

Hercules Redevelopment Agency

Hercules, California

*Basic Financial Statements
and Independent Auditors' Reports*

For the year ended June 30, 2005

C&L
Caporicci & Larson
Certified Public Accountants

Hercules Redevelopment Agency

Basic Financial Statements

For the year ended June 30, 2005

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INDEPENDENT AUDITORS' REPORT

To the Members of the Governing Board
of the Hercules Redevelopment Agency
Hercules, California

We have audited the accompanying financial statements of the governmental activities and each major fund of the Hercules Redevelopment Agency (Agency), a component unit of the City of Hercules, California (City) as of and for the year ended June 30, 2005, which collectively comprise the Agency's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the Agency's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States and the standards applicable to financial audits contained in *Governmental Accounting 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities and each major fund of the Agency as of June 30, 2005, and the respective changes in financial position for the year then ended in conformity with generally accepted accounting principles in the United States.

As described in Note 1 to the basic financial statements, the Agency adopted Statement of the Governmental Accounting Standards Board No. 40, *Deposit and Investment Risk Disclosures (Amendment of GASB No. 3)*.

The accompanying Required Supplementary Information, such as Management's Discussion and Analysis, budgetary comparison information and other information as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures which consist principally of inquires of management regarding the methods of measurement and presentation of the Required Supplementary Information. However, we did not audit the information and express no opinion on it.

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To the Members of the Governing Board
of the Hercules Redevelopment Agency
Hercules, California
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Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Agency's basic financial statements. The accompanying supplementary information is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The 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.

Capricci & Carlson

Oakland, California
December 22, 2005

*City of Hercules Redevelopment Agency
Management's Discussion and Analysis*

For The Fiscal Year Ended June 30, 2005

As management of the City of Hercules Redevelopment Agency (Agency), we offer readers of the Agency's Financial Statements this narrative overview and analysis of the financial activities of the Agency for the fiscal year ended June 30, 2005.

Government Accounting and Standards Board Statement No. 34, "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments", known as GASB 34, requires, among other things, that the Agency must provide this management discussion and analysis of its financial activities for the fiscal year. GASB 34 represents an effort to make governmental reporting clearer and more understandable to readers. It allows a reader to focus on longer term financial issues as well as short-term financial aspects of the Agency. This document should be read in conjunction with the accompanying Basic Financial Statements and the notes to those statements to get a complete picture of the Agency's finances.

I. Financial Highlights

Once again the Agency's rapidly increasing property assessed value is reflected in the growth of tax increment revenue and that revenue is sufficient to cover debt related expenses and to provide funding for both housing and non housing priorities. The Agency continues to show increasing benefit from projects initiated in prior fiscal years. Of particular note for the 2004-2005 fiscal year the Affordable Housing Program provided housing opportunities via the Inclusionary Housing Program to 16 households. In addition educational classes were provided in the areas of first-time homebuyers and credit counseling. Work has started on a new housing development (Lewis property) and further significant progress has been made in facilitating the development of significant and much needed commercial space on the Bart property project. All of this development has, and will continue to help the City of Hercules's (City) growing electric utility develop into a viable and beneficial asset to the City.

The following are the amounts received from tax increments in fiscal year 2004-05 with comparative totals for the previous five fiscal years:

| <u>Fiscal Year Receipt</u> | <u>1999-00</u> | <u>2000-01</u> | <u>2001-02</u> | <u>2002-03</u> | <u>2003-04</u> | <u>2004-05</u> |
|----------------------------|------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Total for the Year | <u>\$996,943</u> | <u>\$1,342,459</u> | <u>\$1,653,706</u> | <u>\$2,962,200</u> | <u>\$5,003,025</u> | <u>\$9,449,358</u> |

The liabilities of the Agency exceeded its assets at the close of the fiscal year by \$2.5 million (Net Assets). The Agency's investment in assets is primarily in City owned property, and other than property held for resale, it does not hold property in its own name. Therefore a negative net asset amount would be expected. In fact the Agency needs to show indebtedness in order to be eligible to receive tax increment revenue.

The Agency's total net assets increased by \$.57 million during the fiscal year. The increase is primarily due to the payoff of debt (1994 Tax Allocation Bonds).

As of the close of the fiscal year, the Agency's funds (all governmental) reported combined ending fund balances of negative \$1.5 million, which is a decrease of \$3.4 million in comparison with the prior year.

The total net debt of the Agency decreased by \$4.1M (37%) during the fiscal year. The reason for these decreases was the annual repayments of bonded debt and the retirement of the 1994 Tax Allocation Bonds.

II. Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to the Agency's basic financial statements. The City of Hercules Redevelopment Agency basic financial statements are comprised of three components: 1) Government-Wide Financial Statements, 2) Fund Financial Statements, and 3) Notes to the Basic Financial Statements. This report also contains other supplementary information in addition to the Basic Financial Statements themselves.

The basic financial statements include only the Agency, which is a component unit of the City and is reported in the City's Comprehensive Annual Financial Report (CAFR) using the blended method.

Government-Wide Financial Statements: The Government-Wide Financial Statements are statements required by GASB 34 that present the financial picture of the Agency and provide readers with a broad view of the Agency's finances. These statements present governmental activities and include all assets of the Agency (including capital assets) as well as all liabilities (including long-term debt). Additionally, certain interfund receivables, payables and other interfund activity have been eliminated as prescribed by GASB 34.

The Statement of Net Assets and the Statement of Activities and Changes in Net Assets report information about the Agency as a whole and about its activities. These statements include *all* assets and liabilities of the Agency using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account, regardless of when cash is received or paid.

The Statement of Net Assets presents information on all of the Agency's assets and liabilities, with the difference between the two reported as net assets. The Agency, while a separate legal entity, acts as a financial conduit for the City and as such does not hold title to the assets it helps construct. Therefore, its net assets are not any indication of its financial health.

The Statement of Activities and Changes in Net Assets presents information showing how the government'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 only result in cash flows in future fiscal periods (e.g., uncollected taxes). Additionally, certain interfund receivables, payables and other interfund activity have been eliminated as prescribed by GASB 34.

The Agency only has governmental activities, including public works related activity and administration, which are reflected in the Statement of Net Assets and the Statement of Activities and Changes in Net Assets. Property tax increment and interest income finance these activities.

Fund Financial Statements: The Fund Financial Statements provide detailed information about the Agency's most significant funds, called Major Funds. The concept of Major Funds, and the determination of which are Major Funds, was established by GASB 34 and replaces the concept of combining like funds and presenting them in total. Instead, each Major Fund is presented individually, with all Non-major Funds combined in a single column on each fund statement. Subordinate schedules present the detail of these Non-major Funds. Major Funds present the major activities of the Agency for the year.

Fund Financial Statements include statements for the governmental activities. The Agency has no business-type activities.

Fund Financial Statements are prepared on the modified accrual basis of accounting, which means they measure only current financial resources and uses. The capital assets and other long-lived assets, along with long-term liabilities, are presented only in the Government-Wide Financial Statements.

In order to better understand the Agency's long-term and short-term requirements, it is useful to compare the Agency's Governmental Fund Statements with the governmental activities in the Government-Wide Financial Statements. A reconciliation is provided for both the Governmental Funds Balance Sheet to the Government-Wide Statement of Net Assets, and the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances to the Government-Wide Statement of Activities and Changes in Net Assets to facilitate this comparison.

A fund is a grouping of related accounts that is 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 compliance with finance-related legal requirements. All of the Agency's funds were determined to be Major Funds. These funds include the Operating Fund, the Capital Projects Fund, the Affordable Housing Fund, and the Debt Service Fund, which are reported in detail in the Fund Financial Statements.

