SUCCESSOR AGENCY TO THE REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
(A Component Unit of the
City of San José, California)

Independent Auditor's Reports
and Basic Financial Statements

For the Period from Inception
(February 1, 2012) through June 30, 2012

MGO Certified Public Accountants.

SUCCESSOR AGENCY TO THE
REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
(A Component Unit of the City of San José, California)
For the Period From Inception (February 1, 2012) through June 30, 2012

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MGO Certified Public Accountants.

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

Independent Auditor's Report

We have audited the accompanying basic financial statements of the Successor Agency of the Redevelopment Agency of the City of San José (SARA), a component unit of the City of San José (City), California, as of June 30, 2012 and for the period from inception (February 1, 2012) through June 30, 2012, as listed in the table of contents. These financial statements are the responsibility of the SARA's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the SARA as of June 30, 2012, and the changes in its financial position for the period from inception (February 1, 2012) through June 30, 2012 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 6 to the basic financial statements, on June 8, 2012, Moody's Investors Service downgraded the former Redevelopment Agency of the City of San José Senior Obligations Rating to below "Baa1", which triggered a Special Termination Event under the Continuing Covenant Agreement of the 2010 C Housing Set-Aside Tax Allocation Bonds (Bonds). The Bonds have an outstanding balance at June 30, 2012 of $88.6 million and are reported as a current liability. For the period commencing on August 15, 2012 and ended on November 15, 2012, the bank agreed to forebear from exercising its rights and remedies under the bond documents in respect to the existing default. Negotiations are presently underway to extend the forbearance agreement. The SARA cannot predict the outcome of the negotiations.

As discussed in Note 6 to the basic financial statements, in connection with the issuance of the former Agency's 1996 and 2003 Merged Area Redevelopment Project Revenue Bonds, the former Agency obtained four letters of credit (LOCs) as credit facilities amounting to $93.7 million at June 30, 2012 to support the variable-rate demand bonds. On August 7, 2012, the bank agreed to extend the expiry of the existing term of the LOCs to March 1, 2013, therefore the bonds are reported as a current liability.

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

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

Macias Gini & O'Connell LLP

Walnut Creek, California
November 19, 2012

SUCCESSOR AGENCY TO THE REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

Management's Discussion and Analysis - Unaudited
June 30, 2012

As management of the Successor Agency to the Redevelopment Agency of the City of San José (SARA), we offer readers of the SARA's basic financial statements this narrative overview and analysis of the financial activities of the SARA for the period from its inception on February 1, 2012 through June 30, 2012. We encourage readers to consider the information presented here in conjunction with the SARA's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

Pursuant to AB X1 26, redevelopment agencies in California were dissolved effective February 1, 2012. The legislation, which was upheld by the California Supreme Court in *California Redevelopment Association v. Matosantos*, and subsequently amended by AB 1484 (together, "The Redevelopment Dissolution Law") provided that all assets, properties, contracts, leases, books, records, buildings and equipment were transferred to the SARA on February 1, 2012. SARA will be responsible for overseeing the dissolution process and the wind down of the former Redevelopment Agency of the City of San José's (Agency) activities.

At February 1, 2012, the SARA recorded the receipt of the former Agency's assets ($376.3 million) and liabilities ($2,480.3 million); the receipt of unencumbered cash of the City's Housing Activities Fund funded with the former Agency's low and moderate income tax increment revenues ($6.9 million); and the invalidation of certain loans made between the City and the former Agency ($35.3 million) as an extraordinary event (see Note 2 to the Basic Financial Statements).

On June 8, 2012, Moody's Investors Service downgraded the former Agency's Senior Obligations Rating to below "Baa1", which triggered a Special Termination Event under the Continuing Covenant Agreement of the Series 2010C Bonds. The SARA requested that Wells Fargo Bank forbear from exercising its rights, including without limitation, its rights to accelerate the obligations. For the period commencing on August 15, 2012 and ending on November 15, 2012, Wells Fargo Bank has agreed to forebear from exercising and its rights and remedies under the Bond Documents in respect to the existing default. At June 30, 2012, SARA has a balance of $88.6 million payable on these bonds.

