

**City of Manhattan Beach
Management's Discussion and Analysis**

CITY OF MANHATTAN BEACH

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the City of Manhattan Beach, we offer our readers of these financial statements this narrative overview and analysis of the financial activities of the City of Manhattan Beach for the fiscal year ended June 30, 2006. We encourage readers to consider this information in conjunction with additional information that we have furnished in our letter of transmittal, which can be found on pages i to xi of this report.

FINANCIAL HIGHLIGHTS

- The assets of the City of Manhattan Beach exceeded its liabilities, at the close of the fiscal year ended June 30, 2006, by \$167,465,417 (*net assets*). Of this amount, \$39,747,050 (*unrestricted net assets*) may be used to meet the government's ongoing obligations to citizens and creditors.
- The City's capital assets increased by \$21,089,793. This increase is mostly attributable to the construction completed to date for the new Police and Fire facility in the amount of \$12,818,442, an additional capitalized amount of \$952,717 for related furniture and fixtures, and \$2,131,969 for the refurbishment of the Strand. This year's increase also included \$850,481 of capital lease values for a new Fire Truck and Sewer Vacuum truck. Other increases include improvements to streets and roadways, utility systems, the Metlox public plaza, and City parks.
- The City's total net assets increased by \$9,373,189. This increase is attributable to several factors primarily including the results of operations combined with the effect of the difference in accounting for capital assets within governmental funds versus the statement of activities. Under the GASB 34 model, the statement of activities is presented on a full accrual basis calling for the capitalization of all capital and infrastructure costs as opposed to the expenditure of such costs in the individual governmental funds.
- As of June 30, 2006, the City's governmental activities reported combined ending net assets of \$129,043,118, an increase of \$7,772,722, in comparison with the adjusted opening balance. \$24,859,008 (*unrestricted net assets*) is available for spending at the government's discretion. Further to this point, it is important to note that a good majority of these dollars are derived through a variety of special use funds and, as such, are limited to specific types of applications. Additionally, this unreserved balance includes several material City Council directed capital project designations which have resulted from a long-standing infrastructure improvement and fiscal policy plan.
- As of June 30, 2006, the City's business activities reported combined ending net assets of \$38,422,299, an increase of \$1,600,467 in comparison with the adjusted opening balance. \$14,888,042 of this balance is unrestricted to be used in the future support of the operational and capital needs of these enterprises. This unreserved balance includes several material City Council directed capital project designations which have resulted from a long-standing infrastructure improvement and fiscal policy plan.
- As of June 30, 2006, the balance in the General Fund was \$21,579,053, or 52% (6.2 months), of total General Fund expenditures. The General Fund reported excess revenues over expenditures of \$4,154,921 before net transfers out of \$182,000.
- A net transfer out of \$182,000 from the General Fund was made to primarily fund the Citywide Facilities Strategic Plan project: A significant community involved study which will identify existing general government facilities needs as a basis for developing a prioritized long term future capital improvement plan for such facilities.
- The City's total bonded debt decreased by \$545,000 (1%) during the current fiscal year. This decrease is primarily attributable the scheduled pay down of issued bonds in the General, Water, Wastewater and Parking funds. Long term insurance claim reserves, and employee leave

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balances, remained relatively stable at prior year levels. Fiscal year 2005-2006 saw the introduction of new safety and utility vehicle capital lease liabilities of \$720,693.

USING THIS ANNUAL REPORT

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements, which is comprised of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Reporting on the City as a Whole

Government-wide financial statements: The *government-wide financial statements* are designed to provide readers with a broad overview of the City's finances in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City of Manhattan Beach is improving or deteriorating.

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, public works, planning, building and safety, and recreation. The City's business-type activities include water, wastewater, storm water and parking.

The government-wide financial statements can be found on pages 21 to 23 of this report.

Reporting on the City's Most Significant Funds

Fund financial statements: A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Manhattan Beach, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds and fiduciary funds.

Governmental funds: *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing

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decisions. Both the governmental fund balance sheet and governmental fund statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City of Manhattan Beach maintains 12 individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund and the Capital Improvement funds, all of which are considered to be major funds. Data from the other 8 governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these *nonmajor* governmental funds is provided in the form of *combining statements* elsewhere in the fund financial statements section of this report.

The City of Manhattan Beach adopts an annual appropriated budget for each of its governmental funds. A budgetary comparison statement has been provided for each governmental fund to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found on pages 26 to 45 of this report.

Proprietary funds: The City of Manhattan Beach maintains two types of *proprietary funds*. Services for which the City charges customers a fee are generally reported in the City's *enterprise funds*. These proprietary funds, like the government-wide statements, provide both long-term and short-term financial information. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for its fleet of vehicles, computer systems, shared building and maintenance costs, and City-wide insurance costs. Because these services predominantly benefit the governmental function, they have been included within governmental activities in the government-wide financial statements and related intra-fund charges have been eliminated accordingly.

Proprietary fund financial statements provide the same type of information as the government-wide financial statements, only in more detail. All four internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the internal service funds is provided in the form of combining statements elsewhere in this report. Five of the City's seven enterprise funds are considered major funds and presented as such in the fund financial statements. The two nonmajor funds, County and State parking lots, are presented individually in the combining statements.

The combining statements referred to earlier in connection with nonmajor governmental funds, proprietary and internal service funds are presented immediately following the notes to the financial statements. Combining and individual fund statements and schedules can be found on pages 88 to 114 of this report.

Notes to the financial statements: The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 47 to 85 of this report.

