

**CITY OF PASADENA
GENERAL FUND
COMPARATIVE STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
Fiscal Years 2005 through 2007**

	Fiscal Year Ended June 30,		
	2005	2006	2007
Revenues:			
Taxes	\$103,263,885	\$108,259,679	\$115,916,861
Licenses and permits	2,422,590	2,389,206	2,024,034
Intergovernmental revenues	12,513,767	12,013,725	12,705,093
Charges for services	26,212,130	27,954,633	30,711,841
Fines and forfeits	6,541,630	6,911,046	7,593,705
Investment earnings	16,527,891	18,656,672	22,024,174
Net changes in fair value of investments	(85,675)	(831,808)	(857,707)
Rental income	1,632,951	1,536,322	1,317,087
Miscellaneous revenue	2,186,348	2,155,607	2,063,664
Total revenues	<u>\$171,215,517</u>	<u>\$179,045,082</u>	<u>\$195,214,166</u>
Expenditures:			
Current:			
General government	\$ 26,439,776	\$ 30,274,937	\$ 34,178,408
Public Safety	75,440,612	78,487,902	88,398,871
Transportation	21,886,752	23,974,050	24,514,491
Culture and leisure	12,349,300	13,097,817	13,700,557
Community development	8,082,604	8,796,832	9,468,514
Debt service:			
Principal retirement	40,000,000 ⁽¹⁾	—	—
Total expenditures	<u>\$184,199,044</u>	<u>\$154,631,538</u>	<u>\$170,260,841</u>
Excess (deficiency) of revenues over (under) expenditures	<u>\$ (12,983,527)</u>	<u>\$ 24,413,544</u>	<u>\$ 24,953,325</u>
Other Financing Sources (Uses):			
Issuance of long-term debt	\$ 2,181,479	\$ —	\$ 87,401
Transfers in	60,497,106	26,940,474	13,634,346
Transfers out	(39,910,724)	(40,969,032)	(51,653,771)
Total other financing sources (uses)	\$ 22,767,861	\$ (14,028,558)	\$(37,932,024)
Change in fund balances	9,784,334	10,384,986	(12,978,699)
Fund balances at beginning of year, as restated	59,297,092	69,081,426	79,466,412
Fund balances at end of year	<u>\$ 69,081,426</u>	<u>\$ 79,466,412</u>	<u>\$ 66,487,713</u>

Source: Audited Basic Financial Statements of the City of Pasadena For Fiscal Year Ended June 30, 2007.

⁽¹⁾ Includes \$40,000,000 of the proceeds of Pension Obligation Bonds.

General Fund taxes increased by approximately \$12.6 million from the fiscal year ended June 30, 2005 to June 30, 2007. These changes were due primarily to increases in property taxes from increasing assessed valuations, retail sales taxes from an improving economy as well as transient occupancy tax and utility users' tax. Revenues received from licenses and permits were received from a variety of sources and reflect, in part, a strong local economy. Revenues received from charges for services also increased, reflecting a strong local economy.

Investment Practices

General. The City Treasurer is responsible for investing City funds pursuant to an Investment Policy (the "Investment Policy") established by the City Council.

The Treasurer invests temporarily idle cash for the City as part of a pooled investment program which combines general receipts with special funds for investment purposes. The City's accounting division then allocates interest earnings on a pro rata basis when the interest is earned and distributes interest receipts based on the previously established allocations. All funds of the City, other than bond proceeds, the investment assets of the Commission, the City's Capital Endowment Fund and the Stranded Investment Reserve Fund, are invested pursuant to this pooled investment program. Funds of the Commission are invested pursuant to the Investment Policy, but are kept separate from other City funds. The Treasurer does not invest funds of any other governmental entities as part of its pooled investment program. All bond proceeds are invested in accordance with the permitted investments described in the applicable trust indenture.

Pooled Investment Portfolio. As of June 30, 2007, the funds invested pursuant to the pooled investment program had a market value of \$283,355,442. The City Treasurer prices the pooled portfolio and all other funds and investments under management on a monthly basis. The market values are obtained from Interactive Data Corporation ("IDC") and Bloomberg Financial Systems. The weighted average maturity of these investments was 1.77 years. Of the investments on that date, approximately 24.26% had maturities of ninety days or less.

The assets of the portfolio as of June 30, 2007 are shown in the following table:

**CITY OF PASADENA
POOLED INVESTMENT PORTFOLIO
Assets as of June 30, 2007**

Type	Market Value	Percentage of Total ⁽¹⁾
Repurchase Agreements	\$ 50,200,000	17.87%
Certificates of Deposit	560,000	0.20
Local Agency Investment Fund (LAIF)	658,278	0.23
Municipal Bonds	1,371,550	0.49
Treasury Securities	12,520,750	4.46
Corporate Bonds	15,681,457	5.58
Mortgage Backed Securities/GNMAs	2,420	0.00
Federal Agencies	198,831,613	70.76
Cash in Bank	1,154,834	0.41
Total	\$280,980,902	100.00%
Accrued Interest Receivable	2,374,540	
Grand Total	\$283,355,442	

Source: City of Pasadena.

