

**CITY OF HIGHLAND, ILLINOIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING APRIL 30TH, 2006**

**CITY OF HIGHLAND, ILLINOIS
Council/Manager - Form of Government
April 30, 2006**

CITY COUNCIL

Mayor Joe Michaelis

CITY MANAGER

Mark Latham

COUNCIL MEMBERS

Mike Gould

Mike Riffel

Wayne Sinnock

Ruth Zobrist

CITY CLERK

Barbara Bellm

CITY TREASURER

Dennis Foehner

DEPARTMENT DIRECTORS

Sam Sivewright

Sharon Rusteberg

Mark Rosen

Judy Schmitt

Terry Baney

Joe Gillespie

Angela Kim

Light & Power

Finance

Parks & Recreation

Personnel

Police Chief

Public Works

Public Library

**CITY OF HIGHLAND, ILLINOIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING APRIL 30TH, 2006**

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, 2006 with comparative information for the fiscal year ending April 30, 2005.

FINANCIAL HIGHLIGHTS

- Total Net Assets of the City of Highland equal \$54.6 million, up from \$54.1 million in FY '05. This is a result of \$74.8 million in assets less \$20.2 million in liabilities (\$69.1 million in assets less \$15.0 in liabilities during FY '05).
- Revenue growth was slower than the growth rate of expenses. Total revenues increased a healthy 7% to a total of \$25.4 million. However, total expenditures increased 10% to a total of \$24.9 million. A major reason behind the 9% expenditure increase was the cost of electricity within the Light & Power Fund.
- Due to the combination of a 12% growth rate in population (certified by the U.S. Census Bureau) and the annual debt payment towards the GO Bond, the City's bonded debt per capita fell from \$103.11 in FY 2005 to \$63.08 in FY 2006.
- The City's legal debt margin continues to be well under the statutory debt limitation. Total GO Debt is currently \$595,000 whereas the limitation is \$12.7 million. The current Street GO Bond will be retired during FY 2008. In addition, the City Council abated all future property tax levies related to the Street GO Bond due to the passage of a Non-Home Rule sales tax referendum in March of 2006. The abatement applies to the 2005 and 2006 property tax levy, which is collected in FY 2007 and FY 2008.
- 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 asset year-end balance for fiscal year 2006 is \$45.4 million (net of depreciation). This is comprised of \$23.7 million for governmental activities plus \$21.7 million for business-type activities.
- The City of Highland issued a \$6.25 million alternate revenue bond for the Light & Power Fund in April of 2006. Future revenues within the enterprise were pledged in order to finance a number of large capital projects in the upcoming future, including the construction of a new substation in the rapidly growing residential areas on the eastern side of the city.
- Sales tax receipts, shown within the "Intergovernmental" revenue line item, increased 5% to a total of \$2.2 million. This is a continuation of the growth consistently seen in sales tax receipts for the City of Highland.

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.

**CITY OF HIGHLAND, ILLINOIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING APRIL 30TH, 2006**

**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 1996 Street Improvements Project) 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.
- *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.
- *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.

**CITY OF HIGHLAND, ILLINOIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING APRIL 30TH, 2006**

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.

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

The following table provides a comparison between the activities for fiscal year 2006 and the activities for fiscal year 2005 under the GASB statement #34 model.

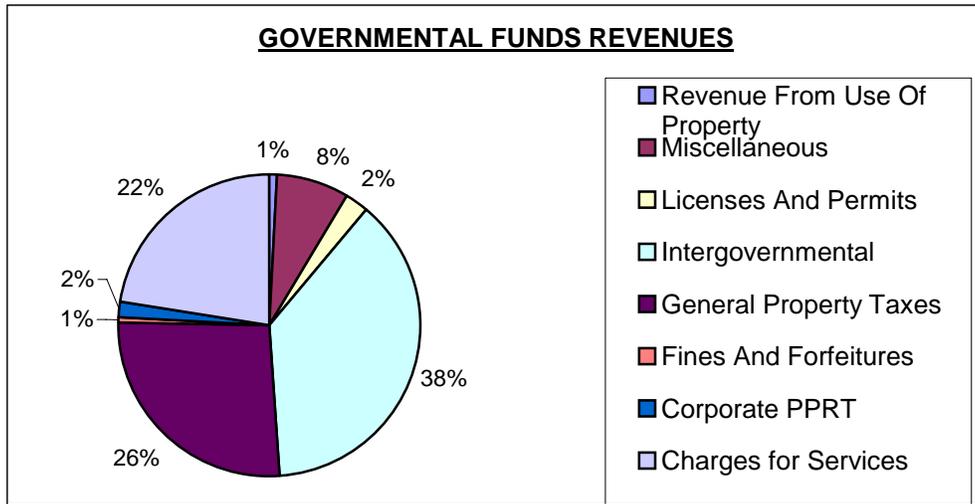
**Changes in the City of Highland's Activities
(in millions of dollars)**

