



December 29, 2006

Honorable Mayor, Mayor Pro Tem and City Councilmembers:

It is a pleasure to submit the Comprehensive Annual Financial Report (CAFR) of the City of Santa Clarita (City) for Fiscal Year 2005-06, in accordance with Chapter 2.12 of the City's Municipal Code. The intent of this report is to provide the City Council, the City staff and the public with an understanding of the City's financial condition as of June 30, 2006.

Management assumes full responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal controls that has been established for this purpose. Because the cost of internal controls should not outweigh their benefits, the City's comprehensive framework of internal controls has been designed to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and reported in a manner designed to present fairly the financial position and results of operations of the various funds of the City.

State Law requires the City to prepare an annual financial report. This report fulfills that obligation. Diehl, Evans, & Company, LLP, an independent firm of certified public accountants, has issued an unqualified ("clean") opinion on the City of Santa Clarita's financial statements for the year ended June 30, 2006. The independent auditor's report is located at the front of the financial section of this report. The CAFR has been prepared in conformity with generally accepted accounting principles (GAAP) and with the financial reporting requirements prescribed by the Governmental Accounting Standards board (GASB). These reporting requirements specify that management provide a narrative introduction, overview, and analysis to accompany the financial statements in the form of a Management's Discussion and Analysis (MD&A). The MD&A, which immediately follows the independent auditor's report, complements this letter of transmittal and should be read in conjunction with it.



The CAFR is organized into three main sections:

1. Introductory Section – Includes this letter of transmittal, highlighted financial information, City's organizational chart, list of City officials, and financial reporting awards.
2. Financial Section – Includes the independent auditor's report, MD&A, Audited Financial Statements (government-wide and fund statements), Notes to the Financial Statements, and Required Supplementary Information.
3. Statistical Section – Includes selected financial and demographic information, generally presented on a multi-year basis.

Also, as a recipient of federal and state financial assistance, the City is required to have a "Single Audit" performed by our independent audit firm. The Single Audit was designed to meet the special needs of the federal grantor agencies. The standards governing the Single Audit engagements require that the independent auditor report not only on the fair presentation of the financial statements, but also on the audited government's internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. These reports are available in the City's separately issued Single Audit Report.

CITY PROFILE

The City of Santa Clarita was officially incorporated on December 15, 1987, after a ballot measure was passed by the City's residents. Located 35 miles northwest of downtown Los Angeles and 40 miles east of the Pacific Ocean, between Interstate 5 and State Highway 14, Santa Clarita forms an inverted triangle with the Santa Susana and San Gabriel mountain ranges. Encompassing the communities of Canyon Country, Newhall, Saugus, and Valencia, Santa Clarita covers approximately 52 square miles and is geographically the largest city within the County of Los Angeles. With a population of over 160,000 people, the Federal Bureau of Investigation has rated Santa Clarita as the safest City of its size within the County and the United States. Santa Clarita residents enjoy numerous park facilities and services, including the use of the new community center in Old Town Newhall, and within the Santa Clarita Valley area, there are additional recreational and historical facilities. With its unique blend of rural, old west heritage, and urban sophistication, this fast-growing City has established an enviable balance between quality living and growth. CNN/Money Magazine named Santa Clarita as California's best place to live and ranked Santa Clarita as the #18 best place to live in the United States.

The City of Santa Clarita is a general law City and operates under a Council-Manager form of government. The five City Councilmembers are elected at large to four-year overlapping terms, with elections held bi-annually. The position of Mayor is selected from among the Councilmembers. The governing Council is responsible, among other things, for passing ordinances, adopting the budget, and appointing committees. The City Council appoints the City Manager, who is responsible for carrying out the policies and ordinances of the Council, overseeing the day-to-day operations of the government, and for appointing the various Department Managers. The City Council also appoints the City Attorney.

The City provides, either directly or under contract with the County of Los Angeles, a full range of municipal services including public safety, construction, maintenance of streets and other infrastructure, public works, parks and recreation, community development, and cultural events. The City also provides services through the Santa Clarita Redevelopment Agency (RDA) and the Santa Clarita Public Financing Authority (PFA), which are blended component units of the City of Santa Clarita. The financial activity of these entities is included in the accompanying CAFR, as their activity is under the control of the City. Separate component unit reports for each entity are also available.

