

**CITY OF EAST PALO ALTO, CALIFORNIA**

**Basic Financial Statements**

**June 30, 2007**

**CITY OF EAST PALO ALTO**  
**Financial Statements**  
**For the Year Ended June 30, 2007**

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November 26, 2007

The Honorable City Council of  
the City of East Palo Alto, 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 East Palo Alto, California, (City) as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of East Palo Alto's management. 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 East Palo Alto, California, as of June 30, 2007, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated November 26, 2007 on our consideration of the City of East Palo Alto'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 financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The management's discussion and analysis and other required supplementary information identified in the accompanying table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. 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's basic financial statements. The accompanying combining nonmajor fund financial statements listed as supplementary information in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and in our opinion is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

*Moreland & Associates, Inc.*

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balance resulting from increased revenues generated during the current fiscal year, as well as cost savings. In addition, the City acquired both the Lighting and Drainage districts from San Mateo County at which time all of their respective assets were transferred during the current year.

- Government-wide net liabilities decreased by approximately \$600,000. This was mainly the result of payment obligations such as the UCI loan and bond principal payments made during the year.
- Governmental revenues resulted in an increase of approximately \$8.3M from prior year. This increase resulted from a greater level of grant activities and higher property tax revenues generated from increased assessed valuations.
- Governmental expenditures increased by \$1.8M over prior year as a result of higher expenditures in public safety activities and public works projects.

## OVERVIEW OF THE FINANCIAL STATEMENTS

### Government-wide Financial Statements

The government-wide financial statements are design to provide the readers with a broad view of the City's finances in a manner similar to a private-sector business.

*Statement of Net Assets:* Presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets (deficit). Over time, the change in net assets (deficit) may serve as a useful indicator of whether the financial position of the City is improving or declining.

*Statement of Activities:* Presents information showing how the City's net assets (deficit) changed during the most recent fiscal year. All changes in net assets (deficit) are reported as soon as the underlying event giving rise to the change occurs, regardless of timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flow in future fiscal periods (e.g. revenues pertaining to uncollected taxes and expenses pertaining to earned unused vacation leave). Non-financial factors, such as changes in the City's property tax base and the condition of the City's roads must be considered in order to properly assess the overall financial health of the City.

- In the Statement of Net Assets and the Statement of Activities, we divide the City into two types of activities:
- Governmental activities - Most of the City's basic services are reported here, including police, public works, community development, and general administration. Taxes, user fees, and state and federal grants finance most of these activities.
- Business-type activities - The City charges a fee to cover all or most of the cost of certain services it provides. The City's water system and franchised garbage collection services are reported here.

## **Fund Financial Statements**

A fund is a grouping of related accounts used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other State and local governments, uses fund accounting to ensure and demonstrate financial compliance with legal requirements. 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. 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.

### **Reporting the City's Major Funds**

The analysis of the City's major funds begins on page 20. The fund financial statements provide detailed information about the most significant funds - not the City as a whole. Some funds are required to be established by State law and by bond covenants. However, the City establishes many other funds to help it control and manage money for particular purposes (like the Capital Project Fund) or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money (like grants received from the Federal Government). The City's two types of funds - governmental and proprietary - use different accounting approaches.

- *Governmental funds* - Most of the City's basic services are reported in the 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 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 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 at the bottom of 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.

### **The City as Trustee**

The City is the trustee, or *fiduciary*, for its employees' 401K and 401A pension plans. It is also responsible for other assets that - because of a trust arrangement - can be used only for the trust beneficiaries. All of the City's fiduciary activities are reported in separate Statements of Fiduciary Net Assets and Changes in Fiduciary Net 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.

## Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

### **Government-wide Financial Analysis**

The City provides comparative information in its Management Discussion & Analysis by presenting two years of financial information in the GASB Statement No. 34 format and a comparative analysis of government-wide data. Net assets serve as a useful indicator of a government's financial position. For the City, assets exceeded liabilities by approximately \$15.3M. However a significant portion of these assets are not liquid, and are not available to pay liabilities. Of the \$71.0M total assets; only \$49.6M has short or long term liquidity. The remaining assets are capital assets such as roadways, storm drains, lighting, water system and other infrastructures owned by the City.

### Analysis of Net Assets

Government-wide assets exceeded liabilities by \$14.3M at the end of the current fiscal year. The following table is a summary of the government-wide net assets for the governmental and business-type activities:

<b>STATEMENT OF NET ASSETS</b>						
<b>(Dollars in thousands)</b>						
	<u>Governmental Activities</u>		<u>Business-type Activities</u>		<u>Total</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
<b>Assets:</b>						
Current and other assets	\$ 49,621	\$ 42,506	\$ 2,172	\$ 1,648	\$ 51,794	\$ 44,154
Capital Assets	<u>21,298</u>	<u>21,129</u>	<u>5,382</u>	<u>5,658</u>	<u>26,680</u>	<u>26,787</u>
Total assets	<u>70,920</u>	<u>63,636</u>	<u>7,554</u>	<u>7,306</u>	<u>78,474</u>	<u>70,942</u>
<b>Liabilities:</b>						
Current and other liabilities	5,236	4,110	434	462	5,670	4,572
Noncurrent liabilities	<u>50,395</u>	<u>52,081</u>	<u>          </u>	<u>          </u>	<u>50,395</u>	<u>52,081</u>
Total liabilities	<u>55,632</u>	<u>56,191</u>	<u>434</u>	<u>462</u>	<u>56,065</u>	<u>56,653</u>
<b>Net Assets:</b>						
Investment in capital, net of debt	21,298	20,575	5,382	5,702	26,680	26,277
Restricted	14,391	6,425	<u>          </u>	<u>          </u>	14,391	6,425
Unrestricted	<u>(20,401)</u>	<u>(19,557)</u>	<u>1,738</u>	<u>1,142</u>	<u>(18,663)</u>	<u>(18,415)</u>
Total Net Assets	<u>\$ 15,288</u>	<u>\$ 7,443</u>	<u>\$ 7,120</u>	<u>\$ 6,844</u>	<u>\$ 22,408</u>	<u>\$ 14,287</u>

*Numbers may not add due to rounding*

### Governmental Activity

- Total assets of \$71.0M consist of current and other assets of \$49.6M and capital assets of \$21.3M. Current and other assets increased \$7.3M. This increase of \$7.3M is comprised of a \$3.1M Agency cash balance due mainly to an increase in tax increment revenue generated within the University Circle Redevelopment Project Area from the sale of three class A office buildings by its developer; a \$2.0M General Fund cash balance caused by a loan repayment from the Agency, transient occupancy tax revenue and a reduction in operating expenditures from prior year as key management positions were vacant during the year; another \$1.2M from the transfer of both the Lighting District and the Drainage District from San Mateo County. The remaining \$1.0M balance comprised of various funding sources from grants related to development activities.
- Total liabilities of \$55.6M consist of \$5.2M of current liabilities and \$50.4M of long-term debt. Total liabilities decreased by \$560,000. This decrease mainly resulted from a principal loan repayment related to UCI Stage 2A project of approximately \$570,000.
- Net assets are comprised of 1) \$21.3M investment in capital assets (e.g. land building, improvements, infrastructure, etc.) less any outstanding debt used to acquire those assets. The City utilizes capital assets to provide services to citizens. These assets, however, are not available for future spending. Although the investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources since the capital assets themselves cannot be liquidated for these liabilities; (2) \$14.4M represents resources that are subject to external restrictions on how they may be expended and (3) a remaining deficit of \$20.4M. The \$20.4M deficit is comprised of long-term obligations secured by future tax increments and liabilities for claims and judgments and compensated absences. The City intends to liquidate those liabilities as the payments become due from continued annual operations.

### Business-type Activity

The City's business-type activities reflect a \$5.4M investment in capital assets, which primarily consists of water-service type assets and infrastructure. Approximately, \$1.7M unrestricted net assets are available at year-end to pay current and future obligations. No major capital improvements were added to the water system during the current fiscal year.

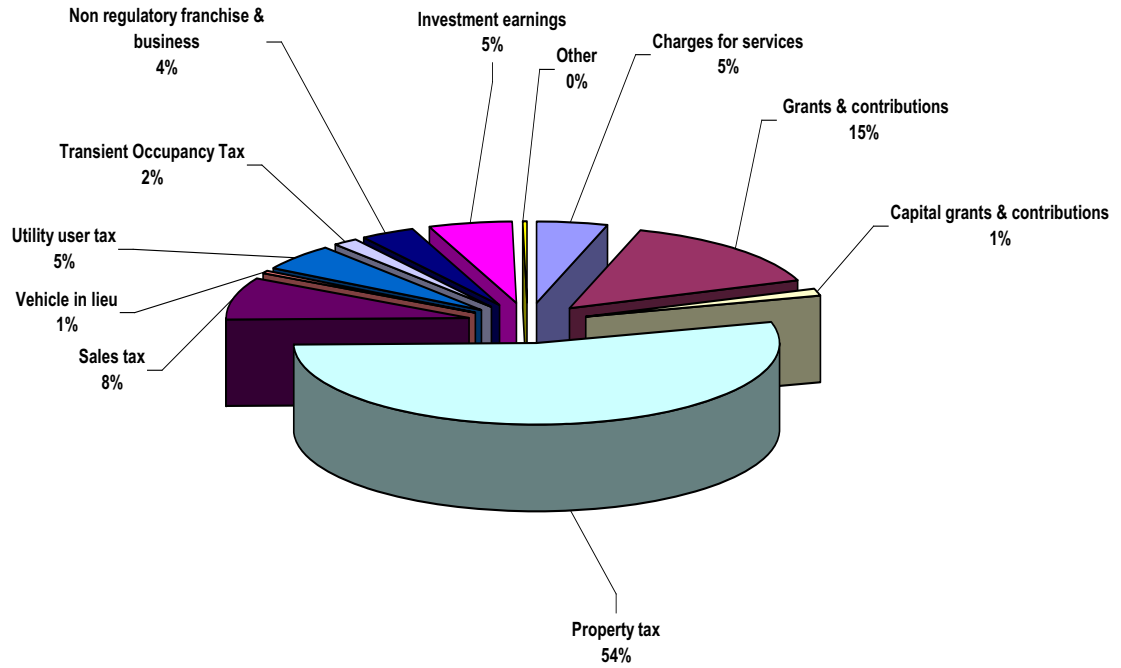
### Analysis of Statement of Activities

The statement of activities shows the net increases / (decreases) of net assets during the fiscal year-end. The following table indicates the changes in net assets for governmental and business-type activities:

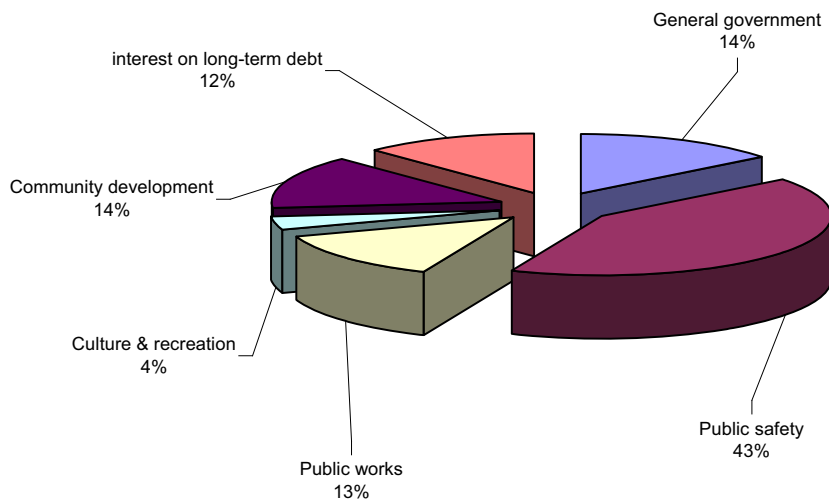
<b>Statement of Activities</b>						
<b>(Dollars in thousands)</b>						
	<u>Governmental Activities</u>		<u>Business-type Activities</u>		<u>Total</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
<b>Revenues</b>						
Program revenues:						
Charges for services	\$ 1,419	\$ 2,056	\$ 2,389	\$ 1,976	\$ 3,808	\$ 4,032
Operating grants and contributions	4,419	2,257			4,419	2,257
Capital grants and contributions	435	461			435	461
General revenues:						
Property taxes	15,946	10,605			15,946	10,605
Sales taxes	2,498	2,750			2,498	2,750
Vehicle in lieu	201	231			201	231
Utility user tax	1,586	1,418			1,586	1,418
Transient Occupancy Tax	500	-				
Non regulatory franchise and business	1,086	981			1,086	981
Investment earnings	1,638	645	94	71	1,732	716
Gain on sale of assets		(2)				(2)
Other general revenues	87	72			87	72
Total revenues	<u>\$ 29,816</u>	<u>\$ 21,474</u>	<u>\$ 2,483</u>	<u>\$ 2,047</u>	<u>\$31,798</u>	<u>\$ 23,521</u>
<b>Expenses</b>						
Program expenses:						
General government	\$ 3,170	\$ 2,991			\$ 3,170	\$ 2,991
Public safety	9,502	9,011			9,502	9,011
Public works	2,967	2,191			2,967	2,191
Culture and recreation	799	779			799	779
Community development	2,789	3,304			2,789	3,304
Water services			\$ 441	\$ 512	441	512
Garbage collection			1,766	1,733	1,766	1,733
Interest on long-term debt	2,744	1,959			2,744	1,959
Total expenses	<u>21,970</u>	<u>20,235</u>	<u>2,206</u>	<u>2,245</u>	<u>24,177</u>	<u>22,480</u>
Increase (decrease) in net assets	7,845	1,238	276	(198)	8,122	1,040
Beginning net assets	7,444	6,206	6,844	7,042	14,288	13,248
Ending net assets	<u>\$ 15,289</u>	<u>\$ 7,444</u>	<u>\$ 7,120</u>	<u>\$ 6,844</u>	<u>\$22,410</u>	<u>\$ 14,288</u>

The government-wide net assets increased by approximately \$7.8M as noted in the table above. The primary reason for the increase is the result of revenues exceeding expenses in the governmental activities. Further explanations on governmental type revenue and expenditure are illustrated in the charts below:

**Governmental Activities  
Revenues by Source**



**Governmental Activities  
Expenditures by Type**



### Governmental activities

- Overall total revenues are approximately \$29.8M; an increase of \$8.3M (27.9%) from the prior year. General revenues increased nearly \$5.9M from prior year. This was mainly attributed to increased property tax revenues as a result of increased assessed valuation on property within the City, especially the University Circle Project Area where the assessed valuation tripled in value from the prior year. Additionally, program revenues increased nearly \$2.4M from significant spending in grant related activities and projects.
- Overall total expenses are approximately \$22.0M; an increase of \$1.8M (8%) from the prior year. The significant components of the increase are increased public safety programs and infrastructure improvements from the prior year.

