

CITY OF MANHATTAN BEACH

MANAGEMENT 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, 2003. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal, which can be found on pages x to xi of this report.

FINANCIAL HIGHLIGHTS

- The assets of the City of Manhattan Beach exceed its liabilities, at the close of the fiscal year ended June 30, 2003, by \$144,207,435 (*net assets*). Of this amount, \$63,478,033 (*unrestricted net assets*) may be used to meet the government's ongoing obligations to citizens and creditors.
- The City's total net assets increased by \$8,499,163. 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, 2003, the City's governmental activities reported combined ending fund balances of \$110,319,324, an increase of \$8,687,391 in comparison with the adjusted opening balance. Approximately \$50,281,092 (*unrestricted fund balance*) 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, 2003, the fund balance for the General fund was \$17,969,918 or 55% of total General fund expenditures. The General Fund reported excess revenues over expenditures of \$4,647,067 before net transfers out of \$2,398,686.

- Transfers out of approximately \$4.5 million from the General Fund were made to fund major capital initiatives including construction of a new Public Safety facility and accumulating funds for future improvements to the Strand Walkway.
- The City's total bonded debt increased by \$13,070,000 (95%) during the current fiscal year. This increase was primarily attributable to the increase of \$13,350,000 in Certificates of Participation for the construction of the Metlox public parking facility which was completed on schedule in January 2004. Other long term liability balances, including employee leave balances & insurance reserves, capital leases remained near 2002 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 comprise 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, Waste Water, Storm and parking.

The government-wide financial statements can be found on pages 24-26 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 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 10 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 Improvements fund, 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 *non-major* 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 27-31 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 citywide 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 inter-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 non-major funds, 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 85-108 of this report.

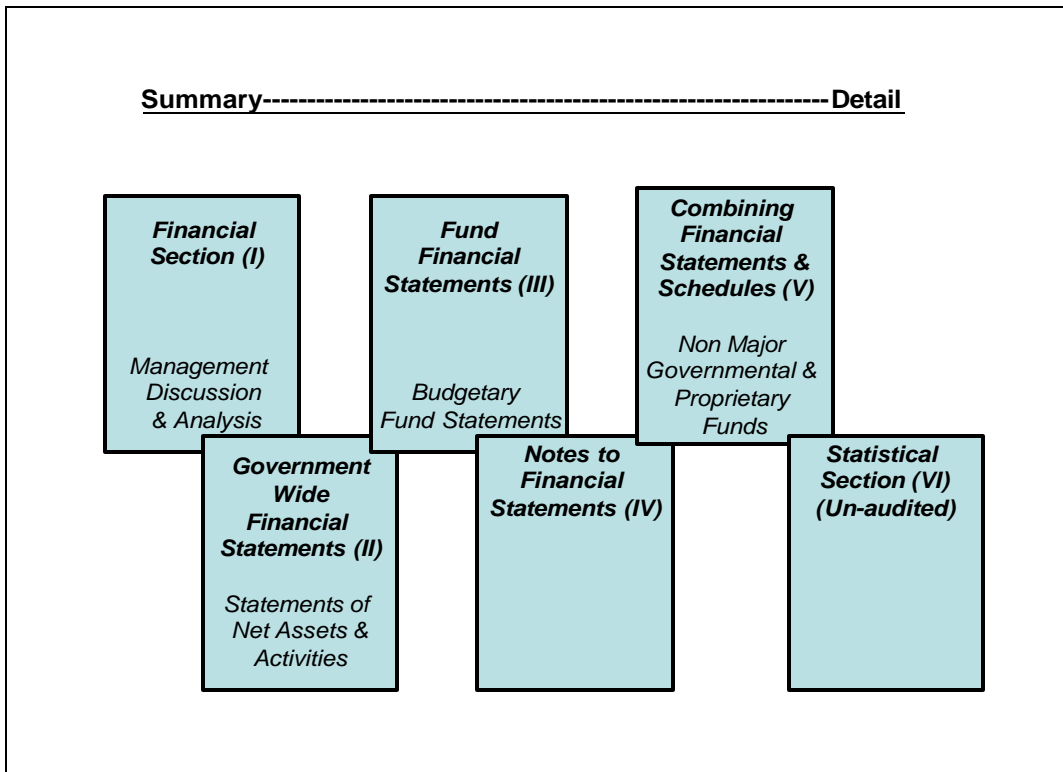
Notes to the financial statements: The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 42-84 of this report.

