

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

**Annual Financial Report
For the Year Ended June 30, 2007**

EAST PALO ALTO REDEVELOPMENT AGENCY
Annual Financial Report
June 30, 2007

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November 26, 2007

The Board of Directors of the
East Palo Alto Redevelopment Agency

Independent Auditors' Report

We have audited the accompanying financial statements of the governmental activities and each major fund of the East Palo Alto Redevelopment Agency (Agency), a component unit of the City of East Palo Alto, California as of and for the year ended June 30, 2007, which collectively comprise the Agency's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Agency 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 and each major fund of the Agency as of June 30, 2007, and the respective changes in financial position 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 Agency'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 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.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the City of East Palo Alto Redevelopment Agency (Agency), we present a narrative overview and analysis of the Agency's financial activities for the fiscal year ended June 30, 2007. The management's discussion and analysis is designed to provide (a) an overview of the Agency's financial activities, (b) highlights of significant financial issues, (c) challenges facing the Agency's financial position in future years, and (d) identification of any material deviations from the approved budget.

We advise readers to consider the information presented here in conjunction with additional information furnished in this financial report.

FINANCIAL HIGHLIGHTS

The Agency continues to attract development interest. A new development, known as University Palms, recently obtained Redevelopment Agency approval for a relocation plan for residential and business tenants in order that it may proceed with approximately 207,000 square feet of office development and approximately 24,000 square feet of retail. Additionally, another development site known as Cummings Park is in its final phase of construction of 22,000 square feet of retail space and 34 residential units. It is scheduled for occupancy in the spring of 2008. These projects along with other light condominium and light industrial urban in-fill projects are expected to add to the future assessed value of property within the Agency's boundaries. The Agency continues to utilize cash reserves to reduce the debt owed to the City of East Palo Alto (the City); however, the rate of repayment has declined compared to recent years. The Agency's primary revenue source is incremental property taxes, which significantly increased by \$4.2M during the current fiscal year; resulting mainly from the resale of the University Circle Project Area's three class A office buildings and the opening of the Four Seasons Hotel.

The following are some key financial highlights for the fiscal year ending June 30, 2007:

- The liabilities exceeded assets by \$25.6M (net deficit). This net deficit is comprised of long-term bonds and loans requiring payment in the future. Information related to debt payments can be found on page 30 of the financial statements. Overall, analysis of the statement of net assets shows that the Agency is able to meet current obligations; however, currently it would be unable to meet long-term financial obligations. While this is not an unusual situation for Redevelopment Agencies, management must carefully balance the Agency's current and future resources between debt obligations and development activities.
- The net deficit decreased approximately \$3.8M. This decrease is the result of \$4.9M increase in current income; offset by a reduction of approximately \$700,000 to reimburse the City for transient occupancy tax forgone and an overall decrease in operating expenditure of \$400,000.
- Total assets increased approximately \$3.1M. The increase is due to an increase in cash receipts collected from additional tax increment generated as a result of increased assessed values from the sale of the University Circle Office Building and the opening of the Four Season's Hotel.

- Total liabilities decreased approximately \$662,000. The decrease is primarily due to the repayment of the University Circle Investors (UCI) Stage 2 loan; whereby the Agency repaid approximately \$480,000 in principal payment and \$73,000 in accumulated compound interest.
- Government-wide revenues increased approximately \$4.9M. The increased is primarily an increase of \$4.7M in general revenues derived mainly from tax increment revenues and a prior year reclassification of \$900,000 daycare facility transferred to the City; offset by decrease of \$700,000 resulting from a transfer of General Fund.
- Government-wide expenditures increased approximately \$419,000. The overall increase is the result of a prior year one-time reduction of \$686,000 related to deferred charges on the 2005 Public Financing Authority (PFA) bonds; which was offset against the annual bond interest payment. In comparison, the current year, net of the \$686,000 reduction, would have otherwise shown an increase of less magnitude to reflect only the additional interest payment related to the new issuance of the PFA bond issued in fiscal year 2005/06.

USING THIS ANNUAL REPORT

This discussion and analysis is intended to serve as an introduction to the Agency's basic financial statements. The Agency's basic financial statements are comprised of three components: (1) government-wide financial statements; (2) fund financial statements; and, (3) notes to the financial statements. This report also contains other supplemental information in addition to the basic financial statements to provide further understanding of the Agency's activities.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

Government-wide Financial Statements

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

Statement of Net Assets: Presents information on all of the Agency'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 Agency is improving or declining.

