General Fund

BACKGROUND

	2002 Actual	2003 Adopted Budget	2003 Actual	2004 Adopted Budget
Revenue	$ 81,006,857	$ 81,273,170	$ 84,065,940	$ 79,468,394
Operating expenses	76,582,084	80,919,300	80,384,320	80,875,801
Operating surplus	4,424,773	353,870	3,681,620	(1,407,407)
Capital budget:				
Use of restricted streets capital reserves	800,000	-	-	-
Streets capital	3,500,000	2,484,942	2,484,942	-
Remaining surplus (deficit)	1,724,773	(2,131,072)	1,196,678	(1,407,407)
General capital	2,490,924	2,017,730	2,233,730	1,015,150
Net addition to (use of) reserves	$ (766,151)	$ (4,148,802)	$ (1,037,052)	$ (2,422,557)

The adopted fiscal year 2004 General Fund budget is the culmination of a process begun in the middle of fiscal year 2002. After several years of historically strong revenue growth, several of the City's key General Fund revenues began to reflect a weakening economy in the spring of 2001. Growth rates in these key revenues began to moderate significantly. The terrorist attacks of September 11th compounded this trend. In the wake of September 11th, revenues such as sales tax and transient occupancy tax (TOT) declined for the first time in more than four years. At the same time, the City's costs began to experience significant growth in a number of areas, most of which were partially or completely beyond the City's control. In particular, insurance costs, including workers' compensation, property insurance and employee health insurance, have increased substantially in the last three years. In addition, due to the poor performance of financial markets over the last three years, the City's retirement contributions to the California Public Employees Retirement System (PERS) are also increasing dramatically. These concurrent trends in both revenues and expenditures combined to present the City with both significant budget challenges and opportunities.

In some ways, the current budget environment is similar to the recession of the early 1990s. However, there are also fundamental and important differences. Like the previous recession, key General Fund revenues have been impacted. For example, in fiscal year 2002, two of the General Fund's most important and economically sensitive revenues declined. Sales tax declined 4.1% and transient occupancy tax declined 3.3% from fiscal year 2001 levels. Unlike the recession of the early 1990s, however, the current budget challenges are due more to increasing costs than declining or stagnant revenues. In fact, even had revenues continued to grow at historical levels, the City would still be facing budget challenges. The cost increases mentioned above (and discussed in further detail later in this overview) are a significant dimension that was not present in the recession of the 1990s.

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Another similarity between the recession of the early 1990s and the current situation is the State's budget situation. In 1991, the State faced a sizeable budget deficit, which it solved in large part by taking funds from local governments. Through the use of the Educational Revenue Augmentation Fund (ERAF), the State shifted local property tax dollars to schools, thus enabling it to reduce its own obligation to school funding by an equal amount. The ERAF shift, which continues to grow each year, is now costing the Santa Barbara's General Fund over $2 million of property tax revenue annually. In fact, much of the state's budget surplus during the late 1990s was the result of the continuing ERAF shift that was never returned to local governments once the economy recovered.

Once again, the State was facing an unprecedented budget deficit for fiscal year 2004. After a long and heated political battle, the State adopted its fiscal year 2004 budget in July 2003. Unfortunately, the State once again used many one-time measures to address its staggering $38 billion projected deficit and once again solved part of its deficit at the expense of local government, although the impacts to cities were not as significant as had originally been expected.

The biggest impact of the State's adopted budget on the General Fund is the City's share ($1.2 million) of the $852 million of State-retained vehicle license fee (VLF) payments. Earlier this year, the State "pulled the trigger" contained in the original VLF legislation that enabled the State to administratively restore the VLF to the 1998 level, when it was originally lowered. While this leaves intact the ongoing VLF payments to local governments, the State retained 3 months of fiscal year 2004 VLF backfill payments, indicating that this "loan" will be repaid in 3 years when, presumably, the fiscal issues will have been resolved. Clearly, the City remains skeptical as to the security of this unilaterally executed loan agreement. Since this action was taken after the adoption of the City's budget, the VLF revenue included in the adopted budget does not reflect the $1.2 million estimated reduction in VLF payments from the State this fiscal year.

However, the current General Fund budget challenges are in large measure expenditure-driven, and there is no expectation that these cost pressures will abate in the short term. The City is not in a position to simply wait for a better economic climate to grow revenues back to a balanced General Fund budget, given the size of cost increases, which are, in large part, out of the control of the City. For example, employee health insurance, workers' compensation and retirement costs are all expected to grow in excess of the rate of inflation over the next several years. Therefore, to address the budget challenges, adjustments to both expenditures and revenues were required to balance the fiscal year 2004 budget.

The City's goal has been, and continues to be, to combine the judicious use the General Fund's accumulated reserves with expenditure reductions to permit a gradual and orderly transition to a smaller, more efficient organization. Often referred to as a "soft landing," the concept is to manage the return to a balanced budget while avoiding layoffs or other unnecessary disruptions to the organization. This is exactly the scenario for which the General Fund has accumulated

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reserves. For example, the adopted fiscal year 2003 General Fund budget contained approximately $2 million in expenditure reductions combined with the budgeted use of an equivalent amount of reserves. Although vacant positions were eliminated, the $2 million of reductions were accomplished without layoffs. The adopted fiscal year 2004 budget continues this approach. An example of this approach is the fact that the adopted budget contains 27 fewer positions citywide than were authorized in the amended fiscal year 2003 budget.

Because of conservative budgeting practices, invariably the use of reserves at fiscal year-end is less than originally budgeted. For example, the adopted fiscal year 2003 year budget provided for the use of $2.1 million of reserves to balance the operating budget. However, at the end of fiscal year 2003, the fund generated an operating surplus of just over a $1 million. It is this experience, combined with the continued use of conservative budget assumptions that permits the City to maintain General Fund reserves at levels consistent with adopted policies, despite budgeting their use.

SUMMARY OF ADOPTED FISCAL YEAR 2004 BUDGET

As the table at the top of the page C-1 indicates, the adopted fiscal year 2004 General Fund operating budget projects total revenue of $79.5 million, combined with the use of $1.4 million of reserves, to fund an operating budget of $80.9 million. The use of an additional $1 million of reserves for capital brings the total adopted use of reserves to $2.4 million. The use of reserves for capital is in keeping with both past practice and the City Council policy, established in 1995, of using non-recurring revenue (reserves) to fund non-recurring costs (capital).

The adopted General Fund capital program is 55% lower than the fiscal year 2003 capital program. This is primarily because a number of ongoing maintenance activities as well as some equipment replacement that had previously been included in the capital program have been moved into the operating budget. As recurring maintenance activities, these items are more appropriately budgeted in the operating budget and paid from current-year operating revenue. For example, almost $240,000 was included in the fiscal year 2003 capital program for the annual replacement of General Fund desktop computers and related network infrastructure. In the adopted fiscal year 2004 budget, these costs have been budgeted in the operating budget.

Overall, General Fund operating expenditures in the adopted budget are approximately $80.9 million, an increase of only $491,000 over fiscal year 2003 actual expenditures. Given the significant increases in employee health insurance, workers' compensation and retirement costs, as well as the costs transferred to the operating that were previously funded within the capital program, the net increase over actual prior year expenditures was mitigated due to a structural change implemented in the fiscal year 2004 adopted budget.

The significant structural change, resulting in a smaller General Fund budget for fiscal year 2004, is that all Public Works Streets programs have been moved out of the General Fund and into a

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separate, Special Revenue Fund. The City's Streets programs are funded almost entirely with restricted revenue. Under standard governmental budgeting and accounting standards, this is the classic definition of a Special Revenue Fund. Moving the Streets programs out of the General Fund allows the City to more easily track use of the restricted revenue. For example, under the City Code of Ordinances, 50% of the City's utility users tax revenue is restricted to streets use. Each year, City Finance Department staff must track and reconcile the use of those funds to ensure compliance with the Code provision. By moving the Streets programs along with the restricted portion of the utility users tax (50%) to a separate Special Revenue Fund, the accounting and reconciliation process becomes much easier. In addition, all City-funded Streets expenditures, including capital, will be accounted for within a single fund. Moving the Streets programs out of the General Fund results in a reduction to the General Fund of approximately $5 million.

In an effort to provide better cost accounting, the adopted fiscal year 2004 budget moves several other entire operations out of the General Fund. Under the old structure, the budgets of all other General Fund programs did not properly reflect the true costs of providing their respective services because they did not include costs for information systems, custodial or communications support. The Information Systems, Custodial and Electronic Communications Systems programs now have been moved out of the General Fund and into Internal Service Funds. Under governmental budgeting and accounting standards, Internal Service Funds, like Enterprise Funds, recover all of their costs from user charges. The only difference is that the customers of Internal Service Funds are other City departments and operations, unlike Enterprise Funds, such as the City's Water, Wastewater, Parking and Golf funds, which provide services to the community. By moving these programs to Internal Service Funds, the costs are appropriately allocated to each individual General Fund program based upon their individual usage, better reflecting true and total program costs. The City already accounts for the Motor Pool, Building Maintenance and Self-Insurance programs as Internal Service Funds. It is very important to understand that this structural change has not affected the General Fund's total costs. The same costs have simply been allocated across each program, rather than being budgeted in consolidated programs. The new allocation methodology does increase individual department and program budgets, but does not affect the General Fund as a whole.

The adopted budget also proposes similar changes to the allocation of property and liability insurance premiums, and the General Fund-wide building maintenance program. In prior years, these costs were budgeted in the General Fund's Non-Departmental program, rather than being allocated to individual programs. Once again, this resulted in an understatement of the true costs of each General Fund program and the services they provide. As with changes described above, as simply a better allocation of existing costs, this change does result in an increase to individual department and program budgets, but not to the General Fund as a whole.

Although there is additional discussion of General Fund expenditures later in this overview, several significant cost increases that affect all City funds – including the General Fund - warrant

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discussion at this time. As mentioned above, these include retirement costs, costs for employee health insurance, and property and liability insurance.

The City's retirement contributions to the California Public Employees Retirement System (PERS) increased substantially on July 1, 2003. The adopted fiscal year 2004 budget contains $8.1 million for retirement contributions. This is an increase of $1.9 million (31%) from the current fiscal year. Retirement costs comprise 10% of the total adopted General Fund budget. The table below summarizes the City's actual PERS contribution rates for the prior fiscal year (2003), the adopted budget (fiscal year 2004) and a PERS-provided estimate for fiscal year 2005. The rates represent a percent of pay and are a combination of both the employee and employer portions (the City pays both).

PERS Contribution Rates by Contribution Group

Contribution Group	FY 2003	FY 2004	FY 2005
Miscellaneous	7.000%	10.161%	15.800%
Police	27.793%	32.665%	43.200%
Fire	19.899%	30.549%	43.400%

The dramatic increase in rates is a direct result of the losses sustained in the financial markets over the last two years. Over that period, PERS' investments have lost money, falling significantly short of the 8.25% actuarial assumption for investment returns. Until the investment environment recovers, the City can expect the PERS contribution rates to remain historically high. It should be mentioned that during the late 1990s when PERS was earning as much as 20% on its investment portfolio, the City's employer contribution rates were close to zero.

Employee health insurance is another cost that is growing much faster than inflation. The City currently participates in the PERS health insurance system. However, due to expected increases of between 20% and 30% in PERS health insurance premiums, the City will contract with other lower cost insurance providers in fiscal year 2004, beginning January 1st. Clearly, employee health insurance costs will continue to be a concern to both the City and its employees for some time to come.

Finally, property and workers' compensation insurance costs have increased dramatically over the last several years. The City is self-insured for workers' compensation. Over the last three years, the General Fund's workers' compensation costs have increased almost $900,000 (76%). In addition, the City's self-insured retention (deductible) for workers' compensation has increased from $300,000 to $500,000 per incident. The City purchases commercial property insurance, including coverage for earthquake and flood. In fiscal year 2000, the City paid $461,000 for property insurance with a basic deductible of $100,000 per occurrence. In fiscal year 2003, the City paid over $1.5 million for coverage with a $2 million deductible per occurrence. This represents a 225% increase in cost with a 20-fold increase in the deductible. The General Fund

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has absorbed a proportionate share of this increase. The City's property insurance premium for fiscal year 2004 is roughly the same as fiscal year 2003, just under $1.5 million with the same deductible limits.

In light of the uncertainties surrounding the significant cost items discussed above, as well as the State budget situation, the adopted fiscal year 2004 General Fund budget contains a supplemental budgetary reserve. In addition to the usual Appropriated Reserve of $375,000, the adopted budget contains a $500,000 budgetary reserve. This means that more than a third the $1,407,407 use of reserves to balance the budget is in the supplemental budgetary reserve. Without this supplemental budgetary reserve, the reserves needed to balance the adopted operating budget would be less than $1 million.

LONG-RANGE FINANCIAL PLANNING

For many years now, the City staff has used a multi-year forecasting model to project General Fund budgets several years into the future and assess the long-term impacts of current budget decisions and options. The model allows staff to perform "what-if" projections using different sets of assumptions for both revenues and expenditures. At least annually, a series of these projections are reviewed with the City Council Finance Committee. Particularly in unsettled budgetary times, such as now, the model is an extremely useful tool in making decisions and projecting the impacts of those decisions up to three years into the future. The table on the following page is a summary of the current version of the multi-year model. The table contains data for the prior year's actual year-end balances, the adopted fiscal year 2004 budget and projections for three additional fiscal years.

For the projections of fiscal years 2005, 2006 and 2007, the following assumptions are used for this version of the model:

	FY 2005	FY 2006	FY 2007
Revenue growth	3%	3%	3%
Expenditure growth:			
Salaries	2%	2%	2%
Health insurance	7.50%	7.50%	7.50%
PERS	PERS estimate	5%	5%
Workers' Comp.	5%	5%	5%
Supplies & services	0%	2%	0%

In each case, the percentage represents the annual growth assumed for that particular item. For example, this version of the model assumes 3% annual revenue growth and 2% annual growth in salaries.

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Multi-Year Forecast
General Fund

	FY 2003 Actual	FY 2004 Adopted	FY 2005 Estimated	FY 2006 Estimated	FY 2007 Estimated
Total Revenues	$84,065,940	$79,468,394	$82,226,212	$84,692,999	$87,233,789
Total Expenditures	82,869,262	80,875,800	86,077,447	88,393,483	90,482,671
Net Operating Surplus (Deficit)	1,196,678	(1,407,406)	(3,851,235)	(3,700,484)	(3,248,882)
Cumulative Budget Measures	-	-	2,000,000	3,000,000	3,000,000
Budgeted Use of Reserves	1,196,678	(1,407,406)	(1,851,235)	(700,484)	(248,882)
Anticipated Year-End Variance	-	1,617,516	1,721,549	1,767,870	1,809,653
Expected Oper. Surplus (Deficit)	1,196,678	210,110	(129,686)	1,067,386	1,560,771
Capital Program	(2,233,730)	(1,015,150)	(1,000,000)	(1,000,000)	(1,000,000)
Adjustment to Policy Reserves	(106,012)	(772,037)	(347,405)	(313,378)	-
Net Addition to (Use of) Reserves	(1,143,064)	(1,577,077)	(1,477,091)	(245,992)	560,771
Beginning Reserves Balance	19,091,123	17,948,059	16,370,982	14,893,891	14,647,899
Ending Reserves Balance	$17,948,059	$16,370,982	$14,893,891	$14,647,899	$15,208,670

Using these assumptions, the model projects that, without further adjustments, the General Fund will continue to run operating deficits [“Net Operating Surplus (Deficit)”] of between $3 million and $4 million through at least fiscal year 2007. This makes it clear that, based on the assumptions noted above, additional adjustments will certainly be required to return the General Fund to a balanced budget.