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 its 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.

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 \$144,207,435 at June 30, 2003.

By far the largest portion of the City's net assets (67 percent) 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

	Government Activities 2003	Business-Type Activities 2003	Total 2003
Current and other assets	\$ 59,683,724	\$ 28,323,990	\$ 87,007,714
Capital assets	69,498,249	26,917,225	96,415,474
Total assets	129,181,973	55,241,215	184,423,188
Long-term liabilities outstanding	12,420,313	17,506,778	29,927,091
Other liabilities	6,442,336	3,846,326	10,288,662
Total liabilities	18,862,649	21,353,104	40,215,753
Invested in net capital assets	59,985,188	9,377,225	69,362,413
Restricted	53,044	11,313,945	11,366,989
Unrestricted	50,281,092	13,196,941	63,478,033
Total net assets	\$110,319,324	\$ 33,888,111	\$144,207,435

An additional portion of the City's net assets (9 percent or \$5.7 million), within the Special Revenue funds, represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets (\$57,793,506) 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 citywide basis, net assets increased by \$8,499,163. Governmental activities, as a group, increased by \$8,687,391 and accounted for most of the growth in the net assets of the City.

City of Manhattan Beach Changes in Net Assets

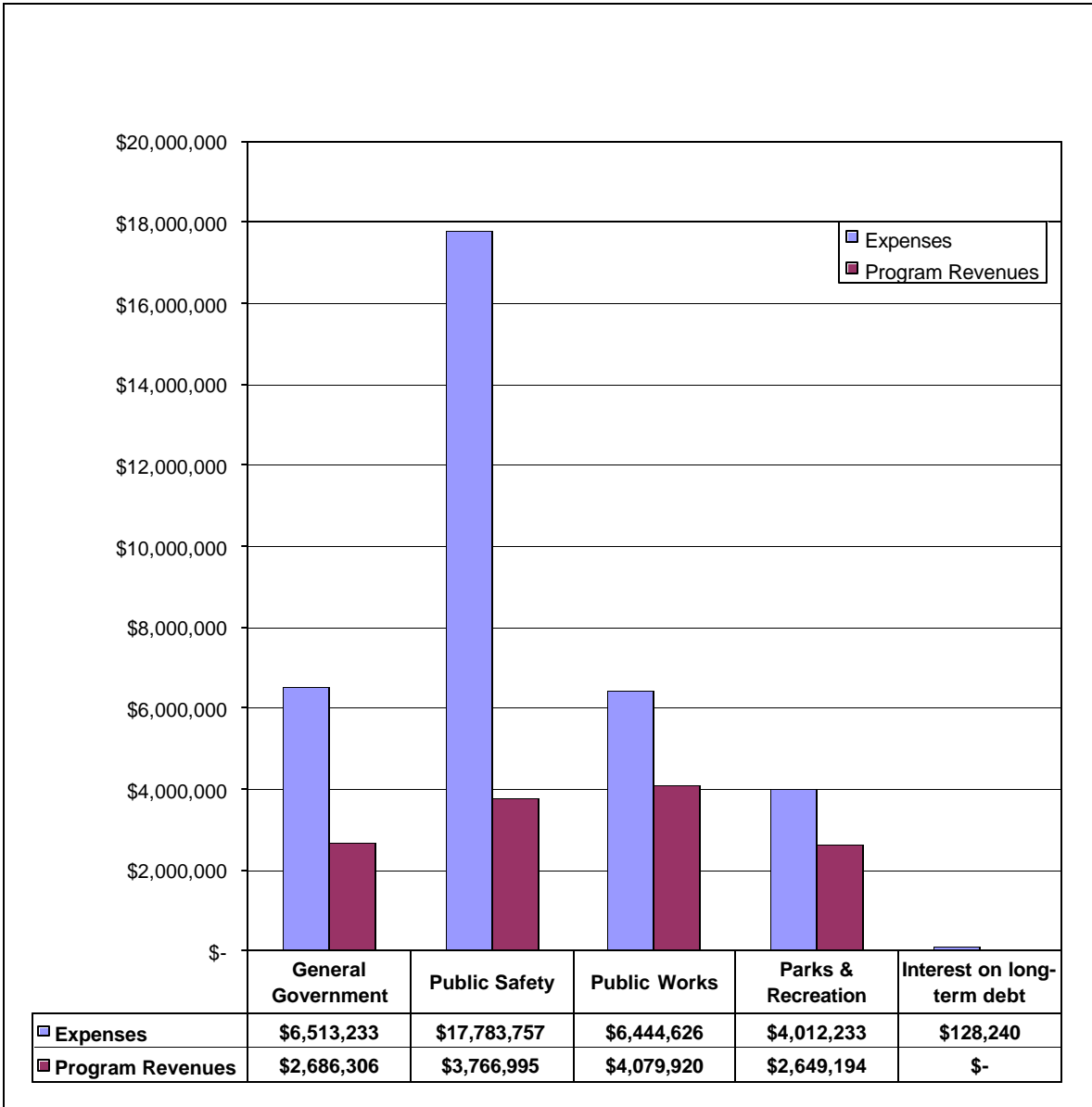
	Governmental Activities 2003	Business- Type Activities 2003	Total 2003
Program revenues:			
Charges for services	\$ 9,966,136	\$ 12,973,669	\$ 22,939,805
Operating contributions & grants	2,621,663	25,810	2,647,473
Capital contributions and grants	594,616	400,000	994,616
General revenues:			
Property taxes	10,021,646		10,021,646
Other taxes	14,749,308		14,749,308
Other	3,516,567	534,633	4,051,200
Total revenues	41,469,936	13,934,112	55,404,048
Expenses:			
General government	6,513,233		6,513,233
Public safety	17,783,757		17,783,757
Public works	6,444,626		6,444,626
Parks and recreation	4,012,233		4,012,233
Interest on long-term debt	128,240		128,240
Water, Waste, Storm		7,320,432	7,320,432
Refuse		3,090,089	3,090,089
Parking		1,612,275	1,612,275
Total expenses	34,882,089	12,022,796	46,904,885
Revenues over Expenses	6,587,847	1,911,316	8,499,163
Transfers In (out)	2,099,544	(2,099,544)	0
Increase in Net Assets	8,687,391	(188,228)	8,499,163
Net assets - July 1, 2002	101,631,933	34,076,339	135,708,272
Net assets - June 30, 2003	\$110,319,324	\$33,888,111	\$144,207,435

Key elements of this increase are as follows:

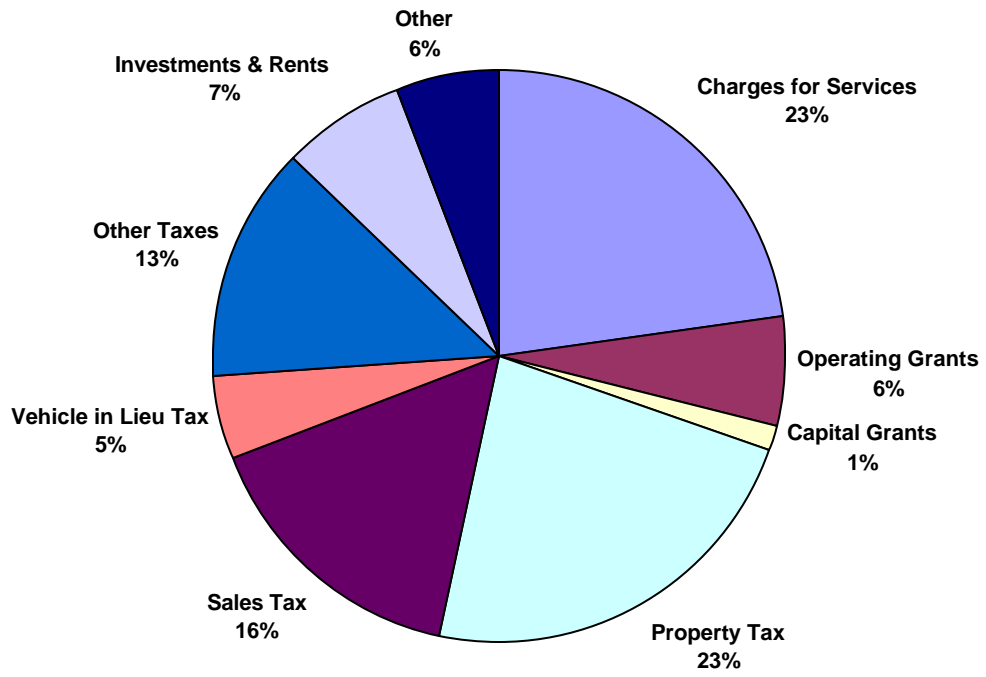
- The difference in the method of accounting for capital assets in the governmental funds versus the statement of activities accounts for an increase in excess of \$4 million in net assets considering both capital costs and depreciation. Governmental funds fully expend capital asset costs in the period they are acquired. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives.
- In 2002-2003 the General Fund benefited from an additional transfer in of \$2.1 million as a result of a newly completed utility cost allocation study which was applied on both a prospective and retroactive basis. This study was performed as part of an ongoing citywide User Fee study. On the other side of this equation, a transfer out of the Utility funds was made for the same amount in the fiscal year.
- In 2002-2003 the General Fund reported an operating surplus, before transfers, of \$4.6 million which added to the overall strength of city wide net asset balances.
- In 2002-2003 the Utility Funds reported an operating surplus, before transfers, of \$1.9 million again adding to the overall strength of city wide net asset balances.

