

FINANCIAL SECTION

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Honorable Mayor and City Council
City of Redlands
Redlands, California

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Redlands, California, as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the management of the City of Redlands. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Redlands, California, as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, of the City of Redlands, California for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The information identified in the accompanying table of contents as *management's discussion and analysis* and *required supplementary information* is not a required part of the basic financial statements but is supplementary information required by accounting standards generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Redlands' basic financial statements. The introductory section, combining and individual nonmajor fund financial statements, schedules and statistical tables are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements and schedules

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have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section and statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 27, 2006 on our consideration of the City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financing reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be the results of our audit.

Mayer Hoffman McCann P.C.

Irvine, California
October 27, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the financial performance of the City of Redlands provides an overview of the City's financial activities for the fiscal year ended June 30, 2006. Please read it in conjunction with the transmittal letter and financial statements identified in the accompanying table of contents.

Using the Accompanying Financial Statements

This annual CAFR 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. Also included in the accompanying report are fund financial statements. For governmental activities, the fund financial 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 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.

OVERVIEW OF THE FINANCIAL STATEMENTS

The annual report consists of four parts – *management's discussion and analysis* (this section), the *basic financial statements*, *required supplementary information*, and an optional section that presents *combining statements* for non-major governmental funds and internal service funds. The basic financial statements include two kinds of statements that present different views of the City:

- The first two statements are *government-wide financial statements* that provide both *long-term* and *short-term* information about the City's overall financial status.
- The remaining statements are *fund financial statements* that focus on *individual parts* of the City government, reporting the City's operations in *more detail* than the government-wide statements.
 - The *governmental funds* statements tell how *general government* services like public safety were financed in the *short term* as well as what remains for future spending.
 - *Proprietary fund* statements offer *short- and long-term* financial information about the activities the government operates like businesses, such as the sewer system.
 - *Fiduciary fund* statements provide information about fiduciary relationships – like the agency funds of the City – in which the City acts solely as *agent* or *trustee* for the benefit of others, to whom the resources in question belong.

The financial statements also include *notes* that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of *required supplementary information* that provides additional financial and budgetary information.

Figure A-1 summarizes the major features of the City's financial statements, including the portion of the City government they cover and the types of information they contain. The remainder of this overview section of management's discussion and analysis explains the structure and contents of each of the statements.

Figure A-1

Major Features of the City's Government-wide and Fund Financial Statements

	<u>Fund Statements</u>			
	<u>Government-wide Statements</u>	<u>Governmental Funds</u>	<u>Proprietary Funds</u>	<u>Fiduciary Funds</u>
Scope	Entire City government (except fiduciary funds) and the City's component units	The activities of the City that are not proprietary or fiduciary	Activities the City operates similar to private businesses	Instances in which the City is the trustee or agent for someone else's resources
Required financial statements	<ul style="list-style-type: none"> • Statement of net assets • Statement of activities 	<ul style="list-style-type: none"> • Balance sheet • Statement of revenues, expenditures and changes in fund balances 	<ul style="list-style-type: none"> • Statement of net assets • Statement of revenues, expenses and changes in net assets • Statement of cash flows 	<ul style="list-style-type: none"> • Statement of fiduciary net assets • Statement of changes in fiduciary net assets
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus	Accrual accounting and economic resources focus
Type of asset/liability information	All assets and liabilities, both financial and capital, and short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets or long-term debt included	All assets and liabilities, both financial and capital, and short-term and long-term	All assets and liabilities, both short-term and long-term; the City's fiduciary funds do not currently contain capital assets, although they can
Type of inflow/outflow information	All revenues and expenses during the year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year; expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during the year, regardless of when cash is received or paid	All revenues and expenses during the year, regardless of when cash is received or paid

Reporting the City as a Whole

The accompanying **government-wide financial statements** include two statements that present financial data for the City as a whole. 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.

These two statements report the City's net assets and changes in them. You can think of the City's net assets – the difference between assets and liabilities – as one way to measure the City's financial health, or *financial position*. Over time, *increases and decreases* in the City's net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the City's property tax base and the condition of the City's roads, to assess the *overall health* of the City.

