Review of the

County of Santa Clara

FY 2009-10 Recommended Budget

Prepared for the
Board of Supervisors of the
County of Santa Clara

Prepared by the
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County of Santa Clara

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June 11, 2009

To: Board of Supervisors

From: Management Audit Manager RM

Subject: **Analysis of the FY 2009-10 Santa Clara County Recommended Budget**

The attached report is a limited review of the FY 2009-10 County of Santa Clara Recommended Budget. To prepare this report, we analyzed major County revenue and expenditure accounts that receive funds from or contribute funds to the County General Fund. Other funds were also analyzed when appropriate. In addition, we reviewed FY 2008-09 revenue and expenditure reports through Accounting Period 10, the FY 2009-10 Recommended Budget document, and other documents and work papers prepared by staff of the County Executive's Office and individual departments. Our staff met with County Executive staff, various County financial officers, and department managers regarding the assumptions and projections upon which the FY 2009-10 Recommended Budget is based. The report has been discussed with the Budget Director, who will provide a separate written response to the recommendations contained herein.

The County Executive's FY 2009-10 Recommended Budget includes $4,008,279,044 in expenditures for all funds, which amounts to $1,499,081, or 0.04 percent, less than the $4,009,778,125 budget adopted by the Board of Supervisors for FY 2008-09. The Recommended Budget for FY 2009-10 also includes 15,336.3 positions, or 27.4 positions (0.18 percent) less than the 15,363.7 positions approved by the Board of Supervisors as of July 1, 2008. In terms of the General Fund, the FY 2009-10 Recommended Budget includes $2,193,622,340 in expenditures, which amounts to $46,550,293, or 2.08 percent, less than the $2,240,172,633 budget adopted by the Board of Supervisors for FY 2008-09. The Recommended Budget for FY 2009-10 also includes 9,063.7 General Fund positions, or 223.4 positions (2.41 percent) less than the 9,287.1 positions approved by the Board of Supervisors as of July 1, 2008.

The attached table summarizes our recommended revenue and expenditure changes by individual findings within Budget Units. Detailed explanations of our recommendations are discussed in the body of the report. In total, this report includes General Fund and other recommendations that amount to $14,960,508 in net reduced revenue and $31,119,348 in net reduced expenditures, for a combined net increase in resources of $16,158,840. These adjustments pertain to the projected FY 2008-09 General Fund Balance and the FY 2009-10 Recommended Budget.

We would like to thank the Office of Budget and Analysis and various departmental staff for their cooperation, responsiveness and assistance during the FY 2009-10 Budget Review.

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SUMMARY OF MANAGEMENT AUDIT DIVISION RECOMMENDATIONS
FY 2009-10 BUDGET REVIEW

Item No.	Budget Unit	Department Name	Revenue/Expenditure Account	Revenue Increases	Expenditure Decreases	Net Savings
1	101-509	General Fund Balance	Additional Salary and Benefit Savings	-	802,596	802,596
2	110	General Fund Balance	Aircraft Taxes	109,000	-	109,000
3	101-509	All Departments	Salary Savings Factor	-	13,963,955	13,963,955
4	101-921	All Departments	Budget Salary Reduction	-	111,627	111,627
5	108	Countywide Modified Financial Policies	Salaries and Employee Benefits	-	3,248,081	3,248,081
6	112	Tax Collector's Office	Secured Property Tax	4,920,000	-	4,920,000
7	112	Tax Collector's Office	Supplemental Property Tax	(2,150,000)	-	(2,150,000)
8	112	Tax Collector's Office	Penalties and Costs	67,698	-	67,698
9	135	Fleet Management	Building and Improvements	-	560,243	560,243
10	135	Fleet Management	Bulk Fuel	-	601,527	601,527
11	148	Department of Revenue	Civil Assessments	1,600,000	-	1,600,000
12	217	Criminal Justice System-wide Costs	Public Safety Sales Tax	(13,057,245)	-	(13,057,245)
13	230	Office of the Sheriff	Professional and Specialized Services	-	350,000	350,000
14	235	Department of Correction	Food	-	340,672	340,672
15	410-921	Health and Social Services	Realignment Sales Tax	(6,449,961)	-	(6,449,961)
16	921	Valley Medical Center	Budget and Accounting Systems	-	-	-
17	921	Valley Medical Center	Salaries and Employee Benefits	-	2,600,000	2,600,000
18	921	Valley Medical Center	Services and Supplies (See Items Below)	-	-	-
18.1	921	Valley Medical Center	Consulting Fee-Legal	-	394,330	394,330
18.2	921	Valley Medical Center	Electricity, Natural Gas and Water	-	1,520,000	1,520,000
19	921	Valley Medical Center	Interest Expense	-	6,626,317	6,626,317
	TOTAL			**(14,960,508)**	**31,119,348**	**16,158,840**

FY 2008-09 General Fund Balance

The FY 2009-10 Recommended Budget includes as a one-time revenue source an estimate of $126,261,000 in General Fund Balance to be carried over from FY 2008-09 to FY 2009-10. This includes approximately $129.8 million in unspent contingency reserve funds and $27.8 million in unspent State Budget Reserve Funds, as well as $13.2 million in prior year Social Services Agency revenue and $12.4 million in American Recovery and Reinvestment Act funds, for total resources of $183.1 million. However, the General Fund Balance estimate also assumes that department budgets will end FY 2008-09 with a $56.8 million deficit of expenditures versus revenues, primarily due to considerable revenue shortfalls related to the economic recession and the housing market crisis. To help address the County's budget, the Management Audit Division has identified additional savings that will be generated from unexpended salaries and benefits and aircraft taxes. Our analysis of each General Fund Balance source follows.

1. *Additional Salary and Benefit Savings*

Based on an analysis of Accounting Period 10 data, which reflects actual expenditures through April 30, 2008, and payroll data from May, the Management Audit Division projects that $13,278,484 of net unbudgeted salary savings will be achieved in FY 2008-09. In comparison, the Office of Budget and Analysis (OBA) is reporting on its Financial Status Report for Accounting Period 10 that the County will achieve only $12,475,888 in net unbudgeted salary savings in FY 2008-09. Differences in the projections from OBA and the Management Audit Division are illustrated in the following table.

Comparison of OBA and Management Audit Division
Estimates of FY 2008-09 Unbudgeted Salary Savings

	OBA	Mgmt Audit
Budgeted Expenditures*	$1,084,655,660	$1,084,863,346
Projected Expenditures	(1,065,892,595)	(1,066,386,629)
Projected Unbudgeted Salary Savings**	**$18,709,543**	**$18,476,717**
Adjustment for Social Services Revenue	(2,185,172)	(1,024,974)
Adjustment for Mental Health Revenue	(689,031)	(669,658)
Adjustment for Sheriff's Revenue	(3,359,452)	(3,503,602)
Total Revenue Adjustments***	(6,233,655)	(5,198,233)
Adjusted Projected Unbudgeted Savings	**12,475,888**	**13,278,484**
Difference in Net Projections		**$802,596**

* Budgeted expenditures include budgeted salary savings, which is a negative appropriation that reduces funding for authorized positions to take into account unspent appropriations resulting from vacant positions and the savings realized from filling vacant positions at a lower salary level than originally

budgeted. The budget figures differ for OBA and the Management Audit Division because OBA used the current modified budget reported by departments, and the Management Audit Division used the current modified budget reported in SAP.

** Unbudgeted salary savings is the difference between what was budgeted for salary savings and what was actually achieved. Our projection of FY 2008-09 actual salary savings amounts to $37,089,284.

*** The adjustment for Social Services Agency, Mental health (Prop. 63) and Sheriff's Department (court security, VTA, contract cities) revenue reflects the fact that these budget units have substantial amounts of reimbursement revenue that would not be received if corresponding expenditures did not occur. We have therefore offset both our salary savings estimate and OBA's for those agencies by the percentage of expenditures offset by these revenues. Also, salary savings estimates do no include the budgets for the five members of the Board of Supervisors, since Board members have full control of their own budgets.

Our projection of net unbudgeted salary savings for FY 2008-09, after adjustment for lost reimbursements, is approximately $803,000 million greater than that of OBA. While both projections are based on actual expenses through Accounting Period 10, they rely on slightly different methodologies to project salary and benefit expenses through the end of the year. The Management Audit Division's projection incorporates year-to-date expenses, net of accruals, and an estimate of year-end expenses based on current payroll data and the number of workdays remaining in the year. The methodology that OBA has developed is similar but uses the number of pay periods remaining in the year plus a year-end accrual period to project year-end expenses based on current payroll data.

In addition, because Registrar of Voters comprises most of the difference, the Management Audit Division compared its projection in FY 2008-09 to the level of savings achieved previously. Our projection of FY 2008-09 unbudgeted salary savings for the Registrar amounts to $1,274,956, on a projected total Object 1 expenditure of $8,424,123. In FY 2007-08, salary savings in this budget was $695,047, on an Object 1 expenditure of $8,408,367. Expenditures in the two years were similar, but the budgeted amount in the current fiscal year was much higher. In reviewing a draft version of this report, we also checked whether Registrar payroll for the pay period ended May 31, which included the May 19 special election, was unusually high, and therefore could account for the Registrar's projected salary expenditure of $9.36 million, substantially higher than ours. Our review found the May 31 payroll to be in line with prior payrolls. Based on these factors, we are therefore comfortable with our projection and believe that the registrar will achieve nearly 1.3 million in unbudgeted salary savings in FY 2008-09.

Based on our analysis, we recommend that the County Executive recognize that an additional $802,596, for a total of $13,278,484 will be generated from net unbudgeted salary savings in FY 2008-09.

2. *Aircraft Taxes*

This line item represents revenue from personal property taxes assessed on airplanes. In FY 2007-08, receipts of $4,875,008 were received as of Period 10, which amounted to 89.17 percent of the $5,466,523 that was ultimately collected. Applying this same percentage to the current fiscal year, year-to-date collections of $4,645,594 should result in a year-end collection of $5,209,273, or about $109,000 higher than the current forecast by the Controller's Office of $5,100,000. The additional $109,000 would be an addition to the FY 2008-09 year-end Fund Balance. The Office of Budget and Analysis agrees with this change.

FY 2009-10 Departmental Budgets

BU 101-509 – All Departments	**Various Pages**

3. *Salary Savings Factor*

Expenditure Account 5107000		**Salary Savings Factor**
County Executive Recommended	**Management Audit Proposed**	**Expenditure Decrease**
($19,140,524)[1]	**($33,104,479)[1]**	**$13,963,955**

The County Executive has recommended a General Fund budget of $20,786,281 in the expenditure account for salary savings in FY 2009-10. This is a negative appropriation that reduces funding for authorized positions to take into account unspent appropriations resulting from vacant positions, and the savings realized from filling vacant positions at a lower salary level than originally budgeted. Of this amount, $19,140,524 is budgeted for General Fund departments, excluding Budget Unit 200 for Child Support Services, since it is fully supported by State and federal sources[2]. The budgeted amount represents a 2.92 percent salary savings factor on the permanent employee salaries budget of $712,839,518.

