2008 Long Term Financial Plan
Trends and Forecast Analysis

I: INTRODUCTION

This document is the City of Napa's Long Term Financial Plan (LTFP). Since the Long Term Financial Plan is a fairly 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 the 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 fiscal policy section, a trend analysis based on actual audited data for the past 10 fiscal years (FY 1997-98 through FY 2006-07), a statement of current financial position, a forecast including projections for the current fiscal year (FY 2007-08) and looking ahead six years, through FY 2013-14. 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.

This plan takes into consideration the ten-year trend data based on actual audited information as well as significant new development either in the pipeline or known to be commencing soon. It does not, however, speculate as to projects beyond what is certain at this time.

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 have been developed and approved by the City Council. However, a full analysis of those issues with recommended findings and alternative solutions is still a work in progress. The Fiscal Policies section has been included to illustrate the City's compliance with the various policies. Preparing the necessary issue papers and policies to respond to identified issues will become the basis for work plan goals to be established in the future. Specific work efforts requiring the dedication of staff or other resources may be considered as the City Council reviews other program priorities.

The following table displays the status of the recommended issues for study/action from the 2007 LTFP:

Description/Item	Status	Comments
Develop formal Fiscal Policy document	Completed	Developed and adopted as part of the 2007-09 Budget Process.
Bring operating revenues and expenditures into alignment	In Process	Adopted Fiscal Policy. Goal is to comply with FY 2009-2011 budget cycle.
Identify appropriate staffing levels for core programs and services	In Process	Ongoing reviews taking place.
Appropriate use of debt	Completed	Adopted Fiscal Policy detailing appropriate uses of debt vs. internal loans/transfers.
Long term funding source for new facilities and existing infrastructure	In Process	Transportation Sales Tax scheduled for a November 2008 vote will address a major interest. Parks Master Plan is underway.
Labor cost containment alternatives	In Process	Benefit alternatives under review.
Establishing standards for prudent reserves	In Process	Established as part of Fiscal Policy document. Open items include an equipment replacement reserve and will be developed as part of the 2009-11 budget cycle.
Impact of new development on service delivery and financial position	In Process	Napa Pipe Study, Water Study and Parks Master Plan are all underway.
Service delivery options	Delayed	Researching various options of sharing resources with other local entities.
Funding for capital equipment and major maintenance	In Process	Six-year plan and funding to be developed during FY 2009-2011 budget cycle per Fiscal Policy.
Opportunities for revenue development • Fees • Strengthen Tax Base • Tax Options • Collection Practices	In Process	Adopted Fiscal Policy to adjust user fees and rates annually. The City is experiencing stronger local investment and the tax base is improving.
Funding for medical retiree program (GASB 45)	In Process	Funds have been appropriated in the 2007/08 and 2008/09 budgets.
Changes to organizational structure to enhance efficiency and streamline operations	Ongoing	In process of developing organizational recommendations beginning with Community Development and Police Department.
Funding to provide more timely compliance with Americans with Disabilities Act requirements	In Process	FY 07-09 Budgets allocated $200K per year. Ongoing increasing appropriations will be considered in future budget cycles.

II: FISCAL POLICY

Objective

To review the City's Fiscal Policy on an annual basis in order to determine appropriate changes, additions or deletions.

Background

As recommended by the Government Finance Officers Association (GFOA), City staff developed, and presented to Council, a set of Fiscal Policy statements that have been adopted to address the following areas:

- General Financial Goals
- Operating Budget Policies
- Revenue Policies
- Expenditure Policies
- Utility Rate and Fees Policies
- Capital Improvement Budget Policies
- Short-Term Debt Policies
- Long-Term Debt Policies
- Reserve Policies
- Investment Policies
- Accounting, Auditing & Financial Reporting Policies

GFOA further recommends that the adopted Fiscal Policy be reviewed on an annual basis in conjunction with the preparation of the Long Term Financial Plan and the City's budget process. This review is performed by staff in order to document proposed new policies identified through the preparation of the Long Term Financial Plan. Additionally, as circumstances change, there is sometimes a need to modify existing Fiscal Policy statements.

In an effort to present clear fiscal direction in a concise format, staff developed each policy to allow ease in implementation.

Recommendation

It is recommended that the City's revised Fiscal Policy as follows be reviewed and adopted by Council.

Council Action

The original Fiscal Policy was approved by the City Council by a vote of 5-0 via Resolution R2007 102 to adopt the 2007-09 Budget and attached Fiscal Policy on June 19, 2007.

Fiscal Policy Statement	Status	Comment
General Financial Goals		
To maintain and enhance the sound fiscal condition of the City.	√	
Operating Budget Policies		
The City will adopt a balanced two-year budget by June 30 of every other year.	√	
A bi-annual base operating budget will be developed by verifying or conservatively projecting revenues and expenditures for the current and forthcoming fiscal year.	√	
Current revenues will be sufficient to support current operating expenditures.	--	The current budget includes a revenue shortfall. This will be brought into balance in the 2009-11 budget cycle.
Annual operating budgets will provide for adequate design, construction, maintenance and replacement of the City's capital plant and equipment.	√	
The purchase of new or replacement capital equipment with a value of $25,000 or more and with a minimum useful life of two years will require City Council approval.	√	
The City will project its equipment replacement and maintenance needs for the next six years and will update this projection each year. From this projection a maintenance and replacement schedule will be developed and followed.	--	A program and policy will be developed during the next budget cycle to address this need.

Legend:
√ Budget Complies with Fiscal Policy Standard
-- Fiscal Policy Standard is not met in Budget
+ New Fiscal Policy

Fiscal Policy Statement	Status	Comment
Operating Budget Policies (Continued)		
The City will forecast its General Fund expenditures and revenues for each of the next six years and will update this forecast at least annually.	√	
The City will review, on a bi-annual basis, the General Fund operating position (operating revenues less operating expenditures) to determine if funds are available to operate and maintain future public facilities.	√	
If funding is not available for operations and maintenance costs, the City will delay construction of proposed new facilities.	--	Operating and maintenance costs for proposed facilities will be factored into future CIP budgets for review prior to approval.
Revenue Policies		
The City will strive to maintain a diversified and stable revenue base to shelter it from short-term fluctuations in any one revenue source.	√	
The City will estimate its annual revenues by an objective, analytical process utilizing trend, judgmental, and statistical analysis as appropriate. Revenue estimates adopted by the City Council must be conservative.	√	
User fees will be adjusted annually to recover the full cost of services provided, except when the City Council determines that a subsidy from the General Fund is in the public interest.	--	This policy and practice will be developed during the next budget cycle.

Legend:
√ Budget Complies with Fiscal Policy Standard
-- Fiscal Policy Standard is not met in Budget
+ New Fiscal Policy

Fiscal Policy Statement	Status	Comment
Revenue Policies (Continued)		
Non-recurring revenues will be used for non-recurring expenditures only. (Including capital and reserves).	--	Compliance will be achieved with the 2009-11 budget process, when the operating position is positive.
The City will annually identify developer fees and permit charges received from "non-recurring" services performed in the processing of new development. Revenue from these sources will be used to meet peak workload requirements.	√	
Utility Rates and Fees Policies		
The City will set fees and user charges for each utility fund at a level that fully supports the total direct and indirect cost of the activity. Indirect costs include the cost of annual debt service used for capital assets and overhead charges.	√	Per policy, rates have been adjusted to meet the cost of providing service. Water rates increased 3.4% (CPI) effective October 2007 and will continue to increase each October by CPI. Garbage rates increased 5.65% January 2007 and are set to increase 3.45% effective September 1, 2008 pending Public Hearing and Council approval.
Expenditure Policies		
The City will maintain a level of expenditures which will provide for the public well-being and safety of the residents of the community.	√	

Legend:
- √ Budget Complies with Fiscal Policy Standard
- -- Fiscal Policy Standard is not met in Budget
- \+ New Fiscal Policy

Fiscal Policy Statement	Status	Comment
Capital Improvement Budget Policies		
The City will make all capital improvements in accordance with an adopted capital improvement program.	√	
The City will develop an annual six-year plan for capital improvements, including CIP design, development, implementation, and operating and maintenance costs.	--	The six-year plan will be revised to include the details described prior to the next budget cycle.
The City will use intergovernmental assistance to finance only those capital improvements that are consistent with the Capital Improvement Plan and City priorities, and who's operating and maintenance costs have been included in the budget.	--	Operating and maintenance costs will be factored into future intergovernmental project considerations.
The City will coordinate development of the capital improvement budget with the development of the operating budget. All operating costs for services needed to implement the CIP will be included in the operating budget for the year the CIP is to be implemented.	--	Operating and maintenance costs will be considered in future budget cycles as a part of the project review.
The Council will review the Street Improvement Program every two years during budget time and will transfer as much as possible from the General Fund and Gas Tax Fund to the Capital Project Fund – Street Improvement.	√	

Legend:
√ Budget Complies with Fiscal Policy Standard
-- Fiscal Policy Standard is not met in Budget
\+ New Fiscal Policy

Fiscal Policy Statement	Status	Comment
Capital Improvement Budget Policies (Continued) The Park Acquisition & Development Fund, as well as other special development impact funds, may only be used to fund facilities included in the Master Plan for City Facilities.	--	Park Master Plan and City Facility Study are underway.
The Water Fund and the Materials Diversion fund may only use funds generated by their service charges, grants and other outside sources of funds to fund their CIP projects.	√	
The City may use short-term debt to cover temporary or emergency cash flow shortages. All short-term borrowing will be documented and made available for City Council review.	√	
The City Council may issue interfund loans rather than outside debt instruments to meet short-term cash flow needs. Interfund loans must be repaid consistent with terms established in a written agreement.	√	
The City will confine long-term borrowing to capital improvements that cannot be funded from current revenues.	√	
Where possible, the City will use special assessment, revenue, interfund loans or other self-supporting bonds instead of general obligation bonds when feasible.	√	

Legend:
√ Budget Complies with Fiscal Policy Standard
-- Fiscal Policy Standard is not met in Budget
\+ New Fiscal Policy

Fiscal Policy Statement	Status	Comment
Reserve Policies		
The General Fund Undesignated Fund Balance will be maintained at a level of between 2% - 5% of its operating budget. GFOA recommends a level of 5 to 15%.	--	Undesignated Fund Balance is projected to be 10% for FY 2008-09.
The City will maintain General Fund Emergency reserves at a level at least equal to 12% of budgeted operating expenditures. The primary purpose of these reserves is to protect the City's essential service programs and funding requirements during periods of economic downturn (defined as a recession lasting two or more years), or other unanticipated or emergency expenditures that could not be reasonably foreseen during preparation of the budget.	--	Emergency Reserve = $7.0 million, or 11.3 % of General Fund operating expenditures for FY 2007-08. In FY 2008-09 $7.9 million will be reserved or 12% of expenditures.
A Contingency Reserve will be established to provide for non-recurring unanticipated expenditures or to set aside funds to cover known contingencies with unknown costs. The level of the Contingency Reserve will be established as needed but shall not be less than 1% of General Fund operating expenditures.	--	Contingency Reserve will be maintained at $400,000 each year. This is approximately $200,000 below the policy target which will be achieved in the next budget cycle.
A Compensated Absence Reserve will be established to accumulate funds to be used for payment of accrued benefits for separating employees. This reserve will be maintained at a level at least equal to 50% of the prior year end Vacation Liability balance.	√	The mid-cycle update recommends setting aside 50% of the previous year end vacation accrued leave balance which is approximately $250,000 for FY 2007-08.

Legend:
- √ Budget Complies with Fiscal Policy Standard
- -- Fiscal Policy Standard is not met in Budget
- \+ New Fiscal Policy

Fiscal Policy Statement	Status	Comment
Reserve Policies (Continued)		
Self-insurance reserves will be maintained at a level which, together with purchased insurance policies, adequately protects the City. Council approved a revision to the Self-insurance reserve policy on May 6, 2008. The revision calls for reserve funding level goals to be modified to correspond with the format used by the City's actuary and that the reserve funding level goal for each program be no less than the target 80% confidence level appropriately discounted for investment income.	√	In 2008-09, base requirements of General Liability Reserve = $592,000 and Workers Compensation Reserve = $3,380,000 will be achieved.
The City will comply with GASB 45 and establish an irrevocable trust to fund future retiree medical costs.	--	Annual required contributions starting at $1.4 million are necessary to meet long term needs for the medical retiree program. In FY 2007-08, $800,000 has been appropriated and $1.18 million in FY 2008-09. The mid-cycle budget amendments add $745,000 in contributions for FY 2008-09. The City will begin contributing to a trust managed through CalPERS and adequate funds will be contributed to fund obligations in successive budget cycles.

