CITY OF SAN JOSE, CALIFORNIA

Single Audit Reports

Basic Financial Statements with
Federal and Airport Compliance Sections

For the Year Ended June 30, 2012

MGO Certified Public Accountants.

CITY OF SAN JOSE, CALIFORNIA

For the Year Ended June 30, 2012

Table of Contents

CITY OF SAN JOSE, CALIFORNIA

For the Year Ended June 30, 2012

Table of Contents (Continued)

MGO Certified Public Accountants.

Walnut Creek
2121 N. California Blvd., Suite 750
Walnut Creek, CA 94596
925.274.0190

Sacramento

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

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

As discussed in Note IV.C.3. to the basic financial statements, on June 8, 2012, Moody's Investors Service downgraded the former Redevelopment Agency of the City of San José's Senior Obligations Rating to below "Baa1", which triggered a Special Termination Event under the Continuing Covenant Agreement of its 2010 C Housing Set-Aside Tax Allocation Bonds (Bonds). The Bonds have an outstanding balance at June 30, 2012 of $88.6 million and are reported as a current liability. For the period commencing on August 15, 2012 and ended on November 15, 2012, the bank agreed to forebear from exercising its rights and remedies under the bond documents in respect to the existing default. Negotiations are presently underway to extend the forbearance agreement. The City cannot predict the outcome of the negotiations.

As discussed in Note IV.D.3 to the basic financial statements, in connection with the Redevelopment Dissolution Law, the County of Santa Clara's Auditor-Controller issued its Agreed-Upon Procedures Report on October 5, 2012, which identified three separate issues questioning a total of $203.0 million of assets held by the City and a component unit, which are currently in dispute by the City and the Successor Agency to the Redevelopment Agency of the City of San José. The City has requested meet and confer meetings with the State Department of Finance and is in the process of other administrative procedures to resolve these issues. Due to uncertainties with the Redevelopment Dissolution Law, the ultimate outcome of these issues cannot presently be determined, accordingly, no provision for any liability that may result has been recorded in the financial statements. It is reasonably possible that a determination may be made at a later date by an appropriate State or judicial authority that would resolve this matter unfavorably to the City.

As discussed in Note IV.A.1.4. to the basic financial statements, based on the most recent actuarial valuations as of June 30, 2011, the Police and Fire Department Retirement Plan's and the Federated City Employees' Retirement System's independent actuaries determined that, at June 30, 2011, the value of the defined benefit pensions plans' actuarial accrued liability exceeded the actuarial value of their assets by $510.3 million and $981.6 million, respectively. Also, as described in Note IV.A.2.4., based on the most recent actuarial valuations as of June 30, 2011, the Police and Fire Department Retirement Plan's and the Federated City Employees' Retirement System's independent actuaries determined that, at June 30, 2011, the value of the postemployment healthcare plans' actuarial accrued liability exceeded the actuarial value of their assets by $943.1 million and $1,009.9 million, respectively.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 19, 2012 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, Housing Activities Fund and the Affordable Housing Investment 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 basic financial statements. The accompanying schedule of expenditures of federal awards, schedule of revenues and expenditures of passenger facility charges, and schedule of revenues and expenditures of customer 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,* the *Passenger Facility Charge Audit Guide for Public Agencies*, and the *California Civil Code Section 1936, as amended by SB 1192,* respectively, and are not a required part of the basic 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 basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Macias Gini & O'Connell LLP

Walnut Creek, California

November 19, 2012, except for our report on the schedule of expenditures of federal awards,
schedule of passenger facility charge revenues and expenditures and
schedule of customer facility charge revenues and expenditures,
as to which the date is February 7, 2013

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, 2012. 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, 2012, total assets exceed total liabilities by $7.410 billion. Of this amount, $131.7 million represents unrestricted net assets, which is comprised of a deficit balance of $197.3 million for governmental activities, and a positive balance of $329.0 million for business-type activities. In addition, the City's restricted net assets total $1.068 billion ($939.5 million for governmental activities and $128.4 million for business-type activities) and are dedicated to specific purposes. Lastly, net assets of $6.210 billion are invested in capital assets, net of related debt ($5.351 billion for governmental activities and $859.4 million for business-type activities).

- Total net assets increased by $1.761 billion or 31.2 percent during 2011-2012 from $5.648 billion to $7.410 billion. The majority of the increase was primarily due to the extraordinary gain on the dissolution of the former Redevelopment Agency ("Agency") of $2.062 billion resulting from the transfer of liabilities in excess of its assets to the Successor Agency to the Redevelopment Agency of the City of San José ("SARA"), a private-purpose trust fund reported in the financial statements of the City. Excluding the extraordinary gain, net assets decreased by $300.6 million.

- In accordance with the decision of the California Supreme Court on December 29, 2011, all redevelopment agencies in the State of California were dissolved and ceased to operate as a legal entity as of February 1, 2012. Prior to that date, the final seven months of activity of the former Agency was reported in the governmental funds and governmental activities of the City. After the date of dissolution, the assets, liabilities, and activities of the former Agency were reported in SARA. The dissolution of all redevelopment agencies in the State of California qualifies as an extraordinary item since this state-wide dissolution was both unusual in nature and infrequent in occurrence. Accordingly, the movement of the liabilities in excess of its assets of the former Agency as of February 1, 2012 from governmental funds of the City to SARA was recorded as an extraordinary gain in the governmental fund financial statements ($70.5 million) and in the government-wide financial statements ($2.104 billion). In connection with the dissolution, the City also incurred extraordinary losses that offset some of this gain including the transfers-out of Housing Activities Fund's cash to pay SARA's enforceable obligations ($6.9 million) and the invalidation of loans and interest between the former Agency and the City ($35.3 million). The receipt of these liabilities in excess of assets as of February 1, 2012 was reported in the SARA trust fund as an extraordinary loss ($2.062 billion). A reconciliation of the difference between the extraordinary gain in the governmental fund financial statements and the government-wide financial statements is shown on page 53 under Note I.F.16.

- Governmental funds reported a combined ending fund balance of $1.186 billion at June 30, 2012, which is $62.3 million or 5.0 percent less than the June 30, 2011 balance. The decrease was attributable to the dissolution of the former Agency ($60.6 million) and a decrease in the fund balance for Housing Activities ($363.0 million), and Special Assessment Districts ($26.2 million). These decreases were partially offset by increases in fund balance including the General Fund ($16.4 million), Affordable Housing Investment Fund ($355.1 million), and other nonmajor funds ($16.5 million).

- Unassigned fund balance totals $49.2 million, which is 4.1 percent of combined governmental fund balances at June 30, 2012.

- Total long-term obligations decreased by $1.821 billion to $3.493 billion at June 30, 2012, which represents a decrease of 34.3 percent compared to $5.315 billion at June 30, 2011. The primary factor leading to this decrease was the $2.313 billion transfer of former Agency debt to SARA. This decrease was partially offset by the issuances of the Norman Y. Mineta San José International Airport ("Airport") Revenue Bonds in the amount of $508.6 million to refund certain variable rate commercial paper notes (a current obligation) ($354.3 million) and to refund existing revenue bonds totaling ($92.2 million).

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.

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 the primary government of the City, the former Agency for a seven-month period, and four separate components 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, former Redevelopment Agency, Housing Activities, Affordable Housing Investment, 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 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.

The City accounts 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 data 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, Housing Activities Fund, and the Affordable Housing Investment 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.

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, 2012, the City's total assets exceed total liabilities by $7.410 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, 2012 and 2011
(in thousands)

	Governmental Activities		Business-type Activities		Totals	
	FY 2012	FY 2011	FY 2012	FY 2011	FY 2012	FY 2011
Assets:						
Current and other assets…….. $	1,616,435	1,646,164	786,254	745,374	2,402,689	2,391,538
Capital assets…………………	6,597,594	7,090,733	2,158,564	2,206,930	8,756,158	9,297,663
Total assets………………	8,214,029	8,736,897	2,944,818	2,952,304	11,158,847	11,689,201
Liabilities:						
Current and other liabilities…..	154,890	259,550	101,211	466,655	256,101	726,205
Long-term liabilities……………	1,966,262	4,173,724	1,526,807	1,140,808	3,493,069	5,314,532
Total liabilities…………….	2,121,152	4,433,274	1,628,018	1,607,463	3,749,170	6,040,737
Net assets:						
Invested in capital assets, net of related debt…………	5,350,666	3,810,801	859,392	889,674	6,210,058	4,700,475
Restricted net assets………..	939,509	622,241	128,361	122,534	1,067,870	744,775
Unrestricted net assets………	(197,298)	(129,419)	329,047	332,633	131,749	203,214
Total net assets………… $	6,092,877	4,303,623	1,316,800	1,344,841	7,409,677	5,648,464

At June 30, 2012, 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 $6.210 billion comprise 83.8 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. During 2011-2012, net assets invested in capital assets, net of related debt for governmental activities increased by $1.510 billion primarily due to the net effect of transfers of the former Agency's capital related long-term debt ($1.945 billion) and capital assets ($180.4 million) to SARA.

A portion of the City's net assets, $1.068 billion or 14.4 percent are subject to legal restrictions on their use, including $939.5 million in governmental activities and $128.4 million in business-type activities. During 2011-2012, restricted net assets increased by $323.1 million primarily due to the transfer of the former Agency's Housing Tax Allocation Bonds ($329.0 million) to SARA. Of the total net assets, $131.7 million or 1.8 percent represents unrestricted net assets, which comprises a deficit balance of $197.3 million for governmental activities, and a positive balance of $329.0 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 2011-2012, the City's total net assets increased by $1.761 billion or 31.2 percent. The increase in total net assets is primarily attributed to an extraordinary gain of $2.062 billion resulting from the transfer of liabilities in excess of assets to SARA. Excluding the extraordinary gain, total net assets decreased by $300.6 million, or $81.4 million lower than the decrease of $382.0 million experienced in 2010-2011. Expenses decreased by $104.6 million from the prior fiscal year.

Notable changes in the statement of net assets between June 30, 2012 and June 30, 2011 include:

- Capital assets decreased by $541.5 million or 5.8 percent compared to the prior fiscal year. Governmental capital assets decreased by $493.1 million and business-type capital assets decreased by $48.4 million. The decrease in governmental capital assets resulted from transfers of the former Agency's capital assets to SARA totaling $180.4 million, and depreciation expense of $362.7 million for major infrastructure and other assets. The decrease in governmental capital assets was slightly offset by additions (net) to capital assets of $58.8 million. The decrease in business-type capital assets was primarily due to depreciation expense of $81.3 million but was offset by additional projects at the Wastewater ($13.8 million) and at the Airport ($16.5 million). Projects completed as of June 30, 2012 include the Terminal Equity Improvement, Terminal B Phase I project, airport signage, surface parking, South Loop parking, and airfield improvements.

- Current and other assets increased by $11.2 million or 0.5 percent due to an increase of $40.9 million for business-type activities, which was partially offset by a decrease of $29.7 million for governmental activities. The increase in current assets for business-type activities is due to the net proceeds of $43.9 million from the issuance of revenue bonds to refund existing bonds and certain commercial paper notes for Airport capital projects. The decrease in governmental activities is primarily the result of a decrease in cash balances of governmental activities due to the payment of pension contributions during the year.

- Long-term liabilities decreased by a net amount of $1.821 billion or 34.3 percent. The net decrease was primarily the result of the transfer of the former Agency's long-term debt ($2.313 billion) to SARA. The decrease was partially offset by the issuance of 2011 Airport revenue bonds ($508.6 million) to refund various short-term commercial paper notes ($354.3 million) and revenue bonds ($92.2 million). In addition, the Airport used $21.9 million of the proceeds to pay down various revenue bonds.

- Current and other liabilities for the City decreased by $470.1 million or 64.7 percent due to a decrease of $104.7 million for governmental activities and a decrease of $365.4 million for business-type activities. The decrease for governmental activities is primarily due to short-term liabilities previously recorded by the former Agency ($138.9 million) that are now recorded in the SARA financial statements. The decrease for business-type activities is primarily the result of a $7.9 million pay down of commercial paper notes payable and the refunding of $354.2 million of short-term commercial paper notes payable with long-term bonds for the Airport.

Unrestricted net assets for governmental activities decreased by $67.9 million or 52.4 percent resulting in a deficit balance of $197.3 million at year-end. A significant part of the 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 net other post employment benefits obligation (NOPEBO) and reducing net assets by an additional $68.1 million. At June 30, 2012, the City's NOPEBO balance for governmental activities is $292.2 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, 2012 and 2011
(in thousands)

	Governmental Activities		Business-type Activities		Totals	
	FY 2012	FY 2011	FY 2012	FY 2011	FY 2012	FY 2011
Revenues:						
Program revenues:						
Fees, fines, and charges for services…………..	$ 340,932	316,858	362,623	349,167	703,555	666,025
Operating grants and contributions……………..	123,829	100,045	670	701	124,499	100,746
Capital grants and contributions………………….	22,749	33,041	10,899	19,413	33,648	52,454
General revenues:						
Property taxes……………………………………..	404,877	481,145	-	-	404,877	481,145
Utility taxes…………………………………………..	110,912	108,528	-	-	110,912	108,528
Franchise fees……………………………………..	41,709	41,273	-	-	41,709	41,273
Transient occupancy taxes……………………….	22,451	18,102	-	-	22,451	18,102
Sales taxes shared revenue………………………	154,026	137,970	-	-	154,026	137,970
State of California in-lieu………………………….	2,611	4,889	-	-	2,611	4,889
Business taxes……………………………………	41,134	37,963	-	-	41,134	37,963
Unrestricted interest and investment earnings…..	6,950	8,142	3,562	3,886	10,512	12,028
Other revenue………………………………………	21,207	33,237	-	-	21,207	33,237
Total revenues…………………………………..	1,293,387	1,321,193	377,754	373,167	1,671,141	1,694,360
Expenses:						
General government………………………………..	111,996	148,515	-	-	111,996	148,515
Public safety……………………………………….	490,442	487,659	-	-	490,442	487,659
Community services……………………………….	247,518	254,481	-	-	247,518	254,481
Sanitation……………………………………………	135,543	129,138	-	-	135,543	129,138
Capital maintenance……………………………….	473,674	515,909	-	-	473,674	515,909
Interest and fiscal charges………………………..	123,696	163,280	-	-	123,696	163,280
Norman Y. Mineta San José International Airport……………………………………………	-	-	200,380	195,867	200,380	195,867
Wastewater Treatment System……………………	-	-	149,980	147,283	149,980	147,283
Municipal Water System…………………………..	-	-	29,260	24,600	29,260	24,600
Parking System……………………………………..	-	-	9,290	9,630	9,290	9,630
Total expenses………………………………….	1,582,869	1,698,982	388,910	377,380	1,971,779	2,076,362
Deficiency before transfers and extraordinary items	(289,482)	(377,789)	(11,156)	(4,213)	(300,638)	(382,002)
Transfers………………………………………..	3,357	5,303	(3,357)	(5,303)	-	-
Extraordinary gain (loss) on dissolution of the former Redevelopment Agency…………….	2,075,379	-	(13,528)	-	2,061,851	-
Change in net assets…………………………..	1,789,254	(372,486)	(28,041)	(9,516)	1,761,213	(382,002)
Net assets at beginning of year	4,303,623	4,676,109	1,344,841	1,354,357	5,648,464	6,030,466
Net assets at end of year………………………….	$ 6,092,877	4,303,623	1,316,800	1,344,841	7,409,677	5,648,464

Governmental activities: Net assets for governmental activities increased by $1.789 billion or 41.6 percent during 2011-2012 from $4.304 billion to $6.093 billion. Total expenses decreased by $116.1 million whereas total revenues decreased by $27.8 million. Although the year over year decrease in expenses was larger compared to the year over year decrease in revenues, expenses continue to exceed revenues resulting in a decrease in net assets before transfers and extraordinary items. Significant elements of the decrease in net assets before transfers and extraordinary items for governmental activities from June 30, 2011 to June 30, 2012 are as follows:

- Contributing factors resulting in increases to certain revenue categories are as follows; Transient occupancy tax receipts from guests staying in the City's local hotels increased by $4.3 million or 24.0 percent. For the fourteen largest hotels in the City, the average room rate increased from $117 to $129 and the occupancy rate rose from 58.5 percent to 61.6 percent during the year indicating signs of economic recovery. Operating grants and contributions increased by $23.8 million or 23.8 percent primarily due to additional Federal and State grants received for public safety ($10.3 million), neighborhood stabilization program ($12.2 million), HOME grants ($3.5 million), and Mobilehome Seismic Retrofit ($5.6 million). Sales tax revenue increased by $16.1 million or 11.6 percent indicating a modest improvement in consumer spending. Business tax revenues improved by $3.2 million or 8.4 percent. Fees, fines, and charges for services increased by $24.1 million or 7.6 percent primarily due to higher developer revenues for in-lieu fees, and fee increases charged by the City for services such as building permits. Utility taxes increased by $2.4 million or 2.2 percent due to higher utility charges.

- Contributing factors resulting in decreases to certain revenue categories are as follows: State of California in lieu decreased by $2.3 million or 46.6 percent due to a re-categorization of aircraft property tax revenue, which was formerly included as aircraft in-lieu tax in the revenue from the State of California category, is now included in the property tax category. Capital grants and contributions decreased by $10.3 million or 31.1 percent primarily due to a decrease of $7.5 million in dedication of capital assets from developers. Property tax revenues decreased by $76.3 million or 15.9 percent due to the redistribution of the June 2012 former Agency's property tax revenues in the amount of $82.2 million into the SARA private-purpose trust fund.

- Interest and investment income showed a decrease of $1.2 million or 14.6 percent from the prior year due to a decrease in the fair value of investments. In addition, lower cash balances combined with lower interest yields contributed to the decrease. The increase in pre-payment of the City's contribution to its two retirement plans in July 2011, along with expenses continuing to outpace revenues, caused lower cash balances. In addition, the annualized investment interest yield for the City's investment pool declined from 0.7 percent as of June 30, 2011 to 0.6 percent as of June 30, 2012, reflecting the continued lower interest rate environment experienced in the capital markets.

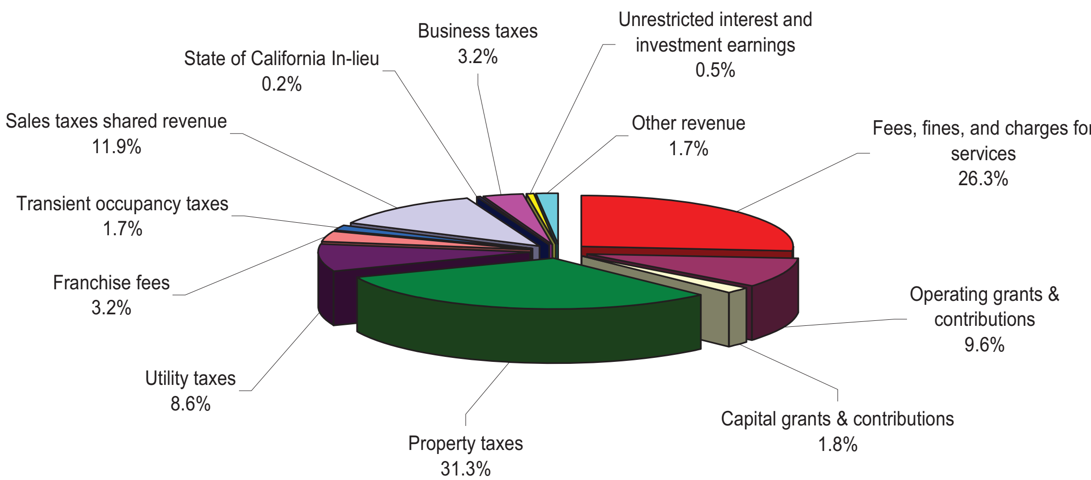
- General government expenses decreased by $36.5 million or 24.6 percent during 2011-2012 primarily due to a decrease in expenses recorded by the former Agency ($13.3 million) during the last seven months of its existence. The decrease in general government expenses ($7.3 million) attributable to the General Fund is explained in more detail in the governmental fund section later in this document.

- Public safety expenses increased by $2.8 million during 2011-2012 due to increases in pension and healthcare rates.

- Community services expenses decreased by $7.0 million or 2.7 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 increased by $6.4 million or 5.0 percent primarily due to an increase in costs for the commercial solid waste recycling program.
- Capital maintenance decreased by $42.2 million or 8.2 percent primarily due to reductions in capital maintenance spending programs.
- Interest and fiscal charges decreased by $39.6 million or 24.2 percent primarily due to obligations of the former Agency that are now reported under the SARA private-purpose trust fund.

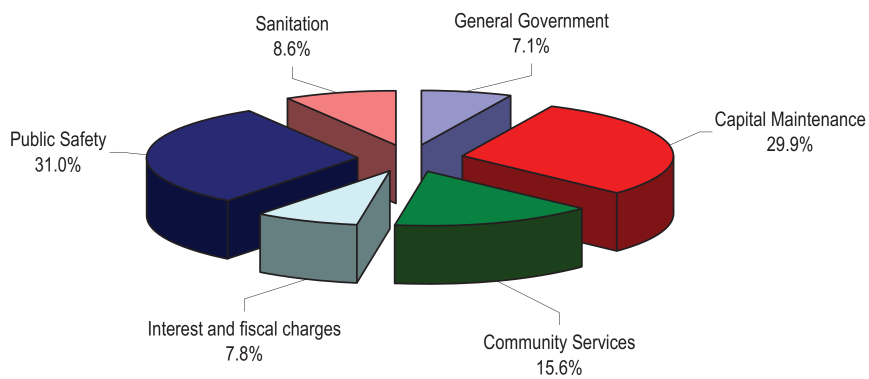
Governmental Activities Revenues 2012



The chart above shows the primary components of governmental activities revenue sources for 2011-2012. Of the $1.293 billion in total revenues generated by governmental activities, 79.1 percent is attributable to four categories: property taxes (31.3 percent), fees, fines, and charges for services (26.3 percent), sales taxes (11.9 percent), and operating grants and contributions (9.6 percent). Except for property taxes, which were down by $76.3 million compared to the previous year attributable to the dissolution of the former Agency, sales taxes, utility taxes, and revenues for fees, fines and charges for services increased slightly over the prior year.

The chart below shows the principal categories of 2011-2012 expenses for governmental activities. Of the $1.583 billion in total expenses incurred by governmental activities, the categories accounting for 76.5 percent of the total are: public safety (31.0 percent); capital maintenance (29.9 percent); and community services (15.6 percent).

Governmental Activities Expenses 2012



<u>Business-type activities:</u> Business-type activities net assets decreased by $28.0 million or 2.1 percent to $1.317 billion during 2011-2012.

The notable components of net assets for business-type activities during 2011-2012 are:

- Airport net assets decreased by $35.5 million or 8.5 percent. The Airport had an operating income of $6.2 million, an increase of $19.8 million or 145.3 percent compared to the prior year loss of $13.6 million. Operating revenues increased by $9.3 million or 7.3 percent despite the decline in major airport traffic activities. Revenue increases were experienced in terminal rentals, parking and roadway, Customer Facility Charges and fuel handling fees. These increases were offset by decreases in landing fees, terminal buildings and concessions, airfield, and general aviation and other revenues. Operating expenses of $130.9 million were $10.5 million or 7.4 percent lower compared to 2010-2011, highlighted by decreases in expenses associated with terminal building and concessions ($9.4 million) and general and administrative ($0.8 million) due to outsourcing of custodial services and the reduction in building maintenance staff. Nonoperating expenses exceeded nonoperating revenues by $49.0 million, which represented an increase of $14.9 million from 2010-2011. This increase in nonoperating expenses was mainly due to the expensing of interest costs in 2011-2012 for construction projects substantially completed in the prior fiscal year.

- Wastewater Treatment System net assets increased by $20.4 million or 2.7 percent from $757.0 million to $777.4 million. Operating revenues were flat at $167.7 million when compared to operating revenues for the previous year. Although sewer service charges increased by $3.6 million due to a 3.0 percent sewer rate increase effective July 1, 2011, and increases were experienced in sewer connection fees ($1.0 million) and recycled water sales and other miscellaneous revenues ($1.1 million), these increases in revenues were offset by a $5.7 million decrease in contribution from the City of Santa Clara and other participating agencies to the Treatment Plant's costs. Total operating expenses increased by $2.6 million or 1.8 percent primarily due to a $2.1 million increase in other postemployment benefits costs, and a $0.5 million increase in various project costs incurred to rehabilitate the aging treatment plant and sewer collection system. Net nonoperating expenses increased by $0.9 million mainly due to decreases in the fair value of investments. Capital grants and contributions decreased by $5.0 million primarily due to a $3.4 million reduction in grants received from the U.S. Bureau of Reclamation for construction of wastewater recycling facilities and recycled water projects. In addition, there were reduction in reimbursements from the California Department of Transportation ($1.2 million) and capital dedications from developers ($0.7 million) as projects were substantially completed.

- Municipal Water System net assets decreased by $1.0 million or 1.2 percent from $84.1 million to $83.1 million. Operating revenues of $28.5 million increased by $2.5 million or 9.7 percent, which includes a 3.8 percent rate increase effective July 1, 2011. Operating expenses of $29.3 million increased by $4.7 million or 19.0 percent mainly due to higher wholesale prices of water.

- Parking System net assets decreased by $11.9 million or 13.7 percent from $87.1 million to $75.1 million primarily due to a $13.5 million extraordinary loss from the dissolution of the former Agency. As mentioned in the financial highlights above, pursuant to AB X1 26, all prior loans made between the City and the former Agency, except for loans made from the Affordable Housing Investment Fund for payment of Supplemental Education Revenue Augmentation Fund ("SERAF"), were invalidated on February 1, 2012. As such, the Parking System loans to the former Agency totaling $13.5 million were written off and reported as an extraordinary loss to the fund. Operating revenues increased by $2.0 million or 21.4 percent primarily due to more activity at the parking facilities resulting from an improving economy. Operating expenses decreased by $0.3 million or 3.5 percent reflecting reductions to operations and maintenance costs. Net nonoperating revenues were flat when compared to the previous year.

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, 2012, the City's governmental funds reported combined fund balances of $1.186 billion, a decrease of $62.3 million or 5.0 percent compared to the balance at June 30, 2011. The governmental fund balances are categorized as nonspendable, restricted, committed, assigned, or unassigned.

- $20.5 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;
- $921.6 million 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;
- $91.9 million is reported as committed fund balance that had been limited by formal Council action to specific purposes.
- $102.9 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.
- $49.2 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 funds totaled approximately $1.777 billion in 2011-2012, an increase of $72.6 million or 4.3 percent from 2010-2011 primarily due to increases in transfers-in ($269.5 million). The increase was partially offset by the absence of long-term debt issuance ($162.0 million) in the current year.

General Fund: The General Fund is the chief operating fund of the City. At June 30, 2012, the General Fund's available (unassigned) fund balance is $49.4 million or 27.0 percent of the $183.0 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, 2012, available fund balance represents 7.3 percent of total General Fund expenditures of $673.0 million, while total fund balance represents 27.2 percent of total General Fund expenditures. This measure of financial health shows a modest improvement from the prior fiscal year. At June 30, 2011, the same measures were 6.5 percent and 24.3 percent, respectively.

For the first time in five years, revenues exceeded expenditures resulting in an excess of $48.9 million in 2011-2012. The excess was generated through a combination of slightly stronger revenues and continued implementation of cost reduction measures including deep service reductions and eliminations, reduction in employee total compensation, and service delivery changes.

In 2011-2012, General Fund revenues of $721.9 million were $41.1 million or 6.0 percent higher than 2010-2011 revenues of $680.8 million. Taxes and special assessments revenues increased by $65.2 million or 13.2 percent. The increase was attributed to the following: reclassification of business taxes to business tax category ($37.4 million), increases in sales tax ($16.1 million), property tax ($4.5 million), marijuana business tax ($2.5 million), utility tax ($2.4 million), transient occupancy tax revenues ($1.8 million), and electric franchise fees ($0.4 million).

License, permits and fines decreased by $31.3 million or 33.5 percent primarily due to a reclassification of $37.4 million formerly in this category to the business taxes category to conform to budgetary practices but was offset by an increase of $6.1 million in revenues from various permits. Intergovernmental revenues rose by $9.1 million due to a new SAFER grant ($4.6 million), 2010 COPS Hiring Program ($2.1 million), 2009 Assistance Firefighters Grant ($1.7 million), and 2009 UASI grant ($1.2 million). Charges for services increased by $2.2 million due to increases in departmental charges from Public Works for services related to engineering, grinding, and utility excavations, and from Parks, Recreation and Neighborhood fees ($0.8 million). Investment income showed a gain of $1.1 million over the prior year mainly due to an increase in fair value of investments. Other revenue decreased by $5.2 million due to the nonrecurring termination of the Airport West Option Payment ($2.0 million) received in the prior year and decreases in other miscellaneous revenues.

2011-2012 General Fund expenditures of $673.0 million were $12.7 million or 1.9 percent lower than 2010-2011 expenditures of $685.7 million. General government expenditures decreased by $7.3 million primarily due to a lower sick leave payout ($8.3 million) but were partially offset by an increase in expenditures resulting from the transfer of the Public Works Real Estate Services Unit to the Office of Economic Development ($1.7 million).

Public safety expenditures increased by $11.9 million due primarily to the reduction in cost reimbursement through overhead allocation resulting from salary and position reductions ($9.2 million) and expenditures related to the Fire Self-contained Breathing Apparatus program.

Community services expenditures decreased by $6.0 million due to substantial staffing and service cuts in libraries and reduced expenditures for park enhancement and other community support programs. Sanitation expenditures slightly increased by $0.1 million due to additional costs for commercial solid waste programs. Infrastructure and fixed asset capital outlay expenditures increased by $1.6 million due to costs associated with additional fire equipment.

Capital maintenance expenditures decreased by $13.0 million or 26.1 percent primarily due to reductions in staffing and compensation of personnel in Public Works, the transfer of the real estate division of Public Works to the Office of Economic Development, and reduction in custodial services costs.

Redevelopment Agency fund: As mentioned under the Financial Highlights section of this MD&A, the California Supreme Court upheld AB X1 26 and dissolved all redevelopment agencies in the State of California effective February 1, 2012. As such, for 2011-2012, only seven months of revenues and expenditures of the former Agency were reported in the governmental funds. The remaining five month period (February 1 through June 30) of financial activity of the former Agency was reported in a private purpose trust fund under SARA.

Housing Activities fund: The Housing Activities fund accounts for the City's commitment to providing affordable housing activities. 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. At June 30, 2012, the fund's loan receivable balance (net), which represents loans to developers of various affordable housing projects and first time homebuyers was $61.1 million. This balance includes loans to developers for various projects, including Taylor Oaks Apartments, Northrup, Roundtable, Kings Crossing, Peacock Commons, Archer Studios, Canoas, Terrace, Curtner Gardens, Homesafe, Markham Plaza, Plaza Del Sol, Verandas, and Willow Glen Senior Housing. 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.

Prior to the dissolution of the former Agency, the Housing Activities fund was a special revenue fund that accounted for all of the City's affordable housing activities, including the twenty percent requirement to set-aside funds from former Agency incremental property taxes for low and moderate income housing and related expenditures. Upon dissolution of the former Agency and the City Council's election to retain the housing assets, functions, and powers previously performed by the former Agency, the City created a housing successor fund (Affordable Housing Investment Fund) and transferred the assets and housing activities associated with the twenty percent incremental property taxes set-aside funds for low and moderate income housing.

Affordable Housing Investment fund: The Affordable Housing Investment Fund is the City housing successor fund, which was created to administer the housing assets and functions related to the Low and Moderate Income Housing Program retained by the City following the dissolution of the former Agency. At June 30, 2012, the fund's loan receivable balance (net) was $253.5 million and includes the following low and affordable housing projects including the Belovida, Almaden, Orvieto Apartments, Cinnabar Commons, El Parador and El Paseo Studios, Hillview Glen, Monte Vista, Oak Tree Village, Rincon De Los Esteros, and Terramina Square.

On October 16, 2012, the Affordable Housing Investment Fund was renamed the Low and Moderate Income Housing Asset fund to comply with the requirements of Assembly Bill 1484.

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 $52.9 million in special assessment and special tax debt outstanding at June 30, 2012 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 from City funds.

Total expenditures for 2011-2012 increased by $28.3 million or 211.9 percent compared to the prior fiscal year primarily due to expenditures associated with the Convention Center renovation and expansion.

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 finance low and moderate income housing activities and programs. The amount of commercial paper notes outstanding decreased from $46.6 million on June 30, 2011 to $45.3 million on June 30, 2012, a decrease of $1.3 million, which represented defeasance of commercial paper notes.

Other financing sources (net of uses) decreased by $12.9 million or 27.3 percent to $34.4 million primarily due to a $24.4 million decrease in transfers-out offset by a $7.0 million decrease in transfers-in.

