Audit of the City's Financial Condition

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City of
SACRAMENTO
Office of the City Auditor

Research and Analysis Division

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Table of Contents

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OVERVIEW

This report provides a detailed yet accessible analysis of the City's financial health using two methodologies. Chapter 1 uses the modified 10-point test as presented by Dean Mead. Chapter 2 draws from the financial and economic indicators included in the International City/County Management Association's (ICMA) *Evaluating Financial Condition: A Handbook for Local Government* (Handbook). Our analysis has found that Sacramento's financial condition slowly improved during the review period and Sacramento is performing better than many of its peers (the COVID-19 pandemic impacted the 2020 and 2021 analysis). However, its performance on the debt and solvency ratios lagged the peer group.

Chapter 1

We used the modified 10-point test to assess Sacramento's overall financial condition relative to six benchmark cities: San Jose, Stockton, Fresno, Long Beach, Oakland, and Bakersfield. The analysis reviews the period between fiscal years ending in 2011 and 2021. The assessment encompassed 10 ratios related to four areas of financial health: financial position, revenues, debt, and capital assets. Points were awarded for each ratio based on which quartile of the benchmark group the results fell: two points in the top quartile, one point in the second quartile, zero points in the third quartile, and negative one point in the bottom quartile.

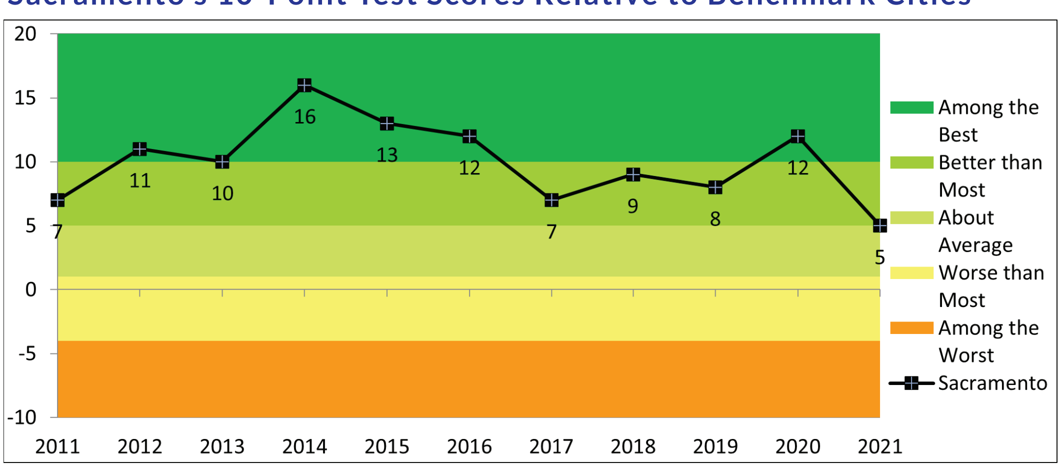
Summary of Sacramento's Financial Condition Ratio Scores

Indicator Ratio	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Short-Run Financial Position	-1	-1	1	2	1	2	2	2	2	2	1
Liquidity	1	1	1	2	2	2	2	2	2	2	1
Financial Performance	0	1	1	2	1	2	1	1	1	2	1
Solvency	2	2	1	2	1	1	0	0	0	1	0
Primary Government Revenues	1	2	1	2	2	2	1	2	1	2	0
Governmental Activities Revenues	1	2	1	1	1	1	1	2	2	2	1
Primary Government Debt Burden	2	2	1	1	1	0	-1	-1	-1	-1	-1
Governmental Funds Debt Coverage	1	1	1	1	1	-1	0	0	-1	1	1
Enterprise Funds Debt Coverage	1	1	1	2	2	1	2	0	0	-1	-1
Capital Assets	-1	0	1	1	1	2	-1	1	2	2	2
Annual Total	**7**	**11**	**10**	**16**	**13**	**12**	**7**	**9**	**8**	**12**	**5**

Chapter 2

We used the ICMA Handbook to conduct additional analysis of the City's financial condition. To understand and evaluate financial condition, the Handbook provides a comprehensive approach to evaluate up to 42 indicators across six financial categories: 1) revenue indicators, 2) expenditure indicators, 3) operating position indicators, 4) debt indicators, 5) unfunded liability indicators, and 6) capital plant indicators.
This chapter includes indicators selected to complement the Mead 10-point test of financial condition in Chapter 1. It also includes comparisons to the benchmark group for some of the indicators, when it seems helpful to do so. However, there are no scores attached to the benchmarked indicators. The data has also not been adjusted for inflation.

Sacramento's 10-Point Test Scores Relative to Benchmark Cities



Sacramento ranked "among the best" in 6 of the 11 years of the benchmark period and "better than most" for the remaining five years. The City's score in 2020 was 12 and declined to 5 in 2021.

Introduction

In accordance with the City Auditor's 2021/22 Audit Plan, we have completed the *Audit of the City's Financial Condition*. We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

This report provides Sacramento's residents and public officials with a detailed yet accessible analysis of the City's financial health. This is especially important and timely considering the recent COVID-19 pandemic, which has forced the City to reallocate resources to address the public health crisis. The data for the audit is derived from the audited annual comprehensive financial report (ACFR) and annual budgets for Sacramento and other cities.

What is Financial Condition?

According to the International City/County Management Association's (ICMA) report, *Evaluating Financial Condition: A Handbook for Local Government* (Handbook), financial condition is multifaceted. First, financial condition refers to fiscal solvency over a defined period. This can refer to the ability of an entity to raise enough money to meet immediate expenses over a short, defined period (30 to 60 days). Financial condition can also refer to the ability of an entity to generate enough revenues to pay its obligations over a defined budgetary cycle. Finally, financial condition relates to the ability of a government or other organization to manage the full life cycle of revenues and outlays, including pension and other postemployment financial obligations.

Financial condition also relates to resiliency. Can an organization weather a financial downturn, such as a recession, or meet the demands of a growing, or declining, population? Would the City be able to maintain service levels under any of these scenarios? Finally, a basic assessment of financial condition for local government involves evaluating whether a city can continue paying for what is allocated, if there are reserves for financing emergencies, and if there is enough financial flexibility to allow the government to adjust to exogenous shocks.

Financial condition is defined in this report as the City's capacity to finance its services on a continuous basis according to three criteria: 1) its ability to maintain existing service levels, 2) withstand economic disruption, and 3) meet the changing demands brought by growth or decline.

Financial Assessment Models

There are several approaches to measuring financial condition of government entities. Dean Mead considered multiple approaches before deciding to update the 10-point test described below. The common feature was that analyses rely on looking at different measures of a city's finances to create a picture of the overall financial condition. These measures of financial condition use audited financial statements, which include revenues and expenditures, debts, and other indicators. The purpose of the measures is to provide a comprehensive review of a city's finances.

In this report, we will apply two models: the Dean Mead modified 10-point test and the Financial Trend Monitoring System from ICMA's Handbook.

Dean Mead Modified 10-Point Test

The modified 10-point test used in this report was develop by Dean Mead of the Governmental Accounting Standards Board (GASB).[1] In 2006 he introduced a modified version of a 10-point test initially developed by Dr. Ken W. Brown in 1993. Dr. Brown, who was a professor at Southwest Missouri State University at the time, was concerned that a thorough financial condition assessment that involves a large number of factors and indicators could be time consuming and that it might not be a regular part of financial management as a result. In 1993, Dr. Brown published a 10-point test for evaluating a city's financial condition. The ratios he produced were designed for cities with populations under 100,000 and wouldn't require costly or time-consuming analytic techniques. Dr. Brown's initial analysis was designed to use data from the Financial Indicators Database published by the Government Finance Officers Association.

GASB Statement 34, implemented in 1999, made more information available through financial reporting than was available in 1993. Mead updated some of the 10 ratios to take advantage of the reporting changes. The modified 10-point test covers four financial factors: 1) financial position, financial performance, liquidity, and solvency; 2) revenues; 3) debt burden and coverage; and 4) capital assets. This version of the test has been used by the City of San Diego's Auditor's Office.

Evaluating Financial Condition: A Handbook for Local Government

The ICMA is the "professional and educational organization for appointed administrators and assistant administrators in local government. The mission of ICMA is to create excellence in local government by developing and fostering professional local government management worldwide. To further this mission, ICMA develops and disseminates effective approaches to management through training programs, information services and publications."[2]

It was in this spirit that the ICMA developed a handbook to help local governments make sense of the many factors that affect financial condition. To guide the analysis of financial condition, ICMA developed what it calls the Financial Trend Monitoring System (system). The system ICMA provides can be used to identify the factors that affect financial condition by providing a framework to assemble data from multiple sources. The indicators used in the monitoring system draw from city budgets and financial reports and are combined with economic and demographic data to create a series of financial indicators that can be used to monitor changes in financial condition over time.

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[1] Mead, Dean. "A Manageable System of Economic Condition Analysis for Governments." *Public financial Management*, edited by Howard A. Frank, CRC Press, 2006, 383-419.

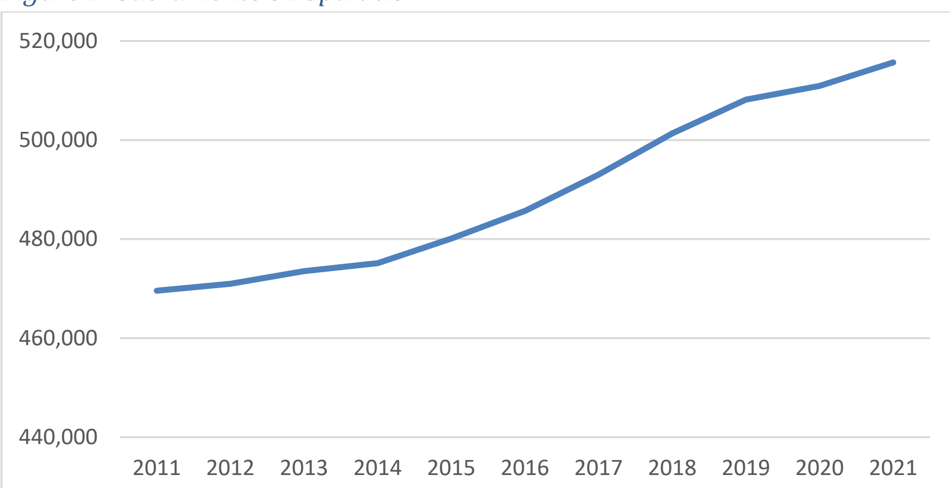
[2] International City/County Management Association, *Evaluating Financial Condition A Handbook for Local Government*, 2003, p. 3

One difference between these two frameworks is that the Mead modified 10-point test assigns numerical scores of city performance, which can be compared with prior years to track improvements or deteriorations in the government's financial condition. The scores can also be rated against the scores of comparable governments. This report uses the Mead modified 10-point test for Sacramento and a peer comparison group for the period 2011 to 2021. The report also adds additional detail by analyzing supplementary indicators from the ICMA Handbook.

Sacramento's Economy and Economic Outlook

Since its establishment in 1849, Sacramento has grown into one of the largest cities in California. Sacramento became the capital for the State of California in 1854. As the capital city, it is the seat of the California Legislature and the Governor of California. Sacramento also serves as the seat of Sacramento County government. With a population of 515,673 as of 2021, Sacramento is currently the sixth largest city in California.[3] The City grew 9.1 percent between 2011 and 2021, which is faster than population growth in the state as a whole, which grew 5.1 percent over that time. The figure below shows Sacramento's population growth over the report's review period.

Figure 1: Sacramento's Population



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

Sacramento City Budget

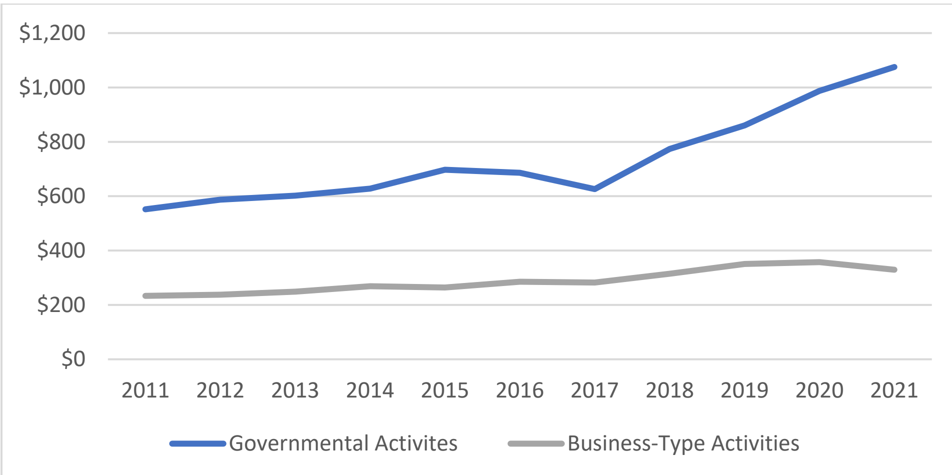
Sacramento is a charter city and operates under a Council-Manager form of government. The City operates with a nine-member elected City Council (Council), including an elected Mayor. There are no other elected City officials. The Mayor and City Council are the policy-making body for the City of Sacramento. The City Manager is the Chief Executive Officer of the City and is responsible for the leadership and direction of all operations, programs, and services, per City Charter.[4] The City's budget process is described in additional detail in the Appendix.

[3] Based on California Department of Finance estimates as of January 1, 2021.

[4] City of Sacramento, 2022. *City of Sacramento Charter, Article V. City Manager, Section 61*.

Figure 2 shows that Sacramento's revenue has risen, with minor fluctuations, since 2011. Total revenue from governmental activities totaled over one billion dollars in 2021.[5] In 2011, total revenues were over $550 million. Revenue for business-type activities have grown as well, but at a more modest pace, rising from just below $230 million in 2011 to more than $330 million in 2021.[6]

Figure 2: Sacramento's Revenue ($ millions)



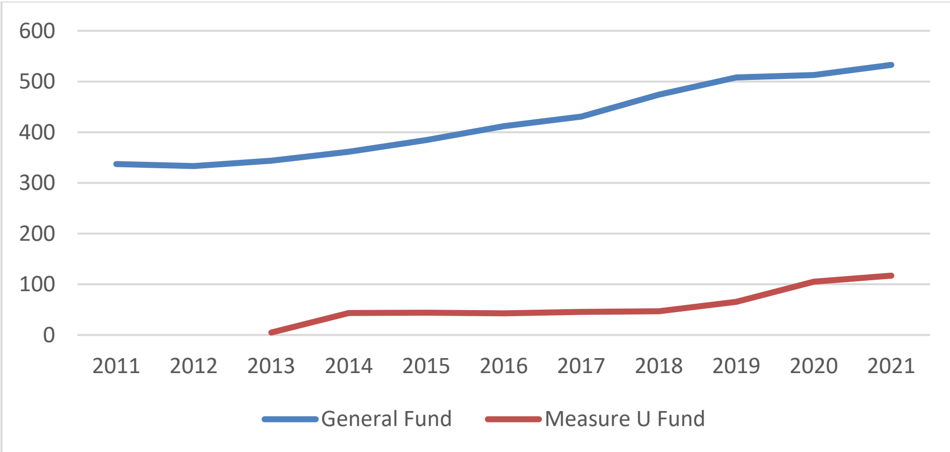
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

The figure below shows that General Fund and Measure U Fund revenues have gradually increased over the benchmarking period. Measure U was approved by voters in 2012 as a temporary half-cent tax and went into effect near the end of fiscal year 2013. It was initially designed to be temporary, but in 2018 voters approved a revised version of the sales tax, which made it permanent and raised it to a full cent. Measure U funding is considered part of the General Fund but is reported separately in the financial report because the governmental funds are organized by fund groups, and the Measure U sales tax is grouped separately in these accounts. General Fund and Measure U Fund revenues increased modestly in 2021 despite the pandemic. Figure 3 displays the General Fund revenues and Measure U Fund revenues separately to show the growth of Measure U from its inception in fiscal year 2013.

[5] Most of the City's basic services, such as police; fire; public works; community development; youth, parks, and community enrichment; and general government are categorized as governmental activities. Taxes and state and federal grants finance most of these activities.

[6] Business-type activities are services provided by the City that are funded by customer fees. Among these are the City's utility services, convention center, and off-street parking facilities.

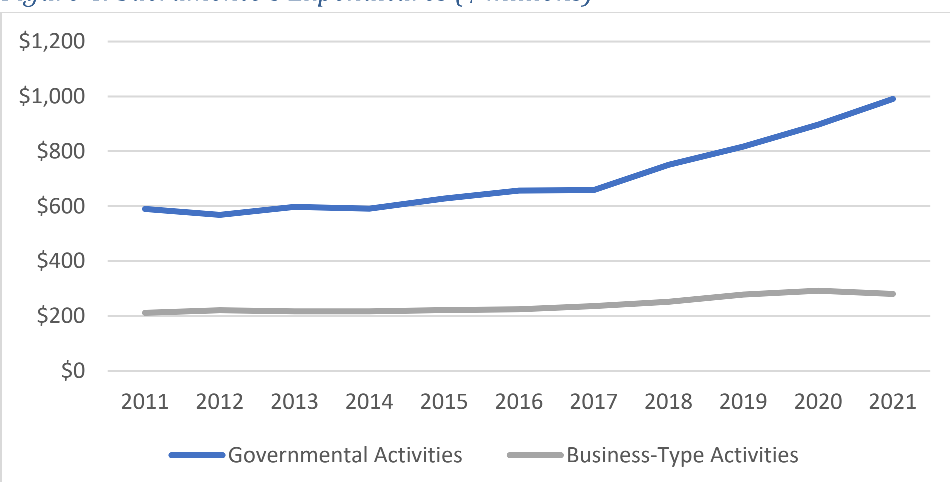
Figure 3: General Fund and Measure U Fund Revenues ($ millions)



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

Turning from revenues to expenditures, figure 4 shows that Sacramento's expenditures have risen since 2011. In fiscal year 2021, Sacramento's total expenditures increased primarily in response to the COVID-19 pandemic although business-type expenditures declined from the prior year.

Figure 4: Sacramento's Expenditures ($ millions)



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

Sacramento's Economic Base

Sacramento is home to many established and growing industries that are sources of new ideas, and which raise revenue for the City. According to the City's Office of Innovation & Economic Development, Sacramento's key private sector industries are:

- Agriculture Hub and Research and Development
- Clean Technology and Energy
- Life Science and Health Care
- Post-Secondary Education

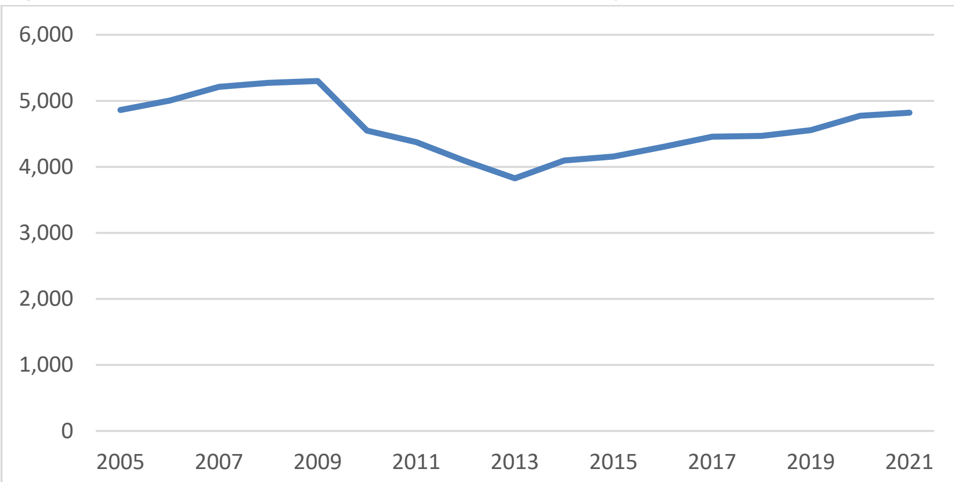
- Linking Industries[7]

Growth or disruptions in these industries may impact the City's financial condition.

The government is also a major employer in the Sacramento region. According to the City's 2021 ACFR, the state government is the largest single employer in Sacramento, employing more than 80,000 people. Sacramento County and the federal government represent the third and fifth largest employers, interspersed between the U.C. Davis Health System and Kaiser Permanente.

Figure 5, displayed below, extends the period analyzed to show the City's staffing levels prior to the 2007 to 2009 recession. The City's workforce peaked in 2009 with 5,300 full-time equivalent workers. Sacramento had to drastically cut its workforce as revenue declined amid the economic downturn. The number of employees declined to fewer than 4,000 in 2013. Sacramento's total employment level has increased by almost 1,000 since 2013, but staffing remains below its 2009 peak.

