TOWN OF LOS GATOS
REDEVELOPMENT AGENCY

BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005
WITH INDEPENDENT AUDITORS' REPORTS
THEREON

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TOWN OF LOS GATOS
REDEVELOPMENT AGENCY

TABLE OF CONTENTS

FOR THE YEAR ENDED JUNE 30, 2005

	PAGE
Independent Auditors' Report	1 - 2
Management's Discussion and Analysis	3 - 9
Basic Financial Statements:	
Government-wide Financial Statements:	
Statement of Net Assets	10
Statement of Activities	11
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet	12
Reconciliation of the Balance Sheet – Statement of Net Assets	13
Statement of Revenues, Expenditures and Changes in Fund Balances	14
Reconciliation of Statement of Revenues, Expenditures and Changes in Fund Balances – Statement of Activities	15
Notes to the Financial Statements	16 - 24
Required Supplementary Information:	
Budgetary Comparison Schedules:	
Statement of Revenues, Expenditures and Changes in Fund Balance - Budget to Actual Redevelopment Fund	25
Supplementary Information:	
Budgetary Comparison Schedules:	
Statement of Revenues, Expenditures and Changes in Fund Balance - Budget to Actual Redevelopment Fund	26
Statement of Revenues, Expenditures and Changes in Fund Balance - Budget to Actual Redevelopment Fund	27
Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*	28
Summary of Compliance Findings	29
Summary of Prior Year Compliance Findings	30

C. G. UHLENBERG LLP

CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITORS' REPORT

Members of the Board of the
Town of Los Gatos Redevelopment Agency
Los Gatos, California

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Los Gatos Redevelopment Agency (the "Agency"), a component unit of the Town of Los Gatos, California, 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 financial statements are the responsibility of the Agency's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Los Gatos Redevelopment Agency as of June 30, 2005, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued a report dated September 23, 2005 on our consideration of the Agency's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results pf the 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 read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis 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 consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion the financial statements that collectively comprise the Agency's basic financial statements. The combining financial statements listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements of the Agency. Such 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.

C. G. Uhlenberg LLP

September 23, 2005
Redwood City, California

Management's Discussion and Analysis

As a component unit of the Town of Los Gatos, the Redevelopment Agency ("Agency") was established in response to the need to rebuild existing infrastructure damaged in the 1989 Loma Prieta Earthquake. The Redevelopment Agency area encompasses approximately 440 acres in and around Downtown Los Gatos, which includes retail and residential areas, lodging, schools, and main traffic thoroughfares. Projects such as street and utility reconstruction, parking, streetscape and civic improvements were called out in the Redevelopment Plan. The Agency has the power to condemn properties for this purpose and to issue debt payable out of the incremental property taxes expected to be realized because of its redevelopment activities. The Agency may enter into development agreements with developers and others to further its purposes.

FISCAL 2005 FINANCIAL HIGHLIGHTS

Agency revenues experienced continued growth in the project area as compared to the prior year. Property tax increments, the Agency's primary revenue source, increased $636,454 from the amounts received the prior year.

- The assets of the Agency exceeded its liabilities at June 30, 2005 by $4,958,464 (net assets). Included in the determination of net assets is a negative (deficit) balance of ($6,493,531) in unrestricted net assets. The deficit in unrestricted net assets is normal in California redevelopment agencies. All redevelopment agencies leverage current tax increment revenues by issuing long-term debt to raise capital to eliminate blight and promote economic growth within the Agency's project area.
- The Agency's total net assets increased by $1,105,778 from the prior year. The increase is largely due to an increase in property tax increment growth and a $979,094 growth in net assets in the Agency's Low and Moderate Income Housing Fund.
- As of June 30, 2005 the Agency's governmental funds reported combined ending fund balances of $12,137,311, an increase of $1,136,396 in comparison from the prior year's combined fund balance of $11,000,915. The increase is due primarily to an increase in fund balances in the Town's Low and Moderate Housing Fund.
- At June 30, 2005 total unreserved fund balance in the Town's governmental funds of $4,032,770 increased $372,926 in comparison with the prior year's balances of $3,704,844.
- The Agency's total outstanding debt increased by $183,050 during the current fiscal year. The increase is due to an increase in the Town's operating advances to the Agency made during the year.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This Report is in three parts:

1) Management's Discussion and Analysis (this part),
2) The Basic Financial Statements, which include the Agency-wide and the Fund financial statements, along with the Notes to these financial statements,
3) Budget/Actual Statements for budgeted Capital Projects Funds.

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 long-term and short-term.

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 of the Agency's programs. The Statement of Activities explains in detail the change in Net Assets for the year.

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 Major Funds. The Fund Financial Statements measure only current revenues and expenditures, current assets, liabilities and fund balances; they exclude capital assets, long-term debt, and other long-term amounts.

