

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, 2006. Please read this *Management Discussion and Analysis (MD&A)* in conjunction with the City's *Letter of Transmittal*, pages 3–10, 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 net assets increased \$7.2 million to \$114.3 million:** Of this increase, governmental activities increased \$3.9 million to \$71.3 million and business-type activities increased \$3.3 million to \$43.0 million.
- **City government-wide revenues increased \$2.6 million and expenses increased \$3.7 million:** For governmental activities, revenue increased \$1.9 million, expenses increased \$3.4 million, and transfers in increased \$0.1 million. For business-type activities, revenue increased \$0.7 million, expenses increased \$0.3 million, and transfers out increased \$0.1 million.
- **City government-wide program revenues increased \$1.7 million:** For governmental activities, charges for services increased \$0.4 million and capital grants and contributions increased \$0.8 million. For business-type activities, charges for services increased \$0.5 million.
- **City government-wide general revenues increased \$0.9 million:** For governmental activities, property taxes increased \$0.3 million, franchise taxes increased \$0.1 million, and other revenues increased \$0.3 million. For business-type activities, other revenues increased \$0.2 million.
- **City's cash and investments increased \$3.3 million and long-term liabilities decreased \$4.0 million:** For governmental activities, cash and investments increased \$1.2 million and long-term liabilities decreased \$1.6 million. For business-type activities, cash and investments increased \$2.1 million and long-term liabilities decreased \$2.4 million.
- **Component Unit:** Department net assets increased \$8.9 million to \$109.2 million; Department revenues increased \$4.1 million; and Department expenditures increased \$1.0 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

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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 and ambulance. The government-wide financial statements are found on pages 37–39 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 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 44–63 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 47 and 51.

The City maintains thirteen governmental funds, six of which are considered major funds with the remaining seven combined into a single, aggregated presentation for reporting in the fund financial statements. All funds that receive property tax revenues have been classified as major funds; i.e., General, Fire, Parks and Recreation, Capital Improvement, and Debt Service Funds. The Park Development Fund is also classified as a major fund due to the significant park renovation and improvement program currently funded by the \$9.5 million park improvement bonds issued in 2001. The remaining governmental funds are classified as non-major funds. A budgetary comparison statement is included for the General Fund and each major special revenue fund. Non-major, debt service, and capital project individual fund data is provided in combining and individual fund statements and schedules found on pages 108–128.

- **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 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

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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 67–102 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 121–123.
 - 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 112–120 and for proprietary funds - enterprise and internal service funds - on pages 124–128.
- **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 132–138.

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 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 141–178.

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. Also, since the City received and expended over \$500,000 in federal grant funds, the City was subject to *US Office of Management and Budget Circular A-133 Compliance Supplement* audit. These Talbot, Korvola, Warwick, LLP reports are found 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.

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Government-Wide --- Comparative Summary Statement of Net Assets June 30, 2006 and 2005 (in millions)

