
City of Los Altos
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2013

The purpose of this discussion and analysis is to provide an overview of the City's financial performance and activities for the fiscal year ended June 30, 2013. Readers are encouraged to consider this information in conjunction with the executive summary have furnished in the letter of transmittal that can be found on pages i to viii of this report.

During fiscal year 2012-13, the City implemented GASB Statement No. 63-Financial Reporting of Deferred Outflows and Resources, and Net Position. The most notable impact of GASB 63 was the renaming of "net position" to "net position" to reflect the difference between assets and liabilities. Net position may serve over time as a useful indicator of a government's financial position.

FINANCIAL HIGHLIGHTS

The City ended its fiscal year on a government-wide basis with total revenues of \$43M, a 5% increase from the prior year, and expenses of \$38.2M, an increase of 10%. The results represent combined government and business operations, increases in net position including sizable infrastructure maintenance costs and the impact of expended pension side-fund pay downs. Favorable fiscal results have again strengthened general reserves, remained within budget limits and are sufficient to sustain capital project plans.

Operational revenue gains were noted across the board in property, sales, utility users, hotel occupancy, business license and real estate transfer taxes as well recreation programming. Community development fees came in at significant increases as a factor of several landmark private developments that have entered full construction mode during the year of this reporting. City-wide building and planning fees also repeated 2012 robust levels. No revenue declines of note were observed beyond the anticipated drop in interest income. Sewer and solid waste revenues were stable and positioned to facilitate future operational and capital needs.

The increase in Government-wide expenses is mostly a derivative of governmental fund activities. Budget spending limits were met given a continued focus on cost control and additional hiring deferrals in recent years. Los Altos continues to mitigate cost pressures in a variety of ways including realizing full pay-down of CalPERS pension side-fund liabilities; strategically managing staffing vacancies; strict capital project management; and the implementation of second and third-tier pension plans. Resource uses continue to reflect an emphasis on public safety, infrastructure maintenance, quality of life and community development activity.

Much progress has again been made on capital improvement projects, including street maintenance and resurfacing, streetscape and intersection improvements, City-wide concrete and sidewalk repairs, pedestrian and traffic safety enhancements, and safety technology enhancements. The City made significant capital investments in the maintenance and improvement of the City-wide sewer systems in line with the Sewer Master Plan recently adopted by Council.

The City's positive operating revenues over expenditures reflect prudent cost-conscious budgeting and financial management stewardship. The margin of revenues over expenditures came in above prior year level results setting a favorable position as upcoming budgets are developed. Budget estimates have been met for all key operating and business funds.

Government-Wide View

- Net position (excess of assets over liabilities) equaled \$102M, an increase of \$5.2M, or 5% including the impact of the net asset pension write down. This trend is attributed to significant grant and capital contributions with partial offsets given the use of funds for infrastructure maintenance and improvements. These numbers are based on a restated governmental beginning balance given a change in accounting presentation adjustment related to the treatment of City net pension assets. These assets represent the City's total net holdings and are not necessarily unrestricted depending upon the source of the original funding.
- Unrestricted assets equaled \$37.7M. Governmental unrestricted assets totaled \$29.9M at year end, while business activities related unrestricted assets totaled \$7.8M. It is important to note that unrestricted net position, as presented in the government-wide section of the CAFR, do not account for local fund restrictions, project assignments and/or policy reserves as classified within the governmental fund section of the report.
- Governmental activities reported ending net position of \$87.4M, an increase of \$4.1M, or 5%. The increase in government assets arises from positive operating results, significant development fee collections and cost containment. These results also reflect the substantial income of development tax proceeds, positive revenue trends offset by use of resources of nearly \$1.1M, for infrastructure maintenance beyond capitalized costs.
- Business activities reported ending net position of \$14.6M, an increase of \$1.1 M or 8% given positive operating results in the Sewer and Solid Waste Funds, substantial capital investments along with partial offsets of Storm Drain activity losses.
- On a combined basis, restricted net position amounted to \$7.4M vs. \$3.9M last year and represents the extent to which funds are categorically constrained.

Fund Level View

- The General Fund realized an operating surplus of \$3.1M or \$1.7M above the prior year
- General Fund revenues, excluding transfers, increased robustly over prior year actuals by \$2.4M or 8% to \$31.3M. Current year results also exceeded budget estimates by 5%. Related expenditures increased by \$700,000 to \$28.2M, or 3%, a pace of growth 50% below the prior year trend.
- The City made a near final CalPERS side fund liabilities pre-payment of \$950,000 to further mitigate pension costs pressures.

