

THE REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

A Component Unit of the City of San José, California



COMPREHENSIVE ANNUAL FINANCIAL REPORT FISCAL YEAR ENDED JUNE 30, 2006



10th Largest U.S. City

www.sjredevelopment.org

Photos: Included in this CAFR are photos of some notable redevelopment projects of the Agency. The cover photos from left to right are San Jose Downtown at Night, Tech Museum of Innovation, and Central Place in Downtown.



Children's Discovery Museum



Three Sixty Residences

THE REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

A Component Unit of the City of San José, California

COMPREHENSIVE ANNUAL FINANCIAL REPORT FISCAL YEAR ENDED JUNE 30, 2006

PREPARED BY:

Harry S. Mavrogenes
Executive Director/Chief Administrative Officer

David C. Baum
Director of Finance/Chief Financial Officer
FINANCE DIVISION



Redevelopment Agency of the City of San Jose

(A Component Unit of the City of San José, California)

Comprehensive Annual Financial Report For the Fiscal Year Ended June 30, 2006

Prepared by:

Harry S. Mavrogenes
Executive Director/
Chief Administrative Officer

Norberto Dueñas
Deputy Executive Director

David C. Baum
Director of Finance/Chief Financial Officer

Finance Division

Coordination and Control

Abraham M. Andrade, Jr.
Assistant Director of Finance

Alex R. Guiang
Senior Accountant

Preparation and Assistance

Lupe M. Aguinaga
Fiscal Officer

Dat K. Nguyen
Financial Analyst

Shubha S. Gavali
Fiscal Support Technician

Sandy Shayesteh
Contract Manager

Sydney S. Chui
Financial Analyst

Lily C. Yang
Senior Account Clerk

Shalah A. Hade
Accountant

Justina C. Hsu
Budget Manager

Holly H. Le
Payroll Specialist

Margarita Z. Soria
Fiscal Support Technician

Graphic Design: Paul Asper

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

COMPREHENSIVE ANNUAL FINANCIAL REPORT

Fiscal Year Ended June 30, 2006

TABLE OF CONTENTS

	<u>Table No.</u>	<u>Page No.</u>
INTRODUCTORY SECTION		
Transmittal Letter		1-7
GFOA Certificate of Achievement For Excellence in Financial Reporting		8
Organizational Chart		9
List of Board of Directors		10
Geographic Locator Map		11
FINANCIAL SECTION		
Independent Auditor's Report		12-13
Management's Discussion and Analysis (Required Supplementary Information)		14-26
Basic Financial Statements		
Government-wide Financial Statements		
Statement of Net Assets		27
Statement of Activities		28
Fund Financial Statements		
Balance Sheet - Governmental Funds		29
Reconciliation of the Balance Sheet of Governmental Funds to the Statement of Net Assets of Governmental Activities		30
Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds		31
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities of Governmental Activities		32-33
Notes to the Basic Financial Statements		34-61
Other Required Supplementary Information		
Schedule of Revenues, Expenditures, and Changes in Fund Balances - Budget and Actual on a Budgetary Basis - General Fund		62
Schedule of Revenues, Expenditures, and Changes in Fund Balances - Budget and Actual on a Budgetary Basis - Special Revenue Fund		63
Notes to Other Required Supplementary Information		64-65

(Continued on next page)

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

COMPREHENSIVE ANNUAL FINANCIAL REPORT

Fiscal Year Ended June 30, 2006

TABLE OF CONTENTS (Continued)

	<u>Table No.</u>	<u>Page No.</u>
Other Supplementary Information		
Schedule of Revenues, Expenditures, and Changes in Fund Balances - Budget and Actual on a Budgetary Basis - Other Major Governmental Funds		
Housing Debt Service Fund		66
Merged Debt Service Fund		67
Capital Projects Fund		68
Notes to the Supplementary Information		69-70
 STATISTICAL SECTION		
Description to the Statistical Schedules		71
Net Assets (deficit) by Component - Governmental Activities	Table 1	72
Change in Net Assets - Governmental Activities	Table 2	73
Fund Balances of Governmental Funds	Table 3	74
Changes in Fund Balances of Governmental Funds	Table 4	75
Actual Assessed Value and Tax Increment Revenue - Merged Area Redevelopment Project	Table 5	76
Merged Area Redevelopment Projects - Ten Largest Property Owners	Table 6	77
Debt Profile	Table 7	78
Debt Service Coverage - Governmental Activities	Table 8	79
Project Area and Debt Termination	Table 9	80
Miscellaneous Statistics	Table 10	81
Population and Area of the City of San José	Table 11	82
Operating Indicators By Function	Table 12	83



Dr. Martin Luther King Jr. Library



Plaza de San Jose



Introductory Section

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October 2, 2006

To the Honorable Mayor, Members of the Board of Directors of the
Redevelopment Agency of the City of San José and the
Citizens of the City of San José:

State law requires that the Redevelopment Agency of the City of San José (the Agency) publish a complete set of financial statements presented in conformity with the accounting principles generally accepted in the United States of America (GAAP) applied to governmental entities. The financial statements are to be audited by a certified public accountant in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Pursuant to that requirement, we hereby issue this Comprehensive Annual Financial Report (CAFR) of the Agency for the fiscal year ending June 30, 2006.

This is the 6th consecutive year that the Agency has produced a CAFR, which is prepared in conformance with the Governmental Accounting Standards Board (GASB) Statement 34 reporting model. This report consists of management's representations concerning the finances of the Agency. Consequently, management assumes full responsibility for the completeness and reliability of all the information presented in this report. To provide a reasonable basis for making these representations, the management of the Agency has established a comprehensive internal control framework that is designed both to protect the Agency's assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of the Agency's financial statements in conformity with GAAP. Because the cost of internal controls should not outweigh their benefits, the Agency's comprehensive framework of internal controls has been designed to provide reasonable, rather than absolute, assurance that the financial statements will be free from material misstatement. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

The Agency's financial statements have been audited by Macias Gini & O'Connell LLP, CPAs, a firm of licensed certified public accountants. The goal of the independent audit was to provide reasonable assurance that the financial statements of the Agency for the fiscal year ended June 30, 2006, are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and

disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the Agency's financial statements for its governmental activities and each major fund for the fiscal year ended June 30, 2006, are fairly presented in conformity with GAAP. The independent auditor's report is presented as the first component of the financial section of this report, which can be found on pages 12 and 13.

GAAP requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The Agency's MD&A can be found on pages 14 to 26 following the report of the independent auditor.

The Agency implemented in this year the new GASB Standard No. 44, which requires additional schedules to be reported in the Statistical Section. GASB 44 improves the understandability and usefulness of the Statistical Section of the CAFR by requiring to present financial trends information, revenue capacity information, debt capacity information, demographic and economic information, and operating information. You can find these new schedules beginning on page 71.

PROFILE OF THE AGENCY

The Agency was established in 1956 under California State Law by the San José City Council and is a separate legal entity from the City of San José (the City). This year is the 50th Anniversary of the Agency and for 50 years it has been continuously dedicated to improving, creating, and building the quality of life in the City of San José. The City of San José is the 10th largest city in the United States, has the nation's best public safety record of any metropolitan area, is America's Most Livable Big City, and is California's third largest city. In 1975, the San José City Council declared itself the Agency Board of Directors (Board), replacing a separate board. The City Council consists of a Mayor and ten Council members. The Mayor is elected at-large for a four-year term. Council Members are elected by district, also for four years. Effective January 1, 1991, the Council members were limited to two consecutive terms, consistent with the term limit for the Mayor. The Agency's Executive Director/Chief Administrative Officer is responsible for the operations of the Agency and reports directly to the Agency Board (City Council).

As an agency of the State of California, it performs all activities authorized under the California Redevelopment Law. That law clarifies an important difference between the Agency and the City in the use of the Agency's funds. While City revenues may be used for the full range of city services, redevelopment agency funds generally must be spent only on programs and projects that benefit the redevelopment areas - primarily for

physical improvements to correct blighted conditions - not for operating costs such as police or fire protection. For more than two decades, the Agency has been revitalizing and enlivening the City's downtown, neighborhoods, and industrial areas to meet the needs of a dynamic and diverse community. As of June 30, 2006, the Agency has twenty-one (21) ongoing redevelopment project areas (see geographic locator map on page 11), which are grouped into 4 area categories: Downtown, Neighborhood Business Districts/Clusters, Industrial, and Strong Neighborhoods Initiative. The Agency is one of the largest redevelopment agencies in the State of California in terms of both capital budget and tax increment revenue generation.

The California Redevelopment Law also provides tax increment financing as a source of revenue to redevelopment agencies to fund redevelopment activities. Once a redevelopment area is adopted, the agency can only receive tax increment to the extent that it can show on an annual basis that it has incurred indebtedness that must be repaid with tax increment. Due to the nature of the redevelopment financing, agency liabilities normally exceed assets, thus resulting in a deficit in the statement of net assets. Therefore, the Agency traditionally carries a deficit to collect tax increment revenues.

The Agency used the criteria in conformity with the standards prescribed by GASB in determining that there are no component units for which the Agency is responsible for inclusion in its financial statements. Under GASB Statement No. 14, *The Financial Reporting Entity*, the Agency is considered as a component unit of the City of San José and is blended in the City's basic financial statements.

The annual budget serves as the foundation for the Agency's financial planning and control. Prior to June 30, the annual budget is finalized and presented to the Agency Board. At the time the budget is approved, the Board also adopts the annual appropriation resolution and annual revenue resolution, which incorporates the expected revenues and expenditures, as they are delineated in the budget. The level of budgetary control, at which expenditures cannot legally exceed the budgeted amount, is at the appropriation level. However, management can transfer budgeted amounts between activities included in each appropriation without the approval of the Agency Board.

The Agency also maintains an encumbrance accounting system as one method of maintaining budgetary control. Year-end encumbrances are carried forward and become part of the following year's budget. Appropriations that are not encumbered lapse at the end of the fiscal year. Budget-to-actual comparisons (using the budgetary basis of accounting) are provided in this report for all governmental funds for which the appropriated annual budget has been adopted. For the general fund and special revenue fund, the comparisons are presented under Other Required Supplementary Information on pages 62 to 65. For the debt service funds and capital projects fund, the comparisons are presented under Other Supplementary Information subsection of this report on pages 66 to 70.

FACTORS AFFECTING FINANCIAL CONDITION

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the Agency operates.

Local economy. The Agency's Industrial and Downtown Redevelopment Project areas generate the highest tax increment revenue.

For the past ten years, the Agency's tax increment revenues have increased by 96%, while total expenditures increased by 90%. These increases are the result of revitalization efforts implemented by the Agency in the project areas over the past decade. The bonds issued in the last ten years totaled \$2.2 billion, the proceeds of which were used to finance the Agency's revitalization efforts.

During the past ten years, the unemployment rate in the area rose from a low of 3.8% (June 1996) to a high of 5.0% (June 2006) according to statistics from the California Employment Development Department. The fluctuations are attributed to economic factors affecting the national and local economy in the past decade. However, the unemployment rate in the same area declined from last year, as a result of improving local economy.

The City of San José experienced modest economic recovery during the Fiscal Year 2005-06. In July 2006, the County Assessor published the annual tax roll, which resulted in a 7% growth in tax increment revenue for the Agency for Fiscal Year 2006-2007. The growth is due to increase in corporate investments in equipment and other taxable personal property, an indication of an improving local economy.

Long-term financial planning. The growth in tax increment revenues for Fiscal Year 2006-2007 places the Agency on a more solid ground to finance its redevelopment projects and to issue new bonds estimated to generate approximately \$75 million for Fiscal Year 2006-2007 and \$87 million for Fiscal Year 2007-2008. With the issuances of new bonds and the modest sign of economic recovery, the Agency increases its ability to continue to focus on its Investing in Results Initiative Program. The Agency's Core Services continue to be the following:

- A. Promote and Implement Neighborhood Improvement Strategies,
- B. Enhance the Quality and Supply of the City's Housing Stock,
- C. Initiate and Facilitate Public Facilities and Spaces, and
- D. Initiate and Facilitate Private Development.

These Core Services constitute the strategic goals that guide the Agency's budget priorities. Funds for each core service are incorporated in the Fiscal Year 2006-2007 Capital/Program Budgets, including the Fiscal Year 2006-2008 Capital Improvement Program adopted by the Board (City Council) on September 19, 2006. The Agency's

Operating Budget was adopted on June 30, 2006. The total budget for the Fiscal Year 2006-2007 aggregated to \$335.0 million and is allocated as follows: \$123.9 million for capital projects/programs, \$32.4 million for the State mandated set-aside housing funds, \$134.7 million for debt service on outstanding debt, \$0.9 million for AB1290 pass-through revenue sharing, \$7.3 million for operating expenditures, \$31.2 million for County pass-through payment, delegated funds payment and administrative fee, and \$4.6 million for other obligated payments.

The budget for the four core service areas, which is included in the capital projects/programs for \$123.9 million as noted above, is comprised of neighborhood improvement strategies of \$41.5 million, \$3.2 million for housing stock, \$5.9 million for land acquisition for future development, \$29.9 million for private development, \$30.0 million for public facilities, and \$13.4 million for capital operating costs.

The Agency's Five-Year Projection (Fiscal Year 2007–2011), which was included in the Fiscal Year 2006-2007 Capital/Program Budgets that was approved on September 19, 2006 shows a total spending of \$1.471 billion. Of this amount, \$375.0 million will be spent on capital expenditures, \$947.0 million for financing/non-project costs, \$23.0 million for operating expenditures, and \$126.0 million for obligated payments. Tax increment revenues will provide \$939.0 million or 64% of the overall funding source of the Five-year Spending Plan while proceeds of bond issues of \$363.0 million will provide 25% of overall funding source. Other revenues of \$173.0 million from unreserved funds, interest earnings, developer contributions and rental income will provide the remaining 11% funding requirements.

Major current and future initiatives. The Agency's major redevelopment projects during Fiscal Year 2005-2006 includes funding of the Strong Neighborhoods Initiative (SNI) for \$43.0 million, Neighborhood Business Districts (NBD) for \$20.0 million, and existing contractual commitments of approximately \$28.0 million.

SNI has around 90 projects such as 13th Street Streetscape Improvements, Coyote Creek Trail, Starbird Teen Center, Scott-Clifton Neighborhood Park, Gifford Streetscape Improvements, Capitol Park Neighborhood Center, Edenvale Community Center, Roosevelt Park Skatepark, Zolezzi Park, etc.

NBD has around six major projects that include façade improvement program, shopping center improvement program, streetscape and park construction program, Neighborhood Business Association activities and Neighborhood Business District Development program, neighborhood retail development program, and childcare program.

The contractual commitment includes the CIM mixed-use (retail and housing) project, renovation of major un-reinforced masonry buildings, Biotech Incubator, Software Business Cluster, and downtown business improvements.

The Agency will continue and complete these projects in the next fiscal years and has added the North San José Intensification Project with estimated costs of around \$30.0 million allocated throughout the life of the project.

Cash management policies and practices. By Agency policy, funds are invested in compliance with the investment policy of the City of San José. As such, the Agency is permitted to invest in the City's cash and investment pool, obligations of the U.S. Treasury or its agencies, certificates of deposit, mutual funds invested in U.S. government securities, and other permitted investments. The City's investment policy objectives are to minimize credit and interest rate risks, provide sufficient liquidity to meet all possible cash demands, and attain the maximum yield possible while adhering to the first two objectives.

Debt and net assets (deficit) management. At year-end, the Agency had a number of debt issues outstanding. Of the total outstanding debt of \$2.1 billion, \$1.5 billion represents various issues of Tax Allocation Bonds (TABs) that are senior/parity debt. Bonds that are categorized as senior/parity debt have senior payment priority over other Agency obligations.

The debt issues will be repaid from future collections of tax increment revenues. Tax increment revenues expected by the Agency through year 2040 (last day to pay current debt) total \$3.6 billion with zero percent growth and \$4.8 billion with seven percent growth. These amounts are also more than enough to cover the Agency's net deficit of \$1.6 billion (see Statement of Net Assets on page 27).

In accordance with the California Community Redevelopment Law, the Agency established in 1986 the maximum amount of revenue it may receive from the redevelopment areas in the amount of \$7.6 billion. Accordingly, the Agency is limited in the issuance of debt by the aggregate amount of debt service required to pay off outstanding bonds. As of June 30, 2006, the Agency cumulatively received approximately \$2.2 billion of tax increment revenues.

Pursuant to outstanding bond covenants, the Agency must make an annual calculation, no later than December 1 of each year (commencing with December 1, 2004), of the future cumulative debt service on all outstanding debt secured by tax increment (excluding 20% Housing Set-Aside Amount).

As a guarantee of debt payment when due, bond insurance policies were purchased for these TABs from major insurance companies – MBIA Insurance Corporation, AMBAC Assurance Corporation, and Financial Guaranty Insurance Company. The benefit of obtaining insurance is several million dollars in present value interest savings, since the cost of municipal bond insurance is offset by the reduction of the bond interest rate.

Risk management. The Agency carries commercial and general liability property insurance policies. In addition, third-party coverage is maintained for workers'

compensation claims. The insurance premiums are funded as part of the operating costs in the general fund, and insurance claims are recognized in the capital projects fund. In addition, the Agency has instituted a safety program that minimizes losses and the carrying cost of workers' compensation coverage.

AWARDS AND ACKNOWLEDGEMENTS


The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting (page 8) to the Agency for its CAFR for the fiscal year ended June 30, 2005. The Certificate of Achievement for Excellence in Financial Reporting Award is the highest form of recognition in financial reporting for state and local governments, including local government agencies. Last year's report was the fifth CAFR produced by the Agency, which has continuously received this prestigious award. In order to be awarded a Certificate of Achievement, a CAFR should give a clear and thorough view of the government's finances. It should enhance the reader's understanding of the information required by GAAP for fair presentation of the financial statements, be efficiently organized, and adhere to certain accounting terminology and GFOA formatting conventions. The report satisfied both GAAP and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our CAFR for this fiscal year ended June 30, 2006 continues to meet the Certificate of Achievement for Excellence in Financial Reporting Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The preparation of this report reflects the responsibility of the Agency's management to maintain the highest standards of financial reporting. This project could not have been possible without the efforts and dedicated services of the staff of the Agency's Finance Division, in particular recognition to Shalah Hade, Accountant, who retires this year after forty-four years working with the Agency/City. We would like to express our appreciation to the staff of the Agency who assisted and contributed to the preparation of this report (*back of title page*). We particularly express our appreciation to the staff of Macias Gini & O'Connell LLP, CPAs for their significant support and guidance. Due credit should also be given to the Mayor and the Agency Board for their progressive and responsible leadership in the fiscal affairs of the Agency.