⁽¹⁾ At market value.

Investment Policy. The City's treasury operations are managed according to the Investment Policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturities. The Investment Policy is reviewed and authorized by the City Council on an annual basis. The City Council approved the Investment Policy for fiscal year ended June 30, 2007 on November 20, 2006.

The Investment Policy establishes three primary objectives, in the following order of priority, for the City's investment activities.

(a) Safety of Principal. The City will seek to preserve principal by mitigating credit risk and market risk (by structuring the portfolio so that securities mature at the same time as major cash outflows occur and by prohibiting the taking of short positions).

(b) Liquidity. The City will maintain sufficient liquidity in the investment portfolio to enable the City to meet all operating requirements which might be reasonably anticipated and investments will be authorized only in securities that are actively traded in the secondary market. The City operates its own electric and water utility and bills monthly for such services. The utility billing program generates

significant cash flow on a daily basis. Historical cash flow trends are compared to current cash flow requirements on an ongoing basis in an effort to ensure that the City's investment portfolio will remain sufficiently liquid to enable the City to meet all reasonably anticipated operating requirements.

(c) Return on Investment. The City will design its investment portfolio to attain a "market average rate of return" through economic cycles and, whenever possible, consistent with risk limitations and prudent investment principles, to augment returns above the market average rate of return.

The City's cash management system is designed to accurately monitor and forecast expenditures and revenues, thus enabling the City to invest funds to the fullest extent possible. The City attempts to earn the highest yield obtainable while keeping within the investment criteria established by the Investment Policy for the safety and liquidity of public funds.

To meet its short-term cash flow needs, the City typically maintains an average investment balance of about \$30 million in securities with a maturity of 30 days or less.

Authorized Investments. Funds are invested only in those securities authorized by the various sections of the California Government Code and the City's Investment Policy, which include obligations of the United States Treasury, agencies of the United States Government, local and State bond issues, bankers acceptances, commercial paper of prime quality, certificates of deposit (both collateralized and negotiable), repurchase and reverse repurchase agreements, medium-term corporate bonds, shares of beneficial interest in diversified management companies (mutual funds), and asset-backed (including mortgage-related) and pass-through securities.

The City does not invest funds in any security that could result in a zero interest accrual if held to maturity, and has no investments in derivative products such as interest rate swaps, futures, options or reverse purchase agreements in connection with its investments. The City has entered into interest rate swap agreements in connection with certain of its obligations. The City does not have any investments which are reverse repurchase agreements. A reverse repurchase agreement is a transaction in which a holder of securities, such as the City, sells the same to a third party and agrees to repurchase them at a later date. The proceeds received by the seller can in turn be invested in additional securities, thus producing "leverage."

The Government Code stipulates that no investments may be made in securities with maturities in excess of five years without express authority from the City's legislative body. The Government Code and the City's Investment Policy place various other restrictions on investment in and allocation of funds to various investment categories, including the following:

- The value of bankers acceptances, bills of exchange or time drafts drawn on and accepted by commercial banks may not exceed 40% of the City's portfolio book value as measured on the date of purchase and the days to maturity of such investments may not exceed 180 days.
- Commercial paper must be rated P1 and issued by U.S. corporations with assets greater than \$500 million and a long-term debenture rating of A or better. The City is not permitted to purchase commercial paper that exceeds 270 days to maturity nor hold more than 10% of a corporation's outstanding commercial paper. The value of the City's holdings of commercial paper may not exceed 15% of the book value of the City's portfolio as measured on the date of purchase.
- The value of the City's holdings of negotiable certificates of deposits may not exceed 30% of the book value of the City's portfolio as measured on the date of purchase.
- The market value of the securities used as collateral for repurchase agreements may not be permitted to fall below 102% of the value of the repurchase agreement. Execution of a PSA Master Repurchase Agreement is required for all repurchase agreements transacted and the maturity of repurchase agreements may not exceed one year.

- The value of City's reverse repurchase agreement holdings may not exceed 20% of the book value of the City's portfolio as measured on the day of purchase. Reverse repurchase agreements may not exceed 92 days to maturity unless the agreement includes a written guarantee of minimum earnings for the entire period. Term reverse repurchase transactions in excess of 92 days are only permitted if the securities underlying the reverse are matched to the maturities of the reinvestments.
- No more than 25% of the City's investment portfolio may be invested in time deposits.
- Medium-term corporate bonds must be rated in a rating category of "A" or its equivalent or better by a nationally recognized rating service. The value of the City's holdings of medium-term corporate bonds is limited to 30% of the City's portfolio book value as measured on the date of purchase and no more than 5% of the cost value may be invested in bonds held by one corporation.
- The value of the City's mutual fund holdings may not exceed 20% of the City's portfolio book value as measured on the date of purchase.
- Any eligible mortgage pass-through security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable pass-through certificate or consumer receivable-backed bond must be issued by an issuer having an "A" or higher rating for the issuer's debt as provided by a nationally recognized rating service and rated in a rating category of "AA" or its equivalent or better by a nationally recognized rating service. In addition, purchases of such securities may not exceed 20% of all of the City's surplus funds that may be invested in accordance with the foregoing investment guidelines and restrictions.