In connection with the issuance of the 1996 and 2003 Bonds, the former Agency obtained four letters of credit (LOCs) as credit facilities from the credit facility provider, JPMorgan Chase Bank (JPMorgan), for these bonds. On June 30, 2012, the balance outstanding on these bonds was $93.7 million. On June 28, 2012, the SARA received an additional transfer of $6.9 million from the Redevelopment Property Tax Trust Fund held by County of Santa Clara. This distribution in conjunction with previous distributions provided for sufficient funds to be transferred to U.S. Bank, the fiscal agent for the JPMorgan subordinate bonds. As a result of these actions on August 7, 2012, JPMorgan agreed to extend the expiry of the existing term of the LOCs from September 1, 2012 to March 1, 2013.

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%.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the SARA's basic financial statements. The SARA's basic financial statements comprise two components: 1) basic financial statements and 2) notes to the basic financial statements. This report also contains other supplementary information in addition to the basic financial statements. These financial statements are prepared on the economic resources measurement focus and the accrual basis of accounting.

This year is the first period the SARA reported financial activity. In future years, when prior year information is available, a comparative analysis of the SARA's financial data will be presented.

FINANCIAL ANALYSIS

Net assets may serve over time as a useful indicator of a government's financial position. At the close of June 30, 2012, the SARA has a net deficit of $2.1 billion. Historically, the former Agency carried a deficit to collect tax increment revenues due primarily to the nature of tax increment financing method previously allowed under California Redevelopment Law whereby a redevelopment agency issues bonds or incurs long-term debt to finance its redevelopment projects by pledging future tax increment revenues.

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

Shown below is a schedule that summarizes the SARA's net assets held in trust:

Statement of Fiduciary Net Assets
June 30, 2012
(In thousands)

Assets	
Current and other assets	$ 247,457
Capital assets, net	128,476
Total Assets	375,933
Liabilities	
Long-term liabilities	2,377,254
Other liabilities	62,061
Total Liabilities	2,439,315
Total net assets held in trust	$ (2,063,382)

The SARA has $154.0 million in restricted cash and investments held in interest and principal reserves for repayment of debt, amounts required to be held in cash reserves per bond indenture, and temporary investments for unexpended bond proceeds. Other funds are held in escrow accounts pursuant to contracts and agreements made by the former Agency, their use restricted for a particular purpose.

The SARA's capital assets reflect a total net book value of $128.5 million. The total includes $90.9 million in Governmental Use properties to be transferred to the City upon approval of the SARA Oversight Board and confirmation of the State Department of Finance (DOF). The remaining balance of properties and equipment includes: $26.2 million is being used to secure debt; and $11.4 million of other capital assets will be included in the SARA's Long-Range Management Plan, which will be forwarded to the Oversight Board and DOF for approval upon the receipt of a Finding of Completion from the DOF. The funds from the sales identified as the "Parcels securing the JP Morgan Letter of Credit" are to be used to reduce the debt service on the 1996 and 2003 Merged Area Revenue Bonds and the funds from the sale of the "North San Pedro" properties are to be shared 50/50 with the County per the March 2011 Settlement Agreement. The SARA's 50% share plus the balance of sales proceeds from the remaining unpledged capital assets will be used to fund the SARA's enforceable obligations.

Long-term liabilities total $2.4 billion. Long-term liabilities are mainly represented by tax allocation bonds totaling $1.7 billion, housing set-aside bonds of $329.0 million, and revenue bonds of $93.6 million issued to finance redevelopment projects and $294.9 million of other obligations.

Operating activities. Over the five-month period ended June 30, 2012, the SARA had deductions over additions in the amount of $1.5 million and an extraordinary item of ($2.1 billion) as previously described.

Key elements of the SARA's additions and deductions are presented below:

SARA's Changes in Fiduciary Net Assets
For the Five-month Period Ended June 30, 2012
(In thousands)

	5-month Ended June 30, 2012
Additions	
Redevelopment property tax revenues	$ 82,236
Other revenues	1,051
Total additions	83,287
Deductions	
General and administrative	967
Project expenses	816
Pass-through amounts to the County of Santa Clara	8,177
Loss on fair value of property held for resale	27,417
Depreciation	2,040
Interest on debt	45,401
Total deductions	84,818
Extraordinary item from Redevelopment Agency Dissolution	(2,061,851)
Change in net assets	(2,063,382)
Net assets held in trust, beginning of period	-
Net assets held in trust, end of year	$ (2,063,382)

On June 25, 2012, the County Auditor-Controller provided a property tax distribution of $70.6 million, which reflected a deduction of $3.8 million in pre-1989 tax overrides. The SARA filed suit challenge this deduction and the County Auditor-Controller placed the dispute amount in a special impound account instead of distributing this tax pending the outcome of litigation (see Note 10). On June 28, 2012, the SARA received an additional property tax distribution of $6.9 million for a total June 2012 distribution of $77.5 million. In addition, the SARA recognized $4.7 million of other tax revenues for the period ended June 30, 2012 (see Note 7).