Legend:
√ Budget Complies with Fiscal Policy Standard
-- Fiscal Policy Standard is not met in Budget
\+ New Fiscal Policy

Fiscal Policy Statement	Status	Comment
Reserve Policies (Continued)		
The City will maintain a Fleet Replacement Reserve for costs associated with the replacement of vehicles and other rolling stock (such as trailers, compressors or other equipment on wheels) as they become unserviceable, obsolete or reach a predetermined service life. The reserve will be maintained at a level adequate to replace all stock, per the pre-determined replacement schedule.	--	Fleet Replacement Reserve transfer = $700,000 each year to restore funds from prior cycle. The fund reserve will be studied to determine its appropriate reserve requirements during this budget cycle.
The City will establish Water Operating Reserves with minimum Reserve levels determined by independent studies approved by Council.	√	Water Reserve = $7.7 million
The City will establish a Golf Course Operating Reserve to cover costs during a year when revenue is down due to limited play or adverse conditions. The reserve should be funded at a level at least equal to 10% of operating expenditures.	--	Golf Course Operating Reserve will be deferred until the next cycle, when a stronger revenue position should exist.
The City will maintain a Solid Waste/Materials Diversion Operating Reserve to cover unforeseen revenue shortfalls, increases in expenses, and potential environmental compliance expenditures. This fund does not have a separate "emergency reserve", and market volatility, emergency/disaster incidents and other circumstances would present immediate cash flow issues. Therefore, the reserve should be funded at a level of 25% of operating expenditures.	√ +	Funding Target will be reached in FY 2008/09

Legend:
√ Budget Complies with Fiscal Policy Standard
-- Fiscal Policy Standard is not met in Budget
\+ New Fiscal Policy

Fiscal Policy Statement	Status	Comment
Reserve Policies (Continued)		
The City will maintain a Rate Stabilization Reserve in the Solid Waste Fund. This reserve will be funded at a level of 5% of collection revenues to stabilize collection rates to avoid wide swings in rates over time.	√ +	Funding Target will be reached in FY 2008/09
The City will maintain a Capital Replacement Reserve in the Solid Waste Fund to provide for major renovation, modernization and/or rebuilding of the Napa MDF. This reserve is for projects that exceed $250,000 in any given year.	√ +	Based on a 30-year capital replacement plan, this reserve will be funded annually to address projected needs at a rate of $268,000 per year.
The City will maintain a Capital Maintenance Reserve in the Solid Waste Fund to pay for planned capital improvement program repairs and maintenance at the Napa MDF. This reserve is for projects that DO NOT exceed $250,000 in any given year.	√ +	Based on an 8-year capital maintenance schedule, this reserve will be funded annually to address projected needs at a rate of $125,243 in FY 2008/09 with an annual escalator of 3.85%.
The City will maintain a Liability Reserve in the Solid Waste Fund to fund liabilities of the City for items related to the Solid Waste Fund. These include the final fulfillment of the City's legal obligations with regard to construction of the passive Hidden Glenn Park (site formerly referred to as Coombsville Dump).	√ +	Funding Target will be reached in FY 2008/09

Legend:
√ Budget Complies with Fiscal Policy Standard
-- Fiscal Policy Standard is not met in Budget
+ New Fiscal Policy

Fiscal Policy Statement	Status	Comment
Investment Policies		
The City Treasurer will annually submit an investment policy to the City Council for review and adoption.	√	Adopted June 17, 2008
The City Treasurer will invest the City’s monies in accordance with applicable laws and adopted investment policies and direct the investment of bond or note monies on deposit with a trustee or fiscal agent in accordance with the applicable indenture or issuance document.	√	
Accounting, Auditing & Financial Reporting Policies		
The City's accounting and financial reporting systems will be maintained in conformance with generally accepted accounting principles and standards of the Government Accounting Standards Board.	√	
Quarterly financial reports will be submitted to the City Council and will be made available to the public.	√	
Full and continuing disclosure will be provided in the general financial statements and bond representations.	√	
Maintain a good credit rating in the financial community.	√	Standard & Poor's = AA- for 2007 Water Revenue Bond issuance. General Fund rating has not been secured as there has been no recent City-backed debt issuance.

Legend:
√ Budget Complies with Fiscal Policy Standard
-- Fiscal Policy Standard is not met in Budget
+ New Fiscal Policy

Fiscal Policy Statement	Status	Comment
Accounting, Auditing & Financial Reporting Policies (Continued)		
An annual audit will be performed by an independent public accounting firm with the subsequent issue of an official Comprehensive Annual Financial Report (CAFR), including an audit opinion.	--	Independent audited Basic Financial Statements are now prepared. With the advent of the new financial system, the CAFR will be prepared.
Maintain a liquidity ratio of at least 1:1	√	The City currently maintains an 8:1 ratio.

Legend:
√ Budget Complies with Fiscal Policy Standard
-- Fiscal Policy Standard is not met in Budget
+ New Fiscal Policy

III: 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 1998-2007 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 1997-98 through FY 2006-07, 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.

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.

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.

Unfavorable: This trend is **negative**, and there is an immediate need for the City to take corrective action.

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, State budget cuts and rising benefit costs have had a 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

The General Fund's operating revenues increased 15.0%, or $7.6 million in FY 2006-07. This change was primarily due to increased transient occupancy tax revenue of 24%. Similarly, sales tax, including in-lieu sales tax from the "Triple Flip," increased by 13.6% and property tax revenue increased by 9.4%. The fund's operating expenditures increased 3.9%, or $1.6 million. Salary costs increased $1.3 million and accounted for most of the operating increase.

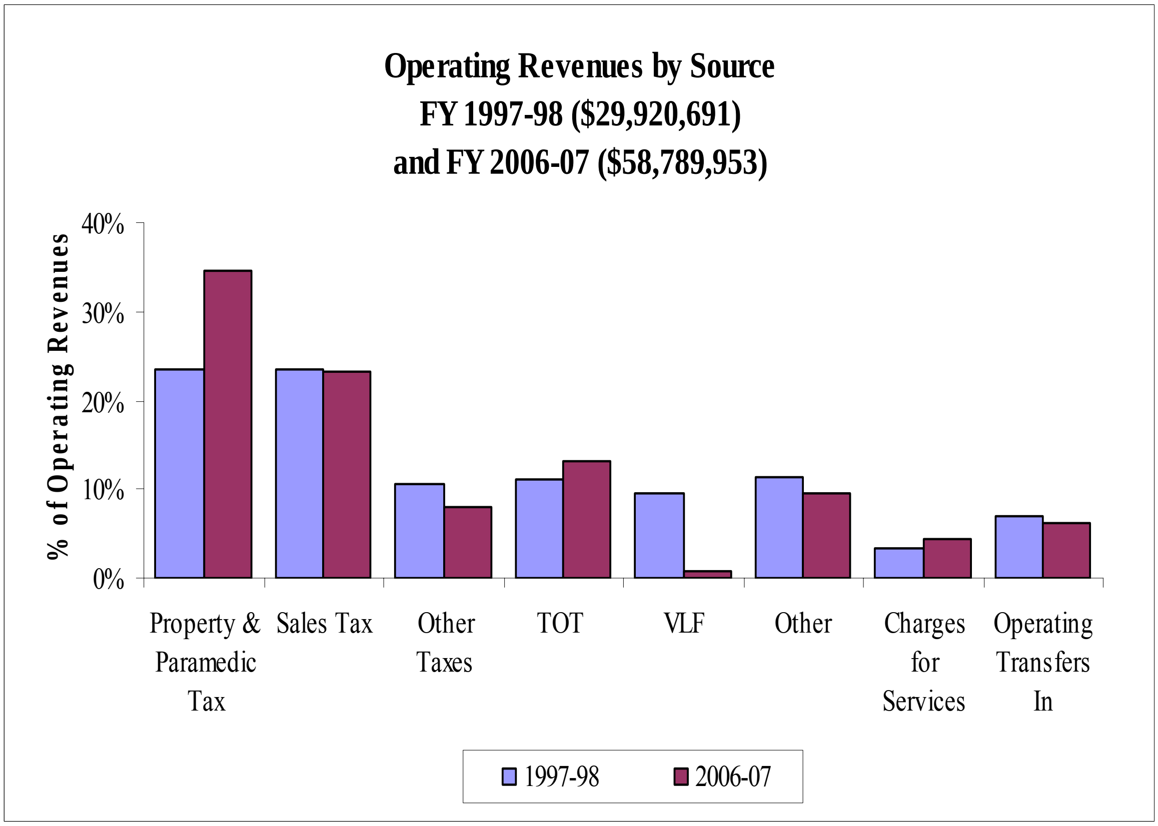
In summary, because of actions taken to balance the budget, the City's current financial condition is satisfactory. However, some areas of concern include:

- Expenditure growth trends have outpaced revenue growth; however, with the major hotels coming online in the near future, this trend should be reversed.
- Benefit costs, while more stable than previous years, are still on the rise.
- Critical operating reserves have been used in recent years to support operations. These reserves are being restored in the current budget cycle.
- Infrastructure maintenance costs must be addressed. The proposed sales tax increase, if approved, would go a long way to meeting this unfunded need.
- 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 $1.4 million per year. The City adopted a reserve policy as part of the 2007-09 budget process which provides for GASB 45 compliance and the establishment of an irrevocable trust to fund future retiree medical costs. The 2007-08 contribution amount is $800,000. The mid-cycle budget amendments call for an additional $745,000 contribution over the next two years to catch up to the required annual contribution amount.
- The City is very reliant on elastic revenue sources.
- The State Legislature continues to work on the State's budget issues. It is uncertain how the State's budget solution will impact the City.

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 chart. Taxes, including property, sales and other taxes make up the largest category of General Fund revenues at 79% of revenues generated in fiscal year 2006-07 as compared to 69% in the 1997-98 fiscal year.

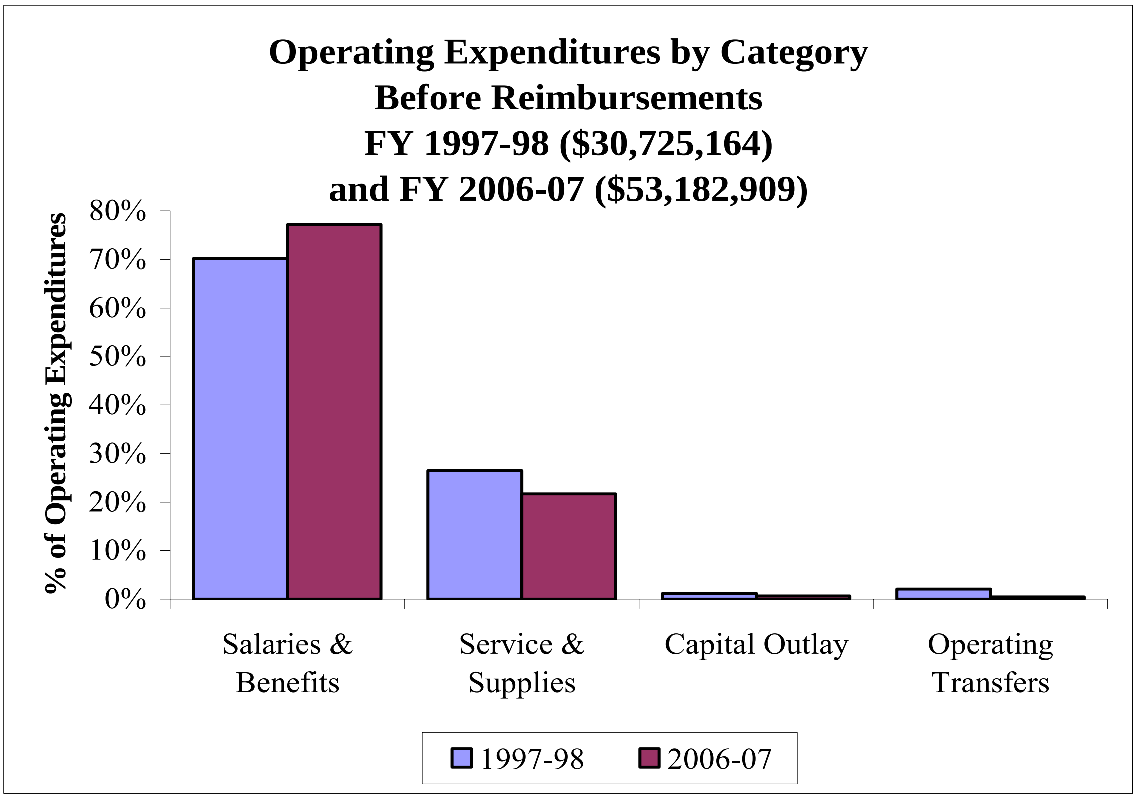


The two largest sources of revenue to the City continue to be property and sales tax. Included in the property tax category for FY 2006-07 is $5.4 million in backfilled VLF revenue from the State. While growth in property tax revenues has been steady, sales tax revenue growth has been uneven. Transient 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 5.0%, or $2.6 million to $53.2 million from the prior year. The fund's operating expenditures increased 3.9%, or $1.6 million.