| | City of McMinnville – Primary Government | | | | | | Component Unit | |
|---|--|----------------------|----------------------------|----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | Governmental Activities | | Business – Type Activities | | Total City | | Department | |
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| Cash and investments | \$17.4 | \$17.1 | \$11.8 | \$ 9.7 | \$29.2 | \$26.8 | \$33.2 | \$27.6 |
| Other assets | 2.2 | 1.9 | 1.3 | 1.4 | 3.5 | 3.3 | 4.3 | 3.9 |
| Capital assets | <u>64.4</u> | <u>63.3</u> | <u>52.8</u> | <u>53.9</u> | <u>117.2</u> | <u>117.2</u> | <u>76.0</u> | <u>75.3</u> |
| Total assets | <u>84.0</u> | <u>82.3</u> | <u>65.9</u> | <u>65.0</u> | <u>149.9</u> | <u>147.3</u> | <u>113.5</u> | <u>106.8</u> |
| Other liabilities | 2.0 | 2.6 | 0.6 | 0.6 | 2.6 | 3.2 | 3.8 | 4.8 |
| Long-term liabilities | <u>10.7</u> | <u>12.3</u> | <u>22.3</u> | <u>24.7</u> | <u>33.0</u> | <u>37.0</u> | <u>0.5</u> | <u>1.7</u> |
| Total liabilities | <u>12.7</u> | <u>14.9</u> | <u>22.9</u> | <u>25.3</u> | <u>35.6</u> | <u>40.2</u> | <u>4.3</u> | <u>6.5</u> |
| Investment in capital assets, net of related debt | 59.5 | 56.8 | 30.7 | 29.3 | 90.2 | 86.1 | 76.0 | 75.3 |
| Restricted | 2.5 | 2.1 | - | - | 2.5 | 2.1 | - | - |
| Unrestricted | <u>9.3</u> | <u>8.5</u> | <u>12.3</u> | <u>10.4</u> | <u>21.6</u> | <u>18.9</u> | <u>33.2</u> | <u>25.0</u> |
| Total net assets | <u>\$71.3</u> | <u>\$67.4</u> | <u>\$43.0</u> | <u>\$39.7</u> | <u>\$114.3</u> | <u>\$107.1</u> | <u>\$109.2</u> | <u>\$100.3</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 \$7.2 million, a 6.7 percent increase, which is comprised of a \$3.6 million increase in assets with a \$3.6 million decrease in liabilities. The Department's net assets increased \$8.9 million, a 8.7 percent increase, which is due to \$6.7 million increase in assets and \$2.2 million decrease of liabilities. The government-wide statement of net assets is located on page 37.

City --- Comparative Summary Statement of Net Assets – Governmental Activities: The governmental activities net asset increase of \$3.9 million, a 5.8 percent increase, is comprised of a \$2.7 million increase in assets and a \$1.2 million decrease in liabilities.

- The \$2.7 million asset increase is due to a \$1.2 million increase in cash and investments, \$0.4 million increase in other assets and \$1.1 million increase in capital assets.
- The \$1.2 million liability decrease is due to a \$1.6 million decrease in long-term liabilities and a \$0.4 million increase in other liabilities.

City --- Comparative Summary Statement of Net Assets – Business-Type Activities: The business-type activities net asset increase of \$3.3 million, an 8.3 percent increase, is comprised of a \$0.9 increase in assets and a \$2.4 million decrease in liabilities.

- The \$0.9 million asset increase is due to a \$2.1 million increase in cash and investments, a \$0.1 million decrease in other assets, and a \$1.1 million decrease in net capital assets.
- The \$2.4 million liability decrease is due to principal payments on long-term liabilities.

Component Unit - Department --- Comparative Summary Statement Of Net Assets: The Department's net assets increase of \$8.9 million, a 8.7 percent increase, is due to \$5.6 million increase in cash and investments, \$0.4 million increase in other assets, \$0.7 increase in net capital assets, \$1.0 million decrease in other liabilities, and \$1.2 million decrease in long-term liabilities.

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Government-Wide --- Comparative Summary Statement of Activities For the Years Ended June 30, 2006 and 2005 (in millions)