Respectfully submitted,


Harry S. Mavrogenes
Executive Director/
Chief Administrative Officer


David C. Baum
Director of Finance/
Chief Financial Officer

Certificate of Achievement for Excellence in Financial Reporting

Presented to

The Redevelopment Agency
of the City of San Jose,
California

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2005

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



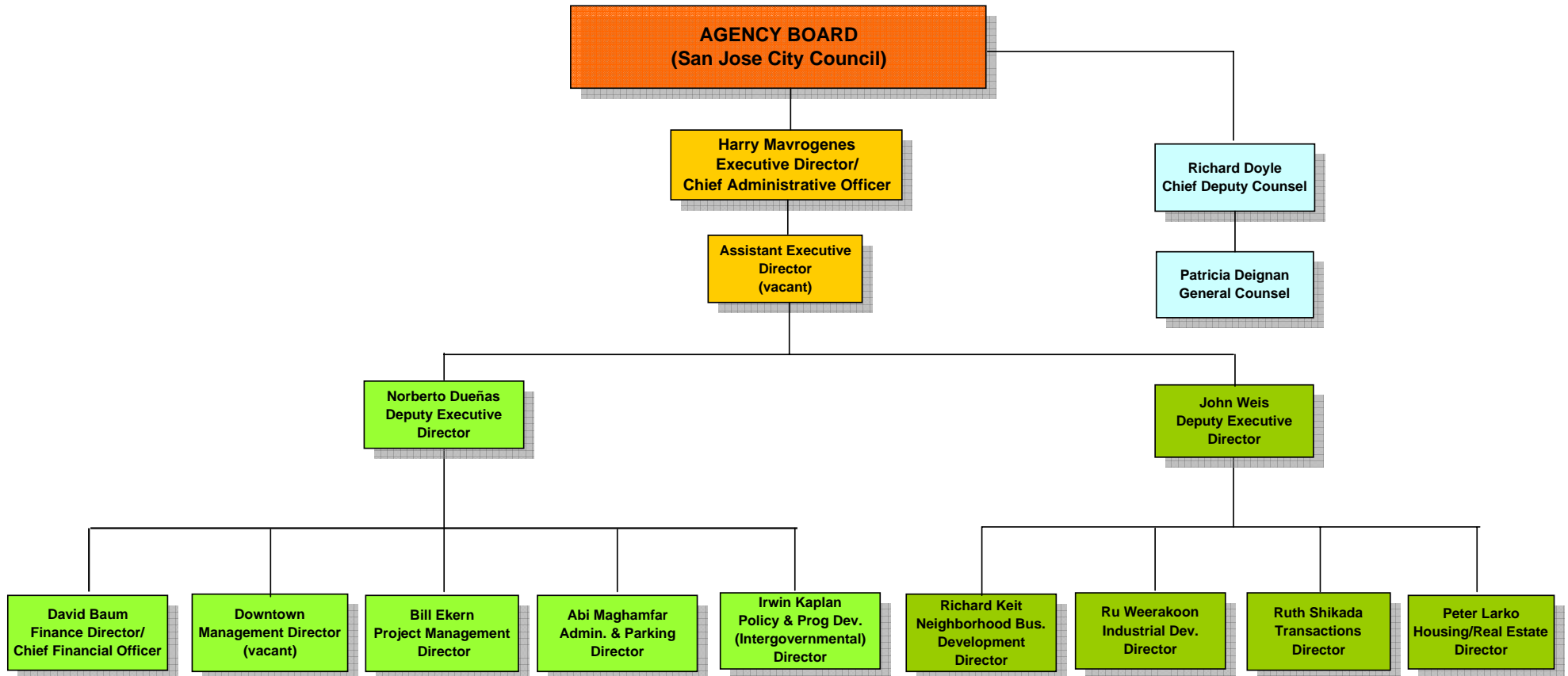
Carla E. Perry

President

Jeffrey R. Emer

Executive Director

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
Organizational Chart



The
 Redevelopment
 Agency of the
 City of San Jose
 Board of
 Directors
 (San Jose City
 Council)



Chairman
 Mayor Ron Gonzales
 Term Expires 12/31/06



Vice Chairman
 Vice Mayor Cindy Chavez
 District 3
 Term Expires 12/31/06



Linda J. LeZotte
 District 1
 Term Expires 12/31/06



Forrest Williams
 District 2
 Term Expires 12/31/08



Chuck Reed
 District 4
 Term Expires 12/31/08



Nora Campos
 District 5
 Term Expires 12/31/06



Ken Yeager
 District 6
 Term Expires 12/31/08



Madison Nguyen
 District 7
 Term Expires 12/31/06



David D. Cortese
 District 8
 Term Expires 12/31/08



Judy Chirco
 District 9
 Term Expires 12/31/06



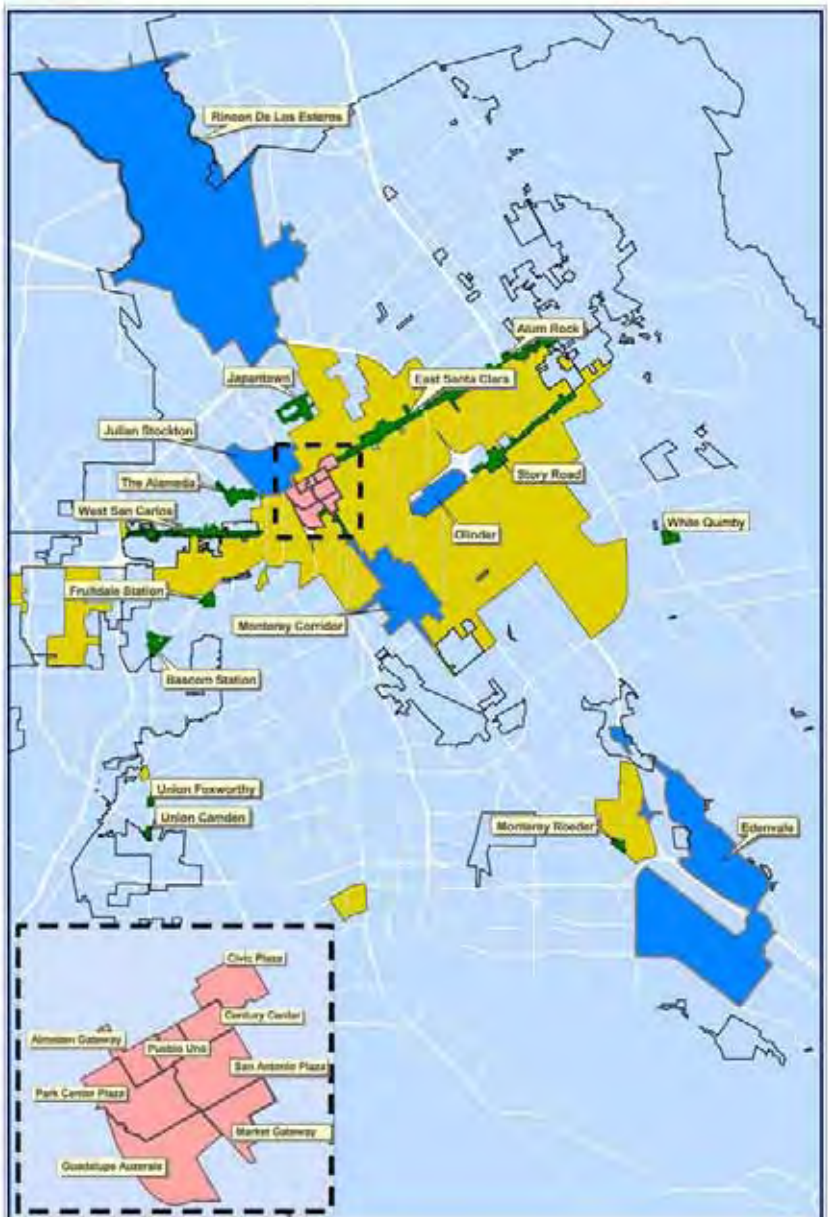
Nancy Pyle
 District 10
 Term Expires 12/31/08



Geographic Locator Map

Redevelopment project areas:

- Downtown
- Industrial
- Neighborhood Business Districts/Clusters
- Strong Neighborhoods Initiative



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San Jose BioCenter



O'Donnell's Garden Park

Auditor's Report

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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
Redevelopment Agency of the
City of San José, California

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the governmental activities and each major fund of the Redevelopment Agency of the City of San José (Agency), a component unit of the City of San José, California, as of and for the fiscal year ended June 30, 2006, 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 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 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, 2006, 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 September 20, 2006, 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 information for the general fund and 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Agency's basic financial statements. The information identified in the table of contents as the introductory, other supplementary information, and statistical sections is presented for purposes of additional analysis and is not a required part of the basic financial statements. The other supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.


Certified Public Accountants

Walnut Creek, California
September 20, 2006



Fourth Street Garage



Mexican Heritage Plaza

Management's Discussion and Analysis

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REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Management's Discussion and Analysis June 30, 2006

As management of the Redevelopment Agency of the City of San José (the Agency), we offer readers of the Agency's basic financial statements this narrative overview and analysis of the financial activities of the Agency for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal, which can be found beginning on page 1 of this CAFR report.

FINANCIAL HIGHLIGHTS

Liabilities of the Agency exceeded its assets in governmental activities at the close of fiscal year 2006 by \$1,649,310,000 (net assets deficit). Of this amount, \$40,455,000 represents investment in capital assets, and \$57,280,000 represents resources restricted for debt service payment and low/moderate income housing activities. The remaining negative amount of \$1,747,045,000 represents the accumulated unrestricted deficit at the close of fiscal year 2006.

Total revenues in the governmental activities decreased by a net amount of \$4,361,000 or approximately 2% from last year. The net decrease is mainly attributable to the collection of loans that happened in fiscal year 2004-2005 in the amount \$4,435,000.

Total expenses in governmental activities were \$108,951,000 (change in net assets) more than the \$192,881,000 total revenues generated during the current year. Compared to last year, total expenses in governmental activities increased by \$7,276,000 or by 2%. The increase in expenses was due to the resumption of some important redevelopment projects that were deferred as a result of economic downturn, including new redevelopment projects.

At the close of the current fiscal year, the Agency's governmental funds reported combined ending fund balances of \$134,478,000, a decrease of \$98,191,000 in comparison to the prior year. Of the combined fund balance, \$7,446,000 or 6% is available for redevelopment projects at the discretion of the Agency Board (City Council).

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Management's Discussion and Analysis (Continued) June 30, 2006

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Agency's basic financial statements. The Agency's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the basic financial statements. This report also contains required and other supplementary information in addition to the basic financial statements themselves.

Government-wide Financial Statements

The *Government-wide Financial Statements* are designed to provide readers with a broad overview of the Agency's finances, in a manner similar to a private-sector business.

The *statement of net assets* reports all financial and capital resources of the Agency. The Agency presents the statement in a format that displays assets less liabilities equal net assets/(deficit). Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Agency is improving or deteriorating.

The *statement of activities* presents information showing how the Agency's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods such as revenues pertaining to uncollected taxes and earned but unused vacation and sick leave.

The *governmental activities* of the Agency include general government, community development, housing, and debt service. The government-wide financial statements can be found on pages 27 and 28 of this report.

Fund Financial Statements

Fund Financial Statements are designed to report information about groupings (*funds*) of related accounts, which are 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 finance-related legal compliance. All *funds* of the Agency are categorized as *governmental funds*.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Management's Discussion and Analysis (continued) June 30, 2006

Governmental funds are used to account for essentially the same functions reported as *governmental activities* in the *government-wide financial statements*. However, unlike the *government-wide financial statements*, governmental fund financial statements focus on *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 may be useful in determining what financial resources are available in the near future to finance the Agency's redevelopment programs.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The Agency maintains several individual governmental funds created according to their purpose. The individual fund information is presented separately in the governmental fund balance sheet (page 29) and in the governmental fund statement of revenues, expenditures, and changes in fund balances (page 31) for all the Agency's governmental funds.

Notes to the Basic Financial Statements

Notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 34 to 61 of this report.

Other Information

In addition to the basic financial statements and accompanying notes, this report also presents required supplementary information concerning the Agency's budgetary comparison for certain governmental funds – general fund and special revenue fund (pages 62 to 65).

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Management's Discussion and Analysis (continued) June 30, 2006

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the Agency, it is also an important determinant of its ability to finance current and future redevelopment projects.

At the close of fiscal year 2006, the Agency has a net deficit of \$1,649,310,000. Of this amount, \$40,455,000 is invested in capital assets, \$41,947,000 is restricted for debt service, and \$15,333,000 is restricted for low and moderate-income housing. The remaining negative balance of \$1,747,045,000 represents a deficit, which will be covered from collection of future tax increment and other revenues. The largest portion of the Agency's deficit is caused by the outstanding long-term obligations of \$2,172,550,000. Traditionally, the Agency carries a deficit to collect tax increment as mentioned earlier in the letter of transmittal. This is primarily due to the nature of tax increment financing method allowed under California law whereby a redevelopment agency issues bonds or incurs long-term debt to finance its redevelopment projects by pledging future tax increment revenues.

The Agency uses debt proceeds to finance its redevelopment projects which include land, commercial and retail buildings, housing, public parking, street improvements, park improvements, transportation improvements, cultural facilities, and community centers. Once redevelopment projects that are public facilities are completed by the Agency, the responsibilities for their continued maintenance and operations are transferred to the City of San José (City) including the capitalized redevelopment project costs. Listed below are some notable public facilities transferred, or will be transferred, to the City:

- San José McEnery Convention Center,
- Children's Discovery Museum,
- San José Museum of Art,
- HP Pavilion at San José (Arena),
- Tech Museum of Innovation,
- Mexican Heritage Plaza,
- Guadalupe River Park and Gardens,
- Dr. Martin Luther King Jr. Library,
- Washington United Youth Center and Biblioteca Latinoamericana,
- San José Repertory Theater,
- 4th Street Parking Garage, and
- California Theatre

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Management's Discussion and Analysis (continued)
June 30, 2006**

In addition, completed projects with private developers are also transferred to the developers in accordance with the Disposition and Development Agreements. Although completed public facilities and Joint Agency-Private Partnership projects are transferred to the City of San José and private developers, respectively, the related debt remains with the Agency.

Shown below is a comparative schedule that summarizes the Agency's net assets (deficit):

Agency's Net Assets (Deficit)
Governmental Activities
As of June 30, 2006 and 2005
(In thousands)

	2006	2005
Current and other assets	\$ 235,079	\$ 316,473
Accumulated redevelopment project costs	327,225	355,040
Capital assets, net	40,455	6,831
Total assets	602,759	678,344
Long-term liabilities	2,172,550	2,150,806
Other liabilities	79,519	67,897
Total liabilities	2,252,069	2,218,703
Net assets:		
Invested in capital assets	40,455	6,831
Restricted net assets	57,280	79,032
Unrestricted net assets (deficit)	(1,747,045)	(1,626,222)
Total net assets	\$ (1,649,310)	\$ (1,540,359)

The Agency uses its accumulated redevelopment project costs and capital assets of \$327,225,000 and \$40,455,000, respectively, to provide community development services to the citizens of the City of San José (see pages 47 to 49 for additional information). These assets are not available for future spending and cannot be used to liquidate the Agency's debt since the resources needed to repay the debt will be provided primarily from collections of future tax increments and other revenues.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Management's Discussion and Analysis (continued)
June 30, 2006**

Long-term bonds and notes are mainly represented by tax allocation bonds, revenue bonds, and housing set-aside bonds issued to finance redevelopment projects. The change from last year represents a net increase of \$2,470,000 due to the issuance of 2005 Merged Area Tax Allocation Refunding Bonds for \$220,080,000, loans obtained from City's Parking Fund for \$3,400,000, HUD 108 loan program for \$31,000,000 and ERAF loan program of \$14,920,000 partially offset by retirement of \$254,280,000 of Merged Area Tax Allocation Bonds, \$3,300,000 of Merged Area Housing Set-aside Bonds, \$1,400,000 of Merged Area Revenue Bonds and \$7,950,000 of other debt obligations.

Governmental activities. Overall the Agency's financial position decreased from the prior year. Under the governmental activities, the Agency's net deficit increased by \$108,951,000 from the previous fiscal year. The increase accounts for 7 percent of the accumulated deficit at June 30, 2006.

Key elements of the changes in net assets of the governmental activities are presented below:

Agency's Changes in Net Assets (Deficit)
For the Fiscal Years Ended June 30, 2006 and 2005
(In Thousands)

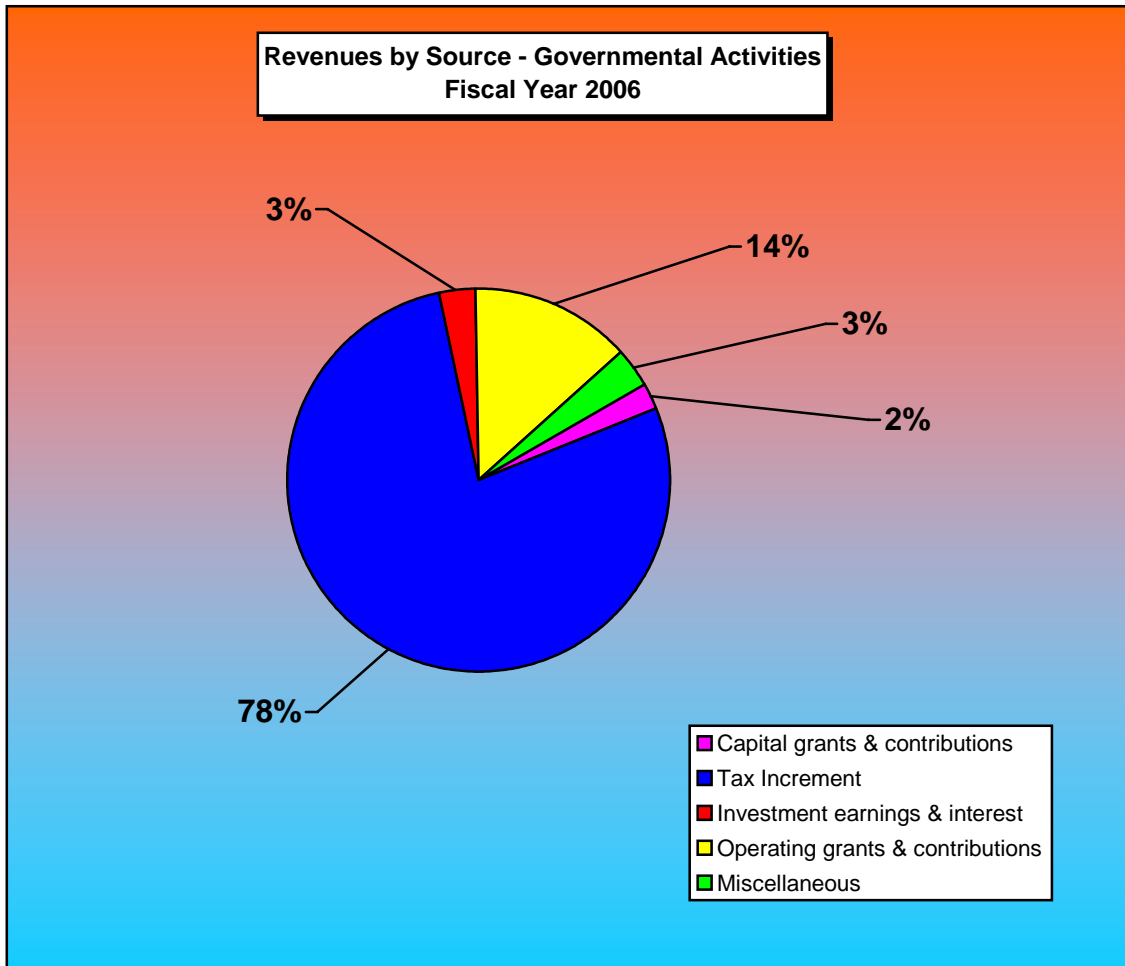
	2006	2005
Revenues:		
Program revenues:		
Operating grants and contributions	\$ 26,193	\$ 27,547
Capital grants and contributions	4,457	5,749
General revenues:		
Tax increment	149,819	149,977
Unrestricted investment earnings	6,043	6,029
Miscellaneous	6,369	7,940
Total revenues	192,881	197,242
Expenses:		
General government	6,910	8,497
Community development	147,052	134,001
Housing	50,881	60,545
Debt service	96,989	91,512
Total expenses	301,832	294,555
Change in net assets	(108,951)	(97,313)
Net assets deficit - beginning of year	(1,540,359)	(1,443,046)
Net assets deficit - end of year	\$(1,649,310)	\$(1,540,359)

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Management's Discussion and Analysis (continued)
June 30, 2006**

Tax increment, which represents approximately 78% of total revenues, decreased from last year by a minimal \$158,000 or around 0.1% due to the effects of past years' sluggish economy.

Operating grants and contributions under program revenues decreased by \$1,354,000 or 5% from last year due to a lower debt service contribution from the City's Housing Department as a result of refunding housing bonds issued in fiscal year 2004-2005.



Community development expenses of \$147,052,000, which represent approximately 49% of Agency's total governmental expenses, increased by \$13,051,000 or 10% from last year. The increased was due to resumption of completing redevelopment projects from last year

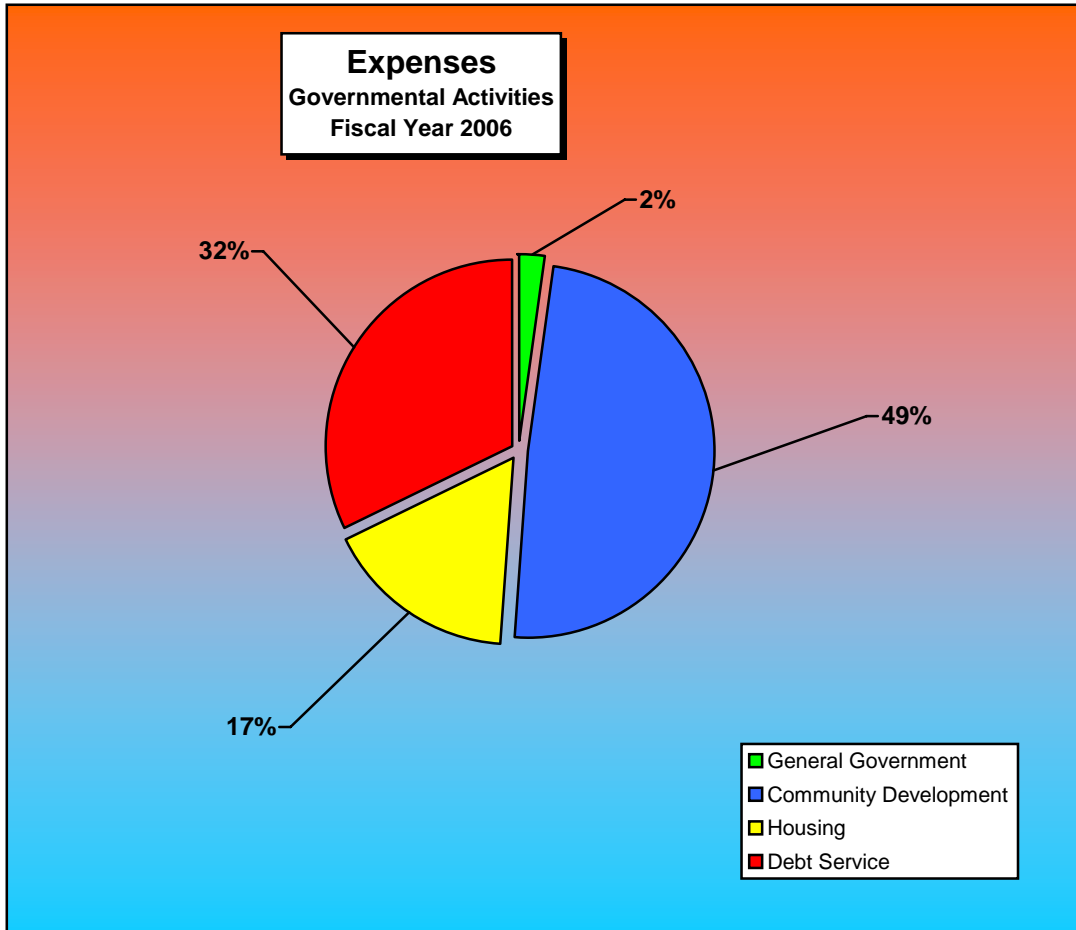
**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Management's Discussion and Analysis (continued)
June 30, 2006**

and continuing services in the San Jose's neighborhoods through the Strong Neighborhoods Initiative program.

