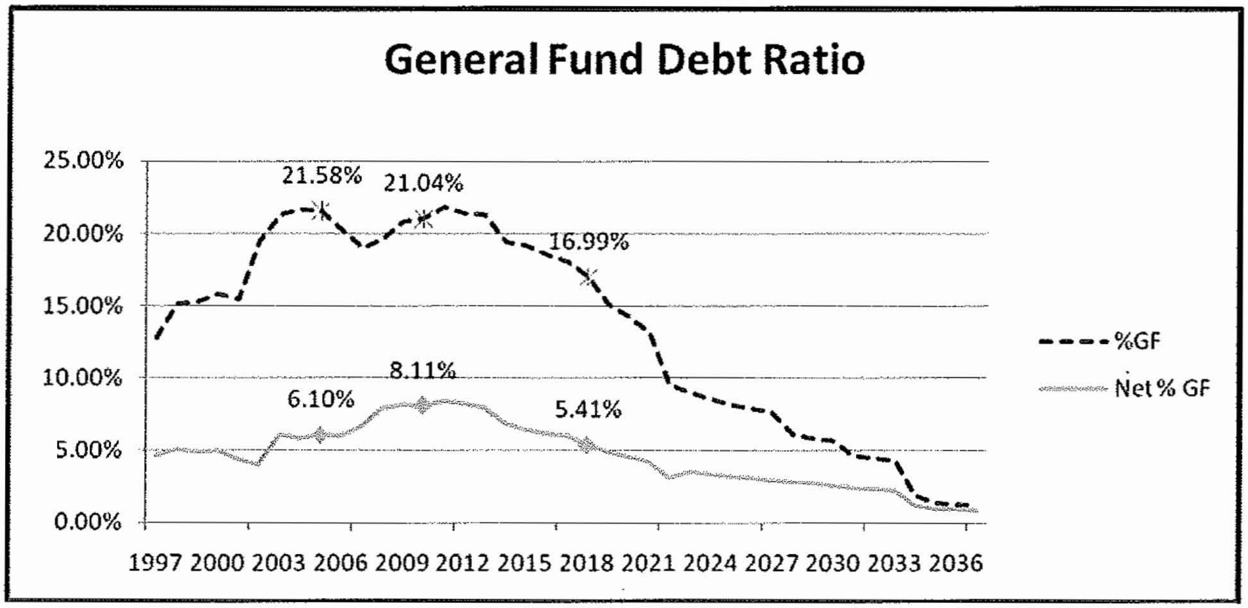


From 1999 through 2006, the City issued bonded debt for various public improvements including Meadowview Service Center, Public Safety Center, Memorial Garage, City Hall, Water Treatment Plant Expansions, and in 2006 the Community Reinvestment Program that addressed many of our cultural and recreational facilities. Combined the bond issuances depicted above reflect $1.9 billion in bond debt issued with approximately **$866 million** in City bond debt outstanding.



