

**CITY OF CYPRESS
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2011**

As management of the City of Cypress (City), we offer readers of the City of Cypress' financial statements this narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2011. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal, which can be found in the introductory section of this report, and with the City's financial statements, which follow this discussion.

Financial Highlights

- The assets of the City exceed its liabilities at the close of the fiscal year ended June 30, 2011 by \$298,153,895 (*net assets*). Of this amount, \$77,249,756 (*unrestricted net assets*) may be used to meet the government's ongoing obligations to citizens and creditors.
- The City's total net assets increased by \$3,149,495 during the fiscal year.
- As of June 30, 2011, the City's governmental funds reported combined ending fund balances of \$105,286,514, an increase of \$463,106 in comparison with the prior year. A total of \$34,545 is unassigned within the General fund and is available for spending at the government's discretion (*unassigned fund balance of the governmental funds with a positive fund balance*).
- As of June 30, 2011, the total fund balance of the General fund was \$26,363,599. Of this total, slightly over \$6.0 million has been committed by the City Council as part of a stabilization agreement to be used should General fund revenues decrease or expenditures increase unexpectedly due to unforeseen factors. Another \$4.5 million has been committed by awarding contracts for storm drainage capital expenditures. In addition to these commitments, a total of \$15,721,208 of the fund balance has been assigned – primarily for use on future capital improvements. While these assigned amounts are not legally restricted, it continues to be the City's policy to set-aside and annually transfer amounts to the City's Capital Project Fund for future infrastructure improvement projects as identified in the various infrastructure master plans and outlined in the City's Seven-Year Capital Improvement Plan.

Overview of the Financial Statements

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

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

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

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

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all, or a significant portion, of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, community development, public safety, public works and recreation. The business-type activities of the City are related to the sanitary sewer system.

The government-wide financial statements include not only the City itself (known as the *primary government*), but also two legally separate entities, the Cypress Redevelopment Agency and the Cypress Recreation and Park District. The City is financially accountable for these entities and the financial information for these *blended component units* is reported within the financial information presented for the primary government itself.

The government-wide financial statements can be found in the financial section of this report immediately following Management's Discussion and Analysis (MD&A).

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

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

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Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds and governmental activities*.

The City maintains various individual governmental funds. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances for the General fund, the Recreation and Park District Special Revenue fund, the Redevelopment Agency Debt Service fund, the City Capital Projects fund and the Redevelopment Agency Capital Projects fund, all of which are considered to be major funds. Data from the other governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these *non-major* governmental funds is provided in the form of *combining statements* elsewhere in this report.

The City adopts an annual appropriated budget for each of its major funds. The required supplementary information section of the basic financial statements include budgetary comparison statements for the General fund and the Recreation and Park District Special Revenue fund to demonstrate budgetary compliance with the annual budget. Budgetary comparison statements have been provided elsewhere in this report for the other major funds.

The basic governmental fund financial statements can be found in the financial section of this report immediately following the government-wide financial statements.

As part of this annual discussion and analysis, management will discuss financial highlights of the City's General fund, all other major funds, and any funds experiencing a significant change in fund balances or any other noteworthy activity.

Proprietary funds. The City maintains two different types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City uses an enterprise fund to account for its sanitary sewer system. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for its central services, the Recreation District's central services, employee benefits, liability insurance and workers' compensation insurance. Because these services benefit governmental functions, they have been included in *governmental activities* within the government-wide financial statements.

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Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Sewer fund, which is considered a major fund of the City. The *internal service funds* are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the internal service funds is provided in the form of *combining statements* elsewhere in this report.

The basic proprietary fund financial statements can be found immediately following the basic governmental fund financial statements.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statement because the resources of those funds are *not* available to support the City's own programs. The City's only fiduciary funds are agency funds. Agency funds are used to hold various deposits and other monies which are not eligible to be used at the City's discretion. The basic fiduciary fund financial statements can be found immediately following the basic proprietary fund financial statements.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the basic financial statements can be found in the financial section of this report immediately following the basic fiduciary fund financial statements.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information*. In addition to the City's progress in funding its obligation to provide pension benefits to its employees, the previously discussed budgetary comparison schedules for the General fund and the Recreation and Park District Special Revenue fund are included in the required supplementary information section. Required supplementary information can be found immediately following the notes to the basic financial statements.

The combining statements (referred to previously in connection with nonmajor governmental funds and the internal service funds) are presented immediately following the required supplementary information.

The *blended component units* (referred to earlier in connection with the government-wide financial statements), although legally separate, function at the discretion and direction of the City's management. Their financial position and results of operations, therefore, have been included as an integral part of the primary government, and are presented in the fund financial statements.

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Government-wide Financial Analysis

The government-wide financial statements provide long-term and short-term information about the City's overall financial condition. This analysis addresses the financial statements of the City as a whole.

Summary of Net Assets
As of June 30, 2011 and 2010

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
Assets:						
Current and other assets	\$ 147,018,596	\$ 139,030,151	\$ 8,485,468	\$ 6,035,647	\$ 155,504,064	\$ 145,065,798
Capital assets	159,248,382	160,465,631	10,097,512	9,110,878	169,345,894	169,576,509
Total assets	<u>306,266,978</u>	<u>299,495,782</u>	<u>18,582,980</u>	<u>15,146,525</u>	<u>324,849,958</u>	<u>314,642,307</u>
Liabilities:						
Long-term liabilities outstanding	13,073,956	7,088,769	6,000,000	6,000,000	19,073,956	13,088,769
Other liabilities	7,462,300	6,411,505	159,807	137,633	7,622,107	6,549,138
Total liabilities	<u>20,536,256</u>	<u>13,500,274</u>	<u>6,159,807</u>	<u>6,137,633</u>	<u>26,696,063</u>	<u>19,637,907</u>
Net Assets:						
Invested in capital assets, net of related debt	156,103,382	157,015,631	4,097,512	3,110,878	160,200,894	160,126,509
Restricted	52,377,584	56,564,959	8,325,661	5,898,014	60,703,245	62,462,973
Unrestricted	77,249,756	72,414,918	-	-	77,249,756	72,414,918
Total net assets	<u>\$ 285,730,722</u>	<u>\$ 285,995,508</u>	<u>\$ 12,423,173</u>	<u>\$ 9,008,892</u>	<u>\$ 298,153,895</u>	<u>\$ 295,004,400</u>

Net assets of the City increased by approximately \$3.1 million (1.1 percent) to nearly \$298.2 million, of which \$160.2 million is invested in capital assets such as land, buildings and improvements, equipment, and infrastructure. Of the remaining total, \$60.7 million is restricted to specifically stipulated spending agreements originated by law, contract or other agreements with external parties. The remaining \$77.2 million classified as unrestricted increased by 6.7% from \$72.4 million, and while subject to being designated for specific purposes as approved by the City Council and management, it may be used to meet the City's ongoing obligations.

