REPORT TO COUNCIL
City of Sacramento

915 I Street, Sacramento, CA 95814-2604
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Staff
December 7, 2010

Honorable Mayor and
Members of the City Council

Title: General Fund Cash, Cash Flow, and Short Term Borrowing

Location/Council District: Citywide

Recommendation: Receive and file –**Notification of need to borrow for General Fund cash flow needs in Fiscal Year 2011/12 and background on cash issues are provided.**

Contact: Russell T. Fehr, City Treasurer, (916) 808-5832

Presenters: Russell T. Fehr, City Treasurer

Departments: Office of the City Treasurer

Division: City Treasurer

Organization No: 05001011

Description/Analysis:

Issue: Since Fiscal Year2008/09 the General Fund has had to borrow for cash flow needs in the first half of the year. This occurs even though the General Fund begins and ends a fiscal year with a positive cash balance. This situation has arisen due to the depletion of operating capital and reserves necessary to carry the General Fund through the revenue "dry periods."

In June 2010, with the approval of short-term cash borrowing – 2011 Tax and Revenue Anticipation Notes (TRANS), the City Treasurer and Director of Finance also sought authorization to utilize inter-fund transfers as authorized by City Charter Section113. This action was necessary to ensure sufficient cash reserves are available to meet the City's financial obligations. It is anticipated that borrowing of internal and external funds will be necessary for fiscal year 2011-12. Both internal borrowing and issuing short term debt will be examined, and the least costly options will be presented to the City Council for approval in May or June, 2011.

Policy Considerations: Due to the financial impacts of the prolonged economic downturn and the use of one-time funds to mitigate the service level and staffing impacts, the cash balances of the General Fund have been significantly depleted. The General Fund now has to borrow for cash flow needs. The possibility of running a negative cash balance was contemplated with Section 113 of the City Charter, which permits internal borrowing such as that approved and implemented for fiscal years 2009 and 2010. With prolonged financial pressures, staff anticipates the need for cash flow borrowings during the revenue "dry periods" will be needed in the foreseeable future.

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.

Sustainability Considerations: None

Commission/Committee Action: None.

Rationale for Recommendation: Due to the differences in timing in General Fund expenditures and revenues, there is a cash flow gap of approximately $90 million in the first half of the fiscal year. This gap is made up with the allocation of property taxes in the second half of the year. The use of reserves and other one-time funding sources in the budgetary process has resulted in insufficient cash to bridge the cash flow gap. Short term cash flow loans to the General Fund are now required. These loans may come from internal sources of discretionary cash or from issuing short term debt. The City has utilized both approaches in the year and preceding two years.

Financial Considerations: If cash balances are further depleted, then the annual borrowing for the General Fund cash flow needs will increase. This will increase risk and cost. If the City ends in a position where borrowing on the financial markets is required, then there is a significant increase in risk. The cash position of the General Fund must be an important consideration in the development of future annual budgets. It is critical to maintain the cash position of the General Fund through first minimizing and then eliminating the use of one-time resources.

Emerging Small Business Development (ESBD): Not Applicable

Respectfully Submitted by:

APPROVED AS TO FORM:

Russell T. Fehr, City Treasurer

Lawrence J. Duran
CITY ATTORNEY

Table of Contents:

