

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, 2007. 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

- As of June 30, 2007, the City's total net assets citywide (including all governmental and business type activities) totaled \$170,053,430. This is an increase from the prior fiscal year of \$2,588,013, or 1.5%.
 - Governmental net assets increased by \$1,505,168 (1.2%) to \$130,548,286, primarily due to general revenues exceeding expenses by \$1,352,093, and a prior period restatement of \$153,075.
 - Business type activity net assets increased by \$1,082,845 (2.8%), largely due to investment earnings of \$935,323.
- Unrestricted net assets, which may be used to meet the government's on-going obligations within certain parameters and requirements, totaled \$43,203,170. This is an increase of \$3,456,120 (8.7%) over FY 2005-2006 levels.
- Citywide capital assets, net of depreciation, increased by \$7,165,831, or 6.5% from the prior year. This increase is mainly due to completion of the construction of the Police & Fire facility, progress on the Strand renovation, annual street improvement activities, and Water, Storm Water and Parking Fund improvements. Additionally, an adjustment of \$1.86 million to recognize the City's proportional investment in a regional emergency dispatch center has been included in FY 2006-2007.
- The City's debt increased by \$7,662,497 during FY 2006-2007. This increase is the result of the issuance of pension obligation bonds for \$6.8 million, and the addition of the debt associated with the previously mentioned emergency dispatch center (\$1.83 million), which had been considered debt of the joint power authority, but has been reclassified as City debt. It is important to note that the sale of the pension bonds also resulted in a corresponding increase in net assets for prepaid pension obligations.
- As of June 30, 2007, the General Fund balance was \$20,979,013. The Fund expenditures exceeded revenues by \$3,888,526. The imbalance was caused by the expenditure of \$6.8 million for the previously discussed pension obligation bonds without a corresponding revenue from the bond proceeds. Bond proceeds are considered "other financing sources" and do not appear as a revenue. Therefore, the increase in fund balance before transfers was \$2,911,474.
- Total Governmental Fund revenue totaled \$63,171,310, an increase of 14.2% (\$9,871,008) from the prior year. Prepayment revenues from property owners for underground assessment district construction accounted for \$5.35 million of the increase from the prior year. General taxes, charges for services and other revenues added another \$2.98 million
- Governmental Fund expenditures totaled \$74,331,770, up \$10,379,217 (16.2%) from FY 2005-2006. The pension obligation bond expenditure of \$6.8 million, as well as disbursements from the underground assessment district funds account for the increase. Additionally, the prior year included \$13 million in Police & Fire facility expenditures which were not repeated in FY 2006-2007.
- The General Fund transferred out \$3,922,885 for the following purposes:
 - \$2,459,711 to the Capital Improvement Fund for future projects
 - \$69,270 to the Street Lighting Fund to relieve a deficit from operations

- \$50,000 to the Parking Fund to maintain working capital levels
- \$1,343,904 to the Insurance Fund to mitigate on-going deficits.

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 on a full-accrual basis, 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).

The government wide statement of activities has two components:

Governmental Activities

This is a consolidation of all governmental funds and includes the General Fund, Capital Projects Funds, Special Revenue Funds and Internal Service Funds. These funds are supported by taxes, intergovernmental revenues, grants, and charges for services. Expenses include materials and labor, depreciation, and amortization of prepaid pension obligations. Governmental fund expenditures for payment of principal on long debt and capital assets are excluded. All intra-governmental charges and expenses and transfers within governmental funds are eliminated.

All internal service fund expenses and depreciation on capital assets are fully allocated to each functional program. Expenses are classified among the following programs: general government, public safety, culture and recreation, and public works. Program activities that produce revenues or receive grant support are applied against program expenses to yield the net expenses. Revenues that cannot be attributed to a specific program, such as taxes and interest (e.g. General Revenues), are shown separately. The total of General Revenues, less net program expenses, generates the change in net assets. Total net assets of governmental activities differs from fund balances of governmental funds by long term assets (capital and prepaid pension), long term liabilities and the total of internal service fund net assets.

Business Type Activities

This includes all enterprise funds (Water, Waste Water, Storm Water, Refuse and Parking Funds). These activities have been traditionally presented as enterprise funds and tie directly to the *Statement of Revenues, Expenses, and Change in Net Assets – Proprietary Funds*, as shown in the Funds section of this report.

The government-wide financial statements can be found on pages 19 to 20 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 spend-able resources, as well as on balances of spend-able resources available at the end of the fiscal year. In effect, the budgetary government fund statements are working capital flow of funds statements.

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 decisions. Following the governmental funds *Balance Sheet*, and *Statement of Revenues, Expenditures and Changes in Fund Balances*, there are respective reconciliations of the fund balance to *Statement of Net Assets*, and *Net Change in Fund Balances* – total governmental funds to change in net assets of governmental activities. As discussed above, the reconciliations include treatment of capital expenditures, depreciation, changes in capital assets, long term debt, prepaid pension costs, full accrual versus modified accrual and change in net assets of internal service funds

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 Projects funds, all of which are considered to be major funds. Data from the other 9 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 24 to 41 of this report.

Proprietary funds: Proprietary funds account for goods and services provided to customers and for cost recovery via service charges. There are two types of proprietary funds: enterprise funds which provide services to outside users (residents and businesses of Manhattan Beach), and internal service funds, which provide services to City departments. 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-governmental charges and transfers have been eliminated accordingly, except for charges and transfers to the enterprise funds, which are quasi-internal transactions.

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. Three of the City's seven enterprise funds are considered major funds and presented as such in the fund financial statements. The four non-major

funds, Storm Water, Refuse, County and State parking lots, are presented individually in the combining statements.

