CITY OF SAN JOSE, CALIFORNIA

Single Audit Reports

Basic Financial Statements with
Federal and Airport Compliance Sections

For the Year Ended June 30, 2013

MGO Certified Public Accountants.

CITY OF SAN JOSE, CALIFORNIA

For the Year Ended June 30, 2013

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For the Year Ended June 30, 2013

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MGO Certified Public Accountants.

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Independent Auditor's Report

City Council
City of San José, California

Report on the Financial Statements

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 (City), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San José, California, as of June 30, 2013, 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.

Emphasis of Matters

Change in Accounting Principles

As described in Note I.E. to the basic financial statements, effective July 1, 2012, the City adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position,* and Statement No. 65, *Items Previously Reported as Assets and Liabilities.*

Unfunded Actuarial Accrued Liabilities

As described in Note IV.A.1.4 to the basic financial statements, based on the most recent actuarial valuations as of June 30, 2012, the Police and Fire Department Retirement Plan's and the Federated City Employees' Retirement System's independent actuaries determined that, at June 30, 2012, the values of the defined benefit pension plans' actuarial accrued liability exceeded the actuarial value of their assets by $694 million and $1.1 billion, respectively. The most recent actuarial values of assets for the Police and Fire Department Retirement Plan and the Federated City Employees' Retirement System as of June 30, 2012 do not reflect the impact of deferred investment losses of $125 million and $114 million, respectively, that will be recognized in future valuations. Also, as described in Note IV.A.2.4., based on the most recent actuarial valuations as of June 30, 2012, the Police and Fire Department Retirement Plan's and the Federated City Employees' Retirement System's independent actuaries determined that, at June 30, 2012, the values of the postemployment healthcare 401(h) plans' actuarial accrued liability exceeded the actuarial value of their assets by $931 million and $959 million, respectively. The June 30, 2012 actuarial valuation of the Police and Fire

Department Retirement Plan's postemployment healthcare plans does not reflect the new Section 115 subtrusts (the Police Department Postemployment Healthcare Plan and the Fire Department Postemployment Healthcare Plan) as those plans had no financial activity as of the most recent valuation date.

Our opinion is not modified with respect to these matters.

Other Matters

Required Supplementary Information

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, Low and Moderate Income Housing Asset Fund, and the Integrated Waste Management 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 GASB 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.

Management has omitted the schedules of funding progress and employer contributions for the Section 115 subtrusts of the Police and Fire Department Retirement Plan (the Police Department Postemployment Healthcare Plan and the Fire Department Postemployment Healthcare Plan) that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the GASB 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. Our opinion on the basic financial statements is not affected by this missing information.

Other Information

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 passenger facility charge revenues and expenditures, and schedule of customer facility charge revenues and expenditures 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 Senate Bill 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 12, 2013 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control over financial reporting and compliance.

Macias Gini & O'Connell LLP

Walnut Creek, California

November 12, 2013, 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 6, 2014

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, 2013. 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 position for the City's governmental and business-type activities indicates that as of June 30, 2013, total assets and deferred outflows of resources exceed total liabilities and deferred inflows of resources by $6.961 billion. Of this amount, $141.7 million represent unrestricted net position, which is comprised of a deficit balance of $217.3 million for governmental activities, and a positive balance of $359.0 million for business-type activities. In addition, the City's restricted net position totals $989.6 million ($864.8 million for governmental activities and $124.8 million for business-type activities) and is dedicated to specific purposes. Lastly, net position of $5.830 billion is the City's net investment in capital assets ($5.012 billion for governmental activities and $817.6 million for business-type activities).

- The City adopted the provisions of Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*, as of July 1, 2012. The City restated the July 1, 2012 net position to write off unamortized bond issuance costs previously reported as an asset or included in deferred amounts from refundings. Gains and losses on refundings of debt were reclassified from a contra liability account and reported as deferred inflows of resources or deferred outflows of resources, respectively. The total impact of this change was a $25.2 million reduction in the beginning net position. The 2012 financial statements were not restated.

- The net position decreased by $448.5 million or 6.1 percent during 2012-2013 to $6.961 billion from $7.410 billion. The majority of the decrease was primarily due to the extraordinary loss of $167.2 million. The main components of this extraordinary loss includes the return of capital assets in the amount of $117.1 million from the City and the San José Diridon Development Authority ("Diridon Authority") to the Successor Agency to the Redevelopment Agency of the City of San José ("SARA") and an allowance established for a receivable due from SARA in the amount of $52.6 million. The components of the extraordinary item recorded in the financial statements are discussed in Note I.F.17. Excluding the extraordinary loss, net position decreased by $281.2 million due to a change in accounting as discussed above in the amount of $25.2 million and from operating activities of $256.0 million.

- Governmental funds reported a combined ending fund balances of $1.157 billion at June 30, 2013, which is $29.1 million or 2.5 percent less than the June 30, 2012 balance. The decrease was attributable to a decrease in the fund balance for the Low and Moderate Income Housing Asset Fund ($52.4 million), Special Assessment Districts ($73.6 million), and San José Financing Authority Debt Service ($8.2 million). These decreases were partially offset by increases in fund balances including the General Fund ($43.9 million), Housing Activities Fund ($23.1 million), and other nonmajor funds ($38.0 million).

- Unassigned fund balance totals $64.2 million, which is 5.5 percent of combined governmental fund balances at June 30, 2013.

- Total long-term liabilities increased by $19.4 million to $3.512 billion at June 30, 2013, which represents an increase of 0.6 percent compared to $3.493 billion at June 30, 2012. The increase was due to an increase of $33.2 million in governmental activities long-term liabilities but was partially offset by a decrease of $13.8 million in long-term liabilities for business-type activities. The primary factor leading to the increase in governmental activities was the recording of net other postemployment benefits ($66.0 million) and the obligations related to the New Market Tax Credit financing ($18.1 million). This increase was partially offset by payments of scheduled debt service ($48.1 million) of governmental bonds. The decrease in business-type activities was due to payments of scheduled debt service including Airport revenue bonds of $13.4 million and Wastewater revenue bonds and State loans of $9.1 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 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 position*** presents information on all assets, deferred outflows of resources, liabilities, and deferred inflows of resources. The difference between total assets and deferred outflows of resources and total liabilities and deferred inflows of resources is the City's net position. Over time, increases or decreases in net position 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 position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will 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 parking operations.

The government-wide financial statements include the primary government of the City 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, Housing Activities, Low and Moderate Income Housing Asset, Integrated Waste Management, 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 project 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 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 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, Low and Moderate Income Housing Asset Fund, and the Integrated Waste Management 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 position: As noted earlier, net position may serve as a useful indicator of a government's financial position. As of June 30, 2013, the City's total assets and deferred outflows of resources exceed total liabilities and deferred inflows of resources by $6.961 billion.

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

Statement of Net Position
June 30, 2013 and 2012
(in thousands)

		Governmental Activities		Business-type Activities		Totals	
		FY 2013	FY 2012	FY 2013	FY 2012	FY 2013	FY 2012
Assets:							
Current and other assets………..	$	1,594,138	1,616,435	804,313	786,254	2,398,451	2,402,689
Capital assets…………………		6,222,847	6,597,594	2,106,430	2,158,564	8,329,277	8,756,158
Total assets………………		7,816,985	8,214,029	2,910,743	2,944,818	10,727,728	11,158,847
Deferred outflows of resources:							
Loss on refundings of debt…………..		1,645	-	1,336	-	2,981	-
Liabilities:							
Current and other liabilities…..		159,371	154,890	95,561	101,211	254,932	256,101
Long-term liabilities…………..		1,999,432	1,966,262	1,513,032	1,526,807	3,512,464	3,493,069
Total liabilities…………….		2,158,803	2,121,152	1,608,593	1,628,018	3,767,396	3,749,170
Deferred inflows of resources:							
Gain on refundings of debt………		-	-	2,104	-	2,104	-
Net position:							
Net investment in capital assets		5,012,359	5,350,666	817,594	859,392	5,829,953	6,210,058
Restricted ……………………….		864,808	939,509	124,753	128,361	989,561	1,067,870
Unrestricted …………………….		(217,340)	(197,298)	359,035	329,047	141,695	131,749
Total net position…………	$	5,659,827	6,092,877	1,301,382	1,316,800	6,961,209	7,409,677

At June 30, 2013, the City reported positive balances in all three categories of net position on a total basis.

Net investment in capital assets (infrastructure, land, buildings, other improvements, vehicles, and equipment, less outstanding debt used to acquire them) of $5.830 billion comprise 83.8 percent of the City's total net position. 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 2012-2013, net investment in capital assets for governmental activities decreased by $380.1 million due primarily to the return of capital assets by the City and the Diridon Authority ($117.1 million) to SARA and depreciation expense ($359.3 million).

A portion of the City's net position, $989.6 million or 14.2 percent, are subject to legal restrictions on their use, including $864.8 million in governmental activities and $124.8 million in business-type activities. Of the total net position at June 30, 2013, $141.7 million or 2.0 percent represents unrestricted net position, which comprises a deficit balance of $217.3 million for governmental activities, and a positive balance of $359.0 million for business-type activities. Primary factors contributing to the governmental activities deficit balance are the City's long-term liabilities for other postemployment benefits and workers' compensation.

During 2012-2013, the City's total net position decreased by $448.5 million. Notable changes in the statement of net position between June 30, 2013 and June 30, 2012 include:

- Capital assets decreased by $426.9 million or 4.9 percent compared to the prior fiscal year. Governmental capital assets decreased by $374.8 million and business-type capital assets decreased by $52.1 million. The decrease in governmental capital assets resulted from transfers of capital assets from the City and the Diridon Authority to SARA totaling $117.1 million, and depreciation expense of $359.3 million for major infrastructure and other assets. The decrease in governmental capital assets was slightly offset by additions (net) to capital assets of $101.7 million. The decrease in business-type capital assets was primarily due to depreciation expense of $83.8 million but was offset by additional projects primarily within the Wastewater Treatment System and at the Airport ($31.6 million). Airport projects completed as of June 30, 2013 include the reconstruction of Taxiway W, taxi staging area, and the common lounge area.

- Current and other assets decreased by $4.2 million or 0.2 percent due to a decrease of $22.3 million for governmental activities, which was partially offset by an increase of $18.1 million for business-type activities. The increase in current assets for business-type activities is mainly due to an increase in cash and cash equivalents from Wastewater Treatment System and Municipal Treatment System operations. The decrease in governmental activities is primarily the result of a decrease in cash held by fiscal agents, which were used for projects such as the Convention Center expansion.

- Long-term liabilities increased by a net amount of $19.4 million or 0.6 percent, comprised of a $33.2 million increase for governmental activities, and a $13.8 million decrease for business-type activities. The increase for governmental activities was due to an increase in other long-term obligations ($82.6 million), offset by debt service payments ($48.1 million). The decrease in business-type activities was due to debt service payments for Airport revenue bonds ($13.4 million) and Wastewater revenue bonds and State loans ($9.1 million).

- Current and other liabilities for the City decreased slightly by $1.2 million or 0.5 percent due to a decrease of $5.7 million for business-type activities and an increase of $4.5 million for governmental activities. The increase for governmental activities was due to higher payables to vendors but was offset by a decrease in advances and deposits. The decrease for business-type activities was due to lower short-term notes payables and unearned revenue balances.

Unrestricted net position for governmental activities decreased by $20.0 million or 10.2 percent resulting in a deficit balance of $217.3 million at June 30, 2013. A significant part of the reduction in unrestricted net position is the result of continued under-funding of the annual required contribution of the City's other postemployment benefits thereby increasing its net other postemployment benefits obligation ("NOPEBO") and reducing net position by an additional $66.0 million. At June 30, 2013, the City's NOPEBO balance for governmental activities is $358.2 million. The reduction in unrestricted net position resulting from increased NOPEBO was offset by a combination of modest increases in unrestricted revenue sources and continued cost reduction strategies.

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

Statement of Activities
For the Years Ended June 30, 2013 and 2012
(in thousands)

	Governmental Activities		Business-type Activities		Totals	
	FY 2013	FY 2012	FY 2013	FY 2012	FY 2013	FY 2012
Revenues:						
Program revenues:						
Fees, fines, and charges for services	$ 399,161	340,932	370,399	362,623	769,560	703,555
Operating grants and contributions	108,858	123,829	565	670	109,423	124,499
Capital grants and contributions	36,365	22,749	16,246	10,899	52,611	33,648
General revenues:						
Property taxes	329,591	404,877	-	-	329,591	404,877
Utility taxes	111,750	110,912	-	-	111,750	110,912
Franchise fees	43,741	41,709	-	-	43,741	41,709
Transient occupancy taxes	25,258	22,451	-	-	25,258	22,451
Sales taxes shared revenue	163,751	154,026	-	-	163,751	154,026
State of California in-lieu	524	2,611	-	-	524	2,611
Business taxes	45,140	41,134	-	-	45,140	41,134
Unrestricted interest and investment income	2,019	6,950	(1,612)	3,562	407	10,512
Other revenue	20,678	21,207	-	-	20,678	21,207
Total revenues	1,286,836	1,293,387	385,598	377,754	1,672,434	1,671,141
Expenses:						
General government	133,330	111,996	-	-	133,330	111,996
Public safety	489,572	490,442	-	-	489,572	490,442
Community services	214,770	247,518	-	-	214,770	247,518
Sanitation	160,860	135,543	-	-	160,860	135,543
Capital maintenance	475,995	473,674	-	-	475,995	473,674
Interest and fiscal charges	64,467	123,696	-	-	64,467	123,696
Norman Y. Mineta San José International Airport	-	-	199,681	200,380	199,681	200,380
Wastewater Treatment System	-	-	147,994	149,980	147,994	149,980
Municipal Water System	-	-	31,523	29,260	31,523	29,260
Parking System	-	-	10,231	9,290	10,231	9,290
Total expenses	1,538,994	1,582,869	389,429	388,910	1,928,423	1,971,779
Deficiency before transfers and extraordinary items	(252,158)	(289,482)	(3,831)	(11,156)	(255,989)	(300,638)
Transfers	829	3,357	(829)	(3,357)	-	-
Extraordinary gain (loss) on dissolution of the former Redevelopment Agency	(167,244)	2,075,379	-	(13,528)	(167,244)	2,061,851
Change in net position	(418,573)	1,789,254	(4,660)	(28,041)	(423,233)	1,761,213
Net position at beginning of year, as previously reported	6,092,877	4,303,623	1,316,800	1,344,841	7,409,677	5,648,464
Change in accounting principle	(14,477)	-	(10,758)	-	(25,235)	-
Net position at beginning of year, as restated	6,078,400	4,303,623	1,306,042	1,344,841	7,384,442	5,648,464
Net position at end of year	$ 5,659,827	6,092,877	1,301,382	1,316,800	6,961,209	7,409,677

Governmental activities: Net position for governmental activities decreased by $433.1 million or 7.1 percent during 2012-2013 from $6.093 billion to $5.660 billion. Total expenses decreased by $43.9 million whereas total revenues decreased by $6.6 million. Expenses continue to exceed revenues resulting in a decrease in net position before transfers and extraordinary items. Significant elements of the decrease in net position before transfers and extraordinary items for governmental activities from June 30, 2012 to June 30, 2013 are as follows:

- Contributing factors resulting in increases to certain revenue categories are as follows: Fees, fines, and charges for services increased by $58.2 million or 17.1 percent primarily due to higher developer revenues for in-lieu fees, and fee increases charged by the City for services such as building permits. Sales tax revenue increased by $9.7 million or 6.3 percent indicating a modest improvement in consumer spending. Business tax revenues improved by $4.0 million or 9.7 percent due to an increase in Cardroom Tax receipts resulting from the opening of M8trix Casino and additional receipts from general business tax amnesty program. Transient occupancy tax receipts from guests staying in the City's local hotels increased by $2.8 million or 12.5 percent. For the fourteen largest hotels in the City, the average room rate increased from $129 to $139 and the occupancy rate rose from 61.6 percent to 66.6 percent during the year indicating signs of continued economic recovery. Franchise fees increased by $2.0 million or 4.9 percent due to growth in the Commercial Solid Waste Franchise Fee resulting from a new fee methodology. Capital grants and contributions increased by $13.6 million or 59.9 percent primarily due to additional Federal grants for Police and Fire emergency services equipment.

- Contributing factors resulting in decreases to certain revenue categories are as follows: Property tax revenue decreased by $75.3 million or 18.6 percent due to the redistribution of the former Agency's property tax revenues into the SARA private purpose trust fund starting February 1, 2012. Without the effect of the redistribution of the property taxes to SARA in the amount of $87.7 million, the City's property tax revenues increased by $12.4 million reflecting increasing assessed property tax valuations. Operating grants and contributions decreased by $15.0 million or 12.1 percent primarily due to the end of American Recovery and Reinvestment Act funded grants in the current fiscal year ($9.0 million), and reductions in Federal and State grants received for public safety ($3.0 million), neighborhood stabilization program ($1.0 million), and HOME grants ($1.2 million). State of California in lieu decreased by $2.1 million or 79.9 percent due to the State legislature's elimination of Motor Vehicle In-Lieu fee revenues to cities in California.

- Decrease in the fair value of investments resulted in the City's interest and investment income of $4.9 million or 70.9 percent from the prior year. In addition, the annualized investment interest yield for the City's investment pool remained flat at 0.6 percent at June 30, 2012 and June 30, 2013, reflecting a slow recovery in the interest rate environment experienced in the capital markets.

- General government expenses increased by $21.3 million or 19.0 percent during 2012-2013 primarily due to advances to SARA for its debt service payments ($12.3 million) for the Convention Center and other administrative and support costs of SARA in the amount of $3.5 million. This increase was offset by reductions in personnel costs ($1.3 million) due to the elimination of seven positions in Information Technology and lower sick leave payouts ($1.9 million) compared to the prior year. The increase in general government expenses ($0.8 million) attributable to the General Fund is explained in more detail in the governmental fund section later in this section.

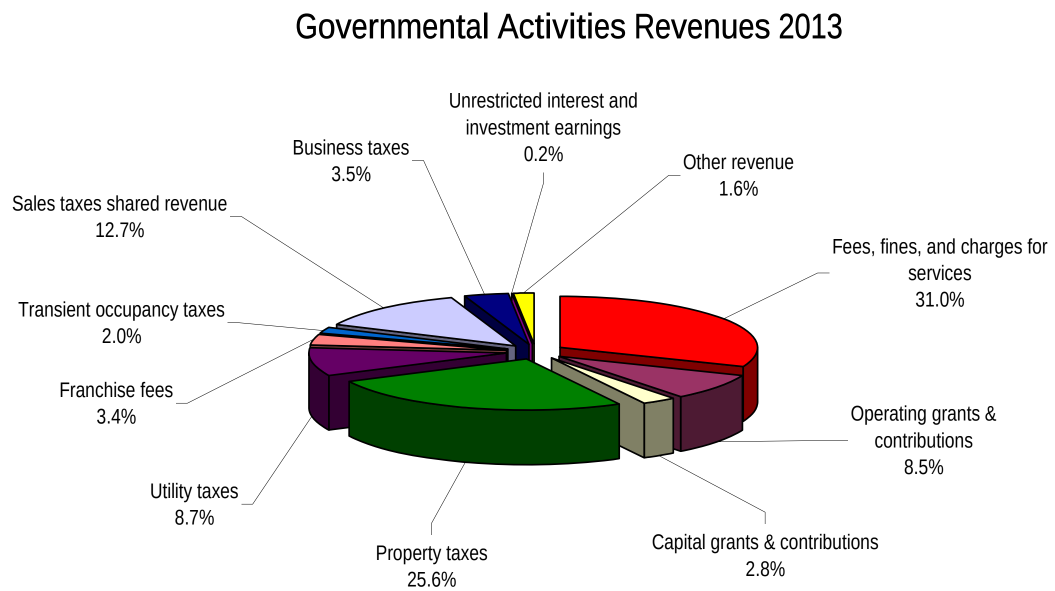
- Public safety expenses remained relatively stable at $489.6 million with a slight decrease of $0.9 million or 0.2 percent from $490.4 million in the prior fiscal year.

- Community services expenses decreased by $32.7 million or 13.2 percent due primarily to the scale down of the City's housing programs as a result of the dissolution of the Agency.

- Sanitation expenses increased by $25.3 million or 18.7 percent primarily due to an increase in costs for the commercial solid waste recycling program.

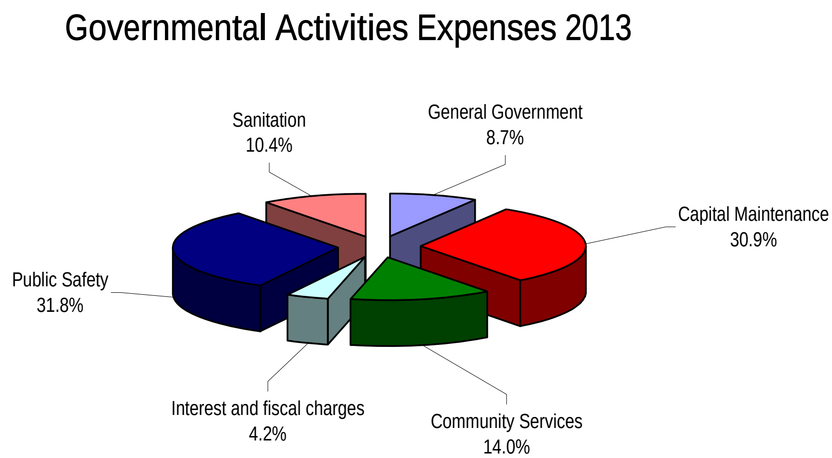
- Capital maintenance increased by $2.3 million or 0.5 percent primarily due to increases in capital maintenance spending programs.

- Interest and fiscal charges decreased by $59.2 million or 47.9 percent primarily due to obligations of the Agency transferred to the SARA private purpose trust fund on February 1, 2012. A full fiscal year of interest and fiscal charges is recorded in the SARA private purpose trust fund commencing in fiscal year 2013.



The chart above shows the primary components of governmental activities revenue sources for 2012-2013. Of the $1.287 billion in total revenues generated by governmental activities, 78.0 percent is attributable to four categories: property taxes (25.6 percent), fees, fines, and charges for services (31.0 percent), sales taxes (12.7 percent), and utility taxes (8.7 percent). Except for property taxes, which were down by $75.3 million compared to the previous year attributable to the dissolution of the former Agency, sales taxes, utility taxes, and franchise fees increased slightly over the prior year.

The chart below shows the principal categories of 2012-2013 expenses for governmental activities. Of the $1.539 billion in total expenses incurred by governmental activities, the categories accounting for 76.7 percent of the total are: public safety (31.8 percent); capital maintenance (30.9 percent); and community services (14.0 percent).



Business-type activities: Business-type activities net position decreased by $15.4 million or 1.2 percent to $1.301 billion during 2012-2013.

The notable components of net position for business-type activities during 2012-2013 are:

- Airport net position decreased by $48.2 million or 12.7 percent. This includes a change in accounting principle related to the implementation of GASB 65 resulting in a prior year adjustment in the amount of $10.1 million to write off unamortized bond issuance costs previously reported as an asset. The Airport had an operating loss of $1.3 million, a decrease of $7.5 million or 121.2 percent compared to prior year operating income of $6.2 million. Operating revenues decreased $14.0 million or 10.2 percent, which was mainly due to the reclassification of customer facility fees from operating revenues to nonoperating revenues in the current year ($13.4 million). Revenue increases were experienced in landing fees, airfield, fuel handling fees and general aviation. These increases were offset by decreases in terminal rental, terminal buildings and concessions, and parking and roadway. Operating expenses of $124.4 million were lower by $6.5 million or 5.0 percent compared to the prior fiscal year. Decreases were experienced in non-personal costs, overhead charges, other postemployment benefits costs, and fees charged by the City for police and firefighting services. Nonoperating expenses exceeded nonoperating revenues by $43.8 million, which represented a decrease of $5.1 million from 2011-2012. This decrease was mainly due to the reclassification of customer facility fees from operating revenues to non-operating revenues in the current year ($13.4 million), offset by the increase in interest cost due to the conversion of short-term commercial paper to long-term bonds ($5.0 million), and a decrease in investment income ($2.5 million).

- Wastewater Treatment System net position increased by $31.3 million or 4.0 percent from $777.4 million to $808.7 million. This includes a change in accounting principle related to the implementation of GASB 65 resulting in a prior year adjustment in the amount of $0.7 million to write off $0.4 million of unamortized bond issuance costs previously reported as an asset and $0.3 million of bond issuance costs included in the unamortized loss on refundings previously reported as a contra liability. Approximately $268.5 million, or 33.2 percent of the total net position, constitutes unrestricted net position, which may be used to finance day-to-day operations without constraints established by debt covenants or other legal requirements. Operating revenues increased $4.0 million primarily due to higher sewer service and user charge collections reflective of economic rebound mainly in the commercial sector ($3.9 million), higher sales of recycled water ($1.1 million), higher South Bay Water Recycling strategic plan contribution ($1.2 million) offset by lower contributions from the Tributary Agencies toward the Water Pollution Control Plant's operating and capital improvement costs ($2.2 million). Total operating expenses declined by $1.5 million to $145.6 million mainly due to attritions of work force at the Treatment Plant, which also contributed to a decrease in other postemployment benefit cost. Net nonoperating expenses increased by $2.1 million primarily due to decrease in the fair value of investment and lower interest expense on long-term debt payments. Capital grants and contribution increased by $5.8 million mainly due to more funding appropriated from the U.S. Bureau of Reclamation for construction of wastewater recycling facilities and recycled water projects to minimize treated sewage effluent discharge into the South Bay.

- Municipal Water System net position increased by $0.4 million or 0.5 percent from $83.1 million to $83.6 million. Operating revenues of $32.3 million increased by $3.8 million or 13.4 percent due to an increase in demand in addition to a potable water rate increase of 9.5 percent and an increase in the recycled water rate index. Operating expenses of $31.5 million increased by $2.3 million or 7.7 percent mainly due to higher wholesale prices of water.

- Parking System net position increased by $1.1 million or 1.4 percent from $75.1 million to $76.2 million. Operating revenues increased by $0.5 million or 4.3 percent primarily due to increased activity at the parking facilities resulting from a recovering economy. Operating expenses increased by $0.9
- million or 10.1 percent reflecting higher general and administrative costs.

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, 2013, the City's governmental funds reported combined fund balances of $1.157 billion, a decrease of $29.1 million or 2.5 percent compared to the balance at June 30, 2012. The governmental fund balances are categorized as nonspendable, restricted, committed, assigned, or unassigned.

- $0.9 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.
- $852.2 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.
- $118.2 million is reported as committed fund balance that had been limited by formal Council action to specific purposes.
- $121.5 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.
- $64.2 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.

General Fund: The General Fund is the chief operating fund of the City. At June 30, 2013, the General Fund's unassigned fund balance is $64.2 million or 28.3 percent of the $226.9 million total General Fund balance. Comparing unassigned 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, 2013, unassigned fund balance represents 9.2 percent of total General Fund expenditures of $695.3 million, while total fund balance represents 32.6 percent of total General Fund expenditures. This measure of financial health shows a modest improvement from the prior fiscal year. At June 30, 2012, the same measures were 7.3 percent and 27.2 percent, respectively.

Consistent with the prior year, revenues exceeded expenditures resulting in an excess of $57.7 million in 2012-2013. The excess was generated through a combination of slightly stronger revenues and continued implementation of cost reduction measures. Compared to the prior year, there were no further service cuts, instead reductions were limited to areas where alternative service delivery models can reduce costs and enhance service levels.

In 2012-2013, General Fund revenues of $753.0 million were $31.1 million or 4.3 percent higher than 2011-2012 revenues of $721.9 million. Taxes and special assessments revenues increased by $18.9 million or 3.4 percent. The increase was primarily attributed to the following: increases in sales tax ($9.7 million), franchise tax ($6.2 million), property tax ($3.3 million), business tax ($1.9 million), and marijuana business tax ($0.5 million), offset by a decrease in State of California motor vehicle in-lieu fees ($2.0 million).

License, permits and fines decreased by $1.1 million or 1.7 percent mainly due to a decrease in revenues from parking citations ($2.3 million) but were offset by increases in building permit fees ($1.2 million). Intergovernmental revenues remained consistent with an increase of $0.04 million or 0.2 percent. Charges for services increased by $4.4 million due to increases in state mandated fees ($0.6 million), zoning charges ($1.9 million) and sports fields reservations ($1.5 million). Investment income showed a decrease of $1.9 million over the prior year mainly due to a decrease in fair value of investments. Other revenues increased by $10.7 million mainly due to revenues related to a one-time payment of $6.9 million from the County to adjust prior payments of property tax administration fees.

2012-2013 General Fund expenditures of $695.3 million were $22.3 million or 3.3 percent higher than 2011-2012 expenditures of $673.0 million.

General government expenditures increased by $12.9 million primarily due to the debt service ($12.3 million) that the City paid on behalf of SARA, increases in general liability claim expenditures in the current year ($1.5 million), offset by decreases in salary expenditures due to position reductions in the Information Technology department ($1.3 million).

Public safety expenditures decreased by $7.1 million due primarily to vacancy savings in Police ($7.1 million) and Fire ($2.1 million) This decrease was partially offset by increases in professional and consultant services expenditures ($1.2 million).

Community services expenditures decreased by $15.6 million mainly due to various expenditures ($17 million) related to the Building Development Fee program that that were transferred to capital maintenance, offset by increases in salaries and fringe benefits expenditures ($2.2 million). Sanitation expenditures slightly increased by $0.7 million due to increases in staffing expenditures ($0.5 million) and professional and consultant services ($0.3 million).

Capital outlay expenditures increased by $1.8 million due to costs associated with purchases of additional fire equipment.

Capital maintenance expenditures increased by $24.9 million or 68.0 percent due to a reclassification from community services expenditures of Building Development Fee program personnel costs ($17.0 million) and higher Public Works labor costs ($5.0 million).

Housing Activities fund: 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, 2013, the fund's loan receivable balance (net), which represents loans to developers of various affordable housing projects and first time homebuyers, was $65.9 million. This balance includes loans to developers for various projects, including Ford and Monterey, Taylor Oaks Apartments, Northrup, Roundtable, Kings Crossing, Peacock Commons, Archer Studios, Canoas, Terrace, Curtner Gardens, Homesafe, Markham Plaza, Plaza Del Sol, Verandas, Corde Terra Village Senior, 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.

Low and Moderate Income Housing Asset fund: The Low and Moderate Income Housing Asset fund was created pursuant to the Redevelopment Dissolution Law 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, 2013, the fund's loan receivable balance (net) was $254.1 million.

Integrated Waste Management fund: The Integrated Waste Management accounts for activities related to the Integrated Waste Management Program, which includes garbage collection, recycling services and related billing operations. At June 30, 2013, this fund had a fund balance of $12.9 million committed to this program.

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 $49.1 million in special assessment and special tax debt outstanding at June 30, 2013 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 2012-2013 increased by $49.0 million or 117.3 percent compared to the prior fiscal year primarily due to capital outlay, which were funded in part by the Special Hotel Tax Revenue Bonds, Series 2011 associated with the Convention Center renovation and expansion.

Financing Authority fund: The City's Financing Authority Debt Service fund accounts for debt activity related to lease revenue bonds and commercial paper notes, which serves as a mechanism for financing City public improvements.

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, 2013, the unrestricted net position was $58.1 million for the Airport, $268.5 million for the Wastewater Treatment System, $17.9 million for the Municipal Water System and $14.5 million for the Parking System. Net position for proprietary funds fell from $1.317 billion at June 30, 2012 to $1.301 billion at June 30, 2013, resulting in a decrease of $15.4 million or 1.2 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 2012-2013 budgets in June 2012.

During the fiscal year ended June 30, 2013, there was a $47.1 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; business tax; licenses, permits and fines; intergovernmental; charges for current services; and other revenues.

Actual budgetary basis expenditures of $714.0 million were $48.8 million less than the amended budget and $89.8 million less than the original budget. Savings were experienced over all expenditure categories.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The City's capital assets, net of accumulated depreciation, for its governmental and business-type activities together amounted to $8.329 billion at June 30, 2013. 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, 2013, net capital assets decreased by $426.9 million ($374.7 million in governmental activities and $52.1 million in business-type activities) or 4.9 percent compared to net capital assets at June 30, 2012. The decrease in capital assets of $374.7 million in governmental activities is primarily due to depreciation expense of $359.3 million, deletions of capital assets totaling $11.9 million, and transfers of capital assets of $117.1 during 2012-2013. These decreases were partially offset by additional infrastructure projects totaling $113.6 million in the governmental activities. The decrease of $52.1 million in capital assets in the business-type activities resulted from depreciation expense of $83.8 million, offset by additions of capital projects of $31.6 million at the Airport and within the Wastewater Treatment System.

Total construction-in-progress increased by $50.7 million or 36.3 percent from $139.9 million at June 30, 2012 to $190.7 million at June 30, 2013. Construction-in-progress for the governmental activities increased by $91.4 million or 131.0 percent primarily due to the Convention Center renovation and expansion project expenditures. Business-type activities contributed a decrease of $40.6 million to the total construction-in-progress as additions to the Airport and the Wastewater Treatment System construction-in-progress totaling $14.4 million was offset by $55.0 million in projects that were completed and placed in-service. The completed Airport projects include the following: reconstruction of Taxiway W, the construction of the common lounge area, and the taxi staging building.