Operating Fund: Operating fund is used to account for staff time and other operating costs of the agency (e.g., non-capital studies or analysis and other consultants)

Capital Projects Fund: Capital projects fund is used to account for the capital expenditures of the agency, other than housing.

Debt Service Fund: Debt service fund is used to account for the repayment of principal and interest on debt as well as pass thru obligations to other taxing agencies or non-taxing entities.

Affordable Housing Fund: Affordable housing fund is used to account for the 20% set aside of the tax increments that is required by State Law to be used for low and moderate income housing purposes.

The Agency adopts an annual appropriated budget for all of its funds. A budgetary comparison statement has been provided to demonstrate compliance with this budget.

Notes to the Basic Financial Statements: The notes provide additional information that is essential to a full understanding of the data provided in the Government-Wide and Fund Financial Statements. The notes to the basic financial statements can be found on pages 21 through 34 of this report.

Other Information: In addition to the basic financial statements and accompanying notes, this report also presents certain Required Supplementary Information concerning the Agency's progress in funding its obligation to provide pension benefits to its employees. Required Supplementary Information can be found on pages 35 through 38 of this report.

III. Government-Wide Financial Analysis

The largest portion of the Agency's net assets reflects amounts designated for capital projects (e.g., land, buildings, machinery, and equipment). Unlike most other types of governmental bodies who provide day-to-day services, the main purpose of the Agency is to provide capital funds for the development of a certain geographical area of the City.

The following analysis focuses on the net assets and changes in net assets of the Agency's Governmental Activities, presented in the Government-Wide Statement of Net Assets and Statement of Activities and Changes in Net Assets.

Redevelopment Agency Net Assets
 At June 30, 2005
 (Amounts expressed in millions of dollars)

| | 2004 | 2005 |
|--|----------|----------|
| Current assets | \$ 8.6 | \$ 7.2 |
| Noncurrent assets | 10.1 | 10.0 |
| Total assets | 18.7 | 17.2 |
| Current liabilities | 0.7 | 2.6 |
| Noncurrent liabilities | 21.1 | 17.1 |
| Total liabilities | 21.8 | 19.7 |
| Net assets: | | |
| Invested in capital assets, net of related debt | (7.2) | (3.4) |
| Restricted | 1.8 | 4.9 |
| Unrestricted | 2.4 | (4.0) |
| Total net asset (deficit) | \$ (3.0) | \$ (2.5) |

The Agency's Net Assets increased by \$.5 million during the fiscal year. All of the significant changes were primarily due to the payoff of the 1994 Tax Allocation Bonds. In addition, there was more money taken in during the year than was actually spent during the year.

Governmental Activities: All the activities of the agency are governmental and it has no business-type activities.

Redevelopment Agency
Changes in Net assets
 Fiscal year ended June 30, 2005
 (Amounts expressed in millions of dollars)

| | 2003-04 | 2004-05 |
|---------------------------------|----------|----------|
| General Revenues: | | |
| Property tax (tax increment) | \$ 5.0 | \$ 9.4 |
| Investment Income | 0.2 | 0.2 |
| Miscellaneous | 0.1 | 0.4 |
| Total general revenue | 5.3 | 10.0 |
| Expenses | 3.6 | 9.6 |
| Change in net assets (decrease) | 1.7 | 0.4 |
| Net assets - beginning of year | (4.7) | (2.9) |
| Net assets - end of year | \$ (3.0) | \$ (2.5) |

Tax increment revenues increased substantially because of the development growth in the merged project area. Expenditures were greater than the previous year because more money was spent on projects and programs.

IV. 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 spendable resources. Such information is useful in assessing the Agency's financing requirements. In particular, unreserved fund balances may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. It should, however, be noted that most of the unreserved amounts have been designated by the Agency for specific uses.

The Agency is required by State law to set aside 20% of the tax increment revenue in a separate fund for low and moderate-income housing purposes. This fund had total revenue of \$2.2 million and expenditures of \$.95 million. The ending fund balance was \$2.45 million, an increase of \$.85 million from the prior year.

The debt service fund had total revenues and transfers-in/out of \$3.6 million. The expenditure including debt service and pass-through payments to other taxing agencies amounted to \$7.4 million. The fund balance decreased by \$3.8 million because the 1994 Tax Allocation Bonds were paid off.

The expenditures for the capital project fund amounted to \$3.16 million. A total of \$5.7 million was transferred to the operating special revenue fund. The fund balance decreased by \$6.1 million to negative \$2.2 million at the year-end.

V. Budgetary Highlights

The original budget was from the second year of a two year budget and was structured differently than how the Agency ultimately accounted for its programs. The funds were restructured as indicated above and the budget was redistributed to those new funds. There were adjustments to the budgets during the year that included slightly over \$1.50 million in projects and programs from the Capital Projects, Operating Special Revenue, and Affordable Housing Funds.

The variances between budget-to-actual in the various funds had mostly to do with the payoff of the debt issue, and generally not spending as much as originally budgeted. As is the case every year, there were projects and programs that were not completed by year-end. On the revenue side, the actual cumulative tax increment revenue received was much greater than originally anticipated as a result of the significant growth in the merged project area.

VI. Capital Asset and Debt Administration

Capital assets: As noted earlier the Agency acts as financial conduit for the City of Hercules and as a result its investments in capital assets are recoded as City assets rather than Agency assets.

The capital expenditures during the year were minimal with money being spent on the Sycamore Avenue Extension project and the train station project. Most of the year was spent in planning the development of the coming projects.

Long-term debt: At the end of the current fiscal year, the Agency had total bonded debt outstanding of \$6.9 million. None of this amount related to the Affordable Housing Fund. The tax increments revenue of the Agency secures all bonded debt of the Agency.

The Agency's bonded debt decreased by \$4.1 million during the fiscal year. The decrease was due, in part, to the scheduled annual repayment of existing debt, however there was also an advance refunding of the 1994 Tax Allocation Bonds in the amount of \$3.8 million.

Additional information on the Agency long-term debt can be found in note number 6 on pages 30 through 32 of this report. The RDA had no new debt during the 2004-05 fiscal year.

VII. Economic Factors and Next Year's Budgets

Since the Agency's primary source of revenue is tax increments, property values and new construction in the redevelopment area are the key economic factors that define the future resources of the agency. The Agency does have some undeveloped land; however there are discussions with developers underway to develop most of the land that is left in the Agency. Those discussions indicate that there will be a combination of retail, commercial, market rate and affordable housing, and open space. So, most of the revenue growth is expected to come from that development over the next few years with some of the increase attributable to normal assessed values growth.

The State's budget deficit has had an impact on the Agency. In fiscal year, 2004-05 the Agency paid \$.3 million to the Educational Revenue Augmentation Fund (ERAF) as required by the State. The last time this kind of take away occurred was in early 1990s when the State was having difficulty balancing its budget. This diversion of funds has so far occurred only on a year-by-year basis and is not expected to be an ongoing loss of revenue.

These factors were considered in preparing the Agency's two year budget for the fiscal years 2004-05 and 2005-06.

VIII. Requests for Information

This financial report is designed to provide a general overview of the City of Hercules Redevelopment Agency's finances for residents, taxpayers, investors, creditors, and anyone else with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Department, 111 Civic Drive, Hercules, California 94547.

BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

Hercules Redevelopment Agency

Statement of Net Assets

June 30, 2005

| | <u>Governmental Activities</u> |
|---|------------------------------------|
| ASSETS | |
| Current assets: | |
| Cash and investments | \$ 2,450,460 |
| Cash and investments with fiscal agents | 4,700,567 |
| Accounts receivable | 49,672 |
| Interest receivable | 28,792 |
| Total current assets | <u>7,229,491</u> |
| Noncurrent assets: | |
| Loans and notes receivable, net | 2,590,263 |
| Land held for resale | 3,862,040 |
| Capital assets: | |
| Non depreciable | 208,426 |
| Depreciable, net | 3,317,690 |
| Total capital assets, net of accumulated depreciation | <u>3,526,116</u> |
| Total noncurrent assets | <u>9,978,419</u> |
| Total assets | <u>17,207,910</u> |
| LIABILITIES | |
| Current liabilities: | |
| Accounts payable | 2,190,388 |
| Interest payable | 129,189 |
| Long-term debt due within one year | 262,619 |
| Total current liabilities | <u>2,582,196</u> |
| Noncurrent liabilities: | |
| Advances from other City Funds | 10,433,257 |
| Long-term debt due in more than one year | 6,644,716 |
| Total noncurrent liabilities | <u>17,077,973</u> |
| Total liabilities | <u>19,660,169</u> |
| NET ASSETS | |
| Invested in capital assets, net of related debt | (3,381,219) |
| Restricted for: | |
| Special projects and programs | 235,951 |
| Debt service | 4,700,567 |
| Total restricted | <u>4,936,518</u> |
| Unrestricted | <u>(4,007,558)</u> |
| Total net assets | <u>\$ (2,452,259)</u> |

See accompanying Notes to Basic Financial Statements.

Hercules Redevelopment Agency
Statement of Activities and Changes in Net Assets
For the year ended June 30, 2005

| Functions/Programs | Expenses | Program Revenue | | Net Revenues (Expenses) |
|--|---------------------|----------------------|------------------|-------------------------|
| | | Charges for Services | Total | |
| Primary government: | | | | |
| General government | \$ 7,905,654 | \$ 57,165 | \$ 57,165 | \$ (7,848,489) |
| Interest on long-term debt (unallocated) | 1,646,293 | - | - | (1,646,293) |
| Total governmental activities | \$ 9,551,947 | \$ 57,165 | \$ 57,165 | (9,494,782) |
| General revenues: | | | | |
| Property taxes | | | | 9,449,358 |
| Investment earnings | | | | 280,810 |
| Miscellaneous | | | | 400,057 |
| Capital contribution to the City | | | | (160,717) |
| Total general revenues and contributions | | | | 9,969,508 |
| Change in net assets | | | | 474,726 |
| Net assets (deficit) - beginning of year, as restated | | | | (2,926,985) |
| Net assets (deficit)- end of year | | | | \$ (2,452,259) |

See accompanying Notes to Basic Financial Statements.

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GOVERNMENTAL FUND FINANCIAL STATEMENTS

Redevelopment Operating Special Revenue Fund

This fund accounts for the operating costs of the Redevelopment Agency.

Redevelopment/Affordable Housing Special Revenue Fund

This fund accounts for Redevelopment Area tax increment monies to be expended for low and moderate income housing purposes.

Redevelopment Agency Debt Service Fund

This fund accounts for the accumulation of resources used for the payment of principal and interest on the Redevelopment Agency tax allocation bonds, certificates of participation, and notes payable. It is funded primarily through tax increment revenue and operating transfers from other City funds.

Redevelopment Agency Capital Projects Fund

This fund accounts for major capital projects undertaken by the Redevelopment Agency.

Hercules Redevelopment Agency

Balance Sheet

Governmental Funds

June 30, 2005

| | Major Funds | | | | Total |
|--|---|--|---|---|-----------------------------|
| | Redevelopment Operating Special Revenue Fund | Affordable Housing Special Revenue Fund | Redevelopment Agency Debt Service Fund | Redevelopment Agency Capital Projects Fund | |
| ASSETS | | | | | |
| Cash and investments | \$ 1,261,172 | \$ - | \$ 1,189,288 | \$ - | \$ 2,450,460 |
| Cash and investments with fiscal agents | - | - | 4,700,567 | - | 4,700,567 |
| Accounts receivable | - | - | 34,672 | 15,000 | 49,672 |
| Loans and notes receivable | - | 2,340,263 | - | 250,000 | 2,590,263 |
| Interest receivable | - | - | 28,792 | - | 28,792 |
| Due from other fund | 4,451,550 | 2,460,688 | - | - | 6,912,238 |
| Land held for resale | - | - | - | 3,862,040 | 3,862,040 |
| Total assets | \$ 5,712,722 | \$ 4,800,951 | \$ 5,953,319 | \$ 4,127,040 | \$ 20,594,032 |
| LIABILITIES AND FUND BALANCES | | | | | |
| Liabilities: | | | | | |
| Accounts payable | \$ ⁶⁰¹ 8,290 | \$ 15,995 | \$ 168,977 | \$ ⁶¹⁷ 1,997,126 | \$ ⁶³⁰ 2,190,388 |
| Deferred revenue | - | 2,334,717 | - | 250,000 | 2,584,717 |
| Due to other fund | - | - | 2,785,198 | ⁶¹¹ 4,127,040 | 6,912,238 |
| Advances from other City funds | - | - | 10,433,257 | ⁶¹³ - | 10,433,257 |
| Total liabilities | 8,290 | 2,350,712 | 13,387,432 | 6,374,166 | 22,120,600 |
| Fund Balances: | | | | | |
| Reserved for: | | | | | |
| Low and moderate income housing | - | 235,951 | - | - | 235,951 |
| Land held for resale | - | - | - | 3,862,040 | 3,862,040 |
| Debt service | - | - | 4,700,567 | - | 4,700,567 |
| Future commitments | 67,884 | - | - | - | 67,884 |
| Unreserved, undesignated: | 5,636,548 | 2,214,288 | (12,134,680) | (6,109,166) | (10,393,010) |
| Total fund balances | (5,704,432) | 2,450,239 | (7,434,113) | (2,247,126) | (1,526,568) |
| Total liabilities and fund balances | \$ 5,712,722 | \$ 4,800,951 | \$ 5,953,319 | \$ 4,127,040 | \$ 20,594,032 |

Total net Assets

Hercules Redevelopment Agency
Reconciliation of the Governmental Funds Balance Sheet
to the Government-Wide Statement of Net Assets
June 30, 2005

| | |
|--|-----------------------|
| Total Fund Balances - Total Governmental Funds | \$ <u>(1,526,568)</u> |
|--|-----------------------|

Amounts reported for governmental activities in the Statement of Net Assets are different because:

Capital assets used in governmental activities were not current financial resources. Therefore, they were not reported in the Governmental Funds Balance Sheet.

| | |
|----------------------|------------------|
| Non-depreciable | 208,426 |
| Depreciable, net | <u>3,317,690</u> |
| Total capital assets | <u>3,526,116</u> |

Revenues which are deferred on the Funds Balance Sheet because they are not available currently are reported as revenues in the Statement of Activities and Changes in Net Assets and accordingly increase the net assets on the Statement of Net Assets.

2,584,717

Interest payable on long-term debt does not require current financial resources. Therefore, interest payable is not reported as a liability in the Governmental Funds Balance Sheet.