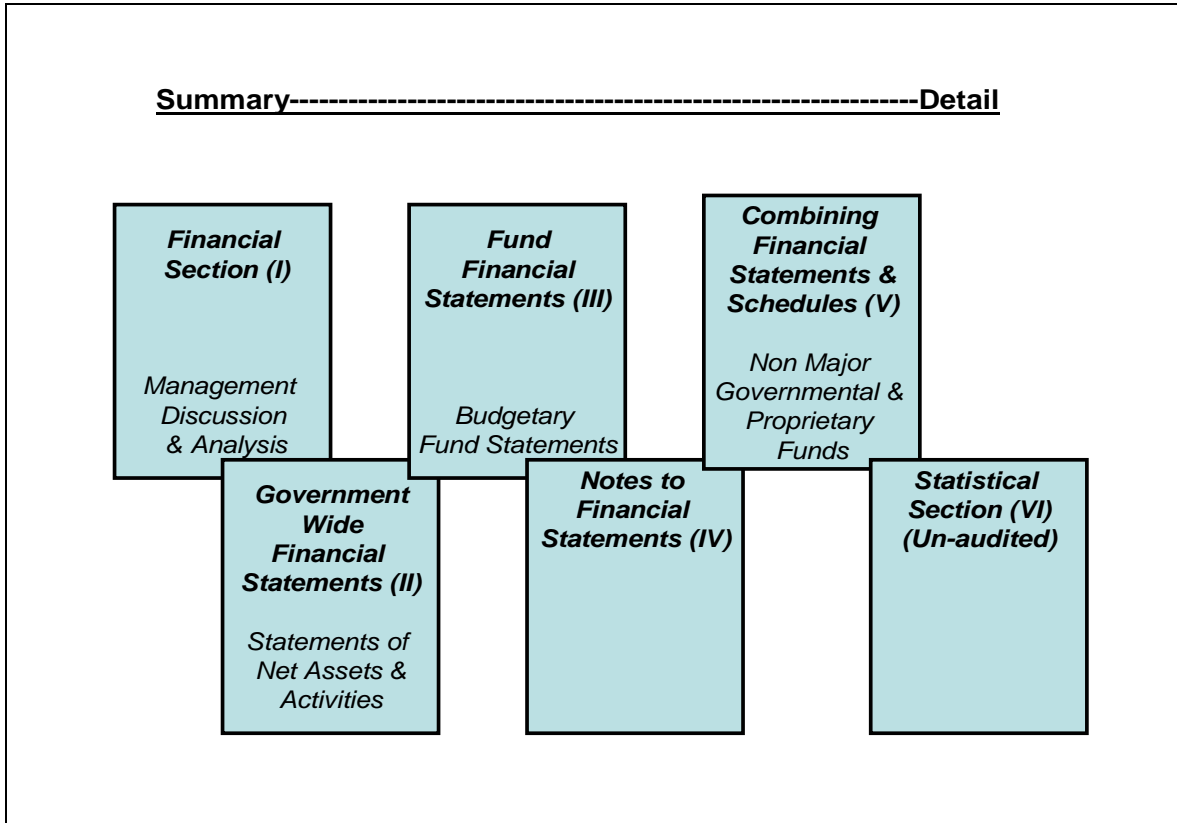
The City as Trustee

Other information: In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* concerning the City's progress in funding its obligation to provide pension benefits to its employees and budget-to-actual financial comparisons for the General Fund. The City has elected to present this information within the basic financial statement and financial statement sections of the report.

All of the City's fiduciary activities are reporting distinctly in a separate Statement of Fiduciary Assets and Liabilities. These figures are not combined with other financial statements because the City cannot use these assets to finance present or future operations. The City is responsible for ensuring that the assets reported in these funds are used for their intended purpose.

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In summary the various sections of this financial report are arranged as follows:



FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City of Manhattan Beach, assets exceeded liabilities by \$167,465,417 at June 30, 2006.

By far, the largest portion of the City's net assets (65%) reflects its investment in capital assets (e.g., land, infrastructure, buildings and equipment). The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending.

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City of Manhattan Beach Net Assets

	Government Activities 2006	Government Activities 2005	Business- Type Activities 2006	Business- Type Activities 2005
Current and other assets	\$55,041,683	\$63,736,173	\$18,450,554	\$20,525,123
Capital assets	110,186,766	92,510,048	38,427,032	35,013,955
Total Assets	165,228,449	156,246,221	56,877,586	55,539,078
Long-term liabilities outstanding	26,123,142	26,020,593	16,439,899	16,812,289
Other liabilities	10,062,189	8,955,232	2,015,388	1,904,957
Total Liabilities	36,185,331	34,975,825	18,455,287	18,717,246
Invested in net capital assets	87,848,226	70,373,993	21,672,032	17,903,955
Restricted	16,335,884	24,613,125	1,862,225	4,075,681
Unrestricted	24,859,008	26,283,278	14,888,042	14,842,196
Total Net Assets	\$129,043,118	\$121,270,396	\$38,422,299	\$36,821,832

A portion of the City's restricted net assets (\$10,676,274), within the governmental activities category, is earmarked for debt service and bond, or project, funds held in trust. The remaining portion represents Special Revenue Fund resources that are subject to external restrictions on how they may be used. The balance of unrestricted net assets (\$24,859,008) may be used to meet the government's ongoing obligations to citizen services and creditors. A significant portion of this remaining balance is subject to City Council directed capital project designations and policy reserves displayed in financial Note 7.

Statement of activities: On a City-wide basis, net assets increased by \$9,373,189. Governmental activities, as a group, increased by \$7,772,722 and accounted for most of the growth in the net assets of the City.

