

City of McMinnville, Oregon

Management's Discussion and Analysis

The "Management's Discussion and Analysis" (MD&A) section of the City of McMinnville's (City) *Comprehensive Annual Financial Report* presents a narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2010. Readers are encouraged to consider the information presented here in conjunction with additional information furnished in the City's "Letter of Transmittal", of this *Comprehensive Annual Financial Report (CAFR)*. In an effort to make the MD&A more readable, all amounts have been rounded to the nearest million or in some cases thousand.

Financial Highlights

Government-Wide:

- The assets of the City exceeded liabilities by \$134.7 million at June 30, 2010. This compares to \$132.5 million for the prior year.
- The net assets balance of \$134.7 million is composed of investments in capital assets, net of related debt, such as buildings, parks and roads (\$103.2 million), restricted amounts for future capital projects, debt service, and a non-expendable library endowment (\$3.5 million), and an unrestricted balance (\$28.0 million), which may be used to meet the government's ongoing obligations to citizens and creditors.

Fund Level:

- The City's governmental funds report a combined fund balance of \$13.4 million, a decrease of \$3.3 million from last fiscal year. Approximately \$5.8 million of that total is reserved by legal or contractual provisions. The remaining \$7.5 million is unreserved. The decrease is primarily due to the spending down of bond proceeds for capital improvement projects.
- Total property taxes increased \$0.4 million or almost four percent. Property taxes are used to fund general government, public safety, cultural and recreational operations and to pay debt service. The increase in property tax revenue resulted from increases in assessed property values and new construction.
- The City's proprietary funds report a net assets balance of \$60.3 million, an increase of \$3.0 million over the prior year. The increase was primarily due to a \$0.7 million increase in cash and investments and a \$2.6 million decrease in non-current liabilities due to principal payments on loans and revenue bonds.

Overview of the Financial Statements

The discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The basic statements include three components: 1) government-wide financial statements; 2) fund financial statements; and 3) notes to the basic financial statements. This report contains other supplementary information in addition to the basic financial statements and required information.

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Government-wide financial statements: The government-wide financial statements are prepared using the full accrual method of accounting similar to private-sector accounting. Both the Statement of Net Assets and the Statement of Activities 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 users fees and charges (business-type activities).

These government-wide financial statements include three reporting units; i.e., governmental activities and business-type activities that are combined for the primary government total, and the component unit, McMinnville Water & Light Department (Department). Governmental activities of the City are General Government, Public Safety, Community Development, Culture and Recreation, Airport, and Highways and Streets. Business-type activities for the City are Wastewater, Ambulance and Building.

- **Statement of Net Assets:** This statement includes all assets and liabilities with the difference reported as net assets. Evaluating increases or decreases in net assets over time can serve as a useful indicator of whether the financial position of the City is improving or deteriorating.
- **Statement of Activities:** This statement presents information showing how the government's net assets changed during the fiscal year. The statement reports governmental and business-type activities' function/program expenses and program revenues and indicates the amount that must be supplemented by general revenues. General revenues include property taxes, franchise fees, and unrestricted state shared revenues and investment earnings.

Fund financial statements: These statements focus on major governmental and proprietary funds separately. The City's major governmental funds are each presented separately and the remaining non-major funds are combined into a column titled "Total Non-Major Governmental Funds." Statements for the City's proprietary and fiduciary funds follow the governmental statements.

- **Governmental funds:** Governmental funds are used to account for the 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 expendable resources, as well as on balances of expendable resources available at the end of the fiscal year. This fund reporting method may be more useful in evaluating the City's short-term financial requirements and position.

The City maintains ten governmental funds, three of which are considered major funds. All funds that receive property tax revenues have been classified as major funds; i.e., General Fund and Debt Service Fund. The Airport Maintenance Fund is also classified as a major fund to be consistent with the prior year. The remaining governmental funds, four special revenue and three capital projects, are classified as non-major funds and are aggregated for reporting in the fund financial statements. Non-major governmental funds data is provided in combining and individual fund statements.

