

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Independent Auditor's Reports,
Management's Discussion and Analysis, and
Basic Financial Statements

For The Fiscal Year Ended June 30, 2008

EAST PALO ALTO REDEVELOPMENT AGENCY

For The Fiscal Year Ended June 30, 2008

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MACIAS GINI & O'CONNELL LLP
CERTIFIED PUBLIC ACCOUNTANTS & MANAGEMENT CONSULTANTS

3000 S Street, Suite 300
Sacramento, CA 95816
916.928.4600

2175 N. California Boulevard, Suite 645
Walnut Creek, CA 94596
925.274.0190

515 S. Figueroa Street, Suite 325
Los Angeles, CA 90071
213.286.6400

402 West Broadway, Suite 400
San Diego, CA 92101
619.573.1112

The Board of Directors of the
East Palo Alto Redevelopment Agency
East Palo Alto, California

Independent Auditor's Report

We have audited the accompanying financial statements of the governmental activities and each major fund of the East Palo Alto Redevelopment Agency, California (Agency), a component unit of the City of East Palo Alto, California, as of and for the fiscal year ended June 30, 2008, 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'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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the 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, 2008, and the respective changes in financial position, thereof for the fiscal 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 December 26, 2008, on our consideration of the Agency's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and 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 budgetary comparison schedule – special revenue fund as listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. 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.

Macias Gini & Connell LLP
Certified Public Accountants
Walnut Creek, California

December 26, 2008

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, 2008. 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

In spite of current economic conditions, the Agency continues to attract development interest. A new development, known as University Palms, recently commenced the initial phases of construction including relocation of existing residential and commercial tenants and, demolition of existing structures in order to proceed with approximately 207,000 square feet of office development including approximately 24,000 square feet of retail. Additionally, another development site known as Cummings Park completed its final phase of construction of 22,000 square feet of commercial space and 34 residential units. The sale of residential units in the project have been slow, reflecting current market conditions. However, the project sponsor experienced notable success in auctioning units. Several of the retail spaces have been leased and are currently being occupied, including a Jamba Juice, dental office and a full service restaurant and bar which opened in October 2008.

The previously vacant Home Expo site is currently under renovation and two new stores - a Nordstrom Rack and Sports Authority, are scheduled to open in the third quarter of the 2008-2009 fiscal year. These projects are expected to add to the future assessed value of property within the Agency's boundaries as well as sales tax to the City of East Palo Alto's (the City) General Fund. Other urban in-fill development projects are being delayed given current financial market conditions.

The Agency continues to utilize cash reserves to reduce the debt owed the City. However, the rate of repayment has decline compared to recent years. The Agency's primary revenue source is property tax increment, which decreased by \$765,000 during the current fiscal year; resulting mainly from one-time supplemental payments received in the prior year for the resale of the University Circle Project Area's three class A office buildings.

The following are some key financial highlights for the fiscal year ending June 30, 2008:

- The liabilities exceeded assets by \$17.2M (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 27 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 California redevelopment agencies, management must carefully balance the Agency's current and future resources between debt obligations and development activities.
- The net deficit decreased approximately \$8.3M. This decrease is the result of \$2.7M in current income and approximately \$5.6M primarily due to a prior period audit adjustment. Information related to this prior period adjustment can be found on page 24 of the financial statement.

- Total assets increased approximately \$3.8M. The increase is due mainly to current year net operating income of \$2.7 million and the receipt of proceeds of approximately \$1.3 million in cash from the City's General Fund to fund the operating deficit in the Ravenswood Project Area.
- Total liabilities decreased approximately \$4.5M. The decrease is primarily due to a prior period audit adjustment of \$5.6M to correct the Agency's pass-through obligation. This decrease is offset by an increase of \$1.3M mainly due to an increase in the loan amount the Agency owes the City's General Fund.
- Government-wide revenues decreased approximately \$275,000. The slight decrease is primarily due to a \$765,000 reduction in property tax; offset by an increase in investment earnings of \$490,000.
- Government-wide expenditures increased approximately \$741,000. Of this increase, \$342,000 resulted from higher pass-through payments to taxing agencies. Most of this increase was a result of the increased tax increment being generated in the University Circle Project Area. The remaining increase of \$399,000 is mainly related to the increased expenditure activity in the completion of phase one capital improvements to Bay Road.

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 \$17.2M. 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 \$41.0M consist of current and other assets of \$40.0M and capital assets of \$1.0M. Current and other assets increased by \$3.8 as a result of an increase in cash resulting from a \$2.8M operating income at the end of the fiscal year. The remaining difference is due to the transfer of cash from the City's General Fund to offset the operating deficit in Ravenswood.