The combining statements referred to earlier in connection with non-major 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 84 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 43 to 82 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. Note 9 provides a detailed analysis of City retirement plans.

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.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

As noted earlier, net assets (assets in excess of liabilities) may serve over time as a useful indicator of a government's financial position. In the case of the City of Manhattan Beach, net assets totaled \$170,053,430 at June 30, 2007.

By far, the largest portion of the City's net assets (69%) 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.

City of Manhattan Beach Net Assets

	Governmental Activities		Business Type Activities		Total	
	2007	2006	2007	2006	2007	2006
Current and Other Assets	\$ 56,880,075	\$ 55,041,683	\$ 17,835,432	\$ 18,450,554	\$ 74,715,507	\$ 73,492,237
Capital Assets	117,352,597	110,186,766	39,837,692	38,427,032	157,190,289	148,613,798
Total Assets	174,232,672	165,228,449	57,673,124	56,877,586	231,905,796	222,106,035
Long term Liabilities						
Outstanding	33,281,489	26,123,142	16,086,855	16,439,899	49,368,344	42,563,041
Other Liabilities	10,402,897	10,062,189	2,081,125	2,015,388	12,484,022	12,077,577
Total Liabilities	43,684,386	36,185,331	18,167,980	18,455,287	61,852,366	54,640,618
Invested in Capital Assets						
Net of Related Debt	93,644,407	87,848,226	23,447,692	21,672,032	117,092,099	109,520,258
Restricted	8,011,040	16,335,884	1,747,121	1,862,225	9,758,161	18,198,109
Unrestricted	28,892,839	24,859,008	14,310,331	14,888,042	43,203,170	39,747,050
Total Net Assets	\$ 130,548,286	\$ 129,043,118	\$ 39,505,144	\$ 38,422,299	\$ 170,053,430	\$ 167,465,417

Net assets of the City's *Governmental* activities amounted to \$130.55 million, an increase over the prior year of \$1.51 million. Of the \$130.55 million, \$93.64 million is invested in capital assets net of related debt such as land, buildings, machinery, infrastructure, equipment and other improvements; \$8.01 million is restricted for debt service or for Special Revenue Fund resources that are subject to external restrictions on use. The balance of unrestricted net assets (\$28.89 million) 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 capital project designations and policy reserves displayed in financial Note 8.

Net assets of the City's *Business-type* activities totaled \$39.51 million. This represents an increase from FY 2005-2006 of \$1.08 million. \$23.45 million is invested in capital assets (land, buildings, machinery, equipment, etc.) net of related debt, while \$1.75 million is reserved for debt service and for business improvement district use. \$14.31 million is unrestricted and may be used at the City Council's discretion.

The City's total change in net assets amounts to \$2.59 million. The following is the condensed Statement of Activities and Changes in Net Assets for the fiscal years ending June 30, 2007 and June 30, 2006:

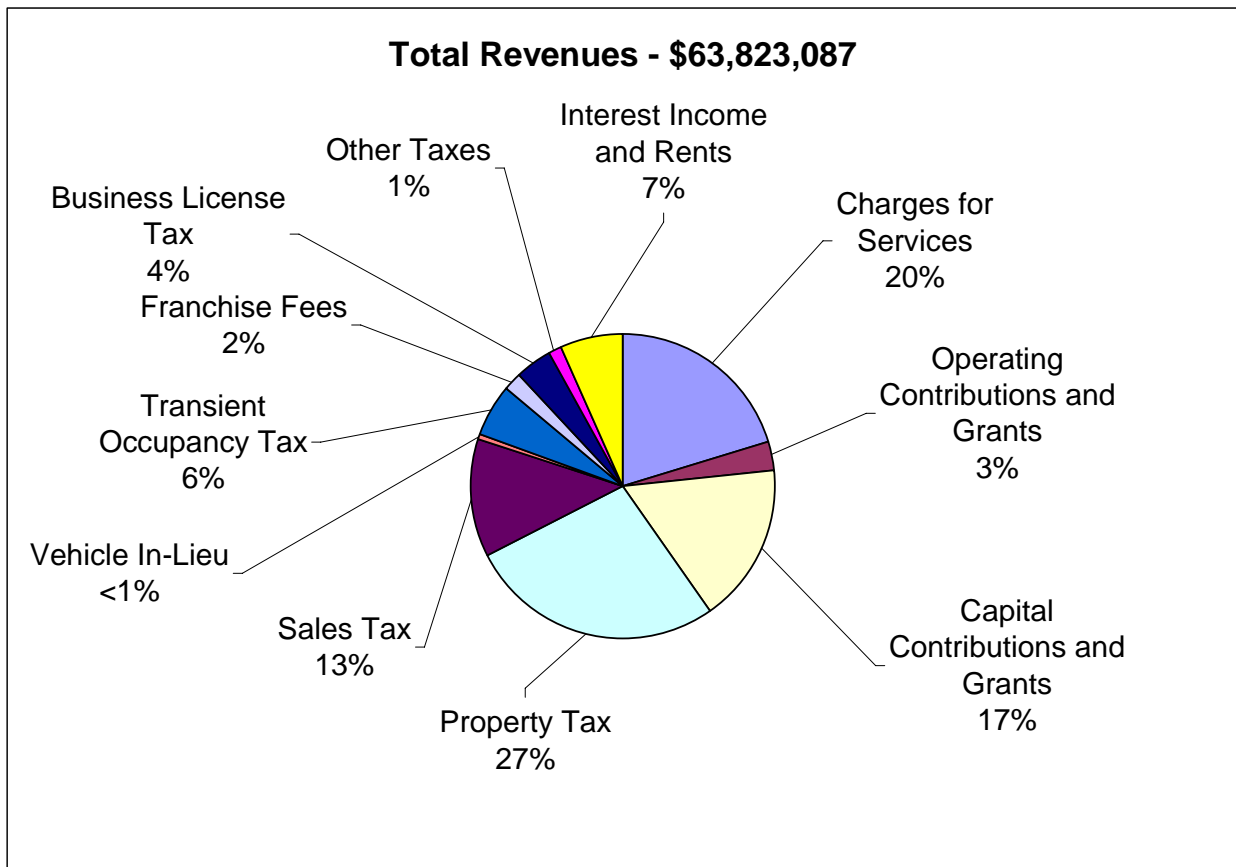
City of Manhattan Beach Changes in Net Assets

