

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, 2004. 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 i to xi of this report.

FINANCIAL HIGHLIGHTS

- The assets of the City of Manhattan Beach exceeded its liabilities, at the close of the fiscal year ended June 30, 2004, by \$152,945,949 (*net assets*). Of this amount, \$63,363,635 (*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 \$8,604,668. 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, 2004, the City's governmental activities reported combined ending net assets of \$117,293,341, an increase of \$6,974,017, in comparison with the adjusted opening balance. \$49,133,592 (*unrestricted net assets*) is available for spending at the government's discretion. Further to this point, it is important to note that a good majority of these dollars are derived through special project funds and, as such, their use is limited to specific types of applications. Additionally, this unreserved balance includes several material City Council directed capital project designations which have resulted from a long-standing infrastructure improvement plan.
- As of June 30, 2004, the City's business activities reported combined ending net assets of \$35,652,608, an increase of \$1,630,651 in comparison with the adjusted opening balance. \$14,230,043 of this balance is unrestricted to be used in the future support of the operational and capital needs of these enterprises. This unreserved balance includes several material City Council directed capital project designations which have resulted from a long-standing infrastructure improvement plan.
- As of June 30, 2004, the balance in the General Fund was \$20,667,534, or 59% (seven months), of total General Fund expenditures. The General Fund reported excess revenues over expenditures of \$3,597,616 before net transfers out of \$900,000.
- Transfers out of approximately \$975,000 from the General Fund were made to pay for major capital initiatives including construction of a new Public Safety facility and accumulating reserves for future improvements to the Strand Walkway.
- The City's total bonded debt decreased by \$265,000 (1%) during the current fiscal year. This decrease was primarily attributable to the scheduled pay down of issued bonds in the General, Water, Wastewater and Parking funds. Other long term liability balances, including employee leave balances and insurance reserves, and capital leases remained near 2003 levels. In fiscal year 2004-2005, the City issued \$12.9 million in additional debt to fully fund the new Police and Fire facility.

**City of Manhattan Beach
Management's Discussion and Analysis (Continued)**

USING THIS ANNUAL REPORT

Overview of the Financial Statements

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

Reporting on the City as a Whole

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

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

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

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

The government-wide financial statements can be found on pages 19 to 21 of this report.

Reporting on the City's Most Significant Funds

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

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

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

City of Manhattan Beach Management's Discussion and Analysis (Continued)

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

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

The basic governmental fund financial statements can be found on pages 22 to 28 of this report.

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

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

The combining statements referred to earlier in connection with nonmajor governmental funds, proprietary and internal service funds are presented immediately following the notes to the financial statements. Combining and individual fund statements and schedules can be found on pages 76 to 99 of this report.

Notes to the financial statements: The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 40 to 73 of this report.