Government Activities

Expenses and Program Revenues – Governmental Activities

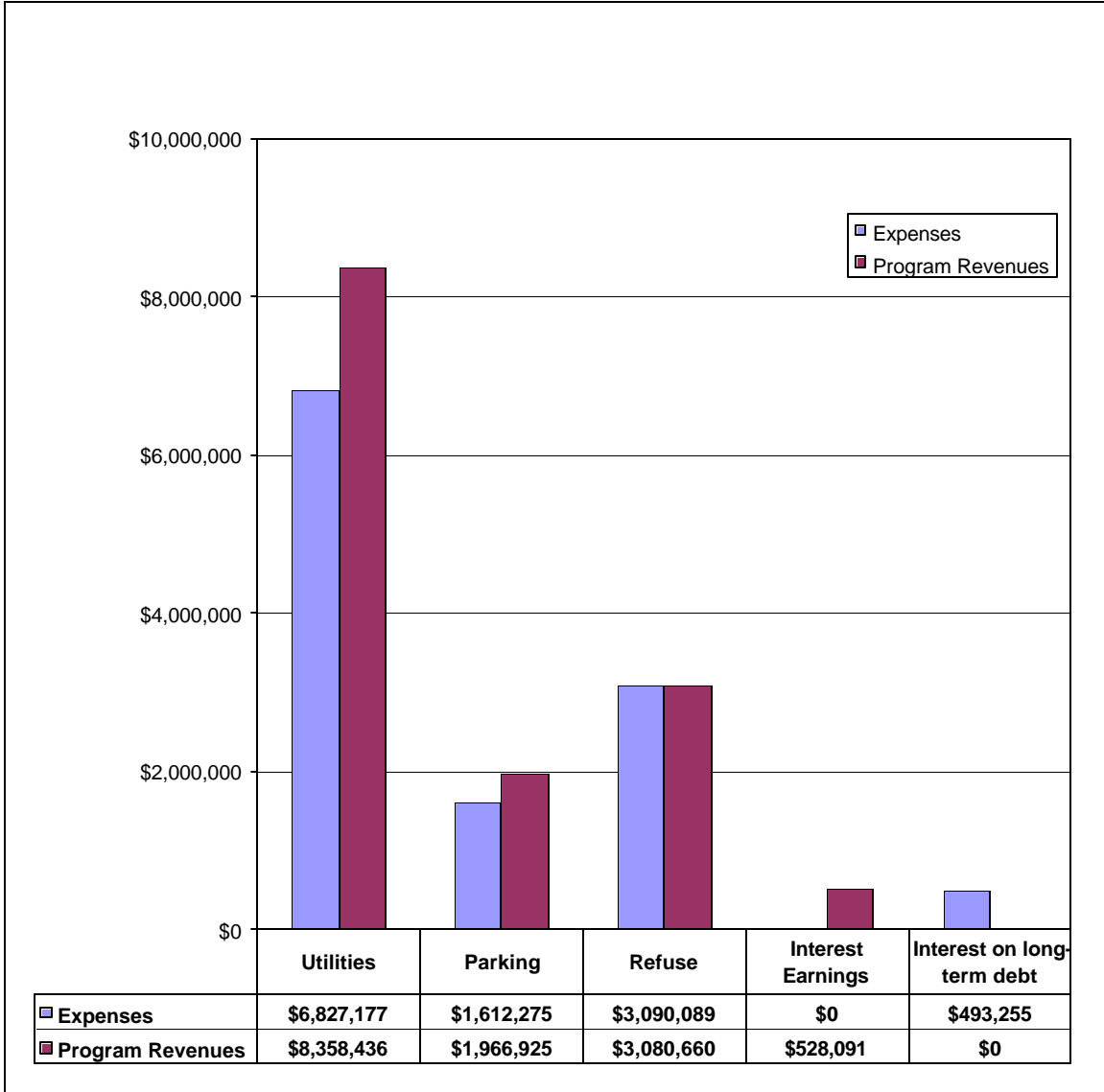


Revenues by Source – Governmental Activities



Business Type Activities

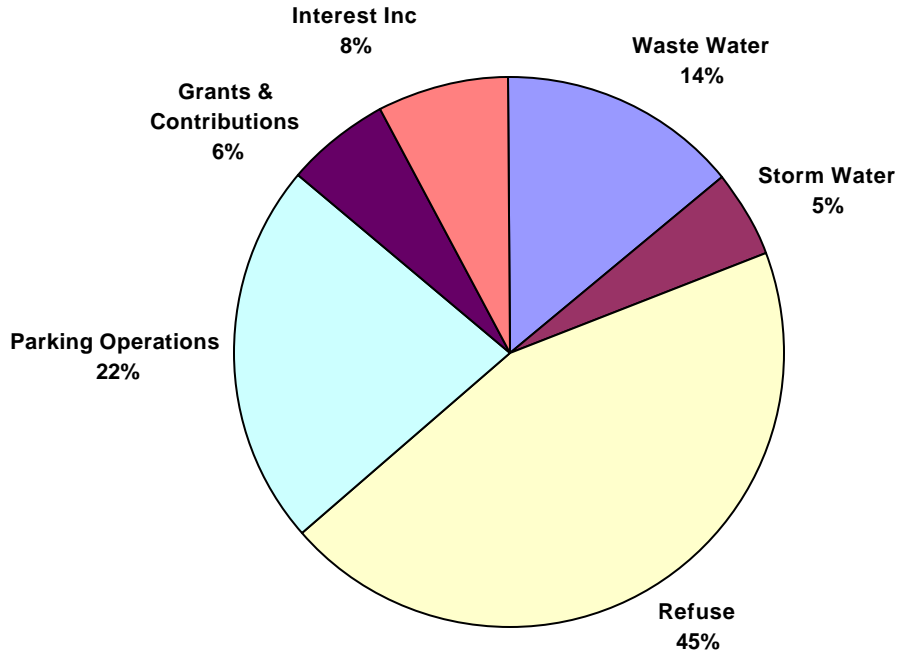
Expenses and Program Revenues – Business Type Activities



