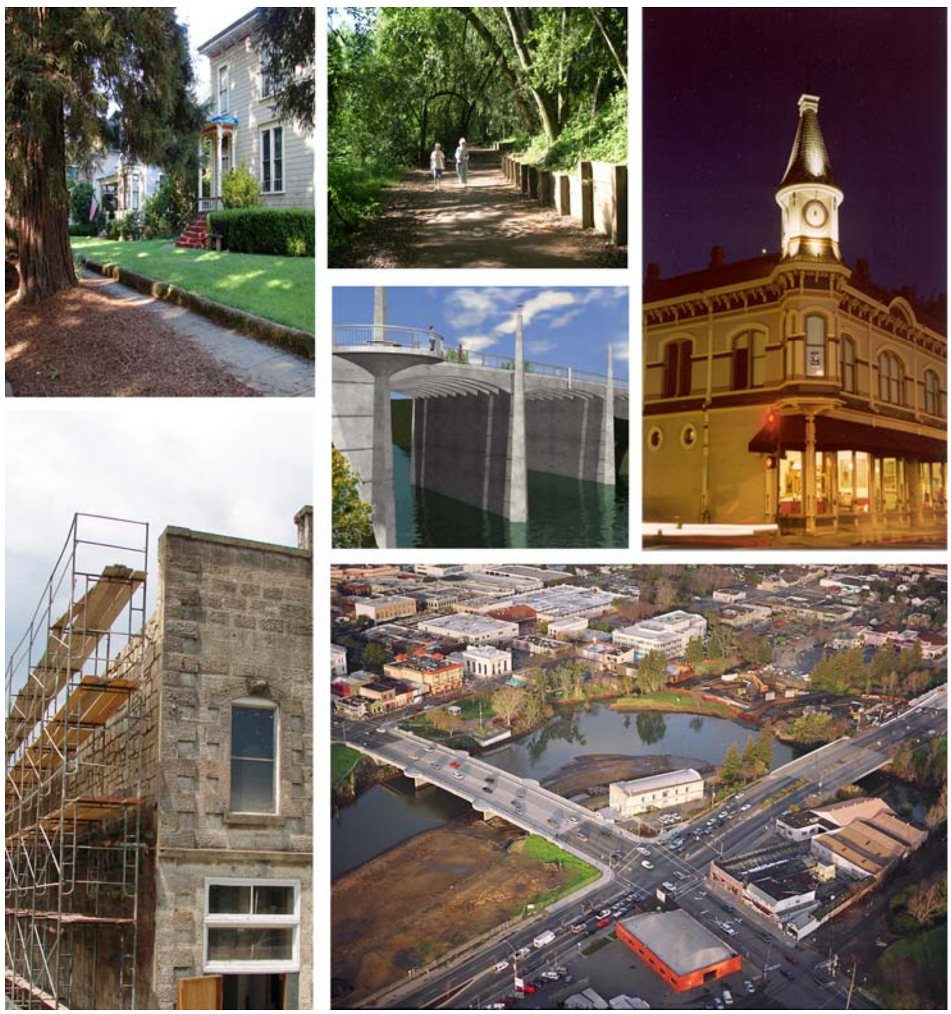
City of Napa, California



2007 Long Term Financial Plan Trends and Forecast Analysis

2007 Long Term Financial Plan
Trends and Forecast Analysis

Forecast through 2013

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2007 Long Term Financial Plan
Trends and Forecast Analysis

I: INTRODUCTION

This document represents the City of Napa's first Long Term Financial Plan (LTFP). Since the Long Term Financial Plan is a new tool for the City this introduction will provide some background, and explain why consideration of this financial analysis is a critical component of the budget process.

Purpose of the Long Term Financial Plan

It is proposed that staff will regularly update the plan to provide a clear path to a successful future for the City of Napa. The entire City organization is committed to do all that is necessary to develop and stabilize our financial base because a strong financial foundation is essential to the provision of critical services to the community. In an environment of economic uncertainty, financial planning is always a prudent activity and development of a LTFP is essential to sound fiscal management. In general, budgetary problems will result when revenues do not keep pace with expenditures, but there is more to financial planning than trying to keep your budget in balance. In challenging times like these, a LTFP will seek to identify negative trends that can be addressed proactively to avoid serious long-term impacts.

Although financial plans are only as good as the assumptions and data utilized in establishing them, the development of a sound strategic plan will always be crucial to successful management of the City's resources.

Components of this Long Term Financial Plan

The City's plan is focused on emerging issues and has been documented for public review to encourage input and feedback from various stakeholders.

This plan includes a trend analysis based on actual audited data, a statement of current financial position and a forecast looking ahead three budget cycles or through the year 2013. The plan is not able to predict with certainty the City's fiscal future, rather it serves as a tool to highlight significant issues or problems that must be addressed if the City's goals are to be achieved.

Time did not allow for the development of a complete LTFP this year. The foundation of the plan exists, the trends, the forecast and identification of key issues. However, a full analysis of those issues with recommended findings, alternative solutions and the formation of appropriate fiscal policies is still a work in progress. Preparing the necessary issue papers and policies to respond to identified issues will become the basis for work plan goals to be established over the next few months. Specific work efforts requiring the dedication of staff or other resources may be considered as the City Council reviews other program priorities over the next few months.

II: FINANCIAL TREND ANALYSIS

Objective
Utilizing the International City Management Association's (ICMA) Financial Trend Monitoring System, we have provided a comprehensive Financial Trend Report, including specific recommendations to address those trends considered unfavorable or where a warning trend has been observed. Ratings assigned to each trend include: Favorable (F), Unfavorable (U), Warning (W), or Caution (C).

Background
As part of the long-term financial plan update process, the City's financial trends have been analyzed for the past ten years. Many factors are utilized in order to analyze the financial condition of the City of Napa. These factors include:

- The economic condition of the City;
- Types and amounts of revenues and whether they are sufficient and the right mix to support the constituents of the City;
- Expenditure levels and whether these expenditures are sufficient to provide the citizens of Napa with the desired level of services in the future, especially considering the City's diversity of programs;
- Fund balances and reserve levels and whether they are sufficient to protect the City against an economic downturn and /or natural disaster.

Three major areas of the General Fund analyzed include:

General Fund Revenues	The accumulation of financial resources that fund those services that have the greatest impact upon the citizens of Napa including police, fire, public service and maintenance, and recreation.
General Fund Expenditures	The application of financial resources towards the cost of providing the services of police, fire, public service and maintenance, recreation, and other services.
General Fund Operating Position	The ability of the City to balance current revenues with current expenditures, maintain adequate reserve levels, and to cover short-term liabilities.

Additional indicators affecting General Fund operations will also be analyzed as part of this report.

The 1996-2006 financial trend analysis combines several sources of data into a meaningful overview of the General Fund's current financial position, and assists the City Administration and Council in making determinations that will lead to adoption of

City fiscal policies. Reports examined as part of this analysis include those from FY 1995-96 through FY 2005-06, combining information from budgets and financial reports, annual State Controller's Reports, and the International City Management Association's (ICMA) Trend Monitoring System. One of the following ratings will be assigned to each indicator:

Favorable:	This trend is **positive** with respect to the City's goals, policies, and national criteria.
Unfavorable:	This trend is **negative**, and there is an immediate need for the City to take corrective action.
Warning:	This rating indicates that a trend has **changed** from a positive direction and is going in a direction that may have an **adverse** effect on the City's financial condition. The City also uses this rating to indicate that, although a trend may appear to be favorable, it is not yet in conformance with adopted fiscal policies.
Caution:	This rating is used when there are factors influencing the indicator that may not be apparent in existing trend, but could result in a **change** of status from a **positive** to a **negative** direction in the future.

Overview of the City's Financial Condition

Through the strong leadership of the City Council and hard work by City staff, we have been able to maintain sound financial health over the past 10 years. However, the impact of State budget cuts and rising benefit costs have had significant impact on Napa, the City made budget adjustments in order to ensure revenues are sufficient to cover expenditures. Below are observations we can make from the financial trend analysis.

Over the past ten years, the City has incurred a number of FEMA eligible floods and an earthquake. The expenditures and related FEMA reimbursements have been reflected in the General Fund. Because these occurrences are sporadic and can skew trends, the costs and related expenditures are not reflected in the trends and projections. It is recommended that FEMA activity be segregated in another fund.

The General Fund's operating revenues increased 10.1%, or $4.8 million. This change was primarily due to increased property tax revenue of 15.9%. Similarly, sales tax, including in-lieu sales tax from the "Triple Flip," increased by 16.2%. The fund's operating expenditures increased 2.9%, or $1.4 million. Benefit costs increased $1.3 million and accounted for the operating increase, while salaries remained almost level due to the freezing of 30 positions during the FY 2005-07 budget process.

In summary, because of actions taken to balance the budget, the City's current financial condition is satisfactory. However, some areas of concern include:

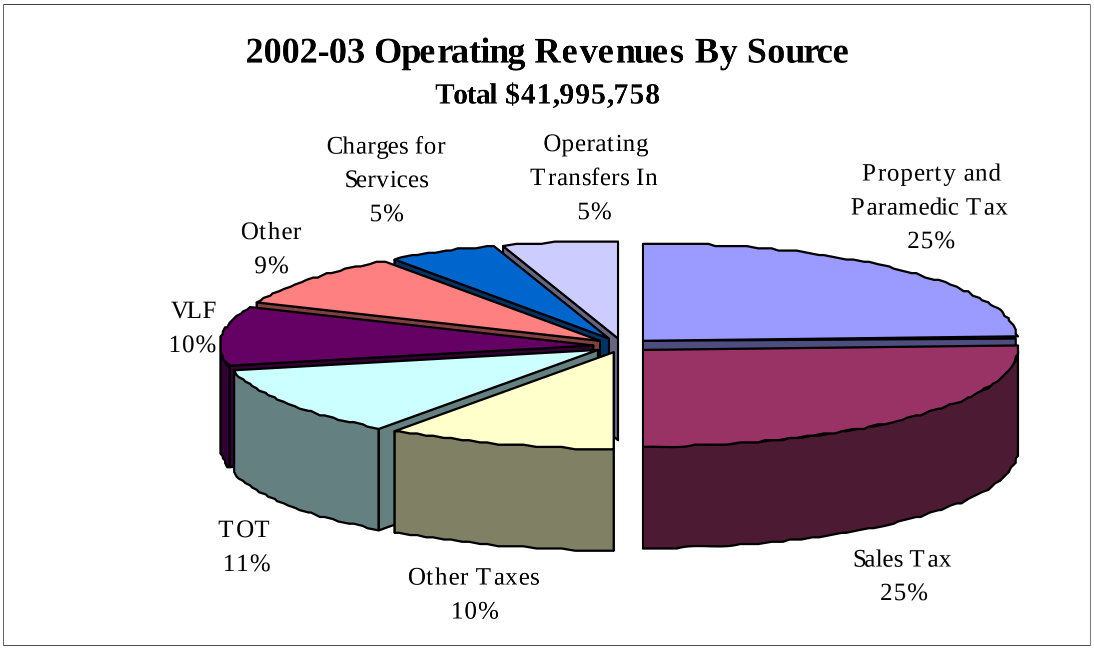
- Expenditures growth trends have outpaced revenue growth.
- Rising costs of benefits.

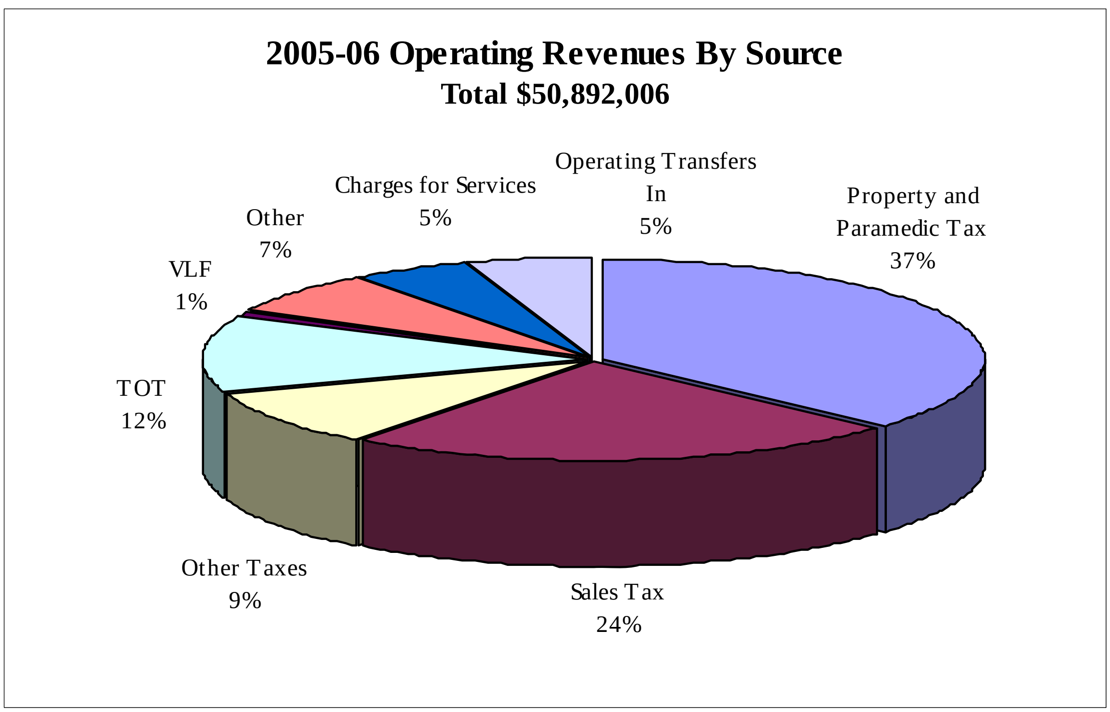
- In order to balance revenues with expenditures, 30 positions were frozen in the FY 2005-07 budget cycle. Those positions have not yet been restored.
- Critical operating reserves have also been used in recent years to support operations. These reserves have largely been depleted.
- Addressing infrastructure maintenance costs.
- The General Fund contribution to CIP is relatively low, at $750,000 per year.
- An actuarial analysis of the cost of retiree medical benefits indicates the City would need to set aside $1.329 million per year. Currently, the City is using a "pay as you go" method of financing these costs, which results in expenditures of approximately $600,000 per year.
- The City does not have a comprehensive and formal set of adopted fiscal policies addressing reserves for unfunded future needs.
- The City is very reliant on elastic revenue sources.

We must plan with caution for the upcoming years, keeping in mind potential fiscal opportunities and threats.

General Fund Operating Results – Revenues

The General Fund's revenue sources with related percentages of total operating revenues are shown in the following charts. Taxes, including property, sales and other taxes make up the largest category of General Fund revenues at 82% of revenues generated in fiscal year 2005-06 as compared to 71% in the 2002-03 fiscal year.



