Wastewater Treatment System
(Enterprise Funds of the City of San José)

Independent Auditor's Reports,
Management's Discussion and Analysis,
Financial Statements, and
Required Supplementary Information

For the Year Ended June 30, 2023

MGO | Certified Public Accountants

Wastewater Treatment System
(Enterprise Funds of the City of San José)
For the Year Ended June 30, 2023

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MGO. Certified Public Accountants

Independent Auditor's Report

Honorable City Council
Wastewater Treatment System
San José, California

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of the Wastewater Treatment System (WWTS), certain enterprise funds of the City of San José, California (City), as of and for the year ended June 30, 2023, and the related notes to the financial statements, which collectively comprise the WWTS's financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of the WWTS as of June 30, 2023, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States (*Government Auditing Standards)*. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the WWTS and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note 2 to the financial statements, the financial statements of the WWTS are intended to present the financial position, the changes in financial position and cash flows of only that portion of the business-type activities and major enterprise fund of the City that is attributable to the transactions of the WWTS. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2023, the changes in its financial position, or, where applicable, its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

The WWTS's management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the WWTS's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, the schedule of the proportionate share of the net pension liability, the schedule of employer contributions – defined benefit pension plan, the schedule of the proportionate share of the net OPEB liability, and the schedule of employer contributions – postemployment healthcare plan identified as required supplementary information in the accompanying table of contents, be presented to supplement the financial statements. Such information is the responsibility of management and, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with GAAS, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Management is responsible for the other information included in the annual report. The other information comprises the Reconciliation of Net Position of WWTS to City's ACFR but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 17, 2023 on our consideration of the WWTS'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 solely 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 effectiveness of the WWTS's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the WWTS's internal control over financial reporting and compliance.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 17, 2023

Description of Reporting Entity

The following discussion and analysis pertain to the financial performance of the City of San José's Wastewater Treatment System ("WWTS") for the year ended June 30, 2023. The WWTS Funds account for the financing, construction, and operations of the San José-Santa Clara Wastewater Treatment Plant ("Treatment Plant"), including the San José Sanitary Sewage Collection System.

The purpose of this financial report is to comply with the required annual disclosure for the Wastewater Revenue Bonds Series 2022B (Green Bonds – Climate Certified) ("2022B Bonds") issued through the San José Financing Authority in December 2022. Pursuant to Resolution No. 80770, a Resolution Providing for the Allocation of Wastewater System Revenues, the Pledge of Wastewater Net System Revenues and Establishing Covenants to Secure the Payment of Obligations Payable from Wastewater Net System Revenues ("Master Resolution"), no revenues from the South Bay Water Recycling Program System ("SBWR") will be pledged, or otherwise available for repayment of the 2022B Bonds. For this reason, this financial report excludes the financial or operational information regarding SBWR.

Financial Statements

The financial statements of WWTS represent a separate proprietary enterprise fund responsible for wastewater conveyance and treatment within a service area comprising 1.4 million customers. In accordance with Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments,* public entities like WWTS, which engage solely in business-type activities, are required to present enterprise fund financial statements as follows: (1) statement of net position; (2) statement of revenues, expenses, and changes in net position; (3) statement of cash flows; and (4) notes to the financial statements.

WWTS financial statements are prepared using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP").

Financial Highlights

The following table indicates the net position on June 30, 2023, and 2022 (in thousands):

WWTS Funds	**2023**	**2022**	**$ Change**	**% Change**
Current Assets	$ 493,505	$ 485,643	$ 7,862	1.6%
Restricted Assets	2	-	2	N/A
Capital Assets	1,287,202	1,184,578	102,624	8.7%
Total Assets	1,780,709	1,670,221	110,488	6.6%
Deferred Outflows	54,407	48,388	6,019	12.4%
Current Liabilities	58,532	47,196	11,336	24.0%
Noncurrent Liabilities	586,941	475,789	111,152	23.4%
Total Liabilities	645,473	522,985	122,488	23.4%
Deferred Inflows	14,652	67,325	(52,673)	-78.2%
Net Investment in Capital Assets	945,104	947,708	(2,604)	-0.3%
Unrestricted	229,887	180,591	49,296	27.3%
Net Position	$ 1,174,991	$ 1,128,299	$ 46,692	4.1%

Summary of Statement of Net Position

The net position increased by $46.7 million or 4.1 percent from $1.128 billion to $1.175 billion. The increase was primarily due to operating revenues exceeding operating expenses (before capital contributions) by $48.3 million. The largest portion, $945.1 million or 80.4 percent, of the net position was its net investment in capital assets (e.g., land, buildings, and infrastructure) less outstanding debt that was used to acquire those assets. Approximately $229.9 million, or 19.6 percent of the total net position, constitutes unrestricted net position which may be used to finance day-to-day operations without constraints established by debt covenants or other legal requirements.

The Other Information section of this report shows how the WWTS in this report ties back to WWTS in ACFR.

The following table indicates the changes in net position for the years ended June 30, 2023, and 2022 (in thousands):

WWTS Funds	2023	2022	$ Change	% Change
Operating revenues	$ 255,507	$ 279,954	$ (24,447)	-8.7%
Operating expenses	207,172	183,256	23,916	13.1%
Operating income	48,335	96,698	(48,363)	-50.0%
Nonoperating expenses, net	(3,061)	(5,619)	2,558	45.5%
Contributions	1,968	(280)	2,248	802.9%
Transfers	(550)	1,391	(1,941)	-139.5%
Change in net position	46,692	92,190	(45,498)	-49.4%
Net position, beginning of year	1,128,299	1,036,109	92,190	8.9%
Net position, end of year	$ 1,174,991	$ 1,128,299	$ 46,692	4.1%

Summary of Statement of Revenues, Expenses, and Changes in Net Position

Operating revenues decreased $24.4 million primarily due to lower contributions from the City of Santa Clara and the Tributary Agencies toward the Treatment Plant for ongoing maintenance and replacement costs due to a lower CIP budget year-over-year. Operating income decreased by $48.4 million due to higher expenses compared to the prior fiscal year. The increase was mainly due to a net increase of $10.2 million in pension expense and other postemployment benefits expense. Also, a $18.5 million increase in personal and non-personal service costs including higher chemicals and energy costs and contractual services was offset by a $3.1 million decrease in Owner-Controlled Insurance Program expenses. The Owner-Controlled Insurance Program is a centralized insurance program for risks associated with onsite construction.

Net nonoperating expenses decreased by $2.5 million primarily due to investment income increasing by $18.7 million offset by interest expense increasing by $16.2 million due to the refunding of the revenue notes payable with the issuance of bonds to fund the CIP program.

Capital Assets

As of June 30, 2023, the Treatment Plant has completed its 10th year of capital investment in long-term rehabilitation and modernization of its facility as part of the approved 2013 Plant Master Plan ("PMP"). The PMP recommends more than 114 capital improvement projects to be implemented over a 30-year planning period at an estimated investment level of approximately $2.0 billion. The PMP assumes an implementation schedule of 2010 through 2040.

The WWTS's capital assets, net of accumulated depreciation and amortization, amounted to $1.3 billion at June 30, 2023. This investment includes land, infrastructure, structures and improvements, vehicles, equipment, intangible assets, and construction in progress. The WWTS's decision to depreciate infrastructure capital assets results in recording a large non-cash depreciation expense each year that offsets additions to capital assets. For the year ended June 30, 2023, net capital assets increased by $ 102.6 million. The increase was primarily due to total acquisitions of $135.4 million, with $112.8 million of that in improvements at the Wastewater Treatment Facility.

Capital assets, net of depreciation and amortization, are presented below to illustrate changes between June 30, 2023, and June 30, 2022 (in thousands):

	2023	2022	Change
Land	$ 41,588	$ 41,588	$ -
Buildings	450,246	449,892	354
Vehicles and Equipment	255,538	248,594	6,944
Construction in Process	704,352	591,538	112,814
Other Improvements	675,263	662,510	12,753
Right-to-use Subscription Based Information Technology Arrangements ("SBITA")	643	-	643
Less Acc. Depreciation & Amortization	(840,428)	(809,483)	(30,945)
Total Capital Assets, net	$ 1,287,202	$ 1,184,639	$ 102,563

Long-term Debt

On December 15, 2022, the City of San José Financing Authority ("Financing Authority") issued $268.4 million of the 2022B Bonds, and applied the net proceeds to prepay Wells Fargo Bank, National Association ("Wells Fargo") for Subordinate Wastewater Revenue Notes, Series A. The 2022B Bonds were issued as a long-term fixed-rate debt structure with level debt service.

On June 20, 2023, the City and Financing Authority approved resolutions authorizing the execution of a Fourth Amendment to Credit Agreement and a Fourth Amended and Restated Fee Letter Agreement with Wells Fargo, related to the issuance by the Financing Authority of its Subordinate Wastewater Revenue Notes for a term through October 16, 2026, in an aggregate principal amount outstanding at any one time of up to $200,000,000 effective October 18, 2023.

Request for Information

Questions concerning any of the information provided in this report or requests for additional financial information should be addressed in writing to the Director of Finance, City of San José, 200 E. Santa Clara Street, San José, CA 95113.

Wastewater Treatment System
(Enterprise Funds of the City of San José)
Statement of Net Position
June 30, 2023
($000's)

ASSETS		
Current assets:		
Equity in pooled cash and investments held in City Treasury	$	488,348
Receivables, net of allowances for uncollectible amounts		
Accrued interest		1,976
Others		2,508
Inventories		673
Total current assets		493,505
Restricted assets:		
Cash held with fiscal agent		2
Total restricted assets		2
Noncurrent assets:		
Capital assets:		
Land		41,588
Buildings		450,246
Vehicles and equipment		255,538
Construction in progress		704,352
Other improvements		675,263
Right-to-use Subscription Based Information Technology Arrangements		643
Less: accumulated depreciation and amortization		(840,428)
Total capital assets, net		1,287,202
Total assets		1,780,709
DEFERRED OUTFLOWS OF RESOURCES		
Other postemployment benefits		18,963
Pension		35,444
Total deferred outflows of resources	$	54,407

Wastewater Treatment System
(Enterprise Funds of the City of San José)
Statement of Net Position (Continued)
June 30, 2023
($000's)

LIABILITIES	
Current liabilities:	
Accounts payable:	
Other	$ 44,766
Accrued interest	2,392
Accrued salaries, wages, and payroll taxes	1,447
Accrued vacation, sick leave and compensatory time	4,420
Right-to-use Subscription-Based Information Technology Arrangements	149
Estimated liability for self-insurance	316
Bonds payable - current (net of premium)	5,042
Total current liabilities	58,532
Noncurrent liabilities	
Bonds payable, net	295,470
Right-to-use Subscription-Based Information Technology Arrangements	356
Estimated liability for self-insurance	1,014
Notes payable	98
Accrued vacation, sick leave and compensatory time	759
Pollution remediation obligation	27,952
Net other postemployment benefit liability	50,102
Net pension liability	211,190
Total noncurrent liabilities	586,941
Total liabilities	645,473
DEFERRED INFLOWS OF RESOURCES	
Other postemployment benefits	12,486
Pension	2,166
Total deferred inflows of resources	14,652
NET POSITION	
Net investment in capital assets	945,104
Unrestricted	229,887
Total net position	$ 1,174,991

The Notes to the Financial Statements are an integral part of this statement.