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

- Water
- Waste Water
- Storm Water
- Refuse
- Parking

Revenues by Source – Business Type Activities



In fiscal year 2002-2003 revenues for the City's business type activities amounted to \$13,934,112 including \$425,810 in grants and contributions. All other revenue is derived from operations and investment earnings. Total operating expenses equaled \$12,022,796 for a positive operating income of \$1,911,316 before transfers. When considering the impact of the transfer out of \$2,099,544 discussed above, net assets decreased by \$188,288 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, an increase of \$4.7 million in comparison with the prior year. Approximately 93 percent of this total amount, \$45.4 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 (1) to liquidate contracts and purchase orders of the prior period (\$3.04 million) and (2) to reserve for prepaid items and debt service (\$214,662).

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 \$45.4 million unreserved governmental fund balance noted above, \$32.9 million has been designated by City Council actions and \$3.4 million exist in restricted use special revenue funds. Considering these designations, \$9.1 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 \$17.1 million, while total fund balance reached \$17.9 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 52 percent of total General fund expenditures, while total fund balance represents 64 percent of that same amount.

During the current fiscal year, General Fund revenues exceeded expenses by approximately \$4.65 million. Along with transfer activity out of this fund, fund balance increased by \$2.25 million. The current year transfer activity included:

- \$3.8 million into the Capital Improvement Fund to further build reserves for the construction of the new public safety facility, which begins in FY 2003-2004;
- \$234,500 to the Capital Improvement Fund for future Strand Walkway improvements;
- \$426,436 to the Insurance Reserve Fund to maintain risk management policy reserves;
- \$2.1 million from certain business type activity funds into the General Fund as a result of the cost allocation plan study.

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 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 directed priorities are set and planned for. The Capital Improvement Fund is one of the major funds which is covered in that citywide plan.

At the end of the current fiscal year, unreserved fund balance of the Capital Improvement fund was \$24.8 million, while total fund balance reached \$24.9 million. It is critical to note that \$20.7 million of the unreserved balance has been specifically earmarked for planned infrastructure projects leaving an unreserved and undesignated balance of \$4.2 million as indicated in note #7 to these financial statements. Key designations at year end include:

- **\$18.4** million for the construction of a new Police/ Fire facility
- **\$1.10** million for improvements to the Strand Walkway
- **\$1.00** million for improvements to Artesia Boulevard

During the current fiscal year, the fund balance of the City's Capital Improvement Fund increased by \$2.7 million mainly due to the previously mentioned transfers from the General Fund.

Dedicated revenues in this fund amounted to \$1.2 million. These dedicated sources have been recorded in the Capital Project Fund and are dedicated to funding general government capital improvement projects in the effort to maintain and enhance City infrastructure. 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 percent. This has resulted in the generation of \$304,715 of revenue for the year, an amount which is 5% below prior year levels. Clearly, the impact on general tourism of the September 11 terrorist strike has been severe and long lasting.

Parking Meter Rates: In FY2001 City Council approved an increase of on-street parking meter rates from \$0.50 to \$0.75 per hour. This has resulted in additional parking meter revenue of \$537,634 this fiscal year. Actual revenues were in line with budget estimates. Additionally, in May of 2002, parking lot meter rates were increased by \$0.25 to \$0.50 per hour. This rate increase will assist in funding the construction of the new Metlox public parking lot and town square.

Parking Citation Rates: City Council approved an increase of most parking citation rates from \$26 to \$30 in FY2001. This increase resulted in parking citation revenue of \$109,180 this current year. Additionally, in May 2002, expired meter parking citation rates were increased from \$26 to \$30 and all other parking citations from \$30 to \$35. This latest increase generated \$135,673 in additional revenue in fiscal year 2002-2003 for the General Fund

Capital expenditures equaled \$2.5 million including 2003-2004 expended costs for the Police/Fire facility, mostly for design and engineering, of \$1.6 million. The formal award for construction of the new facility was awarded in fiscal 2003-2004 with construction to begin in February 2004. The total cost of this project approximates \$39 million and will be funded through a combination of cash reserves and debt issuance.