(129,189)

Long-term liabilities are not due and payable in the current period and therefore they are not reported in the Governmental Funds Balance Sheet.

| | |
|---|--------------------|
| Long-term liabilities - due within one year | (262,619) |
| Long-term liabilities - due in more than one year | <u>(6,644,716)</u> |
| Total long-term liabilities | <u>(6,907,335)</u> |

| | |
|---|------------------------------|
| Net Assets (Deficit) of Governmental Activities | \$ <u><u>(2,452,259)</u></u> |
|---|------------------------------|

Hercules Redevelopment Agency
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the year ended June 30, 2005

| | Major Funds | | | | Total |
|---|---|--|---|---|--------------------|
| | Redevelopment Operating Special Revenue Fund | Affordable Housing Special Revenue Fund | Redevelopment Agency Debt Service Fund | Redevelopment Agency Capital Projects Fund | |
| REVENUES: | | | | | |
| Property taxes | \$ 4,579,296 | \$ 1,700,657 | \$ 3,169,404 | \$ - | \$ 9,449,357 |
| Use of money and property | 54,534 | 64,039 | 162,237 | - | 280,810 |
| Charge for services | - | 17,330 | - | - | 17,330 |
| Miscellaneous | 10,000 | 390,058 | - | - | 400,058 |
| Total revenues | 4,643,830 | 2,172,084 | 3,331,641 | - | 10,147,555 |
| EXPENDITURES: | | | | | |
| Current: | | | | | |
| General government | 1,965,669 | 952,635 | 1,667,025 | - | 4,585,329 |
| Capital outlay | - | - | - | 3,158,802 | 3,158,802 |
| Debt service: | | | | | |
| Principal repayment | - | - | 4,117,411 | - | 4,117,411 |
| Interest and fiscal charges | - | - | 1,652,107 | - | 1,652,107 |
| Total expenditures | 1,965,669 | 952,635 | 7,436,543 | 3,158,802 | 13,513,649 |
| REVENUES OVER (UNDER) | | | | | |
| EXPENDITURES | 2,678,161 | 1,219,449 | (4,104,902) | (3,158,802) | (3,366,094) |
| OTHER FINANCING SOURCES (USES): | | | | | |
| Transfers in | 6,647,302 | - | 3,990,416 | 2,785,198 | 13,422,916 |
| Transfers out | (3,617,581) | (372,835) | (3,711,792) | (5,720,708) | (13,422,916) |
| Total other financing sources (uses) | 3,029,721 | (372,835) | 278,624 | (2,935,510) | - |
| Net change in fund balances | 5,707,882 | 846,614 | (3,826,278) | (6,094,312) | (3,366,094) |
| FUND BALANCES: | | | | | |
| Beginning of year | (3,450) | 1,603,625 | (3,607,835) | 3,847,186 | 1,839,526 |
| End of year | \$ 5,704,432 | \$ 2,450,239 | \$ (7,434,113) | \$ (2,247,126) | \$ (1,526,568) |

See accompanying Notes to Basic Financial Statements.

Hercules Redevelopment Agency

Reconciliation of the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances to the Government-Wide Statement of Activities and Changes in Net Assets For the year ended June 30, 2005

| | |
|--|----------------|
| Net Change in Fund Balances - Total Governmental Funds | \$ (3,366,094) |
|--|----------------|

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

| | |
|--|-----------|
| This amount presents current year contribution of capital assets to the City of Hercules | (160,717) |
|--|-----------|

| | |
|--|-----------|
| Depreciation expense on capital assets was reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they did not require the use of current financial resources. Therefore, depreciation expense was not reported as expenditures in Governmental Funds. | (100,008) |
|--|-----------|

| | |
|---|----------|
| Loss on the disposal of capital assets was reported in the Government-Wide Statement of Activities and Changes in Net Assets, but it does not require the use of current financial resources. Therefore, loss on the disposal of capital assets was not reported as an expenditure in Governmental Funds. | (61,515) |
|---|----------|

| | |
|--|--------|
| Revenues that do not meet the revenue recognition criteria in the Fund Financial Statements are recorded as deferred revenue on the fund balance sheets but recognized as revenue in the Government-Wide Financial Statements. These amounts present current year deferred revenue recognized. | 39,835 |
|--|--------|

Bond proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the Government-Wide Statement of Net Assets. Repayment of bond principal is an expenditure in governmental funds, but the repayment reduces long-term liabilities in the Government-Wide Statement of Net Assets.

Long-term debt repayments:

| | |
|----------------------|-----------|
| Tax Allocation Bonds | 4,117,411 |
|----------------------|-----------|

| | |
|--------------|------------------|
| Total | 4,117,411 |
|--------------|------------------|

| | |
|---|-------|
| Interest expense on long-term debt is reported in the Government-Wide Statement of Activities and Changes in Net Assets, but it does not require the use of current financial resources. Therefore, interest expense is not reported as expenditures in governmental funds. The following amount represents the change in accrued interest from prior year. | 5,814 |
|---|-------|

| | |
|--|-------------------|
| Change in Net Assets of Governmental Activities | \$ 474,726 |
|--|-------------------|

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NOTES TO BASIC FINANCIAL STATEMENTS

Hercules Redevelopment Agency
Notes to Basic Financial Statements
For the year ended June 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the Redevelopment Agency (Agency) of the City of Hercules, California, (City) have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental agencies. The Governmental Accounting Standards Boards (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant of the Agency's accounting policies are described below.

A. Reporting Entity

The Agency was formed in 1983 for the purpose of renovating designated Redevelopment Project areas within the limits of the City. The Agency is a component unit of the City, and is accounted for as separate funds in the City's basic financial statements.

B. Basis of Accounting / Measurement Focus

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

Government-Wide Financial Statements

The Agency's government-wide financial statements include a Statement of Net Assets and a Statement of Activities and Changes in Net Assets. These statements present summaries of governmental activities for the Agency.

These statements are presented on an "economic resources" measurement focus and the accrual basis of accounting. Accordingly, all of the Agency's assets and liabilities, including capital assets, as well as infrastructure assets and long-term liabilities, are included in the accompanying Statement of Net Assets. The Statement of Activities presents changes in net assets. Under the accrual basis of accounting, revenues are recognized in the period in which they are earned while expenses are recognized in the period in which the liability is incurred. The type of transactions reported as program revenues for the Agency is charges for services.

Certain eliminations have been made as prescribed by GASB Statement No. 34 in regards to interfund activities, payables and receivables. All internal balances in the Statement of Net Assets have been eliminated. The following interfund activities have been eliminated:

- ◆ Transfers in/out
- ◆ Due to/ from

Hercules Redevelopment Agency
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

B. Basis of Accounting/Measurement Focus, Continued

Governmental Fund Financial Statements

Governmental fund financial statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances for all major governmental funds and non-major funds aggregated. An accompanying schedule is presented to reconcile and explain the differences in net assets as presented in these statements to the net assets presented in the government-wide financial statements. All of the Agency's funds are presented as major funds.

All governmental funds are accounted for on a spending or "current financial resources" measurement focus and the modified accrual basis of accounting. Accordingly, only current assets and current liabilities are included on the balance sheets. The Statement of Revenues, Expenditures and Changes in Fund Balances presents increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets.

Revenues are recorded when received in cash, except for that revenues subject to accrual (generally 60 days after year-end) are recognized when due. The primary revenue sources, which have been treated as susceptible to accrual by the Agency, are property tax and investment earnings. Expenditures are recorded in the accounting period in which the related fund liability is incurred.

Deferred revenues arise when potential revenues do not meet both the "measurable" and "available" criteria for recognition in the current period. Deferred revenues also arise when the government receives resources before it has a legal claim to them, as when grant monies are received prior to incurring qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met or when the government has a legal claim to the resources, the deferred revenue is removed and revenue is recognized.

