

**REDEVELOPMENT AGENCY
OF THE CITY OF MONTEREY
BASIC COMPONENT UNIT FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011**

This Page Intentionally Left Blank

**REDEVELOPMENT AGENCY
OF THE CITY OF MONTEREY**

**Basic Component Unit Financial Statements
June 30, 2011**

TABLE OF CONTENTS

	<u>Page</u>
INDEPENDENT AUDITORS' REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED).....	3
COMPONENT UNIT BASIC FINANCIAL STATEMENTS:	
Agency-wide Financial Statements:	
Statement of Net Assets	8
Statement of Activities.....	9
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet	12
Reconciliation of the Governmental Funds – Balance Sheet with the Statement of Net Assets	13
Statement of Revenues, Expenditures and Changes in Fund Balance.....	14
Reconciliation of the Net Change in Fund Balances - Total Governmental Funds with the Statement of Activities	15
Statement of Revenues, Expenditures and Changes in Fund Balance – Budget and Actual: Low and Moderate Income Housing Fund	16
Notes to the Basic Financial Statements.....	17
 INDEPENDENT AUDITORS REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE (INCLUDING THE PROVISIONS CONTAINED IN THE GUIDELINES FOR COMPLIANCE AUDITS OF REDEVELOPMENT AGENCIES) AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS	 25

This Page Intentionally Left Blank

INDEPENDENT AUDITORS' REPORT

Board of Directors
Redevelopment Agency of the City of Monterey
Monterey, California

We have audited the financial statements of the governmental activities and each major fund of the Redevelopment Agency of the City of Monterey, a component unit of the City of Monterey, as of and for the year ended June 30, 2011, which collectively comprise the Redevelopment Agency of the City of Monterey's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the Redevelopment Agency of the City of Monterey's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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 Redevelopment Agency of the City of Monterey as of June 30, 2011, and the respective changes in financial position, where applicable, and the budgetary comparison for the special revenue fund for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in note 1H to the financial statements, the accompanying financial statements reflect certain changes in the reporting of fund types and fund balance classifications for governmental funds due to the implementation of Governmental Accounting Standards Board Statement no.54.

Management's Discussion and Analysis is supplementary information required by the Governmental Accounting Standards Board, but is not a required part of the basic financial statements. We have applied certain limited procedures to this information, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information, but we did not audit this information and we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 30, 2011 on our consideration of the Redevelopment Agency of the City of Monterey'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.

R.J. Ricciardi, Inc.

R.J. Ricciardi, Inc.
Certified Public Accountants

San Rafael, California
December 30, 2011

This Page Intentionally Left Blank

REDEVELOPMENT AGENCY OF THE CITY OF MONTEREY

(A Component Unit of the City of Monterey, California)

MANAGEMENT'S DISCUSSION AND ANALYSIS

Please read this overview in conjunction your reading of the accompanying Basic Financial statements.

A. *THE PURPOSE OF THE AGENCY*

The Agency is a component unit of the City of Monterey; it is controlled by the City, which appoints the Agency's Board of Directors. City employees perform all the duties and functions required of the Agency.

The Agency's purpose under California law is to eliminate urban blight in the City of Monterey; it is given certain powers under the law to assist it in that endeavor. The Agency may not assess or receive property taxes, but it may receive any increases in property taxes over amounts received in the year before the property in the Agency's area became subject to redevelopment (called the Base Year). The increases are called Property Tax Increments. One-fifth of the property tax increments received must be used to increase the supply of low and moderate-income housing.

B. *FISCAL YEAR 2010-11 FINANCIAL HIGHLIGHTS*

Financial highlights of the year include the following:

- Agency general revenues were \$4,592,490 (page 8), while total revenues were \$8,163,456 (page 13).
- Low & Moderate Income Housing Fund revenues of \$1,626,129 were \$1,033,441 less than the prior year, due to the sale of Ocean Harbor House units the previous fiscal year. Expenditures of \$632,707 were \$259,011 less than the prior year, due to a \$200,000 non-profit public housing project rehabilitation grant issued in the prior fiscal year. Ending fund balance increased \$993,422.
- Debt Service Fund revenues of \$6,537,327 were \$91,994 less than the prior year due to decline in property tax revenue, while expenditures of \$10,189,274 were \$5,363,031 more than the prior year, due to the payoff of a bond and payments of an advance to the City.

C. *THE BASIC FINANCIAL STATEMENTS*

The Basic Financial Statements comprise the Agency-wide Financial Statements and the Fund Financial Statements; these two sets of financial statements provide two different views of the Agency's financial activities and financial position.

The Agency-wide Financial Statements provide a longer-term view of the Agency's activities as a whole, and comprise the Statement of Net Assets and the Statement of Activities. The Statement of Net Assets provides information about the financial position of the Agency as a whole, including all its capital assets and long-term liabilities on the full accrual basis, similar to that used by corporations. The Statement of Activities provides information about all the Agency's revenues and all its expenses, also on the full accrual basis, with the emphasis on measuring net revenues or expenses of each the Agency's programs. The Statement of Activities explains in detail the change in Net Assets for the year.

All of the Agency's activities are grouped into Government Activities.

