

**CITY OF SAN JOSE, CALIFORNIA**

Single Audit Reports

Basic Financial Statements with  
Federal Compliance Section

For the Year Ended June 30, 2011

**CITY OF SAN JOSE, CALIFORNIA**

For the Year Ended June 30, 2011

***Table of Contents***

	<b><i>Page</i></b>
<b>FINANCIAL SECTION</b>	
Independent Auditor's Report .....	1
Management's Discussion and Analysis (Required Supplementary Information – Unaudited) .....	3
Basic Financial Statements:	
Government-wide Financial Statements:	
Statement of Net Assets .....	24
Statement of Activities .....	25
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet .....	26
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets .....	28
Statement of Revenues, Expenditures and Changes in Fund Balances.....	30
Reconciliation of the Changes in Fund Balances of Governmental Funds to the Statement of Activities .....	32
Proprietary Funds:	
Statement of Fund Net Assets .....	34
Statement of Revenues, Expenses, and Changes in Fund Net Assets .....	36
Statement of Cash Flows .....	38
Fiduciary Funds:	
Statement of Fiduciary Net Assets .....	40
Statement of Changes in Fiduciary Net Assets .....	41
Notes to Basic Financial Statements.....	43
Required Supplementary Information (Unaudited):	
Schedule of Revenues, Expenditures and Changes in Fund Balances – Budget and Actual:	
General Fund .....	129
Housing Activities.....	130
Schedules of Funding Progress .....	131
Notes to Required Supplementary Information .....	132

**CITY OF SAN JOSE, CALIFORNIA**

For the Year Ended June 30, 2011

***Table of Contents (Continued)***

	<b><i>Page</i></b>
<b>FEDERAL COMPLIANCE SECTION</b>	
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 <i>Government Auditing Standards</i> .....	135
Independent Auditor's Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and the Passenger Facility Charges Program and on Internal Control over Compliance in Accordance with OMB Circular A-133 .....	137
Schedule of Expenditures of Federal Awards.....	139
Schedule of Revenues and Expenditures of Passenger Facility Charges .....	145
Notes to the Schedule of Expenditures of Federal Awards and Schedule of Revenues and Expenditures of Passenger Facility Charges.....	147
Federal Awards Schedule of Findings and Questioned Costs .....	152
Passenger Facility Charges Schedule of Findings and Questioned Costs .....	158
Summary Schedule of Prior Audit Findings .....	159

City Council  
City of San José, California

### Independent Auditor's Report

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San José, California (the City), as of and for the year ended June 30, 2011, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City'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 City'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, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San José, California, as of June 30, 2011, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note I.E. to the financial statements, as of July 1, 2010, the City adopted the provisions of Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

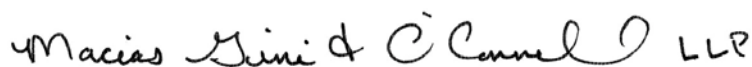
The accompanying financial statements have been prepared assuming that the Redevelopment Agency of the City of San José (Agency) will continue as a going concern. As discussed in Notes I.A. and IV.D.5. to the financial statements, as of June 29, 2011, the California State Legislature has enacted legislation that is intended to provide for the dissolution of redevelopment agencies in the State of California unless certain payments can be made to the State of California. Such changes to the California Redevelopment Law have also terminated the authority of redevelopment agencies to undertake new obligations to redevelop property. The effects of this legislation are uncertain pending the result of certain lawsuits that have been initiated challenging the constitutionality of this legislation. However, based on the Agency's financial condition, the effects of this legislation raise substantial doubt about the Agency's ability to continue as a going concern. Management's plans regarding those matters also are described in Note IV.D.5. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As described in Note IV.A., based on the most recent actuarial valuations as of June 30, 2010, the Police and Fire Department Retirement Plan's and the Federated City Employees' Retirement System's independent actuaries determined that, at June 30, 2010, the value of the defined benefit pension plans' actuarial accrued liability exceeded the actuarial value of their assets by \$653.8 million and \$780.9 million, respectively. Also, as described in Note IV.A., based on the most recent actuarial valuations as of June 30, 2010, the independent actuaries determined that, at June 30, 2010, the value of the postemployment healthcare plans' actuarial accrued liability exceeded the actuarial value of its assets by \$887.7 million for the Police and Fire Department Retirement Plan and \$818.4 million for the Federated City Employees' Retirement System.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2011 on our consideration of the City'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 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; the schedules of revenues, expenditures, and changes in fund balances – budget and actual for the General Fund and the Housing Activities Fund; and the schedules of funding progress 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 City's financial statements as a whole. The accompanying schedule of expenditures of federal awards and schedule of revenues and expenditures of passenger facility charges are presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and the *Passenger Facility Charge Audit Guide for Public Agencies*, respectively, and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.



Walnut Creek, California

November 30, 2011, except for our report on the schedule of expenditures of federal awards as to which the date is January 31, 2012

**City of San José**  
**Management's Discussion and Analysis**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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Management's Discussion and Analysis ("MD&A") provides an overview of the City of San José's ("City") activities and financial performance for the fiscal year ended June 30, 2011. Readers are encouraged to read the MD&A in conjunction with the basic financial statements that immediately follow, along with the letter of transmittal at the beginning of the Introductory Section, and with other portions of this Comprehensive Annual Financial Report ("CAFR"). All amounts have been rounded to the nearest one hundred thousand dollars and one tenth of a percent.

**FINANCIAL HIGHLIGHTS**

- The government-wide statement of net assets for the City's governmental and business-type activities indicates that as of June 30, 2011, total assets exceed total liabilities by \$5.648 billion. Of this amount, \$203.2 million represents unrestricted net assets, which is comprised of a deficit balance of \$129.4 million for governmental activities, and a positive balance of \$332.6 million for business-type activities. In addition, the City's restricted net assets total \$744.8 million (\$622.3 million for governmental and \$122.5 million for business-type activities) and are dedicated to specific purposes. Lastly, net assets of \$4.700 billion are invested in capital assets, net of related debt (\$3.810 billion for governmental and \$890.0 million for business-related activities).
- Total net assets decreased by \$382.0 million or 6.3 percent during 2010-2011 from \$6.030 billion to \$5.648 billion. Depreciation expense of \$442.9 million accounts for this decrease. Excluding depreciation, net assets increased by \$60.9 million.
- Governmental funds reported a combined ending fund balance of \$1.248 billion at June 30, 2011, which is \$63.9 million or 5.4 percent more than the June 30, 2010 balance. Governmental funds that experienced increases in fund balance include Special Assessment Districts (\$128.7 million) and the San José Financing Authority Debt Service Fund (\$14.0 million). These increases were partially offset by decreases in fund balance for the year including the General Fund (\$4.3 million), Redevelopment Agency (\$38.9 million), Housing Activities (\$2.8 million), and other nonmajor funds (\$32.8 million).
- Unassigned fund balance totals \$44.6 million, which is 3.6 percent of combined governmental fund balances at June 30, 2011.
- Total noncurrent obligations increased by \$94.4 million to \$5.315 billion at June 30, 2011, which represents an increase of 1.8 percent compared to \$5.220 billion at June 30, 2010. Primary factors leading to this increase include the issuance of \$138.4 million of Special Hotel Tax Revenue Bonds and Lease Revenue Bonds to finance the Convention Center Expansion and Renovation Project, an increase of \$74.0 million in the City's net other postemployment benefits obligation ("NOPEBO"), an increase of \$23.6 million in the County of Santa Clara ("County") pass through obligation, and an increase of \$9.8 million in the City's self-insurance obligation. These increases were partially offset by a reduction of \$19.4 million in accrued vacation, sick leave and compensatory leave, and principal payments of \$128.6 million on outstanding bonds and loans related to governmental and business-type activities.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis provides an introduction to the City's basic financial statements which are comprised of four components:

- Government-wide Financial Statements
- Fund Financial Statements
- Notes to the Basic Financial Statements
- Required Supplementary Information

In addition, this report also contains other supplementary information.

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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**Government-wide Financial Statements**

**Government-wide Financial Statements** provide readers with a broad overview of the City's finances in a manner similar to that of a private-sector business.

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

The **statement of activities** presents information showing how the 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. Examples include revenues pertaining to uncollected taxes and expenses pertaining to earned but unused vacation and sick leave.

Both of these government-wide financial statements address functions that principally are supported by taxes and intergovernmental revenues (*governmental activities*) and other functions that intend to recover all or in part a portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, capital maintenance, community services, sanitation, and interest and fiscal charges. The City's business-type activities include airport, wastewater treatment, water supply, and various parking management operations.

The government-wide financial statements include not only the primary government of the City, but also a legally separate redevelopment agency and four legally separate financing authorities for which the City is financially accountable.

**Fund Financial Statements**

**Fund Financial Statements** report information about groupings of related accounts used to maintain control over resources segregated for specific activities or objectives. As do other state and local governments, the City uses fund accounting to ensure and demonstrate finance-related legal compliance. Each City fund falls into one of three categories: *governmental funds*, *proprietary funds*, or *fiduciary funds*.

**Governmental funds** 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 evaluating the City's capacity to finance its programs in the near future.

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

The governmental funds balance sheet and the governmental funds statement of revenues, expenditures and changes in fund balances present information separately for the General Fund, Redevelopment Agency, Housing Activities, Special Assessment Districts, and the San José Financing Authority Debt Service, which are all classified as major funds. These statements also report several individual governmental funds classified as nonmajor funds such as special revenue, debt service, and capital

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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projects funds, which are combined into a single, aggregated presentation. Individual fund data for each of the nonmajor governmental funds is provided in the form of *combining statements* elsewhere in this CAFR.

***Proprietary funds*** generally account for services charged to external or internal customers through fees. Proprietary funds provide the same type of information as shown in the government-wide financial statements for *business-type activities*, only in more detail. The City accounts for its airport, wastewater treatment, water system, and parking management operations in proprietary funds.

For the year ended June 30, 2011, the City implemented Governmental Accounting Standards Board ("GASB") Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, to account for its Public Works program support, employee benefits, and stores, vehicle maintenance, and operations as internal service funds. These services predominantly benefit governmental functions. Therefore, they are included as *governmental activities* in the government-wide financial statements. Individual fund balances for each of the nonmajor internal service funds are provided in the form of *combining statements* elsewhere in this CAFR.

***Fiduciary funds*** account for resources held for the benefit of City employees and outside parties in a similar manner as that for proprietary funds. Pension plan trust funds, private purpose trust funds, and agency funds are reported as fiduciary funds. The government-wide financial statements do not include fiduciary funds as their resources are not available to support City programs.

**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.

**Required Supplementary Information** includes the budgetary schedules for the General Fund and Housing Activities Fund. In addition, pension and other postemployment healthcare schedules present the City's progress toward funding its obligations to provide future pension and other postemployment healthcare benefits for its active and retired employees.

**Combining and individual fund statements and schedules** provide information for nonmajor governmental funds, internal service funds, and fiduciary funds and are presented immediately following the required supplementary information.



**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

**GOVERNMENT-WIDE FINANCIAL ANALYSIS**

**Analysis of net assets:** As noted earlier, net assets may serve as a useful indicator of a government's financial position. As of June 30, 2011, the City's total assets exceed total liabilities by \$5.648 billion.

The following table is a condensed summary of the City's net assets for governmental and business-type activities:

**Statement of Net Assets**  
**June 30, 2011 and 2010**  
(in thousands)

	Governmental Activities		Business-type Activities		Totals	
	FY 2011	FY 2010	FY 2011	FY 2010	FY 2011	FY 2010
<b>Assets:</b>						
Current and other assets..... \$	1,646,164	1,642,082	745,374	806,956	2,391,538	2,449,038
Capital assets.....	7,090,733	7,412,751	2,206,930	2,194,124	9,297,663	9,606,875
Total assets.....	<u>8,736,897</u>	<u>9,054,833</u>	<u>2,952,304</u>	<u>3,001,080</u>	<u>11,689,201</u>	<u>12,055,913</u>
<b>Liabilities:</b>						
Current and other liabilities.....	259,550	317,602	466,655	487,756	726,205	805,358
Long-term liabilities.....	4,173,724	4,061,122	1,140,808	1,158,967	5,314,532	5,220,089
Total liabilities.....	<u>4,433,274</u>	<u>4,378,724</u>	<u>1,607,463</u>	<u>1,646,723</u>	<u>6,040,737</u>	<u>6,025,447</u>
<b>Net assets:</b>						
Invested in capital assets, net of related debt.....	3,810,801	4,201,672	889,674	926,638	4,700,475	5,128,310
Restricted net assets.....	622,241	527,931	122,534	120,510	744,775	648,441
Unrestricted net assets.....	(129,419)	(53,494)	332,633	307,209	203,214	253,715
Total net assets..... \$	<u>4,303,623</u>	<u>4,676,109</u>	<u>1,344,841</u>	<u>1,354,357</u>	<u>5,648,464</u>	<u>6,030,466</u>

At June 30, 2011, the City reported positive balances in all three categories of net assets on a total basis.

Net assets invested in capital assets (infrastructure, land, buildings, other improvements, vehicles, and equipment, less outstanding debt used to acquire them) of \$4.700 billion comprise 83.2 percent of the City's total net assets. These capital assets facilitate providing services to the San José community, but they are not liquid, and therefore they are not available for future spending.

A portion of the City's net assets, \$744.8 million or 13.2 percent are subject to legal restrictions on their use, including \$622.2 million in governmental activities and \$122.6 million in business-type activities. Of the total net assets, \$203.2 million or 3.6 percent represents unrestricted net assets, which comprises a deficit balance of \$129.4 million for governmental activities, and a positive balance of \$332.6 million for business-type activities. Primary factors contributing to the governmental activities deficit balance are the City's other postemployment benefits and workers' compensation long-term liabilities.

During 2010-2011, the City's total net assets decreased by \$382.0 million or 6.3 percent. The decrease in total net assets is slightly lower than the decrease of \$391.5 million experienced in 2009-2010. Expenses decreased slightly from the prior fiscal year, which reflects the City's efforts in proactively containing expenses. After having experienced continuous declines in revenues over the past two fiscal years, revenues in 2010-2011 were flat compared to 2009-2010.

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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Notable changes in the statement of net assets between June 30, 2011 and June 30, 2010 include:

- Capital assets decreased by \$309.2 million or 3.2 percent compared to the prior fiscal year. Governmental capital assets decreased by \$322.0 million, but were slightly offset by an increase in business-type capital assets of \$12.8 million. The decrease in governmental capital assets resulted from asset additions (net) of \$40.7 million less \$362.4 million in depreciation expense for major infrastructure and other assets, and \$14.4 million from the sale of five parcels of land for real estate development by the Redevelopment Agency ("Agency"). The increase in business-type capital assets was primarily due to the completion of several projects at the Norman Y. Mineta San José International Airport ("Airport") during 2010-2011 including the Westside taxiway overlay, Terminal B airport signage, Terminal B parking, South Loop parking, and airfield improvements.
- Current and other assets decreased by \$57.5 million or 2.3 percent due to a decrease of \$61.6 million for business-type activities, which was slightly offset by an increase of \$4.1 million for governmental activities. The decrease is primarily the result of reduced cash balances as business-type activities' bond proceeds were expended on the Airport's construction projects. An increase in current assets for governmental activities is due to two bond issuances for the Convention Center Expansion and Renovation Project (hotel tax bonds and lease revenue bonds), and an increase in the loan receivable balance resulting from issuance of low-income housing loans offset by a decrease in cash balances of governmental activities due to an increase (\$92.0 million) in prepayment of City required contributions for pension benefits and postemployment healthcare benefits to Police and Fire Department Retirement Plan ("PFDRP") and Federated City Employees' Retirement System ("FCERS").
- Long-term liabilities increased by a net amount of \$94.4 million or 1.8 percent. The overall net increase was primarily the result of an increase of \$74.0 million for NOPEBO, \$9.8 million for self-insurance obligations due to higher workers' compensation and general liability claims, \$23.6 million for the Agency's pass through obligation due to the County, which is a result of the March 2011 settlement agreement with the County, and \$138.4 million for the issuance of hotel tax bonds and lease revenue bonds. These increases were partially offset by a reduction in accrued liabilities such as accrued vacation, sick leave and compensatory leave (\$19.4 million) and pollution remediation obligation (\$0.2 million), and the reduction of the principal payments on the debt and loans (\$128.7 million).
- Current and other liabilities for the City decreased by \$79.2 million or 9.8 percent due to a decrease of \$58.1 million for governmental activities and a decrease of \$21.1 million for business-type activities. The decrease for governmental activities is primarily the result of a settlement of \$47.2 million to the County for a pass-through tax increment obligation by the Agency (see Note (IV.C.2.)), a decrease of \$6.9 million in short-term liabilities for commercial paper notes issued to support the City's various public improvements, a reduction of \$23.5 million in accounts payable from the prior year and a reduction of \$7.0 million for advances, deposits, and reimbursable credits mainly due to checks issued to property owners to distribute surplus funds held in special assessment funds, \$0.6 million in interest payable as a result of lower interest rates, and the recognition \$1.0 million of previously unrecognized unearned revenue. These decreases were slightly offset by increases of \$7.7 million in deposits received from developers, and \$9.1 million in accrued liabilities mainly due to recognizing a short term pension liability payable to the FCERS. The decrease for business-type activities is primarily the result of a decrease of \$7.3 million in short-term liabilities for commercial paper notes issued in connection with the Airport capital projects and a decrease of \$13.8 million in accrued liabilities mainly due to lower activity for Airport capital projects.
- Unrestricted net assets for governmental activities decreased by \$75.9 million or 141.9 percent resulting in a deficit of \$129.4 million in unrestricted net assets at year-end. A significant part of

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

this reduction in unrestricted net assets is the result of continued under funding of the annual required contribution of the City's other postemployment benefits thereby increasing its NOPEBO and reducing net assets by an additional \$68.5 million. At June 30, 2011, the City's NOPEBO balance for governmental activities is \$224.1 million.

**Analysis of activities:** The following table indicates the changes in net assets for governmental and business-type activities:

**Statement of Activities**  
**For the Years Ended June 30, 2011 and 2010**  
**(in thousands)**

	Governmental Activities		Business-type Activities		Totals	
	FY 2011	FY 2010	FY 2011	FY 2010	FY 2011	FY 2010
<b>Revenues:</b>						
Program revenues:						
Fees, fines, and charges for services.....	\$ 316,858	291,708	349,167	323,476	666,025	615,184
Operating grants and contributions.....	100,045	110,926	701	1,149	100,746	112,075
Capital grants and contributions.....	33,041	49,926	19,413	46,237	52,454	96,163
General revenues:						
Property taxes.....	481,145	498,973	-	-	481,145	498,973
Utility taxes.....	108,528	108,151	-	-	108,528	108,151
Franchise fees.....	41,273	38,410	-	-	41,273	38,410
Transient occupancy taxes.....	18,102	17,250	-	-	18,102	17,250
Sales taxes shared revenue.....	137,970	123,312	-	-	137,970	123,312
State of California in-lieu.....	4,889	7,169	-	-	4,889	7,169
Business license tax.....	36,811	34,952	-	-	36,811	34,952
Marijuana tax.....	1,152	-	-	-	1,152	-
Unrestricted interest and investment earnings.....	8,142	5,010	3,886	1,192	12,028	6,202
Other revenue.....	33,237	35,786	-	-	33,237	35,786
Total revenues.....	<u>1,321,193</u>	<u>1,321,573</u>	<u>373,167</u>	<u>372,054</u>	<u>1,694,360</u>	<u>1,693,627</u>
<b>Expenses:</b>						
General government.....	148,515	137,159	-	-	148,515	137,159
Public safety.....	487,659	457,892	-	-	487,659	457,892
Community services.....	254,481	260,835	-	-	254,481	260,835
Sanitation.....	129,138	130,343	-	-	129,138	130,343
Capital maintenance.....	515,909	588,382	-	-	515,909	588,382
Interest and fiscal charges.....	163,280	161,734	-	-	163,280	161,734
Norman Y. Mineta San José International						
Airport.....	-	-	195,867	171,976	195,867	171,976
Wastewater Treatment System.....	-	-	147,283	140,831	147,283	140,831
Municipal Water System.....	-	-	24,600	24,355	24,600	24,355
Parking System.....	-	-	9,630	11,579	9,630	11,579
Total expenses.....	<u>1,698,982</u>	<u>1,736,345</u>	<u>377,380</u>	<u>348,741</u>	<u>2,076,362</u>	<u>2,085,086</u>
Excess (deficiency) before transfers	(377,789)	(414,772)	(4,213)	23,313	(382,002)	(391,459)
Transfers.....	5,303	3,291	(5,303)	(3,291)	-	-
Change in net assets.....	(372,486)	(411,481)	(9,516)	20,022	(382,002)	(391,459)
Net assets at beginning of year	4,676,109	5,087,590	1,354,357	1,334,335	6,030,466	6,421,925
Net assets at end of year.....	<u>\$ 4,303,623</u>	<u>4,676,109</u>	<u>1,344,841</u>	<u>1,354,357</u>	<u>5,648,464</u>	<u>6,030,466</u>

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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**Governmental activities:** Net assets for governmental activities decreased by \$372.5 million or 8.0 percent during 2010-2011 from \$4.676 billion to \$4.304 billion. Total expenses decreased by 2.2 percent whereas total revenues remained consistent compared with the prior year, even though certain revenue categories experienced increases or decreases. During 2009-2010, revenues and expenses decreased by 2.2 percent and 3.4 percent, respectively.

Although revenues were flat compared to the prior fiscal year and expenses decreased from the prior fiscal year, expenses continue to exceed revenues. Significant elements of the decrease in net assets for governmental activities from June 30, 2010 to June 30, 2011 are as follows:

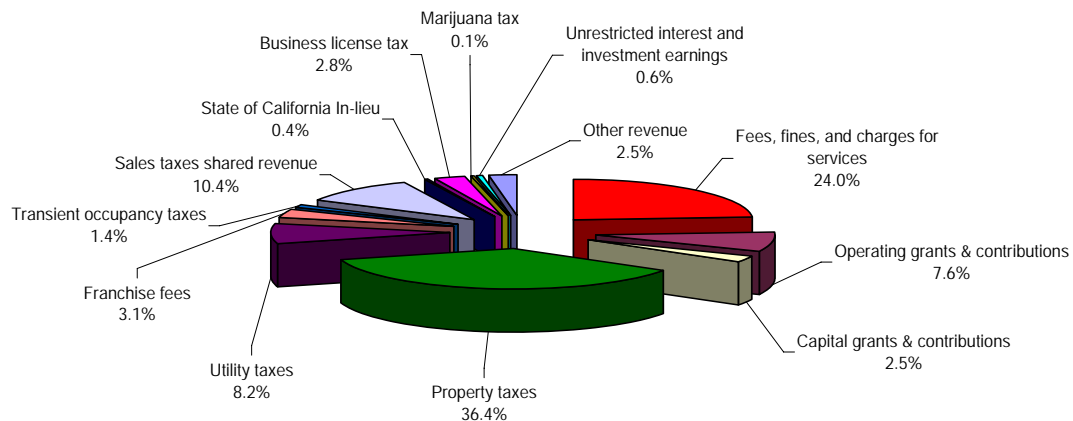
- Contributing factors resulting in increases to certain revenue categories are as follows; fees, fines, and charges for services increased by \$25.2 million or 8.6 percent primarily due to higher developer revenues for in-lieu fees, and fee increases charged by the City for services such as building permits. Sales tax revenue increased by \$14.7 million or 11.9 percent showing improvement due to the economic recovery. Transient occupancy tax receipts from guests staying in the City's local hotels increased by \$0.9 million or 4.9 percent. For the fourteen largest hotels in the City, the average room rate increased from \$117 to \$121 and the occupancy rate rose from 55.9 percent to 59.8 percent during the year indicating signs of economic recovery. Business tax revenues increased by \$1.9 million or 5.3 percent showing improvement due to the economic recovery. The City's Marijuana tax, implemented effective March 1, 2011, generated \$1.2 million, representing 7.0 percent of gross receipts from marijuana business entities operating in the City. Franchise fees increased by \$2.9 million or 7.5 percent due to higher rates.
- Contributing factors resulting in decreases to certain revenue categories are as follows; operating grants and contributions decreased by \$10.9 million or 9.8 percent principally due to a reduction in Federal and State grants received for street maintenance such as Proposition 1B revenues and Pedestrian Bicycle Facility revenues and community oriented grants like Community Development Block Grant (\$1.2 million) and Workforce Investment Administration Grant (\$5.0 million). Capital grants and contributions also decreased by \$16.9 million or 33.8 percent primarily due to a decrease of \$24 million in donation of capital assets from developers and this decrease was offset by increases in capital grants received for the Street Resurfacing and Rehabilitation Project (\$8.3 million) under the American Recovery and Reinvestment Act and for the Light Rail Project Phase II from Department of Transportation for Clean Air (\$3.5 million). Property tax revenues decreased by \$17.8 million or 3.6 percent due to the continued decreasing property values in the City.
- Interest and investment income showed an increase of \$3.1 million or 62.5 percent from the prior year due to an increase in the fair value of investments. However, lower cash balances combined with lower interest yields still persist. The increase in pre-payment of the City's contribution to its two retirement plans in July 2010, along with expenditures continuing to outpace revenue increases, caused lower cash balances. In addition, the annualized investment interest yield for the City's investment pool declined from 1.5 percent as of June 30, 2010 to 0.7 percent as of June 30, 2011, reflecting the continued lower interest rate environment experienced in the capital markets.
- General government expenses increased by \$11.4 million or 8.3 percent during 2010-2011 due to increases in self-insurance liability (\$6.0 million), worker's compensation claims liability (\$1.9 million), and the recognition of loss on disposal of capital assets (\$3.5 million). The decrease in general government expenses attributable to the General Fund is explained in more detail in the governmental fund section later in this document.
- Public safety expenditures increased \$29.8 million or 6.5 percent mainly due to an increase in the pension and healthcare rates. However, the increases were partially offset by a reduction in

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

compensated absence liabilities (\$8.1 million) due to a large number of police and fire personnel retirements during fiscal year 2010-2011.

- Community services expenses decreased by \$6.4 million or 2.4 percent primarily resulting from large reductions in service levels for branch libraries (open 39 hours per week as compared to 47 hours in the prior year) and for parks maintenance and enhancement combined with staffing level reductions to align with service eliminations.
- Sanitation expenses decreased by \$1.2 million or 0.9 percent primarily due to a reduction in costs for the commercial solid waste recycling program.
- Capital maintenance decreased by \$72.5 million or 12.3 percent primarily due to extensive reductions in capital spending programs by the Agency (\$41.7 million).
- Depreciation expense for infrastructure and other capital assets was \$362.4 million, an increase of 2.3 percent from prior year.

**Governmental Activities Revenues 2011**



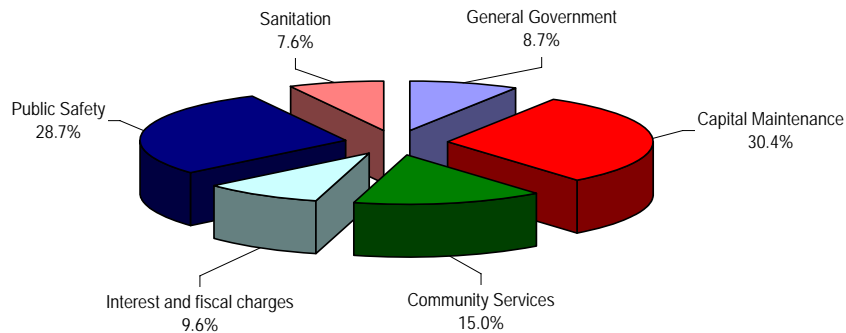
The chart above shows the primary components of governmental activities revenue sources for 2010-2011. Of the \$1.321 billion in total revenues generated by governmental activities, 70.8 percent is attributable to three categories: property taxes (36.4 percent); fees, fines, and charges for services (24.0 percent); and sales taxes (10.4 percent). The overall percentage of revenues to total revenues for these three main categories increased slightly over the prior year percentage (69.2 percent) mainly due to higher developer's revenues for in-lieu fees and building permits.

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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The chart below shows the principal categories of 2010-2011 expenses for governmental activities. Of the \$1.699 billion in total expenses incurred by governmental activities, the categories accounting for 74.1 percent of the total are: capital maintenance (30.4 percent); public safety (28.7 percent); and community services (15.0 percent).

**Governmental Activities Expenses 2011**



**Business-type activities:** Business-type activities net assets decreased by \$9.5 million or 0.7 percent to \$1.345 billion during 2010-2011.

The notable components of net assets for business-type activities during 2010-2011 are:

- The Airport net assets decreased by \$36.1 million or 8.0 percent. The Airport incurred an operating loss of \$13.6 million, a decrease in loss of \$24.7 million or 64.4 percent compared to the prior year loss of \$38.3 million. Operating revenues increased by \$16.6 million or 14.9 percent reflecting a slight increase in passenger traffic for international and domestic destinations, and an increase in parking rental activity. Increased revenues were also noted for non airline revenues such as terminal buildings/concessions, and parking and roadway. Operating expenses of \$141.4 million were \$8.1 million or 5.4 percent lower compared to 2009-2010, highlighted by decreases in general and administrative (\$5.3 million) due to outsourcing of custodial services and the reduction in building maintenance staff, and depreciation and amortization (\$3.8 million), which were offset by a small increase in operations and maintenance (\$1.0 million). Nonoperating expenses exceeded nonoperating revenues by \$34.0 million, which represented an increase of \$31.8 million from 2009-2010. This increase in net operating expenses was mainly due to the expensing of interest costs in 2010-2011 for construction projects substantially completed in the prior fiscal year.

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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- Wastewater Treatment System net assets increased by \$26.5 million or 3.6 percent from \$730.5 million to \$757.0 million. Operating revenues increased \$9.4 million or 6.0 percent from \$158.3 million to \$167.7 million primarily due to an \$8.7 million or 6.7 percent increase in charges for services due to a 6.0 percent sewer rate increase effective July 1, 2010. Total operating expenses increased by \$7.2 million or 5.2 percent primarily due to \$4.5 million in support payments to the Santa Clara Valley Water District to collaborate on the development of a local recycled water use program, and a \$4.5 million increase in maintenance costs for the aging treatment plant and sewer collection system. These increases in operating expenses were partially offset by \$1.8 million in savings through employee compensation reduction, continuous monitoring of expenses and implementing other cost saving measures. Net nonoperating expenses decreased by \$2.0 million attributable primarily to an increase in the fair value of investments, and lower interest expense on long-term debt payments. Capital grants and contributions decreased by \$2.9 million or 25.8 percent mainly due to a \$3.0 million decrease in project costs reimbursement from the California Department of Transportation, and a \$4.1 million decrease in capital donations from developers offset by a \$4.2 million increase in U.S. Bureau of Reclamation grants for construction of wastewater recycling facilities.
- Municipal Water System net assets increased by \$1.2 million or 1.4 percent from \$82.9 million to \$84.1 million. Operating revenues of \$26.0 million increased by \$1.2 million or 5.0 percent, which includes a 3.75 percent rate increase effective July 1, 2010. Operating expenses of \$24.6 million increased by \$0.3 million or 1.2 percent mainly due to higher wholesale prices of water costs.
- Parking System net assets decreased by \$1.1 million or 1.2 percent from \$88.2 million to \$87.1 million. Operating revenues decreased by \$0.9 million or 8.8 percent primarily due to less activity at parking facilities as a result of the sluggish economy. Operating expenses decreased by \$1.9 million or 16.8 percent reflecting reductions to operations and maintenance costs to offset revenue declines. Net nonoperating revenues increased by \$0.1 million mainly from higher fair value of investments.

**FINANCIAL ANALYSIS OF THE CITY'S FUNDS**

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

As of June 30, 2011, the City's governmental funds reported combined fund balances of \$1.248 billion, an increase of \$63.9 million or 5.4 percent compared to the balance at June 30, 2010. In accordance with GASB 54, the governmental fund balances are categorized as nonspendable, restricted, committed, assigned, or unassigned.

- \$1.1 million consists of nonspendable fund balance including prepaid items, advances and deposits, and other assets that are not intended to convert into cash and long-term in nature and do not represent currently available resources;
- \$1.008 billion is reported as restricted fund balance that includes restrictions imposed by external parties or enabling legislation. This amount includes unspent bond proceeds, unspent grant revenues, and restricted tax revenues;
- \$105.0 million is reported as committed fund balance that includes amounts that have been limited to specific purposes. This amount includes all of the earmarked reserves in the General Fund, and the committed fund balances reported for the Redevelopment Agency Fund, and the non major governmental funds and these fund balances are committed for the purpose of the fund.
- \$89.9 million is reported as assigned fund balance that includes amounts that may be used for specific purposes, but do not meet the criteria to be classified as restricted or committed.

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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- \$44.6 million is reported as unassigned fund balance that represents the residual classification for the City's General Fund and includes all spendable amounts not contained in the other classifications.

Revenues and other financing sources for governmental functions totaled approximately \$1.704 billion in 2010-2011, a decrease of \$192.3 million or 10.1 percent from 2009-2010 primarily due to lower proceeds from long-term debt and long-term loans, a reduction in investment income due to reduced interest rates, lower collections of property tax, fewer internal transfers, and lower State revenues.

**General Fund:** The General Fund is the chief operating fund of the City. At June 30, 2011, the General Fund's available (unassigned) fund balance is \$44.8 million or 26.9 percent of the \$166.6 million total General Fund balance. Comparing available fund balance and total fund balance to total fund expenditures may be useful as a measure of the General Fund's capacity to liquidate future obligations. At June 30, 2011, available fund balance represents 6.5 percent of total General Fund expenditures of \$685.7 million, while total fund balance represents 24.3 percent of total General Fund expenditures. This measure of financial health shows a slight decline from the prior fiscal year. At June 30, 2010, the same measures were 6.5 percent and 25.0 percent, respectively.

For the fourth consecutive year, revenue sources in 2010-2011 were not sufficient to cover all expenditures. In order to meet the current expenditures, a combination of one-time revenues, use of reserves, and continued reduction in City services coupled with an offset of net transfers from the General Fund resulted in a \$4.3 million or 2.5 percent decrease to the General Fund ending fund balance at June 30, 2011.

In 2010-2011, General Fund revenues of \$680.8 million were \$31.5 million or 4.9 percent higher than 2009-2010 revenues of \$649.3 million. Taxes and special assessments revenues increased by \$5.8 million or 1.2 percent, and consisted of increases in following revenue sources: sales tax (\$10.7 million), marijuana tax (\$1.2 million), electric franchise tax (\$2.1 million), utility tax (\$0.3 million), and transient occupancy tax (\$0.3 million). These increases were partially offset by a continuing decline in property taxes (\$7.3 million) due to lower property assessed valuations.

License, Permits & Fines increased by \$11.5 million or 14.0 percent representing increased collections of cardroom tax (\$2.2 million) due to the increased number of tables both of cardrooms located in the City and betting limit increases to the permissible limit available under State law, planning & building permit fees (\$5.8 million), fines & citations (\$1.8 million), fire permit fees (\$1.2 million), and multi housing permits (\$0.4 million). Intergovernmental revenue rose by \$2.8 million due to increased Federal funding for Energy and Efficiency and Conservation Block Grant, received under the America Recovery & Reinvestment Act. Additionally, the 911 Emergency community reimbursement from the State of California (\$0.7 million), 2009 COPS Technology Program (\$0.7 million) contributed to the revenue increase reported in the General Fund. Charges for services increased by \$5.1 million due to increased revenue collections experienced at the newly renovated Happy Hollow Park and Zoo resulting from implementing a new service delivery model, and increased service fees generated by Public Works, Planning, Finance, and Parks, Recreation, and Neighborhood Services. Investment income showed gain of \$2.1 million over the prior year mainly due to an increase in fair value of investments. Other revenue increased by \$4.2 million due to higher lease payments received for the Airport West property, and higher revenues for Public Art and other miscellaneous revenues.

2010-2011 General Fund expenditures of \$685.7 million were \$2.2 million or 0.3 percent higher than 2009-2010 expenditures of \$683.5 million. General government expenditures increased by \$2.5 million primarily due to election costs (\$1.9 million) incurred by the City, and higher general liability claim costs (\$0.5 million). Capital maintenance expenditures increased by \$3.5 million primarily due to increased grant expenditures related to Federal funding for Energy and Efficiency and Conservation Program (\$3.0 million) and Fire Apparatus Replacement Program (\$0.4 million).



**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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Public safety expenditures increased by \$5.5 million due to higher grant expenditures (\$3.4 million) for the COPS technology grant, Mobile Identification Services Program, Metropolitan Medical Response Program, the Driving Under Influence grant. Additional increases were due to higher worker's compensation claims (\$0.9 million) and higher pension contributions for police and fire members (\$11.2 million) that were offset by reduction in police and fire personnel costs ((\$10.0 million) due to the implementation of dynamic deployment and reducing five fire engine companies and one fire truck company and elimination of various fire fighter recruit programs, fire safety public education programs and reducing staff for police patrol services, police field patrol services, and staffing for police investigations, consolidating services of financial crimes and high tech units and restructuring the police warrant units.

Community services expenditures decreased by \$6.8 million due to substantial staffing and services cuts in libraries (\$4.0 million), and expenditures reduced for park enhancement and maintenance services (\$1.9 million), several community support programs (\$2.5 million) and summer safety initiative programs (\$0.5 million) however these decreases were offset by an increase (\$2.1 million) in spending for the Children's Health Initiative Program. Sanitation expenses decreased by \$0.9 million due to reduced spending for commercial solid waste programs. Infrastructure and fixed asset capital outlay expenditures decreased by \$1.9 million due to deferrals of capital projects as a result of budgetary constraints.

**Redevelopment Agency fund:** The Redevelopment Agency fund accounts for the activities of the City's Redevelopment Agency ("Agency") responsible for redeveloping and upgrading blighted areas. Fund balance for the Agency's governmental funds decreased \$38.9 million or 39.1 percent to \$60.6 million at June 30, 2011. A deficiency of revenues under expenditures of \$67.4 million was offset by other financing sources (net) of \$28.5 million, including proceeds from the sale of capital assets (\$20.0 million) and the reclassification of the pass through obligation due to the County (\$23.6 million) to long-term. On June 29, 2011, changes to the California Redevelopment Law have terminated the authority of redevelopment agencies to undertake new obligations to redevelop property. This raises substantial concerns over continuing operations of the Agency. Management's plans regarding those matters also are described in Note IV.D.5 to the financial statements.

The following are some of the highlights for the Agency:

- Revenues decreased \$20.0 million or 9.5 percent from \$210.5 million in the prior fiscal year to \$190.5 million. Revenue decreases were noted in all revenue categories except in rental income. The largest decrease is for the collection of Taxes and Special Assessments (\$18.8 million). Lower cash balances and lower market yield on investments resulted in a decrease in investment income (\$0.8 million). Intergovernmental revenue and other revenue decreased by \$0.3 million and \$0.5 million, respectively. The decreases were offset by a slight increase in rental income (\$0.3 million).
- Expenditures decreased by \$135.2 million or 34.4 percent from the prior fiscal year mainly due to reduced capital program spending and significant staffing reductions. In addition, prior year expenditures included the Agency's pay-off on the Housing Term-loan in the amount of \$50.0 million from some of the proceeds from the issuance of Housing set-aside tax allocation bonds series 2010 ABC. Lower capital maintenance costs (\$71.8 million) resulted from the Agency's continued elimination of several capital projects and programs as a result of declining tax increment revenue
- Other financing sources (uses) decreased by \$39.8 million from \$68.3 million in the prior fiscal year to \$28.5 million. There was no new issuance of bonds, and proceeds from the sale of capital assets decreased by \$13.6 million and there was a net decrease of \$53.9 million in transfers in (out). However, the decreases were partially offset by a reporting reclassification of the County pass through obligation of (\$23.6 million) due to the Agency's need to defer short term liability to long term obligation.

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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Additional information about the Agency's finances appears in their separately issued financial statements.

**Housing fund:** The Housing Activities fund accounts for the City's commitment to providing low and moderate income residents with a diverse range of safe and affordable housing opportunities. Objectives include preserving the existing affordable housing stock, increasing the supply of affordable housing, and providing services to homeless and at-risk populations. Twenty percent (20%) of the Agency's gross property tax increment and tax allocation bonds secured by the 20% gross tax increment revenues provide the housing fund's primary resources. As required by California State law, the 20% gross tax increment revenue is used solely for affordable housing. In addition, the City's Housing Activities fund receives resources from the U.S. Department of Housing and Urban Development and the California Department of Housing and Community Development. The fund's loans receivable balance (net) which represents loans to developers of various affordable housing projects and first time home buyers increased during the year by \$8.2 million or 2.6 percent to \$318.5 million as of June 30, 2011 due to an increase in loans to developers for various projects, including the Orvieto Apartments, Fourth Street Apartments, King Crossing, Archer Studios, and Brookwood housing projects. These additions to the loan receivable balance were offset by an increase in the valuation allowance in the Housing Activities fund based on the City's annual review of the valuations and adjustments reflecting the terms of the loans. The Housing Activities fund also advanced an amount of \$14.5 million to the Agency that included funding for the second installment payment for the SERAF in May 2011 in the amount of \$12.8 million.

Total expenditures slightly increased by \$1.6 million to \$42.6 million from \$41.0 million in the prior fiscal year.

**Special Assessment Districts fund:** The Special Assessment Districts fund accounts for debt issuance and capital improvements related to the specific purposes of eight special assessment and community facilities districts located in different parts of the City. A total of \$57.9 million in special assessment and special tax debt outstanding at June 30, 2011 is secured by special assessments or special taxes charged to the owners' real property in the district issuing the debt. The City is not obligated to cure any deficiency or redeem any debt of special assessment districts. In addition, during 2010-2011, there was an issuance of special tax debt to finance the expansion and renovation of the Convention Center that is discussed below.

Other financing sources and uses increased by a net \$134.4 million to \$129.6 million primarily due to the issuance of the Special Hotel Tax Revenue Bonds, Series 2011 in the aggregate amount of \$107.4 million to finance the Convention Center Expansion and Renovation Project. These bonds payments will be made solely from the revenue derived from the levy of a special tax on hotel properties within the Convention Center Facilities District. Total expenditures for 2010-2011 increased by \$0.6 million or 4.9 percent compared to the prior fiscal year.

**Financing Authority fund:** The City's Financing Authority Debt Service fund accounts for the issuance of commercial paper notes secured by lease revenues as a mechanism for financing City public improvements and purposes such as: Phase II improvements of the City's Central Service Yard; non-construction costs for technology, furniture, and equipment at City Hall; capital improvements at the City's HP Pavilion, procuring the consolidated utility billing system; and making the loan to the Housing Activities fund to fund low and moderate income housing activities and programs. The amount of commercial paper notes outstanding decreased from \$53.5 million on June 30, 2010 to \$46.6 million on June 30, 2011, a decrease of \$6.9 million, which represented commercial paper principal payments.

Other financing sources and uses increased by a net \$8.1 million or 20.7 percent to \$47.4 million due to the issuance of Lease Revenue Bonds, Series 2011A, in the amount of \$31.0 million to finance a portion of the costs of the Convention Center Expansion and Renovation Project. In addition, there was a \$1.2 million increase in transfers-in offset by a \$23.3 million increase in transfers-out.

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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**Proprietary funds**

The City's proprietary funds provide the same type of information found in the government-wide financial statements for business-type activities, but in more detail. At June 30, 2011, the unrestricted net assets were \$79.9 million for the Norman Y. Mineta San José International Airport, \$216.9 million for the Wastewater Treatment System, \$14.6 million for the Municipal Water System and \$21.2 million for the Parking System. Net assets for proprietary funds fell from \$1.354 billion at June 30, 2010 to \$1.345 billion at June 30, 2011, resulting in a decrease of \$9.5 million or 0.7 percent.

Other aspects of proprietary fund activities are discussed in the business-type activities section above.

**GENERAL FUND BUDGETARY HIGHLIGHTS**

The City's Charter requires the City Manager to submit balanced operating and capital budgets to the City Council prior to the beginning of a new fiscal year that begins each July 1 and ends on the following June 30. Council approved the 2010-2011 budgets in June 2010.

During the fiscal year ended June 30, 2011, there was a \$103.2 million increase in the budgeted source and use of funds between the original and final amended operating budget for the General Fund. This increase was due primarily to the issuance of Tax Revenue Anticipation Notes, which accounted for \$75 million of the revenue increase and \$75.5 million of the expenditure increase. Adjustments to the budgeted revenue estimates were also brought forward based on actual collection trends, anticipated year-end performance, and any changes to anticipated grants and reimbursements during the course of the year. Several revenue categories were adjusted upwards during 2010-2011, including sales tax, marijuana tax, licenses, permits and fines, charges for current services, other revenue, and revenues from intergovernmental. These upward revenue adjustments were partially offset by declines in a number of revenue categories, including property tax, utility tax, franchise fees, investment income, and revenue from the State of California in-lieu. Net upward expenditure adjustments were brought forward to appropriate grant funding received during the year, to adjust expenditure line-items based on revised expenditure projections, and to adjust reserve levels. Net upward adjustments of \$15.0 million to the General Fund earmarked reserves were approved in 2010-2011, including the establishment of a 2010-2011 Ending Fund Balance Reserve of \$12.9 million.

Actual budgetary basis expenditures of \$706.6 million were \$51.3 million less than the amended budget and \$35.8 million less than the original budget. Savings were experienced over all expenditure categories, except for debt service.

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The City's investment in capital assets, net of accumulated depreciation, for its governmental and business-type activities together amounted to \$9.298 billion at June 30, 2011. This investment includes land, infrastructure, structures and improvements, vehicles, equipment, intangible assets, and construction-in-progress. The City's decision to depreciate infrastructure capital assets results in recording a large non-cash depreciation expense each year that offsets additions to capital assets. The result of the new additions less depreciation expense during 2010-2011 yielded a \$322.0 million decrease in governmental activities net capital assets offset by a \$12.8 million increase in business-type activities net capital assets resulting in an overall decrease of \$309.2 million or 3.2 percent in net capital asset balances between June 30, 2010 and June 30, 2011.

Total construction-in-progress decreased by \$333.9 million or 70.7 percent from \$472.1 million at June 30, 2010 to \$138.2 million at June 30, 2011. The construction-in-progress for the governmental activities decreased by \$191.9 million mainly due to the completion of the Seven Trees Library and

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

Community Center, Bascom Library and Community Center, and South San José Police Station. Business-type activities contributed a decrease of \$142.0 million to the total construction-in-progress primarily due to the completion of Airport projects that totaled \$196.9 million. The completed Airport projects include the following: the improvements of terminal area roadway, which resulted in a widened Airport Blvd and a dedicated shuttle lane between Terminal A and the new rental car garage; Green Island Parking; Terminal B Parking, South Loop Parking and airfield improvements. The reduction in the Airport construction-in-progress was somewhat offset by the ongoing construction of capital projects of approximately \$55.0 million related to the Terminal Area Improvement Program, West Side Airfield Reconstruction, public parking improvement projects, and the remainder of North Concourse building projects. The net decrease to construction-in-progress for Wastewater Treatment Systems was \$0.6 million.

The City records infrastructure assets at historical cost in the government-wide financial statements and depreciates assets from acquisition date to the end of the current fiscal year as required by GASB Statement No. 34. For governmental fund financial statements recording purposes, capital asset purchases are recorded as expenditures, rather than capitalizing and recording related depreciation. Capital assets, net of depreciation, for governmental and business-type activities in the government-wide financial statements are presented below to illustrate changes between June 30, 2010 and June 30, 2011 (in thousands):

	Governmental activities		Business-type activities		Total	
	2011	2010	2011	2010	2011	2010
Land	\$ 528,605	541,457	134,926	134,926	663,531	676,383
Intangible assets	-	-	12,882	12,882	12,882	12,882
Construction in progress	69,813	261,698	68,368	210,415	138,181	472,113
Buildings	1,161,245	1,049,521	1,287,753	1,294,630	2,448,998	2,344,151
Improvements, other than buildings	194,400	123,108	614,558	477,962	808,958	601,070
Infrastructure	5,107,454	5,401,177	-	-	5,107,454	5,401,177
Furniture and fixtures, vehicles, equipment	28,528	34,909	86,554	60,965	115,082	95,874
Property under capital leases	688	881	1,889	2,344	2,577	3,225
Total capital assets	\$ 7,090,733	7,412,751	2,206,930	2,194,124	9,297,663	9,606,875

Commitments outstanding as of June 30, 2011, related to governmental and business-type activities construction in progress totaled approximately \$5.8 million and \$33.7 million, respectively. Additional information about the City's capital assets can be found in Note III.D to the financial statements.