None of the moneys on deposit in the City's investment portfolio is currently invested in leveraged products or inverse floating rate bonds. The City has no investments in outside investment pools except for State's Local Agency Investment Fund (LAIF). The City does not have a practice of lending its portfolio's securities to others in return for a fee, although it is not prohibited from doing so.

General Obligation Debt

Under the City Charter, the City may not incur indebtedness by general obligation bond which would in the aggregate exceed 15% of the total assessed valuation of all the real and personal property within the City subject to assessment for taxation for municipal purposes. In addition, no bonded indebtedness which will constitute a general obligation of the City may be created unless authorized by the affirmative vote of two-thirds of the electorate voting on such proposition at any election at which the question is submitted. Such bonds are secured by an ad valorem property tax assessed against the property owners of the City.

The City currently has no general obligation debt outstanding.

Estimated Direct and Overlapping Bonded Debt

The estimated direct and overlapping bonded debt of the City as of June 1, 2008 is set forth in the following table. [to be updated]

**CITY OF PASADENA
COMPUTATION OF DIRECT AND OVERLAPPING DEBT
As of June 1, 2008**

2007-08 Assessed Valuation:	\$18,947,317,712
Redevelopment Incremental Valuation:	2,612,134,921
Adjusted Assessed Valuation:	\$16,335,182,791

<u>OVERLAPPING TAX AND ASSESSMENT DEBT:</u>	<u>% Applicable</u>	<u>Debt 6/1/08</u>
Los Angeles County Flood Control District	2.029%	\$ 2,012,971
Metropolitan Water District	0.926	3,030,011
Pasadena Area Community College District	32.421	27,595,313
La Canada Unified School District	0.230	59,705
Pasadena Unified School District	69.968	138,935,458
City of Pasadena Community Facilities District No. 1	100.	8,685,000
Los Angeles County Improvement District No. 2658-M	0.987	9,870
Los Angeles County Regional Park and Open Space Assessment District	1.858	5,016,507
TOTAL OVERLAPPING TAX AND ASSESSMENT DEBT		\$185,344,835

<u>DIRECT AND OVERLAPPING GENERAL FUND DEBT:</u>		
Los Angeles County General Fund Obligations	1.858%	\$ 18,943,291
Los Angeles County Pension Obligations	1.858	10,160,457
Los Angeles County Superintendent of Schools Certificates of Participation	1.858	331,859
Los Angeles County Sanitation District Nos. 15, 16 & 17 Certificates of Participation	0.357-58.007	14,308,737
Pasadena Area Community College District Certificates of Participation	32.421	1,105,556
City of Pasadena General Fund Obligations	100.	391,704,972⁽¹⁾
City of Pasadena Pension Obligations	100.	123,195,036
TOTAL DIRECT AND OVERLAPPING GENERAL FUND DEBT		\$560,594,908

COMBINED TOTAL DEBT \$745,939,743⁽²⁾

⁽¹⁾ Excludes the Bonds to be sold.

⁽²⁾ Excludes tax and revenue anticipation notes, enterprise revenue, mortgage revenue and tax allocation bonds and non-bonded capital lease obligations.

<u>Ratios to 2007-08 Assessed Valuation:</u>	
Total Overlapping Tax and Assessment Debt	0.98%

<u>Ratios to Adjusted Assessed Valuation:</u>	
Combined Direct Debt (\$515,745,008)	3.16%
Combined Total Debt	4.57%

STATE SCHOOL BUILDING AID REPAYABLE AS OF 6/30/08: \$0

Source: California Municipal Statistics, Inc.

CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES AND APPROPRIATIONS

Article XIII A of the California Constitution

Section 1(a) of Article XIII A of the State Constitution limits the maximum ad valorem tax on real property to 1% of full cash value (as defined in Section 2 of Article XIII A), to be collected by counties and apportioned according to law. Section 1(b) of Article XIII A provides that the 1% limitation does not apply to (1) ad valorem taxes to pay interest or redemption charges on indebtedness approved by the voters prior to July 1, 1978, or (2) any bonded indebtedness for the acquisition or improvement of real property approved on or after July 1, 1978 by two-thirds of the votes cast by the voters voting on the proposition, or (3) any bonded indebtedness incurred by a school district, community college district or county office of education for the construction, rehabilitation or replacement of school facilities or the acquisition or lease of real property for school facilities approved after November 8, 2000 by 55% of the voters of the district or county, as appropriate, voting on the proposition. Section 2 of Article XIII A defines "full cash value" to mean "the county assessor's valuation of real property as shown on the 1975-76 tax bill under 'full cash value' or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment" ("Full Cash Value"). The Full Cash Value may be adjusted annually to reflect inflation at a rate not to exceed 2% per year, or to reflect a reduction in the consumer price index or comparable data for the area under taxing jurisdiction, or may be reduced in the event of declining property value caused by substantial damage, destruction or other factors.