	Governmental Activities		Business -Type Activities		Total	
	2007	2006	2007	2006	2007	2006
Program Revenues:						
Charges for Services	\$ 12,904,269	\$ 11,484,126	\$ 14,889,212	\$ 14,097,876	\$ 27,793,481	\$ 25,582,002
Operating Contributions and Grants	1,933,403	2,767,865	10,861	19,758	1,944,264	2,787,623
Capital Contributions and Grants	10,923,007	5,598,244	-	-	10,923,007	5,598,244
General Revenues:						
Property Taxes	17,257,507	15,666,320	-	-	17,257,507	15,666,320
Other Taxes	16,223,609	15,911,571	-	-	16,223,609	15,911,571
Motor Vehicle in Lieu	245,008	835,709	-	-	245,008	835,709
Other	4,336,284	3,033,968	935,323	546,197	5,271,607	3,580,165
Total Revenues	63,823,087	55,297,803	15,835,396	14,663,831	79,658,483	69,961,634
Expenses:						
General Government	9,057,584	7,070,028	-	-	9,057,584	7,070,028
Public Safety	27,134,132	24,270,798	-	-	27,134,132	24,270,798
Public Works	19,721,241	10,380,032	-	-	19,721,241	10,380,032
Parks & Recreation	5,593,739	4,724,704	-	-	5,593,739	4,724,704
Interest on Long-Term debt	990,298	875,519	-	-	990,298	875,519
Water, Waste, Storm	-	-	8,894,850	7,950,790	8,894,850	7,950,790
Refuse	-	-	3,858,401	3,692,611	3,858,401	3,692,611
Parking	-	-	1,973,300	1,623,963	1,973,300	1,623,963
Total Expenses	62,496,994	47,321,081	14,726,551	13,267,364	77,223,545	60,588,445
Revenues Over Expenses	1,326,093	7,976,722	1,108,845	1,396,467	2,434,938	9,373,189
Transfers In (Out)	26,000	(204,000)	(26,000)	204,000		
Increase (Decrease) in Net Assets	1,352,093	7,772,722	1,082,845	1,600,467	2,434,938	9,373,189
Net Assets - Beginning	129,043,118	121,270,396	38,422,299	36,821,832	167,465,417	158,092,228
Restatement	153,075	-	-	-	153,075	-
Net Assets - June 30 (Year End)	\$ 130,548,286	\$ 129,043,118	\$ 39,505,144	\$ 38,422,299	\$ 170,053,430	\$ 167,465,417
Total Change from Prior Year	\$ 1,505,168	\$ 7,772,722	\$ 1,082,845	\$ 1,600,467	\$ 2,588,013	\$ 9,373,189

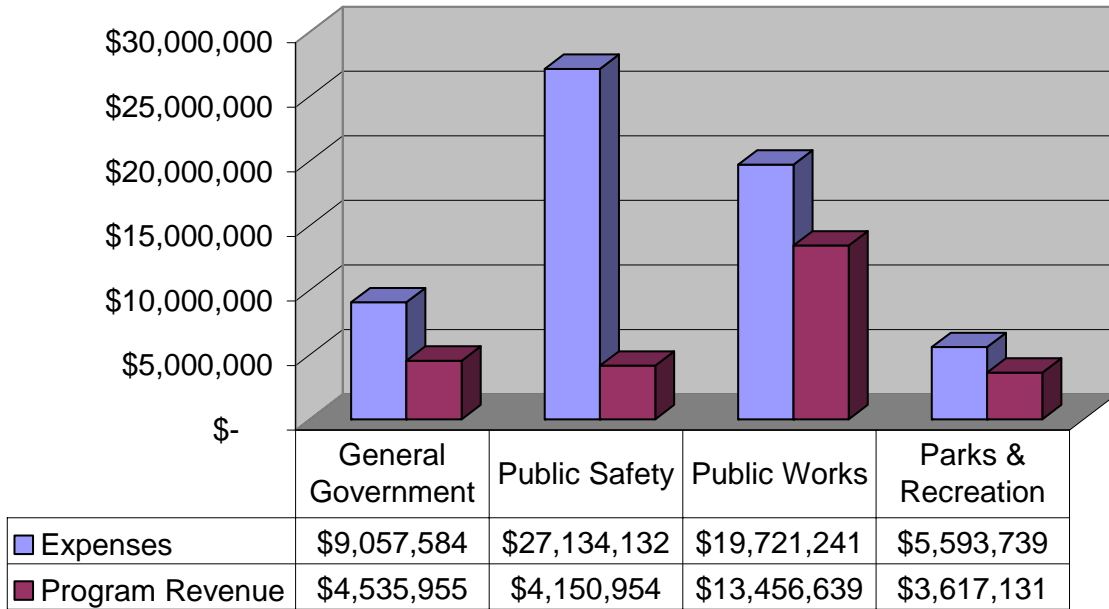
Changes in Net Assets - Governmental Activities

The City's governmental activities in FY 2006-2007 increased net assets by \$1.51 million, which was a 1.2% increase from FY 2005-2006. Revenues and transfers exceeding expenditures by \$1.35 million is the primary reason for this increase.