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, 2012, the unrestricted net assets were $64.0 million for the Airport, $237.7 million for the Wastewater Treatment System, $15.7 million for the Municipal Water System and $11.6 million for the Parking System. Net assets for proprietary funds fell from $1.345 billion at June 30, 2011 to $1.317 billion at June 30, 2012, resulting in a decrease of $28.0 million or 2.1 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 2011-2012 budgets in June 2011.

During the fiscal year ended June 30, 2012, there was a $41.2 million increase in the budgeted revenues between the original and final amended operating budget for the General Fund. The increase reflected higher actual receipts in sales tax, utility, business tax, licenses, permits and fines, intergovernmental, charges for current services, and other revenues

Actual budgetary basis expenditures of $694.1 million were $49.7 million less than the amended budget and $45.4 million less than the original budget. Savings were experienced over all expenditure categories.

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 $8.756 billion at June 30, 2012. 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. At June 30, 2012, net capital assets decreased by $541.5 million ($493.1 million in governmental activities and $48.4 million in business-type activities) or 5.8 percent compared to net capital assets at June 30, 2011. The decrease in capital assets of $493.1 million in governmental activities is primarily due to depreciation expense of $362.7 million and the transfer of capital assets totaling $180.4 million to SARA during 2011-2012. These decreases were partially offset by additional infrastructure projects totaling $58.8 million in the governmental activities. The decrease of $48.4 million in capital assets in the business-type activities resulted from depreciation expense of $81.3 million, offset by additions of capital projects of $30.3 million at the Airport and Wastewater.

Total construction-in-progress increased by $1.7 million or 1.3 percent from $138.2 million at June 30, 2011 to $139.9 million at June 30, 2012. The construction-in-progress for the governmental activities remained flat at $69.8 million. Business-type activities contributed a modest increase of $1.8 million to the total construction-in-progress as addition to Airport construction-in-progress totaling $16.5 million was offset by a $7.3 million projects that were completed and placed in-service. The completed Airport projects include the following: improvements to the terminal area roadway, which included 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 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, 2011 and June 30, 2012 (in thousands):

		Governmental activities		Business-type activities		Total	
		2012	2011	2012	2011	2012	2011
Land	$	463,726	528,605	134,926	134,926	598,652	663,531
Intangible assets		-	-	12,882	12,882	12,882	12,882
Construction in progress		69,764	69,813	70,159	68,368	139,923	138,181
Buildings		1,037,128	1,161,245	1,253,657	1,287,753	2,290,785	2,448,998
Improvements, other than buildings		189,103	194,400	604,248	614,558	793,351	808,958
Infrastructure		4,813,511	5,107,454	-	-	4,813,511	5,107,454
Furniture and fixtures, vehicles, equipment		23,867	28,528	81,233	86,554	105,100	115,082
Property under capital leases		495	688	1,459	1,889	1,954	2,577
Total capital assets	$	6,597,594	7,090,733	2,158,564	2,206,930	8,756,158	9,297,663

Commitments outstanding as of June 30, 2012, related to governmental and business-type activities construction in progress totaled approximately $3.8 million and $18.2 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 2011-2012 tax roll was $124.438 billion, which results in a net total debt capacity of $18.666 billion. As of June 30, 2012, the City had $460.7 million of General Obligation bonds outstanding.

General Obligation Bonds and Other Bond Ratings

The City continues to receive high general credit ratings from all three national rating agencies despite the difficult financial and economic conditions nationally and locally. In March 2012, Moody's Investors Service ("Moody's") downgraded the City's general obligation rating from Aaa to Aa1 citing a multi-year erosion of the City's General Fund reserves and the City's management being significantly challenged to manage retirement costs. In April 2012, Standard & Poor's ("S&P") also downgraded the City's general obligation rating from AAA to AA+ reflecting long-term structural budget challenges. These downgrades follow actions from Fitch Ratings ("Fitch") in 2011 when Fitch downgraded the City's general obligation rating from AAA to AA+ reflecting a reduction of fund balance in the General Fund following several years of structural imbalance, high and rising pension and retiree healthcare costs, and reduced expenditure flexibility following significant labor concessions and service reductions already implemented.

During the year, Standard & Poor's reduced its ratings on the Airport Bonds from A to A- and revised the outlook from negative to stable. As of June 30, 2012, the Airport's bond ratings were A2 from Moody's, A- from Fitch and A- from Standard & Poor's.

Subsequent to June 30, 2012, the Airport Revenue Bonds were downgraded by Fitch Ratings from A- with a negative outlook to BBB+ with a stable outlook.

Outstanding Debt

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

During 2011-2012, the City's gross outstanding long-term debt decreased by $1.854 billion to $2.961 billion, comprised of governmental activities ($1.465 billion) and business-type activities ($1.495 billion). The balances at June 30, 2011 were $3.705 billion for governmental activities and $1.110 billion for business-type activities, for a total of $4.815 billion. The decrease of $1.854 billion is primarily due to the transfer of $2.313 billion of long-term debt of the former Agency to SARA but was offset by the issuance of the 2011 Airport revenue bonds. For more information on the dissolution of the former Agency, please refer to the financial highlights of this MD&A and the Notes to Basic Financial Statements on page 54.

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

		As of June 30, 2012	As of June 30, 2011	Net Change
Governmental Activities:				
General obligation bonds	$	460,670	480,320	(19,650)
HUD Section 108 loan		20,803	21,877	(1,074)
San Jose Financing Authority				
Lease revenue bonds		659,578	669,233	(9,655)
Lease revenue bonds with				
reimbursement agreement		129,020	-	129,020
Revenue bonds with				
pledge agreement		35,105	-	35,105
Special assessment bonds with limited				
governmental commitment		160,310	163,904	(3,594)
Redevelopment Agency		-	2,369,575	(2,369,575)
Sub-total		1,465,486	3,704,909	(2,239,423)
Business-Type Activities:				
Revenue bonds		1,468,705	1,079,125	389,580
State of CA-Revolving Fund Loan		26,746	30,651	(3,905)
Sub-total		1,495,451	1,109,776	385,675
Total:	$	2,960,937	4,814,685	(1,853,748)

Additional information about the City's long-term obligations appears in Note III.F. of the Notes to Basic Financial Statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

- The City completed 2011-2012 with better operating financial results than expected when the 2011-2012 Adopted Budget was developed. Although the economic indicators in this region appear to have stabilized, the City still faces fiscal challenges on a long-term basis as the local economy continues to work its way out of the Great Recession. A set of 2012-2013 budget balancing strategies were developed through a comprehensive community outreach process and City Council Study Sessions including a Council Priority Setting Study Session. In June 2012, the City Council approved a balanced General Fund budget for fiscal year 2012-2013, with a projected surplus of $9.0 million, a significant change compared to the $115.0 million shortfall addressed in the 2011-2012 Adopted Budget.

- Due to the improved forecast, the City does not face further service cuts in fiscal year 2012-2013. Instead, reductions are limited to areas where alternative service delivery models can reduce costs and enhance service levels. In addition, the $9.0 million projected surplus will be used to meet projected shortfalls in future years.

- The insufficient property tax revenues to pay enforceable obligations of the former Agency is projected to be $24.4 million in 2012-2013. As a result, it was assumed that City funds would be used to ensure adequate funding for SARA obligations for which the City was obligated. This resulted in a $19.0 million transfer from the General Fund, with the General Purpose Parking Fund and the Community Development Block Grant Fund addressing the remaining shortfall. More information on SARA is provided in Note IV.C.1-6.

- As of June 30, 2011, the most recent actuarial valuation date, the Police and Fire Department Retirement Plan ("PFDRP") had an 84.0 percent actuarial funded ratio for pension benefits. The actuarial accrued liability for pension benefits was $3.196 billion, and the actuarial value of assets was $2.686 billion resulting in an unfunded actuarial accrued liability ("UAAL") of $510.3 million. As of June 30, 2011, the most recent actuarial valuation date, the Federated City Employees' Retirement System ("FCERS") had a 65.0 percent actuarial funded ratio for pension benefits. The actuarial accrued liability for benefits was $2.770 billion and the actuarial value of assets was $1.789 billion, resulting in a UAAL of $981.6 million.

- The adopted 2012-2013 operating budget projects retirement costs at $187.7 million in the General Fund and $246.5 million in all funds, based on analysis provided by Cheiron, the City Retirement Boards' actuary. Compared to 2012-2013 levels, City retirement contributions for all funds are forecasted to grow approximately 27.0 percent by 2016-2017.

- As noted in the Trust and Agency Funds section of this CAFR, the PFDRP's net assets experienced a decrease of $46.0 million in 2011-2012 following a $372.5 million increase in net assets in the prior year primarily as a result of the depreciation of the fair value of investments caused by a short-term deterioration of the equity investment market. The FCERS's net assets experienced a decrease of $109.0 million in 2011-2012 following a $275.3 million increase in net assets in the prior year primarily as a result of the depreciation of the fair value of investments caused by a short-term deterioration in the investment market.

- For 2012-2013, the City's contribution rates for pension benefits, as a percentage of payroll, are as follows: for police and fire members of PFDRP, 56.6 percent and 58.4 percent, respectively, and 44.5 percent for FCERS members. For 2012-2013, the City's contribution rates for health and dental benefits, as a percentage of payroll, are as follows: for police and fire members of PFDRP, 9.0 percent and 6.6 percent, respectively, and 7.9 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 2012-2013 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 $120.2 million and $121.0 million, respectively, paid by the City in July 2012.

- 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, 2012 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 (ARC) over 5 years beginning fiscal 2009-2010 and ending 2013-2014. Effective June 26, 2011, the Fire members entered into an MOA with the City to phase-in to full funding of the ARC over a five year period with fiscal year 2011-2012 as the first year of the phase-in.

- As of June 30, 2011, the most recent actuarial valuation date, the PFDRP was 6.0 percent funded for other postemployment benefits. The actuarial accrued liability for benefits was $1.004 billion, and the actuarial value of assets was $60.7 million resulting in a UAAL of $943.1 million. As of June 30, 2011, the most recent actuarial valuation date, the FCERS was 12.0 percent funded for other postemployment benefits. The actuarial accrued liability for benefits was $1.145 billion and the actuarial value of assets was $135.5 million, resulting in a UAAL of $1.001 billion.

All of these factors were considered in preparing the City's budget for 2012-2013.

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.

This page intentionally left blank

Basic Financial Statements

City of San José
Statement of Net Assets
June 30, 2012
($000's)

		Governmental Activities	Business-Type Activities	Total
ASSETS				
Equity in pooled cash and investments held in City Treasury	$	568,627	389,120	957,747
Receivables (net of allowances for uncollectibles)		144,028	13,405	157,433
Due from outside agencies		3,133	66	3,199
Internal balances		(5,245)	5,245	-
Inventories		1,214	1,179	2,393
Loans receivable (net of allowances for uncollectibles)		321,445	250	321,695
Advances and deposits		298	5,331	5,629
Other assets		41,233	191	41,424
Restricted assets:				
Equity in pooled cash and investments held in City Treasury		40,054	118,575	158,629
Cash and investments held with fiscal agent		253,193	231,517	484,710
Other cash and investments		5,710	-	5,710
Receivables (net of allowances for uncollectibles)		-	3,672	3,672
Deferred bond issuance costs (net of accumulated amortization)		14,919	17,703	32,622
Long-term receivables from SARA		227,826	-	227,826
Capital assets (net of accumulated depreciation):				
Nondepreciable		533,490	217,967	751,457
Depreciable		6,064,104	1,940,597	8,004,701
Total assets		8,214,029	2,944,818	11,158,847
LIABILITIES				
Accounts payable		33,339	14,839	48,178
Accrued liabilities		14,678	1,663	16,341
Interest payable		10,753	26,139	36,892
Due to SARA		850	-	850
Due to outside agencies		457	-	457
Short-term notes payable		45,348	47,937	93,285
Unearned revenue		15,124	5,470	20,594
Advances, deposits, and reimbursable credits		9,649	5,163	14,812
Long-term payables - SARA		280	-	280
Other liabilities		24,412	-	24,412
Long-term obligations:				
Due within one year		69,666	29,087	98,753
Due in more than one year		1,896,596	1,497,720	3,394,316
Total liabilities		2,121,152	1,628,018	3,749,170
NET ASSETS				
Invested in capital assets, net of related debt		5,350,666	859,392	6,210,058
Restricted for:				
Debt service		50,305	24,462	74,767
Capital projects		358,319	103,899	462,218
Community services		526,442	-	526,442
Public safety		4,443	-	4,443
Unrestricted		(197,298)	329,047	131,749
Total net assets	$	6,092,877	1,316,800	7,409,677

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

City of San José
Statement of Activities
For the Year Ended June 30, 2012
($000's)

			Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
Functions/Programs		**Expenses**	**Fees, Fines, and Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**	**Governmental Activities**	**Business -Type Activities**	**Total**
Governmental activities:								
General government	$	111,996	24,732	171	-	(87,093)	-	(87,093)
Public safety		490,442	22,099	21,721	-	(446,622)	-	(446,622)
Community services		247,518	90,252	70,529	-	(86,737)	-	(86,737)
Sanitation		135,543	151,644	-	85	16,186	-	16,186
Capital maintenance		473,674	52,205	31,408	22,664	(367,397)	-	(367,397)
Interest and fiscal charges		123,696	-	-	-	(123,696)	-	(123,696)
Total governmental activities		**1,582,869**	**340,932**	**123,829**	**22,749**	**(1,095,359)**	**-**	**(1,095,359)**
Business -Type activities:								
Norman Y. Mineta San José								
International Airport		200,380	154,713	670	7,399	-	(37,598)	(37,598)
Wastewater Treatment System		149,980	167,783	-	3,371	-	21,174	21,174
Municipal Water System		29,260	28,542	-	129	-	(589)	(589)
Parking System		9,290	11,585	-	-	-	2,295	2,295
Total business-type activities		**388,910**	**362,623**	**670**	**10,899**	**-**	**(14,718)**	**(14,718)**
Total	$	**1,971,779**	**703,555**	**124,499**	**33,648**	**(1,095,359)**	**(14,718)**	**(1,110,077)**

		Governmental Activities	Business -Type Activities	Total
General revenues:				
Taxes and franchise fees:				
Property and other taxes		404,877	-	404,877
Utility		110,912	-	110,912
Franchise		41,709	-	41,709
Transient occupancy		22,451	-	22,451
Business taxes		41,134		41,134
Sales taxes shared revenue		154,026	-	154,026
State of California in-lieu		2,611	-	2,611
Unrestricted interest and investment income		6,950	3,562	10,512
Other revenue		21,207	-	21,207
Transfers		3,357	(3,357)	-
Total general revenues and transfers		**809,234**	**205**	**809,439**
Extraordinary gain (loss) from dissolution of the Redevelopment Agency		2,075,379	(13,528)	2,061,851
Change in net assets		**1,789,254**	**(28,041)**	**1,761,213**
Net assets - beginning		**4,303,623**	**1,344,841**	**5,648,464**
Net assets - ending	$	**6,092,877**	**1,316,800**	**7,409,677**

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

City of San José
Balance Sheet
Governmental Funds
June 30, 2012
($000's)

		General Fund	Redevelopment Agency	Housing Activities
ASSETS				
Equity in pooled cash and investments held in City Treasury	$	187,781	-	4,313
Receivables (net of allowance for uncollectibles)		50,540	-	2,671
Due from outside agencies		3,090	-	-
Due from other funds		1,438	-	-
Loans receivables (net of allowance for uncollectibles)		2,241	-	61,121
Advances and deposits		252	-	-
Restricted assets:				
Equity in pooled cash and investments held in City Treasury		726	-	1,348
Cash and investments held with fiscal agent		11	-	3
Other cash and investments		-	-	-
Advances to other funds		3,297	-	-
Advances receivable - SARA		-	-	-
Other assets		-	-	-
Total assets	$	249,376	-	69,456
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable	$	9,651	-	962
Accrued salaries, wages, and payroll taxes		12,096	-	28
Due to other funds		-	-	-
Due to SARA		124	-	726
Due to other agencies		457	-	-
Short-term notes payable		-	-	-
Deferred revenue		4,322	-	23,009
Advances, deposits, and reimbursable credits		7	-	-
Advances from other funds		18,200	-	-
Long-term advances from SARA		-	-	-
Other liabilities		21,491	-	-
Total liabilities		66,348	-	24,725
Fund balances:				
Nonspendable		13	-	-
Restricted		392	-	44,731
Committed		63,014	-	-
Assigned		70,236	-	-
Unassigned		49,373	-	-
Total fund balances		183,028	-	44,731
Total liabilities and fund balances	$	249,376	-	69,456

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

Affordable Housing Investment Fund	Special Assessment Districts	San José Financing Authority Debt Service	Nonmajor Governmental Funds	Total Governmental Funds
36,058	-	-	319,456	547,608
1,436	53,250	-	35,904	143,801
-	-	-	43	3,133
-	-	-	10,297	11,735
253,477	-	-	4,606	321,445
-	5	-	41	298
-	625	-	37,355	40,054
-	130,062	59,703	63,414	253,193
-	-	-	5,710	5,710
-	-	14,091	15,656	33,044
65,371	-	-	-	65,371
20,771	-	-	20,462	41,233
377,113	183,942	73,794	512,944	1,466,625
41	1,400	91	20,415	32,560
110	23	-	2,000	14,257
-	-	103	11,833	11,936
-	-	-	-	850
-	-	-	-	457
-	-	45,348	-	45,348
7,448	52,885	-	14,995	102,659
-	4,138	-	5,504	9,649
14,091	-	3,297	2,500	38,088
280	-	-	-	280
-	-	-	2,921	24,412
21,970	58,446	48,839	60,168	280,496
-	5	-	20,503	20,521
355,143	125,491	24,955	370,844	921,556
-	-	-	28,928	91,942
-	-	-	32,673	102,909
-	-	-	(172)	49,201
355,143	125,496	24,955	452,776	1,186,129
377,113	183,942	73,794	512,944	1,466,625

City of San José
Reconciliation of the Governmental Funds Balance Sheet
to the Statement of Net Assets
June 30, 2012
($000's)

Total fund balances-governmental funds (Page 25)		$ 1,186,129
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	463,726	
Construction in progress	69,764	
Infrastructure assets	11,365,408	
Other capital assets	1,758,071	
Accumulated depreciation	7,066,078	
Total capital assets		6,590,891
Long-term receivables are not available to pay for current period expenditures and, therefore, are deferred on the modified accrual basis.		34,650
Long-term receivables associated with lease and pledge revenue agreements from the private-purpose trust fund are not current financial resources and therefore are not reported in the governmental funds		162,455
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.		14,919
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.		52,885
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.		(10,753)
Internal service funds are used by management to charge the cost of public works support, employee benefits, and stores, vehicle, maintenance and operations to individual funds. The assets and liabilities are included in governmental activities in the statement of net assets.		24,635
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	(1,469,561)	
Accreted interest on capital appreciation bonds	(510)	
Accrued vacation, sick leave and compensatory time	(54,328)	
Estimated liability for self-insurance	(137,720)	
Net other postemployment benefits obligation	(292,244)	
Other	(8,571)	
Total long-term liabilities		(1,962,934)
Net assets of governmental activities (Page 22)		$ 6,092,877

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

This page intentionally left blank

City of San José
Statement of Revenues, Expenditures
and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2012
($000's)

		General Fund	Redevelopment Agency	Housing Activities
REVENUES				
Taxes and special assessments	$	561,088	87,662	-
Licenses, permits, and fines		62,197	-	-
Intergovernmental		24,664	26	23,594
Charges for current services		35,405	-	-
Rent		-	353	-
Investment income		4,681	297	1,891
Other revenue		33,839	1,577	9,556
Total revenues		721,874	89,915	35,041
EXPENDITURES				
Current:				
General government		71,897	1,520	-
Public safety		444,336	-	-
Community services		114,048	-	38,398
Sanitation		849	-	-
Capital maintenance		36,671	16,192	-
Capital outlay		3,577	96	-
Debt service:				
Principal		1,074	74,955	-
Interest and fiscal charges		536	56,350	-
Total expenditures		672,988	149,113	38,398
Excess (deficiency) of revenues over (under) expenditures		48,886	(59,198)	(3,357)
OTHER FINANCING SOURCES (USES)				
Proceeds from sale of capital assets		969	11,268	-
Reclassification of demand bonds to short-term liability		-	(88,600)	-
Transfers in		12,605	25,156	17,532
Transfers out		(27,233)	(19,720)	(370,286)
Total other financing sources (uses)		(13,659)	(71,896)	(352,754)
Extraordinary gain (loss) from dissolution of the Redevelopment Agency		(18,820)	70,478	(6,863)
Net change in fund balances		16,407	(60,616)	(362,974)
Fund balances - beginning		166,621	60,616	407,705
Fund balances - ending	$	183,028	-	44,731

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

Affordable Housing Investment Fund	Special Assessment Districts	San José Financing Authority Debt Service	Nonmajor Governmental Funds	Total Governmental Funds
-	14,645	-	128,970	792,365
-	-	-	-	62,197
-	-	1,831	62,054	112,169
-	-	-	192,117	227,522
-	-	-	20,617	20,970
7,401	554	509	1,467	16,800
6,013	416	-	4,880	56,281
13,414	15,615	2,340	410,105	1,288,304
-	-	-	14,968	88,385
-	-	-	1,454	445,790
4,318	-	-	57,955	214,719
-	-	-	133,059	133,908
-	65	-	107,418	160,346
-	27,926	-	21,439	53,038
-	3,594	11,305	19,650	110,578
-	10,135	25,984	23,333	116,338
4,318	41,720	37,289	379,276	1,323,102
9,096	(26,105)	(34,949)	30,829	(34,798)
-	-	-	-	12,237
-	-	-	-	(88,600)
346,047	16	34,500	40,382	476,238
-	(143)	(58)	(54,732)	(472,172)
346,047	(127)	34,442	(14,350)	(72,297)
-	-	-	-	44,795
355,143	(26,232)	(507)	16,479	(62,300)
-	151,728	25,462	436,297	1,248,429
355,143	125,496	24,955	452,776	1,186,129

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, 2012
($000's)

Net change in fund balances--total governmental funds (Page 29)		$ (62,300)
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	53,038	
Depreciation expense	(359,192)	
Excess of depreciation expense over capital outlay		(306,154)
The net effect of various miscellaneous transactions involving capital assets (i.e. sales, retirements, trade-ins, donations)		
Donated assets	4,298	
Proceeds from sale of capital assets	(12,237)	
Gain on disposal of assets	3,403	
		(4,536)
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.		(2,023)
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.		110,578
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	(45)	
Increase in accrued interest expense	(7,914)	
Amortization of deferred amounts, premiums and discounts	339	
Total net interest expense and amortization of discount/premium		(7,620)
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.		(6,383)
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.		3,227
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	(68,134)	
Net decrease in vacation, sick leave, and compensatory time	7,433	
Net increase in estimated liability for self-insurance	4,699	
Net decrease in other liabilities	1,283	
Total additional expenditures		(54,719)
Expenditures reported in the governmental funds but not in governmental activities include reclassfication of demand bonds to short-term obligations		88,600
Long-term assets were not financial resources of the former Agency and the long-term liabilities were not due and payable, and as such the transfers of these liabilities in excess of assets to SARA are not recorded in the governmental funds.		2,030,584
Change in net assets of governmental activities (Page 23)		$ 1,789,254

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

This page intentionally left blank

City of San José
Statement of Fund Net Assets
Proprietary Funds
June 30, 2012
($000's)

		Enterprise Funds					
		Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total	Internal Service Funds
ASSETS							
Current assets:							
Equity in pooled cash and investments held in City Treasury	$	86,109	271,326	18,781	12,904	389,120	21,019
Receivables (net of allowance for uncollectibles)		8,547	1,981	2,661	216	13,405	227
Due from outside agencies		-	66	-	-	66	-
Due from other funds		-	377	-	-	377	-
Prepaid expenses, advances and deposits		186	-	-	-	186	-
Inventories		-	1,179	-	-	1,179	1,214
Total unrestricted current assets		94,842	274,929	21,442	13,120	404,333	22,460
Restricted assets:							
Equity in pooled cash and investments held in City Treasury		63,087	53,451	-	2,037	118,575	-
Cash and investments held with fiscal agent		224,917	6,600	-	-	231,517	-
Receivables (net of allowances for uncollectibles)		3,672	-	-	-	3,672	-
Prepaid expenses, advances and deposits		5	-	-	-	5	-
Total restricted current assets		291,681	60,051	-	2,037	353,769	-
Total current assets		386,523	334,980	21,442	15,157	758,102	22,460
Noncurrent assets:							
Deferred bond issuance costs (net of accumulated amortization)		17,166	537	-	-	17,703	-
Loan receivable		250	-	-	-	250	-
Advances and deposits		5,331	-	-	-	5,331	-
Advances to other funds		-	5,044	-	-	5,044	-
Capital assets (net of accumulated depreciation):							
Nondepreciable		117,749	80,027	605	19,586	217,967	-
Depreciable		1,365,496	466,384	66,843	41,874	1,940,597	6,703
Total noncurrent assets		1,505,992	551,992	67,448	61,460	2,186,892	6,703
Total assets	$	1,892,515	886,972	88,890	76,617	2,944,994	29,163

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

City of San José
Statement of Fund Net Assets
Proprietary Funds
June 30, 2012
($000's)

		Enterprise Funds					
		Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total	Internal Service Funds
LIABILITIES							
Current liabilities:							
Accounts payable	$	3,570	7,257	2,852	745	14,424	779
Accrued liabilities		477	1,082	69	35	1,663	421
Interest payable		8	277	-	-	285	-
Due to other funds		-	-	176	-	176	-
Short-term notes payable		47,937	-	-	-	47,937	-
Accrued vacation, sick leave and compensatory time		1,536	2,230	157	77	4,000	-
Estimated liability for self-insurance		560	1,300	126	-	1,986	-
Advances and deposits payable		1,083	-	-	88	1,171	-
Unearned revenue		3,885	-	-	-	3,885	-
Loans payable		-	3,977	-	-	3,977	-
Pollution remediation obligation		330	-	-	-	330	-
Total current liabilities unrestricted		59,386	16,123	3,380	945	79,834	1,200
Current liabilities payable from restricted assets:							
Accounts payable and accrued liabilities		415	-	-	-	415	-
Interest payable		25,615	239	-	-	25,854	-
Unearned revenue		1,585	-	-	-	1,585	-
Current portion of bonds payable		13,296	5,114	-	-	18,410	-
Pollution remediation obligation		384	-	-	-	384	-
Total current liabilities payable from restricted assets		41,295	5,353	-	-	46,648	-
Total current liabilities		100,681	21,476	3,380	945	126,482	1,200
Noncurrent liabilities:							
Accrued vacation, sick leave and compensatory time		510	644	-	-	1,154	3,328
Estimated liability for self-insurance		1,071	1,939	-	-	3,010	-
Advance contributions from participating agencies		-	2,827	-	-	2,827	-
Advances, deposits and reimbursable credits		-	-	1,165	-	1,165	-
Loans payable		-	22,769	-	-	22,769	-
Bonds payable (net of premium/discount and deferred loss on refunding)		1,399,159	43,647	-	-	1,442,806	-
Net other postemployment benefits obligation		9,964	16,261	1,223	533	27,981	-
Total noncurrent liabilities		1,410,704	88,087	2,388	533	1,501,712	3,328
Total liabilities		1,511,385	109,563	5,768	1,478	1,628,194	4,528
NET ASSETS							
Invested in capital assets, net of related debt		247,771	482,713	67,448	61,460	859,392	6,703
Restricted for debt service		16,176	6,249	-	2,037	24,462	-
Restricted for capital projects and other agreements		53,174	50,725	-	-	103,899	1,368
Unrestricted		64,009	237,722	15,674	11,642	329,047	16,564
Total net assets	$	381,130	777,409	83,122	75,139	1,316,800	24,635

City of San José
Statement of Revenues, Expenses, and Changes in Fund Net Assets
Proprietary Funds
For the Year Ended June 30, 2012
($000's)

	Enterprise Funds					
	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total	Internal Service Funds
OPERATING REVENUES						
Charges for services	$ 46,141	140,968	28,472	11,585	227,166	113,223
Rentals and concessions	80,835	3,248	-	-	84,083	-
Customer transportation fees	10,137	-	-	-	10,137	-
Service connection, engineering and inspection	-	3,150	-	-	3,150	-
Contributions	-	14,387	-	-	14,387	-
Other	-	5,908	-	-	5,908	-
Total operating revenues	137,113	167,661	28,472	11,585	344,831	113,223
OPERATING EXPENSES						
Operations and maintenance	60,474	100,415	25,554	3,112	189,555	105,612
General and administrative	18,328	21,738	1,267	3,578	44,911	-
Depreciation and amortization	52,130	24,738	2,438	2,485	81,791	3,552
Materials and supplies	-	286	-	115	401	-
Other expenses	-	-	-	-	-	354
Total operating expenses	130,932	147,177	29,259	9,290	316,658	109,518
Operating income (loss)	6,181	20,484	(787)	2,295	28,173	3,705
NONOPERATING REVENUES (EXPENSES)						
Passenger facility charges	16,787	-	-	-	16,787	-
Operating grants	670	-	-	-	670	-
Investment income	2,217	1,193	98	54	3,562	231
Interest expense	(69,438)	(2,654)	(1)	-	(72,093)	-
Contributions refunded from participating agencies	-	(146)	-	-	(146)	-
Loss on disposal of capital assets	(10)	(3)	-	-	(13)	-
Other revenues, net	813	122	70	-	1,005	-
Net nonoperating revenues (expenses)	(48,961)	(1,488)	167	54	(50,228)	231
Income (loss) before capital contributions, transfers, and extraordinary loss	(42,780)	18,996	(620)	2,349	(22,055)	3,936
Capital contributions	7,399	3,371	129	-	10,899	-
Transfers in	-	-	-	-	-	111
Transfers out	(115)	(1,980)	(508)	(754)	(3,357)	(820)
Extraordinary loss from dissolution of the Redevelopment Agency	-	-	-	(13,528)	(13,528)	-
Changes in net assets	(35,496)	20,387	(999)	(11,933)	(28,041)	3,227
Net assets - beginning	416,626	757,022	84,121	87,072	1,344,841	21,408
Net assets - ending	$ 381,130	777,409	83,122	75,139	1,316,800	24,635

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

This page intentionally left blank

City of San José
Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2012
($000's)

	Enterprise Funds					
	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total	Internal Service Funds
CASH FLOWS FROM OPERATING ACTIVITIES						
Receipts from customers and users	$ 137,111	153,549	27,915	11,561	330,136	-
Cash received from interfund services provided	-	-	-	-	-	111,707
Payments to suppliers	(55,233)	(62,464)	(21,376)	(4,458)	(143,531)	(87,500)
Payments to employees	(25,912)	(64,026)	(4,270)	(2,189)	(96,397)	(19,235)
Other receipts	1,208	14,437	-	-	15,645	-
Net cash provided by operating activities	57,174	41,496	2,269	4,914	105,853	4,972
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Transfer from other funds	-	-	-	-	-	111
Transfer to other funds	(115)	(1,980)	(508)	(754)	(3,357)	(820)
(Advances to) / payments from other funds	-	1,035	(1,000)	(1,681)	(1,646)	-
Subsidies from operating grants	740	-	-	-	740	-
Advances and deposits received	-	-	17	-	17	-
Net cash provided by (used in) noncapital and related financing activities	625	(945)	(1,491)	(2,435)	(4,246)	(709)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
Passenger facility charges received	16,735	-	-	-	16,735	-
Refunded commercial paper	(354,250)	-	-	-	(354,250)	-
Proceeds from issuance of bonds	504,401	-	-	-	504,401	-
Payment for redemption of bonds	(92,165)	-	-	-	(92,165)	-
Principal payment on commercial paper	(7,892)	-	-	-	(7,892)	-
Subsidies from capital grants	6,197	3,962	-	-	10,159	-
Acquisition and construction of capital assets	(18,717)	(14,064)	(241)	(82)	(33,104)	(1,510)
Principal paid on debt	(21,915)	(8,850)	-	-	(30,765)	-
Bond issuance cost paid	(6,775)		-	-	(6,775)	-
Interest paid on debt	(61,776)	(2,569)	-	-	(64,345)	-
Advances and deposits received	594	-	-	-	594	-
Net cash used in capital and related financing activities	(35,563)	(21,521)	(241)	(82)	(57,407)	(1,510)
CASH FLOWS FROM INVESTING ACTIVITIES						
Proceeds from sales and maturities of investments	285,217	5,460	-	-	290,677	-
Purchase of investments	(300,469)	(6,248)	-	-	(306,717)	-
Interest received	1,057	1,355	90	54	2,556	231
Land and building rentals	-	79	-	-	79	-
Net cash provided by (used in) investing activities	(14,195)	646	90	54	(13,405)	231
Net change in cash and cash equivalents	8,041	19,676	627	2,451	30,795	2,984
Cash and cash equivalents - beginning	328,216	305,453	18,154	12,490	664,313	18,035
Cash and cash equivalents - ending	$ 336,257	325,129	18,781	14,941	695,108	21,019

