

CITY OF HIGHLAND, ILLINOIS
FY 2007 Audit - Management's Discussion & Analysis

CITY OF HIGHLAND, ILLINOIS
Council/Manager - Form of Government
April 30, 2007

MAYOR

Joseph Michaelis

CITY MANAGER

Mark Latham

CITY COUNCIL MEMBERS

Mike Gould

Mike Riffel

Wayne Sinnock

Ruth Zobrist

CITY CLERK

Barbara Bellm

CITY TREASURER

Dennis Foehner

DEPARTMENT DIRECTORS

Terry Baney

Joe Gillespie

Matthew Johnson

Paul Joseph

Angela Kim

Mark Rosen

Sharon Rusteberg

Judy Schmitt

Police Chief

Public Works

Light & Power

Community Development

Public Library

Parks & Recreation

Finance

Personnel

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This section of the City of Highland's annual financial report presents discussion and analysis from City management regarding the City's financial performance during the fiscal year that ended on April 30, 2007 with comparative information for the fiscal year ended April 30, 2006.

FINANCIAL HIGHLIGHTS

- Total Net Assets of the City of Highland equal \$57.5 million, up from \$54.6 million in FY '06. This is a result of \$87.0 million in assets less \$29.5 million in liabilities (\$74.8 million in assets less \$20.2 in liabilities during FY '06). The increases are primarily due to the issuance of a \$9.68 million alternate revenue bond for Street Projects. Future revenues from the newly enacted 1% Non-Home Rule Sales Tax have been pledged for the repayment of the bonds.
- Overall City expenditures increased less than 1%, from \$24.9 million in FY '06 to \$25.1 million in FY '07. A significant reason for this was that the City's cost of power from the IMEA decreased in excess of \$1 million dollars. This is due primarily to the retirement of IMEA debt related to the construction of a new power plant in Trimble County. Another outcome of this was that the Light & Power Fund avoided an operating loss for the first time since 1999.
- The City's bonded debt per capita of \$32.33 is practically non-existent. This is due to a shifting of the debt burden in recent years from property taxes to alternate revenue bonds. As a result, the City's legal debt margin continues to be well under the statutory debt limitation. Based on assessed valuation, the City has the ability (by referendum) to borrow up to \$13.9 million. The General Obligation debt balance of \$305,000 will be retired in the next fiscal year.
- The City of Highland is compliant with the GASB 34 reporting model, which requires accounting for depreciation of fixed assets within governmental activities. Shown within the Statement of Net Assets, the fixed assets year-end balance for fiscal year 2007 is \$48.6 million (net of depreciation). This is comprised of \$23.5 million for governmental activities plus \$25.1 million for business-type activities.
- Sales tax receipts, shown within the "Intergovernmental" revenue line item, increased 49% to a total of \$3.3 million. The total includes seven months of receipts from the Non-Home Rule Sales Tax that was passed by voters in March of 2006, which is dedicated to street projects. The standard 1% sales tax by itself increased 4.2% to a total of \$2.3 million. This is a continuation of the growth consistently seen in sales tax receipts for the City of Highland, and is an indicator of a strong local economy.
- An area of concern is the General Corporate Fund, where primary operating expenses exceeded primary operating revenues by \$316,428. This is a continuation of the trend seen in recent years, as the expenses increased 7.9% while the revenues increased 6.8%. The overall fund balance decreased \$333,090 during FY '07. Operational and maintenance expenditures make up the majority of these expenditures, since the capital projects related to Street Improvements are shown separately due to the 2006 Street Bond.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements.

- The Statement of Net Assets and the Statement of Activities provide information about the activities of the City as a whole and present a longer-term view of the City's finances.
- For governmental activities, these statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statements also report the City's operations in more detail than the government-wide statements by providing information about the City's most financially significant funds.
- The remaining statements provide financial information about activities for which the City acts solely as a trustee or agent for the benefit of those outside of the government.

**Reporting the City as a Whole –
The Statement of Net Assets and the Statement of Activities**

One of the most important questions asked about the City's finances is "Is the City as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about the City as a whole and about its activities in a way that helps answer this question. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

**Reporting the City's Most Significant Funds -
Fund Financial Statements**

Some funds are required to be established by State law and bond covenants. However, the City Council establishes many other funds to help it control and manage money for particular purposes (such as the 2006 Electric Bonds for Infrastructure Improvements) or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money.