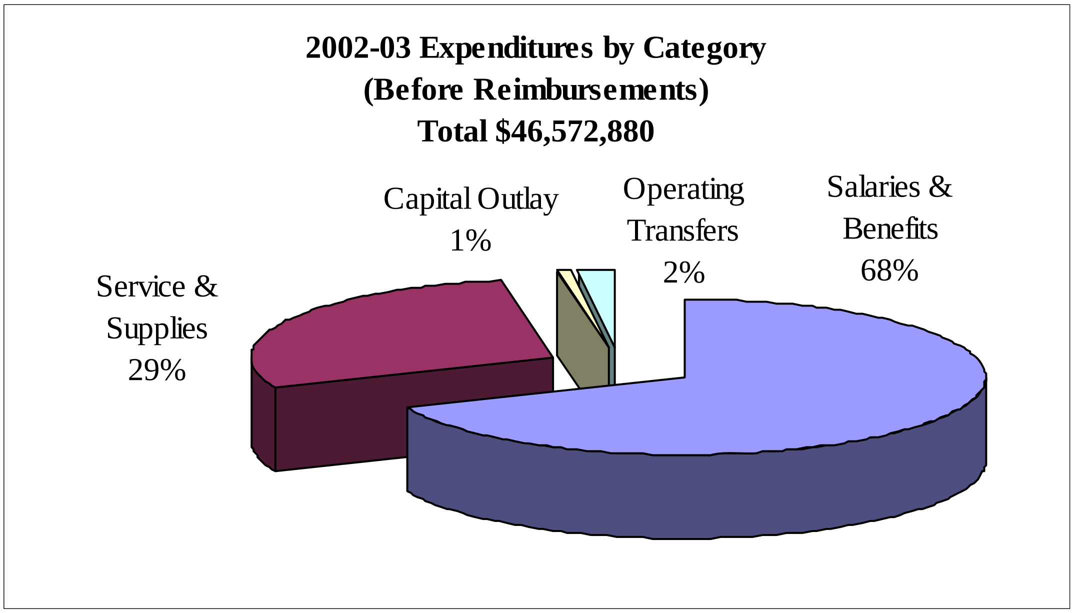


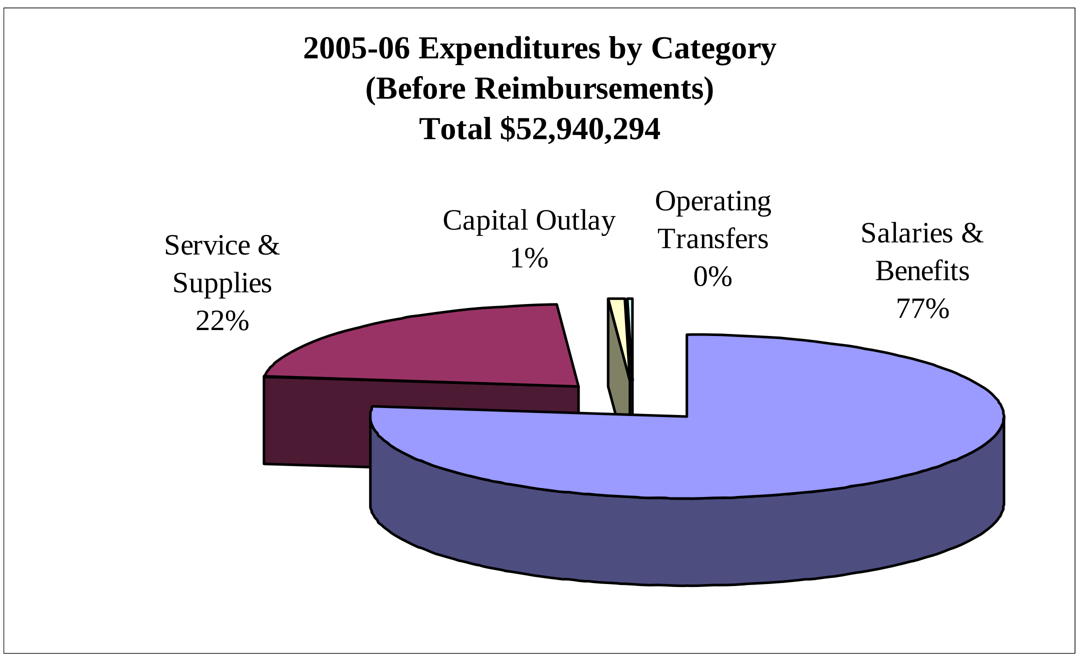
The two largest sources of revenue to the City continue to be property and sales tax. Included in the property tax category for FY 2005-06 is $5.1 million in backfilled VLF revenue from the State. While growth in property tax revenues has been steady, sales tax revenue growth has been uneven. Transient occupancy tax revenue has shown healthy increases every year since 1998, reflecting the strong tourism demand for Napa. There are a number of new development projects expected to be completed over the next six years which will contribute to City revenue growth significantly.

General Fund Operating Results – Expenditures

The majority of the City's operating costs reside in the General Fund. Total General Fund expenditures increased 10.9%, or $5.2 million to $53.2 million from the prior year. The fund's operating expenditures increased 2.9%, or $1.4 million.

The following charts compare operating expenditures by category for the fiscal years 2002-03 and 2005-06.





The composition of General Fund operating expenditures by category has changed with the recent escalation of benefit costs when comparing fiscal year 2005-06 to fiscal year 2002-03. Driving this escalation was a 132% increase in the cost of benefits during the period from $5.1 million to $12 million. Cost of salaries increased 8% from $26.7 to $28.7 million for the period. As a result, salaries and benefits were approximately 77% in 2005-06, an increase of 9 percentage points from 2002-03, despite a workforce reduction of 8% resulting from the freezing of thirty positions. The Services and Supplies category decreased by 7 percentage points during that three-year period to account for 22% of total expenditures.

Summary of Trends

The following pages contain a listing of the indicators analyzed as part of this financial trend analysis and a brief summary of the rating assigned to each indicator. An expanded discussion of each indicator follows the summary.

Indicator Number	Description	Finding	Comments
General Fund Revenues			
1	Revenues Per Capita	F	Revenues per capita (constant dollars) reflected increases since fiscal 2002-03, after two years of decline following 9/11. New development will improve this trend.
2	Property Tax Revenues	F	Property tax revenues have increased steadily since 1998. Without anomalies such as ERAF III and VLF backfill, revenues increased by an average annual rate of 9.2%
3	Sales Tax Revenues	F	Sales tax revenue trends have followed economic cycles, and the largest sector is general retail sales. Because of the City's dependency on tourism, it is important to continue our efforts to diversify our tax base while continuing to enhance our attractiveness as a tourism destination.
4	Transient Occupancy Tax Revenues	F	Revenue growth in this category has been steadily increasing. Projects in the pipeline suggest sustainable momentum of these revenues. Again, this revenue is primarily based on the tourism industry.
5	Business License Tax Revenue	F	Revenue in this category experienced a modest decline from 1999-00 through 2004-05, recovering in FY 2005-06.

F Favorable
W Warning
U Unfavorable
C Caution

6	Vehicle License Fee Revenue	F	The passage of Proposition 1A provides protection of these revenues from State takeaway.
7	Elastic Revenues	C	Heavy reliance on these revenues, 44.5% in fiscal 2006, exposes the City to income fluctuations due to economic uncertainty. New development underway is expected to increase this percentage.
8	One-Time Revenues	F	The City receives very little one-time revenue in the General Fund. Note: Natural disaster related grant funds were excluded from this analysis.

General Fund Expenditures

9	Expenditures Per Capita	U	While expenditures per capita shows a leveling off trend, this was only achievable by freezing 30 positions in the budget, thereby reducing the overall service level to the community.
10	Authorized Positions Per Capita	U	Authorized positions per capita have varied very little per year until FY 2004-05 to 2005-06 with the freezing of 30 positions (8%) in the budget. A reduction to the overall service level to the community has resulted.

F Favorable
W Warning
U Unfavorable
C Caution

11	Fringe Benefits as a Percentage of Operating Expenditures	U	2006 saw an increase of 12.1 percentage points to 24% of total expenditures. In current dollars, this increase amounted to $1.3 million. These significant increases occurred despite freezing 30 positions. The most significant increases occurred in CalPERS retirement rates, which are expected to level off or decrease slightly in the future. Ongoing increases in health care are expected.
12	Salary Expenditures as a Percentage of Operating Expenditures	F	While salary expenditures in total remained almost level in fiscal year 2005-06 and has declined for the past two years, the experience is a result of an 8% reduction in the workforce.
13	Capital Outlay as a percentage of Operating Expenditures	C	Capital outlay has never been above 2.16% of operating expenditures over the last ten years. It is recommended that the City establish a policy assuring that equipment is replaced in a timely manner to avoid inefficiencies and more costs in the future.

General Fund Operating Position

14	Operating Position	U	The City has experienced a number of years with operating deficits, but achieved a modest operating surplus in FY 2005-06 due to an 8% reduction in the work force and a higher than normal vacancy rate (3.5%).

F Favorable
W Warning
U Unfavorable
C Caution

15	Unreserved Fund Balance/Emergency Reserve as a Percentage of Budged Operating Expenditures	U	The City has no formal reserve policy, and has used reserves to cover operating budget shortfalls. It is recommended that Council consider adopting a reserve policy.
16	Liquidity Ratio	F	The liquidity ratio has remained over 4 percent. Financial rating agencies recommend cities maintain a ratio minimum of 1:1.
17	Debt Service	F	The City has no current debt service in its General Fund.

Additional Indicators

18	Assessed Property Value	F	Assessed values have gained an average of 7.9% during the past nine years. Strong real estate demand fueled by low mortgage rates contributed to its strength.
19	Population	F	Population growth has slowed in recent years as Napa is largely built out. The FY 2005-06 population is estimated at 76,705.

F Favorable
W Warning
U Unfavorable
C Caution

Financial Trend Summary:

- **Revenue Trends**

1.	Revenue/Capita	(F)
2.	Property Tax Revenues	(F)
3.	Sales Tax Revenues	(F)
4.	Transient Occupancy Tax	(F)
5.	Business License Revenues	(F)
6.	VLF Revenues	(F)
7.	Elastic Revenues	(C)
8.	One Time Revenues	(F)

- **Expenditure Trends**

9.	Expenditure/Capita	(U)
10.	Authorized Positions/Capita	(U)
11.	Fringe Benefits	(U)
12.	Salary Expenditure	(F)
13.	Capital Outlay	(C)

- **Operating Position**

14.	Operating Position	(U)
15.	Fund Balance	(U)
16.	Liquidity	(F)
17.	Debt Service	(F)

- **Additional Indicators**

18.	Assessed Property Value	(F)
19.	Population	(F)

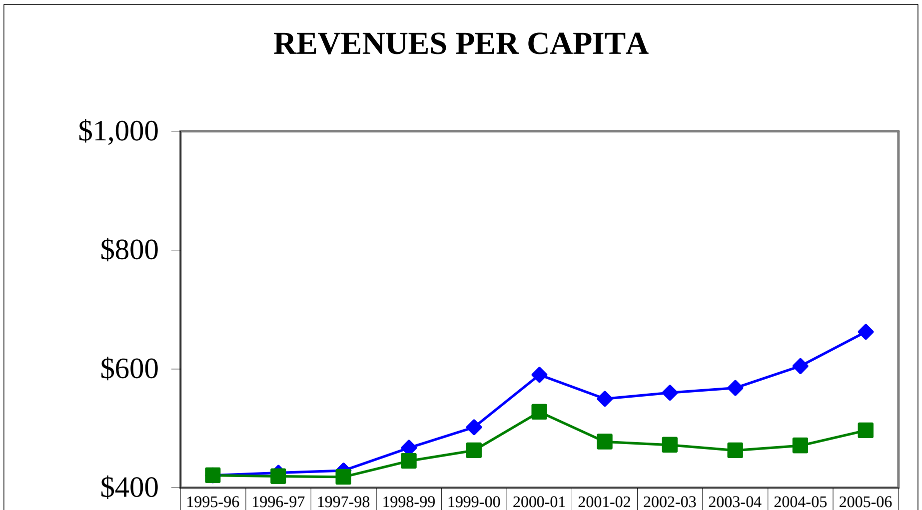
F Favorable
W Warning
U Unfavorable
C Caution

General Fund Revenues
General Fund revenues finance the majority of the daily operations of the City. As a result, changes in revenue levels and composition of these revenues will have a significant impact on the City's ability to provide services to the citizens of Napa. The dollar amount received is important, but the type of revenue received also plays an important role in the financial stability of the City. Revenues should be balanced between those that change as the economy shifts (elastic) and those that flow independently of economic activity (inelastic). General Fund revenues should also come from diverse sources within the community and be sufficiently flexible to finance expenditures as the needs of the City change.

The following section evaluates eight indicators used to determine the financial condition of the City's revenue base. A detailed revenue analysis is provided for the following indicators:

- Revenues Per Capita
- Property Tax Revenues
- Sales Tax Revenues
- Transient Occupancy Tax Revenues
- Business License Tax Revenues
- Vehicle License Fee Revenues
- Elastic Revenues as a Percentage of Operating Revenues
- One-Time Revenues as a Percentage of Operating Revenues

Indicator 1: Revenues Per Capita



	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Actual Dollars	421	425	429	467	502	590	550	560	568	605	663
Constant Dollars	421	419	419	445	463	528	478	472	463	471	496

Finding: Favorable

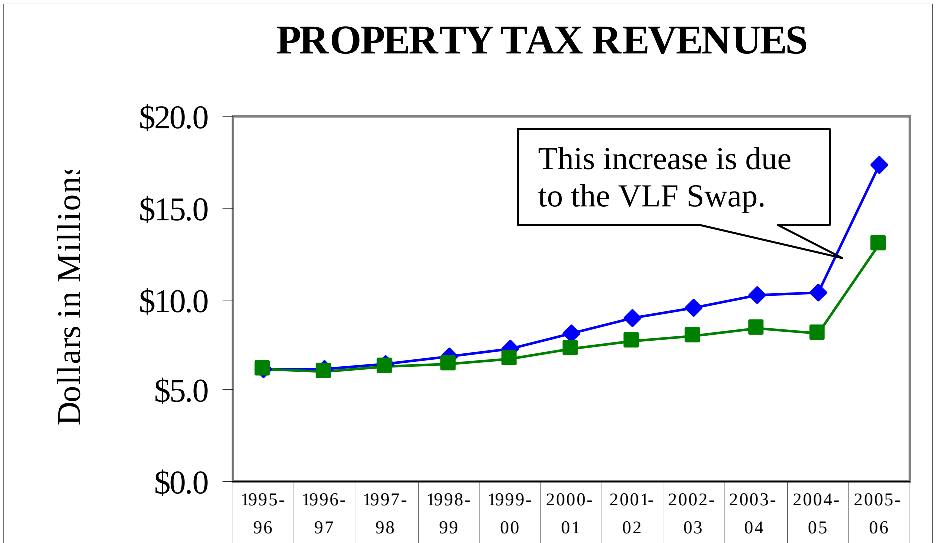
Description

Revenues per capita in constant dollars are a measure of the City's ability to maintain current service levels. Constant dollars reflect the real changes in operating revenue after adjusting for inflation. An increase in constant dollar revenues normally means a city will be able to respond positively to increasing service demands. Conversely, a decrease in constant dollars may indicate that revenue yields are not sufficient to maintain existing levels of service.