Statement of Activities: Presents information showing how the Agency'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 but unused vacation leave).

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 Agency, like other State and local governments, uses fund accounting to ensure and demonstrate financial compliance with legal requirements. All of the funds of the Agency are governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on the near-term inflows and outflows of spendable resources as well as on balances of spendable resources available at the end of the fiscal year. Such information is useful in determining what financial resources are available in the near future to finance the Agency's programs.

The Agency maintains three individual governmental funds. Information is presented separately in the governmental fund balance sheet and the statement of revenues, expenditures, and changes in fund balance for the Capital Projects Fund, the Special Revenue Fund, and the Debt Service Fund.

The Agency adopts an annual appropriated budget for its Capital Projects, Special Revenue, and Debt Service funds. A budgetary comparison statement has been provided in the Required Supplemental Information section of the financial statement to demonstrate budget compliance.

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

Net assets typically serve as a useful indicator of a government's financial position. For the Agency, liabilities exceed assets by approximately \$25.6M. Over the years the Agency issued tax allocation bonds secured by future tax increments and incurred debt owed to the City and other governmental agencies or developers. Proceeds of the debt have been utilized for redevelopment projects, and the Agency is able to meet current debt obligations, as well as fund annual administrative and development activities as a result of the incremental tax revenues generated by successful redevelopment projects.

Analysis of Net Assets (Deficit)

- Total assets of \$37.2M consist of current and other assets of \$36.4 million and capital assets of \$0.8M. Current and other assets increased by \$2.8M as a result of higher tax increment generated by the University Circle Project Area; whereby the project area more than tripled its tax increment revenues, from the prior year, resulting directly from the sale of the three office buildings and the opening of the Four Season's Hotel. The Agency also acquired a parcel at the corner of Bay and University in the amount of \$263,235; resulting in an increase in capital assets. This asset was acquired by using the 2005 Public Financing Authority bond proceeds, which generated \$1.4M in additional funds for general projects throughout the City.

- Total liabilities of \$62.8M consist of \$2.9M of current liabilities and \$59.8M of long-term debt. Total liabilities decreased by \$662,000 primarily due to the payment of a loan commitment related to the 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 \$1.7M in any given year. Due to the significant increase of tax increment generated in the current year, for reasons noted above, the repayment threshold was triggered. At time of payment, the Agency had borrowed \$480,000 against the \$3.9M line of credit and therefore repaid \$570,000, which included accumulated interest of \$90,000.
- Of the Agency's total deficit of \$25.6M; \$9.6M is restricted for low and moderate-income housing, and, \$19.4M is restricted for debt payments related to bonds issued by Agency and the PFA. The unrestricted net deficit balance is \$54.6M.

**CITY OF EAST PALO ALTO REDEVELOPMENT AGENCY
STATEMENT OF NET ASSETS (DEFICIT)
(Dollars in thousands)**

	Governmental Activities	
	2007	2006
Assets:		
Current and other assets	\$ 36,367	\$ 33,520
Capital assets	825	562
Total Assets	37,192	34,082
Liabilities:		
Current and other liabilities	2,946	1,756
Noncurrent liabilities	59,817	61,668
Total Liabilities	62,763	63,424
Net Assets:		
Investment in capital, net of debt		8
Restricted for:		
Low and moderate income housing	9,616	2,132
Debt Service	19,442	19,503
Unrestricted	(54,629)	(50,985)
Total Net Assets (Deficit)	\$ (25,571)	\$ (29,342)

Governmental Activities - The change in the net assets (deficit) of the Agency of \$3.8M is related to governmental activities. Key financial elements are as follows:

	Statement of Activities (Dollars in thousands) Governmental Activities	
	<u>2007</u>	<u>2006</u>
Revenues		
Program revenues:		
Grants and contributions		\$ (900)
General revenues:		
Property taxes	\$ 8,623	4,410
Investment earnings	1,326	858
Net transfers	(571)	83
Gain on sale of assets		(2)
Miscellaneous	61	31
	<u>9,439</u>	<u>4,480</u>
Expenses:		
Program expenses:		
General government	564	708
Public works		53
Community development	1,914	1,850
Administration		384
Interest on long-term debt	3,186	2,236
	<u>5,664</u>	<u>5,231</u>
Total Expenses		
	3,775	(751)
Increase (Decrease) in Net Assets		
Net Assets, Beginning of Year	<u>(29,344)</u>	<u>(28,593)</u>
Net Assets, End of Year	<u>\$ (25,569)</u>	<u>\$ (29,344)</u>