Legislation enacted by the State Legislature to implement Article XIII A provides that, notwithstanding any other law, local agencies may not levy any ad valorem property tax except to pay debt service on indebtedness approved by the voters as described above.

The voters of the State subsequently approved various measures that further amended Article XIII A. One such amendment generally provides that the purchase or transfer of (i) real property between spouses or (ii) the principal residence and the first \$1,000,000 of the Full Cash Value of other real property between parents and children, do not constitute a "purchase" or "change of ownership" triggering reappraisal under Article XIII A. Another amendment permitted the State Legislature to allow a person over the age of 55 who meets certain criteria, or a "severely disabled homeowner," who sells his or her residence and buys or builds another of equal or lesser value within two years in the same county, to transfer the old residence's assessed value to the new residence. Another amendment permitted the State Legislature to allow a person who is either 55 years of age or older, or who is "severely disabled," to transfer the old residence's assessed value to his or her new residence located in either the same or a different county and acquired or newly constructed within two years of the sale of the old residence.

Another amendment permitted the State Legislature to exclude from the definition of "new construction" certain additions and improvements, including seismic retrofitting improvements and improvements utilizing earthquake hazard mitigation technologies, constructed or installed in existing buildings after November 6, 1990.

Article XIII A has also been amended to provide that there would be no increase in the Full Cash Value in the event of reconstruction of property damaged or destroyed in a disaster.

Section 4 of Article XIII A provides that cities, counties and special districts cannot, without a two-thirds vote of the qualified electors, impose special taxes, which has been interpreted to include special fees in excess of the cost of providing the services or facility for which the fee is charged, or fees levied for general revenue purposes.

Article XIII B of the California Constitution

State and local government agencies in California are each subject to annual "appropriations limits" imposed by Article XIII B of the State Constitution ("Article XIII B"). Article XIII B prohibits government agencies and the State from spending "appropriations subject to limitation" in excess of the appropriations limit imposed. "Appropriations subject to limitation" are generally authorizations to spend "proceeds of taxes," which include all tax revenues, and the proceeds to the entity from (i) regulatory licenses, user charges and other user fees to the extent that such proceeds exceed "the cost reasonably borne by that entity in providing the regulation, product, or service" (ii) the investment of tax revenues, and (iii) certain subventions received from the State. No limit is imposed on appropriations for debt service on indebtedness existing prior to the passage of Article XIII B, thereafter

authorized by the voters, required to comply with certain mandates of courts or the federal government, or appropriations of revenue from other certain limited sources.

As amended at the June 5, 1990 election by Proposition 111, Article XIII B provides that, in general terms, a city's annual appropriations limit is based on the appropriations limit for the prior year adjusted annually to reflect changes in cost of living, population and, when appropriate, transfer of financial responsibility of providing services from one governmental unit to another or to a private entity. It may also be adjusted in the event an emergency is determined by the legislative body. If city revenues during any two consecutive fiscal years exceed the combined appropriations limits for those two years, the excess must be returned by a revision of tax rates or fee schedules within the two subsequent fiscal years.

Section 7900, et seq. of the California Government Code defines certain terms used in Article XIII B and sets forth the methods for determining the appropriations limits for local jurisdictions. The City's appropriation limit for fiscal year 2007-08 is \$199,851,168. It has been determined that \$127,310,326 of the City's fiscal year 2007-08 budgeted appropriations is subject to the limitation.

Article XIII C and Article XIII D of the California Constitution

On November 5, 1996, the voters of the State approved Proposition 218, the "Right to Vote on Taxes Act." Proposition 218 added Articles XIII C and XIII D to the State Constitution, which contain a number of provisions affecting the ability of the City to levy and collect both existing and future taxes, assessments, fees and charges.

Article XIII C requires that all new local taxes be submitted to the electorate before they become effective. Taxes for general governmental purposes of the City require a majority vote and taxes for specific purposes, even if deposited in the general fund, require a two-thirds vote. The voter approval requirements of Article XIII C reduce the flexibility of the City Council to deal with fiscal problems by raising revenue through new or extended or increased taxes, and no assurance can be given that the City will be able to raise taxes in the future to meet increased expenditure requirements.

Article XIII D contains several new provisions making it generally more difficult for local agencies to levy and maintain "assessments" for municipal services and programs. "Assessment" is defined to mean any levy or charge upon real property for a special benefit conferred upon the real property. This definition applies to landscape and maintenance assessments for open space areas, street medians, street lights and parks.