Ravenswood is the last project area within the City to be developed. As a result, this project area requires staffing resources and consulting services to develop the project. There has been progress made towards the completion of the Engineers Report, which will identify the infrastructure needs for the project and provide the Agency with a basis to begin the task of developing a financing plan to underwrite the cost of building such infrastructure in the project area. It's anticipated that the cost of the improvements will be expensive. Therefore, the need exists to fiscally merge Ravenswood with the other two project areas (University Circle & Gateway 101) to achieve a sufficiently broad financing vehicle (such as an assessment district)

to pay the costs required to build such infrastructure. As such, the Agency has hired a consulting firm to conduct a fiscal merger study to determine the feasibility of such a merger ensuring compliance with redevelopment law.

- Total liabilities of \$58.3M consist of \$2.2M of current liabilities and \$56.1M of long-term debt. Total liabilities net reduction of \$4.5M is comprised of a \$6.2M decrease to liabilities; offset by an increase of \$1.7M.

The \$6.2M in reductions resulted from a restatement of \$5.6M in pass-through obligations; whereby the Agency agreed that this amount is not truly a liability of the Agency, but rather a commitment that should the Agency generate enough tax increment, those payments will be paid. If however, the Agency does not generate enough tax increment to make those payments, the Agency does not have an obligation to make those payments. The remaining difference of \$600,000 is mainly due to the payment of bond principal.

The \$1.7M offset consists of an advance made to the Agency from the General Fund of \$1.3M and \$400,000 to other liabilities accounts such as account payable and interest payable. The Ravenswood Redevelopment Project Area does not generate enough tax increment to cover its operating costs. In order to cover those costs, it requires an advance from the General Fund; whereby repayments will be made upon available tax increment in future years.

- Of the Agency's total deficit of \$17.2M; \$10.6M is restricted for low and moderate-income housing, and, \$19.9M is restricted for debt payments related to bonds issued by Agency and the PFA. The unrestricted net deficit balance is \$48.7M.

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

	<u>Governmental Activities</u>	
	<u>2008</u>	<u>2007</u>
Assets:		
Current and other assets	\$ 40,038	\$ 36,367
Capital assets	<u>975</u>	<u>825</u>
Total Assets	<u>41,013</u>	<u>37,192</u>
Liabilities:		
Current and other liabilities	2,174	2,526
Long-term liabilities	<u>56,089</u>	<u>60,237</u>
Total Liabilities	<u>58,263</u>	<u>62,763</u>
Net Assets:		
Investment in capital, net of debt	975	825
Restricted for:		
Low and moderate income housing	10,602	9,616
Debt service	19,882	19,442
Unrestricted	<u>(48,709)</u>	<u>(55,453)</u>
Total Net Assets (Deficit)	<u>\$ (17,250)</u>	<u>\$ (25,570)</u>

Analysis of Changes in Net Assets (Deficit)

Key financial elements to the changes in the net assets (deficit) of the Agency of \$8.3M are as follows:

CITY OF EAST PALO ALTO REDEVELOPMENT AGENCY
STATEMENT OF ACTIVITIES
(Dollars in thousands)

	Governmental Activities	
	2008	2007
Revenues:		
General revenues:		
Property taxes	\$ 7,857	\$ 8,623
Investment earnings	1,816	1,326
	9,673	9,949
Total Revenues		
Expenses:		
Program expenses:		
General government	653	564
Public works	77	-
Community development	2,307	1,855
Intergovernmental	612	571
Interest on long-term debt	3,268	3,186
	6,917	6,176
Total		
Increase (Decrease) in Net Assets	2,756	3,773
Beginning Net Assets, as previously reported	(25,570)	(29,343)
Prior Period adjustment	5,564	-
Beginning Net Assets, as restated	(20,006)	(29,343)
Ending Net Assets	\$ (17,250)	\$ (25,570)

- Fiscal Year ending 2008 total revenues was approximately \$9.7M; a decrease of \$276,000 or 3% from the prior year. This decrease is the result of a decrease in property tax increment revenue of \$766,000; offset by an increase of approximately \$490,000 in investment earnings. The reduction in property tax for the current year resulted from one-time supplemental payment paid in the prior year to the Agency and not a result of declined assessed valuation. The increase in investment earnings in the current year is a direct result an early termination of the 2005 investment agreement with XL Capital which was downgraded due to the number of sub-prime loans it had guaranteed. XL Capital was obligated to pay a breakage fee for opting out of the investment agreement with the East Palo Alto Public Financing Authority and to cover any additional cost associated with obtaining another investment agreement with another provider, in this case GE Capital.
- Total expenses were approximately \$6.9M; an increase of \$741,000 or 12% over the prior year. Approximately \$342,000 or 46% of this increase related to an increase in pass-through payments to other taxing agencies. This obligation is based on tax increment and in some cases

the taxing formula increases each year, resulting in higher payments to some taxing entities. The remaining increase is the result of an increase of redevelopment activities over the prior year. Such activities are the completion of improvements to Bay Road Phase I project, which required redevelopment funding as a local match to the federal grant. It also required the funding of a project engineer to oversee the project. Furthermore, the increased costs associated with personnel salaries and benefits and the need to consult with legal counsel on redevelopment matters.

