**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**

(A Component Unit of the
City of San José, California)

Independent Auditor's Reports and
Basic Financial Statements

For the Period July 1, 2011 through
January 31, 2012

MGO Certified Public Accountants.

**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**
(A Component Unit of the City of San José, California)
For the Period July 1, 2011 through January 31, 2012

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MGO Certified Public Accountants.

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Newport Beach

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Board of Directors
Redevelopment Agency of the
City of San José, California

**Independent Auditor's Report**

We have audited the accompanying financial statements of the governmental activities and each major fund of the Redevelopment Agency of the City of San José (Agency), a component unit of the City of San José, California, as of January 31, 2012 and for the period July 1, 2011 through January 31, 2012, which collectively comprise the Agency's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Agency's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Agency as of January 31, 2012, and the respective changes in financial position thereof for the period July 1, 2011 through January 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note I.A. to the basic financial statements, the California State Legislature enacted legislation that dissolved redevelopment agencies in the State of California as of February 1, 2012. On February 1, 2012, the City, as the Successor Agency to the Redevelopment Agency of the City of San José (Successor Agency), became responsible for overseeing the dissolution process and the wind down of redevelopment activity.

As discussed in Note III.D. to the basic financial statements, on June 8, 2012, Moody's Investors Service downgraded the Agency's Senior Obligations Rating to below "Baa1", which triggered a Special Termination Event under the Continuing Covenant Agreement of the 2010 C Housing Set-Aside Tax Allocation Bonds (Bonds). The Bonds had an outstanding balance at January 31, 2012 of $88.6 million, have been classified as a current liability in the accompanying basic financial statements and were transferred to the Successor Agency on February 1, 2012. For the period commencing on August 15, 2012 and ended on November 15, 2012, the bank agreed to forebear from exercising its rights and remedies under the bond covenant with respect to the existing default. Negotiations are presently underway to extend the forbearance agreement. Neither the former Agency nor the Successor Agency can predict the outcome of the negotiations.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 19, 2012, on our consideration of the Agency's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information for the general fund and special revenue fund, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, 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 basic financial statements, and other knowledge we obtained during our audit of the basic 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Agency's basic financial statements. The other supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. The other supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the other supplementary information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 19, 2012

**REDEVELOPMENT AGENCY OF**
**THE CITY OF SAN JOSE**

**Management's Discussion and Analysis - Unaudited**
**January 31, 2012**

As management of the former Redevelopment Agency of the City of San José ("Agency"), we offer readers of the Agency's basic financial statements this narrative overview and analysis of the financial activities of the Agency for the seven-month period ended January 31, 2012. We encourage readers to consider the information presented here in conjunction with the Agency's financial statements, which follow this section, as well as information contained in the Auditor's Report for the Successor Agency to the Redevelopment Agency of the City of San Jose (SARA) for the period from inception (February 1, 2012) through June 30, 2012.

## FINANCIAL HIGHLIGHTS

Pursuant to AB X1 26 and subsequent California Supreme Court decision in *California Redevelopment Association v. Matosantos* redevelopment agencies in California were dissolved effective February 1, 2012. On January 24, 2012, the City Council adopted Resolution 76128 declaring the City as the Successor Agency to the Redevelopment Agency of the City of San José ("SARA"). SARA is a separate legal entity. As such, by operation of law, assets, properties, contracts, leases, books, records, buildings and equipment of the former Agency were transferred to the SARA on February 1, 2012.

Total liabilities of the Agency exceeded its assets in governmental activities at the close of January 31, 2012 by $2.1 billion (net deficit). Of this net deficit, $69.0 million represents resources restricted for debt service payments. The remaining negative amount of $2.2 billion represents the accumulated unrestricted deficit at the close of January 31, 2012. The total net deficit improved by $13.4 million or 0.6% at the close of January 31, 2012.

## OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Agency's basic financial statements. The Agency's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the basic financial statements. This report also contains required and other supplementary information in addition to the basic financial statements.

### Government-wide Financial Statements

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

The *statement of net assets* reports all financial and capital resources of the Agency. The Agency presents the statement in a format that displays assets less liabilities equal net assets (deficit). Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Agency is improving or deteriorating.

The *statement of activities* presents information showing how the Agency's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows.* Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods.

The *governmental activities* of the Agency include general government, community development, housing, and debt service. The government-wide financial statements can be found on pages 11 and 12 of this report.

## Fund Financial Statements

*Fund Financial Statements* are designed to report information about groupings *(funds)* of related accounts, which are used to maintain control over resources that have been segregated for specific activities or objectives. The Agency, like other state and local governments, uses *fund accounting* to ensure and demonstrate finance-related legal compliance. All *funds* of the Agency are categorized as *governmental funds*.

*Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the *government-wide financial statements*. However, unlike the *government-wide financial statements*, governmental funds financial statements focus on *near-term inflows and outflows of spendable resources,* as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in determining what financial resources are available to the SARA in the near future to pay enforceable obligations of the former Agency.

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

The Agency maintains several individual governmental funds created according to their purpose. The individual fund information is presented separately in the governmental funds balance sheet (page 13) and in the governmental funds statement of revenues, expenditures, and changes in fund balances (page 15) for all the Agency's governmental funds.

## Notes to the Basic Financial Statements

Notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 17 to 49 of this report.

## Other Information

In addition to the basic financial statements and accompanying notes, this report also presents required supplementary information concerning the Agency's budgetary comparison for certain governmental funds – general fund and special revenue fund (pages 51 to 54).

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

This Management's Discussion and Analysis is the last period the Agency will present its financial statements. The Agency has used its prior audited financial statements as of and for the year ended June 30, 2011 for comparative purposes.

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. At the close of January 31, 2012, the Agency has a net deficit of $2.1 billion. This is composed of $69.0 million restricted for debt service payments, and $2.2 billion accumulated unrestricted deficit. The largest portion of the Agency's deficit is caused by the outstanding long-term liabilities of $2.4 billion. Historically, the Agency carried a deficit to collect tax increment due primarily to the nature of tax increment financing method previously allowed under California law whereby a redevelopment agency issues bonds or incurs long-term debt to finance its redevelopment projects by pledging future tax increment revenues.

The Agency used debt proceeds to finance its redevelopment projects, including public projects such as public parking, street improvements, park improvements, transportation improvements, cultural facilities, and community centers. Once redevelopment projects that were public facilities were completed by the Agency, the responsibilities for their continued maintenance and operations were transferred to the appropriate public entity such as City of San José (City) including the capitalized redevelopment project costs. In addition, completed projects with private developers were also transferred to the developers in accordance with the Disposition and Development Agreements. Although completed public facilities and Joint Agency-Private Partnership projects were transferred to the City or private entities, the related debt remained with the Agency.

Shown below is a schedule that summarizes the Agency's net assets (deficit):

Agency's Statement of Net Assets (Deficit)
Governmental Activities
January 31, 2012 and June 30, 2011
(In thousands)

| | January 31, 2012 | June 30, 2011 |
|---|---|---|
| **Assets** | | |
| Current and other assets | $ 195,891 | $ 232,807 |
| Capital assets, net | 180,407 | 189,738 |
| **Total Assets** | 376,298 | 422,545 |
| **Liabilities** | | |
| Long-term liabilities | 2,414,244 | 2,487,808 |
| Other liabilities | 66,055 | 52,126 |
| **Total Liabilities** | 2,480,299 | 2,539,934 |
| **Net assets (deficit)** | | |
| Restricted for debt service | 68,997 | 87,573 |
| Unrestricted net deficit | (2,172,999) | (2,204,982) |
| **Total net assets (deficit)** | $ (2,104,002) | $ (2,117,409) |

The Agency uses its capital assets of $180.4 million to eliminate blight in the San José' redevelopment project areas (see Notes II.E. and II.F. on pages 28 and 29 for additional information).

Long-term liabilities are mainly represented by tax allocation bonds, revenue bonds, and housing set-aside bonds issued to finance redevelopment projects and other advances payable to the City as discussed in Note II.G to the basic financial statements. The change from last year's long-term obligations is a net decrease of $73.5 million or 3%, which is the net result of the total debt service payments of $76.2 million and an additional loan from the City of $2.7 million. The total debt service payment includes $49.2 million payments for tax allocation bonds, $9.5 million payments for housing bonds and $17.1 million payments for subordinated and other long-term debt.

***Governmental activities***. Overall the Agency's financial position increased from the prior year. Under the governmental activities, the Agency's net deficit has decreased by $13.4 million during the seven-month period ended January 31, 2012.

Key elements of the changes in net assets of the governmental activities are presented below:

Agency's Changes in Net Assets (Deficit)
For the Seven-month Period Ended January 31, 2012 and
Twelve-month Period Ended June 30, 2011
(In thousands)

| | 7-month Ended January 31, 2012 | 12-month Ended June 30, 2011 |
|---|---|---|
| **Revenues:** | | |
| Program revenues: | | |
| Operating grants and contributions | $ 40,421 | $ 40,356 |
| Capital grants and contributions | 119 | 190 |
| Charges for services | 353 | 1,472 |
| General revenues: | | |
| Tax increment | 87,662 | 183,645 |
| Unrestricted investment earnings | 298 | 1,130 |
| Miscellaneous | 6,735 | 6,806 |
| Total revenues | 135,588 | 233,599 |
| **Expenses:** | | |
| General government | 430 | 5,812 |
| Community development | 39,915 | 218,864 |
| Housing | 17,532 | 46,764 |
| Debt service | 64,304 | 112,357 |
| Total expenses | 122,181 | 383,797 |
| Change in net assets | 13,407 | (150,198) |
| Net deficit - beginning of year | (2,117,409) | (1,967,211) |
| Net deficit - end of year | $ (2,104,002) | $ (2,117,409) |

Operating grants and contributions comprised of $40.4 million from the City for repayment of debt service on Housing Bonds ($23.3 million); lease payment pursuant to the Second Amended and Restated Reimbursement Agreement for the 2001 Convention Center Refunded Bonds ($15.4 million) and debt service payment guarantees for the HUD 108 loans ($1.7 million).

Tax increment revenues of $87.7 million represent receipts for the seven-month period ended January 31, 2012. Tax increment revenues reflect the County's reduction of $5 million for prior year's roll corrections.

Miscellaneous revenues consist of developers' contributions, parking revenue, Project Service Memorandum (PSM) refunds from the City of San José, and gains from sale of properties $6.7 million for the reporting period.

Community Development expenses of $39.9 million, includes primarily $15.4 million payment to the City for debt service payment on the Convention Center Lease Revenue Bonds, $7.5 million expense accrual to the County to record the semi-annual pass-through payment, $5.5 million in capital projects (not subject to capitalization by the Agency) and program expenditures, depreciation expense of $2.9 million, an increase in the allowance for doubtful accounts in the amount of $2.7 million and administrative related expenses of $0.9 million.

When compared to the fiscal year ended June 30, 2011, the variance of $179.0 million primarily reflects the Agency's transfer of land and public use properties to the City, totaling $109.6 million, and the transfer of seven parcels of land to the San Jose Diridon Development Authority with an aggregate book value of $29.2 million. Various properties held for redevelopment aggregating $13.5 million were disposed of in accordance with purchase agreements. In addition, reductions in the level of staffing directly related to the Agency's capital projects and programs were reduced by $9.9 million.

Housing expenses of $17.5 million, reflect the transfer of the 20% housing set-aside from tax increment revenues contributed to the City's low and moderate-income housing fund received prior to the February 1, 2012 effective date of AB X1 26.

Debt service expenses represent paid and accrued interest for the seven-month period of $64.3 million. The decrease from the prior year is attributed to the different reporting periods, seven months versus twelve months.

## FINANCIAL ANALYSIS OF THE AGENCY'S FUNDS

As noted earlier, the Agency uses *fund accounting* to ensure and demonstrate compliance with finance-related legal requirements.

***Governmental funds.*** The focus of the Agency's *governmental funds* is to provide information on near-term inflows, outflows, and balances of resources that are available for spending. Such information is useful in assessing the Agency's financial requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. Individual fund information of governmental funds reported by the Agency includes general fund, special revenue fund, housing debt service fund, merged debt service fund, and capital projects fund, which are all considered major funds.

***Combined Fund Balance.*** At the end of January 31, 2012, the Agency's governmental funds, which reported *combined fund balances* of $30.1 million, declined by $128.1 million or 81% from last year. The decline was principally due to the reclassification of the Series 2010C Housing Set-Aside Tax Allocation Bonds of $88.6 million from a long-term obligation to a demand bond upon the Agency's Special Termination Event and the current period debt service expenditures exceeded revenues resulting in the use of prior year tax increment held on reserve with the trustee. In prior fiscal years, these funds are replenished prior to the end of the fiscal year. However due to the truncated reporting period, revenues have only been reported for a seven (7) month period versus twelve (12) months and debt service expenditures for the seven-months period included principal payments on bonds outstanding.

***General fund.*** The Agency's general fund is used to account for the general and administrative expenditures. At the end of January 31, 2012, the total fund balance decreased by a net amount of $84.7 thousand.

***Special revenue fund.*** The special revenue fund is used to account for the portion of tax increment revenue designated for low and moderate-income housing. As previously required by the California Community Redevelopment Law, the Agency allocated 20 percent ($17.5 million) of the tax increment received during the period for the City's low and moderate-income housing projects. No fund balance remains at January 31, 2012.

***Housing Debt Service Fund.*** The net total fund deficit of $72.0 million, includes $16.1 million, which is restricted to be spent in accordance with bond indentures (20% Housing Set-Aside bonds). The fund balance decreased by $81.9 million during the seven month period due principally to the reclassification of the Series 2010C Housing Set-Aside Tax Allocation Bonds of $88.6 million from a long- term obligation to a demand bond upon the Agency's Special Termination Event. (See Subsequent Events – Note III.D: ***2010C Housing Set-Aside Tax Allocation Bonds Special Event of Default***).

***Merged Debt Service Fund.*** The total fund balance of $102.1 million decreased by $17.8 million in the seven-month period. The decrease in fund balance was principally due to the current period debt service expenditures exceeded revenues resulting in the use of prior year tax increment held on reserve with the trustee as the transfers in from the Capital Projects Fund of $28.3 million combined with tax increment revenue of $70.1 million was not enough to cover debt service of $116.3 million. As stated previously, the debt service reserve is replenished with the receipts of redevelopment property tax revenues in the second half of the fiscal year to cover bond principal payments made in the first half of the fiscal year.

***Capital Projects Fund.*** The total fund balance in the Agency's capital projects fund had a net decrease of $28.3 million from July 1, 2011 through January 31, 2012. The total revenues of $19.0 million along with proceeds from sale of capital assets of $11.3 million and proceeds from City's advances of $2.7 million were not sufficient to cover the total expenditures of $32.9 million and transfers to pay debt service of $28.3 million. This was mainly due to a truncated tax increment reporting period of the Agency's tax increment revenues as discussed above.

## General Fund Budgetary Highlights

As stated earlier, the General Fund only accounts for the Agency's general and administrative expenditures. The Agency's administrative costs totaled $0.4 million for the seven month period of July 1, 2011 through January 31, 2012 or 52% of the approved 12-month period budget. The amount represents the actual payments to the City of San Jose for support services (i.e. General Counsel, City Clerk's Office and City Hall Rent).

## Capital Assets

### *Accumulated Redevelopment Project Costs*

The Agency's investment in properties for redevelopment projects for its governmental activities decreased by $25.6 million or 30% due to reclassification of $19.1 million of completed projects to Other Capital Assets and sale and disposal of properties, as discussed on Note II.E to the basic financial statements.

Major activities during the seven-month period ended January 31, 2012 included the following:

1) *Receipt of proceeds from sale of Block 3 Surface Parking Lot with a book value of $2,424,181 to private property owner.*

2) *Receipt of proceeds from sale of Fountain Alley Parking Lot with a book value of $3,570,095 to private property owner.*

These sales occurred prior to July 1, 2011 but escrow closed and revenues were received in the reporting period.

***Other Capital Assets***

For government-wide financial statement presentation, depreciable capital assets were depreciated from acquisition date to the end of the current fiscal period using the straight-line method.

Additional information about the Agency's capital assets can be found on pages 28 to 30 of the notes to the financial statements.

**Debt Administration**

At January 31, 2012, the Agency had long-term bonds and notes outstanding aggregating to $2.4 billion, a decrease of $73.6 million or 3% from last fiscal year due mainly to debt service payments. Of this amount, $2.0 billion represents senior debt backed by tax increment revenues. The remainder of the Agency's debt represents other bonds and notes secured by tax increment and other revenues such as developer payments, lease payment revenue, interest earnings and other sources.

Breakdown of the long-term debt is as follows (in thousands):

| | |
|---|---|
| **Senior Debt:** | |
| Tax Allocation Bonds: | |
| Merged Area | $ 1,661,800 |
| Housing Set-Aside | 328,980 |
| Subtotal - Tax Allocation Bonds | 1,990,780 |
| Subordinate Debt: | |
| Merged Area Revenue Bonds | 93,655 |
| Pledge Obligation - 4th/San Fernando Parking Revenue Bonds | 33,435 |
| Convention Center Refunding Bonds | 129,020 |
| California Statewide Communities Development Authority ERAF Loans | 15,545 |
| HUD Section 108 Loans | 29,745 |
| City of San Jose Parking Fund Loan | 13,528 |
| City of San Jose Parkland Fees Advances | 8,112 |
| City of San Jose Autumn Property | 630 |
| City of San Jose SERAF Loan | 78,287 |
| County of Santa Clara Pass-through Obligation | 23,562 |
| Subtotal - subordinated debt | 425,519 |
| Total long-term debt | $ 2,416,299 |

On November 21, 2011, Standard & Poor's Rating Services lowered its long-term rating and underlying (SPUR) to 'BBB' from 'BBB+' on the outstanding Merged Area Tax Allocation Bonds of the Agency. Standard & Poor's also removed the "Credit Watch negative" and assigned "negative outlook". In January 2012, Moody's Investor Services announced that it was downgrading all California tax allocation bonds rated Baa2 and above by one notch. Fitch Ratings followed suit the following week by placing all California bonds secured by tax increment revenue on a "Rating Watch Negative". The Moody's rating action increased the City's Housing Department's and Agency's variable rate bond costs. It is estimated that this action will increase the Housing Department's Wells Fargo Private Placement Bond interest costs by $440,000 per year. In addition, it is estimated that this rating action, along with the November 21, 2011 downgrade by Standard & Poor's will increase the SARA's Letter of Credit (LOC) fees by $226,000 in the current fiscal year.

Additional information about the Agency's long-term obligations is available on pages 31 to 41 in the notes to the financial statements.

## ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

No information is provided on the Agency's economic factors and next year's budget since the Agency is dissolved effective February 1, 2012. All assets, properties, contracts, leases, books, records, buildings and equipment of the Agency are transferred to the Successor Agency to the Redevelopment Agency of the City of San José as of February 1, 2012 by operation of law.

## REQUEST FOR INFORMATION

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the Agency's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer, 200 East Santa Clara St., 14th Floor, San José, CA 95113. Additional financial data may also be found on the Agency's website (www.sjredevelopment.org/finance.htm).

**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**

Statement of Net Assets

Governmental Activities

January 31, 2012

| | |
|---|---|
| **Assets:** | |
| Cash and investments (Note II.A) | $ 8,887,540 |
| Receivables: | |
| Accrued interest | 4,573 |
| Due from the City of San José | 1,206,115 |
| Other | 518,428 |
| Advances to the City of San José (Note III.C) | 530,280 |
| Loans receivable, net (Note II.B) | 30,898,837 |
| Deposits | 155,315 |
| Deferred charges, net | 31,870,986 |
| Restricted assets: | |
| Cash and investments (Note II.A) | 121,818,652 |
| Accumulated redevelopment project costs (Note II.E): | |
| Nondepreciable | 58,621,837 |
| Other capital assets (Note II.F): | |
| Nondepreciable | 8,391,118 |
| Depreciable, net | 113,393,877 |
| Total assets | 376,297,558 |
| **Liabilities:** | |
| Accounts payable | 1,415,276 |
| Accrued liabilities | 18,873 |
| Due to other governmental agencies | 4,059,757 |
| Due to the County of Santa Clara (Note II.G) | 7,542,151 |
| Unearned revenue (Note II.C) | 2,332,577 |
| Liabilities payable from restricted assets: | |
| Deposits, retentions, and other payables | 895,932 |
| Accrued interest payable | 49,790,660 |
| Long-term liabilities (Note II.G): | |
| Due within one year | 168,423,696 |
| Due in more than one year | 2,245,820,428 |
| Total liabilities | 2,480,299,350 |
| **Net assets (deficit)** (Note II.H): | |
| Restricted for debt service | 68,996,973 |
| Unrestricted deficit | (2,172,998,765) |
| Total net deficit | $ (2,104,001,792) |

See accompanying notes to the basic financial statements.

**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**
Statement of Activities
Governmental Activities
For the Period July 1, 2011 Through January 31, 2012

| | | Functions | | | |
|---|---|---|---|---|---|
| | **Total** | **General Government** | **Community Development** | **Housing** | **Debt Service** |
| **Expenses:** | | | | | |
| Salaries, wages and benefits | $ 851,943 | $ - | $ 851,943 | $ - | $ - |
| Materials, supplies and other services | 718,920 | 429,661 | 289,259 | - | - |
| Project expenses | 53,450,427 | - | 35,918,059 | 17,532,368 | - |
| Depreciation | 2,855,491 | - | 2,855,491 | - | - |
| Interest on debt | 64,303,653 | - | - | - | 64,303,653 |
| Total expenses | 122,180,434 | 429,661 | 39,914,752 | 17,532,368 | 64,303,653 |
| **Program revenues:** | | | | | |
| Charges for services | 352,914 | 333,488 | 19,426 | - | - |
| Operating grants and contributions | 40,420,751 | - | 17,070,483 | 23,350,268 | - |
| Capital grants and contributions | 119,469 | - | 119,469 | - | - |
| Net program revenues (expenses) | (81,287,300) | $ (96,173) | $ (22,705,374) | $ 5,817,900 | $ (64,303,653) |
| **General revenues:** | | | | | |
| Tax increment | 87,661,838 | | | | |
| Unrestricted investment earnings | 297,612 | | | | |
| Miscellaneous | 6,734,909 | | | | |
| Total general revenues | 94,694,359 | | | | |
| **Change in net assets** | 13,407,059 | | | | |
| **Net deficit, beginning of year** | (2,117,408,851) | | | | |
| **Net deficit, end of year** | $ (2,104,001,792) | | | | |

See accompanying notes to the basic financial statements.

**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**
Balance Sheet
Governmental Funds
January 31, 2012

| | General | Special Revenue | Debt Service Housing | Debt Service Merged | Capital Projects | Total |
|---|---|---|---|---|---|---|
| **Assets:** | | | | | | |
| Cash and investments (Note II.A) | $ 873,272 | $ - | $ - | $ - | $ 8,014,268 | $ 8,887,540 |
| Receivables (net): | | | | | | |
| Accrued interest | - | - | 4,573 | - | - | 4,573 |
| Due from other funds (Note II.D) | - | - | - | - | 135,147 | 135,147 |
| Due from the City of San José | - | 135,147 | - | - | 1,070,968 | 1,206,115 |
| Others | 100,526 | - | - | - | 417,902 | 518,428 |
| Advances to the City of San José (Note III.C) | 250,000 | - | - | - | 280,280 | 530,280 |
| Loans receivable, net (Note II.B) | - | - | - | - | 30,898,837 | 30,898,837 |
| Deposits | 1,202 | - | - | - | 154,113 | 155,315 |
| Restricted assets: | | | | | | |
| Cash and investments (Note II.A) | - | - | 16,642,371 | 102,083,749 | 3,092,532 | 121,818,652 |
| **Total assets** | $ 1,225,000 | $ 135,147 | $ 16,646,944 | $ 102,083,749 | $ 44,064,047 | $ 164,154,887 |
| **Liabilities and Fund Balances:** | | | | | | |
| Liabilities: | | | | | | |
| Accounts payable | $ 31,378 | $ - | $ 14,600 | $ - | $ 1,369,298 | $ 1,415,276 |
| Accrued liabilities | 7,420 | - | - | - | 11,453 | 18,873 |
| Due to other funds (Note II.D) | - | 135,147 | - | - | - | 135,147 |
| Due to the County of Santa Clara (Note II.G) | - | - | - | - | 7,542,151 | 7,542,151 |
| Demand bonds payable (Note II.H) | - | - | 88,600,000 | - | - | 88,600,000 |
| Deferred revenue (Note II.C) | - | - | - | - | 29,076,610 | 29,076,610 |
| Unearned revenue (Note II.C) | - | - | - | - | 2,332,577 | 2,332,577 |
| Deposits, retentions, and other payables | 9,400 | - | - | - | 886,532 | 895,932 |
| Due to other governmental agencies | - | - | - | - | 4,059,757 | 4,059,757 |
| Total liabilities | 48,198 | 135,147 | 88,614,600 | - | 45,278,378 | 134,076,323 |
| Fund balances (deficits) (Note II.H): | | | | | | |
| Nonspendable | 251,202 | - | - | - | 2,103,107 | 2,354,309 |
| Restricted | - | - | 16,162,637 | 102,083,749 | 541,247 | 118,787,633 |
| Committed | 109,138 | - | - | - | 6,063,547 | 6,172,685 |
| Assigned | 291,662 | - | - | - | 3,990,312 | 4,281,974 |
| Unassigned | 524,800 | - | (88,130,293) | - | (13,912,544) | (101,518,037) |
| Total fund balances (deficits) | 1,176,802 | - | (71,967,656) | 102,083,749 | (1,214,331) | 30,078,564 |
| **Total Liabilities and Fund Balances** | $ 1,225,000 | $ 135,147 | $ 16,646,944 | $ 102,083,749 | $ 44,064,047 | $ 164,154,887 |

See accompanying notes to the basic financial statements.

**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**
Reconciliation of the Balance Sheet of
Governmental Funds to the Statement of Net Assets
of Governmental Activities
January 31, 2012

Amounts reported for governmental activities in the statement of net assets are different because:

| | | |
|---|---|---|
| Fund balances of all governmental funds (page 13) | | $ 30,078,564 |
| Accumulated redevelopment project costs are capitalized costs that will be transferred to the City and/or developers upon project completion. These costs are not spendable current financial resources and, therefore, are not reported in the balance sheet of the governmental funds. | | 58,621,837 |
| Other capital assets used in governmental activities are not spendable current financial resources and, therefore, are not reported in the balance sheet of governmental funds. | | 121,784,995 |
| A significant portion of loans receivable and other long-term receivables are not available to pay for current period expenditures and, therefore, are deferred on the modified accrual basis of accounting. | | 29,076,610 |
| Bond issuance costs are expended in governmental funds when paid, and are capitalized and amortized over the life of the corresponding bonds for purposes of the statement of net assets. | | 31,870,986 |
| Long-term liabilities are not due and payable in the current period and therefore, are not reported in the balance sheet of governmental funds. | | |
| Tax allocation bonds | $ (1,902,180,000) | |
| Revenue bonds | (93,655,000) | |
| Pledge obligation (4th/San Fernando Parking Revenue Bonds) | (33,435,000) | |
| Convention Center refunding bonds | (129,020,000) | |
| CSCDA ERAF loans | (15,545,000) | |
| HUD Section 108 loans | (29,745,000) | |
| City of San José Parking Fund loans | (13,528,395) | |
| City of San José Deferred Parkland Fees loan | (8,111,800) | |
| City of San José Autumn Property loan | (630,000) | |
| City of San José SERAF loan | (78,286,961) | |
| County Pass Through Obligation | (23,561,815) | |
| Unamortized premiums on bonds | (37,903,638) | |
| Unamortized deferred amount on refundings | 40,314,485 | |
| Environmental remediation obligations | (356,000) | (2,325,644,124) |
| Interest payable on long-term debt does not require the use of current financial resources and, therefore, interest payable is not accrued as a liability in the balance sheet of governmental funds. | | (49,790,660) |
| Net deficit of governmental activities (page 11) | | $ (2,104,001,792) |

See accompanying notes to the basic financial statements.

**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**

Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds

For the Period July 1, 2011 Through January 31, 2012

| | General | Special Revenue | Debt Service Housing | Debt Service Merged | Capital Projects | Total |
|---|---|---|---|---|---|---|
| **Revenues:** | | | | | | |
| Tax increment | $ - | $ 17,532,368 | $ - | $ 70,129,470 | $ - | $ 87,661,838 |
| Intergovernmental (Note III.C) | - | - | 23,350,268 | - | 17,164,218 | 40,514,486 |
| Investment income | 7,771 | - | 12,648 | 76,935 | 200,258 | 297,612 |
| Rent | 333,488 | - | - | - | 19,426 | 352,914 |
| Grant revenue | - | - | - | - | 25,734 | 25,734 |
| Other | 3,660 | - | - | - | 1,573,083 | 1,576,743 |
| Total revenues | 344,919 | 17,532,368 | 23,362,916 | 70,206,405 | 18,982,719 | 130,429,327 |
| **Expenditures:** | | | | | | |
| General government | 21,323 | - | - | - | 1,141,202 | 1,162,525 |
| Intergovernmental: | | | | | | |
| Payments to the City of San José (Note III.C) | 408,338 | 17,532,368 | - | - | 16,015,497 | 33,956,203 |
| Payments to the County of Santa Clara (Note II.G) | - | - | - | - | 7,542,151 | 7,542,151 |
| Payments to other governmental agencies | - | - | - | - | 2,554,422 | 2,554,422 |
| Debt service: | | | | | | |
| Principal repayment | - | - | 9,460,000 | 66,330,000 | - | 75,790,000 |
| Interest and other charges | - | - | 7,229,960 | 49,966,580 | - | 57,196,540 |
| Capital outlay: | | | | | | |
| Project expenditures | - | - | - | - | 5,484,166 | 5,484,166 |
| Payments to the City of San José (Note III.C) | - | - | - | - | 150,000 | 150,000 |
| Total expenditures | 429,661 | 17,532,368 | 16,689,960 | 116,296,580 | 32,887,438 | 183,836,007 |
| **Excess (deficiency) of revenues over (under) expenditures** | (84,742) | - | 6,672,956 | (46,090,175) | (13,904,719) | (53,406,680) |
| **Other Financing Sources (Uses):** | | | | | | |
| Proceeds from City's loans/advances | - | - | - | - | 2,651,988 | 2,651,988 |
| Reclassification of demand bonds (Note II.G) | - | - | (88,600,000) | - | - | (88,600,000) |
| Proceeds from sale of capital assets (Note II.E) | - | - | - | - | 11,268,355 | 11,268,355 |
| Transfers in (Note II.D) | - | - | - | 28,280,003 | - | 28,280,003 |
| Transfers out (Note II.D) | - | - | - | - | (28,280,003) | (28,280,003) |
| Total other financing sources (uses) | - | - | (88,600,000) | 28,280,003 | (14,359,660) | (74,679,657) |
| **Net change in fund balances** | (84,742) | - | (81,927,044) | (17,810,172) | (28,264,379) | (128,086,337) |
| **Fund balances, beginning of year** | 1,261,544 | - | 9,959,388 | 119,893,921 | 27,050,048 | 158,164,901 |
| **Fund balances (deficits), end of year** | $ 1,176,802 | $ - | $ (71,967,656) | $ 102,083,749 | $ (1,214,331) | $ 30,078,564 |

See accompanying notes to the basic financial statements.

**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**

Reconciliation of the Statement of Revenues, Expenditures, and Changes in
Fund Balances of Governmental Funds to the Statement of Activities of Governmental Activities
For the Period July 1, 2011 Through January 31, 2012

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

| | | |
|---|---|---|
| Net change in fund balances of all governmental funds (page 15) | | $ (128,086,337) |
| Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of these assets is either allocated over their estimated useful lives and reported as depreciation expense or accumulated as redevelopment project costs and transferred or sold to the City and/or developers upon project completion. The components of related costs not reported in the statement of activities for the current period are as follows: | | |
| Costs capitalized related to acquisition of various capital assets | 95,730 | |
| Disposal of capitalized costs | (6,551,821) | |
| Depreciation expense | (2,855,491) | (9,311,582) |
| Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the governmental funds. For governmental funds, loans made that are not expected to be repaid in the near future are offset with deferred revenue, whereas, loans made are considered project expenditures and loans collected are considered current year revenue. However, on the statement of activities only interest earnings and bad debt expense are reported: | | |
| Revenues collected that were earned in prior years | 251,761 | |
| Loans collected during the year | (96,532) | |
| Loans made during the year | 286,403 | |
| Changes in estimates of allowance for doubtful accounts | (2,893,792) | (2,452,160) |
| Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds: | | |
| Change in environmental remediation obligation | | 22,000 |
| Bond issuance costs are expended in governmental funds when paid, however, are capitalized and amortized over the life of the corresponding bonds for the purposes of the statement of activities: | | |
| Amortization of bond issuance costs | | (1,395,761) |
| Repayment of long-term debt principal is reported as an expenditure in governmental funds and, thus, has the effect of reducing fund balance because current financial resources have been used. However, the principal payments reduce the liabilities in the statement of net assets and do not result in an expense in the statement of activities. The Agency's long-term debt was reduced because principal payments were made: | | |
| Tax allocation bonds | 58,660,000 | |
| Convention Center refunding bonds | 8,785,000 | |
| Revenue bonds | 3,215,000 | |
| Pledge obligation (4th/San Fernando Parking Revenue Bonds) | 1,670,000 | |
| ERAF loans | 1,785,000 | |
| HUD Section 108 loans | 1,675,000 | 75,790,000 |
| Accrued interest expense on long-term debt is reported in the statement of activities, but does not require the use of current financial resources. Amortization of bond premiums, discounts and deferred amounts on refunding is expensed as a component of interest expense on the statement of activities. This amount represents the net accrued interest expense and the amortization of bond premiums, discounts and deferred amounts on refunding not reported in governmental funds: | | |
| Decrease in accrued interest expense | (7,510,809) | |
| Amortization of bond premiums | 3,927,473 | |
| Amortization of deferred amounts on refunding | (3,523,777) | (7,107,113) |
| Expenditures reported in the governmental funds but not in governmental activities include reclassification of demand bonds to short-term obligations | | 88,600,000 |
| Proceeds from borrowing are reported as financing sources in governmental funds and, thus, contribute to the change in fund balance. In the government-wide statements, however, issuing debt increases long-term liabilities in the statement of net assets and does not affect the statement of activities: | | |
| Proceeds were received from SERAF and Parking Fund loans from City of San José | | (2,651,988) |
| Change in net assets of governmental activities (page 12) | | $ 13,407,059 |

See accompanying notes to the basic financial statements.

**REDEVELOPMENT AGENCY OF**
**THE CITY OF SAN JOSÉ**

**Notes to the Basic Financial Statements**
**January 31, 2012**

## I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the Redevelopment Agency of the City of San José (the Agency) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant accounting policies of the Agency are described below:

### A. Reporting Entity

The Agency was established in 1956 by the San José City Council as a public entity legally separate from the City of San José (City). In January 1975, the City Council declared itself the Agency Board, replacing a separate board. Until June 28, 2011, the Agency had the broad authority to acquire, rehabilitate, develop, administer, and sell or lease property in a "Redevelopment Area." Redevelopment projects are developed in cooperation with private developers. Public redevelopment projects are also developed under cooperation agreements between the Agency and the City or other public entity that will own the project.

On June 28, 2011, Assembly Bill X1 26 ("AB X1 26") was enacted. This legislation is referred to herein as the Redevelopment Dissolution Law. On December 29, 2011, the California Supreme Court upheld the constitutionality of AB X1 26, and all redevelopment agencies in California were dissolved by operation of law effective February 1, 2012. The legislation provides for successor agencies and oversight boards that are responsible for overseeing the dissolution process and the wind down of redevelopment activity. At the City's meeting on January 24, 2012, the City Council affirmed its decision to serve as the Successor Agency to the Redevelopment Agency of the City of San José, effective February 1, 2012.

Since the legislation was adopted, the City Council and Redevelopment Agency Board took several actions to comply with its requirements. One of its requirements was to develop an Enforceable Obligations Payment Schedule (EOPS) detailing the obligations of the Agency (and its 20% Low and Moderate Income Housing Fund, which was administered by the City's Housing Department). The EOPS lists the Agency's obligations and the amount due on the obligations. Enforceable obligations include: bonds secured by both the 80% and 20% funds; loans due to third parties; payments required by law, judgments or settlements; contracts and agreements with third parties; administrative costs, and funds borrowed from the 20% Low and Moderate Income Housing Fund. Additionally, the EOPS includes a listing of Agency obligations to the City.

The financial statements as of January 31, 2012 and for the period July 1, 2011 through January 31, 2012, serve as the final financial statements for the Agency. Effective February 1, 2012, all the activities related to the winding down of the former Agency's financial affairs will be reported in the financial statements for the Successor Agency of the Redevelopment Agency of the City of San José (SARA) and included in the City of San José's Comprehensive Financial Report (CAFR) as a fiduciary fund (private-purpose trust fund). A separate financial report for the period February 1, 2012 through June 30, 2012, containing additional information and more detailed information regarding financial position and changes in financial position will be included in the Successor Agency to the Redevelopment Agency of the City of San José basic financial statements.