Housing expenses of \$50,881,000 which represent approximately 17% of Agency's total governmental expenses, decreased by \$9,664,000 or 16% from last year. The decrease is the net effect of partial drawdown of the remaining proceeds of the 2005 Housing Bonds.

Total general government expenses of \$6,910,000 decreased by \$1,588,000 or 19% from last year. The change was mainly due to the \$1,657,000 decrease in the City support services, which was reallocated to Community Development Expenses to better align the Agency's operating costs.



REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Management's Discussion and Analysis (continued) June 30, 2006

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.

Governmental funds. 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 financial requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. Individual fund information of governmental funds reported by the Agency includes general fund, special revenue fund, housing debt service fund, merged debt service fund, and capital projects fund, which are all considered major funds.

At the end of the current fiscal year, the Agency's governmental funds reported *combined fund balances* of \$134,478,000, a decrease of \$98,191,000 in comparison with the prior year. Of this total amount, \$7,446,000 constitutes *unreserved fund balance*, which is available for redevelopment spending at the discretion of the Agency Board. The remainder of the fund balance is *reserved* to indicate that it is *not* available for new spending because it has been committed: 1) to pay debt service (\$79,668,000), 2) to reflect the amount of assets that are long-term in nature and thus, do not represent available spendable resources (\$4,102,000), 3) to pay for low and moderate-income housing projects (\$15,333,000), and 4) to liquidate contractual commitments of the period (\$27,929,000).

General fund. The Agency's general fund is used to account for the general and administrative expenditures. Fund transfers from the capital projects fund are made to the general fund as general and administrative expenditures are incurred and deemed necessary. Fund balance of the general fund aggregated to \$1,130,000, an increase of \$897,000 from previous year. The increase was due to the net effects of additional funds transferred from capital projects fund aggregating to \$6,976,000.

Special revenue fund. The special revenue fund is used to account for the portion of tax increment revenue designated for low and moderate-income housing. As required by the California Community Redevelopment Law, the Agency allocated 20 percent (\$29,964,000) of the tax increment received during the year for low and moderate-income housing projects. As of June 30, 2006, the entire 20% housing monies were transferred to the City for housing projects.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Management's Discussion and Analysis (continued) June 30, 2006

Debt service funds. The debt service funds have a total fund balance of \$95,001,000, representing Housing Debt (\$15,333,000) and Merged Debt (\$79,668,000). The total fund balance in the Agency's debt service funds decreased by \$19,116,000 in the current year mainly due to the City's drawdown of the remaining proceeds of the 2005 Merged Area Housing Set-Aside Tax Allocation Bonds issued during fiscal year 2004-2005.

Capital projects fund. The fund balance in the Agency's capital projects fund had a net decrease of \$79,921,000 from last fiscal year as the result of total revenues and other fund financing sources of \$108,718,000 being lesser than the aggregate expenditures and other fund financing uses \$188,639,000.

Total capital outlay expenditures of \$96,777,000, which represents around 65% of the overall expenditures of the Agency's capital projects fund, increased by \$25,861,000 or around 36% when compared to last year's activity. This year's increase was due to the resumption of several capital project activities which were deferred previously.

General Fund Budgetary Highlights

As previously mentioned, the General Fund only accounts for the Agency's general and administrative expenditures. During the year, changes to the general fund original budget were approved by the Board, as follow:

- Decrease in non-personnel services by \$793,000.
- Decrease in payment to the City of San Jose by \$152,000.

The decrease in the original budget non- personnel services was due to reduction of non-personal/equipment and leasehold improvement. The payment to the City representing budgeted expenditures for the Mayor/Board was reduced as a result of budget shift to capital projects fund's budget.

Total actual expenditures on budgetary basis of \$7,098,000 were lower by \$787,000 from the amended budget amount of \$7,885,000 as a result of limiting acquisition of new equipment and leasehold improvement, and salary and benefit costs of civil service positions at the Agency decreased due to employee turnover. During the year, budgetary basis for actual revenues and other financing sources (fund transfers in from Capital Projects Fund) exceeded the budgetary basis for actual expenditures by \$708,000, resulting to a fund balance of \$942,000.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Management's Discussion and Analysis (continued) June 30, 2006

Accumulated Redevelopment Project Costs and Capital Assets

Accumulated Redevelopment Project Costs

The Agency's investment in properties for redevelopment projects for its governmental activities as of June 30, 2006 amounted to \$327,224,000. This is comprised of 54% of land (\$176,978,000), 5% of construction in progress (\$16,210,000) and 41% of buildings (\$134,036,000).

Major events during the current fiscal year included the following:

- Current year addition of \$3,817,000 of construction costs incurred on the following projects: \$2,458,000 for Civic Plaza Streetscape, \$738,000 for Guadalupe River Park and Gardens, \$465,000 for Convention Center Annex/Expansion, and \$156,000 for other public projects.
- Transfer of \$134,036,000 from construction in progress to buildings for two projects (the Dr. Martin Luther King, Jr. Library and the California Theatre) as they are considered substantially completed
- Transfer of two other projects (the José Theater and the Convention Center Annex/Expansion) with building costs totaling \$13,811,000 and site acquisition costs totaling \$20,115,000, to capital assets. The change in categorization of these assets was the result of management's change in use of these assets.
- Parcels of land were acquired during the year for eventual use for redevelopment projects at a cost of \$13,679,000. Costs of land aggregating to \$340,000 were transferred to private developers and the City in accordance with Disposition and Development Agreements while costs of land aggregating to \$11,046,000 were sold to the private developers for future development projects.

The overall impact of the above activities were a decrease of land of \$17,822,000, a decrease of construction in progress of \$144,029,000 and an increase of buildings of \$134,036,000 during current year.

At June 30, 2006, the Agency had contractual commitments of \$5,173,000 for its accumulated redevelopment project costs.

Additional information about the Agency's accumulated redevelopment project costs can be found on page 47 and 48 of notes to the financial statements.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Management's Discussion and Analysis (continued) June 30, 2006

Capital Assets

For the government-wide financial statement presentation, depreciable capital assets were depreciated from acquisition date to the end of the current fiscal year using the straight-line method. The Agency's capital assets consist of 1) the parking garage located beneath the Fairmont Plaza Hotel in downtown San José with net book value of \$5,375,000 at June 30, 2006, 2) leasehold improvements of the retail site at the Fairmont Plaza Hotel – Annex with a net book value of \$1,155,000 and 3) the transfer in of two completed projects (the José Theater and the Convention Center Annex/Expansion) and the associated site acquisition costs from construction in progress under the category of accumulated redevelopment project costs. Additional information about the Agency's capital assets can be found on pages 48 and 49 of notes to the financial statements.

Debt Administration

At June 30, 2006, the Agency had long-term bonds and notes outstanding aggregating to \$2,149,970,000. Of this amount, \$1,861,475,000 represents bonds backed by tax increment revenues. The remainder of the Agency's debt represents other bonds and notes secured by tax increment and other revenues such as developer payments, lease payment revenue, interest earnings and other sources. Breakdown is as follows (in thousands):

Merged Area Tax Allocation Bonds (TABs)	\$ 1,469,900
Housing Set-Aside bonds	275,375
Merged Area Revenue Bonds	<u>116,200</u>
Sub Total	1,861,475
Convention Center Refunding Bonds	171,800
4th/San Fernando Parking Revenue Bonds	
Pledge Obligation	42,545
CSCDA ERAF Loan	32,645
HUD Section 108 Loans	34,705
City of San José Parking Fund Loan	<u>6,800</u>
Total Debt	<u>\$ 2,149,970</u>

During the year, the Agency issued the following tax allocation bonds:

- Tax Allocation Tax Exempt Refunding Bonds Series 2005A for \$152,950,000 and Series B for \$67,130,000.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Management's Discussion and Analysis (continued) June 30, 2006

The ratings on Tax Allocation Bonds (TABs) with bond insurance are "AAA" by Standard & Poor's and Fitch rating agencies and "Aaa" by Moody's. Without bond insurance, the ratings are "A-" by Standard & Poor's, "A3" by Moody's, and "A" by Fitch. The Housing Set-Aside Bonds, comprised of various issues, are rated "A" to "AAA" - the highest short term rating from Moody's. The Agency's Merged Area Revenue Bonds are rated "A+1" - the highest short term rating from Standard & Poor's. All other bonds are rated "AAA"

Additional information about the Agency's long-term obligations can be found on pages 50 to 55 in the notes to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Agency Board (City Council) considers many factors when setting redevelopment project priorities and the budget for the ensuing year. Below are significant factors in considering the Agency's budget for the fiscal year 2006-2007:

- 7% or \$11 million increase in tax increment for San José redevelopment areas, per County Assessor's published Annual Tax Roll in July 2006.
- New debt of approximately totaled to \$75 million is planned to be issued by the Agency in fiscal year 2006-2007.
- Vacancy rate for commercial property in Silicon Valley according to Collier International, a commercial/industrial real estate management firm, was approximately 12% as of the quarter ending June 30, 2006. In addition, R&D space vacancy rate for the same period was approximately 15%.
- Unemployment rate of 5.0% at July 2006 in San José, as reported by California Employment Development Department, a decrease from the 5.8% rate at July 2005. This is slight higher than the State's unemployment rate of 4.8% and national average rate of 4.8% for the same period.

REQUEST FOR INFORMATION

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the Agency's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer, 200 East Santa Clara St., 14th Floor, San José, CA 95113. Additional financial data may also be found on the Agency's website (www.sjredevelopment.org/finance.htm).

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Tech Museum of Innovation



The Globe

Basic Financial Statements

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REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Statement of Net Assets

Governmental Activities

June 30, 2006

ASSETS

Cash and investments (Note II.A)	\$	39,647,841
Receivables (net):		
Accrued interest		110,027
Due from the City of San José (Note III.C)		1,698,608
Due from U.S Department of Housing and Urban Development		20,000,000
Other		828,426
Advances to the City of San José (Note III.C)		1,184,712
Loans receivable, net (Note II.B)		35,914,334
Deposits		59,516
Deferred charges, net		23,063,807
Restricted cash and investments (Note II.A)		112,572,993
Accumulated redevelopment project costs (Note II.E):		
Land held for redevelopment		176,978,449
Construction in progress		16,210,270
Buildings		134,035,738
Capital assets (Note II.F):		
Nondepreciable		20,114,747
Depreciable, net		20,340,179
Total assets		<u>602,759,647</u>

LIABILITIES

Accounts payable and accrued liabilities (Note II.G)		3,760,040
Due to the City of San José (Note III.C)		10,214,713
Due to the County of Santa Clara (Note III.D)		12,071,927
Unearned revenue (Note II.C)		13,583,517
Liabilities payable from restricted assets:		
Deposits, retentions, and other payables		2,168,013
Accrued interest payable		37,721,241
Noncurrent liabilities (Note II.H):		
Due within one year		43,654,119
Due in more than one year		2,128,895,797
Total liabilities		<u>2,252,069,367</u>

NET ASSETS

Invested in capital assets		40,454,926
Restricted for:		
Debt service		41,946,763
Low and moderate income housing activities		15,333,475
Unrestricted deficit		(1,747,044,884)
Total net assets (deficit)	\$	<u>(1,649,309,720)</u>

See accompanying notes to the basic financial statements.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
Statement of Activities
Governmental Activities
For the Year Ended June 30, 2006

	<u>Total</u>	<u>General Government</u>	<u>Community Development</u>	<u>Housing</u>	<u>Debt Service</u>
Expenses:					
Salaries, wages and benefits	\$ 11,428,881	\$ 3,044,879	\$ 8,384,002	\$ -	\$ -
Materials, supplies and other services	6,310,700	3,864,548	2,446,152	-	-
Project expenses	186,801,178	-	135,919,885	50,881,293	-
Depreciation	301,830	-	301,830	-	-
Interest on debt	96,988,927	-	-	-	96,988,927
Total expenses	<u>301,831,516</u>	<u>6,909,427</u>	<u>147,051,869</u>	<u>50,881,293</u>	<u>96,988,927</u>
Program revenues:					
Operating grants and contributions	26,193,506	-	13,326,443	12,867,063	-
Capital grants and contributions	4,456,803	-	4,456,803	-	-
Net program revenue (expense)	<u>(271,181,207)</u>	<u>\$ (6,909,427)</u>	<u>\$ (129,268,623)</u>	<u>\$ (38,014,230)</u>	<u>\$ (96,988,927)</u>
General revenues:					
Tax increment	149,818,668				
Unrestricted investment earnings	6,042,745				
Miscellaneous	6,369,147				
Total general revenues	<u>162,230,560</u>				
Change in net assets	(108,950,647)				
Net assets (deficit), beginning of year	<u>(1,540,359,073)</u>				
Net assets (deficit), end of year	<u>\$ (1,649,309,720)</u>				

See accompanying notes to the basic financial statements.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Balance Sheet
Governmental Funds
June 30, 2006

	General	Special Revenue	Debt Service		Capital Projects	Total
			Housing	Merged		
ASSETS						
Cash and investments (Note II.A)	\$ 2,289,463	\$ -	\$ -	\$ -	\$ 37,358,378	\$ 39,647,841
Receivables:						
Accrued interest	-	-	-	-	110,027	110,027
Due from other funds (Note II.D)	-	-	-	-	180,319	180,319
Due from the City of San José (Note III.C)	-	-	-	-	1,698,608	1,698,608
Due from U.S. Department of Housing and Urban Development	-	-	-	-	20,000,000	20,000,000
Others	53,246	-	-	-	775,180	828,426
Advances to the City of San José (Note III.C)	-	-	-	-	1,184,712	1,184,712
Loans receivable, net (Note II.B)	-	-	-	-	35,914,334	35,914,334
Deposits	38,716	-	-	-	20,800	59,516
Restricted cash and investments (Note II.A)	-	-	15,404,263	79,848,323	17,320,407	112,572,993
TOTAL ASSETS	\$ 2,381,425	\$ -	\$ 15,404,263	\$ 79,848,323	\$ 114,562,765	\$ 212,196,776
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts payable and accrued liabilities (Note II.G)	\$ 705,710	\$ -	\$ 70,788	\$ -	\$ 2,983,542	\$ 3,760,040
Due to other funds (Note II.D)	-	-	-	180,319	-	180,319
Due to the City of San José (Note III.C)	521,841	-	-	-	9,692,872	10,214,713
Due to the County of Santa Clara (Note III.D)	-	-	-	-	12,071,927	12,071,927
Deferred revenue (Note II.C)	7,300	-	-	-	35,732,572	35,739,872
Unearned revenue (Note II.C)	-	-	-	-	13,583,517	13,583,517
Deposits, retentions, and other payables	16,739	-	-	-	2,151,274	2,168,013
Total liabilities	1,251,590	-	70,788	180,319	76,215,704	77,718,401
Fund balances:						
Reserved for:						
Long-term receivables	-	-	-	-	2,858,005	2,858,005
Advances and deposits	38,716	-	-	-	1,205,512	1,244,228
Debt service	-	-	-	79,668,004	-	79,668,004
Low and moderate income housing activities	-	-	15,333,475	-	-	15,333,475
Encumbrances	188,273	-	-	-	27,740,521	27,928,794
Unreserved, designated for redevelopment activities	902,846	-	-	-	6,543,023	7,445,869
Total fund balances	1,129,835	-	15,333,475	79,668,004	38,347,061	134,478,375
TOTAL LIABILITIES AND FUND BALANCE:	\$ 2,381,425	\$ -	\$ 15,404,263	\$ 79,848,323	\$ 114,562,765	\$ 212,196,776

See accompanying notes to the basic financial statements.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Reconciliation of the Balance Sheet of Governmental Funds to the Statement of Net Assets of Governmental Activities June 30, 2006

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

Fund balances of all governmental funds (Page 29)	\$	134,478,375
Capital assets used in governmental activities are not spendable current financial resources and, therefore, are not reported in the balance sheet of governmental funds.		40,454,926
Accumulated redevelopment costs are capitalized costs that will be transferred to the City and/or developers upon project completion. These costs are not spendable current financial resources and, therefore, are not reported in the balance sheet of the governmental funds.		327,224,457
A significant portion of loans receivable and other long-term receivables are not available to pay for current period expenditures and, therefore, are deferred on the modified accrual basis of accounting.		35,739,872
Bond issuance costs are expended in governmental funds when paid, and are capitalized and amortized over the life of the corresponding bonds for purposes of the statement of net assets. Deferred charges, net of accumulated amortization		23,063,807
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	(1,745,275,000)	
Revenue bonds	(116,200,000)	
Convention Center refunding bonds	(171,800,000)	
Pledge obligation (4th/San Fernando Parking Revenue Bonds)	(42,545,000)	
ERAF Loan	(32,645,000)	
City of San José Parking Fund loan	(6,800,000)	
HUD Section 108 loans	(34,705,000)	
Unamortized premiums on bonds	(33,346,472)	
Unamortized deferred amount on refundings	34,481,823	
Claims liabilities	(22,500,000)	
Compensated absences	(1,215,267)	(2,172,549,916)
Interest payable on long-term debt does not require the use of current financial resources and, therefore, interest payable is not accrued as a liability in the balance sheet of governmental funds.		(37,721,241)
Net assets (deficit) of governmental activities (page 27)		<u>\$ (1,649,309,720)</u>

See accompanying notes to the basic financial statements.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSÉ
Statement of Revenues, Expenditures, and Changes in Fund Balance
Governmental Funds
For the Year Ended June 30, 2006

	General	Special Revenue	Debt Service		Capital Projects	Total
			Housing	Merged		
REVENUES:						
Tax increment	\$ -	\$ 29,963,734	\$ -	\$ 97,534,256	\$ 22,320,678	\$ 149,818,668
Intergovernmental	-	-	12,867,063	-	13,752,892	26,619,955
Investment income	107,700	-	746,107	1,388,214	3,800,724	6,042,745
Grant revenue	-	-	-	-	4,030,354	4,030,354
Rent	574,596	-	-	-	406,644	981,240
Other	147,755	-	-	-	3,637,551	3,785,306
Total revenues	<u>830,051</u>	<u>29,963,734</u>	<u>13,613,170</u>	<u>98,922,470</u>	<u>47,948,843</u>	<u>191,278,268</u>
EXPENDITURES:						
General government	3,427,459	-	-	-	10,631,343	14,058,802
Intergovernmental:						
Payments to the City of San José (Note III.C)	3,481,968	30,013,987	20,867,305	-	13,641,443	68,004,703
Payments to the County of Santa Clara (Note III.D)	-	-	-	-	28,183,783	28,183,783
Payments to other governmental agencies	-	-	-	-	395,992	395,992
Debt service:						
Principal repayment	-	-	3,300,000	38,310,000	-	41,610,000
Interest and other charges	-	-	9,363,871	84,620,995	-	93,984,866
Payments to refunded bond escrow agent	-	-	-	6,944,942	-	6,944,942
Bond issuance costs	-	-	-	5,538,538	-	5,538,538
Capital outlay:						
Project expenditures	-	-	-	-	76,985,271	76,985,271
Payments to the City of San José (Note III.C)	-	-	-	-	19,792,019	19,792,019
Total expenditures	<u>6,909,427</u>	<u>30,013,987</u>	<u>33,531,176</u>	<u>135,414,475</u>	<u>149,629,851</u>	<u>355,498,916</u>
DEFICIENCY OF REVENUES UNDER EXPENDITURES	<u>(6,079,376)</u>	<u>(50,253)</u>	<u>(19,918,006)</u>	<u>(36,492,005)</u>	<u>(101,681,008)</u>	<u>(164,220,648)</u>
OTHER FINANCING SOURCES (USES):						
Refunding bonds issued	-	-	-	220,080,000	-	220,080,000
Premium on refunding bonds	-	-	-	17,191,021	-	17,191,021
Bonds and notes issued	-	-	-	-	49,320,000	49,320,000
Payment to refunded bond escrow agent	-	-	-	(232,009,738)	-	(232,009,738)
Proceeds from the sale of capital assets	-	-	-	-	11,448,790	11,448,790
Transfers in (Note II.D)	6,975,898	-	-	32,033,164	-	39,009,062
Transfers out (Note II.D)	-	-	-	-	(39,009,062)	(39,009,062)
Total other financing sources (uses)	<u>6,975,898</u>	<u>-</u>	<u>-</u>	<u>37,294,447</u>	<u>21,759,728</u>	<u>66,030,073</u>
NET CHANGE IN FUND BALANCE	896,522	(50,253)	(19,918,006)	802,442	(79,921,280)	(98,190,575)
FUND BALANCES, BEGINNING OF YEAR	233,313	50,253	35,251,481	78,865,562	118,268,341	232,668,950
FUND BALANCES, END OF YEAR	<u>\$ 1,129,835</u>	<u>\$ -</u>	<u>\$ 15,333,475</u>	<u>\$ 79,668,004</u>	<u>\$ 38,347,061</u>	<u>\$ 134,478,375</u>

See accompanying notes to the basic financial statements.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Reconciliation of the Statement of Revenues, Expenditures, and Changes in
Fund Balances of Governmental Funds to the Statement of Activities of Governmental Activities
For the Year Ended June 30, 2006

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

Net change in fund balances of all governmental funds (Page 31) \$ (98,190,575)

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 or accumulated as redevelopment project costs and transferred to the City and/or developers upon project completion. The components of capital outlay related costs not reported in the statement of activities for the current period are as follows:

Costs capitalized related to accumulated redevelopment projects costs	\$ 17,495,893	
Disposal of capitalized costs related to transfer of capital assets	(11,385,907)	
Depreciation expense	<u>(301,830)</u>	5,808,156

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the governmental funds. For governmental funds, loans made that are not expected to be repaid in the near future are offset with deferred revenue, whereas, loans made are considered project expenditures and loans collected are considered current year revenue. However, on the statement of activities only interest earnings and bad debt expense are reported.