The Notes to Basic 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, 2012
($000's)

	Enterprise Funds					
	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total	Internal Service Funds
Reconciliation of operating income (loss) to net cash provided by operating activities:						
Operating income (loss)	$ 6,181	20,484	(787)	2,295	28,173	3,705
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:						
Depreciation and amortization	52,130	24,738	2,438	2,485	81,791	3,552
Other nonoperating revenues	813	42	70	-	925	-
Decrease (increase) in:						
Accounts receivable	(595)	234	(626)	(24)	(1,011)	932
Due from outside agencies	-	47	-	-	47	-
Inventories	-	(37)	-	-	(37)	(462)
Prepaid expenses, advances and deposits	3	-	-	-	3	-
Increase (decrease) in:						
Accounts payable and accrued liabilities	(3,775)	(7,684)	763	(3)	(10,699)	(1,843)
Accrued vacation, sick leave and compensatory time	(270)	(849)	-	(109)	(1,228)	(912)
Estimated liability for self-insurance	(674)	(929)	3	-	(1,600)	-
Unearned revenue	912	-	-	-	912	-
Advances and deposits payable	15	-	-	86	101	-
Other liabilities	2,434	5,450	408	184	8,476	-
Total adjustments	50,993	21,012	3,056	2,619	77,680	1,267
Net cash provided by operating activities	$ 57,174	41,496	2,269	4,914	105,853	4,972
Reconciliation of cash and cash equivalents to the statement of net assets:						
Equity in pooled cash and investments held in City Treasury						
Unrestricted	$ 86,109	271,326	18,781	12,904	389,120	21,019
Restricted	63,087	53,451	-	2,037	118,575	-
Cash and investments held with fiscal agent	224,917	6,600	-	-	231,517	-
Less investments not meeting the definition of cash equivalents	(37,856)	(6,248)	-	-	(44,104)	-
Cash and cash equivalents	$ 336,257	325,129	18,781	14,941	695,108	21,019
Noncash noncapital, capital and related financing, and investing activities:						
Loss on disposal of capital assets	$ (10)	(3)	-	-	(13)	-
Acquisition of capital assets on accounts payable and accrued liabilities	1,409	-	-	-	1,409	-
Capital contributions from developers	-	863	129	-	992	-
Amortization of deferred charges and other charges	473	149	-	-	622	-
Change in fair value of investments	961	259	-	-	1,220	-
Extraordinary loss on write-off of SERAF advance	-	-	-	(13,528)	(13,528)	-

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

City of San José
Statement of Fiduciary Net Assets
Fiduciary Funds
June 30, 2012
($000's)

	Pension Trust Funds	Private Purpose Trust Funds	Agency Fund
ASSETS			
Current assets:			
Equity in pooled cash and investments held in City Treasury	$ -	104	1,696
Cash and investments	-	6,965	-
Investments of retirement plans:			
Investments, excluding securities lending collateral:			
Fixed income	1,308,742	-	-
Global and domestic equity	1,488,100	-	-
Pooled international equity	488,819	-	-
Private equity	220,941	-	-
International currency contracts, net	941	-	-
Opportunistic	277,885	-	-
Real assets	447,805	-	-
Real estate	199,118	-	-
Securities lending cash collateral investment pool	239,396	-	-
Total investments of retirement plans	4,671,747	-	-
Receivables:			
Accrued investment income	12,908	-	2
Employee contributions	2,623	-	-
Employer contributions	3,563	-	-
Due from the City of San José	-	850	-
Other	6,003	519	-
Restricted cash and investments	-	153,999	-
Total current assets	4,696,844	162,437	1,698
Noncurrent assets:			
Advances to the City of San José	-	280	-
Loans receivable, net	-	31,275	-
Deposits	-	155	-
Deferred charges, net	-	30,940	-
Property held for resale	-	22,474	-
Capital assets:			
Nondepreciable	-	35,581	-
Depreciable, net	-	92,895	-
Total noncurrent assets	-	213,600	-
Total assets	$ 4,696,844	376,037	1,698

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

City of San José
Statement of Fiduciary Net Assets
Fiduciary Funds
June 30, 2012
($000's)

	Pension Trust Funds	Private Purpose Trust Funds	Agency Fund
LIABILITIES			
Current liabilities:	$		
Due to brokers	18,873	-	-
Accrued interest payable	-	41,682	-
Pass through payable to the County of Santa Clara	-	15,719	-
Unearned revenues	-	2,340	-
Securities lending collateral, due to borrowers	241,875	-	-
Other liabilities	7,607	2,320	1,698
Total current liabilities	268,355	62,061	1,698
Long-term liabilities:			
Due within one year	-	258,149	-
Due in more than one year	-	2,119,105	-
Total noncurrent liabilities	-	2,377,254	-
Total liabilities	268,355	2,439,315	1,698
NET ASSETS (DEFICITS)			
Held in trust for:			
Employees' pension benefits	4,227,713	-	
Employees' postemployment healthcare benefits	200,776	-	
Redevelopment dissolution and other purposes	-	(2,063,278)	
Total net assets (deficits)	$ 4,428,489	(2,063,278)	

The Notes to Basic 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, 2012
($000's)

ADDITIONS		Pension Trust Funds	Private Purpose Trust Funds
Redevelopment property tax revenues	$	-	82,237
Investment income:			
Interest		73,268	155
Dividends		44,609	-
Net rental income		6,610	322
Net change in fair value of plan investments		(218,025)	-
Investment expenses		(17,986)	-
Total investment income (loss)		(111,524)	477
Securities lending income:			
Securities lending income		3,109	-
Securities lending rebates and expenses		(774)	-
Total securities lending income		2,335	-
Contributions:			
Employer		255,130	-
Employees		56,369	-
Total contributions		311,499	-
Other		-	578
Total additions		202,310	83,292
DEDUCTIONS			
General and administrative		7,217	967
Project expenses		-	816
Pass through amounts to the County of Santa Clara		-	8,177
Loss on fair value of property held for resale		-	27,417
Depreciation		-	2,040
Interest on debt		-	45,401
Health insurance premiums		61,556	-
Refunds of contributions		4,121	-
Retirement and other benefits:			
Death benefits		16,081	-
Retirement benefits		268,315	-
Total deductions		357,290	84,818
Extraordinary loss from dissolution of the Redevelopment Agency		-	(2,061,851)
Change in net assets		(154,980)	(2,063,377)
Net assets held in trust for pension, postemployment healthcare benefits and other purposes:			
Beginning of year		4,583,469	99
End of year	$	4,428,489	(2,063,278)

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

INDEX TO THE NOTES

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

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

- **Successor Agency to the Redevelopment Agency of the City of San José** – The SARA was created to serve as a custodian for the assets and to wind down the affairs of the former Agency. The SARA is a separate public entity from the City, subject to the direction of an Oversight Board. The Oversight Board is comprised of seven-member representatives from local government bodies: two City representatives appointed by the Mayor; two County of Santa Clara (County) representatives; the County Superintendent of Education; the Chancellor of California Community Colleges; and the largest special district taxing entity in the Merged Project.

In general, the SARA's assets can only be used to pay enforceable obligations in existence at the date of dissolution (including the completion of any unfinished projects that were subject to legally enforceable contractual commitments). In future fiscal years, the SARA will only be allocated revenue in the amount that is necessary to pay the estimated annual installment payments on enforceable obligations of the former Agency until all enforceable obligations of the former Agency have been paid in full and all assets have been liquidated. Based upon the nature of the SARA's custodial role, the SARA is reported in a fiduciary fund (private-purpose trust fund).

- **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. Certain members of the City Council are also members of the Parking Authority's Board of Directors. On May 8, 2012, the City Council suspended the Parking Authority as there was no foreseeable need to finance the construction of additional public parking in the San José Downtown area through the Parking Authority.

- **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 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 "Financing Authority") was created by a Joint Exercise of Powers Agreement between the City and the former Agency. The Financing 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 Financing 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 former Agency. The Diridon Authority was created for the purposes of overseeing the development 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 2012, 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; 13th 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 (for the period July 1, 2011 through January 31, 2012)

- Successor Agency to the Redevelopment Agency of the City of San José (for the period February 1, 2012 through June 30, 2012)
- Norman Y. Mineta San José International Airport (the "Airport")
- San José – Santa Clara Clean Water Financing Authority
- San José Diridon Development 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 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.

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 the activities of the former Agency for the seven months ended January 31, 2012.

The ***Housing Activities Fund*** is a special revenue fund that accounts for 20% redevelopment property tax revenue until February 1, 2012 and all of the City's affordable housing activities funded by federal and state grants. Prior to the dissolution of redevelopment agencies, the Housing Activities Fund accounted for all of the City's affordable housing activities, including the 20% redevelopment property tax revenue (i.e. former tax increment) set-aside for low and moderate income housing and related expenditures. Upon dissolution of the former Agency and the City Council's election to retain the housing activities previously funded by the former Agency, the City created a housing successor fund (Affordable Housing Investment Fund) and transferred the assets and affordable housing activities.

The ***Affordable Housing Investment Fund*** is a special revenue fund that was created to administer the housing assets and functions related to the Low and Moderate Income Housing Program retained by the City following the dissolution of the former Agency. On October 16, 2012, the Affordable Housing Investment Fund was renamed to Low and Moderate Income Housing Asset Fund to comply with the requirement of Assembly Bill 1484.

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 Financing 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.

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 Systems".

The ***Private Purpose Trust Funds*** account for the custodial responsibilities that are assigned to SARA with the passage of AB X1 26, and for the resources legally held in trust towards support of the EMQ Families First Agency (a.k.a. Eastfield Ming Quong).

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 and 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 user 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 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

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.

In November 2010, GASB issued Statement No.61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34.* This 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. Application of this statement is effective for the City's fiscal year ending June 30, 2013.

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which is intended to clarify the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. Application of this statement is effective for the City's fiscal year ending June 30, 2014.

In March 2012, the GASB issued Statement No. 66, *Technical Corrections – 2012-an amendment* *of GASB Statements No. 10 and No. 62*, to resolve conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. This statement amends Statement No. 10, *Codification of Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of a state and local government's risk financing activities to the general fund and the internal service fund type. This statement also amends Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current servicing fee rate. Application of this statement is effective for the City's fiscal year ending June 30, 2014.

In June 2012, the GASB issued two new standards, GASB Statement No. 67, *Financial Reporting for Pension Plans-an amendment of GASB Statement No. 25* and GASB Statement No. 68, *Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No. 27* to improve the guidance for accounting and reporting on the pensions that governments provide to their employees.

Key changes include:

- Separating how the accounting and financial reporting is determined from how pensions are funded.

- Employers with defined benefit pension plans will recognize a net pension liability, as defined by the standard, in their government-wide, proprietary and fiduciary fund financial statements.

- Incorporating ad hoc cost-of-living adjustments and other ad hoc postemployment benefit changes into projections of benefit payments, if an employer's past practice and future expectations of granting them indicate they are essentially automatic.

- Using a discount rate that applies (a) the expected long-term rate of return on pension plan investments for which plan assets are expected to be available to make projected benefit payments, and (b) the interest rate on a tax-exempt 20-year AA/Aa or higher rated municipal bond index to projected benefit payments for which plan assets are not expected to be available for long-term investment in a qualified trust.

- Adopting a single actuarial cost allocation method – entry age normal – rather than the current choice among six actuarial cost methods.

- Requiring more extensive note disclosures and required supplementary information.

The statements relate to accounting and financial reporting and do not apply to how governments approach the funding of their pension plans. At present, there generally is a close connection between the ways many governments fund pensions and how they account for and report information about them in audited financial reports. The statements would separate how the accounting and financial reporting is determined from how pensions are funded. Application of Statement 67 is effective for financial statements for the City's fiscal year ending June 30, 2014. Application of Statement 68 is effective for the City's fiscal year ending June 30, 2015.

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.

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, 2012, the total investment income from these investments assigned and transferred to the General Fund was approximately $228,000.

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 liens are placed on properties. 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 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 full 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 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 and a leveraged asset associated with New Market Tax Credit Financing Program. At June 30, 2012, the City reported other assets in the amount of $41,233,000. Of which, $20,771,000 is for the housing rehabilitation program, $19,610,000 for the New Market Tax Credit Financing Program, and $852,000 for economic development programs. 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, gains or losses occurring from advance refundings 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 in excess of one year. Capital assets are reported in the applicable governmental or business-type activity columns in the government-wide financial statements, the proprietary funds' statement of net assets, and the private-purpose trust fund. Capital assets are defined as assets with an initial individual cost of more than $5,000 for general capital assets and $100,000 for major infrastructure assets, and an estimated useful life in excess of one year. Such assets are recorded at historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the time received. Capital outlay is recorded as expenditures of the 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 hours may be accumulated up to two times the annual accrual rate, not to exceed a maximum of 400 hours for non-sworn employees and 360 hours for employees represented by the San José Police Officer's Association ("SJPOA"). Employees represented by the International Association of Firefighters, Local 230, may accumulate vacation hours up to 400 hours for employees on a 40-hour workweek and 576 hours for employees on a 56-hour workweek.

Generally, 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 unused sick leave hours as determined by the respective collective bargaining agreements. Certain bargaining unit employees in the FCERS are no longer eligible for a sick leave payout effective January 1, 2012.

12. Interfund Transactions

Interfund 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 interfund loans and unsettled service transactions, or "advances to/from other funds," i.e., the non-current portion of interfund loans. Any residual balances outstanding between the governmental activities and the 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 interfund 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, 2012, the government-wide statement of net assets reported restricted assets of $939,509,000 in governmental activities and $128,361,000 in business-type activities. Of these amounts $380,952,000 and $67,400,000, 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

Under GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, 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. Fund balance for the City's 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.

- *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 adoption of an ordinance by the City Council, the highest level of decision making authority of the City. 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 by the City for specific purposes through City Council budgetary actions. Intent is expressed by (a) the City Council or (b) a body or official to which the City Council has delegated the authority to assign amounts to be used for specific purpose.

- *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.

16. Extraordinary Items

Extraordinary items are both 1) unusual in nature (possessing a high degree of abnormality and clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity) and 2) infrequent in occurrence (not reasonably expected to recur in the foreseeable future, taking into account the environment in which the entity operates).

The dissolution of all redevelopment agencies in the State of California qualifies as an extraordinary item since this state-wide dissolution was both unusual and infrequent. Accordingly, the transfer of the former Agency's liabilities in excess of its assets as of February 1, 2012 from the City's governmental activities to the SARA fiduciary fund was recorded as an extraordinary gain in the City's government-wide financial statements and as an extraordinary gain or loss in the governmental and proprietary funds. The receipt of these liabilities in excess of assets was reported in the SARA fiduciary fund financial statements as an extraordinary loss. In addition to the transfer of the former Agency's assets and liabilities, the transfer of cash out of the Housing Activities

Fund's Low and Moderate Income Housing Program to pay enforceable obligations of SARA in the amount of $6,863,000 was also recorded as an extraordinary loss.

AB X1 26 specifically invalidates existing agreements between the former Agency and the City, except for 1) those entered into at the time of issuance of debt, for the purpose of securing repayment of such debt; and 2) loans or advances from the Low and Moderate Income Housing Fund. Therefore, on February 1, 2012, AB X1 26 invalidated the following City loans previously reported as long-term receivables from the former Agency: (1) City of San José Parking Fund Loan ($13,528,000); (2) City of San José Parkland Fees ($8,112,000); (3) City of San José Autumn Street Property ($630,000); and (4) the portion of the City of San José Supplemental Education Revenue Augmentation Fund Loans ("SERAF Loans") and its related accumulated interest and fees that were funded from sources other than the Low and Moderate Income Housing Fund ($10,078,000); and (5) invalidation of accrued interest with SERAF Loans in excess of the LAIF rates pursuant to AB X1 26 as amended with AB 1484 in the amount of ($2,940,000).

The components of the extraordinary gains and losses recorded in the financial statements are as follows (dollars in thousands):

Governmental activities:	
Former Agency's transfers of net assets at January 31, 2012:	
Transfers out of former Agency Fund assets	$ (164,020)
Transfers out of former Agency Fund liabilities	234,498
Extraordinary gain reported in the former Agency Fund	70,478
Transfers out of the former Agency's capital assets	(180,407)
Transfers out of the former Agency's other long-term assets	(60,947)
Transfers out of the former Agency's long-term debt, net deferred amounts	2,224,731
Transfers out of the former Agency's interest payable and other long-term liabilities	50,147
Extraordinary gain from transfers of the former Agency liabilities in excess of assets	2,104,002
Transfers out of Housing Activities Fund's cash to pay SARA's enforceable obligations	(6,863)
Invalidation of loans and interest between the former Agency and the City:	
Loans funded and/or assumed by the General Fund	(18,820)
Accrued interest on SERAF Loans in excess of the LAIF rate	(2,940)
Extraordinary loss from invalidation of loans and interest	(21,760)
Extraordinary gain from dissolution of the former Agency - governmental activities	2,075,379
Business-type activities:	
Invalidation of loans and interest between the former Agency and the City:	
Loans funded from the Parking System Fund	(13,528)
Extraordinary loss from dissolution of the former Agency - business-type activities	(13,528)
Extraordinary gain from dissolution of the former Agency - primary government	$ 2,061,851

17. 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:

	Secured	Unsecured
Valuation/lien dates	January 1	January 1
Levy dates	October 1	July 1
Due dates (delinquent after)	50% on November 1 (December 10) 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, 2012, was approximately $120.2 billion, an increase of approximately 0.8% from the previous year. The City's tax rate was approximately $0.188 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).

18. 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, 2012, the City's portion of the capital and operating costs was approximately 82.8% and, based on operations through the fiscal year ended June 30, 2012, the City's interest in the net assets of the Plant was approximately 82.9%.

II. Stewardship, Compliance, and Accountability

A. Deficit Fund Balance and Net Assets

A deficit fund balance of $172,000 was reported in the non-major capital projects Fiber Optics Development Fund. It will be eliminated with future transfers from the General Fund.

The Public Works Programs Support Internal Service Fund also reported deficit net assets of $969,000. The deficit is expected to be eliminated in future years through rate increases for its services provided to the City departments.

Prior to February 1, 2012, the California Redevelopment Law provided tax increment financing as a source of revenue to redevelopment agencies to fund redevelopment activities. Once a redevelopment area was adopted, the former Agency could only receive tax increment to the extent that it could show on an annual basis that it has incurred indebtedness that must be repaid with tax increment. Due to the nature of the redevelopment financing, the former Agency liabilities exceeded assets. Therefore, the former Agency historically carried a deficit, which was expected to be reduced as future tax increment revenues were received and used to reduce its outstanding long-term debt. This deficit was transferred to the SARA on February 1, 2012. At June 30, 2012, SARA has a deficit of $2,063,382,000, which will be eliminated with future redevelopment property tax revenues distributed from the Redevelopment Property Tax Trust Fund administered by the County's Auditor-Controller.

B. Deficit Unrestricted Net Assets – Governmental Activities

At June 30, 2012, the City reports a deficit unrestricted net assets in its Statement of Net Assets – governmental activities in the amount of $197,298,000. 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 its bargaining units, the funding to fully fund the OPEB's annual required contributions is being phased in over a five year period with varying ending dates (see Note IV.A.).

III. Detailed Notes on All Funds

A. Cash, Deposits and Investments

As of June 30, 2012, total City cash, deposits and investments, at fair value, are as follows (dollars in thousands):

	Governmental Activities	Business-type Activities	Fiduciary Funds: Pension Trust	Fiduciary Funds: Private-Purpose Trust	Fiduciary Funds: Agency	Carrying Value
Equity in pooled cash and investments	$ 568,627	$ 389,120	$ -	$ 104	$ 1,696	$ 959,547
Other cash and investments	-	-	-	6,965	-	6,965
Restricted investments:						
Equity in pooled cash and investments	40,054	118,575	-	-	-	158,629
Cash and investments with fiscal agents	253,193	231,517	-	153,999	-	638,709
Other cash and investments	5,710	-	-	-	-	5,710
Investments of retirement plans	-	-	4,671,747	-	-	4,671,747
Total deposits and investments	$ 867,584	$ 739,212	$ 4,671,747	$ 161,068	$ 1,696	$ 6,441,307
Deposits / (Outstanding items)						$ (21,530)
Investments						6,462,837
Total deposits and investments						$ 6,441,307

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 and fiduciary 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 cash and 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 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, 2012, was approximately 387 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, 2012, the City's pooled and fiscal agent investments in LAIF was approximately

$333,172,000. The weighted average maturity of LAIF was 268 days at June 30, 2012. The total amount recorded by all public agencies in LAIF at June 30, 2012 was approximately $21.9 billion. LAIF is part of the State's Pooled Money Investment Account (PMIA). PMIA has a total of approximately $60.5 billion and of that amount, 96.53% was invested in non-derivative financial products and 3.47% 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 August 30, 2011, 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 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, 2012:

Authorized Investment Type	Maximum Maturity	Maximum Percentage or Dollar of Portfolio	Maximum Investment in One Issuer
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 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 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 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.

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, 2012. 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):

		Maturity				
Type of Investment	Credit Rating	Under 30 Days	31 - 180 Days	181 - 365 Days	1 - 5 Years	Carrying Value
Pooled investments in the City Treasury:						
Federal Farm Credit Banks	Aaa / AA+	-	10,009	14,655	115,558	140,222
Federal Home Loan Banks	Aaa / AA+	-	20,003	55,092	119,691	194,786
Federal Home Loan Banks - Callable	Aaa / AA+	-	-	-	5,000	5,000
Federal Home Loan Banks - Discount	P-1 / A-1+	-	20,993	-	-	20,993
Federal Home Loan Mortgage Corporation	Aaa / AA+	-	25,033	10,038	80,403	115,474
Federal Home Loan Mortgage Corporation - Callable	Aaa / AA+	-	-	-	75,303	75,303
Federal Home Loan Mortgage Corporation - Discount	P-1 / A-1+	-	96,342	-	-	96,342
Federal National Mortgage Association	Aaa / AA+	-	20,022	5,016	75,600	100,638
Federal National Mortgage Association - Callable	Aaa / AA+	-	-	-	75,313	75,313
Federal National Mortgage Association - Discount	P-1 / A-1+	33,747	38,997	-	-	72,744
Commercial paper - Discounted	P-1 / A-1	90,221	31,990	-	-	122,211
Negotiable certificate of deposit	P-1 / A-1	50,002	-	-	-	50,002
Money market mutual funds	Aaa-mf	26,300	-	-	-	26,300
California local agency investment fund	Not Rated	-	-	50,000	-	50,000
Total pooled investments in the City Treasury		200,270	263,389	134,800	546,867	1,145,328
Investments with fiscal agents:						
Federal Farm Credit Banks	Aaa / AA+	-	-	-	37,856	37,856
Federal Home Loan Banks	Aaa / AA+	-	785	-	-	785
Federal Home Loan Banks - Discount	P-1 / A-1+	-	28,016	-	-	28,016
Federal Home Loan Mortgage Corporation - Discount	P-1 / A-1+	-	2,696	10,986	-	13,682
Commercial paper	P-1 / A-1+	-	1,909	-	-	1,909
Medium-term notes	Aaa / AA+	-	-	818	-	818
Money market mutual funds	Aaa-mf	118,560	-	-	-	118,560
California local agency investment fund	Not Rated	-	-	283,172	-	283,172
Total investments with fiscal agents		118,560	33,406	294,976	37,856	484,798
Total Citywide investments (excluding Retirement Systems)		$ 318,830	$ 296,795	$ 429,776	$ 584,723	$ 1,630,126
Trust Funds:						
Total investments in Retirement Systems (See page 64)						4,671,747
Total investments in SARA (See page 116)						160,964
Total investments						$ 6,462,837

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, 2012.

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, 2012, 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	12.24%
Federal Home Loan Banks	19.28%
Federal Home Loan Mortgage Corporation	25.07%
Federal National Mortgage Association	21.71%

In addition, the following major funds hold investments with trustees that represent 5% or more of the funds' investments outside the City Treasury as of June 30, 2012:

Special Assessment Districts:	
Federal Home Loan Mortgage Corporation	5.72%
San José Financing Authority Debt Service:	
Federal Home Loan Bank	48.24%
Airport:	
Federal Farm Credit Bank	16.83%
Wastewater Treatment System:	
Federal Home Loan Mortgage Corporation	94.67%

Foreign Currency Risk. The risk that changes in exchange rates will adversely affect the fair value of an investment. As of June 30, 2012, the investments in the City's investment pool were not subject to foreign currency risk.

2. Retirement Systems

Investment Policies – The City's Municipal Code delegates authority to the Boards of Administration of FCERS and PFDRP (the "Retirement Boards") to invest moneys of the respective plans 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, each Retirement Board 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. In December 2011, the Retirement Board of FCERS aligned its asset allocation to the expected returns to the liabilities as determined in the June 30, 2011 valuations by increasing the level of asset allocation to absolute return strategies and real assets and reducing the allocation to equity and fixed income. The Retirement Systems' investment asset allocations are as follows:

	Type of Investment	Policy Limits and Descriptions
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. Under allocated asset classes have been 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 45%	
	Fixed Income - Target 10%	
	Absolute Return strategies - Target 25%	
	Real Assets - Target 20%	

As of June 30, 2012, PFDRP's separate real estate properties include: office buildings in O'Fallon, MO, and San José, CA. In fiscal year 2012, PFDRP sold its apartment complexes in Houston, TX and Colorado Springs, CO; office buildings in Denver, CO, near Chicago, IL, and in Anchorage, AK; and warehouses near Minneapolis, MN. As of June 30, 2012, the office building in O'Fallon, MO had a mortgage loan payable of approximately $9,014,000, which does not exceed 50% of the assets as allowed in PFDRP's Real Estate Investment Guidelines.

On June 26, 2012, FCERS sold its warehouse located in Northern California.

At June 30, 2012, the Retirement Systems held the following investments (dollars in thousands):

	PFDRP	FCERS	Total
Securities and other:			
Fixed income:			
Domestic fixed income	$ 613,111	$ 165,906	$ 779,017
International fixed income	15,652	2,180	17,832
Collective short-term investments	83,959	249,347	333,306
Corporate convertible bonds	73,068	51,234	124,302
Pooled fixed income bond funds	18,660	35,625	54,285
Total fixed income	804,450	504,292	1,308,742
Global equity	516,505	353,211	869,716
Domestic equity	618,384	-	618,384
Pooled international equity	-	488,819	488,819
Private equity	125,463	95,478	220,941
International currency contracts, net	489	452	941
Opportunistic	194,009	83,876	277,885
Real assets	280,386	167,419	447,805
Real estate	105,253	93,865	199,118
Securities lending cash collateral investment pool	239,396	-	239,396
Total investments	$ 2,884,335	$ 1,787,412	$ 4,671,747

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, 2012, PFDRP's investments include $12,215,000 of bank loan securities and corporate bonds that were floating rate securities tied to the 1 and 3 month London Interbank Offered Rate (LIBOR).

As of June 30, 2012, FCERS's investments include $12,215,000 of bank loan securities that were floating rate securities tied to the 1 and 3 month LIBOR. FCERS also had exposure to interest rate risk on its fully collateralized infrastructure swaps. The FCERS invested in infrastructure swaps with a notional amount of $74,041,000 at June 30, 2012, in which it receives the total return S&P Global Infrastructure Index, net of the 3-month LIBOR plus 50 to 55 basis points. The FCERS also invested in commodities swaps with a notional amount of $226,788,000 at June 30, 2012, in which it receives a total return of the United States three month treasury bill rate plus 10 to 12 basis points.

The following tables provide the segmented time distribution for fixed income investments based on expected maturity as of June 30, 2012, concerning the fair value of investments and interest rate risk (dollars in thousands):

	PFDRP							
	0 - 3 months	3 - 6 months	6 months - 1 year	1 - 5 years	5 - 10 years	More than 10 years	**Total Fair Value**	**Total Cost**
Domestic fixed income:								
Asset backed securities	$ 2,025	$ -	$ -	$ 2,020	$ 1,249	$ 4,650	$ 9,944	$ 11,781
Bank loans	-	1,142	1,094	10,280	-	-	12,516	10,987
Collateralized mortgage obligations	-	-	-	-	12,534	13,522	26,056	24,019
Corporate bonds	-	2,789	4,305	31,476	26,037	111,685	176,292	155,145
FHLMC	-	-	-	-	4,688	11,159	15,847	15,585
FNMA	-	-	-	-	1,092	21,344	22,436	22,116
GNMA	-	-	-	-	-	3,301	3,301	3,086
State and local obligations	-	-	-	-	739	10,535	11,274	9,639
U.S. TIPS	-	-	-	130,289	137,528	-	267,817	249,484
U.S. Treasury securities	5,799	-	-	31,878	2,605	27,346	67,628	65,306
Total domestic fixed income	7,824	3,931	5,399	205,943	186,472	203,542	613,111	567,148
International corporate bonds	40	-	917	4,290	4,645	5,760	15,652	15,422
Pooled fixed income bond funds	-	-	-	18,660	-	-	18,660	18,295
Corporate convertible bonds	-	-	13,437	38,725	9,809	11,097	73,068	72,789
Collective short-term investments	12,791	-	-	-	-	71,168	83,959	83,976
Total fixed income	$ 20,655	$ 3,931	$ 19,753	$ 267,618	$ 200,926	$ 291,567	$ 804,450	$ 757,630

	FCERS							
	0 - 3 months	3 - 6 months	6 months - 1 year	1 - 5 years	5 - 10 years	More than 10 years	**Total Fair Value**	**Total Cost**
Domestic fixed income:								
Asset backed securities	$ 2,025	$ -	$ -	$ 2,020	$ -	$ -	$ 4,045	$ 6,042
Bank loans	-	1,142	-	11,375	-	-	12,517	11,036
Corporate bonds	-	636	-	15,073	5,367	3,799	24,875	20,602
U.S. TIPS	-	-	-	82,931	41,538	-	124,469	120,522
Total domestic fixed income	2,025	1,778	-	111,399	46,905	3,799	165,906	158,202
International fixed income	-	-	-	2,176	4	-	2,180	1,987
Collective short-term investments	1,917	-	260	-	-	247,170	249,347	249,701
Corporate convertible bonds	-	-	4,369	32,015	3,601	11,249	51,234	50,560
Pooled fixed income bond funds	-	-	-	-	2,672	32,953	35,625	29,216
Total fixed income	$ 3,942	$ 1,778	$ 4,629	$ 145,590	$ 53,182	$ 295,171	$ 504,292	$ 489,666

Custodial Credit Risk – The Retirement Systems do not have a policy regarding custodial credit risk. As of June 30, 2012 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.

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, 2012 concerning credit risk of fixed income investments (dollars in thousands):

	PFDRP		FCERS	
S&P quality Rating	Fair Value	Fair value as a % of fixed income investments	Fair Value	Fair value as a % of fixed income investments
AAA	$ 15,541	3.3%	$ 2,696	0.7%
AA	74,524	16.0%	-	0.0%
A	90,989	19.6%	8,844	2.3%
BBB	79,742	17.1%	15,559	4.1%
BB	19,300	4.1%	15,186	4.0%
B	10,109	2.2%	10,083	2.6%
CCC & below	1,726	0.4%	1,718	0.5%
Not rated	173,773	37.3%	325,736	85.8%
Total investments exposed to credit risk	$ 465,704	100.0%	$ 379,822	100.0%

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.