Prior to the enactment of AB X1 26, the Agency generally financed redevelopment projects through the issuance of tax allocation bonds. These bonds were payable from the incremental portion of property taxes collected within a project area relating to the increase in assessed valuation resulting from redevelopment. The County of Santa Clara (County) collects these incremental tax revenues on behalf of the Agency. The Agency has a tax sharing agreement with the County that requires sharing of incremental tax revenues with the County, as further discussed in Note II.G – Tax Sharing Agreement with the County of Santa Clara.

The Agency has merged all of its redevelopment areas into a single "Merged Project Area" in order to combine tax increment revenues to obtain greater financing power through issuance of tax allocation bonds.

Under GASB Statement No. 14, *The Financial Reporting Entity*, the Agency is considered a component unit of the City since the Agency Board consists exclusively of the Mayor and City Council. Consequently, the Agency's financial statements are blended in the City's basic financial statements.

## B. Measurement Focus, Basis of Accounting, and Basis of Presentation

*Government-wide Financial Statements*

The government-wide financial statements are reported using the *economic resources measurement focus and the accrual basis of accounting*. Revenues are recognized when earned and expenses are recorded when a liability is incurred regardless of the timing of related cash flows. Non-exchange transactions, in which the Agency gives (or receives) value without directly receiving (or giving) equal value in exchange, include property tax increment, grants, and donations. On an accrual basis, revenue from property tax increment is recognized in the fiscal year for which the taxes are levied.

Other revenues such as grants and similar items are recognized in the fiscal year in which all eligibility requirements have been satisfied. When both restricted and unrestricted resources are available, unrestricted resources are used only after the restricted resources related to bond proceeds and grants are depleted.

The statement of net assets and statement of activities display information about the Agency as a whole and, accordingly, eliminations have been made to remove interfund activities.

The statement of activities presents a comparison of direct expenses and program revenues for activities of the Agency. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular program or function. Program revenues include 1) charges paid by the recipients of goods or services offered by the programs and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including property tax increment, are presented instead as general revenues.

*Fund Financial Statements*

The accounts of the Agency are organized and operated on the basis of funds. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds maintained is consistent with legal and managerial requirements.

Governmental fund financial statements are reported using the *current financial resources measurement focus and the modified accrual basis of accounting*. Under this method, revenues are recognized as soon as they are measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Agency considers revenues to be available if they are collected within 60 days after the end of the current period. The primary revenue sources susceptible to accrual are property tax increment, intergovernmental and grant revenues, investment income, developer contributions, and rent. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments are recorded only when payment is due. General capital assets acquisitions are reported as expenditures in governmental funds. Proceeds of long-term debt and capital leases are reported as other financing sources.

The fund financial statements provide information about the Agency's funds. The emphasis of fund financial statements is on major governmental funds, each displayed in a separate column. The Agency reports the following major governmental funds:

- The *General Fund* is used to account for the Agency's general and administrative expenditures.
- The *Special Revenue Fund* is used to account for revenue sources that are legally restricted to expenditures for specified purposes. The purpose of this fund is to account for that portion of tax increment revenue required to be used towards low and moderate-income housing.
- The *Housing Debt Service Fund* was established to account for the payment of interest and principal on the Agency's merged area housing set-aside tax allocation bonds. The primary source of revenue for this fund is intergovernmental revenue from the City of San José Housing Department representing repayments of housing bonds per bond indentures. In addition, the fund holds unspent debt proceeds that are transferred to the City upon request to fund low and moderate housing activities.
- The *Merged Debt Service Fund* was established to account for the payment of interest and principal on the Agency's merged area tax allocation bonds, revenue bonds, refunding revenue bonds, and other loans. The primary source of revenue for this fund is the incremental property tax revenues.
- The *Capital Projects Fund* accounts for all revenues and costs of implementing the redevelopment projects in accordance with the California Redevelopment Law including acquisition of properties, cost of site improvements, and other costs that benefit the projects.

## C. Assets, Liabilities, Equity and Operations

### 1. Investments

The Agency records investment transactions on the trade date. Investments are reported at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Fair value is defined as the amount that the Agency could reasonably expect to receive for an investment in a current sale between a willing buyer and seller and is generally measured by quoted market prices. Investment income, including unrealized gains and losses, is recognized as revenue in both government-wide and fund financial statements.

### 2. Property Tax Increment Revenues

Incremental property tax revenues represent taxes collected in the merged redevelopment project area from the excess of taxes levied and collected over that amount which was levied and collected in the base year (the inception year of redevelopment project areas) property tax assessment along with a provision for inflation.

Under California Proposition 13, the 1975-1976 regular roll value serves as the original base value of the property. Thereafter, changes to the assessment on real property value or a portion thereof, caused by new construction or changes in ownership create the base year value used in establishing the full cash value. The full cash value is the amount of cash or equivalent value of property if exposed for sale in the open market. The full cash value may be adjusted annually to reflect inflation at a rate not to exceed 2% per year, or reduction in the consumer price index or comparable local data at a rate not to exceed 2% per year, or reduced in the event of declining property values caused by damage, destruction or other factors, including a general economic downturn. The maximum basic property tax rate is 1% of the net taxable value of the property. The total tax rate may be higher for various properties because of voter-approved general obligation bonds that are secured by property taxes for the annual payment of principal and interest.

The County of Santa Clara assesses properties, bills, and collects property taxes, as follows:

| | Secured | Unsecured |
|---|---|---|
| Valuation/lien dates | January 1 | January 1 |
| Levy dates | October 1 | July 1 |
| Due dates (delinquent after) | 50% on November 1 (December 10)<br>50% on February 1 (April 10) | July 1 (August 31) |

Taxes are secured by liens on the property being taxed. The term "unsecured" refers to taxes on property other than land and buildings. Supplemental property taxes are levied based on changes in assessed values between the date of real property sales and construction and the next normal assessment date.

The Agency participates in the Teeter Plan offered by the County of Santa Clara. Under the Teeter Plan, the County apportions secured property and supplemental property taxes on an accrual basis when due (irrespective of actual collections) to its local political subdivisions, including the Agency, for which the County acts as the tax-levying or tax-collecting agency. In return, the County then receives all future delinquent payments, penalties and interest.

The County bills and collects property taxes and remits to the Agency its share of the amount levied. The County allocates property taxes to the Agency based on 100% of the tax levy, notwithstanding any delinquencies, under the Teeter Plan. Revenue is recognized when it is levied and received from the County, as discussed under section of Basis of Accounting.

### 3. Restricted Assets

Assets are restricted for specified uses by bonded debt requirements, grant provisions or other requirements and their use is limited by applicable bond covenants or agreements. Liabilities payable from such restricted assets are separately classified on the statement of net assets.

### 4. Capital Assets

**Accumulated Redevelopment Project Costs -** Accumulated Redevelopment Project Costs consist of costs associated with land acquisition, building construction, and construction in progress for redevelopment projects that will be transferred to the City or a developer (i.e. title and ownership of the assets will be given to the City or a developer) in accordance with development agreements. These are recorded in the government-wide financial statements at historical cost.

**Other Capital Assets -** The Agency defines other capital assets as assets used in redevelopment operations with an initial individual cost of at least $5,000 and an estimated useful life in excess of one year. The capital assets consist of both depreciable and nondepreciable assets. Other capital assets are recorded in the government-wide financial statements at historical cost and are being depreciated using the straight-line method over the estimated useful life of 40 years for the parking structure and buildings, 25 years for leasehold improvements, and 5 years for equipment.

Maintenance and repairs are charged to operations when incurred. Betterments and major improvements, which significantly increase values, change capacities, or extend useful lives, are capitalized. Upon sale or retirement of capital assets, the cost and related accumulated depreciation are removed from the respective accounts and any resulting gain or loss is included in the statement of activities. However, the proceeds from the sale of capital assets are recorded as other financing sources in the governmental fund statement of revenues, expenditures, and changes in fund balances.

### 5. Compensated Absences (Accrued Vacation and Sick Leave)

As part of the employees' compensation package, the Agency provides benefits to its employees by establishing Paid Time-Off (PTO) and Extended Sick Leave (ESL) benefit programs. Under these programs, employees are permitted to accumulate earned PTO and ESL benefits and to carry over up to 400 unused PTO hours to the following fiscal year. Vested or accumulated PTO and ESL are reported as a long-term liability on the statement of net assets and are paid out of the General Fund and Capital Projects Fund. All regular employees scheduled to work 20 hours or more per week are entitled to the PTO and ESL benefits. The amount of PTO earned each year is based on employees' continuous length of service, measured from the date of employment. The maximum PTO annual accrual per employee may not exceed 400 hours at the end of the fiscal year. ESL hours are credited at the rate of 40 hours per fiscal year for all regular employees regardless of length of service and can be carried over with no limit.

Agency employees may choose once during the fiscal year to receive the cash value for accumulated PTO hours of over 200 unused hours by selling time back to the Agency, providing that the employees' PTO balance after the sell-back is above 200 and less than the maximum allowable. Upon separation from employment, earned and unused PTO is paid in full, while only 25% of earned but unused ESL is paid out.

As of January 31, 2012, the Agency paid all terminated employees their unused PTO and ESL leave in the amount of $128,409 based on the above criteria.

### 6. Issuance Costs, Original Issue Discounts, Premiums, and Refundings

In the government-wide financial statements, activity associated with the issuance of bonds and other debt is reported as assets and liabilities in the statement of net assets. Issuance costs, premiums, discounts, and gains or losses occurring from refundings are deferred and amortized over the life of the bonds and other debt. Issuance costs are reported as deferred charges and are amortized into the appropriate functional expense category. Long-term debt is reported net of the applicable premiums, discounts, and deferred amounts on refunding. The premiums, discounts, and deferred amounts on refunding are amortized as a component of the interest expense in a systematic and rational manner over the remaining life of the debt instrument.

In the fund financial statements, bond issuance costs, premiums, and discounts are recognized at the time bonds are issued. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures and all other amounts are reported as other financing sources or uses.

### 7. Interfund Transactions

Interfund transactions are reflected either as loans, services provided, reimbursements, or transfers in the governmental fund financial statements. Loans between funds are reported as receivables and payables as appropriate, and are subject to elimination upon consolidation and are referred to as "due to/from other funds."

Services provided, deemed to be at market or near market rates, are treated as revenues and expenditures/expenses. Reimbursements are recorded 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. Transfers between governmental funds are netted as part of the reconciliation to the government-wide presentation.

### 8. Use of Estimates

The preparation of the basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

## II. DETAILED NOTES ON ALL FUNDS

## A. Cash and Investments

The Agency's cash and investments consist of the following at January 31, 2012:

| Cash and Investments | Amount |
|---|---|
| Unrestricted | $ 8,887,540 |
| Restricted | 121,818,652 |
| Total cash and investments | $ 130,706,192 |

***Investments***

The Agency has adopted the investment policy of the City, which is governed by provisions of the California Government Code and the City's Municipal Code. The Agency also has investments subject to provisions of the bond indentures of its various bond issues. According to the investment policy and bond indentures, the Agency is permitted to invest in the City's 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, money market mutual funds invested in U.S. Government securities, along with various other permitted investments.

The Agency maintains most of its unrestricted investments in the City's cash and investment pool. It is not possible to disclose relevant information about the Agency's separate portion of the cash and investment pool, as there are no specific investments belonging to the Agency itself. Information regarding the characteristics of the entire investment pool can be found in the City's June 30, 2012, basic financial statements. A copy of that report may be obtained by contacting the City's Finance Department, 200 East Santa Clara Street, 13th Floor, San José, CA, 95113 or can be found at the City's Finance Department Web Site at http://www.sanjoseca.gov/.

Investment in the City's investment pool reflects a balance of $6,335,172 at January 31, 2012. The amounts held in the City's investment pool can be withdrawn upon demand. The weighted average maturity of the City's investment pool at January 31, 2012 is 575 days. Income earned or losses arising from investments in the City's cash and investment pool are allocated by the City on a monthly basis to the appropriate funds based on the average weekly cash balance of such funds.

As of January 31, 2012, the Agency invested a total amount of $25,071,163 with State of California Local Agency Investment Fund (LAIF), which is comprised of $12,545,477 from the 2003 Tax Allocation Bonds reserve fund, $2,525,068 from the 2008 Tax Allocation Bond's reserve and capitalized interest funds, $26,015 from 2008 Tax Allocation Bonds project funds, $9,969,603 from the 2010 Housing Set-Aside Bonds reserve fund and $5,000 in an Agency LAIF account deposited in the City's investment pool. Government Code Section 16429.1 authorizes each local government agency to invest funds in the LAIF administered by the California State Treasurer. The total amount recorded by all public agencies in LAIF at January 31, 2012 was approximately $21.7 billion. LAIF is part of the State's Pooled Money Investment Account (PMIA). The total amount recorded by all public agencies in PMIA at January 31, 2012 was $66.1 billion and of that amount, 3.16% was invested in structured notes and asset-backed securities. The weighted average maturity of LAIF was 245 days at January 31, 2012. The Local Investment Advisory Board has oversight responsibility for LAIF. The value of the pool shares in LAIF, which may be withdrawn upon request, is determined on an amortized cost basis, which is different from the fair value of the Agency's position in the pool.

### *Custodial Credit Risk*

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

The California Government Code requires that a financial institution secure its deposits made by State or local governmental units by pledging securities in an undivided collateral pool held by the depository regulated under State law (unless so waived by the governmental unit). The market value of the pledged governmental securities and/or first trust deed mortgage notes held in the collateral pool must be at least 110% and 150% of the Agency's and City's deposits, respectively. The collateral is held by the pledging financial institution's trust department and is considered held in the Agency's name or City's name, in the case of Agency's investment with the City Cash and Investment Pool. The Agency's investments held by the City are not subject to custodial credit risk at January 31, 2012.

As of January 31, 2012, $10,186,539 of the Agency's bank balance was exposed to custodial credit risk because it was uninsured beyond the Federal Deposit Insurance Corporation (FDIC) insurance coverage limit of $250,000, but collateralized by the pledging financial institutions as required by Section 52652 of the California Government Code. Such collateral is held by the pledging financial institutions' trust department or agent, in the Agency's name. The actual book balance amounted to $10,639,102 as of January 31, 2012.

The Agency invests in individual investments and in investment pools. Individual investments are evidenced by specific identifiable securities instruments, or by an electronic entry registering the owner in the records of the institution issuing the security, called the book entry system. In order to increase security, the Agency employs the trust department of a bank or trustee as the custodian of certain Agency investments, regardless of their form.

### *Interest Rate Risk*

Interest rate risk is the risk that changes in market rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market rates. The Agency's investment policy has mitigated interest rate risk by establishing policies over liquidity.

### *Credit Risk*

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This risk is measured by the assignment of a rating by the nationally recognized statistical rating organizations. The Agency's investment policy has mitigated credit risk by limiting investments to the safest types of securities, by prequalifying financial institutions, by diversifying the portfolio and by establishing monitoring procedures.

### *Concentration of Credit Risk*

Concentration of credit risk is the risk that the failure of any one issuer would place an undue financial burden on the Agency. The Agency's investment with the City's cash and investment pool and LAIF mitigates the concentration of credit risk by diversifying the portfolio and limiting investments in any one issuer to no more than 5% of the total portfolio other than securities issued by the U.S. government and its affiliated agencies. Investments issued by or explicitly guaranteed by the U.S. Government and investments in mutual funds, external investment pools, and other pooled investments are exempt from this requirement, as they are normally diversified themselves.

A summary of the Agency's cash and investments at January 31, 2012 is as follows:

| Investment | Credit Rating | Maturity (in days) Under 30 | 31 - 180 | 181 - 365 | 366 & Over | Fair Value |
|---|---|---|---|---|---|---|
| City of San Jose | | | | | | |
| Cash and Investment Pool | Unrated | $ - | $ - | $ - | $ 6,335,172 | $ 6,335,172 |
| State of California | | | | | | |
| Local Agency Investment Fund | Unrated | - | - | 25,071,163 | - | 25,071,163 |
| U.S. Treasury Notes | Aaa | - | - | - | 2,291,314 | 2,291,314 |
| Federal Farm Credit Bank Bonds | Aaa | - | - | - | 5,782,661 | 5,782,661 |
| Money Market Mutual Funds | Aaa | 72,695,992 | 7,889,985 | - | - | 80,585,977 |
| Subtotal | | $ 72,695,992 | $ 7,889,985 | $ 25,071,163 | $ 14,409,147 | 120,066,287 |
| Certificates of Deposit | | | | | | 8,092,536 |
| Bank deposits | | | | | | 2,546,569 |
| Petty cash | | | | | | 800 |
| Grand Total | | | | | | $ 130,706,192 |

***Restricted Cash and Investments in the Debt Service Funds***

Under the provisions of the bond indentures, certain accounts with trustees were established for repayment of debt, amounts required to be held in reserve, and temporary investments for unexpended bond proceeds. These accounts are reported in debt service funds. As of January 31, 2012, the amounts held by the trustees aggregated to $118,726,115 in compliance with amounts required to be held by the trustee. All restricted investments held by trustees as of January 31, 2012 were invested in U.S. Treasury Notes, Federal Farm Credit Bank Bonds, money market mutual funds and LAIF, and were in compliance with the bond indentures.