Revenues earned but not available in the current year	2,000,000	
Revenues collected that were earned in prior years	(78,901)	
Loans collected during the year	(318,498)	
Loans made during the year	<u>2,700,246</u>	4,302,847

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 claims liability	(16,000,000)	
Change in long-term compensated absences	<u>(198,811)</u>	(16,198,811)

Bond issuance costs are expended in governmental funds when paid, however, are capitalized and amortized over the life of the corresponding bonds for the purposes of the statement of activities:

Capitalization of bond issuance costs	5,538,538	
Amortization of bond issuance costs	<u>(1,180,400)</u>	4,358,138

Repayment of long-term debt principal is reported as an expenditure in governmental funds and, thus, has the effect of reducing fund balance because current financial resources have been used. However, the principal payments reduce the liabilities in the statement of net assets and do not result in an expense in the statement of activities. The Agency's long-term debt was reduced because principal payments were made to bond holders and HUD:

Tax allocation bonds	32,260,000	
Convention Center refunding bonds	5,050,000	
Revenue bonds	1,400,000	
Pledge obligation (4th/San Fernando Parking Revenue Bonds)	1,325,000	
ERAF Loan	1,360,000	
HUD Section 108 loans	215,000	
Payment to refunded bond escrow agent	<u>238,954,680</u>	280,564,680

(Continued on next page)

See accompanying notes to the basic financial statements.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Reconciliation of the Statement of Revenues, Expenditures, and Changes in
Fund Balances of Governmental Funds to the Statement of Activities of Governmental Activities
For the Year Ended June 30, 2006

(Continued from previous page)

Accrued interest expense on long-term debt is reported in the statement of activities, but does not require the use of current financial resources.

Amortization of bond premiums, discounts and deferred amounts on refunding is expensed as a component of interest expense on the statement of activities. This amount represents the net accrued interest expense and the amortization of bond premiums, discounts and deferred amounts on refunding not reported in governmental funds:

Increase in accrued interest expense	\$	(2,585,277)	
Amortization of bond premiums		2,190,312	
Amortization of deferred amounts on refunding		<u>(2,609,096)</u>	\$ (3,004,061)

Proceeds from borrowing are reported as financing sources in governmental funds and, thus, contribute to the change in fund balance. In the government-wide statements, however, issuing debt increases long-term liabilities in the statement of net assets and does not affect the statement of activities.

Proceeds were received from:

The issuance of refunding bonds, including the issuance premium	(237,271,021)	
The borrowing through loan programs - ERAF Loan	(14,920,000)	
The borrowing through loan programs - Parking Loan	(3,400,000)	
The borrowing through loan programs - HUD Section 108 Loan	<u>(31,000,000)</u>	<u>(286,591,021)</u>

Change in net assets of governmental activities (page 28)		<u>\$ (108,950,647)</u>
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See accompanying notes to the basic financial statements.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

The Notes to the Financial Statements include a summary of significant accounting policies and all other disclosures considered necessary for an adequate understanding of the Agency's basic financial statements. For easy navigation, an index of the Notes is shown below:

<u>NOTE</u>	<u>DESCRIPTION</u>	<u>PAGE No.</u>
I.	Summary of Significant Accounting Policies	
	A. Reporting Entity	35
	B. Measurement Focus, Basis of Accounting, and Basis of Presentation	35-37
	C. Assets, Liabilities, Equity and Operations	
	1. Investments	37
	2. Property Tax Increment Revenues	37-38
	3. Restricted Assets	38
	4. Accumulated Redevelopment Project Costs	39
	5. Capital Assets	39
	6. Compensated Absences (Accrued Vacation and Sick Leave)	39-40
	7. Issuance Costs, Original Issue Discounts, Premiums, and Refundings	40
	8. Interfund Transactions	40
	9. Use of Estimates	40
	10. Effects of New Pronouncements	41
II.	Detailed Notes on All Funds	
	A. Cash and Investments	41-44
	B. Loans Receivable	44-46
	C. Deferred Revenue and Unearned Revenue	46
	D. Interfund Balances and Transactions	47
	E. Accumulated Redevelopment Project Costs	47-48
	F. Capital Assets	48-49
	G. Accounts Payable and Accrued Liabilities	49
	H. Debt	50-55
	I. Net Assets/Fund Balances	55-56
III.	Other Information	
	A. Contingencies	56-57
	B. Commitments	57-58
	C. Related Party Transactions with the City of San José	59-60
	D. Tax Sharing Agreement and Other Payments to the County of Santa Clara	61

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

A. Reporting Entity

The Agency was established in 1956 by the San José City Council as a public entity legally separate from the City of San José (the City). In 1975, the City Council declared itself the Agency Board, replacing a separate board. The Agency has the broad authority to acquire, rehabilitate, develop, administer, and sell or lease property in a “Redevelopment Area.” Redevelopment projects may be developed in cooperation with private developers. Redevelopment projects are also developed under cooperation agreements between the Agency and the City. The cooperation agreements call for the City to provide general, administrative, and other services in exchange for amounts paid by the Agency.

The Agency generally finances redevelopment projects through the issuance of tax allocation bonds. These bonds are payable from the incremental portion of property taxes collected within a project area relating to the increase in assessed valuation resulting from redevelopment. The County of Santa Clara (the County) collects these incremental tax revenues on behalf of the Agency. The Agency has a tax sharing agreement with the County that requires sharing of incremental tax revenues with the County.

The Agency has merged all of its redevelopment areas into a single “Merged Project Area” in order to combine tax increment revenues to obtain greater financing power through issuance of tax allocation bonds.

Under GASB Statement No. 14, *The Financial Reporting Entity*, the Agency is considered a component unit of the City since the Agency Board consists exclusively of the Mayor and the ten members of the City Council. Consequently, the Agency’s financial statements are blended in the City’s basic financial statements.

B. Measurement Focus, Basis of Accounting, and Basis of Presentation

Government-wide Financial Statements

The government-wide financial statements are reported using the *economic resources measurement focus and the accrual basis of accounting*. Revenues are recognized when earned and expenses are recorded when a liability is incurred regardless of the timing of related cash flows. Nonexchange transactions, in which the Agency gives (or receives) value without directly receiving (or giving) equal value in exchange, include property tax increment, grants, and donations. On an accrual basis, revenue from property tax increment is recognized in the fiscal year for which the taxes are levied.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

Other revenues such as grants and similar items are recognized in the fiscal year in which all eligibility requirements have been satisfied. When both restricted and unrestricted net assets are available, unrestricted resources are used only after the restricted resources related to grants are depleted.

The statement of net assets and statement of activities display information about the Agency as a whole and, accordingly, eliminations have been made to remove interfund activities.

The statement of activities presents a comparison of direct expenses and program revenues for activities of the Agency. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular program or function. Program revenues include 1) charges paid by the recipients of goods or services offered by the programs and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including property tax increment, are presented instead as general revenues.

Fund Financial Statements

The accounts of the Agency are organized and operated on the basis of funds. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements.

Governmental fund financial statements are reported using the *current financial resources measurement focus and the modified accrual basis of accounting*. Under this method, revenues are recognized as soon as they are measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Agency considers revenues to be available if they are collected within 60 days after the end of the current fiscal period. The primary revenue sources susceptible to accrual are property tax increment, intergovernmental and grant revenues, investment income, developer contributions, and rent. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments are recorded only when payment is due. General capital assets acquisitions are reported as expenditures in governmental funds. Proceeds of long-term debt and capital leases are reported as other financing sources.

The fund financial statements provide information about the Agency's funds. The emphasis of fund financial statements is on major governmental funds, each displayed in a separate column.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

The Agency reports the following major governmental funds:

- The *General Fund* is used to account for the Agency's general and administrative expenditures.
- The *Special Revenue Fund* is used to account for revenue sources that are legally restricted to expenditures for specified purposes. The purpose of this fund is to account for that portion of tax increment revenue required to be used towards low and moderate-income housing.
- The *Housing Debt Service Fund* was established to account for the payment of interest and principal on the Agency's merged area housing tax allocation bonds. The primary source of revenue for this fund is intergovernmental revenue from the City of San José Housing Department representing tax increment pledged per housing bond indentures.
- The *Merged Debt Service Fund* was established to account for the payment of interest and principal on the Agency's merged area tax allocation bonds, revenue bonds, refunding revenue bonds, and other loans. The primary source of revenue for this fund is the incremental property tax revenues.
- The *Capital Projects Fund* accounts for all revenues and costs of implementing the redevelopment projects in accordance with the California Redevelopment Law including acquisition of properties, cost of site improvements, and other costs that benefit the projects.

C. Assets, Liabilities, Equity and Operations

1. Investments

The Agency records investment transactions on the trade date. Investments are reported at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Fair value is defined as the amount that the Agency could reasonably expect to receive for an investment in a current sale between a willing buyer and seller and is generally measured by quoted market prices. Investment income, including unrealized gains and losses, is recognized as revenue in both government-wide and fund financial statements.

2. Property Tax Increment Revenues

Incremental property tax revenues represent taxes collected in the merged redevelopment project area from the excess of taxes levied and collected over that amount which was levied and collected in the base year (the inception year of redevelopment project areas) property tax assessment along with a provision for inflation.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

Under California Proposition 13, the 1975-1976 regular roll value serves as the original base value of the property. Thereafter, changes to the assessment on real property value or a portion thereof, caused by new construction or changes in ownership create the base year value used in establishing the full cash value. The full cash value is the amount of cash or equivalent value of property if exposed for sale in the open market. The full cash value may be adjusted annually to reflect inflation at a rate not to exceed 2% per year, or reduction in the consumer price index or comparable local data at a rate not to exceed 2% per year, or reduced in the event of declining property values caused by damage, destruction or other factors, including a general economic downturn. The maximum basic property tax rate is 1% of the net taxable value of the property. The total tax rate may be higher for various properties because of voter-approved general obligation bonds that are secured by property taxes for the annual payment of principal and interest.

The County of Santa Clara assesses properties, bills, and collects property taxes, as follows:

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

Taxes are secured by liens on the property being taxed. The term “unsecured” refers to taxes on property other than land and buildings. Supplemental property taxes are levied based on changes in assessed values between the date of real property sales and construction and the next normal assessment date.

The County bills and collects property taxes and remits to the Agency its share of the amount levied. The County allocates property taxes to the Agency based on 100% of the tax levy, notwithstanding any delinquencies. Revenue is recognized when it is levied and received from the County, as discussed under section of Basis of Accounting.

3. Restricted Assets

Assets that are restricted for specified uses by bonded debt requirements, grant provisions or other requirements are classified as restricted because they are maintained in separate bank accounts or by fiscal agents, and their use is limited by applicable bond covenants or agreements. Liabilities payable from such restricted assets are separately classified on the statement of net assets.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

4. Accumulated Redevelopment Project Costs

Accumulated redevelopment project costs consist of costs associated with land acquisition and construction in progress for redevelopment projects that will be transferred to the City or a developer (i.e. title and ownership of the assets will be given to the City or a developer) in accordance with development agreements. Because these assets will not be used in the Agency's operations, the accumulated redevelopment project costs are not considered capital assets.

5. Capital Assets

The Agency defines capital assets as assets used in redevelopment operations with an initial individual cost of at least \$5,000 and an estimated useful life in excess of one year. The capital assets consist of both depreciable and nondepreciable assets. The Agency's depreciable assets consist of the parking garage located beneath the Fairmont Plaza Hotel, buildings used to secure the HUD Section 108 loans obtained from U.S. Department of Housing and Urban Development, and certain leasehold improvements to the Fairmont Annex retail space. The capital assets are recorded in the government-wide financial statements at historical cost and are being depreciated using the straight-line method over the estimated useful life of 40-years for the parking structure and buildings and 25-years for leasehold improvements.

Maintenance and repairs are charged to operations when incurred. Betterments and major improvements, which significantly increase values, change capacities, or extend useful lives, are capitalized. Upon sale or retirement of capital assets, the cost and related accumulated depreciation are removed from the respective accounts and any resulting gain or loss is included in the statement of activities. However, the proceeds from the sale of capital assets are recorded as other financing sources in the governmental fund statement of revenues, expenditures, and changes in fund balances.

6. Compensated Absences (Accrued Vacation and Sick Leave)

As part of the employees' compensation package, the Agency provides benefits to its employees by establishing a Paid Time Off (PTO) and Extended Sick Leave (ESL) benefit programs. Under these programs, employees are permitted to accumulate earned PTO and ESL benefits and to carry over up to 400 unused PTO hours to the following fiscal year. Vested or accumulated PTO and ESL are reported as a long-term liability on the statement of net assets and are paid out of the General Fund. All regular employees scheduled to work 20 hours or more per week are entitled to the PTO and ESL benefits. The amount of PTO earned each year is based on employees' continuous length of service, measured from the date of employment. The maximum PTO annual accrual per employee may not exceed 400 hours at the end of the fiscal year. ESL hours are credited at the rate of 40 hours per fiscal year for all regular employees regardless of length of service.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

Beginning fiscal year 2006, Agency employees may choose, at one time during the year, to receive the cash value for accumulated PTO hours of over 200 unused hours by selling time back to the Agency, providing that the employees' PTO balance after the sell-back is above 200 and less than the maximum allowable. Upon termination, payouts of PTO and ESL are calculated as earned on a bi-weekly accrual schedule. Earned and unused PTO is paid in full while only 25% of earned but unused ESL is paid out.

7. Issuance Costs, Original Issue Discounts, Premiums, and Refundings

In the government-wide financial statements, activity associated with the issuance of bonds and other debt are reported as assets and liabilities in the statement of net assets. Issuance costs, premiums, discounts, and gains or losses occurring from refundings are deferred and amortized over the life of the bonds and other debt. Issuance costs are reported as deferred charges and are amortized into the appropriate functional expense category. Long-term debt is reported net of the applicable premiums, discounts, and deferred amounts on refunding and are amortized as a component of interest expense.

In the fund financial statements, bond issuance costs, premiums, and discounts are recognized at the time bonds are issued. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures and all other amounts are reported as other financing sources or uses.

8. Interfund Transactions

Interfund transactions are reflected either as loans, services provided, reimbursements, or transfers in the government fund financial statements. Loans between funds are reported as receivables and payables as appropriate, and are subject to elimination upon consolidation and are referred to as "due to/from other funds."

Services provided, deemed to be at market or near market rates, are treated as revenues and expenditures/expenses. Reimbursements are recorded when one fund incurs a cost, charges the appropriate benefiting fund, and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers between governmental funds are netted as part of the reconciliation to the government-wide presentation.

9. Use of Estimates

The preparation of the basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

10. Effects of New Pronouncements

At July 1, 2005, the Agency implemented GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section—an amendment of NCGA Statement 1*. This statement amends the portions of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, that guide the preparation of the statistical section. As a result, the Agency updated its statistical section by presenting detailed information, typically in ten-year trends, to assist users in utilizing the basic financial statements, notes to basic financial statements, and required supplementary information to assess the Agency’s economic condition.

At July 1, 2005, the Agency implemented GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation—an amendment of GASB Statement No. 34*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. This statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government—such as citizens, public interest groups, or the judiciary—can compel a government to honor. This statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. Finally, this statement requires governments to disclose the portion of total net assets that is restricted by enabling legislation. The disclosure changes related to this statement are reflected in Note II (I).

II. DETAILED NOTES ON ALL FUNDS

A. Cash and Investments

The Agency’s cash and investments consist of the following at June 30, 2006:

Cash and investments (unrestricted)	\$ 39,647,841
Restricted cash and investments	112,572,993
Total cash and investments	<u>\$ 152,220,834</u>

Investments

The Agency has adopted the investment policy of the City, which is governed by provisions of the California Government Code and the City’s Municipal Code. The Agency also has investments subject to provisions of the bond indentures of its various bond issues. According to the investment policy and bond indentures, the Agency is permitted to invest in the City’s cash and investment pool, the State of California Local Agency Investment Fund (LAIF), obligations of the U.S. Treasury or U.S. Government agencies, time deposits, money market mutual funds invested in U.S. Government securities, along with various other permitted investments.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

The Agency maintains all of its unrestricted investments in the City's cash and investment pool. It is not possible to disclose relevant information about the Agency's separate portion of the cash and investment pool, as there are no specific investments belonging to the Agency itself. Information regarding the characteristics of the entire investment pool can be found in the City's June 30, 2006 basic financial statements. A copy of that report may be obtained by contacting the City's Finance Department, 200 East Santa Clara Street, 13th Floor, San José, CA, 95113 or can be found at the City's Finance Department Web Site at <http://www.sanjoseca.gov/>. At June 30, 2006, the Agency's share of the City's cash and investment pool totaled \$30,928,869.

Income earned or losses arising from investments in the City's cash and investment pool are allocated on a monthly basis to the appropriate funds based on the average weekly cash balance of such funds.

In relation to the reserve account for the 2003 Merged Area Tax Allocation Bonds and the project accounts for the 2005 Housing Series C & D, the Agency has invested \$27,912,780 with LAIF as of June 30, 2006. The Agency's proportionate share of structured notes and asset-backed securities as of that date is \$716,521 or 2.567%. The Local Investment Advisory Board (Board) has oversight responsibility for LAIF. The Board consists of five members, as designated by state statute. The value of the pool shares in LAIF, which may be withdrawn upon request, is determined on an amortized cost basis, which is different from the fair value of the Agency's position in the pool.

Custodial Credit Risk

The Agency's investment policy states that uninsured deposits shall be collateralized in the manner prescribed by State law. The amounts placed on deposit with banks were covered by federal depository insurance or were collateralized by the pledging financial institutions as required by Section 53652 of the California Government Code. Such collateral is held by the pledging financial institutions' trust department or agent in the Agency's name. Accordingly, the exposure to custodial credit risk is low as of and for the year ended June 30, 2006.

Interest Rate Risk

Interest rate risk is the risk that changes in market rates will adversely affect the fair market value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market rates. The Agency's investment policy has mitigated interest rate risk by establishing policies over liquidity, including maturity limits by investment classification. These limits, for investments other than the external investment pools and money market mutual funds which have a maturity of one day, are as few as 10 days and as long as 5 years.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This risk is measured by the assignment of a rating by the nationally recognized statistical rating organizations. The Agency's investment policy has mitigated credit risk by limiting investments to the safest types of securities, by prequalifying financial institutions, by diversifying the portfolio and by establishing monitoring procedures.

Concentration of Credit Risk

Concentration of credit risk is the risk that the failure of any one issuer would place an undue financial burden on the Agency. The Agency's investment with the City's Cash and Investment Pool mitigates the concentration of credit risk by diversifying the portfolio and limiting investments in any one issuer to no more than 5 percent of the total portfolio other than securities issued by the U.S. government and its affiliated agencies. Investments issued by or explicitly guaranteed by the U.S. Government and investments in mutual funds, external investment pools, and other pooled investments are exempt from this requirement, as they are normally diversified themselves. At June 30, 2006, the Agency invested more than 5 percent of the total portfolio for the following non-exempt investments: Federal Home Loan Bank Discount Notes for \$17,342,791 and Federal Home Loan Mortgage Corp Discount Notes for \$40,781,185.

A summary of the Agency's investments at June 30, 2006 are as follows:

Type of Investment	Fair Value	Moody's Credit Risk Ratings	Weighted Average Maturity
City of San José cash and investment pool	\$ 30,928,869	Unrated	327 days
State of California Local Agency Investment Fund	27,912,780	Unrated	152 days
Federal Home Loan Bank Discount Notes	17,342,791	Prime - 1	21 days
Federal Home Loan Mortgage Corp Discount Notes	40,781,185	Prime - 1	25 days
Money market mutual funds	9,215,830	Aaa	14 days
Total investments	126,181,455		
Petty cash	2,100		
Deposits with banks	8,716,872		
Certificates of deposits (escrow accounts)	17,320,407		
Total cash and investments	<u>\$ 152,220,834</u>		

Restricted Investments in the Debt Service Funds

Under the provisions of the bond indentures, certain accounts with trustees were established for repayment of debt, amounts required to be held in reserve, and amounts to be held for the withdrawal of qualified reimbursements. These accounts are reported in debt service funds. As of June 30, 2006, the amounts held by the trustees aggregated to \$95,252,586, of which \$15,584,582 is available for withdrawal and \$79,668,004 is in compliance with amounts required to be held by the trustee at that date. All restricted investments held by trustees as of June 30, 2006 were invested in federal agencies securities, money market mutual funds and LAIF, and were in compliance with the bond indentures. Pursuant to the 1993 bond indenture, \$180,319 has

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

been determined by the trustee to be released from restriction and was remitted back to the Agency during July of 2006.

Restricted Deposits in the Capital Projects Fund

Pursuant to contracts and agreements made by the Agency, certain funds are required to be held in escrow accounts that remain the property of the Agency; however, their use is restricted for a particular purpose, which as of June 30, 2006 are as follows:

Project/Program	Amount
CIM Block 3 Project	\$ 13,131,242
HUD Section 108 funds (EU Building)	1,518,886
Paseo Villas Housing	737,652
California Theatre	554,440
Miscellaneous Redevelopment Projects	1,378,187
Total restricted deposits	\$ 17,320,407

B. Loans Receivable

Composition of loans receivable as of June 30, 2006 is as follows:

Description	Loan Balance
1 Parcels of land sold to developers	\$ 10,585,610
2 HUD Section 108 loan	2,858,005
3 Grocery store improvement	1,426,363
4 Rehabilitation of apartment complex	665,857
5 Relocation of historic homes	3,423,025
6 Rehabilitation of residential units	342,728
7 Rehabilitation of commercial buildings	7,329,600
8 Downtown building improvements	3,656,035
9 Residential housing	3,780,000
10 Rehabilitation of historic hotel building	5,265,000
11 Rehabilitation of commercial retail complex	1,505,099
Total loans receivable	40,837,322
Less allowance for doubtful accounts	(4,922,988)
Loans receivable, net	\$ 35,914,334

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

1.) Over the years, parcels of land have been sold to commercial real estate developers in exchange for various interest bearing loans. Such loans have terms ranging from 16 to 40 years, with interest rates ranging from 2% to 10%, after interest-free periods of up to 10 years, and call for principal and interest payments monthly or annually over the remaining life of the loans. The recognition of revenue from the sale of the land has been deferred in the governmental fund financial statements on such loans until they are repaid since the amounts do not meet the availability criteria. As of June 30, 2006, the amount due from developers was \$10,585,610.