Wastewater Treatment System
(Enterprise Funds of the City of San José)
Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended June 30, 2023
($000's)

OPERATING REVENUES	
Charges for services:	
District operational revenue	$ 22,158
Sewer service and use charges	190,046
Rentals and concessions:	
Receiving station revenue	115
Service connection, engineering, and inspection	1,785
Contributions	26,928
Other:	
District capital revenue	14,220
Other revenues	255
Total operating revenues	255,507
OPERATING EXPENSES	
Operation and maintenance	138,460
General and administrative	35,188
Depreciation and amortization	32,746
Materials and supplies	778
Total operating expenses	207,172
Operating income	48,335
NONOPERATING REVENUES (EXPENSES)	
Investment income	10,469
Land and building rental	279
Interest expense and fees	(13,750)
Loss on disposal of capital assets	(59)
Net nonoperating expenses	(3,061)
Income before capital contributions and transfers	45,274
Capital contributions	1,968
Transfers out	(550)
Change in net position	46,692
Net position - beginning	1,128,299
Net position - ending	$ 1,174,991

The Notes to the Financial Statements are an integral part of this statement.

Wastewater Treatment System
(Enterprise Funds of the City of San José)
Statement of Cash Flows
For the Year Ended June 30, 2023
($000's)

CASH FLOWS FROM OPERATING ACTIVITIES:	
Receipts from customers and users	$ 28,470
Contributions	26,928
Payments to suppliers	(76,770)
Payments to employees	(100,068)
Net cash provided by operating activities	78,560
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:	
Transfers out	(550)
Net cash used in noncapital financing activities	(550)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:	
Bond proceeds	300,714
Revenue notes repayment	(236,771)
Interest and fees paid	(11,251)
Bond issuance costs	(684)
Contributed capital	307
Acquisition of capital assets	(133,125)
Net cash used in capital and related financing activities	(80,810)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Investment interest received	9,626
Land and building rentals	247
Net cash provided by investing activities	9,873
Net increase in cash and cash equivalents	7,073
Cash and cash equivalents - beginning	481,277
Cash and cash equivalents - ending	$ 488,350

The Notes to the Financial Statements are an integral part of this statement.

Wastewater Treatment System
(Enterprise Funds of the City of San José)
Statement of Cash Flows (Continued)
For the Year Ended June 30, 2023
($000's)

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$	48,335
Adjustments to reconcile operating income to cash provided by operating activities:		
Depreciation and amortization		32,746
Decrease (increase) in:		
Accounts receivable, net		(109)
Inventories		193
Increase (decrease) in:		
Net pension liability, deferred outflows and inflows of pension related resources		(3,749)
Net other postemployment benefits liability, deferred outflows and inflows of postemployment benefits related resources		(2,292)
Accounts payable		6,001
Accrued salary, wages, payroll taxes		(2,723)
Accrued vacation, sick leave and compensatory time		553
Estimated liability for self-insurance		(167)
Pollution remediation obligation		(228)
Net cash provided by operating activities	$	78,560
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE STATEMENT OF NET POSITION:		
Equity in pooled cash and investments held in City Treasury		
Unrestricted	$	488,348
Cash held with fiscal agents		2
Total cash and cash equivalents	$	488,350
NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:		
Loss on disposal of capital assets	$	(59)
Donated assets		1,661
Underwriters' discount paid through escrow		(388)
Amortization of bond premium		591
Amortization of Right-to-use Susbcription-Based Information Technology Arrangements		(154)
Interest expense on Right-to-use Subscription-Based Information Technology Arrangements liability		(25)

The Notes to the Financial Statements are an integral part of this statement.

NOTE 1 – DESCRIPTION OF WASTEWATER TREATMENT OPERATIONS

(a) Overview

The Wastewater Treatment System Fund is an Enterprise Fund for the Treatment Plant and the City of San José Collection System. The Treatment Plant is co-owned by the City of San José ("the City") and City of Santa Clara and treats wastewater for over 1.4 million residents and thousands of businesses in the cities of San José, Santa Clara, Milpitas, Campbell, Los Gatos, Monte Sereno, Cupertino, and unincorporated areas of the County of Santa Clara.

The City owns and operates the sanitary sewer collection and conveyance system, which provides wastewater collection service for the City. The Sanitary Sewer Collection System includes approximately 2,030 miles of wastewater collection system pipeline that conveys wastewater to the San José-Santa Clara Wastewater Treatment Facility.

(b) Governance

The City acts as the administering agency for the Treatment Plant under the terms of the Sewage Treatment Plant Agreement, dated May 6, 1959 ("1959 Agreement"), between the City and the City of Santa Clara, and under separate agreements among the respective Tributary Agencies, the City and the City of Santa Clara (as amended from time to time, each, a "Master Agreement," and collectively, the "Master Agreements").

As the administering agency, the City has the authority and responsibility for operating the Treatment Plant and determining annual operating and capital costs. The Treatment Plant Advisory Committee ("TPAC"), required by the 1959 Agreement and the Master Agreements, advises the City and the City of Santa Clara on operation, maintenance, repair, and improvement of the Treatment Plant, and the development and administration of related programs and policies. The TPAC also advises the City and the City of Santa Clara on administrative matters including amendments to contracts and agreements, the sale of capacity rights in the Treatment Plant, and other matters, including the annual budget process.

The TPAC meets monthly and consists of nine members. Pursuant to the Master Agreements, members include three members from the City Council of the City of San José, two members from the City Council of the City of Santa Clara, and one representative of the City Manager's Office of the City. The remaining members consist of representatives from the City of Milpitas, Cupertino Sanitary District, and the West Valley Sanitation District. The TPAC members are appointed by, and serve at the pleasure of, the governing body of such members.

The City regulates wastewater generated within its jurisdictional boundaries by ordinance. Pursuant to the Master Agreements, each Tributary Agency is required to adopt and enforce ordinances, resolutions, rules, and regulations to conform to the City's ordinance. Any waiver of such ordinances, resolutions, rules, and regulations of the Tributary Agencies must be authorized by written resolution of the City Councils of the City and the City of Santa Clara. The Tributary Agencies have also agreed to comply with the applicable statues, ordinances, rules and regulations of agencies of the United States of America, and the State of California, including the National Pollutant Discharge Elimination System ("NPDES") Permit (as hereinafter defined).

(c) Operations

The City constructed the original portion of the Treatment Plant in 1956, which consisted only of primary treatment facilities with a capacity of 36 million gallons per day (“mgd”) designed to treat organic waste from canneries. In 1959, the City and the City of Santa Clara entered into the 1959 Agreement pursuant to which, among other things, the City of Santa Clara became a co-owner of the Treatment Plant and helped finance improvements to expand the capacity of the Treatment Plant to 54 mgd.

A secondary treatment plant was completed in 1964, and minor additions were made in 1965, 1966 and 1968. Additional primary, secondary and chlorination facilities were completed in 1970. In early 1979, the advanced wastewater treatment facilities including nitrification and filtration processes were completed. In the mid-1980s, the treatment facilities expanded to the present 167 mgd capacity, and the Master Agreements were executed with the Tributary Agencies to memorialize their participation in the expansion. The Master Agreements with each of the Tributary Agencies were amended over the years to memorialize participation in South Bay Water Recycling Program System.

In addition to the original construction and subsequent treatment process expansions described above, several significant infrastructure investments have been made at the Treatment Plant over the past 25 years. Such improvements include the wet weather reliability improvement project (2007), the sodium hypochlorite disinfection facility which converted to sodium hypochlorite for the disinfection process, greatly reducing the public safety risk from the Treatment Plant (2011), electrical reliability improvements (2004-2013), digester gas storage rehabilitation (2016), digester gas compressor upgrades (2017), emergency diesel generators (2017), iron salt feed station (2018), and the cogeneration facility (2021).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation and Accounting

The financial statements are prepared in accordance with GAAP. GASB is responsible for establishing GAAP for state and local governments through its pronouncements. The City of San José’s Wastewater Treatment System (“WWTS”) operations are accounted for as enterprise funds of the City and are reported using the economic resources measurement focus and the accrual basis of accounting – similar to business enterprises. Accordingly, revenues are recognized when they are earned, and expenses are recognized when liabilities are incurred. Enterprise fund-type operating statements present increases (revenues) and decreases (expenses) in total net position.

WWTS’s financial statements are intended to present the financial position, the changes in financial position, and, where applicable, cash flows of only that portion of the business-type activities and major enterprise fund of the City that is attributable to the transactions of WWTS. They do not purport to, and do not, present fairly the financial position of the City, as of June 30, 2023, the changes in its financial position, or, where applicable, its cash flows for the year ended in accordance with accounting principles generally accepted in the United States of America.

(b) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(c) Revenue Recognition

WWTS recognizes revenue on the accrual basis of accounting. This includes invoices issued to the Tributary Agencies that share treatment plant services as well as the wire transfers from the Santa Clara County ("County") property tax rolls.

(d) Equity in Pooled Cash and Investments Held in City Treasury

The cash balances of the WWTS funds are pooled and invested by the City Treasurer (i.e., Director of Finance) unless otherwise dictated by legal or contractual requirements. Income and losses arising from the investment activity of pooled cash are allocated to the participating funds and component units on a monthly basis, based on their proportionate shares of the average weekly cash balance.

Pooled cash and investments in the City Treasury are considered to be cash and cash equivalents for purposes of the accompanying statement of cash flows. Pooled cash and investments represent deposits and investments held in the City's cash management pool. This cash management pool possesses the characteristics of a demand deposit account; therefore, investments in this pool are considered to be cash equivalents. WWTS also considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

(e) Accounts Receivable

The accounts receivable balance on June 30, 2023, was $4.5 million, which consists of approximately $2.0 million in accrued interest and $2.5 million in other receivables, net of allowance. Approximately 95% of the City's Sewer Service and Use Charge revenues are billed and collected on the tax rolls with the County. The County sends the revenue collected from the tax rolls to the City by a wire transfer of funds. The remaining 5% of the charges are billed directly to customers by the City.

(f) Capital Assets

Capital assets include land, buildings, improvements, vehicles and equipment, infrastructure, and all other tangible assets that are used in operations and that have initial useful lives in excess of one year. Capital assets are defined as assets with an initial individual cost of more than $5,000 for general capital assets and $100,000 for major infrastructure assets, and an estimated useful life in excess of one year. Such assets are recorded at historical cost if purchased or constructed. Donated capital assets are recorded at acquisition value at the time received.

Buildings, improvements, infrastructure, vehicles and equipment, and furniture and fixtures are depreciated using the straight-line method over the following estimated useful lives:

Buildings	5 – 40 years
Improvements, other than buildings	10 - 50 years
Infrastructure	25 - 50 years
Vehicles and equipment	2 - 40 years
Furniture and fixtures	10 years

With GASB Statement No. 96, *Subscription-Based Information Technology Arrangements* ("SBITA"), WWTS recognizes an intangible right-to-use software subscription asset when the applicable accounting criteria is met. The capitalization threshold for WWTS as subscriber is an initial cost of more than $250,000 per item at its net present value for software subscription. The subscription asset must also have an initial useful life of more than one year. In addition, a subscription asset should be at least 75% of fair market value in order to qualify as an exchange-like transaction. The intangible right-to-use assets are reported as capital assets. The SBITA asset is amortized on a straight-line basis over the shorter of the subscription term or useful life.