**General Fund Bonded Debt Limit**

The City Charter limits bonded indebtedness for General Obligation bonds to 15 percent of the total assessed valuation of all real and personal property within the City. The total assessed value on the City's 2010-2011 tax roll was \$123.364 billion, which results in a net total debt capacity of \$18.505 billion. As of June 30, 2011, the City had \$480.3 million of General Obligation bonds outstanding.

**General Obligation Bonds and Other Bond Ratings**

As of June 30, 2011, the City received affirmation of its general obligation bond ratings from the three major rating agencies: Aaa from Moody's Investors Service; AAA from Standard & Poor's; and AA+ from Fitch Ratings.

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

Fitch Ratings and Moody's Investors Service reaffirmed the A- and A2 rating on the City's Airport Revenue Bonds of \$1.023 billion. Standard & Poor's has not taken any action with respect to its rating of 'A', which was assigned on July 16, 2007. The rating outlook on the bonds remains negative.

As of June 30, 2011, the Redevelopment Agency Tax Allocation Bonds were rated Baa1 from Moody's Investors Service; BBB+ from Standard & Poor's; and BBB- from Fitch Ratings. The Agency Housing Set-Aside Bonds were rated A2 from Moody's; A from Standard & Poor's; and A from Fitch.

Subsequent to June 30, 2011, the Airport Revenue Bonds and the Redevelopment Agency Tax Allocation Bonds were downgraded. On November 10, 2011, Standard & Poor's reduced its ratings on the Airport Bonds from A to A- and revised the outlook from negative to stable. On November 18, 2011, Standard & Poor's reduced its ratings on the Redevelopment Agency TABs from BBB+ to BBB, citing tighter debt service coverage as a result from a decline in assessed values. A negative outlook was assigned because of the amount of assessed value under dispute. The Agency's Housing Set-Aside Bonds remain at its A rating and the negative credit watch was removed and a stable outlook assigned as a result of the successful negotiations with JPMorgan to extend their letter of credit.

**Outstanding Debt**

The City's debt service obligations include general obligation bonds, revenue bonds, lease revenue bonds, special assessment and special tax bonds, and Redevelopment Agency tax allocation bonds.

At June 30, 2011, the City had \$3.705 billion of gross outstanding long-term debt related to governmental activities and \$1.110 billion related to business-type activities, for a total of \$4.815 billion. These amounts for the fiscal year ended June 30, 2010 were \$3.674 billion for governmental activities and \$1.131 billion for business-type activities, for a total of \$4.805 billion.

The table below identifies the net changes in each category (in thousands):

	<u>As of</u> <u>June 30, 2011</u>	<u>As of</u> <u>June 30, 2010</u>	<u>Net</u> <u>Change</u>
<b>Governmental Activities:</b>			
General obligation bonds	\$ 480,320	499,970	(19,650)
HUD Section 108 loan	21,877	22,915	(1,038)
Lease revenue and revenue bonds	669,233	644,983	24,250
Special assessments and special tax bonds	163,904	60,905	102,999
Redevelopment Agency	<u>2,369,575</u>	<u>2,445,460</u>	<u>(75,885)</u>
Sub-total	<u>3,704,909</u>	<u>3,674,233</u>	<u>30,676</u>
<b>Business-Type Activities:</b>			
Revenue bonds	1,079,125	1,096,035	(16,910)
State of CA-Revolving Fund Loan	<u>30,651</u>	<u>34,487</u>	<u>(3,836)</u>
Sub-total	<u>1,109,776</u>	<u>1,130,522</u>	<u>(20,746)</u>
<b>Total:</b>	<u>\$ 4,814,685</u>	<u>4,804,755</u>	<u>9,930</u>

Additional information about the City's long-term obligations appears in Note III.F. of the notes to the financial statements.

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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**ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES**

- The fiscal challenges faced in 2010-2011 are expected to continue in 2011-2012 and beyond until the local economy improves, primarily through healthy job growth. A set of 2011-2012 budget balancing strategies were developed through a comprehensive community outreach process and City Council Study Sessions including Council Priority Setting Study Session. In June 2011, the City Council approved a balanced General Fund budget for fiscal year 2011-2012, closing a funding gap of approximately \$115.2 million through a combination of deep service reductions and eliminations, reductions in employee total compensation, revenue increases, service delivery changes, use of reserves, and funding shifts.
- The adopted 2011-2012 budget includes position eliminations, including approximately 370 full time employees subject to layoff, and an additional 446 employees subject to being moved to different positions through the seniority/bumping process including many moving into lower paying classifications. The total number of City positions has decreased to 1985-1986 levels when the City's population was 740,000.
- To preserve City services and prevent additional layoffs, the Mayor and the City Council approved memoranda of agreements with six bargaining units and implemented the terms of its last, best, and final offer for six bargaining units in order to effect a 10.0% reduction in total compensation (wages and benefits) and roll back of any prior year wage increases for all bargaining units.
- The California State Legislature has enacted legislation that is intended to provide for the dissolution of redevelopment agencies in the State of California unless certain payments can be made to the State of California. Such changes to the California Redevelopment Law have also terminated the authority of redevelopment agencies to undertake new obligations to redevelop property. The effects of this legislation are uncertain pending the result of certain lawsuits that have been initiated challenging the constitutionality of this legislation as discussed in Note IV.D.5. However, based on the Agency's current financial condition, these conditions raise substantial doubt about the Agency's ability to continue as a going concern. Management's plans are also discussed in Note IV.D.5.
- On November 18, 2011, the Mayor submitted a memorandum to the City Clerk requesting that the following items be agendized for the December 6, 2011 City Council meeting: (1) consideration of and action on a Declaration of a Fiscal and Service Level Emergency; and (2) consideration of and action on a Ballot Measure on Pension Reform for the March 2012 election, including ballot measure language and related statements and resolutions.
- As of June 30, 2010, the most recent actuarial valuation date, the Police and Fire Department Retirement Plan ("PFDRP") was 79.8 percent funded for pension benefits. The actuarial accrued liability for pension benefits was \$3.230 billion, and the actuarial value of assets was \$2.577 billion resulting in an unfunded actuarial accrued liability ("UAAL") of \$653.8 million. As of June 30, 2010, the most recent actuarial valuation date, the Federated City Employees' Retirement System ("FCERS") was 68.9 percent funded for pension benefits. The actuarial accrued liability for benefits was \$2.510 billion and the actuarial value of assets was \$1.729 billion, resulting in a UAAL of \$780.9 million.
- As noted in the Trust and Agency Funds section of this CAFR, the PFDRP's net assets experienced an increase of \$372.5 million in 2010-2011 following a \$270.6 million increase in net assets in the prior year primarily as a result of the appreciation of the fair value of investments caused by the partial recovery of the equity investment market. The FCERS's net assets experienced an increase of \$275.3 million in 2010-2011 following a \$178.6 million increase in net

**City of San José**  
**Management's Discussion and Analysis (Continued)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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assets in the prior year primarily as a result of the appreciation of the fair value of investments caused by the partial recovery in the investment market.

- The Boards of Administration for PFDRP and FCERS have each decided to transition from biennial to annual valuations beginning June 30, 2011. The contribution rates effective June 27, 2011, for fiscal year 2011-2012, were based on the June 30, 2010 actuarial valuations for PFDRP and FCERS. It is anticipated that the annual required contribution ("ARC") rates calculated in the June 30, 2011 valuation reports for both PFDRP and FCERS will become effective in 2012-2013 after the respective Boards' approval of the actuarial valuation reports.
- For 2011-2012, the City's contribution rates for pension benefits, as a percentage of payroll, are as follows: for police and fire members of PFDRP, 49.29 percent and 51.05 percent, respectively, and 28.34 percent for FCERS members. These rates represent a significant increase in the City's contribution rates compared to the rates in effect in 2010-2011. For 2011-2012, the City's contribution rates for health and dental benefits, percentage of payroll, are as follows: for police and fire members of PFDRP, 7.61 percent and 5.27 percent, respectively, and 7.16 percent for FCERS members.
- On June 24, 2008, the City Council adopted ordinance No. 28332 amending Chapter 3.36 and 3.28 of Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for pension benefits and postemployment healthcare benefits to PFDRP and FCERS. The lump sum prepayment for 2011-2012 was calculated to be actuarially equivalent to the biweekly payments that would otherwise have been the City's required contributions to the benefit pension plans and the postemployment healthcare plans. The Boards of Administration for PFDRP and FCERS approved the actuarially determined prepayment amount of \$137.1 million and \$108.4 million, respectively, paid by the City on July 1, 2011.
- Contributions to the Postemployment Healthcare Plans are made by both the City and the participating members. Contributions to PFDRP for the fiscal year ended June 30, 2011 for Fire members of PFDRP were based on the Board's 10-year cash flow funding policy. The Police members of PFDRP and the bargaining units representing the FCERS's members entered into Memoranda of Agreements ("MOA") with the City to increase the contribution rates for retiree health and dental in order to phase-in to full funding of the GASB Statement No. 45 annual required contribution over the next 5 years.
- As of June 30, 2010, the most recent actuarial valuation date, the PFDRP was 6.2 percent funded for other postemployment benefits. The actuarial accrued liability for benefits was \$946.3 million, and the actuarial value of assets was \$58.6 million resulting in a UAAL of \$887.7 million. As of June 30, 2010, the most recent actuarial valuation date, the FCERS was 11.7 percent funded for other postemployment benefits. The actuarial accrued liability for benefits was \$926.4 million and the actuarial value of assets was \$108.0 million, resulting in a UAAL of \$818.4 million.
- In November 2010, San José voters approved Measure U allowing the City to adopt an ordinance to add a new chapter 4.66 to Title 4 of the San José Municipal Code to impose a tax on marijuana businesses in the City up to a rate of 10 percent of gross receipts. City Council set the rate at 7.0 percent of gross receipts, which went into effect March 1, 2011.
- A 3.0 percent rate increase to the Sewer Service and Use Charge was approved, increasing the average residential payment by \$0.99 per month, from \$32.86 to \$33.85 effective as of July 2011. This increase will support the continued rehabilitation and replacement of infrastructure at the Wastewater Treatment Plant and in the sanitary sewer collection systems. A Recycle Plus rate increase of 9.0 percent and Municipal Water rate increase of 6.75 percent were also approved effective as of July 2011. The increased Recycle Plus rate is to provide for ongoing

**City of San José**  
**Management's Discussion and Analysis (Concluded)**  
**(Required Supplementary Information - Unaudited)**  
**June 30, 2011**

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improvements for recycling facilities. The Municipal Water rate increase is to pay for increases in wholesale water costs from the Santa Clara Valley Water District and San Francisco Public Utilities Commission and to cover for ongoing investment in the distribution infrastructure.

- San José's average unemployment rate for calendar year 2010 increased from 12.0 percent to 12.4 percent over the prior year. The City's average unemployment rate for calendar year 2010 was the same as the statewide average of 12.4 percent.

All of these factors were considered in preparing the City's budget for 2011-2012.

**REQUEST FOR INFORMATION**

This financial report is designed to provide our residents, taxpayers, customers, investors, and creditors with a general overview of the City's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Director of Finance, 200 E. Santa Clara Street, San José, CA 95113.



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Basic Financial Statements



**City of San José**  
**Statement of Net Assets**  
**June 30, 2011**  
**(\$000's)**

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total</u>
<b>ASSETS</b>			
Equity in pooled cash and investments held in City Treasury	\$ 578,999	344,301	923,300
Receivables (net of allowances for uncollectibles)	144,775	13,046	157,821
Due from outside agencies	3,043	113	3,156
Internal balances	(17,128)	17,128	-
Inventories	752	1,143	1,895
Loans receivable (net of allowances for uncollectibles)	360,875	250	361,125
Advances and deposits	527	5,926	6,453
Other assets	21,623	448	22,071
Restricted assets:			
Equity in pooled cash and investments held in City Treasury	61,354	110,832	172,186
Cash and investments held with fiscal agent	429,881	236,538	666,419
Other cash and investments	12,650	-	12,650
Receivables (net of allowances for uncollectibles)	-	2,990	2,990
Deferred bond issuance costs (net of accumulated amortization)	48,813	12,659	61,472
Capital assets (net of accumulated depreciation):			
Nondepreciable	598,418	216,176	814,594
Depreciable	6,492,315	1,990,754	8,483,069
Total assets	<u>8,736,897</u>	<u>2,952,304</u>	<u>11,689,201</u>
<b>LIABILITIES</b>			
Accounts payable	54,715	21,978	76,693
Accrued liabilities	49,787	6,344	56,131
Interest payable	53,465	18,796	72,261
Due to outside agencies	2,006	-	2,006
Short-term notes payable	46,645	410,079	456,724
Unearned revenue	16,061	4,559	20,620
Advances, deposits, and reimbursable credits	14,861	4,899	19,760
Other liabilities	22,010	-	22,010
Noncurrent obligations:			
Due within one year	134,567	28,676	163,243
Due in more than one year	4,039,157	1,112,132	5,151,289
Total liabilities	<u>4,433,274</u>	<u>1,607,463</u>	<u>6,040,737</u>
<b>NET ASSETS</b>			
Invested in capital assets, net of related debt	3,810,801	889,674	4,700,475
Restricted for:			
Debt service	58,084	17,465	75,549
Capital projects	381,257	105,069	486,326
Community services	178,333	-	178,333
Public safety	4,567	-	4,567
Unrestricted	(129,419)	332,633	203,214
Total net assets	<u>\$ 4,303,623</u>	<u>1,344,841</u>	<u>5,648,464</u>

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

**City of San José**  
**Statement of Activities**  
**For the Year Ended June 30, 2011**  
**(\$000's)**

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		Total
		Fees, Fines, and Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business -Type Activities	
Governmental activities:							
General government	\$ 148,515	25,716	13	-	(122,786)	-	(122,786)
Public safety	487,659	21,454	9,368	-	(456,837)	-	(456,837)
Community services	254,481	85,971	47,574	-	(120,936)	-	(120,936)
Sanitation	129,138	137,677	-	61	8,600	-	8,600
Capital maintenance	515,909	46,040	43,090	32,980	(393,799)	-	(393,799)
Interest and fiscal charges	163,280	-	-	-	(163,280)	-	(163,280)
<b>Total governmental activities</b>	<b>1,698,982</b>	<b>316,858</b>	<b>100,045</b>	<b>33,041</b>	<b>(1,249,038)</b>	<b>-</b>	<b>(1,249,038)</b>
Business -Type activities:							
Norman Y. Mineta San José							
International Airport	195,867	145,895	701	10,863	-	(38,408)	(38,408)
Wastewater Treatment System	147,283	167,721	-	8,445	-	28,883	28,883
Municipal Water System	24,600	26,010	-	105	-	1,515	1,515
Parking System	9,630	9,541	-	-	-	(89)	(89)
<b>Total business-type activities</b>	<b>377,380</b>	<b>349,167</b>	<b>701</b>	<b>19,413</b>	<b>-</b>	<b>(8,099)</b>	<b>(8,099)</b>
<b>Total</b>	<b>\$ 2,076,362</b>	<b>666,025</b>	<b>100,746</b>	<b>52,454</b>	<b>(1,249,038)</b>	<b>(8,099)</b>	<b>(1,257,137)</b>
General revenues:							
Taxes:							
Property and other taxes					481,145	-	481,145
Utility					108,528	-	108,528
Franchise					41,273	-	41,273
Transient occupancy					18,102	-	18,102
Business license					36,811	-	36,811
Marijuana tax					1,152	-	1,152
Sales taxes shared revenue					137,970	-	137,970
State of California in-lieu					4,889	-	4,889
Unrestricted interest and investment income					8,142	3,886	12,028
Other revenue					33,237	-	33,237
Transfers					5,303	(5,303)	-
<b>Total general revenues and transfers</b>					<b>876,552</b>	<b>(1,417)</b>	<b>875,135</b>
<b>Change in net assets</b>					<b>(372,486)</b>	<b>(9,516)</b>	<b>(382,002)</b>
<b>Net assets - beginning</b>					<b>4,676,109</b>	<b>1,354,357</b>	<b>6,030,466</b>
<b>Net assets - ending</b>					<b>\$ 4,303,623</b>	<b>1,344,841</b>	<b>5,648,464</b>

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

**City of San José**  
**Balance Sheet**  
**Governmental Funds**  
**June 30, 2011**  
**(\$000's)**

	<u>General Fund</u>	<u>Redevelopment Agency</u>	<u>Housing Activities</u>
<b>ASSETS</b>			
Equity in pooled cash and investments held in City Treasury	\$ 184,039	14,938	41,521
Receivables (net of allowance for uncollectibles)	46,257	491	5,714
Due from outside agencies	2,911	-	51
Due from other funds	2,728	179	-
Loans receivables (net of allowance for uncollectibles)	2,142	34,835	318,470
Advances and deposits	268	192	-
Restricted assets:			
Equity in pooled cash and investments held in City Treasury	838	1,168	6,959
Cash and investments held with fiscal agent	11	137,478	3
Other cash and investments	-	9,430	-
Advances to other funds	3,951	830	67,255
Other assets	-	-	20,771
Total assets	<u>\$ 243,145</u>	<u>199,541</u>	<u>460,744</u>
<b>LIABILITIES AND FUND BALANCES</b>			
Liabilities:			
Accounts payable	\$ 9,837	2,234	2,566
Accrued salaries, wages, and payroll taxes	41,358	931	660
Due to other funds	44	1,061	135
Due to other agencies	500	1,506	-
Short-term notes payable	-	-	-
Deferred revenue	4,028	34,332	35,007
Advances, deposits, and reimbursable credits	7	957	-
Advances from other funds	250	97,904	14,671
Other liabilities	20,500	-	-
Total liabilities	<u>76,524</u>	<u>138,925</u>	<u>53,039</u>
Fund balances:			
Nonspendable	13	192	-
Restricted	397	51,460	407,705
Committed	51,587	2,667	-
Assigned	69,852	6,297	-
Unassigned	44,772	-	-
Total fund balances	<u>166,621</u>	<u>60,616</u>	<u>407,705</u>
Total liabilities and fund balances	<u>\$ 243,145</u>	<u>199,541</u>	<u>460,744</u>

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

<b>Special Assessment Districts</b>	<b>San José Financing Authority Debt Service</b>	<b>Nonmajor Governmental Funds</b>	<b>Total Governmental Funds</b>
-	-	320,466	560,964
57,910	-	33,243	143,615
-	-	81	3,043
-	-	13,250	16,157
-	-	5,428	360,875
5	-	62	527
16,775	-	35,614	61,354
147,356	61,489	83,544	429,881
-	-	3,220	12,650
-	14,091	13,142	99,269
-	-	852	21,623
<u>222,046</u>	<u>75,580</u>	<u>508,902</u>	<u>1,709,958</u>
3,716	152	34,860	53,365
60	-	5,084	48,093
-	-	14,967	16,207
-	-	-	2,006
-	46,645	-	46,645
57,899	-	10,729	141,995
8,643	-	5,254	14,861
-	3,321	201	116,347
-	-	1,510	22,010
<u>70,318</u>	<u>50,118</u>	<u>72,605</u>	<u>461,529</u>
5	-	914	1,124
151,723	25,462	371,081	1,007,828
-	-	50,749	105,003
-	-	13,775	89,924
-	-	(222)	44,550
<u>151,728</u>	<u>25,462</u>	<u>436,297</u>	<u>1,248,429</u>
<u>222,046</u>	<u>75,580</u>	<u>508,902</u>	<u>1,709,958</u>

**City of San José**  
**Reconciliation of the Governmental Funds Balance Sheet**  
**to the Statement of Net Assets**  
**June 30, 2011**  
**(\$000's)**

**Total fund balances-governmental funds** (Page 27) \$ 1,248,429

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

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. These assets consist of:

Land	528,605	
Construction in progress	69,813	
Infrastructure assets	11,352,807	
Other capital assets	1,861,150	
Accumulated depreciation	<u>6,730,387</u>	
Total capital assets		7,081,988

Long-term receivables are not available to pay for current period expenditures and, therefore, are deferred on the modified accrual basis. 68,035

Bond issuance costs are expended in governmental funds when paid, however, such costs are capitalized and amortized over the life of the corresponding bonds for purposes of the statement of net assets.  
 Deferred charges, net of amortization 48,813

Special assessments are reported as revenue when levied in government-wide financial statements. In governmental funds, these assessments are reported as deferred revenue (a liability) since they are not available. 57,899

Interest payable on long-term debt does not require the use of current financial resources and, therefore, interest payable is generally not accrued as a liability in the balance sheet of governmental funds. (53,465)

Internal service funds are used by management to charge the cost of public works support, employee benefits, and vehicle, maintenance and operations to individual funds. The assets and liabilities are included in governmental activities in the Statement of Net Assets. 21,408

Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:

Bonds and notes payable	(3,706,417)	
Accreted interest on capital appreciation bonds	(1,005)	
Accrued vacation, sick leave and compensatory time	(61,761)	
Estimated liability for self-insurance	(142,419)	
Net other postemployment benefits obligation	(224,110)	
Other	<u>(33,772)</u>	
Total long-term liabilities		<u>(4,169,484)</u>

**Net assets of governmental activities** (Page 24) \$ 4,303,623

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

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**City of San José**  
**Statement of Revenues, Expenditures**  
**and Changes in Fund Balances**  
**Governmental Funds**  
**For the Year Ended June 30, 2011**  
**(\$000's)**

	<u>General Fund</u>	<u>Redevelopment Agency</u>	<u>Housing Activities</u>
<b>REVENUES</b>			
Taxes and special assessments	\$ 495,848	183,645	-
Licenses, permits, and fines	93,471	-	-
Intergovernmental	15,613	190	17,213
Charges for current services	33,188	-	-
Rent	-	1,472	-
Investment income	3,618	1,130	8,650
Other revenue	39,071	4,044	4,106
Total revenues	<u>680,809</u>	<u>190,481</u>	<u>29,969</u>
<b>EXPENDITURES</b>			
Current:			
General government	79,167	14,847	-
Public safety	432,476	-	-
Community services	120,035	-	42,546
Sanitation	749	-	-
Capital maintenance	49,625	50,892	14
Capital outlay	2,034	6,364	-
Debt service:			
Principal	1,038	74,340	-
Interest and fiscal charges	553	111,432	-
Bond issuance costs	-	-	-
Total expenditures	<u>685,677</u>	<u>257,875</u>	<u>42,560</u>
Deficiency of revenues under expenditures	<u>(4,868)</u>	<u>(67,394)</u>	<u>(12,591)</u>
<b>OTHER FINANCING SOURCES (USES)</b>			
Bonds issued	-	-	-
Discount on bonds	-	-	-
Proceeds from sale of capital assets	504	20,073	-
Reclassification to long-term liability	-	23,562	-
Transfers in	29,583	25,870	36,807
Transfers out	(29,485)	(41,034)	(27,002)
Total other financing sources (uses)	<u>602</u>	<u>28,471</u>	<u>9,805</u>
Net change in fund balances	(4,266)	(38,923)	(2,786)
Fund balances - beginning (as restated)	<u>170,887</u>	<u>99,539</u>	<u>410,491</u>
Fund balances - ending	<u>\$ 166,621</u>	<u>60,616</u>	<u>407,705</u>

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

<b>Special Assessment Districts</b>	<b>San José Financing Authority Debt Service</b>	<b>Nonmajor Governmental Funds</b>	<b>Total Governmental Funds</b>
11,974	-	113,567	805,034
-	-	-	93,471
-	-	80,653	113,669
-	-	173,140	206,328
-	-	19,620	21,092
118	(38)	3,848	17,326
414	-	10,309	57,944
<u>12,506</u>	<u>(38)</u>	<u>401,137</u>	<u>1,314,864</u>
-	-	18,795	112,809
-	-	1,784	434,260
-	-	60,369	222,950
-	-	127,560	128,309
168	-	113,606	214,305
3,961	-	37,320	49,679
4,426	8,375	19,650	107,829
3,468	24,522	24,464	164,439
1,355	484	-	1,839
<u>13,378</u>	<u>33,381</u>	<u>403,548</u>	<u>1,436,419</u>
<u>(872)</u>	<u>(33,419)</u>	<u>(2,411)</u>	<u>(121,555)</u>
107,425	30,985	-	138,410
(1,946)	(704)	-	(2,650)
-	-	-	20,577
-	-	-	23,562
24,096	41,523	48,866	206,745
(1)	(24,441)	(79,260)	(201,223)
<u>129,574</u>	<u>47,363</u>	<u>(30,394)</u>	<u>185,421</u>
128,702	13,944	(32,805)	63,866
<u>23,026</u>	<u>11,518</u>	<u>469,102</u>	<u>1,184,563</u>
<u>151,728</u>	<u>25,462</u>	<u>436,297</u>	<u>1,248,429</u>

**City of San José**  
**Reconciliation of the Changes in Fund Balances of Governmental Funds**  
**to the Statement of Activities**  
**For the Year Ended June 30, 2011**  
**(\$000's)**

**Net change in fund balances—total governmental funds** (Page 31) \$ 63,866

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

Capital outlays are reported as expenditures in governmental funds. However, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these amounts are:

Capital outlay	49,679	
Depreciation expense	(358,821)	
Excess of depreciation expense over capital outlay		(309,142)

The net effect of various miscellaneous transactions involving capital assets (i.e. sales, retirements, trade-ins, donations)

Donated assets	11,777	
Proceeds from sale of capital assets	(20,577)	
Disposal of assets	(3,146)	
		(11,946)

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.

Bond issuance costs	1,839	
Amortization and refunding of bond issuance costs	(3,121)	
Total bond issuance costs, net of amortization		(1,282)

Repayment of long-term obligation 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. For the government-wide statements, 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 City's long-term obligations were reduced because principal payments were made to bondholders and HUD.

107,829

Accrued interest expense on long-term debt is reported in the government-wide statement of activities, but does not require the use of current financial resources. Amortization of bond premiums, discounts and deferred amounts on refunding should be 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.

Accrued interest on capital appreciation bonds	(95)	
Net discount on bonds issued	2,650	
Decrease in accrued interest expense	848	
Amortization of deferred amounts, premiums and discounts	441	
Total net interest expense and amortization of discount/premium		3,844

Bond proceeds provide current financial resources to governmental funds, however, issuing debt increases long-term liabilities in the statement of net assets.

(138,410)

Because some revenues will not be collected for several months after the City's fiscal year ends, they are not considered "available" revenue and are deferred in the governmental funds. Deferred revenues decreased by this amount this year.

(3,604)

Internal service funds are used by management to charge the cost of public works support, employee benefits, and vehicle, maintenance and operations to individual funds. The change in net assets is included in governmental activities in the Statement of Activities.

3,151

Some items 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. These activities consist of:

Net increase in net OPEB obligation	(68,540)	
Net decrease in vacation, sick leave, and compensatory time	15,344	
Net increase in estimated liability for self-insurance	(10,634)	
Net increase in other liabilities	(22,962)	
Total additional expenditures		(86,792)

**Change in net assets of governmental activities** (Page 25) \$ (372,486)

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

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**City of San José**  
**Statement of Fund Net Assets**  
**Proprietary Funds**  
**June 30, 2011**  
**(\$000's)**

	Enterprise Funds					Internal Service Funds
	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total	
<b>ASSETS</b>						
Current assets:						
Equity in pooled cash and investments held in City Treasury	\$ 62,755	252,934	18,154	10,458	344,301	18,035
Receivables (net of allowance for uncollectibles)	7,254	3,573	2,026	193	13,046	1,160
Due from outside agencies	-	113	-	-	113	-
Due from other funds	-	1,050	-	-	1,050	-
Prepaid expenses, advances and deposits	443	-	-	-	443	-
Inventories	-	1,143	-	-	1,143	752
Total unrestricted current assets	<u>70,452</u>	<u>258,813</u>	<u>20,180</u>	<u>10,651</u>	<u>360,096</u>	<u>19,947</u>
Restricted assets:						
Equity in pooled cash and investments held in City Treasury	57,113	51,688	-	2,031	110,832	-
Cash and investments held with fiscal agent	229,989	6,549	-	-	236,538	-
Receivables (net of allowances for uncollectibles)	2,990	-	-	-	2,990	-
Prepaid expenses, advances and deposits	5	-	-	-	5	-
Total restricted current assets	<u>290,097</u>	<u>58,237</u>	<u>-</u>	<u>2,031</u>	<u>350,365</u>	<u>-</u>
Total current assets	<u>360,549</u>	<u>317,050</u>	<u>20,180</u>	<u>12,682</u>	<u>710,461</u>	<u>19,947</u>
Noncurrent assets:						
Deferred bond issuance costs (net of accumulated amortization)	12,033	626	-	-	12,659	-
Loan receivable	250	-	-	-	250	-
Advances and deposits	5,926	-	-	-	5,926	-
Advances to other funds	-	5,405	-	11,847	17,252	-
Capital assets (net of accumulated depreciation):						
Nondepreciable	108,433	87,634	605	19,504	216,176	-
Depreciable	1,408,894	468,591	68,910	44,359	1,990,754	8,745
Total noncurrent assets	<u>1,535,536</u>	<u>562,256</u>	<u>69,515</u>	<u>75,710</u>	<u>2,243,017</u>	<u>8,745</u>
Total assets	<u>\$ 1,896,085</u>	<u>879,306</u>	<u>89,695</u>	<u>88,392</u>	<u>2,953,478</u>	<u>28,692</u>

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

**City of San José**  
**Statement of Fund Net Assets**  
**Proprietary Funds**  
**June 30, 2011**  
**(\$000's)**

	<b>Enterprise Funds</b>					<b>Internal Service Funds</b>
	<b>Norman Y. Mineta San José International Airport</b>	<b>Wastewater Treatment System</b>	<b>Municipal Water System</b>	<b>Parking System</b>	<b>Total</b>	
<b>LIABILITIES</b>						
Current liabilities:						
Accounts payable	\$ 4,099	11,871	1,843	640	18,453	1,350
Accrued liabilities	1,735	4,153	313	143	6,344	1,694
Interest payable	48	317	-	-	365	-
Due to other funds	-	-	1,000	-	1,000	-
Short-term notes payable	410,079	-	-	-	410,079	-
Accrued vacation, sick leave and compensatory time	1,609	2,545	157	186	4,497	-
Estimated liability for self-insurance	571	1,300	124	-	1,995	-
Advances and deposits payable	1,068	-	-	2	1,070	-
Unearned revenue	2,773	-	-	-	2,773	-
Loans payable	-	3,905	-	-	3,905	-
Pollution remediation obligation	330	-	-	-	330	-
Total current liabilities unrestricted	<u>422,312</u>	<u>24,091</u>	<u>3,437</u>	<u>971</u>	<u>450,811</u>	<u>3,044</u>
Current liabilities payable from restricted assets:						
Accounts payable and accrued liabilities	3,525	-	-	-	3,525	-
Interest payable	18,167	264	-	-	18,431	-
Unearned revenue	1,786	-	-	-	1,786	-
Current portion of bonds payable	12,681	4,884	-	-	17,565	-
Pollution remediation obligation	384	-	-	-	384	-
Total current liabilities payable from restricted assets	<u>36,543</u>	<u>5,148</u>	<u>-</u>	<u>-</u>	<u>41,691</u>	<u>-</u>
Total current liabilities	<u>458,855</u>	<u>29,239</u>	<u>3,437</u>	<u>971</u>	<u>492,502</u>	<u>3,044</u>
Noncurrent liabilities:						
Accrued vacation, sick leave and compensatory time	705	1,178	-	-	1,883	4,240
Estimated liability for self-insurance	1,746	2,868	-	-	4,614	-
Advances from other funds	-	-	174	-	174	-
Advance contributions from participating agencies	-	2,681	-	-	2,681	-
Advances, deposits and reimbursable credits	-	-	1,148	-	1,148	-
Loans payable	-	26,746	-	-	26,746	-
Bonds payable (net of premium/discount and deferred loss on refunding)	1,010,623	48,761	-	-	1,059,384	-
Net other postemployment benefits obligation	7,530	10,811	815	349	19,505	-
Total noncurrent liabilities	<u>1,020,604</u>	<u>93,045</u>	<u>2,137</u>	<u>349</u>	<u>1,116,135</u>	<u>4,240</u>
Total liabilities	<u>1,479,459</u>	<u>122,284</u>	<u>5,574</u>	<u>1,320</u>	<u>1,608,637</u>	<u>7,284</u>
<b>NET ASSETS</b>						
Invested in capital assets, net of related debt	272,598	483,698	69,515	63,863	889,674	8,745
Restricted for debt service	9,185	6,249	-	2,031	17,465	-
Restricted for capital projects and other agreements	54,942	50,127	-	-	105,069	460
Unrestricted	79,901	216,948	14,606	21,178	332,633	12,203
Total net assets	<u>\$ 416,626</u>	<u>757,022</u>	<u>84,121</u>	<u>87,072</u>	<u>1,344,841</u>	<u>21,408</u>

**City of San José**  
**Statement of Revenues, Expenses, and Changes in Fund Net Assets**  
**Proprietary Funds**  
**For the Year Ended June 30, 2011**  
**(\$000's)**

	Enterprise Funds					Internal Service Funds
	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total	
<b>OPERATING REVENUES</b>						
Charges for services	\$ 44,054	139,394	25,952	9,541	218,941	119,872
Rentals and concessions	76,870	2,640	-	-	79,510	-
Customer transportation fees	6,840	-	-	-	6,840	-
Service connection, engineering and inspection	-	2,107	-	-	2,107	-
Contributions	-	16,516	-	-	16,516	-
Other	39	7,034	-	-	7,073	-
Total operating revenues	<u>127,803</u>	<u>167,691</u>	<u>25,952</u>	<u>9,541</u>	<u>330,987</u>	<u>119,872</u>
<b>OPERATING EXPENSES</b>						
Operations and maintenance	70,809	96,457	21,026	3,421	191,713	112,651
General and administrative	19,095	23,446	1,076	3,544	47,161	356
Depreciation and amortization	51,532	24,357	2,491	2,520	80,900	3,567
Materials and supplies	-	322	-	145	467	-
Other expenses	-	-	-	-	-	189
Total operating expenses	<u>141,436</u>	<u>144,582</u>	<u>24,593</u>	<u>9,630</u>	<u>320,241</u>	<u>116,763</u>
Operating income (loss)	<u>(13,633)</u>	<u>23,109</u>	<u>1,359</u>	<u>(89)</u>	<u>10,746</u>	<u>3,109</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>						
Passenger facility charges	17,311	-	-	-	17,311	-
Operating grants	701	-	-	-	701	-
Investment income	1,613	2,066	116	91	3,886	261
Interest expense	(54,431)	(2,990)	(7)	-	(57,428)	-
Contributions refunded from participating agencies	-	291	-	-	291	-
Loss on disposal of capital assets	-	(2)	-	-	(2)	-
Other revenues, net	781	30	58	-	869	-
Net nonoperating revenues (expenses)	<u>(34,025)</u>	<u>(605)</u>	<u>167</u>	<u>91</u>	<u>(34,372)</u>	<u>261</u>
Income (loss) before capital contributions and transfers	<u>(47,658)</u>	<u>22,504</u>	<u>1,526</u>	<u>2</u>	<u>(23,626)</u>	<u>3,370</u>
Capital contributions	10,863	8,445	105	-	19,413	-
Transfers in	657	268	20	9	954	87
Transfers out	-	(4,693)	(470)	(1,094)	(6,257)	(306)
Changes in net assets	<u>(36,138)</u>	<u>26,524</u>	<u>1,181</u>	<u>(1,083)</u>	<u>(9,516)</u>	<u>3,151</u>
Net assets - beginning (as restated)	<u>452,764</u>	<u>730,498</u>	<u>82,940</u>	<u>88,155</u>	<u>1,354,357</u>	<u>18,257</u>
Net assets - ending	<u>\$ 416,626</u>	<u>757,022</u>	<u>84,121</u>	<u>87,072</u>	<u>1,344,841</u>	<u>21,408</u>

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

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**City of San José**  
**Statement of Cash Flows**  
**Proprietary Funds**  
**For the Year Ended June 30, 2011**  
**(\$000's)**

	Enterprise Funds					Internal Service Funds
	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>						
Receipts from customers and users	\$ 128,461	151,571	25,993	9,488	315,513	-
Cash received from interfund services provided	-	-	-	-	-	119,872
Payments to suppliers	(62,281)	(55,410)	(17,358)	(5,192)	(140,241)	(98,657)
Payments to employees	(26,167)	(58,728)	(4,201)	(1,925)	(91,021)	(17,125)
Other receipts	386	16,516	-	-	16,902	-
Net cash provided by operating activities	40,399	53,949	4,434	2,371	101,153	4,090
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>						
Transfer from other funds	672	268	20	9	969	87
Transfer to other funds	-	(4,693)	(470)	(1,094)	(6,257)	(306)
(Advances to) / payments from other funds	-	1,019	(1,000)	(3,364)	(3,345)	-
Subsidies from operating grants	286	-	-	-	286	-
Advances and deposits received	-	-	15	-	15	-
Net cash provided by (used in) by noncapital and related financing activities	958	(3,406)	(1,435)	(4,449)	(8,332)	(219)
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>						
Passenger facility charges received	18,049	-	-	-	18,049	-
Proceeds from commercial paper	371,344	-	-	-	371,344	-
Principal payment on commercial paper	(378,613)	-	-	-	(378,613)	-
Subsidies from capital grants	17,998	5,713	-	-	23,711	-
Acquisition and construction of capital assets	(88,768)	(23,489)	(233)	(480)	(112,970)	(2,638)
Principal paid on debt	(12,120)	(8,626)	-	-	(20,746)	-
Interest paid on debt	(54,093)	(2,816)	-	-	(56,909)	-
Advances and deposits received	945	-	-	-	945	-
Net cash used in capital and related financing activities	(125,258)	(29,218)	(233)	(480)	(155,189)	(2,638)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>						
Proceeds from sales and maturities of investments	385,686	-	-	-	385,686	-
Purchase of investments	(99,065)	-	-	-	(99,065)	-
Interest received	4,095	2,863	151	91	7,200	261
Net cash provided by investing activities	290,716	2,863	151	91	293,821	261
Net change in cash and cash equivalents	206,815	24,188	2,917	(2,467)	231,453	1,494
Cash and cash equivalents - beginning	121,401	281,265	15,237	14,956	432,859	16,541
Cash and cash equivalents - ending	\$ 328,216	305,453	18,154	12,489	664,312	18,035

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

**City of San José**  
**Statement of Cash Flows**  
**Proprietary Funds**  
**For the Year Ended June 30, 2011**  
**(\$000's)**

	Enterprise Funds					Internal Service Funds
	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total	
<b>Reconciliation of operating income (loss) to net cash provided by operating activities:</b>						
Operating income (loss)	\$ (13,633)	23,109	1,359	(89)	10,746	3,109
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:						
Depreciation and amortization	51,532	24,357	2,491	2,520	80,900	3,567
Other nonoperating revenues	781	-	58	-	839	-
Decrease (increase) in:						
Accounts receivable	(1,078)	381	(17)	(53)	(767)	(523)
Due from outside agencies	-	15	-	-	15	-
Inventories	-	(54)	-	-	(54)	(13)
Prepaid expenses, advances and deposits	(289)	-	-	-	(289)	-
Increase (decrease) in:						
Accounts payable and accrued liabilities	1,848	4,132	316	(117)	6,179	(276)
Accrued vacation, sick leave and compensatory time	(1,205)	(1,127)	15	10	(2,307)	(1,774)
Estimated liability for self-insurance	(657)	(162)	(33)	-	(852)	-
Unearned revenue	1,193	-	-	-	1,193	-
Advances and deposits payable	117	-	-	-	117	-
Other liabilities	1,790	3,298	245	100	5,433	-
Total adjustments	54,032	30,840	3,075	2,460	90,407	981
Net cash provided by operating activities	\$ 40,399	53,949	4,434	2,371	101,153	4,090
<b>Reconciliation of cash and cash equivalents to the statement of net assets:</b>						
Equity in pooled cash and investments held in City Treasury						
Unrestricted	\$ 62,755	252,934	18,154	10,458	344,301	18,035
Restricted	57,113	51,688	-	2,031	110,832	-
Cash and investments held with fiscal agent	229,989	6,549	-	-	236,538	-
Less investments not meeting the definition of cash equivalents	(21,641)	(5,718)	-	-	(27,359)	-
Cash and cash equivalents	\$ 328,216	305,453	18,154	12,489	664,312	18,035
<b>Noncash noncapital, capital and related financing, and investing activities:</b>						
Acquisition of capital assets on accounts payable and accrued liabilities	\$ 2,542	-	-	-	2,542	-
Contributions from developers	-	1,571	105	-	1,676	-
Redevelopment Agency's equity transfer due to annexation	-	30	-	-	30	-
Amortization of deferred charges and other charges	345	232	-	-	577	-
Change in fair value of investments	1,371	251	-	-	1,622	-

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

**City of San José**  
**Statement of Fiduciary Net Assets**  
**Fiduciary Funds**  
**June 30, 2011**  
**(\$000's)**

	<u>Pension Trust Funds</u>	<u>James Lick Private Purpose Trust Fund</u>	<u>Agency Fund</u>
<b>ASSETS</b>			
Equity in pooled cash and investments held in City Treasury	\$ -	99	3,226
Investments of retirement plans:			
Investments, excluding securities lending collateral:			
Fixed income	1,325,515	-	-
Global equity	1,508,703	-	-
Pooled international equity	667,249	-	-
Private equity	312,707	-	-
International currency contracts, net	503	-	-
Opportunistic	59,734	-	-
Real assets	473,198	-	-
Real estate	217,702	-	-
Securities lending cash collateral investment pool	502,109	-	-
Total investments	<u>5,067,420</u>	<u>-</u>	<u>-</u>
Receivables:			
Accrued investment income	12,243	-	2
Employee contributions	4,089	-	-
Employer contributions	16,920	-	-
Other	13,911	-	-
Total assets	<u>5,114,583</u>	<u>99</u>	<u>\$ 3,228</u>
<b>LIABILITIES</b>			
Due to brokers	22,238	-	-
Securities lending collateral, due to borrowers	504,915	-	-
Other liabilities	3,961	-	3,228
Total liabilities	<u>531,114</u>	<u>-</u>	<u>\$ 3,228</u>
<b>NET ASSETS</b>			
Held in trust for:			
Employees' pension benefits	4,388,345	-	
Employees' postemployment healthcare benefits	195,124	-	
Other purpose	-	99	
Total net assets	<u>\$ 4,583,469</u>	<u>99</u>	

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

**City of San José**  
**Statement of Changes in Fiduciary Net Assets**  
**Fiduciary Funds**  
**For the Year Ended June 30, 2011**  
**(\$000's)**

	<b>Pension Trust Funds</b>	<b>James Lick Private Purpose Trust Fund</b>
<b>ADDITIONS</b>		
Investment income:		
Interest	\$ 74,353	5
Dividends	29,413	-
Net rental income	12,923	-
Net change in fair value of plan investments	608,113	-
Investment expenses	(13,467)	-
Total investment income	711,335	5
Securities lending income:		
Securities lending income	4,267	-
Securities lending rebates and expenses	(1,238)	-
Total securities lending income	3,029	-
Contributions:		
Employer	171,245	-
Employees	81,501	-
Total contributions	252,746	-
Total additions	967,110	5
<b>DEDUCTIONS</b>		
General and administrative	6,284	-
Health insurance premiums	55,643	-
Refunds of contributions	2,415	-
Retirement and other benefits:		
Death benefits	15,096	-
Retirement benefits	239,887	-
Total deductions	319,325	-
Change in net assets	647,785	5
Net assets held in trust for pension, postemployment healthcare benefits and other purposes:		
Beginning of year	3,935,684	94
End of year	\$ 4,583,469	99

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

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**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**INDEX TO THE NOTES**

<b>I. Summary of Significant Accounting Policies</b>	
A. Reporting Entity .....	44
B. Financial Statement Presentation .....	45
C. Measurement Focus and Basis of Accounting .....	47
D. Use of Estimates .....	48
E. New Pronouncements .....	48
F. Assets, Liabilities, and Net Assets or Equity .....	49
<b>II. Stewardship, Compliance, and Accountability</b>	
A. Deficit Fund Balances .....	56
B. Deficit Unrestricted Net Assets – Governmental Activities .....	56
<b>III. Detailed Notes on all Funds</b>	
A. Cash, Deposits, and Investments .....	56
B. Receivables, Net of Allowances .....	73
C. Loans Receivable .....	73
D. Capital Assets .....	75
E. Leases .....	76
F. Long-term Debt and Other Obligations .....	80
G. Interfund Transactions .....	99
H. Governmental Fund Balances .....	105
<b>IV. Other Information</b>	
A. Defined Benefit Retirement Plans .....	106
B. Defined Contribution Retirement Plan .....	118
C. Commitments and Contingencies .....	119
D. Subsequent Events .....	124

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**I. Summary of Significant Accounting Policies**

**A. Reporting Entity**

The City of San José, California (the “City”), was chartered on March 25, 1850, and has operated under a Council–Manager form of government since 1916. The City has defined its reporting entity in accordance with generally accepted accounting principles (“GAAP”) in the United States of America, which provide guidance for determining which governmental activities, organizations, and functions should be included in the reporting entity. In evaluating how to define the City for financial reporting purposes, management has considered all potential component units. The primary criterion for including a potential component unit within the reporting entity is the governing body’s financial accountability. A primary government is financially accountable if it appoints a voting majority of a component unit’s governing body and it is able to impose its will on the component unit, or if there is a potential for the component unit to provide specific financial benefits to, or impose specific financial burdens on, the primary government. A primary government may also be financially accountable if a component unit is fiscally dependent on the primary government regardless of whether the component unit has a separately elected governing board, a governing board appointed by a higher level of government, or a jointly appointed board. Based upon the application of these criteria, the following is a brief description of each component unit included within the City’s reporting entity. All such component units have been “blended” as though they are part of the primary government because the component unit’s governing body is substantially the same as the City’s primary government, and/or the component units provide services entirely, or almost entirely, to the City or otherwise exclusively, or almost exclusively, benefits the City, even though it does not provide services directly to it.

- **Redevelopment Agency of the City of San José** – The Redevelopment Agency of the City of San José (the “Agency”) was created by the City Council with the authority and responsibility for redeveloping and upgrading blighted areas of the City. The members of the City Council are also members of the Agency’s Board of Directors and, as such, are authorized to transact business and exercise their power to plan, engineer, and carry out projects of the Agency.

Until June 29, 2011, the Agency has had the broad authority to acquire, rehabilitate, develop, administer, and sell or lease property in a redevelopment project area. As of June 29, 2011, changes to the California Redevelopment Law have terminated the authority of redevelopment agencies to undertake new obligations to redevelop property. The validity of this new law is currently being litigated. Due to the uncertainty of the status of the new law and the fact that it became effective on the penultimate date of the fiscal year, for the purposes of these Notes, the City will treat the new law as a subsequent event, as discussed further in Note IV.D. Subsequent Events.

- **Parking Authority of the City of San José** – The Parking Authority of the City of San José (the “Parking Authority”) was created by the City Council to provide funding through debt issuance for parking facilities constructed on City-owned land. Such parking facilities are leased to the City. Members of the City Council are also members of the Parking Authority’s Board of Directors.
- **San José – Santa Clara Clean Water Financing Authority** – The San José – Santa Clara Clean Water Financing Authority (the “Clean Water Financing Authority”) was created pursuant to a Joint Exercise of Powers Agreement between the City and the City of Santa Clara. The purpose was to finance the acquisition of, and additions and improvements to the existing San José – Santa Clara Water Pollution Control Plant (the “Plant”). The Clean Water Financing Authority is governed by a five-member Board of Directors, three are members of the San José City Council and two are members of the City Council of the City of Santa Clara. The Clean Water Financing Authority and the cities of San José and Santa Clara subsequently entered

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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into an Improvement Agreement, which requires each city to make base payments that are at least equal to each city's allocable share of debt service requirements of the Clean Water Financing Authority's outstanding revenue bonds.