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- **Proprietary funds:** The City maintains two types of proprietary funds, enterprise funds and internal service funds.
 - Enterprise funds are used to account for Wastewater Services, Ambulance Services and Building operations. Enterprise funds use the full accrual method of accounting, as do the government-wide financial statements; therefore, no separate reconciliation is necessary.
 - Internal service funds are used to accumulate and allocate costs internally among the operating funds. The City's internal service funds are Information Systems & Services and Insurance Services. These funds are included with the proprietary funds in the fund financial statements and with the governmental activities in the government-wide financial statements, since the funds served are primarily governmental activities.
- **Fiduciary fund:** The City maintains one fiduciary fund, an agency fund, which is used to account for the Length of Service Award Program (LOSAP) for the City's volunteer firefighters. The primary purpose of the LOSAP is to provide retirement income for volunteers in recognition of their service to the City. The assets of the plan remain in the name of the City. The agency fund is described in more detail in the notes to basic financial statements of the *CAFR*, Note IV. D. 2.

Notes to basic financial statements: The notes to basic financial statements are essential to a complete understanding of the government-wide and fund financial statements.

Other information: In addition to the basic financial statements and accompanying notes, this report also presents certain required and other supplementary information. This includes budget and actual comparisons for each fund, property tax and debt service schedules, and a schedule of expenditures of federal awards.

Statistical section: The statistical section includes a number of financial schedules to enable the reader to understand the City's overall financial health. This section presents multi-year summaries for financial trends, revenue capacity, debt capacity, demographic and general operating information.

Independent certified public accountants reports: These reports provide supplemental communication on City compliance and internal controls as required by Oregon Statutes and Federal Law.

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Government-Wide Financial Analysis

Statement of Net Assets:

The following table reflects a summary of Net Assets compared to the prior fiscal year:

Government-Wide --- Comparative Summary Statement of Net Assets June 30, 2010 and 2009 (in millions)

	City of McMinnville – Primary Government						Component Unit	
	Governmental Activities		Business – Type Activities		Total City		Department	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Cash and investments	\$15.1	\$19.2	\$19.3	\$18.7	\$ 34.4	\$ 37.9	\$ 17.3	\$ 35.6
Other assets	2.0	1.7	1.6	1.8	3.6	3.5	8.4	6.1
Capital assets	<u>81.0</u>	<u>79.6</u>	<u>49.7</u>	<u>49.6</u>	<u>130.7</u>	<u>129.2</u>	<u>113.9</u>	<u>97.2</u>
Total assets	<u>98.1</u>	<u>100.5</u>	<u>70.6</u>	<u>70.1</u>	<u>168.7</u>	<u>170.6</u>	<u>139.6</u>	<u>138.9</u>
Other liabilities	1.8	2.7	0.9	0.5	2.7	3.2	5.3	6.3
Non-current liabilities	<u>19.9</u>	<u>20.6</u>	<u>11.4</u>	<u>14.3</u>	<u>31.3</u>	<u>34.9</u>	<u>1.6</u>	<u>1.7</u>
Total liabilities	<u>21.7</u>	<u>23.3</u>	<u>12.3</u>	<u>14.8</u>	<u>34.0</u>	<u>38.1</u>	<u>6.9</u>	<u>8.0</u>
Investment in capital assets, net of related debt	64.6	64.7	38.6	35.6	103.2	100.3	103.9	97.1
Restricted	3.2	3.0	0.3	0.4	3.5	3.4	-	-
Unrestricted	<u>8.6</u>	<u>9.5</u>	<u>19.4</u>	<u>19.3</u>	<u>28.0</u>	<u>28.8</u>	<u>28.8</u>	<u>33.8</u>
Total net assets	<u>\$76.4</u>	<u>\$77.2</u>	<u>\$58.3</u>	<u>\$55.3</u>	<u>\$134.7</u>	<u>\$132.5</u>	<u>\$132.7</u>	<u>\$130.9</u>

For the City, assets exceeded liabilities by \$134.7 million at the end of the current fiscal year. The largest portion of the City's net assets are invested in capital assets and are reported net of related outstanding debt (\$103.2 million). The City uses these capital assets to provide services to its citizens. Therefore, they do not represent resources available for future spending. Restricted net assets total \$3.5 million and represent amounts that are legally restricted for capital expansion, debt service, or other purposes. Finally, the remaining \$28.0 million is unrestricted, meaning it is available for meeting the City's ongoing obligations.