The City's investment in capital assets (less any related outstanding debt used to acquire those assets) is the largest portion of the City's net assets and represents 53.7% of total net assets, which is a slight decrease as compared to the percentage of overall net assets for the prior year. While the City uses these capital assets to provide services to citizens; these assets are *not* available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

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Changes in Net Assets
For the fiscal year ended June 30, 2011 and 2010

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
Revenues						
Program Revenues:						
Charges for services	\$ 2,799,057	\$ 2,780,498	\$ 1,262,636	\$ 704,287	\$ 4,061,693	\$ 3,484,785
Operating grants and contributions	3,662,451	3,420,628	59	63	3,662,510	3,420,691
Capital grants and contributions	1,236,994	1,796,783	350,397	108,006	1,587,391	1,904,789
General Revenues:						
Sales tax	11,464,617	10,018,391	-	-	11,464,617	10,018,391
Property taxes/tax increment	15,711,876	14,925,866	7,319	7,198	15,719,195	14,933,064
Other taxes	5,162,390	4,865,847	-	-	5,162,390	4,865,847
Other	467,534	511,375	32,493	41,337	500,027	552,712
Total Revenues	<u>40,504,919</u>	<u>38,319,388</u>	<u>1,652,904</u>	<u>860,891</u>	<u>42,157,823</u>	<u>39,180,279</u>
Expenses						
General government	3,599,445	3,650,493	-	-	3,599,445	3,650,493
Community development	3,856,480	2,938,808	-	-	3,856,480	2,938,808
Public safety	14,140,187	13,982,176	-	-	14,140,187	13,982,176
Public works	12,129,841	12,977,516	-	-	12,129,841	12,977,516
Recreation	4,432,552	4,350,280	-	-	4,432,552	4,350,280
Interest on long-term debt	215,658	218,001	-	-	215,658	218,001
Sewer	-	-	634,165	592,049	634,165	592,049
Total Expenses	<u>38,374,163</u>	<u>38,117,274</u>	<u>634,165</u>	<u>592,049</u>	<u>39,008,328</u>	<u>38,709,323</u>
Transfers	<u>(2,395,542)</u>	<u>-</u>	<u>2,395,542</u>	<u>-</u>	<u>-</u>	<u>-</u>
Increase in Net Assets	(264,786)	202,114	3,414,281	268,842	3,149,495	470,956
Beginning Net Assets	285,995,508	285,793,394	9,008,892	8,740,050	295,004,400	294,533,444
Ending Net Assets	<u>\$ 285,730,722</u>	<u>\$ 285,995,508</u>	<u>\$ 12,423,173</u>	<u>\$ 9,008,892</u>	<u>\$ 298,153,895</u>	<u>\$ 295,004,400</u>

The following significant revenue items contributed to the change in net assets for governmental activities for the fiscal year ended June 30, 2011:

- The City's program revenues totaled 19.0 percent of total revenues and decreased by 3.7 percent from the prior year. The largest program revenues are operating grants which tend to fluctuate from year-to-year based on availability. These operating grants include grants used to maintain the City's capital assets and interest earned on restricted cash balances. Charges for services (which includes such items as planning and building fees, city services and recreation user fees) are the second largest source of program revenues and were essentially unchanged from the prior year. Capital grants also tend to fluctuate annually based on the availability of grants and project eligibility that are consistent with the capital projects being undertaken by the City. The City received higher allocations for various operating grants (including narcotics asset seizure and housing rehabilitation monies) during the past year which resulted in an overall increase in operating grants and contributions. The City was also once again the recipient of several one-time federal and state capital grants during the fiscal year ended June 30, 2011; however, the amount awarded and received was less than the prior year. These grants were expended primarily for various street improvement projects throughout the City.
- The City's general revenues represent 81.0 percent of total revenues. General revenues increased approximately 8.2% from the prior year, largely a result of a partial rebound from the economic downturn of recent years and a decrease in revenue takeaways at the State level during the past year. Sales taxes, the largest general revenue, accounted for over 28 percent of total revenues, and increased by

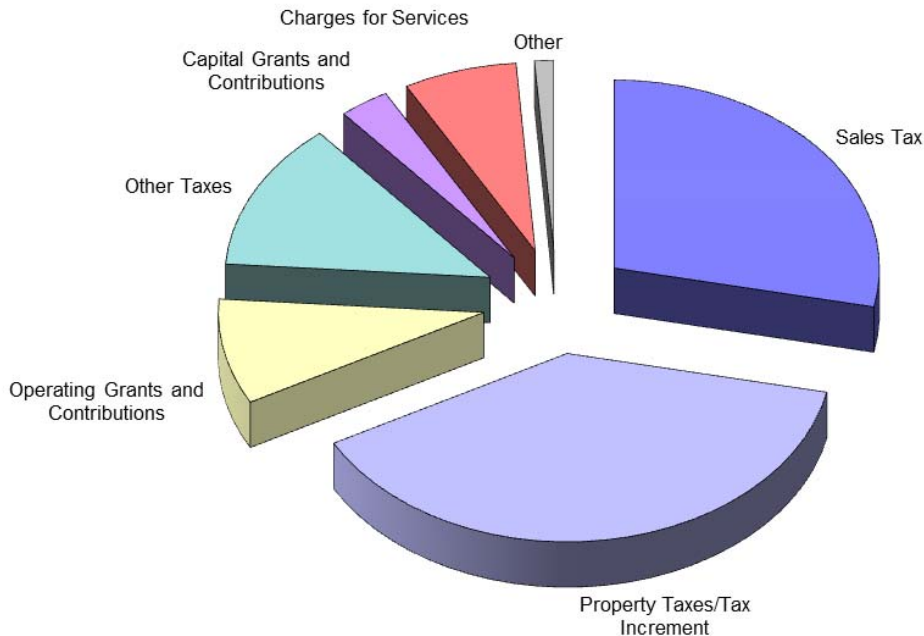
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14.4 percent in the past year. This increase in sales taxes comes after experiencing consecutive years of double digit decreases, including a 14 percent decrease in the prior year. The sales tax increase can be attributed to both the lessening of the severe economic downturn and a one-time reallocation of approximately \$800,000 by the State Board of Equalization for sales tax amounts collected in prior years that were not properly allocated to the City. Property taxes/tax increment revenues experienced increases due to fewer State takeaways than in the prior year. In the prior year, the State initiated Proposition 1A borrowing from the City and Supplemental Educational Revenue Augmentation Fund (SERAF) shifts impacting the Redevelopment Agency. While the amounts borrowed from the City will be paid back, the shifts related to the Redevelopment Agency will not be and totaled nearly \$1.9 million in the prior fiscal year. During the fiscal year ended June 30, 2011, State takeaways were limited to SERAF shifts impacting the Redevelopment Agency and totaled "only" \$388,413. The City continues to experience the ongoing positive impact of Proposition 13 on assessed valuations in the City, which have outweighed the immediate negative impact caused by the drop in property values throughout the City. However the increase in property taxes received for redevelopment activities (due to the decrease in the SERAF shift) resulted in larger amounts being required to be passed through to other taxing entities, which in turn yield lower net tax increment monies to the Agency than the gross increase. Other taxes, such as transient occupancy taxes and franchise taxes, experienced increases due in part to the positive impact of the economic recovery. The decrease associated with other general revenues relates to the lower market interest rate earned on the City's accumulated cash balances throughout the year.

All revenues from governmental activities are summarized in the following graph.

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Revenues by Source – Governmental Activities



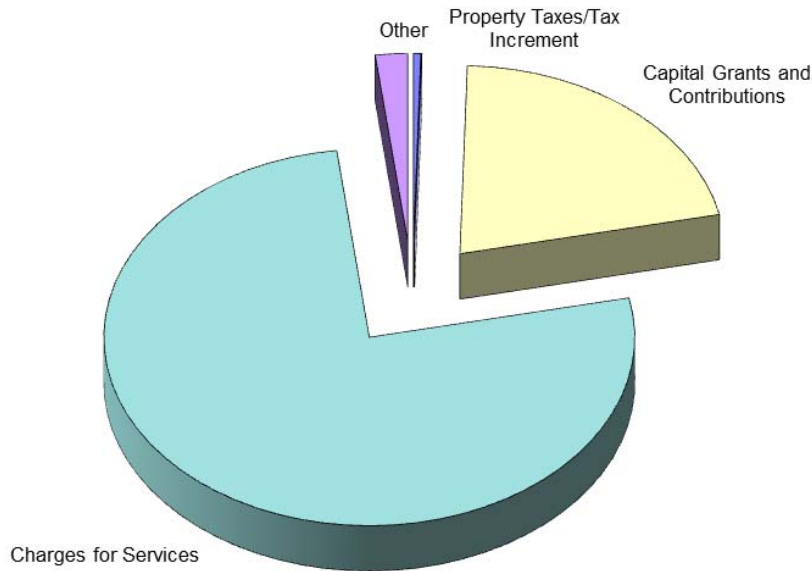
The following significant revenue items contributed to the change in net assets for business-type activities for the fiscal year ended June 30, 2011:

- Program revenues for the City's sewer system are the primary revenue source for the City's lone business-type activity. Charges for sewer services comprised 76.4 percent of total revenues and increased by 79.3 percent from the prior year. The large increase was anticipated and is a result of implementing another year of the multi-step fee increase which was approved several years ago. The fee increase will allow for a dedicated revenue source to provide funding for the ongoing maintenance and capital improvements associated with the City's sewer system. The City also received \$350,397 in federal grant monies for the design and construction of eligible sewer system improvements in the past year, as compared to \$108,006 in the prior year. These grant amounts tend to fluctuate from year-to-year based on availability and project eligibility.
- General revenues for business-type activities are limited to investment earnings on cash balances and a small amount of property tax that is allocated to the City and is restricted to use for sewer purposes. The overall decrease in general revenues relate to the lower market interest rate earned on the accumulated cash balances held for the sewer system.