Business-type activities increased City's net assets by \$276,000 in the current fiscal year. Key factors of this increase are as follows:

- Garbage service revenues (charges for services) exceeded expenditures by \$346,000 mainly as a result of South Bayside Waste Management Authority settlement with the City's garbage collection service provider to refund the City for the over charges in the garbage fee rates from previous years. This increase was offset by an operating deficit of \$70,000 to Water services.
- Although Water revenues increased by \$117,000 and expenditures decreased by \$71,000 from the previous year, the current year's operating revenues of \$370,000 were not able to cover the operating expenses of \$440,000; thereby resulting in a net operation deficit of \$70,000. This operating deficit was funded using prior year's fund balance.

## **FINANCIAL ANALYSIS OF THE GOVERNMENT'S FUNDS**

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

### **Governmental Funds**

The focus of the City's governmental funds is to provide information on near-term inflows, outflows and balances of resources that are available for spending. Such information is useful in assessing the City's financing requirements. Types of governmental funds reported by the City include the General Fund, Special Revenue Funds, Debt Service Funds and Capital Project Funds.

At June 30, 2007, the City's governmental funds reported a combined ending fund balance of \$43.6M, an increase of \$6.2M in comparison to the prior year.

- Governmental revenues at fiscal year end were \$30.1M, an increase of \$8.3M in revenues from the previous year. This was mainly a result of increased property tax revenues due to increased assessed valuation of properties within the City and a payment of transient occupancy tax received from the hotel.
- Governmental expenditures totaled approximately \$23.8M, an increase of \$1.6M (7%) over the previous year. There were minor fluctuations within the various expenditure

programs resulting in no significant change overall. However, the primary cause of the \$1.6M increase in expenditure resulted from capital projects such as Bay Road, the new Police Department facility, and additional interest and fiscal charges related to the PFA 2005 Bond.

The General Fund is used to account for all revenues and expenditures necessary to carry out basic government activity of the City that is not accounted for through other funds.

At June 30, 2007 fund balance was \$14.5M; an increase of \$2.0M (16%) from the prior year. Of the total fund balance approximately \$3.2M is unreserved and is available for spending at City's discretion. Of this \$3.2M, City has earmarked approximately \$527,000 (16%) fund balance for pending/future litigations, to purchase technology equipment, City vehicles and related equipment for various City departments; another \$611,000 (19%) was designated to balance the upcoming FY2007-2008 Adopted General Fund Operating Budget; leaving a net balance of \$2.1M as available sources. Unreserved fund balance represents 7.1% of the total fund expenditures of \$14.0M. The City has available funds for unanticipated emergencies based on the adopted financial plan policy, which requires a minimum reserve set aside of 6 (six) weeks of operating costs estimated at \$1.6M. The Council may set aside this reserve amount as a part of the FY2007-2008 budget amendment. Although the General Fund recognizes an unreserved fund balance in the current year, being able to meet such level of reserves annually will continue to be a challenge for the City, as cost of services increases, revenue sources fluctuate depending on the economy and current vacancies being filled. Management intends to continue meeting these challenges through careful financial planning, monitoring budget expenditures, and by identifying ways to reduce cost and/or generate more revenues for the City.

Revenues equaled \$15.5M; an increase of \$2.2M (17%) over prior year. The increase was a combination of various activities such as a one-time settlement pay-out; new revenue generated from transient occupancy tax; loan repayment from Agency and increased property tax revenues.

Expenses equaled \$14.0M; an increase of \$200,000 (1%) over prior year. The increase was largely due to overall increased in salaries and benefits, an increase in program activities related to public safety and public works; including a portion of the cost associated with the improvements on the San Francisquito Creek.

Both revenue and expenses increased over the prior year, however, revenues exceeded expenses, creating an operating income of approximately \$1.4M. The Agency approved an accelerated repayment of debt owed to the General Fund in the amount of \$759,000 to fund other current obligations due and payable shortly after June 30, 2007 and to balance the FY2007-2008 Operating Budget.

The East Palo Alto Redevelopment Agency accounts for the activities of the Agency, which was created to prepare and carry out redevelopment plans for designated areas within the City.

The Capital Project Fund's revenues were \$7.1M in the current year, an increase of approximately \$3.4M from the previous year. The increase was a result of an increase in assessed valuation related to property within the redevelopment project area, specifically University Circle Project Area as a sale transaction of three "class A" office buildings causing the assessed valuation to triple. Expenditures in the current year were \$3.7M; an increase of approximately \$700,000 from the prior year. The increase is primarily due to pass-through tax increment payments, loan payment related to UCI Stage 2A and more redevelopment activities in the current year.

In the current year, the Agency had reserved for encumbrances of approximately \$300,000, land held for resale for approximately \$537,000 and \$324,000 reserved fund balance, leaving an unreserved fund balance of approximately \$3.0M. However it's important to note that the Agency has a long-term advance from the City's General Fund estimated at \$11.2M, and the Agency's obligated to make such payments is subordinate to all other long term debt obligations. If the Agency's ability to collect tax increment revenues expires, then any remaining long-term advance due to the City will be forgiven. This long-term debt the Agency owes is not uncommon for Redevelopment Agencies.

Low and Moderate Income Housing accounts for the legally required set-aside of 20% of property tax increment revenues received from within the Agency's redevelopment project areas and accounts for expenditures restricted to low and moderate income housing projects.

Total tax increment revenues received in the current year were approximately \$1.7M, a portion of which was used to repay low and moderate housing related debt.

Proprietary Funds: The City's proprietary funds provide the same type of information found in the government-wide financial statements but in more detail.

At the end of the fiscal year, the unrestricted net assets for the Water and Garbage Funds were \$6.3M and \$833,000, respectively. The combined increase in net assets for both funds was \$277,000 compared to prior year. Further discussions of these funds have been addressed previously in the discussion of the City's business-type activities.

### **General Fund Budgetary Highlights**

Differences between the original FY 2007 General Fund budget and the final amended budget resulted in an approximate \$2.0M increase in budgeted revenues and a \$1.9M increase in expenditure appropriations. Following are the main components of the changes in revenues and expenditure appropriations.

- The fiscal year 2007 adopted revenues equaled \$14.4M and the final amended revenue was \$16.4M; an increase of \$2.0M from the original budget. When the adopted budget was approved, the City anticipated a General Fund deficit of (\$150,000). However due to higher than anticipated increased property tax revenue and increased TOT revenue of \$830,000 and \$322,000 respectively, including an additional transfer of \$611,000 from the Redevelopment Agency and other net revenues totaling \$237,000 the amended budget reflects an operating fund balance of \$687,000. This fund balance would then be used to balance the FY2007-2008 Adopted Budget, which showed an operating deficit of \$978,000, the remaining deficit would be covered by another transfer from the Agency during the FY2007-08 budget year. The current year fund balance of \$687,000 does not account for the \$936,000 estimated advance from the Agency as a pass-through to the City to cover the operating deficit in the Ravenswood Project Area.
- The fiscal year 2007 adopted appropriations equaled \$14.4M, an increase of \$1.9M from the final amended appropriations of \$16.3M. The increase is the result of higher than anticipated increase in law enforcement services such as overtime and contract services with the County Sheriff's department, as well as, purchasing three new police vehicles. Other increases resulted from costs associated with the San Francisquito Creek whereby, the City's General Fund had to absorb some of the cost of improvement to the creek; and

transfers to other funds. These changes were not anticipated during the current year and were not originally budgeted, thereby amending the FY2006-2007 budget.

## CAPITAL ASSET AND DEBT ADMINISTRATION

### Capital Assets

The City's capital assets for its governmental and business-type activities as of June 30, 2007 amounted to \$26.7M (net of accumulated depreciation). Capital assets include land, construction in progress, buildings and improvements, machinery and equipment, and infrastructure. The total decrease in the City's capital assets for the fiscal year was approximately \$106,000 or 1.0 percent.

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

Governmental Capital Assets						
June 30, 2007						
(Dollars in thousands)						
	Governmental Activities		Business-type Activities		Total	
	2007	2006	2007	2006	2007	2006
Land	\$ 868	\$ 605	\$ 207	\$ 207	\$ 1,075	\$ 812
Construction in Progress	1,326	1,489			1,326	1,489
Buildings and Improvements	3,949	3,495	44	44	3,993	3,539
Improvements Other than Buildings	2,854	2,741	7,022	6,981	9,876	9,722
Furnishings & Equipment	1,204	1,102	63	63	1,267	1,165
Vehicles	1,110	1,169	90	90	1,200	1,259
Street and Roadways	31,559	31,559			31,559	31,559
Storm Drain System	3,261	3,261			3,261	3,261
Less Accumulated Depreciation	<u>(24,831)</u>	<u>(24,292)</u>	<u>(2,044)</u>	<u>(1,727)</u>	<u>(26,875)</u>	<u>(26,019)</u>
Total	<u>\$ 21,300</u>	<u>\$ 21,129</u>	<u>\$ 5,382</u>	<u>\$ 5,658</u>	<u>\$ 26,682</u>	<u>\$ 26,787</u>

Major capital assets events during the current fiscal year included the following:

#### Governmental Activities:

- Capital assets increased a total of \$710,000, net of current year depreciation of \$539,000.
- Construction in progress (CIP) decreased \$163,000 over the prior year. This is mainly a result of the completion of the new police facility totaling \$184,000, offset by an increase to the Bay Road Improvement project, totaling \$21,000.

Business-Type Activities:

- Water Services' capital assets decreased by \$276,000 (net of accumulated depreciation). This is a result of the depreciation of the water assets in the amount of \$317,000 net of a \$41,000 increase in improvements being made to the water system.

For government-wide financial statements presentation, all depreciable capital assets were depreciated from acquisition date to the end of the current fiscal year. Fund financial statements record capital assets purchases as expenditures.

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

Additional information about the City's and Water Services' capital assets can be found in Note III C. to the financial statements.

**Debt Administration**

At year-end, the City had \$52.9M in debt related to governmental activities. There was no debt related to the business-type activities. Debt outstanding increased by \$17.4M or 49 % from prior year. Debt outstanding as of June 30, 2007 with a comparison to prior year, including net change follows:

	<b>Debt Outstanding</b> (Dollars in Thousand)		
	<u>As of June 30, 2007</u>	<u>As of June 30, 2006</u>	<u>Net Change</u>
Tax Allocation Bonds	\$ 25,220	\$ 25,620	(400)
Revenue Bonds	17,995	17,995	
Amortized Bond Premium	770	806	(35)
Loan from other governments	6,084	6,914	(830)
Claims & Judgments	263	555	(293)
Compensated Absences	1,013	968	45
Total government activity debt	<u>\$ 51,345</u>	<u>\$ 52,858</u>	<u>\$ (1,513)</u>

A \$1.5M net reduction in debt; resulted from payment of bond principal totaling \$400,000; a loan payment of \$553,000 related to the University Stage 2A project; whereby the Agency was obligated to repay this loan once the tax increment generated in the University Circle Project Area exceeded an excess of \$1.7 million in any given year. Due to the significant increase of tax increment generated in the current year, the repayment threshold was triggered. The additional \$347,000 resulted in scheduled payments of the excise tax judgment and redevelopment agency pass-thru agreements, offset by adjustments to compensated absences and amortized bond premium.

In FY 2007 no debt activity was reported in the business-type activities.

Additional information about the City's debt can be found in Note III F to the financial statements.

## **ECONOMIC FACTORS AND NEXT YEAR'S BUDGET**

The City population has slightly increased over the past several years, with a slight increase of 1.5% in 2007. The City unemployment rate decreased from 10.5% to 9.2% in 2007. Historically, the City's unemployment rates are higher than the rates of the County and the State of California. In 2006, the County unemployment rate was 3.7%. The City attributes the higher rates to a variety of factors, including less-than-optimal business development and retail activity within the City and, to broader socio-economic issues that challenge the competitiveness of City residents in the labor market relative to educational opportunities and employment preparedness. The City is trying to address these challenges through a variety of approaches and partnerships such as First Source Hiring (FSH) placement and employment training initiatives, small business retention programs, new business promotion/facilitation and collaborative efforts with the local school district and other education local providers.

