

Management's Discussion and Analysis

This discussion and analysis is intended to be an easily readable analysis of the City of Albert Lea's (City) financial activities based on currently known facts, decisions or conditions. This analysis focuses on current year activities and should be read in conjunction with the Transmittal Letter found on pages 1-4 and with the financial statements that follow.

Report Layout

In addition to the Management's Discussion and Analysis (MD&A), the report consists of government-wide statements, fund financial statements, notes to the basic financial statements, combining schedules of nonmajor funds and supplementary information. The first several statements are highly condensed and present a government-wide view of the City's finances. Within this view, all City operations are categorized and reported as either governmental or business-type activities. Governmental activities include basic services such as police, fire and inspection, public works, parks and recreation, library, community development and general government administration. The City's business-type activities include water, sewer, solid waste management, parking, storm sewer, and public lighting. These government-wide statements are designed to be more corporate-like in that all activities are consolidated into a total for the City.

Basic Financial Statements

- The Statement of Net Assets focuses on resources available for future operations. In simple terms, this statement presents a snap-shot view of the assets the community owns, the liabilities it owes and the net difference. The net difference is further separated into amounts restricted for specific purposes and unrestricted amounts.
- The Statement of Activities focuses on gross and net costs of city programs and the extent to which such programs rely upon general tax and other revenues. This statement summarizes and simplifies the user's analysis to determine the extent to which programs are self-supporting and/or subsidized by general revenues.
- Fund financial statements focus separately on major governmental funds and proprietary funds. Governmental fund statements follow the more traditional presentation of financial statements. The City's major governmental funds are presented in their own column and the remaining funds are combined into a column titled "Other Governmental Funds." A budgetary comparison is presented for the general fund, which is the only fund for which a budget is legally adopted. Statements for the City's proprietary funds follow the governmental funds and include net assets, revenue, expenses and changes in net assets, and cash flow.
- The notes to the basic financial statements provide additional disclosures required by governmental accounting standards and provide information to assist the reader in understanding the City's financial condition.

Readers desiring additional information on nonmajor funds can find it in the Combining Statements of Nonmajor Funds section of this report. Completing the financial section of the report are schedules on capital assets and other financial schedules. Finally, the statistical section presents trend information, revenue capacity information, debt capacity information, demographics and economic information, and operating information.

The government-wide financial statements not only include the City, but also a legally separate entity, the Albert Lea Port Authority, for which the City is financially accountable. The Port Authority is reported as a discretely presented component unit. Complete financial statements are available from the Port Authority's executive director at P.O. Box 370, Albert Lea, MN 56007.

City as a Whole

Government-wide Financial Statements

Net Assets serve as a useful indicator of a government's financial position. For the City of Albert Lea, assets exceeded liabilities by \$95.5 million at the end of the current year. The largest portion of the City's net assets are invested in capital assets (e.g. land, building, equipment and streets) and reported net of related outstanding debt (\$54.3 million, or 57%). The City uses these capital assets to provide services to its citizens; thus they do not represent resources available for future spending. Restricted net assets total \$10.7 million, or 11%, and represent cash and investments that are legally restricted for police and fire expenditures. Finally, the remaining \$30.5 million, or 32%, are unrestricted meaning they are available for meeting the City's ongoing obligations.

Beginning in 2006, the operations of two enterprise funds were returned to the general fund. As part of this change \$2.4 million in capital assets were transferred from business-type activities to governmental activities.