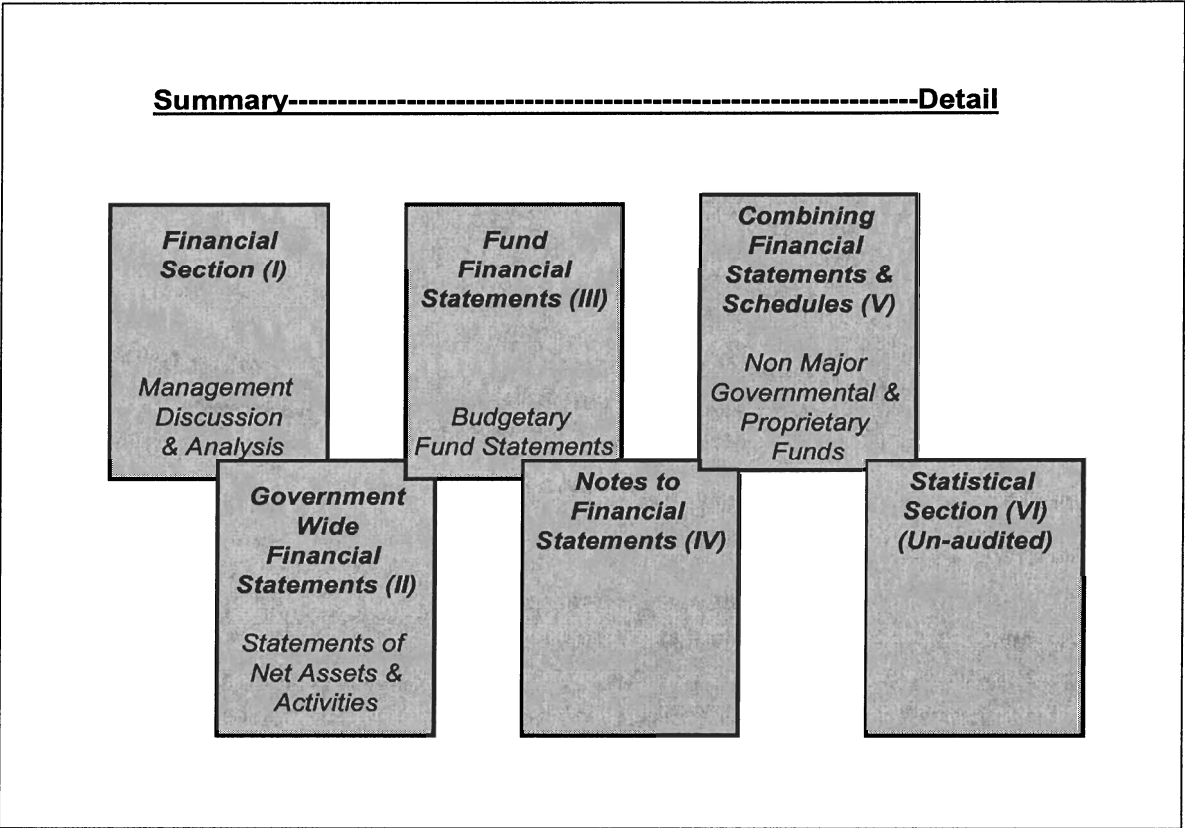
The City as Trustee

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

**City of Manhattan Beach
Management's Discussion and Analysis (Continued)**

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 \$152,945,949 at June 30, 2004.

By far, the largest portion of the City's net assets (55%) 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
Management's Discussion and Analysis (Continued)**

City of Manhattan Beach Net Assets

	Governmental Activities 2004	Business- Type Activities 2004	Total 2004	Total 2003
Current and other assets	\$ 61,590,789	\$ 20,545,358	\$ 82,136,147	\$ 87,007,714
Capital assets	75,655,611	34,558,438	110,214,049	96,415,474
Total Assets	137,246,400	55,103,796	192,350,196	184,423,188
Long-term liabilities outstanding	12,538,056	17,162,640	29,700,696	29,927,091
Other liabilities	7,415,003	2,288,548	9,703,551	10,288,662
Total Liabilities	19,953,059	19,451,188	39,404,247	40,215,753
Invested in net capital assets	66,438,114	17,103,437	83,541,551	69,362,413
Restricted	1,721,635	4,319,128	6,040,763	11,366,989
Unrestricted	49,133,592	14,230,043	63,363,635	63,478,033
Total Net Assets	\$117,293,341	\$ 35,652,608	\$ 152,945,949	\$ 144,207,435

A portion of the City's net assets (5%, or \$6,007,476), within the governmental activities category, represent Special Revenue Fund resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets (\$57,356,159) may be used to meet the government's ongoing obligations to citizen services and creditors. A significant portion of this remaining balance is also subject to City Council directed capital project designations and policy reserves as indicated in the financial Note 7.

Statement of activities: On a City-wide basis, net assets increased by \$8,604,668 governmental activities, as a group, increased by \$6,974,017 and accounted for most of the growth in the net assets of the City.

**City of Manhattan Beach
Management's Discussion and Analysis (Continued)**

City of Manhattan Beach Changes in Net Assets

	Governmental Activities 2004	Business- Type Activities 2004	Total 2004	Total 2003
Program revenues:				
Charges for services	\$ 11,047,726	\$ 13,130,824	\$ 24,178,550	\$ 22,939,805
Operating contributions and grants	2,110,230	11,230	2,121,460	2,647,473
Capital contributions and grants	2,449,473	198,959	2,648,432	994,616
General revenues:				
Property taxes	11,223,986	-	11,223,986	10,021,646
Other taxes	15,153,734	-	15,153,734	14,749,308
Other	2,578,674	302,082	2,880,756	4,051,200
Total Revenues	44,563,823	13,643,095	58,206,918	55,404,048
Expenses:				
General government	6,843,576	-	6,843,576	6,513,233
Public safety	19,786,367	-	19,786,367	17,783,757
Public works	6,596,160	-	6,596,160	6,444,626
Parks and recreation	4,300,710	-	4,300,710	4,012,233
Interest on long-term debt	137,993	-	137,993	128,240
Water, Waste, Storm	-	7,347,450	7,347,450	7,320,432
Refuse	-	3,147,820	3,147,820	3,090,089
Parking	-	1,442,174	1,442,174	1,612,275
Total Expenses	37,664,806	11,937,444	49,602,250	46,904,885
Revenues Over Expenses	6,899,017	1,705,651	8,604,668	8,499,163
Transfers In (Out)	75,000	(75,000)	-	-
Increase in Net Assets	6,974,017	1,630,651	8,604,668	8,499,163
Net Assets - July 1, 2003	110,319,324	33,888,111	144,207,435	135,708,272
Restatement	-	133,846	133,846	-
Net Assets - June 30, 2004	\$117,293,341	\$35,652,608	\$152,945,949	\$144,207,435