| | City of McMinnville – Primary Government | | | | | | Component Unit | |
|--|--|----------------------|----------------------------|----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | Governmental Activities | | Business – Type Activities | | Total City | | Department | |
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Revenues: | | | | | | | | |
| Program revenues: | | | | | | | | |
| Charges for services | \$ 4.9 | \$ 4.5 | \$10.1 | \$ 9.6 | \$15.0 | \$14.1 | \$38.3 | \$36.8 |
| Operating grants and contributions | 1.9 | 1.9 | - | - | 1.9 | 1.9 | 0.8 | 0.4 |
| Capital grants and contributions | 5.0 | 4.2 | 0.9 | 0.9 | 5.9 | 5.1 | 1.2 | 1.2 |
| General revenues: | | | | | | | | |
| Property taxes | 9.0 | 8.7 | - | - | 9.0 | 8.7 | - | - |
| Franchise taxes | 2.2 | 2.1 | - | - | 2.2 | 2.1 | - | - |
| Other | <u>1.2</u> | <u>0.9</u> | <u>0.4</u> | <u>0.2</u> | <u>1.6</u> | <u>1.1</u> | <u>4.9</u> | <u>2.7</u> |
| Total revenues | <u>24.2</u> | <u>22.3</u> | <u>11.4</u> | <u>10.7</u> | <u>35.6</u> | <u>33.0</u> | <u>45.2</u> | <u>41.1</u> |
| Expenses: | | | | | | | | |
| Governmental activities | 20.4 | 17.0 | - | - | 20.4 | 17.0 | - | - |
| Business-type activities | - | - | 8.0 | 7.7 | 8.0 | 7.7 | - | - |
| Component unit | - | - | - | - | - | - | <u>36.3</u> | <u>35.3</u> |
| Total expenses | <u>20.4</u> | <u>17.0</u> | <u>8.0</u> | <u>7.7</u> | <u>28.4</u> | <u>24.7</u> | <u>36.3</u> | <u>35.3</u> |
| Change in net assets before transfers | 3.8 | 5.3 | 3.4 | 3.0 | 7.2 | 8.3 | 8.9 | 5.8 |
| Transfers | <u>0.1</u> | - | <u>(0.1)</u> | - | - | - | - | - |
| Change in net assets | 3.9 | 5.3 | 3.3 | 3.0 | 7.2 | 8.3 | 8.9 | 5.8 |
| Beginning net assets | 67.4 | 62.1 | 39.7 | 36.7 | 107.1 | 98.8 | 100.3 | 94.5 |
| Ending net assets | <u>\$71.3</u> | <u>\$67.4</u> | <u>\$43.0</u> | <u>\$39.7</u> | <u>\$114.3</u> | <u>\$107.1</u> | <u>\$109.2</u> | <u>\$100.3</u> |

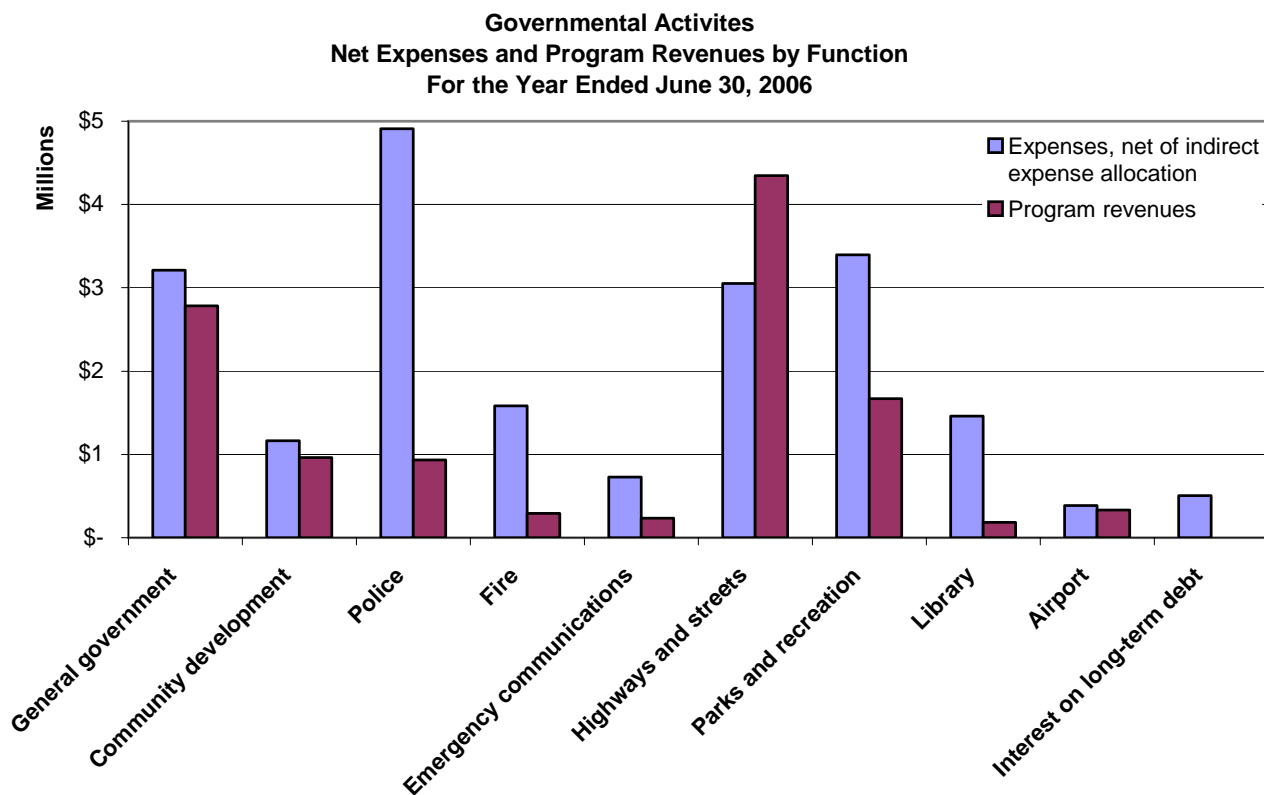
Comparative Summary Statement of Activities – City and Department: The Comparative Government-Wide Summary Statement of Activities reports program revenues, general revenues, and expenses disclosing whether the activity has shown an increase or decrease in net assets for the year. The comparative summary statement of activities reports the City's comparative change in net assets decreased \$1.1 million from fiscal year ended June 30, 2005. The comparative change in net asset decrease is comprised of a \$2.6 million revenue increase and a \$3.7 million expense increase. The Department's comparative change in net assets increased \$3.1 million over fiscal year ended June 30, 2005. The comparative change in net increase is comprised of a \$4.1 million revenue increase and \$1.0 million expense increase. The government-wide statement of activities is located on pages 38–39.