Comments and Analysis

Revenues per capita (constant dollars), excluding one-time revenues, have increased since 1996, from $419 to $496 in 2006, although there was a dip from 2001 to 2003 due to a lagging economy. Sales tax revenues were flat, while interest income declined as a result of the Federal Reserve's actions to lower Federal Funds rate to historic lows. In addition, the state's deferral of VLF backfill in 2004 to 2005 caused a $1.27 million reduction in General Fund revenues in 2004 and a corresponding increase in 2005.

Indicator 2: Property Tax Revenues



	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Actual Dollars	6.16	6.15	6.49	6.82	7.22	8.09	8.92	9.49	10.25	10.41	17.36
Constant Dollars	6.16	6.06	6.33	6.50	6.66	7.23	7.75	8.01	8.36	8.13	12.98

Finding: Favorable

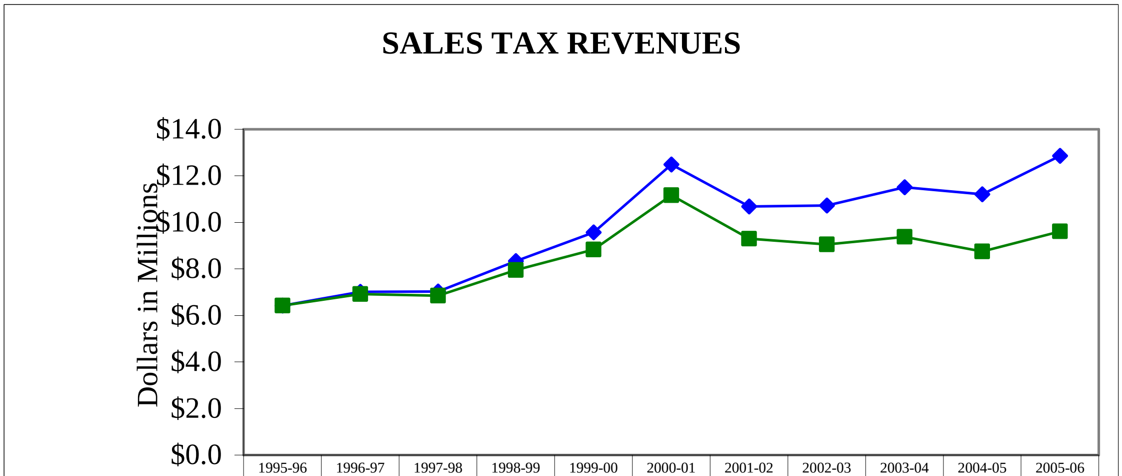
Description

Property tax revenues are evaluated over time to measure the City's economic health. Constant dollars are examined in order to evaluate that part of the change that is not due to inflation. Property taxes are the City's largest source of revenue (27% before the addition of VLF and 34% after the addition) and are relatively inelastic in that they should remain constant as the economy changes. By State law (Proposition 13), the County levies property taxes at one percent of full market value at the time of purchase. Assessed values can be increased by no more than two percent per year. The City also has the authority to impose an excess property tax levy to pay debt service on voter-approved debt. From 1992 through 2006, the cumulative ERAF shift has totaled $34.8 million.

Comments and Analysis

Sales of appreciated real estate have resulted in increased assessed values and a corresponding increase in property tax revenues for the City. The significant increase in revenue shown for FY 2005-06 is the result of property taxes received in exchange for lost Vehicle License Fee (VLF) revenue, resulting from the permanent decrease in the VLF rate per the FY2004-05 State budget. In addition, property tax revenue for FY 2004-05 and FY 2005-06 reflect a two year payment of property taxes to the State (ERAF III) of $909,000 per year. Without these unusual items, property tax revenue increased by 16% from 2005 to 2006, and has increased an average of 9.2% annually since 1998. Factors that contributed to a favorable housing market included strong demand for Wine Country property and mortgage rates that remained near 40 year lows. However, we expect the strong revenue trend to level as interest rates have increased and the housing market has slowed.

Indicator 3: Sales Tax Revenues



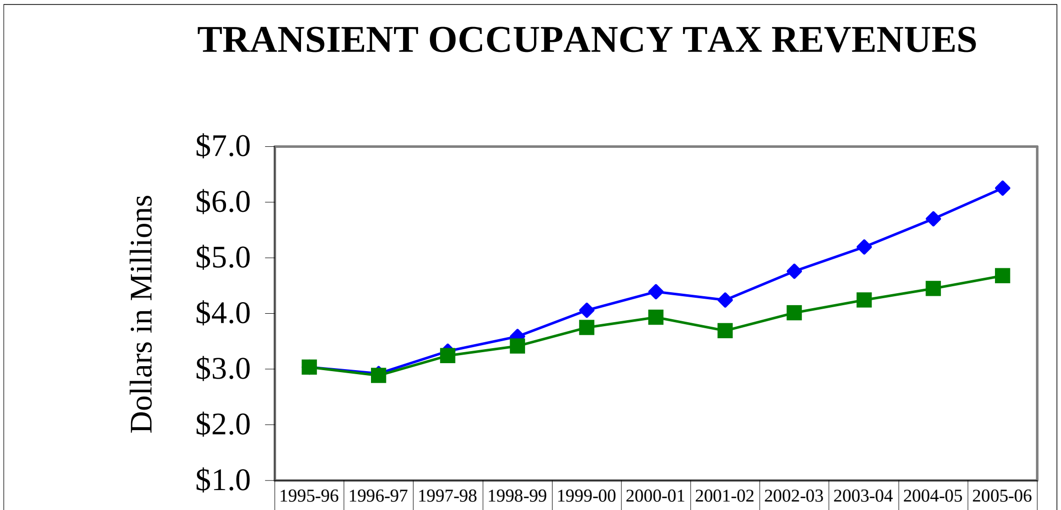
	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Actual Dollars	6.42	7.02	7.03	8.34	9.57	12.49	10.69	10.72	11.51	11.21	12.86
Constant Dollars	6.42	6.92	6.85	7.95	8.83	11.16	9.29	9.05	9.38	8.75	9.62

Finding: Favorable

Description
Sales tax revenue is a strong indicator of the city's economic health. Sales taxes are the City's second largest source of revenue (23%) and are elastic in nature, varying with changes in the economy. Constant dollars are examined in order to evaluate the sales tax revenue changes not related to inflation. The State Board of Equalization levies the sales tax on most retail sales with principal exemptions applying to sales of food for home consumption and prescription drugs. The overall Napa County sales tax rate is 7.75%, of which the City receives the 1% local portion. The city also receives a portion of the 0.5% earmarked for public safety as mandated by the State.

Comments and Analysis
Napa's sales tax revenue is heavily dependent on the tourism industry and therefore tends to follow economic cycles. Revenues increased steadily through 2001, then declined as the economy lagged after 9/11. Recent years have shown an increase in sales tax, and this trend is expected to continue, particularly with the development of new hotel properties in the City. Restaurants and department stores are the largest economic segments. New automobile sales, which accounted for 11.1% of sales tax revenues in 2002, have declined to 8.6% in 2006, reflecting the poor showing of domestic auto sales. General retail sales, which accounts for 32% of sales tax revenues, gained 6.8% from the prior period. The City should consider opportunities to diversify its tax base and should continue to benefit from its strong tourism attraction.

Indicator 4: Transient Lodging Tax Revenues



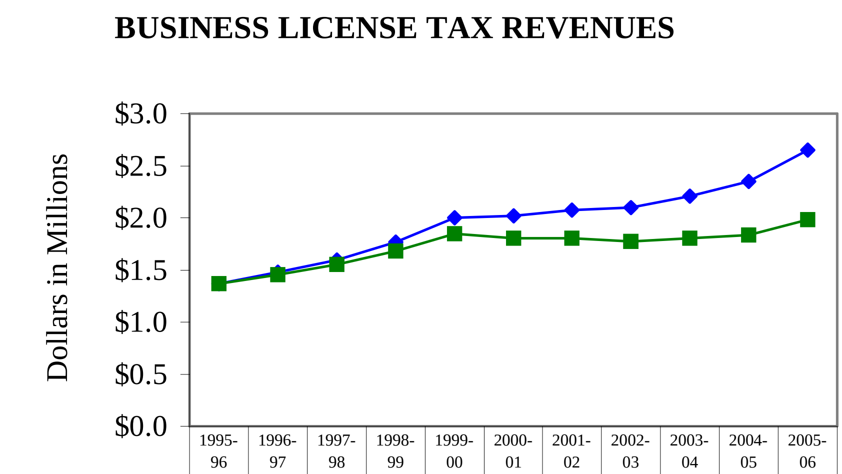
	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Actual Dollars	3.03	2.92	3.32	3.58	4.06	4.39	4.24	4.75	5.20	5.70	6.25
Constant Dollars	3.03	2.88	3.24	3.42	3.74	3.93	3.69	4.01	4.24	4.45	4.67

Finding: Favorable

Description
Transient occupancy tax revenue (TOT) is a strong indicator of the city's economic health. This revenue source is the City's third largest source of revenue (12%) and is elastic in nature, varying with changes in the economy. Constant dollars are examined in order to evaluate the tax revenue changes not related to inflation. The City of Napa levies the tax on rooms at hotels, motels, and bed and breakfasts within the City. The tax rate is 12%, of which the City receives 100%.

Comments and Analysis
Napa's transient occupancy tax revenue is heavily dependent on the tourism industry and therefore tends to follow economic cycles. Revenues increased steadily through 2001, then declined as the economy lagged after 9/11. Recent years have shown an increase in tax, and this trend is expected to continue, particularly with the development of new hotel properties in the City.

Indicator 5: Business License Tax Revenues



	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Actual Dollars	1.37	1.48	1.59	1.77	2.00	2.02	2.07	2.10	2.21	2.35	2.65
Constant Dollars	1.37	1.46	1.55	1.68	1.85	1.80	1.80	1.77	1.80	1.84	1.98

Finding: Favorable

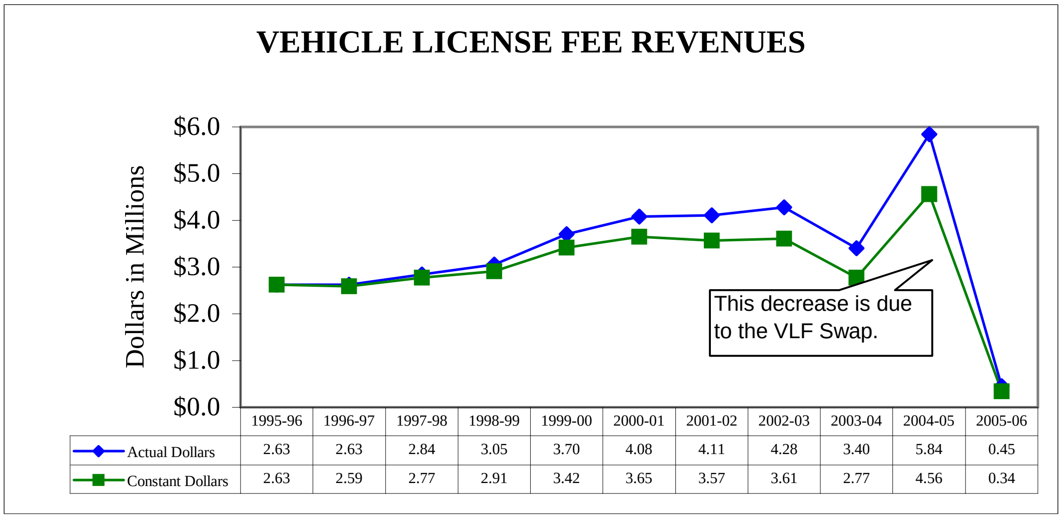
Description

Business license tax revenues are a major revenue category (5%) that factors into the analysis of the City's economic health. Constant dollars are utilized in evaluating the part of the change not related to inflation. This tax is generally based on gross receipts of individual business within the City. Much like sales tax revenues, business license tax revenues are relatively elastic as they vary directly with changes in the economy.

Comments and Analysis

The five-year trend for these revenues remains positive due to the growing economy. Further, the City began an audit campaign in fiscal year 2004-05 that has increased the number of licenses issued by 635, or 10.5%, from 6,046 to 6,681 licensed businesses in 2005-06.

Indicator 6: Vehicle License Fee Revenue



	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Actual Dollars	2.63	2.63	2.84	3.05	3.70	4.08	4.11	4.28	3.40	5.84	0.45
Constant Dollars	2.63	2.59	2.77	2.91	3.42	3.65	3.57	3.61	2.77	4.56	0.34

Finding: Favorable

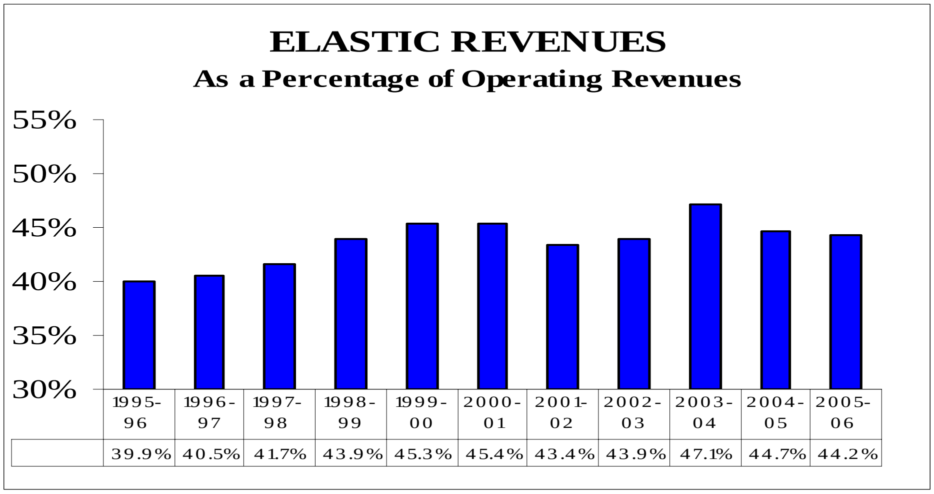
Description

Vehicle license fees (VLF) are imposed annually by the State as a fee on the ownership of a registered vehicle in California, in lieu of taxing vehicles as personal property. Proposition 47, passed by voters in 1986, constitutionally guaranteed that Vehicle License Fees were sent to local governments. However, the State retains authority over both the amount of revenues that are collected and the method of distribution. The legislature also holds the authority to alter the level of VLF revenues. Under prior law, local governments were backfilled by the State general fund for any loss of revenue due to VLF reductions. This backfill was to occur automatically without being subject to the annual budget process. However, the payment of VLF backfill was affected by the State's budget crisis and the State withheld $1.27 million in City VLF revenues for fiscal year 2003-04. In 2005, the State repaid the $1.27 million and the State legislature reduced the VLF tax rate to 0.65%. The offset revenue (also known as "backfill") was replaced with additional property tax revenue for cities and counties. This backfilled revenue is shown under the property tax category for FY 2005-06, which is why there is a significant reduction in VLF revenue that year and a corresponding increase to the property tax revenues.