- **City of San José Financing Authority** – The City of San José Financing Authority (the "Authority") was created by a Joint Exercise of Powers Agreement between the City and the Agency. The Authority was created for the purpose of facilitating the financing of public improvements and facilities within the City and is authorized to issue bonds for this purpose. The Authority is governed by an 11-member Governing Board, which consists of the members of the City Council.
- **San José Diridon Development Authority** – The San José Diridon Development Authority (the "Diridon Authority") was created in March 2011 by a Joint Exercise of Powers Agreement between the City and the Agency. The Diridon Authority was created for the purposes of constructing, maintaining, operating, and future redevelopment of properties within the Diridon area of the City, and is authorized to issue bonds for this purpose. The Diridon Authority is governed by an 11-member Governing Board, which consists of the members of the City Council.

Separate financial reports for the fiscal year ended June 30, 2011, containing additional information and more detailed information regarding financial position, changes in financial position, and, where applicable, cash flows, are available from the City's Director of Finance, 200 East Santa Clara Street; 13<sup>th</sup> Floor, San José, CA 95113-1905, for the following:

- Federated City Employees' Retirement System (the "FCERS")
- Police and Fire Department Retirement Plan (the "PFDRP")
- Redevelopment Agency of the City of San José
- Norman Y. Mineta San José International Airport (the "Airport")
- San José – Santa Clara Clean Water Financing Authority

#### **B. Financial Statement Presentation**

**Government-wide Financial Statements.** The government-wide financial statements, i.e. the statement of net assets and the statement of activities, display information about the primary government and its component units. These statements include the financial activities of the overall government, except for fiduciary activities. Eliminations have been made to minimize the double counting of internal activities. For example, the direct expense charges based on actual use are not eliminated, whereas indirect expense allocations made in the funds are eliminated. These statements distinguish between the *governmental* and *business-type* activities of the City. Governmental activities, which normally are supported by taxes, intergovernmental revenues and other non-exchange transactions, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties.

The statement of activities, which is included in the government-wide financial statements, presents a comparison between direct expenses and program revenues for each business-type activity of the City and each function of the City's governmental activities. Direct expenses are those that are specifically associated with a business-type activity or governmental function and; therefore, are clearly identifiable to a particular activity or function. Program revenues include 1) fees, fines and charges paid by the recipients of goods or services offered by the programs, and 2) grants and contributions that are restricted to meet the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are instead presented as general revenues.



**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

---

**Fund Financial Statements.** The fund financial statements provide information about the City's funds, including its fiduciary funds. Separate statements for each fund category, such as governmental, proprietary and fiduciary, are presented. The emphasis of fund financial statements are on the major governmental and enterprise funds of the City and are reported separately in the accompanying financial statements. All remaining governmental funds are aggregated and reported as non-major funds in the accompanying financial statements.

Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

The City reports the following major governmental funds:

The **General Fund** is the City's primary operating fund. It accounts for all revenues and expenditures necessary to carry out basic governmental activities of the City that are not accounted for through other funds.

The **Redevelopment Agency Fund** is a capital projects fund that accounts for administrative, operating, low-to-moderate income housing program, debt and construction activities necessary to carry out responsibilities for redeveloping and upgrading blighted areas in the City. The Agency's primary source of funds is from the incremental property taxes collected within certain project areas related to the increase in assessed valuation resulting from redevelopment.

The **Housing Activities Fund** is a special revenue fund that accounts for the City's affordable housing activities. Under California Redevelopment Law, redevelopment agencies are required to deposit a minimum of twenty percent of incremental property taxes to set-aside funds for low and moderate income housing and related expenditures. In addition, this fund also receives funding from federal and state grants for various housing programs.

The **Special Assessment Districts Fund** is a capital projects fund that accounts for the capital project and debt activities related to debt issued to finance public improvements benefiting properties against which special assessments or special taxes are levied.

The **City of San José Financing Authority Fund** is a debt service fund that accounts for the debt activities related to capital projects funded with Authority debt.

The City reports the following major enterprise funds:

The **Norman Y. Mineta San José International Airport Fund** accounts for the activities of the City owned commercial service and general aviation airport.

The **Wastewater Treatment System Fund** accounts for the financing, construction and operations of the Plant and the regional water reclamation program.

The **Municipal Water System Fund** accounts for the operations of the five water system operating districts: North San José, Evergreen, Coyote, Edenvale, and Alviso.

The **Parking System Fund** accounts for the operations of the parking garage facilities, parking lots, and parking meters located within the City.

The City also reports the following types of funds:

The **Internal Service Funds** are used to account for the public works support services provided to City-wide capital programs; the cost of operating on automotive maintenance facility used by other City departments; and employee benefits including medical, vision, dental, and unemployment insurance costs on a cost-reimbursement basis.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

---

The ***Pension Trust Funds*** account for the accumulated resources to be used for retirement annuity and postemployment healthcare payments to members of the FCERS and the PFDRP, collectively, the "Retirement System".

The ***James Lick Private Purpose Trust Fund*** is used to account for resources legally held in trust for use towards the support of the EMQ Families First Agency (a.k.a. Eastfield Ming Quong). All resources of the fund, including any earnings on invested resources, are used to support the organization's activities.

The ***Agency Funds*** account for assets held by the City in a custodial capacity on behalf of the San José Arena.

### **C. Measurement Focus and Basis of Accounting**

The basis of accounting determines when transactions are reported on the financial statements. The government-wide, proprietary and fiduciary funds (excluding agency funds) financial statements are reported using the economic resources measurement focus. The government-wide, proprietary funds and fiduciary funds financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Non-exchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property and sales taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenues from sales and use, transient occupancy and utility users tax are recognized when the underlying transactions take place. Revenues from grants, entitlements and donations are recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental funds are reported using the current financial resources measurement focus. This focus is on the determination of, and changes in financial resources, and generally only current assets and current liabilities are included in the balance sheet. These funds use the modified accrual basis of accounting, whereby revenues are recognized in the accounting period in which they become both measurable and available to finance expenditures of the fiscal period. For this purpose, the City considers revenues as available if they are collected within sixty days of the end of the current fiscal period. Expenditures are generally recorded when a liability is incurred. However, principal and interest on long-term debt and certain estimated liabilities, such as compensated absences and self-insurance claims, are recorded only when payment is due.

In governmental funds, revenues from taxes, franchise fees, investment income, certain state and federal grants and charges for services associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues in the current period. All other revenue items are considered measurable and available only when cash is received by the City.

Proprietary funds distinguish between operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's enterprise funds are charges to customers for sales and services. In addition, Wastewater Treatment System Fund contributions from other participating agencies for their allocation of the Plant's operating and maintenance expense are also included as operating revenues. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Under the terms of grant agreements, the City funds certain programs by a combination of specific cost-reimbursement grants, categorical block grants and general revenues. Thus, when program

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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expenses are incurred, there are both restricted and unrestricted net assets available to finance the program. It is the City's policy to first apply restricted cost-reimbursement grant resources to such programs, followed by restricted categorical block grants, and then by unrestricted general revenues.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board ("GASB"). Governments also have the option of following subsequent private-sector guidance for business-type activities and enterprise funds, subject to the same limitation. The City has elected not to follow subsequent private-sector guidance.

**D. Use of Estimates**

A number of estimates and assumptions relating to the reporting of revenues, expenditures/expenses, assets and liabilities, and the disclosure of contingent liabilities were used to prepare these financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

**E. New Pronouncements**

During the year ended June 30, 2011, the City implemented the following GASB Statements:

In February 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54). The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. Under previous reporting standards, the City's governmental fund balances were reported under three categories: reserved, unreserved, and designated. The new reporting standard replaces these three fund balance categories with five new classifications: nonspendable, restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent. Additional disclosure concerning the implementation of GASB 54 is available in Note III.H.

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*. This statement updates and improves existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investments pools which improve financial reporting by providing more complete information, by providing consistency of measurements, and by providing clarifications of existing standards. This standard did not have any effect on the City's financial statements.

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

In November 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements ("SCAs"), which are a type of public-private or public-public partnership. This Statement requires disclosures about an SCA including a general description of the arrangement and information about the associated assets, liabilities, and deferred inflows, the rights granted and retained, and guarantees and commitments. Application of this Statement is effective for the City's fiscal year ending June 30, 2013.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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In November 2010, GASB issued Statement No.61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statement No. 14 and No. 34*. The Statement modifies certain requirements for inclusion of component units in the financial reporting entity. The requirements of this Statement result in financial reporting entity financial statements being more relevant by improving guidance for including, presenting and disclosing information about component units and equity interest transactions of a financial reporting entity. Application of this Statement is effective for the City's fiscal year ending June 30, 2013.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board ("FASB") Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' ("AICPA") Committee on Accounting Procedure

Hereinafter, these pronouncements collectively are referred to as the "FASB and AICPA pronouncements." This Statement will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. Application of this Statement is effective for the City's fiscal year ending June 30, 2013.

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. This Statement also amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The requirements of this Statement are effective for the City's fiscal year ending June 30, 2013.

In June 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*. This Statement sets forth criteria to establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The requirements of this Statement enhance comparability and improve financial reporting by clarifying the circumstances in which hedge accounting should continue when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The requirements of this Statement are effective for the City's fiscal year ending June 30, 2012.

## **F. Assets, Liabilities, and Net Assets or Equity**

### **1. Cash and Cash Equivalents**

Restricted and unrestricted pooled cash and investments held in the City Treasury and other unrestricted investments, invested by the City Treasurer, are considered cash equivalents for purposes of the statement of cash flows because the City's cash management pool and funds invested by the City Treasurer possess the characteristics of demand deposit accounts. Other restricted and unrestricted investments with maturities less than three months at the time of purchase are also considered cash equivalents for purposes of the statement of cash flows.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**2. Equity in Pooled Cash and Investments Held in City Treasury**

Most cash balances of the City's funds and some of its component units are pooled and invested by the City Treasurer unless otherwise dictated by legal or contractual requirements. Income and losses arising from the investment activity of pooled cash are allocated to the participating funds and component units on a monthly basis, based on their proportionate shares of the average weekly cash balance.

**3. Deposits and Investments**

Investments are accounted for in accordance with the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, as amended.

This Statement requires governmental entities to report investments at fair value in the statement of net assets or balance sheet and to recognize the corresponding change in fair value of investments in the year in which the change occurred.

**Pooled Cash and Investments held in City Treasury.** The City reports its investments held in City Treasury at fair value. The fair value is based on quoted market information obtained from fiscal agents or other sources. Income from some investments is assigned to the General Fund. The assignment of the income from these investments is supported by legal or contractual provisions approved by the City Council. For the fiscal year ended June 30, 2011, the total investment income from these investments assigned and transferred to the General Fund was approximately \$2,537,000.

**Retirement Systems.** The Retirement Systems' investment policies authorize various types of investments. These investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price on the last business day of the fiscal year at current exchange rates, if applicable. Investments that do not have an established market are reported at estimated fair value based on the most recently available investor reports or audited financial statements issued by the manager of those funds. The fund manager provides an estimated unrealized gain/loss of the fund based on the most recently audited financial statements and other fund information. The fair value of separate real estate properties is based on annual independent appraisals. In addition, per the Retirement Systems' Real Estate Investment Guidelines, mortgage loans at fair value on the separate real estate properties are not allowed to exceed 50% of the property's fair value. Purchases and sales of securities are reflected on the date of trade. Investment income is recognized as earned. Rental income from real estate activity is recognized as earned, net of expenses.

**Other Investments.** Non-pooled investments are generally carried at fair value. However, investments in investment agreements are carried at cost. Income from non-pooled investments is recorded based on the specific investments held by the fund. The investment income is recorded in the fund that earned the income.

**4. Inventories**

Inventories of proprietary funds are valued at the lower of cost (first-in/first-out) or market.

**5. Special Assessment Districts**

Special assessments are recorded as receivables when they become a lien on property. Special assessments not considered available are recorded as receivables and offset by deferred revenues in the governmental fund financial statements. In general, special assessment and special tax bonds are fully secured by liens against the privately owned properties benefited by the

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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improvements for which the bonds were issued. There is no reserve for delinquent receivables since priority liens exist against the related properties and hence the City's management believes value will ultimately be received by the City. Surplus funds remaining at the completion of a special assessment district project are disposed of in accordance with the City Council's resolutions and with the applicable assessment bond laws of the State of California. A liability is recorded for the balance remaining until a final legal determination has been made.

**6. Advances and Deposits**

Amounts deposited in connection with eminent domain proceedings and special assessment surpluses are reported as advances and deposits. In the governmental fund statements, non-current portions of these are offset equally by either a deferred credit or a fund balance in the nonspendable, restricted or committed account to indicate they do not constitute expendable financial resources available for appropriation.

**7. Other Assets**

Other assets primarily consist of real properties acquired outright and/or through foreclosure in connection with the housing rehabilitation program. These assets are recorded at the lower of cost or estimated net realizable value.

**8. Bond Issuance Costs, Original Issue Discounts and Premiums and Deferred Amounts on Refundings**

In the government-wide financial statements and the proprietary fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds. Bonds payable are reported net of the applicable bond premium or discount and deferred amounts on refundings. Bond issuance costs are deferred and are amortized over the term of the related debt. Gains or losses occurring from advance refundings, completed subsequent to June 30, 1993, are deferred and amortized into expense for both business-type activities and proprietary funds. For governmental activities, they are deferred and amortized into expense if they occurred subsequent to June 30, 2001.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

**9. Restricted Assets**

Assets that are restricted for specific uses by bonded debt requirements, grant provisions or other requirements are classified as restricted because their use is limited by applicable bond covenants or agreements.

**10. Capital Assets**

Capital assets include land, buildings, improvements, vehicles and equipment, infrastructure and all other tangible and intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Capital assets are reported in the applicable governmental or business-type activity columns in the government-wide financial statements and the proprietary funds' statement of net assets. Capital assets are defined as assets with an initial individual cost of more than \$5,000 for general capital assets and \$100,000 for major infrastructure assets, and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the time received. Capital outlay is recorded as expenditures of the

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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governmental funds and as assets in the government-wide financial statements to the extent the City's capitalization threshold is met. Interest incurred during the construction phase of capital assets of business-type activities is reflected in the capitalized value of the asset constructed, net of interest earned on the invested proceeds of tax-exempt debt over the same period. Amortization of assets acquired under capital leases is based on the shorter of the lease term or the estimated useful life of the asset and is included in depreciation and amortization.

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

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

Capital assets which are used for general governmental purposes and are not available for expenditure are accounted for and reported in the government-wide financial statements. Capital assets that meet the definition of the major infrastructure networks or extend the life of existing infrastructure networks are capitalized as infrastructure. Infrastructure networks include roads, bridges, drainage systems, and lighting systems.

**11. *Compensated Absences – Accrued Vacation, Sick Leave, and Compensatory Time***

Vacation, sick leave, compensatory time, and related benefits are accrued as determined by the agreement between the City and the respective employees' collective bargaining group. For governmental funds, compensated absence obligations are recorded in the appropriate governmental funds when due. The portion not currently due is recorded in the government-wide financial statements. For proprietary funds, compensated absences are expensed when earned by employees. At year-end, the accrued but unpaid compensated absence obligations are recorded as current and non-current liabilities in the appropriate proprietary funds.

Vacation pay may be accumulated up to two times the annual accrual rate, not to exceed a maximum of 400 hours for non-sworn employees.

Employees represented by the San José Police Officer's Association ("SJPOA") may carry over to the next payroll calendar year not more than 200 hours of unused vacation leave. Employees represented by the International Association of Firefighters, Local 230, may carryover to the next payroll calendar year not more than 200 hours of unused vacation leave for employees on a 40-hour workweek and 240 hours for those employees on a 56-hour workweek.

Employees in the FCERS who retire with at least 15 years of service or 20 years for police officers and firefighters in the PFDRP may be eligible to receive, upon retirement, sick leave payouts based on percentages of accumulated sick hours as determined by the respective collective bargaining agreements.

**12. *Inter-fund Transactions***

Inter-fund transactions are reflected as loans, services provided, reimbursements and/or transfers. Loans and balances related to unsettled service transactions are reported as receivables and payables as appropriate, are subject to elimination upon consolidation of similar fund types, and are referred to as either "due to/from other funds," i.e., the current portion of inter-fund loans and unsettled service transactions, or "advances to/from other funds," i.e., the non-current portion of inter-fund loans. Any residual balances outstanding between the governmental activities and the

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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business-type activities are reported in the government-wide financial statements as “internal balances”.

Services provided are deemed to be at market or near market rates and are treated as revenues and expenditures/expenses. Reimbursements are defined as when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other inter-fund transactions are treated as transfers. Transfers between governmental or proprietary funds are netted as part of the reconciliation to the government-wide presentation.

**13. Self-Insurance**

The City is self-insured for workers’ compensation, general liability, auto liability, and certain other risks. The City’s workers’ compensation activities are funded and accounted for separately in the fund financial statements based upon the activities of each fund. The current portion of claims liability is accounted for in the General Fund and the enterprise funds on the basis of settlements reached or judgments entered within the current fiscal year. In the government-wide financial statements and the enterprise fund financial statements, the estimated liability for all self-insurance liability claims is recorded as a liability.

**14. Net Assets/Fund Equity**

The government-wide and proprietary fund financial statements utilize a net assets presentation. Net assets are categorized as invested in capital assets (net of related debt), restricted, and unrestricted.

- *Invested In Capital Assets, Net of Related Debt* - This category groups all capital assets, including infrastructure, into one component of net assets. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction, or improvement of these assets reduce the balance in this category.
- *Restricted Net Assets* – This category represents net assets that have external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation. At June 30, 2011, the government-wide statement of net assets reported restricted assets of \$622,241,000 in governmental activities and \$122,534,000 in business-type activities. Of these amounts \$411,091,000 and \$72,875,000, respectively are restricted by enabling legislation.
- *Unrestricted Net Assets* – This category represents net assets of the City, not restricted for any project or other purpose.

**15. Fund Balances**

As discussed at Note I.E., the City implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, for the year ended June 30, 2011. Under GASB 54, the financial statements reporting for governmental funds classify fund balances based primarily on the extent to which the City is bound to honor constraints on the specific purposes for which those funds can be spent. As of June 30, 2011, fund balance for government funds consist of the following categories:

- *Nonspendable Fund Balance* – includes amounts that are not in a spendable form, such as inventories, prepaid items, and long-term loans and notes receivables. It also includes amounts that are legally or contractually required to be maintained intact or required to be retained in perpetuity, such as the principal of an endowment fund.



**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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- *Restricted Fund Balance* – includes amounts reported as restricted when constraints placed on the use of resources are either (1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or (2) imposed by law through constitutional provisions or enabling legislation.
- *Committed Fund Balance* – includes amounts that have been limited to specific purposes as defined in the City Charter or through a formal budgetary action of the City Council occurring through adoption of an ordinance or resolution. These commitments may be changed or lifted, but only by the same formal action that was used to impose the constraint originally. City Council action to commit fund balance must occur within the fiscal reporting period while the amount committed may be subsequently determined.
- *Assigned Fund Balance* – includes amounts that are intended to be used for specific purposes through City Council budgetary actions. For all governmental funds other than the General Fund, any remaining positive amounts not classified as nonspendable, restricted or committed must be designated as assigned fund balance.
- *Unassigned Fund Balance* – includes amounts within the General Fund, the residual resources, either positive or negative, in excess of what can be properly classified in one of the other four fund balance categories. Unassigned amounts are technically available for any purpose. Other governmental funds may only report a negative unassigned balance that was created after classification in one of the other four fund balance categories.

In circumstances when an expenditure is made for a purpose for which amounts are available in multiple fund balance categories, fund balance is depleted in the order of restricted, committed, assigned, and unassigned.

With the adoption of GASB 54, the City reviewed its governmental fund classifications and determined that the following special revenue funds: Public Works Program Support Fund, Employee Benefits Fund, and Stores, Vehicle Maintenance, and Operation Fund did not meet the new special revenue fund criteria of GASB 54 and as such reclassified these funds as internal service funds. As a result, the beginning fund balances/net assets were restated as follows:

	<b>Nonmajor Governmental Funds</b>	<b>Internal Service Funds</b>
Fund balances/Net assets, as previously reported	\$ 483,699,000	\$ -
Reclassify funds:		
Public Works Program Support	(4,116,000)	4,116,000
Employee Benefits	(5,096,000)	5,096,000
Stores, Vehicle Maintenance, and Operation Funds	(5,385,000)	5,385,000
Convert to accrual basis of accounting:		
Record capital assets	-	9,674,000
Record compensated absences	-	(6,014,000)
Fund balances/Net assets, as restated	\$ 469,102,000	\$ 18,257,000

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**16. Property Taxes**

Property taxes are collected on behalf of and remitted to the City by the County of Santa Clara (the "County"). The amount of property tax levies is restricted by Article 13A of the California State Constitution (commonly referred to as Proposition 13).

The County assesses property values, levies, bills, and collects the related property taxes as follows:

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

The City has elected to participate in the "Teeter Plan" offered by the County whereby cities receive 100% of secured property and supplemental property taxes levied in exchange for foregoing any interest and penalties collected on the related delinquent taxes. Accordingly, property taxes levied for the fiscal year are recorded as revenue when received from the County.

General property taxes are based either on a flat 1% rate applied to the fiscal 1976 full value of the property or on 1% of the sales price of the property on sales transactions and construction that occur after the fiscal 1976 valuation. Assessed values on properties (exclusive of increases related to sales and construction) can rise at a maximum of 2% per year depending on increases in the consumer price index.

The City's net assessed valuation for the fiscal year ended June 30, 2011, was approximately \$119.2 billion, a decrease of approximately 3% from the previous year. The City's tax rate was approximately \$0.189 per \$100 of assessed valuation, which included the 1% basic levy and additional levies for general obligation bonds Measures "O" and "P" (2000) and Measure "O" (2002).

**17. Wastewater Treatment System**

The Wastewater Treatment System is an enterprise of the City and is comprised of the Plant, including South Bay Water Recycling, and the San José Sewage Collection System.

The Plant provides wastewater treatment services to the City and to six other sewage collection agencies. The Clean Water Financing Authority was established to provide financing for the capital programs of the Plant including the regional water reclamation program. The City's sewer service rates pay for the City's share of the Plant operations, maintenance, and administration and capital costs.

In 1959, the City and the City of Santa Clara entered into an agreement to jointly own and operate the Plant. Under the agreement, the City serves as the administering agency and is responsible for operating and maintaining the Plant. The cities share in the capital and operating costs on a pro rata basis determined by the ratio of each city's assessed valuation to the sum of both cities' assessed valuations. Annually, these percentages are determined and applied to the capital and operating costs on an accrual basis. For the fiscal year ended June 30, 2011, the City's portion of the capital and operating costs was approximately 81.0% and, based on operations through the fiscal year ended June 30, 2011, the City's interest in the net assets of the Plant was approximately 81.1%.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**II. Stewardship, Compliance, and Accountability**

**A. Deficit Fund Balance**

A deficit fund balance of \$222,000 was reported in the non-major capital projects Fiber Optics Development Fund. It will be eliminated with future transfers from the General Fund.

**B. Deficit Unrestricted Net Assets – Governmental Activities**

At June 30, 2011, the City reports a deficit unrestricted net assets in its Statement of Net Assets – governmental activities in the amount of \$129,419,000. This deficit is primarily due to the City's accrual of certain long-term liabilities, such as compensated absences and estimated claims, that are recognized as expenses under the accrual basis of accounting as the liabilities are incurred; however, these expenses are not budgeted (funded) until the liabilities are anticipated to come due; and the City's recognition of other postemployment benefit (OPEB) obligations for OPEB costs in which the actuarial annual required contributions are greater than the amount funded into the OPEB plans to date. Pursuant to the City's latest agreements with most of its bargaining units, the funding to fully fund the OPEB's annual required contributions will be phased in over a five year period (see Note IV.A.).

**III. Detailed Notes on All Funds**

**A. Cash, Deposits and Investments**

As of June 30, 2011, total City cash, deposits and investments, at fair value, are as follows (dollars in thousands):

	Governmental Activities	Business-type Activities	Fiduciary Funds			Carrying Value
			Pension Trust	Private-Purpose Trust	Agency	
Equity in pooled cash and investments	\$ 578,999	\$ 344,301	\$ -	\$ 99	\$ 3,226	\$ 926,625
Restricted investments:						
Equity in pooled cash and investments	61,354	110,832	-	-	-	172,186
Cash and investments with fiscal agents	429,881	236,538	-	-	-	666,419
Other cash and investments	12,650	-	-	-	-	12,650
Investments of retirement plans	-	-	5,067,420	-	-	5,067,420
Total deposits and investments	<u>\$ 1,082,884</u>	<u>\$ 691,671</u>	<u>\$ 5,067,420</u>	<u>\$ 99</u>	<u>\$ 3,226</u>	<u>\$ 6,845,300</u>
Deposits						\$ 27,005
Investments						<u>6,818,295</u>
Total deposits and investments						<u>\$ 6,845,300</u>

**Pooled Cash and Investments Held in City Treasury.** The City maintains a cash and investment pool that is available for use by all funds and certain component units. Each fund's portion of this pool is displayed on the accompanying governmental fund balance sheets and proprietary fund statement of net assets as "Equity in pooled cash and investments held in City Treasury."

**Other Cash and Investments.** The City has other investments outside the City Treasury that are invested pursuant to various governing bond covenants, San José Municipal Code or California Government Code provisions.

Other investments consist primarily of deposits and investments with trustees related to the issuance of bonds and to certain loan programs operated by the City. These investments are made either in accordance with bond covenants, and are pledged for payment of principal, interest, and specified capital improvements or in accordance with trust and grant agreements.

**Investments of Retirement Systems.** The Retirement Systems' funds are invested pursuant to policy guidelines established by the respective Boards. The objective of each investment policy is to maximize the expected return of the funds at an agreed upon level of risk. The Retirement

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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Boards have established percentage guidelines for types of investments to ensure the portfolio is diversified.

**Investment Risk.** The investments are subject to certain types of risk, including interest rate risk, credit quality risk, concentration of credit risk, custodial credit risk and foreign currency risk. These risks are addressed separately for the investments related to governmental and business-type activities and those related to the Retirement Systems, as follows:

**1. Governmental and Business-Type Activities**

**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 time of maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. Additionally, the fair values of the investments may be highly sensitive to interest rate fluctuations. One of the ways that the City manages its exposure to interest rate risk is by purchasing a combination of shorter-term and longer-term investments and by timing the cash flows from the maturities so that a portion is maturing or coming close to maturing evenly over time, as necessary to provide the cash flow and liquidity needs for operations.

The City has the ability to hold investments until their respective maturity dates; however, the Investment Policy does not prohibit the sale of securities prior to maturity. The average maturity of the City's pooled cash and investments as of June 30, 2011, was approximately 376 days. However, any portfolio restructuring requires prior conceptual approval in writing from the Director of Finance. Section 17.2 of the Investment Policy further defines the parameters with respect to restructuring the portfolio.

**Credit Quality 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 a nationally recognized statistical rating organization. The City's Investment Policy has mitigated credit risk by limiting investments to the safest type of securities, by prequalifying financial institutions, by diversifying the portfolio and by establishing monitoring procedures.

**Investment in Local Agency Investment Fund.** The City is a voluntary participant in the California Local Agency Investment Fund ("LAIF") that is governed by the California Government Code under the oversight of the Local Investment Advisory Board ("Board"). The Board consists of five members as designated by state statute. The fair value of the City's investment in the LAIF pool is reported in the accompanying financial statements at amounts based upon the City's pro-rata share of the fair value provided by LAIF, for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis, which is different from the fair value of the City's position in the LAIF pool.

As of June 30, 2011, the City's pooled and fiscal agent investments in LAIF was approximately \$370,808,000. The weighted average maturity of LAIF was 237 days. The total amount recorded by all public agencies in the LAIF pool at that date was approximately \$24.0 billion. Of that amount, 94.99% was invested in non-derivative financial products and 5.01% in structured notes and asset backed securities.

**Concentration of Credit Risk.** Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The City's investment policy sets forth the policies regarding concentration of credit risk.

The City Council adopted an investment policy (the "Policy") on April 2, 1985, as last amended on September 28, 2010, related to the City's cash and investment pool, which is subject to annual review. The Policy specifically prohibits trading securities for the sole purpose of speculating or

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

taking an un-hedged position on the future direction of interest rates. Per the Policy, the investments conform to Sections 53600 et seq. of the California Government Code and the applicable limitations contained within the Policy.

The following table identifies the investment types that are authorized by the Policy as of June 30, 2011:

<b>Authorized Investment Type</b>	<b>Maximum Maturity</b>	<b>Maximum Percentage or Dollar of Portfolio</b>	<b>Maximum Investment in One Issuer</b>
U.S. Treasury Obligations	5 years	None	None
U.S. Government Agency Issues	5 years	None	None
Bankers' Acceptances	180 days	20% *	5% *
Insured Time Deposits	3 years *	\$10 million *	5% *
Uninsured Time Deposits	18 months *	\$10 million *	5% *
Commercial Paper	270 days	20% *	5% *
Negotiable Certificates of Deposit	180 days *	20% *	5% *
Repurchase Agreements	92 days *	50% *	10% *
Reverse Repurchase Agreements	30 days *	Lesser of \$25 million or 20% *	None
Corporate Notes	3 years *	20% *	5% *
Local Agency California Investment Fund	None	State Treasurer Limit	None
Money Market Mutual Funds	None	20%	10%
Municipal Bonds - Category 1 (City)	5 years	10% *	5% *
Municipal Bonds - Category 2 (State of CA)	5 years	5% *	5% *
Municipal Bonds - Category 3 (CA Issuers)	5 years	5% *	5% *
Municipal Bonds - Category 4 (Other 49 States)	5 years	5% *	5% *
Investment Agreements	None	None	None
Mortgage Backed Securities (MBS) and Collateralized Mortgage Obligations (CMO)	5 years	10%*	None
Asset Based Securities (ABS)	5 years	5% *	None

\* Represents where the City's investment policy is more restrictive than the California Government Code.

Other restrictions on investments are summarized as follows:

- Purchases of United States government agency securities are limited to issues of Federal Farm Credit Banks, the Federal Home Loan Banks, Federal Home Loan Mortgage Corporation, and the Federal National Mortgage Association.
- Purchases of Bankers' Acceptances ("BAs") are limited to issues by domestic U.S. or foreign banks, which must be rated by Fitch Ratings ("Fitch") as follows: an issuer rating of "B" or better for domestic U.S. banks, "C" or better for California banks or "A/B" or better for foreign banks. Additionally, foreign BAs must be in U.S. dollar denominations. BAs eligible for investment must be rated "P1, A1, F1" or better from two of the three nationally recognized rating services; Moody's Investors Service ("Moody's"), Standard & Poor's ("S&P"), or Fitch, respectively.
- Deposits up to the Federal Deposit Insurance Corporation ("FDIC") limit may be invested in, but are not limited to, banks and savings and loans with offices located in the San José area and deposits shall not exceed the net worth of that depository. Uninsured time deposits are limited to issuances from banks and savings and loans with offices located in the San José area and deposits shall not exceed the net worth of that depository. Additionally, concerning uninsured time

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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deposits, depositories must have an issuer rating of “B” or better by Fitch and be collateralized in a manner prescribed by state law for depositories.

- Commercial paper eligible for investment must be rated “P1, A1 or F1” or better by two of the three nationally recognized rating services; Moody’s, S&P or Fitch, respectively. Issuing corporations must be organized and operating within the United States, have total assets in excess of \$500,000,000 and shall issue debt, other than commercial paper, if any, that is rated “A3, A- or A-“ or higher, respectively, by Moody’s, S&P or Fitch.
- Negotiable certificates of deposit are limited to banks and savings and loans with an issuer rating of “A/B” or better by Fitch and may not exceed the net worth of the issuing institution.
- Repurchase agreements are to be executed only with primary dealers of the Federal Reserve Bank of New York and financial institutions, which have entered into the City’s Master Repurchase Agreement and any subsequent amendments to the Master Repurchase Agreement. Securities accepted as collateral for the repurchase agreement are limited to U.S. Treasury or U.S. Federal Government Agencies permitted under the Policy. The market value of the securities that have been accepted as collateral shall, at the time of transfer, equal at least 102 percent of face value of the repurchase agreement. For other than overnight investments, the securities transferred shall be marked to market on a daily basis and maintained at a market value to at least 102 percent of the repurchase agreement’s face value.
- Reverse repurchase agreements under the Policy are limited to the lesser of \$25,000,000 or 20% of the portfolio value and to those occasions where unanticipated short-term cash requirements can be met more advantageously by initiating a reverse repurchase agreement than by selling a security into the secondary market prior to maturity.
- Corporate notes eligible for investment must be rated “A3, A- or A-” or better by two of the three nationally recognized rating services; Moody’s, S&P or Fitch, respectively.
- Funds invested in LAIF, a State of California managed investment pool, may be made up to the maximum dollar amount of \$50,000,000 per separate legal entity in conformity with account balance limits authorized by the California State Treasurer. The current maximum amount authorized by the State Treasurer is \$50,000,000.
- Investments in money market mutual funds are limited to those funds registered with the Securities and Exchange Commission (“SEC”) and for which either one of the credit criteria are met: (1) obtained the highest ranking or highest letter and numerical rating provided by no less than two nationally recognized rating services or (2) retained an investment advisor registered with the SEC or exempt from the SEC registration requirements with no less than five years experience investing in securities and obligations authorized by California Government Code Section 53601 and managing money market mutual funds with assets under management in excess of \$500,000,000. Investments by the funds are restricted to U.S. Treasury and U.S. Government Agency backed securities permitted under the Policy and must be maintained at no less than \$1.00 per share.
- Municipal bonds under the Policy are limited to a total of no more than 20% of the portfolio value. The Policy establishes four municipal bond categories: (1) bonds issued by the City or its agencies (as defined in the Policy), (2) by the State of California, (3) by other California local agencies, and (4) by any of the other 49

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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states, respectively. Eligible securities must be rated "A3, A- or A-" or better by two of the three nationally recognized rating services; Moody's, S&P, or Fitch.

- Investment agreements may be used for the investment of bond proceeds in accordance with the permitted investment provisions of the specific bond indentures and in accordance with other safeguards outlined in the Policy to reduce the risk associated with a provider's inability to meet its contractual obligations.
- Mortgage backed securities and collateralized mortgage obligations must be issued by a United States government agency and must be AAA-rated or better by a nationally recognized rating service.
- Asset backed securities must be AAA-rated or better by a nationally recognized rating service. The issuer of any asset backed security must have an "A3, A- or A-" rating or better by Moody's, S&P or Fitch, respectively, of its underlying debt.

The Policy permits the Director of Finance to authorize investments that depart from the Policy's numerical limits if such an action is in the best interest of the City and is otherwise consistent with the Policy and applicable City, state and federal laws. Whenever a deviation or exception to the Policy occurs, it must be reported to the City Manager within 3 business days and to the City Council within 10 days of its discovery.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

The following schedule indicates the interest rate risk, credit quality risk and concentration of credit risk of the City's investments, as of June 30, 2011. The credit ratings listed are for Moody's and S&P, respectively. Certain investments, such as obligations, which are backed by the full faith and credit of the United States Government, are exempt from credit rating disclosures (dollars in thousands):

Type of Investment	Credit Rating	Maturity				Carrying Value
		Under 30 Days	31 - 180 Days	181 - 365 Days	1 - 5 Years	
Pooled investments in the City Treasury:						
Federal Farm Credit Banks	Aaa / AAA	\$ -	\$ 20,222	\$ -	\$ 70,184	\$ 90,406
Federal Farm Credit Banks - Callable	Aaa / AAA	-	-	-	5,019	5,019
Federal Home Loan Banks	Aaa / AAA	-	10,009	4,998	112,127	127,134
Federal Home Loan Banks - Callable	Aaa / AAA	-	-	-	9,988	9,988
Federal Home Loan Banks - Discount	P-1 / A-1+	13,000	-	853	-	13,853
Federal Home Loan Mortgage Corporation	Aaa / AAA	-	-	10,138	70,313	80,451
Federal Home Loan Mortgage Corporation - Callable	Aaa / AAA	-	-	-	20,023	20,023
Federal Home Loan Mortgage Corporation - Discount	P-1 / A-1+	15,232	111,221	23,755	-	150,208
Federal National Mortgage Association	Aaa / AAA	-	-	-	85,300	85,300
Federal National Mortgage Association - Callable	Aaa / AAA	-	-	-	22,571	22,571
Federal National Mortgage Association - Discount	P-1 / A-1+	144,270	40,000	24,623	-	208,893
Commercial paper - Discounted	P-1 / A-1+	75,649	56,385	-	-	132,034
Medium-term notes	Aaa / AAA	-	25,305	-	-	25,305
Negotiable certificates of deposit	P-1 / A-1	-	40,016	-	-	40,016
Money market mutual funds	AAAm	-	-	2,190	-	2,190
California local agency investment fund	Not Rated	-	-	71,124	-	71,124
Total pooled investments in the City Treasury		<u>248,151</u>	<u>303,158</u>	<u>137,681</u>	<u>395,525</u>	<u>1,084,515</u>
Investments with fiscal agents:						
U.S. Treasury bills	Exempt	63,346	-	4,890	-	68,236
Federal Home Loan Banks	Aaa / AAA	10,030	12,567	52,349	817	75,763
Federal Home Loan Banks - Discount	P-1 / A-1+	-	914	-	-	914
Federal National Mortgage Association - Discount	P-1 / A-1+	-	-	1,951	-	1,951
Commercial paper	P-1 / A-1+	35,331	1,366	-	-	36,697
Medium-term notes	Aaa / AAA	-	-	-	826	826
Money market mutual funds	AAAm	182,075	214	-	-	182,289
California local agency investment fund	Not Rated	-	-	287,034	-	287,034
Total investments with fiscal agents		<u>290,782</u>	<u>15,061</u>	<u>346,224</u>	<u>1,643</u>	<u>653,710</u>
Other investments:						
California local agency investment fund	Not Rated	-	-	12,650	-	12,650
Total other investments		<u>-</u>	<u>-</u>	<u>12,650</u>	<u>-</u>	<u>12,650</u>
Total Citywide investments (excluding Retirement Systems)		<u>\$ 538,933</u>	<u>\$ 318,219</u>	<u>\$ 496,555</u>	<u>\$ 397,168</u>	<u>1,750,875</u>
Retirement Systems:						
Total investments in Retirement Systems						<u>5,067,420</u>
Total investments						<u>\$ 6,818,295</u>

**Custodial Credit Risk.** Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the City 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 City will not be able to recover the value of its 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 City's deposits, respectively. The collateral is held by the pledging financial institution's trust department and is considered held in the City's name. The investments held by the City were not subject to custodial credit risk at June 30, 2011.



**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**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 City. The City 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 the investment types discussed in the above table. 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.

As of June 30, 2011, the City's pooled investments in the City Treasury have investments in U.S. Agencies that represents 5% or more of the total pooled investments in the following:

Federal Farm Credit Banks	8.8%
Federal Home Loan Banks	13.9%
Federal Home Loan Mortgage Corporation	23.1%
Federal National Mortgage Association	29.2%

In addition, as of June 30, 2011, the Agency has \$35,331,000 invested in commercial paper. This represents tax increment money sent to the Agency's fiscal agent for future debt service payment on the Agency's outstanding Tax Allocation Bonds. Under the bond indenture, investments in commercial paper are limited to the top two ratings issued by nationally recognized statistical rating organizations (NRSROs). It is the Agency's policy to limit its investments in this investment type to the top rating issued by NRSROs. As of June 30, 2011, the Agency's investment in commercial paper includes investments in General Electric Capital Corporation (11.5%) and Union Bank (11.5%), which exceeded the 5% concentration risk threshold (total Agency investments with fiscal agent), but is a permitted investment under the bond indenture.

As of June 30, 2011, the San José Financing Authority, Airport and Wastewater Funds investments with its fiscal agents totaled \$61,489,000, \$229,989,000, and \$6,549,000, respectively, which includes \$47,447,000, \$22,597,000, and \$5,719,000, respectively, invested in bonds with Federal Home Loan Banks.

**Foreign Currency Risk.** The risk that changes in exchange rates will adversely affect the fair value of an investment. As of June 30, 2011, the investments in the City's investment pool were not subject to foreign currency risk.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**2. Retirement Systems**

**Investment Policies** – The City’s Municipal Code delegates authority to the Retirement Systems’ Boards of Administration to reinvestment moneys of the Retirement Systems as provided in the Municipal Code. The Retirement Boards have adopted detailed investment guidelines consistent with the limitations set forth in the Municipal Code. In fiscal year 2010, the Boards approved new asset allocations to target higher expected returns at similar risk levels by changing the asset allocation to a more diversified structure that includes commodities, absolute return, and opportunistic investments. The Retirement Systems’ investment asset allocations are as follows:

	<u>Type of Investment</u>	<u>Policy Limits and Descriptions</u>
PFDRP	Equity - Target of 40%	Minimum of 30% and maximum of 50% of the fair value of the aggregate portfolio. U.S. Large Cap - Target 18% U.S. Small Cap - Target 5% Non U.S. Developed Markets - Target 12% Non U.S. Emerging Markets - Target 5%
	Fixed Income - Target of 25%	Minimum of 15% and maximum of 35% of the fair value of the aggregate portfolio. Core Fixed Income - Target 5% U.S. Treasury Inflation Protected Securities (TIPS) - Target 10% Long Duration Fixed Income - Target 5% Opportunistic Credit - Target 5%
	Alternative Assets - Target of 35%	Minimum of 10% and maximum of 60% of the fair value of the aggregate portfolio. Funds allotted to the alternatives asset class are temporarily invested in other asset classes. Private Equity - Target 5% Real Estate - Target 10% Inflation-Linked Assets - Target 10% Absolute Return - Target 5% Opportunistic - Target 5%
FCERS	Global Equity - Target 49%	Minimum of 43% and maximum of 55% of the fair value of the aggregate portfolio.
	Fixed Income - Target 20%	Minimum of 15% and maximum of 25% of the fair value of the aggregate portfolio.
	Alternatives - Target of 31%	Minimum of 26% and maximum of 36% of the fair value of the aggregate portfolio. Funds allotted to the alternatives asset class are temporarily invested in other asset classes. Real Estate - Target 5% Real Assets - Target 10% Hedge Funds - Target 5% Private Equity - Target 6% Opportunistic - Target 5%

As of June 30, 2011, PFDRP’s separate real estate properties include: apartment complexes in Houston, TX and Colorado Springs, CO; office buildings in Denver, CO, O’Fallon, MO, San José, CA, in Chicago, IL, and in Anchorage, AK; and warehouses in Minneapolis, MN. As of June 30, 2011, the office buildings in O’Fallon, MO and Anchorage, AK had mortgage loans payable of approximately \$20,200,000, which do not exceed 50% of the assets as allowed in PFDRP’s Real Estate Investment Guidelines. As of June 30, 2011, FCERS held a warehouse located in Northern California with no outstanding mortgage loans.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

At June 30, 2011, the Retirement Systems held the following investments (dollars in thousands):

	<u>PFDRP</u>	<u>FCERS</u>	<u>Total</u>
Securities and other:			
Fixed income:			
Domestic fixed income	\$ 666,669	\$ 407,359	\$ 1,074,028
Collective short-term investments	40,479	35,738	76,217
International fixed income	15,417	2,256	17,673
Corporate convertible bonds	72,133	52,675	124,808
Pooled fixed income bond funds	11,359	21,430	32,789
Total fixed income	<u>806,057</u>	<u>519,458</u>	<u>1,325,515</u>
Global equity	1,030,206	478,497	1,508,703
Pooled international equity	170,697	496,552	667,249
Private equity	220,064	92,643	312,707
International currency contracts, net	413	90	503
Opportunistic	26,949	32,785	59,734
Real assets	306,243	166,955	473,198
Real estate	127,029	90,673	217,702
Securities lending cash collateral investment pool	340,167	161,942	502,109
Total investments	<u>\$ 3,027,825</u>	<u>\$ 2,039,595</u>	<u>\$ 5,067,420</u>

Investments are subject to certain types of risks, including interest rate risk, custodial credit risk, credit quality risk, foreign currency risk, and concentration of credit risk. The following describes those risks:

**Interest Rate Risk** – The fair value of fixed income investments fluctuate in response to changes in market interest rates. Increases in prevailing interest rates generally translate into decreases in fair value of those instruments. The fair value of interest sensitive instruments may also be affected by the creditworthiness of the issuer, prepayment options, and other general interest rate conditions. Certain fixed income investments have call provisions that could result in shorter maturity periods. The Retirement Systems do not have a policy regarding interest rate risk.

As of June 30, 2011, PFDRP's investments include \$22,695,000 of bank loan securities that were floating rate securities tied to the 1 and 3 month London Interbank Offered Rate (LIBOR).

As of June 30, 2011, FCERS's investments include \$23,145,000 of bank loan securities that were floating rate securities tied to the 1 and 3 month LIBOR. FCERS also has exposure on its fully collateralized infrastructure swaps with a notional amount of \$37,408,000 in which it receives the total S&P Global Infrastructure Index rate, net of the 3-month U.S. LIBOR plus 55 basis points.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

The following tables provide the segmented time distribution for fixed income investments based on expected maturity as of June 30, 2011, concerning the fair value of investments and interest rate risk (dollars in thousands):

	PFDRP						Total Fair Value	Total Cost
	0 - 3 months	3 - 6 months	6 months - 1 year	1 - 5 years	5 - 10 years	More than 10 years		
Domestic fixed income:								
Asset backed securities	\$ -	\$ -	\$ 2,025	\$ 4,017	\$ -	\$ 1,367	\$ 7,409	\$ 7,368
Bank loans	-	-	-	21,743	-	-	21,743	19,428
Collateralized mortgage obligations	-	-	-	-	-	20,148	20,148	19,455
Corporate bonds	-	1,015	507	36,039	31,403	105,672	174,636	160,935
FHLMC	-	-	-	-	-	15,210	15,210	14,720
FNMA	-	-	-	-	2,847	47,994	50,841	49,967
GNMA	-	-	-	-	-	6,074	6,074	5,948
State and local obligations	-	-	-	-	-	7,519	7,519	7,321
U.S. TIPS	-	-	-	130,966	136,773	48,441	316,180	298,737
U.S. Treasury securities	-	12,151	-	5,486	8,993	20,279	46,909	47,162
Total domestic fixed income	-	13,166	2,532	198,251	180,016	272,704	666,669	631,041
International fixed income	-	701	-	3,346	5,878	5,492	15,417	16,824
Collective short-term investments	4,106	-	-	-	-	36,373	40,479	40,437
Corporate convertible bonds	-	-	3,646	52,654	6,209	9,624	72,133	67,125
Pooled fixed income bond funds	-	-	-	-	-	11,359	11,359	10,853
Total fixed income	<u>\$ 4,106</u>	<u>\$ 13,867</u>	<u>\$ 6,178</u>	<u>\$ 254,251</u>	<u>\$ 192,103</u>	<u>\$ 335,552</u>	<u>\$ 806,057</u>	<u>\$ 766,280</u>

	FCERS						Total Fair Value	Total Cost
	0 - 3 months	3 - 6 months	6 months - 1 year	1 - 5 years	5 - 10 years	More than 10 years		
Domestic fixed income:								
Asset backed securities	\$ -	\$ -	\$ -	\$ 960	\$ -	\$ 408	\$ 1,368	\$ 1,059
Bank loans	-	-	1,635	21,595	1,103	-	24,333	21,684
Corporate bonds	-	1,122	-	19,751	15,412	3,534	39,819	34,249
FHLMC	-	-	2,179	6,104	-	-	8,283	8,155
FNMA	-	-	-	7,290	-	-	7,290	7,125
Other U.S. Government agency	-	3,341	1,519	-	-	-	4,860	5,057
U.S. TIPS	-	-	-	83,297	85,061	28,656	197,014	179,921
U.S. Treasury securities	-	-	19,085	55,933	49,374	-	124,392	120,365
Total domestic fixed income	-	4,463	24,418	194,930	150,950	32,598	407,359	377,615
International fixed income	-	-	-	565	1,133	558	2,256	1,865
Collective short-term investments	35,738	-	-	-	-	-	35,738	35,774
Corporate convertible bonds	-	-	3,244	38,331	4,330	6,770	52,675	47,883
Pooled fixed income bond funds	-	-	-	-	-	21,430	21,430	19,500
Total fixed income	<u>\$ 35,738</u>	<u>\$ 4,463</u>	<u>\$ 27,662</u>	<u>\$ 233,826</u>	<u>\$ 156,413</u>	<u>\$ 61,356</u>	<u>\$ 519,458</u>	<u>\$ 482,637</u>

**Custodial Credit Risk** – The Retirement Systems do not have a policy regarding custodial credit risk. As of June 30, 2011 all of the Retirement Systems’ investments, excluding invested securities lending collateral, are held in the Retirement Systems’ names, and/or are not exposed to custodial credit risk. Securities lending collateral are invested in the lending agent’s investment fund (see discussion on securities lending below).

