

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the *City of Calistoga's* annual financial report presents our discussion and analysis of the City's financial performance during the fiscal year that ended on June 30, 2008. Please read it in conjunction with the City's audited financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The City's fiscal 2008 total net assets increased by \$902,000 over fiscal 2007 after conducting all City operations and programs. The assets of the City exceeded its liabilities by about \$ 25 million at the end of the 2008 fiscal year. Of that amount, there is an overall surplus of \$ 1.7 million (the unrestricted net assets) is available to meet the City's ongoing obligations and operating expenses for the next fiscal year. About 73 % of the City's net assets are invested in capital assets such as the water and wastewater system.
- Overall City-wide revenues from all governmental and business-type activities increased by about \$ 1.6 million compared to the 2007 fiscal year for a 2008 total of about \$ 13.3 million. All of the increase was related to governmental activities; and was primarily due to capital projects funded from grants and contributions and increases in Transient occupancy and Property tax revenues. Business-type activity revenues remained similar to the prior year at about \$ 4.7 million.
- The City's total expense of all programs in fiscal 2008 increased by about \$ 826,000 compared to the 2007 fiscal year for a 2008 total of about \$ 12.4 million.
- The General Fund reported a year end fund balance of \$ 1.7 million at the end of the 2008 year. Of that \$ 1.7 million, \$ 600,000 is not available and represents cash loans made to other funds; primarily to the City's special revenue funds to provide short term cash flow funding for capital improvements. This short term funding was repaid in fiscal 2009 with planned current revenues and grants.
- The City business-type water and wastewater enterprise funds ended the 2008 fiscal year with net assets of \$ 13.8 million. However, of that amount about \$ 12.7 million is invested in the water and wastewater facilities and systems (net of related debt) leaving a \$ 1.1 million in restricted and unrestricted net assets.
- For fiscal 2008, an additional major fund, Capital Lease Projects, was created to account for the issuance of \$ 4.7 million in capital lease obligations for the capital funding of the community pool, fire station, public works and recreation facilities. The Community Development Block Grant (CDBG) fund was still classified as a major fund due the increase in assets of about \$1.5 million from the recording of long term affordable housing loans and other grant programs.
- The City's other non-major governmental funds ended 2008 with about \$ 2.1 million available for special purposes; primarily public safety capital, housing, quality of life and other special purposes.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of five parts – a *management's discussion and analysis* (this section), the *basic financial statements*, *required supplementary information*, an optional section that presents *combining statements* for nonmajor governmental funds and budget to actual comparison statements and a *statistical* section. 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, general government, community services, public works and other services 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 City's water and wastewater systems.

MANAGEMENT'S DISCUSSION AND ANALYSIS

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 further explains and supports the information in the financial statements. In addition to these required elements, we have included a section with combining statements that provide details about our nonmajor funds, each of which are added together and presented in single columns in the basic financial statements. Also included are optional budgetary comparison statements for the City's nonmajor governmental funds.

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 City of Calistoga
Government-Wide and Fund Financial Statements**

	Fund Statements		
	Government-Wide Statements	Governmental Funds	Proprietary Funds
Scope	Entire City government	The activities of the City that are not proprietary or fiduciary, such as police, fire, streets, general government, and community services	Activities the City operates similar to private businesses: the water and wastewater systems
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
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
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 included	All assets and liabilities, both financial and capital, and short-term and long-term
Type of inflow/outflow information	All revenues and expenses during 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 year, regardless of when cash is received or paid

Government-wide Statements

The government-wide statements report information about the City as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes *the entire City's* assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two government-wide statements report the City's *net assets* and how they have changed. Net assets – the difference between the City's assets and liabilities – is one way to measure the City's financial health, or *position*. Over time, increases or decreases in the City's net assets are an indicator of whether its financial health is improving or deteriorating, respectively.