Attachments

1 Background - pg. 3

General Fund Cash, Cash Flow, and Short Term Borrowing December 7, 2010

Background

Back to Table of Contents

Summary

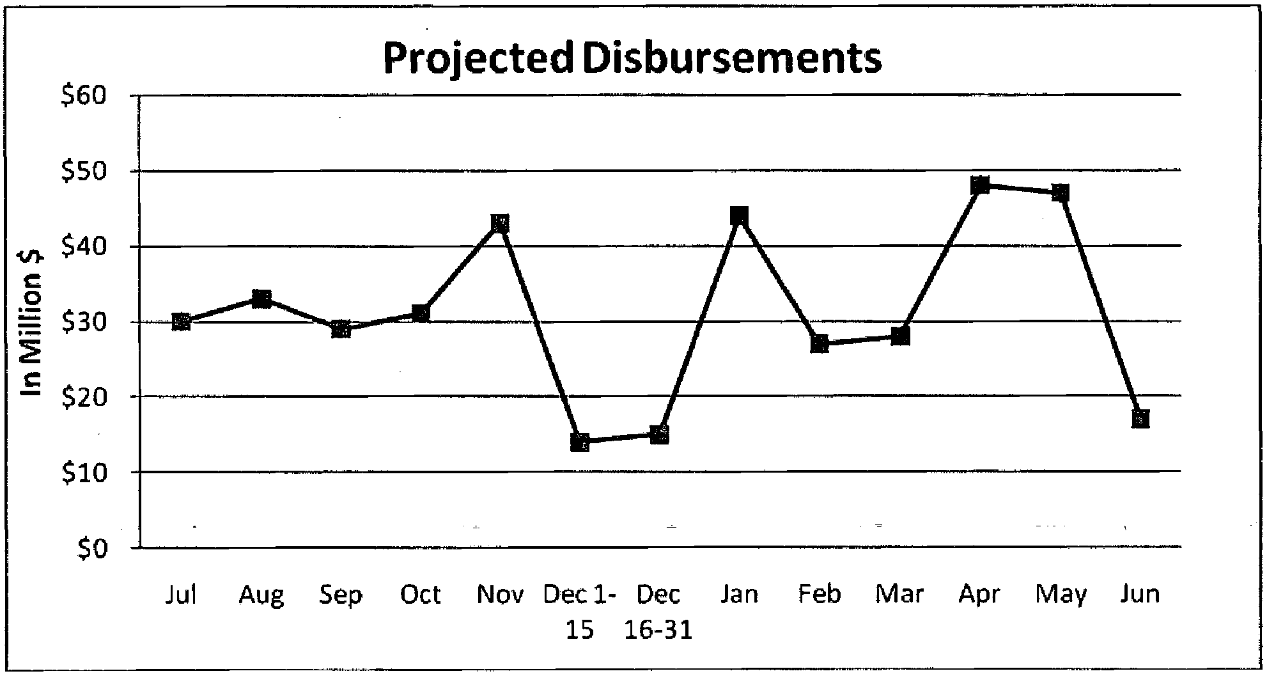
Over the past five years the cumulative depletion of General Fund cash and fund balance has been approximately $100 million. Where there once was sufficient General Fund cash to cover the cash flow gap in the first half of the fiscal year, this is no longer the case. The General Fund has to borrow in the first half of a fiscal year to have sufficient cash available to meet the payroll and other obligations. Notice is being provided of the need and intent to borrow for cash flow purposes in the coming Fiscal Year 2011/12. This background describes the General Fund cash flow challenge, potential future risks to financial solvency, and some general recommendations to maintain internal cash balances.

- To maintain fiscal solvency, the City must have sufficient cash in the bank at the time expenditures are made.
- There is a significant annual cash flow gap in the General Fund due to the relative timing of expenditures and revenue collections.
- In the General Fund, expenditures are fairly even on a monthly basis. Revenues, however, are concentrated in the second half of the year due to the pattern of property tax collection and allocation.
- In terms of the current fiscal year, the cash flow gap in the first half of the year is approximately $90 million.
- If the cash balance (reserves and fund balance) of the General Fund is less than $90 million at the start of the year, then the General Fund must borrow cash in the municipal debt markets to meet obligations.
- The beginning cash balance of the General Fund has been insufficient to cover the cash flow gap in Fiscal Years 2008/09, 2009/10, and 2010/11. In the first two years the cash flow gap was covered with internal borrowing, and for the current year the City issued $40 million in cash flow notes. Going forward, we expect a similar and growing cash flow gap in Fiscal Year 2011/12.
- So long as the City has sufficient discretionary cash resources to cover the annual cash flow gap in the General Fund, the City faces no liquidity risk.
- The City would no longer have certain control of financial solvency if internal discretionary cash resources are not sufficient to cover the cash flow gap in the General Fund. The City would be dependent on borrowing from financial markets with no absolute guarantee of success or cost.
- To avoid this risk, sustainable General Fund budgets must be put into place. The use of one-time resources must first be minimized and then eliminated.