During the five-month period ended June 30, 2012, the SARA reclassified 4 properties with a book value of $49.9 million from capital assets to property held for resale and wrote down these properties in the amount of $27.4 million to the lower of cost or net realizable value.

Interest expense including accrued interest on SARA's outstanding debt for the period totaled $45.4 million.

Capital Assets

The SARA's investment in properties transferred from the former Agency is comprised of the following at June 30, 2012:

	Land and Construction in Progress	Depreciable Cost	Total Cost	Accumulated Depreciation	Net Book Value
Governmental use assets:					
Dr. Martin Luther King, Jr. Library	$ -	$ 64,785,278	$ 64,785,278	$ 9,966,967	$ 54,818,311
Sidewalk on WozWay	786,264	-	786,264	-	786,264
Convention Center Phase I Expansion	-	3,773,759	3,773,759	830,581	2,943,178
Edenvale Community Center	-	15,576,138	15,576,138	1,038,409	14,537,729
Civic Auditorium	-	11,637,152	11,637,152	1,817,337	9,819,815
San Jose Municipal Stadium Improvements	-	560,781	560,781	37,385	523,396
Montgomery Theater	-	374,740	374,740	37,474	337,266
St. James Park Improvements	-	272,670	272,670	18,178	254,492
Julian Street Realignment Construction Project	976,695	-	976,695	-	976,695
Guadalupe River Park - Freeway Landscape	5,831,917	-	5,831,917	-	5,831,917
Santa Clara Valley Water District Easement	27,957	-	27,957	-	27,957
Subtotal	7,622,833	96,980,518	104,603,351	13,746,331	90,857,020
Assets used to secure debt (JPMorgan Collateral)					
Billy DeFrank Community Center	2,077,461	1,070,435	3,147,896	160,566	2,987,330
Guadalupe River Park - Locus Street	1,002,642	-	1,002,642	-	1,002,642
Balbach/Almaden Parking Lot	2,374,931	-	2,374,931	-	2,374,931
San Jose Stage	983,995	107,985	1,091,980	25,197	1,066,783
West Julian Parcel	975,819	-	975,819	-	975,819
Anti Graffiti Office Parcel	310,909	-	310,909	-	310,909
Camera 1/2 Fish Building Parcel	1,075,927	-	1,075,927	-	1,075,927
Japantown Miraido Parcel	5,350,115	-	5,350,115	-	5,350,115
Mexican Heritage Plaza - Retail Lot	368,593	-	368,593	-	368,593
Hanchett Parking Lot	426,632	-	426,632	-	426,632
Little Portugal Parking Lot	3,900	-	3,900	-	3,900
Ryland Park (under Coleman overcrossing)	463,253	-	463,253	-	463,253
Camera 12 Parcel	563,101	-	563,101	-	563,101
Plaza Hotel Parcel	2,212,794	-	2,212,794	-	2,212,794
Westinghouse Lot	82,937	-	82,937	-	82,937
Subtotal	18,273,009	1,178,420	19,451,429	185,763	19,265,666
Assets used to secure debt (HUD Collateral)					
Jose Theatre	845,820	7,155,774	8,001,594	1,100,886	6,900,708
Other capital assets:					
4th Street Parking Facility - Tenant Improvements	-	2,316,567	2,316,567	154,438	2,162,129
Hilton Hotel Ground Lease	1,304,000	-	1,304,000	-	1,304,000
Market Gateway Housing Ground Lease	3,253,517	-	3,253,517	-	3,253,517
Century Residential Housing Ground Lease	4,281,701	-	4,281,701	-	4,281,701
Equipment	-	1,144,956	1,144,956	1,025,147	119,809
Other	-	355,255	355,255	23,684	331,571
Subtotal	8,839,218	3,816,778	12,655,996	1,203,269	11,452,727
Total	$ 35,580,880	$ 109,131,490	$ 144,712,370	$ 16,236,249	$ 128,476,121

Additional information about the SARA's capital assets can be found on page 17, Note 5 of the financial statements.

