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***January 15, 2019***

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

We are pleased to present the Comprehensive Annual Financial Report of the City of Manhattan Beach for the Fiscal Year ended June 30, 2018. This report has been prepared in accordance with generally accepted accounting principles as set forth in the pronouncements of the Governmental Accounting Standards Board (GASB). We are also pleased to report that the City has received an unmodified opinion from the independent auditor, meaning that financial statements are presented, in all material respects, in accordance with applicable financial reporting framework.

The City's financial policies require an external independent audit be performed annually, and that the auditor's opinions be included in the Comprehensive Annual Financial Report (CAFR). Further, it states that the results be reviewed with the Finance Subcommittee, which met with the auditor and discussed the results in December 2018.

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

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

The City's financial statements have been audited by Lance, Soll & Lunghard, CPAs, an accounting firm selected by the City Council, based on a recommendation from the Finance Subcommittee.

The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. The

independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unmodified opinion and that the City of Manhattan Beach's financial statements for the fiscal year ended June 30, 2018, are fairly presented in conformity with generally accepted accounting principles (GAAP).

The independent auditor's report is presented as the first component of the financial section of this report.

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

## **Profile of the Government**

The City of Manhattan Beach is located in the South Bay region of Los Angeles County. The current population<sup>1</sup> is 35,991. The City encompasses approximately four square miles.

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

In 2016, the City Council adopted Ordinance No. 16-0026 to comply with Senate Bill No. 415, the California Voter Participation Rights Act, toward the goal of increasing voter turnout in municipal elections. After the next election on March 5, 2019, the City will combine its municipal elections scheduled in March 2021 and March 2023 and conduct future elections with statewide elections scheduled in November 2020 and November 2022, respectively. The terms of city office holders elected in 2017 and 2019 have been shortened to meet the timing of the November 2020 election and beyond.

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

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

Planning Commission	Parking and Public Improvements Commission
Parks & Recreation Commission	Board of Building Appeals
Library Commission	Business Improvement District Advisory Boards
Cultural Arts Commission	

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<sup>1</sup> State of California, Department of Finance, E-1 Population Estimates for Cities. Sacramento, California, May 2018.

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

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

## **Budget Process**

The City operates on a biennial budget schedule. The first year of the budget (FY 2016-17) was adopted in June 2016, while the second year (FY 2017-18) was approved at that time. The second year was subsequently reviewed and adopted by the City Council with minor modifications in June 2017.

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

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

After final review and approval by the City Manager, the proposed budget document is presented to the City Council in May. Multiple study sessions and a public hearing are held by the City Council. The budget is adopted by resolution prior to June 30.

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

## **Economic Condition**

### *Local Economy*

The South Bay region is home to a number of industries including aerospace, entertainment, technology, leisure and tourism, and manufacturing. Economists report that the South Bay area has strong fundamentals including high levels of education, high incomes and competitive industries. Further, the area fares better during weak economic conditions than some other areas of the state. The most recently available figures indicate that Manhattan Beach has a 3.5% unemployment rate, compared to Los Angeles County at 4.7% and the State of California at 4.1%<sup>2</sup>.

### *Long Term Planning*

Each year during the budget process, the City develops a five-year forecast of General Fund revenues and expenditures. During the most recent budget cycle, the forecast concluded that unassigned General Fund balances will remain in a range from an estimated \$23.2 million at the end of FY 2017-18 to \$16.3 million in FY 2022-23. It is important to note that those estimates indicate the need to utilize unassigned fund balance (designated as an economic uncertainty reserve by City Council) for the on-going support of Storm Water operations and Street Lighting and Landscape fund deficits, which may only be mitigated by a Proposition 218 vote. According to the City's Financial Policy, unassigned fund balance of at least 20% of General Fund expenditures will be maintained. However, at the end of FY 2022-23, there will be no excess beyond 20% of General Fund Expenditures. The most recent five-year forecast can be found in the Adopted Biennial Budget for fiscal years 2018-19 and 2019-20, available online at [www.citymb.info/budget](http://www.citymb.info/budget).