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City of Manhattan Beach Changes in Net Assets

	Governmental Activities 2006	Governmental Activities 2005	Business- Type Activities 2006	Business- Type Activities 2005
Program revenues:				
Charges for services	11,484,126	11,412,225	14,097,876	13,653,362
Operating contributions and grants	2,767,865	2,571,735	19,758	20,088
Capital contributions and grants	5,598,244	4,795,086	0	21,807
General revenues:				
Property taxes	15,666,320	11,793,140	0	0
Other taxes	15,911,571	14,576,155	0	0
Motor Vehicle In Lieu	835,709	2,472,372	0	0
Other	3,033,968	2,659,742	546,197	450,702
Total Revenues	55,297,803	50,280,455	14,663,831	14,145,959
Expenses:				
General government	7,070,028	7,814,392	0	0
Public safety	24,270,798	23,756,438	0	0
Public works	10,380,032	10,355,400	0	0
Parks and recreation	4,724,704	4,772,150	0	0
Interest on long-term debt	875,519	574,108	0	0
Water, Waste, Storm	0	0	7,950,790	7,926,665
Refuse	0	0	3,692,611	3,430,815
Parking	0	0	1,623,963	1,476,255
Total Expenses	47,321,081	47,272,488	13,267,364	12,833,735
Revenues Over Expenses	7,976,722	3,007,967	1,396,467	1,312,224
Transfers In (Out)	(204,000)	143,000	204,000	(143,000)
Increase in Net Assets	7,772,722	3,150,967	1,600,467	1,169,224
Net Assets - Beginning	121,270,396	117,293,341	36,821,832	35,652,608
Restatement	0	826,088	0	0
Net Assets - June 30 Year End	129,043,118	121,270,396	38,422,299	36,821,832

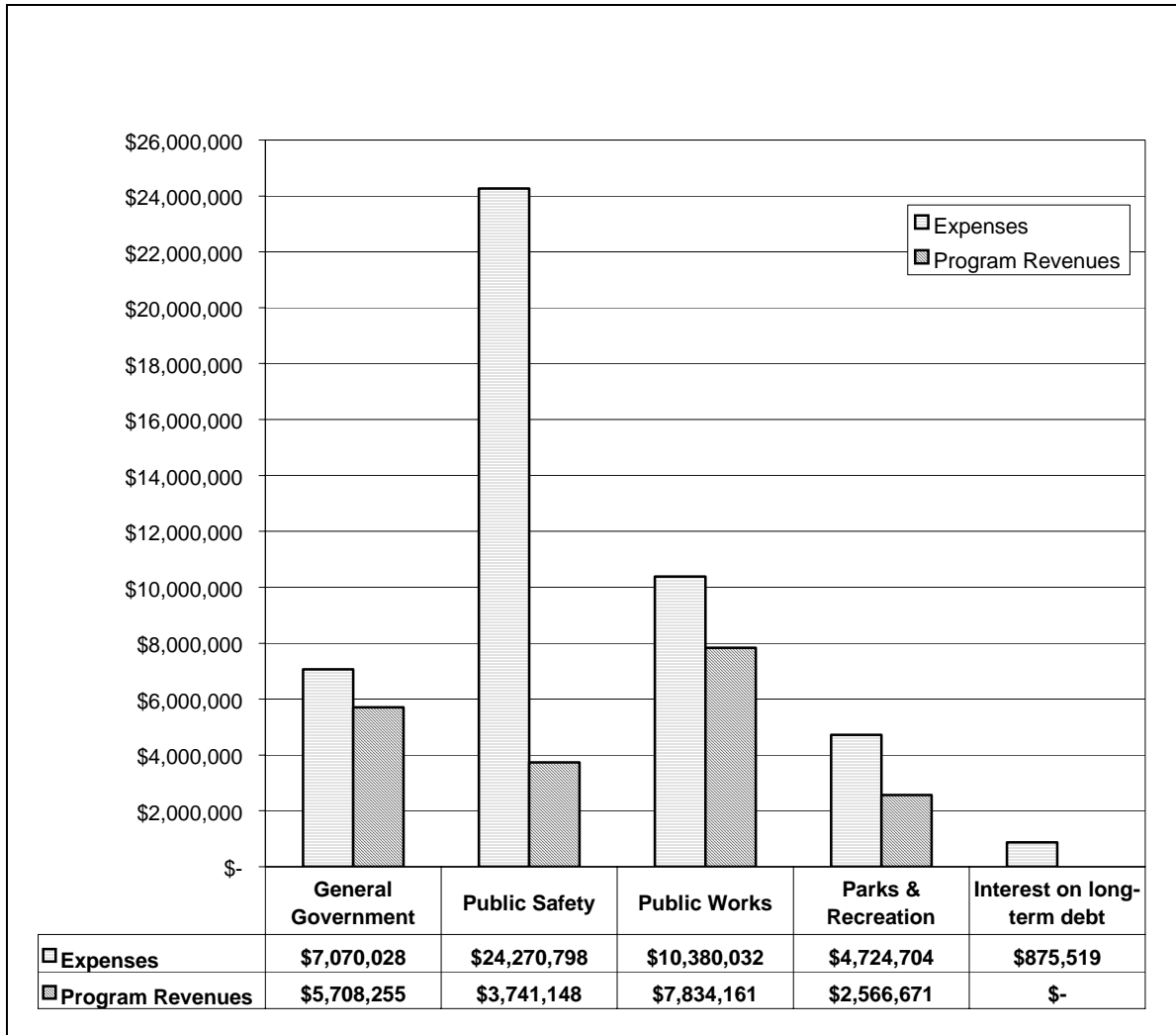
Key elements of this increase in FY 2005-2006 are as follows:

- The General Fund reported an operating surplus, before transfers, of \$4.2 million, which added to the overall strength of citywide net asset balances.
- The Utility Funds reported net income, before transfers, of \$1.7 million, again, adding to the overall strength of citywide net asset balances.
- The Internal Service Funds reported net income, before transfers, of \$451,062, to support future equipment replacement schedules and service support reserves. These also add to the overall strength of citywide net asset balances.
- The General Fund reported a positive equity restatement of \$165,882 to record short term accrued employee leave on a Government-Wide basis and not within the governmental funds
- Although this equity is restricted in nature, the Underground Assessment District Fund reported a surplus of \$2.6 million as result of pre-paid bond assessments to be applied, along with resulting bond proceeds, to the future construction of related district projects.

