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*December 17, 2002*

Honorable Mayor, Councilmembers and Citizens of Manhattan Beach  
Manhattan Beach City Hall  
Manhattan Beach, California 90266

The Comprehensive Annual Financial Report (CAFR) of the City of Manhattan Beach for the Fiscal Year Ended **June 30, 2002 (FY2002)** is hereby submitted. This report has been prepared in accordance with generally accepted accounting principles as set forth in the pronouncements of the Governmental Accounting Standards Board. This report is also in compliance with the relevant requirements of Governmental Accounting, Auditing and Financial Reporting published by the Government Finance Officers Association of the United States and Canada. Responsibility for the accuracy, completeness and fairness of the data presented, including all disclosures, rests with management. We believe the information presented is accurate in all material aspects, and that it is reported in a manner designed to fairly present the financial position and results of operations of the various funds, account groups, and component unit of the City of Manhattan Beach. All disclosures necessary to enable the reader to gain an understanding of the City's financial activities have been included.

In accordance with the above-mentioned guidelines, the accompanying report consists of three sections. The **Introductory Section** contains the table of contents, the transmittal letter, a list of the City's principal elected and appointed officials, and an organizational chart. The **Financial Section** consists of the independent auditors' report, the general purpose financial statements, notes to the financial statements, and the combining and individual fund and account group financial statements and schedules. The **Statistical Section**, which is not audited, contains selected financial and demographic information, generally presented on a multi-year basis.

## **DESCRIPTION OF REPORTING ENTITY**

The City of Manhattan Beach was incorporated December 12, 1912, as a general law city in the State of California. The City operates under a Council-Manager form of government and provides the following services: police, fire, highway and streets, cultural and recreation, planning and zoning, utilities, and general administrative services.

The financial statements present the financial activity of the City of Manhattan Beach (the primary government) and its component unit. The component unit discussed below is included in the City's reporting entity because of the significance of its operational or financial relationships with the City, although it is a legally separate organization. However, the City of Manhattan Beach elected officials

have continuing full or partial accountability for fiscal matters of this entity. The financial reporting entity consists of: (1) the City, (2) organizations for which the City is financially accountable, and (3) organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the City's financial statements to be misleading or incomplete.

An organization is fiscally dependent on the primary government if it is unable to adopt its own budget, levy taxes or set rates or charges, or issue bonded debt without approval by the primary government. In a blended presentation, a component unit's balances and transactions are reported in a manner similar to the balances and transactions of the City. Component units are presented on a blended basis when the component unit's governing body is substantially the same as the City's or the component unit provides services almost entirely to the City.

***Blended Component Units:*** The financial statements of the City of Manhattan Beach include the financial activities of the Manhattan Beach Capital Improvements Corporation. The Capital Improvements Corporation was formed on August 6, 1996 and first used to issue debt to finance capital improvements to the City's water and wastewater systems. In FY2002 this corporation issued \$9,535,000 in debt to refinance existing ground lease commitments for the newly opened Marine Avenue Sports Fields resulting in long term savings of both interest and principal. The activities of the Capital Improvements Corporation are reflected in both the General Long Term Debt account group and the Enterprise Funds.

## **LOCAL ECONOMIC CONDITION AND OUTLOOK**

The City of Manhattan Beach is a beachfront community located in the South Bay area of Los Angeles County. With a population approaching 34,000 and an area encompassing nearly four square miles, the City's economic base consists primarily of residential development, with commercial development along the major arterials and some light industrial in the northeastern portion.

The City of Manhattan Beach has experienced stable but flat economic trends over the course of the year in line with conservative budget estimates. It is important to note that General Fund revenues exceeded budget estimates. Nearly all categories maintained the viability of the projected fiscal plan adopted at the beginning of the year. General Fund revenues decreased slightly by one percent (1%) over the prior fiscal year, with strong gains experienced in property tax, franchise tax, and recreation class activity collections. However, lowering trends were noted in sales and transient occupancy tax, vehicle code fines, hotel percentage rent, and interest earnings. In line with the prior year trend, property tax revenues have again increased, by eleven percent (11%). This trend reflects a continued increase in property values resulting from active market turnover and household improvements citywide. On the other hand, sales tax, hotel tax, and interest income decreased by four percent (4%), twenty two percent (22%), and seven percent (7%) respectively from fiscal year 2001. These downward trends clearly reflect the recessionary state of the national and local economy.

Although growth rates have softened, Building permit and plan check activity continue to perform favorably near prior year levels. FY2002 continued to display strong planning and residential construction activity beyond budget expectations. Building permit and plan check revenue fell below the prior year by \$32,001 or 1.4% while exceeding budget estimates by \$423,704 or 23%. This performance reflects sustained real estate building and improvement activity in the City coming off of significant recent year gains fueled by unique projects such as the Manhattan Beach Studios and the Gateway Shopping Center. These revenues have normalized as expected as we wind up a five-year boom period in building activity.

Interest earnings exceeded budget estimates citywide even though this revenue source decreased by \$166,248 or seven percent (7%) in the governmental funds over the prior year. These decreases in earnings can be attributed to the rapid and repeated fall in interest rates experienced this fiscal year. These declines were partially offset by the mitigating impact of higher average fund balances and prudent investment policies and practices.

