

City of McMinnville, Oregon Management's Discussion and Analysis

City of McMinnville (City) management provides readers of these financial statements this narrative overview and analysis of the City's financial activities for the fiscal year ended June 30, 2007. Please read this *Management Discussion and Analysis (MD&A)* in conjunction with the City's *Letter of Transmittal*, pages 3–12, 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

- **City government-wide assets exceeded liabilities by \$123.8 million:** Of this amount, \$95.5 million is invested in capital assets, \$2.9 million is restricted, and \$25.4 million is available for day-to-day operation.
- **City government-wide net assets increased by \$9.5 million:** Of the \$9.5 million increase, governmental activities increased \$5.2 million and business-type activities increased \$4.3 million.
 - The governmental activities increase resulted most significantly, \$2.9 million, from the highways and streets program. The remaining \$2.3 million increase is primarily a result of general revenues exceeding governmental activity expenses.
 - The business-type activities increase resulted mainly from the wastewater program.
- **City government-wide revenues increased \$3.0 million:** For governmental activities, program revenues increased \$1.7 million and general revenues \$0.6 million. For business-type activities, program revenues increased \$0.5 million, and general revenues increased \$.2 million.
 - The governmental activities revenue increase is due to developer capital contribution of roads transferred to the City upon subdivision completion and transportation system development charges awaiting the updated *Transportation Master Plan* for project designation. Also, governmental activities general revenues increased most significantly due to the maximum assessed valuation increase of the city which increased property taxes \$0.4 million.
 - The business-type activities revenue increase results almost entirely from the 2.75 percent increase in sewer rates resulting from the City Council adoption of an updated *Sewer Rate Study* in 2003-2004.
- **City government-wide program expenses increased \$0.7 million:** For governmental activities, expenses increased \$0.6 million; and for business-type activities, expenses increased \$0.1 million.
 - Governmental activities expense increased primarily due to personal services costs. The City extended a 2.8 percent cost of living adjustment to all full-time employees at July 1, 2006 with certain additional union and managerial salary parity adjustments.
 - Business-type activities expense had a small increase as the wastewater program is in the process of updating the *1994 Collection System Facility Plan*, the *1991 Storm Drainage Master Plan*, and engineering and designing for water reclamation facility off-line storage.
- **City's government-wide cash and investments increased \$16.8 million and long-term liabilities increased \$9.0 million:** For governmental activities, cash and investments increased \$14.6 million and long-term liabilities increased \$11.6 million. For business-type activities, cash and investments increased \$2.2 million and long-term liabilities decreased \$2.6 million.
 - Governmental activities cash and investments increased most significantly due to the \$13.3 million (\$0.2 million premium) public safety civic buildings bond proceeds. The

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governmental activities liability increase is a combination of the \$13.1 million public safety civic buildings bond sale and the debt service payments for 2006-2007.

- Business activities cash and investments increase is totally due to the wastewater program accumulating a reserve per City Council policy and the business-type activities long-term liabilities decrease is totally due to the wastewater system annual debt repayment.
- **Component Unit government-wide net assets and activities:** Department net assets increased \$8.4 million to \$117.6 million; Department revenues increased \$1.8 million; and Department expenses increased \$2.3 million.

Overview of the Financial and Statistical Sections

The City *CAFR*'s basic financial statements are comprised of the following three sections: 1) government-wide financial statements; 2) fund financial statements; and 3) notes to the basic financial statements. The *CAFR* also contains a significant amount of additional financial information, a statistical section, and independent certified public accountant reports.

Government-wide financial statements: The government-wide financial statements are prepared using the full accrual method of accounting similar to private-sector accounting. The government-wide financial statements present 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, community development, public safety – police, public safety – fire, public safety – emergency communications, highways and streets, culture and recreation – parks and recreation, culture and recreation – library, airport, and interest on long-term debt. Business-type activities for the City are wastewater services and ambulance. The government-wide financial statements are found on pages 39–41 of the *CAFR*.

- **Statement of Net Assets:** This statement reports all assets and liabilities with the difference reported as net assets. In the government-wide financial statements, governmental activities report capital assets, including infrastructure and the associated depreciation, and long-term liabilities.
- **Statement of Activities:** This statement reports governmental activities' function/program expenses and then "matches" them with function/program dedicated revenues computing cost of the function/program that must be supplemented by general governmental activities revenue sources that are primarily property taxes, franchise fees, payments-in-lieu of taxes from the Department, and state shared revenues. The statement also reports function/program business-type activities and the Department using the same format, disclosing whether the activity has shown an increase or decrease in net assets for the year.

Fund financial statements: In governmental accounting, funds are used to maintain accounting control over resources dedicated for specific activities or functions/programs. Fund financial statements can be found on pages 46–65 in this *CAFR*.

- **Governmental funds:** Governmental funds are used to account for essentially the same functions/programs reported as governmental activities in the government-wide financial statements; although the fund financial statements use the modified accrual method of accounting that does not report capital assets, including infrastructure and the associated depreciation or long-term liabilities. This fund reporting method may be more useful in evaluating the City's short-term financial requirements and position. Reconciliations between the fund financial statements and the government-wide financial statements are found on pages 49 and 53.