The next line down in the table (“Cumulative Budget Measures”) indicates a preliminary plan of action for continued General Fund adjustments. It reflects another $2 million of adjustments to the General Fund in fiscal year 2005 and an additional $1 million in fiscal year 2006 (for a cumulative $3 million by fiscal 2006). The impact of the additional adjustments is reflected in the next line down (“Budgeted Use of Reserves”). That line indicates that the implementation of the $3 million adjustments would reduce the budgeted use of reserves to zero by fiscal year 2007. The operating budget would essentially be balanced by that time.

The “Anticipated Year-End Variance” assumes that there will be an annual favorable budget variance equal to 2% of the operating budget. This amount would normally come from a combination of revenue over budget and expenditures under budget and is consistent with historical experience. The projection indicates that, with the cumulative $3 million of additional adjustments discussed above, by the end of fiscal year 2006, even a $1 million capital program could be funded from current revenue [“Expected Operating Surplus (Deficit)” of $1,067,386].

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The balance of the table projects the impact of both the operating results and the capital program on the General Fund's reserve balances. Based upon all of the assumptions listed and described above, the model indicates that as early as fiscal year 2006, the "Net Addition to (Use of) Reserves" would essentially be balanced. The City's General Fund would no longer be using reserves to fund either operating or capital. The bottom line of the projection indicates that under this set of assumptions, the General Fund would end fiscal year 2007 with $15.2 million of budgetary reserves. This would represent a net use of reserves of only (approximately) $2.7 million between the end of fiscal year 2003 (with an ending reserve balance of almost $17.9 million) and the end of fiscal year 2007 (with an ending reserve balance of $15.2 million).

Clearly, the results projected by this version – or any version - of the model are only as good as the assumptions. One significant assumption that has not been mentioned is that this version does not factor in any potential impacts from the State budget crisis. Despite this, staff believes that the basic assumptions used in this version are reasonable based upon the current situation. The model is updated regularly as the situation changes and this allows staff to focus on the longer-term implications of both external impacts and potential policy decisions. It is an extremely useful tool; so much so, that virtually all of the City's Enterprise Funds now prepare and maintain a similar model for their own long-range planning.

The balance of this General Fund overview will focus on specific revenue and expenditure issues. Details on operating expenditures by department and program can be found in the department summaries and program narratives later in this document.

REVENUE

In total, fiscal year 2004 General Fund revenues are projected at $79,468,394. This represents a reduction of almost $4.6 million (5.5%) from the prior fiscal year year-end results. The decline is a bit misleading in that it is attributable to a significant structural change. As discussed above, all Streets programs will be moved out of the General Fund and into a dedicated Streets Special Revenue Fund. As a part of this change, 50% of the City's projected utility users tax, totaling $5.6 million, will also be moved to the new fund in accordance with the provisions of the City's Code of Ordinances. It is this change that accounts for the reduction in projected General Fund revenue.

The chart on the following page displays the General Fund's major revenue sources. As the chart indicates, taxes, at 63%, still constitute the largest source of General Fund revenue. Interfund Reimbursements, which represent payments to the General Fund from other City funds for various services provided to those funds, is the second largest category at 14%. Fees and service charges at 9% is the third largest, followed by intergovernmental (8%), fines (3%) and use of money and property (2%).

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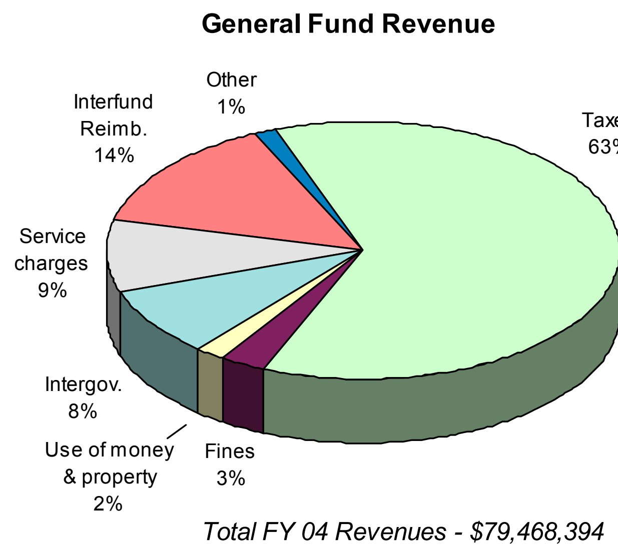
Overall, staff is projecting moderate growth in the General Fund's major tax revenues. Additional detail is presented below, but growth rates are projected to be between 2% and 5%, depending on the particular revenue.

The other notable factor affecting overall revenue projections are the fee increases implemented by the various General Fund departments. Through a combination of anticipated growth in activity levels and the projected impact of the fee increases contained in the adopted budget, total service charge revenue is expected to increase almost 20% in fiscal year 2004.



In summary, the revenue growth rate projections to develop and contained in the adopted budget are consistent with recent experience and staff believes they are reasonable. However, if the City experiences a renewed economic slowdown with a corresponding impact on revenues, additional adjustments to the budget will be required. Additional detail on specific revenue sources is presented below.

Taxes

Overall, the adopted fiscal year 2004 tax revenue estimate is 8.1% below fiscal year 2003 year-end actual results. As discussed above, this is an anomaly due to the structural change in accounting for utility users tax revenue and Streets programs. Without the change in utility users tax accounting, projected tax revenue would be 2.4% above fiscal year 2003 year-end actual results. The table on the following page details the City's tax revenues with amounts presented for the adopted budget for the prior fiscal year, and the adopted fiscal year 2004 budget.

Comparing the adopted budget amounts to the prior year year-end actual results, less one-half of the utility users' tax that was transferred to the Streets Fund, presents a clearer picture of the growth rates staff is projecting for next fiscal year. This is similar the methodology staff uses to develop the revenue estimates. Staff begins by evaluating fiscal year 2003 year-to-date amounts and projects estimated year-end balances. Then projections for the budget year are developed based upon the prior year, year-end estimates, less any adjustments for any structural changes.

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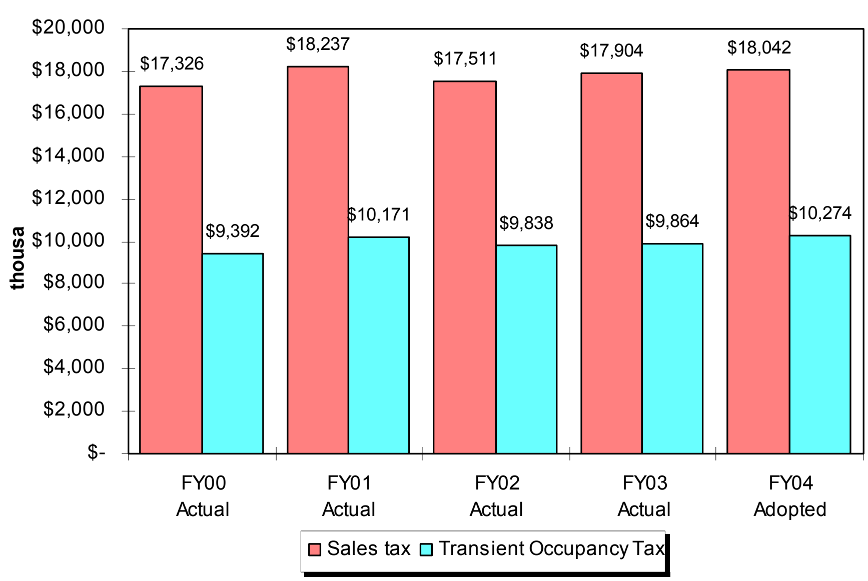
	Fiscal 2003 Adopted	Fiscal 2003 Actual	Fiscal 2004 Adopted	Percent Growth
Sales and use	$ 17,853,400	$ 17,903,527	$ 18,042,000	0.8%
Utility users	11,364,100	10,886,009	5,607,700	-48.5%
Property	9,541,000	10,373,212	10,992,200	6.0%
Transient occupancy	9,974,700	9,864,403	10,273,900	4.2%
Franchise				
Electric	630,000	699,995	750,700	7.2%
Gas	339,600	294,542	320,600	8.8%
Cable television	525,000	775,047	911,300	17.6%
Business license	1,733,400	1,831,973	1,876,300	2.4%
Real property transfer	265,500	874,582	408,000	-53.3%
Total taxes	$ 52,226,700	$ 53,503,290	$ 49,182,700	-8.1%

As the table above indicates, the City needs only 0.8% growth in sales tax revenue to meet the budget estimates adopted for fiscal year 2004. As the City's largest and most economically sensitive revenue source, staff tends to be somewhat conservative with sales tax projections. A negative variance of only 1% in the sales tax projection translates into a revenue loss of over $180,000. In addition, sales tax is more difficult to project because of the significant delay in the state's reporting of actual results.



The chart to the right displays information on both sales tax and transient occupancy tax (TOT), including the actual fiscal 2003 year-end amounts. As the chart indicates, both sales tax and transient occupancy tax declined in fiscal year 2002, but were up modestly in fiscal year 2003. Although transient occupancy tax is expected to return to fiscal year 1991 levels in fiscal year 2004, sales tax revenue is not expected to do so until next fiscal year. Transient occupancy tax is budgeted to grow 4.2% next fiscal year. Unlike sales tax, the City receives TOT on a monthly basis and therefore it is somewhat more predictable.

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Property tax continues to show strong growth. Staff is projecting 6% growth for fiscal year 2004 over fiscal year 2003 actual amounts.

Revenue from the City's 6% utility users tax is projected to increase 3% next year. The City's utility users tax revenue has been unusually volatile over the last two years as natural gas prices skyrocketed and then returned back to close to previous levels. However, staff feels that the revenue estimate is realistic for fiscal year 2004. As previously mentioned, the General Fund's share of the utility users tax will be reduced by 50% due to the establishment of a separate Streets Special Revenue Fund.

Franchise fees, in total, are projected to grow by 12%. The large increase is due to another structural change in the cable television franchise fee. Beginning January 1, 2003, management of public and educational access television on the South Coast of Santa Barbara County was assumed by the Community Media Access Center (CMAC), an independent non-profit corporation. Prior to that date, Cox Communications operated this community service using 1.5% of the City's franchise fee. With the creation of CMAC, the City now receives the additional 1.5% franchise fee and, in turn, pays it to CMAC. Therefore, even though cable franchise revenue is up considerably, it is offset with a corresponding increase in cost.

Business license tax is projected to grow 2.4% over the current year.

Real property transfer tax appears to be projected for a significant decrease but, once again, this is due to an anomaly. The fiscal year 2003 actual balance of $874,582 includes a $397,000 payment from the County that represents a correction to the amounts they have paid the City over the last two fiscal years. Finance staff did an analysis of the real property transfer tax and concluded that the County had not been paying the correct amounts. Staff requested the County to audit the payments and, as a result, the $397,000 shortage was identified. Adjusting for this one-time payment, real property transfer tax still is projected to decrease 14.6% over fiscal year 2003 actual amounts.

Fines and Forfeitures

This revenue category is projected to provide almost $2.6 million in General Fund revenue (3%). This is approximately $350,000 higher than fiscal year 2003 year-end results. The largest item in this group is parking fines, which is anticipated to generate $2.3 million of the $2.6 million total. The parking fine revenue projection for fiscal year 2004 includes adoption of an increase in fines for various parking violations. The amount of the increase varies by type of violation.

Use of Money and Property

This category, totaling $1.6 million (2% of General Fund revenue) is comprised of two items. The first, and smaller, is the rents and leases earned on General Fund properties, primarily the three Community Centers. This provides approximately $430,000.

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The more significant revenue in this category is investment income. The fiscal year 2004 estimate for investment income is $1.1 million. This is down substantially from the fiscal year 2003 budget of $2.1 million. Fiscal year 2003 actual balance at year-end was only $1.9 million, approximately $200,000 below budget. Based upon the continuing low interest rate environment, staff believes that investment income will continue to decline as higher yielding securities mature and are replaced with much lower yielding investments.

Intergovernmental

Intergovernmental revenues are projected to contribute approximately $6.7 million (8%) to the General Fund budget. This is actually a slight decline from the fiscal year 2003 budget. The reason for the anticipated decline is the loss of $150,000 in reimbursements from the State for compliance with State mandates. By far the most significant individual revenue in this category, budgeted at $5.8 million, is the vehicle license fee (VLF). This revenue is paid to the City by the State and, as mentioned earlier, the State retained 3 months of the fiscal year 2004 VLF backfill payments to cities to help balance its own budget. Since this action was taken after the adoption of the City's budget, the VLF revenue included in the adopted budget does not reflect the $1.2 million estimated reduction in VLF payments from the State this fiscal year.

Service Charges

After taxes and Interfund charges, this is the third largest revenue category in the General Fund. In total, service charges are projected to provide just over $7.4 million (9%) of General Fund revenue. As the table at the top of the next page indicates, the adopted fiscal year 2004 amount is approximately $1.4 million (23%) above the adopted fiscal year 2003 amounts. In a number of cases, the total projected growth in revenue is due to a combination of increases in fees and anticipated activity levels.

	Fiscal 2002 Actual	Fiscal 2003 Adopted	Fiscal 2004 Adopted
Community Development	$ 2,488,475	$ 2,503,200	$ 3,161,746
Finance	649,065	625,000	652,500
Fire	47,589	41,800	130,200
Library	26,467	28,250	26,000
Parks and Recreation	2,063,012	2,100,847	2,396,050
Police	509,290	467,824	774,951
Public Works	242,677	241,000	260,000
Total	$ 6,026,575	$ 6,007,921	$ $ 7,401,447

General Fund

While there is always sensitivity to increased fees for government services, staff believes it is important that the City establish fee levels to recover a significant portion of the costs of providing those services. Service costs not recovered through program fees must be subsidized with tax revenue. While this may be appropriate in some cases, as a rule, staff believes that the users of the services ought to bear the costs of providing them. As has been discussed earlier in this document, the City will continue to work towards the goal of becoming a smaller and more efficient organization. Over time, this will lower the costs of providing services to the public. However, in many cases, the City's current fee levels recover only a small fraction of the cost of providing the services. The City has already committed to conducting a fee study in conjunction with the development of the fiscal year 2005 budget. When completed, that study will clearly define not only the fully allocated costs of providing General Fund services, but also the percent of those costs recovered through the associated fees. The fee study will facilitate discussion of both the costs of providing services and the appropriate levels of fees.

Interfund Charges and Reimbursements

This category of revenue represents reimbursements to the General Fund for services provided to the City's Enterprise and Special Revenue funds. The adopted fiscal year 2004 budget projects a total of $11.2 million from this revenue source. This represents 14% of total General Fund revenue. Four items account for over $9.6 million of the total.

The General Fund's overhead allocation represents just over $5 million. These are charges to the City's Enterprise and Special Revenue funds for administrative costs provided by the General Fund. Examples of the services provided include most of the payroll, accounts payable, accounting, human resources, legal, City Clerk and City Administrator support. Each administrative service is individually allocated based upon usage. For example, payroll costs are allocated based upon the number of paychecks issued for each fund.

The Airport pays just over $1 million to the General Fund for Fire Department staffing of the Airport Rescue and Firefighting (ARFF). This is the fire station at the Airport that provides FAA mandated fire and rescue services. The Airport pays for the direct costs of the firefighters as well as all associated costs of maintaining the station and equipment.

Public Works generates approximately $2.6 million from engineering charges to City projects. Virtually all of these charges are incurred from engineering support of capital projects. When the General Fund-paid engineering staff works on a capital project, the cost of their time is charged to that project.

The final notable item in this revenue category is payment from the City's Redevelopment Agency (RDA) for staffing of the Agency. The RDA has no staff. Under a contract approved each year as a part of the RDA's budget process, the City commits to providing staffing to the Agency. This reimbursement totals approximately $900,000.

General Fund

EXPENDITURES

As mentioned at the beginning of this section, overall General Fund operating expenditures in the adopted fiscal year 2004 budget are $80,875,801. Including capital, the total adopted General Fund budget is $81,890,951.

