

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, 2005. 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, 2005, by \$158,092,228 (*net assets*). Of this amount, \$41,125,474 (*unrestricted net assets*) may be used to meet the government's ongoing obligations to citizens and creditors.
- The City's capital assets increased by \$17,309,954. This increase is mostly attributable to the construction completed to date for the new Police and Fire facility in the amount of \$15,571,875. 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 \$5,146,279. 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 new 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, 2005, the City's governmental activities reported combined ending net assets of \$121,270,396, an increase of \$3,150,967, in comparison with the adjusted opening balance. \$26,283,728 (*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 special project funds and, as such, their use is 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 plan.
- As of June 30, 2005, the City's business activities reported combined ending net assets of \$36,821,832, an increase of \$1,169,224 in comparison with the adjusted opening balance. \$14,842,196 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 plan.
- As of June 30, 2005, the balance in the General Fund was \$17,440,250, or 46% (5.5 months), of total General Fund expenditures. The General Fund reported excess revenues over expenditures of \$3,004,345 before net transfers out of \$6,954,720.
- Transfers out of \$6,988,164 from the General Fund were made to pay for major capital initiatives including construction of a new Public Safety facility, associated bond costs, and improvements to the Strand Walkway, funding newly established safety post retirement health benefit obligations, and seeding required working capital levels in the City's insurance fund.
- The City's total bonded debt increased by \$12,450,000 (47%) during the current fiscal year. This increase is primarily attributable to the November 2004 issuance of Certificates of Participation (\$12,980,000) for the long planned construction of the Police and Fire facility. This increase is offset marginally by the scheduled pay down of issued bonds in the General, Water, Wastewater and Parking funds. Long term insurance claim reserves experienced an increase of \$460,463 or

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23% mostly due to increased workers compensation reserves. Other long term liability balances, mostly made up of employee leave balances, remain near 2004 levels.

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 19 to 21 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 22 to 28 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 76 to 99 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 40 to 73 of this report.

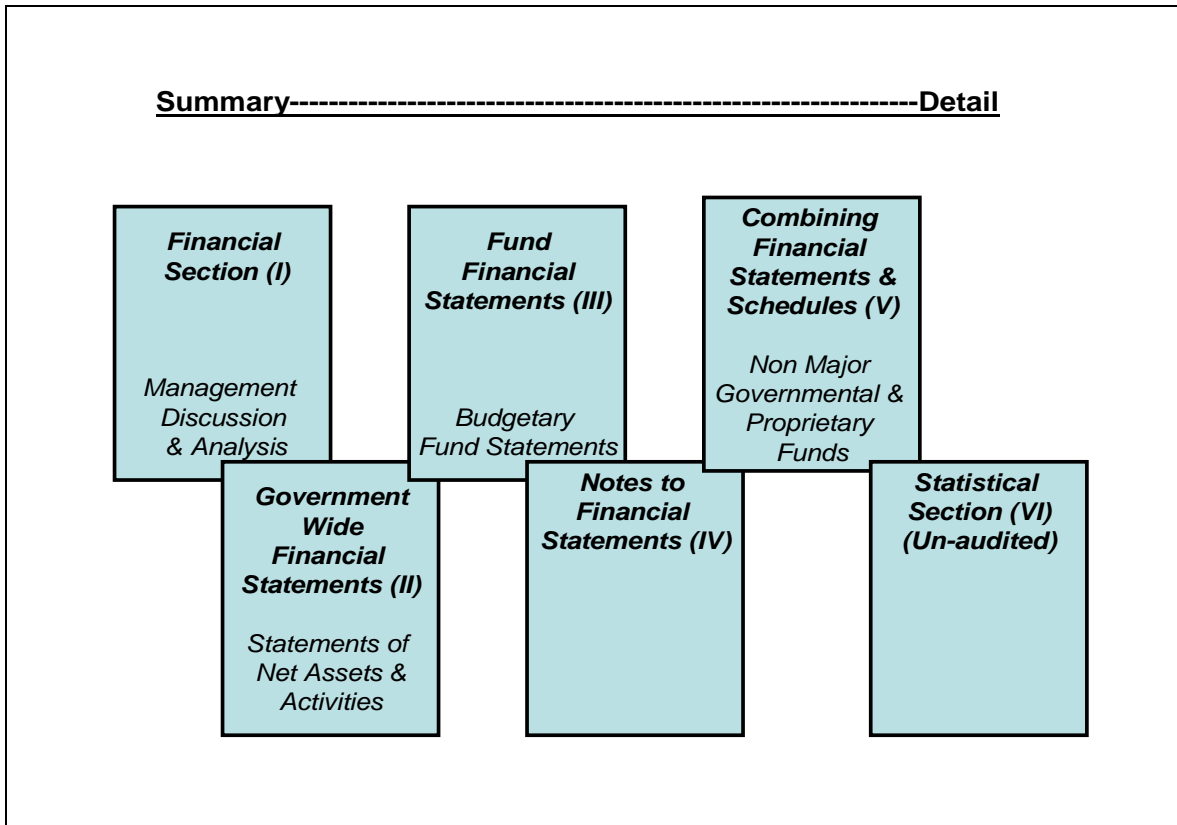
The City as Trustee

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 \$158,092,228 at June 30, 2005.