(g) Defined Benefit Plans

1. Pension

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pension and pension expense, information about the fiduciary net position of the WWTS's participation in the Federated City Employees' Retirement System ("FCERS"), and additions to/deductions from the FCERS' fiduciary net position have been determined on the same basis as they are reported by the FCERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms. FCERS' investments are reported at fair value. While the City reports its pension plan managed by FCERS as a single employer defined benefit pension plan, WWTS recognizes a proportionate share of its participation in FCERS based on the WWTS pension contributions relative to the total City pension contributions to FCERS. For more information regarding WWTS retirement benefits, please refer to Note 7 and the Required Supplementary Information ("RSI") section.

2. Other Postemployment Benefits

For purposes of measuring the net Other Postemployment Benefits ("OPEB") liability, deferred outflows of resources and deferred inflows of resources related to OPEB and OPEB expense, information about the fiduciary net position of the WWTS's participation in the FCERS, and additions to/deductions from the FCERS' fiduciary net position have been determined on the same basis as they are reported by the FCERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms. FCERS investments are reported at fair value. While the City reports its OPEB plan managed by FCERS as a single employer defined benefit OPEB plan, WWTS recognizes a proportionate share of its participation in the FCERS OPEB plan based on the WWTS OPEB contributions relative to the total City OPEB contributions to FCERS. For more information regarding WWTS OPEB benefits, please refer to Note 8 and the RSI section.

(h) Net Position

Net Position is classified in the following three components:

Net Investment in Capital Assets groups all capital assets, including infrastructure, into one component of net position. Accumulated depreciation/amortization and the outstanding balances of debt and deferred outflows/inflows of resources associated with debt that are attributable to acquisition, construction, or improvement of these assets reduces the balance in this category.

Restricted Net Position consists of the constraints placed on net asset use by external creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted Net Position consists of the remaining balance of net position not subject to the aforementioned categorizations.

When both restricted and unrestricted resources are available for use, it is WWTS's policy to use restricted resources first and then unrestricted resources, as needed.

(i) Operating Revenues and Expenses

Enterprise funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with WWTS's principal ongoing operations. The principal operating revenues are charges to customers for sales and services. In addition, contributions from other participating agencies for their allocation of the operating and maintenance expenses, their share of debt service, and other commitments towards the improvements are also included as operating revenues. Operating expenses include the cost of sales and services, administrative expenses and depreciation and amortization on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

(j) Interfund Transactions

Interfund transactions are reflected as services provided, reimbursements and/or transfers. Services provided are deemed to be at market or near market rates and are treated as revenues and expenditures/expenses in the fund receiving revenue or being charged. Reimbursements are defined as when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers.

(k) New Pronouncements

<u>During the year ended June 30, 2023, the WWTS implemented the following GASB Statements:</u>

The WWTS has adopted GASB Statement No. 91, *Conduit Debt Obligations*. This statement provides a single method of reporting conduit debt obligations by issuers and eliminates diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. The application of Statement No. 91 did not have any effect on the WWTS's financial statements.

The WWTS has adopted GASB Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. This statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements ("PPPs"). As used in this statement, a PPP is an arrangement in which a government (the transferor) contracts with an operator (a governmental or nongovernmental entity) to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction. Some PPPs meet the definition of a service concession arrangement ("SCA"), which the Board defines in this statement as a PPP in which (1) the operator collects and is compensated by fees from third parties; (2) the transferor determines or has the ability to modify or approve which services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services; and (3) the transferor is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement. This statement also provides guidance for accounting and financial reporting for availability payment arrangements ("APAs"). As defined in this statement, an APA is an arrangement in which a government compensates an operator for services that may include designing, constructing, financing, maintaining, or operating an underlying nonfinancial asset for a period of time in an exchange or exchange-like transaction. The application of Statement No. 94 did not have any effect on the WWTS's financial statements.

The WWTS has adopted GASB Statement No. 96, *Subscription-Based Information Technology Arrangements*. This statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements ("SBITAs") for government end users (governments). This statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. To the extent relevant, the standards for SBITAs are based on the standards established in Statement No. 87, *Leases*, as amended. A SBITA is defined as a contract that conveys control of the right-to-use another party's (a SBITA vendor's) information technology ("IT") software, alone or in combination with tangible capital assets (the underlying IT assets), as specified in the contract for a period of time in an exchange or exchange-like transaction. The subscription term includes the period during which a government has a noncancellable right-to-use the underlying IT assets. The subscription term also includes periods covered by an option to extend (if it is reasonably certain that the government or SBITA vendor will exercise that option) or to terminate (if it is reasonably certain that the government or SBITA vendor will not exercise that option). Under this statement, a government generally should recognize a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability. There was no impact on beginning net position as a result of implementation.

WWTS has adopted GASB Statement No. 99, *Omnibus 2022*. The objectives of this statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing: (1) Classification and reporting of derivative instruments within the scope of Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, that do not meet the definition of either an investment derivative instrument or a hedging derivative instrument; (2) Clarification of provisions in Statement No. 87, *Leases*, as amended, related to the determination of the lease term, classification of a lease as a short-term lease, recognition and measurement of a lease liability and a lease asset, and identification of lease incentives; (3) Clarification of provisions in Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*, related to (a) the determination of the PPP term and (b) recognition and measurement of installment payments and the transfer of the underlying PPP asset; (4) Clarification of provisions in Statement No. 96, *Subscription-Based Information Technology Arrangements*, related to the SBITA term, classification of a SBITA as a short-term SBITA, and recognition and measurement of a subscription liability; (5) Extension of the period during which the London Interbank Offered Rate ("LIBOR") is considered an appropriate benchmark interest rate for the qualitative evaluation of the effectiveness of an interest rate swap that hedges the interest rate risk of taxable debt; (6) Accounting for the distribution of benefits as part of the Supplemental Nutrition Assistance Program ("SNAP"); (7) Disclosures related to nonmonetary transactions; (8) Pledges of future revenues when resources are not received by the pledging government; (9) Clarification of provisions in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, as amended, related to the focus of the government-wide financial statements; (10) Terminology updates related to certain provisions of Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*; and (11) Terminology used in Statement 53 to refer to resource flows statements.

The requirements of this statement that are effective as follows: Items (5), (6), (7), (8), (9), (10), and (11) were implemented starting fiscal year 2022, and all reporting period thereafter; Items (2), (3), and (4) related to leases, PPPs, and SBITAs are effective for this fiscal year, and all reporting periods thereafter.

The WWTS is currently analyzing its accounting practices to determine the potential impact on the financial statements for the upcoming GASB Statements:

In April 2022, the GASB issued Statement No. GASB 99, *Omnibus 2022*. The only outstanding item (1), which is related to financial guarantees and the classification and reporting of derivative instruments within the scope of Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, will take effect for financial statements with fiscal years beginning after June 15, 2023.

In June 2022, GASB issued Statement No. 100, *Accounting Changes and Error Corrections – an amendment of GASB Statement No. 62*. The primary objective of this statement is to enhance accounting and financial reporting requirements for accounting changes and error corrections to provide more understandable, reliable, relevant, consistent, and comparable information for making decisions or assessing accountability. This statement defines accounting changes as changes in accounting principles, changes in accounting estimates, and changes to or within the financial reporting entity and describes the transactions or other events that constitute those changes. As part of those descriptions, for (1) certain changes in accounting principles and (2) certain changes in accounting estimates that result from a change in measurement methodology, a new principle or methodology should be justified on the basis that it is preferable to the principle or methodology used before the change. That preferability should be based on the qualitative characteristics of financial reporting—understandability, reliability, relevance, timeliness, consistency, and comparability. This statement also addresses corrections of errors in previously issued financial statements. The requirements of this statement are effective for accounting changes and error corrections made in fiscal years beginning after June 15, 2023, and all reporting periods thereafter. Earlier application is encouraged.

In June 2022, GASB issued Statement No. 101, *Compensated Absences*. This statement requires that liabilities for compensated absences be recognized for (1) leave that has not been used and (2) leave that has been used but not yet paid in cash or settled through noncash means. A liability should be recognized for leave that has not been used if (a) the leave is attributable to services already rendered, (b) the leave accumulates, and (c) the leave is more likely than not to be used for time off or otherwise paid in cash or settled through noncash means. Leave is attributable to services already rendered when an employee has performed the services required to earn the leave. Leave that accumulates is carried forward from the reporting period in which it is earned to a future reporting period during which it may be used for time off or otherwise paid or settled. In estimating the leave that is more likely than not to be used or otherwise paid or settled, a government should consider relevant factors such as employment policies related to compensated absences and historical information about the use or payment of compensated absences. However, leave that is more likely than not to be settled through conversion to defined benefit postemployment benefits should not be included in a liability for compensated absences. This statement requires that a liability for certain types of compensated absences—including parental leave, military leave, and jury duty leave—not be recognized until the leave commences. This statement also requires that a liability for specific types of compensated absences not be recognized until the leave is used. The requirements of this statement are effective for the fiscal years beginning after December 15, 2023, and all reporting periods thereafter. Earlier application is encouraged.

NOTE 3 – EQUITY IN POOLED CASH AND INVESTMENTS HELD IN CITY TREASURY

WWTS's cash as of June 30, 2023, is classified in the financial statements as follows (in thousands):

Unrestricted Equity in pooled cash and investments held in City Treasury:	$	488,348
Restricted cash held with fiscal agent:		2
Total:	$	488,350

(a) *Nature of Cash*

WWTS maintains all its cash as deposits in the City pooled cash and investments held in the City Treasury. The pool is managed by the City Treasurer and WWTS has an equity share in the pool as reflected in the enterprise fund's accounting records. Funds from the operating account are used to disburse funds for operations and capital outlays, under the direction of WWTS. The receipts account is in the name of the City and is under the custodianship of the City. All revenues collected by WWTS are deposited into the various WWTS Funds depending on the program they support.

A restricted cash account with a balance of $2,000 is maintained as part of a rate stabilization reserve for the City of San José's rate payers.

(b) *Pooled Cash and Investments held in the City Treasury*

The City Council adopted an investment policy ("Investment Policy") on April 2, 1985, related to the City cash and investment pool, which is subject to annual review and was reviewed and amended on March 14, 2023. The Investment Policy specifically prohibits trading securities for the sole purpose of speculating or taking an un-hedged position on the future direction of interest rates. Per the Investment Policy, the investments conform to Sections 53600 et seq. of the California Government Code, and the applicable limitations contained within the Investment Policy.

WWTS invests funds subject to the Investment Policy. According to the Investment Policy, WWTS is permitted to invest in the City cash and investment pool, the State of California Local Agency Investment Fund ("LAIF"), obligations of the U.S. Treasury or U.S. Government Agencies, time deposits, investment agreements, money market mutual funds invested in U.S. Government securities, along with various other permitted investments.

