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January 5, 2010

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

We are pleased to present the Comprehensive Annual Financial Report (CAFR) of the City of Manhattan Beach for the Fiscal Year ended June 30, 2009. This report has been prepared in accordance with generally accepted accounting principles (GAAP) as set forth in the pronouncements of the Governmental Accounting Standards Board (GASB).

The City's financial policies require an independent audit be performed annually, and that the auditor's opinions be included in the Comprehensive Annual Financial Report. Further, it states that the results be reviewed with the Finance Subcommittee, and presented to the City Council no later than February 1st of the following year. The Finance Subcommittee met with the auditors and discussed the results in December 2009.

Responsibility for the accuracy of the data and the fairness of presentation, including all footnotes and disclosures, rests with the City. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds of the City. All material, statements and disclosures necessary for the reader to obtain a thorough understanding of the City's financial activities have been included.

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

The City's financial statements have been audited by Lance, Soll & Lunghard, CPAs, an accounting firm selected by the City Council, based on a recommendation from the Finance Subcommittee. The goal of the independent audit was to provide reasonable assurance that the financial statements of the City are free of material misstatement. The independent audit involved examining, on a test basis,

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accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the City of Manhattan Beach's financial statements for the fiscal year ended June 30, 2009, are fairly presented in conformity with GAAP.

The independent auditors' report is presented as the first component of the financial section of this report. The City was not required to conduct a single-audit, an audit of Federal Grant Funding, and, as such, no separate single audit opinion and report is included.

GAAP requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The City's MD&A can be found immediately following the report of the independent auditors.

Profile of the Government

The City of Manhattan Beach is located in South Bay region of Los Angeles county. The current population¹ is 36,718. The City encompasses approximately four square miles.

Incorporated in 1912 under the general laws of the State of California, the city operates under the Council-Manager form of government. The City Council is comprised of five members elected at-large for overlapping four-year terms. Each member serves as Mayor for a nine month period once during his or her four year term in office. The City Treasurer is also elected to a four year term, and serves as the chairperson for the Finance Subcommittee. City Councilmembers are limited to two terms.

The City Council is responsible for, among other things, passing ordinances, adopting the budget, appointing committees, and appointing the City Manager and City Attorney. The City Council members also serve as the governing body of the Manhattan Beach Capital Improvements Corporation (please see Note 1 in the CAFR for more information).

In addition, the City Council appoints the members of the following advisory Boards and Commissions:

Planning Commission	Parking and Public Improvements Commission
Parks & Recreation Commission	Cultural Arts Commission
Library Commission	Board of Building Appeals
Environmental Task Force	

¹ State of California Department of Finance, January 2009

The city is a full-service municipality, and provides a variety of services to the community, including:

Police services	Fire and paramedic services
Culture and recreation	Building and safety
Solid waste and recycling	Water and waste water utilities
Storm water management	Parking facilities
Street and landscape maintenance	General government

Budget Process

The City's budget process begins in January of each year. Line-item budget development is accomplished through the City's financial system, which allows each department to build its budget using computerized worksheets. The departments are responsible for developing the Materials & Supplies line items and part-time employees' salaries. The remaining Salary & Benefit information is calculated and entered by the Finance Department. All supplemental budget requests (new personnel, service or equipment) are subject to City Manager review and approval before becoming part of the operating budget. This process applies to all governmental and enterprise funds.

The Finance Director provides the City Manager with proposed revenue projections. These revenue estimates are then reviewed with the department budget requests to determine available funding levels for the fiscal year. The City Manager and Finance Director then hold meetings with the departments to review the operating and supplemental budget requests.

After final review and approval by the City Manager, the proposed budget document is presented to the City Council in May. At least one study session and public hearing are held by the City Council, and then the budget is adopted by resolution prior to June 30.