The government-wide financial statements of the City are reported in two categories:

- *Governmental activities* – All of the City's basic services are included here, such as general government, police, fire, streets, public works, and community services. Property taxes, sales taxes, transient occupancy taxes, special and other taxes, user charges and fees and state, local and federal grants finance these activities.
- *Business-Type activities* - The City charges fees to customers to help cover the costs of certain services. The City's water and wastewater enterprises are reported here.

Fund Financial Statements

The fund financial statements provide more detailed information about the City's most significant funds – not the City as a whole. Funds are accounting devices that the City uses to keep track of specific sources of funding and spending for particular purposes.

- The City's major governmental funds, the General, CDBG Open Grant and Capital Lease Projects Funds, are reported in separate columns and all other non-major governmental funds are aggregated in a single column. The City's water and wastewater funds are reported separately each as a major fund.
- The City Council establishes other funds to control and manage money for particular purposes (such as restricted donations). Some funds are maintained to demonstrate that the City is properly using certain specific fees for their intended purpose (such as landscape maintenance fees).
- Other funds are maintained for similar purposes but in addition demonstrate the City's ability to repay its long-term debt obligations, such as capital lease obligations

The City has two kinds of funds:

- *Governmental funds* – 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 flow in and out 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. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statement, or on the subsequent page, that explains the relationship (or differences) between them.
- *Proprietary funds* - The City maintains two different types of proprietary funds. *Enterprise funds* are used to report the same functions reported as business-type activities in the government-wide financial statements; the City's water and wastewater operations. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the City of Calistoga's various functions. The City uses an internal service fund to account for its fleet of vehicles and equipment. Because these services predominately benefit governmental rather than business-type functions, they have been included within the governmental activities in the government-wide financial statements. Proprietary funds provide the same type of information as the government-wide statements, only in more detail. The proprietary fund statements provide separate information for the City's water and wastewater operations, both of which are considered to be major funds of the City. The internal service funds are presented in a separate column alongside the totals for the City's proprietary enterprise funds.

MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

Net Assets. The City's combined net assets increased by about \$ 900,000 between fiscal years 2007 and 2008 to \$ 25 million. About 73% of the net assets of the City are represented by the City's net investment in its capital assets such as buildings, land, equipment and facilities. The remaining 27% is essentially represented by cash, investments and receivables. About 91% of the City's total liabilities are represented by long-term obligations.

Table A-1
City of Calistoga Net Assets
(in millions of dollars)

	Governmental Activities		Business-type Activities		Fiscal Year Totals		Total Percentage Change
	2008	2007	2008	2007	2008	2007	2007 to 2008
Current and other assets	\$ 11.0	\$ 6.9	\$ 2.5	\$ 2.2	\$ 13.5	\$ 9.1	48.5%
Internal balances	0.4	1.7	(0.4)	(1.7)	-	-	0.0%
Capital assets	7.9	5.2	29.7	29.5	37.6	34.7	8.4%
Total assets	19.3	13.8	31.8	30.0	51.1	43.8	16.7%
Long-term debt outstanding	6.1	1.7	16.8	14.8	22.9	16.5	38.8%
Other liabilities	2.1	2.2	1.2	1.1	3.2	3.3	-1.7%
Total liabilities	8.2	3.9	18.0	15.9	26.1	19.8	32.0%
Net assets							
Invested in capital assets	5.4	3.9	12.7	14.6	18.1	18.5	-2.0%
Restricted	4.4	4.5	0.8	0.9	5.2	5.4	-3.7%
Unrestricted	1.3	1.5	0.3	(1.4)	1.6	0.1	1500.0%
Total net assets	\$ 11.1	\$ 9.9	\$ 13.8	\$ 14.1	\$ 24.9	\$ 24.0	3.9%

Changes in net assets. The City's 2008 total revenues of about \$ 13.3 million was about \$ 1.6 million more than in 2007, a 14 % increase. This increase was the result of one time grants and transient occupancy tax revenues received in 2008. About 47 % of the City's revenue comes from some type of taxes including property, sales, transient occupancy, and other taxes. The rest comes from fees charged for services, state/local/federal grants and contributions. The total cost of all programs and services in 2008 was about \$12.5 million and includes a wide range of services such as police and fire protection, streets, public works, general administration, community services, water, and wastewater operations. (See Table A-2).