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City --- Comparative Summary Statement of Activities – Governmental Activities: The Comparative Summary Statement of Activities as relates to governmental activities reports a \$3.8 million change in net assets before transfers, a decrease of \$1.5 million over the fiscal year ended June 30, 2005. This decrease is comprised of \$1.9 million increase in revenue and \$3.4 million increase in expenses.

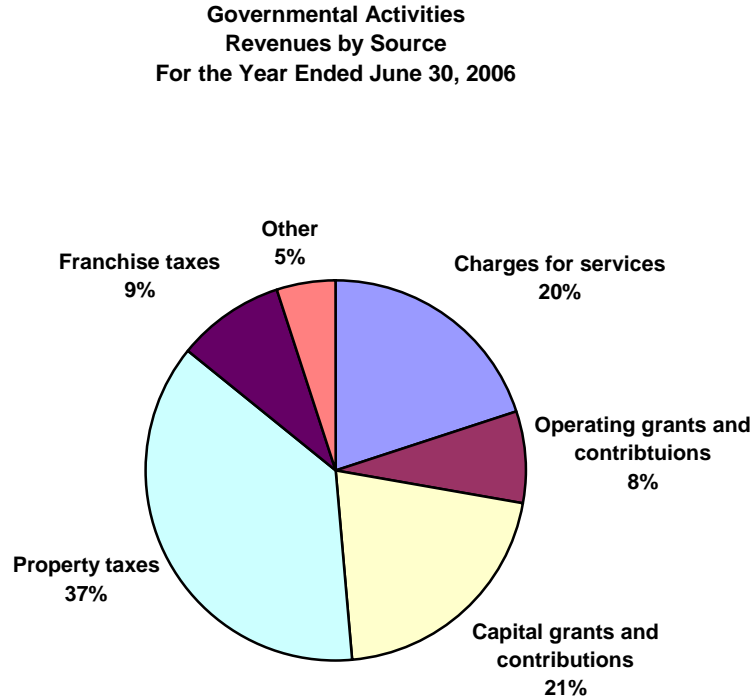
- The \$1.9 million governmental revenue increase is due to an increase of \$1.2 million in program revenues, \$0.3 million in property taxes, \$0.1 million increase in franchise taxes, and \$0.3 million in other revenues:
- The \$3.4 million governmental expense increase is due to \$3.7 million in activity expense increases and \$0.3 million activity expense decreases. The \$3.7 million activity expense increases were \$1.9 million general government, of which \$1.6 million was for design and construction of the new Virginia Garcia Memorial Health Center; \$0.6 million police; \$0.7 million parks and recreation; \$0.2 million library; and \$0.1 million each for fire; community development, and airport. The \$0.3 million activity expense decreases were \$0.2 million highways and streets and \$0.1 million long-term debt interest expense.