Debt Administration

At June 30, 2012, the SARA had long-term bonds and notes outstanding aggregating to $2.4 billion, a decrease of $37.0 million from February 1, 2012, resulting from debt service payments on the CSCDA ERAF Loans and an extraordinary item for the write-off of principal and interest payable on invalidated City loans. Of this amount, $2.0 billion represents senior debt backed by redevelopment property tax revenues. The remainder of the SARA's debt represents other bonds and notes secured by redevelopment property tax and other revenues such as developer payments, lease payment revenue, interest earnings and other sources.

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

Senior Debt:	
Tax Allocation Bonds:	
Merged Area	$ 1,661,800
Housing Set-Aside	328,980
Subtotal - Tax Allocation Bonds	1,990,780
Subordinate Debt:	
Merged Area Revenue Bonds	93,655
Pledge Obligation - 4th/San Fernando Parking Revenue Bonds	33,435
Convention Center Refunding Bonds	129,020
California Statewide Communities Development Authority ERAF Loans	13,760
HUD Section 108 Loans	29,745
City of San Jose SERAF Loan	65,371
County of Santa Clara Pass-through Obligation	23,562
Subtotal - subordinated debt	388,548
Total long-term debt	$ 2,379,328

Credit Rating Actions

On November 21, 2011, Standard & Poor's Rating Services (S&P) lowered its long-term rating and underlying (SPUR) to 'BBB' from 'BBB+' on the outstanding Merged Area Tax Allocation Bonds of the Agency. S&P also revoked the "Credit Watch negative" and assigned "negative" outlook. In January 2012, Moody's Investors Service (Moody's) announced that it was downgrading all California tax allocation bonds rated Baa2 and above by one notch. Fitch Ratings (Fitch) followed suit the following week by placing all California bonds secured by tax increment revenue on a "Rating Watch Negative". The Moody's rating action increased the SARA's variable rate bond costs. The action taken by rating agencies increased the SARA's Wells Fargo Private Placement Bond interest costs by approximately $440,000 and JPMorgan Letter of Credit (LOC) fees by approximately $226,000 in the fiscal year 2011-2012.

During the week of June 4, 2012, Moody's, S&P, and Fitch, took rating actions on the former Redevelopment Agency of the City of San José (the "Agency") tax allocation bonds ("TABs"). The ratings actions from Moody's, S&P, and Fitch are summarized below:

	Moody's	S&P	Fitch
Agency 80% Merged Area TABs	Range from "Ba3" to "Ba2"	BBB	Range from "BB-" to "BB+"
Housing 20% Set-Aside TABs	Baa2	A	A

It is estimated that these actions will increase the annual fees paid to JPMorgan by approximately $725,000 per year and to Wells Fargo Bank as holder of the subordinate 20% Housing Set-Aside TABS by approximately $530,000. In addition to the individual TAB ratings on June 14, 2012, Moody's downgraded to Ba1 all California TABs that were rated Baa3 or higher.

Additional information about the SARA's long-term obligations is available on pages 18 to 27 in the notes to the financial statements.

REVENUES AND RECOGNIZED OBLIGATION PAYMENTS SCHEDULE

Pursuant to AB X1 26, the SARA is required to adopt a Recognized Obligation Payments Schedule ("ROPS"). A ROPS, listing all enforceable obligations due and payable in the six month coverage period, is prepared semi-annually and is the basis for the distribution of property tax revenues from the Redevelopment Property Tax Trust Fund (Trust Fund). Management has determined that the ROPS will replace the SARA's annual budget.

The semi-annual Administrative Budget for the SARA is presented and approved by the Successor Agency (governing) Board and the SARA's Oversight Board, and subsequently approved as part of the ROPS by the State Department of Finance.

In the event that future redevelopment property tax revenues are not sufficient to cover the former Agency'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 2001 F (Convention Center); City of San José Financing Authority Revenue Bonds, Series 2001 A (4th and San Fernando Streets Parking Facility Project); U.S. Housing and Urban Development (HUD) 108 loans and Education Revenue Augmentation Fund (ERAF) payments; and the SARA annual administrative budget and City support service expenses.