In the Statement of Net Assets and the Statement of Activities, we divide the City services into two kinds of activities:

- Governmental activities – Most of the City's basic services are reported here. Sales taxes, property taxes, state subventions, and other revenues finance most of these activities.
- Business-type activities – The City charges a fee to customers to help it cover all or most of the cost of the services accounted for in these funds.

Reporting the City's Most Significant Funds

The **fund financial statements** provide detailed information about the City's most significant funds – not the City as a whole. Some funds are required to be established by State law or by bond covenants. However, City Council establishes many other funds to help it control and manage money for particular purposes or to show that it is meeting administrative responsibilities for using certain taxes, grants, or other money. The City's two kinds of funds – *governmental* and *proprietary* – use different accounting approaches.

- *Governmental funds* – Most of the City's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year end that are available for spending. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other *current financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the City's general government operations and the basic services it provides. Governmental fund information 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 a reconciliation on the page following the fund financial statements.
- *Proprietary funds* – When the City charges customers for the services it provides – whether to outside customers or to other units of the City – these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. In fact, the City's enterprise funds (a component of proprietary funds) are the same as the business-type activities we report in the government-wide statements but provide more detail and additional information, such as cash flows, for proprietary funds. We use internal service funds (the

other component of proprietary funds) to report activities that provide supplies and services for the City's other programs and activities.

Reporting the City's Fiduciary Responsibilities

The City is an agent for certain assets held for, and under the control of, other organizations and individuals. All of the City's fiduciary activities are reported in a separate Statement of Fiduciary Assets. We exclude these activities from the City's other financial statements because the City cannot use these assets to finance its operations. The City is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

A summary of the government-wide *statement of net assets* follows:

CITY OF REDLANDS Statement of Net Assets June 30, 2006

Table 1

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2006	2005	2006	2005	2006	2005
Current and other Assets	62,835,891	63,738,421	48,138,038	45,176,273	110,973,929	108,914,694
Capital Assets	394,673,614	384,223,513	137,392,890	133,476,847	532,066,504	517,700,360
Total Assets	457,509,505	447,961,934	185,530,928	178,653,120	643,040,433	626,615,054
Long-term Debt Outstanding	73,285,839	74,445,218	48,040,697	49,373,470	121,326,536	123,818,688
Other Liabilities	5,210,272	4,517,320	3,645,332	4,598,088	8,855,604	9,115,408
Total Liabilities	78,496,111	78,962,538	51,686,029	53,971,558	130,182,140	132,934,096
Net Assets:	379,013,394	368,999,396	133,844,899	124,681,562	512,858,293	493,680,958
Invested in Capital Assets, Net of Debt	338,283,471	333,560,602	101,228,505	106,786,695	439,511,976	440,347,297
Restricted	19,302,690	20,169,777	-	-	19,302,690	20,169,777
Unrestricted	21,427,233	15,269,017	32,616,394	17,894,867	54,043,627	33,163,884
Total Net Assets	379,013,394	368,999,396	133,844,899	124,681,562	512,858,293	493,680,958

The increase in net assets can provide an indication that the overall financial position of the City improved during the year, by a total of \$19,177,335 as indicated in the Changes in Net Assets Table 2 below. Table 1 shows that net assets of the government-wide activities increased by 3.9 percent from \$493,680,958 in 2005 to \$512,858,293 in 2006. Governmental Activities net assets increased by 2.7 percent from \$368,999,396 at June 2005 to \$379,013,394 at June 2006. The City's net assets of business-type activities increased by 7.3 percent from \$124,681,562 in 2005 to \$133,844,899 in 2006.

The increase in the net assets of the Governmental Activities during 2006 was the result of increases in capital assets. In Highways and Streets, construction in progress increased by \$8.3 million, primarily due to the construction of the Alabama and Orange Street bridges, and infrastructure increased by \$2.6 million. In Culture and Recreation, construction in progress increased by \$3 million due to construction for a sports park. The increase in net assets of the Business Activities was also primarily the result of an increase in capital assets, with \$3.6 million infrastructure added to the Water Enterprise, including the 1350 Zone Reservoir project which provides storage for up to 3.9 million gallons of potable water in northwest Redlands and Phase I of the Capital Improvement Pipeline Replacement project, and \$1.2 million in

improvements to the airport runway in the Aviation Enterprise. Additionally, cash in the Business Activities increased significantly as a result of an increase in development impact fee revenue: \$1.6 million in the Water Enterprise and \$1.2 million in the Sewer Enterprise.