During the fiscal year, the budget can be amended as necessary to meet the City's needs. The City Council has the legal authority to amend the budget at any time. Department Heads and their designated representatives may only authorize expenditures based on appropriations previously approved by City Council action, and only from accounts under their organizational responsibility. Actual expenditures may exceed budget appropriations by line-item, but may not exceed the department's budget. The City Manager has the authority to approve interdepartmental appropriation transfers as long as they are within the same fund. Inter fund transfers require a budget amendment by the City Council.

Economic Condition

Local Economy

Manhattan Beach is located in the South Bay area of Los Angeles county. The region is home to a number of industries including aerospace, entertainment, leisure and tourism, and manufacturing. Economists report that the South Bay area has strong fundamentals including high levels of education, high incomes and competitive industries. Further, the area has fared better during the economic crisis than some other areas of the state. Case in point, the most recently available figures indicate that Manhattan Beach has a 4.3% unemployment rate, while the county and state are in excess of 12%.

Long Term Planning

Each year during the budget process, the City develops a five year forecast of General Fund revenues and expenditures. During the most recent budget cycle (FY 2009-2010), when the severe economic downturn was clearly evident, the forecast concluded that expenditures will exceed revenues for the next four years, gradually improving from a \$1.5 million deficit in FY 09-10 to a slight surplus by FY 2013-2014. However, the forecast also projects that reserves and designations will remain within policy, and that sufficient unreserved funds are available to weather the storm. The complete five year forecast can be found in the FY 2009-2010 budget document, available on line at www.citymb.info.

Financial Policies

In 1997-1998, the City Council approved the City's first set of financial policies, designed to promote sound financial management and ensure that the City's fiscal integrity remains intact as staff and Councilmembers change. This Comprehensive Annual Financial Report reflects these financial guidelines and presents all fund reserves and designations in an effort to define fund balance commitments and obligations as of the financial report date.

During FY 2008-2009, the Cash and Investment Policies were of particular importance. The economic crisis of late calendar year 2008 caused a panic in the financial markets which had the effect of temporarily reducing the value of the City's investment holdings. Through the prudent policies in place, large losses were mitigated. The City's approach to the situation of taking a calm, measured approach, and further reducing exposure to particular sectors and firms as the markets stabilized, allowed the City to realize no net losses on investment liquidation.

It is the City's policy to maintain our AAA/Aaa rating from all three rating agencies: Standard & Poor's, Fitch and Moody's. This rating, the highest possible, indicates the City's low debt, healthy reserve levels and conservative budgeting and fiscal policies.

Major Initiatives

Environmental Programs: In FY 2008-2009, the Council continued to focus on the environment and how the City can reduce carbon emissions, water and air pollution; conserve natural resources and, in general, become more "green." Previously, the Council signed on to the U.S. Mayors Climate Protection Agreement, and an assessment of the City's carbon footprint was developed. This will help guide the desired goal of a 7% reduction from 1990 levels of greenhouse gas emissions by 2012 – in line with the Kyoto Protocol.

Progress was made towards these goals in FY 2008-2009 through the passage of ordinances setting forth green building standards, eliminating fats, oils and greases from being released into the sanitary sewer system by restaurants, promoting water conservation, and requiring new clean air vehicle standards for taxis operating under the City's franchise agreements. Additionally, new tiered water rates were developed (which are being implemented in January 2010), and a new drug drop box was installed at City Hall to provide an alternative to the use of the sewer system to discard old and outdated drugs. Finally, an energy audit was performed which has identified a number of projects that may be funded in order to reduce carbon emissions, as well as save money in the future. Those projects will be reviewed for funding during FY 2009-2010.

School District Support: Given the on-going State budget crisis, and its affects on the City's school district (a separate entity), the City Council took the initiative to provide a cash contribution to the district to help support its programs. For FY 2008-2009, this contribution totaled \$520,000. This is in addition to other in-kind services already provided by the City which total approximately \$1 million annually. This support was provided in recognition of the value the schools have to the community and the resulting boost to home values that the public education system in Manhattan Beach brings. A second cash contribution of \$1.3 million is included in the FY 2009-2010 budget to continue the support as additional cuts in education funding are enacted at the State level.