Revenues by Source - Governmental Activities - Fiscal Year 2007



**Governmental Activities Revenue and Expenses
by Function/Program
Year Ended June 30, 2007**



Functional expenses (excluding interest on debt) for the years ending June 30, 2007 and 2006 were as follows:

	Total Cost of Services		Net Cost of Services	
	2007	2006	2007	2006
General Government	\$ 9,057,584.00	\$ 7,070,028.00	\$ (4,521,629.00)	\$ (1,361,773.00)
Public Safety	27,134,132	24,270,798	(22,983,178)	(20,529,650)
Public Works	19,721,241	10,380,032	(6,264,602)	(2,545,871)
Parks and Recreation	5,593,739	4,724,704	(1,976,608)	(2,158,033)
Total	<u>\$ 61,506,696.00</u>	<u>\$ 46,445,562.00</u>	<u>\$ (35,746,017.00)</u>	<u>\$ (26,595,327.00)</u>

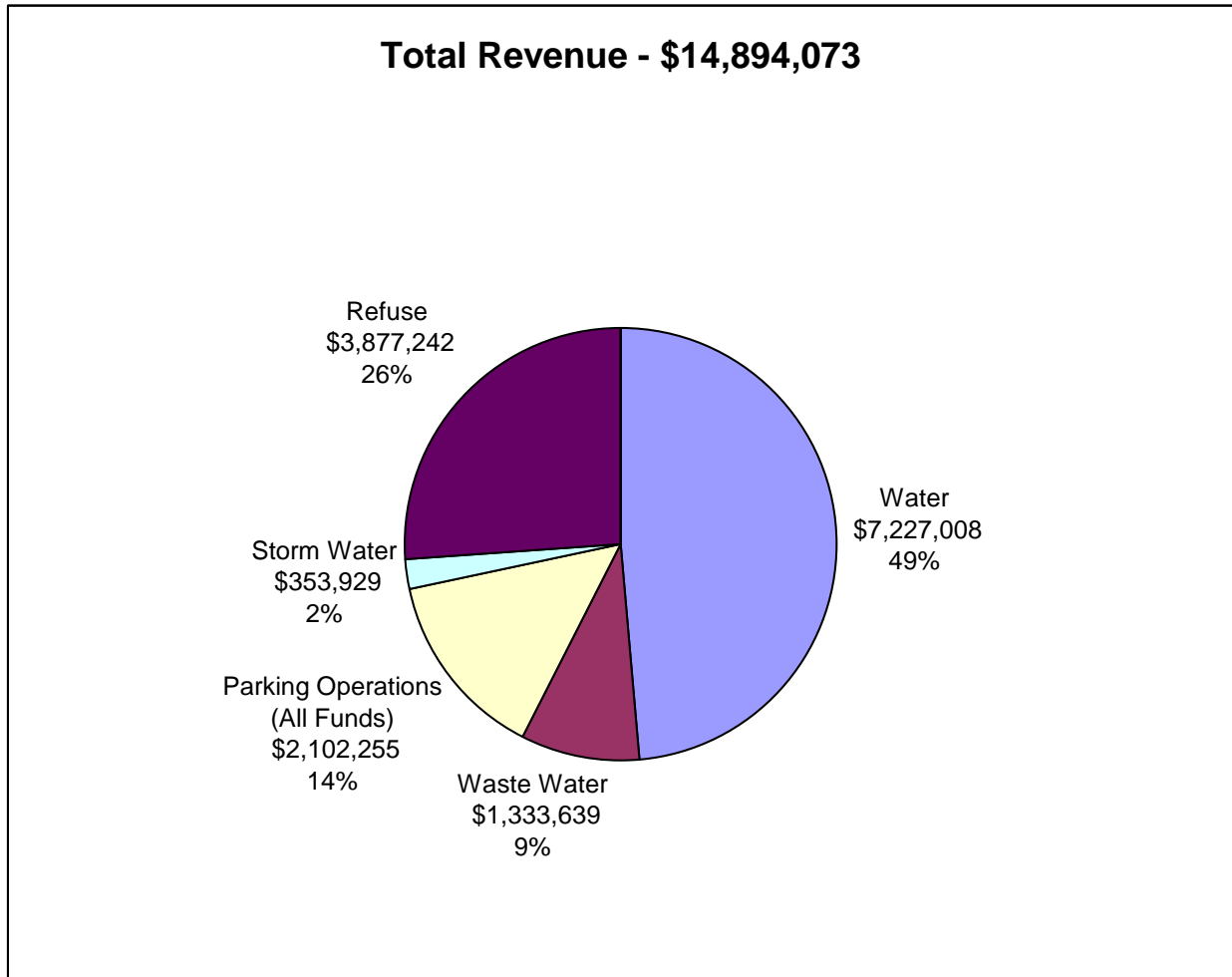
In total, the net cost of services increased by \$9.15 million, or 34% from the prior year. Activities contributing to the change include:

- Disbursements for Utility Underground Assessment District construction projects
- Salary and benefit cost increases citywide
- Reduced revenue from real estate related activities including building permits and plan check fees
- Increased building maintenance and utility costs

Business Type Activities

In fiscal year 2006-2007, revenues for the City's business type activities amounted to \$14,894,073, including \$10,861 in Refuse Fund grants. Total operating expenses equaled \$13,894,377 for a positive operating income of \$988,835 before non-operating revenues, expenses and transfers. When considering the impact of those activities, net assets increased by \$1,082,845 this current year.