Key elements of this increase are as follows:

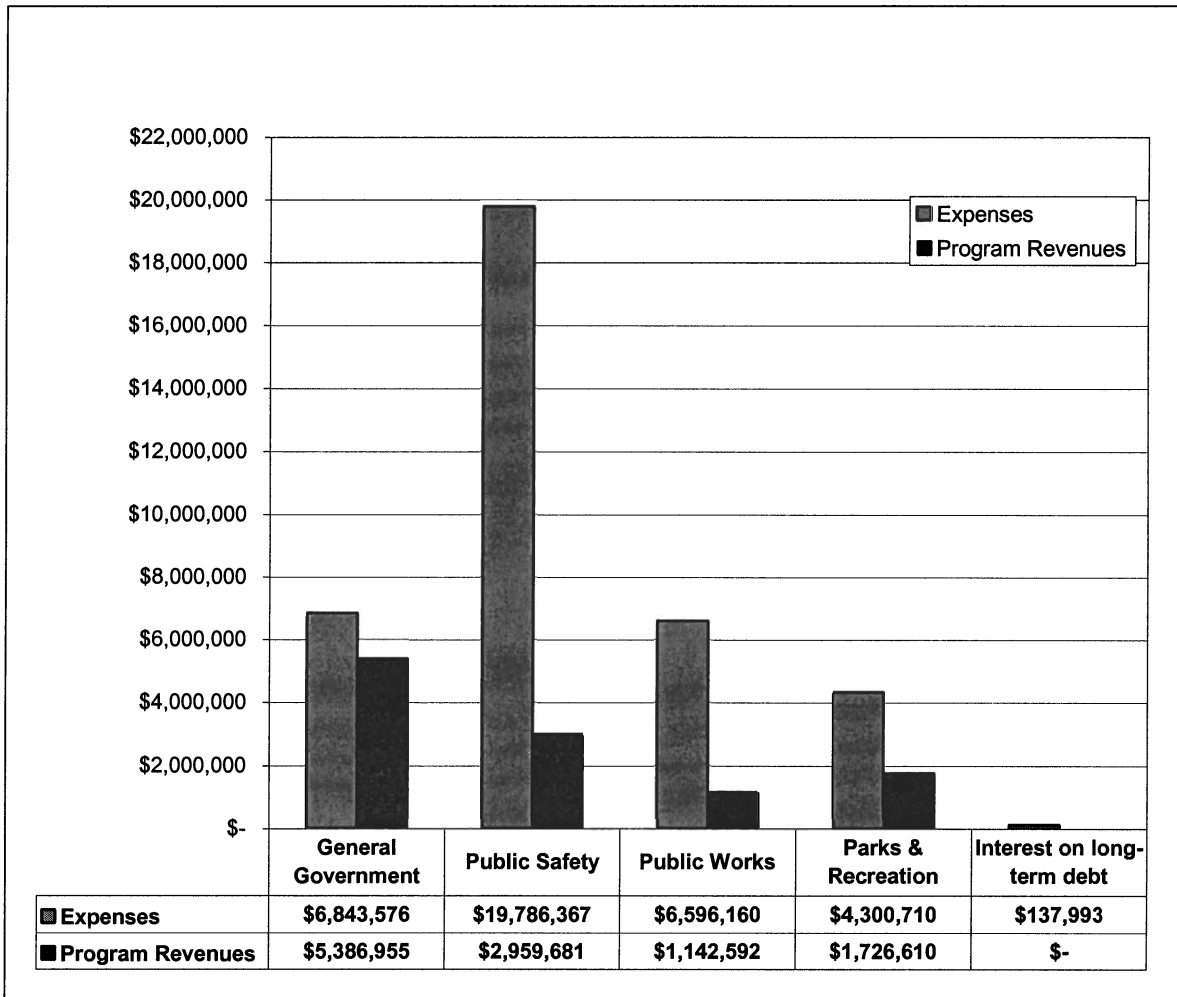
- In 2003-2004, the General Fund reported an operating surplus, before transfers, of \$3.6 million, which added to the overall strength of City-wide net asset balances.
- In 2003-2004, the Utility Funds reported an operating surplus, before transfers, of \$1.7 million, again, adding to the overall strength of City-wide net asset balances.
- In 2003-2004, the governmental group of funds benefited from \$1.5 million in one-time capital construction assessment pre-payments. This amount was recorded into a newly created Utility Underground Fund along with other capital improvement funds with the resulting pre-payments recorded as restricted cash holdings.