- The unemployment rate decreased in 2006 due to overall improved economic conditions related to the creation of temporary construction-related and permanent jobs that East Palo Alto residents were able to successfully compete for as a result of employment opportunities created by the opening of a Four Seasons Hotel, construction of the Cummings Park, other housing development project and, sustained efforts to achieve employment targets through the city's First Source Hiring program related to existing retail jobs in the Gateway 101 shopping center. Approximately 43% and 42% of the employees in the shopping center were from the City of East Palo Alto for the first and second quarter of 2007 respectively.
- The "Measure R" tax, which increases the business license tax on toxic waste facilities from 1% to 10% of gross revenues, was approved by the voters two years ago. However this tax was challenged; a settlement was recently reached with Romic Environmental Technologies Corp, which resulted in a settlement amount of \$337,500 for the City. The settlement calls for \$137,500 to be paid immediately, \$100,000 to be paid in June 2008 and the remaining \$100,000 to be paid in June 2009. This facility was closed in November of 2007 and extensive plans are being developed to clean up this site and prepare it for productive reuse.
- The "Measure J" Utility User Tax was passed by the voters on the November 2005 ballot. The measure removed the sunset date (November 2006), thereby authorizing the City to continue imposing the tax. The utility user's tax is currently \$1.6 million annually. Discussion continues both on the State and Federal level, that could result in legislation or regulations that have adverse fiscal implications related to the collection of the tax as it is related to telephone services.
- The City placed a measure on the November 2006 ballot known as "Measure C", which also required a two-thirds majority under Prop 218. This tax was approved by the voters and is expected to generate approximately \$700,000 annually (for ten years) to be used to improve public safety services and violence prevention programs beginning in the 07-08 fiscal year.

- On March 15, 2007 a settlement agreement, between the Agency and the Hotel Developers of the Four Seasons hotel was reached over the Transient Occupancy Tax known as TOT. The agreement resulted in the City receiving annual TOT of \$500,000 annually beginning in 2006 and continuing until the earlier of the following events:
  - January 30, 2011;
  - Or
  - The date on which the Hotel Developer has received and retained the cumulative sum of TOT equal to the actual amount of TOT generated during the first 42 months of the hotel operations, up to a maximum of \$7 million.

Any TOT collected and retained up to the \$7 million becomes an obligation of the Agency to reimburse the City from future tax increment generated from the University Circle Project. As of June 30, 2007, the hotel collected \$2.0 million in TOT, of which \$500,000 was sent to the City, leaving a net balance of \$1.5 million that was retained by the hotel developers. The Agency reimbursed the City's General Fund \$611,525 of the estimated \$1.5 million current obligation, leaving a net obligation amount of approximately \$900,000. In 2008, the Agency budgeted to repay an additional \$611,525 of TOT to the City's General Fund.

- The City's fiscal position is improving compared to prior years; however, the City continues to face fiscal challenges implementing its FY07-08 budget. Although revenues have increased so has operating expenditures. Personnel costs are on the rise as the City tries to compete in the market for qualified experienced professionals; and there are increased costs in materials, contract services and operating supplies. In order to adopt a balanced budget for FY07-08, the City Council required the Agency to reimburse the General Fund \$611,525 as noted above. The City was able to restore two of the fifteen positions that were eliminated as a part of the prior year budget. Additionally, the Council approved a new position; an Assistant City Attorney, a vital position needed to meet an ever increasing legal services demand in the City Attorney's Department. The services of a grant funded Senior Project Engineer have been secured to assist the city's Engineering Division in implementing first phase reconstruction of Bay Road and roadway capital projects throughout the City, which are funded by grants that are approaching critical deadlines and are at risk of being lost. Although the City was successful in reducing the General Fund structural deficit and improved productivity cost, controls will only have limited results in solving the City's ongoing revenue/expenditure imbalance in the General Fund. New sources of revenues will be required in order to avoid potential significant service cuts and program elimination in the future. The recent rise in housing foreclosures throughout the State provides a cause for concern relative to the evolving impact of sub-prime housing loans. Such foreclosures have the potential to exert significant downward pressure on property value and property tax revenues for the City.
- All of these factors were considered in preparing the City's budget for FY 2008.

## **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 ensure transparency relative to city fiscal operations. If you have questions about this report or need additional financial information, contact the City's Finance Department, East Palo Alto Government Center, 2415 University Avenue, East Palo Alto, CA 94303.

**CITY OF EAST PALO ALTO**  
**Statement of Net Assets**  
**June 30, 2007**

<u>Assets</u>	Primary Government		
	Governmental Activities	Business-type Activities	Total
Current Assets:			
Cash and cash equivalents	\$ 19,367,429	\$ 2,013,986	\$ 21,381,415
Cash and investments with fiscal agent	19,442,244		19,442,244
Receivables, net	1,545,195	158,368	1,703,563
Prepayments	59,872		59,872
Total Current Assets	40,414,740	2,172,354	42,587,094
Noncurrent Assets:			
Deposits and other assets	144,962		144,962
Deferred charges	1,485,287		1,485,287
Property held for resale	537,429		537,429
Loans receivable	7,039,017		7,039,017
Capital assets:			
Nondepreciable assets	2,193,711	206,750	2,400,461
Capital assets net of depreciation	19,104,507	5,175,033	24,279,540
Total Noncurrent Assets	30,504,913	5,381,783	35,886,696
Total Assets	70,919,653	7,554,137	78,473,790
<u>Liabilities</u>			
Current Liabilities:			
Accounts payable	1,546,029	380,138	1,926,167
Accrued liabilities	558,475		558,475
Deferred revenue	354,112		354,112
Deposits payable and advances	976,538	53,622	1,030,160
Advances from developers	453,838		453,838
Interest payable	397,407		397,407
Current portion of noncurrent liabilities	949,976		949,976
Total Current Liabilities	5,236,375	433,760	5,670,135
Noncurrent Liabilities:			
Tax allocation bonds payable, net of unamortized premium of \$770,332	43,565,332		43,565,332
Due to other governmental agencies - long-term pass-through	5,034,043		5,034,043
Compensated absences	1,012,907		1,012,907
Claims and judgments	262,500		262,500
Other loans and notes payable	520,350		520,350
Total Noncurrent Liabilities	50,395,132		50,395,132
Total Liabilities	55,631,507	433,760	56,065,267
<u>Net Assets</u>			
Invested in capital assets	21,298,218	5,381,783	26,680,001
Restricted for:			
Public safety	97,796		97,796
Highways and streets	3,372,600		3,372,600
Parks and recreation	1,304,783		1,304,783
Low and moderate income housing	9,616,232		9,616,232
Unrestricted net assets (deficit)	(20,401,483)	1,738,594	(18,662,889)
Total Net Assets	\$ 15,288,146	\$ 7,120,377	\$ 22,408,523

See Accompanying Notes to Financial Statements.

**CITY OF EAST PALO ALTO**  
**Statement of Activities**  
**For the Year Ended June 30, 2007**

<u>Functions/Programs</u>	Program Revenues			
<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
<b>Governmental Activities:</b>				
General government	\$ 3,170,200	\$ 41,641	\$ 790,447	\$ 110,622
Public safety	9,220,203	99,012	325,049	191,898
Culture and recreation	798,679	7,696	265,822	
Public works	2,964,223	178,202	2,943,947	116,218
Community development	3,131,545	966,262	93,750	16,450
Interest on long-term debt	<u>2,744,481</u>			
Total Governmental Activities	<u>22,029,331</u>	<u>1,292,813</u>	<u>4,419,015</u>	<u>435,188</u>
<b>Business-type Activities:</b>				
Water service	440,589	329,539		
Garbage collection	<u>1,765,870</u>	<u>2,059,546</u>		
Total Business-type Activities	<u>2,206,459</u>	<u>2,389,085</u>		
Total Primary Government	<u>\$ 24,235,790</u>	<u>\$ 3,681,898</u>	<u>\$ 4,419,015</u>	<u>\$ 435,188</u>

General revenues and losses:

Taxes:

Property taxes

Sales taxes

Vehicles in lieu taxes

Utility users taxes

Transient occupancy tax

Nonregulatory franchise and business taxes

Investment earnings

Miscellaneous

Total General Revenues and Gains

Change in Net Assets

Net Assets, Beginning of Year

Net Assets, End of Year

See Accompanying Notes to Financial Statements.

Net (Expense) Revenue and Changes in Net Assets		
Primary Government		
Governmental Activities	Business-type Activities	Total
\$ (2,227,490)		\$ (2,227,490)
(8,604,244)		(8,604,244)
(525,161)		(525,161)
274,144		274,144
(2,055,083)		(2,055,083)
(2,744,481)		(2,744,481)
<u>(15,882,315)</u>		<u>(15,882,315)</u>
	\$ (111,050)	(111,050)
	293,676	293,676
	<u>182,626</u>	<u>182,626</u>
<u>(15,882,315)</u>	<u>182,626</u>	<u>(15,699,689)</u>
16,143,870		16,143,870
2,481,442		2,481,442
201,344		201,344
1,585,722		1,585,722
500,000		500,000
1,086,173		1,086,173
1,638,500	93,672	1,732,172
89,974		89,974
<u>23,727,025</u>	<u>93,672</u>	<u>23,820,697</u>
7,844,710	276,298	8,121,008
<u>7,443,436</u>	<u>6,844,079</u>	<u>14,287,515</u>
<u>\$ 15,288,146</u>	<u>\$ 7,120,377</u>	<u>\$ 22,408,523</u>

**CITY OF EAST PALO ALTO**  
**Balance Sheet**  
**Governmental Funds**  
**June 30, 2007**

<u>Assets</u>	<u>General Fund</u>	<u>Low and Moderate Income Housing Special Revenue Fund</u>	<u>Debt Service Fund</u>
Cash and cash equivalents	\$ 4,219,469	\$ 2,958,208	\$ 1,175,637
Cash and investments with fiscal agent			19,442,201
Receivables, net	403,366	58,024	
Due from other funds	197,829		
Prepayments	59,872		
Deposits	44,692		
Advances to other funds	11,217,369		
Property held for resale			
Loans receivable		6,600,000	
Total Assets	\$ 16,142,597	\$ 9,616,232	\$ 20,617,838
<u>Liabilities and Fund Balance</u>			
Liabilities:			
Accounts payable	\$ 258,598		
Retention payable	7,487		
Other accrued liabilities	417,499		
Deposits	873,933		
Deferred revenue			
Advances from developers	1,175		
Excise taxes payable	50,000		
Due to other funds			
Advances payable			
Notes payable			
Total Liabilities	1,608,692		
Fund Balance:			
Reserved for:			
Encumbrances	162,228		
Debt service			\$ 20,617,838
Property held for resale			
Advances to other funds	11,217,369		
Loans receivable		\$ 6,600,000	
Capital projects			
Unreserved, reported in:			
General Fund	3,154,308		
Capital project funds			
Special revenue funds		3,016,232	
Total Fund Balance (Deficit)	14,533,905	9,616,232	20,617,838
Total Liabilities and Fund Balance	\$ 16,142,597	\$ 9,616,232	\$ 20,617,838

See Accompanying Notes to Financial Statements.

Redevelopment Agency Capital Projects Fund	Nonmajor Governmental Funds	Total
\$ 3,952,618	\$ 7,061,497	\$ 19,367,429
43		19,442,244
	1,113,791	1,575,181
		197,829
		59,872
97,605	2,665	144,962
	50,000	11,267,369
537,429		537,429
60,000	379,017	7,039,017
<u>\$ 4,647,695</u>	<u>\$ 8,606,970</u>	<u>\$ 59,631,332</u>
\$ 1,040,531	\$ 196,900	\$ 1,496,029
	130,853	138,340
2,636		420,135
102,605		976,538
	496,059	496,059
452,663		453,838
		50,000
	197,829	197,829
11,217,369	50,000	11,267,369
	520,350	520,350
<u>12,815,804</u>	<u>1,591,991</u>	<u>16,016,487</u>
300,451	550,106	1,012,785
		20,617,838
537,429		537,429
60,000		11,277,369
		6,600,000
264,382		264,382
		3,154,308
(9,330,371)	166,794	(9,163,577)
	6,298,079	9,314,311
<u>(8,168,109)</u>	<u>7,014,979</u>	<u>43,614,845</u>
<u>\$ 4,647,695</u>	<u>\$ 8,606,970</u>	<u>\$ 59,631,332</u>

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**CITY OF EAST PALO ALTO**  
**Reconciliation of the Balance Sheet of Governmental Activities to the Statement of Net Assets**  
**June 30, 2007**

Fund balance of all governmental funds	\$ 43,614,845
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets are not included in the governmental funds.	21,298,218
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the balance sheet of governmental funds.	(50,824,758)
Bond issuance costs are expended in governmental funds when paid, and are capitalized and amortized over the life of the bonds for purposes of the statement of net assets. Deferred charges, net of accumulated amortization.	1,485,287
Interest payable on long-term debt is not accrued as a liability in the balance sheet of governmental funds.	(397,407)
Certain revenues in the governmental funds are deferred because they are not collected within the prescribed period after year-end. However, the revenues are included on the accrual basis in government-wide statements.	<u>111,961</u>
Net Assets of Governmental Activities	<u><u>\$ 15,288,146</u></u>

See Accompanying Notes to Financial Statements.