Comments and Analysis

Although VLF revenues have been stable from fiscal year 2001 to 2003, the deficit situation faced by the State lead to a temporary borrowing of VLF backfill money from local agencies. As a result, Napa's VLF revenues were reduced by $1.27 million in fiscal year 2003-04. This VLF Gap loan was repaid in fiscal 2005. The passage of Proposition 1A constitutionally guarantees the now statutorily reduced .65% and property tax backfill between the .65% and 2% to the cities and counties. As a result, we have assigned a favorable rating to this indicator.

Indicator 7: Elastic Revenues



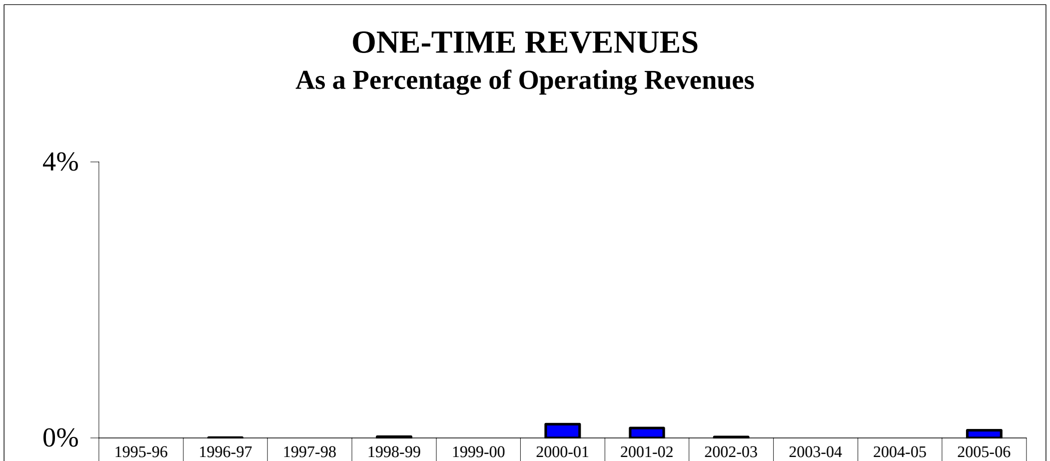
Finding: Caution

Description
Elastic revenues are those that vary directly with fluctuations in the economy. Included in this category are sales taxes, transient occupancy taxes (TOT), business license taxes, and license and permits. During times of inflation, a high percentage of elastic revenues is desired in order to insulate the government from the higher prices found in the market. During a recession or periods of slow economic growth, elastic revenues tend to decline.

Comments and Analysis
Elastic revenues as a percentage of operating revenues climbed steadily from 1995-96 to 2000-01. Since that time, the percentage has varied with the economy, and is now roughly at the same percentage as in 2000. The City is heavily dependent on the tourism industry, which is expected to continue. A reliance on elastic revenues exposes the City to income fluctuations as a result of economic uncertainty. New projects underway will significantly increase TOT revenue, which is subject to economic fluctuations. Based on an expected continuing growth of elastic revenues as a percentage of total revenues, we have assigned a Caution rating for this indicator.

Recommendation:
Given the City's current and projected heavy reliance on elastic revenues, policies should be adopted to provide secure emergency reserves adequate to support the City through an economic decline spanning three years. Staff should also evaluate the economic development strategies that would diversify the tax base providing more economic stability and security.

Indicator 8: One-Time Revenues



	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
	0.0%	0.0%	0.0%	0.0%	0.0%	0.2%	0.1%	0.0%	0.0%	0.0%	0.1%

Finding: Favorable

Description
One-time revenues are those that are not expected to continue in future years. Examples of such revenues include single purpose grant revenue, revenue from the sale of assets, and other miscellaneous reimbursements. Continual use of one-time revenues to balance the annual budget is an indication that the revenue base may not be strong enough to support current service levels. Natural disaster related revenues from the Federal Emergency Management Agency and the State of California Office of Emergency Services are excluded from this analysis.

Comments and Analysis
One time revenues constitute a minimal amount of overall City general fund revenue, and are primarily from the sale of surplus assets.

Recommendation:
A fiscal policy should be developed that would limit the use of one-time revenues to one-time expenditures (i.e. capital projects, reserve contributions). This will avoid placing ongoing operations in the position of depending on an infusion of ongoing revenue in the future.

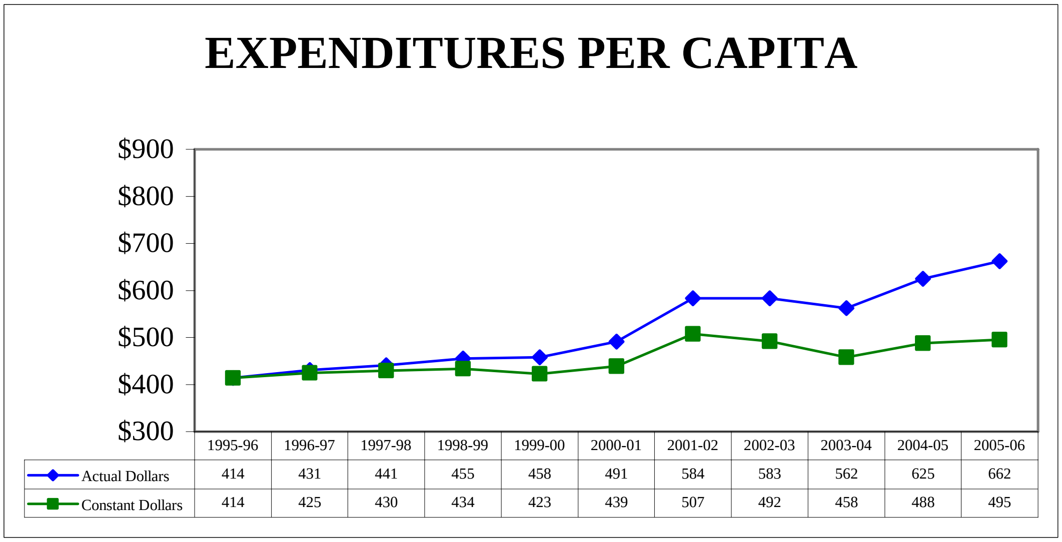
General Fund Expenditures

General Fund expenditures are largely indicative of the level and types of services the City provides. Changes in the total dollar amount of expenditures can indicate a shift in the level of services delivered, either because demand has changed or because the cost of maintaining existing services has increased or decreased. Therefore, the analyses that follow show not only the change in total dollars, but changes in the types of expenditures for the past fiscal year.

A full expenditure analysis is provided for the following:

- Expenditures Per Capita
- Authorized Positions Per Capita
- Fringe Benefits as a Percentage of Operating Expenditures
- Salary as a Percentage of Operating Expenditures
- Capital Outlay as a Percentage of Operating Expenditures

Indicator 9: Expenditures Per Capita



	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Actual Dollars	414	431	441	455	458	491	584	583	562	625	662
Constant Dollars	414	425	430	434	423	439	507	492	458	488	495

Finding: Unfavorable

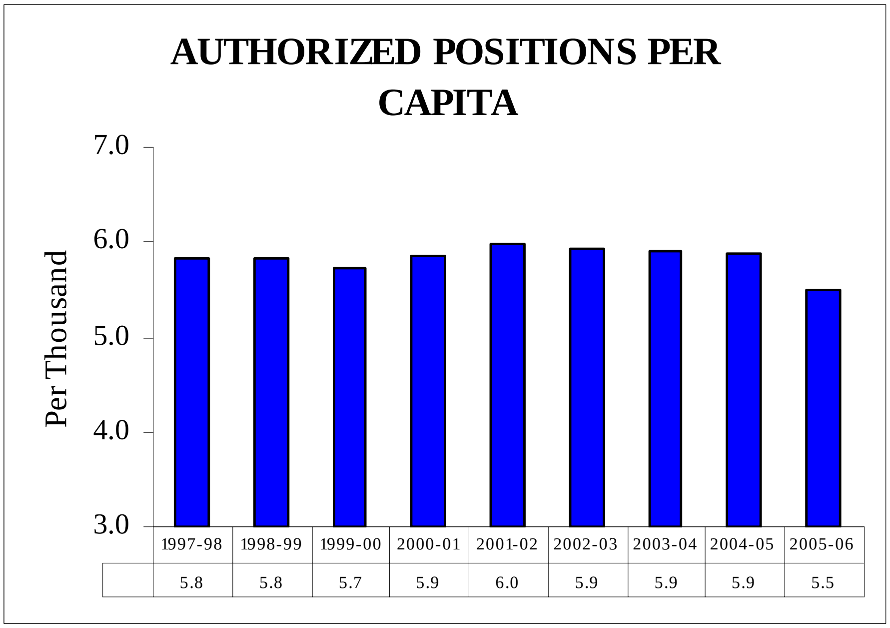
Description

Expenditures per capita demonstrate the change in expenditures relative to the change in population. This indicator analyzes the demand for City services as the population changes. Increasing per capita expenditures may indicate the costs of maintaining existing service levels are rising or service levels are changing to reflect new demands. A decrease in expenditures per capita could signal the City's inability to maintain current service levels, or that the City is maintaining current service levels with added efficiency.

Comments and Analysis

While the chart above shows a leveling off of expenditures per capita, that is only achievable because 30 positions were frozen during the FY 2005-07 budget cycle in order to balance the budget. Employee benefit costs have increased, primarily due to significant increases in CALPERS pension contribution rates as a result of investment losses. Although there has been slow growth in population, the real cost to provide services to support capital and operational demands have increased disproportionately. As a result, an Unfavorable rating is assigned to this indicator. CALPERS rates are expected to stabilize or decrease slightly due to the new CALPERS rate smoothing model. Health insurance rates, however, are projected to continue to increase at a 15% annual average rate.

Indicator 10: Authorized Positions Per Capita



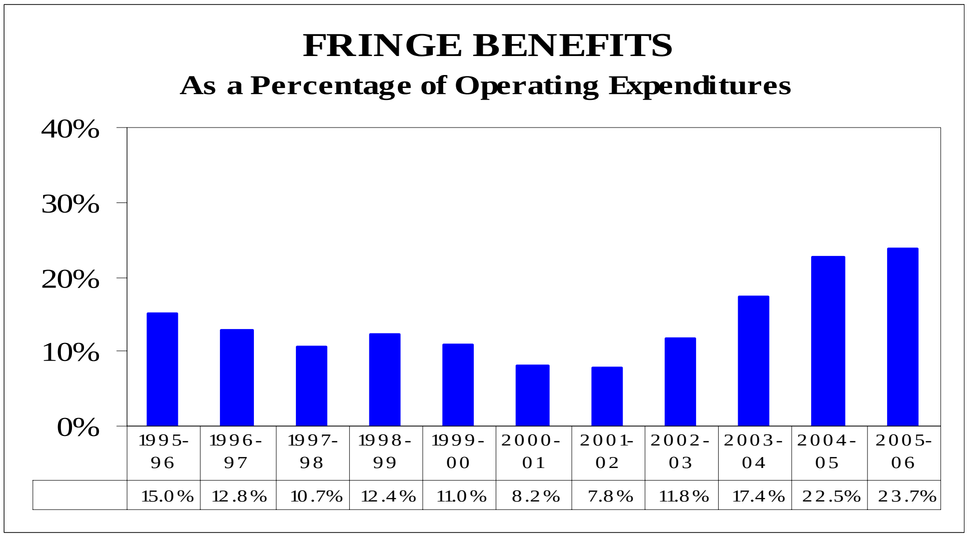
Finding: Unfavorable

Description
This indicator measures the number of authorized positions per capita. If this figure is rising, it could indicate that the City is becoming more labor intensive or that employee productivity is declining. Conversely, if this figure is declining, it could indicate that employee productivity is increasing; a need for more employees to respond to additional service demands; or the City is becoming less labor intensive. Although a downward trend may indicate that City staff is becoming more efficient at maintaining current service levels, the employee level should not get so low that service levels cannot be maintained.

Comments and Analysis
Authorized positions per capita have decreased from 5.8 to 5.5 per thousand from 1998 to 2006. In the FY 2005-07 budget process, 30 positions were frozen (7%), which is the primary reason for the decrease. However, had these positions had not been frozen, authorized positions per capita would have remained relatively stable over time while increased demand for maintenance of new facilities, such as parks, has increased. The current low level of employees will affect service level performance.

Recommendation:
Given the increasing demand for services and the inability to fund necessary staff, care should be taken to focus resources on the highest priority, programs and alternative service delivery options. Deficiencies should be studied.

Indicator 11: Fringe Benefits as a Percentage of Operating Expenditures



Finding: Unfavorable

Description

Fringe benefits include the City's share of payroll taxes, pension plan costs, medical, life and disability insurance, and workers' compensation funding. Fringe benefits are directly related to salaries and wages, so changes in the percentage rate reflect a change in the benefits package or the City's cost in maintaining its benefits.

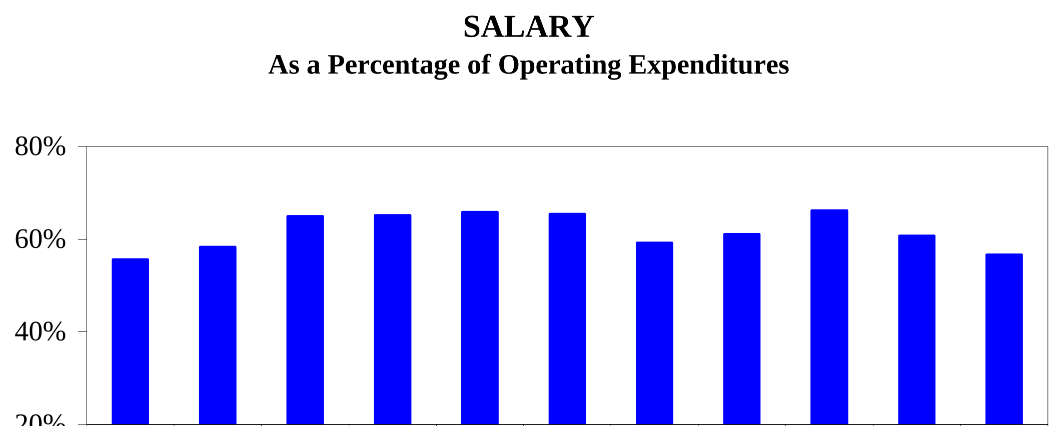
Comments and Analysis

Fringe benefit costs as a percentage to the City's total operating expenditures declined from 1996 to 2002 then increased dramatically due to health care, workers compensation and retirement cost increases. The increase from 2004 to 2005 was $1.3 million in total, or 12%. The percentage increase was modest in FY 2005-06 due to 30 frozen positions. As a result, we have assigned an unfavorable rating to this indicator. Staff expects benefit costs to stabilize going forward due to the new CALPERS rate smoothing model. Health insurance rates, however, are projected to continue to increase at double digit rates.