The City operates on a fiscal year basis, beginning July 1 and ending June 30. The City's Municipal Code requires the City Manager to prepare a budget and present it to the City Council each year. The budget process begins in January of each year and is carried out under the direction of the City Manager in cooperation with the various City departments. Departmental budgets and requests, submitted first to the City Manager, are considered for approval by the appointed Budget Team and the City Council Budget Subcommittee. The final Annual Budget is submitted to City Council for adoption by June 30, to take effect on July 1 of each fiscal year. Budgetary control for the City is maintained through its accounting systems. Once adopted, the budget may be amended throughout the year as necessary. Budgetary control is established at the function or program level within each fund.

LOCAL ECONOMY

Santa Clarita remains a great place to live and work. Santa Clarita was named as one of the Los Angeles top 5 Most Business Friendly Cities by the LAEDC (Los Angeles Economic Development Corporation). Santa Clarita was also named as one of the 25 best affordable communities in the United States by Businessweek.com. as well as a new Enterprise Zone by Governor Schwarzenegger.

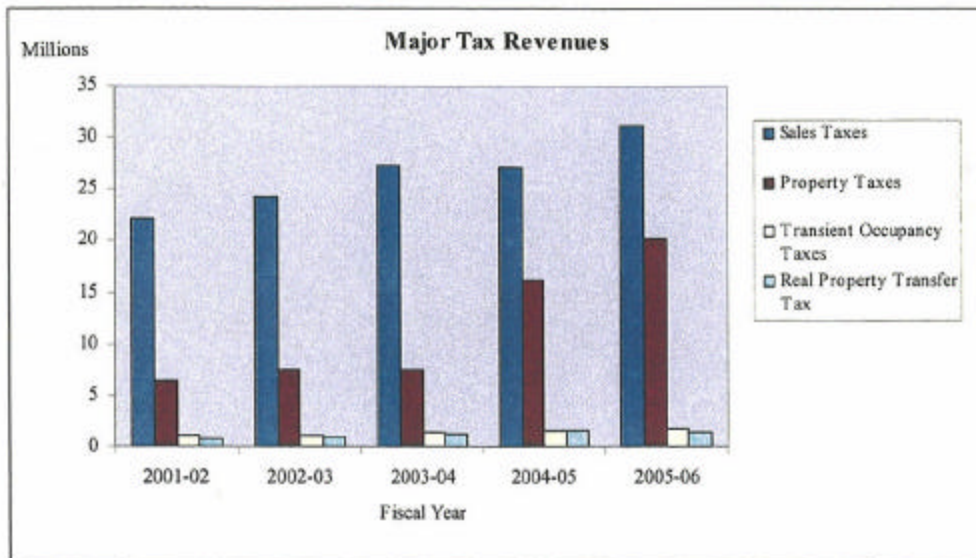
Santa Clarita's employment rates and job growth remain strong. Among cities with population over 100,000, Santa Clarita enjoys the lowest unemployment rate in Los Angeles County. Employment within the City encompasses construction, manufacturing, professional and technical, wholesale goods distribution, finance, real estate, administrative, hospitality services, and recreation. Residents and businesses enjoy access to three colleges within the Santa Clarita Valley, as well as close proximity to the California State University campus at Northridge.

On a long-term basis, the City continues to make strides in economic development and business retention, which has already developed a strong and diverse retail base. This retail base has provided the City with its current strong financial position. The City's continued control over expenditure growth has been and will continue to be a key factor in maintaining the City's strong financial position.

LONG-TERM FINANCIAL PLANNING

Santa Clarita's serene and attractive well-planned community of 167,000 is a model City containing all elements needed for well-balanced living and working conditions. Santa Clarita has consistently ranked in the top five safest cities in the County and the United States. The City maintains a diversified employment base with an unemployment rate of under 3 percent. Santa Clarita's adult population over the age of 25 is highly educated. This setting of safety, along with a highly qualified population, continually attracts and retains world-class corporations.

The City of Santa Clarita has experienced continuous growth since its incorporation in 1987, in economic as well as demographic measures. In 1988, the City's land area encompassed 39.4 square miles with a population of just over 147,000. As of 2006, the population has increased by 13.6% to just over 167,000, and land area has grown by 32% up to 52.04 square miles. The City directly works with private and public sectors to attract new business to the Santa Clarita Valley, assist in the retention and expansion of business already located in the Santa Clarita Valley, and to create new jobs. The continued increases in business development, land area, and demographic growth have had a direct affect on the City's revenue growth, producing overall increases in property tax revenues, sales tax, and transit occupancy tax for the five-year period ending June 30, 2006.



The City works to provide for the necessary funding of essential services and Council and community identified priorities while taking steps to ensure the City remains in good financial health. The City prepares extended forecasts for the general fund each year in order to determine the future impact of our current actions. These forecasts indicate continued general fund revenue growth over the next five years, primarily due to continued projected increases in sales and property taxes. This revenue growth, along with the City's balanced budget policy, will provide for continued maintenance of the general fund balance and reserves.