- City --- Comparative Summary Statement of Net Assets – Governmental Activities:** Total net assets decreased by \$0.8 million. This resulted from a decrease of \$3.7 million in restricted cash and investments as bond proceeds were spent down to pay for Public Safety and Civic Buildings and Park Development construction projects. This decrease was offset by a \$1.4 million increase in capital assets as construction projects were completed. Also, non-current liabilities decreased \$0.7 million primarily due to principal payments on general obligation bonds.
- City --- Comparative Summary Statement of Net Assets – Business-Type Activities:** Total net assets increased by \$3.0 million. Cash and investments increased by \$0.6 million due to the City's decision in previous years to fund capital projects from operating funds. The City has established a policy to build a reserve of \$7.5 million to fund future capital improvements. At fiscal year end, that reserve was \$4.4 million. Non-current liabilities decreased \$2.9 million due to principal payments on loans and revenue bonds.
- Component Unit - Department --- Comparative Summary Statement of Net Assets:** The Department's overall financial position remained stable during fiscal year 2009-10 with minimal change in net assets. Cash and investments decreased \$18.3 million, while capital assets increased by \$16.7 million. This is the result of funding construction projects internally. Liabilities decreased by \$1.1 million, largely due to a reduction in accounts payable and winding down of water treatment plant expenditures.

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Statement of Activities:

Total net assets of the City increased by \$2.2 million from the prior fiscal year. Governmental activities net assets decreased by \$0.8 million and business-type activities increased by \$3.0 million.

Government-Wide --- Comparative Summary Statement of Activities For the Years Ended June 30, 2010 and 2009 (in millions)

	City of McMinnville – Primary Government						Component Unit	
	Governmental Activities		Business – Type Activities		Total City		Department	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Revenues:								
Program revenues:								
Charges for services	\$ 3.8	\$ 3.7	\$10.9	\$11.0	\$ 14.7	\$ 14.7	\$ 35.3	\$ 34.6
Operating grants and contributions	2.6	1.7	-	-	2.6	1.7	0.5	0.2
Capital grants and contributions	1.1	3.3	-	-	1.1	3.3	0.3	0.4
General revenues:								
Property taxes	11.6	11.1	-	-	11.6	11.1	-	-
Franchise taxes	2.2	2.1	-	-	2.2	2.1	-	-
Other	<u>0.7</u>	<u>0.9</u>	<u>0.1</u>	<u>0.3</u>	<u>0.8</u>	<u>1.2</u>	<u>1.8</u>	<u>3.7</u>
Total revenues	<u>22.0</u>	<u>22.8</u>	<u>11.0</u>	<u>11.3</u>	<u>33.0</u>	<u>34.1</u>	<u>37.9</u>	<u>38.9</u>
Expenses:								
Governmental activities:								
General government	2.1	2.4	-	-	2.1	2.4	-	-
Community development	1.3	1.2	-	-	1.3	1.2	-	-
Public safety	9.9	9.8	-	-	9.9	9.8	-	-
Highways and streets	3.5	3.6	-	-	3.5	3.6	-	-
Culture and recreation	5.6	5.5	-	-	5.6	5.5	-	-
Airport	0.5	0.6	-	-	0.5	0.6	-	-
Interest on long-term debt	0.8	0.9	-	-	0.8	0.9	-	-
Business-type activities:								
Wastewater	-	-	5.8	5.9	5.8	5.9	-	-
Ambulance	-	-	2.5	2.3	2.5	2.3	-	-
Building	-	-	0.4	0.6	0.4	0.6	-	-
Component unit	-	-	-	-	-	-	<u>36.1</u>	<u>33.3</u>
Total expenses	<u>23.7</u>	<u>24.0</u>	<u>8.7</u>	<u>8.8</u>	<u>32.4</u>	<u>32.8</u>	<u>36.1</u>	<u>33.3</u>
Change in net assets before transfers	(1.7)	(1.2)	2.3	2.5	0.6	1.3	1.8	5.6
Transfers	<u>(0.5)</u>	<u>(1.2)</u>	<u>0.5</u>	<u>1.2</u>	-	-	-	-
Change in net assets	<u>(2.2)</u>	<u>(2.4)</u>	<u>2.8</u>	<u>3.7</u>	<u>0.6</u>	<u>1.3</u>	<u>1.8</u>	<u>5.6</u>
Beginning net assets	77.2	79.6	55.3	51.6	132.5	131.2	130.9	125.3
Change in accounting principle	<u>1.4</u>	-	<u>0.2</u>	-	<u>1.6</u>	-	-	-
Ending net assets	<u>\$76.4</u>	<u>\$77.2</u>	<u>\$58.3</u>	<u>\$55.3</u>	<u>\$134.7</u>	<u>\$132.5</u>	<u>\$132.7</u>	<u>\$130.9</u>