The City maintains fourteen governmental funds, seven of which are considered major funds. All funds that receive property tax revenues have been classified as major funds; i.e., General, Fire,

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Parks and Recreation, Improvements, and Debt Service Funds. The Park Development Fund and the Public Safety Civic Buildings Construction Fund are also classified as major funds due to the significant park renovation and improvement projects currently funded by the \$9.5 million park improvement bonds issued in 2001 and the Police Station and the City Council/Municipal Courtroom buildings to be constructed from the \$13.1 million public safety civic buildings bonds issued in 2006. The remaining governmental funds, five special revenue and two capital projects, are classified as non-major funds and are combined into a single, aggregated presentation for reporting in the fund financial statements. Non-major governmental funds data is provided in combining and individual fund statements and schedules found on pages 108–111. Budgetary comparison statements are included for the General Fund and each major special revenue fund with the fund financial statements on pages 54-62. Budgetary comparison statements for non-major special revenue, capital projects, and debt service funds are included with the supplemental information on pages 112-121.

- **Proprietary funds:** The City maintains two types of proprietary funds, enterprise funds, and internal service funds.
 - Enterprise funds are used to report the same functions/programs presented as business-type activities in the government-wide financial statements. The City's Wastewater Services and Ambulance Funds are enterprise funds. The 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 an accounting device used to accumulate and allocate costs internally among the City's various functions/programs. The City uses internal service funds to account for information systems and services and insurance coverages. These funds are included with the proprietary funds in the fund financial statements and included with the governmental activities in the government-wide financial statements, since the funds served are primarily governmental activities.

Notes to the financial statements: The notes to the financial statements are essential to a complete understanding of the government-wide and fund financial statements. The notes to the financial statements are found on pages 69–102 in the *CAFR*.

Supplementary information:

- **Combining and individual fund statements and schedules:** In addition to the basic financial statements, the *CAFR* contains significant additional information.
 - Combining financial statements: Governmental non-major fund combining financial statements are presented. These financial statements aggregate the non-major governmental funds; pages 108–111. Internal service fund combining financial statements are presented and aggregated, pages 122–124.
 - Budgetary comparison schedules: Budgetary comparison schedules for each individual fund not presented as part of the fund financial statements are presented for the governmental funds on pages 112–121 and for proprietary funds - enterprise and internal service funds - on pages 125–129.
- **Other financial schedules:** Additional information of interest to report to readers is included in this section. Schedules include federal financial assistance, future debt service requirements, property tax transactions, and accountability for independently elected officials, pages 134–140.

Statistical section: The City adopted *Governmental Accounting Standards Board (GASB) Statement No. 44, Economic Condition Reporting: The Statistical Section – an amendment of NCGA Statement 1*, during fiscal year ended June 30, 2006. This statement added to and modified the statistical

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schedules in the Statistical Section of the CAFR. This section presents multi-year summaries for financial trends, revenue capacity, debt capacity, demographic and economic, and operating information, pages 144–186.

Independent certified public accountants reports: State of Oregon statutes require municipal auditors to include additional communications on certain compliance and internal controls of the City. These Talbot, Korvola & Warwick LLP reports are located at the end of the *CAFR*.

Government-Wide Financial Analysis

The Government-Wide Statement of Net Assets reports all assets and liabilities with the difference reported as net assets. This statement should, over time, serve as a useful indicator of whether the financial position of the City and the Department are improving or deteriorating. In the government-wide financial statements, governmental activities report capital assets, including infrastructure and the associated accumulated depreciation, and long-term liabilities.

Government-Wide --- Comparative Summary Statement of Net Assets June 30, 2007 and 2006 (in millions)

	City of McMinnville – Primary Government						Component Unit	
	Governmental Activities		Business – Type Activities		Total City		Department	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Cash and investments	\$32.0	\$17.4	\$14.0	\$11.8	\$ 46.0	\$ 29.2	\$ 39.2	\$ 33.2
Other assets	2.1	2.2	1.3	1.3	3.4	3.5	4.5	4.3
Capital assets	<u>66.9</u>	<u>64.4</u>	<u>52.2</u>	<u>52.8</u>	<u>119.1</u>	<u>117.2</u>	<u>78.0</u>	<u>76.0</u>
Total assets	<u>101.0</u>	<u>84.0</u>	<u>67.5</u>	<u>65.9</u>	<u>168.5</u>	<u>149.9</u>	<u>121.7</u>	<u>113.5</u>
Other liabilities	2.2	2.0	0.5	0.6	2.7	2.6	3.8	3.8
Long-term liabilities	<u>22.3</u>	<u>10.7</u>	<u>19.7</u>	<u>22.3</u>	<u>42.0</u>	<u>33.0</u>	<u>0.3</u>	<u>0.5</u>
Total liabilities	<u>24.5</u>	<u>12.7</u>	<u>20.2</u>	<u>22.9</u>	<u>44.7</u>	<u>35.6</u>	<u>4.1</u>	<u>4.3</u>
Investment in capital assets, net of related debt	62.9	59.5	32.6	30.7	95.5	90.2	78.0	76.0
Restricted	2.9	2.5	-	-	2.9	2.5	-	-
Unrestricted	<u>10.7</u>	<u>9.3</u>	<u>14.7</u>	<u>12.3</u>	<u>25.4</u>	<u>21.6</u>	<u>39.6</u>	<u>33.2</u>
Total net assets	<u>\$76.5</u>	<u>\$71.3</u>	<u>\$47.3</u>	<u>\$43.0</u>	<u>\$123.8</u>	<u>\$114.3</u>	<u>\$117.6</u>	<u>\$109.2</u>