Major Funds account for the major financial activities of the Agency and are presented individually, while the activities of any Non-major Funds would be presented in summary, with subordinate schedules presenting the detail for each of these other funds. The Agency does not have any Non-major Funds. Major Funds are explained below.

Together, all these statements are now called the Basic Financial Statements; formerly they were called the general-purpose financial statements.

The Agency-wide Financial Statements

All of the Agency's basic services are considered to be Governmental activities, including; economic development, pass through agreements, and debt service. General Agency revenues such as incremental property taxes and investment earnings support these services.

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

Governmental Fund financial statements 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 presented only in the Agency-wide financial statements.

The Fund financial statements provide detailed information about each of 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 Statement 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 summarized and presented only in a single column. Subordinate schedules present the detail of these Non-major funds. Major Funds present the major activities of the Agency for the year. The Agency's Major Funds may change from year to year as a result of changes in the pattern of Agency's activities.

The Agency has three Major Governmental Funds in 2005. These are the Redevelopment Fund, the Housing Set-Aside Fund, and the Certificate of Participation Fund, each of which is discussed in detail below.

FINANCIAL ACTIVITIES OF THE AGENCY AS A WHOLE

This analysis focuses on the net assets and changes in net assets of the Agency as a whole. Tables 1, 2 and 3 focus on the Agency's Governmental Statement of Net Assets and Statement of Activities.

Governmental Activities
Governmental Net Assets presents total program assets and liabilities and the resulting allocation of the Agency's net assets.

Table 1
Governmental Net Assets at June 30, 2005
(In Millions)

Cash and Investments	$	15.45
Other Assets	$	5.25
Total Assets	**$**	**20.70**
Long Term Debt Outstanding	$	11.75
Other Liabilities	$	3.99
Total Liabilities	**$**	**15.74**
Net Assets:		
Invested in Net Assets	$	3.35
Restricted	$	8.10
Unrestricted	$	(6.49)
Total Net Assets:	**$**	**4.96**

The Agency's governmental net assets amounted to $4.96 million at June 30, 2005. The Agency's net assets at June 30, 2005 are comprised of the following:

- Unrestricted cash and investments comprised $12.02 million of pooled cash and investments available for operations. Substantially all of these amounts were held in the Town's cash and investment pool as described in Note 3 to the financial statements. Restricted cash and investments of $3.43 million are funds held by trustees as prescribed under the Certificate of Participation issuances.

- Other Assets of $5.25 million represents the value of the Parking Lot #4 parking structure, which was considered infrastructure and not presented in the prior year's financial report. Upon implementation of GASB 34, this infrastructure asset is now included as Other Assets in the Agency-wide financial statements.

- Short term payables and pass-through obligations comprise $2.15 million of Agency liabilities. As part of the Redevelopment Plan, the Agency entered into agreements with other taxing agencies to pass-through portions of incremental property taxes and amounts due are reflected at June 30, 2005.

- As of June 30, 2005 the Town of Los Gatos had advanced the Agency a total of $1.5 million to partially fund ongoing Agency operations. This advance is repayable on demand.

- Long-term debt of $11.75 million, of which $11.35 million is due in future years and $.40 million, is due currently.

- The $3.35 million of 'Investments in Capital Assets, Net of Related Debt' describes the portion of Net Assets that represents the current net book value of the Agency's capital assets, less the outstanding balance of any debt issued to finance these assets.

- Restricted net assets total $8.10 million, of which $3.32 million may be used only for capital projects, $4.34 million is restricted for low and moderate income housing purposes, and $.44 million may be used only for debt service. The restrictions on these funds were placed there by outsiders and cannot be changed by the Agency.

- Unrestricted net assets are 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 or restrictions. The Agency had $(6.49) million of unrestricted net assets at June 30, 2005. This deficit is a result of the $11.75 million in long-term debt proceeds, which are deducted from fund balance.

Changes in Governmental Net Assets
The Statement of Activities presents program revenues and expenses and general revenues in detail. All these are elements in the Changes in Governmental Net Assets summarized below.

Table 2
Changes in Governmental Net Assets
(In Millions)

	2005
Revenues	
Program Revenues	
Redevelopment Projects	$ -
General Revenues:	
Property Tax Increments	$ 5.01
Interest	$ 0.26
Total Revenues	**$ 5.27**
Activities:	
Functions / Programs	
Redevelopment Projects	$ 0.88
Pass-through payments	$ 2.08
Interest and Fees	$ 0.68
Total Government Activities	**$ 3.64**
Change in Net Assets	**$ 1.63**

As Table 2 above shows, $0.00 million (0%) of the Agency's 2005 Governmental revenue is program revenue and $5.27 million (100%) came from general revenues such as taxes and interest. Program revenues were comprised of charges for services, which include reimbursements for expenses incurred in providing services. General revenues are not allocable to programs. General revenues are used to pay for the net cost of governmental programs.