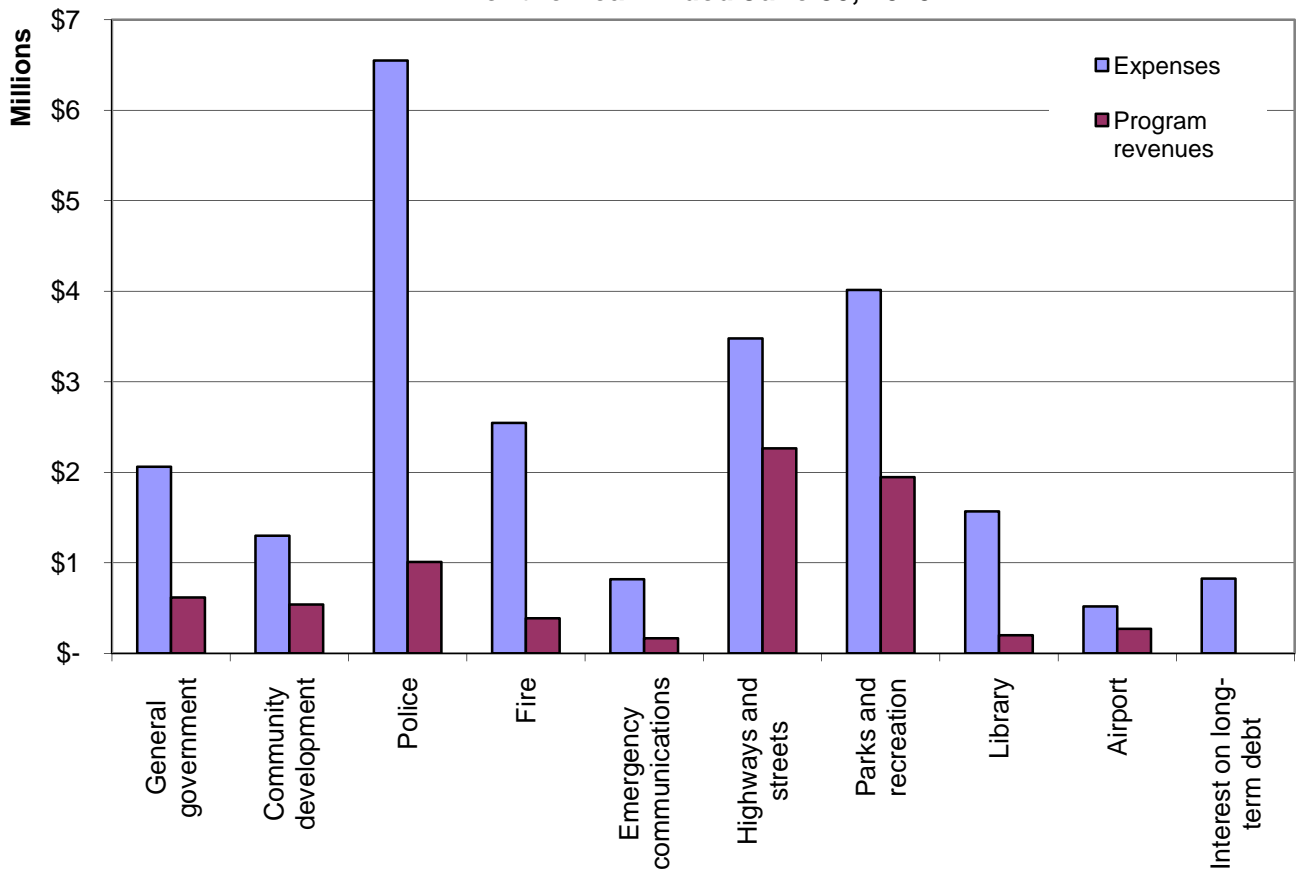
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- City --- Comparative Summary Statement of Activities – Governmental Activities:** Program revenues decreased \$1.2 million. This resulted from a combination of factors. Operating grants and contributions revenue increased by \$0.9 million primarily due to an intergovernmental energy efficiency incentive. This increase was offset by a decrease in capital grants and contributions revenue of \$2.2 million primarily due to a decrease in airport Federal Aviation Administration (FAA) grants.

Total expenses for governmental activities decreased \$0.3 million. Expenses for community development, public safety, highways and streets, culture and recreation, and airport were relatively consistent with the prior fiscal year. However, general government expenses decreased by \$0.3 million due to a significant loss on disposal which in occurred in fiscal year 2008-09 when the old police station was demolished.