By far, the largest portion of the City's net assets (56%) 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

	Governmental Activities 2005	Business- Type Activities 2005	Total 2005	Total 2004
Current and other assets	\$ 63,736,173	\$ 20,525,123	\$ 84,261,296	\$ 82,136,147
Capital assets	92,510,048	35,013,955	127,524,003	110,214,049
Total Assets	156,246,221	55,539,078	211,785,299	192,350,196
Long-term liabilities outstanding	26,020,593	16,812,289	42,832,882	29,700,696
Other liabilities	8,955,232	1,904,957	10,860,189	9,703,551
Total Liabilities	34,975,825	18,717,246	53,693,071	39,404,247
Invested in net capital assets	70,373,993	17,903,955	88,277,948	83,541,551
Restricted	24,613,125	4,075,681	28,688,806	6,040,763
Unrestricted	26,283,278	14,842,196	41,125,474	63,363,635
Total Net Assets	\$121,270,396	\$ 36,821,832	\$ 158,092,228	\$ 152,945,949

A portion of the City's net assets (4%, or \$5,493,705), within the governmental activities category, represent Special Revenue Fund resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets (\$41,125,474) may be used to meet the government's ongoing obligations to citizen services and creditors. A significant portion of this remaining balance is also subject to City Council directed capital project designations and policy reserves as indicated in the financial Note 7.

Statement of activities: On a City-wide basis, net assets increased by \$5,146,279. Governmental activities, as a group, increased by \$3,977,055 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 2005	Business- Type Activities 2005	Total 2005	Total 2004
Program revenues:				
Charges for services	\$ 11,412,225	\$ 13,653,362	\$ 25,065,587	\$ 24,178,550
Operating contributions and grants	2,571,735	20,088	2,591,823	2,121,460
Capital contributions and grants	4,795,086	21,807	4,816,893	2,648,432
General revenues:				
Property taxes	11,793,140	-	11,793,140	11,223,986
Other taxes	14,576,155	-	14,576,155	13,519,021
Motor Vehicle In Lieu	2,472,372	-	2,472,372	1,634,713
Other	2,659,742	450,702	3,110,444	2,880,756
Total Revenues	50,280,455	14,145,959	64,426,414	58,206,918
Expenses:				
General government	7,814,392	-	7,814,392	6,843,576
Public safety	23,756,438	-	23,756,438	19,786,367
Public works	10,355,400	-	10,355,400	6,596,160
Parks and recreation	4,772,150	-	4,772,150	4,300,710
Interest on long-term debt	574,108	-	574,108	137,993
Water, Waste, Storm	-	7,926,665	7,926,665	7,347,450
Refuse	-	3,430,815	3,430,815	3,147,820
Parking	-	1,476,255	1,476,255	1,442,174
Total Expenses	47,272,488	12,833,735	60,106,223	49,602,250
Revenues Over Expenses	3,007,967	1,312,224	4,320,191	8,604,668
Transfers In (Out)	143,000	(143,000)	-	-
Increase in Net Assets	3,150,967	1,169,224	4,320,191	8,604,668
Net Assets - July 1, 2004	117,293,341	35,652,608	152,945,949	144,207,435
Restatement	826,088	-	826,088	133,846
Net Assets - June 30, 2005	\$121,270,396	\$36,821,832	\$158,092,228	\$152,945,949

Key elements of this increase are as follows:

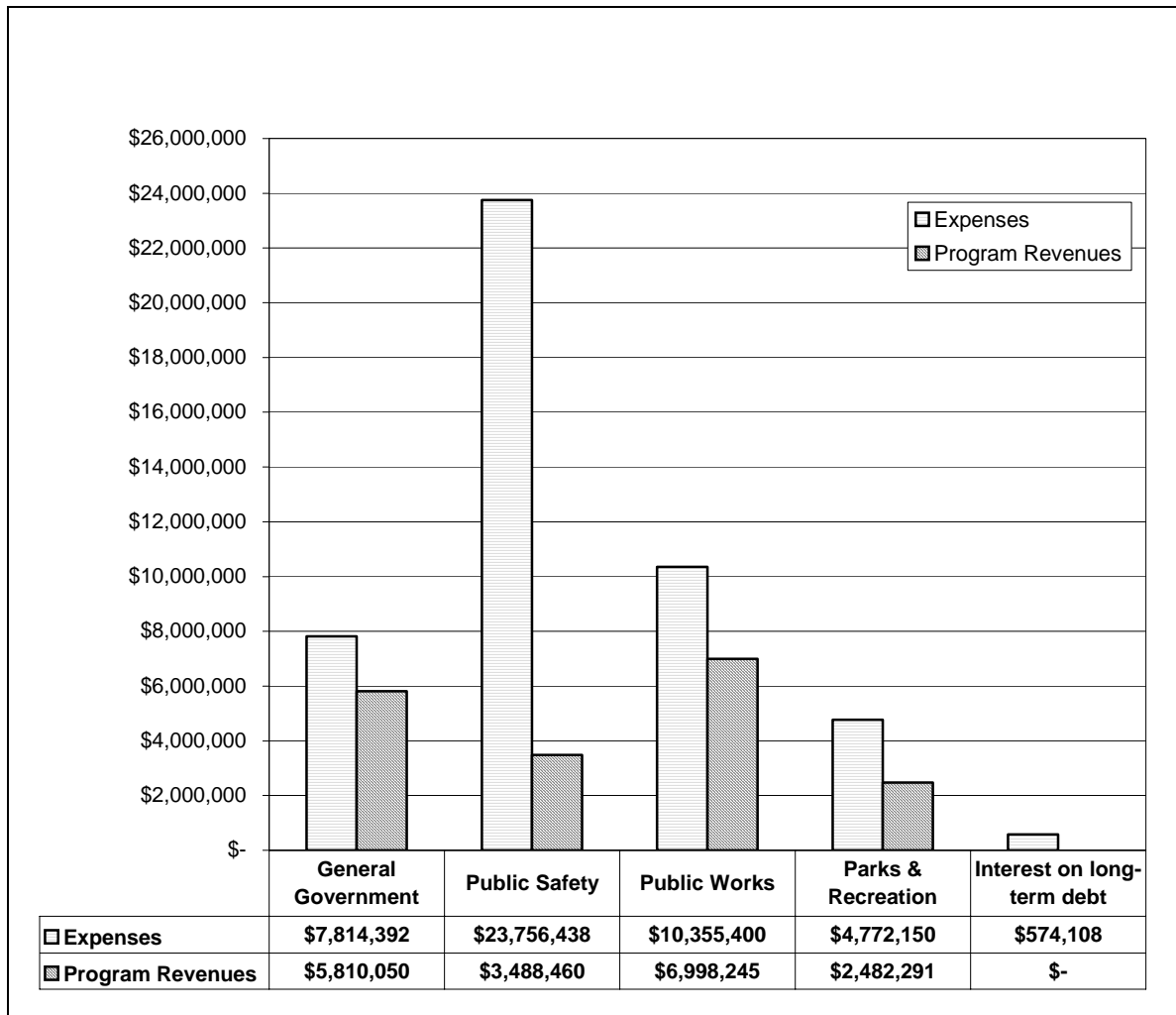
- In 2004-2005, the General Fund reported an operating surplus, before transfers, of \$3 million, which added to the overall strength of citywide net asset balances.
- In 2004-2005, the Utility Funds reported an operating surplus, before transfers, of \$1.3 million, again, adding to the overall strength of citywide net asset balances.
- The use of \$695,000 of from the General Fund to seed the newly established Police retirement health benefit which is recorded in the City's Pension Fund.
- In 2004-2005, the citywide statements reported a \$826,088 positive restatement of beginning equity in recognition of a prior year pre-funding of outstanding PERS obligations in accordance with GASB 27.