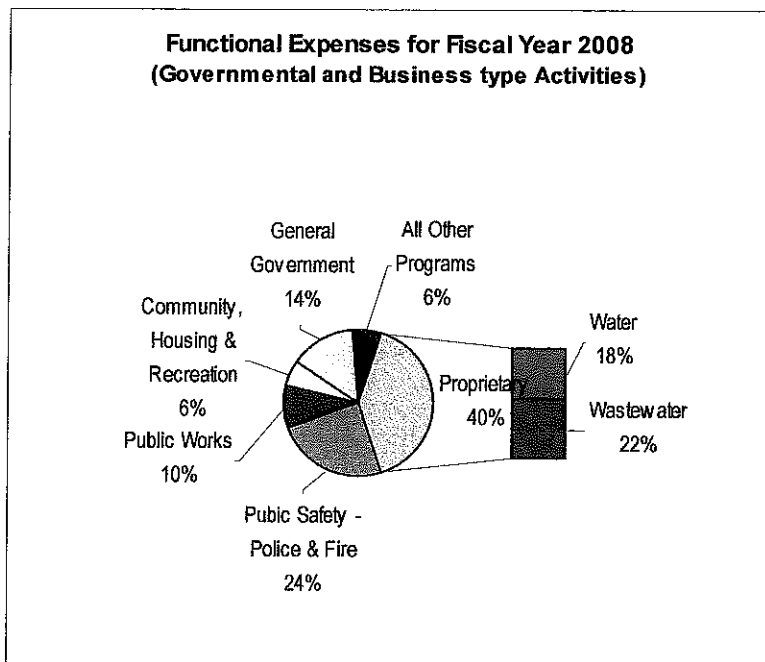
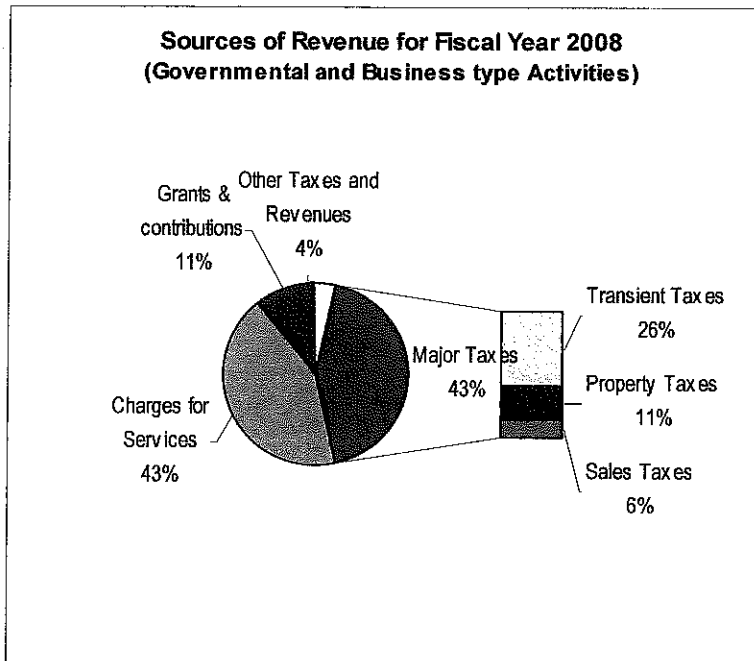
MANAGEMENT'S DISCUSSION AND ANALYSIS

Table A-2
Changes in the City of Calistoga's Net Assets
(in millions of dollars)