- Total governmental fund balances equaled \$39M at fiscal year-end, a strong increase of \$3.5M, or 10%, due to the inflow of significant development tax dollars, focused cost savings efforts, a recovering regional economy and overall favorable operational results. Significant expenditures were both expected and realized in the capital improvement funds.
- General government capital spending approximated \$4.3M. The level of capital reinvestment in Los Altos reflects a sustained focus on the maintenance of streets, facilities, traffic calming efforts and safety. As result, the Capital Improvements Projects Fund balance decreased by \$1.5M net of incoming grant and special purpose revenues to end the year at \$4.8M.
- The Real Property Proceeds Fund balance increased by \$500,000 as result of additional final pre-sale deposits on the sale of property at 400 Main Street increasing this fund's balance to \$7.4M.
- The balance in the Community Facilities Renewal Fund increased by \$100,000 with City funding as Los Altos plans for the inevitability of community facility redevelopment. At year-end, this fund balance approximated \$7.2M.
- The in-lieu Park Fund entered the "major fund" reporting group ending the year with a material balance of \$4.6M and displaying extraordinary growth of \$3.6M given the significant level of private development advanced in the past year.
- The Equipment Replacement Fund balance remained at \$3.7M with the use of funds for replacement purchases offset by annual General Fund contributions.
- Sewer operations ended the year favorably with an increase in net position of \$600,000. Sewer revenues of \$5.1M were 13% higher as compared to a drop in 2012 given a shift in water usage trends. This marks the third year of noted movement towards consumer conservation. Consequently, expenses also exceeded prior year levels by 2% coming in at \$4.5M. A review of maintenance expenses reflects continued attention to system maintenance. In the current year, the City adopted a multi-year master plan that updates a long-term rate and capital plan for these operations.
- As reported in the prior year, the Storm Drain Fund has exhausted available resources. These operations are now fully General Fund-subsidized and will continue to be absent the implementation of a fee-based model.
- Both Workers' Compensation and general liability claim liabilities have increased materially with the latest update of related actuarial valuations. The Workers' Compensation Fund ended the year with an unrestricted fund balance of \$211,000, a decrease of \$89,000. Related liabilities increased from \$2.5M to \$3M. The General Liability fund ended the year with unrestricted fund balances of \$322,000, a decrease of \$195,000. Related liabilities increased from \$190,000 to \$350,000. Both funds cover their actuarial valuations but the noted trends will require larger future funding levels short of dramatic changes in claim experiences and legislation.
- Other Non-major Governmental Funds ended the year with a total combined fund balance of \$2.9M, reflecting the reclassification of the in-lieu Parks fund to the major fund group given its significant development fee collections.

USING THIS ANNUAL REPORT

Overview of the Financial Statements

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

Reporting on the City as a Whole

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

The *statement of net position* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net position*. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

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

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, maintenance and public works services, planning, building, engineering and recreation. The City's business-type activities include water, wastewater, storm water and parking.

The government-wide financial statements can be found on pages 21 to 23 of this report.

Reporting on the City's Most Significant Funds

Fund Financial Statements: A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds; proprietary funds; and fiduciary funds.

Governmental Funds: *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

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

The City maintains 24 individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund, Capital Project Fund, Equipment Replacement Fund, In-Lieu Park Land Fund, Real Property Proceeds Fund and the Community Facilities Renewal Fund, all of which are considered to be major funds. Data from the other 19 governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these *non-major* governmental funds is provided in the form of *combining statements* elsewhere in the fund financial statements section of this report.

An annual appropriated budget is adopted each year for each governmental fund. A budgetary comparison statement has been provided for several key governmental funds to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found on pages 26 to 32 of this report.

Proprietary Funds: The City maintains two types of *proprietary funds*. Services for which the City charges customers a fee are generally reported in the City's *enterprise funds*. These proprietary funds, like the government-wide statements, provide both long-term and short-term financial information. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for its City dental plan, unemployment insurance, Workers' Compensation and Liability Insurance costs. Because these services predominantly benefit the governmental function, they have been included in the government-wide financial statements and related intra-fund charges have been eliminated accordingly.

Proprietary fund financial statements provide the same type of information as the government-wide financial statements, only in more detail. All four internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the internal service funds is provided in the form of combining statements elsewhere in this report. The City's three enterprise funds (Sewer, Solid Waste and Storm Drain) are considered major funds and presented as such in the fund financial statements. The City follows the practice of adopting annual budgets for these operations as well.

The combining statements referred to earlier in relation to non-major governmental funds, proprietary and internal service funds are presented immediately following the notes to the financial statements. Combining and individual fund statements and schedules can be found on pages 76 to 91 of this report.

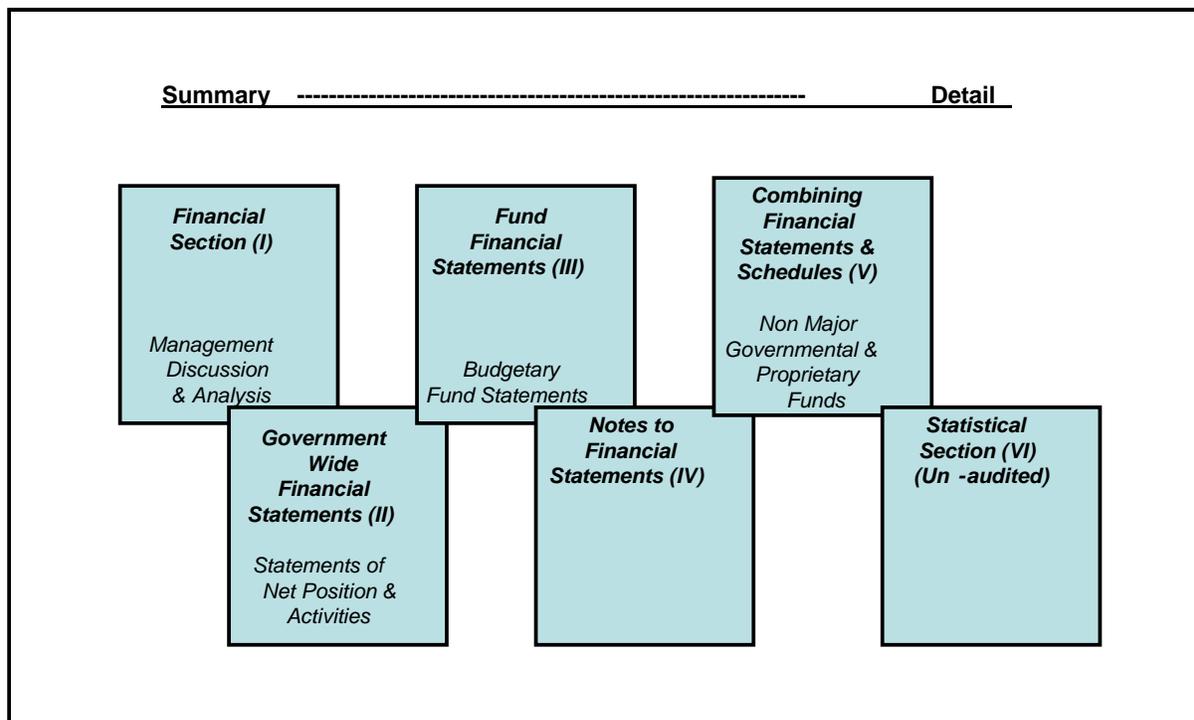
Notes to the Basic Financial Statements: The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. These can be found on pages 39 to 68 of this report.