Fines and Forfeitures revenue did not meet budget projections and fell below prior year results by three percent (3%) or \$61,679. Parking citation and vehicle code enforcement activity contributed most of the declines in this area. The City continues its efforts to maintain safe and effective traffic flow and enforce parking and traffic regulations citywide.

Other notable increases in general revenues include: a \$193,969 increase in franchise tax collections boosted greatly by the renewal of the citywide taxicab franchise arrangement; an increase of \$ 288,054 in city funds exchange collections resulting from the sale of Proposition A transportation funds; and an additional \$343,222 in recreation class and facility revenues indicative of an increase in overall demand and activity programming.

City staff continues to cautiously observe the evolution of Proposition 218 passed in November 1996. This law affects local governments' ability to charge property-related fees and assessments and to impose or raise taxes by requiring voter approval. This legislation has had a significant fiscal impact on many California cities. The future impact is significant to the extent that the proposition may limit the City's ability to raise additional revenues. In FY2003 the City completed an independent review of inter-fund charges to its enterprise utility funds which validated the propriety of all such charges. In fact the results of the study indicate that the City may opt to increase internal support charges by the General Fund to cover existing internal costs.

## **Significant Economic & Financial Events**

### **Dedicated Capital Project Revenue:**

**Hotel Tax:** In September 1998, City Council approved an increase in the transient occupancy tax from 8.5 to 10 percent. This has resulted in the generation of \$320,685 of revenue for the year, an amount which is 22% below prior year levels. Clearly, the impact on general tourism of the September 11 terrorist strike has been severe and long lasting. These funds have been recorded in the Capital Project Fund and are dedicated to funding general government capital improvement projects in the effort to maintain and enhance City infrastructure.

**Parking Meter Rates:** In FY2001 City Council approved an increase of on street parking meter rates from \$0.50 to \$0.75 per hour. This has resulted in additional parking meter revenue of \$268,844 for a total of \$529,325 this fiscal year. These funds have been recorded in the Capital Project Fund and are dedicated to funding general government capital improvement projects in the effort to maintain and enhance city infrastructure. Actual revenues were in line with budget estimates. Additionally, in May of 2002, parking lot meter rates were increased by \$0.25 to \$0.50 per hour. This rate increase is expected to generate \$197,400 in additional revenue next year and will be recorded in the Parking Fund to assist in funding the construction of the new Metlox public parking lot and town square.

**Parking Citation Rates:** City Council approved an increase of most parking citation rates from \$26 to \$30 in FY2001. This increase resulted in additional parking meter revenue of \$82,636 for a total of \$102,528 this current year. These funds have been recorded in the Capital Project Fund and are dedicated to funding general capital improvement projects in the effort to maintain and enhance city infrastructure. Additionally, in May 2002, expired meter parking citation rates were increased from \$26 to \$30 and all other parking citations from \$30 to \$35. This latest increase is expected to generate \$308,466 in additional revenue next year to be recorded in the General Fund.

### **Unrealized Investment Portfolio Gain:**

In recent years, the accounting profession adopted Government Accounting Standard #31 (GASB31) requiring that all investment holdings at year end be shown at fair market value. The current FY2002 investment portfolio reflects an overall market gain of \$1,167,413 as compared to \$872,082 in the prior year. \$220,973 of this unrealized market gain appears in the governmental fund group and increases cash and fund balances accordingly. The balance of the citywide gain, \$74,358, is recorded in the enterprise and trust funds. The impact of the GASB31 standard on investments is recorded as a new revenue classification "net increase (decrease) in the fair value of investments" which appears on all related Statements of Revenues and Expenditures. These are paper gains only which are subject to change with interest rate movements from year to year. Because the City's investment strategy adheres to a strict philosophy of holding all investments to their scheduled maturity dates, all investments will be redeemed at full par value. Over the course of the current year investment income exceeded budget estimates by \$241,108 citywide.

## MAJOR INITIATIVES

### For The Year

***Marine Sports Fields Refinancing:*** In FY2000, the City finalized the purchase of land adjacent to the existing Marine Avenue Park. A total of 7.1 acres of open space was purchased at a cost of \$7.3 million funded from available capital project and General Fund reserves. This land was purchased from a long-standing Manhattan Beach commercial organization utilizing the space for employee parking. The purchase of this property presented itself as a rare opportunity for the City to increase the amount of open recreational space available to the community. In that same year the City entered into a sale-leaseback transaction with the Beach Cities Health District (BCHD) whereby the City sold the open space and subsequently entered into a capital lease for six of the seven acres. The lease agreement called for the construction of recreational field facilities authorizing the BCHD to spend \$2.5 million to do so. Subsequently, City Council approved the use of an additional \$1 million of available reserves for the project. Over the past two years this transaction was recorded as a capital lease for a total capitalized value of \$9.8 million with \$8.8 million recorded as long-term debt. Construction of the sport fields was completed on schedule for the City's most significant park development in decades.

In FY2002, the City issued \$9,535,000 in Certificates of Participation debt to fully redeem the outstanding capital lease obligations at original cost. All title and rights of the property and related improvements have been transferred to the City and the financial statements reflect this transaction in the General Long Term Debt Group of Accounts. The resulting bond income stream and capital lease payoff transactions are recorded in the General Fund as other sources and uses of funds respectively.