**Credit Quality Risk** – PFDRP’s Investment Policy dictates that all domestic and international bonds and notes in which PFDRP’s assets are invested, and which mature one year or more from the date of original issues, are required to carry a rating of “BBB” or better by two of the following three rating services: Moody’s, S&P, or Fitch. In the event that ratings are provided by only two agencies and the third is non-rated, the more conservative (lowest) rating will be assigned. If only one agency assigns a rating, that rating will be used; or, if unrated, the security shall be of equivalent quality in the judgment of the investment manager to a similar domestic issue. Investment managers may, with prior written authorization from PFDRP, invest a maximum of 20% of their fixed income portfolio in bonds or notes that are rated B or BB. If bonds are downgraded below the minimum credit quality allowable in the PFDRP’s investment policy at the time of purchase, the investment manager is permitted to hold up to 2% of the PFDRP’s portfolio managed by the individual manager, using the lowest of Moody’s, S&P, and Fitch’s rating in the event of a split-rated security.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

FCERS's Investment Policy dictates that assets shall generally be invested in investment grade, marketable, fixed-income securities. Domestic fixed income investment grade shall be defined as being rated Baa/BBB or better by Moody's or S&P. "Yankee" bonds issued by foreign countries and denominated in U.S. dollars are allowed so long as they are rated Baa/BBB or better by Moody's or S&P. If a security is not rated by Moody's or S&P, the equivalent rating determined by the investment manager's research department will be used. Should a current holding fall below this standard, the manager shall notify FCERS of the downgrade and confer with FCERS staff as to whether the security will continue to be held or disposed. Up to 10% investment in BB or B securities will be permitted with written authorization of the FCERS's Board. The investment managers employed to manage fixed-income securities will have discretion in the day-to-day management of the funds under their control.

The Retirement Systems may hedge against the possible adverse effects of currency fluctuations on the Retirement Systems' portfolios of international fixed income obligations when it is considered appropriate. This is typically achieved using forward currency contracts. Short-term investments may consist of commercial paper rated at least A1 or P1, repurchase agreements, short-term U.S. securities, and other money market investments.

The following table provides information as of June 30, 2011 concerning credit risk (dollars in thousands):

S&P quality Rating	PFDRP		FCERS	
	Fair Value	Fair value as a % of fixed income investments	Fair Value	Fair value as a % of fixed income investments
AAA	\$ 81,831	18.8%	\$ 5,927	3.0%
AA	33,518	7.7%	874	0.4%
A	84,196	19.4%	9,827	5.0%
BBB	69,651	16.0%	21,190	10.7%
BB	28,497	6.6%	32,876	16.6%
B	18,629	4.3%	22,768	11.5%
CCC & below	1,601	0.4%	2,811	1.4%
Not rated	116,958	26.9%	101,779	51.4%
Total investments exposed to credit risk	434,881	<u>100.0%</u>	198,052	<u>100.0%</u>
Exempt *	371,176		321,406	
Total fixed income investments	<u>\$ 806,057</u>		<u>\$ 519,458</u>	

\* Investments issued or explicitly guaranteed by the U.S. government are not considered to have credit risk and are considered exempt.

**Foreign Currency Risk** – This is the risk that changes in the exchange rates will adversely affect the fair value of an investment. To mitigate this risk, the Retirement Systems' investment policies permit individual investment managers to defensively hedge currency to mitigate the impact of currency fluctuation on the underlying asset value.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

The following tables provide information as of June 30, 2011, concerning the fair value of investments and foreign currency risk (dollars in thousands):

<b>PFDRP</b>						
Currency Name	Cash	Private Equity	Equity	Fixed Income	Pending Foreign Currency Exchanges	Total Exposure
Australian Dollar	\$ -	\$ -	\$ 376	\$ -	\$ -	\$ 376
Brazilian Real	13	-	5,151	81	-	5,245
Canadian Dollar	33	-	15,055	-	(16)	15,072
Chilean Peso	-	-	536	-	-	536
Danish Krone	8	-	2,360	-	-	2,368
Egyptian Pound	-	-	549	-	-	549
Euro Currency	1,843	-	92,655	4,404	1	98,903
Hong Kong Dollar	41	-	9,777	586	3	10,407
Indian Rupee	-	-	2,526	-	(3)	2,523
Indonesian Rupiah	-	-	3,664	-	-	3,664
Israeli Shekel	9	-	1,024	-	-	1,033
Japanese Yen	1,172	-	77,155	4,048	21	82,396
Mexican Peso	-	-	785	-	-	785
New Taiwan Dollar	566	-	1,374	-	3	1,943
New Zealand Dollar	-	-	1,051	-	-	1,051
Norwegian Krone	-	-	401	-	(9)	392
Philippine Peso	-	-	412	-	-	412
Pound Sterling	1,127	-	58,830	3,827	404	64,188
Singapore Dollar	-	-	3,707	-	-	3,707
South African Rand	-	-	3,016	-	-	3,016
South Korean Won	12	-	4,206	-	(3)	4,215
Swedish Krona	-	-	6,691	-	9	6,700
Swiss Franc	-	-	12,796	-	3	12,799
Thailand Baht	-	-	795	-	-	795
Turkish Lira	-	-	744	-	-	744
Total	<u>\$ 4,824</u>	<u>\$ -</u>	<u>\$ 305,636</u>	<u>\$ 12,946</u>	<u>\$ 413</u>	<u>\$ 323,819</u>

<b>FCERS</b>						
Currency Name	Cash	Private Equity	Equity	Fixed Income	Pending Foreign Currency Exchanges	Total Exposure
Australian Dollar	\$ 25	\$ -	\$ 12,131	\$ -	\$ -	\$ 12,156
British Pound Sterling	364	-	41,929	2,739	100	45,132
Canadian Dollar	7	-	4,308	-	21	4,336
Danish Krone	-	-	3,979	-	-	3,979
Euro Currency	63	8,774	47,886	3,206	(5)	59,924
Hong Kong Dollar	5	-	4,234	440	3	4,682
Indian Rupee	-	-	-	-	(3)	(3)
Indonesian Rupiah	-	-	-	107	-	107
Japanese Yen	331	-	41,991	3,004	(40)	45,286
New Taiwan Dollar	-	-	-	-	4	4
Norwegian Krone	1	-	3,904	-	-	3,905
Singapore Dollar	-	-	2,905	-	-	2,905
South Korean Won	-	-	-	-	(3)	(3)
Swedish Krona	21	-	5,746	-	13	5,780
Swiss Franc	-	-	19,242	-	-	19,242
Total	<u>\$ 817</u>	<u>\$ 8,774</u>	<u>\$ 188,255</u>	<u>\$ 9,496</u>	<u>\$ 90</u>	<u>\$ 207,432</u>

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**Concentration of Credit Risk** – PFDRP’s investment policy does not limit the amount that can be invested in a single issuer. However, it limits the aggregate amount that can be invested in each class of investments, limits the portion of the total PFDRP assets that a manager can hold in a single security with the exception of government backed securities and real estate equity to 5%, and limits the PFDRP assets placed with an investment manager to represent no more than 10% of that manager’s total assets. FCERS’s investment policy limits investment managers to no more than 10% of FCERS’s assets under their management to be invested in securities of any single issuer with the exception of U.S. Government and its agencies.

**Derivatives** – The Retirement Systems’ investment policies allow for investments in derivative instruments that comply with the Retirement Systems’ basic objective of achieving the highest return on investment funds, consistent with safety, and in accordance with accepted investment practices. Due to the level of volatility associated with certain derivative investments in general, the Retirement Systems specifically prohibit investment managers from using derivative or synthetic securities that expose the Retirement Systems to potentially high price volatility or are leveraged, or whose marketability may become severely limited. Derivative investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price on the last business day of the fiscal year at current exchange rates, if applicable. Investments that do not have an established market are reported at estimated fair value based the most recently available investor reports or audited financial statements issued by the manager of those funds. The fund manager provides an estimated unrealized gain/loss of the fund based on the most recently available audited financial statements and other fund information. The fair value of derivative investments that are not exchange traded, such as swaps, and rights is determined by the Retirement Systems’ custodians based on the base market value of similar instruments. Futures contracts are marked-to-market at the end of each trading day, and the settlement of gains or losses occur on the following business day through variation margins. As a result, futures have no fair value as of June 30, 2011. The fair value of international currency forwards represents the unrealized gain or loss on the related contracts, which is calculated as the difference between the specified contract exchange rate and the exchange rate at the end of the reporting period.

The fair values and notional amounts of derivative instruments outstanding as of June 30, 2011, classified by type, and the changes in fair value of such derivative instruments for the year then ended as reported in the financial statements are as follows (amounts in thousands):

PFDRP					
Investment Derivative Instruments	Net Appreciation (Depreciation) in Fair Value of Investments through June 30, 2011		Fair Value at June 30, 2011		Notional Amount
	Classification	Amount	Classification	Amount	
Commodity swaps	Investment income/ (loss)	\$ 77,183	Commodities	\$ -	\$ -
International currency forwards	Investment income/ (loss)	(2,579)	International currency contracts, net	413	82,520
Rights	Investment income/ (loss)	21	Global Equity	1	3
Warrants	Investment income/ (loss)	(1)	Global Equity	-	-
Total derivative instruments		<u>\$ 74,624</u>		<u>\$ 414</u>	

FCERS					
Investment Derivative Instruments	Net Appreciation (Depreciation) in Fair Value of Investments through June 30, 2011		Fair Value at June 30, 2011		Notional Amount
	Classification	Amount	Classification	Amount	
Commodity swaps	Investment income/ (loss)	\$ 9,483	Commodity swaps	\$ -	\$ -
Infrastructure swaps	Investment income/ (loss)	3,298	Infrastructure swaps	1,269	37,408
Foreign currency forwards	Investment income/ (loss)	(1,184)	Foreign currency contracts, net	90	-
Future options bought/written	Investment income/ (loss)	697	Fixed income - collective short-term investments	-	-
Rights	Investment income/ (loss)	912	Equity (domestic and foreign)	2	-
Total derivative instruments		<u>\$ 13,206</u>		<u>\$ 1,361</u>	

Derivative investments are subject to certain types of risks, including counterparty credit risk (non-exchange traded), interest rate risk, and foreign currency risk. The following describes the risks applicable to the investment derivative instruments that are reported as of June 30, 2011:

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**Counterparty Credit Risk** – The Retirement Systems are exposed to credit risk on derivative instruments that are in asset positions and non-exchange traded.

As of June 30, 2011, PFDRP held rights with a fair value of approximately \$1,000 and a notional value of \$3,000 held by an unrated counterparty. PFDRP's investments in forward currency contracts bear credit risk in that parties to the contracts may fail to perform according to the terms of the contract. As of June 30, 2011, total commitments in forward currency contracts to purchase and sell international currencies were \$82,520,000 and \$82,520,000 respectively, with fair values of \$82,566,000 and \$82,153,000, respectively, held by counterparties with an S&P rating of at least AA-.

FCERS entered into an infrastructure swap with a notional value of \$37,408,000 held by a counterparty with an A+ rating. FCERS's investments in forward currency contracts bear credit risk in that parties to the contracts may fail to perform according to the terms of the contract. As of June 30, 2011, total commitments in forward currency contracts to purchase and sell international currencies were \$26,265,000 and \$26,265,000 respectively, with fair values of \$26,244,000 and \$26,154,000, respectively, held by counterparties with an S&P rating of at least AA-.

**Interest Rate Risk** – The Retirement Systems had exposure to interest rate risk on their fully collateralized commodity and infrastructure swaps. The fair values of the commodity swaps were marked-to-market daily based on their applicable indices, with unrealized gains and losses collateralized to minimize counterparty risk. As of June 30, 2011, PFDRP did not hold commodity swaps. As of June 30, 2011, FCERS invested in an infrastructure swap with a notional amount of approximately \$37,408,000 in which it receives the total return S&P Global Infrastructure Index rate, net of the 3-month U.S. LIBOR plus 55 basis points. The infrastructure swap was executed in April 2011 and matures in April 2012 with a quarterly rate reset frequency. FCERS derivative instruments had maturity dates of less than one year. The Retirement Systems do not have a policy regarding interest rate risk, however, the Retirement Systems do settle on a transaction plus one day basis (T+1), therefore limiting Retirement Systems' exposure to counterparty risk.

**Foreign Currency Risk** – This is the risk that changes in the exchange rates will adversely affect the fair value of underlying investments. To mitigate this risk, the Retirement Systems' investment policies permit individual investment managers to mitigate the impact of currency fluctuation on the underlying asset value. The Retirement Systems' investment managers enter into international forward currency contracts, which are commitments to purchase or sell stated amounts of international currency. The Retirement Systems utilize these contracts to control exposure and facilitate the settlement of international security purchase and sale transactions. At June 30, 2011, the Retirement Systems' net position in these contracts is recorded at fair value as international currency contract investments. The fair values of international currency contracts are determined by quoted currency prices from national exchanges. The Retirement Systems' commitments relating to forward currency contracts are settled on a net basis.



**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

The following tables provide information as of June 30, 2011, concerning the fair value of forward currency contracts and foreign currency risk (dollar in thousands):

Currency Name	Pending Foreign Currency Exchanges			Rights
	PFDRP	FCERS	Total	FCERS
Australian Dollar	\$ -	\$ -	\$ -	\$ 2
British Pound Sterling	-	100	100	-
Canadian Dollar	(16)	21	5	-
Euro Currency	1	(5)	(4)	-
Hong Kong Dollar	3	3	6	-
Indian Rupee	(3)	(3)	(6)	-
Japanese Yen	21	(40)	(19)	-
New Taiwan Dollar	3	4	7	-
Norwegian Krone	(9)	-	(9)	-
Pound Sterling	404	-	404	-
South Korean Won	(3)	(3)	(6)	-
Swedish Krona	9	13	22	-
Swiss Franc	3	-	3	-
<b>Total</b>	<b>\$ 413</b>	<b>\$ 90</b>	<b>\$ 503</b>	<b>\$ 2</b>

**Securities Lending.** The municipal code and the investment policies, adopted by the Retirement Boards permit the use of a securities lending program with its principal custodian banks (“Custodians”). The Retirement Systems do not have a threshold for the amounts of securities on loan. The investment policy of FCERS requires that loan maturities cannot exceed one year, and no more than 15% of the portfolio can be lent longer than six months. The custodial agreements with the Custodians authorize such Custodian to loan securities in the Retirement Systems’ investment portfolio under such terms and conditions, as the Custodians deem advisable and to permit the loaned securities to be transferred into the name of the borrowers. The Retirement Systems receive a fee from the borrower for the use of the loaned securities. As of June 30, 2011, the Retirement Systems’ had no exposure to borrower credit risk related to the securities lending transactions as the Custodians are responsible for the replacement of the loaned securities with other securities of the same issuer, class and denomination, or if such securities are not available on the open market, the Custodian is required to credit the Retirement Systems’ account with the market value of such unreturned loaned securities if the loaned securities are not returned by the borrower. All securities loan agreements can be terminated on demand within a period specified in each agreement by either the Retirement Systems or borrowers.

Securities lending collateral represents investments in an investment pool purchased with cash collateral, as well as securities collateral that may not be pledged or sold without a default by the borrower. Securities lending transactions collateralized with securities that cannot be pledged or sold without borrower default are not reported as assets and liabilities in the fiduciary statement of net assets. The Retirement Systems do not match the maturities of investments made with cash collateral with the securities on loan.

PFDRP authorized State Street Corporation (“State Street”) to invest and reinvest cash and collateral in State Street’s Quality D Short-term Investment fund, which consists of a liquidity pool and a liquidating account known as the duration pool. The duration pool was established and allocated the asset-backed securities (regardless of maturity) and securities of any type with a remaining maturity of 91 days or greater. Each Quality D Fund owns a specified percentage interest in the duration pool, which is redeemable only in kind, not cash. The Quality D duration pool will not make additional investments. At the time of purchase, all securities with maturities of 13 months or less shall be rated at least A1, P1 or F1 by at least any two nationally recognized statistical rating organizations (“NRSROs”), or be determined by the Investment Manager to be of comparable

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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quality. Securities with maturities in excess of 13 months shall be rated at least A-, A3 or A- by at least any two of NRSROs, or be determined by the Investment Manager to be of comparable quality. The fund may invest up to 10% of its assets at time of purchase in commingled vehicles that conform with the State Street's Investment Policy Guidelines. As of June 30, 2011, the cash collateral pool for the duration and liquidity pool totaled \$6.3 billion and \$17.2 billion, respectively. The weighted average maturities for the duration and liquidity pool were 35.97 and 31.67 days, respectively. The cash collateral duration pool included asset backed securities (54.97%), certificates of deposit (13.56%), bank notes (23.16%), U.S. Agency (8.22%) and other securities (.09%). As of June 30, 2011, the underlying securities loaned by PFDRP as a whole amounted to approximately \$340,802,000. The cash collateral and the non-cash collateral totaled \$342,973,000 and \$3,527,000, respectively, at carrying cost. The net asset value (NAV) of the cash collateral pool at June 30, 2011 was at \$1.00 or \$222,580,000 and \$0.9767 or \$117,587,000 for the liquidity and duration pools, respectively on a mark to market basis. The NAV of less than \$1.00 for the duration pool is due to the decline in the fair value of assets held by the cash collateral pool. The NAV of \$0.9767 of the duration cash collateral pool results in an unrealized loss of approximately \$2,806,000 for PFDRP. PFDRP's investment in the liquidity and duration cash collateral investment pools are presented in the statement of net plan assets at their respective NAV or \$340,167,000. The unrealized loss of \$2,806,000 for the duration pool is reflected in the securities lending income earnings line of the statement of changes in fiduciary net assets. PFDRP is exposed to market risk including the possible loss of principal value in the cash collateral pool due to the fluctuation in the market value of the assets held by the cash collateral pool.

FCERS authorized The Northern Trust Company ("Northern Trust") to invest and reinvest cash collateral in Northern Trust's pooled investment vehicle, which must have a weighted average life of 60 days or less. Securities with maturities of 13 months or more must have a rating of A or better. Securities with maturities of less than 13 months must be rated at least P-3. As of June 30, 2011, the size of the cash collateral pooled vehicle was \$27.8 billion with a weighted average life of 21 days. The cash collateral investments included time deposits (12% of the pool), repurchase agreements (22%), asset backed securities (4%), certificates of deposit (20%), variable rate securities (9%) and commercial paper and other bank notes (33%). As of June 30, 2011, the underlying securities loaned by FCERS as a whole amounted to \$162,705,000. The cash collateral and the non-cash collateral totaled \$161,942,000 and \$4,345,000, respectively. As of June 30, 2011, the net asset value of the cash collateral pool was 100% based on a combination of mark-to-model and mark-to-market basis.

The Retirement Systems are exposed to investment risk including the possible loss of principal values in the cash collateral pools due to the fluctuation in the market value of the assets held by the cash collateral pools.

The loaned securities as of June 30, 2011 consisted of U.S. Treasury securities, U.S. government agency securities, domestic corporate bonds, international corporate bonds, domestic equity securities, and international equity securities. In return, the Retirement Systems receive collateral in the form of cash or securities equal to at least 102% for domestic and 105% for international of the market value of transferred securities plus accrued interest for reinvestment.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

The following table provides information concerning securities lent and collateral received as of June 30, 2011 (dollars in thousands):

<b>Type of Investment Lent</b>	<b>PFDRP</b>	<b>FCERS</b>	<b>Total Fair Value</b>
For Cash Collateral:			
U.S. treasury notes and bonds	\$ 35,864	\$ 53,217	\$ 89,081
U.S. government agency securities	-	4,097	4,097
Domestic corporate bonds	45,785	24,297	70,082
International corporate bonds	252	-	252
Domestic equity securities	239,823	66,279	306,102
International equity securities	15,590	10,570	26,160
Total Lent for Cash Collateral	337,314	158,460	495,774
For Non-Cash Collateral:			
U.S. treasury notes and bonds	-	3,321	3,321
Domestic corporate bonds	-	146	146
Domestic equity securities	3,488	90	3,578
International equity securities	-	688	688
Total Lent for Non-Cash Collateral	3,488	4,245	7,733
Total Securities Lent	\$ 340,802	162,705	\$ 503,507
<b>Type of Collateral Received</b>			
Cash Collateral *	\$ 340,167	\$ 161,942	\$ 502,109
Non-Cash Collateral:			
For lent U.S. treasury notes and bonds	-	3,391	3,391
For lent domestic corporate bonds	-	149	149
For lent domestic equity securities	3,527	92	3,619
For lent international equity securities	-	713	713
Total Non-Cash Collateral	3,527	4,345	7,872
Total Collateral Received	\$ 343,694	166,287	\$ 509,981

\* Amount represents the mark-to-market value of PFDRP's cash collateral pool at a 100% liquidity portfolio and 97.67% for the duration portfolio for fiscal year 2011.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**B. Receivables, Net of Allowances**

At June 30, 2011, receivables of the City's major individual funds and nonmajor funds taken in aggregate, including the applicable allowance for uncollectible accounts are as follows (dollars in thousands):

Receivables – Governmental Activities:	General Fund	Redevelopment Agency	Housing Activities	Special Assessment Districts	Total Nonmajor Funds	Internal Service Funds	Governmental Activities
Taxes	\$ 30,219	\$ -	\$ -	\$ -	\$ 4,771	\$ -	\$ 34,990
Accrued interest	133	67	1,504	10	1,631	-	3,345
Grants	3,435	-	4,168	-	13,127	-	20,730
Special assessments	-	-	-	57,899	-	-	57,899
Other	25,429	424	45	1	17,679	1,160	44,738
Less: allowance for uncollectibles	(12,959)	-	(3)	-	(3,965)	-	(16,927)
Total receivables, net	<u>\$ 46,257</u>	<u>\$ 491</u>	<u>\$ 5,714</u>	<u>\$ 57,910</u>	<u>\$ 33,243</u>	<u>\$ 1,160</u>	<u>\$ 144,775</u>

Business-Type Activities:	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total Business-Type Activities
Accounts	\$ 9,594	\$ 1,616	\$ 2,803	\$ 194	\$ 14,207
Accrued interest	100	228	13	8	349
Grants	1,172	2,138	-	-	3,310
Less: allowance for uncollectibles	(622)	(409)	(790)	(10)	(1,830)
Total receivables, net	<u>\$ 10,244</u>	<u>\$ 3,573</u>	<u>\$ 2,026</u>	<u>\$ 193</u>	<u>\$ 16,036</u>

Special assessment receivables in the amount of \$57,899,000 are not expected to be collected within the subsequent year.

**C. Loans Receivable, Net of Allowances**

The composition of the City's loans receivable balance for governmental activities, net of the allowance for uncollectible accounts, as of June 30, 2011 is as follows (dollars in thousands):

Type of Loan	General Fund	Redevelopment Agency	Housing Activities	Nonmajor Funds	Total Governmental Activities
20% Housing Program Developer, rehabilitation, second mortgage and relocation loans	\$ -	\$ -	\$ 564,811	\$ -	\$ 564,811
Loans funded by federal grants	-	-	49,553	7,657	57,210
Economic development, real estate developer and other loans	2,142	46,376	48,101	765	97,384
Less: allowance for uncollectibles	-	(11,541)	(343,995)	(2,994)	(358,530)
Total loans, net	<u>\$ 2,142</u>	<u>\$ 34,835</u>	<u>\$ 318,470</u>	<u>\$ 5,428</u>	<u>\$ 360,875</u>

California Community Redevelopment Law requires that at least 20% of the incremental tax revenues generated from certain redevelopment project areas be used to increase, improve, and preserve the affordable housing stock for families and individuals with very low, low, and moderate incomes. In response to this requirement, the City established its 20% Housing Program to offer financial assistance to qualified developers, families, and individuals by providing loans at "below market" rates.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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Typical loans and related terms are summarized as follows:

<u>Loan Type</u>	<u>Interest Rate</u>	<u>Due</u>
New Construction and Permanent	0 - 4%	up to 55 years
Multi-unit rental rehabilitation	3%	5 or more years
Take-out (first time homebuyer)	4%	7 to 40 years
Home improvement	3 - 6%	1 to 30 years

Loans are secured by first, second, third or lower in lien-property deeds of trust except for take-out loans, which are all secured by second deeds of trust. Interest and principal are typically due in installments, except for take-out loans, which do not require payments until their maturity dates.

The City has also invested in multi-family rental housing projects serving low to moderate income individuals through subordinate loans with terms of up to 55 years. Generally, these loans are to be repaid through fixed payments or net cash flow payments from project operations and the term and potential risk of each loan varies. Because of the net cash flow feature of these subordinate loans, there is greater risk of variability in the timing of payments and, potentially, a lower probability of eventual repayment on these subordinate loans than on other loan types.

The City maintains a valuation allowance against loans receivable comprised of an allowance for risk and an allowance for present value discount. The allowance for risk is maintained to provide for losses that can be reasonably anticipated. The allowance is based upon continuing consideration of changes in the character of the portfolio, evaluation of current economic conditions, and such other factors that, in the City's judgment, deserve recognition in estimating potential loan losses. The allowance for risk takes into consideration maturity dates, interest rates, and other relevant factors.

In accordance with City policy, loans are funded at below market rates of interest and include amortized net cash flow deferred repayment terms. This policy exists to enhance the well-being of the recipients or beneficiaries of the financial assistance, who, as described above, are very low, low, or moderate-income individuals or families, or developers of housing for such individuals or families.

Accordingly, for financial statement purposes, the City has established an allowance account against the loans receivable balance containing a present value discount. The present value discount gives recognition to the economic cost of providing loans at interest rates below market, and represents an estimate of the present value of projected net cash flows to the City from the loan portfolio. The present value discount attributable to the loans will be recognized as interest income only as such loans are repaid in full because of the deferred nature of the loan portfolio and the high level of uncertainty relating to the likelihood that cash flows will occur as projected. The difference between the individual outstanding loan balances and the calculated net present value of the loans results in the allowance for present value discount. Losses are recognized as an addition to the allowance and any subsequent recoveries are deducted from the allowance.

The City's management believes the combined amount of the aforementioned risk and present value discount allowances is adequate to reflect the net realizable value of the Community Development Block Grant ("CDBG") loans, Home Investment Partnership Program ("HOME") loans, and 20% Housing Program loans receivable as of June 30, 2011.

In the normal course of operations for housing programs, the City has outstanding commitments to extend credit, which have been encumbered as of June 30, 2011. These commitments involve elements of credit and interest rate risk similar to those described above for outstanding loans receivable. As of June 30, 2011, amounts committed to extend credit under normal lending agreements totaled approximately \$35,765,000.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**D. Capital Assets**

**1. Summary Schedule**

The following is a summary of capital assets activity for the fiscal year ended June 30, 2011 (dollars in thousands):

	Balance July 1, 2010,	Additions	Deletions	Transfers	Balance June 30, 2011
<b>Governmental activities:</b>					
Capital assets, not being depreciated:					
Land	\$ 541,457	\$ 1,563	\$ 14,415	\$ -	\$ 528,605
Construction in progress	261,698	36,564	50	(228,399)	69,813
Total capital assets, not being depreciated	<u>803,155</u>	<u>38,127</u>	<u>14,465</u>	<u>(228,399)</u>	<u>598,418</u>
Capital assets, being depreciated:					
Buildings	1,384,245	8,104	21,135	155,285	1,526,499
Improvements, other than buildings	132,939	2,055	-	71,949	206,943
Infrastructure	11,340,293	11,379	-	1,135	11,352,807
Vehicles and equipment	107,554	4,430	5,036	30	106,978
Furnitures and fixtures	26,507	-	-	-	26,507
Property under capital leases	13,379	-	-	-	13,379
Total capital assets, being depreciated	<u>13,004,917</u>	<u>25,968</u>	<u>26,171</u>	<u>228,399</u>	<u>13,233,113</u>
Less accumulated depreciation for:					
Buildings	334,724	42,469	11,939	-	365,254
Improvements, other than buildings	9,831	2,712	-	-	12,543
Infrastructure	5,939,116	306,237	-	-	6,245,353
Vehicles and equipment	85,920	8,124	4,974	-	89,070
Furnitures and fixtures	13,232	2,655	-	-	15,887
Property under capital leases	12,498	193	-	-	12,691
Total accumulated depreciation	<u>6,395,321</u>	<u>362,390</u>	<u>16,913</u>	<u>-</u>	<u>6,740,798</u>
Total capital assets, being depreciated, net	<u>6,609,596</u>	<u>(336,422)</u>	<u>9,258</u>	<u>228,399</u>	<u>6,492,315</u>
Governmental activities capital assets, net	<u>\$ 7,412,751</u>	<u>\$ (298,295)</u>	<u>\$ 23,723</u>	<u>\$ -</u>	<u>\$ 7,090,733</u>
<b>Business-type Activities:</b>					
Capital assets, not being depreciated:					
Land	\$ 134,926	\$ -	\$ -	\$ -	\$ 134,926
Intangible assets	12,882	-	-	-	12,882
Construction in progress	210,415	75,248	-	(217,295)	68,368
Total capital assets, not being depreciated	<u>358,223</u>	<u>75,248</u>	<u>-</u>	<u>(217,295)</u>	<u>216,176</u>
Capital assets, being depreciated:					
Buildings	1,573,520	12,015	-	25,660	1,611,195
Improvements, other than buildings	888,113	3,796	-	160,728	1,052,637
Vehicles and equipment	180,803	2,302	42	30,907	213,970
Property under capital leases	13,406	-	-	-	13,406
Total capital assets, being depreciated	<u>2,655,842</u>	<u>18,113</u>	<u>42</u>	<u>217,295</u>	<u>2,891,208</u>
Less accumulated depreciation for:					
Buildings	278,890	44,552	-	-	323,442
Improvements, other than buildings	410,151	27,928	-	-	438,079
Vehicles and equipment	119,838	7,618	40	-	127,416
Property under capital leases	11,062	455	-	-	11,517
Total accumulated depreciation	<u>819,941</u>	<u>80,553</u>	<u>40</u>	<u>-</u>	<u>900,454</u>
Total capital assets, being depreciated, net	<u>1,835,901</u>	<u>(62,440)</u>	<u>2</u>	<u>217,295</u>	<u>1,990,754</u>
Business-type activities capital assets, net	<u>\$ 2,194,124</u>	<u>\$ 12,808</u>	<u>\$ 2</u>	<u>\$ -</u>	<u>\$ 2,206,930</u>

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**2. Depreciation**

Depreciation expense charged to various governmental and business-type activities of the City for the fiscal year ended June 30, 2011 is as follows (dollars in thousands):

<b>Governmental activities:</b>	
General government	\$ 10,722
Public safety	8,312
Capital maintenance	307,035
Community services	32,754
Capital assets held by City's internal service funds	<u>3,567</u>
Total depreciation expense - governmental activities	<u>\$ 362,390</u>
 <b>Business-type activities:</b>	
Norman Y. Mineta San José International Airport	\$ 51,185
Wastewater Treatment System	24,357
Municipal Water System	2,491
Parking System	<u>2,520</u>
Total depreciation expense - business-type activities	<u>\$ 80,553</u>

**3. Capitalized Interest**

Interest costs that related to the acquisition of buildings and improvements and equipment acquired with tax-exempt and taxable debt are capitalized for business-type activities. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project, with interest earned on invested tax-exempt debt proceeds over the same period. Capitalized interest cost is prorated to completed projects based on the completion date of each project. There was no capitalized interest cost for the year ended June 30, 2011.

**4. Construction Commitments**

Commitments outstanding as of June 30, 2011, related to governmental and business-type activities construction in progress totaled approximately \$5,841,000 and \$33,675,000, respectively.

**E. Leases**

**1. Operating Leases as Lessee**

The City has commitments under various operating lease agreements requiring annual rental payments, which are described as follows:

**Governmental Activities**

The City has ongoing commitments under operating lease agreements for business equipment, office facilities and land necessary for City operations, which expire at various dates through 2021. Each governmental fund includes the expenditures related to such lease agreements. There are both cancelable and non-cancelable lease agreements. Rental expenditures reported by the General Fund, Nonmajor Governmental Funds and the Redevelopment Agency Fund under these operating lease agreements for the fiscal year ended June 30, 2011 amounted to approximately \$1,952,000, \$1,220,000, and \$3,118,000, respectively.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

The future minimum lease payments anticipated under the existing lease commitments, as of June 30, 2011, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	General Fund	Redevelopment Agency	Nonmajor Governmental Funds	Total Governmental Activities
2012	\$ 1,824	\$ 1,884	\$ 422	\$ 4,130
2013	1,570	1,441	127	3,138
2014	918	1,362	97	2,377
2015	235	978	-	1,213
2016	114	859	-	973
2017-2021	88	2,419	-	2,507
Totals	<u>\$ 4,749</u>	<u>\$ 8,943</u>	<u>\$ 646</u>	<u>\$ 14,338</u>

**Business-Type Activities**

**Airport Office Lease.** The City leases the Airport's office space under a lease agreement, which, as amended, expires in December 2014. The City decided to terminate the lease agreement effective November 30, 2010. In accordance with the provisions of the lease agreement, a termination payment in the amount of \$905,000 was paid to the landlord in July 2010.

**Airport Gas-Powered Buses.** In December 2007, the City entered into an operating lease and maintenance agreement for fourteen compressed natural gas powered buses for the Airport. The term of the agreement is from August 1, 2008 to July 31, 2015. In September 2009, the agreement was amended to add ten buses for the period of June 30, 2010 to May 31, 2017. Rental expenses for the Airport buses for the year ended June 30, 2011 was approximately \$1,848,000.

**Future Minimum Payments.** The future minimum payments anticipated under these commitments, as of June 30, 2011, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	Operating Leases
2012	\$ 2,234
2013	2,241
2014	2,249
2015	2,258
2016	1,067
2017	881
Total	<u>\$ 10,930</u>



**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**2. Operating Leases as Lessor**

The City also leases building space, facilities, and/or the privilege of operating a concession to tenants and concessionaries resulting in the receipt of annual rents, which are described as follows:

**Governmental Activities**

In October 1991, the City entered into a 15-year agreement (the "initial term") with the San José Arena Management Corporation (the "Manager"), an unrelated entity, regarding the management, operations, and maintenance of the San José Arena, and use of the San José Arena by the San José Sharks, a franchise of the National Hockey League. The agreement was subsequently amended on December 19, 2000 extending the agreement for an additional 10 years (the "extended term"). The initial term commenced on October 24, 1991 and terminated on July 31, 2008. The extended term commenced on August 1, 2008 and terminates on July 31, 2018. As part of the amended agreement, the Manager is required to pay the City annual minimum rental and hockey rental payments of \$1,642,000 and \$1,460,000, respectively, as defined by the agreement. Amounts in addition to the annual minimum rental payments include reimbursements for repair and maintenance expenditures and other fees which fluctuate based on the level of annual activities. In the fiscal year ended June 30, 2011, the City received approximately \$5,610,000 from the Manager. As of June 30, 2011, leased assets had a total historic cost of approximately \$118,114,000 and accumulated depreciation of approximately \$47,576,000.

**Business-Type Activities**

**Airline-Airport Lease and Operating Agreements.** The City entered into an Airline-Airport lease and operating agreement with various passenger and cargo airlines ("Signatory Airlines") serving the Airport. The airline lease agreement, which took effect on December 1, 2007, is scheduled to expire on June 30, 2012 and may be extended for one additional five-year term by mutual agreement of the City and the Signatory Airlines. In August 2011, the City Council authorized the Director of Aviation to extend the term for five years through June 30, 2017, which will provide the airlines the ability to continue to conduct operations and occupy leased space through the extended term. The existing rates and charges structure, as well as all other terms and conditions, will remain unchanged.

The key provisions in the airline lease agreement include compensatory rate making for the terminal cost center and residual rate making for the airfield cost center. The airline lease agreement also includes a revenue sharing provision to evenly divide net unobligated Airport revenues between the Airport and the airlines currently operating at the Airport after each fiscal year. In any fiscal year in which there are net unobligated Airport revenues and all requirements of the City's Airport financing documents have been satisfied, the remaining net unobligated Airport revenues are to be evenly divided between the City and the airlines. If net revenues exceed the projected levels outlined in the Airport Forecast identified in the new airline lease agreement, then the airlines share of the difference will be deposited into the Rate Stabilization Fund up to a cap of \$9,000,000. Once the Rate Stabilization Fund has been fully funded or in the event that the actual net revenues do not exceed the projected net revenues, the airlines share of net revenues shall be applied as a credit to the airline terminal revenue requirement for the following fiscal year, thus reducing terminal rental rates for the following fiscal year. The first \$1,000,000 of the City's share of any net revenues shall be retained by the Airport in a discretionary fund to be used for any lawful Airport purpose. The remaining balance of the City's share shall be applied to the capital costs of the Airport's Master Plan Program. For the fiscal year ended June 30, 2011, the Airport's revenues as defined in its lease agreement exceeded its expenditures and reserve requirements by approximately \$34,472,000. The surplus received during the fiscal year ended June 30, 2011 will be distributed in accordance with the revenue sharing provisions of the airline lease agreement, and/or used in the budget balancing actions for fiscal year 2013.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**Other Leases.** The Airport also enters into leases with concessionaires, airline carriers, and other business entities for building space and/or the privilege of operating a concession at the Airport. The terms of these operating leases range from one month to 27 years. The leases with concessionaires are generally based on the greater of a percentage of their sales or a minimum annual guaranteed amount. Rental revenues from the operating leases were \$76,044,000 for the fiscal year ended June 30, 2011.

The future minimum rentals to be received from the operating leases, as of June 30, 2011, are as follows (dollars in thousands):

<b>Fiscal Year</b>		
<b>Ending</b>		
<b>June 30,</b>	<b>Amount</b>	
<b>June 30,</b>	<b>Amount</b>	<b>Amount</b>
2012	\$	74,854
2013		35,608
2014		35,619
2015		31,405
2016		31,382
2017-2021		155,404
2022-2026		25,326
2027-2031		26,993
2032-2036		23,471
2037-2041		10,215
Total	\$	<u>450,277</u>

These future minimum rentals are based upon annual rates and charges agreed to by the airlines and other tenants. In addition to the future minimum rentals disclosed above, the Airport expects to receive approximately \$1,194,000 from month-to-month rentals in the fiscal year ending June 30, 2012. As of June 30, 2011, leased assets had historic costs of approximately \$1,031,000,000 and accumulated depreciation of approximately \$75,461,000.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**F. Long-Term Debt and Other Obligations**

**1. Summary Schedule of Long-Term Debt**

The following is a summary of long-term debt of the City as of June 30, 2011 (dollars in thousands, unless otherwise noted):

	Purpose	Issue Amount	Issue Date	Final Maturity	Range of Interest Rates	Principal Payments (\$ millions)	Balance June 30, 2011
<b>Governmental Activities:</b>							
City of San Jose:							
General Obligation Bonds:							
Series 2001 (Libraries and Parks)	Community Facilities	\$ 71,000	06/06/2001	09/01/2031	4.75-5.125%	2.37	\$ 49,670
Series 2002 (Libraries, Parks, Public Safety)	Community Facilities	116,090	07/18/2002	09/01/2032	4.00-5.00%	3.87	85,130
Series 2004 (Libraries, Parks, Public Safety)	Community Facilities	118,700	07/14/2004	09/01/2034	4.00-5.00%	3.96	94,970
Series 2005 (Libraries and Public Safety)	Community Facilities	46,300	06/23/2005	09/01/2035	3.00-4.50%	1.54-1.55	38,600
Series 2006 (Libraries and Parks)	Community Facilities	105,400	06/29/2006	09/01/2036	4.00-5.00%	3.51-3.52	91,360
Series 2007 (Parks and Public Safety)	Community Facilities	90,000	06/20/2007	09/01/2037	4.00-5.50%	3.00	81,000
Series 2008 (Libraries and Parks)	Community Facilities	33,100	06/25/2008	09/01/2038	4.00-5.00%	1.10-1.11	30,890
Series 2009 (Public Safety)	Community Facilities	9,000	06/25/2009	09/01/2039	4.00-5.00%	0.30	8,700
							480,320
HUD Section 108 Note (FMC)	Economic Development	25,810	02/10/2005	08/01/2024	Variable	1.04-2.22	21,877
City of San Jose Financing Authority:							
Lease Revenue Bonds:							
Series 1993B (Community Facilities)	Community Facilities	18,045	04/13/1993	11/15/2012	6.00%	0.25-0.29	1,528
Series 1997B (Fire, Childcare, Library Land)	Community Facilities	9,805	07/29/1997	08/01/2012	4.85-4.875%	0.37-0.41	755
Series 2002B (Civic Center Project)	Civic Center	292,425	11/14/2002	06/01/2037	3.75-4.25%	0.21-33.45	291,650
Series 2003A (Central Service Yard)	Refunding	22,625	09/18/2003	10/15/2023	3.40-4.70%	1.00-1.61	16,500
Series 2006A (Civic Center Project)	Refunding	57,440	06/01/2006	06/01/2039	4.00-5.00%	0.00-17.44	57,440
Series 2007A (Recreational Facilities)	Refunding	36,555	06/28/2007	08/15/2030	4.125-4.75%	0.91-2.22	32,485
Series 2008A (Civic Center)	Refunding	60,310	08/14/2008	06/01/2039	Variable	0.00-21.89	56,920
Series 2008B-1 (Civic Center Garage)	Refunding	17,640	07/10/2008	06/01/2039	Variable	0.36-0.945	17,280
Series 2008B-2 (Civic Center Garage)	Refunding	17,640	07/10/2008	06/01/2039	Variable	0.36-0.945	17,280
Series 2008C (Hayes Mansion)	Refunding	10,915	06/26/2008	06/01/2027	Variable	0.00-4.57	10,915
Series 2008D (Taxable) (Hayes Mansion)	Refunding	47,390	06/26/2008	06/01/2025	Variable	2.10-4.20	43,385
Series 2008E-1 (Taxable) (Ice Centre)	Refunding	13,015	07/03/2008	06/02/2025	Variable	0.59-1.26	12,460
Series 2008E-2 (Taxable) (Ice Centre)	Refunding	13,010	07/03/2008	06/02/2025	Variable	0.595-1.26	12,455
Series 2008F (Taxable) (Land Acquisition)	Refunding	67,195	06/11/2008	06/01/2034	Variable	1.605-4.81	67,195
Series 2011A (Convention Center)	Convention Center	30,985	04/12/2011	05/01/2042	3.00-5.75%	0.43-2.165	30,985
							669,233
Special Assessment Bonds with Limited Governmental Commitment:							
Special Assessment Bonds:							
Series 24K (Seismic Retrofit)	Seismic Retrofit	1,494	06/29/1993	09/02/2013	8.50%	0.01	24
Series 24Q (Hellyer-Piercy)	Public Infrastructure	27,595	06/26/2001	09/02/2023	5.10-5.875%	1.07-2.05	19,525
Series 24R (2002 Consolidated Refunding)	Consolidated Refunding	13,940	07/03/2002	09/02/2015	3.90-4.38%	0.82-1.07	5,065
Special Tax Bonds:							
CFD No. 1 (Capitol Expressway Auto Mall)	Public Infrastructure	4,100	11/18/1997	11/01/2022	5.40-5.70%	0.17-0.30	2,665
CFD No. 6 (Great Oaks-Route 85)	Public Infrastructure	12,200	12/18/2001	09/01/2023	4.80-6.00%	0.46-0.87	8,305
CFD No. 9 (Bailey/Highway 101)	Public Infrastructure	13,560	02/13/2003	09/01/2032	5.10-6.65%	0.27-0.95	11,605
CFD No. 10 (Hassler-Silver Creek)	Public Infrastructure	12,500	07/23/2003	09/01/2023	4.10-5.25%	0.52-0.94	9,290
Series 2011 (Convention Center)	Public Infrastructure	107,425	04/12/2011	05/01/2042	3.00-6.50%	0.4-7.71	107,425
							163,904
Redevelopment Agency:							
Tax Allocation Bonds:							
Series 1993 (Merged Area Refunding)	Advance Refundings	692,075	12/01/1993	08/01/2015	6.00%	0.00-18.20	32,835
Series 1997 (Merged Area)	Redevelopment Projects	106,000	03/27/1997	08/01/2028	5.375-5.625%	0.01-0.72	6,110
Series 1999 (Merged Area)	Redevelopment Projects	240,000	01/06/1999	08/01/2019	4.75%	0.00-7.17	12,920
Series 2002 (Merged Area)	Redevelopment Projects	350,000	01/24/2002	08/01/2019	4.00-4.50%	0.00-11.29	22,565
Series 2003 (Merged Area)	Redevelopment Projects	135,000	12/22/2003	08/01/2033	4.00-5.00%	0.00-34.10	127,545
Series 2004A (Merged Area)	Refunding	281,985	05/27/2004	08/01/2019	4.229-5.25%	8.78-31.90	201,990
Series 2005A (Merged Area)	Refunding	152,950	07/25/2005	08/01/2028	4.00-5.00%	0.30-26.21	141,250
Series 2005B (Merged Area)	Refunding	67,130	07/25/2005	08/01/2015	5.00%	4.23-21.56	67,130
Series 2006A (Taxable) (Merged Area)	Redevelopment Projects	14,300	11/14/2006	08/01/2022	5.65%	1.80-6.00	13,300
Series 2006B (Merged Area)	Redevelopment Projects	67,000	11/14/2006	08/01/2035	4.50-5.00%	1.00-21.00	67,000
Series 2006C (Merged Area)	Refunding	423,430	12/15/2006	08/01/2032	3.75-5.00%	12.00-74.28	423,430
Series 2006D (Merged Area)	Refunding	277,755	12/15/2006	08/01/2023	4.00-5.00%	0.61-67.33	276,165
Series 2007A (Taxable) (Merged Area)	Redevelopment Projects	21,330	11/07/2007	08/01/2017	5.10%	1.76-2.67	16,035
Series 2007B (Merged Area)	Redevelopment Projects	191,600	11/07/2007	08/01/2036	4.25-5.00%	1.53-23.97	191,600
Series 2008A (Merged Area)	Redevelopment Projects	37,150	12/17/2008	08/01/2018	5.25-6.50%	3.27-13.09	30,980
Series 2008B (Merged Area)	Redevelopment Projects	80,145	11/13/2008	08/01/2035	6.25-7.00%	4.24-29.07	80,145
							1,711,000
Revenue Bonds (Subordinate):							
Series 1996A (Merged Area)	Redevelopment Projects	29,500	06/27/1996	07/01/2026	Variable	1.00-2.00	24,000
Series 1996B (Merged Area)	Redevelopment Projects	29,500	06/27/1996	07/01/2026	Variable	1.00-2.00	24,000
Series 2003A (Taxable) (Merged Area)	Redevelopment Projects	45,000	08/27/2003	08/01/2028	Variable	1.13-2.70	33,870
Series 2003B (Merged Area)	Redevelopment Projects	15,000	08/27/2003	08/01/2032	Variable	0.00-3.90	15,000
							96,870

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

	<u>Purpose</u>	<u>Issue Amount</u>	<u>Issue Date</u>	<u>Final Maturity</u>	<u>Range of Interest Rates</u>	<u>Principal Payments (\$ millions)</u>	<u>Balance June 30, 2011</u>
<b>Governmental Activities (continued):</b>							
Redevelopment Agency (continued):							
City of San Jose Financing Authority Revenue Bonds (Subordinate):							
Series 2001A (4th & San Fernando)	Parking Facility	48,675	04/10/2001	09/01/2026	4.125-5.25%	1.61-3.21	36,710
Series 2001F (Convention Center)	Refunding	186,150	07/01/2001	09/01/2022	4.25-5.00%	8.79-14.73	137,805
							<u>174,515</u>
HUD Section 108 Note (Masson/Dr. Eu/Security)	Redevelopment Projects	5,200	02/11/1997	08/01/2016	Variable	0.33-0.47	2,365
HUD Section 108 Note (CIM Block 3/Central Place)	Redevelopment Projects	13,000	02/08/2006	08/01/2025	Variable	0.57-1.14	12,430
HUD Section 108 Note (Story/King Retail)	Redevelopment Projects	18,000	06/30/2006	08/01/2025	Variable	0.75-1.57	16,625
							<u>31,420</u>
CSCDA - 2005 ERAF Loan	Redevelopment Projects	19,085	04/27/2005	08/01/2015	4.77-5.01%	2.04-2.36	8,775
CSCDA - 2006 ERAF Loan	Redevelopment Projects	14,920	05/03/2006	08/01/2016	5.53-5.67%	1.53-1.91	8,555
							<u>17,330</u>
Housing Set-Aside Tax Allocation Bonds:							
Series 1997E (AMT) (Merged Area)	Affordable Housing	17,045	06/23/1997	08/01/2027	5.75-5.85%	0.34-3.67	17,045
Series 2003J (Taxable) (Merged Area)	Afford. Housing/Refunding	55,265	07/10/2003	08/01/2024	4.125-5.25%	2.02-3.51	37,750
Series 2003K (Merged Area)	Afford. Housing/Refunding	13,735	07/10/2003	08/01/2029	3.52-4.40%	0.23-1.07	6,975
Series 2005A (Merged Area)	Refunding	10,445	06/30/2005	08/01/2024	3.75-5.00%	0.97-2.27	10,445
Series 2005B (Taxable) (Merged Area)	Refunding	119,275	06/30/2005	08/01/2035	4.41-5.46%	0.70-8.30	111,695
Series 2010A-1 (Merged Area)	Afford. Housing/Refunding	54,055	04/29/2010	08/01/2035	5.00-5.50%	1.24-6.30	54,055
Series 2010A-2 (Merged Area)	Afford. Housing/Refunding	2,655	04/29/2010	08/01/2017	4.00-5.00%	0.50-1.66	2,655
Series 2010B (Taxable) (Merged Area)	Afford. Housing/Refunding	10,695	04/29/2010	08/01/2015	1.362-4.881%	1.09-3.78	6,920
							<u>247,540</u>
Housing Set-Aside Tax Allocation Bonds (Subordinate):							
Series 2010C (Taxable) (Merged Area)	Afford. Housing/Refunding	93,000	04/29/2010	08/01/2035	Variable	2.30-5.21	90,900
Total Governmental Activities - Bonds, Certificates of Participation and Notes Payable							<u>\$ 3,704,909</u>
<b>Business-type Activities:</b>							
Norman Y. Mineta San Jose International Airport:							
Revenue Bonds:							
Series 1998A (AMT)	Refunding	\$ 14,015	01/27/1998	03/01/2018	4.50-4.75%	0.73-1.09	\$ 6,540
Series 2001A	Runway Construction	158,455	08/14/2001	03/01/2031	4.10-5.239%	3.83-10.06	131,335
Series 2002A	Refunding	53,600	01/09/2003	03/01/2018	4.776-5.375%	0.00-9.29	53,600
Series 2002B (AMT)	Refunding	37,945	01/09/2003	03/01/2012	4.809-5.00%	2.38-6.55	2,380
Series 2004C (AMT)	Airport Facilities	75,730	06/24/2004	03/01/2026	4.625-5.25%	1.00-10.59	72,730
Series 2004D	Airport Facilities	34,270	06/24/2004	03/01/2028	5.00%	0.00-12.56	34,270
Series 2007A (AMT)	Airport Facilities	545,755	09/13/2007	03/01/2047	5.00-6.00%	0.00-73.50	545,755
Series 2007B	Airport Facilities	179,260	09/13/2007	03/01/2037	4.25-5.00%	0.00-28.80	179,260
							<u>1,025,870</u>
Clean Water Financing Authority:							
Revenue Bonds:							
Series 2005A	Refunding	54,020	10/05/2005	11/15/2016	3.25-5.00%	4.79-5.80	31,835
Series 2009A	Refunding	21,420	01/29/2009	11/15/2020	3.00-4.626%	0.00-5.41	21,420
							<u>53,255</u>
State of California - Revolving Fund Loan	Wastewater Facilities	73,566	06/24/1997	05/01/2019	Various	1.77-3.77	30,651
Total Business-type Activities - Bonds and Loan Payable							<u>\$ 1,109,776</u>
Grand Total							<u>\$ 4,814,685</u>

## 2. Debt Compliance

There are a number of limitations and restrictions contained in the various bond indentures. The City believes it is in compliance with all significant limitations and restrictions.