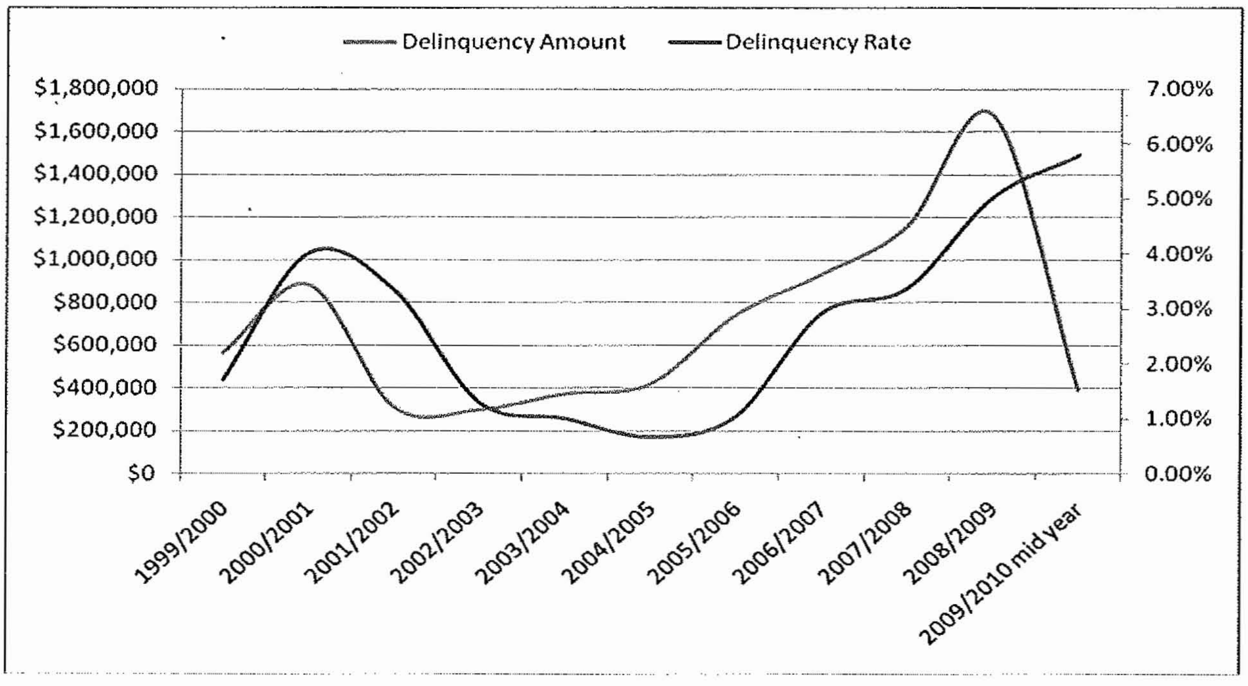
Although the General Fund has a direct obligation for about 40% of the debt, as lease obligations, the financial health of the other funds is critical to ensuring the General Fund does not have to subsidize debt payments for other funds. For instance, the City backs $85 million of SHRA tax increment debt; if the property tax base declined to a level that there was not sufficient tax increment to meet their obligation – under the bond documents the City is liable for the debt and would be required to make the debt service payment or risk default on the bonds.

The ratio of lease debt burden to General Fund revenues is one of many benchmarks that market analysts look to when assessing the fiscal health of an organization. As a general guideline it is recommended that direct General Fund debt ratio be no higher than 5%, which is still comparatively high for California City medians. As depicted on the above chart, without growth to General Fund revenues, the City's direct lease debt remains above 5% through 2021without the issuance of additional debt.



The regional economic impacts discussed earlier spill over into the City's debt program via the delinquency and foreclosure rates of the City's bonded special tax districts. Assessment districts (AD) and community facility districts (CFD) allow for the financing of public improvements such as street lighting, drainage, and payment of fees, etc. Property owners within the district pay for the improvements received through an assessment on the property tax bill. The City of Sacramento has eight bonded ADs and 10 bonded CFDs (consisting of 23 bond issues) with a combined outstanding principal of $198,097,000 as of 6/30/2009.

<u>Rising tax delinquencies:</u> The change in the economic environment in Sacramento has dramatically increased the number of special tax delinquencies over the last four years.

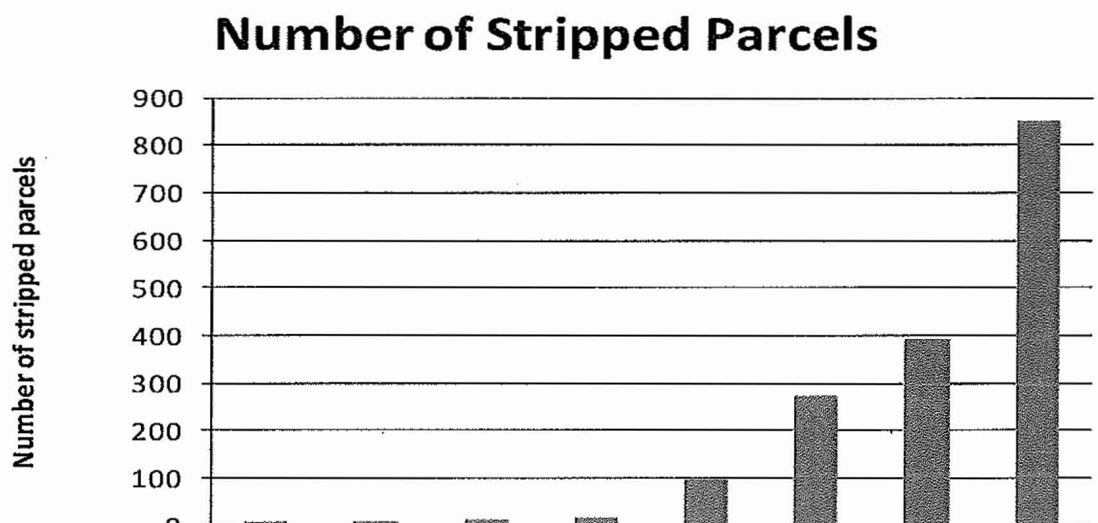


For fiscal year 2009, the delinquency rate for payment of special taxes for bonded districts was 5.7%. However, preliminary indications for the December tax payments show an overall decline in delinquencies in most bonded districts.