All revenues from business-type activities are summarized in the following graph.

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Revenues by Source – Business-type Activities



Total expenses for governmental activities increased by approximately \$257,000 (0.7 percent) over the prior year. The small net increase in expenses is a result of several factors, including the ongoing process of each department undergoing a thorough review of their operations as part of the annual budget process, which has resulted in across the board cuts to annual operating costs. Some of the most significant cuts have occurred in personnel through the ongoing elimination of vacant positions and increased control of overtime costs. In addition to the city-wide budget decreases, there have been non-recurring expenses in the past two years which have accounted for significant fluctuations in various expense categories. Community development expenses increased over \$917,000 from the prior year, largely the result of the Redevelopment Agency recording a nearly \$1.7 million loss on the sale of land to the City. The loss was related to 13 acres of land that the Agency had purchased several years ago and was holding with the intent to resell to a developer for retail purposes. However with the downturn in the economy and its negative impact on retail development, the land remained as an asset of the Agency with a basis of \$20.2 million until March 2011. At that time, the land was sold to the City for its appraised value of \$18,580,000 resulting in the loss of nearly \$1.7 million. In the prior fiscal year, the Agency had made the final payment of \$1,030,000 in development assistance related to the purchase of housing affordability covenants on 80 low and very low income units. These two non-recurring transactions in each of the last two years have caused community development expenses to be much higher than a “typical” year. Public works expenditures decreased nearly \$850,000 (6.5 percent) from the prior year due to incurring fewer expenses for street maintenance (such as slurry seal

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and overlay projects) and storm drain maintenance. Public safety (police) continues to account for the largest percentage (36.9 percent) of total expenses related to governmental activities, which is an increase of 1.1 percent from the previous year.

Total expenses for business-type activities increased by \$42,116 (7.1 percent) due to increased personnel costs allocated to sewer maintenance and an increase in depreciation expense on sewer system assets.

A "one-time" transfer between governmental activities and business-type activities occurred in the past fiscal year. This transfer of nearly \$2.4 million related to the Redevelopment Agency paying for improvements to the sanitary sewer system within the Lincoln Avenue Project Area. While there is no net effect to the City from this transfer, the respective net assets of governmental activities and business-type activities were impacted.

Financial Analysis of the Government's Funds

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the City's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information may be useful in assessing the City's financing requirements and operating needs.

As of the end of the current fiscal year, the City's governmental funds reported total combined ending fund balances of \$105,286,514, an increase of \$463,106. The increase in fund balances is the result of many offsetting factors, including the increase in many revenue sources due to a partial rebound in the economy and incurring a significant amount of capital expenditures in accordance with the first year of the City's Seven Year Capital Improvement Program.

Total fund balance is broken down into five categories – ranging from nonspendable to unassigned. Approximately 48.6 percent of the City's total fund balance at June 30 2011 is nonspendable, which is a decrease of over \$20.2 million from the prior year and is primarily the result of the Agency selling land to the City and paying down the associated note. Restricted fund balance amounts decreased slightly from the prior year and totaled 22.2 percent of total fund balance. These restricted amounts can only be used for specific purposes, with the major restrictions being limited for recreation uses, street maintenance and improvements, street lighting and redevelopment purposes. Committed fund balance amounts total just over \$21.5 million (20.4 percent) and have increased by nearly \$6.7 million in the past year. The increase in committed fund balance relates to the City Council approving several significant contracts for improvements to the City's streets and storm drainage system during the past year. These contracts have authorized the selected vendors to proceed with the capital improvements, but the actual expenditures were not

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incurred prior to June 30th. An additional \$32.5 million of fund balance is categorized as assigned. These assignments of fund balance are made by City management for specific purposes – with the large majority of the assignments being for future capital improvements. It continues to be the City's policy to set-aside available resources in order to provide a funding mechanism to pay for future improvements to the City's infrastructure and public facilities, and the recording of available fund balance amounts as assigned achieves this policy. The remaining amount of fund balance is categorized as unassigned and relate to a small amount that is available in the General fund and the large negative fund balance amount that exists in the Agency Debt Service Fund due to the outstanding notes payable to the City. This negative fund balance amount is required to be categorized as unassigned since in essence, there is no fund balance amount to categorize.

Proprietary funds. The City's *proprietary funds* provide the same type of information found in the government-wide financial statements, but in more detail. The City's major proprietary fund is the Sewer enterprise fund. Net assets of the Sewer fund at the end of the fiscal year totaled \$12.4 million, which is a \$3.4 million increase from the prior year. The increase in net assets is primarily the result of the Redevelopment Agency transferring nearly \$2.4 million to the Sewer fund for capital improvements to the sanitary sewer system.

Major Fund Financial Highlights

General Fund

The General fund is the primary operating fund of the City. At the end of fiscal year 2010-11, the total fund balance of the General fund was \$26,363,599 (compared to \$21,455,618 at the beginning of the year). The fund balance of the General fund is composed of four different categories – restricted, committed, assigned and unassigned. The majority of the increase in overall fund balance is related to amounts categorized as committed and assigned. At June 30, 2011, a total of \$4.5 million had been committed by the City Council in the form of approved contracts for storm drainage system improvements. These outstanding contracts, when combined with the \$5.4 million of fund balance that has been assigned for future storm drainage improvements, yields a total of \$9.0 million that is available for storm drainage improvements in the General fund at end of the fiscal year. This represents an increase of over \$2.0 million from the prior year. The fund balance amount assigned for other future capital improvements increased by nearly \$1.9 million during the year. As a measure of the general fund's liquidity, it may be useful to compare the total of assigned and unassigned fund balances to total fund expenditures since assigned and unassigned amounts are essentially available for any purpose. Total assigned and unassigned fund balance represents 62.7 percent (down slightly from 63.0 percent the previous year) of the total expenditures in the General fund. Despite the City Council's and management's policy to set-aside monies for future infrastructure needs, the annual amount that is being accumulated in the

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General Fund and annually transferred to the City's Capital Project Fund to fund future projects will not be sufficient to fund all infrastructure and other capital needs of the City.

For the fiscal year ended June 30, 2011, the cash and investments balance in the General fund was \$27,304,783, an increase of \$5,669,957 from the prior fiscal year. The increase is the result of the annual transfer from the City's Capital Projects fund for storm drainage improvements (\$4.4 million in the fiscal year ended June 30, 2011) and the positive impact of operations on cash. Total receivables increased by \$228,360, to \$2,648,932, due largely to the partial rebound of the economy and the positive impact on year-end accruals for sales tax and transient occupancy tax receipts.