***South Bay Regional Public Communications Authority (RCC):*** On November 21, 2000 City Council approved a new Joint Powers Agreement authorizing the issuance of bonds to finance the purchase and construction of a new emergency dispatch services facility. RCC issued \$2.18 million in revenue bonds on the City's behalf in January 2001, and the construction of the new facility has been completed in FY 2002. The bonds will be amortized over a thirty-year period and are expected to bear an average variable interest rate conservatively projected at 3.58% per year. On January 16, 2001 the City subsequently entered into an operating agreement with RCC that provides for the funding authority to complete the upgrade of the 911 emergency dispatch facilities. Under this structure the City assumes no debt and as such this is accounted for as an operating lease in the City's financial statements. The facility held its grand opening in June 2002, is in full operation, and provides us with state of the art safety dispatch services in support of our police and fire departments.

***Ongoing Water/Wastewater System Upgrade:*** In September 1996, the City issued \$4,615,000 in Certificates of Participation through the Manhattan Beach Capital Improvements Corporation to finance the upgrade of the City's water and wastewater system. Through this aggressive five-year capital project, important Water and Sewer infrastructure improvements have been made throughout the City. Net revenues of the Water and Wastewater Funds secure the 30-year issue. As of June 30, 2002 all construction fund balances for Water and Wastewater have been expended. The related remaining debt service is recorded in each respective enterprise fund for a total outstanding principal amount of \$4,345,000.

***Financial Credit Rating:*** In calendar 2002 the City sought to obtain a financial credit rating from nationally recognized agencies. This was pursued in anticipation of issuing bonds for the construction of public developments at the Metlox site as well as a new Police/Fire facility. The results of the credit rating have come in and the City has attained the highest possible rating, "AAA", from both S&P and Fitch. Beyond this point, the City is proceeding with its plans to issue bonds for both facilities starting with Metlox Certificates of Participation to be placed in the market in early 2003. The bond sizing will approximate \$12 million for the Metlox public improvements. The bond issuance for Police/Fire, to take place in 2004, is estimated at \$10 million.

## **For The Future**

***Public Safety Facilities:*** In the current year the City has outlined a specific financing plan for the future construction of a new public safety facility to replace existing Police and Fire buildings that are outdated and limited in space. The project, which is well within design stage, is estimated to cost \$35 million. In prior years, the City had designated specific reserves of \$11.36 million in the Capital Projects Fund for this improvement. In line with the FY2002 budget, an additional \$4.75 million was set aside increasing the total project reserve to \$16.02 million. In the November 2001 election, the City sought voter approval of a \$15 million General Obligation Bond to facilitate the financing of this facility. The required approval majority was not attained and the City proceeded to develop an internal financing plan. Alternative financing options in procuring the remaining balance of required funds were presented to City Council in FY2002. The upcoming FY2003 budget reflects an increased accumulated reserve balance of \$20 million for this project with the expectation that \$25 million will be available at the time of construction in 2004. The remaining amount will be debt financed with Certificates of Participation.

***Metlox Site Development:*** In August 1997, the City purchased the southern half of the former Metlox pottery site, a 1.5-acre parcel of undeveloped property in the downtown area. In early 1998 the City purchased the remaining half of the property for a total combined cost of \$5.5 million. The City has engaged a financial advisor and selected a development partner. The conceptual design phase has been completed and the City has entered into a formal development agreement with the development partner. This multi-million dollar project is expected to be a positive economic benefit adding to the City's ground lease, property, hotel, and retail tax revenue base. An environmental impact report has been completed and construction will begin in early 2003. The public elements of this development will

include a two level 460 space subterranean parking structure as well as a 40,000 square feet open space town square. The cost of the public improvements is estimated at \$14.6 million. The City will retain ownership of the underlying land, parking facilities and public open space. The private retail development will include a mix of hotel, retail, restaurant and office space elements and the developer has entered into a long term ground lease with the City. In May 2002 the City presented financing options to City Council related to the public parking and space component of this development. This resulted in a decision to debt finance \$11.6 million of the public project cost and increase dedicated parking meter revenues to assist funding the resulting future debt service. All debt financing, and capital transactions will be recorded in the parking enterprise funds and will be backed by the strength of the City's overall credit.

***Other Major Infrastructure Projects:*** Other significant capital projects scheduled for future completion and reserved for in this financial statement include: improvements to Polliwog Park; the Strand; Artesia, and Aviation improvements; the refurbishment of city parkettes; the roundhouse rehabilitations, and continued improvement to the City's storm drains, sidewalks and streets.

## **FINANCIAL CONTROLS AND PROCEDURES**

***Financial Policies:*** Throughout the years, the City of Manhattan Beach has followed a fiscally conservative philosophy of building and maintaining healthy financial reserves. This practice has allowed the City to continue providing quality services to its residents in a time when many local agencies were being forced to cut back due to fiscal constraints. In 1997-1998, the City Council approved the City's first set of financial policies, designed to promote sound financial management and ensure that the City's fiscal integrity remains intact as staff and Council members change. This Comprehensive Annual Financial Report reflects the implementation of these financial guidelines and presents all fund reserves and designations in an effort to define fund balance commitments and obligations as of the financial report date.