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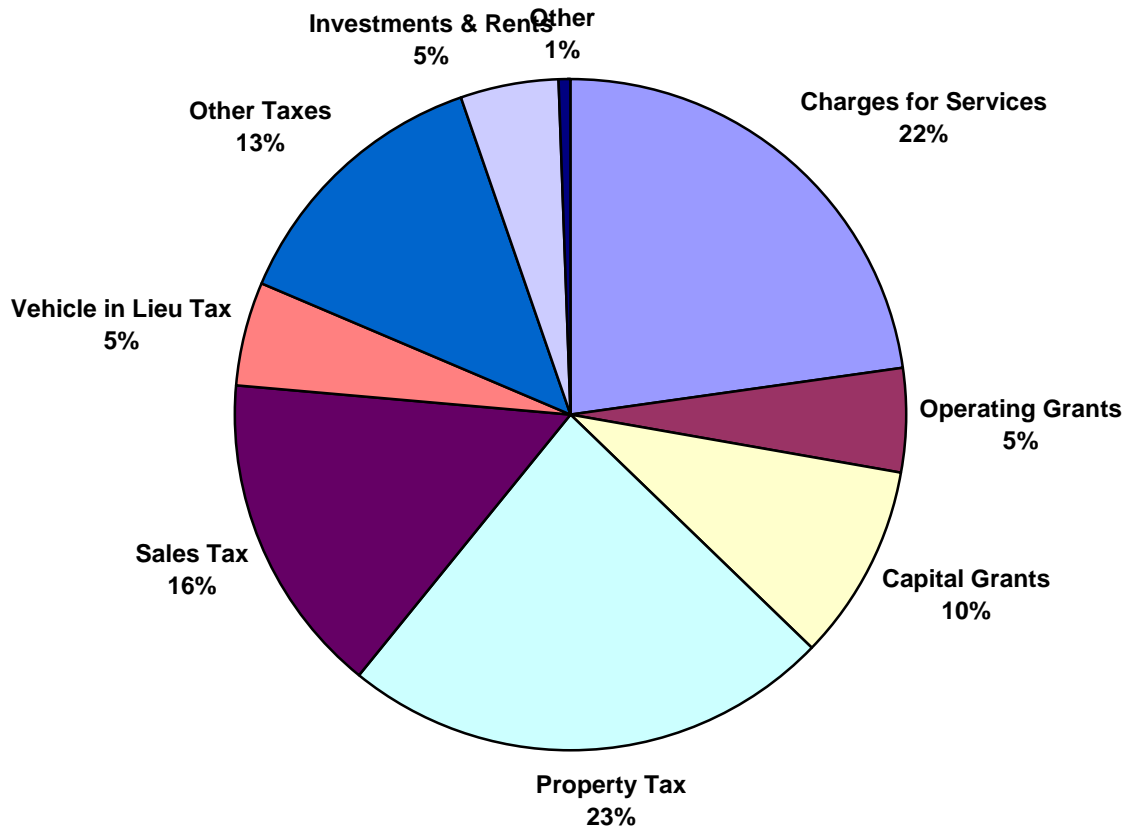
- In 2004-2005, the citywide statements reported \$760,909 of accrued income receivable as a result of the California State budget "Triple Flip" Sales and Vehicle License fee deferral. This is presented as deferred income in the governmental statements and income on a full accrual basis within the citywide statements.
- The difference in the method of accounting for capital assets in the governmental funds versus the statement of activities accounts for an increase of \$17.1 million in net assets considering both capital costs and depreciation. Governmental funds fully expend capital asset costs in the period they are acquired. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives. The use of cash reserves in the current year to fund the above mentioned capital assets results in an offsetting decrease of working capital.
- The difference in the method of accounting for long-term debt in the governmental funds versus the statement of activities accounts for an increase in \$250,000 related to Police & Fire facility, Marine Bond debt, and capital leases. Governmental funds fully expend principal payments in the period they are paid. However, in the statement of activities, such payments reduce the related liability.