***Restricted Investments in the Capital Projects Fund***

Pursuant to contracts and agreements made by the Agency, certain funds are required to be held in escrow accounts that remain the property of the Agency; however, their use is restricted for a particular purpose, which as of January 31, 2012, are as follows:

| Project/Program | Amount |
|---|---|
| Dr. Martin Luther King, Jr Library | $ 1,819,950 |
| The 88 Tower (Retail and Housing) | 708,242 |
| HUD Section 108 Loans Debt Service Account | 541,427 |
| Center for Employment Training Toxic Fund | 22,287 |
| ACE Charter School | 626 |
| Total other restricted deposits | $ 3,092,532 |

## B. Loans Receivable

Composition of loans receivable as of January 31, 2012 is as follows:

| | Description | Loan Balance |
|---|---|---|
| 1. | Parcels of land sold to developers | $ 1,728,360 |
| 2. | HUD Section 108 loans | 3,109,292 |
| 3. | Rehabilitation of apartment complex | 406,391 |
| 4. | Historic homes relocation loans | 3,882,441 |
| 5. | Rehabilitation of residential units | 170,571 |
| 6. | Commercial building loans | 10,696,399 |
| 7. | Residential housing projects | 16,543,506 |
| 8. | Rehabilitation of historic hotel building | 5,265,000 |
| 9. | Small business loan program | 299,463 |
| | Total loans | 42,101,423 |
| | Accrued interest receivable | 4,572,567 |
| | Total loans and interest receivable | 46,673,990 |
| | Less allowance for doubtful accounts | (15,775,153) |
| | Loans receivable, net | $ 30,898,837 |

1. Over the years, parcels of land have been sold to commercial real estate developers in various mixed-use projects. In one downtown residential condominium project, a non-interest bearing promissory note was recorded in 2007 whereby the Agency deferred a portion of the land sale until the first residential unit closed escrow. On April 26, 2011, the loan agreement was amended giving right to the developer to convert the project from for-sale to rental. The amended agreement also gave the developer the authority to subsequently convert any units back to for-sale units. The principal loan and interest are due and payable when all proceeds of sold condominium units exceed the invested capital threshold. As of January 31, 2012, the amount due from the developer was $1,728,360. A 100% provision for doubtful accounts was provided for the entire loan balance because the likelihood of the payment criteria being met is questionable in the foreseeable future.

2. In 1997 and 2007, the Agency extended loans to developers using funds obtained from the U.S. Department of Housing and Urban Development Section 108 loan proceeds. These loans have a 20-year repayment schedule, bear interest at an annual rate of 3%, and require principal and interest payments to the Agency on a monthly basis. As of January 31, 2012, the amount due from the developers was $3,109,292. During the seven-month period ended January 31, 2012, the Agency re-evaluated the allowance for doubtful accounts on these loans and recorded an allowance for doubtful accounts in the amount of $1,372,892 at January 31, 2012. The increase in the allowance of $1,372,892 is equal to the principal balance of a loan due to amounts in arrears during this reporting period.

3. In 1999, the Agency extended a loan to a developer for rehabilitation of an apartment complex. The loan to the developer has a 19-year repayment schedule, bears interest at an annual rate of 3%, and requires principal and interest payments to the Agency on a monthly basis. As of January 31, 2012, the amount due from the developer was $406,391.

4. The Agency relocated historic single-family homes to vacant lots in downtown San José. These homes were provided to families and a non-profit agency, which provided the interior and exterior improvements. The loans are to be amortized and forgiven over a certain number of periods and to be paid only in the event of non-compliance with the terms and conditions of the agreements. At the time residential occupancy of the house ceases or the property is transferred to anyone other than the owner by any method other than inheritance, the unamortized portion of the loan shall become due and payable in full. Unpaid principal shall bear an interest rate of 8% per annum. The total loans of $3,882,441 have been offset with a 100% provision for doubtful accounts as it is anticipated that these loans will be forgiven or fully amortized over the period of the loan.

5. The Agency extended various bank-assisted loans to aid first-time homebuyers and to aid with the rehabilitation of homes. The loans accrue interest at various interest rates and are due when the related properties are sold. As of January 31, 2012, the amount due from such loans was $170,571. This amount has been offset with a 100% provision for doubtful accounts because of the indefinite timeline of repayment.

6. The Agency extended various loans to property owners for the rehabilitation and improvements of commercial buildings. These loans accrue interest at various interest rates and are due within 10 to 25 years. At January 31, 2012, the total amount due from such loans was $10,696,399. During the seven-month period ended January 31, 2012, the Agency re-evaluated the allowance for doubtful accounts on these loans and increased the allowance for doubtful accounts to a total of $3,355,889 at January 31, 2012.

7. The Agency entered into Disposition and Development Agreements with various developers for the construction of residential housing units in redevelopment project areas. The funding assistance extended by the Agency was converted to loans bearing an interest rate ranging from 2% to 4% and the repayment of the loan is contingent upon the positive net cash flow of the project. As of January 31, 2012, the amount due from the developers was $16,543,506.

8. In May 2005, the Agency amended and restated a Disposition and Development Agreement with a developer recognizing a loan for the rehabilitation of a historic hotel building. The loan has a 60-year repayment schedule, bears no interest, and requires principal payments to the Agency on a semi-annual basis starting in fiscal year 2020-2021. As of January 31, 2012, the amount due from the developer was $5,265,000. A 100% provision for doubtful accounts was provided for the entire loan balance due to the extended timeline before payments commence.

9. In June 2002, the Agency Board approved the creation of the Small Business Loan Program to be administered by the City's Office of Economic Development (OED) and to be funded by the Agency with non-tax increment funds. The program offered reduced-rate loans to small businesses located in Downtown and Neighborhood Business Districts. The loans bear an interest rate of 3% with a 5-year term. In July 2008, administration of the program was transferred from OED to the Agency. The Agency has not funded the program since then. As of January 31, 2012, the outstanding loans totaled $299,463.

## C. Deferred Revenue and Unearned Revenue

At January 31, 2012, the various components of deferred revenue and unearned revenue reported in the governmental funds and governmental activities were as follows:

| | Amount |
|---|---|
| Amounts considered unavailable (deferred revenue), as reported in the fund financial statements: | |
| Related to loans receivable | $ 29,076,610 |
| Amounts considered unearned: | |
| Related to developers contributions | $ 2,290,327 |
| Related to other long-term receivables | 42,250 |
| Total unearned revenue, as reported in the fund financial statements | $ 2,332,577 |

## D. Interfund Balances and Transactions

The composition of borrowing between funds as of January 31, 2012, is as follows:

| Due from Other Funds: | Due to Other Funds: | Amount |
|---|---|---|
| Capital Projects Fund | Special Revenue Fund | $135,147 |

The $135,147 represents the amount to be returned to the Agency by the City's Housing Department from its low-moderate income housing funds, as a result of County's over remittance of supplemental assessments in the month of June 30, 2011.

During the seven-month period ended January 31, 2012, the Agency transferred out $28,280,003 from the capital projects fund to the merged debt service fund to make the required debt service payments.

### E. Capital Assets - Accumulated Redevelopment Project Costs

For the seven-month period ended January 31, 2012, the change in accumulated redevelopment project costs consisted of the following:

| | July 1, 2011 | Disposition | Reclassifed to Other Capital Assets | January 31, 2012 |
|---|---|---|---|---|
| Nondepreciable: | | | | |
| Land held for redevelopment | $ 63,639,418 | $ (5,994,276) | $ - | $ 57,645,142 |
| Construction in progress | 20,615,651 | (557,545) | (19,081,411) | 976,695 |
| Total Accumulated Project Costs | $ 84,255,069 | $ (6,551,821) | $ (19,081,411) | $ 58,621,837 |

During the period ended January 31, 2012, the Agency received proceeds in the amount of $11,268,355 from the sale of two parcels of land held for redevelopment with an aggregating book value of $5,994,276 as follows: Block 3 Surface Parking Lot ($2,424,181) and Fountain Alley Parking Lot ($3,570,095). In addition, the Agency evaluated its capital assets listing and expensed $557,545 of accumulated project costs related to cancelled projects.

Construction in progress as of January 31, 2012, consisted of the Julian Street Realignment project.

The accumulated redevelopment project costs consist of the following construction in progress and land parcels at January 31, 2012:

| Property description | Cost |
|---|---|
| Market Gateway Housing Ground Lease | $ 3,253,517 |
| Century Residential Housing Ground Lease | 4,281,701 |
| SCVWD Easement | 27,957 |
| GRP/Freeway Landscape | 5,831,917 |
| Hoffman/ Via Monte Community Center | 2,211,175 |
| Julian Street Realignment project | 976,695 |
| North San Pedro properties | 18,272,701 |
| Subtotal | 34,855,663 |
| Assets used to secure debt (JPMorgan Collateral): | |
| San Jose Stage | 983,995 |
| West Julian site | 975,819 |
| Anti Graffiti Office | 310,909 |
| Camera 1 and 2 Building | 1,075,927 |
| Japantown Miraido | 5,350,115 |
| Mexican Heritage Plaza - Retail Lot | 368,593 |
| Hanchett parking Lot | 426,632 |
| Little Portugal Parking Lot | 3,900 |
| Ryland Park (under Coleman overpass) | 463,253 |
| Camera 12 | 563,101 |
| Plaza Hotel | 2,212,794 |
| Westinghouse lot | 82,937 |
| Subtotal | 12,817,975 |
| Assets used to secure debt (HUD Collateral): | |
| East Santa Clara Development Site | 10,948,199 |
| Total | $ 58,621,837 |

## F. Other Capital Assets

A summary of changes in the Agency's other capital assets for the seven-month period year ended January 31, 2012, is as follows:

| | July 1, 2011 | Additions | Reclassified from Accumulated Project Costs | January 31, 2012 |
|---|---|---|---|---|
| Capital assets, not being depreciated: | | | | |
| Land | $ 8,391,118 | $ - | $ - | $ 8,391,118 |
| Capital assets, being depreciated: | | | | |
| Buildings | 93,521,487 | - | 15,576,138 | 109,097,625 |
| Building improvements | 15,797,906 | 95,730 | 355,255 | 16,248,891 |
| Public improvements | - | - | 833,451 | 833,451 |
| Leasehold improvements | - | - | 2,316,567 | 2,316,567 |
| Equipment | 1,144,956 | - | - | 1,144,956 |
| Total capital assets, being depreciated | 110,464,349 | 95,730 | 19,081,411 | 129,641,490 |
| Less accumulated depreciation: | | | | |
| Buildings | 10,895,265 | 1,996,495 | - | 12,891,760 |
| Building improvements | 1,651,014 | 631,901 | - | 2,282,915 |
| Public improvements | - | 32,412 | - | 32,412 |
| Leasehold improvements | - | 90,089 | - | 90,089 |
| Equipment | 845,843 | 104,594 | - | 950,437 |
| Total accumulated depreciation | 13,392,122 | 2,855,491 | - | 16,247,613 |
| Total capital assets, being depreciated, net | 97,072,227 | (2,759,761) | 19,081,411 | 113,393,877 |
| Total capital assets, net | $ 105,463,345 | $ (2,759,761) | $ 19,081,411 | $ 121,784,995 |

The Other Capital Assets consist of the following:

| | Land | Depreciable Cost | Total Cost | Accumulated Depreciation | Net Book Value |
|---|---|---|---|---|---|
| **Governmental use assets*:** | | | | | |
| Dr. Martin Luther King, Jr. Library | $ - | $ 64,785,278 | $ 64,785,278 | $ 9,274,817 | $ 55,510,461 |
| Sidewalk on WozWay | 786,264 | - | 786,264 | - | 786,264 |
| Convention Center Phase I Expansion | - | 3,773,759 | 3,773,759 | 725,754 | 3,048,005 |
| Edenvale Community Center | - | 15,576,138 | 15,576,138 | 605,739 | 14,970,399 |
| Civic Auditorium | - | 11,637,152 | 11,637,152 | 1,494,083 | 10,143,069 |
| San Jose Municipal Stadium Improvements | - | 560,781 | 560,781 | 21,808 | 538,973 |
| Montgomery Theater | - | 374,740 | 374,740 | 27,064 | 347,676 |
| St. James Park Improvements | - | 272,670 | 272,670 | 10,604 | 262,066 |
| Subtotal | 786,264 | 96,980,518 | 97,766,782 | 12,159,869 | 85,606,913 |
| **Assets used to secure debt (JPMorgan Collateral)** | | | | | |
| Billy DeFrank Community Center* | 2,077,461 | 1,070,435 | 3,147,896 | 149,416 | 2,998,480 |
| Guadalupe River Park - Locus Street* | 1,002,642 | - | 1,002,642 | - | 1,002,642 |
| Balbach/Almaden Parking Lot | 2,374,931 | - | 2,374,931 | - | 2,374,931 |
| San Jose Stage | - | 107,985 | 107,985 | 22,197 | 85,788 |
| Subtotal | 5,455,034 | 1,178,420 | 6,633,454 | 171,613 | 6,461,841 |
| **Assets used to secure debt (HUD Collateral)** | | | | | |
| Jose Theatre | 845,820 | 7,155,774 | 8,001,594 | 1,024,436 | 6,977,158 |
| **Other capital assets:** | | | | | |
| Block 3 - Central Place Parking Garage | - | 20,510,000 | 20,510,000 | 1,837,354 | 18,672,646 |
| 4th Street Parking Facility - Tenant Improvements | - | 2,316,567 | 2,316,567 | 90,089 | 2,226,478 |
| Hilton Hotel Ground Lease | 1,304,000 | - | 1,304,000 | - | 1,304,000 |
| Equipment | - | 1,144,956 | 1,144,956 | 950,437 | 194,519 |
| Other | - | 355,255 | 355,255 | 13,815 | 341,440 |
| Subtotal | 1,304,000 | 24,326,778 | 25,630,778 | 2,891,695 | 22,739,083 |
| Total | $ 8,391,118 | $ 129,641,490 | $ 138,032,608 | $ 16,247,613 | $ 121,784,995 |

* The Successor Agency will take the appropriate action to transfer those projects identified as governmental use assets to the City upon approval of the Successor Agency Oversight Board and confirmation of the State Department of Finance. The Agency invested in improvements on these sites. .

Parcels of Agency-owned land and other capital assets with an aggregate book value of $19.3 million were used to secure the Letters of Credit obtained from JPMorgan Chase Bank supporting the Agency's 1996 and 2003 Revenue Variable Rate Bonds. In addition, as additional security for the Letters of Credit, the City executed and recorded for the benefit of the JPMorgan a Deed of Trust against the California Theatre, which is owned by the City. As security for payments due to the County of Santa Clara under the Settlement Agreement executed in March 2011, the Agency also (i) executed and recorded for the benefit of the County Deeds of Trust subordinate to JP Morgan on those same parcels of Agency-owned land (except for the California Theatre), (ii) assigned to the County one-half (1/2) of the Agency sales proceeds from the sale of the North San Pedro properties under two separate Disposition and Development Agreements with private developers, and (iii) executed and recorded for the benefit of the County a Deed of Trust against the North San Pedro properties, with an aggregate book value of $18.3 million.

The José Theatre and the East Santa Clara Development site in the Capital Assets – Redevelopment Accumulated Project Costs and two properties owned by the City were used to secure HUD Section 108 loans obtained from the U.S. Department of Housing and Urban Development.

Changes during the seven-month ended January 31, 2012 include capitalized expenditures in the amount of $95,730 for the Civic Auditorium project. Depreciation of the capital assets is charged to the community development functional expense in the statement of activities.

**Notes to the Basic Financial Statements (Continued)**
**January 31, 2012**

## G. Debt

### *Long-term Debt*

The following is a summary of bonds and loans payable of the Agency as of January 31, 2012 (in thousands):

| Type of Indebtedness | Purpose | Original Issue Amount | Issue Date | Maturity Date | Interest Rate Range | Annual Principal Installments | January 31, 2012 Balance |
|---|---|---|---|---|---|---|---|
| **Tax Allocation Bonds (TAB):** | | | | | | | |
| 1993 Merged Refunding | Advance refunding | $ 692,075 | 12/01/1993 | 08/01/2015 | 6.00% | $0-18,195 | $ 18,195 |
| 1997 Merged | Merged area project | 106,000 | 03/27/1997 | 08/01/2028 | 5.38-5.63% | $10-715 | 5,810 |
| 1999 Merged | Merged area project | 240,000 | 01/06/1999 | 08/01/2019 | 4.75% | $0-7,165 | 12,920 |
| 2002 Merged | Merged area project | 350,000 | 01/24/2002 | 08/01/2015 | 4.00-4.50% | $0-11,290 | 13,165 |
| 2003 Merged | Merged area project | 135,000 | 12/22/2003 | 08/01/2033 | 4.00-5.00% | $25- 34,100 | 127,545 |
| 2004 A Merged Refunding | Refunding TABs | 281,985 | 05/27/2004 | 08/01/2019 | 4.23- 5.25% | $8,775-31,900 | 193,215 |
| 2005 A/B Merged Refunding | Refunding TABs | 220,080 | 07/26/2005 | 08/01/2028 | 4.00- 5.00% | $0-26,210 | 198,115 |
| 2006 A/B Merged | Merged area project | 81,300 | 11/14/2006 | 08/01/2035 | 4.50- 5.65% | $0-21,000 | 80,300 |
| 2006 C/D Merged Refunding | Refunding TABs | 701,185 | 12/15/2006 | 08/01/2032 | 3.75-5.00% | $0-74,280 | 698,990 |
| 2007 A-T/B Merged | Merged area project | 212,930 | 11/07/2007 | 08/01/2036 | 0-5.10% | $0-23,970 | 205,685 |
| 2008 A/B Merged | Merged area project | 117,295 | 11/13/2008 | 08/01/2035 | 0–7.00% | $0-6,700 | 107,860 |
| 1997 Housing, Series E | Low-moderate income housing | 17,045 | 06/23/1997 | 08/01/2027 | 5.75-5.85% | $340-3,670 | 17,045 |
| 2003 Housing, Series J/K | Low-moderate income housing | 69,000 | 07/10/2003 | 08/01/2029 | 3.40- 5.25% | $230-3,505 | 40,815 |
| 2005 Housing Series A/B | Low-moderate income housing | 129,720 | 06/30/2005 | 08/01/2035 | 0-5.46% | $0-8,300 | 120,300 |
| 2010 Housing Series A/B | Low-moderate income housing | 67,405 | 04/15/2010 | 08/01/2035 | 0-5.5% | $0-6,305 | 62,220 |
| 2010 Housing Series C | Low-moderate income housing | 93,000 | 04/29/2010 | 08/01/2035 | Variable | $2,425-5,210 | 88,600 |
| **Total Tax Allocation Bonds** | | | | | | | **1,990,780** |
| **Other Long-term Debt:** | | | | | | | |
| 1996 Merged Area Revenue, Series A/B | Merged area projects | 59,000 | 06/27/1996 | 07/01/2026 | Variable | $2,000-4,000 | 46,000 |
| 2003 Merged Area Revenue, Series A/B | Merged area projects | 60,000 | 08/27/2003 | 08/01/2032 | Variable | $1,300-3,900 | 47,655 |
| Pledge obligation-4th/San Fernando Parking Revenue Bonds | 4th/San Fernando parking facility | 48,675 | 04/10/2001 | 09/01/2026 | 4.13-5.25% | $1,740-3,205 | 33,435 |
| 2001 Convention Center Refunding Bonds, Series F | Convention Center project | 190,730 | 07/01/2001 | 09/01/2022 | 4.25-5.00% | $9,150-14,730 | 129,020 |
| CSCDA 2005 ERAF Loan | Fund the State's ERAF Program | 19,085 | 04/27/2005 | 08/01/2015 | 4.77-5.01% | $2,140-2,355 | 7,755 |
| CSCDA 2006 ERAF Loan | Fund the State's ERAF Program | 14,920 | 05/03/2006 | 08/01/2016 | 5.53-5.67% | $1,615-1,905 | 7,790 |
| HUD Section 108 Loans | Merged area projects | 5,200 | 02/11/1997 | 08/01/2016 | Variable | $355-465 | 2,035 |
| HUD Section 108 Loans (CIM) | Merged area projects | 13,000 | 02/08/2006 | 08/01/2025 | Variable | $600-1,135 | 11,830 |
| HUD Section 108 Loans (Story & King) | Merged area projects | 18,000 | 06/30/2006 | 08/01/2025 | Variable | $785-1,570 | 15,880 |
| City of San José Parking Fund Loan | Merged area projects | 6,800 | 04/12/2005 | 06/30/2015 | None | $6,800 | 6,800 |
| City of San José Parking Fund Loan | Merged area projects | 1,683 | 02/27/2010 | 06/30/2016 | None | $1,683 | 3,364 |
| City of San José Parking Fund Loan | Merged area projects | 3,364 | 02/27/2011 | 06/30/2016 | None | $3,364 | 3,364 |
| City of San José Parkland Fees | Parkland Dedication | 8,112 | 07/01/2007 | 06/30/2014 | None | $8,112 | 8,112 |
| City of San José - cost of Autumn property purchased | Merged area projects | 630 | 05/01/2010 | 06/30/2012 | None | $630 | 630 |
| City of San José SERAF Loans | Fund the State's SERAF Payment | 77,315 | 2010-2011 | 06/30/2015 | Variable | $12,873-52,499 | 78,287 |
| Other Long-term Obligation-County Pass Through (Note II.G) | Pass-through payment | 23,562 | 06/30/2011 | 06/30/2017 | Variable | $4,713 | 23,562 |
| **Total Other Long-term Debt** | | | | | | | **425,519** |
| **Total Long-term Debt** | | | | | | | **$ 2,416,299** |