Net Revenue (Expense) of Governmental Activities
Table 3 presents the net (expense) or revenue of each of the Agency's governmental activities, including interest on long-term debt. Net expense is defined as total program cost less the revenues generated by those specific activities.

Table 3
Net Revenue (Expense) of Governmental Activities
(In Millions)

	2005
Redevelopment Projects	$ (0.88)
Property Tax Increments	$ (2.08)
Interest	$ (0.68)
Totals	**$ (3.64)**

THE AGENCY'S FUND FINANCIAL STATEMENTS

Table 4 below summarizes Governmental Activity and balances at the fund level:

Table 4
Financial Highlights at Fund Level
(In Millions)

Governmental Funds	**2005**
Total Assets	$ 15.91
Total Liabilities	$ 3.77
Total Fund Balances	$ 12.14
Total Revenues	$ 5.27
Total Expenditures	$ 4.13
Total Other Financing Sources (Uses)	$ -

Analyses of Major Governmental Funds

Redevelopment Fund
Accounts for activities of the Redevelopment Agency of the Town and the related program tax revenues. This fund encompasses three core functions: Redevelopment Agency administration, Capital Project development and implementation, and the implementation of the Economic Vitality Program.

Housing Set Aside Fund
Accounts for administering the housing component of the Redevelopment plan. The revenue source for this program comes from the 20% State-mandated housing set-aside deducted from incremental property taxes.

Certificates of Participation Fund
This Fund accounts for financial resources to be used for the payment of principal and interest in long-term obligations. Each of the Agency's debt issues is discussed in detail in Note 6 to the financial statements. Certificates of Participation are used to fund the key infrastructure projects in the Downtown redevelopment area. At June 30, 2005, the Agency's debt comprised:

Government Activity Debt	**June 30, 2005 Balance (In Millions)**	
1992 Certificates of Participation	$	1.45
2002 Certificates of Participation	$	10.30
Total Long Term Debt	**$**	**11.75**

ECONOMIC OUTLOOK AND MAJOR INITIATIVES

The economy of the Agency and its major initiatives are discussed in detail in the Letter of Transmittal in the Town of Los Gatos' Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2005.

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 finances. Questions about this Report should be directed to the Finance Department, at 110 East Main Street, Los Gatos, CA 95030.

Basic Financial Statements

TOWN OF LOS GATOS REDEVELOPMENT AGENCY
STATEMENT OF NET ASSETS
JUNE 30, 2005

	Governmental Activities
ASSETS	
Cash and investments	$ 12,016,526
Restricted cash and investments	3,434,616
Accounts receivable	388,801
Intergovernmental receivable	70,896
Capital assets - net	4,792,454
Total Assets	$ 20,703,293
LIABILITIES	
Accounts payable	$ 55,884
Accrued payroll and benefits	10,931
Interest payable	226,301
Advances from Town of Los Gatos	1,500,000
Deferred Revenue	126,801
Pass through obligations	2,079,912
Long-term liabilities:	
Due within one year	400,000
Due more than one year	11,345,000
Total Liabilities	$ 15,744,829
NET ASSETS	
Invested in capital assets, net of related debt	$ 3,347,454
Restricted for:	
Redevelopment projects	3,320,273
Low income housing	4,335,193
Debt service	449,075
Total restricted net assets	8,104,541
Unrestricted	(6,493,531)
Total Net Assets	$ 4,958,464

The notes to the financial statements are an integral part of this statement.

TOWN OF LOS GATOS REDEVELOPMENT AGENCY
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

	Governmental Activities
Program Expenses:	
Redevelopment	$ 880,421
Pass-through payment	2,084,767
Interest and fees	682,358
Total Program Expenses	3,647,546
Program Revenues:	
Charges for services	4,597
Total Program Revenues	4,597
Net Program Income (Expense)	(3,642,949)
General Revenues:	
Tax allocation increment	5,013,351
Interest	251,151
Total General Revenues	5,264,502
Change in Net Assets	1,621,553
Net Assets - Beginning	3,852,686
Prior Period Adjustment	(515,775)
Net Assets - Beginning as Restated	3,336,911
Net Assets - Ending	$ 4,958,464

The notes to the financial statements are an integral part of this statement.