The Reconciliation of the Fund Financial Statements to the Government-Wide Financial Statements is provided to explain the differences created by the integrated approach of GASB Statement No. 34.

C. Cash, Cash Equivalents and Investments

The Agency pools cash resources from all funds in order to facilitate the management of cash. The balance in the pooled cash account is available to meet current operating requirements. Cash in excess of current requirements is invested in various interest-bearing accounts and other investments for varying terms.

In accordance with GASB Statement No. 40, *Deposit and Investment Disclosures (Amendment of GASB No. 3)*, certain disclosure requirements for Deposits and Investment Risks were made in the following areas:

- Interest Rate Risk
- Credit Risk
 - Overall
 - Custodial Credit Risk
 - Concentrations of Credit Risk

Hercules Redevelopment Agency
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

C. Cash, Cash Equivalents and Investments, Continued

In addition, other disclosures are specified including use of certain methods to present deposits and investments, highly sensitive investments, credit quality at year-end and other disclosures

The Agency has implemented GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Highly liquid market investments with maturities of one year or less at time of purchase are stated at amortized cost. All other investments are stated at fair value. Market value is used as fair value for those securities for which market quotations are not readily available. Interest earned on investments is allocated using the LAIF factor to selected funds by the City.

The Agency participates in an investment pool managed by the State of California titled Local Agency Investment Fund (LAIF) which has invested a portion of the pool funds in Structured Notes and Asset-Backed Securities. LAIF's investments are subject to credit and market risk with the full faith and credit of the State of California collateralizing these investments. In addition, these Structured Notes and Asset-Backed Securities are subject to market risk as to change in interest rates.

Cash equivalents are considered amounts in demand deposits and short-term investments with a maturity date within three months of the date acquired by the Agency and are presented as "Cash and Investments" in the basic financial statements.

D. Capital Assets

The Agency's assets are capitalized at historical cost or estimated historical cost. Agency policy has set the capitalization threshold for reporting capital assets at \$2,500. Gifts or contributions of capital assets are recorded at fair market value when received. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets as follows:

| | |
|-----------------------------------|----------|
| Buildings and improvements | 25 years |
| Improvements other than buildings | 15 years |

E. Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities. Bond premiums and discounts and issuance costs, if material, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financial sources. Premiums received on debt issuance are reported as other financing sources while discounts on debt issuance are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Hercules Redevelopment Agency
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

F. Fund Balances

In the fund financial statements, governmental funds report reservations of fund balances for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balances represent tentative management plans that are subject to change.

The following is a listing of the Agency's reserves and designations:

Reserved for Low and Moderate Income Housing - represents funds reserved for low and moderate income housing.

Reserved for Land Held for Resale - represents amounts provided to indicate that land held for resale is not "available" as a resource to meet expenditures of the current year.

Reserved for Debt Service - represents amounts accumulated in accordance with a bond indenture or similar covenant.

Reserved for Future Commitments - represents funds that are reserved for future miscellaneous commitments.

G. Net Assets

In the government-wide financial statements, net assets are classified in the following categories:

Invested in Capital Assets, Net of Related Debt - This amount consists of capital assets net of accumulated depreciation and reduced by outstanding debt that was attributed to the acquisition, construction, or improvement of the assets.

Restricted Net Assets - This amount is restricted by external creditors, grantors, contributors, or laws or regulations of other governments.

Unrestricted Net Assets - This amount is all net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted net assets."

H. Use of Restricted/Unrestricted Net Assets

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, the Agency's policy is to apply restricted net assets first.

I. Property Taxes

Under California law, property taxes are assessed and collected by the County of Contra Costa (County). Under the Teeter plan, the County remits the full assessment regardless of the amounts received. The County assesses, bills, and collects property taxes as follows:

| | |
|-----------------|---------------------------|
| Lien Date | January 1 |
| Levy Date | July 1 |
| Due Date | November 1 and February 1 |
| Collection Date | December 10 and April 10 |

Hercules Redevelopment Agency
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

I. Property Taxes, Continued

The Agency is required to set aside a portion of tax increments received to increase and improve the community's supply of low and moderate-income housing. The amount set aside each year is required to equal 20% of the tax increment receipts from the redevelopment area which amounted to \$1,700,657 for the fiscal year ended June 30, 2005.

J. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates.

K. New Pronouncements

In 2005, the Agency adopted a new accounting standard in order to conform to the following Governmental Accounting Standards Board Statement:

- Statement No. 40, *Deposit and Investment Disclosures (Amendment of GASB No. 3)* – The Statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. The Statement requires certain disclosures of investments to address the different risk factors.

2. CASH AND INVESTMENTS

Cash and investments at June 30, 2005 consisted of the following:

| | |
|---|---------------------|
| Cash and investments pooled with the City | \$ 2,450,460 |
| Cash and investments held with fiscal agent | 4,700,567 |
| Total cash and investments | \$ 7,151,027 |

The Agency pools its cash and investments with the City in order to achieve a higher return on investment. Certain funds, which are held and invested by independent outside custodians through contractual agreements, are not pooled. These funds include cash with fiscal agents.

The investments made by the Agency are limited to those allowable under State statutes and may include the following types of investments:

| | |
|-----------------------------|--|
| Certificates of Deposit | Government Agency Securities |
| Bankers Acceptances | Treasury Bills and Notes |
| Commercial Papers | Passbook Savings Accounts |
| Repurchase Agreements | Mutual Funds |
| Medium-Term Corporate Notes | State of California Local Agency Investment Fund |

See the City's basic financial statements for disclosures related to cash and investments and the related interest rate risk, credit rate risk, custodial risk and concentration risk.

Hercules Redevelopment Agency
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2005

3. LOANS AND NOTES RECEIVABLE

Loans and notes receivable at June 30, 2005 consisted of the following:

| | |
|----------------------------|----------------------------|
| Bridge Housing Corporation | \$ 1,634,716 |
| Home Emergency Loan | 5,547 |
| Eden Housing | 700,000 |
| Radston's Office Plus | <u>250,000</u> |
| Total | <u><u>\$ 2,590,263</u></u> |

The Agency loaned the Bridge Housing Corporation (Corporation) \$1,400,000 to finance construction of a sixty unit senior citizen housing development next to City Hall. On September 8, 1998, the Agency approved an addition to the loan of \$115,000 for a total of \$1,515,000. On January 1, 1999, the loan began to bear interest at the rate of 3.5% per year and is repayable in 2041, subject to certain conditions. The construction was completed in September 1999. At June 30, 2005 the Corporation's loan balance was \$1,634,716.

On September 19, 2002, the Agency entered into a home emergency loan with Ghadah Azizi in the amount of \$7,040 with interest at 5% per annum. A monthly principal and interest repayment of \$74.67 is required starting from October 2002 to September 2012. The remaining principal amount of the loan including interest is to be due and payable in one lump sum if the above owner ceases to occupy the property or upon any transfer, refinance, sale, or conveyance of all or a part of the property. The balance outstanding as of June 30, 2005 is \$5,547.

On July 1, 2002 the Agency loaned Eden Housing, Inc. \$700,000 to assist in the development of low and moderate income housing for senior citizens. The loan does not bear interest. The repayment of the loan is only due and payable if a default has been declared by the Agency and the Borrower fails to cure the default. Upon expiration of the 55-year Regulatory Agreement, the loan will be forgiven and the Promissory Note will be cancelled by the Agency. The balance outstanding as of June 30, 2005 was \$700,000.