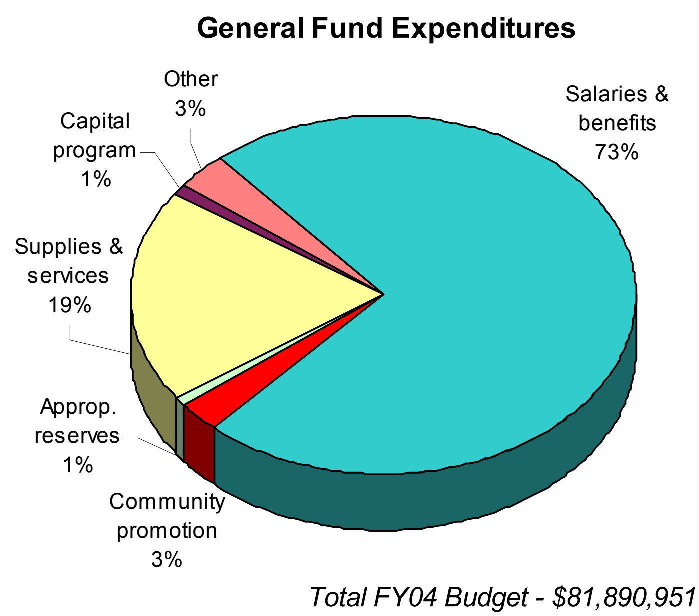
The adopted General Fund operating budget is within $44,000 of the fiscal year 2003 adopted budget and represents an increase of $491,000 over actual fiscal year 2003 year-end expenditures. The adopted budget also contains the elimination of 26.9 full-time equivalent positions.

Given all of the structural changes to the General Fund (described earlier in this overview), year-to-year comparisons become problematic. The removal of the Streets programs from the General Fund to a dedicated Special Revenue Fund, the conversion of Information Systems, Custodial and Communications Systems programs to Internal Service Funds, and the subsequent allocation of those costs to the various individual General Fund programs, all make it difficult to make direct comparisons.

In addition, as was described earlier, the General Fund operating budget has absorbed significant increases in retirement and insurance costs. The adopted budget contains no provision for any salary increases for any bargaining unit beyond what is contained in existing labor agreements.

The chart to the right displays the adopted fiscal year 2004 budget, including capital, by object of expenditure. As is always the case, salaries and benefits (73%) represent the largest portion of the General Fund budget.

Capital expenditures represent 1% of the General Fund budget. As indicated in the chart, the Community Promotion budget comprises approximately 3% of the budget. The Community Promotion program accounts for City contributions to various civic events such as the 4th of July celebration, Old Spanish Days and Summer Solstice, as well as to organizations such as the Chamber of Commerce and the



General Fund

Conference and Visitors Bureau.

The table below summarizes General Fund operating expenditures by department for the adopted fiscal year 2003 budget, the fiscal 2003 year-end results, and the adopted fiscal year 2004 budget. The percentage change column is based on the change from fiscal year 2003 year-end expenditures to the adopted fiscal year 2004 budget.

	Fiscal 2003		Fiscal 2004	Percent Change FY03 Actual
	Adopted	Actual	Adopted	to FY2004
Administrative Services	$ 2,671,795	$ 3,038,636	$ 1,705,287	-43.9%
City Administrator	1,689,197	1,309,732	1,742,995	33.1%
City Attorney	1,663,096	1,452,184	1,681,641	15.8%
Community Development	6,778,165	6,746,341	7,499,416	11.2%
Finance	3,215,155	3,430,861	4,306,500	25.5%
Fire	12,671,713	13,126,940	14,037,658	6.9%
Library	3,459,700	3,343,287	3,687,342	10.3%
Mayor and Council	460,524	431,135	556,099	29.0%
Non-Departmental	5,742,150	4,878,964	3,881,547	-20.4%
Parks and Recreation	10,540,529	10,448,121	12,589,365	20.5%
Police	22,977,805	23,325,404	24,601,638	5.5%
Public Works	9,049,471	8,852,715	4,586,312	-48.2%
Total expenditures	$ 80,919,300	$ 80,384,320	$ 80,875,800	0.6%

The following are brief comments on those departments with notable changes.

Administrative Services - The adopted fiscal year 2004 budget for Administrative Services is almost 44% below fiscal year 2003 year-end actual results. The entire decrease is due to the removal of the Information Systems programs from the General Fund to a new Internal Service Fund. The remaining programs in Administrative Services are the City Clerk's Office and Human Resources. The City's Channel 18 television station was also formerly a part of the Administrative Services Department, but is now part of the City Administrator's office.

City Attorney - The adopted City Attorney's budget includes the elimination of one attorney position that has been vacant since the start of the fiscal year 2003.

Community Development - The adopted fiscal year 2004 budget for Community Development totals approximately $7.5 million and includes the elimination of four full-time equivalent positions.

General Fund

Finance - The increase in the adopted Finance Department budget is attributable to the addition of the contract with the Community Media Access Center (CMAC) for the provision of public and educational access television. As described above, this cost is fully offset by an increase in the cable television franchise revenue paid to the City by Cox Communications. The cost of this contract is budgeted in Finance because Finance staff administers the cable television franchise agreement.

Fire Department - The adopted budget for the Fire Department is approximately $14 million, making it the second largest in the General Fund, behind only the Police Department. The adopted budget proposes the elimination of eleven positions. Since the Fire Department is required to maintain constant staffing at each station, the loss of the positions will be backfilled with overtime. The use of overtime represents a savings to the City because no additional benefits accrue on overtime. The majority of the increase in the adopted Fire Department budget is attributable to the impact of the PERS rate increase. The department's retirement costs will go up more than $700,000. In addition, there is an impact of almost $200,000 from the newly allocated costs such as insurance and communications systems (radio) maintenance.

Mayor & Council - The entire increase in the adopted Mayor and Council budget is attributable to the newly allocated costs. But for the allocated costs, this budget would have declined slightly.

Non-Departmental - The Non-Departmental budget is comprised of two distinct programs – Community Promotion and General Government. The Community Promotion program accounts for the City's contributions to marketing and tourism promotion, as well as arts and special community events such as Fiesta, Summer Solstice and the City's Fourth of July celebrations. The adopted Community Promotion budget is status quo.

The General Government program accounts for the General Fund's appropriated reserves, capital budget and debt service. The significant decline in the Non-Departmental budget is due to the allocation in the adopted budget of significant costs budgeted in this program in prior fiscal years. As previously discussed, all property and liability insurance costs for the General Fund as well as the planned maintenance program for all General Fund facilities have been budgeted in this program for many years. Beginning with the adopted fiscal year 2004 budget, all these costs have been removed from the Non-Departmental program and allocated directly to the various General Fund programs. The change has resulted in the significant decline in the level of the Non-Departmental budget.

Parks and Recreation – Virtually the entire increase in the adopted Parks and Recreation Department budget is attributable to the newly allocated costs such as facilities maintenance, insurance and custodial. The impact of the new methodology is significant for Parks and Recreation because of all the facilities that fall within the department's purview. For example, the impact on the three community centers alone from the newly allocated costs is nearly $400,000.

General Fund

Once again, it is important to keep in mind that from a General Fund perspective these are not new costs. They are simply being allocated to the appropriate programs for the first time. In fact, Parks and Recreation is an excellent example of the reason for the change in methodology. Using the community centers as an example, it is now clear that the true cost of operating those centers has been significantly understated for many years because the costs of insurance, maintenance and custodial have never been allocated to the centers' budgets.

Police Department – The adopted Police Department budget is $24.6 million. It is by far the largest departmental budget in the General Fund, representing just over 30% of the General Fund operating budget. The adopted budget proposes the elimination of seven positions as well as the expiration of an additional 2.5 positions that were authorized as limited term, grant funded positions. As with Parks and Recreation, the Police Department's adopted budget is significantly impacted by the newly allocated costs as well as the increased retirement costs.

Public Works – The adopted Public Works operating budget is almost 50% lower than the prior year actual level. The decrease is due entirely to the previously described structural changes. All Streets programs are being transferred out of the General Fund to a dedicated Special Revenue Fund and the Custodial and Communications Systems programs are being transferred to an Internal Service Fund. The only Public Works programs remaining in the General Fund are Administration, Engineering Services, Land Development and Environmental.

SUMMARY

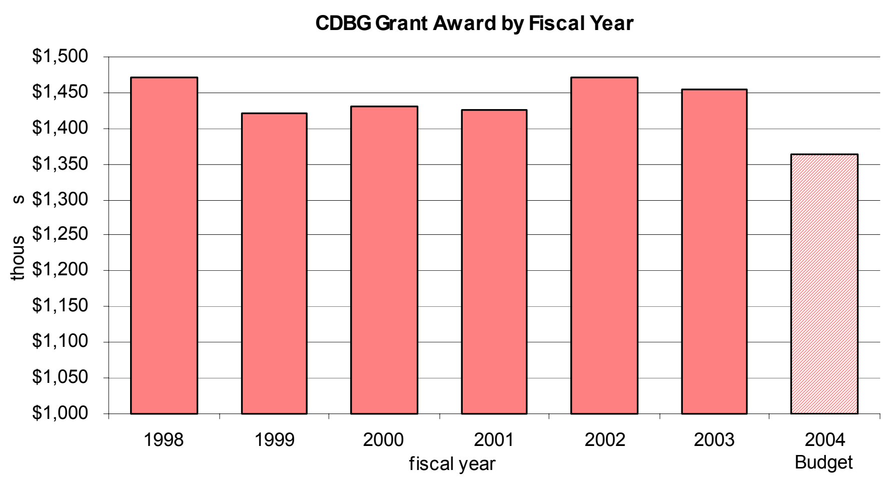
Overall, the City's General Fund remains in a strong financial position. With the support of the City Council and through prudent planning, the General Fund has accumulated considerable reserves. As planned, these reserves are now available to assist the General Fund as it transitions to a smaller and more efficient operation through attrition. Through long-range planning, a financial plan has been established to guide the City back to a balanced budget while maintaining the integrity of the reserves upon which the City relies. The adopted fiscal year 2004 operating budget is another step in a process that was begun during fiscal year 2002. The number of General Fund positions is being reduced while significant cost increases beyond the City's control are being absorbed, and the City's cost accounting is being improved. While the reductions and adjustments begun in fiscal year 2002, and continued in the adopted fiscal year 2003 budget, and into the adopted fiscal year 2004 budget are a start, it is clear that additional adjustments will be necessary over the next two or three fiscal years. However, the process that has begun will result in a smaller, leaner and more responsive organization. City staff looks forward to the challenge.

Special Revenue Funds

COMMUNITY DEVELOPMENT BLOCK GRANT FUND

	Fiscal Year			
	2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenue				
CDBG revenue	$ 1,115,026	$ 3,058,649	$ 1,236,186	$ 1,364,000
Program income	833,878	471,431	662,620	450,000
Total revenue	1,948,904	3,530,080	1,898,807	1,814,000
Operating expenditures	1,948,904	3,530,080	1,898,807	1,814,000
Net addition to (use of) reserves	$ -	$ -	$ -	$ -

The City's Community Development Block Grant (CDBG) Fund is used to account for the annual federal block grant received by the City from the U.S. Department of Housing and Urban Development. This annual grant supports programs including the City's Rental Housing Mediation Task Force, human service grants and a low and moderate income housing rehabilitation loan program.



Over the last several years, the City has been concerned that federal budget actions would adversely impact the City's annual CDBG award. Despite this concern, the chart to the right indicates that over the last several years, the City's grant award has been fairly stable at just over $1.4 million. However, for fiscal year 2004, the City is projecting a slightly lower amount of $1.36 million. Although the City's grant award has declined slightly since the peak in fiscal year 2002, the City is still enjoying substantially greater CDBG funding than in the early 1990s when grant amounts were approximately $800,000. Despite the apparent stability, the City remains concerned that federal budget actions may adversely affect the programs supported by the grant award.

Besides the annual federal grant award, the other major source of revenue in this fund comes

Special Revenue Funds

from repayments of the housing loans issued under the housing rehabilitation program.

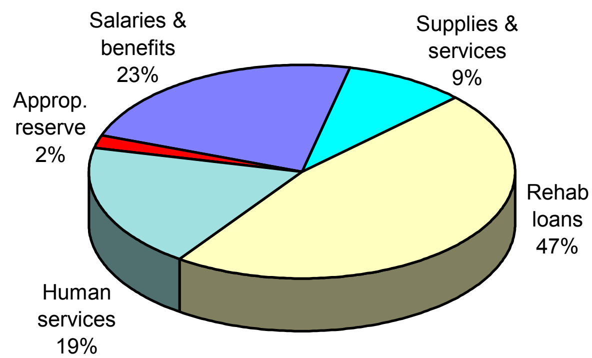
As of June 30, 2003, the City had almost $7.5 million in outstanding CDBG funded housing rehabilitation loans. The City maintains a "revolving" loan fund so that as loan repayments are received the funds are re-appropriated and loaned again. Fiscal year 1997 was the first time that loan repayments (also known as "program income") have been included in the adopted budget. Previously, loan repayments had been brought to the Council as a supplemental budget action later in the fiscal year after much of the year's repayments had been received. However, since the routine repayments are quite predictable, they are now included in the adopted budget. As indicated in the table at the top of the previous page, loan repayments for fiscal year 2004 are projected to be $450,000. In some years, loan repayments significantly exceed expectations. For example, in fiscal year 2003 loan repayments totaled over $662,000 while in fiscal year 2002 the amount was approximately $471,000, just slightly more than budgeted. The additional amounts represent unscheduled pre-payments of loan balances due to property sales or re-financings. Due to the indeterminate nature of these prepayments, no attempt is made to include them in the budget. In the event significant pre-payments are received during the year, a supplemental appropriation will be requested.

The chart below displays the CDBG budget by category of expense. Human service grants and housing rehabilitation loans represent 66% of the budget.

The CDBG human services grants are allocated, along with the General Fund human services funding, based upon recommendations submitted to the City Council by the City's Community Development and Human Services Committee. The Committee's recommendations for fiscal year 2004, funded from the City's fiscal year 2003 appropriations, were recently submitted to Council.

All requests for housing rehabilitation loans are evaluated by program staff and are submitted to the City's Loan Committee for approval. The Loan Committee is comprised of the Assistant City Administrator, the Community Development Director and the Finance Director. The Loan Committee can approve loans up to $60,000. Loans of more than $60,000 require approval of City Council.

CDBG Budgeted Expenditures



Total FY04 budget - $1,814,000

Special Revenue Funds

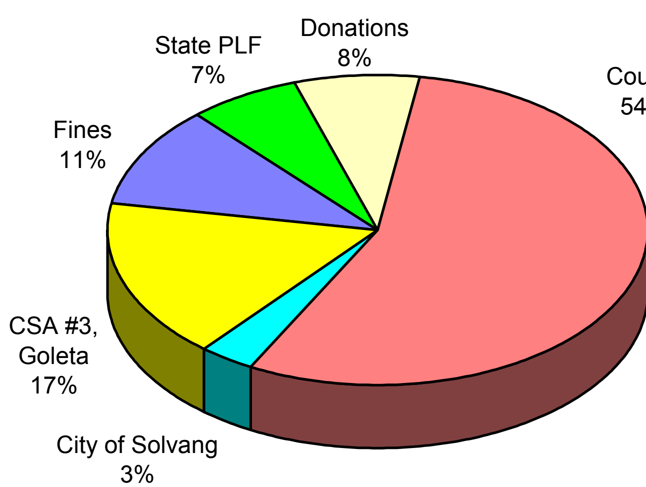
COUNTY LIBRARY FUND

	Fiscal Year			
	2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenue	$ 1,611,368	$ 1,374,911	1,334,045	$ 1,228,193
Operating expenditures	1,244,511	1,449,631	1,401,019	1,657,428
Net addition to (use of) reserves	366,857	(74,720)	(66,974)	(429,235)

The County Library Fund accounts for the costs of providing a full range of library services to the residents of Solvang, Santa Ynez, Los Olivos, Carpinteria, Montecito and Goleta, under contract with the County of Santa Barbara. The chart below indicates that revenue to support these services comes from a variety of sources including the County, State Public Library Fund (PLF) Grant, the City of Solvang, fines and donations. Although additional contributions from various "Friends of the Library" community groups are received occasionally, they are not budgeted because of the generally unpredictable nature of the donations. No City of Santa Barbara funds are included in the County Library Fund budget.