A summary of the government-wide statement of activities follows:

Change in Net Assets – Year Ended June 30, 2006
Table 2

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2006	2005	2006	2005	2006	2005
Program Revenues:						
Charges for Services	9,306,510	8,293,577	31,569,061	32,128,747	40,875,571	40,422,324
Operating Grants & Contributions	18,542,273	9,849,623	423,720	1,488,852	18,965,993	11,338,475
Capital Grants & Contributions	3,715,690	38,659,823	7,891,272	4,794,810	11,606,962	43,454,633
General Revenues:						
Property Taxes	23,914,760	15,346,936			23,914,760	15,346,936
Sales Taxes	15,267,688	13,646,820			15,267,688	13,646,820
Franchises	1,097,157	996,858			1,097,157	996,858
Other Taxes	1,230,525	1,115,401			1,230,525	1,115,401
Investment Income	2,180,119	1,356,544	1,442,393	1,147,888	3,622,512	2,504,432
Intergovernmental	1,225,814	8,261,949			1,225,814	8,261,949
Total Revenues	76,480,536	97,527,531	41,326,446	39,560,297	117,806,982	137,087,828
Program Expenses:						
General Government	11,868,103	10,634,567			11,868,103	10,634,567
Public Safety	36,994,587	32,397,475			36,994,587	32,397,475
Highways and Streets	8,325,785	6,284,884			8,325,785	6,284,884
Culture and Recreation	3,692,986	2,858,152			3,692,986	2,858,152
Library	1,871,418	1,806,206			1,871,418	1,806,206
Interest and Fiscal Charges	3,713,659	3,169,104			3,713,659	3,169,104
Water			14,882,261	15,165,061	14,882,261	15,165,061
Disposal			8,799,485	8,339,209	8,799,485	8,339,209
Sewer			6,922,541	6,945,863	6,922,541	6,945,863
Aviation			218,316	456,441	218,316	456,441
Cemetery			591,363	630,307	591,363	630,307
Groves			749,143	872,263	749,143	872,263
Total Expenses	66,466,538	57,150,388	32,163,109	32,409,144	98,629,647	89,559,532
Increase in Net Assets before						
Transfers/Land Sale Proceeds	10,013,998	40,377,143	9,163,337	7,151,153	19,177,335	47,528,296
Land Sale Proceeds	-	-				216,174
Transfers	-	(729,010)	-	729,010	-	-
Increase (decrease) Net Assets	10,013,998	39,648,133	9,163,337	7,880,163	19,177,335	47,528,296
Beginning Net Assets	368,999,396	329,351,263	124,681,562	116,801,399	493,680,958	446,152,662
Ending Net Assets	379,013,394	368,999,396	133,844,899	124,681,562	512,858,293	493,680,958

Governmental Activities

Revenues for the City's governmental activities decreased 21.6 percent from \$97,527,531 in 2005 to \$76,480,536 in 2006. Total governmental activity expenses increased by 16.3 percent from \$57,150,388 in 2005 to \$66,466,538 in 2006. The cost of all *government-wide* activities increased by 10.1 percent from \$89,559,532 in 2005 to \$98,629,647 in 2006. As shown in the Statement of Activities pages 17 and 18 of the CAFR, the amount that taxpayers ultimately financed for these activities through City taxes was \$34,902,065, while other costs were paid by those who directly benefited from the programs (\$9,306,510) or by other governments and organizations that subsidized certain programs with operating grants and contributions (\$18,542,273) or capital grants and contributions (\$3,715,690). Overall, the City's governmental program revenues were \$31,564,473 including intergovernmental aid, fees for services, and contributions from developers.