Water and Waste Water Systems: During FY 2008-2009, the City Council authorized infrastructure and rate studies of the City's water and waste water (sewer) utilities. The studies were ordered to ensure funding for the timely maintenance and repair of these mission critical systems. Additionally, with the cost of imported water rising in response to drought conditions, adjustments in rates are necessary in order to maintain the financial integrity of the utilities. The studies were completed and presented to the City Council in early FY 2009-2010, with the appropriate tiered rate structures taking effect in January 2010. The rates will allow for cash funding of the majority of maintenance costs going forward, as well as the funding of increased reserves for the enterprises.

Stimulus Funds: After the passage of the American Reinvestment and Recovery Act of 2009 (also known as the stimulus bill), the City aggressively pursued grant opportunities. While much of the funding came through after the close of the fiscal year, the City has been awarded over \$1.5 million in project funds, which will be utilized for street resurfacing projects, energy retrofits and a variety of public safety programs and projects. The City continues to actively seek stimulus and grant funding opportunities as they become available.

Downtown Parking Management Plan: As a popular beachside community, with a vibrant downtown full of shopping and dining attractions, the availability and management of the parking inventory is of vital concern to the City. As a result, the City Council authorized the development of a plan to maximize the use of the existing parking resources. The plan included the creation of a new, low cost merchant parking program, a residential permit system for the neighborhoods adjacent to the downtown to alleviate merchant parking issues, and a rate adjustment to encourage long term parking in lower cost lots in order to provide convenient parking for business patrons. The study will be reviewed during FY 2009-2010 for effectiveness and modifications.

Executive Financial Overview

This top level overview is presented as a supplement to the more detailed and comprehensive analysis presented in the Management Discussion and Analysis (MD&A). As such, it serves to highlight key financial performance indicators for our major funds. We encourage readers to review the MD&A for a further analysis of the City's financial condition.

General Fund

The General fund is the primary operating fund of the City of Manhattan Beach. In comparing year end 2009 to 2008, the total fund balance decreased by \$107,389. General Fund expenditures exceeded revenues by approximately \$99,672. Other financing sources including transfers-in, transfers-out and sale of capital assets resulted in a net decrease in fund balance of \$7,717. At the end of fiscal year 2009, the total General Fund balance equaled \$18.3 million. The unreserved fund

balance is \$16.7 million. Within the unreserved fund balance, City Council has established designations for financial policy and economic uncertainties of \$14.5 million leaving an unreserved and undesignated fund balance of \$2.2 million, which is available for use at City Council's discretion.

General Fund transfers included:

- \$170,953 to the Street Lighting and Landscape Fund to relieve a deficit fund balance
- \$110,230 in excess reserves from the County Lot Fund in accordance with the contract
- \$50,000 from the CIP Fund to the City Council Contingency account

The City's General Fund showed signs of the recession, particularly in Sales Tax, Interest and Rents, and construction related fees such as building permits and plan check fees. This can be noted by the trends below:

Revenue Category	2008 Actual	2009 Actual	Increase (Decrease)	%
Property Tax	\$ 18,567,451	\$ 19,930,492	\$ 1,363,041	7.3%
Other Taxes (Sales, Hotel, Business License)	\$ 16,278,198	\$ 15,044,017	\$ (1,234,181)	-7.6%
Licenses and Permits (Building, Construction, Film Permits)	\$ 1,408,697	\$ 1,136,934	\$ (271,763)	-19.3%
Fines (Parking Citations, Vehicle Code Fines)	\$ 2,047,187	\$ 2,472,306	\$ 425,119	20.8%
Interest and Rents (Including Ground Leases)	\$ 3,897,287	\$ 3,214,403	\$ (682,884)	-17.5%
Received From Other Agencies (Vehicle License Fees, Grants)	\$ 571,403	\$ 415,905	\$ (155,498)	-27.2%
Service Charges (Plan Check Fees, P&R Class, Ambulance Fees)	\$ 4,638,335	\$ 4,590,854	\$ (47,481)	-1.0%
Interfund Charges (Admin. Svc. Charges)	\$ 2,829,644	\$ 2,928,910	\$ 99,266	3.5%
Miscellaneous	\$ 1,672,904	\$ 273,099	\$ (1,399,805)	-83.7%
Totals	<u>\$ 51,911,106</u>	<u>\$ 50,006,920</u>	<u>\$ (1,904,186)</u>	<u>-3.7%</u>

Sales tax was down approximately 9% from the prior year's actual receipts, and came in below budgetary estimates by 10.6%. Transient Occupancy Tax also showed declines compared to 2008, and fell below our budget projections by 21%. Building permits performed 23% below the prior year and 20% below budgetary estimates, while plan check fees were 18% below budget and 21% below

prior fiscal year levels. On an overall basis, General Fund revenues decreased by 3.7% from 2008 results, and came in 4% under our budget estimates.

It is clear that our Property Tax revenues reflect the peak values and growth of the real estate market before the real estate down turn, which commenced in earnest in late 2007, about the time the 2008-2009 property tax assessments were established. While FY 2008-2009 property tax collections grew by 7.3%, FY 2009-2010 revenues now reflect the effects of the housing market declines. As a result, property tax will grow approximately 1.5% in FY 09-10.

Despite the General Fund revenue drop of 3.7%, fund balance decreased by only \$107,389 due to the efforts in reducing expenditures during the year. Those efforts allowed us to realize \$3 million in expenditure savings compared to the final budget. Overall, expenditures came in 5.7% below final budget appropriations, and decreased from the prior year by 7.7% (this due to one time expenditures to pre-fund other post employment benefits in the prior year totaling \$5.7 million that were not repeated in FY 2008-2009). Staff vacancies and a selective hiring freeze contributed to these savings.

Other Funds

Capital Improvement Fund

The Capital Improvement Projects Fund (CIP) is designed to manage general governmental capital projects. In FY 2009, the CIP Fund had revenues of \$1.26 million, and capital expenditures of \$2.12 million. A transfer-out of \$50,000 to the General Fund was made to augment the City Council Contingency account. At June 30, 2009 the total balance in the CIP Fund was \$5.4 million. Of this balance, \$994,196 is reserved for planned infrastructure projects, and \$817,178 is reserved for debt service for the Police & Fire facility. \$970,000 has also been designated for the City's Underground Assessment District Loan Program. Unreserved fund balance totals \$3.5 million, with \$2.5 million of that amount remaining unreserved and undesignated. Project reserves at year end include:

- \$320,000 for the Strand Stairs project
- \$280,000 for Live Oak and Manhattan Heights park fencing
- \$150,000 for the Energy Retrofit Audit
- \$100,000 for Artesia Blvd. improvements
- \$75,000 for Live Oak Park retaining wall and landscaping
- \$69,200 for City Hall and Library painting and landscaping

Special Revenue, Internal, and Enterprise Funds

This group includes the City's enterprises such as Water, Waste Water and Storm Water funds; internal service funds such as fleet, insurance, building maintenance and information systems; and Special Revenue funds including Proposition A & C, Grants, Asset Forfeiture, etc. Among this group, several under-performing funds deserve our attention.

The Water Fund had negative net income from operations of \$318,590 in FY 2009. This is a continuation of the decline from FY 2008, albeit at a slower pace, when net operating income was negative \$489,873. This is the result of revenues not keeping pace with operating expenses (labor, purchased water costs, services, etc.) which have risen over the past few years (up 4.7% in FY

2009). City Council has already taken steps to address this issue. During FY 2008-2009, the Council initiated rate studies for both Water and Waste Water utilities, and implemented new tiered water rates that take effect in January 2010.