Figure 5: Sacramento's Full-Time Equivalent Workforce



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

In January 2019, the City of Sacramento contracted with Management Partners to complete a citywide Innovation and Efficiency Assessment. The primary objectives of the report were to provide an independent assessment of Sacramento's near and medium-term fiscal condition and identify 10 to 20 opportunities to gain efficiency/cost savings and generate additional revenue without displacing existing public employees.

Management Partners found that Sacramento was devastated by the Great Recession in 2008-2011, when it lost nearly a third of its full-time staffing and implemented many service-delivery changes in

[7] In addition to the other industry sectors, Sacramento demonstrates strength in five "Linking" industries. Linking industry sectors perform or engage in activities within all of the four key industries. Sacramento's five linking industries include: advanced manufacturing, business and financial services, government, retail, and entertainment and tourism.

order to survive. Sacramento has been focused on rebuilding over the last several years. The analysis concluded that the City's fiscal position is tenuous, even with the approval of the Measure U sales tax in November 2018. Management Partners suggested that for the foreseeable future, the City will not be able to afford staffing levels such as those it had in 2008.

COVID-19 World Pandemic

In December 2019, a new strain of coronavirus (COVID-19) was identified in Wuhan, China. Coronaviruses are a large family of viruses that can cause respiratory infections in humans. They include severe diseases such as severe acute respiratory syndrome (SARS), Middle East respiratory syndrome (MERS), and COVID-19.

Along with other state and local agencies across the country, Sacramento faced extraordinary challenges due to the pandemic. The City responded to the impact of the pandemic by attempting to minimize strain on the General and Measure U Funds revenue streams.

Federal and state efforts to curb the transmission of the virus early in the pandemic resulted in negative impacts on the City's year-end 2020 revenues and 2021 revenues. Budgeted revenues reflect a cautious and gradual phase-in for recovery on most of the City's revenue streams. Notably, the Transient Occupancy Tax (TOT) and revenue from parking are forecast by the City to be lower than estimated prior to the pandemic.

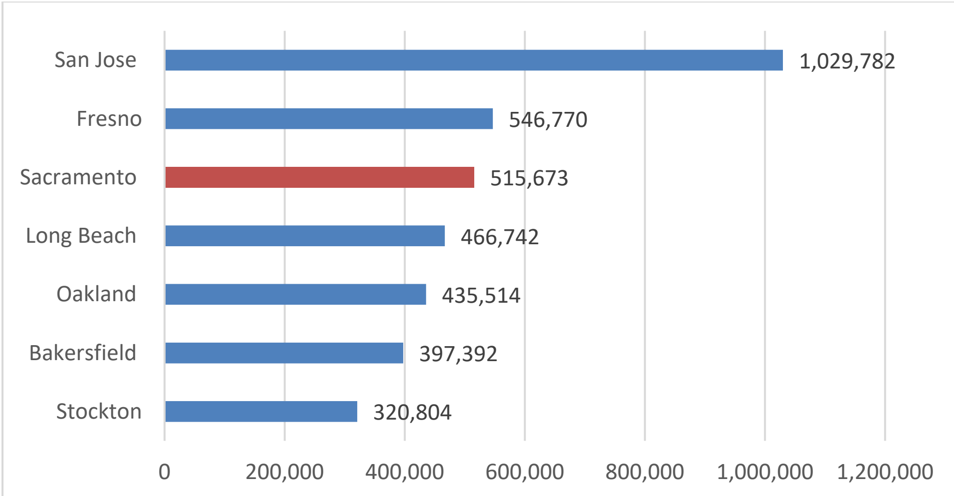
Despite the severity of this downturn, the California State Auditor estimates that only 18 cities in California did not receive enough stimulus funds to cover their COVID-19 related revenue losses. Neither Sacramento, nor the benchmark cities, were included among these 18 cities identified by the State Auditor.

Peer Comparison

Several cities within California have conducted financial condition audits. These cities include San Jose, San Diego, and Oakland. Several other cities around the country have conducted similar studies, including cities like Seattle, Washington and Portland, Oregon metropolitan area. A number of states also monitor and report on the financial condition of state and local entities. Several states have created financial dashboards, including, California, Massachusetts, Michigan, New York, North Carolina, Ohio, and Washington.

To gain an understanding of whether a ratio provides a "good" or "bad" result, Dean Mead recommends building a comparison group. Through comparison, a city can be evaluated with respect to other governments, and the analyst can measure the degree to which a city performs better or worse than its peers. This study uses population to create a peer comparison group to compare Sacramento with its peers in California. Figure 6 below shows the population of the selected cities. Additional details are provided in the Objective, Scope, and Methodology section below.

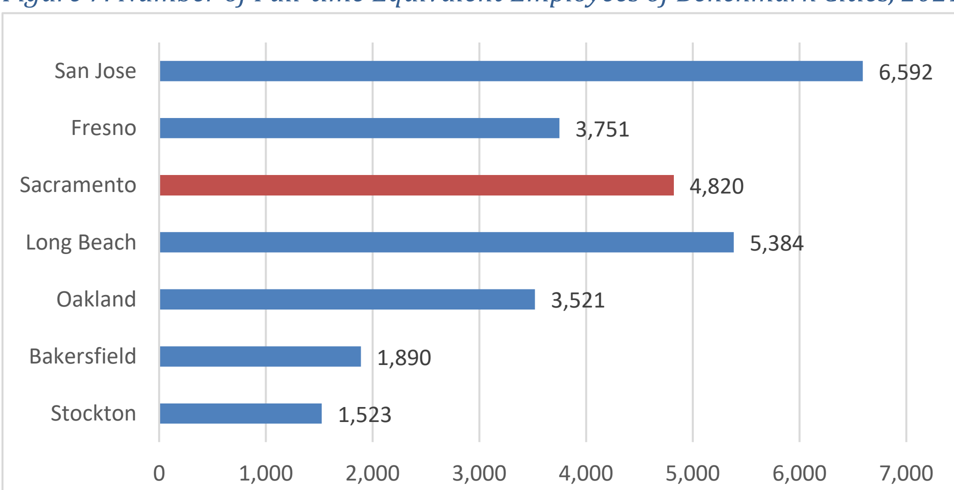
Figure 6: Population of Benchmark Cities, 2021



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Figure 7 displays the number of full-time equivalent (FTE) employees for Sacramento and the cities in the benchmark. FTE is a measure of the workload of a position and is designed to distinguish workloads comparable to a full-time position. An FTE of 1.0 means that the position is equivalent to a full-time workload, while an FTE of 0.5 signals that the position is half-time. Employment ranges from slightly more than 1,500 employees to more than 6,500. In 2021 Sacramento employed more than 4,800 full-time equivalent employees, which is more than Fresno and less than Long Beach.

Figure 7: Number of Full-time Equivalent Employees of Benchmark Cities, 2021



Note: The data for San Jose come from annual budget reports rather than the annual comprehensive financial report.
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

California State Auditor

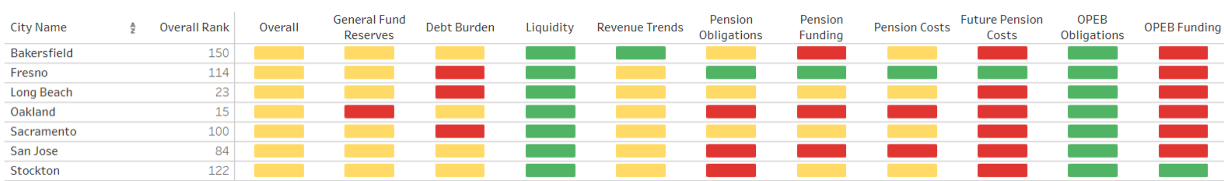
California Government Code section 8546.10 authorizes the State Auditor to identify local government agencies that have risks associated with their economy, efficiency, or effectiveness. In 2019, the California State Auditor created an online dashboard, which ranks California's cities based on an evaluation of their fiscal health, which is a term that is often used synonymously with financial condition.

The State Auditor uses 10 indicators, which are all scored, resulting in a possible score of 100 for the entities' overall financial condition.[8] By doing so, the State Auditor can measure financial condition and compare cities. The dashboard allows users to view individual city rankings and ratings, which are scored using a stop-light indicator rating system. This system rates cities based on their risk of experiencing fiscal distress with red being high risk (0-41.76 points), yellow being moderate risk (41.77-71.23 points), and green being low risk (71.24-100 points).

For the 2019-20 period Sacramento scored 60.03 (yellow light), where 100 is a perfect score and lower scores represent higher degrees of fiscal risk. This score translates to a ranking of 100 out of 423 cities, where 1 is the worst. One challenge with this analysis is that larger cities, such as Sacramento, may not be directly comparable to smaller cities, an observation made by San Diego's Office of the City Auditor. The top performing cities in the State Auditor's evaluation had populations below 100,000 in 2019-20. The top performer, Calimesa, had a population of only 9,913. Ultimately, it is more appropriate to compare cities of similar size.

The figure below reports the results from the California State Auditor's report on financial condition for Sacramento and the benchmark cities. The benchmark cities ranked between a range of 15 and 150 in the State's analysis, with higher results indicating better performance. Bakersfield and Stockton were the top performers in the peer group according to the State Auditor. Fresno, Sacramento, and San Jose performed in the middle range, while Oakland and Long Beach had the lowest scores.

Figure 8: California State Auditor Ranking of Benchmark Cities



Source: California State Auditor, Fiscal Health of California Cities, 2019-20.

Investor Caveat

The Office of the City Auditor developed this report, and it is intended for the public. The report is the result of a performance audit and was not part of the annual audit of the City's financial statements. Expressions of opinion in the report are not intended to guide prospective investors in securities offered by the City.

[8] Not all the indicators are weighted the same. The highest points possible for each of the ten indicators range from five to thirty.

Objective, Scope, and Methodology

The audit objective was to examine the City's financial condition by calculating established financial ratios, analyzing trends in the City's financial data over the prior 11 fiscal years, and comparing Sacramento's performance with its peers in California. Specifically, our audit objective was to examine the City's financial well-being in four areas: financial position, revenues and expenditures, debt, and capital assets.

To address our audit objective, we selected two established methodologies to analyze financial data. Chapter 1 uses the modified 10-point test for assessing financial condition for local governments, as presented by Dean Mead. This method incorporates short and long-term aspects of a city's financial well-being while being relatively simple to use and understand.

Chapter 2 draws from the financial and economic indicators included in the International City/County Management Association's *Evaluating Financial Condition: A Handbook for Local Government*.

Both approaches rely primarily on audited financial data published in the annual comprehensive financial reports (ACFRs).

The report compares Sacramento against a peer group of similar cities. The cities were selected based on their relative size to Sacramento and were limited to cities within California. Our preliminary review identified three cities with smaller populations: Long Beach, Oakland, and Bakersfield, and three with larger populations: Fresno, San Francisco, and San Jose. This audit excludes San Francisco because it has a city/county structure. The amount, and type, of revenues and expenditures diverge considerably between cities and counties.

San Francisco was replaced with Stockton as a benchmark city for our analysis. Selecting a larger city than Sacramento would have required substituting San Diego for San Francisco, a city with a larger population than San Jose and nearly three times the population of Sacramento. Stockton, by contrast, is in the Central Valley and is closer in size. That makes it a suitable replacement for San Francisco.

Chapter 1 calculates ratios for Sacramento and the benchmark cities using the Dean Mead modified 10-point test. Chapter 2 was created to augment the analysis of financial condition presented in Chapter 1. Selected indicators are benchmarked against the peer group, but in other cases data is provided to further the reader's understanding about conditions in Sacramento.

Chapter 1: The Modified 10-Point Test of Financial Condition Results

This chapter follows the 10-point test developed by Ken W. Brown and modified by Dean Mead in Public Financial Management to objectively assess Sacramento's financial condition. The modified 10-point test calculates 10 ratios to measure both short and long-term financial well-being. These ratios provide City leaders with the ability to assess financial condition, evaluate if they can maintain current programming, and if there are sufficient reserves for financing emergencies.

The modified 10-point test was used to assess Sacramento's overall financial condition relative to six benchmark cities: San Jose, Stockton, Fresno, Long Beach, Oakland, and Bakersfield. The analysis reviews the period between fiscal years ending in 2011 and 2021. The assessment encompassed 10 ratios related to four areas of financial health: financial position, revenues, debt, and capital assets. This assessment is designed as a general indicator of financial health and is not intended to capture all details of the City's finances.

To implement the 10-point test, a city would first calculate 10 financial ratios using data from annual financial reports. The results would then be scored relative to a peer group with similar populations and governance structures. These scores provide the government and citizens a clear indication of how positively or negatively the City performed relative to its peers or to its own history. The figure below provides a brief description of the 10 ratios and provides a suggested interpretation of the ratio results.

Figure 9: The Modified 10-Point Test Ratios

	Ratio	Ratio Calculation	Ratio Interpretation
1	Short-run Financial Position	Unreserved General Fund balance / General Fund revenues	A high ratio suggests larger reserves for dealing with unexpected resource needs in the near term.
2	Liquidity	General Fund cash and investments / (General Fund liabilities – General Fund deferred revenues)	A high ratio suggests a greater capacity for paying off short-term obligations.
3	Financial Performance	Change in governmental activities net assets / total governmental activities net assets	A high ratio suggests that annual costs are being adequately financed and financial position is improving.
4	Solvency	(Primary government liabilities – deferred revenues) / primary government revenues	A low ratio suggests that outstanding obligations can be more easily met with annual revenues.
5	Revenues A: Primary Government Revenues	(Primary government operating grants and contributions + unrestricted aid) / total primary government revenues	A low ratio suggests a government is not heavily reliant on intergovernmental aid.
6	Revenues B: Governmental Activities Revenues	(Net (expense) revenue for governmental activities / total governmental activity expenses) x -1	A low ratio suggests basic government services are more self-sufficient through charges, fees, and categorical grants, and less reliant on general tax support.
7	Primary Government Debt Burden	Total outstanding debt for the primary government / population	A low ratio suggests less burden on taxpayers and greater capacity for additional borrowing.
8	Coverage A: Governmental Funds Debt Coverage	Debt service / noncapital governmental funds expenditures	A low ratio suggests general governmental long-term debt can be more easily repaid when it comes due.
9	Coverage B: Enterprise Funds Debt Coverage	(Enterprise funds operating revenue + interest expense) / interest expense	A high ratio suggests greater resource availability for repaying the debts of enterprise activities as they come due.
10	Capital Assets	(Ending net value of primary government capital assets – beginning net value) / beginning net value	A high ratio suggests a government is keeping pace, on average, with the aging of its capital assets and replenishing them.

Source: Auditor generated based on table from Mead (2006).

The analysis began by first gathering the necessary data from the Annual Comprehensive Financial Statements (ACFRs) for Sacramento and the comparison group. After calculating the 10 ratios for Sacramento and each of the comparison cities, points are awarded for each ratio. Two points are awarded for each ratio that falls in the top quartile (top 25 percent) of the benchmark group. One point is assigned for the second quartile (between 25 and 50 percent). No points are awarded for a ratio in the third quartile (between 50 and 75 percent) and a point is subtracted for a ratio in the lowest quartile (bottom 25 percent). The points from each individual ratio are summed and can be used to compare performance within a city over time, or between cities. The interpretation for the total score is provided in figure 10.

Figure 10: Benchmark Scoring Methodology

Overall Score	Rating Relative to Other Cities
10 or more	Among the Best
5 to 9	Better than Most
1 to 4	About Average
0 to -4	Worse than Most
-5 or less	Among the Worst

Source: Auditor generated based on table from Mead (2006).

Sacramento's total score is obtained by summing the points for each of the 10 ratios. The results over the 11-year period can be used to analyze improvements or deteriorations in the City's financial well-being. Sacramento's financial condition generally scored near the top when compared to the benchmark cities.

Figure 11 displays the scores Sacramento received over the forecast period. In 2021 Sacramento scored in the top half in 6 of 10 ratios, which is a score of 1 or 2 in the following table. This is comparable to its performance in 2011, when the City was in the top half of performance in 7 out of 10 ratios. The total score decreased from 7 to 5 between these two time periods. Over the benchmarking period Sacramento's score ranged from a low of 5 in 2021 to a high of 16 in 2014.

The City's highest scores for the 11-year period were related to short-term ratios including liquidity, primary government revenues, and governmental activities revenues, even though in 2021 the primary government revenues ratio score declined to 0. The lowest scores relate to the City's long-term debt. The ratio for the City's primary government debt burden per capita (ratio 7) was in the lowest quartile (bottom 25 percent) compared to the benchmark cities for the past five years.

Figure 11: Summary of Sacramento's Financial Condition Ratio Scores

Financial Condition Indicator Ratio	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1: Short-Run Financial Position	-1	-1	1	2	1	2	2	2	2	2	1
2: Liquidity	1	1	1	2	2	2	2	2	2	2	1
3: Financial Performance	0	1	1	2	1	2	1	1	1	2	1
4: Solvency	2	2	1	2	1	1	0	0	0	1	0
5: Revenues A: Primary Government Revenues	1	2	1	2	2	2	1	2	1	2	0
6: Revenues B: Governmental Activities Revenues	1	2	1	1	1	1	1	2	2	2	1
7: Primary Government Debt Burden	2	2	1	1	1	0	-1	-1	-1	-1	-1
8: Coverage A: Governmental Funds Debt Coverage	1	1	1	1	1	-1	0	0	-1	1	1
9: Coverage B: Enterprise Funds Debt Coverage	1	1	1	2	2	1	2	0	0	-1	-1
10: Capital Assets	-1	0	1	1	1	2	-1	1	2	2	2
Annual Total	**7**	**11**	**10**	**16**	**13**	**12**	**7**	**9**	**8**	**12**	**5**

Source: Auditor generated from ratio calculations.

Overall Modified 10-Point Test Results

Figure 12 displays Sacramento's rank relative to the peer comparison group. Notably, the City was ranked in the top three for eight out of 11 years of the benchmarking period. Sacramento tied with its peers on one occasion in 2019 and this is emphasized with a red box.

Figure 12: Sacramento's 10-Point Test Rankings

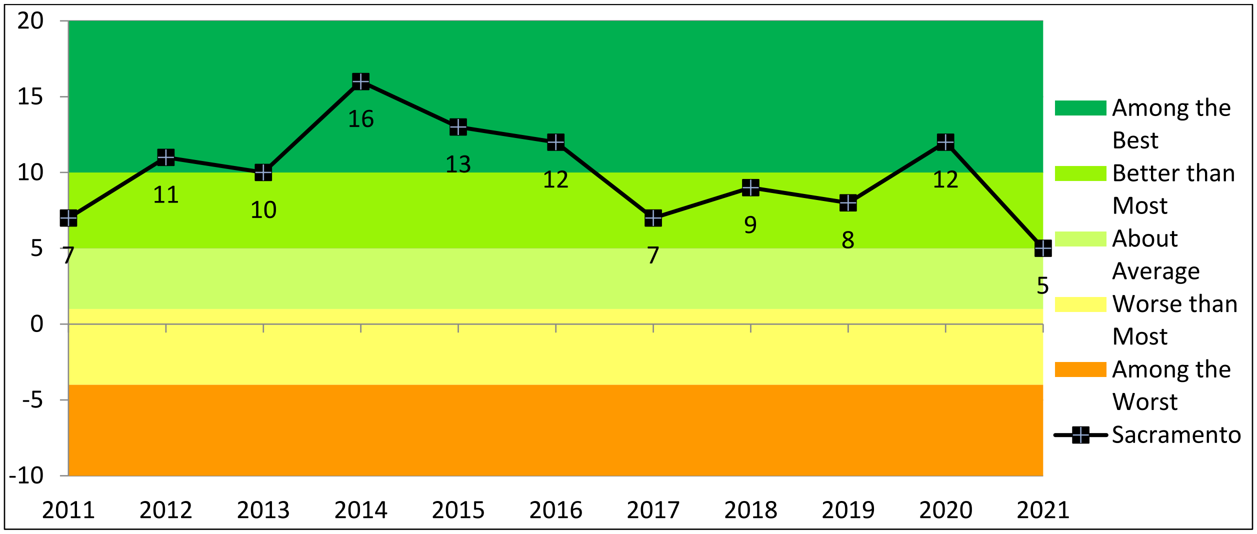
Rank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1st	12	**11**	16	**16**	**13**	**12**	12	13	9	13	15
2nd	11	9	**10**	12	10	11	9	11	**8**	**12**	13
3rd	**7**	6	8	9	7	9	8	10	8	11	6
4th	3	4	7	3	7	8	**7**	**9**	7	3	**5**
5th	0	4	0	1	6	3	4	4	4	3	4
6th	-3	-1	0	1	-1	-1	1	-3	3	0	1
7th			-1	-2	-2	-2	-1	-4	1	-2	-4

Note: Fresno's financial reports for 2011 and 2012 were not electronically available, which results in only six rankings for 2011 and 2012.

Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

The figure below shows that Sacramento ranked “among the best” in 6 of the 11 years. The City’s score was “better than most” for the remaining five years. Sacramento was consistently ranked in the group of governments that are “among the best” between 2012 and 2016. Sacramento then ranked “better than most” for three years before returning to “among the best” in 2020. The City’s score in 2020 was 12 and declined to 5 in 2021.