The Fund Financial Statements report the Agency's operations in more detail than the Agency-wide statements and focus primarily on the short-term activities of the Agency's two Funds. The Fund Financial Statements measure only current revenues and expenditures and fund balances; they exclude capital assets, long-term debt and other long-term amounts.

REDEVELOPMENT AGENCY OF THE CITY OF MONTEREY

(A Component Unit of the City of Monterey, California)

Major Funds account for the major financial activities of the Agency and are presented individually with subordinate schedules presenting the detail for each of these other funds. The Agency reports both of its Funds as Major Funds; their purpose is explained in Note 1.C. to the financial statements.

The Agency-wide Financial Statements

The Statement of Net Assets and the Statement of Activities present information about the following:

- **Governmental activities**—All of the Agency's basic services are considered to be governmental activities, including general government and community development. These services are supported by general Agency revenues such as property tax increments.

Agency-wide financial statements are prepared on the accrual basis, which means they measure the flow of all economic resources of the Agency as a whole.

Fund Financial Statements

The Fund Financial Statements provide detailed information about each of the Agency's most significant funds, called Major Funds. Each Major Fund is presented individually. Major Funds present the major activities of the Agency for the year, and may change from year to year as a result of changes in the pattern of Agency's activities.

All the Agency's Funds are Governmental Funds; financial statements for these Funds are prepared on the modified accrual basis, which means they measure only current financial resources and uses. Capital assets and other long-lived assets, along with long-term liabilities, are not presented in the Governmental Fund Financial Statements.

Comparisons of Budget and Actual financial information are presented only for the Low & Moderate Income Housing Fund; the Debt Service Fund is not budgeted.

D. FINANCIAL ACTIVITIES OF THE AGENCY AS A WHOLE

This analysis focuses on the net assets and changes in net assets of the Agency's Governmental Activities in the Agency-wide Statement of Net Assets and Statement of Activities that follow.

The Agency's net deficit from governmental activities declined to a deficit of \$16,537,891 in 2011 from a deficit of \$19,320,958 in 2010. It is important to note that the reason for this deficit is the accounting treatment required for the Repayment Agreement the Agency has with the City that amounted to \$31,472,961 at June 30, 2011. This is the amount owed by the Agency to the City for capital assets and other expenditures made by the City on the Agency's behalf. The Agency has no capital assets as all assets constructed with Agency funds are transferred to the City under capital leases. Therefore, the Repayment Agreement liability is the primary component of the Agency's unrestricted net assets deficit.

The \$2,783,067 Change in Net Assets reflected in the Statement of Activities was due to a number of factors including:

- Cash and investments, including with fiscal agent, decreased \$4,514,091 largely due to early payoff of the 1999 Bond, and payments made to the City under the Repayment Agreement (\$5,218,740).
- Long-term debt and interest payable declined \$8,983,739 as no new debt was issued and repayments of that amount were made on existing debt.
- Restricted net assets totaled \$15,206,574 at June 30, 2011, all of which may only be used for low-and moderate-income-housing.

REDEVELOPMENT AGENCY OF THE CITY OF MONTEREY

(A Component Unit of the City of Monterey, California)

- Unrestricted net assets is normally the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants or other legal requirements. However, it also includes long-term debt issued to finance infrastructure and capital assets that have been transferred to the City of Monterey.

Fiscal Year 2010-11 Government Activities

The Agency's fiscal 2011 revenue came primarily from property tax increments, which amounted to \$6,265,671, a decrease of \$24,682 from the prior year. Investment earnings contributed an additional \$285,830 in fiscal 2011, an increase of \$20,888.

Agency expenses of \$10,821,981 in fiscal 2011 were for interest (\$159,019), SERAF (\$449,289), administration (\$597,225), payment on advances and principal (\$8,983,740), and community development (\$632,707).

E. THE AGENCY'S FUND FINANCIAL STATEMENTS

At June 30, 2011, the Agency's governmental funds reported a combined fund balance of \$13,819,844, which is a decrease of \$2,658,524 compared with last year. The Low & Moderate Income Housing Fund accounts for \$15,206,574 in fund balance, all of which is either restricted or non-spendable, while the Debt Service Fund reflected a fund balance of negative \$1,386,730. This negative balance is due to a \$1.5 million advance made from the Low & Moderate Income Housing fund in 1987.

The Agency makes loans to qualified moderate-income residents or employees of the City to assist in the purchase of their principal residence. At June 30, 2011, the outstanding balance of these loans was \$1,493,621. Interest on these loans is at below market rates, and principal payments are deferred if the properties are occupied by qualified individuals.

The Agency also has agreed to provide project subsidy loans; the balance on these loans at June 30, 2011 was \$8,627,402.

All these loans are accounted for in the Low & Moderate Income Housing Fund and explained in detail in Note 3 to the financial statements.

F. DEBT ADMINISTRATION

As of June 30, 2011, the one Revenue Bond issue (1999) has been paid and defeased in accordance with the indenture. Further detail is discussed in Note 6 to the financial statements.

ECONOMIC OUTLOOK AND MAJOR INITIATIVES

The Agency's primary revenue source is property tax increments, as discussed above. These increments are expected to increase moderately as property values in the Redevelopment area increase. However, as a component unit of the City of Monterey, the Agency's economic outlook and major initiatives are tied to those of the City, which are discussed in detail in the City's Transmittal Letter and Management's Discussion & Analysis segments of its Comprehensive Annual Financial Report for the year ended June 30, 2011.