Comparative Summary Statement of Net Assets – City and Department: The Comparative Summary Statement of Net Assets reports that the City's net assets increased \$9.5 million, an 8.3 percent increase, which is comprised of a \$18.6 million increase in assets with a \$9.1 million increase in liabilities. The Department's net assets increased \$8.4 million, a 7.7 percent increase, which is due to \$8.2 million increase in assets and \$0.2 million decrease in liabilities. The government-wide statement of net assets is located on page 39.

City --- Comparative Summary Statement of Net Assets – Governmental Activities: The governmental activities net asset increase of \$5.2 million, a 7.3 percent increase, is comprised of a \$17.0 million increase in assets and a \$11.8 million increase in liabilities.

- The \$17.0 million asset increase is due to a \$14.6 million increase in cash and investments, \$0.1 million decrease in other assets and \$2.5 million increase in capital assets.
- The \$11.8 million liability increase is due to a \$11.6 million increase in long-term liabilities and a \$0.2 million increase in other liabilities.

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City --- Comparative Summary Statement of Net Assets – Business-Type Activities: The business-type activities net asset increase of \$4.3 million, a 10.0 percent increase, is comprised of a \$1.6 million increase in assets and a \$2.7 million decrease in liabilities.

- The \$1.6 million asset increase is due to a \$2.2 million increase in cash and investments, no change in other assets, and a \$0.6 million decrease in net capital assets.
- The \$2.7 million liability decrease is due a \$0.1 million decrease in other liabilities and a \$2.6 million decrease in long-term liabilities.

Component Unit - Department --- Comparative Summary Statement Of Net Assets: The Department's net assets increase of \$8.4 million, a 7.7 percent increase, is due to \$6.0 million increase in cash and investments, \$0.2 million increase in other assets, \$2.0 increase in capital assets, no change in other liabilities, and \$0.2 million decrease in long-term liabilities.

Government-Wide --- Comparative Summary Statement of Activities For the Years Ended June 30, 2007 and 2006 (in millions)

	City of McMinnville – Primary Government						Component Unit	
	Governmental Activities		Business – Type Activities		Total City		Department	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Revenues:								
Program revenues:								
Charges for services	\$ 4.8	\$ 4.9	\$10.5	\$10.1	\$ 15.3	\$ 15.0	\$ 40.2	\$ 38.3
Operating grants and contributions	2.0	1.9	-	-	2.0	1.9	0.7	0.8
Capital grants and contributions	6.7	5.0	1.0	0.9	7.7	5.9	1.8	1.2
General revenues:								
Property taxes	9.4	9.0	-	-	9.4	9.0	-	-
Franchise taxes	2.3	2.2	-	-	2.3	2.2	-	-
Other	1.3	1.2	0.6	0.4	1.9	1.6	4.3	4.9
Total revenues	<u>26.5</u>	<u>24.2</u>	<u>12.1</u>	<u>11.4</u>	<u>38.6</u>	<u>35.6</u>	<u>47.0</u>	<u>45.2</u>
Expenses:								
Governmental activities	21.0	20.4	-	-	21.0	20.4	-	-
Business-type activities	-	-	8.1	8.0	8.1	8.0	-	-
Component unit	-	-	-	-	-	-	38.6	36.3
Total expenses	<u>21.0</u>	<u>20.4</u>	<u>8.1</u>	<u>8.0</u>	<u>29.1</u>	<u>28.4</u>	<u>38.6</u>	<u>36.3</u>
Change in net assets before transfers	5.5	3.8	4.0	3.4	9.5	7.2	8.4	8.9
Transfers	(0.3)	0.1	0.3	(0.1)	-	-	-	-
Change in net assets	5.2	3.9	4.3	3.3	9.5	7.2	8.4	8.9
Beginning net assets	71.3	67.4	43.0	39.7	114.3	107.1	109.2	100.3
Ending net assets	<u>\$76.5</u>	<u>\$71.3</u>	<u>\$47.3</u>	<u>\$43.0</u>	<u>\$123.8</u>	<u>\$114.3</u>	<u>\$117.6</u>	<u>\$109.2</u>

Comparative Summary Statement of Activities – City and Department: The Comparative Government-Wide Summary Statement of Activities reports program revenues, general revenues, and expenses disclosing whether the activity has shown an increase or decrease in net assets for the year. The comparative summary statement of activities reports the City's comparative change in net assets increased \$2.3 million from year ended June 30, 2006. The comparative change in net asset increase is comprised of a \$3.0 million revenue increase and a \$0.7 million expense increase. The Department's comparative change in net assets decreased \$0.5 million over the year ended June 30, 2006. The comparative change in net assets decrease is comprised of \$1.8 million revenue increase

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and \$2.3 million expense increase. The government-wide statement of activities is located on pages 40–41.