As of June 30, 2023, WWTS's share of the City cash and investment pool totaled $488.4 million. It is not possible to disclose relevant information about WWTS's separate portion of the cash and investment pool, as there are no specific investments belonging to WWTS itself. Information regarding the characteristics of the entire investment pool can be found in the City's June 30, 2023 ACFR. A copy of that report may be obtained by visiting the City's website at www.sanjoseca.gov or by contacting the City's Finance Department, 200 East Santa Clara Street, 13th Floor, San José, CA, 95113.

(c) *Interest Rate Risk*

Interest rate risk is the risk that changes in market rates will adversely affect the fair value of an investment. Generally, debt investments with fixed coupons for longer terms are subject to more variability in their value as a result of changing interest rates. The City manages its exposure to interest rate risk by capping the weighted average maturity of the investment portfolio at 2.5 years (or 913 days). Also, the City sets the maximum maturity for every investment at the time of purchase by asset class, with the longest not to exceed five years.

In practice, the City purchases a combination of short-term and long-term investments and times the cash flows to meet liquidity needs for operations. The weighted average days to maturity of the City's pooled cash and investments on June 30, 2023, was approximately 530 days.

(d) Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligations to the holder of the investment. When investing, the City applies the Prudent Investor Standard and acts with care, prudence and diligence to safeguard the principal, maintain liquidity and seek reasonable yields. The City's investment policy has strict rating requirements. The City manages credit risk by selecting high quality securities, diversifying the portfolio, and establishing monitoring procedures.

(e) Concentration of Credit Risk

It is not possible to disclose relevant information about WWTS's separate portion of the cash and investment pool, as there are no specific investments in the City's cash and investment pool belonging to WWTS itself. The Investment Policy sets forth the policies regarding concentration of credit risk.

As of June 30, 2023, the City's pooled investments in the City Treasury have investments that represent 5% or more of the total pooled investments in the following:

Federal Home Loan Bank	24.18%
Federal Home Loan Mortgage Corporation	10.52%
Federal National Mortgage Association	7.75%
Federal Farm Credit Bank	6.79%

NOTE 4 – ACCOUNTS RECEIVABLE

The accounts receivable balance on June 30, 2023, was $4.5 million, which consists of approximately $2.0 million in accrued interest and $2.5 million in other receivables, net of allowance. Management estimated the uncollectible amounts to be $0.4 million at June 30, 2023, using its calculation methodology based on historical experience and current market conditions. Approximately 95% of the City's Sewer Service and Use Charge revenues are billed and collected on the tax rolls through a Teeter Plan in place with the County. The County sends the revenue collected from the tax rolls to the City by a wire transfer of funds. The remaining 5% of the charges are billed directly to customers by the City.

NOTE 5 – CAPITAL ASSETS

The following is a summary of capital assets activity for the year ended June 30, 2023 (in thousands):

	Balance July 1, 2022	Additions	Deletions	Transfers	Balance June 30, 2023
Capital assets, not being depreciated					
Land	$ 41,588	$ -	$ -	$ -	$ 41,588
Construction in progress	591,538	119,356		(6,542)	704,352
Total capital assets, not being depreciated	633,126	119,356	-	(6,542)	745,940
Capital assets, being depreciated					
Buildings	449,892	354	-	-	450,246
Vehicles and equipment	248,594	2,321	(1,919)	6,542	255,538
Other improvements	662,510	12,753	-	-	675,263
Right-to-use assets: SBITA	-	643	-	-	643
Total capital assets, being depreciated	1,360,996	16,071	(1,919)	6,542	1,381,690
Less accumulated depreciation/amortization					
Buildings	(300,172)	(11,630)	-	-	(311,802)
Vehicles and equipment	(168,599)	(7,735)	1,860	-	(174,474)
Other improvements	(340,771)	(13,227)	-	-	(353,998)
Right-to-use assets: SBITA	-	(154)	-	-	(154)
Total accumulated depreciation/amortization	(809,542)	(32,746)	1,860	-	(840,428)
Total capital assets, net	$ 1,184,580	$ 102,681	$ (59)	$ -	$ 1,287,202

Depreciation and amortization expense was $32.7 million for the year ended June 30, 2023.

NOTE 6 – LONG-TERM DEBT OBLIGATIONS

(a) City of San José Financing Authority Subordinate Wastewater Revenue Notes

The City, the Financing Authority, and Wells Fargo Bank, National Association ("Wells Fargo") are parties to a Credit Agreement dated as of October 1, 2017 as amended by subsequent amendments, including a Fourth Amendment to Credit Agreement dated June 29, 2023 ("Credit Agreement") pursuant to which the Financing Authority has issued to Wells Fargo (i) a subordinate tax-exempt wastewater revenue note in an amount not to exceed $200 million and (ii) a subordinate taxable wastewater revenue note in an amount not to exceed $200 million outstanding at any one time. The Credit Agreement is an interim financing program under a three-year contract that enables the issuance of subordinate wastewater revenue notes that can be outstanding at any one time in an amount not to exceed $200 million to finance capital improvements at the Treatment Plant. Advances on the notes will be made on a regular basis to reimburse the City for capital costs incurred at the Treatment Plant. Total notes outstanding as of June 30, 2023, were $98,000.

In the event that the notes are not refinanced as anticipated, the Credit Agreement provides for repayment of the notes following the termination of the Credit Agreement. Assuming no events of default under the Credit Agreement have occurred and subject to the City and the Financing Authority making certain representations and warranties, if the Financing Authority fails to repay the unpaid notes on the Termination Date (as defined in the Credit Agreement), the unpaid notes will bear interest at the Bank Rate (as defined in the Credit Agreement) and will be amortized in equal quarterly installments over a period ending three years following the Termination Date of the Credit Agreement.

The source of repayment of the notes, including associated fee and interest costs, is installment payments made to the Financing Authority by the City from pledged net system revenues received by the City related to the Wastewater Treatment System, pursuant to a Subordinate Installment Purchase Contract, dated as of October 1, 2017, by and between the City and the Financing Authority, and City Resolution No. 80770, which amended and restated City Resolution No. 78382 (the "Master Resolution"), and which provides for the allocation and pledge of Net system Revenues to secure the payment of wastewater revenue obligations payable from Wastewater Net System Revenues. Payments on the notes are subordinate to payments on the 2022B Bonds and will be subordinate to payments on long-term bonds issued in the future.

On June 20, 2023, the City Council and Financing Authority Board approved the Fourth Amendment to the Credit Agreement and a related Fourth Amended and restated Fee Letter Agreement with Wells Fargo, which extended the Termination Date of the Credit Agreement through October 16, 2026, and reduced the aggregate principal amount of the notes that can be outstanding at any one time from $300 million to $200 million.

Events of default under the Credit Agreement by the City or the Financing Authority include: (i) non-payment; (ii) default under any the Related Documents (as defined in the Credit Agreement); (iii) bankruptcy; (iv) a breach of various covenants, including financial covenants to maintain 115% of Debt Service on Parity Obligations (as defined in the Master Resolution) and 110% of Debt Service on Parity Obligations and Subordinate Obligations (as defined in the Master Resolution); (v) breach of representations and warranties; (vi) default with respect to a Material Debt (as defined in the Credit Agreement); (vii) final judgment of $10 million or more against the City or the Financing Authority payable from System Revenues; (viii) City or Financing Authority contesting validity of obligations related to payment of the notes or a determination by a court of competent jurisdiction that the obligations of the City or the Financing Authority related to payment of the notes are not valid or binding; (ix) invalidity of a Lien (as defined in the Credit Agreement) created by the Credit Agreement or the Related Documents; and (x) ratings events including downgrades by any of Moody's, S&P, Fitch, or Kroll of its long term ratings on long-term debt that constitutes Parity Obligations under the Master Resolution below "A3," "A-," "A-" or "A-," respectively.

Wells Fargo has certain rights and remedies upon the occurrence and continuance of specified events of default in the Credit Agreement including (i) by notice to the Financing Authority and the City to terminate Wells Fargo's commitment to make advances under the notes; (ii) exercise rights and remedies under the Related Documents (as defined in the Credit Agreement); (iii) exercise rights and remedies at law or in equity; (iv) bring action in mandamus or other action or proceeding to compel performance by the Financing Authority and/or the City under the Master Resolution or Installment Purchase Agreement; and (v) appointment of a trustee to protect and enforce Wells Fargo's rights.

In addition to these rights and remedies, Wells Fargo has the right to accelerate repayment of the notes, which is automatic in the case of bankruptcy. The Credit Agreement includes subjective acceleration provisions in the event that: (i) City fails to comply with laws and contracts, which in the reasonable opinion of Wells Fargo, would materially adversely affect the rights of Wells Fargo or the City's ability to perform its obligations under the Credit Agreement; (ii) either the City or the Financing Authority fails to promptly pay taxes, assessments or government charges which if not paid would likely result in a material adverse effect (defined below); and (iii) either the City or the Financing Authority breaches its covenant to promptly inform Wells Fargo of an event that could reasonably be expected to result in a material adverse change (defined below) or which could be expected to result in a material adverse effect. Under the Credit Agreement, material adverse change and material adverse effect are defined as any event or change, in Wells Fargo's sole discretion, which materially and adversely affects (i) the enforceability of the Credit Agreement or any related document; (ii) the ability of the City or the Financing Authority to perform their respective obligations under the Credit Agreement or any related document; or (iii) Wells Fargo's rights and remedies.

As of June 30, 2023, the Financing Authority has drawn $98,000 of the aggregated principal amount of $200 million available under the credit agreement as follows (in thousands).

July 1, 2022	Additions	Deletions	June 30, 2023	Interest Rate
$ 236,870	$ 63,228	$ (300,000)	$ 98	4.41%

(b) City of San José Financing Authority Wastewater Revenue Bonds Series 2022B (Green Bonds – Climate Bond Certified)

On December 15, 2022, the City of San José Financing Authority issued $268.4 million of the Wastewater Revenue Bonds, Series 2022B (Green Bonds – Climate Bond Certified) ("2022B Bonds") to refinance the Financing Authority's outstanding Subordinate Wastewater Revenue Notes, Series A. The 2022B Bonds were issued as a long-term fixed-rate debt structure with level debt service. The underlying ratings at issuance and as of June 30, 2023, by S&P, Fitch, and Kroll are AAA, AAA, and AAA, respectively.

The Financing Authority issued 2022B Bonds to refinance the Financing Authority's outstanding Subordinate Wastewater Revenue Notes, Series A. The 2022B Bonds were issued as a long-term fixed-rate debt structure with level debt service. The Financing Authority issued the Bonds pursuant to a master indenture with a trustee bank ("Trustee"). The Master Indenture and the City specify the events of default as follows: (i) failure to

pay debt service, or redemption premium when due; (ii) failure to comply with covenants and conditions of the Master Indenture and such default shall have continued for a specified period of days following the Financing Authority's receipt from the Trustee; (iii) bankruptcy or similar debtor relief proceedings; (iv) or payment of any installment payment under the master installment purchase contract. Upon an event of default under the Master Indenture, the Trustee may, and upon the written request of the holders of a majority in principal amount of the 2022B Bonds then outstanding, and in each case so long as the Trustee is indemnified to its satisfaction therefore, shall proceed to protect or enforce its rights or the rights of the holders of 2022B Bonds hereunder by a suit in equity or action at law that the Trustee shall deem appropriate in support of any of its rights and duties.