The City's three types of funds use different accounting approaches:

- *Governmental funds* – Most of the City's basic services are included in governmental funds, which focus on (1) how *cash and other financial assets* that can readily be converted to cash flows into and out of these funds and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed *short-term* view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in the reconciliation within exhibits #4 and #6 of the "Basic Financial Statements" section.
- *Enterprise Funds* – Services for which the City charges customers for the full cost of the services it provides are generally reported in Enterprise Funds. These business-type activities, like the government-wide statements, provide both long- and short-term financial information. Business-type activities are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities.

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- *Fiduciary funds* – The City has fiduciary responsibility for other assets that – because of trust arrangements – can be used only for the trust beneficiaries. The City is responsible for ensuring the assets reported in these funds are used for their intended purposes. All of the City's fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets. We exclude these activities from the City's government-wide financial statements because the City cannot use these assets to finance its operations.

In the supplemental information section, the City has provided detailed schedules of revenues, expenditures, and changes in fund balances for three funds. In addition, detailed historical data can be found regarding tax levies, building permits, and property values. Information regarding principal taxpayers, overlapping debt, and miscellaneous statistics about the City of Highland are also included. The reports are intended to provide the user with information beyond the realm of the traditional auditing requirements. The general corporate fund includes general government, public safety, highways and streets, economic development, and culture and recreation. The Ambulance Fund details activities within the municipal ambulance service of Highland. The City Property Replacement Fund is a reserve account for all fund types.

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FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

The following table provides a comparison between the activities for FY '07 and the activities for FY '06 under the GASB statement #34 model.

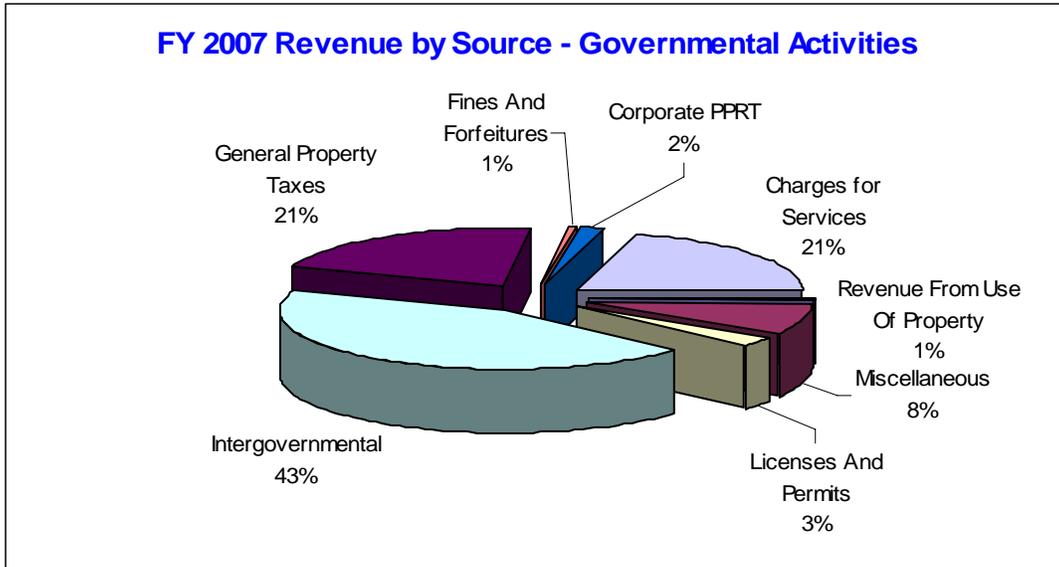
Changes in the City of Highland's Activities
(in millions of dollars)