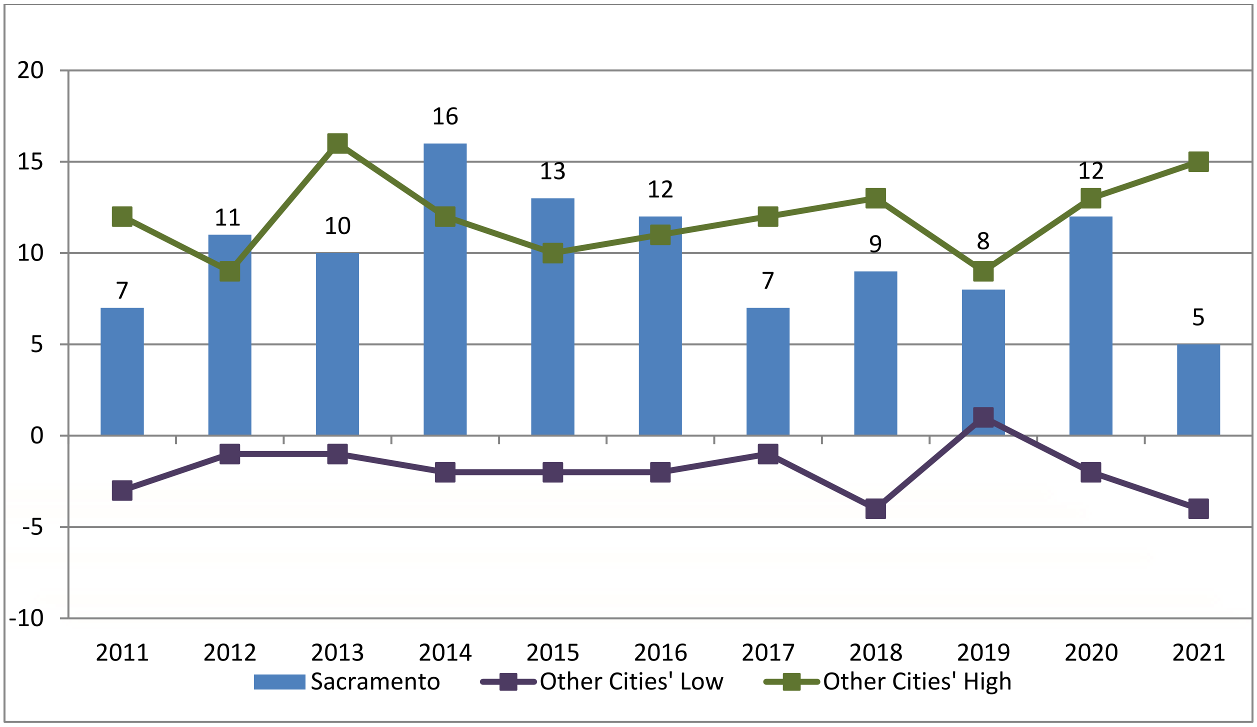
Figure 13: Sacramento’s 10-Point Test Scores Relative to Benchmark Cities



Source: Auditor generated from cities’ scores.

Figure 14 shows Sacramento’s scores relative to other cities’ high and low scores. Sacramento’s performance exceeded its peer comparison group in four years but was well above the lowest scores throughout. Across the entire period the other cities’ scores ranged from a high of 16 to a low of negative 4.

Figure 14: Financial Condition Ratio Scores, Sacramento Compared to Benchmark Cities



Source: Auditor generated from cities' scores.

The results from this analysis can also be compared with the California State Auditor's analysis. For the 2019-20 reporting period, Sacramento ranked fourth behind Bakersfield, Stockton, and Fresno in the State Auditor's ranking. San Jose, Long Beach, and Oakland were the lowest performing of the group of benchmarked cities in this report. Bakersfield also ranked in first place in this analysis during the same period.

However, there are differences in the two approaches. One difference is that the State Auditor's analysis puts more emphasis on pension and other postemployment benefits (OPEB). Six of the ten categories in the California State Auditor's analysis were related to pension and OPEB. The ratios in the Mead 10-point test address these categories, but also include capital assets, which are not in the State Auditor's analysis. Another difference is that the State Auditor groups all cities together, while this report selects a peer comparison group based on population and proximity.

Individual Indicators of Financial Position

The first section of this chapter evaluates four ratios of financial position. Financial position is the government's financial standing at a point in time and is one of the primary indicators used in financial condition analysis. A higher ratio for the first three ratios indicates a relatively better capacity to handle unforeseen resource needs and a better ability to meet short-term obligations. The fourth ratio, a measure of solvency, is an indicator of a government's overall capacity for satisfying its outstanding obligations. Subsequent sections, covering ratios five through ten, examine revenues, debt, and capital assets.

Ratio 1: Short-Run Financial Position

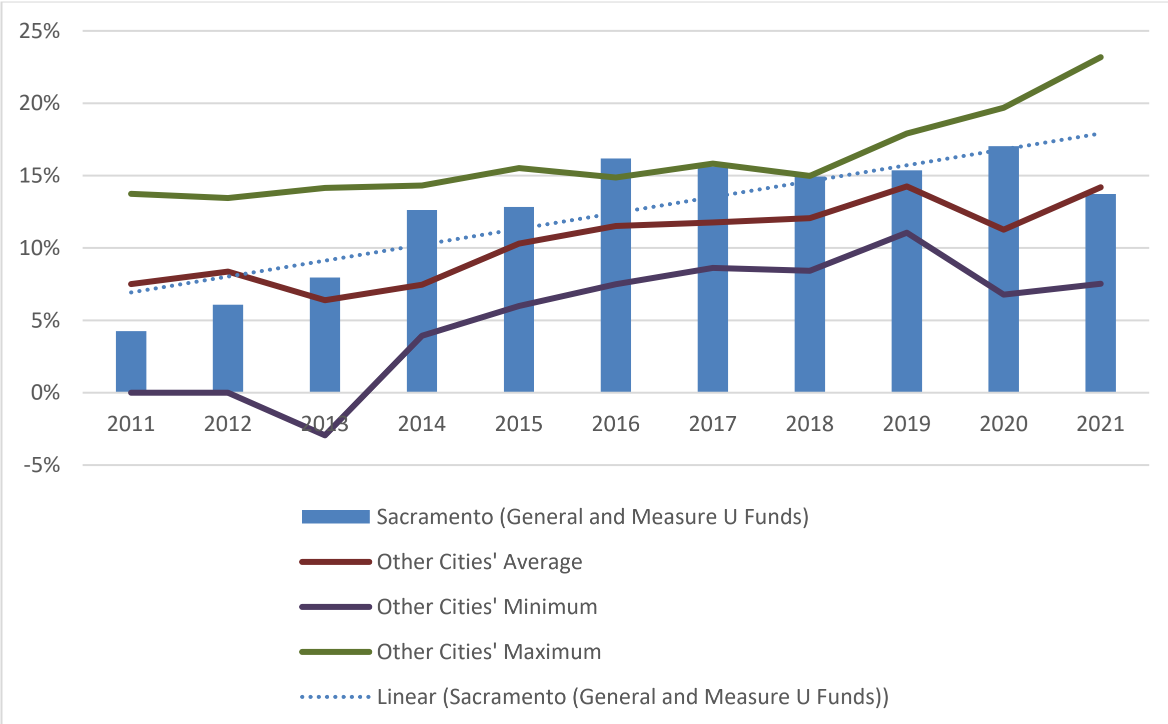
This ratio measures the City's ability to handle unforeseen resource needs over the short-term. The calculation for this ratio divides unreserved General Fund balance by General Fund revenues. The City's unreserved General Fund balance is composed of the economic uncertainty reserve and unassigned fund balance. The economic uncertainty reserve is one component of the City's rainy-day fund. The City Council's stated policy goal is to achieve a reserve equal to 10 percent of annual budgeted General Fund and Measure U Fund revenues and a target reserve equal to two months of regular ongoing General Fund and Measure U Fund expenditures, including transfers.[9]

Unassigned fund balance is a residual after other categories of the General and Measure U Funds measures have been accounted for. Sacramento has had unassigned and reserves equal to more than 10 percent of General and Measure U Funds revenues since 2014. This means that the City's available financial resources were equal to, or above, 10 percent of its annual General and Measure U Funds' revenues. The reserve balance has gradually risen to a range of 15-17 percent of General and Measure U Funds' revenues over the past five years. In 2021 the reserve balance was 14 percent of General and Measure U fund revenues.

Figure 15 below identifies the City's short-run financial position by fiscal year and compares it to the minimum, average, and maximum ratios of the other benchmarked cities. Sacramento was below the benchmark average during fiscal years 2011 and 2012. However, the ratio has subsequently surpassed the other cities' average.

[9] Although the City's policy goal is to achieve a reserve equal to 10 percent of annual budgeted General Fund and Measure U Fund revenues, the modified 10-point test requires that the ratio be calculated using actual revenue. As a result, the calculated reserve for this report may differ from City's reported figures which use the budgeted amount.

Figure 15: Short-Run Financial Position Ratio



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

The figure below shows that Sacramento has improved in this ratio over the past decade, moving from 5th place among its peers to as high as first place in 2016. Sacramento was subsequently tied in first in 2017 and 2018 and was in second place between 2019 (tied) and 2020. General Fund revenue increased in 2021 while the unreserved General Fund balance dipped to just above its 2019 level. This led to the City dropping slightly and it is currently tied for third place in 2021.

Figure 16: Sacramento's Short-run Position Compared to Benchmark Cities

Rank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1st	14%	13%	14%	14%	16%	**16%**	16%	15%	18%	20%	23%
2nd	9%	12%	13%	**13%**	14%	15%	**16%**	**15%**	**15%**	**17%**	21%
3rd	8%	9%	9%	11%	**13%**	15%	15%	14%	15%	15%	14%
4th	7%	7%	**8%**	6%	11%	12%	13%	12%	14%	9%	**14%**
5th	**4%**	**6%**	4%	5%	8%	11%	9%	12%	14%	9%	11%
6th	0%	0%	2%	4%	7%	9%	9%	10%	13%	7%	8%
7th			-3%	4%	6%	7%	9%	8%	11%	7%	8%

Note: Fresno's financial reports for 2011 and 2012 were not electronically available, which results in only six rankings for 2011 and 2012.
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

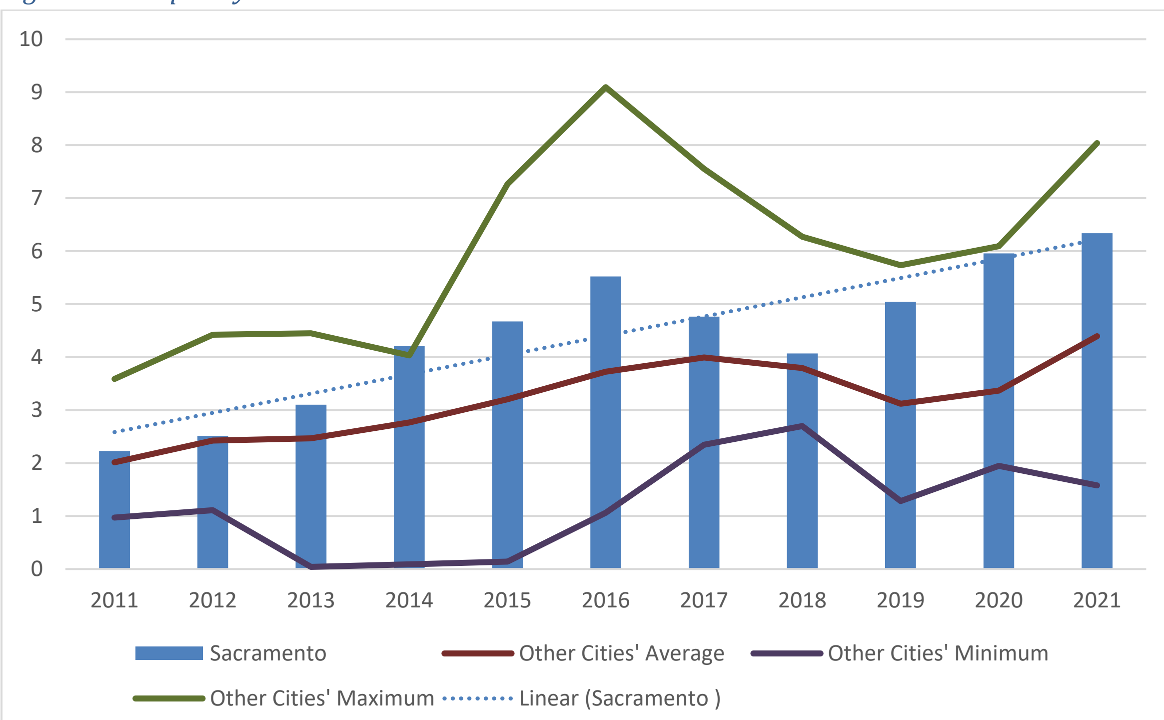
Ratio 2: Liquidity

The liquidity ratio measures the City's ability to meet its short-term obligations with current assets. A higher ratio suggests a greater capacity for paying off short-run obligations. A ratio below 1.0 indicates an inability to pay current obligations.

The liquidity ratio is calculated by dividing cash and investments held in the General Fund (including the Measure U Fund for Sacramento) by General Fund liabilities. The liabilities data includes deferred or unearned revenues, which must be subtracted before the calculation. These are resources that are not expected to be collected within a timeline to finance current expenditures.[10]

Sacramento's liquidity ratio was 6.3 in 2021, which means that its resources that are most readily converted to cash amount to more than six times the obligations it must pay in the next year. Sacramento's performance on this ratio, shown in the figure below, has improved over the benchmarking period, despite year-to-year fluctuations. In 2011 its ratio was 2.2. Sacramento's scores consistently surpassed the benchmark average over the 11-year period. Its score in 2021 ranked it in the second quartile, and it earned one point.

Figure: 17: Liquidity Ratio



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Sacramento's performance in ratio 2 compares favorably with the peer comparison group. The figure below shows that Sacramento has remained in 3rd place or better in all but one of the benchmarking

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[10] Prior to the implementation of GASB 65, cities reported deferred inflows of resources under General Fund liabilities. Deferred revenues are resources that do not yet qualify to be considered revenues, such as taxes that are expected to be collected but are not expected to be collected in the short-term and will not be available to finance current expenditures. The GASB statement broke these revenues out of the liabilities section. Sacramento, for instance, included these funds until 2014. In such cases they were removed from the liabilities category for the calculation. The liabilities section still included unearned revenue, which was removed.

years. The City's performance was above average for benchmark cities. This suggests that Sacramento's capacity to pay current bills is better than most of its peer group. In 2021 Sacramento's score increased even though its performance against the peer group declined from second to third place.

Figure 18: Sacramento's Liquidity Compared to Benchmark Cities

Rank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1st	3.6	4.4	4.4	**4.2**	7.3	9.1	7.6	6.3	5.7	6.1	8.0
2nd	2.5	3.0	3.4	4.0	**4.7**	**5.5**	**4.8**	**4.1**	**5.0**	**6.0**	7.4
3rd	**2.2**	**2.5**	3.2	3.9	4.1	4.2	4.1	3.8	4.3	5.8	**6.3**
4th	1.9	2.0	**3.1**	3.4	3.3	3.2	3.9	3.7	2.7	2.3	5.3
5th	1.1	1.6	2.1	3.4	2.7	2.5	3.6	3.4	2.5	2.0	2.1
6th	1.0	1.1	1.6	1.8	1.8	2.2	2.5	2.9	2.2	2.0	2.0
7th			0.0	0.1	0.1	1.1	2.3	2.7	1.3	1.9	1.6

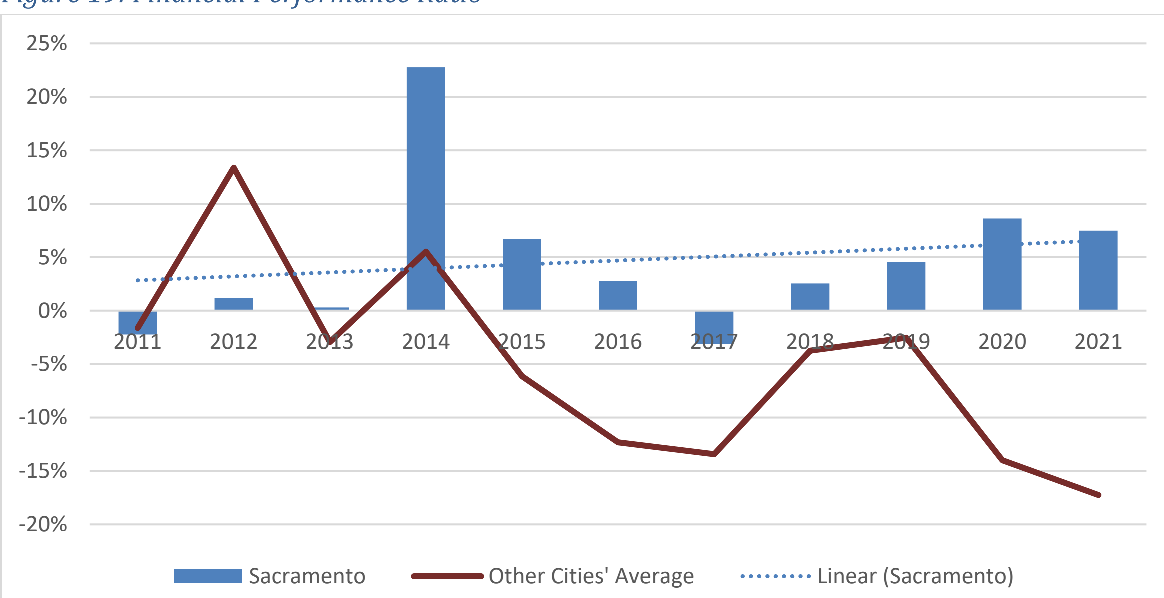
Note: Fresno's financial reports for 2011 and 2012 were not electronically available, which results in only six rankings for 2011 and 2012.
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Ratio 3: Financial Performance

The financial performance ratio measures the rate at which a city is making ends meet each year. Utilizing the change in net assets for governmental activities, this ratio demonstrates how well the City was able to pay expenses with revenues from a specific year. The ratio is calculated by dividing the change in governmental activities net assets by total governmental activities net assets. A high ratio suggests that annual costs are being adequately financed and financial position is improving.

The benchmark cities had a wider variance on this ratio than in others. Therefore, figure 19 displays Sacramento's result with the benchmark average excluding other cities' maximum and minimum.

Figure 19: Financial Performance Ratio



Note: The financial performance ratio of the City of Long Beach was an outlier and was excluded from this analysis.
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Figure 20 shows Sacramento's performance compared to the benchmark cities in ratio 3 has followed a stair-step progression over the benchmark period. In 2011 Sacramento was down in 5th place before moving to first in 2014. Then the ranking stayed fairly consistent near the third rank for a few years. Sacramento's financial performance was improving in the last couple of years until 2021, when the level fell off slightly. However, annual costs appear to be adequately financed.

Figure 20: Sacramento's Financial Performance Compared to Benchmark Cities

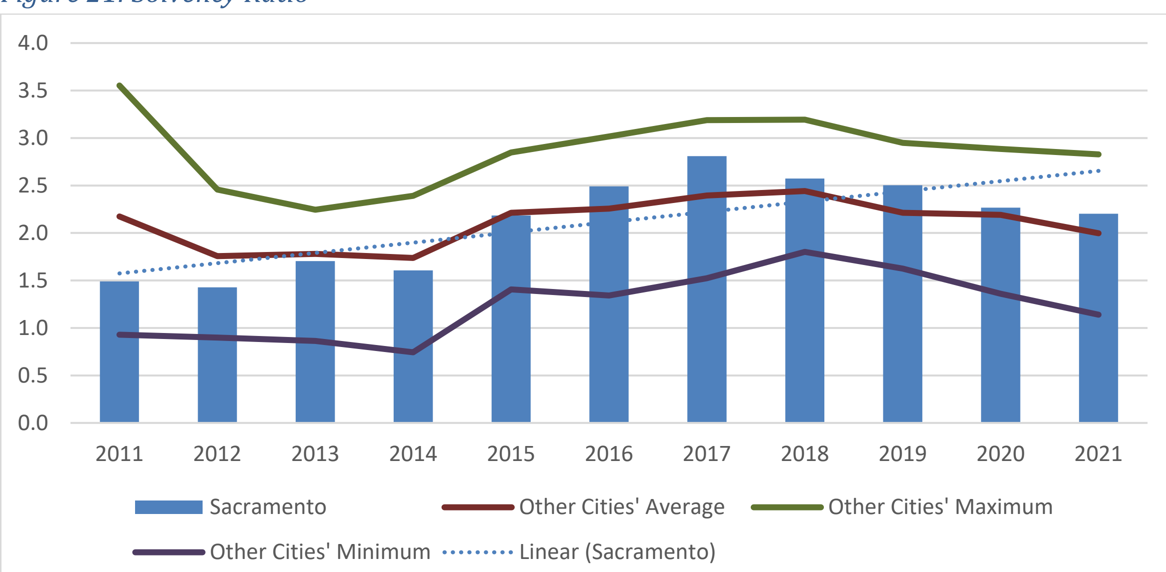
Rank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1st	9%	36%	9%	**23%**	55%	10%	6%	4%	9%	94%	85%
2nd	6%	29%	6%	18%	11%	**3%**	4%	4%	6%	**9%**	11%
3rd	0%	11%	**0%**	7%	**7%**	3%	-3%	3%	**5%**	4%	9%
4th	-1%	**1%**	0%	4%	0%	0%	**-3%**	**3%**	2%	2%	**7%**
5th	**-2%**	-3%	-2%	4%	-2%	-2%	-7%	-11%	1%	-2%	-3%
6th	-5%	-7%	-7%	2%	-6%	-7%	-67%	-19%	-31%	-9%	-12%
7th	-9%	-22%	-14%	-4%	-95%	-73%	-211%	-121%	-621%	-65%	-91%

Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Ratio 4: Solvency

The solvency ratio adds a long-run dimension to the analysis of the City's operating position. It is an indicator of the City's overall capacity for repaying or otherwise satisfying its outstanding obligations. Ratio 4 is calculated by dividing primary government liabilities (less deferred revenue) by primary government revenues. A low ratio suggests that annual revenues are sufficient for satisfying the City's outstanding obligations. Figure 21 shows Sacramento's performance on this indicator deteriorated during the benchmark period. In 2011 the City's ratio was 1.5 and rose to 2.2 in 2021. The current ratio is down from its peak of 2.8 in 2017, however.