Government Activities

Expenses and Program Revenues - Governmental Activities - Fiscal Year 2005



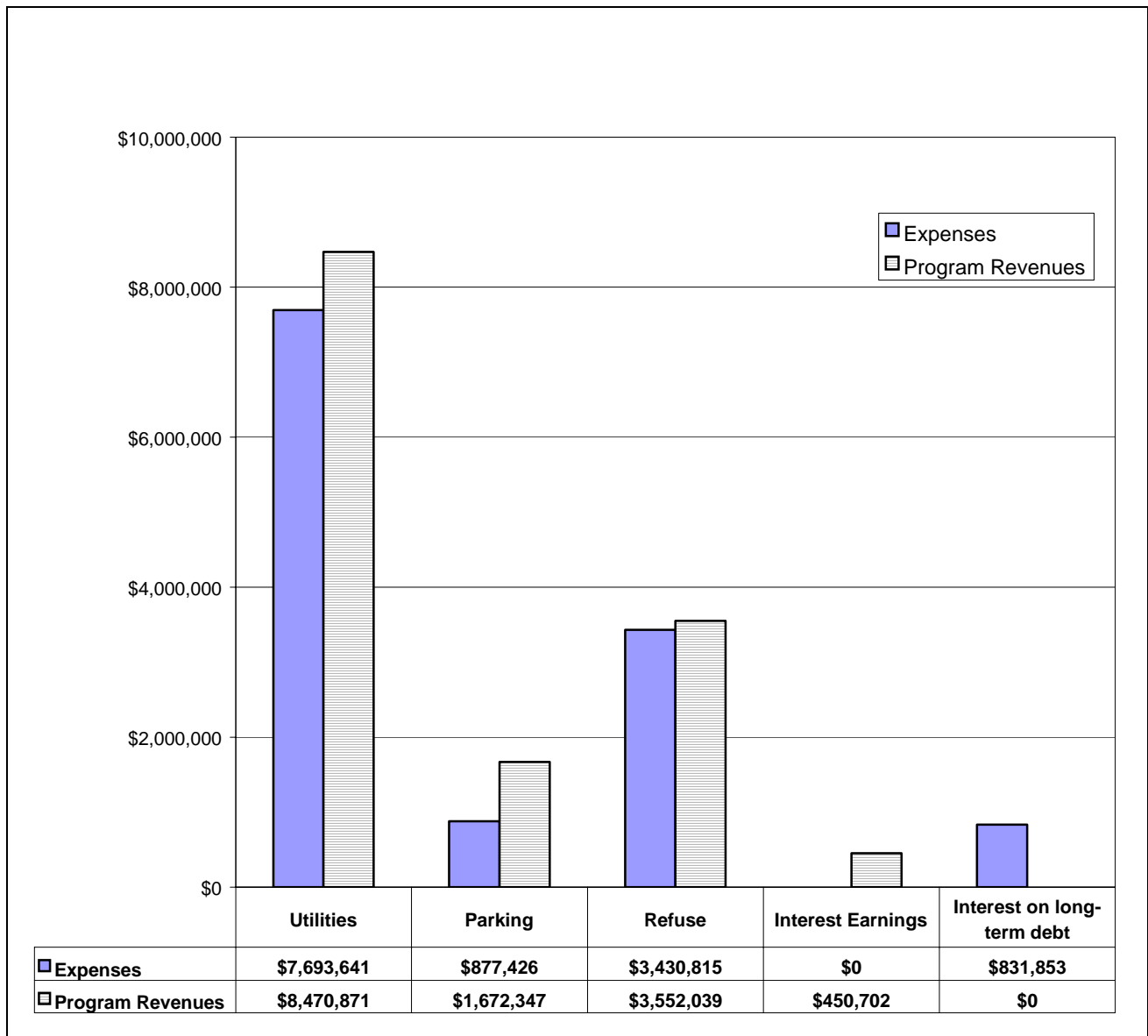
Revenues by Source - Governmental Activities - Fiscal Year 2005



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Business Type Activities

Expenses and Program Revenues - Business Type Activities - Fiscal Year 2005

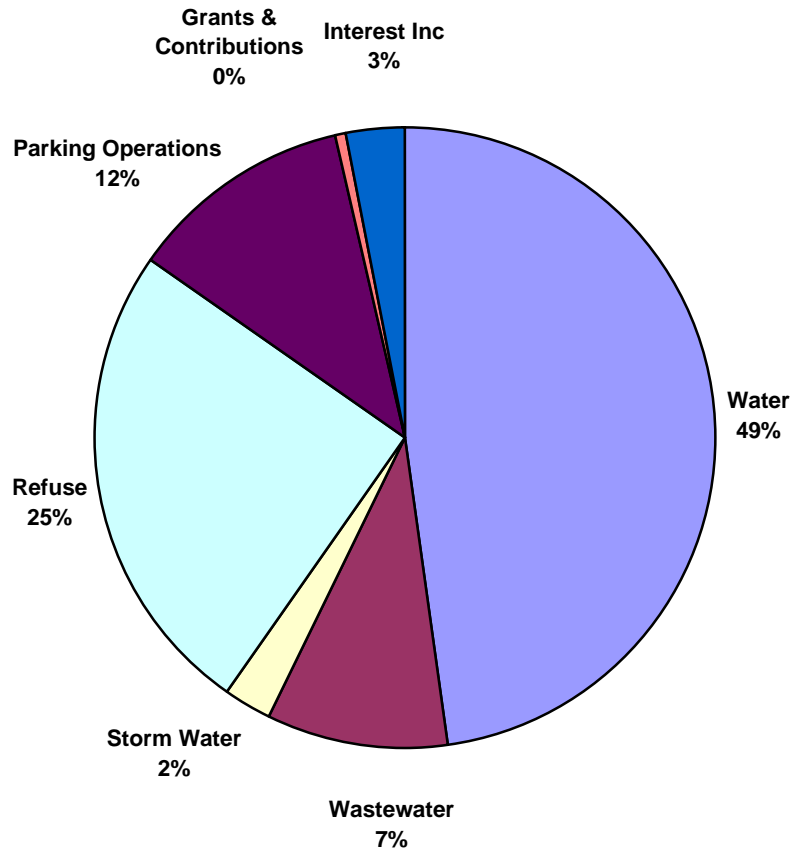


The City's business-type operations include several major service areas:

- Water
- Wastewater
- Storm Water
- Refuse
- Parking

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Revenues by Source - Business Type Activities FY 2005