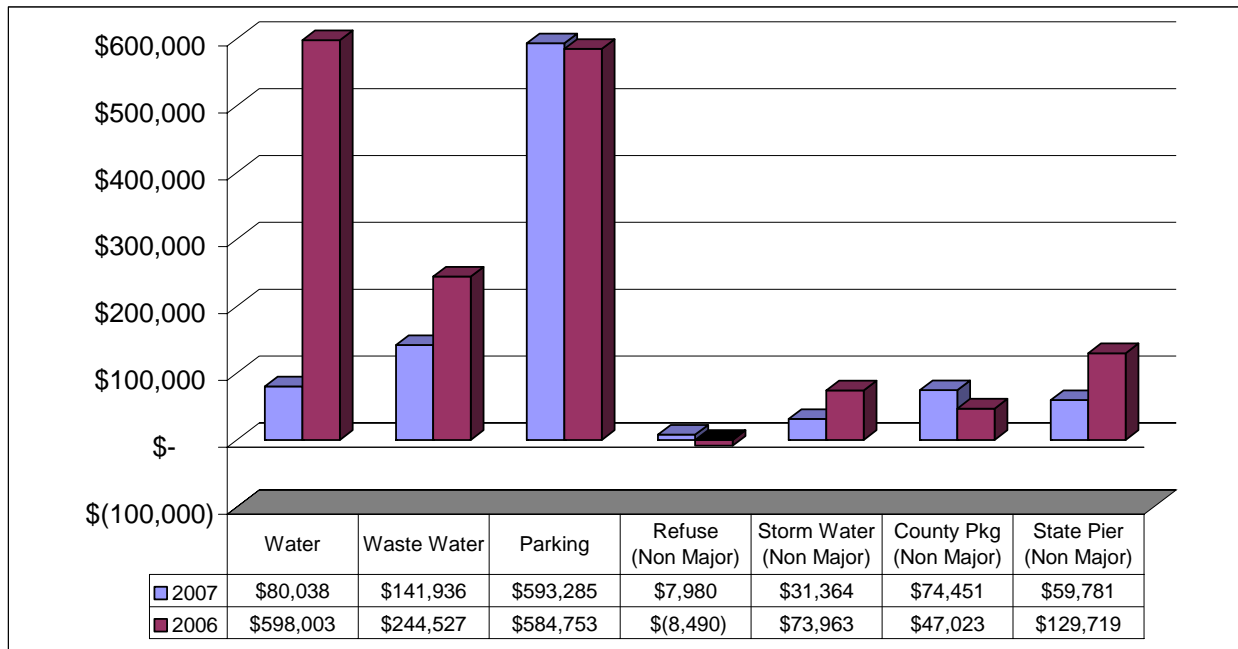
Revenues by Source - Business Type Activities FY 2007



The City's business-type activities increased net assets by \$1.08 million, or 2.8%. This was primarily due to interest income across all funds of \$935,323.

Operating Income varied across the business-type activities in FY 2007. A year-over-year comparison is presented below. Further analysis of the major funds is discussed later in this report.

Operating Income for Business-Type Activities for 2006 & 2007



FUND FINANCIAL STATEMENTS

Governmental Funds

As of the end of the 2007 fiscal year, the City's governmental funds ending fund balances totaled \$34.4 million, a decrease of \$5.68 million in comparison with the prior year. Activities contributing to this decrease include:

- The use of resources for construction of underground utility districts. The source of these funds is from assessments paid by property owners for the purpose of placing utility lines underground. The net change from this use was \$2.6 million within the Underground Assessment District fund;
- Planned expenditures of \$2.16 million in the Safety and Civic Center Construction Fund for completion of the new Police & Fire facility.
- A decrease in Special Revenue Funds balance of \$519,394 due to extensive capital improvement projects in the gas Tax Fund.
- Capital improvement projects totaling \$2.1 million for Strand Improvements (\$1.26 million), furniture, fixtures and equipment for the new Police & Fire facility (\$552,000) and \$916,000 for City Hall upgrades and the Facilities Strategic Planning process
- The transfer of \$1.34 million out to the Insurance Reserve Fund.

These decreases were offset by General Fund flow of resources over expenditures of \$2.9 million. Resources include revenues plus proceeds of debt issuance which are not included in the revenues. However, the corresponding use of debt proceeds was included in the expenditures.

Approximately 75% of the total Governmental Funds total, \$26.2 million, constitutes unreserved fund balance. The remainder of the fund balance (\$8.2 million) is reserved to indicate that it is not available for new spending because it has already been committed for on-going capital projects, purchase orders of the prior period, and for legally-required debt service reserves.

It is important to note that City Council established fund designations in its financial policy requirements and budgetary capital planning initiatives. Components of fund balances are listed in Note 8 of these financial statements. Of the \$26.2 million unreserved governmental fund balance noted above, \$17 million has been designated by City Council actions, and \$657,891 remain restricted for underground utility payments. Considering these designations, \$9.2 million in governmental fund balances (General, Capital Improvement, Gas Tax, Prop A, Prop C, Funds, etc.) 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 \$19.7 million, while total fund balance was \$20.98 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% (5 months) of total General Fund expenditures, while total fund balance represents 46% (5.5 months) of that same amount (once the one-time extraordinary expenditure of \$6.8 million for pension obligation bonds is discounted).