**CITY OF EAST PALO ALTO**  
**Statement of Revenues, Expenditures**  
**and Changes in Fund Balances**  
**Governmental Funds**  
**For the Year Ended June 30, 2007**

	General Fund	Low and Moderate Income Housing Special Revenue Fund	Debt Service Fund
<b>Revenues:</b>			
Taxes and assessments	\$ 11,719,353	\$ 1,724,524	
Licenses and permits	741,979		
Intergovernmental	490,933		
Charges for services	1,434,153		
Interest	561,719	177,308	\$ 919,873
Contributions and donations	486,600		
Other revenues	24,547	60,766	
<b>Total Revenues</b>	<b>15,459,284</b>	<b>1,962,598</b>	<b>919,873</b>
<b>Expenditures:</b>			
<b>Current:</b>			
General government	2,176,829		
Public safety	9,079,045		
Culture and recreation	429,144		
Public works	1,040,564		
Community development	721,263	60,000	
Administration			263,235
Tax increment pass-through payments			
Capital outlay	390,670		
<b>Debt service:</b>			
Principal	185,650		400,000
Interest and fiscal charges			2,400,868
<b>Total Expenditures</b>	<b>14,023,165</b>	<b>60,000</b>	<b>3,064,103</b>
<b>Excess (Deficiency) of Revenues Over Expenditures</b>	<b>1,436,119</b>	<b>1,902,598</b>	<b>(2,144,230)</b>
<b>Other Financing Sources (Uses):</b>			
Transfers in	675,312	40,028	1,823,617
Transfers out	(223,538)	(568,560)	
<b>Total Other Financing Sources (Uses)</b>	<b>451,774</b>	<b>(528,532)</b>	<b>1,823,617</b>
<b>Net Change in Fund Balance</b>	<b>1,887,893</b>	<b>1,374,066</b>	<b>(320,613)</b>
<b>Fund Balance (Deficit), Beginning of Year</b>	<b>12,646,012</b>	<b>8,242,166</b>	<b>20,938,451</b>
<b>Fund Balance (Deficit), End of Year</b>	<b>\$ 14,533,905</b>	<b>\$ 9,616,232</b>	<b>\$ 20,617,838</b>

See Accompanying Notes to Financial Statements.

Redevelopment Agency Capital Projects Fund	Nonmajor Governmental Funds	Total
\$ 6,898,096	\$ 138,767	\$ 20,480,740
		741,979
	2,371,862	2,862,795
	323,416	1,757,569
229,278	224,594	2,112,772
	1,561,365	2,047,965
4,661		89,974
<u>7,132,035</u>	<u>4,620,004</u>	<u>30,093,794</u>
563,749	477,729	3,218,307
	238,152	9,317,197
	176,135	605,279
	1,407,030	2,447,594
1,019,542	173,332	1,974,137
69,335		332,570
1,030,352		1,030,352
	476,963	867,633
570,413		1,156,063
474,272	15,610	2,890,750
<u>3,727,663</u>	<u>2,964,951</u>	<u>23,839,882</u>
<u>3,404,372</u>	<u>1,655,053</u>	<u>6,253,912</u>
(1,866,582)	287,586	2,826,543
<u>(1,866,582)</u>	<u>(167,863)</u>	<u>(2,826,543)</u>
	119,723	
1,537,790	1,774,776	6,253,912
(9,705,899)	5,240,203	37,360,933
<u>\$ (8,168,109)</u>	<u>\$ 7,014,979</u>	<u>\$ 43,614,845</u>

**CITY OF EAST PALO ALTO**  
**Reconciliation of the Statement of Revenues, Expenditures and**  
**Changes in Fund Balances of Governmental Funds to the Statement of Activities**  
**For the Year Ended June 30, 2007**

Net change in fund balance - total governmental funds: \$ 6,253,912

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures while governmental activities report depreciation expense to allocate those expenditures over the life of the assets.

Capital asset purchases/deletions capitalized	\$ 1,049,286	
Depreciation expense	<u>(879,209)</u>	170,077

Proceeds from long-term debt provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Repayments of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets: 1,522,255

Other differences in items reported in the statement of activities and items reported in the governmental funds:

Change in accrued compensated absences	\$ (44,940)	
Amortization of deferred charges and bond issuance costs	4,286	
Change in accrued interest on debt	(315,398)	
Current year receipts earned	<u>254,518</u>	
		<u>(101,534)</u>

Change in Net Assets of Governmental Activities \$ 7,844,710

See Accompanying Notes to Financial Statements.

**CITY OF EAST PALO ALTO**  
**Statement of Net Assets**  
**Proprietary Funds**  
**June 30, 2007**

	Business-type Activities		
	Garbage Collection	Water Service	Totals
<u>Assets</u>			
Current Assets:			
Cash and cash equivalents	\$ 1,185,033	\$ 828,953	\$ 2,013,986
Receivables, net	25,000	133,368	158,368
Total Current Assets	<u>1,210,033</u>	<u>962,321</u>	<u>2,172,354</u>
Noncurrent Assets:			
Land		206,750	206,750
Structures and improvements		43,790	43,790
Other improvements		7,021,935	7,021,935
Furniture and equipment		63,943	63,943
Vehicles		89,891	89,891
Accumulated depreciation		<u>(2,044,526)</u>	<u>(2,044,526)</u>
Total Noncurrent Assets		<u>5,381,783</u>	<u>5,381,783</u>
Total Assets	<u>1,210,033</u>	<u>6,344,104</u>	<u>7,554,137</u>
<u>Liabilities</u>			
Current Liabilities:			
Accounts payable	377,170	2,968	380,138
Noncurrent Liabilities:			
Deposits		<u>53,622</u>	<u>53,622</u>
Total Liabilities	<u>377,170</u>	<u>56,590</u>	<u>433,760</u>
<u>Net Assets</u>			
Invested in capital assets		5,381,783	5,381,783
Unrestricted	<u>832,863</u>	<u>905,731</u>	<u>1,738,594</u>
Total Net Assets	<u>\$ 832,863</u>	<u>\$ 6,287,514</u>	<u>\$ 7,120,377</u>

See Accompanying Notes to Financial Statements.

**CITY OF EAST PALO ALTO**  
**Statement of Revenues, Expenses and Changes in Fund Net Assets**  
**Proprietary Funds**  
**For the Year Ended June 30, 2007**

	Business-type Activities		
	Garbage Collection	Water Service	Totals
Operating Revenues:			
Charges for services and other fees	\$ 1,571,184	\$ 329,539	\$ 1,900,723
Other reimbursements	488,362		488,362
Total Operating Revenues	<u>2,059,546</u>	<u>329,539</u>	<u>2,389,085</u>
Operating Expenses:			
Depreciation		316,891	316,891
Outside services	1,521,675	123,698	1,645,373
Administration	244,195		244,195
Total Operating Expenses	<u>1,765,870</u>	<u>440,589</u>	<u>2,206,459</u>
Operating Income (Loss)	293,676	(111,050)	182,626
Nonoperating Revenues:			
Interest income	52,730	40,942	93,672
Change in Net Assets	346,406	(70,108)	276,298
Net Assets, Beginning of Year	<u>486,457</u>	<u>6,357,622</u>	<u>6,844,079</u>
Net Assets, End of Year	<u><u>\$ 832,863</u></u>	<u><u>\$ 6,287,514</u></u>	<u><u>\$ 7,120,377</u></u>

See Accompanying Notes to Financial Statements.

**CITY OF EAST PALO ALTO**  
**Statement of Cash Flows**  
**Proprietary Funds**  
**For the Year Ended June 30, 2007**

	Garbage Collection Fund	Water Service Fund	Totals
Cash Flows from Operating Activities:			
Receipts from customers and contractors	\$ 2,034,546	\$ 218,403	\$ 2,252,949
Payments to suppliers	(1,518,416)	(155,366)	(1,673,782)
Payments to employees	(244,195)		(244,195)
	271,935	63,037	334,972
Net Cash Provided (Used) by Operating Activities			
Cash Flows from Capital and Related Financing Activities:			
Acquisition and construction of capital assets		(40,902)	(40,902)
		(40,902)	(40,902)
Cash Flows from Investing Activities:			
Interest received on investments	52,730	40,942	93,672
	52,730	40,942	93,672
Net Increase (Decrease) in Cash and Cash Equivalents	324,665	63,077	387,742
Cash and Cash Equivalents, Beginning of Year	860,368	765,876	1,626,244
Cash and Cash Equivalents, End of Year	\$ 1,185,033	\$ 828,953	\$ 2,013,986
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:			
Operating Income (Loss)	\$ 293,676	\$ (111,050)	\$ 182,626
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation expense		316,891	316,891
Decrease (increase) in accounts receivable	(25,000)	(111,136)	(136,136)
Increase (decrease) in accounts payable	3,259	(31,668)	(28,409)
	271,935	63,037	334,972
Net Cash Provided by Operating Activities	\$ 271,935	\$ 63,037	\$ 334,972

See Accompanying Notes to Financial Statements.

**CITY OF EAST PALO ALTO**  
**Statement of Fiduciary Net Assets**  
**Fiduciary Funds**  
**June 30, 2007**

	Trust Funds	
<u>Assets</u>	Section 401(a) Retirement Plan	Section 401(k) Retirement Plan
Cash and investments with fiscal agent	\$ 272,625	\$ 1,865,964
Participant loans receivable		254,502
Total Assets	\$ 272,625	\$ 2,120,466
<u>Net Assets</u>		
Held in trust for pension benefits	\$ 272,625	\$ 2,120,466
Total Net Assets	\$ 272,625	\$ 2,120,466

See Accompanying Notes to Financial Statements.

**CITY OF EAST PALO ALTO**  
**Statement of Changes in Fiduciary Net Assets**  
**Fiduciary Funds**  
**For the Year Ended June 30, 2007**

	Trust Funds	
	Section 401(a) Retirement Plan	Section 401(k) Retirement Plan
Additions:		
Contributions from participants		\$ 26,682
Interest		149,028
Gain in fair value of investments	\$ 7,223	6
Total Additions	7,223	175,716
Deductions:		
Expenses	35	169,411
Change in Net Assets	7,188	6,305
Net Assets, Beginning of Year	265,437	2,114,161
Net Assets, End of Year	\$ 272,625	\$ 2,120,466

See Accompanying Notes to Financial Statements.

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**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements**  
**June 30, 2007**

I. Summary of Significant Accounting Policies

A. Description of Reporting Entity

The City of East Palo Alto (City) was incorporated in 1983, under the General Laws of the State of California and enjoys all the rights and privileges pertaining to “General Law” cities. The City uses the City Council/Manager form of government. Local government is comprised of five Council members who are elected every four years and act under powers granted under State law. The City provides a variety of services including general administration, public safety, street and highway maintenance, redevelopment, and public works.

The financial reporting entity consists of (a) the primary government, City of East Palo Alto and its component units, which are either (b) organizations for which the primary government is financially accountable, or (c) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete.

The City Council acts as the governing body and is able to impose its will on the following organizations, establishing financial accountability. As a result of this close relationship, those organizations are considered component units of the City and are included within the financial statements of the City using the blended method.

Blended Component Units

*East Palo Alto Redevelopment Agency.* The East Palo Alto Redevelopment Agency (Agency) was established pursuant to the State of California Health and Safety Code, Section 33000. The Agency is responsible for rehabilitation and economic revitalization of certain areas within the City. Complete financial statements of the Agency may be obtained at the City of East Palo Alto, 2415 University Avenue, East Palo Alto, California 94303.

*East Palo Alto Public Financing Authority.* The East Palo Alto Public Financing Authority (Authority) was organized in October 1999 under a joint exercise of power agreement to provide financing for public improvements for the City and the East Palo Alto Redevelopment Agency. The Authority’s financial activity is reported in the Debt Service Fund. Separate financial statements of the Authority are not prepared.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

B. Government-wide and Fund Financial Statements

The basic financial statements of the City have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the City's accounting policies are described below.

The statement of net assets and statement of activities display information about the reporting government as a whole. They include all funds of the reporting entity except for fiduciary funds. The statements distinguish between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

Fund financial statements of the reporting entity are organized into funds each of which is considered to be a separate accounting entity. Each fund is accounted for by providing a separate set of self-balancing accounts, which constitute its assets, liabilities, fund equity, revenues, and expenditures/expenses. Funds are organized into three major categories: governmental, proprietary, and fiduciary. An emphasis is placed on major funds within the governmental and proprietary categories.

C. Measurement Focus and Basis of Accounting

Measurement focus is a term used to describe "which" transactions are recorded within the various financial statements.

The government-wide statement of net assets and the statement of activities are presented using the economic resources measurement focus using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place. As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

In the governmental fund financial statements, the "current financial resources" measurement focus and the modified accrual basis of accounting is used. Only current financial assets and liabilities are generally included on their balance sheets. Their operating statements present sources and uses of available spendable financial resource during a given period. These funds use fund balance as their measure of available spendable financial resources at the end of the period.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then use unrestricted resources as needed.

All proprietary funds are accounted for on an "economic resources" measurement focus, which means that all assets and all liabilities associated with their activity are included on their balance sheets. Proprietary fund type operating statements present increases (revenues) and decreases (expenses) in total assets.

Pension trust funds are accounted for on the "flow of economic resources" measurement focus.

The governmental funds are accounted for using the modified accrual basis of accounting. Revenues are recognized when they become measurable and available. Measurable means the amount of the transaction can be determined, and available means the amount is collectible within the current period or soon enough thereafter (generally sixty days) to be used to pay liabilities of the current period. Amounts which could not be measured or were not available were not accrued as revenue in the current fiscal year.

Those revenues considered susceptible to accrual are franchise taxes, property taxes, grant revenues, special assessments, and certain other intergovernmental revenues and interest. Fines, licenses, and permits are not susceptible to accrual because they are not measurable until received in cash.

Property taxes and interest are susceptible to accrual. Sales taxes collected and held by the State on behalf of the City for sales transactions occurring through June 30, 2007, are also recognized as revenue. Other receipts and taxes become measurable and available when cash is received by the City and are recognized as revenue at that time.

Amounts reported as program revenues include 1) charges to members, customers or applicants for foods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

Expenditures are generally recognized under the modified accrual basis of accounting when the related fund liability is incurred. An exception to this general rule is principal and interest on general long-term debt which is recognized when due.

Proprietary and pension trust funds are accounted for using the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The City has elected not to follow subsequent private-sector guidance.

**Fund Accounting**

The accounts of the City are organized on the basis of funds, each of which is considered a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures or expenses, as appropriate. Government resources are allocated to, and accounted for, in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

The various funds are combined into broad fund types:

Governmental fund types

*General Fund* – The General Fund is the general operating fund of the City and accounts for all financial resources except those accounted for by another fund. Significant sources of revenues are property taxes, sales and use taxes, investment earnings, and business licenses. Activities included are general government, public works, public safety, and culture and recreation.