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, 2008, the Agency reported combined fund balances of \$37.0M compared to \$33.3M at June 30, 2007, an increase of \$3.7M. This is the result of a significant increase in assets related to cash balance at June 30, 2008. This increase resulted from prior year's property tax revenue generated in the University Circle Project Area due to the resale of the three office buildings within the City 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 \$5.4M. Fund balance increased approximately \$2.3M. 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 27 of the financial statements. As of June 30, 2008, the Agency's bonded indebtedness was \$42.8M, comprised of the 1999 Bond Issue of \$16.4M; the 2003 Bond Refunding of \$8.4M; and, the 2005 Authority Bond issue of \$18.0M. These bonds are secured by future property tax increment revenue. Debt service expenditures include \$2.4M in interest payments and \$420,000 in bond principal payments.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS

- Overall property taxes for the Agency are expected to decline for the upcoming fiscal year as overall economic conditions continue to reflect weakness. A continuation of such conditions will likely lead to an increase in appeal petitions by property owners to the County Tax Assessor for reductions in assessed residential and commercial property valuation.
- Two new retail stores are expected to open by spring of 2009.
- State action in response to budget challenges resulted in a shift of tax increment of \$671,251 to the Educational Relief Augmentation Fund (ERAF) by the Agency in Fiscal Year 2008-09.
- The Agency is also expected to comply with AB 1389 which requires redevelopment agencies to make up millions in missed or unreported pass-through payments to schools and community colleges over the past five years. The Agency is currently reviewing the impact of this bill and may be required to make additional pass-through payments in the upcoming fiscal year. The San Mateo County Investment Pool sustained a loss of \$150 million in its investments related to the Lehman Brothers bankruptcy filing. The City's share of the investment loss is an estimated \$1.1 million. This loss will be distributed proportionately across all City funds including the Agency.

Some of these factors were considered in preparing the Agency's operating budget for FY 2008-09. Others occurred after the Agency had finalized its budget and will taken those factors under consideration as when it amends the FY08-09 budget.

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.

GOVERNMENT – WIDE FINANCIAL STATEMENTS

EAST PALO ALTO REDEVELOPMENT AGENCY

Statement of Net Assets (Deficit)

Governmental Activities

June 30, 2008

Assets:

Cash and investments	\$ 11,310,379
Accrued interest receivable	132,910
Deposits and prepayments	97,650
Restricted cash and investments	19,881,567
Property held for resale	537,429
Notes receivable	6,660,000
Deferred charges	1,417,617
Capital assets:	
Nondepreciable	<u>975,041</u>
Total assets	<u>41,012,593</u>

Liabilities:

Accounts payable	1,160,180
Interest payable	590,799
Deposits	102,605
Accrued liabilities	37,284
Advances from developers	283,015
Long-term debt:	
Due within one year	480,480
Due in more than one year	<u>55,608,141</u>
Total liabilities	<u>58,262,504</u>

Net assets (deficit):

Invested in capital assets	975,041
Restricted for low and moderate income housing	10,601,585
Restricted for debt services	19,881,567
Unrestricted	<u>(48,708,104)</u>
Total net deficit	<u>\$ (17,249,911)</u>

See accompanying notes to the basic financial statements.

EAST PALO ALTO REDEVELOPMENT AGENCY

Statement of Activities

Governmental Activities

For the Fiscal Year Ended June 30, 2008

Expenses	
General government	\$ 652,634
Public works	77,627
Community development	2,307,391
Intergovernmental	611,525
Interest and fiscal charges	3,267,716
Total expenses	<u>6,916,893</u>
General revenues	
Property tax increment	7,857,564
Unrestricted investment income	1,815,705
Total general revenues	<u>9,673,269</u>
Change in net assets	<u>2,756,376</u>
Net deficit, beginning of year, as previously reported	(25,570,306)
Prior period adjustment	5,564,019
Net deficit, beginning of year, as restated	<u>(20,006,287)</u>
Net deficit, end of year	<u><u>\$ (17,249,911)</u></u>

See accompanying notes to the basic financial statements.