Cash Flow

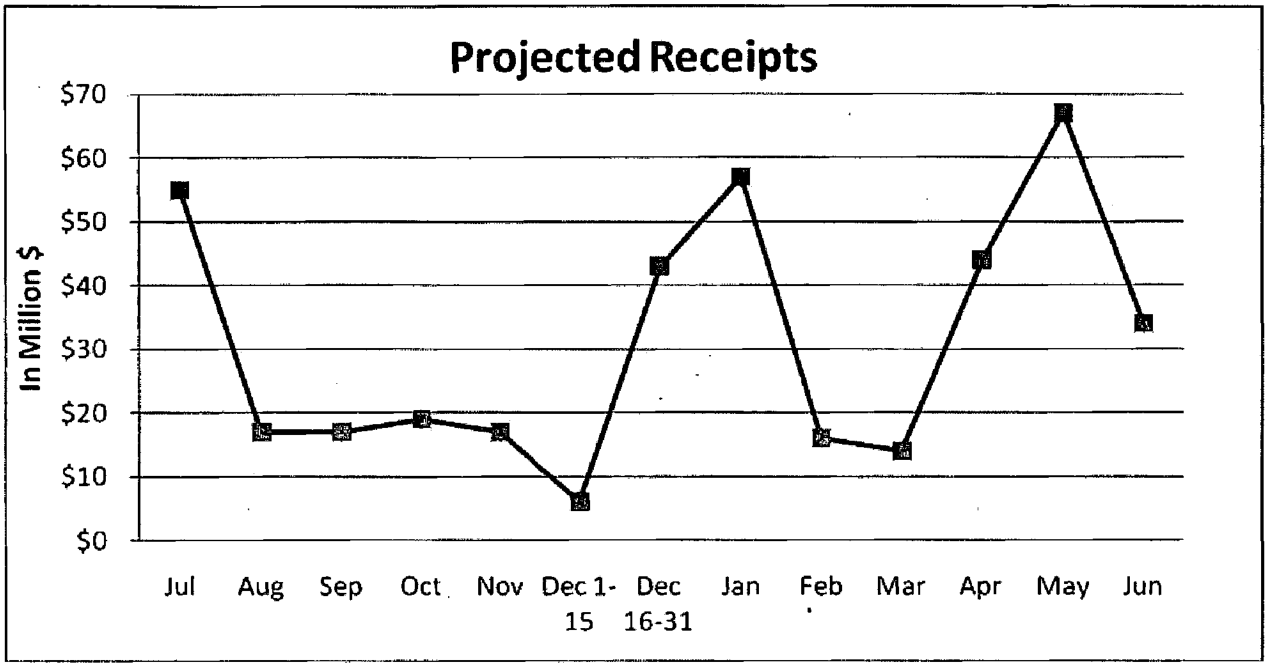
Cash refers to real money the City holds in bank accounts and the various investments making up Treasury Pool A. Cash flow refers to the timing of expenditures and the receipt of revenue. Whereas budgets are presented and managed on an annual basis, there is a strong and necessary timing element to cash management. In cash flow management, matching actual expenditures and the receipt of revenues is critical to investing surplus cash and generating income. Cash flow is tightly managed in order to maximize interest earnings. Cash earns virtually no interest income sitting in the bank not invested.

The General Fund is now facing an annual cash flow challenge due to differences in the timing of expenditures and the revenue collection. The following graph illustrations monthly expenditures taken from the cash flow model used for the FY 2011 cash flow notes.



On a monthly basis, expenditures are fairly even in most months of the fiscal year. Peak monthly expenditures come when debt service payments are made and in the two months where three, rather than two, payrolls are met.