	Governmental Activities		Business-type Activities		Totals	
	Fiscal Year 2007	2006	Fiscal Year 2007	2006	Fiscal Year 2007	2006
Revenues						
Program Revenues						
Charges for Services	\$ 2.9	\$ 2.6	\$ 15.2	\$ 14.7	\$18.1	\$17.3
Operating Grants and Contributions	0.2	0.2			0.2	0.2
General Revenues						
Property Taxes, General Purposes	2.7	2.3			2.7	2.3
Property Taxes, Debt Service	-	0.3			0.0	0.3
Intergovernmental	5.3	4.0			5.3	4.0
Miscellaneous	1.2	0.9	0.5	0.4	1.7	1.3
Total Revenues	\$ 12.3	\$ 10.3	\$ 15.7	\$ 15.1	\$ 28.0	\$ 25.4
Expenditures						
General Government	\$ 1.1	\$ 1.0			\$ 1.1	\$ 1.0
Public Safety	4.1	3.6			4.1	3.6
Highways and Streets	2.3	2.4			2.3	2.4
Culture and Recreation	2.3	2.2			2.3	2.2
Economic Development	0.2	-			0.2	0.0
Employer's Cont. to Retirement Fund	0.6	0.6			0.6	0.6
Interest on Long-Term Debt	0.5	0.2			0.5	0.2
Electric			\$ 9.2	\$ 10.3	9.2	10.3
Water			2.0	1.9	2.0	1.9
Sewer			1.9	1.8	1.9	1.8
Solid Waste			1.0	0.9	1.0	0.9
Total Expenditures	\$ 11.1	\$ 10.0	\$ 14.1	\$ 14.9	\$ 25.2	\$ 24.9
Excess of Revenues Over Expenditures	\$ 1.2	\$ 0.3	\$ 1.6	\$ 0.2	\$ 2.8	\$ 0.5

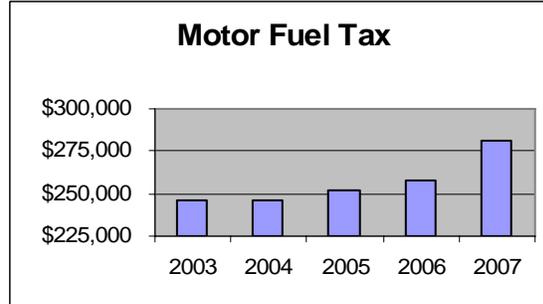
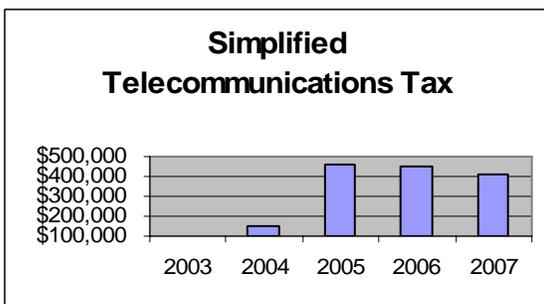
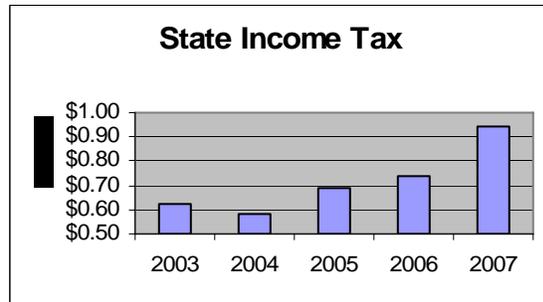
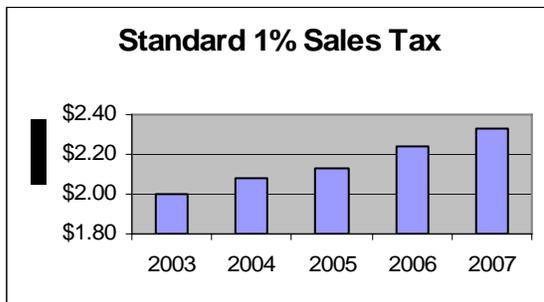
Governmental Activities

Governmental Activities include all funds except Business-Type Activities and the Police Pension Fiduciary Fund. Examples include the following: General Fund (which includes the Police Dept, Fire Dept, Community Development, General Administration, and Streets & Alley Dept among others), Ambulance Fund, Parks and Recreation, and the various Library Funds.