Other Information: In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* concerning the City’s budget-to-actual financial comparisons for the General Fund. The City has elected to present this information within the basic financial statement and financial statement sections of the report.

The City as Trustee

Fiduciary Funds: The City is the trustee, or fiduciary, for the North County Library Authority and three special assessment districts - Raymundo and Avalon curb and gutter improvements, and Blue Oak Sewer Lane improvements. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City’s own programs. The City is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

In summary, the various sections of this financial report are arranged as follows:



GOVERNMENT-WIDE FINANCIAL ANALYSIS

This analysis focuses on the net position and changes in net position at the City-wide level as presented in the statement of net position and statement of activities which are summarized below as of June 30, 2013. As noted earlier, net position may serve over time as a useful indicator of a government's financial status. On a combined basis, the City experienced a \$5.2M, or a 5% increase in net position. A summary is noted below:

City of Los Altos Net Position

	Governmental Activities		Business-Type Activities	
	2013	2012	2013	2012
Cash and Investments	\$ 46,350,225	\$ 40,710,097	\$ 7,923,383	\$ 7,546,024
Other Assets	1,256,034	5,428,628	353,919	528,091
Capital Assets	51,767,330	50,270,889	6,773,419	5,951,698
Total Assets	99,373,589	96,409,614	15,050,721	14,025,813
Bond Debt	1,760,000	1,855,000	-	-
Other Liabilities	10,202,786	7,483,460	434,467	534,830
Total Liabilities	11,962,786	9,338,460	434,467	534,830
Net Position				
Investments in Capital - Net of Related Debt	50,102,330	50,270,889	6,773,419	5,951,698
Restricted	7,405,661	3,925,741	-	-
Unrestricted	29,902,812	29,124,661	7,842,871	7,539,285
Total Net Position	\$ 87,410,803	\$ 83,321,291	\$ 14,616,290	\$ 13,490,983

Investment in capital assets makes up the largest portion of the City's net position, over fifty percent (56%). These assets reflect land, buildings, infrastructure, machinery and equipment, less any associated outstanding debt. As these assets represent foundational infrastructure used in support of basic City services, they are generally not available for future spending.

An additional portion of the City's net position, seven percent (7%), represents resources subject to external spending restrictions. The remaining thirty-seven percent (37%) are defined as unrestricted and generally available for future capital projects and discretionary use with the caveat these funds are a composite of several governmental funds which may include assigned project commitments and assignments specifically associated with active and ongoing projects.

Some key entity-wide observations include the following:

- Cash and investments holdings increased by 12%, a factor of favorable operations, cost savings and collection of substantial one-time developments fees, in particular over \$4 million in in-lieu park and traffic impact fees from the new construction First Street retail and local multi-family units. Real property proceeds of nearly \$500,000 were also realized in this year.

- Net position equaled \$102M, an increase of \$5.2% or 5%, due to the resource flow activity noted above and the capitalization of completed projects.
- Substantial capital improvements, approximating \$2.3M, were realized. These include pedestrian and bicycle safety enhancements, street repairs and striping, major streetscape and intersection enhancements, concrete repairs, facility maintenance, and safety technology improvements.
- Business-type activities reported net position of \$14.6M at year end, a \$1.1M, or 8%, increase. The Sewer Master Plan has been completed laying a future path of funding and project needs. Solid Waste revenues exceeded direct expenses allowing for future initiatives in this important environmental area of operations.

Governmental Activities

Governmental programs, which include general public services, realized revenue increases of \$2.3M, or 7%, while total expenditures increased by 11% or \$3.3M. Including all sources and uses, governmental net position increased by \$4.1M, or 5%, ending the year with a total fund balance of \$87.4M.