The following tables provide information as of June 30, 2012, concerning the fair value of investments and foreign currency risk (dollars in thousands):

PFDRP

Currency Name	Cash	Private Equity	Equity	Fixed Income	Pending Foreign Currency Exchanges	Total Exposure
Australian Dollar	$ 144	$ -	$ 26,277	$ -	$ 79	$ 26,500
Brazilian Real	186	-	8,896	35	-	9,117
British Pound Sterling	594	-	95,834	-	94	96,522
Canadian Dollar	82	-	41,626	-	24	41,732
Chilean Peso	41	-	1,985	-	-	2,026
Colombian Peso	47	-	789	-	-	836
Danish Krone	3	-	3,057	-	-	3,060
Euro Currency	2,764	-	103,118	7,489	352	113,723
Hong Kong Dollar	230	-	22,282	125	-	22,637
Indonesian Rupiah	36	-	2,341	-	-	2,377
Israeli Shekel	1	-	300	-	-	301
Japanese Yen	1,102	-	87,316	7,806	(128)	96,096
Malaysian Ringgit	17	-	1,363	-	-	1,380
Mexican Peso	5	-	541	-	-	546
New Taiwan Dollar	-	-	-	-	16	16
Norwegian Krone	80	-	3,789	-	61	3,930
Philippine Peso	-	-	480	-	-	480
Polish Zloty	-	-	703	-	-	703
Singapore Dollar	126	-	8,704	2,651	-	11,481
South African Rand	8	-	4,644	-	-	4,652
South Korean Won	154	-	16,798	-	-	16,952
Swedish Krona	125	-	7,989	1,556	(9)	9,661
Swiss Franc	166	-	23,077	-	-	23,243
Thailand Baht	21	-	1,619	-	-	1,640
Turkish Lira	21	-	2,438	-	-	2,459
Total	$ 5,953	$ -	$ 465,966	$ 19,662	$ 489	$ 492,070

FCERS

Currency Name	Cash	Private Equity	Equity	Fixed Income	Pending Foreign Currency Exchanges	Total Exposure
Australian Dollar	$ 19	$ -	$ 10,014	$ -	$ 39	$ 10,072
British Pound Sterling	685	-	43,257	-	82	44,024
Canadian Dollar	(26)	-	5,757	-	31	5,762
Danish Krone	245	-	3,203	-	-	3,448
Euro Currency	640	9,252	36,405	5,016	285	51,598
Hong Kong Dollar	93	-	4,526	125	-	4,744
Israeli Shekel	2	-	384	-	-	386
Japanese Yen	405	-	38,855	5,536	(31)	44,765
New Taiwan Dollar	-	-	-	-	11	11
Norwegian Krone	91	-	4,371	-	43	4,505
Singapore Dollar	30	-	3,389	1,835	-	5,254
Swedish Krona	114	-	4,594	1,100	(8)	5,800
Swiss Franc	236	-	15,536	-	-	15,772
Turkish Lira	1	-	-	-	-	1
Total	$ 2,535	$ 9,252	$ 170,291	$ 13,612	$ 452	$ 196,142

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 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. Derivative instruments 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, 2012. 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, 2012, 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

	Net Appreciation (Depreciation) in Fair Value of Investments through June 30, 2012		Fair Value at June 30, 2012		Notional
Investment Derivative Instruments	Classification	Amount	Classification	Amount	Amount
International currency forwards	Investment income	$ 668	International currency contracts, net	$ 489	$ 62,324
Futures long/short (domestic and foreign)	Investment income	1,318	Fixed income (domestic and foreign)	-	30,300
Index futures long/short (domestic and foreign)	Investment income	2,361	Equity income (domestic and foreign)	-	768
Rights	Investment loss	(4)	Global Equity	5	8
Warrants	Investment income	7	Global Equity	36	18
Total derivative instruments		$ 4,350		$ 530	

FCERS

	Net Appreciation (Depreciation) in Fair Value of Investments through June 30, 2012		Fair Value at June 30, 2012		Notional
Investment Derivative Instruments	Classification	Amount	Classification	Amount	Amount
Total return swaps	Investment loss	$ (7,849)	Real assets	$ 13,552	$ 300,829
Foreign currency forwards	Investment loss	(421)	Foreign currency contracts, net	445	46,207
Future options bought/written	Investment loss	(4,951)	Fixed income - collective short-term investments	-	38,650
Rights / Warrants	Investment income	99	Global equity	39	22
Total derivative instruments		$ (13,122)		$ 14,036	

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, 2012:

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, 2012, PFDRP held rights and warrants with a fair value of approximately $5,000 and $36,000 with notional value of $8,000 and $18,000 held by unrated counterparties. 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, 2012, total commitments in forward currency contracts to purchase and sell international currencies were $62,324,000 and $62,324,000 respectively, with fair values of $62,574,000 and $62,085,000, respectively, held by counterparties with an S&P rating of at least AA-.

FCERS entered into infrastructure and commodity swaps with notional amounts of $74,041,000 and $226,788,000, respectively, held by counterparties with S&P ratings of A. FCERS's investments in forward currency contracts bear counterparty credit risk in that parties to the contracts may fail to perform according to the terms of the contract. As of June 30, 2012, total commitments in forward currency contracts to purchase and sell international currencies were $46,207,000 and $46,207,000 respectively, with fair values of $46,424,000 and $45,979,000, respectively, held by counterparties with an S&P rating of at least A and above.

Interest Rate Risk –FCERS had exposure to interest rate risk on its 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, 2012, PFDRP did not hold commodity swaps. As of June 30, 2012, FCERS invested in infrastructure and commodity swaps with notional amounts of $74,041,000 and $226,788,000, respectively. FCERS receives the total return S&P Global Infrastructure Index, net of the 3-LIBOR plus 50 to 55 basis points. FCERS also receives the total return United States three month Treasury bill rate plus 10 to 12 basis points for the commodities swaps. FCERS's infrastructure swaps were executed in December 2011 and April 2012 and mature in December 2012 and April 2013 with a quarterly rate reset frequency. The commodity swaps were executed in June 2012 and matured August 2012 with a monthly rate reset frequency. FCERS does 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, 2012, 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.

The following tables provide information as of June 30, 2012, concerning the fair value of forward currency contracts and foreign currency risk (dollars in thousands):

	Pending Foreign Currency Exchanges			Rights
Currency Name	PFDRP	FCERS	Total	FCERS
Australian Dollar	$ 79	$ 39	$ 118	$ -
British Pound Sterling	94	82	176	-
Canadian Dollar	24	32	56	-
Euro Currency	352	279	631	39
Japanese Yen	(128)	(31)	(159)	-
New Taiwan Dollar	16	11	27	-
Norwegian Krone	61	41	102	-
Swedish Krona	(9)	(8)	(17)	-
Total	$ 489	$ 445	$ 934	$ 39

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 securities lending activities. 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 them to lend securities in the Retirement Systems' investment portfolio under such terms and conditions, as the Custodians deem advisable and to permit the lent securities to be transferred into the name of the borrowers. The Retirement Systems receive a fee from the borrower for the use of the lent securities. As of June 30, 2012, the Retirement Systems' had no exposure to borrower credit risk related to the securities lending transactions as the Custodians were responsible for the replacement of the lent securities with other securities of the same issuer, class and denomination, or if such securities were not available on the open market, the Custodian was required to credit the Retirement Systems' account with the market value of such unreturned lent securities if the lent securities were not returned by the borrower. 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. All securities lending agreements can be terminated on demand within a period specified in each agreement by either the Retirement Systems or borrowers.

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 collateral in State Street's Quality D Short-term Investment fund, which, effective December 3, 2010, 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 investor 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. The liquidity pool investment policy guidelines provide that the State Street Investment Manager shall maintain the dollar-weighted average maturity of the fund in a manner that the Investment Manager believes is appropriate to the objective of the fund; provided (a) in no event shall any eligible security be acquired with a remaining legal final maturity (i.e., the date on which principal must be repaid) of greater than 18 months, (b) the Investment Manager shall endeavor to maintain a dollar-weighted average maturity of the fund not to exceed 75 calendar days and (c) the Investment Manager shall endeavor to maintain a dollar-weighted average maturity to final of the Quality D Fund not to exceed 180 days.

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 quality. Securities with maturities in excess of 13 months shall be rated at least A-, A3 or A- by at least any two of S&P, Moody's, or Fitch, 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, 2012, the cash collateral pool for the duration and liquidity pool totaled $1.4 billion and $15.1 billion, respectively. The weighted average maturities for the duration and liquidity pool were 40.32 and 35.93 days, respectively. The cash collateral duration pool included asset backed securities (99.54%) and other securities (0.46%). The liquidity pool included asset backed securities (17.84%), certificates of deposit (34.33%), bank notes (2.49%), commercial paper (19.70%), repurchase agreements (22.62%) and other securities (3.02%). As of June 30, 2012, the underlying securities loaned by PFDRP as a whole amounted to approximately $257,596,000. The cash collateral and the non-cash collateral totaled $241,875,000 and $18,572,000, respectively, at carrying cost. The net asset value (NAV) of the cash collateral pool at June 30, 2012 was at $1.01 or $211,526,000 and $0.9177 or $27,870,000 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 $0.9177 of the duration cash collateral pool results in an unrealized loss of approximately $2,499,000 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 $239,396,000. The unrealized loss of $2,479,000 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.

The lent securities as of June 30, 2012 consisted of U.S. Treasury securities, domestic corporate bonds, domestic equity securities, international corporate bonds, and international equity securities. In return, PFDRP receives 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 of the collateral.

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. In August 2011, the FCERS exited the Northern Trust securities lending program.

The following table provides information on PFDRP's securities lent and collateral received as of June 30, 2012 (dollars in thousands):

Type of Investment Lent	
For Cash Collateral:	
U.S. treasury notes and bonds	$ 58,421
Domestic corporate bonds	45,050
Domestic equity securities	95,501
International equity securities	40,541
Total Lent for Cash Collateral	239,513
For Non-Cash Collateral:	
U.S. treasury notes and bonds	17,278
Domestic equity securities	805
Total Lent for Non-Cash Collateral	18,083
Total Securities Lent	$ 257,596
Type of Collateral Received	
Cash Collateral *	$ 239,396
Non-Cash Collateral:	
For lent U.S. treasury notes and bonds	17,751
For lent domestic equity securities	821
Total Non-Cash Collateral	18,572
Total Collateral Received	$ 257,968

* Amount represents the mark-to-market value of the cash collateral pool at a 100.00% for the liquidity portfolio and 91.77% for the duration portfolio for fiscal year 2012.

B. Receivables, Net of Allowances

At June 30, 2012, 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	Housing Activities	Affordable Housing Investment Fund	Special Assessment Districts	Total Nonmajor Funds	Internal Service Funds	Governmental Activities
Taxes	$ 32,713	$ -	$ -	$ -	$ 5,229	$ -	$ 37,942
Accrued interest	208	58	1,386	12	1,730	20	3,414
Grants	2,504	2,451	-	-	9,200	-	14,155
Special assessments	-	-	-	52,885	-	-	52,885
Other	28,391	165	50	353	23,961	249	53,169
Less: allowance for uncollectibles	(13,276)	(3)	-	-	(4,216)	(42)	(17,537)
Total receivables, net	$ 50,540	$ 2,671	$ 1,436	$ 53,250	$ 35,904	$ 227	$ 144,028

Business-Type Activities:	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total Business-Type Activities
Accounts	$ 9,954	$ 1,484	$ 3,466	$ 210	$ 15,114
Accrued interest	298	325	21	16	660
Grants	2,303	682	-	-	2,985
Less: allowance for uncollectibles	(336)	(510)	(826)	(10)	(1,682)
Total receivables, net	$ 12,219	$ 1,981	$ 2,661	$ 216	$ 17,077

Special assessment receivables in the amount of $52,885,000 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, 2012 is as follows (dollars in thousands):

Type of Loan	General Fund	Housing Activities	Affordable Housing Investment Fund	Nonmajor Funds	Total Governmental Activities
Housing Program Developer, rehabilitation, second mortgage and relocation loans	$ -	$ -	$ 554,062	$ -	$ 554,062
Loans funded by federal grants	-	60,346	-	7,922	68,268
Economic development, real estate developer and other loans	2,241	50,013	-	165	52,419
Less: allowance for uncollectibles	-	(49,238)	(300,585)	(3,481)	(353,304)
Total loans, net	$ 2,241	$ 61,121	$ 253,477	$ 4,606	$ 321,445

Prior to effective date of the Redevelopment Dissolution Law, California Community Redevelopment Law required 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 former 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. Upon dissolution of the former Agency, the City assumed the housing activity function of the former Agency. All loans receivable relating to the Low and Moderate Income Housing Program have been transferred from the Housing Activities Fund to the Affordable Housing Investment Fund, which was established as of February 1, 2012 (subsequently renamed the Low and Moderate Income Housing Asset Fund in October 2012 in compliance with AB 1484). As of June 30, 2012, loans receivable relating to the Low and Moderate Income Housing Program totaled approximately $253,477,000, net of allowance for uncollectible accounts.

The City will continue to use these funds as well as other state and federal funding sources to offer financial assistance to qualified developers, individuals and families by providing loans at "below market" interest rates.

Typical loans and related terms are summarized as follows:

Loan Type	Interest Rate	Due
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 Affordable Housing Investment Fund loans receivable as of June 30, 2012.

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, 2012. These commitments involve elements of credit and interest rate risk similar to those described above for outstanding loans receivable. As of June 30, 2012, amounts committed to extend credit under normal lending agreements totaled approximately $12,189,000.

D. Capital Assets

1. Summary Schedule

The following is a summary of capital assets activity for the fiscal year ended June 30, 2012 (dollars in thousands):

	Balance July 1, 2011	Additions	Deletions	Transfers	Balance June 30, 2012
Governmental activities:					
Capital assets, not being depreciated:					
Land	$ 528,605	$ 7,219	$ 6,062	$ (66,036)	$ 463,726
Construction in progress	69,813	37,590	2,741	(34,898)	69,764
Total capital assets, not being depreciated	598,418	44,809	8,803	(100,934)	533,490
Capital assets, being depreciated:					
Buildings	1,526,499	1,332	19	(100,538)	1,427,274
Improvements, other than buildings	206,943	121	-	-	207,064
Infrastructure	11,352,807	6,639	-	5,962	11,365,408
Vehicles and equipment	106,978	5,945	7,266	(1,145)	104,512
Furnitures and fixtures	26,507	-	-	-	26,507
Property under capital leases	13,379	-	-	-	13,379
Total capital assets, being depreciated	13,233,113	14,037	7,285	(95,721)	13,144,144
Less accumulated depreciation for:					
Buildings	365,254	40,086	19	(15,175)	390,146
Improvements, other than buildings	12,543	5,541	-	(123)	17,961
Infrastructure	6,245,353	306,544	-	-	6,551,897
Vehicles and equipment	89,070	7,725	7,235	(950)	88,610
Furnitures and fixtures	15,887	2,655	-	-	18,542
Property under capital leases	12,691	193	-	-	12,884
Total accumulated depreciation	6,740,798	362,744	7,254	(16,248)	7,080,040
Total capital assets, being depreciated, net	6,492,315	(348,707)	31	(79,473)	6,064,104
Governmental activities capital assets, net	$ 7,090,733	$ (303,898)	$ 8,834	$ (180,407)	$ 6,597,594
Business-type Activities:					
Capital assets, not being depreciated:					
Land	$ 134,926	$ -	$ -	$ -	$ 134,926
Intangible assets	12,882	-	-	-	12,882
Construction in progress	68,368	25,830	-	(24,039)	70,159
Total capital assets, not being depreciated	216,176	25,830	-	(24,039)	217,967
Capital assets, being depreciated:					
Buildings	1,611,195	890	19	7,949	1,620,015
Improvements, other than buildings	1,052,637	4,551	-	13,293	1,070,481
Vehicles and equipment	213,970	1,694	2,205	2,797	216,256
Property under capital leases	13,406	-	-	-	13,406
Total capital assets, being depreciated	2,891,208	7,135	2,224	24,039	2,920,158
Less accumulated depreciation for:					
Buildings	323,442	42,934	18	-	366,358
Improvements, other than buildings	438,079	28,154	-	-	466,233
Vehicles and equipment	127,416	9,800	2,193	-	135,023
Property under capital leases	11,517	430	-	-	11,947
Total accumulated depreciation	900,454	81,318	2,211	-	979,561
Total capital assets, being depreciated, net	1,990,754	(74,183)	13	24,039	1,940,597
Business-type activities capital assets, net	$ 2,206,930	$ (48,353)	$ 13	$ -	$ 2,158,564

Upon dissolution of the former Agency pursuant to AB X1 26 (See Note I.F.16.), capital assets in the amount of $180,407,000 previously recorded in the former Agency's records were transferred to SARA on February 1, 2012.

2. Depreciation

Depreciation expense charged to various governmental and business-type activities of the City for the fiscal year ended June 30, 2012 is as follows (dollars in thousands):

Governmental activities:		
General government	$	10,527
Public safety		8,732
Capital maintenance		310,258
Community services		29,675
Capital assets held by City's internal service funds		3,552
Total depreciation expense - governmental activities	$	362,744
Business-type activities:		
Norman Y. Mineta San José International Airport	$	51,657
Wastewater Treatment System		24,738
Municipal Water System		2,438
Parking System		2,485
Total depreciation expense - business-type activities	$	81,318

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, 2012.

4. Construction Commitments

Commitments outstanding as of June 30, 2012, related to governmental and business-type activities construction in progress totaled approximately $3,787,000 and $18,221,000, 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 2017. 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 and the Nonmajor Governmental Funds under these operating lease agreements for the fiscal year ended June 30, 2012 amounted to approximately $1,992,000 and $473,000, respectively.

The future minimum lease payments anticipated under the existing lease commitments, as of June 30, 2012, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	General Fund	Nonmajor Governmental Funds	Total Govermental Activities
2013	$ 1,781	$ 201	$ 1,982
2014	1,130	116	1,246
2015	356	20	376
2016	214	20	234
2017	93	20	113
Totals	$ 3,574	$ 377	$ 3,951

Business-Type Activities

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 restated to add ten buses for the period of June 30, 2010 to May 31, 2017. In May 2012, the restated lease was amended to allow the early termination of the lease term pertaining to the first 14 buses with City's payment of $4,407,000. To relieve its lease commitment, the City simultaneously entered into an agreement to relinquish the use of the 14 buses to a third party for a total price of $3,400,000. Rental expense for the Airport buses for the year ended June 30, 2012 was approximately $1,720,000.

Future Minimum Payments. The future minimum payments anticipated under these commitments for the 10 remaining Gas-Powered buses, as of June 30, 2012, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	Operating Leases
2013	$ 947
2014	950
2015	952
2016	955
2017	877
Total	$ 4,681

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, 2012, the City received approximately $5,836,000 from the Manager. As of June 30, 2012, leased assets had a total historic cost of approximately $118,114,000 and accumulated depreciation of approximately $50,548,000.

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, was scheduled to expire on June 30, 2012. In August 2011, the City Council authorized the Director of Aviation to extend the term for five years through June 30, 2017, which allowed 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, 2012, the Airport's revenues as defined in its lease agreement exceeded its expenditures and reserve requirements by approximately $30,643,000. The surplus received during the fiscal year ended June 30, 2012 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 2014.

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 26 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 $78,227,000 for the fiscal year ended June 30, 2012.

The future minimum rentals to be received from the operating leases, as of June 30, 2012, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	Amount
2013	$ 88,458
2014	90,844
2015	87,893
2016	88,684
2017	89,605
2018-2022	135,013
2023-2027	113,770
2028-2032	112,338
2033-2037	111,297
2038-2041	71,016
Total	$ 988,918

These future minimum rentals are based upon annual rates and charges agreed to by the airlines and other tenants. As of June 30, 2012, leased assets had historic costs of approximately $1,031,260,000 and accumulated depreciation of approximately $101,478,000.

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, 2012 (dollars in thousands, unless otherwise noted):

	Purpose	Issue Amount	Issue Date	Final Maturity	Range of Interest Rates	Principal Payments ($ millions)	Balance June 30, 2012
Governmental Activities:							
City of San José:							
General Obligation Bonds:							
Series 2001 (Libraries and Parks)	Community Facilities	$ 71,000	06/06/2001	09/01/2031	5.00-5.125%	$ 2.37	$ 47,300
Series 2002 (Libraries, Parks, Public Safety)	Community Facilities	116,090	07/18/2002	09/01/2032	4.00-5.00%	3.87	81,260
Series 2004 (Libraries, Parks, Public Safety)	Community Facilities	118,700	07/14/2004	09/01/2034	4.00-5.00%	3.96	91,015
Series 2005 (Libraries and Public Safety)	Community Facilities	46,300	06/23/2005	09/01/2035	3.00-4.50%	1.54-1.55	37,060
Series 2006 (Libraries and Parks)	Community Facilities	105,400	06/29/2006	09/01/2036	4.00-5.00%	3.51-3.52	87,850
Series 2007 (Parks and Public Safety)	Community Facilities	90,000	06/20/2007	09/01/2037	4.00-5.50%	3.00	78,000
Series 2008 (Libraries and Parks)	Community Facilities	33,100	06/25/2008	09/01/2038	4.00-5.00%	1.10-1.11	29,785
Series 2009 (Public Safety)	Community Facilities	9,000	06/25/2009	09/01/2039	4.00-5.00%	0.30	8,400
							460,670
HUD Section 108 Note (FMC)	Economic Development	25,810	02/10/2005	08/01/2024	Variable	1.13-2.22	20,803
City of San José 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	763
Series 1997B (Fire, Childcare, Library Land)	Community Facilities	9,805	07/29/1997	08/01/2012	4.85-4.875%	0.37-0.41	365
Series 2002B (Civic Center Project)	Civic Center	292,425	11/14/2002	06/01/2037	3.75-4.25%	0.21-33.45	290,775
Series 2003A (Central Service Yard)	Refunding	22,625	09/18/2003	10/15/2023	3.40-4.70%	1.00-1.61	15,505
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	31,475
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	16,910
Series 2008B-2 (Civic Center Garage)	Refunding	17,640	07/10/2008	06/01/2039	Variable	0.36-0.945	16,905
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	41,300
Series 2008E-1 (Taxable) (Ice Centre)	Refunding	13,015	07/03/2008	06/02/2025	Variable	0.59-1.26	11,870
Series 2008E-2 (Taxable) (Ice Centre)	Refunding	13,010	07/03/2008	06/02/2025	Variable	0.595-1.26	11,860
Series 2008F (Taxable) (Land Acquisition)	Refunding	67,195	06/11/2008	06/01/2034	Variable	1.605-4.81	65,590
Series 2011A (Convention Center)	Convention Center	30,985	04/12/2011	05/01/2042	3.00-5.75%	0.43-2.165	30,985
Series 2001F (Convention Center)	Refunding	186,150	07/01/2001	09/01/2022	4.25-5.00%	8.79-14.73	129,020
Revenue Bonds:							
Series 2001A (4th & San Fernando Parking Facility)	Parking Facility	48,675	04/10/2001	09/01/2026	4.125-5.25%	1.61-3.21	35,105
							823,703
Special Assessment Bonds with Limited Governmental Commitment:							
Special Assessment Bonds:							
Series 24Q (Hellyer-Piercy)	Public Infrastructure	27,595	06/26/2001	09/02/2023	5.10-5.875%	1.07-2.05	18,455
Series 24R (2002 Consolidated Refunding)	Consolidated Refunding	13,940	07/03/2002	09/02/2015	3.90-4.38%	0.82-1.07	3,995
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	2,500
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	7,845
CFD No. 9 (Bailey/Highway 101)	Public Infrastructure	13,560	02/13/2003	09/01/2032	5.10-6.65%	0.27-0.95	11,340
CFD No. 10 (Hassler-Silver Creek)	Public Infrastructure	12,500	07/23/2003	09/01/2023	4.20-5.25%	0.52-0.94	8,750
Series 2011 (Convention Center)	Public Infrastructure	107,425	04/12/2011	05/01/2042	3.00-6.50%	0.4-7.71	107,425
							160,310
Total Governmental Activities - Bonds and Notes Payable							$ 1,465,486
Business-type Activities:							
Norman Y. Mineta San José International Airport:							
Revenue Bonds:							
Series 2001A	Runway Construction	$ 158,455	08/14/2001	03/01/2031	5.00%	$8.28-$10.06	$ 45,710
Series 2002A	Refunding	53,600	01/09/2003	03/01/2018	5.375%	4.46-9.29	49,140
Series 2004C (AMT)	Airport Facilities	75,730	06/24/2004	03/01/2026	4.625-5.25%	1.00-10.59	71,730
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
Series 2011A-1 (AMT)	Refunding	150,405	07/08/2011	03/01/1934	2.00-6.25%	0.00-21.12	146,370
Series 2011A-2	Refunding	86,380	07/08/2011	03/01/1934	2.00-5.25%	0.00-12.22	84,075
Series 2011B	Refunding	271,820	12/14/2011	03/01/1941	1.00-6.75%	0.00-27.33	264,085
							1,420,395
Wastewater Treatment System							
Clean Water Financing Authority							
Revenue Bonds:							
Series 2005A	Refunding	54,020	10/05/2005	11/15/2016	3.50-5.00%	4.95-5.80	26,890
Series 2009A	Refunding	21,420	01/29/2009	11/15/2020	3.00-4.626%	0.00-5.41	21,420
							48,310
State of California - Revolving Fund Loan	Wastewater Facilities	73,566	06/24/1997	05/01/2019	Various	1.77-3.91	26,746
Total Business-type Activities - Bonds and Loan Payable							$ 1,495,451
Grand Total							$ 2,960,937

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, 2012, are approximately $18,665,770,000 and $18,205,100,000, respectively.

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 $48,000.

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, 2012, the City has recorded approximately $52,885,000 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 $52,885,000 as of June 30, 2012 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 Note III.F.8. for further discussions on the 2011 bonds.

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, 2012, the outstanding conduit multi-family housing revenue bonds issued by the City aggregated to approximately $534,401,000.

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

7. **City of San José Financing Authority Variable-Rate Demand Lease Revenue Bonds**

Included in long-term debt is $232,270,000 of variable-rate demand bonds issued by the Financing Authority. The Financing Authority 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 Financing Authority has 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.).

The credit facilities that support the Financing Authority's variable-rate bonds as of June 30, 2012 are as follows (dollars in thousands):

	Balance June 30, 2012	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)	33,815	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)	41,300	U.S. Bank	10/21/2013
Series 2008E (Taxable) (Ice Centre)	23,730	Bank of America, N.A./U.S. Bank	10/21/2013
Series 2008F (Taxable) (Land Acquisition)	65,590	Bank of America, N.A.	05/02/2014
Total variable rate lease revenue bonds	$ 232,270		

The Financing Authority's variable-rate demand lease revenue bonds are payable upon demand of the bondholder at a purchase price equal to principal plus accrued interest. The Financing 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 Financing Authority's trustees are authorized to draw on the credit facilities in the amounts required to pay the purchase price of bonds tendered.

The Financing 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, 2012, then the take-out provision will remain in effect until June 30, 2015 or June 30, 2017, 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 Financing Authority is required to pay the credit facility providers an annual commitment fee ranging from 1.10% to 1.25% 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, 2012, 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, 2012.

8. Summary of Changes in Long-term Obligations

Governmental Activities - The changes in long-term obligations for the year ended June 30, 2012 are as follows (dollars in thousands):

	July 1, 2011	Additional Obligations, Interest Accretion and Net Increases	Current Maturities, Retirements, and Net Decreases	June 30, 2012	Amounts Due Within One Year
Governmental Activities:					
Long-term debt payable:					
General Obligation bonds	$ 480,320	$ -	$ (19,650)	$ 460,670	$ 19,645
HUD Section 108 loan	21,877	-	(1,074)	20,803	1,125
San Jose Financing Authority					
Lease revenue bonds	668,228	-	(9,160)	659,068	10,374
Accreted interest on capital appreciation bonds	1,005	45	(540)	510	510
Lease revenue bonds with reimbursement agreement*	-	129,020	-	129,020	9,150
Revenue bonds with pledge agreement*	-	35,105	-	35,105	1,670
Special Assessment bonds with limited governmental commitment	163,904	-	(3,594)	160,310	3,675
Redevelopment Agency					
Merged Area tax allocation bonds	1,711,000	-	(1,711,000)	-	-
Housing Set-Aside tax allocation bonds	338,440	-	(338,440)	-	-
Merged Area revenue bonds	96,870	-	(96,870)	-	-
Pledge and reimbursement agreements	174,515	-	(174,515)	-	-
HUD Section 108 notes payable	31,420	-	(31,420)	-	-
California Statewide Communities Development Authority - ERAF loan	17,330	-	(17,330)	-	-
Total long-term debt payable	3,704,909	164,170	(2,403,593)	1,465,486	46,149
Less deferred amounts:					
For refunding gain (loss)	(42,558)	-	43,896	1,338	58
For issuance premiums	50,637	-	(43,462)	7,175	309
For issuance discounts	(6,766)	-	1,638	(5,128)	(315)
Total deferred amounts	1,313	-	2,072	3,385	52
Total long-term debt payable and deferred amounts	3,706,222	164,170	(2,401,521)	1,468,871	46,201
Other Long-term obligations:					
Hayes Mansion construction loan	1,200	-	-	1,200	-
Arbitrage liability	310	-	(262)	48	-
Accrued vacation, sick leave and compensatory time	66,001	35,739	(44,084)	57,656	23,000
Accrued landfill postclosure costs	7,905	-	(465)	7,440	465
Estimated liability for self-insurance	142,419	16,424	(21,123)	137,720	-
Net other postemployment benefits (OPEB) obligation	224,110	68,134	-	292,244	-
Pollution remediation obligation	1,995	-	(912)	1,083	-
Pass through obligation to County	23,562	-	(23,562)	-	-
Total other long-term obligations	467,502	120,297	(90,408)	497,391	23,465
Governmental activities long-term obligations	$ 4,173,724	$ 284,467	$ (2,491,929)	$ 1,966,262	$ 69,666

* Debt previously reported by the former Agency was re-established as San Jose Financing Authority debt with associated long-term agreements, receivable from the SARA (see page 84 for discussion).

As discussed in Note I.F.16-Extraordinary Items, the former Agency transferred its long-term debt and other obligations to SARA. Please refer to Note IV.C.3 for a summary of the bonds issued by the former Agency and detailed discussion on these bonds.

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, 2012 is approximately $723,713,000, with the final payment due on September 1, 2039.

The City did not issue any GO bonds in fiscal year 2012; however, it plans to issue the final series of GO bonds in fiscal year 2013. 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/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, Nonmajor Governmental Funds, and SARA. 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 these bonds as of June 30, 2012 is approximately $1,249,922,000, with the final payment due on May 1, 2042.

The amount remaining on these bonds includes payments for the 2001A and 2001F bonds, which are payable through a pledge agreement (2001A) and a reimbursement agreement (2001F) by the former Agency, which were assumed by the SARA. Prior to the dissolution of the former Agency, the City eliminated the interfund balances between the Agency and the Financing Authority for financial reporting purposes pursuant to GASB Statement No. 14. Upon the Agency's dissolution, the City re-established the receivable balance from SARA and the related bonds payable, which totaled $162,455,000 and $164,125,000, respectively, at June 30, 2012. A description of these bonds is as follows:

- **Revenue Bonds with Pledge Agreement.** In March 2001, the Financing Authority issued Revenue Bonds, Series 2001A in the amount of $48,675,000 to finance the construction of the 4th Street and San Fernando Parking Facility Project. The former Agency entered into an Agency Pledge Agreement with the Financing Authority, which was assumed by the SARA, whereby the payments are payable from and secured by surplus "Agency Revenues". Under the terms of the Agency Pledge Agreement, SARA's payments are limited in each year to an amount equal to the annual debt service due on the bonds minus surplus revenues generated by the parking facility. Surplus Agency Revenues consist of (i) estimated tax increment revenues, which are pledged to the payment of the former Agency's outstanding tax allocation bonds and deemed to be "Surplus" in the current fiscal year in accordance with the resolution or indenture pursuant to which the outstanding tax allocation bonds were issued; plus (ii) all legally available revenues of SARA.

- SARA makes payments on the Financing Authority Series 2001A bonds pursuant to Exhibit A of the Agency Pledge Agreement by and between the former Agency and the Financing

Authority. However, the City records debt payments pursuant to the annual debt service schedule, which results in a timing difference in the amount of $1,670,000 balances outstanding as of June 30, 2012. At June 30, 2012, the Financing Authority's bonds payable is $35,105,000, whereas the corresponding receivable from SARA is $33,435,000.

- **Lease Revenue Bonds with Reimbursement Agreement.** In connection with the issuance of the 2001F Convention Center Refunding Bonds, the former Agency and the City entered into the Second Amended and Restated Reimbursement Agreement, which was assumed by the SARA, under which the SARA is obligated to use redevelopment property tax or other revenues to reimburse the City for lease payments made to the Financing Authority for the project. The Series 2001F bonds (tax exempt) mature in 2022 and have an outstanding balance of $129,020,000 as of June 30, 2012.

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, 2012 is approximately $319,882,000, 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 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. In summary, 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.