## 3. Legal Debt Limit and Margin

The City's legal debt limit (as defined by Section 1216 of the City Charter) and debt margin as of June 30, 2011, are approximately \$18,504,600,000 and \$18,024,280,000, respectively.

In accordance with the California Community Redevelopment Law, the Agency establishes its own legal debt limit and a separate tax increment limit, based primarily on the aggregate of all future projected tax increment revenues from existing redevelopment areas. On April 7, 2009, the City Council/Agency Board approved the amendment to the Agency's Redevelopment Plans for the Merged Project Area by increasing the tax increment limit from \$7.6 billion to \$15.0 billion and to establish a single limit of \$7.6 billion for the bonded indebtedness that may be outstanding at any one time. On May 5, 2009, the City Council/Agency Board approved the amendment to the

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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Agency's Redevelopment Plan for the Strong Neighborhoods Initiative ("SNI") Redevelopment Project by authorizing the collection of tax increment from a portion of the SNI project called Diridon Area.

**4. Arbitrage**

The Tax Reform Act of 1986 instituted certain arbitrage restrictions with respect to the issuance of tax-exempt bonds after August 31, 1986. Arbitrage regulations deal with the investment of all tax-exempt bond proceeds at an interest yield greater than the interest yield paid to bondholders. Generally, all interest paid to bondholders can be retroactively rendered taxable if applicable rebate liabilities are not reported and paid to the Internal Revenue Service ("IRS") at least every five years. During the current year, the City performed calculations to determine the rebate liabilities for the City's tax-exempt bond issues listed above. However, as no bond issue with a positive rebate liability was due for a fifth-year payment, the rebate amount calculated has been recorded as a liability reportable to the IRS. The rebate liability amount is recorded as a liability in the Governmental Activities column of the government-wide statements in the amount of \$310,000.

**5. Special Assessment and Special Tax Bonds with Limited City Commitment**

All obligations of the City under the Special Assessment and Special Tax Bonds are not considered general obligations of the City, but are considered limited obligations, payable solely from the assessments/special taxes and from the certain funds pledged therefore under the Paying Agent Agreement or Fiscal Agent Agreement. Neither the faith and credit nor the taxing power of the City, or any political subdivision thereof, is pledged to the payment of the bonds. The City is not obligated to advance available surplus funds from the City Treasury to cure any deficiency in the Redemption Fund for these bonds; provided, however, the City is not prevented, in its sole discretion, from so advancing funds.

As of June 30, 2011, the City has recorded approximately \$57,899,000 of deferred revenue and related special assessments receivables in the Special Assessment Districts Fund. These balances consist primarily of property tax assessments and/or special taxes to be collected in the future by the County of Santa Clara for future debt service of the special assessment districts and the community facilities districts.

The City issued Special Hotel Tax Revenue Bonds, Series 2011 (Convention Center Expansion and Renovation Project), which are secured by a first lien on the Convention Center Facilities District No. 2008-1 special tax revenues and any of the Available Transient Occupancy Tax (Available TOT) as defined in the bond documents that is appropriated by City Council as part of the City's annual budget process to pay debt service. The Base Special Tax and Additional Special Tax (as defined in the bond documents) are property-based taxes levied on hotel properties within the Convention Center Financing District and remitted to the City on a monthly or quarterly basis in the same manner as the City's Transient Occupancy Tax. The estimated deferred revenue of \$57,899,000 as of June 30, 2011 noted above does not include special taxes associated with the 2011 bonds because these special taxes are calculated based on occupancy and a percentage of room rent and therefore the amount is undeterminable. Please refer to Notes III.F.8. and III.F.11. for further discussions on the 2011 bonds.

On May 25, 2010, the City Council approved staff recommendations for surplus funds held by the City related to expired special assessment districts. Surplus funds of \$11,105,000 as of June 30, 2009, were documented and a disposition plan for these funds was adopted. All funds were transferred and accounted for in fiscal year 2009-2010 according to the disposition plan. Surplus funds of \$4,410,000, plus investment income, consisting primarily of bond proceeds for the construction of district improvements, were transferred to the General Fund. Surplus funds of \$6,695,000, plus investment income, consisting primarily of property assessments and bond reserve funds, are to be disbursed as refunds to eligible past assesses within three years. Surplus

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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claim forms were mailed to eligible past assessesees in March 2011. Unclaimed funds in amounts unforeseeable will become the property of the City after the following claim deadlines: March 27, 2012 (one year claim period for assessments) and May 12, 2014 (three year claim period plus the required noticing period for reserves and water main deposit repayments).

**6. Conduit Debt**

The City has issued multi-family housing revenue bonds to provide funds for secured loans to builders of multi-family housing projects. The purpose of the program is to provide needed rental housing for low to moderate-income households. To comply with IRS requirements in order to meet the tax-exempt status, the owner is required to set aside a certain percentage of all units built for low to moderate-income households. The bonds are payable solely from payments made on the related secured loans. These tax-exempt housing bonds have maturity dates that are due at various dates through January 1, 2047. As of June 30, 2011, the outstanding conduit multi-family housing revenue bonds issued by the City aggregated to approximately \$516,271,000.

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 rental housing project on Agency-owned land in the Japantown Redevelopment 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 June 30, 2011, the outstanding balance was \$9,677,000.

In the opinion of the City's officials, these bonds are not payable from any revenues or assets of the City or the Agency. Neither the faith and credit nor the taxing power of the City, the Agency, the State, or any political subdivision thereof are pledged for the payment of the principal or interest on the bonds.

**7. Variable-Rate Demand Bonds**

Included in long-term debt is \$334,760,000 of variable-rate demand bonds issued by the Authority and the Agency. These entities 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. The Authority and the Agency have entered into credit facilities that support the variable-rate demand bonds. 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 scheduled redemption of these bonds is incorporated in the Annual Requirements to Maturity schedules (see Note III.F.9.).

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

The credit facilities that support the variable-rate bonds as of June 30, 2011 are as follows (dollars in thousands):

	Balance June 30, 2011	Credit Facility Description	
		Provider	Expiration Date
City of San José Financing Authority:			
Lease Revenue Bonds:			
Series 2008A (Civic Center)	\$ 56,920	Union Bank	10/21/2013
Series 2008B (Civic Center Garage)	34,560	Bank of America, N.A./Union Bank	10/21/2013
Series 2008C (Hayes Mansion)	10,915	U.S. Bank	10/21/2013
Series 2008D (Taxable) (Hayes Mansion)	43,385	U.S. Bank	10/21/2013
Series 2008E (Taxable) (Ice Centre)	24,915	Bank of America, N.A./U.S. Bank	10/21/2013
Series 2008F (Taxable) (Land Acquisition)	67,195	Bank of America, N.A.	05/02/2014
Total variable rate lease revenue bonds	<u>237,890</u>		
Redevelopment Agency:			
Revenue Bonds:			
Series 1996A (Merged Area)	24,000	JPMorgan Chase Bank, N.A.	11/25/2011 *
Series 1996B (Merged Area)	24,000	JPMorgan Chase Bank, N.A.	11/25/2011 *
Series 2003A (Taxable) (Merged Area)	33,870	JPMorgan Chase Bank, N.A.	11/25/2011 *
Series 2003B (Merged Area)	15,000	JPMorgan Chase Bank, N.A.	11/25/2011 *
Total variable-rate revenue bonds	<u>96,870</u>		
Total variable-rate demand bonds	<u>\$ 334,760</u>		

\* Subsequently extended to July 1, 2012.

**City of San José Financing Authority Variable-Rate Demand Lease Revenue Bonds.** The Authority's \$237,890,000 variable-rate demand lease revenue bonds are payable upon demand of the bondholder at a purchase price equal to principal plus accrued interest. The Authority's remarketing agents are required to use their best efforts to remarket the bonds and, to the extent that bonds are not remarketed, the Authority's trustees are authorized to draw on the credit facilities in the amounts required to pay the purchase price of bonds tendered.

The Authority's repayment of unreimbursed draws made on the credit facilities bear interest at varying rates with the principal amortization amounts and periods ranging from 3 to 5 years. The interest rate, and principal amortization schedule of an unreimbursed draw are determined by the take-out provisions of the applicable reimbursement agreement, which will remain in effect until all principal of an unreimbursed draw is amortized. For example, if a draw occurs on June 30, 2011, then the take-out provision will remain in effect until June 30, 2014 or June 30, 2016, depending on the agreement. If the unreimbursed draws represent a significant portion of the outstanding debt, the principal will generally be amortized over multiple years because, under State law, lease payments may not exceed the fair rental value for the leased property. Per the terms of the reimbursement agreements, the providers of the credit facilities have the right to require an appraisal of the applicable leased property to increase the amount of the rent payable.

The Authority is required to pay the credit facility providers an annual commitment fee ranging from 0.60% to 1.10% for each credit facility based on the terms of the applicable reimbursement agreement and the outstanding principal amount of the bonds supported by the credit facility. As of June 30, 2011, the letters of credit supporting Series 2008 ABCDE had an expiration date of October 21, 2013 and the Series 2008F had an expiration date of May 2, 2014. There are no unreimbursed draws made on the credit facilities supporting Series 2008 ABCDEF bonds at June 30, 2011.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**Redevelopment Agency Variable-Rate Revenue Demand Bonds.** The Agency's \$96,870,000 variable-rate revenue demand bonds ("1996 and 2003 Bonds") are payable upon demand of the bondholder at a purchase price equal to principal plus accrued interest. The Agency's remarketing agents are required to use their best efforts to remarket the bonds and, to the extent that bonds are not remarketed, the Agency's 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 letters of credit as credit facilities for the bonds. At June 30, 2011, the letters of credit were set to expire on November 25, 2011, but have been extended through July 1, 2012 as discussed in Note IV. D: Subsequent Events. 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 June 30, 2011, 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 2.10% to 2.30%, based on the terms of the applicable reimbursement agreement and the outstanding principal amount of the bonds supported by the credit facility. In addition, the Agency made the required deposit with JP Morgan Chase Bank, N.A., a liquidity reserve in the amount of \$5,000,000, as well as deeds of trust on several Agency owned parcels. One of these parcels (California Theatre) was subsequently transferred to the City subject to the deeds of trust in favor of JP Morgan Chase Bank, N.A.

The Agency's \$90,900,000 variable rate Housing Set-Aside Tax Allocation Bonds, 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 Agency and Wells Fargo Bank.



**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**8. Summary of Changes in Long-term Obligations**

**Governmental Activities** - The changes in long-term obligations for the year ended June 30, 2011 are as follows (dollars in thousands):

	July 1, 2010	Additional Obligations, Interest Accretion and Net Increases	Current Maturities, Retirements, and Net Decreases	June 30, 2011	Amounts Due Within One Year
<b>Governmental Activities:</b>					
Long-term debt payable:					
General Obligation bonds	\$ 499,970	\$ -	\$ (19,650)	\$ 480,320	\$ 19,650
HUD Section 108 loan	22,915	-	(1,038)	21,877	1,074
San Jose Financing Authority					
Lease revenue bonds	643,552	30,985	(6,309)	668,228	8,620
Accreted interest on capital appreciation bonds	1,431	95	(521)	1,005	540
Special assessment and special tax bonds with					
limited governmental commitment	60,905	107,425	(4,426)	163,904	3,577
Redevelopment Agency					
Revenue bonds	284,150	-	(12,765)	271,385	13,605
HUD Section 108 notes payable	33,000	-	(1,580)	31,420	1,675
Merged Area tax allocation bonds	1,757,730	-	(46,730)	1,711,000	49,200
Housing Set-Aside tax allocation bonds	349,845	-	(11,405)	338,440	9,460
California Statewide Communities Development					
Authority - ERAF loan	20,735	-	(3,405)	17,330	3,570
Total long-term debt payable	<u>3,674,233</u>	<u>138,505</u>	<u>(107,829)</u>	<u>3,704,909</u>	<u>110,971</u>
Less deferred amounts:					
For refunding gain (loss)	(46,192)	-	3,634	(42,558)	(3,634)
For issuance premiums	54,874	-	(4,237)	50,637	4,237
For issuance discounts	(4,278)	(2,650)	162	(6,766)	(166)
Total deferred amounts	<u>4,404</u>	<u>(2,650)</u>	<u>(441)</u>	<u>1,313</u>	<u>437</u>
Total long-term debt payable and deferred amounts	<u>3,678,637</u>	<u>135,855</u>	<u>(108,270)</u>	<u>3,706,222</u>	<u>111,408</u>
Other Long-term obligations:					
Hayes Mansion construction loan	1,200	-	-	1,200	-
Arbitrage liability	275	35	-	310	-
Accrued vacation, sick leave and compensatory time	83,120	39,422	(56,541)	66,001	22,599
Accrued landfill postclosure costs	8,370	-	(465)	7,905	465
Estimated liability for self-insurance	131,785	29,704	(19,070)	142,419	-
Net other postemployment benefits (OPEB) obligation	155,570	68,540	-	224,110	-
Pollution remediation obligation	2,165	192	(362)	1,995	95
Pass through obligation to County	-	23,562	-	23,562	-
Total other long-term obligations	<u>382,485</u>	<u>161,455</u>	<u>(76,438)</u>	<u>467,502</u>	<u>23,159</u>
Governmental activities long-term obligations	<u>\$ 4,061,122</u>	<u>\$ 297,310</u>	<u>\$ (184,708)</u>	<u>\$ 4,173,724</u>	<u>\$ 134,567</u>

**General Obligation Bonds** are issued pursuant to a two-thirds majority voter authorization. In 2000 and 2002, San José voters approved three ballot measures (Measures O and P in 2000 and Measure O in 2002) that authorized the total issuance of \$598,820,000 of general obligation ("GO") bonds for library, parks and public safety projects. GO bonds are secured by a pledge of the City to levy ad valorem property taxes without limitation of rate or amount. The ad valorem property tax levy is calculated for each fiscal year to generate sufficient revenue to pay 100% of annual debt service net of other available funding sources. As of June 30, 2011, the City of San José had issued \$589,590,000 of GO bonds with proceeds split for three purposes: library projects (\$205,885,000), parks and recreation projects (\$228,030,000), and public safety projects (\$155,675,000). Total principal and interest remaining on the bonds as of June 30, 2011 is approximately \$765,613,000, with the final payment due on September 1, 2039.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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The City plans to issue the final series of GO bonds in fiscal year 2012. A total of \$9,230,000 of the authorization remains un-issued for the library and public safety programs. The proceeds of those bonds would be used to fund a portion of the library and public safety projects approved by voters in November 2000 and March 2002. The timing, size, and purpose of the bond issue will depend upon the expenditure and encumbrance needs of the various projects to be financed.

**Lease Revenue Bonds** are issued primarily to finance various capital improvements to be leased to the City and are secured by lease rental revenue from "lessee" departments in the General Fund and Nonmajor Governmental Funds. The lease rental revenue for each fiscal year is generally equal to 100% of annual debt service net of other available funding sources. Total principal, interest, and accreted value remaining on the bonds as of June 30, 2011 is approximately \$1,062,430,000, with the final payment due on May 1, 2042.

**Special Assessment and Special Tax Bonds** are issued by the City to finance public improvements in special assessment or tax districts established by the City and are secured by assessments or special taxes levied on properties located within the special districts. The assessments and special taxes, as applicable, are calculated for each fiscal year to generate sufficient revenue to pay 100% of annual debt service net of other available funding sources. Total principal and interest remaining on the bonds as of June 30, 2011 is approximately \$333,398,000, with the final payment due on May 1, 2042.

*Special Hotel Tax Revenue Bonds*, Series 2011 was issued by the City on April 12, 2011 to finance the costs of the Convention Center Expansion and Renovation Project (the "Project"). The 2011 Bonds are generally payable from three sources of funds: (i) revenues generated by the levy of the Base Special Tax; (ii) Revenues generated by the levy of the Additional Special Tax; and (iii) Available Transient Occupancy Tax to the extent appropriated by the City Council for this purpose. A full description of the sources of repayment can be found in the Official Statement of the 2011 Bonds. Please refer to Notes III.F.5. and III.F.11. for further discussions on the 2011 bonds.

**Redevelopment Agency's Merged Area Tax Allocation Bonds (TABs)**, (comprised of Series 1993, Series 1997, Series 1999, Series 2002, Series 2003, Series 2004A, Series 2005 A & B, Series 2006 A, B, C & D, Series 2007 A & B, and Series 2008 A &B, collectively the "Senior TABs") are issued primarily to finance redevelopment projects and are secured primarily by a pledge of tax increment revenues (minus the 20% Housing Set Aside and other statutory deductions) consisting of a portion of 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 June 30, 2011, 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 \$2,938,513,000. 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 June 30, 2011 is approximately \$2,762,921,000. The 80% tax increment revenues recognized during the fiscal year ended June 30, 2011 was \$146,916,000 to cover the February 1 and August 1 debt service. The total debt service (principal and interest) on the Senior TABs amounted to \$131,781,000 for fiscal year 2010-2011.

**Redevelopment Agency's Variable Rate Revenue Bonds** (comprised of Series 1996 A & B, and Series 2003 A & B, collectively the "Subordinate Variable Rate Bonds") are issued primarily to finance redevelopment projects within the Merged Area Redevelopment Project. The bonds are ratably and equally secured by a pledge of the subordinated tax increment revenues and are subordinate to the Merged Area Tax Allocation Bonds of the Agency.

**Redevelopment Agency Housing Set-Aside Tax Allocation Bonds** (comprised of Series 1997E, Series 1999, Series 2003 J & K, Series 2005 A & B, and Series 2010 A-1, A-2 & B, and the 2010

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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 June 30, 2011, 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 \$734,628,000. 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 June 30, 2011 is approximately \$530,064,000. The 20% tax increment revenue recognized during the fiscal year ended June 30, 2011 was approximately \$36,729,000. The total debt service of Housing TABs for fiscal year 2010-2011 was approximately \$25,344,000.

**Other Long-Term Obligation** payments are primarily made from general revenues recorded in the General Fund.

**Business-Type Activities** - The changes in long-term obligations for the year ended June 30, 2011 are as follows (dollars in thousands):

	July 1, 2010	Additional Obligations and Net Increases	Current Maturities, Retirements, and Net Decreases	June 30, 2011	Amounts Due Within One Year
<b>Business-Type Activities:</b>					
Norman Y. Mineta San Jose International Airport:					
Revenue bonds	\$ 1,037,990	\$ -	\$ (12,120)	\$ 1,025,870	\$ 12,620
Deferred amounts:					
For refunding	(2,064)	-	479	(1,585)	(399)
For issuance premiums	5,090	-	(363)	4,727	505
For issuance discounts	(5,751)	-	43	(5,708)	(45)
Clean Water Financing Authority:					
Revenue bonds	58,045	-	(4,790)	53,255	4,945
Deferred amounts:					
For refunding	(1,757)	-	379	(1,378)	(297)
For issuance premiums	2,004	-	(236)	1,768	236
State of California - Revolving Fund Loan	34,487	-	(3,836)	30,651	3,905
Accrued vacation, sick leave and compensatory time	8,687	3,640	(5,947)	6,380	4,497
Estimated liability for self-insurance	7,449	1,055	(1,895)	6,609	1,995
Net other postemployment benefits (OPEB) obligation	14,073	5,432	-	19,505	-
Pollution remediation obligation	714	210	(210)	714	714
Business-type long-term obligations	<u>\$ 1,158,967</u>	<u>\$ 10,337</u>	<u>\$ (28,496)</u>	<u>\$ 1,140,808</u>	<u>\$ 28,676</u>

**Airport Revenue Bonds** are issued primarily to finance the construction of capital improvements at the Norman Y. Mineta San José International Airport. Pursuant to the Airport's Master Trust Agreement, the City has irrevocably pledged the general airport revenues and certain other funds held or made available under the Airport's Master Trust Agreement, first to the payment of maintenance and operation costs of the Airport, and second to the payment of principal and premium, if any, and interest on the bonds. General airport revenues generally include all revenues, income, receipts and monies derived by the City from the operation of the Airport with the exception of certain expressly excluded revenues. The net revenues available to pay debt service in the current fiscal year totaled approximately \$99,045,000, which is composed of \$46,598,000 of net general airport revenues and \$52,447,000 of other available funds. Bond debt service payable from general airport revenues in the current fiscal year totaled approximately \$32,502,000, which is net of \$21,388,000 of bond debt service paid from the passenger facility charges ("PFC"). The City has covenanted in the Master Trust Agreement that net revenues available to pay debt service for each fiscal year will be at least 125% of annual debt service for such fiscal year plus any other available funds, as defined in the Master Trust Agreement. Annual debt service, as defined in the Master Trust Agreement, is equal to Debt Service of a given fiscal year excluding interest funded from the proceeds and applied toward the payment of interest, less the Available PFC Revenues, as defined in the Master Trust Agreement for such fiscal year. Total principal and interest remaining on the

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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bonds as of June 30, 2011 is approximately \$2.0 billion, with the final payment due on March 1, 2047.

Ambac Indemnity Corporation (Ambac), a subsidiary of Ambac Financial, has issued a reserve fund surety bond of \$4,250,000 that expires on March 1, 2018 and is on deposit in the General Account of the Bond Reserve Fund, securing the Series 1998A, 2001A, 2002A, and 2002B Airport Revenue Bonds. The reserve requirement in the General Account is also satisfied, in part, by a \$6,600,000 surety bond from National Public Finance Guaranty Corporation (“NPFPG”), as successor to the MBIA Insurance Corporation. The ratings of Ambac and NPFPG were reduced or withdrawn subsequent to the deposit of the respective surety bonds to the General Account. The Master Trust Agreement does not require that the rating of any surety bond held in the General Account be maintained after the date of deposit.

The Ambac surety bond expires on March 1, 2018 and the NPFPG surety bond expires on March 1, 2016. According to the Master Trust Agreement for the Airport Revenue Bonds, in the event that such surety bonds for any reason terminates or expires, and the remaining amount on deposit in the General Account is less than the Required Reserve (as defined in the Master Trust Agreement), the Airport is to address such shortfall by delivering to the trustee a surety bond or a letter of credit meeting the criteria of a Qualified Reserve Facility under the Master Trust Agreement, or depositing cash to the General Account in up to twelve equal monthly installments. See note below regarding Ambac’s filing for bankruptcy protection.

The City plans to issue Series 2011C Airport Revenue Bonds to refund a portion of the outstanding Series 2001A Airport Revenue Bonds. Since the Series 2011C Airport Revenue Bonds are economic refunding bonds, which are anticipated to result in a decrease in annual debt service associated with the Series 2001A Airport Revenue Bonds being refunded, no net deposit to the General Account of the Bond Reserve Fund will be required in conjunction with the issuance of Series 2011C Airport Revenue Bonds.

**San José-Santa Clara Clean Water Financing Authority Sewer Revenue Bonds** are issued primarily to finance the construction of capital improvements at the Plant and the City has pledged its net systems revenues as security for its obligations under the improvement agreement to make base payments and additional payments with respect to the outside revenue bonds. The net system revenues available to pay debt service in the current fiscal year totaled approximately \$62,099,000. Bond debt service payable from net system revenues in the current fiscal year totaled approximately \$6,958,000. The City has covenanted in the Improvement Agreement that net system revenues will be at least 115% of its allocable percentage of annual debt service. The City’s allocable percentage of annual debt service is currently 100%. Total principal and interest remaining on the bonds as of June 30, 2011 is approximately \$63,960,000, with the final payment due on November 15, 2020.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**9. Annual Requirements to Maturity**

The annual requirements to amortize all bonds and notes outstanding as of June 30, 2011 are as follows (dollars in thousands):

Fiscal Year Ending June 30,	Governmental Activities					
	City of San Jose General Obligation Bonds and HUD Loan [1]		City of San Jose Financing Authority Lease Revenue and Reassessment Revenue Bonds [1,2,3,4]			
	Principal	Interest	Principal	Accreted Interest	Interest	
2012	\$ 20,724	\$ 22,347	\$ 9,160	\$ 495	\$ 22,128	
2013	20,770	21,479	10,374	510	21,917	
2014	20,826	20,586	11,275	-	21,136	
2015	20,887	19,711	12,385	-	20,896	
2016	20,968	18,826	13,845	-	20,637	
2017 - 2021	106,107	80,587	89,960	-	97,245	
2022 - 2026	106,420	57,333	121,285	-	83,045	
2027 - 2031	98,265	33,354	122,860	-	63,585	
2032 - 2036	73,215	11,114	163,580	-	36,566	
2037 - 2041	14,015	728	111,340	-	5,918	
2041 - 2045	-	-	2,164	-	124	
<b>Total</b>	<b>\$ 502,197</b>	<b>\$ 286,065</b>	<b>\$ 668,228</b>	<b>\$ 1,005</b>	<b>\$ 393,197</b>	

Fiscal Year Ending June 30,	Governmental Activities					
	Special Assessment Bonds with Limited Governmental Commitment		Redevelopment Agency Redevelopment Project Bonds and HUD Loans [1,3]		Redevelopment Agency Housing Set-Aside Bonds [1]	
	Principal	Interest	Principal	Interest	Principal	Interest
2012	\$ 3,577	\$ 9,920	\$ 68,050	\$ 92,073	\$ 9,460	\$ 14,308
2013	3,683	9,406	71,205	88,892	9,845	13,973
2014	4,224	9,227	74,995	85,458	10,310	13,606
2015	5,630	9,026	78,720	81,810	10,795	13,200
2016	5,615	8,751	80,340	77,977	11,330	12,760
2017 - 2021	28,050	39,513	449,010	331,044	65,965	56,093
2022 - 2026	27,260	31,284	491,255	218,790	79,780	40,430
2027 - 2031	20,905	25,059	425,350	111,350	81,495	21,899
2032 - 2036	25,215	17,792	286,810	30,397	59,460	5,997
2037 - 2041	32,035	9,015	5,400	115	-	-
2041 - 2045	7,710	501	-	-	-	-
<b>Total</b>	<b>\$ 163,904</b>	<b>\$ 169,494</b>	<b>\$ 2,031,135</b>	<b>\$ 1,117,906</b>	<b>\$ 338,440</b>	<b>\$ 192,266</b>

Fiscal Year Ending June 30,	Business-Type Activities			
	Airport Revenue Bonds [4]		Wastewater Treatment System Revenue Bonds and Loans	
	Principal	Interest	Principal	Interest
2012	\$ 12,620	\$ 52,801	\$ 8,850	\$ 2,569
2013	13,165	52,211	9,102	2,310
2014	21,795	51,550	9,369	2,048
2015	22,855	50,446	9,643	1,736
2016	23,965	49,288	9,993	1,414
2017 - 2021	126,010	227,410	36,949	3,028
2022 - 2026	152,700	192,927	-	-
2027 - 2031	155,030	151,641	-	-
2032 - 2036	320,430	105,914	-	-
2037 - 2041	127,190	25,483	-	-
2042 - 2046	40,495	10,456	-	-
2047 - 2051	9,615	577	-	-
<b>Total</b>	<b>\$ 1,025,870</b>	<b>\$ 970,704</b>	<b>\$ 83,906</b>	<b>\$ 13,105</b>

- [1] Projected interest payments for the variable rate series of bonds are based on the following rates in effect on June 30, 2011: Financing Authority Lease Revenue Bonds: Series 2008A (0.07%), Series 2008B-1 (0.03%), Series 2008B-2 (0.04%), Series 2008C (0.05%), Series 2008D (0.15%), Series 2008E-1 (0.15%), Series 2008E-2 (0.15%), Series 2008F (0.16%). Redevelopment Agency Revenue Bonds: Series 1996A (0.05%), Series 1996B (0.04%), Series 2003A (0.17%), Series 2003B (0.04%). Redevelopment Agency Housing Set-Aside Tax Allocation Bonds: Series 2010C (1.97%). HUD Section 108 Notes: City and Agency Loans (0.454%). Each series may be set at different interest rate calculation modes, including daily, weekly, monthly, and long rates."
- [2] Amount shown is accreted value payable in each period. As of June 30, 2011, \$1,005,000 of value had accreted on the outstanding capital appreciation bonds, which combined with the \$668,228,000 principal amount of outstanding lease revenue bonds totals \$669,324,000 of outstanding lease revenue debt.
- [3] Projected debt service payments for the Authority Series 2001A Parking Revenue Bonds and Series 2001F Lease Revenue Bonds are included in the Agency Redevelopment Project category, reflecting that the Agency is the primary source of payment for those bonds.
- [4] Does not include notional amortization of outstanding commercial paper notes. Airport Revenue Bonds include addition of the 2011A-1 and 2011A-2 bonds and the defeasance of the 1998A and partial refunding of the 2001A bonds.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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For governmental and business-type activities, the specific year for payment of estimated liabilities for the Hayes Mansion construction loan, arbitrage liability, accrued vacation, sick leave and compensatory time, accrued landfill post-closure costs, estimated liability for self-insurance, the net OPEB obligation and the pollution remediation obligation are not practicable to determine.

**10. Impact of the Ambac Financial Group Inc. Bankruptcy Filing**

On November 9, 2010, Ambac Financial Group Inc. (Ambac Financial) filed for bankruptcy protection under Chapter 11 of the 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 (Ambac Assurance), a subsidiary of Ambac Financial, has issued a reserve fund surety bond for the Redevelopment Agency's Series 1998, 1999 and 2005B tax allocation bonds and the Series 2006D tax allocation refunding bonds. According to the bond indenture for each of these series of bonds, in the event that such surety bond for any reason lapses or expires, the Redevelopment 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 uncertain at this time whether the Ambac Financial bankruptcy will cause the financial guaranty insurance policies or the reserve fund surety bonds to lapse or expire. If such an event does occur, the Agency will be required to take one of the three actions documented above in order to maintain compliance with the bond indenture.

Ambac Assurance has also issued a reserve fund surety bond that is on deposit in the General Account of the Bond Reserve Fund, securing the Series 1998A, 2001A, 2002A, and 2002B Airport Revenue Bonds and the Series 2011A-1 and the Series 2011A-2 Airport Revenue Bonds (issued in July 2011). According to the Master Trust Agreement for these bonds, in the event that such surety bond for any reason terminates or expires, and the remaining amount on deposit in the General Account is less than the Required Reserve (as defined in the Master Trust Agreement), the Airport is to address such shortfall by delivering to the trustee a surety bond or a letter of credit meeting the criteria of a Qualified Reserve Facility under the Master Trust Agreement, or depositing cash to the General Account in up to twelve equal monthly installments.

Ambac Assurance has also issued a reserve fund surety bond that is on deposit in the reserve fund established for the City of San José Financing Authority Revenue Bonds, Series 2001A (4<sup>th</sup> and San Fernando Parking Garage) (the "CSJFA Series 2001A Bonds"). According to the Indenture of Trust for the CSJFA Series 2001A Bonds, prior to the expiration of the surety bond, the Authority is to (1) replace the surety bond with a new Qualified Reserve Account Credit Instrument (as defined in the Indenture of Trust) or (2) deposit or cause to be deposited with the trustee an amount of moneys equal to the Reserve Requirement (as defined in the Indenture of Trust), to be derived from Revenues (as defined in the Indenture of Trust). In the event that the Authority fails to do either of the above, then the trustee is to draw on the surety bond before such expiration to provide moneys to fund the reserve in the amount of the Reserve Requirement.

It is uncertain at this time whether the Ambac Financial bankruptcy will cause the reserve fund surety bonds to lapse or expire. If such an event does occur, it is uncertain whether and when the Airport or the Authority would be required to take one of the actions described above in order to maintain compliance with the respective bond indenture.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**11. New Debt Issuances and Short-Term Debt Activities**

**Governmental Activities**

**Convention Center Bonds**

The City and the San José Financing Authority each issued a series of bonds for the purpose of financing the renovation and expansion of the San José McEnery Convention Center. The City issued \$107,425,000 of Special Hotel Tax Bonds, Series 2011 and the Authority issued \$30,985,000 in Lease Revenue Bonds, Series 2011A.

The Special Hotel Tax Bonds bear interest at fixed rates ranging from 3.00% to 6.50% and have a final maturity date of May 1, 2042. The Special Hotel Tax Bonds are secured by a first lien on the Convention Center Facilities District No. 2008-1 special tax revenues and any Available Transient Occupancy Tax (Available TOT) appropriated by City Council as part of the City's annual budget process to pay debt service. The Base Special Tax and Additional Special Tax (as defined in the bond documents) are property-based taxes levied on hotel properties within the Convention Center Financing District and remitted to the City on a monthly or quarterly basis in the same manner as the City's Transient Occupancy Tax. Please refer to Notes III.F.5. and III.F.8. for further discussions on the 2011 bonds.

The Lease Revenue Bonds bear interest at fixed rates ranging from 3.00% to 5.75% and have a final maturity date of May 1, 2042. The Lease Revenue Bonds are secured by lease payments made from the City's General Fund appropriations to the Authority under a Facility Lease for use and occupancy of certain facilities.

**City of San José Financing Authority Lease Revenue Commercial Paper Notes Payable**

The City's CP Program utilizes a lease revenue financing structure. Under this program, the Authority is able to issue commercial paper notes ("CP Notes") at prevailing interest rates for periods of maturity not to exceed 270 days. The CP Notes are secured by a pledge of lease revenues from various City assets and additionally secured by a direct-pay letter of credit ("LOC") provided by State Street Bank and Trust Company ("State Street") and the California State Teachers' Retirement System ("CalSTRS") (together, the "Banks"). The current Letter of Credit Agreement between the Authority and the Banks expires on January 27, 2013. Per the terms of the Letter of Credit Agreement, the Banks are severally but not jointly responsible for payments on the draws made on the LOC. The respective obligations of the Banks are: State Street Bank at 75% and the CalSTRS at 25%. State Street serves as the agent for the Banks.

The current Letter of Credit and Reimbursement Agreement specifies an annual commitment fee equal to 1.25% per annum of the daily average Stated Amount and Unutilized Commitment of the Letter of Credit in effect from time to time for the period from January 27, 2010 to and including the Letter of Credit Expiration Date; provided, however, that in the event that the long-term unsecured general obligation debt ratings of the City are downgraded by two or more Rating Agencies, the annual commitment fee shall increase by 15 basis points (0.15%) per annum for each rating category (including each "+" or "-" or numerical designation) below the "Aa1" category by Moody's or the "AA+" category by Fitch or S&P through the "A2" category by Moody's or the "A" category by Fitch or S&P and by 20 basis points (0.20%) per annum for every rating category (including each "+" or "-" or numerical designation) below the "A2" category by Moody's or the "A" category by Fitch or S&P (and if such ratings are withdrawn or suspended, for purposes of this provision, such ratings shall be deemed to be downgraded below the "Baa2" category by Moody's or the "BBB" category by Fitch or S&P).

Interest on any Principal Advances (draws under the Letter of Credit that are not reimbursed by the City on the same day) are calculated at various increasing interest rates depending on the number

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

---

of days the Principal Advance remains outstanding ranging from the rate of (i) the Alternative Base plus 0.75% per annum for the period from the date of the Principal Advance to and including the date thirty days thereafter to (ii) the Alternative Base Rate plus 2.25% per annum for the period from the date ninety-one days after the Principal Advance and thereafter.

Interest on any Default Advances (draws that are not reimbursed by the City following the Letter of Credit Expiration Date or if an Event of Default has occurred as defined under the Letter of Credit and Reimbursement Agreement) are payable at the Default Rate from the date of such Default Advance until payment in full, payable in arrears, upon demand, and the unpaid amount of each Default Advance is due immediately upon demand by the Banks, but if no demand is made, then on each Quarterly Date in an amount equal to the then fair rental value with respect to the Components subject to the Sublease for such quarterly period; provided, however, that the unpaid amount of each Default Advance shall be paid by the Authority in each year only to the extent of the then fair rental value with respect to the Components subject to the Sublease for such Base Rental Period. The Default Rate means, on any particular date, a rate of interest per annum equal to the Alternative Base Rate in effect on such date, plus 3.25% per annum. The Alternative Base Rate means, for any day, the higher of (i) the Reference Rate (prime rate), in effect on such date plus 3%, (ii) the Fed Funds Rate, plus 3%, or (iii) the LIBOR Index Rate plus 3%; provided, that at no time shall the Alternative Base Rate be less than the Floor Rate (7% per annum) nor higher than the Maximum Rate (10% per annum).

The Authority issues the CP Notes under the Marks-Roos Local Bond Pooling Act of 1985 pursuant to an Amended and Restated Trust Agreement between the Authority and Wells Fargo Bank, National Association (as amended and supplemented, the "Trust Agreement") and an Amended and Restated Issuing and Paying Agent Agreement between the Authority and Wells Fargo Bank, National Association. Barclays Capital Inc. currently serves as the dealer for the CP Notes pursuant to an Amended and Restated Commercial Paper Dealer Agreement. The City has leased to the Authority various City-owned facilities pursuant to a Site Lease, as amended (the "Site Lease"). The Authority subleased these same facilities back to the City pursuant to a Sublease, as amended (the "Sublease") in exchange for the rental payments which support repayment of the CP Notes. The facilities subject to the Site and Sublease (pursuant to the Third Amendments to the Site Lease and to the Sublease, both dated March 1, 2011, which substituted leased assets) are: the Tech Museum, the Animal Care Center, Fire Station No. 1, and the South San José Police Substation.

As of June 30, 2011, \$27,068,000 of tax-exempt commercial paper notes were outstanding at an interest rate of 0.18% and \$19,577,000 of taxable commercial paper notes were outstanding at an interest rate of 0.25%. The changes in commercial paper notes during the fiscal year ended June 30, 2011 are as follows (dollars in thousands):

<b>July 1, 2010</b>	<b>Additions</b>	<b>Deletions</b>	<b>June 30, 2011</b>
\$53,530	\$1,546	\$8,431	\$46,645

This program was initially established on January 13, 2004, whereby the City Council and the Authority each adopted a resolution authorizing the issuance of the Authority tax-exempt lease revenue commercial paper notes in an amount not to exceed \$98,000,000. This commercial paper program was initially established as a mechanism for financing public improvements of the City including the offsite parking garage for the new Civic Center and non-construction costs for technology, furniture, equipment and relocation services for the new Civic Center.

On June 21, 2005, the City Council and the Authority each adopted a resolution authorizing the issuance of taxable lease revenue commercial paper notes, under the same \$98,000,000 not to exceed limitation as the tax-exempt notes. This subsequent authorization permits the Authority to issue taxable commercial paper notes to pay for expenses otherwise authorized under the



**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

---

commercial paper program, but ineligible to be paid from tax-exempt commercial paper proceeds. The City Council and the Authority approved an expansion of the capacity of the lease revenue commercial paper program from \$98,000,000 to \$116,000,000 on November 15, 2005.

**2010 Tax and Revenue Anticipation Note**

On July 1, 2010, the City issued a short-term note for cash flow borrowing purposes to facilitate the prefunding of the employer retirement contributions. The Initial Note Portion of \$40,000,000 was purchased by JP Morgan Chase Bank, N.A. on the closing date of the financing, July 1, 2010. At the City's discretion, additional borrowings may occur under the terms of the 2010 Note and the Note Purchase Agreement; specifically, at any time up to the Commitment Termination Date of June 30, 2011 and up to the Unutilized Commitment amount \$35,000,000. On October 8, 2010, the City drew down the remaining Unutilized Commitment in the amount of \$35,000,000 per the Note Purchase Agreement. Security for repayment of the 2010 is a pledge of the City's 2010-2011 secured property tax revenues received on and after April 1, 2011 plus all other legally available General Fund revenues of the City, if required. The City repaid the \$75,000,000 2010 Note on January 31, 2011.

**Business-Type Activities**

**Airport Commercial Paper Notes Payable**

The Airport Commercial Paper Notes program was established in November 1999, pursuant to City Council Resolution 69200, to provide interim financing for Airport capital needs in anticipation of issuance of Airport revenue bonds that would replace the short-term notes with permanent long-term financing. Airport commercial paper notes are debt obligations backed by Net General Airport Revenues and are subordinate to Airport senior lien debt, also backed by these revenues.

Under the Airport's Commercial Paper Notes program, the Airport is able to issue commercial paper notes at prevailing interest rates for periods of maturity not to exceed 270 days. The Commercial Paper Notes program is also secured by Letters of Credit ("LOC") summarized below (dollars in thousands):

Provider	Credit Facility Description LOC Capacity <sup>1</sup>	Expiration Date
Bank of America, N.A.	\$ 76,545	01/11/2013
Citibank, N.A.	100,000	01/12/2012
JPMorgan Chase Bank, N.A.	100,000	01/11/2013
Lloyds TSB Bank plc	128,586	09/07/2011
Wells Fargo, N.A.	75,000	01/13/2014
Total	\$ 480,131	

1. Reflects principal component of the LOC commitment.

The terms of each bank's credit facility are specified in the respective Letter of Credit and Reimbursement Agreement (the "Reimbursement Agreement"). In general, the bank agrees to advance funds to the Issuing and Paying Agent in an amount sufficient to pay the principal and interest due on maturing commercial paper notes in an amount not to exceed the stated amount of the related LOC. In the event that the commercial paper dealer is unable to find investors to purchase commercial paper notes to repay the advance from the bank, the City must pay interest to the bank based on a formula specified in the Reimbursement Agreement. Additionally, each bank has a separate Fee Letter to specify the commitment fee payable by the City and the other fees and charges imposed by the bank related to the issuance of its LOC.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

The outstanding balance for the Airport commercial paper notes as of June 30, 2011 is summarized in the table below (dollars in thousands):

LOC Provider	Outstanding as of June 30, 2011	Interest Rate
Bank of America, N.A.	\$ 18,344	0.22 - 0.24%
Citibank, N.A.	100,000	0.22 - 0.25%
JPMorgan Chase Bank, N.A.	100,000	0.22 - 0.25%
Lloyds TSB Bank plc	119,740	0.20%
Wells Fargo, N.A.	71,995	0.20 - 0.25%
<b>Total</b>	<b>\$ 410,079</b>	

The change in Airport commercial paper notes payable during fiscal year 2011 is as follows (dollars in thousands):

June 30, 2010	Additions	Deletions	June 30, 2011
\$417,348	\$371,344	\$378,613	\$410,079

The Airport is planning to issue general airport revenue bonds to refund subordinated commercial paper notes issued to help fund the costs of the Consolidated Rental Car Facility. Although the commercial paper notes have short-term maturities, the Airport's intent is to pay the remaining balance on a long-term basis based on the assumption that taxable commercial paper will be paid on a 30-year amortization period with the first principal payments paid in fiscal 2012.

**12. Landfill Post-closure Costs**

The City has five closed landfills for which post-closure and monitoring services may be required for approximately a 30 year period, which began in fiscal year 1996, coinciding with the closure of the last landfill. An estimated liability of \$7,905,000 related to the closed landfills is recorded in the government-wide financial statements as of June 30, 2011. The City's Environmental Compliance Officer performs an annual evaluation of the aforementioned liability. Actual costs may be higher due to inflation, changes in technology, or changes in regulations. The City does not own or operate any open landfills at this time.