OUTSTANDING AUDITS AND REPORTING REQUIREMENTS

SARA staff continues to work closely with the State Controller's Office (SCO), State Department of Finance (DOF) and the County Auditor-Controller (CAC) to complete the outstanding audits and reporting requirements for compliance with AB X1 26 and AB 1484.

Reporting requirements include (1) DOF - Review of Housing Assets, (2) CAC – Review of Former Redevelopment Agency's Assets, Liabilities and Other Indebtedness, (3) SCO – Asset Transfers Review, (4) DOF – Due Diligence Review – Housing, and (5) DOF – Due Diligence Review – Non Housing. Upon completion and approval/certification of these reports/reviews, the SARA will receive a Finding of Completion and be allowed to submit a Property Management Plan for the disposition and sale of its assets. In addition, the Finding of Completion allows the SARA to request approval of the Oversight Board along with DOF confirmation to reinstate loans between SARA and the City.

REQUEST FOR INFORMATION

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

SUCCESSOR AGENCY TO THE
REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
(A Component Unit of the City of San José, California)
Statement of Fiduciary Net Assets
June 30, 2012

Assets		
Current assets:		
Cash and investments	$	6,965,428
Receivables:		
Due from the City of San José		849,979
Other		518,808
Restricted deposit in transit to fiscal agent		16,629,830
Restricted cash and investments		137,369,071
Total current assets		162,333,116
Noncurrent assets:		
Advances to the City of San José		280,280
Loans receivable, net		31,274,681
Deposits		155,315
Deferred charges		30,939,554
Property held for resale		22,473,641
Capital assets:		
Nondepreciable		35,580,880
Depreciable, net		92,895,241
Total noncurrent assets		213,599,592
Total assets		375,932,708
Liabilities		
Current liabilities:		
Accounts payable		1,413,586
Accrued salaries and benefits		71,112
Accrued interest payable		41,682,429
Due to the City of San José		199,994
Pass-through payable to the County of Santa Clara		15,719,157
Unearned revenues		2,339,444
Deposits, retentions, and other payables		635,400
Total current liabilities		62,061,122
Noncurrent liabilities:		
Due within one year		258,148,696
Due in more than one year		2,119,105,493
Total noncurrent liabilities		2,377,254,189
Total liabilities		2,439,315,311
Net assets held in trust	$	(2,063,382,603)

See accompanying notes to the basic financial statements.

SUCCESSOR AGENCY TO THE
REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
(A Component Unit of the City of San José, California)
Statement of Changes in Fiduciary Net Assets
For the Period from Inception (February 1, 2012) through June 30, 2012

Additions:		
Redevelopment property tax revenues	$	82,236,223
Investment income		150,274
Rent		322,255
Other		577,876
Total additions		83,286,628
Deductions:		
General and administrative:		
Salaries, wages and benefits		588,589
Materials, supplies and other services		378,499
Project expenses		816,060
Pass-through amounts to the County of Santa Clara		8,177,006
Loss on fair value of property held for resale		27,417,434
Depreciation		2,039,636
Interest on debt		45,401,119
Total deductions		84,818,343
Extraordinary item from Redevelopment Agency Dissolution		(2,061,850,888)
Change in net assets		(2,063,382,603)
Net assets, beginning of period		-
Net assets, end of period	$	(2,063,382,603)

See accompanying notes to the basic financial statements.

NOTE 1 – REPORTING ENTITY

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

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

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

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States ("GAAP").

Basis of Accounting

The financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenues from grants, entitlements and donations are recognized in the fiscal year in which all eligibility requirements have been satisfied.

Investments

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

Redevelopment Property Tax Revenues

Pursuant to the Redevelopment Dissolution Law, funds that would have been distributed to the former Agency as tax increment, hereafter referred to as redevelopment property tax revenues, are deposited into the SARA's Redevelopment Property Tax Trust Fund ("Trust Fund") administered by the County's Auditor-Controller for the benefit of holders of the former Agency's enforceable obligations and the taxing entities that receive pass-through payments. Any remaining funds in the Trust Fund, plus any unencumbered redevelopment cash and funds from asset sales are distributed by the County to the local agencies in the project area unless needed to pay enforceable obligations.