A summary of changes in long-term debt during the seven-month period ended January 31, 2012 follows (in thousands):

| | July 1, 2011 | Addition | Reductions | January 31, 2012 | Amount Due One Year |
|---|---|---|---|---|---|
| Tax allocation bonds: | | | | | |
| 1993 Merged Refunding | $ 32,835 | $ - | $ (14,640) | $ 18,195 | $ - |
| 1997 Merged | 6,110 | - | (300) | 5,810 | 320 |
| 1999 Merged | 12,920 | - | - | 12,920 | - |
| 2002 Merged | 22,565 | - | (9,400) | 13,165 | - |
| 2003 Merged | 127,545 | - | - | 127,545 | - |
| 2004 A Merged Refunding | 201,990 | - | (8,775) | 193,215 | 24,640 |
| 2005 A/B Merged Refunding | 208,380 | - | (10,265) | 198,115 | 20,545 |
| 2006 A/B Merged | 80,300 | - | - | 80,300 | - |
| 2006 C/D Merged Refunding | 699,595 | - | (605) | 698,990 | 630 |
| 2007 A-T/B Merged | 207,635 | - | (1,950) | 205,685 | 2,050 |
| 2008 A/B Merged | 111,125 | - | (3,265) | 107,860 | 3,405 |
| 1997 Housing, Series E | 17,045 | - | - | 17,045 | 340 |
| 2003 Housing, Series J/K | 44,725 | - | (3,910) | 40,815 | 2,545 |
| 2005 Housing, Series, A/B | 122,140 | - | (1,840) | 120,300 | 3,105 |
| 2010 Housing, Series A/B | 63,630 | - | (1,410) | 62,220 | 1,430 |
| 2010 Housing, Series C | 90,900 | - | (2,300) | 88,600 | 88,600 |
| Subtotal tax allocation bonds | 2,049,440 | - | (58,660) | 1,990,780 | 147,610 |
| Other long-term debt: | | | | | |
| 1996 Merged Area Revenue, Series A/B | 48,000 | - | (2,000) | 46,000 | 2,000 |
| 2003 Merged Area Revenue, Series A/B | 48,870 | - | (1,215) | 47,655 | 1,300 |
| Pledged obligation - 4th/ San Fernando parking revenue bonds | 35,105 | - | (1,670) | 33,435 | 1,740 |
| 2001 Convention Center Refunding | 137,805 | - | (8,785) | 129,020 | 9,150 |
| CSCDA ERAF Loans | 17,330 | - | (1,785) | 15,545 | 3,755 |
| HUD Section 108 loans, variable | 31,420 | - | (1,675) | 29,745 | 1,740 |
| City of San José - Parking Fund Loans[1] | 11,847 | 1,681 | - | 13,528 | - |
| City of San José - Deferred Parkland Fees[1] | 8,112 | - | - | 8,112 | - |
| City of San José - other advances[1] | 630 | - | - | 630 | 630 |
| City of San José - SERAF Loans (principal)[1] | 74,816 | - | - | 74,816 | - |
| City of San José - SERAF Loans (interest)[2] | 2,500 | 971 | - | 3,471 | - |
| County Pass-through Obligation | 23,562 | - | - | 23,562 | - |
| Subtotal other long-term debt | 439,997 | 2,652 | (17,130) | 425,519 | 20,315 |
| Subtotal long-term debt before unamortized | 2,489,437 | 2,652 | (75,790) | 2,416,299 | 167,925 |
| Issuance premium (discount) | 41,830 | - | (3,927) | 37,903 | 3,927 |
| Deferred amount on refunding | (43,838) | - | 3,524 | (40,314) | (3,524) |
| Total long-term debt payable | 2,487,429 | 2,652 | (76,193) | 2,413,888 | 168,328 |
| Environmental remediation | 378 | - | (22) | 356 | 96 |
| Total long-term obligations | $ 2,487,807 | $ 2,652 | $ (76,215) | $ 2,414,244 | $ 168,424 |

1 As discussed below, per AB X1 26 all prior loans made between the City and the Agency, except for loans made from the Low and Moderate Income Housing Fund for payment of SERAF, are invalidated on February 1, 2012.

2 As discussed in the Note III.D., interest accrued from origination in excess of the LAIF rate is invalidated pursuant to AB X1 26, as amended by AB 1484.

The Merged Tax Allocation Bonds (TABs) are senior debt and are repaid with the 80% tax increment. The Housing bonds are repaid with the 20% Housing Set-Aside amounts. The other long-term debt is repaid with lease revenue, interest earnings, parking revenue, repayment of developers' loans, rents, and other revenues, including tax increment remaining after payment of Merged Area TABs.

***Merged Area Tax Allocation Bonds***

The Merged Area Tax Allocation Bonds (TABs), which are comprised of Series 1993, Series 1997, Series 1999, Series 2002, Series 2003, Series 2004A, Series 2005A/B, Series 2006A/B, Series 2006C/D, Series 2007A-T/B and Series 2008A/B, are all secured primarily by a pledge of tax increment revenues, consisting of a portion of all taxes levied upon all taxable properties within each of the tax increment generating redevelopment project areas constituting the Merged Area Redevelopment Project, and are equally and ratably secured on a parity with each TAB series.

As of January 31, 2012, assuming no growth in assessed value throughout the term of each constituent project area, the total accumulated 80% tax increment revenue through the period of the bonds would be approximately $2,835,022,000 (Urban Analytics, January 2012). These revenues have been pledged until the year 2036, the final maturity date of the bonds. The total principal and interest remaining on these Tax Allocation Bonds as of January 31, 2012 is approximately $2,671,798,000. The 80% tax increment revenue recognized during the reporting period July 1, 2011 through January 31, 2012 in the amount of $70,129,470 was transferred to the fiscal agent to cover the February 1, 2012 debt service with the residual amount of $29,421,000 being held on reserve for the August 1, 2012 debt service payment. The total debt service (principal and interest) on the Senior TABs amounted to $91,122,691 for the subject reporting period.

Historically, upon receipt of property tax increment, the Agency calculated the 80% and 20% amounts of tax increment and would then transfer the 20% portion to the Low and Moderate Income Housing Fund held by the City, as required by the California Health and Safety Code. The previous requirement to bifurcate the tax increment into the 80% and 20% portions was eliminated in AB X1 26. However, in order to maintain compliance with bond indentures secured by both the 80% and 20% tax increment, the SARA plans to continue bifurcating tax increment into 80% and 20% portions on an ongoing basis and segregating the funds accordingly until all annual senior debt service obligations have been satisfied. See the Successor Agency to the Redevelopment Agency of the City of San José basic financial statements for information regarding redevelopment property taxes received after January 31, 2012.

***Housing Set-Aside Tax Allocation Bonds***

Housing Set-Aside Tax Allocation Bonds (comprised of Series 1997E, Series 2003J/K, Series 2005A/B, and Series 2010A-1, A-2 & B, and the 2010 Subordinate Series 2010C, collectively the “Housing TABs”) are issued to finance affordable housing projects and are secured by a pledge of and lien upon the 20% tax increment revenue set-aside for the low and moderate income housing fund.

As of January 31, 2012, assuming no growth in assessed value throughout the term of each constituent project area, the total accumulated 20% tax increment revenue through the period of the bonds would be approximately $718,029,000 (Urban Analytics, January 2012). These revenues have been pledged until the year 2035, the final maturity date of the bonds. The total principal and interest remaining on these Housing Set-Aside Tax Allocation Bonds as of January 31, 2012 is approximately $524,848,000. The 20% tax increment revenue recognized during the seven-month period ended January 31, 2012 was $17,532,368. The total debt service on housing bonds (principal and interest) amounted to $16,689,960 for the subject reporting period.

***Variable-Rate Demand Bonds***

**1996 Merged Area Revenue Bonds -** In June 1996, the Agency issued the 1996 Merged Area Redevelopment Project Revenue Bonds, Series A and Series B, for $29,500,000 each, to provide additional proceeds to finance various redevelopment projects in the Merged Project Area. The 1996 Bonds are subordinate to the 1993 Merged Area Refunding Tax Allocation Bonds. The 1996 Bonds have a variable rate of interest and Series A bears interest at a weekly rate while Series B bears interest at a daily rate. The rate modes (daily, weekly, monthly) may be changed at the Agency's option.

In connection with the issuance of the 1996 Bonds, the Agency obtained direct pay letters of credit in the amount to cover the outstanding par value of the bonds, which is currently $46,000,000. The letters of credit were set to expire on July 1, 2012, but have been extended to March 1, 2013 (see Note III.D - Subsequent Events).

The daily and weekly rates are the rates that result in the market value of the bonds being equal to 100% of the principal amount outstanding. The average interest rate for the daily and weekly rates for January 31, 2012, was 0.06% for the 1996 Series A and 0.05% for the 1996 Series B, respectively. The total debt service (principal and interest) on the 1996 Bonds amounted to $2,026,810 for the seven-month period ended January 31, 2012.

**2003 Merged Area Revenue Bonds -** In August 2003, the Agency issued Merged Area Revenue Bonds Series A and Series B aggregating $60,000,000. The proceeds of the bonds were used mainly to finance redevelopment projects within the Merged Area. The 2003 Merged Area Revenue Bonds are ratably and equally secured by a pledge of the subordinated revenues and subordinate to the debt service payment of Senior Obligations of the Agency. The 2003 Merged Area Revenue Bonds are supported by two direct-pay letters of credit, in the amount to cover the outstanding par value of the bonds which is currently $47,655,000. The letters of credit were to expire on July 1, 2012, but have been extended to March 1, 2013 (see Note III.D - Subsequent Events).

The 2003 Merged Area Revenue Bonds have a variable rate of interest at a weekly rate, until converted to bear interest at another variable rate or fixed rate at the option of the Agency. The weekly rates are the rates that result in the market value of the bonds being equal to 100% of the outstanding principal and accrued interest. For the seven-month period ended January 31, 2012, the average weekly interest rate for the 2003 Series A was 0.12% and 0.05% for the 2003 Series B. The total debt service (principal and interest) on 2003 Merged Area Revenue Bonds amounted to $1,257,378 for the seven-month period ended January 31, 2012.

The scheduled redemption of these bonds is incorporated in the annual requirements to maturity schedules. The Agency issued these bonds to provide variable-rate exposure to the debt portfolio and to provide additional flexibility with respect to restructuring or redeeming the debt issued for certain projects. Under the reimbursement agreements related to these credit facilities, the trustee is authorized to draw an amount sufficient to pay the purchase price of bonds that have been tendered and have not otherwise been remarketed.

The credit facilities that support the Agency's variable-rate demand bonds are as follows:

| | Balance January 31, 2012 (in thousands) | | Credit Facility Description: Provider | Expiration Date * |
|---|---|---|---|---|
| Redevelopment Agency Revenue Bonds: | | | | |
| Series 1996A (Merged Area) | $ | 23,000 | JPMorgan Chase Bank, N.A. | 7/1/2012 |
| Series 1996B (Merged Area) | | 23,000 | JPMorgan Chase Bank, N.A. | 7/1/2012 |
| Series 2003A (Taxable) (Merged Area) | | 32,655 | JPMorgan Chase Bank, N.A. | 7/1/2012 |
| Series 2003B (Merged Area) | | 15,000 | JPMorgan Chase Bank, N.A. | 7/1/2012 |
| Total variable rate revenue bonds | $ | 93,655 | | |

* The Agency extended the expiration date of these credit facilities subsequent to period end (see Note III.D - Subsequent Events).

The variable-rate revenue bonds (1996 and 2003 Bonds) are payable upon demand of the bondholder at a purchase price equal to principal plus accrued interest. The remarketing agents are required to use their best efforts to remarket the bonds and, to the extent that bonds are not remarketed, the bond trustees are authorized to draw on the credit facilities in the amounts required to pay the purchase price of bonds tendered.

In connection with the issuance of the 1996 and 2003 Bonds, the Agency obtained four letters of credit as credit facilities from the credit facility provider, JPMorgan Chase Bank, for the bonds. At January 31, 2012, the letters of credit were set to expire on July 1, 2012 (see Note III.D regarding the extension of the letters of credit). The Agency's repayment of unreimbursed draws made on the credit facilities bear interest at varying rates with the principal amortized from the date of the draw to the expiration of the credit facility. As of January 31, 2012, there have been no draws under the credit facilities. The Agency shall immediately reimburse the bank for any drawing or drawings made under the Letters of Credit.

The Agency is required to pay the credit facility provider an annual commitment fee for each credit facility ranging from 2.1% to 2.5%, based on the terms of the applicable reimbursement agreement and the outstanding principal amount of the bonds supported by the credit facility. In addition, in fiscal year 2010, the Agency deposited $5 million as a liquidity reserve as an added source of security for the bank. Parcels of Agency-owned land and the City's California Theatre were also used to secure the Letters of Credit (see Note II.E - Capital Assets – Accumulated Redevelopment Project Costs).

In the event the LOCs are not renewed or a substitute LOC can not be obtained from another financial institution, the full amount of the outstanding 1996 and 2003 Merged Area Revenue Bonds becomes "due and payable". In the event the LOC is not extended and insufficient funds exist to pay the amount due and payable, the interest rate on the Bonds increases to a default rate of 11.5%.

**2010 Housing Set-Aside Tax Allocation Bonds -** On April 29, 2010, the Agency issued $93,000,000 in Taxable Subordinate Housing Set-Aside Tax Allocation Variable Rate Bonds, Series 2010C. The 2010C bonds were to (1) refinance the Bank of New York Term Loan and (2) finance and refinance the City's gap loans made or to be made in connection with certain affordable housing developments. The 2010C bonds are secured by 20% housing set-aside tax allocation revenues on a basis subordinate to the senior bonds. The 2010C bonds were issued as multi-modal, variable rate bonds with a taxable interest rate that resets weekly. The 2010C bonds have a single maturity anticipated to be no later than August 1, 2035, but with a scheduled mandatory tender date in three years and mandatory sinking fund redemption payments on August 1 of each year.

The Series 2010C were directly purchased by Wells Fargo Bank. Because the bonds were directly purchased, the bond indenture does not require a credit facility to support the debt service payments until the bank's tender date of April 29, 2013, or such other date agreed to in writing by the SARA and Wells Fargo Bank. At January 31, 2012, the balance of $88,600,000 is reclassified as a governmental fund liability in the Housing Debt Service Fund.

The Series 2010C bears an interest rate at 1-month LIBOR, two London Business Days before the 1st day of each month plus 172 basis points, with a final maturity date of August 1, 2035. The average weekly interest rate for the Series 2010C as of January 31, 2012 was 2.095%. The agreement with Wells Fargo Bank contains covenants including a requirement for certain ratings by Moody's and Standard & Poor's.

Wells Fargo Bank has the option to tender the bonds in April 2013. Without an extension of the existing agreement with Wells Fargo or a new agreement with another financial institution, the full amount will become due and payable. Refer to Note III.D - Subsequent Events for additional information related to this agreement.

***4th and San Fernando Streets Parking Facility Bonds***

In March 2001, the City of San José Financing Authority (the "Financing Authority"), issued Revenue Bonds, Series 2001 A in the amount of $48,675,000 to finance the construction of the 4th and San Fernando Parking Facility Project. The Financing Authority is a Joint Powers Authority authorized pursuant to a Joint Exercise of Powers Agreement between the City and the Agency to borrow money for the purpose of financing the acquisition and construction of assets of the City and the Agency, of which the Series 2001 A bonds were issued by the Financing Authority and reflected as debt of the Agency. The Agency entered into the Agency Pledge Agreement with the Financing Authority, whereby Agency payments are payable from and secured by surplus Agency Revenues and, therefore, this debt reflects only the 4th Street parking facility obligation. Agency payments are limited in each year to an amount equal to the annual debt service due on the bonds minus surplus revenues generated by the parking facility. Surplus Agency Revenues consist of (i) estimated tax increment revenues, which are pledged to the payment of the Agency's outstanding tax allocation bonds and deemed to be "Surplus" in the current fiscal year in accordance with the resolution or indenture pursuant to which the outstanding tax allocation bonds were issued, plus (ii) all legally available revenues of the Agency.

No surplus parking revenue was received from the parking facility's operations to help the Agency pay the $3,362,792 debt service during the seven-month period ended January 31, 2012. The Agency has an outstanding obligation, per Agency Pledge Agreement, of $33,435,000.

***Convention Center Refunding Bonds***

In July 2001, the Financing Authority issued the Convention Center Lease Revenue Refunding Bonds, Series 2001 F (tax exempt) and Series 2001 G (taxable) amounting to $186,150,000 and $4,580,000, respectively. The bonds were issued to refund the 1993 Revenue Bonds, Series C. The net proceeds were placed in an irrevocable trust to provide future debt service payments on the refunded bonds. As a result, the 1993 bonds were considered defeased and the liabilities have been removed from the financial statements. As of January 31, 2012, there were no defeased bonds outstanding.