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, 2012 are as follows (dollars in thousands):

	July 1, 2011	Additional Obligations and Net Increases	Current Maturities, Retirements, and Net Decreases	June 30, 2012	Amounts Due Within One Year
Business-Type Activities:					
Norman Y. Mineta San Jose International Airport:					
Revenue bonds	$ 1,025,870	$ 508,605	$(114,080)	$ 1,420,395	$ 13,180
Deferred amounts:					
For refunding	(1,585)	(2,205)	694	(3,096)	(510)
For issuance premiums	4,727	2,594	(592)	6,729	642
For issuance discounts	(5,708)	(6,798)	933	(11,573)	(16)
Clean Water Financing Authority:					
Revenue bonds	53,255	-	(4,945)	48,310	5,125
Deferred amounts:					
For refunding	(1,378)	-	297	(1,081)	(247)
For issuance premiums	1,768	-	(236)	1,532	236
State of California - Revolving Fund Loan	30,651	-	(3,905)	26,746	3,977
Accrued vacation, sick leave and compensatory time	6,380	2,692	(3,918)	5,154	4,000
Estimated liability for self-insurance	6,609	-	(1,613)	4,996	1,986
Net other postemployment benefits (OPEB) obligation	19,505	8,476	-	27,981	-
Pollution remediation obligation	714	108	(108)	714	714
Business-type long-term obligations	$ 1,140,808	$ 513,472	$(127,473)	$ 1,526,807	$ 29,087

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 $120,566,000, which is composed of $61,649,000 of net general airport revenues and $58,917,000 of other available funds. Bond debt service payable from general airport revenues in the current fiscal year totaled approximately $59,389,000, which is net of $21,336,000 of bond debt service paid from the accumulated 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. Under the Master Trust Agreement, "debt service" means for any specified period the sum of (a) the interest falling due on any then outstanding current interest bonds, assuming that all principal installments are paid when due, but excluding any interest funded from the proceeds of any series of bonds and applied toward payment of interest on such bonds, and (b) the principal installments payable on any then outstanding bonds. Under the Master Trust Agreement, annual debt service excludes Available PFC Revenues, as defined in the Master Trust Agreement, for such fiscal year. Total principal and interest remaining on the bonds as of June 30, 2012 is approximately $2.9 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 ("NPFG"), as successor to the MBIA Insurance Corporation. The ratings of Ambac and NPFG 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 NPFG 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.

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 $46,537,000. Bond debt service payable from net system revenues in the current fiscal year totaled approximately $11,419,000. 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, 2012 is approximately $57,004,000, with the final payment due on November 15, 2020.

9. Annual Requirements to Maturity

The annual requirements to amortize all bonds and notes outstanding as of June 30, 2012 are as follows (dollars in thousands):

	Governmental Activities						
	City of San Jose General Obligation Bonds and HUD Loan [1]		City of San Jose Financing Authority Bonds [1,2,3,4]			Special Assessment Bonds with Limited Governmental Commitment	
Fiscal Year Ending June 30,	Principal	Interest	Principal	Accreted Interest	Interest	Principal	Interest
2013	$ 20,770	$ 21,522	$ 21,194	$ 510	$ 29,851	$ 3,675	$ 9,405
2014	20,826	20,627	22,585	-	28,605	4,215	9,227
2015	20,887	19,749	24,240	-	27,795	5,630	9,026
2016	20,968	18,861	26,270	-	26,937	5,615	8,751
2017	21,035	17,944	28,695	-	25,982	5,040	8,480
2018 - 2022	106,591	76,150	172,010	-	112,534	29,570	37,970
2023 - 2027	104,556	52,586	153,700	-	82,239	24,390	29,849
2028 - 2032	98,255	28,526	124,674	-	59,253	22,205	23,752
2033 - 2037	61,485	7,827	175,755	-	29,626	25,850	16,180
2038 - 2042	6,100	243	74,070	-	3,397	34,120	6,932
Total	$ 481,473	$ 264,035	$ 823,193	$ 510	$ 426,219	$ 160,310	$ 159,572

	Business-Type Activities			
	Airport Revenue Bonds [4]		Wastewater Treatment Revenue Bonds and Loans	
Fiscal Year Ending June 30,	Principal	Interest	Principal	Interest
2013	$ 13,180	$ 76,846	$ 9,102	$ 2,310
2014	21,720	76,269	9,369	2,048
2015	23,180	75,259	9,643	1,736
2016	24,550	74,138	9,992	1,414
2017	25,960	72,996	10,130	1,122
2018 - 2022	138,595	344,706	26,820	1,906
2023 - 2027	185,290	304,795	-	-
2028 - 2032	269,435	247,288	-	-
2033 - 2037	547,430	143,989	-	-
2038 - 2042	128,130	35,472	-	-
2043 - 2047	42,925	8,027	-	-
Total	$ 1,420,395	$ 1,459,785	$ 75,056	$ 10,536

[1] Projected interest payments for the variable rate series of bonds are based on the following rates in effect on June 30, 2012:

Financing Authority Lease Revenue Bonds: Series 2008A (0.12%), Series 2008B-1 (0.22%), Series 2008B-2 (0.13%), Series 2008C (0.14%), Series 2008D (0.18%), Series 2008E-1 (0.20%), Series 2008E-2 (0.18%), Series 2008F (0.20%). City of San José HUD Section 108 Notes (0.66685%). 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, 2012, $510,000 of value had accreted on the outstanding capital appreciation bonds, which combined with the $659,068,000 principal amount of outstanding lease revenue bonds totals $659,578,000 of outstanding lease revenue debt.

[3] Projected debt service payments for the City of San José Financing Authority Series 2001A Revenue Bonds and Series 2001F Lease Revenue Bonds are included in the City of San José Financing Authority Bonds category.

[4] Does not include notional amortization of outstanding commercial paper notes

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 that is on deposit in the General Account of the Bond Reserve Fund, securing the Series 2001A and 2002A Airport Revenue Bonds and the Series 2011A-1 and the Series 2011A-2 Airport Revenue Bonds. 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 (4th and San Fernando Parking Facility) (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 Financing 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 Financing 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 still uncertain at this time whether the Ambac Financial bankruptcy will cause the reserve fund surety bonds to lapse or expire as no event has occurred during the fiscal year. If such an event does occur, it is uncertain whether and when the Airport or the Financing Authority would be required to take one of the actions described above in order to maintain compliance with the respective bond indenture.

11. New Debt Issuances and Short-Term Debt Activities

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

The City's Commercial Paper ("CP") Program utilizes a lease revenue financing structure. Under this program, the Financing 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 Financing 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 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 Financing 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 Financing Authority issues the CP Notes under State law pursuant to an Amended and Restated Trust Agreement between the Financing 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 Financing 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 Financing Authority various City-owned facilities pursuant to a Site Lease, as amended (the “Site Lease”). The Financing 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, 2012, $26,255,000 of tax-exempt commercial paper notes was outstanding at an interest rate of 0.20% and $19,093,000 of taxable commercial paper notes was outstanding at an interest rate of 0.50%. The changes in commercial paper notes during the fiscal year ended June 30, 2012 are as follows (dollars in thousands):

July 1, 2011	Additions	Deletions	June 30, 2012
$46,645	$136	$1,433	$45,348

This program was initially established on January 13, 2004, whereby the City Council and the Financing Authority each adopted a resolution authorizing the issuance of the Financing 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, and equipment and relocation services for the new Civic Center.

On June 21, 2005, the City Council and the Financing 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 Financing Authority to issue taxable commercial paper notes to pay for expenses otherwise authorized under the commercial paper program, but ineligible to be paid from tax-exempt commercial paper proceeds. The City Council and the Financing 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.

2011 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 the employer retirement contributions. The Initial Note Portion of $100,000,000 was purchased by JPMorgan Chase Bank, N.A. on the closing date of the financing, July 1, 2011. At the City's discretion, additional borrowings were permitted to 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 City repaid the $100,000,000 2011 Note on February 2, 2012.

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 with each provider securing designated series of outstanding commercial paper notes (dollars in thousands):

Credit Facility Description			
Provider		LOC Capacity[1]	Expiration Date
Bank of America, N.A.	$	50,000	01/11/2013
JPMorgan Chase Bank, N.A.		50,000	01/11/2013
Wells Fargo, N.A.		75,000	01/13/2014
Total	$	175,000	

1. Reflects principal component of the LOC commitment.

The terms of each bank's credit facility are specified in the respective LOC 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. The initial facility rates were established based on the underlying credit rating on the Airport's bonds. As of June 30, 2012, the facility fee rates are 1.65% for BANA, 1.60% for JPMorgan, and 1.40% for Wells Fargo Bank. These facility fee rates can increase at any time when a rating is withdrawn, suspended or otherwise unavailable and upon occurrence of an event of default or rating downgrade. In July 2012, Fitch Ratings downgraded its rating with respect to the outstanding Airport Revenue Bonds from “A-“ with negative outlook to “BBB+” with stable outlook. As a result, the facility rate charged by Wells Fargo Bank increased to 1.65% effective July 20, 2012.

The outstanding balance for the Airport commercial paper notes as of June 30, 2012 is summarized in the table below (dollars in thousands):

LOC Provider	Outstanding as of June 30, 2012	Interest Rate
JPMorgan Chase Bank, N.A.	$ 21,317	0.47%
Wells Fargo, N.A.	26,620	0.19%
Total	$ 47,937	

The change in Airport commercial paper notes payable during fiscal year 2012 is as follows (dollars in thousands):

June 30, 2011	Additions	Deletions	June 30, 2012
$410,079	$0	$362,142	$47,937

2011 Airport Revenue Bonds

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 certain variable rate 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 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.

A portion of the Series 2011A-1 proceeds and the remaining balances in the 1998A principal and interest accounts totaling approximately $6,700,000 were used to pay the redemption price of the refunded Series 1998A Bonds. The refunding achieved approximately $363,000 in aggregate debt service savings or $303,000 on a present value basis.

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% and will mature in March 2034. The refunding achieved approximately $7,861,000 in aggregate debt service savings or $5,425,000 on a present value basis.

In December 2011, the City issued Airport Revenue Bonds Series 2011B in the amount of $271,820,000. The Series 2011B Bonds were issued to (i) refund certain subordinated commercial paper notes that were originally issued to finance and/or refinance the costs of designing and constructing certain improvements to the Airport, (ii) pay a portion of interest to accrue on the Series 2011B Bonds through March 1, 2014, (iii) make a cash deposit to the 2011B account of the bond reserve fund, and (iv) fund an increase of the rolling coverage amount, and pay the costs of issuing the 2011B Bonds. The bonds were issued with interest rates ranging from 1.00% to 6.75% and have a final maturity date of March 1, 2041.

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 $7,440,000 related to the closed landfills is recorded in the government-wide financial statements as of June 30, 2012. 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 2012, 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, 2011 to October 1, 2012 is provided below:

Coverages	Limit per Occurence	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

During fiscal year 2012, for the policy period of October 1, 2011 to October 1, 2012, the City maintained an airport liability policy covering the Airport including operation of vehicles on premises, which provides a limit of $200,000,000 combined single limit for bodily injury and property damage subject to a deductible of $0 each occurrence and annual aggregate, with a sublimit of $50,000,000 each occurrence and in the annual aggregate for personal injury and a sublimit of $100,000,000 each occurrence and in the annual aggregate for war liability. During the past three years, there have been no any instances that the amount of claim settlements exceeded 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 per occurrence combined single limit for bodily injury and property damage and no deductible. 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, 2012. 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 June 30, 2010	$ 139,234
Claims and changes in estimates during 2011	31,273
Claims payments	(21,479)
Liability as of June 30, 2011	149,028
Claims and changes in estimates during 2012	13,923
Claims payments	(20,235)
Liability as of June 30, 2012	$ 142,716

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 are in process. All remaining work associated with the opening of the facility is covered by the Terminal Area Improvement Project ("TAIP") OCIP, as described 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. As of June 30, 2012, the balance of the North Concourse reserve fund is $1,028,000. Chartis will continue to hold the remaining funds in the claims loss reserve fund until such time as the exposure to risk of claims ceases or the City opts to cash out the remaining funds in exchange for accepting responsibility for potential future claims.

On March 15, 2007, the City purchased 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, 2012 is as follows:

	Terminal Area Improvement Projects	
Coverages	**Limits**	**Deductible Per Occurrence**
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. The term of the TAIP OCIP was subsequently extended to June 30, 2011. 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, 2012 is $4,303,000. This deposit is recorded as advances and deposits in the accompanying statement of net assets.

14. 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. The City initiated a five-year phase-in to fully pre-fund the annual required contribution for retiree healthcare benefits pursuant to memoranda of agreement with the majority of its employee units beginning in fiscal year 2010 through fiscal year 2014, and with the members of the San José Firefighters Union (International Association of Firefighters, Local 230) beginning in fiscal year 2012 through fiscal year 2016. 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 term of the respective memoranda of agreement. 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, 2012, the City recorded net OPEB obligations totaling $320,225,000 in the government-wide financial statements, of which $292,244,000 is in governmental activities and $27,981,000 is in business-type activities.

15. 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. Although the City has 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 hired by the City. 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, 2012, the government-wide statement of net assets reported a net pollution remediation obligation in the amount of $1,083,000 in governmental activities, and $714,000 in business-type activities.

G. Interfund Transactions

The composition of interfund balances as of June 30, 2012, with explanations of transactions, is as follows (dollars in thousands):

1. Due from/Due to other funds

Receivable Fund	Payable Fund		Amount	
General Fund	Nonmajor Governmental Funds	$	1,438	(1)
Nonmajor Governmental Funds	Nonmajor Governmental Funds		10,194	(2)
	San José Financing Authority		103	(2)
Wastewater Treatment System	Nonmajor Governmental Funds		201	(3)
	Municipal Water System		176	(4)
		$	12,112	

(1) $1,151 represents accrual of gas tax transfer and $287 represents accrual of construction and conveyance tax transfer.
(2) Represents short-term borrowing for working capital.
(3) Represents short-term portion of loan for Fiber Optics Conduit project.
(4) Represents short-term portion of loan for the North Coyote Valley Water Project.

2. Advances to/Advances from other funds

Receivable Fund	Payable Fund		Amount	
General Fund	San José Financing Authority	$	3,297	(1)
San José Financing Authority	Affordable Housing Investment Fund		14,091	(2)
Nonmajor Governmental Funds	Nonmajor Governmental Funds		2,500	(3)
	General Fund		13,156	(4)
Wastewater Treatment System	General Fund		5,044	(4)
		$	38,088	

(1) Represents a loan to support the Rancho Del Pueblo golf course.
(2) Represents proceeds of the commercial paper notes loaned to the Affordable Housing Investment Fund to replace the 20% redevelopment property tax revenues set aside to make the SERAF loan to the former Agency.
(3) Represents a loan for the Roberto Antonio Balermino Park Project.
(4) Represents SERAF loan amounts assumed by the General Fund per the term of the SERAF loan agreement and payable in 2014-2015.

3. Advances Receivable from SARA

At June 30, 2012, the City has advances receivable from the SARA as follows (in thousands):

Receivable Fund	Purpose		Amount
Affordable Housing Investment Fund	SERAF principal	$	64,816
	SERAF interest		555
		$	65,371

In July 2009, the State Legislature passed AB X4 26, which required redevelopment agencies statewide to deposit a total of $2.05 billion of property tax increment into the county held Supplemental Educational Revenue Augmentation Fund ("SERAF") to be distributed to meet the State's Proposition 98 obligations to schools. The former Agency's SERAF obligation was $62,200,000 in fiscal year 2009-2010 and $12,800,000 in fiscal year 2010-2011. Payments were made by May 10 of each respective fiscal year.

On May 4, 2010, the former Agency and the City entered into a loan agreement where the City agreed to loan the former Agency through two separate payments (May 2010 and May 2011) with a combined amount of $74,816,000 to make the SERAF payment. Sources of the loan were from the City's Low and Moderate Income Housing Fund ($64,816,000), which was specifically authorized by the legislation, and idle moneys from City special funds ($10,000,000).

As discussed in Note I.F.16, pursuant to AB X1 26, the City retained the $64,816,000 SERAF Loan made from the Low and Moderate Income Housing Fund in fiscal year 2009-10 and 2010-11 and the interest accrued at the LAIF rate associated with this loan in the amount of $555,000 at June 30, 2012. Under the loan agreement, SARA 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 2015-16.

Management believes, in consultation with legal counsel, that the SERAF Loan made from the Low and Moderate Income Housing Fund and the interest accrued are valid enforceable obligations payable by SARA under the requirements of the AB X1 26. A portion of this receivable is questioned in the County Auditor-Controller's report as discussed in Note IV.D.3. However, since the County Auditor Controller has no legal authority under AB X1 26 to enforce this determination, the City has not made adjustments to the financial statements to reflect this view. It is reasonably possible that a determination may be made at a later date by an appropriate State or judicial authority that would resolve this issue unfavorably to the City. The City has not made adjustments to the financial statements due to this uncertainty.

4. Due to SARA

The former Agency entered into Annual Cooperation Agreements to assist in funding various projects constructed on its behalf by the City and to reimburse the City for the actual salaries and fringe benefits of City employees who work under the supervision of the former Agency's Executive Director or designee, as well as other City staff in providing support services to the former Agency. As of June 30, 2012, the City has a payable amount of $124,000 to recognize the total reimbursements due to SARA. The City's Housing Activities Fund is also due $726,000 to the SARA for reimbursement of prepaid housing administrative expenditures at June 30, 2012.

5. Long-term Advances from SARA

The former Agency advanced a portion of a loan made by the City's Housing Department to a third party for a transitional housing project. The former Agency is entitled to 24.5% of the total loan repayment or $280,280. The advance will be repaid to SARA in part in FY 2012-13 and future payments will be made to SARA as the loan is collected by the City's Housing Department.

6. 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:

Transfers from	Transfers to	Amount	
Airport	General Fund	$ 115	(1)
Wastewater Treatment System	General Fund	256	(2)
	Nonmajor Governmental Funds	1,724	(3)
Municipal Water System	General Fund	242	(4)
	Nonmajor Governmental Funds	117	(5)
	San José Financing Authority	149	(6)
Parking System	General Fund	506	(7)
	Nonmajor Governmental Funds	248	(8)
		$ 3,357	

(1) Transfer to General Fund for Human Resources/Payroll System upgrade.
(2) Transfer to General Fund for Human Resources/Payroll System upgrade.
(3) Transfers of $1,671 for City Hall debt service payments and $53 for the household hazardous waste facility.
(4) Transfer of $17 to General Fund for Human Resources/Payroll System upgrade and $225 for administrative services.
(5) Transfer for City Hall debt service payments.
(6) Transfer for debt service payments.
(7) Transfer of $9 to General Fund for Human Resources/Payroll System upgrade and $497 miscellaneous non-downtown receipts.
(8) Transfer of $168 for City Hall debt service payments and $80 for the Downtown Property and Business Improvement District.

Between governmental activities:

Transfers from	Transfers to	Amount	
General Fund	San José Financing Authority	$ 2,295	(1)
	Nonmajor Governmental Funds	24,827	(2)
	Internal Service Funds	111	(3)
Redevelopment Agency	General Fund	357	(4)
	Housing Activities	17,532	(5)
	San José Financing Authority	1,681	(6)
	Nonmajor Governmental Funds	150	(7)
Housing Activities	Affordable Housing Investment Fund	346,047	(8)
	General Fund	26	(9)
	Nonmajor Governmental Funds	727	(10)
	San José Financing Authority	136	(11)
	Redevelopment Agency	23,350	(11)
Nonmajor Governmental Funds	General Fund	10,352	(12)
	Nonmajor Governmental Funds	12,335	(13)
	San José Financing Authority	30,239	(14)
	Redevelopment Agency	1,806	(15)
San José Financing Authority	Nonmajor Governmental Funds	42	(16)
	Special Assessment Districts	16	(17)
Special Assessment Districts	General Fund	143	(18)
Internal Service Funds	General Fund	608	(19)
	Nonmajor Governmental Funds	212	(20)
		$ 472,992	

(1) Debt service payments of $1,490 for the 2007A bond series and $805 to replenish the Financing Authority.
(2) Transfers for various debt service payments, loan repayments, operations and subsidies.
(3) Transfers of $9 to increase flexible spending account and $102 for vehicle and fleet replacement.
(4) Transfer for San José Arena pass-through payment.
(5) Transfer of 20% former Agency property tax increment revenue required under the former California Community Redevelopment Law prior to the dissolution of the former Agency.
(6) Pledged obligation payment for 4th Street and San Fernando parking facility.
(7) Transfers for Hellyer-Piercy Assessment District improvements pursuant to the terms of the improvement districts.
(8) Transfers for the establishment of the Affordable Housing Investment Fund, as Housing Successor of the former Agency.
(9) Transfer to General Fund for Human Resources/Payroll System Upgrade.
(10) Transfer for City Hall debt service payment.
(11) Transfers for various debt service payments.
(12) Various transfers for project savings, operations, interest earnings, and capital projects.
(13) Various transfers for debt service, operations, capital projects, and project savings.
(14) Various transfers for debt service payments.
(15) Transfer for HUD 108 loan payments.
(16) Transfer of library project completion surplus.
(17) Return of issuance cost related to the Special Hotel Tax Revenue Bonds.
(18) Transfer to General Fund for administrative services.
(19) Transfers of $15 for the Human Resources/Payroll System Upgrade, $5 interest earnings, $88 for Plan and Specific Programs, $200 over-collected funds and $300 for operations.
(20) Transfers of $202 for debt service payments and $10 to the Civic Center Construction Fund.

H. Governmental Fund Balances

As of June 30, 2012, total fund balances for the City's major and nonmajor governmental funds are as follows (dollars in thousands):

	General Fund	Housing Activities	Affordable Housing Investment Fund	Special Assessment Districts	San José Financing Authority Debt Service	Nonmajor Governmental Funds	Total Governmental Funds
Nonspendable:							
Advances and deposits	$ 13	$ -	$ -	$ 5	$ -	$ 41	$ 59
Other assets	-	-	-	-	-	20,462	20,462
Subtotal	13	-	-	5	-	20,503	20,521
Restricted for:							
General government	300	-	-	-	-	-	300
Public safety	-	-	-	-	-	4,143	4,143
Community services	92	44,731	355,143	-	-	90,132	490,098
Capital Maintenance	-	-	-	125,491	-	239,416	364,907
Debt service	-	-	-	-	24,955	37,153	62,108
Subtotal	392	44,731	355,143	125,491	24,955	370,844	921,556
Committed to:							
General government	29,856	-	-	-	-	-	29,856
Public safety	7,046	-	-	-	-	-	7,046
Community services	15,952	-	-	-	-	13,692	29,644
Sanitation	29	-	-	-	-	11,710	11,739
Capital Maintenance	9,881	-	-	-	-	3,526	13,407
Capital outlay	250	-	-	-	-	-	250
Subtotal	63,014	-	-	-	-	28,928	91,942
Assigned to:							
General government	19,133	-	-	-	-	-	19,133
Public safety	35,182	-	-	-	-	-	35,182
Community services	9,288	-	-	-	-	13,288	22,576
Sanitation	76	-	-	-	-	-	76
Capital Maintenance	6,557	-	-	-	-	19,385	25,942
Subtotal	70,236	-	-	-	-	32,673	102,909
Unassigned	49,373	-	-	-	-	(172)	49,201
Total fund balances	**$ 183,028**	**$ 44,731**	**$ 355,143**	**$ 125,496**	**$ 24,955**	**$ 452,776**	**$ 1,186,129**

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 reserve fund was 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. In addition, a cash and emergency reserve funds were established by the City Charter to address known but unspecified expenses and emergency needs. 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, 2012, 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, 2012, 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, 2012, the emergency reserve amount accounts for $3,000,000 of the unassigned fund balance.

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 the City's Municipal Code.

The current membership in the Defined Benefit Pension Plans as of June 30, 2012, is as follows:

	PFDRP	FCERS
Defined Benefit Pension Plans:		
Retirees and beneficiaries currently receiving benefits	1,910	3,688
Terminated vested members not yet receiving benefits	166	969
Active members	1,718	3,076
Total	3,794	7,733

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

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 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. Retirement Systems' Boards policy is to obtain actuarial evaluations every year beginning June 30, 2010. The most recent valuations were completed as of June 30, 2011 and included in the valuations was the Retirement Systems Boards' adopted funding policy of establishing the annual required contribution to be the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll for the fiscal year.

The City fully funded the fiscal year 2011-2012 annual required contribution amount on July 1, 2011 as reported in the June 30, 2011 actuarial valuations.

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 2012 was calculated to be actuarially equivalent to the bi-weekly 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, 2011.

The contribution rates for the Defined Benefit Pension Plans for the City and the participating employees for fiscal year 2012 were established in accordance with actuarially determined requirements computed through actuarial valuations dated June 30, 2010, except for the period June 24, 2012 through June 30, 2012, which were based on the June 30, 2011 valuation. The contribution rates in effect and the amounts contributed to the pension plans for the fiscal year ended June 30, 2012 are as follows (dollars in thousands):

	PFDRP			FCERS		
	City[1]	Participants	Total	City[1]	Participants	Total
Actuarial Rate:						
Defined Benefit Pension Plan:						
7/01/11 - 6/23/12 (police members)	49.29%	10.46%				
7/01/11 - 6/23/12 (fire members)	51.05%	10.76%				
7/01/11 - 6/23/12				28.34%	4.68%	
6/24/12 - 6/30/12 (police members)	56.57% [2]	11.13%				
6/24/12 - 6/30/12 (fire members)	58.43% [2]	11.21%				
6/24/12 - 6/30/12				44.45% [2]	5.74%	
Annual Pension Contribution						
Defined Benefit Pension Plan	$ 121,009	$ 19,345	$ 140,354	$ 87,082	$ 10,555	$ 97,637

(1) The actual contribution rates paid by the City for the fiscal year ended June 30, 2012 differed due to the City funding the annual required contribution amount based on the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll for the fiscal year.

(2) The resolutions adopted by the Retirement Plans' Boards setting the contribution rates for fiscal year 2012-2013 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 2012-2013.

3. Annual Pension Cost and Net Pension Obligation

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

	Fiscal year ended	Annual Pension Cost (APC)(1)	Percent APC Contributed	Net Pension Obligation
PFDRP	6/30/10	$ 52,315	100%	$ -
	6/30/11	77,918	100%	-
	6/30/12	121,009	100%	-
FCERS	6/30/10	54,566	100%	-
	6/30/11	59,180	100%	-
	6/30/12	87,082	100%	-

(1) 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, 2011, the most recent actuarial valuation date, PFDRP was 84% funded for pension benefits (an increase from 80% in the June 30, 2010 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 $510,286,000. The UAAL does not reflect the impact of approximately $58,000,000 of accumulated deferred investment loss resulting from unfavorable investment returns from fiscal years 2008 and 2009. 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, 2011 actuarial valuation date, PFDRP's AAL decreased by approximately $34,449,000 due to favorable demographic experience and changes in actuarial assumptions as recommended by the PFDRP's Board's actuary in the June 30, 2011 experience study. PFDRP's UAAL decreased from approximately $653,751,000 as of June 30, 2010 to $510,286,000 as of June 30, 2011.

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

(a) 14% reduction in the number of active members;

(b) 24% reduction in expected payroll;

(c) increase in amortization period for changes in methods and assumptions from closed 16-year periods to closed 20-year period beginning with the valuation date in which they are effective;

(d) 11.5% reduction in average pay;

(e) reduction in the discount rate from 7.75%, net of expenses, to 7.50%, net of investment expenses[*]; and

(f) reduction in wage growth assumption from 4.25% to 0% for two years and 3.5% thereafter.

(*) The June 30, 2011 valuation includes the Board approved the actuary's recommendation to include administrative expenses and supplemental retiree benefits reserve (SRBR) costs as additions to normal cost (valued at $3.0 million for administrative expenses and 0.22% of the market value of assets for the SRBR). SRBR is a reserve required by the Municipal Code to be set aside from investment earnings to provide supplemental benefits to retirees.

The annual required contribution determined for PFDRP in the June 30, 2010 valuation for fiscal year ended June 30, 2012 was the greater of $121,009,000 (if paid at the beginning of the fiscal year) or 51.05% for fire member and 49.29% for police members of actual payroll for the fiscal year. PFDRP's payroll for fiscal year 2012 of $184,746,000 was less than the actuarial payroll of $251,058,000 resulting in an annual contribution of $121,009,000 as of July 1, 2011, including year end contributions receivable and prior year contribution adjustments.

FCERS's Funded Status and Funding Progress. As summarized in the table below, as of the June 30, 2011 actuarial valuation date, FCERS was 65% funded on an actuarial basis for pension benefits. FCERS's UAAL of $981,567,000 does not reflect the impact of approximately $28,000,000 of accumulated deferred investment losses resulting primarily from unfavorable investment returns in fiscal years 2008 and 2009. FCERS' actuarial valuation uses a five-year smoothing method for investment returns, This means that the current year's gains or losses, as calculated at year-end, are smoothed with the results from the prior four years.

As of June 30, 2011, FCERS's most recent actuarial valuation, the funded status of FCERS decreased from 69% to 65%. The decrease in pension funding status was primarily due to actuarial assumption changes as recommended by the FCERS Board's actuary and adopted by the Board for the June 30, 2011 valuation.

FCERS's June 30, 2011 actuarial valuation includes the following actuarial assumption changes:

(a) a decrease in the investment return assumption from 7.95%, net of expenses, to 7.50%, net of investment expenses only[*];

(b) a decrease in the payroll wage inflation assumption from 3.90% to 3.25%; and

(c) a decrease of 14% in the number of active members and decrease of 24% in the expected payroll.

[*] The June 30, 2011 valuation includes the Board approved actuary's recommendation to include administrative expenses and supplemental retiree benefits reserve (SRBR) costs as additions to normal cost (valued at 0.70% of payroll for administrative expenses and 0.35% of the market value of assets for the SRBR). SRBR is a reserve required by the Municipal Code to be set aside from investment earnings to provide supplemental benefits to retirees.

Defined Benefit Pension Plans' Funded Status and Funding Progress Summary

	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	UAAL	Funded Ratio	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
PFDRP	6/30/11	$ 2,685,721	$ 3,196,007	$ 510,286	$ 84%	$ 190,726	$ 268%
FCERS	6/30/11	1,788,660	2,770,227	981,567	65%	228,936	429%

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 a "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 2012-2013 provide that the employer's contribution rates may be adjusted in order to achieve a minimum dollar contribution for fiscal year 2012-2013.

The annual required contribution determined for FCERS in the June 30, 2010 valuation for fiscal year ending June 30, 2012 was the greater of $86,888,000 (if paid at the beginning of the fiscal year) or 28.34% of actual payroll for the fiscal year. The actual payroll of FCERS for the fiscal year of $224,742,000 was less than the actuarial payroll of $318,544,000 resulting in an annual contribution of $87,082,000, including year-end contributions receivable and prior year contribution adjustments of $194,000.

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:

PFDRP

Description	Method/Assumption	Method/Assumption
Valuation date	June 30, 2011	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 pay, closed, layered; equivalent single amortization period 13.6 years	Level percentage of payroll (assuming a 4.25% total payroll increase), closed, layered; equivalent single amortization period of 15 years
Remaining amortization period	(1) Outstanding balance of the unfunded accrued liability calculated through the June 30, 2003 valuation amortized over next 6 years; (2) Prior service cost for the February 4, 1996 benefit improvement amortized over the next 6 years; (3) Actuarial gains and losses and plan changes are amortized over 16 years from the date of each such event, beginning with the June 30, 2005 valuation; and (4) Actuarial methods and assumption changes are amortized over 20 years from the date of each such event, beginning with the June 30, 2011 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 80% to 120% Market Value Corridor	5 year smoothed market with a 80% to 120% Market Value Corridor
Investment rate of return	7.5% per annum (net of investment expenses)	7.75% per annum (net of administrative, SRBR and investment expenses)
Post-retirement mortality	RP-2000 Male Combined Healthy Mortality Table with no collar adjustment, projected 10 years. (set back 3 years) RP-2000 Female Combined Healthy Mortality Table with no collar adjustment, projected 10 years. RP-2000 combined healthy male mortality table with no collar adjustment, projected 10 years, set back 2 years.	(a) Service: 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. (b) Disability: RP-2000 combined healthy male mortality table with no collar adjustment, projected 10 years, set back 1 year.
Active service, withdrawal, death, disability service retirements	Based upon the June 30, 2011 Actuarial Experience Analysis.	Based upon the June 30, 2009 Actuarial Experience Analysis.
Salary increases	0.00% for FY 2013 and 2014, and 3.5% thereafter. Merit component added based on an individual years of service ranging from 8.00% to 2.25%.	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.