The following chart compares expenditures by category for the fiscal years 1997-98 and 2006-07.



The composition of General Fund operating expenditures by category has changed with the recent escalation of benefit costs when comparing fiscal year 2006-07 to fiscal year 1997-98. Driving this escalation was a 275% increase in the cost of benefits during the period from $3.2 million to $12.3 million. Cost of salaries increased 51% from $20 to $30 million for the period. As a result, salaries and benefits were approximately 77% of general fund expenditures in 2006-07, an increase of 7 percentage points from 1997-98, despite a workforce reduction of 8% resulting from the freezing of thirty positions. The Services and Supplies category decreased by 4 percentage points during the ten-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	C	Property tax revenues have increased steadily since 1998. However, with the current housing market decline and the tightening of the credit market, the strong trend is expected to level off.
3	Sales Tax Revenues	C	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 and FY 2006-07.

F Favorable
C Caution
W Warning
U Unfavorable

6	Elastic Revenues	C	Heavy reliance on these revenues, 45.6% in fiscal 2007, exposes the City to income fluctuations due to economic uncertainty. New development underway is expected to increase this percentage.
7	Nonrecurring Revenues	F	The City receives very little nonrecurring revenue in the General Fund. Note: Natural disaster related grant funds were excluded from this analysis.

<u>General Fund Expenditures</u>

8	Expenditures Per Capita	C	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. The City added 29 positions in the FY 2007-08 budget.
9	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. 29 of positions were added in FY 2007-08.

F Favorable
C Caution
W Warning
U Unfavorable

10	Fringe Benefits as a Percentage of Operating Expenditures	U	2007 saw an increase of 2.4 percentage points to 29% of total expenditures. In current dollars, this increase amounted to $.29 million compared to an increase of $1.3 million in 2006. The smaller increase in growth of fringe benefit expenditures is primarily due to the slight leveling of PERS rates. Ongoing increases in health care are expected.
11	Salary Expenditures as a Percentage of Operating Expenditures	F	Salary expenditures in total increased by 4.4% or $1.3 million in 2007 despite freezing 30 positions in the FY 05-06 budget. 29 positions were added as part of the 2007-09 budget cycle.
12	Capital Outlay as a percentage of Operating Expenditures	C	Capital outlay has never been above 2.21% of operating expenditures over the last ten years. It is anticipated that the City will establish a policy as part of the 2010-11 budget cycle to assure that equipment is replaced in a timely manner to avoid inefficiencies and more costs in the future.

<u>General Fund Operating Position</u>

13	Operating Position	C	The City has experienced a number of years with operating deficits, but achieved an operating surplus in FY 2006-07 due to a 24.5% increase in transient occupancy tax revenue as well as double digit increases in property tax, sales tax and business license revenues.

F Favorable
C Caution
W Warning
U Unfavorable

14	Unreserved Fund Balance/Emergency Reserve as a percentage of Budgeted Operating Expenditures	F	The City adopted a formal reserve policy as part of the 2007-09 budget process. It is recommended that the City continue to build reserves to the appropriate levels.
15	Liquidity Ratio	F	The liquidity ratio has remained over 4%. Financial rating agencies recommend cities maintain a ratio minimum of 1:1.
16	Debt Service	F	The City has no current debt service in its General Fund.

<u>Additional Indicators</u>

17	Assessed Property Value	C	Assessed values have gained an average of 7.8% during the past ten years. Strong real estate demand fueled by low mortgage rates contributed to its strength.
18	Population	F	Population growth has slowed in recent years as Napa is largely built out. The FY 2006-07 population was 76,997.

F Favorable
C Caution
W Warning
U Unfavorable

Financial Trend Summary:

- **Revenue Trends**

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

- **Expenditure Trends**

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

- **Operating Position**

13.	Operating Position	(C)
14.	Fund Balance/Reserves	(F)
15.	Liquidity	(F)
16.	Debt Service	(F)

- **Additional Indicators**

17.	Assessed Property Value	(C)
18.	Population	(F)

Rating Changes
There were 6 trend changes from the last fiscal year, 3 of which were in a positive direction, while 3 changes were in a negative direction.

Property Tax Revenues and Assessed Property Values were downgraded from Favorable ratings to ratings of Caution due to the tightening credit market and the recent housing market decline.

Sales Tax Revenues were downgraded from a Favorable rating to a rating of Caution. Due to the current state of the economy, we expect the sales tax receipts to flatten or decline in the next fiscal year.

Expenditures per Capita improved from an Unfavorable rating to a rating of Caution due to the fact that the indicator has been relatively stable on a constant dollar basis; however it is expected to increase with the unfreezing of 29 positions in FY 2007-08.

F Favorable
C Caution
W Warning
U Unfavorable

Operating Position changed from Unfavorable to Caution as FY 2006-07 showed a positive operating position of $5.6 million. The operating position is expected to decline over the next couple of years; however, a positive operating position is forecast throughout the forecast period.

Fund Balance improved from an Unfavorable rating to a Favorable rating. This improvement came as the City adopted several reserve policies designed to ensure positive operating position and appropriate funding of reserves to reduce the reliance on the General Fund for certain nonrecurring, unforeseen or contingency expenditures.

Additionally, the Vehicle License Fee revenue indicator has been removed as it is no longer a significant source of revenue since the VLF swap went into effect.

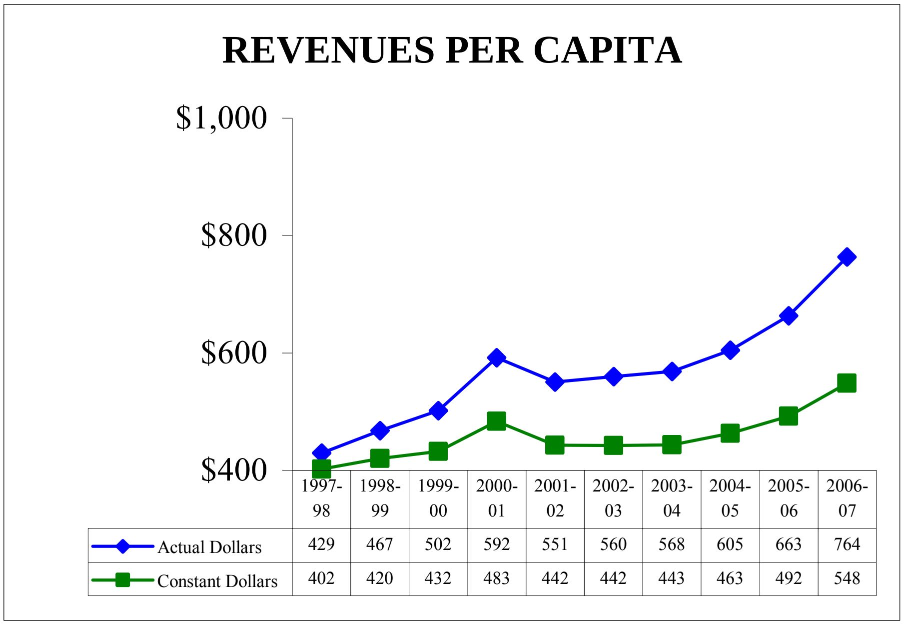
General Fund Revenues

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
- Elastic Revenues as a Percentage of Operating Revenues
- Nonrecurring Revenues as a Percentage of Operating Revenues

Indicator 1: Revenues Per Capita



	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Actual Dollars	429	467	502	592	551	560	568	605	663	764
Constant Dollars	402	420	432	483	442	442	443	463	492	548

Finding: Favorable

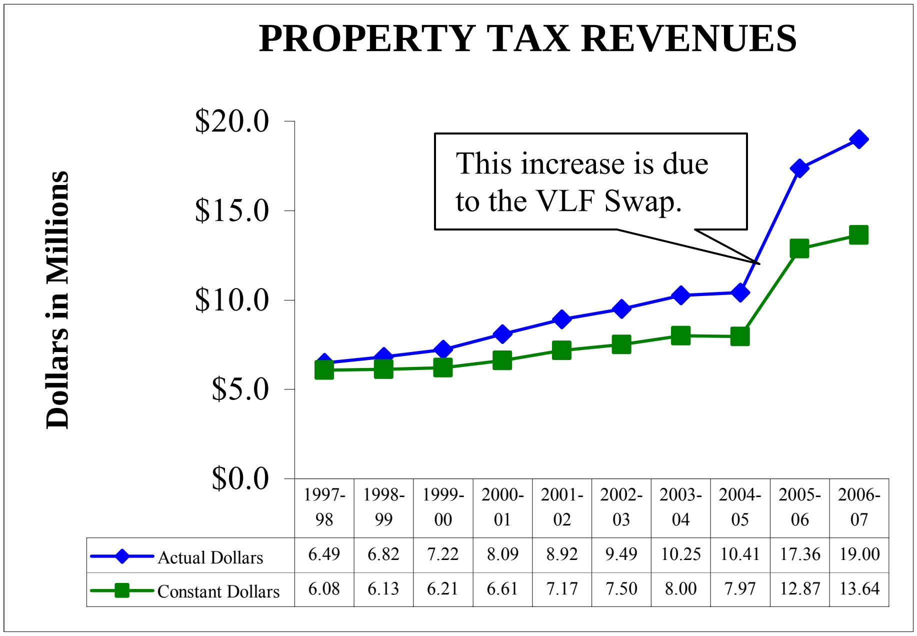
Description

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 nonrecurring revenues, have increased since 1998, from $402 to $548 in 2007, although there was a dip from 2001 to 2003 due to a lagging economy. 2007 saw an increase in transient occupancy tax revenues of 24.5%, an increase in sales tax revenues of 13.6% and an increase in property tax revenues of 9.4%. This has resulted in an 11% increase in revenues per capita from 2005-06 to 2006-07.

Indicator 2: Property Tax Revenues



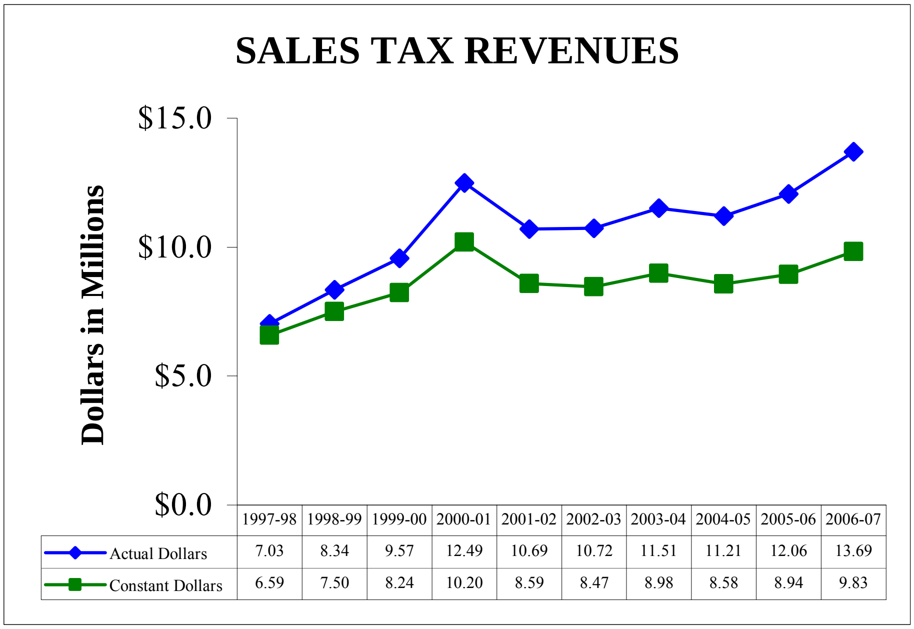
	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Actual Dollars	6.49	6.82	7.22	8.09	8.92	9.49	10.25	10.41	17.36	19.00
Constant Dollars	6.08	6.13	6.21	6.61	7.17	7.50	8.00	7.97	12.87	13.64

Finding: Caution
2007 LTFP 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 (23% before the addition of VLF and 33% 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. Currently, no such debt exists. From 1992 through 2007, 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 growth 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 FY 2004-05 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 20% from 2005 to 2007, and has increased an average of 8.6% 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 the credit market tightens and the housing market remains in decline.