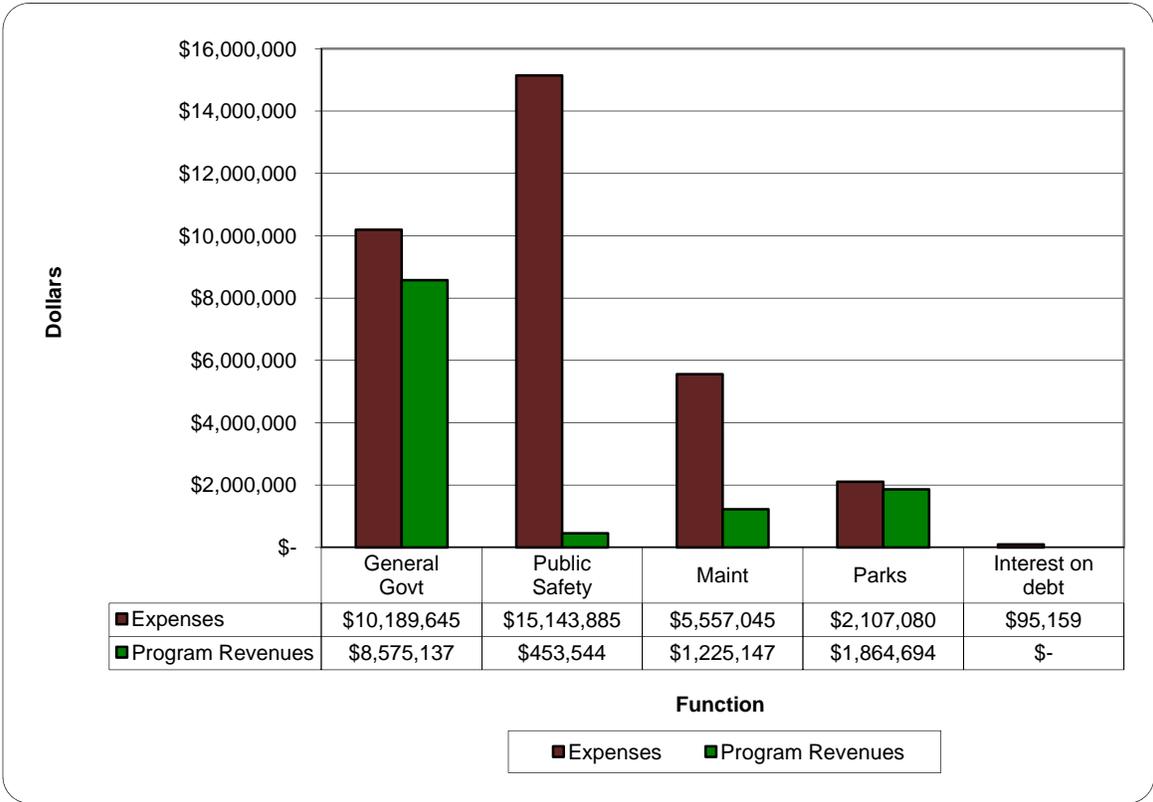
- Property tax continues to be the City's single largest source of revenue representing about 38% of general government-wide revenues. Property tax returned to a growth trend increasing by \$830,000, or 6%.
- Charges for services, making up 28% of government revenues, displayed extraordinary, in some cases one-time, planning and building activity increasing by a banner \$4.2M, or 66%. This revenue category was again bolstered by gains in recreation programming and a general spurt in residential remodel and rebuilding activity. Both community development and recreation services continue to capitalize on their cost recovery goals.
- Other major taxes showed gains of \$700,000, or 8%. Highlights include a 7% increase in sales tax, a 9% increase in hotel occupancy tax, a 17% in business license tax, 25% increase in real estate transfer tax and 2% in Utility Users Tax.
- Interest revenues came in under budget but moderately above prior year actuals by \$50,000 given continued tepid interest rates. Yields remain at historic low rates in line with the current Federal Reserve posture.
- Government expenses, including allocated capital maintenance costs, increased by \$3.2M or 11%. A closer review reveals that the change in pension net asset accounting treatment, a first time adjustment this year, accounted for 3% of this increase. Most of the cost increases are mostly attributable to the rise in safety, public works and building and planning activity.
- Interest on long-term debt remained flat reflective of the City's low debt level.

A comparison of the governmental activities and business-type activities program revenues and expenses for the current year and prior year is presented below:

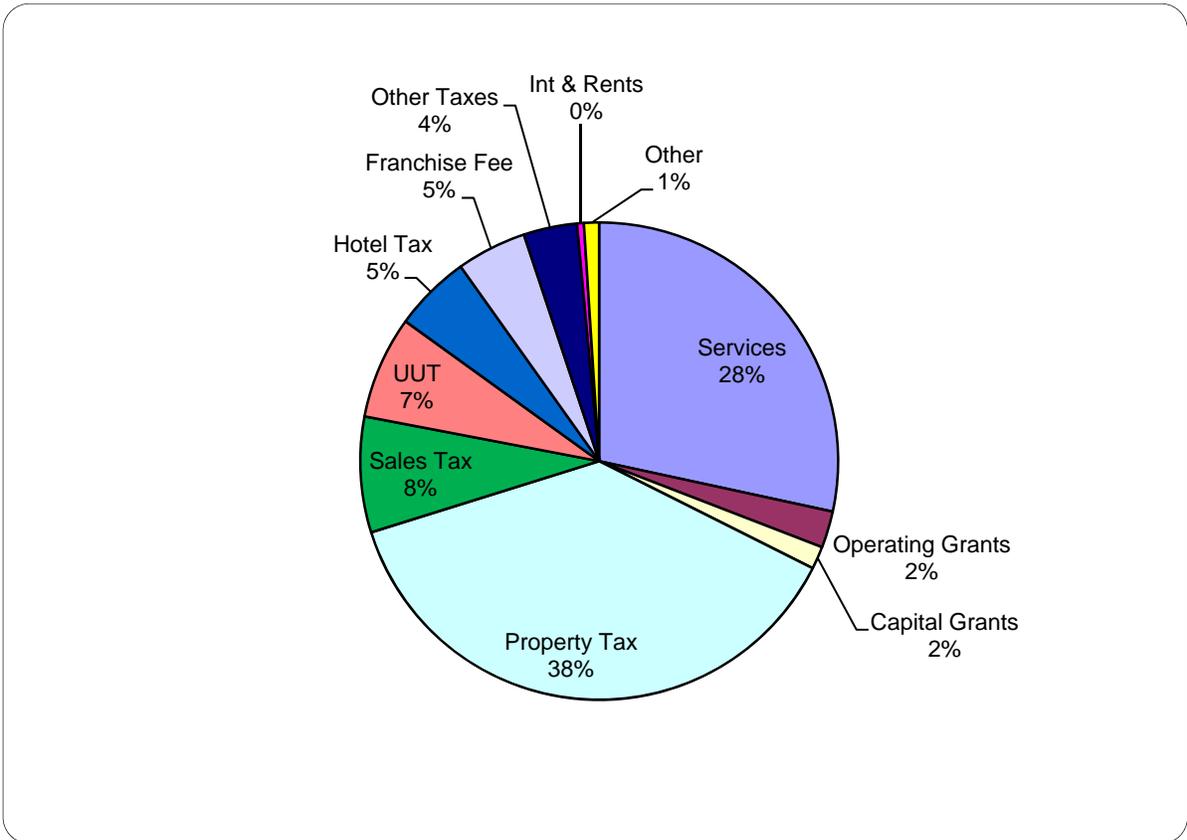
**City of Los Altos Changes in Net Position
Fiscal Year Ending June 30, 2013**