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, 2012 and June 30, 2013 (in thousands):

		Governmental activities		Business-type activities		Total	
		2013	2012	2013	2012	2013	2012
Land	$	400,642	463,726	134,926	134,926	535,568	598,652
Intangible assets		-	-	12,882	12,882	12,882	12,882
Construction in progress		161,122	69,764	29,544	70,159	190,666	139,923
Buildings		934,019	1,037,128	1,229,370	1,253,657	2,163,389	2,290,785
Improvements, other than buildings		186,205	189,103	614,127	604,248	800,332	793,351
Infrastructure		4,516,780	4,813,511	-	-	4,516,780	4,813,511
Furniture and fixtures, vehicles, equipment		23,777	23,867	84,282	81,233	108,059	105,100
Property under capital leases		302	495	1,299	1,459	1,601	1,954
Total capital assets	$	6,222,847	6,597,594	2,106,430	2,158,564	8,329,277	8,756,158

Commitments outstanding as of June 30, 2013, related to governmental and business-type activities construction in progress totaled approximately $34.1 million and $21.7 million, respectively. Additional information about the City's capital assets can be found in the Notes to Basic Financial Statements, Note III.D.

General Obligation Bonded Debt Limit

The City Charter limits bonded indebtedness for General Obligation bonds to 15.0 percent of the total assessed valuation of all real and personal property within the City. The total assessed value of taxable property on the City's 2012-2013 tax roll was $126.2 billion, which results in a net total debt capacity of $18.9 billion. As of June 30, 2013, the City had $441.0 million of General Obligation bonds outstanding.

General Obligation Bonds and Other Bond Ratings

The City continued to receive high general credit ratings from all three national rating agencies despite the difficult financial and economic conditions nationally and locally. In April 2013, Moody's Investors Service ("Moody's") affirmed the City's general obligation rating of Aa1 citing the City's fiscal condition, which continued to gradually improve after a multi-year period of decline. In May 2013, Standard & Poor's ("S&P") affirmed the City's general obligation rating of AA+ and revised the outlook to stable. Fitch Ratings ("Fitch") affirmed the City's general obligation rating of AA+ with a stable outlook.

Near the end of the fiscal year, the Financing Authority issued fixed-rate refunding bonds (Series 2013A and Series 2013B) to refinance bonds that were originally issued to finance or refinance the Civic Center and Civic Center Garage projects. As part of the bond issuance process, the Series 2013A and the Series 2013B Bonds received ratings of Aa3/AA/AA from Moody's, S&P, and Fitch, respectively, all with a stable outlook for the 2013A and 2013B Bonds.

During the year, the underlying ratings on outstanding senior-lien debt issued by Norman Y. Mineta San José International Airport were affirmed by the three rating agencies. In February 2013, S&P affirmed the underlying ratings of A- and maintained a stable outlook, while Moody's affirmed the underlying ratings of

A2 and revised the outlook from negative to stable. In June 2013, Fitch affirmed the underlying ratings on Airport Revenue Bonds at 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 2012-2013, the City's gross outstanding long-term debt decreased by $118.3 million to $2.843 billion, comprised of governmental activities ($1.370 billion) and business-type activities ($1.473 billion). The balances at June 30, 2012 were $1.465 billion for governmental activities and $1.495 billion for business-type activities, for a total of $2.961 billion. The decrease of $118.3 million is primarily due to the scheduled debt service payments.

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

		As of June 30, 2013	As of June 30, 2012	Net Change
Governmental Activities:				
General obligation bonds	$	441,025	460,670	(19,645)
HUD Section 108 loan		14,706	20,803	(6,097)
San José Financing Authority				
Lease revenue bonds		604,155	659,578	(55,423)
Lease revenue bonds with				
reimbursement agreement		119,870	129,020	(9,150)
Revenue bonds with				
pledge agreement		33,435	35,105	(1,670)
Special assessment bonds with limited				
governmental commitment		156,545	160,310	(3,765)
Sub-total		1,369,736	1,465,486	(95,750)
Business-Type Activities:				
Revenue bonds		1,450,140	1,468,705	(18,565)
State of CA-Revolving Fund Loan		22,769	26,746	(3,977)
Sub-total		1,472,909	1,495,451	(22,542)
Total:	$	2,842,645	2,960,937	(118,292)

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

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

- The City completed 2012-2013 with better operating financial results than expected when the 2012-2013 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 to achieve a more desirable level of budget stability including providing a higher level of service to the community. In June 2013, the City Council approved a balanced General Fund budget for fiscal year 2013-2014 that closed a projected shortfall of $2.6 million and has a focus on achieving budget and service level stability, target investments to meet priority needs of the community, and to continue service delivery efficiencies.

- The Adopted Budget sets aside $13.7 million to address the forecasted shortfall in 2014-2015 and establishes other reserves to better position the City to address potential funding needs.

Targeted investments are focused on the most pressing service delivery and infrastructure needs. However, a large portion of those investments ($20.0 million) is contingent on the outcome of pending litigation associated with elements of retirement reform and the implementation of the lowest cost healthcare plan changes. A $20 million contingency plan is included in the 2013-2014 Adopted Budget to address the uncertainty.

- Due to an improved forecast for 2013-2014, the City does not face further service cuts in the fiscal year. The small projected shortfall was closed with service delivery efficiencies and cost savings with no service level impacts.

- 2013-2014 redevelopment property tax revenues are forecast to be less than the amount necessary to pay enforceable obligations of SARA. In August 2013, the City advanced to SARA $13.2 million to fund the debt service for the Convention Center ($11.5 million) and the 4th Street Garage ($1.7 million). In addition, in October 2013, the City reevaluated SARA's cash position and determined that additional advances to SARA are needed in order for SARA to pay the $2.2 million debt service on the Educational Revenue Augmentation Fund loan. More information related to SARA is provided in Note IV.C.

- As of June 30, 2012, the most recent actuarial valuation date, the Police and Fire Department Retirement Plan ("PFDRP") had an 80 percent actuarial funded ratio for pension benefits. The actuarial accrued liability for pension benefits was $3.398 billion, and the actuarial value of assets was $2.704 billion resulting in an unfunded actuarial accrued liability ("UAAL") of $694.3 million. As of June 30, 2012, the most recent actuarial valuation date, the Federated City Employees' Retirement System ("FCERS") had a 62 percent actuarial funded ratio for pension benefits. The actuarial accrued liability for pension benefits was $2.841 billion and the actuarial value of pension assets was $1.763 billion, resulting in a UAAL of $1.078 billion.

- As of June 30, 2012, the most recent actuarial valuation date, PFDRP's Postemployment Healthcare Plan had a 7 percent actuarial funded ratio for postemployment healthcare benefits. The actuarial accrued liability for postemployment healthcare benefits was $997.3 million and the actuarial value of assets was $66.4 million resulting in a UAAL of $930.9 million. As of June 30, 2012, the most recent actuarial valuation date, FCERS's Postemployment Healthcare Plan had a 13 percent actuarial funded ratio for postemployment healthcare benefits. The actuarial accrued liability for postemployment healthcare benefits was $1.097 billion and the actuarial value of postemployment healthcare benefit assets was $137.8 million, resulting in a UAAL of $958.8 million.

- The adopted 2013-2014 operating budget projects retirement costs at $211.4 million in the General Fund and $271.2 million in all other funds. In addition, the 2014-2018 five-year Forecast projects General Fund retirement costs to increase an additional 21.3 percent by 2017-2018.

- As noted in the Trust and Agency Funds section of this CAFR, the PFDRP's net position experienced an increase of $222.8 million in 2012-2013 following a $46.0 million decrease in net position in the prior year primarily as a result of investment gain experienced in the first three quarters of the fiscal year. The FCERS's net position experienced an increase of $132.2 million in 2012-2013 following a $109.0 million decrease in net position in the prior year primarily as a result of the appreciation in the fair value of investments caused by an increase in the equity markets.

- On August 28, 2012, the City Council adopted 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. In addition, the contribution rate for Tier 2 members includes a change in the cost sharing between the City and active Tier 2 members, which is a 50/50 split of all costs.

- For 2013-2014, the City's contribution rates for pension benefits, as a percentage of payroll, are as follows: for police and fire members of PFDRP, 65.3 percent and 66.8 percent, respectively, and 50.9 percent for Tier 1 FCERS members and 6.7 percent for Tier 2 FCERS members. For 2013-2014, the City's contribution rates for postemployment healthcare benefits, as a percentage of payroll, are as follows: for police and fire members of PFDRP, 10.3 percent and 8.0 percent, respectively, and 8.7 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 the fiscal year ending June 30, 2014, 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 $136.6 million for PFDRP, $124.3 million for FCERS Tier 1 members, and $5.0 million for FCERS Tier 2 members. The prepayment for PFDRP and for FCERS Tier 1 members was paid by the City in July 2013. The City did not exercise its option to prepay its contribution for FCERS Tier 2 members.

- Contributions to the Postemployment Healthcare Plans of both PFDRP and FCERS are made by both the City and the participating employee members. Effective June 28, 2009 and June 26, 2011, the Police members and Fire members, respectively, of the PFDRP entered into a Memorandum of Agreement (MOA) with the City to phase-in to fully contributing the GASB Statement No. 43 annual required contribution (ARC) over a five year period; fiscal year 2012-2013 was the second year of the phase-in for the Fire members. The Fire and the Police members of the PFDRP entered into separate MOAs with the City; however, both agreements contain incremental increase caps of 1.25 percent and 1.35 percent of pensionable pay in each year for the members and the City, respectively. Additionally, if the postemployment healthcare contribution rates exceed 10 percent for members and 11 percent for the City (excluding the implicit subsidy), the parties shall meet and confer on how to address the contribution rates above 10 percent and 11 percent, respectively.

- The City and the bargaining units representing employee members of FCERS entered into separate MOAs to increase the contribution rates for postemployment healthcare benefits to the ARC over a five year period. The year ended June 30, 2013 was the fourth year of the five year phase-in period. The MOAs also provide that the five year phase-in of the ARC will not have an incremental increase of more than 0.75 percent of pensionable pay in each fiscal year for the employee or City contributions. In the fifth year of the phase-in period, the City and the employee members contributions for retiree medical benefits are split evenly and the retiree dental benefits are split in a ratio of 8 to 3 with the City contributing 8/11 and the employee members contributing 3/11. The fiscal year ended June 30, 2013, marked the end of the 0.75 percent cap on contributions. However, the bargaining units representing the FCERS employee members and the City have agreed to extend the incremental increase limitation of not more than 0.75 percent of pensionable pay for fiscal year ending June 30, 2014. In addition, the 0.75 percent limitation is extended to December 20, 2014. Beginning on December 21, 2014, the contribution rates will be based on the full ARC for the remainder of the fiscal year ending June 30, 2015 and all subsequent fiscal years. These terms related to payment of the ARC also apply to unrepresented employee members of FCERS.

All of these factors were considered in preparing the City's budget for 2013-2014.

FORWARD-LOOKING STATEMENTS AND REQUESTS FOR INFORMATION

Forward-Looking Statements

When used in this CAFR, the words or phrases "will likely result," "are expected to," "will continue," "is "anticipated, "estimate," "project," "forecast," "expect," "intend" and similar expressions identify "forward-looking statements", but are not the exclusive means of identifying forward-looking statements in the CAFR. Such statements are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated in such forward-looking statements. Any forecast is subject to such uncertainties. Inevitably, some assumptions used to develop the forecasts will not be realized and unanticipated events and circumstances may occur. Therefore, there are likely to be differences between forecasts and actual results, and those differences may be material.

Readers are urged not to place undue reliance on these forward-looking statements, which speak only as of the date of this CAFR. The City undertakes no obligation to revise or update any forward-looking statements in order to reflect any event or circumstance that may arise after the date of the CAFR.

Requests 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. All summaries of documents contained in this CAFR are made subject to the provisions of such documents and do not purport to be complete statements of any or all such provisions. Each reference in this CAFR to a document is qualified in its entirety by reference to such document, which is on file with the City.

Questions concerning any of the information provide in this report or requests for additional financial information should be addressed to the Director of Finance, 200 East Santa Clara Street, San José, California 95113. Requests for documents may be directed to the City department designated in the CAFR as the holder of the particular document or to the Director of Finance.

Basic
Financial Statements

Basic Financial Statements

City of San José
Statement of Net Position
June 30, 2013
($000's)

		Governmental Activities	Business-Type Activities	Total
ASSETS				
Equity in pooled cash and investments held in City Treasury	$	643,615	426,627	1,070,242
Receivables (net of allowances for uncollectibles)		139,283	19,131	158,414
Due from outside agencies		2,915	-	2,915
Internal balances		(5,062)	5,062	-
Inventories		3,683	1,308	4,991
Loans receivable (net of allowances for uncollectibles)		326,186	-	326,186
Advances and deposits		1,028	4,980	6,008
Other assets		42,783	179	42,962
Restricted assets:				
Equity in pooled cash and investments held in City Treasury		53,176	213,140	266,316
Cash and investments held with fiscal agent		190,223	118,827	309,050
Other cash and investments		3,370	-	3,370
Receivables (net of allowances for uncollectibles)		-	3,537	3,537
Prepaid bond insurance costs (net of accumulated amortization)		423	8,159	8,582
Long-term receivables from SARA		192,515	3,363	195,878
Capital assets (net of accumulated depreciation):				
Nondepreciable		561,764	177,352	739,116
Depreciable		5,661,083	1,929,078	7,590,161
Total assets		7,816,985	2,910,743	10,727,728
DEFERRED OUTFLOWS OF RESOURCES				
Loss on refundings of debt		1,645	1,336	2,981
LIABILITIES				
Accounts payable		43,084	14,613	57,697
Accrued liabilities		14,987	1,603	16,590
Interest payable		11,729	25,343	37,072
Due to SARA		545	308	853
Due to outside agencies		390	-	390
Short-term notes payable		42,796	45,380	88,176
Unearned revenue		15,285	2,532	17,817
Advances, deposits, and reimbursable credits		7,520	5,782	13,302
Long-term payables to SARA		467	-	467
Other liabilities		22,568	-	22,568
Long-term obligations:				
Due within one year		63,910	39,472	103,382
Due in more than one year		1,935,522	1,473,560	3,409,082
Total liabilities		2,158,803	1,608,593	3,767,396
DEFERRED INFLOWS OF RESOURCES				
Gain on refundings of debt		-	2,104	2,104
NET POSITION				
Net investment in capital assets		5,012,359	817,594	5,829,953
Restricted for:				
Debt service		49,758	22,796	72,554
Capital projects		298,035	101,957	399,992
Community services		512,463	-	512,463
Public safety		4,552	-	4,552
Unrestricted (deficit)		(217,340)	359,035	141,695
Total net position	$	5,659,827	1,301,382	6,961,209

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, 2013
($000's)

		Program Revenues			Net (Expense) Revenue and Changes in Net Position		
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	$ 133,330	49,213	186	13,691	(70,240)	-	(70,240)
Public safety	489,572	21,868	20,180	-	(447,524)	-	(447,524)
Community services	214,770	109,291	46,953	-	(58,526)	-	(58,526)
Sanitation	160,860	148,270	-	306	(12,284)	-	(12,284)
Capital maintenance	475,995	70,519	41,539	22,368	(341,569)	-	(341,569)
Interest and fiscal charges	64,467	-	-	-	(64,467)	-	(64,467)
Total governmental activities	**1,538,994**	**399,161**	**108,858**	**36,365**	**(994,610)**	**-**	**(994,610)**
Business -Type activities:							
Norman Y. Mineta San José International Airport	199,681	154,246	565	6,954	-	(37,916)	(37,916)
Wastewater Treatment System	147,994	171,689	-	9,143	-	32,838	32,838
Municipal Water System	31,523	32,371	-	149	-	997	997
Parking System	10,231	12,093	-	-	-	1,862	1,862
Total business-type activities	**389,429**	**370,399**	**565**	**16,246**	**-**	**(2,219)**	**(2,219)**
Total	**$ 1,928,423**	**769,560**	**109,423**	**52,611**	**(994,610)**	**(2,219)**	**(996,829)**

	Governmental Activities	Business -Type Activities	Total
General revenues:			
Taxes and franchise fees:			
Property and other taxes	329,591	-	329,591
Utility	111,750	-	111,750
Franchise	43,741	-	43,741
Transient occupancy	25,258	-	25,258
Business taxes	45,140	-	45,140
Sales taxes shared revenue	163,751	-	163,751
State of California in-lieu	524	-	524
Unrestricted interest and investment income	2,019	(1,612)	407
Other revenue	20,678	-	20,678
Transfers	829	(829)	-
Total general revenues and transfers	**743,281**	**(2,441)**	**740,840**
Extraordinary item from dissolution of the Redevelopment Agency	(167,244)	-	(167,244)
Change in net position	**(418,573)**	**(4,660)**	**(423,233)**
Net position - beginning, as previously reported	6,092,877	1,316,800	7,409,677
Change in accounting principle	(14,477)	(10,758)	(25,235)
Net position - beginning, as restated	6,078,400	1,306,042	7,384,442
Net position - ending	**$ 5,659,827**	**1,301,382**	**6,961,209**

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

City of San José
Balance Sheet
Governmental Funds
June 30, 2013
($000's)

		General Fund	Housing Activities	Low and Moderate Income Housing Asset
ASSETS				
Equity in pooled cash and investments held in City Treasury	$	210,893	14,064	21,621
Receivables (net of allowance for uncollectibles)		54,142	1,971	1,593
Due from outside agencies		2,915	-	-
Due from other funds		19,312	-	-
Loans receivables (net of allowance for uncollectibles)		1,491	65,930	254,095
Advances and deposits		236	-	-
Restricted assets:				
Equity in pooled cash and investments held in City Treasury		1,258	7,147	-
Cash and investments held with fiscal agent		11	3	-
Other cash and investments		-	-	-
Advances to other funds		3,297	-	-
Advances receivable from SARA		-	-	12,911
Other assets		-	2,300	20,021
Total assets	$	293,555	91,415	310,241
LIABILITIES				
Accounts payable	$	10,584	1,230	46
Accrued salaries, wages, and payroll taxes		12,723	31	87
Due to other funds		-	-	-
Due to SARA		128	-	-
Due to other agencies		373	-	-
Short-term notes payable		-	-	-
Unearned revenue		4,750	-	-
Advances, deposits, and reimbursable credits		7	-	-
Advances from other funds		18,236	-	-
Long-term advances from SARA		-	-	467
Other liabilities		19,860	-	-
Total liabilities		66,661	1,261	600
DEFERRED INFLOWS OF RESOURCES		-	22,291	6,904
FUND BALANCES				
Nonspendable		13	-	-
Restricted		330	67,863	302,737
Committed		89,114	-	-
Assigned		73,237	-	-
Unassigned		64,200	-	-
Total fund balances		226,894	67,863	302,737
Total liabilities, deferred inflows of resources and fund balances	$	293,555	91,415	310,241

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

Integrated Waste Management	Special Assessment Districts	San José Financing Authority Debt Service	Nonmajor Governmental Funds	Total Governmental Funds
22,748	-	-	352,107	621,433
11,488	49,293	-	20,489	138,976
-	-	-	-	2,915
-	-	-	8,239	27,551
-	-	-	4,670	326,186
-	5	-	787	1,028
-				
-	-	17	44,754	53,176
-	84,333	49,277	56,599	190,223
-	-	-	3,370	3,370
-	-	-	15,674	18,971
-	-	14,227	-	27,138
-	-	-	852	23,173
34,236	133,631	63,521	507,541	1,434,140
10,210	11,990	376	7,216	41,652
191	25	-	1,515	14,572
-	17,890	239	9,422	27,551
-	-	-	417	545
-	-	17	-	390
-	-	42,796	-	42,796
7,005	-	-	3,530	15,285
3,894	2,681	-	938	7,520
-	-	3,297	2,500	24,033
-	-	-	-	467
-	-	-	2,708	22,568
21,300	32,586	46,725	28,246	197,379
-	49,120	-	1,446	79,761
-	5	-	893	911
-	51,920	16,796	412,553	852,199
12,936	-	-	16,174	118,224
-	-	-	48,229	121,466
-	-	-	-	64,200
12,936	51,925	16,796	477,849	1,157,000
34,236	133,631	63,521	507,541	1,434,140

City of San José
Reconciliation of the Governmental Funds Balance Sheet
to the Statement of Net Position
June 30, 2013
($000's)

Total fund balances-governmental funds (Page 25)		$ 1,157,000
Amounts reported for governmental activities in the statement of net position 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	400,642	
Construction in progress	161,122	
Infrastructure assets	11,375,523	
Other capital assets	1,676,895	
Accumulated depreciation	(7,397,489)	
Total capital assets		6,216,693
Other long-term assets associated with the New Market Tax Credit (NMTC) financing program are not current financial resources, therefore, are not reported in governmental funds.		19,610
Long-term receivables are not available to pay for current period expenditures and, therefore, are reported as deferred inflows of resources in governmental funds.		30,641
Long-term receivables associated with lease, pledge revenue agreements, and reimbursement arrangements from the private-purpose trust fund are not current financial resources and therefore are not reported in the governmental funds.		165,377
Prepaid bond insurance 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 position.		423
Refunding of debt reported as deferred outflows of resources are not financial resources, therefore are not reported in the funds. Such costs are capitalized and amortized over the life of the corresponding bonds for purposes of the statement of net position.		1,645
Special assessments are reported as revenue when levied in government-wide financial statements. In governmental funds, these assessments are reported as deferred inflows of resources since they are not available.		49,120
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.		(11,729)
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 position.		27,728
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	(1,420,644)	
Accrued vacation, sick leave and compensatory time	(58,115)	
Estimated liability for self-insurance	(133,786)	
Net other postemployment benefits obligation	(358,238)	
Other	(25,898)	
Total long-term liabilities		(1,996,681)
Net position of governmental activities (Page 22)		$ 5,659,827

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

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City of San José
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2013
($000's)

	General Fund	Housing Activities	Low and Moderate Income Housing Asset
REVENUES			
Taxes and special assessments	$ 580,026	-	-
Licenses, permits, and fines	61,137	-	-
Intergovernmental	24,707	12,755	-
Charges for current services	39,768	-	-
Rent	-	-	5
Investment income	2,807	1,057	9,635
Other revenue	44,555	22,301	644
Total revenues	753,000	36,113	10,284
EXPENDITURES			
Current:			
General government	84,793	-	-
Public safety	437,253	-	-
Community services	98,459	12,947	11,864
Sanitation	923	-	-
Capital maintenance	61,593	-	-
Capital outlay	5,356	-	-
Debt service:			
Principal	6,097	-	-
Interest and fiscal charges	777	-	-
Bond issuance costs	-	-	-
Current refunding escrow	-	-	-
Total expenditures	695,251	12,947	11,864
Excess (deficiency) of revenues over (under) expenditures	57,749	23,166	(1,580)
OTHER FINANCING SOURCES (USES)			
Refunding bonds issued	-	-	-
Premium on bonds	-	-	-
Payment to refunded bond escrow agent	-	-	-
Proceeds from sale of capital assets	6,198	-	-
Transfers in	11,840	-	-
Transfers out	(31,921)	(34)	(687)
Total other financing sources (uses)	(13,883)	(34)	(687)
Extraordinary loss from dissolution of the Redevelopment Agency	-	-	(50,139)
Net change in fund balances	43,866	23,132	(52,406)
Fund balances - beginning	183,028	44,731	355,143
Fund balances - ending	$ 226,894	67,863	302,737

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

Integrated Waste Management	Special Assessment Districts	San José Financing Authority Debt Service	Nonmajor Governmental Funds	Total Governmental Funds
-	16,710	-	139,730	736,466
-	-	-	-	61,137
306	-	-	68,323	106,091
122,164	-	-	86,704	248,636
-	-	-	24,015	24,020
(110)	306	110	(1,223)	12,582
-	1,713	19,202	9,723	98,138
122,360	18,729	19,312	327,272	1,287,070
-	-	-	15,690	100,483
-	-	-	2,978	440,231
-	-	-	59,923	183,193
138,658	-	-	21,300	160,881
-	26	-	103,758	165,377
-	77,238	-	23,793	106,387
-				
-	3,765	21,535	19,645	51,042
-	9,647	31,386	22,477	64,287
-	-	1,762	-	1,762
-	-	31,985	-	31,985
138,658	90,676	86,668	269,564	1,305,628
(16,298)	(71,947)	(67,356)	57,708	(18,558)
-	-	335,980	-	335,980
-	-	45,506	-	45,506
-	-	(348,750)	-	(348,750)
-	-	-	-	6,198
-	-	26,462	45,368	83,670
(2,086)	(1,624)	(1)	(46,683)	(83,036)
(2,086)	(1,624)	59,197	(1,315)	39,568
-	-	-	-	(50,139)
(18,384)	(73,571)	(8,159)	56,393	(29,129)
31,320	125,496	24,955	421,456	1,186,129
12,936	51,925	16,796	477,849	1,157,000

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, 2013
($000's)

Net change in fund balances--total governmental funds (Page 29)		$	(29,129)
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	106,387		
Depreciation expense	(356,221)		
Excess of depreciation expense over capital outlay			(249,834)
The net effect of various miscellaneous transactions involving capital assets (i.e. sales, retirements, trade-ins, donations)			
Donated assets	4,618		
Proceeds from sale of capital assets	(6,198)		
Loss on disposal of assets	(5,679)		
			(7,259)
Increase in long-term receivables associated with lease, pledge revenue, and reimbursement arrangements from the private purpose trust fund are not current financial resources and therefore are not reported in the governmental funds			2,922
Prepaid bond insurance 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.			(19)
NMTC financing programs are reported as expenditures in governmental funds, but are recorded as an asset in the statement of net position.			19,610
Amortization of deferred inflows of resources and deferred outflows of resources resulting from the deferred refunding gains and losses.			2,983
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 position 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 and bond proceeds were made to escrow for refundings.			431,777
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	(47)		
Net premium on bonds issued	(45,506)		
Decrease in accrued interest expense	(976)		
Amortization of premiums and discounts on bonds issued	(2,155)		
Total net interest expense and amortization of discount/premium			(48,684)
Bond proceeds provide current financial resources to governmental funds, however, issuing debt increases long-term liabilities in the statement of net position.			(335,980)
Because some revenues will not be collected for several months after the City's fiscal year ends, they are not considered "available revenues" and are reported as deferred inflows of resources in the governmental funds.			(7,774)
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 position is included in governmental activities in the statement of activities.			3,093
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	(65,994)		
Net increase in vacation, sick leave, and compensatory time	(3,787)		
Net decrease in estimated liability for self-insurance	3,934		
Net increase in other liabilities	(17,327)		
Total additional expenditures			(83,174)
Capital assets disallowed to be transferred to the City and the Diridon Authority were returned to SARA. The capital assets were not financial resources of the City's governmental funds and as such the return of assets were not recorded in the governmental funds.			(117,105)
Change in net position of governmental activities (Page 23)		$	(418,573)

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

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City of San José
Statement of Fund Net Position
Proprietary Funds
June 30, 2013
($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	$ 91,953	301,497	20,358	12,819	426,627	22,182
Receivables (net of allowance for uncollectibles)	7,845	7,478	3,511	297	19,131	307
Prepaid expenses, advances and deposits	178	-	-	-	178	-
Inventories	-	1,308	-	-	1,308	3,683
Total unrestricted current assets	99,976	310,283	23,869	13,116	447,244	26,172
Restricted assets:						
Equity in pooled cash and investments held in City Treasury	157,114	53,985	-	2,041	213,140	-
Cash and investments held with fiscal agent	112,531	6,296	-	-	118,827	-
Receivables (net of allowances for uncollectibles)	3,537	-	-	-	3,537	-
Prepaid expenses, advances and deposits	1	-	-	-	1	-
Total restricted current assets	273,183	60,281	-	2,041	335,505	-
Total current assets	373,159	370,564	23,869	15,157	782,749	26,172
Noncurrent assets:						
Prepaid bond insurance (net of accumulated amortization)	8,092	67	-	-	8,159	-
Advances and deposits	4,980	-	-	-	4,980	-
Advances to other funds	-	5,062	-	-	5,062	-
Long-term receivable from SARA	-	-	-	3,363	3,363	-
Capital assets (net of accumulated depreciation):						
Nondepreciable	99,505	57,434	664	19,749	177,352	-
Depreciable	1,343,857	480,299	65,010	39,912	1,929,078	6,154
Total noncurrent assets	1,456,434	542,862	65,674	63,024	2,127,994	6,154
Total assets	1,829,593	913,426	89,543	78,181	2,910,743	32,326
DEFERRED OUTFLOWS OF RESOURCES						
Loss on refundings of debt	$ 698	638	-	-	1,336	-

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

City of San José
Statement of Fund Net Position
Proprietary Funds
June 30, 2013
($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	$	3,287	6,455	2,800	754	13,296	1,432
Accrued liabilities		423	1,069	71	40	1,603	415
Interest payable		5	237	-	-	242	-
Due to SARA		-	-	-	308	308	-
Short-term notes payable		45,380	-	-	-	45,380	-
Accrued vacation, sick leave and compensatory time		1,620	2,514	184	78	4,396	-
Estimated liability for self-insurance		560	740	118	-	1,418	-
Advances and deposits payable		1,463	-	-	89	1,552	-
Unearned revenue		2,532	-	-	-	2,532	-
Loans payable		-	4,049	-	-	4,049	-
Pollution remediation obligation		330	-	-	-	330	-
Total current liabilities unrestricted		55,600	15,064	3,173	1,269	75,106	1,847
Current liabilities payable from restricted assets:							
Accounts payable and accrued liabilities		1,317	-	-	-	1,317	-
Interest payable		24,884	217	-	-	25,101	-
Current portion of bonds payable, net		22,295	5,556	-	-	27,851	-
Pollution remediation obligation		1,428	-	-	-	1,428	-
Total current liabilities payable from restricted assets		49,924	5,773	-	-	55,697	-
Total current liabilities		105,524	20,837	3,173	1,269	130,803	1,847
Noncurrent liabilities:							
Accrued vacation, sick leave and compensatory time		527	610	-	-	1,137	2,751
Estimated liability for self-insurance		1,119	2,098	-	-	3,217	-
Advance contributions from participating agencies		-	2,996	-	-	2,996	-
Advances, deposits and reimbursable credits		-	-	1,234	-	1,234	-
Loans payable		-	18,720	-	-	18,720	-
Bonds payable (net of premium/discount)		1,376,038	38,925	-	-	1,414,963	-
Net other postemployment benefits obligation		12,076	21,163	1,581	703	35,523	-
Total noncurrent liabilities		1,389,760	84,512	2,815	703	1,477,790	2,751
Total liabilities		1,495,284	105,349	5,988	1,972	1,608,593	4,598
DEFERRED INFLOWS OF RESOURCES							
Gain on refundings of debt		2,104	-	-	-	2,104	-
NET POSITION							
Net investment in capital assets		209,381	482,878	65,674	59,661	817,594	6,154
Restricted for debt service		16,547	6,249	-	-	22,796	-
Restricted for capital projects and other agreements		48,861	51,055	-	2,041	101,957	913
Unrestricted		58,114	268,533	17,881	14,507	359,035	20,661
Total net position	$	332,903	808,715	83,555	76,209	1,301,382	27,728

City of San José
Statement of Revenues, Expenses, and Changes in Fund Net Position
Proprietary Funds
For the Year Ended June 30, 2013
($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	$ 45,409	146,405	32,296	12,088	236,198	110,710
Rentals and concessions	77,706	4,363	-	-	82,069	-
Service connection, engineering and inspection	-	3,093	-	-	3,093	-
Contributions	-	13,411	-	-	13,411	-
Other	-	4,417	-	-	4,417	-
Total operating revenues	123,115	171,689	32,296	12,088	339,188	110,710
OPERATING EXPENSES						
Operations and maintenance	51,312	96,406	27,745	4,393	179,856	104,630
General and administrative	18,763	23,707	1,337	3,768	47,575	-
Depreciation and amortization	54,352	25,295	2,441	1,993	84,081	3,073
Materials and supplies	-	216	-	77	293	-
Total operating expenses	124,427	145,624	31,523	10,231	311,805	107,703
Operating income (loss)	(1,312)	26,065	773	1,857	27,383	3,007
NONOPERATING REVENUES (EXPENSES)						
Passenger facility charges	17,295	-	-	-	17,295	-
Customer facility charges	13,385	-	-	-	13,385	-
Operating grants	565	-	-	-	565	-
Investment loss	(257)	(1,206)	(85)	(64)	(1,612)	(65)
Interest expense	(75,058)	(2,200)	-	-	(77,258)	-
Bond issuance costs	(196)	-	-	-	(196)	-
Contributions paid to participating agencies	-	(169)	-	-	(169)	-
Loss on disposal of capital assets	-	(1)	-	-	(1)	(44)
Other revenues, net	451	-	75	5	531	-
Net nonoperating revenues (expenses)	(43,815)	(3,576)	(10)	(59)	(47,460)	(109)
Income (loss) before capital contributions and transfers	(45,127)	22,489	763	1,798	(20,077)	2,898
Capital contributions	6,954	9,143	149	-	16,246	-
Transfers in	-	2,042	-	-	2,042	800
Transfers out	-	(1,664)	(479)	(728)	(2,871)	(605)
Changes in net position	(38,173)	32,010	433	1,070	(4,660)	3,093
Net position - beginning, as previously reported	381,130	777,409	83,122	75,139	1,316,800	24,635
Change in accounting principle	(10,054)	(704)	-	-	(10,758)	-
Net position - beginning, as restated	371,076	776,705	83,122	75,139	1,306,042	24,635
Net position - ending	$ 332,903	808,715	83,555	76,209	1,301,382	27,728

