

CITY OF HIGHLAND, ILLINOIS
FY 2008 Audit - Management's Discussion & Analysis

CITY OF HIGHLAND, ILLINOIS
Council/Manager - Form of Government
April 30, 2008

MAYOR

Joseph Michaelis

CITY MANAGER

Mark Latham

CITY COUNCIL MEMBERS

Chris Bardill

Peg Bellm

Mike Riffel

Ruth Zobrist

CITY CLERK

Barbara Bellm

CITY TREASURER

Dennis Fohner

DEPARTMENT DIRECTORS

Terry Baney

Joe Gillespie

Matthew Johnson

vacant

Angela Kim

Mark Rosen

Sharon Rusteberg

Lisa Schoeck

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, 2008 with comparative information for the fiscal year ended April 30, 2007.

FINANCIAL HIGHLIGHTS

- During Fiscal Year 2008 the City of Highland paid off the remaining balance of the 1996 Street Improvements Bond that was financed with general obligation debt. As a result, the City of Highland no longer utilizes property taxes for repayment of any debt.
- Total assets exceeded liabilities at the close of the fiscal year by approximately \$60.4 million (net assets). Of this amount, the unrestricted amount of \$20 million may be used to meet the City's ongoing obligations to citizens and creditors.
- City-wide net assets increased 5% during the fiscal year. An increase of 5.4% was realized in governmental activities while a 4.6% increase occurred within enterprise activities. The increase was realized despite an overall increase in City expenditures of 7%.
- 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 2008 is \$52.1 million (net of depreciation). This is comprised of \$24.1 million for governmental activities plus \$28.0 million for business-type activities. The 7% increase in fixed assets is largely represented by the City's investment in upgrading the electric infrastructure, street projects, and the Low Level Outlet Project at Silver Lake.
- Receipts of the traditional sales tax, shown within the "Intergovernmental" revenue line item, only increased 0.7% during FY 2008. This represents the second lowest annual growth rate in sales tax during the past 10 years. By comparison, the average growth rate for the City of Highland during the same time period has been 5.4% annually. According to City estimates, the number of retailers in Highland has remained the same. The decrease in sales tax growth is indicative of the economic climate across the country. The traditional sales tax accounts for 30% of all general corporate revenues.
- FY 2008 was the first full year of receipts from the 2006 Non-Home Rule Sales Tax Referendum. This 1% increase in NHR sales tax was estimated to bring in an additional \$1.3 - \$1.5 million annually to the City for street projects. Receipts for the year equaled \$1.4 million.
- A decrease in building permit activity due to the national economic slowdown may have both short and long term repercussions for the City. Connection fee revenues were significantly lower as well. The growth rate of the City's equalized assessed value (EAV), which is an important component in property tax calculations, may be diminished in the future due to the decrease in building activity.

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 '08 and the activities for FY '07 under the GASB statement #34 model. The city-wide total for both revenues and expenditures increased \$1.7 million during the fiscal year. In the case of both governmental and business-type activities, revenues exceeded the expenditures. The surplus is utilized by the City of Highland to meet the City's fiscal policy in relation to reserves for operations, maintenance, and capital projects.

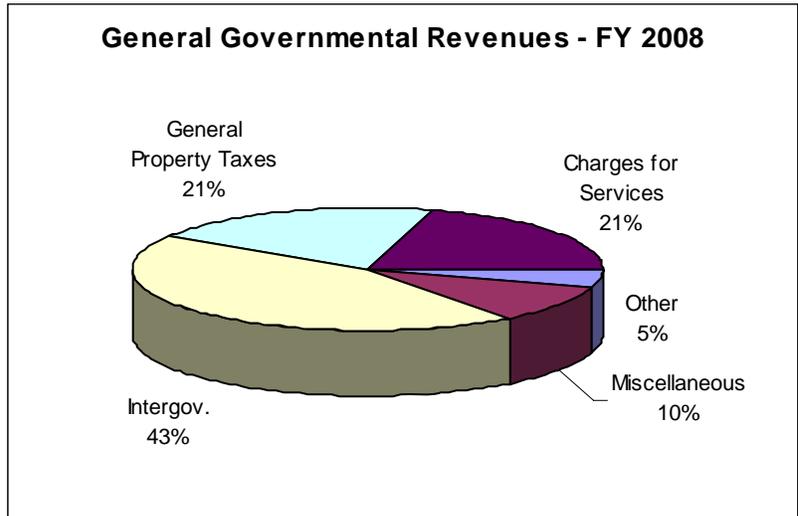
Changes in the City of Highland's Activities
(in millions of dollars)