***Internal Control Structure:*** Management of the City is responsible for establishing and maintaining fiscal internal controls designed to safeguard the assets of the government from loss, theft or misuse, and to ensure that accounting data is accurately compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of controls should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits require estimates and judgments by management.

***Budgetary Controls and Changes:*** The City of Manhattan Beach maintains budget controls. The objective of these controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the City Council. Budget control is primarily maintained at the fund level in the governmental fund types. The City maintains a centralized purchasing function as one method of accomplishing budgetary controls. All purchase orders are reviewed by Purchasing and Finance management to assure adequate budget funding before binding commitments are finalized. Additionally, all machinery and equipment purchases are processed through centralized warehouse receiving to further strengthen internal controls. The City's financial software includes a full encumbrance purchasing accounting system with real time approval and budget checking capabilities. Full encumbrance accounting allows for the speedy identification of fund obligations at the time of requisition, providing tremendous budgetary control. The Comprehensive Annual Financial Report isolates all encumbrance obligations existing at June 30, 2002, related to governmental funds, and presents them as fund balance reserves on the respective balance sheets.

***Cash Management:*** It is the City's policy to invest all temporarily idle short-term funds and longer-term reserves in a manner that will maximize return without sacrificing security and jeopardizing liquidity requirements. Idle funds are invested in accordance with the Government Code and a formal investment policy approved by the City Council. The policy, which is reviewed and updated annually, allows investments in a variety of specific instruments such as Certificates of Deposit, Bankers Acceptances, U.S. Government and Agency securities, Repurchase Agreements, Commercial Paper, and the State's Local Agency Investment Fund.

***Risk Management.*** The City is a member of the Independent Cities Risk Management Authority (ICRMA), a joint powers authority consisting of twenty-eight medium-sized California municipalities, for the purpose of pooling the City of Manhattan Beach's risk for general liability losses with those of other member cities. The City's self-insured retention is \$250,000 per occurrence for Liability and Worker's Compensation. Under the ICRMA, insurance coverage in excess of the self-insured amount is provided up to a limit of \$20,000,000. Premiums for excess insurance coverage are set annually based upon actual claims experience as well as other factors.



## FINANCIAL INFORMATION

### Governmental Funds

The information in this section pertains to the City's general governmental operations. General governmental function finances are administered through the General, Special Revenue and Capital Projects Funds.

**Revenues:** The following schedule presents a summary of General Fund, Special Revenue Fund and Capital Projects Fund revenues for the fiscal year ended June 30, 2002, and the percentage of increases and decreases in relation to the previous year. In the following discussion of financial information revenue variances are based on prior year audited balances.

#### Fiscal Year 2001-2002 Government Fund Revenues

<b>Revenue Source</b>	<b>Amount</b>	<b>Percent of Total</b>	<b>Percent Increase (Decrease)</b>	<b>Dollar Increase (Decrease)</b>
Taxes	\$ 22,096,665	54%	(1%)	\$(137,533)
Licenses & Permits	1,447,841	4%	4%	53,803
Fines & Forfeitures	1,890,321	5%	(8%)	(154,363)
Use of Money & Property	3,677,986	9%	(7%)	(295,301)
Charges for Services	5,253,485	13%	11%	529,051
Intergovernmental	4,248,036	10%	(19%)	(971,584)
Other *	2,125,964	5%	(54%)	747,258
<b>Total Revenue</b>	<b>\$ 40,740,298</b>	<b>100%</b>	<b>(1%)</b>	<b>\$(228,669)</b>

- \* In FY2002 the City recorded a GASB 31 gain of \$220,973 as opposed to \$964,321 in the prior year for this fund group. This gain represents a book entry change in market valuation of the City's investment portfolio relative to the prior year. Although both years reflect a positive market valuation, the change in recorded value between years as required by GAAP reflects a relative decrease of \$743,348. Excluding the impact of this one-time transaction, governmental fund revenues increased by 1.26% or \$514,679 overall.

The City continues to enjoy stable and diverse revenue sources in line with budget projections although general gains have flattened compared to recent past years. Succinctly put, the impact of the economic recession has been felt in FY2002 adding further merit to the City's prudent, proactive and conservative, budgeting and planning process. Governmental fund revenue increases and decreases over the previous fiscal year are attributed to several factors:

***Property and Sales Tax:*** First and foremost, the Governmental fund revenues reflect the City's continued economic stability in FY2002 as well as the signs of a slowing economy. Property tax revenue increased by eleven percent (11%), or \$887,564, as a result of the strong regional and local real estate market performance. A review of our County property tax information reveals that the City's assessed value of taxable secured property equals \$6.5 billion, a strong indicator of the continued desirability and economic growth of Manhattan Beach from both a residential and commercial perspective. Sales Tax revenues decreased by 4% or \$297,964 as opposed to 3% gains last year yet, Sales Tax and Property Tax exceeded our budget estimates. Sales Tax remains as the City's single most market sensitive revenue source as a high percentage of our Sales Tax base is concentrated among a small group of high volume retailers. We remain cautious given the current economic climate.