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

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City of San José
Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2013
($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	$ 120,163	157,114	31,525	12,011	320,813	-
Cash received from interfund services provided	-	-	-	-	-	110,631
Payments to suppliers	(42,135)	(54,616)	(25,159)	(5,684)	(127,594)	(88,892)
Payments to employees	(23,996)	(61,905)	(3,596)	(2,061)	(91,558)	(18,138)
Other receipts	451	13,411	-	-	13,862	-
Net cash provided by operating activities	54,483	54,004	2,770	4,266	115,523	3,601
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Transfer from other funds	-	2,042	-	-	2,042	800
Transfer to other funds	-	(1,664)	(479)	(728)	(2,871)	(605)
(Advances to) / payments from other funds	-	359	(176)	-	183	-
Subsidies from operating grants	888	-	-	-	888	-
Advances and deposits received	-	-	69	-	69	-
Long-term receivable from SARA	-	-	-	(3,363)	(3,363)	-
Net cash provided by (used in) noncapital and related financing activities	888	737	(586)	(4,091)	(3,052)	195
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
Passenger facility charges received	17,272	-	-	-	17,272	-
Customer facility charges received	13,536	-	-	-	13,536	-
Proceeds from issuance of bonds	49,140	-	-	-	49,140	-
Payment for redemption of bonds	(49,140)	-	-	-	(49,140)	-
Principal payment on commercial paper	(2,557)	-	-	-	(2,557)	-
Subsidies from capital grants	7,940	4,048	-	-	11,988	-
Acquisition and construction of capital assets	(14,163)	(15,702)	(518)	(192)	(30,575)	(2,568)
Principal paid on debt	(13,440)	(9,102)	-	-	(22,542)	-
Bond issuance cost paid	(196)	-	-	-	(196)	-
Interest paid on debt	(76,363)	(2,310)	-	-	(78,673)	-
Advances and deposits received	351	-	-	-	351	-
Net cash used in capital and related financing activities	(67,620)	(23,066)	(518)	(192)	(91,396)	(2,568)
CASH FLOWS FROM INVESTING ACTIVITIES						
Proceeds from sales and maturities of investments	16,444	6,258	-	-	22,702	-
Purchase of investments	(17,436)	(6,249)	-	-	(23,685)	-
Interest received (loss on investments)	688	(1,284)	(89)	(64)	(749)	(65)
Net cash provided by investing activities	(304)	(1,275)	(89)	(64)	(1,732)	(65)
Net change in cash and cash equivalents	(12,553)	30,400	1,577	(81)	19,343	1,163
Cash and cash equivalents - beginning	336,257	325,129	18,781	14,941	695,108	21,019
Cash and cash equivalents - ending	$ 323,704	355,529	20,358	14,860	714,451	22,182

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, 2013
($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)	$ (1,312)	26,065	773	1,857	27,383	3,007
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:						
Depreciation and amortization	54,352	25,295	2,441	1,993	84,081	3,073
Other nonoperating revenues	451	-	75	5	531	-
Decrease (increase) in:						
Accounts receivable	(590)	(1,249)	(846)	(82)	(2,767)	(79)
Loan receivable	250	-	-	-	250	-
Due from outside agencies	-	66	-	-	66	-
Inventories	-	(129)	-	-	(129)	(2,470)
Other assets	-	20	-	-	20	-
Increase (decrease) in:						
Accounts payable and accrued liabilities	3,842	(815)	(50)	322	3,299	647
Accrued vacation, sick leave and compensatory time	-	250	27	-	277	(577)
Estimated liability for self-insurance	48	(401)	(8)	-	(361)	-
Unearned revenue	(2,938)	-	-	-	(2,938)	-
Advances and deposits payable	380	-	-	1	381	-
Other liabilities	-	4,902	358	170	5,430	-
Total adjustments	55,795	27,939	1,997	2,409	88,140	594
Net cash provided by operating activities	$ 54,483	54,004	2,770	4,266	115,523	3,601
Reconciliation of cash and cash equivalents to the statement of net position:						
Equity in pooled cash and investments held in City Treasury						
Unrestricted	$ 91,953	301,497	20,358	12,819	426,627	22,182
Restricted	157,114	53,985	-	2,041	213,140	-
Cash and investments held with fiscal agent	112,531	6,296	-	-	118,827	-
Less investments not meeting the definition of cash equivalents	(37,894)	(6,249)	-	-	(44,143)	-
Cash and cash equivalents	$ 323,704	355,529	20,358	14,860	714,451	22,182
Noncash noncapital, capital and related financing, and investing activities:						
Loss on disposal of capital assets	$ -	(1)	-	-	(1)	-
Capital contributions from developers	-	916	149	-	1,065	-
Amortization of bond discount/premium, and prepaid bond insurance costs	325	236	-	-	561	-
Amortization of deferred inflow/outflow of resources	(582)	(189)	-	-	(771)	-
Change in fair value of investments	37	(1)	-	-	36	-
Decrease in capital related receivables	(1,115)	-	-	-	(1,115)	-

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

City of San José
Statement of Fiduciary Net Position
Fiduciary Funds
June 30, 2013
($000's)

	Pension Trust Funds	Private Purpose Trust Funds	Agency Fund
ASSETS			
Current assets:			
Equity in pooled cash and investments held in City Treasury	$ -	352	2,026
Cash and investments	-	32,850	-
Investments of retirement plans:			
Investments, excluding securities lending collateral:			
Fixed income	929,658	-	-
Global equity	2,698,076	-	-
Private equity	200,312	-	-
International currency contracts, net	(633)	-	-
Opportunistic	389,676	-	-
Real assets	338,658	-	-
Real estate	244,908	-	-
Securities lending cash collateral investment pool	426,902	-	-
Total investments of retirement systems	5,227,557	-	-
Receivables:			
Accrued investment income	7,668	-	2
Employee contributions	2,447	-	-
Employer contributions	4,850	-	-
Due from the City of San José	-	853	-
Other	1,249	376	-
Restricted cash and investments	-	137,757	-
Total current assets	5,243,771	172,188	2,028
Noncurrent assets:			
Advances to the City of San José	-	467	-
Accrued interest	-	5,339	-
Loans receivable, net	-	25,056	-
Deposits	-	155	-
Property held for resale	-	22,474	-
Capital assets:			
Nondepreciable	-	87,840	-
Depreciable, net	-	153,956	-
Total noncurrent assets	-	295,287	-
Total assets	5,243,771	467,475	2,028
DEFERRED OUTFLOWS OF RESOURCES			
Loss on refundings of debt	$ -	36,655	

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

City of San José
Statement of Fiduciary Net Position
Fiduciary Funds
June 30, 2013
($000's)

	Pension Trust Funds	Private Purpose Trust Funds	Agency Fund
LIABILITIES			
Current liabilities:			
Due to brokers	$ 24,919	-	-
Accrued interest payable	-	40,957	-
Pass through payable to the County of Santa Clara	-	31,792	-
Unearned revenue	-	1,889	-
Securities lending collateral, due to borrowers	427,363	-	-
Other liabilities	8,004	2,334	2,028
Total current liabilities	460,286	76,972	2,028
Long-term liabilities:			
Due within one year	-	212,442	-
Due in more than one year	-	2,151,666	-
Total noncurrent liabilities	-	2,364,108	-
Total liabilities	460,286	2,441,080	2,028
NET POSITION (DEFICIT)			
Held in trust for:			
Employees' pension benefits	4,551,071	-	
Employees' postemployment healthcare benefits	232,414	-	
Redevelopment dissolution and other purposes	-	(1,936,950)	
Total net position (deficit)	$ 4,783,485	(1,936,950)	

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

City of San José
Statement of Changes in Fiduciary Net Position
Fiduciary Funds
For the Year Ended June 30, 2013
($000's)

ADDITIONS		Pension Trust Funds	Private Purpose Trust Funds
Redevelopment property tax revenues	$	-	168,704
Investment income:			
Interest		58,975	778
Dividends		56,309	-
Net rental income		3,713	539
Net change in fair value of plan investments		311,202	-
Investment expenses		(18,115)	-
Total investment income (loss)		412,084	1,317
Securities lending income:			
Securities lending income		3,932	-
Securities lending rebates and expenses		(660)	-
Total securities lending income		3,272	-
Contributions:			
Employer		245,402	-
Employees		62,356	-
Total contributions		307,758	-
Other		-	2,042
Total additions		723,114	172,063
DEDUCTIONS			
General and administrative		6,732	4,888
Project expenses		-	1,804
Pass through amounts to the County of Santa Clara		-	16,073
Depreciation		-	3,785
Interest on debt		-	102,709
Health insurance premiums		54,877	-
Refunds of contributions		2,431	-
Retirement and other benefits:			
Death benefits		17,192	-
Retirement benefits		286,886	-
Total deductions		368,118	129,259
Extraordinary gain from the dissolution of the Redevelopment Agency		-	114,599
Change in net position		354,996	157,403
Net position (deficit) held in trust for pension, postemployment healthcare benefits and other purposes:			
Beginning of year, as previously reported		4,428,489	(2,063,278)
Change in accounting principle		-	(31,075)
Beginning of year, as restated		4,428,489	(2,094,353)
End of year	$	4,783,485	(1,936,950)

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 criterions for including a potential component unit within the reporting entity are the governing body's financial accountability and a financial benefit or burden relationship and whether it is misleading to exclude. A primary government is financially accountable and shares a financial benefit or burden relationship, if it appoints a voting majority of an organization's governing body and it is able to impose its will on the organization, or if there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the primary government. A primary government may also be financially accountable if an organization is fiscally dependent on the primary government regardless of whether the organization has a separately elected governing board, a governing board appointed by a higher level of government, or a jointly appointed board, and there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the primary government. 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" (or in the case of the Successor Agency to the Redevelopment Agency of the City of San José reported as a fiduciary fund) 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 there is a financial benefit or burden relationship between the City and the component unit, management of the City has operational responsibilities for the component unit, 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.

- **Successor Agency to the Redevelopment Agency of the City of San José** – The Successor Agency to the Redevelopment Agency of the City of San José ("SARA") was created to serve as a custodian for the assets and to wind down the affairs of the former Redevelopment Agency of the City of José ("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 Area.

  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). SARA is only allocated revenue in the amount that is necessary to pay the estimated annual installment payments on enforceable obligations of the Agency until all enforceable obligations of the 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).

- **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 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 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 City departments and component units for the fiscal year 2013, 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")
- Successor Agency to the Redevelopment Agency of the City of San José
- Norman Y. Mineta San José International Airport (the "Airport")
- San José – Santa Clara Clean Water Financing Authority
- San José Diridon Development Authority

B. Financial Statement Presentation

***Government-wide Financial Statements*.** The government-wide financial statements, i.e. the statement of net position 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 prevent 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 nonmajor 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 ***Housing Activities Fund*** is a special revenue fund that accounts all of the City's affordable housing activities funded by federal and state grants, as well as various fees. 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 Agency and the City Council's election to retain the housing activities previously funded by the Agency, the City created a housing successor fund (Low and Moderate Income Housing Asset Fund) and transferred the assets and affordable housing activities funded by the Agency.

The ***Low and Moderate Income Housing Asset 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 Agency on February 1, 2012. On October 16, 2012, the former Affordable Housing Investment Fund was renamed to Low and Moderate Income Housing Asset Fund to comply with the requirement of AB 1484.

The ***Integrated Waste Management Fund*** is a special revenue fund that accounts for activities related to the Integrated Waste Management Program, which includes garbage collection, recycling services and related billing operations.

The ***Special Assessment Districts Fund*** is a capital project 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 Debt Service 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, the regional water reclamation program (known as South Bay Water Recycling), and the San José Sewage Collection System.

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 an 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 the Redevelopment Dissolution Act and for the James Lick fund which holds resources in trust for the 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. Agency funds do not have a measurement focus but are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Non-exchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property and sales taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenues from sales and use, transient occupancy and utility 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, 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 nonoperating 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 nonoperating 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 position 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.

D. Use of Estimates

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

E. New Pronouncements

During the year ended June 30, 2013, the City implemented the following Governmental Accounting Standards Board ("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. This statement did not have any effect on the City's financial statements.

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. This statement did not have any effect on the City's financial statements.

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*, which incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the

AICPA Committee on Accounting Procedures which do not conflict with or contradict other GASB pronouncements. This statement did not have any effect on the City's financial statements.

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources and renames the resulting measure as net position rather than net assets. The City renamed net assets as net position in the current year financial statements.

In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. As of July 1, 2012, the City adopted the provisions of GASB Statement No. 65 and restated the beginning net position of the City's governmental activities, business-type activities, enterprise funds, and the SARA private purpose trust fund to write off unamortized bond issuance costs.

The components of change in accounting principle are as follows (dollars in thousands):

	Governmental Activities	Business-Type Activities and Enterprise Funds	Private Purpose Trust Funds
Net position, beginning of year, as previously reported	$ 6,092,877	$ 1,316,800	$ (2,063,278)
Change in accounting principle:			
Write off of debt issuance costs	(14,477)	(10,758)	(31,075)
Net position, beginning of year, as restated	$ 6,078,400	$ 1,306,042	$ (2,094,353)

In addition, the remaining balance of the loss on refunding debt was reclassified from a contra liability to deferred outflows of resources and the gain on refunding debt was reclassified from a liability to deferred inflows of resources in the government-wide, proprietary funds, and SARA private purpose trust fund statements of net position.

The City also reclassified deferred revenues that totaled $87,535,000 at July 1, 2012 that are unavailable in governmental funds to deferred inflows of resources.

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

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 financial statements. 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.

In January 2013, the GASB issued GASB Statement No. 69, *Government Combinations and Disposals of Government Operations.* This statement is intended to improve accounting and financial reporting for state and local government's combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale.

The new standard provides guidance for:

- Determining whether a specific government combination is a government merger, a government acquisition, or a transfer of operations;
- Using carrying values (generally, the amounts recognized in the pre-combination financial statements of the combining governments or operations) to measure the assets, deferred outflows of resources, liabilities, and deferred inflows of resources combined in a government merger or transfer of operations;
- Measuring acquired assets, deferred outflows of resources, liabilities, and deferred inflows of resources based upon their acquisition values in a government acquisition; and
- Reporting the disposal of government operations that have been transferred or sold.

Application of Statement 69 is effective for the City's fiscal year ending June 30, 2015.

In April 2013, the GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees.* The objective of this statement is to enhance comparability of financial statements among governments by requiring consistent reporting by those governments that extend nonexchange financial guarantees and by those governments that receive nonexchange financial guarantees and to enhance the information disclosed about a government's obligations and risk exposure from extending nonexchange financial guarantees. This statement also will augment the ability of financial statement users to assess the probability that governments will repay obligation holders by requiring disclosures about obligations that are issued with this type of financial guarantee. Application of Statement 70 is effective for the City's fiscal year ending June 30, 2014.

F. Assets, Deferred Outflows of Resources, Liabilities, Deferred Inflows of Resources, and Net Position 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 position 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 year ended June 30, 2013, the total investment income from these investments assigned and transferred to the General Fund was approximately $217,000.

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 inflows of resources 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 credit or a classification of 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 an asset associated with the City's New Market Tax Credit Financing ("NMTCF") program. These assets are recorded at the lower of cost or estimated net realizable value.

8. Prepaid Bond Insurance, Original Issue Discounts and Premiums, and Refundings

Prepaid bond insurance costs are amortized using the straight-line method over the life of the bonds. Amortization of these balances is recorded as a component of operating expenses.

In the government-wide, proprietary fund and fiduciary fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, proprietary fund and fiduciary fund financial statements. Bond premiums and discounts are deferred and amortized over the life of the bonds. Bonds payable are reported net of the applicable bond premium or discount. Original issue premiums are amortized using the straight-line method over the life of the bonds. Gains or losses from refunding of debt are reported as deferred inflows or outflows of resources and amortized over the shorter of the life of the refunded debt or refunding debt. Amortization of these balances is recorded as a component of interest expense.

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 position, 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 ("IAFF"), 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 FCERS who retire with at least 15 years of service, or 20 years for police officers and firefighters in 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.

As of June 30, 2013, employees hired on or after September 30, 2012 into classifications represented by the Association of Building, Mechanical, and Electrical Inspectors ("ABMEI"); the Association of Engineers and Architects, IFPTE Local 21 ("AEA"); the Association of Legal Professionals of San José ("ALP"); the Association of Maintenance Supervisory Personnel, IFPTE Local 21 ("AMSP"); the City Association of Management Personnel, IFPTE Local 21 ("CAMP"); and unrepresented management employees ("Unit 99"), were not eligible for a sick leave payout.

As of June 30, 2013, employees represented by the Confidential Employees' Organization, AFSCME Local 101 ("CEO"); the International Brotherhood of Electrical Workers, Local No. 332 ("IBEW"); the International Union of Operating Engineers, Local No. 3 ("OE#3"); and the Municipal Employees' Federation, AFSCME Local 101 ("MEF"), were not eligible for a sick leave payout effective January 1, 2012.

As of June 30, 2013, the City and SJPOA were engaged in binding interest arbitration on a successor agreement pursuant to the City Charter, including the issue of sick leave payout for current employees and sick leave payout for employees yet to be hired.

Subsequent to June 30, 2013, agreements were reached with various bargaining units amending sick leave payout. Specifically, employees hired on or before September 29, 2012 into classifications represented by the ABMEI, AEA, ALP, AMSP, CAMP, CEO, IBEW, MEF, and unrepresented management employees ("Unit 99"), are eligible for a sick leave payout based on the employee's sick leave balance and hourly rate as of June 22, 2013. Employees in these bargaining units may continue to accrue sick leave after June 22, 2013, but such accrued sick leave may not be used for sick leave payout purposes. In addition, an employee may receive pay increases subsequent to June 22, 2013, but the employee's sick leave payout will be based on their rate of pay as of June 22, 2013. If an employee reduces their sick leave balance below what it was as of June 22, 2013, such employee will not be able to restore their sick leave balance for sick leave payout purposes.

Employees hired on or before July 6, 2013, into classifications represented by the SJPOA are eligible for a sick leave payout based on the employee's sick leave balance and hourly rate as of July 6, 2013. An employee may continue to accrue sick leave after July 6, 2013, but such accrued sick leave may not be used for sick leave payout purposes. In addition, an employee may receive pay increases subsequent to July 6, 2013, but the employee's sick leave payout will be based on their rate of pay as of July 6, 2013. If an employee reduces their sick leave balance below what it was as of July 6, 2013, such employee will not be able to restore their sick leave balance for sick leave payout purposes.

As noted above, employees hired on or after September 30, 2012 into classifications represented by ABMEI, AEA, ALP, AMSP, CAMP, CEO, IBEW, MEF, and Unit 99 are not eligible for a sick leave payout. Employees hired on or after July 7, 2013 into classifications represented by the SJPOA are not eligible for a sick leave payout.

Employees represented by the OE#3, are not eligible for a sick leave payout effective January 1, 2012.

Negotiations between the City and IAFF regarding sick leave payout for current and future employees are currently ongoing.

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 noncurrent 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. Deferred Outflows/Inflows of Resources

Unamortized portions of the gain and loss on refunding debt are reported as deferred inflows and deferred outflows of resources, respectively. In addition to this, when an asset is recorded in governmental fund financial statements but the revenue is not available, a deferred inflow of resources is reported until such time as the revenue becomes available.

15. Net Position

The government-wide and proprietary fund financial statements utilize a net position presentation. Net position is categorized as net investment in capital assets, restricted, and unrestricted.

- *Net Investment In Capital Assets* - This category groups all capital assets, including infrastructure, into one component of net position. 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 Position* – This category represents net position 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, 2013, the government-wide statement of net position reported restricted position of $864,808,000 in governmental activities and $124,753,000 in business-type activities. Of these amounts $330,613,000 and $62,338,000, respectively are restricted by enabling legislation.

- *Unrestricted Net Position* – This category represents net amounts that do not meet the criteria for "restricted" or "net investment in capital assets".

16. 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 governmental funds consists 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 action, which include the approval of appropriations and revenue sources pertaining to the next fiscal year's budget. 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.

17. 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 subsequent determinations from the State Controller's Office ("SCO") and the Department of Finance ("DOF") prior to DOF's Finding of Completion (see Note IV.D.3.) were recorded as an extraordinary item in the financial statements.

In March 2013, the SARA received the final Asset Transfer Review Report (the "Report") from the State Controller regarding various properties that the Agency transferred to the City and Diridon Authority. In the Report, the State Controller identified and disallowed various properties that the Agency transferred to the City and the Diridon Authority prior to June 28, 2011, the effective date of the Redevelopment Dissolution Law. In June 2013, the City Council and Diridon Authority Board, each adopted a resolution authorizing the return to the SARA of various properties identified in the Report. Accordingly, the asset transfer from the City to SARA was recorded as an extraordinary loss in the City's government-wide financial statements. The receipt of these assets was reported in the SARA fiduciary fund financial statements as an extraordinary gain. In addition to the land and building transfers, the Report also identified a disallowed cash transfer. The City returned the cash from the Low and Moderate Income Housing Asset Fund as required.

The DOF additionally invalidated a portion of the Supplemental Educational Revenue Augmentation Fund ("SERAF") loan in the amount of $52,645,000 and the City has established an allowance against its receivables from SARA for this amount (see Note III.G.3.).

In addition, the Oversight Board approved the inclusion of $14,091,000 from commercial paper proceeds, used for the Agency's housing programs, as an enforceable obligation of SARA. As a result, the Low and Moderate Income Housing Asset Fund was no longer obligated to report an advance from the Financing Authority in the amount of $14,091,000 for borrowing the commercial paper proceeds. The repayment of the commercial paper proceeds is currently reported in the Recognized Obligation Payment Schedule (ROPS) of SARA and is reported in the SARA financial statements at June 30, 2013. This amount is reported as an extraordinary gain in the Low and Moderate Income Housing Asset Fund financial statement.

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

Asset transfers to SARA:		
Land	$	(52,259)
Buildings		(81,533)
Accumulated depreciation		16,687
Total		(117,105)
Invalidation of other asset tranfers between the Agency and the City reported in the Low and Moderate Income Housing Asset Fund:		
Cash		(11,585)
SERAF loan collectibility allowance		(52,645)
Recognition of housing obligations funded by commercial paper proceeds		14,091
Extraordinary loss from dissolution of the Agency	$	(167,244)

18. 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 year ended June 30, 2013, was approximately $121.8 billion, an increase of approximately 1.3% from the previous year. The City's tax rate was approximately $0.184 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).

19. 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 South Bay Water Recycling. The City's sewer service rates pay for the City's share of the Plant operations, maintenance, and administration and capital costs and for maintenance and operation of the San José Sewage Collection System.

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 year ended June 30, 2013, the City's portion of the capital and operating costs was approximately 82.2% and, based on operations through the year ended June 30, 2013, the City's interest in the net position of the Plant was approximately 83.2%.

II. Stewardship, Compliance, and Accountability

A. Deficit Net Position

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 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, 2013, SARA has a deficit of $1,937,302,000, 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 Position – Governmental Activities

At June 30, 2013, the City reports a deficit unrestricted net position in its Statement of Net Position – governmental activities in the amount of $217,340,000. 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 (see Note IV.A).

III. Detailed Notes on All Funds

A. Cash, Deposits and Investments

As of June 30, 2013, total City cash, deposits and investments, at fair value, are as follows (dollars in thousands):

			Fiduciary Funds			
	Governmental Activities	Business-Type Activities	Pension Trust	Private-Purpose Trust	Agency	Carrying Value
Equity in pooled cash and investments	$ 643,615	$ 426,627	$ -	$ 352	$ 2,026	$ 1,072,620
Other cash and investments	-	-	-	32,850	-	32,850
Restricted assets:						
Equity in pooled cash and investments	53,176	213,140	-	-	-	266,316
Cash and investments with fiscal agents	190,223	118,827	-	137,757	-	446,807
Other cash and investments	3,370	-	-	-	-	3,370
Investments of retirement systems	-	-	5,227,557	-	-	5,227,557
Total deposits and investments	$ 890,384	$ 758,594	$ 5,227,557	$ 170,959	$ 2,026	$ 7,049,520
Deposits / (Outstanding items)						$ (20,468)
Investments						7,069,988
Total deposits and investments						$ 7,049,520

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 statements of net position 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. 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. The average maturity of the City's pooled cash and investments at June 30, 2013, was approximately 560 days.

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.

At June 30, 2013, the City's pooled and fiscal agent investments in LAIF was approximately $288,090,000 and the SARA's investments in LAIF was approximately $26,079,000. The weighted average maturity of LAIF was 278 days at June 30, 2013. The total amount recorded by all public agencies in LAIF at June 30, 2013 was approximately $21.2 billion. LAIF is part of the State's Pooled Money Investment Account (PMIA). PMIA has a total of approximately $58.8 billion and of that amount, 98.04% was invested in non-derivative financial products and 1.96% 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 28, 2012, 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, 2013:

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, 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, respectively.
- 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, 2013. The credit ratings listed are for Moody's and S&P, respectively. Certain investments, such as obligations, which are backed by the full faith and credit of the United States Government, are exempt from credit rating disclosures (dollars in thousands):

Type of Investment	Credit Rating	Maturity: Under 30 Days	Maturity: 31 - 180 Days	Maturity: 181 - 365 Days	Maturity: 1 - 5 Years	Carrying Value
Pooled investments in the City Treasury:						
Federal Farm Credit Banks	Aaa / AA+	$ -	$ 65,119	$ 40,112	$ 139,395	$ 244,626
Federal Home Loan Banks	Aaa / AA+	34,503	65,067	15,055	98,582	213,207
Federal Home Loan Banks - Callable	Aaa / AA+	-	-	-	9,742	9,742
Federal Home Loan Banks - Discount	P-1 / A-1+	31,000	-	-	-	31,000
Federal Home Loan Mortgage Corporation	Aaa / AA+	-	25,035	25,092	74,812	124,939
Federal Home Loan Mortgage Corporation - Callable	Aaa / AA+	-	-	-	166,436	166,436
Federal Home Loan Mortgage Corporation - Discount	P-1 / A-1+	15,000	48,994	-	-	63,994
Federal National Mortgage Association	Aaa / AA+	-	50,089	-	69,735	119,824
Federal National Mortgage Association - Callable	Aaa / AA+	-	5,011	-	84,919	89,930
Federal National Mortgage Association - Discount	P-1 / A-1+	25,000	5,855	-	-	30,855
Commercial paper - Discount	P-1 / A-1	73,999	46,082	-	-	120,081
Negotiable certificate of deposit	P-1 / A-1	10,000	30,004	-	-	40,004
Money market mutual funds	Aaa-mf	39,110	-	-	-	39,110
California local agency investment fund	Not Rated	-	-	68,800	-	68,800
Total pooled investments in the City Treasury		228,612.00	341,256.00	149,059.00	643,621.00	1,362,548
Investments with fiscal agents:						
U.S. Treasury bills	Exempt	-	2,045	-	-	2,045
Federal Farm Credit Banks	Aaa / AA+	-	37,893	-	-	37,893
Federal Home Loan Banks - Discount	P-1 / A-1+	-	13,605	-	-	13,605
Commercial paper	P-1 / A-1+	-	771	-	-	771
Money market mutual funds	Aaa-mf/AAAm	35,672	-	-	-	35,672
California local agency investment fund	Not Rated	-	-	219,290	-	219,290
Total investments with fiscal agents		35,672	54,314	219,290	-	309,276
Total Citywide investments (excluding Retirement Systems)		$ 264,284	$ 395,570	$ 368,349	$ 643,621	1,671,824
Trust Funds:						
Total investments in Retirement Systems (See page 64)						5,227,557
Total investments in the SARA (See page 122)						170,607
Total investments						$ 7,069,988

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, 2013.

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, 2013, 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	17.95%
Federal Home Loan Banks	18.64%
Federal Home Loan Mortgage Corporation	26.08%
Federal National Mortgage Association	17.66%

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, 2013:

Special Assessment Districts:	
Federal Home Loan Banks	8.72%
Airport	
Federal Farm Credit Banks	33.67%
Wastewater Treatment System	
Federal Home Loan Mortgage Corporation	99.26%

Foreign Currency Risk. The risk that changes in exchange rates will adversely affect the fair value of an investment. As of June 30, 2013, the City's investment policy does not permit investments in the pool to hold foreign currency as such 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 monies 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. At June 30, 2013, the Retirement Systems' investment target asset allocations are as follows:

	FCERS - Pension		
Asset Class	**Minimum**	**Target**	**Maximum**
Equity and real estate	38%	45%	52%
Fixed income	5%	10%	20%
Absolute return strategies	20%	25%	30%
Real assets	15%	20%	25%

	PFDRP - Pension		
Asset Class	**Minimum**	**Target**	**Maximum**
Equity	25%	37%	50%
Fixed income	20%	30%	40%
Inflation-linked asset	12%	17%	25%
Absolute return	5%	15%	25%
Cash	0%	0%	5%

	FCERS - Postemployment Healthcare		
Asset Class	**Minimum**	**Target**	**Maximum**
Global equity	53%	59%	65%
Fixed income	23%	28%	33%
Real assets	8%	13%	18%

	PFDRP - Postemployment Healthcare		
Asset Class	**Minimum**	**Target**	**Maximum**
Equity	25%	43%	50%
Fixed income	20%	35%	40%
Inflation-linked asset	12%	22%	25%
Cash	0%	0%	5%

As of June 30, 2013, PFDRP's separate real estate properties include: office buildings in O'Fallon, MO and San José, CA. As of June 30, 2013, the office building in O'Fallon, MO had a mortgage payable with a fair value of $8,752,000. The outstanding mortgage loan payable does not exceed 50% of the assets as allowed in the Plan's Real Estate Investment Guidelines.

At June 30, 2013, the Retirement Systems held the following investments (dollars in thousands):

	PFDRP	FCERS	Total
Securities and other:			
Fixed income:			
Domestic fixed income	$ 155,006	$ 240,737	$ 395,743
Collective short-term investments	393,467	134,887	528,354
International fixed income	5,558	3	5,561
Total fixed income	554,031	375,627	929,658
Global equity	1,583,589	1,114,487	2,698,076
Private equity	130,800	69,512	200,312
International currency contracts, net	(1,323)	690	(633)
Opportunistic	237,199	152,477	389,676
Real assets	244,205	94,453	338,658
Real estate	129,966	114,942	244,908
Securities lending cash collateral investment pool	426,902	-	426,902
Total investments	$ 3,305,369	$ 1,922,188	$ 5,227,557

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.

The FCERS also had exposure to interest rate risk on its fully collateralized infrastructure swap. The FCERS invested in infrastructure swaps with a notional amount of $92,292,000 at June 30, 2013, 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 does not have a policy regarding interest rate risk, however, the FCERS does settle swap activity on a transaction plus one day basis (T+1), therefore limiting the FCERS's exposure to counterparty risk.

The following tables provide the segmented time distribution for fixed income investments based on expected maturity as of June 30, 2013, (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	$ -	$ -	$ -	$ -	$ -	$ 5,070	$ 5,070	$ 5,495
Bank loans	-	-	3,397	-	-	-	3,397	3,397
Collateralized mortgage obligations	-	-	-	-	553	8,440	8,993	8,813
Corporate bonds	591	427	3,417	14,620	9,639	6,437	35,131	37,473
FHLMC	-	-	-	-	-	12,754	12,754	12,998
FNMA	-	-	-	-	242	23,494	23,736	23,405
Guaranteed investment contracts	-	-	3,279	2,406	5,378	376	11,439	10,925
U.S. Treasury Inflation Protected Securities (TIPS)	5,783	-	-	34,280	8,946	5,477	54,486	55,606
Total domestic fixed income	6,374	427	10,093	51,306	24,758	62,048	155,006	158,112
Collective short-term investments	393,467	-	-	-	-	-	393,467	403,875
International fixed income	-	-	446	1,916	2,527	669	5,558	5,440
Total fixed income	$ 399,841	$ 427	$ 10,539	$ 53,222	$ 27,285	$ 62,717	$ 554,031	$ 567,427

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	$ -	$ -	$ -	$ -	$ -	$ 1,835	$ 1,835	$ 2,449
Bank loans	-	3,397	-	-	-	-	3,397	3,397
Guaranteed investment contracts	-	-	-	5,684	119,082	376	125,142	125,895
U.S. TIPS	-	-	67,290	-	43,073	-	110,363	111,555
Total domestic fixed income	-	3,397	67,290	5,684	162,155	2,211	240,737	243,296
Collective short-term investments	134,887	-	-	-	-	-	134,887	135,228
International fixed income	-	-	-	-	3	-	3	3
Total fixed income	$ 134,887	$ 3,397	$ 67,290	$ 5,684	$ 162,158	$ 2,211	$ 375,627	$ 378,527

Custodial Credit Risk – The Retirement Systems do not have a policy regarding custodial credit risk. As of June 30, 2013 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, respectively. "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, respectively. 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, 2013 concerning credit risk of fixed income investments for PFDRP (dollars in thousands):

	PFDRP	
S&P quality Rating	**Fair Value**	**Fair value as a % of fixed income investments**
AAA	$ 1,254	0.3%
AA	43,936	8.8%
A	14,369	2.9%
BBB	13,295	2.7%
BB	1,551	0.3%
Not rated	425,140	85.1%
Total investments exposed to credit risk	$ 499,545	100.0%

As of June 30, 2013, FCERS only held TIPS and intermediate government bonds, both of which were U.S. Government issued instruments hence exempt from credit risk.