	Governmental Activities		Business-type Activities		Fiscal Year Totals		Total Percentage Change
	2008	2007	2008	2007	2008	2007	2007 to 2008
Revenues							
Program revenues							
Charges for services	\$ 1.1	\$ 1.3	\$ 4.6	\$ 4.1	\$ 5.7	\$ 5.4	5.6%
Grants and contributions	1.3	0.6	0.1	0.6	1.4	1.2	16.7%
General revenues							
Transient occupancy taxes	3.4	2.5	-	-	3.4	2.5	36.0%
Property, Sales and other taxes	2.7	2.5	-	-	2.7	2.5	8.0%
Other	0.1	0.1	-	-	0.1	0.1	0.0%
Total revenues	8.6	7.0	4.7	4.7	13.3	11.7	13.7%
Expenses							
General government	1.8	1.3			1.8	1.3	38.5%
Public safety	3.0	2.7			3.0	2.7	11.1%
Community services	0.2	0.4			0.2	0.4	-50.0%
Housing	0.1	0.1			0.1	0.1	0.0%
Recreation services	0.4	0.3			0.4	0.3	33.3%
Public works	1.2	1.1			1.2	1.1	9.1%
Planning & Building	0.6	0.6			0.6	0.6	0.0%
Water	-	-	2.3	2.2	2.3	2.2	4.5%
Wastewater	-	-	2.7	2.8	2.7	2.8	-3.6%
Other	0.2	0.1			0.2	0.1	100.0%
Total expenses	7.5	6.6	5.0	5.0	12.5	11.6	7.8%
Excess (deficiency) before transfers and Special Items	1.1	0.4	(0.3)	(0.3)	0.8	0.1	700.0%
Special items							
Lien recovery	-	-	-	-	-	-	0.0%
Claim settlement	-	-	-	-	-	-	0.0%
Transfers	0.0	-	(0.0)	-	-	-	0.0%
Increase(decrease) in net assets	1.1	0.4	(0.3)	(0.3)	0.8	0.1	700.0%
Net assets, beginning	9.0	9.6	14.0	14.3	24.0	23.9	0.4%
Net assets, ending	\$ 11.1	\$ 10.0	\$ 13.7	\$ 14.0	\$ 24.8	\$ 24.0	3.3%

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Sources of the City's major types of revenue and the areas where such resources are used is shown below in summary graphic form:



Governmental and Business-Type Activities

Revenues from all governmental type activities in fiscal year 2008 increased about \$ 1.6 million to \$8.6 million compared to \$ 7 million in 2007. About 40 % of the revenue from governmental activities is derived from the Transient Occupancy tax (it is 48% of the only General Fund revenue). The Transient Occupancy tax revenue increased by \$900,000 in 2008 primarily due to the opening of a new resort.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The City received increases in property tax allocations as a result of development and state law changes.

As the above graph shows, the City's primary sources of revenue come from charges for service. About 43 % of all City revenues are from water sales, wastewater fees, and local charges for services. The majority of the City's operating expenses are incurred to provide public safety, water and wastewater services. These three programs account for about 64 % of the City's total operating expenses in fiscal 2008.

When all operations were concluded, the governmental activities function reported about a \$ 1.1 million increase in net assets for fiscal 2008. This amount primarily reflects an increase in current tax revenues from growth in new development. There was about a \$ 300,000 decrease in the net assets of business type-activities due to higher operating costs.

Table A-3 presents the cost of each of the City's five largest programs – public safety, public works, general administration, water and wastewater. The cost of all programs this year was \$ 12.5 million, compared to \$ 11.6 million in fiscal 2007; about a 7.8 % increase for the year. For governmental activities, program costs increased in 2008 by about \$ 900,000. Most of that increase relates to increases in public safety and general government.