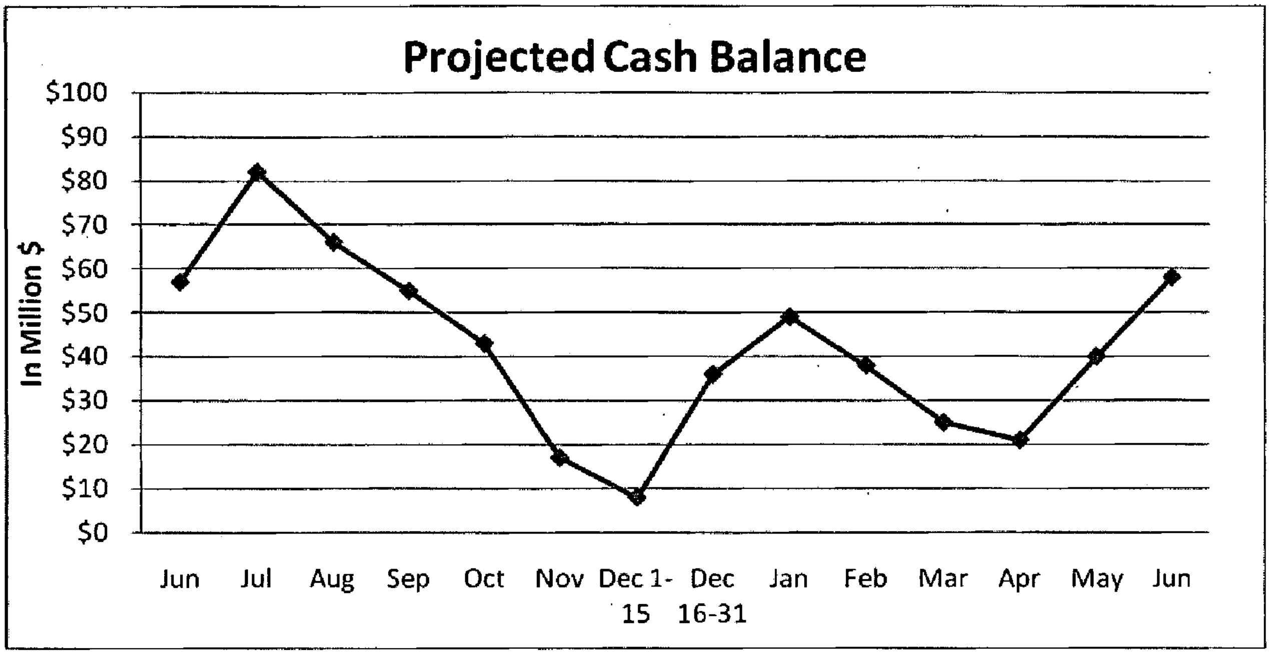
The timing of revenue collection is displayed in the following graph:



Cash collections are low in the first half of the fiscal year. The spike in July is due to the receipt of the $40 million borrowed with the cash flow notes. The concentration of cash collections in the second half of the fiscal year is due to the timing of property tax collection and distribution. Property taxes are the largest source of General Fund revenue, and virtually all property tax revenue is received in the second half of the fiscal year, after December 20th. Even with a balanced budget where revenues covered expenditures, much more would be spent than collected in the first half of the year.

General Fund Cash Flow Challenge

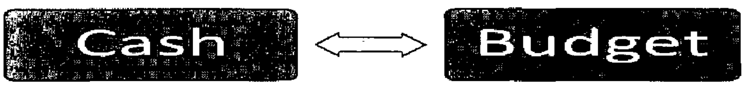
The combination of monthly cash in and cash out is a significant cash flow challenge for the General Fund in the first half of the fiscal year:



In the cash flow model for the current year, Fiscal Year 2011, expenditures (cash out) exceeded financing sources (cash in) by approximately **$90 million** before the first property tax allocation in late December. This cash flow gap was covered with an initial balance of $57 million and a cash flow note issue of $40 million. If there is not $90 million in cash made available to the General Fund in the first half of a fiscal year, then the City will not be able to meet its obligations.