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

FCERS

Description	Method/Assumption	Method/Assumption
Valuation date	June 30, 2011	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	7.50% per annum	7.95% per annum
Postretirement mortality	For healthy annuitants, the male and female RP-2000 combined employee and annuitant mortality tables projected to 2015 and set back two years. For disabled annuitants, the CalPERS ordinary disability table from their 2000-2004 study for miscellaneous employees.	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 3.25% inflation rate plus a rate increase for merit/longevity for years 0 to 15+ years of service ranging from 4.50% to 0.25% at the 14th 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 total payroll increases	3.25%	3.90%

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 and their beneficiaries. 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, 2012, is as follows:

	PFDRP	FCERS
Postemployment Healthcare Plans:		
Retirees and beneficiaries currently receiving benefits	1,852	3,062
Terminated vested members not yet receiving benefits	5	111
Active members	1,718	3,076
Total	3,575	6,249

2. OPEB Funding Policy

As stated above in the Defined Benefit Pension Plan section of this note, Retirement Systems' Boards policy is 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 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 2012 was calculated to be actuarially equivalent 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, 2011, 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 and June 28, 2009 for police 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 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 2012 was the third 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. Fiscal year 2012 was the first year of the phase-in for fire 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, 2012 was the third 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 2012 were based on actuarial valuations dated June 30, 2010, except for the period June 24, 2012 through June 30, 2012, which were based on the June 30, 2011 valuation. The contribution rates in effect and the amounts contributed to the PFDRP and the FCERS for the fiscal year ended June 30, 2012 are as follows (dollars in thousands):

	PFDRP			FCERS		
	City [1]	Participants	Total	City [1]	Participants	Total
Actuarial Rate:						
Postemployment Healthcare Plan:						
7/01/11 - 6/23/12 (police members)	7.61%	7.01%				
7/01/11 - 6/23/12 (fire members)	5.27%	4.86%				
7/01/11 - 6/23/12				7.16%	6.52%	
6/24/12 - 6/30/12 (police members)	8.96% [2]	8.26%				
6/24/12 - 6/30/12 (fire members)	6.62% [2]	6.11%				
6/24/12 - 6/30/12				7.91% [2]	7.26%	
Annual OPEB Contribution						
Postemployment Healthcare Plan:	$ 21,205	$ 11,474	$ 32,679	$ 25,834	$ 14,995	$ 40,829

(1) The actual contribution rates paid by the City for the fiscal year ended June 30, 2012 differed due to the City funding the annual required contribution amount based on the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll for the fiscal year.

(2) The resolutions adopted by the Retirement Plans' Boards setting the contribution rates for fiscal year 2012-2013 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 2012-2013.

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, 2012, were as follows (dollars in thousands):

	PFDRP	FCERS
Annual required contribution	$ 63,824	$ 66,991
Interest on net OPEB obligation	8,753	5,235
Adjustment to annual required contribution	(7,220)	(4,822)
Annual OPEB cost	65,357	67,404
Contributions made	(21,205)	(25,834)
Implicit rate subsidy	(4,730)	(4,382)
Increase in net OPEB obligation	39,422	37,188
Net OPEB obligation – beginning of year	154,105	89,510
Net OPEB obligation – end of year	$ 193,527	$ 126,698

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

	Fiscal year ended	Annual OPEB Cost	Total Employer Contributions	Percent Annual OPEB Cost Contributed	Net OPEB Obligation
PFDRP	6/30/10	$ 38,536	$ 15,994	42%	$ 107,054
	6/30/11	64,108	17,057	27%	154,105
	6/30/12	65,357	25,935	40%	193,527
FCERS	6/30/10	39,414	21,585	55%	62,589
	6/30/11	48,529	21,608	45%	89,510
	6/30/12	67,404	30,216	45%	126,698

4. OPEB Funded Status and Funding Progress

As summarized in the table below, as of June 30, 2011, 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, 2011 valuation date (dollars in thousands):

	Actuarial Valuation Date	**Actuarial Value of Assets**	**Actuarial Accrued Liability (AAL)**	**UAAL**	**Funded Ratio**	**Annual Covered Payroll**	**UAAL as a Percentage of Covered Payroll**
PFDRP	6/30/2011	$ 60,709	$ 1,003,795	$ 943,086	6%	$ 190,726	494%
FCERS	6/30/2011	135,454	1,145,359	1,009,905	12%	228,936	441%

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 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 a "floor funding method" for payment of the 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 2012-2013 provide that the employer's contribution rates may be adjusted in order to achieve a minimum dollar contribution for fiscal year 2012-2013.

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, 2012 were based on the actuarial valuation performed as of June 30, 2010, except for the period June 24, 2012 through June 30, 2012, which were based on the June 30, 2011 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:

PFDRP

Description	Method/Assumption	Method/Assumption
Valuation date	June 30, 2011	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, 2011, open	30 years as of June 30, 2010, open
Actuarial asset valuation method	5 year smoothed market with a 80% to 120% Market Value Corridor	5 year smoothed market with a 80% to 120% Market Value Corridor
Discount rate*	5.7%	6.3%
Inflation rate	3.5%	3.5%
Projected payroll increases	0.00% for FY 2013 and 2014, and 3.50% thereafter. Merit component added based on individual year's of service ranging from 8.00% to 2.25%	4.25% (includes across-the-board salary increase of 0.75%).
Healthcare cost trend rate:		
Medical	Future medical inflation assumed to be at 9.17% per annum graded down to 4.5% over a 15 year period for medical-pre age 65 and 6.83% per annum graded down to 4.5% over a 15 year period for medical-post age 65.	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	4.50% graded down to 4% over a three year period.	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 portion of the ARC contributed by the City for the fiscal year.

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:

FCERS

Description	Method/Assumption	Method/Assumption
Valuation date	June 30, 2011	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 (net)*	6.10%	6.71%
Inflation rate	3.25%	3.90%
Salary increases	The base annual rate of salary increase is 3.25% inflation rate plus a rate increase for merit/longevity for 0 to 14+ years of service ranging from 4.5% to 0.25% at the 15th 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	3.25%	3.90%
Healthcare cost trend rate:		
Medical	The valuation assumes that future medical inflation will be at a rate of 9.17% per annum graded down to 4.5% per annum over a 15 year period for medical-pre age 65 and 6.83% to 4.5% per annum graded down over a 15 year period 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.
Dental	Dental inflation is assumed to be 4.5% graded down to 4% over a three year period.	Dental inflation is assumed to be 5% graded down to 4% over a four year period.

* 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.

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. On January 24, 2012, the City Council voted to terminate its contract with CalPERS. The City subsequently delivered a resolution of its intention to terminate its contract with CalPERS and is currently awaiting a termination valuation report from CalPERS for determining the potential liability for any deficit in funding relating to current participants earned benefits. 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, 2012 was 15.526%. The contractual employee cost sharing is 7.0% plus a fee of $0.93 per bi-weekly pay period pay period for the 1959 Survivor Benefit program, 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, 2012, 2011, and 2010 were $117,000, $108,000, and $127,000, respectively, equal to the required contributions for each year.

B. Commitments and Contingencies

1. Norman Y. Mineta San José International Airport

Purchase Commitments. As of June 30, 2012, the Airport was obligated for purchase commitments of approximately $9,600,000, primarily for the remainder of the costs for Terminal Area Improvement Program (TAIP) projects. Additionally, the Airport has projected that it will expend or encumber approximately $105,100,000 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 the fuel supplier 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, 2012, the Airport paid its share of the remediation costs totaling $109,000.

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 has recently demolished its fuel farm and removed its Underground Storage Tanks (“USTs”) during fiscal year 2010. The City removed its USTs in September 2011. The fuel supplier is currently starting the site’s interim remedial action approved by the County in February 2012. The approved plan is a fixed area remedial excavation to remove the secondary source materials beneath and adjacent to the former USTs.

With the adoption of GASB Statement No. 49, the Airport has accrued $714,000 as of June 30, 2012 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 $1,400,000 and $2,000,000 depending upon the method of accomplishment and actual remediation requirements.

Master Plan. The Airport Master Plan consists of a program of facility improvements designed to fully accommodate commercial aviation demand (passengers and cargo) projected for the future, with development phased as demand warrants and is determined to be financially feasible. The Master Plan was originally adopted by the City of San José 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 TAIP. Most of the program elements of Phase 1 were completed as of June 30, 2012. Ongoing projects include a common use lounge, Terminal A/A+ space refurbishment, building system upgrades, Terminal A baggage system ceiling protection, and completion of the northeast area (formerly the rental car fueling and wash site). The northeast area will provide for a fuel truck maintenance facility, shuttle bus staging and storage, a taxi staging building, and adjacent employee parking. Construction of the Phase 2 projects is contingent upon satisfying specified activity-based triggers. In June 2010, the City Council approved an additional amendment to the Master Plan that updated projected aviation demand and facility requirements, and modified specific components of the Airport Development Program. Pursuant to the amended Master Plan, the former interim long-term public parking and employee parking lots on the northwest side of the Airport (which have been relocated to the east side terminal area) will be gradually converted to new general aviation leasehold facilities. A request for proposals for a second full service fixed based operator was issued and is anticipated that a lease will be approved by the City in fiscal year 2013. 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. San José – Santa Clara Water Pollution Control Plant

For fiscal years 2013-2017, the Five Year capital improvement program includes approximately $17,884,000 for 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, 2012 an amount of $120,201,000 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.

3. Retirement Systems – Unfunded Commitments

As of June 30, 2012, the PFDRP had unfunded commitments to contribute capital for private equity, direct lending, and real estate investments in the amount of $115,934,000 and FCERS had unfunded commitments to contribute capital for private equity fund investments in the amount of $105,377,000.

4. 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, 2012, 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.

5. 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, 2012, total governmental fund encumbrance balances for the City are as follows (dollars in thousands):

General Fund	$ 20,444
Housing Activities	1,484
Affordable Housing Investment Fund	10,705
Special Assessment Districts	72,779
Nonmajor governmental funds	35,610
Total governmental funds	$ 141,022

C. Successor Agency to the Redevelopment Agency of the City of San José

1. Cash and Investment Held by SARA

A summary of SARA's cash and investments at June 30, 2012 is as follows (dollars in thousands):

Type of Investment	Credit Rating	Maturity (in days) Under 30	31 - 180	181 - 365	366 to 3 years	Fair Value
State of California						
Local Agency Investment Fund	Unrated	$ -	$ -	$ 26,615	$ -	$ 26,615
U.S. Treasury Notes	Aaa	-	-	-	8,280	8,280
Money Market Mutual Funds	Aaa	92,310	3,438	-	-	95,748
Subtotal		$ 92,310	$ 3,438	$ 26,615	$ 8,280	130,643
Certificates of Deposit						8,251
Restricted deposit in transit to fiscal agent						16,630
Bank deposits						5,440
Total cash and investments						$ 160,964

2. Property Held for Resale and Capital Assets Held by SARA

Property Held for Resale is recorded as an asset at the lower of cost or net realizable value. SARA reclassifies capital assets originally received from the former Agency to property held for resale upon the State Department of Finance approval of a Long-Term Property Management Plan or when the conversion of property for cash is necessary to pay SARA's enforceable obligations when due.

During the five-month period ended June 30, 2012, SARA reclassified 4 properties with a book value of $49,891,000 from capital assets to property held for resale and wrote down these properties in the amount of $27,417,000 to their lower of cost or net realizable value.

SARA holds the following capital assets as of June 30, 2012 (dollars in thousands):

	Feburary 1, 2012	Additions	Recategorized to Property Held for Resale	June 30, 2012
Capital assets, not being depreciated:				
Land	$ 66,036	$ -	$ (31,432)	$ 34,604
Construction in progress	977	-	-	977
Total capital assets, not being depreciated	67,013	-	(31,432)	35,581
Capital assets, being depreciated:				
Buildings	109,097	-	(20,510)	88,587
Building and other improvements	19,399	-	-	19,399
Equipment	1,145	-	-	1,145
Total capital assets, being depreciated	129,641	-	(20,510)	109,131
Less accumulated depreciation for:				
Buildings	12,892	1,426	(2,051)	12,267
Building and other improvements	2,405	539	-	2,944
Equipment	950	75	-	1,025
Total accumulated depreciation	16,247	2,040	(2,051)	16,236
Total capital assets, being depreciated, net	113,394	(2,040)	(18,459)	92,895
Private-Purpose Trust Fund capital assets, net	$ 180,407	$ (2,040)	$ (49,891)	$ 128,476

Parcels of the former Agency-owned land with an aggregate book value of $19,300,000 were used to secure the Letters of Credit ("LOCs") obtained from JPMorgan Chase Bank (JPMorgan) supporting the former Agency's 1996 and 2003 Revenue Variable Bonds. In addition, as additional security for the LOCs, the City executed and recorded for the benefit of the JPMorgan a Deed of Trust against the City owned California Theatre. As security for payments due to the County under the Settlement Agreement executed in March 2011, the former Agency also (i) executed and recorded for the benefit of the County Deeds of Trust subordinate to JPMorgan on those same parcels of former Agency-owned land (except for the California Theatre), (ii) assigned to the County one-half (1/2) of the former Agency sales proceeds from the sale of the North San Pedro properties under two separate Disposition and Development Agreements with private developers, and (iii) executed and recorded for the benefit of the County a Deed of Trust against the North San Pedro properties, with an aggregate book value of $18,300,000.

In addition, the José Theatre and three other properties were used to secure HUD Section 108 loans obtained from the U.S. Department of Housing and Urban Development.

3. Summary of SARA's Long-Term Debt

The following is a summary of bonds and loans payable of the SARA as of June 30, 2012 (dollars in thousands, unless otherwise noted):

Type of Indebteness	Purpose	Issue Amount	Issue Date	Final Maturity	Range of Interest Rates	Principal Payments (millions)	Balance June 30, 2012
Tax Allocation Bonds (TAB):							
1993 Merged Refunding	Advance refunding	$ 692,075	12/01/1993	08/01/2015	6.00%	$0-18,195	$ 18,195
1997 Merged	Merged area project	106,000	03/27/1997	08/01/2028	5.38-5.63%	$10-715	5,810
1999 Merged	Merged area project	240,000	01/06/1999	08/01/2019	4.75%	$0-7,165	12,920
2002 Merged	Merged area project	350,000	01/24/2002	08/01/2015	4.00-4.50%	$0-11,290	13,165
2003 Merged	Merged area project	135,000	12/22/2003	08/01/2033	4.00-5.00%	$0- 34,100	127,545
2004 A Merged Refunding	Refunding TABs	281,985	05/27/2004	08/01/2019	4.23- 5.25%	$8,775-31,900	193,215
2005 A/B Merged Refunding	Refunding TABs	220,080	07/26/2005	08/01/2028	4.00- 5.00%	$0-26,210	198,115
2006 A/B Merged	Merged area project	81,300	11/14/2006	08/01/2035	4.50- 5.65%	$0-21,000	80,300
2006 C/D Merged Refunding	Refunding TABs	701,185	12/15/2006	08/01/2032	3.75-5.00%	$0-74,280	698,990
2007 A-T/B Merged	Merged area project	212,930	11/07/2007	08/01/2036	0-5.10%	$0-23,970	205,685
2008 A/B Merged	Merged area project	117,295	11/13/2008	08/01/2035	0-7.00%	$0-6,700	107,860
							1,661,800
Revenue Demand Bonds (Subordinate):							
1996 Merged Area Revenue, Series A/B	Merged area projects	59,000	06/27/1996	07/01/2026	Variable	$2,000-4,000	46,000
2003 Merged Area Revenue, Series A/B	Merged area projects	60,000	08/27/2003	08/01/2032	Variable	$1,300-3,900	47,655
							93,655
Housing Set-Aside Tax Allocation Bonds:							
1997 Housing, Series E	Low-moderate income housing	17,045	06/23/1997	08/01/2027	5.75-5.85%	$340-3,670	17,045
2003 Housing, Series J/K	Low-moderate income housing	69,000	07/10/2003	08/01/2029	3.40- 5.25%	$230-3,505	40,815
2005 Housing Series A/B	Low-moderate income housing	129,720	06/30/2005	08/01/2035	0-5.46%	$0-8,300	120,300
2010 Housing Series A/B	Low-moderate income housing	67,405	04/15/2010	08/01/2035	0-5.5%	$0-6,305	62,220
2010 Housing Series C (Subordinate)	Low-moderate income housing	93,000	04/29/2010	08/01/2035	Variable	$2,425-5,210	88,600
							328,980
Other Long-term Debt:							
Pledge Agreement - Revenues Bonds	4th/San Fernando parking facility	48,675	04/10/2001	09/01/2026	4.13-5.25%	$1,740-3,205	33,435
Reimbursement Agreement - Refundin Revenue Bonds 2001F	Convention Center project	190,730	07/01/2001	09/01/2022	4.25-5.00%	$9,150-14,730	129,020
CSCDA 2005 ERAF Loan	Fund the State's ERAF Program	19,085	04/27/2005	08/01/2015	4.77-5.01%	$2,140-2,355	6,735
CSCDA 2006 ERAF Loan	Fund the State's ERAF Program	14,920	05/03/2006	08/01/2016	5.53-5.67%	$1,615-1,905	7,025
HUD Section 108 Loans	Merged area projects	5,200	02/11/1997	08/01/2016	Variable	$355-465	2,035
HUD Section 108 Loans (CIM)	Merged area projects	13,000	02/08/2006	08/01/2025	Variable	$600-1,135	11,830
HUD Section 108 Loans (Story & King)	Merged area projects	18,000	06/30/2006	08/01/2025	Variable	$785-1,570	15,880
City of San José SERAF Loan	Fund the State's SERAF Payment	64,816	2010-2011	06/30/2015	Variable	$12,873-52,499	65,371
Other Long-term Obligation:							
County Pass Through	Pass-through payment	23,562	06/30/2011	06/30/2017	Variable	$4,713	23,562
							294,893
Grand Total							$ 2,379,328

Tax Allocation Bonds (Senior TABs) are issued primarily to finance redevelopment projects and are secured primarily by a pledge of redevelopment property tax revenues (i.e. former tax increment), 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.

Variable-Rate Demand Bonds (Subordinate)

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

The daily and weekly rates are the rates that result in the market value of the bonds being equal to 100% of the principal amount outstanding. The average interest rate for the daily and weekly rates for June 30, 2012, was 0.18% for the 1996 Series A and 0.22% for the 1996 Series B, respectively.

2003 Merged Area Revenue Bonds – In August 2003, the former Agency issued Merged Area Revenue Bonds Series A and Series B aggregating $60,000,000. The proceeds of the bonds were used mainly to finance redevelopment projects within the Merged Area. The 2003 Merged Area Revenue Bonds are ratably and equally secured by a pledge of the subordinated revenues and subordinate to the debt service payment of Senior Obligations of the former Agency.

The 2003 Merged Area Revenue Bonds have a variable rate of interest at a weekly rate, until converted to bear interest at another variable rate or fixed rate at the option of the SARA. The weekly rates are the rates that result in the market value of the bonds being equal to 100% of the outstanding principal and accrued interest. The rates for June 30, 2012 were 0.18% for the 2003 Series A and 0.22% for the 2003 Series B.

The former Agency issued these bonds to provide variable-rate exposure to the debt portfolio and to provide additional flexibility with respect to restructuring or redeeming the debt issued for certain projects. The former Agency has 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 credit facilities that support the SARA's variable-rate bonds as of June 30, 2012 are as follows (dollars in thousands):

	Balance June 30, 2012	Credit Facility Description	
		Provider	Expiration Date*
Revenue Bonds:			
Series 1996A (Merged Area)	$ 23,000	JPMorgan Chase Bank, N.A.	3/1/2013
Series 1996B (Merged Area)	23,000	JPMorgan Chase Bank, N.A.	3/1/2013
Series 2003A (Taxable) (Merged Area)	32,655	JPMorgan Chase Bank, N.A.	3/1/2013
Series 2003B (Merged Area)	15,000	JPMorgan Chase Bank, N.A.	3/1/2013
Total variable-rate revenue bonds	$ 93,655		

* Expiration date of these credit facilities were extended by the JPMorgan Chase Bank.

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

The former Agency obtained four letters of credit (LOCs) as credit facilities from the credit facility provider, JPMorgan Chase Bank (JPMorgan), for the 1996 and 2003 Bonds. On August 7, 2012 JPMorgan agreed to extend the term of the LOCs to March 1, 2013.

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

The SARA is required to pay the credit facility provider an annual commitment fee for each credit facility ranging from 2.1% to 3.0%, based on the terms of the applicable reimbursement agreement and the outstanding principal amount of the bonds supported by the credit facility. In addition, in fiscal year 2010 the former Agency made the required deposit with JPMorgan Chase Bank, N.A., a liquidity reserve in the amount of $5,000,000 as an added source of security of the bank. Parcels of the former Agency owned land and the City's California Theatre were also used to secure the Letters of Credit.

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

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

The Series 2010C were directly purchased by Wells Fargo Bank. Because the bonds were directly purchased, the bond indenture does not require a credit facility to support the debt service payments until the bank's tender date of April 29, 2013, or such other date agreed to in writing by the SARA and Wells Fargo Bank. On June 8, 2012, Moody's Investors Service downgraded the former Agency's Senior Obligations Rating to below "Baa1", which triggered a Special Termination Event under the Continuing Covenant Agreement of the Series 2010C Bonds. The SARA requested that Wells Fargo Bank forbear from exercising its rights, including without limitation, its rights to accelerate the obligations. For the period commencing on August 15, 2012 and ending on November 15, 2012, Wells Fargo Bank has agreed to forebear from exercising and its rights and remedies under the Bond Documents in respect to the existing default. At June 30, 2012, the balance of $88,600,000 is classified as an obligation due within one year. Negotiations are presently under way to extend the forbearance agreement. The SARA cannot predict the outcome of the negotiations.

The Series 2010C bears an interest rate at 1-month LIBOR, two London Business Days before the 1st day of each month plus 250 basis points, with a final maturity date of August 1, 2035. The average weekly interest rate for the Series 2010C as of June 30, 2012 was 3.05%.

A summary of the changes in long-term debt during the period from inception (February 1, 2012) through June 30, 2012 follows (in thousands):

	February 1, 2012	Additions	Reductions	June 30, 2012	Amount Due One Year
Tax allocation bonds:					
1993 Merged Refunding	$ 18,195	$ -	$ -	$ 18,195	$ -
1997 Merged	5,810	-	-	5,810	320
1999 Merged	12,920	-	-	12,920	-
2002 Merged	13,165	-	-	13,165	-
2003 Merged	127,545	-	-	127,545	-
2004 A Merged Refunding	193,215	-	-	193,215	24,640
2005 A/B Merged Refunding	198,115	-	-	198,115	20,545
2006 A/B Merged	80,300	-	-	80,300	-
2006 C/D Merged Refunding	698,990	-	-	698,990	630
2007 A-T/B Merged	205,685	-	-	205,685	2,050
2008 A/B Merged	107,860	-	-	107,860	3,405
1997 Housing, Series E	17,045	-	-	17,045	340
2003 Housing, Series J/K	40,815	-	-	40,815	2,545
2005 Housing, Series, A/B	120,300	-	-	120,300	3,105
2010 Housing, Series A/B	62,220	-	-	62,220	1,430
2010 Housing, Series C	88,600	-	-	88,600	88,600
Subtotal tax allocation bonds	1,990,780	-	-	1,990,780	147,610
Other long-term debt:					
1996 Merged Area Revenue, Series A/B	46,000	-	-	46,000	46,000
2003 Merged Area Revenue, Series A/B	47,655	-	-	47,655	47,655
Pledge Agreement - 4th & San Fernando parking revenue bonds	33,435	-	-	33,435	1,740
Reimbursement Agreement - 2001 Convention Center refunding revenue bonds	129,020	-	-	129,020	9,150
CSCDA ERAF Loans	15,545	-	(1,785)	13,760	3,755
HUD Section 108 loans, variable	29,745	-	-	29,745	1,740
City of San José - SERAF Loans (principal)	64,816	-	-	64,816	-
City of San José - SERAF Loans (interest)	454	101	-	555	-
County Pass-through Obligation	23,562	-	-	23,562	-
Subtotal other long-term debt	390,232	101	(1,785)	388,548	110,040
Subtotal long-term debt before unamortized	2,381,012	101	(1,785)	2,379,328	257,650
Issuance premium (discount)	37,903	-	-	37,903	3,928
Deferred amount on refunding	(40,314)	-	-	(40,314)	(3,524)
Total long-term debt payable	2,378,601	101	(1,785)	2,376,917	258,054
Environmental remediation	356	-	(19)	337	95
Total long-term obligations	$ 2,378,957	$ 101	$ (1,804)	$ 2,377,254	$ 258,149

4. SARA's Conduit Debt

In August 1997, the former 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 the former Agency-owned land in the Japantown Redevelopment Area. The former 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, 2012, the outstanding balance was $9,260,000.

5. City's Commitments to SARA

In the event that future redevelopment property tax revenues are not sufficient to cover the SARA's enforceable obligations, the City has committed other sources of funding to cover costs related to the following obligations: the City of San Jose Financing Authority Lease Revenue Bonds, Series

2001F (Convention Center Refunding), City of San Jose Financing Authority Revenue Bonds, Series 2001A (4^{th} Street & San Fernando Parking Facility Project), Housing and Urban Development (HUD) 108 loans, Education Revenue Augmentation Fund (ERAF) loan payments, and the SARA's annual administrative budget and City Support Service expenses.

6. Commitments and Contingencies Related to SARA

Tax Sharing Agreement with the County of Santa Clara

1983 and 2001 Settlement Agreement

In 1983, the former Agency and the County entered into a tax sharing agreement under which the former 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 former Agency approved an Amended and Restated Agreement (the "Amended Agreement"). In addition to the continued Pass-Through Payment, the Amended Agreement delegated to the County the authority to undertake redevelopment projects in or of benefit to the Merged Area, and requires the Agency to transfer funds to the County to pay for such projects in an amount of 20% of the proceeds of any bonds secured by 80% tax increment (excludes refinancing bonds) (the "Delegated Payment").

March 16, 2011 Settlement Agreement

In September 2009, the former 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 former 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 former 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 pass-through 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 and the San José parties. The following terms and conditions have been completed:

1. The Agency paid the County $21,500,000 in restricted tax exempt bond proceeds.
2. The Agency paid the County an additional $5,000,000 in unrestricted funds.
3. The Agency acquired from the City title to the Old City Hall property and transferred it to the County for a credit of $10,000,000 against the debt; the Agency transferred certain parcels it owned, valued at $10,000,000 in exchange for the Old City Hall.

The following obligation remains outstanding with the County as of June 30, 2012:

1. The Agency will pay the County $23,600,000 in 5 equal annual installments ($4,720,000 per installment plus interest accrued as of the payment date) no later than June 30 of 2014, 2015, 2016, 2017 and 2018.

During the year ended June 30, 2012, the former Agency and SARA did not have sufficient tax increment revenues to make the fiscal year 2011-2012 pass-through payment. The amount of pass-through payments due to the County at June 30, 2012 is $15,719,000. The interest rate for any late pass-through payment for fiscal years 2011-2012 and beyond will be as follows: (a) the rate of return earned by the County Treasurer Investment Pool for the relevant time period (“County Pool Rate”) for the first year the payments are overdue; (b) the County Pool Rate plus 3% additional interest rate penalty for the second year the payment is overdue; (c) the County Pool Rate plus 6% additional interest rate penalty for the third year the payment is overdue; and (d) the County Pool Rate plus 9% additional interest rate penalty for the fourth year and any additional years the payments are overdue, provided however that in no event shall the interest rate exceed 10% in any year.

Ambac Bankruptcy

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

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

Dissolution Legislation “True up” Process

The provisions of AB 1484, which was a trailer bill to the FY 2012-2013 State budget, required that the County Auditor-Controller determine if the tax revenues received by the former Agency in January 2012 (before dissolution) were in excess of the amount spent by the former Agency and SARA on enforceable obligations as defined by the Redevelopment Dissolution Law during the period from January 1 through June 30, 2012. If there was an excess, SARA must remit the residual amounts to the County by July 12, 2012, for allocation to the taxing entities. This is referred to as the “true up” process. Due to the manner in which some of the former Agency’s bond obligations were categorized on the Recognized Obligation Payment Schedule (“ROPS”) during this period, the County Auditor-Controller’s calculations indicated that there was a $39,300,000 “overpayment” of tax revenues to the former Agency. On July 6, 2012, the Oversight Board of SARA approved corrections to the previously approved ROPS to clarify that there were no residual tax revenues to distribute to the taxing entities from the Redevelopment Property Tax Trust Fund (“Trust Fund”) administered by the County’s Auditor-Controller.

SARA has been working with the State Department of Finance (“DOF”) to document why the perceived $39,300,000 “overpayment” is incorrect. However, pending resolution with DOF and per the legislation, on July 9, 2012, the County Auditor-Controller submitted an invoice to SARA in the amount of $39,300,000. SARA has not paid this invoice. The legislation provides that if SARA does not pay the amount owed, the State Board of Equalization will be directed to withhold the City’s sales tax revenues until the amount due is paid. On August 27, 2012, SARA received a letter from DOF indicating that they do not intend to pursue civil penalties or a sales tax offset. Management believes, in consultation with legal counsel and the DOF, that the invoice for the “overpayment” is erroneous.

D. Subsequent Events

1. Tax and Revenue Anticipation Notes

On July 2, 2012, the City entered into the Note Purchase Agreement with U.S. Bank under which U.S. Bank agreed to purchase the City's short-term notes up to a maximum amount of $125,000,000 in accordance with the terms of the Note Purchase Agreement for cash flow borrowing purposes to facilitate the prefunding of employer retirement contributions. Pursuant to the Note Purchase Agreement, the City issued and U.S. Bank purchased the City's notes in the amount of $100,000,000 (the "Initial Note") at a fixed interest rate of 0.952%. Under the Note Purchase Agreement, at the City's discretion, the City may issue subsequent notes at any time up to the Commitment Termination Date of December 31, 2012 and up to the Unutilized Commitment amount of $25,000,000 at a variable interest rate calculated pursuant to the terms of the Note Purchase Agreement. Security for repayment of the Initial Note and any subsequent notes (collectively, the "2012Notes") 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 2013 plus all other legally available General Fund revenues of the City, if required. The final maturity of the Initial Note is February 14, 2013. The final maturity of any subsequent note is June 28, 2013.

2. New Retirement Benefit Tier

On June 5, 2012, the San José voters enacted the *Sustainable Retirement Benefits and Compensation Act (Pension Act)*. The Pension Act amended the City Charter to change benefits for current employees, establish different benefits for new employees, and place other limitations on benefits.

Section 1508-A of the Pension Act applicable to new employees was adopted on August 28, 2012 by City Council Ordinance No. 29120 to provide Tier 2 pension benefits for new FCERS members hired on or after September 30, 2012. The new tier includes significant benefit changes from the existing Tier 1 plan including, but not limited to, a decrease in the benefits multiplier from 2.5% per year to 2.0% per year, an increase from 55 years to 65 years of age for retirement eligibility at full benefits, a consumer price index driven cost-of-living increase with a maximum of 1.5% instead of the existing annual fixed 3.0% increase, a decrease in maximum benefit to 65% of final average salary from 75%, no survivor benefits for death after retirement unless the member elects a reduced benefit, pensionable compensation to be based on base salary only, rather than base compensation plus premium pays; members to contribute 50% of the total Normal Cost, any accrued unfunded actuarial liability and administrative costs of the FCERS; year of service credit to require 2,080 hours of work rather than 1,730 hours of work and final average compensation based on the highest consecutive 3 years of compensation compared to highest 1 year. Significant portions of the Pension Act applicable to existing employees and effective June 23, 2013 are currently subject to legal challenge by members of the FCERS. Additionally, various bargaining units representing members of the FCERS have filed unfair labor practice charges with the California Public Employment Relations Board related to the Pension Act.

3. Successor Agency to the Redevelopment Agency of the City of San José

Findings of the Agreed-Upon Procedures Report

Pursuant to the California Health and Safety Code section 34182, the County Auditor-Controller was responsible to cause the performance of procedures to establish the former Agency's assets and liabilities, to document pass-through obligations, and to document the amount and terms of indebtedness incurred by the former Agency. The County issued its Agreed-Upon Procedures

Report ("AUP") on October 5, 2012 and submitted it to the State Controller's Office ('SCO") and the DOF. Other than as a reference for the DOF and the State Controller's Office, the AUP has no consequence in the dissolution process. The report identified the following issues, which are disputed by the City and SARA:

SERAF Loan – The AUP questions a portion ($54 million) of SARA's total SERAF obligation funded by the former Agency's Low and Moderate Income Housing Fund, stating that it should not be classified as an obligation to the City's Low and Moderate Income Housing Fund. The City's position is that cash was used to fund the SERAF loan, therefore the obligation for repayment of the $54 million remains. As such, the City's Affordable Housing Investment Fund has not removed these receivables nor has SARA removed these obligations from its financial statements at June 30, 2012. The DOF has raised concerns with the SERAF loan in its review of housing asset transfers based on previous discussion with the County Auditor-Controller. This is now the subject of a meet and confer meeting between the City, SARA and the DOF.

Unencumbered Housing Cash – In February 2012, a cash transfer of program income, which consists of loan repayments, development deposits and lease revenues, in the amount of $10.2 million was made from the Low and Moderate Income Housing Fund held by the City to the City's Affordable Housing Investment Fund. The City asserts that the $10.2 million transfers of program income represents Housing Assets and therefore may be transferred to the City's Affordable Housing Investment Fund as the Housing Successor. To date, the independent accountant approved by the County Auditor-Controller has not finalized its "due diligence review" required by Health and Safety Code Section 34179.5 used to determine the balance available for transfer to SARA from the Low and Moderate Income Housing Fund held by the City. As such, neither the City nor SARA has included this transfer back from the City to the SARA in the respective financial statements at June 30, 2012.