*Special Revenue Funds* – Special Revenue Funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes.

*Debt Service Funds* – Debt Service Funds are used to account for the accumulation of resources for, and the payment of, long-term debt principal and interest.

*Capital Projects Funds* – Capital Projects Funds are used to account for financial resources segregated for the acquisition and construction of major capital projects or facilities.

Proprietary fund type

*Enterprise Funds* – Enterprise Funds are used to account for operations that are financed and operated in a manner similar to private business.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

Fiduciary fund type

*Trust Funds* – Trust Funds are used to account for assets held by the City in a trustee capacity for others.

Major funds

The City reports the following major governmental funds: the General Fund, the Low and Moderate Income Housing Special Revenue Fund, the Debt Service Fund, and the Redevelopment Agency Capital Projects Fund. Additionally, the City reports the Garbage Collection and Water Service Enterprise funds as major proprietary funds.

D. Assets, Liabilities, Net Assets, and Budgeting

1. Cash and Investments

The City pools cash and investments from all sources, except the fiscal agent cash and investments, for the purpose of increasing income through investment activities. The City considers pooled cash and investment amounts, with original maturities of three months or less, to be cash equivalents.

2. Investments Valuation

In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, highly liquid market investments with maturities of one year or less at time of purchase are stated at amortized cost. All other investments are stated at fair value. Market value is used as fair value for those securities for which market quotations are readily available. Changes in market value and recognition of both realized and unrealized gains are recorded to investment income and are each individual components of investment income.

3. Property Taxes

State statutes provide that the property tax rate be limited generally to one percent of market value, be levied only by the County, and be shared with applicable jurisdictions. The County of San Mateo collects the taxes and distributes them to taxing jurisdictions on the basis of assessed valuations subject to adjustments for voter-approved debt. Property taxes are levied March 1 and are due on November 1 and March 1, and become delinquent on December 10 and April 10. The City receives property taxes pursuant to an arrangement with the County known as the “Teeter Plan”, whereby the County assumes responsibility for the collection of delinquent taxes and pays the full allocation to the City.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

The City receives tax increment revenues allocated to the City from the redevelopment project area.

4. Interfund Transactions

Transactions between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either “interfund receivable/payables” (i.e. the current portion of interfund loans) or “advances to/from other fund” (i.e. the noncurrent portion of interfund loans). All other outstanding balances between funds are reported as “due to/from other funds.”

Advances between funds are offset by a fund balance reserve account in applicable governmental funds to indicate they are not available for appropriation and are not expendable available financial resources.

5. Deposits

Condemnation payments made by the City relating to the acquisition of property are carried as a fund asset until the close of escrow or the release of the deposits to the landowners and the transfer of possession of the property to the City. Such deposits are generally held by the State of California or by the applicable Superior Court. Fund balance accounts are reserved to indicate that such assets are not available for appropriation.

6. Prepayments

Payments made for services that will benefit periods beyond June 30, 2007 are recorded as prepaid items. In the governmental fund types, there is a reservation of fund balance equal to the amount of prepaid items since these are not available for appropriation.

7. Compensated Absences

Compensated absences are recorded as long-term debt. This liability is reflected as a non-current liability in the government-wide financial statements. The proprietary funds do not accrue compensated absences because the City uses contract labor.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

8. Capital Assets

Capital assets used in governmental fund operations, including infrastructure assets (i.e. roads, curbs, gutters, bridges, sidewalks, drainage systems, lighting systems, and other assets) are reflected in the government-wide financial statements, along with related depreciation. Capital assets are defined by the City as assets with an initial individual cost of more than \$5,000. Purchased capital assets are valued at historical cost or estimated historical cost. Donated capital assets are valued at their fair value on the date donated.

Capital assets acquired under lease or purchase agreements are capitalized when the City accumulates an ownership equity in the assets acquired.

Depreciation of capital assets in the proprietary funds and the government-wide financial statements has been provided over the estimated useful lives of the assets using the straight-line method. The estimated useful lives are as follows:

Buildings and improvements	30 years
Furniture, fixtures and equipment	5-10 years
Vehicles	5 years
Infrastructure	7-55 years

9. Bond Discounts, Premiums, Issuance Costs, and Costs in Excess of Net Assets Acquired

For governmental funds, bond premiums and discounts, and any related issuance costs, are recognized during the period of issuance. Bond proceeds are reported as other financing sources net of the applicable premium or discount. Issuance costs, whether or not withheld from the actual net proceeds received, are reported as debt service expenditures.

Debt is reported net of unamortized issuance costs and discounts/premiums in the government-wide financial statements.

10. Fund Equity

Reservations of fund balance represent amounts that are not appropriable or are legally segregated for a specific purpose. Fund balance reservations used by the City include:

- *Encumbrances* – reflects balances for purchases of goods or services ordered, but not received.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

- *Debt service* – represents funds reserved for the payment of principal and interest on long-term debt.
- *Property held for resale* – represents funds reserved for property that the Agency is holding for resale in the construction of capital projects.
- *Long-term advances and loans receivable* – represents amounts, of a long-term nature that do not represent available, spendable resources.
- *Capital projects fund* – represents amounts reserved for the acquisition and construction of major capital projects or facilities.

11. Property Held for Resale

Property acquired by the City for resale to developers and other third parties is carried as an asset of the respective fund. Such property is recorded at the lower of cost or estimated realizable value. Fund balance accounts are reserved to indicate that such assets are not available for appropriation. At June 30, 2007, the carrying amount of property held for resale totaled \$537,429, with this amount offset by a reservation of fund balance.

12. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain amounts and disclosures. Accordingly, actual results could differ from those estimates.

II. Stewardship, Compliance, and Accountability

A. Budgetary Policy and Control

The City adopts a budget annually for all governmental fund types, except for capital projects. This budget is effective July 1 for the ensuing fiscal year. From the effective date of the budget, which is adopted at the department level, the amounts stated therein as proposed expenditures become appropriations to the various City departments. The legal level of budgetary control is the fund level. The City Council may amend the budget by resolution during the fiscal year. The City Manager has the authority to make adjustments to the operating budget between departments. Transfers of operating budgets between funds, use of unappropriated fund balances, and significant changes in capital improvement project budgets require the approval of the City Council.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

Annual budgets are adopted on a basis consistent with accounting principles generally accepted in the United States except for capital projects, which are adopted on a project length basis. Supplemental appropriations made during the fiscal year were not substantial.

Under encumbrance accounting, purchase orders, contracts and other commitments for the expenditures of monies are recorded in order to reserve that portion of the applicable appropriation. Encumbrance accounting is employed as an extension of the formal budgetary process. Encumbrances outstanding at year-end are carried over to the next fiscal year as part of that year's budget resolution.

The City does not budget for individual Redevelopment Agency funds, therefore, a detailed budgetary comparison schedule has not been included for the Low and Moderate Income Housing Special Revenue Fund or Debt Service Fund.

III. Detailed Notes on All Funds

A. Cash and Investments:

Cash and investments as of June 30, 2007 are classified in the accompanying financial statements as follows:

Statement of Net Assets:	
Cash and investments	\$ 21,381,415
Cash and investments with fiscal agent	19,442,244
	<hr/>
Total Cash and Investments	40,823,659
Fiduciary Funds:	
Cash and investments with fiscal agent	2,138,589
	<hr/>
Total Cash and Investments	<u>\$ 42,962,248</u>

Cash and investments as of June 30, 2007 consist of the following:

Cash on hand	\$ 6,400
Deposits with financial institutions	2,668,924
Investments	40,286,924
	<hr/>
Total Cash and Investments	<u>\$ 42,962,248</u>

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

Investments Authorized by the California Government Code and the City's Investment Policy

The table below identifies the investment types that are authorized for the City by the California Government Code (or the City's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the City's investment policy, where more restrictive) that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the City, rather than the general provisions of the California Government Code or the City's investment policy.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage of *Portfolio</u>	<u>Maximum Investment in One Issuer</u>
U.S. Government Securities	2 years	None	None
U.S. Agency Securities	2 years	None	None
Banker's Acceptances	180 days	40%	30%
Commercial Paper	5 years	25%	None
Demand Deposits	5 years	None	None
Money Market Mutual Funds	5 years	20%	None
Repurchase Agreements	30 days	20%	None
Passbook Savings Accounts	5 years	None	None
Certificates of Deposit	5 years	30%	None
Local Agency Investment Fund (LAIF)	5 years	None	None
County Investment Fund	5 years	None	None
Guaranteed Investment Contracts	5 years	None	None
Medium Term Notes	2 years	30%	None

\* Excluding amounts held by bond trustee that are not subject to California Government Code Restrictions.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

Investments Authorized by Debt Agreements:

Investment of debt proceeds held by bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the City's investment policy. The table below identifies the investment types that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address interest rate risk, credit risk, and concentration of credit risk.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Allowed</u>	<u>Maximum Investment in One Issuer</u>
U. S. Treasury Obligations	None	None	None
U. S. Agency Securities	None	None	None
Repurchase Agreements	None	None	None
Money Market Mutual Funds	N/A	None	None
Certificates of Deposit	None	None	None
Commercial Paper	92 days	None	None
Local Agency Investment Fund	N/A	None	None
Money Market Fund	N/A	None	None

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the City manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

Information about the sensitivity of the fair values of the City's investments (including investments held by bond trustee) to market interest rate fluctuations is provided by the following table that shows the distribution of the City's investments by maturity:

<u>Investment Type</u>	<u>Remaining Maturity (in Months)</u>		
	<u>12 Months or Less</u>	<u>13 to 24 Months</u>	<u>60 Months or Less</u>
San Mateo County Pool Investment	\$ 16,179,541	\$ 16,179,541	
Local agency investment fund	4,565,139	4,565,139	
Certificate of Deposit	100,000	100,000	
Held by Fiscal Agent:			
Gauranteed Investment Contract	18,047,298		\$ 16,080,902
Money Market Funds	<u>1,394,946</u>	<u>1,394,946</u>	
Total	<u>\$ 40,286,924</u>	<u>\$ 22,239,626</u>	<u>\$ 1,966,396</u>

**Disclosures Relating to Credit Risk**

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The following presentation is the minimum rating required by (where applicable) the California Government Code, the City's investment policy, or debt agreements, and the actual rating as of year end for each investment type:

<u>Investment Type</u>		<u>Minimum Rating</u>	<u>Exempt From Rating</u>
San Mateo County Pool Investment	\$ 16,179,541	Not Rated	\$ 16,179,541
Local agency investment fund	4,565,139	Not Rated	4,565,139
Certificate of Deposit	100,000	Not Rated	100,000
Held by Fiscal Agent:			
Gauranteed Investment Contract	18,047,298	N/A	18,047,298
Money Market Fund	<u>1,394,946</u>	N/A	<u>1,394,946</u>
Total	<u>\$ 40,286,924</u>		<u>\$ 40,286,924</u>

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

Concentration of Credit Risk

The investment policy of the City contains no limitation on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. Investments in any one issuer (other than U.S. Treasury securities, mutual funds and external investment pools) that represent 5% or more of total City investments are as follows:

<u>Issuer</u>	<u>Investment Type</u>	<u>Reported Amount</u>
Investments with Fiscal Agent		
Asset Funding Company LLC	Guaranteed Investment Contract	\$16,080,902

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

Investment in State Investment Pool

The City is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. The fair value of the City's investment in this pool is reported in the accompanying financial statements at amounts based upon the City's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

B. Note Receivable, Long-term

A \$5,500,000 note receivable is payable by Nairobi Housing Associates. The \$5,500,000 loan made by the Agency to Nairobi Housing Associates was funded by a loan made by the David and Lucille Packard Foundation (Packard Foundation) to Bridge Housing Corporation and then passed through to Nairobi Housing Associates via the Agency. The note bears interest at one percent per annum payable annually, and the entire principal amount is due 35 years after issuance of a certificate of occupancy for the related housing development. A \$1,100,000 note is from Nugent Square Partners, LLP at 1% per annum due January 2045.

The City also has a loan receivable of \$60,000 from a local property owner and \$379,017 of Housing Assistance Loans.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

C. Capital Assets

Capital asset activity for the year ended June 30, 2007 was as follows:

	Balance July 1, 2006	Additions	Disposals	Balance at June 30, 2007
Governmental Activities:				
Nondepreciable:				
Land	\$ 605,146	\$ 263,235		\$ 868,381
Construction-in-progress	1,488,869	20,945	\$ (184,484)	1,325,330
Total Nondepreciable Capital Assets	<u>2,094,015</u>	<u>284,180</u>	<u>(184,484)</u>	<u>2,193,711</u>
Depreciable:				
Buildings and improvements	3,494,640	454,593		3,949,233
Improvements other than buildings	2,740,870	112,707		2,853,577
Furnishings and equipment	1,101,742	104,757	(2,485)	1,204,014
Vehicles	1,169,403	384,665	(444,352)	1,109,716
Streets and roadways	31,558,903			31,558,903
Storm drain system	3,260,989			3,260,989
Total Depreciable Capital Assets	43,326,547	1,056,722	(446,837)	43,936,432
Less Accumulated Depreciation	<u>(24,292,421)</u>	<u>(879,209)</u>	<u>339,705</u>	<u>(24,831,925)</u>
Total Depreciable Capital Assets, Net	<u>19,034,126</u>	<u>177,513</u>	<u>(107,132)</u>	<u>19,104,507</u>
Governmental Activities Capital Assets, Net	<u>\$ 21,128,141</u>	<u>\$ 461,693</u>	<u>\$ (291,616)</u>	<u>\$ 21,298,218</u>

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

	Balance July 1, 2006	Additions	Disposals	Balance at June 30, 2007
Business-type Activities:				
Nondepreciable:				
Land	\$ 206,750			\$ 206,750
Total Nondepreciable Capital Assets	206,750			206,750
Depreciable:				
Buildings and improvements	43,790			43,790
Improvements other than buildings	6,981,034	\$ 40,901		7,021,935
Furnishings and equipment	63,943			63,943
Vehicles	89,890			89,890
Total Depreciable Capital Assets	7,178,657	40,901		7,219,558
Less Accumulated Depreciation	(1,727,635)	(316,891)		(2,044,526)
Total Depreciable Capital Assets, Net	5,451,022	(275,990)		5,175,032
Business-type Activities, Capital Assets, Net	\$ 5,657,772	\$ (275,990)	\$ -	\$ 5,381,782

Depreciation expense of \$879,209 was charged to the following functions/programs of the primary government as follows:

Governmental Activities:	
General government	\$ 10,217
Public safety	105,332
Culture and recreation	178,261
Community development	83,835
Public works	501,564
Depreciation Expense - Governmental Activities	\$ 879,209

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

D. Property Held for Resale

The \$537,429 in land held for resale consists of one parcel of land acquired by the Redevelopment Agency for the purpose of resale to developers in regard to the development of the Gateway 101 Retail Center and related projects.