- Fiscal Year ending 2007 total revenues was approximately \$9.4M; an increase of \$4.9M or 52% from the prior year. This increase is the result of a \$4.2M increase in property tax increment and approximately \$468,000 in additional investment earnings in the current year. In addition, there is an increase in net contributions of \$900,000 as a direct result of a prior year contribution of a developer funded daycare facility belonging to the City rather than the Agency. These increases are offset by a transfer of \$655,000 to the City from the Agency as a partial reimbursement of Transient Occupancy Tax (TOT) forgone by the City as a result of the settlement agreement made between the Agency and the hotel developers. Upon the City's request, the Agency is obligated to repay the City from tax increment generated by the University Circle Project for this recovery of lost TOT.

- Total expenses were approximately \$5.7M; an increase of \$419,000 or 7% over the prior year. This is the combination of a decrease of redevelopment activities over the prior year by \$531,000; offset by a \$951,000 increase in interest expense on long term debt. In the prior year, a lower interest expense amount was reported as deferred bond charges related to the 2005 PFA bond issue which was reduced against this expense line item. Otherwise, interest expense on long term debt would have only increased slightly compared to prior year.

FINANCIAL ANALYSIS OF THE AGENCY'S FUNDS

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

The focus of the Agency'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 Agency's financing requirements.

At June 30, 2007, the Agency reported combined fund balances of \$33.3M compared to \$31.1M at June 30, 2006, an increase of \$2.2M. This is the result of a significant increase in property tax revenue generated in the University Circle Project Area due to the resale of the three office buildings and the opening of a five star hotel.

The Special Revenue Fund - The Low and Moderate Income Housing Fund accounts for the portion of property tax increment required under California law to be set aside to fund low and moderate income housing expenditures. Agency housing loan and grant programs are accounted for in this fund.

The Capital Projects Fund is the general fund for the Agency and accounts for the activities of the Agency, which was created to prepare and carry out redevelopment plans within designated project areas of the City. The Agency has three distinct project areas – Gateway/101, University Circle, and Ravenswood.

The combined fund balance at year-end was \$3.0M. Fund balance increased approximately \$1.1M. The primary cause of the increase in fund balance was the increase in tax increment revenues for the University Circle Project Area.

The Debt Service Fund accounts for the resources used for the purpose of paying principal, interest and related costs on the Agency's Tax Allocation Bonds and other long-term obligations, which are more fully described on page 30 of the financial statements. As of June 30, 2007, the Agency's bonded indebtedness was \$43.3M, comprised of the 1999 Bond Issue of \$16.8M; the 2003 Bond Refunding of \$8.5M; and, the 2005 Authority Bond issue of \$18.0M. These Tax Allocation Bonds are secured by future property tax increment revenue. Debt service expenditures include \$2.4M in interest payments and \$400,000 in bond principal payments.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS

- Property taxes for the Gateway 101 and Ravenswood Project Area are expected to increase as additional development activities continue.
- On March 15, 2007 a settlement agreement was reached between the Agency and the Hotel Developers, of the Four Seasons Hotel, related to the Transient Occupancy Tax (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:
 - 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 \$7.0M.

Any TOT collected and retain up to the \$7.0M 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 \$2.0M in TOT, of which \$500,000 was sent to the City, leaving a net balance of \$1.5M that was retained by the hotel developers. The Agency reimbursed the City's General Fund \$611,525 of the estimated \$1.5M 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.

All of these factors were considered in preparing the Agency's budget for FY 2008.

CONTACTING THE AGENCY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our Agency Board of Directors, citizens, taxpayers, customers, investors, and creditors with a general overview of the Agency's finances; and, to ensure transparency relative to Agency fiscal operations. If you have questions about this report or need additional financial information, contact the Agency's Finance Department, at the EPA Governmental Center, 2415 University Avenue, East Palo Alto, CA 94303.