2.) In 1997, the Agency extended loans to developers using funds obtained from the U.S. Department of Housing and Urban Development Section 108 loan proceeds. These loans have a 20-year repayment schedule, bear interest at an annual rate of 3%, and require principal and interest payments to the Agency on a monthly basis. As of June 30, 2006, the amount due from the developers was \$2,858,005.

3.) In 2005, a developer assigned its loan with the Agency to a new entity by assuming all the rights, title, interest, and obligations as borrower. The loan was restructured, has a 13-year term bearing interest at an annual rate of 4%, and requires principal and interest payments to the Agency on an annual basis. The loan agreement stipulated that on each consecutive anniversary of the opening date of the business, the new borrower shall deem to have been paid one-seventh of the original loan including interests if it continues its grocery business operations in the premise. Because of this arrangement and anticipation that the new borrower will continue its business operations in the premise, a 100% provision for doubtful accounts was provided for the entire loan balance of \$1,426,363.

4.) In 1999, the Agency extended a loan to a developer for rehabilitation of an apartment complex. The loan to the developer has a 19-year repayment schedule, bears interest at an annual rate of 3%, and requires principal and interest payments to the Agency on a monthly basis. As of June 30, 2006, the amount due from the developer was \$665,857.

5.) The Agency relocated historic single-family homes to vacant lots in downtown San José. These homes were provided to families and a non-profit agency, which provided the interior and exterior improvements. The loans are to be paid only in the event of non-compliance with the terms and conditions of the agreement. At the time residential occupancy of the house ceases or the property is transferred to anyone other than the owner by any method other than inheritance, the unamortized portion of the loan shall become due and payable in full. Unpaid principal shall bear an interest rate of 8% per annum. The total loans of \$3,423,025 have been offset with a 100% provision for doubtful accounts as it is anticipated that these loans will be forgiven.

6.) The Agency extended various bank-assisted loans to aid first-time homebuyers and to aid with the rehabilitation of homes. The loans accrue interest at various interest rates and are due when the related properties are sold. As of June 30, 2006, the net amount due from such loans was approximately \$342,728. An allowance for doubtful accounts in the amount of \$73,600 was made for anticipated write-offs.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

7.) Rehabilitation loans were extended to property owners for the rehabilitation and improvements of commercial buildings. The loans accrue interest at various interest rates and are due within 60 to 240 months. At June 30, 2006, the total amount due from such loans was \$7,329,600.

8.) In 2004, commercial loans were extended to two developers for improvements of downtown buildings. The loans accrue interest at 3% and are due in 10 and 20 years, respectively. At June 30, 2006, the amount due from such loans was \$3,656,035.

9.) In 1989, the Agency entered into a disposition and development agreement with a developer for the construction of residential housing units in the redevelopment project area. In 1997, the funding assistance extended by the Agency was converted to a loan bearing an interest rate of 4% per annum and due in 59 years. As of June 30, 2006, the amount due from the developer was \$3,780,000.

10.) In May 2005, the Agency amended and restated a disposition and development agreement with a developer recognizing a loan for the rehabilitation of a historic hotel building. The loan has a 60-year repayment schedule, bears no interest, and requires principal payments to the Agency on a semi-annual basis starting in fiscal year 2020-2021. As of June 30, 2006, the amount due from the developer was \$5,265,000.

11.) In November 2004, the Agency extended a loan to a developer for rehabilitation of a commercial retail complex. The loan to the developer has a due date of December 31, 2007 and accrues monthly interest at a rate equal to LIBOR plus 195 basis points. As of June 30, 2006, the amount due from the developer was \$1,505,099.

C. Deferred Revenue and Unearned Revenue

At June 30, 2006, the various components of deferred revenue and unearned revenue reported in the Capital Projects Fund and governmental activities were as follows:

	Amount
Amounts considered unavailable:	
Related to loans receivable	\$ 33,056,329
Related to other long-term receivables	2,683,543
Total deferred revenue, as reported in the fund financial statements	\$ 35,739,872
Amounts considered unearned:	
Related to developer contributions	\$ 13,148,535
Related to other long-term receivables	434,982
Total unearned revenue, as reported in the fund financial statements	\$ 13,583,517

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

D. Interfund Balances and Transactions

The composition of borrowing between funds for the fiscal year ended June 30, 2006 is as follows:

Due from Other Funds	Due to Other Funds	Amount
Capital Projects Fund	Merged Debt Service Fund	\$ 180,319

As listed in the table above, the \$180,319 amount represents a return of funds to the Agency pursuant to the 1993 bond indenture, which states that the trustee must release certain funds from restriction and remitted those funds directly to the Agency.

The composition of interfund transfers for the fiscal year ended June 30, 2006 is as follows:

Transfer-in Fund	Transfer-out Fund	Amount
Merged Debt Service Fund	Capital Projects Fund	\$ 32,033,164
General Fund	Capital Projects Fund	6,975,898
Total		<u>\$ 39,009,062</u>

As listed in the table above, the \$32,033,164 amount represents transfers necessary to make required debt service payments; the \$6,975,898 amount represents a transfer of funds necessary to cover the general and administrative expenditures of the Agency.

E. Accumulated Redevelopment Project Costs

For the fiscal year ended June 30, 2006, the change in accumulated redevelopment project costs consisted of the following:

	July 1, 2005	Additions	Dispositions	Transfers	June 30, 2006
Land held for redevelopment	\$ 194,800,337	\$ 13,678,766	\$ (11,385,907)	\$ (20,114,747)	\$ 176,978,449
Construction in progress	160,239,514	3,817,127	-	(147,846,371)	16,210,270
Buildings	-	-	-	134,035,738	134,035,738
Total	<u>\$ 355,039,851</u>	<u>\$ 17,495,893</u>	<u>\$ (11,385,907)</u>	<u>\$ (33,925,380)</u>	<u>\$ 327,224,457</u>

During current year, parcels of land with a cost aggregating to \$13,678,766, mainly located in the Agency's Strong Neighborhood Initiative-Burbank/Del Monte Project Area, were acquired for eventual use for housing site assembly projects.

During the year, cost of land aggregating to \$11,046,182 was sold to private developers for future development projects while cost of land aggregating to \$339,725 was transferred to developers in accordance with Disposition and Development Agreements and the City. These dispositions are comprised of properties located at 2nd/3rd Street with a cost of \$5,127,521, 303 Almaden Avenue with a cost of \$5,302,101, North San Pedro Street with a cost of \$616,560, and 102 & 114 West Alma Avenue with a cost of \$339,725.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

At the end of the current year, two projects (the Dr. Martin Luther King, Jr. Library and the California Theater) totaling \$134,035,738 were transferred from construction in progress to buildings, as they were considered substantially completed. No depreciation expense was recorded for these buildings during the current year. These buildings, along with site acquisition costs, are scheduled to be transferred to the City during fiscal year 2007.

In addition, two other projects (the José Theater and the Convention Center Annex/Expansion) with building costs totaling \$13,810,633 and site acquisition costs totaling \$20,114,747, were transferred to capital assets. The change in categorization of these assets was the result of management's change in use of these assets. Management decided to utilize these assets as security for the HUD Section 108 loans obtained from U.S. Department of Housing and Urban Development during the current fiscal year (see Note II.H). Accordingly, the Agency will maintain these assets in its portfolio for as long as they are securing the HUD Section 108 loans.

Construction in progress as of June 30, 2006 consisted of the following:

Civic Plaza Streetscape	\$	5,500,887
Bellevue Park		2,485,502
Guadalupe River Park		1,552,637
4th Street Garage Parking - Tenant's Improvement		1,450,916
Other projects		5,220,328
		5,220,328
Total construction in progress	\$	16,210,270

F. Capital Assets

A summary of changes in the Agency's capital assets for the fiscal year ended June 30, 2006 is as follows:

	July 1, 2005	Additions	Dispositions	Transfers	June 30, 2006
Capital assets, not being depreciated:					
Land	\$ -	\$ -	\$ -	\$ 20,114,747	\$ 20,114,747
Capital assets, being depreciated:					
Buildings	-	-	-	13,810,633	13,810,633
Parking structure	10,000,000	-	-	-	10,000,000
Leasehold improvements	1,279,000	-	-	-	1,279,000
Total capital assets, being depreciated	11,279,000	-	-	13,810,633	25,089,633
Less accumulation depreciation for:					
Parking structure	4,375,000	250,000	-	-	4,625,000
Leasehold improvements	72,624	51,830	-	-	124,454
Total accumulated depreciation	4,447,624	301,830	-	-	4,749,454
Total capital assets, being depreciated, net	6,831,376	(301,830)	-	13,810,633	20,340,179
Total capital assets, net	\$ 6,831,376	\$ (301,830)	\$ -	\$ 33,925,380	\$ 40,454,926

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

The capital assets consist of land, buildings, the parking garage located beneath the Fairmont Plaza Hotel, which was constructed in 1987, and certain improvements to the Fairmont Annex retail space. Depreciation attributable to these capital assets is charged to the Community Development functional expense in the statement of activities.

During the current year, two completed projects (the José Theater and the Convention Center Annex/Expansion) and the associated site acquisition costs were transferred from accumulated redevelopment project costs, as described in Note II.E. These projects were used to secure HUD Section 108 loans. The Agency will start depreciating the buildings starting in fiscal year 2007.

G. Accounts Payable and Accrued Liabilities

Agency accounts payable and accrued liabilities at June 30, 2006 are as follows:

	General Fund	Debt Service Fund - Housing	Capital Projects Fund	Total
Accounts payable	\$ 329,901	\$ 70,788	\$ 2,983,542	\$ 3,384,231
Accrued salaries and benefits	375,809	-	-	375,809
Total	<u>\$ 705,710</u>	<u>\$ 70,788</u>	<u>\$ 2,983,542</u>	<u>\$ 3,760,040</u>

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

H. Debt

Long-term Debt

The following is a summary of bonds and loans payable of the Agency as of June 30, 2006 (in thousands):

Type of Indebtedness	Purpose	Original Issue Amount	Issue Date	Maturity Date	Range Interest Rate	Annual Principal Installments	June 30, 2006 Balance
Tax Allocation Bonds:							
1993 Merged Refunding	Advanced refunding	\$692,075	12/1/1993	8/1/2024	4.75-6.00%	\$12,290-42,405	\$ 277,125
1997 Merged	Merged Area projects	106,000	3/27/1997	8/1/2028	5.38-5.63%	\$10-3,110	11,600
1998 Merged	Merged Area projects	175,000	3/19/1998	8/1/2029	5.00-5.25%	\$1,275-31,350	149,265
1999 Merged	Merged Area projects	240,000	1/6/1999	8/1/2031	4.75-5.00%	\$4,100-23,595	166,595
2002 Merged	Merged Area projects	350,000	1/24/2002	8/1/2032	3.00-5.00%	\$1,875-29,890	247,865
2003 Merged	Merged Area projects	135,000	12/22/2003	8/1/2033	3.00-5.00%	\$25-34,100	128,280
2004 A Merged Refunding	Refund portion of Merged Bonds	281,985	5/27/2004	8/1/2019	2.00-5.25%	\$540-31,900	269,090
2005 A Merged Refunding	Refund portion of Merged Bonds	152,950	7/26/2005	8/1/2028	3.25-5.00%	\$110 - 26,210	152,950
2005 B Merged Refunding	Refund portion of Merged Bonds	67,130	7/26/2005	8/1/2015	4.50 - 5.00%	\$4,225 - 21,560	67,130
1997 Housing, Series E	Low-moderate income housing	17,045	6/23/1997	8/1/2027	5.75-5.85%	\$2,420-14,625	17,045
2003 Housing, Series J & K	Low-moderate income housing	69,000	7/10/2003	8/1/2029	2.00-5.25%	\$3,300-16,370	62,460
2005 Housing Series A & B	Low-moderate income housing	129,720	6/30/2005	8/1/2035	3.75-5.46%	\$970-57,755	129,720
2005 Housing Series C & D	Low-moderate income housing	66,150	6/30/2005	8/1/2035	Variable	\$830-1,380	66,150
Total Tax Allocation Bonds							1,745,275
Other Long-term Debt:							
1996 Merged Area Revenue, Series A/B	Merged area projects	59,000	6/27/1996	7/1/2026	Variable	\$1,400-3,400	56,200
2003 Merged Area Revenue, Series A/B	Merged area projects	60,000	8/27/2003	8/1/2032	Variable	\$500 - 3,900	60,000
Pledge obligation - 4th/San Fernando Parking Revenue Bonds	4th/San Fernando parking facility project	48,675	4/10/2001	9/1/2026	3.80-5.25%	\$1,275-8,310	42,545
2001 Convention Center Refunding Bonds, Series F	Convention Center refunding project	190,730	7/1/2001	9/1/2022	4.00-5.00%	\$5,050-14,730	171,800
CSCDA ERAF Loan	Fund the State's ERAF Program	19,085	4/27/2005	8/1/2015	3.87-5.01%	\$1,640 - 2,355	17,725

Continued on next page

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

(Continued from previous page) Type of Indebtedness	Purpose	Original Issue Amount	Issue Date	Maturity Date	Range Interest Rate	Annual Principal Installments	June 30, 2006 Balance
CSCDA ERAF Loan	Fund the State's ERAF Program	14,920	5/3/2006	8/1/2016	5.28-5.67%	\$985 - \$1,905	14,920
City of San José Parking Fund Loan	Merged area projects	6,800	4/12/2005	1/31/2009	Variable	\$6,800	6,800
HUD Section 108 Loans	Merged area projects	5,200	2/11/1997	8/1/2016	Variable	\$235 – 465	3,705
HUD Section 108 Loans	Merged area projects	13,000	2/8/2006	8/1/2025	Variable	\$570 – 1,135	13,000
HUD Section 108 Loans	Merged area projects	18,000	6/30/2006	8/1/2025	Variable	\$670 – 1,570	18,000
Total Other Long-term Debt							<u>404,695</u>
Total Long-term Debt							<u><u>\$ 2,149,970</u></u>

A summary of the changes in long-term debt during the fiscal year ended June 30, 2006 follows (in thousands):

	Balance July 1, 2005	Additions	Payments/ Refundings	Balance June 30, 2006	Amount Due in One Year
Tax allocation bonds:					
1993 Merged Refunding	\$ 317,330	\$ -	\$ (40,205)	\$ 277,125	\$ 16,320
1997 Merged	83,255	-	(71,655)	11,600	235
1998 Merged	168,320	-	(19,055)	149,265	1,330
1999 Merged	222,115	-	(55,520)	166,595	4,205
2002 Merged	302,085	-	(54,220)	247,865	2,145
2003 Merged	129,010	-	(730)	128,280	735
2004 A Merged Refunding	281,985	-	(12,895)	269,090	540
2005 A & B Merged Refunding	-	220,080	-	220,080	-
1997 Housing, Series E	17,045	-	-	17,045	-
2003 Housing, Series J & K	65,760	-	(3,300)	62,460	3,370
2005 Housing, Series A & B	129,720	-	-	129,720	950
2005 Housing, Series C & D	66,150	-	-	66,150	1,660
Total tax allocation bonds	<u>1,782,775</u>	<u>220,080</u>	<u>(257,580)</u>	<u>1,745,275</u>	<u>31,490</u>
Other long-term debt:					
1996 Merged Area Revenue, Series A/B	57,600	-	(1,400)	56,200	1,400
2003 Merged Area Revenue, Series A/B	60,000	-	-	60,000	1,100
Pledge obligation – 4th/San Fernando parking revenue bonds	43,870	-	(1,325)	42,545	1,375
2001 Convention Center Refunding Bonds, Series F	176,850	-	(5,050)	171,800	5,585
CSCDA ERAF Loan	19,085	14,920	(1,360)	32,645	2,625
City of San José Parking Fund Loan	3,400	3,400	-	6,800	-
HUD Section 108 loans, variable rate loans	3,920	31,000	(215)	34,705	235
Total other long-term debt	<u>364,725</u>	<u>49,320</u>	<u>(9,350)</u>	<u>404,695</u>	<u>12,320</u>
Total long-term debt, before premiums, discounts, and deferred amount on refunding	2,147,500	269,400	(266,930)	2,149,970	43,810
Unamortized issuance premium	18,663	17,191	(2,507)	33,347	2,282
Unamortized deferred amount on refunding	(22,873)	(14,218)	2,609	(34,482)	(2,681)
Total long-term debt payable	2,143,290	272,373	(266,828)	2,148,835	43,411
Claims liabilities	6,500	22,500	(6,500)	22,500	-
Compensated absences	1,016	418	(219)	1,215	243
Total long-term obligations	<u>\$ 2,150,806</u>	<u>\$ 295,291</u>	<u>\$ (273,547)</u>	<u>\$ 2,172,550</u>	<u>\$ 43,654</u>

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

The Merged Tax Allocation Bonds are senior debt and are repaid with the tax increment. The Housing Bonds are repaid with the Housing Set-Aside Amounts. The Merged Revenue Bonds are repaid with subordinated revenues. The remaining long-term debt is repaid with other revenues.

2005 Merged Area Tax Allocation Refunding Bonds

On July 26, 2005, the Redevelopment Agency issued Merged Area Tax Allocation Refunding Bonds Series 2005A and Series B amounting to \$152,950,000 and \$67,130,000, respectively. The proceeds of the bonds were used to current refund a portion of the Agency's Merged Area Tax Allocation Bonds, Series 1993, Series 1997, Series 1998, Series 1999 and Series 2002 and to pay the costs of issuance of the Series 2005A and 2005B refunding bonds. The 2005 bonds are secured by a pledge of the tax revenues on parity with other outstanding Merged Area Tax Allocation Bonds.

The refunding of Series 1993, Series 1997, Series 1998, Series 1999, and Series 2002 resulted in the accounting recognition of a deferred loss of \$14,218,049 for the fiscal year ended June 30, 2006. However, the Agency in effect reduced its aggregate debt service payments by approximately \$7,232,108 over the next 24 years and obtained a net economic gain (difference between the present values of the old and new debt service payments) of \$6,886,437.

The Series 2005A refunding bonds, which are insured by MBIA, bear interest rates ranging from 3.25% to 5.00%, and have a final maturity date of August 1, 2028. The Series 2005B refunding bonds, which are insured by AMBAC, bear interest rates ranging from 4.50% to 5.00%, and have a final maturity date of August 1, 2015.

California Statewide Communities Development Authority (CSCDA) Educational Revenue Augmentation Fund (ERAF) Loan

As part of its actions to address the State's fiscal crisis, the State of California enacted a budget requiring local governments to give up a grand total of \$1.3 billion in local funds for each of the next two fiscal years. For the current year, the Agency's share of \$14,500,614 was paid onto the Educational Revenue Augmentation Fund (ERAF) and is frequently referred as the ERAF payment. The Agency was required to make the payment to the County of Santa Clara on or before May 10, 2006. To finance the ERAF payment, the Agency as a participant of the California Statewide Communities Development Authority (CSCDA) decided to join for the second year the California Redevelopment Association/Educational Revenue Augmentation Fund (CRA/ERAF) Loan Program. On May 3, 2006, CSCDA issued bonds aggregating to \$20,135,000 and the Agency's share of the bonds was \$14,920,000. For fiscal year 2005, the Agency's share in the CSCDA loan amounted to \$19,085,000. As of June 30, 2006, the Agency's aggregate loans with CSCDA have a balance of \$32,645,000. The loans with CSCDA are scheduled to be repaid over a 10-year period and bear fixed interest rate from 5.28% to 5.67%. The final maturity date for the loans is August 1, 2016.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

City of San José Parking Fund Loan

On April 12, 2005, the Agency entered into a loan agreement with the City of San José in an amount of \$6,800,000 from the future facilities reserve within the City's General Purpose Parking Fund. The loan from the City to the Agency constitutes indebtedness under the California Redevelopment Law. The Loan was received by the Agency from the City in 2 installments: \$3,400,000 on April 15, 2005 and \$3,400,000 on February 1, 2006. The Agency is allowed to use the Loan proceeds for any programs or projects contained in the Agency's Adopted FY 2004-05 Capital and Operating Budgets and the FY 2004-05, FY 2005-06 Two Year Spending Plan, as may be amended from time to time. Interest on the loaned amounts shall accrue monthly on a compounded basis based on the City's investment Portfolio No.1's rate of return. The final maturity date of the loan, along with accrued interest, shall be repaid to the City on or before January 31, 2009.

4th and San Fernando Streets Parking Facility

In March 2001, the City of San José Financing Authority (the Authority) issued Revenue Bonds, Series 2001A in the amount of \$48,675,000 to finance the construction of the 4th & San Fernando Parking Facility Project. The Agency entered into the *Agency Pledge Agreement* with the Authority, whereby Agency payments are payable from and secured by surplus Agency Revenues. Agency payments are limited in each year to an amount equal to the annual debt service due on the bonds minus surplus revenues generated by the garage. Surplus Agency Revenues consist of (i) estimated tax increment revenues, which are pledged to the payment of the Agency's outstanding tax allocation bonds and deemed to be "Surplus" in the current fiscal year in accordance with the resolution or indenture pursuant to which the outstanding tax allocation bonds were issued, plus (ii) all legally available revenues of the Agency. As of June 30, 2006, the Agency has outstanding obligation, per Agency Pledge Agreement, of \$42,545,000.