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FUND FINANCIAL STATEMENTS

EAST PALO ALTO REDEVELOPMENT AGENCY

Balance Sheet
Governmental Funds
June 30, 2008

	Special	Capital Projects Funds			Debt	Total
	Revenue Fund	Gateway/101	University Circle	Ravenswood	Service Fund	
Assets						
Cash and investments	\$ 3,914,665	\$ 362,393	\$ 5,274,687	\$ 568,080	\$ 1,190,554	\$ 11,310,379
Accrued interest receivable	86,920	2,332	42,326	1,332	-	132,910
Deposits and prepayments	-	86,157	11,493	-	-	97,650
Restricted cash and investments	-	-	-	-	19,881,567	19,881,567
Property held for resale	-	537,429	-	-	-	537,429
Notes receivable	6,600,000	60,000	-	-	-	6,660,000
Total assets	\$ 10,601,585	\$ 1,048,311	\$ 5,328,506	\$ 569,412	\$ 21,072,121	\$ 38,619,935
Liabilities and fund balances						
Liabilities:						
Accounts payable	\$ -	\$ 388,003	\$ 605,117	\$ 164,825	\$ 2,235	\$ 1,160,180
Deposits	-	91,112	11,493	-	-	102,605
Accrued liabilities	-	2,637	-	34,647	-	37,284
Advances from developers	-	1,590	-	281,425	-	283,015
Total liabilities	-	483,342	616,610	480,897	2,235	1,583,084
Fund balances:						
Reserved for:						
Capital projects	-	264,382	-	-	-	264,382
Debt service	-	-	-	-	21,069,886	21,069,886
Encumbrances	-	2,642	-	287,369	-	290,011
Notes receivable	6,600,000	60,000	-	-	-	6,660,000
Property held for resale	-	537,429	-	-	-	537,429
Unreserved:						
Reported in:						
Special revenue fund	4,001,585	-	-	-	-	4,001,585
Capital project funds	-	(299,484)	4,711,896	(198,854)	-	4,213,558
Total fund balances	10,601,585	564,969	4,711,896	88,515	21,069,886	37,036,851
Total liabilities and fund balances	\$ 10,601,585	\$ 1,048,311	\$ 5,328,506	\$ 569,412	\$ 21,072,121	\$ 38,619,935

See accompanying notes to the basic financial statements.

EAST PALO ALTO REDEVELOPMENT AGENCY
 Reconciliation of the Balance Sheet of Governmental Funds to the
 Statement of Net Assets (Deficit) - Governmental Activities
 June 30, 2008

Fund balances - total governmental funds	\$ 37,036,851
<p>Amounts reported for governmental activities in the statement of net assets are different because:</p>	
<p>Bonds 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.</p>	
Deferred charges, net of accumulated amortization	1,417,617
<p>Capital assets are recorded as assets in the statement of net assets.</p>	
	975,041
<p>Interest payable on long-term debt is not accrued as a liability in the balance sheet of governmental funds.</p>	
	(590,799)
<p>Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the governmental funds.</p>	
Bonds payable	\$(43,529,852)
Advances from the City	(12,558,769)
	<u>(56,088,621)</u>
Net assets (deficit) of governmental activities	<u><u>\$(17,249,911)</u></u>

See accompanying notes to the basic financial statements.

EAST PALO ALTO REDEVELOPMENT AGENCY
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Fiscal Year Ended June 30, 2008

	Special	Capital Projects Funds			Debt	Total
	Revenue Fund	Gateway/101	University Circle	Ravenswood	Service Fund	
Revenues:						
Property taxes	\$ 1,571,513	\$ 2,415,369	\$ 3,305,697	\$ 564,985	\$ -	\$ 7,857,564
Interest	199,276	3,801	174,188	5,780	1,432,660	1,815,705
Total revenues	1,770,789	2,419,170	3,479,885	570,765	1,432,660	9,673,269
Expenditures:						
Current:						
General government	-	97,907	130,527	424,200	-	652,634
Public works	-	-	-	77,627	-	77,627
Community development	218,359	240,174	166,315	525,488	-	1,150,336
Administration	-	21,281	28,792	3,956	6,803	60,832
Tax increment pass-throughs	-	399,538	600,236	96,449	-	1,096,223
Intergovernmental	-	-	611,525	-	-	611,525
Capital outlay	-	-	-	149,836	-	149,836
Debt service:						
Principal	-	-	-	-	420,000	420,000
Interest and fiscal charges	-	-	107,966	553,800	2,380,369	3,042,135
Total expenditures	218,359	758,900	1,645,361	1,831,356	2,807,172	7,261,148
Excess (deficiency) of revenues over (under) expenditures	1,552,430	1,660,270	1,834,524	(1,260,591)	(1,374,512)	2,412,121
Other financing sources (uses)						
Proceeds from advances from City	-	-	-	1,341,400	-	1,341,400
Transfers in	-	-	-	-	1,826,560	1,826,560
Transfers out	(567,077)	(528,358)	(731,125)	-	-	(1,826,560)
Total other financing sources (uses)	(567,077)	(528,358)	(731,125)	1,341,400	1,826,560	1,341,400
Net change in fund balances	985,353	1,131,912	1,103,399	80,809	452,048	3,753,521
Fund balances, beginning of year	9,616,232	(566,943)	3,608,497	7,706	20,617,838	33,283,330
Fund balances, end of year	<u>\$ 10,601,585</u>	<u>\$ 564,969</u>	<u>\$ 4,711,896</u>	<u>\$ 88,515</u>	<u>\$ 21,069,886</u>	<u>\$ 37,036,851</u>

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 – Governmental Activities
For the Fiscal Year Ended June 30, 2008

Net change in fund balances - total governmental funds \$ 3,753,521

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

Governmental funds report capital outlays as expenditures. However in the
statement of activities the cost of these assets is either allocated over their
estimated useful lives and reported as depreciation expense. 149,836

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.