Figure 21: Solvency Ratio



Note: A lower ratio is more favorable for this ratio.

Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Sacramento's position in ratio 4 deteriorated quickly from 2014 to 2017. Although its score has been improving slightly each year since, it has generally stayed in fifth place since 2017.

Figure 22: Sacramento's Solvency Compared to Benchmark Cities

Rank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1st	0.9	0.9	0.9	0.7	1.4	1.3	1.5	1.8	1.6	1.4	1.1
2nd	**1.5**	**1.4**	1.4	**1.6**	1.6	1.7	1.7	1.9	1.6	1.6	1.6
3rd	1.7	1.6	**1.7**	1.6	**2.2**	2.3	2.4	2.1	1.9	2.1	1.9
4th	2.2	1.6	1.9	1.7	2.2	**2.5**	2.7	2.5	2.4	**2.3**	2.0
5th	2.5	2.2	2.0	1.7	2.5	2.6	**2.8**	**2.6**	**2.5**	2.6	**2.2**
6th	3.6	2.5	2.2	2.2	2.6	2.6	2.9	3.2	2.8	2.6	2.6
7th			2.2	2.4	2.8	3.0	3.2	3.2	2.9	2.9	2.8

Note: A lower ratio is more favorable for this ratio.
Fresno's financial reports for 2011 and 2012 were not electronically available, which results in only six rankings for 2011 and 2012.
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Revenues

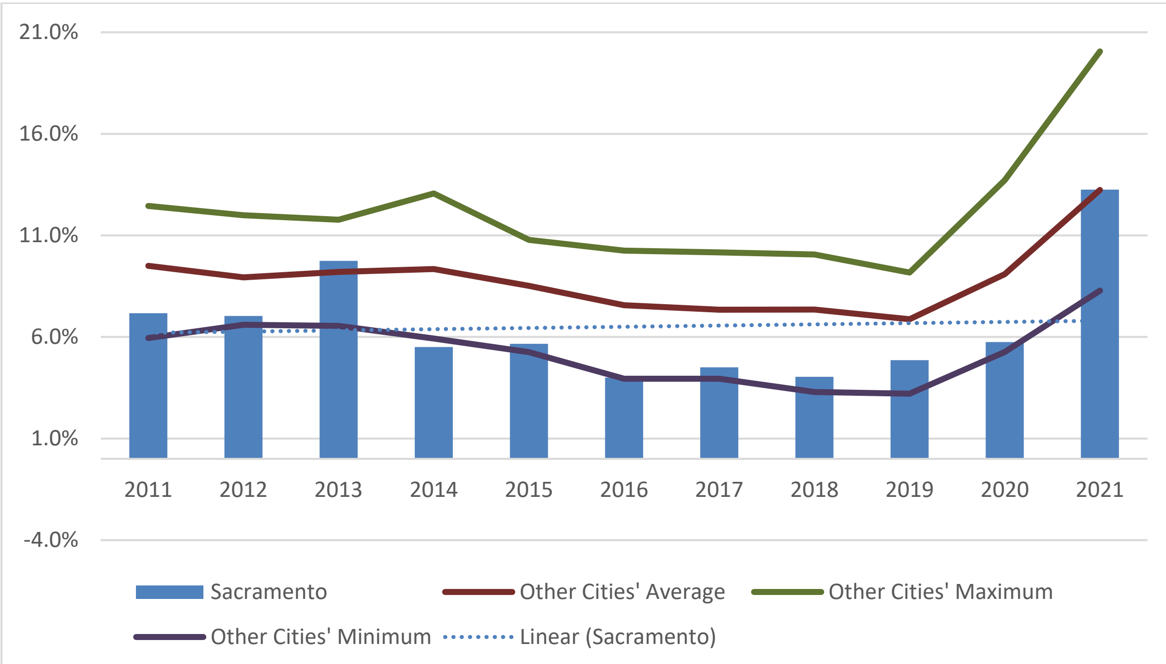
This section presents two measures of Sacramento's revenue. The first ratio is a measure of the dependence on intergovernmental aid (ratio 5). The second is a measure of how reliant revenues are on general taxes versus business services charges and other fees (ratio 6). Together, these two ratios present a long-term and government-wide perspective to the overall assessment of the City's financial condition.

Ratio 5: Primary Government Revenues

The primary government revenues ratio provides a measure of the sources of the City's revenues. To calculate the ratio, primary government operating grants and contributions and unrestricted aid are divided by total primary government revenues. The ratio considers different sources of revenues of the primary government, including business-type activities. Intergovernmental aid is revenue transferred from another level of government. Reliance on intergovernmental aid can be risky during an economic downturn because federal and state agencies frequently withdraw or reduce payments to local governments as a cutback measure. A low ratio suggests a government is not heavily reliant on intergovernmental aid. Ratio 5 is displayed in figure 23 below.

In Sacramento's case, its ratio was 7.2 percent in 2011. This means that around 7.2 percent of the City's total revenue was in the form of intergovernmental operating support. The impact of the pandemic is especially evident in this ratio when the federal and state governments directly transferred billions of dollars to local governments. In 2020 there was a modest increase to 5.8 from 4.9 percent, but the ratio more than doubled in 2021 to 13.3 percent. This increase does not indicate a long-term trend but is instead a result of a sharp increase in operating grants and contributions, which increased from just over $77 million to more than $186 million. Operating grants and contributions revenue increased $110 million primarily due to funding the City received from the Coronavirus Aid, Relief, and Economic Security (CARES) Act program, Sacramento Emergency Rental Assistance program, Whole Person Care program, and the Great Plates Delivery program. The impacts of the pandemic, and the associated state and federal response, will likely be felt for many years.

Figure 23: Primary Government Revenues Ratio



Note: A lower ratio is more favorable for this ratio.

Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Figure 24 shows that Sacramento has not been as dependent on intergovernmental aids and grants as some of the benchmark cities. Sacramento relied on government grants to cope with the pandemic and 2021's result appears to be an outlier, relative to its experience.

Although a lower ratio is scored positively, it is important for local governments to maximize the acquisition of state and federal grants as they directly benefit the local economy. However, for cities that are more reliant on external financial assistance, they must incorporate into their budget planning potential impacts of economic downturns. These events can suddenly reduce the availability of intergovernmental funding. Sacramento is still benefitting from pandemic relief and will have to adjust as this support dissipates.

Figure 24: Sacramento's Primary Government Revenues Compared to Benchmark Cities

Rank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1st	5.9%	6.6%	6.5%	**5.5%**	5.3%	3.9%	3.9%	3.3%	3.2%	5.3%	8.3%
2nd	6.6%	**7.0%**	6.9%	5.9%	**5.7%**	**4.0%**	4.3%	**4.0%**	4.4%	**5.8%**	10.4%
3rd	**7.2%**	7.4%	8.2%	6.1%	5.7%	5.6%	**4.5%**	5.2%	**4.9%**	6.6%	11.2%
4th	10.1%	9.2%	**9.7%**	9.2%	8.9%	8.3%	7.7%	6.2%	7.3%	8.4%	12.9%
5th	12.4%	9.4%	10.2%	9.5%	9.9%	8.4%	8.4%	9.3%	8.3%	9.9%	**13.3%**
6th	12.4%	12.0%	11.6%	12.3%	10.5%	9.0%	9.5%	10.0%	8.9%	10.7%	16.5%
7th			11.8%	13.1%	10.8%	10.2%	10.2%	10.1%	9.2%	13.7%	20.1%

Note: A lower ratio is more favorable for this ratio.

Fresno's financial reports for 2011 and 2012 were not electronically available, which results in only six rankings for 2011 and 2012.

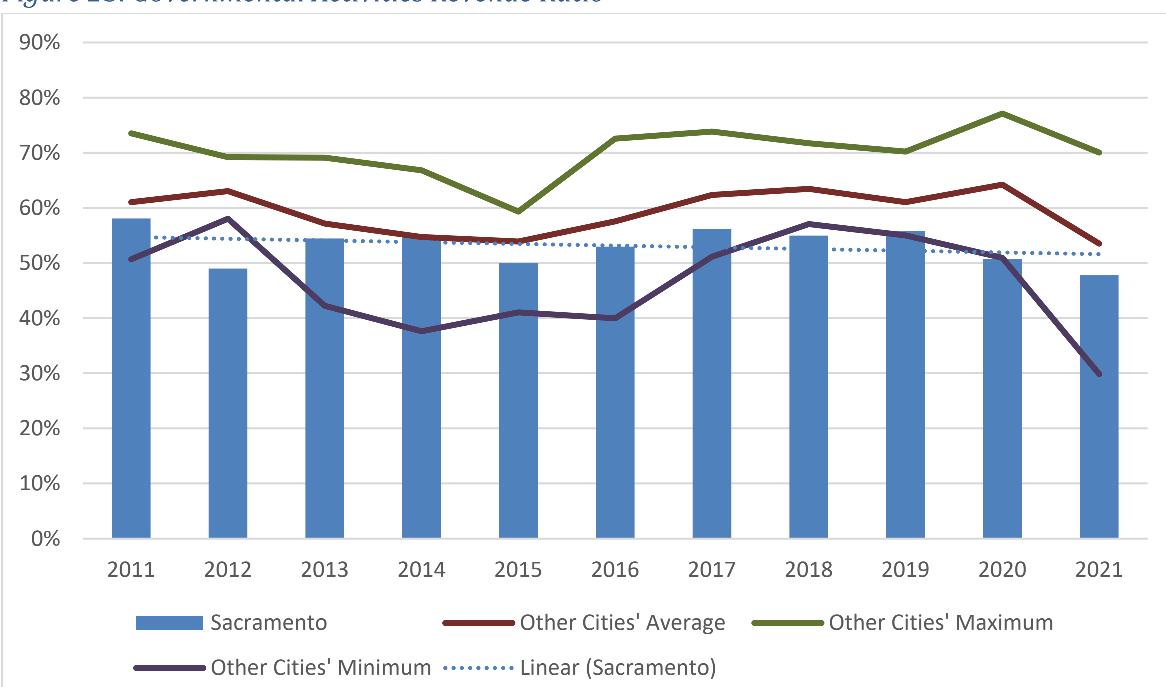
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Ratio 6: Governmental Activities Revenues

The governmental activities revenues ratio measures the extent to which governmental activities functions and programs are self-financed through charges, fees, and categorical grants, or whether they are supported by taxes and other general revenues. Net revenue (expense) for governmental activities is divided by total governmental activities expenses and multiplied by negative one because net revenue is typically a negative number. A low ratio suggests basic government services are more self-sufficient and less reliant on general tax support.

Figure 25 shows that Sacramento has maintained relatively consistent taxpayer support for governmental activities, ranging between 48 percent and 58 percent during the review period.

Figure 25: Governmental Activities Revenue Ratio



Note: A lower ratio is more favorable for this ratio.

Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Furthermore, figure 26 shows Sacramento's ratio has tightened in recent years to a range between 48 and 56 percent and its ranking against its peers has generally stayed in the top three over the past decade. In 2021 the ratio was down to 48 percent from 51 percent in 2020 when the pandemic caused a slowdown in economic activity.

Figure 26: Sacramento's Governmental Activities Revenue Compared to Benchmark Cities

Rank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1st	51%	49%	42%	38%	41%	40%	51%	55%	55%	51%	30%
2nd	53%	58%	53%	51%	50%	48%	55%	57%	56%	51%	37%
3rd	58%	60%	54%	51%	50%	53%	56%	58%	56%	57%	48%
4th	61%	61%	56%	55%	57%	59%	61%	59%	57%	65%	58%
5th	68%	67%	58%	60%	57%	61%	66%	67%	63%	66%	59%
6th	74%	69%	65%	62%	59%	65%	67%	68%	65%	69%	67%
7th			69%	67%	59%	73%	74%	72%	70%	77%	70%

Note: A lower ratio is more favorable for this ratio.
Fresno's financial reports for 2011 and 2012 were not electronically available, which results in only six rankings for 2011 and 2012.
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Debt

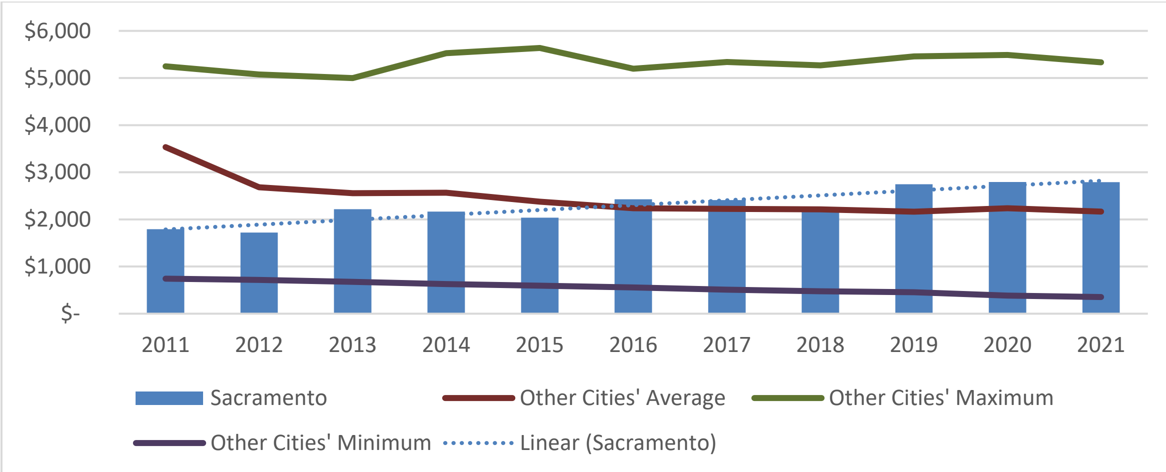
Debt can be an effective way to finance long-term expenditures, such as capital outlays. However, an overreliance on debt can adversely impact the City's financial condition. This section presents three measures of Sacramento's debt burden.

Ratio 7: Primary Governmental Debt Burden Per Capita

The primary government debt burden per capita ratio identifies the level of long-term debt burden on the City's residents. The ratio is calculated by dividing total outstanding primary government long-term debt by the City's population. A low ratio suggests less burden on taxpayers and greater capacity for additional borrowing.

The total outstanding debt for the City of Sacramento was more than $1.4 billion in 2021. Adjusted by population, the City's per capita debt burden decreased slightly in 2021 to $2,790 from $2,795 in 2020. The lowest per capita debt level, $1,721, occurred in 2012. Sacramento was above the benchmark average between 2016 and 2021.

Figure 27: Primary Governmental Debt Per Capita Ratio



Note: A lower ratio is more favorable for this ratio.
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Sacramento's per capita debt was below the benchmark average until 2015 but has surpassed the benchmark average since 2016. This suggests the City is in a worse position relative to its peers to repay outstanding debt. This also complicates the prospects for future borrowing. In the peer rankings, displayed in figure 28 below, Sacramento has trended down over the review period.

Figure 28: Sacramento's Per-Capita Debt Compared to Benchmark Cities

Rank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1st	$743	$715	$674	$628	$596	$557	$508	$474	$454	$384	$353
2nd	$1,792	$1,721	$1,815	$1,750	$1,516	$1,440	$1,345	$1,314	$1,195	$1,534	$1,482
3rd	$2,657	$2,171	$2,171	$2,144	$1,662	$1,664	$1,818	$2,008	$1,844	$1,715	$1,661
4th	$4,002	$2,396	$2,218	$2,165	$2,038	$2,139	$2,049	$2,043	$1,987	$2,115	$1,938
5th	$5,021	$3,048	$2,790	$2,598	$2,275	$2,426	$2,278	$2,164	$2,043	$2,190	$2,225
6th	$5,247	$5,074	$2,888	$2,757	$2,574	$2,429	$2,409	$2,231	$2,746	$2,795	$2,790
7th			$4,998	$5,527	$5,637	$5,196	$5,340	$5,269	$5,460	$5,488	$5,333

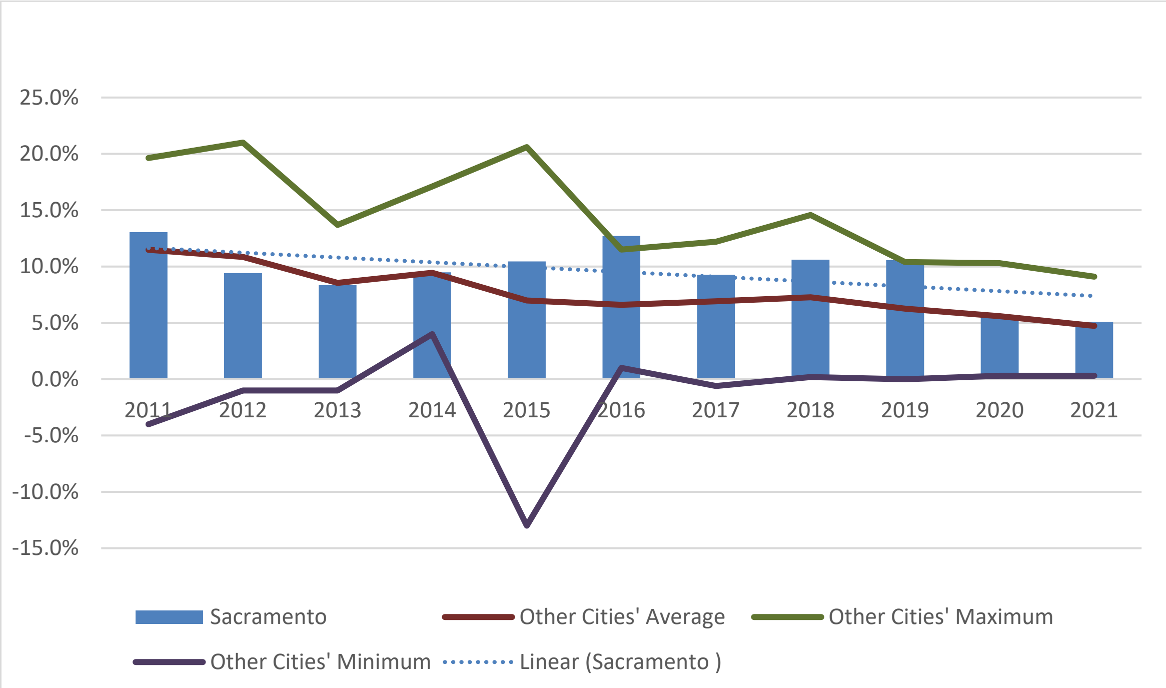
Note: A lower ratio is more favorable for this ratio.
Fresno's financial reports for 2011 and 2012 were not electronically available, which results in only six rankings for 2011 and 2012.
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Ratio 8: Governmental Funds Debt Coverage

The government funds debt coverage ratio measures debt service expenditures in relation to operating costs. These expenditures are the annual amount of principal and interest on long-term debt and the amount of interest on short-term debt that a city must pay each year. The ratio is calculated by dividing debt service expenditures by noncapital governmental funds expenditures. Debt service expenditures reduce spending flexibility by adding to a city's obligations and can be a major component of fixed costs. A low ratio suggests general governmental long-term debt can be more easily repaid when it comes due.

The figure below shows that Sacramento's government funds debt coverage ratio was near the average of the benchmarked cities in the first years of the benchmarking period. It broke away from the average in 2015 and has remained above it since, however the difference has narrowed in recent years. The level declined in 2020 and 2021 and Sacramento is now much closer to the other cities' average.