Property Transfers – The County Auditor-Controller also stated that numerous properties transferred to the San José Diridon Development Authority in the amount of $29.1 million and the City in the amount of $109.7 million in early 2011 are subject to being ordered transferred back to SARA by the SCO as required under Health and Safety Code Section 34167.5. To date, the SCO has not finalized its final review of asset transfers made by the former Agency. As such, neither the City nor SARA has included these transfers of property back from the City to SARA in the respective financial statements at June 30, 2012.

Due to uncertainties with the Redevelopment Dissolution Law, the ultimate outcome of these issues cannot presently be determined, accordingly, no provision for any liability that may result has been recorded in the financial statements.

4. Airport Debt Refunding

City of San José Airport Revenue Bonds, Series 2012A - On November 8, 2012, the City refunded the City of San José Airport Revenue Bonds, Series 2002A in the amount of $49,140,000. The Series 2012A bonds were purchased as fixed rate direct placement with Bank of America Public Capital Corp with an interest rate of 1.53%. The refunding provides approximately $1,000,000 of debt service savings through the final maturity in 2018.

5. Events (Unaudited) Subsequent to the Date of the Independent Auditor's Report

In November 2012, Wells Fargo Bank agreed to extend the forbearance period to April 29, 2013 to coincide with the expiration of the three year private placement on the former Agency's 2010C Housing Set-Aside Tax Allocation Bonds. In January 2013, the City's Affordable Housing Investment Fund transferred $10.2 million of housing assets back to SARA**.**

Required Supplementary Information

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

City of San José
Required Supplementary Information (Unaudited)
June 30, 2012

General Fund
Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
For the Year Ended June 30, 2012
($000's)

	Budgeted Amounts Original	Budgeted Amounts Final	Actual Amounts Budgetary Basis Variance with Final Budget Over (Under)	Actual Amounts Budgetary Basis	Budgetary to GAAP Differences	Actual Amounts GAAP Basis	
REVENUES							
Taxes and franchise fees:							
Property	$ 201,454	200,275	1,437	201,712	-	201,712	
Sales	140,906	155,390	(1,364)	154,026	-	154,026	
Utility	108,560	111,520	(608)	110,912	-	110,912	
State of California in-lieu	2,821	2,121	490	2,611	-	2,611	
Franchise	43,025	41,800	(91)	41,709	-	41,709	
Business tax	38,795	40,974	160	41,134	-	41,134	
Other	7,202	8,300	684	8,984	-	8,984	
Licenses, permits and fines	52,088	59,745	2,452	62,197	-	62,197	
Intergovernmental	25,228	33,701	(9,037)	24,664	-	24,664	
Charges for current services	30,549	33,671	1,734	35,405	-	35,405	
Investment income	3,551	3,825	674	4,499	182	4,681	(1)
Other revenues	33,763	37,792	(3,679)	34,113	(274)	33,839	(3)
Total revenues	687,942	729,114	(7,148)	721,966	(92)	721,874	
EXPENDITURES							
Current:							
General government	110,617	100,097	(17,972)	82,125	(10,228)	71,897	(2)
Public safety	462,193	459,941	(12,522)	447,419	(3,083)	444,336	(2)
Community services	110,502	121,341	(5,773)	115,568	(1,520)	114,048	(2)
Capital maintenance	49,816	55,839	(12,916)	42,923	(6,252)	36,671	(2)
Sanitation	1,199	1,189	(311)	878	(29)	849	(2)
Capital outlay	3,444	3,577	-	3,577	-	3,577	
Debt service:							
Principal	1,074	1,246	(172)	1,074	-	1,074	
Interest	526	526	-	526	10	536	(5)
Total expenditures	739,371	743,756	(49,666)	694,090	(21,102)	672,988	
Excess (deficiency) of revenues over expenditures	(51,429)	(14,642)	42,518	27,876	21,010	48,886	
OTHER FINANCING SOURCES (USES)							
Proceeds for sale of capital assets	1,800	1,500	(531)	969	-	969	
Transfers in	14,716	11,614	991	12,605	-	12,605	
Transfers out	(25,490)	(31,645)	(4,412)	(27,233)	-	(27,233)	
Total other financing sources (uses)	(8,974)	(18,531)	(3,952)	(13,659)	-	(13,659)	
Extraordinary loss from dissolution of Redevelopment Agency	-	-	-	-	(18,820)	(18,820)	(4)
Net change in fund balances	(60,403)	(33,173)	38,566	14,217	2,190	16,407	
Fund balances - beginning	136,530	136,530	-	136,530	30,091	166,621	
Beginning encumbrance	-	-	-	20,933	(20,933)	-	
Fund balances - ending	$ 76,127	103,357	38,566	171,680	11,348	183,028	

Explanation of differences:
(1) Gain or loss in fair value of investments are not formally budgeted transactions.
(2) Encumbrances of funds for which formal budgets are prepared.
(3) Loan repayments for which budgets are prepared.
(4) Extraordinary loss on dissolution of Redevelopment Agency is not a budgeted transaction.
(5) Interest expenditure associated with assumption of SERAF loan.

See accompanying Notes to Required Supplementary information.

(Continued)

City of San José
Required Supplementary Information (Unaudited)
June 30, 2012

Housing Activities
Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
For the Year Ended June 30, 2012
($000's)

	Budgeted Amounts Original	Budgeted Amounts Final	Actual Amounts Budgetary Basis Variance with Final Budget Over (Under)	Actual Amounts Budgetary Basis	Budgetary to GAAP Differences	Actual Amounts GAAP Basis	
REVENUES							
Intergovernmental	$ 37,015	33,866	(10,272)	23,594	-	23,594	
Investment income	6,449	2,040	(245)	1,795	96	1,891	(1)
Other revenues	12,827	11,116	(199)	10,917	(1,361)	9,556	(3)
Total revenues	56,291	47,022	(10,716)	36,306	(1,265)	35,041	
EXPENDITURES							
Current:							
Community services	106,915	94,388	(46,160)	48,228	(9,830)	38,398	(2), (3)
Total expenditures	106,915	94,388	(46,160)	48,228	(9,830)	38,398	
Excess (deficiency) of revenues over expenditures	(50,624)	(47,366)	35,444	(11,922)	8,565	(3,357)	
OTHER FINANCING SOURCES (USES)							
Transfers in	48,315	31,400	(13,868)	17,532	-	17,532	
Transfers out	(26,465)	(50,955)	7,781	(43,174)	(327,112)	(370,286)	(4)
Total other financing sources (uses)	21,850	(19,555)	(6,087)	(25,642)	(327,112)	(352,754)	
Extraordinary loss from dissolution of Redevelopment Agency	-	-	(6,863)	(6,863)	-	(6,863)	
Net change in fund balances	(28,774)	(66,921)	22,494	(44,427)	(318,547)	(362,974)	
Fund balance - beginning	(4,830)	(4,830)	-	(4,830)	412,535	407,705	
Beginning encumbrance	-	-	-	34,102	(34,102)	-	
Fund balances - ending	$ (33,604)	(71,751)	22,494	(15,155)	59,886	$ 44,731	

Explanation of differences:
(1) Gain or loss in fair value of investments are not formally budgeted transactions.
(2) Encumbrances of funds for which formal budgets are prepared.
(3) Expenditures and repayments that increase and decrease certain loan receivables for which formal budgets are prepared.
(4) Transfer for establishing the Affordable Housing Investment Fund was not budgeted.

See accompanying Notes to Required Supplementary information.

(Continued)

Affordable Housing Investment Fund
Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
For the Year Ended June 30, 2012
($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					
REVENUES							
Investment income	$ -	5	7,269	7,274	127	$ 7,401	(1)
Other revenues	-	13,054	1,525	14,579	(8,566)	6,013	(3)
Total revenues	-	13,059	8,794	21,853	(8,439)	13,414	
EXPENDITURES							
Current:							
Community services	-	24,743	(9,422)	15,321	(11,003)	4,318	(2), (3)
Excess (deficiency) of revenues over expenditures	-	(11,684)	18,216	6,532	2,564	9,096	
OTHER FINANCING SOURCES (USES)							
					-		
Transfers in	-	18,934	(726)	18,208	327,839	346,047	(4)
Net change in fund balances	-	7,250	17,490	24,740	330,403	355,143	
Fund balance - beginning	-	-	-	-	-	-	
Beginning encumbrance	-	-	-	-	-	-	
Fund balances - ending	$ -	7,250	17,490	24,740	330,403	$ 355,143	

Explanation of differences:

(1) Gain or loss in fair value of investments are not formally budgeted transactions.
(2) Encumbrances of funds for which formal budgets are prepared.
(3) Expenditures and repayments that increase and decrease certain loan receivables for which formal budgets are prepared.
(4) Transfer in from the Housing Activities Fund for establishing the Affordable Housing Investment Fund was not budgeted.

See accompanying Notes to the Required Supplementary information.

(Continued)

Schedule of Funding Progress
($000's)

Police and Fire Department Retirement Plan - Defined Benefit Pension Plan

Actuarial Valuation Date	Actuarial Value of Assets (1)	Actuarial Accrued Liability (AAL) (2)	Unfunded (Overfunded) AAL	Funded Ratio	Annual Covered Payroll (3)	Unfunded AAL as a Percentage of Covered Payroll
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%
6/30/11	2,685,721	3,196,007	510,286	84%	190,726	268%

Federated City Employees' Retirement System - Defined Benefit Pension Plan

Actuarial Valuation Date	Actuarial Value of Assets (1)	Actuarial Accrued Liability (AAL) (2)	Unfunded AAL	Funded Ratio	Annual Covered Payroll (3)	Unfunded AAL as a Percentage of Covered Payroll
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%
6/30/11	1,788,660	2,770,227	981,567	65%	228,936	429%

(1) Excludes accounts payable, postemployment healthcare plan assets, supplemental retiree benefit reserve.
(2) Excludes postemployment healthcare liability.
(3) Annual covered payroll represents the actuarial estimate of annual covered payroll for the subsequent year for June 30, 2011 valuation. The amount presented for the June 30, 2009 and 2010 valuations represents actual annual covered payroll.

Police and Fire Department Retirement Plan - Postemployment Healthcare Benefit Plan

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL	Funded Ratio	Annual Covered Payroll	Unfunded AAL as a Percentage of Covered Payroll
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%
6/30/11	60,709	1,003,795	943,086	6%	190,726	494%

Federated City Employees' Retirement System - Postemployment Healthcare Benefit Plan

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL	Funded Ratio	Annual Covered Payroll	Unfunded AAL as a Percentage of Covered Payroll
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%
6/30/11	135,454	1,145,359	1,009,905	12%	228,936	441%

(Continued)

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. 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 statements, 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 statements. In addition, the allowance for bad debts is not included in the budgetary basis financial statements, 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 statements.

(Continued)

- 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 statements.

- 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 statements, 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.

- Certain New Market Tax Credit Financing 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 City extends the leverage loan to outside agency “Chase Investment Fund”, the City records an asset, in the GAAP basis financial statements and an expenditure on the budgetary basis financial schedules.

- Extraordinary losses/gains resulted from dissolution of the former Agency are included in the City’s GAAP basis financial statements. However, formal budgets are not prepared for this event, and as such are excluded from the budgetary basis financial schedules.

III. Budget Revisions

On October 16, 2012, the City Council approved certain fiscal year 2012 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)

This Page Left Intentionally Blank.

MGO Certified Public Accountants.

Walnut Creek
2121 N. California Blvd., Suite 750
Walnut Creek, CA 94596
925.274.0190

Sacramento

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

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, 2012, which collectively comprise the City's basic financial statements, and have issued our report thereon dated November 19, 2012, except for our report on the schedule of expenditures of federal awards, schedule of passenger facility charge revenues and expenditures, and schedule of customer facility charge revenues and expenditures as to which the date is February 7, 2013. Our report contains emphasis of a matter paragraphs discussing the dissolution of the Redevelopment Agency of the City of San José; discussing the $88.6 million 2010 C Housing Set-Aside Tax Allocation Bonds Special Termination Event on June 8, 2012; discussing an uncertainty of $203.0 million of assets held by the City and a component unit in connection with the Redevelopment Dissolution Law; and discussing 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 opinions 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.

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or 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. We consider the deficiency described in item 2012-1 in the accompanying Federal Awards Schedule of Findings and Questioned Costs to be a material weakness.

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. We consider the deficiencies described in items 2012-2, 2012-3 and 2012-4 in the accompanying Federal Awards Schedule of Findings and Questioned Costs to be significant deficiencies.

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.*

We noted certain matters that we reported to management of the City in a separate letter dated November 19, 2012.

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, 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 & O'Connell LLP

Walnut Creek, California
November 19, 2012

MGO Certified Public Accountants.

Walnut Creek
2121 N. California Blvd., Suite 750
Walnut Creek, CA 94596
925.274.0190

Sacramento

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

Independent Auditor's Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major 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* that could have a direct and material effect on each of the City's major federal programs for the year ended June 30, 2012. 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 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; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 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 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 finding 2012-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 Nos. 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.

As described in finding 2012-B in the accompanying Federal Awards Schedule of Findings and Questioned Costs, the City did not comply with requirements of eligibility that are applicable to the Home Investment Partnerships Program (CFDA No. 14.239). 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 paragraphs, 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 for the year ended June 30, 2012.

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. 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 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, 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 deficiencies in internal control over compliance that we consider to be material weaknesses.

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 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 will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying Federal Awards Schedule of Findings and Questioned Costs as findings 2012–A and 2012-B to be material weaknesses.

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, 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 & O'Connell LLP

Walnut Creek, California
February 7, 2013

CITY OF SAN JOSE, CALIFORNIA
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2012

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures: Federal Grant	Expenditures: Other
U.S. Department of Commerce					
Direct programs:					
Economic Adjustment Assistance	11.307	07-39-02866	$ 345,000	$ 60,595	$ -
Economic Adjustment Assistance	11.307	Prior Year Ending Loan Balance	-	394,933	-
Total U.S. Department of Commerce			345,000	455,528	-
U.S. Department of Housing and Urban Development					
Direct programs:					
CDBG - Entitlement Grants Cluster:					
Community Development Block Grants/Entitlement Grants	14.218	B10-11 MC-06-0021	20,047,149	10,876,421	-
Housing and Economic Recovery Act 2008 - Neighborhood Stabilization Program I	14.218	B08-MN-06-0008	8,044,421	180,730	-
ARRA - Community Development Block Grant ARRA Entitlement Grants (CDBG-R)	14.253	B09-MY-06-0021	2,700,463	535,923	-
Community Development Block Grants/Entitlement Grants	14.218	Prior Year Ending Loan Balance	-	6,776,978	-
Subtotal CDBG - Entitlement Grants Cluster			30,792,033	18,370,052	-
Emergency Solutions Grant Program	14.231	S10 MC-060021	556,404	67,156	-
Emergency Solutions Grant Program	14.231	E11MC060021	441,448	406,237	-
Subtotal Emergency Solutions Grant Program			997,852	473,393	-
Home Investment Partnerships Program	14.239	M01-02 MC06215	8,754,615	14,896	-
Home Investment Partnerships Program	14.239	M05-06 MC06215	9,694,145	1,909,578	-
Home Investment Partnerships Program	14.239	M07-08 MC06215	10,311,927	340,329	-
Home Investment Partnerships Program	14.239	MC09-10 MC06215	11,600,058	3,397,010	-
Home Investment Partnerships Program	14.239	MC11-12 MC06215	4,155,900	200,000	-
Home Investment Partnerships Program	14.239	Prior Year Ending Loan Balance	-	48,502,770	-
Subtotal Home Investment Partnerships Program			44,516,645	54,364,583	-
Housing Opportunities for Persons with AIDS	14.241	CA-H0-9-F0-04	796,679	11,077	-
Housing Opportunities for Persons with AIDS	14.241	CA-H0-10-F0-04	871,489	85,828	-
Housing Opportunities for Persons with AIDS	14.241	CA-H0-11-F0-04	861,520	762,127	-
Housing Opportunities for Persons with AIDS	14.241	CA-H10-0004	1,262,800	424,341	-
Subtotal Housing Opportunities for Persons with AIDS			3,792,488	1,283,373	-
ARRA - Homelessness Prevention and Rapid Re-Housing Program	14.257	S-09-MY-06-0021	4,128,763	392,637	-
Pass-through County of Santa Clara:					
ARRA - Neighborhood Stabilization Program II	14.256	B-09-CN-CA-0054	27,442,641	20,452,322	-
Total U.S. Department of Housing and Urban Development			111,670,422	95,336,360	-
U.S. Department of Interior					
Direct program:					
ARRA - Water Reclamation and Reuse Program	15.504	R10AC20R43	6,335,000	1,080,633	1,370,033

See accompanying notes to the Schedule of Expenditures of Federal Awards.

CITY OF SAN JOSE, CALIFORNIA
Schedule of Expenditures of Federal Awards (Continued)
Year Ended June 30, 2012

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures Federal Grant	Expenditures Other
U.S. Department of Justice					
Direct programs:					
Missing Children's Assistance	16.543	2008-MC-CX-K002	1,342,837	214,250	-
Missing Children's Assistance	16.543	2011-MC-CX-K003	392,960	338,709	-
Commercial Sexual Exploitation	16.543	2011-MC-CX-K033	292,000	60,054	-
Subtotal Missing Children's Assistance			2,027,797	613,013	-
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	2008-JL-FX-0161	469,494	18,484	-
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	2009-D1-BX-0108	250,000	7,187	-
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	2010-VT-BX-0010	170,000	80,324	-
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	2011-VT-BX-K006	500,000	61,659	-
Subtotal Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program			1,389,494	167,654	-
Bulletproof Vest Partnership Program	16.607	2010 1121-0235	89,291	89,291	-
Public Safety Partnership and Community Policing Grants	16.710	2010-DD-BX-0618	400,000	104,390	-
Public Safety Partnership and Community Policing Grants	16.710	2009CSWX0023	447,773	47,195	-
Public Safety Partnership and Community Policing Grants	16.710	2010ULWX0028	7,187,984	2,143,389	-
Public Safety Partnership and Community Policing Grants	16.710	2011ULWX0007	1,703,644	166,222	-
Public Safety Partnership and Community Policing Grants	16.710	2009CKWX0131	695,000	13,370	-
Public Safety Partnership and Community Policing Grants	16.710	2010CKWX0395	710,000	287,960	-
Subtotal Public Safety Partnership and Community Policing Grants			11,144,401	2,762,526	-
ARRA - Internet Crimes Against Children Task Force Program (ICAC)	16.800	2009-SN-B9-K017	863,930	311,121	-
Equitable Sharing Program	16.922	CA0431300	-	22,128	-
Edward Byrne Memorial Justice Assistance Grant (JAG) Program Cluster:					
Direct programs:					
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2008-DJ-BX-0220	101,076	1,861	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2009-DJ-BX-0349	370,729	35,389	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2010-DJ-BX-0821	320,933	192,728	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2011-DJ-BX-2315	262,694	41,257	-
ARRA - Edward Byrne Memorial Justice Assistance Grant (JAG) Program/ Grants to Units of Local Government	16.804	2009-SB-B9-0976	1,378,612	375	-
Subtotal JAG Program Cluster Direct programs			2,434,044	271,610	-
Pass-through County of Santa Clara:					
Edward Byrne Memorial Justice Assistance Grant Program	16.738	DC11 22 0430	125,897	101,051	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	ZA09 01 0430	116,801	55,542	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	ZA09 01 0430	19,593	12,998	-
Subtotal pass-through County of Santa Clara			262,291	169,591	-
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	288,497	-
Subtotal JAG Program Cluster			3,071,335	729,698	-
Total U.S. Department of Justice			18,586,248	4,695,431	-

See accompanying notes to the Schedule of Expenditures of Federal Awards.

CITY OF SAN JOSE, CALIFORNIA
Schedule of Expenditures of Federal Awards (Continued)
Year Ended June 30, 2012

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures Federal Grant	Expenditures Other
U.S. Department of Labor					
Direct programs:					
WIA Pilots, Demonstrations, and Research Projects	17.261	EA-18597-09-60-A-6	315,392	22,399	-
WIA Pilots, Demonstrations, and Research Projects	17.261	EA-20121-10-60-A-6	95,000	48,342	-
Subtotal WIA Pilots, Demonstrations, and Research Projects			410,392	70,741	-
Pass-through State of California, Employment Development Department:					
Workforce Investment Act (WIA) Cluster:					
WIA Adult Program:					
25% RR AA II	17.258	K074173523 PSC	445,000	239,587	-
25% RR AA II	17.258	K178692528 TSS	985,000	985,000	-
25% DW	17.258	K178692537 Cisco	3,002,730	37,391	-
WIA Adult 2 Program	17.258	K178692202	2,672,927	1,089,733	-
WIA Adult 2 Program	17.258	K282502201	241,415	241,415	-
WIA Adult 2 Program	17.258	K282502202	2,911,695	1,940,420	-
WIA 15% Incentive Performance	17.258	K178692113	15,352	15,352	-
Subtotal - WIA Adult Program			10,274,119	4,548,898	-
WIA Youth Activities	17.259	K178692301	3,449,393	1,712,016	-
WIA Youth Activities	17.259	K282502301	3,365,644	2,078,561	-
Subtotal - WIA Youth Activities			6,815,037	3,790,577	-
WIA Dislocated Workers:					
NUMMI Bridge	17.260	K074173308	970,000	249,396	-
NUMMI NEG	17.260	K074173768	2,006,901	473,984	-
ARRA - OJT	17.260	K074173775 OJT	725,462	143,421	-
Subtotal - WIA Dislocated Workers			3,702,363	866,801	-
WIA Dislocated Worker Formula Grants:					
WIA DLW 2	17.278	K178692502	2,561,228	1,163,903	-
WIA DLW 2	17.278	K282502501	754,983	754,983	-
WIA DLW 2	17.278	K282502502	3,185,619	914,005	-
WIA RR 2	17.278	K182502541	403,718	238,027	-
WIA RR	17.278	K282502540	113,113	113,113	-
WIA RR	17.278	K282502541	339,339	339,235	-
Subtotal - WIA Dislocated Worker Formula Grants			7,358,000	3,523,266	-
Subtotal WIA Cluster pass-through State of California			28,149,519	12,729,542	-
Workforce Investment Act (WIA) National Emergency Grants:					
NUMMI NEG	17.277	K178692768	1,493,839	1,083,476	-
Total U.S. Department of Labor			30,053,750	13,883,759	-

See accompanying notes to the Schedule of Expenditures of Federal Awards.

CITY OF SAN JOSE, CALIFORNIA
Schedule of Expenditures of Federal Awards (Continued)
Year Ended June 30, 2012

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures	
				Federal Grant	Other
U.S. Department of Transportation					
Direct programs:					
Federal Aviation Administration:					
Airport Improvement Program	20.106	3-06-0226-73	4,628,099	81,245	19,568
Airport Improvement Program	20.106	3-06-0226-76	4,114,764	59,584	14,350
Airport Improvement Program	20.106	3-06-0226-79	2,245,529	632,499	152,336
Airport Improvement Program	20.106	3-06-0226-80	7,496,370	6,914,807	1,665,432
Subtotal Airport Improvement Program			18,484,762	7,688,135	1,851,686
Highway Planning and Construction Cluster:					
Pass-through California Department of Transportation:					
Highway Planning and Construction:					
TiMC (HPP 2017) $5.4M	20.205	HPP2017	5,400,000	664,548	166,137
SVSC ITS Enhancement	20.205	ITS99-5005(058)	3,699,581	329,191	36,460
Safe Routes to School (SRTS)	20.205	SRTSL-5005(091)	770,366	284,443	7,559
Minidoka Avenue Sidewalk Improvement	20.205	SRTSL-5005(097)	746,000	402,098	65,726
TEA-21-ITS: New CC TiMC (Web II)	20.205	ITS03-5005(073)	579,123	45,728	47,629
E. Santa Clara Street Bridge at Coyote Creek	20.205	BRLZ-5005(089)	50,000	7,938	1,028
2010 Street Resurfacing and Rehabilitation	20.205	04-SCL-0-SJS	7,297,000	407,193	287,794
San Carlos Multimodal Streetscape Improvements Phase I	20.205	RPSTPLE-5005(101)	1,500,000	185,282	195,639
ARRA- Resurfacing Project	20.205	ESPL-5005(096)	15,414,200	100,268	-
Subtotal Highway Planning and Construction			35,456,270	2,426,689	807,972
Recreational Trails Program:					
SAFETEA-LU Trail: Bay Reach 7/9 (aka Reach 9B)	20.219	SCL 050082 HPLUL-5005(086)	422,156	6,850	1,712
SAFETEA-LU Trail: Coyote Creek (237 to Story Road)	20.219	SCL 050083 HPLUL-5005(087)	1,317,999	73,774	18,443
SAFETEA-LU Trail: Almaden Express Pedestrian Bridge	20.219	SCL 050089 DEMO05-5005(088)	352,000	9,680	16
CMAQ Los Gatos Creek Reach	20.219	SCL110029	1,200,000	6,739	1,685
Subtotal Recreational Trails Program			3,292,155	97,043	21,856
Subtotal pass-through California Department of Transportation			38,748,425	2,523,732	829,828
Pass-through Metropolitan Transportation Commission:					
Highway Planning and Construction:					
Housing Incentive Program - SJSU to Japantown Ped Corridor	20.205	CML-5005(093)	1,393,654	70,327	2,005
San Fernando Enhanced Bikeway & Pedestrian	20.205	RPSTPLE-5005(105)	1,425,000	-	75,628
The Alameda - A Plan for the Beautiful Way	20.205	STPL-5005(103)	3,132,000	-	717,688
Walk n' Roll San Jose! (Non-infrastructure)	20.205	CML-5005(107)	943,000	40,045	5,188
Walk n' Roll San Jose! (Infrastructure)	20.205	CML-5005(108)	567,762	48,337	6,263
Subtotal pass-through Metropolitan Transportation Commission			7,461,416	158,709	806,772
Pass-through Valley Transportation Authority:					
Highway Planning and Construction:					
Community Design and Transportation	20.205	CML-5005(094)	1,300,000	10,853	-
Recreational Trails Program:					
CMAQ Trail: Lower Guadaluper River (Gold Street - 880)	20.219	SCL 050081 VTP 2030-30-B3 #B31	1,377,000	199,125	49,316
Subtotal Highway Planning and Construction Cluster			48,886,841	2,892,419	1,685,916

See accompanying notes to the Schedule of Expenditures of Federal Awards.

CITY OF SAN JOSE, CALIFORNIA
Schedule of Expenditures of Federal Awards (Continued)
Year Ended June 30, 2012

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures Federal Grant	Expenditures Other
U.S. Department of Transportation (continued)					
Pass-through California Office of Traffic Safety:					
State and Community Highway Safety					
Avoid the 13	20.600	AL0980	139,316	8,844	-
DUI E&A Grant	20.600	AL1116	382,259	112,365	-
DUI E&A Grant	20.600	20244	375,000	227,620	-
Subtotal State and Community Highway Safety			896,575	348,829	-
Total U.S. Department of Transportation			68,268,178	10,929,383	3,537,602
National Endowment for the Arts					
Direct program:					
Promotion of the Arts_Grants to Organizations and Individuals:					
Our Town	45.024	11-4292-7079	250,000	18,478	54,565
Excellence in Arts	45.024	11-62007034	20,000	-	1,030
Subtotal Promotion of the Arts_Grants to Organizations and Individuals			270,000	18,478	55,595
National Endowment for the Humanities					
Pass-through California State Library:					
Grants to States Programs:					
San Jose Historeality	45.310	40-7611	49,875	21,019	-
Work Wise - Component for Tutors	45.310	40-7612	83,816	14,057	-
Subtotal Grants to States Program			133,691	35,076	-
Total National Endowment for the Humanities			133,691	35,076	-
U.S. Small Business Administration					
Direct program:					
Silicon Valley Small Business Assistance Portal	59.000	SBAHQ-09-I-0217	245,643	108,721	-
U.S. Environmental Protection Agency					
Direct program:					
Congressionally Mandated Projects	66.202	00T58101-0	485,000	340,952	398,342
Pass-through SF Bay Fund:					
The San Francisco Bay Water Quality Improvement Fund	66.126	W9-00T60701	680,000	152,689	80,961
Total U.S. Environmental Protection Agency			1,165,000	493,641	479,303
U.S. Department of Energy					
Direct programs:					
ARRA - Renewable Energy Research and Development	81.087	DE-EE0002075	1,301,636	327,593	536,152
ARRA - Electricity Delivery and Energy Reliability, Research, Development and Analysis	81.122	OE0000388	299,983	93,975	-
Energy Efficiency and Conservation Block Grant Program (EECBG)					
ARRA - Energy Efficiency and Conservation Block Grant Program	81.128	DE-EE0000881	8,840,600	3,230,854	-
Pass-through Association of Bay Area Governments					
Energy Efficiency and Conservation Block Grant Program (EECBG)					
ARRA - Retrofit California Program	81.128	DE-EE0003562	750,000	412,781	-
Subtotal Energy Efficiency and Conservation Block Grant Program (EECBG)			9,590,600	3,643,635	-
Total U.S. Department of Energy			11,192,219	4,065,203	536,152

See accompanying notes to the Schedule of Expenditures of Federal Awards.

CITY OF SAN JOSE, CALIFORNIA
Schedule of Expenditures of Federal Awards (Continued)
Year Ended June 30, 2012

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures Federal Grant	Expenditures Other
U.S. Department of Education					
Direct program:					
Fund for the Improvement of Education	84.215	U215K080308	277,074	43,890	-
U.S. Department of Health and Human Services					
Direct program:					
Social Services Research and Demonstration	93.647	90XP0429/01	300,000	220,515	-
ARRA - Prevention and Wellness - Communities Putting Prevention to Work Funding Opportunities Announcement (FOA)	93.724	1U58DP002545-01	128,190	124,321	94,086
ARRA - Prevention and Wellness - Communities Putting Prevention to Work Funding Opportunities Announcement (FOA)	93.724	1U58DP002545-01	101,020	24,392	-
Subtotal ARRA - Prevention and Wellness - Communities Putting Prevention to Work Funding Opportunities Announcement (FOA)			229,210	148,713	94,086
Total U.S. Department of Health and Human Services			529,210	369,228	94,086
U.S. Department of Homeland Security					
Direct programs:					
Hazard Mitigation Grant	97.039	HMGP #1731-44-21	3,000,000	630,023	-
Assistance to Firefighters Grant	97.044	EMW-2009-FO-12086	1,716,387	1,716,387	429,097
Assistance to Firefighters Grant	97.044	EMW-2010-FR-00459	442,804	427,241	106,810
Subtotal Assistance to Firefighters Grant			2,159,191	2,143,628	535,907
Staffing for Adequate Fire and Emergency Response (SAFER)	97.083	EMW-2010-FH-00551	14,922,759	5,034,168	-
ARRA - TSA Airport Checked Baggage Inspection System Program	97.117	HSTS04-09H-REC161	20,916,360	(254,092)	(28,232)
Pass-through the County of Santa Clara:					
Emergency Management Performance Grants	97.042	2011-0048 FIPS OES 085-00000	153,685	108,671	-
Pass-through the Bay Area UASI					
Homeland Security Grant Program:					
FY 09 Urban Areas Security Initiative	97.067	2009-0019 FIPS 075-95017	2,351,143	1,319,750	-
FY 10 Urban Areas Security Initiative	97.067	2010-0085 FIPS 075-95017	252,890	233,957	-
FY 09 Urban Area Security Grant (SUASI)	97.067	N/A	1,596,850	633,808	-
FY 10 Urban Area Security Grant (SUASI)	97.067	N/A	1,030,400	303,195	-
Subtotal pass-through the Bay Area UASI			5,231,283	2,490,710	-
Pass-through the County of Santa Clara:					
Homeland Security Grant Program:					
State Homeland Security Program -SHSP	97.067	N/A	469,540	55,381	-
FY09 Metropolitan Medical Response System	97.067	2009-0019 FIPS 085-00000	321,221	320,579	-
FY10 Metropolitan Medical Response System	97.067	2010-0085 FIPS 085-00000	317,419	110,350	-
FY09 State Homeland Security Grant Program (SHSP)	97.067	N/A	270,000	92,060	-
Subtotal pass-through the County of Santa Clara			1,378,180	578,370	-
Subtotal Homeland Security Grant Program			6,609,463	3,069,080	-
Total U.S. Department of Homeland Security			47,761,458	10,731,478	507,675
Total Federal Awards			$ 296,832,893	$ 142,246,809	$ 6,580,446

See accompanying notes to the Schedule of Expenditures of Federal Awards.

This Page Left Intentionally Blank.

(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.

(2) BASIS OF PRESENTATION

The accompanying schedule is 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 and 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. 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 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. Total allowable AIP expenditures are presented in the accompanying SEFA.