**City of Manhattan Beach
Management's Discussion and Analysis (Continued)**

- The difference in the method of accounting for capital assets in the governmental funds versus the statement of activities accounts for an increase of \$6.5 million in net assets considering both capital costs and depreciation. Governmental funds fully expend capital asset costs in the period they are acquired. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives.
- The use of cash reserves in the current year to fund the above mentioned capital assets results in a decrease of working capital of \$5 million.
- The difference in the method of accounting for long-term debt in the governmental funds versus the statement of activities accounts for an increase in \$300,000. Governmental funds fully expend principal payments in the period they are paid. However, in the statement of activities, such payments reduce the related liability.

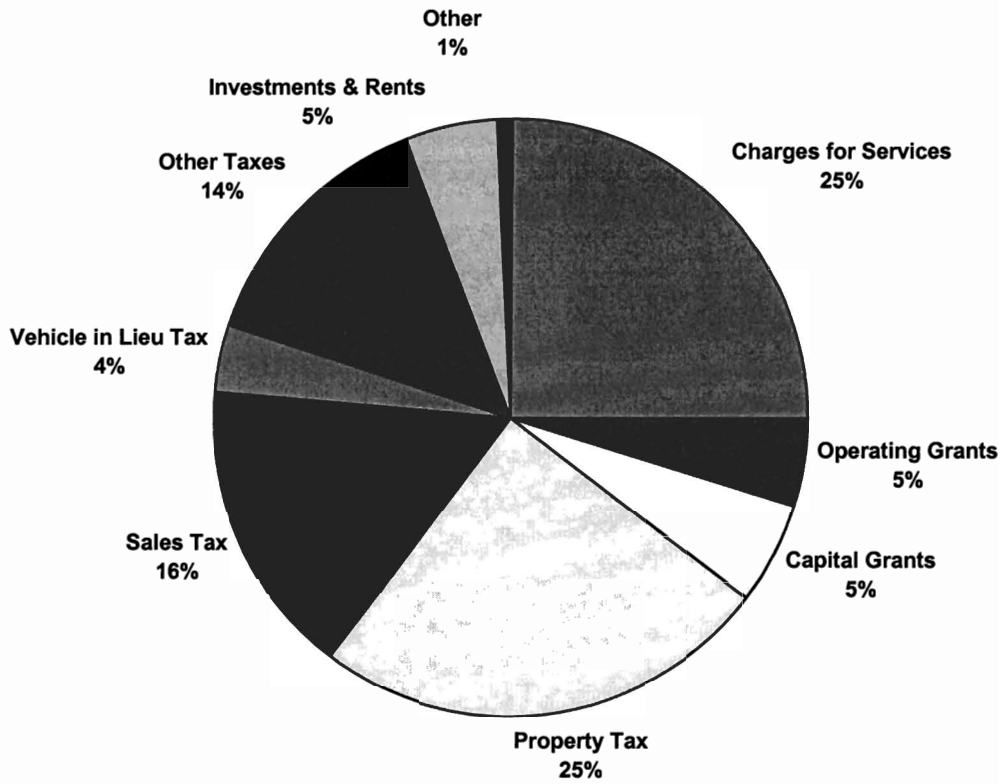
Government Activities

Expenses and Program Revenues - Governmental Activities - Fiscal Year 2004



**City of Manhattan Beach
Management's Discussion and Analysis (Continued)**

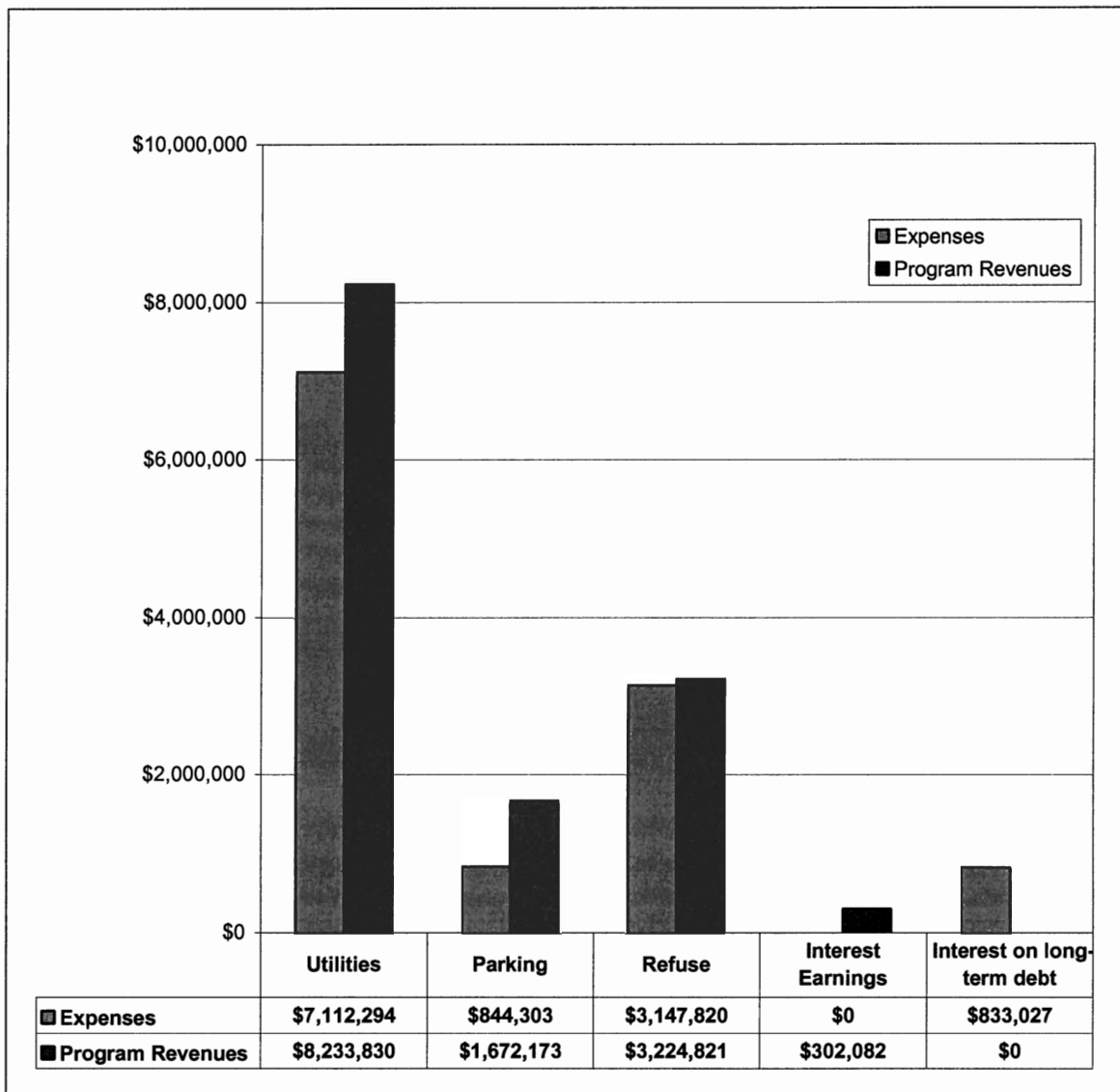
Revenues by Source - Governmental Activities - Fiscal Year 2004



