

REPORT

To the Honorable Mayor and City Council
From the City Manager

December 17, 2007

SUBJECT

Comprehensive Annual Financial Report for Fiscal Year Ended June 30, 2007

BACKGROUND

The City's independent auditors, Caporicci and Larson, Certified Public Accountants, have completed their audit of the City's financial records and the City's Comprehensive Annual Financial Report (CAFR) for the 2006/07 fiscal year (Attachment 2). This report, which is prepared by the City's Finance Department, summarizes and presents the financial transactions for all funds of the City of Redwood City, the City of Redwood City Redevelopment Agency, and the Port of Redwood City for the fiscal year ended June 30, 2007. Moreover, this report also presents the financial position of the foregoing entities as of June 30, 2007.

The financial statements and notes thereto have been prepared in accordance with the standards set forth by the Governmental Accounting Standards Board and the guidelines established by the Government Finance Officers Association of the United States and Canada.

The 2006 version of Redwood City's report was awarded the Government Finance Officers Association Certificate of Achievement for Excellence in Financial Reporting. This was the 20th consecutive year that the City received this honor. We fully expect that the 2007 report will also receive this award.

This report is technical in nature; hence our staff is available to meet with you to answer any questions you may have concerning the report's contents. You are encouraged to call with any questions you may have.

Under generally accepted auditing standards, independent auditors are encouraged to report matters concerning an entity's internal control structure. As a result of an audit, auditors issue a report titled *Report to Management and City Council*, which addresses areas requiring improvement. This report and staff's responses thereto have been independently reviewed by members of the Audit Committee (Attachment 1).

General Fund Highlights

Revenues

Budgeted Revenue	Actual Revenue	Variance	% Change
\$75,699,043	\$82,660,057	\$6,961,014	9.20

General Fund Revenue Comparison (FY 2005/06 to FY 2006/07)

FY 2005/06 Actual Revenue	FY 2006/07 Actual Revenue	Variance	% Change
\$77,202,089	\$82,660,057	\$5,457,968	7.07

The revenue increases this fiscal year are primarily due to an increase in property taxes, sales and other taxes. Some of the general fund revenue highlights are:

- Property taxes exceeded budget by \$1.3 million primarily due to the receipt of a \$2.6 million payment from the County of San Mateo due to the over-deduction of Education Revenue Augmentation Fund amounts from the City in prior years, which exceeded the estimated amount by \$1 million.
- Sales and other taxes exceeded budget by \$2.6 million mostly due to better than anticipated sales tax revenue (\$1.7 million). The unanticipated receipt of sales taxes attributable to prior period sales and the decrease in sales anticipated due to the Costco expansion, which has since been delayed, account for the increase in sales tax revenue over budget. Other increases in tax revenue include higher utility users' taxes (\$.4 million), transient occupancy taxes (\$.2 million), and business license taxes (\$.2 million).
- Licenses and permits exceed budget by \$.6 million due to higher construction activity during the year.
- Intergovernmental revenue exceeded budget by \$.4 million due to the unanticipated \$.5 million receipt from the state for mandated program reimbursement.
- Charges for services were \$.8 million more than budgeted primarily due to plan checking and planning services revenue related to unanticipated increases in construction activity, along with unanticipated increases in recreation program fees.

The City continues to rely very heavily upon property and sales taxes (exclusive of proposition 172 sales tax revenue) as almost 60% of the general fund revenue is derived from these two sources. Sales taxes provided 23% of general fund revenue while property taxes accounted for 37% of general fund revenue.

Expenditures

Total general fund expenditures for FY 2006/07 were \$69.9 million. This was \$3 million, or 4.5% over the amount expended in FY 2005/06.

Employee costs continue to represent the highest single source of expenditures accounting for 74% of all general fund expenditures.

Transfers

Each year funds are transferred out of the general fund to support the traffic safety fund. In FY 2006/07 \$973,316 was transferred to the traffic safety fund. Also, an amount equal to the utility users' tax revenue less the Public Financing Authority bond payment is transferred to the capital outlay fund. This transfer amounted to \$6.3 million in FY 2006/07. In FY 2006/07 the general fund also transferred \$2.6 million to the capital outlay fund as a one-time support for the construction of the new Redwood Shores Library. A transfer of \$1.1 million dollars was made in FY 2006/07 to the self-insurance fund to help cover a deficit resulting from increased liability in the workers' compensation fund. A \$350,000 transfer was made to the parking fund to help support operating deficit as the new downtown operations has not become self-sufficient.