Under the terms of the agreement between the City and the County, the City is compensated for managing these County library services. The City receives an administration fee amounting to 9% of the annual County appropriation for County (non-City) resident library services.

County Library Fund Revenues



FY04 Budgeted Revenues - $1,228,193

The adopted budget is based upon staff's best estimates of next year's funding levels from both the County and the State. Changes in the level of either of these revenue sources will require corresponding program and expenditure adjustments. Given the grim budget outlook for both the State and counties, it is likely that the budget for these programs may have to be revised later in the fiscal year. Since neither

Special Revenue Funds

the State nor the County generally adopt a budget prior to the July 1 start of the fiscal year, such adjustments are usually brought before the Council in the autumn.

The budget includes $155,000 for the acquisition of collection materials. The use of accumulated reserves, reflected in the table on the preceding page, is to support the acquisition of these collection materials as well as various programs and activities.

Special Revenue Funds

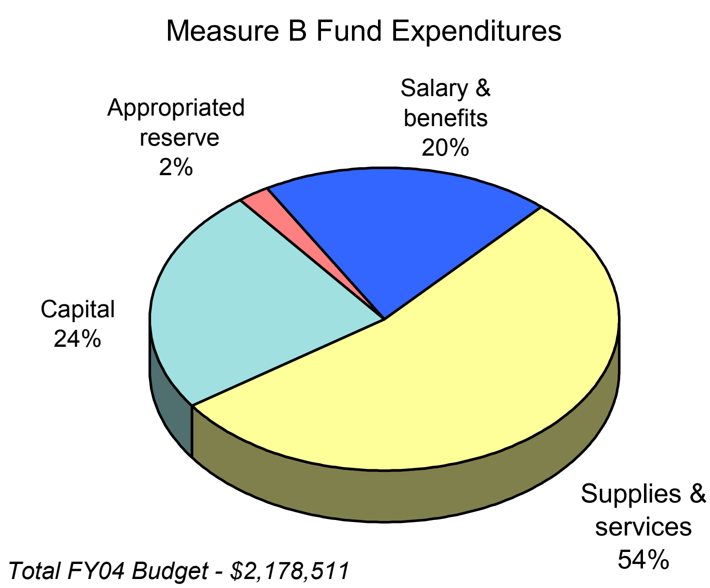
CREEKS RESTORATION & WATER QUALITY IMPROVEMENT (MEASURE B) FUND

		Fiscal Year						
		2001 Actual		2002 Actual		2003 Actual		2004 Adopted
Revenue	$	-	$	2,096,749	$	2,137,039	$	2,104,780
Operating expenses		-		1,038,550		905,031		1,653,511
Operating surplus		-		1,058,199		1,232,008		451,269
Capital budget		-		458,615		596,849		525,000
Net addition to (use of) reserve:	$	-	$	599,584	$	635,159	$	(73,731)

In November 2000, the City's voters overwhelmingly approved Measure B, a two-percent increase in the City's transient occupancy tax effective January 1, 2001. Under the terms of the measure, all proceeds from the tax increase are restricted for use in the City's Creeks Restoration and Water Quality Improvement Program. In order to meet the intent of the measure, the City opened a Special Revenue Fund to account solely for all revenues and expenditures associated with this program.

The Creeks Restoration and Water Quality Improvement Program is managed by the City's Parks and Recreation Department. Under the direction of the Parks and Recreation Director, the Creeks Restoration and Water Quality Improvement Manager manages the program.

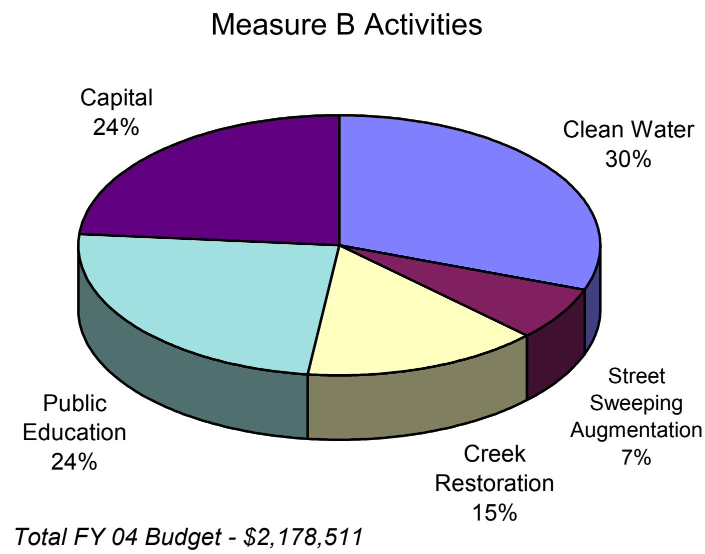
The adopted budget for fiscal year 2004 is approximately $2.2 million, including the use of approximately $74,000 of accumulated reserves for capital. $50,000 of the budgeted revenue is projected to come from investment income. The balance, just over $2 million, is projected to come from the two-percent transient occupancy tax (TOT). The $2 million TOT estimate for fiscal year 2004 is consistent with the assumptions used to budget the General Fund's TOT.



Special Revenue Funds

The chart on the preceding page displays the expenditure budget by object of expenditure. As the chart indicates, 24% of the budget is dedicated to capital ($525,000). Projects include the development of the Arroyo Burro and Mission Creek Watershed Plans ($150,000 each) and the Laguna Channel Urban Runoff Treatment Project ($100,000).

With salary and benefit costs representing only 20% of the budget, the Measure B Fund more closely resembles one of the City's Enterprise Funds rather than the General Fund. Three Public Works positions (1.75 full-time equivalents) that are included in the Measure B budget in fiscal year 2003 have been removed in the adopted fiscal year 2004 budget. Some funding has been included in the supplies and services category (non-contractual services) for services provided to the Measure B Fund by these positions, but costs will only be charged based upon actual hours provided.



The chart on the right displays the adopted budget by activity. Public Education activities comprise approximately $525,000 (24%) of the budget and include a full-time Public Education Coordinator position as well as $100,000 for production and airing of bilingual radio and television educational campaigns. The adopted budget also includes approximately $650,000 for Clean Water activities including water testing ($40,000) and source tracking studies ($40,000). Street Sweeping Augmentation ($150,000) supports expanded residential street sweeping.

In summary, the adopted fiscal year 2004 budget includes a reduction in the number of positions allocated to the Measure B Fund as well as a capital program in excess of $500,000.

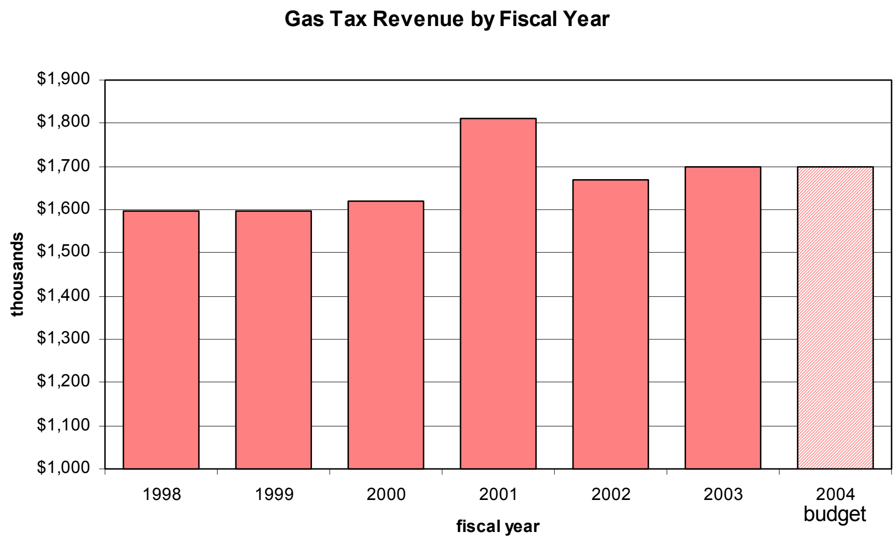
Special Revenue Funds

GAS TAX

	Fiscal Year 2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenue	$ 1,810,879	$ 1,667,888	$ 1,698,393	$ 1,700,000
Operating expenditures	1,810,879	1,667,888	1,698,393	1,700,000
Net addition to (use of) reserves	$ -	$ -	$ -	$ -

The Gas Tax revenue received by the City is a portion of the state's 18 cents per gallon tax on fuel used to propel a motor vehicle or aircraft. Article XIX of the California Constitution restricts the use of gas tax revenue to research, planning, construction, improvement, maintenance and operation of public streets and highways or public mass transit. The funds are distributed by the state on a per capita basis.

Paid to the City by the State, gas tax revenue is initially accounted for in the City's Gas Tax Special Revenue Fund. After receipt, all gas tax revenues are transferred to the City's Streets Fund for use in the City's street operations and maintenance activities. Each year, the City is audited by the State Controller's Office to ensure that the funds are used in accordance with state law.



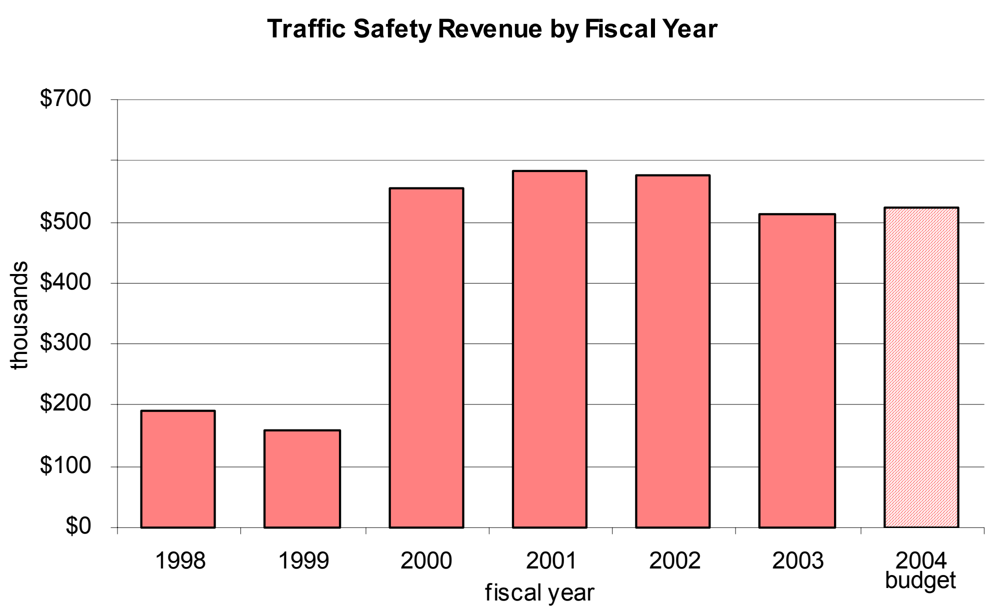
The City anticipates receiving approximately $1.7 million in gas tax revenue in fiscal year 2004, which is approximately the same as the amount received in fiscal year 2003.

Special Revenue Funds

TRAFFIC SAFETY FUND

		Fiscal Year						
		2001 Actual		2002 Actual		2003 Actual		2004 Adopted
Revenue	$	584,468	$	574,953	$	511,685	$	525,000
Operating expenditures		584,468		574,953		511,685		525,000
Net addition to (use of) reserves	$	-	$	-	$	-	$	-

Pursuant to state law, the City must deposit all fines and forfeitures received as a result of citations issued by City police officers for Vehicle Code violations into a special "Traffic Safety Fund." These funds may be used solely for traffic control devices, maintenance of equipment and supplies for traffic law enforcement, traffic accident prevention, the maintenance, improvement or construction of public streets, bridges or culverts and the compensation of school crossing guards who are not regular, full-time employees of the City's Police Department. The County pays these funds to the City. After being recorded in the City's Traffic Safety Fund as required by law, virtually the entire amount received is transferred to the General Fund and is expended by the Police Department for traffic law enforcement and school crossing guards.



As the chart to the right indicates, there was a substantial increase in the City's Traffic Safety revenue in fiscal year 2000. Effective with fiscal year 1999, State legislation changed the Vehicle Code to allocate to cities fees paid for "court supervised programs" (i.e., traffic schools) in lieu of base fines. The City began receiving this additional revenue in fiscal year 2000. Since this change in

Special Revenue Funds

State law, the amounts received by the City have been fairly stable at around $575,000. Based upon the actual amounts received in fiscal year 2003, the estimated revenue for fiscal year 2004 has been reduced to $525,000.

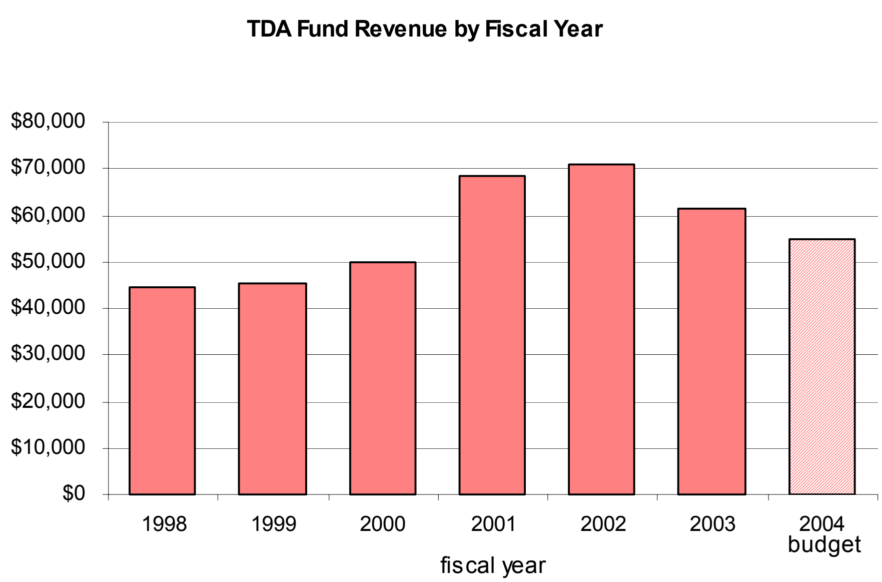
Special Revenue Funds

TRANSPORTATION DEVELOPMENT FUND

	Fiscal Year			
	2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenue	$ 68,520	$ 70,981	$ 61,295	$ 55,000
Capital expenditures	21,525	2,065	158,862	55,000
Net addition to (use of) reserves	$ 46,995	$ 68,916	$ (97,567)	$ -

Transportation Development Act (TDA) funds are restricted for use in support of alternative transportation including sidewalks and bikeways. Each year, the City receives approximately $50,000 of TDA funds from the County. This revenue along with approximately $5,000 of annual interest income earned on accumulated balances is appropriated each year to the Street Capital Program. Because of the relatively small amount of TDA revenue received annually, the proceeds are often accumulated over multiple years in order to fund specific projects. For example, in year 2003, TDA fund expenditures included the use of over $97,000 of accumulated prior year balances for the Sidewalk In-Fill Program. Total expenditures of approximately $159,000 represented almost two years of accumulated TDA revenues. This accumulation of prior year amounts also generates additional revenue in the form of interest income.