The reasons for significant changes in the revenues and expenses of the City's governmental activities presented above are as follows:

Charges for services increased by \$1,012,933 or 12.2 percent in 2006 over the prior year.

Operating Grants and Contribution increased by \$8,692,650 or 88.3 percent from prior year due to an adjustment to deferred revenue made as a result of increased grant activity.

Capital Grants and Contributions decreased from \$38,659,823 in 2005 to \$3,715,690 in 2006. The decrease was primarily from prior year right-of-way contributions valued at \$35,224,044 related to residential development projects. Amounts for 2006 represent contributions from developers.

Property Taxes increased by \$8,567,824 or 55.8 percent. In 2006, the City was able to fully realize the growth in the residential and commercial real estate market that has been steady in recent years, but which was absorbed in the prior year as a result of a payment to the County Education Revenue Augmentation Fund (ERAF) pursuant to the State Budget legislation, Proposition 1A. Additionally, the City benefited from the increased value of personal property assets owned by a local utility. The latter accounted for 25% of the City's net taxable value increase.

Sales tax growth continued in 2006, with an increase of \$1,620,868 or 11.9 percent over 2005. Contributing to this increase is the sales tax revenue generated within an unincorporated area of San Bernardino County known as the "Donut Hole." A tax-sharing agreement with the County provides that the City receive 90 percent of all sales tax generated in this area. As new retail businesses have been built within the "Donut Hole," sales taxes have continued to grow.

Franchise Fees increased by \$100,299 or 10.1 percent and Other Taxes increased by \$115,124 or 10.3 percent.

Investment income increased by \$823,575 or 60.7 % as a result of improved investment returns and as a result of a \$647,911 interest receivable booked on the outstanding loan receivable f.

Intergovernmental Revenues decreased by \$7,036,135 or 85.2% percent, primarily due to a reduction in Motor Vehicle License Fees which in prior year included Motor Vehicle In-lieu revenue that is now included in Property Tax revenue, and as a result of a repayment by the State of its \$1,146,381 VLF Gap Loan from the City.

General Government expenses increased by \$1,233,536 or 11.6 percent, due to (grant funded) costs related to the Mission Gables and Union Avenue improvement projects and increased costs for contracted building inspection services.

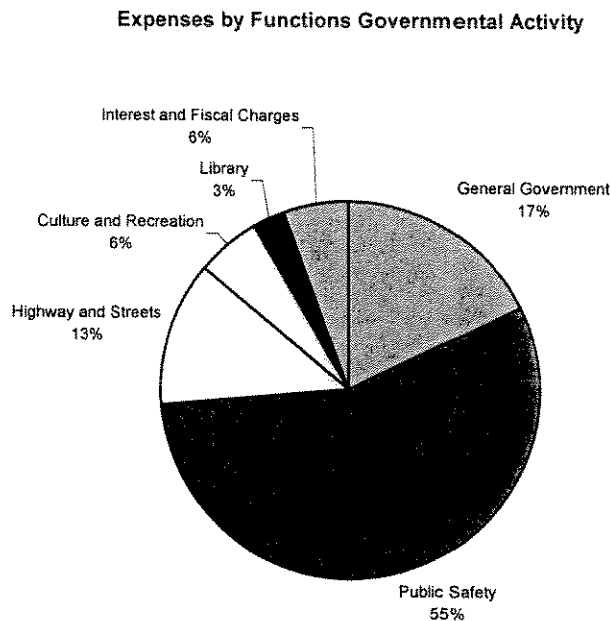
Public Safety expenses increased by \$4,599,112 million or 14.2 percent over prior year primarily due to increased pension (CalPERS) costs, salary increases and retirements.

Highways and Streets increased by \$2,040,901 or 32.5%, primarily due to costs associated with the Alabama and Orange Street bridges.

In 2006, Culture and Recreation expenses increased by \$834,834 or 29.2 percent due to a GASB 34 conversion entry in the prior year. This entry added \$914,000 in expenses in 2005, representing the difference between retired fixed assets and accumulated depreciation.

Library expenses increased by \$65,212 or 3.6 percent.

Interest and fiscal charges decreased by \$544,555 or 17.2 percent.