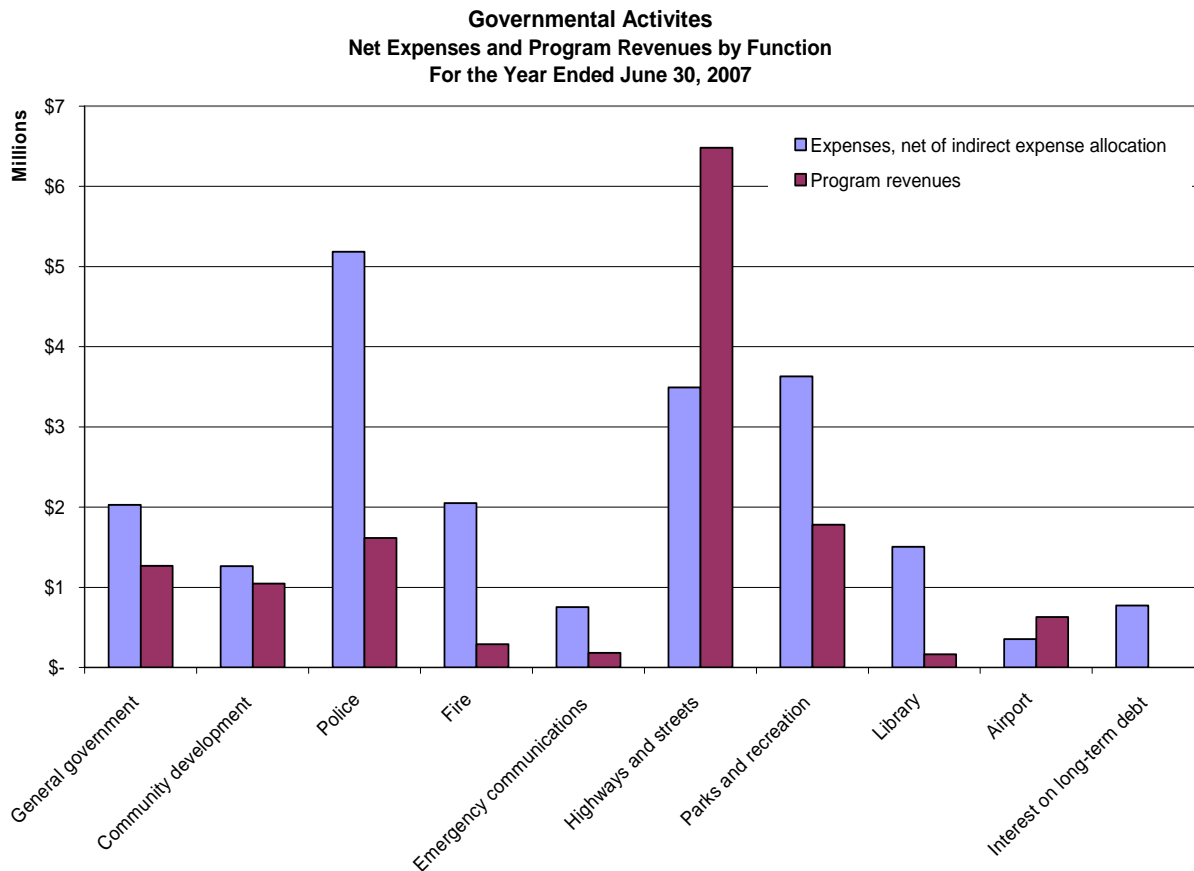
City --- Comparative Summary Statement of Activities – Governmental Activities: The Comparative Summary Statement of Activities as relates to governmental activities reports a \$5.5 million positive change in net assets before transfers, an increase of \$1.7 million over year ended June 30, 2006. The increase is comprised of \$2.3 million increase in revenue and \$0.6 million increase in expenses.

- The \$2.3 million governmental revenue increase, is a 9.5 percent revenue increase and is due to an increase of \$1.7 million in program revenues and \$0.6 million in general revenues. The program revenue increase is comprised of a decrease of \$0.1 million in charges for services, an increase of \$0.1 million in operating grants and contributions, and an increase of \$1.7 million in capital grants and contributions. The general revenue increase is comprised of increases of \$0.4 million in property taxes, \$0.1 million in franchise taxes, and \$0.1 million in other revenues.
- The \$0.6 million governmental activities expense increase, is a 2.9 percent increase in expenses.

Transfers out to business-type activities of \$ 0.3 million lowers the positive change in net assets to \$5.2 million.