CONTACTING THE AGENCY'S FINANCIAL MANAGEMENT

These financial statements are intended to provide citizens, taxpayers, investors and creditors with a general overview of the Agency's financial condition and results of operations. Questions should be directed to the Finance Department at 735 Pacific Street, Suite A, Monterey, CA 93940.

REDEVELOPMENT AGENCY OF THE CITY OF MONTEREY

(A Component Unit of the City of Monterey, California)

AGENCY-WIDE FINANCIAL STATEMENTS

STATEMENT OF NET ASSETS AND STATEMENT OF ACTIVITIES

The Statement of Net Assets and the Statement of Activities summarize the entire Agency's financial activities and financial position. They are prepared on the same basis as is used by most businesses, which means they include all the Agency's assets and all its liabilities, as well as all its revenues and expenses. This is known as the full accrual basis—the effect of all the Agency's transactions is taken into account, regardless of whether or when cash changes hands, but all material internal transactions between Agency funds have been eliminated.

The Statement of Net Assets reports the difference between the Agency's total assets and the Agency's total liabilities, including the Agency's long-term debt. The Statement of Net Assets presents similar information to the old balance sheet format, but presents it in a way that focuses the reader on the composition of the Agency's net assets, by subtracting total liabilities from total assets.

The Statement of Net Assets summarizes the financial position of all of the Agency's Governmental Activities in a single column.

The Agency's Governmental Activities include the activities of its Debt Service Fund.

The Statement of Activities reports increases and decreases in the Agency's net assets. It is also prepared on the full accrual basis, which means it includes all the Agency's revenues and all its expenses, regardless of when cash changes hands. This differs from the "modified accrual" basis used in the Fund financial statements, which reflect only current assets, current liabilities, available revenues and measurable expenditures.

REDEVELOPMENT AGENCY
OF THE CITY OF MONTEREY
STATEMENT OF NET ASSETS
JUNE 30, 2011

	<u>Governmental Activities</u>
ASSETS	
Cash and investments available for operations	\$ 3,710,441
Restricted cash and cash equivalents	803,650
Interest receivable	91,765
Due from other funds	-
Project subsidy loans	8,627,402
Down payment assistance loans	1,493,621
Capital lease receivable	-
Property held for resale	<u>223,794</u>
Total Assets	<u>14,950,672</u>
LIABILITIES	
Accounts payable and accrued liabilities	15,602
Interest payable	-
Long term debt:	
Due within one year	-
Due in more than one year	<u>31,472,961</u>
Total Liabilities	<u>31,488,563</u>
NET ASSETS (DEFICIT)	
Restricted for:	
Low and Moderate Income Housing	<u>15,206,574</u>
Total Restricted Net Assets	<u>15,206,574</u>
Unrestricted	<u>(31,744,465)</u>
Total Net Assets	<u><u>\$ (16,537,891)</u></u>

See accompanying notes to financial statements

REDEVELOPMENT AGENCY
OF THE CITY OF MONTEREY
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2011

<u>Functions/Programs</u>	
Governmental Activities:	
General government	\$ 1,046,514
Community development	632,707
Interest on long term debt	<u>130,201</u>
Total program expenses	<u>1,809,423</u>
General revenues:	
Taxes: Property tax increment	6,265,671
Investment income	285,830
Rental income	60,059
Interest portion of facility lease	(2,124,821)
Other	<u>105,750</u>
Total general revenues	<u>4,592,490</u>
Change in Net Assets	2,783,067
Net Assets-Beginning	<u>(19,320,958)</u>
Net Assets-Ending	<u><u>\$ (16,537,891)</u></u>

See accompanying notes to financial statements

This Page Intentionally Left Blank

REDEVELOPMENT AGENCY OF THE CITY OF MONTEREY

(A Component Unit of the City of Monterey, California)

FUND FINANCIAL STATEMENTS

Fund Financial Statements are compiled so that only individual major funds are presented, while non-major funds are combined in a single column.

Major funds are defined generally as having significant activities or balances in the current year; no distinction is made between Fund types.

MAJOR GOVERNMENTAL FUNDS

The Redevelopment Agency of the City of Monterey determined all its funds to be major funds, as follows:

LOW AND MODERATE INCOME HOUSING FUND

This fund accounts for revenue sources legally restricted for expenditures for the specified purposes of low and moderate income housing.

DEBT SERVICE FUND

This fund accounts for tax increment revenues, bond proceeds and related interest income required to be set aside for future debt service. The fund is used to repay principal and interest on indebtedness of the Agency. Debt service funds are referred to as "Special Funds" by the California Health and Safety Code and the Agency's bond resolutions.