As the chart on the right indicates, the City's annual TDA revenue has increased somewhat since 1998. Based upon this increase, the budget for TDA revenue was increased in fiscal year 1999 from $25,000 to $50,000 annually, with the balance of revenue budgeted each year attributable to interest income.



A summary list of the Streets Capital Program, which is funded in small part by TDA revenue, can be found in thesummary section earlier in this document. A detailed listing of the Streets Capital Program can be found later in this document. For fiscal year 2004, the TDA revenue will be used to continue the Sidewalk In-Fill Program.

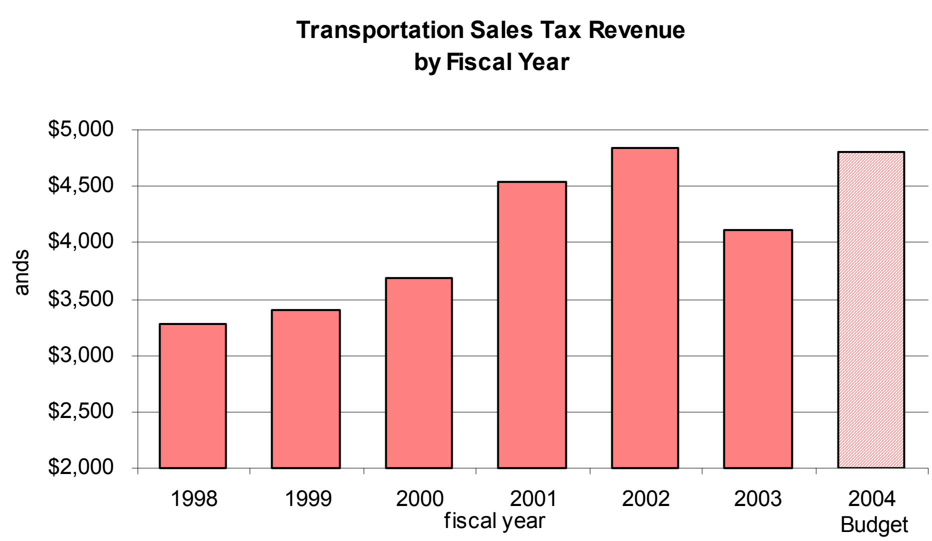
Special Revenue Funds

TRANSPORTATION SALES TAX (MEASURE D) FUND

	Fiscal Year			
	2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenues				
Transportation sales tax	$ 4,535,262	$ 4,840,405	$ 4,120,382	$ 4,800,000
Interest income	378,535	309,305	212,517	225,000
Total revenue	4,913,797	5,149,710	4,332,899	5,025,000
Operating expenditures	1,755,972	2,040,794	2,218,913	2,892,630
Operating surplus	3,157,825	3,108,916	2,113,985	2,132,370
Capital budget	2,036,275	2,464,434	2,373,144	2,609,020
Net addition to (use of) reserves	$ 1,121,550	$ 644,482	$ (259,159)	$ (476,650)

This fund is also known as the "Measure D" Fund, after the designation of the ballot proposition approved by Santa Barbara County voters in November 1989. The ballot measure enacted a twenty-year, one-half cent sales tax, proceeds of which are restricted for use in the City's streets and transportation programs. The revenue generated by this tax is subject to an annual "maintenance of effort" requirement. This ensures that the proceeds of the sales tax will be used to supplement - not supplant - the City's existing streets programs. For any year in which the City fails to maintain its discretionary General Fund street program (operating and capital) at or above the base year (fiscal 1987) level of $2.7 million, the City is not entitled to the Measure D revenues. The City is audited each year to verify that the maintenance of effort has been met.

As indicated in the chart to the right, the City's Measure D sales tax revenue grew steadily through fiscal year 2002, but came in lower in fiscal year 2003 because of lower sales tax receipts and allocations.



As in the past, the revenue estimate, and therefore the budget, is based upon an estimate provided by the Santa Barbara County Association of Governments (SBCAG).

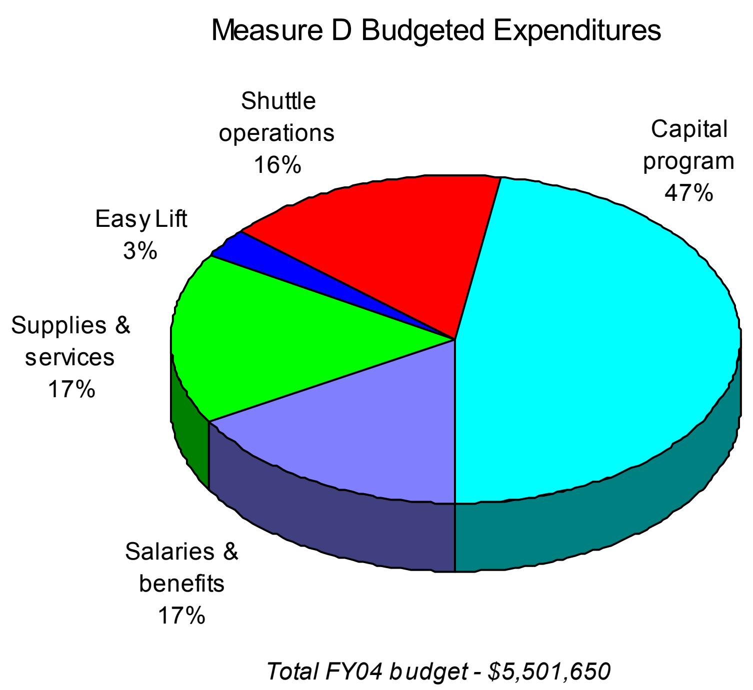
Special Revenue Funds

SBCAG is the agency that oversees the Measure D program on a countywide basis. Traditionally, the revenue estimate provided by SBCAG has been conservative. This has resulted in actual revenue exceeding budget, often leaving a fiscal year-end budget surplus. The actual amount received in fiscal year 2002 exceeded the amount budgeted in fiscal year 2003, and in light of this, the estimated revenue for fiscal year 2004 was been increased substantially ($450,000) over the fiscal year 2003 adopted budget. In spite of this increase in estimated revenue, the adopted fiscal year 2004 budget proposes the use of $476,650 of accumulated reserves to support an expanded capital program. The adopted fiscal year 2004 capital program, totaling $2.6 million, is over $235,000 greater than the fiscal year 2003 capital program.

The Measure D Fund budget is developed based upon an annual and five year program of projects that is prepared by the City and submitted to SBCAG for approval. The adopted fiscal year 2004 budget is consistent with those plans.

As mentioned above, just over $2.6 million or 47% of the adopted fiscal year 2004 Measure D Fund budget is dedicated to the Street Capital Program. $885,000 (16%) of the budget supports the Downtown and Cross-town Shuttle programs and $160,000 (3%) represents a transit grant to Easy Lift. The balance of the budget, approximately $1.8 million (34%) supports street maintenance activities.

The adopted budget for fiscal year 2004, totaling just over $5.5 million, reflects a substantial increase over historical levels. In fact, the total adopted budget is almost $1 million more than the fiscal year 2003 operating and capital expenditures.



The significant amount of funds provided by Measure D has been, and continues to be, a critical component of the City's street operations and capital programs.

Enterprise Funds

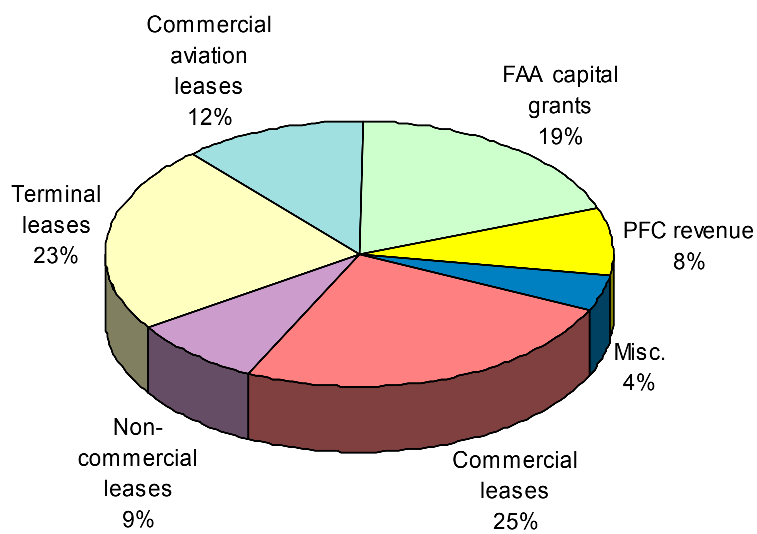
AIRPORT FUND

	Fiscal Year 2001 Actual	Fiscal Year 2002 Actual	Fiscal Year 2003 Actual	Fiscal Year 2004 Adopted
Operating budget				
Revenue	$ 9,849,544	$ 9,459,701	$ 10,712,160	$ 9,916,777
Expenses	6,644,214	7,607,396	8,627,798	9,331,777
Operating surplus	$ 3,205,330	$ 1,852,305	$ 2,084,362	$ 585,000
Capital budget				
FAA & capital grants	$ 1,011,710	$ 7,177,352	$ 1,596,184	$ 2,621,164
PFC revenue	1,101,098	1,031,594	1,013,573	1,100,000
Capital expenses	3,477,990	13,141,611	2,715,371	3,206,164
Net addition to (use of) reserves	$ 1,840,148	$ (3,080,360)	$ 1,978,748	$ 1,100,000

The adopted fiscal year 2004 Airport Fund budget reflects an operating surplus of $585,000 and a capital program of just over $3.2 million. The $1.1 million net addition to reserves is attributable entirely to the Passenger Facility Charge (PFC) capital revenue, none of which is being appropriated in the adopted budget. This is discussed in further detail below.

The chart to the right displays total fiscal 2004 operating and capital revenues as contained in the adopted budget. As the chart indicates, virtually all of the Airport's operating revenue is derived from leases. Overall, fiscal year 2004 operating revenue is projected to be approximately $1.2 million (14%) higher than the revenue contained in the adopted fiscal 2003 budget. Two thirds of the increase in operating revenue is projected to come from airport operations. Commercial aviation leases are projected to grow approximately $436,000 (38%) and leases of terminal facilities are projected to grow approximately $332,000 (12%). Given the

Airport Fund Revenues



Total FY04 Revenue - $13,637,941

Enterprise Funds

operating revenues realized in fiscal year 2003, staff feels that the revenues estimates for fiscal year 2004 are conservative and that actual revenue in fiscal year 2004 will likely exceed budget.

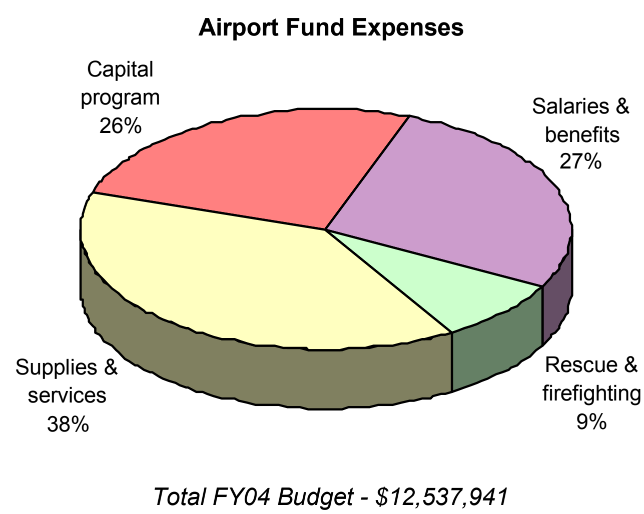
After two fiscal years of substantial capital appropriations and expenses, the adopted fiscal year 2004 capital budget, at $3.2 million, returns to more historical levels. In fiscal year 2002 and to a lesser extent 2003, the capital budget contained large projects from the Airport Facilities Master Plan. The implementation of this plan continues to be a top priority for the City. The largest project is the design and permitting of the terminal expansion project ($7.7 million).

Funding for the Airport's capital program comes from three sources. The largest source is from Federal Aviation Administration (FAA) capital grants. FAA capital grants continue to fund the largest portion of the Airport's capital program, including a significant portion of the work associated with the Airport Facilities Master Plan. As the table on the preceding page indicates, the Airport's FAA grants are estimated at $2.6 million for fiscal year 2004. In most cases, FAA grants fund 90% of approved project costs, with the Airport required to provide a 10% match.

The Airport's second source for capital funding is the Passenger Facility Charge (PFC). With the approval of the FAA, on January 1, 1998, the Airport began to levy and collect a PFC. The PFC is a fee of $3 per airline passenger ticket with the proceeds restricted by federal law to approved capital improvements. It is estimated that the PFC will generate approximately $1.1 million in fiscal year 2004. None of the estimated $1.1 million of PFC revenue will be appropriated in the adopted fiscal year 2004 budget. Rather, the funds are being accumulated for specified, FAA-approved future projects. This is the reason for the $1.1 million surplus in the adopted fiscal year 2004 budget reflected in the table at the top of the previous page.

The third source for capital funding comes from Airport Fund operating revenue in excess of operating expenses. For fiscal year 2004, operating revenue is projected to contribute $585,000 to the capital program.

The chart to the right displays expenses in the adopted fiscal year 2004 Airport Fund budget by category. The capital program, as discussed above, represents 26% of the total budget. The largest projects in the adopted fiscal year 2004 capital budget include the North Taxiway B Relocation ($1.2 million) and the construction of 20 T-hangers ($1.4 million) both funded from FAA grants. Additional details on the Airport's complete capital program may be found later in this document.



Enterprise Funds

At 38%, supplies and services represent a significant portion of the budget. The cost of Airport Rescue and Firefighting (ARFF) services represents a full 9% of the budget. ARFF services are provided to the Airport by the City's Fire Department with the Airport Fund reimbursing the City's General Fund for personnel costs. For fiscal year 2004, the Airport Fund budget contains almost $1.1 million for this required service. Over the last two years, the Airport Fund's operating costs have increased substantially. The largest portion of these cost increases is related to increased security requirements in the wake of the September 11, 2001 terrorist attacks. Five full-time security positions were added in February 2002 at a cost of almost $275,000. In addition, the adopted budget contains more than $250,000 for additional contract security services now required under federal regulations. Although there is a possibility that the federal government will reimburse the Airport Fund for some or all of these costs, so far virtually the entire cost has been borne by the Airport Fund.

Enterprise Funds

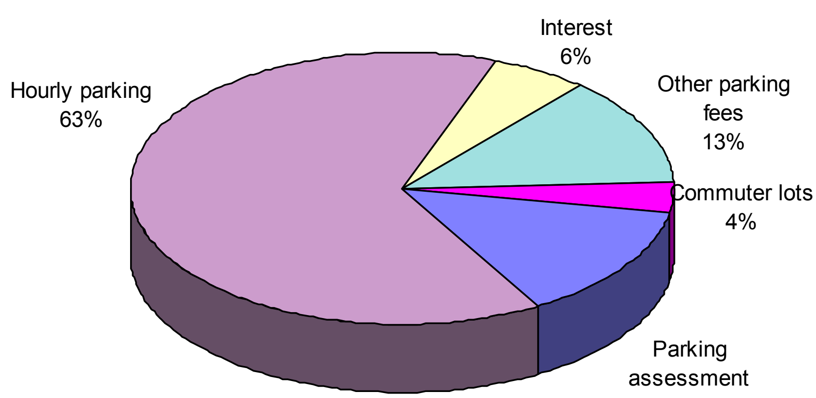
DOWNTOWN PARKING FUND

	Fiscal Year			
	2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenue	$ 5,057,342	$ 4,977,364	$ 4,685,611	$ 4,850,000
Operating expenses	3,993,106	3,808,471	4,190,609	4,294,747
Operating surplus	1,064,236	1,168,893	495,001	555,253
Capital budget	643,418	137,326	430,520	530,000
Net addition to (use of) reserves	$ 420,818	$ 1,031,567	$ 64,482	$ 25,253

The fiscal year 2004 Parking Fund budget contains operating revenue sufficient to cover all operating costs and the capital program. As the chart below indicates, the various parking user fees provide the bulk of the Parking Fund revenue. Combined, these fees represent 80% of total revenue. The parking assessment (PBIA) that supports a portion of the seventy-five minute free parking period in the City's downtown lots is budgeted to provide $675,000 (14%) of total revenues. The only other Parking Fund revenue is interest income, budgeted at $275,000 (6%). The revenue estimates for hourly parking contained in the adopted budget were increased over the recommended budget estimates to reflect regular parking capacity due to delays in the construction of the Granada Garage. Construction has been delayed until next year due to lot redesign.