### **Financial Policies**

In 1997-1998, the City Council approved the City's first set of financial policies, designed to promote sound financial management and ensure that the City's fiscal integrity remains intact as staff and Councilmembers change. While presenting General Fund balance in accordance with GASB pronouncements, the City Council established certain policy "reserves" within what GASB defines as the unassigned category. The unassigned category is the residual classification of fund balance that is not in restricted or committed classifications. In the General Fund section of this transmittal letter, General Fund unassigned balance is broken down in accordance with City Council Financial Policy.

### **Major Initiatives**

#### *Manhattan Village Mall Enhancement Project*

On December 2, 2014, the City Council approved the Mall Expansion Project with additional conditions. The approval allowed construction of Phases 1 and 2, and deferred Phase 3 (Fry's corner) for future public review and input. On December 20, 2016 the City Council endorsed the updated site plan which includes as Phase 1 the consolidation and expansion of the Macy's property, totaling 60,000 square feet, and construction of a parking structure. This phase was completed in late 2018. Phase 2 encompasses refinement of the plaza area and improved parking and circulation elements, with new restaurant and retail uses totaling 50,000 square feet. Upon completion, the shopping center will total approximately 646,000 square feet. The City continues to work closely with the developer and property owners for the remaining phases.

#### *Sepulveda Corridor Plan*

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<sup>2</sup> State of California, Employment Development Department, October (Preliminary) 2018

The Sepulveda Boulevard corridor is a major transportation corridor for the South Bay region. In Manhattan Beach, this corridor runs north-south through the heart of the City, functions as a commercial corridor and houses major tenants such as the Manhattan Village Mall and Shopping Center, Target, Toyota, Skechers Headquarters, as well as medical facilities, financial institutions, salons, fitness studios, eateries, automotive shops, and other local businesses.

At the November 7, 2017 City Council meeting, the City Council approved the Sepulveda Corridor Initiatives Work Plan and establishment of a Working Group. The various planning initiatives focused on economic vitality, planning, parking, traffic and corridor beautification. Development of the Work Plan is ongoing with significant progress expected in 2019.

#### *Sepulveda Bridge Widening Project*

The Sepulveda Bridge is located on Sepulveda Boulevard (State Route 1) between Rosecrans Avenue and 33rd Street. The existing bridge, and immediately north and south of the bridge, has three northbound and three southbound lanes in each direction, serving an average of 71,000 vehicles per day. The proposed project will widen the east side of the bridge to provide a fourth northbound lane to remove the existing bottleneck at the bridge. Sepulveda Boulevard, including the bridge, is owned and maintained by Caltrans. Due to the local significance of the roadway, the City entered into an agreement with Caltrans in February 2009 to widen the bridge as a joint project with the City taking the lead and Caltrans serving in a supporting role. Since then, the City has secured project funding and is working with Caltrans to finalize seismic retrofit plans in accordance with recent code changes as well as to coordinate with neighboring property owners. Grants totaling \$15.9 million are available for the project, and the preliminary cost estimate to complete the project is \$18.2 million.

#### *Peck Reservoir Replacement Project*

The Peck Reservoir Facility, at 1800 Peck Avenue, was built in 1967. At almost 60 years old, it has exceeded its useful life and is in need of replacement. Once exceeded, these facilities become less reliable, expensive to maintain and are subject to failure. This project was identified as a top priority and recommended as part of the 2010 Water System Master Plan. The replacement of the Peck Reservoir will help ensure the long-term dependability of the water system in our community. The Peck Reservoir Replacement Project consists of the demolition of the existing 7.5 million gallon, partially buried concrete reservoir, pump station and other facilities situated within the existing 2.7 acre property. A new 8 million gallon reservoir will be constructed at the same location. The City is in the initial design phase and construction is estimated to cost approximately \$24 million over the course of the project.

### **EXECUTIVE FINANCIAL OVERVIEW**

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

#### **General Fund**

The General Fund is the primary operating fund of the City of Manhattan Beach. The General Fund balance increased by \$1.8 million over 2017. The increase is attributable to net revenues over expenditures of \$3.5 million offset by Other Financing Sources (transfers-in, transfers-out) equal to a negative \$1.6 million. Transfers-in included \$246,618 from the County Parking Lot Fund in line with the contract with the County of Los Angeles. Offsetting this fund balance increase, transfers-out included \$198,935 to the Street Lighting and Landscape District Fund to cure a deficit fund balance, \$667,000 to the Insurance Fund to support long term liabilities, and a Storm Water Fund subsidy of \$982,355 to support operations. At the end of fiscal year 2018, the total General Fund balance equaled \$26.9 million, of which \$3.0 million is either nonspendable or restricted. In addition, \$1.0 million is committed to School Safety/Security, leaving an unassigned fund balance of \$22.9 million. Within the unassigned fund balance, City Council has established earmarks for financial policies and economic uncertainties of \$18.1 million, leaving \$4.8 million available for use at City Council's discretion.