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

EAST PALO ALTO REDEVELOPMENT AGENCY

Statement of Net Assets

June 30, 2007

<u>Assets</u>	<u>Governmental Activities</u>
Current Assets:	
Cash and investments	\$ 8,086,463
Receivables, net	58,024
Total Current Assets	<u>8,144,487</u>
Noncurrent Assets:	
Cash and investments with fiscal agent	19,442,244
Land held for resale	537,429
Deposits and prepayments	97,605
Deferred charges	1,485,287
Long-term receivables	6,660,000
Capital assets, net of depreciation	825,205
Total Noncurrent Assets	<u>29,047,770</u>
Total Assets	<u>37,192,257</u>
<u>Liabilities</u>	
Current liabilities:	
Accounts payable	1,040,531
Interest payable	397,408
Other liabilities	2,636
Deposits	102,605
Advances from developers	452,663
Bonds payable	420,000
Due to other governmental agencies	529,976
Total Current Liabilities	<u>2,945,819</u>
Noncurrent liabilities:	
Advances from City of East Palo Alto	11,217,369
Due to other governmental agencies	5,034,043
Bonds payable, net of unamortized premium of \$770,332	43,565,332
Total Noncurrent Liabilities	<u>59,816,744</u>
Total Liabilities	<u>62,762,563</u>
<u>Net Assets</u>	
Restricted for:	
Low and moderate income housing	9,616,232
Debt service	19,442,201
Unrestricted (deficit)	<u>(54,628,739)</u>
Total Net Deficit	<u>\$ (25,570,306)</u>

See Accompanying Notes to Financial Statements.

EAST PALO ALTO REDEVELOPMENT AGENCY
Statement of Activities
For the Year Ended June 30, 2007

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Net (Expense) Revenues and Changes in Net Assets Governmental Activities Totals</u>
Governmental Activities:		
General government	\$ 563,200	\$ (563,200)
Community development	1,915,773	(1,915,773)
Interest and fiscal charges	<u>3,186,252</u>	<u>(3,186,252)</u>
Total Governmental Activities	<u>\$ 5,665,225</u>	<u>(5,665,225)</u>
General Revenues:		
Property tax increment		8,622,619
Unrestricted investment earnings		1,326,457
Miscellaneous		60,767
Transfers to City		<u>(571,497)</u>
Total General Revenue and Transfers		<u>9,438,346</u>
Change in Net Assets		3,773,121
Net Deficit, Beginning of Year		<u>(29,343,427)</u>
Net Deficit, End of Year		<u>\$ (25,570,306)</u>

See Accompanying Notes to Financial Statements.

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FUND FINANCIAL STATEMENTS

EAST PALO ALTO REDEVELOPMENT AGENCY

**Balance Sheet
Governmental Funds
June 30, 2007**

<u>Assets</u>	<u>Special Revenue</u>	<u>Capital Projects</u>	<u>Debt Service</u>	<u>Total Governmental Funds</u>
Cash and investments	\$ 2,958,208	\$ 3,952,618	\$ 1,175,637	\$ 8,086,463
Cash and investments held by fiscal agents		43	19,442,201	19,442,244
Receivables:				
Interest	58,024			58,024
Notes, long-term	6,600,000	60,000		6,660,000
Deposits and prepayments		97,605		97,605
Property held for resale		537,429		537,429
	<hr/>	<hr/>	<hr/>	<hr/>
Total Assets	<u>\$ 9,616,232</u>	<u>\$ 4,647,695</u>	<u>\$ 20,617,838</u>	<u>\$ 34,881,765</u>
 <u>Liabilities and Fund Balance</u>				
Liabilities:				
Accounts payable		\$ 1,040,531		\$ 1,040,531
Deposits		102,605		102,605
Accrued liabilities		2,636		2,636
Advances from developers		452,663		452,663
		<hr/>		<hr/>
Total Liabilities		<u>1,598,435</u>		<u>1,598,435</u>
 Fund Balance:				
Reserved:				
Encumbrances		300,451		300,451
Property held for resale		537,429		537,429
Notes, long-term	\$ 6,600,000	60,000		6,660,000
Debt service			\$ 20,617,838	20,617,838
Capital projects		264,382		264,382
Unreserved, undesignated	3,016,232	1,886,998		4,903,230
	<hr/>	<hr/>	<hr/>	<hr/>
Total Fund Balance	<u>9,616,232</u>	<u>3,049,260</u>	<u>20,617,838</u>	<u>33,283,330</u>
Total Liabilities and Fund Balance	<u>\$ 9,616,232</u>	<u>\$ 4,647,695</u>	<u>\$ 20,617,838</u>	<u>\$ 34,881,765</u>

See Accompanying Notes to Financial Statements.