The Granada Garage project is the most significant issue facing the Parking Fund at this time, even with the construction delay until fiscal year 2005. As one of the largest and most expensive capital projects ever undertaken by the City, the Granada Garage project will continue to be the top priority of the Parking Fund and the Public Works Department. Once construction does begin, parking Fund staff will be respons-

Parking Fund Revenues

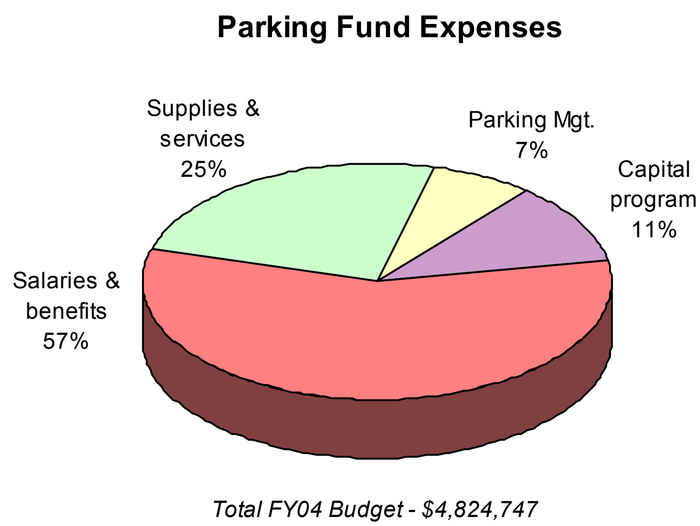


Total FY04 Revenues - $4,850,000

Enterprise Funds

ible for implementing plans to mitigate the associated impacts on both the parking inventory and the neighboring businesses.

As the chart to the right indicates, the largest segment of the Parking Fund's expense budget is salaries and benefits (57%). Almost half ($1.3 million) of the $2.7 million in salaries and benefits is temporary wages for staffing the City's various lots.



Several years ago, a new program was added to the Parking Fund. The Parking Management Program is intended to reduce the demand for commuter parking in the downtown area by encouraging the use of alternative transportation. The program funds educational efforts and incentives to encourage commuters to choose alternative means of transportation as well as support for downtown transit services. These programs, combined with the reduction in the free parking period from 90 minutes to 75 minutes, provide incentives to downtown workers to make use of alternative transportation. The adopted budget provides for over $350,000 for alternative transportation programs and incentives, including $175,000 for the "My-Ride" free bus pass program.

The adopted $530,000 capital program includes construction of a 492 square foot storage building at the Railroad Depot lot ($300,000) as well as capital maintenance on the City's downtown lots ($55,000). One of the issues facing the Parking Fund over the next several years will be increasing capital maintenance needs on the downtown parking facilities, especially the garages, as they begin to age. Staff expects that the annual capital program may need to double over the next several years in order to maintain the City's investments in these expensive capital assets.

Enterprise Funds

GOLF FUND

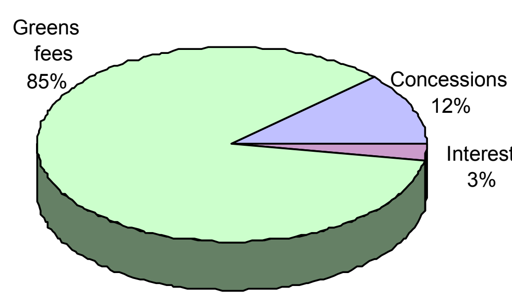
	Fiscal Year 2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenue	$ 1,929,274	$ 1,970,319	$ 2,001,412	$ 2,064,500
Operating expenses	1,664,530	1,727,025	1,927,018	1,764,500
Operating surplus	264,744	243,294	74,394	300,000
Capital budget	-	120,346	365,066	300,000
Net addition to (use of) reserves	$ 264,744	$ 122,948	$ (290,672)	$ -

The Golf Fund's adopted fiscal year 2004 budget provides for operating revenue sufficient to support all operating costs as well as a $300,000 capital program. Operating revenue in the adopted budget reflects a modest 3% growth over the fiscal year 2003 actual year-end revenue. The revenue estimate reflects the impact of modest increases to most of the Golf Fund's fees. Most of the green fees will increase by only $1.

Greens fees of various types comprise 85% ($1.76 million) of the revenue budget. The Golf Fund's fee structure offers discounts to residents of Santa Barbara County. Residents may purchase a resident card for a nominal $15 annual fee. The card entitles the holder to discounts of from $7 per round (weekday play) to $13 per round (weekend play). Additional discount programs are available for both weekday-only and full-week play.

With the exception of a small amount of investment income, the balance of the Golf Fund revenue is from concession agreements with the golf professional and the clubhouse restaurant. Revenue from these agreements is budgeted at $250,000. Golf Fund staff perform all course maintenance but the golf professional provides management of course operations, golf lessons and operation of the pro shop, under the concession agreement with the City.

Golf Fund Revenues



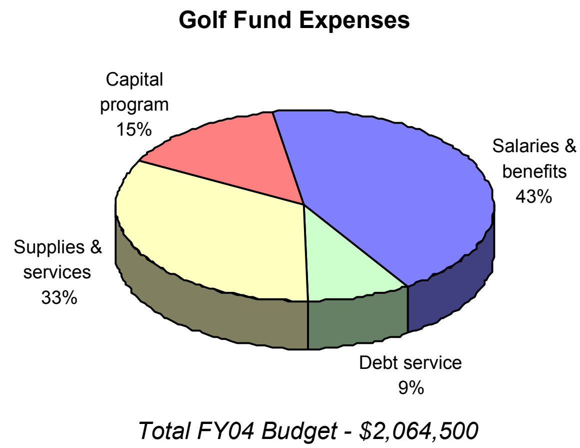
Total FY04 Revenues - $2,064,500

Expenses in the adopted fiscal year 2004 budget, including capital, total approximately $2.1 million. The chart on the following page summarizes the distribution of expenses. Salaries and benefits comprise 43% of the budget. Other than personnel costs, water is the Fund's single largest cost ($159,000). In terms of acre-feet consumed, the golf course is one of the largest water customers in the City's municipal water system. The adopted $300,000 capital program includes the

Enterprise Funds

purchase of replacement power turf equipment ($50,000), construction of a covered storage area for sand and gravel ($50,000) and various improvements to tees, greens and cart paths ($200,000).

The fund's debt service, at just over $182,000, is principal and interest on the Golf Fund's share of the 2002 Municipal Refunding Certificates of Participation (COP). The 2002 certificates were issued to refund certificates originally sold in 1986 and previously refunded in 1993. The original proceeds were used to expand and renovate the clubhouse. The 2002 refunding lowered the Fund's annual debt service by approximately $15,000. The principal balance currently outstanding is approximately $2.1 million. Final maturity of the certificates is in 2018.



Overall, the Golf Fund is in excellent financial condition. Operating revenues more than meet operating expenses, and the fund maintains reserve balances in accordance with the City's policy requirements.

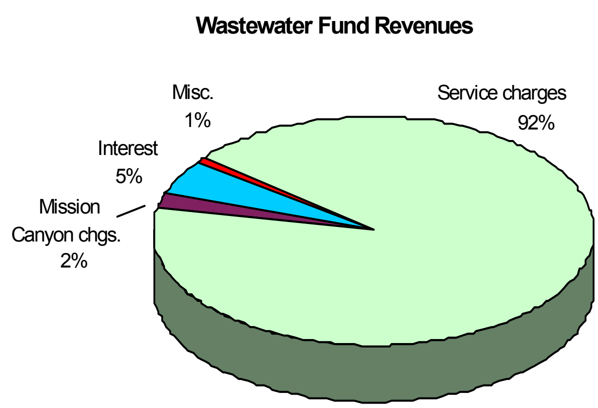
Enterprise Funds

WASTEWATER FUND

	Fiscal Year			
	2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenue	$ 10,347,982	$ 9,704,473	9,994,460	$ 10,575,000
Operating expenses	7,132,069	7,638,702	7,564,434	9,068,006
Operating surplus	3,215,913	2,065,771	2,430,026	1,506,994
Capital budget	2,431,847	4,172,476	2,858,131	3,954,000
Net addition to (use of) reserves	$ 784,066	$ (2,106,705)	$ (428,105)	$ (2,447,006)

The adopted fiscal year 2004 Wastewater Fund budget contains revenue sufficient to fund all operating costs and $1.5 million of a nearly $4 million capital program. Estimated revenue of almost $10.6 million includes the adoption of a 4% rate increase, effective July 1, 2003. The rate increase is the second consecutive annual increase after almost a decade of no rate increases. Despite the financial pressures of increasing capital needs, the Wastewater Fund continues to maintain a solid financial position. However, as discussed below, the increasing capital needs dictate the rate adjustment and will likely require additional rate increases over the next several years.

Wastewater Fund revenue is much more stable than revenue in the Water Fund. Wastewater revenues are comprised almost entirely of the regular, monthly service charges. Because these are based upon the customer's water usage in the lower rate blocks, they are more stable and less susceptible to variations than metered water sales. Service charges are projected to provide $9.6 million (92%) of the $10.6 million revenue total. Investment income, the second largest source of revenue for the fund, is budgeted at $525,000. This is a reduction of $275,000 from the fiscal year 2003 budget due to the continuing low interest rate environment as well as the continued use of reserves to fund a portion of the capital program. The only other revenue of note is the $200,000 representing charges to Mission Canyon (non-city) residents.



Total FY04 Revenues - $10,575,000

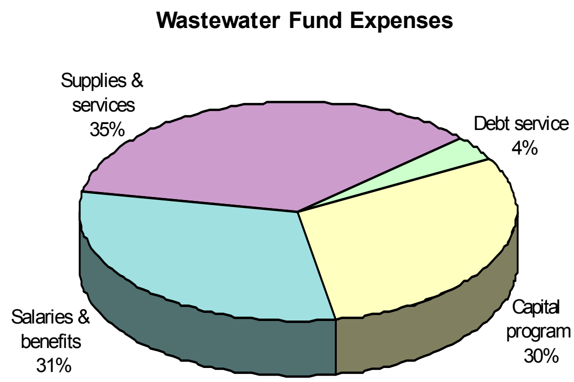
Wastewater Fund operating expenses are

Enterprise Funds

budgeted at just over $9 million and the adopted capital program is just below $4 million. As the chart below indicates, capital represents 30% of the entire budget.

Debt service, at $459,000, represents 4% of the budget. The Wastewater Fund has only one outstanding debt issue. The 1994 Wastewater Revenue Refunding Bonds were issued to refinance revenue bonds originally issued in 1974. The final payment of these bonds is due on July 1, 2003, which is the first day of the new fiscal year.

In fiscal year 2003, the year-end actual revenues were lower than originally budgeted. Sewer service charges alone, which represent the largest component of the fund's revenues, were down 7% due to lower flow levels. Since many of the fund's costs are variable in nature, expenditures were under budget by a corresponding amount due to the lower treatment levels. Staff anticipates that flow levels will return to normal levels during fiscal year 2004 and the budgeted revenues and expenditures reflect this. The $9 million adopted budget is essentially status quo over the fiscal year 2003 adopted budget.



Total FY04 Expenses $13,022,006

The most noteworthy aspect of the budget is the capital program. At almost $4 million, it represents an increase of approximately 51% over the fiscal year 2003 adopted capital program. As mentioned above, $1.5 million of the capital program will be funded from current revenue with the balance ($2.4 million) funded from either reserves or from the issuance of some type of debt. The use of reserves (one-time funds) for capital (one-time costs) is consistent with established City financial policies. However, in this case, the use of reserves would almost certainly require the use of "policy reserves," as the Wastewater Fund's reserves in excess of policy requirements are limited. The capital program is considerably larger than historical levels. In addition to the usual Main Replacement program ($1.65 million) and other projects, the capital program includes just over $2 million for major renovation of, and improvements to, the El Estero Treatment Plant. A recent independent evaluation of the El Estero Treatment Facility, commissioned by the City, identified a ten-year capital improvement program in order to protect the City's massive investment in that facility and maintain compliance with the ever increasing and tightening federal and state treatment standards. A total of $22.2 million in recommended capital improvements was identified over the ten-year horizon of the study. Implementing the study's recommendations will require substantial increases to the Wastewater Fund's ongoing capital program. Financing the recommended long-term capital maintenance and improvements to the El Estero Facility will

Enterprise Funds

likely require both the continued use of reserves and the issuance of debt. Whether the debt is in the form of low-interest state loans or bonds, additional rate increases over the next several years will likely be required to support the increased capital program. Although recommended rate increases will be kept to the minimum level necessary, maintenance of the El Estero Treatment Facility is absolutely essential.

In summary, the Wastewater Fund operating budget is balanced and a substantial capital program is planned. In conjunction with fund balance reserves that will continue to exceed the policy levels established by Council in November 1995, this fund is still in a strong financial position.

Enterprise Funds

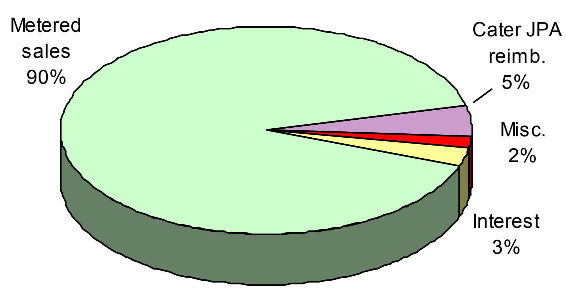
WATER FUND

	Fiscal Year 2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenue	$ 25,610,275	$ 25,115,398	$ 24,138,395	$ 24,641,937
Operating expenses	17,838,312	18,416,458	19,903,277	21,923,471
Operating surplus	7,771,963	6,698,940	4,235,118	2,718,466
Capital funding	-	1,752,295	5,110,456	-
Capital budget	4,877,939	7,476,988	16,536,093	6,412,497
Net addition to (use of) reserves	$ 2,894,024	$ 974,247	$ (7,190,519)	$ (3,694,031)

The adopted fiscal year 2004 Water Fund budget contains operating revenues sufficient to cover all operating expenses and contribute $2.7 million towards a $6.4 million capital program. The balance of the capital program ($3.7 million) will be funded from a combination of accumulated reserves in excess of the Council-established policy requirements ($2.2 million) and reprogramming of previously budgeted capital funds ($1.5 million).

The operating revenue contained in the adopted budget reflects the impact of a 4% rate increase for metered water sales, which became effective on July 1, 2003. As the chart to the right indicates, the vast majority of estimated Water Fund revenue is provided by metered water sales ($22.3 million or 90%). Interest income, budgeted at $700,000, is derived from the investment of the Water Fund's capital and operating reserves. The estimate for investment income is approximately $200,000 below fiscal year 2003 year-end interest earned, due to the continued low interest rate environment as well as lower Water Fund reserve balances.