TOWN OF LOS GATOS REDEVELOPMENT AGENCY
GOVERNMENTAL FUNDS
BALANCE SHEET
JUNE 30, 20005

	CAPITAL PROJECT FUNDS		DEBT SERVICE FUND	
	Redevelopment	Housing Set-Aside	Certificates of Participation	Total Governmental Funds
ASSETS:				
Cash and investments available for operations	$ 345,095	$ 4,075,395	$ 7,596,036	$ 12,016,526
Restricted cash and investments	2,985,541	-	449,075	3,434,616
Accounts receivable	-	388,801	-	388,801
Intergovernmental receivable	-	-	70,896	70,896
TOTAL ASSETS	3,330,636	4,464,196	8,116,007	15,910,839
LIABILITIES AND FUND EQUITY:				
Accounts payable	1,634	-	54,250	55,884
Accrued payroll and benefits	8,729	2,202	-	10,931
Advances from Town of Los Gatos	-	-	1,500,000	1,500,000
Deferred revenue	-	126,801	-	126,801
Pass through obligations (Note)	-	-	2,079,912	2,079,912
Total Liabilities	10,363	129,003	3,634,162	3,773,528
FUND EQUITY				
Reserved for:				
Encumbrances	448,688	-	-	448,688
Debt service	-	-	449,075	449,075
Redevelopment projects	2,871,585	-	-	2,871,585
Low and moderate income housing	-	4,335,193	-	4,335,193
Unreserved, designated for:				
Debt service	-	-	4,032,770	4,032,770
Total Fund Balance	3,320,273	4,335,193	4,481,845	12,137,311
TOTAL LIABILITIES AND FUND BALANCE	$ 3,330,636	$ 4,464,196	$ 8,116,007	$ 15,910,839

The notes to the financial statements are an integral part of this statement.

TOWN OF LOS GATOS REDEVELOPMENT AGENCY
RECONCILIATION OF THE BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
JUNE 30, 2005

Fund Balance of Governmental Fund Statements		$ 12,137,311
Amounts reported for governmental activities in the statement of net assets different because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.		
Capital assets	$ 6,487,348	
Accumulated depreciation	(1,694,894)	4,792,454
Interest payable on long-term debt does not require the use of current financial resources and, therefore, are not reported in the Governmental Funds.		(226,301)
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the funds.		
Certificates of participation		(11,745,000)
Government Wide Net Assets		$ 4,958,464

The notes to the financial statements are an integral part of this statement.

TOWN OF LOS GATOS REDEVELOPMENT AGENCY
GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2005

	CAPITAL PROJECT FUNDS		DEBT SERVICE FUND	
	Redevelopment	Housing Set-Aside	Certificates of Participation	Total Governmental Funds
Revenues:				
Tax allocation increment	$ -	$ -	$ 5,316,509	$ 5,316,509
Less: ERAF[1] Allocations	-	-	(303,158)	(303,158)
Interest income	69,111	24,138	157,902	251,151
Other	4,597	-	-	4,597
Total Revenues	73,708	24,138	5,171,253	5,269,099
Expenditures:				
Capital outlay	769,571	208,367	-	977,938
Pass through payment	-	-	2,084,767	2,084,767
Debt service:				
Principal retirement	-	-	385,000	385,000
Interest and fees	-	-	684,998	684,998
Total Expenditures	769,571	208,367	3,154,765	4,132,703
Excess (Deficiency) of Revenues over Expenditures	(695,863)	(184,229)	2,016,488	1,136,396
Other Financing Sources (Uses)				
Transfers in	515,750	1,163,323	-	1,679,073
Transfers out	-	-	(1,679,073)	(1,679,073)
Other financing use	-	-	930,710	930,710
Other financing source	-	-	(930,710)	(930,710)
Total Other Financing Sources (Uses)	515,750	1,163,323	(1,679,073)	-
Net Change in Fund Balances	(180,113)	979,094	337,415	1,136,396
Fund Balances - Beginning	3,500,386	3,356,099	4,144,430	11,000,915
Fund Balances - Ending	$ 3,320,273	$ 4,335,193	$ 4,481,845	$ 12,137,311

[1] Educational Revenue Augmentation Fund

The notes to the financial statements are an integral part of this statement.

TOWN OF LOS GATOS REDEVELOPMENT AGENCY
RECONCILIATION OF THE STATEMENT OF REVENUE, EXPENDITURES AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

The schedule below reconciles the Net Changes in Fund Balances reported on the Governmental Funds Statement of Revenue, Expenditures and Change 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 reported on the full accrual basis.

Net Changes in Fund Balances - Total Governmental Funds		$ 1,136,396
Amounts reported for governmental activities in the statement of net assets different because:		
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.		
Expenditure for capital assets	$ 259,709	
Depreciation expense is deducted from the fund balance	(162,192)	97,517
The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. This amount is the net effect of these differences in the treatment of long-term debt.		
Repayment of debt principle is added back to fund balance		385,000
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):		
Interest payable		2,640
Government Wide Changes in Net Assets		$ 1,621,553

The notes to the financial statements are an integral part of this statement.

Notes to Financial Statements

1. DESCRIPTION OF THE AGENCY AND REDEVELOPMENT PROJECTS

The Town of Los Gatos Redevelopment Agency (the "Agency") is a public body established and authorized to transact business under the provisions of the Community Redevelopment Law of the State of California, including the power to issue bonds for any of its corporate purposes. Its purposes are to stimulate and attract private investment and eliminate physical, social and/or economic blight.