Principal payment on bonds	\$ 420,000	
Proceeds on advances from the City	(1,341,400)	
Amortization of bond premium, discounts, and loss on refundings	35,480	
Amortization of deferred charges	<u>(67,670)</u>	(953,590)

Some expenses reported in the statement of activities do not require the
use of current financial resources and therefore are not reported as
expenditures in governmental funds.

Change in accrued interest	<u>(193,391)</u>
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Change in net assets of governmental activities	<u><u>\$ 2,756,376</u></u>
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See accompanying notes to the basic financial statements.

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**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 1 – Summary of Significant Accounting Policies

(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) Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on the Agency's activities. For the most part, the effect of interfund activity has been removed from these statements. The Agency is only engaged in governmental activities, which normally are supported by taxes and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include (1) charges to customers or applicants who purchase, use or directly benefit from goods, services or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. The Agency did not have program revenue for the year ended June 30, 2008. Taxes and other items not properly included among program revenues are reported instead as general revenues.

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 2 – Summary of Significant Accounting Policies

(b) Measurement Focus, Basis of Accounting and Financial Statement Presentation

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available if they are collected within 60 days of the end of the current fiscal year. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when payment is due.

Property taxes and interest associated with the current fiscal period are all considered being susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when the Agency receives cash.

The Agency reports the following major governmental funds:

- The *Special Revenue Fund* is used to account for 20% portion of the Agency's tax increment revenues and other sources that are required to be set-aside for low and moderate income housing and related expenditures.
- The *Capital Projects Fund* is used to account for resources restricted for the acquisition or construction of specific capital projects or items. The Agency has three distinct project areas – Gateway/101, University Circle, and Ravenswood.
- The *Debt Service Fund* is used to account for the accumulation of financial resources for the payment of principal and interest on the long-term debt of the Agency. Property tax increment is used for the payment and interest on the Agency's debt.

(c) Cash and Investments

The Agency's cash and investments, excluding restricted cash and investments, are pooled with the City's cash and investment pool. Statutes, the City's investment and the Agency policies authorize the City to invest in the State Local Agency Investment Fund, the San Mateo County Pool Investment Program, securities of the U.S. and other government issues, bankers' acceptances, commercial paper, negotiable certificates of deposit, repurchase agreements, medium-term corporate notes, mutual funds as permitted by the California Government Code and nonnegotiable certificates of deposits. Investments are stated at fair value. The fair value of investments is determined annually and is based on current market prices. Investment income earned on the commingled pool is allocated quarterly among the funds based upon the average monthly balance of cash maintained by each fund.

Cash and investments that are restricted for specified uses by bonded debt or other requirements are classified as restricted cash and investments.

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 2 – Summary of Significant Accounting Policies (Continued)

(d) 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.

(e) Property Tax Incremental Revenues

Incremental property tax revenues represent taxes collected on the project area from the excess of taxes levied and collected over that amount which was levied and collected in the base year (the year of project inception) property tax assessment.

The County of San Mateo (County) assesses properties and bills for and collects property taxes as follows:

	<u>Secured</u>	<u>Unsecured</u>
Valuation/lien dates	January 1	January 1
Levy dates	On or before November 1	July 1
Due dates (delinquent after)	50% on November 1 (December 10) 50% on February 1 (April 10)	July 1 (August 31)

The term “unsecured” refers to taxes on personal property other than land and buildings. Secured taxes are secured by liens on the property being taxed. The County bills and collects property taxes and remits to the Agency its share of the amount levied less administrative fees.

(f) 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.

(g) Property 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 expenditure in the fund carrying the land as an asset.

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 2 – Summary of Significant Accounting Policies (Continued)

(h) 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, 2008 totaled \$1,676,380.

(i) Net Assets

The government-wide financial statements utilize a net assets presentation. Net assets are categorized as restricted and unrestricted.

Invested In Capital Assets – This category groups all capital assets net of accumulated depreciation into one component of net assets.

Restricted Net Assets – This category presents external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

Unrestricted Net Assets – This category represents net assets of the Agency, not restricted for any project or other purpose.

(j) Restatement of Net Assets

Based on the pass-through agreements entered into by the Agency in 1998 with the Menlo Park Fire District and East Palo Alto Sanitary District, the Agency is to pay 10.24% and 3.968%, respectively, of tax increment received by the Agency from the University Circle Project Area to help defray the costs incurred. In the event that the Agency is not able to make the payment, the payment will be deferred to future years when tax increment is available. If the Agency has not repaid the balance by the time of the Agency's ability to collect tax increment revenues expires, then the unpaid balance will be forgiven. During fiscal year 2008, the Agency re-evaluated its assessment on the terms of the pass-through agreement and determined that the underpayment in prior years did not constitute liabilities to the Agency. Instead, the agreements represent the Agency's commitment to pay when future tax increment is received. As a result, the June 30, 2007 beginning net assets were restated in the amount of \$5,564,019 representing the removal of the long term debt related to the pass-through agreements at June 30, 2007.