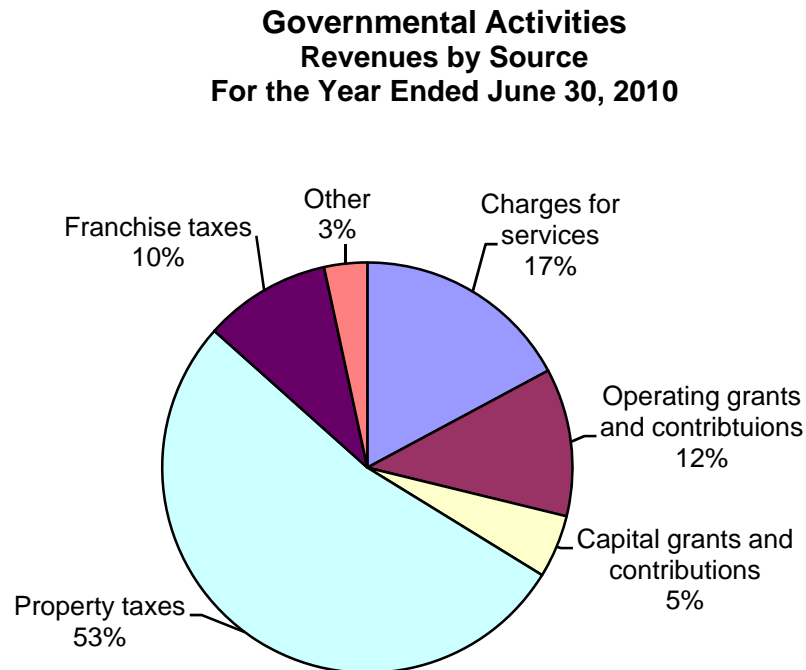
The following bar chart compares each governmental activity expense with the revenue stream for each activity.

Governmental Activities
Expenses and Program Revenues by Function
For the Year Ended June 30, 2010



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The following pie chart illustrates the relative size of revenue sources for governmental activities.



City --- Comparative Summary Statement of Activities – Business-Type Activities: Revenues for business-type activities decreased by \$0.3 million. This decrease is attributable to several factors, including \$0.1 million in charges for services (wastewater user fees and system development charges). Although cash and investments for business-type activities increased \$0.6 million, unrestricted investment earnings decreased by \$0.2 million due to significantly lower interest rates compared to the prior fiscal year.

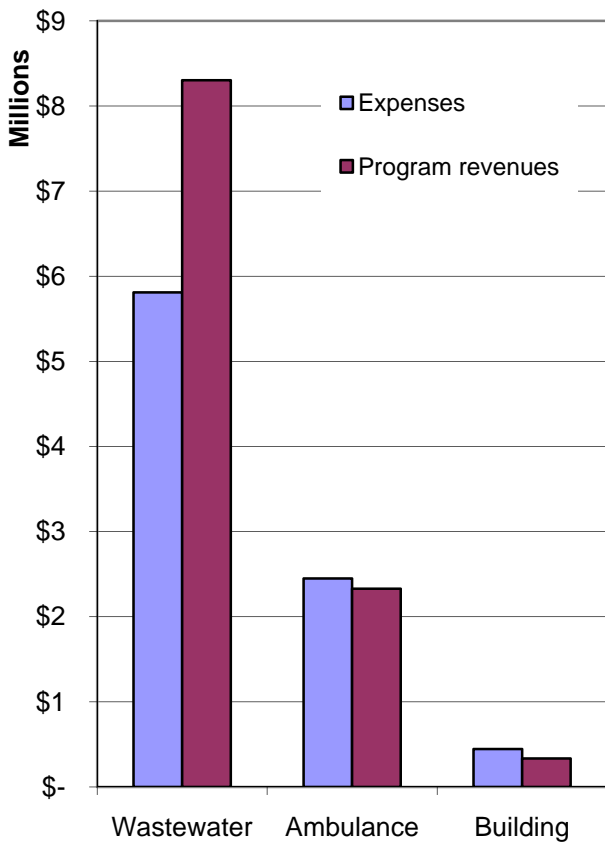
Total expenses for business-type activities decreased in the current fiscal year by \$0.1 million. This was primarily due a reduction in expenses for Building operations, which resulted from decreased construction activity. Expenses for Wastewater and Ambulance operations remained relatively consistent with the prior year.