The Redevelopment plan was established as a result of the Loma Prieta Earthquake in 1989 and the need to rebuild existing infrastructure. The Redevelopment Agency area encompasses approximately 440 acres in and around Downtown Los Gatos, which includes retail and residential areas, lodging, schools, and main traffic thoroughfares. Projects such as street and utility reconstruction, parking, streetscape and civic improvements were called out in the Plan.

As part of the Redevelopment Plan, the Agency entered into agreements with various taxing authorities, which required the Agency to pass through portions of incremental property taxes to each taxing authorities. Expenditures for these pass-through agreements amounted to $2,079,912 for the year ended June 30, 2005. In addition, as of June 30, 2005 the Agency owed $2,079,912 in pass-through amounts to other agencies.

As the Town is financially accountable for the Agency, the Agency is considered a component unit of the Town. As such, the Agency is reported as part of the Town in the basic financial statements of the Town.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The Agency's Basic Component Unit Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America. The Government Accounting Standard Board (GASB) is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the U.S.A.

GASB requires that the financial statements described below be presented.

Government-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 effect of interfund of activities. Governmental activities are generally financed through taxes, intergovernmental revenues, and other nonexchange transactions.

The Statement of Activities presents a comparison between direct expenses and program revenues for each function of the Agency's activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to

a particular function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs, (b) grants and contributions that are restricted to meeting the operational needs of a particular program and (c) fees, grants and contributions that are restricted to financing the acquisition or construction of capital assets. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements - The fund financial statements provide information about the Agency's funds. The emphasis of fund financial statements is on major individual governmental funds, each of which is displayed in a separate column. All remaining governmental funds are aggregated and reported as nonmajor funds.

Major Funds

GASB Statement 34 defines major funds and requires the Agency's major governmental funds to be identified and presented separately in the fund financial statements. All other funds, called nonmajor funds, are combined and reported in a single column, regardless of their fund-type.

Major funds are defined as funds that have assets, liabilities, revenues or expenditures/expenses equal to ten percent of their fund-type total and five percent of the grand total. The General Fund is always a major fund. The Agency may also select other funds it believes should be presented as major funds.

The Agency reported the following major governmental funds in the accompanying financial statements:

Redevelopment Fund – This fund is used to account for financial resources used for the acquisition or construction of major capital facilities.

Housing Set Aside Fund – This fund is used to account for twenty percent housing set aside from the tax increment proceeds.

Certificates of Participation Fund – This fund is used to account for the accumulation of financial resources and the payment of general long-term obligation principal, interest and related costs.

Basis of Accounting

The government-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 sixty days after year-end. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, which is recognized upon becoming due and payable; and except for claims, judgments and compensated absences, which are recognized when estimable and probable. Governmental capital asset acquisitions are reported as *expenditures* in governmental funds. Proceeds of governmental long-term debt and acquisitions under capital leases are reported as *other financing sources*.

Non-exchange transactions, in which the Agency gives or receives value without directly, receiving or giving equal value in exchange, include taxes, grants, entitlements, and donations. On the accrual basis, revenue from taxes is recognized in the fiscal year for which the taxes are levied or assessed. 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 other taxes, intergovernmental revenue, interest, and charges for services.

The Agency may fund programs with a combination of cost-reimbursement grants, categorical block grants and general revenues. Thus, both restricted and unrestricted net assets may be available to finance program expenditures. The Agency's policy is to first apply restricted grant resources to such programs followed by general revenues as necessary.

Cash and Investments

The Agency's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments if they are liquid.

The Town's investment policy and California Government Code permit investments in obligations of U.S. Treasury and its agencies, commercial paper, banker's acceptances, repurchase agreements, certificates of deposit, medium term notes, passbook savings account demand deposits, mutual funds and the State of California Local Agency Investment Fund.

Investments for the Agency are reported at fair value. The value is determined based upon market closing prices.

Interfund Receivables and Payables

Balances representing lending/borrowing transactions between funds outstanding at the end of the fiscal year are reported as either "due to/due from other funds" (amounts due within one year), "advances to/from other funds" (non-current portions of interfund lending/borrowing transactions), or "loans to/from other funds" (long-term

lending/borrowing transactions as evidenced by loan agreements). Advances and loans to other funds are offset by a fund balance reserve in applicable Governmental Funds to indicate they are not available for appropriation, and are not expendable available financial resources.

Long-Term Obligations

In the government-wide financial statements long-term debt and other long-term obligations are reported as liabilities in the Statement of Net Assets.