	Governmental Activities		Business-type Activities		Totals	
	Fiscal Year 2008	2007	Fiscal Year 2008	2007	Fiscal Year 2008	2007
Revenues						
Program Revenues						
Charges for Services	\$ 3.0	\$ 2.9	\$ 16.0	\$ 15.2	\$19.0	\$18.1
Operating Grants and Contributions	0.1	0.2			0.1	0.2
General Revenues						
Property Taxes, General Purposes	2.9	2.7			2.9	2.7
Intergovernmental	5.9	5.3			5.9	5.3
Miscellaneous	1.3	1.2	0.5	0.5	1.8	1.7
Total Revenues	\$ 13.2	\$ 12.3	\$ 16.5	\$ 15.7	\$ 29.7	\$ 28.0
Expenditures						
General Government	\$ 1.2	\$ 1.1			\$ 1.2	\$ 1.1
Public Safety	4.2	4.1			4.2	4.1
Highways and Streets	2.6	2.3			2.6	2.3
Culture and Recreation	2.3	2.3			2.3	2.3
Economic Development	0.1	0.2			0.1	0.2
Employer's Cont. to Retirement Fund	0.6	0.6			0.6	0.6
Interest on Long-Term Debt	0.6	0.5			0.6	0.5
Electric			\$ 10.3	\$ 9.2	10.3	9.2
Water			2.1	2.0	2.1	2.0
Sewer			1.9	1.9	1.9	1.9
Solid Waste			1.0	1.0	1.0	1.0
Total Expenditures	\$ 11.6	\$ 11.1	\$ 15.3	\$ 14.1	\$ 26.9	\$ 25.2
Excess of Revenues Over Expenditures	\$ 1.6	\$ 1.2	\$ 1.2	\$ 1.6	\$ 2.8	\$ 2.8

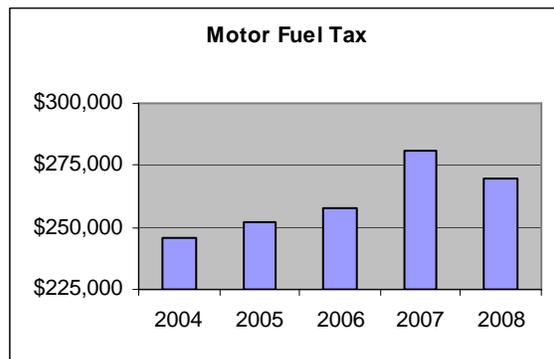
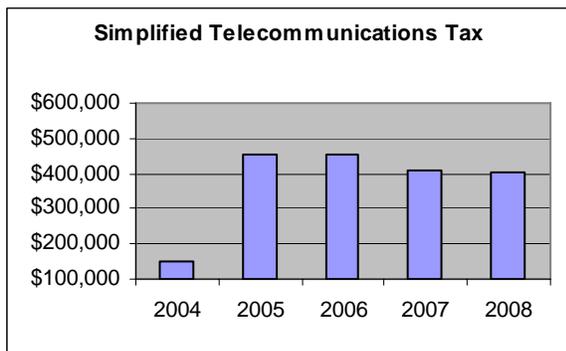
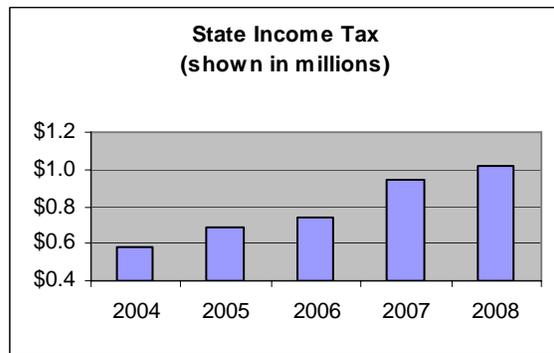
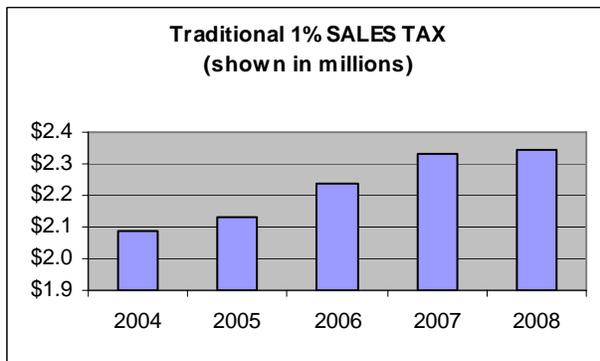
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Governmental Activities

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.