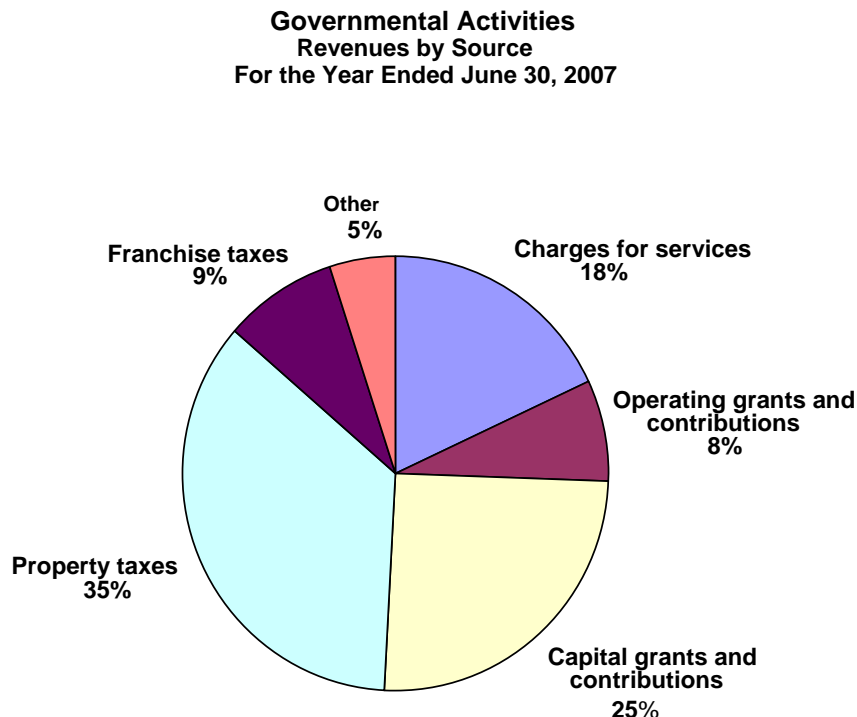
- The \$0.3 million transfer was to the Ambulance Fund to subsidize emergency medical service operations.

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



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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: The Comparative Summary Statement of Activities as relates to business-type activities reports a \$4.0 million positive change in net assets before transfers, a \$0.6 million increase over year ended June 30, 2006. The increase is comprised of \$0.7 million revenue increase and \$0.1 million expense increase:

- The \$0.7 million business-type revenue increase, a 6.1 percent increase, is due to increases of \$0.4 million in charges for services, \$0.1 million in capital grants and contributions, and \$0.2 million in other revenues.
- The \$0.1 million business-type expense increase is a 1.3 percent increase

Transfers in from governmental activities of \$0.3 million increases the positive change in net assets to \$4.3 million.

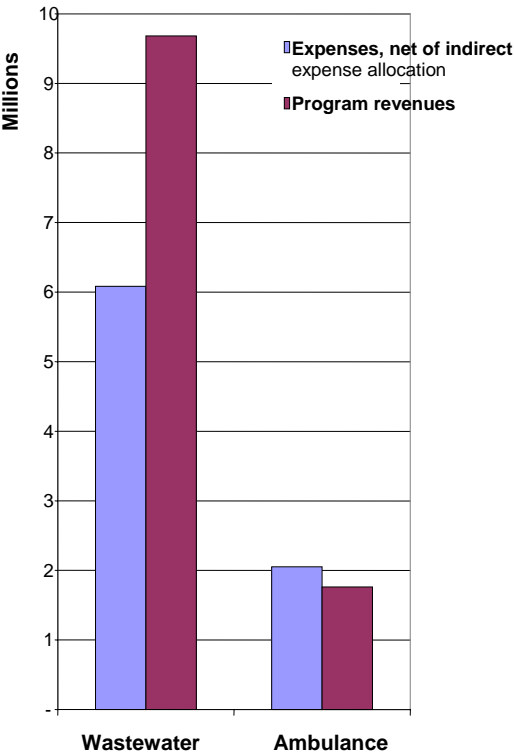
- The \$0.3 million transfer into the Ambulance Fund was from the Fire Fund to subsidize emergency medical service operations with property taxes.

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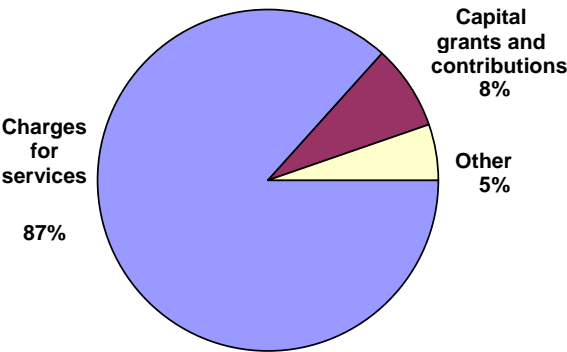
The bar chart on the left below compares each business-type activity expense with the revenue stream for that activity. The significant differential between wastewater revenue and expenses is a result of the financial policy set by City Council to set sewer rates at a level to establish an approximate \$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, 2007



Business-Type Activities
Revenues by Source
For the Year Ended June 30, 2007



Component Unit - Department --- Comparative Summary Statement of Activities: The Department’s Comparative Statement of Activities reports a \$8.4 million positive change in net assets, a \$0.5 million decrease from year ended June 30, 2006. This decrease resulted from a \$1.8 million revenue increase and a \$2.3 million expense increase.