During the current fiscal year, General Fund expenditures exceeded revenues by approximately \$3.89 million. This imbalance is primarily the result of the issuance of pension obligation bonds for \$6.8 million. This transaction, which involved receiving bond proceeds and then disbursing the proceeds to the pension system (CalPERS), has the effect of a \$6.8 million expenditure without the benefit of the bond proceeds as an offsetting revenue. The bond proceeds are stated as "Other Financing Sources" which appear after the comparison of revenues and expenditures. When considering the \$6.8 million in bond proceeds, the General Fund increase before transfers was \$2.9 million.

Net transfer activity in this fund totaled \$3,714,321, and included the following transfers:

- The General Fund transferred \$2,459,711 into the Capital Improvement Fund for future projects
- Funds totaling \$1,343,904 was transferred to the Insurance Reserve Fund to alleviate on-going deficits.
- The Street Lighting Fund received \$69,270 to relieve a deficit fund balance.
- The Parking Fund received \$50,000 from the General Fund to maintain working capital levels.
- \$76,000 of excess reserves from the County Lot Fund was transferred to the General Fund in line with the contract with the County of Los Angeles.

Capital Improvement Fund

The Capital Improvement Fund serves to plan and manage the construction and maintenance of non-enterprise Projects are funded through dedicated revenue sources as well as General Fund surpluses 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 priorities are planned. The Capital Improvement Fund is one of the major funds covered in that City-wide plan.

At the end of the current fiscal year, the unreserved fund balance of the Capital Improvement Fund was \$3.0 million, while total fund balance reached \$7.55 million. \$1 million of the unreserved balance has been specifically earmarked for the underground assessment district loan program, leaving \$2 million in undesignated fund balance at June 30, 2007 (please see Note 8 to these financial statements). Project reserves, which total \$3.64 million at year-end include:

- \$1.07 million for Playground equipment
- \$753,690 for the Manhattan Village soccer field artificial turf project
- \$443,790 to complete the Strand improvement project
- \$280,000 for Live Oak and Manhattan Heights fencing projects
- \$100,000 for Downtown Streetscape improvements
- \$100,000 for improvements to Artesia Boulevard

During Fiscal Year 2006-2007, the Capital Improvement Fund expenditures exceeded revenues by \$2.12 million. However, fund balance increased by \$1.78 million. The increase is the result of the completion of the Police/Fire facility, which allowed for a transfer of \$1.44 in remaining funds from the construction fund to the CIP fund. Additionally, the prior year General Fund surplus funded a transfer in of \$2.46 million. Please see Note 4 for further details.

Dedicated revenues in this fund amounted to \$1.23 million in FY 2006-2007. These revenues 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: 15% of the Transient Occupancy Tax has been dedicated to funding CIP's. This has resulted in the generation of \$542,000 of revenue for the year. This is 15% above prior year levels marking a significant increase in general local tourism and patronage.

Parking Meter Rates: A twenty-five cent per hour increment of on-street parking meter rates, dedicated to capital improvements, generated revenue of \$556,178 this fiscal year. Actual revenues were slightly ahead of budget estimates, and even with last year's results.

Parking Citation Rates: Four dollars of most parking citations is dedicated to the CIP fund. For FY 2006-2007, revenue of \$127,384 was realized; an increase of 18% over the prior year.

This fund realized \$384,000 in grants, permits, interest and other revenue.

Capital Improvement Fund expenditures equaled \$3.73 million which included:

- \$1.26 million for Strand Improvements
- \$815,105 for Police & Fire facility debt service
- \$601,852 for City Hall upgrades and rehabilitation
- \$382,900 for the Facilities Strategic Plan project
- \$338,312 towards the artificial turf project at the Manhattan Village soccer field
- \$301,352 in furniture, fixtures and equipment, as well as some related construction cost, for the completion of the Police/Fire facility

Other Governmental Funds

Other non major governmental funds include all Special Revenue funds used exclusively to account for intergovernmental and assessment proceeds which are restricted in 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 2006-2007, these funds operated within budget guidelines. Combined fund balances at year-end approximated \$5.2 million, a decrease of \$500,000 from 2006. Gas Tax projects totaling \$2 million for

sidewalk repair and street resurfacing were the main reason for the decrease in overall fund balances. Changes in fund balances for this group can be expected to fluctuate as capital projects are expended over time.

One fund in particular, the Street Lighting Fund, continues to run deficits each year. For FY 2006-2007, expenditures exceeded revenues by \$146,100, eliminating any remaining fund balance. As a result, the General Fund contributed \$69,270 for continued operations. General Fund contributions will be necessary until a Proposition 218 assessment vote is successful in raising the assessment rates and revenues.

Proprietary Funds

The City's proprietary funds consist of enterprise funds and internal service funds. The enterprise funds include Water, Waste Water and Parking Funds (major funds), as well as Storm Water, Refuse, and both the County and State Parking Lot Funds (which are considered non-major). Internal service funds include Insurance Reserve, Information Systems, Fleet Management and Building Maintenance and Operations.

At year-end, total net assets of all enterprise funds amounted to \$39.5 million, of which \$14.3 million is unrestricted. Within that amount, Council, by policy, has established certain designations for continuing CIP's and financial policy goals, which total \$6.4 million. 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, enterprise funds combined net income was \$1.1 million before transfers. Net assets increased for all funds by \$1.1 million including a contractual \$76,000 transfer out to the General Fund from the County Lot Fund, and \$50,000 in from the General Fund in support of the Parking Fund.