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, 2013, concerning the fair value of investments and foreign currency risk (dollars in thousands):

	PFDRS				
Currency Name	Cash	Private Equity	Equity	Pending Foreign Currency Exchanges	Total Exposure
Australian Dollar	$ 29	$ -	$ 20,310	$ (39)	$ 20,300
Brazilian Real	32	-	-	-	32
Canadian Dollar	20	-	34,708	(46)	34,682
Chilean Peso	1	-	-	-	1
Danish Krone	14	-	3,585	-	3,599
Euro Currency	1,963	-	70,446	(464)	71,945
Hong Kong Dollar	102	-	7,370	-	7,472
Indian Rupee	10	-	-	-	10
Israeli Shekel	18	-	1,094	-	1,112
Japanese Yen	1,513	-	61,050	(407)	62,156
New Zealand Dollar	1	-	246	-	247
Norwegian Krone	72	-	3,601	-	3,673
Pound Sterling	137	-	63,613	(352)	63,398
Singapore Dollar	280	-	5,096	-	5,376
South Korean Won	-	-	971	-	971
Swedish Krona	276	-	8,204	(15)	8,465
Swiss Franc	366	-	23,640	-	24,006
Total	$ 4,834	$ -	$ 303,934	$ (1,323)	$ 307,445

	FCERS				
Currency Name	Cash	Private Equity	Equity	Pending Foreign Currency Exchanges	Total Exposure
Australian Dollar	$ (23)	$ -	$ 6,297	$ (63)	$ 6,211
Canadian Dollar	(3)	-	20,506	(44)	20,459
Euro Currency	126	8,773	10,192	(88)	19,003
Hong Kong Dollar	800	-	1,958	12	2,770
Hungarian Forint	5	-	42	-	47
Indian Rupee	-	-	-	331	331
Indonesian Rupiah	3	-	622	-	625
Israeli Shekel	19	-	627	-	646
Japanese Yen	490	-	3,628	137	4,255
Malaysian Ringgit	4	-	1,388	-	1,392
Mexican Peso	9	-	561	-	570
Moroccan Dirham	1	-	9	-	10
Norwegian Krone	6	-	2,652	-	2,658
Philippine Peso	-	-	28	-	28
Polish Zloty	11	-	303	-	314
Pound Sterling	(168)	-	28,228	(80)	27,980
Singapore Dollar	1	-	1,063	-	1,064
South African Rand	134	-	1,174	485	1,793
South Korean Won	-	-	2,233	-	2,233
Swedish Krona	(24)	-	53	-	29
Swiss Franc	152	-	9,148	-	9,300
Thailand Baht	5	-	251	-	256
Total	$ 1,548	$ 8,773	$ 90,963	$ 690	$ 101,974

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. As of June 30, 2013, the Retirement Systems' investments did not hold investments in any one issuer, excluding investments issued by or explicitly guaranteed by the U.S. Government, that represented five percent or more of the total plan net position.

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, 2013. 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, 2013, classified by type, and the changes in fair value of such derivative instruments for the year then ended as reported in the financial statements are as follows (amounts in thousands):

PFDRP

Investment Derivative Instruments	Net Appreciation (Depreciation) in Fair Value of Investments through June 30, 2013 Classification	Amount	Fair Value at June 30, 2013 Classification	Amount	Notional Amount
International currency forwards	Investment income	$ (2,773)	International currency contracts, net	$ (1,323)	$ 51,021
Futures long/short (domestic and foreign)	Investment income	(3,470)	Fixed income (domestic and foreign)	-	155,879
Index futures long/short (domestic and foreign)	Investment income	28,670	Equity income (domestic and foreign)	-	939
Rights	Investment income	(93)	Global Equity	4	2
Warrants	Investment income	29			
Total derivative instruments		$ 22,363		$ (1,319)	

FCERS

Investment Derivative Instruments	Net Appreciation (Depreciation) in Fair Value of Investments through June 30, 2013 Classification	Amount	Fair Value at June 30, 2013 Classification	Amount	Notional Amount
Total return swaps	Investment income	$ 28,383	Real assets	$ (3,510)	$ 92,292
Foreign currency forwards	Investment income	(3,137)	Foreign currency contracts, net	690	271,575
Future options bought/written	Investment income	(9,364)	Fixed income - collective short-term investments	-	83
Rights / Warrants	Investment income	(342)	Global equity	-	17
Total derivative instruments		$ 15,540		$ (2,820)	

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, 2013:

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, 2013, PFDRP held rights with a fair value of approximately $4,000 with notional shares of 2 held by unrated counterparties. PFDRP's investments are exposed to credit risk on derivative instruments that are in asset positions. 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, 2013, total commitments in forward currency contracts to purchase and sell international currencies were $51,021,000 and $51,021,000, respectively, with fair values of $49,586,000 and $50,909,000, respectively, held by counterparties with an S&P rating of at least AA-.

As of June 30, 2013, FCERS entered into infrastructure swaps with notional amount of $92,292,000 held by counterparties with S&P ratings of A or higher. 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, 2013, total commitments in forward currency contracts to purchase and sell international currencies were $271,575,000 and $271,575,000 respectively, with fair values of $271,948,000 and $271,258,000, respectively, held by counterparties with an S&P rating of at least A and above.

Interest Rate Risk – As of June 30, 2013, 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, 2013, FCERS invested in infrastructure swaps with notional amounts of $92,292,000. FCERS receives the total return S&P Global Infrastructure Index, net of the 3-month LIBOR plus 50 to 55 basis points. FCERS's infrastructure swaps were executed in April 2010, December 2011 and August 2012 and mature in October 2013, December 2013 and August 2013, respectively, with a quarterly 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. At June 30, 2013, FCERS's derivative investments had maturity dates of less than one year.

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, 2013, 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, 2013, concerning the fair value of forward currency contracts and foreign currency risk (dollars in thousands):

	Pending Foreign Currency Exchanges		
Currency Name	PFDRP	FCERS	Total
Australian Dollar	$ (39)	$ (63)	$ (102)
British Pound Sterling	(302)	(80)	(382)
Canadian Dollar	(60)	(44)	(104)
Euro Currency	(500)	(88)	(588)
Hong Kong Dollar	-	12	12
Indian Rupee	-	331	331
Japanese Yen	(407)	137	(270)
South African Rand	-	485	485
Swedish Krona	(15)	-	(15)
Total	$ (1,323)	$ 690	$ (633)

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.

As of August 15, 2011, FCERS exited the Custodians' securities lending program. As of June 30, 2013, PFDRP does not have exposure to borrower credit risk related to the securities lending transactions as the Custodian was 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 PFDRP's accounts with the market value of such unreturned lent securities if the lent securities were not returned by the borrower. PFDRP receives a fee from the borrower for the use of the lent securities. 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 borrower default.

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 position. PFDRP does 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 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. Investments made prior to the December 3, 2010, shall continue to be permissible to the extent they complied at the time of purchase.

As of June 30, 2013, the cash collateral pool for the duration and liquidity pools totaled $903,000,000 and $13.3 billion, respectively. The weighted average maturities for the duration and liquidity pools were 43.89 and 28.78 days, respectively. The cash collateral duration pool included asset backed securities (99.38%) and other securities (0.62%). The liquidity pool included asset backed securities (13.69%), certificates of deposit (45.94%), bank notes (2.78%), commercial paper (13.51%), repurchase agreements (19.41%) and other securities (4.68%). As of June 30, 2013, the underlying securities loaned by PFDRP as a whole amounted to approximately $421,790,000. The cash collateral and the non-cash collateral totaled $427,363,000 and $588,000, respectively, at carrying cost. PFDRP's share of the cash collateral pool at June 30, 2013 was at $1.01 or $416,399,000 and $0.9545 or $10,503,000 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 $0.9545 of the duration cash collateral pool results in an unrealized loss of approximately $501,000 for PFDRP. PFDRP's investment in the liquidity and duration cash collateral investment pools are presented in the statement of net plan position at their respective NAV or $426,902,000. The unrealized loss of $459,000 for the duration pool is reflected in the securities lending income earnings line of the statement of changes in fiduciary net position. 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, 2013 consisted of domestic corporate bonds, domestic equity securities, and international equity securities. In return, PFDRP receives collateral in the form of cash or securities equal to at least 101% for domestic and 106% for international of the market value of transferred securities plus accrued interest for reinvestment of the collateral.

The following table provides information on PFDRP's securities lent and collateral received as of June 30, 2013 (dollars in thousands):

Type of Investment Lent		
For Cash Collateral:		
Domestic corporate bonds	$	444
Domestic equity securities		410,429
International equity securities		10,340
Total Lent for Cash Collateral		421,213
For Non-Cash Collateral:		
U.S. treasury notes and bonds		8
Domestic equity securities		569
Total Lent for Non-Cash Collateral		577
Total Securities Lent	$	421,790
Type of Collateral Received		
Cash Collateral *	$	426,902
Non-Cash Collateral:		
For lent domestic equity securities		588
Total Collateral Received	$	427,490

* Amount represents the mark-to-market value of the cash collateral pool at a 100.00% for the liquidity portfolio and 95.45% for the duration portfolio for fiscal year 2013.

B. Receivables, Net of Allowances

At June 30, 2013, 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	Low & Moderate Income Housing Asset	Integrated Waste Management	Special Assessment Districts	Nonmajor Funds	Internal Service Funds	Total Governmental Activities
Taxes	$ 35,121	$ -	$ -	$ -	$ -	$ 5,429	$ -	$ 40,550
Accrued interest	276	80	1,372	32	11	1,808	20	3,599
Grants	3,339	1,836	-	167	-	6,552	-	11,894
Special assessments	-	-	-	-	49,120	-	-	49,120
Other	31,297	58	221	13,910	162	7,510	328	53,486
Less: allowance for uncollectibles	(15,891)	(3)	-	(2,621)	-	(810)	(41)	(19,366)
Total receivables, net	$ 54,142	$ 1,971	$ 1,593	$ 11,488	$ 49,293	$ 20,489	$ 307	$ 139,283

Receivables – Business-Type Activities:	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total Business-Type Activities
Accounts	$ 10,423	$ 3,457	$ 4,361	$ 289	$ 18,530
Accrued interest	308	393	25	18	744
Grants	995	4,222	-	-	5,217
Less: allowance for uncollectibles	(344)	(594)	(875)	(10)	(1,823)
Total receivables, net	$ 11,382	$ 7,478	$ 3,511	$ 297	$ 22,668

Special assessment receivables in the amount of $49,120,000 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, 2013 is as follows (dollars in thousands):

Type of Loan	General Fund	Housing Activities	Low & Moderate Income Housing Asset	Nonmajor Governmental Funds	Total Governmental Activities
Housing Program Developer, rehabilitation, second mortgage and relocation loans	$ -	$ -	$ 559,300	$ -	$ 559,300
Loans funded by federal grants	-	67,824	-	8,010	75,834
Economic development, real estate developer and other loans	1,491	43,960	-	165	45,616
Less: allowance for uncollectibles	-	(45,854)	(305,205)	(3,505)	(354,564)
Total loans, net	$ 1,491	$ 65,930	$ 254,095	$ 4,670	$ 326,186

The City uses funds generated from the former Agency Housing Loans 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 Rates	Due
New construction and permanent	0 - 4%	up to 55 years
Multi-unit rental rehabilitation	3%	5 or more years
First time home buyer	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 first time homebuyer loans, which are all secured by second deeds of trust. Interest and principal are typically due in installments, except for first time homebuyer, 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 Low and Moderate Income Housing Asset Fund loans receivable as of June 30, 2013.

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, 2013. These commitments involve elements of credit and interest rate risk similar to those described above for outstanding loans receivable. As of June 30, 2013, amounts committed to extend credit under normal lending agreements totaled approximately $2,106,000.

D. Capital Assets

1. Summary Schedule

The following is a summary of capital assets activity for the fiscal year ended June 30, 2013 (dollars in thousands):

	Balance July 1, 2012	Additions	Deletions	Transfers	Balance June 30, 2013
Governmental activities:					
Capital assets, not being depreciated:					
Land	$ 463,726	$ 56	$ 10,881	$ (52,259)	$ 400,642
Construction in progress	69,764	97,703	118	(6,227)	161,122
Total capital assets, not being depreciated	533,490	97,759	10,999	(58,486)	561,764
Capital assets, being depreciated:					
Buildings	1,427,274	126	3,086	(81,533)	1,342,781
Improvements, other than buildings	207,064	337	-	1,834	209,235
Infrastructure	11,365,408	5,722	-	4,393	11,375,523
Vehicles and equipment	104,512	9,629	6,096	-	108,045
Furnitures and fixtures	26,507	-	-	-	26,507
Property under capital leases	13,379	-	-	-	13,379
Total capital assets, being depreciated	13,144,144	15,814	9,182	(75,306)	13,075,470
Less accumulated depreciation for:					
Buildings	390,146	37,530	2,227	(16,687)	408,762
Improvements, other than buildings	17,961	5,069	-	-	23,030
Infrastructure	6,551,897	306,846	-	-	6,858,743
Vehicles and equipment	88,610	7,001	6,033	-	89,578
Furnitures and fixtures	18,542	2,655	-	-	21,197
Property under capital leases	12,884	193	-	-	13,077
Total accumulated depreciation	7,080,040	359,294	8,260	(16,687)	7,414,387
Total capital assets, being depreciated, net	6,064,104	(343,480)	922	(58,619)	5,661,083
Governmental activities capital assets, net	$ 6,597,594	$ (245,721)	$ 11,921	$ (117,105)	$ 6,222,847
Business-type Activities:					
Capital assets, not being depreciated:					
Land	$ 134,926	$ -	$ -	$ -	$ 134,926
Intangible assets	12,882	-	-	-	12,882
Construction in progress	70,159	14,398	-	(55,013)	29,544
Total capital assets, not being depreciated	217,967	14,398	-	(55,013)	177,352
Capital assets, being depreciated:					
Buildings	1,620,015	1,801	3	16,271	1,638,084
Improvements, other than buildings	1,070,481	11,058	-	28,183	1,109,722
Vehicles and equipment	216,256	4,366	518	10,559	230,663
Property under capital leases	13,406	-	-	-	13,406
Total capital assets, being depreciated	2,920,158	17,225	521	55,013	2,991,875
Less accumulated depreciation for:					
Buildings	366,358	42,358	2	-	408,714
Improvements, other than buildings	466,233	29,362	-	-	495,595
Vehicles and equipment	135,023	11,876	518	-	146,381
Property under capital leases	11,947	160	-	-	12,107
Total accumulated depreciation	979,561	83,756	520	-	1,062,797
Total capital assets, being depreciated, net	1,940,597	(66,531)	1	55,013	1,929,078
Business-type activities capital assets, net	$ 2,158,564	$ (52,133)	$ 1	$ -	$ 2,106,430

Upon the decision of the DOF, capital assets in the amount of $117,105,000 previously recorded in the City's records were returned to the SARA during the year ended June 30, 2013.

2. Depreciation

Depreciation expense charged to various governmental and business-type activities of the City for the fiscal year ended June 30, 2013 is as follows (dollars in thousands):

Governmental activities:		
General government	$	10,799
Public safety		8,190
Capital maintenance		307,748
Community services		29,484
Capital assets held by City's internal service funds		3,073
Total depreciation expense - governmental activities	$	359,294
Business-type activities:		
Norman Y. Mineta San José International Airport	$	54,027
Wastewater Treatment System		25,295
Municipal Water System		2,441
Parking System		1,993
Total depreciation expense - business-type activities	$	83,756

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, 2013.

4. Construction Commitments

Commitments outstanding as of June 30, 2013, related to governmental and business-type activities construction in progress totaled approximately $34,148,000 and $21,675,000, respectively.

E. Leases

1. Operating Leases as Lessee

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

Governmental Activities

The City has ongoing commitments under operating lease agreements for business equipment, office facilities and land necessary for City operations, which expire at various dates through 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, 2013 amounted to approximately $1,832,000 and $198,000, respectively.

The future minimum lease payments anticipated under the existing lease commitments, as of June 30, 2013, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	General Fund	Nonmajor Governmental Funds	Total Govermental Activities
2014	$ 1,766	$ 117	$ 1,883
2015	1,012	21	1,033
2016	818	-	818
2017	101	-	101
Totals	$ 3,697	$ 138	$ 3,835

Business-Type Activities

Airport Gas-Powered Buses. In May 2012, the City entered into an operating lease and maintenance agreement for ten compressed natural gas powered buses for the Airport. The term of the agreement ends May 31, 2017. Rental expense for the Airport buses for the year ended June 30, 2013 was approximately $1,264,000.

Future Minimum Payments. The future minimum payments anticipated under these commitments for the 10 buses, as of June 30, 2013, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	Operating Leases
2014	$ 950
2015	952
2016	955
2017	879
Total	$ 3,736

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 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. During the fiscal year ended June 30, 2013, the City received approximately

$5,719,000 from the Manager. As of June 30, 2013, leased assets had a total historic cost of approximately $118,114,000 and accumulated depreciation of approximately $53,520,000.

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, 2013, the Airport's revenues as defined in its lease agreement exceeded its expenditures and reserve requirements by approximately $29,741,000. The surplus for fiscal year ended June 30, 2013 will be distributed in accordance with the revenue sharing provisions of the lease agreement as described above and/or used in the budget balancing actions for fiscal year 2015.

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 25 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 $74,630,000 for the fiscal year ended June 30, 2013.

The future minimum rentals to be received from the operating leases, as of June 30, 2013, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	Amount
2014	$ 88,234
2015	93,070
2016	93,655
2017	94,432
2018	30,616
2019-2023	77,900
2024-2028	117,031
2029-2033	114,413
2034-2038	112,792
2039-2041	76,699
Total	$ 898,842

These future minimum rentals are based upon annual rates and charges agreed to by the airlines and other tenants. As of June 30, 2013, leased assets had historic costs of approximately $1,028,621,000 and accumulated depreciation of approximately $126,869,000.

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, 2013 (dollars in thousands, unless otherwise noted):

	Purpose	Issue Amount	Issue Date	Final Maturity	Range of Interest Rates	Principal Payments ($ millions)	Balance June 30, 2013
Governmental Activities							
City of San José							
General Obligation Bonds:							
Series 2001 (Libraries and Parks)	Community Facilities	$ 71,000	06/06/2001	09/01/2031	5.00-5.13%	2.37	$ 44,935
Series 2002 (Libraries, Parks, Public Safety)	Community Facilities	116,090	07/18/2002	09/01/2032	4.00-5.00%	3.87	77,390
Series 2004 (Libraries, Parks, Public Safety)	Community Facilities	118,700	07/14/2004	09/01/2034	4.00-5.00%	3.96	87,060
Series 2005 (Libraries and Public Safety)	Community Facilities	46,300	06/23/2005	09/01/2035	4.00-4.50%	1.54-1.55	35,520
Series 2006 (Libraries and Parks)	Community Facilities	105,400	06/29/2006	09/01/2036	4.00-5.00%	3.51-3.52	84,340
Series 2007 (Parks and Public Safety)	Community Facilities	90,000	06/20/2007	09/01/2037	4.00-5.50%	3.00	75,000
Series 2008 (Libraries and Parks)	Community Facilities	33,100	06/25/2008	09/01/2038	4.00-5.00%	1.10-1.11	28,680
Series 2009 (Public Safety)	Community Facilities	9,000	06/25/2009	09/01/2039	4.00-5.00%	0.30	8,100
							441,025
HUD Section 108 Note (FMC)	Economic Development	25,810	02/10/2005	11/01/2024	Variable	1.13-2.22	14,706
City of San José Financing Authority							
Lease Revenue Bonds:							
Series 2001F (Convention Center)	Refunding	186,150	07/01/2001	09/01/2022	5.00%	9.57-14.73	119,870
Series 2003A (Central Service Yard)	Refunding	22,625	09/18/2003	10/15/2023	3.80-4.70%	1.07-1.61	14,470
Series 2006A (Civic Center Project)	Refunding	57,440	06/01/2006	06/01/2039	4.10-5.00%	0.00-17.44	56,125
Series 2007A (Recreational Facilities)	Refunding	36,555	06/28/2007	08/15/2030	4.13-4.75%	1.22-2.22	30,405
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	2.09-4.20	38,920
Series 2008E-1 (Taxable) (Ice Centre)	Refunding	13,015	07/03/2008	06/01/2025	Variable	0.59-1.26	11,240
Series 2008E-2 (Taxable) (Ice Centre)	Refunding	13,010	07/03/2008	06/01/2025	Variable	0.60-1.26	11,230
Series 2008F (Taxable) (Land Acquisition)	Refunding	67,195	06/11/2008	06/01/2034	Variable	1.61-4.81	63,885
Series 2011A (Conventional Center)	Convention Center	30,985	04/12/2011	05/01/2042	3.00-5.75%	0.00-2.16	30,985
Series 2013A (Civic Center Project)	Refunding	305,535	05/28/2013	06/01/2039	3.00-5.00%	2.93-21.33	305,535
Series 2013B (Civic Center Garage Project)	Refunding	30,445	06/19/2013	06/01/2039	3.00-5.00%	0.73-1.83	30,445
Revenue Bonds:							
Series 2001A (4th & San Fernando Garage)	Parking Facility	48,675	04/10/2001	09/01/2026	4.30-5.00%	1.74-3.21	33,435
							757,460
Special Assessment Bonds with Limited Government Commitment							
Special Assessment Bonds							
Series 24Q (Hellyer-Piercy)	Public Infrastructure	27,595	06/26/2001	09/02/2023	5.30-5.88%	1.18-2.03	17,235
Series 24R (2002 Consolidated Refunding)	Consolidated Refunding	13,940	07/03/2002	09/02/2015	4.13-4.38%	0.82-1.07	2,945
Special Tax Bonds							
CFD No. 1 (Capitol Expressway Auto Mall)	Public Infrastructure	4,100	11/18/1997	11/01/2022	5.50-5.70%	0.18-0.30	2,330
CFD No. 6 (Great Oaks-Route 85)	Public Infrastructure	12,200	12/18/2001	09/01/2023	5.00-6.00%	0.51-0.87	7,360
CFD No. 9 (Bailey/Highway 101)	Public Infrastructure	13,560	02/13/2003	09/01/2032	5.45-6.65%	0.30-0.95	11,060
CFD No. 10 (Hassler-Silver Creek)	Public Infrastructure	12,500	07/23/2003	09/01/2023	4.38-5.25%	0.59-0.94	8,190
Series 2011 (Convention Center)	Public Infrastructure	107,425	04/12/2011	05/01/2042	3.00-6.50%	0.40-7.71	107,425
							156,545
Total Governmental Activities - Bonds and Notes Payable							**$ 1,369,736**
Business-Type Activities							
Norman Y. Mineta San José International Airport							
Revenue Bonds:							
Series 2001A	Runway Construction	$ 158,455	08/14/2001	03/01/2031	0.00-5.00%	0.00-10.06	$ 45,710
Series 2004C (AMT)	Airport Facilities	75,730	06/24/2004	03/01/2026	4.63-5.25%	1.00-10.59	70,730
Series 2004D	Airport Facilities	34,270	06/24/2004	03/01/2028	0.00-5.00%	0.00-12.56	34,270
Series 2007A (AMT)	Airport Facilities	545,755	09/13/2007	03/01/2047	5.00-6.00%	5.78-73.50	545,755
Series 2007B	Airport Facilities	179,260	09/13/2007	03/01/2037	4.25-5.00%	2.00-28.80	179,260
Series 2011A-1 (AMT)	Refunding	150,405	07/28/2011	03/01/2034	3.00-5.75%	3.20-21.12	143,180
Series 2011A-2	Refunding	86,380	07/28/2011	03/01/2034	3.50-5.25%	1.86-12.22	82,255
Series 2011B	Refunding	271,820	12/14/2011	03/01/2041	3.32-5.75%	0.49-27.33	264,085
Series 2012A (Non-AMT)	Airport Facilities	49,140	11/08/2012	03/01/2018	1.53%	8.10-8.59	41,710
							1,406,955
Wastewater Treatment System							
Cleanwater Financing Authority							
Revenue Bonds:							
Series 2005A	Refunding	54,020	10/05/2005	11/15/2016	3.75-5.00%	5.13-5.80	21,765
Series 2009A	Refunding	21,420	01/29/2009	11/15/2020	3.00-3.50%	0.00-5.15	21,420
							43,185
State of California - Revolving Fund Loan	Wastewater Facilities	73,566	06/24/1997	05/01/2019	Various	1.77-4.35	22,769
							65,954
Total Business-Type Activities - Bonds and Loan Payable							**$ 1,472,909**
Grand Total							**$ 2,842,645**

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. During the course of the fiscal year, the City identified several noncompliant issues with the continuing disclosure requirements and these have been remedied since then.

3. Legal Debt Limit and Margin

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 2012-2013 tax roll was $126.3 billion, which results in a net total debt capacity of $18.9 billion. As of June 30, 2013, the City had $441,025,000 of General Obligation bonds outstanding.

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 statement of net position in the amount of $33,000.

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, 2013, the City has recorded approximately $49,120,000 of deferred inflows of resources 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 receivables in the amount of $49,120,000 as of June 30, 2013 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.

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, 2013, the outstanding conduit multi-family housing revenue bonds issued by the City aggregated to approximately $483,245,000.

In August 1997, the Agency served as the conduit issuer of $10,595,000 in Multifamily Housing Revenue Bonds in order to provide funds for a mortgage loan to a private developer for rental housing project on the former Agency-owned land. As of June 30, 2013, the outstanding balance was $9,185,000.

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 $136,190,000 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 reimbursement agreements for 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, 2013 are as follows (dollars in thousands):

	Credit Facility Description			
	Capacity [1]	Provider	Expiration Date	
City of San José Financing Authority:				
Lease Revenue Bonds:				
Series 2008C (Hayes Mansion)	$ 10,915	U.S. Bank	10/21/2013	(2)
Series 2008D (Taxable) (Hayes Mansion)	38,920	U.S. Bank	10/21/2013	(2)
Series 2008E (Taxable) (Ice Centre)	22,470	Bank of America, N.A./U.S. Bank	10/21/2013	(2)
Series 2008F (Taxable) (Land Acquisition)	63,885	Bank of America, N.A.	5/2/2014	
Total variable rate lease revenue bonds	$ 136,190			

(1) Reflects principal components of the LOC commitments.

(2) In September 2013, the credit facilities' providers extended the expiration dates. See Note IV.D.

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 a principal amortization period of 3 years. Per the reimbursement agreements for the Series 2008CDE Bonds, any unreimbursed draw on the LOC will be amortized over a three year period, and will bear interest at 25%. Payments due to the bank for a term loan may not exceed the fair market rental value of the asset(s) under the lease. However, the City and Authority agree to reassess the fair market rental value when requested by the bank during a term loan period in order for the City to increase the amount of its lease payments. Per the reimbursement agreement for the Series 2008F Bonds, any unreimbursed draw on the LOC will be amortized over a three year period, however, lease payments may not exceed the maximum annual lease payment under the sublease. The interest rate during the amortization period is per a formula up to a maximum rate of 18% per annum. 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. Additionally, each of the reimbursement agreements specifies other terms in order to promote prompt repayment of the credit facility providers.

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 agreement with the credit facility provider and the outstanding principal amount of the bonds supported by the credit facility. As of June 30, 2013, the letters of credit supporting Series 2008CDE 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 2008CDEF bonds at June 30, 2013.

8. Summary of Changes in Long-term Obligations

Governmental Activities - The changes in long-term obligations for the year ended June 30, 2013 are as follows (dollars in thousands):

	July 1, 2012	Additional Obligations, Interest Accretion and Net Increases	Current Maturities, Retirements, and Net Decreases	June 30, 2013	Amounts Due Within One Year
Governmental Activities:					
Long-term debt payable:					
General Obligation bonds	$ 460,670	$ -	$ (19,645)	$ 441,025	$ 19,645
HUD Section 108 loan	20,803	-	(6,097)	14,706	-
San José Financing Authority					
Lease revenue bonds	659,068	335,980	(390,893)	604,155	8,310
Accreted interest on capital appreciation bonds	510	47	(557)	-	-
Lease revenue bonds with reimbursement agreement	129,020	-	(9,150)	119,870	9,570
Revenue bonds with pledge agreement	35,105	-	(1,670)	33,435	1,740
Special assessment and special tax bonds with limited governmental commitment	160,310	-	(3,765)	156,545	4,210
Total long-term debt payable	1,465,486	336,027	(431,777)	1,369,736	43,475
Issuance premiums/discounts:					
For issuance premiums	7,175	45,506	(451)	52,230	2,059
For issuance discounts	(5,128)	-	2,606	(2,522)	(89)
Total issuance premiums/discounts	2,047	45,506	2,155	49,708	1,970
Total long-term debt payable, net of issuance premiums/discounts	1,467,533	381,533	(429,622)	1,419,444	45,445
Other long-term obligations:					
Hayes Mansion construction loan	1,200	-	-	1,200	-
Arbitrage liability	48	-	(15)	33	-
Accrued vacation, sick leave and compensatory time	57,656	42,573	(39,363)	60,866	18,000
Accrued landfill postclosure costs	7,440	-	(465)	6,975	465
Estimated liability for self-insurance	137,720	17,939	(21,873)	133,786	-
Net other postemployment benefits (OPEB) obligation	292,244	65,994	-	358,238	-
Pollution remediation obligation	1,083	-	(262)	821	-
NMTC Financing Obligation	-	18,069	-	18,069	-
Total other long-term obligations	497,391	144,575	(61,978)	579,988	18,465
Governmental activities long-term obligations	$ 1,964,924	$ 526,108	$ (491,600)	$ 1,999,432	$ 63,910

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, 2013, 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, 2013 is approximately $682,681,000, with the final payment due on September 1, 2039.

The City did not issue any 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 issuance of this final series will depend upon the expenditure and encumbrance needs of the various projects to be financed.

Lease Revenue/Revenue Bonds are issued by the Financing Authority primarily to finance various capital improvements, and with the exception of the 2001A Bonds, the financed capital improvements are to be leased to the City and are secured by lease revenue from "lessee" departments in the General Fund, Nonmajor Governmental Funds, and the SARA. The lease 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, 2013 are approximately $1,174,738,000, with the final payment due on May 1, 2042.

The outstanding balance remaining on these aforementioned bonds includes payments for the 2001A and 2001F bonds, which are payable through a pledge agreement (2001A) and a reimbursement agreement (2001F) by the Agency, which were assumed by the SARA. 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 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 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 $1,740,000 balances outstanding as of June 30, 2013. At June 30, 2013, the Financing Authority’s bonds payable is $33,435,000, whereas the corresponding receivable from the SARA is $31,695,000.

  Due to SARA’s cash flow deficiencies to make the annual pledge agreement payment in fiscal year ended June 30, 2013, the City’s Parking System advanced $3,363,000 to the SARA to make the payment under the Agency Pledge Agreement to the Financing Authority (see Note III.G.3).

- **Lease Revenue Bonds with Reimbursement Agreement.** In connection with the issuance of the 2001F Convention Center Refunding Bonds, the 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 $119,870,000 as of June 30, 2013.

  Due to SARA’s cash flow deficiencies to make the annual payment on its reimbursement agreement, the City’s General Fund paid $12,343,000 to the SARA to assist with the payment of the Reimbursement Agreement to the Financing Authority (see Note III.G.3).

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, 2013 is approximately $306,681,000, with the final payment due on May 1, 2042.

Other Long-Term Obligation payments are primarily made from general revenues recorded in the General Fund, except for payments related to the City's New Market Tax Credit financing obligation, which will be paid from the Integrated Waste Management fund and the Hayes Mansion Construction loan, which will be paid from the nonmajor special revenue fund, Community Facility Revenue.

Business-Type Activities - The changes in long-term obligations for the year ended June 30, 2013 are as follows (dollars in thousands):

	July 1, 2012	Additional Obligations and Net Increases	Current Maturities, Retirements, and Net Decreases	June 30, 2013	Amounts Due Within One Year
Business-Type Activities:					
Norman Y. Mineta San José International Airport:					
Revenue bonds	$ 1,420,395	$ 49,140	$ (62,580)	$ 1,406,955	$ 22,275
Issuance premiums/discounts:					
For issuance premiums	6,729	-	(3,802)	2,927	63
For issuance discounts	(11,573)	-	24	(11,549)	(43)
Clean Water Financing Authority:					
Revenue bonds	48,310	-	(5,125)	43,185	5,320
Issuance premiums/discounts:					
For issuance premiums	1,532	-	(236)	1,296	236
State of California - Revolving Fund Loan	26,746	-	(3,977)	22,769	4,049
Accrued vacation, sick leave and compensatory time	5,154	5,503	(5,124)	5,533	4,396
Estimated liability for self-insurance	4,996	728	(1,089)	4,635	1,418
Net other postemployment benefits (OPEB) obligation	27,981	7,542	-	35,523	-
Pollution remediation obligation	714	1,044	-	1,758	1,758
Business-type long-term obligations	$ 1,530,984	$ 63,957	$ (81,909)	$ 1,513,032	$ 39,472

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 fiscal year 2012-2013 totaled approximately $126,031,000, which is comprised of $60,025,000 of net general airport revenues and $66,006,000 of other available funds. Bond debt service payable from general airport revenues in fiscal year 2012-2013 totaled approximately $64,225,000, which is net of $22,100,000 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, 2013 is approximately $2.8 billion, with the final payment due on March 1, 2047.

Ambac Assurance Corporation ("Ambac Assurance"), a subsidiary of Ambac Financial Group, Inc. ("Ambac Financial") and formerly known as Ambac Indemnity Corporation 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 2001A, Series 2011A-1, Series 2011A-2 and 2012A Airport Revenue Bonds. The Ambac Assurance 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. The City may also be required to make a deposit of cash or another qualified reserve facility in order to maintain the required reserve in the general account in the case of non-payment under, or cancellation, of either surety bond, including as a result of the liquidation of Ambac Assurance or NPFG. See Note III.F.10. regarding Ambac Financial's filing for bankruptcy protection and other proceedings.