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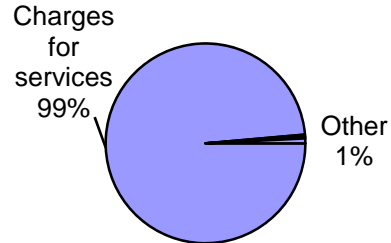
The bar chart on the left below compares each business-type activity expense with the revenue stream for that activity. The significant difference between wastewater revenue and expenses is due to the financial policy set by City Council to set sewer rates at a level to establish an approximate \$7.5 million reserve by the year 2014.

The pie chart on the right below illustrates the relative size of revenue sources for business-type activities.

**Business-Type Activities
Net Expenses and Program
Revenues by Function
For the Year Ended June 30, 2010**



**Business-Type Activities
Revenues by Source
For the Year Ended June
30, 2010**



Component Unit - Department --- Comparative Summary Statement of Activities: Revenue for the Department decreased overall by \$1.0 million. Increased consumption of electricity resulted in an increase in charges for services revenue of \$0.7 million. This was offset by a decrease in general revenues of \$1.9 million which was largely due to a reduction in interest income from lower rates earned on investments and a reduction in timber harvesting net income. Expenses increased \$2.8 million mainly due to higher power costs in combination with a \$1.2 million decrease of Other Post-Employment Benefit (OPEB) expense due to the recognition of the entire net OPEB obligation in the prior fiscal year.

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Fund Financial Analysis

Fund accounting segregates revenues according to their intended purposes and is used to aid management in demonstrating legal and contractual compliance with revenue source spending requirements.

Governmental Funds – Comparative Ending Fund Balances June 30, 2010 and 2009 (in thousands)

	Ending Fund Balances						Net Change 2010
	Unreserved		Reserved		Total		
	2010	2009	2010	2009	2010	2009	
Major funds:							
General	\$ 6,287	\$ 7,262	\$ 111	\$ 97	\$ 6,398	\$ 7,359	\$ (961)
Airport maintenance	671	567	-	-	671	567	104
Public safety facilities construction(1)	-	-	-	466	-	466	(466)
Park development(2)	-	36	-	4,357	-	4,393	(4,393)
Debt service	-	-	1,282	1,070	1,282	1,070	212
Non-major funds	<u>573</u>	<u>716</u>	<u>4,429</u>	<u>2,109</u>	<u>5,002</u>	<u>2,825</u>	<u>2,177</u>
Total ending fund balance	<u>\$ 7,531</u>	<u>\$ 8,581</u>	<u>\$ 5,822</u>	<u>\$ 8,099</u>	<u>\$ 13,353</u>	<u>\$ 16,680</u>	<u>\$ (3,327)</u>

- (1) Public Safety Facilities Construction Fund was a major fund in 2009 and a non-major fund in 2010. 2010 reserved fund balance was \$161 thousand.
- (2) Park Development Fund was a major fund in 2009 and a non-major fund in 2010. 2010 reserved fund balance was \$2,204 thousand and unreserved fund balance was \$31 thousand.

City --- Governmental Funds: Governmental fund financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they are measurable and available and expenditures generally are recorded when a liability is incurred, except for long-term liabilities.

The General Fund is the City's main operating fund. At fiscal year end, the unreserved fund balance was \$6.3 million compared to \$7.3 million at prior year end. The decrease resulted from management's decision to spend down the General Fund reserve to fund operations. Expenses for personal services, including salaries and wages and fringe benefits, are increasing at a faster pace than revenues, resulting in the \$1.0 million deficit.

The General Fund is currently used to account for Administration, Finance, Engineering, Planning, Police, Municipal Court, Fire, Parks and Recreation, and Library. Fiscal year 2009-10 General Fund revenues, excluding property taxes, increased 12 percent from the prior fiscal year, primarily due to intergovernmental incentives of \$642,000 for an energy efficiency project at the Aquatic Center. All other revenue classifications, including licenses and permits, charges for services, fines and forfeitures, and miscellaneous revenues, were relatively consistent with the prior year. Property tax revenue increased by nearly four percent, due to increases in assessed property values and new construction.

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The Debt Service Fund balance is increasing as the City builds a reserve for debt service payments that are due early in the following fiscal year prior to receipt of property tax revenue. For the Public Safety and Courtroom/Civic Buildings and the Parks Improvements bonds, principal and interest payments of approximately \$1.3 million are due in August of each fiscal year.