**Summary of Changes in Fund Balances - General Fund
For the fiscal year ended June 30, 2011 and 2010**

	2011	2010	Change
Revenues			
Taxes:			
Sales	\$ 11,464,617	\$ 10,018,391	\$ 1,446,226
Property	3,885,682	3,083,124	802,558
Other	8,623,421	8,408,416	215,005
Total taxes	<u>23,973,720</u>	<u>21,509,931</u>	<u>2,463,789</u>
Licenses and permits	288,787	294,903	(6,116)
Fines and forfeitures	225,201	297,792	(72,591)
From use of property	2,101,282	2,496,389	(395,107)
From other agencies	481,712	465,074	16,638
Charges for services	2,629,490	2,583,176	46,314
Other	91,553	116,332	(24,779)
Total Revenues	<u>29,791,745</u>	<u>27,763,597</u>	<u>2,028,148</u>
Expenditures			
General government	3,338,194	3,564,623	(226,429)
Community development	1,302,794	1,397,433	(94,639)
Public safety	13,632,671	13,923,228	(290,557)
Public works	5,101,410	5,389,835	(288,425)
Capital Outlay	1,752,855	44,765	1,708,090
Total Expenditures	<u>25,127,924</u>	<u>24,319,884</u>	<u>808,040</u>
Excess of revenues over expenditures	4,663,821	3,443,713	1,220,108
Net transfers	244,161	(66,713,509)	66,957,670
Increase in fund balance	<u>\$ 4,907,982</u>	<u>\$ (63,269,796)</u>	<u>\$ 68,177,778</u>

Total general fund revenues for the fiscal year ended June 30, 2011 increased by \$2,028,148 from the prior year. Individual components of this change are highlighted as follows:

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- Sales tax revenue, the largest revenue source of the General fund, increased by \$1,446,226 due to both the partial rebound associated with the ongoing recession and the one-time reallocation of approximately \$800,000 by the State Board of Equalization for sales tax amounts distributed in prior years that were not properly credited to the City.
- Property tax revenues increased due to the State initiating Proposition 1A borrowing, which diverted nearly \$850,000 out of the General fund, in the prior year. When this “one-time” borrowing in the prior year is factored out, property tax revenues were consistent with the prior year. The City has assessments for a significant portion of its housing stock capped by Proposition 13 limitations, which have tended to offset any negative impact the decrease in property market values have had on property tax apportionments.
- Other taxes increased due to the positive economic factors that impacted the demand for rooms in the City’s Business Park resulting in the increase in transient occupancy taxes. Despite gains in many of the components of other taxes (likely as a result of the bettering of the economy), parimutuel and satellite wagering taxes related to the Los Alamitos Race Track located within the City were down once again this past year.
- The general fund received nearly \$3.5 million in State backfill monies for Motor Vehicle License Fees (MVLFF) which is recorded as taxes. These backfill amounts were approximately \$10,000 less than was received in the prior year and offset the ongoing annual decrease in MVLFF revenues resulting from the State takeaway that began several years ago.
- While the market interest rates earned on much of the City’s cash reserves continued to decrease during the fiscal year ended June 30, 2011, causing idle cash balances to generate lower interest earnings, the overall decrease in interest earnings is a result of the Redevelopment Agency paying off nearly \$18.6 million in outstanding notes with the City in March 2011. This early repayment of debt, which resulted from the sale of 13 acres of land from the Agency to the City, caused interest earnings to be \$290,000 less than budget estimates (and prior year totals).

Changes in general fund expenditures, by function, occurred as follows during the year ended June 30, 2011:

- General government expenditures decreased by \$226,429 (6.3 percent) due largely to lower city attorney activities during the fiscal year ended June 30, 2011. In the prior year, the city attorney incurred non-recurring charges related to several personnel issues, a street sweeper collision, and multiple non-personnel police department issues.
- Community development expenditures decreased by \$94,639 (6.8 percent) due largely to staff spending more of their time working on Redevelopment Agency issues and charging these hours to the appropriate entity and having one position vacant for a portion of the year.

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- Public safety (police) expenditures were down by \$290,557 (2.1 percent) from the prior fiscal year. While there were increases associated with the implementation of the second year of a four-year contract with sworn officers, these increases were offset by the ongoing control of overtime hours worked and various staffing vacancies within the department during the year.
- Public works expenditures decreased by \$288,425 (5.4 percent). The decrease is the result of incurring fewer expenditures in many areas, including street maintenance and cleaning, sidewalk repair and programs funded with operating grant monies. This City continues to see ongoing savings in several areas, due to eliminating several vacant positions in the maintenance and engineering divisions in the prior fiscal year. The job duties with these positions have been absorbed by other positions within the department or have been contracted out, resulting in significant ongoing salary savings.
- Capital outlay expenditures recorded in the General fund relate to improvements to the storm drainage system and have a tendency to fluctuate based on the allocation of resources in the Seven Year Capital Improvement Program budget. The City has recently begun implementing the needed improvements identified in the master plan of drainage and has largely exhausted monies that were legally restricted for drainage. As a result, the General fund began funding the majority of capital outlay expenditures for storm drainage in the fiscal year ended June 30, 2011.

Net transfers in the General Fund decreased dramatically due to the \$68.4 million “one-time” transfer to the City’s Capital Projects Fund for future infrastructure improvements that occurred in the prior year. The details associated with the some of the other transactions comprising net transfers are summarized as follows:

- A total of \$4.3 million was transferred into the City’s General fund from the City’s Capital Projects fund for storm drainage improvements. Additionally, the General fund annually receives transfers from the nonmajor governmental funds for reimbursement of eligible street maintenance expenditures as well as for administrative fees associated with the lighting and maintenance districts. Such transfers totaled slightly over \$1.1 million during the fiscal year ended June 30, 2011.
- In accordance with City policy, the General fund transferred \$1,750,000 to the City’s Capital Projects fund for projects budgeted in the fiscal year ended June 30, 2011. Additionally, a total of \$3.4 million was transferred to the City’s Capital Projects fund for future infrastructure projects.

General Fund Budgetary Highlights

Differences between the original appropriations budget and the final amended budget totaled a net increase of \$1,063,956. The annual carryover of appropriations to the new fiscal year for encumbrances and services not completed in the prior fiscal year

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accounted for \$826,209 of the difference. The significant remaining changes in appropriations are summarized as follows:

- \$83,891 in increases in public safety activities related to the police department's acceptance of various federal grants for DUI checkpoints, terrorism response, seat belt enforcement and other activities. These increases in appropriations were fully offset by an increase in revenues in the General fund.
- \$35,000 increase in public works for an Office of Traffic Safety grant for the purchase of traffic control device inventory software. Public works appropriations were also amended upward by \$53,334 for the award of a new janitorial contract which included park facilities and would be reimbursed by the Park District. Both these appropriation increases were offset by an increase to estimated revenues in the General fund.
- \$33,926 increase for Community Development to purchase additional banners which would place additional emphasis on marketing and branding of the City. These banners were purchased with restricted monies which had been contributed by developers specifically for promotional purposes.

The budgeted amount for transfers out were amended upward by \$28,604 to fund repairs to the City's gun range and for additional capital outlay purchases approved in previous years and carried over into the new fiscal year.

Total actual General fund revenues ended up exceeding the final amended revenue budget by nearly \$350,000 as a result of several factors. Stronger sales tax and transient occupancy tax receipts, due primarily to the recovery of the local economy, caused overall tax revenues to come in nearly \$1.2 million over original budget estimates. These excess revenues from taxes were partially offset by decreases to two other General fund revenue categories. Specifically, investment earnings came in below budget due to the ongoing low market interest rates being earned on cash balances and the payoff in March 2011 of a portion of the outstanding note between the City and Redevelopment Agency. This early payoff of nearly \$18.6 million on the note resulted in the General fund receiving \$290,000 less in interest than what otherwise would have been received. The other major reason for revenues being less than the amended budget relates to over \$430,000 in grant monies which were awarded and approved by Council during the year, but had not been "earned" as of fiscal year end. These grant revenues, along with associated expenditures, will be carried over and earned in future fiscal years.

Total operating expenditures were nearly \$1.8 million below the final amended budget (before any carryover amounts to the fiscal year ended June 30, 2011) and these savings were attributed to all departments throughout the City. Some of the major savings related to not expending the majority of the City Manager's contingency, the cancellation of the scheduled election for City Council, and having various staffing vacancies throughout the year in various departments of the City. As discussed earlier, the impact of unexpended grant amounts that will be carried over to the next fiscal year further account for the budget savings associated with operations. Capital outlay expenditures reported in the

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General fund relate to storm drainage projects approved as part of the Seven Year Capital Improvement Plan. While nearly \$11.3 million was included in the amended budget for these improvements, less than \$1.8 million had been expended by June 30, 2011. Of the \$9.5 million that had not been expended, a total of \$4.5 million in contracts had been awarded to vendors as of fiscal year end. These contract amounts, along with the remaining unexpended balance, will be carried over and awarded/expended in future years.