(k) Estimates

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

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 3 – Cash and Investments

Investments in City Pool

The Agency's cash and investments, excluding deposits and investments with fiscal agents, are invested in the City's cash and investment pool. The City's pooled investment account possesses the characteristics of a demand deposit account, and consists of cash in banks, State Treasurer's Local Agency Investment Fund, State Local Agency Investment Fund and the San Mateo County Pool Investment Program. At June 30, 2008, the Agency invested \$11,310,379 in the City's cash and investment pool.

Interest Rate Risk

As a means of limiting its exposure to fair value losses arising from rising interest rates, the City's investment policy limits the weighted average maturity of the City's cash and investment pool to less than five years.

Additional information regarding custodial credit risk, interest rate risk and concentration of credit risk of the City's pooled cash and investments is presented in Note III(a) of the City's basic financial statements.

Deposits and Investments with Fiscal Agent

Included in the Agency's restricted cash and investments at June 30, 2008 are investments in mutual funds and a guaranteed investment contract held by a fiscal agent. Investments have been made only as permitted by specific State statutes governing their investment or applicable Agency resolution or bond indenture. These investments have been classified as restricted on the statement of net assets and balance sheet because their use is limited by bond covenants.

Credit Risk

The Agency's investment policy limits mutual funds to be consisted of securities and obligations of the U.S. Government and limits to the highest ranking or the highest letter and numerical rating by not less than two of the three nationally recognized rating services.

A summary of the Agency's deposits and investments with fiscal agent at June 30, 2008 is shown below:

	Credit Rating	Fair Value	Investment Maturity (in years)			
			Less than 1	1-2	2-5	More than 5
Guaranteed Investment Agreement with General Electric Funding Capital	Not Rated	\$ 16,678,833	\$ -	\$ 16,678,833	\$ -	\$ -
Guaranteed Investment Agreement with Bear Stearns Capital Markets, Inc.	Not Rated	1,966,397	-	-	-	1,966,397
Money market mutual fund - Wells Fargo Advantage 100% Treasury	AAAm	1,236,337	1,236,337	-	-	-
Total		<u>\$ 19,881,567</u>	<u>\$ 1,236,337</u>	<u>\$ 16,678,833</u>	<u>\$ -</u>	<u>\$ 1,966,397</u>

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 4 – Notes Receivable

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. In addition, a \$1,100,000 note is payable by Nugent Square Partners, LLP at 1% per annum due January 2045 and a \$60,000 note is payable by a local business at 8% per annum due March 2014.

NOTE 5 – Property Held for Resale

The property held for resale balance at June 30, 2008 of \$537,429 represents 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.

NOTE 6 – Capital Assets

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

	<u>Balance at July 1, 2007</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at June 30, 2008</u>
Capital assets, not being depreciated:				
Land	\$ 263,235	\$ -	\$ -	\$ 263,235
Construction in progress	561,970	149,836	-	711,806
Total capital assets	<u>\$ 825,205</u>	<u>\$ 149,836</u>	<u>\$ -</u>	<u>\$ 975,041</u>

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 7 – Long-Term Debt

A summary of changes in long-term debt during the year ended June 30, 2008, follows:

	Balance July 1, 2007	Additions	Retirements	Balance June 30, 2008	Due Within One Year
Bonds:					
1999 Tax allocation bonds	\$ 16,760,000	\$ -	\$ (350,000)	\$ 16,410,000	\$ 370,000
2003 Tax allocation bonds	8,460,000	-	(70,000)	8,390,000	75,000
2005 Authority bonds	17,995,000	-	-	17,995,000	-
Unamortized premium, discounts, and loss on refundings	770,332	-	(35,480)	734,852	35,480
Advances and loans from the City	11,217,369	1,341,400	-	12,558,769	-
Total	\$ 55,202,701	\$ 1,341,400	\$ (455,480)	\$ 56,088,621	\$ 480,480

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, \$1,656,713 is held in a bond reserve fund with a trustee at June 30, 2008.

The bonds bear interest at rates of 4.2% to 6.625% 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 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.

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 7 – Long-Term Debt (Continued)

Future debt service on the 1999 bonds at June 30, 2008, assuming no redemptions of the 1999 bonds other than scheduled mandatory sinking account redemption are as follows:

Year ending June 30:	Principal	Interest	Total
2009	\$ 370,000	\$ 1,048,167	\$ 1,418,167
2010	390,000	1,027,498	1,417,498
2011	410,000	1,005,088	1,415,088
2012	435,000	980,571	1,415,571
2013	460,000	953,938	1,413,938
2014-2018	2,765,000	4,292,628	7,057,628
2019-2023	3,780,000	3,239,546	7,019,546
2024-2028	5,205,000	1,766,061	6,971,061
2029-2030	2,595,000	174,735	2,769,735
Total	<u>\$ 16,410,000</u>	<u>\$ 14,488,232</u>	<u>\$ 30,898,232</u>

The 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% to 6.45% 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 Agency on or after October 1, 2013, at a redemption price of par, together with accrued interest to the date fixed for redemption.