Emergence of Cash Flow Gap

The cash flow gap has opened in recent years due to extensive use of one-time resources in annual budgets and in actual results. The cash position of the General Fund is rooted in the annual budget and the actual results of the budgetary plan:



The ongoing economic downturn has had devastating impacts of City services, City employees, and City revenues. In order to minimize the impacts on service levels and staffing levels extensive use of one-time resources has been included in annual budgets. The length and depth of the economic downturn was not anticipated at its beginning. Actual revenues have come in below estimates in many cases. The planned and actual use of one-time resources results in more cash going out than comes in. This depletes the overall cash holdings of the General Fund.

The following table illustrates the annual change in fund balance for the General Fund since Fiscal Year 2004/05. This roughly corresponds to annual changes in cash position.

Annual Change in Fund Balance
Fiscal Year 2004/05 to 2009/10

Fiscal Year	Change in Fund Balance (in millions)
2004/05	$15.5
2005/06	($5.2)
2006/07	($17.3)
2007/08	($32.5)
2008/09	($26.9)
2009/10	*($17.0)

* Estimated, unaudited

Over the past five years the cumulative depletion of fund balance has been approximately $100 million. This is equivalent to the depletion in General Fund cash. Where there once was sufficient General Fund cash to cover the cash flow gap in the first half of the fiscal year, this is no longer the case.

Discretionary Internal Cash Resources

Loans to the General Fund for cash flow purposes may be made from some, but not all city funds. Loans could come from the Risk Funds, the Parking Fund, the Convention Center Fund, and Utility Funds. Any loans would be fully repaid with interest at the Treasury Pool rate so that there is no negative impact on the lending funds. At the start of the current year, approximately $120 million discretionary cash was available, but the use of some of that cash was anticipated in the various fund budgets. We anticipate the year to year balance to decline.

Loans may not be made from assessment district funds, community facility funds, bond funds, restricted state and federal funds, and other restricted funds.

Solvency Risk

If the City's discretionary cash holdings fall below the needs of the General Fund in the first half of a fiscal year, then the City will assume an appalling new risk level. If the City cannot borrow from internal sources for cash flow needs, then the City will be absolutely dependent on short-term borrowing on the financial markets. The City will lose control of its financial destiny. There is no guarantee of success in borrowing in the future. Even with a balanced budget, the City could run out of cash before property taxes are allocated in late December.

The City was very successful in issuing cash flow notes for the current year, Fiscal Year 2010/11, with the cost for the loan less than an internal loan. But a primary reason for this success is that the City did not have to borrow; the City had, rather, a choice between borrowing internally or issuing the cash flow notes. The presence of internal cash holdings was cited in the top scale credit ratings for the issues.

Restoring Cash Holdings

The only way to restore the cash position of the General Fund is to actually spend less than is taken in on an annual basis. Given the enormous pressure on the budget and significant known future budget problems, it may not be possible to make contributions to reserves in the next several years.

Maintaining Cash Position

The real cash flow threat is not based on the current status and situation; rather, continued use of one-time resources in the budget and not reacting to any negative actual results compared to the budget plan will escalate the cash flow problem.

Conclusion and Recommendations

There remains some limited capacity to use one-time resources in the coming budget. However, it is critical that such use of one-time financings be minimized, and then eliminated. Future spending plans must be support by on-going revenues.

It is not the role of the Office of the City Treasurer to make specific budget recommendations. Yet the cash position of the General Fund must now become an important consideration in the future development of annual budgets. General comments include:

- The use of one-time financing sources must be minimized in the short term and then eliminated;

- Given there are known fixed cost increases coming in future years, no new expenditure obligations should be made until after actual revenue growth can support those new obligations. Commitments should not be made on the basis of projected revenue growth. Multi-year obligations are particularly risky in this context.
- In the current economic environment, and that forecast for the Sacramento Region and the State of California, it will be several years before there is robust revenue growth.

The City of Sacramento is, as are many other cities, states, and counties, in a very difficult financial situation. Actions that worsen that situation and increase financial risks should be avoided whenever possible.