



MID-YEAR BUDGET REPORT

Staff Report

February 11, 2004

TO: City Council

FROM: Paul Navazio, Finance Director

SUBJECT: Presentation of Comprehensive Annual Financial Report for Fiscal Year (FY2002/2003) Ended June 30, 2003 and FY2003/2004 Mid-Year Budget Update.

Recommendation

This Informational Item serves to transmit to the City Council:

1. The Comprehensive Annual Financial Report (CAFR) (FY2002/2003) ended June 30, 2003, and
2. The Mid-Year (FY2003/2004) Budget Update.

Fiscal Impact

None from this item.

Summary

This report summarizes the FY2002/2003 year-end results of General Fund operations as published in the Comprehensive Annual Financial Report (CAFR), presents revenue and expenditure results through the first six months of FY2003/2004, and reviews preliminary projections which underlie the development of the upcoming FY2004/2005 budget.

Highlights of the report include:

- For FY2002/2003, the General Fund experienced an operating surplus of \$ 756,154 resulting in an increase in the Unreserved Fund Balance from \$7.14 million at the beginning of the fiscal year to \$7.89 million as of June 30, 2002. This result is in contrast to the expected draw down of \$2.37 million assumed in the FY2002/2003 budget. The year-end Unreserved Fund Balance represents 28% of General Fund revenues.
 - General Fund revenues were \$28.38 million or \$712,000 above the ending budget estimate of \$27.67 million. The favorable results are primarily attributable to better-than-expected fee revenues in Planning & Building Inspections, Park Services, and Construction Permits.

- General Fund Expenditures ended the year at \$26.96 million or \$ 2.4 million under the ending budget of \$29.38 million. The bulk of the savings result from personnel costs being well under budget and reflect savings from positions held vacant as a result of the City's selective hiring freeze, as well as additional steps taken to control General Fund expenditures.
- General Fund revenues through the first six months of 2003/2004 were \$14.27 million, or 46.2% of budgeted revenues. Year-to-date results suggest a potential shortfall of an estimated \$ \$1.9 million for the year caused primarily by a reduction in estimate of Sales Tax revenues (\$434,000) and the impact of the loss of the State's backfill of Vehicle License Fee revenues (\$1.3 million) from July through October of this fiscal year.
- Through mid-year, General Fund expenditures (including encumbrances) were \$21.10 million, or 63% of the adjusted budget, and are projected to end the year well within budget due, again, primarily to salary savings from vacant positions and deferral of discretionary non-personnel expenditures.
- The preliminary forecast for next fiscal year, as presented last fall to the City Council, shows a structural General Fund deficit of \$2.6 million for FY2004/2005, growing by approximately \$500,000 per year, thereafter. Staff is in the process of reviewing and updating the Budget Forecast and will provide the City Council with a full update next month. Based on the revised forecast, including factoring in the results of the ballot measure (Measure P) to establish a new ½ cent sales tax, Council direction will be sought to inform development of the City Manager's Proposed FY2004/2005 Budget.
- The City's outlook continues to be clouded by the uncertainty surrounding general economic conditions as well as potential impacts from the ongoing State budget crisis. While the Governor's Proposed Budget includes a shift of \$1.3 billion in local property tax revenues from cities and counties to the State – a proposal that would reduce the City's Property Tax revenues by \$524,000 – additional take-aways are likely to be included in the final State Budget.

The City Council will receive the annual CAFR with this report and members of the community may review copies at the following locations:

- City of Davis
 - City Clerk's Office.
 - Finance Department Front Counter
- Yolo County – Davis Branch Library
- UC Davis - Shields Library

Summary of General Fund Operations

Table 1 below presents a summary of the City’s General Fund fiscal condition. Included are beginning budget, ending budget, and actual results for FY2002/2003, as well as beginning budget and projections from FY2003/2004.

Table 1: General Fund Summary - 2002/2003 (CAFR p.27) and 2003/2004 Projection

Description	2002/2003 Beginning Budget	2002/2003 Ending Budget	2002/2003 Actual Results	2003/2004 Beginning Budget	2003/2004 Projection
Beginning Unreserved Fund Balance (6/30/02)*	\$6,513,168	\$7,138,576	\$7,138,576	\$7,894,730	\$7,894,730
Revenues	27,032,013	27,669,029	28,380,949	30,824,293	29,171,059
Expenditures	(28,646,647)	(29,375,900)	(26,958,120)	(32,786,120)	(32,045,679)
Transfers	0	0	0	0	0
Change in Reserved Fund Balance **	(370,000)	(370,000)	(666,675)	0	0
Ending Unreserved Fund Balance (6/30/03)	\$4,528,534	\$5,061,705	\$7,894,730	\$5,932,903	\$5,020,110
Percentage (E.U.F.B./Revenues)	16.8%	18.3%	27.8%	19.2%	17.2%
* Fund Balance numbers are net of \$1,035,000 PERS Reserve					
** This line item is included to link the Audited Financial Statements with Budget Estimates and also includes changes in encumbrance balances.					