The following bar chart compares the revenue streams for each governmental activity with the expenses for each activity.



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



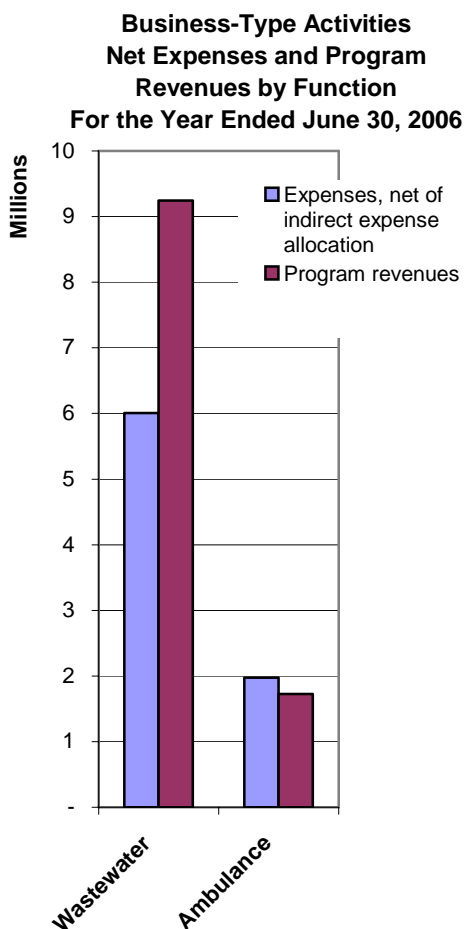
City --- Comparative Summary Statement of Activities – Business-Type Activities: The Comparative Summary Statement of Activities as relates to business-type activities reports a \$3.4 million change in net assets before transfers, a \$0.4 million increase over fiscal year ended June 30, 2005. The increase is comprised of \$0.7 million revenue increase and \$0.3 million expense increase:

- The \$0.7 million business-type revenue increase is due to an increase of \$0.5 million charges for services and a \$0.2 million increase in other revenues.
- The \$0.3 million business-type expense increase is due to an increase of \$0.2 million wastewater services and increase of \$0.1 million ambulance.

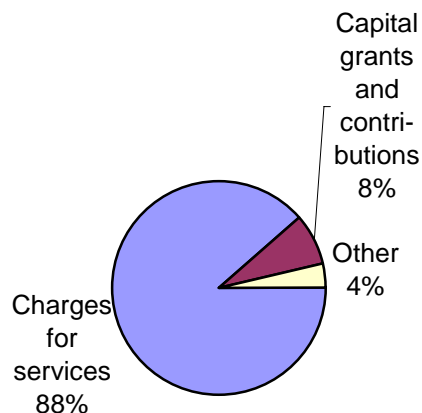
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The bar chart on the left below compares the revenue streams for each business-type activity with the expenses for that activity. The significant differential between wastewater revenue and expenses is a result of the financial policy set by City Council 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
Revenues by Source
For the Year Ended June 30, 2006**