The Waste Water Fund also had negative net income from operations of \$548,446. This loss was primarily due to the expense associated with infrastructure and rate studies performed during the year in preparation for future capital improvements, as well as on-going operations. The studies resulted in the new rates to support operations.

The Storm Water Fund net operating income in FY 2009 was a negative \$203,072. This was the result of operating expenses increasing by 31.6% over 2008 levels to \$550,234, while revenues increased by 2.6% to \$347,162 from the prior year. Storm Water revenues are based upon assessments, which in order to increase, requires property owner approval through an assessment ballot. Additionally, increased regulation of storm water will serve to drive up the costs associated with this activity. Until revenues can be adjusted, the Storm Water Fund will remain subject to funding limitations, and when necessary, General Fund subsidies.

Trust and Agency Funds

In several cases, the City acts as a custodian of funds held for the benefit of others which mostly relates to the administration of employee pension and 401(a) deferred compensation plans. All such plans funding requirements have been maintained. City Plans include the supplemental retirement and single highest year programs - dormant plans which were previously offered by the City. It is significant to note that this financial report does not include the value of trust holdings in the employees' 457 deferred compensation plan totaling \$13.35 million at June 30, 2009. This recognizes enacted legislation establishing the City as a plan trustee and protecting these employee-owned assets from external creditors.

The trust and agency fund group also includes debt service funds held in trust on behalf of the undergrounding assessment districts. This fund accounts for assessment collections and the related debt service payments. The cash held as of June 30, 2009, will be used to pay bondholders in FY 2009-2010.

Please refer to Management Discussion and Analysis (MD&A) in the Financial Section that follows.

CURRENT TRENDS AND EVENTS

Early in Fiscal year 2008-2009, the economy turned dramatically. The integrity of the country's financial system came into question with major financial institutions failing, and the government stepping in to provide support. Home foreclosures continued to increase to record highs, brought on by questionable lending practices, further exacerbating a weak housing market. Unemployment rose to levels not seen in a generation. Retail sales nosedived as consumers suddenly began to save money in lieu of shopping and buying.

Now, one year later, we are feeling the full effects of the severe recession. While Manhattan Beach is often envied for our fiscal stability, and ability to weather the storms, there is no doubt that we have been, and continue to be affected by the economic problems. Our revenues tied to retail sales activity, such as sales tax, have declined. Our building related fees such as building permits and plan

check fees, have declined beyond last year's slide, and will be further impacted. Our hospitality industry has certainly felt the effects of recession as business and leisure travel drop off, which in turn has reduced our transient occupancy tax and sales tax.

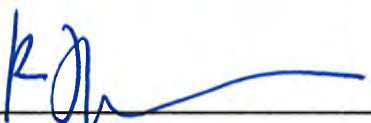
The City's biggest General Fund revenue source, property tax, which had grown rapidly over recent years, is now in a low-to-no-growth pattern, rising approximately 1.5% in FY 2009-2010. As home values drop, many properties sold in the last 3-4 years are being reassessed as taxable values exceed market value. Additionally, we can expect FY 2010-2011 property tax revenues to remain muted due to a negative adjustment in the Consumer Price Index, which is factored into the future assessed values.

Couple these revenue challenges with an expenditure structure that is 70% labor based, with salary and benefit costs pre-determined through labor agreements, and it is evident that we face significant fiscal challenges in the coming years.

The good news is that Manhattan Beach has been preparing for times like these for many years. We have reserves established and funded, and we run a lean operation. We have the ability to weather this storm while continuing to provide outstanding services. And when the economy improves, we will take that opportunity once again to prepare for the next rainy day.

OTHER INFORMATION

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


Richard Thompson, Interim City Manager


Bruce Moe, Finance Director