Figure 29: Governmental Funds Debt Coverage Ratio



Note: A lower ratio is more favorable for this ratio.

Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Sacramento's management of debt in the first few years of the review placed it in a middle range amongst its peers. The figure below shows the City's highest ranking was third place in 2012 and that its ranking held steady in fourth place until 2015. Its performance since has placed it between fourth and last place. Sacramento's performance improved in 2020 and 2021 as the data show the calculated ratio declined from 10.6 percent in 2019 to 5.7 percent in 2020 and 5.1 percent in 2021. The City's peers have also improved during the benchmarking period.

Figure 30: Sacramento's Governmental Funds Debt Coverage Compared to Benchmark Cities

Rank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1st	-4.0%	-1.0%	-1.0%	4.0%	-13.0%	1.0%	-0.6%	0.2%	0.0%	0.3%	0.3%
2nd	5.9%	4.5%	6.1%	6.0%	5.2%	2.4%	5.0%	3.0%	4.4%	2.4%	1.9%
3rd	12.9%	**9.4%**	7.9%	7.3%	5.6%	5.4%	6.7%	5.6%	6.1%	4.0%	3.5%
4th	**13.1%**	9.6%	**8.4%**	**9.5%**	**10.5%**	8.3%	7.9%	9.1%	7.9%	**5.7%**	**5.1%**
5th	15.6%	13.1%	12.3%	9.8%	11.6%	11.0%	**9.3%**	**10.6%**	8.8%	8.2%	6.6%
6th	18.9%	17.9%	12.4%	12.5%	11.9%	11.5%	10.3%	11.1%	10.4%	8.4%	7.1%
7th	19.6%	21.0%	13.7%	17.1%	20.6%	**12.7%**	12.2%	14.6%	**10.6%**	10.3%	9.1%

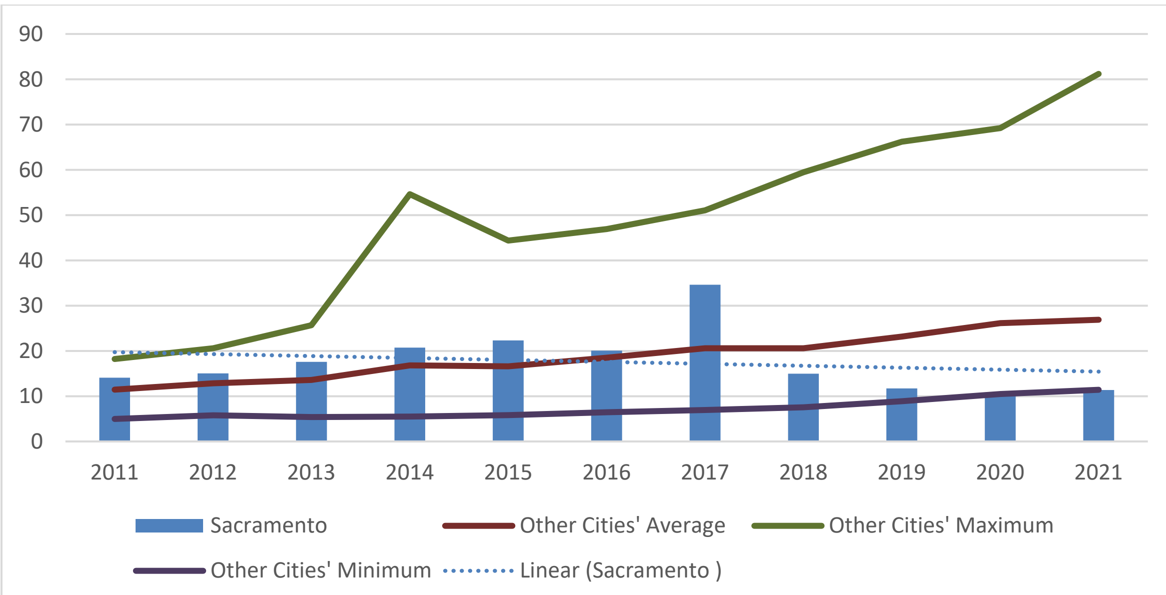
Note: A lower ratio is more favorable for this ratio.

Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Ratio 9: Enterprise Funds Debt Coverage

The enterprise funds debt coverage ratio is a measure of the sufficiency of resources available to repay enterprise debt. Enterprise funds are used to account for self-supporting City programs that provide services on a user-fee basis to the general public. The amount and types of enterprise funds may differ between cities. The ratio is calculated by dividing enterprise funds operating revenue and interest expense by interest expense. A high ratio suggests greater resource availability for repaying the debts of enterprise activities as they come due. The figure below shows Sacramento's ratio was slightly above the other cities' average until 2017. The notable increase in 2017 was due to a decline in interest expense in the water, solid waste, and other enterprise funds.

Figure 31: Enterprise Funds Debt Coverage Ratio



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Sacramento's ratios were below other cities in 2018 through 2020. This suggests that Sacramento is in a worse position to repay enterprise fund debt than benchmark cities. Sacramento was in the bottom quartile in 2021 and therefore the City loses one point.

Figure 32: Sacramento's Enterprise Funds Debt Coverage Compared to Benchmark Cities

Rank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1st	18.2	20.6	25.7	54.6	44.4	46.9	51.1	59.5	66.2	69.2	81.2
2nd	17.0	20.3	23.2	**20.7**	**22.3**	21.6	**34.6**	16.6	18.6	35.7	24.0
3rd	**14.1**	**15.0**	**17.6**	12.1	18.6	**20.1**	23.8	15.8	17.6	15.5	16.0
4th	10.3	9.9	11.1	11.5	13.0	14.9	18.6	15.3	17.1	13.8	14.9
5th	6.8	7.7	10.6	11.3	11.6	14.5	15.7	**15.0**	**11.7**	12.1	13.8
6th	5.0	5.8	5.5	5.9	6.0	6.6	7.4	8.9	10.6	**10.8**	11.4
7th			5.4	5.5	5.8	6.5	6.9	7.6	8.9	10.5	**11.4**

Note: Fresno's financial reports for 2011 and 2012 were not electronically available, which results in only six rankings for 2011 and 2012.
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

The three debt ratios in this section highlight a challenge for Sacramento at a time when the City wants to issue additional debt to tackle a myriad of problems. The City recently engaged its primary municipal advisor, Fieldman, Rolapp & Associates, Inc., to review the impact that a new long-term bond issue, to combat homelessness and increase affordable housing, would have to the City's General Fund budget and projections. The feasibility analysis estimated that the City's General Fund revenues, including Measure U revenues, are projected to increase at an average annual growth rate of 1.95 percent to over $896.6 million in fiscal year 2032. Total expenditures, including Measure U expenditures, are projected to increase 3.1 percent per year to $975.5 million in fiscal year 2032. Over the 10-year timeframe, expenditures outpace revenues resulting in an aggregate deficit of $169.4 million. The advisors concluded that given the financial model forecast, "the City does not have the capacity to absorb additional General Fund-backed debt obligations at this time without making severe structural changes to expenditures and the services currently being provided or without any new revenue sources."

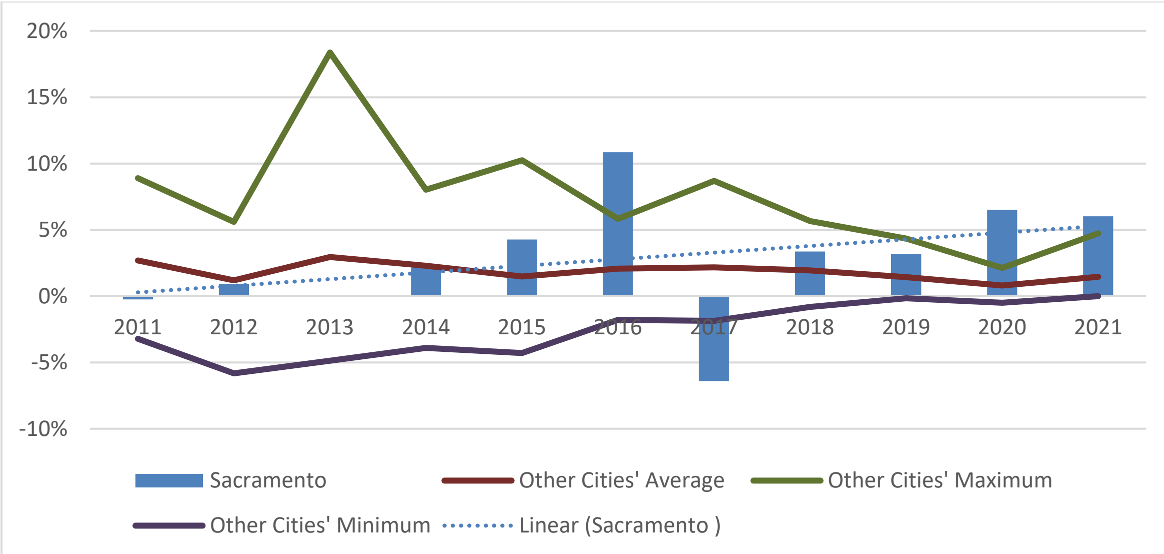
Capital Assets

Cities frequently initiate new capital asset projects to enhance quality of life. It is also important for city leaders to reinvest in their existing assets, such as buildings, streets, and other resources, to preserve and protect them. If cities do not adequately maintain their assets, their usefulness may decline, maintenance costs may rise, and it may ultimately dampen the quality of life of residents.

Ratio 10: Capital Assets

The capital assets ratio measures the change of the net value of capital assets. It is a measure of whether a government is keeping pace, on average, with the aging of its capital assets. The ratio is calculated by subtracting the beginning net value of primary government capital assets from the ending net value and then dividing this result by the beginning net value. A positive percentage change suggests the capital assets are being replenished; a negative number suggests they are being depleted. As shown in figure 33 below, the City's capital assets ratio was positive for most of the years in the benchmarking period. Two years, 2016 and 2017, stand out for the rapid increase in 2016 and sharp downturn in 2017. In 2016 the City added $223 million for the Golden 1 Center. Although the City made several notable capital asset additions in 2017, the year's major capital asset deletion included the sale of the Golden 1 Center in the amount of $223 million.

Figure 33: Capital Assets Ratio



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Cities frequently defer capital investments in periods of financial stress because it can be a relatively painless method of conserving scarce resources. Sacramento, for example, kept its investment in capital assets low following the 2007-2009 recession. The rate of investment gradually improved as the City regained its financial footing. Sacramento's investment was initially subdued, but despite year-to-year fluctuations, the City's general performance trended upward during the benchmark period. Sacramento surpassed the benchmark average for the past four years, but its performance has fluctuated over the years. Sacramento ranked in the top quartile in 2019 through 2021 and earned two points. This is the only indicator that earned two points in 2021.

Figure 34: Sacramento's Capital Assets Compared to Benchmark Cities

Rank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1st	8.9%	5.6%	18.4%	8.0%	10.2%	**10.9%**	8.7%	5.7%	4.3%	**6.5%**	**6.0%**
2nd	4.3%	4.7%	5.6%	7.3%	5.0%	5.8%	4.3%	5.3%	**3.2%**	2.1%	4.7%
3rd	3.2%	2.9%	1.0%	**2.2%**	**4.3%**	5.1%	3.6%	**3.4%**	2.0%	2.0%	2.6%
4th	0.3%	**0.9%**	**0.0%**	1.8%	1.5%	4.1%	-0.5%	0.7%	1.3%	0.9%	1.0%
5th	**-0.3%**	-1.4%	-0.2%	1.5%	-0.2%	0.8%	-1.2%	0.7%	0.7%	0.2%	0.2%
6th	-3.2%	-5.8%	-2.1%	-1.0%	-3.4%	-1.6%	-1.9%	0.1%	0.5%	0.1%	0.2%
7th			-4.9%	-3.9%	-4.3%	-1.8%	**-6.4%**	-0.8%	-0.2%	-0.5%	0.0%

Note: Fresno's financial reports for 2011 and 2012 were not electronically available, which results in only six rankings for 2011 and 2012.
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Despite Sacramento's comparatively strong performance on this ratio in the last three years, the next few years will likely be difficult for the City because certain revenue sources, like the Transient Occupancy Tax and parking fees, have been adversely impacted by the pandemic. This has forced the City to prioritize only the most critical investments in the near term. It is also important to recognize that Sacramento has a sizeable backlog of deferred maintenance.

The Youth, Parks, and Community Enrichment Department, to highlight one example, has over $160 million in various deferred maintenance needs, including safety and accessibility issues. The department, starting in fiscal year 2022, will direct any unspent Measure U Fund appropriations in the Youth, Parks, and Community Enrichment Department to deferred maintenance until the backlog of deferred maintenance projects has been completed. In our opinion, this is an area that will have to be closely monitored because relying on unspent funds may be insufficient to reduce the backlog in a meaningful way.

Chapter 2: The ICMA Handbook and Financial Condition

This chapter draws on the financial and economic indicators included in the International City/County Management Association's (ICMA) *Evaluating Financial Condition: A Handbook for Local Government* (Handbook). The Handbook was created to provide managers of local governments with a method for monitoring financial conditions. Specifically, the Handbook enables users to: examine local financial condition; identify existing and emerging financial problems; and, if applicable, develop remedies to identified problems.

To understand and evaluate financial condition, the Handbook provides a comprehensive approach to evaluate up to 42 indicators across 11 categories. There are six financial categories: 1) revenue indicators, 2) expenditure indicators, 3) operating position indicators, 4) debt indicators, 5) unfunded liability indicators, and 6) capital plant indicators. The remaining categories are environmental factors, including issues such as the likelihood of disaster risks, political culture, and particular community needs and resources. By selecting indicators from multiple categories, it is possible to develop a better understanding of the government's financial condition.

This chapter includes indicators selected to complement the Mead 10-point test of financial condition in Chapter 1. It also includes comparisons to the benchmark group for some of the indicators, when it seems helpful to do so. However, there are no scores attached to the benchmarked indicators. This chapter uses a selection of the indicators available but does not reproduce indicators that are already calculated in the Mead analysis or presented in the introduction. The data are taken directly from their respective ACFRs and have not been adjusted for inflation.

Revenues

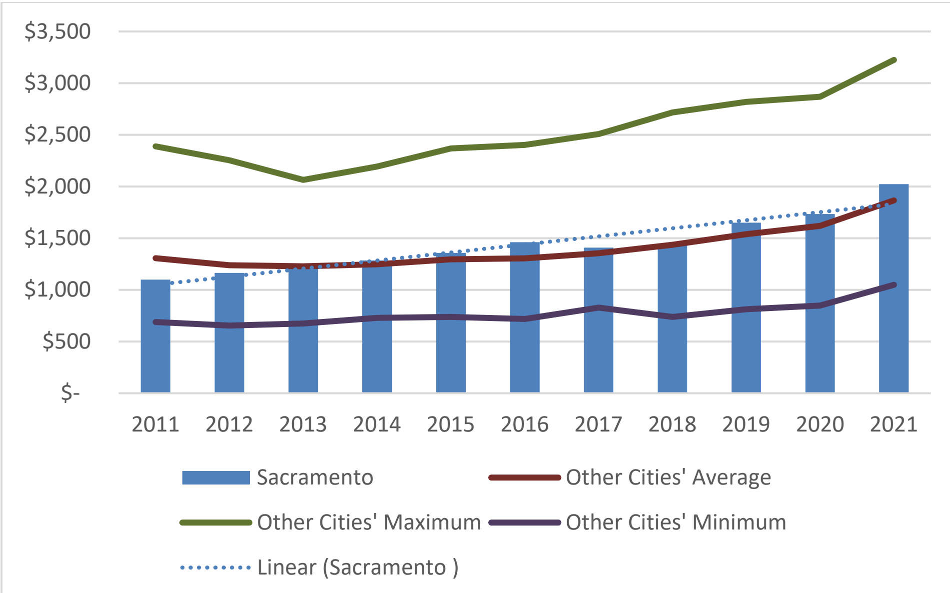
Revenues are an important determinant of a city's ability to provide services for its citizens. The Handbook identifies several important issues to consider in revenue analysis, including how dependable, diverse, and flexible the revenue sources are.

The first indicator, a measure of per capita revenue, is displayed in figure 35 below. This indicator shows changes in revenues relative to changes in population size. If the cost of services is directly related to population size, controlling for population growth can inform policymakers and the public about the health of the City's finances. If per capita revenues are decreasing over time, it may be an indication that the government will be unable to maintain existing services unless it finds cost savings or new revenue sources.

In Sacramento's case, per capita revenue growth fluctuated between a decline of 3.6 percent in 2017 to a high of 16.6 percent in 2021. There was also a notable jump of 14.2 percent in 2019, which included the additional half-cent increase in Measure U that went into effect April 1, 2019. Sacramento's per capita revenue, shown in figure 35 below, has closely tracked the benchmark average.

Per capita revenues have continued to increase during the pandemic. This does not mean that every source of revenue has improved or maintained its prior growth rate. Instead, COVID-19 led to a loss in parking revenue due to the closure of non-essential businesses and reduction of vehicle traffic, rent reductions, and temporary easing of the financial burden of fines and penalties. Temporary transfers from the federal government have lessened the impact of the pandemic.

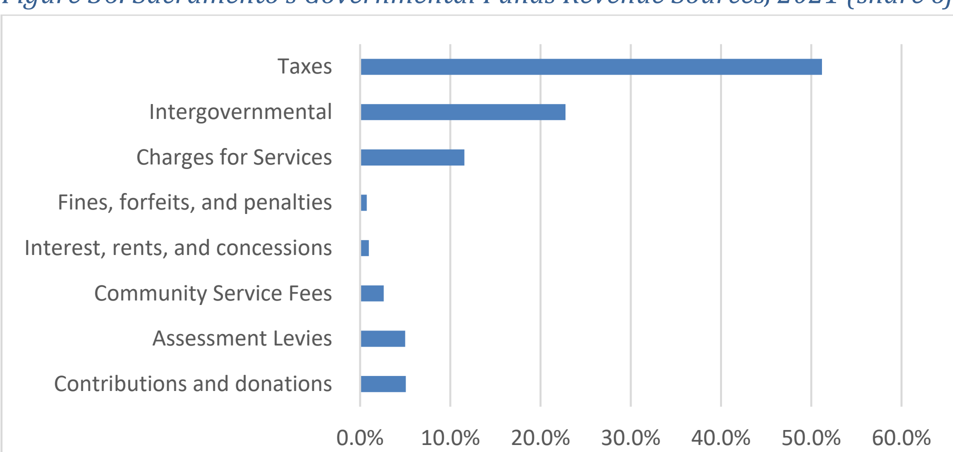
Figure 35: Sacramento's Per Capita Revenues Compared to Benchmark Cities



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Sacramento raises revenue from a mix of taxes, charges for service, and grants and contributions, among other sources. Figure 36 provides a more detailed picture of Sacramento's tax revenue sources for governmental funds. Three categories, taxes, intergovernmental, and charges for service, accounted for more than 85 percent of total revenues in 2021. The graphs of 2011 and 2021 were similar, so only 2021 is displayed.

Figure 36: Sacramento's Governmental Funds Revenue Sources, 2021 (share of total)

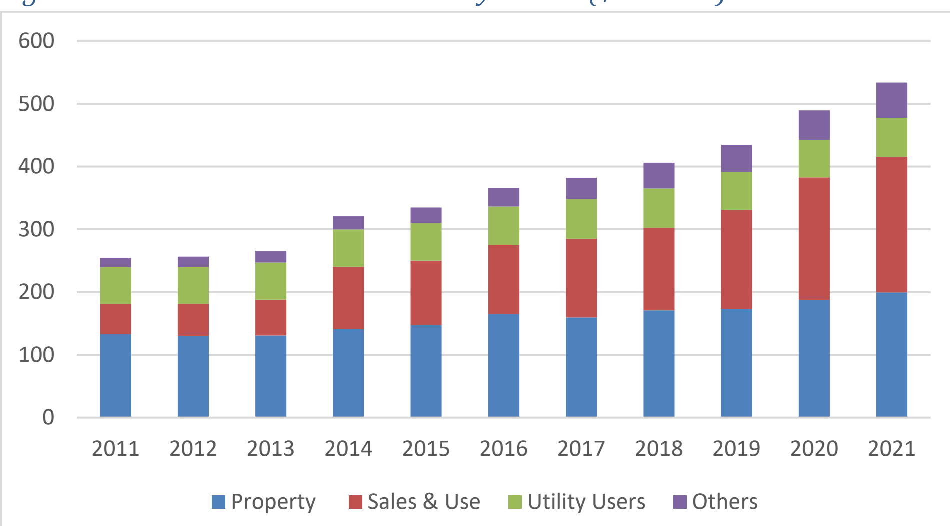


Source: Auditor generated from review of the 2021 Annual Comprehensive Financial Report of the City of Sacramento.