Water Fund Operating Revenue



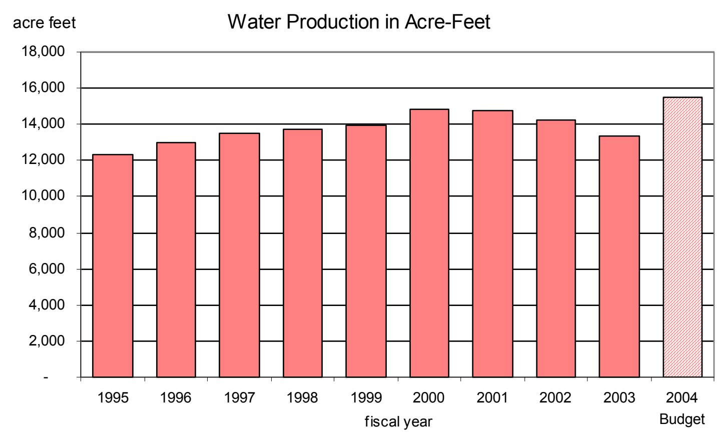
Total FY04 Operating Revenue - $24,641,937

The other notable Water Fund revenue is a reimbursement the City receives from the Carpinteria and Montecito water districts. Under a joint powers authority agreement (JPA), the City treats all water for both districts at the City's Cater water treatment facility. Under the terms of the JPA, the districts pay their pro-rata share of the operating and capital costs of the Cater treatment facility. The districts' approximate 40% share

Enterprise Funds

(combined) is based upon an allocation of the Cater treatment capacity and is projected to result in $1.2 million of revenue in fiscal year 2004.

With 85% of the Water Fund revenue generated by metered water sales, one of the most critical elements of Water Fund revenue projections is the water sales estimate in acre-feet. As the chart to the right indicates, water production has been growing gradually since 1994. Metered sales revenue for the adopted fiscal year 2004 budget is based upon an estimate of 15,500 acre-feet, or five hundred acre-feet more than the budget estimate for fiscal year 2003. Based upon recent experience, it is expected that the target will be met. However, even if actual production and sales fall somewhat below the budgeted target, the Water Fund expenditure budget can be controlled to ensure that a balance is maintained.

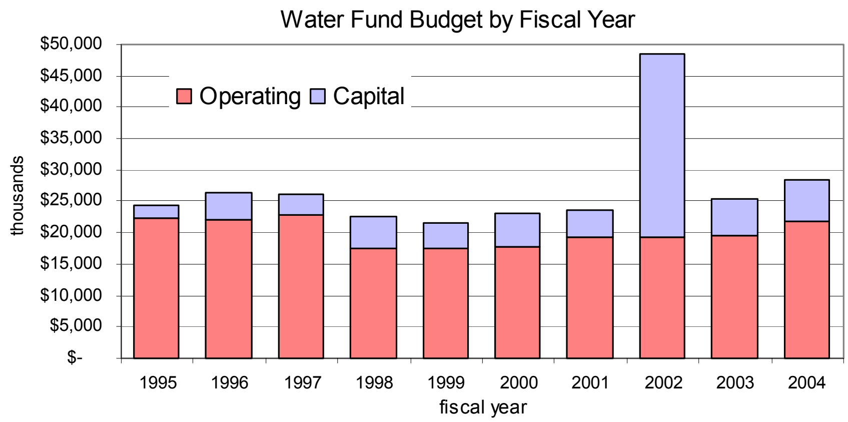


On the expenditure side, the Water Fund operating budget remains lower than it was in the mid-1990's. This is because of the completion of payments on the desalination plant in fiscal year 1997. Beginning in fiscal year 1998, the capital costs of the desalination plant were removed from the budget as were the payments received from Montecito and Goleta water districts for their participation in the project.

The adopted capital program totals $6.4 million. This is an increase of almost $650,000 (11%) over the current fiscal year. Included in the adopted program is the annual water main replacement program ($2.4 million), which will replace 16,000 feet of water mains throughout the distribution system. Also included is a $2 million groundwater supply program that will provide for rehabilitation of the Ortega Groundwater Treatment Plant, installation of a new well at Santa Barbara High School and rehabilitation of the City Hall well.

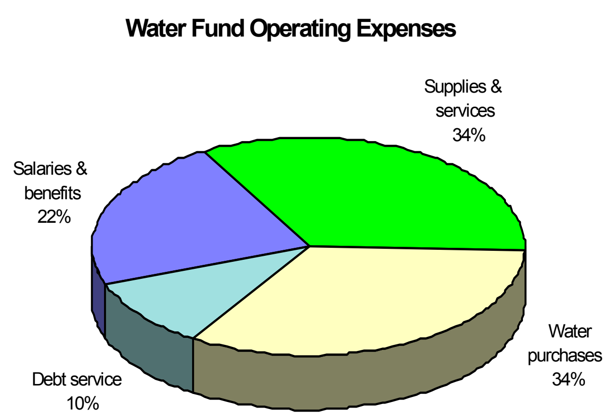
The chart on the following page presents a ten-year history of the adopted Water Fund operating and capital budgets. The most noteworthy element of the entire ten-year period is the size of the fiscal year 2002 capital budget. At $29.1 million, it exceeded the total of the previous seven years' capital budgets combined. This is still relevant because the two major projects contained in that capital budget will continue to have significant workload impacts during fiscal year 2004. The Sheffield Reservoir Project ($14.1 million) will replace the existing open reservoir with underground reservoir tanks. The Cater Strategic Plan Implementation Project ($19.5 million) will

Enterprise Funds



renovate a number of major components at the Cater Treatment Plant, protecting the City's investment in that facility and enabling the plant to continue to meet more stringent water quality standards. Both projects are being fully funded with very low interest loans from the State Department of Water Resources. The cost of the Cater project is being shared with the Montecito and Carpinteria water districts. Under the joint powers agreement discussed above, the two water districts are responsible for their pro-rata share of the project. Each district will pay its share of the debt service on the 20-year low interest state loan.

The adopted fiscal year 2004 operating budget is $21.9 million, an increase of approximately $2.3 million (12%) over the adopted fiscal year 2003 budget. As always, the largest individual cost item in the operating budget is water purchases (34%). Water is purchased from both the federal Cachuma Project ($2.9 million) and the State Water Project ($4.4 million). The total water purchase budget of $7.3 million is an increase of $1.4 million (25%) over the amount contained in the adopted fiscal year 2003 budget. This represents more than half of the total $2.3 million increase in the adopted operating budget. Virtually all of the increased water purchase cost is attributable to Cachuma water purchases.



Total FY04 Operating Budget - $21,923,471

As the chart on the right indicates, fixed costs, including water purchases and debt service, comprise 44% of Water Fund operating expenses. Because of the magnitude of these fixed costs, unlike most other City funds, salaries and benefits comprise only 22% of the Water Fund budget. Of the $7.3 million of supplies and services, just over $900,000 is for electricity, approximately $1.0 million is for facilities maintenance, $612,000 is for treatment chemicals, and an additional $1.7 million is paid to the General Fund for

Enterprise Funds

overhead allocation. Other significant items include over $400,000 for vehicle and equipment rents, and maintenance and fuel (paid to the City's Motorpool program) and $413,000 for insurance. These items combined amount to just over $5 million or 68% of the supplies and services budget.

The Water Fund has five outstanding debt obligations. As of June 30, 2003, the combined principal outstanding on these five debt issues totaled approximately $30.2 million. The debt issues include a 1994 revenue bond ($6.7 million), a 2002 Refunding Certificate of Participation ($15 million) and three loans from the State ($8.5 million). This does not include approximately $28.2 million in new debt for the additional state loans referenced above for the Cater and Sheffield projects. As of the end of fiscal year 2003, only $5.1 million of the total $19.2 million State loan for the Cater project was drawn; and, to date, no amounts have been drawn on the $14.1 million State loan for the Sheffield project.

In summary, the Water Fund continues to maintain a solid financial position. Both revenue and the operating budget are stable and the focus during the next fiscal year will be on completing the significant capital program.

Enterprise Funds

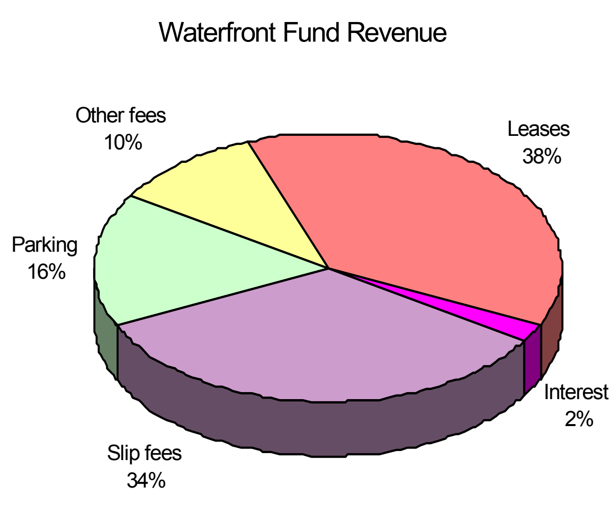
WATERFRONT FUND

	Fiscal Year 2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenue	$ 11,340,424	$ 9,272,147	$ 9,584,710	$ 9,301,230
Operating expenses	7,192,846	7,580,384	7,418,397	8,836,345
Operating surplus	4,147,578	1,691,763	2,166,313	464,885
Capital budget	1,168,227	1,641,774	1,629,286	1,935,000
Net addition to (use of) reserves	$ 2,979,351	$ 49,989	$ 537,027	$ (1,470,115)

The adopted Waterfront Fund budget for fiscal year 2004 contains sufficient operating revenue to fund all operating expenses and $464,885 of a $1.9 million capital program. The $1.5 million use of reserves for capital represents use of funds from the Harbor Capital Preservation Reserve Fund. Projected operating revenue of $9.3 million includes a 4% increase in slip fees.

As with the City's other Enterprise Funds, the adopted Waterfront Fund budget reflects a significant capital improvement program. The Waterfront Fund is in reasonably good financial position with fairly substantial accumulated reserves. In addition to the required reserves established by Council policy, there is the Harbor Capital Preservation Fund, a dedicated capital reserve, currently funded at approximately $4 million.

The adopted capital program is almost $900,000 (85%) above the current year level. Significant projects include repairs and maintenance to Stearns Wharf ($550,000), annual marina maintenance ($200,000), electrical metering of harbor slips ($235,000) and funds for the construction of the new Waterfront Administrative Offices ($500,000).



Total FY04 Revenues - $9,301,230

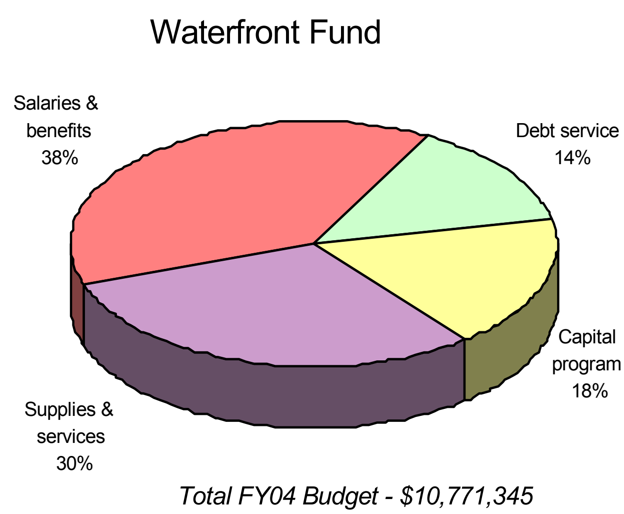
As the chart on the right indicates, Waterfront revenues fall into three main categories. Leases of waterfront property provide approximately $3.5 million or 38% of total revenue. Most of the Waterfront leases are long-term leases on a "percent of gross basis" under which the Waterfront receives a minimum base rent, or up to 11% of the tenant's gross receipts, whichever is greater.

Enterprise Funds

The specific percent of gross receipts paid by the tenant varies from lease to lease. Since virtually all of the significant leases are long-term in nature, the Waterfront has little control over lease revenue in the short run. Therefore, in the short-term, the only revenues over which management can exercise direct control are the parking and harbor-related fees. The Waterfront, in cooperation with the Finance Department, has established a formal lease audit program. Since most of the Waterfront leases are on a "percent of gross" basis, a regular audit program ensures that the City is receiving the revenue to which it is entitled. The Waterfront has already realized substantial additional revenues as a result of this lease audit program.

The second category of Waterfront revenue is from parking. Parking on Stearns Wharf and in the various Waterfront lots generates approximately $1.5 million or 16% of total revenue. The waterfront tracks parking receipts for nine different lots plus Stearns Wharf. In addition, annual parking permits generate approximately $245,000.

The third significant category of Waterfront revenue is harbor fees, including slip fees. Slip fees are estimated to generate just over $3.1 million (34%) of total revenue in fiscal year 2004. As mentioned above, this estimate includes adoption of a 4% increase in slip fees. In addition to slip fees, "other fees" include visitor fees ($365,000), slip transfer fees ($345,000) and live-aboard fees ($135,600).



The chart to the right displays the Waterfront Fund's expenses by category for fiscal 2004. The capital program (18%) and debt service (14%) combined represent 32% of the total budget.

The Waterfront Fund currently has two outstanding debt obligations. As of June 30, 2003, the total principal due on these two obligations totaled $20.5 million. The 2002 Refunding Waterfront Certificates of Participation ($19.4 million) represent a refinancing of debt originally issued in 1984 to fund repairs and capital improvements to Stearns Wharf and the harbor. The other obligation is a loan from the City General Fund ($1.9 million), the proceeds of which were used in the 1980s to make major repairs to Stearns Wharf. The Waterfront Fund is repaying the General Fund, without interest, at the rate of $100,000 per year. At this rate it will be another eighteen years before the loan is fully repaid. Although not yet executed, an additional $1.5 million General Fund loan has already been authorized to help pay for the construction of new Waterfront administrative offices.

Total operating expenses in the adopted fiscal year 2004 budget are just over $800,000 (10%) more than in the adopted fiscal year 2003 budget. Over $300,000 of this increase is in the

Enterprise Funds

salaries and benefits category. Most of this increase is due to increases in health insurance, retirement costs and temporary wages. Other notable operating expense increases include electricity ($118,000) and facilities maintenance ($145,000).

In summary, the Waterfront Fund remains very strong operationally with revenues exceeding operating expenses. Although it continues to be necessary to spend a portion of the fund's accumulated reserves for capital, including a portion of the Harbor Preservation Fund, the Waterfront Fund remains in solid financial condition.

Internal Service Funds

DUPLICATIONS FUND

	Fiscal Year 2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenue	$ 286,043	$ 298,941	$ 341,175	$ 375,978
Operating expenses	282,814	279,173	315,433	399,191
Operating surplus (deficit)	3,229	19,768	25,742	(23,213)
Capital budget	-	50,000	-	-
Net addition to (use of) reserves	$ 3,229	$ (30,232)	$ 25,742	$ (23,213)

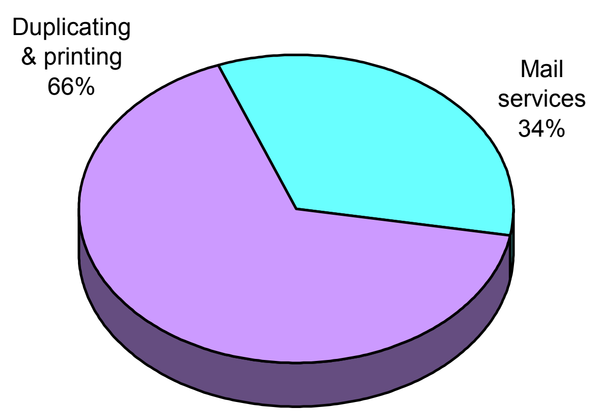
The adopted fiscal year 2004 Duplications Fund operating budget is $399,191, including the use of approximately $23,000 in reserves.

As an internal service fund, the fund's revenue is comprised of charges for services rendered to other City funds and departments. The revenues are derived from printing and copying (66%) as well as interoffice and external mail services (34%). The Duplications staff also processes and mails over 30,000 utility and accounts receivable billings monthly.