Other Major Funds

As mentioned previously, management annually discusses financial highlights of the City's major funds and any other funds that experience significant changes in fund balance during the year or have activities that management considers relevant to the operations of the City.

Recreation and Park District Special Revenue Fund

The Recreation and Park District special revenue fund is the sole operating fund of the Cypress Recreation and Park District (District). At the end of the current fiscal year, total fund balance was \$6,255,493 as compared to \$5,514,369 at the beginning of the year. The fund balance represents 155.0 percent (compared with 139.0 percent from the previous year) of the fund's total expenditures and the large majority of the fund balance amount is categorized as restricted. These restrictions are separated into amounts that are required to be used for improvements to open space and those amounts that may be used for general recreation activities. Since the bulk of the District's operations are funded with annual property tax revenues, a portion of the restricted fund balance for general recreation usage is needed to meet cash flow shortages between property tax receipts. The remaining restricted amounts (for both open space and recreation) are being accumulated for future non-recurring expenditures such as facility and infrastructure improvements that have been identified as part of a consultant's assessment analysis of the specific needs of the District for these types of capital improvements.

For the fiscal year ended June 30, 2011, the cash and investments balance in the Recreation and Park District special revenue fund was \$6,411,896, an increase of \$843,540 from the prior fiscal year. As mentioned above, amounts are being accumulated for future capital improvement expenditures. Total receivables at fiscal year end are \$378,240, with \$297,156 of total being related to the State's borrowing of property tax monies in the fiscal year ended June 30, 2010. The State is expected to repay these borrowed amounts in 2014.

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Summary of Changes in Fund Balances
Recreation and Park District Special Revenue Fund
For the fiscal year ended June 30, 2011 and 2010

	2011	2010	Change
Revenues			
Taxes:			
Property	\$ 3,623,026	\$ 3,376,902	\$ 246,124
From use of property	149,293	157,768	(8,475)
From other agencies	49,637	48,647	990
Charges for services	972,204	840,360	131,844
Other	7,748	6,265	1,483
Total Revenues	<u>4,801,908</u>	<u>4,429,942</u>	<u>371,966</u>
Expenditures			
Recreation	3,954,218	3,967,218	(13,000)
Capital outlay	82,728	-	82,728
Total Expenditures	<u>4,036,946</u>	<u>3,967,218</u>	<u>69,728</u>
Excess of revenues over expenditures	764,962	462,724	302,238
Net transfers	(23,838)	(6,098)	(17,740)
Increase in fund balance	<u>\$ 741,124</u>	<u>\$ 456,626</u>	<u>\$ 284,498</u>

Total Recreation and Park District Special Revenue fund revenues for the fiscal year ended June 30, 2011 increased by \$371,966 from the prior year. Individual components of this change are highlighted as follows:

- Property tax revenues, the District's largest revenue source, increased by \$246,124 due to the State initiating Proposition 1A borrowing in the prior fiscal year which resulted in nearly \$300,000 being diverted away from the District. Aside from this takeaway, the District experienced modest property tax growth resulting from the ongoing impact of Proposition 13 and its positive impact on assessed valuations outweighing the downturn in the real estate market. However, property tax receipts related to prior year assessments (that are collected and remitted to the City in the current year) decreased by approximately \$50,000 from the prior year total.
- The ongoing decrease in the market rate earned on the District's cash balances resulted in a drop in investment income.
- Charges for services increased due to experiencing increases in contract class revenue and senior citizen activity fees. Additionally, a total of \$88,000 in park development fees were received in the current fiscal year compared to no fees being received during the fiscal year ended June 30, 2010. These development fees tend to fluctuate year to year based on building activity within the City.

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Notable changes in expenditures during the fiscal year ended June 30, 2011 follow:

- Operating expenditures decreased by \$13,000 (0.3 percent) due primarily to the ongoing attempts by management to limit growth in operations. As part of the annual budget process, a thorough review was done to identify any areas where savings could be achieved without eliminating any existing programs. Several areas were identified which helped offset any cost increases associated with personnel.
- Capital outlay expenditures had been put on hold during the fiscal year ended June 30, 2010 pending the results of the infrastructure needs analysis. This resulted in no capital outlay expenditures being incurred during the prior fiscal year. Now that the needs have been identified and approved by Council, the City begun work on several projects (irrigation improvements, wood shelter reconstruction, lighting replacement, etc.). It is expected that additional capital improvements will continue into the upcoming fiscal year(s).

Redevelopment Agency Debt Service Fund

The Redevelopment Agency Debt Service Fund accounts for the receipt of tax increment revenues and the payment of interest and principal on debt of the Agency. The fund balance increased by \$17,614,445 during the year to a total of (\$23,374,566) at June 30, 2011. The following is a summary of the fiscal year activity:

Summary of Changes in Fund Balances
Redevelopment Agency Debt Service Fund
For the fiscal year ended June 30, 2011 and 2010

	2011	2010	Change
Revenues			
Taxes:			
Property	\$ 2,615,805	\$ 1,664,968	\$ 950,837
From use of property	14,482	25,761	(11,279)
From other agencies	42,567	42,810	(243)
Total Revenues	<u>2,672,854</u>	<u>1,733,539</u>	<u>939,315</u>
Expenditures			
Interest and charges	<u>1,899,014</u>	<u>2,179,224</u>	<u>(280,210)</u>
Excess of revenues over expenditures	773,840	(445,685)	1,219,525
Net transfers	16,840,605	(41,161)	16,881,766
Increase (decrease) in fund balance	<u>\$ 17,614,445</u>	<u>\$ (486,846)</u>	<u>\$ 18,101,291</u>

Total revenues for the fiscal year ended June 30, 2011 were \$2,615,805, which represents a 57.1% increase from the prior fiscal year. The large revenue increase is due to the State

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diverting nearly \$1.9 million in tax increment monies away from the Agency through the Supplemental Educational Revenue Augmentation Fund (SERAF) in the prior fiscal year, compared to approximately \$388,000 being diverted during the fiscal year ended June 30, 2011. As a result of the higher gross property taxes, the amount required to be passed through to other agencies increased, which in turn decreases net property tax revenues retained by the Agency. Total expenditures for the fiscal year were \$1,899,014, which represents a \$280,210 decrease from the prior year. The decrease was a result of paying less interest on the outstanding promissory note with the City due to the payoff of \$18,580,000 in principal in March 2011.

Net transfers are the primary component of the large increase in fund balance. In a typical year, the net transfers include the annual transfer to cover the debt service costs associated with the 2001 Lease Revenue Bonds and annual transfers necessary for cash flow purposes. These transfers for cash flow purposes tend to fluctuate from year to year based on need and equaled a net transfer out of \$400,000 in the prior year as compared to a net transfer out of \$1.3 million in the current year. In addition to these recurring transfers, an additional transfer was made in the fiscal year ended June 30, 2011. This transfer related to the transaction discussed previously in which the Agency sold 13 acres of land held for resale to the City for \$18,580,000 and in turn paid down the principal on the outstanding note. Since the land that was sold was recorded in the Agency's Capital Project Fund, it was necessary to transfer the amount available from the land sale to the Agency's Debt Service Fund to pay off the outstanding debt. This caused the huge rise in net transfers in the fiscal year ended June 30, 2011.

City Capital Projects Fund

The City Capital Projects Fund provides a cost center for City projects funded (either partially or in full) with General Fund monies. In accordance with City Council policy, an annual transfer is made from the General Fund to the Capital Projects Fund to pay for a portion of the projects approved as part of the Seven-Year Capital Improvement Program. The following table summarizes the activity during the past two years.