HUD Section 108 Loans

In June 2006, the Agency received loan proceeds of \$13,000,000 under the provisions of the U.S. Department of Housing and Urban Development (HUD) Section 108. The proceeds are used to finance certain projects in the Merged Project Area.

On June 29, 2006, the Agency also requested for a drawdown for another loan of \$18,000,000 that was approved by HUD during fiscal year ended June 30, 2004. The loan is for reimbursement of costs incurred on the Story/King Retail Project. The loan proceeds were received by the Agency on July 12, 2006. At June 30, 2006, a corresponding receivable balance of \$18,000,000 was recorded related to this loan.

At June 30, 2006, the Agency has outstanding loans due of approximately \$34,705,000. The notes payable to HUD mature annually through August 2025 and bear interest at 20 basis points above the LIBOR index.

The Agency secured current year loans issued totaling \$31,000,000 by collateralizing Agency-owned property. At June 30, 2006, \$33,925,380 of capital assets was used for collateral on the loans.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

Debt Service Requirements

The debt service requirements for all debt are based upon a fixed rate of interest, except the 1996 Series A and B Merged Area Revenue Bonds, 2003 Series A and B Merged Area Revenue Bonds, 2005 Series C and D Housing Bonds, the HUD Section 108 loans and the Parking Loan with the City of San Jose, which bear interest at variable rates. Interest on the 1996 Series A and B Merged Area Revenue Bonds, 2003 Series A and B Merged Area Revenue Bonds, and the 2005 Series C and D Housing Bonds may be set at different interest rate calculation modes, including daily, monthly and fixed rates. On June 30, 2006, all the variable rate bonds were set in weekly modes. Interest on the HUD Section 108 loan is adjusted monthly on the first day of each month to a variable interest rate equal to 20 basis points above the applicable LIBOR rate. Interest on the Parking Loan with the City of San Jose is adjusted monthly based on the City's investment Portfolio No.1's rate of return.

For purposes of calculating the annual debt service requirements as of June 30, 2006, the following assumed effective rates have been used:

Bond issues	Effective interest rate
1996 Merged Area Revenue, Series A	3.87%
1996 Merged Area Revenue, Series B	3.85%
2003 Merged Area Revenue, Series A	5.35%
2003 Merged Area Revenue, Series B	3.94%
2005 Housing, Series C	3.97%
2005 Housing, Series D	3.99%
HUD Section 108 loan	5.43%
Parking Loan with the City of San José	4.11%

The annual requirements to amortize outstanding tax allocation bonds and other long-term debt outstanding as of June 30, 2006, including mandatory sinking fund payments, are as follows (in thousands):

Year Ending June 30,	Merged Tax Allocation Bonds		Housing Tax Allocation Bonds		Other Obligations		Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2007	\$ 25,510	\$ 72,333	\$ 5,980	\$ 12,833	\$ 12,320	\$ 18,870	\$ 43,810	\$ 104,036
2008	35,395	70,691	6,720	12,637	13,475	18,126	55,590	101,454
2009	37,285	68,751	6,935	12,407	21,200	18,465	65,420	99,623
2010	39,255	66,755	7,175	12,143	16,060	16,809	62,490	95,707
2011	41,255	64,684	7,450	11,849	17,980	16,029	66,685	92,562
2012-2016	239,845	289,025	42,100	54,124	102,850	66,280	384,795	409,429
2017-2021	301,585	222,903	52,420	43,297	107,545	40,166	461,550	306,366
2022-2026	350,050	144,105	60,715	29,551	86,165	13,948	496,930	187,604
2027-2031	290,205	62,776	55,010	14,266	19,500	3,019	364,715	80,061
2032-2036	109,515	7,979	30,870	2,869	7,600	179	147,985	11,027
Total	<u>\$ 1,469,900</u>	<u>\$ 1,070,002</u>	<u>\$ 275,375</u>	<u>\$ 205,976</u>	<u>\$ 404,695</u>	<u>\$ 211,891</u>	<u>\$ 2,149,970</u>	<u>\$ 1,487,869</u>

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

Conduit Debt

In April 1998, the Agency served as the conduit issuer of \$38,000,000 in Multifamily Housing Revenue Bonds in order to provide funds for a mortgage loan to finance the acquisition and construction of a multifamily residential project in the Century Center Redevelopment Project Area. The Agency has no obligation for these bonds, as they will be payable solely from and secured to the extent provided in the indenture by a pledge of certain revenues and other amounts to be received by the Agency under the Loan Agreement. A developer has arranged for an initial irrevocable direct-pay letter of credit to be issued in favor of the trustee. As of June 30, 2006, the outstanding balance was \$38,000,000.

In August 1997, the Agency served as the conduit issuer of \$10,595,000 in Multifamily Housing Revenue Bonds in order to provide funds for a mortgage loan to finance a multifamily rental housing project in the Japantown Redevelopment Project Area. The Agency has no obligation for these bonds as they are secured primarily by fully modified pass-through mortgage-backed securities guaranteed as to timely payment of principal and interest by the Government National Mortgage Association. The bonds were issued for the purpose of expanding the community's supply of low to moderate-income housing, and to construct a community center and retail space. The loan is secured on a nonrecourse basis and is insured by the Federal Housing Authority pursuant to and in accordance with the provisions of Section 221(d) (4) of the National Housing Act and applicable regulations thereunder. As of year-ended June 30, 2006, the outstanding balance was \$10,058,000.

I. Net Assets/Fund Balances

The government-wide financial statements utilize a net assets presentation. Net assets are categorized as follows:

- *Invested in Capital Assets* – This category groups all capital assets into one component of net assets. The balance is the net of accumulated depreciation; however, all bond proceeds associated with the acquisition have been repaid and, therefore, do not reduce the net asset position of the capital 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. At June 30, 2006, the Agency's statement of net assets reported restricted net assets of \$57,280,238, of which \$0 was restricted by enabling legislation.
- *Unrestricted Net Assets (Deficit)* – This category represents net assets (deficit) of the Agency, not restricted for any project or other purpose.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

Fund balances consist of reserved and unreserved amounts. Reserved fund balance represents that portion of the fund balances which is not available for appropriation for expenditure or is legally segregated for a specific future use. The remaining portion is unreserved fund balance. In the budget, management has designated certain portions of fund balance to indicate tentative plans for financial resource utilization in a future period, such as for general contingencies or other capital projects.

As of June 30, 2006, reservations of fund balance are described below:

- *Long-term receivables* – to reflect the amount due from developers related to the HUD Section 108 loan. Such amounts do not represent available spendable resources.
- *Advances and deposits* - to reflect the amount due from other funds that are long-term in nature and amounts deposited with third parties. Such amounts do not represent available spendable resources.
- *Debt service* - to reflect the funds held by trustees or fiscal agents for future payment of bond principal, interest, and reserve accounts. These funds are legally restricted for repayment of debt.
- *Low and moderate-income housing activities* - to reflect the amounts required by state law to be used for low and moderate-income housing activities.
- *Encumbrances* - to reflect the outstanding contractual obligations for which goods and services have not yet been received.

III. OTHER INFORMATION

A. Contingencies

Risk Management

The Agency is exposed to various risks of loss related to torts, theft, damage to and destruction of assets, errors and omissions, general liabilities, workers' compensation, and unemployment claims for which the Agency carries commercial insurance policies. The insurance premiums are paid from the General Fund. Claim expenses and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated using actuarial methods or other estimating techniques. The technique to estimate claims is based on many complex factors, such as inflation, changes in legal doctrines, past settlements, and damages award. Accordingly, claims are reevaluated periodically to consider the effects of inflation, recent claim settlement trends (including frequency and amount of pay-outs), and other economic and social factors. The estimated claims liability includes amounts of incremental claims adjustment expense related to specific claims and other claims adjustments expenses, if any, regardless of whether allocated to specific claims. During the past three years, there have been no instances where the amount of claim settlements exceeded insurance coverage, nor have there been any significant reductions of insurance coverage.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

Litigation

In August 2004, the City and the Agency filed a lawsuit seeking a judicial determination as to whether the County had breached an agreement entered into among the parties in May 2001 (the 2001 Agreement). In April 2005, the County filed a cross complaint against the City and the Agency alleging, among other things, breach of the 2001 Agreement, breach of the 2001 Agreement's implied covenant of good faith and fair dealing, and intentional interference with prospective economic relations.

In February 2006, the San Mateo Superior Court granted County's motion for Summary Judgment holding that the County had not breached the 2001 Agreement. Subsequently, the City, the Agency and the County have decided to settle the lawsuit and have come to a tentative settlement that is still in the negotiation process. The tentative settlement among the City, the Agency and the County is that each would drop their respective lawsuits and the Agency and/or City would pay the County a sum of \$22.5 million, to be used by County on specified facilities that benefit the citizens of the City of San José. The Agency and/or City will pay the \$22.5 million in three installments of \$7.5 million over a three-year period, commencing on July 1, 2007 (i.e., FY 2008).

The Agency is subject to various other claims and from time to time is involved in lawsuits in which damages are sought. As litigation is subject to many uncertainties and as the outcome of litigated matters cannot be predicted with certainty, it is reasonably possible that some of these legal actions could be decided unfavorably against the Agency.

Changes in the balances of unpaid claims liabilities during the past two years are as follows (in thousands):

	Fiscal Year	
	2006	2005
Unpaid claims, beginning of fiscal year	\$ 6,500	\$ -
Incurred claims	22,500	6,500
Claims payment	(6,500)	-
Unpaid claims, end of fiscal year	\$ 22,500	\$ 6,500

B. Commitments

Capital Expenditure Projections

On September 13, 2005, the Agency Board adopted the Operating and Capital Budgets for fiscal year 2005-2006 with Two-Year Spending Plan. The Two-Year Spending Plan shows a total spending of \$637 million for the 2-year period (fiscal years 2005-2006 and 2006-2007). Of this amount, \$209 million is to be spent on capital expenditures, \$316 million for financing/non-project costs, \$16 million for operating expenditures, \$55 million for obligated payments and \$41 million for capital reserve.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

Defined Contribution Retirement Plan

In January 1995, the Agency Board adopted a defined contribution retirement plan, the Redevelopment Agency of the City of San José Retirement Plan (the Plan), which provides pension benefits for its employees. For eligible employees who contribute 3.5% of their annual base salary, the Agency contributes approximately 9.0%. Agency contributions are based on a formula taking into account employee annual base salary and length of service. The Agency's contributions for each employee (and interest allocated to the employee's account) are fully vested after three years of continuous service from the original date of employment. Agency contributions and interest forfeited by employees who leave employment before vesting occurs may be used to reduce the Agency's contribution requirement or to offset the plan's operating expenses. Three Agency employees are co-trustees of the Plan. The Agency contracts with an advisor to manage the Plan with all assets being held in trust by a third party custodian in the name of each of the Plan's participants. Each of the Plan's participants directs the investments of their separate account. The Agency Board must authorize changes to the Plan.

The total payroll in fiscal year 2005-2006 for the Agency's direct employees was approximately \$7,453,000. Both the Agency and the participating employees made contributions to the Plan amounting to approximately \$689,299 and \$263,533, respectively.

Leases

A schedule by years of future minimum rental payments required under the Agency's noncancellable operating leases for office facilities, business equipment, and land as of June 30, 2006 (net of income from subleases) is as follows (in thousands):

Year Ending June 30,	Minimum payments	Income from Subleases	Net minimum payments
2007	\$ 3,084	\$ (42)	\$ 3,042
2008	2,728	-	2,728
2009	2,684	-	2,684
2010	2,214	-	2,214
2011	1,970	-	1,970
2012-2016	3,164	-	3,164
2017-2021	2,358	-	2,358
Total	<u>\$ 18,202</u>	<u>\$ (42)</u>	<u>\$ 18,160</u>

The total net rent expense for operating leases in fiscal year 2005-2006 was approximately \$3,103,640.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

C. Related Party Transactions with the City of San José

Amounts Received from and Payments to the City

The Agency is required by the California Community Redevelopment Law to designate 20% of all incremental property tax revenues for low and moderate-income housing activities (the Special Revenue Fund). In addition, in fiscal year 1992, the Agency elected to designate 20% of County supplemental assessment revenues for those purposes. The City's Housing Department administers these designated funds. During fiscal year 2005-06, the Agency transferred to the City's Housing Department \$30,013,987 of property taxes in the Special Revenue Fund.

Annually, the City's Housing Department makes payments to the Agency for the repayment of debt service on the Housing Bonds, Series A through K. Approximately \$12,867,063 of such payments was made during fiscal year 2005-2006. Also during fiscal year 2005-2006, the Agency transferred to the City's Housing Department \$20,867,305, representing drawdowns of proceeds from the 2005 Housing Set-Aside Tax Allocation Bonds issued in June 2005.

As part of the pledge agreement entered by the Agency and the City of San José Financing Authority on the 4th/San Fernando Garage Parking Revenue Bond - Series 2002A, the Agency transferred, during the year, the total amount of \$3,366,054 representing principal and interest due on the bonds in the subsequent year.

In June 2001, the Agency Board, in relation to Parkland Dedication Ordinance (PDO) and Park Impact Ordinance (PIO), adopted a resolution approving a Parkland In-Lieu Fee Low-Income Unit Voucher Program/(Voucher Program) for the payment of subsidized parkland fees for low-income residential units by the Agency. On October 26, 2004 the Board extended the program until December 31, 2005. Under the PDO/PIO, developers of new residential projects are required to dedicate parkland, construct improvements and/or pay equivalent in-lieu fees for neighborhood and community-serving parks under the Voucher Program. Developers of low-income residential units are issued a voucher from the City's Housing Department to present to the City's Building Division in lieu of the payment of parkland fees, required by PDO and PIO. The Agency then reimburses the City's Parks Trust Fund in the amount of the voucher. As of June 30, 2006, the Agency paid a cumulative amount of \$22,343,000 to the City. For the fiscal year ended June 30, 2006, the Agency accrued an additional amount of \$2,618,200, representing unpaid vouchers turned in by the developers to the City during the fiscal year, resulting in an increase of the payable balance to the City to \$8,111,800 at June 30, 2006.

In addition, other payments are made to and received from the City. The following significant transactions were made during the year: 1) the Agency paid from its General Fund and Capital Projects Fund approximately \$5,138,889 for City support services, 2) a payment made by the City to the Agency in the amount of \$13,326,443 and reimbursed by the Agency pursuant to the Second Amended and Restated Reimbursement Agreement for the Convention Center Refunded Bonds, and 3) the payments related to the San José Arena management agreement are paid from the Agency's Capital Projects Fund and totaled \$315,000 for fiscal year 2005-2006.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

In the past, the Agency advanced a portion of a loan made by the City's Housing Department to a third party providing shelter for women. The advance is recorded at its net realizable value of \$580,362 and will be repaid when the loan is collected by the City's Housing Department.

In the current year, the Agency advanced the amount of \$604,350 to the City as a security for a downtown project development as required under a Subdivision Improvement Agreement with the understanding that the money will be returned by the City to the Agency once the developer met the required agreement.

On March 20, 2001, the Agency Board authorized a fund transfer of \$2,000,000 to the City to provide public improvements. The City used these improvement funds to extend a loan to a non-profit organization, which provides community events in downtown San José. As a guarantee of loan repayment, the non-profit organization issued a promissory note to the City in the amount of \$2,000,000, secured by its own land and building on May 31, 2001. As part of the City's arrangement with the Agency, the City will return the funds to the Agency when the non-profit organization repays the loan. The Agency reported the fund transfer as expenditures at the time of transfer and will be reported as revenue when City returns the money upon collection from the non-profit organization.

Cooperation Agreements with the City

The Agency entered into Cooperation Agreements to assist in funding various projects constructed on its behalf by the City and to reimburse the City for the actual salaries and fringe benefits of City employees who work under the supervision of the Agency's Executive Director or designee, including other City staff in providing support services to the Agency. These agreements state the Agency's commitment for a one-year period consistent with the Agency's capital and operating budgets and are renewed on an annual basis.

The agreements further call for the Agency to submit a Project Service Memorandum (PSM) to the appropriate City Department prior to the start of the construction project. Funds are transferred to the City to cover the costs of completing the project including reasonable related administrative costs. After a PSM is approved by the Agency and agreed upon by the City, the Agency shall have no additional obligation relating to the agreed costs of the project except as may be agreed to in writing by the Agency and City. Any surplus funds in the project account are returned to the Agency. The agreement also states that the Agency may cancel the project and any unused funds shall be returned by the City to the Agency.

The amounts paid for construction projects in connection with these Cooperation Agreements during fiscal year 2005-2006 totaled \$17,173,819.

At June 30, 2006, the Agency recorded a Due from the City of San José in the amount of \$1,154,574, representing the funds to be received from the City for unused construction money on capital projects funded by the Agency in accordance with the Cooperation Agreements.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Basic Financial Statements
June 30, 2006**

D. Tax Sharing Agreement and Other Payments to the County of Santa Clara

Tax Sharing

In 1983, the Agency and the County of Santa Clara (the County) entered into a tax sharing agreement under which the Agency would pay a portion of tax increment revenue generated in the Merged Area and part of the Rincon de los Esteros Project Area (the County Pass-Through Payment). On December 16, 1993, the Agency, the County, and the City entered into a Settlement Agreement, which continued the County Pass-Through Payment.

On May 22, 2001, the County, the City, and the Agency approved an Amended and Restated Agreement (the "Amended Agreement"). In addition to the continued Pass-Through Payment, the Amended Agreement delegated to the County the authority to undertake redevelopment projects in or of benefit to the Merged Area, and requires the Agency to transfer funds to the County to pay for such projects (the "Delegated Payment"). The Delegated Payment stemming from a portion of the property tax increment ceased by June 30, 2004. After January 1, 2004, 20% of the proceeds of any debt secured by the Agency's Tax Revenues (excluding refunding bonds) must be paid to the County as the Delegated Payment.

For the fiscal year 2005-2006, the Pass-Through amount totaled \$12,071,927 and the Delegated Payment was \$0.

ERAF Payment

On August 5, 2004, SB 1096 was signed into law requiring redevelopment agencies statewide to shift for two years (2004-2006) the amount of \$250 million in property tax increment revenues to the State of California Educational Revenue Augmentation Fund as a way to reduce the State's 2004-2006 budget deficit. The Agency's share of this revenue shift for fiscal year 2005-2006 amounted to \$14,500,614, which was paid on May 10, 2006.

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San Jose Grand Prix



San Jose Museum of Art

Other Required Supplementary Information

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REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
Schedule of Revenues, Expenditures, and Changes in Fund Balance
Budget and Actual on a Budgetary Basis - General Fund
For the Year Ended June 30, 2006

	Budgeted Amounts		Actual Amounts Budgetary Basis	Actual Amounts Budgetary Basis	Budgetary to GAAP Differences	Actual Amounts GAAP Basis
	Original	Final	Variance with Final Budget Positive/(Negative)			
Revenues:						
Investment income	\$ 107,790	\$ 107,700	\$ -	\$ 107,700	\$ -	\$ 107,700
Rent	574,596	574,596	-	574,596	-	574,596
Other	147,755	147,755	-	147,755	-	147,755
Total revenues	<u>830,141</u>	<u>830,051</u>	<u>-</u>	<u>830,051</u>	<u>-</u>	<u>830,051</u>
Expenditures:						
Current:						
General government:						
Personnel services	3,941,738	3,941,738	613,446	3,328,292	-	3,328,292
Non-personnel services	1,181,625	388,872	101,432	287,440	(188,273)	99,167
Intergovernmental:						
Payments to the City of San José	3,705,756	3,554,103	72,135	3,481,968	-	3,481,968
Total expenditures	<u>8,829,119</u>	<u>7,884,713</u>	<u>787,013</u>	<u>7,097,700</u>	<u>(188,273)</u>	<u>6,909,427</u>
Excess (deficiency) of revenues over (under) expenditures	(7,998,978)	(7,054,662)	(787,013)	(6,267,649)	188,273	(6,079,376)
Other financing sources (uses):						
Transfers in	<u>7,765,665</u>	<u>6,975,898</u>	<u>-</u>	<u>6,975,898</u>	<u>-</u>	<u>6,975,898</u>
Net change in fund balance	(233,313)	(78,764)	(787,013)	708,249	188,273	896,522
Fund balance, beginning of year	<u>233,313</u>	<u>233,313</u>	<u>-</u>	<u>233,313</u>	<u>-</u>	<u>233,313</u>
Fund balance, end of year	<u>\$ -</u>	<u>\$ 154,549</u>	<u>\$ (787,013)</u>	<u>\$ 941,562</u>	<u>\$ 188,273</u>	<u>\$ 1,129,835</u>

See Accompanying Notes to Other Required Supplementary Information

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
Schedule of Revenues, Expenditures, and Changes in Fund Balance
Budget and Actual on a Budgetary Basis - Special Revenue Funds
For the Year Ended June 30, 2006

	Budgeted Amounts		Actual Amounts Budgetary Basis Variance with Final Budget Positive/(Negative)	Actual Amounts Budgetary Basis	Budgetary to GAAP Differences	Actual Amounts GAAP Basis
	Original	Final				
Revenues:						
Tax increment	\$ 30,088,373	\$ 30,088,373	\$ (124,639)	\$ 29,963,734	\$ -	\$ 29,963,734
Expenditures:						
Intergovernmental:						
Payments to the City of San José	30,138,626	30,138,626	124,639	30,013,987	-	30,013,987
Net change in fund balance	(50,253)	(50,253)	-	(50,253)	-	(50,253)
Fund balance, beginning of year	50,253	50,253	-	50,253	-	50,253
Fund balance, end of year	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

See Accompanying Notes to Other Required Supplementary Information

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to Other Required Supplementary Information
June 30, 2006**

STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

A. Budget Information

The budget of the Agency is an operating plan that identifies estimated costs and results in relation to estimated revenues. Budgets are prepared according to the following guidelines for the General and Special Revenue Funds:

General Fund

The operating expenditures are budgeted by appropriation according to type of expenditures, categorized as personnel and non-personnel.