The City maintains a general fund balance sufficient to provide for various identified contingencies, as well as an established operating reserve. In addition, the general fund contributes annually to the City's facilities replacement fund, which provides for major maintenance and replacement of infrastructure and capital improvements. The City's Capital Improvement Program (CIP) is a component of the annual budget process that addresses the City's short- and long-term capital needs. Just as important, the CIP emphasizes a plan of action that effectively maintains the existing infrastructure to a sound physical standard, as well as providing new facilities to support current growth and complement new development.

MAJOR INITIATIVES

In August of 2004, the City Council adopted The Big Picture Community Plan (The Plan). The Plan was developed after an extensive public engagement process by the City, which included over 61 community meetings, mixed media advertisements, direct mailings and phone contacts. The result was identification of key community issues and their related impacts within the following ten areas:

Traffic, Air Quality, Cultural Arts, Growth, Open Space, Parks,
Youth Activities, Newhall Redevelopment, Public Safety,
Economic Development

The Plan was developed to address these issues and prioritize and categorize projects for budget funding within the ten areas of concern. On December 2005, the \$31 million, six-lane Golden Valley Interchange was opened to the public. This 380-foot long bridge/interchange was part of the City's centerpiece project, the Cross Valley Connector. The Cross Valley Connector is the City's plan to ease traffic and is achieved by the seamless connection between the I-5/SR126 on the Westside of the City to the SR-14/Golden Valley Interchange on the East. This eight-and-a-half mile, \$245 million road will provide a new way to travel across Santa Clarita Valley and ease traffic congestion valley-wide.

In Fall 2005, the Santa Clarita Transit Maintenance Facility was opened and in full operation. This 65,000 square feet facility houses the City's transit system and includes service bays, office space, automated bus washes, and diesel and alternative fueling stations. Transit Maintenance Facility is the first LEED (Leadership in Energy and Environmental Design) Certified Project in the City of Santa Clarita and is a demonstration of the City's commitment to greener development and responsible public policy. The project is now LEED Registered, and listed on the USGBC web site.

AWARDS AND ACKNOWLEDGMENTS

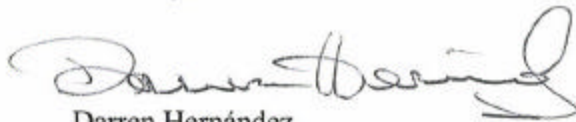
The California Society of Municipal Finance Officers (CSMFO) awarded a Certificate of Award for Outstanding Financial Reporting, and the Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate for Excellence in Financial Reporting, to the City of Santa Clarita for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2005. This was the seventeenth consecutive year that the City has achieved these prestigious awards. In order to be awarded a Certificate of Achievement or Certificate of Award for Outstanding Financial Reporting, a government unit must publish an easily readable and efficiently organized Comprehensive Annual Financial Report. This report must satisfy GAAP and applicable legal requirements.

A Certificate of Achievement and Certificate of Award for Outstanding Financial Reporting is valid for a period of one year only. We believe our current comprehensive annual financial report continues to meet the requirements of the GFOA Certificate of Achievement Program and the CSMFO Outstanding Financial Reporting Award, and we are submitting it to GFOA to determine its eligibility for another certificate. In regards to the submission to the CSMFO program, the criteria for the awards program have recently been modified to only

include agencies that are first time applicants or those agencies that are not submitting to the GFOA program. This modification is due to the similarity between the GFOA and CSMFO programs. Since the City has been a multi-year recipient of the CSMFO award and is submitting the CAFR for consideration of the GFOA Certificate of Achievement, the City is not eligible to submit to the new CSMFO program.

This report is a joint effort by many people from many different areas of responsibility. The preparation of this report could not have been accomplished without the hard work and team effort of the Finance Division. I would like to express my appreciation to all members of the Division who assisted and contributed to its preparation, in particular, Gina Schuchard, Finance Manager; Mary Ann Ruprecht, Senior Financial Analyst; Carmen Magaña, Jan Downey, and Joseph Lillio, Financial Analysts; Michelle O'Melia, Project Technician; and Holly Faulconer, Graphic Designer. I would also like to thank the Mayor, Mayor Pro Tem, Councilmembers, City Manager Ken Pulskamp, Assistant City Manager Ken Striplin, and the Department Directors, for their continuing efforts in planning and administering the financial operations of the City in a responsible and progressive manner.

Sincerely,



Darren Hernández,
Director of Administrative Services & City Treasurer

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