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 7 – Long-Term Debt (Continued)

Future debt service on the 2003A bonds at June 30, 2008, assuming no redemptions of the 2003A bonds other than scheduled mandatory sinking account redemption are as follows:

Year ending June 30:	Principal	Interest	Total
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	15,000	248,850	263,850
2014-2018	80,000	1,234,231	1,314,231
2019-2023	105,000	1,212,319	1,317,319
2024-2028	130,000	1,184,125	1,314,125
2029-2033	<u>4,670,000</u>	<u>817,000</u>	<u>5,487,000</u>
Total	<u>\$ 5,060,000</u>	<u>\$ 5,697,925</u>	<u>\$ 10,757,925</u>

Future debt service on the 2003B bonds at June 30, 2008, assuming no redemptions of the 2003B bonds other than scheduled mandatory sinking account redemption are as follows:

Year ending June 30:	Principal	Interest	Total
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	75,000	191,276	266,276
2014-2018	450,000	882,376	1,332,376
2019-2023	600,000	721,178	1,321,178
2024-2028	825,000	498,888	1,323,888
2029-2033	<u>1,115,000</u>	<u>188,501</u>	<u>1,303,501</u>
Total	<u>\$ 3,330,000</u>	<u>\$ 3,284,739</u>	<u>\$ 6,614,739</u>

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 7 – Long-Term Debt (Continued)

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 General Electric Capital Funding. 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 Agency 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% 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.

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 7 – Long-Term Debt (Continued)

Future debt service on the 2005 bonds at June 30, 2008, assuming no redemptions of the 2005 bonds other than scheduled mandatory sinking account redemption was:

Year ending June 30:	Principal	Interest	Total
2009	\$ -	\$ 846,644	\$ 846,644
2010	-	846,644	846,644
2011	580,000	836,784	1,416,784
2012	600,000	816,424	1,416,424
2013	620,000	794,454	1,414,454
2014-2018	3,520,000	3,523,322	7,043,322
2019-2023	4,425,000	2,604,335	7,029,335
2024-2028	5,600,000	1,390,500	6,990,500
2029-2030	2,650,000	134,250	2,784,250
Total	<u>\$ 17,995,000</u>	<u>\$ 11,793,357</u>	<u>\$ 29,788,357</u>

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. At June 30, 2008, the outstanding balance was comprised of two advances totaled to \$12,558,769.

The first advance was for the ongoing assistance and services in connection with the implementation of the redevelopment plan for the Ravenswood Project Area. There was no repayment schedule and the repayment of the advance is limited to property tax increment revenues. The rate of interest on the advance is 12%. During the year ended June 30, 2008, the Agency received proceeds of \$1,341,400 on the advance from the City. At June 30, 2008, the Agency's ending advance balance was \$5,956,400.

The second advance was for the funding of the Ravenswood High School Site that developed into a retail shopping center. There was no interest provision or repayment schedule and the repayment of this advance is limited to property tax increment revenues. The ending advance balance at June 30, 2008 was \$6,602,369.

If the Agency has not repaid these advances by the time of the Agency's ability to collect tax increment revenues expires, then the unpaid portion of the advances will be forgiven.

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 8 – Net Asset Deficit

The Agency’s governmental activities liabilities exceeded assets by \$17,249,911. The Agency carries a deficit to collect tax increment due to the nature of tax increment financing method allowed under California law. In California a redevelopment agency issues bonds or incurs long-term debt to finance its redevelopment projects by pledging future tax increment revenues. The Agency uses the debt proceeds to finance its redevelopment projects which are maintained by the City. As a result, the public facilities are recorded as assets of the City but the related debt issued to finance these projects remains with the Agency.

NOTE 9 – Interfund Transfers

The Agency records transfers between funds to cover scheduled debt service payment. Interfund transfer amounts for the year ended June 30, 2008 were as follows:

	Transfer In	Transfer Out
Special revenue fund	\$ -	\$ 567,077
Capital projects fund - Gateway/101	-	528,358
Capital projects fund - University Circle	-	731,125
Debt service fund	1,826,560	-
Total	\$ 1,826,560	\$ 1,826,560

NOTE 10 – 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, 2008 is \$7,945,000.

NOTE 11 – Risk Management

The Agency is exposed to various risks of loss related to torts, theft of, damage and destruction of assets, errors and omissions, and natural disasters. The Agency, as a component unit of the City, was covered with respect to certain risks from the City’s commercial insurance policies. Additional disclosures required under GASB Statements No. 10 and No. 30 and information regarding the City’s insurance is presented in the notes to the City’s basic financial statements.

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 12 - Commitments and Contingencies

Long-Term Pass-Throughs

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) 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, 2008, the total commitment was \$3,865,386.

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, 2008, the total commitment was \$923,068.

Low and Moderate Income Housing Funds

During the fiscal year, the Low and Moderate Income Housing Fund received property tax revenue of \$1,571,513 representing the 20% of the tax increment that is required to be set-aside and deposited into such funds.