During the year ended June 30, 2012, the U.S. Department of Homeland Security, Office of Inspector General disallowed certain expenditures claimed by the Airport in prior years related to the TSA Airport Checked Baggage Inspection System Program (CFDA No. 97.117). Disallowed expenditures in the amount of $254,092 are reported as a negative amount in the SEFA for the year ended June 30, 2012.

(6) AMOUNTS PROVIDED TO SUBRECIPIENTS

Included in the total expenditures of federal awards are the following amounts passed through to subrecipients:

Program Title	Federal Catalog Number	Provided to Subrecipients
Community Development Block Grants/Entitlement Grants	14.218	$ 2,802,649
ARRA - Community Development Block Grants-Entitlement Grants	14.253	336,231
Emergency Solutions Grant Program	14.231	380,528
Home Investment Partnerships Program	14.239	792,127
Housing Opportunities for Persons with AIDS	14.241	1,211,207
ARRA - Homeless Prevention and Rapid Re-Housing Program	14.257	388,856
Workforce Investment Act (WIA) Adult Program	17.258	769,169
Workforce Investment Act (WIA) Youth Activities	17.259	983,248
Workforce Investment Act (WIA) Dislocated Workers Formula Grants	17.278	994,782

(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, 2012, along with the value of total outstanding and new loans made during the current year in the SEFA.

The following is a summary of the loan programs maintained by the City and their balances at June 30, 2012:

Program Title	CFDA Number	Amount Outstanding	Prior year loans with continuing compliance requirements	New loans
Economic Adjustment Assistance	11.307	$ 394,933	$ 394,933	$ -
Community Development Block Grants/Entitlement Grants	14.218	7,527,481	6,776,978	750,503
HOME Investment Partnerships Program	14.239	54,072,711	48,502,770	5,569,941
		$ 61,995,125	$ 55,674,681	$ 6,320,444

(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 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 $31.65 million 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 2012, the program incurred expenditures of $1,080,633.

Furthermore, in June 2010 the City 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 the Agreement R10AP20057 was executed on November 30, 2010. As of June 30, 2012, Congress appropriated $1,652,000 towards the Phase 1B obligation.

(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 includes programs with various funding sources or grants by CFDA numbers not summarized in the SEFA.

CFDA Number - Program Title Grant Identifying Number or Pass-through Grantor	Federal Expenditures
Highway Planning and Construction Cluster:	
CFDA No. 20.205 - Highway Planning and Construction	
Pass-through California Department of Transportation	$ 2,426,689
Pass-through Metropolitan Transportation Commission	158,709
Pass-through Valley Transportation Authority	10,853
CFDA No. 20.205 - Highway Planning and Construction	2,596,251
CFDA No. 20.219 - Recreational Trails Program	
Pass-through California Department of Transportation	97,043
Pass-through Valley Transportation Authority	199,125
CFDA No. 20.219 - Recreational Trails Program	296,168
Total Highway Planning and Construction Cluster	$ 2,892,419

(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 California Emergency Management Agency (Cal EMA) for the year ended June 30, 2012. This information is included in the City's Single Audit Report at the request of Cal EMA.

Program Title and Expenditure Category	Grant Number Grant Period	Cumulative Expense through June 30, 2011	Actual 7/1/11-6/30/12 Non-match	Actual 7/1/11-6/30/12 Match	Cumulative Expense through June 30, 2012	Revenue
Internet Crimes Against Children Task Force Program (Federal)	2008 MC CX K002					
Personnel Services	7/1/08 - 6/30/2012	$ 393,721	$ 89,370	$ -	$ 483,091	$ 483,091
Operating Expenses		552,711	124,880	-	677,591	677,591
Equipment		182,157	-	-	182,157	182,157
Total		$ 1,128,589	$ 214,250 [1]	$ -	$ 1,342,839	$ 1,342,839
Internet Crimes Against Children Task Force Program (Federal)	2011 MC CX K003					
Personnel Services	04/01/11 - 9/30/12	$ -	$ 159,173	$ -	$ 159,173	$ 122,650
Operating Expenses		-	179,536	-	179,536	138,341
Equipment		-	-	-	-	-
Total		$ -	$ 338,709 [1]	$ -	$ 338,709	$ 260,991
Internet Crimes Against Children Task Force Program (State)	IC11037928					
Personnel Services	07/01/11 - 06/30/12	$ -	$ 124,223	$ -	$ 124,223	$ 118,794
Operating Expenses		-	-	-	-	-
Equipment		-	-	-	-	-
Total		$ -	$ 124,223	$ -	$ 124,223	$ 118,794

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.

CITY OF SAN JOSE, CALIFORNIA

Federal Awards Schedule of Findings and Questioned Costs

Year Ended June 30, 2012

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?	Yes
♦ Significant deficiency(ies) identified?	Yes
Noncompliance material to the financial statements noted?	No

Federal Awards

Internal control over major programs:	
♦ Material weakness(es) identified?	Yes
♦ Significant deficiency(ies) identified?	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) and the Home Investment Partnerships Program (CFDA # 14.239), which are 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
14.239	Home Investment Partnerships Program
14.256	ARRA - Neighborhood Stabilization Program II
15.504	ARRA - Water Reclamation and Reuse Program
20.205, 20.219	Highway Planning and Construction Cluster
81.128	ARRA – Energy Efficiency and Conservation Block Grant Program
97.067	Homeland Security Grant Program
97.083	Staffing for Adequate Fire and Emergency Response (SAFER)

Dollar threshold used to distinguish between type A and type B programs:	$3,000,000
Auditee qualified as a low-risk auditee?	No

Section II Financial Statement Findings

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

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

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

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

With the increasing audit requests related to the Successor Agency's activities, it is essential that the Successor Agency has sufficient accounting and fiscal personnel to adequately meet and maintain accurate financial records of the former Agency and subsequent Successor Agency.

Recommendation
We recommend that the Successor Agency obtain additional assistance from the City to reduce the likelihood that errors may occur and not be detected or corrected on a timely basis and therefore improve internal controls over financial reporting. Areas where the City could provide additional support include:

- Monitoring and management of the loan portfolio to ensure accurate receivable balances (e.g., bad debt, allowance for doubtful accounts, and collectability and availability analysis).
- Evaluating the cost basis for redevelopment capital assets and valuation for property held for resale for proper reporting.
- Recording of close-out entries (e.g., interest receivable on loans, intergovernmental payables, and deferred revenue) in the financial statements.
- Recording year-end accrual closing entries (e.g., unearned revenue adjustments, capital asset activity, and interest payable).

Management Response
The last year has been a fiscally challenging year for the former Redevelopment Agency (Agency). The economic recession took a considerable toll on tax increment revenues and as early as 2010 the Agency began a significant reduction in workforce. At the beginning of fiscal year 2010-11, staffing levels were 92 with 9 devoted to financial operations and affairs of the Agency. By the time dissolution was final on February 1, 2012, the total staffing was 10 with only 4 devoted to the financial operations and affairs of

Item 2012-1 – Internal Control Over Financial Reporting – Preparation of Financial Statements (continued)

the former Agency, now the Successor Agency to the Redevelopment Agency (SARA). During the transition period, the SARA staff has been assisted with resources from both the City Finance and Housing Departments to complete the necessary financial statements for the reporting periods ending January 31, 2012 and June 30, 2012.

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

Item 2012-2 – Significant Deficiency
Risk Assessment of Internal Controls

As discussed in the prior year, 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. Internal control is a dynamic integral process that should be continuously adapting to the changes the City is facing. Over the past decade, the City has reduced budgeted positions by 28 percent. The last two budgets included widespread reductions in services with corresponding reductions in authorized/budgeted positions coupled with reductions in employee total compensation. City Council's approval of the 2011-2012 Adopted Budget resulted in the loss of 140 employees through layoffs. In addition, through the execution of Civil Service Rules, over 500 employees were moved into new positions where they are required to learn or re-learn, the skills and knowledge necessary to successfully fulfill the requirements of their new position. We observed City staff who are facing continual pressures to maintain service levels with fewer resources and have not been provided adequate or sufficient training nor have changes in business processes been implemented to improve work flow efficiencies. These organizational changes can have a significant impact on the effectiveness of the internal control system.

Item 2012-2 – Risk Assessment of Internal Controls (continued)

The staffing constraints are factors in errors in the City's fiscal year 2012 year-end financial reporting process including:

- Errors in accounts payable year-end cut-off totaling $0.8 million.
- Lack of understanding in the composition of the pooled cash and investments reconciling entry of $18 million.
- Inadequate review of complex government-wide reconciling journal entries.

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 magnitude of any deficiencies identified and develop a work plan to re-structure the organization to ensure internal controls are adequate for its changed environment and reduced workforce.

Recommendation
As a result of organizational changes, the City should identify and quantify the risks of any significant internal control weaknesses that have not been addressed because of insufficient resources or staff capabilities. Once these risks are identified, the City should develop a work plan to mitigate these risks in internal controls.

Management Response
Management agrees that the reduction in Citywide positions and the associated impact of executing the Civil Service Rules with these position eliminations have been disruptive to the financial operations of the organization. The City Auditor's Report "Ten Years of Staffing Reductions at the City of San Jose: impacts and Lessons Learned" stated that in addition to laying-off 337 people over the last ten years (all but 6 were laid-off in the last three years), 2,444 full-time employees retired and 1,507 full-time employees resigned. According to the report, of the 2,130 positions eliminated since 2002-2003, over 1,100 (52%) were eliminated in the last three years. This level of downsizing has had significant service level impacts across the organization including those services related to financial operations.

Management believes opportunities exist for continued improvement in identification of the impacts on the City's financial operations and internal control structure as well as developing a work plan to address these impacts. However, management believes the City has made progress toward stabilizing and improving staffing for the primary financial reporting operations in the City's Finance Department. For example, a permanent appointment has been made for the Director of Finance position. This appointment establishes a continuity of management with a seasoned veteran of the Finance Department who has played a vital role in CAFR production since 2010. Concurrently, the Finance Treasury Division Manager continues as the Acting Assistant Director bringing his technical expertise to the CAFR production process in the areas of treasury and debt management, pension plan disclosure and his previous work experience. In addition, the Acting Accounting Division Manager continues to bring 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 currently provides organizational stability to the Accounting Division. It should also be noted that within the last year a Principal Accountant position was restored in the Finance Department's Accounting Division as an initial step in rebuilding critical skills and expertise needed in the Finance Department.

Item #2012-2 – Risk Assessment of Internal Controls (continued)

Management acknowledges the impact on the organization of the deficiencies in formalized roles and responsibilities in City departments and the impact it may have on the quality and consistency of financial reporting. The decentralization of finance functions to other City departments has made each department responsible for establishing and maintaining specific and defined roles and responsibilities to assure a seamless transition when positions become vacant and then subsequently filled. Due to the aforementioned reduction and turnover in City staffing, consistencies in how roles and responsibilities are established and maintained within departments and with the Finance Department has diminished.

The Finance Department will work with City departments to identify the reduction in all finance related positions and assess current staffing levels on a Citywide basis. In addition, the Finance Department will work with City departments to assess the consistency of finance procedural documentation to ensure consistency and continuity throughout the organization. It should be noted that the ability to complete this work and to implement solutions may be impacted by current staffing levels in all City departments. In light of staffing constraints, the City will consider its options to utilize consulting services to assist the City in assessing the current consistency and content of finance procedural documentation to ensure best practices, consistency, and continuity throughout the organization.

As the City begins planning for the preparation of the fiscal year 2013 CAFR, the Finance Department is making a concerted effort to assemble the strongest team possible within the staffing constraints of the Department and the organization. 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 has subscribed to an on-line accounting research tool to assist the Accounting staff in performing the necessary research and analysis of accounting rules and regulations as a way to enhance staff's knowledge and efficiency. The City has also initiated research into financial reporting solution packages that could potentially streamline the CAFR process and provide more time for analytical reviews of data.

Item 2012-3 Significant Deficiency
Housing Department Budgetary Controls

Under the Redevelopment Dissolution Law, the Redevelopment Agency of the City of San José (Agency) and the Successor Agency to the Redevelopment Agency of the City of San José (Successor Agency) were no longer required to set-aside 20% of property tax revenues to the City's Housing Department for low and moderate income housing activities. In fiscal year 2010-2011, the last full fiscal year of this source of funds, the Housing Activities Fund received $34.8 million from this revenue source. Commencing February 1, 2012, the Housing Activities Fund's primary sources of revenues will be limited to grant funds from U.S. Department of Housing and Urban Development and repayments on loans from its loan portfolio. In fiscal year 2011-2012, the Housing Activities Fund final budgeted revenues and other financing sources reported a total $78.4 million and final budgeted expenditures and other financing uses reported a total $145.3 million or a deficiency of $66.9 million. On a budgetary basis, the Housing Activities Fund reported a deficiency of funding sources under its funding uses of $44.4 million and a deficit fund balance of $15.2 million.

During our audit, we made inquiries regarding the nature of these budgetary deficits and noted that the primary cause was due to the decrease in the 20% set-aside. Additionally, upon inquiry it was noted that there is not a plan in place to remedy the fund deficit on a budgetary basis as all available funding sources are budgeted for current projects. As such, the City may not be properly analyzing the Fund's available funding sources and budgetary accounts.

Recommendation
The City should improve its monitoring of its Housing budget compared to actual statements so that a Fund does not close the year in a deficit position.

Management Response
The City regularly monitors its budgets to ensure that no fund closes the year in a deficit position. In this particular case, there were extenuating circumstances that made it appear that the Housing Activities Fund had a deficit year-end balance. As previously noted, legislation was passed to dissolve all redevelopment agencies throughout the State effective February 1, 2012. This action directly impacted the City's Housing Activities Fund.

Since 1988, the City's Housing Department has managed the Low and Moderate Income Housing Fund, 20% of all redevelopment funding as required by law, for affordable housing programs. Prior to fiscal year 2011-2012, these funds have been included in the Housing Activities Fund financial statements. With the dissolution of the City's Redevelopment Agency, affordable housing assets, including the existing loan portfolio, were transferred to the Affordable Housing Investment Fund. Tax increment dollars, the former 20% Low and Moderate Income Housing Funds, were transferred to the Successor Agency to the Redevelopment Agency Fund. As a result, two separate Funds now hold the former 20% Fund assets.

As a result, when examining the Housing Activities Fund, it appears that there is a gap in actual amounts on a budgetary basis in the financial statements. However, when examining the $15.2 million deficit fund balance in the Housing Activities Fund in conjunction with the $24.7 million surplus fund balance in the Affordable Housing Investment Fund, there is a net surplus balance. The City is currently working to resolve the fund balance presentation issue, and plans to have the issue resolved prior to completion of the fiscal year 2012-2013 financial statements.

Many unintended consequences have been identified through the extraordinary event of dissolving the Redevelopment Agency. This identification of a budgetary deficit is an example of an unintended consequence, and as noted earlier management plans to have the issue resolved during the fiscal year 2012-2013 CAFR preparation process.

Item 2012-4 – Significant Deficiency
Accounting for Housing Loans Reserves

Each year for preparation of the City's basic financial statements, the City's Housing Department conducts an analysis of its loan portfolio. The analysis includes a calculation of loan loss reserves to fairly state the value of reserves as of the balance sheet date of June 30 for the City's Major Housing, Community Development Block Grant (CDBG), and HOME loans. From the analysis, an adjustment is recorded to the general ledger to fairly state the value of loan loss reserves for the City's basic financial statements.

During the year, the City implemented a new customer relationship management (CRM) system to track outstanding loans and to compute the present value of the loan loss reserves. This computation is extracted to an excel spreadsheet for further analysis. We noted that the CRM system had a formula error in the calculation of the reserve, which resulted in an understatement of the allowance on the City's loans receivable of $19.3 million at June 30, 2012. The City subsequently corrected this error in its financial statements.

Recommendation
We recommend that the Housing Department develop procedures to review its CRM database and system computations in order to ensure that accurate financial information is available to management for analysis of its loan portfolio.

Management Response
The City agrees with this recommendation. New procedures are being developed to reconcile the CRM database and Financial Management System to ensure that loans are recorded accurately. In addition, staff is currently testing the computations derived from the CRM database to ensure accuracy in recording the loan loss reserve in the future.

Section III Federal Award Findings and Questioned Costs

Finding 2012-AHighway 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:	ITS99-5005(058), RPSTPLE-5005(101), and SRTSL-5005(097)
Award Year:	2006, 2011, 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 necessary follow-up after the 15 day time period and 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 review of the City's compliance with the Davis-Bacon Act for the Highway Planning and Construction (HPC) Cluster, we tested 51 items from a population of 99 certified payrolls for the HPC Cluster. Our testing showed that the Office of Equality Assurance did not perform timely follow-up of past due certified payroll reports with the prime contractors for 26 of the 51 items selected. Of the 26 items identified as past due, the Office of Equality Assurance did not receive the required certified payroll reports prior to the City's project managers' instruction to disburse funds to the prime contractors for 18 of the 51 items selected (resulting in questioned costs). The 18 items were comprised of both payments to prime contractors and subcontractors.

Effect

The City's Public Works Department through the Office of Equality Assurance is responsible for the City's compliance with the Davis-Bacon Act, and 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 did 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 $413,470, which are related to various projects. This was computed by totaling the contractors disbursements to subcontractors during the months certified payrolls were not submitted.

Recommendation

Due to the City's budget constraints and a reduction in the number of employees in the Office of Equality Assurance, the City may not have sufficient resources or defined processes to perform the necessary follow-ups after the 15 day time period in situations of non-compliance. We recommend the City evaluate the effectiveness of its current internal control policies and procedures in light of its current resource changes. In addition, we recommend that the City establish internal control policies and procedures over withholding payment until the certified payrolls are received.

Finding 2012-AHighway Planning and Construction Cluster – Davis-Bacon Act (continued)

Management Response

The City concurs with this recommendation. The City is updating the City of San José Standard Specifications for Public Works Construction ("Specifications"). It is a major work product and the revisions will supersede the publication of the same title dated 1992. One of the sections of the Specifications is devoted to Labor Standards. A subsection will be Certified Payroll Records – Contents of Certified Payroll Records; Verification of Payroll Records; Location of Certified Payroll Records; Availability of Certified Payroll Records; Submittal of Certified Payroll Records; Failure to Timely Submit Certified Payroll Records; Withholding Payment; and Payment Not a Waiver. The Specifications are anticipated to be completed by June 30, 2013.

Given the complexity and staff time involved in updating the Specifications, the Office of Equality Assurance issued a memo on June 29, 2012 to appropriate City staff reminding them of the requirement that contractors shall maintain and provide to the City, with each partial payment request, certified payrolls for all of its employees and those employees of contractor's subcontractors. Additionally, the Office of Equality Assurance was able to receive the past due payroll certified reports from the contractors and the subcontractors prior to issuance of the Single Audit Report.

Finding 2012-BHome Investment Partnerships Program – Eligibility

Program Identification:

Awarding Agency:	U.S. Department of Housing and Urban Development
Program Name:	Home Investment Partnerships Program
CFDA:	14.239
Award Number:	MC09-10 MC06215
Award Year:	2009

Criteria

The HOME Investment Partnership Program includes income targeting requirements. Only low-income or very low-income persons, as defined in 24 CFR section 92.2, can receive housing assistance. The City is responsible for verifying that applicants meet the low-income or very low-income requirements before granting the applicant a loan.

Condition

During our review of the City's compliance with the eligibility requirements for the HOME program, we tested 8 individuals from a population of 33 individuals who qualified for HOME loans. Our testing showed that the Housing Department granted a loan to an individual who did not meet the low-income or very low-income limits.

Effect

The City's Housing Department is responsible with overseeing the compliance of the eligibility requirements and did not ensure, in all instances, that the individuals who were receiving loans using HOME funds met the low-income or very-low income requirements. There is a risk that federal funds are not being used on eligible applicants, resulting in unallowable costs.

Questioned Costs

The known questioned cost is $87,800, the amount of the loan that the individual received.

Finding #2012-B Home Investment Partnerships Program – Eligibility (continued)

Recommendation

Due to the City's budget constraints and recent reductions in the number of employees at the Housing Department, the City may not have sufficient resources to perform all the necessary requirements to verify that applicants are eligible to receive HOME funding. We recommend the City evaluate the effectiveness of its current internal control policies and procedures in light of its current staffing changes. In addition, we recommend that the City update its internal control policies and procedures over verifying income limits against the HUD current income guidelines to ensure current guidelines are being followed.

Management Response

The City agrees that an error was made with the approval of one borrower, and has since changed the funding source for the loan. However, the oversight was made due to an incorrect income limit chart being inadvertently used to verify qualifying income during the underwriting process, and not due to insufficient resources.

To ensure that HUD is not charged for this error, the funding source for the loan was changed. To avoid an oversight in the future, the City will employ an online tool recently provided by HUD during loan underwriting to electronically check income limits for eligibility. Additionally, the City will enhance its internal controls by implementing a management review of the income determination.

CITY OF SAN JOSE, CALIFORNIA

Summary Schedule of Prior Audit Findings

Year Ended June 30, 2012

Financial Statement Findings

2011 Comment:	***2011-1 - Risk Assessment of Internal Controls***
Condition/Effect:	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. 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.
Recommendation:	The City should update its documentation, test its internal controls, assess the 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.
Status:	Not implemented. See comment 2012-2.
2011 Comment:	***2011-2 - Airport Cost Allocation Plan***
Condition/Effect:	During our audit, we noted that the fiscal year 2011 Airport Cost Allocation Plan (ACAP) used a factor of 400 full-time equivalents (FTEs). However, the Airport has approximately 206 FTEs at June 30, 2011. Unlike expenditures, the City does not adjust nonfinancial factors 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.
Recommendation:	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.
Status:	Not implemented. The City maintained the same methodology in allocating central service program costs. The ACAP used 305 FTEs compared to the approximate actual of 181 FTEs as of June 30, 2012, and thus the Airport may still be burdened with a disproportionate share of overhead costs. Effective fiscal year 2013-2014, the City will use actual FTEs as the cost allocation basis for the ACAP

CITY OF SAN JOSE, CALIFORNIA

Summary Schedule of Prior Audit Findings

Year Ended June 30, 2012

Federal Award Findings

2011 Comment:	***2011-A – Highway Planning and Construction Cluster – Davis-Bacon Act***
Condition/Effect:	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 items 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 items selected.
Recommendation:	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.
Status:	Not implemented, see current year finding 2012-A.

MGO Certified Public Accountants.

Walnut Creek
2121 N. California Blvd., Suite 750
Walnut Creek, CA 94596
925.274.0190

Sacramento

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

Independent Auditor's Report on Compliance with Requirements of the Passenger Facility Charge Program and on Internal Control over Compliance in Accordance with the Passenger Facility Charge Audit Guide for Public Agencies

City Council
City of San José, California

Compliance

We have audited Norman Y. Mineta San José International Airport's (Airport), an enterprise fund of the City of San José (City), compliance with the types of compliance requirements described in the *Passenger Facility Charge Audit Guide for Public Agencies* (the Guide), issued by the Federal Aviation Administration, applicable to its passenger facility charge program for the year ended June 30, 2012. Compliance with the requirements referred to above is the responsibility of the Airport's management. Our responsibility is to express an opinion on the Airport'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; and the Guide. Those standards and the 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 material effect on the passenger facility charge program occurred. An audit includes examining, on a test basis, evidence about the Airport'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 Airport's compliance with those requirements.

In our opinion, the Airport complied, in all material respects, with the requirements referred to above that are applicable to its passenger facility charge program for the year ended June 30, 2012.

Internal Control Over Compliance

Management of the Airport is responsible for establishing and maintaining effective internal control over compliance with the compliance requirements referred to above. In planning and performing our audit, we considered the Airport's internal control over compliance to determine the auditing procedures for the purpose of expressing our opinion on compliance, 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 Airport's internal control over compliance.

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 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 compliance requirement will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses in internal control over compliance. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the City Council, the City's and the Airport's management, and the Federal Aviation Administration of the U.S. Department of Transportation, and is not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & O'Connell LLP

Walnut Creek, California
February 7, 2013

CITY OF SAN JOSE, CALIFORNIA
Schedule of Passenger Facility Charge Revenues and Expenditures
Year Ended June 30, 2012

	Passenger Facility Charge Revenue	Interest Earned	Total Revenues	Expenditures on Approved Projects	Under (over) Expenditures on Approved Projects
Fiscal year 2011-12 transactions:					
Quarter ended September 30, 2011	$ 2,548,153	$ -	$ 2,548,153	$ -	$ 2,548,153
Quarter ended December 31, 2011	3,419,480	-	3,419,480	-	3,419,480
Quarter ended March 31, 2012	4,621,330	-	4,621,330	21,336,421	(16,715,091)
Quarter ended June 30, 2012	6,198,015	152,462	6,350,477	-	6,350,477
	$ 16,786,978	$ 152,462	$ 16,939,440	$ 21,336,421	(4,396,981)
			Balance, beginning of year		42,967,880
			Balance, end of year		$ 38,570,899

See accompanying notes to the Schedule of Passenger Facility Charge Revenues and Expenditures.

CITY OF SAN JOSE, CALIFORNIA

Notes to the Schedule of Passenger Facility Charge Revenues and Expenditures

Year Ended June 30, 2012

(1) GENERAL

The Schedule of Passenger Facility Charge Revenues and Expenditures presents only the activity of the Passenger Facility Charge (PFC) program of the Norman Y. Mineta San José International Airport (Airport), an enterprise fund of the City.

The Aviation Safety and Capacity Expansion Act of 1990 (Public Law 101-508, Title II, Subtitle B) authorized the imposition of PFCs and use of the resulting revenue on Federal Aviation Administration (FAA) approved projects. 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 FAA approvals.

(2) BASIS OF ACCOUNTING

The accompanying schedule are presented using the accrual basis of accounting as described in Note I to the City's basic financial statements.

(3) RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS

Under the Airport's Master Trust Agreement, the Airport may for any period elect to designate any PFC revenues as "Available PFC Revenues" by filing with the Trustee a written statement designating the amount of such Available PFC Revenues and containing a statements that the Available PFC Revenues are legally available to be applied to pay bond debt service during such period. An amount of $21,336,421 from accumulated PFC Revenues had been designated as Available PFC Revenues for payment of eligible bond debt service in fiscal year ended June 30, 2012.

(4) RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Amounts reported in the Schedule of Passenger Facility Charge Revenues and Expenditures agree to or can be reconciled with the amounts reported to the FAA on the Passenger Facility Charge Quarterly Status Reports.

CITY OF SAN JOSE, CALIFORNIA

Notes to the Schedule of Passenger Facility Charge Revenues and Expenditures

Year Ended June 30, 2012

(5) PFC APPROVED PROJECTS AND EXPENDITURES

The general description of the approved projects and the expenditures for the year ended June 30, 2012 are as follows:

Passenger Facility Charge Project Number/Description		Identifying Number	Passenger Facility Charge Amount	Expenditures
#1	Communication Center Upgrade	92-01-C-00-SJC	$ 528,691	$ -
#2	Fire Truck Replacement	92-01-C-00-SJC	599,826	-
#3	Handlift Replacement	92-01-C-00-SJC	103,000	-
#4	Noise Attenuation	92-01-C-00-SJC	47,792,121	-
#5	Noise Monitoring System Upgrade	92-01-C-00-SJC	184,000	-
#6	Noise Remedy/Land Acquisition	92-01-C-00-SJC	5,133,000	-
#7	Security Access Control System	92-01-C-00-SJC	1,032,000	-
#40A	Runway 12R/30L Reconstruction	01-12-C-00-SJC	72,022,700	3,657,995
#40B	Runway 12R/30L Extention	01-12-C-00-SJC	38,671,724	1,655,479
#52	Taxiway Z - Apron Reconstruction (Phase II)	01-11-C-00-SJC	825,000	-
#53	Terminal C Fire Protection	01-11-C-00-SJC	580,000	-
#54	Fiber Optic Cable to ARC & Fire Station 29	01-11-C-00-SJC	87,345	-
#55	Green Island Bridge	01-11-C-00-SJC	825,000	-
#56	Replacement of AACS and CCTV	01-11-C-00-SJC	4,418,645	-
#57	Skyport Grade Separation	01-11-C-00-SJC	18,218,154	-
#58	Terminal Drive Improvements	01-11-C-00-SJC	1,146,165	-
#59	Replacement of PASSUR	01-11-C-00-SJC	221,000	-
#60	Terminal C Restroom	01-11-C-00-SJC	2,485,000	-
#61	Interim Air Cargo Ramp Extension	01-11-C-00-SJC	1,100,000	-
#62	Runway 30R/12L Reconstruction	01-11-C-00-SJC	84,105,103	3,918,171
#63	Noise Attenuation Category II & III	01-11-C-00-SJC	4,500,000	-
#64	Taxiway Y Extension	01-11-C-00-SJC	12,890,000	431,776
#65	Extended Noise Attenuation	02-13-C-00-SJC	61,589,000	-
#67	Terminal B - North Concourse	06-15-C-00-SJC	495,095,000	10,194,000
#68	Terminal B Extension, Phase I	08-16-C-00-SJC	110,159,000	1,479,000
#69	Roadway Improvements: Grade Separations	08-16-C-00-SJC	10,244,000	-
	Total Passenger Facility Charge Programs		$ 974,555,474	$ 21,336,421

This Page Left Intentionally Blank.

MGO Certified Public Accountants.

Walnut Creek
2121 N. California Blvd., Suite 750
Walnut Creek, CA 94596
925.274.0190

Sacramento

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

Independent Auditor's Report on Compliance with Requirements of the Customer Facility Charge Program and on Internal Control over Compliance

City Council
City of San José, California

Compliance

We have audited Norman Y. Mineta San José International Airport's (Airport), an enterprise fund of the City of San José (City), compliance with the compliance requirements described in the California Civil Code Section 1936, applicable to its customer facility charge program for the year ended June 30, 2012. Compliance with the requirements referred to above is the responsibility of the Airport's management. Our responsibility is to express an opinion on the Airport'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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the California Civil Code Section 1936. Those standards and the California Civil Code Section 1936 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 material effect on the customer facility charge program occurred. An audit includes examining, on a test basis, evidence about the Airport'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 Airport's compliance with those requirements.

In our opinion, the Airport complied, in all material respects, with the requirements referred to above that are applicable to its customer facility charge program for the year ended June 30, 2012.

Internal Control Over Compliance

Management of the Airport is responsible for establishing and maintaining effective internal control over compliance with the compliance requirements referred to above. In planning and performing our audit, we considered the Airport's internal control over compliance to determine the auditing procedures for the purpose of expressing our opinion on compliance, 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 Airport's internal control over compliance.

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 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 compliance requirement will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses in internal control over compliance. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

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

Macias Gini & O'Connell LLP

Walnut Creek, California
February 7, 2013

CITY OF SAN JOSE, CALIFORNIA

Schedule of Customer Facility Charges Revenues and Expenditures

Year Ended June 30, 2012

Revenues	
Customer facility charges:	
$10 per rental contract (7/01/2011-11/30/2011)	$ 3,117,083
$6 per contract day (12/01/2011-6/30/2012)	7,019,970
Interest income	12,016
Total revenues	10,149,069
Expenditures	
ConRAC debt service expenditures	10,149,069
Total expenditures	10,149,069
Revenues over expenditures	$ -

See accompanying notes to the Schedule of Customer Facility Charge Revenues and Expenditures.

CITY OF SAN JOSE, CALIFORNIA

Notes to the Schedule of Customer Facility Charge Revenues and Expenditures

Year Ended June 30, 2012

(1) GENERAL

California Civil Code Section 1936, as amended by Senate Bill 1192 (Code), permits an airport sponsor to require rental car companies to collect from a renter a Customer Facility Charge (CFC) to finance, design and construct a consolidated airport rental car facility; to finance, design, construct, and operate common-use transportation systems that move passengers between airport terminals and those consolidated car rental facilities, and acquire vehicles for use in that system; and to finance, design, and construct terminal modifications solely to accommodate and provide customer access to common-use transportation systems.

Since January 1, 2008, the Norman Y. Mineta San José International Airport (Airport) has imposed a CFC of $10.00 per rental contract. Effective on December 1, 2011, pursuant to Section 1936 of the California Civil Code (Section 1936), the City increased the CFC to $6.00 per contract day, to a maximum of five days, on each rental instead of the $10.00 per rental contract CFC to help pay first for debt service associated with the Consolidated Rental Car Facility (ConRAC) and then certain operating expenses related to the transportation of rental car customers between Terminal A and the ConRAC.

(2) BASIS OF ACCOUNTING

The accompanying schedule are presented using the accrual basis of accounting as described in Note I to the City's basic financial statements.

(3) RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS

Expenditures of CFCs are reported in the City's basic financial statements as reduction of liabilities in the Airport enterprise fund. CFC expenditures agree or can be reconciled with the amounts reported in the City's basic financial statements.