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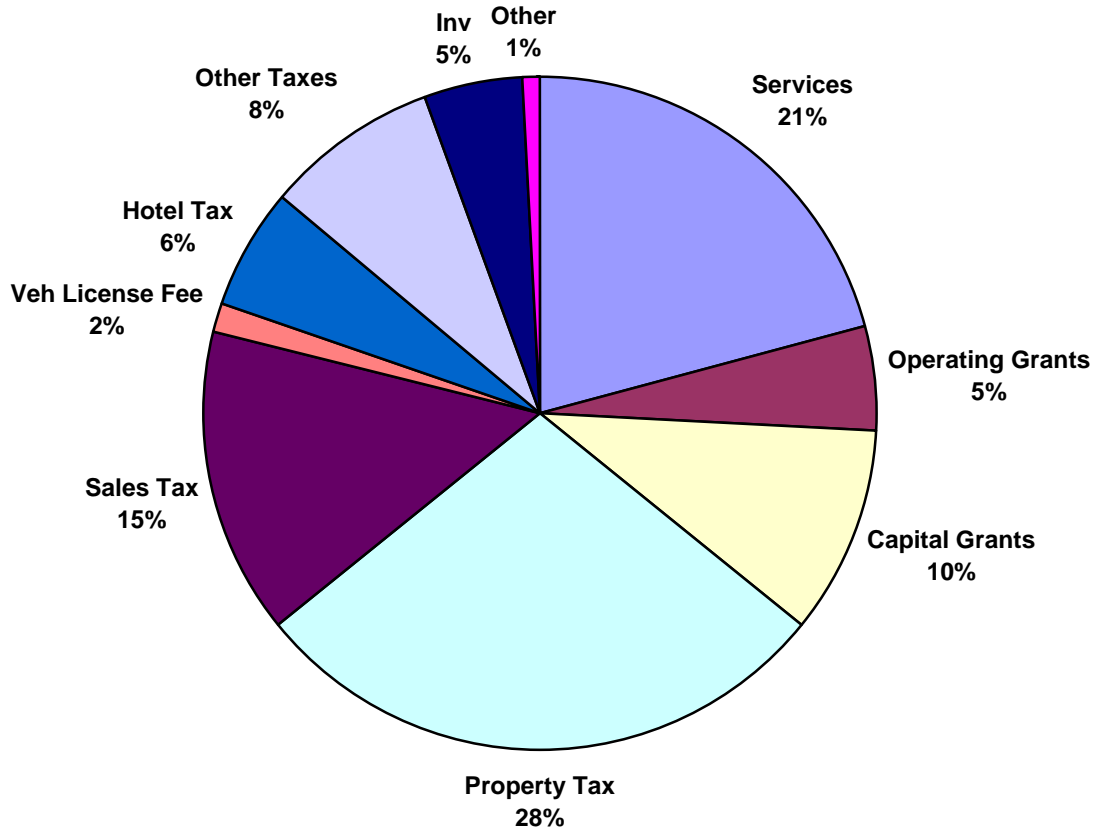
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Government Activities

Expenses and Program Revenues - Government Activities - Fiscal Year 2006



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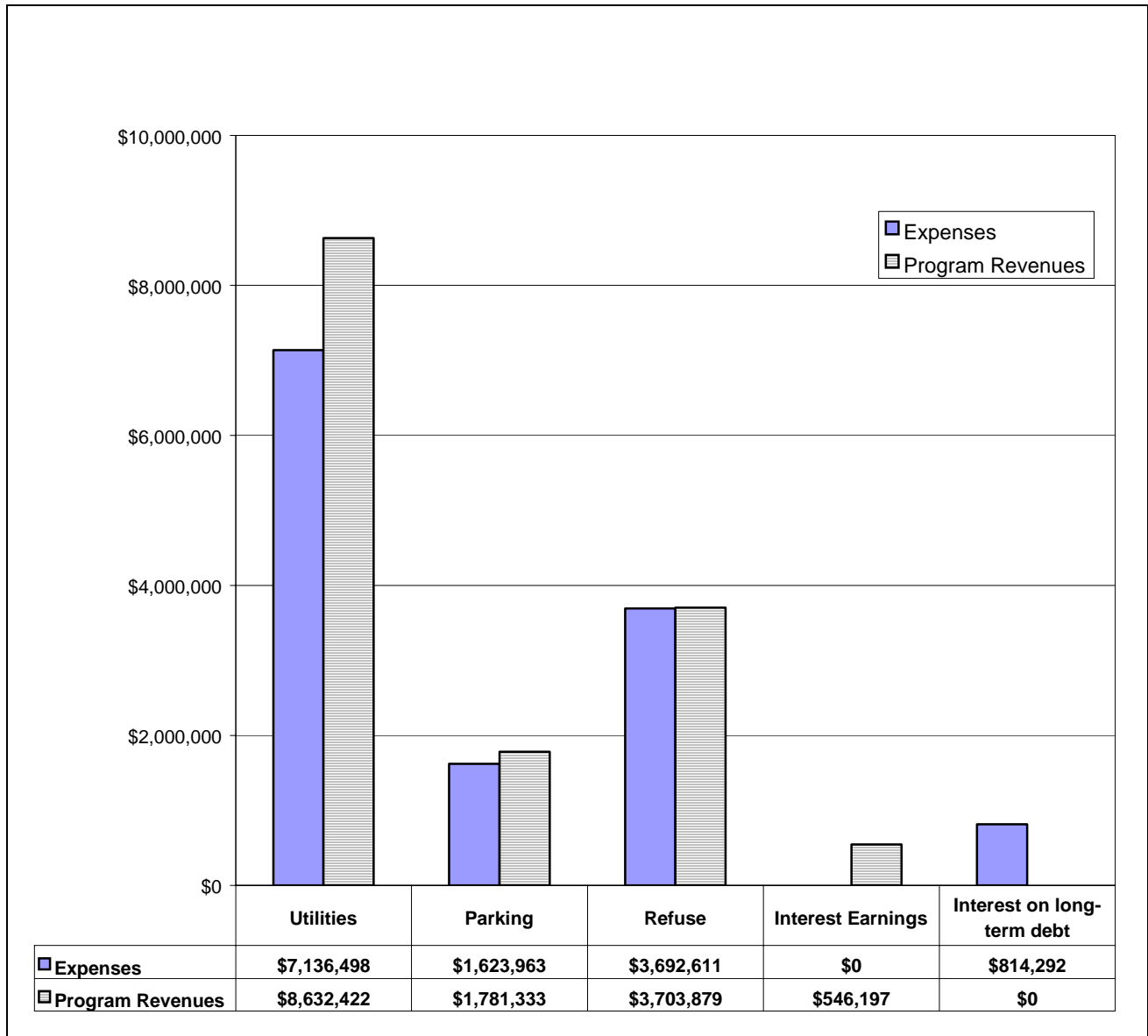
Revenues by Source - Government Activities - Fiscal Year 2006