E. Interfund Balances and Transactions

Interfund receivable and payable balances at June 30, 2007 were:

	Advances to Other Funds	Advances from Other Funds
Long-term Advances:		
General fund	\$ 11,217,369	
Capital projects funds:		
Redevelopment agency		\$ 11,217,369
Nonmajor Funds:		
Lighting District	50,000	
Drainage District		50,000
Total	\$ 11,267,369	\$ 11,267,369

The City has advanced funds to its Redevelopment Agency for the acquisition of land and other financial assistance. The balance due at June 30, 2007 was \$11,897,086.

Transfer amounts for the year ended June 30, 2007 were:

	Transfer in				
	General Fund	Low and Moderate Income Housing	Gateway University Debt Service	Nonmajor Governmental Funds	Total
Transfer out					
Major Funds					
General Fund				\$ 223,538	\$ 223,538
Redevelopment Agency					
Capital Projects	\$ 611,525		\$ 1,255,057		1,866,582
Low and Moderate					
Income Housing Fund			568,560		568,560
Nonmajor Governmental Funds	63,787	\$ 40,028		64,048	167,863
Total	\$ 675,312	\$ 40,028	\$ 1,823,617	\$ 287,586	\$ 2,826,543

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

F. Long-term Debt

Long-term debt activity for the year ended June 30, 2007 was as follows:

<u>Governmental Activities</u>	<u>Balance July 1, 2006</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2007</u>	<u>Due Within One Year</u>
Redevelopment Agency:					
Bonds:					
'99 Tax allocation bonds	\$ 17,095,000		\$ (335,000)	\$ 16,760,000	\$ 350,000
'03 Tax allocation bonds	8,525,000		(65,000)	8,460,000	70,000
'05 Revenue Bond	17,995,000			17,995,000	
Plus unamortized premium	805,812		(35,480)	770,332	
Long-term pass-through					
Due to other governments:					
Menlo Park Fire					
Protection District	4,552,056	\$ 300,000	(374,737)	4,477,319	382,232
East Palo Alto Sanitary District	1,288,196		(201,496)	1,086,700	147,744
Notes payable:					
University Circle Investors	553,522		(553,522)		
<b>Total Redevelopment Agency</b>	<b>50,814,586</b>	<b>300,000</b>	<b>(1,565,235)</b>	<b>49,549,351</b>	<b>949,976</b>
City of East Palo Alto:					
Loans from other governments:					
CHFA	520,350			520,350	
Excise tax payment	200,000		(200,000)		
Claims and judgments	355,000		(92,500)	262,500	
Compensated absences	967,967	62,355	(17,415)	1,012,907	
<b>Total City of East Palo Alto</b>	<b>2,043,317</b>	<b>62,355</b>	<b>(309,915)</b>	<b>1,795,757</b>	
<b>Total</b>	<b>\$ 52,857,903</b>	<b>\$ 362,355</b>	<b>\$ (1,875,150)</b>	<b>\$ 51,345,108</b>	<b>\$ 949,976</b>

1. Tax Allocation Bonds

The City issued \$22,785,000 in University Circle-Gateway 101 Corridor Merged Project Area Tax Allocation Bonds, Series 1999, dated October 21, 1999. The bonds were issued to finance the redevelopment activities within the City's Gateway 101 Corridor Redevelopment Project Area, to refinance and retire certain obligations related to the project area, to fund capitalized interest on a portion of the 1999 bonds, and to fund a reserve account for the bonds, and to pay issuance costs.

The bonds are secured by a pledge of the City's tax increment revenues including the City's housing set-aside tax increment revenues. The annual tax increment revenues expected to be received by the City and pledged to secure repayment of the 2003 bonds are sufficient to pay annual debt service.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

To provide additional security, pursuant to the 1999 bond agreement, \$1,966,397 is held in a bond reserve fund with a trustee.

The bonds are due in annual principal installments of \$335,000 to \$1,340,000 through 2029. Interest rates range from 4.2 to 6.6 percent and are payable semi-annually on April 1 and October 1. The total amount outstanding as of June 30, 2007 was \$16,760,000.

The 1999 bonds maturing on or after October 1, 2010 are subject to optional redemption by the City on or after October 1, 2009, with premiums up to 2 percent.

Future debt service on the 1999 bonds at June 30, 2007, assuming no redemptions of the 1999 bonds other than scheduled mandatory sinking account redemption was:

Year Ending June 30,	Principal	Interest	Total
2008	\$ 350,000	\$ 1,292,548	\$ 1,642,548
2009	370,000	1,273,416	1,643,416
2010	390,000	1,252,748	1,642,748
2011	410,000	1,230,338	1,640,338
2012	435,000	1,205,820	1,640,820
2013-2017	2,605,000	5,587,200	8,192,200
2018-2022	3,545,000	4,606,334	8,151,334
2023-2027	4,880,000	3,226,375	8,106,375
2028-2029	3,775,000	1,250,990	5,025,990
Total	<u>\$ 16,760,000</u>	<u>\$ 20,925,769</u>	<u>\$ 37,685,769</u>

The Redevelopment Agency of the City issued \$5,155,000 in University Circle-Gateway 101 Corridor Merged Project Area Tax Allocation Bonds, Series 2003A and \$3,600,000 Refunding Bonds, Series 2003B, dated December 11, 2003. The bonds were issued to refund the portion of the 1999 Bonds that mature on October 1, 2032, to refinance and retire certain obligations related to the project area, to fund capitalized interest on a portion of the 2003 bonds, to fund a reserve account for the bonds, and to pay issuance costs.

The bonds are secured by a pledge of the tax revenues from the Project Areas. The annual tax increment revenues expected to be received by the City and pledged to secure repayment of the 2003 bonds are sufficient to meet annual debt service.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

However, the City has also entered into an agreement in connection with certain freeway off-ramp and related improvements whereby it has agreed to remit, for a period of up to twenty years, any tax increment revenues from the University Circle Project Area in excess of \$1,700,000 in any fiscal year to a developer to reimburse the costs of construction of such improvements. For details see Note III E.3.

The bonds bear interest at rates of 4.00 to 6.45 percent and the interest is payable each April 1 and October 1 commencing April 1, 2004. Principal on the bonds is payable each October 1, commencing October 1, 2004. On December 11, 2003, the original bonds consisted of \$5,155,000 and \$3,600,000 with annual principal installments ranging from \$10,000 to \$1,610,000 through 2032.

The 2003A bonds and the 2003B bonds maturing on or after October 1, 2014 are subject to optional redemption by the City on or after October 1, 2013, at a redemption price of par, together with accrued interest to the date fixed for redemption.

Future debt service on the 2003A bonds at June 30, 2007, assuming no redemptions of the 2003A bonds other than scheduled mandatory sinking account redemption was:

Year Ending June 30,	Principal	Interest	Total
2008	\$ 10,000	\$ 251,750	\$ 261,750
2009	15,000	251,250	266,250
2010	15,000	250,650	265,650
2011	15,000	250,050	265,050
2012	15,000	249,450	264,450
2013-2017	75,000	1,237,744	1,312,744
2018-2022	100,000	1,217,188	1,317,188
2023-2027	125,000	1,190,344	1,315,344
2028-2032	3,090,000	1,011,000	4,101,000
2033	1,610,000	40,250	1,650,250
Total	<u>\$ 5,070,000</u>	<u>\$ 5,949,676</u>	<u>\$ 11,019,676</u>

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

Future debt service on the 2003B bonds at June 30, 2007, assuming no redemptions of the 2003B bonds other than scheduled mandatory sinking account redemption was:

Year Ending June 30,	Principal	Interest	Total
2008	\$ 60,000	\$ 208,128	\$ 268,128
2009	60,000	205,656	265,656
2010	65,000	202,658	267,658
2011	70,000	199,000	269,000
2012	70,000	195,206	265,206
2013-2017	425,000	908,584	1,333,584
2018-2022	565,000	757,293	1,322,293
2023-2027	775,000	549,956	1,324,956
2028-2032	1,050,000	258,323	1,308,323
2033	250,000	8,063	258,063
Total	<u>\$ 3,390,000</u>	<u>\$ 3,492,867</u>	<u>\$ 6,882,867</u>

The City issued \$17,995,000 University Circle-Gateway 101 Corridor Merged Project Area Revenue Bonds, 2005 Series A, dated August 1, 2005. The proceeds of the 2005 Authority Bonds were used to: execute a purchase in lieu of redemption of the 1999 Bonds scheduled to mature on October 1, 2010 through and including October 1, 2029 on their October 1, 2009 call date; pay interest costs on the 2005 Authority Bonds up to and including October 1, 2009; and, provide the City, through the Authority, with additional funds for infrastructure costs. The purchase in lieu of redemption of the 1999 Bonds through the issuance of the 2005 Authority Bonds generated \$1,360,000 in additional funds for general government projects throughout the City. The City completed the Cross-Over Purchase in Lieu of Redemption (considered a debt refunding) to reduce its total debt service payments over the next 25 years by \$52,554 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$1,406,212.

The purchase in lieu of redemption structure used is somewhat different from a standard refunding in that on their October 1, 2009 call date, the 1999 Bonds scheduled to mature on October 1, 2010 through and including October 1, 2029 will be purchased from bond holders and instead of being cancelled, will instead become property of the Authority. In other words, there will be no changes to the 1999 Bonds until the October 1, 2009 purchase date. After the October 1, 2009 purchase date, the Authority, in its role as a Joint Powers Authority (the "JPA") will become the owner of the 1999 Bonds. The Agency will continue to make

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

debt service payments on the 1999 Bonds as previously scheduled. Additionally, up to and including the October 1, 2009 purchase date, debt service on the 2005 Authority Bonds will be payable solely from an investment agreement with XL Asset Funding Company I LLC. The principal invested under the investment agreement, together with interest earnings thereon will be sufficient to pay the interest cost of the 2005 Authority Bonds up to and including October 1, 2009 and to purchase the 1999 Bonds in lieu of redemption on October 1, 2009.

To provide security to the owners of the 2005 Authority Bonds after the October 1, 2009 purchase date, the Authority has assigned all principal and interest payments to be received from the 1999 Bonds to the benefit of the 2005 Authority Bonds, through a Bond Assignment and Purchase Agreement. According to the provisions of the Bond Assignment and Purchase Agreement, all debt service payments on the 1999 Bonds will be received by the Trustee and applied directly to the payment of debt service on the 2005 Authority Bonds. The City will not hold, nor have access to the debt service payments received from the 1999 Bonds. As such, the source of repayment for the 2005 Authority Bonds after the October 1, 2009 purchase date is the principal and interest paid on the 1999 Bonds, which is paid from tax increment revenue generated from the Project Areas.

The bonds bear interest at rates of 3.4 to 5 percent and the interest is payable each April 1 and October 1 commencing October 1, 2005. Interest on the Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months. Principal on the bonds is payable each October 1, commencing October 1, 2010.

Future debt service on the 2005 bonds at June 30, 2006, assuming no redemptions of the 2005 bonds other than scheduled mandatory sinking account redemption was:

Year Ending June 30,	Principal	Interest	Total
2008			
2009			
2010	\$ 580,000	\$ 846,644	\$ 1,426,644
2011	600,000	826,924	1,426,924
2012	620,000	805,924	1,425,924
2013-2017	3,520,000	3,607,694	7,127,694
2018-2022	4,425,000	2,705,205	7,130,205
2023-2027	5,600,000	1,530,500	7,130,500
2028-2029	2,650,000	200,500	2,850,500
Total	<u>\$ 17,995,000</u>	<u>\$ 10,523,391</u>	<u>\$ 28,518,391</u>

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

2. Long-term Pass-through Due to Other Governments

Menlo Park Fire Protection District – In 1988 the City’s Redevelopment Agency (RDA) entered into an agreement with the Menlo Park Fire Protection District (District) whereby the RDA will pay to the District the equivalent of 10.24% of the tax increment received by the RDA from the University Circle Project Area (Project Area), up to a maximum of \$300,000 per year, to help defray the additional costs to the District to manage the new risk in the Project Area. In the event that the RDA is not able to make the payment, the District has agreed that the payment will be deferred to future years when tax increment is available. At June 30, 2007, the RDA owes the District \$4,477,319. No repayment schedule is available as the repayment is based on future tax increment received.

East Palo Alto Sanitary District – In 1988 the RDA entered into an agreement with the East Palo Alto Sanitary District (EPSD) whereby the RDA will pay to the EPSD the equivalent of 3.968% of the tax increment received by the RDA from the University Circle Project Area up to a cumulative total of \$1,500,000 to defray the additional costs to the EPSD to provide wastewater transport facilities to the University Circle Project Area. At June 30, 2007 the RDA owes the EPSD \$1,086,700. No repayment schedule is available as the repayment is based on the future tax increment the RDA receives from the University Circle Project Area.