In a past memo to the Board of Supervisors, the County Executive explained that salary savings factors differ between General Fund departments, based on operational factors, but average between 3 percent and 4 percent Countywide. The County Executive bases the salary savings factor solely on permanent employee salaries, since employee benefits rates are calculated using a vacancy rate factor that results in a built-in salary savings for these expenses. However, not all benefits have this built-in salary savings. This includes the County-paid employee share of PERS as well as FICA and Medicare. As a result, budgeted salary savings, not including Child Support Services and the Board of Supervisors, amounts to only about 1.73 percent of the gross budget for salaries and benefits in FY 2009-10.

Because budgeted salary savings does not account for all benefits, we compared our projection of FY 2008-09 actual salary savings to the County Executive's recommendation of FY 2009-10 budgeted salary savings. Based on Accounting Period 10 data, we project that actual salary savings for the current fiscal year will amount to $43,830,015, or $18,476,717 in excess of the FY 2008-09 budget for salary savings. This equates to about a 3.95 percent actual salary savings factor in FY 2008-09 for General Fund departments, excluding Child Support Services and the Board of Supervisors. <u>As a result, the projected salary savings realized for FY 2008-09 is more than double the budgeted salary savings for FY 2009-10, as shown in the following table.</u>

[1] Excludes Budget Unit 200, which is 100 percent State funded, and the Board of Supervisors budgets.
[2] We also have excluded the Board of Supervisors budgets, since those budgets are fully in the control of each individual Board member.

Comparison of FY 2008-09 Projected and FY 2009-10 Budgeted
Salary Savings for General Fund Departments

	FY 2008-09 Projected	FY 2009-10 Budgeted
Salary Savings	$43,830,015	$19,140,524
Gross Budgeted Salaries and Benefits	$1,110,216,644	$1,103,482,632
Salary Savings Factor	**3.95%**	**1.73%**

A salary savings factor of 3.95 percent falls within the range of 3 to 6 percent that the Board of Supervisors has established as its policy relating to salary savings (Board Policy No. 4.5). It is also in line with the actual salary savings factor achieved in the fiver prior years, as follows:

Fiscal Year	Salary Savings Factor
FY 2008-09	3.95 percent
FY 2007-08	4.74 percent
FY 2006-07	4.93 percent
FY 2005-06	3.78 percent
FY 2004-05	6.16 percent
FY 2003-04	5.66 percent

In addition, based on payroll information for General Fund departments as of May 4, 2009, the FY 2009-10 Recommended Budget includes 592.5 full-time equivalent (FTE) vacant funded positions, at a cost of $60,306,645 (see Attachment 1). If these positions, or another combination of positions with the same total cost, remained vacant throughout the year, the salary savings factor that would be achieved is 5.4 percent, excluding use of such savings for overtime and extra help in some departments, primarily those with 24/7 operations. Consequently, if only half the cost of the vacant positions were saved, the County would achieve a salary savings factor of approximately 2.7 percent, versus the 1.73 percent that is included in the FY 2009-10 Recommended Budget.

During the review process of a draft version of this report, OBA staff asserted that our analysis of salary savings did not account for the impact of the 94.5 FTE vacant positions being eliminated in the FY 2009-10 budget, or the impact of another 84.5 FTE current vacant positions that will be filled shortly by employees whose positions are being eliminated by budget cuts. In fact, Attachment 1 only addresses vacant positions that are budgeted in the FY 2009-10 Recommended Budget. Furthermore, even after accounting for salary savings that would not occur due to the immediate filling of 84.5 FTE vacant positions by staff whose positions are being cut, the budgeted cost of the remaining vacancies, based on an average cost per position of $101,783, is still approximately $51.7 million. In addition, this analysis assumes that no new vacancies will occur in FY 2009-10. The Employee Services Agency reports that approximately 394 FTE General Fund vacancies have occurred thus far in FY 2008-09.

Consequently, we believe that there is a significant amount of additional salary savings that will occur in the 2009-10 Fiscal Year, if the Recommended Budget is adopted with only the budgeted salary savings of 1.73 percent of Object 1 expenditures. If the Board increases the budgeted rate of salary savings to 3.0 percent after adjustments for loss of reimbursements from the Social Services Agency, Mental Health Department and the Sheriff's Department, a net gain in General Fund resources of approximately $5.4 million would be available in FY 2009-10. This money would be available for the Board to use for other spending priorities.

BU 101-921 – All Departments	Various Pages

4. *Salary Calculation Adjustment*

Expenditure Account 5107100		Budget Salary Reduction
County Executive Recommended	Management Audit Proposed	Expenditure Decrease
($3,794,745)	($3,906,372)	$111,627

Detail of the Budget Reduction Shown Above for General Fund Departments[3] (Object 1):

Expenditure Account 5107100		Budget Salary Reduction
County Executive Recommended	Management Audit Proposed	Expenditure Decrease
($3,553,252)	($3,616,109)	$62,857[4]

VMC Enterprise Fund (Object 1):

Expenditure Account 5107100		Budget Salary Reduction
County Executive Recommended	Management Audit Proposed	Expenditure Decrease
($241,493)	($290,263)	$48,770[4]

The FY 2009-10 Recommended Budget includes negotiated salary increases for several of the County employee bargaining units that are separately represented by labor organizations. As of the date the Recommended Budget was published many of the collective bargaining agreements had been renegotiated to reduce or eliminate scheduled salary increases, while negotiations with some labor organizations were still ongoing. Each collective bargaining agreement provides for a percentage salary increase effective as of various dates throughout the fiscal year. The FY 2009-10 Recommended Budget includes increases for eight labor organizations on a date other than the first day of a month. Because the County's current budget software entitled BRASS, which is used by the Office of Budget and Analysis (OBA), is limited in its capability to precisely

[3] If the Board of Supervisors approves this recommended budget adjustment, the detail by budget unit will be provided.

[4] The amount shown is net of most if not all reduced State, federal and other reimbursements that would not be realized. Includes Budget Units 202, 204, 230, 235, 240, 293, 410, 412, 414, 418 and 921.

calculate employee salary increases, changes in rates of pay can only be calculated from the first day of a month.

Consequently, the FY 2009-10 increased salary and fringe benefit cost of the eight bargaining units were automatically calculated from the first day of the month preceding the effective date of the negotiated increase, thereby overstating the FY 2009-10 budget. Based on our analysis, the net cost of salaries and fringe benefits (in General Fund cost centers after excluding reimbursements) are overstated by approximately $111,627. Of this amount, $53,776 pertains to two days calculated at the 4.0 percent increased rate of pay which goes into effect on November 3, 2009, but was budgeted effective November 1, 2009 for certain nursing classifications represented by union codes 01, 04 and 92. Another $45,291 is attributable to six days calculated at a 6.0 percent increased rate of pay which goes into effect on September 7, 2009, but was budgeted effective September 1, 2009 for certain law enforcement classifications represented by union codes 01, 09, 10, 18 and 30. Lastly, an additional $12,560 relates to one day calculated at the 5.0 percent increased rate of pay which goes into effect on June 2, 2010, but was budgeted effective June 1, 2010 for deputy sheriff and correction officer classifications represented by union code 30.

Detailed schedules of positions by classification, cost center, budget unit and fund are available, and identify the excess salary and fringe benefit costs that are included in the FY 2009-10 Recommended Budget.

BU 108 – Countywide Modified Financial Policies	**Page 85**

5. *Prepayment of Annual Employer Contribution to CalPERS*

Expenditure Account 5100000		**Salaries and Employee Benefits**
County Executive Recommended	**Management Audit Proposed**	**Expenditure Decrease**
($5,885,000)	**($9,133,081)**	**$3,248,081**

Detail of the Net Budget Reduction Shown Above for All Funds (Object 1):

Expenditure Account 5110600		**PERS Retirement**
County Executive Recommended	**Management Audit Proposed**	**Expenditure Decrease**
$231,397,764	**$217,255,315**	**$12,428,076**
Revenue Account 4301100 **Revenue Account (various)**		**Interest on Deposits** **Various Reimbursements**
County Executive Recommended	**Management Audit Proposed**	**Revenue (Decrease)**
Interest on Deposits **$22,296,568**	**$20,825,501**	**($1,471,067)**
Various Reimbursements		**($1,244,721)**

The FY 2009-10 Recommended Budget includes approximately $158.5 million of County paid contributions to CalPERS pertaining to employer contribution requirements. This amount includes approximately $155.6 million budgeted as CalPERS Retirement and $2.9 million budgeted as Miscellaneous Salaries. Additional employer contributions to CalPERS made by miscellaneous employees amount to approximately $34.9 million and are budgeted as permanent salaries. This amount accounts for the increased cost of the 2.5 percent at 55 years of age retirement plan versus the prior plan of 2.0 percent at 50 years of age. Finally, the employer contribution paid by the Superior Court on its employees is estimated to amount to $6.0 million. In total, the FY 2009-10 County employer contribution to CalPERS amounts to $199.4 million.

This annual contribution amount was calculated based on bi-weekly County payments throughout the fiscal year. The Recommended Budget proposes that the FY 2009-10 annual employer contribution again be prepaid in order to take advantage of the interest rate differential between the CalPERS assumed rate of return of 7.75 percent and the County's projected FY 2009-10 average rate of return on Commingled Fund investments of 1.62 percent. As a result, an estimated net benefit of $5.9 million was budgeted for the General Fund and the Valley Medical Center Enterprise Fund.

However, working with the Employee Services Agency (ESA) fiscal staff, we were able to do a more detailed analysis of the amounts budgeted for employer contributions to CalPERS for the employer share of costs only, versus the comparable fixed prepayment amount of $186.9 million offered by CalPERS. Our analysis determined that the recommended budget was based on an employer contribution rate of 10.172 percent instead of a rate of 9.948 percent, which is the official FY 2009-10 CalPERS employer contribution rate of 12.879 percent minus 2.931 percent, which is the portion of the employer rate paid by employees. As a result, the Recommended Budget overstated the CalPERS employer contribution.

Our analysis also determined that the total net benefit to the County is approximately $12.4 million. The benefit to the General Fund and Valley Medical Center Enterprise Fund would amount to approximately $9.1 million, and other funds would benefit by about $0.6 million. The $9.7 million all funds benefit accounts for the loss of investment income of $1.5 million that otherwise would have been earned by the County Commingled Fund. In addition, for the FY 2008-09 budget, OBA worked with revenue-supported departments to develop a more precise estimate of reduced reimbursements from State, federal and other non-County entities, based on reduced CalPERS expenditures. OBA determined that reimbursement revenues were estimated to decline by approximately $1.2 million in FY 2008-09 if CalPERS costs were reduced. Without duplicating that effort for FY 2009-10, we revised the FY 2008-09 estimate of reduced reimbursement revenue, based on the percentage change in the FY 2009-10 General Fund budget for salary and benefit costs compared with FY 2008-09.