	Government 2013	Government 2012	Business 2013	Business 2012
Revenues				
Program Revenue				
Charges for Services	\$ 10,620,376	\$ 6,368,897	\$ 5,999,417	\$ 5,324,514
Operating Grants and Contributions	925,841	998,202	-	-
Capital Grants and Contributions	572,305	4,372,871	-	-
General Revenue				
Property Tax	14,130,040	13,301,950	-	-
Sales Tax	2,926,441	2,746,374	-	-
Utility User Tax	2,600,054	2,547,777	-	-
Other Taxes	3,301,726	2,868,347	-	-
Franchise Fees	1,769,516	1,731,193	-	-
Interest Income	173,514	114,781	9,844	37,259
Sale of Capital Assets	(7,767)	-	-	-
Miscellaneous	381,715	130,833	-	-
Total Revenues	37,393,761	35,181,225	6,009,261	5,361,773
Expenses				
Public Safety	15,108,658	14,797,058	-	-
Public Works	5,536,748	5,157,456	-	-
Recreation	2,099,856	2,193,281	-	-
Community Development	4,579,416	3,583,076	-	-
Admin/Community Services	5,652,479	4,034,260	-	-
Interest on Long-Term Debt	95,159	69,284	-	-
Sewer	-	-	4,529,242	4,386,069
Solid Waste	-	-	354,735	341,449
Storm Drain	-	-	231,910	212,653
Total Expenses	33,072,316	29,834,415	5,115,887	4,940,171
Excess (Deficiency) before transfers	4,321,445	5,346,810	893,374	421,602
Transfers	(231,933)	(247,370)	231,933	247,370
Loss on Disposal of Assets	-	(544,576)	-	-
Change in Net Position	4,089,512	4,554,864	1,125,307	668,972
Net Position - Beginning of Year	83,321,291	82,516,290	13,490,983	12,822,011
Prior Period Net Pension Asset Adjustment	-	(3,749,863)	-	-
Net Position - End of Year	\$ 87,410,803	\$ 83,321,291	\$ 14,616,290	\$ 13,490,983

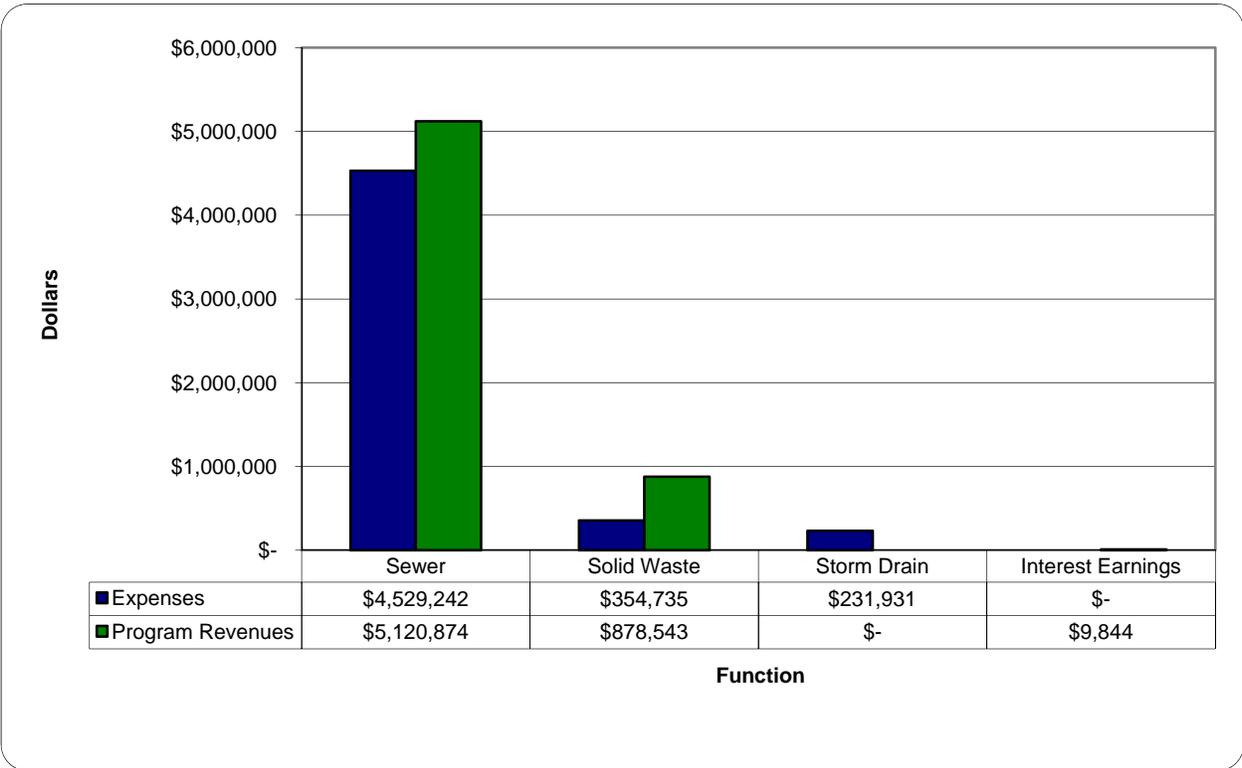
Program Expenses and Revenues - Governmental Activities