In connection with the issuance of the 2001 Convention Center Refunding Bonds, the Agency and the City entered into the Second Amended and Restated Reimbursement Agreement under which the Agency is obligated to use tax increment or other revenue to reimburse the City for lease payments made to the

Financing Authority for the project. The Series 2001F bonds (tax exempt) mature in 2022 and the Series 2001F bonds have an outstanding balance of $129,020,000 as of January 31, 2012.

***California Statewide Communities Development Authority (CSCDA) Educational Revenue Augmentation Fund (ERAF) Loans***

Over the years, the Agency has been sporadically required to make payments to the State of California's Educational Revenue Augmentation Fund (ERAF) through the County of Santa Clara. To finance the 2006 and 2005 ERAF payments, the Agency participated in the California Redevelopment Association/Educational Revenue Augmentation Fund (CRA/ERAF) Loan Program. The loans are secured by all of the Agency's revenues but are subordinate to senior and junior debt obligations. As of January 31, 2012, the 2006 loan has a balance of $7,790,000, bears a fixed interest rate from 5.53% to 5.67% on remaining interest payments, and matures on August 1, 2016. The 2005 loan has a balance of $7,755,000 as of January 31, 2012, bears a fixed interest rate from 4.77% to 5.01%, and matures on August 1, 2015.

***HUD Section 108 Loans***

In 1997, the Agency received loan proceeds of $5,200,000 under the provisions of the U.S. Department of Housing and Urban Development (HUD) Section 108. The proceeds were used to finance the following downtown projects: Security Building, Bassler & Haynes and Beach Buildings (Eu Bldgs), and the Masson Building.

In 2006, the Agency received loan proceeds aggregating to $31,000,000 under the provisions of HUD Section 108 program. The proceeds were used to finance the CIM Mix-Used Project (Central Place/Tower 88) ($13,000,000) and for reimbursement of costs incurred on the Story/King Retail Project ($18,000,000).

As of January 31, 2012, the outstanding loans due to HUD aggregated to $29,745,000. The notes payable to HUD mature annually through August 2025 and bear interest at 20 basis points above the LIBOR index. The average rate for January 2012 was 0.78%. The HUD loans are secured by several City and Agency owned capital assets (Convention Center South Hall, Jose Theater, East Santa Clara development site, Arena Lot D) with an aggregate gross value of $35,096,000 as of January 31, 2012, and CDBG grants that were awarded or will be awarded to the City.

***City of San José Parking Fund Loans***

On April 12, 2005, the Agency entered into a loan agreement with the City of San José in an amount of $6,800,000 from the future facilities reserve within the City's General Purpose Parking Fund. The loan was received by the Agency from the City in two installments: $3,400,000 on April 15, 2005, and $3,400,000 on February 1, 2006. Interest on the loaned amounts originally accrued monthly on a compounded basis based on the City's Investment Portfolio No.1's rate of return. The Agency used the loan proceeds for programs or projects contained in its Adopted Budget.

On June 12, 2007, the City Council/Agency Board amended the term of the loan to extend the loan maturity date to July 31, 2012, and removed the provision for any future interest beyond June 30, 2007, in exchange for the Agency promising to acquire property for a new downtown parking facility in the Almaden-Gateway Redevelopment Project Area.

Due to the decrease in tax revenues resulting from the economic downturn and the size of the payment the Agency was required by the State to make to the Supplemental Educational Revenue Augmentation Fund ("SERAF"), the Agency was forced to make substantial reductions to its budget in fiscal year 2009-10 and fiscal year 2010-11. The City agreed to loan the Agency from the City's Parking Capital Development Fund its debt service payments to be made by the Agency on the 4th Street Parking Facility Bonds discussed as follows. On March 1, 2010, the City loaned the Agency $1,682,999, representing the March 1, 2010 debt service payment on the 4th Street Parking Facility Bonds. In 2011, the City loaned $3,363,999 to cover the debt service due during fiscal year 2010-11 on the 4th Street Parking Facility Bonds. During the seven-months ended January 31, 2012, the City loaned an additional $1,681,396 to provide funding for the current period debt service payment.

As of January 31, 2012, the City has loaned the Agency a total of $13,528,395. Under the term of the Second Amended Agreement, the Agency is required to repay to the City the principal amount of the initial loan on or before June 30, 2015. If the principal payment is not made on or before June 30, 2015, interest will be calculated monthly on a compounded basis, at the rate earned on funds with City's Investment Portfolio No. 1 from July 1, 2007 to the final date of payment. The revised agreement further requires the Agency to pay the City the remaining loan on or before June 30, 2016, provided that the City and Agency acknowledge that an extension of the repayment due date may be necessary depending on City and Agency priorities at such time.

AB X1 26 states that all prior loans made between the City and the Agency, except for loans made from the Low and Moderate Income Housing Fund for payment of SERAF, are invalidated on February 1, 2012. See Note III.D - Subsequent Events for additional information related to the status of these loans.

***City of San José Parkland Fees Loan***

In June 2001 the Agency Board, in relation to the Parkland Dedication Ordinance (PDO) and the Park Impact Ordinance (PIO), adopted a resolution approving a Parkland In-Lieu Fee Low-Income Unit Voucher Program (Voucher Program) for the payment of subsidized parkland fees for low-income residential units by the Agency. On October 26, 2004, the Board extended the program until December 31, 2005. Under the PDO/PIO, developers of new residential projects are required to dedicate parkland, construct improvements and/or pay equivalent in-lieu fees for neighborhood and community–serving parks. Developers of low-income residential units were issued a voucher from the City's Housing Department to present to the City's Building Division in lieu of the payment of parkland fees, required by the PDO and the PIO. The Agency would then reimburse the City's Parks Trust Fund in the amount of the voucher. In prior years, the Agency paid a cumulative amount of $22,343,000 to the City and currently owes the City a balance of $8,111,800 as of January 31, 2012. On June 22, 2010, the Agency and the City entered a cooperation agreement whereby the Agency agreed to transfer the amounts owed to the City in fiscal year 2015-16.

AB X1 26 states that all prior loans made between the City and the Agency, except for loans made from the Low and Moderate Income Housing Fund for payment of SERAF, are invalidated on February 1, 2012. See Note III.D - Subsequent Events for additional information related to the status of this loan.

***City of San José Autumn Property Loan***

On April 20, 2010, in connection with the land assembly necessary for the proposed Autumn Street Extension Project, the Agency entered into a Cooperation Agreement with the City, whereby the Agency acquired real property owned by the City at 406 North Autumn Street for a purchase price of $630,000. The Agency subsequently exchanged this property with an adjacent property owner, together with additional cash consideration by the Agency, for other parcels necessary for the proposed Autumn Street Extension Project. Pursuant to the Cooperation Agreement, the purchase price is due within thirty (30) days of receipt by the Agency of written notice that the City has issued a Certificate of Occupancy for private development on the 406 North Autumn Street property. On February 1, 2012, the Cooperation Agreement was invalidated by the provisions of AB X1 26.

***Supplemental Educational Revenue Augmentation Funds (SERAF) Loan***

On July 24, 2009, the State Legislature passed Assembly Bill (AB) 26 x4, which required redevelopment agencies statewide to deposit a total of $2.05 billion of property tax increment into the county held Supplemental Educational Revenue Augmentation Funds (SERAF) to be distributed to meet the State's Proposition 98 obligations to schools. The Agency's SERAF obligation was $62.2 million in fiscal year 2009-2010 and $12.8 million in fiscal year 2010-2011. Payments were made by May 10 of each respective fiscal year.

On May 4, 2010, the Agency and the City entered into a loan agreement where the City agreed to loan the Agency through two separate payments (May 2010 and May 2011) with a combined amount of $74,815,668 to make the SERAF payment. Sources of the loan were from the City's Low and Moderate Income Housing Fund ($64,815,668), which was specifically authorized by the legislation, and idle moneys from City special funds ($10,000,000). The City of San José SERAF loan bears variable interest rates at the City's investment pool rate for the $10,000,000 lent from City funds, the City's commercial paper loan program rate for $24,815,668 lent from the Low and Moderate Income Housing Fund, and the 2010 Housing Set-aside Tax Allocation Bonds rates for $40,000,000 lent from the Low and Moderate Income Housing Fund.

On June 28 2012, the State legislature passed AB 1484 further amending the redevelopment dissolution. AB X1 26 states that all prior loans made between the City and the former Agency, except for loans made from the Low and Moderate Income Housing Fund for payment of SERAF, are invalidated on February 1, 2012. Therefore, on February 1, 2012 the $10,000,000 SERAF loan from City special funds and its related accumulated interest and fees in the amount of $77,917 will be invalidated under this provision.

**Tax Sharing Agreement with the County of Santa Clara**

**1983 and 2001 Settlement Agreement**

In 1983, the Agency and the County of Santa Clara (the County) entered into a tax sharing agreement under which the Agency would pay a portion of tax increment revenue generated in the Merged Area and part of the Rincon de los Esteros Project Area (the County Pass-Through Payment). On December 16, 1993, the Agency, the County, and the City entered into a Settlement Agreement, which continued the County Pass-Through Payment.

On May 22, 2001, the County, the City, and the Agency approved an Amended and Restated Agreement (the "Amended Agreement"). In addition to the continued Pass-Through Payment, the Amended Agreement delegated to the County the authority to undertake redevelopment projects in or of benefit to the Merged Area, and requires the Agency to transfer funds to the County to pay for such projects in an amount of 20% of the proceeds of any bonds secured by 80% tax increment (excludes refinancing bonds) (the "Delegated Payment").

**March 16, 2011 Settlement Agreement**

In September 2009, the Agency informed the County that due to the Supplemental Educational Revenue Augmentation Fund ("SERAF") requirement and insufficient tax increment revenues, it did not have sufficient unrestricted funds to make the fiscal year 2009-10 pass-through payment. The Agency further informed the County that it had reserved restricted funds for the fiscal year 2008-09 pass-through ($21.3 million) pending negotiations regarding the payment. On August 20, 2010, the County submitted an invoice to the Agency in the amount of $45.2 million, which included the fiscal year 2008-09 pass-through amounts of $21.3 million, the fiscal year 2009-10 amounts of the $19.2 million, and interest of $4.7 million.

On March 9, 2011, the County of Santa Clara filed a lawsuit in the Santa Clara Superior Court against the Agency, City and San José Diridon Development Authority (the "San José parties") to recoup these payments. On March 16, 2011, a Settlement Agreement was reached and entered into between the County of Santa Clara and the San José. The following terms and conditions have been completed:

1. The Agency paid the County $21.5 million in restricted tax exempt bond proceeds.
2. The Agency paid an additional $5 million in unrestricted funds.
3. The Agency acquired from the City title to the Old City Hall property and transferred it to the County for a credit of $10 million against the debt; the Agency transferred certain parcels it owned, valued at $10 million in exchange for the Old City Hall.

The following obligation remains outstanding with the County as of January 31, 2012:

1. The Agency will pay the County $23.6 million to be paid in 5 equal annual installments ($4.72 million per installment plus interest accrued as of the payment date) no later than June 30 of 2014, 2015, 2016, 2017 and 2018.

During the seven-month period ended January 31, 2012, the Agency did not have sufficient tax increment revenues per Health and Safety Code section 34183(b) to make the fiscal year 2011-2012 pass-through payment. The amount due to the County at January 31, 2012 is $7,542,151. The interest rate for any late pass-through payment for fiscal years 2011-12 and beyond will be as follows: (a) the rate of return earned by the County Treasury Investment Pool for the relevant time period ("County Pool Rate") for the first year the payments are overdue; (b) the County Pool Rate plus 3% additional interest rate penalty for the second year the payment is overdue; (c) the County Pool Rate plus 6% additional interest rate penalty for the third year the payment is overdue; and (d) the County Pool Rate plus 9% additional interest rate penalty for the fourth year and any additional years the payments are overdue, provided however that in no event shall the interest rate exceed 10% in any year.

### *Debt Service Requirements*

The debt service requirements for all debt are based upon a fixed rate of interest, except 1996 Merged Area Revenue Bonds, Series A/B, 2003 Merged Area Revenue Bonds, Series A/B, 2010 Housing Set-Aside Bonds, Series C, HUD Section 108 Loans, and SERAF Loans, which bear interest at variable rates. Interest on the 1996 Merged Area Revenue Bonds Series A/B, 2003 Merged Area Revenue Bonds, Series A/B, and 2010 Housing Set-Aside Bonds, Series C may be set at different interest rate calculation modes, including daily, weekly, monthly and fixed rates. Interest on the 2010 Housing Set-Aside Bonds Series C and HUD Section 108 loans is adjusted monthly, two days before the first day of each month to a variable interest rate equal to 172 basis points above the applicable LIBOR rate for the 2010 Housing Set-Aside Bonds Series C and 20 basis points for the HUD Section 108 Loan. The SERAF Loans funded by the Low and Moderate Income Housing Fund bear interest at variable rates based on the 2010 Housing Set-Aside Bonds, Series C and City's Commercial Paper Obligation.

For purposes of calculating the annual debt service requirements for variable rate debt as of January 31, 2012, the following June 30, 2012 effective rates, which approximate the January 31, 2012 rates, have been used:

| Bond issues | Effective interest rate |
|---|---|
| 1996 Merged Area Revenue, Series A | 0.18000% |
| 1996 Merged Area Revenue, Series B | 0.22000% |
| 2003 Merged Area Revenue, Series A | 0.18000% |
| 2003 Merged Area Revenue, Series B | 0.22000% |
| 2010 Housing Set-Aside, Series C | 3.05000% |
| HUD Section 108 loans | 0.66685% |
| SERAF Loan - Commercial paper | 0.50000% |
| SERAF Loan - Low & Mod Housing | 3.05000% |

The annual requirements to amortize outstanding tax allocation bonds and other long-term debt outstanding as of January 31, 2012, including mandatory sinking fund payments, are as follows (in thousands):

| Year Ending | Merged Tax Allocation Bonds | | Housing Tax Allocation Bonds (2) | | Obligations with 3rd Parties (3) | | Obligations with the City (4) | |
|---|---|---|---|---|---|---|---|---|
| June 30 | Principal | Interest | Principal | Interest | Principal | Interest | Principal | Interest |
| 2012(1) | $ - | $ 40,708 | $ - | $ 6,969 | $ 1,785 | $ 3,781 | $ - | $ 101 |
| 2013 | 51,590 | 80,095 | 9,845 | 14,874 | 19,685 | 8,917 | - | 235 |
| 2014 | 54,210 | 77,377 | 10,310 | 14,479 | 25,572 | 8,191 | - | 236 |
| 2015 | 56,975 | 74,516 | 10,795 | 14,043 | 26,538 | 7,394 | 52,454 | 237 |
| 2016 | 59,880 | 71,516 | 11,330 | 13,569 | 25,257 | 6,550 | 12,816 | 49 |
| 2017-21 | 343,310 | 309,610 | 65,965 | 59,623 | 115,655 | 21,692 | - | - |
| 2022-26 | 407,440 | 214,437 | 79,780 | 42,893 | 84,510 | 4,272 | - | - |
| 2027-31 | 403,785 | 111,229 | 81,495 | 23,154 | 18,360 | 155 | - | - |
| 2032-36 | 279,210 | 30,395 | 59,460 | 6,264 | 7,600 | 10 | - | - |
| 2037-41 | 5,400 | 115 | - | - | - | - | - | - |
| Total | $ 1,661,800 | $ 1,009,998 | $ 328,980 | $ 195,868 | $ 324,962 | $ 60,962 | $ 65,270 | $ 858 |

(1) Period from February 1, 2012 through June 30, 2012
(2) Assumes the 2010C Housing Set-Aside Tax Allocation Bonds would not become due and payable on demand on November 15, 2012. The annual redemption of these bonds is incorporated in the annual payments to maturity schedule.
(3) Assumes Merged Area Revenue Bonds would not be payable on demand upon expiration of the Letter of Credit on March 1, 2013. The annual redemption of these bonds is incorporated in the annual payments to maturity schedule.
(4) Excludes City loans and its related accumulated interest and fees invalidated by AB X1 26 on February 1, 2012.

### *Conduit Debt*

In August 1997, the Agency served as the conduit issuer of $10,595,000 in Multifamily Housing Revenue Bonds in order to provide funds for a mortgage loan to a private developer for a rental housing project on the Agency-owned land in the Japantown Redevelopment Project Area. The Agency has no obligation for these bonds as they are secured primarily by fully modified pass-through mortgage-backed securities guaranteed as a timely payment of principal and interest by the Government National Mortgage Association. The bonds were issued for the purpose of expanding the community's supply of low to moderate-income housing. Additionally, the loan is secured on a nonrecourse basis and is insured by the Federal Housing Authority pursuant to and in accordance with the provisions of Section 221(d) (4) of the National Housing Act. As of January 31, 2012, the outstanding balance was $9,260,000.

### H. Net Assets/Fund Balances

The government-wide financial statements utilize a net assets presentation. Net assets are categorized as follows:

- *Invested in Capital Assets, Net of Related Debt* – This category groups all capital assets excluding Accumulated Redevelopment Project Costs into one component of net assets. These capital assets are reduced by the accumulated depreciation and the outstanding balances of outstanding bonds that are attributable to the acquisition, construction, or improvement of those assets. At January 31, 2012, the amount of the Agency's net assets invested in capital assets, net of related debt is not significant.

- *Restricted Net Assets* – This category presents external restrictions imposed by bond indentures, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation, or funds dedicated to low and moderate housing activities. At January 31, 2012, the Agency's statement of net assets reported restricted net assets of $68,996,973 for future debt service payments.

- *Unrestricted Net Assets/Deficit* – This category represents negative balance/deficit. As of January 31, 2012, the deficit amounted to ($2,172,998,765).

Beginning Fiscal Year 2010-11, the Agency implemented the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54). GASB 54 provides clearer classifications that can be more consistently applied in the governmental funds to enhance the usefulness of fund balance information. The fund balance classifications are primarily based on the extent to which the Agency is bound to observe constraints imposed upon the use of the resources or on specific purposes for which the funds can be spent.