REDEVELOPMENT AGENCY
OF THE CITY OF MONTEREY
GOVERNMENTAL FUNDS
BALANCE SHEET
JUNE 30, 2011

	Low and Moderate Income Housing Special Revenue	Debt Service	Total Governmental Funds
ASSETS			
Cash and investments available for operations	\$ 3,623,598	\$ 86,843	\$ 3,710,441
Restricted cash and cash equivalents	803,650	-	803,650
Interest receivable	90,887	878	91,765
Due from other funds	-	-	-
Advances to other funds	1,472,383	-	1,472,383
Project subsidy loans	8,627,402	-	8,627,402
Down payment assistance loans	1,493,621	-	1,493,621
Capital lease receivable	-	-	-
Property held for resale	223,794	-	223,794
Total Assets	<u>\$ 16,335,335</u>	<u>\$ 87,720</u>	<u>\$ 16,423,055</u>
LIABILITIES			
Accounts payable and accrued liabilities	\$ 13,535	\$ 2,067	\$ 15,602
Advances from other funds	-	1,472,383	1,472,383
Deferred revenue	1,115,226	-	1,115,226
Total Liabilities	<u>1,128,761</u>	<u>1,474,450</u>	<u>2,603,211</u>
FUND BALANCES			
Fund balances			
Nonspendable fund balance	13,065,788		13,065,788
Restricted fund balance	2,140,786		2,140,786
Committed fund balance			-
Assigned fund balance			-
Unassigned fund balance	<u> </u>	<u>(1,386,730)</u>	<u>(1,386,730)</u>
Total Fund Balances	<u>15,206,574</u>	<u>(1,386,730)</u>	<u>13,819,844</u>
Total Liabilities and Fund Balances	<u>\$ 16,335,335</u>	<u>\$ 87,720</u>	<u>\$ 16,423,056</u>

See accompanying notes to financial statements

REDEVELOPMENT AGENCY
OF THE CITY OF MONTEREY
RECONCILIATION OF THE
GOVERNMENTAL FUNDS -- BALANCE SHEET
WITH THE
STATEMENT OF NET ASSETS
JUNE 30, 2011

Total fund balances (deficits) reported on the governmental funds balance sheet	\$	13,819,844
---	----	------------

Amounts reported for Governmental Activities in the Statement of Net Assets
are different from those reported in the Governmental Funds above because of the following:

ACCRUAL OF NON-CURRENT REVENUES AND EXPENSES

Revenues which are deferred on the Fund Balance Sheets because they are not available currently are taken into revenue in the Statement of Activities.		1,115,226
---	--	-----------

LONG TERM ASSETS AND LIABILITIES

The assets and liabilities below are not due and payable in the current period and therefore are not
reported in the Funds:

Long-term debt due within one year		-
Long-term debt in more than one year		(31,472,961)
Interest payable		-
		-

NET ASSETS OF GOVERNMENTAL ACTIVITIES	\$	(16,537,891)
---------------------------------------	----	--------------

See accompanying notes to financial statements

REDEVELOPMENT AGENCY
OF THE CITY OF MONTEREY
GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
FOR THE YEAR ENDED JUNE 30, 2011

	Low and Moderate Income Housing Special Revenue	Debt Service	Total Governmental Funds
REVENUES:			
Property tax increment	\$ 1,333,504	\$ 4,932,167	\$ 6,265,671
Investment income	126,816	159,014	285,830
Rental income	60,059	-	60,059
Facility lease	-	1,446,145	1,446,145
Other	105,750	-	105,750
Total Revenues	1,626,129	6,537,327	8,163,456
EXPENDITURES:			
Current:			
General government	-	597,225	597,225
Community development	632,707	-	632,707
Payment on advances	-	5,218,740	5,218,740
SERAF contribution	-	449,289	449,289
Non-current:			
Principal	-	3,765,000	3,765,000
Interest	-	159,019	159,019
Fiscal charges	-	-	-
Total Expenditures	632,707	10,189,274	10,821,981
NET CHANGE IN FUND BALANCES	993,422	(3,651,946)	(2,658,524)
Beginning Fund Balances	14,213,152	2,265,216	16,478,368
Ending Fund Balances	\$ 15,206,574	\$ (1,386,730)	\$ 13,819,844

See accompanying notes to financial statements

REDEVELOPMENT AGENCY
OF THE CITY OF MONTEREY
RECONCILIATION OF THE
NET CHANGE IN FUND BALANCES - TOTAL GOVERNMENTAL FUNDS
WITH THE
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2011

The schedule below reconciles the Net Changes in Fund Balances reported on the Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balance, which measures only changes in current assets and current liabilities on the modified accrual basis, with the Change in Net Assets of Governmental Activities reported in the Statement of Activities, which is prepared on the full accrual basis.

NET CHANGE IN FUND BALANCES - TOTAL GOVERNMENTAL FUNDS	\$ (2,658,524)
--	----------------

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

LONG TERM DEBT PROCEEDS AND PAYMENTS

Repayment of long term debt is an expenditure in the governmental funds, but in the Statement of Net Assets the repayment reduces long-term liabilities.