On December 5, 2000, the Agency entered into a promissory note agreement with the Radston's Office Plus (Payors) in the amount of \$250,000 with interest at 5% per annum. All principal and interest are deferred until December 5, 2010. Commencing on December 5, 2010, the Payors shall pay a lump-sum cash amount of \$125,000 which represents all deferred and unpaid interest only. The principal balance of \$250,000 will be fully amortized and paid over the next ten years at \$2,652 per month, principal and interest, commencing on December 5, 2010. The loan is secured by a Deed of Trust on real property. At June 30, 2005, the outstanding balance of the loan was \$250,000.

4. LAND HELD FOR RESALE

Land held for resale of \$3,862,040 is comprised of one parcel of land in the Dynamite Project area. The parcel remains from prior year's purchases within the project area and is being held for future development.

Hercules Redevelopment Agency
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2005

5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2005, consisted of the following:

| | Balance July 1, 2004 | Prior Period Adjustment | Additions | Deletions | Transfers | Balance June 30, 2005 |
|---|-------------------------|----------------------------|---------------------|--------------------|---------------------|--------------------------|
| Governmental Activities: | | | | | | |
| Capital assets, not being depreciated: | | | | | | |
| Land | \$ 271,101 | \$ - | \$ - | \$ (61,515) | \$ (160,717) | \$ 48,869 |
| Construction in progress | 159,557 | - | - | - | - | 159,557 |
| Total capital assets, not being depreciated | 430,658 | - | - | (61,515) | (160,717) | 208,426 |
| Capital assets, being depreciated: | | | | | | |
| Land improvements | 11,379 | - | - | - | - | 11,379 |
| Buildings and improvements | 4,965,778 | - | - | - | - | 4,965,778 |
| Total capital assets, being depreciated | 4,977,157 | - | - | - | - | 4,977,157 |
| Accumulated depreciation: | | | | | | |
| Land improvements | (7,112) | - | (572) | - | - | (7,684) |
| Buildings and improvements | (1,650,949) | 98,602 | (99,436) | - | - | (1,651,783) |
| Less accumulated depreciation | (1,658,061) | 98,602 | (100,008) | - | - | (1,659,467) |
| Total capital assets, being depreciated, net | 3,319,096 | 98,602 | (100,008) | - | - | 3,317,690 |
| Capital assets, net | \$ 3,749,754 | \$ 98,602 | \$ (100,008) | \$ (61,515) | \$ (160,717) | \$ 3,526,116 |

Depreciation expense for the year ended June 30, 2005 was \$100,008 which was allocated to general government.

6. LONG-TERM OBLIGATIONS

The Agency's long-term obligation transactions for the year ended June 30, 2005, was as follows:

| | Balance July 1, 2004 | Additions | Retirements | Balance June 30, 2005 | Classification | |
|------------------------------------|-------------------------|-------------|-----------------------|--------------------------|-----------------------------------|---|
| | | | | | Amounts Due Within One Year | Amounts Due in More than One Year |
| 1994 Tax Allocation Bonds | \$ 3,835,000 | \$ - | \$ (3,835,000) | \$ - | \$ - | \$ - |
| 2001 Tax Allocation Bonds | 6,500,000 | - | (215,000) | 6,285,000 | 225,000 | 6,060,000 |
| Long-Term Notes Payable | 689,746 | - | (67,411) | 622,335 | 37,619 | 584,716 |
| Total long-term obligations | \$ 11,024,746 | \$ - | \$ (4,117,411) | \$ 6,907,335 | \$ 262,619 | \$ 6,644,716 |

Hercules Redevelopment Agency
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2005

6. LONG-TERM OBLIGATIONS, Continued

A. 1994 Tax Allocation Bonds

On June 29, 1994 the Agency, in conjunction with the Association of Bay Area Governments California Redevelopment Agency Pool, issued \$3,550,000 of 1994 Tax Allocation Bonds, Series A, with interest rates of 4.20% to 6.00% and \$1,080,000 of Series B, with interest rates of 4.00% to 7.50% for a total principal amount of \$4,630,000. The proceeds were used to advance refund the outstanding balance of the 1987 Tax Allocation Bonds and generate funds in the amount of \$864,186 for use for future projects.

Interest on the 1994 Tax Allocation Bonds is payable semi-annually on June 15 and December 15. Bonds maturing on or after December 15, 2004, are subject to call on December 15, 2004, and on any interest payment date thereafter at par, plus a premium of one percent to two percent of the principal amount through June 15, 2006, at which point they may be redeemed at par. The bonds are special obligations of the Agency; the Series A bonds are secured by the Agency's tax increment revenues and the Series B bonds are secured by surplus revenues not required for payment of the Series A bonds. The outstanding balance was paid off during the fiscal year.

B. 2001 Tax Allocation Bonds

The Agency issued subordinate Tax Allocation Bonds, Series 2001, dated September 4, 2001, totaling \$6,500,000. The purpose of the bonds was to provide funds to finance certain redevelopment activities within, and of benefit to, the Hercules Merged Project Area. The interest rate on the bonds ranges from 4.50% to 6.40%. The interest is payable on each March 1 and September 1 commencing March 1, 2002. The bonds are subject to optional and mandatory early redemption provisions. The bonds are payable from and secured by a pledge of tax revenues in the Merged Project Area. Principal is due annually beginning on September 1, 2004, in amounts ranging from \$215,000 to \$575,000. The bonds mature on September 1, 2022.

The annual debt service requirements to maturity at June 30, 2005, were as follows:

| For the Years Ending June 30, | Principal | Interest | Total |
|----------------------------------|---------------------|---------------------|----------------------|
| 2006 | \$ 225,000 | \$ 387,566 | \$ 612,566 |
| 2007 | 235,000 | 376,879 | 611,879 |
| 2008 | 250,000 | 365,129 | 615,129 |
| 2009 | 260,000 | 352,004 | 612,004 |
| 2010 | 275,000 | 338,029 | 613,029 |
| 2011-2015 | 1,655,000 | 1,414,400 | 3,069,400 |
| 2016-2020 | 2,265,000 | 810,880 | 3,075,880 |
| 2021-2022 | 1,120,000 | 108,480 | 1,228,480 |
| Total | \$ 6,285,000 | \$ 4,153,367 | \$ 10,438,367 |

Hercules Redevelopment Agency
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2005

10. INTERFUND TRANSACTIONS, Continued

B. Due To/From Other Funds

Due to/from other funds reported in the Fund Financial Statements for the year ended June 30, 2005, were as follows:

| | Due from | | Total |
|--|---|--|---------------------|
| | Redevelopment Operating Special Revenue | Affordable Housing Special Revenue | |
| Due to | | | |
| Redevelopment Agency Debt Service | \$ 2,785,198 | \$ - | \$ 2,785,198 |
| Redevelopment Agency Capital Projects | 1,666,352 | 2,460,688 | 4,127,040 |
| Total | \$ 4,451,550 | \$ 2,460,688 | \$ 6,912,238 |

11. PUBLIC EMPLOYEE RETIREMENT SYSTEM

Plan Description - The Agency participates in the City's pension plan - California Public Employees' Retirement System (PERS), an agent multiple-employer defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provisions and all other requirements are established by state statute and City ordinance. Refer to the City's basic financial statements as of June 30, 2005, for detailed information regarding the pension plan.

12. COMMITMENTS

Hercules LLC - An agreement with Hercules LLC was established with the Agency to assist with development of a 206 acre mixed-use project consisting of 880 residential units, 6 acres of commercial, residential or mixed-use projects, and open space and park uses. Project Tax Increment is defined to include all increases in value over the base year amount of \$7,654,000, less statutory payments to affected taxing entities. The agreement states that the Agency shall pay the developer the first 75% of the unrestricted portion (net of affordable housing set aside and required payments to affected taxing entities), and the first 90% of the housing portion (affordable housing set aside) of the project tax increment funds for properties located within the project site. The financing term for these payments is for 45 years from the adoption date of Ordinance No. 351 or April 13, 1999.