**City of Manhattan Beach
Management's Discussion and Analysis (Continued)**

Business Type Activities

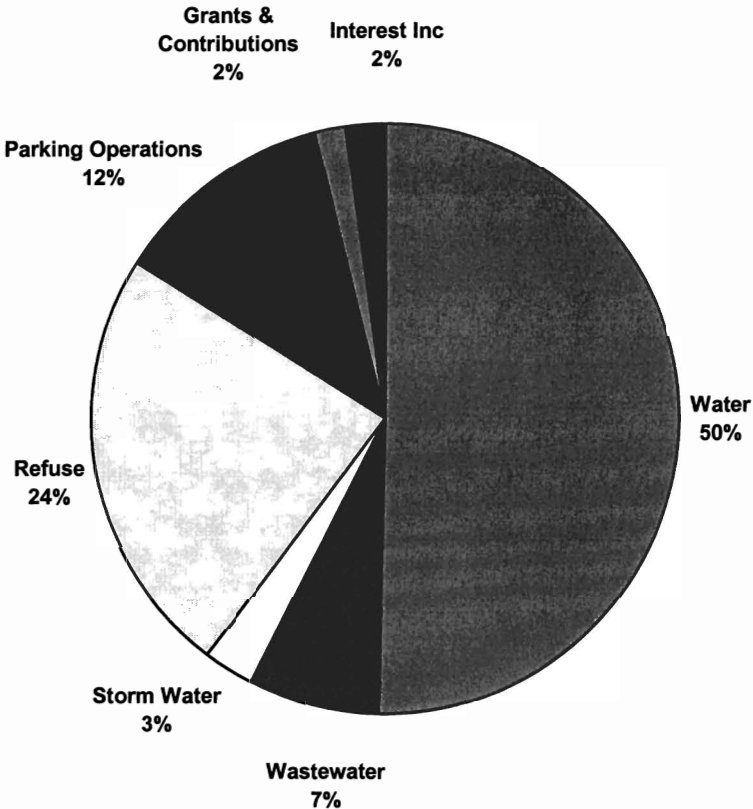
Expenses and Program Revenues - Business Type Activities - Fiscal Year 2004



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

- Water
- Wastewater
- Storm Water
- Refuse
- Parking

Revenues by Source - Business Type Activities FY 2004



In fiscal year 2003-2004, revenues for the City's business type activities amounted to \$13,643,095, including \$210,189 in grants and contributions. All other revenue is derived from operations and investment earnings. Total operating expenses equaled \$11,937,444 for a positive operating income of \$1,705,651 before transfers. When considering the impact of the transfer out of \$75,000 from the parking funds, net assets increased by \$1,630,651 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 \$49.3 million, an increase of \$700,000 in comparison with the prior year. Approximately 88% of this total amount, \$43.3 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 construction contracts and purchase orders of the prior period (\$5.98 million), and 2) to reserve for prepaid items and debt service (\$97,723).