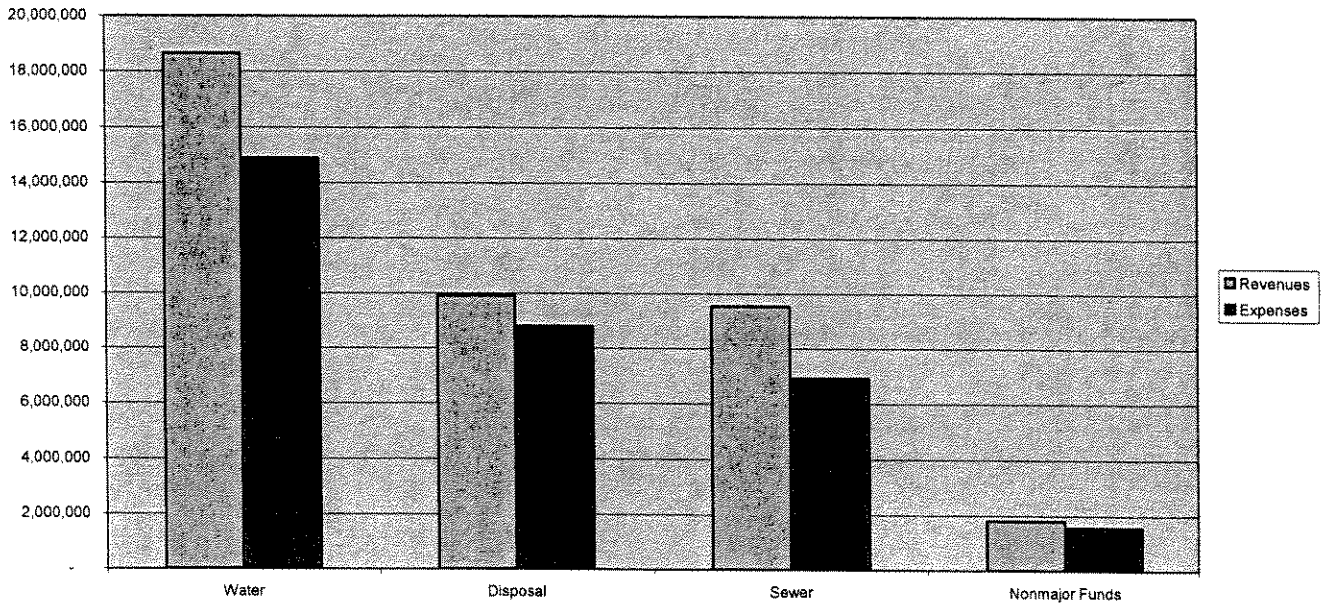
Business-Type Activities

Revenues of the City's Business-Type Activities (See Table 2) increased by 4.5 per cent from \$39,560,297 in 2005 to \$41,326,446 in 2006 and expenses decreased by .8 per cent from \$32,409,144 in 2005 to \$32,163,109 in 2006.

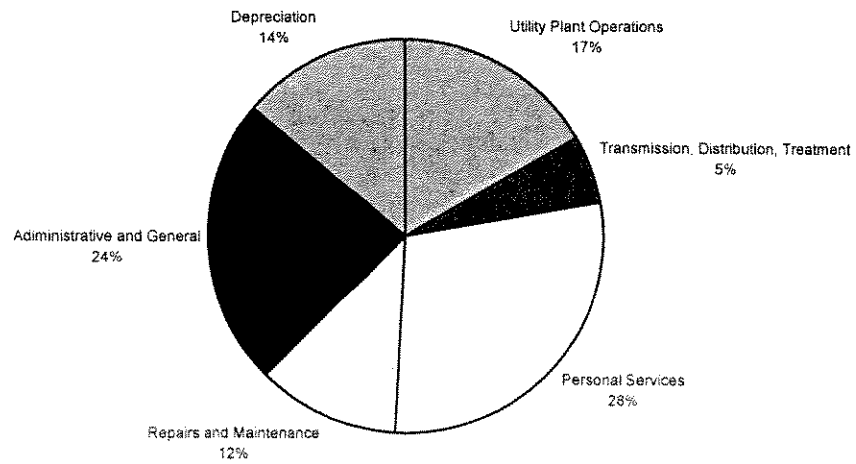
The Operating revenues of the City's Water Utility increased 18.3% from \$15,695,243 in 2005 to \$18,559,646 in 2006 due to an increase in development impact fees and in increase in service charge rates. Operating revenues of the City's Disposal Utility decreased 19.7% from \$12,167,429 in 2005 to \$9,768,863 in 2006 due to a prior \$3.4 million adjustment to the landfill closure liability resulting from expansion of the landfill. Operating revenues of the City's Sewer Utility increased 26% from \$7,562,576 in 2005 to \$9,531,910 largely due to impact fees, which increased 56.5 per cent.