While the adopted budget projected a decrease in the General Fund’s Unreserved Fund Balance (to \$4.72 million, or 19% General Fund revenues), actual results saw an increase in the fund balance of \$741,000 to \$7.14 million, or 27% of General Fund reserves. This result compares favorably to the Council’s General Fund reserve policy 15%, and suggests that the City Council may have added flexibility with which to address the City’s structural budget deficit and/or address unfunded one-time needs.

Based on a review of mid-year FY2003/2004 results, the General Fund unreserved Fund Balance is expected to fall to \$4.92 million, or 15.9% of General Fund revenues. This projection is due primarily to the anticipated draw-down of fund balance built into the FY2003/2004 budget as well as the loss on one-time State Vehicle License Fee backfill revenues.

General Fund Revenues

Table 2 presents a summary of major General Fund revenue sources. FY2002/2003 revenues were \$28,280,949, which is \$711,920 above the revenue budget and represents an overall increase of 9.2% over FY2001/2002 results.

Revenue by Source	2002/2003 Final Budget	2002/2003 Actual	Variance Favorable / (Unfavorable)	Variance Percentage	2003/2004 Final Budget	2003/2004 Year to Date	2003/2004 Estimate	Variance Favorable / (Unfavorable)
Property Taxes	\$6,744,200	\$6,554,110	(190,090)	-2.8%	\$7,054,600	\$3,684,122	\$7,104,700	50,100
Sales & Use Tax	5,560,000	5,501,492	(58,508)	-1.1%	6,100,000	2,361,595	5,666,000	(434,000)
Motor Vehicle In Lieu	3,570,000	3,578,071	8,071	0.2%	3,830,000	1,025,554	2,509,666	(1,320,334)
Parks Services	1,838,954	2,127,670	288,716	15.7%	1,787,300	1,396,376	1,787,300	0
Municipal Services Tax	1,780,000	1,772,132	(7,868)	-0.4%	1,830,000	1,379,416	1,854,000	24,000
Business License Tax	977,000	1,043,991	66,991	6.9%	1,130,000	910,133	1,183,000	53,000
Construction Permits	833,518	1,020,962	187,444	22.5%	1,137,000	502,275	1,137,000	0
Transient Occupancy Tax	884,200	908,964	24,764	2.8%	998,000	502,945	972,000	(26,000)
Planning & Building Inspec	1,652,803	2,066,017	413,214	25.0%	1,206,647	1,057,917	1,206,647	0
Fire Dept. Services	564,510	628,288	63,778	11.3%	585,726	106,592	585,726	0
Franchise Fees (PG&E)	470,500	435,543	(34,957)	-7.4%	430,000	0	430,000	0
Investment Earnings	135,000	159,886	24,886	18.4%	65,893	0	65,893	0
Property Transfer Tax	197,400	239,465	42,065	21.3%	250,000	126,602	250,000	0
All Other Sources	2,460,944	2,344,357	(116,587)	-4.7%	4,419,127	1,216,971	4,419,127	0
Total	\$27,669,029	\$28,380,948	\$711,919	2.6%	\$30,824,293	14,270,498	\$29,171,059	(1,653,234)

Most of the City's major General Fund revenue sources saw moderate growth in FY2002/2003. Tax revenues showed across-the-board growth in Property taxes (3.8%), Sales and Use Tax (5.2%), Business License Tax (4.7%) and Property Transfer tax (22%). In addition, results in Motor Vehicle In Lieu (5.2%) and Transient Occupancy Taxes (3.0%) contribute to signs of an economic recovery. Other revenue sources, particularly fee-supported revenues also contributed to improved revenues. Specifically, Planning and Building Inspection Fees grew to \$2.07 million, for an increase of 134% over prior year. In addition, Parks and Fire Department fees grew by 17% and 8%, respectively.

While overall revenue growth is expected to continue, current year revenues are projected to fall \$1.7 million below the budgeted levels for FY2003/2004. The major shortfalls are expected to result from the loss of \$1.15 million in State Vehicle License Fee revenues and a reduction of \$434,000 in the City's estimate of current-year Sales Tax receipts. Sales tax has been difficult to predict as receipts are highly sensitive to general economic conditions as well as to changes in the retail tax base. This revenue source, as well as development-based revenues will need to be analyzed in detail as part of the pending update to the Budget Forecast Model.