***Hotel & Other Taxes:*** The FY2002 Financial Report displays significant decreases in the collection of hotel-related taxes and fees in the General Fund. In particular, Hotel Transient Occupancy taxes decreased by 22% or \$517,285 and related percentage rent collections decreased by 24% or \$164,404. These decreases are clearly attributed to stalled tourism resulting from the terrorist events of September 11 further aggravated by the general state of the economy. Occupancy rates are down and many hotels have adjusted rates accordingly. On a positive note, overall Franchise Tax collections have increased by \$193,969 or 28% mainly due to the renewal of a citywide taxicab franchise operating agreement and an overall increase in utility franchise fee collections. Local business license taxes increased by \$39,892 or 2% shrugging off the regional drop in retail sales. Real estate transfer taxes decreased by \$69,864 or 13% as opposed to large gains in the prior year.

***Licenses & Permits:*** Collections in this revenue group increased modestly compared to the prior year and exceeded our budget estimates for FY2002 indicating continued strength in residential and commercial building and improvement activity. Building Permit fees decreased by four percent (4%), or \$52,690, over prior years while Building Plan Check and report fees increased by two percent (2%), or \$20,689. It should be noted that fees in this area in recent years were boosted by material one-time commercial developments such as the Manhattan Beach Studios and the Gateway Shopping Center. In prior years staff anticipated the completion of these unique projects and, as such, budget estimates were lowered accordingly. In the end result overall fees came in twenty three percent (23%), or \$423,704, above budget estimates reflecting an unexpected continued strength in general remodel and improvement activity citywide.

**Other Noteworthy Revenue Items:** Beyond the specific revenue items discussed above, several other revenue line items were noted to have significant changes compared to the prior year. These are as follows:

- **Traffic Enforcement** - Parking & Vehicle code fines decreased by \$221,197, or 12%, as opposed to prior year gains in this area. On a combined basis these revenue sources have come in just under budget at 98% of estimates.
- **Dedicated Capital Project Revenue** - An increase of \$82,636 over last year was realized in the Capital Project Fund as result of a \$4 increase in select parking citation rates adopted in late FY2001. In FY2002 parking citations generated \$529,325 in revenue for this fund an increase of \$169,704 over last year. On the other hand dedicated hotel tax collections into this fund were down by \$91,478. Even with these trends, the Capital Improvement fund exceeded estimated budget projections overall.
- **Interest Earnings** – Annual interest earnings have contribute greatly to increases in overall revenue in recent years. Although we exceed budget estimates in 2002, this revenue source has begun displaying decreases in response to the general decline in interest rates. In the near term we expect rates to remain relatively flat at historically low levels. In FY2002 interest earnings decreased by \$166,248 over the prior year. As noted above, the FY2002 CAFR records GASB 31 “paper” market valuation gains for this fund group equaling \$964,321 in the prior year and \$220,973 in the current year. These market gains are subject to change as interest rates fluctuate and may never be realized as the City typically holds investments to maturity.
- **Other Changes** - State Vehicle Registration Fee revenue increased modestly by \$16,783. An ERAF Property Tax reimbursement revenue of \$146,934 was received in 2001 but not repeated in 2002. The Gas Tax Fund collected \$178,520 less from the State for one-time traffic and congestion mitigation funds (AB2928) while receiving \$208,423 in other additional grant funds. The Federal & State Grants Fund received \$681,824 fewer in Proposition A Park Bond dollars given the completion of the Creative Arts Center upgrades in the prior year. Lastly the Capital Project fund collected a \$250,000 permit and development fee in FY2001 as a one time collection related to the laying of telecommunication cable lines brought ashore within the city boundaries. An additional \$288,054 in funds were received into the General Fund for the sale of Proposition A transportation dollars.

The changes described above serve to explain the primary reasons for the overall increases in Governmental Fund revenues.

**Expenditures:** The following schedule presents a summary of General Fund, Special Revenue Fund, and Capital Improvements Fund expenditures for the Fiscal Year ended June 30, 2002, and the percentage of increases and decreases in relation to the previous year. In the following discussion of financial information, expenditure variances are based on prior year audited balances.

**Fiscal Year 2001-2002 Government Fund Expenditures**

<b>Expenditure Source</b>	<b>Amount</b>	<b>Percent of Total</b>	<b>Percent Increase (Decrease)</b>	<b>Dollar Increase (Decrease)</b>
General Government	\$ 6,453,362	18%	6%	\$340,560
Public Safety	16,974,210	48%	4%	603,768
Public Works	4,891,118	14%	10%	432,396
Recreation	5,057,722	14%	64%	1,970,754
<b>Operating Total</b>	<b>\$ 30,376,412</b>	<b>94%</b>	<b>11%</b>	<b>\$ 3,347,478</b>
Capital Projects	2,045,689	6%	(66)%	(3,903,772)
<b>Grand Total</b>	<b>\$ 35,422,101</b>	<b>100%</b>	<b>(2)%</b>	<b>\$ (556,294)</b>

Operating expenditures in the Governmental Funds increased by eleven percent (11%), or \$3,347,478, and remained within adopted budgetary limits. In contrast, governmental capital expenditures decreased significantly by 66%, or (\$3,903,772), from the previous fiscal year. On a combined basis, both operating and capital expenditures decreased by 2% overall. The decrease in capital projects between years is mainly attributed to the unique recording of capital lease improvements of \$2.34 million at the Marine and Aviation Sports Fields in the prior year. Excluding the impact of this major park development last year, FY2002 capital project expenditures levels decreased by \$1,564,885 given the existence of the following high dollar improvements in 2001: \$600,000 in street paving and improvements citywide; \$640,000 for the refurbishment of the Creative Arts Center; and \$629,000 for the construction of a retaining wall on Aviation Boulevard. High dollar 2002 capital expenditures in this fund group included \$1,011,821 for the design of the Police/Fire facility, \$558,000 in street paving and improvements, and \$160,128 for Sepulveda widening.