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Summary of Changes in Fund Balances
City Capital Projects Fund
For the fiscal year ended June 30, 2011 and 2010

	2011	2010	Change
Revenues			
From use of property	\$ 60,770	\$ 83,561	\$ (22,791)
From other agencies	231,457	417,685	(186,228)
Total Revenues	<u>292,227</u>	<u>501,246</u>	<u>(209,019)</u>
Expenditures			
Public works	3,127,152	3,475,026	(347,874)
Capital outlay	359,813	664,734	(304,921)
Total Expenditures	<u>3,486,965</u>	<u>4,139,760</u>	<u>(652,795)</u>
Excess of revenues over expenditures	(3,194,738)	(3,638,514)	443,776
Net transfers	1,404,275	67,515,653	(66,111,378)
Increase in fund balance	<u>\$ (1,790,463)</u>	<u>\$ 63,877,139</u>	<u>\$ (65,667,602)</u>

Total revenues for the fiscal year ended June 30, 2011 decreased \$209,019 from the prior fiscal year, which was the result of several factors. Interest earnings continued to fall due to lower market interest rate being earned throughout the year on accumulated cash balances. The City's revenues from other agencies (grant monies) tend to fluctuate from year to year based on eligibility and availability. In the fiscal year ended June 30, 2011, the City only received one significant grant which was a \$202,000 reimbursement from the Department of Energy for improvements to the heating and air conditioning system at City Hall. In the prior year, the City received reimbursements of approximately \$117,000 in federal American Recovery and Reinvestment Act monies and \$300,000 in State Proposition 1B monies for eligible streets and concrete improvements.

Total expenditures tend to vary from year-to-year depending on the status of non-recurring projects such as public facility renovations and street improvements such as median projects. During the current fiscal year the City expended slightly over \$1.3 million on various street projects, as compared to nearly \$2.0 million in the prior year.

During the prior fiscal year, a "one-time" transfer of \$68.4 million was made from the General Fund to the Capital Projects Fund so that monies could be formally set-aside and accumulated for future capital project expenditures consistent with the Seven Capital Improvement Plan. In a typical year, the amount shown as net transfers is comprised of multiple transfers in from various funds of the City and a single transfer out to the General Fund for use on storm drainage projects. Two of the annual transfers into the City Capital Projects Fund are from the General Fund. One portion of the transfer represents the annual funding requirement approved by the Council to fund current year projects, while the other component relates to monies allocated for infrastructure improvements that will be appropriated in future years. Total transfers in from the General Fund were \$5,150,000 during the fiscal year ended June 30, 2011. Transfers in

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from other funds relate to restricted monies coming from special revenue funds that are eligible to pay for a portion of street and public facility projects. The amount of these transfers in vary from year to year based on eligibility and availability and totaled slightly over \$550,000 for the fiscal year ended June 30, 2011, as compared to \$220,000 in the prior year. As mentioned earlier, an annual transfer out is made from the City Capital Projects Fund to the General Fund for storm drainage projects. Such transfers out for drainage projects totaled \$4.3 million for the fiscal year ended June 30, 2011 as compared to \$2.8 million in the prior year.

Redevelopment Agency Capital Projects Fund

The Redevelopment Agency Capital Projects Fund accounts for the construction and development activities in the Agency's three project areas, as well as low and moderate income housing activities required by State law. Funding for these activities is provided through advances from the City Capital Project Fund that will be paid back (via the Agency's Debt Service Fund) from tax increment receipts or proceeds from other activities, such as the sale of land. The fund balance in the Agency's Capital Projects Fund decreased by more than \$20.1 million during the fiscal year ended June 30, 2011. A summary of the changes in fund balances follows:

Summary of Changes in Fund Balances
Redevelopment Agency Capital Projects Fund
For the fiscal year ended June 30, 2011 and 2010

	2011	2010	Change
Revenues			
Taxes:			
Property	\$ 1,295,166	\$ 1,345,773	\$ (50,607)
From use of property	31,713	46,007	(14,294)
From other agencies	306,733	233,536	73,197
Other revenue	6,000	6,550	(550)
Total Revenues	<u>1,639,612</u>	<u>1,631,866</u>	<u>7,746</u>
Expenditures			
Community development	2,681,419	1,740,617	940,802
Excess of revenues over expenditures	(1,041,807)	(108,751)	(933,056)
Net transfers	(19,675,542)	(400,000)	(19,275,542)
Increase (decrease) in fund balance	<u>\$ (20,717,349)</u>	<u>\$ (508,751)</u>	<u>\$ (20,208,598)</u>

Total revenue for the fiscal year ended June 30, 2011 was \$1,639,312, which represents a small increase over the prior fiscal year. The increase in revenue can be attributed to receiving a larger allocation of Community Development Block Grant (CDBG) monies for housing rehabilitation activities than in the prior year, which more than offset the decrease in annual interest earnings.

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As discussed earlier in the analysis of the government-wide statements, one component of the increase in community development expenditures (as compared with the prior year) is due to recording the nearly \$1.7 million loss on the sale of land to the City. The 13 acres of land that was sold for its appraised value of \$18,580,000 had a basis in the Redevelopment Agency Capital Project Fund of slightly over \$20 million. In the prior fiscal year, the Agency made the final payment of \$1,030,000 in development assistance related to the purchase of housing affordability covenants on 80 low and very low income units in the prior year. Typically, expenditures in the Agency's Capital Projects fund are limited to home loan activities associated with restricted low and moderate income housing monies and any activities related to the Agency's three project areas, which has been minimal the last several years.

The large amount reported in net transfers is also related to the sale of the 13 acres of land to the City. Upon sale of the land, the Agency paid off \$18,580,000 of the promissory note with the City. In order to properly account for this payoff, it was necessary to transfer the proceeds from sale of the land from the Agency's Capital Projects Fund to the Agency's Debt Service Fund. In addition to the impact from the sale of land, the Agency also transferred nearly \$2.4 million to the Sewer Enterprise Fund to pay for a portion of eligible sanitary sewer improvements within the Lincoln Avenue Project Area. The final component impacting net transfers relates to reallocating amounts between the Agency's Capital Projects Fund and the Agency's Debt Service Fund to meet anticipated cash flow needs. Prior year net transfers were limited to a \$400,000 transfer for budgeted cash flow needs.

Sewer Enterprise Fund

The Sewer Enterprise fund accounts for the maintenance and improvements made to the City's sewer system. The primary revenue source associated with this fund is fees collected from user of the sewer system. During the fiscal year ended June 30, 2011, the City reclassified the Sewer fund from a special revenue fund to an enterprise fund in accordance with the requirements of GASB Statement No. 54. As a result of this reclassification, all infrastructure assets associated with the sanitary sewer system are recorded as assets in the Sewer Fund and the full-accrual method of accounting is now used to account for sewer activities within the fund. The net assets increased over \$3.4 million during the year. The following is a comparison of the enterprise activity in the fund for the past two years (as restated):

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Summary of Changes in Net Assets
Business-type Activities - Sewer Enterprise Fund
For the fiscal year ended June 30, 2011 and 2010

	2011	2010	Change
Operating Revenues			
Taxes:			
Property	\$ 7,319	\$ 7,198	\$ 121
From other agencies	350,456	108,069	242,387
Charges for services	1,262,636	703,628	559,008
Other	-	659	(659)
Total Operating Revenues	<u>1,620,411</u>	<u>819,554</u>	<u>800,857</u>
Operating Expenditures			
Sewer Maintenance	267,586	232,757	34,829
Depreciation	322,329	289,992	32,337
Total Operating Expenditures	<u>589,915</u>	<u>522,749</u>	<u>34,829</u>
Non-Operating Revenues (Expenses)			
Interest income	32,493	41,337	(8,844)
Interest expense	(44,250)	(69,300)	25,050
Total Non-operating Revenues	<u>(11,757)</u>	<u>(27,963)</u>	<u>16,206</u>
Income before transfers	1,018,739	268,842	782,234
Transfers			
Net transfers	2,395,542	-	2,395,542
Total Transfers	<u>2,395,542</u>	<u>-</u>	<u>2,395,542</u>
Increase (Decrease) in net assets	<u>\$ 3,414,281</u>	<u>\$ 268,842</u>	<u>\$ 3,177,776</u>

Total Sewer fund revenues for the fiscal year ended June 30, 2011 increased by \$800,857 over the prior year. The increase is due to two factors. First, the City received just over \$350,000 in Community Development Block Grant (CDBG) for eligible sewer system repairs, as compared to \$108,000 that was earned in the prior fiscal year. Additionally, the City Council approved a multi-step increase in sewer fees charged to both residential and commercial accounts. These increases will be phased in over several years and the second increase went into effect during the fiscal year ended June 30, 2011.