General Fund Expenditures

Table 3 summarizes General Fund expenditure results for all departments. FY2002/2003 expenditures ended the year at \$26,958,120, or \$2.4 million under the approved budget of \$29,375,900. This result represents an increase of 12% over FY2001/2002 expenditures.

Table 3: General Fund Expenditures - 2002/2003 Budget to Actual Comparison (CAFR p.27)

Expenditure by Department	2001/2002 Actual	2002/2003 Final Budget	2002/2003 Actual	Difference Favorable / (Unfavorable)	2002/2003 Budget vs Actual
City Council	\$107,673	\$109,329	\$114,662	5,333	104.9%
City Attorney	220,873	266,108	247,803	(18,305)	93.1%
City Manager	951,670	989,960	970,414	(19,546)	98.0%
Administrative Services	1,527,542	1,732,991	1,509,673	(223,318)	87.1%
Planning & Building	2,219,566	3,162,917	2,626,386	(536,531)	83.0%
Parks & Community Services	6,963,038	9,031,183	7,985,894	(1,045,289)	88.4%
Public Safety - Fire	4,420,458	4,980,436	4,813,682	(166,754)	96.7%
Public Safety - Police	7,145,454	8,035,415	7,831,812	(203,603)	97.5%
Public Works	517,695	666,369	753,059	86,690	113.0%
Capital Improvements	700	401,192	104,735	(296,457)	26.1%
Total	\$24,074,669	\$29,375,900	\$26,958,120	(2,417,780)	91.8%

The Parks and Community Services Department turned in the largest savings of \$1,045,289 primarily due to construction delays and operations savings in Parks and Open Space Management. Other departments contributing to expenditure savings include Planning and Building (\$536,531), Administrative Services (\$223,318), Police (\$203,603), Fire (\$166,754).

In general, the below-budget expenditures reflect significant savings in personnel costs attributable to a growing number of vacancies resulting from the continuation of the City's selective hiring freeze (currently 34 positions) and deferral of discretionary non-personnel expenses.

Expenditures through the first six months of FY2003/2004 suggest the potential for significant savings in the current year as well. Salary savings alone are conservatively expected to amount to \$750,000, or 3% of total General Fund expenditures. Staff is in the process of updating current year and FY2004/2005 budget-year expenditure projections in conjunction with the update to the Budget Forecast Model and the development of the baseline expenditure budget for FY2004/2005.

Preliminary FY2005 Budget Projections

Staff is in the process of developing the preliminary baseline budget for FY2004/2005, including a comprehensive update of the City’s Budget Forecast Model. This model, last presented to the City Council in October, 2003 provides the overall context for development of the annual budget within a multi-year planning framework.

The current Budget Forecast Model continues to reflect a structural General Fund deficit resulting from annual operating expenditures in excess of annual revenues. This is compounded in the out-years of the forecast by annual expenditure growth outpacing revenue growth. Overall, General Fund expenditures over the six-year planning timeframe have been projected to grow at an average rate of 4%-5% per year, while revenues are projected to grow at a rate of 3%-4% per year. This “growth gap” translates into an increase in the annual structural deficit of approximately \$500,000 per year.

The major contributor to the growth in General Fund expenditures is personnel salaries and benefits (including retirement, health and workers’ compensation costs). Salaries are governed by negotiated memorandum of understanding with the City’s bargaining units, and may vary to the extent that certain contracts will be subject to negotiation for FY2004/2005.

One of the largest cost increases for next year will again be for CalPERS retirement benefits. Due to the prolonged economic slump, the CalPERS system has sustained three years of heavy investment losses that will lead to significant increases in employer costs in the coming years.

Table 4 below reviews the projected rates for each of the City’s retirement plans for the next few years. These rates result in an increase of approximately \$1.0 million in (all funds) retirement costs for FY2004/2005. Retirement plan rates are expected to continue to increase over the next forecast period and will have a significant impact on the budget forecast model and future budgets.

Table 4: Estimated Projection of PERS Rates

Formula	03/04	04/05	05/06	06/07	07/08
Misc. 2% @55	0.0%	9.8%	11.1%	12.2%	12.8%
Fire 3% @ 50	15.3%	24.7%	30.3%	31.7%	32.4%
Police 3% @50	6.4%	16.3%	22.0%	34.1%	34.8%

Health Insurance costs are also expected to continue to increase over the next several years, compounding the budgetary impact of the 41% in rates over the past two years. The City contracts for medical insurance coverage through the CalPERS Health Benefits Program and is seeing major changes in the number and types of plans that are available. Citywide costs for health insurance will be approximately \$4.0 million for the 2004 calendar year.