As of January 31, 2012, the fund balances in the governmental funds are classified below:

- *Nonspendable Fund Balance* – to reflect the assets ($2,354,309) that are not in spendable form, including deposits and long-term receivables.
- *Restricted Fund Balance* - to reflect the amounts ($118,787,633) that are subject to externally enforceable legal restrictions. The restrictions are imposed by parties outside the Agency such as creditors through bond debt indenture, grantor, and other governments through laws and regulations. This includes bond reserves ($38,216,573), and funds held by trustees or fiscal agents for future payment of bond principal and interest ($80,509,547).
- *Committed Fund Balance* - to reflect the funds ($6,172,685) whose use is constrained by limitations that the Agency Board imposed through board resolutions. This includes resources available for contract commitments for redevelopment projects approved by the Agency Board as of January 31, 2012.
- *Assigned Fund Balance* - to reflect funds ($4,281,974) use for redevelopment activities. This portion of fund balance is the excess of nonspendable, restricted and committed fund balance.
- *Unassigned Fund Balance* - to reflect the net deficit (-$101,518,037) of the Agency in excess of what can be properly classified in one of the fund balance categories. This amount represents negative balance/deficit excess of nonspendable, restricted, committed fund balance over total unassigned general fund balance.

## III. OTHER INFORMATION

### A. Contingencies

***Risk Management***

The Agency is exposed to various risks of loss related to torts, theft, damage to and destruction of assets, errors and omissions, general liabilities, workers' compensation, and unemployment claims for which the Agency carries commercial insurance policies. The insurance premiums are paid from the General Fund. Claim expenses and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated using actuarial methods or other estimating techniques. The technique to estimate claims is based on many complex factors, such as inflation, changes in legal doctrines, past settlements, and damages awarded. Accordingly, claims are reevaluated periodically to consider the effects of inflation, recent claim settlement trends (including frequency and amount of pay-outs), and other economic and social factors. The estimated claims liability includes amounts of incremental claims adjustment expense related to specific claims and other claims adjustments expenses, if any, regardless of whether allocated to specific claims. During the past three years, there has not been any worker's compensation liability and no instances where the amount of claim settlements exceeded insurance coverage, nor have there been any significant reductions of insurance coverage from the prior year.

***Environmental Land Remediation Obligation***

The Agency has implemented GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This Statement addresses the accounting and reporting of current and potential pollution remediation including contamination that an entity is subject to. A review of the Agency's property during the year reveals that there is no current pollution remediation required based on their current uses (i.e. surface parking and other uses), except the Adobe property and the Miraido property as discussed below.

**Adobe Property -** In prior years, the Agency entered a Disposition and Development Agreement with Adobe Systems, Inc. for development of office towers and underground parking garage on land owned by the Agency in the downtown area. After the parking garage was in operation, it was found that water has been accumulating in the parking underground area. To prevent ground water intrusion, accumulation and contamination in the area, a permanent dewatering and ground water treatment and discharge system (Groundwater Treatment System) was installed that cleanses the water from volatile organic compounds prior to discharging to the Guadalupe River. The cost for the operation and maintenance, sampling and reporting for the Groundwater Treatment System is approximately $95,000 per year based on the annual change in the consumer price index. Projected over four years, the cost would be $356,000, which has been recognized as a liability as of January 31, 2012. Although the Agency sold the land to Adobe during fiscal year 2010-2011, it is still liable to maintain the treatment system and remedy the property from contamination.

**Miraido Property -** On December 2, 2010, the Agency received a Notice of Responsibility from the County of Santa Clara for soil remediation at the Miraido Village Site located at 560 North 6th Street in San Jose. The Agency owns the underlying land and ground leases the site to the Japantown Development Limited Partnership (Miraido). The Agency was added as an additional responsible party. The cleanup process is currently underway with Miraido's consultant working with the Santa Clara County Department of Environmental Health and with the San Francisco Regional Water Quality Control Board on finalizing the details of the cleanup process. The cleanup will take approximately three years to complete and, upon completion, Miraido expects to receive a No Further Action letter.

Miraido is responsible for all cleanup activities and expected to be reimbursed by the State of California LUST fund in an amount up to $500,000. Miraido's consultant has estimated that the cost to achieve case closure is approximately $400,000, with which the Agency's consultant concurs. Under the Ground Lease, Miraido is required to indemnify the Agency if Miraido fails to complete the cleanup process and the Agency incurs any cleanup costs as a result of such failure. As of January 31, 2012, the Agency has not incurred any cleanup costs and Miraido has been conducting the cleanup as required under the Ground Lease.

***Litigation/Unpaid Claims***

The Agency is subject to various other claims and from time to time is involved in lawsuits in which damages are sought. As litigation is subject to many uncertainties and as the outcome of litigated matters cannot be predicted with certainty, it is reasonably possible that some of these legal actions could be decided unfavorably against the Agency.

There are two lawsuits outstanding which are transferred by operation of law to the SARA as of February 1, 2012. If the cases result in an unfavorable ruling against the SARA, there is a potential loss to the SARA of $600,000.

***Ambac Bankruptcy***

On November 9, 2010, Ambac Financial Group Inc. (Ambac Financial) filed for bankruptcy protection under Chapter 11 Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. Ambac Financial is a holding company whose affiliates provide financial guarantees and financial services to its customers. Ambac Assurance Corporation, a subsidiary of Ambac Financial, has issued a financial guaranty insurance policy for payment of principal and interest when due and a reserve fund surety bond for the Agency's Series 1999 and 2005 B tax allocation bonds and the Series 2006 D tax allocation refunding bonds in an amount of $27,775,500. According to the bond indenture for each of these bonds, in the event that such surety bond or insurance policy for any reason lapses or expires, the Agency must immediately (1) deliver a letter of credit, or (2) deliver to the trustee a surety bond or an insurance policy, or (3) make the required deposits to the bond reserve fund.

It is unclear, if such an event were to occur, whether the Agency would be required to take one of the three actions documented above in order to maintain compliance with the bond indenture.

## B. Commitments

***General Fund and Capital Projects Fund Encumbrances***

At January 31, 2012, the Agency had encumbered $6,063,547 for capital improvements and affordable housing costs in connection with the North San Pedro Housing Project, and $109,138 for third party consultant services in support of Agency operations. These encumbrances will be transferred to the Successor Agency as its commitments.

***Defined Contribution Retirement Plan***

In January 1995, the Agency Board adopted a defined contribution retirement plan, the Redevelopment Agency of the City of San José Retirement Plan (the Plan), which provides pension benefits for its employees. For eligible employees who contribute 3.5% of their annual base salary, the Agency contributes approximately 9.0%. Agency contributions are based on a formula taking into account employee annual base salary and length of service. The Agency's contributions for each employee (and interest allocated to the employee's account) are fully vested after three years of continuous service from the original date of employment. Agency contributions and interest forfeited by employees who leave employment before vesting occurs may be used to reduce the Agency's contribution requirement or to offset the plan's operating expenses. Three Agency employees are co-trustees of the Plan. The Agency contracts with an advisor to manage the Plan with all assets being held in trust by a third party custodian in the name of each of the Plan's participants. Each of the Plan's participants directs the investments of their separate account. The Agency Board must authorize changes to the Plan.

The total payroll in the seven-month period ended January 31, 2012 for the Agency's direct employees was $690,000. Both the Agency and the participating employees made contributions to the Plan amounting to $70,000 and $34,000, respectively.

***Leases***

A schedule by years of future minimum rental payments required under the Agency's non-cancelable operating leases for office facilities, business equipment, and property as of January 31, 2012, is as follows (in thousands):

| Year Ending June 30 | Minimum payments | |
|---|---|---|
| 2012 * | $ | 487,093 |
| 2013 | | 1,742,529 |
| 2014 | | 1,304,527 |
| 2015 | | 942,813 |
| 2016 | | 827,067 |
| 2017 | | 846,018 |
| 2018-2021 | | 3,100,548 |
| Total | $ | 9,250,595 |

* For the period February 1, 2012 through June 30, 2012.

The total rent expense for operating leases in the seven-month period ended January 31, 2012 was approximately $990,000. These leases will be transferred to the Successor Agency as its commitments.

## C. Related Party Transactions with the City of San José

***Amounts Received from and Payments to the City***

***Intergovernmental Revenue***

Annually, the City's Housing Department makes payments to the Agency for the repayment of debt service on the Housing Bonds (see Note II.G for the Housing Bonds breakdown). In the seven-month period ended January 31, 2012, the Agency received $23,350,268 from the City to pay the principal and interest due on the housing bonds.

In addition, the Agency received from the City during the current period a total amount of $17,164,218 representing the City's lease payment pursuant to the Second Amended and Restated Reimbursement Agreement for the 2001 Convention Center Refunded Bonds ($15,358,631) and the City's assistance on the Agency's debt service on its HUD Section 108 Loans ($1,805,587).

***Payments to the City***

The Agency paid $408,338 from its General Fund to the City for support services of designated employees allocated to redevelopment activities (i.e. City Clerk's Office and City Attorney's Office).

Prior to February 1, 2012, the Agency was required by the California Community Redevelopment Law to designate 20% of all incremental property tax revenues for low and moderate-income housing activities (the Special Revenue Fund). In addition, in fiscal year 1992, the Agency elected to designate 20% of County supplemental assessment revenues for those purposes. The City's Housing Department administers these designated funds. During the seven-month period ended January 31, 2012, the Agency transferred to the City's Housing Department $17,532,368 in required tax increment set-aside.

During the year, the Agency transferred a total amount of $16,015,497 from its Capital Projects Fund to the City. This transfer represents (1) $15,358,631 reimbursement to the City for the lease payment during the year pursuant to the Second Amended and Restated Reimbursement Agreement for the 2001 Convention Center Refunded Bonds, and (2) $356,784 payment to the City related to the City's offsetting lost property taxes from the San José Arena.

***Cooperation Agreements with the City***

Prior to February 1, 2012, the Agency entered into Annual Cooperation Agreements to assist in funding various projects constructed on its behalf by the City and to reimburse the City for the actual salaries and fringe benefits of City employees who work under the supervision of the Agency's Managing Director or designee, as well as other City staff in providing support services to the Agency. These agreements state the Agency's commitment for a one-year period consistent with the Agency's capital and operating budgets and are renewed on an annual basis.

The agreements further call for the Agency to submit a Project Service Memorandum (PSM) to the appropriate City Department prior to the start of the construction project. Funds are transferred to the City to cover the costs of completing the project including reasonable related administrative costs. After a PSM is finalized, the Agency has no additional obligation relating to the agreed costs of the project except as may be agreed to in writing by the Agency and City. Any surplus funds in the project account are returned to the Agency. The agreement also states that the Agency may cancel the project and any unused funds shall be returned by the City to the Agency. As of January 31, 2012, the City and Agency recorded an accrual in the amount of $1,070,968 to recognize the total amount to be refunded by the City to the Agency for surplus funds on PSM projects.

The Improvement District 99-218SJ (Hellyer-Piercy) was formed in 2001 to fund the construction of necessary infrastructure improvements for a portion of the Edenvale Redevelopment Area. As part of its contribution to the financing of the infrastructure improvements, the Agency agreed pursuant to the Cooperation Agreement between the Agency and the City, to make the assessment payments to the City on behalf of property owners who participate in the program. A transfer of $150,000 from the Agency to the City was made prior to January 31, 2012 to cover the costs for FY 2011-12 including $12,000 for City administrative staff time to process the semi-annual assessment payments in accordance with the County Tax Collector's payment schedule.

***Other Agency and City Transaction/Obligations***

The Agency advanced a portion of a loan made by the City's Housing Department to a third party for a transitional housing project. In prior years, the advance was recorded at its net realizable value of $580,362. During the seven-month period ended January 31, 2012, the Agency re-evaluated the value of the loan and noted that the Agency is entitled to 24.5% of the total loan repayment or $280,280. Therefore, the Agency wrote-down the advance receivable from the City in the amount of $300,082. The advance will be repaid in part in FY 2012-13 and future payments will be made as the loan is collected by the City's Housing Department.

In accordance with the cooperation agreement between the Agency and the City, the Agency advanced money to the City to fund the housing loans of two City senior officers on loan to the Agency in the amount of $250,000, as part of the City's employment benefits to attract the most talented and experienced senior officials from around the country and reside in San José. The term of the loans is 30 years and repayments are made monthly on interest (3.481% - 4.520%) only. The principal balance of the loans is due in 30 years or within six months of the sale of the property or the employee's termination with the City or on default of the loan. The two senior officers separated from City service in June 2011. As of January 31, 2012, one of these loans was paid in full resulting in a balance of $250,000, which was paid subsequent to January 31, 2012.

In the event that tax increment revenues are not sufficient to cover the Agency's enforceable obligations, the City has committed other sources of funding to cover costs related to the following obligations: the City of San Jose Financing Authority Lease Revenue Bonds, Series 2001 F (Convention Center Refunding), City of San Jose Financing Authority Revenue Bonds, Series 2001 A (4th Street & San Fernando Parking Facility Project), Housing and Urban Development (HUD) 108 loans, Education Revenue Augmentation Fund (ERAF) loan payments, and the Successor Agency's annual administrative budget and City Support Service expenses. For additional information regarding long-term debt, refer to Section II.H of the Notes to Basic Financial Statements.

**D. Subsequent Events**

***Invalidation of Loans with the City***

AB X1 26 specifically invalidates existing agreements between the Agency and the City, except for 1) those entered into at the time of issuance of debt, for the purpose of securing repayment of such debt, and 2) loans or advances from the Low and Moderate Income Housing Fund. Therefore, on February 1, 2012, AB X1 26 invalidated the following loans currently reported as long-term liabilities: (1) City of San José Parking Fund Loan ($13,528,395); (2) City of San José Parkland Fees ($8,110,800); (3) City of San José Autumn Street Property ($630,000); (4) the portion of the City of San José SERAF Loans and its related accumulated interest and fees that were funded from sources other than the Low and Moderate Income Housing Fund ($10,077,917); and (5) invalidation of accrued interest with SERAF loans in excess of the LAIF rates pursuant to AB X1 26 as amended with AB 1484 in the amount of ($2,939,512).

Subsequent legislation adopted on June 28, 2012 provides that loans between the City and SARA may be re-established when SARA receives a "finding of completion" from the State Department of Finance and approval of the Oversight Board.

***2010C Housing Set-Aside Tax Allocation Bonds Special Event of Default***

On April 29, 2010, the Agency issued housing set-aside tax allocation bonds Series 2010C (variable rate taxable) in the amount of $93,000,000. The balance outstanding at January 31, 2012 is $88,600,000. The variable rate Housing Set-Aside Tax Allocation Bonds, Series 2010C ("the Bonds") were directly purchased by Wells Fargo Bank ("the Bank"). On June 8, 2012, Moody's Investors Service downgraded the Agency's Senior Obligations Rating to below "Baa1", which triggered a Special Termination Event under the Continuing Covenant Agreement of the Bonds. SARA requested that the Bank forbear from exercising its rights, including without limitation, its rights to accelerate the obligations. For the period commencing on August 15, 2012 and ending on November 15, 2012, the Bank has agreed to forebear from exercising its rights and remedies under the Bond Documents in respect to the existing default. Negotiations are presently under way to extend the forbearance agreement. The SARA cannot predict the outcome of the negotiations.

***1996 and 2003 Merged Area Revenue Bonds Letter of Credit Extensions***

In connection with the issuance of the 1996 and 2003 Bonds, the Agency obtained four letters of credit ("LOCs") as credit facilities from JPMorgan. The 1996 Bonds and 2003 Bonds are variable rate demand bonds with an outstanding balance of $93,655,000. On May 24, 2012, the Oversight Board for SARA approved the extension of the LOCs from a July 1, 2012 expiration date to an expiration date of July 1, 2013. However, as a result of the uncertainty surrounding the amount of property tax increment to be distributed to SARA, in June 2012, JPMorgan notified SARA and the City of its inability to proceed with a one year extension of the LOCs. On June 8, 2012, the last date provided for under the bond documents, an extension was finalized through September 1, 2012.

On June 28, 2012, SARA received an additional transfer of $6,944,321 from the Redevelopment Property Tax Trust Fund of the San Jose Successor Agency (the "San Jose Trust Fund") held by Santa Clara County ("County"). This distribution in conjunction with previous distributions provided for sufficient funds to be transferred to U.S. Bank, the fiscal agent for the JPMorgan subordinate bonds. As a result of these actions on August 7, 2012, JPMorgan agreed to extend the expiry of the existing term of the LOCs from September 1, 2012 to March 1, 2013.

***Dissolution Legislation "True up" Process***

The provisions of AB1484, which was a trailer bill to the FY 2012-13 State Budget, required that the County Auditor-Controller determine if the tax revenues received by the Agency in January 2012 (before dissolution) were in excess of the amount spent by the former Agency and the SARA on enforceable obligations as defined by the Redevelopment Dissolution Law during the period from January 1 through June 30, 2012. If there was an excess, the SARA must remit the residual amounts to the County by July 12, 2012, for allocation to the taxing entities. This is referred to as the "true up" process. Due to the manner in which some of the former Agency's bond obligations were categorized on the Recognized Obligation Payment Schedule (ROPS) during this period, the County Auditor-Controller's calculations indicated a $39,344,400 "overpayment" of tax revenues to the SARA. On July 9, 2012, the Oversight Board of the SARA approved corrections to the previously approved ROPS to clarify that there were no residual tax revenues to distribute to the taxing entities from the San Jose Redevelopment Property Tax Trust Fund ("Trust Fund").

The SARA has been working with the State Department of Finance (DOF) to document why the perceived $39.3 million "overpayment" is incorrect. However, pending resolution with DOF and per the legislation, on July 9, 2012, the County Auditor-Controller submitted an invoice to the SARA in the amount of $39.3 million. The SARA has not paid this invoice. The legislation provides that if the Successor Agency does not pay the amount owed, the State Board of Equalization will be directed to withhold the City's sales tax revenues until the amount due is paid. On August 27, 2012, the SARA received a letter from State Department of Finance ("DOF") indicating that they do not intend to pursue civil penalties or a sales tax offset. Management believes, in consultation with DOF, that the invoice for the "overpayment" is erroneous.