Several enterprise funds are worth noting this year. In each of these cases, operating expenses are rising at a greater pace than revenues, signifying the need for future rate increases to sustain the operations:

- Water Fund net income from operations fell from \$598,000 in FY 2006 to \$80,000 in 2007 – the result of operating expenses (labor, materials, services, etc.) rising by 12.7%, while revenues only rose at a rate of 4%.
- Waste Water Fund net operating income decreased by 42% from \$244,530 in FY 06 to \$141,940 for FY 07. Operating expenses increased by 12%, or \$125,608.
- Storm Water Fund net operating income dropped from the prior year by \$42,600 (58%) due to operating expenses increasing by 51,201 (19%)

The reduction in net operating income in all three funds is mitigated somewhat from non-operating revenues (interest income). However, the message remains that rate increases will be necessary to maintain levels of service.

Another fund worth noting is the Parking Fund. The fund income, before transfers, was \$121,664 and year end Net Assets were \$7.25 million. Of the total net assets amount, \$907,575 remains unrestricted. This year's operation included Metlox bond interest expense of \$598,559 which was supported by the Fund's revenue stream. It is important to note that while the fund had positive net income, the overall cash flow generated from parking operations is insufficient to meet payment of bond principal and provide for future capital improvements. For FY 2006-2007, the fund experienced negative cash flow of \$292,422. A transfer from the General Fund for \$50,000 maintained policy (working capital) reserve levels within the fund. Future transfers will be required to sustain the fund, unless future action is taken to enhance the revenues associated with the operations.

Unrestricted net assets of the internal service funds at the end of the year amounted to \$2.6 million with a net assets total of \$5.8 million. Net assets increased by \$1,510,600, largely due to the transfer-in of \$1.34 million from the General Fund to the Insurance Reserve fund to provide adequate funding and working capital reserves. Despite increased charge-outs to the using departments, the Insurance Reserve fund continues to experience increasing claims cost and requires General Fund transfers. FY 2006-2007 claims totaled \$2.96 million, \$523,177 ahead of FY 2005-2006 levels. The City continues to look for ways to proactively manage risk and reduce these costs.

General Fund Budgetary Highlights

Estimated Revenues

The difference between the original estimated revenues and final estimated revenues was \$7,096,572. The primary component of this increase was \$6.8 million in bond proceeds for the pension obligation bonds previously discussed. This amount was offset by a \$6.8 million appropriation in following section. In addition, there were increases of \$188,000 matching reimbursable appropriations shown in following section

Appropriations

The final amended budget reflects an increase of \$7,906,289 over the adopted appropriations.

Significant budget adjustments included:

- \$6,800,000 for safety pension obligation bonds
- \$291,889 in re-appropriations for open purchase orders from fiscal 2005-2006.
- \$275,000 for an engineering analysis for underground assessment districts 12, 13, & 14
- \$110,000 for Fire Department overtime incurred due to mutual support (reimbursable)
- \$62,000 for Begg pool maintenance
- \$93,706 for bond interest on the pension obligation bonds.
- \$67,008 for four replacement defibrillators (reimbursable grant)

Aside from purchase order carry over, pension obligation bonds and reimbursable expenditures, total appropriation adjustments were \$518,123 (1.1% of original appropriation), over half of which was due to underground assessment engineering costs that will be reimbursed in the future if the districts are formed.

Capital Asset and Debt Administration

Capital Assets: The City's investment in capital assets government wide as of June 30, 2007, is \$157,190,292 (net of accumulated depreciation). This is an increase from the prior year of \$8.6 million, or 6%. This investment in capital assets includes land, buildings, park improvements, roadways, sewer, storm drains, vehicles, computer equipment, furniture and other equipment.

City of Manhattan Beach Capital Assets
(Net of depreciation)

	Governmental Activities		Business -Type Activities		Totals	
	2007	2006	2007	2006	2007	2006
Land	\$ 33,634,566	\$ 33,634,566	\$ 1,757,434	\$ 1,757,434	\$ 35,392,000	\$ 35,392,000
Buildings	42,451,235	2,669,999	15,750,237	1,276,588	58,201,472	3,946,587
Machinery & Equipment	2,567,276	2,265,024	312,971	258,446	2,880,247	2,523,470
Vehicles	3,123,711	2,961,236	-	-	3,123,711	2,961,236
Infrastructure	27,711,821	28,466,520	20,453,153	19,775,538	48,164,974	48,242,058
Work In Progress	7,863,988	40,189,421	1,563,900	15,359,026	9,427,888	55,548,447
Total	<u>\$117,352,597</u>	<u>\$ 110,186,766</u>	<u>\$ 39,837,695</u>	<u>\$ 38,427,032</u>	<u>\$ 157,190,292</u>	<u>\$ 148,613,798</u>

During the current fiscal year, governmental capital assets increased by \$7.2 million (6.5%). The increase is the result of the following activities:

- Construction of the new Police and Fire facility, which added \$2 million
- Progress on the Strand Improvements for \$1.26 million
- \$1.86 million as a result of the prior period adjustment due to the City's proportional ownership of South Bay Regional Public Communications Authority (RCC) facility. This facility was previously recorded as an asset of the Joint Powers Authority, of which the City is a member. The debt associated with the facility has also been added to the City's liabilities.
- \$1.5 million of vehicle purchases, machinery and equipment.
- Annual street resurfacing and sidewalk improvement activities which added \$1.99 million

During the current fiscal year, \$1.4 million in additions to business type activity assets were realized, the bulk of which relates to the following items:

- Water system improvements for \$1.19 million
- Parking structure maintenance for a total of \$223,707
- Storm Water projects which added \$44,000

Additional information on the City's capital assets can be found in Note 5 of this report.