Pro Media - To assist with development of a 57,600 square foot and a 27,000 square foot building at the Project Site, the Agency entered into an agreement with Pro Media Corporation. The Agreement provides for the owner to expend at least \$4 million in hard construction costs. The Agreement provides for the Agency to pay the owner 60% of the Project Tax Increment as defined above over the financing term. The financing term commences on the date any increased property tax assessment first becomes effective on the project site from any improvements, and ends on the earliest of the following: (i) fifteen years from the commencement of the financing term, (ii) termination of the agreement, (iii) expiration of the Redevelopment Plan or (iv) the remaining life of the Agency.

Hercules Redevelopment Agency
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2005

12. COMMITMENTS, Continued

KB Home Sycamore Avenue Project - An Agreement provides that the Agency will reimburse the Developer for the widening of Sycamore Avenue and the Palm Avenue alignment from either Agency funds, or from bond proceeds. The total amount is estimated to be \$1.3 million and has been included in the Five Year Capital Improvement Plan to be paid from RDA Tax Allocation Bond proceeds.

Taylor Woodrow Homes, Inc. - An agreement with Taylor Woodrow Homes, Inc., (project known as the Hercules Village Project) was established with the Agency to assist with development of 78 residential units comprised of 14 attached townhouses and 64 detached units. Fifteen percent of the residential units in the projects will be provided to households whose incomes are within the very Low to Moderate Income Limits as defined by the Department of Housing and Urban Development. The agreement states that the total very Low Income Household Subsidy shall be no more than \$200,000, per fiscal year and no more than a total of \$400,000 for Fiscal Years 2003-2004 and 2004-2005 combined. The Agency shall use a portion of the Tax Increment Housing Set Aside that it receives from the Hercules Village Project to mitigate a portion of the Very Low Income Household Subsidy.

Hercules New Town Center DDA - A Disposition and Development Agreement was approved with Hercules New Town Center, LLC to assist with the development of the 6.62-acre Park and Ride Parcel (after completion of an exchange with BART for the Agency's 8.69-acre Willow Avenue parcel) into a relatively high density, mixed-use town center featuring retail, residential, and office uses and a town square, all supported by structured parking. Accordingly, the project requires Agency financial assistance to be developed in accordance with the Agency's vision for the area. The proposed project requires rezoning, which is required to be processed using the Agency's Planned Development Plan process. The disposition of the Park and Ride parcel will occur after the BART exchange is completed and other conditions have been satisfied. The price that the developer will pay will vary between zero and \$5 million depending upon the intensity of the development proposed by the developer and approved by the Agency. Upon the disposition, the Agency shall be required to provide up to \$12 million in funds to assist with planning, design, and construction of the project. Such funding is expected to occur in Fiscal Year 2007-2008. The Agency shall use proceeds from the 2005 Tax Increment Bond to fund this obligation if and when it arises. The DDA has the potential to cover other parcels in the vicinity of the Park and Ride parcel under certain future circumstances, but any financial assistance to such other parcels is highly contingent and is not expected to occur for years into the future, if at all.

13. CONTINGENCIES

Lawsuits - The City is a defendant in a number of lawsuits which have arisen in the normal course of business. While substantial damages are alleged in some of these actions, their outcome cannot be predicted with certainty. In the opinion of the City Attorney, these actions when finally adjudicated will not have a material adverse effect on the financial condition of the City. Since it is a component unit of the City, the Agency may also be impacted by these lawsuits.

As of June 30, 2005, in the opinion of Agency management, there were no additional outstanding matters that would have a significant effect on the financial position of the funds of the Agency.

Hercules Redevelopment Agency
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2005

14. PRIOR PERIOD ADJUSTMENTS

A. Government-Wide Financial Statements

Prior period adjustments were recorded to the government-wide financial statements to correct prior year accumulated depreciation due to an incorrect calculation error as of June 30, 2004.

| | Net Assets, as Previously Reported | Prior Period Adjustments Accumulated Depreciation | Net Assets, as Restated |
|---|--|--|----------------------------|
| Government-Wide Activities: | | | |
| Net assets | \$ (3,025,587) | \$ 98,602 | \$ (2,926,985) |
| Total government-wide activities | <u>\$ (3,025,587)</u> | <u>\$ 98,602</u> | <u>\$ (2,926,985)</u> |

15. SUBSEQUENT EVENT

Hercules Merged Project Area Tax Allocation Bonds, Series 2005

On August 5, 2005, the Agency issued Hercules Merged Project Area Tax Allocation Bonds, Series 2005, in the amount of \$56,260,000. The proceeds of the bonds will be used to finance certain public capital improvements within the Agency's Merged Project Area and refund the Agency Subordinate Tax Allocation Bonds, Series 2001. The Bonds mature annually each August 1 from 2006 to 2035, in amounts ranging from \$740,000 to \$2,960,000 and bear interest at rates ranging from 3.50% to 5.00%. Interest is payable semiannually on February 1 and August 1. The Bonds maturing on or after August 1, 2016, are subject to optional redemption prior to maturity At the option of the Agency on or after August 1, 2015, as a whole or in part, on any interest payment date, at a price equal to the principal amount, plus accrued interest on the redemption date. The bonds are payable exclusively from pledged tax revenues to be derived from the project area and from the amounts on deposit in certain funds and accounts, including the reserve account and the revenue fund.

REQUIRED SUPPLEMENTAL INFORMATION

Hercules Redevelopment Agency
Required Supplemental Information
For the year ended June 30, 2005

1. BUDGETARY PRINCIPLES

In establishing the budgetary data reflected in the financial statements, the Agency follows the below listed procedures:

1. Public hearings are conducted to obtain public comments.
2. The Executive Director is authorized to transfer budgetary amounts within a single fund; however, any revisions that alter the total expenditures of any fund must be approved by the Agency Board.
3. Legally adopted budgets and formal budgetary integration is employed as a management control device during the year.
4. Budgets are adopted on a basis consistent with GAAP.
5. Budgeted revenue amounts represent the original budget modified by adjustments authorized during the year. Budgeted expenditure amounts represent original appropriations adjusted for supplemental appropriations during the year which were contingent upon new or additional revenue sources and reappropriated amounts for prior year encumbrances. The Executive Director must approve adjustments to departmental budgets; however, management may amend the budgeted amounts within departmental expenditure classifications.
6. Certain appropriations carry over at the end of the fiscal year and then are rebudgeted for the coming year.