The eleven percent (11%) citywide increase in Governmental Fund operational expenses primarily arose from the following factors:

- **Employee salaries** increased by 5.5%, or \$866,132, above prior year levels, yet remained within original budget projections. These increases were a direct result of Police and Fire bargaining group negotiations in the prior year translating into a \$447,604 FY2002 increase in safety salaries. As no new safety positions were added in the current year, this increase was not influenced by the addition of labor resources. The remaining increase of \$418,528 can be attributed to normal scheduled increases for all other employee groups citywide.

- **Employee benefit cost** increased by a significant \$738,730 or 25% above prior year levels, yet remained within budget projections. These increases are attributed to three main components of this cost group which have been presented in past budget meetings as major fiscal challenge areas to be attended to:
  - **Public employee retirements costs (PERS)** increased by \$516,191 or 74% with the increase of Police and Fire retirement plan levels. The Police benefit was increased from 2% @ 50 to 3% @ 50, and the Fire benefit was increased from 2% @ 50 to 3% @ 55. With the increase in these plan benefits the employer rate went from .998% to 4.161 for Fire and .998% to 10.295% for Police. With the introduction of these higher benefits the Safety plan was unbundled from a single joint plan to two distinct plans for Police and Fire. These costs came in within adopted budget projections.
  - **Workers compensation** costs charge to functional departments increased by \$119,940 or 20% in response to the national and statewide increase in related premiums and claim costs. Cost increases in this area have been on the rise for several years and seemingly will continue at this rate. These cost increases were properly anticipated in the 2002 budget.
  - **Employee medical** costs increased by \$128,322 or 10% and remain within budget. Medical cost increases are expected to increase in double digit ranges in each of the next few years.
- **New and extraordinary lease financing costs** of \$907,269 were recorded in the Parks and Recreation department for debt service related to the existing Marine Avenue Sports Fields lease. In FY2002 this lease debt was refinanced and the recorded costs represent all operating lease costs due through the date of financing, April 24, 2002. On a related note, \$182,465 of new debt service costs were recorded in Parks & Recreation as result of the issuance of \$9,535,000 in variable rate demand certificates of participation for the sports fields refinancing. The bonds, issued in April 2002 carried bond delivery, administration and interest costs associated with and recorded in the 2002 fiscal year. Debt service going forward will approximate \$540,000 per year. Both of these factors explain a major component of the overall increase in the Recreation service costs for the year.
- An increase of \$132,858 or 14% in additional fee assessments for **emergency dispatch services** from the South Bay Regional Public Communications Authority as a result of rising operational costs and the City's participating percentage. This cost area has been on the rise for the past two years and is expected to level out as the new facility assumes full operating status.
- A one time expenditure increase of \$400,000 in Parks & Recreation for the **sale of Proposition A transportation funds** to a nearby city in the current year with a resulting offset in General Fund revenue. These special revenue funds carry an expenditure deadline resulting in the sale of such monies every other year to benefit general city operations.
- \$119,207 or 14% increase in **utility costs** with electricity costs leading the way coming in \$101,745 above the prior year. Telephone and water costs increased by \$13,849 and \$17,957 respectively. In total this cost group remained within our budget estimates.
- An additional \$128,198 in **machinery and equipment purchases** over the prior year including: over \$300,000 for the purchase and installation of a new citywide phone system, \$13,939 for a recreation related printing press, \$18,435 for new police laser speed guns, and \$14,194 for a police emergency rescue phone. Large dollar purchases in the prior year included \$28,000 for new parking enforcement hand held ticketing devices; \$37,000 for new storage equipment for police records;

\$38,000 for installation of the live scan automated fingerprint identification equipment and new portable safety radios; \$27,000 for an electronic messaging sign to be used for traffic safety and control; \$26,000 for air fill stations in support of fire suppression; \$13,000 for new vehicle safety exhaust systems for the health and safety of fire staff; and \$25,000 for a new police vehicle.

- An increase of \$159,848 in internal **information system service charges** reflecting the beginning stages of significant upgrades to the citywide network including communications, software and equipment improvements.

Beyond the specific expenditure items mentioned above, the remaining increases are primarily due to changes in contract personnel, material and services, and general building and maintenance cost expenditures.

As a partial offset to the salary and benefit costs listed above, it should be noted that in FY2001 the City incurred a one-time personnel recruitment and relocation expenditure of \$427,500 in providing a home loan for the City's Police Chief. When comparing the 2001 with 2002, this presents itself as a material positive variance.

In all cases, overall expenditures citywide were within adopted budget appropriation limits with the General Fund ending the year at 5% under adopted expenditure limits. The financial statements indicate that the Recreation department exceeded budgeted appropriations by \$78,999 in this fund group. This is easily explained when considering the more than full offset of these costs in increased revenues resulting from a tremendous gain in demand for recreational class offerings.