	Government Activities		Business-type Activities		Totals	
	Fiscal Year		Fiscal Year		Fiscal Year	
	2006	2005	2006	2005	2006	2005
Revenues						
Program Revenues						
Charges for Services	\$ 2.6	\$ 2.4	\$ 14.7	\$ 13.7	\$ 17.3	\$ 16.1
Operating Grants and Contributions	0.2	-			0.2	0.0
General Revenues						
Property Taxes, General Purposes	2.3	2.4			2.3	2.4
Property Taxes, Debt Service	0.3	0.3			0.3	0.3
Intergovernmental	4.0	3.8			4.0	3.8
Miscellaneous	0.9	0.6	0.4	0.5	1.3	1.1
Total Revenues	\$ 10.3	\$ 9.5	\$ 15.1	\$ 14.2	\$ 25.4	\$ 23.7
Expenditures						
General Government	\$ 1.0	\$ 1.1			\$ 1.0	\$ 1.1
Public Safety	2.5	2.3			2.5	2.3
Highways and Streets	2.4	2.2			2.4	2.2
Health - EMS	1.1	0.9			1.1	0.9
Culture and Recreation	2.2	2.0			2.2	2.0
Employer's Cont. to Retirement Fund	0.6	0.6			0.6	0.6
Interest on Long-Term Debt	0.2	-			0.2	0.0
Electric			\$ 10.3	\$ 9.3	10.3	9.3
Water			1.9	1.7	1.9	1.7
Sewer			1.8	1.8	1.8	1.8
Solid Waste			0.9	0.9	0.9	0.9
Total Expenditures	\$ 10.0	\$ 9.1	\$ 14.9	\$ 13.7	\$ 24.9	\$ 22.8
Excess (Deficiency) of Revenues						
Over (Under) Expenditures	\$ 0.3	\$ 0.4	\$ 0.2	\$ 0.5	\$ 0.5	\$ 0.9

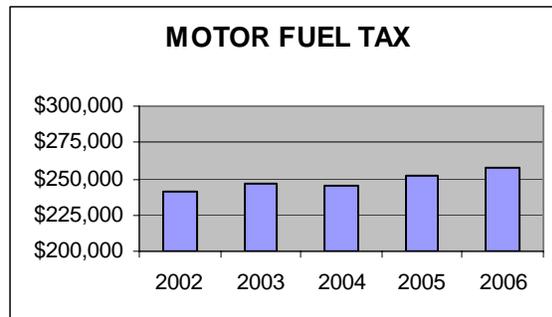
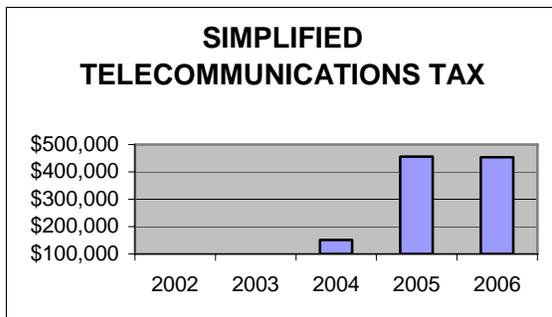
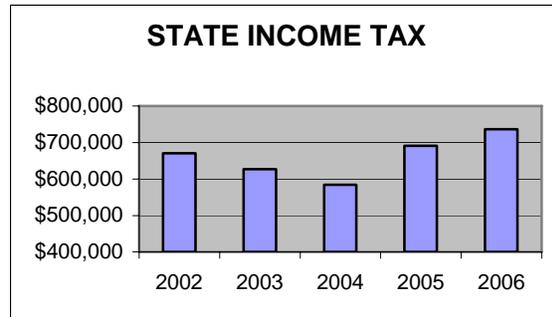
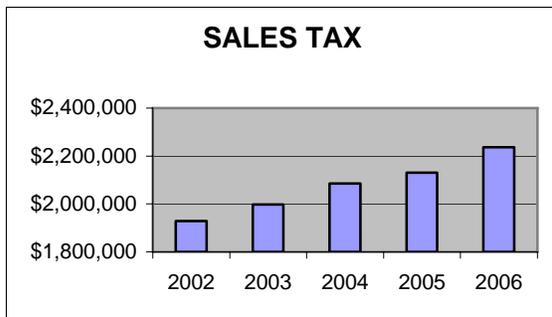
**CITY OF HIGHLAND, ILLINOIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING APRIL 30TH, 2006**