The City's General Fund revenues showed improvement from the prior year, particularly in Property Tax and Service Charges. This can be noted by the trends below:

Revenue Category	2018 Actual	2017 Actual	Increase/ (Decrease)	%
Property Tax	\$30,318,225	\$28,215,709	\$2,102,516	7.5%
Other Taxes (Sales, Hotel, Business License, etc.)	18,905,654	19,441,259	(\$535,605)	(2.8%)
Licenses and Permits (Building, Construction, Film Permits)	3,365,669	2,703,626	\$662,043	24.5%
Fines (Parking Citations, Vehicle Code Fines)	2,472,310	2,494,090	(\$21,780)	(0.9%)
Use of Money and Property (Interest, Rents and Ground Leases)	2,746,518	3,455,654	(\$709,136)	(20.5%)
Received From Other Agencies (Vehicle License Fees, Grants)	363,670	315,831	\$47,839	15.1%
Service Charges (Plan Check Fees, P&R Class, Ambulance Fees)	9,075,601	8,019,934	\$1,055,667	13.2%
Interfund Charges (Admin Service Charge)	3,180,389	2,996,532	\$183,857	6.1%
Miscellaneous*	1,180,783	1,709,522	(\$528,739)	(30.9%)
<b>Total</b>	<b>\$71,608,819</b>	<b>\$69,352,157</b>	<b>\$2,256,662</b>	<b>3.3%</b>

\*Includes proceeds from the Sale of Capital Assets in 2018 (\$10,345) and 2017 (\$1,543) and one-time Property Transfer Fees in 2017 (\$730,000).

With the City's relatively high property values, Property Taxes continue to be the main driver of revenue growth at 42% of all General Fund revenues. Property Taxes remained strong in FY 2017-18 with a 7.5% increase over the prior year. Sales Tax totaling \$8,970,809 was relatively flat (0.1% increase) with the prior year. Business License Tax of \$3,764,684 exceeded the prior year by \$60,224 or 1.6%. The most significant factor in the decrease in Other Taxes was the decrease of \$664,186 (15%) in Transient Occupancy Taxes. This decline was due to significant remodeling of the WestDrift Hotel (formally Marriott Hotel) which was completed in FY 2017-18. Building permit revenue increased by \$497,767 (30.7%) and construction permits increased \$130,286 (28.2%) compared to the prior year, which was mainly attributable to the Manhattan Village Mall and Gelson's projects as well as other commercial projects. Real Estate Transfer Tax revenue also increased 4.3% to \$788,202 due to continued high housing prices and real estate market activity.

On an overall basis, total General Fund revenues totaled \$71.6 million, up nearly \$2.3 million or 3.3% ahead of last year and exceeding budget estimates by \$1.3 million (excluding transfers and capital leases). However, when comparing the activity in each year, consideration should be given to two extraordinary events: a one-time property transfer fee of \$730,000 in fiscal year 2016-17 due to the Marriott sale and the remodeling of this hotel in 2018 which impacted Transient Occupancy Taxes.

General Fund expenditures totaled \$68,160,240 in FY 2017-18, an increase of \$1.6 million over the prior fiscal year but \$3.8 million under the total budget. When compared to the prior year's actual, Salaries and Benefits increased by \$1.5 million or 3.3%. Materials and Services, which includes Contract and Legal Services, increased by \$391,360 or 1.9%. Capital Outlay decreased by \$312,565 or 81.3% due to one-time computer equipment purchases in the prior fiscal year. Overall, City departments were uniformly under budget with variances offset by savings in other areas.

## **Other Funds**

### *Capital Improvement Fund*

The Capital Improvement Projects Fund (CIP) is designed to manage general governmental infrastructure and facilities capital projects. In FY 2017-18, CIP Fund total revenues were \$4.1 million and expenditures were \$1.5 million. It should be noted that on-going projected revenues of \$1.7 million less debt service of \$0.8 million result in a steady state excess of only \$0.9 million. With the increase in Transient Occupancy Tax due to the completion of the Marriott remodel and increase in parking rates, that excess will increase. Notwithstanding the increase, and future General Fund transfers, grants or new revenues will be required to finance larger scale projects in the future.