Distributions are to be made twice each year on the following cycles:

Distribution Dates	Covers Recognized Obligation Payment Schedules to be Paid
January 2	January 1 through June 30
June 1	July 1 through December 31

The amounts distributed for Recognized Obligation Payment Schedules (ROPS) are forward looking to the next six month period.

Restricted Assets

Assets are restricted for specified uses by bond debt requirements, grant provisions or other requirements and their use is limited by applicable bond covenants or agreements.

Property Held for Resale

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

During the five-month period ended June 30, 2012, the SARA reclassified 4 properties with a book value of $49.9 million from capital assets to property held for resale and wrote down these properties in the amount of $27.4 million to the lower of cost or net realizable value.

Capital Assets

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

Issuance Costs, Original Issue Discounts, Premiums, and Refundings

Issuance costs are reported as deferred charges and are amortized into the appropriate expense category. Long-term debt is reported net of the applicable premiums, discounts, and deferred amounts on refunding. The premiums, discounts, and deferred amounts on refunding are amortized as a component of the interest expense in a systematic and rational matter over the remaining life of the debt instrument.

Extraordinary Item

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

The dissolution of all redevelopment agencies in the State of California qualifies as an extraordinary item since this state-wide dissolution was both unusual and infrequent. Accordingly, the transfer of the assets and liabilities of the former Agency, the transfer of the City's Low and Moderate Income Housing Fund's unencumbered assets, and the invalidation of loans and related accrued interest in excess of the State of California Local Agency Investment Fund (LAIF) rate advanced from the City as of February 1, 2012 were recorded as an extraordinary loss in the SARA's financial statements.

The components of the extraordinary loss recognized are as follows:

Transfers in of the former Agency's assets as of January 31, 2012	$	376,297,558
Transfers in of the former Agency's liabilities as of January 31, 2012		(2,480,299,350)
Transfers in of cash from the Low and Moderate Income Fund held by the City to pay enforceable obligations		6,863,280
Invalidation of certain loans made between the City and the former Agency on February 1, 2012 pursuant to AB X1 26		32,348,112
Invalidation of accrued interest on the Supplemental Educational Revenue Augmentation Funds Loan in excess of the LAIF rate pursuant to AB X1 26, as amended		2,939,512
Extraordinary loss from Redevelopment Agency Dissolution	$	(2,061,850,888)

Prior to February 1, 2012, the California Redevelopment Law provided tax increment financing as a source of revenue to redevelopment agencies to fund redevelopment activities. Once a redevelopment area was adopted, the former Agency could only receive tax increment to the extent that it could show on an annual basis that it has incurred indebtedness that must be repaid with tax increment. Due to the nature of the redevelopment financing, the former Agency liabilities exceeded assets. Therefore, the former Agency historically carried a deficit, which was expected to be reduced as future tax increment revenues were received and used to reduce its outstanding long-term debt.

Use of Estimates

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results may differ from those estimates.

NOTE 3 – CASH AND INVESTMENTS

The SARA's cash and investments consist of the following at June 30, 2012:

Cash and Investments	Amount
Cash and investments	$ 6,965,428
Restricted deposit in transit to fiscal agent	16,629,830
Restricted cash and investments	137,369,071
Total cash and investments	$ 160,964,329

Investments

The SARA follows the investment policy of the City, which is governed by provisions of the California Government Code and the City's Municipal Code. The SARA also has investments subject to provisions of the bond indentures of the former Agency's various bond issues. According to the investment policy and bond indentures, the SARA is permitted to invest in the City's cash and investment pool, LAIF, obligations of the U.S. Treasury or U.S. Government agencies, time deposits, money market mutual funds invested in U.S. Government securities, along with various other permitted investments.