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 & State Grants Fund, Gas Tax Fund, Propositions A&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 2002-2003 these funds operated within budget guidelines. Combined fund balances at year end equaled \$5.7 million, a decrease of \$292,002 over 2002. This decrease can be expected 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 & State Lot Funds are considered non-major.

At year end total Net Assets of all Proprietary Funds amounted to \$33.9 million of which \$13.2 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 \$1.9 million before transfers. Net assets decreased for all funds by \$188,228 given a \$2.1 million transfer out of the utility funds to reimburse the General Fund for support costs revealed in a recent cost allocation study.

Unrestricted net assets of the Internal Service funds at the end of the year amounted to \$2.5 million with a net assets total of \$4.6 million. Net assets decreased by \$289,583 mostly due to continued rising workers compensation claims costs.

General Fund Budgetary Highlights

The difference between the original budget and the final amended budget was an increase of \$652,458 and can be briefly summarized as follows:

- **\$642,458** to roll forward 2001-2002 active purchase orders provided for in prior reserve balances and budgets.
- **\$10,000** of funding to contribute towards the construction of a new track at Mira Costa High School

The \$10,000 of new and unplanned funding was budgeted from available fund balance. On an overall basis within the General Fund, expenditures were \$1.8 million less than budgetary estimates including these budget adjustments, thus eliminating the need to draw upon existing fund balance.

Capital Asset and Debt Administration

Capital Assets: The City's investment in capital assets government wide as of June 30, 2003, amounts to \$96,415,474 (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 2003	Business-Type Activities 2003	Total 2003
Land	33,634,566	1,757,434	35,392,000
Buildings	5,576,164	6,734,215	12,310,379
Machinery & Equipment	1,431,408	107,202	1,538,610
Vehicles	2,047,398	0	2,047,398
Infrastructure	26,808,713	18,318,374	45,127,087
Total	69,498,249	26,917,225	96,415,474

The financial statements issued for year ended June 30, 2003 mark the first year of implementation of GASB Statement #34. This being the case, a valuation of all citywide infrastructure assets was performed and, as expected, a material change in value and presentation of the City's capital assets has occurred. As result of the valuations the City's governmental capital assets beginning balances, net of depreciation, were materially modified as follows:

Impact of GASB #34 Valuations

	Beginning Balance July 1, 2002	GASB 34 Adjustments Original Cost	GASB 34 Adjustments Depreciation	Restated Balance July 1, 2002
Governmental Funds				
Land	36,982,902	(3,348,336)		33,634,566
Buildings	3,766,614	1,544,635	(2,110,984)	3,200,265
Machinery & Equipment	3,585,487		(2,002,794)	1,582,693
Vehicles	1,986,014			1,986,014
Parks	3,202,524	6,039,057	(2,653,240)	6,588,341
Streets & Roadways		31,034,321	(12,715,376)	18,318,945
Total Governmental	49,523,541	35,269,677	(19,482,394)	65,310,824

During the current year several large dollar additions to governmental capital assets were realized. These include the following:

- **\$2.5** million of inception to date work in progress costs towards the construction of a new Police/Fire facility. The bulk of these costs relate to design and engineering costs incurred inception to date.
- **\$1.3** million of park improvements including major improvements to Polliwog park and various city parkettes
- **\$1.5** million of citywide street improvement projects the bulk of which related to the citywide street resurfacing program

Additional information on the City's capital assets can be found in note #5 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 \$30,448,355. Of this amount, \$26,875,000 relates to outstanding bonds. A breakdown of this debt is as follows:

City of Manhattan Beach Outstanding Liabilities

	Governmental Activities 2003	Business- Type Activities 2003	Total 2003
Marine Ave Park COPs	\$ 9,335,000		\$ 9,335,000
Capital Equipment Lease	178,061		178,061
Accrued Employee Leave & Benefits	1,707,381	56,668	1,764,049
Water & Wastewater Bonds		4,190,000	4,190,000
Metlox Parking COPs		13,350,000	13,350,000
Insurance Claim Reserves	1,631,245		1,631,245
Total Liabilities	12,851,687	17,596,668	30,448,355
Current	431,374	89,890	521,264
Long Term Liabilities	12,420,313	17,506,778	29,927,091

The City's total debt increased by \$10.5 million (34 percent) during the current fiscal year. This is primarily due to the issuance of \$13 million in Certificates of Participation for the construction of a two level subterranean parking structure at the Metlox site. This construction was completed in January 2004. Other changes have to do with changes in insurance reserve and employee compensation balances.