Tax revenues merit extra consideration because they are an important revenue source. Sacramento's tax revenue has increased from just over $250 million in 2011 to more than $500 million in 2021. Property taxes increased over the period as the housing market stabilized and prices appreciated. Property taxes rose from just over $130 million to just under $200 million between 2011 and 2021. The Utility Users tax, which is assessed against customers of gas, electric, and cable television providers, has raised a consistent amount, rising from just under $59 million in 2011 to just over $62 million in 2021. Other taxes rose from over $15 million to more than $56 million in 2021.

Another primary driver of this growth was the increase in sales tax revenue, which increased from less than $50 million in 2011 to more than $215 million in 2021. A portion of the sales tax revenue growth, shown in red in figure 37 below, is attributable to the introduction of Measure U. Measure U was approved by voters in 2012 as a temporary half-cent tax and went into effect near the end of fiscal year 2013. In 2013 the new tax raised slightly less than five million dollars. That jumped to more than $43 million in 2014, once it was in effect for the full year. Measure U was initially designed to be temporary, but in 2018 voters approved a revised version of the Measure U sales tax, which made the tax permanent and raised it from a half-cent to a full cent. Measure U revenues increased to more than $115 million in 2021.

Figure 37: Sacramento's Tax Revenue by Source ($ millions)



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

Expenditures

Expenses are the City's costs for providing services and represent the government's output. A city that spends more than its peers should provide either a greater range of services or more of a specific service. This analysis does not provide any assessment of the efficacy of a city's spending. The immediate interest is whether revenues are sufficient to cover its expenditures.

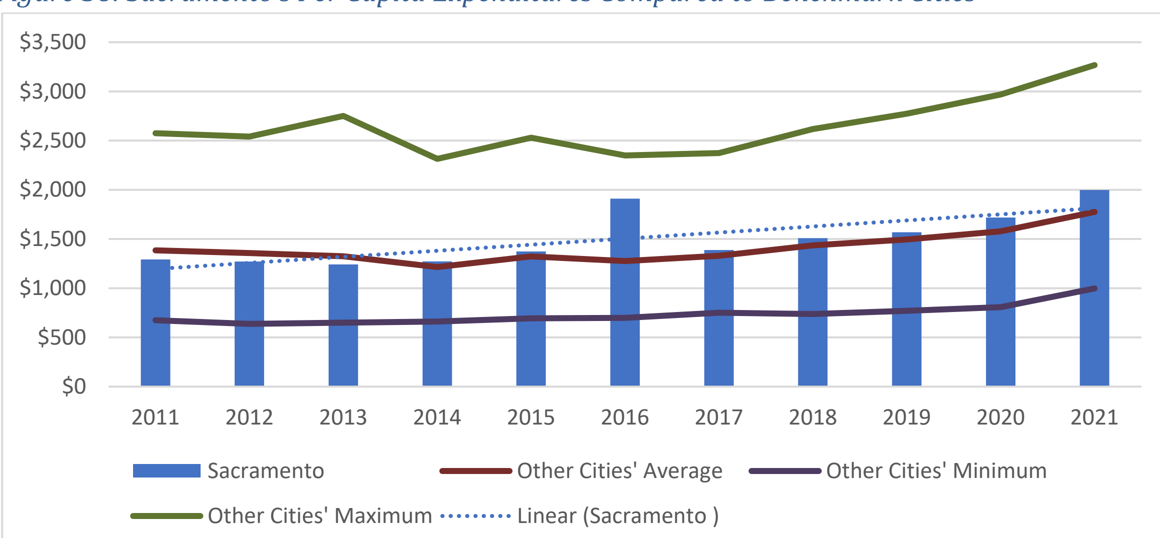
Most local governments are required to maintain a balanced budget. Therefore, it is unlikely that expenditures would exceed revenues. However, it is important to understand how cities balance their budgets because the annual budget can be balanced in a few ways that might create long-term challenges. For example, to meet short-run imbalances, city leadership could borrow, use reserves, use bond proceeds for operations, or redirect intergovernmental grants. Finally, a city might defer capital improvements or defer funding of a future pension plan liability.

Figure 38 displays Sacramento's per capita expenditures alongside the averages for other cities. This measure includes spending beyond what is in the City's General Fund. Not all cities have the same obligations. Some elect to spend more on utilities, waste removal, or other services than others, which accounts for some of the variation between cities.

Sacramento's per capita expenditure was $1,293 in 2011 and rose to $1,999 in 2021. Per capita revenues have modestly outpaced expenditures annually, in part because of Measure U as discussed above. Per capita revenues were $2,022 in 2021 (as shown in figure 35 above).

One notable feature of figure 38 is the spike in expenditures in 2016. The City's annual expenditure growth spiked with the introduction of the Golden 1 Center Capital Projects Fund in 2016, which was established to account for the Golden 1 Center project costs. In fiscal year 2016, $223 million was transferred to this fund from bond proceeds in the debt service fund and expended for the Golden 1 Center capital project.

Figure 38: Sacramento's Per Capita Expenditures Compared to Benchmark Cities



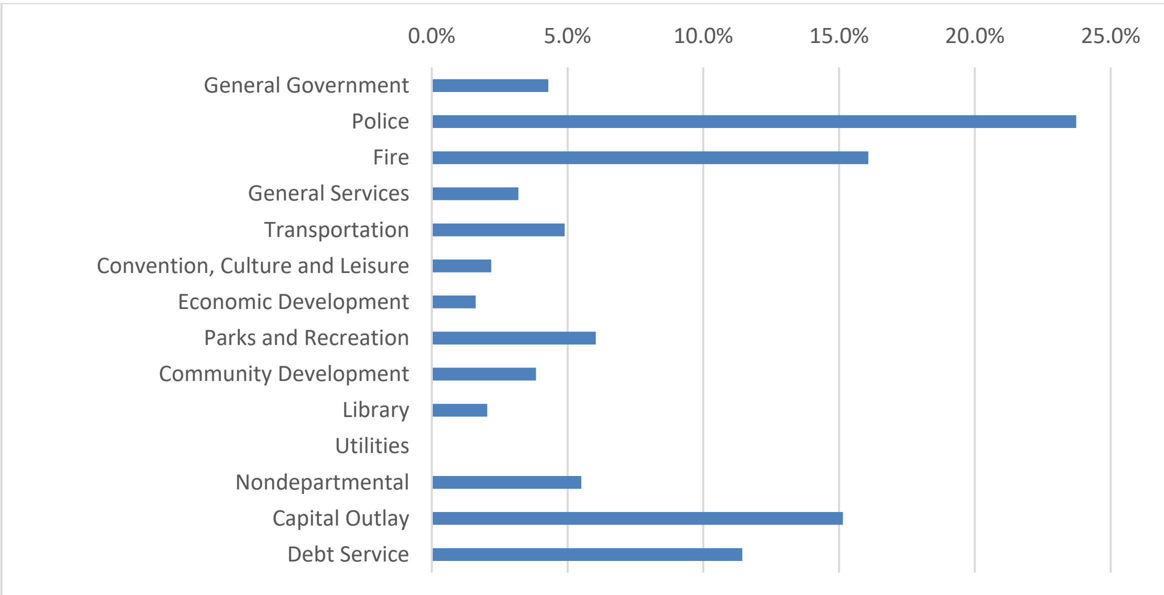
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Sacramento's governmental funds expenditures are concentrated in the programmatic areas displayed in figure 39.[11] In 2011, slightly less than 40 percent of spending went to public safety activities (police and fire). The next two largest categories, capital outlays and debt service, accounted for more than 25

[11] This measure of expenditures is for the government funds and excludes business-type funds, which are funded by specific revenue sources.

percent of total expenditures. Between 2011 and 2021 the City reorganized its operations and moved, renamed, and dissolved some departments. Therefore figure 39 and figure 40 employ slightly different department names.

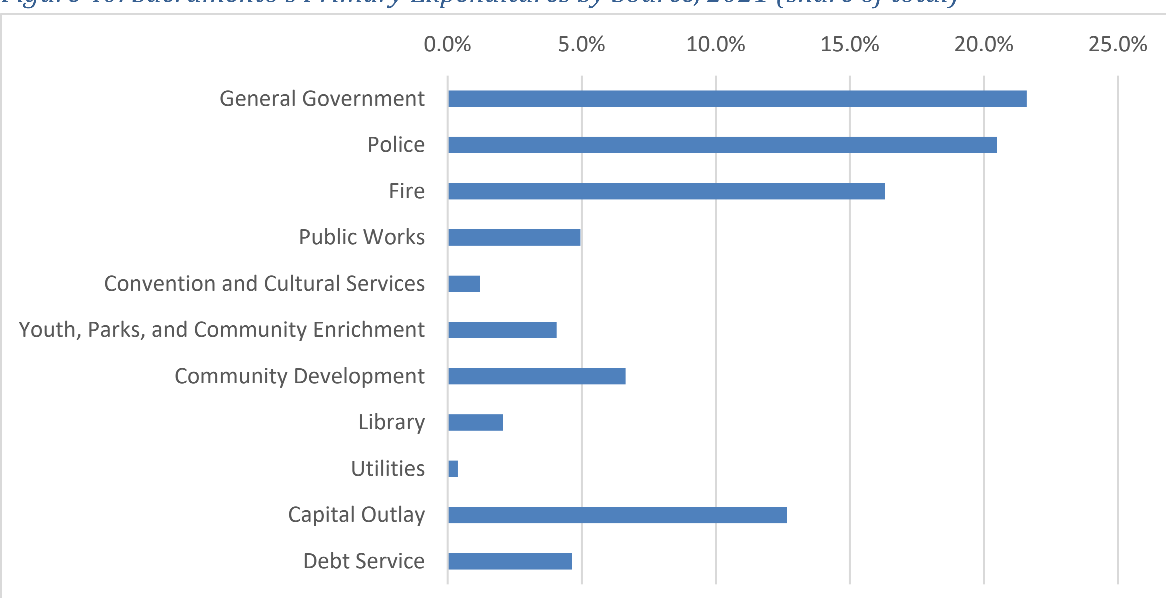
Figure 39: Sacramento's Primary Expenditures by Source, 2011 (Share of total)



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

In 2021, fire and police accounted for more than 35 percent of total expenditures and general government was just above 20 percent. Notably, expenditures on debt service declined from 11.4 percent in 2011 to 4.6 percent in 2021.

Figure 40: Sacramento's Primary Expenditures by Source, 2021 (share of total)



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

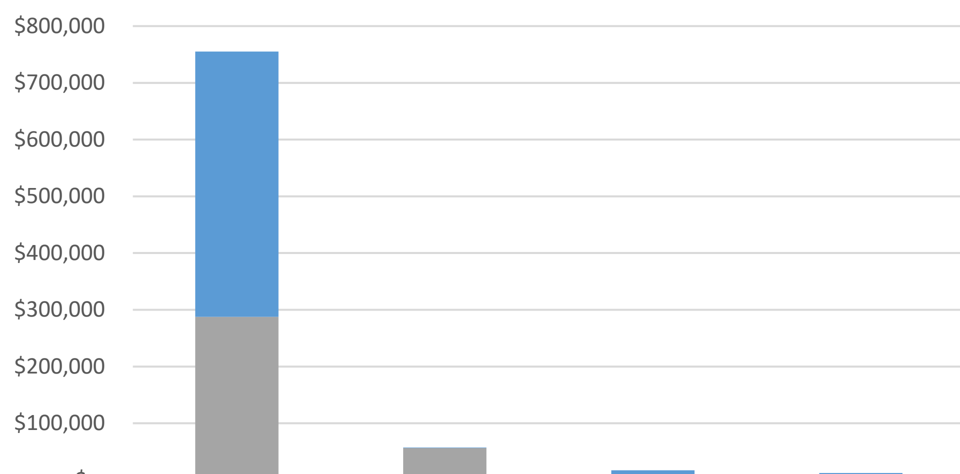
Long-Term Debt and Liabilities

Debt financing may be an effective way to finance capital improvements and long-term obligations by spreading costs over many years. While debt can be used effectively to manage long-term funding needs, its mismanagement can cause serious financial problems. California, for example, has had multiple municipal bankruptcy cases during the past three decades such as Vallejo (2008), San Bernadino (2012), and Stockton (2012). While municipal bankruptcies are uncommon, a temporary inability to repay debt can affect a city's credit score and ability to borrow.

Sacramento's long-term liabilities (not including pension and other postemployment benefits) comes from issuing bonds and incurring long-term obligations. To borrow money, the City issues different types of debt to finance governmental activities. In 2011, the City classified its debt in three primary categories. These categories, displayed in the figure below, are revenue bonds, notes payable, and capital lease obligations. Finally, the figure also includes deferred amounts.

Most of Sacramento's long-term debt in 2011 was from revenue bonds. Revenue bonds are payable from revenue generated by a city enterprise, such as water and wastewater utilities. Revenue bonds for government and business-type activities amounted to more than $750 million combined in 2011. The other primary source of business-type long-term debt are notes payable, which are written promissory notes. Total notes payable rose from more than $57 million to nearly $141 million in 2021. Capital lease obligations are a direct form of borrowing and are secured by the collateral of the asset being financed. The City's capital lease obligations declined from slightly less than $17 million in 2011 to nearly $200,000 in 2021. Finally, the City's deferred amounts, primarily for issuance premiums, amounted to over $12 million in 2011 and more than $76 million in 2021.

Figure 41: Composition of Sacramento's Long-Term Debt 2011 ($ thousands)

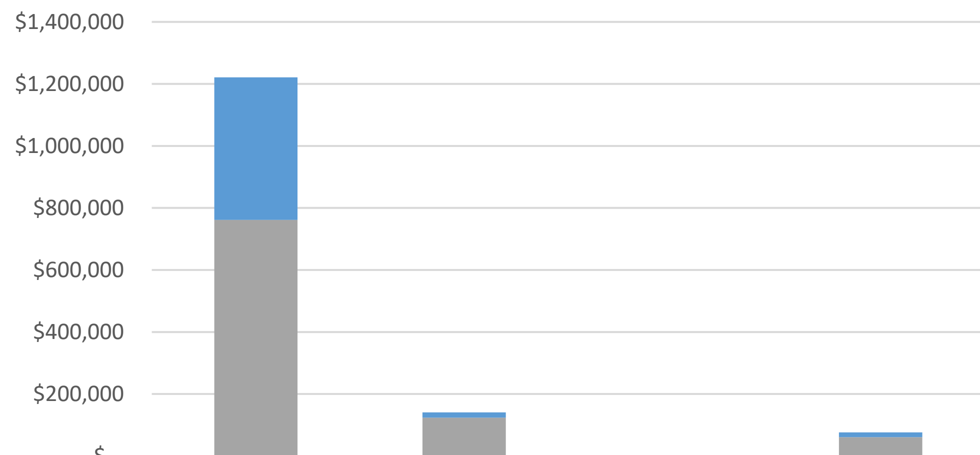


	Revenue Bonds	Notes Payable	Capital Lease Obligations	Deferred Amounts
Governmental Activities	$467,502	$677	$9,910	$10,086
Business-Type Activities	$287,634	$56,388	$7,066	$2,316

Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

In 2021 (figure 42), revenue bonds were still the City's primary debt instrument. Business and government-type revenue bonds accounted for 85 percent of total long-term debt in 2021, down from 90 percent in 2011. Notes payable and deferred amounts both increased in 2021.

Figure 42: Composition of Sacramento's Long-Term Debt 2021 ($ thousands)



	Revenue Bonds	Notes Payable	Capital Lease Obligations	Deferred Amounts
Governmental Activities	$459,657	$16,909	$199	$15,625
Business-Type Activities	$761,418	$124,073	$-	$60,979

Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

Credit Ratings

Credit rating agencies provide an independent appraisal of the credit quality and likelihood of timely repayment of a bond issue. Investors rely on the credit ratings made by the credit rating agencies, Moody's, S&P, and Fitch. Credit ratings are an assessment of the City's creditworthiness and capacity to meet financial obligations.

The City of Sacramento issues its own municipal bonds. Municipal credit ratings are opinions about the investment quality of issuers and issues in the markets. Municipal ratings are viewed in relation to the general state of the agency, local, regional, state, and national economy, debt levels and mix, revenue and expense cash flows, and the issuer's management strategies.

The City's issuer credit rating as of 2021 is AA with a stable outlook from S&P, Aa2 with a stable outlook from Moody's, and AA- with a stable outlook from Fitch. These ratings imply that the debtor has a strong capacity to meet its financial commitments and very low default risk.

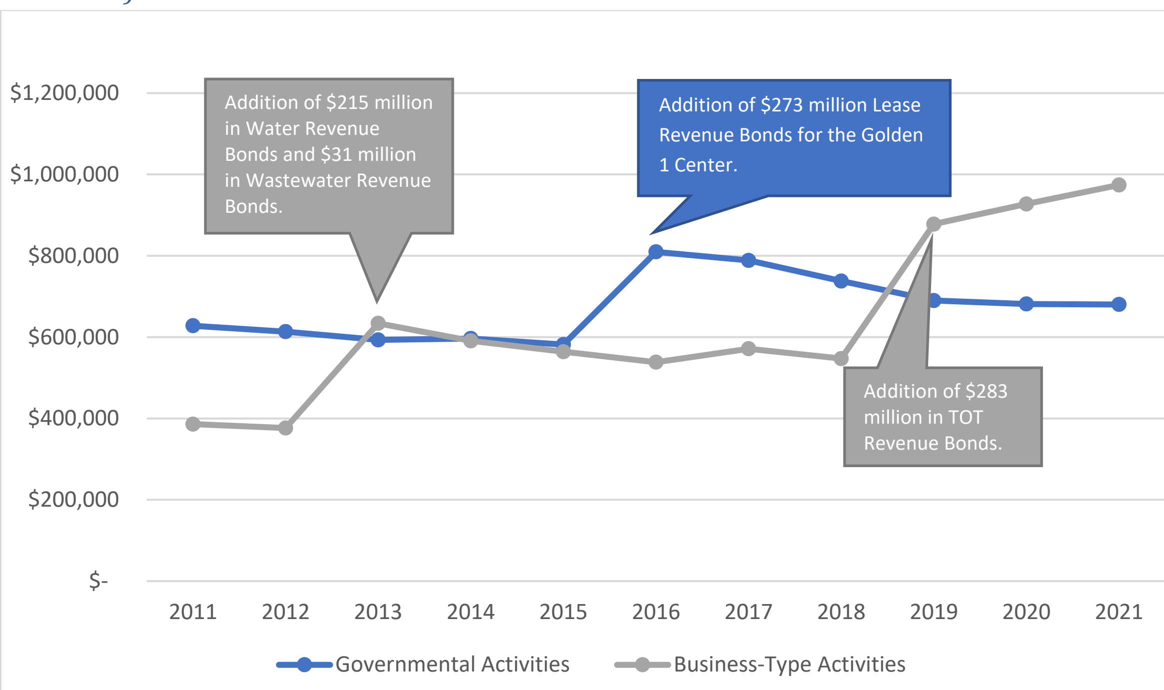
Long-term Liabilities

In addition to debt, the City has various other types of long-term liabilities. These include accrued vacation, sick, and other leave; accrued claims and judgments; and fee credits. The City's total long-term liabilities associated with business-type and governmental activities increased from just over $1.0 billion in 2011 to over $1.6 billion in fiscal year 2021, an increase of more than 60 percent. This measure of liabilities excludes Sacramento's pension liabilities and other postemployment benefits liabilities (OPEB), which are examined in the next section.

Figure 43 below shows that the liabilities for governmental activities in 2021, at just over $680 million, are higher than in 2011, when they were below $630 million. However, the City's long-term liabilities for governmental activities have been on a slight downward trend since 2016. There was a large jump in the data when the City issued the revenue bonds for the Golden 1 Center, which added $273 million.

Figure 43 also displays the trend for business-type activities, which experienced two significant spikes during the review period. In 2013, the City issued the 2013 series Water Revenue Bonds and Wastewater Revenue Bonds. Long-term liabilities increased $261 million due to the issuance of the revenue bonds and other additions to long-term liabilities, although they were partially offset by retirement of existing debt. In 2018 the City issued three Transient Occupancy Tax (TOT) Revenue Bonds to finance the costs of renovating the City's Convention Center, Community Center Theater, and Memorial Auditorium, as well as other projects eligible for TOT funding. This caused a substantial increase in long-term liabilities in 2018.