Operating expenses of the City's Water Utility decreased 2.5% from \$14,298,128 in 2005 to \$13,935,054 in 2006 due to fluctuations in all areas, but particularly due to a decrease in repairs and maintenance and depreciation expense. Operating expenses of the City's Disposal Utility increased 5.8% from \$8,252,456 in 2005 to \$8,731,885 in 2006 primarily as a result of increases in repairs and maintenance. Operating expenses of the City's Sewer Utility decreased 1.4% from \$6,118,698 in 2005 to \$6,031,420 in 2006 primarily due to a decrease in repairs and maintenance and administrative and general expenses.

Expenses and Program Revenues - Business-type Activities



Operating Expenses - Business-type Activities



MAJOR FUNDS

As noted earlier, the City uses fund accounting to provide proper financial management of the City's resources and to demonstrate compliance with finance-related legal requirements.

Major Governmental Funds. The **General Fund** is the chief operating fund of the City. At the end of June 2006, total fund balance of the general fund was \$11,808,960, a decrease of \$3,808,998 or 24.4 percent from the prior year fund balance of \$15,617,958. As a measure of the general fund's liquidity, it can be useful to compare the total fund balance to total fund expenditure, which shows that fund balance is 22.8 percent of general fund expenditures, however only \$2.9 million of the \$11.8 million fund balance is unreserved. The unreserved fund balance of \$2.9 million, together with the \$1.8 million fund balance reserved for contingency, the only portion of the reserved fund balance readily available for spending, represents 9.2% of general fund expenditures. Total general fund expenditures this year were \$7,773,272 more than prior year and total general fund revenue this year was \$5,705,475 more than prior year.

Significant changes in the revenues of the City's General Fund from the prior year are as follows:

- Sales Tax increased \$ 1,620,868 over prior year
- Property Tax increased by \$6,766,378 (includes amount previously shown in Motor Vehicle In-Lieu Revenue)
- Franchise Fees increased \$100,298
- Other Taxes increased \$263,756
- Licenses & Permits increased \$968,799
- Intergovernmental decreased \$4,577,820 (included Motor Vehicle In-Lieu Revenue in prior year)
- Charges for services increased \$120,147
- Charges for Services to other City funds decreased by \$94
- Investment Income increased \$442,188
- "Other" Revenue increased by \$955

The **Public Facilities Development** fund accounts for the collection and related expenditure of development impact fees designated for constructing new and upgrading existing public facilities. This fund holds an Advance Payable to the General Fund in the amount of \$3,984,436, a decrease from last year of \$1,149,342.

Major Enterprise Funds. The **Water Fund** has total net assets of \$69,931,486 at the end of the fiscal year; \$2,126,716 is unrestricted. The **Disposal Fund** has total net assets of \$15,095,973 at the end of the fiscal year; (\$1,099,800) are unrestricted. The **Sewer Fund** has total net assets of \$32,587,898 at the end of the fiscal year; (\$1,966,276) are unrestricted. These funds account for the respective utility services provided by the City. Other factors concerning the finances of these funds have already been addressed in the discussion of the City's business-type activities.