EAST PALO ALTO REDEVELOPMENT AGENCY
Reconciliation of the Balance Sheet of Governmental Funds
to the Statement of Net Assets
June 30, 2007

Fund balance of all governmental funds \$ 33,283,330

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

Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the balance sheet of governmental funds.

Tax allocation bonds, net	(43,985,332)
Due to other governments	(5,564,019)
Advances	(11,217,369)

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
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Capital assets are recorded as assets in the statement of net assets.	825,205
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Interest payable on long-term debt is not accrued as a liability in the balance sheet of governmental funds.	(397,408)
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Net Assets of Governmental Activities	\$ (25,570,306)
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See Accompanying Notes to Financial Statements.

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

	Special Revenue	Capital Projects	Debt Service	Totals Governmental Funds
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Revenues:				
Property taxes	\$ 1,724,524	\$ 6,898,095		\$ 8,622,619
Interest	177,307	229,277	\$ 919,873	1,326,457
Other revenues	60,767	4,661		65,428
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total Revenues	1,962,598	7,132,033	919,873	10,014,504
Expenditures:				
Current:				
General government		563,200		563,200
Community development	60,000	1,036,980		1,096,980
Administration		69,335		69,335
Debt service:				
Principal		553,522	400,000	953,522
Payment of advances		1,454,645		1,454,645
Tax increment pass-through payments		1,030,352		1,030,352
Interest and fiscal charges		474,272	2,400,868	2,875,140
Capital outlay			263,235	263,235
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total Expenditures	60,000	5,182,306	3,064,103	8,306,409
Excess (Deficiency) of Revenues Over Expenditures	1,902,598	1,949,727	(2,144,230)	1,708,095
Other Financing Sources (Uses):				
Proceeds of advances		1,095,000		1,095,000
Transfers in	40,028		1,823,617	1,863,645
Transfers out	(568,560)	(1,866,582)		(2,435,142)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total Other Financing Sources (Uses)	(528,532)	(771,582)	1,823,617	523,503
Net Change in Fund Balance	1,374,066	1,178,145	(320,613)	2,231,598
Fund Balance, Beginning of Year	8,242,166	1,871,115	20,938,451	31,051,732
Fund Balance, End of Year	<u>\$ 9,616,232</u>	<u>\$ 3,049,260</u>	<u>\$ 20,617,838</u>	<u>\$ 33,283,330</u>

See Accompanying Notes to Financial Statements.

EAST PALO ALTO REDEVELOPMENT AGENCY
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: \$ 2,231,598

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. 263,235

The issuance of long-term liabilities provides current financial resources to governmental funds, while the repayment of the principal of long-term liabilities consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities. This amount is the net effect of these differences in the treatment of long-term liabilities and related items.

Net changes in due to other governments	\$	276,233	
Proceeds of advances		(1,095,000)	
Amortization of bond discount, bond premium, and other deferred charges and change in interest payable		(311,112)	
Principal payments on bonds		400,000	
Payment of advances		1,454,645	
Payment of note payable		<u>553,522</u>	
			<u>1,278,288</u>

Change in Net Assets of Governmental Activities \$ 3,773,121

See Accompanying Notes to Financial Statements.

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EAST PALO ALTO REDEVELOPMENT AGENCY
Notes to Financial Statements
June 30, 2007

I. Summary of Significant Accounting Policies

The following is a summary of the significant accounting policies of the East Palo Alto Redevelopment Agency:

A. Financial Reporting Entity

The East Palo Alto Redevelopment Agency (Agency), although a legally separate entity from the City of East Palo Alto, California (City), is a component unit of the City because the City is financially accountable for the Agency. The Agency is governed by the City's elected five-member Council.

The Agency was organized pursuant to provisions of the Community Redevelopment Law of the State of California for the purpose of conducting economic development and redevelopment activities. The financial statements present only the information relative to the Agency and do not present the financial position or results of operations of the City.

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.

B. Basis of Presentation

Government-wide Financial Statements

The statement of net assets and statement of activities display information about the reporting government as a whole. The statements contain only governmental activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange revenues.

Fund Financial Statements

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. A fund is considered major if it is the primary operating fund of the Agency or meets the following criteria:

EAST PALO ALTO REDEVELOPMENT AGENCY
Notes to Financial Statements (Continued)
June 30, 2007

- Total assets, liabilities, revenues, or expenditures/expenses of that individual governmental or enterprise fund are at least 10 percent of the corresponding total for all funds of that category or type; and,
- Total assets, liabilities, revenues, or expenditures/expenses of that individual governmental or enterprise fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined.