The City's financial position improved during 2006 with their net assets increasing from \$93.1 million to \$95.5 million. A condensed version of the Statement of Net Assets at December 31, 2006 follows:

Net Assets at Year-end (in millions)

	Governmental Activities		Business-type Activities		Total Government
	2006	2005	2006	2005	2006
Cash and investments	\$19.2	\$19.5	\$6.8	\$6.1	\$26.0
Other assets	19.1	18.7	1.0	1.3	20.1
Capital assets	24.2	19.0	40.5	42.8	64.7
Total assets	<u>62.5</u>	<u>57.2</u>	<u>48.3</u>	<u>50.2</u>	<u>110.8</u>
Other liabilities	1.7	1.2	.2	.3	1.9
Long term outstanding	11.2	10.4	2.2	2.4	13.4
Total liabilities	<u>12.9</u>	<u>11.6</u>	<u>2.4</u>	<u>2.7</u>	<u>15.3</u>
Net assets:					
Invested in capital assets,					
Net of related debt	15.8	9.6	38.5	40.5	54.3
Restricted	10.7	11.1			10.7
Unrestricted	23.1	24.9	7.4	7.0	30.5
Total net assets	<u>\$49.6</u>	<u>\$45.6</u>	<u>\$45.9</u>	<u>\$47.5</u>	<u>\$95.5</u>

The City's TIF 5-15 Broadway Ridge Redevelopment received an advance from the general fund during 2006. This advance was to be used for major renovations to the Freeborn Bank Building. There were \$0.8 million in renovations completed by year-end.

Although the City's Capital Projects Funds' net assets saw little change in 2006, there was a significant project started during the year. The City was the recipient of two grants from the State for the East Main Flood Mitigation project. There was \$0.8 million spent on property acquisition in 2006 and \$0.7 million received in state grants.

A condensed version of the Statement of Activities follows:

Governmental and Proprietary Activities
For the year ended December 31, 2006
(in millions)

	Governmental Activities		Business-type Activities		Total Government
	2006	2005	2006	2005	2006
Revenues					
Program revenues					
Charges for services	\$1.2	\$1.3	\$5.4	\$5.2	\$6.6
Grants and contributions					
Operating	1.5	1.1			1.5
Capital	4.0	4.1	.5	1.5	4.5
General revenues					
Taxes	5.4	4.6			5.4
Interest	.8	.5	.2	.2	1.0
Grants and contributions	6.1	5.7			6.1
Total revenues	<u>19.0</u>	<u>17.3</u>	<u>6.1</u>	<u>6.9</u>	<u>25.1</u>
Expenses					
General government	3.6	1.9			3.6
Police	3.2	3.1			3.2
Fire and inspection	1.6	1.6			1.6
Public works	5.0	5.5			5.0
Parks and recreation	2.6	2.5			2.6
Library	.8	.8			.8
Community development	.3	.2			.3
Interest on long-term debt	.3	.3			.3
Water			1.5	1.4	1.5
Sewer			3.6	3.3	3.6
Solid waste management			.2	.1	.2
Parking					
Storm sewers				.4	
Public lighting				.3	
Total expenses	<u>17.4</u>	<u>15.9</u>	<u>5.3</u>	<u>5.5</u>	<u>22.7</u>
Excess (deficiency) before transfers	1.6	1.4	.8	1.4	2.4
Transfers	2.4	(2.1)	(2.4)	2.1	
Change in net assets	4.0	(.7)	(1.6)	3.5	2.4
Beginning net assets	45.6	46.3	47.5	44.0	93.1
Ending net assets	<u>\$49.6</u>	<u>\$45.6</u>	<u>\$45.9</u>	<u>\$47.5</u>	<u>\$95.5</u>

Governmental activities.

Governmental activities provided a \$1.6 million increase to the City's net assets and accounts for 67% of the total City increase. Total revenues increased by \$1.7 million of which \$1.5 million was in general revenues. Taxes increased by \$0.8 million due to an increase in the operating tax levy by that same amount. Interest earnings were up by \$0.3 million as a result of higher interest rates. The increase in grants and contributions is attributable to a \$0.3 million increase in local government aid. Program expenses increased by \$1.5 million. In actuality, program expenses remained nearly flat with one exception. The City's TIF 5-13 Larson Manufacturing Fund provided a business subsidy of \$1.7 million during 2006. The City purchased land from their component unit for \$1.7 million. They in turn sold it to Larson Manufacturing for \$1 as an economic incentive for locating in the City of Albert Lea. The City will eventually be repaid through tax increment received in that district.