Special Revenue Fund

Twenty percent of the tax increment revenues are budgeted by the Board for payment to the low and moderate-income housing program of the City of San José.

During the fiscal year, the procedures followed to establish the budgetary data reflected in the accompanying budget to actual schedules were as follows:

Original Budget

Prior to the beginning of the fiscal year, the Executive Director of the Agency presents to the Board the fiscal budget for the ensuing year, both operating and capital budget. After the tax revenue data is available in July from the County Assessor, an amended budget is submitted to the Board for approval. The budget is prepared on a budgetary basis, which does not conform with GAAP, as encumbrances are included as expenditures. Revenue estimates are presented to the Agency Board in total and are approved by revenue resolution.

Prior to June 30 of each year, the annual budget is finalized through passage of the annual appropriation resolution and an annual revenue resolution by the Agency Board, which is the legal authority for enactment of the budget. Management allocates budgeted revenue to the Special Revenue Fund based on priorities established by the California Community Redevelopment Law, bond indentures, and other legal agreements.

The annual appropriation resolution adopts the expenditure budget at the appropriation level (project, personnel, and non-personnel). Accordingly, the lowest level of budgetary control exercised by the Agency Board is the appropriation level. Management can transfer budgeted amounts between project activities included in each appropriation without the approval of the Agency's Board.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to Other Required Supplementary Information
June 30, 2006**

Final Budget

Supplemental appropriations may be approved during the budget year if there are funds available in the capital reserve. Appropriations lapse at the close of the fiscal year to the extent that they have not been expended or encumbered. No expenditures may be made in excess of amounts appropriated by the Agency Board.

The Agency Board approves changes to the revenue estimates by adoption of a supplemental revenue resolution. The budgetary data presented in the accompanying budget to actual schedules includes all revisions approved by the Agency Board.

B. Budgetary Results Reconciled To GAAP

The budgetary process is based upon accounting for certain transactions on a basis other than GAAP. The results of operations are presented in the budget and actual comparison statement in accordance with the budgetary process (budgetary basis) to provide a meaningful comparison with the budget.

The only difference between the budgetary basis actual and GAAP basis is that the year-end encumbrances of \$188,273 are recognized as the equivalent of expenditures in the budgetary basis schedules, while encumbered amounts are not recognized as expenditures on the GAAP basis statements until recorded as actual expenditures.



Guadalupe River Park & Gardens



Monopoly in the Park

Other Supplementary Information

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REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
Schedule of Revenues, Expenditures, and Changes in Fund Balance
Budget and Actual on a Budgetary Basis - Housing Debt Service Fund
For the Year Ended June 30, 2006

	Budgeted Amounts		Actual Amounts	Actual	Budgetary	Actual
	Original	Final	Budgetary Basis	Amounts	to GAAP	Amounts
			Variance with	Budgetary	Differences	GAAP Basis
			Final Budget	Basis		
			Positive/(Negative)			
Revenues:						
Intergovernmental	\$ 12,867,063	\$ 12,867,063	\$ -	\$ 12,867,063	\$ -	\$ 12,867,063
Investment income	746,107	746,107	-	746,107	-	746,107
Total revenues	<u>13,613,170</u>	<u>13,613,170</u>	<u>-</u>	<u>13,613,170</u>	<u>-</u>	<u>13,613,170</u>
Expenditures:						
Intergovernmental:						
Payments to the City of San José	20,867,305	20,867,305	-	20,867,305	-	20,867,305
Debt service:						
Principal retirement	3,300,000	3,300,000	-	3,300,000	-	3,300,000
Interest	9,363,871	9,363,871	-	9,363,871	-	9,363,871
Total expenditures	<u>33,531,176</u>	<u>33,531,176</u>	<u>-</u>	<u>33,531,176</u>	<u>-</u>	<u>33,531,176</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(19,918,006)</u>	<u>(19,918,006)</u>	<u>-</u>	<u>(19,918,006)</u>	<u>-</u>	<u>(19,918,006)</u>
Net change in fund balance	<u>(19,918,006)</u>	<u>(19,918,006)</u>	<u>-</u>	<u>(19,918,006)</u>	<u>-</u>	<u>(19,918,006)</u>
Fund balance, beginning of year	<u>35,251,481</u>	<u>35,251,481</u>	<u>-</u>	<u>35,251,481</u>	<u>-</u>	<u>35,251,481</u>
Fund balance, end of year	<u>\$ 15,333,475</u>	<u>\$ 15,333,475</u>	<u>\$ -</u>	<u>\$ 15,333,475</u>	<u>\$ -</u>	<u>\$ 15,333,475</u>

See Accompanying Notes to Supplementary Information

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
Schedule of Revenues, Expenditures, and Changes in Fund Balance
Budget and Actual on a Budgetary Basis - Merged Debt Service Fund
For the Year Ended June 30, 2006

	Budgeted Amounts		Actual Amounts	Actual Amounts Budgetary	Budgetary to GAAP Differences	Actual Amounts GAAP Basis
	Original	Final	Variance with Final Budget Positive/(Negative)			
Revenues:						
Tax increment	\$ 97,534,256	\$ 97,534,256	\$ -	\$ 97,534,256	\$ -	\$ 97,534,256
Investment income	432,909	432,909	955,305	1,388,214	-	1,388,214
Total revenues	<u>97,967,165</u>	<u>97,967,165</u>	<u>955,305</u>	<u>98,922,470</u>	<u>-</u>	<u>98,922,470</u>
Expenditures:						
Debt service:						
Principal retirement	38,310,000	38,310,000	-	38,310,000	-	38,310,000
Interest	84,620,995	84,620,995	-	84,620,995	-	84,620,995
Bond issuance costs	5,538,538	5,538,538	-	5,538,538	-	5,538,538
Payment to refunded bond escrow agent	6,944,942	6,944,942	-	6,944,942	-	6,944,942
Total expenditures	<u>135,414,475</u>	<u>135,414,475</u>	<u>-</u>	<u>135,414,475</u>	<u>-</u>	<u>135,414,475</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(37,447,310)</u>	<u>(37,447,310)</u>	<u>955,305</u>	<u>(36,492,005)</u>	<u>-</u>	<u>(36,492,005)</u>
Other financing sources (uses):						
Refunding bonds issued	220,080,000	220,080,000	-	220,080,000	-	220,080,000
Premium on refunding bonds	17,191,021	17,191,021	-	17,191,021	-	17,191,021
Payment to refunded bond escrow agent	(232,009,738)	(232,009,738)	-	(232,009,738)	-	(232,009,738)
Transfers in	32,033,164	32,033,164	-	32,033,164	-	32,033,164
Total other financing sources	<u>37,294,447</u>	<u>37,294,447</u>	<u>-</u>	<u>37,294,447</u>	<u>-</u>	<u>37,294,447</u>
Net change in fund balance	<u>(152,863)</u>	<u>(152,863)</u>	<u>955,305</u>	<u>802,442</u>	<u>-</u>	<u>802,442</u>
Fund balance, beginning of year	<u>78,865,562</u>	<u>78,865,562</u>	<u>-</u>	<u>78,865,562</u>	<u>-</u>	<u>78,865,562</u>
Fund balance, end of year	<u>\$ 78,712,699</u>	<u>\$ 78,712,699</u>	<u>\$ 955,305</u>	<u>\$ 79,668,004</u>	<u>\$ -</u>	<u>\$ 79,668,004</u>

See Accompanying Notes to Supplementary Information

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
Schedule of Revenues, Expenditures, and Changes in Fund Balance
Budget and Actual on a Budgetary Basis - Capital Projects Fund
For the Year Ended June 30, 2006

	Budgeted Amounts		Actual Amounts Budgetary Basis	Actual Amounts	Budgetary	Actual
	Original	Final	Variance with Final Budget Positive/(Negative)	Budgetary Basis	to GAAP Differences	Amounts GAAP Basis
Revenues:						
Tax increment	\$ 22,819,238	\$ 22,819,238	\$ (498,560)	\$ 22,320,678	\$ -	\$ 22,320,678
Intergovernmental	13,752,892	13,752,892	-	13,752,892	-	13,752,892
Investment income	3,837,688	3,476,932	323,792	3,800,724	-	3,800,724
Grant revenue	3,511,000	2,907,453	1,122,901	4,030,354	-	4,030,354
Rent	258,072	236,099	170,545	406,644	-	406,644
Other	3,091,047	4,187,425	(549,874)	3,637,551	-	3,637,551
Total revenues	47,269,937	47,380,039	568,804	47,948,843	-	47,948,843
Expenditures:						
Current:						
General government:						
Personnel services	9,101,028	9,101,028	717,026	8,384,002	-	8,384,002
Non-personnel services	2,546,234	3,814,910	720,151	3,094,759	(847,418)	2,247,341
Intergovernmental:						
Payments to the City of San José	13,641,443	13,641,443	-	13,641,443	-	13,641,443
Payments to the County of Santa Clara	28,183,783	28,183,783	-	28,183,783	-	28,183,783
Payments to other governmental agencies	395,992	395,992	-	395,992	-	395,992
Capital outlay:						
Project expenditures	82,451,790	162,597,393	58,719,019	103,878,374	(26,893,103)	76,985,271
Payments to the City of San José	19,398,870	19,398,870	2,225,051	17,173,819	2,618,200	19,792,019
Total expenditures	155,719,140	237,133,419	62,381,247	174,752,172	(25,122,321)	149,629,851
Excess (deficiency) of revenues over (under) expenditures	(108,449,203)	(189,753,380)	(61,812,443)	(126,803,329)	25,122,321	(101,681,008)
Other financing sources (uses):						
Notes issued	49,320,000	49,320,000	-	49,320,000	-	49,320,000
Proceeds from sale of land	13,400,000	2,639,600	8,809,190	11,448,790	-	11,448,790
Transfers out	(39,009,062)	(39,009,062)	-	(39,009,062)	-	(39,009,062)
Total other financing sources	23,710,938	12,950,538	8,809,190	21,759,728	-	21,759,728
Net change in fund balance	(84,738,265)	(176,802,842)	(53,003,253)	(105,043,601)	25,122,321	(79,921,280)
Fund balance, beginning of year	118,268,341	118,268,341	-	118,268,341	-	118,268,341
Fund balance, end of year	\$ 33,530,076	\$ (58,534,501)	\$ (53,003,253)	\$ 13,224,740	\$ 25,122,321	\$ 38,347,061

See Accompanying Notes to Supplementary Information

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Supplementary Information
June 30, 2006**

STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

A. Budget Information

The budget process for the Housing Debt Service Fund, Merged Debt Service Fund, and Capital Projects Fund followed the same procedures to establish the budgetary data for the General Fund and Special Revenue Fund, which can be found in the Notes to Other Required Supplementary Information on pages 64-65.

Housing and Merged Debt Service Funds

Expenditures are budgeted according to bond indenture requirements. Appropriations for Housing and Merged Debt Service Funds were implicitly adopted by the Agency Board when the formal bond resolutions were approved.

Capital Projects Fund

Capital Projects Fund expenditures are budgeted by project, on a project-length basis. Annual appropriations include items such as direct project payments, land acquisition, payments to the City under cooperation agreements, and other expenditures.

B. Budgetary Results Reconciled To GAAP

The budgetary process is based upon accounting for certain transactions on a basis other than GAAP. The results of operations are presented in the budget and actual comparison schedule in accordance with the budgetary process (budgetary basis) to provide a meaningful comparison with the budget.

The major difference between the budgetary basis actual and GAAP basis is that the year-end encumbrances are recognized as the equivalent of expenditures in the budgetary basis basic financial statements, while encumbered amounts are not recognized as expenditures on the GAAP basis until recorded as actual expenditures. In addition, certain expenditures recorded for GAAP purposes may be budgeted in a different fiscal year.

**REDEVELOPMENT AGENCY OF
THE CITY OF SAN JOSE**

**Notes to the Supplementary Information
June 30, 2006**

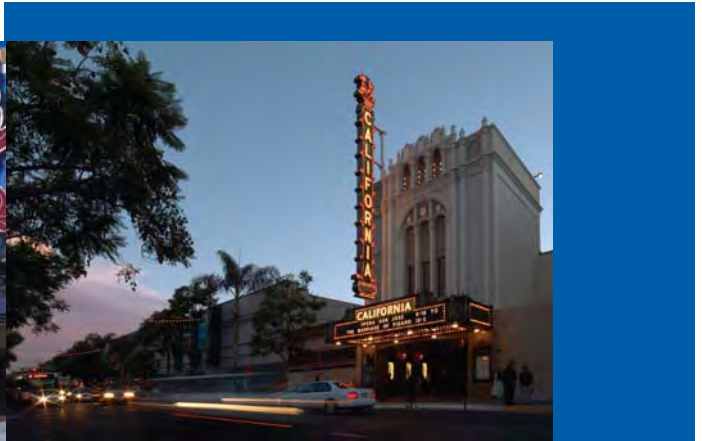
A summary of the adjustments necessary to reconcile the results of operations on a budgetary basis to the results of operations on a GAAP basis are as follows:

	<u>Capital Projects Fund</u>
Expenditures per statement of revenues, expenditures, and changes in fund balances (GAAP basis)	\$ 149,629,851
GAAP basis expenditures to be budgeted in subsequent periods	(8,111,800)
Prior year GAAP basis expenditures budgeted in this period	5,493,600
Encumbrances	<u>27,740,521</u>
Expenditures - budgetary basis	<u><u>\$ 174,752,172</u></u>

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The Alameda NBD Facade Improvements



California Theatre

Statistical Section

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REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
 DESCRIPTION OF THE STATISTICAL SCHEDULES
 JUNE 30, 2006

This part of the Agency’s comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements, notes disclosures, and the required supplementary information says about the Agency’s overall financial health.

Contents	Table	Page
Financial Trends These schedules contain trend information to help the reader understand how the Agency’s financial performance and well-being have changed over time.	1 – 4	72 – 75
Revenue Capacity These schedules contain information to help the reader assess the Agency’s tax increment revenue source.	5 – 6	76 – 77
Debt Capacity These schedules present information to help the reader assess the affordability of the Agency’s current level of outstanding debt and the ability to issue additional debt in the future.	7 – 9	78 – 80
Demographic and Economic Information These schedules offer demographic and economic indicators to help the reader understand the environment within which the Agency’s financial activities take place.	10 – 11	81 – 82
Operating Information These schedules contain service data to help the reader understand how the information in the Agency’s financial report relates to the services the Agency’s provides and the activities it performs.	12	83

Sources: Unless otherwise noted, the information in these schedules is derived from the comprehensive annual financial reports for the relevant years.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Table 1

Net Assets (deficit) by Component
 Governmental Activities
 Last Five Fiscal Years
 (accrual basis of accounting)
 (dollars expressed in thousands)

	Fiscal Year				
	2002	2003	2004	2005	2006
Governmental activities					
Invested in capital assets	\$ 6,375	\$ 6,125	\$ 7,008	\$ 6,831	\$ 40,455
Restricted for:					
Debt Service	50,734	58,109	37,849	43,734	41,947
Low and moderate housing income housing activities	42,470	351	191	35,298	15,333
Other	21,116	22,021	-	-	-
Unrestricted deficit	<u>(1,221,108)</u>	<u>(1,389,801)</u>	<u>(1,488,094)</u>	<u>(1,626,222)</u>	<u>(1,747,045)</u>
Total governmental activities net assets (deficit)	<u>\$ (1,100,413)</u>	<u>\$ (1,303,195)</u>	<u>\$ (1,443,046)</u>	<u>\$ (1,540,359)</u>	<u>\$ (1,649,310)</u>

Note: The Agency initially implemented the new reporting model (GASB 34) in fiscal year 2001-2002. Since GASB 34 changes significantly both the recording and presentation of financial data, fiscal years prior to 2002 have not been restated for the purpose of providing the 10-year comparative information for the above schedule.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Table 2

Changes in Net Assets
Governmental Activities
Last Five Fiscal Years
(accrual basis of accounting)
(dollars expressed in thousands)

	Fiscal Year				
	2002	2003	2004	2005	2006
Expenses					
General government	\$ 25,064	\$ 26,903	\$ 22,269	\$ 8,498	\$ 6,910
Community development	232,048	334,344	181,384	134,001	147,052
Housing	65,521	82,227	61,679	60,545	50,881
Debt Service	86,245	92,895	94,084	91,512	96,989
Total governmental activities expenses	<u>408,878</u>	<u>536,369</u>	<u>359,416</u>	<u>294,556</u>	<u>301,832</u>
Program revenues					
Operating grants and contributions					
Community development	13,113	13,352	12,704	13,019	13,326
Housing	9,953	11,741	11,468	14,528	12,867
Capital grants and contribution					
Community development	48,358	97,690	18,114	5,749	4,457
Total program revenues	<u>71,424</u>	<u>122,783</u>	<u>42,286</u>	<u>33,296</u>	<u>30,650</u>
Net program expenses	<u>(337,454)</u>	<u>(413,586)</u>	<u>(317,130)</u>	<u>(261,260)</u>	<u>(271,182)</u>
General revenues					
Tax increment	188,459	198,026	170,208	149,977	149,819
Unrestricted investment earnings	14,155	7,513	4,331	6,029	6,043
Revenue from the collection of loans	215	-	-	4,435	-
Miscellaneous	6,626	5,265	2,740	3,505	6,369
Total general revenues	<u>209,455</u>	<u>210,804</u>	<u>177,279</u>	<u>163,946</u>	<u>162,231</u>
Changes in net assets	<u><u>\$(127,999)</u></u>	<u><u>\$(202,782)</u></u>	<u><u>\$(139,851)</u></u>	<u><u>\$(97,314)</u></u>	<u><u>\$(108,951)</u></u>

Note: The Agency initially implemented the new reporting model (GASB 34) in fiscal year 2001-2002. Since GASB 34 changes significantly both the recording and presentation of financial data, fiscal years prior to 2002 have not been restated for the purpose of providing the 10-year comparative information for the above schedule.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Table 3

Fund Balances of Governmental Funds
Last Ten Fiscal Years
(modified accrual basis of accounting)
(dollars expressed in thousands)

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
General fund										
Reserved for:										
Advances and deposits	\$ -	\$ -	\$ -	\$ -	\$ 39	\$ 43	\$ 44	\$ 42	\$ 39	\$ 39
Encumbrances	541	694	1,515	1,365	2,207	2,230	1,486	1,420	187	188
Unreserved, designated for redevelopment activities	299	19	1,657	3,275	1,962	520	3,719	5,243	7	903
Total general fund	<u>\$ 840</u>	<u>\$ 713</u>	<u>\$ 3,172</u>	<u>\$ 4,640</u>	<u>\$ 4,208</u>	<u>\$ 2,793</u>	<u>\$ 5,249</u>	<u>\$ 6,705</u>	<u>\$ 233</u>	<u>\$ 1,130</u> (a)
All other governmental funds										
Reserved for:										
Long-term receivables	\$ -	\$ -	\$ -	\$ 4,402	\$ 3,714	\$ 3,554	\$ 3,384	\$ 3,267	\$ 3,053	\$ 2,858
Advances and deposits	1,026	895	746	580	601	601	601	601	601	1,206
Debt service	28,550	37,304	46,383	49,506	49,981	87,631	94,185	76,546	78,869	79,668
Low and moderate income housing activities	20,669	11,073	11,626	1,610	679	42,470	351	191	35,298	15,333 (b)
Grants with purpose restrictions	-	-	-	-	20,171	21,116	22,021	-	-	-
Encumbrances	34,614	42,567	53,929	58,037	87,726	104,753	63,691	37,387	31,869	27,740
Unreserved, designated for redevelopment activities	99,614	170,822	288,296	181,056	7,261	137,196	8,747	138,864	82,746	6,543 (c)
Total all other governmental funds	<u>184,473</u>	<u>262,661</u>	<u>400,980</u>	<u>295,191</u>	<u>170,133</u>	<u>397,321</u>	<u>192,980</u>	<u>256,856</u>	<u>232,436</u>	<u>133,348</u>
Total fund balances of governmental funds	<u>\$ 185,313</u>	<u>\$ 263,374</u>	<u>\$ 404,152</u>	<u>\$ 299,831</u>	<u>\$ 174,341</u>	<u>\$ 400,114</u>	<u>\$ 198,229</u>	<u>\$ 263,561</u>	<u>\$ 232,669</u>	<u>\$ 134,478</u>

- (a) The increase in total fund balance of the general fund in fiscal year 2006 is explained in Management's Discussion and Analysis.
- (b) The decrease in reserved fund balance in fiscal year 2006 was due to the drawdowns of the remaining proceeds of housing bonds issued in previous fiscal year for housing projects.
- (c) The substantial decrease in unreserved, designated for redevelopment activities in fiscal year 2006 is explained in Management Discussion and Analysis.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Table 4

Changes in Fund Balances of Governmental Funds

Last Ten Fiscal Years

(modified accrual basis of accounting)

(dollars expressed in thousands)