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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, 2007 and 2006 (in thousands)

	Ending Fund Balances							
	Unreserved		Reserved		Total		Net Change	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Major funds:								
General	\$ 3,955	\$ 3,651	\$ 581	\$ 525	\$ 4,536	\$ 4,176	\$ 360	\$ (561)
Fire	1,602	1,242	-	-	1,602	1,242	360	(22)
Parks and recreation	1,638	1,607	-	-	1,638	1,607	31	(17)
Improvement	1,570	1,866	-	-	1,570	1,866	(296)	683
Debt service	-	-	657	585	657	585	72	(102)
Public safety buildings construction	-	-	12,905	-	12,905	-	12,905	-
Park development	-	-	5,076	4,525	5,076	4,525	551	319
Non-major funds	<u>1,424</u>	<u>800</u>	<u>1,754</u>	<u>1,535</u>	<u>3,178</u>	<u>2,335</u>	<u>843</u>	<u>565</u>
Total ending fund balance	<u>\$10,189</u>	<u>\$9,166</u>	<u>\$20,973</u>	<u>\$7,170</u>	<u>\$31,162</u>	<u>\$16,336</u>	<u>\$14,826</u>	<u>\$865</u>

City --- Governmental Funds: The basis of accounting for governmental funds is on near-term inflows, outflows, and fund balances of spendable resources; i.e., modified accrual; thus not recording capital assets or long-term debt as are reported in the government-wide financial statements. The chart above summarizes the unreserved, reserved, and total ending fund balances of the major governmental funds and the aggregated non-major funds along with the net change of fund balance from operations for years ended June 30, 2007 and 2006.

The governmental fund balances increased by \$14.8 million due to \$15.1 million of fund balance increases and a \$0.3 million fund balance decrease. Of particular interest in the 2007 Net Change Column above are the following:

- Increase in the General and Fire fund balances and decrease in the Improvements fund balance resulting from the City Council re-allocation of property tax dollars from improvement projects toward operations, in particular funding of three new police officer and three new fire fighter/paramedic positions.
- The Public Safety Civic Buildings Construction fund balance results from the \$13.1 million sale of the public safety buildings bond and the May 2007 ground breaking on the new Police Station.

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Proprietary Funds – Comparative Ending Net Assets June 30, 2007 and 2006 (in thousands)

	Ending Net Assets							
	Unrestricted		Invested in Capital Assets Net of Related Debt		Total		Net Change	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Fund:								
Wastewater	\$14,400	\$12,015	\$32,289	\$30,460	\$46,689	\$42,475	\$4,214	\$3,522
Ambulance	602	574	315	254	917	828	89	(189)
Internal service	<u>238</u>	<u>281</u>	<u>733</u>	<u>663</u>	<u>971</u>	<u>944</u>	<u>27</u>	<u>263</u>
Total ending net assets	<u>\$15,240</u>	<u>\$12,870</u>	<u>\$33,337</u>	<u>\$31,377</u>	<u>\$48,577</u>	<u>\$44,247</u>	<u>\$4,330</u>	<u>\$3,596</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. The chart above summarizes net assets as unrestricted and invested in capital assets net of related debt, and total ending net assets of the Wastewater Fund, Ambulance Fund, and internal service funds in the aggregate along with the net change from operations.

The proprietary funds comparative ending net assets increased by \$4.3 million over fiscal year ended June 30, 2006 net assets and is entirely due to positive net asset change increases. Of particular note in the 2007 Net Change Column above are the following:

- The \$4.2 million Wastewater Fund net asset increase reflects the City Council's commitment to not only funding current wastewater service operations, but to save toward future Water Reclamation Facility expansion and wastewater collection system improvements.
- The \$0.1 million Ambulance net asset increase results from the property tax subsidy of \$300,000 otherwise this fund would have had a decrease of net assets.

Budgetary Highlights

Each fiscal year a final budget adjustment contingency transfer resolution is made prior to year-end to reflect actual department spending patterns in response to changing service delivery needs or expenditure changes. The June 2007 contingency transfer resolution totaled \$299,000 as compared to \$532,000 in June 2006.

No supplemental budgets were passed during the 2006-2007 budget year.

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Capital Assets

Government-Wide Capital Assets June 30, 2007 and 2006 (in millions)

	Governmental Activities		Business-Type Activities		Total City	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Land	\$ 25.7	\$ 24.1	\$ 0.9	\$ 0.9	\$ 26.6	\$ 25.0
Land improvements	11.0	11.0	0.1	0.1	11.1	11.1
Buildings	19.6	17.6	40.9	40.6	60.5	58.2
Machinery and equipment	3.7	3.5	1.0	0.9	4.7	4.4
Vehicles	3.3	3.2	1.1	0.9	4.4	4.1
Infrastructure	44.6	41.8	32.8	31.7	77.4	73.5
Construction in progress	1.8	2.5	0.2	0.2	2.0	2.7
Total capital assets	<u>109.7</u>	<u>103.7</u>	<u>77.0</u>	<u>75.3</u>	<u>186.7</u>	<u>179.0</u>
Accumulated depreciation	(42.8)	(39.3)	(24.8)	(22.5)	(67.6)	(61.8)
Net capital assets	<u>\$66.9</u>	<u>\$64.4</u>	<u>\$52.2</u>	<u>\$52.8</u>	<u>\$119.1</u>	<u>\$117.2</u>

City --- Capital Assets: The City reported \$119.1 million invested in capital assets net of accumulated depreciation at June 30, 2007. The governmental activities net capital assets increased \$2.5 million and the business-type activities net capital assets decreased \$0.6 million.