Maintenance expenditures increased by \$67,166 due to incurring additional personnel charges over the prior year. Depreciation expense associated with sewer infrastructure assets also increased as compared to the prior year. With the City implementing many of the improvements outlined in the sewer master plan, it is expected that depreciation expense will continue to increase as these additions to the sewer system are capitalized. As discussed previously, the Redevelopment Agency Capital Projects Fund transferred nearly \$2.4 million to the Sewer fund to pay for a portion of eligible sanitary sewer

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improvements within the Lincoln Avenue Project Area. This “one-time” transfer is the primary reason for the increase in net assets at June 30, 2011.

Capital Asset and Debt Administration

Capital assets. The City’s investment in capital assets as of June 30, 2011 amounts to \$169,345,894 (net of accumulated depreciation) and consists of \$159,248,382 for governmental activities and \$10,097,512 for business-type activities. The investment in capital assets for governmental activities includes land, buildings and improvements, vehicles and equipment, furniture and fixtures, roads, storm drains, sidewalks, street lights, and construction in progress. The investment in business-type activities is limited to the City’s sanitary sewer system. The City’s overall investment in capital assets during the past fiscal year increased by over \$5.3 million (2.0 percent) before depreciation. The following table summarizes capital asset activity for the fiscal year ended June 30, 2011.

Summary of Capital Assets
As of June 30, 2011 and 2010

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
Governmental Activities:						
Capital Assets, Not Depreciated:						
Land	\$ 7,793,597	\$ 7,793,597	\$ -	\$ -	\$ 7,793,597	\$ 7,793,597
Construction in Progress	5,218,567	2,178,733	1,494,752	185,789	6,713,319	2,364,522
Total, Not Depreciated	13,012,164	9,972,330	1,494,752	185,789	14,506,916	10,158,119
Capital Assets, Being Depreciated:						
Buildings and Improvements	29,696,047	29,297,157	-	-	29,696,047	29,297,157
Machinery and Equipment	10,278,321	9,712,175	-	-	10,278,321	9,712,175
Infrastructure	196,465,051	196,437,993	19,337,825	19,337,825	215,802,876	215,775,818
Total, Being Depreciated	236,439,419	235,447,325	19,337,825	19,337,825	255,777,244	254,785,150
Less Accumulated Depreciation:						
Buildings and Improvements	(10,704,849)	(9,842,956)	-	-	(10,704,849)	(9,842,956)
Machinery and Equipment	(7,782,426)	(7,140,530)	-	-	(7,782,426)	(7,140,530)
Infrastructure	(71,715,926)	(67,970,539)	(10,735,065)	(10,412,736)	(82,450,991)	(78,383,275)
Total Accumulated Depreciation	(90,203,201)	(84,954,025)	(10,735,065)	(10,412,736)	(100,938,266)	(95,366,761)
Total Depreciated, Net	146,236,218	150,493,300	8,602,760	8,925,089	154,838,978	159,418,389
Governmental Activities Capital Assets, Net	\$ 159,248,382	\$ 160,465,630	\$ 10,097,512	\$ 9,110,878	\$ 169,345,894	\$ 169,576,508

Major governmental activities capital asset transactions during the fiscal year 2010-11 included the following:

- Additions to construction in progress included storm drainage capacity and pump station improvements of \$2.3 million, as well as traffic signal improvements of approximately \$416,000 and intersection improvements of \$329,000.
- The additions to buildings and improvements include booster pump replacements at several park locations, installation of a closed-circuit television system at the police department, and several facility condition assessment improvements.
- Machinery and equipment additions were comprised primarily of capitalized costs associated with the replacement of five vehicles and 30 “rugged” computers for use by the police department. Both the replacement of 165 desktop computers

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throughout the City and the implementation of the City's new payroll and human resources software, comprise a significant portion of the increase in machinery and equipment.

Major business-type activities capital asset transactions during the fiscal year 2010-11 included the following:

- Additions of \$1.3 million to construction in progress include sewer capacity and condition improvement projects at approximately 200 locations throughout the City.

Additional information on the City's capital assets can be found in note 7 (on page 64) in the notes to the basic financial statements section of this report.

Long-Term debt. The City had total debt outstanding of \$13,073,956 at the end of fiscal year 2010-11. The following schedule summarizes the City's long-term liabilities.

Summary of Long-Term Debt
As of June 30, 2011 and 2010

	2011	2010	Change
Claims Payable	\$ 2,272,177	\$ 2,291,970	\$ (19,793)
Compensated Absences	2,651,779	2,491,756	160,023
Retiree's Health Benefits	5,005,000	4,992,676	12,324
Lease Revenue Bonds	3,145,000	3,450,000	(305,000)
Total	\$ 13,073,956	\$ 13,226,402	\$ (152,446)

Long-term debt activity during the fiscal year ended June 30, 2011 included:

- A net decrease in claims payable resulted from the decrease in the estimate of outstanding workers compensation claims being slightly larger than the increase in liability insurance claims outstanding at June 30, 2011.
- A net increase of \$160,023 in compensated absences due to accruals exceeding leave usage and payoffs during the prior year and the impact of negotiated pay raises. Increases in compensated absences are common in years where there are few retirements or resignations of long-term employees, such as in the past year.
- In accordance with GASB 45, the City had an actuarial valuation performed to determine the liability for postemployment benefit plans as of June 30, 2011. The results of this revised actuarial valuation resulted in the City's liability for retiree's health benefits increasing slightly to a total of \$5,005,000.
- The scheduled principal payment on the 2001 Lease Revenue Bonds of \$305,000.

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It should be noted that the City continues to opt to be conservative and record the entire actuarially determined liability associated with retiree's health benefits, not just the net OPEB obligation which is required by GASB 45. Additionally, the City has set aside sufficient monies in the Employees Benefits Internal Service Fund to pay for the entire \$5,005,000 long-term liability. However, these monies have not been placed in an irrevocable trust and therefore are not considered funded assets for actuarial and GASB 45 purposes.

Additional information on the City's long-term debt can be found in note 9 (on pages 67-69) in the notes to the basic financial statements section of this report.

Economic Factors and their impact on future City Budgets

Despite the negative impact of one of the worst economic downturns in memory during the past several years, which resulted in significantly lower revenue streams, the outlook for the City remains relatively positive. The City has historically limited growth in its operating budget and focused on building up its reserves, with the expectation that it would be able to survive any such downturns without having to make drastic budget cuts or decrease levels of service. Despite this proactive approach to limit controllable costs, the City remains vulnerable to both the continued uncertainties associated with the overall economic climate and the annual attempts by the State to balance their budget at the expense of local governments. The history of legislative actions at the State level which have taken away, or shifted, local funding serves as a constant reminder that the City's long-term autonomy is not a certainty.

While the passage of Proposition 1A several years ago abolished many of the methods historically used to divert City revenues, past experiences indicate that if the State is desperate for revenues they will likely find creative new ways to route revenues away from local governments. As if on cue, the Governor recently signed legislation that will essentially eliminate redevelopment agencies unless an annual fee is paid to the State. The City has carefully reviewed this legislation and determined that it is in the City's best interests to forego paying the annual extortion to the State and dissolve the Cypress Redevelopment Agency. Multiple lawsuits have been filed regarding the legality of this legislation and the City is anxiously awaiting the upcoming rulings. However the City remains optimistic that even in the event that the State prevails on the lawsuits regarding Redevelopment Agencies, the City will be able to still present a balanced budget which maintains current service levels. While it remains to be seen what the ultimate fate of Redevelopment Agencies will be, it serves as another reminder that there are no guarantees for local entities in regards to preserving the status quo. It is important to remember that any future State takeaways (such as Redevelopment Agencies) would be in addition to the ERAF shift in the early 1990's which has permanently decreased annual property tax revenues by more than \$3.0 million (between the City and Recreation and Park District), as well as the multiple "one-time" ERAF shifts that occurred sporadically over the past ten years.