The City's main operating fund is the general fund. At year end the general fund's unreserved fund balance was \$7.3 million. This represents 51% of the upcoming year's budgeted expenditures and 56% of the current year's actual expenditures.

The general fund's fund balance increased \$0.5 million during the current year. Key components to the change for the year ended December 31, 2006 are as follows:

- Property tax levy increased \$0.8 million.
- Intergovernmental revenue increased \$0.6 million which is half due to the increase in local government aid and half due to a federal airport grant.
- Interest earnings increased \$0.3 million due to higher interest rates.
- Public works expenditures increased \$0.8 million. This includes \$0.5 million for storm sewer and public lighting operations which were reported as enterprise funds in 2005, \$0.2 million airport expenditures related to federal airport grant, and \$0.1 million in general increased costs.
- Remaining costs of operations remained about the same as prior year.
- The City chose to transfer \$1 million out of its general fund for capital improvements.

Business-type activities.

Business-type activities provided a \$0.8 million increase to the City's total net assets, or 33% of the total City increase. At the end of the year total net assets for enterprise funds was \$45.9 million. Of this amount \$7.4 million is unrestricted and \$38.5 is the net investment in capital assets.

Total revenues decreased by \$0.8 million. Included in prior year revenues are \$0.7 million in charges for services for the storm sewer and public lighting utilities. These two utilities are no longer enterprise funds but are now part of general fund operations. Since the total increase in charges for services increased by \$0.2 million, by taking into consideration the transfer of these two utilities, the remaining business-type activities had a \$0.9 increase in charges for services. This increase is due to the city implementing a 20% water rate increase and a 20% sewer rate increase at the beginning of 2006. The business-type activities received capital contributions of watermain and sanitary sewer from both private developers and the city's capital projects funds. These contributions were \$1.0 million less than in the previous year. These contributions can fluctuate from year to year depending on the construction activity in any given year. Program expenses also declined primarily as a result of the transfer of two enterprise funds. Prior year expenses included \$0.7 million in expenses for these two enterprise funds. Of this \$0.7 million, \$0.2 million were overhead costs which were shifted to the water and sewer funds to cover and the remaining \$0.5 million was shifted to the general fund.

Budgetary Highlights

Over the course of the year, the City Council revised the budget three times. The City had budgeted for an aerial photography project in the amount of \$110,000. Bids received on this project were closer to \$70,000. The City Council chose to reduce the appropriation for this item by \$40,000 and transfer the funds to the capital projects fund for another project. During the year, it was decided to form the Albert Lea Public Library Foundation and to transfer the bequests the City had on hand to this foundation. A budget adjustment was made for \$62,335. At the end of the year, there were some individual departments with budget shortfalls due to unexpected events. Transfers totaling \$403,850 were made to cover these shortfalls. By the end of the year, the net increase to the original budget was \$426,185. The most significant of these adjustments was \$175,000 which was transferred to the airport budget. This was to cover the 95% portion of a runway project that was reimbursed by the federal government. Additional information on adjustments to the budget can be found in note III.A. on page 46 of the basic financial statements.

In total, the general fund's expenditures were \$.7 million less than was budgeted. The departments with the greatest amount of budgeted funds remaining at year end were public works (including street, street maintenance, and snow & ice) and fire. In total, the general fund's revenues were \$1.6 million more than was budgeted. Franchise fees were \$.3 million more than estimated. This is an item that can vary depending on the weather and local heating costs. Interest revenues were \$.8 million more than estimated due to higher interest rates. The City also received \$.3 million in federal funds for two airport projects.