The bonds remaining amount are due in annual installments of $3.95 million to $16.85 million, bearing an interest rate of 5%. The bonds mature on November 1, 2052.

The following is a summary of the bonds payable activity for the year ended June 30, 2023 (in thousands):

	July 1, 2022	Additions	Reductions	June 30, 2023	Amounts Due Within One Year
Revenue Bonds	$ -	$ 268,355	$ -	$ 268,355	$ 3,950
Issuance Premiums	-	32,748	(591)	32,157	1,092
	$ -	$ 301,103	$ (591)	$ 300,512	$ 5,042

The annual requirements to amortize the bonds outstanding as of June 30, 2023, are as follows (in thousands):

Year Ending June 30,	Principal	Interest
2024	$3,950	$13,319
2025	4,155	13,116
2026	4,365	12,903
2027	4,590	12,680
2028	4,825	12,444
2029-2033	28,105	58,244
2034-2038	36,095	50,260
2039-2043	46,345	40,006
2044-2048	59,510	26,840
2049-2053	76,415	9,934
Total	$268,355	$249,746

NOTE 7 – DEFINED BENEFIT RETIREMENT PLAN

(a) General Information

The City sponsors and administers a single employer defined benefit retirement system, Federated City Employees' Retirement System ("FCERS") which, with the exception of certain unrepresented employees, covers all full-time and certain part-time employees of the City. The FCERS provides general retirement benefits under a single employer Defined Benefit Pension Plan, as well as the Postemployment Healthcare Plan. All full-time and certain part-time employees in the WWTS are in the FCERS. The FCERS is administered by the Chief Executive Officer of the Office of Retirement Services, an employee of the City, who serves at the pleasure of the Board of Administration for the FCERS.

The separately issued annual report of FCERS, together with various chapters in Title 3 of the City Municipal Code, provides more detailed information about the FCERS, and may be obtained from the City of San José Office of Retirement Services, 1737 North First Street, Suite 600, San José, California 95112 or at http://www.sjretirement.com. The WWTS presents the related defined benefit disclosures of FCERS as a participant in a cost-sharing arrangement with the City.

(b) Benefits Provided

FCERS provides general retirement benefits including pension, death, and disability benefits to members. FCERS benefits are based on average final compensation, years of service, and cost of living increases as specified by the City Municipal Code. The contribution and benefit provisions and all other requirements are established by the City Charter and the City Municipal Code. Information regarding disability and death benefits can be found in the annual reports of the FCERS and on the Office of Retirement Services website.

Effective June 18, 2017, the FCERS has several Tiers as follows:

FCERS Membership Tiers

Tier	Hire Date	Pension	Defined Benefit Retiree Healthcare (Medical/Dental)
Tier 1	• On or before September 29, 2012 • Former Tier 1 rehired on or after June 18, 2017 who did not take a return of contributions	Tier 1	Medical/Dental(2)(4)
Tier 1 Rehire	• Former Tier 1 rehired on or after September 30, 2012 through June 17, 2017	Tier 1(1)	Medical/Dental(2)(4)(5)
Tier 1 Classic	• "Classic" membership with California Public Employees' Retirement System ("CalPERS")/reciprocal agency hired on or after September 30, 2012, but before September 27, 2013	Tier 1(6)	Medical/Dental
	• "Classic" membership with CalPERS/reciprocal agency hired on or after September 27, 2013	Tier 1(6)	Not Eligible(3)(4)
Tier 2 (or Tier 2A)	• Hired/rehired/reinstated on or after September 30, 2012, but before September 27, 2013	Tier 2	Medical/Dental(2)(4)
Tier 2B	• Hired/rehired/reinstated after September 27, 2013 and have not met City's eligibility for retiree healthcare	Tier 2	Not Eligible(3)(4)

(1) Employees in these tiers are responsible for 50% of the amortization costs for having any prior years of service in Tier 2 changed to Tier 1.

(2) Employees in these tiers were provided a one-time irrevocable election to remain in the Federated Healthcare Plan or opt into the Federated Voluntary Employees' Beneficiary Association ("VEBA"). Employees that opted into the Federated VEBA are not eligible for Federated Healthcare Plan. The Federated VEBA was implemented on March 25, 2018.

(3) Employees in these tiers were mandatorily placed into the Federated VEBA.

(4) Unrepresented employees were eligible to opt into the Federated VEBA but are not eligible to make ongoing contributions to the Federated VEBA.

(5) All Tier 1 rehires formerly in Tier 2B and Tier 2C who opted to remain in the Federated Healthcare Plan began contributing to the Federated Healthcare Plan on March 25, 2018.

(6) Employees in these tiers are responsible for 50% of the amortization costs for any prior years of service in Tier 2 changed to Tier 1 for all employees in the "Classic" tier regardless of start date.

The following tables summarize the benefits for FCERS members:

	FCERS			
	Tier 1 (1)	Tier 1 Classic (2)	Tier 2A (3)	Tier 2B (4)
Pension				
Service required to leave contributions in retirement system	5 years		5 years Federated City Service (Year of Service = 2080 hours worked in the applicable 12-month period)	
Service Retirement				
Age/Years of Service	55 with 5 years service 30 years service at any age		62 years with 5 years Federated City Service May retire on or after 55 years with 5 years Federated City Service. A reduction factor of 5% per year for each year between age 55 and the Tier 2 member's age at retirement before age 62, prorated to the closest month.	
"Deferred Vested" retirement	55 with 5 years service (This applies to members who separate from City service before retirement and leave their contributions in the retirement system.)		May commence on or after 55 years with 5 years Federated City Service with actuarial equivalent reduction (This applies to members who separate from City service before retirement and leave their contributions in the retirement system.) Can begin at age 55 with reduction factor of 5% per year for each year between age 55 and the Tier 2 member's age at retirement before age 62, prorated to the closest month.	
Allowance	2.5% x Years of Service x Final Compensation (75.0% max) Final Compensation is the highest average monthly earnable pensionable salary during 12 consecutive months, capped at 108% of the second highest 12 comsecutive months. **Tier 1**:If separation takes place prior to July 1, 2001, Final Compensation is highest average monthly salary during 36 consecutive months **Tier 1 Classic:** If separation takes place on or after July 1, 2001, Final Compensation is highest average monthly salary during 12 consecutive months. If seperation takes place prior to July 1, 2001, Final Compensation is highest average monthly salary during 36 consecutive months.		2.0% x Years of Federated City Service x Final Compensation (70.0% max) "Final Compensation" is the average monthly (or biweekly) base pay for the highest 3 consecutive Years of Federated City Service Excludes premium pay or any other forms of additional compensation	
Disability Retirement (Service Connected)				
Minimum Service	None		None	
Allowance	40% of Final Compensation plus 2.5% x Years of Service in excess of 16 years x Final Compensation (Maximum 75% of Final Compensation)		2% x Years of Federated City Service x Final Compensation (Minimum of 40.0% and maximum of 70.0% of Final Compensation)	

FCERS (Continued)

	Tier 1 (1) / Tier 1 Classic (2)	Tier 2A (3) / Tier 2B (4)
Disability Retirement (Non-Service Connected)		
Minimum Service	5 years	5 years
Allowance	**Tier 1:** 20% of Final Compensation for up to 6 years of service. Add 2% for each year of service in excess of 6 years but less than 16 years. Add 2.5% for each year of service in excess of 16 years of services. (Maximum 75% of Final Compensation). For those who entered the Retirement System on 8/31/98 or before, the calculation is as follows: 40% of Final Compensation plus 2.5% x Years of Service in excess of 16 years x Final Compensation (Maximum 75% of Final Compensation) If under 55 years old, subtract 0.5% for every year under age 55 **Tier 1 Classic:** 40% of Final Compensation plus 2.5% years of service in excess of 16 years x Final Compensation (Maximum 75% of Final Compensation) If under 55 years old, subtract 0.5% for every year under age 55. For those who entered the System on 9/01/98 or later, the calculation is as follows: 20% of Final Compensation for up to 6 year of service. Add 2% for each year of service in excess of 6 years but less than 16 years. Add 2.5% for each year of service in excess of 16 years of service(Maximum 75% of Final Compensation)	2% x Years of Federated City Service x Final Compensation. (Minimum of 20% and maximum of 70.0% of Final Compensation)
Reciprocity		
Reciprocity	As of December 9, 1994, the City of San José Federated City Employees' Retirement System adopted a reciprocal agreement with CalPERS. This may result in improved benefits for members who transfer between this retirement system and CalPERS or certain other public agency retirement systems that also have reciprocal agreements with CalPERS. Final eligibility for reciprocity is determined at the time of retirement.	
Cost-of-Living Adjustments (COLA)		
Cost-of-Living adjustments	Retirees are eligible for a 3% annual cost-of-living adjustment (COLA). Regular COLAs are compounded and paid each April. There is no prorating of COLA.	Retirees are eligible for annual cost-of-living adjustment (COLA) limited to the lesser of the increase in the Consumer Price Index (San José-San Francisco-Oakland, U.S. Bureau of Labor Statistics index, CPI-U, December to December), or a back loaded 2.0% COLA per fiscal year. The back loaded COLA shall be calculated as follows: i. Service at retirement of 1-10 years: 1.25% per year ii. Service at retirement of 1-10 years and hired before June 16, 2017: 1.5% iii. Service at retirement of 11-20 years: 1.5% per year iv. Service at retirement of 21-25 years: 1.75% per year v. Service at retirement of 26 years and above: 2.0% per year COLAs are applied annually on April 1st. The first COLA will be prorated based on the number of months retired prior to April 1st. Partial months are not included in the proration.

(1) Federated Tier 1 applies to employees hired on or before September 29, 2012.

(2) Employees with "Classic" membership from a CalPERS or reciprocal agency hired by the City of San José, on or after June 18, 2017. A CalPERS "Classic" member is a member who previously worked for a CalPERS or other reciprocal agency and meets the following criteria: 1. First established CalPERS membership or membership in a CalPERS reciprocal agency prior to January 1, 2013, 2. AND is hired by the City of San José after a break in service of less than six months 3. AND did not have concurrent (overlapping) service with the other agency. City of San José Reciprocity Election Form must be submitted within thirty (30) days of the first day of employment with the City. Employees in Tier 1 Classic are not eligible for the defined benefit retiree healthcare plan.

(3) Tier 2A applies to employees hired between September 30, 2012 and September 27, 2013.

(4) Tier 2B are employees who were newly hired on or after September 27, 2013.

(c) Contributions

This subsection provides information related to contributions paid by WWTS for pension benefits provided by FCERS.

Under GASB Statement No. 68, the City's and the participating employees' contributions to the Defined Benefit Pension Plan are based upon an actuarially determined percentage of each employee's pensionable and earnable salary to arrive at an actuarially determined contribution ("ADC") sufficient to provide adequate assets to pay benefits when due. The contribution requirements are established by City Charter Articles XV and XV-A, and Title 3 of the San José Municipal Code.