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Business Type Activities

Expenses and Program Revenues - Business Type Activities - Fiscal Year 2006

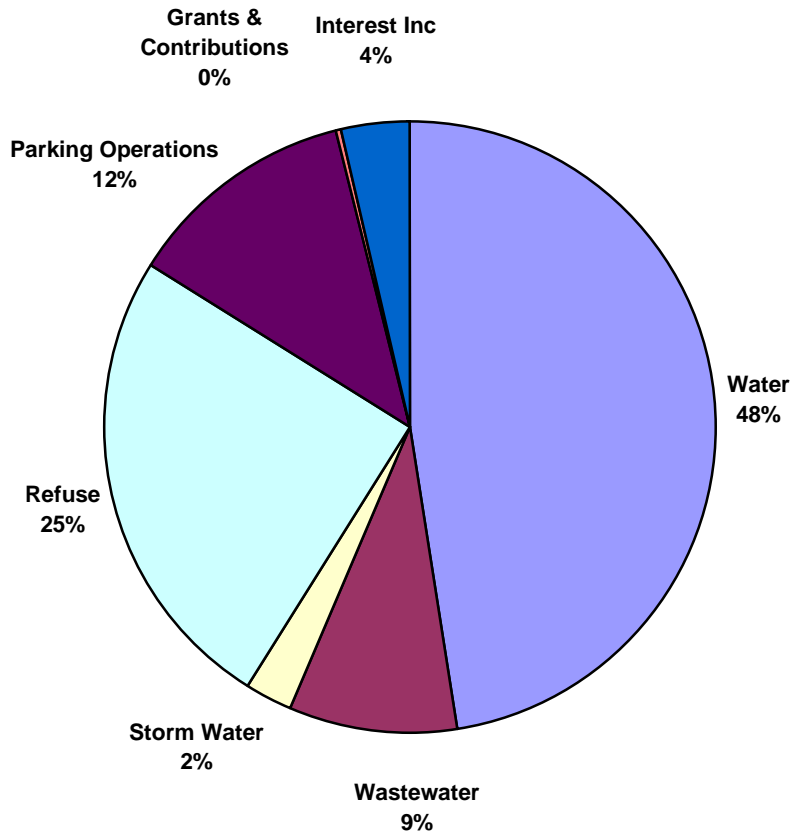


The City's business-type operations include several major service areas:

- Water
- Wastewater
- Storm Water
- Refuse
- Parking

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Revenues by Source - Business Type Activities FY 2006



In fiscal year 2005-2006, revenues for the City's business type activities amounted to \$14,663,831, including \$19,758 in grants, contributions and investment earnings. Total operating expenses equaled \$13,267,364 for a positive operating income of \$1,396,467 before transfers. When considering the impact of the net transfer in of \$204,000, net assets increased by \$1,600,467 this current year.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

Governmental Funds

As of the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$39.88 million, a decrease of \$8.7 million in comparison with the prior year. This decrease is primarily explained by the planned use of resources in completing the new Police/Fire & Civic Center facility. Approximately 69% of this total amount, \$27.75 million, constitutes unreserved fund balance. \$2.98 million of this unreserved balance is restricted homeowner assessment pre-payments held in trust for recently approved under grounding projects. The remainder of the fund balance is reserved to indicate that it is not available for new spending because it has already been committed to: 1) liquidate construction contracts and purchase orders of the prior period (\$10.52 million); 2) reserve for prepaid items and debt reserves (\$1.3 million); and 3) \$309,205 for long term receivables.

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It is important to note that City Council approved a variety of fund designations in adherence to its financial policy requirements and budgetary capital planning initiatives. This is evidenced by the presentation of the components of fund balances as listed in Note 7 of these financial statements. Of the \$27.75 million unreserved governmental fund balance noted above, \$15.7 million has been designated by City Council actions, and \$3 million remain in restricted for under grounding pre-payments. Considering these designations, \$9.05 million in governmental fund balances remain unreserved and undesignated.

General Fund

The General Fund is the chief operating fund of the City of Manhattan Beach. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$20.53 million, while total fund balance reached \$21.58 million. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 49% of total General Fund expenditures, while total fund balance represents 52% of that same amount.

During the current fiscal year, General Fund revenues exceeded expenses by approximately \$4.2 million. Considering transfer activity out of this fund of \$182,000, the General Fund balance increased by \$4 million. The current year activity included:

- The General Fund transferred \$230,000 into the Capital Improvement Fund to complete funding of the citywide Facilities Strategic Plan project budget.
- \$48,000 of excess reserves from the County Lot Fund was transferred to the General Fund in line with budget projections.

When evaluating available reserves, it is important to note that local governing body has defined a variety of financial designations which are outlined within note 7 of this financial statement. These designations are applied as a matter of fiscal policy and contingency planning.