**City of Manhattan Beach
Management's Discussion and Analysis (Continued)**

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 \$43.3 million unreserved governmental fund balance noted above, \$32.5 million has been designated by City Council actions, and \$3 million remain in restricted use special revenue funds. Considering these designations, \$7.8 million in governmental fund balances remain unreserved and undesignated.

General Fund

The General Fund is the chief operating fund of the City of Manhattan Beach. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$20.2 million, while total fund balance reached \$20.7 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 58% of total General Fund expenditures, while total fund balance represents 59% of that same amount.

During the current fiscal year, General Fund revenues exceeded expenses by approximately \$3.6 million. Along with transfer activity out of this fund of \$900,000, fund balance increased by \$2.7 million. The current year transfer activity included:

- \$975,000 transferred to the Capital Improvement Fund to further build reserves for the construction of the new public safety facility and Strand Walkway improvements;
- \$75,000 received from the County Lot Fund in accordance with existing agreements.

Capital Improvement Fund

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

At the end of the current fiscal year, unreserved fund balance of the Capital Improvement Fund was \$8.19 million, while total fund balance reached \$9.19 million. It is critical to note that \$8.16 million of the unreserved balance has been specifically earmarked for planned infrastructure projects leaving an unreserved and undesignated balance of \$22,154 as indicated in Note 7 to these financial statements. Key designations at year-end include:

- \$5.50 million for the construction of a new Police and Fire facility
- \$2.56 million for improvements to the Strand Walkway
- \$100 thousand for improvements to Artesia Boulevard

During the current fiscal year, the fund balance of the City's Capital Improvement Fund decreased significantly by \$15.7 million mainly due to the following transfer activity from and to the fund. These transfers mark the final chapter in a planned accumulation of reserves to finance the City's most significant capital projects, the Police and Fire Facility and the Strand Walkway:

- \$17.5 million to the Police and Fire Construction Fund
- \$975 thousand from the General Fund for capital project funding

Dedicated revenues in this fund amounted to \$1.2 million. These sources have been recorded in the Capital Project Fund and are earmarked for funding general government capital improvement projects in the effort to maintain and enhance City infrastructure. A breakdown of these follows:

**City of Manhattan Beach
Management's Discussion and Analysis (Continued)**

Hotel Tax: In September 1998, City Council approved an increase in the transient occupancy tax from 8.5% to 10%. This has resulted in the generation of \$324,244 of revenue for the year, an amount which is 6% above prior year levels marking a turn around after the impact of the September 11 terrorist strike.

Parking Meter Rates: In fiscal year 2001, City Council approved an increase of on-street parking meter rates from \$0.50 to \$0.75 per hour. This has resulted in additional parking meter revenue of \$550,026 this fiscal year. Actual revenues were ahead of budget estimates and 3% above the prior year.

Parking Citation Rates: City Council approved an increase of most parking citation rates from \$26 to \$30 in fiscal year 2001. This increase resulted in parking citation revenue of \$124,496 this current year, an increase of 14% over the prior year.

Capital Improvement Fund expenditures equaled \$779,260, which included \$295,000 in design costs for the Strand Walkway project, \$229,057 in Polliwog Park improvements, and \$288,346 for other City-wide projects. The Strand Walkway project will extend into fiscal year 2004-2005 and is projected to cost \$4.5 million. \$2.6 million in designated reserves for this project have been set aside within the Capital Improvement Fund in the current year with the balance being designated in fiscal year 2004-2005.

As mentioned above \$17.5 million was transferred from the Capital Improvement Fund to the newly created Police and Fire Construction Fund in the current year. Beyond this transfer, the Capital Improvement Fund has designated an additional \$5.5 million in reserves, which will be used to fund the project schedule for completion in December 2005. The construction contract for the new facility was awarded in fiscal 2003-2004 and construction began in February 2004. The total cost of this project approximates \$41 million and will be funded through a combination of cash reserves and debt issuance.

Other Governmental Funds

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

In 2003-2004, these funds operated within budget guidelines. Combined fund balances at year-end approximated \$6 million, an increase of \$322,949 over 2003. Changes in fund balances for this group can be expected to fluctuate as capital projects are expended over time.