The contribution rates for the period July 1, 2022, through June 30, 2023, were established in accordance with actuarially determined requirements computed through actuarial valuations performed as of June 30, 2021. The contribution rates in effect and the amounts contributed to the pension plan for the year ended June 30, 2023, are as follows:

	City			Participants [2]	
Defined Benefit Pension Plan	**Tier 1**	**Minimum Dollar Amount (3)**	**Tier 2**	**Tier 1**	**Tier 2**
Actuarial Rate:					
06/25/23-06/30/23	20.16%		8.01%	7.34%	8.01%
06/26/22-06/26/23 [1]	20.32%	$ 162,602	8.13%	7.41%	8.13%

(1) *The actual contribution rates paid by the City for year ended June 30, 2023 differed for Tier 1 due to the City funding the actuarially determined contribution amount based on the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll, for the fiscal year.*

(2) *Under Measure F, certain Tier 2 members who had previous Tier 1 service or prior service with a reciprocal employer were reclassified to Tier 1. Ordinance No. 30183, which became effective January 4, 2019, amended the Municipal Code to reflect these changes. Effective March 24, 2019, reclassified Tier 1 members paid an additional 3.00% in contributions for the year ended June 30, 2023. Classic Tier 1 members paid an additional 1.09% in contributions for the year ended June 30, 2023.*

(3) *Contributions are structured as a normal cost, plus a payment on the Unfunded Actuarial Liability (UAL). Tier 1 City contributions are administered as a contribution rate plus a minimum dollar amount based on actuarial payroll.*

(d) Net Pension Liability, Pension Expense and Deferred Outflows/Inflows of Resources Related to Pension

As of June 30, 2023, the WWTS reported $211.2 million of net pension liability ("NPL") for its proportionate share of the City's NPL. The WWTS portion of the NPL was based on the WWTS's share of its contributions to the FCERS relative to the total City's contributions to FCERS. The NPL of the FCERS was measured as of June 30, 2022, and the total pension liability (TPL) for the FCERS used to calculate the NPL was determined by the actuarial valuation for FCERS as of June 30, 2021, and rolled forward to June 30, 2022, using standard update procedures. The WWTS's percentage of the City's NPL for the FCERS NPL was 12.94% as of June 30, 2023, which changed from 14.11% as of June 30, 2022.

The discount rate used to measure the total pension liability was 6.625% for the valuation dated June 30, 2021. It is assumed FCERS members' contributions and City's contributions will be made based on the actuarially determined rates based on the funding policy of the FCERS Board. Based on those assumptions, the FCERS' fiduciary net position is expected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Proportionate Share of the Net Pension Liability to Changes in Discount Rates

The following presents the WWTS proportionate share of the net pension liability, calculated using the discount rate of 6.625% in effect as of the measurement date, as well as what the proportionate share of the net pension liability would be if it was calculated using discount rates that are one percentage point lower (5.625%) or one percentage point higher (7.625%) than the rate used for the FCERS plan (in thousands):

FCERS sensitivity analysis	1% Decrease (5.625%)	Measurement Date Discount Rate (6.625%)	1% Increase (7.625%)
Proportionate share of net pension liability	$ 279,166	$ 211,190	$ 155,626

Pension Expense and Deferrals

For the year ended June 30, 2023, WWTS recognized a pension benefit of $3.8 million and reported deferred outflows and inflows of resources related to pension from the following sources (in thousands):

	Deferred Outflows of Resources	Deferred Inflows of Resources
Contributions subsequent to measurement date	$ 25,803	$ -
Difference between expected and actual experience	6,023	916
Changes in assumptions	3,618	97
Net difference between projected and actual earnings on pension plan investments	-	1,153
	$ 35,444	$ 2,166

As of June 30, 2023, WWTS reported $25.8 million as deferred outflows of resources related to contributions subsequent to the measurement date for the FCERS, which will be recognized as a reduction of the net pension liability in the year ending June 30, 2024. Other amounts reported as deferred outflows of resources related to pensions will be recognized as pension expense, as shown in the tables above.

Amounts reported as deferred outflows and deferred inflows of resources will be recognized in pension expense as follows (in thousands):

Fiscal Year Ending June 30:	Deferred Outflows/(inflows) of Resources
2024	$ 987
2025	300
2026	(4,114)
2027	10,302
	$ 7,475

Recognition of Deferred Outflows and Deferred Inflows of Resources

Gains and losses related to changes in total pension liability and fiduciary net position are recognized in pension expense systematically over time.

One fifth of the net earnings is recognized in the first year when the gain or loss occurred for the difference between projected and actual earnings on pension plan investments. The other deferred amounts are amortized over the expected average remaining service lifetime. The remaining amounts are categorized as deferred outflows and deferred inflows of resources related to pension and are to be recognized in future pension expense.

The recognition period differs depending on the source of the gain or loss:

Net difference between projected and actual earnings on pension plan investments	5 years
All other amounts	Expected average remaining service lifetime (“EARSL”) (5.0 years at June 30, 2022 measurement date)

Long-term Expected Rate of Return on Plan Investments

The assumption for the long-term expected rate of return on FCERS investments of 6.625% for the valuation date at June 30, 2021, was selected by estimating the median nominal rates of return based on long-term capital market assumptions adopted by the FCERS Board, including nominal expected rates of return for each of the asset classes, and reducing the estimated median by a margin so that there is estimated to be a greater than 50 percent probability of achieving the returns.

The FCERS’ Defined Benefit Pension Plan investment asset allocation is as follows:

	FCERS	
	Target Asset Allocation	**Long-term Expected Real Rate of Return**
Public Equity	49%	5.1%
Private Equity	8%	7.4%
Investment Grade Bonds	8%	0.2%
Core Real Estate	5%	3.8%
Immunized Cash Flows	5%	-0.5%
Venture/ Growth Capital	4%	7.9%
Growth Real Estate	3%	6.3%
Emerging Market Bonds	3%	2.2%
Private Debt	3%	5.0%
Market Neutral Strategies	3%	2.2%
Private Real Assets	3%	5.8%
Long-term Government Bonds	2%	0.6%
Treasury Inflation-protected Securities	2%	0.2%
High Yield Bonds	2%	2.2%
Cash and Cash Equivalents	N/A	-0.5%

(e) Actuarial Methods and Assumptions

The significant actuarial methods and assumptions used to compute the total pension liability (asset) as of the measurement date June 30, 2022, are from the actuarial valuation report with a valuation date of June 30, 2021, and rolled forward to June 30, 2022, using standard update procedures by the actuary for the plan.

Description	FCERS Method/Assumption
Measurement date	June 30, 2022
Valuation date	June 30, 2021
Inflation rate	2.25%
Discount rate	6.625% per annum (net of investment expenses) The Board expects a long-term rate of return of 7.1% based on Meketa's 2021 20-year capital market assumptions and the Retirement System's current investment policy. A margin for adverse deviation was used to improve the probability of achieving the discount rate
Post-retirement mortality	
Healthy retirees:	0.995 for males and 0.960 for females, times the 2010 Public General Mortality Table (PubG-2010)
Healthy non-annuitant:	0.992 for males, and 1.084 for females times the 2010 Public General Mortality Table (PubG-2010) for healthy employees.
Disabled retirees:	1.051 for males and 0.991 for females, times the CalPERS 2009 Ordinary Disability Mortality Table
Rates of service retirement, withdrawal, death, disability retirements	Based on current experience
Salary increases	
Wage Inflation	The base wage inflation assumption of 3.00%
Merit Increase	Merit/longevity increase based on years of service ranging from 3.75% at hire to 0.10% for members with 15 or more years of service
Cost-of-Living Adjustment	Tier 1 – 3% per year Tier 2 – 1.25% to 2.0% depending on years of service

Payable to the Pension Plan

As of June 30, 2023, the WWTS has no outstanding contributions payable to the pension plan.

NOTE 8 – OTHER POST EMPLOYMENT BENEFITS (OPEB)

(a) General Information

In addition to the FCERS Defined Benefit Pension Plan, the City also sponsors and administers a single employer FCERS Postemployment Healthcare Plan, which includes an Internal Revenue Code ("IRC") 115 Trust. The Postemployment Healthcare Plan covers eligible full-time and certain part-time employees in the Regional Wastewater Facility and are accounted for in the Pension Trust Funds of the City.

Generally, the defined benefit Postemployment Healthcare Plan provides medical and dental benefits to eligible retirees and their beneficiaries. Benefits are 100% of the premium cost for the lowest priced medical insurance plan available to an active City employee, and 100% of the premium cost for a dental insurance plan available to an active City employee.

Per the terms of the framework discussed in the Note 7, the City established a VEBA for retiree healthcare for the members of the FCERS in FY 2018. The City does not make contributions into the VEBA and the VEBA is not subject to the jurisdiction of the FCERS Board.

The Internal Revenue Service approved allowing eligible employees who are rehired by the City during calendar years 2018 through 2022 to opt into the applicable VEBA and transfer the retiree healthcare contributions from the Postemployment Healthcare Plan to their individual VEBA accounts.

The City issues a publicly available financial report that may be obtained from the Office of Retirement Services, 1737 North First Street, Suite 600, San Jose, CA 95112, or at https://www.sjretirement.com.

(b) Contributions

Contribution amounts to the Postemployment Healthcare Plan for both the City and the participating members are based upon agreements between the City and the bargaining units. With the implementation of Measure F, ADC was calculated beginning with the year ended June 30, 2019.

On June 24, 2008, the City Council adopted Ordinance No. 28332 amending Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for postemployment healthcare benefits to FCERS.

Subsequently, in October 2014, the Board of Administration of FCERS approved implementing an incremental reduction approach to determining the "actuarial equivalence" for the City's prefunding of its contribution when the economic expansion has exceeded 58 months in duration and/or the S&P 500 has returns in excess of 130%. The incremental reduction is 15% per year, up to a maximum of 45%. In March 2022, the Board of Administration for FCERS approved a modification to the incremental reduction approach that added market valuations as an additional criterion for triggering a reduction in the prefunding discount rate.

The City elected to prefund its actuarially determined OPEB contributions for the year ended June 30, 2023, using the reductions in the discount rate mentioned above.

The FCERS Board on February 15, 2018, approved a contribution policy for the Postemployment Healthcare Plan that sets the City's contribution as a flat dollar amount.

(c) Funding Policy

Historically, member and City contributions to the Postemployment Healthcare Plan were negotiated through collective bargaining and were not actuarially determined. Until the City entered into agreements with various bargaining groups in 2009 and prior to implementation of Measure F, contributions for the health and dental benefits for both the City and the participating employees of the Postemployment Healthcare Plan were based upon an actuarially determined percentage of employees' base salary sufficient to provide adequate assets to pay benefits when due over the next 15 years for FCERS. From 2009 until the implementation of Measure F, the City had been in the process of phasing in payment of the annual required contribution ("ARC") for the retiree health and dental benefits provided by Postemployment Healthcare Plan as calculated pursuant to GASB Statement No. 43 and

GASB Statement No. 45 then in effect. However, the contribution rates for the City and members of the Postemployment Healthcare Plan were capped before the full ARC was reached.