State Budget Uncertainties

The City's long-term fiscal outlook is also threatened by the uncertainty surrounding the State's budget crisis. Over the past 18 months, the State has proposed and/or implemented plans that result in loss of local revenues to cities and counties. While this year's loss of Vehicle License Fee backfill (\$1.14 million) was couched as a one-time revenue loss, additional take-aways are proposed for FY2004/2005. Specifically, the Governor's Proposed Budget includes a plan to shift \$1.3 billion in property tax revenues from cities and counties to the State. If approved by the Legislature, this proposal would result in a loss of \$524,000 in annual, recurring revenues to the City and an additional loss of \$114,000 to the Davis Redevelopment Agency. In addition, the Proposed State Budget includes a loss of Booking Fee (\$68,000) and Traffic Congestion Relief Funds (\$140,000) to the City.

The Governor's current proposals may not represent the full extent of impacts to the City. This year's State budget was balanced based on the assumption that California voters approved a \$15 billion deficit reduction bond placed on the March ballot. Should this measure fail, the State will need to take steps to re-balance the current year budget, and may need to resort to mid-year budget reductions, including the possibility of further take-aways from local government.

Looking forward to FY2004/2005, the budget proposed by the Governor does not fully address the State's structural budget deficit. According to the Legislative Analyst's Office, the Governor's budget, if approved by the Legislature, would leave the State with a \$6 billion deficit for FY2005/2006. In addition, as the Governor's budget attempts to address this year's budget gap almost entirely through cuts in health, transportation and social services programs. As such, the Legislature is expected to attempt to restore many of the proposed program reductions through either revenue enhancements (tax increases), or, deeper cuts to other areas of the State budget – including possible additional cuts to local government.

While it is impossible to predict what will be included in the final State budget, it is clear that the City will need to develop contingency plans for a number of scenarios that could negatively impact the City's budget. It should also be recognized that the final State budget is not likely to be adopted prior to the City Council's need to adopt the City budget, ensuring that a fair degree of uncertainty will continue into next fiscal year, and beyond.



PERS RESERVE POLICY

Staff Report

TO: City Council
FROM: Karen Wilcox, Accounting Manager
VIA: Karl Mohr, Finance Director
SUBJECT: PERS Reserve Policy

Recommendation

Adopt the proposed PERS reserve policy.

Fiscal Impact

The proposed policy will enable the City to cushion expected future impacts from increases in PERS funding obligations.

Background and Analysis

As Council is aware, the City participates in the Public Employees Retirement System (PERS) to provide retirement benefits for City employees. Contributions to PERS are based on varying percentages of payroll costs, and such costs are broken into two components, split between the City and individual employees. As a result of past of employee negotiations, the City pays both its share and employees' share of PERS costs.

For the past two years, there has been no requirement for the City's share of PERS costs. The employee contribution requirement remains, for which the City budgets annually to pay on behalf of its employees. No City matching contributions are currently required because the actuarial analysis conducted by PERS indicates that there are sufficient reserves for future needs, largely resulting from higher than anticipated investment returns achieved by PERS during recent extraordinary stock market gains.

During this time, the City has budgeted for its matching contribution and then let the unexpended budget fall to fund balance at the end of the year. We did not want to reduce these costs, have Departments use such savings to supplement program budget, and then have to face substantial budget cuts when – not if – City PERS contribution requirements return. Under this approach, unexpended PERS costs simply fall back to fund balance at the end of the fiscal year.

Under the new budget philosophy of enabling Departments more control over managing their budgets, we want budgets to more accurately reflect real expected costs. Thus, the 2000/2001 Departmental budgets will not include the City PERS cost. However, we still believe that we should set aside a reserve fund to cushion the impact of future increases in PERS costs.

Although it is not clear when it will occur, once the City's matching contribution is again required, it may create a potentially significant increase in departmental operating budgets. To cushion that increase, we propose to set aside an amount equal to two years of City contributions. When the contribution is again required, we can then apportion out the reserve to Department budgets to offset resulting cost increases.

Proposed Policy

Currently, the annual potential liability for City matching funds is about \$700,000. The City shall set aside \$525,000 for the next 3 years in order to reach the cumulative total of \$1,575,000. Thereafter, each year the City will calculate the amount of the current year's potential liability and set aside the difference between twice that amount and the amount already held in reserve.





INVESTMENT POLICY

Memorandum

May 20, 2003

TO: City Council
FROM: Robert Sousa, Finance Director
SUBJECT: Investment Policy

Recommendation

Approve the following investment policy.

Fiscal Impact

This policy will guide the investment of all City financial resources.