Long Term Liabilities: Total long term debt is \$55,374,180, an increase of \$6,523,345 over fiscal 2005-2006. Governmental liabilities increased by \$6,862,161 and business type liabilities decreased by \$338,816.

City of Manhattan Beach Outstanding Liabilities

	<u>Governmental Activities</u>		<u>Business Type Activities</u>		<u>Total</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Marine Avenue COP's	\$ 8,580,000	\$ 8,780,000	\$ -	\$ -	\$ 8,580,000	\$ 8,780,000
Capital Equipment Lease	558,190	720,693	-	-	558,190	720,693
Police & Fire Facility COP's	12,740,000	12,980,000	-	-	12,740,000	12,980,000
Accrued Employee Leave & Benefits	2,226,775	1,995,445	81,579	55,395	2,308,354	2,050,840
Supplemental Leave	35,595	41,536	-	-	35,595	41,536
Water and Wastewater COP's	-	-	3,820,000	3,920,000	3,820,000	3,920,000
Metlox Parking COP's	-	-	12,570,000	12,835,000	12,570,000	12,835,000
Pension Obligation Bonds	6,800,000	-	-	-	6,800,000	-
So. Bay Communications (RCC)	1,830,000	1,905,000	-	-	1,830,000	1,905,000
Insurance Claim Reserves	5,963,069	5,441,774	-	-	5,963,069	5,441,774
Unamortized Bond Premium	168,972	175,993	-	-	168,972	175,993
Total Liabilities	\$ 38,902,601	\$ 32,040,441	\$ 16,471,579	\$ 16,810,395	55,374,180	48,850,836
Current	\$ 5,621,112	\$ 4,012,298	\$ 384,724	\$ 370,496	6,005,836	4,382,794
Long Term Liabilities	\$ 33,281,489	\$ 28,028,143	\$ 16,086,855	\$ 16,439,899	\$49,368,344	\$44,468,042

Governmental

As can be seen in the above table, there is new governmental debt of \$6,800,000 due to the issuance of pension obligation bonds. The proceeds from this issue were used to payoff police and fire pension side fund obligations with the California Public Employees Retirement System (CalPERS). These obligations represent the balance of unfunded liabilities of the police and fire plans that existed at the time the police and fire plans were transitioned to like-plan pools effective fiscal 2005-2006. Through the sale of the bonds, the City will realize cost savings since the effective rate of the bonds is substantially lower than the imputed amortization interest rate at CalPERS (refer to Note 9 for a description of City retirement plans).

Principal obligations for existing debt were reduced in accordance with existing debt service schedules. The total decrease was \$677,503. This decrease was offset by increases in liabilities for compensated absences and insurance which totaled \$752,625. The increase in insurance reserves is due to workers compensation and liability cases. The increase in compensated absences is due to increases in salary and accrued leave hours.

For comparison purposes, the 2006 liabilities include the principal balance of the South Bay Regional Public Communications Authority (RCC) bond that is included in the restatement of net assets (refer to Note 16).

Business Type

Long term liabilities decreased as a result of the reduction in bond principal of \$365,000 (\$100,000 in Water/Waste Water bonds and \$265,000 in Metlox Public Improvement bonds). This reduction was offset by an increase of \$26,184 in employee leave and benefits. No new debt was issued in FY 2006-2007.

For the details regarding components of long term liabilities refer to Note 6.

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 \$372,204,931.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The City Council adopted a balanced FY 2007-2008 operating budget in June 2007.

The City's major General Fund revenue sources remain strong. Property Tax, which is our single biggest source, has seen near double-digit growth rates for the past several years. In anticipation of a housing and building activity slow down, we conservatively projected 2007-2008 property taxes to exceed 2006-2007 collections by 2%. Subsequent to adoption of the budget, the assessed valuations for 2007-2008 were published by the County, indicating 9.9% growth in FY 2007-2008. While such rates of growth are not expected to continue, we expect the housing market to remain stable. Our second largest revenue source in the General Fund, Sales Tax, is projected to increase by 2% over FY 2006-2007 results. Transient Occupancy Tax, which has seen strong growth in the past two years, is projected to be 3.5% over the prior year. In keeping with the anticipated housing slow down, we reduced building permit and plan check fees.

On the expenditure side of the equation, there are long term labor agreements in place with the three bargaining units (Police, Fire and Miscellaneous), with the first expiration date occurring in summer 2010. These agreements give us a measure of predictability in our labor costs, which equal nearly 70% of the General Fund expenditures. On a related note, however, the City will be faced with increased retiree medical liabilities with the passage in 2006 of State Assembly bill AB 2544. This legislation requires the City, as a subscriber to the CalPERS medical plans, to provide certain minimum cash contributions towards retirees' medical premiums, effective January 1, 2008.

Along with AB 2544, the City has proactively prepared for the implementation of GASB 45 in FY 2008-2009. In late 2007, the City ordered an actuarial report addressing the liabilities associated not only with AB 2544, but for existing retiree health plans for the labor groups. The total liabilities associated with these plans totals \$5.7 million. The City has already set aside \$2.5 million for these liabilities, and will be considering our options for amortizing the remaining unfunded liability.

The City is in the process of identifying the next round of major capital improvements through our Facilities Strategic Plan. A steering committee consisting of City Council and community members have held many public meetings to receive input, and identified several options for future recreation and other public facilities. While the ultimate plan is yet to be identified, construction of these facilities will most likely require outside funding, the sources of which will need to be identified and evaluated.

Overall, the General Fund budget anticipates revenues and expenditures to increase 6.7% over the prior year's budget. Our five-year forecast assumes 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.