Capital Improvement Fund

The Capital Improvement Fund serves to plan and manage the construction and maintenance of City Infrastructure. This fund is replenished through specific dedicated revenue sources as well as General Fund surplus which may arise from year to year. Along with its operating budget, the City adopts a five-year capital project plan on an annual basis in which City Council-directed priorities are set and planned for. The Capital Improvement Fund is one of the major funds which is covered in that City-wide plan.

At the end of the current fiscal year, unreserved fund balance of the Capital Improvement Fund was \$1.93 million, while total fund balance reached \$5.77 million. Only \$100,000 of the unreserved balance has been specifically earmarked for planned infrastructure projects leaving an unreserved and undesignated balance of \$1.83 million as indicated in Note 7 to these financial statements. Key reserves at year-end include:

- \$2.9 million for approved and uncompleted capital projects, including \$1.7 million to complete the Strand improvement project
- \$100,000 for improvements to Artesia Boulevard

During the current fiscal year, the fund balance of the City's Capital Improvement Fund decreased by \$1.65 million mainly due to the completion of the City's most significant capital projects – Police/Fire facility and Strand Improvements. The current year transfer activity included

- A \$475,000 transfer of excess reserve earnings and project savings out of the Police and Fire Construction Fund to the Capital Improvement Fund for City Council approved City Hall remodel costs.

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- A \$230,000 into the Capital Improvement Fund, from the General Fund, to complete funding of the citywide the Facilities Strategic Plan project budget.
- A \$37,000 transfer out of available Capital Improvement Fund reserves to the Parking Fund to finalize Metlox public square improvements.

Dedicated revenues in this fund amounted to \$1.1 million. These sources have been recorded in the Capital Project Fund and are earmarked for funding general government capital improvement projects in the effort to maintain and enhance City infrastructure. A breakdown of these follows:

Hotel Tax: In September 1998, the Transient Occupancy Tax increased from 8.5% to 10%. This has resulted in the generation of \$470,732 of revenue for the year, an amount which is 24% above prior year levels marking a significant increase in general local tourism and patronage.

Parking Meter Rates: In fiscal year 2001, 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 \$558,266 this fiscal year. Actual revenues were ahead of budget estimates and slightly above the prior year.

Parking Citation Rates: City Council approved an increase of most parking citation rates from \$26 to \$30 in fiscal year 2001. This increase resulted in parking citation revenue of \$107,992 this current year, a decrease of 8% over the prior year.

Beyond these dedicated revenues, this fund realized \$252,903 in grant funds.

Capital Improvement Fund expenditures equaled \$3.8 million which included \$2.1 million for Strand Improvements, \$892,272 for El Porto parking lot Improvements, \$577,856 for Police & Fire debt service, with the balance going to City Hall repairs and a contribution to the Mira Costa high school track. The Strand Walkway project will extend into fiscal year 2006-2007 and is projected to cost \$4.5 million. \$1.7 million in designated reserves for this project have been set aside within the Capital Improvement Fund in the current year.

Prior year reports noted the planned transfer of reserve dollars from the Capital Improvement Fund to the City's Safety & Civic Center Construction fund to cash finance a portion of the construction of a new Police/Fire facility. This project was substantially completed in FY2005-2006 as marked by a grand opening held this past summer. The building is fully operational and was completed under budget with significant savings.

Other Governmental Funds

Other non major governmental funds include several Special Revenue funds used exclusively to account for intergovernmental and assessment proceeds which are restricted as to use by law. This group of funds includes the Street Lighting Fund, Federal and State Grants Fund, Gas Tax Fund, Propositions A and C Funds, Asset Forfeiture Fund, Police Safety Grant Fund and the Air Quality Management Fund. The majority of the dollars which flow through these funds are used for the maintenance of streets, parks, local transportation programs and the purchase of safety and fuel efficient equipment.

In 2005-2006, these funds operated within budget guidelines. Combined fund balances at year-end approximated \$5.7 million, an increase of \$165,905 over 2005. Changes in fund balances for this group can be expected to fluctuate as capital projects are expended over time.

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Proprietary Funds

The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. The funds presented in these financials are the Water, Storm Water, Wastewater, Refuse and Parking funds. Within the parking operations, both the County and State Lot Funds are considered nonmajor. Supporting internal service funds are also displayed.

At year-end, total net assets of all proprietary funds amounted to \$38.4 million, of which \$14.9 million is unrestricted. The remaining restricted balance has been classified as such given the existence of legal reserve requirements for ongoing bonded capital projects, business improvement district funds and debt service requirements.

Overall, proprietary funds displayed positive income from operations for the year with a combined total of \$1.4 million before transfers. Net assets increased for all funds by \$1.6 million including a contractual \$48,000 transfer out to the General Fund from the County Lot Fund.

Unrestricted net assets of the internal service funds at the end of the year amounted to \$2.1 million with a net assets total of \$4.3 million. Net assets increased by \$431,586 as we noted a relative stabilization of insurance costs and projected claim reserves. In FY 2005-2006, the Insurance Reserve Fund remains within the established working capital reserve level of \$2 million but total equity, after long term liabilities, is recorded as a negative balance of \$202,125. The FY 2006-2007 budget addressed this shortfall via an approved future transfer of surplus reserves along with increased annual budget appropriation levels and departmental charge outs. Additionally, the City remains hopeful that State reform legislation will mitigate these costs in the near term.

The Parking Fund displayed a positive income, before transfers, of \$88,327 and ending year end Net Assets of \$7.1 million. Of the total net assets amount, \$984,673 remains unrestricted. This year's operation included a full year of Metlox Bond interest expense of \$604,125 which was supported by the Fund's revenue stream.