The annual contribution costs for the Postemployment Healthcare Plan benefits are allocated to both the City and the active employee members. Contributions to the Postemployment Healthcare Plan for both the City and the participating members are based upon agreements between the City and the bargaining units. With the implementation of Measure F, member contributions are fixed as a percentage of pay and the City's contribution toward the explicit subsidy (premium subsidy) is an ADC determined by the Postemployment Healthcare Plan. The ADC for the Postemployment Healthcare Plan is the normal cost plus the amortization payment on the unfunded actuarial liability, less expected member contributions. The City has an option to limit its ADC for the Postemployment Healthcare Plan to a fixed percentage of the payroll of all active members of the pension plan. The ADC for the Postemployment Healthcare Plan is calculated beginning with FY 2019.

The City will pay the implicit subsidy on a pay-as-you go basis as part of active health premiums. An implicit subsidy for retiree health benefits exists because the medical experience for retirees under age 65 are pooled with the experience for active employees, thereby resulting in a lowering of the premium paid for retirees under age 65. The implicit subsidy is included in the actuarial valuation of the Postemployment Healthcare Plan. The implicit subsidy is shown as both a contribution and payment from the Postemployment Healthcare Plan. However, the implicit subsidy is not actually contributed to or paid from the Postemployment Healthcare Plan. Rather, it is paid directly by the City on a pay-as-you-go basis as a part of active member health plan premiums. The actuary for the Postemployment Healthcare Plan separately calculates the total unfunded actuarial liability being the aggregate unfunded actuarial liability for both implicit and explicit subsidies, and the unfunded actuarial liability for only the explicit subsidy. The unfunded actuarial liability for the explicit subsidy is used to calculate the City ADC to the Postemployment Healthcare Plan. As of March 25, 2018, members remaining in the FCERS Postemployment Healthcare Plan contribute 7.5% of pay.

The contributions to the FCERS Postemployment Healthcare Plan for the WWTS and the participating employees for the year ended June 30, 2023, are shown below:

	City - Board Adopted		Member with Healthcare
	Tier 1	Tier 2	Tier 1 and Tier 2
Actuarial Rate:			
Postemployment Healthcare Plan:	*	*	
07/01/2022 - 06/30/2023			7.50%

*In February 2018, the Board approved the contribution policy that sets the City healthcare beginning with fiscal year 2019. The City's contribution for the Postemployment Health Plan during 2023 was a flat amount of $22,997,000. $18,318,000 in regular contributions and $5,370,000 in implicit subsidy, and ($691,000) in adjustments and accruals.

(d) Net OPEB Liability

The WWTS's reported $50.1 million of net OPEB liability for the Postemployment Healthcare Plan. It is measured as the total OPEB liability, less the plan fiduciary net position as of the June 30, 2022, measurement date. The WWTS's net OPEB liability as of June 30, 2023, for FCERS Postemployment Healthcare Plan is measured as of June 30, 2022, using an annual actuarial valuation as of June 30, 2021, and rolled forward to June 30, 2022, using standard update procedures by the actuary for the plan. In summary, the WWTS proportionate share of the City's net OPEB liability at June 30, 2023 is 14.87%. Last year at June 30, 2022, the rate was 15.46%.

Description	**FCERS Method/Assumption**
Measurement date	June 30, 2022
Valuation date	June 30, 2021
Actuarial cost method:	Entry age normal, level of percentage of pay
Actuarial assumptions:	
Discount rate	6.00% per year. The Board expects a long-term rate of return of 6.1% based on Meketa's 20-year capital market assumptions and the System's current investment policy.
Inflation rate	2.25%
Merit Increase	Merit component added based on an individual's years of service ranging from 3.75% at hire to 0.10% for members with 15 or more years of service
Wage Inflation Rate	3.00%
Rate of Mortality*	Mortality is projected on a generational basis using the MP-2020 scale
Pre-Retirement Turnover*	Please see below table
Healthcare Trend Rate – Medical	The valuation assumes that future medical inflation will be at a rate of 7.49% to 3.78% per annum graded down over a 55-year period for medical pre-age 65 and 4.15% to 3.78% per annum for medical post-age 65. For fiscal year beginning 2022, actual calendar year 2022 premiums are combined with a trend assumption for calendar year 2023, actual premiums are used
Healthcare Trend Rate – Dental	Dental inflation is assumed to be 3.50%

* Actuarial Methods and Assumptions – FCERS Mortality Rates

Category	Male	Female
Healthy Annuitant	0.995 times the 2010 Public General Mortality Table (PubG-2010) for Healthy Retirees	0.960 times the 2010 Public General Mortality Table (PubG-2010) for Healthy Retirees
Healthy Non-Annuitant	0.992 times the 2010 Public General Mortality Table (PubG-2010) for Healthy Retirees	1.084 times the 2010 Public General Mortality Table (PubG-2010) for Healthy Retirees
Disabled Annuitant	1.051 times the CalPERS 2009 Ordinary Disability Mortality Table	0.991 times the CalPERS 2009 Ordinary Disability Mortality Table

Samples of Rates of Termination are shown in the following Table:

Rate of Termination	
Year	Percent
0	15.00%
1	12.75%
2	11.75%
3	10.75%
4	9.75%
5	8.75%
6	7.75%
7	6.50%
8	5.50%
9	4.75%
10	4.25%
11	4.00%
12	3.75%
13	3.50%
14	3.25%
15+	3.25%

Terminations do not apply once a member is eligible for retirement.

Long-term Expected Rate of Return on Plan Investments

The assumption for the long-term expected rate of return on OPEB plan investments of 6.00% for the valuation year ended June 30, 2021 was selected by estimating the median nominal rate of return based on long-term capital market assumptions adopted by the FCERS Board, including nominal expected rates of return for each asset class, and reducing the estimated median by a margin so that there is estimated to be a greater than 50 percent probability of achieving the return.

Best estimates of geometric real rates of return for each major asset class included in FCERS's target asset allocation as of the June 30, 2022, measurement date is summarized in the following table.

Asset Class	Target Asset Allocation	Long-Term Expected Real Rate of Return
Public equity	58.0%	5.0%
Investment grade bonds	14.0%	0.2%
Core real estate	12.0%	3.8%
Short-term Investment grade bonds	6.0%	-0.3%
Commodities	5.0%	2.3%
Long-term Investment grade bonds	5.0%	0.6%

Discount Rate for FCERS

The discount rate used to measure the total OPEB liability was 6.00% for the measurement year ended June 30, 2022, and is based on the long-term expected rate of return on investments. It is assumed that FCERS member contributions remain fixed at 7.5% of pay for employees eligible to participate in the Postemployment Healthcare Plan and the City contributes the actuarially determined contribution toward the explicit subsidy up to a maximum of 14% of the total payroll. In addition, the City pays the implicit subsidy on a pay-as-you-go basis. Based on those assumptions, the FCERS' fiduciary net position is expected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on OPEB plan investments for FCERS was applied to all periods of projected benefit payments to determine the total OPEB liability.

Sensitivity of the Net OPEB Liability to Changes in Discount Rate

The following presents WWTS's proportionate share of the City's net OPEB liability for FCERS, as well as what the WWTS's proportionate share of the net OPEB liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the measurement date rate (in thousands).

(Dollar Amounts in Thousands) FCERS sensitivity analysis	1% Decrease (5.00%)	Measurement Date Discount Rate (6.00%)	1% Increase (7.00%)
Proportionate share of net OPEB liability	$ 64,622	$ 50,102	$ 38,287

Sensitivity of the Net OPEB Liability to Changes in the Health Care Cost Trend Rate

The following presents the WWTS's proportionate share of the City's net OPEB liability for FCERS, as well as what the WWTS's proportionate share of the net OPEB liability would be if it were calculated using a health care cost trend rate that is one percentage point lower or one percentage point higher than the measurement date rate (in thousands).

(Dollar Amounts in Thousands) FCERS sensitivity analysis	1% Decrease	Measurement Date Health Care Cost Trend Rates	1% Increase
Proportionate share of net OPEB liability	$ 36,960	$ 50,102	$ 66,303

Recognition of Deferred Outflows and Deferred Inflows of Resources for FCERS

Gains and losses related to changes in total OPEB liability and fiduciary net position are recognized in OPEB expense systematically over time. One fifth of the net earnings is recognized in the first year when the gain or loss occurred for the difference between projected and actual earnings on OPEB plan investments. The other deferred amounts are amortized over the expected average remaining service lifetime. The remaining amounts are categorized as deferred outflows and deferred inflows of resources related to OPEB and are to be recognized in future OPEB expense.

The recognition period differs depending on the source of the gain or loss:

Net difference between projected and actual earnings on OPEB plan investments	5 Years
All other amounts	Expected average remaining service lifetime ("EARSL") (5.0 Years at June 30, 2022 measurement date)

For the year ended June 30, 2023, WWTS recognized OPEB benefit of $2.2 million and reported deferred outflows and inflows of resources related to OPEB from the following sources (in thousands):

(Dollar Amounts in Thousands)	**Deferred Outflows of Resources**	**Deferred Inflows of Resources**
Contributions subsequent to measurement date	$ 3,419	$ -
Difference between expected and actual experience	-	12,486
Changes in assumptions	8,328	-
Net difference between projected and actual earnings on pension plan investments	7,216	-
	$ 18,963	$ 12,486

The $3.4 million reported as deferred outflows of resources related to contributions subsequent to the June 30, 2022, measurement date, which will be recognized as a reduction to the net OPEB liability during the year ending June 30, 2024.

Other amounts reported as deferred outflows/(inflows) of resources related to OPEB will be recognized as expense as follows (in thousands):

Fiscal Year Ending June 30:	Deferred Outflows/(inflows) of Resources
2024	$ 752
2025	454
2026	91
2027	1,761
	$ 3,058

NOTE 9 – POLLUTION REMEDIATION

As part of the wastewater treatment process, the water is filtered, treated, and the solids removed. The solid material byproduct is called biosolids and placed in lagoons in the Treatment Plant buffer lands where the biosolids are dredged and then dried to reduce the water content for eventual off-site disposal.

In the 1960s and 1970s, biosolids from the wastewater were kept on the Treatment Plant buffer lands and stored in lagoons over about 200-acres. These biosolids, estimated to be approximately 750,000 cubic yards, were tested for disposal purposes, and found to contain several metals that characterized the biosolids as hazardous waste. The San Francisco Bay Regional Water Quality Control Board ("Water Board") issued an order in August 2019 to require the City to remediate the biosolids. The City received approval from the Water Board to consolidate the biosolids into a smaller footprint (about 25 acres) and cap with clean soil. The City has decided to do the work in two phases. Phase 1 was completed in late 2020 at cost of about $6.2 million. The remaining biosolids will be placed in the consolidated area in a second phase implemented over several years. The project is expected to be completed in 2026 or 2027. The estimated cost for the Phase 2 removal is currently $28.0 million.