Fund Balance

The net effect of the revenues, expenditures, transfers, and changes in other fund balance reserves has been an increase of \$2.8 million in the unreserved fund balance (available for any Council designated expenditure) bringing the balance to \$23.9 million. In FY 1999/00, the Council adopted a Finance Committee recommendation to maintain this amount between 15% and 20% of estimated revenues. Applying this formula (using FY 2007/08 budgeted revenues) leaves approximately \$8.5 million in excess fund balance. In view of the financial risks confronting the City, staff recommends that these funds be retained in the general fund to be used to sustain the organization in the event any of these risks materialize or the City experiences the effects of another economic downturn.

Special Revenue Funds Highlights

Special revenue funds are used to account for revenue received from specific taxes or other dedicated revenue sources (other than for major capital projects) restricted by law or administrative action to expenditures for specified purposes.

Property tax increment revenues received by the Redevelopment Agency totaled \$9.5 million in FY 2006/07 compared to \$8.4 million in FY 2005/06. This represents a 13.8% increase arising primarily from the completion of the Downtown Retail Cinema project, which is privately owned.

The transportation fund receives revenue from the San Mateo County Transportation Authority based on the voter approved (Measure A) countywide one-half of one percent sales and use tax levied for transportation-related programs and projects. In FY 2006/07, the City received \$1,314,067 in "Measure A" revenue compared to \$1,278,604 in FY 2005/06. This represents a 3% increase.

Gas tax revenues (received from the state through gasoline taxes paid by motorists) remained relatively level at \$1.438 million in FY 2006/07 compared to \$1.447 million in FY 2005/06. These funds may only be used for roadway maintenance and construction purposes as defined in sections 2105, 2106, and 2107 of the State Streets and Highway Codes. According to the State Board of Equalization there is a slight downward trend in consumption as gasoline prices continue to increase.

Self-Insurance Fund Highlights

The self-insurance internal service fund had positive net cash provided by operating activities of \$255,736. The net activity includes a \$1.1 million dollar general fund transfer recommended by the Audit Committee approved in FY 2006/07 to cover the prior year deficit. The deficit was a result of increased workers' compensation claims costs over the past few years. The \$1.1 million dollar transfer along with the current year decrease in workers' compensation claims costs enabled the City to record the workers' compensation liability at the higher confidence level of 75% for FY 2006/07.

Debt Service Funds Highlights

General Fund (Public Financing Authority Bonds and Lease Revenue Refunding Bonds)
The City issued \$26,715,000 in bonds in 1991 to refinance (at a lower interest rate) the 1986 bonds (issued to fund construction of the Main Fire Station and Main Library) and to provide funds for constructing the Police Facility. In 1998, \$12,160,000 of these bonds was refunded to realize savings from lower interest rates. In FY 2003/04, the City issued \$11,475,000 of bonds to refund the balance (\$6,725,000) of the 1991 bonds and to provide \$4,390,000 for new projects. The annual debt service for both of these bond issues is paid by proceeds from the utility users' tax. During FY 2006/07, a total of \$1,655,000 of principal for both bond issues was retired, leaving a combined balance of \$15,110,000 of debt outstanding as of June 30, 2007. The 1998 bonds will be paid off in July of 2011 and the 2003 bonds will be paid off by July 2018.

Redevelopment Agency

The Redevelopment Agency issued \$16,950,000 of bonds in 1991 to provide funding for capital projects undertaken by the Agency and to satisfy legal requirements that the Agency have sufficient debt to receive the annual property tax increment revenue from the County. These bonds, which were refunded in 1997 to obtain savings from lower interest rates, will be paid off in 2011. During FY 2006/07, \$1,160,000 of principal was retired leaving a balance of \$6,675,000 of debt outstanding as of June 30, 2007.