3. Notes Payable

University Circle Investors – During 2000 the RDA entered into an agreement with University Circle Investors (UCI) whereby UCI agreed to advance to the RDA \$3,900,000 for the completion of Stage 2A of the University Circle Redevelopment Project. At June 30, 2006 the RDA owed UCI \$553,522. The note was paid off during the year.

4. Loan from Other Government

The City entered into a \$1,000,000 loan agreement with the California Housing Finance Agency in September 2001. The agreement allows revolving borrowings by the City to finance acquisition of properties for affordable housing projects. The agreement provides for payment of 3% annual interest on outstanding balances. The City has borrowed \$1,000,000 under this agreement. There is no specific payment schedule under this agreement through its expiration in 2011. The balance at June 30, 2007 is \$520,350.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

IV. Other Information

A. Risk Management

The City is exposed to various risks of loss related to torts, theft of, damage and destruction of assets, errors and omissions, and natural disasters. The City purchases commercial insurance to provide coverage with respect to certain risks.

Liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Claim liabilities are calculated considering recent claim settlement trends including the frequency and amount of payouts and other economic and social factors. The liability for claims and judgments is reported in the general long-term debt account group because it is not expected to be liquidated with expendable available financial resources.

The City's commercial insurance policies include general liability coverage of \$7 million with a \$100,000 retention per occurrence, and a \$9 million excess liability coverage and employee dishonesty coverage of \$1,000,000. The State Compensation Insurance Fund provides workers' compensation insurance with a \$1 million per occurrence coverage.

Changes in the balance of claims liabilities during the past two years were as follows:

	<u>Year Ended June 30, 2006</u>	<u>Year Ended June 30, 2007</u>
Unpaid claims, beginning of fiscal year	\$ 402,000	\$ 355,000
Incurred claims		
Claim payments	<u>(47,000)</u>	<u>(92,500)</u>
Unpaid Claims, End of Fiscal Year	<u>\$ 355,000</u>	<u>\$ 262,500</u>

Adequacy of Protection

During the past three fiscal years none of the above programs of protection have had settlements or judgments that exceeded pooled or insured coverage. There have been no significant reductions in pooled or insured liability coverage from coverage in the prior year.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

**B. Operating Leases**

The City leases building and office facility space under noncancellable operating leases. Total costs for such leases were \$375,888 for governmental activities and \$34,236 for business-type activities for the fiscal year ended June 30, 2007. The future minimum lease payments for these leases are as follows:

Year Ending June 30,	
2008	\$ 77,175
Total	\$ 77,175

**C. Joint Ventures**

The City is one of twelve members of the South Bayside Waste Management Authority (Authority), which is a joint powers agreement that commenced operations March 1, 2000. The Authority was formed for the purpose of joint ownership, financing, and administration of the San Carlos Transfer Station and the San Mateo Recyclery; and the planning, administration management, review, monitoring, enforcement, and reporting of solid waste, recyclable material, and plant material collection activities with the service area of the Authority.

Through the operation of franchise agreements with each member, BFI Waste Systems of North America, Inc. collects fees charged for the use of the facilities and remits them to the Authority. Pursuant to an Operations Agreement with the Authority, BFI will operate the facilities and be paid compensation based on costs, a provision for profit and incentives for cost savings and performance.

The City does not maintain any equity interest in the Authority. Below is the audited financial information as of and for the fiscal year ended June 30, 2006 (latest available):

Total assets	\$ 41,956,003
Total liabilities	(27,000,715)
Total Fund Equity	\$ 14,955,288
Operating revenue	\$ 35,736,003
Operating expenses	32,819,223
Operating income	2,916,780
Nonoperating revenues (expenses), net	(794,462)
Net Income	\$ 2,122,318

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

The City is also one of five members of the San Francisquito Creek Joint Powers Authority (SFCJPA) which exists to manage flood control and other environmental issues surrounding the San Francisquito Creek. The City has no equity interest in the SFCJPA. Below is the audited information as of and for the year ended June 30, 2007:

Total assets	\$	212,258
Total liabilities		96,255
Total Fund Equity	\$	116,003
Operating revenue	\$	314,225
Operating expenses		538,708
Operating loss		(224,483)
Nonoperating revenues (expenses), net		190,016
Net Income (Loss)	\$	(34,467)

**D. Retirement Plans**

**1. Plan Description 401(k)**

*Administration* – The City maintains the East Palo Alto Retirement Plan (Plan), a single-employer, defined-contribution pension plan administered by the City.

*General* – On October 23, 1985, the City adopted a defined-contribution plan funded by employer and employee contributions. The contributions to the Plan are placed into the City of East Palo Alto Retirement Trust. The Plan was open to all eligible employees on their employment commencement date. As of January 1, 2001, this plan was replaced by California Public Employees Retirement System as the retirement plan for the City.

*Contributions* – The participants were permitted to defer a portion of compensation into the Plan. The deferral could be greater than 3.5 percent; however, the amount of deferral could not exceed 15 percent of compensation. The City no longer makes any contributions to the Plan on behalf of the employees. Participants forfeit their benefit from employer contributions to the extent that they terminate employment without becoming fully vested.

*Participant amounts* – Each participant’s account is credited with the participant’s contribution, allocations of the City’s contribution, and the Plan earnings. Allocations are based on participant earnings or account balances, as defined. The benefit to which a participant is entitled is the benefit that can be provided from the participant’s vested account.

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

*Vesting* – Participants are immediately vested in their contributions plus actual earnings thereon. Vesting in the City’s contribution portion of their accounts plus actual earnings thereon is 100 percent vested after five (5) years of credited services or if the participant reaches age 65 while an employee of the City or if the termination of employment with the City is due to death or complete disability.

*Participant notes receivable* – Participants may borrow from their fund accounts a minimum of \$1,000 up to a maximum \$50,000 or 50 percent of the vested interest of the participant’s account. Each loan bears a reasonable rate of interest, which equals the rate of return commensurate with the prevailing interest rate charge on similar commercial loans. Loans shall be repaid within five (5) years from the date of the loan, unless the loan is used to acquire the participant’s principal residence. All loans shall be repaid in amortized payments through payroll deduction. Each loan is secured by the participant’s salary deferral account under the Plan.

*Payment of benefits* – Benefits under the Plan are distributable upon normal retirement at age 65 and termination of employment, disability, and death. Payments are made on single lump sum distribution equal to the value of the participant’s vested interest in his or her account.

2. ICMA Retirement Corporation

*General* – The City is also a participant in the ICMA Retirement Corporation. The Plan is only available to a limited number of management employees on their employment commencement date.

*Contributions* – Under the Plan, the City’s contribution is based on the City’s agreement with each employee. The City contributes 7 percent of qualifying compensation to the Plan. Each participating employee is required to make a minimum contribution to the Plan based on their specific agreement. Both the City contribution and participant contributions are 100 percent vested immediately.

3. Plan Description (California Public Employees Retirement System)

*General* – In 2001 the City joined the California Public Employees Retirement System (CalPERS), and began to contribute to CalPERS, a cost sharing multiple-employer public employee defined benefit pension plan. CalPERS provides retirement and disability benefits annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provisions and all other requirements are established

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

by State statute and City ordinance. Copies of CalPERS' annual financial report may be obtained from their Executive Office located at 400 P Street, Sacramento, CA 95814.

Funding policy – Active plan members are required by State statute to contribute 7% of their annual covered salary. The City is required to contribute to actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate for fiscal year 2006-07 was 8.881% for miscellaneous employees and 13.983% for police officers. The contribution requirements of the plan members are established by State statute and the employer contribute rate is established and may be amended by CalPERS.

Annual Pension Cost: For 2007, the City's annual pension cost of \$800,477 for PERS was equal to the City's required and actual contributions. The required contribution was determined as part of the June 30, 2006 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses), (b) projected annual salary increase that vary by duration of service, and (c) 3.25% per year cost-of-living adjustments. Both (a) and (b) included an inflation component of 3%. The actuarial value of PERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period (smooth market value).

The following is three-year trend information for the miscellaneous employees plan:

<u>Fiscal Year</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
6/30/2005	\$ 227,308	100%	-0-
6/30/2006	357,380	100%	-0-
6/30/2007	357,088	100%	-0-

The following is three-year trend information for the safety police plan:

<u>Fiscal Year</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
6/30/2005	\$ 302,739	100%	-0-
6/30/2006	436,645	100%	-0-
6/30/2007	443,389	100%	-0-

**CITY OF EAST PALO ALTO**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

E. Conduit Debt

The Redevelopment Agency, on June 1, 1999, authorized the issuance of up to \$13 million of the Redevelopment Agency of the City of East Palo Alto Multifamily Housing Mortgage Revenue Bonds, 1999 Series A and Series B, and taxable 1999 Series C to assist a developer in financing the construction of a multifamily rental housing project known as Gateway 101 Apartments. The bonds are to be secured by the developer's project and related rental operations, and are not an obligation of the Redevelopment Agency.

F. Commitments and Contingencies

*Grant programs* – Amounts received or receivable from grantor agencies are subject to audit and adjustment by grantor agencies, principally the Federal government. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of expenditures, which may be disallowed by the grantors, cannot be determined at the present time.

G. Agency and Hotel Developers Settlement

On March 15, 2007 a settlement agreement was reached between the Agency and the Hotel Developers, of the Four Seasons Hotel, over the Transient Occupancy Tax known as TOT. The agreement resulted in the City receiving annual TOT of \$500,000 beginning in 2006 and continuing until the earlier of the following events:

- i. January 30, 2011;
- Or
- ii. The date on which the Hotel Developer has received and retained the cumulative sum of TOT equal to the actual amount of TOT generated during the first 42 months of the hotel operations, up to a maximum of \$7 million.

Any TOT collected and retained up to the \$7 million becomes an obligation of the Agency to reimburse the City from future tax increment generated from the University Circle Project. As of June 30, 2007, the hotel collected \$2.0 million in TOT, of which \$500,000 was sent to the City, leaving a net balance of \$1.5 million that was retained by the hotel developers. The Agency reimbursed the City's General Fund \$611,525 of the estimated \$1.5 million current obligation, leaving a net obligation amount of approximately \$900,000. In 2008, the Agency budgeted to repay an additional \$611,525 of TOT to the City's General Fund.

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## **Required Supplementary Information**

**CITY OF EAST PALO ALTO**  
**General Fund**  
**Budgetary Comparison Schedule**  
**For the Year Ended June 30, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	Positive (Negative) Variance with Final Budget
	<u>Original</u>	<u>Final</u>		<u>Final Budget</u>
Fund Balance, Beginning of Year	\$ 12,646,012	\$ 12,646,012	\$ 12,646,012	\$
Resources (Inflows):				
Taxes and assessments	10,228,129	11,049,572	11,719,353	669,781
Licenses and permits	802,500	823,700	741,979	(81,721)
Intergovernmental	315,000	577,995	490,933	(87,062)
Charges for services	1,336,238	1,363,250	1,434,153	70,903
Interest	290,900	479,575	561,719	82,144
Contributions and donations	500,000	383,020	486,600	103,580
Transfers in	922,382	1,717,907	675,312	(1,042,595)
Other revenues	30,000	30,000	24,547	(5,453)
Amount Available for Appropriations	<u>14,425,149</u>	<u>16,425,019</u>	<u>16,134,596</u>	<u>(290,423)</u>
Charges to Appropriations (Outflows):				
Current:				
General government	2,599,706	2,453,407	2,176,829	276,578
Public safety	8,512,265	9,661,764	9,079,045	582,719
Culture and recreation	515,010	495,333	429,144	66,189
Public works	902,226	1,189,827	1,040,564	149,263
Community development	1,020,582	889,932	721,263	168,669
Capital outlay	36,000	422,405	390,670	31,735
Principal			185,650	(185,650)
Transfers out	810,560	1,199,426	223,538	975,888
Total Charges to Appropriations	<u>14,396,349</u>	<u>16,312,094</u>	<u>14,246,703</u>	<u>2,065,391</u>
Resources Over (Under) Charges to Appropriations	<u>28,800</u>	<u>112,925</u>	<u>1,887,893</u>	<u>1,774,968</u>
Fund Balance, End of Year	<u>\$ 12,674,812</u>	<u>\$ 12,758,937</u>	<u>\$ 14,533,905</u>	<u>\$ 1,774,968</u>

See Accompanying Note to Required Supplementary Information.

**CITY OF EAST PALO ALTO**  
**Note to Required Supplementary Information**  
**June 30, 2007**

I. Budgeting

The City adopts a budget annually for all governmental fund types, except for capital projects. This budget is effective July 1 for the ensuing fiscal year. From the effective date of the budget, which is adopted at the department level, the amounts stated therein as proposed expenditures become appropriations to the various City departments. The legal level of budgetary control is the fund level. The City Council may amend the budget by resolution during the fiscal year. The City Manager has the authority to make adjustments to the operating budget between departments. Transfers of operating budgets between funds, use of unappropriated fund balances, and significant changes in capital improvement project budgets require the approval of the City Council.

Annual budgets are adopted on a basis consistent with accounting principles generally accepted in the United States except for capital projects, which are adopted on a project length basis. Supplemental appropriations made during the fiscal year were not substantial.

Under encumbrance accounting, purchase orders, contracts and other commitments for the expenditures of monies are recorded in order to reserve that portion of the applicable appropriation. Encumbrance accounting is employed as an extension of the formal budgetary process. Encumbrances outstanding at year-end are carried over to the next fiscal year as part of that year's budget resolution.

The City does not budget for individual Redevelopment Agency funds therefore, a detailed budgetary comparison schedule has not been included for the Low and Moderate Income Housing Special Revenue Fund or Debt Service Fund.