Governmental Activities

Governmental Activities include all funds except Business-Type activities and the Police Pension Fiduciary Fund. Funds that are included in the Governmental Activities include the following: General Fund (which includes the Police Dept, Public Works, and Fire Dept among others), Ambulance Fund, Parks and Recreation, and the various Library Funds.

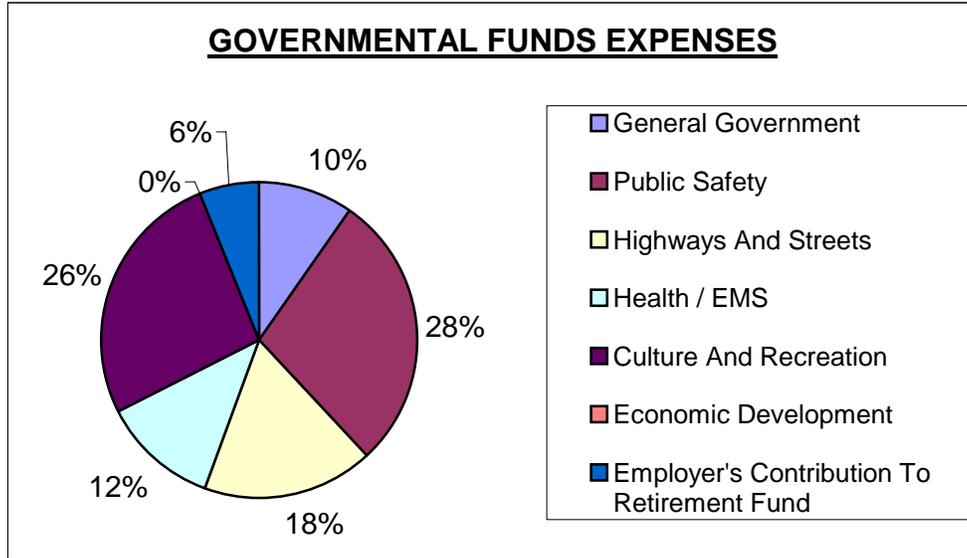


Intergovernmental revenues include revenues due to the City of Highland that pass through the State of Illinois. These include, but are not limited to, the revenues seen in the following charts. Sales Tax continues to increase, due in part to the commercial and residential growth within the City (see Current Economic Factors and Next Year's Budget). The Simplified Telecommunications Tax, which was increased from 1% to 6% in FY 2004, equaled \$453,825.