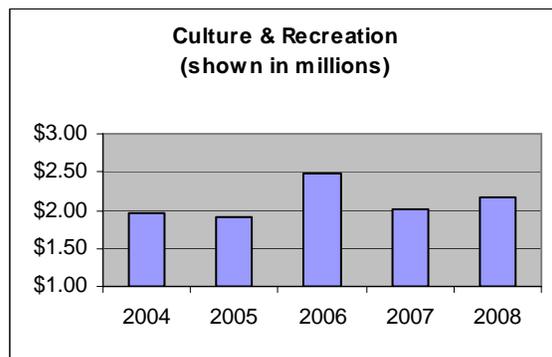
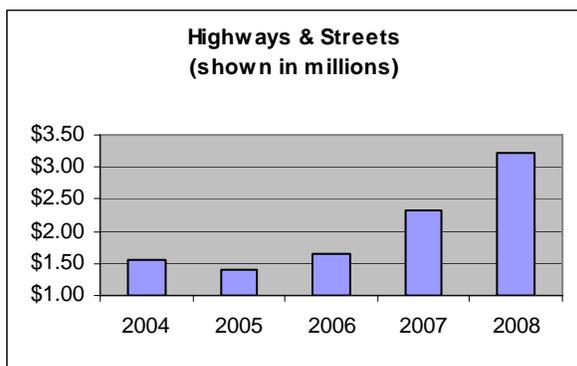
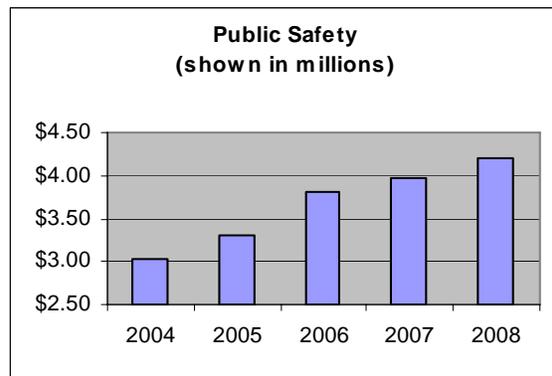
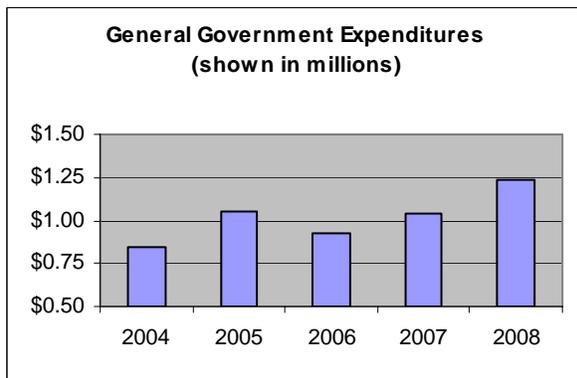
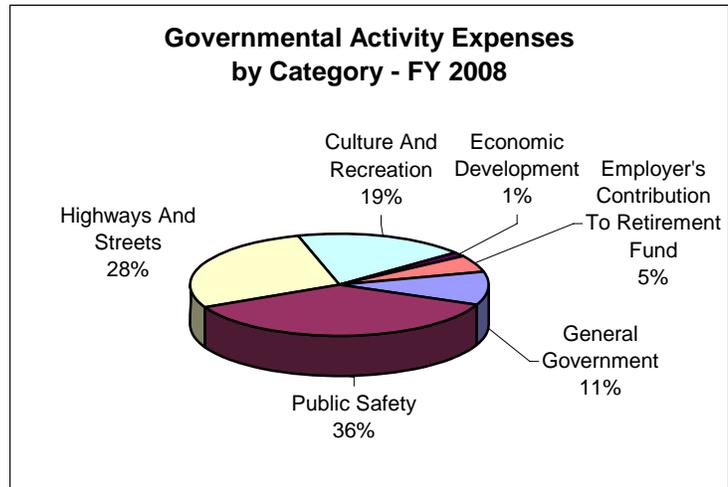


Intergovernmental revenues include revenues due to the City of Highland that pass through the State of Illinois. These include, but are not limited to, sales tax, income tax, and the simplified telecommunications tax. Corporate replacement tax as well as fines and forfeitures are included within the “other” category. The “miscellaneous” category includes interest income. “Charges for Services” includes billings from the City’s Ambulance service and user fees from Parks & Recreation.