Figure 43: Sacramento's Long-Term Liabilities (excluding Net OPEB and Pension Liabilities; $ thousands)

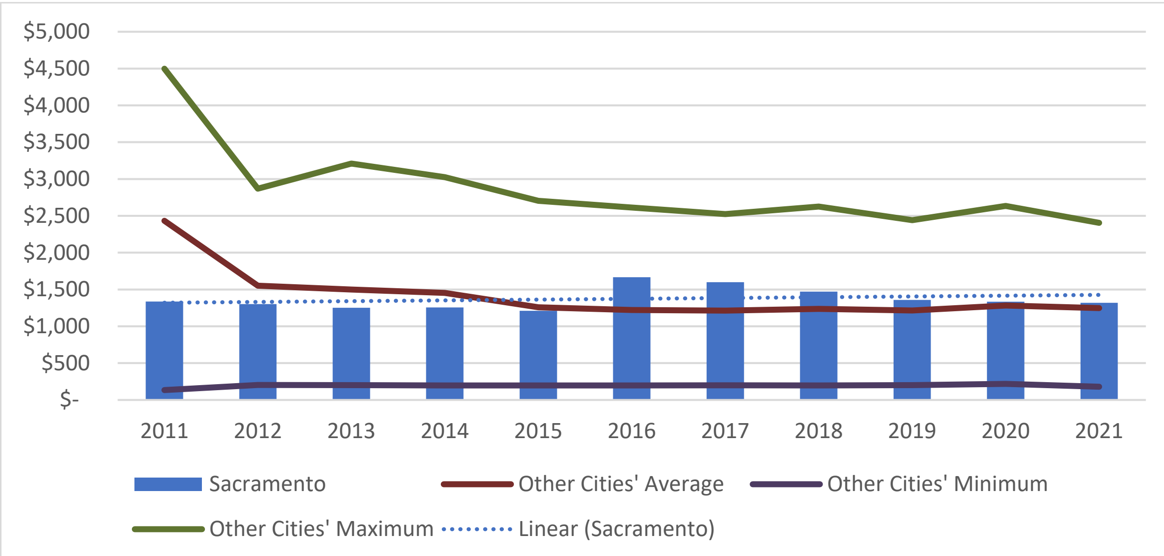


Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

Figure 44 shows that Sacramento's governmental activities' long-term liabilities, adjusted by population, were lower than other cities' average in the first half of the review period (2011-2015) but surpassed the average during the second five-year period (2016-2020). In 2021, Sacramento's per capita liability was

$1,319, down from its peak in 2016 and from its level in 2011, but still above the average for other cities.

Figure 44: Governmental Activities' Long-Term Liabilities per Resident (excluding Net OPEB and Pension Liabilities) Compared to Benchmark Cities



Note: Fresno's financial reports for 2011 and 2012 were not electronically available and it was therefore not included in the benchmark analysis for those years.
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Pension and OPEB

This section analyzes Sacramento's pension liabilities and other postemployment benefits liabilities (OPEB), which are significant long-term financial obligations. Sacramento provides defined benefit retirement benefits through the California Public Employees' Retirement System (CalPERS) and the Sacramento City Employees' Retirement System (SCERS). SCERS is a single-employer defined benefit pension plan. SCERS has not accepted new members since January 28, 1977, and only two working members remain.

CalPERS is an agent multiple-employer public employee defined benefit pension plan. All full-time, and some part-time, employees hired after January 28, 1977, are eligible to participate in CalPERS. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and their beneficiaries. Sacramento maintains two defined benefit plans, which are administered by CalPERS. The Safety Plan is open to sworn police and fire employees while the Miscellaneous Plan is open to all others. Benefit provisions under the Safety and Miscellaneous Plans (the Plans) are established by State statute and City resolution.

In the California State Auditor's analysis, the indicators associated with pensions and OPEB were more likely to present problems. Sacramento, and most of the benchmark cities, rated poorly in these categories. Stockton was an exception, but its superior performance is the result of the city's bankruptcy and should serve as a cautionary tale rather than as a model of financial management.

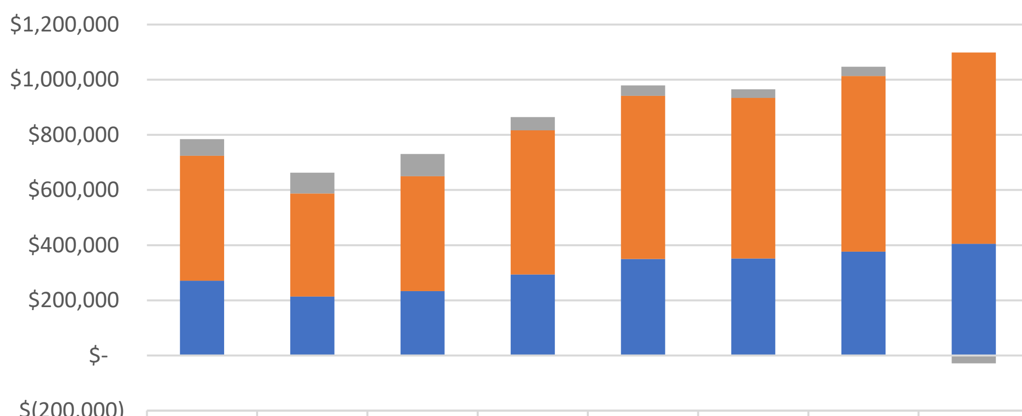
Net Pension Liability by Plan Type and Fiscal Year

To determine a city's net pension liability, it is necessary to calculate the benefits already earned by employees (total pension liability) and the resources accumulated and held in trust to pay those benefits (fiduciary net position). The difference between the two amounts (total pension liability – fiduciary net position) is the net pension liability which is also known as unfunded pension liability.

For this indicator we have truncated the series because of data availability. The fiscal year ending June 30, 2015, was the first year of implementation of GASB Statement No. 68. For state and local governments that follow GASB standards, this standard required new financial reporting requirements for pension benefits. Specifically, it required state and local governments to recognize their long-term obligations for pension benefits as a liability for the first time, and to measure the annual costs of pension benefits more comprehensively.

Figure 45 below displays pension plan liability by plan type. In fiscal year 2014, the total net pension liability by plan type was $60.2 million for SCERS, $271.2 million for the Miscellaneous Plan, and $453 million for the Safety Plan. By the end of fiscal year 2021 these costs had risen to more than $400 million for the Miscellaneous Plan and more than $690 million for the Safety Plan. The SCERS liability became an asset in 2021, with a positive value of over $28 million. Care should be exercised because the shift in valuation was a result of strong financial market performance from the City's investment of SCERS money and it may return to a liability again in the future.

Figure 45: Sacramento's Net Pension Liability by Plan Type ($ thousands)



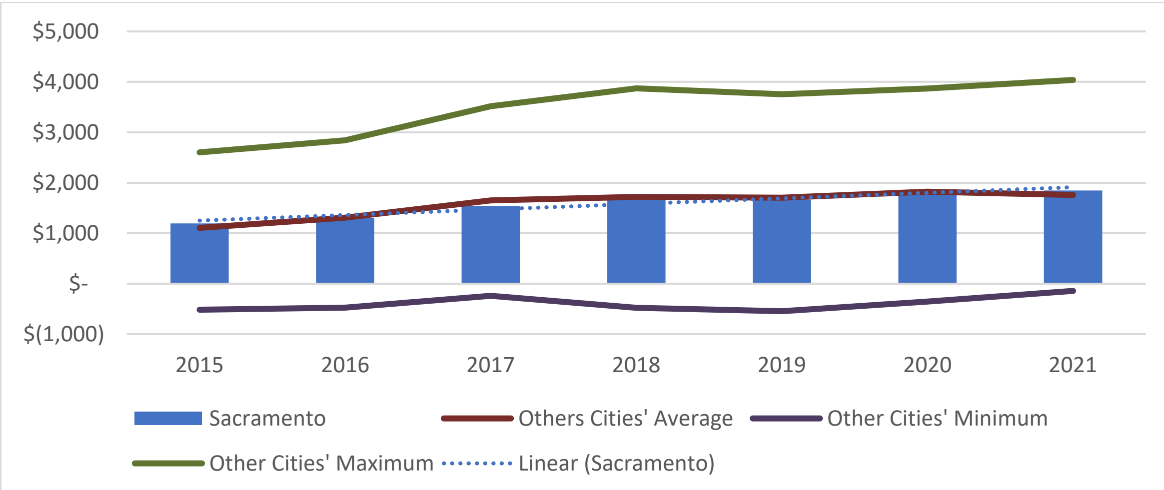
	2014	2015	2016	2017	2018	2019	2020	2021
SCERS	$60,256	$75,215	$80,971	$48,369	$38,060	$31,505	$33,530	$(28,774)
Safety Plan	$453,027	$373,931	$416,301	$522,452	$591,480	$582,271	$636,831	$693,566
Miscellaneous Plan	$271,204	$213,647	$233,618	$293,925	$349,931	$351,588	$376,580	$404,912

Miscellaneous Plan Safety Plan SCERS

Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

Sacramento's net pension liability per capita for governmental activities is rising in line with the benchmark average. Figure 46 shows that between 2015 and 2021 net pension liability per capita rose from just below $1,200 to more than $1,800.

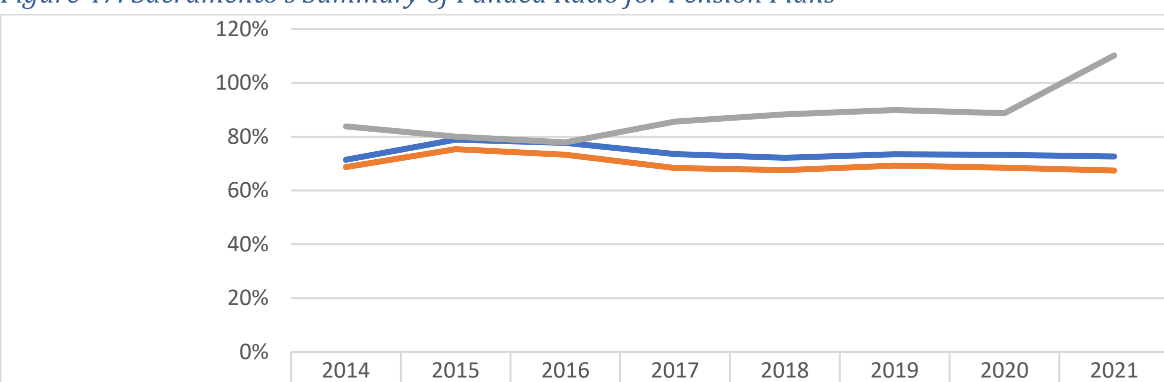
Figure 46: Governmental Activities' Net Pension Liability per Capita Compared to Benchmark Cities



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

An important question regarding pensions is how much of the obligation is funded. In Sacramento's case, as seen in figure 47, the funded ratio is declining for the miscellaneous and safety plans. Ideally, this ratio would be over 80 percent and should be increasing over time, according to ICMA. Instead, the funded ratio for the Safety Plan declined from 69 percent in 2014 to 67 percent in 2021. The ratio for the Miscellaneous Plan is two percentage points higher than in 2014, but well below the 79 percent achieved in 2015. However, it should be noted that during the benchmarking period, CalPERS made some changes to its methods and assumptions used to determine contribution rates that may have caused an increase to the City's unfunded liability.

Figure 47: Sacramento's Summary of Funded Ratio for Pension Plans



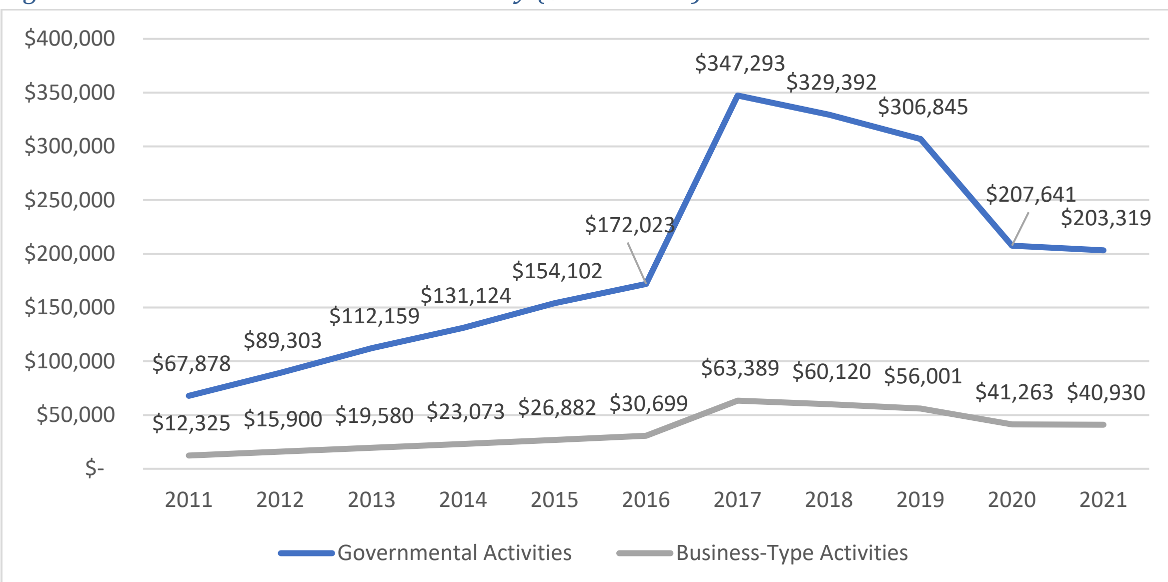
	2014	2015	2016	2017	2018	2019	2020	2021
Miscellaneous Plan	71%	79%	78%	74%	72%	73%	73%	73%
Safety Plan	69%	75%	73%	68%	68%	69%	68%	67%
SCERS	84%	80%	78%	86%	88%	90%	89%	110%

Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

Other Postemployment Benefits

Other postemployment benefits (OPEB) are benefits other than pensions that the City provides to its retired employees. Some local governments allow their employees to accumulate a portion of their unused vacation and sick leave to be paid when they leave employment or at retirement. In most cases this category relates to the net liability for retiree medical benefits accounted for and reported in accordance with GASB Statement No. 75.[12] Sacramento's net OPEB liability, as shown in figure 48, is $203 million for governmental activities and slightly less than $41 million for business-type activities for the period ending June 30, 2021. The increase in 2017 in the figure below is the result of the change in reporting standards (GASB 75). Sacramento's net OPEB liability should continue to trend down as fewer employees are eligible for benefits. Benefits were closed to miscellaneous employees in 2012 and police in 2013. The Fire Department maintains some benefits for its employees.

Figure 48: Sacramento's Net OPEB Liability ($ thousands)



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

In figure 49, the average of the other cities in the benchmark comparison group had net OPEB liabilities per capita for governmental activities that tracked with Sacramento's. The average of other cities' was below Sacramento's levels for half of the observations. However, in 2021 Sacramento's value was below the benchmark average.

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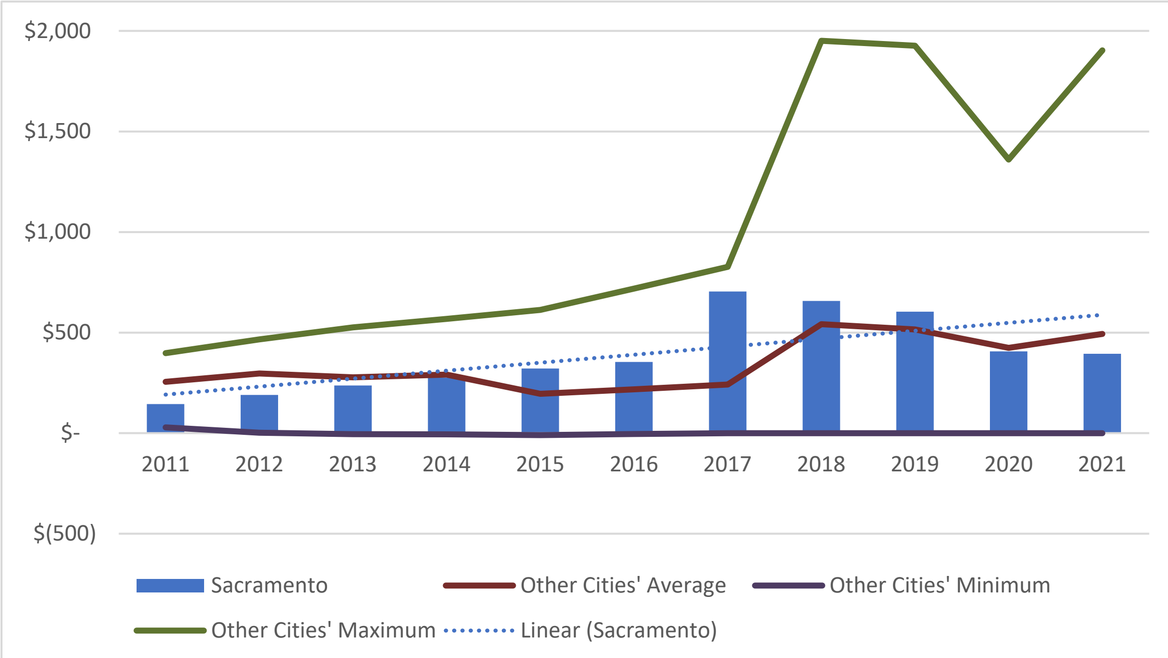
[12] The primary objective of GASB Statement No. 75 is to improve the accounting and financial reporting standards of state and local governments for postemployment benefits other than pensions. GASB 75 supersedes GASB Statements No. 45 and No. 57. The new statement established new standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expenditures. GASB 75 specifically requires that the actuarial present value of projected benefit payments be attributed to periods when the employee is in active service. The actuarial present value is calculated using the entry age actuarial cost method with each period's service cost determined as a level percentage of pay.

Figure 49: Governmental Activities' Net OPEB Liability per Capita Compared to Benchmark Cities



Note: Fresno was excluded from the 2011 and 2012 analysis because the annual comprehensive financial reports were not available and Long Beach was excluded from the 2011 through 2014 analysis because the Net OPEB liability information for governmental activities was not available in the annual comprehensive financial reports for those years.
Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Operating Position

According to the ICMA Handbook, "the term 'operating position' refers to a government's ability to (1) balance its budget on a current basis, (2) maintain reserves for emergencies, and (3) have sufficient liquidity to pay its bills on time." Sacramento is required to adopt an annual budget that is balanced. However, over the course of the fiscal year, Sacramento's budget may be in either an operating surplus or an operating deficit. If current revenues exceed current expenditures, an operating surplus develops. In the opposite case, an operating deficit develops. A surplus or deficit may arise because of intentional policy choices or because of challenges in forecasting revenues and expenditures accurately. This is especially pronounced during economic downturns or other periods, such as the global pandemic. Deficits may be funded from unreserved fund balances while excess revenue may be used to increase fund balances. Measures for net position and reserves are presented below.

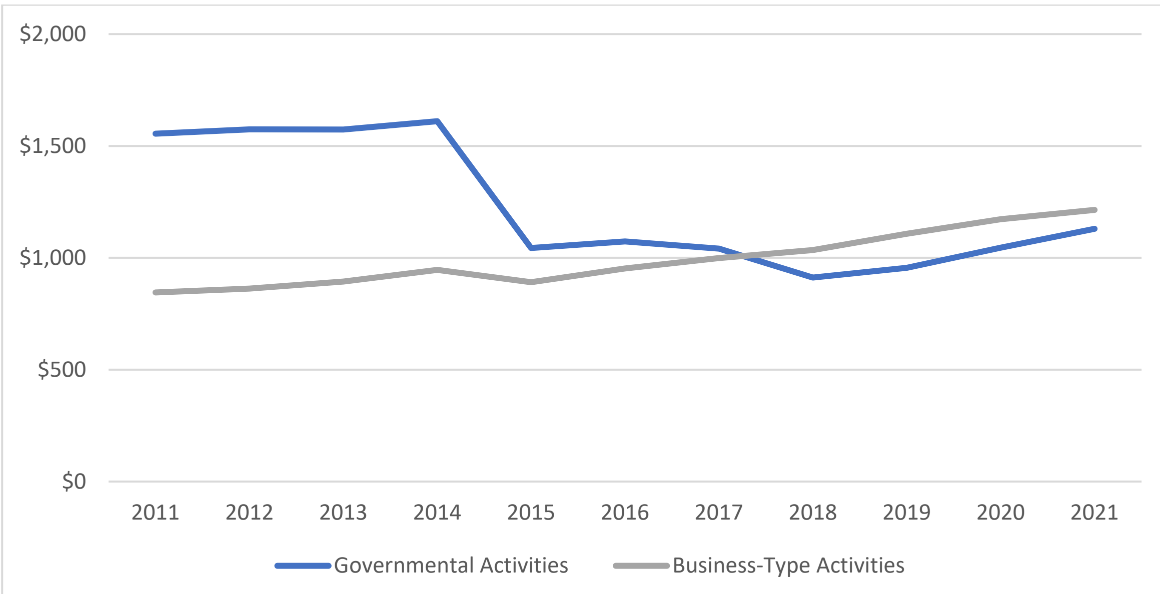
Net Position

According to the GASB, net position represents the residual of all other elements presented in a statement of financial position: assets, liabilities, deferred outflow of resources, and deferred inflow of resources. However, these residual resources are not always in a spendable form and may have restrictions on how some of the resources can be used.

Figure 50 below displays total net position for governmental and business-type activities. Changes in accounting practices required cities to recognize the unfunded pension and OPEB liabilities in their financial statements. These reporting changes that were effective fiscal years 2014 and 2017 reduced Sacramento's total net position because the City's total recorded liabilities increased.