Tax Increment

The Agency has no direct taxing power and does not have the power to pledge the general credit or taxing power of the Town, the State of California or any political subdivision thereof. However, California's Health and Safety Code allows redevelopment agencies with appropriate approvals of the local legislative bodies to recover costs of financing public improvements from increased tax revenues (tax increment) associated with increased property values of individual project areas. Property tax increment is recorded as revenue when it becomes both measurable and available to finance expenditures.

Property Held for Resale

Property held for resale is acquired as part of the Agency's redevelopment program. All of these properties are residential. Costs of developing and administering Agency projects are charged to capital outlay expenditures as incurred.

The Agency does not maintain cost records by parcel, as there is no relationship between costs incurred and the final disposition value, which is significantly affected by various use restrictions. For financial statement presentation, this property is stated at the lower of estimated cost or net realizable value.

Budgets and Budgetary Accounting

Prior to June 1, the Town Manager submits to the Town Council a proposed operating budget for the upcoming fiscal year. The proposed budget includes a summary of proposed expenditures and forecasted revenues of the Agency's governmental funds.

The Town Council adopts the budget by June 30 through passage of an adopting ordinance. All appropriated amounts, as originally adopted or as amended by the City Council, lapse at year-end or are subject to reappropriation in the following fiscal year. The budget is adopted on a cash basis, which is not consistent with generally accepted accounting principles.

The actual results of operations are presented in the combined statement of revenues and expenditures – budget and actual in accordance with the budget basis to provide a meaningful comparison of actual results to the budget.

Use of Estimates

The Agency's management has made certain estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

3. CASH AND INVESTMENTS

Cash

The Agency holds its cash in the Town of Los Gatos (the "Town"). The Town maintains a cash and investment pool and allocates interest to the various funds based upon the average quarterly cash balances. Information regarding credit risk and collateral requirements, as applicable, can be found in the Town's financial statements.

Investments

The Agency voluntarily participates in LAIF, regulated under Section 16429 of the State Government Code. LAIF allows local governments such as the Agency to participate in a Pooled Money Investment Account managed by the State Treasurer Office and overseen by the Pooled Money Investment Board and State Treasurer investment committee. A Local Agency Investment Advisory Board oversees LAIF. As of June 30, 2005, the Agency's investment in LAIF was $2,268,752.

Information regarding investment risks related to credit risk, concentration of credit risk and interest rate risk can be found in the Town's financial statements.

Under GASB 31, the Agency must adjust the carrying value of its investments to reflect their fair value at each fiscal year end, and it must include the effects of these adjustments in income for that fiscal year.

4. CAPITAL ASSETS

The following is a summary of the Agency's capital assets:

Capital Assets	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005
Infrastructure:				
Parking Lot # 4 Project	$ 4,355,330	$ 104,355	$ -	$ 4,459,685
Alleys	229,709	15,669	-	245,378
Streets	1,642,600	139,685	-	1,782,285
Total capital assets	6,227,639	259,709	-	6,487,348
Less accumulated depreciation:				
Parking Lot #4 Project	1,016,927	101,693	-	1,118,620
Alleys	434	7,657	-	8,091
Streets	515,341	52,842	-	568,183
Total accumulated depreciation	1,532,702	162,192	-	1,694,894
Total capital assets - net depreciation	$ 4,694,937	$ 97,517	$ -	$ 4,792,454

Depreciation expense was $162,192 for the fiscal year ended June 30, 2005.

5. ADVANCES FROM THE TOWN

The Town advanced $1,500,000 to the Agency to partially fund operations. The advance bears interest at 10% and is repayable on demand, provided that sufficient tax increment revenue funds are available. For the fiscal year ended June 30, 2005 the Agency paid the Town $137,500 in interest on this advance.

6. LONG-TERM OBLIGATIONS

1992 Certificates of Participation (COPs)

The Town issued **Certificates of Participation (COPs)** in the original principal amount of $2,960,000 dated August 1, 1992. The Town's Motor Vehicle License Fee Revenues were pledged as security for the COPs, and the guarantee was registered with the State Controllers Office. The COPs were issued to finance certain construction costs of the Town's Parking Lot 4 Project, which was constructed on land located in the Los Gatos Central Redevelopment Project Area. The COPs are similar to bond debt, and they allow investors to participate in a share of guaranteed payments. Because they are similar to debt, the present value of the total of the payments to be made is recorded as long-term debt. Principal payments are due annually on August 1st, which interest payments payable semi-annually on February 1st and August 1st.

To assist the Town in paying the cost of acquisition and construction of the Parking Lot 4 Project, the Town and its Redevelopment Agency entered into a Reimbursement Agreement. Under this agreement, the Agency will use available net tax increment revenues resulting from the Project's effect on land values to repay the Town for all lease payments made by the Town to the Agency under the lease agreement for the Project. Net tax increment revenues are all taxes allocated to and paid into the Redevelopment Agency Capital Projects Fund for the Project Area. Reimbursements under this agreement commenced in fiscal 1995-1996. Accordingly the COPs have been recorded in the Agency's General Long-Term Debt Account Group. In addition, the Parking Lot 4 Project, which was constructed with proceeds of the COPs, has been included in the Agency's financial statements.