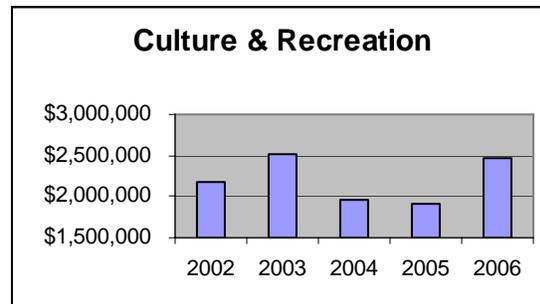
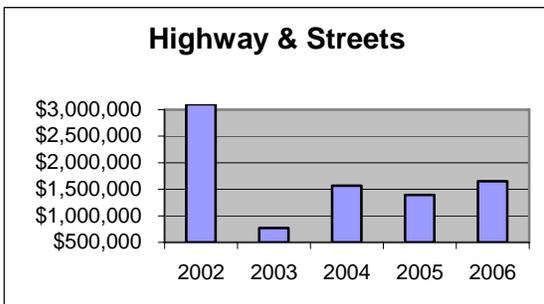
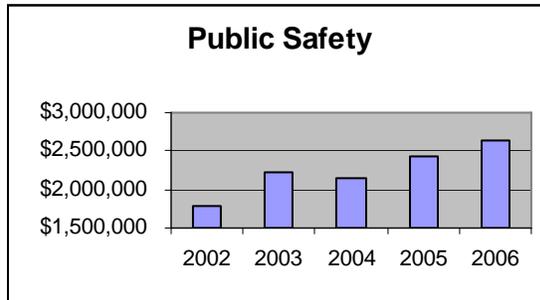
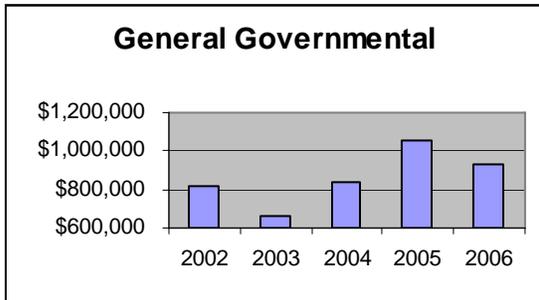


**CITY OF HIGHLAND, ILLINOIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING APRIL 30TH, 2006**

Expenditures of Governmental Activities are spread among a wide variety of functions. Among these are public safety, highways and streets, as well as culture and recreation. These areas are funded with the aforementioned revenues such as property taxes and intergovernmental revenues.



Capital expenditures are depreciated over their useful life as a result of the GASB 34 reporting model. "Economic Development" is shown as a separate area this year, due to the renewed emphasis placed upon the area by city management and staff. A Community Development Director is expected to join the staff during the next fiscal year.

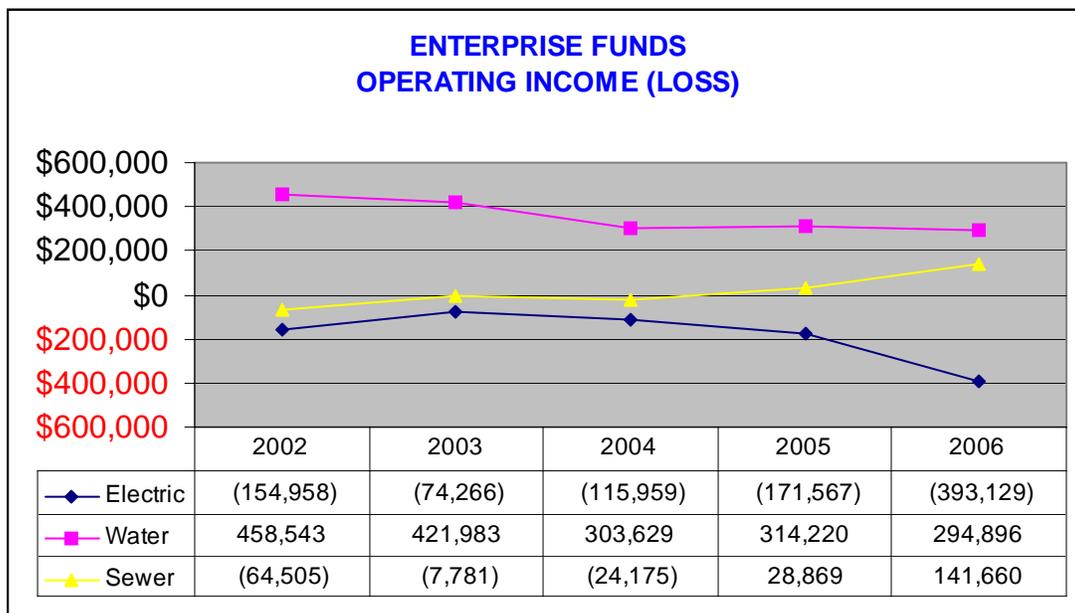
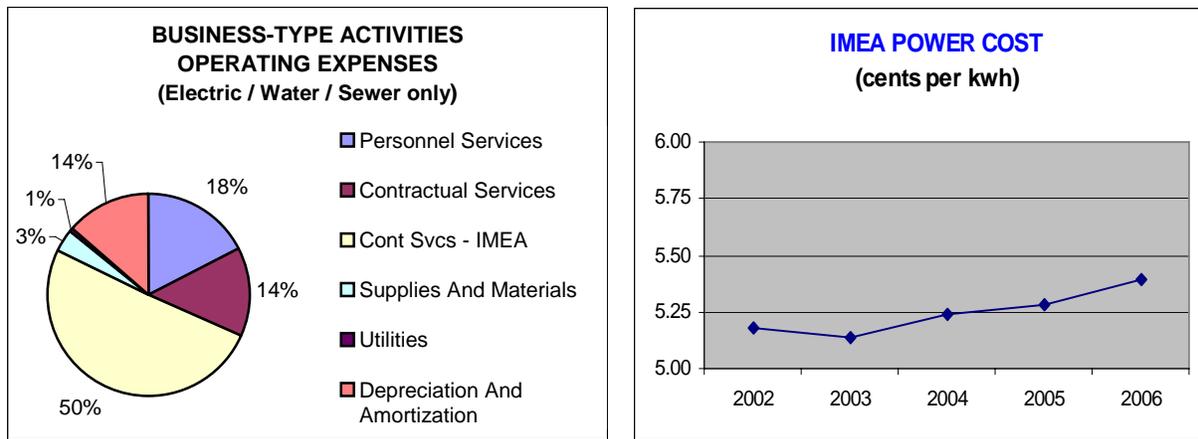