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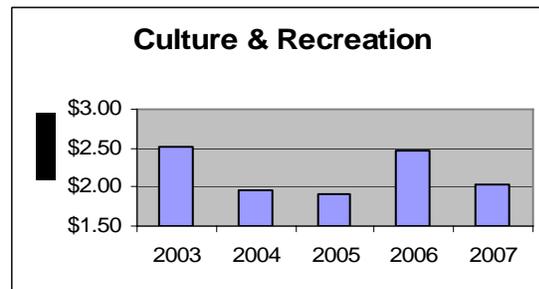
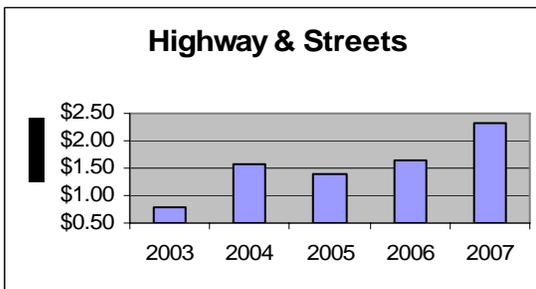
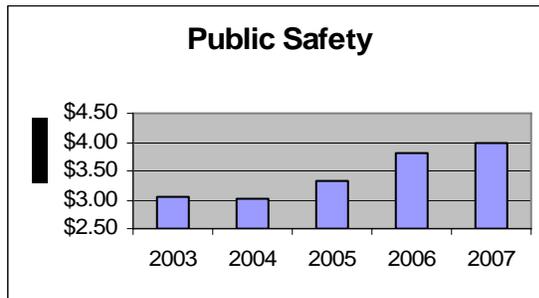
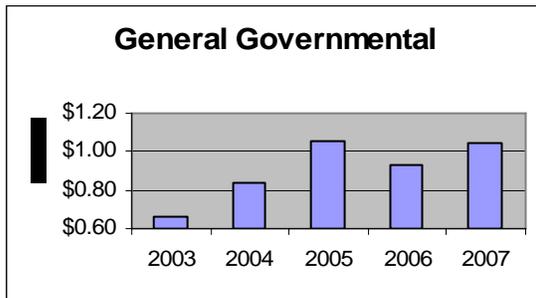
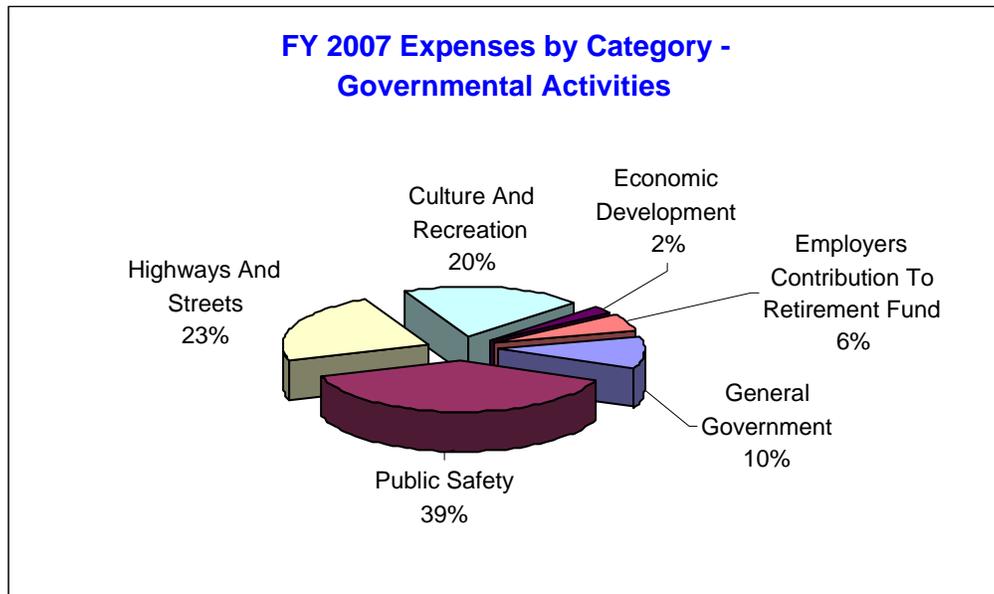


Intergovernmental revenues include revenues due to the City of Highland that pass through the State of Illinois. These include, but are not limited to, the revenues seen in the following charts. The increase in State Income Tax and Motor Fuel Tax is directly related to the certified population increase (8,438 to 9,433) that resulted from the partial special census in 2005.