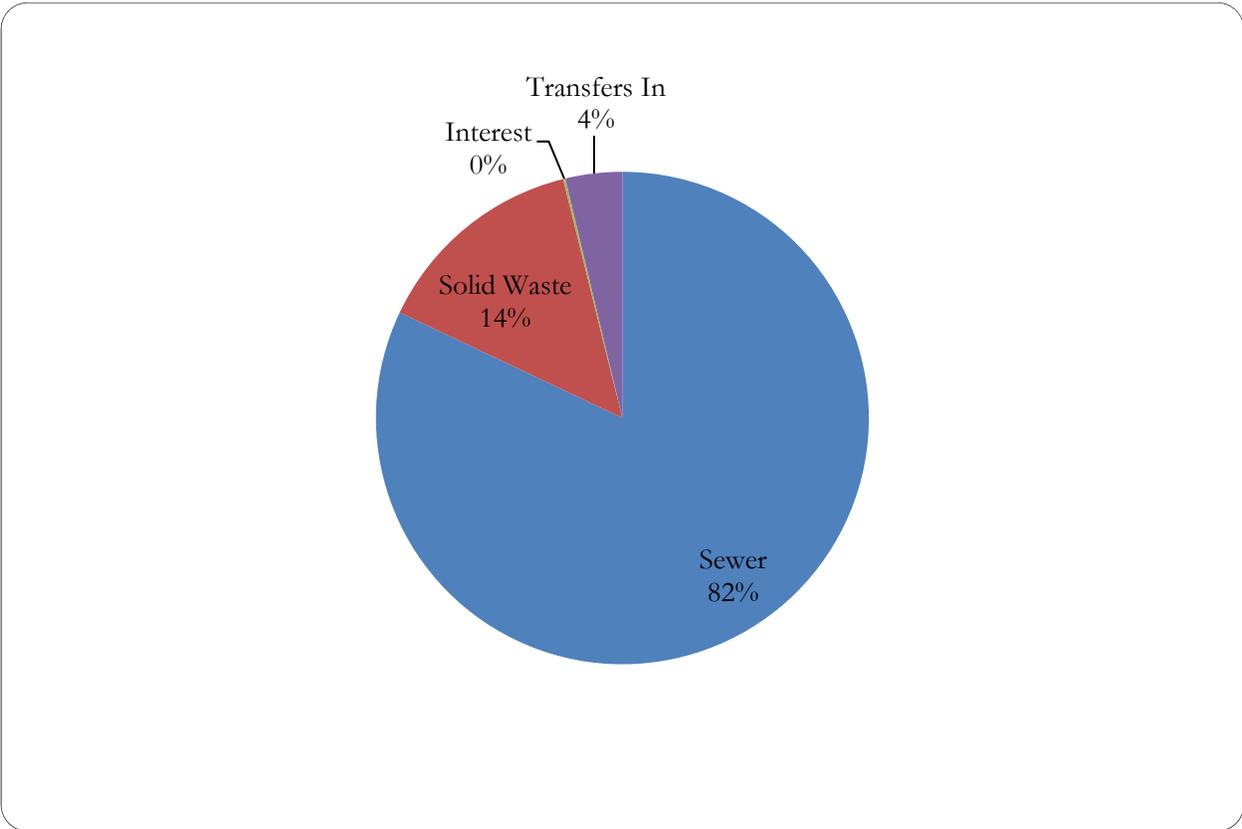
Government Revenues - All Sources



Program Expenses and Revenues - Business-Type Activities



Business Revenues - All Sources



Business-Type Activities

The programs for the business-type activities include sewer and solid waste collection management. These activities represent 14% of the total net position. Net position from business-type activities increased by \$1.1M, or 8%, with favorable operating results augmented by Storm Drain and internal service fund incoming transfers.