The entire budget is comprised of personnel costs (46%) and supplies and services (54%). The operating budget is approximately $84,000 (27%) above the actual fiscal year 2003 expenditures. The majority of the increase ($53,000) is attributable to higher overhead allocation charges from the General Fund. The balance of the increase is attributable to higher costs for medical insurance and retirement contributions.

In fiscal year 2002, the Duplications Fund made two significant purchases, which have helped staff to increase revenues. Two new medium-volume copiers were acquired to handle much of the copying volume. In addition, Duplications acquired a new digital color copier/ printer, which has expanded the quality and type of jobs that can be performed for the City's departments.

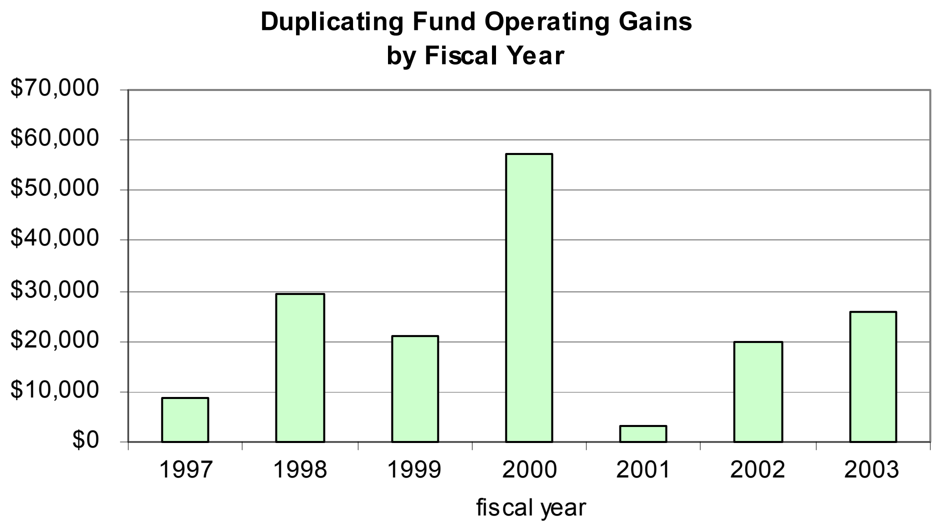
Duplications Fund Revenues



Total FY04 Revenues - $375,978

Internal Service Funds

As the chart below indicates, for each of the last seven fiscal years, the Duplications Fund has enjoyed a small operating surplus. This followed four consecutive years of small operating losses. While the use of reserves during that four-year period was relatively small, staff was committed to making changes to improve the situation. Since that time, Finance Department staff reduced some costs and implemented some nominal revenue enhancements. As a result of these changes and several significant billable projects (including the budget), the fund's situation has improved over the last two years. Moreover, the addition of the color copier has provided the Duplications Fund with another source of revenue. Despite these factors, the adopted fiscal year 2004 budget anticipates the use of a small amount of accumulated reserves.



In addition, the General Fund has provided a small operating subsidy of approximately $35,000 in each of the last several years. In fiscal year 1999, this operating subsidy turned what would have been a small operating loss into an operating gain. In fiscal year 2000, however, the Duplications Fund generated a small operating gain, even before the General Fund subsidy. The adopted fiscal year 2004 budget continues this General Fund operating subsidy. The intent of the subsidy, in part, is to allow the fund to accumulate enough resources to fund the replacement of required capital equipment.

Sustaining the recent success will continue to be a challenge. Essentially, the Duplications Fund is, at best, a break-even operation. In the long run, the fund is unlikely to generate sufficient surplus to provide for capital replacement; thus, the rationale for the General Fund operating subsidy discussed above.

Internal Service Funds

While virtually all of the services provided by the Duplications Fund can be obtained from the private sector, staff believes there is a significant value to having this capability in-house. In addition to cost considerations, issues such as timeliness, responsiveness and confidentiality are important factors.

Internal Service Funds

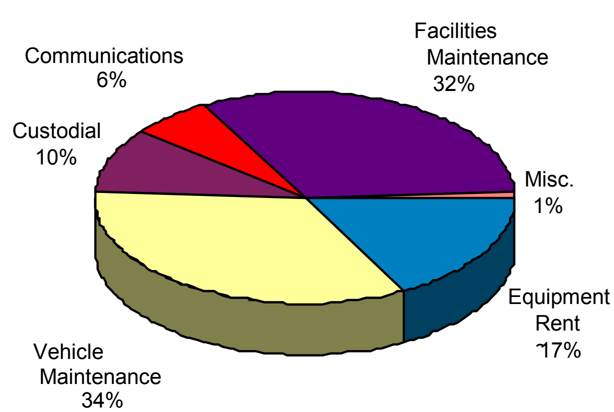
INTRA-CITY SERVICE FUND

	Fiscal Year			
	2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenue	$ 6,657,559	$ 6,968,025	$ 7,482,804	$ 8,209,436
Operating expenses	4,829,109	4,815,014	5,440,260	7,015,366
Operating surplus	1,828,450	2,153,011	2,042,545	1,194,070
Capital budget	2,353,791	1,171,069	1,725,914	1,733,479
Net addition to (use of) reserves	$ (525,341)	$ 981,942	$ 316,631	$ (539,409)

Part of the City's Public Works Department, the Intra-City Service (ICS) Fund is an internal service fund providing services to other City funds and departments. The adopted fiscal year 2004 budget contains significant changes to the ICS Fund. Two operational areas that were previously part of the City's General Fund have been moved into the ICS Fund beginning in fiscal year 2004. These two areas, Custodial Services and Communications Systems, will be added to the Motor Pool and Facilities Maintenance functions that are already budgeted in the ICS Fund. Like the Motor Pool and Building Maintenance functions, both the Custodial Services and Communications Systems operations provide services exclusively to other City departments. Including these two operations in the ICS Fund will ensure that the costs of providing the related services are properly borne by the other City operations benefiting from the services. The significant increase in both revenues ($727,000 or 10%) and operating expenses ($1.6 million or 29%) is attributable to the addition of these two operations.

The Facilities Maintenance function provides on-call response for repairs and maintenance of facilities throughout the City, as well as managing the City's annual planned maintenance program. The facilities maintenance program also provides management of small and medium-sized improvements to various City facilities. The Motor Pool program provides vehicle and equipment maintenance as well as managing the City's vehicle replacement program. The Communications Systems function provides management and maintenance of the City's radio, telephone and related

ICS Fund Revenues



Total FY04 Revenues - $8,209,436

Internal Service Funds

communications systems. Custodial Services function provides custodial services to various City facilities.

The adopted fiscal year 2004 budget anticipates total Intra-City Service Fund revenues of $8.2 million plus a use of reserves of $539,000. The use of reserves is primarily to fund the adopted capital program; however, a small portion of the reserves will be used to support operations.

The majority of the $1.7 million capital program is for the citywide vehicle replacement program ($1.4 million). Also included in the capital program is the replacement of a hydraulic hoist in the Motor Pool's vehicle maintenance operation ($172,000).

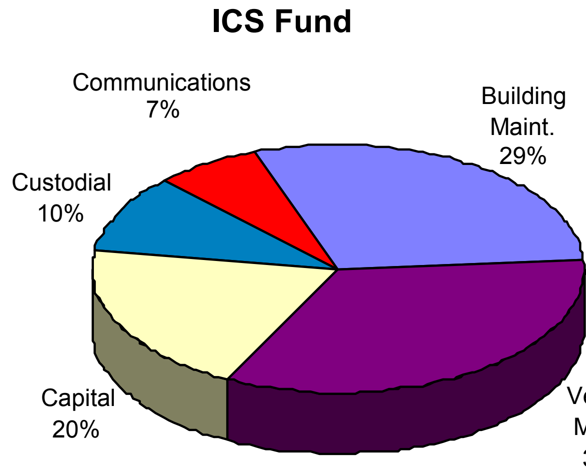
The chart on the previous page displays the various ICS Fund revenues for fiscal year 2004. Even with the addition of the Custodial Services and Communications Systems operations, the majority of the revenue is still generated from the Motor Pool and Facility Maintenance operations.

The building maintenance function operates on a work order system. Each job is tracked and billed to the customer department. Facilities maintenance staff handles repairs and call-out response. The planned maintenance program is handled almost exclusively by contract.

The Motor Pool charges an annual rental for each City vehicle in service. These rental payments are accumulated and used to replace vehicles in accordance with the City's vehicle replacement schedule. Each vehicle is also charged an annual maintenance fee, which covers all required maintenance and all repairs as needed. Since the maintenance charge is a flat annual fee, the ICS Fund can end up spending more on maintenance and repairs for individual vehicles than is recovered through the maintenance charge. On the whole however, sufficient funds are raised to keep the City's vehicles and equipment operating.

The chart on the right displays the ICS Fund expenses by category.

Overall, the ICS Fund continues to generate sufficient revenue to fund all operating expenses and a substantial vehicle replacement program.



Total FY04 Budget - $8,748,845

Internal Service Funds

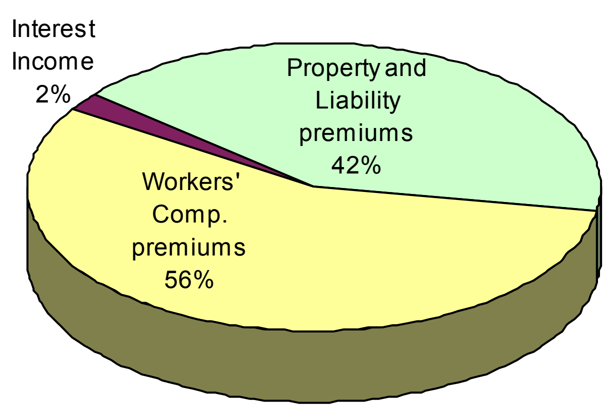
SELF-INSURANCE FUND

	Fiscal Year			
	2001 Actual	2002 Actual	2003 Actual	2004 Adopted
Revenue	$ 3,074,666	$ 4,818,170	$ 6,213,694	$ 6,349,792
Operating expenses	4,695,310	5,550,245	8,801,642	6,349,792
Net addition to (use of) reserves	$ (1,620,644)	$ (732,075)	$ (2,587,948)	$ -

The City is partially self-insured for both workers' compensation and liability. The City's self-insured retention (deductible) for workers' compensation is $500,000 per claim. A commercial workers' compensation policy provides additional coverage above the City's self-insured retention. For liability, the City is a member of the Authority of California Cities Excess Liability (ACCEL), a joint powers authority created to pool common municipal liability exposures such as general, automobile and public officials errors and omissions liability. There are currently a total of 11 California cities in ACCEL. Member entities share the cost of losses over an individual self-insured retention. Shared losses are capped at $22 million. The City's self-insured retention is $1,000,000. Since ACCEL is effectively an insurance company, if the premiums the City pays are not needed to pay claims, they are returned to the City with interest, instead of becoming insurance company profits. Since the City has been in ACCEL, over $6 million in premium rebates have been returned to the City. This is an excellent indication that, to date, ACCEL has been a major success.

Insurable property is covered for all risks by commercial policies with a pooled aggregate limit of $500 million and a deductible of $2 million per occurrence. The City has separate limits of $50 million per occurrence for both flood and earthquake. The City's property insurance is purchased through a consortium of over 4,000 public entities that pool their purchasing power in order to better manage costs. The City currently has

Self-Insurance Fund Revenues



Total FY04 Revenues - $6,349,792

Internal Service Funds

declared, insured property values totaling $225 million.

The Self Insurance Fund acts as the City's own insurance company. The chart on the previous page displays, the $6.4 million of total revenue adopted for fiscal year 2004 is divided between workers' compensation premiums (56%), property and liability premiums (42%), and interest income (2%). As an internal service fund, the fund's revenue comes almost entirely from "premiums" charged to the City's other funds and departments for the coverage provided. The only other revenue the fund receives is interest income, budgeted at $120,000 for fiscal year 2004.

Premiums Charged

	FY 2001 Actual	FY 2004 Adopted	Increase Dollars	Increase Percent
Workers' Compensation	$ 1,724,316	$ 3,453,228	$ 1,728,912	100%
Property / Liability	1,136,795	2,776,564	$ 1,639,769	144%
Total premiums	$ 2,861,111	$ 6,229,792	$ 3,368,681	118%

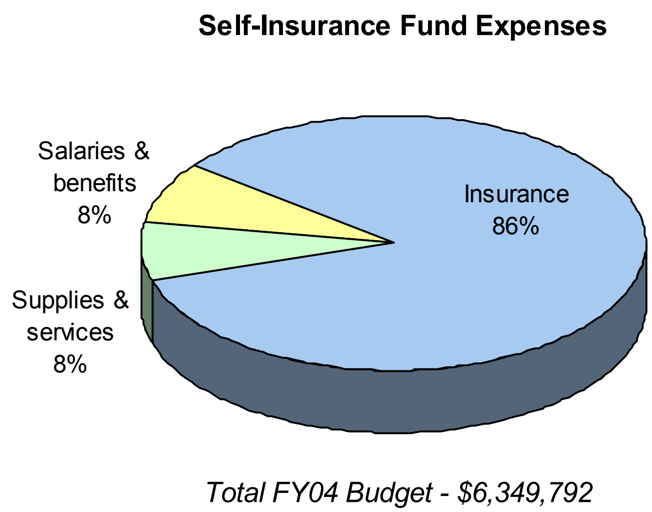
As the table to the right indicates, as recently as fiscal year 2001, total Self Insurance Fund revenue, paid by the other City funds and departments, totaled just under $3 million, compared to the $6.2 million adopted for fiscal year 2004. Like many entities, both public and private, the City has experienced dramatic increases in the cost for all lines of insurance over the last several years. In particular, both workers' compensation and property insurance costs have grown rapidly.

As the table indicates, total charges paid for insurance by the City's various funds and departments have increased almost $3.4 million, or 118%, in just the last three years. This represents over $3 million that has been diverted from the actual programs and services provided by the City's departments. Over the same period, the City has had to accept significantly higher deductibles or the premium increases would have been even larger. In the last three years, the City's deductible for workers' compensation has increased from $300,000 to $500,000 per occurrence and the property insurance deductible has increased from $100,000 to $2 million.

Every two years, in conjunction with the budget development process, the City contracts for an actuarial study on its self-insurance programs. The actuarial study recommends both how much the City should have in its self-insurance reserves and how much the City should budget for claims expense for each of the next two years. The actuarial study is based upon a combination of the City's specific loss history and certain industry standards. It has been the City's experience over the years that the actuarial study, because of its conservative assumptions, generally over-estimates the amount needed by the City for annual claims expense. This is due to the generally conservative nature of the study and the fact that the City's loss experience continues to be better than public agency industry standards. Based upon this experience, the City has traditionally set the premiums charged to the City's various funds significantly lower than the actuarial study recommends. Despite an increase in the cost of workers' compensation claims over the last several years, this is once again true with the most recent actuarial study and the adopted fiscal year 2004 budget.

Internal Service Funds

The chart to the right displays the Self-Insurance Fund's expense budget by category. Insurance costs represent a full 86% of the budget. Insurance costs include premiums paid for commercial insurance (property insurance, for example), as well as the claims budget for the City's self-insured exposures such as liability and workers' compensation.



In addition to managing the City's insurance portfolio, staff from the Self-Insurance Fund also provides occupational safety services to the City's various departments. This includes a significant training program, as well as accident investigation and working with departments to minimize the City's exposure to liability. The fact that the City's claims experience consistently runs below the actuarial projections is a testament to the effectiveness of the City's risk management program.

In summary, the costs of insurance have risen dramatically in the last several years and staff does not anticipate any significant change in this trend in the immediate future. At best, a stabilization of the premium increases can be expected.