Additionally, in FY 2003/04 the Redevelopment Agency issued \$33,997,448 of bonds to finance various downtown improvements. These bonds are also the sole responsibility of the Redevelopment Agency and will be paid off by 2032. No principal from the 2003 bonds was paid in FY 2006/07 and will not begin to be paid until FY 2010/11.

Capital Projects Funds Highlights

Capital projects funds are used to account for the resources dedicated to the construction and acquisition of capital facilities, except those capital facilities financed by enterprise funds.

The City expended over \$11.6 million in FY 2006/07 for general capital projects. The more visible projects on which funds were expended in FY 2006/07 are: the Downtown Plaza/Public Space (\$4.1 million), Redwood Shores Library (\$2.7 million), the Sidewalk Replacement Program (\$.7 million), Red Morton Synthetic Turf (\$.5 million), Parks Renovation Program (\$.3 million), and the Storm Drain Collection System (\$.5 million).

During the year ended June 30, 2007, General Improvement District 1-64 facilities fee fund revenue was \$397,196 compared to \$233,544 for the year ended June 30, 2006.

Enterprise Funds Highlights

Water Fund

For the fiscal year ended June 30, 2007, the water enterprise fund had retained earnings available for appropriation of \$10.1 million, including \$8.3 million in the water rate stabilization fund. The net amount of the water rate stabilization fund leaves a balance of \$1.8 million which is \$.7 million short of covering the \$2.0 million emergency reserve and \$500,000 operating reserve that the Council has directed staff to maintain.

In terms of the City Council's adopted policy to keep total annual revenues and expenses in balance, cash basis revenues of \$20.6 million were more than cash operating expenses of \$17.9 million.

Sewer Fund

The same Council policy of total annual revenues and expenses in balance applies to the sewer fund as well. Cash basis revenues of \$15 million were less than cash operating and capital outlays of \$15.1 million due primarily to the increase in the contribution to South Bayside System Authority (SBSA).

For fiscal year ended June 30, 2007, the sewer enterprise fund ended with a deficit balance of (\$.5) million in retained earnings available for appropriation. The operating deficit is attributed to the unanticipated increased contribution amount to the SBSA for FY 2006/07. The City is a member of the South Bayside System Authority JPA, a sewage treatment facility. As a member agency, the City is required to contribute annual amounts established by the SBSA commission to both the operations and capital improvement program. In FY 2006/07, due to public notice requirements required by proposition 218, the sewer rate adjustment was adopted prior to the SBSA Commission approving their new budget for FY 2006/07. This budget included additional member contributions to the capital improvement plan, which had not been previously budgeted. Accordingly, we were unable to charge the full cost of operating the sewer utility to ratepayers in FY 2006/07.

Parking Fund

Redwood City maintains on-street and off-street parking spaces within the downtown area. In FY 2005/06 the City began operations of the new downtown underground parking garage. In FY 2006/07 operating revenues increased to \$862,328 compared to \$438,284 in FY 2005/06, while operating expenses increased to \$1.7 million, an increase of \$1.2 million from FY 2005/06. The increase in operating expenses is attributed to costs associated with the maintenance and operations of the new parking garage and costs associated with public safety patrol in the downtown area. The general fund also transferred \$350,000 to the parking fund to partially cover the operating deficit. The remainder of the deficit was drawn from retained earnings in the parking fund. The result is a net loss for the year ending June 30, 2007 of \$(863,492).

Port

The net assets for the Port increased by \$2.5 million for the fiscal year ended June 30, 2007. Operating revenues decreased from \$6.2 million in FY 2005/06 to \$5.5 million in FY 2006/07 while operating expenses decreased from \$3.6 million in FY 2005/06 to \$3.5 million in FY 2006/07.

ALTERNATIVES

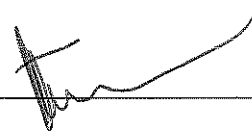
Council could elect not to accept the financial report which would result in additional costs associated with additional field work required to be completed by Caporicci & Larson. The additional field work is required to comply with new auditing guidelines which require that financial reports be published soon after field work is completed.

FISCAL IMPACT

The costs associated with not accepting the financial report will range from \$2,000 to \$3,000 depending on how much additional field work is required. These amounts are currently not budgeted; a budget amendment would be required.



Brian Ponty
Director of Finance and Financial Planning



Peter Ingram
Interim City Manager