**Other Financing Sources & Uses:** This year's financial statements reflect significant other sources and uses of funds of \$9,443,752 and \$8,838,158 respectively. These amounts relate exclusively to the Marine Avenue Sports Fields refinancing and represent the amount of net incoming bond proceeds and the symmetrical use of proceeds to pay off existing capital lease obligations.

## **FUND BALANCES**

**Governmental Funds:** A discussion of changes in Governmental Fund balances follows with an emphasis on the most material funds in this group, the General and Capital Improvement Funds.

**General Fund:** For FY2002, revenues exceed Operating expenditures by \$3,957,869 compared to excess revenues of \$7,240,848 in the prior year. These surpluses are reflective of the City's strong local economy as well as the application of prudent fiscal policies and budgetary controls. On the other hand, the decrease in the surplus margin is a clear indication of flattening revenue growth in a rising cost environment. Given these conditions, the diligent application of our conservative budgeting practices and attention to expenditure controls is critical as we weather these lean years. As prescribed in the current year budget and subsequently approved City Council actions, several significant operating transfers were made from the General Fund for a total of \$6,383,429. After the transfer out of surplus

amounts, the General Fund balance decreased by \$1,819,966 while still maintaining reserve levels within policy established requirements. These transfers are as follows:

- An Operating transfer from the General Fund of **\$4,889,118 to the Capital Improvement Fund (CIP)** was identified in the adopted budget and transacted in the FY2002. \$4,641,754 of this transfer was designated specifically for the future funding of Police/Fire safety facilities. \$247,364 was added to existing designations for Strand walkway improvements. It should be noted that a reserve of \$1.063 million for enhanced library services existing at the end of last year was closed out to the Police/Fire facility reserve during FY2002 to accommodate an accepted financing plan for the new safety facility.
- An Operating transfer of **\$1,569,311 to the Insurance Reserve Fund** was made to defray rising Workers Compensation and Liability claims and premium costs. A similar transfer of \$429,227 was made in the prior year pointing to the ominous nature of these cost increases.
- An Operating transfer of **\$75,000 of surplus reserves from the County Parking Lot Fund** into the General Fund was made in line with existing County agreements and budget projections.

**Capital Improvement Fund:** The Capital Improvement Fund acts as a conduit for General Fund monies to be used in the acquisition and construction of general service improvements to City infrastructure. On an annual basis, City Council adopts a capital expenditure plan, and necessary fund transfers from the General Fund are scheduled accordingly if required beyond dedicated revenue sources. In FY2002, the balance in the Capital Improvement Fund increased significantly by \$5,623,528 as a result of a net surplus of funds of \$734,410 from normal operations (capital expenditures over revenues) and incoming fund transfers in support of major infrastructure reserves. The most notable capital expenditure was the use of \$1.1 million of existing dedicated reserves for design of the new Police/Fire facility scheduled to start construction in 2004. As approved in the adopted budget, transfers of \$4.889 million from the General Fund were made into the Capital Improvement Fund resulting in accumulated reserve designations at June 30, 2002 of \$16.02 million for Civic Center safety facilities, and \$926,640 for Strand walkway improvements. As mentioned above, \$1.063 million for library services existing last year were absorbed into the Police/Fire reserves for use in funding that high priority project. \$1,026,300 has been designated for improvements to Artesia Blvd. which was relinquished to city ownership in the current year. Additional reserves of \$1.039 million is reflected as a component of fund balance for projects approved but not yet completed.

**Special Revenue Funds:** Special Revenue Funds are used to account for proceeds of specific revenue sources, many intergovernmental in nature, that are restricted by law to expenditures of particular purposes. Funds in this group include the Street Lighting & Landscaping, Gas Tax, Propositions A and "C," AB2766 (Air Quality) and a variety of Police and Safety Grant Funds.

In FY2002, all fund balances in this group were noted to increase over the prior year with the exception of the Street Lighting and Proposition A funds. The Proposition A Fund decreased given the planned sale of \$400,000 of excess funds for use in general operations. The Street Lighting fund decrease is indicative of rising utility rates in a fund that is limited in growth by proposition 218 requirements. On the other hand Gas Tax, Police Safety Grants, Asset Forfeiture, Proposition C, and AB2766 (Air Quality) funds all increased as a result of normal operations accumulating reserves to be used in the future towards capital purchases, vehicle and transport operations. In all cases expenditures remained within appropriation levels with the exception of the Proposition A Fund where an additional \$100,000 in funds was sold given attractive pricing and existing reserve levels.

***Proprietary Fund Operations:*** Proprietary Funds report the Enterprise and Internal service operations of the City. These funds have been established to account for the financing of self-supporting activities that render services to the general public and to other City operations on a user fee basis.

The City's enterprise operations consist of Water, Wastewater, Stormwater, Refuse, and Parking funds. With the exception of the Refuse Fund and the County Parking Lot Fund, which transferred excess reserves of \$75,000 to the General Fund, each fund recognized an increase in retained earnings over the prior year. In this current year several infrastructure improvement projects were completed resulting in \$1,696,380 in capitalized costs in the Water, Wastewater, Storm Water and Parking funds. The combined balance sheets for enterprise funds present combined equity reserves of \$3,303,161 for ongoing capital project costs remaining to be completed. Ending equity reserves for all funds in this category are adequate to support working capital requirements and capital project demands.