Article XIII D also contains several new provisions affecting a "fee" or "charge," defined for purposes of Article XIII D to mean "any levy other than an ad valorem tax, a special tax, or an assessment, imposed by a local government upon a parcel or upon a person as an incident of property ownership, including user fees or charges for a property related service." All new and existing property related fees and charges must conform to requirements prohibiting, among other things, fees and charges which (i) generate revenues exceeding the funds required to provide the property related service, (ii) are used for any purpose other than those for which the fees and charges are imposed, (iii) with respect to any parcel or person, exceed the proportional cost of the service attributable to the parcel, (iv) are for a service not actually used by, or immediately available to, the owner of the property in question, or (v) are used for general governmental services, including police, fire or library services, where the service is available to the public at large in substantially the same manner as it is to property owners. Further, before any property related fee or charge may be imposed or increased, written notice must be given to the record owner of each parcel of land affected by such fee or charge. The City must then hold a hearing upon the proposed imposition or increase, and if written protests against the proposal are presented by a majority of the owners of the identified parcels, the City may not impose or increase the fee or charge. Moreover, except for fees or charges for sewer, water and refuse collection services (or fees for electrical and gas service, which are not treated as "property related" for purposes of Article XIII D), no property related fee or charge may be imposed or increased without majority approval by the property owners subject to the fee or charge or, at the option of the local agency, two-thirds voter approval by the electorate residing in the affected area.

In addition to the provisions described above, Article XIII C removes prohibitions and limitations on the initiative power in matters of any "local tax, assessment, fee or charge." Consequently, the voters of the City could, by future initiative, repeal, reduce or place limitations on the ability of the City to increase any local tax, assessment, fee or charge. "Fees" and "charges," are not defined in Article XIII C, and it is not clear whether the definitions of

these terms in Article XIID (which are generally property-related as described above) would limit the scope of the initiative power set forth in Article XIIC. If the Article XIID definitions are not held to limit the scope of Article XIIC initiative powers, then the Article XIIC initiative power may apply to a broader category of fees and charges than the property-related fees and charges governed by Article XIID that currently constitute a substantial portion of general fund revenues. No assurance can be given that the voters of the City will not, in the future, approve initiatives that repeal, reduce or place limitations on the ability of the City to increase local taxes, assessments, fees or charges.

The interpretation and application of Proposition 218 will ultimately be determined by the courts with respect to a number of the matters discussed above, and it is not possible at this time to predict with certainty the outcome of such determination. The City imposes some taxes, assessments, fees and charges that could be affected by Proposition 218. To date, Proposition 218 has not impacted the revenues that are available to the City to make the Base Rental Payments required pursuant to the Sublease.

Proposition 1A

As part of Governor Schwarzenegger's agreement with local jurisdictions, Senate Constitutional Amendment No. 4 was enacted by the Legislature and subsequently approved by the voters as Proposition 1A ("Proposition 1A") at the November 2004 election. Proposition 1A amended the State Constitution to, among other things, reduce the Legislature's authority over local government revenue sources by placing restrictions on the State's access to local governments' property, sales, and vehicle license fee revenues as of November 3, 2004. Beginning with fiscal year 2008–09, the State will be able to borrow up to 8 percent of local property tax revenues, but only if the Governor proclaims such action is necessary due to a severe State fiscal hardship and two-thirds of both houses of the Legislature approves the borrowing. The amount borrowed is required to be paid back within three years. The State also will not be able to borrow from local property tax revenues for more than 2 fiscal years within a period of 10 fiscal years. In addition, the State cannot reduce the local sales tax rate or restrict the authority of local governments to impose or change the distribution of the statewide local sales tax.

Proposition 1A also prohibits the State from mandating activities on cities, counties or special districts without providing for the funding needed to comply with the mandates. Beginning in fiscal year 2005–06, if the State does not provide funding for the mandated activity, the requirement on cities, counties or special districts to abide by the mandate would be suspended. In addition, Proposition 1A expanded the definition of what constitutes a mandate on local governments to encompass State action that transfers to cities, counties and special districts financial responsibility for a required program for which the State previously had partial or complete responsibility. The State mandate provisions of Proposition 1A do not apply to schools or community colleges or to mandates relating to employee rights.

Proposition 62

A statutory initiative ("Proposition 62") was adopted by State voters at the November 4, 1986 General Election, which (1) requires that any tax for general governmental purposes imposed by local governmental entities be approved by resolution or ordinance adopted by two-thirds vote of the governmental agency's legislative body and by a majority of the electorate of the governmental entity voting in such election, (2) requires that any special tax (defined as taxes levied for other than general governmental purposes) imposed by a local governmental entity be approved by a two-thirds vote of the voters within that jurisdiction voting in such election, (3) restricts the use of revenues from a special tax to the purpose or for the service for which the special tax was imposed, (4) prohibits the imposition of ad valorem taxes on real property by local governmental entities except as permitted by Article XIII A, (5) prohibits the imposition of transaction taxes and sales taxes on the sale of real property by local governmental entities and (6) requires that any tax imposed by a local governmental entity on or after August 1, 1985 be ratified by a majority vote of the electorate voting in such election within two years of the adoption of the initiative or be terminated by November 15, 1988. Proposition 62 requirements are generally not applicable to general taxes and special taxes levied prior to its November 4, 1986 effective date.

On September 28, 1995, the California Supreme Court filed its decision in *Santa Clara County Local Transportation Authority v. Carl Guardino*, 11 Cal. 4th 220 (1995) (the "Santa Clara decision"), which upheld a Court of Appeal decision invalidating a 1/2-cent countywide sales tax for transportation purposes levied by a local

transportation authority. The California Supreme Court based its decision on the failure of the authority to obtain a two-thirds vote of the electorate for the levy of a "special tax," as required by Proposition 62. The Santa Clara decision did not address the question of whether or not it should be applied retroactively.