Proprietary Funds

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

At year-end, total net assets of all proprietary funds amounted to \$35.7 million, of which \$14.2 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 \$1.7 million before transfers. Net assets increased for all funds by \$1.6 million including a \$75,000 transfer out to the General Fund from county parking lot operations.

**City of Manhattan Beach
Management's Discussion and Analysis (Continued)**

Unrestricted net assets of the internal service funds at the end of the year amounted to \$2.4 million with a net assets total of \$4.4 million. Net assets decreased by \$192,294 mostly due to continued rising insurance costs and investments made in updating our technology systems.

In May of 2002, parking lot meter rates were increased by \$0.25 to \$0.50 per hour. As a result of these changes, the parking fund experienced additional parking meter revenue of \$46,000 over the prior year and \$167,000 over the base year of increase. This additional income, which has not yet realized the full operational potential of the Metlox development, will assist in funding the debt service related to the construction of downtown's newest public parking structure and town square.

General Fund Budgetary Highlights

The difference between the original budget and the final amended budget was an increase of \$685,224 and can be briefly summarized as follows:

- \$586,354 to roll forward 2002-2003 active purchase orders provided for in prior reserve balances and budgets.
- \$84,000 of funding for Fire Department mutual aid overtime in response to regional California fires.
- \$11,237 of funding for police uniforms and safety equipment.
- \$3,633 of assistance funding for beach litter patrol.

\$98,870 of the current year budget adjustments was appropriated from available fund balance. On an overall basis within the General Fund, expenditures were \$1.1 million less than budgetary estimates including these budget adjustments, thus eliminating the need to draw upon existing fund balance. Other budget adjustments included reclassifications from planned contingency accounts resulting in a net zero change on the overall budget.

Capital Asset and Debt Administration

Capital Assets: The City's investment in capital assets government wide as of June 30, 2004, amounts to \$110,214,049 (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 2004	Business- Type Activities 2004	Total 2004	Total 2003
Land	\$ 33,634,566	\$ 1,757,434	\$ 35,392,000	\$ 35,392,000
Buildings	10,872,609	13,284,936	24,157,545	12,310,379
Machinery and Equipment	1,630,502	334,733	1,965,235	1,538,610
Vehicles	1,955,587	-	1,955,587	2,047,398
Infrastructure	27,562,347	19,181,335	46,743,682	45,127,087
Total	\$ 75,655,611	\$ 34,558,438	\$ 110,214,049	\$ 96,415,474

**City of Manhattan Beach
Management's Discussion and Analysis (Continued)**

During the current fiscal year, several large dollar additions to governmental capital assets were realized making up an overall increase of \$8.2 million. These additions include the following:

- \$5.6 million of inception to date work in progress costs towards the construction of a new Police and Fire facility. Construction commenced in February 2004 following design and engineering costs incurred in the prior year.
- \$1.6 million of City-wide street improvement projects the bulk of which related to the City-wide street resurfacing program, Aviation resurfacing, construction of the new 13th Street extension and Strand Walkway improvement design costs.
- \$786,979 of vehicle and machinery purchases.
- \$229,000 of Polliwog Park improvements.

During the current fiscal year, several large dollar additions to business activity assets were realized making up an overall increase of and additional \$8.2 million. These additions include the following:

- \$6.8 million for the substantial completion of the Metlox two-level subterranean parking structure, which opened for use in fiscal year 2003-2004. Approximately \$2 million remains to be spent in the next year for completion of utility extensions and the public plaza.
- \$1.4 million in Water, Storm and Wastewater system improvements mainly related the upgrade of water valve systems, line improvements and the 13th Street extension project.

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 \$30,437,037. Of this amount, \$26,610,000 relates to outstanding Certificates of Deposit. A breakdown of this debt is as follows:

City of Manhattan Beach Outstanding Liabilities

	Governmental Activities 2004	Business- Type Activities 2004	Total 2004	Total 2003
Marine Ave Park COPs	\$ 9,155,000	\$ -	\$ 9,155,000	\$ 9,335,000
Capital Equipment Lease	62,495	-	62,495	178,061
Accrued Employee Leave and Benefits	1,741,710	57,645	1,799,355	1,764,049
Water and Wastewater COPs	-	4,105,000	4,105,000	4,190,000
Metlox Parking COPs	-	13,350,000	13,350,000	13,350,000
Insurance Claim Reserves	1,965,188	-	1,965,188	1,631,245
Total Liabilities	12,924,393	17,512,645	30,437,038	30,448,355
Current	386,338	350,004	736,342	521,264
Long-Term Liabilities	\$ 12,538,055	\$ 17,162,640	\$ 29,700,696	\$ 29,927,091

The City's total debt decreased by \$226,395 (1%) during the current fiscal year due to scheduled principal payments.