	Total Cost of Services		Total Percentage Change
	2008	2007	2007 to 2008
Public Safety	\$ 3.0	\$ 2.7	11.1%
General Government	1.8	1.3	38.5%
Public Works	1.2	1.1	9.1%
Water	2.3	2.2	4.5%
Wastewater	2.7	2.8	-3.6%
All other	1.5	1.5	0.0%
Total	\$ 12.5	\$ 11.6	7.8%

Governmental Activities

Users and contributors funded \$ 2.4 million of the \$ 7.4 million in costs of city's governmental activity programs leaving the City general revenues to fund the other \$ 5 million. General revenues were sufficient to pay for these services. The expense of governmental services was absorbed by:

- Those who directly benefited from or used the programs (about \$1.1 million), and
- Other governments and organizations that subsidized certain programs with grants and contributions (about \$ 1.3 million).

The City had to use \$ 5 million of its \$ 6.1 million in general and tax revenues to pay the remaining operating costs which left a net assets increase of about \$ 1.1 million in the governmental activities.

Business-Type Activities

The City's business-type activities (water and wastewater) sustained a \$ 300,000 decrease in net assets. The water and wastewater activities both had cost increases from higher maintenance and operations in fiscal 2008 compared to the prior year.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

As the City completed the year, its governmental funds reported a combined fund balance of about \$ 7.6 million, \$ 3.5 million higher than was reported at the end of fiscal year 2007. The costs of the City's General Fund operations were about \$ 2.1 million more than General Fund revenues. After transfers in and out, the General Fund reported a net \$200,000 decrease. This was primarily due to a combination of an increase in one time capital outlay expenses, increases in revenues and operating costs in fiscal 2008 over fiscal 2007.

At year end, the City's General Fund had a fund balance of about \$1.7 million. Of the \$ 1.7 million, about \$ 600,000 was not available for use as it represents cash advanced primarily to the City's special revenue funds to provide short term cash flow funding for capital improvements. In addition, the City's other major and nonmajor governmental funds ended the 2008 fiscal year with a combined fund balance of \$5.9 million which is to be used only for certain specific future purposes.

The water and wastewater enterprises at the end of fiscal 2008 had a net restricted and unrestricted cash of \$1.1 available for future operations and improvements. See discussion below for future projections.

General Fund Budgetary Highlights

Over the course of the year, the City Council revised the City budget several times. These budget amendments falls into two categories: changes made during the year for unanticipated appropriations and at the year end review for adjustments in revenues and costs and increases in appropriations to better reflect operations and improvements during the year. Even with these adjustments, actual General Fund expenditures were only \$78,000 more than final budget amounts, or .8%. The General Fund expenditure budget changes from the original to final budgets were significant, due to a delay in completing a planned capital improvement project (the community pool) during the year. The Budget changes amounted to about an 18 % increase over the original budget.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2008, the City had invested \$ 37.5 million (net of accumulated depreciation) in a broad range of capital assets, including land, vehicles, equipment, the water system, wastewater system and other capital assets. (See Table A-4.) This amount represents a net increase (including additions and deductions) of about \$ 2.9 million, or about 8.4%, more than last year. This is primarily due to planned capital improvement projects, such as the Community Pool and water facilities improvements.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Table A-4

City of Calistoga's Capital Assets

(net of depreciation, in millions of dollars)

	Governmental Activities		Business-type Activities		Fiscal Year Totals		Total Percentage Change
	2008	2007	2008	2007	2008	2007	2007 to 2008
Land	\$ 2.0	\$ 2.0	\$ 0.8	\$ 0.8	\$ 2.7	\$ 2.7	0.0%
Construction in progress	2.1	0.6	6.0	5.0	8.1	5.6	44.2%
Buildings	0.5	0.6			0.5	0.6	-14.3%
Machinery and equipment	0.2	0.2			0.2	0.2	-1.5%
Internal service equipment	1.1	0.7			1.1	0.7	57.3%
Improvements	2.0	1.1			2.0	1.1	84.4%
Water utility system			7.8	8.0	7.8	8.0	-2.5%
Wastewater system			15.1	15.7	15.1	15.7	-4.0%
Total	\$ 7.9	\$ 5.2	\$ 29.6	\$ 29.5	\$ 37.5	\$ 34.6	8.4%

This year's major capital assets additions included:

In fiscal 2008, the City expended about \$ 1 million on water and wastewater system improvements and \$ 3.2 million on governmental related improvements. The City has implemented infrastructure accounting and reporting to comply with financial reporting standards. The City has not recaptured the estimated and or historical costs of other major infrastructure assets put in service subsequent to fiscal year 1980 and prior to June 30, 2003. Under the national financial reporting standards, the City is not required to record such assets in its financial statements.