General Fund Budgetary Highlights

The difference between the original budget and the final amended budget was an increase of \$791,697 and can be briefly summarized as follows:

- \$285,067 to roll forward 2004-2005 active purchase orders provided for in prior reserve balances and budgets.
- \$268,071 of an approved reimbursable advance for districts 6-10 underground utility design costs
- \$147,933 of funding for awarded safety grants.
- \$68,626 of funding for a current year approved Residential Code Enforcement Officer in Community Development.
- \$22,000 for Fire safety emergency response equipment - "Jaws of Life"

Beyond 2005 purchase order roll forwards amounts and reimbursable under-grounding design costs, budget adjustments amounted less than 1% of the original budget including grant funded adjustments. On an overall basis within the General Fund, expenditures were \$926,072 less than budgetary estimates including these budget adjustments, thus eliminating the need to draw upon existing fund balance. Other budget adjustments included reclassifications from planned contingency accounts resulting in a net zero change on the overall budget.

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Capital Asset and Debt Administration

Capital Assets: The City's investment in capital assets government wide as of June 30, 2006, amounts to \$148,613,798 (net of accumulated depreciation). This investment in capital assets includes land, buildings, park improvements, roadways, sewer, storm drains, vehicles, computer equipment and furniture and other equipment.

**City of Manhattan Beach Capital Assets
(Net of depreciation)**

	Governmental Activities 2006	Governmental Activities 2005	Business-Type Activities 2006	Business-Type Activities 2005
Land	\$33,634,566	\$33,634,566	\$1,757,434	\$1,757,434
Buildings	2,669,999	2,764,404	1,276,588	1,305,655
Machinery & Equipment	2,265,024	1,432,812	258,446	232,743
Vehicles	2,961,236	1,753,264	0	0
Infrastructure	28,466,520	26,309,155	19,775,538	17,983,569
Work In Progress	40,189,421	26,615,847	15,359,026	13,734,554
Total	\$110,186,766	\$92,510,048	\$38,427,032	\$35,013,955

During the current fiscal year, several large dollar additions to governmental capital assets were realized making up an overall increase of \$21.1 million. These additions, most of which remain at a work-in-progress state at year end, include the following:

- \$12.8 million of additional work in progress costs towards the construction of a new Police and Fire facility. Construction commenced in February 2004 and was substantially completed within the current year.
- \$1 Million in Furniture and Fixture additions related to the new Police-Fire Facility
- \$892,242 for improvements to the El Porto parking lot.
- \$2.1 million towards the completion of the Strand Improvements.
- \$1.1 million of citywide street improvement projects the bulk of which related to Police/Fire Streetscape, Valley-Morningside resurfacing, 15th and Ardmore intersection, and annual slurry seal re-conditioning.
- \$1.6 of vehicle purchases, including \$850,481 of capital leases for a new Fire and Sewer Vacuum truck.

During the current fiscal year, \$4 million in additions to business activity assets were realized, the bulk of which relates to the following items:

- \$1.8 million towards the completion of the Metlox Public Plaza which was opened for business in the current year.

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- \$1.2 in Water, Storm and Wastewater system improvements mainly related the line replacements and valve and control upgrades.

Additional information on the City's capital assets can be found in Note 4 of this year-end financial report.

Long Term Liabilities: At the end of the current fiscal year, the City of Manhattan Beach had total debt outstanding of \$46,945,835. Of this amount, \$39,060,000 relates to outstanding Certificates of Participation. A breakdown of this debt is as follows:

City of Manhattan Beach Outstanding Liabilities

	Governmental Activities 2006	Governmental Activities 2005	Business-Type Activities 2006	Business-Type Activities 2005
Marine Ave Park COPs	\$8,780,000	\$8,970,000	0	0
Capital Equipment Lease	720,693	0	0	0
Police Fire Facility COPs	\$12,980,000	\$12,980,000	0	0
Accrued Employee Leave & Benefits	2,036,980	1,814,768	55,395	63,542
Water and Wastewater COPs	0	0	3,920,000	4,015,000
Metlox Parking COPs	0	0	12,835,000	13,095,000
Insurance Claim Reserves	5,441,774	2,425,651	0	0
Bond Premium	175,993	186,056	0	0
Total Liabilities	30,135,440	26,376,475	16,810,395	17,173,542
Current	4,012,298	355,882	370,496	361,253
Long-Term Liabilities	\$26,123,142	\$26,020,593	\$16,439,899	\$16,812,289

The City's total debt decreased by \$269,841, or 1%, as compared to the previous year. This reduction results from the normal realization of the debt amortization schedules and no new bond debt was issued. In the prior year the City issued \$12,980,000 in Certificates of Participation for the construction of the Police and Fire facility. This facility is valued at \$41 million and the balance, beyond bond financing, was funded by accumulated City cash reserves. This project was substantially completed as of June 30, 2006, and has been finalized \$ 1million under budget as of the date of this report. Long term workers compensation and Liability insurance claim reserves remained relatively level with last year although costs remain high as has been the trend for several years. This year two new capital leases were introduced in the amount of \$720,693 to procure a new Fire and Sewer Vacuum truck: both five years leases with a rate of under 4%.

State statutes limit the amount of general obligation debt a governmental entity may issue to **3.75%** of its total assessed valuation. The current debt limitation for the City of Manhattan Beach is \$340,533,341. Additional information on the City's long-term debt can be found in table 9 of the statistical section of this financial report.

ECONOMIC OUTLOOK

The budget for fiscal year 2006-2007 was adopted by the City Council in June 2006. Major projects, accomplishments, and initiatives include:

Metlox Public Improvements

Fiscal year 2002-2003 marked the commencement of the construction of a City-owned two-level subterranean parking structure as part of the Metlox public improvement project. Valued at \$14 million,

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this parking structure is the first phase of a joint public-private development several years in the making. The parking lot contains 460 parking spaces and was opened for use in January 2004. The parking structure was completed on time and within budget. The mixed use commercial development portion of the project began in summer 2004 and was completed in FY 2005-2006. It includes retail, restaurant, office and a boutique style inn. These facilities surround the City-owned town square which was also completed this past year. The public open space is used as a general shopping and gathering area and also for City-programmed activities. These public improvements have been funded exclusively through Parking Fund operations using certificates of participation of \$13,350,000 originally issued in 2002-2003.