**13. Estimated Liability for Self-Insurance**

The City is exposed to various risks of losses related to torts, errors and omissions, general liability, injuries to employees, unemployment claims, and employee health and dental insurance. During fiscal year 2011, the City maintained an all-risk property policy including boiler and machinery exposures, coverage for loss due to business interruption and flood. The City did not carry earthquake insurance as it was not available at reasonable rates. A summary of insurable coverage for the policy period October 1, 2010 to October 1, 2011 is provided below:

Coverages	Limit per Occurrence	Deductible Per Occurrence
Property, including Business Interruption	\$1 billion	\$100,000
Flood Zone, Special Flood Hazard Area	\$15 million per occurrence and annual aggregate	5% of values at risk (\$1 million minimum deductible)
Flood Zone B	\$25 million per occurrence and annual aggregate	2% of values at risk (\$100,000 minimum deductible)
Flood, Other Locations	\$100 million per occurrence and annual aggregate	\$100,000

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

---

During fiscal year 2011, for the policy period of October 1, 2010 to October 1, 2011, the City maintained an airport liability policy covering the Airport, which provides a limit of \$200,000,000 combined single limit for bodily injury and property damage with a \$25,000,000 each occurrence limit for personal injury subject to a per occurrence deductible of \$25,000 and an aggregate deductible of \$25,000. The Airport's \$200,000,000 liability policy specifically excluded war and terrorism from its coverage. During the past three years, there have been not been any instances that the amount of claim settlements exceeding the insurance coverage. A separate automobile policy provided coverage for the off-premise operations of Airport vehicles including shuttle bus fleets. Coverage included \$1,000,000 single combined limit per occurrence. Physical damage coverage was available for the Airport Shuttle Bus Fleet and is subject to a \$25,000 comprehensive and collision deductible. Settled claims have not exceeded the commercial coverage in any of the past three fiscal years. As part of general support services, the City charges the Airport for the cost of general liability coverage.

Claims liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. The result of the process to estimate the claims liability is not an exact amount as it depends on many complex factors, such as inflation, changes in legal doctrines, new discovered information and damage awards. Accordingly, claims are reevaluated periodically to consider the effects of inflation, recent claims settlement trends (including frequency and amount of pay-outs), economic and social factors, newly discovered information and changes in the law. The estimate of the claims liability also includes increases or decreases to previously reported unsettled claims. The workers' compensation estimate includes allocated loss adjustment expenses, which represent the direct cost associated with the defense of individual claims as well as unallocated loss adjustment expenses, which represent the costs to administer all claims to final settlement, which may be years into the future and have been discounted to their present value using a rate of 3.5% for the amounts recorded.

With respect to the general liability accrual, the City has numerous unsettled lawsuits filed or claims asserted against it as of June 30, 2011. The City Attorney and, with respect to workers' compensation claims, the City's Risk Manager have reviewed these claims and lawsuits in order to evaluate the likelihood of an unfavorable outcome to the City and to arrive at an estimate of the amount or range of potential loss to the City. The City has included a provision for losses in its claims liability for loss contingencies that are both probable and can be reasonably estimated.

Changes in the reported liability during the past two years are as follows (dollars in thousands):

Liability as of July 1, 2009	\$ 139,953
Claims and changes in estimates during 2010	25,934
Claims payments	<u>(26,653)</u>
Liability as of June 30, 2010	139,234
Claims and changes in estimates during 2011	31,273
Claims payments	<u>(21,479)</u>
Liability as of June 30, 2011	<u><u>\$ 149,028</u></u>

**Owner Controlled Insurance Programs** - On March 31, 2004, the City bound certain liability insurance coverage for the major components of the North Concourse Project through an owner-controlled insurance program ("OCIP") with Chartis, formerly American International Group ("AIG"), AIU Holdings, Inc. and AIU LLC ("AIU"). An OCIP is a single insurance program that provides insurance coverage for construction jobsite risk of the project owner, general contractors and all subcontractors associated with construction at the designated project site. The North Concourse Project has been completed and the policies expired December 31, 2008. Closeout procedures on the North Concourse Project have been completed. All remaining work associated with the opening of the facility is covered by the Terminal Area Improvement Project ("TAIP") OCIP, as described

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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below, or is addressed in the contracts for work not covered by the TAIP OCIP by requiring the contractors performing such work to provide insurance coverage naming the City as an additional insured.

The City was also required to establish a claims loss reserve for the North Concourse Project in the aggregate amount of \$3,900,000 available in a cash working fund. The full amount of the claims loss reserve had been deposited with the insurance carrier and was recorded as advances and deposits in the accompanying statement of net assets. The claims loss reserve funds the deductible of up to \$250,000 per occurrence to a maximum loss exposure to the City of \$3,900,000. Due to the positive performance of this OCIP, the City was able to negotiate a large portion of the unused claims reserve in advance of the 10-year coverage term and in March 2010, the amount of \$2,517,000 was returned to the Airport. Over the next 12 months, Chartis will continue to review the loss reserve fund and future disbursements will be expected if no completed operation claims arise over the next 10 years.

On March 15, 2007, the City found additional liability insurance through another OCIP for major components of the Airport's TAIP OCIP through Chartis. The coverage for this program as of June 30, 2011 is as follows:

<u>Coverages</u>	<u>Terminal Area Improvement Projects</u>	
	<u>Limits</u>	<u>Deductible Per Occurrence</u>
General Liability	\$2 million per occurrence/ \$4 million aggregate	\$250,000
Workers' Compensation	Statutory	\$250,000
Employers' Liability	\$1 million per accident	\$250,000
Excess Liability	\$200 million	None

The liability under the TAIP OCIP is based upon an estimated payroll of \$92,500,000 for the covered projects and a construction period of 57 months, commencing on March 15, 2007 through December 31, 2010. In the event that the actual payroll for the covered TAIP projects exceeds the estimated \$92,500,000 payroll or in the event the construction period extends beyond 57 months, the City will be obligated to pay increased premiums for the TAIP OCIP and, in addition, may be required to augment the claims loss reserve fund. The terms of the TAIP OCIP require the City to fund a claims loss reserve fund with Chartis in the amount of \$8,900,000. The claims loss reserve fund is available to Chartis to pay claims within the City's deductible subject to an aggregate maximum loss exposure within coverage limits to the City of \$8,900,000. The City was able to negotiate a reduction in funding to 74% of the claims loss reserve and interest generated remains in the fund. As of June 30, 2009, the full amount of \$6,500,000 was deposited with Chartis and the balance at June 30, 2011 is \$4,860,000. This deposit is recorded as advances and deposits in the accompanying statement of net assets.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**13. Net Other Postemployment Benefits (OPEB) Obligation**

The City implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, prospectively and as such, the City did not have a net OPEB obligation at transition, July 1, 2007. The PFDRP and FCERS calculated a net OPEB obligation in accordance with GASB 45 as discussed in Note IV A.2. Beginning in fiscal year 2010, the City initiated a five-year phase-in to fully pre-fund retiree healthcare benefits for the majority of its employee units, with the exception of members of the San José Firefighters Union (International Association of Firefighters, Local 230). The phase-in plan will continue to result in an incremental increase in retiree healthcare contributions for both the City and its employees over the next three years. Phasing-in to fully pre-fund retiree healthcare benefits does not mean that the existing obligation is paid off immediately. It is projected that it will take approximately 30 years to pay off the existing unfunded retiree healthcare liability. At June 30, 2011, the City recorded net OPEB obligations totaling \$243,615,000 in the government-wide financial statements, of which \$224,110,000 is in governmental activities and \$19,505,000 is in business-type activities.

**14. Pollution Remediation Obligations**

The City is currently responsible for the management and cleanup of pollution remediation activities at several City sites including five active leaking petroleum storage tank sites: Fire Stations #5 and #16, Las Plumas Warehouse, Family Shelter, and the Airport, as discussed in Note IV C.1. The Agency is obligated for the management and cleanup of one ground water accumulation and contamination site at the Adobe office building site and a potential obligation related to the Miraido Village site. Although the City and Agency have significant experience in estimating these types of cleanups, the calculation of the expected outlays related to this pollution remediation is based on estimates provided by both City engineers and consultants and engineers hired by the City and the Agency. The amount of the estimated pollution remediation liability assumes that there will be no major increases in the cost of providing these cleanup services. As of June 30, 2011, the government-wide statement of net assets reported a net pollution remediation obligation in the amount of \$1,995,000 in governmental activities, and \$714,000 in business-type activities.

**15. Pass-through Obligation to the County of Santa Clara**

In 1983, the Agency and the County of Santa Clara (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 (County Pass-Through Payment). In 1993, the Agency, the County, and the City entered into a Settlement Agreement, which continued the County pass-through payment. As of June 30, 2011, the Agency either paid and/or settled all of the outstanding pass-through payment obligations to the County, except the \$23,562,000 that has been reported in government-wide statement of net assets in governmental activities. As a result, the Agency reclassified this obligation from an accrued liability to a long-term obligation during fiscal year 2010-2011.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**G. Interfund Transactions**

The composition of interfund balances as of June 30, 2011, with explanations of transactions, is as follows (dollars in thousands):

**1. Due from/Due to other funds**

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Redevelopment Agency	\$ 1,061 (1)
	Nonmajor Governmental Funds	1,667 (2)
Redevelopment Agency	General Fund	44 (3)
	Housing Activities	135 (4)
Nonmajor Governmental Funds	Nonmajor Governmental Funds	13,250 (5)
Wastewater Treatment System	Nonmajor Governmental Funds	50 (6)
	Municipal Water System	1,000 (7)
		<u>\$ 17,207</u>

- (1) \$993 represents reimbursement for services performed for the Agency, \$27 represents accrual of pooled cash fund discount and interest and \$41 represents rent for the property located at 406 N. Autumn Street.
- (2) \$1,440 represents accrual of gas tax transfer and \$227 represents accrual of construction and conveyance tax transfer.
- (3) Represents accrual of fair value change in the pooled cash funds.
- (4) Represents a true up of tax increment revenues transferred to the Housing Activities Fund based on County's year-end adjustments.
- (5) Represents short-term borrowing for working capital.
- (6) Represents short-term portion of loan for Fiber Optics Conduit project.
- (7) Represents short-term portion of loan for the North Coyote Valley Water Project.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**2. Advances to/Advances from other funds**

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	San José Financing Authority	\$ 3,321 (1)
	Redevelopment Agency	630 (2)
Redevelopment Agency	Housing Activities	580 (3)
	General Fund	250 (4)
Housing Activities	Redevelopment Agency	67,255 (2)
San José Financing Authority	Housing Activities	14,091 (5)
Nonmajor Governmental Funds	Redevelopment Agency	13,142 (2)
Parking System	Redevelopment Agency	11,847 (2)
Wastewater Treatment System	Nonmajor Governmental Funds	201 (6)
	Municipal Water System	174 (7)
	Redevelopment Agency	5,030 (2)
		\$ <u>116,521</u>

- (1) Represents a \$3,297 loan to support the Rancho Del Pueblo golf course and \$24 represents a loan for Seismic District bond purchase.
- (2) See detailed Agency discussion in table below.
- (3) Represents discounted loan to the YWCA Villa Nueva Housing project.
- (4) Represents executive staff home loan.
- (5) Represents proceeds of the commercial paper notes loaned to the Housing Activities fund in connection with the SERAF loan.
- (6) Represents a long-term loan and interest for the Fiber Optics Conduit project and is scheduled to be paid by June 30, 2013.
- (7) Represents a loan for the North Coyote Valley Water Project.

At June 30, 2011, the City has advances receivable from the Agency as follows (in thousands):

<u>Receivable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Property transfer	\$ 630
Housing Activities	SERAF principal	64,816
	SERAF interest and fees	2,439
Nonmajor Governmental Funds	SERAF principal	5,000
	SERAF interest and fees	30
	Parkland in-lieu voucher program	8,112
Parking System	Parking fund loans	11,847
Wastewater Treatment System	SERAF principal	5,000
	SERAF interest and fees	30
		\$ <u>97,904</u>

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**Property Transfer.** On April 20, 2010, the Agency and the City entered into a cooperation agreement, under which the City conveyed the real property located at 406 N. Autumn Street for the purchase price of \$630,000 to the Agency so the Agency could exchange the property for the other parcels with developers needed to form land assemblage necessary for the proposed City owned Autumn Street Extension Project. The Agency's obligation to pay the City the purchase price is due upon the Agency completing the exchange with the developer and upon the City's notification to the Agency that the City has issued a Certificate of Occupancy for private development on that property. As of June 30, 2011, the Certificate of Occupancy has not been issued on the property.

**Redevelopment Agency Supplemental Education Revenue Augmentation Fund ("SERAF").** In July 2009, the State Legislature adopted, and the Governor signed, Assembly Bill No. 26x4, which mandated redevelopment agencies in the State make deposits to SERAF accounts established in each county treasury with deposits totaling \$1.7 billion for fiscal year 2009-10 and \$350,000,000 for fiscal year 2010-11. Pursuant to the state mandate, the Agency paid approximately \$62,200,000 on May 10, 2010 and \$12,800,000 on May 10, 2011 to the County of Santa Clara SERAF account, making the Agency's total SERAF obligation approximately \$75,000,000.

To enable the Agency to make the SERAF payments, the Agency entered into a loan agreement with the City and the City of San José Financing Authority on May 6, 2010 and a First Amendment to the loan agreement on May 10, 2011 (together, the "SERAF Loan Agreement"). In accordance with the SERAF Loan Agreement, the City provided \$74,816,000 in initial principal funding to the Agency (together with applicable interest and fees, the "SERAF Loan") from the following sources:

- \$64,816,000 from Housing Activities Fund (Low and Moderate Income Housing, the "Low-Mod Housing Fund"); of which \$52,000,000 was advanced to the Agency in fiscal year 2009-10 and the remaining \$12,816,000 was advanced in fiscal year 2010-11. The funding sources of the Low-Mod Housing Fund for the SERAF Loans were as follows: (1) \$40,000,000 from the issuance of Housing Set-Aside Tax Allocation Bonds ("Housing TABs"), Series 2010C; (2) \$12,000,000 from proceeds of City of San José Financing Authority Lease Revenue Commercial Paper Notes (the "Commercial Paper Notes"); and (3) \$12,816,000 from the Low-Mod Housing Fund. The Housing TABs and the Commercial Paper Notes provided sufficient funds to support various affordable housing projects and programs and freed up a corresponding amount in the Low-Mod Housing Fund to be loaned to the Agency.

The First Amendment to the SERAF Loan Agreement allowed the issuance of Commercial Paper Notes to be delayed until the City determines that funding is needed for future Low-Mod Housing projects in an amount not to exceed \$25,000,000 in total initial principal amount. As of June 30, 2011, an initial loan of \$12,000,000 in principal (leaving a remaining balance of \$13,000,000 available to be loaned to the Low-Mod Housing Fund) and an additional loan of \$2,100,000 in accrued interest and fees associated with the SERAF Loan have been funded through the issuance of Commercial Paper Notes for a combined total outstanding Commercial Paper Notes balance of \$14,100,000.

The Lease Revenue Commercial Paper program is a General Fund backed program and therefore, to the extent that the Commercial Paper Notes are required to be redeemed for any reason and if neither the Low-Mod Housing Fund nor the Agency is able to repay the portion of the SERAF Loan funded from the Commercial Paper Notes, then the General Fund or any other legally available fund would be required to make the necessary payment. Under the SERAF Loan Agreement, the Agency has the option to make interest payments on an ongoing basis, or to pay accrued interest upon final payment of the SERAF Loan in fiscal year 2015-2016. Assuming the Low-Mod Housing Fund borrows the remaining \$13,000,000 available under the SERAF Loan Agreement as described above through the issuance of Commercial



**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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Paper Notes and if the Agency elects to pay the accrued interest with its repayment of the outstanding principal of the SERAF Loan in fiscal year 2015-2016, the outstanding principal amount is projected to increase from \$25,000,000 to approximately \$35,000,000 by fiscal year 2015-2016.

- \$10,000,000 from three other City funds: the Subdivision Park Trust Special Revenue Fund, Community Facility Revenue Special Revenue Fund (Ice Centre), and the Wastewater Treatment System (Sewage Treatment Plant Connection Fee). To the extent that these funds require replenishment at any time due to the capital needs of the respective programs, and the Agency is unable to repay the Loan in whole or in part, the General Fund or any other legally available fund would be required to make the necessary payment.

These funds advanced \$10,000,000 in principal funds to the Agency in fiscal year 2009-2010. As of June 30, 2011, the balance outstanding including accrued interest is \$10,060,000.

In summary, at June 30, 2011, the City has advanced a total of \$77,315,000 related to SERAF to the Agency representing principal of \$74,816,000 and accrued interest and fees of \$2,499,000.

**Parkland In-Lieu Voucher Program.** In June 2001, the Agency Board, in relation to Parkland Dedication Ordinance ("PDO") and 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 PDO/PIO. The Agency would then reimburse the City's Subdivision Parks Trust Fund in the amount of the voucher. As of June 30, 2011, the Agency owed the City \$8,112,000 related to the Voucher Program. 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 2016.

**Parking Fund Loans.** At June 30, 2011, the Agency owes the City \$11,847,000 in Parking Fund Loans. On April 12, 2005, the Agency entered into a loan agreement with the City in an amount of \$6,800,000 from the future facilities reserve within the City's Parking System Fund. The City advanced the loan to the Agency 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'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 economic downturn and the unexpected size of the payment the Agency is required by the State to make to the SERAF, the Agency made substantial reductions starting in its fiscal year 2010 Capital and Operating Budget and its 2010-2015 Capital Improvement Program. In order to assist the Agency in remitting the Agency's required payment to SERAF, the City has agreed to reimburse the Agency from the City's Parking Systems Fund two years of debt service payments to be made by the Agency on the 4<sup>th</sup> & San Fernando Parking Garage Revenue Bonds. Under the terms of the Second Amendment to Loan Agreement approved by the City Council on February 23, 2010 and executed on October 4, 2010, the Agency shall 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

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

funds within the City's investment portfolio 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. As of June 30, 2011, the City advanced to the Agency a total of \$5,047,000 for debt service payments on the 4<sup>th</sup> & San Fernando Parking Garage Revenue Bonds.

**3. Transfers in/Transfers out**

Transfers are indicative of funding for capital projects, lease payments or debt service and subsidies of various City operations. The following schedules summarize the City's transfer activity with explanations of transactions (dollars in thousands):

**Between governmental and business-type activities:**

<u>Transfers from</u>	<u>Transfers to</u>	<u>Amount</u>
General Fund	Airport	\$ 214 (1)
	Municipal Water System	20 (1)
	Parking System	9 (1)
	Wastewater Treatment System	268 (1)
Parking System	General Fund	462 (2)
	Nonmajor Governmental Funds	632 (3)
Nonmajor Governmental Funds	Airport	443 (4)
Municipal Water System	Nonmajor Governmental Funds	140 (5)
	San José Financing Authority	160 (5)
	General Fund	170 (6)
Wastewater Treatment System	General Fund	4 (7)
	Nonmajor Governmental Funds	3,170 (8)
	San José Financing Authority	1,519 (9)
		<u>\$ 7,211</u>

- (1) Refund of postemployment benefit contribution.
- (2) Transfer to the General Fund for miscellaneous non-downtown receipts.
- (3) Transfer of \$450 for convention center parking receipts and \$182 for City Hall debt service payments.
- (4) Transfer for reimbursable expenses.
- (5) Transfer for City Hall debt service payments.
- (6) Transfers of late fees collected to reimburse expenses.
- (7) Transfer for interest earnings.
- (8) \$1,540 is funding for the household hazardous waste facility and \$1,630 is for City Hall debt service payments.
- (9) Repayment of commercial paper.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**Between governmental activities:**

<u>Transfers from</u>	<u>Transfers to</u>	<u>Amount</u>
General Fund	Redevelopment Agency	\$ 79 (1)
	Housing Activities	44 (2)
	San José Financing Authority	1,389 (3)
	Nonmajor Governmental Funds	27,375 (4)
	Internal Service Funds	87 (5)
Redevelopment Agency	General Fund	382 (6)
	Housing Activities	36,763 (7)
	San José Financing Authority	3,364 (8)
	Nonmajor Governmental Funds	525 (9)
Housing Activities	Redevelopment Agency	25,344 (10)
	Nonmajor Governmental Funds	918 (10)
	San José Financing Authority	552 (10)
	General Fund	188 (11)
Nonmajor Governmental Funds	Redevelopment Agency	447 (12)
	General Fund	28,277 (13)
	Nonmajor Governmental Funds	15,554 (14)
	San José Financing Authority	34,539 (15)
San José Financing Authority	Nonmajor Governmental Funds	345 (16)
	Special Assessment Districts	24,096 (17)
Special Assessment Districts	General Fund	1 (18)
Internal Service Fund	General Fund	99 (19)
	Nonmajor Governmental Funds	207 (20)
		<u>\$ 200,269</u>

- (1) Transfer of \$20 for San José Municipal Stadium transformer and \$59 refunded for Small Business Chambers.
- (2) Refund of postemployment benefit contribution.
- (3) Debt service payments of \$373 for the 1997B bond series, \$423 for the 2003A bond series and \$593 for the 2008F bond series.
- (4) Transfer for various debt service payments, loan repayments, operations and subsidies.
- (5) Transfer for vehicle and fleet replacement.
- (6) \$354 for San José Arena pass-through payment and \$28 for rent received for the property at Keyes Street.
- (7) \$36,729 for 20% increment tax transfers as required under California Community Redevelopment Law and \$34 in interest earnings.
- (8) Debt service payment for 4th & San Fernando parking garage.
- (9) \$230 for capital projects and \$295 for capital project refund.
- (10) Transfer for debt service payments.
- (11) Reimbursement on behalf of the Agency for loan administration and fees associated with the SERAF loan.
- (12) \$88 for interest on the Watson Park restoration project, \$181 for reimbursement of capital outlay and \$178 is for various Project Service Memorandum refunds.
- (13) Various transfers for project savings, operations, interest earnings, and capital projects.
- (14) Various transfers for debt service, operations, capital projects, and project savings.
- (15) Various transfers for debt service payments.
- (16) Transfer of commercial paper proceeds.
- (17) Transfer of bond proceeds for Convention Center expansion and renovation project.
- (18) Transfer of interest earnings to the General Fund.
- (19) Transfer for interest earnings and Plan and Specification program.
- (20) Transfer for City Hall debt service payments.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**H. Governmental Fund Balances**

As of June 30, 2011, total fund balances for the City's major and nonmajor governmental funds are as follows (dollars in thousands):

	General Fund	Redevelopment Agency	Housing Activities	Special Assessment Districts	San José Financing Authority Debt Service	Nonmajor Governmental Funds	Total Governmental Funds
<b>Nonspendable:</b>							
Long-term receivables	\$ 13	\$ 192	\$ -	\$ 5	\$ -	\$ 62	\$ 272
Advances and deposits	-	-	-	-	-	852	852
Subtotal	13	192	-	5	-	914	1,124
<b>Restricted for:</b>							
Public safety	300	-	-	-	-	4,267	4,567
Community services	97	-	407,705	-	-	90,474	498,276
Capital Maintenance	-	-	-	151,723	-	240,187	391,910
Debt service	-	51,460	-	-	25,462	36,153	113,075
Subtotal	397	51,460	407,705	151,723	25,462	371,081	1,007,828
<b>Committed to:</b>							
General government	26,367	2,667	-	-	-	-	29,034
Public safety	5,567	-	-	-	-	864	6,431
Community services	11,853	-	-	-	-	25,423	37,276
Sanitation	49	-	-	-	-	21,251	21,300
Capital Maintenance	7,501	-	-	-	-	3,211	10,712
Capital outlay	250	-	-	-	-	-	250
Subtotal	51,587	2,667	-	-	-	50,749	105,003
<b>Assigned to:</b>							
General government	18,834	-	-	-	-	-	18,834
Public safety	36,759	-	-	-	-	-	36,759
Community services	8,402	-	-	-	-	495	8,897
Sanitation	64	-	-	-	-	-	64
Capital Maintenance	5,793	6,297	-	-	-	13,280	25,370
Subtotal	69,852	6,297	-	-	-	13,775	89,924
<b>Unassigned</b>							
	44,772	-	-	-	-	(222)	44,550
<b>Total fund balances</b>	<b>\$ 166,621</b>	<b>\$ 60,616</b>	<b>\$ 407,705</b>	<b>\$ 151,728</b>	<b>\$ 25,462</b>	<b>\$ 436,297</b>	<b>\$ 1,248,429</b>

**City Reserves Policy.** The City adopted the Reserves Policy in October 2004. It formally set aside amounts for use in emergency situations or when revenue shortages or budgetary imbalances arise. A contingency, cash, and emergency reserve funds were setup in the General Fund to account for one-time purposes or as part of multi-year financial plan to balance the budget and avoid operating deficits. The minimum requirements for each fund were also established accordingly.

The **Contingency Reserve Fund** was created to meet unexpected circumstances such as a General Fund revenue shortfall. The policy established a minimum of three percent of the operating budget as the reserve balance. As of June 30, 2011, the contingency amount accounts for \$30,000,000 of the unassigned fund balance.

The **Cash Reserve Fund** was created for the payment of any authorized expenditures of the City for any fiscal year in anticipation of and before the collection of taxes and other revenues of the City for such fiscal year, and for the payment of authorized expenses of the City for any fiscal year which became due and payable and must be paid prior to the receipt of tax payments and other revenues for such fiscal year. A reserve shall be built up in said fund from any available sources other than restricted sources in an amount which the Council deems sufficient for said purposes. As of June 30, 2011, the cash reserve amount accounts for \$5,000 of the unassigned fund balance.

The **Emergency Reserve Fund** was created for the purpose of meeting any public emergency involving or threatening the lives, property or welfare of the people of the City or property of the City. A reserve shall be built up in said fund from any available sources, other than restricted sources, in an amount which the Council deems desirable. As of June 30, 2011, the emergency reserve amount accounts for \$3,000,000 of the unassigned fund balance.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**IV. Other Information**

**A. Defined Benefit Retirement Plans**

**A. 1 City Sponsored Defined Benefit Pension Plans**

**1. Plan Description**

The City sponsors and administers two single employer defined benefit retirement systems, the Police and Fire Department Retirement Plan ("PFDRP") and the Federated City Employees' Retirement System ("FCERS"), and collectively, "the Retirement Systems", which together cover all full-time and certain part-time employees of the City. The Retirement Systems provide general retirement benefits under single employer Defined Benefit Pension Plans, as well as the Postemployment Healthcare Plans. The Retirement Systems are accounted for in the Pension Trust Funds.

The separately issued annual reports of PFDRP and FCERS, together with the City's Municipal code provide more detailed information about the Retirement Systems. Those reports may be obtained from the City of San José Department of Retirement Services, 1737 North First Street, Suite 580, San José, California 95112.

The Defined Benefit Pension Plans provide general retirement benefits including pension, death, and disability benefits to members. Benefits are based on average final compensation, years of service, and limited required cost-of-living increases. The Defined Benefit Pension Plans are administered by the Director of Retirement, an employee of the City, under the direction of the City Manager and the Boards of Administration for the Retirement Systems. The contribution and benefit provisions and all other requirements are established by the City Charter and City's Municipal Code.

The current membership in the Defined Benefit Pension Plans as of June 30, 2011, is as follows:

	PFDRP	FCERS
Defined Benefit Pension Plans:		
Retirees and beneficiaries currently receiving benefits	1,889	3,430
Terminated vested members not yet receiving benefits	79	672
Active members	1,886	3,519
Total	3,854	7,621

The Retirement Systems are not subject to the provisions of the Employee Retirement Income Security Act of 1974, a federal law that sets minimum standards for most voluntarily established pension and health plans in private industry to provide protection for individuals in these plans.

**2. Funding Policy**

It has been the Retirement Systems' Boards policy to obtain actuarial valuations every two years. However, the Retirement Systems' Boards took action to obtain actuarial evaluations every year beginning June 30, 2010. Actuarial valuations of an ongoing plan involve estimates and assumptions about the probability of occurrence of events far into the future. For pension plans, the assumptions include those about future employment trends, mortality rates, level of salary increases, and investment rate of return. Actuarially determined amounts are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

The contributions to the Defined Benefit Pension Plans from the City and the participating employees are based upon an actuarially determined percentage of each employee's base salary sufficient to provide adequate assets to pay benefits when due.

On June 24, 2008, the City Council adopted ordinance No. 28332 amending Chapter 3.36 and 3.28 of Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for pension benefits to PFDRP and FCERS. The lump sum prepayment for fiscal year 2011 was calculated to be actuarially equivalent to the biweekly payments that would otherwise have been the City's required contributions to the pension plans. The Boards of Administration for the PFDRP and FCERS approved the actuarially determined prepayment amount to be paid by the City on July 1, 2010.

The City and five bargaining units with members in FCERS entered into Memorandum of Agreement ("MOA") during fiscal year 2011 to require the employees represented by these bargaining units ongoing and one-time additional retirement contributions. Additionally, the employees represented by the Police Officers Association ("POA") also agreed to make additional contributions in fiscal years 2011. They were applied to reduce the contributions that the City would otherwise be required to make for the unfunded pension liability from June 27, 2010 through June 25, 2011. The City calculated and implemented the additional contribution rate during fiscal year 2011. The contribution rates provided below do not reflect the additional retirement contributions.

The contribution rates for the Defined Benefit Pension Plans for the City and the participating employees for fiscal year 2011 were established in accordance with actuarially determined requirements computed through actuarial valuations dated June 30, 2009, except for the period June 26, 2011 through June 30, 2011, which were based on the June 30, 2010 valuation. The contribution rates in effect and the amounts contributed to the pension plans for the fiscal year ended June 30, 2011 are as follows (dollars in thousands):

	PFDRP			FCERS		
	City	Participants	Total	City	Participants	Total
Actuarial Rate:						
Defined Benefit Pension Plan:						
7/01/10 - 6/25/11 (police members)	38.32% <sup>(1)</sup>	9.81%				
7/01/10 - 6/25/11 (fire members)	40.24% <sup>(1)</sup>	10.09%				
7/01/10 - 6/25/11				25.75% <sup>(1), (2)</sup>	4.54%	
6/26/11 - 6/30/11 (police members)	49.29%	10.46%				
6/26/11 - 6/30/11 (fire members)	51.05%	10.76%				
6/26/11 - 6/30/11				28.34% <sup>(3)</sup>	4.68%	
Annual Pension Contribution						
Defined Benefit Pension Plan	\$ 77,918 <sup>(4)</sup>	\$ 29,629	\$ 107,547	\$ 59,180	\$ 24,602	\$ 83,782

- (1) The actual contribution rate paid by the City for fiscal year ended June 30, 2011 differed as a result of the City exercising its option to make annual lump sum payments. In fiscal year 2011 the contribution rates paid by the City differed due to police members making on-time additional retirement contributions that were applied to reduce the City's contributions.
- (2) In fiscal year 2010-2011, the City initially funded a contribution rate of 23.18% and later funded an additional 2.57% to provide for the actuarial required contribution.
- (3) The resolutions adopted by the Retirement Plans' Boards setting the contribution rates for fiscal year 2011-2012 provide that the City's Budget Office may adjust the employer's contribution rates in order to achieve a minimum dollar contribution for fiscal year 2011-2012.
- (4) In fiscal year 2010-2011, the City's contribution was offset by 0.45% on account of a transfer of \$1,200,000 from the Supplemental Retiree Benefit Reserve (SRBR) to the valuation assets which was applied to reduce the City's annual required contribution for fiscal year 2010-2011.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**3. Annual Pension Cost and Net Pension Obligation**

In October 2011, FCERS's actuary presented the FCERS Board with its analysis of the FCERS's ARC funding for fiscal year 2010-2011. The actuarial analysis of the ARC determined that a remaining payment of \$8,046,000 or 2.57% of covered payroll would be required to fund the fiscal year 2010-2011 ARC. Since this amount was not paid until fiscal year 2011-2012, the City has recognized the amount as a current liability as reflected on its basic financial statements for the fiscal year ended June 30, 2011.

The following is three-year trend information for the City's Defined Benefit Pension Plans (dollars in thousands):

	<b>Fiscal year ended</b>	<b>Annual Pension Cost (APC)</b>	<b>Percent APC Contributed</b>	<b>Net Pension Obligation</b>
<b>PFDRP</b>	6/30/09	\$ 53,103	100%	\$ -
	6/30/10	52,315	100%	-
	6/30/11 <sup>(1)</sup>	77,918	100%	-
<b>FCERS</b>	6/30/09	57,020	100%	-
	6/30/10	54,566	100%	-
	6/30/11 <sup>(1)</sup>	59,180	100%	-

<sup>(1)</sup> These amounts represent the annual pension cost factoring in the City's elected lump-sum prepayment.

**4. Funded Status and Funding Progress**

**PFDRP's Funded Status and Funding Progress.** As summarized in the table below, as of June 30, 2010, the most recent actuarial valuation date, PFDRP was 79.8% funded for pension benefits (a decrease from 86.7% in the June 30, 2009 valuation) representing the difference between the actuarial value of assets and the actuarial accrued liabilities ("AAL") resulted in an unfunded actuarial accrued liability ("UAAL") of \$653,751,000. The UAAL does not reflect the impact of approximately \$354,000,000 of deferred pension and healthcare net investment losses resulting from unfavorable investment returns from fiscal years 2006 through 2010. PFDRP's actuarial valuation uses a five-year smoothing method for investment returns. This means that, for actuarial valuation purposes, the annual gains or losses, as calculated at year-end, are smoothed (amortized) with the net gains and losses resulting from the prior four years. As of the June 30, 2010 actuarial valuation date, PFDRP's AAL increased by approximately \$267,000,000 due to demographic experience losses and changes in actuarial assumptions as recommended by the PFDRP's Board's actuary in the June 30, 2010 experience study. PFDRP's UAAL increased from approximately \$393,900,000 as of June 30, 2009 to \$653,751,000 as of June 30, 2010.

The net change to the UAAL was primarily the result of:

- (a) unfavorable investment returns during fiscal years 2008 and 2009;
- (b) lower than expected salary increases;
- (c) more deaths than expected among retirees/beneficiaries;
- (d) more service retirements offset by fewer disability retirements;
- (e) reduction in the discount rate from 8.00%, net of expenses, to 7.75%, net of expenses; and
- (f) other changes in actuarial assumptions and experience.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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In addition, the June 30, 2010 valuation reflects the PFDRP's return to an 80-120% market value corridor from the one year 70-130% market value corridor used in the June 30, 2009 valuation. The market value of assets corridor limits the smoothing of assets to be no greater than 120% and no less than 80% of the market value of assets as of June 30, 2010. Under this practice, any investment gains or losses that would cause the smoothed assets to fall outside of this 80-120% market value corridor would be recognized immediately rather than be smoothed over the next five years. The total unrecognized investment losses, for pension and health assets, were approximately \$354,000,000 before and after the application of the 120% market value of assets corridor.

**FCERS's Funded Status and Funding Progress.** As summarized in the table below, as of the June 30, 2010 actuarial valuation date, FCERS was 69% funded on an actuarial basis for pension benefits. FCERS's UAAL of \$780,944,000 does not reflect the impact of approximately \$245,000,000 of deferred investment losses resulting from investment returns in fiscal years 2008 and 2009.

As of June 30, 2010, FCERS's most recent actuarial valuation, the funded status of FCERS decreased from 71% to 69%. The decrease in pension funding status was due to an increase in the AAL and a decrease in the actuarial value of assets. The net return on the market value of assets for the period from July 1, 2009 to June 30, 2010 was better-than-expected. However, on an actuarial asset value basis, the smoothing in of the less-than-expected returns for the period from July 1, 2007 to June 30, 2009 reduced the actuarial value of assets. The increase in the UAAL was due to deferred investment losses from fiscal years' 2008 and 2009 and changes in actuarial assumptions as recommended by FCERS's new actuary for the June 30, 2010 valuations.

FCERS's June 30, 2010 actuarial valuation includes actuarial assumption changes approved by FCERS including phasing in the impact of changes in economic assumptions on contribution rates of the following:

- (a) an increase in the investment return assumption from 7.75%, net of expenses, to 7.95%, net of expenses;
- (b) an increase in the underlying inflation assumption from 3.67% to 3.90%; and
- (c) an increase in the payroll growth assumption from 3.83% to 3.90%.

The increase in the discount rate and payroll wage inflation rate assumptions are due to FCERS transition to phasing in the discount and wage inflation rate.

The June 30, 2010 valuation also included the impact of a 30/20 layered amortization methodology adopted by FCERS in the June 30, 2009 valuation. Previously FCERS amortized the UAAL over a 30-year open amortization basis. There was no impact of this change on the June 30, 2009 valuation as the amortization for the first year of a 30-year closed amortization period is the same as a 30 year open period.

**Defined Benefit Pension Plans' Funded Status and Funding Progress Summary**

	<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL)</u>	<u>UAAL</u>	<u>Funded Ratio</u>	<u>Annual Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
PFDRP	6/30/10	\$ 2,576,705	\$ 3,230,456	\$ 653,751	80%	\$ 222,699	294%
FCERS	6/30/10	1,729,414	2,510,358	780,944	69%	275,869	283%



**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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The Schedule of Funding Progress, presented as Required Supplementary Information (“RSI”) following the Notes to Basic Financial Statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

In fiscal year 2010-2011, the Retirement Systems’ Boards approved an establishment of “floor funding method” for payment of annual required contributions (“ARC”) for pension benefits to address unexpected shortfalls in contributions that may result when payroll does not grow at the rate assumed by the actuaries. The “floor funding method” interprets the ARC as the greater of the annual dollar contribution amount established in the valuation, or the ARC that would result from applying the employer contribution rate determined from that same valuation to the actual emerging payroll of Retirement Systems members throughout the fiscal year. Therefore, the resolutions adopted by the Retirement Systems’ Boards setting the contribution rates for fiscal year 2011-2012 provide that the employer's contribution rates may be adjusted in order to achieve a minimum dollar contribution for fiscal year 2011-2012.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**5. Actuarial Methods and Assumptions**

The significant actuarial methods and assumptions used to compute the actuarially determined PFDRP's annual required contributions and the funded status are as follows:

<b>PFDRP</b>		
<u>Description</u>	<u>Method/Assumption</u>	<u>Method/Assumption</u>
Valuation date	June 30, 2009	June 30, 2010
Actuarial cost method	Entry age normal cost method	Entry age normal cost method
Amortization method for actuarial accrued liabilities	Level percentage of payroll (assuming a 4.25% total payroll increase)	Level percentage of payroll (assuming a 4.25% total payroll increase)
Remaining amortization period	(1) Outstanding balance of unfunded accrued liability calculated through June 30, 2003 valuation amortized over next 8 years; (2) Prior service cost for the February 4, 1996 benefit improvement amortized over the next 8 years; and (3) Future actuarial experience gains and losses, changes in assumptions, and benefit improvements amortized over 16 years from the date of each such event, beginning with June 30, 2005 valuation.	(1) Outstanding balance of the unfunded accrued liability calculated through the June 30, 2003 valuation amortized over next 7 years; (2) Prior service cost for the February 4, 1996 benefit improvement amortized over the next 7 years; and (3) Future actuarial experience gains and losses, changes in assumptions, and benefit improvements amortized over 16 years from the date of each such event, beginning with the June 30, 2005 valuation.
Actuarial asset valuation method	5 year smoothed market with a 70% to 130% Market Value Corridor	5 year smoothed market with a 80% to 120% Market Value Corridor
Investment rate of return	8% per annum	7.75% per annum
Post-retirement mortality	RP-2000 Male Combined Healthy Mortality Table with no collar adjustment, projected 10 years. (set back 4 years) RP-2000 Female Combined Healthy Mortality Table with no collar adjustment, projected 10 years. (set back 1 year)	RP-2000 Male Combined Healthy Mortality Table with no collar adjustment, projected 10 years. (set back 4 years) RP-2000 Female Combined Healthy Mortality Table with no collar adjustment, projected 10 years.
Active service, withdrawal, death, disability service retirement	Based upon the June 30, 2009 Actuarial Experience Analysis.	Based upon the June 30, 2009 Actuarial Experience Analysis.
Salary increases	9.75% for the first 5 years of service, 6.75% for 6-7 years of service, and 6% for 8+ years of service. The total salary increase of 4.25% is for combined inflation and real across-the-board salary increase.	9.75% for the first 5 years of service, 6.75% for 6-7 years of service, and 6% for 8+ years of service. The total salary increase of 4.25% is for combined inflation and real across-the-board salary increase.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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The significant actuarial methods and assumptions used to compute the actuarially determined FCERS's annual required contributions and the funded status are as follows:

<b>FCERS</b>		
<u>Description</u>	<u>Method/Assumption</u>	<u>Method/Assumption</u>
Valuation date	June 30, 2009	June 30, 2010
Actuarial cost method	Entry age normal cost method	Entry age normal cost method
Amortization method for unfunded actuarial accrued liabilities	Level percentage of payroll	Level percentage of payroll
Remaining amortization period	20-year layered, closed, level percentage of payroll with the June 30, 2009 UAAL amortized over a closed 30-year period.	20-year layered, closed, level percentage of payroll with the June 30, 2009 UAAL amortized over a closed 30-year period.
Actuarial asset valuation method	5 year smoothed market	5 year smoothed market
Investment rate of return	7.75% per annum	7.95% per annum
Postretirement mortality	The 1994 Group Annuity Mortality Table set back three years for males and one year for females was used for healthy retirees and beneficiaries. The disabled mortality table used was the 1981 Disability Mortality Table.	The 1994 Group Annuity Mortality Table set back three years for males and one year for females was used for healthy retirees and beneficiaries. The disabled mortality table used was the 1981 Disability Mortality Table.
Active service, withdrawal, death, disability service retirement	Tables based upon current experience	Tables based upon current experience
Salary increases	The base annual rate of salary increase is comprised of a 3.67% inflation rate plus 0.41% for wage inflation for a total rate of 4.08%. This is added to a rate increase for merit/longevity for the first 5 years of service ranging from 5.50% to 0.75% at the 5th year of service.	The base annual rate of salary increase is 3.90% inflation rate plus a rate increase for merit/longevity for the first 5 years of service ranging from 5.75% to 0.25% at the 5th year of service.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**A. 2 Postemployment Healthcare Plans**

**1. Plan Description**

In addition to the Defined Benefit Pension Plans, the City also sponsors and administers two single employer postemployment healthcare plans, the Police and Fire Department Postemployment Healthcare Plan and the Federated City Employees' Postemployment Healthcare Plan, which together cover eligible full-time and certain part-time employees of the City. The postemployment healthcare plans are accounted for in the Pension Trust Funds.

The separately issued annual reports of PFDRP and FCERS, together with the City's Municipal Code provide more detailed information about the Postemployment Healthcare Plans. As stated in Section IV.A.1 of this note, those reports may be obtained from the City of San José Department of Retirement Services.

The Postemployment Healthcare Plans provide medical and dental benefits to eligible retirees. Benefits are 100% of the premium cost for the lowest priced medical insurance plan and 100% of the premium cost for a dental insurance plan available to an active City employee. The Postemployment Healthcare Plans are administered by the Director of Retirement, an employee of the City, under the direction of the City Manager and Boards of Administration for the Retirement Systems. The contribution and benefit provisions and all other requirements are established by the City's Municipal Code and Memoranda of Agreements (MOAs).

The current membership in the Postemployment Healthcare Plans as of June 30, 2011, is as follows:

	<b>PFDRP</b>	<b>FCERS</b>
Postemployment Healthcare Plans:		
Retirees and beneficiaries currently receiving benefits	1,798	3,073
Terminated vested members not yet receiving benefits	31	86
Active members	1,886	3,519
Total	3,715	6,678

**2. OPEB Funding Policy**

As stated above in the Defined Benefit Pension Plan section of this note, it has been the Retirement Systems' Boards policy to obtain actuarial valuations every two years. However, the Retirement Systems' Boards took action to obtain actuarial evaluations every year beginning as of June 30, 2010. Actuarial valuations of an ongoing plan involve estimates and assumptions about the probability of occurrence of events far into the future. For postemployment healthcare plans, the assumptions include those about future employment trends, mortality rates, level of salary increases, healthcare cost trend, and investment rates of return. Actuarially determined amounts are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future.

Projections of postemployment healthcare benefit costs for financial reporting purposes are based on the substantive plan as understood by the employer and plan members, and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and the plan members to that point.

On June 24, 2008, the City Council adopted ordinance No. 28332 amending Chapter 3.36 and 3.28 of Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for postemployment healthcare benefits to PFDRP and FCERS. The lump sum prepayment for fiscal year 2011 was calculated to be actuarially equivalent

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

to the biweekly payments that would otherwise have been the City's required contributions to the postemployment healthcare plans. The Boards of Administration for PFDRP and FCERS approved the actuarially determined prepayment amount to be paid by the City on July 1, 2010, respectively.

Contributions to the Postemployment Healthcare Plans are made by both the City and the participating members. Contributions to PFDRP for periods prior to June 26, 2011 for Fire members of PFDRP were based on the Board's 10-year cash flow funding policy. Effective June 28, 2009, the Police members of PFDRP entered into a MOA and the bargaining units representing the FCERS's members entered into MOAs with the City to increase the contribution rates for retiree health and dental in order to phase-in to fully funding the GASB Statement No. 43 ARC over the next 5 years; fiscal year 2011 was the second year of the phase-in. The MOA between the City and Police members of the PFDRP further provided that the PFDRP member contribution rate shall not have an incremental increase of more than 1.25% and 1.35% of pensionable pay in each year for the Police members and City, respectively. Additionally, the MOA with PFDRP members provided that if the retiree healthcare contributions exceed 10% of Police member and 11% of City contributions, respectively, (excluding the implicit rate subsidy) the parties shall meet and confer on how to address the contributions above 10% and 11%. Effective June 26, 2011, the Fire members of PFDRP entered into a MOA with the City to fully fund the ARC over a five year period subject to the same limitations specified in the MOA with Police members.

The MOA between the City and the bargaining units representing the members of FCERS provided that the five-year phase-in of the ARC will not have an incremental increase of more than 0.75% of pensionable pay in each fiscal year for the FCERS members or the City; the fiscal year ended June 30, 2011 was the second year of the five-year phase-in. Notwithstanding these limitations on incremental increases, the agreements with members of FCERS further provide that by the end of the five-year phase-in the City and the members shall be contributing the full ARC in the ratio currently provided in the relevant sections of the San José Municipal Code.

The contributions are not currently sufficient to provide adequate assets to pay benefits in accordance with the requirements of GASB Statement No. 43. The contribution rates for the Postemployment Healthcare Plans for the City and the participating employees for fiscal year 2011 were based on actuarial valuations dated June 30, 2009, except for the period June 26, 2011 through June 30, 2011, which were based on the June 30, 2010 valuation. The contribution rates in effect and the amounts contributed to the PFDRP and the FCERS for the fiscal year ended June 30, 2011 are as follows (dollars in thousands):

	PFDRP			FCERS		
	City	Participants	Total	City	Participants	Total
Actuarial Rate:						
Postemployment Healthcare Plan:						
7/01/10 - 6/25/11 (police members)	6.26% <sup>(1)</sup>	5.76%				
7/01/10 - 6/25/11 (fire members)	3.92% <sup>(1)</sup>	3.61%				
7/01/10 - 6/25/11				6.41% <sup>(1)</sup>	5.76%	
6/26/11 - 6/30/11 (police members)	7.61% <sup>(2)</sup>	7.01%				
6/26/11 - 6/30/11 (fire members)	5.27% <sup>(2)</sup>	4.86%				
6/26/11 - 6/30/11				7.16% <sup>(2)</sup>	6.52%	
Annual OPEB Contribution						
Postemployment Healthcare Plan:	\$ 17,001	\$ 11,229	\$ 28,230	\$ 21,071	\$ 16,041	\$ 37,112

(1) The actual contribution rate paid by the City for fiscal year ended June 30, 2011 differed as a result of the City exercising its option to make annual lump sum payments.