The governmental activities \$2.5 million net capital assets increase resulted from \$6.0 million increase in capital assets and \$3.5 million increase in accumulated depreciation.

- The \$6.7 million increase in governmental activities capital assets is comprised of the following capital asset increases: \$1.6 million land, street right-of-way developer donations; \$2.0 million buildings, the purchased and remodeled new Community Development Center that now houses the Planning, Building, and Engineering offices and continued park system improvements; \$0.2 million machinery and equipment, most notably a fire record management system and new self-contained breathing apparatus air compressor fill station; \$0.1 million vehicles, primarily police vehicles; and \$2.8 million infrastructure, street and storm drainage system developer subdivision donations along with minor City paid projects.
- The \$0.7 million decrease in construction in progress reflects significant prior-year construction in progress placed in service during 2006-2007, most notably the new Community Development Center and park system improvements. The \$1.8 million remaining in construction in progress at year end is primarily related to five projects, BPA Westside Pedestrian/Bicycle Pathway, Police Station, City Council/Municipal Courtroom building, airport runway and taxiway project, and economic resource planning financial system software project.

The business-type activities \$0.6 million decrease in net capital assets resulted from a \$1.7 million increase in capital assets and a \$2.3 million increase in accumulated depreciation.

- The \$1.7 million increase in capital assets is comprised of the following capital asset increases: \$0.3 million building, the Water Reclamation Facility energy conservation and autothermal thermophilic aerobic digestion projects; \$0.1 million machinery and equipment, \$0.2 million vehicles, a wastewater service vehicle with truck-mounted crane and an emergency medical ambulance; and \$1.1 million infrastructure, sanitary sewer system developer subdivision donations along with City paid projects.
- The \$0.2 million in construction in progress at year-end is the Water Reclamation Facility telemetry upgrade project.

City and Department capital assets are described in more detail in the notes to the financial statements of the *CAFR*, note III. D. pages 82–84.

City of McMinnville - Management's Discussion and Analysis

Change in Government-Wide Capital Assets For the Years Ended June 30, 2007 and 2006

(in millions)

	Governmental Activities		Business-Type Activities		Total City	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Beginning balance	\$64.4	\$63.3	\$52.8	\$53.9	\$117.2	\$117.2
Additions	6.2	4.6	1.7	1.3	7.9	5.9
Net disposals	(0.1)	(0.1)	-	(0.1)	(0.1)	(0.2)
Depreciation expense	(3.6)	(3.4)	(2.3)	(2.3)	(5.9)	(5.7)
Ending balance	<u>\$66.9</u>	<u>\$64.4</u>	<u>\$52.2</u>	<u>\$52.8</u>	<u>\$119.1</u>	<u>\$117.2</u>

City --- Change in Capital Assets:

Governmental activities capital asset additions, shown net of construction in progress assets put into service, are \$6.2 million, which is \$5.0 million of assets placed in service and \$1.2 million new construction in progress.

Business-type activities capital asset additions, shown net of construction in progress assets put into service, are \$1.7 million, which is \$1.5 million of assets placed in service and \$0.2 million construction in progress at year-end. The net capital assets decreased due to depreciation in excess of additions. The completion of the *Water Reclamation Facility Capacity Review and Expansion Study*, update of the *1994 Collections System Facility Plan*, and update of the *1991 Storm Drainage Master Plan*, presently in process, will affect additions as new projects are designed and constructed.

Debt Administration

Government-Wide Outstanding Debt June 30, 2007 and 2006

(in millions)

	Governmental Activities		Business-Type Activities		Total City	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
General obligation bonds	\$21.0	\$ 9.3	\$ -	\$ -	\$21.0	\$ 9.3
Revenue bonds	-	-	18.3	20.4	18.3	20.4
Certificates of participation	0.4	0.6	-	-	0.4	0.6
Notes payable	<u>0.1</u>	<u>0.1</u>	<u>1.3</u>	<u>1.7</u>	<u>1.4</u>	<u>1.8</u>
Total outstanding debt	<u>\$21.5</u>	<u>\$10.0</u>	<u>\$19.6</u>	<u>\$22.1</u>	<u>\$41.1</u>	<u>\$32.1</u>

City --- Outstanding Debt: At June 30, 2007, the City had \$41.1 million in outstanding debt. Of that total \$21.5 million is governmental activities debt and \$19.6 million is business-type activities debt.

Of the \$21.5 million governmental activities debt, \$21.0 million is funded by a dedicated bonded debt service property tax levy. The remaining outstanding governmental activities debt of \$0.5 million must be paid through current resources, which is through operating property taxes. The governmental activities debt maturing within one year paid with the dedicated bonded debt service property tax levy is \$0.685 million principal with \$1.025 million interest and debt paid from governmental activities operating resources is \$222,000 principal with \$20,000 interest.