Component Unit - Department --- Comparative Summary Statement of Activities: The Department's Comparative Statement of Activities reports a \$8.9 million change in net assets, a \$3.1 million change from fiscal year ended June 30, 2005. This increase resulted from a \$4.1 million revenue increase and a \$1.0 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, 2006 and 2005 (in thousands)

| | Ending Fund Balances | | | | | | | |
|---------------------------|----------------------|---------|----------|---------|----------|----------|------------|-----------|
| | Unreserved | | Reserved | | Total | | Net Change | |
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| Major funds: | | | | | | | | |
| General | \$3,651 | \$4,150 | \$ 525 | \$ 587 | \$ 4,176 | \$ 4,737 | \$(561) | \$ 904 |
| Fire | 1,242 | 1,264 | - | - | 1,242 | 1,264 | (22) | 163 |
| Parks and recreation | 1,607 | 1,624 | - | - | 1,607 | 1,624 | (17) | 325 |
| Capital improvement | 1,866 | 1,183 | - | - | 1,866 | 1,183 | 683 | (222) |
| Debt service | - | - | 585 | 687 | 585 | 687 | (102) | (215) |
| Park development | - | - | 4,525 | 4,206 | 4,525 | 4,206 | 319 | (3,716) |
| Non-major funds | 800 | 781 | 1,535 | 989 | 2,335 | 1,770 | 565 | (117) |
| Total ending fund balance | \$9,166 | \$9,002 | \$7,170 | \$6,469 | \$16,336 | \$15,471 | \$ 865 | \$(2,878) |

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, 2006 and 2005.

The governmental fund balances increased by \$0.9 million due to \$1.6 million of fund balance increases and \$0.7 million fund balance decreases. The net increase resulted from the following fund balance changes:

- The \$1.6 million governmental fund balance increases were the following: \$0.7 million Capital Improvement Fund, \$0.6 million in non-major funds, and \$0.3 million Park Development Fund.
- The \$0.7 million governmental fund balance decreases were the following: \$0.6 million General Fund, \$0.1 million Debt Service Fund.

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Proprietary Funds – Comparative Ending Net Assets June 30, 2006 and 2005 (in thousands)

| | Ending Net Assets | | | | | | | |
|------------------------------------|------------------------|------------------------|---|------------------------|------------------------|------------------------|-----------------------|-----------------------|
| | Unrestricted | | Invested in Capital Assets Net of Related Debt | | Total | | Net Change | |
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Fund: | | | | | | | | |
| Wastewater | \$12,015 | \$9,911 | \$30,460 | \$29,042 | \$42,475 | \$38,953 | \$3,522 | \$3,188 |
| Ambulance | 574 | 706 | 254 | 311 | 828 | 1,017 | (189) | (80) |
| Internal service | <u>281</u> | <u>274</u> | <u>663</u> | <u>407</u> | <u>944</u> | <u>681</u> | <u>263</u> | <u>(172)</u> |
| Total ending net assets | <u>\$12,870</u> | <u>\$10,891</u> | <u>\$31,377</u> | <u>\$29,760</u> | <u>\$44,247</u> | <u>\$40,651</u> | <u>\$3,596</u> | <u>\$2,936</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 change in ending net assets increased by \$3.6 million over fiscal year ended June 30, 2005 net asset change and is due to \$3.8 million net asset change increases and a \$0.2 million net asset change decrease. The net increase resulted from the following net asset changes:

- The \$3.8 million proprietary fund net asset change increases were the following: \$3.5 million Wastewater Fund and \$0.3 million internal service funds.
- The \$0.2 million proprietary fund net asset change decrease resulted from Ambulance Fund operations.

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 2006 contingency transfer resolution totaled \$532,000 with only \$165,000 affecting the General Fund.

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Capital Assets

Government-Wide Capital Assets June 30, 2006 and 2005 (in millions)

| | Governmental Activities | | Business-Type Activities | | Total City | |
|-----------------------------|-------------------------|----------------------|--------------------------|----------------------|-----------------------|-----------------------|
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Land | \$24.1 | \$23.5 | \$0.9 | \$0.9 | \$25.0 | \$24.4 |
| Land improvements | 11.0 | 10.8 | 0.1 | 0.1 | 11.1 | 10.9 |
| Buildings | 17.6 | 17.5 | 40.6 | 40.7 | 58.2 | 58.2 |
| Machinery and equipment | 3.5 | 3.1 | 0.9 | 0.9 | 4.4 | 4.0 |
| Vehicles | 3.2 | 3.2 | 0.9 | 0.8 | 4.1 | 4.1 |
| Infrastructure | 41.8 | 40.2 | 31.7 | 30.7 | 73.5 | 70.9 |
| Construction in progress | 2.5 | 1.0 | 0.2 | 0.0 | 2.7 | 0.9 |
| Accumulated depreciation | <u>(39.3)</u> | <u>(36.0)</u> | <u>(22.5)</u> | <u>(20.2)</u> | <u>(61.8)</u> | <u>(56.2)</u> |
| Total capital assets | <u>\$64.4</u> | <u>\$63.3</u> | <u>\$52.8</u> | <u>\$53.9</u> | <u>\$117.2</u> | <u>\$117.2</u> |