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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.

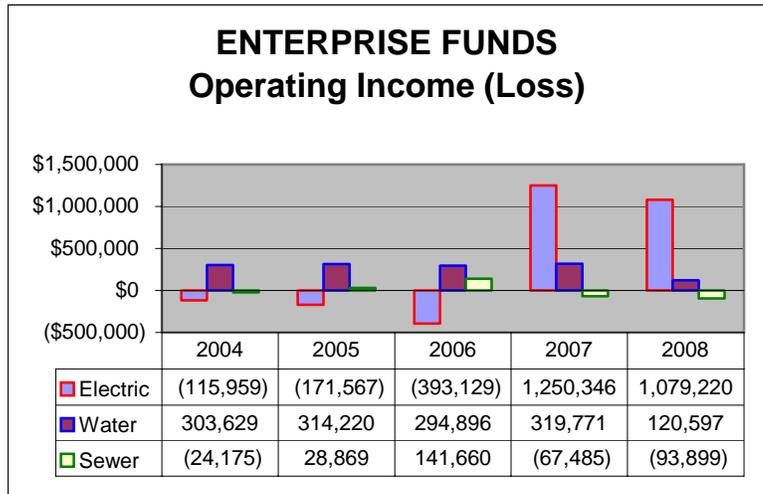


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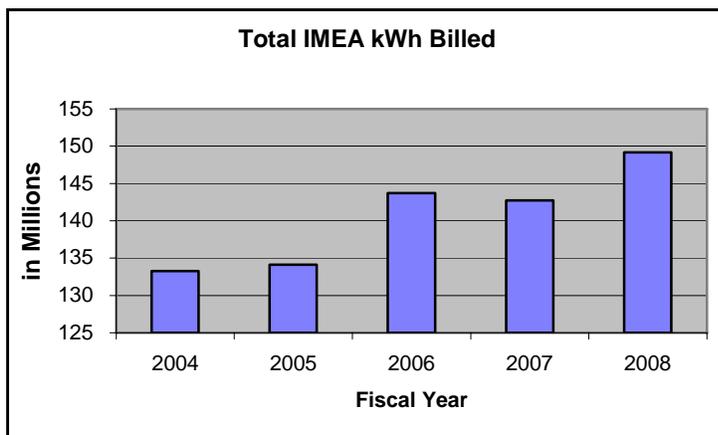
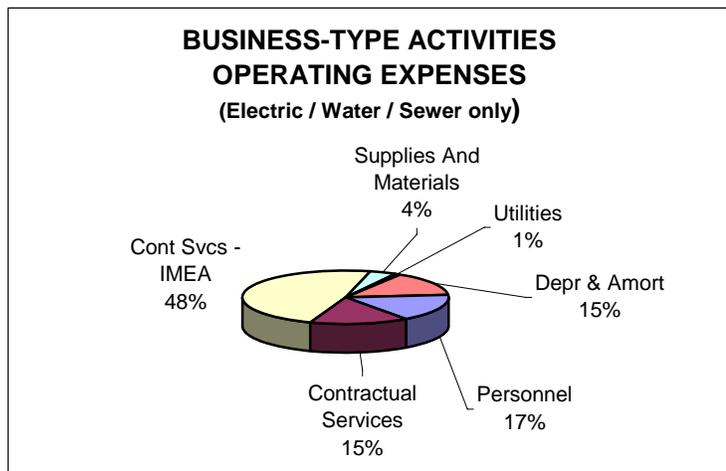
Business-type Activities

Business-type Activities include revenues and expenditures related to the Light & Power, Water, Sewer, and Solid Waste funds. Business-type activities do not receive property or intergovernmental taxes. Each enterprise fund operates as an independent entity, relying solely on user fees for operations.