- The Joint Sewer System Authority (JSSA) formed in 1968 by a joint exercise of powers among the Cities of Palo Alto, Mountain View and Los Altos, constructed, maintains and operates sewage treatment facilities serving its member cities. The City of Palo Alto acts as administrator for JSSA and bills each member its share of the operating costs. The City is obligated through the year 2018 under an operating agreement with the City of Palo Alto for water treatment plant and sewer services. Payments under this agreement are based on expected usage and are adjusted annually based on actual use and site operating costs.
- Sewer revenue increased by 14%, partially offsetting the conservation utility usage trends noted last year and addressed in the recently updated Sewer Master Plan.
- Sewer expenses rose consistent with revenue trends, increasing by 3%, or \$145,000. Net position increased by \$600,000, quite an improvement from the prior year, ending the year with a total equity of \$12.6M.
- Revenue for solid waste collections increased by \$60,000 or 7% mostly as result of the annual increase in administrative fees. Expenditures remained relatively stable. Accordingly, net position for the fund increased by \$530,000 leaving a total fund balance of \$2M. Recent cost allocation plan changes in the level of administrative fee support will moderately alter this income pattern going forward.
- The General Fund contributed to the Storm Drain Fund to augment annual expenses. For FY 2012/13 the transfer equaled \$230,000 to cover annual operational costs. As projected in budgetary estimates and the prior year financial reports, this fund has exhausted its reserves. Currently, the Storm Drain and Urban Runoff Pollution Control Programs (URPP) are categorized as enterprise activities, but lacking a fee that pays for these services, the City may need to consider Storm Drain and URPP as General Fund activities.

FUND FINANCIAL ANALYSIS

The City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds: The focus of the City's governmental funds is to provide information on near-term inflows, outflows and balances of *spendable* resources. Such information is useful in assessing the City's financing requirements. In particular, unassigned or committed fund balances may serve as a useful measure of a government's net resources available for use at the end of the fiscal year. Fund balances have been re-categorized and presented in compliance with GASB54.

The City's governmental funds reported a combined ending fund balance of \$39M, an increase of \$3.5M or nearly 10%. Of the total combined balance, 6% remains as unassigned and without commitment.

The City has taken the judicious path of defining and assigning established key fund balance reserves as called out in adopted financial policies and projected in fiscal forecasts – what some might call “rainy day funds.” These key reserves are as defined as follows:

<i>General Fund Contingency Reserves</i>	<i>June 30, 2013</i>
<i>Emergency Operating</i>	\$5,525,000
<i>Unreserved Fund Balance</i>	2,428,281
<i>Total General Fund Available Funds</i>	<i>\$7,953,281</i>

The emergency and operating reserves, components of the General Fund, are safeguards in the event of an economic or financial crisis. Similarly, the state budget stabilization reserve was created in response to California's delicate fiscal condition. They are certainly strategies to have in place with the current financial climate.

The City has set aside \$500,000, an increase of \$100,000 over last year, for Other Post Employee Benefits (OPEB) to initiate funding of minimum post-retirement health liabilities as prescribed by CALPERS health plans. The OPEB reserve was created in response to GASB 45.

Overall favorable operating results have led to a total General Fund balance of \$8.5M, after transfers, and an unassigned fund balance of \$2.4M. These amounts align closely with long-term budgetary forecast and the adopted biennial operating plan.

Beyond the General Fund, other funds also have key balances of importance in supporting the City's fiscal plan. These are summarized as follows:

<i>Other Key Fund Balances</i>	<i>June 30, 2013</i>
<i>Ongoing Capital Projects</i>	\$3,046,926
<i>Capital Project Unreserved</i>	1,793,117
<i>Equipment Replacement</i>	3,670,288
<i>Real Property Proceeds</i>	7,414,894
<i>Community Facility Renewal</i>	7,165,592
<i>Park in Lieu Fees</i>	4,590,390
<i>Total</i>	<i>\$27,681,207</i>

It is notable this year that the in-lieu park funds, restricted as to parks, park land and recreation uses, have risen to the level of \$4.6M as result of the significant private development activity in Los Altos. These, and the other dollars listed above, are anticipated to apply to future capital needs.

The Capital Projects Fund balance varies materially as progress occurs on approved projects and external funding becomes available. In FY 2012/13, general government capital project spending approximated \$4.3M, a significant level commensurate with the prior year. Beyond funding previously approved projects, the City remains challenged to address the long list of identified and unfunded projects for future consideration.

Proprietary Funds: Proprietary funds provide the same type of information found in the government-wide financial statements, but with more detail.

Unrestricted net position at the end of the year in the Sewer Fund remained at \$6M including approved capital projects. The Storm Drain Fund balance remains dependent on the General Fund while the Solid Waste Fund increased to \$2M. Factors concerning the changes in fund balance in these funds have already been addressed in the discussion of the City’s business-type activities.

Both the Sewer and Solid Waste funds receive revenues from the City as a customer for routine service operations. In FY 2012-13 the City paid approximately \$14,000 in sewer fees and \$320,000 in waste hauling and disposal services. These amounts are recorded within the “Charges for Services” revenue line item in the proprietary financial statements.

Capital Assets and Debt Administration

Capital Assets: The City’s investment in capital assets for its governmental and business-type activities at year-end amounts to \$59M (net of accumulated depreciation).