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 fiscal year ended June 30, 2013 totaled approximately $46,537,000. Bond debt service, plus debt service on the State Revolving Fund Loan, payable from net system revenues in the fiscal year totaled approximately $11,412,000. 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 (1) the bonds as of June 30, 2013 is approximately $50,057,000, with the final payment due on November 15, 2020 and (2) the loan as of June 30, 2013 is approximately $24,123,000 with the final payment due on May 1, 2019.

9. Annual Requirements to Maturity

The annual requirements to amortize all bonds and notes outstanding as of June 30, 2013 are as follows (dollars in thousands):

	Governmental Activities					
	City of San José General Obligation Bonds and HUD Loan [1]		City of San José Financing Authority Bonds [1,2,3]		Special Assessment Bonds with Limited Governmental Commitment	
Fiscal Year Ending June 30,	Principal	Interest	Principal	Interest	Principal	Interest
2014	$ 19,645	$ 20,570	$ 19,620	$ 30,016	$ 4,210	$ 9,222
2015	19,645	19,701	25,705	29,262	5,620	9,021
2016	19,650	18,822	27,755	28,368	5,610	8,747
2017	19,804	17,914	30,195	27,365	5,035	8,476
2018	21,129	17,024	32,615	26,274	5,305	8,204
2019 - 2023	107,084	71,451	195,635	110,483	31,135	36,322
2024 - 2028	102,589	47,785	138,250	79,135	21,380	28,552
2029 - 2033	95,880	23,754	123,295	55,528	23,600	22,347
2034 - 2038	48,605	5,149	129,450	28,325	26,525	14,530
2039 - 2043	1,700	56	34,940	2,520	28,125	4,714
Total	$ 455,731	$ 242,226	$ 757,460	$ 417,278	$ 156,545	$ 150,136

	Business-Type Activities			
	Airport Revenue Bonds [2]		Wastewater Treatment System Revenue Bonds and Loans	
Fiscal Year Ending June 30,	Principal	Interest	Principal	Interest
2014	$ 22,275	$ 74,652	$ 9,369	$ 2,048
2015	23,450	73,923	9,643	1,736
2016	24,520	73,104	9,993	1,414
2017	25,605	72,284	10,130	1,122
2018	26,860	71,323	9,498	847
2019 - 2023	143,620	337,580	17,322	1,059
2024 - 2028	197,575	295,122	-	-
2029 - 2033	323,210	232,375	-	-
2034 - 2038	475,360	114,864	-	-
2039 - 2043	109,170	27,195	-	-
2044 - 2047	35,310	5,451	-	-
Total	$ 1,406,955	$ 1,377,872	$ 65,954	$ 8,226

[1] Projected interest payments for the variable rate series of bonds are based on the following rates in effect on June 30, 2013:
Financing Authority Lease Revenue Bonds: Series 2008C (0.06%), Series 2008D (0.17%), Series 2008E-1 (0.16%), Series 2008E-2 (0.14%), Series 2008F (0.13%).
HUD Section 108 Notes: City of San José (0.47465%)
[2] Does not include notional amortization of outstanding commercial paper notes.
[3] Does not include projected credit facility fees and expenses.

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 postclosure costs, estimated liability for self-insurance, the net OPEB obligation and the pollution remediation obligation are not practicable to determine.

10. Ambac Assurance Surety Bonds Held in Bond Revenue Funds

Ambac Assurance, a subsidiary of Ambac Financial, issued a reserve fund surety bond that is on deposit in the General Account of the Bond Reserve Fund, securing the Series 2001A, Series 2011A-1, Series 2011A-2, and Series 2012A 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 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.

On May 1, 2013, Ambac Financial emerged from bankruptcy protection which had been filed under Chapter 11 of the Bankruptcy Code in November 2010. Ambac Assurance remains subject to rehabilitation proceedings undertaken by the Wisconsin Office of the Commissioner of Insurance. No assurance can be made regarding the claims paying ability of Ambac Assurance on the surety bonds described above.

11. New Debt Issuances and Short-Term Debt Activities

<u>Governmental Activities</u>

City of San José Financing Authority Lease Revenue Refunding Bonds, Series 2013A and 2013B

On May 7, 2013, the City Council and Authority Board approved the issuance of the Bonds supported by a pledge of General Fund lease payments from the City to the Authority to fund debt service payments. The City of San José Financing Authority (the "Authority") issued fixed-rate refunding bonds (the "Bonds") to refinance Authority bonds that previously financed the Civic Center and Civic Center Garage projects for interest rate savings and to reduce variable interest rate exposure:

<u>Civic Center Project</u>
On May 28, 2013, the Authority issued $305,535,000 of Lease Revenue Refunding Bonds, Series 2013A (the "2013A Bonds") in order to current refund (a) $290,775,000 of fixed-rate Authority Lease Revenue Bonds, Series 2002B and (b) $56,920,000 of variable-rate Lease Revenue Refunding Bonds, Series 2008A. The 2013A Bonds were issued at fixed rates ranging from 3.00% to 5.00%, have a true interest cost of 3.69%, and have a final maturity date of June 1, 2039. The proceeds from the 2013A Bonds, which include net original issue premium of $44,251,000, and the remaining balances in the 2002B accounts in the amount of $28,307,000 were used to pay the redemption price of the refunded Series 2002B and Series 2008A Bonds. The issuance of the 2013A Bonds provides approximately $95,800,000 in aggregate debt service savings or $48,400,000 on a present value basis.

Civic Center Garage Project
On June 19, 2013 the Authority issued $30,445,000 of Lease Revenue Refunding Bonds, Series 2013B (the "2013B Bonds") in order to current refund $33,040,000 of variable-rate Lease Revenue Refunding Bonds, Series 2008B. The 2013B Bonds were issued at fixed rates ranging from 3.00% to 5.00%, have a true interest cost of 3.89%, and have a final maturity date of June 1, 2039. The proceeds from the 2013B Bonds, which include net original issue premium of $1,255,000, and the remaining balances in the 2008B accounts in the amount of $3,678,000, were used to pay the redemption price of the 2008B Bonds. The issuance of the 2013B Bonds results in approximately $378,000 in gross loss, or $1,600,000 on a net present value basis. The objective for issuing the 2013B Bonds was to refund variable interest rate bonds with fixed rate bonds.

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 two direct-pay letters of credit ("LOCs") provided by State Street Bank and Trust Company ("State Street") and U.S. Bank National Association ("U.S. Bank") (together, the "Banks"). The Letter of Credit and Reimbursement Agreements between the Financing Authority and the Banks expire on August 28, 2015 (the "Stated Expiration Date").

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. The City Council and the Financing Authority have approved a reduction of the capacity of the lease revenue commercial paper program from $116,000,000 to $85,000,000 on February 12, 2013, with each Bank LOC providing $42,500,000 in capacity.

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 Fourth Amendments to the Site Lease and to the Sublease, both dated February 1, 2013, which substituted leased assets) are: the Animal Care Center, Fire Station No. 1, Fire Station No. 3, the Police Communications Center, and the South San José Police Substation (the "Pledged Properties").

The annual commitment fee payable to each Bank equals 1.30% per annum of the daily average Stated Amount of the Letter of Credit in effect from time to time for the period from February 28, 2013 to and including the Letter of Credit Expiration Date; provided, however, that in the event that the long-term unenhanced lease revenue debt ratings of the City are downgraded as specified in the agreements with the Banks, the annual commitment fee shall increase.

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.

Interest on any Term Loan (draws that are not reimbursed by the City one hundred eighty-one days after a Principal Advance or the Letter of Credit Expiration Date, whichever comes first) are payable at the Term Loan Rate from the date of such Term Loan Conversion Date, payable monthly in arrears on the first day of each calendar month and on the date on which the final installment of the principal of the Term Loan is payable. The principal amount of each Term Loan is amortized over such a three-year period; provided, however, that the unpaid amount of each Term Loan shall be paid by the City in each year only to the extent of the then fair rental value with respect to the Pledged Property subject to the Sublease for such Base Rental Period, and to the extent not so repaid, such Term Loan shall be paid by the City during each subsequent Base Rental Period, to the extent owed, to the extent of the then fair rental value with respect to the Components subject to the Sublease for each such Base Rental Period, and such Term Loan shall continue to be an obligation of the City pursuant to the Sublease to be paid on or before the expiration of the three-year amortization period. Per the terms of the reimbursement agreements, Banks have the right to require that the rent payable for any of the Pledged Properties be redetermined in order to increase the amount of the rent payable. Additionally, each of the reimbursement agreements specifies other terms in order to promote prompt repayment to the Banks.

As of June 30, 2013, $25,678,000 of tax-exempt commercial paper notes was outstanding at an interest rate of 0.20% and $17,118,000 of taxable commercial paper notes was outstanding at an interest rate of 0.27%. The changes in commercial paper notes during the fiscal year ended June 30, 2013 are as follows (dollars in thousands):

July 1, 2012	Deletions	June 30, 2013
$45,348	$2,552	$42,796

2012 Tax and Revenue Anticipation Note

The City issued a short-term note (the "2012 Note") in a total commitment amount not to exceed $125,000,000 for cash flow purposes to facilitate the prefunding of employer retirement contributions. The Initial Note Portion of the 2012 Note was purchased by U.S. Bank on July 2, 2012 in the amount of $100,000,000 at an interest rate of LIBOR plus 0.10%. Security for repayment of the 2012 Note was a pledge of the City's 2012-2013 secured property tax and sales tax revenues plus all other legally available General Fund revenues legally available to the City, if required. The City fully repaid the 2012 Note on February 14, 2013.

Business-Type Activities

2012 Airport Revenue Bonds

In November 2012, the City issued Airport Revenue Refunding Bonds Series 2012A in the amount of $49,140,000. The Series 2012A Bonds were issued to refund all of the outstanding Airport Revenue Refunding Bonds, Series 2002A. The Bonds were purchased by Banc of America Public Capital Corp on November 8, 2012 and have a final maturity date of March 1, 2018. The refunding provides approximately $6,152,000 in aggregate debt service savings or $5,906,000 on a present value basis.

Airport Commercial Paper Notes Payable

In November 1999, the City Council authorized the issuance of the City of San José, Norman Y. Mineta San José International Airport subordinated commercial paper. In March 2008, the City Council further authorized the subordinated commercial paper notes to be issued in an aggregate principal amount of up to $600,000,000 outstanding at any one time.

Under the commercial paper program, the Airport is able to issue commercial paper notes at prevailing interest rates for periods of maturity not to exceed 270 days. The outstanding commercial paper notes are secured by a subordinate pledge of the Airport's revenues and additionally secured by a letter of credit. As of June 30, 2013, the commercial paper notes program is secured by a $75,000,000 letter of credit (LOC) provided by Wells Fargo Bank, N.A. (WFB). The LOC will expire on March 13, 2014. The terms of the credit facility are specified in the LOC and Reimbursement Agreement (the "Reimbursement Agreement"). In general, WFB 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 and repay principal in accordance with the schedule and terms set forth in the Reimbursement Agreement and Term Loan. Additionally, WFB 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 rate was established based on the underlying credit rating on the Airport's bonds. The facility fee rate 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 (Fitch) 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 WFB increased to 1.65% effective July 20, 2012. The facility fee rates are 1.65% as of June 30, 2013.

The change in Airport commercial paper notes payable during fiscal year 2013 is as follows (dollars in thousands):

July 1, 2012	Deletions	June 30, 2013	Interest Rate
$47,937	$2,557	$45,380	0.17% - 0.25%

12. Landfill Post-closure Costs

The City has five closed landfills for which postclosure 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 $6,975,000 related to the closed landfills is recorded in the government-wide financial statements as of June 30, 2013. 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 2013, 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, 2012 to October 1, 2013 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 2013, for the policy period of October 1, 2012 to October 1, 2013, the City maintained an airport liability policy covering the Airport, including operation of vehicles on premises, which provide a $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. A separate automobile policy provided coverage for the off-premise operations of Airport vehicles including shuttle bus fleets with a limit of $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 $10,000 comprehensive and $25,000 collision deductible. As part of general support services, the City charges the Airport for the cost of liability and property insurance coverage. Settled claims have not exceeded the City's commercial insurance coverage in any of the past three years.

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, which may be years into the future and have been discounted to their present value using a rate of 3.1% 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, 2013. 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, 2011	$ 149,028
Claims and changes in estimates during 2012	13,923
Claims payments	(20,235)
Liability as of June 30, 2012	142,716
Claims and changes in estimates during 2013	18,833
Claims payments	(23,128)
Liability as of June 30, 2013	$ 138,421

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. The balance of the North Concourse reserve fund as of June 30, 2013 is $948,000.

On March 15, 2007, the City obtained 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, 2013 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 45 months, commencing on March 15, 2007 through December 31, 2010. 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 to fund 74% of the claims loss reserve and interest generated remains in the fund. The full amount of $6,500,000 was deposited with Chartis in fiscal year 2009 and was recorded as advances and deposits in the accompanying statement of net position. In August 2013, as part of the annual loss reserve analysis by Chartis, an amount of $1,398,000 has been returned to the Airport leaving a balance of $4,032,000.

The TAIP Project has been completed. Chartis will continue to hold the remaining funds in the claims loss reserve 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.

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*. 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. At June 30, 2013, the City recorded net OPEB obligations totaling $393,761,000 in the government-wide financial statements, of which $358,238,000 is in governmental activities and $35,523,000 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.B.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, 2013, the government-wide statement of net position reported a net pollution remediation obligation in the amount of $821,000 in governmental activities, and $1,758,000 in business-type activities.

16. New Market Tax Credit Financing Obligation

In connection with the City's New Market Tax Credit (NMTC) financing transaction to construct the San José Environmental Innovation Center (EIC), the City has a long-term lease obligation for its possession and beneficial use of the EIC facility. This master lease agreement has a 35-year term with a one-time renewal option of 10 years. Quarterly rent payments in the amount of $100,000 are to commence upon the completion of the EIC's construction and possession by the City, which is currently estimated to be completed in April 2014. As of June 30, 2013, the government-wide statement of net position (governmental activities) reported the NMTC financing obligation in the amount of $18,069,000.

G. Interfund Transactions

The composition of interfund balances as of June 30, 2013, 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	$	1,422	(1)
	Special Assessment Districts		17,890	(2)
Nonmajor Governmental Funds	Nonmajor Governmental Funds		8,000	(2)
	San José Financing Authority Debt Service		239	(2)
		$	27,551	

(1) $1,138 represents accrual of gas tax transfer and $284 represents accrual of construction and conveyance tax transfer

(2) Represents short-term borrowing for working capital

2. Advances to/Advances from other funds

Receivable Fund	Payable Fund		Amount	
General Fund	San José Financing Authority Debt Service	$	3,297	(1)
Nonmajor Governmental Funds	Nonmajor Governmental Funds		2,500	(2)
	General Fund		13,174	(3)
Wastewater Treatment System	General Fund		5,062	(3)
		$	24,033	

(1) Represents a $3,297 loan to support the Rancho Del Pueblo golf course
(2) Represents a loan for the Roberto Antonio Balermino Park Project
(3) Represents SERAF loan amounts due from the former Agency assumed by the General Fund per the terms of the SERAF loan agreement and payable in 2014-2015

3. Long-term Receivables from SARA

At June 30, 2013, the City's Low and Moderate Income Housing Asset Fund has advances receivable from the SARA as follows (in thousands):

		Amount
SERAF loan principal	$	64,816
SERAF interest		740
SERAF loan - gross		65,556
Less allowance for collectability		(52,645)
SERAF loan - net	$	12,911

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

The Redevelopment Dissolution Law provides that all prior loans made between the City and the Agency, except for loans made from the Low and Moderate Income Housing Fund for payment of SERAF, are invalidated on February 1, 2012, but may be reinstated once certain conditions related to dissolution are met by SARA. As such, the $10,000,000 portion of the SERAF loan was recorded as part of an extraordinary loss in 2012. In addition, interest accrued in excess of the LAIF rates pursuant to the Redevelopment Dissolution Law in the amount of $2,940,000 was also invalidated in 2012. 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 $740,000 at June 30, 2013. However, the DOF has determined that a significant portion of the SERAF loan in the amount of $52,645,000 should not be reported in the ROPS as an enforceable obligation. The City has recorded a collectability allowance against this amount. The remaining amount of $12,911,000 includes the interest accrued at the LAIF rate associated with this loan in the amount of $95,000 as of June 30, 2013. 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 2016.

Management continues to believe, in consultation with legal counsel, that the entire SERAF loan made from the Low and Moderate Income Housing Asset Fund in the amount of $65,556,000 and the interest accrued are valid enforceable obligations payable by SARA under the requirements of the Redevelopment Dissolution Law.

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 José Financing Authority Lease Revenue Bonds, Series 2001F (Convention Center Refunding), City of San José Financing Authority Revenue Bonds, Series 2001A (4th 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.

As of June 30, 2013, total long-term receivables from SARA are as follows (dollars in thousands):

Description			
Advances receivable from SARA:			
SERAF Loan	$	12,911	
Housing obligations funded by commercial paper proceeds		14,227	(1)
Other long-term receivables from SARA:			
Revenue bonds with pledge agreement		31,695	(2)
Lease revenue bonds with reimbursement agreement		119,870	(3)
2012-2013 reimbursement advance		17,175	(4)
Total long-term receivables from SARA	$	195,878	

(1) The Financing Authority has a receivable from SARA, which assumed the obligation from the Low and Moderate Income Housing Asset Fund, related to the commercial paper proceeds used for housing activities in the amount of $14,091,000 and accrued interest from the Financing Authority of $136,000.

(2) The long-term receivable related to the Series 2001A (4th and San Fernando Streets Parking Facility Project) pledge agreement.

(3) The long-term receivables related to the Series 2001F (Convention Center) reimbursement agreement.

(4) The long-term receivables relate to advances to SARA under the 2012-2013 Reimbursement Advance as follows: $3,472,000 from the General Fund for administrative and support service costs; $3,363,000 from the Parking System for the 2001A bond debt service payments; and $12,343,000 from the General Fund for the 2001F bond debt service payments, net $2,003,000 deduction for direct administrative service and other costs.

4. Due to SARA

The State Controller’s final Asset Transfer Review requires the City to pay SARA the net revenue earned from parking and rent from the properties transferred to the Diridon Authority. As of June 30, 2013, the City has a payable in the amount $804,000 related to the net revenue earned from parking and rent from the properties transferred from SARA.

In addition, as of June 30, 2013, the City has a payable in the amount of $49,000 related to other reimbursements.

5. Long-term Advances from SARA

The City has a payable and SARA has a receivable related to an Agency advance of a portion of a loan made by the City’s Housing Department to a third party for a transitional housing project. The SARA is entitled to 24.5% of the total loan repayment and therefore has long-term receivable of $467,000 due from the City as of June 30, 2013.

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 for the year ended June 30, 2013 with explanations of transactions (dollars in thousands):

Between governmental and business-type activities:

Transfer from	Transfer to		Amount	
Nonmajor Governmental Funds	Wastewater Treatment System	$	2,042	(1)
Wastewater Treatment System	Nonmajor Governmental Funds		1,664	(2)
Municipal Water System	General Fund		225	(3)
	San José Financing Authority Debt Service		147	(4)
	Nonmajor Governmental Funds		107	(5)
Parking System	General Fund		497	(6)
	Nonmajor Governmental Funds		231	(7)
		$	4,913	

(1) Transfer for the loan repayment between the Fiber Optics Development Fund and the Wastewater Treatment System
(2) Transfer for City Hall debt service payments
(3) Transfer for the late fee collections from Water Utility customers
(4) Transfer for interest, principal and fees for debt service payments
(5) Transfer of $85 for City Hall debt service payment and $22 for interest and fees from the Consolidated Utility Billing System
(6) Transfer of San José Arena parking revenue
(7) Transfer of $157 for City Hall debt service payments and $74 for the Downtown Property and Business Improvement District

Between governmental activities:

Transfer from	Transfer to	Amount	
General Fund	San José Financing Authority Debt Service	$ 3,304	(1)
	Nonmajor Governmental Funds	27,817	(2)
	Internal Service Funds	800	(3)
Housing Activities	Nonmajor Governmental Funds	34	(4)
Low and Moderate Income Housing Asset	Nonmajor Governmental Funds	687	(5)
Integrated Waste Management	General Fund	250	(7)
	Nonmajor Governmental Funds	1,218	(8)
	San José Financing Authority Debt Service	618	(9)
Special Assessment Districts	General Fund	1,624	(6)
San José Financing Authority Debt Service	Nonmajor Governmental Funds	1	
Nonmajor Governmental Funds	General Fund	8,848	(7)
	Nonmajor Governmental Funds	13,400	(8)
	San José Financing Authority Debt Service	22,393	(9)
Internal Service Funds	General Fund	396	(10)
	Nonmajor Governmental Funds	209	(11)
		$ 81,599	

(1) Debt service payments of $299 for the 2007A bond series, $1,705 for the 2008F bond series, and $1,300 for the 2003A bond series
(2) Transfers of $15,287 for City Hall debt service, $2,214 for loan repayment to Fiber Optics, $10,316 for debt service payments, operations, and subsidies
(3) Transfer to fund vehicle and fleet replacement purchases
(4) Transfer for City Hall debt service payment
(5) Transfer for City Hall debt service payment
(6) Transfers of $150 for administrative services and $1,474 for the debt service payments
(7) Various transfers for operations, interest earnings, and capital projects
(8) Transfers of $2,956 for City Hall debt service payment and $11,662 for debt service, operations, capital projects, and project savings
(9) Transfer of $11,724 for City Hall debt service payment and $11,287 for various debt service payments
(10) Transfers of $96 to update the City’s standard specifications for capital projects, $200 for over-collected funds, and $100 for operations
(11) Transfer for City Hall debt service payment

H. Deferred Inflows of Resources

As of June 30, 2013, total deferred inflows of resources in the governmental funds related to the following unavailable resources (dollars in thousands):

Description	
Housing Activities loan receivable	$ 22,291
Low and Moderate Income Housing Asset loan receivable	6,904
Special Assessments receivable	49,120
Community Development Block Grant (CDBG) loan receivable	1,421
Interest on SERAF loan receivable	25
Total deferred inflows of resources	$ 79,761

I. Governmental Fund Balances

As of June 30, 2013, total fund balances for the City's major and nonmajor governmental funds are as follows (dollars in thousands):

	General Fund	Housing Activities	Low & Moderate Income Housing Asset	Integrated Waste Management	Special Assessment Districts	San José Financing Authority Debt Service	Nonmajor Governmental Funds	Total Governmental Funds
Nonspendable:								
Advances & Deposits	$ 13	$ -	$ -	$ -	$ 5	$ -	$ 41	$ 59
Economic Development	-	-	-	-	-	-	852	852
Subtotal	13	-	-	-	5	-	893	911
Restricted for:								
Affordable Housing	-	67,863	302,737	-	-	-	-	370,600
Capital Maintenance	-	-	-	-	51,920	-	19,175	71,095
Capital Projects and Improvements	-	-	-	-	-	-	113,533	113,533
Economic Development	-	-	-	-	-	-	4,687	4,687
Libraries	30	-	-	-	-	-	8,723	8,753
Parks, Recreation, & Neighborhood Development	-	-	-	-	-	-	96,372	96,372
Public Safety	300	-	-	-	-	-	4,252	4,552
Public Works & Transportation	-	-	-	-	-	-	81,630	81,630
Sanitation	-	-	-	-	-	-	39,490	39,490
Debt Service	-	-	-	-	-	16,796	44,691	61,487
Subtotal	330	67,863	302,737	-	51,920	16,796	412,553	852,199
Committed to:								
Affordable Housing	3,500	-	-	-	-	-	-	3,500
Capital Maintenance	20,975	-	-	-	-	-	-	20,975
Capital Projects and Improvements	-	-	-	-	-	-	1,070	1,070
Community Welfare	3,544	-	-	-	-	-	-	3,544
Cultural Affairs	-	-	-	-	-	-	12,112	12,112
General Administration	37,497	-	-	-	-	-	-	37,497
Parks, Recreation, & Neighborhood Development	1,500	-	-	-	-	-	2,010	3,510
Public Safety	21,977	-	-	-	-	-	-	21,977
Public Works & Transportation	-	-	-	-	-	-	982	982
Sanitation	121	-	-	12,936	-	-	-	13,057
Subtotal	89,114	-	-	12,936	-	-	16,174	118,224
Assigned to:								
Affordable Housing	191	-	-	-	-	-	-	191
Capital Maintenance	1,647	-	-	-	-	-	65	1,712
Capital Projects and Improvements	1,303	-	-	-	-	-	34,033	35,336
Community Welfare	983	-	-	-	-	-	4,142	5,125
Cultural Affairs	354	-	-	-	-	-	-	354
Economic Development	409	-	-	-	-	-	18	427
General Administration	10,686	-	-	-	-	-	-	10,686
Libraries	2,217	-	-	-	-	-	-	2,217
Parks, Recreation, & Neighborhood Development	4,067	-	-	-	-	-	9,971	14,038
Public Safety	42,003	-	-	-	-	-	-	42,003
Public Works & Transportation	9,267	-	-	-	-	-	-	9,267
Sanitation	110	-	-	-	-	-	-	110
Subtotal	73,237	-	-	-	-	-	48,229	121,466
Unassigned	64,200	-	-	-	-	-	-	64,200
Total Fund Balances	**$ 226,894**	**$ 67,863**	**$ 302,737**	**$ 12,936**	**$ 51,925**	**$ 16,796**	**$ 477,849**	**$ 1,157,000**

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 established 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, 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, 2013, the contingency amount accounts for

$29,309,000 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, 2013, the cash reserve amount accounts for $5,600 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, 2013, the emergency reserve amount accounts for $3,400,000 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 cost-of-living increases as specified by the Municipal Code. The Defined Benefit Pension Plans are administered by the Director of Retirement Services, 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.

On August 28, 2012, the City Council adopted 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.

On December 18, 2012, the City Council adopted ordinance No. 29184 that provides unclassified executive management and professional employees in Unit 99 who are first hired on or after January 20, 2013, with a one-time irrevocable election to either participate in a newly created Defined Contribution Plan or become a Tier 2 member in the FCERS.

The current membership in the Defined Benefit Pension Plans as of June 30, 2013, is as follows:

	PFDRP		FCERS	
	Police	Fire	Tier 1	Tier 2
Defined Benefit Pension Plans:				
Retirees and beneficiaries currently receiving benefits*	1,178	817	3,711	-
Terminated and/or vested members not yet receiving benefits	188	41	994	7
Active members	1,028	679	2,856	238
Total	2,394	1,537	7,561	245

* The combined domestic relations orders are not included in the count above as their benefit payment is included in the retiree member count.

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, 2012.

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 the fiscal year ended June 30, 2013 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 at the beginning of the fiscal year.

On June 5, 2012, San José voters adopted Measure B which enacted the *Sustainable Retirement Benefits and Compensation Act* (the Pension Act). The Pension Act amended the City Charter to, among other changes, (1) increase pension contribution requirements for current employees effective June 23, 2013; (2) require the City to establish an alternative voluntary plan with reduced benefits for current employees (the "Voluntary Election Plan" or "VEP") subject to IRS approval; (3) place limitations on disability retirements, (4) authorize the City Council to temporarily suspend the cost of living adjustments if the City Council adopts a resolution declaring a fiscal and service level emergency; (5) require the elimination of the Supplemental Retirement Reserve within the PFDRP and FCERS; (6) codify in the City Charter contribution requirements for current employees for the retiree health and dental benefits and provide for a reservation of rights for the City Council to terminate or modify any retiree healthcare plan; (7) require the establishment of Tier 2 plans for new employees within PFDRP and FCERS; and (8) reserve to the voters the right to approve future changes to retirement benefits. The status of the legal challenges is discussed in Note IV.B.7.

On August 28, 2012, the City Council adopted ordinance No. 29120 to provide Tier 2 pension benefits for new System members hired on or after September 30, 2012. The contribution rate for Tier 2 members includes a change in the cost sharing between the City and active Tier 2 members which is a 50/50 split of all costs. Currently, Tier 1 members split normal costs with 8/11 paid by the City and 3/11 paid by Tier 1 members. The prepayment made by the City on July 2, 2012 was not adjusted when Tier 2 became effective.

The contribution rates for the Defined Benefit Pension Plans for the City and the participating employees for the fiscal year ended June 30, 2013 were established in accordance with actuarially determined requirements computed through actuarial valuations dated June 30, 2011, except for the period June 23, 2013, through June 30, 2013, which were based on the June 30, 2012 valuation. The contribution rates in effect and the amounts contributed to the pension plans for the fiscal year ended June 30, 2013, are as follows (dollars in thousands):

	PFDRP		
	City	Participants	Total
Actuarial Rate:			
Defined Benefit Pension Plan:			
06/23/13 - 06/30/13 (police members)	65.32% (1)	11.64%	
06/23/13 - 06/30/13 (fire members)	66.79% (1)	11.72%	
07/01/12 - 06/22/13 (police members)	56.57% (1)	11.13%	
07/01/12 - 06/22/13 (fire members)	58.43% (1)	11.21%	
Annual Pension Contribution			
Defined Benefit Pension Plan	$ 105,234	$ 20,227	$ 125,461

	FCERS						
	City			Participants			Total
	Tier 1	Tier 2	Total	Tier 1	Tier 2	Total	
Actuarial Rate:							
Defined Benefit Pension Plan:							
06/23/13-06/30/13	50.85% (1)	6.68%		5.97%	6.68%		
09/30/12-06/22/13		6.68%			6.68%		
07/01/12-06/22/13	44.45% (1)			5.74%			
Annual Pension Contribution							
Defined Benefit Pension Plan			$ 103,109			$ 12,652	$ 115,761

(1) The resolutions adopted by the Retirement Systems' Boards setting the contribution rates for the fiscal year ended June 30, 2013 and June 30, 2014 provide that the City's Budget Office may adjust the employer's contribution rates in order to achieve a minimum dollar contribution for that fiscal year.

In fiscal year ended June 30, 2011, the Retirement Systems' Boards approved the 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 the fiscal year ended June 30, 2013 and June 30, 2014 (applicable to June 23, 2013 – June 30, 2013) provide that the employer's contribution rates may be adjusted in order to achieve a minimum dollar contribution for that fiscal year.

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	6/30/11	$ 77,918	100%	$ -
	6/30/12	121,009	100%	-
	6/30/13	105,234	100%	-
FCERS	6/30/11	59,180	100%	-
	6/30/12	87,082	100%	-
	6/30/13	103,109	100%	-

(1) These amounts represent the annual pension cost factoring.

4. Funded Status and Funding Progress

PFDRP’s Funded Status and Funding Progress. As summarized in the table below, as of June 30, 2012, the most recent actuarial valuation date, PFDRP was 80% funded for pension benefits (a decrease from 84% in the June 30, 2011 valuation) representing the difference between the actuarial value of assets and the actuarial accrued liabilities (“AAL”) and resulting in an unfunded actuarial accrued liability (“UAAL”) of $694,253,000. The UAAL does not reflect the impact of approximately $124,600,000 of deferred investment losses. Deferred losses of $314,400,000 resulting from unfavorable investment returns in the years ended June 30, 2009 and 2012 are offset by deferred gains of $189,800,000 related to years ended June 30, 2010 and 2011. 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, 2012 actuarial valuation date, PFDRP’s AAL increased by approximately $201,800,000 due primarily to the earning of additional benefits, interest and a change in the discount rate assumption from 7.50% to 7.25%. PFDRP’s UAAL increased from approximately $510,286,000 as of June 30, 2011, to $694,253,000 as of June 30, 2012.

On January 29, 2013, the City Council approved ordinance No. 29198 to eliminate the Supplemental Retiree Benefit Reserve (SRBR). The Board approved taking the elimination of the SRBR into consideration for the June 30, 2012 valuation. The increase in the AAL would have been approximately $32,500,000 higher without this action.

The annual required contribution determined for PFDRP in the June 30, 2011 valuation for fiscal year ended June 30, 2013, was the greater of $105,297,000 (if paid at the beginning of the fiscal year) or 58.43% for fire member and 56.57% for police members of actual payroll for the fiscal year.

The total actuarial payroll for police and fire for the fiscal year was $190,726,000 ($121,735,000 for police members and $68,991,000 for fire members) The actual payroll for fire members of $70,031,000 was more than the actuarial payroll of $68,991,000, so the City paid an additional $608,000 in pension contributions for fire members over the prepaid required annual contribution of $105,297,000 as of July 1, 2012, for a total of $105,905,000, excluding 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, 2012 actuarial valuation date, FCERS was 62% funded on an actuarial basis for pension benefits. FCERS's UAAL of $1,078,027,000 does not reflect the impact of approximately $113,700,000 of accumulated deferred investment losses resulting primarily from unfavorable investment returns in the years ended June 30, 2009 and 2012, which are offset by deferred gains related to years 2010 and 2011. FCERS' actuarial valuation also uses a five-year smoothing method for investment returns. As of the June 30, 2012 valuation, FCERS's AAL increased by approximately $71,000,000 due primarily to the earning of additional benefits and interest, offset by benefit payments.

On December 4, 2012, the City Council adopted ordinance No. 29174 to eliminate the SRBR. The Board approved taking the elimination into consideration for the June 30, 2012 valuation. The increase in the AAL would have been approximately $43,100,000 higher without this action.