Based on the analysis of all of the aforementioned issues, the total net General Fund benefit, including the Valley Medical Center Enterprise Fund is projected to amount to approximately $9,133,081, which is $3,248,081 more than the projected savings in the Recommended Budget. Attachment 2 provides a detailed description of the projected expenditure savings, revenue loss and reduced reimbursements.

BU 112 – Tax Collector's Office Page 247

6. *Secured Property Tax*

Revenue Account 4001100		Secured Property Tax
County Executive Recommended	Management Audit Proposed	Revenue Increase
$394,420,000	**$399,340,000**	**$4,920,000**

The County Executive has recommended a budget of $394,420,000 for secured property tax revenue, which includes the County's portion of the 1 percent tax on the secured roll and the County retirement tax, and the County's share of unitary taxes and the unitary retirement tax. In developing the FY 2009-10 Recommended Budget, the Office of Budget and Analysis assumed that the secured roll would experience negative growth of 1.12 percent. However, based on more up-to-date information from the Assessor's Office, the secured roll may decline by only 0.17 percent.

In addition, while the Office of Budget and Analysis (OBA) initially assumed roll corrections of $35.0 million in FY 2009-10, the Controller-Treasurer Department currently estimates roll corrections will be slightly less at $30.0 million. We believe this figure is still very conservative considering that the Department once thought roll corrections would amount to $25.0 million in FY 2008-09, and they will most likely end up at about $18.0 million. Between FY 2006-07 and FY 2008-09, the Department overestimated the amount of roll corrections by at least $7.0 million and as much as $18.6 million, as shown in the following table.

Estimated and Actual Roll Corrections for Santa Clara County
(In Millions)

Fiscal Year	Estimated Corrections[5]	Actual Corrections	Difference
FY 2008-09	$25.0	$18.0	-$7.0
FY 2007-08	$30.0	$18.0	-$12.0
FY 2006-07	$35.0	$16.4	-$18.6

The table above also shows that roll corrections have not exceeded $18.0 million since the housing market started its downturn in FY 2006-07. In addition, as noted by OBA, while the Assessor anticipates an increase in the number of appeals filed in FY 2009-10, the Assessor has a successful history in defending appeals. The "value at risk"[6] of

[5] This is the Controller-Treasurer Department's estimate that was used for the Adopted Budget.
[6] The value at risk is the difference between the value on the assessment roll and the appellant's opinion of value.

appeals is also expected to increase, but appellants often provide unrealistic opinions of their property's value. With this in mind and because roll corrections varied widely, between $20.5 million and $37.8 million, in the previous three fiscal years (i.e., FY 2003-04, FY 2004-05 and FY 2005-06), our analysis took into account the five-year average of $24.7 million.

Another factor that could impact FY 2009-10 secured property tax revenue is the amount of tax increment lost to redevelopment agencies (RDAs). The Controller-Treasurer Department's current estimate holds the RDA tax increment loss flat in FY 2009-10. However, it could very well grow at a negative rate between FY 2008-09 and FY 2009-10, rather than the positive rate seen in recent years, as a result of declining home values. If this were to happen, it would help boost the County's secured property tax revenue. Since it is unknown exactly what will become of the RDA tax increment loss in FY 2009-10, our analysis does not make any adjustments to this factor, but rather holds it flat.

Consequently, assuming a growth factor of negative 0.17 percent on the secured roll and $24.7 million in roll corrections, we estimate that revenue from secured property tax will amount to $4,920,000 more than the County Executive has recommended in FY 2009-10. To reflect this new information, we recommend that the FY 2009-10 budget for secured property tax be increased to $399,340,000.

7. *Supplemental Property Tax*

Revenue Account 4006100		**Supplemental Property Tax**
County Executive Recommended	**Management Audit Proposed**	**Revenue (Decrease)**
$18,000,000	**$15,850,000**	**($2,150,000)**

Based upon year-to-date collection activity as of April 2009, the Controller-Treasurer Department estimates that supplemental property tax revenue will amount to $18.65 million, or $1.35 million less than the $20.0 million estimated for this revenue account, in FY 2008-09. The unfavorable variance in supplemental property tax revenue results from declining home values and home sales as a result of the collapse in the housing and financial markets.

The County is likely to experience a 24.6 percent reduction in supplemental property tax revenue in FY 2008-09 from that of FY 2007-08. Based on this reduction and trends over time, the Controller-Treasurer Department assumes the revenue will experience a 10 percent year-over-year decline in FY 2009-10. However, the dollar value of real property transfers (the primary driver of supplemental property tax revenue) will drop by an estimated 33.8 percent between FY 2007-08 and FY 2008-09. During FY 2008-09, the negative growth rate peaked in February at 47.9 percent, resulting in an estimated year-over-year decline that is slightly higher during the second half of the year at 35.9

percent. In comparison, real property transfers declined by 41.6 percent between the last six months of FY 2006-07 and the last six months of FY 2007-08.

While the less severe negative growth expected for January through June 2009 may indicate slight improvement in real property transfer activity, a six-month lag can be expected between real property transactions and resultant collections of supplemental property tax. Consequently, we believe it may be more reasonable to expect a 15 percent reduction, rather than a 10 percent reduction, in supplemental property tax collections during FY 2009-10 from that of FY 2008-09. Applying a 15 percent reduction factor to FY 2008-09 estimated supplemental property tax collections yields a revenue estimate for FY 2009-10 of $15.85 million, or $2.15 million less than the County Executive's Recommended Budget.

8. Delinquent Tax Penalties and Costs

Revenue Account 4205100		**Penalties and Costs**
County Executive Recommended	**Management Audit Proposed**	**Revenue Increase**
$22,500,000	**$22,567,698**	**$67,698**

Revenues for this account are based upon the amount of funds that are available to be transferred from the Tax Loss Reserve Fund at the end of the fiscal year. According to the Revenue and Taxation Code, the County must retain a minimum of 25 percent of the amount of current year delinquencies in the fund. According to delinquency data from the Tax Collector and the amount of funds expected to be available in the Tax Loss Reserve Fund as of June 30, 2009, the Controller-Treasurer Department currently estimates that $22,567,698 is expected to become available to the General Fund in FY 2009-10. This represents $67,698 more than the $22,500,000 in the County Executive's Recommended Budget.[7] We agree with the Department's projection methodology and recommend that the FY 2009-10 budget for penalties and costs be increased to $22,567,698.

[7] We excluded $0.5 million included in the line item for penalties and costs that is coming from the Tax Collector's Delinquent Property Tax Improvement Fund and being used to fund the Tax Collection and Apportionment System project.

BU 135 – Fleet Management — Page 172

9. *Fleet Property Rental Payments*

Expenditure Account 5270100		Building and Improvements
County Executive Recommended	Management Audit Proposed	Expenditure Decrease
$586,000	$25,757	$560,243

This item represents rent payment to the Roads and Airports Department for Fleet's use of three maintenance yards. However, as described in detail in the Management Audit Division's recent audit report of the County's Fleet Management Division, these rent charges are unauthorized by the Board of Supervisors and inconsistent with the Interdepartmental Services Agreement and should be ceased immediately.

Even though a 1996 Interdepartmental Service Agreement specified the terms under which the Roads and Airports Department could collect surcharges from non-Roads vehicles to cover costs of using Roads facilities, the Roads and Airports Departments has instead, since 2004, charged the Fleet Management Division unauthorized full market-rate rent for use of the East, South and West maintenance yards. A study commissioned by the Roads and Airports Department in 2003 recommended that market rent for the three properties be charged as follows:

Market Rent Study
GSA-Occupied Roads and Airports Maintenance Yards

Location	Annual Rent
East Yard	$252,000
South Yard	171,600
West Yard	163,200
Total	**$586,800**

Since FY 2004-05, the Roads and Airports Department has levied annual rental charges on the Facilities and Fleet Department, in the amount of $586,000 since FY 2006-07. The recent management audit includes recommendations for the Roads and Airports Department to return past rental payments to the Facilities and Fleet Internal Service Fund.

While charging market rate rent is unauthorized, a reasonable amount of consideration should be calculated and paid to the Road Fund as compensation for use of the facilities for non-roads purposes. The components of the consideration should include the cost of maintenance, insurance, and building use related to the portion of the three Roads and Airports maintenance facilities occupied by Facilities and Fleet. These costs should be limited to the percentage of non-Roads vehicle maintenance and repair work performed by FAF at each facility. In addition, the amount of lost investment return on the cost of the land used by FAF for non-Roads purposes should be calculated and included with the costs listed above.

The Management Audit Division calculated the current values of the South, East and West Yard properties based on historic interest rates applied from the date of acquisition. The table below shows the dates of acquisition, cost of acquisition, and the inflated value resulting from the interest rate analysis.

Current Values of Roads and Airports
South, East and West Yards

	South Yard	East Yard	West Yard
Date of Acquisition	1/1/95	8/26/63	11/3/52
Cost of Acquisition	$785,000	$684,000	$22,000
Inflated FY10 Value	**$1,447,889**	**$12,400,535**	**$583,647**

Using the above values, the Management Audit Division estimated costs for lost return on investment, building use, maintenance and insurance, which are described below. In total, we estimate that payment of $25,757 would be reasonable compensation of the use of Roads and Airports facilities in FY 2009-10. The General Fund portion would amount to $20,811.

Lost Return on Investment

As an example of how to calculate the lost return on investment, the 1995 cost of the 8.27-acre South County facility was $785,000. Facilities and Fleet occupies 0.62 acres or 7.497 percent of the property. The original $785,000 property cost, inflated to FY 2009-10 value is approximately $1,447,889. Applying the current rate of return of the Commingled Fund of approximately 2.66 percent results in a FY 2009-10 investment return of $38,514 ($1,447,889 X .0266). Based on the Facilities and Fleet occupancy of 7.497 percent of the site and a 60 percent non-roads vehicle maintenance and repair rate, the FY 2009-10 annual compensation related to roads land use would amount to $1,732 ($38,514 X .07497 X 0.60), which is in addition to the proportionate charges for the maintenance, building use and insurance. The same calculus yields lost return on investments charges of $22,265 for the East Yard and $256 for the West Yard. The analysis of East and West Yards considers the fact that Fleet's vehicle maintenance operations at both of those sites will relocate to FAF property in December 2009.

Building Use and Maintenance Expense

Due to the age of the buildings at the East and West Yards, there would be no depreciation expense and de minimus maintenance expense. For the South Yard, the current book value of the buildings, according to the Controller's Office, is $26,284. A 2 percent facility use charge would amount to $526, of which approximately 80 percent, or $421, could be charged to Facilities and Fleet for its proportionate use of the buildings.

Insurance

The Roads and Airports Department will pay a total of $12,197 in property insurance payments in FY 2009-10. If we assume, conservatively, that Facilities and Fleet should be responsible for one-quarter of that cost, distribute that across the three Yards, and adjust for the portion of vehicle service provided to non-Roads vehicles at each site, the charge is $610 for each South and East Yards, and $335 for the West Yard.