Capital Assets and Debt Administration

Capital Assets

At December 31, 2006 the City had \$64.7 million invested in net capital assets, including police and fire equipment, park and recreation facilities, buildings, roads, bridges and water and sewer lines. This amount represents a net increase (additions, deductions, and depreciation) of \$2.9 million, or 4.7% over last year. At the beginning of 2006, the capital assets of the two enterprise funds which were converted to general fund operations were transferred from business-type activities to governmental activities in the amount of \$2.4 million. The other significant changes include the Tiger Hills residential development (\$1.2 million), the acquisition of property in the East Main Street flood mitigation project (\$0.8 million), the renovations to the Freeborn Bank Building (\$0.8 million), and the arena and downtown parking lot projects (\$0.4 million).

	Capital Assets at Year-end (in millions)					
	Governmental Activities		Business-type Activities		Totals	
	2006	2005	2006	2005	2006	2005
Land	\$3.5	\$2.5	\$0.9	\$1.0	\$4.4	\$3.5
Buildings	12.0	10.7	34.0	34.0	46.0	44.7
Improvements	3.3	2.8	26.3	25.8	29.6	28.6
Equipment	11.5	10.7	2.3	2.3	13.8	11.0
Infrastructure	28.6	24.4		3.0	28.6	27.4
Subtotal	58.9	51.1	63.5	66.1	122.4	117.2
Accumulated depreciation	34.7	32.1	23.0	23.3	57.7	55.4
Capital assets, net	\$24.2	\$19.0	\$40.5	\$42.8	\$64.7	\$61.8

Additional information on the City's capital assets can be found in note IV.D. on pages 49-50 of the basic financial statements.

Debt Outstanding

At year-end, the City had \$10.4 million in bonds and notes outstanding. There was a total of \$1.2 million in debt retired during the year.

Debt Outstanding at Year-end
(in millions)

	Governmental Activities		Business-type Activities		Totals	
	2006	2005	2006	2005	2006	2005
G.O. Tax Increment Bonds		\$.1				\$.1
PIR Assessment Bonds	\$4.2	4.9			\$4.2	4.9
Cap Imp Assessment Bonds	3.7	3.7			3.7	3.7
Notes	.5	.7			.5	.7
Revenue Bonds			\$1.3	\$1.4	1.3	1.4
Revenue Refunding Bonds			.7	.8	.7	.8
Total bonds and notes	\$8.4	\$9.4	\$2.0	\$2.2	\$10.4	\$11.6

The City's bond rating is A-1 from Moody's and A from Standard and Poor's. Other obligations include accrued severance pay and an advance from the Albert Lea Port Authority, a component unit, in the amount of \$1.7 million. More detailed information on the City's long-term liabilities is presented in note IV.F. on pages 51-54 of the basic financial statements.

Economic Factors and Next Year's Budgets and Rates

- The State of Minnesota's Local Government Aid for 2007 will decrease slightly.
- LGA makes up 39% of the 2007 budgeted general fund revenues (down from 42% and 44% in 2006 and 2005).
- The 2007 general fund budgeted expenditures are up \$1.0 million or 8% from the 2006 general fund budgeted expenditures.
- The City's property tax levy for 2007 increased by \$.3 million. The citizen's tax rate did not increase. The levy increase was absorbed by a \$1 million increase in tax capacity.
- The City has begun a plan of issuing bonds for their capital projects with the intent to levy taxes to make the bond payments.

The City has experienced three consecutive years of the state not having a levy limit in place. The City has tried to take advantage of that situation and use it as an opportunity to become less reliant on LGA. With the tax levy and LGA comprising approximately two-thirds of the City's total revenues, the City has had to closely look at their total revenue picture. The City has tried to take a conservative approach and maintain healthy reserves to be prepared for the unexpected. The state auditor recommends having up to 50% of the following year's expenditures in reserve. The City is currently slightly in excess of this recommendation. The City will continue to look at how they can best serve the community and also stay within the City's financial resources for future budget years.

Financial Contact

The City's financial statements are designed to present users (citizens, taxpayers, customers, investors, and creditors) with a general overview of the City's finances and to demonstrate the City's accountability. If you have questions about the report or need additional financial information, please contact the City's Finance Director at 221 East Clark Street, Albert Lea, Minnesota 56007.