All funds are accounted for as governmental activities, therefore the Agency has no business-type activity statements. The Agency also considers all funds major funds.

The major funds of the financial reporting entity are described below.

C. Governmental Funds

Special Revenue Fund – The Special Revenue Fund is used to account for the 20% portion of the Agency’s tax increment revenue and other sources that are required to be set-aside for low and moderate income housing and related expenditures.

Capital Projects Fund – The Capital Projects Fund is used to account for resources restricted for the acquisition or construction of specific capital projects or items.

Debt Service Fund – The Debt Service Fund is used to account for the accumulation of financial resources for the payment of interest and principal on the long-term debt of the Agency. Property tax increment is used for the payment of principal and interest on the Agency’s debt.

D. Measurement Focus and Basis of Accounting

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

1) Government-wide Financial Statements

On the government-wide Statement of Net Assets and the Statement of Activities, governmental 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.

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Notes to Financial Statements (Continued)
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2) Fund Financial Statements

In the fund financial statements, the “current financial resources” measurement focus and the modified accrued 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 resources during a given period. These funds use fund balance as their measure of available spendable financial resources at the end of the period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when payment is due.

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

3) Cash and Investments

For the purpose of the Statement of Net Assets, cash and investments include the Agency’s share of cash and investments pooled with the City.

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.

4) Capital Assets

Capital assets are reported in the government-wide financial statements. Capital assets are defined by the Agency as assets with an initial cost of more than \$5,000 and an estimated life in excess of 1 year. Purchased capital assets are recorded at historical cost. Donated capital assets are valued at estimated fair value or the date donated. The Agency has no infrastructure assets. Depreciation of capital assets has been provided over the estimated useful life of 30 years for buildings and improvements.

5) Property Taxes Receivable

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

EAST PALO ALTO REDEVELOPMENT AGENCY
Notes to Financial Statements (Continued)
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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 Agency 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 Agency. The Agency receives tax increment revenues allocated to the Agency by the County. The Agency recognizes property tax revenues (including tax increment revenues) in the year levied.

6) Interfund Receivables and Payables

During the course of operations, numerous transactions occur between individual funds that may result in amounts owed between funds. Those related to goods and services type transactions are classified as "due to and from other funds." Short-term interfund loans are reported as "interfund receivables and payables." Interfund receivables and payables between funds within governmental activities are eliminated in the statement of net assets.

7) Long-Term Debt

All long-term debt to be repaid from governmental resources is reported as liabilities in the government-wide statements. The long-term debt consists primarily of notes and bonds payable and advances and loans due to the City of East Palo Alto and other government agencies.

Long-term debt for governmental funds is not reported as liabilities in the fund financial statements. The debt proceeds are reported as revenue and payment of principal and interest is reported as expenditures.

8) Land Held for Resale

Land acquired by the Agency for resale to developers and other third parties is carried as an asset of the respective fund. Such land is recorded at the lower of cost or estimated realizable value is less than historical cost, the Agency adjusts the carrying value of the land to estimated realizable value and records the decline in value of land held for resale as an expenditure in the fund carrying the land as an asset.

9) Deposits

Condemnation payments made by the Agency 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

EAST PALO ALTO REDEVELOPMENT AGENCY
Notes to Financial Statements (Continued)
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Agency. Such deposits are generally held by the State of California or by the applicable Superior Court.

10) Administrative Costs

The Agency has no employees of its own. Instead, the Agency utilizes employees of the City as required and the corresponding personnel and administrative costs are allocated to project areas based on percentage of actual activity. Allocated personnel and administrative costs for the year ended June 30, 2007 totaled \$1,529,972.

11) 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.

12) Budgets

As part of the City's comprehensive budget processes, the Agency adopts an annual operating budget prepared on the modified accrual basis for all funds combined within the Agency. The Agency does not budget for individual Redevelopment Agency Funds.

II. 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:

City pool	\$ 8,086,463
Cash and investments with fiscal agent	<u>19,442,244</u>
Total Cash and Investments	<u><u>\$ 27,528,707</u></u>

The Agency pools its available cash with the City for investment purposes. See the City's basic financial statements for the year ended June 30, 2007, for additional disclosure on cash and investments.