10. Fleet Bulk Fuel

Expenditure Account 5285100		**Bulk Fuel**
County Executive Recommended	**Management Audit Proposed**	**Expenditure Decrease**
$6,303,423	**$5,701,896**	**$601,527**

The Fleet Management Division of the Facilities and Fleet Department purchases bulk fuel for County vehicles. For the last five years, the average actual expenditure for bulk fuel was $4.01 million. As displayed in the table below, bulk fuel costs during this period ranged from $2.48 million to $5.66 million, with an average annual growth rate of 19.8 percent.

Bulk Fuel Expenditures, FY 2004-05 – FY 2008-09

Fiscal Year	Actual Expenditures
FY 2008-09 proj.[8]	$4,758,012
FY 2007-08	5,657,201
FY 2006-07	4,042,347
FY 2005-06	3,128,571
FY 2004-05	2,481,224

The Recommended Budget includes $6,303,423 for bulk fuel, 32.5 percent more than the Management Audit Division's projection of $4,758,012 for current year costs, based on actual expenditures through Accounting Period 11.

The Recommended Budget for bulk fuel is based on the fuel price of $3.25 per gallon, which was also the assumption for FY 2008-09. The Fleet Management Division

[8] Projected based on FY 2008-09 actual expenditures through Accounting Period 11. The Department's own projection, calculated at an earlier date, was $4,730,057.

estimates the total expenditure amount by incorporating miles per gallon by vehicle class and miles driven by class in the prior fiscal year.

The Management Audit Division believes that $3.25 per gallon is high, particularly since the County pays approximately 47 cents per gallon less than the price consumers pay for retail gasoline due to the fact that the County is not required to pay taxes and fees that retail customers are required to pay at the pump.[9] Therefore, the Department's assumption is equivalent to a retail price of approximately $3.72 per gallon, which is $1.07 per gallon more than the current price listed for San Francisco by the Energy Information Administration.

The Department expresses a concern related to the difficulty in forecasting fuel prices, and cites the occurrence of price spikes such as that of the spring and summer of 2008. The Management Audit Division believes that the most effective way to consider the volatility of fuel prices is to base the estimate on the average annual growth in actual expenditures across several years. Over the past five fiscal years, the average annual growth in actual fuel expenditures was 19.8 percent. Using this growth rate, the bulk fuel expenditure for FY 2009-10 is estimated to be $5,701,896, or $601,527 less than the Recommended Budget.

While summer price peaks are to be expected in accordance with typical seasonal price patterns, the spike of 2008, when local retail prices reached $4.58 per gallon, was extraordinary. If an unusual price spike were to occur during FY 2009-10, such that budgeted fuel funding was insufficient, the Department should request additional funds through mid-year adjustments.

[9] The sum 47 cents per gallon is comprised of 18.4 cents for Federal Fuel Tax; 18 cents for State Fuel Tax; 1.4 cents for State Underground Storage Tank Fee; and 9.25 for Sales Tax. (Source: California State Board of Equalization, Fuel Taxes Division)

BU 148 – Department of Revenue **Page 268**

11. *Civil Assessments*

Revenue Account 4712050		Civil Assessments
County Executive Recommended	Management Audit Proposed	Revenue Increase
$0	$ 1,600,000	$ 1,600,000

The Department of Revenue's Traffic Program receives civil assessment revenue from the State as reimbursement for the cost of collecting traffic fines and fees. The County received no revenue for this program until April 2008, after State legislation was passed to authorize the semi-annual return of specified amounts of these funds. The Department estimates that civil assessment revenue will amount to about $1,600,000 in FY 2009-10, and the revenue is expected to grow. Per state law, it cannot exceed $2,500,000 annually.

Despite the fact that the program will yield approximately $1.6 million in civil assessment revenue in FY 2009-10, the revenue is budgeted at zero in the FY 2009-10 Recommended Budget because the County Executive's Office is holding these monies to assist the Superior Court with the construction of a new Family Resources Courthouse. Individuals representing the County, Superior Court and State Administrative Office of the Courts (AOC) have been negotiating roles, responsibilities and financing for more than a year. The Board of Supervisors is aware of the revenue's proposed use and approved a final, non-binding term sheet with the Court and AOC on November 4, 2008. The County is currently in the process of reaching a final binding agreement that will be presented to the Board.

The Management Audit Division recognizes that the way in which the funds are used is a policy decision for the Board, but recommends that these funds be budgeted to reflect the expected revenue of $1,600,000. At the same time, if the Board continues to support the revenue's proposed use, the County Executive should establish a reserve that can be used to dedicate and track the funds.

BU 217 – Criminal Justice System-wide Costs — Page 312

12. *Public Safety Sales Tax*

Revenue Account 4420100		Public Safety Sales Tax
County Executive Recommended	Management Audit Proposed	Revenue (Decrease)
$148,223,671	$135,166,426	($13,057,245)

Public Safety Sales Tax is a 0.5 percent tax collected on all taxable sales within the State of California. The tax is collected by the State, and then reallocated to each County based on that County's percentage of taxable sales, relative to the other 57 counties, in the calendar year preceding the fiscal year in which the tax is reallocated. This means that for FY 2009-10, Santa Clara County's percentage of the Statewide pool of Public Safety Sales Tax is based on taxable sales in 2008.

Management Audit staff and the Office of Budget Analysis jointly developed the budget estimate in March and early April. At that time, actual FY 2008-09 receipts from this source, which were down 19.3 percent in January and 11.1 percent in February, on a year-over-year basis, had rebounded in March, and were down only 5.4 percent that month on a year-over-year basis. This strongly influenced the budget estimate, which assumed that taxable sales were beginning to recover, and while continuing below year-ago levels, would improve through Calendar Year 2009, and turn positive in the Spring of 2010.

Unfortunately, Public Safety Sales Tax receipts in April and May down 16.9 percent and 12.5 percent, respectively, compared to the same months in 2008. As a result, we have revised our estimate for this revenue, assuming that year-over-year receipts will continue to be lower in FY 2009-10 than in FY 2008-09, only reaching the same level as FY 2008-09 during the last three months of the next fiscal year. Essentially, this revenue source is strongly influenced by the overall weakness in the California economy that is affecting many other revenue sources. We expect to continue to work with OBA in the coming fiscal year to look at this revenue source on a regular basis. Essentially we will be searching for signs that the economy has hit a bottom and begun to recover, which will make this revenue source much easier to project going forward.

BU 230 – Office of the Sheriff	**Page 316**

13. *Sheriff Professional and Specialized Services*

Expenditure Account 5255100		**Professional and Specialized Services**
County Executive Recommended	**Management Audit Proposed**	**Expenditure Decrease**
$1,192,784	**$842,784**	**$350,000**

Over the past three fiscal years, including the current fiscal year as projected by Management Audit staff, services and supplies expenditures in this Department have been far short of budgeted amounts, either the original approved budget, or the budget as modified by the Board during the fiscal year. This is shown in the following table.

Sheriff's Department Services and Supplies Spending
Actual Versus Budgeted, FY 2005-06 to FY 2008-09

Year	Original Budget	Last Modified	Actual	Difference To Modified
FY 2005-06	$9,813,871	$16,160,640	$14,334,633	-$1,826,007
FY 2006-07	12,887,006	15,536,596	13,225,165	-2,311,431
FY 2007-08	13,863,676	15,768,818	13,381,787	-2,387,031
FY 2008-09 proj.	14,079,815	14,633,418	13,781,072	-852,346

As the table shows, actual expenditures in each year were from $850,000 to more than $2 million less than the final modified budget amounts. A closer review of the individual services and supplies line items shows that Item 5255100-Professional and Specialized Services, accounts for a substantial amount of the unspent funds. The following table compares budgeted and actual spending in this line item over the past three years, and the current year projection.

Sheriff's Department Professional and Specialized Services
Actual Versus Budgeted, FY 2005-06 to FY 2008-09

Year	Original Budget	Last Modified	Actual	Difference To Modified
FY 2005-06	$1,029,601	$1,212,365	$633,418	-$578,947
FY 2006-07	1,322,334	1,322,334	508,017	-814,317
FY 2007-08	1,289,519	1,308,685	387,896	-920,789
FY 2008-09 proj.	1,263,384	1,059,784	699,238	-360,546

Like the first table, this table shows the Department's inability to spend the amount budgeted, by substantial amounts.

According to information provided by the Department, this line item includes 56 different service agreements, contracts or consulting-type expenditures, in 22 different Sheriff's Department cost centers. However, our review found most of the cost is in the following cost centers and specific contracts:

Cost Center 3900—Administration—Includes payments to local cities for participation in the grant-reimbursed Avoid the 13 holiday DUI enforcement program, payments to a news clipping service, fire marshal services, language translation services for telephone assistance on phone calls to the department, and a grant-reimbursed computer network access project.

Cost Center 3905—Personnel—Includes psychological assessments for job applicants and existing staff, credit checks for job applicants, and a maintenance agreement for fitness equipment used by the Department.

Cost Center 3921—Academy—Includes fingerprint checks, background investigations and polygraph testing of recruits. This account has also been used in the past to pay lodging expenses of job candidates.

Cost Center 3922—Reserves—Pays for psychological assessments of reserve deputy candidates.

The following table shows how historical spending in this line item for each of these cost centers compares to the amount budgeted in FY 2009-10.

Historical Spending Versus FY 2009-10 Budget
Professional and Specialized Services, Major Cost Centers

Cost Center	09-10 Budget	08-09 Projected	07-08 Actual	06-07 Actual	05-06 Actual
3900-Admin.	$173,304	$68,332	$31,762	$45,232	$132,857
3905-Personnel	161,483	13,405	12,585	4,493	3,768
3921-Academy	481,962	170,200	152,166	179,339	168,005
3922-Reserves	42,080	0	0	3,580	7,815
Total	**858,829**	**251,837**	**196,513**	**232,644**	**312,445**

As the table shows, expenditures for this line item in these cost centers have never come close in the past four fiscal years to the amount budgeted for FY 2009-10.

Finally, we note that there is one professional service where the amount expended in the current fiscal year is substantially above the budgeted amount. This is in the Sheriff's helicopter program, Cost Center 3911, where expenditures for pilot services to date total $63,720, versus the budgeted amount of $5,000. Although an additional amount of about $50,000 is encumbered in this cost center, based on actual usage in

April of about $10,000, it is unlikely the encumbered amount will be fully spent, barring some major incident requiring extensive helicopter services. The pilot cost for the helicopter has historically been under budgeted, with expenditures in FY 2005-06 equivalent to what is projected in the current year. According to Sheriff's budget staff, similar expenditures occurred in FY 2006-07 and FY 2007-08 as well, but for unexplained reasons, were billed in other cost centers than the helicopter program. This line item in the helicopter program should be increased from the current budgeted amount of $5,000 to $60,000, to reflect actual usage.