Recommendation:

Though projections indicate these trends will moderate in the future, it is recommended that staff pursue cost containment alternatives with labor to reduce benefit cost and create capacity for other operating needs.

Indicator 12: Salary as a Percentage of Operating Expenditures



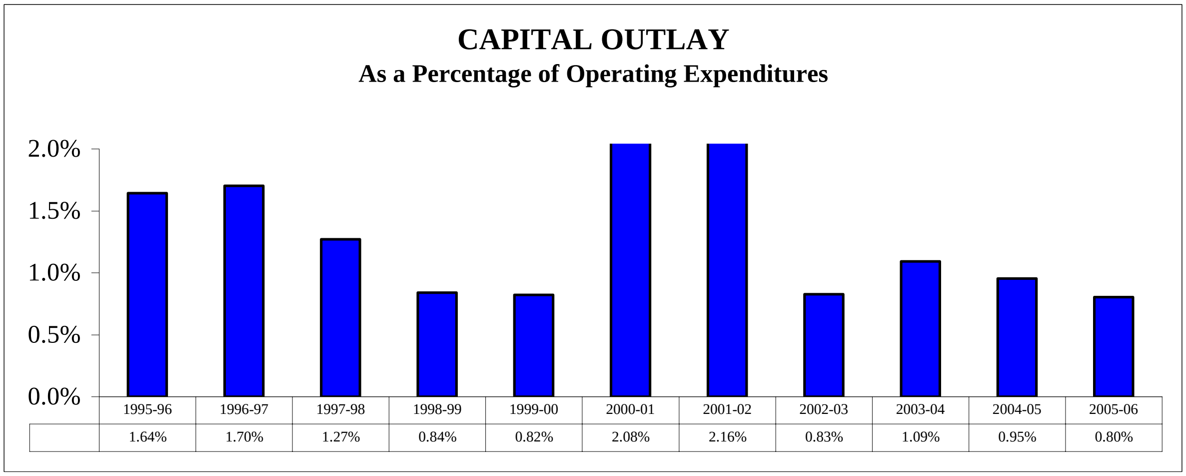
1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
55.6%	58.3%	64.9%	65.2%	65.9%	65.4%	59.2%	61.1%	66.2%	60.8%	56.6%

Finding: Favorable

Description
These expenditures include salary and wages paid to regular, part-time, and temporary staff and represent over 55% of General Fund disbursements. Any changes in salary expenditures will have a material impact on the City's finances.

Comments and Analysis
Salary expenditures as a percentage of operating expenditures has remained relatively stable over time, and decreased in 2005-06 due to frozen positions which reduced the City's workforce by 8% from FY 2003-04. Continued monitoring of this indicator is warranted since these expenditures represent the largest category of General Fund operating costs. A rating of Favorable has been assigned to this indicator as the trend has shown a decrease. However, unfreezing positions in order to properly staff departments would begin an upward trend.

Indicator 13: Capital Outlay



Finding: Caution

Description

Capital outlay does not include capital project expenditures for the construction of improvements or buildings, or for infrastructure such as streets or storm drains. Additionally, this category does not include replacement vehicles as the City has a Vehicle Replacement Policy that provides a mechanism for that funding. The purpose of capital outlay in the operating budget is to replace worn equipment or to add new equipment. The ratio of capital outlay to net operating expenditures is an indicator as to whether worn or obsolete equipment is being replaced. A decline in this ratio over a period of years may indicate that capital outlay needs are being deferred and that inefficient or obsolete equipment is being utilized. This would not only have the effect of lowering productivity, but could also expose the City to greater liability.

Comments and Analysis

Spending on capital outlay has been inconsistent, ranging from a low of 0.82 percent of total operating expenditures to a high of over two percent of operating expenditures during the past ten years. A rating of Caution has been assigned to this indicator as the City may be at risk of foregoing needed capital investment in order to meet budget challenges.

Recommendation:

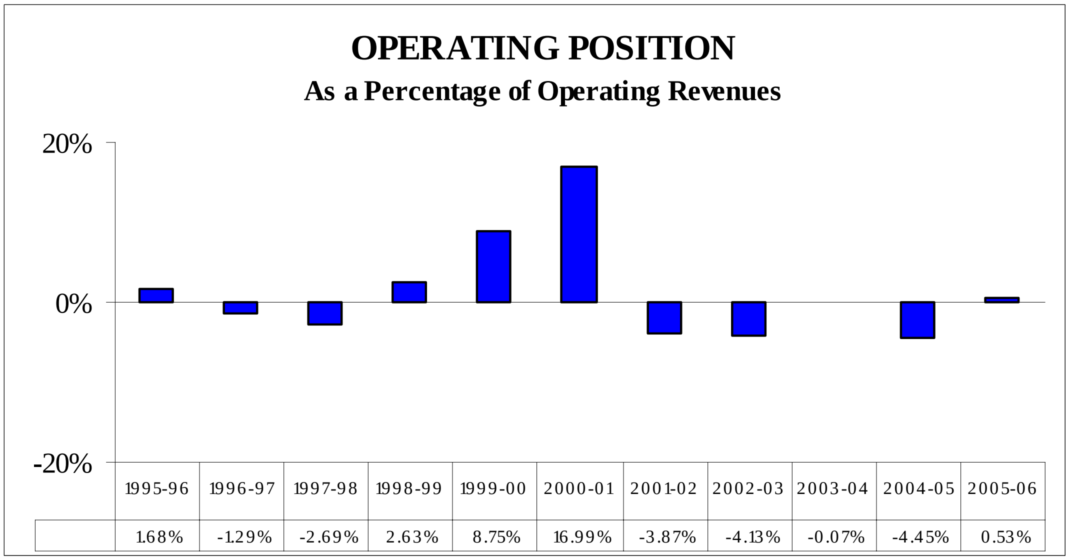
The guidelines established by ICMA indicate that a city should spend roughly 1.5% of operating expenditure on capital outlay. Napa should monitor spending patterns to ensure that equipment replacement is not deferred inappropriately.

General Fund Operating Position
Operating position is defined as the City's ability to balance current revenues against current expenditures, maintain adequate reserve levels, and cover short-term liabilities with short-term assets.

A complete analysis is provided in this section, and the following indicators are examined in detail:

- Operating Position as a Percentage of Operating Revenues
- Unreserved Fund Balance as a Percentage of Operating Expenditures
- Liquidity Ratio
- Debt Service

Indicator 14: Operating Position



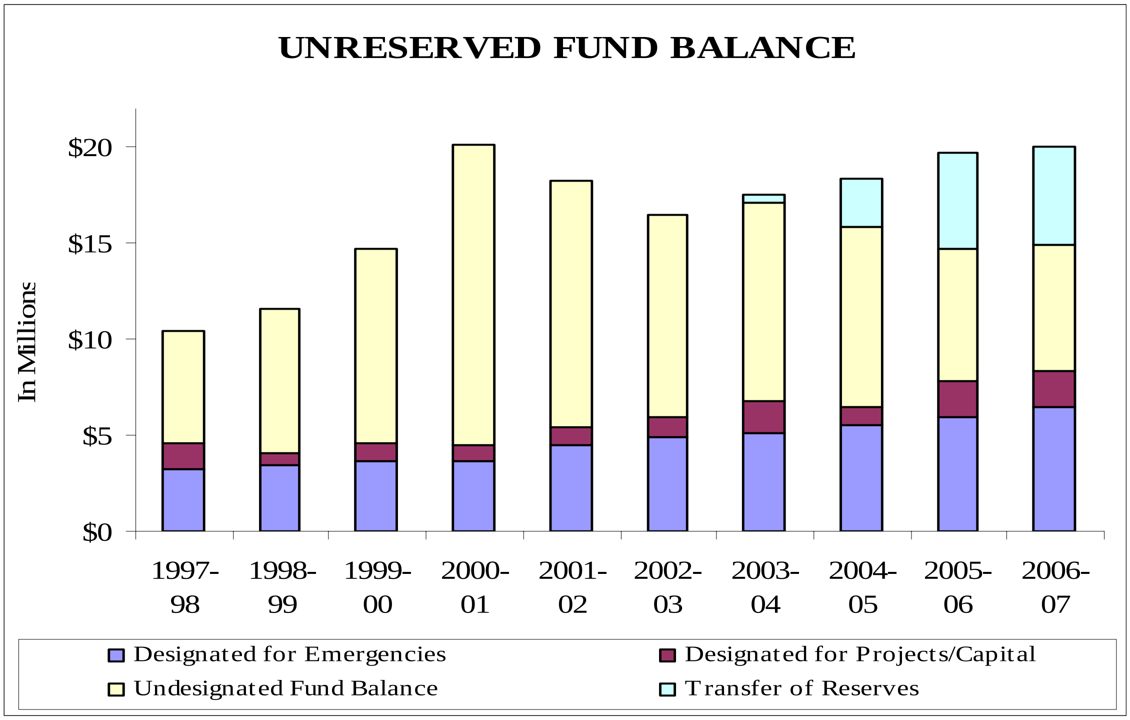
Finding: Unfavorable

Description
This indicator measures the City's ability to balance operating revenues, excluding fund balances from the prior year, against operating expenditures. When operating revenues exceed operating expenditures an operating surplus is achieved. A deficit occurs when the reverse happens and the City is forced to utilize available fund balances from prior years. This analysis is performed for the General Fund only, as this is where the majority of operating activity takes place. It excludes transfers to and from the Capital Improvement Program and revenues and expenditures related to natural disasters which have occurred in the City. A deficit would be of serious concern for the City's ability to balance its budget.

Comments and Analysis
The City has experienced a number of years with operating deficits, but due to the freezing of 30 positions and a higher than normal vacancy rate, has achieved an operating surplus in FY 2005-06 of approximately $270,000. Expenditures have risen at a faster pace than revenues, requiring budget balancing measures that have impacted City service levels.

Recommendation:
Fiscal policies should reflect a commitment to maintaining a positive operating position utilizing reserves to offset an operating deficit should be avoided in order to ensure more stable service delivery in the long term.

Indicator 15: Unreserved Fund Balance/Emergency Reserve



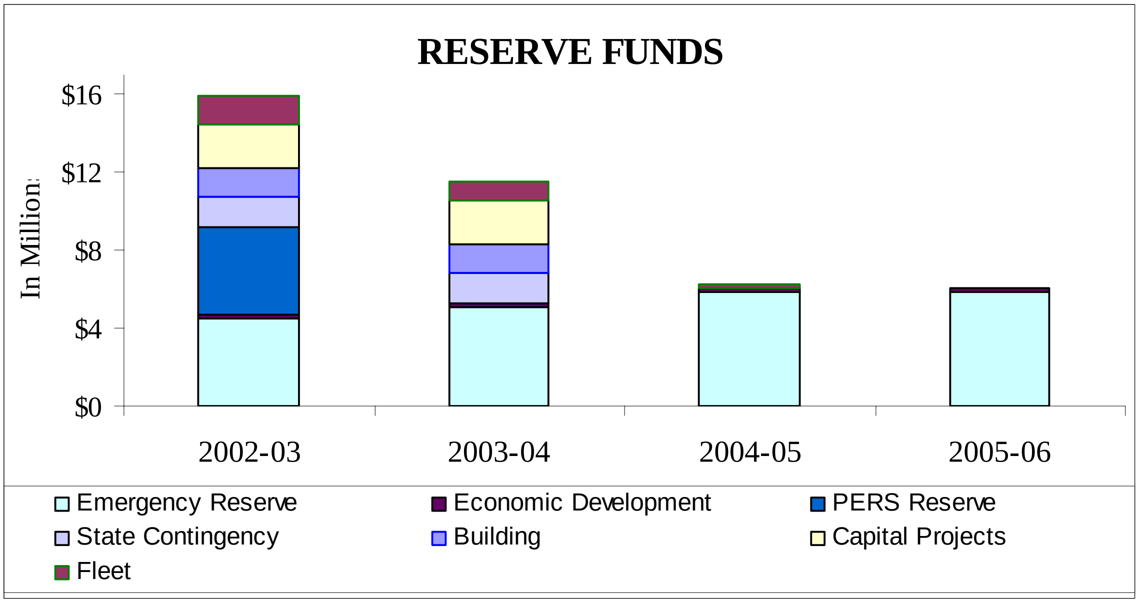
Finding: Unfavorable

Description

Unreserved fund balance refers to those dollars available for use in the event of a financial emergency, short-term revenue fluctuations or an economic downturn. The City attempts to operate each year at a surplus to ensure the maintenance of adequate reserve levels.

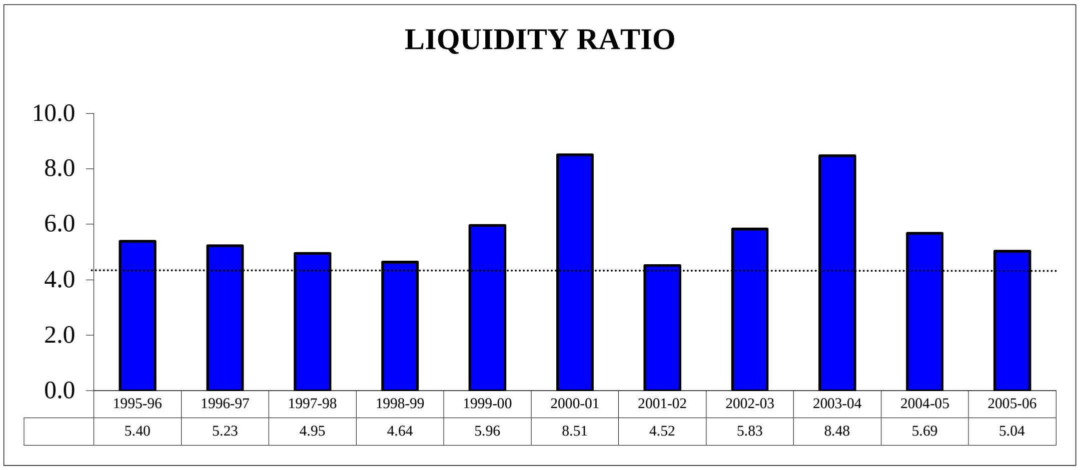
Comments and Analysis

The City currently has a policy of designating an amount equal to ½ of annual property tax revenues as an emergency reserve of $5.9 million. This designated amount is included in the unreserved fund balance analyzed. There are no other formal policies regarding fund balance levels, and fund balance has been used to meet budget shortfalls in recent years. The growth in fund balance in the past three fiscal years resulted from the one time transfer of reserves from the Building Reserve ($1.5 million), Capital Project Reserve ($2.3 million), and Fleet Rebate ($1.4 million). These transfers account for $5.2 million of reserves at June 30, 2006 or 25% of unreserved fund balance. The balance of these reserves has been extinguished.