Indicator 3: Sales Tax Revenues



	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Actual Dollars	7.03	8.34	9.57	12.49	10.69	10.72	11.51	11.21	12.06	13.69
Constant Dollars	6.59	7.50	8.24	10.20	8.59	8.47	8.98	8.58	8.94	9.83

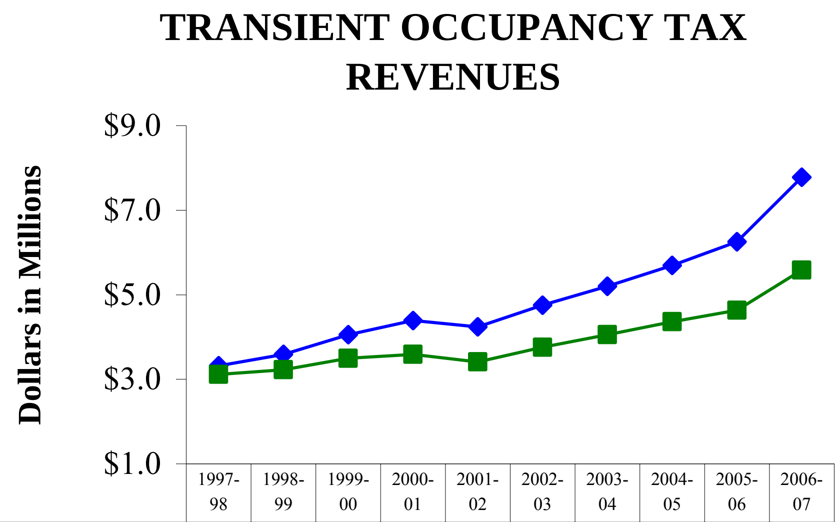
Finding: Caution
2007 LTFP Finding: Favorable

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. 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 2007, reflecting the poor showing of domestic auto sales. General retail sales, which accounts for 30% of sales tax revenues, lost 2% from the prior period while transportation and food products both gained 1%. Due to the current decline in the economy, sales tax receipts are expected to flatten or decline in the next fiscal year.

Recommendation:
The City should consider opportunities to diversify its tax base and should continue to benefit from its strong tourism attraction.

Indicator 4: Transient Occupancy Tax Revenues



	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Actual Dollars	3.32	3.58	4.06	4.39	4.24	4.75	5.20	5.70	6.25	7.78
Constant Dollars	3.11	3.22	3.49	3.59	3.41	3.75	4.06	4.36	4.63	5.59

Finding: Favorable

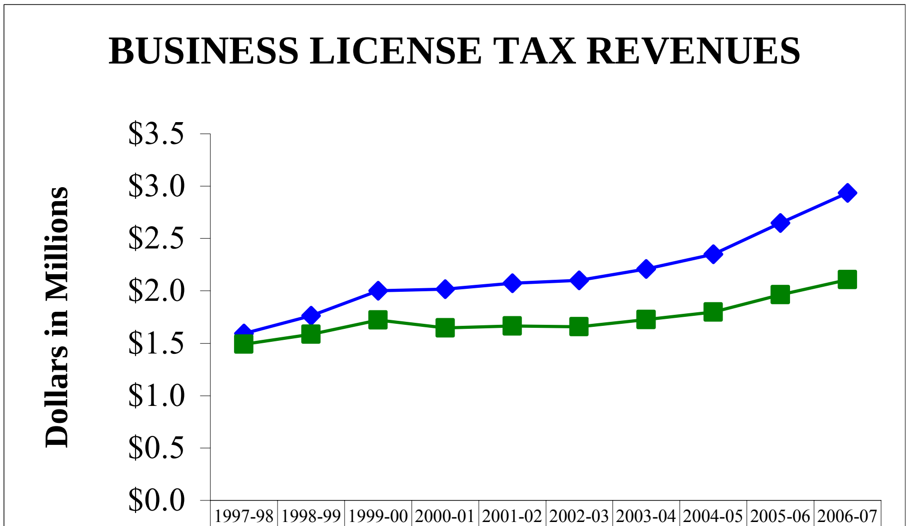
Description

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 (13%) 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



	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Actual Dollars	1.59	1.77	2.00	2.02	2.07	2.10	2.21	2.35	2.65	2.93
Constant Dollars	1.49	1.59	1.72	1.65	1.67	1.66	1.72	1.80	1.96	2.11

Finding: Favorable

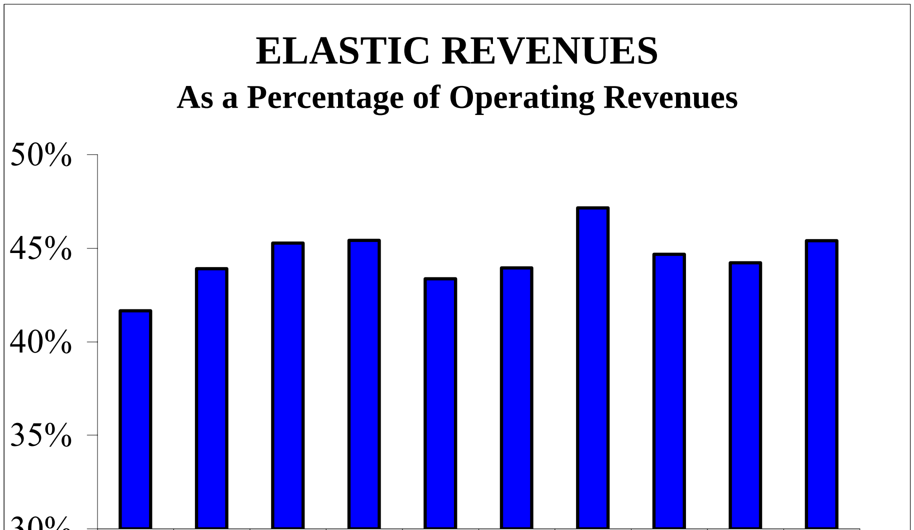
Description

Business license tax revenue is 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 1068, or 17.7%, from 6,046 to 7,114 licensed businesses from 2004-05 to 2006-07.

Indicator 6: Elastic Revenues



	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
	41.7%	43.9%	45.3%	45.4%	43.4%	43.9%	47.1%	44.7%	44.2%	45.4%

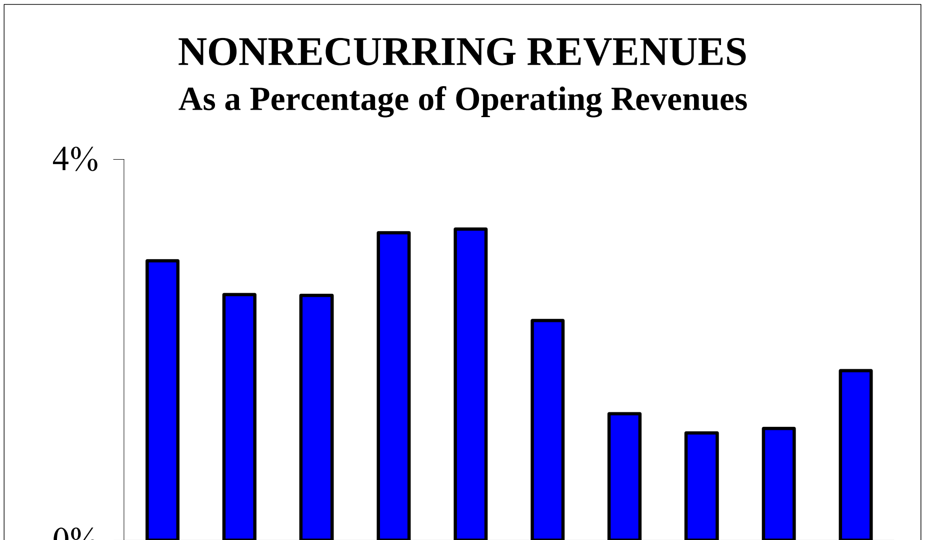
Finding: Caution

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 1% higher than 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. A reserve policy has been adopted as part of the 2007-09 budget cycle to provide secure emergency reserves adequate to support the City through an economic decline spanning two or more years.

Recommendation:
Staff should evaluate the economic development strategies that would diversify the tax base providing more economic stability and security. In addition, the City should maintain a strong and stable commitment to funding and maintaining reserves for use during economic downturns when elastic revenues are impacted.

Indicator 7: Nonrecurring Revenues



	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
	2.9%	2.6%	2.6%	3.2%	3.3%	2.3%	1.3%	1.1%	1.2%	1.8%

Finding: Favorable

Description
Nonrecurring 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 nonrecurring 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.

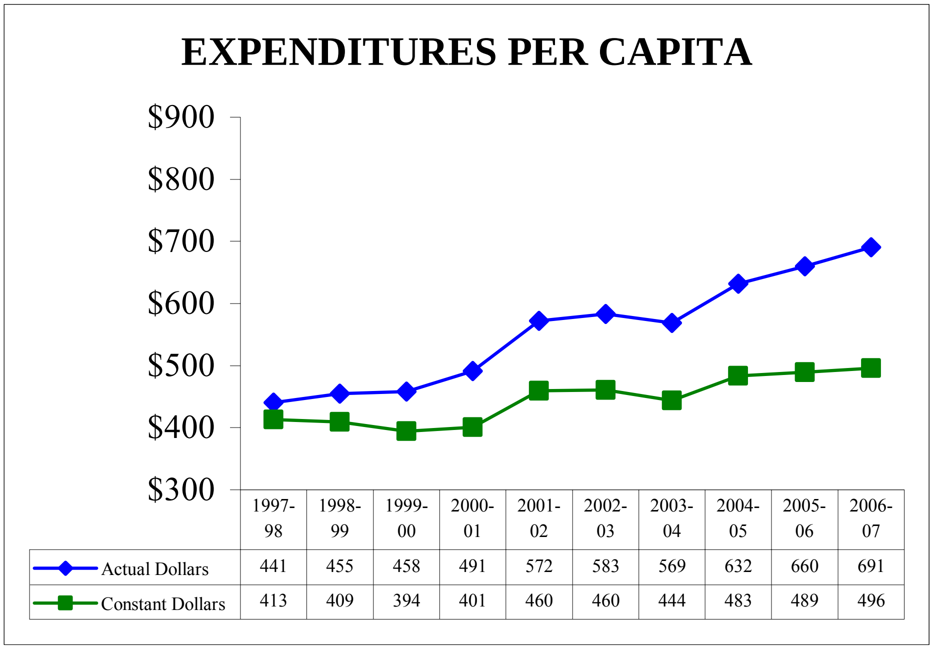
Comments and Analysis
Nonrecurring revenues constitute a minimal amount of overall City general fund revenue, and are primarily from the sale of surplus assets. A fiscal policy was developed as part of the 2007-09 budget process that limits the use of nonrecurring revenues to nonrecurring expenditures (i.e. capital projects, reserve contributions), thus avoiding structural deficits.