However, based on the foregoing analysis, we recommend reducing the overall budgeted amount for the Professional and Specialized Services line item to $842,784, a $350,000 reduction. This reduction brings the budgeted amount in line with historical use, and is in fact higher than actual expenditures in any of the past four fiscal years.

The Department disagrees with this recommendation, arguing that the overall presentation of its Object 2 expenditures is misleading. The Department states that about 36 percent of Object 2 expenditures FY 2008-09 approved budget was for contracts tied to revenue, which would not be received if the monies were not spent. While that may be true, Management Audit staff received no information from the Department indicating that the expenditures that accounted for the bulk of the professional services line item were tied to revenues. The presentation of overall Object 2 spending was provided to avoid the claim that Management Audit staff reviewed only a single line item that was under spent, when other Object 2 line items were overspent. Given that the overall Object 2 budget was not fully spent in recent years, we continue to believe that reductions in this line item are appropriate.

BU 235 – Department of Correction — Page 326

14. *Correction Food Costs*

Expenditure Account 5210180/5210200		Food
County Executive Recommended	Management Audit Proposed	Expenditure Decrease
$5,315,953	$4,975,281	$340,672

The FY 2009-10 Department of Correction (DOC) budget includes an $855,000 increase in food costs, about 19.5 percent. According to the Department, the genesis of this increase was in FY 2007-08, when the Department exceeded its food budget by $729,000, due to a rapid rise in food commodity prices in the winter and spring of 2008. An analysis last fall by the Department indicated that FY 2008-09 food expenditures would again exceed the budgeted amount, by $725,000, and noted that the FY 2008-09 budget had included an augmentation of $275,000 just to address increased milk prices. In fact, the anticipated FY 2008-09 overage is not occurring. Management Audit Division staff projects that food expenditures in the two food line items will amount to about $4,738,363, versus the current budgeted amount of $4,460,933.

Furthermore, a review of food commodity contracts secured for the Department of Correction by the Procurement Department for food items show that since last fall, when the analysis used by Department of Correction staff was prepared, food prices have been mostly level or falling. Very few items have reached the 19.5 percent increase budgeted overall for FY 2009-10. Examples of items that have fallen substantially in price include flour, nuts, sliced carrots, fuji apples, green beans, fresh broccoli, cucumbers, most pork products and scallops. Beef and chicken prices are up slightly. Perhaps most significantly, Producers' Dairy, which supplies dairy products, in its May 25, 2009 price list, announced prices for milk and cheese that were from 20 percent to 36 percent below prior levels. Prices for a half-gallon of homogenized milk are now $1.26, down from $1.66 previously, and well below the price of $1.54 per half gallon when the current dairy contract went into effect in May 2008.

There are also declines in food market prices that have not yet been realized in the prices the County pays, because of current procurement procedures. For example, Citadel Enterprises, the County's supplier for parboiled rice, announced a 36 percent increase in prices as of February 1, 2009. The firm cited an increase in the worldwide price for rice, as reflected in the Chicago Board of Trade futures contract price, which had gone from $13.76 on December 12, 2007 for a contract for future delivery of 2,000 hundredweight of rice, to $23.60 per contract on December 10, 2008. Current prices for such a contract, at all maturities, ranged between $12.055 and $12.915 as of May 22, 2009, below the December 2007 price. The Procurement Department reported that it is working with County Counsel to add language to future commodity contracts that could more closely link the price the County pays to commodity prices, or to some other measure that more accurately reflects current market conditions, so that lower prices can be achieved where they are identified by spot auditing of contracts or other means.

Finally, trends in the County's cost for food are mirroring national trends. The United States Department of Agriculture Economic Research Service, in its Food Price Outlook report updated on May 21, 2009, noted that the Consumer Price Index for food declined in 0.2 percent from March to April 2009, the third consecutive month of falling food prices, the first time such prices had fallen in three straight months since 1958. For all of 2009, the USDA projects food prices overall will increase 3 to 4 percent. For the six months ended in April 2009, prices for cereals and bakery products; meats, fish, poultry and eggs; dairy products; fruits and vegetables; and fats and oils have fallen. Only prices for sugar and sweets have risen significantly.

Based on this analysis, the proposed food budget for the Department of Correction does not reflect current or anticipated market conditions. Rather than the 19.5 percent increase that was budgeted, we recommend a more modest 5 percent increase from the projected FY 2008-09 expenditure of $4,738,633, for an FY 2009-10 budgeted amount of $4,975,281. This represents a savings of $340,672 over the $5,235,953 now budgeted.

The Procurement Department and the Department of Correction agree in concept to reducing the food budget to reflect current market conditions. However, the Department of Correction, which projects a higher year-end expenditure of $4,815,214, has suggested reducing the FY 2009-10 budget by only $250,000. It believes the smaller reduction would provide additional leeway in the event of an increase in jail population. We believe providing the 5 percent increase over projected current year expenditures is sufficient.

BU 410, 412, 501, 921 – Health and Social Services	Various Pages

15. *Realignment Sales Tax*

Revenue Accounts 4405095/4410200/4412100		Realignment Sales Tax
County Executive Recommended	Management Audit Proposed	Revenue (Decrease)
$102,031,482	$95,581,521	($6,449,961)

The State of California collects a 0.5 percent sales tax on all taxable sales in California, and apportions the revenues to local governments to fund health and social services programs as part of a realignment of State and local responsibilities adopted in 1991. There are separate apportionments of this tax that are included in the budgets of the Social Services Agency (4405095-$54,722,352 budgeted), Mental Health Department (4410200-$35,470,698 budgeted) and Santa Clara Valley Health and Hospital System (4412100). In the Health and Hospital System, about $2.4 million is included in the Public Health budget, while about $9.4 million is included in the Valley Medical Center budget, by policy of the Board of Supervisors. Because these revenues come from the same source, and are analyzed using the same technique, Management Audit staff and the County Executive have historically analyzed them as a lump sum, rather than in the separate accounts.

For FY 2009-10, this revenue is adversely affected by the current Statewide and national recession, similar to the Public Safety Sales Tax revenue discussed previously in this report. The budget estimate of $102 million was based on sales tax collections through March, which included a higher-than-expected March receipt that suggested significant year-over-year revenue losses were starting to ease. Actual receipts for April and May 2009, which were respectively 20.1 percent and 15.4 percent below receipts for the same months in 2008, showed this view was too optimistic. Therefore, we have revised our estimate for this revenue in the next fiscal year downward, taking into account projected actual receipts for FY 2008-09, which are expected to be about $99.5 million, and assuming FY 2009-10 receipts will be down another 4 percent, to $95.6 million. This follows closely our assumptions regarding Public Safety Sales Tax, and also tracks closely with the Governor's May Revise, which estimated that realignment sales tax in FY 2009-10 would be down 4.6 percent from the FY 2008-09 levels. As in the case of Public Safety Sales Tax, we will continue to closely monitor trends regarding this revenue during the upcoming fiscal year, looking for a "bottom" in receipts that would then permit us to more confidently project recovery of this revenue source.

BU 921 – Valley Medical Center	Page 535

16. VMC Budget and Accounting Systems

The following recommendations regarding Budget Unit 921 Valley Medical Center Enterprise Fund (Fund 0060) were developed over the past four weeks, during which we met with VMC budget staff to obtain information used in the preparation of its $1.2 billion FY 2009-10 Recommended Budget. Specifically, we attempted to obtain working papers used to calculate the revenue estimates and the expenditure requirements included in the FY 2009-10 Recommended Budget, including any narrative explanations and justifications. However, with the exception of a cash flow analysis, a debt service schedule, and a few spreadsheets, no work papers were provided. Further, because VMC does not use either the County's BRASS budget system or the County's SAP accounting system, VMC staff was unable to provide detailed budget information that would match the revenue and expenditure accounts in SAP and BRASS. This detailed information is necessary to enable us to analyze the amounts included in the Recommended Budget and compare such amounts to current and prior year actuals. In addition, VMC does not provide OBA with detailed cost information for each authorized position, by position number, as is available for all other County positions, and without this information verification of the calculation of all salaries and benefits included in the Recommended Budget is not possible.

Furthermore, unlike all of the other County Departments, including all of the other budget units within the Health and Hospital System, because VMC does not use the County's BRASS budget system, it does not provide the Office of Budget and Analysis (OBA) with any of the revenue and expenditure calculation and justification forms required of all departments. As a result, we were unable to obtain detailed working papers or narrative justifications for any of the revenues or expenditures from OBA in support of the $1.2 billion FY 2009-10 VMC recommended budget. OBA confirmed that it only input the VMC prepared amounts into the FY 2009-10 Recommended Budget, and did not perform any independent analysis of the Department's budgeted amounts.

Given the magnitude of the VMC budget ($1.2 billion) and its impact on the County's General Fund (VMC's operating losses during the past six fiscal years, which were financed entirely by the General Fund, have averaged $140 million annually), it is essential that both the Management Audit Division and the Office of Budget and Analysis have real-time access to the same detailed budget calculations and justifications that are available for all other County Departments, through SAP for accounting information and BRASS for budget information. However, the County Controller reported that his office is in the process of developing an agreement with VMC for the acquisition of new accounting software that will enable VMC to begin fully using the SAP accounting system on an automated basis by FY 2010-11. Consequently, the Board of Supervisors should consider directing the County Executive to require VMC to also convert from its current budget system to the County's BRASS budget system, or any new budget system acquired by OBA for Countywide use, by FY 2010-11.

Despite the limited availability of budgetary information and supporting documentation, we were able to perform analyses of some amounts included by VMC in the recommended budget related to salaries and benefits for new positions, legal services, utilities and interest expense. These issues are discussed below.

17. VMC Salaries and Employee Benefits

Expenditure Account 5100000		**Salaries and Employee Benefits**
County Executive Recommended	**Management Audit Proposed**	**Expenditure Decrease**
$732,684,209	**$730,084,209**	**$2,600,000**

The FY 2009-10 Recommended Budget adds a net of approximately 72.9 full-time-equivalent positions (FTEs) to the Valley Medical Center (VMC) budget, over and above the net 112.6 FTEs added since the FY 2008-09 budget was adopted. These counts are the net result of both additions and deletions of FTEs. The 72.9 FTEs added in the Recommended Budget is the net of the addition of approximately 192 FTEs, less the deletion of approximately 119 FTEs. Of the 192 FTEs added, the County already employs an undetermined number, either in another budget unit, in a position that is being deleted, or in another capacity, such as extra help.

At the request of the Management Audit Division, VMC staff provided a spreadsheet that identifies each addition and deletion, and the budgeted cost of each position. Based on the notes in that file, it appears that at least eight of the 192 FTEs are not actually new County employees. It is possible that others are also not new County employees; for instance, they may be employees in positions that are being deleted who would move immediately into new positions. Of the remaining 184 FTEs, some are budgeted for 12 months, some for 10 months and one for two months. Due to these positions being medical in nature, such as physicians, the total budgeted amount for 14 of these positions exceeds $200,000 per year. On average, they are budgeted for 11 months of FY 2009-10. According to the County's Human Resources Analyst for the hospital, new positions at the hospital take between 60 and 90 days to fill. By budgeting 11 months of salary and benefits, VMC has assumed that the average employee will be hired in 30 days.