City --- Capital Assets: The City reported \$117.2 million invested in capital assets net of accumulated depreciation at June 30, 2006. The governmental activities net capital assets increased \$1.1 million and the business-type activities net capital assets decreased \$1.1 million.

The governmental activities \$1.1 million net increase resulted from \$4.4 million increase in capital assets and \$3.3 million increase in accumulated depreciation.

- The \$4.4 million increase in capital assets is comprised of the following capital asset increases: \$0.6 million land, \$0.2 million land improvements, \$0.1 million buildings, \$0.4 million machinery and equipment, \$1.6 million infrastructure, and \$1.5 million construction in progress.

The business-type activities \$1.1 million decrease resulted from a \$1.2 million increase in capital assets and a \$2.3 million increase in accumulated depreciation. The \$1.2 million increase in capital assets includes \$1.3 million capital asset increases and \$0.1 million capital asset decrease.

- The \$1.3 million increase in capital assets is comprised of the following capital asset increases: \$0.1 million vehicles, \$1.0 million infrastructure, and \$0.2 million construction in progress.
- The \$0.1 million capital asset decrease is a \$0.1 million building decrease.

City and Department capital assets are described in more detail in the notes to the financial statements of the *CAFR*, note III. D. pages 80–82.

Change in Government-Wide Capital Assets For the Years Ended June 30, 2006 and 2005 (in millions)

| | Governmental Activities | | Business-Type Activities | | Total City | |
|--------------------------|-------------------------|----------------------|--------------------------|----------------------|-----------------------|-----------------------|
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Beginning balance | \$63.3 | \$58.1 | \$53.9 | \$53.2 | \$117.2 | \$111.3 |
| Additions | 4.6 | 7.9 | 1.3 | 3.0 | 5.9 | 11.0 |
| Net disposals | (0.1) | - | (0.1) | - | (0.2) | (0.1) |
| Depreciation expense | <u>(3.4)</u> | <u>(2.7)</u> | <u>(2.3)</u> | <u>(2.3)</u> | <u>(5.7)</u> | <u>(5.0)</u> |
| Ending balance | <u>\$64.4</u> | <u>\$63.3</u> | <u>\$52.8</u> | <u>\$53.9</u> | <u>\$117.2</u> | <u>\$117.2</u> |

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City --- Change in Capital Assets:

Governmental activities capital asset additions, shown net of construction in progress assets put in-service are \$4.6 million, which is \$3.1 million of assets placed in service and \$1.5 million construction in progress.

- The \$3.1 million governmental capital assets additions are comprised of the following: \$2.3 million street and storm drainage infrastructure primarily donated to the City by subdivision developers, \$0.4 million information systems and services, \$0.2 million parks and recreation, \$0.1 million police, and \$0.1 million airport land improvements.
- \$1.5 million increase in construction in progress is comprised of the \$1.1 million Community Development Building, \$0.2 public safety building, and \$0.2 million park development projects.

Business-type activities capital asset additions are \$1.3 million, which is \$1.1 million of assets placed in service and \$0.2 million construction in progress at year-end.

- The Wastewater Fund comprised all the \$1.3 million business-type capital assets additions: \$0.9 million wastewater infrastructure donated to the City by subdivision developers, \$0.3 million water reclamation facility, and \$0.1 million wastewater system maintenance betterments.
- The Ambulance Fund had a new ambulance on order at year-end, but it will not be delivered until January 2007.