On December 15, 1997, the Court of Appeals for the State of California, Fourth Appellate District, in *McBrearty v. City of Brawley*, a presently published opinion, determined that (i) *Guardino* is to be applied retroactively to require voter approval of previously enacted taxes, and (ii) the three-year statute of limitations applicable to such taxes runs from the date of the *Guardino* decision (September 28, 1995).

In deciding the *Santa Clara* case on Proposition 62 grounds, the Court disapproved the decision in *City of Woodlake v. Logan*, 230 Cal. App. 3d 1058 (1991) ("*Woodlake*"), where the Court of Appeal had held portions of Proposition 62 unconstitutional as a referendum on taxes prohibited by the California Constitution. The California Supreme Court determined that the voter approval requirement of Proposition 62 is a condition precedent to the enactment of each tax statute to which it applies, while referendum refers to a process invoked only after a statute has been enacted. Numerous taxes to which Proposition 62 would apply were imposed or increased without voter approval in reliance on *Woodlake*. The Court notes as apparently distinguishable, but did not confirm, the decision in *City of Westminster v. County of Orange*, 204 Cal. App. 3d 623 (1988), which held unconstitutional the provision of Proposition 62 requiring voter approval of taxes imposed during the "window period" of August 1, 1985 until November 5, 1986.

Following the *Guardino* decision upholding Proposition 62, several actions were filed challenging taxes imposed by public agencies since the adoption of Proposition 62. On June 4, 2001, the California Supreme Court released its decision in one of these cases, *Howard Jarvis Taxpayers Association v. City of La Habra, et al.* ("*La Habra*"). In this case, the court held that a public agency's continued imposition and collection of a tax is an ongoing violation upon which the statute of limitations period begins anew with each collection. The court also held that, unless another statute or constitutional rule provided differently, the statute of limitations for challenges to taxes subject to Proposition 62 is three years. Accordingly, a challenge to a tax subject to Proposition 62 may only be made for those taxes received within three years of the date the action is brought.

Proposition 62 as an initiative statute does not have the same level of authority as a constitutional initiative, but is analogous to legislation adopted by the State Legislature, except that it may be amended only by a vote of the State's electorate. Since the passage of Proposition 218, however, certain provisions of Proposition 62 (e.g., voter approval of taxes) are governed by the State Constitution. In the view of the City Attorney, Proposition 62 does not apply to charter cities such as the City.

Future Initiatives

Article XIII A, Article XIII B, Proposition 218, Proposition 111 and Proposition 62 were each adopted as measures that qualified for the ballot pursuant to the State's initiative process. From time to time, other initiative measures could be adopted, further affecting City General Fund revenues or the City's ability to expend revenues. The nature and impact of these measures cannot be anticipated by the City. The State Supreme Court has held that an initiative can repeal a tax ordinance and prohibit the imposition of further such taxes, and that the Constitutional prohibition against referenda on tax levies does not apply to initiatives.

STATE OF CALIFORNIA BUDGET INFORMATION

The following information concerning the State of California (the "State") has been obtained from publicly available information which the City believes to be reliable; however, the City takes no responsibility as to the accuracy or completeness thereof and has not independently verified such information. Information about the State budget is regularly available at various State-maintained websites. Text of the State budget may be found at the Department of Finance website, www.dof.ca.gov, under the heading "California Budget." An impartial analysis of the State budget is posted by the Office of the Legislative Analyst (the "LAO") at www.lao.ca.gov. In addition, various State of California official statements, many of which contain a summary of the current and past State budgets, may be found at the website of the State Treasurer, www.treasurer.ca.gov. The information referred to is prepared by the respective State agency maintaining each website and not by the City and the City takes no responsibility for the continued accuracy of the internet addresses or for the accuracy or timeliness of information posted there, and such information is not incorporated herein by these references.

2008 Budget Act

On August 24, 2007 the Governor signed the State Budget Act for Fiscal Year 2007-08 (the "2008 Budget Act"). The 2008 Budget Act assumes a carryover balance from fiscal year 2006-07 of \$4.8 billion. The 2008 Budget Act projects \$102.3 billion in revenues for fiscal year 2007-08 and authorizes the expenditure of an equal amount, leaving the State General Fund with a year-end reserve of \$4.1 billion. Even though the expenditures authorized under the 2008 Budget Act do not exceed the projected revenues for fiscal year 2007-08, the State will still face operating shortfalls in both fiscal years 2008-09 and 2009-10. According to the LAO, the shortfall in future years is due to the fact that many of the State's solutions enacted in the 2008 Budget Act are one-time in nature. For example, the State assumes \$1 billion in one-time revenues from the sale of EdFund, the State's nonprofit student loan guaranty agency, \$293 million in General Fund revenues from amended tribal gaming compacts and \$600 million in General Fund revenues due to the transfer from the State's tobacco securitization fund, which transfer was originally scheduled for fiscal years 2008-09 and 2009-10. In addition, due to the fluctuation in estimates of State revenues in fiscal year 2006-07, the 2008 Budget Act assumes no additional Proposition 98 funding for fiscal year 2006-07. If, however, the finalized revenue figures for fiscal year 2006-07 are higher than expected, the State will automatically owe a settle-up payment of approximately \$411 million for fiscal year 2006-07 Proposition 98 funding, which will be paid out of the State's reserve. The 2008 Budget Act also uses \$567 million of one-time and special fund monies to support fiscal year 2007-08 K-12 costs, which results in the State entering fiscal year 2008-09 with a large ongoing shortfall for K-12 education.