GENERAL FUND BUDGET

Differences between the original 2005-2006 budget and the final amended 2005-2006 budget of the General Fund can be briefly summarized as follows:

- Total Revenues - \$3,802,564 increase in the budget.
- General Government - \$355,367 increase in the budget
- Public Safety - \$2,433,277 increase in the budget.
- Highways and Streets - \$822,161 increase in the budget.
- Culture and Recreation - \$152,214 increase in the budget.
- Library – \$39,648 decrease in the budget.
- Capital Outlay - \$1,004,852 increase in the budget.
- Debt Service –\$98,000 decrease in budget.

Major deviations between the final budget of the General Fund and its actual operating results were as follows:

	Final Budget	Actual Expenditures	Favorable (Unfavorable) Variance
Total Revenues	\$ 46,676,334	\$ 48,142,536	\$ 1,466,202
General Government	8,249,437	8,277,777	(28,340)
Public Safety	31,415,912	31,426,971	(11,059)
Highways and Streets	4,328,143	3,744,630	583,513
Culture and Recreation	3,492,510	3,344,777	147,733
Library	1,867,247	1,856,592	10,655
Capital Outlay	2,012,652	2,649,682	(637,030)
Debt Service	467,984	418,467	49,517
Total Expenditures	\$ 51,833,885	\$ 51,718,896	\$ 114,989

Revenues were over budget primarily due to higher than expected receipts of sales taxes, property taxes and investment income which includes interest receivable of \$647,911 on the outstanding loan receivable due from the RDA.

General Government Expenditures were over budget, in part, due to overages in Administrative Services for retiree health insurance, advertising and electricity. Net expenditures over budget were reduced by the deferral of expenditures into the next fiscal year through encumbrances and carryovers, primarily of contractual services.

Public Safety expenditures were over budget due to increases in salaries and benefits, including overtime, PERS retirement costs, banked leave buy-back and health insurance in the Police Department, and increases in small tools and equipment expense in the Fire Department. Garage charges of \$996,689 also contributed to the overage

Highways and Streets were under budget primarily as a result of encumbrances and carryovers for contractual and other professional services.

Culture and Recreation was under budget primarily as a result of savings in the Parks division for water and other professional services.

Library was under budget due to savings in salaries and benefits, primarily in the area of part-time salaries and insurance.

Capital expenditures were over budget as a result of encumbrances and carryovers of \$613,418, offset by lease value added of \$1,250,448.

Debt Service expenditures were under budget because lease payments for Police vehicles were less than expected and an encumbrance for lease payments on Motorola police radios was carried into the following year.

The favorable variance of \$114,989 of expenditures under budget was the result of careful review and monitoring of the budget by management staff during fiscal year 2005-2006.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital assets

The City's equity investment in capital assets for its governmental and business-type activities as of June 30, 2006, amounted to \$532,066,504 (net of accumulated depreciation). This investment in capital assets includes land, buildings and improvements, machinery and equipment, vehicles, infrastructure, water stock, and construction in progress.

Major capital asset events during the current fiscal year include the following:

The City continued work on the Alabama Street Bridge and began work on the Orange Street Bridge, both destroyed by storms in the early 1990s. The city spent \$3,476,265 and \$775,538 respectively, on these bridges. Total estimated costs for these bridges is \$9 million. et Bridge.s which will cost an estimated \$9 million at completion. The City spent \$887,719 to complete the Mission Gables Bowl House, bringing total costs for the project to almost \$1.7 million. Significant street projects by Public Works included \$1,330,284 for New York Street, \$1,229,334 for streets related to development of the Sports Park and \$775,538 for Cypress Street. Other project expenditures included \$3,335,560 for the Sports Park, \$894,451 for various roofing projects, and \$676,624 for Police Department computer and camera systems.

The Water Utility continued infrastructure improvements to the 1350 Zone Reservoir and transmission main pipeline project for a total cost of \$654,906. The Water Utility also continued construction of improvements through the State Water Connection Project totaling \$1.7 million to meet enhanced state treatment requirements. Capital Improvement Program expenditures totaled \$2,104,703.

The Wastewater (Sewer) Utility incurred \$398,131 in expenditures for its Capital Improvement Program and \$188,621 for the Co-Generation Facility.

The City's Disposal Utility had equipment purchases of \$1,429,861.

The Redlands Municipal Airport spent \$935,300 for a hangar purchase and \$327,620 on rehabilitation of the taxiway/runway.