In fiscal year 2004-2005, revenues for the City's business type activities amounted to \$14,145,959, including \$41,895 in grants and contributions. All other revenue is derived from operations and investment earnings. Total operating expenses equaled \$12,833,735 for a positive operating income of \$1,312,224 before transfers. When considering the impact of the net transfer out of \$143,000 from the parking funds, net assets increased by \$1,169,224 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 \$48.6 million, a decrease of \$700,000 in comparison with the prior year. Approximately 42% of this total amount, \$20.7 million, constitutes unreserved fund balance. 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 (\$8.08 million); 2) reserve for prepaid items and debt reserves (\$1.3 million); 3) Restricted Construction cash holdings (\$17.7 million), and 4) \$723,091 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 \$20.7 million unreserved governmental fund balance noted above, \$15.5 million has been designated by City Council actions, and \$3 million remain in restricted use Special Revenue Funds. Considering these designations, \$5.1 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 \$16.4 million, while total fund balance reached \$17.4 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 43% of total General Fund expenditures, while total fund balance represents 46% of that same amount.

During the current fiscal year, General Fund revenues exceeded expenses by approximately \$3 million. Considering transfer activity out of this fund of \$6.95 million as a result of planned capital project funding, the General Fund balance decreased by \$3.9 million. The current year transfer activity included:

- \$3,325,000 transfer out of the General Fund into the Police and Fire Construction Fund for the Public Safety Facility as planned for in the City budget. This transfer resulted in a reduction in bond requirements, facilitated through the use of prior year surplus amounts, and also increased the construction project budget contingency amount by \$1,325,000.
- \$2,463,163 transfer out of the General Fund into the Capital Improvement Fund to:
 - Increase the designated Strand Improvement Reserve by \$1,596,368 to the approved \$4 million level;
 - To prepay \$866,795 in capitalized interest as a basis for reducing long term debt service payments for the Police & Fire bonds.
 -
- \$695,000 out of the General Fund to the Pension Fund to pay for the unfunded obligation liabilities resulting from newly awarded Police Retirement Health benefits.
- \$355,000 out of the General Fund to the Insurance Fund to re-establish fund working capital policy levels.
- \$150,000 out of the General Fund to the Storm Water Fund in support of fund levels required to maintain operations for this assessment based fund. Increasing assessment levels in this particular fund is needed to cover rising utility and maintenance costs but local governments are precluded from doing so subject to a proposition 218 vote of the people.
- \$33,444 out of the Underground Utility Construction Fund to the General Fund to reimburse the City for bond issuance costs.

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-

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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 \$1.34 million, while total fund balance reached \$7.42 million. Only \$100,000 of the unreserved balance has been specifically earmarked for planned infrastructure projects leaving an unreserved and undesignated balance of \$1.24 million as indicated in Note 7 to these financial statements. Key reserves at year-end include:

- \$1.01 million for approved and uncompleted capital projects
- \$3.74 million for improvements to the Strand Walkway
- \$1.34 million for Police & Fire Bond Reserves
- \$100,000 for improvements to Artesia Boulevard

During the current fiscal year, the fund balance of the City's Capital Improvement Fund decreased by \$1.77 million mainly due to the initiation and continuance of the City's most significant capital projects and the related following transfers. These transfers mark the final chapter in a planned accumulation of reserves to finance the Police and Fire facility and the Strand Walkway:

- A \$2,463,163 transfer out of the General Fund into the Capital Improvement Fund to:
 - Increase the designated Strand Improvement Reserve by \$1,596,368 to the approved \$4.5 million level.
 - To prepay \$866,795 in capitalized interest as a basis for reducing long term debt service payments for the Police & Fire bonds.
- A \$5,533,330 transfer out of the Capital Improvement Fund to the Police and Fire Facility Construction Fund as part of a planned and budgeted funding of accumulated project reserves
- A \$293,000 transfer out of the El Porto County Lot Fund to the Capital Improvement Fund to pay for the construction costs associated with the reconstruction of the El Porto parking lot.

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, City Council approved an increase in the Transient Occupancy Tax from 8.5% to 10%. This has resulted in the generation of \$359,096 of revenue for the year, an amount which is 10% above prior year levels marking a significant turn around after the impact of the September 11 terrorist strike.

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 \$550,718 this fiscal year. Actual revenues were ahead of budget estimates and level with 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 \$116,508 this current year, a decrease of 6% over the prior year.

Beyond these dedicated revenues, this fund realized \$1.03 million in grant funds for specific projects including the El Porto parking lot reconstruction.

Capital Improvement Fund expenditures equaled \$2.3 million which included \$1.2 million for El Porto parking lot Improvements, \$707,000 for Police & Fire debt service and bond fees, and \$404,000 Strand Walkway improvements. The Strand Walkway project will extend into fiscal year 2005-2006 and is

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projected to cost \$4.5 million. \$3.8 million in designated reserves for this project have been set aside within the Capital Improvement Fund in the current year.