Certain of the features of the 2008 Budget Act affecting cities include the following:

1. The 2008 Budget Act suspends funding for California Work Opportunity Responsibility to Kids cost-of-living adjustments for one year and permanently delays for five months the annual State Supplemental Security Income/State Supplementary Program cost-of-living adjustments. The 2008 Budget Act also provides \$35.7 million for county-operated housing assistance programs for emancipated foster youth, of which \$10.5 million is available for reimbursement to counties for costs incurred in fiscal year 2006-07.

2. The 2008 Budget Act provides approximately \$14.3 billion from the General Fund for Medi-Cal expenditures. Approximately \$50.8 million (\$25.4 million from the General Fund) will be provided to county administrations to fund the costs incurred in connection with the implementation of new federal regulations under the Deficit Reduction Act of 2005.

3. Pursuant to Proposition 1A, the State is required to repay local agencies for previously unreimbursed State mandates. The 2008 Budget Act includes only reimbursements for mandates performed in fiscal year 2006-07 and delays the reimbursements for mandates to be performed in fiscal year 2007-08 until fiscal year 2008-09.

4. The 2008 Budget Act appropriates approximately \$4.2 billion for transportation programs, \$950 million of which will be allocated to cities and counties for local streets and roads.

Complete text of the 2007 Budget Act may be found at the website of the Department of Finance (www.dof.ca.gov), under the heading "California Budget." Information on the website is not incorporated herein by reference.

Proposed 2008-09 Governor's Budget

The 2008-09 Governor's Budget, released on January 10, 2008 projects to end fiscal year 2008-09 with a \$2.8 billion total reserve. General Fund revenues and transfers for fiscal year 2008-09 are projected at \$102.9 billion, an increase of \$1.7 billion compared with revised estimates for fiscal year 2007-08. General Fund expenditures for fiscal year 2008-09 are projected at \$101.0 billion, a decrease of \$2.4 billion, or 2.0 percent compared with the revised estimates for 2007-08.

The 2008-09 Governor's Budget has the following major components which might affect cities:

1. Budget Balancing Reductions — The 2008-09 Governor's Budget proposes budget-balancing reductions of \$216.6 million in 2007-08 and \$9.1 billion in 2008-09 to close the \$14.5 billion budget gap. The 10

percent across-the-board reductions applies to all General Fund departments and programs, Boards, Commissions, and elected offices including the legislative and judicial branches except where such a reduction is in conflict with the State constitution or impractical. Many of the reductions require implementation as early as March 1, 2008 in order to achieve a full 10 percent reduction in 2008-09.

2. Cash Flow Management — The deterioration of the budget reserve in the current year has resulted in a projected cash shortage in July and August 2008. In order to manage cash flow for current and budget years and ensure timely payments of the State's debts, the 2008-09 Governor's Budget proposes cash management solutions totaling \$8.7 billion (\$4.2 billion in 2007-08 and \$4.5 billion in 2008-09). These include selling \$3.313 billion of Economic Recovery Bonds by the end of February 2008 to help current year cash flow (which bonds were issued on February 14, 2008) and, among other solutions, delaying disbursement of deferred apportionments for K-12 schools and community colleges to achieve \$1.3 billion savings.

3. Health and Human Services — The 2008-09 Governor's Budget includes \$29.3 billion General Fund for Health and Human Service Programs after budget-balancing reductions, which is a decrease of \$279 million or 1.0 percent below the revised 2007-08 estimate. The 2008-09 Governor's Budget includes \$27.1 million in General Fund expenditure increases in Health and Human Services programs due to policy adjustments.

4. Transportation Funding - The 2008-09 Governor's Budget includes \$1.485 billion to fully fund Proposition 42 in 2008-09. Proposition 1A was passed in November 2006 and provides for the repayment of any remaining Proposition 42 debt by the year 2015-16. Pursuant to Proposition 1A, the 2008-09 Governor's Budget repays \$83 million from the 2003-04 and 2004-05 Proposition 42 suspensions. Because the issuance of tribal gaming bonds continues to be delayed, the Governor's Budget proposes to use the \$100 million in tribal gaming compact revenues that will be received in 2007-08 and 2008-09 until the bonds are sold, to repay past loans made from the State Highway Account, the Traffic Congestion Relief Fund, and the Public Transportation Account ("PTA"). Proposition 1B was also passed in November 2006, providing \$19.925 billion in bonding authority for a total of 16 programs intended to address a broad range of transportation priorities including rehabilitation and expansion of highways, transit and transit security, port security, and air quality. The authority for the use of any bond funds must be provided for in the Budget Act. The Governor's Budget proposes to appropriate \$4.7 billion in Proposition 1B funding.