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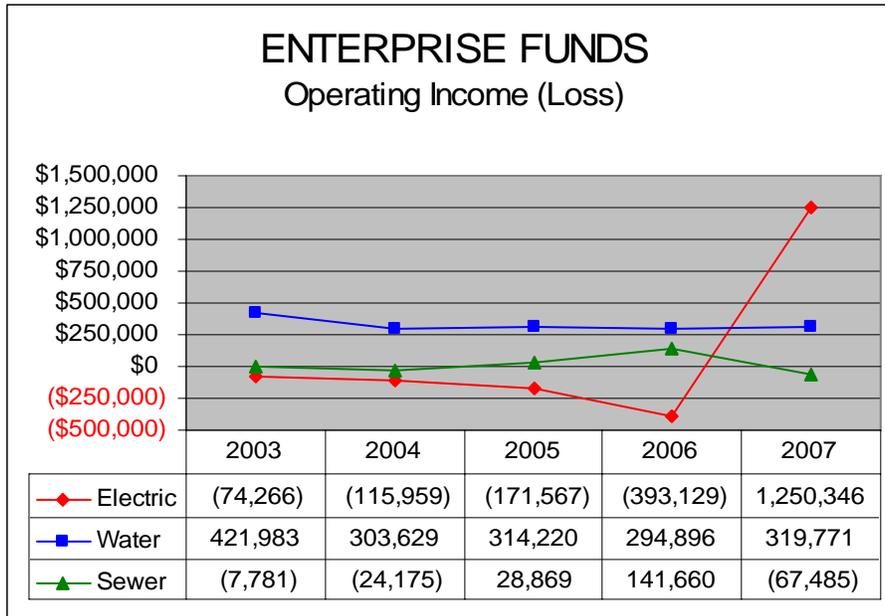
Expenditures of Governmental Activities are spread among a wide variety of functions. Among these are public safety functions of police, fire, and EMS. Also included are the activities of highways and streets as well as culture and recreation (parks & recreation / library). These areas are funded with the aforementioned revenues such as property taxes and intergovernmental revenues. Capital expenditures within Governmental Activities are depreciated over their useful life as a result of the GASB 34 reporting model.



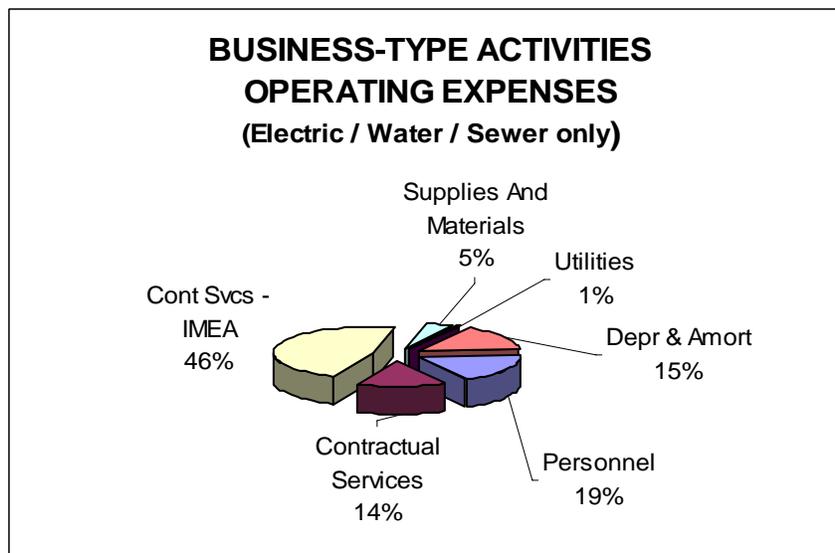
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Business-type Activities

Business-type Activities include revenues and expenditures related to the Light & Power, Water, Sewer, and Solid Waste funds. The Light & Power fund sustained a gain from operations for the first time since 1999. The primary reason is due to a lower cost of power to the City from the Illinois Municipal Electric Agency. This was possible because of the retirement of IMEA debt related to the Trimble County power plant. In addition, the City adjusted the manner in which the power cost adjustment is calculated on customer bills. The additional revenue from four months of applying the revised power cost adjustment calculation equated to \$168,000.



Overall expenditures of Business-type Activities decreased during FY '07. However, when adjusting for purchase power cost and depreciation, the remaining operational and maintenance expenditures remained identical to FY '06 at \$5.81 million.



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STATUS OF CITY RESERVES

The following is a listing of the City's Governmental Fund's reserves. The governmental funds reported a *combined* fund balance of \$17.9 million. The increase is, once again, due primarily to the new Street Bond. The City's capital projects reserve is a property improvement fund for improvement / replacement of equipment and infrastructure.