Proprietary Funds – Comparative Ending Net Assets June 30, 2010 and 2009 (in thousands)

	<u>Unrestricted</u>		<u>Restricted</u>		<u>Invested in Capital Assets Net of Related Debt</u>		<u>Total</u>		<u>Net Change</u>
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2009</u>
Fund:									
Wastewater	\$ 18,626	\$ 18,697	\$ -	\$ -	\$ 37,511	\$ 34,658	\$ 56,137	\$ 53,355	\$ 2,782
Ambulance	1,117	937	-	-	718	543	1,835	1,480	355
Building	-	-	284	375	345	360	629	735	(106)
Internal Service	769	636	-	-	907	1,139	1,676	1,775	(99)
Total ending net assets	<u>\$ 20,512</u>	<u>\$ 20,270</u>	<u>\$ 284</u>	<u>\$ 375</u>	<u>\$ 39,481</u>	<u>\$ 36,700</u>	<u>\$ 60,277</u>	<u>\$ 57,345</u>	<u>\$ 2,932</u>

City --- Proprietary Funds: The basis of accounting for proprietary funds is the same as found in the government-wide financial statements; i.e., full accrual. Total ending net assets increased by \$2.9 million over the prior fiscal year. \$2.7 of the increase is attributable to the City Council's commitment to funding a reserve for future wastewater system improvements. Ambulance Fund net assets increased slightly while Building Fund net assets decreased due to operating expenditures exceeding building permit revenue. Internal service funds include Information Systems & Services and Insurance Services Funds. The Information Systems & Services Fund net assets decreased due to a reduction in charges for services revenue and an increase in depreciation expense compared to the prior fiscal year.

General Fund Budgetary Highlights

During the fiscal year, three resolutions were adopted by the City Council which amended the fiscal year 2009-10 General Fund budget. Two resolutions authorized General Fund contingency transfers totaling \$249,000, as follows:

- \$215,000 for public safety personal services costs and building repairs
- \$10,000 for library building repairs
- \$24,000 for general administration and finance costs

A third resolution authorized a General Fund supplemental budget of \$107,000, allowing the City to spend insurance proceeds and donations to replace a totaled fire vehicle.

The General Fund budget for fiscal year 2009-10 provided for a \$2.3 million decrease in ending fund balance. The actual decrease in ending fund balance was \$1.0 million, a difference of \$1.3 million. Actual General Fund revenues were relatively consistent with budgeted revenues. However, actual expenditures were approximately \$1.0 million less than budgeted. This was due to management's conservative fiscal policies and the resultant savings in all General Fund departments.

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Capital Assets

Government-Wide Capital Assets June 30, 2010 and 2009 (in millions)

	Governmental Activities		Business-Type Activities		Total City	
	2010	2009	2010	2009	2010	2009
Land	\$ 27.6	\$ 27.3	\$ 0.9	\$ 0.9	\$ 28.5	\$ 28.2
Easements	1.4	-	0.2	-	1.6	-
Public Art	0.1	-	-	-	0.1	-
Land improvements	16.2	14.1	0.1	0.1	16.3	14.2
Buildings	32.6	28.2	41.6	41.5	74.2	69.7
Machinery and equipment	5.6	5.2	1.3	1.1	6.9	6.3
Vehicles	3.4	3.5	1.2	1.4	4.6	4.9
Infrastructure	48.1	47.3	34.7	34.0	82.8	81.3
Construction in progress	0.4	4.2	1.1	0.1	1.5	4.3
Total capital assets	135.4	129.8	81.1	79.1	216.5	208.9
Accumulated depreciation	(54.4)	(50.2)	(31.4)	(29.5)	(85.8)	(79.7)
Net capital assets	\$81.0	\$79.6	\$49.7	\$49.6	\$130.7	\$129.2

- **City --- Capital Assets:** The City's total net capital assets increased \$1.5 million from the prior fiscal year. Per Governmental Accounting Standards Board Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, the City has included easements as capital assets in fiscal year 2009-10.
- Governmental activities capital assets increased \$1.4 million. Land increased due to property acquired for a linear park. Land improvements increased due to \$2.1 million in park improvements partially funded with proceeds from the 2001 Park Improvement Bonds. Buildings increased by \$4.4 million as construction of the Civic Hall was completed and construction in progress was reduced correspondingly.
- For business-type activities, net capital assets increased \$0.1 million. The change consisted of a \$2.0 million increase in total capital assets, primarily consisting of inflow and infiltration reduction projects. This increase was offset by a \$1.9 million increase in accumulated depreciation.

City and Department capital assets are described in more detail in the notes to the financial statements of the CAFR, Note III. D.