(2) The resolutions adopted by the Retirement Plans' Boards setting the contribution rates for fiscal year 2011-2012 provide that the City's Budget Office may adjust the employer's contribution rates in order to achieve a minimum dollar contribution for fiscal year 2011-2012.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

**3. Annual Other Postemployment Benefit (“OPEB”) Cost and Net OPEB Obligation**

The City’s annual other postemployment benefit cost and net OPEB obligation for PFDRP and FCERS as of and for the fiscal year ended June 30, 2011, were as follows (dollars in thousands):

	<u>PFDRP</u>	<u>FCERS</u>
Annual required contribution	\$ 62,322	\$ 47,593
Interest on net OPEB obligation	6,744	4,200
Adjustment to annual required contribution	(4,958)	(3,264)
Annual OPEB cost	<u>64,108</u>	<u>48,529</u>
Contributions made	(12,118)	(17,683)
Implicit rate subsidy	(4,939)	(3,925)
Increase in net OPEB obligation	<u>47,051</u>	<u>26,921</u>
Net OPEB obligation – beginning of year	<u>107,054</u>	<u>62,589</u>
Net OPEB obligation – end of year	<u><u>\$ 154,105</u></u>	<u><u>\$ 89,510</u></u>

The following is three-year trend information for the City’s single employer Postemployment Healthcare Plans (dollars in thousands):

	<u>Fiscal year ended</u>	<u>Annual OPEB Cost</u>	<u>Total Employer Contributions</u>	<u>Percent Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
<b>PFDRP</b>	6/30/09	\$ 46,334	\$ 12,548	27%	\$ 84,512
	6/30/10	38,536	15,994	42%	107,054
	6/30/11	64,108	17,057	27%	154,105
<b>FCERS</b>	6/30/09	33,725	15,918	47%	44,760
	6/30/10	39,414	21,585	55%	62,589
	6/30/11	48,529	21,608	45%	89,510

**4. OPEB Funded Status and Funding Progress**

As summarized in the table below, as of June 30, 2010, the most recent actuarial valuation date, PFDRP and FCERS was 6% and 12% funded, respectively on an actuarial basis for OPEB, respectively. Changes to the UAAL were primarily the result of changes in the actuarial assumptions including the expected rate of return on plan investments, payroll growth assumption, and healthcare trend assumption changes to reflect current experience and the actuary’s expectation for the future. The specific funding status for each OPEB plan is summarized in the table below, as of the June 30, 2010 valuation date (dollars in thousands):

	<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL)</u>	<u>UAAL</u>	<u>Funded Ratio</u>	<u>Annual Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
PFDRP	6/30/2010	\$ 58,586	\$ 946,308	\$ 887,722	6%	\$ 222,699	399%
FCERS	6/30/2010	108,011	926,371	818,360	12%	275,869	297%

The Schedule of Funding Progress, presented as RSI following the Notes to Basic Financial Statements, presents information about whether the actuarial value of plan assets increased or decreased in fiscal year 2011 over the transition year in relation to the actuarial accrued liability for benefits. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

In fiscal year 2010-2011, the Retirement Systems' Boards approved an establishment of "floor funding method" for payment of annual required contributions ("ARC") for postemployment healthcare benefits to address unexpected shortfalls in contributions that may result when payroll does not grow at the rate assumed by the actuaries. The "floor funding method" interprets the ARC as the greater of the annual dollar contribution amount established in the valuation, or the ARC that would result from applying the employer contribution rate determined from that same valuation to the actual emerging payroll of Retirement Systems members throughout the fiscal year. Therefore, the resolutions adopted by the Retirement Systems' Boards setting the contribution rates for fiscal year 2011-2012 provide that the employer's contribution rates may be adjusted in order to achieve a minimum dollar contribution for fiscal year 2011-2012.

**5. OPEB Actuarial Methods and Assumptions**

The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrual liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The contributions rates for the fiscal year ended June 30, 2011 were based on the actuarial valuation performed as of June 30, 2009, except for the period June 26, 2011 through June 30, 2011, which were based on the June 30, 2010 valuation. .

The significant actuarial methods and assumptions used to compute the actuarially determined PFDRP's OPEB annual required contributions and the funded status are as follows:

<b>PFDRP</b>		
<u>Description</u>	<u>Method/Assumption</u>	<u>Method/Assumption</u>
Valuation date	June 30, 2009	June 30, 2010
Actuarial cost method	Entry age normal cost method	Entry age normal cost method
Amortization method for actuarial accrued liabilities	30 years, level percentage of pay	30 years, level percentage of pay
Remaining amortization period	30 years as of June 30, 2009, open	30 years as of June 30, 2010, open
Actuarial asset valuation method	5 year smoothed market with a 70% to 130% Market Value Corridor	5 year smoothed market with a 80% to 120% Market Value Corridor
Discount rate*	6.7%	6.3%
Projected payroll increases	The total salary increase of 4.25% is for combined inflation (3.50%) and real across-the-board salary increase (0.75%).	The total salary increase of 4.25% is for combined inflation (3.50%) and real across-the-board salary increase (0.75%).
Healthcare cost trend rate:		
Medical	Projected premiums for FY2009-2010 and 8.25% beginning FY2010-2011, decreasing by 0.50% for each year for 7 years until it reaches an ultimate rate of 5%.	Projected premiums for FY2010-2011 and 9.75% beginning FY2011-2012, decreasing by 0.50% for each year for 10 years until it reaches an ultimate rate of 5%.
Dental	5%	5%

\* Determined as a blended rate of the expected long-term investment returns on plan assets and on the City's investments, based on the funded level of the plan at the valuation date.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

The significant actuarial methods and assumptions used to compute the actuarially determined FCERS's OPEB annual required contributions and the funded status are as follows:

<b>FCERS</b>		
<u>Description</u>	<u>Method/Assumption</u>	<u>Method/Assumption</u>
Valuation date	June 30, 2009	June 30, 2010
Actuarial cost method	Entry age normal cost method	Entry age normal cost method
Amortization method for actuarial accrued liabilities	Level percentage of payroll	Level percentage of payroll
Remaining amortization period	20-year layered, closed, level percentage of payroll with the 6/30/2009 UAAL amortized over a closed 30-year period	20-year layered, closed, level percentage of payroll with the 6/30/2009 UAAL amortized over a closed 30-year period
Actuarial asset valuation method	Market value	Market value
Discount rate*	6.70%	6.71%
Inflation rate	3.67%	3.90%
Salary increases	The base annual rate of salary increase is comprised of a 3.67% inflation rate plus 0.41% for wage inflation for a total rate of 4.08%. This is added to a rate increase for merit/longevity for the first 5 years of service ranging from 5.50% to 0.75% at the 5th year of service	The base annual rate of salary increase is 3.90% inflation rate plus a rate increase for merit/longevity for the first 5 years of service ranging from 5.75% to 0.25% at the 5th year of service
Projected payroll increases	3.83%	3.90%
Healthcare cost trend rate: Medical	The valuation assumes that future medical inflation will be at a rate of 10% per annum graded down each year in 0.50% increments to an ultimate rate of 4.5% for medical-pre age 65 and 7.5% per annum graded down each year in 0.25% increments to an ultimate rate of 4.5% for medical-post age 65.	The valuation assumes that future medical inflation will be at a rate of 9.5% per annum graded down to 4.5% per annum over a 15 year period for medical-pre age 65 and 7.0% to 4.5% per annum graded down over a 15 year period for medical-post age 65.

\* Determined as a blended rate of the expected long-term investment returns on plan assets and on the City's investments, based on the funded level of the plan at the valuation date.



**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**A. 3 California Public Employees' Retirement System (CalPERS)**

**Plan Description.** The Mayor and members of the City Council are eligible to participate in the Public Employees' Retirement Fund ("Fund") of the State of California's Public Employees' Retirement System ("CalPERS"), a cost-sharing multiple-employer plan. CalPERS acts as a common investment and administrative agent for various local and state governmental agencies within the State of California. The City's CalPERS plan is under the CalPERS Miscellaneous 2% at 55 Risk Pool. The Fund provides retirement, disability and death benefits based on the employee's years of service, age and final compensation. Employees vest after five years of service. Benefit provisions and other requirements are established by State statute and by City resolution. CalPERS issues a separate comprehensive annual financial report, copies of which may be obtained from the CalPERS Executive Offices, Lincoln Plaza East, 400 Q Street, Sacramento, California 95814.

**Funding Policy.** The City is required to contribute the actuarially determined amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the Fund's Board of Administration. The required employer contribution rate for the year ended June 30, 2011 was 14.139%. The contractual employee cost sharing is 7.0%, cost-of-living adjustments are 2.0% per year, and benefits are based on a final average compensation period of 36 months. The total contribution requirements for local agencies are established and may be amended by CalPERS. The City's contributions to CalPERS for the years ended June 30, 2011, 2010, and 2009 were \$108,000, \$127,000, and \$133,000, respectively, equal to the required contributions for each year.

**B. Defined Contribution Retirement Plan**

In January 1995, the Agency Board adopted a single employer defined contribution retirement plan, the Agency of the City of San José Retirement Plan (the "Retirement 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%. The Agency's contributions are based on a formula taking into account the employee's 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. The Agency's 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 Retirement Plan. The Agency contracts with an advisor to manage the Retirement Plan with all assets being held in trust by a third party custodian in the name of each of the Retirement Plan's participants. Each of the Retirement Plan's participants directs the investments of his/her separate account. The Agency's Board of Directors may authorize changes to the Retirement Plan.

The Agency's total payroll for the fiscal year ended June 30, 2011 for all non-civil service employees was approximately \$9,000,000. Contributions to the Retirement Plan during the year ended June 30, 2011, made by both the Agency and the participating employees, amounted to approximately \$565,000 and \$216,000, respectively.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**C. Commitments and Contingencies**

**1. Norman Y. Mineta San José International Airport**

**Purchase Commitments.** As of June 30, 2011, the Airport was obligated for purchase commitments of approximately \$13,300,000, primarily for the remainder of the costs for Terminal Area Improvement Program projects. Additionally, the Airport has projected that it will expend or encumber approximately \$197,900,000 on proposed capital projects during the next five fiscal years. It is anticipated that funding for such capital projects will be provided primarily by proceeds from PFCs, federal grants, bond proceeds and other Airport revenues.

**Fuel Storage Facility.** In 1985, the Airport and a fuel supplier with a fuel storage facility adjacent to the City who owned a fuel tank farm facility discovered a fuel leak whereby petroleum products had been released into the soil and ground water from either or both of the City owned facility and/or the other fuel supplier facility. The Airport and a fuel supplier with a fuel storage facility adjacent to the City owned facility agreed to share the costs of a study to develop an acceptable cleanup program for the contaminated site. The cleanup program submitted to the Santa Clara Valley Water District, the responsible regulatory authority, was approved and the cleanup program commenced during the fiscal year ended June 30, 1991. Under an operating agreement, the Airport implemented a groundwater extraction system to control the migration of the contamination and begin efforts to remediate the contamination. The agreement expired but Chevron continued the work.

In November 2009, the City entered into an agreement with the fuel supplier for coordinated corrective actions at the existing fuel tank farms at a cost to the City not to exceed \$1,000,000 and authorizing the Director of Aviation to approve additional expenditures in excess of \$1,000,000 subject to appropriation of funds by City Council. The agreement provides for a 50-50 cost sharing responsibility for actual future costs until successful closure of the site. The agreement also required the City to pay its 50% share of the past costs that the fuel supplier has incurred during the period after expiration of the prior agreement and before the new agreement was in place. During the year ended June 30, 2011, the Airport paid its share of the remediation costs totaling \$211,000.

The fuel supplier is responsible for administering the new agreement including retaining a corrective action contractor. The agreement is also structured to facilitate potential reimbursement from the State Water Resources Control Board Underground Storage Tank Commingled Plume Fund (the "Plume Fund"). Reimbursement from the Plume Fund is potentially available up to \$1,500,000 for each party.

Due to the proximity of the closed City jet fuel farm to the adjacent fuel supplier jet fuel farm that was still active, and the apparently stable contaminant plume, the regulators approved a waiver to allow the City tanks to be left in place until such time as a completely new fuel farm could be built, thereby allowing the fuel supplier site to be closed, and investigation/remediation to be done on both sites at once. The new jet fuel farm was constructed off-Airport across Highway 101 and was placed in service in December 2009. The fuel supplier fuel farm was subsequently closed upon commencement of the new fuel farm.

The fuel supplier is currently conducting an investigation of the combined site in preparation of the site's final remediation plan. One component of the investigation is the subsurface condition underneath the aboveground storage tanks ("ASTs") and underground storage tanks ("USTs") at both the fuel supplier and the City fuel farms. The fuel supplier has recently demolished its fuel farm and removed its USTs, and is sampling the soil underneath its site. The demolition of the City fuel farm and removal of the USTs is currently underway. The completion of the remediation plan is contingent upon sampling and testing of the subsurface soil condition of the City fuel farm site. Once the plan is completed, it will be submitted to the County for its review and approval. The implementation of the remediation plan will commence after its approval by the County.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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With the adoption of GASB Statement No. 49, the Airport has accrued \$714,000 as of June 30, 2011 to cover the estimated remaining costs of its portion of the interim remediation system. Latest estimates of costs to further investigate and cleanup this site is between \$1,000,000 and \$2,000,000 depending upon the method of accomplishment and actual remediation requirements.

**Acoustical Treatment Program.** The Airport had an Acoustical Treatment Program (“ACT”) to comply with the requirements of Title 21 of the California Noise Standard. The program provides acoustical treatment to residences in the noise impact areas surrounding the Airport, at no cost to the property owners. The program is primarily funded by grants from the Federal Aviation Administration (“FAA”) and by PFC revenues. The Airport expended approximately \$788,000 on noise attenuation projects during the fiscal year ended June 30, 2010. The Airport completed its ACT program during the fiscal year ended June 30, 2010. Accordingly, there were no expenditures for the ACT program during the fiscal year ended June 30, 2011.

**Master Plan.** The Airport Master Plan consists of a program of facility improvements designed to fully accommodate commercial aviation demand (passengers and cargo) projected through 2017, with development phased as demand warrants and is determined to be financially feasible. The Master Plan was originally adopted by the City in June 1997 and approved by the FAA in December 1999. In June 2006, the City Council approved revisions to the Airport Master Plan regarding implementation of the Terminal Area Improvement Program. In June 2010, the City Council approved another major amendment to the Master Plan shifting the plan horizon from 2017 to 2027; reducing airline facilities serving cargo demand from 53 acres to 28 acres; and increasing the 56 acres designated for general aviation development to 102 acres. Development of the request for proposal for a second full service fixed based operator is underway and is anticipated that a lease will be approved by the City in fiscal year 2012. Funding for Master Plan projects is from several sources, including grants, PFCs, airline rates and charges, airport revenue bonds, and subordinated commercial paper proceeds.

## **2. Redevelopment Agency (“Agency”)**

**Agency Reimbursements and Obligations to the City.** The Agency has various obligations to the General Fund and various other City funds (see Note III.G.2.), which are subordinate to debt service on its Senior TABs, its Subordinate Variable Rate Bonds and its Housing TABs, as well as other statutory and secured obligations (together, “Senior Agency Obligations”). To the extent that tax increment in any year is insufficient to pay the City after paying Senior Agency Obligations, the Agency may not be able to pay the obligations due to the City. Similarly, if for any reason the Agency’s payment obligations on the Senior Agency Obligations are accelerated, there may not be sufficient funds to pay the obligations due to the City. The City is aware of three current circumstances beyond the control of the City and the Agency that could impact the Agency’s ability to continue to make payments to the City: (1) implementation of legislation to eliminate redevelopment (discussed further below); (2) declining tax increment revenues; and (3) acceleration of certain obligations relating to the Agency’s Subordinate Variable Rate Bonds (discussed further below). Additionally, other circumstances could arise that could adversely affect the Agency’s ability to continue to make payments to the City. The City has not made adjustments to the financial statements due to this uncertainty.

**Implementation of Legislation to Eliminate Redevelopment Agencies.** AB X1 26 provides, among other things, that agreements between a redevelopment agency and the city that created the agency are not enforceable obligations, unless such agreements were entered into at the time of the issuance of indebtedness obligations, solely for the purpose of securing or repaying those indebtedness obligations. As such, if the Supreme Court upholds the constitutionality of AB X1 26, and it is implemented as currently written, the Agency may not be legally authorized to repay many of the obligations it owes to the City.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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Due to the uncertainty of the status of the new law and the fact that it became effective on the penultimate date of the fiscal year, the City has not made adjustments to the financial statements due to this uncertainty. The City treated the new law as a subsequent event, as discussed in Note IV.D. Subsequent Events.

**Acceleration of Obligations Relating to the Agency's Variable Rate Merged Area Redevelopment Project Revenue Bonds (Subordinate Tax Allocation Bonds).** The Agency's Subordinate Variable Rate Bonds are currently supported by letters of credit from JPMorgan Chase Bank, National Association ("JP Morgan"). As of June 30, 2011, the letters of credit were set to expire on November 25, 2011, but have subsequently been extended to July 1, 2012. If the Agency (or, its successor agency under the provisions of AB X1 26) is unable to extend the expiration date of the letters of credit or to replace the letters of credit prior to the expiration date, or if the Agency or its successor agency defaults on its obligations to reimburse JP Morgan for amounts drawn on the letters of credit to pay debt service on the Subordinate Variable Rate Bonds, JP Morgan could elect to cause the trustee for such bonds to draw on the letters of credit to redeem the bonds in full. In such case, all tax increment in excess of the amounts needed to pay debt service on the Agency's Senior TABs could be required to be paid to JP Morgan until JP Morgan is reimbursed in full, with interest, for such draws. As of June 30, 2011, the outstanding principal amount of Subordinate Variable Rate Bonds was \$96,900,000. It could take the Agency several years to repay JP Morgan if JP Morgan were to direct the bond trustee to draw on the letters of credit to redeem all such bonds.

**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").

In August 2004, the City and the Agency filed a lawsuit seeking a judicial determination as to whether the County had breached an agreement entered into among the parties in May 2001 (the 2001 Agreement). In April 2005, the County filed a cross complaint against the City and the Agency alleging, among other things, breach of the 2001 Agreement, breach of the 2001 Agreement's implied covenant of good faith and fair dealing, and intentional interference with prospective economic relations.

In February 2006, the San Mateo Superior Court granted County's motion for Summary Judgment holding that the County had not breached the 2001 Agreement. Subsequently, the City, the Agency and the County settled the lawsuit. Under the terms of the settlement, the Agency agreed to pay the \$22,500,000 in three installments of \$7,500,000 over a three-year period. The final installment payment was made on July 1, 2009.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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*March 16, 2011 Settlement Agreement*

In September 2009, the Agency informed the County that due to the SERAF requirement and insufficient tax increment revenues, it did not have sufficient unrestricted funds to make the fiscal year 2009-2010 pass-through payment. The Agency further informed the County that it had reserved restricted funds for the fiscal year 2008-2009 pass-through (\$21,300,000) pending negotiations regarding the payment. On August 20, 2010, the County submitted an invoice to the Agency in the amount of \$45,200,000, which included the fiscal year 2008-2009 pass-through amount of \$21,300,000, the fiscal year 2009-2010 amount of \$19,200,000 and interest of \$4,700,000.

On March 9, 2011, the County 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 parties with the following terms and conditions:

1. The Agency will pay the County \$21,500,000 from tax-exempt bond proceeds by April 15, 2011, but in no event later than June 30, 2011. The County will use those funds for purposes consistent with limitations imposed by federal law or regulation on the use of tax-exempt bond proceeds.
2. The Agency will pay the County \$5,000,000 in unrestricted funds by June 30, 2011.
3. By June 30, 2011, the Agency will acquire the Old City Hall property from the City and the Agency will transfer title to the County. The County shall be responsible for demolition of existing buildings and improvements, including CEQA clearance and mitigation, demolition, removal or remediation of hazardous materials in the existing buildings and improvements. The Agency will provide marketable title and remain liable for existing, unknown subsurface hazardous materials not associated with the existing buildings and improvements to the extent consistent with existing law. The County will accept the buildings and related improvements in "as is" condition. The Parties agree that the value of the Old City Hall site, under the terms set forth herein, is \$10,000,000. In consideration of the transfer of the property from the City to the Agency, the Agency shall transfer to the County the Agency owned properties, which the County acknowledges have been valued at approximately \$10,000,000 or less.

The Agency satisfied all the terms and conditions listed above by: paying the County \$21,500,000 on March 30, 2011 and \$5,000,000 on May 15, 2011, and transferring the old City Hall property on June 30, 2011. Additionally, the Agency owes the County \$23,562,000 in 5 equal annual installments (\$4,712,000 per installment plus interest accrued as of the payment date) no later than June 30 of 2014, 2015, 2016, 2017 and 2018.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**3. San José – Santa Clara Water Pollution Control Plant**

For fiscal year 2012-2016, the Five Year capital improvement program includes approximately \$15,000,000.00, the South Bay Water Recycling (“SBWR”) project, a regional water reclamation program to recycle highly treated wastewater for irrigation and industrial uses in the cities of San José, Santa Clara, and Milpitas, California. This program is part of an action plan, developed by the City and other agencies tributary to the Plant and adopted by the Regional Water Quality Control Board (“RWQCB”), to control the amount of effluent discharged by the Plant into San Francisco Bay.

The SBWR distribution system includes approximately 60 miles of pipe, a four million-gallon reservoir, a transmission pump station, and two booster pump stations. These facilities were constructed between 1996 and 1998 at a capital cost of approximately \$140,000,000 funded by the tributary agencies, grants, and bond proceeds.

In June 1997, the RWQCB and the City approved the Proposed Revision to the South Bay Action Plan, which described the projects necessary to reduce average dry weather effluent flow from the Plant to below 120,000,000 gallons per day and protect salt marsh habitat for endangered species in the South Bay as required by RWQCB Order 94-117. These projects include expanding the Phase I non-potable reuse system by extending additional piping, placing greater emphasis on water conservation programs, reducing infiltration inflow, augmenting stream flow, and creating wetlands. The estimated cost for implementing these projects was \$127,500,000. In April 2010, the City approved construction of the \$14,777,000 Phase 1C facilities including an additional nine miles of pipeline. As of June 30, 2011 an amount of \$120,139,000 has been expended or encumbered. These estimated costs are to be funded by the City and other tributary agencies through a combination of State Revolving Fund Loans, Sewage Treatment Plant Connection Fees, federal grants, and cash contributions.

**4. Retirement Systems – Unfunded Commitments**

As of June 30, 2011, the PFDRP and FCERS had unfunded commitments to contribute capital for private equity and direct lending investments in the amount of \$116,135,000 and \$38,376,000, respectively.

**5. Federal Financial Assistance Programs**

The City participates in a number of federally assisted grant programs, primarily with the HUD, the FAA, the Department of Transportation, the Department of Homeland Security, the Department of Labor, the Department of Energy, and the Department of Justice. These programs are subject to program compliance audits by the grantors or their representatives.

Although the City’s grant programs are audited in accordance with the provisions of the Single Audit Act Amendments of 1996 for the fiscal year ended June 30, 2011, these programs are still subject to financial and compliance audits by Federal auditors, and to resolution of identified findings and questioned costs. At this time, the amount of expenditures, if any, which may be disallowed by the granting agencies cannot be determined.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**6. Encumbrances**

The City uses encumbrances to control expenditure commitments for the year and to enhance cash management. Encumbrances represent commitments related to contracts not yet performed and purchase orders not yet filled (executory contracts; and open purchase orders). Commitments for such expenditure of monies are encumbered to reserve a portion of applicable appropriations. Encumbrances still open at year end are not accounted for as expenditures and liabilities but, rather, as restricted or committed governmental fund balance. As of June 30, 2011, total governmental fund encumbrance balances for the City are as follows (dollars in thousands):

General Fund	\$ 20,933
Redevelopment Agency	10,154
Housing Activities	34,102
Special Assessment Districts	52
Nonmajor governmental funds	<u>39,517</u>
Total governmental funds	<u>\$ 104,758</u>

**D. Subsequent Events**

**1. Tax and Revenue Anticipation Note**

On July 1, 2011, the City issued a short-term note for cash flow borrowing purposes to facilitate the prefunding of employer retirement contributions. The Initial Note Portion of \$100,000,000 was purchased by JP Morgan Chase Bank, N.A. on the closing date of the financing, July 1, 2011. At the City's discretion, additional borrowings may occur under the terms of the 2011 Note and the Note Purchase Agreement; specifically, at any time up to the Commitment Termination Date of June 30, 2012 and up to the Unutilized Commitment amount of \$25,000,000. Security for repayment of the 2011 Note is a pledge of the City's 2012 secured property tax revenues (excluding property taxes levied for general obligation bonds) and sales tax revenues received during fiscal year 2012 plus all other legally available General Fund revenues of the City, if required. The final maturity for the 2011 Note is June 30, 2012 and the repayment of the 2011 Note has been budgeted in fiscal year 2012 and is anticipated to be paid after the first half of secured property tax revenues is received from the County Auditor-Controller and General Fund cash balances begin to rise in January 2012.

**2. Credit Facilities Renewals and Extensions**

As discussed in Note III F.7.; Variable-rate Demand Bonds, the principal and interest payment of the 1996 and 2003 Merged Area Revenue Bonds are supported by the letters of credit under a reimbursement agreement with JP Morgan-Chase Bank, N.A. The letters of credit were set to expire on November 25, 2011. Failure to extend or replace the letters of credit would require the Agency to redeem the bonds upon the expiration date of the Letters of Credit.

JP Morgan-Chase Bank, N.A. has agreed on October 24, 2011 to extend the 1996 and 2003 Letters of Credit to July 1, 2012, under the same terms of an amendment to reimbursement agreements that amend both the 1996 and 2003 reimbursement agreements.

**3. New Airport Revenue Bonds issuance**

In July 2011, the City issued Airport Revenue Bonds Series 2011A-1 and Series 2011A-2 in the amounts of \$150,405,000 and \$86,380,000, respectively. The Series 2011 A-1 Bonds were issued to (i) refund subordinated commercial paper notes originally issued to refund the Airport Revenue Bond Series 2004A and Series 2004B, (ii) to refund all of the outstanding Airport Revenue

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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Refunding Bonds, Series 1998A, (iii) to make a cash deposit to the General Account of the Bond Reserve Fund, and (iv) to pay a portion of the costs of issuing Series 2011A Bonds. The bonds were issued with interest rates ranging from 2.00% to 6.25% and will mature in March 2034.

The Series 2011A-2 Bonds were issued to refund \$85,625,000 aggregate principal amount of the outstanding Series 2001A, and to pay a portion of the costs of issuing the Series 2011A Bonds. The bonds were issued with interest rates ranging from 2.00% to 5.25%.

#### **4. New Market Tax Credit Financing for the Construction of the Environmental Center**

On October 25, 2011, the City Council adopted a resolution authorizing the City Manager to execute agreements and related documents as necessary in connection with the closing of the New Markets Tax Credit ("NMTC") financing transaction for the Environmental Innovation Center ("EIC") project, which was executed on November 8, 2011. The facility will ultimately house a Clean Technology Demonstration Center, a Habitat for Humanity ReStore center, and a Household Hazardous Waste drop-off facility.

The NMTC program, enacted by Congress and administered by the U.S. Department of the Treasury, was created to promote economic development in distressed areas. Each year, the Treasury's Community Development Financial Institution Fund competitively allocates tax credits to eligible organizations referred to as Community Development Entities ("CDEs"). CDEs solicit private equity investments in exchange for federal income tax credits over a seven-year compliance period totaling 39% of the qualified equity investment made into a qualified active low-income business ("QALICB") that sponsors a project benefiting its community.

The financing structure requires the City to divest its ownership interest in the EIC project for a minimum period of seven years through a ground lease of the EIC with the EIC QALICB, Inc., an independent nonprofit corporation formed by the City on June 20, 2011. The structure also requires the City to serve several key capacities as the leverage lender, developer, ground lessor, and master tenant.

#### **5. Potential Dissolution of Redevelopment Agency - AB X1 26 & 27**

On June 29, 2011, as part of the approval of the State budget, the Governor of California signed two bills that impact the future of redevelopment agencies in the State. One of these bills, Assembly Bill X1 26, provides for the immediate suspension of all redevelopment activity except as required under existing enforceable obligations and requires the dissolution of redevelopment agencies throughout the State by October 1, 2011. The second bill, Assembly Bill X1 27, enables cities and counties to retain their redevelopment agencies by paying a specified amount to the State, as established by formula. These actions were expected to result in the transfer of \$1.7 billion in funds from redevelopment agencies to the State to help resolve the State's budget deficit.

On July 18, 2011, the City joined the California Redevelopment Association, the League of California Cities, and others in filing a petition with the California Supreme Court challenging the constitutionality of this new legislation.

On August 1, 2011, the Agency received information from the State Department of Finance regarding the amount that would be required in order to participate in AB X1 27. According to the information received, the City would be required to pay \$47,000,000 in fiscal year 2011-2012 to avoid the dissolution of the Agency. Additional payments estimated at between \$10,000,000 through \$13,000,000 would be required each year thereafter in order to continue operating.

On August 11, 2011, the California Supreme Court issued a partial stay of AB X1 26 and stayed all of AB X1 27 ("Stay".) The Stay preserved the status quo and left in place those provisions of AB X1 26, which suspended redevelopment activity.



**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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On August 17, 2011, the California Supreme Court modified the Stay to clarify and to exclude from the Stay a single provision, which provision directed the State Director of Finance to determine the payment required for each redevelopment agency to participate in AB X1 27 and set forth the process for calculation of the payment amount. The California Supreme Court also set a briefing schedule, which is designed to facilitate an oral argument as soon as possible in 2011 with a decision prior to January 15, 2012.

On August 22, 2011, the Agency filed an appeal with the State Department of Finance pursuant to AB X1 27, claiming that the payment required to avoid dissolution under AB X1 26 should be reduced from \$47,000,000 to \$35,000,000. The State has notified the Agency that the appeal was denied for being untimely, but the deadlines under the statute are under review by the California Supreme Court in connection with the above mentioned litigation. At this date, neither the City nor the Agency has identified funds to make this payment. Therefore, it is assumed that the Agency will dissolve if the legislation is upheld.

If the California Supreme Court does not find the bills to be unconstitutional, the bills would result in the following:

***Assembly Bill X1 26***

**Suspends Redevelopment Activity.** As of June 29, 2011, the Agency (and the City's Housing Department as it pertains to the use of the Low and Moderate Income Housing Fund) cannot incur new obligations and debt. More specifically, the Agency and Housing Department cannot enter into or amend contracts, renew or extend leases or other agreements, and dispose of or transfer real property or other assets. Agencies are required to continue to make scheduled payments on bonds and other legally binding agreements, and to manage existing contracts, projects, and other agreements.

**Dissolves Redevelopment Agencies.** Unless a redevelopment agency makes payment under Assembly Bill X1 27, as described below, it is dissolved, and all assets and responsibilities for closing out the activities of the former agency are transferred to a "Successor Agency." This provision was to take effect as of October 1, 2011 but has been stayed by the California State Supreme Court.

**Creates Successor Agencies.** The Successor Agency is presumed to be the sponsoring community of the redevelopment agency (i.e., the City). The responsibility of a Successor Agency includes making payments and performing obligations of the former redevelopment agency in accordance with a schedule of enforceable obligations. Enforceable obligations include; bonds, loans, legally required payments, including payments for pension obligations, judgments or settlements, and other legally binding and enforceable agreements. The liability of the Successor Agency is limited to the extent of the total tax increment received to repay the former Agency's indebtedness and the value of assets transferred to it for disposition. Specifically called out as not enforceable are obligations between the sponsoring community (i.e., the City) and the Agency, except for reimbursement agreements and other similar agreements entered into at the time of debt issuance, for the purpose of repaying that debt. Additionally, a Successor Agency is required to dispose of the former agency's assets in an expeditious fashion, to transfer the housing functions to its sponsoring community, to wind down the affairs of the former agency (including the payment of debt and completion of obligated projects), to prepare administrative budgets, and to provide support to the "Oversight Board." In the event that tax increment revenues are not sufficient to cover enforceable obligations, the City would remain responsible for those obligations under which it has previously assumed payment liability (i.e., the HUD 108 loan, ERAF loan and Series 2001A and 2001F bonds). For additional information regarding long-term debt, please refer to Note III.F. Additionally, the City has loaned the Agency \$97,904,000 from various sources that it may not be able to recover from future tax increment.

**City of San José**  
**Notes to Basic Financial Statements**  
**June 30, 2011**

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**Transfer of Housing Functions.** The sponsoring community may choose to assume the housing functions and the housing assets of the dissolved agency. Should the sponsoring community choose not to assume these responsibilities, all assets and functions would be transferred to the local housing authority. This provision was to be effective as of October 1, 2011 but is also subject to the Stay. The Agency has delegated the management of its housing functions to the City through a Coop Agreement entered into November 10, 1987 and it is the intent of the City Administration to retain that authority.

**Creation of Oversight Boards.** The Oversight Board, which is comprised of seven member representatives from local government bodies, is tasked with reviewing and approving the actions of the Successor Agency. Two of the seven members would be City representatives appointed by the Mayor-one of which must be an employee from the recognized employee organization representing the largest number of employees working for the redevelopment agency as of the date of dissolution. The remaining members are appointed by the County (2), the County Superintendent of Education (1), the Chancellor of California Community Colleges (1), and the largest special district taxing entity in the Merged Project.

The accompanying financial statements have been prepared assuming that the Agency will continue as a going concern. As discussed above, the California State Legislature has enacted legislation that is intended to provide for the dissolution of redevelopment agencies in the State of California unless certain payments can be made to the State of California. Such changes to the California Redevelopment Law have also terminated the authority of redevelopment agencies to undertake new obligations to redevelop property. The effects of this legislation are uncertain pending the result of certain lawsuits that have been initiated challenging the constitutionality of this legislation. However, based on the Agency's financial condition, the effects of this legislation raise substantial doubt about the Agency's ability to continue as a going concern. Management's plans regarding those matters are described above. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

#### **6. U.S. Government Debt Downgrade**

On August 5, 2011, Standard & Poor's lowered its long-term credit rating on debt of the U.S. government from AAA to AA+. That action affected Standard & Poor's view of U.S. public finance debt instruments that are directly or indirectly backed by the U.S. As a result, on August 8, 2011, Standard & Poor's lowered its long-term credit ratings of U.S. government-sponsored enterprises and public debt issues that have credit enhancement guarantees by those government-sponsored enterprises to AA+. These credit downgrades relate to the credit risk associated with the City's investments in U.S. Treasury obligations and U.S. government agency securities (FFCB, FHLB, FHLMC and FNMA).

#### **7. Event (Unaudited) Subsequent to the Date of the Independent Auditor's Report**

Pursuant to legislation enacted in the summer of 2011 (Assembly Bill No. 26 (2011-2012 1st Executive Session) enacted as Stats. 2011, 1st Executive Session 2011-2012, Chapter 5 (hereafter Assembly Bill X1 26) and upheld by the California Supreme Court on December 29, 2011, in a case captioned *California Redevelopment Association v. Matosantos*, 2011 Cal. LEXIS 11671 (Cal., December 29, 2011), as of February 1, 2012, redevelopment agencies in California, including the Redevelopment Agency of the City of San José (the "Agency"), will be terminated and successor agencies appointed to wind down the affairs of the redevelopment agencies. The City of San José has elected to be appointed as successor agency for purposes of winding down the affairs of the Agency. The financial statements do not include any adjustments as a result of the dissolution of the Agency.

Required Supplementary Information



**City of San José**  
**Required Supplementary Information (Unaudited)**  
**June 30, 2011**

**General Fund**  
**Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual**  
**For the Year Ended June 30, 2011**  
**(\$000's)**

	Budgeted Amounts		Actual Amounts	Actual	Budgetary	Actual
	Original	Final	Variance with Final Budget Over (Under)	Amounts Budgetary Basis	to GAAP Differences	Amounts GAAP Basis
<b>REVENUES</b>						
Taxes:						
Property	\$ 199,052	194,909	(95)	194,814	-	194,814
Sales	127,232	138,756	(786)	137,970	-	137,970
Utility	113,457	108,557	(29)	108,528	-	108,528
State of California in-lieu	6,906	5,129	(240)	4,889	-	4,889
Franchise	43,121	41,556	(283)	41,273	-	41,273
Marijuana	-	1,120	32	1,152	-	1,152
Other	6,684	6,684	538	7,222	-	7,222
Licenses, permits and fines	88,687	91,516	1,955	93,471	-	93,471
Intergovernmental	19,641	28,507	(12,894)	15,613	-	15,613
Charges for current services	30,614	40,851	(7,663)	33,188	-	33,188
Investment income	4,837	3,968	(741)	3,227	391	3,618 (1)
Other revenues	32,519	114,379	(75,220)	39,159	(88)	39,071 (3)
Total revenues	<u>672,750</u>	<u>775,932</u>	<u>(95,426)</u>	<u>680,506</u>	<u>303</u>	<u>680,809</u>
<b>EXPENDITURES</b>						
Current:						
General government	96,929	98,989	(11,924)	87,065	(7,898)	79,167 (2)
Public safety	446,457	451,751	(15,882)	435,869	(3,393)	432,476 (2)
Capital maintenance	66,845	71,002	(15,310)	55,692	(6,067)	49,625 (2)
Community services	123,898	131,568	(8,007)	123,561	(3,526)	120,035 (2)
Sanitation	946	955	(157)	798	(49)	749 (2)
Capital outlay	5,787	2,034	-	2,034	-	2,034 (2)
Debt service:						
Principal	1,038	1,038	-	1,038	-	1,038
Interest	553	553	-	553	-	553
Total expenditures	<u>742,453</u>	<u>757,890</u>	<u>(51,280)</u>	<u>706,610</u>	<u>(20,933)</u>	<u>685,677</u>
Excess (deficiency) of revenues over expenditures	<u>(69,703)</u>	<u>18,042</u>	<u>(44,146)</u>	<u>(26,104)</u>	<u>21,236</u>	<u>(4,868)</u>
<b>OTHER FINANCING SOURCES (USES)</b>						
Proceeds for sale of capital assets	1,800	500	-	504	-	504
Transfers in	22,700	26,050	3,533	29,583	-	29,583
Transfers out	(31,106)	(29,490)	(5)	(29,485)	-	(29,485)
Total other financing sources (uses)	<u>(6,606)</u>	<u>(2,940)</u>	<u>3,528</u>	<u>602</u>	<u>-</u>	<u>602</u>
Net change in fund balances	(76,309)	15,102	(40,618)	(25,502)	21,236	(4,266)
Fund balance - beginning	141,397	141,397	-	141,397	29,490	170,887
Beginning encumbrance	-	-	-	20,635	(20,635)	-
Fund balance - ending	<u>\$ 65,088</u>	<u>156,499</u>	<u>(40,618)</u>	<u>136,530</u>	<u>30,091</u>	<u>166,621</u>

**Explanation of differences:**

- (1) Gain or loss in fair value of investments are not formally budgeted transactions.
- (2) Encumbrances of funds for which formal budget are prepared.
- (3) Loan repayments for which budgets are prepared.

See accompanying notes to the required supplementary information.

(Continued)

**City of San José**  
**Required Supplementary Information (Unaudited)**  
**June 30, 2011**

**Housing Activities**  
**Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual**  
**For the Year Ended June 30, 2011**  
**(\$000's)**

	Budgeted Amounts		Actual Amounts Budgetary Basis Variance with Final Budget Over (Under)	Actual Amounts Budgetary Basis	Budgetary to GAAP Differences	Actual Amounts GAAP Basis
	Original	Final				
<b>REVENUES</b>						
Intergovernmental	\$ 30,179	25,929	(8,716)	17,213	-	17,213
Investment income	9,298	7,524	1,017	8,541	109	8,650 (1)
Other revenues	9,053	11,204	3,156	14,360	(10,254)	4,106 (3)
Total revenues	<u>48,530</u>	<u>44,657</u>	<u>(4,543)</u>	<u>40,114</u>	<u>(10,145)</u>	<u>29,969</u>
<b>EXPENDITURES</b>						
Current:						
Capital maintenance	8	15	(1)	14	-	14
Community services	113,009	103,757	(7,709)	96,048	(53,502)	42,546 (2), (3)
Total expenditures	<u>113,017</u>	<u>103,772</u>	<u>(7,710)</u>	<u>96,062</u>	<u>(53,502)</u>	<u>42,560</u>
Excess (deficiency) of revenues over expenditures	<u>(64,487)</u>	<u>(59,115)</u>	<u>3,167</u>	<u>(55,948)</u>	<u>43,357</u>	<u>(12,591)</u>
<b>OTHER FINANCING SOURCES (USES)</b>						
Transfers in	48,315	36,727	80	36,807	-	36,807
Transfers out	(40,354)	(40,469)	652	(39,817)	12,815	(27,002)
Total other financing sources (uses)	<u>7,961</u>	<u>(3,742)</u>	<u>732</u>	<u>(3,010)</u>	<u>12,815</u>	<u>9,805</u>
Net change in fund balances	(56,526)	(62,857)	3,899	(58,958)	56,172	(2,786)
Fund balance - beginning	8,828	8,828	-	8,828	401,663	410,491
Beginning encumbrance	-	-	-	45,300	(45,300)	-
Fund balance - ending	<u>\$ (47,698)</u>	<u>(54,029)</u>	<u>3,899</u>	<u>(4,830)</u>	<u>412,535</u>	<u>407,705</u>

**Explanation of differences:**

- (1) Gain or loss in fair value of investments are not formally budgeted transactions.
- (2) Encumbrances of funds for which formal budget are prepared.
- (3) Expenditures, present value discount/ allowance, and repayments that increase and decrease certain loan receivables for which formal budgets are prepared.

See accompanying notes to the required supplementary information.

(Continued)

**City of San José**  
**Required Supplementary Information (Unaudited)**  
**June 30, 2011**

**Schedule of Funding Progress**  
**(\$000's)**

**Police and Fire Department Retirement Plan - Defined Benefit Pension Plan**

<b>Actuarial Valuation Date (4)</b>	<b>Actuarial Value of Assets (1)</b>	<b>Actuarial Accrued Liability (AAL) (2)</b>	<b>Unfunded (Overfunded) AAL</b>	<b>Funded Ratio</b>	<b>Annual Covered Payroll (3)</b>	<b>(Overfunded) Unfunded AAL as a Percentage of Covered Payroll</b>
6/30/07	\$ 2,365,790	2,372,386	6,596	100%	227,734	3%
6/30/09	2,569,569	2,963,482	393,913	87%	243,196	162%
6/30/10	2,576,705	3,230,456	653,751	80%	222,699	294%

**Federated City Employees' Retirement System - Defined Benefit Pension Plan**

<b>Actuarial Valuation Date (4)</b>	<b>Actuarial Value of Assets (1)</b>	<b>Actuarial Accrued Liability (AAL) (2)</b>	<b>Unfunded AAL</b>	<b>Funded Ratio</b>	<b>Annual Covered Payroll (3)</b>	<b>Unfunded AAL as a Percentage of Covered Payroll</b>
6/30/07	\$ 1,622,851	1,960,943	338,092	83%	291,405	116%
6/30/09	1,756,588	2,486,155	729,567	71%	308,697	236%
6/30/10	1,729,414	2,510,358	780,944	69%	275,869	283%

- (1) Excludes accounts payable, postemployment healthcare plan assets, supplemental retiree benefit reserve.  
(2) Excludes postemployment healthcare liability.  
(3) Prior to June 30, 2009, annual covered payroll represented the actuarial estimate of annual covered payroll for the subsequent year.  
(4) Actuarial valuations have been performed biennially through June 30, 2009. Effective June 30, 2010, the PFDRP and FCERS transitioned to annual valuations.

**Police and Fire Department Retirement Plan - Postemployment Healthcare Benefit Plan**

<b>Actuarial Valuation Date</b>	<b>Actuarial Value of Assets</b>	<b>Actuarial Accrued Liability (AAL)</b>	<b>Unfunded AAL</b>	<b>Funded Ratio</b>	<b>Annual Covered Payroll</b>	<b>Unfunded AAL as a Percentage of Covered Payroll</b>
6/30/07	\$ 45,393	666,228	620,835	7%	227,734	273%
6/30/09	55,618	761,604	705,986	7%	243,196	290%
6/30/10	58,586	946,308	887,722	6%	222,699	399%

**Federated City Employees' Retirement System - Postemployment Healthcare Benefit Plan**

<b>Actuarial Valuation Date</b>	<b>Actuarial Value of Assets</b>	<b>Actuarial Accrued Liability (AAL)</b>	<b>Unfunded AAL</b>	<b>Funded Ratio</b>	<b>Annual Covered Payroll</b>	<b>Unfunded AAL as a Percentage of Covered Payroll</b>
6/30/07	\$ 96,601	616,749	520,148	16%	271,833	191%
6/30/09	85,564	796,448	710,884	11%	308,697	230%
6/30/10	108,011	926,371	818,360	12%	275,869	297%

(Continued)

**City of San José**  
**Notes to Required Supplementary Information (Unaudited)**  
**June 30, 2011**

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**I. Budgetary Information**

The adopted budget represents the financial and organizational plan by which the policies and programs approved by the City Council will be implemented. It includes: (1) the programs, projects, services and activities to be provided during the fiscal year; (2) estimated revenues available to finance the operating plan; and (3) the estimated spending requirements of the operating plan. The City Charter requires that the City establish a budgetary system for general operations and prohibits expending funds for which there is no legal appropriation.

The annual appropriation ordinance adopts the budget at the appropriation level by expenditure category (personal services, nonpersonal) within departments. Accordingly, the lowest level of budgetary control exercised by the City Council is the appropriation level within a department. The City's legal level of budgetary control is so detailed that it is not practical to demonstrate compliance within the Comprehensive Annual Financial Report itself. As a result, the City prepares a separate report to demonstrate compliance with its legal level of budgetary control.

Annual budgets are prepared for the General Fund and all Special Revenue Funds, except for the Special Assessment Special Services fund and Emergency Reserve fund. Capital project budgets are based on a project time frame rather than a fiscal year time frame. Debt Service Funds appropriations were adopted by the Council when the formal bond resolutions were approved. Therefore, Capital Project Funds and Debt Service Funds are not reported on budgetary basis.

**II. Budgetary Results Reconciled to GAAP**

The budgetary process is based upon accounting for certain transactions on a basis other than the accounting principles generally accepted in the United States ("GAAP") basis. The results of operations are presented in the accompanying budget and actual comparison schedules in accordance with the budgetary process ("budgetary basis") to provide a meaningful comparison with the budget.

The major differences between the budgetary basis actual and GAAP basis are as follows:

- Year-end encumbrances are recognized as the equivalent of expenditures in the budgetary basis financial schedules, while encumbered amounts are not recognized as expenditures on GAAP basis until the equipment, supplies or services are received.
- Certain loan transactions are recognized as expenditures for the budgetary basis but not for the GAAP basis. When these loans are made, they are recorded as receivables on a GAAP basis and as expenditures on a budgetary basis. When loan repayments are received, they are recorded as reductions to receivables on a GAAP basis, but are recognized as revenues on a budgetary basis.
- Net decreases were made to certain GAAP basis loans receivable to reflect carrying amounts at a discounted present value and allowances for bad debts. The discount is treated as an expenditure on a GAAP basis and is not included in the budgetary basis financial schedules. In addition, the allowance for bad debts is not included in the budgetary basis financial schedules, but is an expenditure on a GAAP basis.
- Certain accounts such as the change in fair value of investments included in the City's GAAP basis amounts, for which no formal budgets are prepared, are excluded from the budgetary basis financial schedules.

(Continued)

**City of San José**  
**Notes to Required Supplementary Information (Unaudited)**  
**June 30, 2011**

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- The Community Facility Revenue non-major special revenue fund has been blended to include the financial operations of the Dolce Hayes Mansion. Formal budgets are not prepared for this financial activity and is excluded from the budgetary basis financial schedules.
- Certain line of credit transactions are recognized as expenditures in the budgetary basis financial schedules but are recorded as an asset in the GAAP basis financial statements. When the outside agency draws down on the line of credit, the City records an asset, advances to other agencies, in the GAAP basis financial statements and an expenditure on the budgetary basis financial schedules. When the outside agency pays down the line of credit, the City records a reduction to its assets in the GAAP basis financial statements and revenues on the budgetary basis financial schedules.
- Certain grant revenues received in advance are recognized on the budgetary basis financial schedules, but are deferred and not recognized as revenue on the GAAP basis financial statements. This process normally creates a variance in recognized revenue from the prior year to the current year.