The annual required contribution determined for FCERS in the June 30, 2011 valuation for year ended June 30, 2013, was the greater of $102,971,000 (if paid at the beginning of the fiscal year) or 44.45% of actual payroll for the fiscal year. The actual payroll of FCERS for the fiscal year of $217,375,000 was less than the actuarial payroll of $240,187,000, resulting in an annual contribution of $102,971,000, excluding year-end contributions receivable and prior year contribution adjustments.

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	6/30/12	$ 2,703,539	$ 3,397,792	$ 694,253	80%	$ 187,959	$ 369%
FCERS	6/30/12	1,762,973	2,841,000	1,078,027	62%	225,859	477%

* Includes year-end contributions and other adjustments.

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.

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, 2012	June 30, 2011
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 14.0 years	Level percentage of pay, closed, layered; equivalent single amortization period 13.6 years
Remaining amortization period	(1) Outstanding balance of the unfunded accrued liability calculated through the June 30, 2003 valuation amortized over next 5 years; (2) Prior service cost for the February 4, 1996 benefit improvement amortized over the next 5 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 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.
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	7.25% per annum (net of investment expenses)	7.50% per annum (net of 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 Male Combined Healthy Mortality Table with no collar adjustment, projected 10 years. (set back 3 years)
(a) Service:	RP-2000 Female Combined Healthy Mortality Table with no collar adjustment, projected 10 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 2 years.	RP-2000 Combined Healthy Male Mortality Table with no collar adjustment, projected 10 years, set back 2 years.
Active service, withdrawal, death, disability service retirements	Based upon the June 30, 2011 Actuarial Experience Analysis.	Based upon the June 30, 2011 Actuarial Experience Analysis.
Salary increases:		
Wage inflation:	0.00% for FY 2013 and 2014, and 3.50% thereafter.	0.00% for FY 2013 and 2014, and 3.5% thereafter.
Merit increase:	Merit component added based on an individual years of service ranging from 8.00% to 2.25%.	Merit component added based on an individual years of service ranging from 8.00% to 2.25%.

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, 2012	June 30, 2011
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. SRBR elimination to be amortized over 20 years.	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	7.50% 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 2 years. For disabled annuitants, the CalPERS ordinary disability table from their 2000-2004 study for miscellaneous employees.	For healthy annuitants, the male and female RP-2000 combined employee and annuitant mortality tables projected to 2015 and set back 2 years. For disabled annuitants, the CalPERS ordinary disability table from their 2000-2004 study for miscellaneous employees.
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% wage 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 3.25% 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.
Projected total payroll increases	3.25%	3.25%
Cost of Living Adjustment	Tier 1 - 3% per year Tier 2 - fluctuates with actual inflation and capped at 1.5%	Tier 1 - 3%

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 Plans, which includes a Postemployment Healthcare 401(h) Plan, the Police Department Postemployment Healthcare Plan (Section 115 Trust) and the Fire Department Postemployment Healthcare Plan (Section 115 Trust) and the Federated City Employees' Postemployment Healthcare Plan, which includes an Internal Revenue Code (IRC) 401(h) Plan and an IRC 115 Trust. These Postemployment Healthcare Plans cover eligible full-time and certain part-time employees of the City, and 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 Services, an employee, 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, 2013, is as follows:

	PFDRP		FCERS	
	Police	Fire	Tier 1	Tier 2
Postemployment Healthcare Plans:				
Retirees and beneficiaries currently receiving benefits*	1,113	780	3,125	-
Terminated and/or vested members not yet receiving benefits	6	1	121	-
Active members	1,028	679	2,856	238
Total	2,147	1,460	6,102	238

* The combined domestic relations orders are not included in the count above as their benefit payment is included in the retiree member count.

2. OPEB Funding Policy

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 the fiscal year ended June 30, 2013 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 at the beginning of the fiscal year.

Contributions to the Postemployment Healthcare Plans are made by both the City and the participating members. 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 a five year period; the fiscal year ended June 30, 2013, was the fourth year of the phase-in. Effective June 26, 2011, the fire members of PFDRP entered into a MOA with the City to fully fund the ARC over a five year period subject to the same limitations specified in the MOA with police members; the fiscal year ended June 30, 2013 was the second year of the phase-in for fire members.

In both MOAs, the City and members of the PFDRP agreed 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 members and City, respectively. Additionally, if the retiree healthcare contribution rates exceed 10% for members or 11% for the City (excluding the implicit rate subsidy) the parties shall meet and confer on how to address the contribution rates above 10% and 11%.

Prior to July 1, 2009, annual contributions for the FCERS Postemployment Healthcare Plan were based on the cost for funding, as a level-percentage of payroll, based upon a 15-year projection of premiums (Policy method). The contributions were not sufficient to meet the requirements of an annual required contribution under GASB Statement No. 43. Effective June 28, 2009, the bargaining units representing the FCERS members entered into Memoranda of Agreement (MOA) with the City to increase contribution rates for retiree health and dental benefits in order to phase-in full funding of the GASB Statement No. 43 annual required contributions over the next five years; fiscal year ended June 30, 2013 was the fourth year of the phase-in. The MOAs also provide 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 employee or City contributions. Notwithstanding these limitations on incremental increases, the MOAs further provide that by the end of the five-year phase-in the City and the employees shall be contributing the full ARC in the ratio currently provided in the relevant sections of the San José Municipal Code.

Effective June 18, 2013, the bargaining units representing the FCERS members and the City have agreed to extend the incremental increase limitation of not more than 0.75% of pensionable pay for fiscal year ending June 30, 2014. In addition, the 0.75% limitation is extended to December 20, 2014; beginning on December 21, 2014, the contribution rates will be based on the full ARC for the remainder of the fiscal year ending June 30, 2015 and all subsequent fiscal years. These terms related to payment of the ARC also apply to unrepresented members of FCERS.

The contribution rates in effect and the amounts contributed to the PFDRP and the FCERS for the fiscal year ended June 30, 2013 are as follows (dollars in thousands):

	PFDRP			FCERS		
	City	Participants	Total	City [1]	Participants	Total
Actuarial Rate:						
Postemployment Healthcare Plan:						
06/23/13 - 06/30/13 (police members)	10.31% [1]	9.51%				
06/23/13 - 06/30/13 (fire members)	7.96% [1]	7.35%				
06/23/13 - 06/30/13				8.66% [1]	8.01%	
07/01/12 - 06/22/13 (police members)	8.96% [1]	8.26%				
07/01/12 - 06/22/13 (fire members)	6.62% [1]	6.11%				
07/01/12 - 06/22/13				7.91% [1]	7.26%	
Annual OPEB Contribution						
Postemployment Healthcare Plan:	$ 15,808	$ 13,498	$ 29,306	$ 21,251	$ 15,979	$ 37,230

(1) The resolutions adopted by the Retirement Systems' Boards setting the contribution rates for the fiscal year ended June 30, 2013 and June 30, 2014 provide that the City's Budget Office may adjust the employer's contribution rates in order to achieve a minimum dollar contribution for that fiscal year.

In fiscal year ended June 30 2011, the Retirement Systems' Boards approved an establishment of a "floor funding method" for payment of the 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 ended June 30, 2013 and June 30, 2014 (for the period between June 23, 2013 and June 30, 2013) provide that the employer's contribution rates may be adjusted in order to achieve a minimum dollar contribution for that fiscal year.

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, 2013, were as follows (dollars in thousands):

	PFDRP	FCERS
Annual required contribution	$ 55,824	$ 57,331
Interest on net OPEB obligation	8,515	6,080
Adjustment to annual required contribution	(7,627)	(6,299)
Annual OPEB cost	56,712	57,112
Contributions made	(15,808)	(21,251)
Implicit rate subsidy	(172)	(3,057)
Increase in net OPEB obligation	40,732	32,804
Net OPEB obligation – beginning of year	193,527	126,698
Net OPEB obligation – end of year	$ 234,259	$ 159,502

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	6/30/11	$ 64,108	$ 17,057	27%	$ 154,105
	6/30/12	65,357	25,935	40%	193,527
	6/30/13	56,712	15,980	28%	234,259
FCERS	6/30/11	48,529	21,608	45%	89,510
	6/30/12	67,404	30,216	45%	126,698
	6/30/13	57,112	24,308	43%	159,502

4. OPEB Funded Status and Funding Progress

As summarized in the table below, as of June 30, 2012, the most recent actuarial valuation date, PFDRP and FCERS was 7% and 13% funded, respectively, on an actuarial basis for OPEB. Decreases to the UAAL of both of the Postemployment Healthcare Plans were primarily due to changes in the medical plans offered and assumptions as recommended by the Retirement Boards' actuary. Medical plan changes effective January 1, 2012, eliminated the $10 co-pay plans, and switched to $25 co-pays for the Kaiser Medicare plans. Medical plan changes effective January 1, 2013, included a new Kaiser $1,500 Deductible HMO. This plan became the lowest cost plan available to active members; and, therefore, became the basis for the retiree premium subsidy. Other lower cost medical plans became available to non-Medicare eligible members. These medical plan changes greatly affected the medical plan election assumption used by the actuary as more retirees selected the lower cost medical plans. The specific funding status for each OPEB plan is summarized in the table below, as of the June 30, 2012 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	6/30/2012	$ 66,385	$ 997,321	$ 930,936	7%	$ 187,959	495%
FCERS	6/30/2012	137,798	1,096,620	958,822	13%	225,859	425%

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.

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, 2013 were based on the actuarial valuation performed as of June 30, 2011, except for the period June 23, 2013 through June 30, 2013, which were based on the June 30, 2012 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, 2012 **	June 30, 2011
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, 2012, open	30 years as of June 30, 2011, 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*	4.40%	5.7%
Projected payroll increases:		
Wage inflation:	0.00% for FY2013 and 2014, and 3.50% thereafter	0.00% for FY 2013 and 2014, and 3.50% thereafter
Merit increase:	Merit component added based on individual years of service ranging from 8.00% to 2.25%	Merit component added based on individual year's of service ranging from 8.00% to 2.25%
Healthcare cost trend rate:		
Medical	Future medical inflation assumed to be at 8.80% to 4.50% per annum graded down over a 14 year period for medical-pre age 65 and 6.63% to 4.50% per annum graded down over a 14 year period for medical-post age 65	Future medical inflation assumed to be at 9.17% per annum graded down to 4.50% over a 15 year period for medical-pre age 65 and 6.83% per annum graded down to 4.50% over a 15 year period for medical-post age 65
Dental	4.50%	4.50% graded down to 4% over a three 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 portion of the ARC contributed by the City for the fiscal year.

** The June 30, 2012 actuarial valuation of the PFDRP's postemployment healthcare plans does not reflect the new Section 115 subtrusts (the Police Department Postemployment Healthcare Plan and the Fire Department Postemployment Healthcare Plan) as those plans had no financial activity as of the most recent valuation date.

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, 2012	June 30, 2011
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)*	4.80%	6.10%
Wage inflation rate	3.25%	3.25%
Salary increases	The base annual rate of salary increase is 3.25% wage inflation rate plus a rate increase for merit/longevity for 0 to 15+ years of service ranging from 4.50% to 0.25% at the 15th year of service	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 4.50% to 0.25% at the 15th year of service
Projected payroll increases	3.25%	3.25%
Healthcare cost trend rate:		
Medical	The valuation assumes that future medical inflation will be at a rate of 8.80% to 4.50% per annum graded down over a 15 year period for medical-pre age 65 and 6.33% to 4.50% per annum graded down over a 14 year period for medical-post age 65.	The valuation assumes that future medical inflation will be at a rate of 9.17% per annum graded down to 4.50% per annum over a 15 year period for medical-pre age 65 and 6.83% to 4.50% per annum graded down over a 15 year period for medical-post age 65.
Dental	Dental inflation is assumed to be 4.50% in the first year and 4% thereafter.	Dental inflation is assumed to be 4.50% graded down to 4% over a three 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, cost-of-living adjustments are 2.0% per year, and benefits are based on a final average compensation period of 36 months. Benefit provisions and other requirements are established by State statute and by City resolution. CalPERS issues a separate comprehensive annual financial report, copies of which may be obtained from the CalPERS Executive Offices, Lincoln Plaza East, 400 Q Street, Sacramento, California 95814.

Funding Policy. The City is required to contribute the actuarially determined amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the Fund's Board of Administration. The required employer contribution rate for the year ended June 30, 2013 was 16.101%. The contractual employee cost sharing is 7.0% plus a fee of $0.93 per bi-weekly pay period for the 1959 Survivor Benefit program. 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, 2013, 2012, and 2011 were $119,500, $117,000, and $108,000, 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, 2013, the Airport was obligated for purchase commitments of approximately $7,100,000 primarily for pavement maintenance, parking revenue control system, terminal building modifications, and various operating and maintenance agreements. The Airport has projected that it will expend or encumber $87,433,000 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 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. As of June 30, 2013, the Airport has accrued its 50% of the remediation costs totaling $1,045,000.

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 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. In March 2013, four groundwater monitoring wells were installed within the area of excavation to monitor and evaluate the effectiveness of the remedial excavation on water quality. As of July 29, 2013, the Airport has completed two consecutive quarters of groundwater monitoring and sampling. Analytical results continue to show a decrease in concentrations. Quarterly monitoring and sampling is recommended through the fourth quarter of 2013. Following four quarters of monitoring and sampling, the site conditions should be evaluated for closure using the framework of the State Water Resources Control Board Low-Threat Underground Storage Tank Closure Policy which became effective August 17, 2012.

The Airport has accrued $1,758,000 as of June 30, 2013 to cover the 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, 2013 with the completion of a common use lounge, a taxi staging building, Terminal A/A+ space refurbishment, and building system upgrades occurring in FY 2013. Ongoing projects include Terminal A baggage system ceiling protection, relocation of northeast electrical services, and completion of the northeast area (formerly the rental car fueling and wash site). Construction of the northeast area began in August 2013 and will provide for a fuel truck maintenance facility, shuttle bus staging and storage, and adjacent employee parking. Construction of the Phase 2 projects is contingent upon satisfying specified activity-based triggers. Funding for Master Plan projects is from several sources, including grants, PFCs, airline rates and charges, airport revenue bonds, and subordinated commercial paper proceeds.

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. In April 2013, the Airport completed a request for proposals process to provide for new general aviation aeronautical services facilities and began negotiating with the successful proposer, Signature Flight Support. It is anticipated that negotiation with Signature will be completed in the fall of 2013 with issuance of a site development permit allowing for the start of construction to follow in early 2014. Signature will be funding the costs related to this project. Lawsuits were filed by Atlantic Aviation against the City challenging the environmental clearance for the facilities and the selection process in which the City Council awarded the lease to Signature.

FAA Audit of Use of Revenue. Federal law requires all airport owners that receive federal assistance, such as the City, to use airport revenues for the capital or operating costs of the Airport. As a general rule, any use of airport revenues by an airport owner for costs that cannot properly be considered airport capital or operating costs is deemed to be improper revenue diversion. On June 2, 2010, auditors from the FAA provided the City with a draft of its audit findings alleging improper use of Airport revenues by the City in three areas of expenditure as described below.

Airport Lease Obligation - In 2005, the City purchased certain real property (referred to as the Airport West Property). The purchase was financed with lease revenue bonds issued by the City of José Financing Authority (Authority). Upon acquisition, the City leased the property from the Authority and used a portion for construction laydown needs to support the Terminal Airport Improvement Program (TAIP). The City agreed to make lease payments from Airport operating revenues. At the time of the acquisition, the City contemplated other potential Airport uses for the property, such as rental car storage, public or employee parking, flight kitchen operations, airport/airline warehouses and compatible non-aviation leaseholds. The City subsequently determined not to use the property for these other potential Airport uses. The City's use of the property for construction laydown needs ceased with the completion of the TAIP on June 30, 2010. The FAA determined that the City could use Airport operating revenues to pay rent only for those portions that the City actually used for Airport construction laydown but not for the remainder of the property not actually used for Airport purposes. The City believes there is no basis under applicable federal law for the distinction made by the FAA auditors between rent payments for actual as opposed to planned Airport uses.

Guadalupe Gardens – In 2002, the City Council approved a Master Plan for Guadalupe Gardens, consisting of approximately 120 acres of mostly vacant, City-owned property located south of the Airport, much of which falls within an FAA-established safety zone. The City acquired the Guadalupe Gardens properties using FAA grants for airport approach protection and noise compatibility. The FAA grant agreements required FAA approval of any planned City-use of the properties acquired with grant proceeds. By letter dated August 9, 2002, addressed to the City's Director of Aviation, the FAA San Francisco Airport District Office ("ADO") approved the City's Master Plan for reuse of Guadalupe Gardens for runway and approach protection, and the City finalized the Master Plan in reliance upon the FAA approval. Citing provisions of federal law that require recipients of FAA grants for acquisition of land for noise compatibility purposes to dispose of any such acquired land when no longer needed by the airport owner for noise compatibility purposes, the FAA auditors determined that the FAA ADO erred in its 2002 approval of the Guadalupe Gardens Master Plan and that the City is obligated to prepare an inventory of the Guadalupe Gardens to identify those parcels that were acquired by the City with noise compatibility grant proceeds. This inventory would then be used to prepare for FAA review and approval of a disposition plan for those parcels no longer needed by the City for noise compatibility. Proceeds of the sale of the parcels proportionate to the FAA grant share of the original purchase price would be required to be used for other approved noise compatibility projects at the Airport or returned to the FAA. Having received official FAA approval of its reuse of the parcels, the City believes it is under no obligation to take any further action to secure further FAA approval of its continuing use of the Guadalupe Gardens.

Cost Allocations - The City uses both direct and indirect methodologies to allocate costs to the Airport. The FAA auditors found the direct cost allocations to be acceptable. The FAA contends that the City's indirect methodology does not correlate to the cost of services actually provided by the City to the Airport. Consequently, the auditors have recommended that the City re-allocate its costs charged to the Airport for fiscal years 2005 through 2010 using an allocation methodology that reflects services actually provided to the Airport and repay any overcharges to the Airport, with interest. The City believes the allocation methodology used to allocate costs to the Airport is in compliance with both the standards and regulations of the FAA Policy and Procedures Concerning the Use of Airport Revenue and OMB A-87. In an effort to resolve the issue, the City proposed to cap the indirect cost allocations for certain City departments at 10%, which was the approximate rate charged to the Airport in pre-capital intensive years. This resulted in a total credit of $5,600,000 that would be applied equally to the Airport cost allocation plan over a seven year period beginning in fiscal year 2012-13.

The City continues discussions with the FAA, but cannot predict the final outcome of the audit.

2. San José – Santa Clara Water Pollution Control Plant

For fiscal years 2014-2018, the Five Year capital improvement program includes approximately $15,524,000 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 million 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, 2013 an amount of $120,663,000 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. Bay Area Water Supply and Conservation Agency

The City belongs to the Bay Area Water Supply and Conservation Agency ("BAWSCA"), which represents the interests of 24 cities and water districts, and two private utilities that purchase water wholesale from the San Francisco regional water system. On January 31, 2013, BAWSCA issued bonds in the amount of $335,800,000 to raise the funds necessary to prepay capital commitments owed to the City and County of San Francisco by BAWSCA member agencies thereby realizing a present value savings of approximately $62,300,000 over all member agencies. For the City, this translates into an annual net savings of purchased water cost of approximately $107,000.

Prior to the bond issuance, there were $356,000,000 in capital cost recovery payments that were outstanding and being repaid as a part of San Francisco's wholesale commodity charge. The capital cost recovery payments were being repaid at a fixed interest rate of 5.13% and were part of the Wholesale Revenue Requirement to the Water Supply Agreement negotiated with San Francisco in 2009. The bonds refinanced this debt at an average interest rate of 3.14%.

The BAWSCA issued revenue bonds that are secured by a surcharge on BAWSCA member agencies. San Francisco will collect the surcharge and send the amount to BAWSCA for payment to bond holders. The surcharge will be in place for the term of the bonds which end in 2034. The surcharge is on the San Francisco wholesale water bill and is accounted for by the City as operational costs.

BAWSCA's annual debt service amount is $24,675,000. The City's annual bond surcharge is estimated to be $747,000 based on all member agencies actual wholesale water use in fiscal year ended June 30, 2012. The annual surcharge for each agency will be based on the actual wholesale water purchase percentage from the last full year for which data is available with an annual reconciliation based on the actual water purchased. A true-up adjustment based on the actual fiscal year ending June 30, 2014 water use will be included in the fiscal year ending June 30, 2016 bond surcharge. The current best projection on the City's annual surcharge for the future is $750,000.

4. Retirement Systems – Unfunded Commitments

As of June 30, 2013, PFDRP had unfunded commitments to contribute capital for private market investments in the amount of $123,440,000, and FCERS had unfunded commitments to contribute capital for private market fund investments in the amount of $99,210,000.

5. Federal Financial Assistance Programs

The City participates in a number of federally assisted grant programs, primarily with the U.S. Department of Housing and Urban Development (HUD), the Federal Aviation Administration (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, 2013, 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.

6. Encumbrances

The City uses encumbrances to control expenditure commitments for the year and to enhance cash management. Encumbrances represent commitments related to contracts not yet performed and purchase orders not yet filled (executory contracts; and open purchase orders). Commitments for such expenditure of monies are encumbered to reserve a portion of applicable appropriations. Encumbrances still open at year end are not accounted for as expenditures and liabilities but, rather, as restricted or committed governmental fund balance. As of June 30, 2013, total governmental fund encumbrance balances for the City are as follows (dollars in thousands):

General Fund	$	19,655
Housing Activities		577
Low and Moderate Income Housing Asset		1,122
Integrated Waste Management		5,235
Special Assessment Districts		9,262
Nonmajor governmental funds		42,309
Total governmental funds	$	78,160

7. Pension Lawsuits Related to Measure B

Significant portions of Measure B are currently subject to legal challenges by bargaining units representing current employees and retirees in the Santa Clara County Superior Court. Additionally, various bargaining units representing current employees have filed unfair labor practice charges with the California Public Employment Relations Board related to Measure B. In connection with the litigation related to Measure B, the City entered into a stipulation to delay implementation of the increased pension contributions from current employees until January 1, 2014. As of June 30, 2013, the IRS has not approved the VEP. A complete copy of Measure B is available from the San José City Clerk, 200 East Santa Clara Street, San José, California 95113.

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

1. Cash and Investments Held by SARA

The SARA's cash and investments consist of the following at June 30, 2013:

Cash and investments	$	32,850
Restricted cash and investments		137,757
Total cash and investments	$	170,607

A summary of SARA's cash and investments at June 30, 2013 is as follows (dollars in thousands):

	Credit	Maturity (in days)				Fair
	Rating	Under 30	31 - 180	181 - 365	366 to 3 years	Value
Investments:						
State of California Local						
Agency Investment Fund	Not Rated	$ -	$ -	$ 26,079	$ -	$ 26,079
U.S. Treasury Bills	Exempt	65,426	-	-	-	65,426
U.S. Treasury Notes	Exempt	-	26,792	2,260	6,012	35,064
Money Market Mutual Fund	Aaa	13	93	-	-	106
Commercial Paper	A1/P1/F1	1,339	3,443	-	-	4,782
Subtotal investments		$ 66,778	$ 30,328	$ 28,339	$ 6,012	131,457
Certificates of Deposit						7,206
Bank deposits						31,944
Total cash and investments						$ 170,607

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 recorded certain capital assets originally received from the Agency as property held for resale. The SARA plans on selling these properties upon the DOF approval of a Long-Term Property Management Plan.

The following is a summary of capital assets activity for the year ended June 30, 2013 (dollars in thousands):

	July 1, 2012	Additions	Transfer from City of San José	Transfer from Diridon Authority	June 30, 2013
Capital assets, not being depreciated:					
Land	$ 34,604	$ -	$ 23,061	$ 29,198	$ 86,863
Construction in progress	977	-	-	-	977
Total capital assets, not being depreciated	35,581	-	23,061	29,198	87,840
Capital assets, being depreciated:					
Buildings	88,587	-	61,033	-	149,620
Building and other Improvements	19,399	-	3,813	-	23,212
Equipment	1,145	-	-	-	1,145
Total capital assets, being depreciated	109,131	-	64,846	-	173,977
Less accumulated depreciation:					
Buildings	12,267	1,871	-	-	14,138
Building and other Improvements	2,944	1,794	-	-	4,738
Equipment	1,025	120	-	-	1,145
Total accumulated depreciation	16,236	3,785	-	-	20,021
Total capital assets, being depreciated, net	92,895	(3,785)	64,846	-	153,956
Total capital assets, net	$ 128,476	$ (3,785)	$ 87,907	$ 29,198	$ 241,796

Parcels of the Agency-owned land with an aggregate book value of $19,231,000 were used to secure the Letters of Credit obtained from JPMorgan Chase Bank ("JPMorgan") supporting the Agency's 1996 and 2003 Revenue Variable Bonds. As additional security for the Letters of Credit, the City executed and recorded for the benefit of the JPMorgan a Deed of Trust against the California Theatre. At June 30, 2013, the City has returned the California Theatre with a net book value of $61,846,000 back to the SARA. As security for payments due to the County of Santa Clara under the Settlement Agreement executed in March 2011, the Agency also (i) executed and recorded for the benefit of the County Deeds of Trust subordinate to JPMorgan on those same parcels of Agency-owned land (except for the California Theatre), (ii) assigned to the County one-half (1/2) of the Agency sales proceeds from the sale of the North San Pedro properties under two separate Disposition and Development Agreements with private developers, and (iii) executed and recorded for the benefit of the County a Deed of Trust against the North San Pedro properties, with an aggregate book value of $18,074,000.

In addition, the Convention Center – South Hall, José Theatre, and Arena Lot D are 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, 2013 (dollars in thousands, unless otherwise noted):

Type of Indebtedness	Purpose	Original Issue Amount	Issue Date	Maturity Date	Interest Rate Range	Annual Principal Installments	June 30, 2013 Balance
Senior Tax Allocation Bonds (TAB):							
1993 Merged Refunding	Advance refunding	$ 692,075	12/1/1993	8/1/2015	6.00%	$0-18,195	$ 18,195
1997 Merged	Merged area project	106,000	3/27/1997	8/1/2028	5.38- 5.63%	$10-715	5,490
1999 Merged	Merged area project	240,000	1/6/1999	8/1/2019	4.75%	$0-7,165	12,920
2002 Merged	Merged area project	350,000	1/24/2002	8/1/2015	4.50%	$0- 11,290	13,165
2003 Merged	Merged area project	135,000	12/22/2003	8/1/2033	4.00- 5.00%	$25- 34,100	127,545
2004 A Merged Refunding	Refunding TABs	281,985	5/27/2004	8/1/2019	4.23- 5.25%	$8,775- 31,900	168,575
2005 A/B Merged Refunding	Refunding TABs	220,080	7/26/2005	8/1/2028	4.20- 5.00%	$0- 26,210	177,570
2006 A/B Merged	Merged area project	81,300	11/14/2006	8/1/2035	4.50- 5.65%	$0- 21,000	80,300
2006 C/D Merged Refunding	Refunding TABs	701,185	12/15/2006	8/1/2032	3.75- 5.00%	$0- 74,280	698,360
2007 A-T/B Merged	Merged area project	212,930	11/7/2007	8/1/2036	0- 5.10%	$0- 23,970	203,635
2008 A/B Merged	Merged area project	117,295	11/13/2008	8/1/2035	0- 7.00%	$0- 6,700	104,455
1997 Housing, Series E	Low-moderate income housing	17,045	6/23/1997	8/1/2027	5.75- 5.85%	$365- 3,670	16,705
2003 Housing, Series J/K	Low-moderate income housing	69,000	7/10/2003	8/1/2029	3.50- 5.25%	$240- 3,505	38,270
2005 Housing, Series A/B	Low-moderate income housing	129,720	6/30/2005	8/1/2035	0- 5.46%	$0- 8,300	117,195
2010 Housing, Series A/B	Low-moderate income housing	67,405	4/15/2010	8/1/2035	0- 5.5%	$0- 6,305	60,790
Total Senior Tax Allocation Bonds							1,843,170
Subordinate Tax Allocation Bonds (TAB):							
1996 Merged Area Revenue, Series A/B	Merged area projects	59,000	6/27/1996	7/1/2026	Variable	$2,400- 4,000	44,000
2003 Merged Area Revenue, Series A/B	Merged area projects	60,000	8/27/2003	8/1/2032	Variable	$1,500- 3,900	46,355
2010 Housing, Series C	Low-moderate income housing	93,000	4/29/2010	8/1/2035	Variable	$2,585- 5,210	86,175
Total Subordinate Tax Allocation Bonds							176,530
Other Long-term Debt:							
Pledge Agreement - Revenue Bonds 2001A	4th/ San Fernando parking facility	48,675	4/10/2001	9/1/2026	4.13- 5.25%	$1,815- 3,205	31,695
Reimbursement Agreement - Refunding Revenue Bonds 2001F	Convention Center project	190,730	7/1/2001	9/1/2022	4.45- 5.00%	$9,570- 14,730	119,870
CSCDA 2005 ERAF Loan	Fund the State's ERAF Program	19,085	4/27/2005	8/1/2015	4.77- 5.01%	$2,240- 2,355	4,595
CSCDA 2006 ERAF Loan	Fund the State's ERAF Program	14,920	5/3/2006	8/1/2016	5.58- 5.67%	$1,705- 1,905	5,410
HUD Section 108 Loans	Merged area projects	5,200	2/11/1997	8/1/2016	Variable	$375- 465	1,682
HUD Section 108 Loans (CIM)	Merged area projects	13,000	2/8/2006	8/1/2025	Variable	$630- 1,135	11,230
HUD Section 108 Loans (Story & King)	Merged area projects	18,000	6/30/2006	8/1/2027	Variable	$825- 1,570	15,095
City of San José (SERAF) Loan	Fund the State's SERAF Paymen	64,816	2010-2011	6/30/2015	Variable	$12,873- 52,499	65,555
City of San José - Commercial paper program	Fund the housing projects	14,227	2010-2012	N/A	0.27%	$14,227	14,227
Other Long-term Obligation - County Pass Through	Pass-through payment	23,562	6/30/2011	6/30/2017	Variable	$4,712	23,562
2012-2013 Reimbursement Advance	Reimbursement	17,175	N/A	6/30/2014	N/A	$17,175	17,175
Total Other Long-Term Debt							310,096
Total Long-Term Debt							$ 2,329,796

Senior 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.

As of June 30, 2013, assuming no growth in assessed value throughout the term of each constituent project area and excluding debt service override levies, the total accumulated 80% redevelopment property tax revenue through the period of the bonds would be approximately $2,760,738,000 (Urban Analytics, April 2013). These revenues have been pledged until the year 2036, the final maturity date of the bonds. The total principal and interest remaining on these Tax Allocation Bonds as of June 30, 2013 is approximately $2,499,405,000. The 80% redevelopment property tax revenue recognized during the year ended June 30, 2013 in the amount of $134,964,000 was transferred to the fiscal agent to cover the annual debt service. The total debt service payments on the Senior TABs amounted to $131,685,000 for the year ended June 30, 2013.

Variable-Rate Demand Bonds (Subordinate)

1996 Merged Area Revenue Bonds – In June 1996, the 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 weekly interest rate for the daily and weekly rates during most of the fiscal year up until June 3, 2013, was 0.17% for the 1996 Series A and 0.18% for the 1996 Series B. The total interest on 1996 Bonds amounted to $40,000 for the fiscal year ended June 30, 2013. In June 2013, the interest rates on the variable rate demand bonds were converted from weekly rate to a flexible rate in callable commercial paper mode.

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 SARA.

The 2003 Merged Area Revenue Bonds had 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 during most of the fiscal year up until June 3, 2013 were 0.30% for the 2003 Series A and 0.17% for the 2003 Series B. The total interest on 2003 Merged Area Revenue Bonds amounted to $43,000 for the fiscal year ended June 30, 2013. In June 2013, interest rates on the variable rate demand bonds were converted from a weekly rate to a flexible rate in callable commercial paper mode.

These bonds were issued 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 SARA 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, 2013 are as follows (dollars in thousands):

		Credit Facility Description	
		Provider	Expiration Date
Revenue Bonds:			
Series 1996A (Merged Area)	$ 22,000	JPMorgan Chase Bank, N.A.	6/1/2014
Series 1996B (Merged Area)	22,000	JPMorgan Chase Bank, N.A.	6/1/2014
Series 2003A (Taxable) (Merged Area)	31,355	JPMorgan Chase Bank, N.A.	6/1/2014
Series 2003B (Merged Area)	15,000	JPMorgan Chase Bank, N.A.	6/1/2014
Total variable-rate revenue bonds	$ 90,355		

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.

In connection with the issuance of the 1996 and 2003 Bonds, on August 7, 2012 JPMorgan delivered amendments to the Letters of Credit directly to the U.S. Bank National Association as Trustee for both the 1996 Bonds and 2003 Bonds. On June 3, 2013, the JPMorgan extended the Letter of Credit through June 1, 2014. As a condition to extending the Letters of Credit, the SARA agreed to the following JPMorgan terms: (1) the annual fee for the Letters of Credit decreased from 3.00% to 2.50% and (2) the interest rate on the 1996 Bonds and 2003 Bonds be converted from a Weekly Rate to a Flexible Rate structured as callable commercial paper mode.

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 of 2.8% for each credit based on the terms of the applicable reimbursement agreement and the outstanding principal amount of the bonds supported by the credit facility. In addition, the SARA has a required deposit with JPMorgan, a liquidity reserve in the amount of $5,000,000 as an added source of security for the bank. Parcels of the former Agency owned land and the City's California Theatre were also used to secure the LOCs.

Housing Set-Aside Tax Allocation Bonds (comprised of Series 1997E, Series 2003J/K, Series 2005A/B, Series 2010A-1, A-2, and 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 asset fund.