Transient Occupancy Tax 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 (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 commitment of the Agency to reimburse the City from future tax increment generated from the University Circle Project. As of June 30, 2008, the hotel collected \$3,858,217 in TOT, of which \$1,000,000 was sent to the City, leaving a net balance of \$2,858,217 million that was retained by the hotel developers. The Agency reimbursed the City's General Fund \$1,223,050 of the estimated \$2,858,217 current commitment, leaving a commitment amount of approximately \$1,635,167. In 2009, the Agency budgeted to repay an additional \$668,000 of TOT to the City's General Fund.

**EAST PALO ALTO
REDEVELOPMENT AGENCY**

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2008

NOTE 13 - SUBSEQUENT EVENTS

Investments in the San Mateo Investment Pool

The credit crisis subsequent to June 30, 2008, moved beyond its origins in subprime mortgages and began to accelerate in September. The financial market experienced an unprecedented turbulence, and the values of most securities declined significantly. Given the volatility of the financial market, readers of financial statements must also consider the current financial information.

On September 15, 2008, Lehman Brothers Holdings Inc. (Lehman) declared bankruptcy sending shockwaves throughout the global financial market. Its action had a direct, negative impact on the San Mateo County Investment Pool (County Pool) in an amount of approximately \$155 million as of September 30, 2008. The Lehman securities represented 6.0% of the \$2.6 billion County investment pool at cost as of September 30, 2008. The County Treasurer marked their investment in Lehman down to zero and charged all pool participant accounts a one-time expense based on their respective average daily cash balances to reflect the reduction in value. The City's share of this one-time expense is approximately \$1.1 million. This loss will be distributed proportionately across all City funds including the Agency.

Educational Revenue Augmentation Fund

On September 23, 2008, AB 1389 was signed into law requiring redevelopment agencies statewide to shift a one-time \$350 million of property tax increment to the State's Educational Revenue Augmentation Fund (ERAF) as a way to reduce the State's \$15.2 billion budget deficit for fiscal year 2008-09. The ERAF money will then be paid to schools and community colleges, relieving the State of payments. The Agency's share of this revenue shift is approximately \$671,000 and payment is to be made by May 10, 2009.

EAST PALO ALTO REDEVELOPMENT AGENCY
Low and Moderate Income Housing Special Revenue Fund
Budgetary Comparison Schedule
For the Fiscal Year Ended June 30, 2008

	Budgeted Amounts		Actual Amounts	Positive (Negative) Variance with Final Budget
	Original	Final		
Fund balance, beginning of year	\$ 9,616,232	\$ 9,616,232	\$ 9,616,232	\$ -
Resources (inflows):				
Taxes and assessments	1,424,735	1,521,560	1,571,513	49,953
Interest	-	-	199,276	199,276
Amount available for appropriations	<u>1,424,735</u>	<u>1,521,560</u>	<u>1,770,789</u>	<u>249,229</u>
Charges to appropriations (outflows):				
Current:				
Community development	248,361	216,841	218,359	(1,518)
Transfers out	804,259	760,779	567,077	193,702
Total charges to appropriations	<u>1,052,620</u>	<u>977,620</u>	<u>785,436</u>	<u>192,184</u>
Resources over (under) charges to appropriations	<u>372,115</u>	<u>543,940</u>	<u>985,353</u>	<u>441,413</u>
Fund balance, end of year	<u>\$ 9,988,347</u>	<u>\$ 10,160,172</u>	<u>\$ 10,601,585</u>	<u>\$ 441,413</u>

See accompanying note to required supplementary information.

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MACIAS GINI & O'CONNELL LLP
CERTIFIED PUBLIC ACCOUNTANTS & MANAGEMENT CONSULTANTS

3000 S Street, Suite 300
Sacramento, CA 95816
916.928.4600

2175 N. California Boulevard, Suite 645
Walnut Creek, CA 94596
925.274.0190

515 S. Figueroa Street, Suite 325
Los Angeles, CA 90071
213.286.6400

402 West Broadway, Suite 400
San Diego, CA 92101
619.573.1112

The Board of Directors of the
East Palo Alto Redevelopment Agency
East Palo Alto, California

**Independent Auditor's Report on Internal Control over Financial Reporting and on
Compliance 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, California (Agency), a component unit of the City of East Palo Alto, California, as of and for the fiscal year ended June 30, 2008, which collectively comprise the Agency's basic financial statements, and have issued our report thereon dated December 26, 2008. 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 Agency's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion 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 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 the 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 the internal control over financial reporting that we consider to be material weaknesses, as described above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Agency's financial statements 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 and as interpreted in the *Suggested Auditing Procedures for Accomplishing Compliance Audits of California Redevelopment Agencies*, issued by the Governmental Accounting and Auditing Committee of the California Society of Certified Public Accountants. 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 instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of the Members of the Agency Board, management and the State Controller and is not intended to be and should not be used by anyone other than these specified parties.


Certified Public Accountants
Walnut Creek, California

December 26, 2008