**CITY OF HIGHLAND, ILLINOIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING APRIL 30TH, 2006**

Business-type Activities

Business-type activities include revenues and expenditures related to the Light & Power, Water, Sewer, and Solid Waste funds. The Water, Sewer, and Solid Waste Funds each showed a gain from operations in FY 2006. However, the Light & Power fund continued its trend of operating at a loss. In the past ten years, the only years with a gain from operations were 1998 and 1999. Non-operating revenues such as interest income have enabled the department to have an increase in net assets in most years. However, net assets actually decreased in FY 2006 by \$265,453.

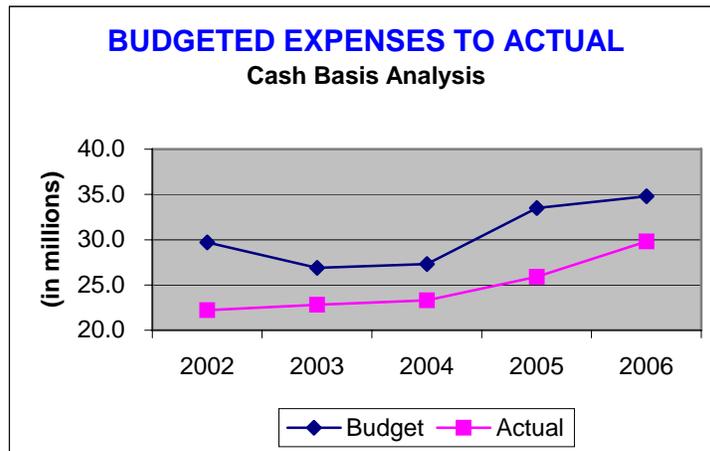
In FY 2006, the operating loss within the Light & Power Fund was \$393,000. The additional \$221,000 loss from the previous year was attributable to (1) the \$110,000 reduction in the IMEA's five year program of capacity credits for the caterpillar generators and (2) the 2.04% increase in the cost per kwh totaled \$165,000. At the same time, revenues increased 8.6%.



**CITY OF HIGHLAND, ILLINOIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING APRIL 30TH, 2006**

GENERAL FUND & BUDGET HIGHLIGHTS

During the budgeting process, the City plans for all anticipated projects and expenses. Since the City budgets in a conservative manner, the actual expenditures are often less than budgeted. In some cases, capital projects are delayed until the following year. In addition, while the audit is presented in a full accrual basis, the city budgets on a cash basis for capital expenditures. In the fiscal year ending April 30, 2006, the total budget was approximately \$35 million. The City prides itself in keeping expenses as low as possible while maintaining the quality of life Highland residents are accustomed to.