**III. Budget Revisions**

On October 18, 2011, the City Council approved certain fiscal year 2011 budget revisions that increased appropriations for various expenditure categories. The budget amounts presented in the accompanying schedule of revenues, expenditures, and changes in fund balances - budget and actual reflect such budget revisions.

(Concluded)



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**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**

City Council  
City of San José, California

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San José, California (the City) as of and for the year ended June 30, 2011, which collectively comprise the City's basic financial statements, and have issued our report thereon dated November 30, 2011, except for our report on the schedule of expenditures of federal awards, as to which the date is January 31, 2012. Our report contains explanatory paragraphs indicating that the City's adopted the provisions of Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*; about the Redevelopment Agency of the City of San José's (Agency) ability to continue as a going concern as a result of the Agency's financial condition and an uncertainty related to recently passed State legislation that could dissolve redevelopment agencies in the State of California; and about the City's defined benefit pension plans' and postemployment healthcare plans' unfunded actuarially accrued liabilities. 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 City is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying Federal Awards Schedule of Findings and Questioned Costs as items 2011-1 and 2011-2 that we consider to be significant deficiencies in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

### ***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the City'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 of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The City's responses to the findings identified in our audit are described in the accompanying Federal Awards Schedule of Findings and Questioned Costs. We did not audit the City's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the City Council, the City's management, and federal awarding agencies and pass-through entities 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 & Connell LLP*

Walnut Creek, California  
November 30, 2011

**Independent Auditor's Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and the Passenger Facility Charges Program and on Internal Control over Compliance in Accordance with OMB Circular A-133**

City Council  
City of San José, California

**Compliance**

We have audited the City of San José's, California (City), compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* and the *Passenger Facility Charge Audit Guide for Public Agencies* issued by the Federal Aviation Administration (*PFC Guide*) that could have a direct and material effect on each of the City's major federal programs and the passenger facility charges program, respectively, for the year ended June 30, 2011. The City's major federal programs are identified in the summary of auditor's results section of the accompanying Federal Awards Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs and the passenger facility charges program is the responsibility of the City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and the *PFC Guide*. Those standards, OMB Circular A-133 and the *PFC Guide* require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program and the passenger facility charges program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the City's compliance with those requirements.

As described in item 2011-A in the accompanying Federal Awards Schedule of Findings and Questioned Costs, the City did not comply with requirements of the Davis-Bacon Act that are applicable to its Highway Planning and Construction Cluster (CFDA numbers 20.205 and 20.219). Compliance with such requirements is necessary, in our opinion, for the City to comply with requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the City complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs and the passenger facility charges program for the year ended June 30, 2011.

### ***Internal Control Over Compliance***

Management of the City is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs and the passenger facility charges program. In planning and performing our audit, we considered the City's internal control over compliance with the requirements that could have a direct and material effect on a major federal program and the passenger facility charges program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133 and the PFC Guide, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance 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 discussed below, we identified a deficiency in internal control over compliance that we consider to be a material weakness.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program and the passenger facility charges program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program and the passenger facility charges program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency in internal control over compliance described in the accompanying Federal Awards Schedule of Findings and Questioned Costs as item 2011-A to be a material weakness.

The City's responses to the findings identified in our audit are described in the accompanying Federal Awards Schedule of Findings and Questioned Costs. We did not audit the City's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the City Council, the City's management, the Federal Aviation Administration, federal awarding agencies and pass-through entities, 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 & C'Connell LLP*

Walnut Creek, California

January 31, 2012

**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Expenditures of Federal Awards  
Year Ended June 30, 2011

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures	
				Federal Grant	Other
<b>U.S. Department of Commerce</b>					
Direct programs:					
Economic Adjustment Assistance	11.307	07-39-02866	\$ 345,000	\$ 225	\$ -
Economic Adjustment Assistance	11.307	Prior Year Ending Loan Balance	-	404,683	-
Total U.S. Department of Commerce			345,000	404,908	-
<b>U.S. Department of Housing and Urban Development</b>					
Direct programs:					
CDBG - Entitlement Grants Cluster:					
Community Development Block Grants/Entitlement Grants	14.218	B09-10 MC-06-0021	20,964,941	9,324,936	-
Housing and Economic Recovery Act 2008 - Neighborhood Stabilization Program I	14.218	B08-MN-06-0008	7,840,867	3,000,483	-
ARRA - Community Development Block Grant ARRA Entitlement Grants (CDBG-R)	14.253	B09-MY-06-0021	2,700,463	1,567,258	-
Community Development Block Grants/Entitlement Grants	14.218	Prior Year Ending Loan Balance	-	6,693,951	-
Subtotal CDBG - Entitlement Grants Cluster			31,506,271	20,586,628	-
Emergency Shelter Grants Program	14.231	S10 MC-060021	442,295	437,149	-
Home Investment Partnerships Program	14.239	M03-04 MC06215	10,503,406	22,314	-
Home Investment Partnerships Program	14.239	M07-08 MC06215	10,311,927	3,337,898	-
Home Investment Partnerships Program	14.239	M09-10 MC06215	10,055,342	1,442,542	-
Home Investment Partnerships Program	14.239	Prior Year Ending Loan Balance	-	46,272,251	-
Subtotal Home Investment Partnerships Program			30,870,675	51,075,006	-
Housing Opportunities for Persons with AIDS	14.241	CA-H08-F0-04	765,180	20,535	-
Housing Opportunities for Persons with AIDS	14.241	CA-H107-0003	1,226,500	7,940	-
Housing Opportunities for Persons with AIDS	14.241	CA-H09-F0-04	796,679	142,179	-
Housing Opportunities for Persons with AIDS	14.241	CA-H10-0004	1,262,800	372,423	-
Housing Opportunities for Persons with AIDS	14.241	CA-H0-10-F0-04	871,489	725,009	-
Subtotal Housing Opportunities for Persons with AIDS			4,922,648	1,268,086	-
ARRA - Homelessness Prevention and Rapid Re-Housing Program	14.257	B-09-MY-06-0021	4,128,763	2,461,166	-
Pass-through County of Santa Clara:					
ARRA - Neighborhood Stabilization Program II	14.256	B-09-CN-CA-0054	19,139,324	6,790,669	-
Total U.S. Department of Housing and Urban Development			91,009,976	82,618,704	-
<b>U.S. Department of Interior</b>					
Direct program:					
ARRA - Water Reclamation and Reuse Program	15.504	R10AC20R43	6,335,000	4,086,087	5,211,487

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges

**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Expenditures of Federal Awards (Continued)  
Year Ended June 30, 2011

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures	
				Federal Grant	Other
<b>U.S. Department of Justice</b>					
Direct programs:					
Equitable Sharing for State and Local Law Enforcement Agencies	16.000	CA0431300	-	34,103	-
Missing Children's Assistance	16.543	2008-MC-CX-K002	1,342,837	476,243	-
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	2008-JL-FX-0161	469,494	170,933	-
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	2008-VT-BX-0005	300,000	103,216	-
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	2009-D1-BX-0108	250,000	147,631	-
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	2010-VT-BX-0010	170,000	89,676	-
Subtotal Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program			<u>1,189,494</u>	<u>511,456</u>	<u>-</u>
Community Capacity Development Office	16.595	2009-WS-QX-0052	142,000	109,767	70,003
Bulletproof Vest Partnership Program	16.607	2009 1121-0235	47,939	47,939	-
Public Safety Partnership and Community Policing Grants	16.710	2009CSWX0023	447,773	208,858	-
Public Safety Partnership and Community Policing Grants	16.710	2009CKWX0131	695,000	436,067	-
Public Safety Partnership and Community Policing Grants	16.710	2010CKWX0395	710,000	393,200	-
Subtotal Public Safety Partnership and Community Policing Grants			<u>1,852,773</u>	<u>1,038,125</u>	<u>-</u>
ARRA - Internet Crimes against Children Task Force Program (ICAC)	16.800	2009-SN-B9-K017	863,930	179,282	-
Edward Byrne Memorial Justice Assistance Grant (JAG) Program Cluster:					
Direct programs:					
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2007-DJ-BX-0531	307,625	31,872	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2008-DJ-BX-0220	101,075	62,209	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2009-DJ-BX-0349	370,994	64,904	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2010-DJ-BX-0821	320,059	8,261	-
ARRA - Edward Byrne Memorial Justice Assistance Grant (JAG) Program/ Grants to Units of Local Government	16.804	2009-SB-B9-0976	1,378,612	1,372,405	-
Subtotal JAG Program Cluster Direct programs			<u>2,478,365</u>	<u>1,539,651</u>	<u>-</u>
Pass-through County of Santa Clara:					
Edward Byrne Memorial Justice Assistance Grant Program	16.738	DC10 21 0430	132,416	130,222	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	ZA09 01 0430	116,801	53,587	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	ZA09 01 0430	19,593	5,450	-
Subtotal pass-through County of Santa Clara			<u>268,810</u>	<u>189,259</u>	<u>-</u>
Pass-through California Emergency Management Agency:					
ARRA - Edward Byrne Memorial Justice Assistance Grant (JAG) Program/ Grants to Units of Local Government	16.804	ZH09017928	375,000	75,656	-
Subtotal JAG Program Cluster			<u>3,122,175</u>	<u>1,804,566</u>	<u>-</u>
Total U.S. Department of Justice			<u>8,561,148</u>	<u>4,201,481</u>	<u>70,003</u>

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges

**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Expenditures of Federal Awards (Continued)  
Year Ended June 30, 2011

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures	
				Federal Grant	Other
<b>U.S. Department of Labor</b>					
Direct programs:					
WIA Pilots, Demonstrations, and Research Projects	17.261	EA-20121-10-60-A-6	95,000	37,739	-
WIA Pilots, Demonstrations, and Research Projects	17.261	EA-18597-09-60-A-6	315,392	28,306	-
Subtotal WIA Pilots, Demonstrations, and Research Projects			410,392	66,045	-
Pass-through State of California, Employment Development Department:					
ARRA - Employment Service/Wagner-Peyser Funded Activities	17.207	K078494144 & 145	99,072	58,411	-
Workforce Investment Act (WIA) Cluster:					
WIA Adult 2 Program	17.258	K074173202	3,034,237	1,779,893	-
WIA Adult 2 Program	17.258	K178692201	561,390	561,390	-
WIA Adult 2 Program	17.258	K178692202	2,672,927	1,583,194	-
WIA 15% LLL CB	17.258	R970569441	15,500	11,686	-
WIA 15% Incentive Performance	17.258	K074173113	24,637	24,637	-
WIA RR AA II 25%	17.258	K074173523 PSC	975,000	177,192	-
ARRA - WIA Adult Program	17.258	R970569102	2,026,103	172,646	-
ARRA - WIA Adult Program	17.258	R970569104	466,785	466,785	-
ARRA - 15%	17.258	K074173153	30,874	30,874	-
Subtotal - WIA Adult Program			9,807,453	4,808,297	-
WIA Youth Activities	17.259	K074173301	3,851,009	1,518,939	-
WIA Youth Activities	17.259	K178692301	3,449,393	1,737,377	-
ARRA - WIA Youth Activities	17.259	R970569103	4,744,413	520,072	-
Subtotal - WIA Youth Activities			12,044,815	3,776,388	-
WIA DLW2	17.260	K178692501	964,451	964,451	-
WIA DLW2	17.260	K074173502	3,048,277	738,677	-
WIA DLW2	17.260	K178692502	2,651,228	1,397,325	-
NUMMI Bridge	17.260	K074173308	970,000	720,605	-
NUMMI NEG	17.260	K074173768	2,006,901	1,532,917	-
ARRA - Dislocated Workers	17.260	R970569105	3,981,615	1,143,682	-
ARRA - RR 25%	17.260	K074173108	902,329	655,434	-
ARRA - RR FM	17.260	R970569106	638,390	267,304	-
ARRA - OJT	17.260	K074173775	725,462	89,482	-
Subtotal - WIA Dislocated Workers			15,888,653	7,509,877	-
WIA RR	17.278	K178692540	134,573	134,573	-
WIA RR 2	17.278	K178692541	403,718	165,691	-
Subtotal - WIA Dislocated Worker Formula Grants			538,291	300,264	-
Subtotal WIA Cluster pass-through State of California			38,279,212	16,394,826	-
Pass-through City of Sunnyvale, NOVA:					
WIA Adult Program	17.258	N/A	100,000	57,559	-
Subtotal WIA Cluster			38,379,212	16,452,385	-
Total U.S. Department of Labor			38,888,676	16,576,841	-

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges



**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Expenditures of Federal Awards (Continued)  
Year Ended June 30, 2011

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures	
				Federal Grant	Other
<b>U.S. Department of Transportation</b>					
Direct programs:					
Federal Aviation Administration:					
Airport Improvement Program	20.106	3-06-0226-73	4,628,099	1,075,898	259,128
Airport Improvement Program	20.106	3-06-0226-76	4,055,182	69,647	16,774
Airport Improvement Program	20.106	3-06-0226-77	2,000,000	19,525	4,703
Airport Improvement Program	20.106	3-06-0226-78	6,657,708	6,657,708	1,055,526
Airport Improvement Program	20.106	3-06-0226-79	2,245,529	1,287,133	310,004
ARRA - Airport Improvement Program	20.106	3-06-0226-75	5,178,291	50,548	-
Subtotal Airport Improvement Program			24,764,809	9,160,459	1,646,135
Pass-through California Department of Transportation:					
Highway Planning and Construction Cluster:					
Highway Planning and Construction:					
TiMC (HPP 2017) \$5.4M					
SVSC ITS Enhancement	20.205	HPP2017	5,400,000	357,109	89,277
Safe Routes to School (SRTS)	20.205	ITS99-5005(058)	1,187,204	1,224,194	306,049
Minidoka Avenue Sidewalk Improvement	20.205	SRTSL-5005(091)	770,366	56,197	13,301
TEA-21-ITS: New CC TMC (Web II)	20.205	SRTSL-5005(097)	746,000	40,000	10,296
Federal Street Maintenance	20.205	ITS03-5005(073)	579,123	47,490	85,364
E. Santa Clara Street Bridge at Coyote Creek	20.205	SCL 050028	16,300,666	35,313	-
Street Resurfacing and Rehabilitation	20.205	BRLZ-5005(089)	50,000	6,501	842
ARRA- Resurfacing Project	20.205	04-SCL-0-SJS	7,297,000	43,514	42,118
Subtotal Highway Planning and Construction		ESPL-5005(096)	15,414,200	7,110,533	-
			47,744,559	8,920,851	547,247
Recreational Trails Program:					
SAFETEA-LU Trail: Bay Reach 7/9 (aka Reach 9B)	20.219	SCL 050082 HPLUL-5005(086)	675,000	21,942	5,486
SAFETEA-LU Trail: Coyote Creek (237 to Story Road)	20.219	SCL 050083 HPLUL-5005(087)	1,317,999	147,874	36,969
SAFETEA-LU Trail: Almaden Express Pedestrian Bridge	20.219	SCL 050089 DEMO05-5005(088)	496,000	91,138	155
Subtotal Recreational Trails Program			2,488,999	260,954	42,610
Subtotal pass-through California Department of Transportation					
			50,233,558	9,181,805	589,857
Pass-through Metropolitan Transportation Commission:					
Highway Planning and Construction:					
Housing Incentive Program - SJSU to Japantown Ped Corridor	20.205	CML-5005(093)	1,554,500	142,000	35,253
Pass-through Valley Transportation Authority:					
Highway Planning and Construction:					
Community Design and Transportation	20.205	CML-5005(094)	1,300,000	39,000	5,888
Recreational Trails Program:					
CMAQ Trail: Lower Guadalupe River (Gold Street - 880)	20.219	SCL 050081 VTP 2030-30-B3 #B31	1,377,000	70,914	17,562
Subtotal Highway Planning and Construction Cluster			54,465,058	9,433,719	648,560

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges

**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Expenditures of Federal Awards (Continued)  
Year Ended June 30, 2011

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures	
				Federal Grant	Other
<b>U.S. Department of Transportation (continued)</b>					
Pass-through California Office of Traffic Safety:					
State and Community Highway Safety					
2009-2010 Sobriety Checkpoint Mini-Grant	20.600	SC10372	146,937	37,156	-
2009-2010 Click it or Ticket Grant	20.600	CT-10372	28,559	1,507	-
2010-2011 Click it or Ticket Grant	20.600	CT-11372	21,432	20,086	-
Avoid the 13	20.600	AL0980	139,316	52,769	-
DUI E&A Grant	20.600	AL1116	382,259	245,724	-
Subtotal State and Community Highway Safety			718,504	357,242	-
Total U.S. Department of Transportation			79,948,371	18,951,420	2,294,695
<b>National Endowment for the Humanities</b>					
Pass-through California State Library:					
Grants to States Programs:					
Staff Education 2010-11	45.310	40-7672	18,928	14,832	-
San Jose Historeality	45.310	40-7611	49,875	17,213	-
Work Wise - Component for Tutors	45.310	40-7612	83,816	62,286	-
Total National Endowment for the Humanities			152,619	94,331	-
<b>U.S. Small Business Administration</b>					
Direct program:					
Silicon Valley Small Business Assistance Portal	59.000	SBAHQ-09-I-0217	245,643	131,473	-
<b>U.S. Environmental Protection Agency</b>					
Direct program:					
Congressionally Mandated Projects	66.202	XP-96942501-0	673,000	190,025	-
<b>U.S. Department of Energy</b>					
Direct programs:					
ARRA - Renewable Energy Research and Development	81.087	DE-EE0002075	1,301,636	661,010	420,658
ARRA - Energy Efficiency and Renewable Energy Information Dissemination, Outreach, Training and Technical Analysis/Assistance	81.117	DE-FC36-08GO18099	200,000	52,876	-
ARRA - Electricity Delivery and Energy Reliability, Research, Development and Analysis	81.122	OE0000388	299,983	109,879	-
Energy Efficiency and Conservation Block Grants (EECBG)					
ARRA - Energy Efficiency and Conservation Block Grants Program	81.128	DE-EE0000881	8,840,600	2,382,140	-
Pass-through Association of Bay Area Governments					
ARRA - Retrofit California Program	81.128	DE-EE0003562	750,000	168,211	-
Subtotal Energy Efficiency and Conservation Block Grants			9,590,600	2,550,351	-
Total U.S. Department of Energy			11,392,219	3,374,116	420,658
<b>U.S. Department of Education</b>					
Direct program:					
Fund for the Improvement of Education	84.215	U215K080308	277,074	77,298	-

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges

**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Expenditures of Federal Awards (Continued)  
Year Ended June 30, 2011

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures	
				Federal Grant	Other
<b>U.S. Department of Health and Human Services</b>					
Direct program:					
Smart Start Quality Improvement	93.647	90XP0429/01	300,000	79,485	-
Pass-through from County of Santa Clara:					
ARRA - Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program	93.714	N/A	2,458,225	1,147,255	-
Pass-through from Council on Aging Silicon Valley: Nutrition Services Incentive Program	93.053	Contract 1200	48,000	24,410	-
Total U.S. Department of Health and Human Services			2,806,225	1,251,150	-
<b>Corporation for National and Community Services</b>					
Direct programs:					
Retired and Senior Volunteer Program	94.002	09SRPCA014	185,812	76,909	185,347
Senior Companion Program	94.016	09SCPCA007	257,986	129,953	175,323
Total Corporation for National and Community Services			443,798	206,862	360,670
<b>U.S. Department of Homeland Security</b>					
Direct programs:					
Airport Checked Baggage Screening Program	97.100	HSTS04-08-H-CT1234	20,660,000	759,690	69,364
ARRA - TSA Airport Checked Baggage Inspection System Program	97.117	HSTS04-09H-REC161	20,916,360	907,323	100,801
Pass-through the County of Santa Clara:					
FY 10 Emergency Management Performance Grants	97.042	2010-0044 FIPSOES 085-00000	153,193	133,193	-
Pass-through the Bay Area UASI					
Homeland Security Cluster:					
FY 08 Urban Areas Security Initiative	97.067	2008-0006 FIPS 075-95017	1,433,385	88,049	-
FY 09 Urban Areas Security Initiative	97.067	2009-0019 FIPS 075-95017	2,306,143	998,747	-
FY 08 Urban Areas Security Initiative (SUASI)	97.067	N/A	1,472,972	24,272	-
FY 09 Urban Area Security Grant (SUASI)	97.067	N/A	1,529,850	961,387	-
Subtotal pass-through the Bay Area UASI			6,742,350	2,072,455	-
Pass-through the County of Santa Clara:					
Homeland Security Cluster:					
Homeland Security Grant Program	97.067	N/A	426,227	56,407	-
FY09 Metropolitan Medical Response System	97.067	2009-0019 FIPS 085-00000	321,221	642	-
FY08 Metropolitan Medical Response System	97.067	2008-0006 FIPS 085-00000	321,221	262,077	-
FY08 State Homeland Security Grant Program (SHSP)	97.067	N/A	290,821	79,427	-
FY09 State Homeland Security Grant Program (SHSP)	97.067	N/A	170,000	169,129	-
Subtotal pass-through the County of Santa Clara			1,529,490	567,682	-
Subtotal Homeland Security Cluster			8,271,840	2,640,137	-
Total U.S. Department of Homeland Security			50,001,393	4,440,343	170,165
Total Federal Awards			\$ 291,080,142	\$ 136,605,039	\$ 8,527,678

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges

**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Revenues and Expenditures of Passenger Facility Charges  
Year Ended June 30, 2011

Passenger Facility Charges Project Number/Description	Identifying Number	Passenger Facility Charges Project Amount	Expenditures	Revenue Recognized
<b>Total Passenger Facility Charges Collection Revenues</b>				
Passenger Facility Charges Collections				\$ 17,310,768
Interest Earned on PFC Program				312,123
<b>Passenger Facility Charges Projects</b>				
#1	Communication Center Upgrade	\$ 528,691	\$ -	-
#2	Fire Truck Replacement	599,826	-	-
#3	Handlift Replacement	103,000	-	-
#4	Noise Attenuation	47,792,121	-	-
#5	Noise Monitoring System Upgrade	184,000	-	-
#6	Noise Remedy/Land Acquisition	5,133,000	-	-
#7	Security Access Control System	1,032,000	-	-
#40a	Runway 12R/30L Reconstruction	72,022,700	3,168,512	-
#40b	Runway 12R/30L Extension	38,671,724	1,433,956	-
#52	Taxiway Z - Apron Reconstruction ( Phase II)	825,000	-	-
#53	Terminal C Fire Protection	580,000	-	-
#54	Fiber Optic Cable to ARC & Fire Station 29	87,345	-	-
#55	Green Island Bridge	825,000	-	-
#56	Replacement of AACS and CCTV	4,418,645	-	-
#57	Skyport Grade Separation	18,218,154	-	-
#58	Terminal Drive Improvements	1,146,165	-	-
#59	Replacement of PASSUR	221,000	-	-
#60	Terminal C Restroom	2,485,000	-	-
#61	Interim Air Cargo Ramp Extension	1,100,000	-	-
#62	Runway 30R/12L Reconstruction	84,105,103	3,393,872	-
#63	Noise Attenuation Category II & III	4,500,000	-	-
#64	Taxiway Y Extension	12,890,000	374,000	-
#65	Extended Noise Attenuation	61,589,000	-	-
#67	Terminal B - North Concourse	495,095,000	12,032,000	-
#68	Terminal B Extension, Phase I	110,159,000	986,000	-
#69	Roadway Improvements: Grade Separations	10,244,000	-	-
Total Passenger Facility Charges Projects		<u>\$ 974,555,474</u>	<u>\$ 21,388,340</u>	<u>\$ 17,622,891</u>

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges

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## CITY OF SAN JOSE, CALIFORNIA

### Notes to the Schedule of Expenditures of Federal Awards and Schedule of Revenues and Expenditures of Passenger Facility Charges

Year Ended June 30, 2011

#### **(1) GENERAL**

The accompanying Schedule of Expenditures of Federal Awards (SEFA) presents the activity of the federal award programs of the City of San José, California (the City). The City's reporting entity is defined in Note I to its basic financial statements. The SEFA includes all federal awards received directly from federal agencies and federal awards passed-through other governmental agencies. In addition, the SEFA includes local, state and other expenditures matched along with the federal award expenditures.

The Schedule of Revenues and Expenditures of Passenger Facility Charges (PFCs) presents only the activity of the passenger facility charges program of the Norman Y. Mineta San José International Airport (Airport), an enterprise fund of the City. PFCs are fees imposed on enplaned passengers by the Airport for the purpose of generating revenue for Airport projects that increase capacity, increase safety, mitigate noise impact and enhance competition between and among air carriers in accordance with Federal Aviation Administration (FAA) approvals.

#### **(2) BASIS OF PRESENTATION**

The accompanying schedules are presented using the modified accrual basis of accounting for program expenditures accounted for in the governmental funds and the accrual basis of accounting for program expenditures accounted for in the proprietary funds as described in Note I to the City's basic financial statements, with the exception of the City's loan programs (see Note 7). For reimbursable grants, except for the San José Water Reclamation & Reuse Program as discussed in Note 8, which revenues are recognized upon Congressional appropriations, the City recognizes revenues commencing on the date of grant approval (provided all eligibility requirements are met) since this is when the City is eligible to claim expenditures for reimbursements. As a result, prior year expenditures are included in the current year SEFA because these expenditures only become eligible when the grant was approved. Pass-through entity identifying numbers are presented where available.

#### **(3) RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS**

Expenditures of federal awards are reported in the City's basic financial statements as expenditures in the general, special revenue and capital projects funds and as expenses for non-capital expenditures and as additions to capital assets for capital related expenditures in the enterprise funds. Federal award expenditures agree or can be reconciled with the amounts reported in the City's basic financial statements.

#### **(4) RELATIONSHIP TO FEDERAL FINANCIAL REPORTS**

Amounts reported in the SEFA and Schedule of Revenues and Expenditures of Passenger Facility Charges agree to or can be reconciled with the amounts reported in the related federal financial reports.

#### **(5) AIRPORT EXPENDITURES**

The FAA reimburses the Airport for approximately 80% of allowable Airport Improvement Program (AIP) grant expenditures, except for the American Recovery and Reinvestment Act (ARRA) funded grant expenditures, which reimburses 100% of the Airport's allowable costs. Total allowable AIP expenditures are presented in the accompanying SEFA.

## CITY OF SAN JOSE, CALIFORNIA

### Notes to the Schedule of Expenditures of Federal Awards and Schedule of Revenues and Expenditures of Passenger Facility Charges (Continued)

Year Ended June 30, 2011

#### (5) AIRPORT EXPENDITURES (Continued)

The accompanying Schedule of Revenues and Expenditures of Passenger Facility Charges includes 100% of expenditures reimbursed by PFC revenue for PFC approved projects.

#### (6) AMOUNTS PROVIDED TO SUBRECIPIENTS

Included in the total expenditures of federal awards are the following amounts passed through to subrecipients:

<u>Program Title</u>	<u>Federal Catalog Number</u>	<u>Provided to Subrecipients</u>
Community Development Block Grants/Entitlement Grants	14.218	\$3,583,730
ARRA - Community Development Block Grants/Entitlement Grants	14.218	136,348
Emergency Shelter Grants Program	14.231	411,951
Home Investment Partnerships Program	14.239	620,712
Housing Opportunities for Persons with AIDS	14.241	1,218,963
ARRA - Homeless Prevention and Rapid Re-Housing Program	14.257	2,369,674
Workforce Investment Act (WIA) Adult Program	17.258	957,587
Workforce Investment Act (WIA) Youth Activities	17.259	999,587
Workforce Investment Act (WIA) Dislocated Workers	17.260	1,253,806
ARRA - Workforce Investment Act (WIA) Adult Program	17.258	287,929
ARRA - Workforce Investment Act (WIA) Dislocated Workers	17.260	694,598

#### (7) LOANS OUTSTANDING

The City participates in certain federal award programs that sponsor revolving loan programs, which are administered by the City. These programs maintain servicing and trust arrangements with the City to collect loan repayments. The funds are returned to the programs upon repayment of the principal and interest. The federal government has imposed certain continuing compliance requirements with respect to the loans under the Community Development Block Grants/Entitlement Grants (CDBG), the HOME Investment Partnerships Program (HOME), and Economic Adjustment Assistance program. In accordance with Subpart B, Section 205 of the Office of Management and Budget Circular A-133, the City has reported the outstanding balance of loans from previous years that have continuing compliance requirements as of June 30, 2011, along with the value of total outstanding and new loans made during the current year in the SEFA.

**CITY OF SAN JOSE, CALIFORNIA**

Notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges (Continued)

Year Ended June 30, 2011

**(7) LOANS OUTSTANDING (Continued)**

The following is a summary of the loan programs maintained by the City and their balances at June 30, 2011:

<u>Program Title</u>	<u>CFDA Number</u>	<u>Amount Outstanding</u>	<u>Prior year loans with continuing compliance requirements</u>	<u>New loans</u>
Economic Adjustment Assistance	11.307	\$ 404,683	\$ 404,683	\$ -
Community Development Block Grants/Entitlement Grants	14.218	7,252,784	6,693,951	558,833
HOME Investment Partnerships Program	14.239	49,552,857	46,272,251	3,280,606
		<u>\$ 57,210,324</u>	<u>\$ 53,370,885</u>	<u>\$ 3,839,439</u>

**(8) SAN JOSE AREA WATER RECLAMATION AND REUSE PROGRAM**

The San José Area Water Reclamation and Reuse Program, now known as South Bay Water Recycling (SBWR), assists the City and tributary agencies of the San José-Santa Clara Water Pollution Control Plant in protecting endangered species habitats, achieving federally mandated water quality standards and reducing reliance on area surface, ground water, and imported water supplies. The U.S. Department of Interior – Bureau of Reclamation awarded the City \$32.5 million in federal fiscal year 1995 and approved an increase of \$2.5 million in federal fiscal year 2000. Funding for subsequent years, for a total of \$35 million in Phase 1A funding for the South Bay Water Recycling Program, is contingent upon subsequent Congressional appropriations acts. As a result of the timing of the subsequent funding approvals, the City requests reimbursements for costs incurred in prior fiscal years.

As of September 30, 2010, Congress appropriated \$31,650,300 towards the Phase 1A obligation. In addition, on April 30, 2010, the U.S. Department of Interior – Bureau of Reclamation awarded the City \$6.31 million from the American Recovery and Reinvestment Act of 2009 (ARRA) towards the \$14.78 million Phase 1C program, of which \$3.35 million was allocated in lieu of reimbursement for Phase 1A, essentially completing the federal obligation for that phase for the program. This additional grant increased the federal share of Phase 1C from 25% to 44% of the project cost. During fiscal year 2011, the program incurred expenditures of \$4,086,087.

Furthermore, in June 2010 the Council authorized the City Manager to enter into a third agreement with the Bureau of Reclamation to fund 25% of the \$82.85 million SBWR Phase 1B project, or \$20.7 million. The first part of this Agreement R10AP20057 is expected to be executed by November 30, 2010 and the City received initial reimbursement of \$1,011,000 in fiscal year 2011 for expenditures reported and incurred in prior years.



**CITY OF SAN JOSE, CALIFORNIA**

Notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges (Continued)

Year Ended June 30, 2011

**(9) PROGRAM TOTALS**

The SEFA does not summarize all programs that receive funding from various funding sources or grants by Catalog of Federal Domestic Assistance (CFDA) number. The following table summarizes these programs by CFDA numbers.

CFDA Number - Program Title Grant Identifying Number or Pass-through Grantor	Federal Expenditures
WIA Cluster:	
CFDA No. 17.258 - WIA Adult Program	
Pass-through State of California Employment Development Department	\$ 4,808,297
Pass-through City of Sunnyvale, NOVA	<u>57,559</u>
CFDA No. 17.258 - WIA Adult Program	<u>\$ 4,865,856</u>
Highway Planning and Construction Cluster:	
CFDA No. 20.205 - Highway Planning and Construction	
Pass-through California Department of Transportation	\$ 8,920,851
Pass-through Valley Transportation Authority	39,000
Pass-through Metropolitan Transportation Commission	<u>142,000</u>
CFDA No. 20.205 - Highway Planning and Construction	<u>9,101,851</u>
CFDA No. 20.219 - Recreational Trails Program	
Pass-through California Department of Transportation	260,954
Pass-through Valley Transportation Authority	<u>70,914</u>
CFDA No. 20.219 - Recreational Trails Program	<u>331,868</u>
Total Highway Planning and Construction Cluster	<u>\$ 9,433,719</u>

**CITY OF SAN JOSE, CALIFORNIA**

Notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges (Continued)

Year Ended June 30, 2011

**(10) INTERNET CRIMES AGAINST CHILDREN (ICAC) STATE GRANT**

The following schedule represents expenditures for the Internet Crimes Against Children Task Force Program from the U.S. Department of Justice and the State of California Governor's Office of Emergency Service (OES) for the year ended June 30, 2011. This information is included in the City's Single Audit Report at the request of OES.

Program Title and Expenditure Category	Grant Number Grant Period	Cumulative Expense through June 30, 2010	Actual 7/1/10-6/30/11		Cumulative Expense through June 30, 2011	Revenue
			Non-match	Match		
Internet Crimes Against Children						
Task Force Program (Federal)	2008 MC CX K002					
Personnel Services	7/1/08 - 6/30/2012	\$ 207,941	\$ 185,780	\$ -	\$ 393,721	\$ 385,600
Operating Expenses		306,262	246,449	-	552,711	550,235
Equipment		138,143	44,014	-	182,157	182,157
Total		<u>\$ 652,346</u>	<u>\$ 476,243</u> <sup>1</sup>	<u>\$ -</u>	<u>\$ 1,128,589</u>	<u>\$ 1,117,992</u>
Internet Crimes Against Children						
Task Force Program (State)	IC07017928					
Personnel Services	1/1/2008-6/30/2011	\$ -	\$ -	\$ -	\$ -	\$ -
Operating Expenses		296,189	(12,274) <sup>2</sup>	-	283,917	283,917
Equipment		133,365	82,718	-	216,083	216,083
Total		<u>\$ 429,554</u>	<u>\$ 70,444</u>	<u>\$ -</u>	<u>\$ 500,000</u>	<u>\$ 500,000</u>
Internet Crimes Against Children						
Task Force Program (State)	IC10027928					
Personnel Services	7/1/2010-6/30/2011	\$ -	\$ 125,000	\$ -	\$ 125,000	\$ 125,000
Operating Expenses		-	-	-	-	-
Equipment		-	-	-	-	-
Total		<u>\$ -</u>	<u>\$ 125,000</u>	<u>\$ -</u>	<u>\$ 125,000</u>	<u>\$ 125,000</u>

1 Amount is reported as federal expenditures in the SEFA under CFDA number 16.543 for the Missing Children's Assistance Grant from the U.S. Department of Justice.

2 Negative amounts shown represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years.

**CITY OF SAN JOSE, CALIFORNIA**

Federal Awards Schedule of Findings and Questioned Costs

Year Ended June 30, 2011

**Section I Summary of Auditor's Results**

*Financial Statements*

Type of auditor's report issued on the basic financial statements of the City: Unqualified

Internal control over financial reporting:

- ◆ Material weakness (es) identified? No
- ◆ Significant deficiencies identified that are not considered to be material weaknesses? Yes

Noncompliance material to the financial statements noted? No

*Federal Awards*

Internal control over major programs:

- ◆ Material weakness (es) identified? Yes
- ◆ Significant deficiencies identified that are not considered to be material weaknesses? None reported.

Type of auditor's report issued on compliance for major programs: Unqualified, except for the Highway Planning and Construction Cluster (CFDA # 20.205 and 20.219) which is qualified.

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? Yes

Identification of major programs:

Federal Domestic Catalog Number(s)	Name of Federal Program or Cluster
14.218, 14.253	CDBG - Entitlement Grants Cluster
14.256	ARRA - Neighborhood Stabilization Program II
15.504	Water Reclamation and Reuse Program
17.258, 17.259, 17.260, 17.278	WIA Cluster
20.205, 20.219	Highway Planning and Construction Cluster
81.128	ARRA – Energy Efficiency and Conservation Block Grants
93.714	ARRA – Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program

Dollar threshold used to distinguish between type A and type B programs: \$3,000,000

Auditee qualified as a low-risk auditee? Yes

## CITY OF SAN JOSE, CALIFORNIA

### Federal Awards Schedule of Findings and Questioned Costs

Year Ended June 30, 2011

#### Section II Financial Statement Findings

##### Item #2011-1 – Risk Assessment of Internal Controls

Internal control is an integral process that is affected by the City's governing body, management and personnel and is designed to address risks and to provide reasonable assurance that in pursuit of the organization's goals, the following general objectives are being achieved:

- Executing orderly, ethical, economical, efficient and effective operations;
- Fulfilling accountability obligations;
- Complying with applicable laws and regulations; and
- Safeguarding resources against loss, misuse and damage.

Internal controls should be continuously monitored in order to adapt to the City's recent organizational changes, changes in its operating environment and reduced resources available for internal controls. The City has been going through a profound change especially in the number of personnel and the experience level of its finance and accounting personnel since the end of fiscal year 2009. For example, in fiscal year 2010, the Finance Department underwent a reorganization when the two remaining Deputy Director positions were eliminated and replaced with an Assistant Director and four Division Managers (Accounting, Treasury, Revenue Management, and Purchasing). In addition, one Principal Accountant position was eliminated, one Supervising Accountant position was relocated from the Revenue Management Division to the Accounting Division, and one Senior Accountant position became vacant due to a resignation. During the course of our audit work for fiscal year 2011, the Assistant Director of Finance was appointed Acting Director of Finance with the retirement of the former Director in September 2011, the Finance Treasury Division Manager was appointed Acting Assistant Director of Finance, a Principal Accountant in the Revenue Management Division was appointed the Acting Accounting Division Manager when the previous incumbent resigned in October 2011, one Supervising Accounting position was deleted and reallocated to a Senior Accountant, one vacant Senior Accountant position was filled through the bumping process from another City department and one Accountant position was eliminated. These staffing challenges are factors in errors and delays in the City's year-end financial reporting process including:

- Delays in the evaluation and review of the impact to the financial report resulting from the implementation of Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.
- Errors in the evaluation of the collectability of receivable balances to properly exclude revenue recognition totaling \$5.1 million that fell outside the City's 60-day availability revenue recognition policy.
- Errors in accounts payable year-end cut-off totaling \$4.5 million.
- Lack of documentation related to the tasks and responsibilities of individuals who are no longer at the City.
- Delays in the review of the Airport's statement of cash flows.

In general, we observed that staff is facing additional pressures to maintain service levels with fewer resources and the City has not adequately assessed the necessary changes in processes to mitigate risk associated with reduced resources in the City's financial reporting and accounting processes. With these organizational changes, the City should update its documentation, test its internal controls, assess the

## CITY OF SAN JOSE, CALIFORNIA

### Federal Awards Schedule of Findings and Questioned Costs

Year Ended June 30, 2011

#### **Item #2011-1 – Risk Assessment of Internal Controls (continued)**

magnitude of any deficiencies identified and develop a work plan to re-structure the organization to ensure that its internal controls are adequate for its changed environment and reduced workforce.

#### *Management Response*

Management agrees opportunities exist for improvement in the identification of the potential effects on the City's internal control structure with position eliminations and changes in personnel, especially those impacting the preparation of Fiscal Year 2010 Comprehensive Annual Financial Review ("CAFR"). However, Management believes the City made appropriate assessments in relation to the Fiscal Year 2011 Comprehensive Annual Financial Report (CAFR) preparation. For example, upon the Director of Finance's departure in September 2011, the Assistant Director of Finance was appointed to the Acting Director position. This appointment established a continuity of management with a seasoned veteran of the Finance Department who played a vital role in the fiscal year 2010 CAFR. Concurrently, the Finance Treasury Division Manager was appointed the Acting Assistant Director bringing his technical expertise to the fiscal year 2011 CAFR in the areas of treasury and debt management, pension plan disclosure and his previous experience in the preparation of the Fiscal Year 2010 CAFR. Upon the Accounting Division Manager's resignation in October 2011 after only six months of employment with the City, a Principal Accountant from the Revenue Management Division was appointed the Acting Accounting Division Manager. This individual brought eight years of prior work experience in the Accounting Division in which he played a key and vital role in preparation of prior CAFRs and provided organizational stability to the Accounting Division.

Finance staff shares the concern of the impact that a lack of formalized roles and responsibilities in City departments may have on the quality and timeliness of financial reporting. The decentralization of finance functions to other City departments has made each department responsible for establishing and maintaining roles and responsibilities to assure a seamless transition when positions become vacant and then subsequently filled. This, however, may lead to inconsistencies in how roles and responsibilities are established and maintained within departments and with the Finance Department. The Finance Department will engage City departments in conversation regarding the need to, and the importance of, establishing and maintaining roles and responsibilities to assure consistency in financial reporting. It should be noted that the ability to implement solutions may be impacted by current staffing levels in all City departments.

As the City begins planning for the preparation of the Fiscal Year 2012 CAFR, the Finance Department is making a concerted effort to assemble the strongest team possible within the staffing constraints of the Department. This effort will involve more closely aligning staff skills with job duties and responsibilities. The Finance Department remains challenged by recent departures of long-tenured, highly knowledgeable staff and resource reductions over the last several fiscal years. Additionally, the Finance Department is working on evaluating the tools available to assist the Accounting staff in performing the necessary research and analysis of accounting rules and regulations. The Department has initially identified the need to acquire and implement electronic governmental accounting research tools as a way to enhance staff's knowledge and efficiency. These tools should be in place by the end of fiscal year 2012.

## CITY OF SAN JOSE, CALIFORNIA

### Federal Awards Schedule of Findings and Questioned Costs

Year Ended June 30, 2011

#### **Item #2011-2 – Airport Cost Allocation Plan**

It is the City's policy to identify and allocate appropriate General Fund and certain other central service program costs that indirectly benefit the Airport Department. The Finance Department develops an Airport Cost Allocation Plan (ACAP) using actual allowable costs from the prior two fiscal years. In addition, allocations of these allowable costs are based on various nonfinancial factors, such as number of purchase orders processed and number of full-time equivalents (FTE) budgeted.

During our audit, we noted that the fiscal year 2011 ACAP used a factor of 400 FTEs. However, the Airport had approximately 206 FTEs at June 30, 2011. Unlike expenditures the City does not adjust nonfinancial factors used in its allocation such as FTEs to actual results. As such, the Airport may be burdened with a disproportionate share of overhead costs when they experience dramatic changes in FTEs and other nonfinancial measurements.

We recommend the City develop a more equitable cost allocation methodology that measures and allocates the relative benefit of administrative efforts received by the Airport during a given fiscal year.

#### *Management Response:*

Management recognizes that there will be a difference between budgeted and actual data. As such, the City strives to use actual data whenever it's available. With the exception of the number of FTEs, the ACAP uses all actual financial and nonfinancial data. Because the ACAP is developed a year prior, the City does not have the actual number of FTEs available to use. The number of budgeted FTEs is the best set of information available to use for the ACAP at the time the plan is developed. The City believes that as the number of FTEs decreases for a department, the overall Citywide FTEs count would also decrease, and that it would have a minimal impact to the allocation basis.

Additionally, management reevaluated the impact of the difference in the number of FTEs, and noted the change in the FTE allocation number did not result in any change to the ending percentage in the ACAP. However, management will continue to monitor the changes in FTE count to determine its effect on the ACAP.

## CITY OF SAN JOSE, CALIFORNIA

### Federal Awards Schedule of Findings and Questioned Costs

Year Ended June 30, 2011

#### Section III Federal Award Findings and Questioned Costs

##### Finding #2011-A Highway Planning and Construction Cluster – Davis-Bacon Act

###### **Program Identification:**

Awarding Agency: United States Department of Transportation  
Passed Through: California Department of Transportation  
Program Name: Highway Planning and Construction Cluster  
CFDA: 20.205 and 20.219  
Award Number: ESPL-5005(096) (ARRA), ITS99-5005(058), and CML 5005(093)  
Award Year: 2009, 2006, and 2009, respectively

###### **Criteria**

The Davis-Bacon Act requires the payment of prevailing wage rates to all laborers and mechanics performing on-site work on federally funded construction contracts in excess of \$2,000. All contractors must submit weekly certified payroll reports accompanied by a Statement of Compliance. The City is responsible for ensuring compliance with Davis-Bacon Act requirements. In the event that the contractor does not provide the required certified payrolls by the due date, the City should initiate timely corrective actions to ensure compliance, such as sending timely follow-up requests to the prime contractor and withholding payment until the certified payrolls are received.

###### **Condition**

During our audit of the City's compliance with the Davis-Bacon Act for the Highway Planning and Construction (HPC) Cluster, we tested 25 pay period samples from a population of 144 construction pay periods for the HPC Cluster. Our testing showed that the Office of Equality Assurance (OEA) did not perform timely follow-up of overdue certified payroll reports with the prime contractors for 8 of the 25 samples selected. Of the 8 samples selected, OEA had not received the required certified payroll reports prior to the City's project managers' instruction to disburse of funds to the prime contractors for 7 of the 25 samples selected (resulting in questioned costs). The 7 samples were subcontractors, which were paid by the prime contractors for services rendered. The City pays the prime contractors for both the prime contractors' and subcontractors' work performed.

###### **Effect**

The City's Office of Equality Assurance, who is responsible for labor compliance with the Davis-Bacon Act, did not consistently verify the laborers and mechanics employed by the contractors and subcontractors were paid prevailing wage rates before payment was released to the contractors. There is a risk that federal funds may be paid to contractors who do not comply with the Davis-Bacon Act requirements, resulting in unallowable costs. In addition, releasing payments before certified payroll compliance is verified could place the City's federal grant reimbursements at risk.

###### **Questioned Costs**

The questioned costs totaled \$333,892, which are related to the SVSC ITS Enhancement non-ARRA grant (grant number ITS99-5005(058)). This was computed by adding the contractors disbursements to subcontractors during the months certified payrolls were not submitted.

**CITY OF SAN JOSE, CALIFORNIA**

Federal Awards Schedule of Findings and Questioned Costs

Year Ended June 30, 2011

**Finding #2011-A Highway Planning and Construction Cluster – Davis-Bacon Act (continued)**

***Recommendation***

Due to the City's budget constraints and a limited number of employees at the Office of Equality Assurance, the City may not have sufficient resources to perform the necessary follow-ups after the 15 day time period in instances of non-compliance. We recommend the City evaluate the effectiveness of its current internal control policies in light of its current resource constraints. In addition, we recommend that the City establish internal control policies over withholding payment until the certified payrolls are received.

***Management Response***

The City agrees with this recommendation. Office of Equality Assurance staff will formalize internal control policies and procedures over withholding payment until the certified payrolls are received. Office of Equality Assurance staff will coordinate with project management staff in affected departments to ensure awareness of the policies, and understanding of staff's roles and responsibilities.



**CITY OF SAN JOSE, CALIFORNIA**

Passenger Facility Charges Schedule of Findings and Questioned Costs

Year Ended June 30, 2011

**Section I Summary of Auditor's Results**

*Financial Statements*

Type of auditor's report issued on the basic financial statements of the City: Unqualified

Internal control over financial reporting:

- ◆ Material weakness (es) identified? No
- ◆ Significant deficiencies identified that are not considered to be material weaknesses? Yes

Noncompliance material to the financial statements noted? No

*Passenger Facility Charges*

Internal control over Passenger Facility Charges:

- ◆ Material weakness (es) identified? No
- ◆ Significant deficiencies identified that are not considered to be material weaknesses? None reported.

Type of auditor's report issued on compliance for the Passenger Facility Charges program: Unqualified

**Section II Financial Statement Findings**

See Section II of Federal Awards and Questioned Costs.

**Section III Passenger Facility Charges Findings and Questioned Costs**

None reported.

**CITY OF SAN JOSE, CALIFORNIA**

Summary Schedule of Prior Audit Findings

Year Ended June 30, 2011

There were no audit findings nor questioned costs for the year ended June 30, 2010.