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Notes to Financial Statements (Continued)
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Investments Authorized by the California Government Code and the Agency's Investment Policy

The table below identifies the investment types that are authorized for the Agency by the California Government Code (or the Agency's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the Agency'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 Agency, rather than the general provisions of the California Government Code or the Agency'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.

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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
Guaranteed Investment Contract	None	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 Agency 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.

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 Agency'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>
Held by Bond Trustee:			
Guaranteed Investment Contract	\$ 18,047,298		\$ 1,966,396
Money Market Funds	1,394,946	\$ 1,394,946	
Total	<u>\$ 19,442,244</u>	<u>\$ 1,394,946</u>	<u>\$ 1,966,396</u>

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Notes to Financial Statements (Continued)
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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>
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>\$ 19,442,244</u>		<u>\$ 19,442,244</u>

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>
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 Agency'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

EAST PALO ALTO REDEVELOPMENT AGENCY
Notes to Financial Statements (Continued)
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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 Agency deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

Investment in State Investment Pool

The Agency 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 Agency's investment in this pool is reported in the accompanying financial statements at amounts based upon the Agency'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.

B. Notes 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.

C. Land Held for Resale and Capital Assets

The \$537,429 portion in land held for resale consists 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.

A summary of changes in Agency capital assets is as follows:

	<u>Balance at</u> <u>July 1, 2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at</u> <u>June 30, 2007</u>
Capital Assets, not Being Depreciated:				
Land		\$ 263,235		\$ 263,235
Construction in progress	\$ 561,970			561,970
 Total Capital Assets	 <u>\$ 561,970</u>	 <u>\$ 263,235</u>	 <u>\$ -</u>	 <u>\$ 825,205</u>

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Notes to Financial Statements (Continued)
June 30, 2007

D. Long Term Debt

During the year ended June 30, 2007, the following changes occurred in liabilities reported in long-term debt:

	Balance July 1, 2006	Additions	Retirements	Balance June 30, 2007	Due Within One Year
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 Bonds	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)		
Advances and loans from City	11,577,014	1,095,000	(1,454,645)	11,217,369	
Total Redevelopment Agency	<u>\$ 62,391,600</u>	<u>\$ 1,395,000</u>	<u>\$ (3,019,880)</u>	<u>\$ 60,766,720</u>	<u>\$ 949,976</u>

1) Tax Allocation Bonds

The Agency 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 Agency'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 Agency's tax increment revenues including the Agency's housing set-aside tax increment revenues. The annual tax increment revenues expected to be received by the Agency and pledged to secure repayment of the 1999 bonds are sufficient to pay annual debt service.

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 bear interest at rates of 4.2 to 6.625 percent and the interest is payable each April 1 and October 1 commencing April 1, 2000. Principal on the bonds is payable each October 1, commencing October 1, 2000. On October 21, 1999, the original bonds consisted of \$4,945,000 in serial bonds and \$17,840,000 in term

EAST PALO ALTO REDEVELOPMENT AGENCY
Notes to Financial Statements (Continued)
June 30, 2007

bonds with a last maturity date of October 1, 2029. The serial bonds of \$4,795,000 were refunded with the 2003 issue.

The 1999 bonds maturing on or after October 1, 2010 are subject to optional redemption by the Agency 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 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 Agency and pledged to secure repayment of the 2003 bonds are sufficient to pay annual debt service.

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.

EAST PALO ALTO REDEVELOPMENT AGENCY
Notes to Financial Statements (Continued)
June 30, 2007

The 2003A bonds and the 2003B bonds maturing on or after October 1, 2014 are subject to optional redemption by the Agency 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>

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>

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Notes to Financial Statements (Continued)
June 30, 2007

The East Palo Alto Public Financing Authority 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 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 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.

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Notes to Financial Statements (Continued)
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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, 2007, 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>

2) Long-Term Pass-Through

Menlo Park Fire Protection District – In 1988 the Agency entered into an agreement with the Menlo Park Fire Protection District (District) whereby the Agency will pay to the District the equivalent of 10.24% of the tax increment received by the Agency 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 Agency 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 Agency 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 Agency entered into an agreement with the East Palo Alto Sanitary District (EPSD) whereby the Agency will pay to the EPSD the equivalent of 3.968% of the tax increment received by the Agency 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 Agency owes the

EAST PALO ALTO REDEVELOPMENT AGENCY
Notes to Financial Statements (Continued)
June 30, 2007

EPSD \$1,086,700. No repayment schedule is available as the repayment is based on the future tax increment the Agency receives from the University Circle Project Area.