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 8: Expenditures Per Capita



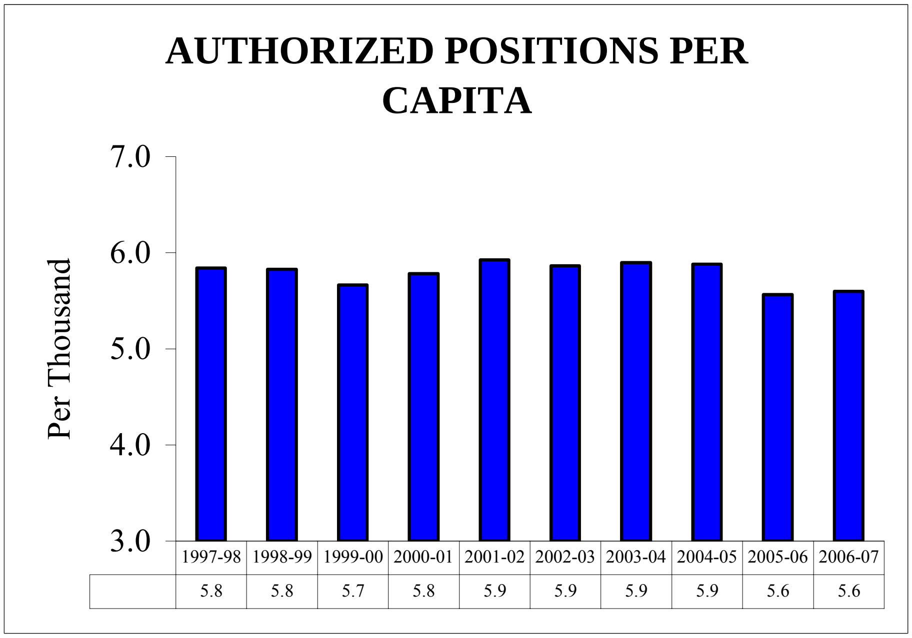
	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Actual Dollars	441	455	458	491	572	583	569	632	660	691
Constant Dollars	413	409	394	401	460	460	444	483	489	496

Finding: Caution
2007 LTFP 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. 29 positions were added in the 2007-09 budget cycle. 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. 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 10% annual average rate. Expenditures per Capita have been relatively stable on a constant dollar basis; however it is expected to increase due to the 29 positions added in FY 2007-08. For this reason we have assigned a "Caution" rating to this indicator.

Indicator 9: Authorized Positions Per Capita



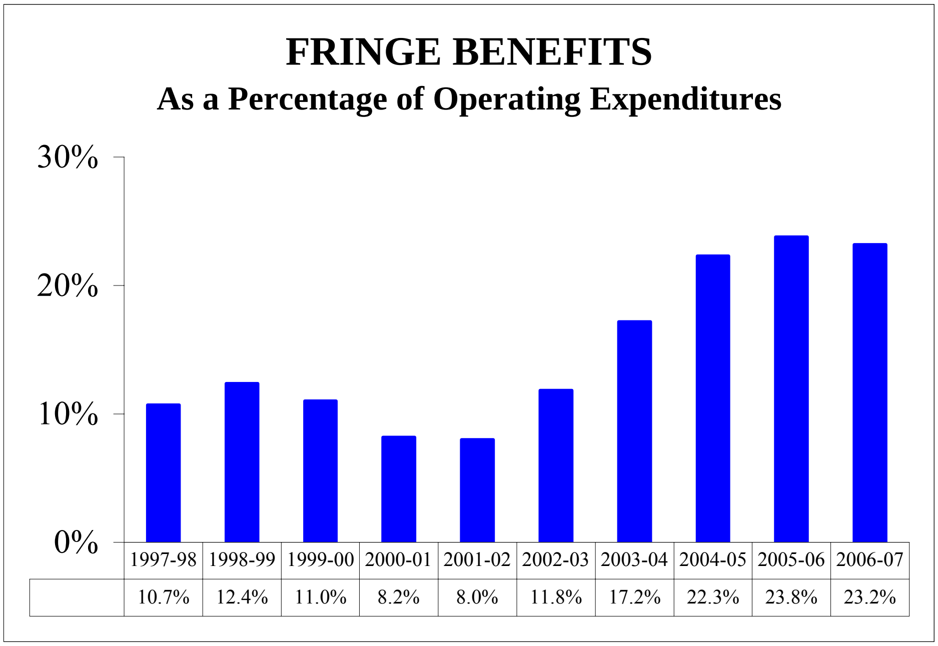
Finding: Unfavorable

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 5.6 per thousand from 1998 to 2007. In the FY 2005-07 budget process, 30 positions were frozen (8%), which is the primary reason for the decrease. However, had these positions 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. Twenty nine positions were added during the FY 2007-09 budget process.

Recommendation:
Given the increasing demand for services, care should be taken to focus resources on the highest priority programs. Deficiencies should be studied.

Indicator 10: 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.

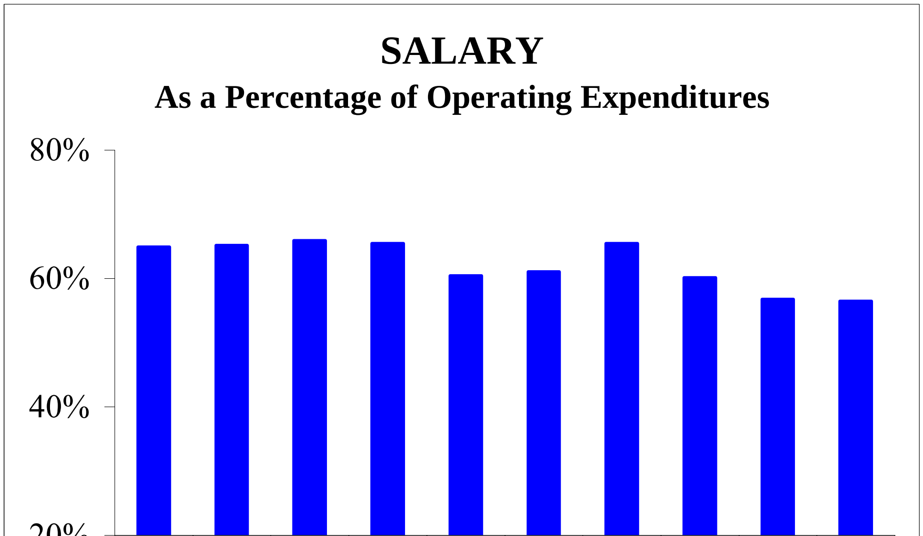
Comments and Analysis

Fringe benefit costs as a percentage to the City's total operating expenditures declined from 1996 to 2002, primarily due to CalPERS' super funded status, the percentage 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 and actually declined in 2006-07 due to 30 frozen positions. Twenty nine positions were added as part of the FY 2007-09 budget cycle. 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. As a result, we have assigned an unfavorable rating to this indicator.

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 11: Salary as a Percentage of Operating Expenditures



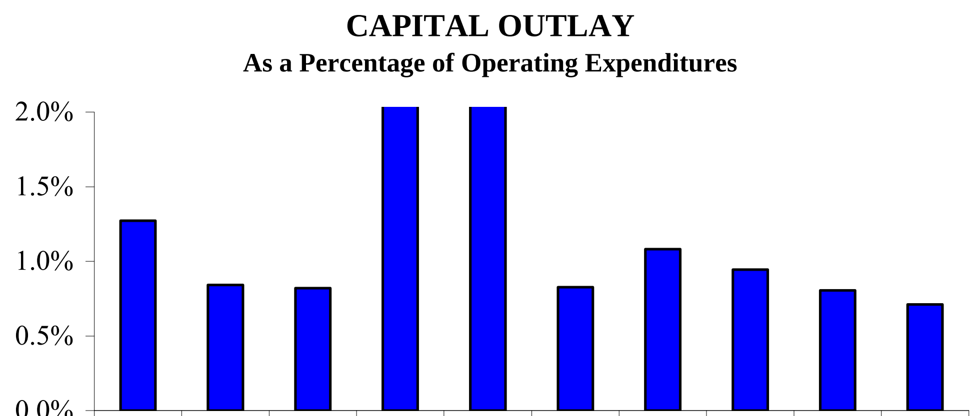
1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
64.9%	65.2%	65.9%	65.4%	60.4%	61.1%	65.5%	60.1%	56.8%	56.5%

Finding: Favorable

Description
These expenditures include salary and wages paid to regular, part-time, and temporary staff and represent over 56% 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.

Indicator 12: Capital Outlay



	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
	1.27%	0.84%	0.82%	2.08%	2.21%	0.83%	1.08%	0.94%	0.81%	0.71%

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 just 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.

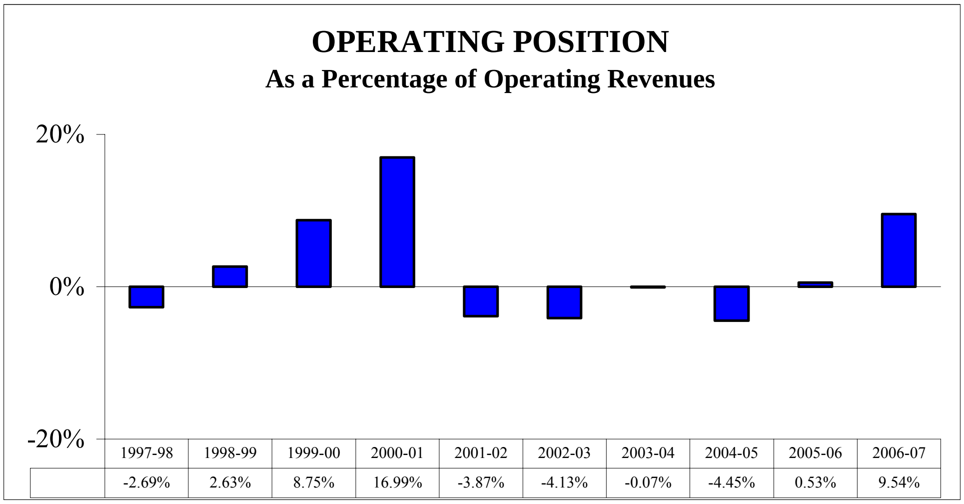
General Fund Operating Position

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/Reserve Funds
- Liquidity Ratio
- Debt Service

Indicator 13: Operating Position



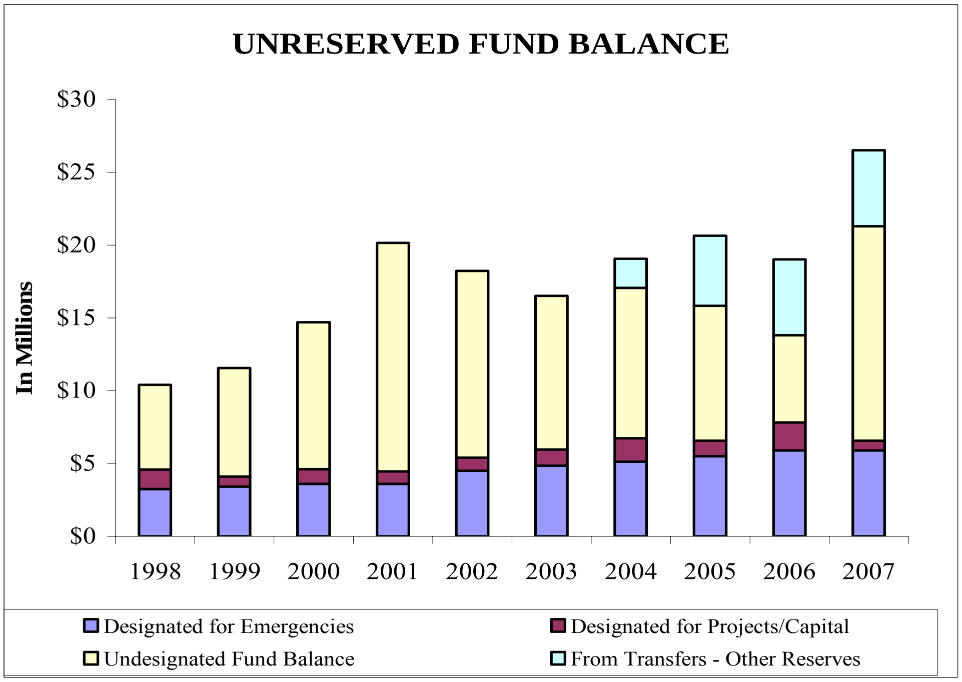
Finding: Caution
2007 LTPF Finding: Unfavorable

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, however, due to the freezing of 30 positions and a 24.5% increase in transient occupancy tax revenue as well as healthy increases in sales tax, property tax and business license revenue, the City has achieved an operating surplus in FY 2006-07 of approximately $5.32 million. Historically, expenditures have risen at a faster pace than revenues, requiring budget balancing measures that have impacted City service levels. The City adopted several fiscal policies as part of the 2007-09 budget cycle including an operating budget policy to ensure that current revenues will be sufficient to support current operating expenditures. This policy reflects a commitment to maintain a positive operating position.