Debt Administration

Government-Wide Outstanding Debt June 30, 2006 and 2005 (in millions)

| | Governmental Activities | | Business-Type Activities | | Total City | |
|-------------------------------|-------------------------|----------------------|--------------------------|----------------------|----------------------|----------------------|
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| General obligation bonds | \$ 9.3 | \$10.7 | \$ - | \$ - | \$ 9.3 | \$10.7 |
| Revenue bonds | - | - | 20.4 | 22.6 | 20.4 | 22.6 |
| Certificates of participation | 0.6 | 0.9 | - | - | 0.6 | 0.9 |
| Notes payable | <u>0.1</u> | <u>0.1</u> | <u>1.7</u> | <u>2.0</u> | <u>1.8</u> | <u>2.1</u> |
| Total outstanding debt | <u>\$10.0</u> | <u>\$11.7</u> | <u>\$22.1</u> | <u>\$24.6</u> | <u>\$32.1</u> | <u>\$36.3</u> |

City --- Outstanding Debt: At June 30, 2006, the City had \$32.1 million in outstanding debt. Of that total \$10.0 million is governmental activities debt and \$22.1 million is business-type activities debt.

Of the \$10.0 million governmental activities debt, \$9.3 million is funded by a dedicated bonded debt service property tax levy. The remaining outstanding governmental activities debt of \$0.7 million must be paid through current resources, which is primarily through operating property taxes. The governmental activities debt maturing within one year paid with the dedicated bonded debt service property tax levy is \$1.4 million principal with \$0.4 million interest expense and debt paid from governmental activities operating resources is \$0.3 million principal with \$0.03 million interest expense.

All the business-type activity debt is either sewer revenue bonds or notes and is payable exclusively from wastewater revenues. The amount of wastewater services debt that matures in the next year and payable from wastewater revenues is \$2.5 million principal with \$0.9 million interest expense.

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 85–92.

Change in Government–Wide Outstanding Debt For the Years Ended June 30, 2006 and 2005 (in millions)

| | Governmental Activities | | Business-Type Activities | | Total City | |
|-------------------|----------------------------|---------------|-----------------------------|---------------|---------------|---------------|
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Beginning balance | \$11.7 | \$14.7 | \$24.6 | \$26.8 | \$36.3 | \$41.5 |
| Debt paid | (1.7) | (3.0) | (2.5) | (2.2) | (4.2) | (5.2) |
| Ending balance | <u>\$10.0</u> | <u>\$11.7</u> | <u>\$22.1</u> | <u>\$24.6</u> | <u>\$32.1</u> | <u>\$36.3</u> |

City --- Change in Outstanding Debt: During 2005-2006, the City paid \$4.2 million principal on outstanding debt.

- The \$1.7 million reduction in governmental activities debt was attributable to debt service.
 - \$1.4 million General obligation bond principal payments funded from dedicated bonded debt service levy.
 - 0.3 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 services debt and is paid by sewer 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 received an A2 general obligation bond debt rating from Moody's Investor's Services, Inc. when the park improvement bonds were sold in August 2001. 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 37 percent from property taxes, the fact that the City has levied the maximum property tax rate of \$5.02 per thousand for the last six 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 the spring of 2006, the citizens of McMinnville overwhelmingly passed a general obligation bond to build a new public safety building to house the City's Police Department and the county's E-911 center.

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 recommends 2.75 percent rate increase 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 \$2.6 million for the year ending June 30, 2006. Unfortunately, the EMS billing operations is under more and more pressure from Medicare and Medicaid to accept less for the services rendered. The collection rate has been trending downward in the past five years from 74.7 percent in 2001-2002 to 62.5 percent in 2005-06, primarily as a result of the Medicare and Medicaid lower reimbursement rates. During the year ended June 30, 2006, ambulance operations posted another net operating loss of approximately \$0.35 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 and was increased from \$50,000 to \$100,000 to \$300,000 in 2006-2007. In addition, for the first time, property tax and full-faith and credit obligations will subsidize the purchase of a new ambulance.

Additional economic factors affecting McMinnville are described in the transmittal letter of this report, pages 4-7.

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.