Background and Analysis

The following investment policy has been drafted based on model investment policies developed by the Government Finance Officers Association (GFOA), a national organization of local agency finance officials. In addition, the policy has been reviewed and critiqued by the City's independent auditors, Maze & Associates. We appreciate the valuable input of our auditors and professional organizations in the development of this important policy. This policy is adopted concurrently with approval of the 2003/2004 City of Davis budget.

1. Purpose

The purpose of the investment management policy is to establish strategies, practices, and procedures to be used in administering the City of Davis portfolio. The goal is to establish guidelines to manage City funds to maximize security and liquidity while also complying with this investment policy and California Government Code Sections 53600 through 53659, which governs investments for municipal governments.

2. Investment Objectives

The City's primary investment objective is to achieve a reasonable rate of return on public funds while minimizing the potential for capital losses arising from market changes or issuer default. Although pursuit of interest earnings on investment is an appropriate City goal, the primary consideration is preservation of capital resources. Thus, the City's yield objective is to achieve a

reasonable rate of return rather than the maximum generation of income that might expose the City to unacceptable levels of risk.

In determining individual investment placements, the following factors shall be considered in priority order: safety, liquidity, yield.

A. Safety

Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective is to mitigate credit risk and interest rate risk as summarized below.

Credit Risk – This is the risk of loss due to the failure of the security issuer or backer. Credit risk may be mitigated by:

- Limiting investment to the safest types of securities;
- Pre-qualifying the financial institutions, brokers/dealers, intermediaries, and advisers with which the City will do business;
- Diversifying the investment portfolio so that potential losses on individual securities will be minimized.

Interest Rate Risk – This is the risk that the market value of securities in the portfolio will fall due to changes in the general interest rates. Interest rate risk may be mitigated by:

- Structuring the investment portfolio such that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity;
- Investing operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools.

B. Liquidity

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with the cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity). A portion of the portfolio also may be placed in money market mutual funds or local government investment pools which offer same-day liquidity for short-term funds.

C. Yield

The investment portfolio shall be designed with the objective of attaining a market rate of return throughout the budgetary and economic cycles, taking into account the investment risk of constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The core of investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the

risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:

- A declining credit security which could be sold early to minimize loss of principal;
- A security swap which would improve the quality, yield, or target duration of the portfolio;
- Liquidity needs of the portfolio that require the security be sold;
- A capital gain that would be realized to better position the overall portfolio to achieve investment policy goals.

3. Standards Of Care

A. Prudence. The City shall operate its pooled idle cash investments under the “Prudent Person Rule” which obligates a fiduciary to ensure that investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation but for investment considering the probable safety of their capital as well as the probable income to be derived.

Investment officers acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security’s credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and the liquidity and the sale of securities are carried out in accordance with the terms of this policy.

Investment officials shall recognize that the investment portfolio is subject to public review and evaluation. The overall program shall be designed and managed with a degree of professionalism worthy of the public trust.

B. Government Code. Government Code Sections 16481.2 , 53601, 53635, and 53646 of the State of California regulate the investment policies of jurisdictions within the State. The City of Davis will adhere to these provisions in developing and implementing the City’s investment policies and practices.

C. Ethics And Conflict Of Interest. Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or could impair their ability to make impartial investment decisions. City employees involved in the investment process shall disclose to the City Manager any material financial interest in financial institutions that conduct business within the jurisdiction. They shall further disclose any large personal financial/investment positions that could be related to the performance of the investment portfolio. Officers shall refrain from undertaking any large personal investment transactions with the same individual with whom business is conducted on behalf of the City.

D. Delegation Of Authority. Authority to manage the investment program is granted to the City Treasurer. Under the oversight of the City Treasurer, responsibility of the operation of the investment program may be delegated to the Accounting Manager or other staff who shall act in accordance with established written procedures and internal controls consistent with the investment policy.

E. Internal Control. The City Treasurer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgements by management.

Accordingly, the investment officer shall establish a process for an annual independent review by an external auditor to assure compliance with policies and procedures. The internal controls shall address the following points:

- Control of collusion
- Separation of transaction authority from accounting and record keeping
- Custodial safekeeping
- Avoidance of physical delivery securities
- Clear delegation of authority to subordinate staff members
- Written confirmation of transactions for investments and wire transfers
- Development of a wire transfer agreement with the lead bank and third-party custodian.

4. Scope

This investment policy shall apply to all financial assets of the City of Davis as accounted for in the Comprehensive Annual Financial Report, including, but not limited to:

- General Fund
- Special Revenue Funds
- Capital Projects Funds
- Debt Service Funds
- Enterprise Funds
- Internal Service Funds
- Trust and Agency Funds
- Redevelopment Funds
- Public Financing Authority Funds
- Any new fund created by the City Council unless specifically exempted with the exception of the following:
 - The City's Deferred Compensation Plan which is controlled by federal law, specific provisions of the City's adopted Plan, and individual employee decisions.