As of June 30, 2013, assuming no growth in assessed value throughout the term of each constituent project area, the total accumulated 20% tax increment revenue through the period of the bonds would be approximately $717,732,000 (Urban Analytics, April 2013). These revenues have been pledged until the year 2035, the final maturity date of the bonds. The total principal and interest remaining on these Housing TABs as of June 30, 2013 is approximately $493,158,000. The 20% redevelopment property tax revenue recognized during the year ended June 30, 2013 was $33,741,000. The total debt service payments on the Housing TABs amounted to $24,652,000 for the subject reporting period.

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 did not require a credit facility to support the debt service payments until the bank's Mandatory Purchase Date of April 29, 2013, or such other date agreed to in writing by the SARA and Wells Fargo Bank. On August 15, 2012, the SARA and Wells Fargo Bank agreed to forbear from exercising its rights and remedies under the Continuing Covenant Agreement and Fiscal Agent Agreement, due to a Moody's downgrade, through November 15, 2012, and the Forbearance Agreement was subsequently extended three more times to coincide with interim extensions of the Mandatory Purchase Date (see Note IV.D.3).

As of June 26, 2013, the Series 2010C bonds bore an interest rate at 1-month LIBOR, two London Business Days before the 1st day of each month plus 280 basis points, with a final maturity date of August 1, 2035. The average weekly interest rate for the Series 2010C as of June 26, 2013 was 3.05%. Under the extended agreement, the principal amortization schedule for the 2010C Bonds would not change. On September 7, 2013, the index rate changed and the interest became a fixed rate based on a three-year LIBOR plus an applicable spread of 260 basis points.

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

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

As of June 30, 2013, the outstanding loans due to HUD totaled to $28,007,000. The notes payable to HUD mature annually through August 2025 and bear interest at 20 basis points above the LIBOR index. The average rate for June 2013 was 0.47%. The HUD loans are secured by several City and SARA owned capital assets (Convention Center - South Hall, José Theatre, and Arena Lot D) with an aggregate gross value of $31,595,000 at June 30, 2013, and CDBG grants that were awarded or will be awarded to the City.

2012-2013 Reimbursement Advance - In the event 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: agreements associated with the City of San José Financing Authority Lease Revenue Bonds, Series 2001F (Convention Center) and City of San José Financing Authority Revenue Bonds, Series 2001A (4th and San Fernando Streets Parking Facility Project); Education Revenue Augmentation Fund ("ERAF") payments; and the SARA annual administrative budget and City support service expenses. As discussed in Note III.G.3, the City has advanced $17,175,000 at June 30, 2013 to the SARA for its enforceable obligations and other administrative expenses.

A summary of the changes in long-term debt during as of June 30, 2013 follows (in thousands):

	July 1, 2012	Additions	Reductions	June 30, 2013	Amount Due One Year
Senior Tax allocation bonds:					
1993 Merged Refunding	$ 18,195	$ -	$ -	$ 18,195	$ -
1997 Merged	5,810	-	(320)	5,490	335
1999 Merged	12,920	-	-	12,920	-
2002 Merged	13,165	-	-	13,165	-
2003 Merged	127,545	-	-	127,545	-
2004 A Merged Refunding	193,215	-	(24,640)	168,575	25,935
2005 A/B Merged Refunding	198,115	-	(20,545)	177,570	21,560
2006 A/B Merged	80,300	-	-	80,300	-
2006 C/D Merged Refunding	698,990	-	(630)	698,360	655
2007 A-T/B Merged	205,685	-	(2,050)	203,635	2,160
2008 A/B Merged	107,860	-	(3,405)	104,455	3,565
1997 Housing, Series E	17,045	-	(340)	16,705	365
2003 Housing, Series J/K	40,815	-	(2,545)	38,270	2,655
2005 Housing, Series A/B	120,300	-	(3,105)	117,195	3,235
2010 Housing, Series A/B	62,220	-	(1,430)	60,790	1,470
Subtotal senior tax allocation bonds	1,902,180	-	(59,010)	1,843,170	61,935
Subordinate tax allocation bonds:					
1996 Merged Area Revenue, Series A/B	46,000	-	(2,000)	44,000	44,000
2003 Merged Area Revenue, Series A/B	47,655	-	(1,300)	46,355	46,355
2010 Housing, Series C	88,600	-	(2,425)	86,175	2,585
Subtotal subordinate tax allocation bonds	182,255	-	(5,725)	176,530	92,940
Other long-term debt:					
Pledge Agreement - 4th & San Fernando					
parking revenue bonds	33,435	-	(1,740)	31,695	1,815
Reimbursement Agreement - 2001 Convention				-	
Center refunding revenue bonds	129,020	-	(9,150)	119,870	9,570
CSCDA ERAF Loans	13,760	-	(3,755)	10,005	3,945
HUD Section 108 Loans, variable	29,745	-	(1,738)	28,007	1,830
City of San José - SERAF Loans (principal)	64,816	-	-	64,816	-
City of San José - SERAF Loans (interest)	555	184	-	739	269
City of San José - Commercial paper program (principal)	-	14,091	-	14,091	14,091
City of San José - Commercial paper program (interest)	-	136	-	136	136
County Pass-through Obligation	23,562	-	-	23,562	4,712
2012-2013 Reimbursement Advance	-	17,175	-	17,175	17,175
Subtotal other long-term debt	294,893	31,586	(16,383)	310,096	53,543
Subtotal long-term debt before unamoritized	2,379,328	31,586	(81,118)	2,329,796	208,418
Issuance premium (discount), net	37,903	-	(3,928)	33,975	3,927
Total long-term debt payable	2,417,231	31,586	(85,046)	2,363,771	212,345
Environmental remediation obligation	337	-	-	337	97
Total Long-term Obligations	$ 2,417,568	$ 31,586	$ (85,046)	$ 2,364,108	$ 212,442

The annual requirements to amortize outstanding tax allocation bonds and other long-term debt outstanding at June 30, 2013, including mandatory sinking fund payments, are as follows (in thousands):

Year Ending June 30	Merged Tax Allocation Bonds Principal	Merged Tax Allocation Bonds Interest	Housing Tax Allocation Bonds Principal	Housing Tax Allocation Bonds Interest	Merged Area Revenue Bonds* Principal	Merged Area Revenue Bonds* Interest	Pledge and Other Agreements Principal	Pledge and Other Agreements Interest
2014	$ 54,210	$ 77,377	$ 10,310	$ 14,479	$ 3,700	$ 171	$ 11,385	$ 7,302
2015	56,975	74,516	10,795	14,043	3,790	164	11,935	6,732
2016	59,880	71,516	11,330	13,569	4,075	156	12,510	6,133
2017	62,920	68,471	11,890	13,066	4,365	147	13,125	5,502
2018	65,905	65,374	12,510	12,527	4,650	138	13,765	4,840
2019-23	375,885	273,840	73,075	53,370	26,555	546	79,680	12,939
2024-28	430,975	172,165	85,050	35,180	25,875	276	9,165	932
2029-33	360,020	75,749	74,125	15,738	17,345	84	-	-
2034-37	143,440	10,187	30,050	2,051	-	-	-	-
Total	$ 1,610,210	$889,195	$ 319,135	$ 174,023	$ 90,355	$ 1,682	$ 151,565	$ 44,380

Year Ending June 30	Obligations with 3rd Parties Principal	Obligations with 3rd Parties Interest	Obligations with the City Principal	Obligations with the City Interest	Total Principal	Total Interest
2014	$ 10,487	$ 718	$ 31,266	$ 406	$ 121,358	$ 100,453
2015	10,812	498	52,000	237	146,307	96,190
2016	8,672	261	12,816	233	109,283	91,868
2017	6,891	135	-	-	99,191	87,321
2018	6,512	155	-	-	103,342	83,034
2019-23	10,500	410	-	-	565,695	341,105
2024-28	7,700	57	-	-	558,765	208,610
2029-33	-	-	-	-	451,490	91,571
2034-37	-	-	-	-	173,490	12,238
Total	$ 61,574	$ 2,234	$ 96,082	$ 876	$ 2,328,921	$ 1,112,390

* Assumes the merged area revenue bonds would not be payable on demand upon expiration of the LOC on June 1, 2014. The scheduled redemption of these bonds is incorporated in the annual requirements to maturity schedules.

5. Commitments and Contingencies Related to SARA

Tax Sharing Agreement with the County of Santa Clara

Prior to 1994, the Redevelopment Law authorized redevelopment agencies to enter into tax sharing agreements with school districts and other taxing agencies to alleviate any financial burden or detriments to such taxing agencies caused by a redevelopment project. In 1983, the Agency and County entered into a tax sharing agreement under which the Agency would pay a portion of tax increment revenue generated in the Merged Area (the “County Pass-Through Payment”). On December 16, 1993, the Agency, the County and the City entered into a Settlement Agreement which continued the County Pass-Through Payment.

On May 22, 2001, the County, the City and the Agency approved an Amended and Restated Agreement (the “Amended Agreement”). In addition to the continued Pass-Through Payment, the Amended Agreement delegated to the County the authority to undertake redevelopment projects in or of benefit to the Merged Area, and requires SARA to transfer funds to the County to pay for such projects (the “Delegated Payment”). Until June 30, 2004, the Delegated Payment was equal to the County Pass-Through Payment. After January 1, 2004, 20% of the proceeds of any debt secured by the SARA’s Tax Increment Revenues (excluding bonds payable from Housing Set-Aside and refunding bonds) must be paid to the County as the Delegated Payment.

Subsequently, the County, the Agency and the City, along with the Diridon Authority, entered into a Settlement Agreement dated March 16, 2011 (the "Settlement Agreement"). The Settlement Agreement related to a lawsuit filed by the County in which the County alleged, among other things, that the Agency had failed to make timely payment of the County Pass-Through Payment for fiscal years 2008-09, 2009-10 and 2010-11 in an aggregate amount, as of June 30, 2011, of $58,270,000.

Pursuant to the Settlement Agreement, the Agency agreed, among other things, to pay the County $21,500,000 of tax-exempt bond proceeds by March 30, 2011, pay an additional $5,000,000 of unrestricted funds and transferred title to certain property to the County, resulting in a remaining amount of $23,780,000 owed to the County, which the Agency agreed to make in five installments no later than June 30 of 2014, 2015, 2016, 2017, and 2018.

The County and the Agency also agreed that the Agency would not issue any bonds or other indebtedness secured by tax increment until the County, the City and the Agency conclude negotiations regarding possible amendments to the Amended Agreement. The Amended Agreement provides that the payments due to the County from the SARA are subordinate to all of the SARA's debt. The County and SARA are involved in litigation in Sacramento County Superior Court related to the subordination of the payments due to the County under the Amended Agreement.

During the year ended June 30, 2013, the SARA did not have sufficient redevelopment property tax revenues to make the fiscal year 2012-2013 pass-through payment. Accordingly, the amount of pass-through payments due to the County increased by $16,073,000 in fiscal year 2012-2013 and the total amount due to the County at June 30, 2013 is $31,792,000.

Litigation Against County Auditor-Controller

The City on its own behalf and as the SARA has filed a lawsuit entitled *City of San José as Successor Agency to the San José Redevelopment Agency v. Vinod Sharma, County of Santa Clara, et al.* in the Sacramento County Superior Court. The suit seeks to recover special levies include a contribution to the County's employees' retirement program (the "PERS Levy") and a levy for the benefit of the Santa Clara Valley Water District (the "Water District Levy") being withheld by the County from property taxes that were previously considered to be "tax increment" paid directly to the Agency and to determine the priority of the County's pass-through payments under the Amended Agreement. The Sacramento Superior Court agreed with the City and SARA that the portion of the PERS levy attributable to former Redevelopment tax increment should not be withheld from SARA; however, the Court agreed with the County that the pass-through payments are not subordinate to other Agency debt pursuant to the Redevelopment Dissolution Law. The Court did not rule on the Water District Levy. Both the City and County have appealed the Sacramento Superior Court decision. The County has continued to withhold the revenues associated with the special levies pending resolution of the appeal. At June 30, 2013, the County has withheld approximately $11,557,000 from the SARA.

D. Subsequent Events

1. Tax and Revenue Anticipation Note

On July 1, 2013, the City entered into the Note Purchase Agreement with Bank of America, N.A. (the "Bank") under which the Bank agreed to purchase the City's short-term note in the full principal amount of $100,000,000 (the "2013 Note") in accordance with the terms of the Note Purchase Agreement. The transaction was needed for cash flow borrowing purposes to facilitate the prefunding of employer retirement contributions. Pursuant to the Note Purchase Agreement, the City issued and the Bank purchased the 2013 Note bearing interest at a variable rate based on a

LIBOR rate, plus a margin of 0.35%. Under the Note Purchase Agreement, at the City's option on any interest payment date, the City may prepay the 2013 Note in whole or in part, with partial prepayment of principal not less than $5,000,000 and in $1,000,000 increments in excess thereof. Security for repayment of the 2013 Note is a pledge of the City's 2013-2014 secured property tax revenues (excluding property taxes levied for general obligation bonds) and all other legally available General Fund revenues of the City, if required. The 2013 Note has a stated maturity of June 30, 2014.

2. New Benefit Tiers

On June 18, 2013, the City Council adopted ordinance No. 29266 creating a second tier of benefits applicable to PFDRP police members hired, rehired, or reinstated on or after August 4, 2013. 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 for the first 20 years of service and 4% per year from 21 to 30 years of service to 2.0% per year; an increase from 55 years to 60 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 90%; a single life annuity compared to a 50% joint survivorship; final average compensation based on the highest consecutive three years of compensation compared to the highest one year; and excluding premium pay from pensionable compensation.

On August 27, 2013, the City Council adopted ordinance No. 29283 eliminating retiree medical and dental benefits for FCERS Tier 2 members hired on or after September 27, 2013. The ordinance also provides that the City shall bear and pay an amount equal to the additional costs incurred by FCERS for that portion of the unfunded liability as determined by the actuary of FCERS that the City and the new members hired on or after September 27, 2013, would have otherwise paid as contributions had those members been eligible for retiree healthcare. The additional payment by the City shall be for a period of time and under the terms and conditions set forth by the City Council. At their September 19, 2013 meeting, the Board of Administration for FCERS approved the additional contribution rate to be paid by the City in compliance with the ordinance. The rate was based on the Tier 2 contribution rates from the June 30, 2012 actuarial valuation approved by the Board of Administration for FCERS.

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

Finding of Completion

On August 30, 2013, the DOF granted a Finding of Completion for the SARA. Pursuant to Health and Safety Code (HSC) section 34179.7, the DOF has verified that the SARA does not owe any amounts to the taxing entities as determined under HSC section 34179.6, subdivisions (d) or (e) and HSC section 34183.5. With a Finding of Completion, the SARA may proceed with the following:

- Place loan agreements between the former Agency and the City on the ROPS, as an enforceable obligation, provided the oversight board makes a finding that the loan was for legitimate redevelopment purposes per HSC.

- Utilize proceeds derived from bonds issued prior to January 1, 2011 in a manner consistent with the original bond covenants.

In addition, the receipt of the Finding of Completion allows SARA to submit a Long-Range Property Management Plan ("LRPMP") to the Oversight Board and the DOF for approval. The LRPMP addresses the disposition and use of real properties held by SARA.

HUD Section 108 Loans

As described on Note IV.C.3, the SARA has three loans with HUD. On August 9, 2013, the DOF reviewed the Oversight Board's approval of the Reimbursement Advance described in Note IV.C.3. and determined that the reimbursement to the City of loan repayments made by City on behalf of SARA for fiscal year 2012-13 in the amount of $1,900,000 was not an enforceable obligation. On November 1, 2013, the DOF confirmed this determination.

Transfer of Governmental Purpose Properties to the City

On October 10, 2013, the SARA Oversight Board approved the return of government purpose properties with a book value of $98,012,000 at June 30, 2013 to the City. This action is currently under review by the DOF.

Housing Set-Aside Tax Allocation Bonds, Series 2010C

On September 12, 2013, SARA and Wells Fargo Bank entered into an Amended and Restated Continuing Covenant Agreement to among other things extend the Mandatory Purchase Date on the Housing Set-Aside Tax Allocation Bonds, Series 2010C from September 30, 2013 to April 29, 2016.

4. City of San José Financing Authority

In September 2013, the providers of the credit facilities extended the expiration dates of the credit facilities that support the Financing Authority's variable-rate bonds as follows (dollars in thousands):

	Credit Facility Description			
		Capacity	Provider	Expiration Date
City of San José Financing Authority:				
Lease Revenue Bonds:				
Series 2008C (Hayes Mansion)	$	10,915	U.S. Bank	2/18/2014
Series 2008D (Taxable) (Hayes Mansion)		38,920	U.S. Bank	2/18/2014
Series 2008E-1 (Taxable) (Ice Centre)		11,240	Bank of America, N.A.	2/20/2014
Series 2008E-2 (Taxable) (Ice Centre)		11,230	U.S. Bank	2/18/2014

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Required Supplementary Information

City of San José
General Fund
Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
For the Year Ended June 30, 2013
($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:							
Property	$ 202,925	205,830	(814)	205,016	-	205,016	
Sales	152,680	161,990	1,761	163,751	-	163,751	
Utility	112,380	111,673	77	111,750	-	111,750	
State of California in-lieu	-	525	(1)	524	-	524	
Franchise	43,625	43,585	156	43,741	-	43,741	
Business Tax	40,550	43,350	1,790	45,140	-	45,140	
Other	8,715	10,100	4	10,104	-	10,104	
Licenses, permits and fines	54,433	59,288	1,849	61,137	-	61,137	
Intergovernmental	19,951	31,133	(6,426)	24,707	-	24,707	
Charges for current services	32,921	36,659	3,109	39,768	-	39,768	
Investment income	3,719	4,551	(501)	4,050	(1,243)	2,807	(1)
Other revenues	34,892	45,208	(653)	44,555	-	44,555	
Total revenues	706,791	753,892	351	754,243	(1,243)	753,000	
EXPENDITURES							
Current:							
General government	129,206	109,163	(14,022)	95,141	(10,348)	84,793	(2)
Public safety	466,201	449,686	(9,696)	439,990	(2,737)	437,253	(2)
Capital maintenance	100,634	84,742	(19,457)	65,285	(3,692)	61,593	(2)
Community services	105,117	105,666	(5,289)	100,377	(1,918)	98,459	(2)
Sanitation	1,008	1,429	(385)	1,044	(121)	923	(2)
Capital outlay	-	5,356	-	5,356	-	5,356	
Debt service:							
Principal	1,125	6,097	-	6,097	-	6,097	
Interest	526	741	-	741	36	777	(2)
Total expenditures	803,817	762,880	(48,849)	714,031	(18,780)	695,251	
Excess (deficiency) of revenues over expenditures	(97,026)	(8,988)	49,200	40,212	17,537	57,749	
OTHER FINANCING SOURCES (USES)							
Loan proceeds	100,000	-	-	-	-	-	
Proceeds for sale of capital assets	1,400	6,373	(175)	6,198	-	6,198	
Transfers in	10,277	12,216	(376)	11,840	-	11,840	
Transfers out	(40,845)	(31,938)	17	(31,921)	-	(31,921)	
Total other financing sources (uses)	70,832	(13,349)	(534)	(13,883)	-	(13,883)	
Net change in fund balance	(26,194)	(22,337)	48,666	26,329	17,537	43,866	
Fund balance - beginning	171,680	171,680	-	171,680	11,348	183,028	
Beginning encumbrance	-	-	-	20,424	(20,424)	-	
Fund balance - ending	$ 145,486	149,343	48,666	218,433	8,461	226,894	

Explanation of differences:
(1) Gain or loss in fair value of investments are not formally budgeted transactions.
(2) Encumbrances of funds for which formal budget are prepared.

See accompanying notes to the required supplementary information.

Housing Activities
Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
For the Year Ended June 30, 2013
($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	$ 25,802	22,782	(10,027)	12,755	-	12,755	
Investment income	1,031	1,031	125	1,156	(99)	1,057	(1)
Other revenues	10,860	21,096	2,574	23,670	(1,369)	22,301	(3)
Total revenues	37,693	44,909	(7,328)	37,581	(1,468)	36,113	
EXPENDITURES							
Current:							
Community services	38,716	31,703	(8,983)	22,720	(9,773)	12,947	(2), (3)
Total expenditures	38,716	31,703	(8,983)	22,720	(9,773)	12,947	
Excess (deficiency) of revenues over expenditures	(1,023)	13,206	1,655	14,861	8,305	23,166	
OTHER FINANCING SOURCES (USES)							
Transfers out	(34)	(34)	-	(34)	-	(34)	
Total other financing sources (uses)	(34)	(34)	-	(34)	-	(34)	
Net change in fund balance	(1,057)	13,172	1,655	14,827	8,305	23,132	
Fund balance - beginning	(15,155)	(15,155)	-	(15,155)	59,886	44,731	
Beginning encumbrance	-	-	-	1,484	(1,484)	-	
Fund balance - ending	$ (16,212)	(1,983)	1,655	1,156	66,707	67,863	

Explanation of differences:

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

See accompanying notes to the required supplementary information.

Low and Moderate Income Housing Asset Fund
Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
For the Year Ended June 30, 2013
($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							
Investment income	$ 6,510	14,210	(4,191)	10,019	(384)	9,635	(1)
Other revenues	42	592	9,843	10,435	(9,786)	649	(3)
Total revenues	6,552	14,802	5,652	20,454	(10,170)	10,284	
EXPENDITURES							
Current:							
Community services	26,336	26,918	(3,548)	23,370	(11,506)	11,864	(2), (3)
Excess (deficiency) of revenues over expenditures	(19,784)	(12,116)	9,200	(2,916)	1,336	(1,580)	
OTHER FINANCING SOURCES (USES)							
Transfers out	(687)	(687)	-	(687)	-	(687)	
Total other financing sources (uses)	(687)	(687)	-	(687)	-	(687)	
Extraordinary loss from dissolution of Redevelopment Agency	-	-	(11,585)	(11,585)	(38,554)	(50,139)	(4)
Net change in fund balance	(20,471)	(12,803)	(2,385)	(15,188)	(37,218)	(52,406)	
Fund balance - beginning	24,740	24,740	-	24,740	330,403	355,143	
Beginning encumbrance	-	-	-	10,705	(10,705)	-	
Fund balance - ending	$ 4,269	11,937	(2,385)	20,257	282,480	302,737	

Explanation of differences:
(1) Gain or loss in fair value of investments are not formally budgeted transactions.
(2) Encumbrances of funds for which formal budget are prepared.
(3) Expenditures and repayments that increase and decrease certain loan receivables for which formal budgets are prepared.
(4) Extraordinary items and non-cash transfers are not formally budgeted transactions.

See accompanying notes to the required supplementary information.

City of San José
Integrated Waste Management
Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
For the Year Ended June 30, 2013
($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	$ 456	456	(150)	306	-	306
Charges for current services	130,277	124,446	(2,282)	122,164	-	122,164
Investment income	78	78	(14)	64	(174)	(110) (1)
Total revenues	130,811	124,980	(2,446)	122,534	(174)	122,360
EXPENDITURES						
Current:						
Sanitation	127,088	128,923	(4,640)	124,283	14,375	138,658 (2)
Total expenditures	127,088	128,923	(4,640)	124,283	14,375	138,658
Excess (deficiency) of revenues over (under) expenditures	3,723	(3,943)	2,194	(1,749)	(14,549)	(16,298)
OTHER FINANCING USES						
Transfers out	(1,468)	(2,086)	-	(2,086)	(1,624)	(2,086)
Net change in fund balance	2,255	(6,029)	2,194	(3,835)	(16,173)	(18,384)
Fund balance - beginning	4,282	4,282	-	4,282	27,038	31,320
Beginning encumbrances	-	-	-	7,138	(7,138)	-
Fund balance - ending	$ 6,537	(1,747)	2,194	7,585	3,727	12,936

Explanation of differences:
(1) Gain or loss in fair value of investments are not formally budgeted transactions.
(2) Encumbrances of funds for which formal budget are prepared.

See accompanying notes to the required supplementary information.

City of San José
Required Supplementary Information (Unaudited)
June 30, 2013

Schedules 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 AAL	Funded Ratio		Annual Covered Payroll (3)	Unfunded AAL as a Percentage of Covered Payroll
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%
6/30/12		2,703,539		3,397,792		694,253	80%		187,959	369%

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
6/30/10	$	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%
6/30/12		1,762,973		2,841,000		1,078,027	62%		225,859	477%

(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.

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
6/30/10	$	58,586	$	946,308	$	887,722	6%	$	222,699	399%
6/30/11		60,709		1,003,795		943,087	6%		190,726	494%
6/30/12		66,385		997,321		930,936	7%		187,959	495%

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
6/30/10	$	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%
6/30/12		137,798		1,096,620		958,822	13%		225,859	425%

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 schedules, but is an expenditure on a GAAP basis.
- Certain accounts such as the change in fair value of investments included in the City's GAAP basis amounts, for which no formal budgets are prepared, are excluded from the budgetary basis financial schedules.

- The Community Facility Revenue non-major special revenue fund has been blended to include the financial operations of the Dolce Hayes Mansion. Formal budgets are not prepared for this financial activity and is excluded from the budgetary basis financial schedules.

- Certain line of credit transactions are recognized as expenditures in the budgetary basis financial schedules but are recorded as an asset in the GAAP basis financial statements. When the outside agency draws down on the line of credit, the City records an asset, advances to other agencies, in the GAAP basis financial statements and an expenditure on the budgetary basis financial schedules. When the outside agency pays down the line of credit, the City records a reduction to its assets in the GAAP basis financial statements and revenues on the budgetary basis financial schedules.

- Certain grant revenues received in advance are recognized on the budgetary basis financial schedules, but are deferred and not recognized as revenue on the GAAP basis financial statements. This process normally creates a variance in recognized revenue from the prior year to the current year.

- Certain New Market Tax Credit Financing transactions are recognized as expenditures in the GAAP basis financial statements and not recognized as expenditures in the budgetary basis financial schedules. 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 Agency are included in the City’s GAAP basis financial statements. However, formal budgets are not prepared for non-cash transactions, and as such are excluded from the budgetary basis financial schedules.

III. Budget Revisions

On September 10, 2013, the City Council approved certain fiscal year 2013 budget revisions that increased appropriations for various expenditure categories. The budget amounts presented in the accompanying schedules of revenues, expenditures, and changes in fund balances - budget and actual reflect such budget revisions.

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Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

City Council
City of San José, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, 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 (City) as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated November 12, 2013, 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 6, 2014. Our report contains emphasis of matters paragraphs discussing the City's adoption of the provisions of Governmental Accounting Standards Board (GASB) Statements No. 63 and 65 and discussing the City's defined benefit pension plans' and postemployment healthcare plans' unfunded actuarially accrued liabilities.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify deficiencies in internal controls, described in the accompanying Federal Awards Schedule of Findings and Questioned Costs as items 2013-001 and 2013-002, that we consider 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.*

City's Response to Findings
The City's response to the findings identified in our audit are described in the accompanying Federal Awards Schedule of Findings and Questioned Costs. The City's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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

Macias Gini & O'Connell LLP

Walnut Creek, California
November 12, 2013

MGO Certified Public Accountants.

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Seattle

Independent Auditor's Report on Compliance For Each Major Federal Program and Report on Internal Control Over Compliance

City Council
City of San José, California

Report on Compliance For Each Major Federal Program

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, 2013. 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.

Management's Responsibility
Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility
Our responsibility is to express an opinion on compliance for each of the City's major federal programs based on our audit of the types of compliance requirements referred to above. 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 on compliance for each major federal program. However, our audit does not provide a legal determination of the City's compliance with those requirements.

Basis for Qualified Opinion on the Highway Planning and Construction Cluster (CFDA Nos. 20.205 and 20.219)
As described in the accompanying Federal Awards Schedule of Findings and Questioned Costs, the City did not comply with requirements regarding CFDA Nos. 20.205 and 20.219 Highway Planning and Construction Cluster as described in finding number 2013-003 for the Davis-Bacon Act. Compliance with such requirements is necessary, in our opinion, for City to comply with the requirements applicable to that program.

Qualified Opinion on Highway Planning and Construction Cluster (CFDA Nos. 20.205 and 20.219)
In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, the City complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the Highway Planning and Construction Cluster (CFDA Nos. 20.205 and 20.219) for the year ended June 30, 2013.

Unmodified Opinion on Each of the Other Major Federal Programs
In our opinion, the City complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its other major federal programs identified in the summary of auditor's results section of the accompanying Federal Awards Schedule of Findings and Questioned Costs for the year ended June 30, 2013.

The City's response to the noncompliance finding identified in our audit is described in the accompanying Federal Awards Schedule of Findings and Questioned Costs. The City's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of the City is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit, we considered the City's internal control over compliance with the types of requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing an opinion on compliance for each major federal program 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 material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a deficiency in internal control over compliance that we consider to be a material weakness.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program 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 deficiency in internal control over compliance described in the accompanying Federal Awards Schedule of Findings and Questioned Costs as finding number 2013-003 to be a material weakness.