Department of Finance Reports Show Continuous Weakening in State Economy. Since the release of the 2008-09 Governor's Budget, monthly finance bulletins issued by the Department of Finance (available at www.dof.ca.gov) have shown continuing weak economic performance in early 2008, including continued job losses in the State and further weakening of the housing markets. These reports have also disclosed General Fund revenues falling below the forecasts made in the 2008-09 Governor's Budget, with the weakest performance among the three major tax sources in sales and use tax receipts. The Department of Finance's April 2008 report on receipts for the month of March reflects continued weakness in performance in corporate tax revenues, and that actual General Fund revenues through March are \$1.184 billion below those forecasted in the 2008-09 Governor's Budget. Continuing revenue declines will exacerbate the fiscal challenges facing the State, and depending on their severity, could increase the projected shortfall by the end of fiscal year 2008-09 by multiple billions of dollars.

LAO Assessment of the 2008-09 Governor's Budget. The LAO has released several reports which include their estimates and assessments of State budget acts and associated fiscal and economic projections. These include a report titled "Analysis of the 2008-09 Budget Bill: Perspectives and Issues" dated February 20, 2008. In the report, the LAO makes the following statements in "The State's Fiscal Picture" section:

"Primarily due to the continued deterioration of the State's revenue outlook, we project that the State's budget shortfall (prior to any corrective actions) has increased to about \$16 billion. Consequently, the reserve at the end of 2008-09 under the Governor's budget policies would be \$1.1 billion—\$1.6 billion less than forecasted by the administration. Despite achieving a positive reserve, we conclude that the administration's budget-balancing approach is fundamentally flawed. Its across-the-board reductions reflect little effort to prioritize and determine which state programs provide essential services or are most critical to California's future. In the absence of a credible plan that prioritizes state spending and revenues, we offer an alternative approach for the Legislature's consideration. By making more targeted reductions and adding ongoing revenue solutions, we believe this approach offers the Legislature a better foundation to begin crafting a 2008-09 budget that focuses on essential services."

May Revision to the 2008-09 Governor's Budget. On May 14, 2008, the Governor released the May Revision to the 2008-09 Governor's Budget (the "May Revision"). The May Revision projects a current budget gap of \$17.2 billion, approximately \$3.0 billion more than the \$14.5 billion budget gap reflected in the 2008-09 Governor's Budget. The May Revision attributes the difference to a lower than expected gross domestic product growth, weaker State job growth, and smaller gains in State personal income in calendar years 2008 and 2009.

The May Revision proposes a combination of spending reductions and revenue solutions to address the State budget gap and to provide for reserves of approximately \$2.0 billion. The May Revision fully funds the Proposition 98 guarantee and abandons earlier proposals by the Governor to close over 40 State parks and to release certain California prison inmates early. The Governor also proposes in the May Revision \$12.6 billion in expenditure reductions across State government and \$627 million in additional reductions to health and human service programs.

The May Revision includes the Governor's plan to address the State's current and ongoing budget problem, which plan focuses on four elements: (1) the Budget Stabilization Act, a constitutional amendment that seeks to address the cyclical nature of the State's revenues by establishing a Revenue Stabilization Fund (the "RSF") in which General Fund revenues above a certain cap would be deposited in the RSF, with certain amounts set aside in an educational subaccount, (2) the sale of bonds backed by the securitization of a portion of State lottery revenues, with the expectation that such securitization will generate \$5.1 billion for the RSF in fiscal year 2008-09 and a total of \$15 billion by fiscal year 2010-11, (3) a temporary 1% sales tax increase as a fail-safe mechanism in the event that the ballot measure authorizing the securitization of lottery revenues is not approved by voters, and (4) the creation of a Tax Modernization Commission to conduct a comprehensive examination of California's tax laws.

Impact of the State Budget on the City

The City cannot predict what actions will be taken in future years by the State Legislature and the Governor to address future State budget deficits. Future State budgets will be affected by national and state economic conditions and other factors over which the City has no control. To the extent that the State budget process results in reduced revenues to the City, the City will be required to make adjustments to its budget.

The Governor's 10% across the board cuts for the current and next fiscal years will have the greatest impact on the City's health department. In response, for fiscal year 2009, the health department's budget has been reduced mostly through the reduction of vacant positions and the City has reserved \$850,000 in the General Fund to be transferred to the Health Fund should State funding not be restored. For fiscal year 2010, should State funding not be restored the City may need to reduce services further, continue General Fund support, or some combination thereof. The fiscal year 2009 budget for the City's health department is approximately \$12 million.

APPENDIX B
AUDITED FINANCIAL STATEMENTS OF
THE CITY OF PASADENA

APPENDIX C
PROPOSED FORM OF BOND COUNSEL OPINION

APPENDIX D
BOOK-ENTRY SYSTEM

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APPENDIX E
SUMMARY OF PRINCIPAL LEGAL DOCUMENTS