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**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**

Schedule of Revenues, Expenditures, and Changes in Fund Balance

Budget and Actual on a Budgetary Basis - General Fund

For the Period July 1, 2011 Through January 31, 2012

| | Budgeted Amounts * | | Actual Amounts Budgetary Basis Variance with Final Budget Positive/ | Actual Amounts Budgetary | Budgetary to GAAP | Actual Amounts |
|---|---|---|---|---|---|---|
| | Original | Final | (Negative) | Basis | Differences | GAAP Basis |
| **Revenues:** | | | | | | |
| Investment income | $ 7,771 | $ 7,771 | $ - | $ 7,771 | $ - | $ 7,771 |
| Rent | 141,000 | 141,000 | 192,488 | 333,488 | - | 333,488 |
| Other | 3,660 | 3,660 | - | 3,660 | - | 3,660 |
| Total revenues | 152,431 | 152,431 | 192,488 | 344,919 | - | 344,919 |
| **Expenditures:** | | | | | | |
| Current: | | | | | | |
| General government: | | | | | | |
| Non-personnel services | 130,461 | 130,461 | 109,138 | 21,323 | - | 21,323 |
| Intergovernmental: | | | | | | |
| Payments to the City of San José | 700,000 | 700,000 | 291,662 | 408,338 | - | 408,338 |
| Total expenditures | 830,461 | 830,461 | 400,800 | 429,661 | - | 429,661 |
| **Net change in fund balance** | (678,030) | (678,030) | 593,288 | (84,742) | - | (84,742) |
| **Fund balance, beginning of year** | 1,261,544 | 1,261,544 | - | 1,261,544 | - | 1,261,544 |
| **Fund balance, end of year** | $ 583,514 | $ 583,514 | $ 593,288 | $ 1,176,802 | $ - | $ 1,176,802 |

* For 12 month period

See accompanying notes to other required supplementary information.

**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**
Schedule of Revenues, Expenditures, and Changes in Fund Balance
Budget and Actual on a Budgetary Basis - Special Revenue Fund
For the Period July 1, 2011 Through January 31, 2012

| | Budgeted Amounts * | | Actual Amounts Budgetary Basis Variance with Final Budget Positive/ | Actual Amounts Budgetary | Budgetary to GAAP | Actual Amounts |
|---|---|---|---|---|---|---|
| | Original | Final | (Negative) | Basis | Differences | GAAP Basis |
| **Revenues:** | | | | | | |
| Tax increment | $ 35,153,491 | $ 34,953,491 | $ (17,421,123) | $ 17,532,368 | $ - | $ 17,532,368 |
| **Expenditures:** | | | | | | |
| Intergovernmental: | | | | | | |
| Payments to the City of San José | 35,153,491 | 34,953,491 | 17,421,123 | 17,532,368 | - | 17,532,368 |
| **Net change in fund balance** | - | - | - | - | - | - |
| **Fund balance, beginning of year** | - | - | - | - | - | - |
| **Fund balance, end of year** | $ - | $ - | $ - | $ - | $ - | $ - |

* For 12 month period

See accompanying notes to other required supplementary information.

# REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

## Notes to Required Supplementary Information
## January 31, 2012

### STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

### A. Budget Information

The budget of the Agency is an operating plan that identifies estimated costs and results in relation to estimated revenues. Budgets are prepared according to the following guidelines for the General and Special Revenue Funds:

*General Fund*

The operating expenditures are budgeted by appropriation according to type of expenditures, categorized as personnel and non-personnel.

*Special Revenue Fund*

Twenty percent (20%) of the tax increment revenues is budgeted by the Board for payment to the low and moderate-income housing program of the City of San José.

During the seven-month period ended January 31, 2012, the procedures followed to establish the budgetary data reflected in the accompanying budget to actual schedules were as follows:

*Original Budget*

Prior to the beginning of the fiscal year, the Managing Director of the Agency presents to the Board the fiscal budget for the ensuing year, both operating and capital budget. After the tax revenue data is available in July - August from the County Assessor, an amended budget is submitted to the Board in September - November for approval in November - December.

The budget is prepared on a budgetary basis, which does not conform to GAAP, as encumbrances are included as expenditures. Revenue estimates are presented to the Agency Board in total and are approved by revenue resolution.

Prior to June 30 of each year, the annual budget is finalized through passage of the annual appropriation resolution and an annual revenue resolution by the Agency Board, which is the legal authority for enactment of the budget. Management allocates budgeted revenue to the Special Revenue Fund based on priorities established by the California Community Redevelopment Law, bond indentures, and other legal agreements.

The annual appropriation resolution adopts the expenditure budget at the appropriation level (project, personnel, and non-personnel). Accordingly, the lowest level of budgetary control exercised by the Agency Board is the appropriation level. Management can transfer budgeted amounts between project activities included in each appropriation without the approval of the Agency's Board.

*Final Budget*

Supplemental appropriations may be approved during the budget year if there are funds available in the capital reserve. Appropriations lapse at the close of the fiscal year to the extent that they have not been expended or encumbered. No expenditures may be made in excess of amounts appropriated by the Agency Board.

The Agency Board approves changes to the revenue estimates by adoption of a supplemental revenue resolution. The budgetary data presented in the accompanying budget to actual schedules includes all revisions approved by the Agency Board.

**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**
Schedule of Revenues, Expenditures, and Changes in Fund Balance
Budget and Actual on a Budgetary Basis - Housing Debt Service Fund
For the Period July 1, 2011 Through January 31, 2012

| | Budgeted Amounts Original | Budgeted Amounts Final | Actual Amounts Budgetary Basis Variance with Final Budget Positive/ (Negative) | Actual Amounts Budgetary Basis | Budgetary to GAAP Differences | Actual Amounts GAAP Basis |
|---|---|---|---|---|---|---|
| **Revenues:** | | | | | | |
| Intergovernmental | $ 23,350,268 | $ 23,350,268 | $ - | $ 23,350,268 | $ - | $ 23,350,268 |
| Investment income | - | - | - | 12,648 | - | 12,648 |
| Total revenues | 23,350,268 | 23,350,268 | - | 23,362,916 | - | 23,362,916 |
| **Expenditures:** | | | | | | |
| Debt service: | | | | | | |
| Principal repayment | 9,460,000 | 9,460,000 | - | 9,460,000 | - | 9,460,000 |
| Interest and other charges | 7,229,960 | 7,229,960 | - | 7,229,960 | - | 7,229,960 |
| Total expenditures | 16,689,960 | 16,689,960 | - | 16,689,960 | - | 16,689,960 |
| **Excess of revenues over expenditures** | 6,660,308 | 6,660,308 | - | 6,672,956 | - | 6,672,956 |
| **Other financing uses:** | | | | | | |
| Reclassification of demand bonds | - | - | - | - | (88,600,000) | (88,600,000) |
| Total other financing uses | - | - | - | - | (88,600,000) | (88,600,000) |
| **Net change in fund balance** | 6,660,308 | 6,660,308 | - | 6,672,956 | (88,600,000) | (81,927,044) |
| **Fund balance, beginning of year** | 9,959,388 | 9,959,388 | - | 9,959,388 | - | 9,959,388 |
| **Fund balance (deficit), end of year** | $ 16,619,696 | $ 16,619,696 | $ - | $ 16,632,344 | $ (88,600,000) | $ (71,967,656) |

See accompanying notes to supplementary information.

**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**

Schedule of Revenues, Expenditures, and Changes in Fund Balance

Budget and Actual on a Budgetary Basis - Merged Debt Service Fund

For the Period July 1, 2011 Through January 31, 2012

| | Budgeted Amounts * | | Actual Amounts Budgetary Basis Variance with Final Budget Positive/ (Negative) | Actual Amounts Budgetary Basis | Budgetary to GAAP Differences | Actual Amounts GAAP Basis |
|---|---|---|---|---|---|---|
| | Original | Final | | | | |
| **Revenues:** | | | | | | |
| Tax increment | $ 141,613,963 | $ 140,613,963 | $ (70,484,493) | $ 70,129,470 | $ - | $ 70,129,470 |
| Investment income | 587,771 | 105,229 | (28,294) | 76,935 | - | 76,935 |
| Total revenues | 142,201,734 | 140,719,192 | (70,512,787) | 70,206,405 | - | 70,206,405 |
| **Expenditures:** | | | | | | |
| Debt service: | | | | | | |
| Principal repayment | 66,330,000 | 66,330,000 | - | 66,330,000 | - | 66,330,000 |
| Interest and other charges | 97,612,769 | 97,440,599 | 47,474,019 | 49,966,580 | - | 49,966,580 |
| Total expenditures | 163,942,769 | 163,770,599 | 47,474,019 | 116,296,580 | - | 116,296,580 |
| **Deficiency of revenues under expenditures** | (21,741,035) | (23,051,407) | (23,038,768) | (46,090,175) | - | (46,090,175) |
| **Other financing sources:** | | | | | | |
| Transfers in | 28,280,003 | 28,280,003 | - | 28,280,003 | - | 28,280,003 |
| Total other financing sources | 28,280,003 | 28,280,003 | - | 28,280,003 | - | 28,280,003 |
| | | | | | - | |
| **Net change in fund balance** | 6,538,968 | 5,228,596 | (23,038,768) | (17,810,172) | - | (17,810,172) |
| **Fund balance, beginning of year** | 119,893,921 | 119,893,921 | - | 119,893,921 | - | 119,893,921 |
| **Fund balance, end of year** | $ 126,432,889 | $ 125,122,517 | $ (23,038,768) | $ 102,083,749 | $ - | $ 102,083,749 |

* For 12 month period

See accompanying notes to supplementary information.

**REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE**
Schedule of Revenues, Expenditures, and Changes in Fund Balance
Budget and Actual on a Budgetary Basis - Capital Projects Fund
For the Period July 1, 2011 Through January 31, 2012

| | Budgeted Amounts * | | Actual Amounts Budgetary Basis Variance with Final Budget Positive/ (Negative) | Actual Amounts Budgetary Basis | Budgetary to GAAP Differences | Actual Amounts GAAP Basis |
|---|---|---|---|---|---|---|
| | Original | Final | | | | |
| **Revenues:** | | | | | | |
| Intergovernmental | $ 15,229,082 | $ 15,358,631 | $ 1,805,587 | $ 17,164,218 | $ - | $ 17,164,218 |
| Investment income | 837,644 | 324,000 | (123,742) | 200,258 | - | 200,258 |
| Rent | - | - | 19,426 | 19,426 | - | 19,426 |
| Grant revenue | 3,709,899 | 3,709,899 | (3,684,165) | 25,734 | - | 25,734 |
| Other | 1,409,605 | 1,409,605 | 163,478 | 1,573,083 | - | 1,573,083 |
| Total revenues | 21,186,230 | 20,802,135 | (1,819,416) | 18,982,719 | - | 18,982,719 |
| **Expenditures:** | | | | | | |
| Current: | | | | | | |
| General government: | | | | | | |
| Personnel services | 1,000,000 | 2,000,000 | 1,148,057 | 851,943 | - | 851,943 |
| Non-personnel services | 837,351 | 837,351 | 548,092 | 289,259 | - | 289,259 |
| Intergovernmental: | | | | | | |
| Payments to the City of San José | 16,015,497 | 15,713,631 | (301,866) | 16,015,497 | - | 16,015,497 |
| Payments to the County of Santa Clara | 2,976,413 | 2,318,000 | (5,224,151) | 7,542,151 | - | 7,542,151 |
| Payments to other governmental agencies | 2,644,853 | 2,300,074 | (254,348) | 2,554,422 | - | 2,554,422 |
| Capital outlay: | | | | | | |
| Project expenditures | 17,957,671 | 12,507,671 | 7,023,505 | 5,484,166 | - | 5,484,166 |
| Payments to the City of San José | 150,000 | 150,000 | - | 150,000 | - | 150,000 |
| Total expenditures | 41,581,785 | 35,826,727 | 2,939,289 | 32,887,438 | - | 32,887,438 |
| **Excess (deficiency) of revenues over (under) expenditures** | (20,395,555) | (15,024,592) | 1,119,873 | (13,904,719) | - | (13,904,719) |
| **Other financing sources (uses):** | | | | | | |
| Proceeds from City's loan/advances | 15,195,406 | 3,458,000 | (806,012) | 2,651,988 | - | 2,651,988 |
| Proceeds from sale of capital assets | 16,791,778 | 14,768,386 | (3,500,031) | 11,268,355 | - | 11,268,355 |
| Transfers out | (28,280,003) | (28,280,003) | - | (28,280,003) | - | (28,280,003) |
| Total other financing sources (uses) | 3,707,181 | (10,053,617) | (4,306,043) | (14,359,660) | - | (14,359,660) |
| **Net change in fund balance** | (16,688,374) | (25,078,209) | (3,186,170) | (28,264,379) | - | (28,264,379) |
| **Fund balance, beginning of year** | 27,050,048 | 27,050,048 | - | 27,050,048 | - | 27,050,048 |
| **Fund balance (deficit), end of year** | $ 10,361,674 | $ 1,971,839 | $ (3,186,170) | $ (1,214,331) | $ - | $ (1,214,331) |

* For 12 month period

See accompanying notes to supplementary information.

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## STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

### A. Budget Information

The budget process for the Housing Debt Service Fund, Merged Debt Service Fund, and Capital Projects Fund followed the same procedures to establish the budgetary data for the General Fund and Special Revenue Fund, which can be found in the Notes to Other Required Supplementary Information on pages 85-86.

*Housing and Merged Debt Service Funds* - Expenditures are budgeted according to bond indenture requirements. Appropriations for Housing and Merged Debt Service Funds were implicitly adopted by the Agency Board when the formal bond resolutions were approved.

*Capital Projects Fund* - Capital Projects Fund expenditures are budgeted by project, on a project-length basis. Annual appropriations include items such as direct project payments, land acquisition, payments to the City under cooperation agreements, and other expenditures.

### B. Budgetary Results Reconciled To GAAP

The budgetary process is based upon accounting for certain transactions on a basis other than GAAP. The results of operations are presented in the budget and actual comparison schedule in accordance with the budgetary process (budgetary basis) to provide a meaningful comparison with the budget.

The only difference between the budgetary basis actual and GAAP basis is that the reclassification of long-term liabilities to short-term is recognized as an other financing use in the GAAP basis statement while this reclassification is not recognized as an other financing use on the budgetary basis schedule.

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Board of Directors
Redevelopment Agency of the
City of San José, California

**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***

We have audited the financial statements of the governmental activities and each major fund of the Redevelopment Agency of the City of San José (Agency), a component unit of the City of San José, California, as of January 31, 2012 and for the period July 1, 2011 through January 31, 2012, which collectively comprise the Agency's basic financial statements and have issued our report thereon dated November 19, 2012. Our report includes an explanatory paragraph referring to Note I.A. to the basic financial statements relating to the recent legislation dissolving California redevelopment agencies as of February 1, 2012 and an emphasis of a matter paragraph referring to Note III.D. to the basic financial statements related to the $88,600,000 2010 C Housing Set-Aside Tax Allocation Bonds Special Termination Event on June 8, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

***Internal Control Over Financial Reporting***

Management of the Agency and the City as Successor Agency to the Redevelopment Agency of the San José are responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Agency's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Agency's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of finding and response, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness.

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 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. We consider the deficiency described in the accompanying schedule of finding and response to be a material weakness.

***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the Agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. 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 or our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Agency's response to the finding identified in our audit is described in the accompanying schedule of finding and response. We did not audit the Agency's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors, management of the Agency and the State Controller's Office and is not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 19, 2012

***Material Weakness - Finding 2012-1 – Internal Control Over Financial Reporting – Preparation of Financial Statements***

On June 28, 2011, the Governor signed AB X1 26, which amended the Community Redevelopment Law California to, among other things, direct the dissolution of all redevelopment agencies in California. On December 29, 2011, the California Supreme Court (Court) issued a decision that upheld the constitutionality of AB Xl 26. As a result of the Court decision, as of February 1, 2012, by implementation of AB X1 26, the Redevelopment Agency of the City of San José (Agency) was dissolved and the Successor Agency to the Redevelopment Agency of the City of San José (Successor Agency) came into existence as a separate legal entity. The City of San José serves as the Successor Agency and will be referred to as the City hereafter.

The dissolution of the Agency severely impacted the organization's internal controls over financial reporting. In 2011, the Agency had 5 individuals who were involved with accounting, fiscal and financial analysis and financial reporting. During the Agency's close-out audit, the City had one individual assigned to perform these tasks. In addition, to the close-out audit, the City has been responding to and providing information to numerous other auditors, rating agencies and consultants with a total staff of 7 individuals from 58 individuals in 2011.

The current staffing complement is not configured to adequately support the Agency's financial reporting responsibilities resulting in a deficiency in internal controls that provide reasonable assurance that closing transactions (capital assets, accruals, deferred revenue, etc.) and full accrual government-wide financial statements are accurately prepared.

With the increasing audit requests related to the Agency's activities, it is essential that the City has sufficient accounting and fiscal personnel to adequately meet and maintain accurate financial records of the former Agency and subsequent Successor Agency. We recommend that the City provide additional assistance to reduce the likelihood that errors may occur and not be detected or corrected on a timely basis and therefore improve internal controls over financial reporting. Areas where the City could provide additional support include:

- Monitoring and management of the loan portfolio to ensure accurate receivable balances (e.g., bad debt, allowance for doubtful accounts, and collectability and availability analysis).
- Evaluating completed and cancelled redevelopment projects for proper reporting. As of January 31, 2012, the amount of completed projects improperly classified as construction in progress totaled $19.1 million and the amount for cancelled projects totaled $0.6 million.
- Recording of close-out entries (e.g., interest receivable on loans, intergovernmental payables, and deferred revenue) in the financial statements.
- Recording government-wide full accrual closing entries (e.g., unearned revenue adjustments, capital asset activity, and interest payable).

***Management Response:***

The last year has been a fiscally challenging year for the former Redevelopment Agency (Agency). The economic recession took a considerable toll on tax increment revenues and as early as 2010 the Agency began a significant reduction in workforce. At the beginning of fiscal year 2010-11, staffing levels were 92 with 9 devoted to financial operations and affairs of the Agency. By the time dissolution was final on

February 1, 2012, the total staffing was 10 with only 4 devoted to the financial operations and affairs of the former Agency, now the Successor Agency to the Redevelopment Agency (SARA). It would not have been possible for the existing staff to successfully operate without the considerable staffing support received from City staff.

Management acknowledges the considerable stress and resource challenges associated with the financial reporting requirements of the former Redevelopment Agency and the current Successor Agency to the Redevelopment Agency (SARA). During the transition period, the SARA staff has been assisted with resources from both the City Finance and Housing Departments to complete the necessary financial statements for the reporting periods ending January 31, 2012 and June 30, 2012.

This past calendar year has been one of transition as the City has worked to develop proper staffing levels and staffing expertise to ensure the orderly "wind-down" of the former Agency's financial affairs. During the next six months, Management will continue the transition process to ensure appropriate internal controls are met with respect to the financial reporting obligations of SARA and to interface with the various outside agencies. It is Management's expectation that most or all of the financial operations, including financial reporting will be transferred to the City's Finance Department by the end of the current fiscal year. The transfer to the Finance Department allows the financial operations to be reviewed and managed by a larger organization, creates more cross-training and knowledge sharing, and ensures the appropriate level of management reviews.