As mentioned above, \$5.3 million was transferred from the Capital Improvement Fund to the City's Safety and Civic Center Construction fund. This represents the final scheduled transfer of funds which was deposited with a third party trustee along with the remaining bond financing dollars. These funds will be used to fund the project scheduled for completion in FY 2005-5006. The construction contract for the new facility was awarded in fiscal 2003-2004 and construction began in February 2004. The total cost of this project is valued at \$41 million.

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 2004-2005, these funds operated within budget guidelines. Combined fund balances at year-end approximated \$5.5 million, a decrease of \$513,771 over 2004. Changes in fund balances for this group can be expected to fluctuate as capital projects are expended over time.

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 \$36.8 million, of which \$14.8 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 \$1.3 million before transfers. Net assets increased for all funds by \$1.2 million including a \$143,000 transfer out to the Capital Improvement Fund from the County Lot Fund for the El Porto project.

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 \$3.9 million. Net assets decreased by \$496,057 mostly due to the dramatic rise in insurance costs and projected claim reserves. In FY 2004-2005, 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 \$369,658. This is a clear indication that expenses are on the rise and future budget action is necessary to increase 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.

In May of 2002, parking lot meter rates were increased by \$0.25 to \$0.50 per hour. As a result of these changes, the Parking Fund experienced additional revenue of \$33,000 over the prior year and \$176,000 over the base year of increase. This additional income, which has not yet realized the full operational potential of the Metlox development, will assist in funding the debt service related to the construction of downtown's newest public parking structure and town square.

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General Fund Budgetary Highlights

The difference between the original budget and the final amended budget was an increase of \$695,232 and can be briefly summarized as follows:

- \$350,515 to roll forward 2003-2004 active purchase orders provided for in prior reserve balances and budgets.
- \$109,445 of funding for Fire Department communications equipment initiated by an award of FEMA grants.
- \$91,353 of funding for Homeland Security initiatives.
- \$79,930 to adjust for annual employee leave pay offs.
- \$27,000 for a Fire Station alerting system
- \$12,250 for an arts education grant pass through to the local school district.

Beyond 2004 purchase order roll forwards amounts, budget adjustments amounted to less than 1% of the original budget including grant funded adjustments. On an overall basis within the General Fund, expenditures were \$1.5 million 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.

Capital Asset and Debt Administration

Capital Assets: The City's investment in capital assets government wide as of June 30, 2005, amounts to \$127,524,003 (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 2005	Business- Type Activities 2005	Total 2005	Total 2004
Land	\$ 33,634,566	\$ 1,757,434	\$ 35,392,000	\$ 35,392,000
Buildings	2,764,404	1,305,655	4,070,059	4,193,896
Machinery and Equipment	1,432,811	309,723	1,742,534	1,965,235
Vehicles	1,753,263	-	1,753,263	1,955,587
Infrastructure	23,828,294	17,906,589	41,734,883	41,952,933
Work In Progress	29,096,710	13,734,554	43,831,264	24,754,398
Total	\$ 92,510,048	\$ 35,013,955	\$ 127,524,003	\$ 110,214,049

During the current fiscal year, several large dollar additions to governmental capital assets were realized making up an overall increase of \$17.3 million. These additions, most of which remain at a work-in-progress state at year end, include the following:

- \$15.6 million of inception to date work in progress costs towards the construction of a new Police and Fire facility. Construction commenced in February 2004 with completion targeted for FY 2005-2006.

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- \$1.2 million for improvements to the El Porto parking lot.
- \$1.4 million of citywide street improvement projects the bulk of which related to Aviation resurfacing, Artesia Boulevard improvements, signal improvements, construction of the new 13th Street extension, and Strand Walkway improvements.
- \$233,886 of vehicle and machinery purchases.

During the current fiscal year, \$1 million in additions to business activity assets were realized, the bulk of which relates to the following items:

- \$534,000 towards the completion of the Metlox Public Plaza. With the completion of the parking structure in the current year, this development is scheduled to open in December 2005.
- \$500,000 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 \$43,550,017. 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 2005	Business- Type Activities 2005	Total 2005	Total 2004
Marine Ave Park COPs	\$ 8,970,000	\$ -	\$ 8,970,000	\$ 9,155,000
Capital Equipment Lease		-		62,495
Police Fire Facility COPs	\$ 12,980,000	\$ -	\$ 12,980,000	
Accrued Employee Leave and Benefits	1,814,768	63,542	1,878,310	1,799,355
Water and Wastewater COPs	-	4,015,000	4,015,000	4,105,000
Metlox Parking COPs	-	13,095,000	13,095,000	13,350,000
Insurance Claim Reserves	2,425,651	-	2,425,651	1,965,188
Bond Premium	186,056	-	186,056	
Total Liabilities	26,376,475	17,173,542	43,550,017	30,437,038
Current	355,882	361,253	717,135	736,342
Long-Term Liabilities	\$ 26,020,593	\$ 16,812,289	\$ 42,832,882	\$ 29,700,696