Light & Power Fund gain from operations beginning in 2007 resulted from a change in the power cost adjustment calculation along, improved accounting for the fuel reimbursement from IMEA, and more in-house engineering. The decrease in operations for the Water & Sewer Funds is due to a decrease in gallons billed and a significant reduction in connection fee revenue as a result of a decrease in construction activity and building permit issuance.



Despite an increase in operating cost within the Sewer Fund of only 1.1%, there was an operating loss. This can be attributed to a decrease in gallons billed during Fiscal Year 2008. For the year, there were six million fewer gallons billed to City customers. In addition, the economic slowdown meant a 55% reduction in connection fee revenue for the Sewer Fund (52% for all enterprises).



Total operating revenues increased 5% during FY '08. Total operating expenditures increased 9%, primarily due to a 14% increase in the cost of power. This is mainly due to an increase in kilowatt hours billed to Highland customers. The heat wave and dry summer of 2007, along with an increase in electric customers, are primary reasons for the increase in kilowatt hours billed.

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STATUS OF CITY RESERVES

The governmental funds reported a *combined* fund balance of \$18.2 million. The recent bond issuance for street projects is reserved funds shown within the “Bldg Construction and Improvements” line. Those funds are designed to be spent on specific projects per the bond covenant, and as such are designed to be spent down. City departments contribute annually to the unreserved “capital projects” line per the City’s budgeting guidelines.

City of Highland
Statement of Governmental Fund Balances

	Fiscal Year 2008	Fiscal Year 2007	Percent Change
<u>Reserved Funds</u>			
Maintenance and Upkeep	\$ 693,099	\$ 653,366	6.08%
Bldg Construction and Improvements	8,945,032	9,926,557	-9.89%
<u>Unreserved Funds</u>			
General	2,522,439	2,459,668	2.55%
Special Revenue	1,331,521	1,173,574	13.46%
Capital Projects	3,513,368	3,091,987	13.63%
Debt Service	1,171,689	657,882	78.10%
Totals	\$ 18,177,148	\$ 17,963,034	1.19%

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of FY 2008, the City had \$52.1 million (net of depreciation) invested in a range of capital assets that include equipment, building and structures, and infrastructure. Infrastructure is valued based on the composite cost. The straight-line depreciation method is used, with a salvage value always being zero.

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

	Governmental Activities		Business-type Activities		Totals	
	Fiscal Year 2008	2007	Fiscal Year 2008	2007	2008	2007
Land	\$ 2.1	\$ 1.5	\$ 0.6	\$ 0.6	\$ 2.7	\$ 2.1
Construction in Progress	0.6	0.5	4.3	2.2	4.9	2.7
Bldgs & Improvements	5.8	6.0	8.3	9.0	14.1	15.0
Other Improvements	1.7	1.7	4.0	2.5	5.7	4.2
Equipment	1.1	1.1	1.9	1.9	3.0	3.0
Infrastructure	12.8	12.7			12.8	12.7
Lines			8.7	8.7	8.7	8.7
Interconnect			0.2	0.2	0.2	0.2
Totals	\$ 24.1	\$ 23.5	\$ 28.0	\$ 25.1	\$ 52.1	\$ 48.6

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Debt Administration

The City of Highland eliminated the remaining balance of the 1996 General Obligation Street Bond during FY 2008. As a result, the City of Highland does not require the use of property taxes in the repayment of debt. Debt repayment is accomplished primarily with sales tax revenue and utility sales. The passage of the 2006 Non-Home Rule Sales Tax Referendum is a major reason for this accomplishment. The City of Highland's legal debt limit of \$15.4 million is now fully available upon approval of voter referendum approval. Total City debt per capita is approximately \$2,500.

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

	Governmental Activities		Business-type Activities		Totals	
	Fiscal Year		Fiscal Year		Fiscal Year	
	2008	2007	2008	2007	2008	2007
Revenue Bonds	\$ 14.3	\$ 14.6	\$ 6.1	\$ 7.4	\$ 20.4	\$ 22.0
General Obligation Bonds	\$ -	\$ 0.3			\$ -	\$ 0.3
Notes Payable			\$ 3.9	\$ 4.2	\$ 3.9	\$ 4.2
Employee Benefits Payable	\$ 0.5	\$ 0.5	\$ 0.3	\$ 0.3	\$ 0.8	\$ 0.8
Totals	\$ 14.8	\$ 15.4	\$ 10.3	\$ 11.9	\$ 25.1	\$ 27.3

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 '08, with a brief look ahead into FY '09.