Debt Administration

Government-Wide Outstanding Debt June 30, 2010 and 2009 (in millions)

	Governmental Activities		Business-Type Activities		Total City	
	2010	2009	2010	2009	2010	2009
General obligation bonds	\$18.8	\$19.7	\$ -	\$ -	\$18.8	\$19.7
Revenue bonds	-	-	11.1	13.6	11.1	13.6
Notes payable	-	-	-	0.4	-	0.4
Total outstanding debt	\$18.8	\$19.7	\$11.1	\$14.0	\$29.9	\$33.7

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City --- Outstanding Debt: At June 30, 2010, the City had \$29.9 million in outstanding debt compared to \$33.7 million last year. Of that total, \$0.9 million of the debt related to governmental activities is due within one year. For business-type activities, \$2.6 million is due within one year. Outstanding debt for governmental and business-type activities decreased as debt service payments reduced principal balances and no new debt was issued. Also, for business-type activities, the debt for a wastewater note payable was retired.

The \$18.8 million governmental activities general obligation debt is payable from property taxes levied specifically for that purpose. All the \$11.1 million business-type activity debt is payable exclusively from wastewater revenues. City and Department outstanding debt are described in more detail in the notes to the financial statements of the *CAFR*, Note III. H.

City --- Bond Ratings: The City received an A2 general obligation bond debt rating from Moody's Investor's Services, Inc. when the Public Safety and Civic Buildings Bonds were sold in November 2006. The City received an A3 Sewer Revenue Bond debt rating from Moody's Investor's Services, Inc. in December 2003 during the process of refunding a significant portion of wastewater debt outstanding. The City has not issued any new bonds since 2006.

Economic Factors and Future Operations

Governmental activities: The economic pressures affecting the City's governmental operations continue to be significant. After the 1996 property tax limitation measure, Oregon governmental operating property taxes became rate based and each entity was given a permanent rate depending on the entity's prior property tax levies. With 48 percent of governmental activities funded by property taxes, the City's ability to meet the demand for services is significantly impacted by the rate of increase in assessed value and new construction. Cost pressures exist in all areas of governmental operations, but most notably in increases for salaries, medical insurance, and retirement benefit contributions.

Business-type activities:

- **Wastewater operations ---** Since the 1993-94 financing of the new Water Reclamation Facility and sewer system improvements, the City has established an outstanding record of meeting the challenges of increased environmental regulations. Meeting these regulatory challenges has not come without a cost; the City's sewer rates are among the highest in the state. The City Council adopted a plan that recommended 2.75 percent rate increases for the next several years, although the City Council opted to not raise sewer rates the last two fiscal years due to the challenging economic environment. Even though rates were not raised in the last two years, it is still projected that revenue will be adequate to fund operational and debt service requirements and build a reserve of approximately \$7.5 million for future expansion of the Water Reclamation Facility. During fiscal year 2009-10, the City completed a wastewater master plan update, which projects that this reserve can be used to fund short-term expansion. Moderate annual rate increases from two to four percent will be necessary beginning in fiscal year 2011-12 and in subsequent years to continue a "pay as you go" funding strategy for wastewater capital improvements.
- **Ambulance operations ---** The ambulance service has experienced significant challenges over the last several years with the proliferation of retirement facilities in the city and the reduction in Medicare and Medicaid reimbursement rates. As the City increases the fees charged for ambulance services, the collection rate has trended downward because the Medicare and Medicaid reimbursement rates have not increased correspondingly. The collection rate was 68.4 percent in fiscal year 2002-03 and 48.9 percent in fiscal year 2009-10. In the past several years, property tax subsidies have helped fund ambulance operations and will continue to be necessary in the future.

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- **Building operations** --- In fiscal years 2008-09 and 2009-10, Building operations expenditures have exceeded revenue due to limited construction activity. It is projected that the fund will have an adequate operating reserve in fiscal year 2010-11. However, a subsidy from the General Fund may be necessary in subsequent years. We anticipate that building construction activity will resume in the future and that a subsidy may not be necessary.

Additional economic factors affecting McMinnville are described in the transmittal letter of this report.

Information Requests

The City's *Comprehensive Annual Financial Report* has been prepared to provide a general overview of the City of McMinnville's finances. City management hopes that interested parties will find this document readable and helpful in assessing the City's overall financial health. The City's Finance Director, Marcia Baragary, CPA, will answer any questions interested parties might have about the report or provide additional information as requested. She may be reached by mail at 230 NE Second Street, McMinnville, OR 97128, by telephone at 503-434-2350, or by email at Marcia.Baragary@ci.mcminnville.or.us.