Fiscal Year 2009 Special Tax Delinquency Summary:

- Number of levied parcels:	38,610
- Number of delinquent parcels as of 6/30/2009:	2,210
- Delinquency rate for Fiscal Year 2009:	5.7%

Accelerated foreclosure process: Bond documents require the City to begin accelerated foreclosure on parcels where delinquencies exceed certain limits. For fiscal year 2009, our office stripped 851 parcels from the County tax roll and mailed foreclosure notices to those property owners. As reflected on the chart below, the number of stripped parcels has increased by more than nine-fold in the past eight years – a clear indication of the economic impacts on City residents.



	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09
# of parcels	9	12	13	18	98	274	393	851

The management and customer service associated with the collection of the increased number of delinquent special taxes has dramatically impacted limited staff resources. Staff works within the constraints of the legal documents and regulations to assist property owners to avoid reaching foreclosure, which could result in a $100 delinquent payment costing upwards of $5,000. As shown in the table below, staff has been able to collect the majority of the delinquent amount internally before turning the remaining delinquent parcels over to foreclosure counsel to begin the legal proceedings.

- Number of stripped parcels from the County tax roll: 851
- Number of parcels in collection as of 1/31/2010: 279
- Total amount levied for Fiscal Year 2009: $18,556,223
- Delinquent amount as of 6/30/09: $963,102

Amount outstanding as of 1/31/2010: $186,925

Future Debt Programs

Staff is currently working with a number of departments to develop debt financing strategies and plans for needed infrastructure. These include an estimated $40 million enhancement to the Community Convention Center, $174 million in utility infrastructure needs over the next five years, and numerous development related projects including the Railyards, T-9, Delta Shores, the J-K-L corridor, and a new arena. All projects at this time suffer from common problems of insufficient operating cash, sufficient revenue streams to meet debt coverage ratios, and the reliability of projected revenue streams.

Again, this results in full City backing of debt issues. Given all the conditions of the City's financing discussed earlier in the report, the City has neither the capacity nor capability of supporting any new long-term City backed debt for the next few years.
The General Fund cannot be exposed to further risk.

Summary/Conclusion – Debt Program

In August of 2009, the City's overall rating was downgraded by Standard and Poor's (S&P's) and Moody's to 'A+ and Aa2', and the lease credit rating to 'A and Aa3', respectively. The common rationale for the downgrade reflects the agencies' view of the City's current and projected budgetary pressures in the context of the difficult local and statewide economy. The four fundamental reasons for this action include:

1. Problems in the local economy, resulting in reductions of property and sales tax revenue.
2. The potential negative impacts on the City from state budget actions.
3. The extensive use of reserves in recent years resulting in reductions in overall reserve levels.
4. Above average debt burden driven by a large amount of lease debt.

Further stress on the City's financial stability could result in additional downgrades and difficulty accessing the financial markets. In order to maintain stability in the City's debt program, it is recommended that no new long-term City-backed debt obligations be undertaken for the coming few years and that the City work on a comprehensive city-wide approach to regain a solid AA rating for all of our funds. This will ensure our ability to readily access the market and develop a strong position for the City to enter the market in a couple years to address the infrastructure needs mentioned above.

Conclusion

A common theme running through this report on the status of investments, cash flow, and debt is the significant negative consequences of the extensive use of reserves and other one- time financing sources in the annual budget process. The reserves were used for the very purpose for which they were established. As the local economic downturn continues year after year, the one- time financing has merely deferred service and staffing reductions rather than providing a bridge to a more favorable local economic environment.

In the next several years revenues will again begin to grow. At that time the City must consider a balanced application of new revenues. There will be enormous pressure to focus on service (staffing) levels and employee compensation. Yet the City faces enormous unfunded liabilities in benefits programs and with the state of aging infrastructure. Funds should be set aside to address the longer term liabilities

Finally, the way to increase interest income, resolve the cash flow problems, and increase capacity to issue long term debt is to rebuild reserves. There will never be a "good time" to spend less than is taken in, but it must to be done.

This is an era of limits and restraints and the City must act appropriately.