Long Term Debt

At the end of 2008, the City had about \$ 24.4 million in long-term debt and capital lease obligations outstanding, which is a net increase of \$ 6.6 million from the prior year. The City did incur an additional equipment lease obligation of \$ 100,000 for public works vehicles. Of the \$ 24.4 million, about 71% relates to the City's business-type activities, mainly the water and wastewater systems, and the remaining 29% is applicable to governmental type financing activities.

In the business-type activities of the \$17.4 million, about \$ 3.1 million is an installment loan agreement for wastewater system improvements, \$ 2.0 million in Certificates of Participation and a \$ 4.7 million state revolving loan obtained to provide financing for construction of the City's wastewater treatment plant facility. In 2006, the City refinanced the water revenue bonded debt of \$ 3.6 million and added \$ 2.0 million in a new installment loan agreement of \$ 5.3 million for water system improvements, which has \$ 5 million outstanding in 2008. In 2008, the City issued \$ 2.5 million in Certificates of Participation for water system improvements relating to Kimball reservoir, treatment plant and pipelines. The installment, certificate and loan payments are paid from service charges and other available resources of the water and wastewater systems as applicable.

The governmental-type activities includes long-term Lease debt of about \$1.1 million in a capital lease entered into in prior years to retire prior debt used to build the City's current public safety facility and acquired Logvy Community Park. In 2008, the City entered into a \$100,000 equipment lease for replacement of public works vehicles. Also in 2008, the City issued \$ 4.7 million in a capital lease obligation for the funding of various community facilities, such as the community pool, fire station, public works facility and a new recreation center.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The capital lease payments are paid from general and special fund monies, and other available resources.

Additional information about the City's long-term obligations can be found in the notes to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

For the 2009 fiscal year, general fund revenue projections continue to be conservative and based on known changes in on going revenues from taxes and one time capital grants.

- Overall General Fund ongoing revenues are projected to increase only slightly, less than 1%, over fiscal year 2008. This minimal increase is due to planned capital grants, property tax assessed valuation and revenue increases in the prior year and conservative projections and the impact of the economic downturns in 2009 and future years. There are no other significant planned changes in tax rates or in other forms of revenue subject to adjustment by the City.
- Rate increases are proposed for the water and wastewater systems in fiscal 2009. It is also planned to review and adjust the development services and impact fees in 2009 to more fully recover costs and fees for new or expanded development impacts.
- The General Fund 2009 budgeted appropriations are adopted and revised at \$ 15.8 million, which \$7.8 million are capital improvements. This is an increase of \$ 6.5 million or about 70 % compared to final 2008 appropriations of \$ 9.3 million. About \$ 5.3 million of this increase is due to capital improvements in the completion of the Community Pool, recreation and fire station facilities. In 2009, the City planned to spend an additional \$ 7.8 million in capital improvements, primarily the community swimming pool, fire station seismic retro fit and rehabilitation, community recreation facilities and operations and special projects. The 2009 revised budget for operations of \$ 7.6 million is projected to increase over the prior year due to the filling of vacant positions, the addition of full time positions and programs.

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, please see the City WEB site at www.ci.calistoga.ca.us or contact the Administrative Services Director/city Treasurer (City of Calistoga, 1232 Washington Street, Calistoga, California 94515, 707-942-2800 or finance@ci.calistoga.ca.us).