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In addition to the ERAF shifts discussed above, the State “borrowed” approximately \$1,213,000 from the City and Recreation and Park District in FY 2009-10 under Proposition 1A. The State is supposed to repay these amounts prior to June 30, 2013 and cannot borrow any additional monies until all outstanding amounts are repaid. However once the initial amount borrowed is repaid, the State does have the ability to implement one additional round of borrowing from local agencies within a ten-year period.

In addition to the ongoing issues impacting revenues, the City is also concerned with the large increases in the actuarially determined contributions that will be required by CalPERS for the City’s pension plan. These rates have risen significantly over the past few years and increases are expected to continue into future years to make up for the enormous losses incurred by CalPERS over the last several years. In anticipation of all these issues, the City continues to have a hiring freeze in effect for all vacant positions that are not deemed essential. This is in addition to the 15 vacant positions that were eliminated during the fiscal year ended June 30, 2010. Additionally, the City has taken steps during the most recent negotiations that require all newly hired full-time employees to pay a larger share of their annual CalPERS pension costs. This is viewed as a first step in helping to get the long-term costs associated with pensions under control.

Current estimates indicate that budgeted General fund revenues and expenditures are on pace with the original budget estimates for the fiscal year ending June 30, 2012. The revenue estimates included in the budget were conservatively prepared and assumed that there would be no additional cuts to the City’s revenue sources controlled by the State. As has been done in the past, staff will be closely monitoring State economic developments and legislative actions to determine the precise impact they may have to local governments. Any material fiscal impact to City operations from such developments will be incorporated into the upcoming mid-year budget review or in future budgets.

The other major ongoing component of the City’s budget relates to the funding of the City’s capital needs. As part of the fiscal year 2011-12 budget, City staff implemented the first year of the seven-year capital funding plan to address the significant infrastructure deficiencies identified during the assessments of the City’s infrastructure systems (particularly storm drains and sewer). Despite the City Council’s approval of a gradual increase in sewer rates over several years, the City does not in the short-term have sufficient or significant dedicated revenue sources (other than General fund monies) for many of their infrastructure needs (including storm drains and major sewer improvements). With near-term growth in General fund revenues unlikely, due to all the circumstances discussed earlier, it will be imperative that alternatives be identified to fund these shortfalls over the long-term. As discussed previously, the City sets aside and accumulates infrastructure monies in the City’s Capital Projects Fund for future improvements by making annual transfers of assigned fund balance amounts from the General fund. While this is consistent with the City’s policy to set-aside the majority of available General fund balance amounts for future infrastructure improvements, it does not alleviate the need to find additional funding methods for the capital improvement project shortfalls that are anticipated over the next 20 to 30 years.

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The originally approved fiscal year 2011-12 budget was balanced and some of the major highlights of the adopted budget are summarized below. As discussed earlier, it appears that current revenues and expenditure estimates are in line with the original budget estimates.

Revenues. The City's projected revenues for FY 2011-12 are \$34,072,839 and do not include any tax rate increases from the previous year. The FY 2011-12 revenue budget is essentially unchanged from the FY 2010-11 adopted revenue budget of \$34,092,562.

The major changes in revenues for the FY 2011-12 Budget are as follows:

- ♦ Increased Sales Tax revenues (including backfill amounts classified as other taxes) of nearly \$274,000 are expected. The increase is due to a slight turnaround from the economic downturn of the past few years and is derived from the latest sales tax collection trends and projections made by the City's sales tax consultant. While added development over the years has increased the number of sales tax providers in the City, the recent negative impact of the overall economy has caused a significant decrease in annual sales tax revenues over the peak of three or four years ago.
- ♦ Other Taxes (excluding the sales tax backfill discussed above) are projected to increase by approximately \$257,000 due to several factors. First, the City expects satellite wagering taxes to decrease \$80,000 due to recent trends and the potential impact of closures of racing facilities. Second, transient occupancy taxes are projected to rise \$250,000 which can be partially attributed to the gradual turnaround of the economy and its impact on business travel. Also, an increase of \$150,000 in the Educational Revenue Augmentation Fund - Vehicle License Fee (ERAF-VLF) backfill paid by the State is projected for the upcoming year.
- ♦ Decreased interest and rent revenue of approximately \$1,066,000 are expected as a result of two factors: 1) the Redevelopment Agency recently paid off nearly \$18.6 million in notes due to the City which paid \$929,000 of annual interest to the City's General Fund; and 2) the interest rate earned on the City's cash balances continues to be low and the City's cash balances will continue to decrease due to implementing another year of the City's Capital Improvement Program (which totals over \$15.3 million) for the upcoming year.
- ♦ Property taxes, based on projections made by the County, are expected to increase slightly when compared to the prior budget. Due to a large portion of the City's property tax base being assessed below current market values due to Proposition 13, the ongoing downturns in the local housing market tends to be offset by the 2% growth associated with the properties controlled by Proposition 13. While it is expected that some additional properties that have been sold in the past five or six years may be reassessed downward in the coming year, the exact impact to City

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revenues resulting from these reassessments will likely not be known until future budget years.

- ◆ Total service charges are projected to increase by slightly more than \$380,000. The primary reason for the increase is the impact of another year of the multi-step adjustment to sewer fees that was approved a few years ago. These additional sewer fees will help pay for the necessary capital improvements associated with maintaining and enhancing the City's sanitary sewer system over the next several years.
- ◆ Other revenues are projected to increase by nearly \$220,000 due largely to the ongoing receipt of federal asset seizure monies. These monies are generated from the Police Department's involvement in local drug enforcement task forces and are restricted to use for approved police expenditures.

Expenditures. The FY 2011-12 Budget once again includes funding of the City's goals and objectives as established by the City Council in April 2007. Some funded objectives include: 1) continuing with the funding of economic development programs to highlight the City in programs in both the General Fund and Redevelopment Agency; 2) communicating with residents and businesses and fostering community well-being through quarterly newsletters, website maintenance and enhancements, and the continuance of the City's banner program; 3) funding of the Capital Improvement Program, maintaining the funding of the tree trimming program, and helping to ensure that adequate replacement funds will exist for future public facilities and infrastructure; 4) ongoing funding of Community Oriented Policing and the replacement of two vehicles and two motorcycles along with various other equipment items to help sustain and enhance public safety; and 5) providing for effective government operations through each department once again reviewing their operations to optimize the use of available resources and limit budget growth.

Other major highlights in the expenditures for the FY 2011-12 Budget are as follows:

- ◆ Maintaining current service levels.
- ◆ Year one of the City's updated Seven Year Capital Improvement Program totals \$15,331,000, of which \$9,875,000 is being funded with General Fund/Infrastructure Reserve Fund monies, \$540,000 is funded with monies accumulated in the Storm Drainage Fund (reported as part of the General Fund) and \$2,016,000 is funded by Sewer Fund monies.
- ◆ Capital Outlay funding of \$290,184 to acquire and/or replace various computer hardware and software, tools and equipment, and two vehicles and two motorcycles used by the police department.
- ◆ The General Fund operating portion of the budget is essentially unchanged from the prior year. The ability for operations to remain flat, despite incorporating

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negotiated/projected salary and benefit increases, is a result of each department once again thoroughly reviewing their budgets and identifying controllable expenditures that could be adjusted downward or delayed without impacting current operations or current service levels. Some of the major components that can be attributed to preventing growth in General Fund operations include: the continuation of freezing currently vacant positions, the continuation of limiting overtime and out-of-area travel, and limiting all capital outlay purchases to non-General fund sources.

Requests for Information

This financial report is designed to provide a general overview of the financial position of the City for all interested parties. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Department, 5275 Orange Avenue, Cypress, CA 90630.