The City's total debt increased by \$13,112,979 (43%) during the current fiscal year due primarily to the issuance of \$12,980,000 in Certificates of Participation in November 2004 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. Additionally, the amount of long term workers compensation insurance claim reserves continue to climb as has been the trend for several years. These increases are marginally offset by the natural pay down of principal on existing bonds and the payoff of the City's capital lease.

State statutes limit the amount of general obligation debt a governmental entity may issue to 15% of its total assessed valuation. The current debt limitation for the City of Manhattan Beach is \$308,130,020.

City of Manhattan Beach Management's Discussion and Analysis

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 2005-2006 was adopted by the City Council in June 2005. Major projects 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, 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 will include retail, restaurant, office and a boutique style inn. The inn has commenced operations and the remainder of the development is scheduled to open December 2005. These facilities will surround the City-owned town square to be used as public open space and for City-programmed activities. In the current year, the City owned public plaza improvements are nearing completion. The 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. The new building will house both Police and Fire personnel, as well as providing additional subterranean parking for the Civic Center and downtown area. The total cost of construction is budgeted at \$41 million. Construction began in February 2004 and project costs approximating \$25 million have been incurred through fiscal year 2004-2005. This project was funded through the use of existing City reserves which are being held in trust as of June 30, 2005. In November 2004, the City issued \$12.9 million in debt in the form of fixed rate certificates of participation to fully fund the project beyond the amount provided by internal cash reserves. The project is currently within budget with occupancy expected to take place within fiscal year 2005-2006.

A review of this year's financial statements reveals the use of cash (\$15 million) for construction and the commencement of annual debt service costs to be paid for from dedicated revenue sources in the Capital Improvement Fund. The use of these reserves for this project, combined with the cost of the Strand Walkway improvements discussed below, places limitations on the City's ability to fund new major projects in future years.

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 have been completed and the project commenced in 2005. Construction bids came in within budget projections.

Utility Under-Grounding

The prior year budget included \$5.15 million, including reimbursement costs, for the completion of utility under-grounding as approved by voter initiatives within three beachfront districts. In August 2004, the City administered the issuance of \$3.3 million in Special Assessment District Bonds, including issuance costs, which will fund construction. Pre-payments of \$1.5 million were collected from participating residents making up the remainder of the project cost. Debt service in future years will be paid through annual homeowner assessments collected with property tax and as such 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. The City is currently in the pre-payment mode, followed by the evaluation of related construction bids in January 2006 and final bond issuance. As we look into future years, several other such under-grounding districts are anticipated to be formed.

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

Other capital improvements for fiscal year 2005-2006 include \$1.4 million in street improvements, \$850,000 in Water, Wastewater and Storm Water line improvements, and \$370,000 in North End Business Improvement District improvements. As we start the budget process in early 2006 the City Council will be addressing citywide infrastructure improvements in need of attention.

ECONOMIC FACTORS

While the California economy has 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 stable. Property Tax, which is our single biggest source, experienced growth of 9% this past year, keeping pace with the double digit growth we have noted in each of the past few years. While such rates of growth are not expected to continue, we are confident that the housing market will remain vibrant. Sales Tax remained at prior year levels, but we remain hopeful to experience a rebound in this area as we look forward to the opening of the Metlox development and realize the benefits of the newly renovated Manhattan Village Mall. Transient Occupancy Tax, which suffered greatly from the effects of September 11, came in a very strong 12% increase from the lows of the past two years bringing us back to 2001 levels. All in all our largest revenue streams appear to be doing well.

In November 2004, the voters overwhelmingly approved Proposition 1A which added some protection for local government revenues from future state take backs. In the short term, the City will experience a \$700,000 loss of diverted state funding (ERAF III) in both FY2005 and FY2006. On a lighter note, we are pleased to report that the State made an early payment 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.

Whereas interest earnings have benefited from increased reserve levels and lucrative yield rates in the past, historically low interest rates and the use of significant levels of Police and Fire reserves have resulted in a significant decline for this revenue source. Considering rate reductions and the use of \$25 million in Police and Fire construction reserves, interest earnings are expected to decline by over \$800,000. We expect further declines as Police and Fire reserves are fully expended in fiscal year 2005-2006. Clearly, current year levels will not be reproduced in the foreseeable future.

On the expense side of the equation, we have fully quantified and calculated the severe impact of increasing 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.