Repayment of debt principal, bonds	3,765,000
Repayment of debt principal, Repayment Agreement	5,218,740
Interest payable attributed to prior fiscal year	28,818
(reduction in interest payable from last year of \$28,818)	

ACCRUAL OF NON-CURRENT ITEMS

The amounts below included in the Statement of Activities do not provide or (require) the use of current financial resources and therefore are not reported as revenue or expenditures in governmental funds (net change):

Deferred revenue	(3,570,966)
(Current year deferred revenue less current year principal payment and prior year deferred revenue, (\$1,115,226-\$3,765,000-\$921,192)	
Interest payable	0

CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES	\$ 2,783,067
---	--------------

See accompanying notes to financial statements

REDEVELOPMENT AGENCY
OF THE CITY OF MONTEREY
LOW AND MODERATE INCOME HOUSING SPECIAL REVENUE FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL
FOR THE YEAR ENDED JUNE 30, 2011

	Budget Amounts		Actual Amounts	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES:				
Property tax increment	\$ 800,399	\$ 800,399	\$ 1,333,504	\$ 533,105
Investment income	144,000	144,000	126,816	(17,184)
Rental income	45,000	45,000	60,059	15,059
Other	-	-	105,750	105,750
Total Revenues	989,399	989,399	1,626,129	636,730
EXPENDITURES:				
Current:				
Community development	2,893,741	3,377,910	632,707	2,745,203
NET CHANGE IN FUND BALANCE	<u>\$ (1,904,342)</u>	<u>\$ (2,388,511)</u>	993,422	<u>\$ 3,381,933</u>
Beginning Fund Balance (as restated)			<u>14,213,152</u>	
Ending Fund Balances			<u>\$ 15,206,574</u>	

See accompanying notes to financial statements

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. ORGANIZATION AND PURPOSE

The Redevelopment Agency of the City of Monterey was created under the provisions of the Community Redevelopment Law (California Health and Safety Code) to redevelop certain areas in the City of Monterey. The Custom House Redevelopment plan was originally adopted in July 1961 and was amended in March 1980 to provide an improved physical, social and economic environment in the Agency's project area. The Cannery Row Redevelopment Plan and the Greater Downtown Monterey Redevelopment Plan were adopted in July 1981 and July 1983 respectively. The Agency is authorized to finance the Plan from various sources, including assistance from the City, the State and federal governments, property tax increments, interest income and the issuance of Agency bonds.

The Agency is an integral part of the City of Monterey and the accompanying component unit financial statements are included as a component unit of the basic financial statements prepared by the City.

B. BASIS OF PRESENTATION

The Agency's Basic Financial Statements are prepared in conformity with accounting principles generally accepted in the United State of America. The Governmental Accounting Standards Board is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the U.S.A.

Agency-wide Statements: The Statement of Net Assets and the Statement of Activities include the financial activities of the overall Agency. Eliminations have been made to minimize the double counting of internal activities.

The Statement of Activities presents a comparison between direct expenses and those revenues that are classified as general revenues, including all taxes and investment income.

Fund Financial Statements: The fund financial statements provide information about the Agency. Separate statements for each governmental fund are presented. The emphasis of fund financial statement is on major individual funds, each of which is displayed in a separate column.

C. MAJOR FUNDS

Major funds are defined as funds that have either assets, liabilities, revenues or expenditures/expenses equal to ten percent of their fund-type total. The Agency considers all its funds to be major governmental funds. A summary of these funds follows:

Low and Moderate Income Housing Special Revenue Fund – This fund accounts for revenue sources legally restricted for expenditures for the specified purposes of low and moderate income housing.

Debt Service Fund – The Debt Service Fund accounts for tax increment revenues, bond proceeds and related interest income required to be set aside for future debt service. The funds are used to repay principal and interest on indebtedness of the Agency. Debt service funds are referred to as "Special funds" by the California Health and Safety Code and the Agency's bond resolutions.

D. BASIS OF ACCOUNTING

The Agency-wide financial statements are reported using the *economic resources measurement focus* and the full *accrual basis* of accounting. Revenues are recorded when *earned* and expenses are recorded at the time liabilities are *incurred*, regardless of when the related cash flows take place.

Governmental funds are reported using the *current financial resources* measurement focus and the *modified accrual* basis of accounting. Under this method, revenues are recognized when *measurable and available*.

The Agency considers all revenues reported in the governmental funds to be available if the revenues are collected within thirty days after year-end. Expenditures are recorded when the related fund liability is incurred, except for claims and judgments and principal and interest on long-term debt. Revenues susceptible to accrual are interest revenue, certain other intergovernmental revenues, and certain charges for services.

Proceeds of governmental long-term debt and acquisitions under capital leases are reported as *other financing sources* in governmental funds.

Non-exchange transactions, in which the City gives or receives value without directly receiving or giving equal value in exchange, include grants, entitlements, and donations. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Other revenues susceptible to accrual include taxes, intergovernmental revenues, interest and charges for services.

E. CASH EQUIVALENTS

The Agency considers all highly liquid restricted investments with a maturity of three months or less when purchased to be cash equivalents.

F. BUDGETARY REPORTING AND BUDGETARY ACCOUNTING

The Agency follows these procedures in establishing the budgetary data reflected in the component unit financial statements.

1. Prior to June 30, the Treasurer submits to the Agency Board a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures and means of financing them.
2. Public hearings are conducted to obtain taxpayer comments.
3. The budget is legally enacted through passage of a resolution during the second Board meeting in the month of June.
4. The Executive Director is authorized to transfer budgeted amounts; however, any revisions that alter the total expenditures of any fund must be approved by the Agency Board.
5. Formal budgetary integration is employed as a management control device during the year for the Special Revenue fund. Budgets are adopted on a basis consistent with generally accepted accounting principles.

Budget amounts are as amended by the Agency Board.