For the fiscal year ended June 30, 2005, lease income and reimbursements in the amount of $930,710 (offsetting) was recorded as other financing sources and uses in the Certificates of Participation Fund. These transactions are eliminated from the Government-Wide Statement of Activities.

2002 Certificates of Participation (COPs)

The 2002 Certificates of Participation financing parallels the 1992 issue. On August 1, 2002, the Town and the Los Gatos Redevelopment Agency issued $10,725,000 in 2002 Certificates of Participation to finance infrastructure improvements in the downtown redevelopment area. The Town has pledged lease payments of real property and facilities comprised of the Parks and Public Works Service Center and Baseball Field, as well as Parking Lot No. 1, 2, and 3, as collateral for the repayment of the Certificates.

The COP principal payments are due annually on August 1st, with interest payments payable semi-annually on February 1st and August 1st.

A summary of general long-term obligations account group transactions for the year ended June 30, 2005 follows:

Long-term Debt	Original Issue Amount	Balance June, 30 2004	Additions	Retirements	Balance June, 30 2005	Due Within One Year
1992 Certificates of Participation, 5-9%, due 8/1/2012	$ 2,960,000	$ 1,615,000	$ -	$ 170,000	$ 1,445,000	$ 175,000
2002 Certificates of Participation, Series A, 2.5-5%, due 8/1/2031	10,725,000	10,515,000	-	215,000	10,300,000	225,000
Total Long-term Debt	$ 13,685,000	$ 12,130,000	$ -	$ 385,000	$ 11,745,000	$ 400,000

Future debt service requirements for general long-term debt with stated maturities are as follows at June 30, 2005:

For the Year Ending June 30	Governmental Activities	
	Principal	Interest
2006	$ 400,000	$ 526,758
2007	415,000	511,458
2008	430,000	495,910
2009	445,000	479,137
2010	465,000	460,975
2011-2015	1,845,000	2,040,304
2016-2020	1,680,000	1,699,837
2021-2025	2,110,000	1,257,883
2026-2030	2,685,000	666,375
2031-2032	1,270,000	64,250
Total Debt Service	$ 11,745,000	$ 8,202,887

The Agency must maintain required amount of cash and investments with the trustee under the terms of the COPs issue. These funds are pledged as reserves to be used if the Town fails to meet its obligations under the COPs issue. These reserves totaled $973,953 at June 30, 2005.

The California Government Code requires these funds to be invested in accordance with Town ordinance, bond indentures or State statues. All these funds have been invested as permitted under the Code.

7. NET ASSETS AND FUND BALANCES

Net Assets are the excess of all the Agency's assets over all its liabilities, regardless of fund. Net Assets are divided into three captions under GASB Statement 34. These captions apply only to Net Assets, which is determined at the Government-wide level, and are described below:

Invested in Capital Assets, net of related debt describes the portion of Net Assets which is represented by the current net book value of the Agency's capital assets, less the outstanding balance of any debt issued to finance these assets.

Restricted describes the portion of Net Assets which are restricted as to use by the terms and conditions of agreements with outside parties, governmental regulations, laws, or other restrictions which the Agency cannot unilaterally alter. These principally include debt service requirements, and redevelopment funds restricted to low and moderate income purposes.

Unrestricted describes the portion of Net Assets which is not restricted to use.

Reservations of Fund Balances - Fund balance consists of reserved and unreserved amounts. Reserved fund balance represents that portion of fund balance that has been appropriated for expenditure or is legally segregated for a specific future use. As of June 30, 2005, portions of fund balance had been reserved because of the following:

Encumbrances are reserved to encumber fund balance for purchase order commitments made before fiscal year end.

Capital Outlay and Redevelopment Projects reserves are funded from storm drain fees, construction taxes and debt proceeds that are legally restricted for major capital projects.

Debt Service reserves reflect the cash balances in the debt service funds that are restricted for debt service payments.

8. TAX INCREMENT SHIFT TO EDUCATIONAL REVENUE AUGMENTATION FUND (ERAF)

In fiscal year 2003 the state of California directed that a portion of the incremental property taxes, which had been received in prior years by redevelopment agencies be paid instead to local educational agencies. During the fiscal year ended June 30, 2005, the Agency paid $303,158 as a result of the State directive.

9. PRIOR PERIOD ADJUSTMENT

Beginning net assets was decreased by $515,775 for accumulated depreciation that was not recorded against Infrastructure in prior years. Per GASB 34, Infrastructure and related depreciation is not required to be recorded by the Agency until June 30, 2008. This error was a result of ongoing reconciliations performed in order to implement GASB 34.