As of June 30, 2018, the total balance of the CIP Fund is \$10.6 million. Carryover funds for defined major capital projects at year end include:

- \$1.2 million in various facilities improvements
- \$1.2 million to purchase street lights and retrofit with LED lights
- \$893,593 for Downtown streetscape improvements
- \$869,170 for Safe Routes to School projects
- \$790,600 for design of the replacement Fire Station #2
- \$722,232 million for turf and light replacements at sports fields
- \$561,955 for Non-Motorized transportation projects
- \$438,723 for ADA-compliant City Hall restroom remodeling, and
- \$1.9 million for other building improvements and street projects.

### *Enterprise, Internal Service, and Special Revenue Funds*

This group includes the City's enterprises such as Water, Waste Water, Storm Water and Refuse funds; internal service funds such as Fleet, Insurance, Building Maintenance and Information Technology; and Special Revenue funds including Gas Tax, Proposition A & C, Measure R & M, Asset Forfeiture, etc. Among this group, several funds deserve attention.

The Water Fund continues to build the resources for planned capital improvements needed to sustain the utility's operation and infrastructure. Net income from operations totaled \$4,258,974, an increase

over prior year which had an operating income of \$3,982,639. Revenue from sales increased by \$856,916 (5.8%), while operating expenses (labor, materials, services, etc.) rose by \$580,581 (5.4%). During FY 2009-10, the City Council approved increased water and waste water rates to support system infrastructure needs as well as to bolster the fiscal integrity of those funds. The new rate structure became effective in January 2010 and provided for annual increases each January through 2014. Accumulated fund balances provide resources for planned capital improvements to the utility's infrastructure, estimated at \$41.7 million over the next five years, including replacement of Peck Reservoir which is estimated to cost nearly \$23.4 million.

The net operating income for the Waste Water Fund was \$1,980,292 versus \$1,893,302 in FY 2016-17, an increase of \$86,990 or 4.6%. Operating revenue increased \$113,406 (3.4%) and operating expenses increased \$26,416 (1.9%). Waste water rates were last adjusted along with the water rates in January 2010. Similar to the water utility, the new rates are being utilized to fund needed capital improvements to the waste water system. Since the Waste Water revenues are based on water consumption, water conservation efforts may result in lower Waste Water revenues without the benefit of lower operational costs as is the case in the Water fund where conservation results in less pumping and less Water being purchased.

Continuing an ongoing trend of losses, the Storm Water Fund net operating loss in FY 2017-18 was \$1,307,998. Accumulated losses for the prior five fiscal years are over \$2.3 million. The combination of fixed fees and rising costs requires General Fund subsidies. The General Fund provided \$982,355 in FY 2017-18. Additionally, capital improvements due to legislative mandates will also result in increased costs. Current assessments were set in 1996. A Proposition 218 assessment vote will be necessary to adjust assessments. Measure W, which is a Los County-wide storm parcel tax passed in November, may provide relief.

The Street Lighting Fund continues to run deficits each year. For FY 2017-18, expenditures exceeded revenues by \$198,935. As in the case of Storm Water Fund, assessments have been constant for 20 years. Because there is no fund balance to draw upon, the General Fund contributes the entire amount needed for continued operations. These contributions will be necessary until a Proposition 218 assessment vote is successful in raising the assessment rates and revenues.

The Insurance Fund again received a cash transfer of \$667,000 from the General Fund to offset workers compensation claims and other accrued claims and judgments. The fund balance for the Insurance Fund is negative \$2.99 million. The unpredictable nature of claims payments, compounded by rising medical costs and claim judgments, caused internal service fund charge-outs to fall behind funding needs. To accommodate both the increased expenses and noncurrent liabilities related to pensions and claim reserves, a phased fund transfer plan was approved by the City Council in 2015. General Fund transfers were made in FY 2015-16 and FY 2016-17 for \$667,000. Even with the FY 2017-18 transfer, the fund remains in a deficit position. In the future, the fund will require either increased charge-outs or on-going transfers to fund accumulated liabilities and current year service costs.