G. ENCUMBRANCES

Under encumbrance accounting, purchase orders, contracts and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation. Encumbrance accounting is employed as an extension of formal budgetary integration. Encumbrances outstanding at year-end are classified as a part of either Restricted Fund Balance or Committed Fund Balance since they do not constitute expenditures or liabilities. Outstanding encumbrances at year-end are automatically reappropriated the following year. Unencumbered and unexpended appropriations lapse at year-end, except capital projects. There were no significant individual encumbrances outstanding as of June 30, 2011.

Open encumbrances at June 30 were predominately related to community services grants reported under the Low and Moderate Income Housing Special Revenue fund.

Total encumbrances by fund balance classification and fund are presented below:

Open Encumbrances as of June 30, 2011

	<u>Restricted Fund Balance</u>
Low and Moderate Income Housing Special Revenue Fund	\$ 27,682

H. FUND BALANCES REPORTING

The Governmental Accounting Standards Board (GASB) has issued Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions (GASB 54) effective for years first ending June 30, 2011. This Statement specifies how fund balances of governmental funds will be displayed in financial reports. Fund balance will be displayed in the following classifications depicting the relative strength of the spending constraints placed on the purposes for which resources can be used:

1. Non-spendable fund balances are associated with inventories, prepaid expenses, long-term loans and notes receivable, and property held for resale (unless the proceeds will be restricted, committed, or assigned once they do become available).
2. Restricted fund balances are subject to constraints for specific purposes imposed by external providers (such as grantors, bondholders and higher levels of government), through constitutional provisions or by enabling legislation.
3. Committed fund balances can be used only for specific purposes determined by formal action of the Redevelopment Agency Board of Directors (the Agency's level of decision-making authority) and use of these funds requires the same formal action. Committed fund balances are specified in the annual adopted budget.
4. Assigned fund balances are intended by the Agency's Board to be used for specific purposes but do not meet the criteria to be classified as restricted or committed. Assigned fund balances include unexpended encumbrances not classified at a more restricted level.
5. Unassigned fund balance is the residual classification for the government's general fund and includes all amounts not contained in the other classifications. It is possible for other governmental funds to have negative unassigned fund balance when non-spendable amounts plus the restricted fund balances for specific purposes amounts exceed the positive fund balance for that fund.

I. ORDER OF FUND BALANCE SPENDING

The Governmental Accounting Standards Board (GASB) Statement No. 54, requires City policy to state the order in which elements of fund balance are to be expended. Fund balance amounts are classified at year end as restricted or committed depending upon the purpose and restrictions imposed on each specific fund. The Agency applies expenditures to the most restrictive available balances first, then less restricted funds as required.

J. GOVERNMENTAL FUND BALANCES

In the Governmental Funds Balance Sheet fund balances are summarized by classification for presentation purposes. Additional detail of the amounts within each classification for the general and major special revenue funds is provided here.

GOVERNMENTAL FUND BALANCES

June 30, 2011

	Low and Moderate Income Housing Special Revenue	Debt Service	Total Governmental Funds
FUND BALANCES			
Nonspendable fund balance			-
Long-term receivables	\$ 13,065,788		\$ 13,065,788
Total Nonspendable	13,065,788	-	13,065,788
Restricted fund balance			
Restricted for specific purposes	1,916,992		1,916,992
Property held for resale	223,794		223,794
Total Restricted	2,140,786	-	2,140,786
Unassigned fund balance		\$ (1,386,730)	(1,386,730)
Total Unassigned	-	(1,386,730)	(1,386,730)
Total fund balance	\$ 15,206,574	\$ (1,386,730)	\$ 13,819,844

K. PROPERTY TAXES

Monterey County assesses properties and bills, collects, and distributes property taxes as follows:

	Secured	Unsecured
Valuation dates	March 1	March 1
Lien/levy dates	January 1	January 1
Due dates	50% on November 1 and March 1	July 1
Delinquent as of	December 10 & April 10	August 31

The term “unsecured” refers to taxes on personal property other than real estate, land and buildings. These taxes are secured by liens on the property being taxed. Property tax revenues are recognized by the Agency in the fiscal year they are assessed, provided they become available as defined above.

L. PROPERTY HELD FOR RESALE

As part of its Low & Moderate Income Housing Program, the Redevelopment Agency purchases and sells affordable homes in the City to low/moderate income homebuyers in accordance with the affordable housing program. Homes are sold at below-market prices, but the Agency has the right of first refusal when the purchasers wish to resell these homes to the Agency at approximately the same price and in the same condition, which the Agency may accept or decline. Homes owned by the Agency are accounted for at cost, which is below market.

NOTE 2 - CASH AND INVESTMENTS

A. DEPOSITS AND INVESTMENTS

The Agency's cash is partially included in a City-wide cash and investments pool, the details of which are presented in the City's basic financial statements and in this footnote, sections A through G. Individual investments are evidenced by specific identifiable pieces of paper called securities instruments, or by an electronic entry registering the owner in the records of the institution issuing the security, called the book entry system.

Investments are reported in the accompanying financial statements at fair value. Changes in fair value that occur during the fiscal year are recognized as investment income reported for that fiscal year. Investment income includes interest earnings, changes in fair value, and any gains or losses realized upon the liquidation or sale of investments.