3) Notes Payable

University Circle Investors – During 2000 the Agency entered into an agreement with University Circle Investors (UCI) whereby UCI will advance to the Agency \$3,900,000 for the completion of Stage 2A of the University Circle Redevelopment Project. The funds will be advanced to the Agency when the Agency requests the funds and provides the required documentation. No interest rate is stated so interest has been imputed. At June 30, 2007, the total loan advance of \$480,421 was paid, including an additional \$92,992 in accrued interest.

E. Advances and Loans from the City of East Palo Alto

The City and Agency have entered into a repayment agreement whereby the City has agreed to provide ongoing financial assistance and services to the Agency in connection with implementation of the redevelopment plan for the three redevelopment project areas.

As of June 30, 2007, there is a long-term liability due to the City of East Palo Alto for the Ravenswood Project Area which consists of debt from various advances with an interest rate of 12 percent. The Agency is obligated to repay the advances out of tax increment revenues as funds become available. The amount due as of June 30, 2007 is \$4,615,000.

An outstanding loan payable of \$6,602,369 from the Gateway 101 Project Area to the City of East Palo Alto relates to the sale of approximately 30 acres of land (known as the Ravenswood High School site) for use of developing a retail shopping center. The agreement contains no provision for interest. The Agency is to make repayments to the City out of available tax increment revenues.

If the Agency has not repaid these advances and loan by the time the Agency's ability to collect tax increment revenues expires, then the unpaid purchase price shall be forgiven by the City.

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F. Interfund Transfers

Interfund transfer amounts for the year ended June 30, 2007 were:

	Operating Transfer In	Operating Transfer Out
Special revenue fund	\$ 40,028	\$ 568,560
Capital projects fund		1,866,582
Debt service fund	1,823,617	
Total	\$ 1,863,645	\$ 2,435,142

The variance of \$571,497 between Transfers In and Transfers Out is due to transfers to the City of East Palo Alto.

G. Conduit Debt

The Agency issued \$11 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 Agency. The balance outstanding as of June 30, 2007 is \$8,084,000.

H. Contingencies

The Agency is involved in several lawsuits arising in the normal course of business and relating to eminent domain to acquire real property interests. The ultimate outcome of such litigation is not determinable at the present time.

I. Low and Moderate Income Housing Funds

During the fiscal year, the Agency transferred \$1,724,524 into the Low and Moderate Income Housing Fund representing the 20% of the tax increment that is required to be set-aside and deposited into such funds.

EAST PALO ALTO REDEVELOPMENT AGENCY
Notes to Financial Statements (Continued)
June 30, 2007

J. Settlements

On March 15, 2007 a settlement agreement was reached between the Agency and the Hotel Developers, of the Four Seasons Hotel, related to 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:

- 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.

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November 26, 2007

The Board of Directors of the
East Palo Alto Redevelopment Agency

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance (Including the Provisions Contained in the Guidelines for Compliance Audits of Redevelopment Agencies) and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

We have audited the financial statements of the governmental activities and each major fund of the East Palo Alto Redevelopment Agency (Agency), a component unit of the City of East Palo Alto, California as of and for the year ended June 30, 2007, which collectively comprise the Agency's basic financial statements, as listed in the table of contents, and have issued our report thereon dated November 26, 2007. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the East Palo Alto Redevelopment Agency's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Agency's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the Agency's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Agency's financial statements that is more than inconsequential will not be prevented or detected by the Agency's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Agency's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the basic financial statements of the East Palo Alto Redevelopment Agency are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. Such provisions include those provisions of laws and regulations identified in the Guidelines for Compliance Audits of California Redevelopment Agencies issued by the State Controller's Office, Division of Accounting and Reporting. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards. However, the results of our procedures disclosed an immaterial instance of noncompliance with the provisions described in the Guidelines for Compliance Audits of California Redevelopment Agencies listed below.

Findings:

07-01. The Agency is required by Health and Safety Code Sections 33490 and 33413(b) to adopt Implementation Plans every 5 years. The Implementation Plan of the Agency expired January 2007 and the new Implementation Plan was not adopted until October 2007.

This report is intended for the information of the Board of Directors and management of the East Palo Alto Redevelopment Agency and the State Controller's Office, Division of Accounting and Reporting and is not intended to be and should not be used by anyone other than these specified parties.

Monland & Associates, Inc.