Required Supplementary Information

TOWN OF LOS GATOS REDEVELOPMENT AGENCY
HOUSING SET-ASIDE FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE - BUDGET AND ACTUAL (GAAP)
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

	Budget	Actual	Variance Favorable (Unfavorable)
Revenues:			
Interest	78,838	$ 24,138	$ (54,700)
Total Revenues	78,838	24,138	(54,700)
Expenditures:			
Capital outlay	261,650	208,367	53,283
Total Expenditures	261,650	208,367	53,283
Excess (Deficiency) of Revenues over Expenditures	(182,812)	(184,229)	(1,417)
Other Financing Sources (Uses)			
Transfers in	893,327	1,163,323	269,996
Total Other Financing Sources (Uses)	893,327	1,163,323	269,996
Net Change in Fund Balance	$ 710,515	979,094	$ 268,579
Fund Balance - Beginning		3,356,099	
Fund Balance - Ending		$ 4,335,193	

Supplementary Information

TOWN OF LOS GATOS REDEVELOPMENT AGENCY
REDEVELOPMENT FUND CAPITAL PROJECTS FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE - BUDGET AND ACTUAL (GAAP)
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

	Budget	Actual	Variance Favorable (Unfavorable)
Revenues:			
Interest	75,000	$ 69,111	$ (5,889)
Other	-	4,597	4,597
Total Revenues	75,000	73,708	(1,292)
Expenditures:			
Capital outlay	885,709	769,571	116,138
Total Expenditures	885,709	769,571	116,138
Excess (Deficiency) of Revenues over Expenditures	(810,709)	(695,863)	114,846
OTHER FINANCING SOURCES (USES)			
Operating transfers in	515,750	515,750	-
Operating transfers (out)	-	-	-
Total Other Financing Sources (Uses)	515,750	515,750	-
Net Change in Fund Balance	$ (294,959)	(180,113)	$ 114,846
Fund Balance - Beginning		3,500,386	
Fund Balance - Ending		$ 3,320,273	

TOWN OF LOS GATOS REDEVELOPMENT AGENCY
CERTIFICATES OF PARTICPATION FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE - BUDGET AND ACTUAL (GAAP)
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

	Budget	Actual	Variance Favorable (Unfavorable)
Revenues:			
Property Tax	$ 3,987,470	$ 5,316,509	$ 1,329,039
Less: ERAF[1] Allocations	(303,000)	(303,158)	(158)
Interest	153,812	157,902	4,090
Total Revenues	3,838,282	5,171,253	1,332,971
Expenditures:			
Pass through payment	1,517,154	2,084,767	(567,613)
Debt Service:			
Principal	385,000	385,000	-
Interest and fees	684,265	684,998	(733)
Total Expenditures	2,586,419	3,154,765	(568,346)
Excess (Deficiency) of Revenues over Expenditures	1,251,863	2,016,488	764,625
Other Financing Sources (Uses)			
Transfers out	(1,409,077)	(1,679,073)	(269,996)
Total Other Financing Sources (Uses)	(1,409,077)	(1,679,073)	(269,996)
Net Change in Fund Balance	$ (157,214)	337,415	$ 494,629
Fund Balance - Beginning		4,144,430	
Fund Balance - Ending		$ 4,481,845	

Other Independent Auditor's Reports

C. G. UHLENBERG LLP

CERTIFIED PUBLIC ACCOUNTANTS

ROBERT E. BARSANTI (RETIRED) • PEGGY H. CHEN, C.P.A. • JEFFREY J. IRA, C.P.A. • KATHERINE CHAO, C.P.A. • JULIE LIN, C.P.A.

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

Members of the Board of the
Town of Los Gatos Redevelopment Agency
Los Gatos, California

We have audited the basic financial statements of the Los Gatos Redevelopment Agency ("the Agency") as of and for the year end June 30, 2005, and have issued our report thereon dated September 23, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Agency's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. Such provisions include those provisions of laws and regulations identified in the *Guidelines for Compliance Audits of California Redevelopment Agencies*, issued by the State Controller. 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

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 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 caused by error or fraud 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 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 Mayor, members of the Town Council, and the State Controller's office, and is not intended to be and should not be used by anyone other than these specified parties.

September 23, 2005
Redwood City, California

FINDINGS AND RECOMMENDATIONS

TOWN OF LOS GATOS REDEVELOPMENT AGENCY

SUMMARY OF COMPLIANCE FINDINGS

YEAR ENDED JUNE 30, 2005

No current year findings.

TOWN OF LOS GATOS REDEVELOPMENT AGENCY

SUMMARY OF PRIOR YEAR COMPLIANCE FINDINGS

YEAR ENDED JUNE 30, 2005

No prior year findings.