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Revenues										
Tax increment	\$ 76,020	\$ 93,739	\$ 112,216	\$ 129,681	\$ 142,151	\$ 188,459	\$ 198,026	\$ 170,208	\$ 149,977	\$ 149,819
Intergovernmental	1,000	-	-	-	30,581	42,311	94,482	38,407	32,276	26,620
Investment income	8,373	9,961	18,061	18,731	16,087	14,155	7,513	4,331	6,029	6,043
Developer contributions	911	4,798	20,219	4,641	13,703	29,630	27,949	2,148	-	-
Grant revenue	1,391	1,607	1,646	1,107	20,207	-	35	1,731	1,020	4,030
Rent	437	697	708	676	553	420	988	998	1,251	981
Other	1,140	2,190	1,662	2,892	11,469	6,206	6,848	1,896	11,298	3,785
Total revenue	89,272	112,992	154,512	157,728	234,751	281,181	335,841	219,719	201,851	191,278
Expenditures										
General government	13,667	15,928	20,145	18,652	16,867	18,622	19,864	16,538	14,761	14,059
Intergovernmental	10,889	26,945	22,951	37,370	109,415	105,824	129,445	118,732	111,532	96,584
Debt service:										
Principal repayment	12,490	13,200	25,013	17,975	22,450	24,445	28,125	33,860	31,265	41,610
Interest and other charges	52,781	58,148	65,986	78,512	77,580	75,332	93,710	91,529	94,603	93,985
Payments to refunded bond escrow agent	2,462	-	-	-	-	6,429	-	11,952	2,022	6,945
Bond issuance costs	2,253	1,548	2,461	-	1,070	9,768	-	8,868	3,977	5,539
Capital outlay	82,055	96,164	114,067	111,631	179,866	239,945	266,900	107,533	70,916	96,777
Other	334	867	724	359	-	-	-	-	-	-
Total expenditures	176,931	212,800	251,347	264,499	407,248	480,365	538,044	389,012	329,076	355,499
Deficiency of revenues under expenditures	(87,659)	(99,808)	(96,835)	(106,771)	(172,497)	(199,184)	(202,203)	(169,293)	(127,225)	(164,221)
Other financing sources (uses)										
Bonds issued	130,307	177,034	237,613	-	44,205	614,383	-	545,985	218,355	269,400
Discount on tax allocation bonds	-	-	-	-	-	(189)	-	-	-	-
Premium on bonds issued	-	-	-	-	-	-	-	16,725	395	17,191
Payment to refunded bond escrow agent	(11,165)	-	-	-	-	(189,651)	-	(332,571)	(126,899)	(232,010)
Proceeds from the sale of capital assets	3,700	835	-	2,450	2,802	-	317	4,486	4,482	11,449
Transfers in	26,993	33,626	46,459	35,492	36,335	42,440	45,238	65,091	21,759	39,009
Transfers out	(26,993)	(33,626)	(46,459)	(35,492)	(36,335)	(42,440)	(45,238)	(65,091)	(21,759)	(39,009)
Total other financing sources (uses)	122,842	177,869	237,613	2,450	47,007	424,543	317	234,625	96,333	66,030
Net change in fund balance	\$ 35,183	\$ 78,061	\$ 140,778	\$ (104,321)	\$ (125,490)	\$ 225,359	\$ (201,886)	\$ 65,332	\$ (30,892)	\$ (98,191)
Debt service as a percentage of noncapital expenditures	68.8%	61.2%	66.3%	63.1%	44.0%	41.5%	44.9%	44.5%	48.8%	52.4%

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Actual Assessed Value and Tax Increment Revenue

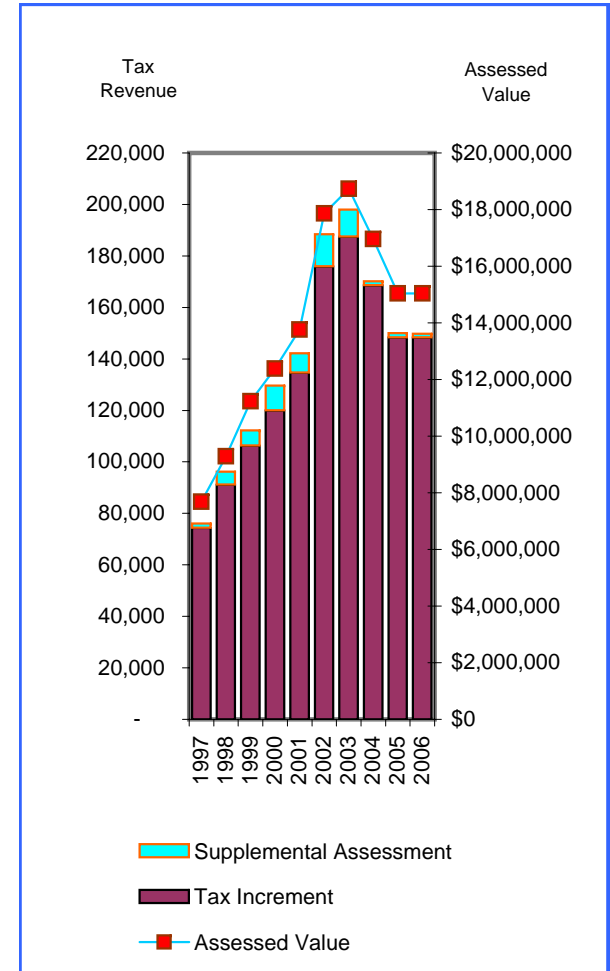
Merged Area Redevelopment Project

Last Ten Fiscal Years

(dollar amounts expressed in thousands)

Table 5

<u>Fiscal Year</u>	<u>Assessed Value (1)</u>	<u>% Change</u>	<u>Tax Increment</u>	<u>Supplemental Assessment</u>	<u>Gross Tax Revenues</u>	<u>% Change</u>
1997	7,680,818 (2)	7% (3)	74,372	1,650	76,022	11.4%
1998	9,292,365	21%	91,113	5,100	96,213	26.6%
1999	11,228,356	21%	106,298	5,918	112,216	16.6%
2000	12,382,598	10%	119,982	9,699	129,681	15.6%
2001	13,761,356	11%	134,649	7,502	142,151	9.6%
2002	17,866,814	30%	175,926	12,533	188,459	32.6%
2003	18,732,944	5%	187,448	10,578	198,026	5.1%
2004	16,962,642	(9.5%)	168,502	1,706	170,208	(14.0%)
2005	15,040,831	(11.3%)	148,329	1,647	149,976	(11.9%)
2006	15,033,930	(0.5%)	148,292	1,527	149,819	(0.1%)



- (1) Total assessed value for tax increment generating area of the Merged Area. Tax increment revenue calculated on incremental assessed value, after subtracting base year assessed value from total assessed value. For fiscal year 2005-2006, total assessed value includes \$11,211,223,000 in value on the secured roll and \$3,822,707,000 in value on the unsecured roll. The current base year is \$1,097,107,000.
- (2) Includes Park Center beginning 1997 which was merged in 1996.
- (3) Percentage change does not include Park Center.

Source: Santa Clara County Assessor, Urban Analytics, LLC and Redevelopment Agency of the City of San Jose.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Table 6

Merged Area Redevelopment Projects
 Ten Largest Property Owners
 Fiscal Year Ended June 30, 2006
 (dollars expressed in thousands)

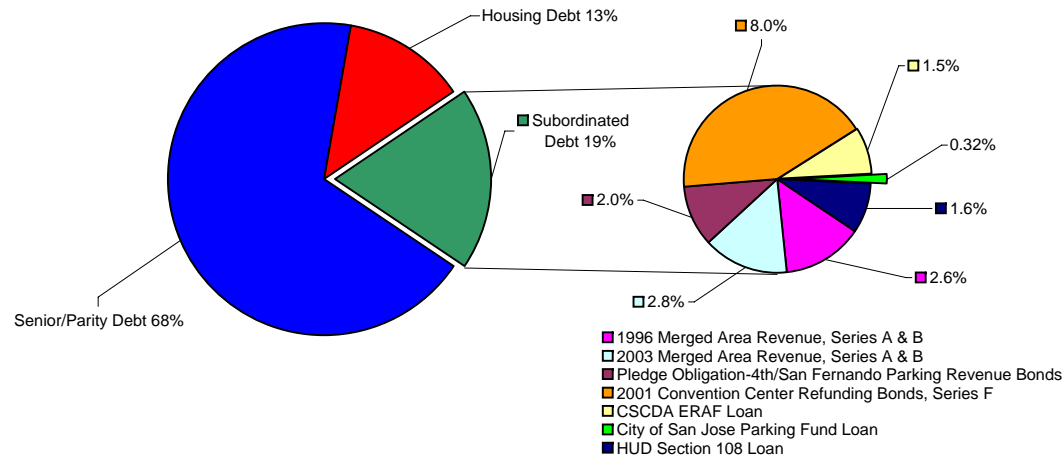
	<u>Taxpayer</u>	<u>Type of Industry</u>	<u>Assessed Secured Value</u>	<u>Assessed Unsecured Value</u>	<u>Total Assessed Value</u>	<u>% of Total</u>
1	Cisco Systems, Inc.	Computer Networking Equipment	\$ 592,863	\$ 1,423,387	\$ 2,016,250	13.41%
2	Hitachi Global Storage Techs, Inc.	Computer Disc Storage	234,548	361,569	596,117	3.97%
3	Equity Office Properties	Real Estate Development	570,822	-	570,822	3.80%
4	Irvine Community Dev Company	Real Estate Development	383,982	7,681	391,663	2.61%
5	Sobrato Companies	Real Estate Development	358,405	-	358,405	2.38%
6	CarrAmerica Realty Corp.	Real Estate Development	281,865	504	282,369	1.88%
7	Adobe Systems	Computer Software	209,032	49,567	258,599	1.72%
8	Mission West	Real Estate Development	209,304	-	209,304	1.39%
9	Agilent Technologies Inc.	Test/Masurement Equipment	116,800	41,108	157,908	1.05%
10	eBay	Internet Software and Services	130,622	16,709	147,331	0.98%
	Total - Ten Largest Property Owners		<u>\$ 3,088,243</u>	<u>\$ 1,900,525</u>	<u>\$ 4,988,768</u>	<u>33.18%</u>
	Total Assessed Value in the Merged Area's income generating area		<u>\$ 11,211,223</u>	<u>\$ 3,822,707</u>	<u>\$ 15,033,930</u>	<u>100.00%</u>

Source: Santa Clara County Assessor, State Board of Equalization and Urban Analytics, LLC.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Table 7

Debt Profile
June 30, 2006



	Due Serially To	Amounts (in thousands)
Senior/Parity Debt (debt payment equally secured)		
1993 Merged Area Refunding Tax Allocation Bonds	2024	\$ 277,125
1997 Merged Area Tax Allocation Bonds	2028	11,600
1998 Merged Area Tax Allocation Bonds	2029	149,265
1999 Merged Area Tax Allocation Bonds	2031	166,595
2002 Merged Area Tax Allocation Bonds	2032	247,865
2003 Merged Area Tax Allocation Bonds	2033	128,280
2004 Merged Area Tax Allocation Bonds, Series A	2019	269,090
2005 Merged Area Tax Allocation Bonds, Series A & B	2028	220,080
Sub -Total		<u>1,469,900</u>
Housing Bonds		
1997 Housing Set-Aside Bonds, Series E	2027	17,045
2003 Housing Set-Aside Bonds, Series J & K	2029	62,460
2005 Housing Set-Aside Bonds, Series A & B	2035	129,720
2005 Housing Set-Aside Bonds, Series C & D	2035	66,150
Sub -Total		<u>275,375</u>
Subordinated Debt (in payment priority)		
1996 Merged Area Revenue, Series A & B	2026	56,200
2003 Merged Area Revenue, Series A & B	2032	60,000
Pledge Obligation-4th /San Fernando Parking Revenue Bonds	2026	42,545
2001 Convention Center Refunding Bonds, Series F	2022	171,800
CSCDA ERAF Loan	2015	32,645
City of San Jose Parking Fund Loan	2009	6,800
HUD Section 108 Loan	2025	34,705
Sub -Total		<u>404,695</u>
Grand Total		<u>\$ 2,149,970</u>

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Table 8

Debt Service Coverage for Senior (Parity) Debt
Governmental Activities
As of June 30, 2006
(dollars expressed in thousands)

Tax Allocation Revenue	\$ 149,818,668
Less: Housing Set-Aside (20%)	(29,963,734)
Net Statutory Pass-Through Payments	<u>(395,992)</u>
Tax Allocation Revenue Available for Debt Service	<u>119,458,942</u>
Maximum Annual Debt Service on Senior Lien Parity Bonds	<u>\$ 107,036,111</u>
Debt Service Coverage - June 30, 2006	<u>1.12</u>

Note:

Debt Service Coverage represents the ratio of tax revenue pledged for the payment of senior (parity) debt service.

New Senior (Parity) Bonds Issuance Coverage Test:

The 1993 Bonds, 1997 Bonds, 1998 Bonds, 1999 Bonds, 2002 Bonds, 2003 Bonds, 2004 Bonds, and 2005 Bonds represent the Parity Debt of the Agency, which are secured by a senior lien pledge of the tax revenues. Bond Indenture requires that tax revenues will be at least equal to 1.15 times the Maximum Annual Debt Service on all outstanding bonds and the then Parity Debt in order for new bonds to be issued.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
 Project Area and Debt Termination
 June 30, 2006

Table 9

	<u>Tax Increment Generating Project Areas</u>	<u>Acreage (a)</u>	<u>Plan Adoption</u>	<u>Plan Termination (b)</u>	<u>Last Day to Repay Debt</u>
1	Almaden Gateway	21	4/7/1988	4/7/2029	4/7/2039
2	Century Center	18	11/8/1983	11/8/2025	11/8/2035
3	Edenvale Area:				
	Edenvale	1,050	7/15/1976	7/15/2018	7/15/2028
	Edenvale East	995	9/1/1981	9/1/2023	9/1/2033
4	Guadalupe Auzerias	73	5/19/1983	5/19/2025	5/19/2035
5	Julian Stockton	330	7/15/1976	7/15/2018	7/15/2028
6	Market Gateway	32	11/8/1983	11/8/2025	11/8/2035
7	Monterey Corridor	515	12/13/1994	12/13/2025	12/13/2040
8	Olinder	158	7/15/1976	7/15/2018	7/15/2028
9	Park Center	61	7/24/1961	1/1/2011	1/1/2021
10	Pueblo Uno	12	7/8/1975	7/8/2017	7/8/2027
11	Rincon Area:				
	Rincon Expansion	1,224	7/3/1979	7/3/2021	7/3/2031
	Rincon North	1,699	6/8/1982	6/8/2024	6/8/2034
	Rincon Original	1,872	7/16/1974	7/16/2016	7/16/2026
	Rincon South (c)		6/8/1982	6/8/2024	6/8/2034
12	San Antonio Plaza	50	1/3/1968	1/1/2011	1/1/2021

- (a) Acreages reflect an in-dept GIS analysis of the tax generation projects as of December 21, 2004.
- (b) Reflects a one-year extension as permitted according to State Bill 1045 and 1096.
- (c) Acreage for the Rincon South has been combined with Rincon North.

Source: Redevelopment Agency of the City of San Jose.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Table 10

Miscellaneous Statistics

June 30, 2006

Date Established:	1956
Governing Body:	City Council (as Board of Directors)
Number of Employees:	113
Population of City of San Jose	953,679*
Area:	
City of San Jose	177.8 sq. mi.*
Redevelopment Area (see geographical map)	18,687 acres dispersed throughout the City

	Project Areas		
	Area	Approximate Acreage **	Tax Increment Generating Area
Redevelopment Project Areas:			
1.) Downtown	8	300	7
2.) Neighborhood Business Districts:			
Neighborhood business districts (6) and non-contiguous business clusters (6)	7	684	0
Strong Neighborhood Initiative (22 neighborhoods)	1	9,874	0
3.) Industrial	5	7,829	5
Total Redevelopment Project Areas	21	18,687	12

Source: * - California Department of Finance and City of San Jose.

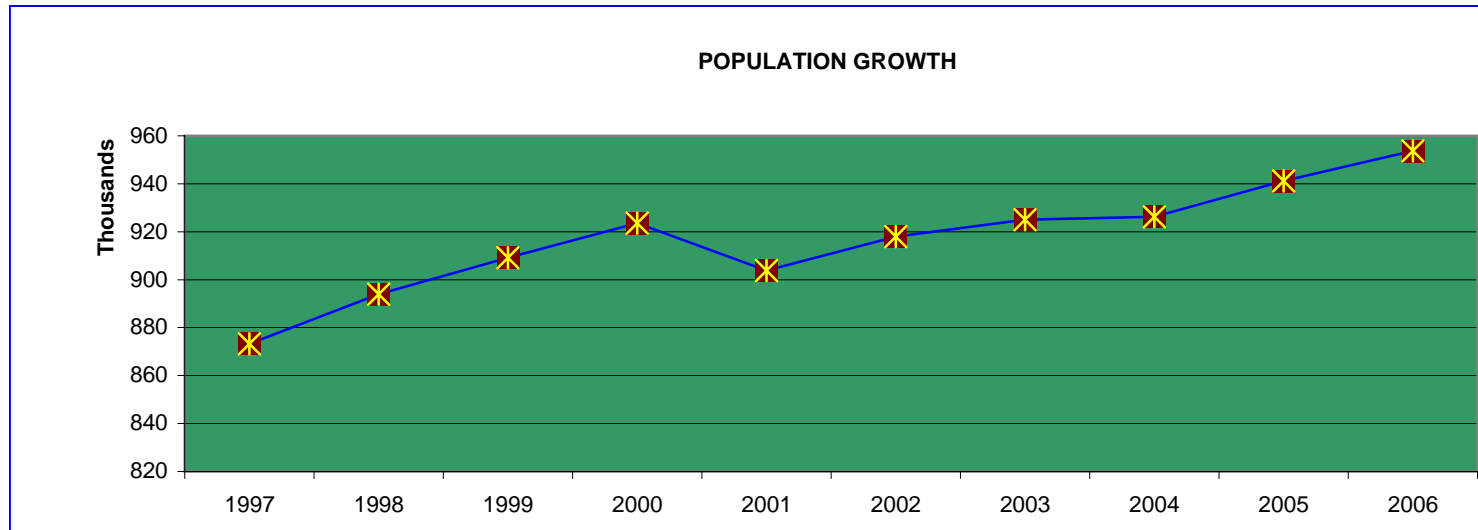
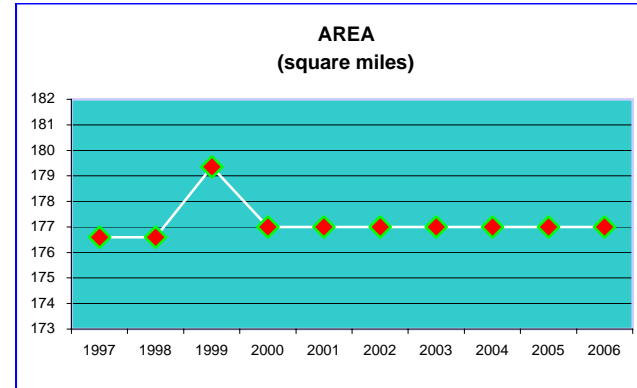
** - Acreages reflect an in-depth GIS analysis of the tax generating project areas as of December 21, 2004 by the Redevelopment Agency of the City of San Jose.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Table 11

Population and Area of the City of San Jose
Last Ten Years

<u>Fiscal Year</u>	<u>Date</u>	<u>Population</u>	<u>Area in Square Miles</u>
1997	January 1	873,286	176.60
1998	January 1	893,969	176.60
1999	January 1	909,100	179.35
2000	January 1	923,591	177.00
2001	January 1	894,943	177.00
2002	January 1	917,971	177.00
2003	January 1	925,000	177.30
2004	January 1	926,200	177.70
2005	January 1	941,116	177.70
2006	January 1	953,679	177.80



Sources: City of San Jose Comprehensive Annual Financial Report for 1997 to 2001
California Department of Finance population estimates for 2002 to 2006.

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
 Operating Indicators By Function
 Last Six Fiscal Years

Table 12

	Fiscal Year					
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Agency's Authorized Number of Employees	126	136	136	124	113	113
Core Services (1):						
Promote and Implement Neighborhood Improvement Strategies						
Number of Projects Completed:						
Façade Improvement Projects	16	51	114	44	53	24
Streetscapes Projects	-	6	6	2	17	10
Initiate and Facilitate Public Facilities and Spaces						
Number of Completed Public Projects	4	7	18	11	9	12
Enhance the Quality and Supply of the City's Housing Stock						
Number of New Housing Units Completed	1,176	945	889	624	254	292
Initiate and Facilitate Private Development						
Number of jobs created	6,146	1,705	543	1,481	1,489	5,509

(1) The Core Services were approved by the Agency Board in fiscal year 2000. Indicators are available only beginning fiscal year 2001.

Source: Various Divisions of the Redevelopment Agency of the City of San Jose.



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
Redevelopment Agency of the
City of San José, California

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED
ON AN AUDIT OF FINANCIAL STATEMENT PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

We have audited the financial statements of the governmental activities and each major fund of the Redevelopment Agency of the City of San José (Agency), a component unit of the City of San José, California, as of and for the fiscal year ended June 30, 2006, which collectively comprise the Agency's basic financial statements and have issued our report thereon dated September 20, 2006. 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

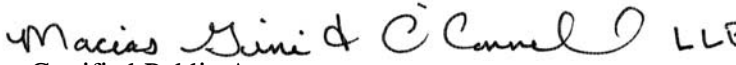
In planning and performing our audit, we considered the Agency's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by Agency staff in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.



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 grants 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 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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


Certified Public Accountants
Walnut Creek, California

September 20, 2006