The City of Monterey pools cash and investments of all funds and component units, except for assets held by fiscal agents. The Agency's share in this pool is displayed in the accompanying financial statements as cash and investments. Investment income earned by the pooled investments is allocated monthly to the various funds and component units based upon monthly cash and investment balances.

The Agency's investments held by fiscal agents are pledged for repayment or as security for certain long-term debt issuances. The California Government Code provides that these monies, in the absence of specific statutory provisions governing the issuance of bonds, may be invested in accordance with the ordinance, resolutions or indentures specifying the types of investments made by its trustee or fiscal agents. As of June 30, 2011, the Redevelopment Agency had the following investments:

Cash invested by City of Monterey	\$3,710,441
Cash and Investments held by fiscal agent:	
Cash invested with trustee	803,650
Investment Agreement	<u>0</u>
Total Cash and Investments	<u><u>\$4,514,091</u></u>

B. AUTHORIZED INVESTMENTS

See the City's financial statements for the year ended June 30, 2011 for disclosure on authorized investments.

C. *INTEREST RATE RISK*

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the City of Monterey manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Information about the sensitivity of the fair values of the Agency's investments (including investments held by bond trustee) to market interest rate fluctuations is provided by the disclosures in the notes to the basic financial statements of the City of Monterey that show the distribution of the City's investments by maturity.

D. *CREDIT RISK*

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligations to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Agency investments are not rated.

E. *CONCENTRATION OF CREDIT RISK*

The Agency did not have any investments in any one issuer (other than U.S. Treasury securities, mutual funds, and investment pools) that represent 5% or more of total investments for the entire entity (or for each separate major fund) for the fiscal year ended June 30, 2011.

F. *CUSTODIAL CREDIT RISK*

Custodial Credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party.

California Law requires banks and savings and loan institutions to pledge government securities with a market value of 110% of the Agency's cash on deposit or first trust deed mortgage notes with a value of 150% of the deposit as collateral for these deposits. Under California Law, this collateral is held in the City of Monterey's name and places the City ahead of general creditors of the institution. The City has waived collateral requirements for the portion of deposits covered by federal deposit insurance.

NOTE 3 – LOANS RECEIVABLE

A. *DOWN PAYMENT ASSISTANCE LOANS*

At fiscal year end, the Agency had \$1,493,621 in Down Payment Assistance Loans. These are loans to qualified moderate income residents of the City or qualified moderate income individuals employed in the City for up to 15% of the purchase price of a residence in the City (to a maximum of \$50,000). Such loans bear simple interest at 5% per annum, with principal and interest deferred for the first fifteen years. At the end of fifteen years the City reviews the income status of the borrower. Based on such review, the balance of the loan is payable in monthly installments over a period of up to 15 years, or deferred for an additional period of five years with repayment upon sale or transfer of the residence. Due to the long-term nature of

the interest receivable, interest on the loans is recorded only when it becomes available as net current assets. Since these loans are not currently available for expenditure, fund balance has been reserved in this amount.

B. PROJECT SUBSIDY LOANS

At fiscal year end, the Agency had \$8,627,402 in Project Subsidy Loans, which includes accrued interest.

In October of 1997, the Agency entered into a Development Agreement and Ground Lease with a developer for the C-21 Redevelopment Mixed Use Project in the Custom House Redevelopment Project Area. Under the terms of the agreement, the developer constructed a theater/retail complex, which included affordable housing units. The developer agreed to provide on-site management of the housing units. The Agency agreed to provide a project subsidy loan of \$2,565,000 to implement the project. No principal or interest repayment is required until 2018.

In April 2003, the Agency authorized a loan with a developer for the construction of 21 units of affordable workforce rental housing. Under the terms of the agreement, the Agency loaned \$2,235,000, at 3% interest per annum for a term of thirty (30) years, fully amortized, with monthly payments of approximately \$9,696 per month. The agreement is secured by deed of trust.

In July 2007 the City entered into a development agreement to provide a loan for the development of 18 affordable rental units in the Monterey Hotel Mixed-Use Project, on a vacant lot in the Old Town Redevelopment Project Area. As of June 30, 2011, the City has provided \$2,994,743 from Redevelopment Housing Set-Aside funds. This project remains in a receivership status. Pursuant to an Inter-creditor Agreement executed between the primary lender, Rabo Bank, the Receiver and the Redevelopment Agency, the Receiver has completed and recorded a two-unit parcel map condominium plan (Unit 1 is Commercial and Unit 2 is residential) for the purpose of securing the RDA loan on the separate residential condominium airspace parcel. The residential condominium contains all of the projects' 18 affordable apartment units. To date the Receiver has nearly completed the exterior finish of the building and is in process to partially reconvey the Rabo Bank loan to the commercial condominium unit and the RDA loan to the residential condominium unit. All parties to the Inter-creditor agreement are actively working to complete the partial reconveyance of the loan deeds or trust. Upon reconveyance of the RDA loan the RDA intends to pursue ownership of the condominium unit through a deed in lieu procedure and complete the residential units. Additional RDA Housing funds will be used to complete the residential apartments. The exterior finish is expected to be completed by the end of October 2011. The RDA is anticipating gaining ownership of the residential condominium unit in early 2012. Completion will begin soon after ownership is gained and the RDA is authorized to release additional funds.