### *Trust and Agency Funds*

In several cases, the City acts as a custodian of funds held for the benefit of others which mostly relates to the administration of employee pension and 401(a) and 457 deferred compensation plans. All such plan funding requirements have been maintained. City Plans include the supplemental



retirement and single highest year programs (dormant plans which were previously offered by the City). Pension activity relating to these dormant plans is included in governmental activities.

This financial report does not include the value of trust holdings in any of the employees' deferred compensation plans at June 30, 2018, thus recognizing enacted legislation establishing the City as a plan trustee and protecting these employee-owned assets from external creditors.

The trust and agency fund group also includes debt service funds held in trust on behalf of five consolidated Utility Under-grounding Assessment Districts (UUAD). Due to favorable interest rates, the City refunded the outstanding bonds of the Underground Districts in March 2018. Interest rates for the refunded bonds ranged from 4.72% to 4.95%. Interest rates for the new refunding bonds are set at a uniform annual rate of 3.00%, and matures in September 2026. The reduced debt service will produce reductions in assessments to service the debt.

## **CURRENT TRENDS AND EVENTS**

The local economy remains stable. The City's biggest General Fund revenue source, property tax, grew by 7.5% (\$2.1 million) in FY 2017-18. Assessed valuations, which indicate tax revenue and help propel property tax growth, are projected to increase by 6.2% in FY 2018-19 over the prior year, driven by demand and resulting price escalations in the local housing market. Single-family homes valued at pre-1978 levels (before Proposition 13) continue to turn over, resulting in higher assessed valuations being added to the property tax rolls. Roughly 20.2% of single-family parcels within the City remain assessed at pre-1978 values.

Sales tax revenues, which have been flat the past couple of years, are expected to continue that trend. The City remains conservative in the sales tax estimates due to stagnation in gasoline and general consumer goods. Transient Occupancy Tax, which experienced a decline in FY 2017-18, is expected to rebound in FY 2018-19 due to the completion of the remodel at the Marriott and trend normally once remodeling is completed at the Residence Inn Hotel. Building activity remains stable, and tourism and travel is supported by a healthy mix of desirable hotels and retailers.

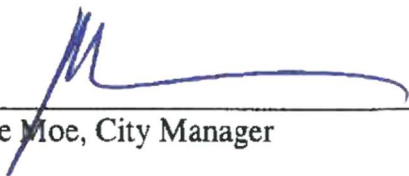
As a service organization, labor accounts for the majority of costs - approximately 70% in the General Fund. Labor agreements with four existing bargaining units (Manhattan Beach Police Officers Association, Police Management Association, Fire Fighters' Association and California Teamsters Local 911) expired on December 31, 2018. Negotiations are currently underway with new labor agreements expected in early 2019. Two new bargaining units were formed representing a Mid-Management Employees Association (MEA) and Fire Management Association (FMA). A two-year labor agreement with MEA was negotiated last year and is effective January 1, 2017 through December 31, 2019. Negotiations with FMA are underway with a labor agreement expected in early 2019.

While current General Governmental trends are positive, there exists a noncurrent pension (California Public Employees' Retirement System - CalPERS) liability that, while not impacting the City in fiscal year ending 2018, will have long term impacts over the next 10 to 20 years. Long term pension liability is an item shared by all public agencies who are members of the CalPERS system. Based on projections, the City's annual contribution to CalPERS will increase from \$8 million in fiscal 2018-19 to \$11 million over the next five years.

Manhattan Beach has maintained a sound financial condition. In fact, Standard & Poor's reaffirmed the City's AAA Credit Rating on November 4, 2016. Established reserves remain funded, and the City continues to operate efficiently and effectively, all while continuing to provide outstanding services for the community.

## **OTHER INFORMATION**

**Acknowledgments:** This report was made possible through the efforts and teamwork of the highly dedicated Finance staff. Special thanks to Henry Mitzner, Julie Bondarchuk and Libby Bretthauer. Appreciation is also expressed to the City Council and City Treasurer for their interest and support, which made this presentation possible. Finally, thanks to the City's auditing firm of Lance, Soll & Lunghard, LLP for their professionalism and diligence in preparing this year-end financial report.



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Bruce Moe, City Manager



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Steve S. Charelian, Finance Director