**City of Manhattan Beach
Management's Discussion and Analysis (Continued)**

State statutes limit the amount of general obligation debt a governmental entity may issue to 15% of its total assessed valuation. The current debt limitation for the City of Manhattan Beach is \$283,291,313. 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 2004-2005 was adopted by the City Council in June 2004. Major projects and initiatives include:

Metlox Public Improvements

Fiscal year 2002-2003 marked the commencement of the construction of a City-owned two-level subterranean parking structure as part of the Metlox public improvement project. Valued at \$14.6 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 parking structure was completed on time and within budget. The mixed use commercial development portion of the project began in summer 2004 and will include retail, restaurant, office and a boutique style inn. Completion is anticipated for summer 2005. 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 originally issued in 2002-2003.

Public Safety Facility

A new state-of-the-art public safety facility has been in the works for several years. The new building will house both Police and Fire personnel as well as providing additional subterranean parking for the Civic Center and downtown area. Design has been ongoing for the past couple of years, and in the current year, a contract was awarded for the construction of the new facility. The total cost of construction is budgeted at \$41 million. Construction began in February 2004 with completion scheduled for December 2005. Preliminary project costs of nearly \$8 million for services such as architectural and engineering have been incurred through fiscal year 2003-2004. This project will be funded through the use of existing City reserves which have been funded in full through the fiscal year 2004 -2005 budget. In November 2004, the City issued \$12.9 million in debt in the form of fixed rate certificates of participation to fully fund the project beyond the amount provided by internal cash reserves. The project is currently within budget.

The construction of the Police and Fire facility will consume \$20 million in working capital and require the related debt service to be funded from dedicated revenue sources in the Capital Improvement Fund. The use of these reserves for this project, combined with the cost of the Strand Walkway improvements discussed below, places limitations on the City's ability to fund new major projects in future years as is evident in the City's capital improvement plan.

Strand Walkway Improvements

The 2004-2005 capital improvement plan officially appropriated \$4 million for the Strand Walkway Improvement project and cash reserves for the full cost have been established within the Capital Improvement Fund. Designs have been completed and the project is scheduled to commence in early 2005.

Utility Under-grounding

The 2004-2005 capital improvement plan includes \$5.15 million, including reimbursement costs, for the completion of utility under-grounding as approved by voter initiatives within three beach-front districts. In August 2004, the City administered the issuance of \$3.3 million in special assessment district bonds which will fund construction. Pre-payments of \$1.5 million were collected from participating residents making up the remainder of the project cost. Debt service in future years will be paid through annual homeowner assessments collected with property tax and as such these bonds are not recorded as City debt. As we look into future years, several other such under-grounding districts are anticipated to be formed.

**City of Manhattan Beach
Management's Discussion and Analysis (Continued)**

Other capital improvements for fiscal year 2004-2005 include \$1.4 million in street improvements, and \$1 million in Water, Wastewater and Storm Water line improvements, the most substantial being \$500,000 for annual line replacements.

ECONOMIC FACTORS

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

Our major General Fund revenue sources remain stable. Property Tax, which is our single biggest source, has experienced growth of 7% to 12% 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 are encouraged by modest gains in this area and stability through the recovery period. Transient Occupancy Tax, which suffered greatly from the effects of September 11, came in at a 7% increase from the lows of the past two years as we hope to get back to 2001 levels. All in all our largest revenue streams appear to be holding their own.

In November 2004, the voters overwhelmingly approved Proposition 1A which added some protection for local government revenues from future state take backs. In the short term, the City will experience a \$700,000 loss of vehicle license fees in both fiscal year 2005 and 2006. Additionally, the state will divert one fourth of our sales tax revenues, but replace it dollar-for-dollar with property tax. While this appears to be revenue neutral, the conversion of sales tax to property tax will change our cash flow since property tax is received twice a year, while sales tax is remitted monthly. While Proposition 1A has added some protection to our revenues, we remain cautious about the impact of the state's budgetary problems on our community and the services we provide.

Interest earnings 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 and Fire reserves in fiscal year 2004-2005 will result in a significant decline for this revenue source. Considering rate reductions and the use of \$17.5 million in Police and Fire construction reserves, interest earnings are expected to decline by over \$800,000. We expect further declines as Police and Fire reserves are fully expended in fiscal year 2004-2005. Clearly, current year levels will not be reproduced in the foreseeable future.

On the expense side of the equation, we have fully quantified and calculated the severe impact of increasing pension retirement rates and resulting costs. This represents an escalating cost which must be controlled in the future if we are to meet our long-term financial plans. Rising medical and worker compensation insurance costs remain a concern. City forecasts predict an increase of annual operating costs approximating \$2 million beginning in fiscal year 2004-2005. Clearly the maintenance of cost control plays a critical role in balancing the fiscal equation considering the relative slow rate of revenue growth currently in play.

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.