STATUS OF CITY RESERVES

The governmental funds reported a *combined* fund balance of \$7.4 million. The following is a listing of the City's Governmental Fund's reserves. 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 2006	Fiscal Year 2005	Percent Change
<u>Reserved Funds</u>			
Maintenance and Upkeep	\$ 646,818	\$ 640,680	0.96%
Bldg Construction and Improvements	457,768	444,575	2.97%
<u>Unreserved Funds</u>			
General	2,792,758	2,554,872	9.31%
Special Revenue	905,727	786,030	15.23%
Debt Service	68,860	66,341	3.80%
Capital Projects	2,485,436	2,627,843	-5.42%
Totals	\$ 7,357,367	\$ 7,120,341	3.33%

**CITY OF HIGHLAND, ILLINOIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING APRIL 30TH, 2006**

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2006, the City had \$45.5 million (net of depreciation) invested in a broad range of capital assets that include equipment, building and structures, and infrastructure. As part of GASB 34, the Finance Department established an implementation policy for capital and fixed assets. The threshold for capitalization is \$5,000. 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		Fiscal Year	
	2006	2005	2006	2005	2006	2005
Land	\$ 1.40	\$ 1.40	\$ 0.60	\$ 0.60	\$ 2.00	\$ 2.00
Construction in Progress	0.90	0.20	0.70	0.10	1.60	0.30
Bldgs & Improvements	6.20	6.40	8.50	8.70	14.70	15.10
Other Improvements	0.20	0.20	1.90	2.10	2.10	2.30
Equipment	1.10	1.00	1.80	1.70	2.90	2.70
Infrastructure	13.90	14.80			13.90	14.80
Lines			8.10	8.30	8.10	8.30
Interconnect			0.20	0.10	0.20	0.10
Totals	\$23.70	\$24.00	\$21.80	\$21.60	\$45.50	\$45.60

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 water storage tank, and the Downtown Square Revitalization Project.

Debt

As of the end of the fiscal year, the City has \$595,000 in general obligation debt. This figure is well below the City's legal debt limitation of \$12.7 million that is allowable based on assessed valuation. During FY 2006, the Electric Fund pledged future revenues in order to attain a \$6.25 million Alternate Revenue Bond for the purpose of infrastructure improvements. As a result, long-term debt saw a significant increase.

**CITY OF HIGHLAND, ILLINOIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING APRIL 30TH, 2006**

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

	Governmental Activities		Business-type Activities		Totals	
	Fiscal Year 2006	Fiscal Year 2005	Fiscal Year 2006	Fiscal Year 2005	2006	2005
Revenue Bonds	5.10	5.40	7.70	1.70	12.80	7.10
General Obligation Bonds	0.60	0.90			0.60	0.90
Notes and Capital Lease Payable			4.50	4.90	4.50	4.90
Employee Benefits Payable	0.50	0.40	0.30	0.30	0.80	0.70
Totals	\$ 6.20	\$ 6.70	\$12.50	\$ 6.90	\$18.70	\$13.60

Other significant debts of the City include an IEPA low interest loan for the 1999 upgrade of the Water Reclamation Facility, alternate revenue bonds used for the construction of the Water Treatment Facility and the purchase of the Korte Recreation Facility. The City has maintained an underlying "A2" bond rating from Moody's since the first rating in 1989. The size of the City of Highland prevents the highest underlying bond rating.

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 the some of the actions taken in FY 2006.

A partial special census was conducted in the fall of 2005 in areas of the city that were identified by city staff as having seen an increase in population since the census of 2000. The certified results increased the official population of Highland from 8,438 to 9,433. This equals a 12% growth rate in five years. The City receives a corresponding per capita increase of certain state revenues based upon the new population figure.

An updated Comprehensive Plan was adopted by the City Council in March of 2006. The update represents a comprehensive approach to the overall development of the City of Highland, drawing on and updating existing plans and policies, as well as creating new ones that will help guide the City and its residents towards the desired image and character of the community.