City of Highland
Statement of Governmental Fund Balances

	Fiscal Year 2007	Fiscal Year 2006	Percent Change
<u>Reserved Funds</u>			
Maintenance and Upkeep	\$ 653,366	\$ 646,818	1.01%
Bldg Construction and Improvements	472,311	457,768	3.18%
<u>Unreserved Funds</u>			
General	2,459,668	2,792,758	-11.93%
Special Revenue	1,173,574	905,727	29.57%
Debt Service	9,454,246	68,860	13629.66%
Capital Projects	3,749,869	2,485,436	50.87%
Totals	\$ 17,963,034	\$ 7,357,367	144.15%

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of FY 2007, the City had \$48.6 million (net of depreciation) invested in a range of capital assets that include equipment, building and structures, and infrastructure. During FY '07, the Finance Department amended its capitalization policy to adopt a capitalization threshold of \$15,000. Infrastructure is valued based on the composite cost. Depreciation is calculated using the straight-line method. Salvage value is zero in all cases.

City of Highland's Capital Assets
(net of depreciation, in millions of dollars)

	Governmental Activities		Business-type Activities		Totals	
	Fiscal Year		Fiscal Year		Totals	
	2007	2006	2007	2006	2007	2006
Land	\$ 1.50	\$ 1.40	\$ 0.60	\$ 0.60	\$ 2.10	\$ 2.00
Construction in Progress	0.50	0.90	2.20	0.70	2.70	1.60
Bldgs & Improvements	6.00	6.20	9.00	8.50	15.00	14.70
Other Improvements	1.70	0.20	2.50	1.90	4.20	2.10
Equipment	1.10	1.10	1.90	1.80	3.00	2.90
Infrastructure	12.70	13.90			12.70	13.90
Lines			8.70	8.10	8.70	8.10
Interconnect			0.20	0.20	0.20	0.20
Totals	\$23.50	\$23.70	\$25.10	\$ 21.80	\$48.60	\$45.50

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Capital improvement projects that were either completed or in progress as of the end of the fiscal year included the Eastside Substation, Iberg Road Upgrade, the construction of a new 1.5 million gallon water storage tank, and the Downtown Square Revitalization Project.

Debt

In recent years, the City has shifted its debt burden from property taxes to alternate revenue bonds. As of the end of the fiscal year, the City has \$305,000 in general obligation debt. This figure is well below the City's legal debt limitation of \$13.9 million that is allowable based on assessed valuation. During FY '07, the City pledged future receipts from the 2006 1% Non-Home Rule Sales Tax Referendum in order to attain a \$9.68 million Alternate Revenue Bond for the purpose of street improvements. As a result, long-term debt saw a significant increase.

City of Highland's Outstanding Debt
(in millions of dollars)

	Governmental Activities		Business-type Activities		Totals	
	Fiscal Year		Fiscal Year			
	2007	2006	2007	2006	2007	2006
Revenue Bonds	\$14.60	\$5.10	\$ 7.40	\$ 7.70	\$22.00	\$12.80
General Obligation Bonds	0.30	0.60			0.30	0.60
Notes Payable			4.20	4.50	4.20	4.50
Employee Benefits Payable	0.50	0.50	0.30	0.30	0.80	0.80
Totals	\$15.40	\$6.20	\$11.90	\$12.50	\$27.30	\$18.70

Other significant debts included in the chart include an IEPA low interest loan for the 1999 upgrade of the Water Reclamation Facility along with alternate revenue bonds used for the construction of the Water Treatment Facility, the purchase of the Korte Recreation Facility, and the 2006 bond issue for electrical system upgrades. The City has earned a bond rating of "Aaa" from Moody's, and is equivalent to the "AAA" rating of S&P/Fitch. The risk of the "Aaa" rating is generally referred to as being the highest quality.

CURRENT EVENTS AND NEXT YEAR'S BUDGET

The City of Highland has taken an aggressive approach towards managing the growth of the community. The following is a brief description of some of the actions taken in FY '07, with a brief look ahead into FY '08.