State statutes limit the amount of general obligation debt a governmental entity may issue to 15 percent of its total assessed valuation. The current debt limitation for the City of Manhattan Beach is \$259,625,304. Additional information on the City's long-term debt can be found in note 6 of this financial report.

ECONOMIC OUTLOOK

The budget for Fiscal Year 2003-2004 was adopted by the City Council in June 2003. Major projects and initiatives include:

Metlox Public Improvements

FY 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 \$14.6 million, this parking structure is the first phase of a joint public-private development several years in making. The parking lot contains 460 parking spaces and was opened for use in January 2004. The mixed use commercial development portion of the project will commence construction in the spring of 2004 and will include retail, restaurant, office and a boutique style inn. These facilities will surround the City-owned town square which will be used as public open space and for City-programmed activities. The public improvements have been funded exclusively through parking fund operations using certificates of participation of \$13,350,000 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. Design has been on-going for the past couple of years, and in December 2003 a contract, valued at approximately \$39.3 million was awarded for the construction of a new facility. Construction will begin in earnest in February 2004 with completion scheduled for late 2005. Preliminary project costs of nearly \$2 million have been incurred in FY 2002-2003 in the beginning phases. This project will be funded through the use of existing City reserves and debt.

Strand Walkway Improvements

The 2003-2004 capital improvement plan includes \$500,000 for design costs for future improvements to the Strand Walkway. This \$4 million project is not yet scheduled but exists as a top priority for the City Council. Over \$1 million in designated reserves have been set aside to date in planning for this project.

Other capital improvements for FY 2003-2004 include \$800,000 for improvements to the El Porto parking lot, and \$2.5 million in Water, Wastewater & Stormwater line improvements, the most substantial being \$1.1 million for the Peck Avenue water blending lines.

ECONOMIC FACTORS

While the overall economy appears to be recovering, we are still cognizant of a number of economic concerns that cause us to remain cautious and focused on proactive planning. Our tradition of conservative budgeting, cost control and “pay-as-you-go” infrastructure funding has served us well as we craft a financial plan for these challenging times.

Our major General Fund revenue sources remain stable. Property Taxes, which is our single biggest source, has experienced growth of 7% to 11% in each of the past few years. While we don't expect such rates of growth to continue, we are confident that the housing market will remain vibrant. Sales Tax has seen little growth recently, but as the national and local economies rebound, we expect to see modest gains in this area. Transient Occupancy Tax, which suffered greatly from the effects of September 11th, is starting to show a modest recovery from the lows of the past two years.

Our biggest concern for our revenues is from the State. The State's huge budget deficits have put pressure on local government funding sources. The City's Vehicle License Fees have been the subject of much debate recently, with the newly elected Governor acting to protect this critical revenue source. However, the Governor's proposed budget for FY 2004-2005 includes property tax shifts from cities and counties to fund education. We will not know the exact impact until the State adopts a budget, but we will clearly remain vigilant and will make every effort to protect our revenues.

Interest earnings projections are especially important to highlight as we look forward. 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/Fire reserves in FY 2003-2004 will result in a significant decline for this revenue source. Considering rate reductions and the use of \$17.5 million in Police/Fire reserves, interest earnings are expected to decline by over \$600,000. We will expect future declines as Police/Fire reserves are fully expended. Clearly, 2002-2003 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 PERS 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. The five year forecast predicts an increase of annual operating costs approximating \$2 million per year beginning in FY 2004-2005.

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.