Recommendation:
Utilizing reserves to offset an operating deficit should be avoided in order to ensure more stable service delivery in the long term.

Indicator 14: Unreserved Fund Balance/Reserve Funds



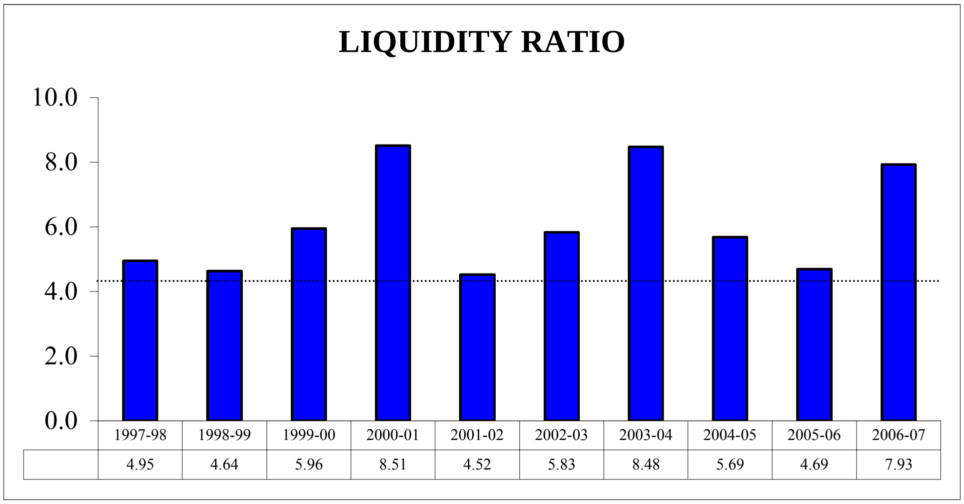
Finding: Favorable
2007 LTFP Finding: Unfavorable

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 fund balance and reserve levels.

Comments and Analysis
The City recently adopted a fiscal policy designating an amount equal to 12% of annual operating expenditures as an emergency reserve. While it is budgeted to fund this reserve to 11.5% by FY 2008-09, full compliance with this policy is expected to be achieved in the next budget cycle. Fund Balance has been used to meet budget shortfalls in recent years. Since FY 2003-04 the City transferred reserves from the Building Reserve ($1.5 million), Capital Project Reserve ($2.3 million) and the Fleet Rebate ($1.4 million). These transfers account for $5.2 million of reserves at June 30, 2007 or 22% of unreserved fund balance. The balance of these reserves has been extinguished. Funds have been budgeted in FY 2007-08 and FY 2008-09 to return the funds to those reserve accounts. This indicator has been upgraded from an Unfavorable rating to a rating of Favorable due to the fact that a formal reserve policy has been adopted as part of the 2007-09 budget cycle and the Unreserved Fund Balance has improved substantially.

Recommendation:
The City should continue to fund the reserves aiming to be fully compliant in the next budget cycle.

Indicator 15: 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 7.93 at the end of fiscal 2007.

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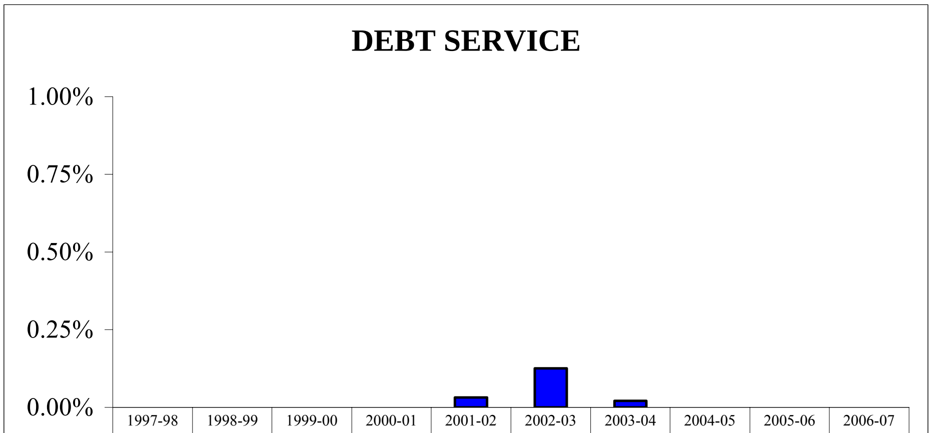
Indicator 16: Debt Service



	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
	0.00%	0.00%	0.00%	0.00%	0.03%	0.13%	0.02%	0.00%	0.00%	0.00%

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 (32.5%), a further analysis has been done on the change in assessed property values from year-to-year. Property values continue to trend upwards as they have done for the past several years.

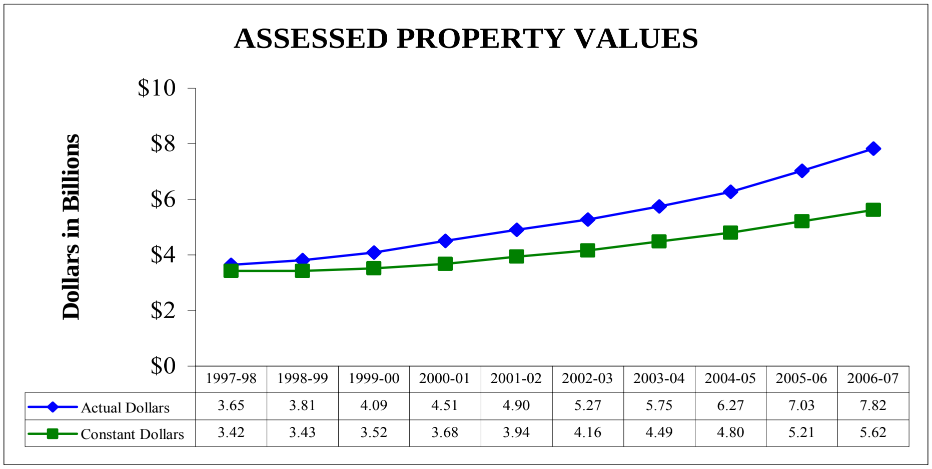
Finally, the population of the City has been analyzed over time to determine its impact on the tax base as well as the effects on additional service demands.

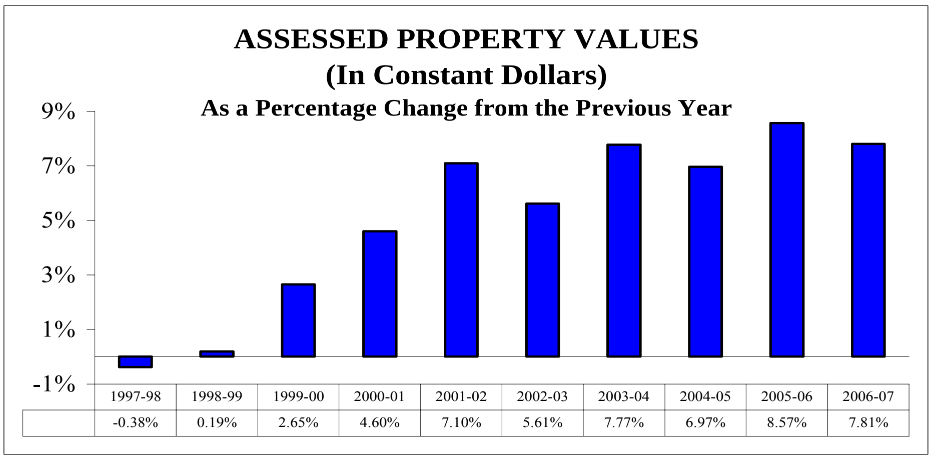
The following indicators are detailed in this section:

- Assessed Property Values

- Population

Indicator 17: Assessed Property Values



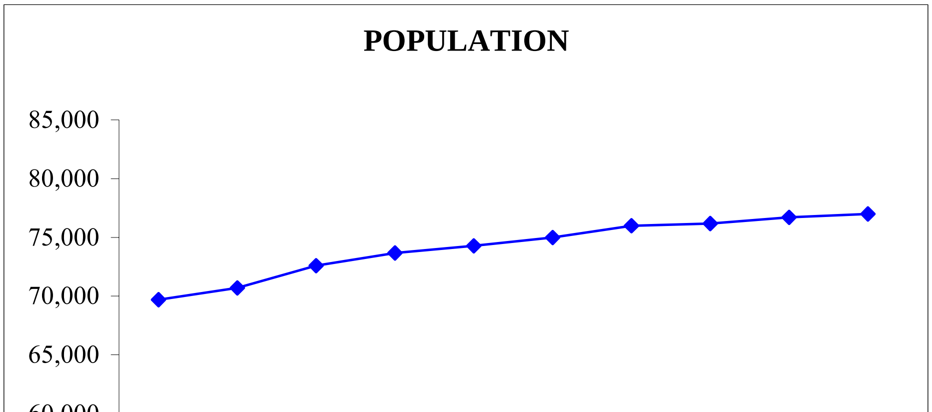


Finding: Caution
2007 LTFP Finding: Favorable

Description
Assessed property values, in both actual and constant dollars, are of primary importance to the City because property tax revenue, comprising 32.5% of the total General Fund operating revenues in fiscal year 2006-07, 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 has been 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. However, with the housing market on the decline it is expected that the City will experience slowed growth in assessed property values over the next few years.

Indicator 18: Population



	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
	69,700	70,700	72,585	73,675	74,271	75,001	75,985	76,167	76,705	76,997

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.

IV: FINANCIAL FORECAST

An updated 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 is also 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 financial forecast for the fiscal years 2008 through 2014 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 an economic downturn, 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 2006-07 increased by 15% over the previous year. Growth is also projected to continue through 2014 due to visibility in both commercial hotel and resort developments that include the Westin, Avia Hotel, and the River House.

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	2013/14
Population (Residential)	77,382	77,769	78,158	78,549	78,941	79,336	79,733
Property Tax (% Change)	7.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
Sales Tax (% Change)	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Transient Occupancy Tax (% Change)	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Investment Earnings Rate	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Salaries (% Change)	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Healthcare Benefits (% Change)	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%
PERS Benefits (% Change)	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Other Benefits (% Change)	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%
Services & Supplies (% Change)	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%

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 and is the foundation for many of the assumptions throughout the forecast period. Inflation is projected to average 3% per year.

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

Factors Not Included In the Forecast

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

- While 30 positions were frozen in the FY 2005-07 budget cycle, 29 new positions were added in FY 2007-08. An additional 2 positions per year are included in the forecast.

- The forecast does not include the cost of fiscal changes that the City may want to consider, including:

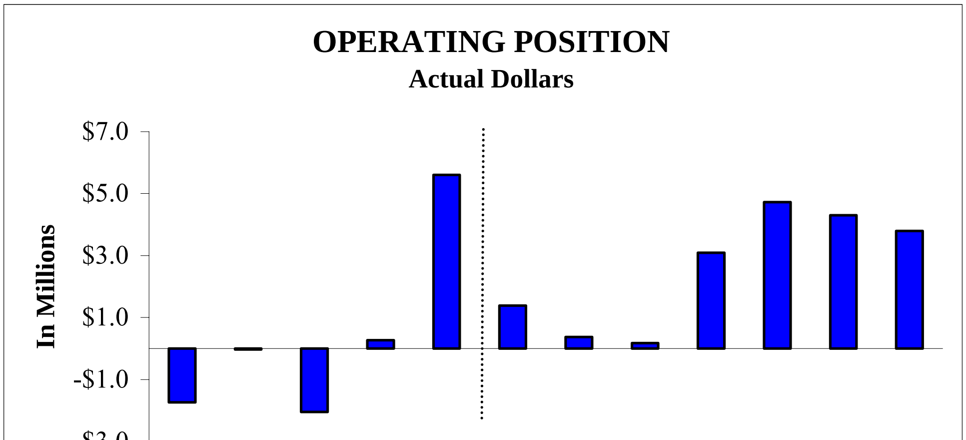
    1. Establishing equipment and other infrastructure replacement funds.
    2. Increasing General Fund contribution to the CIP.
    3. New or enhanced programs.
    4. Potential state impacts.

- Only sizable commercial development in the pipeline with a high likelihood of becoming reality has been included. This includes the Westin, Avia and River House hotel developments.