One notable feature in 2021 was the contribution from the federal government. One component that affected changes in net position, operating grants and contributions revenue, increased $110 million primarily due to the funding the City received from Coronavirus Aid, Relief, and Economic Security (CARES) Act funding, Sacramento Emergency Rental Assistance program, Whole Person Care program, and the Great Plates Delivery program.

Figure 50: Sacramento's Net Position ($ millions)



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

Sacramento's net position for governmental activities was at its lowest during the benchmarking period in 2018, when it began trending up. The business-type activities didn't have the same trajectory, but instead has been gradually trending up over time, with minor volatility along the way. Changes in accounting practice, as mentioned previously, required the City to recognize the unfunded pension and OPEB liabilities in its financial statements.

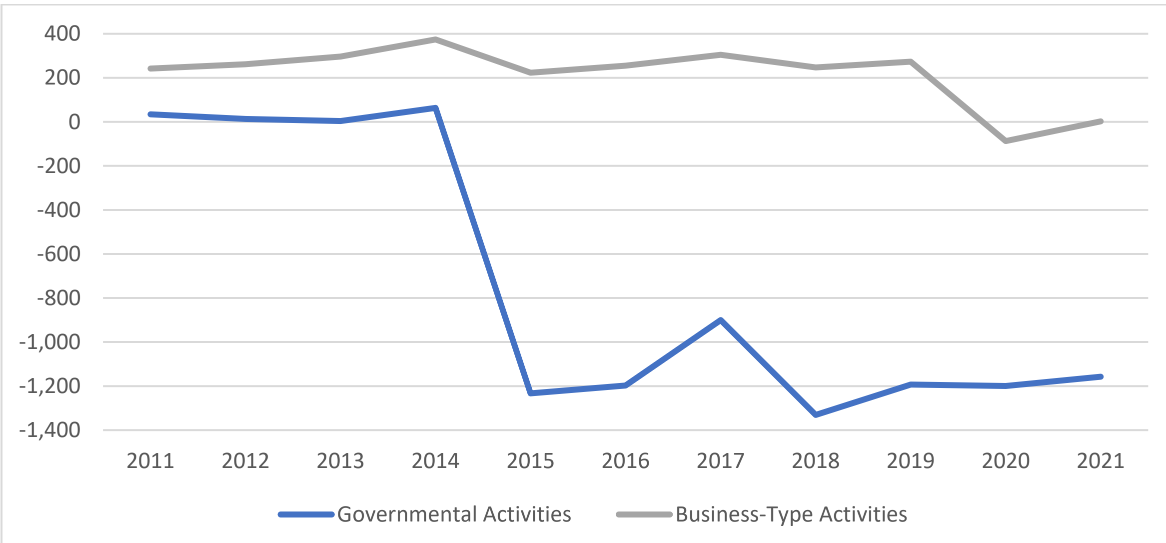
Unrestricted Net Position

Unrestricted net position represents the City's financial position that is not restricted for any project or purpose. It is the City's practice to use restricted resources first followed by unrestricted resources as they are needed. Unrestricted net position is a measure of Sacramento's ability to maintain governmental services when faced with unexpected expenses. This series has been affected twice during this period because of changes to accounting standards. In fiscal year 2015, unrestricted net position decreased due to the implementation of GASB 68 and it decreased again in fiscal year 2018 due to the implementation of GASB 75.[13] This is the cause for the sharp decline in unrestricted net position per capita in 2015 and 2018, evident in figure 51 below.

Unrestricted Net Position Per Capita

The City of Oakland, California puts net position in context by calculating unrestricted net position per resident. Sacramento's unrestricted net position per resident for governmental activities decreased from $34 in 2011 to approximately negative $1,160 in 2021, as shown below. A negative level indicates that the City has long-term commitments that are greater than its currently available resources.

Figure 51: Sacramento's Unrestricted Net Position Per Capita



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento.

Sacramento is not the only city with a negative unrestricted net position as shown in figure 52 below. The other benchmarked cities' unrestricted net position for governmental activities ranged from a maximum of approximately negative $140 to a minimum of negative $4,702 per resident in 2021.

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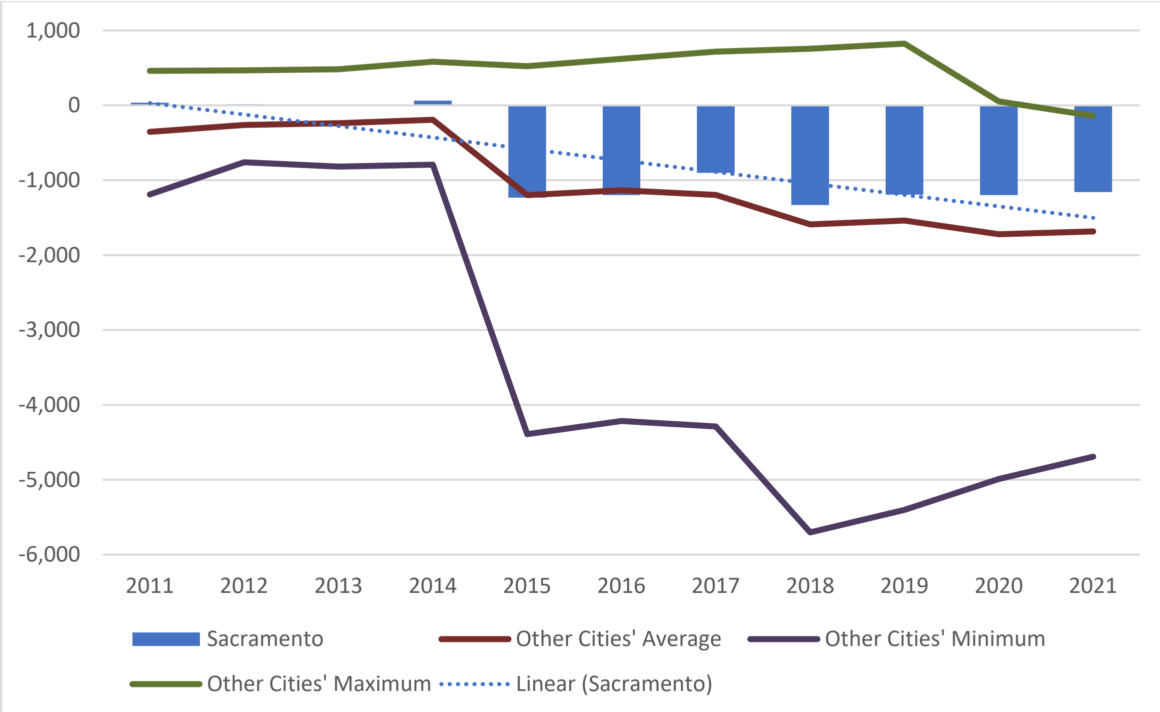
[13] GASB Statements 68 and 75 improve accounting and financial reporting by state and local governments for pensions and postemployment benefits other than pensions (OPEB), respectively.

Figure 52: Governmental Activities' Unrestricted Net Position Per Capita Compared to Benchmark Cities



Source: Auditor generated from review of the annual comprehensive financial reports of the City of Sacramento and benchmarked cities.

Sacramento's Financial Condition

The analysis based on the two frameworks considered in this report, the modified 10-point test and the ICMA Handbook, support the conclusion that Sacramento's financial condition gradually improved during the review period. The benchmark comparisons show that Sacramento is performing better than many of its peers. Sacramento was ranked in the top three for eight out of 11 years of the benchmarking period. Although Sacramento performed well in the benchmark, it does face challenges. Its performance on the debt and solvency ratios lagged the peer group. Finally, Sacramento's relative performance is based on its peer group, and a different comparison group might have produced different results.

The pandemic has created new challenges for the City's finances. Although local governments were initially concerned about the economic impact from the COVID-19 pandemic, the federal response, both to individuals and to state and local governments, mitigated some of the negative economic impacts. Sacramento has received about $200 million in CARES Act and American Rescue Plan Act of 2021 (ARPA) funding.

Federal Coronavirus assistance has helped the City manage the downturn, but this assistance will gradually end. The past two years may not provide much insight into the long-run trends of the City's finances because of government transfers and changes in revenues and expenditures. These trends will become more apparent with distance from the pandemic.

The City's General and Measure U Funds budgets are currently balanced and projected to remain in balance through the end of fiscal year 2023. However, If the City continues to maintain its funding for homeless services, costs are projected to exceed revenues in fiscal year 2024, according to the City's most recent budget forecast. While it is unlikely the City will actually experience budget deficits as it rebounds from the effects of the pandemic because a balanced budget must be approved each year, the Mayor and Council will find themselves with difficult decisions about the direction of the budget and the City's finances.

Appendix A: Key Department's Involved in Sacramento's Financial Condition

The City's financial condition is the result of a whole-of-government approach to performance management, but the Office of the City Manager, the Department of Finance, and the City Treasurer playing central roles.

The City Manager helps guide the overall management of the City and is responsible for the leadership and direction of all operations, programs, and services. The City Manager also implements the Council's policies and priorities, provides policy recommendations to the Council concerning the annual budget, future needs of the City, and oversight of all City departments.

The Finance Department is responsible for overseeing the financial management of the City. The Finance Department currently provides accounting, budgeting, payroll, infrastructure finance, procurement, billing, collection, parking citation, and revenue collection. Internal services and programs include strategic planning and policy analysis. The department also works with independent auditors to complete the audited annual comprehensive financial report.

The City Treasurer is responsible for the deposit and investment of all City funds. The City Treasurer also informs the Council about the status of investments and City funds. Finally, the Council directs the City Treasurer to provide public finance and debt issuance services for the City.

Appendix B: Sacramento's Budget Process

The Mayor and Council pass City ordinances, provide administrative direction and authority by resolution, approve new programs, and approve the annual budget. The stated goal of the Council is to govern the City in a manner that is responsive to the needs and concerns of City residents and financially sound. The City Manager facilitates the implementation of Council's policies and priorities, provides policy recommendations to the Council concerning the annual budget, future needs of the City, and oversight of all City Departments.

The City's budget is one of the documents analyzed in this report. The budget is a statement of the priorities of the City and allocates funding across a range of municipal services including public safety and health, economic development and land-use planning, utilities and solid waste, and general administration.

To establish the annual City budget, the Budget, Policy and Strategic Planning Division of the Finance Department, in coordination with the City Manager and the City's operating departments, implements a multi-stage budget process. Important aspects of this process include developing a proposed revenue and expenditure plan for the coming fiscal year, holding public hearings with the Mayor and Council, and conducting a year-end review for the prior fiscal year and a mid-year report for the ongoing fiscal year.

The City Council adopts the City's operating and capital budgets for a single fiscal year which begins July 1 and ends June 30. Any changes to the proposed budget, as considered and approved by the City Council during budget hearings, are included in the Approved Budget document. Sacramento's fiscal year 2023 Operating and Capital Improvement Program Budgets were approved by the City Council on June 14, 2022. The Budget is almost $1.4 billion from all funding sources.

In addition to the annual budget, Section 117 of Article IX of the City Charter, and federal and state law, requires that the City issue an annual report on its financial position and activity, and that the report be audited by an independent firm of certified public accountants. The City satisfies this requirement by producing the annual comprehensive financial reports. These audited financial statements are discussed in the next section.

Appendix C: The Annual Comprehensive Financial Report

The City reports its financial information using generally accepted accounting principles. The financial information is available in an annual report, the annual comprehensive financial report (ACFR), which is audited by an independent certified public accountant or accounting firm to provide reasonable assurance the financial statements are free from material misstatements. The basic financial statements include three components: government-wide financial statements, fund financial statements, and notes to the basic financial statements.

The government-wide statements report information about the City using accounting methods like those used by private-sector companies. The statement of net position includes all the City's assets and liabilities, as well as any deferred outflows or inflows of resources. The statement of activities includes all current year revenues and expenses regardless of when cash is received or paid. These government-wide statements report the City's net position and how the net position has changed during the fiscal year. Several of the ratios discussed in previous chapters use this data because increases or decreases in net position serve as useful indicators of the City's financial health. The amounts in the statement of net position and the statement of activities are separated into governmental and business-type activities to provide a summary of each type of activity.

Most of the City's basic services, such as police; fire; public works; community development; youth, parks, and community enrichment; and general government are categorized as governmental activities. Taxes and state and federal grants finance most of these activities. Other services, by contrast, are funded by customer fees. Among these are the City's utility services, convention center, and off-street parking facilities. These are categorized as business-type activities.

The second component of the financial reports are the fund financial statements. The fund financial statements focus on individual parts of city government and report the City's operations in more detail than the government-wide statements. The City's funds are separate accounting entities with self-balancing sets of accounts. Each fund was established to account for specific activities in accordance with applicable regulations, restrictions, or limitations. Major funds are reported as separate columns in the fund financial statements. The General and Measure U Funds are the primary operating funds for the City of Sacramento.

The General Fund is the City's primary operating fund and accounts for most financial resources of the general government, except those required to be accounted for in another fund. The Measure U Fund was established to account for the temporary half-cent sales tax approved by voters on November 6, 2012. The tax was originally designed to sunset effective March 31, 2019. On November 6, 2018, Sacramento voters approved a new version of the City's Measure U sales and use tax. This eliminated the sunset provision and raised the tax from a half-cent to one cent. The one cent sales and use tax was effective April 1, 2019. The revenue for the General and Measure U Funds, which represent the discretionary funding of the City, totaled nearly $650 million in 2021.

The fund financial statements categorize activities in a similar manner as the government-wide statements, but the terms are slightly different. In the fund financial statements, separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds. Fiduciary fund statements provide information about the financial relationships in which the City acts as a trustee or custodian for the benefit of others. This includes a closed pension fund and the successor agency for the former redevelopment agency, among other resources. Fiduciary funds are excluded from government-wide financial statements because they cannot be used to finance a city's operations.

Governmental fund statements show how general government services were financed in the short-term and provide the balance for future spending. Business-type activities are referred to as proprietary or enterprise funds in the fund financial statements. These are services for which customer fees are intended to finance the cost of operations.

The fund financial statements do not encompass the additional long-term focus of the government-wide statements, so the financial reports include reconciliations between governmental funds and governmental activities. The analysis in this report draws from both sets of statements because they provide complementary information and help in understanding Sacramento's financial condition.

Appendix D: COVID-19 Response

In December 2019, a new strain of coronavirus (COVID-19) was identified in Wuhan, China. Coronaviruses are a large family of viruses that can cause respiratory infections in humans. They range from the common cold to more severe diseases such as severe acute respiratory syndrome (SARS), Middle East respiratory syndrome (MERS), and COVID-19. The response to the contagion took place at all levels of the United States government. On January 31, 2020, the Federal Health and Human Services Secretary declared a public health emergency to aid the nation's healthcare community in responding to the outbreak of COVID-19 in the United States. On March 4, 2020, Governor Gavin Newsom proclaimed a State of Emergency in response to the threat of COVID-19 in the State of California. Sacramento County proclaimed a public health emergency the following day. On March 11, 2020, the World Health Organization characterized the COVID-19 outbreak as a pandemic. On March 13, 2020, the Sacramento City Council declared a local emergency in the City of Sacramento, California. On March 19, 2020, the County of Sacramento issued a directive ordering all individuals living in the county to stay-at-home, except for essential activities, to help slow the spread of COVID-19. The order stayed in place throughout 2020 and was lifted in June 2021 when the state lifted the Blueprint for a Safer Economy. Although the order was lifted, the pandemic is ongoing and negatively impacting the City's operation.

California State workers and Sacramento City staff have adopted flexible workforce policies. Some essential workers in the City's larger departments, including Police, Fire, Public Works, and Utilities have employees working in the field, but some of the City's workforce is still working remotely. Along with other state and local agencies across the country, Sacramento faced extraordinary challenges due to the pandemic. In its revenue loss calculation to the federal government, the City estimates that revenues were $128 million lower in calendar year 2020 than they would have been in the absence of the global pandemic.

The City responded to the impact of the pandemic by attempting to minimize strain on the General and Measure U Funds revenue streams with a status-quo budget. Budgeted revenues reflect a cautious and gradual phase-in for recovery on most of the City's revenue streams. Notably, the Transient Occupancy Tax (TOT) and revenue from parking are forecast by the City to be lower than estimated prior to the pandemic.

On April 21, 2020, Sacramento received $89 million in federal Coronavirus Aid, Relief, and Economic Security (CARES) Act funding. The City Council adopted a general framework to use the funds for programs and projects that provide small-business and assistance, workforce training programs, youth enrichment, homelessness services and rapid rehousing, creative economy and tourism, and family services. The American Rescue Plan Act of 2021 (ARPA) was signed into law in March 2021. The City became eligible for $112.2 million to address internal financial challenges resulting from the pandemic. Sacramento received the first installment in the amount of $56.1 million of ARPA funds on May 19, 2021. The second tranche was released to Sacramento on June 30, 2022.

In addition to the federal funding coming directly to the City, there are funds available for specific programs from the State of California to address needs associated with the negative economic impacts of the pandemic.

Despite the severity of this downturn, the California State Auditor estimates that only 18 out of 450 cities in California did not receive enough stimulus funds to cover their COVID-19 related revenue losses. Neither Sacramento, nor the benchmark cities, were included among these 18 cities identified by the State Auditor.

City of
SACRAMENTO
Finance Department

MEMORANDUM

Date: August 26, 2022

From: Emily Combs, Finance Director

To: Mayor and Members of the City Council

Cc: Howard Chan, City Manager
Leyne Milstein, Assistant City Manager

Re: Response to Performance Audit of the City's Financial Condition

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The purpose of this memorandum is to provide a response to the Audit Report entitled, "Audit of the City's Financial Condition." The City Auditor's Report focuses on activity from the City's Annual Comprehensive Financial Reports (ACFRs), tracking a 11-year period, with comparative data from six similar cities (two with a larger population and four with a smaller population). The City Auditor selected two established methodologies to analyze financial data: a modified 10-point test and the International City/County Management Association's (ICMA) Evaluating Financial Condition Handbook which draws on certain financial and economic indicators. It is important to note that the City Auditor's assessment of the City's financial condition focuses exclusively on past financial data which may not be indicative of future financial performance.

The City Auditor's performance audit highlights the City's moderate strength in short-run financial position, liquidity, capital assets and revenue. The City's performance related to long-term debt and enterprise fund debt coverage was among the worst when compared to the benchmark cities.

The COVID-19 pandemic impacted the City both operationally and financially, including significant declines in transient occupancy tax (TOT) and parking revenues, both of which compromises the City's ability to meet required debt service payments for the Golden 1 Center (G1C), which was financed by the 2015 G1C Lease Revenue Bonds. In fiscal year (FY) 2021/22, due to shortfalls caused by the pandemic and an anticipated inability to make debt service payments, Council approved one-time General Fund support totaling $11.8 million. This contribution is expected to stabilize the funds responsible for the debt service; however, based on forecasts included as part of the FY2022/23 Approved Budget, revenues are still below pre-pandemic levels. In addition, parking fee revenue is not expected to reach pre-pandemic levels in the next five years. Should TOT and parking revenues fail to recover in the coming years, the City's poor long-term debt financial performance could thwart the City's ability to issue future debt.

Also highlighted is the City's ability to handle unforeseen resource needs over the short-term. As indicated in "Ratio 1: Short-run Financial Position", compared to the benchmarked cities, Sacramento's ability to handle unanticipated needs has improved greatly since 2011. This can be attributed to Council's adoption of a policy goal of achieving a reserve equal to 10 percent of budgeted General/Measure U (G/MU) Fund revenues (Motion 2016-0122 on April 26, 2016 as amended to include Measure U revenues on June 11, 2019, Resolution No. 2019-0248, Attachment 1). Due to escalating expenditures, the FY2022/23 Approved Budget fell short of the City's policy goal with a reserve of only 8.4 percent of budgeted revenues. This metric differs from that reported in the Auditor's analysis which is based on actual revenue received, versus budgeted revenues.

Compared to the benchmark cities, Sacramento's financial performance as described in "Ratio 3: Financial Performance" of the performance audit, is favorable. Historically, the City was able to pay expenses with revenues in the governmental funds. However, beginning in FY2021/22, this was not the case in the G/MU Fund as one-time funds were necessary to balance the budget. Going forward, rising labor and liability costs combined with an escalating urgency to fund the City's deferred maintenance needs totaling approximately $3.9 billion will impact the City's ability to both balance annual budgets (annual revenues above annual expenditures) and meet the community's needs.

While the financial analyses and ratios included in the performance audit report can be used to assess a local government's financial condition, additional information is needed to fully understand the complexity of a large municipality like the City of Sacramento. Even when comparing cities of similar population, there may be significant differences between them including services provided, as well as differences in socioeconomic, political, and regulatory environments. The metrics included in this report are based on formulas that provide a high-level view of the City's financial condition. A more complete assessment can be achieved only through a careful review and understanding of the City's annual budgets, financial statements, and disclosures.