Recommendation:
Had these transfers not occurred, fund balance as a percentage of expenditures would have been at it 40% as experienced in fiscal years 1997-98 and 1998-99. It is recommended that the City consider adopting reserve and other fund balance policies and take measures to ensure that operating revenues are sufficient to cover operating expenditures.

Indicator 16: Liquidity Ratio



Finding: Favorable

Description
Liquidity measures the City's ability to meet short-term obligations. Liquidity is measured by comparing current assets to current liabilities. Current assets include cash, short-term investments, accounts receivable, and other assets that can be rapidly converted to cash. Current liabilities include accounts payable, accrued wages, accrued expenses, and deposits, all obligations that can be immediately demanded for payment. A liquidity ratio of less then 1:1 can indicate insolvency and is cause for alarm. A ratio above that is considered favorable.

Comments and Analysis
The City has been able to maintain a liquidity ratio well above 1:1 for the past ten years. The ratio stood at a healthy 5.04 at the end of fiscal 2006.

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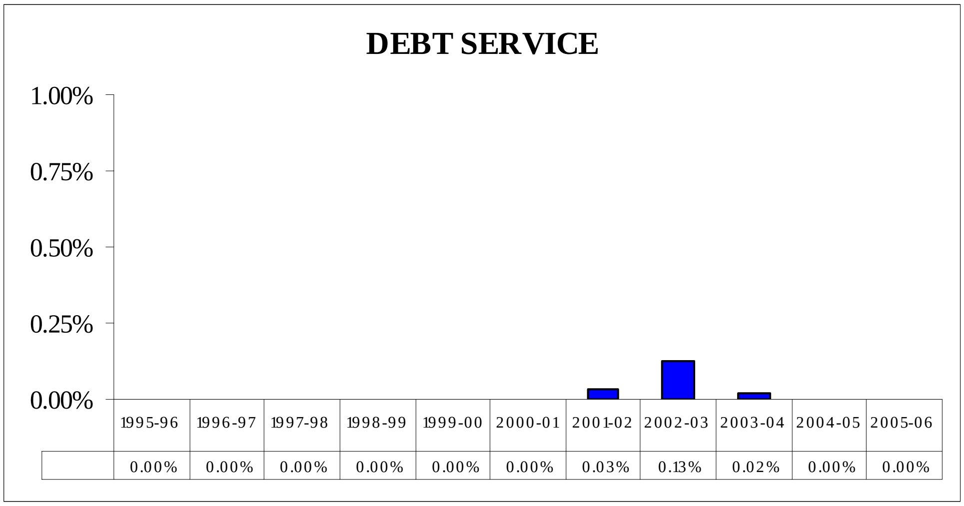
Indicator 17: Debt Service



Finding: Favorable

Description
Debt service includes the principal and interest payments from General Fund obligations of the City. It is analyzed as a percentage of operating revenues, the base against which the size of the debt service payment can be measured and compared.

Comments and Analysis
The City's ratio of debt service to operating revenues is zero and the City has capacity to issue debt.

Additional Indicators
Two additional indicators are analyzed to provide information on the financial condition of the City.

Because of the City's dependence on property tax revenues, the City's largest source of operating revenue (27%), a further analysis has been done on the change in assessed property values from year-to-year. Property values have trended upwards in four consecutive years.

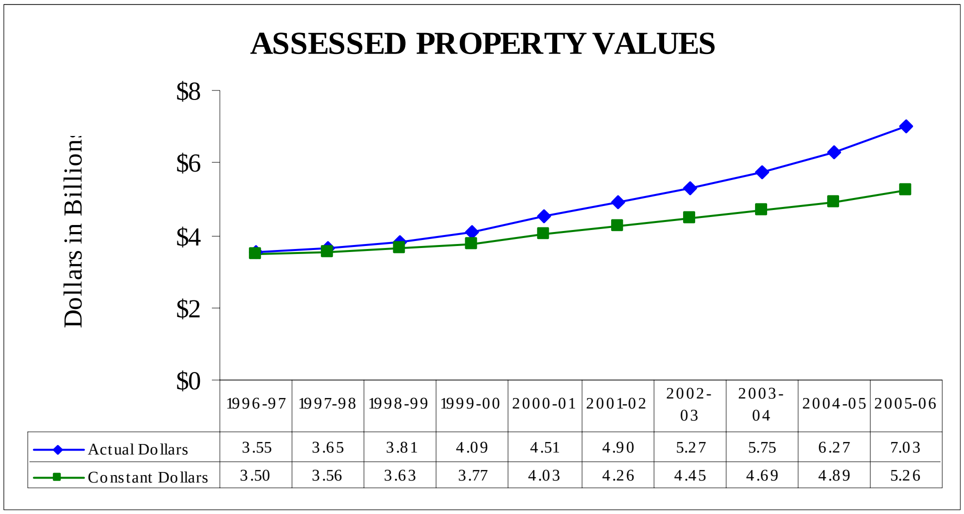
Finally, the population of the City has been analyzed over time to determine its impact on the tax base as well as the effects on additional service demands.

The following indicators are detailed in this section:

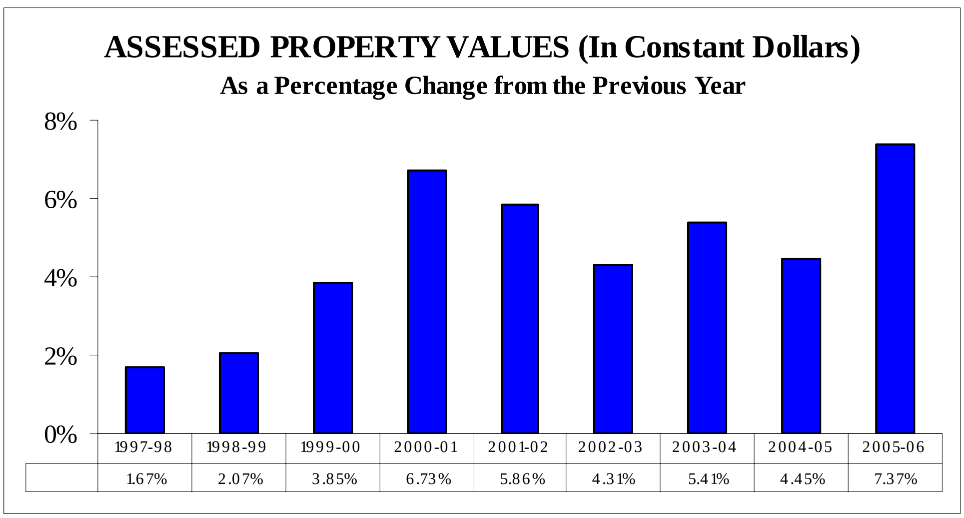
- Assessed Property Values

- Population

Indicator 18: Assessed Property Values



	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Actual Dollars	3.55	3.65	3.81	4.09	4.51	4.90	5.27	5.75	6.27	7.03
Constant Dollars	3.50	3.56	3.63	3.77	4.03	4.26	4.45	4.69	4.89	5.26



	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
	1.67%	2.07%	3.85%	6.73%	5.86%	4.31%	5.41%	4.45%	7.37%

Finding: Favorable

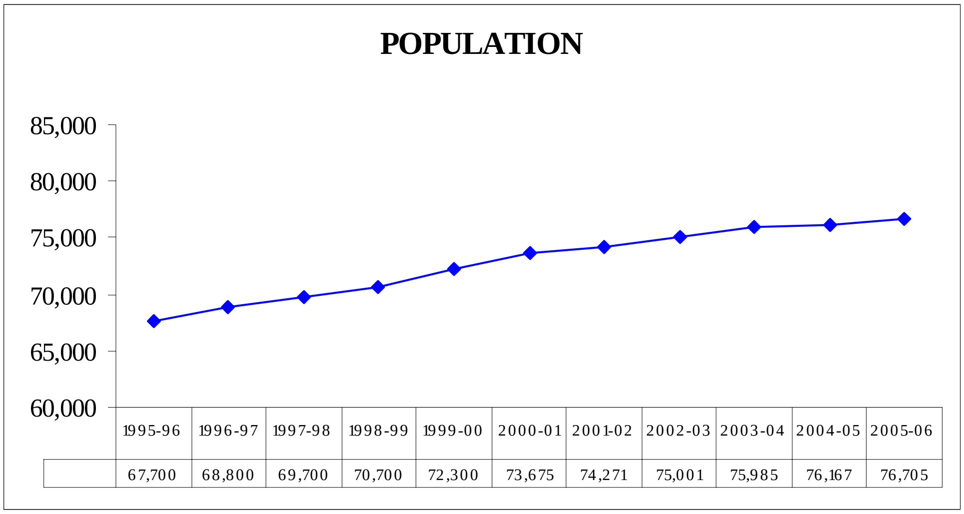
Description

Assessed property values, in both actual and constant dollars, are of primary importance to the City because property tax revenue, comprising 34% of the total General Fund operating revenues in fiscal year 2005-06, is the City's largest source of revenue. The effect of declining property values on total General Fund revenues is a significant concern considering the city's reliance on property taxes. Likewise, a positive trend indicates an improvement in the City's financial condition.

Comments and Analysis

Real estate appreciation continues to be positive for the City due to the strong housing market in California during recent years. The strong local economy and the continued low mortgage rates have contributed to this success.

Indicator 19: Population



Finding: Favorable

Description

The exact relationship between population change and other economic and demographic factors is uncertain. However, a sudden increase in population can create immediate pressures for new capital expenditures and higher levels of service. Conversely, a rapid decline in population allows for a smaller tax base for spreading City costs that cannot be reduced in the short run, such as debt service, pensions, and governmental mandates.

Comments and Analysis

Population growth in the City has progressed steadily and slowly in recent years, averaging less than 1% per year. As a result, the City has not had to increase expenditures to provide increased service levels to the residential population. Staff should monitor future growth based on residential and commercial development activity to identify changing trends that may impact service demands.

FINANCIAL FORECAST

An updated six-year financial forecast for the General Fund has been prepared to reflect economic projections on the City's future financial condition. The General Fund provides the resources to pay for most City services such as police services, street maintenance, park maintenance, recreational and other critical programs. The General Fund also is the most vulnerable to outside influences, such as State and Federal takeaways, downturns in the economy, taxpayer initiatives and other factors.

Development of the Financial Forecast

An updated six-year financial forecast for the fiscal years 2006 through 2013 has been developed for the General Fund. The objective of the financial forecast is to provide a frame of reference for evaluating the City's financial condition as a basis for decision-making.

The forecast presented uses the present level of services and capital needs as the baseline. Inflation and historical analysis are used to predict expenditure patterns while revenues are projected by trend or by specific known events. Information regarding economic indicators and the performance of the economy, as a whole, over the forecast period was taken from the California Department of Finance and the Napa County Auditor/Controller's office, the City's Community Development and Economic Development Departments.

While the national economy has shown signs of recovery, projections for the Napa area are relatively optimistic. Property and sales tax revenues have shown significant year over year increases, and future development underway is expected to have a positive impact on revenues. Without taking into account FEMA reimbursements, General Fund revenue for 2005-06 increased by 5.7% over the previous year. Growth is also projected to continue through 2013 due to visibility in both commercial hotel and resort developments that include the Westin, Inn at Town Center, and the Napa Spa and Resort. Improvements to the Redwood Plaza shopping center and the Gasser project are also expected to contribute to overall growth.

Economic and Demographic Assumptions

The economic assumptions utilized in this forecast are summarized below:

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Population (Residential)	77,474	77,861	78,251	78,642	79,035	79,430
Property Tax (% Change)	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Sales Tax (% Change)	4.2%	3.4%	3.9%	3.6%	3.4%	4.5%
Transient Occupancy Tax (% Change)	5.0%	5.7%	13.2%	32.8%	3.0%	3.0%
Investment Earnings Rate	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%
Salaries (% Change)	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Benefits (% Change)	7.4%	7.5%	7.6%	7.7%	7.8%	7.9%
Services & Supplies (% Change)	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Capital Outlay (% Change)	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Authorized Positions (# Change)	0	0	0	0	0	0

Inflation (Consumer Price Index): Inflation is the measure of the increase in cost of goods and services. Inflation impacts many revenue and most expenditure categories throughout the seven-year forecast and is projected to average 3% per year.

Population: Population size is the primary basis for the allocation of Motor Vehicle taxes and is projected to increase at an average of 0.8% annually. Population is the residential total within the Napa city limits. Year-to-year population growth is a useful factor in predicting increases in other revenue categories, such as Franchise Fees and Business Licenses.

Factors Not Included In the Forecast

- This forecast is based on the General Fund only, and disaster related Federal Emergency Management Agency (FEMA) and State of California Office of Emergency Services (OES) revenues and expenditures are not included.

- No new or enhanced programs are included in the forecast

- None of the 30 positions frozen in the FY 2005-07 budget cycle have been restored. The City will need to decide how to allocate additional available resources.

- Potential state impacts are not included in the forecast.

- The forecast does not include the cost of fiscal changes that the City may want to consider, including:
    1. Funding of specific reserves.
    2. Establishing equipment and other infrastructure replacement funds.
    3. Increasing General Fund contribution to the CIP.
    4. Funding the full cost of retiree medical premiums per the GASB 45 actuarial analysis.