Excepting the one FTE who is budgeted for two months, if the remaining personnel were each budgeted for 10 months, which assumes a 60-day hiring process, the payroll cost would be reduced by an estimated $2.6 million. Therefore, Management Audit recommends reducing the salaries and employee benefits expenditure category in VMC by this amount, and making a corresponding reduction in the General Fund subsidy transfer.

18. VMC Services and Supplies

As of Accounting Period 10, which spans approximately 83 percent of the fiscal year, Valley Medical Center (VMC) had spent $212,177,646 on services and supplies according to SAP, the County's financial system. The financial system reflects an FY 2008-09 modified budget for this expenditure category of $287,075,807. Conservatively assuming that VMC services and supplies expenditures through Period 10 represent only 80 percent of its expenditures for the year, its total FY 2008-09 services and supplies expense will amount to $265,222,058. This conservatively projected total is $21.8 million less than the current modified budget as reflected in SAP. Further, this projection is consistent with recent historical actual under-spending in services and supplies. The amount and percentage of the services and supplies budget that were not spent since FY 2003-04 is shown below. The average amount of under-spending over this period amounts to **$25.9 million.**

Budgeted Versus Actual Services and Supplies Expenditures
(In Millions)

Fiscal Year	Modified Budget	Actual Expenditures	Difference	Percent
FY 2009-10 rec.	$306.9[10]	n/a	n/a	n/a
FY 2008-09 proj.	$287.1	$265.2[11]	-$21.9	-7.6%
FY 2007-08	$288.4	$244.8	-$43.6	-15.1%
FY 2006-07	$223.3	$201.7	-$21.6	-9.7%
FY 2005-06	$197.2	$188.2	-$9.0	-4.6%
FY 2004-05	$190.3	$163.0	-$27.3	-14.3%
FY 2003-04	$183.7	$151.3	-$32.4	-17.6%

The Recommended Budget increases this category of expenditures to $306,902,504[12], or 15.7 percent over the current-year projected actual expenditures. In light of the historical under-utilization of the budget, and the projected increase in this category of expenditures in the FY 2009-10 Recommended Budget, the Management Audit Division recommends reducing the recommended service and supplies budget line items for legal services and utilities by $1,914,330, as detailed the sub-sections that follow.

[10] This amount is the Recommended Budget, less the adjustment described in footnote 11.
[11] This amount is the projected actual expenditure for the current year.
[12] This amount excludes $60 million in transfers to the State necessary to obtain federal funds for uninsured patients that are covered under the Disproportionate Share Hospital (DSH) program.

18.1. VMC Legal Services

Expenditure Account 5257110		Consulting Fee – Legal
County Executive Recommended	Management Audit Proposed	Expenditure Decrease
$494,330	$100,000	$394,330

Section A22-16 of the County Ordinance Code specifies that County Counsel must certify in writing that County Counsel is unable to act on behalf of the County before any County department may hire its own Counsel. A copy of this ordinance is provided as Attachment 3. According to County Counsel, no such certification exists for Valley Medical Center (VMC) to purchase outside legal services. According to VMC staff, all outside legal services are purchased via RFP through County Counsel, which is always informed of the issues and which approves the engagements.

As of Accounting Period 10 of the current year, VMC had spent $43,309 on outside counsel, and a spreadsheet provided by VMC indicates that its proposed FY 2009-10 budget includes $494,330 for legal consultants, and that VMC spent $254,466 on such services in FY 2007-08. These charges are not separately budgeted in the County's BRASS budget system; Management Audit staff therefore relied on the spreadsheet provided by VMC for the budget figures. Management Audit staff asked about the nature of these services and the basis for the dollar amount budgeted, and was told by VMC staff that these expenses are for legal services related to compliance, reimbursement, medical staff and licensing issues. County Counsel reports that Counsel has not been informed of these purchases, and that County Counsel has the capacity to provide most legal services for VMC with in-house staff. Counsel reports that there are outstanding legal issues related to reimbursements that may require outside expertise, but that these outside services should be arranged on a case-by-case basis. VMC staff did not provide a basis for the Recommended Budget dollar amount. A review of historical charges in this account, based on information in the County's SAP financial system, indicates that the average expenditure beginning in FY 2003-04 through the current year-to-date as of Accounting Period 10 has been $96,503. These expenditures ranged from a low of $37,356 in FY 2005-06 to a high of $205,597 in FY 2004-05. Because VMC does not use the County's SAP system, Management Audit staff requested VMC's records regarding historical charges in this account, but VMC did not provide these. The apparent Recommended Budget is almost five times higher than the six-year historical average expenditure, and far exceeds the highest actual expenditure over that period.

Since County Counsel has the capacity to provide for most of the legal needs of VMC, and VMC has not provided a quantitative basis for these expenses and may not have complied with the County Ordinance Code that requires certification by County Counsel for any department to hire its own attorneys to represent the County, the Management Audit Division recommends reducing the proposed budget to $100,000, which is approximately the amount of the historical average expenditure on this line item, for a savings of $394,330. The Recommended Budget General Fund transfer of $81,287,772 to VMC should therefore be reduced by $394,330.

Further, Management Audit recommends that the $100,000 be held in reserve to be used on a case-by-case basis pending certification by County Counsel of the need for additional, outside counsel as required by Santa Clara County Ordinance Code Section A22-16.

18.2. VMC Utilities

Expenditure Account 5290110		**Electricity**
Expenditure Account 5290120		**Natural Gas**
Expenditure Account 5290130		**Water**
County Executive Recommended	**Management Audit Proposed**	**Expenditure Decrease**
Electricity		
$6,017,900	**$4,800,000**	**$1,200,000**
Natural Gas		
$3,285,133	**$3,035,133**	**$250,000**
Water		
$390,515	**$320,515**	**$70,000**

In FY 2007-08, Valley Medical Center (VMC) spent $4,651,352 for electricity, according to accounting reports in the County's SAP accounting system. During the first 10 of the 12 accounting periods in the current year, VMC's electricity expenditures amounted to $3,508,281. Further, the Recommended Budget increases all of the VMC utility accounts, including electricity, natural gas and water, by 29.4 percent compared to actual expenditures in FY 2007-08. Therefore, Management Audit staff inquired of VMC staff about the basis for the Recommended Budget's utility account appropriations. Upon inquiry, Management Audit staff was informed by VMC budget staff that the projections are based on industry projections of 12.7 percent inflation in "utilities," plus increased "volume" and increased "rates." The basis for the inflation projection was said to be from the R-C Healthcare Management website. However, the inflation projections for hospital "utilities" from that website for FY 2009-10 is not 12.7 percent but 4.0 percent, as shown in Attachment 4. Management Audit staff inquired about the basis for the volume and rates calculations, and was informed that calculations had been done, but that they were in a spreadsheet that contained 6,000 rows of information and therefore could not be distributed. Management Audit staff indicated that 6,000 rows of data is not a problem, and requested the calculations. VMC staff stated that it would not be provided. Rather, VMC staff promised to "reconstruct" the calculations on a separate sheet and provide that. No such calculations were provided. Therefore, Management Audit staff used available sources of information to prepare a reasonable estimate of VMC's electricity expenses in FY 2009-10. This calculation specifically included costs associated with new facilities, and was prepared as follows:

The electricity expenditures as of Accounting Period 10 and for the entire year for FY 2007-08 and FY 2006-07 were obtained from the County's SAP accounting system. The proportion of total annual expenditures as of Period 10 for the two years was averaged, and amounts to 76.8 percent. This percentage was applied to the current year actual expenditures as of Accounting Period 10, which is $3,508,281. The baseline current year projected total is therefore $4,570,701. This baseline was then adjusted to account for the fact that three new health facilities opened during the year. The Gilroy and Sunnyvale Valley Health Centers opened in October 2008. The Valley Specialty Center opened in February 2009. The Ten-Year Capital Improvement Plan provides specific estimates, which Management Audit staff verified with VMC personnel, regarding the utilities costs for each of these facilities. Estimated electricity costs were derived from the Capital Plan estimates, pro-rated, and added to the baseline total in an effort to capture the effect of these facilities having been open for the entire year. This produced an estimated FY 2008-09 total electricity expenditure of $4,730,225. About half-way through FY 2009-10, VMC expects to open a health center in Milpitas. Using the Capital Plan's utilities costs estimates for that facility, Management Audit staff estimated $77,080 for electricity for six months of operation for that facility, and added that amount to the projected FY 2008-09 total electricity cost, for a FY 2009-10 projection of $4,807,305. Management Audit staff did not inflate the electricity amount for two reasons. First, the County Facilities and Fleet Department is projecting a slight drop in electricity expenses for the County as a whole in FY 2009-10. Second, according to VMC staff, rooftop solar panels that became operational in April 2009 are expected to reduce the VMC annual electricity bill by $150,000 in FY 2009-10. Therefore, Management Audit staff recommends reducing the proposed VMC electricity budget from more than $6 million to about $4.8 million, for a savings of $1,200,000.

A series of similar calculations and adjustments were performed to arrive at estimates for the natural gas budget and the water budget. However, the estimated current year totals for these amounts were inflated for FY 2009-10 projections at the same rate as the County-wide increases for these accounts, or 2.17 percent for gas and 9.98 percent for water. Management Audit recommends reducing the Recommended Budget by $250,000 for gas and $70,000 for water, for a total VMC utilities budget reduction of $1,520,000. This amount should be deducted from the $81.3 million General Fund subsidy to VMC.

19. VMC Interest Expense

Expenditure Account 5420100		Interest Expense
County Executive Recommended	Management Audit Proposed	Expenditure Decrease
$28,136,110	**$21,509,793**	**$6,626,317**

Working Capital Interest Expense

The FY 2009-10 Recommended Budget includes $28,136,110 for Valley Medical Center (VMC) interest expense related to capital project financing and working capital. A review of the Department's calculation of working capital interest expense determined that the interest rate used was not consistent with the Treasurer's current estimate, which ranges from 1.52 percent to 1.90 percent during FY 2009-10. Based on the Department's projected FY 2009-10 cash flow schedule, use of the current projected interest rates would reduce the interest expense budget requirement by $961,611.

Bond Fund Interest Expense

Variable Rate Interest Debt

In addition, based on discussions with staff in the Controller's Office who manage the payment of debt service on the County's outstanding bonds, it was determined that an average rate of 3.50 percent was used in December 2008 when projecting FY 2009-10 interest expense (Attachment 5). Since that time, interest rates have steadily declined to a current 0.12 percent rate as of June 3, 2009 (Attachment 6). Based on the actual rates the County received on comparable debt in the current fiscal year, the average FY 2008-09 rate was 1.16 percent. During the past 49 months, the average rate was 2.82 percent, including one month of 8.71 percent, which was an outlier due to the financial institution crisis that peaked in February 2008. Excluding February 2008, the average interest rate for the remaining 48 months was 2.70 percent.