- The City Employee Retirement Plan which is subject to regulation by federal and state laws.

Any funds held by third-party trustees subject to prior written consent and approval by the City Treasurer and City Manager. Should these funds be exempted from this policy the trustee is still subject to regulations established by the State of California pertaining to the investments by local agencies as well as the related bond indentures.

5. Safekeeping And Custody

A. Selection Of Eligible Financial Institutions

All financial institutions and broker/dealers who desire to become qualified for investment transactions must supply the following as appropriate:

- Audited financial statement (annually);
- Proof of National Association of Securities Dealers (NASD) certification;
- Proof of state registration;
- Completed broker/dealer questionnaire;
- Certification of having read and understood and agreeing to comply with the City's investment policy.

These documents shall be provided annually as appropriate. In selecting financial institutions for deposit or investment of funds, the authorized Investment Officers shall consider the credit-worthiness of the institution.

B. Broker/Dealers

Investments must be purchased directly from the issuer, from an institution licensed by the State as a broker/dealer, from a member of a federally regulated securities exchange, or from a brokerage firm designed as a primary government dealer by the Federal Reserve Bank. Broker/dealers shall be selected by creditworthiness (e.g. a minimum capital requirement of \$10,000,000 and at least five years of operation).

The City Treasurer will maintain a file of broker/dealers with which the City is currently doing business which will include (at minimum) the firm name, contact person, telephone number, fax number, e-mail address, and annual audited financial statements.

C. Delivery vs. Payment

All trades where applicable will be executed by delivery vs. payment to ensure that securities are deposited prior to the release of funds. To protect against potential losses by collapse of individual securities dealers, all securities owned by the City shall be held in safekeeping by a third party bank trust department acting as agent for the City under terms of a custody agreement executed between the bank and the City.

D. Collateralization

Collateral is required for investments in non-negotiable certificates of deposit and repurchase agreements. In order to reduce market risk, the collateral level shall be at least 102% of market value of principal and interest and marked to market weekly. Securities acceptable as collateral shall be the direct obligations of, or are fully guaranteed as to principal and interest, by the United States or any agency of the United States.

6. Authorized Investments

Investment of City funds is governed by the California Government Code Sections 53600 et seq. Within the context of such limitations, the following investments are authorized:

United States Treasury Bills, Bonds, and Notes or those for which the full faith and credit of the United States are pledged for payment of principal and interest. There is no percentage limitation of the portfolio which can be invested in this category.

Federal Agency Obligations – Obligations issued by the Federal Government agencies such as Government National Mortgage Association (GNMA), the Federal Farm Credit Bank (FFCB), the Federal Home Loan Bank (FHLB), the Federal National Mortgage Association (FNMA), the Student Loan Marketing Association (SLMA), and the Federal Home Loan Mortgage Corporation (FHLMC). There is no percentage limitation of the portfolio which can be invested in this category.

Banker's Acceptances – These are bills of exchange or time drafts drawn on and accepted by commercial banks. Purchase of banker's acceptances may not exceed 270 days maturity and 40% of the cost value of the portfolio. Furthermore, no more than \$5 million or 10% of the cost value of the portfolio, whichever is less, may be invested in the banker's acceptances of any one commercial bank.

Commercial Paper – Commercial paper must be rated P1 by Moody's Investor's Service and A1 by Standard and Poors, issued by domestic corporations having assets in excess of \$500,000,000 and having a AA or better rating on its long term debentures as provided by Moody's and Standard and Poors. Purchases of eligible commercial paper may not exceed 180 days maturity nor represent more than 10% of the outstanding paper of the issuing corporation. Purchases of commercial paper may not exceed 15% of the cost value of the portfolio.

Negotiable Certificates of Deposit – These are issued by nationally or state chartered banks, state or federal savings institutions, or state licensed branches of foreign banks. Purchases of negotiable certificates of deposit may not exceed 30% of the cost value of the portfolio. A maturity limitation of two years is applicable.

Local Agency Investment Fund (LAIF) – As authorized in Government Code Section 16429.1, local agencies may invest in the Local Agency Investment Fund, a money market fund which allows local agencies to pool their investment resources. Current policies of

LAIF set minimum and maximum amounts of monies that may be invested as well as maximum numbers of transactions that are allowed per month.

Certificate of Deposit (CD) - Purchased through a bank or savings and loan association for a specified period of time at a specified rate of interest. The first \$100,000 of a certificate of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC). CD's with a face value in excess of \$100,000 will be collateralized by U.S. Treasury Department securities, which must be at least 110% of the face value of the CD. No other collateralization will be accepted.