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## **Supplementary Information**

**CITY OF EAST PALO ALTO**  
**Combining Balance Sheet**  
**Nonmajor Governmental Funds**  
**June 30, 2007**

<u>Assets</u>	<u>NPDES Fees</u>	<u>Gas Tax</u>	<u>Federal and State Law Enforcement</u>
Cash and cash equivalents	\$ 25,800	\$ 841,014	
Receivables, net			\$ 105,980
Loans receivable			
Deposits			
Advances to other funds			
Total Assets	\$ 25,800	\$ 841,014	\$ 105,980
<u>Liabilities and Fund Balances</u>			
Liabilities:			
Accounts payable	\$ 6,047	\$ 15,291	\$ 6,448
Retention payable			
Deferred revenue			
Due to the General Fund			1,736
Advances from other funds			
Notes payable			
Total Liabilities	6,047	15,291	8,184
Fund Balances:			
Reserved for:			
Encumbrances			20,000
Capital projects			
Unreserved	19,753	825,723	77,796
Total Fund Balances	19,753	825,723	97,796
Total Liabilities and Fund Balances	\$ 25,800	\$ 841,014	\$ 105,980

<u>Park in Lieu</u>	<u>Rent Stabilization</u>	<u>ISTEA Grant</u>	<u>Federal and State Grants</u>	<u>U.S. EPA</u>
\$ 931,354	\$ 316,397	\$ 639,807		
284,916			\$ 330,980	\$ 34,862
<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<u>\$ 1,216,270</u>	<u>\$ 316,397</u>	<u>\$ 639,807</u>	<u>\$ 330,980</u>	<u>\$ 34,862</u>
	\$ 956		\$ 28,510	\$ 2,088
\$ 284,916			37,946	
			163,319	32,774
<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<u>284,916</u>	<u>956</u>	<u>          </u>	<u>229,775</u>	<u>34,862</u>
	10,800			69,125
<u>931,354</u>	<u>304,641</u>	<u>\$ 639,807</u>	<u>101,205</u>	<u>(69,125)</u>
<u>931,354</u>	<u>315,441</u>	<u>639,807</u>	<u>101,205</u>	<u>          </u>
<u>\$ 1,216,270</u>	<u>\$ 316,397</u>	<u>\$ 639,807</u>	<u>\$ 330,980</u>	<u>\$ 34,862</u>

(Continued)

**CITY OF EAST PALO ALTO**  
**Combining Balance Sheet**  
**Nonmajor Governmental Funds (Continued)**  
**June 30, 2007**

<u>Assets</u>	<u>Housing in Lieu</u>	<u>Housing Assist</u>	<u>Public Improvements in Lieu</u>
Cash and cash equivalents	\$ 226,533	\$ 555,188	\$ 370,816
Receivables, net			127,586
Loans receivable		379,017	
Deposits			
Advances to other funds			
Total Assets	\$ 226,533	\$ 934,205	\$ 498,402
<u>Liabilities and Fund Balances</u>			
Liabilities:			
Accounts payable		\$ 45,140	\$ 6,232
Retention payable			
Deferred revenue			127,586
Due to the General Fund			
Advances from other funds			
Notes payable		520,350	
Total Liabilities		565,490	133,818
Fund Balances:			
Reserved for:			
Encumbrances		379,017	
Capital projects			
Unreserved	\$ 226,533	(10,302)	364,584
Total Fund Balances	226,533	368,715	364,584
Total Liabilities and Fund Balances	\$ 226,533	\$ 934,205	\$ 498,402

Measure A	Local Grants	CYSFF Child/ Family	Lighting District	Drainage District
\$ 1,556,396	\$ 151,589	\$ 148,279	\$ 894,979	\$ 74,168
46,002	38,963		113,652	25,115
2,665			50,000	
<u>\$ 1,605,063</u>	<u>\$ 190,552</u>	<u>\$ 148,279</u>	<u>\$ 1,058,631</u>	<u>\$ 99,283</u>
\$ 19,874	\$ 47,870		\$ 1,943	\$ 1,571
62,454	18,736			
				50,000
<u>82,328</u>	<u>66,606</u>		<u>1,943</u>	<u>51,571</u>
6,500		\$ 2,500		4,250
<u>1,516,235</u>	<u>123,946</u>	<u>145,779</u>	<u>1,056,688</u>	<u>43,462</u>
<u>1,522,735</u>	<u>123,946</u>	<u>148,279</u>	<u>1,056,688</u>	<u>47,712</u>
<u>\$ 1,605,063</u>	<u>\$ 190,552</u>	<u>\$ 148,279</u>	<u>\$ 1,058,631</u>	<u>\$ 99,283</u>

(Continued)

**CITY OF EAST PALO ALTO**  
**Combining Balance Sheet**  
**Nonmajor Governmental Funds (Continued)**  
**June 30, 2007**

<u>Assets</u>	<u>Total Special Revenue</u>	<u>Capital Projects Capital Improvements</u>	<u>Total Nonmajor Governmental Funds</u>
Cash and cash equivalents	\$ 6,732,320	\$ 329,177	\$ 7,061,497
Receivables, net	1,108,056	5,735	1,113,791
Loans receivable	379,017		379,017
Deposits	2,665		2,665
Advances to other funds	50,000		50,000
	<hr/>	<hr/>	<hr/>
Total Assets	<u>\$ 8,272,058</u>	<u>\$ 334,912</u>	<u>\$ 8,606,970</u>
 <u>Liabilities and Fund Balances</u>  			
Liabilities:			
Accounts payable	\$ 181,970	\$ 14,930	\$ 196,900
Retention payable	100,400	30,453	130,853
Deferred revenue	431,238	64,821	496,059
Due to the General Fund	197,829		197,829
Advances from other funds	50,000		50,000
Notes payable	520,350		520,350
	<hr/>	<hr/>	<hr/>
Total Liabilities	<u>1,481,787</u>	<u>110,204</u>	<u>1,591,991</u>
 Fund Balances:			
Reserved for:			
Encumbrances	492,192	57,914	550,106
Capital projects		166,794	166,794
Unreserved	6,298,079		6,298,079
	<hr/>	<hr/>	<hr/>
Total Fund Balances	<u>6,790,271</u>	<u>224,708</u>	<u>7,014,979</u>
	<hr/>	<hr/>	<hr/>
Total Liabilities and Fund Balances	<u>\$ 8,272,058</u>	<u>\$ 334,912</u>	<u>\$ 8,606,970</u>

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**CITY OF EAST PALO ALTO**  
**Combining Statement of Revenues, Expenditures**  
**and Changes in Fund Balances**  
**Nonmajor Governmental Funds**  
**For the Year Ended June 30, 2007**

	NPDES Fees	Gas Tax	Federal and State Law Enforcement
	<u>          </u>	<u>          </u>	<u>          </u>
Revenues:			
Taxes and assessments			
Intergovernmental	\$ 118,252	\$ 841,883	\$ 215,288
Charges for services			
Interest	560	35,548	9,067
Contributions and donations			
	<u>          </u>	<u>          </u>	<u>          </u>
Total Revenues	<u>118,812</u>	<u>877,431</u>	<u>224,355</u>
Expenditures:			
Current:			
General government	5,508	69,262	
Public safety			150,138
Culture and recreation			
Public works	93,628	527,638	
Community development			
Debt service:			
Interest			
Capital outlay			217,176
	<u>          </u>	<u>          </u>	<u>          </u>
Total Expenditures	<u>99,136</u>	<u>596,900</u>	<u>367,314</u>
Excess (Deficiency) of Revenues Over Expenditures	<u>19,676</u>	<u>280,531</u>	<u>(142,959)</u>
Other Financing Sources (Uses):			
Transfers in			1,234
Transfers out			
	<u>          </u>	<u>          </u>	<u>          </u>
Total Other Financing Sources (Uses)	<u>          </u>	<u>          </u>	<u>1,234</u>
Net Change in Fund Balance	19,676	280,531	(141,725)
Fund Balance, Beginning of Year	<u>77</u>	<u>545,192</u>	<u>239,521</u>
Fund Balance, End of Year	<u>\$ 19,753</u>	<u>\$ 825,723</u>	<u>\$ 97,796</u>

<u>Park in Lieu</u>	<u>Rent Stabilization</u>	<u>ISTEA Grant</u>	<u>Federal and State Grants</u>	<u>U.S. EPA</u>
			\$ 635,618	\$ 117,266
\$ 53,914	\$ 323,416 14,116		875	
<u>53,914</u>	<u>337,532</u>		<u>636,493</u>	<u>117,266</u>
66,850	81,184		83,763	117,266
5,231			83,198	
			34,188	
	161,298		373,734	
<u>2,085</u>			<u>81,829</u>	
<u>74,166</u>	<u>242,482</u>		<u>656,712</u>	<u>117,266</u>
<u>(20,252)</u>	<u>95,050</u>		<u>(20,219)</u>	
<u>(117,961)</u>			<u>(9,874)</u>	
<u>(117,961)</u>			<u>(9,874)</u>	
(138,213)	95,050		(30,093)	
<u>1,069,567</u>	<u>220,391</u>	<u>\$ 639,807</u>	<u>131,298</u>	
<u>\$ 931,354</u>	<u>\$ 315,441</u>	<u>\$ 639,807</u>	<u>\$ 101,205</u>	<u>\$ -</u>

(Continued)

**CITY OF EAST PALO ALTO**  
**Combining Statement of Revenues, Expenditures**  
**and Changes in Fund Balances (Continued)**  
**Nonmajor Governmental Funds**  
**For the Year Ended June 30, 2007**

	<u>Housing in Lieu</u>	<u>Housing Assist</u>	<u>Public Improvements in Lieu</u>
Revenues:			
Taxes and assessments			
Intergovernmental			
Charges for services			
Interest	\$ 8,845		
Contributions and donations	<u>53,040</u>		<u>\$ 16,403</u>
Total Revenues	<u>61,885</u>		<u>16,403</u>
Expenditures:			
Current:			
General government			
Public safety			
Culture and recreation			
Public works			
Community development	12,034		
Debt service:			
Interest		\$ 15,610	
Capital outlay			
Total Expenditures	<u>12,034</u>	<u>15,610</u>	
Revenues Over Expenditures	<u>49,851</u>	<u>(15,610)</u>	<u>16,403</u>
Other Financing Sources (Uses):			
Transfers in	111,152		
Transfers out	<u>(40,028)</u>		
Total Other Financing Sources (Uses)	<u>71,124</u>		
Net Change in Fund Balance	120,975	(15,610)	16,403
Fund Balances, Beginning of Year	<u>105,558</u>	<u>384,325</u>	<u>348,181</u>
Fund Balances, End of Year	<u><u>\$ 226,533</u></u>	<u><u>\$ 368,715</u></u>	<u><u>\$ 364,584</u></u>

<u>Measure A</u>	<u>Local Grants</u>	<u>CYSFF Child/ Family</u>	<u>Lighting District</u>	<u>Drainage District</u>
\$ 443,555			\$ 113,652	\$ 25,115
71,153	\$ 67,504	\$ 5,020	23,550	1,946
<u>514,708</u>	<u>67,504</u>	<u>5,020</u>	<u>1,098,413</u>	<u>34,473</u>
5,022	718		48,156	
51,181	2,578	2,238		
24,995	78,035	7,500	111,279	13,822
	25,934			
	<u>24,814</u>		<u>19,492</u>	
<u>81,198</u>	<u>132,079</u>	<u>9,738</u>	<u>178,927</u>	<u>13,822</u>
<u>433,510</u>	<u>(64,575)</u>	<u>(4,718)</u>	<u>1,056,688</u>	<u>47,712</u>
		111,152		
		<u>111,152</u>		
433,510	(64,575)	106,434	1,056,688	47,712
<u>1,089,225</u>	<u>188,521</u>	<u>41,845</u>		
<u>\$ 1,522,735</u>	<u>\$ 123,946</u>	<u>\$ 148,279</u>	<u>\$ 1,056,688</u>	<u>\$ 47,712</u>

(Continued)

**CITY OF EAST PALO ALTO**  
**Combining Statement of Revenues, Expenditures**  
**and Changes in Fund Balances (Continued)**  
**Nonmajor Governmental Funds**  
**For the Year Ended June 30, 2007**

	<u>Total Special Revenue</u>	<u>Capital Projects Capital Improvements</u>	<u>Total Nonmajor Governmental Funds</u>
Revenues:			
Taxes and assessments	\$ 138,767		\$ 138,767
Intergovernmental	2,371,862		2,371,862
Charges for services	323,416		323,416
Interest	224,594		224,594
Contributions and donations	1,269,833	\$ 291,532	1,561,365
Total Revenues	<u>4,328,472</u>	<u>291,532</u>	<u>4,620,004</u>
Expenditures:			
Current:			
General government	477,729		477,729
Public safety	238,152		238,152
Culture and recreation	176,135		176,135
Public works	1,171,030	236,000	1,407,030
Community development	173,332		173,332
Debt service:			
Interest	15,610		15,610
Capital outlay	345,396	131,567	476,963
Total Expenditures	<u>2,597,384</u>	<u>367,567</u>	<u>2,964,951</u>
Revenues Over Expenditures	<u>1,731,088</u>	<u>(76,035)</u>	<u>1,655,053</u>
Other Financing Sources (Uses):			
Transfers in	223,538	64,048	287,586
Transfers out	(167,863)		(167,863)
Total Other Financing Sources (Uses)	<u>55,675</u>	<u>64,048</u>	<u>119,723</u>
Net Change in Fund Balance	1,786,763	(11,987)	1,774,776
Fund Balances, Beginning of Year	<u>5,003,508</u>	<u>236,695</u>	<u>5,240,203</u>
Fund Balances, End of Year	<u>\$ 6,790,271</u>	<u>\$ 224,708</u>	<u>\$ 7,014,979</u>