NOTE 10 – COMMITMENTS

Treatment Plant Master Plan

In November 2013, the City Council approved the PMP, a 30-year planning-level document focused on long-term rehabilitation and modernization of the Treatment Plant. The PMP recommends more than 114 capital improvement projects to be implemented over a 30-year planning period at an estimated investment level of approximately $2.0 billion. On September 24, 2013, the City Council approved a consultant agreement with MWH Americas, Inc. to assist and support the City in developing and implementing this CIP. On June 2, 2015, a funding strategy was recommended to and approved by the City Council. An update to the strategy was approved by the City Council on January 12, 2016. For the next five years, the City's portion of the funding for the Treatment Plant Adopted CIP is programmed into the City's 2024-2028 CIP budget. The City's FY 2024 approved operating budget did not require a rate increase in the Sewer Service and Use Charge rate for FY 2024.

Revenues for the 2024-2028 Adopted CIP are derived from several sources: utilization of available resources from the City's Sewer Service and Use Charge and Sewage Treatment Plant Connection Fee, contributions from the City of Santa Clara and other tributary agencies for the treatment of sewage from their respective jurisdictions by the Treatment Plant, interest earnings, Calpine Metcalf Energy Center Facilities repayments, and other debt financing proceeds.

Pursuant to an agreement executed between the City and Santa Clara in 1959 (the "1959 Agreement"), the City is co-owner and administering agency of the Treatment Plant. The Treatment Plant also provides wastewater treatment services to other neighboring agencies through five outside user agreements ("Master Agreements") with City of Milpitas, West Valley Sanitation District, Cupertino Sanitary District, Burbank Sanitary District, and CSD 2-3 (the "Tributary Agencies"). Contributions from the City of Santa Clara and the Tributary Agencies are made pursuant to agreements with each agency based on the anticipated operation and maintenance, and capital budget. The Tributary Agencies' proportional contribution for the operation and maintenance cost is based on the amount and characteristics of the sewage discharged into the Treatment Plant. Each Tributary Agency's capital contribution is based on each agency's contractual capacity in the Treatment Plant. The balance of the Treatment Plant budget is shared between the cities of San José and Santa Clara based on the respective City's assessed property value relative to the total assessed property value in both jurisdictions. In the 2024-2028 Adopted CIP, contributions from the City of Santa Clara and other agencies are approximately $208,518,000. Currently, a short-term financing has been put into place in the 2024-2048 Adopted CIP of approximately $200,000,000, which will be refunded with long-term bonds during FY 2028.

NOTE 11 – CONTINGENCIES

Tributary Agency Claims

On January 22, 2016, and September 7, 2016, the City, as the administering agency, received claims from the Tributary Agencies alleging a breach of contract and inequity under the Master Agreements. The Treatment Plant Advisory Committee ("TPAC") conducted two administrative hearings, on March 24, 2016, and September 7, 2016, regarding such claims and issued reports as required by the Master Agreements. The Tributary Agencies disagreed with the reports and the parties attempted to mediate such claims but were unable to reach resolution. All parties agreed to waive the hearings before their respective joint legislative bodies.

The Tributary Agencies filed a complaint in Santa Clara County Superior Court against the City and the City of Santa Clara on March 23, 2018, resulting in a trial in April, May, and June of 2023. The allegations in the case are substantially similar to the claims raised by the Tributary Agencies and heard through the administrative hearing process in 2016. The Tributary Agencies allege the City breached their respective Master Agreements by, among other allegations, the City charging them for capital and operating expenditures that the Tributary Agencies allege are not authorized under the Master Agreements and, the Tributary Agencies assert, are beyond the requirements to operate the Treatment Plant. The Tributary Agencies also allege that the City has improperly concealed how the funds paid by the Tributary Agencies for Treatment Plant capacity are used. They also allege the City breached the implied covenant of good faith and fair dealing and violated certain California Constitutional provisions limiting local agencies' imposition of property related fees, charges, and taxes. The Tributary Agencies further allege their payments resulted in unjust enrichment to the City and Santa Clara, and that the court should provide declaratory relief in support of their allegations.

The City and Santa Clara brought pre-trial motions that resolved the Tributary Agencies' claims based on California Constitutional provisions in defendants' favor. The Tributary Agencies' remaining claims for breach of contract and breach of the implied covenant of good faith and fair dealing were tried to a jury. The Tributary Agencies sought approximately $100 million in damages. The jury rejected almost all the Tributary Agencies' claims, finding only that the City violated the Master Agreements in the way it allocated certain capital costs, but awarding zero damages.

The parties are currently waiting for the court's decision as to the Tributary Agencies' claims for unjust enrichment and declaratory relief. A further post-trial briefing is expected to be scheduled. The Tributary Agencies have fully paid their portion of the capital cost for the projects to rehabilitate the Treatment Plant to date. The City cannot predict the outcome or the timeline for resolution of this litigation.

Wastewater Treatment System
(Enterprise Funds of the City of San José)
Required Supplementary Information (Unaudited)
For the Year Ended June 30, 2023

Schedule of the Proportionate Share of the Net Pension Liability
(Dollar Amounts in Thousands)

	2023
Proportion of the collective net pension liability	12.94%
Proportionate share of the collective net pension liability	$ 211,190
Covered payroll	$ 54,868
Proportionate share of collective net pension liability as percentage of covered payroll	384.90%
Plan fiduciary net position as a percentage of the total pension liability	59.75%

Schedule of Employer Contributions - Defined Benefit Pension Plan
(Dollar Amounts in Thousands)

	2023
Actuarially determined contribution	$ 25,803
Contribution in relation to the actuarially determined contributions	25,803
Difference between actuarially determined contributions and contributions made	$ -
Covered payroll	$ 49,989
Contribution as a percentage of covered payroll	51.62%

NOTE: The schedules present information to illustrate changes in the WWTS's proportionate share of the net liability and contributions over a 10-year period when the information is available. However, until a 10-year trend is compiled, governments should present information for those years for which information is available. Fiscal Year 2023 was the first year that WWTS issued a stand-alone annual financial report. Prior year information was not available.

Note to Required Supplementary Information Schedules

As a cost-sharing enterprise fund of the City, WWTS is required to recognize a liability for its proportionate share of the City's collective net pension liability. WWTS recognizes pension expense and reports deferred outflows of resources and deferred inflows of resources related to pension for its proportionate shares of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions.

Methods and Assumptions to determine Contributions:	
Fiscal year	**June 30, 2023**
Valuation date	**June 30, 2021**
Actuarial Cost Method	Entry Age
Asset Valuation Method	5-year smoothed market
Discount rate	6.625%
Salary Increases	3.00% plus merit component based on years of service
Amortization Growth Rate	2.75%
Amortization Method	Unfunded actuarial liability as of June 30, 2009 was amortized over a closed 30-year period commencing June 30, 2009. Gains, losses and plan changes are amortized over 20-year periods, and assumption changes are amortized over 25-year periods. Tier 2's UAL as of June 30, 2017 is amortized over a 10-year period. Tier 2 actuarial gains and losses, assumption changes, and plan changes are amortized over 10-year periods
Mortality	Adjusted 2010 Public General (healthy) and 2009 CalPERS (disabled) mortality tables projected on a generational basis with the SOA MP-2021 projection scale

Wastewater Treatment System
(Enterprise Funds of the City of San José)
Required Supplementary Information (Unaudited)
For the Year Ended June 30, 2023

Schedule of the Proportionate Share of the Net OPEB Liability
(Dollar Amounts in Thousands)

	2023
Proportion of the collective net OPEB liability	14.87%
Proportionate share of the collective net OPEB liability	$ 50,102
Covered payroll	$ 54,868
Proportionate share of collective net OPEB asset as percentage of covered payroll	91.31%
Plan fiduciary net position as a percentage of the total OPEB liability	56.32%

Schedule of Employer Contributions - Postemployment Healthcare Plan
(Dollar Amounts in Thousands)

	2023
Actuarially determined contribution	$ 3,419
Contribution in relation to the actuarially determined contributions	3,419
Difference between actuarially determined contributions and contributions made	$ -
Covered payroll	$ 57,445
Contribution as a percentage of covered payroll	5.95%

NOTE: The schedules present information to illustrate changes in the WWTS's proportionate share of the net liability and contributions over a 10-year period when the information is available. However, until a 10-year trend is compiled, governments should present information for those years for which information is available. Fiscal Year 2023 was the first year that WWTS issued a stand-alone annual financial report. Prior year information was not available.

Wastewater Treatment System
(Enterprise Funds of the City of San José)
Required Supplementary Information (Unaudited)
For the Year Ended June 30, 2023

Note to Required Supplementary Information Schedules

The WWTS as a cost-sharing department of the City is required to recognize a liability for its proportionate share of the City's collective net OPEB liability. The WWTS recognizes OPEB expense and reports deferred outflows of resources and deferred inflows of resources related to OPEB for its proportionate shares of collective OPEB expense and collective deferred outflows of resources and deferred inflows of resources related to OPEB. The schedules present information to illustrate changes in the WWTS's proportionate share of the net OPEB liability and contributions over a 10-year period when the information is available. However, until a 10-year trend is compiled, governments should present information for those years for which information is available.

Methods and assumption used to determine contributions:

Fiscal Year	6/30/2023
Valuation Date	**6/30/2021**
Timing	Actuarially determined contribution rates are calculated based on the actuarial valuation one year prior to the beginning of the fiscal year
Actuarial Cost Method	Individual entry age
Amortization Method/Period	20-year layered amortization as a level dollar amount with 3-year phase-in and phase-out
Asset Valuation Method	Fair value of assets
Amortization growth rate	0.00%
Discount rate	6.00%
Ultimate rate of medical inflation	3.78%
Salary increases	3.00% plus merit component based on years of service
Mortality	Adjusted 2010 Public General Mortality tables for healthy members and adjusted 2009 CalPERS mortality tables for disabled members projected on a generational basis with the SOA MP-2021 projection scale

A complete description of the methods and assumptions used to determine contributions for the year ended June 30, 2023, can be found in the June 30, 2021 actuarial valuation report.

Reconciliation of Net Position of WWTS to City's ACFR

WWTS Funds	2023	2022	$ Change	% Change
Assets	$ 1,780,709	$ 1,670,223	$ 110,486	6.6%
Deferred Outflows	54,407	48,388	6,019	12.4%
Liabilities	645,473	522,985	122,488	23.4%
Deferred Inflows	14,652	67,327	(52,675)	-78.2%
Net Position	1,174,991	1,128,299	46,692	4.1%
SBWR Funds 570 & 571 Net Position	11,989	9,391		
Tie out to WWTS Funds in ACFR	$ 1,186,980	$ 1,137,690		

Certified Public Accountants

Independent Auditor's 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*

Honorable City Council
Wastewater Treatment System
City of San José, California

We have audited, in accordance with the 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 (*Government Auditing Standards*), the financial statements of the Wastewater Treatment System (WWTS), certain enterprise funds of the City of San José, California (City), as of and for the year ended June 30, 2023, and the related notes to the financial statements, which collectively comprise the WWTS's financial statements, and have issued our report thereon dated November 17, 2023.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the WWTS's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the WWTS's internal control. Accordingly, we do not express an opinion on the effectiveness of the WWTS's internal control.

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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses or significant deficiencies may exist that were not identified.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the WWTS's financial statements are free from 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 financial statements. 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.*

Macias Gini & O'Connell LLP
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Walnut Creek, CA 94596

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Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 17, 2023