The City's internal service operations include the Insurance Reserve, Information Systems, Fleet Management and Building Maintenance Funds. Two of these funds, Information Systems and Fleet Management, did not exist prior to July 1, 1997 and were first funded by General Fund transfers of \$400,000 and \$1,200,000, respectively. The Insurance Reserve Fund realized a net operating loss of \$1,348,042 for the fiscal year marking a sixth loss year in a row for this fund. In FY2002 \$1,569,311 was transferred from the General Fund to defray eroding fund balances. In recent years the Insurance Reserve Fund has experienced significant workers' compensation case volume requiring higher than expected use of reserves. Premiums are also on the rise. As always, this fund is subject to loss experiences, which are not easily estimated from year to year. In upcoming budget years, allocable charges to our operating departments will be adjusted as a means of replenishing the Insurance Fund to desired levels. Nonetheless cost overruns in this area are increasing at an alarming pace. All other Internal Service funds experienced gains in fund balances or near breakeven results.

***Account Groups:*** Account groups included in the Comprehensive Annual Financial Report are not intended to track operating activities but rather act as record keeping accounts for the value of general fixed assets and long-term debt obligations. Account groups include General Fixed Assets and General Long-Term Debt Accounts and are discussed below.



**General Fixed Assets:** The general fixed assets of the City are those fixed assets used in the performance of general governmental functions and exclude the assets of the proprietary funds. The City's total general fixed assets at June 30, 2002 amounted to \$47,537,527 which represents historical costs, or if not available, estimated values at the time of acquisition. The value of capitalized general assets has increased significantly, by \$9,782,784, primarily due to the capitalization of the Marine Avenue Park which was donated to the City by TRW at an estimated value of \$9,275,000. Additionally, the City has begun capitalizing the Metlox public improvements design equaling \$176,351 in this fiscal year. Depreciation is not recognized in the reporting of general fixed assets, in accordance with generally accepted accounting principles for governmental entities.

**General Long Term Debt Accounts:** The General Long-Term Debt Account Group records all long-term debt related to City general governmental services. The most significant obligations appearing in this group include accrued employee leave balances of \$1,499,788, capital lease obligations of \$279,584 for a municipal energy retrofitting program, and \$9,535,000 for the Marine Sports Field newly issued Certificates of Participation.

**Trust and Agency Funds:** In several cases, the City acts as a custodian of funds held for the benefit of others which mostly relates to the administration of employee pension and 401(a) compensation plan. It is significant to note that this financial report does not include the value of trust holdings in the employees' 457 deferred compensation plan valued at \$8,901,914 at June 30, 2002. This recognizes enacted legislation establishing the City as a plan trustee and protecting these employee owned assets from external creditors.

**Deferred Compensation Plan for Full-Time Employees.** Management employees receive a City-paid contribution ranging from 2.5 to 4.5 percent of their salary into a 401(a) plan. The liability balances for these deferred compensation plans are recorded in the Special Deposits Fund along with restricted deposits held for safety operations and our Employee Section 125 Flexible Spending Plan.

**City Pension Plans:** This fund is used to account for the supplemental retirement and single highest year programs, dormant plans which were previously offered by the City. The Pension Trust Fund is used to account for the distribution of these plans for former employees still receiving benefits.

### **THIRD PARTY ADMINISTERED PENSION PLANS**

**Defined Benefit Pension Plan:** The City contracts with the California Public Employees Retirement System (CalPERS) for certain retirement, disability, death and survivor benefits for full-time employees. The annual actuarial valuation by CalPERS changes from year to year, and the City's contribution rates are modified accordingly.

***Retirement Plan for Part-Time Employees:*** From 1990 to 1997, the City of Manhattan Beach provided its own retirement plan for Part-time, Seasonal and Temporary employees not eligible for participation in the California Public Employees Retirement System. This plan was eliminated in June 1997, as the City opted to provide the Public Agency Retirement System (PARS) program instead.

## **OTHER INFORMATION**

***Independent Audit:*** The accounting firm of Vavrinek, Trine, Day and Co., LLP, was selected by the City to perform the annual audit. The auditors' report on the general purpose financial statements and combining and individual fund statements and schedules is included in the financial section of the City's Comprehensive Annual Financial Report. The City was not required to conduct a single-audit, an audit of Federal Grant Funding, and, as such, no separate single audit opinion and report is included.

***Acknowledgments:*** Preparation of this report could not have been accomplished without the efficient and dedicated services of the Finance Department staff. We would like to express our appreciation to all members of the department, particularly Russell Morreale, Henry Mitzner, Luisa Camba, Sande Johnson and Eugene Wee who assisted and contributed to its preparation. A special thanks is extended to Vavrinek, Trine, Day and Co., LLP, our independent auditors, for their professionalism and diligence in preparing this year end financial report. We would also like to thank the Mayor, members of the City Council, and the City Treasurer for their leadership and support, without which the preparation of this report would not have been possible.

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Geoff Dolan, City Manager

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Bruce Moe, Finance Director