Hercules Redevelopment Agency
Required Supplementary Information, Continued
For the year ended June 30, 2005

Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
Redevelopment Operating Special Revenue Fund

| | Budgeted Amounts | | Actual Amounts | Variance with Final Budget Positive (Negative) |
|---|------------------|---------------------|-------------------|---|
| | Original | Final | | |
| REVENUES: | | | | |
| Taxes | \$ 536,000 | \$ 536,000 | \$ 4,579,296 | \$ 4,043,296 |
| Use of money and property | - | - | 54,534 | 54,534 |
| Miscellaneous | - | - | 10,000 | 10,000 |
| Total revenues | 536,000 | 536,000 | 4,643,830 | 4,107,830 |
| EXPENDITURES: | | | | |
| Current: | | | | |
| General government | 536,000 | 1,000,692 | 1,965,669 | (964,977) |
| Total expenditures | 536,000 | 1,000,692 | 1,965,669 | (964,977) |
| REVENUES OVER (UNDER) | | | | |
| EXPENDITURES | - | (464,692) | 2,678,161 | 3,142,853 |
| OTHER FINANCING SOURCES (USES): | | | | |
| Transfers in | - | 200,000 | 6,647,302 | 6,447,302 |
| Transfers out | - | - | (3,617,581) | (3,617,581) |
| Total other financing sources (uses) | - | 200,000 | 3,029,721 | 2,829,721 |
| Net change in fund balance | \$ - | \$ (264,692) | 5,707,882 | \$ 5,972,574 |
| FUND BALANCE: | | | | |
| Beginning of year | | | (3,450) | |
| End of year | | | \$ 5,704,432 | |

Hercules Redevelopment Agency
Required Supplementary Information, Continued
For the year ended June 30, 2005

Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
Affordable Housing Special Revenue Fund

| | Budgeted Amounts | | Actual Amounts | Variance with Final Budget Positive (Negative) |
|---|---------------------|-----------------------|---------------------|---|
| | Original | Final | | |
| REVENUES: | | | | |
| Taxes | \$ 1,000,000 | \$ 1,000,000 | \$ 1,700,657 | \$ 700,657 |
| Use of money and property | - | - | 64,039 | 64,039 |
| Charges for services | - | - | 17,330 | 17,330 |
| Miscellaneous | - | - | 390,058 | 390,058 |
| Total revenues | <u>1,000,000</u> | <u>1,000,000</u> | <u>2,172,084</u> | <u>1,172,084</u> |
| EXPENDITURES: | | | | |
| Current: | | | | |
| General government | <u>1,132,100</u> | <u>2,118,378</u> | <u>952,635</u> | <u>1,165,743</u> |
| Total expenditures | <u>1,132,100</u> | <u>2,118,378</u> | <u>952,635</u> | <u>1,165,743</u> |
| REVENUES OVER (UNDER) | | | | |
| EXPENDITURES | <u>(132,100)</u> | <u>(1,118,378)</u> | <u>1,219,449</u> | <u>6,341</u> |
| OTHER FINANCING SOURCES (USES): | | | | |
| Transfers out | <u>-</u> | <u>-</u> | <u>(372,835)</u> | <u>(372,835)</u> |
| Total other financing sources (uses) | <u>-</u> | <u>-</u> | <u>(372,835)</u> | <u>(372,835)</u> |
| Net change in fund balance | <u>\$ (132,100)</u> | <u>\$ (1,118,378)</u> | <u>846,614</u> | <u>\$ 6,341</u> |
| FUND BALANCE: | | | | |
| Beginning of year | | | <u>1,603,625</u> | |
| End of year | | | <u>\$ 2,450,239</u> | |

SUPPLEMENTARY INFORMATION

Hercules Redevelopment Agency

Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual

Redevelopment Agency Debt Service Fund

For the year ended June 30, 2005

| | Budgeted Amounts | | Actual Amounts | Variance with Final Budget Positive (Negative) |
|---|---------------------|---------------------|-----------------------|---|
| | Original | Final | | |
| REVENUES: | | | | |
| Taxes | \$ 3,220,450 | \$ 3,220,450 | \$ 3,169,404 | \$ (51,046) |
| Use of money and property | 99,050 | 99,050 | 162,237 | 63,187 |
| Total revenues | 3,319,500 | 3,319,500 | 3,331,641 | 12,141 |
| EXPENDITURES: | | | | |
| Current | | | | |
| General government | 1,930,000 | 1,930,000 | 1,667,025 | 262,975 |
| Debt service: | | | | |
| Principal repayment | 428,000 | 428,000 | 4,117,411 | (3,689,411) |
| Interest and fiscal charges | 1,149,500 | 1,149,500 | 1,652,107 | (502,607) |
| Total expenditures | 3,507,500 | 3,507,500 | 7,436,543 | (3,929,043) |
| REVENUES OVER (UNDER) EXPENDITURES | (188,000) | (188,000) | (4,104,902) | (3,916,902) |
| OTHER FINANCING SOURCES (USES): | | | | |
| Transfers in | - | - | 3,990,416 | 3,990,416 |
| Transfers out | - | - | (3,711,792) | (3,711,792) |
| Total other financing sources (uses) | - | - | 278,624 | 278,624 |
| Net change in fund balance | \$ (188,000) | \$ (188,000) | (3,826,278) | \$ (3,638,278) |
| FUND BALANCE: | | | | |
| Beginning of year | | | (3,607,835) | |
| End of year | | | <u>\$ (7,434,113)</u> | |

Hercules Redevelopment Agency

Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual

Redevelopment Agency Capital Projects Fund

For the year ended June 30, 2005

| | Budgeted Amounts | | Actual Amounts | Variance with Final Budget Positive (Negative) |
|---|-----------------------|-----------------------|-----------------------|---|
| | Original | Final | | |
| REVENUES: | | | | |
| Property taxes | \$ 144,500 | \$ 144,500 | \$ - | \$ (144,500) |
| Total revenues | <u>144,500</u> | <u>144,500</u> | <u>-</u> | <u>(144,500)</u> |
| EXPENDITURES: | | | | |
| Capital outlay | 3,500,000 | 3,550,000 | 3,158,802 | 391,198 |
| Total expenditures | <u>3,500,000</u> | <u>3,550,000</u> | <u>3,158,802</u> | <u>391,198</u> |
| REVENUES OVER (UNDER) | | | | |
| EXPENDITURES | <u>(3,355,500)</u> | <u>(3,405,500)</u> | <u>(3,158,802)</u> | <u>246,698</u> |
| OTHER FINANCING SOURCES (USES): | | | | |
| Transfers in | - | - | 2,785,198 | 2,785,198 |
| Transfers out | - | (200,000) | (5,720,708) | (5,520,708) |
| Total other financing sources (uses) | <u>-</u> | <u>(200,000)</u> | <u>(2,935,510)</u> | <u>(2,735,510)</u> |
| Net change in fund balance | <u>\$ (3,355,500)</u> | <u>\$ (3,605,500)</u> | <u>(6,094,312)</u> | <u>\$ (2,488,812)</u> |
| FUND BALANCE: | | | | |
| Beginning of year | | | <u>3,847,186</u> | |
| End of year | | | <u>\$ (2,247,126)</u> | |

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**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING
BASED ON AN AUDIT OF THE BASIC FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Members of the Governing Board
of the Hercules Redevelopment Agency
Hercules, California

We have audited the basic financial statements of the Hercules Redevelopment Agency (Agency), a component unit of the City of Hercules (City), as of and for the year ended June 30, 2005, and have issued our report thereon dated December 22, 2005. We conducted our audit in accordance with generally accepted auditing standards 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.

Compliance

As part of obtaining reasonable assurance about whether the basic financial statements of the Agency are free of material misstatements, we performed tests of its compliance with certain provision of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. Such provisions included those provisions of laws identified in the *Guidelines for Compliance Audits of California Redevelopment Agencies*, issued by the California State Controller and as interpreted in the *Suggested Auditing Procedures for Accomplishing Compliance Audits of California Redevelopment Agencies*, issued by the Governmental Accounting and Auditing Committee of the California Society of Certified Public Accountants. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

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 opinion on the basic 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 over financial reporting that might be material weaknesses.

A material weakness is a 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 in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees 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.

This report is intended for the information of the Agency Board, management, and the California State Controller. However, this report is a matter of public record and its distribution is not limited.

Caporicci & Larson

Oakland, California
December 22, 2005

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