For FY 2009-10, both Management Audit staff and the Controller's staff project some upward pressure on rates from the current low levels during the fiscal year, since rates are now approaching 0.00 percent, and inflationary pressures from the federal stimulus expenditures, increasing oil prices and other factors will impact the cost of borrowing funds. Assuming that the change in economic conditions results in a reversal of the interest rate trend that occurred in FY 2008-09, when the interest rate declined from a July 1, 2008 rate of 1.70 percent to a June 3, 2009 rate of 0.12 percent, FY 2009-10 rates will increase. However, we believe that the Controller's projected FY 2009-10 average rate of 3.50 percent is overly conservative given current rates.

Barring any extraordinary economic event, we believe rates would gradually increase from the current level of 0.12 percent to about 2.70 percent by December 2009 and remain at that level for the remainder of FY 2009-10. Consequently, we believe a projected FY 2009-10 rate stabilizing at 2.70 percent would be conservative, given the current rate of 0.12 percent and less than 30 days to the beginning of the 2009-10 fiscal year. For comparative purposes, Attachment 7 provides four options to the Recommended Budget projection of 3.50 percent from July 1 to June 30, 2010, which describe alternative scenarios that may occur in FY 2009-10, all of which are considered to be reasonable and conservative. We are recommending Option 4, which would result in a reduced variable rate bond interest expense budget, estimated to amount to approximately $1,164,706.

Fund 483-1999 Bond Fund Interest Earnings Fund

This fund was established by the Controller's Office to account for interest earned on unexpended bond proceeds from the 1994 Series A and Series B bond issues used to finance construction of the North Tower at VMC. In addition, interest proceeds from the subsequent refinancing of the 1994 bond issues in 1997 and 2008 are also deposited in this fund. Federal Internal Revenue Service regulations require strict accounting for tax exempt bond proceeds to ensure that government agencies that issue bonds comply with arbitrage requirements, which prohibit retention of interest earnings in excess of interest cost on tax exempt bond issues.

The interest earnings funds related to each outstanding bond issue are monitored by the Controller to ensure compliance with arbitrage regulations, and to utilize interest earnings in such funds to partially offset annual interest costs of the related outstanding bonds. As of June 4, 2009, the 1994 Bond Fund Interest Earnings Fund (Fund 483) had a cash balance of $5,379,172, none of which had been applied to offset interest costs in the FY 2009-10 budget. Based on discussions with the Controller's Office, approximately $879,172 should be retained for possible arbitrage payments to the federal government, while the remaining $4,500,000 is available for payment of bond interest costs in FY 2009-10. Health and Hospital fiscal staff confirmed that none of these monies were included to offset interest costs on outstanding bonds in the FY 2009-10 budget.

In summary, reduced working capital interest expense, reduced variable rate bond interest costs and available bond fund interest earnings are projected to result in total combined savings of $6,626,317. These savings would result in a dollar-for-dollar reduction in General Fund costs.

Attachment 1

SUMMARY
FY 2009-10 BUDGETED VACANT POSITIONS IN
GENERAL FUND DEPARTMENTS
AS OF 5/4/09

Budget Unit	Department	Vacant Positions[1]	Positions Budgeted	Percent Budgeted	Budgeted Cost[2]
106	Clerk of the Board	4.0	4.0	100%	327,168
107	County Executive	7.0	1.0	14%	116,280
110	Controller-Treasurer	11.0	8.0	73%	711,036
112	Tax Collector	6.0	4.0	67%	72,480
114	Clerk-Recorder	11.0	2.0	18%	166,036
115	Assessor	13.0	12.0	92%	1,374,648
118	Procurement	10.0	9.0	90%	1,071,084
120	County Counsel	7.0	6.0	86%	896,816
130	Human Resources and Labor Relations	4.5	4.5	100%	487,620
132	Risk Management	3.0	3.0	100%	363,586
140	Registrar of Voters	2.0	1.0	50%	-
145	Information Services Department	3.0	2.0	67%	325,930
148	Department of Revenue	5.0	4.0	80%	308,131
168	Office of Affordable Housing	2.0	-	0%	-
190	Communications	9.0	8.0	89%	832,068
202	Office of the District Attorney	25.5	20.0	78%	2,726,903
204	Office of the Public Defender	7.0	6.0	86%	608,618
210	Office of Pretrial Services	1.5	1.0	67%	116,904
230	Office of the Sheriff	154.5	150.5	97%	14,201,816
235	Department of Correction Contract	59.0	59.0	100%	8,208,481
240	Department of Correction	18.0	16.0	89%	1,605,074
246	Probation	27.5	27.5	100%	2,621,636
260	Department of Planning and Development	5.0	4.0	80%	418,218
262	Agriculture and Environmental Management	0.5	0.5	100%	41,880
263	Fleet and Facilities	15.0	6.0	40%	523,908
410	Public Health	36.0	19.0	53%	2,259,958
412	Mental Health	56.0	39.0	70%	4,822,088
414	Children's Shelter and Custody Health	13.0	13.0	100%	1,813,574
417	Drug and Alcohol	12.0	11.5	96%	1,158,986
418	Community Health Services	6.5	1.5	23%	131,892
501	Social Services	180.5	149.5	83%	11,993,826
	Total GF Departments	**715.0**	**592.5**	**83%**	**60,306,645**
	Average Cost Per Position				**101,783**
	Cost of Vacancies after Filling 84.5 Positions				**51,705,950**

Notes:
1. Valley Medical Center has been excluded even though it receives a General Fund subsidy because position numbers follow a different format on the vacancy report and position detail report and cannot be matched.
2. Vacant positions in some General Fund departments, such as BU 230 and BU 501, may be partially or fully reimbursed.

ANALYSIS OF PERS PREPAYMENT NET SAVINGS

Description	Step	FTE	Base Salary Bruce 6/1 Rpt	Base Salary Brass 5/1 Rpt	Full PERS*1	County Paid Employer PERS
Total General Fund	Gn Fd	9,063.7	706,047,854	712,839,518	160,552,233	96,417,340
Total VMC Enterprise Fund	VMC	606.6	490,782,350	491,016,096	79,309,916	49,924,096
Total Other Funds	Other	1,201.0	85,782,774	122,039,576	16,478,910	9,250,748
Total All Funds	**Total**	**10,871.3**	**1,282,612,978**	**1,325,895,190**	**256,341,059**	**155,592,184**
				43,282,212		
			Employee paid employer share		34,468,560	
			Employee reimb of employer paid 08-09 share		361,072	
			Court share of employer contribution		6,002,400	
			Special pay employer contribution-GF		2,946,489	
			Special pay employer contribution-Other*1		0	
			total		**199,370,705**	
			PERS Prepayment Amount		186,942,629	
			Gross Prepayment Savings		12,428,076	
			Less Loss of Interest Revenue		-1,471,067	
			Less Loss of Reimbursement Revenue*2		-1,244,721	
			Net Prepayment Benefit		**9,712,288**	
		77.49%	General fund		7,525,802	
		16.55%	VMC		1,607,279	
		5.96%	Other Excl Courts		579,207	
		100.00%	**Total**		**9,712,288**	
			General Fund incl VMC		**9,133,081**	
			FY 2009-10 Recommended Budget		5,885,000	
			Additional General Fund Savings		**3,248,081**	

*1 $1,022,004 is budgeted for special pay in non-General Fund supported departments, but no analysis was made to determine the amount that pertains to employer contribution of the employer share to PERS.

*2 Estimated lost revenue as reported by departments for FY 2008-09 was used as a base, adjusted by the FY 2009-10 percentage change in General Fund object one costs.

Attachment 2

6/11/09

View recently adopted ordinances as of January 13, 2009 NOT YET CODIFIED OR INTEGRATED IN THIS SITE. (pdf file)

Ordinances enacted through January 13, 2009

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Sec. A22-16. Duties generally, use of outside counsel.

The County Counsel shall act as the legal officer of the departments, institutions, boards, commissions and districts of the County government. No such agency shall employ or consult any attorney for legal advice or counsel in any civil affair of the County government unless the County Counsel shall certify in writing to the County Executive that he is unable to act in behalf of the County.

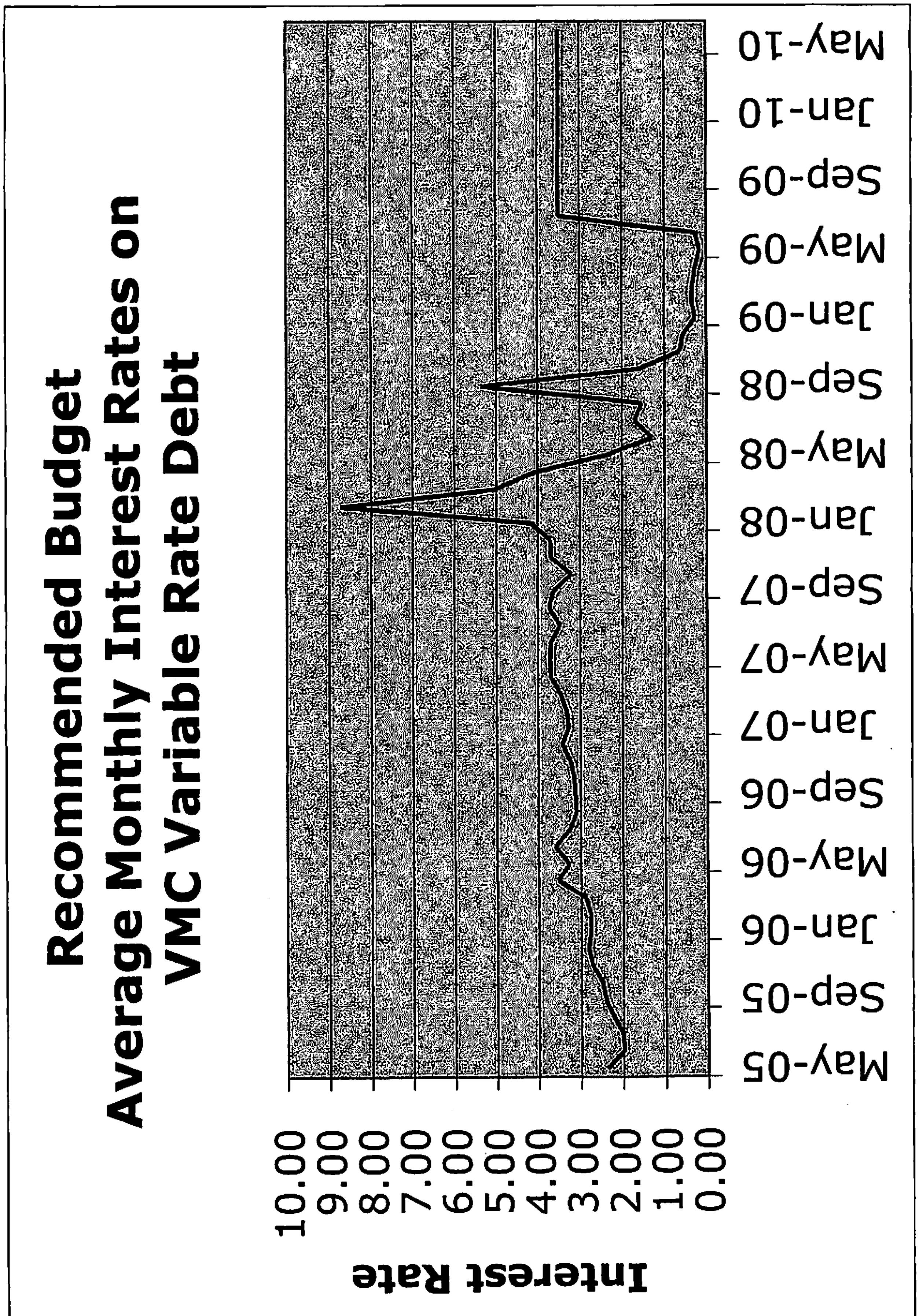
(Code 1954, § 3.1.16-5)