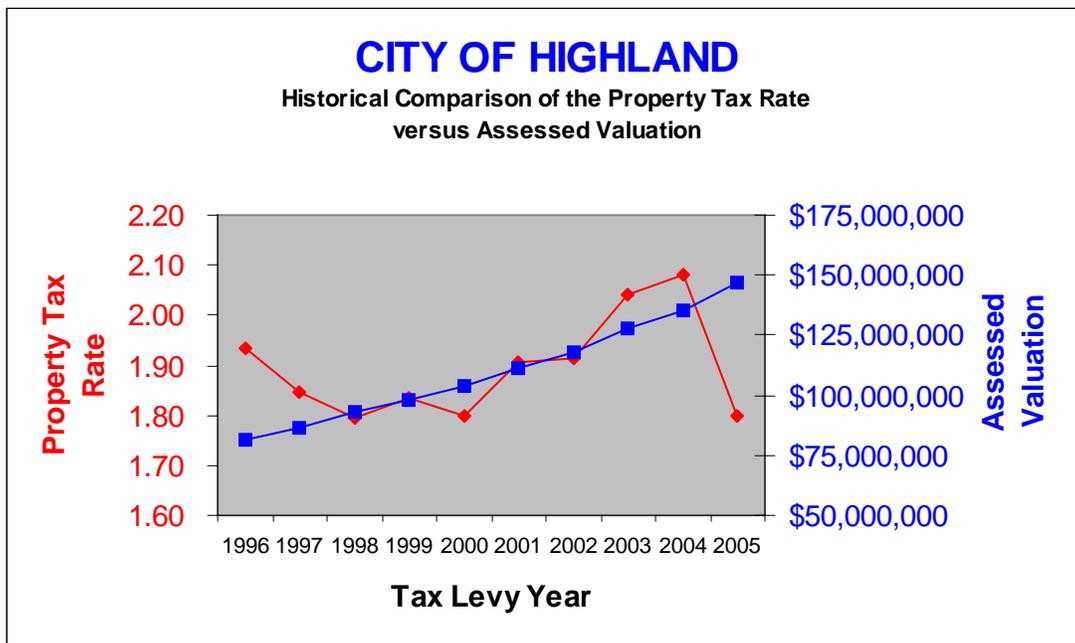
Highland residents passed a Non-Home Rule Sales Tax Referendum in March of 2006. This 1% increase in sales tax is estimated to bring in an additional \$1.5 million annually to the City for infrastructure improvements. 80% of the new revenue has been pledged to support new street projects such as the peripheral route. 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. Due to the abatement and the increase in assessed valuation, the tax rate of the City & Library portion of the property tax bill fell from 2.0803 to 1.7992 per \$100 of assessed value. The City Council is expected to issue alternate revenue bonds against this new revenue stream in FY 2007 in order to expedite the \$10 million in street projects forecasted in the next five years.

**CITY OF HIGHLAND, ILLINOIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING APRIL 30TH, 2006**

\$6.25 million dollars in alternate revenue bonds were issued near the end of the fiscal year for capital improvement projects that are scheduled by the Electric Department over the next few years. Foremost of these projects is the Eastside Substation. 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. Due to the upcoming projects and the bonding, a system analysis and rate analysis is planned for the utility in fiscal year 2007.

Steps have been taken to improve daily operations and help the City become more efficient. The City is pursuing performance measurement type initiatives and continues to review policies and procedures. The City's purchasing policy and employee handbook, for example, are in the process of being updated. Employee training has increased for many departments. Various committees have been re-established and are taking an important role in assisting the City with its management. The Economic Development Committee, for example, was established to help promote the strength of the City to the business community. In addition, the City Council has approved the establishment of a Director of Community Development staff position. The position will oversee the former Building and Zoning Department and be instrumental in future planning for the community.

As of April 2006, the City's Equalized Assessed Value rose 8.45% to a total of \$146,956,459. The average growth rate of EAV during the past 10 years has been 6.8% per year. The EAV is used in conjunction with the 2005 Property Tax Levy for collection of property taxes during FY 2007. With the abatement of the Street Bond Levy, done in conjunction with the passage of the non-home rule sales tax referendum, the City & Library portion of the property tax rate fell 13.5% to a rate of 1.7992.



**CITY OF HIGHLAND, ILLINOIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING APRIL 30TH, 2006**

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.ci.highland.il.us.