NOTE 4 – INTERFUND TRANSACTIONS

During the year ended June 30, 1987, the Special Revenue Fund advanced \$1,472,383 to the Debt Service Fund to meet its debt service requirements. The advance carries no interest and, although there is an agreement to repay, the advance has no definite repayment schedule.

NOTE 5 – CAPITAL LEASES RECEIVABLE

The Agency has entered into long-term agreements with the City of Monterey to lease land and buildings acquired with bond proceeds. Revenue from such lease agreements is used to finance the Agency's debt service requirements. The leases are accounted for as capital leases because at the end of the lease period, the leased assets become the property of the City. As of June 30, 2011, the leased assets have become the property of the city, and no further lease payments will be received.

NOTE 6 – LONG TERM DEBT

A. LEASE REVENUE BONDS

The Agency's revenue bond balances and transactions were as follows:

	Balance June 30, 2010	Retirements	Balance June 30, 2011	Due Within One Year
Lease Revenue Bonds				
1999 Redevelopment Agency, 4.30-4.6%, due 11/1/12	\$ 3,765,000	\$ 3,765,000	\$ 3,765,000	\$ 0

In May 1999, the Agency issued \$19,045,000 of 1999 Lease Revenue Bonds with interest rates ranging from 3.0% to 4.6% to advance refund the outstanding balance of the Agency's 1992 and 1993 Lease Revenue Bonds and to provide funds to repay the Columbarium loan of the City's Cemetery Enterprise Fund. The proceeds of the 1999 Refunding Bonds, along with bond reserve monies held by Trustees for the 1992 and 1993 bonds were used to purchase U.S. government securities which were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the 1992 and 1993 refunded bonds. As a result, the 1992 and 1993 refunded bonds were considered to be defeased and the liability for those obligations was removed from the Agency's financial statements. As of June 30, 2011, the outstanding amount of debt from the 1992 and 1993 Lease Revenue Bonds defeased in substance was \$2,655,000.

The Lease Revenue Bonds are special obligations of the Agency and are secured by the Agency's property tax increment revenues. In April, 2011, the 1999 Bonds were deemed to have been paid and defeased by the irrevocable deposit of moneys in an escrow fund. Amounts of funds deposited were calculated to provide sufficient moneys to pay the respective redemption prices of, and the accrued interest on, the 1999 Lease Revenue Bonds on the Redemption date. Therefore, the liability for those obligations have been removed from the Agency's financial statements. As of June 30, 2011, the outstanding debt of the 1999 Bonds defeased in substance was \$2,490,000.

B. REPAYMENT AGREEMENT

At fiscal year end, the Agency's repayment agreement liability was \$31,472,961. This agreement was authorized in December 1993 by the City Council and Redevelopment Agency Board of Directors to reimburse the City for certain costs incurred on behalf of the Agency. The Repayment Agreement covers assets constructed by the City in the redevelopment areas, assets leased to the City from the Agency and projects paid for with debt financing. The Repayment Agreement requires the Agency to make repayments annually of essentially all available cash; repayments of \$5,218,740 were made in fiscal 2011.

NOTE 7 – JOINT POWERS AGREEMENT

The Agency and the City of Monterey formed the City of Monterey Joint Powers Financing Authority in 1997. The purpose of the Authority is to provide financing for the public improvements for the City, to acquire such public capital improvements and to lease such public capital improvements. Complete financial statements for the Authority can be obtained from the City of Monterey, 735 Pacific Street, Suite A, Monterey, CA 93940.

NOTE 8 – SUBSEQUENT EVENTS

On June 28, 2011, the California State Governor signed ABX1 26 and ABX 1 27, which eliminates redevelopment agencies or requires agencies to make payments to continue their existence. The California Redevelopment Association and League of California Cities have filed a lawsuit to challenge the constitutionality of the state's actions, which is expected to be heard by the California Supreme Court and decided upon by January, 2012. The outcome of the lawsuit could affect ongoing housing programs and the amount of repayment the Redevelopment Agency is able make to the City under the Repayment Agreement between the City and the Redevelopment Agency.

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

Board of Directors
Redevelopment Agency of the City of Monterey
Monterey, California

We have audited the basic financial statements of the Redevelopment Agency of the City of Monterey, a component unit of the City of Monterey, as of and for the year ended June 30, 2011, and have issued our report thereon dated December 30, 2011. We conducted our audit in accordance with U.S. generally accepted auditing standards 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 Redevelopment Agency of the City of Monterey's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Redevelopment Agency of the City of Monterey's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Redevelopment Agency of the City of Monterey's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such there is a reasonable possibility that a material misstatement of the Redevelopment Agency of the City of Monterey's basic financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Redevelopment Agency of the City of Monterey's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. Such provisions included those provisions of laws identified in the *Guidelines for Compliance Audits of California Redevelopment Agencies*, issued by the State Controller and as interpreted in the *Suggested Auditing Procedures for Accomplishing Compliance Audits of California Redevelopment Agencies*, issued by the Governmental Accounting and Auditing Committee of the California Society of Certified Public Accountants. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

The results of our tests disclosed no 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 audit committee, management, Board of Directors, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

R.J. Ricciardi, Inc.

R.J. Ricciardi, Inc.
Certified Public Accountants

San Rafael, California
December 30, 2011

This Page Intentionally Left Blank