Medium Term Corporate Notes with a maximum maturity of five years may be purchased. Securities eligible for investment shall be rated AA or better by Moody's and Standard & Poor's rating services. Purchase of medium term notes may not exceed 30% of the cost value of the portfolio and no more than 10% of the cost value of the portfolio may be invested in notes issued by one corporation. Commercial paper holdings should also be included when calculating the 10% limitation.

Money Market Mutual Funds - Mutual funds invested in U.S. Government securities are permitted under this policy and under the California Government Code Section 53601. In order to be eligible for investment under this section, an investment objective of such a fund must be the maintenance of a price per share of \$1.00. The following criteria must also be met:

- The fund shall have a minimum of \$500 million in total portfolio value.
- The fund shall be registered with the Securities and Exchange Commission, and shall have achieved a rating of Aaa by Moody's and AAA by S&P.
- The fund shall have retained an advisor which is registered with the SEC, or which is exempt from such registration, and has at least 5 years experience managing money market funds, including those in excess of \$50 million.
- Investment in such funds shall not exceed 15% of the City's total portfolio.
- No more than 10% of the City's total portfolio may be invested in any one mutual fund.

Repurchase Agreements (REPOs) - A contractual arrangement between a financial institution, or dealer, and an investor. This agreement normally can run for one or more days. The investor puts up his funds for a certain number of days at a stated yield. In return, he takes a given block of securities as collateral. At maturity, the securities are repurchased and the funds repaid plus interest. The market value of the securities used as collateral for the repurchase agreement shall be monitored and not allowed to fall below 102% of the value of the repurchase agreement. A Master Repurchase agreement is required between the City and the financial institution for all repurchase agreements transacted. Maximum maturity is one year.

California Pooled Investment Authority (CPIA) - Known as CLASS (California Liquid Asset Securities System), this investment pool fund is an alternative to the Local Agency Investment Fund (LAIF). It is managed by MBIA-Municipal Investors Service Corporation,

an investment subsidiary of MBIA, Inc. The CPIA may be used only as an alternative to LAIF.

Security Swaps - The City may take advantage of security swap opportunities to improve the overall quality, yield or target duration of the portfolio. A swap which improves the portfolio yield may be selected even if the transactions result in an accounting loss. Documentation for swaps will be included in the City's permanent investment file documents.

Ineligible Investments - Ineligible investments are those that are not described herein, including but not limited to, common stocks, reverse repurchase agreements, inverse floaters, range notes, mortgage derived interest only strips, derivatives securities, or any security that could result in zero interest accrual.

7. Investment Parameters

A. Diversification

Investments shall be diversified by:

- Limiting investments to avoid concentration in securities from a specific issuer or business center (excluding Local Agency Investment Fund and U.S. Treasury securities);
- Limiting investment in securities that have higher credit risks;
- Investing in securities with varying maturities; and
- Continuously investing a portion of the portfolio in readily available funds such as local government investment pools (LAIF and CLASS), or money market funds to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

B. Maximum Maturities

In order to minimize the impact of market risk, it is intended that all investments will be held to maturity. Investments may be sold prior to maturity for cash flow, appreciation purposes or in order to limit losses, however, no investment shall be made based solely on earnings anticipated from capital gains.

To the extent possible, the City shall attempt to match its investments to anticipated cash flow requirements. Unless matched to a specific cash flow, the City will not directly invest in securities maturing more than 5 years from the date of purchase or in accordance with state and local statutes and ordinances. The City shall adopt weighted average maturity limitations (2 years) consistent with investment objectives.

Because of inherent difficulties in accurately forecasting cash flow requirements, a portion of the portfolio should be continuously invested in readily available funds. No more than 60% of the portfolio should be invested for longer than 18 months.

8. Reporting

A. Methods

The City Treasurer shall prepare at least quarterly investment reports to the City Manager and City Council which shall include the:

- par amount of the investment,
- classification of the investment,
- percentage of the total portfolio which each type of investment represents, name of the institution or entity,
- rate of interest,
- maturity date,
- current market value,
- source of the market value, and
- weighted average maturity of the portfolio.

Reports shall also include a statement that the projected cash flow is adequate to meet expected obligations over the next six months, and that the portfolio is in compliance with this policy.

The report shall be due within 30 days of the end of the quarter. Reports may be rendered more frequently at the discretion of the City Manager or City Treasurer.

Annually there shall be provided to the City Manager and the City Council a report on the performance of the investment program and an update to this policy. The report shall include a narrative discussion of the performance of the investment portfolio and shall include comparisons with appropriate benchmarks to facilitate this evaluation.