- Impacts from new development on staffing demands are not included in the forecast.

Forecast Summary & Results

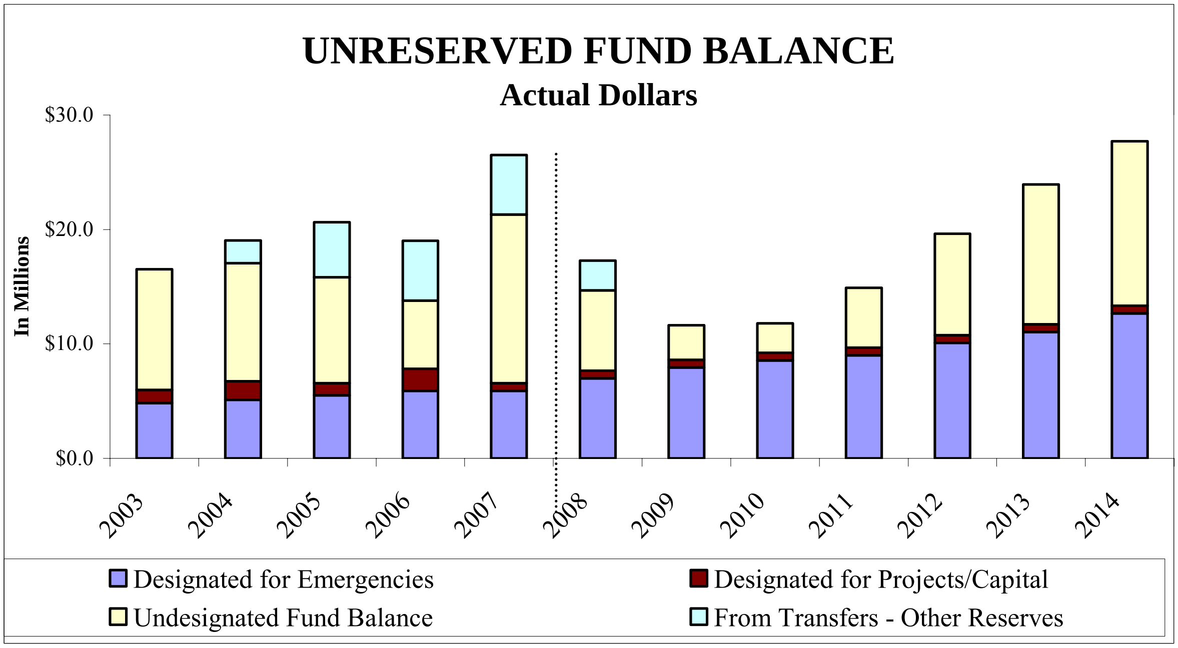
Operating position refers to the City's ability to match revenues to expenditure levels, i.e. if revenues exceed expenditures, the City will have an operating surplus. The opposite is true if revenues fall below expenditures, then the result is an operating deficit. Over the forecast period, the City's revenue and expenditure projections generate a decrease in operating position for fiscal years 2006-07 through 2009-10. This includes restoring 29 of the 30 frozen positions. After 2011-12, expenditure growth outpaces revenue growth. It should be noted that while significant new development in the pipeline is included in our revenue forecast, we do not speculate as to new development projects, however likely, after that time.



	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
	-1.74	-0.03	-2.05	0.27	5.61	1.39	0.37	0.17	3.10	4.72	4.31	3.80

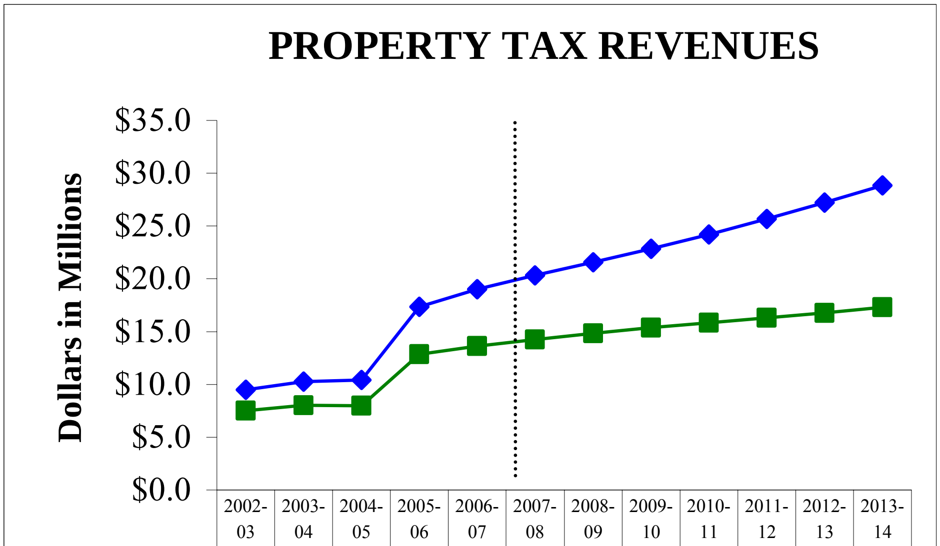
Included in the FY 2004-05 results is a one time payment from the State of $1.27 million, which represents the VLF "backfill" loan repayment. Increases in labor costs are the primary driver of expenditures, which are projected to increase by an average of over 6.5% per year, which includes adding 2 new positions per year. Any additional enhancements to service level will reduce the projected operating position. In addition, the revenue forecast could be further affected by delays in new development 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 included in the forecast.

Unreserved Fund Balance



The Operating Position discussed in the previous slide reflects a decrease in the City's operating position in fiscal year 2008 and continuing through 2010. 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. One time uses of the unreserved fund balance that have been budgeted for in the FY 2007/08 and FY 2008/09 budgets have been included in this projection.

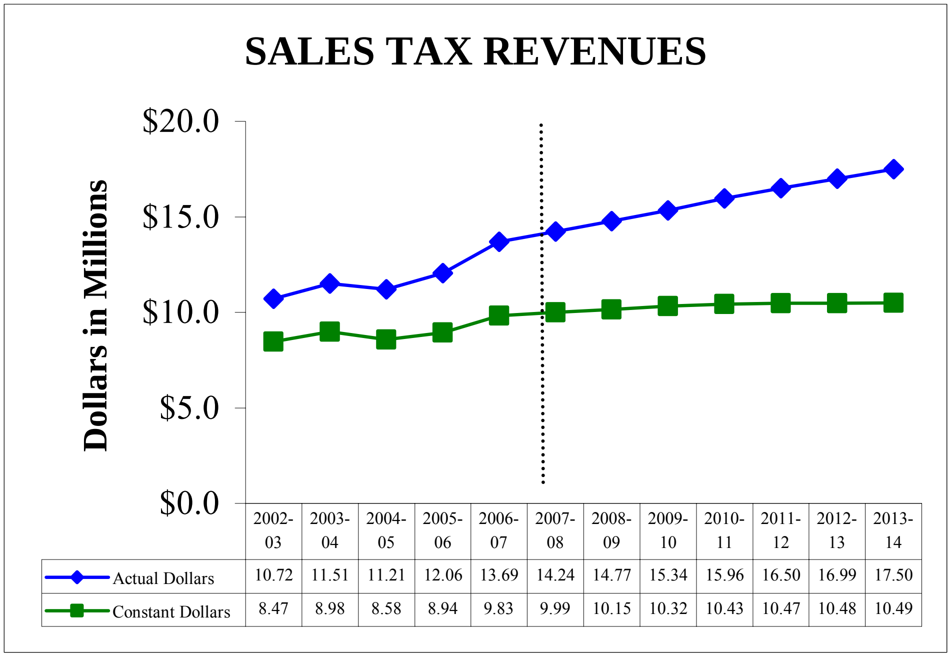
Property Tax Revenues



	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Actual Dollars	9.49	10.25	10.41	17.36	19.00	20.33	21.55	22.84	24.21	25.66	27.20	28.84
Constant Dollars	7.50	8.00	7.97	12.87	13.64	14.26	14.81	15.36	15.82	16.29	16.78	17.29

Property Tax continues to be the City's largest source of revenue and represented 32.5% of total revenues in FY 2006-07. 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 7% in 2008. 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



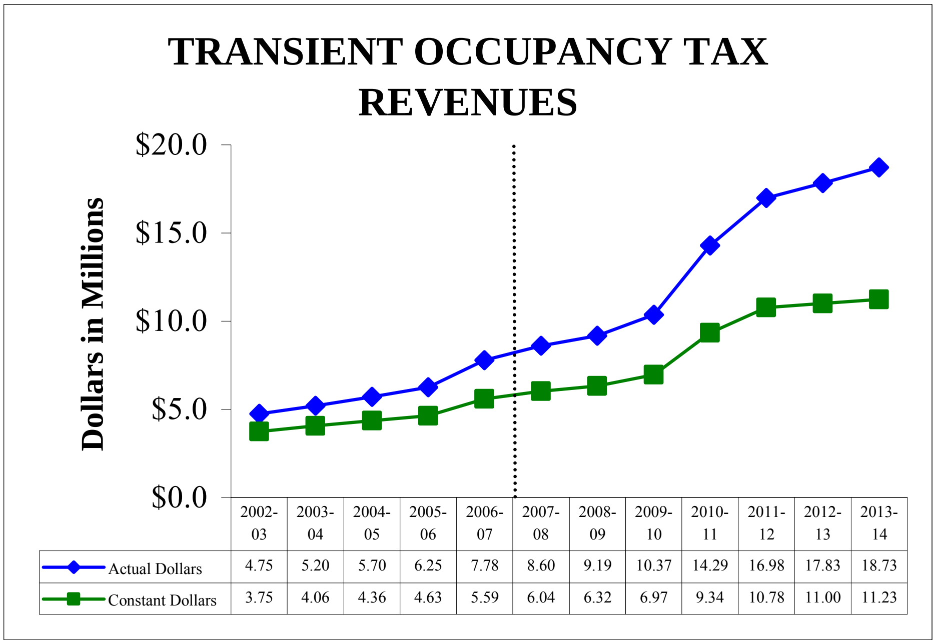
Sales tax is one of the City's most economically sensitive revenue sources and continues to be the City's second largest revenue source. Projected new development is expected to bring an incremental amount of sales tax revenue.

Sales Tax Revenue Forecast
(in thousands)

	Audited 2006-07	Projected 2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Base Sales Tax (Includes Prop 172)	$ 13,695	$ 14,106	$ 14,529	$ 14,965	$ 15,414	$ 15,876	$ 16,352	$ 16,843
Incremental Increases:								
Hotels	0	20	17	71	227	293	302	310
Retail	0	36	48	84	87	89	92	95
Transportation	0	35	71	73	75	78	80	82
Food	0	46	105	151	155	160	165	169
Totals	$ 13,695	$ 14,243	$ 14,770	$ 15,343	$ 15,958	$ 16,496	$ 16,990	$ 17,500
% Increase		4.00%	3.71%	3.88%	4.01%	3.37%	3.00%	3.00%

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 3.0% and 4.0%. 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



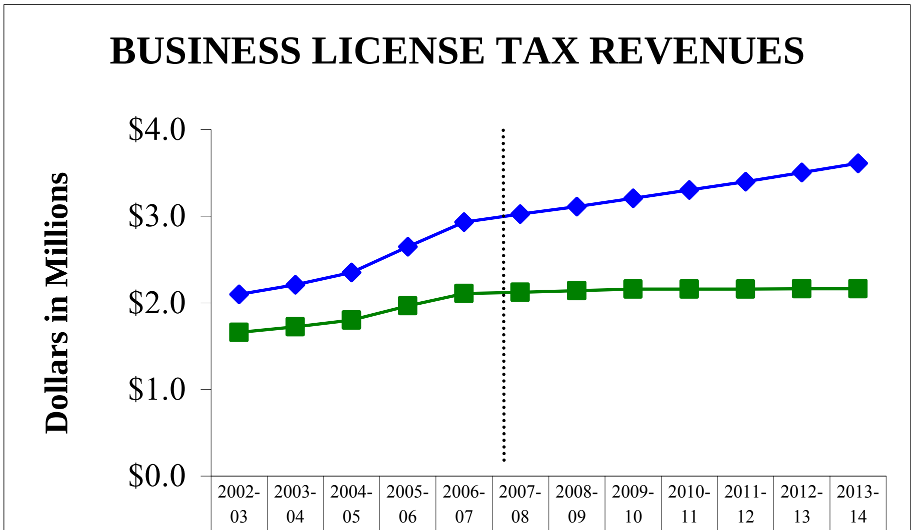
Transient occupancy tax is the other of the City's most economically sensitive revenue sources and is the City's third largest revenue source. Projected new hotel development is expected to bring an incremental amount of transient occupancy tax revenue.