Public Safety Facility

A new state-of-the-art public safety facility has been in the works for several years. A grand opening was held in early FY2006-2007 and houses both Police and Fire personnel. The new facility also provides additional subterranean parking for the Civic Center and downtown area. The total cost of construction was budgeted at \$41 million. Construction began in February 2004 and the project was substantially completed at June 30, 2006 and is fully operational as of the date of this report. This project was funded through the use of existing City reserves and City issued fixed rate certificates of participation in the amount of \$12.8 million. Beyond the infrastructure improvement, the project has been a financial success as well, coming in under budget at its final completion in the subsequent period.

With the grand opening of our new Police & Fire facility, and the Metlox plaza and parking structure, the fiscal year 2006-2007 budget includes new costs for operations and maintenance of both of these facilities.

A new full time building maintenance position was approved for Metlox and the city projects increased utility, janitorial, elevator and escalator maintenance, fire alarm monitoring, and new parking facility maintenance costs. These expenditures were anticipated during the planning stages of both projects, and are a necessary part of operating public facilities. As indicated in the FY 2006-2007 budget, these resulting cost increases to the Parking Fund will be evaluated in considering the possibility of a future parking rate increase.

Strand Walkway Improvements

The 2004-2005 Capital Improvement Plan officially appropriated \$4 million for the Strand Walkway Improvement project and cash reserves for the full cost have been established within the Capital Improvement Fund. Designs were completed and the project commenced in 2005. The project is proceeding nicely and is nearly 60% completed as of June 30, 2006.

Utility Under-Grounding

In August 2004, the City administered the issuance of \$3.3 million in Special Assessment District Bonds, including issuance costs, to fund construction of under grounding districts 04-1,04-3,and 04-5 . These projects have been completed and the debt service paid through annual homeowner assessments collected with property tax. These bonds are not recorded as City debt. In the current year, two additional under-grounding districts were approved via neighborhood vote with construction valued at approximately \$6 million for each district. Special Assessment District Bonds were issued for districts 05-2 and 05-6 and construction is slated to begin in the near term. As we look into future years, several other such under-grounding districts are anticipated to be formed.

Other capital improvements for fiscal year 2006-2007 include \$2.9 million in street improvements, \$2.05 million in Water, Wastewater and Storm Water line improvements, and \$370,000 in North End Business Improvement District improvements.

Citywide Facilities Strategic Plan

As we look beyond the completion of the Police & Fire Facility, the city has begun planning the next round of major capital improvements. Funds were allocated this past year to embark on a citywide strategic facilities planning process. A community and council based subcommittee has identified and selected a consultant to engage the community to identify our future needs for community centers and other public

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facilities. This effort will dovetail with the School District's review of surplus property. As the City moves forward the use of operational surplus reserves may be considered in acquiring and utilizing those parcels for other community needs. Ultimately, the results of the study will be factored into our capital improvement plans at which time a variety funding sources will need to be identified and evaluated.

ECONOMIC FACTORS

While the California economy has experienced good growth over the past year, and the legislative threats have seemed to subside, we are still cognizant of a number of economic and fiscal concerns that cause us to remain cautious and focused on proactive planning. Our tradition of conservative budgeting, cost control and planned infrastructure funding continues to serve us well as we develop our financial plan in these challenging times.

Our major General Fund revenue sources remain strong. Property Tax, which is our single biggest source, experienced growth of 14% in FY 2005-2006, keeping pace with the double digit growth we have noted in each of the past few years. This being said, property tax performance has been boosted extraordinarily because of the growth of VLF collections that was shifted to this revenue source as result of the State's triple flip. While such rates of growth are not expected to continue, we expect the housing market to remain stable. Sales Tax displayed a favorable 13% increase reflecting a significant positive up swing from recent years. This increase is a reflection of the opening of the Metlox development and the benefits of the newly renovated Manhattan Village Mall. Transient Occupancy Tax had an outstanding year coming in at very strong 30% increase. All in all our largest revenue streams have done well.

In November 2004, the voters overwhelmingly approved Proposition 1A which added some protection for local government revenues from future state take backs. As a result of this legislation, the City experienced a \$700,000 loss of diverted state funding (ERAF III) in both FY2005 and FY2006. On a positive note, we are pleased to report that the State made an early repayment of 2003 VLF gap-loan (\$650,000) in the FY 2006. This year, the state diverted one fourth of our sales tax revenues, replacing it dollar-for-dollar with property tax. While this appears to be revenue neutral, the conversion of sales tax to property tax has changed our cash flow stream since property tax is received twice a year, while sales tax is remitted monthly. While Proposition 1A has added some protection to our revenues, we remain cautious about the impact of the state's budgetary problems on our community and the services we provide.

Interest earnings have recovered from prior year rate declines and significant dollar capital project expenditures. In FY 2005-2006, General Fund interest earnings increased by 39% or \$272,891. Short term Treasury yields are positioned to our benefit as we structure our investment ladder to secure these relative attractive earnings rates.

On the expense side of the equation, we have fully quantified and calculated the severe impact of increasing employee pension retirement rates and resulting costs. This represents an escalating cost which must be controlled in the future if we are to meet our long-term financial plans. Rising medical and worker compensation insurance costs remain a concern as indicated by the fund performance within this report. City forecasts predict an increase of annual operating costs approximating \$2-3 million beyond FY2004-2005 with PERS costs alone increasing by \$1.1 million in FY2005-2006. Clearly cost control plays a critical role in balancing the fiscal equation considering the relatively lower rate of revenue anticipated in the near term.

Our budget projections looking forward assume that other operational expense patterns will remain in line with normal historical trends.

Requests for Information

This financial report is designed to provide a general overview of the financial position of the City of Manhattan Beach for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Department, 1400 Highland Avenue, Manhattan Beach, CA 90266.