All the \$19.6 million business-type activity debt is either wastewater notes payable or revenue bonds and is payable exclusively from wastewater revenues. The amount of wastewater debt that matures in the next year and payable from wastewater revenues is \$2.6 million principal with \$0.8 million interest.

City of McMinnville - Management's Discussion and Analysis

City and Department outstanding debt are described in more detail in the notes to the financial statements of the *CAFR*, note III. F., pages 87–92.

Change in Government–Wide Outstanding Debt For the Years Ended June 30, 2007 and 2006 (in millions)

	Governmental Activities		Business-Type Activities		Total City	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Beginning balance	\$10.0	\$11.7	\$22.1	\$24.6	\$32.1	\$36.3
Debt issues	13.1	-	-	-	13.1	-
Debt paid	(1.6)	(1.7)	(2.5)	(2.5)	(4.1)	(4.2)
Ending balance	<u>\$21.5</u>	<u>\$10.0</u>	<u>\$19.6</u>	<u>\$22.1</u>	<u>\$41.1</u>	<u>\$32.1</u>

City --- Change in Outstanding Debt: During 2006-2007, the City issued \$13.1 million in new general obligation bonded debt for the public safety civic buildings bonds and paid \$4.1 million principal on outstanding debt.

- The \$1.6 million reduction in governmental activities debt was attributable to property tax supported debt service.
 - \$1.4 million General obligation bond principal payments funded from dedicated bonded debt service levy.
 - 0.2 Annual payments on certificates of participation, note payable, and capital leases funded from operating resources.
- The \$2.5 million reduction in business-type activities debt service is totally wastewater debt and is paid by sewer user charges by ratepayers.
 - \$2.1 million Wastewater revenue bond principal payments, amortization of the refunding premium and economic gain on the refunding amount.
 - 0.4 Oregon Economic and Community Development Department Water/Wastewater Fund note principal payment.

City --- Bond Ratings: The City again received an A2 general obligation bond debt rating from Moody's Investor's Services, Inc. when the public safety improvement 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 sewer debt outstanding.

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, Measure 47/50, 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 the City's governmental operations funded roughly 35 percent from property taxes, the fact that the City has levied the maximum property tax rate of \$5.02 per thousand of assessed valuation for the last seven years emphasizes the importance of property tax maximum assessed valuation growth with the economic pressure of delivering high value governmental services. Cost pressures exist in all areas of governmental operations, but most notably the increases for salaries, medical insurance, and retirement benefit contributions. In May 2006, the citizens of McMinnville overwhelmingly passed a general obligation bond to build a Police Station and potentially the county's E-911 center. Also part of the bond is a combination City Council/Municipal Courtroom building. Construction on the Police Station began in May 2007 and is scheduled to be completed in June 2008.

City of McMinnville - Management's Discussion and Analysis

Business-type activities:

- **Wastewater operations** --- Since the 1993-1994 financing of the new water reclamation facility and significant sewer collection system improvements over the years since, the City has developed an outstanding record of accomplishment of meeting the challenges of increased environmental regulations in a proactive manner. Meeting these regulatory challenges has not come without a cost; the City of McMinnville sewer rates are among the highest in the state. A *Sewer Rate Study* was completed during 2003-2004. The City Council adopted a plan that recommended 2.75 percent rate increases for the next eight years. This level of rate increase is projected to not only meet operational and debt service requirements but also build a reserve of approximately \$7.5 million for future expansion of the Water Reclamation Facility. During 2005-2006, CH2MHill and West Yost were hired jointly to update the City's *Water Reclamation Facility and Sewer Collection System Master Plans*. This significant undertaking in time and money is projected to be completed in 2007. The product of the plan will be to determine future Water Reclamation Facility and sewer collection system capital needs to address the significant growth the city has experienced and expects to experience in the future.
- **Ambulance operations** --- The ambulance service operations has experienced very challenging operating pressures over the last several years with the proliferation of retirement facilities in the city and the reduction in Medicare and Medicaid reimbursement rates. Emergency medical services (EMS) is constantly busy and billed approximately \$2.8 million for the year ending June 30, 2007. Unfortunately, the EMS billing operations is under more and more pressure from Medicare and Medicaid to accept less payment for services rendered. The collection rate has trended downward in the past five years from 74.7 percent in 2001-2002 to 58.4 percent in 2006-2007, primarily as a result of the Medicare and Medicaid lower reimbursement rates. During the year ended June 30, 2007, ambulance operations posted another net operating loss of approximately \$0.45 million. An operating transfer subsidy of property tax support to help fund ambulance service operations was instituted in the 2004-2005 Adopted Budget and has increased steadily since that time from \$50,000 to \$100,000 to \$300,000 in 2006-2007. In addition, full-faith and credit obligation proceeds and property taxes will subsidize the purchase of a new ambulance.

Additional economic factors affecting McMinnville are described in the transmittal letter of this report, pages 4–8.

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, Carole M. Benedict, 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 benedic@ci.mcminnville.or.us.