The City's response to the internal control over compliance finding identified in our audit is described in the accompanying Federal Awards Schedule of Findings and Questioned Costs. The City's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Macias Gini & O'Connell LLP

Walnut Creek, California
February 6, 2014

CITY OF SAN JOSE, CALIFORNIA
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2013

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	$ 81,490	$ -
Economic Adjustment Assistance	11.307	Prior Year Ending Loan Balance	-	385,500	-
Total U.S. Department of Commerce			345,000	466,990	-
U.S. Department of Housing and Urban Development					
Direct programs:					
CDBG - Entitlement Grants Cluster:					
Community Development Block Grants/Entitlement Grants	14.218	B11-12 MC-06-0021	16,991,318	9,751,837	-
Housing and Economic Recovery Act 2008 - Neighborhood Stabilization Program I	14.218	B08-MN-06-0008	8,044,421	98,199	-
ARRA - Community Development Block Grant ARRA Entitlement Grants (CDBG-R)	14.253	B09-MY-06-0021	2,700,463	143,668	-
Community Development Block Grants/Entitlement Grants	14.218	Prior Year Ending Loan Balance	-	7,039,465	-
Subtotal CDBG - Entitlement Grants Cluster			27,736,202	17,033,169	-
Emergency Solutions Grant Program	14.231	S10 MC-060021	556,404	3,854	-
Emergency Solutions Grant Program	14.231	E12MC060021	1,038,163	841,229	-
Subtotal Emergency Solutions Grant Program			1,594,567	845,083	-
Home Investment Partnerships Program	14.239	MC09-10 MC06215	11,600,058	4,097,573	-
Home Investment Partnerships Program	14.239	Prior Year Ending Loan Balance	-	53,032,061	-
Subtotal Home Investment Partnerships Program			11,600,058	57,129,634	-
Housing Opportunities for Persons with AIDS	14.241	CA-H0-11-F0-04	861,520	45,046	-
Housing Opportunities for Persons with AIDS	14.241	CA-H0-12-F0-04	878,197	825,131	-
Housing Opportunities for Persons with AIDS	14.241	CA-H10-0004	1,262,800	379,224	-
Subtotal Housing Opportunities for Persons with AIDS			3,002,517	1,249,401	-
ARRA - Homelessness Prevention and Rapid Re-Housing Program	14.257	S-09-MY-06-0021	4,128,763	389,778	-
Pass-through County of Santa Clara:					
ARRA - Neighborhood Stabilization Program II	14.256	B-09-CN-CA-0054	29,268,331	7,808,188	-
Total U.S. Department of Housing and Urban Development			77,330,438	84,455,253	-
U.S. Department of Interior					
Direct program:					
ARRA - Title XVI Water Reclamation and Reuse Program	15.504	R10AC20R43	6,335,000	53,394	67,887
Title XVI Water Reclamation and Reuse Program	15.504	R11AC20130	1,200,000	299,818	299,818
Subtotal ARRA - Water Reclamation and Reuse Program			7,535,000	353,212	367,705
Total U.S. Department of Interior			7,535,000	353,212	367,705

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, 2013

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:					
Community-Based Violence Prevention Program	16.123	2012-MU-FX-0011	499,712	106,568	-
Part E - Developing, Testing and Demonstrating Promising New Programs	16.541	2012-NY-FX-0002	125,000	48,450	-
Missing Children's Assistance	16.543	2011-MC-CX-K003	753,716	267,319	-
Missing Children's Assistance	16.543	2011-MC-CX-K033	292,000	110,928	-
Subtotal Missing Children's Assistance			1,045,716	378,247	-
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	2011-VT-BX-K006	500,000	295,013	-
Bulletproof Vest Partnership Program	16.607	2010 1121-0235	89,291	18,620	-
Public Safety Partnership and Community Policing Grants	16.710	2009CSWX0023	447,773	15,322	-
Public Safety Partnership and Community Policing Grants	16.710	2010ULWX0028	7,187,984	1,690,425	-
Public Safety Partnership and Community Policing Grants	16.710	2011ULWX0007	1,703,644	370,605	-
Public Safety Partnership and Community Policing Grants	16.710	2009CKWX0131	695,000	1,291	-
Public Safety Partnership and Community Policing Grants	16.710	2010CKWX0395	710,000	25,256	-
Subtotal Public Safety Partnership and Community Policing Grants			10,744,401	2,102,899	-
Congressionally Recommended Awards	16.753	2010-DD-BX-0618	400,000	295,390	-
ARRA - Internet Crimes Against Children Task Force Program (ICAC)	16.800	2009-SN-B9-K017	863,930	203,167	-
Equitable Sharing Program	16.922	CA0431300	-	17,050	-
Edward Byrne Memorial Justice Assistance Grant (JAG) Program Cluster:					
Direct programs:					
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2010-DJ-BX-0821	319,840	115,625	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2011-DJ-BX-2315	262,442	173,351	-
Subtotal Edward Byrne Memorial Justice Assistance Grant Program			582,282	288,976	-
Pass-through County of Santa Clara:					
Edward Byrne Memorial Justice Assistance Grant Program	16.738	DC11 22 0430	125,897	24,075	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	BSCC 630-12	97,761	66,282	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	ZA09 01 0430	116,801	7,311	-
Subtotal pass-through County of Santa Clara			340,459	97,668	-
Pass-through California Emergency Management Agency:					
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2012-DJ-BX-0071	210,497	14,110	-
ARRA - Edward Byrne Memorial Justice Assistance Grant (JAG) Program/ Grants to Units of Local Government	16.804	ZH09017928	375,000	7,545	-
Subtotal JAG Program Cluster			1,508,238	408,299	-
Total U.S. Department of Justice			15,776,288	3,873,703	-

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, 2013

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures Federal Grant	Expenditures Other
U.S. Department of Labor					
Pass-through State of California, Employment Development Department:					
Workforce Investment Act (WIA) Cluster:					
WIA Adult Program:					
WIA Adult 2 Program	17.258	K386329202	2,867,738	1,682,525	-
WIA Adult 2 Program	17.258	K386329201	236,873	236,873	-
WIA Adult 2 Program	17.258	K282502202	2,911,695	971,921	-
Subtotal - WIA Adult Program			6,016,306	2,891,319	-
WIA Youth Activities	17.259	K386329301	3,317,975	2,039,810	-
WIA Youth Activities	17.259	K282502301	3,365,644	1,287,444	-
Subtotal - WIA Youth Activities			6,683,619	3,327,254	-
WIA Dislocated Worker Formula Grants:					
25% DW	17.278	K178692545	886,209	886,208	-
25% DW	17.278	K178692537	1,078,533	1,041,142	-
New United Motor Manufacturing, Inc. (NUMMI) NEG	17.278	K178692768	1,372,619	287,600	
WIA DLW 2	17.278	K282502502	2,880,093	1,966,640	-
WIA DLW 2	17.278	K386329501	556,494	409,078	
WIA DLW 2	17.278	K386329502	2,495,461	233,678	
WIA RR	17.278	K386329541	508,852	508,722	-
WIA RR	17.278	K386329540	169,617	169,617	-
WIA RR	17.278	K282502541	339,339	104	-
Subtotal - WIA Dislocated Worker Formula Grants			10,287,217	5,502,789	-
Subtotal WIA Cluster pass-through State of California			22,987,142	11,721,362	-
Total U.S. Department of Labor			22,987,142	11,721,362	-

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, 2013

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures Federal Grant	Expenditures Other
U.S. Department of Transportation					
Direct programs:					
Federal Aviation Administration:					
Airport Improvement Program	20.106	3-06-0226-77	2,031,047	31,047	7,478
Airport Improvement Program	20.106	3-06-0226-79	2,245,529	248,083	59,750
Airport Improvement Program	20.106	3-06-0226-80	7,496,370	120,138	28,935
Airport Improvement Program	20.106	3-06-0226-81	7,003,010	6,555,034	1,578,772
Subtotal Airport Improvement Program			18,775,956	6,954,302	1,674,935
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	384,531	93,133
Minidoka Avenue Sidewalk Improvement	20.205	SRTSL-5005(097)	746,000	-	3,566
TEA-21-ITS: New CC TiMC (Web II)	20.205	ITS03-5005(073)	579,123	-	251,622
E. Santa Clara Street Bridge at Coyote Creek	20.205	BRLZ-5005(089)	50,000	3,292	426
2010 Street Resurfacing and Rehabilitation	20.205	04-SCL-0-SJS	9,725,622	3,684,319	802,008
San Carlos Multimodal Streetscape Improvements Phase I	20.205	RPSTPLE-5005(101)	1,500,000	800,000	200,747
Subtotal Highway Planning and Construction			18,000,745	4,872,142	1,351,502
Recreational Trails Program:					
SAFETEA-LU Trail: Lower Guadalupe River (Gold Street - 880)	20.219	HPLUL-5005(084)	2,341,279	1,478,647	366,203
SAFETEA-LU Trail: Coyote Creek (237 to Story Road)	20.219	SCL 050083 HPLUL-5005(087)	1,317,999	6,262	1,551
CMAQ Los Gatos Creek Reach	20.219	SCL110029	1,200,000	4,514	1,128
Subtotal Recreational Trails Program			4,859,278	1,489,423	368,882
Subtotal pass-through California Department of Transportation			22,860,023	6,361,565	1,720,384
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	12,734	40,462
San Fernando Enhanced Bikeway & Pedestrian	20.205	RPSTPLE-5005(105)	1,425,000	1,950	120,981
The Alameda - A Plan for the Beautiful Way	20.205	STPL-5005(103)	3,132,000	786	379,908
Innovative Bicycle Detection System	20.205	CML-5005(106)	1,500,000	16,481	2,307
Walk n' Roll San Jose! (Non-infrastructure)	20.205	CML-5005(107)	943,000	385,386	49,931
Walk n' Roll San Jose! (Infrastructure)	20.205	CML-5005(108)	567,762	40,809	6,315
Subtotal pass-through Metropolitan Transportation Commission			8,961,416	458,146	599,904
Pass-through Valley Transportation Authority:					
Highway Planning and Construction:					
Community Design and Transportation	20.205	CML-5005(094)	1,300,000	68,159	49,756
Recreational Trails Program:					
CMAQ Trail: Lower Guadalupe River (Gold Street - 880)	20.219	SCL 050081 VTP 2030-30-B3 #B31	1,377,000	1,216,804	301,354
Subtotal pass-through Valley Transportation Authority			2,677,000	1,284,963	351,110
Subtotal Highway Planning and Construction Cluster			34,498,439	8,104,674	2,671,398

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

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					
Sobriety Checkpoint Program	20.600	SC13372	120,660	59,325	-
Selective Traffic Enforcement Program	20.600	PT13116	180,000	113,774	-
DUI E&A Grant	20.600	20244	375,000	139,636	-
Subtotal State and Community Highway Safety			675,660	312,735	-
Total U.S. Department of Transportation			53,950,055	15,371,711	4,346,333
National Endowment for the Arts					
Direct program:					
Promotion of the Humanities_Public Programs	45.164	LB-50076-12	2,500	2,020	-
Total National Endowment for the Arts			2,500	2,020	-
U.S. Institute of Museum and Library Services					
Direct program:					
National Leadership Grants	45.312	AL-00-11-0001-11	10,000	10,000	-
U.S. Small Business Administration					
Direct program:					
Silicon Valley Small Business Assistance Portal	59.000	SBAHQ-10-I-0137	200,000	172,436	-
U.S. Environmental Protection Agency					
Direct program:					
Congressionally Mandated Projects	66.202	00T58101-0	485,000	(2,610)	(2,135)
Pass-through SF Bay Fund:					
The San Francisco Bay Water Quality Improvement Fund	66.126	W9-00T60701	680,000	222,011	99,819
Total U.S. Environmental Protection Agency			1,165,000	219,401	97,684
U.S. Department of Energy					
Direct programs:					
ARRA - Renewable Energy Research and Development	81.087	DE-EE0002075	1,301,635	36,736	-
ARRA - Electricity Delivery and Energy Reliability, Research, Development and Analysis	81.122	OE0000388	299,983	57,104	-
Energy Efficiency and Conservation Block Grant Program (EECBG)					
ARRA - Energy Efficiency and Conservation Block Grant Program	81.128	DE-EE0000881	8,840,600	2,993,433	-
Pass-through Association of Bay Area Governments					
Energy Efficiency and Conservation Block Grant Program (EECBG)					
ARRA - Retrofit California Program	81.128	DE-EE0003562	788,479	167,971	-
Subtotal Energy Efficiency and Conservation Block Grant Program (EECBG)			9,629,079	3,161,404	-
Total U.S. Department of Energy			11,230,697	3,255,244	-

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, 2013

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures Federal Grant	Expenditures Other
U.S. Department of Health and Human Services					
Direct program:					
Social Services Research and Demonstration	93.647	90XP0429/01	300,000	(711)	-
ARRA - Prevention and Wellness - Communities Putting Prevention to Work Funding Opportunities Announcement (FOA)	93.724	1U58DP002545-01	101,020	17,147	-
Total U.S. Department of Health and Human Services			401,020	16,436	-
U.S. Department of Homeland Security					
Direct programs:					
Hazard Mitigation Grant	97.039	HMGP #1731-44-21	3,000,000	1,035,480	-
Assistance to Firefighters Grant	97.044	EMW-2011-FO-09738	1,246,538	1,246,538	380,738
Staffing for Adequate Fire and Emergency Response (SAFER)	97.083	EMW-2010-FH-00551	14,922,759	7,577,359	-
Staffing for Adequate Fire and Emergency Response (SAFER)	97.083	EMW-2011-FH-00831	8,623,206	1,810,094	
Subtotal Staffing for Adequate Fire and Emergency Response (SAFER)			23,545,965	9,387,453	-
Pass-through the County of Santa Clara:					
Emergency Management Performance Grants	97.042	2011-0048 FIPS OES 085-00000	133,685	9,368	9,368
Pass-through the Bay Area UASI					
Homeland Security Grant Program:					
FY 10 Urban Areas Security Initiative	97.067	2010-0085 FIPS 075-95017	252,890	18,816	-
FY 10 Urban Area Security Grant (SUASI)	97.067	N/A	1,130,400	819,598	-
FY 11 Urban Area Security Grant (SUASI)	97.067	N/A	1,143,879	841,790	-
Subtotal pass-through the Bay Area UASI			2,527,169	1,680,204	-
Pass-through the County of Santa Clara:					
Homeland Security Grant Program:					
State Homeland Security Program -SHSP	97.067	N/A	469,540	34,070	-
FY10 Metropolitan Medical Response System	97.067	2010-0085 FIPS 085-00000	317,419	207,070	-
FY11 Metropolitan Medical Response System	97.067	2011-0077 FIPS 085-00000	281,693	8,589	-
FY10 State Homeland Security Grant Program (SHSGP)	97.067	N/A	181,699	157,157	
Subtotal pass-through the County of Santa Clara			1,250,351	406,886	-
Pass-through California Emergency Management Agency:					
FY 11 Urban Areas Security Initiative Grant (UASI)	97.067	2011-077 FIPS 075-95017	405,000	257,396	-
Subtotal Homeland Security Grant Program			4,182,520	2,344,486	-
Total U.S. Department of Homeland Security			32,108,708	14,023,325	390,106
Total Federal Awards			$ 223,041,848	$ 133,941,093	$ 5,201,828

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

(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.

During the year ended June 30, 2013, the City reversed certain accruals and received other cost reimbursements related to the Congressionally Mandated Projects Program (CFDA No. 66.202) and the Social Services Research and Demonstration Program (CFDA No. 93.647) in the amount of $2,610 and $711, respectively. These amounts are reported as negative amounts in the SEFA for the year ended June 30, 2013.

(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.

(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	$ 2,755,551
ARRA - Community Development Block Grants-Entitlement Grants	14.253	16,282
Emergency Solutions Grant Program	14.231	789,279
Home Investment Partnerships Program	14.239	541,712
Housing Opportunities for Persons with AIDS	14.241	1,216,422
ARRA - Homeless Prevention and Rapid Re-Housing Program	14.257	389,778
Workforce Investment Act (WIA) Youth Activities	17.259	486,524
Workforce Investment Act (WIA) Dislocated Workers Formula Grants	17.278	555,494

(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, 2013, 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, 2013:

Program Title	CFDA Number	Amount Outstanding	Prior year loans with continuing compliance requirements	New loans
Economic Adjustment Assistance	11.307	$ 385,500	$ 385,500	$ -
Community Development Block Grants/Entitlement Grants	14.218	7,624,475	7,039,465	585,010
HOME Investment Partnerships Program	14.239	56,108,029	53,032,061	3,075,968
		$ 64,118,004	$ 60,457,026	$ 3,660,978

(8) SAN JOSE AREA WATER RECLAMATION AND REUSE PROGRAM (CFDA No. 15.504)

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 (CFDA No. 15.504). Funding for subsequent years, for a total of $35 million in Phase 1A for the SBWR 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 2013, the program incurred expenditures of $353,212, of which $53,394 is ARRA-funded.

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, 2013, Congress appropriated $8,996,417 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	$ 4,872,142
Pass-through Metropolitan Transportation Commission	458,146
Pass-through Valley Transportation Authority	68,159
CFDA No. 20.205 - Highway Planning and Construction	5,398,447
CFDA No. 20.219 - Recreational Trails Program	
Pass-through California Department of Transportation	1,489,423
Pass-through Valley Transportation Authority	1,216,804
CFDA No. 20.219 - Recreational Trails Program	2,706,227
Total Highway Planning and Construction Cluster	$ 8,104,674

(10) INTERNET CRIMES AGAINST CHILDREN (ICAC) 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, 2013. 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, 2012	Actual 7/1/12-6/30/13 Non-match	Actual 7/1/12-6/30/13 Match	Cumulative Expense through June 30, 2013	Revenue
Internet Crimes Against Children						
Task Force Program (Federal)	2011-MC-CX-K033					
Personnel Services	10/01/11 - 9/30/13	$ 59,116	$ 110,343	$ -	$ 169,459	$ 169,458
Operating Expenses		930	585	-	1,515	1,515
Equipment		-	-	-	-	-
Total		$ 60,046	$ 110,928 [1]	$ -	$ 170,974	$ 170,973
Internet Crimes Against Children						
Task Force Program (Federal)	2011-MC-CX-K003					
Personnel Services	04/01/11 - 9/30/12	$ 159,173	$ 112,122	$ -	$ 271,295	$ 122,156
Operating Expenses		179,536	155,197	-	334,733	192,184
Equipment		-	-	-	-	37,375
Total		$ 338,709	$ 267,319 [1]	$ -	$ 606,028	$ 351,715
Internet Crimes Against Children						
Task Force Program (State)	IC-1204-7928					
Personnel Services	07/01/12-6/30/13	$ -	$ 10,186	$ -	$ 10,186	$ 10,186
Operating Expenses		-	89,814	-	89,814	89,814
Equipment		-	-	-	-	-
Total		$ -	$ 100,000	$ -	$ 100,000	$ 100,000

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, 2013

Section I Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:	Unmodified
Internal control over financial reporting:	
♦ Material weakness(es) identified?	No
♦ 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:	Unmodified, except for the Highway Planning and Construction Cluster (CFDA Nos. 20.205 and 20.219) which is modified.
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?	No

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
16.710	Public Safety Partnership and Community Policing Grants
20.106	Airport Improvement Program
20.205, 20.219	Highway Planning and Construction Cluster
81.128	ARRA – Energy Efficiency and Conservation Block Grant Program
97.039	Hazard Mitigation Grant

Dollar threshold used to distinguish between type A and type B programs:	$2,304,344
Auditee qualified as a low-risk auditee?	No

Section II Financial Statement Findings

Finding 2013-001 – Significant Deficiency
Risk Assessment of Internal Controls Over the Financial Reporting Process

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 control is a dynamic integral process that should be continuously adapting to the changes the City is facing. Prior to 2013, the City has cut 28 percent of budgeted positions over the past decade. As noted in last year's Report to Management, the widespread reduction and displacement of staff through the Civil Service Rules resulted in a significant disruption in the City's ability to maintain appropriate financial internal controls. As the City incorporates new personnel into its organization, the City should ensure that while new personnel acquire on-the-job training and experience, adequate supervision and review processes are in place to mitigate errors such as the following that were noted:

- Under-reporting of accounts payable liabilities at year-end totaling $1.2 million.
- Lack of review and approval of the Notice of Separation Form for 2 out of 40 employees' terminated or separated.
- Insufficient review and approval of 2 out of 40 workers compensation reserve computation worksheets tested for reserve amounts in excess of $75 thousand.
- Insufficient review of complex government-wide reconciling journal entries resulting in post-closing adjusting and reclassification entries.

The City is sensitive to these observations and continues to work its way out of its personnel vacancies challenges and providing on-the-job training to its new personnel. Over the past year, the City developed a work plan and started to stabilize the Finance Department to address control deficiencies identified in prior years. The City's appointment of the Director of Finance position in December 2012 and the hiring of three senior accountants and two accountants to fill open positions that were vacant during the economic downturn helped steady the department.

Recommendation

As a result of the recent organizational changes, the City should continue to review the experience of professionals throughout the City assigned to key roles in the preparation of the annual financial statements to ensure that the most experienced professionals are responsible for the higher risk areas of the financial statements and that there is a robust supervision and review process over those professionals with developing experience. A professional development plan should be created for those individuals who are new to the process, which includes a training plan. In addition, the City should assess the magnitude of any deficiencies in the internal control over financial reporting as it continues to identify and quantify the risks of any significant internal control weaknesses that have not yet been addressed. The City should also develop a robust succession plan to prepare for planned and unplanned absences of key finance professionals throughout the City.

Management Response

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 during staffing changes. Due to the reduction and turnover in City staffing, consistencies in establishment and maintenance of roles and responsibilities within departments and with the Finance Department has diminished.

During FY 2012-13, the Finance Department worked with City departments to identify the changes in all finance related positions and assess current staffing levels on a Citywide basis. In addition, the Finance Department obtained documentation from City departments to assist in evaluating documentation of financial operations to ensure consistency and continuity throughout the organization. A Request for Proposals ("RFP") is currently being developed for the purpose of retaining a consultant to conduct a comprehensive study of the City's organizational structure for finance functions and ultimately recommend and aid in the facilitation of actions that will improve the effectiveness and efficiency of the City's internal controls. The work product from the consultant will also include recommendations that will assist City management in addressing the City's need to maintain quality internal controls and sound accounting practices. The expected release date of the RFP is late February 2014.

The City's appointment of the Director of Finance position in December 2012 and the hiring of three senior accountants and two accountants to fill vacant positions did assist in stabilizing the Finance Department especially with regard to the completion of the fiscal year 2013 CAFR and the fiscal year 2014 cost allocation plans. However, the Finance Department remains challenged with retaining knowledgeable and experienced staff, which is illustrated by five vacant senior accountant positions; recruitment for these positions is in process. As the City begins planning for the preparation of the fiscal year 2014 CAFR, the Finance Department is making a concerted effort to assemble the strongest team possible, which will involve more closely aligning staff skills with job duties and responsibilities. Additionally, the City has contracted with a firm to provide a financial reporting solution package that will streamline the CAFR process and provide more time for analytical reviews of data. The City is working to have this solution implemented to assist in the preparation of the fiscal year 2014 CAFR.

FINANCIAL STATEMENT FINDINGS (Continued)

Finding 2013-002 – Cost Allocation Plans

It is the City's policy to identify and allocate appropriate General Fund and certain other central service program costs that indirectly benefit the Airport Department. The Finance Department develops an Airport Cost Allocation Plan (ACAP) using actual allowable costs from the prior two fiscal years. In addition, allocations of these allowable costs are based on various nonfinancial factors such as number of purchase orders processed and number of full-time equivalents (FTE) budgeted.

During our audit, we noted that the fiscal year 2013 ACAP used a factor of 205 FTEs. However, the Airport has approximately 187 FTEs at June 30, 2013. 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. In addition, we noted in the ACAP that the former Redevelopment Agency (Agency) had costs allocated to the Agency as a service department and user department. The Agency was dissolved as of February 1, 2012. The costs that were being allocated to the Agency as user department went unallocated since the Agency is no longer active in 2013. As a result, these unallocated central service costs are not recovered.

Recommendation

The City should update its procedures in order to develop a more equitable cost allocation methodology that measures and allocates the relative benefit of administrative efforts received by City departments during a given fiscal year. As part of updating its procedures, the City should also review, communicate with central service departments, and revise its list of allocated and unallocated costs. This will ensure that allocation bases reflect actual workload and take into account organizational changes.

Management Response:

The City utilizes budgeted FTEs for indirect cost allocation purposes as it considers the budgeted FTE data as more reflective of recent activity levels of departments rather than using actual FTE data from two years prior. Using the actual FTEs reported at year-end may not necessarily depict a true level of use of services as the actual FTE counts do not remain the same throughout a fiscal year due to changes in staffing levels. The City consistently applies the budgeted FTE allocation methodology to all City departments. Therefore, the City believes that the allocation bases currently in place do not result in a disproportionate share of overhead costs to either the Airport or any other City department. However, the City will continue to monitor and evaluate the cost allocation bases to ensure fair share distribution of indirect costs to all City departments.

Additionally, the City has revised its current cost allocation plan procedures to include meetings with key central service departments including, but not limited to, Finance, Public Works, City Manager's Budget Office, and Information Technology to review and analyze the allocable costs and the cost allocation bases prior to completion of the fiscal year 2015 CAP. The City is in the process of reviewing and updating its current cost allocation plan procedures to address organizational changes, specifically ensuring the exclusion of allocated costs to the former Redevelopment Agency as a user department in the cost allocation plan. The revised procedures will be reflected in the fiscal year 2015 cost allocation plan.

Section III Federal Award Findings and Questioned Costs

Program Identification:

Reference Number:	2013-003
Federal Agency:	U.S. Department of Transportation
Federal Program Title:	Highway Planning and Construction Cluster
Federal Catalog Number:	20.205 and 20.219
Passed Through:	California Department of Transportation
Award Number:	RPSTPLE-5005(101)
Award Year:	2011
Category of Finding:	Davis-Bacon Act

Criteria

The Davis-Bacon Act requires all laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of $2,000 financed by federal assistance funds be paid prevailing wage rates. Contractors or subcontractors must submit weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls). The City is responsible for enforcing the compliance of contractors and subcontractors with Davis-Bacon Act requirements. In the event that the contractor does not provide the required certified payrolls by the due date, the City should initiate timely corrective actions to ensure compliance, such as sending timely follow-up requests to the 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 approximately 120 certified payrolls for the HPC Cluster. We noted that the Office of Equality Assurance (OEA) did not perform timely follow-up of overdue certified payroll reports with the prime contractors for 14 of the 51 items selected for testing. Of the 14 items noted, although the City did not disburse payment to the contractor until after receipt of 4 of the certified payrolls, the OEA did not receive the required certified payroll reports prior to the City's project managers' instruction to disburse funds to the prime contractors for 10 of the 51 samples selected, which resulted in questioned costs. The 10 items were a combination of payments to both prime contractors and subcontractors, which were paid by the prime contractors for services rendered.

Questioned Cost

The questioned costs totaled $589,498. This was computed by totaling the City's disbursements to contractors and subcontractors during the months where certified payrolls were not submitted before the contractor was paid.

Effect

The City's OEA, who is responsible for overseeing compliance with the Davis-Bacon Act, did not consistently verify the laborers and mechanics employed by the contractors and subcontractors were paid prevailing wage rates before payment was released to the contractors. There is a risk that federal funds may be paid to contractors who do not comply with the Davis-Bacon Act requirements, resulting in unallowable costs.

Cause of Condition

The City makes monthly payments to contractors. Although contractors are required to submit certified payrolls weekly, they did not consistently comply with the required timeframe.

Recommendation

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

Management Response

The City concurs with this recommendation. On July 29, 2013, the City implemented a revision of its Special Provisions for Construction Contracts and disseminated a memorandum to inform all project managers, inspectors and fiscal staff that effective July 29, 2013, the City's Department of Public Works Special Provisions Section 9-1.06 Partial Payments has been revised.

The revision requires contractors to provide to the project manager or inspector with each application for progress payment certified payroll reports for all of its employees and those employees of its contractors. Once the payment request is received along with the certified payroll reports, the project manager or inspector is to immediately forward the certified payroll reports to the appropriate Office of Equality Assurance (OEA) Contract Compliance Specialist.

In order to ensure no progress payments are authorized without receipt of certified payroll reports, the application for payment form has been revised with a new section "Receipt of Certified Payroll Reports." Submission of the certified payroll records with each application for progress payment is an express condition precedent to the Engineer's obligation to make a progress payment. The Engineer will not approve, in whole or in part any progress payment due the Contractor until the Contractor has submitted the required certified payroll records.

As required by the Office of Management and Budget ("OMB") Circular A-133, the Department of Transportation ("Caltrans"), Audits and Investigations ("A&I"), is required to issue management decisions on Single Audit Report findings and ensure that sub-recipients take appropriate and timely corrective actions. This finding (2013-003) is a repeat finding (2012-A) from the prior fiscal year. On August 27, 2013, per A&I's review, A&I determined that the finding 2012-A is resolved.

CITY OF SAN JOSE, CALIFORNIA

Summary Schedule of Prior Audit Findings

Year Ended June 30, 2013

Prior Years' Financial Statement Findings

2012 Comment:	***2012-1 – Internal Control Over Financial Reporting – Preparation of Financial Statements***
Condition/Effect:	The dissolution of the Redevelopment Agency (Agency) of the City severely impacted the organization's internal controls over financial reporting of the Agency and the Successor Agency to the Redevelopment Agency of the City (Successor Agency). During our audit, we noted that the staffing complement is not configured to adequately support the Successor Agency's financial reporting responsibilities and other increasing audit requests related to the Successor Agency's activities.
Recommendation:	We recommend 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.
Status:	In progress. The Successor Agency and the City began the interface and transfer of the financial operations, including financial reporting, to the City's Finance Department. A complete transition is expected by the end of fiscal year 2014-2015.
2012 Comment:	***2012-2 – 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
Recommendation:	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 The City should also develop a work plan to mitigate these risks in internal controls.
Status:	In progress. See current year comment 2013-001.

2012 Comment: ***2012-3 – Housing Department Budgetary Controls***

Condition/Effect: 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 the 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 of property tax revenues. 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 monitoring of its Housing budget as compared to actual amounts so that a fund does not close the year in a deficit position.

Status: Substantially implemented. Per review of the budgetary statement for the year ended June 30, 2013, the final budget has a net positive change of $13.1 million. The beginning fund deficit was ($15.2) million, therefore, the final budget ending fund balance of ($1.9) million resulting in a reduced deficit in the Housing Activities Fund. The City continues to monitor the Housing budget to ensure the fund does not close the year in a deficit position.

2012 Comment:	***2012-4 – Accounting for Housing Loans Reserves***
Condition/Effect:	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 the understatement of the allowance on the City's loans receivable by $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.
Status:	Implemented.
2012 Comment:	***2012-5 – Successor Agency's Investment Policy Compliance***
Condition/Effect:	The Successor Agency follows the investment policy of the City, which is governed by provisions of the California Government Code and the City's Municipal Code. The Successor Agency also has investments subject to provisions of the bond indentures of the former Agency's various bond issues. City of San Jose Investment Policy Section 9.10 Money Market Mutual Fund states that, *No more than 20% of the portfolio shall be invested in money market mutual funds.* The City's policy does have exceptions for investments of bond proceeds and bond reserve accounts. However, it currently does not have an exception for investments held for a short duration to pay upcoming debt payments. During our audit, we noted that the former Agency and the Successor Agency were not in compliance with the City's Investment Policy by investing more than 20% of their portfolios in money market mutual funds. As of January 31, 2012, the former Agency invested $80.6 million in money market mutual funds out of its total investment portfolio of $130.7 million (61% of the portfolio). As of June 30, 2012, the Successor Agency invested $95.7 million of the total investment portfolio of $161.0 million in money market mutual funds (59% of the portfolio).
Recommendation:	We recommend the Successor Agency work with the City in updating its investment policy to consider its short-term investment needs.
Status:	Implemented.

2012 Comment:	***2012-6 – New Pension Accounting Standards***
Condition/Effect:	The City will be required to implement GASB Statement No. 67 and 68 in fiscal years 2014 and 2015.
Recommendation:	It is likely that these new accounting and reporting standards will dramatically change the City's financial statements and disclosures and will result in the recognition of net pension liability. We recommend consulting with the San José Police and Fire Department Retirement Plan (PFDRP) and the City of San José Federated City Employees Retirement System's (FCERS) actuaries to develop a better understanding of and to quantify the impact of these new accounting and reporting on the City's current financial statements..
Status:	In progress. The City will be implementing the above GASBs in fiscal years 2014 and 2015.
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 environmental and reduced workforce.
Status:	In progress. See current year comment 2013-001.

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 equivalent (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 to 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:	In progress. The City maintained the same methodology in allocating central service program costs. The ACAP used 205 FTEs compared to the approximate actual of 187 FTEs as of June 30, 2013, and thus the Airport may still be burdened with a disproportionate share of overhead costs. See current year comment 2013-002.

Prior Years' Federal Awards Findings

2012 Comment:	***2012-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 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.
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.
Status:	In progress. See finding 2013-003.
2012 Comment:	***2012-B – Home Investment Partnerships Program - Eligibility***
Condition/Effect:	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.
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.
Status:	Corrected.

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 samples from a population of 144 construction pay periods for the HPC Cluster. Our testing showed that the Office of Equality Assurance (OEA) did not perform timely follow-up of overdue certified payroll reports with the prime contractors for 8 of the 25 samples selected. Of the 8 samples selected, OEA had not received the required certified payroll reports prior to the City's project managers' instruction to disburse funds to the prime contractors for 7 of the 25 samples selected (resulting in questioned costs). The 7 samples were subcontractors, which were paid by the prime contractors for services rendered. The City pays the prime contractors for both the prime contractors' and subcontractors' work performed.
Recommendation:	Due to the City's budget constraints and a limited number of employees in the Office of Equality Assurance, the City may not have sufficient resources to perform the necessary follow-ups after the 15 day time period in 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 constraints. In addition, we recommend that the City establish internal control policies and procedures over withholding payment until the certified payrolls are received.
Status:	In progress. See finding 2013-003.

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San Diego

Seattle

Independent Auditor's Report on Compliance with Applicable Requirements of the Passenger Facility Charge Program and 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, 2013.

Management's Responsibility
Compliance with the requirements referred to above is the responsibility of the Airport's management.

Auditor's Responsibility
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 on compliance. Our audit does not provide a legal determination of the Airport's compliance with those requirements.

Opinion
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, 2013.

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 over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Guide. Accordingly, this report is not suitable for any other purpose.

Macias Gini & O'Connell LLP

Walnut Creek, California
February 6, 2014

CITY OF SAN JOSE, CALIFORNIA

Schedule of Passenger Facility Charge Revenues and Expenditures

Year Ended June 30, 2013

	Passenger Facility Charge Revenue	Investment loss*	Total Revenues	Expenditures on Approved Projects	Under (over) Expenditures on Approved Projects
Fiscal year 2012-13 transactions:					
Quarter ended September 30, 2012	$ 2,557,687	$ -	$ 2,557,687	$ -	
Quarter ended December 31, 2012	3,522,864	-	3,522,864	-	
Quarter ended March 31, 2013	4,664,394	-	4,664,394	22,099,631	
Quarter ended June 30, 2013	6,549,438	(139,799)	6,409,639	-	
	$ 17,294,383	$ (139,799)	$ 17,154,584	$ 22,099,631	(4,945,047)
			Balance, beginning of year		38,570,899
			Balance, end of year		$ 33,625,852

* Negative investment fair value adjustments resulted in an investment loss during the year ended June 30, 2013.

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

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Notes to the Schedule of Passenger Facility Charge Revenues and Expenditures

Year Ended June 30, 2013

(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 is 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 $22,099,631 from accumulated PFC Revenues had been designated as Available PFC Revenues for payment of eligible bond debt service in the year ended June 30, 2013.

(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.

(5) PFC APPROVED PROJECTS AND EXPENDITURES

The general description of the approved projects and the expenditures for the year ended June 30, 2013 are as follows:

Passenger Facility Charge Project Number/Description		Identifying Number	Passenger Facility Charge Approved Amount	Expenditures
#40A	Runway 12R/30L Reconstruction	01-12-C-00-SJC	$ 72,022,700	$ 2,904,625
#40B	Runway 12R/30L Extention	01-12-C-00-SJC	38,671,724	1,314,531
#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	3,111,217
#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	342,851
#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	12,947,407
#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 Projects		$ 919,182,836	$ 22,099,631

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Sacramento

Oakland

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Newport Beach

San Diego

Seattle

Independent Auditor's Report on Compliance with Applicable Requirements of the Customer Facility Charge Program and 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, as amended by Senate Bill 1192 (Code), applicable to its customer facility charge program for the year ended June 30, 2013.

Management's Responsibility
Compliance with the requirements referred to above is the responsibility of the Airport's management.

Auditor's Responsibility
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 Code. Those standards and the Code require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the 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.

Opinion
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, 2013.

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 an 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.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Code. Accordingly, this report is not suitable for any other purpose.

Macias Gini & O'Connell LLP

Walnut Creek, California
February 6, 2014

CITY OF SAN JOSE, CALIFORNIA

Schedule of Customer Facility Charges Revenues and Expenditures

Year Ended June 30, 2013

Revenues	
Customer facility charges	$ 13,384,764
Facility rent	4,905,604
Release of funds from capitalized interest account	3,340,447
Interest loss	(19,174)
Total revenues	21,611,641
Expenditures	
Transportation expenditures	2,292,920
ConRAC debt service expenditures	17,025,482
Total expenditures	19,318,402
Revenues over expenditures	$ 2,293,239

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

CITY OF SAN JOSE, CALIFORNIA

Notes to the Schedule of Customer Facility Charge Revenues and Expenditures

Year Ended June 30, 2013

(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.

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 is 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 and as operating expenses in the Airport enterprise fund. CFC expenditures agree or can be reconciled with the amounts reported in the City’s basic financial statements.