Attachment 4

R-C Healthcare Management -- Hospital Inflation
Mid-Year 2009 Semi-Annual Year-to-Year Percent Increase
(As of May 15, 2009)

		Historical		Projected			
Expense	* weight	2006	2007	2008	2009	2010	2011
Salaries and Wages	42.6	4.7	4.2	4.0	3.0	3.0	4.0
Employer Benefits	8.5	5.5	5.3	3.0	2.0	2.0	3.0
Professional Services	5.4	3.7	4.0	3.5	3.0	2.5	2.5
Equipment and Supplies	14.3	4.4	4.2	3.8	2.1	2.0	3.0
Pharmaceuticals	3.1	6.0	6.2	5.2	4.1	4.2	5.0
Food	2.7	6.0	4.3	6.0	4.7	4.5	5.2
Professional Liability Insurance	0.8	8.0	7.8	6.0	3.0	3.0	6.0
Utilities	1.4	10.2	10.8	8.0	4.1	4.0	7.0
Purchased Services	5.4	2.9	3.3	3.5	3.0	2.8	3.5
Other	9.8	2.0	3.1	3.6	3.0	3.0	3.7
TOTAL	**94.0**	**4.5%**	**4.3%**	**4.0%**	**2.9%**	**2.8%**	**3.7%**
CMS Projections (Total Index)		3.7	3.4	3.3	3.6	N/A	N/A
Net Operating Revenues		3.1	0.0	0.0	0.0	0.2	1.0

* Weights do not include a factor for the cost of capital, which is budgeted separately and individually for each organization.


Recommended Budget
Average Monthly Interest Rates on
VMC Variable Rate Debt
Interest Rate
10.00
9.00
8.00
7.00
6.00
5.00
4.00
3.00
2.00
1.00
0.00
May-05
Sep-05
Jan-06
May-06
Sep-06
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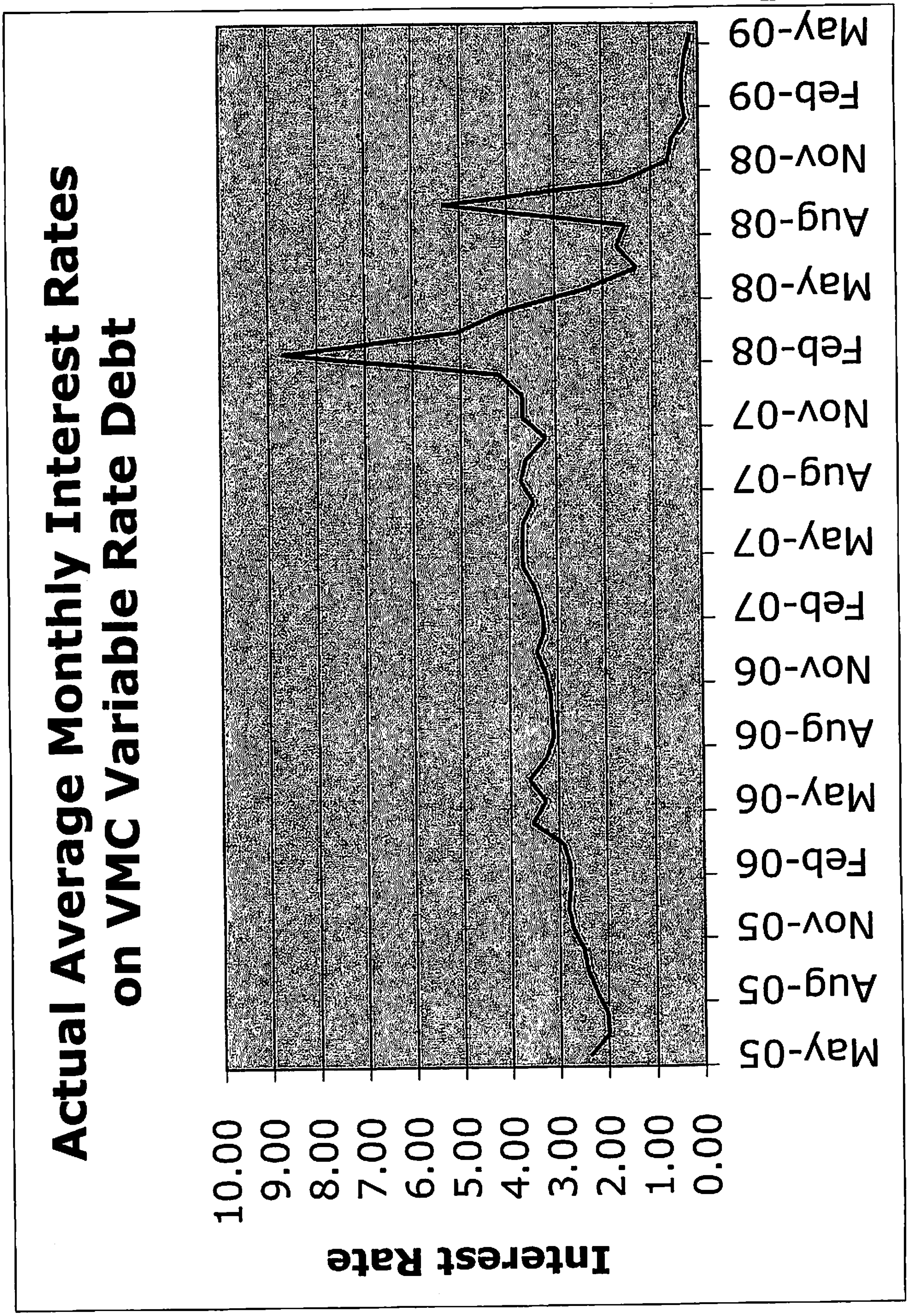
Sep-08
Jan-09
May-09
Sep-09
Jan-10
May-10


Actual Average Monthly Interest Rates on VMC Variable Rate Debt
Interest Rate
10.00
9.00
8.00
7.00
6.00
5.00
4.00
3.00
2.00
1.00
0.00
May-05
Aug-05
Nov-05
Feb-06
May-06
Aug-06
Nov-06
Feb-07
May-07
Aug-07
Nov-07
Feb-08
May-08
Aug-08
Nov-08
Feb-09
May-09

VMC Variable Rate Debt

Attachment 7

Issue	Outstanding	Controller-Rec Bud Interest Rate	Controller-Rec Bud Interest	Mgt Aud Div Interest Rate	Mgt Aud Div Interest	Savings
			OPTION 1: 3.0% vs. 3.5%			
El Camino 1985	31,992,000	0.035	1,119,720	0.030	959,760	159,960
1994 B	50,758,000	0.035	1,776,530	0.030	1,522,740	253,790
Total	**82,750,000**		**2,896,250**		**2,482,500**	**413,750**

Note: Current rates are at historic lows averaging, about 0.27 percent for May 2009. The average monthly rate during the past 49 months was 2.82 percent. Projecting rates to immediately jump from 0.27 percent to 3.5 percent in less than 30 days and remain at that level for the fiscal year is overly conservative.

Issue	Outstanding	Controller-Rec Bud Interest Rate	Controller-Rec Bud Interest	Mgt Aud Div Interest Rate	Mgt Aud Div Interest	Savings
			OPTION 2: 2.82% vs. 3.5%			
El Camino 1985	31,992,000	0.035	1,119,720	0.0282	902,174	217,546
1994 B	50,758,000	0.035	1,776,530	0.0282	1,431,376	345,154
Total	**82,750,000**		**2,896,250**		**2,333,550**	**562,700**

Note: Current rates are at historic lows, averaging about 0.27 percent for May 2009. The average monthly rate during the past 49 months was 2.82 percent, which would be a reasonable and conservative projection given that rates are currently at 0.27 percent and would have to increase significantly above 2.82 percent to average 2.82 percent for the fiscal year.

Issue	Outstanding	Controller-Rec Bud Interest Rate	Controller-Rec Bud Interest	Mgt Aud Div Interest Rate	Mgt Aud Div Interest	Savings
			OPTION 3: 2.70% vs. 3.5%			
El Camino 1985	31,992,000	0.035	1,119,720	0.0270	863,784	255,936
1994 B	50,758,000	0.035	1,776,530	0.0270	1,370,466	406,064
Total	**82,750,000**		**2,896,250**		**2,234,250**	**662,000**

Note: Current rates are at historic lows, averaging about 0.27 percent for May 2009. The average monthly rate during the past 49 months was 2.82 percent. Excluding the month of February 2008 (an outlier at 8.71 percent due to the bankruptcy of Lehman Brothers) results in an adjusted average for the 48-month period of 2.70 percent, which would also be a reasonable and conservative projection. given that rates are currently at 0.27 percent and would have to increase significantly above 2.82 percent to average 2.82 percent for the fiscal year.

Issue	Outstanding	Controller-Rec Bud Interest Rate	Controller-Rec Bud Interest	Mgt Aud Div Interest Rate	Mgt Aud Div Interest	Savings
			OPTION 4: 0.27% to 2.70% by Dec, then 2.70% through June			
El Camino 1985	31,992,000	0.035	1,119,720	0.0027 to 0.0270	669,433	450,287
1994 B	50,758,000	0.035	1,776,530	0.0027 to 0.0270	1,062,111	714,419
Total	**82,750,000**		**2,896,250**		**1,731,544**	**1,164,706**

Note: Current rates are at historic lows averaging about 0.27 percent for May 2009. The average monthly rate during the past 49 months was 2.82 percent. Excluding the month of February 2008 (an outlier at 8.71 percent due to the bankruptcy of Lehman Brothers) results in an adjusted average for the 48-month period of 2.70 percent, which would also be a reasonable and conservative projection. given that rates are currently at 0.27 percent and would have to increase significantly above 2.70 percent to average 2.70 percent for the fiscal year. Assuming a gradual rise in interest rates during the first six months to the 2.70 percent level by December 2009 and staying at that level for the rest of the fiscal year would be reasonable.