Transient Occupancy Tax Revenue Forecast
(in thousands)

	Audited 2006-07	Projected 2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Base Transient Occupancy Tax	$ 7,779	$ 8,168	$ 8,577	$ 9,006	$ 9,456	$ 9,929	$ 10,425	$ 10,946
Incremental Increases:	0	435	609	1,362	4,835	7,056	7,408	7,779
Totals	$ 7,779	$ 8,603	$ 9,186	$ 10,368	$ 14,290	$ 16,984	$ 17,833	$ 18,725
% Increase		10.6%	6.8%	12.9%	37.8%	18.9%	5.0%	5.0%

Using the assumption of moderate economic expansion in subsequent years combined with planned hotel development, including the Meritage expansion, Avia Hotel, Westin and River House, transient occupancy tax revenues are expected to see annual increases between 5% and 38%.

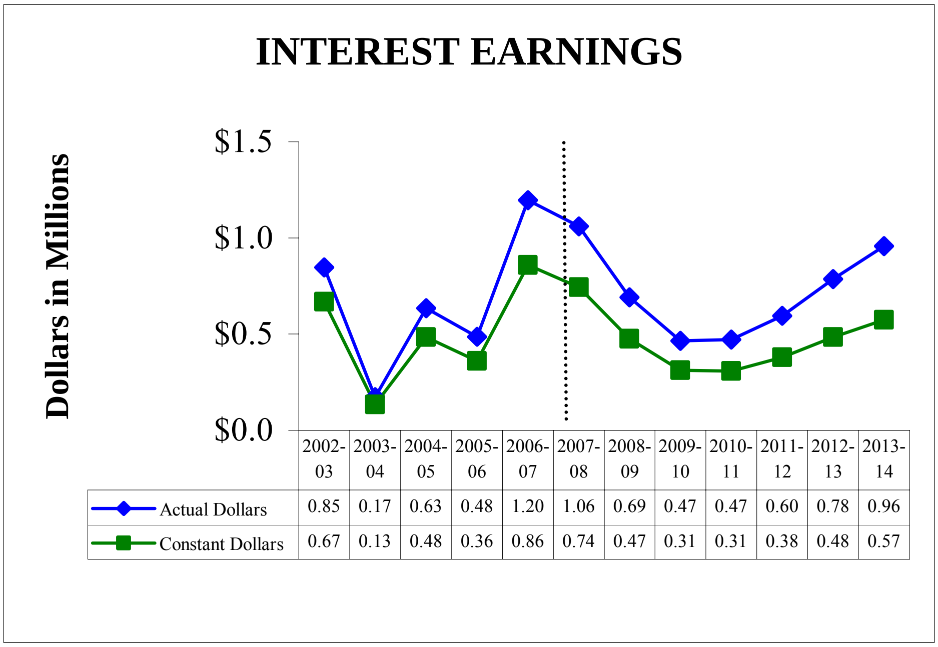
Business License Tax Revenues



	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Actual Dollars	2.10	2.21	2.35	2.65	2.93	3.02	3.11	3.21	3.30	3.40	3.50	3.61
Constant Dollars	1.66	1.72	1.80	1.96	2.11	2.12	2.14	2.16	2.16	2.16	2.16	2.16

Business license tax revenues are based on gross receipts of businesses within the City. The average increase realized in fiscal years 2005-06 and 2006-07 was 11%. 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%.

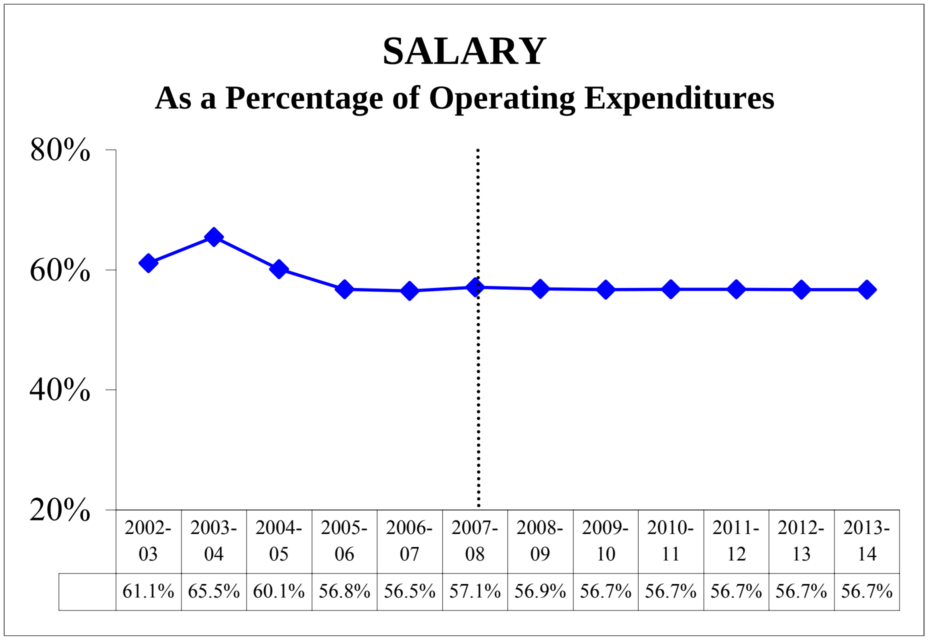
Interest Earnings



	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Actual Dollars	0.85	0.17	0.63	0.48	1.20	1.06	0.69	0.47	0.47	0.60	0.78	0.96
Constant Dollars	0.67	0.13	0.48	0.36	0.86	0.74	0.47	0.31	0.31	0.38	0.48	0.57

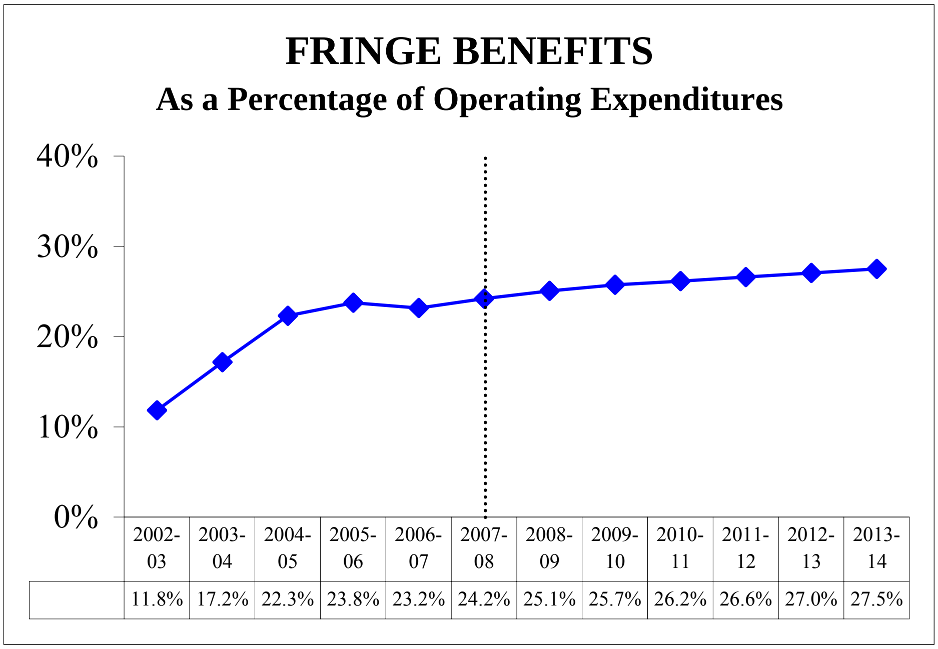
This revenue is based on the earnings generated by the investment of cash on hand. The City's portfolio is made up of accumulated revenues in excess of expenditures. It is also comprised of funds committed for Capital Improvement Projects and other purposes, but not spent. Much of the portfolio is invested in short-term instruments because of these commitments; therefore, has realized lower yields. Low interest rates have contributed to a decline in overall yield. In 2006-07 the City's revenues, particularly TOT and Sales Tax came in higher than expected, while the expenditures came in approximately 10% below budget. The spike in interest earnings in FY 2006-07 is attributed to the additional funds invested and higher interest rates.

Salary as a Percentage of Operating Expenditures



Salaries have continued to account for more than 50% of the City's operating expenditure budget. Even with the release of 29 of the 30 frozen positions and 2 new positions per year beginning in FY 2008-09, the percentage of salaries to total expenditures is expected to be relatively consistent. Annual step and cost of living increases of 5% have been included in the salary projections.

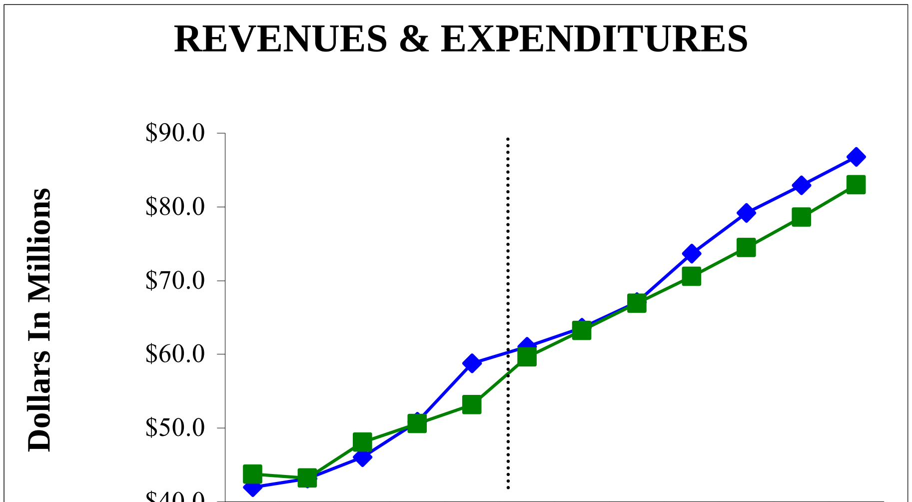
Fringe Benefits as a Percentage of Operating Expenditures



The employee benefits category reflects a moderation of growth commencing fiscal 2008 of the forecast period. The growth rate from the period between 2003 and 2007 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 10% growth rate.

Revenues & Expenditures



	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Total Revenues	42.00	43.18	46.06	50.89	58.79	61.02	63.61	67.09	73.68	79.20	82.92	86.80
Total Expenditures	43.73	43.21	48.11	50.62	53.18	59.64	63.24	66.91	70.59	74.48	78.62	83.00

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 over 6.5% per year. Projected expenditures include the restoration of 29 of the 30 frozen positions and an additional 2 positions per year thereafter. No new programs are assumed.

As indicated on the graph, the forecast predicts that the City will experience a positive net position through 2014, given the assumptions in the model.

V: 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 has improved as reflected in strong revenue growth across the board. Even with the current national economic challenges, 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. 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.

Even with the current national economic downturn, this report is still positive and improving due to continued new development in the Napa area. Despite a positive report on the state of the local economy, it must be noted that forecasted expenditure growth continues to outpace forecasted revenue growth. This is a condition that cannot be allowed to continue.

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 including parks, trails and bridges, but we have not allowed for sufficient 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 $12 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 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. This appeals to the critical need to adopt the proposed sales tax measure in November. To do otherwise will exacerbate current spiraling liability and maintenance costs for critical infrastructure.

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.

VI: RECOMMENDED ISSUES FOR STUDY/ACTION:

- Bringing operating revenues and expenditures into alignment.
- Identifying appropriate staffing levels for core services and programs
- Long term funding source for new facilities and existing infrastructure
- Labor cost containment alternatives
- Ongoing establishment of standards for prudent reserves
- Impact of new development on service delivery and financial position
- Various options for sharing resources with other local entities
- Funding for capital equipment and major maintenance
- Opportunities for revenue development
    - Fees
    - Strengthen tax base
    - Tax options
    - Collection practices
- Changes to the organizational structure to enhance efficiency and streamline operations
- Funding to provide more timely compliance with Americans with Disability Act requirements