Investments in capital assets include land, buildings, improvements, machinery, streets, infrastructure and equipment. Governmental capital assets totaled \$52M and those of business-type activities totaled \$7M. Assets increased by \$2.3M overall with the completion of several significant projects. Additional information on capital assets can be found in footnote 4 of these financial statements as part of the summary listed below:

Capital Assets as of June 30, 2013

	<i>Government Activities</i>	<i>Business Activities</i>	<i>2013 Total</i>	<i>2012 Total</i>
<i>Land</i>	\$11,539,449	0	\$11,539,449	\$11,539,449
<i>Work in Progress</i>	4,075,565	379,320	4,454,885	5,570,144
<i>Buildings</i>	13,582,770	6,155,892	19,738,662	18,688,502
<i>Improvements</i>	3,594,511	0	3,594,511	3,733,354
<i>Machinery & Equip</i>	1,055,114	238,207	1,293,321	1,515,876
<i>Infrastructure</i>	17,919,932	0	17,919,932	15,175,262
<i>Total Assets</i>	\$51,767,341	\$6,773,419	\$58,540,760	\$56,222,587

Debt Administration: At the end of the current fiscal year, City bond and assessment debt decreased by approximately \$100,000. The total outstanding bond debt balance at year-end is approximately \$1.8M and relates solely to the purchase of Rosita Park (formerly known as the Saint Williams site). No additional debt was incurred and the City has no significant capital leases.

Other debt consists of long-term employee compensated absence obligations of \$1.5M, for general and business activities, a factor of accumulated balances at year-end.

Additional information on long-term obligations can be found in footnotes 6 and 7 to these financial statements.

Long-Term Debt as of June 30, 2013

	<i>Government Activities</i>	<i>Business Activities</i>	<i>2013 Total</i>	<i>2012 Total</i>
<i>Certificate of Participation</i>	\$1,760,000	\$0	\$1,760,000	\$1,855,000
<i>Compensated Absences</i>	1,554,510	46,528	1,601,039	1,474,891
<i>Total</i>	\$3,289,236	\$40,655	\$3,329,891	\$3,568,321

The City also carries a year-end net Post-Retirement Health obligation (OPEB) of \$994,000. This obligation increased in line with annual actuarial valuations and is a factor of benefit levels and population metrics.

GENERAL FUND BUDGETARY HIGHLIGHTS

The FY 2012/13 General Fund budget, adopted as part of the biennial plan, equaled \$29.4M and changed modestly by \$1.4M to \$30.9M during the year. The bulk of this change reflects the approved CalPERS pension side-fund pay-down of \$950,000. Prior year encumbrances account for most of the other final adjustments, leaving changes during the fiscal year of less than 2%. Budget to actual results came in favorably with revenues exceeding estimates by 8% and expenditures coming in at 6% below established limits.

ECONOMIC FACTORS AND FY 2013/15 BIENNIAL BUDGET AND RATES

General Fund revenue is forecast to increase by 2% per the FY 2012/13 budget while expenditures are being held to a similar level. No significant changes were made as the budget presents a continuity of a balanced equation. The deferral of personnel positions was expanded primarily given concerns over increasing pension rates, but also the funding of aging city facilities and the fiscal impact of published and pending master plans.

The biennial budget was developed to maintain a sound fiscal posture, present a balanced General Fund and enhance contingency reserve levels in light of historic economic uncertainties. The budget also integrates a comprehensive five-year Capital Improvement Program and strategic forecasts. Key budget highlights are noted below:

- Revenues are expected to increase moderately pending current year results and the City projects meeting its operational goal of a 20% reserve as endorsed in 2008/09 by the City Council. OPEB reserves as required will be added to as well as transfers proposed from the General Fund to fund Capital Projects and Equipment Replacements. In the prior year, the City blended its Emergency Operating and State Budget Stabilization Reserves realizing a contingency reserve level of over \$6M.

- The budget projects an increase of 4.5% in property tax receipts, noting a break in recent sluggishness. This projection includes secured property tax, unsecured property tax, homeowner property tax relief, property tax in lieu of vehicle license fees and supplemental property tax. Property tax makes up nearly half of all governmental funds revenue.
- Other key taxes are estimated to experience moderate increases in the 3% range. Utilizing the most recent data and regional and national trends, sales tax revenue is projected to be relatively flat while hotel occupancy tax again displays recovery with an 11% increase. Other taxes including real estate transfers, motor vehicle license fees and business license all display modest growth.
- Planning and building activity has shown significant development strength. Anticipating a drop off in one-time development activity has influenced a 7% projected decline in this revenue base. These projections still anticipate strength in local activity.
- No new positions were added with the number of authorized positions remaining unchanged at 130.
- The two-year budget honors existing multi-year labor contracts. Salaries for filled authorized positions remain within budget projections.
- General operational costs were held relatively flat growing to 3% at the end of year two. Paced materials, service and equipment expenditures, the enhanced presence of pension reform, prudent salary levels and the deferral of 12 positions continue to factor into such patterns and projections.
- Overall, PERS pension rates increased but were mitigated by the pay-down of the City's side-fund liability expected to be fully paid down in FY 2013/14. Rates for public safety and miscellaneous employees increased moderately from prior year levels but, as recent changes in legislation and forecasts strongly suggest, are expected to materially increase in the short term given method and assumption changes underway. Health insurance rates are assumed to increase by at least 7.5%.
- In the prior year, the City successfully implemented a second-tier pension model that lowers the level of benefit for new hires. This change is anticipated to render material savings as the years evolve. The State of California also mandated pension reform effective 2013 that imposed yet another third and lower benefit plan for new prospective enrollees.
- The budget further significantly augments the funding of OPEB through the establishment of an internal assigned reserve projected to be \$850,000 by the end of FY 2014/15.

For a more current discussion of the state of the economy beyond those assumptions made in the FY 2013/15 two-year budget process, the reader should also refer to the transmittal letter included in this document.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide Los Altos citizens, taxpayers, customers, investors and creditors with a general overview of the City's finances. Questions concerning any of the information provided in this report, or request for additional financial information, should be addressed to the Finance Director, 1 North San Antonio Road, Los Altos, CA 94022.