Overall, the City's net capital assets increased by \$14,366,144 for the fiscal year ended June 30, 2006, or 2.8% over prior year. Infrastructure and Construction in Progress increased by a net of \$10,928,632, representing 76% of the increase.

Capital assets for the governmental and business-type activities are presented below to illustrate changes from the prior year:

	Governmental Activities		Business-type Activities		Total		Increase/ (Decrease) Percent of Change
	2006	2005	2006	2005	2006	2005	
Land	\$ 26,540,739	\$ 26,391,140	\$ 27,840,335	\$ 27,840,335	\$ 54,381,074	\$ 54,231,475	0.28%
Buildings & Improvements	15,257,009	13,431,304	78,970,231	75,819,200	92,227,240	89,050,504	3.57%
Machinery/Equip./Vehicles	15,177,465	14,216,869	11,441,073	10,898,062	26,618,538	25,114,931	5.99%
Infrastructure	398,928,393	396,910,529	112,253,153	108,446,720	511,181,546	505,357,249	1.15%
Water Stock	-	-	9,179,433	9,166,933	9,179,433	9,166,933	0.14%
Construction in Progress	10,958,346	1,901,051	8,665,470	5,706,163	17,623,816	7,607,214	
Accum. Depreciation	(72,188,338)	(68,627,380)	(106,956,805)	(104,200,566)	(179,145,143)	(172,827,946)	3.66%
Total	\$ 394,673,614	\$ 384,223,513	\$ 137,392,890	\$ 133,476,847	\$ 532,066,504	\$ 517,700,360	2.77%

Internal Service Fund capital assets, in the net amount of \$126,159, are included in Governmental Activities.

The City's infrastructure assets are recorded at historical cost in the government-wide financial statements as required by GASB No. 34.

Additional information on the City's Capital Assets can be found in Note 5 of the Notes to the Basic Financial Statements.

LONG-TERM DEBT

Major Long-Term debt events during the current fiscal year include the following:

Leased two Public Works street sweepers valued at \$450,326.

Leased two Fire Water Tenders valued at \$424,274.

Leased fourteen Police vehicles valued at \$322,796.

Leased fifteen Motorola HT police radios valued at \$53,052.

Issued \$1,701,418 in notes payable related to the Safe Drinking Water project.

Amortized bond issue costs totaling \$141,471.

Paid \$5,411,313 scheduled principal and \$4,402,201 interest on existing debt.

Long-Term debts for governmental and business-type activities are presented below to illustrate changes from the prior year:

	Governmental Activities		Business-type Activities		Total		Increase/ (Decrease) Percent of Change
	2006	2005	2006	2005	2006	2005	
Capital Lease Obligations	\$ 1,407,827	\$ 451,487	\$ -	\$ -	\$ 1,407,827	\$ 451,487	211.82%
General Obligation Bonds	4,075,000	4,510,000	-	-	4,075,000	4,510,000	-9.65%
Tax Allocation Bonds	41,105,000	42,680,000	-	-	41,105,000	42,680,000	-3.69%
Certificates of Participation	16,620,000	16,620,000	880,000	1,705,000	17,500,000	18,325,000	-4.50%
Add: Issuance Premium	586,718	640,056	-	-	586,718	640,056	-8.33%
Revenue Bonds	-	-	29,730,000	31,815,000	29,730,000	31,815,000	-6.55%
Notes Payable	135,645	235,277	12,508,936	11,199,198	12,644,581	11,434,475	10.58%
Claims Payable	2,321,085	2,157,738	-	-	2,321,085	2,157,738	7.57%
Compensated Absences	7,034,564	7,150,660	804,744	868,779	7,839,308	8,019,439	-2.25%
Landfill Closure Liability	-	-	4,117,017	3,785,493	4,117,017	3,785,493	8.76%
Total	\$ 73,285,839	\$ 74,445,218	\$ 48,040,697	\$ 49,373,470	\$ 121,326,536	\$ 123,818,688	-2.01%

Additional information on the City's Long-Term Debt can be found in Note 6 and 7 of the Notes to the Basic Financial Statements.

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