FY 2008 was the first full year of receipts from the Non-Home Rule Sales Tax Referendum (passed in March of 2006). This 1% increase in sales tax was estimated to bring in an additional \$1.3 - \$1.5 million annually to the City for street projects. Receipts for the year equaled \$1.4 million. 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. The City Council issued alternate revenue bonds against this new revenue stream during 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". The northwest quadrant of the route is expected to begin construction towards the end of FY 2009. Attempts for land acquisition in order for construction of the northeast quadrant to occur are ongoing. Other projects funding by the Non-Home Rule Sales Tax include the 6th Street Storm Sewer, Iberg Road Reconstruction, and Poplar St. Phase 2 project.

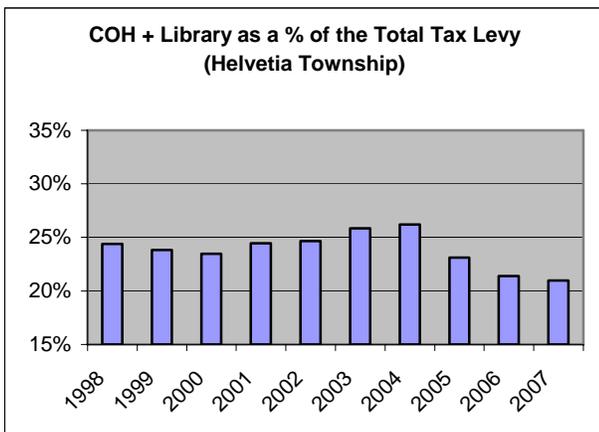
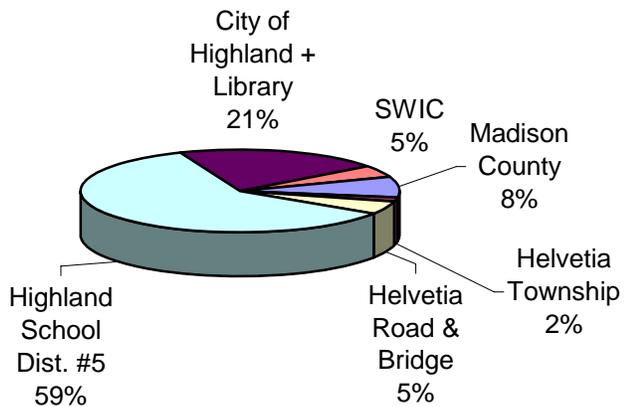
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Other major capital projects that were recently completed or in progress as of the end of the fiscal year include the Eastside Substation and the Low Level Outlet (LLOW) at Silver Lake. The Eastside Substation Project has been financed by the 2006 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. The substation was placed into service shortly after the conclusion of FY '08. Future revenues from this enterprise will pay for the bonds.

The LLOW is used to work in conjunction with the spillway to relieve flood water and prevent overtopping of the dam and compromising the dam structure. The original outlet was damaged shortly after its construction in the early 1960's leaving it inoperable. The structure was rebuilt in 2008 and is now fully functional.

Steps have been taken to improve daily operations and help the City become more efficient. The City uses aspects of various performance management tools such as Six Sigma and Baldrige Analysis for budgeting and trend analysis. Under the direction of the City Manager, various committees have been established to review policies and procedures and to take an active 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 for each department to ensure that adequate infrastructure and services are available concurrently with new development.

As of April 2008, the City's Equalized Assessed Value rose 10.6% to a total of \$178.6 million. The average growth rate of EAV during the past 10 years has been 7.55% per year. The EAV is used in conjunction with the 2007 Property Tax Levy for the collection of property taxes during FY '09. The City of Highland's property tax rate for 2008 represents 21% of the total property tax rate in Helvetia Township (Saline Township is nearly identical).



The City's portion of the total property tax rate for Highland residents has decreased for several years, due to the decrease in the City's property tax rate. The City's tax rate has decreased three years in a row, which equates to a 19% reduction (see Table 5 in the statistical section). The City rate represents its lowest level during the past 10 years. The City takes pride in its ability to lower the tax rate for Highland residents, and seek ways to continue this trend in the future

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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.