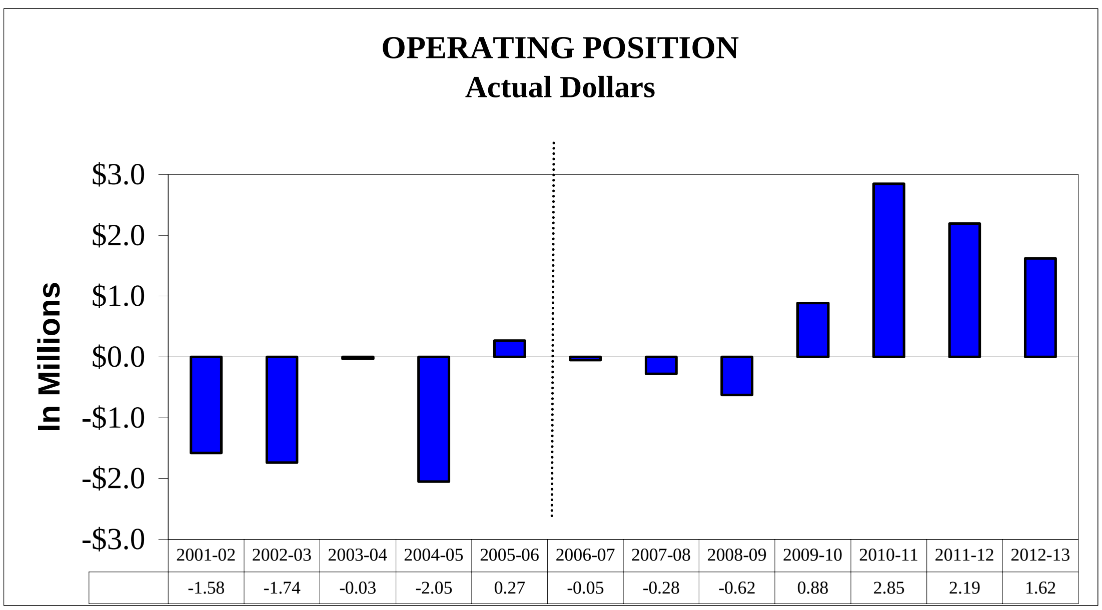
•Only sizable commercial development has been included.

•Impacts from new development on staffing demands.

•The forecast does not include the potential cost of recommendations from staff or Council initiated projects to be developed in the upcoming 2007-2009 budget cycle.

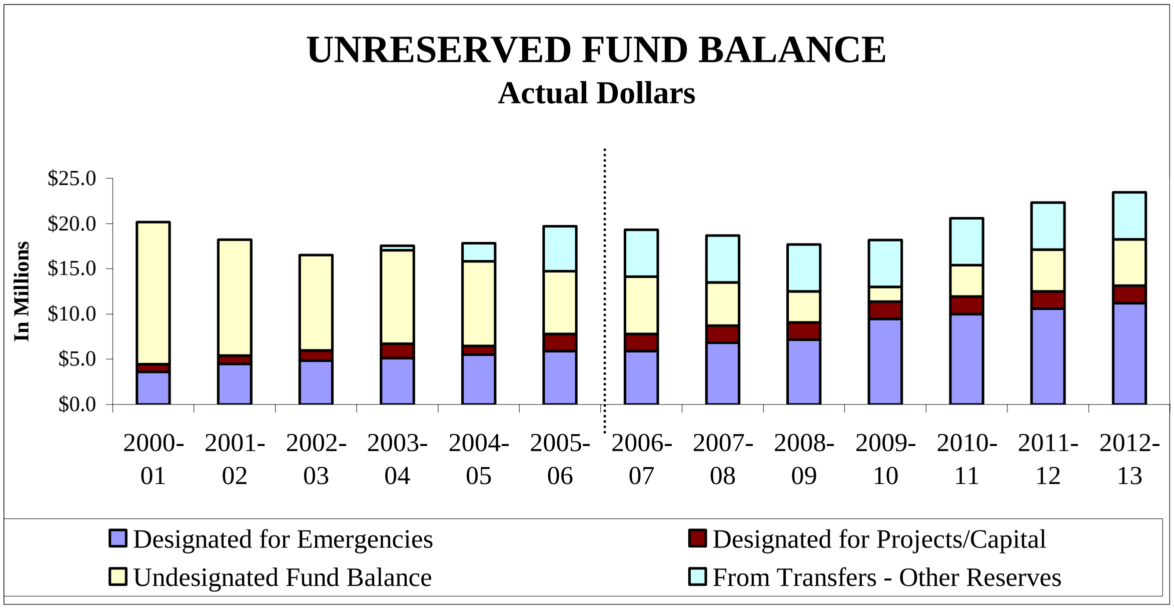
Forecast Summary & Results

Operating position refers to the City's ability to match revenues to expenditure levels, i.e. if revenues exceed expenditures, the City will have an operating surplus. The opposite is true if revenues fall below expenditures, then the result is an operating deficit. Over the six year forecast period, the City's revenue and expenditure projections generate a decrease in operating position for fiscal years 2006-07 through 2008-09, without restoring any of the frozen positions. After 2010-11, expenditure growth outpaces revenue growth.



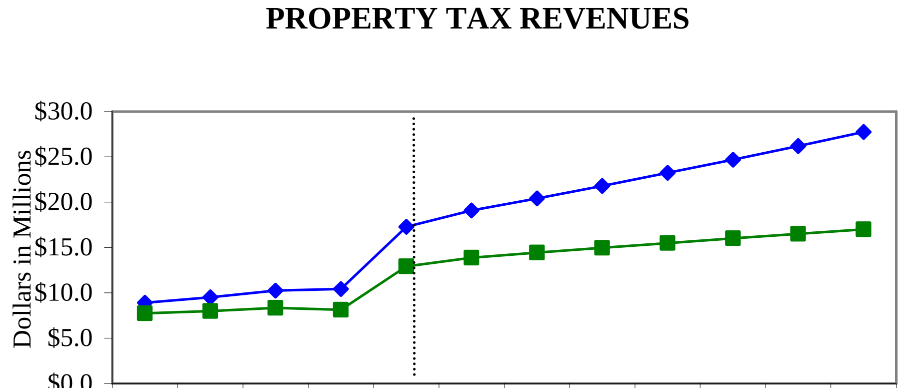
Included in the FY 2004-05 results is a one time payment from the State of $1.27 million, which represents the VLF "backfill" loan repayment. Increases in compensation costs are the primary driver of expenditures, which are projected to increase by over 5.6% per year. Any restoration of frozen positions or other enhancements to service level will reduce the projected operating position. In addition, the revenue forecast could be further affected by delays in new property underway, new property development not yet underway, the level of strength in the real estate market, and the level of tourism beyond that anticipated as part of the new hotel properties that are planned.

Unreserved Fund Balance



The Operating Position discussed in the previous slide reflects a decrease in the City's operating position in fiscal year 2007 and continuing through 2009. The Operating Position projection has not taken into account any reserves that may need to be used to cover natural disasters such as a flood. As mentioned earlier, the projected position also does not take into account any restoration of frozen positions or any other increase in service level to the community. It is recommended that the City develop fiscal policies that include specified reserves of fund balances.

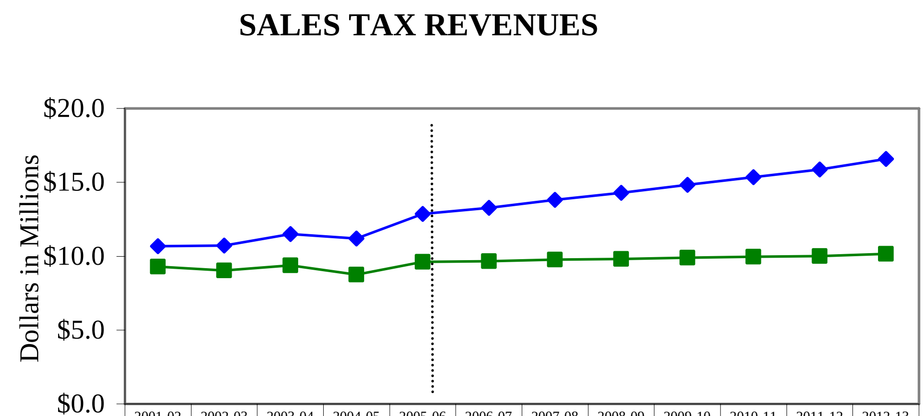
Property Tax Revenues



	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Actual Dollars	8.92	9.49	10.25	10.41	17.30	19.08	20.42	21.81	23.23	24.69	26.20	27.74
Constant Dollars	7.75	8.01	8.36	8.13	12.94	13.89	14.44	14.98	15.51	16.02	16.52	17.00

Property Tax continues to be the City's largest source of revenue and represented 34% of total revenues in FY 2005-06. As a result of continuing escalation of home valuation and historically low mortgage rates during the last few years, property taxes have increased dramatically, with the expected gain of 9% in 2007. A new element was also introduced in this revenue category when the State reduced the Vehicle License Fee from 2% to .65% statutorily in 2005. This difference was paid with Property Tax backfill commonly known as VLF In-Lieu Swap. Since payments are pegged against assessed value growth, VLF became a component of Property Tax revenue effective 2005. The forecast assumes continued growth of assessed values resulting in increased property tax revenue over the six-year period. The cumulative shift of Napa's General Fund property tax to schools in the form of Educational Relief Augmentation Fund (ERAF) totals $34.79 million.

Sales Tax Revenues



	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Actual Dollars	10.69	10.72	11.51	11.21	12.86	13.27	13.82	14.29	14.83	15.36	15.88	16.58
Constant Dollars	9.29	9.05	9.38	8.75	9.62	9.66	9.77	9.82	9.90	9.96	10.01	10.16

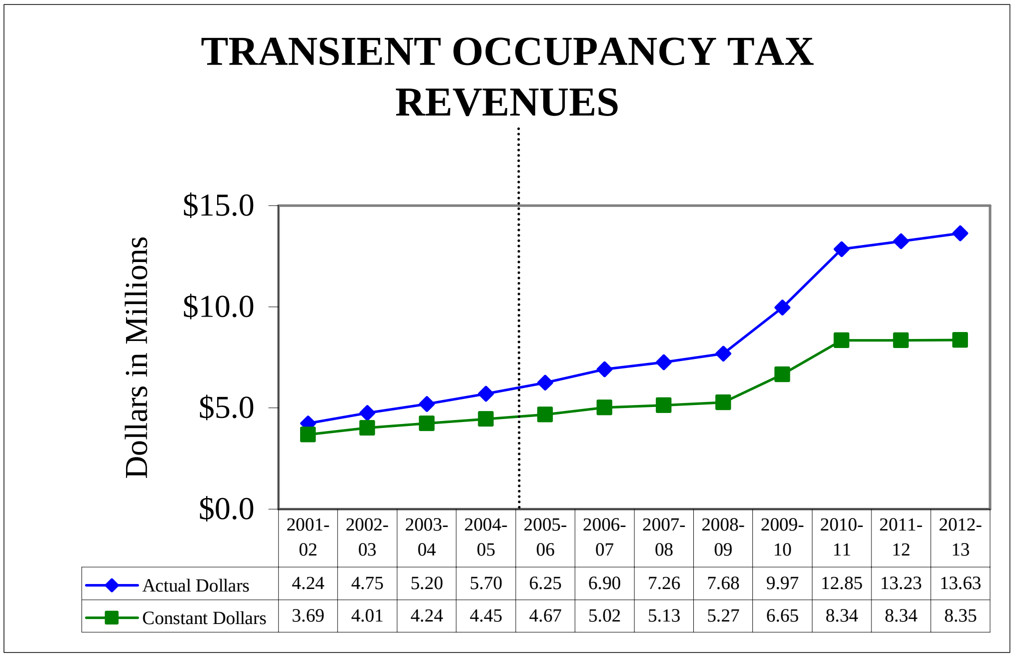
Sales tax is one of the City's most economically sensitive revenue sources and continues to be the City's second largest revenue source. Projected new development is expected to bring an incremental amount of sales tax revenue. Below is a summary of the incremental sales tax added to the sales tax base for this forecast.

Sales Tax Revenue Forecast
(in thousands)

	Estimated 2005-06	Projected 2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Base Sales Tax (Includes Prop 172)	$ 12,057	$ 12,419	$ 12,791	$ 13,175	$ 13,570	$ 13,977	$ 14,397	$ 14,829
Incremental Increases:								
General Location:								
Meritage Hotel		-	26	27	28	29	30	30
Buena Vista Hotel/Timeshare		-	6	6	6	6	7	7
Redwood Plaza Remodel		-	36	37	38	39	40	41
Parkway Plaza Redevelopment:								
Inn At Town Center		-	-	-	9	10	10	10
Riverfront		-	-	-	9	9	10	10
Proposed Redevelopment Area:								
Napa Spa and Resort		-	-	-	-	-	69	71
Gasser		-	-	-	-	-	-	45
Vasser Toyota		-	35	35	36	37	38	39
Straddles Redevelopment Areas:								
Westin		-	-	-	-	41	42	43
Oxbow Market		-	46	47	49	50	52	53
Totals	$ 12,057	$ 12,419	$ 12,940	$ 13,327	$ 13,745	$ 14,198	$ 14,693	$ 15,179

Using the assumption of moderate economic expansion in subsequent years combined with planned commercial development, sales tax revenues are expected to see annual gains of between 3.4% and 4.4%. Again, we emphasize the need to continue to seek ways to diversify the tax base to mitigate Napa's high reliance on elastic tax revenues.

Transient Occupancy Tax Revenues



Transient occupancy tax is the other of the City's most economically sensitive revenue sources and is the City's third largest revenue source. Projected new hotel development is expected to bring an incremental amount of transient occupancy tax revenue. Below is a summary of the incremental transient occupancy tax added to the tax base for this forecast.

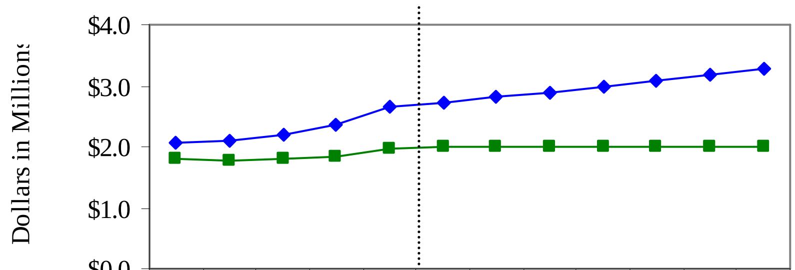
Transient Occupancy Tax Revenue Forecast
(in thousands)

	Estimated 2005-06	Projected 2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Base Lodging Tax	$ 6,249	$ 6,436	$ 6,629	$ 6,828	$ 7,033	$ 7,244	$ 7,461	$ 7,685
Incremental Increases:								
General Location:								
Meritage Hotel		417	521	537	553	570	587	604
Buena Vista Hotel/Timeshare		49	99	102	105	108	111	114
Parkway Plaza Redevelopment:								
Inn At Town Center		-	-	196	980	1,009	1,039	1,070
Proposed Redevelopment Area:								
Napa Spa and Resort						2,580	2,658	2,737
Straddles Redevelopment Areas:								
Westin		-	-	-	1,275	1,314	1,353	1,394
Totals	$ 6,249	$ 6,902	$ 7,249	$ 7,662	$ 8,670	$ 11,510	$ 11,856	$ 12,211

Using the assumption of moderate economic expansion in subsequent years combined with planned hotel development, transient occupancy tax revenues are expected to see annual increases between 3.0% and 32.8%.