Receipts from the Non-Home Rule Sales Tax Referendum (passed in March of 2006) were received in only seven of the twelve months this fiscal year. This 1% increase in sales tax is estimated to bring in an additional \$1.3 - \$1.5 million annually to the City for street projects. 80% of the new revenue has been pledged to support new street construction projects. 20% of the revenue will be used towards the maintenance of existing streets and sidewalks. In return for the passage of the referendum, the City Council abated the remaining years of the 1996 Street Bond property tax levy, thereby reducing the City's property tax rate.

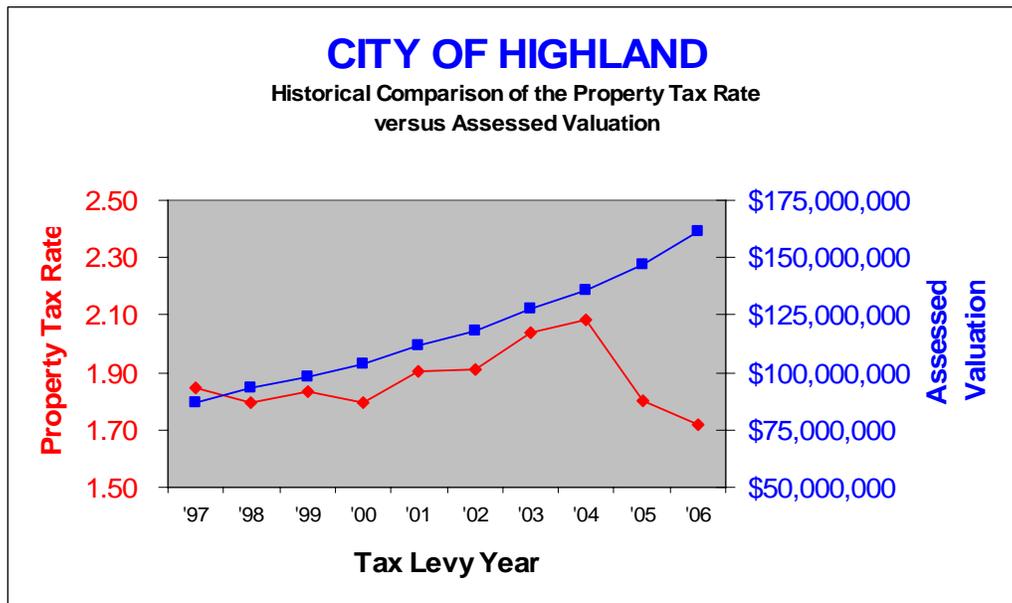
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The City Council issued alternate revenue bonds against this new revenue stream in FY '07 in order to expedite the \$10 million in street projects forecasted in the next five years. Foremost of these projects is the "peripheral route project" that will relieve traffic congestion downtown, and connect the dense residential areas on the eastern side of the community with the commercial district of the northern side of Highland.

FY '07 saw extensive work on the Eastside Substation. The project has been financed by the 2006 alternate revenue bonds for capital improvement projects that are scheduled by the Electric Department over the next few years. This new substation will help alleviate the load on the current system and provide more reliable service to the eastern portion of Highland that has experienced high residential growth in recent years. Future revenues from this enterprise will pay for the bonds. The City's goal is to have the substation operational prior to the summer of 2008.

Steps have been taken to improve daily operations and help the City become more efficient. The City is pursuing performance management initiative and continues to review policies and procedures. General Fund revenues have been departmentalized in order to increase accountability within each separate department. Various committees have been re-established and are taking an important role in assisting the City with its management. For example, a Growth Management Committee, comprised of key city staff members, are working together to create a growth plan that accounts for the short and long-term needs of each department. The Economic Development Committee was established to help promote the strength of the City to the business community. The City has also appointed a Director of Community Development to oversee its efforts in that area.

As of April 2007, the City's Equalized Assessed Value rose 9.85% to a total of \$161,430,206. The average growth rate of EAV during the past 10 years has been 7.05% per year. The EAV is used in conjunction with the 2006 Property Tax Levy for the collection of property taxes during FY '08. With the abatement of the Street Bond Levy, done in conjunction with the passage of the non-home rule sales tax referendum, the tax rate has fallen nearly 18% over the past two years, with the City maintaining or exceeding the same levels of service.



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CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Director of Finance, City of Highland, PO Box 218, Highland, IL 62249.

General information relating to the City of Highland may be found at www.highlandil.gov.