B. Performance Standards

The investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio should obtain a market average rate of return during a market/economic environment of stable interest rates. An appropriate benchmark of the 90-day U.S. Treasury bill shall be established against which portfolio performance shall be compared.

C. Marking To Market

The market value of the portfolio shall be calculated at least quarterly and a statement of the market value of the portfolio shall be issued at least quarterly with the investment report.



**PROPOSITION 4,
GANN APPROPRIATIONS LIMITATIONS**

PROPOSITION 4, GANN APPROPRIATION LIMIT

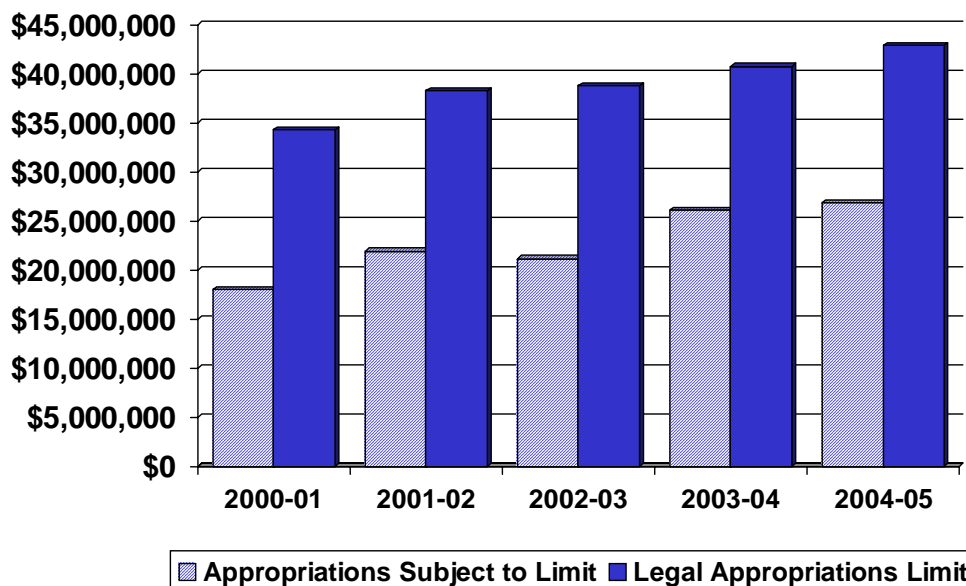
Article XIII B of the California State Constitution, was approved by California voters in November 1979, and modified by Proposition 111 in 1990. This article more commonly referred to as the Gann Initiative or Gann Limit, placed limits on the amount of proceeds of taxes that state and local governmental agencies can receive and spend each year.

The appropriations limit is different for each agency and the limit changes each year. Each year's limit is based on the amount of tax proceeds that were authorized to be spent in fiscal year 1978-79 in each agency, and modified for changes in inflation and population in each subsequent year.

Each year the City Council must adopt, by resolution, an appropriations limit for the following year. Using cost of living data provided by the State of California, and population and per capita personal income data provided by the State Department of Finance, the City's Appropriation Limit for 2004-05 has been computed to be \$42,881,989. Appropriations subject to the limitation in the 2004-05 budget total \$26,883,357, which is \$15,998,632 less than the computed allowable limit.

Additional appropriations to the budget funded by non-tax sources, such as charges for service, restricted revenues, grants or beginning fund balances, would not be affected by the Appropriations Limit.

The graph below shows a history of the City of Davis' Appropriations Limits.



**GANN APPROPRIATIONS LIMITATION COMPUTATION
FY 2003-2004 FINAL BUDGET**

APPROPRIATIONS LIMIT:

2003-2004 APPROPRIATIONS LIMIT		\$40,766,222
2004-2005 ADJUSTMENT FACTORS		
Population	1.0185	
Inflation	<u>1.0328</u>	
Total	<u>1.0519</u>	
ANNUAL ADJUSTMENT		2,115,767
TRANSFER OF RESPONSIBILITY ADJUSTMENT		0
2004-2005 APPROPRIATIONS LIMIT		<u><u>\$42,881,989</u></u>

APPROPRIATIONS SUBJECT TO LIMITATION/ESTIMATED PROCEEDS OF TAXES:

ACTUAL PROCEEDS OF TAXES		\$29,279,541
LESS: QUALIFIED CAPITAL OUTLAY		
DEBT SERVICE APPROPRIATIONS		0
CIP CONST TAX APPROPRIATIONS		<u>(2,396,184)</u>
APPROPRIATIONS SUBJECT TO LIMITATION		\$26,883,357
PERCENTAGE OF APPROPRIATIONS LIMIT USED:		62.69%