Business License Tax Revenues

BUSINESS LICENSE TAX REVENUES

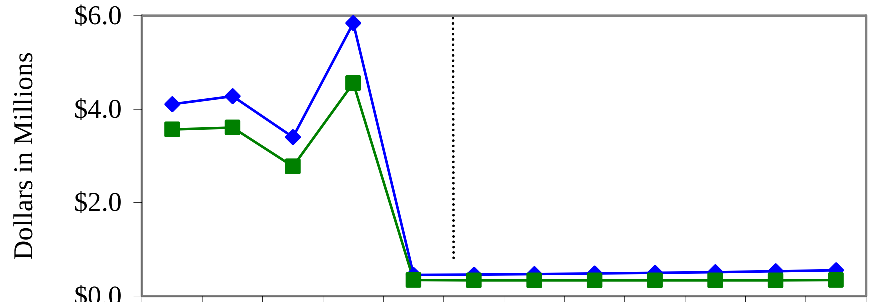


	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Actual Dollars	2.07	2.10	2.21	2.35	2.65	2.73	2.81	2.90	2.98	3.07	3.17	3.28
Constant Dollars	1.80	1.77	1.80	1.84	1.98	1.99	1.99	1.99	1.99	1.99	2.00	2.01

Business license tax revenues are based on gross receipts of businesses within the City. The average increase realized in fiscal years 2004-05 and 2005-06 was 10%. This increase is greater than inflation due to an audit program which increased the business licenses issued and the amounts paid. It is anticipated that future growth will occur at a rate of 3.0%.

Vehicle License Fee Revenues

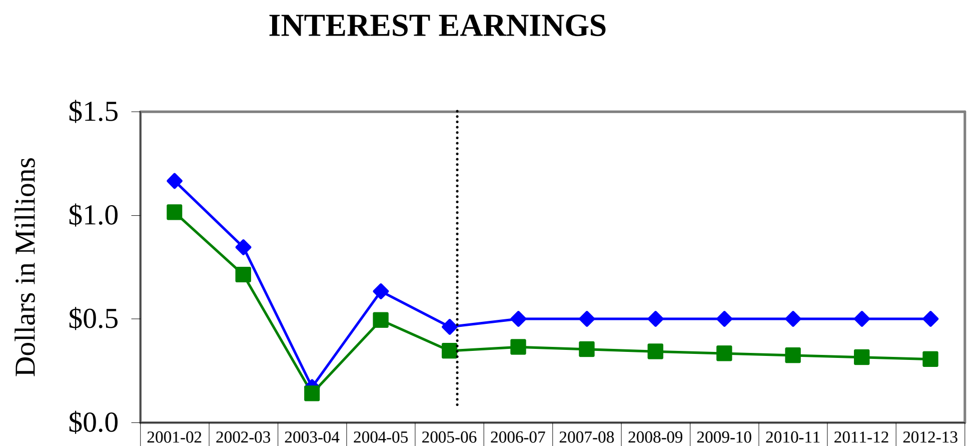
VEHICLE LICENSE FEE REVENUES



	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Actual Dollars	4.11	4.28	3.40	5.84	0.45	0.46	0.47	0.49	0.50	0.52	0.53	0.55
Constant Dollars	3.57	3.61	2.77	4.56	0.34	0.33	0.33	0.33	0.33	0.33	0.33	0.34

Motor Vehicle License Tax revenue declined in 2004 as a result of the State of California's take away of "backfill", defined as a $1.27 million gap loan from the City of Napa to the State of California. As discussed earlier, this gap loan was repaid in 2005 as a one-time revenue. In addition, the Vehicle License Fee was reduced from 2% to .65% statutorily in 2005. Since payments will be pegged against assessed value growth, it will be considered a component of Property Tax revenue effective 2005. This category projects minimum growth, essentially based on projected population growth, at an annual rate of less than one percent. It also assumes no further impact from State of California's budget balancing.

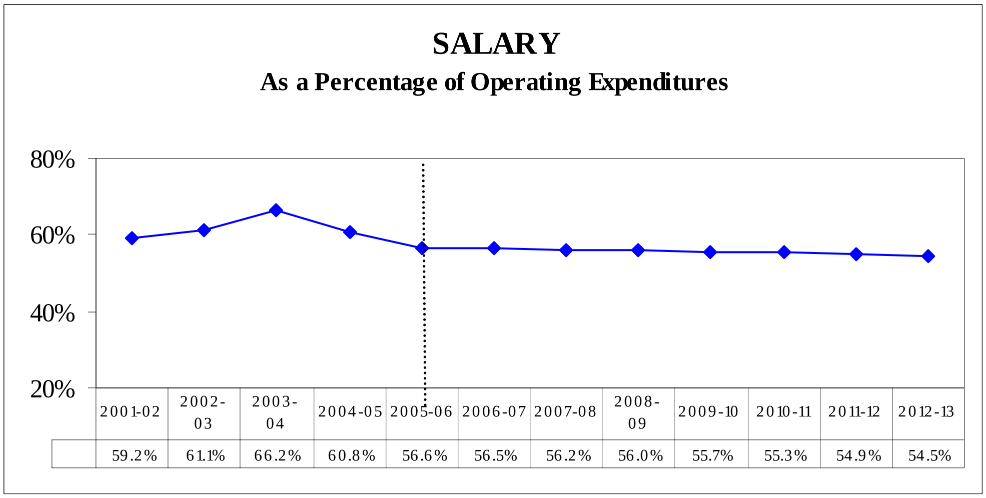
Interest Earnings



	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Actual Dollars	1.17	0.85	0.17	0.63	0.46	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Constant Dollars	1.01	0.71	0.14	0.49	0.35	0.36	0.35	0.34	0.33	0.32	0.32	0.31

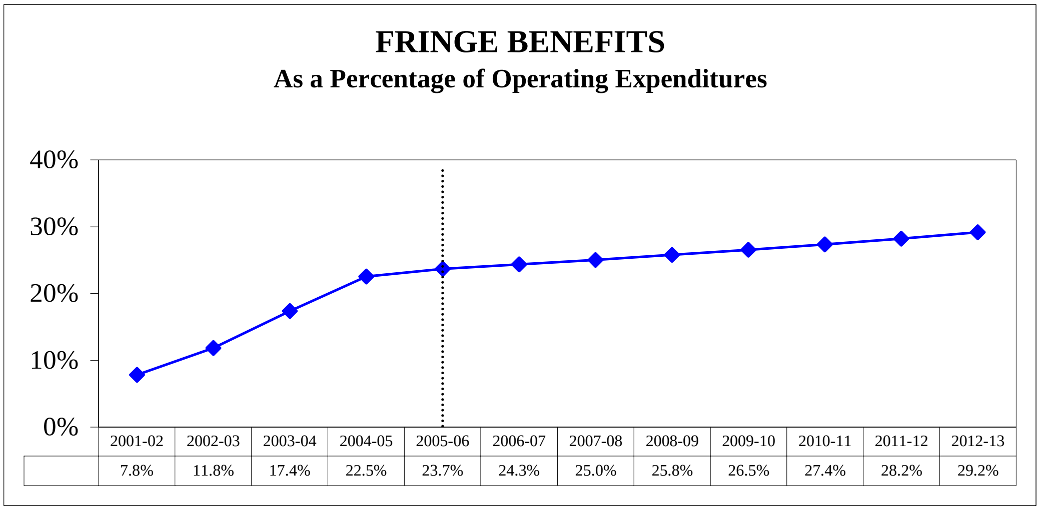
This revenue is based on the earnings generated by the investment of cash on hand. The City's portfolio is made up of accumulated revenues in excess of expenditures. It is also comprised of funds committed for Capital Improvement Projects and other purposes, but not spent. Much of the portfolio is invested in short-term instruments because of these commitments; therefore, has realized lower yields. Low interest rates have contributed to a decline in overall yield.

Salary as a Percentage of Operating Expenditures



Salaries have continued to account for more than 50% of the City's operating expenditure budget. Assuming no staffing additions over the forecast period, the percentage of salaries to total expenditures is expected to be relatively consistent. Annual step and cost of living increase averaging 5% have been included in the salary projections.

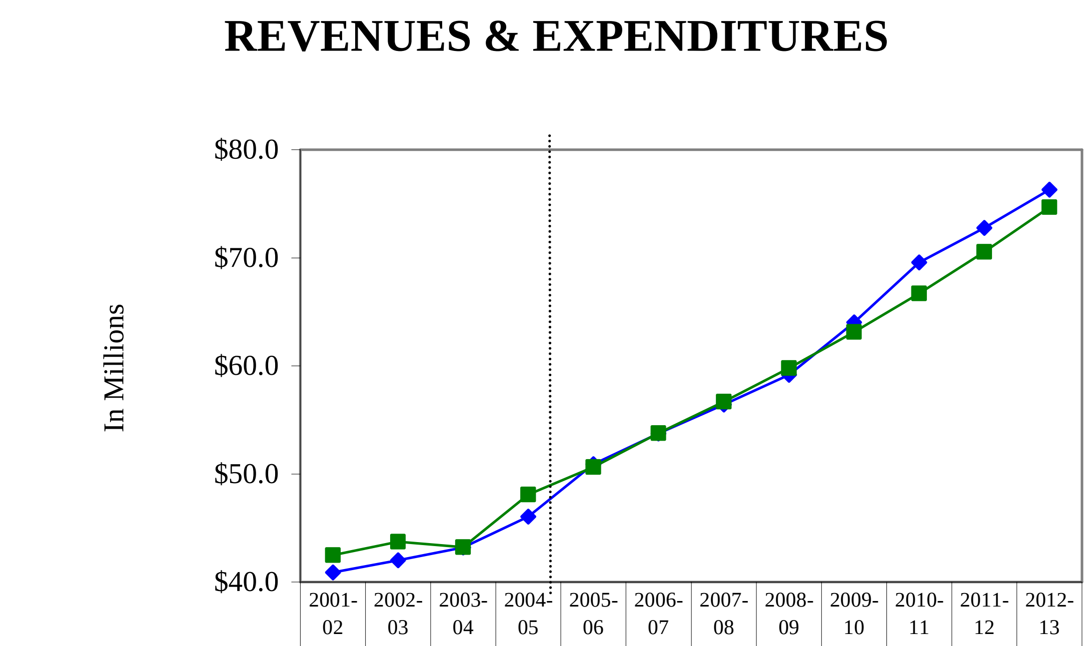
Fringe Benefits as a Percentage of Operating Expenditures



The employee benefits category reflects a moderation of growth commencing fiscal 2007 of the forecast period. The growth rate from the period between 2003 and 2006 is primarily a result of a significant increase in the California Public Employee Retirement System (PERS) employer rates. These rates vary, based on the market performance of PERS assets, the number of City employees covered by the retirement system, their base wage rates and other factors. This increase is attributed to investment losses in the stock market sustained by PERS. Since state law requires that PERS be fully funded, participating agencies like Napa, other cities and counties and the State government are required to make up market losses through increased employer contribution rates. As a result of these large fluctuations in employer rates, PERS has recently implemented additional smoothing in their actuarial calculations, thereby, minimizing the annual effects of investments returns on annual employer contribution rates.

Increases in health care costs are projected to continue to be significant, at an average annual 15% growth rate to.

Revenues & Expenditures



	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Total Revenues	40.90	42.00	43.18	46.06	50.89	53.73	56.41	59.18	64.02	69.56	72.75	76.31
Total Expenditures	42.48	43.73	43.21	48.11	50.62	53.78	56.69	59.81	63.14	66.72	70.56	74.69

Total revenues are forecast to grow by an average annual increase of 6.0% per year. Economic expansion from hotel development projects contribute significantly to overall operating position.

While there is expected moderation of benefit cost, particularly from the smoothing of PERS costs, expenditures are projected to increase at an average annual rate of 5.6% per year. Projected expenditures presume that service levels in effect in fiscal year 2005-06 will remain constant for the forecast period. No new programs are assumed, nor has the cost of any of the 30 frozen positions been restored.

As indicated on the graph, the forecast predicts that the City will experience a negative net position through 2009 and achieve a positive net position through 2013, given the assumptions in the model. It is important to note that revenue growth does not keep pace with expenditure growth at the end of the forecast period.

FINDINGS AND CONCLUSIONS

The information provided in the preceding pages indicates that the City of Napa is experiencing a period of fiscal change. The local economy is strong and improving as reflected in strong revenue growth across the board. Sales tax and transient occupancy revenues have grown steadily and hold promise for continued growth through current and future economic development efforts.

Over-reliance on elastic revenue (sales, transient occupancy) has been moderated by the significant growth in property tax revenue. This has resulted from increased property values reflecting the quality of life in Napa and the continuation of low interest rates which encourages investment. In addition the State, in contrast to past practice, has actually taken steps that benefit the City by replacing lost vehicle license revenue with equivalent property tax revenue adjustments. This transfer allows future revenue growth to be based on property values rather than population growth, a distinct advantage to this City.

Despite a positive report on the state of the local economy, it must be noted that expenditure growth continues to outpace revenue growth. This is a condition that cannot be allowed to continue. The option of utilizing vacant staff positions and accumulated reserves to balance operating deficits is not a viable or effective ongoing strategy.

It should also be noted that the above report focused on the City’s ability to provide for operating service delivery programs that are currently in effect using existing sources of revenue. Clearly there is a need for the growth of current programs The City has committed to building additional facilities like parks, trails and bridges, but we have not allowed for new staff to meet the increasing demands.

In addition, the report does not identify or quantify the lack of funds necessary to provide for the capital projects needed to meet expanding program requirements and to repair, maintain, and in some cases replace existing infrastructure. For example, a recent evaluation of the City’s street inventory has identified the need for $10 million per year over the next 10 years to bring local streets to acceptable operating condition and allow for needed preventative maintenance of the remainder of the road system. Funding for street maintenance that is not provided by State bonds or gas tax proceeds must compete for limited funding within the General Fund. Failure to address these infrastructure needs on a timely basis will result in increased liability and rapidly escalating costs as relatively inexpensive preventative maintenance projects become reconstruction projects due to deferred spending.

The following issues that have been identified in this report warrant consideration and action by the City Council and City staff in order to stabilize and secure the City’s fiscal future. Some can be studied and implemented in the immediate future as part of the pending budget review; others will require considerable study and evaluation involving interested stakeholders.

RECOMMENDED ISSUES FOR STUDY/ACTION:

- A formal *Fiscal Policy* document should be developed to establish standards and practices guiding critical financial management addressing:
    - Operating budget, revenue, expenditures, rates and fees, capital improvements, debt, reserves, investments, reporting
- Bringing operating revenues and expenditures into alignment
- Identifying appropriate staffing levels for core services and programs
- Appropriate use of debt
- Long term funding source for new facilities and existing infrastructure
- Labor cost containment alternatives
- Establishing standards for prudent reserves
- Impact of new development on service delivery and financial position
- Service delivery options
- Funding for capital equipment and major maintenance
- Opportunities for revenue development
    - Fees
    - Strengthen tax base
    - Tax options
    - Collection practices

- Funding for medical retiree program (GASB 45)
- Changes to the organizational structure to enhance efficiency and streamline operations.
- Funding to provide more timely compliance with Americans with Disability Act requirements