As of June 30, 2012, the SARA invested a total amount of $26,614,784 with LAIF, which is comprised of $1,525,000 from its unrestricted accounts, $12,557,270 from the 2003 Tax Allocation Bonds reserve account, $2,527,500 from the 2008 Tax Allocation Bonds reserve and capitalized interest accounts, $26,040 from 2008 Tax Allocation Bonds project account, and $9,978,974 from the 2010 Housing Set-Aside Bonds reserve account. The weighted average maturity of LAIF was 268 days at June 30, 2012. Government Code Section 16429.1 authorizes each local government agency to invest funds in the LAIF administered by the California State Treasurer. The total amount recorded by all public agencies in LAIF at June 30, 2012 was approximately $21.9 billion. LAIF is part of the State's Pooled Money Investment Account (PMIA). PMIA has a total of approximately $60.5 billion and of that amount, 3.47% is in structured notes and asset backed securities. The Local Investment Advisory Board has oversight responsibility for LAIF. The Board consists of five members, as designated by state statute. The value of the pool shares in LAIF, which may be withdrawn upon request, is determined on an amortized cost basis, which is different from the fair value of the SARA's position in the pool.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the SARA 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 SARA will not be able to recover the value of the investment or collateral securities that are in the possession of another party.

The California Government Code requires that a financial institution secure its deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by the depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged governmental securities and/or first trust deed mortgage notes held in the collateral pool must be at least 110% and 150% of the SARA's deposits, respectively. The collateral is held by the pledging financial institution's trust department and is considered held in the SARA's name.

As of June 30, 2012, $12,483,726 of the SARA's bank balance was exposed to custodial credit risk because it was uninsured beyond the Federal Deposit Insurance Corporation (FDIC) insurance coverage limit of $250,000, but collateralized by the pledging financial institutions as required by Section 52652 of the California Government Code. Such collateral is held by the pledging financial institutions' trust department or agent, in the SARA's name. The actual book balance amounted to $13,690,441 as of June 30, 2012. In addition, SARA's restricted deposit in transit to the fiscal agent in the amount of $16,629,830 was not insured or collateralized at June 30, 2012.

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

Interest Rate Risk

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

Credit Risk

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

Concentration of Credit Risk

Concentration of credit risk is the risk that the failure of any one issuer would place an undue financial burden on the SARA. Investments issued by or explicitly guaranteed by the U.S. Government and investments in mutual funds, external investment pools, and other pooled investments are exempt from this requirement, as they are normally diversified themselves.

A summary of the SARA's cash and investments at June 30, 2012 is as follows:

Type of Investment	Credit Rating	Maturity (in days) Under 30	31 - 180	181 - 365	366 to 3 years	Fair Value
State of California						
Local Agency Investment Fund	Unrated	$ -	$ -	$ 26,614,784	$ -	$ 26,614,784
U.S. Treasury Notes	Aaa	-	-	-	8,279,862	8,279,862
Money Market Mutual Funds	Aaa	92,310,299	3,438,313	-	-	95,748,612
Subtotal		$ 92,310,299	$ 3,438,313	$ 26,614,784	$ 8,279,862	130,643,258
Certificates of Deposit						8,250,800
Restricted deposit in transit to fiscal agent						16,629,830
Bank deposits						5,439,641
Petty cash						800
Grand Total						$ 160,964,329

Restricted Cash and Investments with Fiscal Agents

Under the provisions of the bond indentures, certain accounts with trustees were established for repayment of debt, amounts required to be held in reserve, and temporary investments for unexpended bond proceeds. As of June 30, 2012, the amounts held by the trustees aggregated $129,118,258. All restricted investments held by trustees as of June 30, 2012 were invested in U.S. treasury notes, money market mutual funds and LAIF, and were in compliance with the bond indentures.

Restricted Investments Held in Escrow Accounts

Pursuant to contracts and agreements made by the former Agency, certain funds are required to be held in escrow accounts that remain the property of the SARA and their use is restricted for particular purposes, which as of June 30, 2012, are as follows:

Project/Program	Amount
Dr. Martin Luther King, Jr Library	$ 1,822,586
The 88 Tower (Retail and Housing)	718,448
HUD Section 108 Loans Debt Service Account	687,424
Center for Employment Training Toxic Fund	22,342
Total other restricted deposits	$ 3,250,800

NOTE 4 – LOANS RECEIVABLE

Composition of loans receivable as of June 30, 2012 is as follows:

	Description	Loan Balance
1.	Parcels of land sold to developers	$ 1,728,360
2.	HUD Section 108 loans	3,018,947
3.	Rehabilitation of apartment complex	384,798
4.	Historic homes relocation loans	3,261,585
5.	Rehabilitation of residential units	170,571
6.	Commercial building loans	10,434,480
7.	Residential housing projects	16,543,506
8.	Rehabilitation of historic hotel building	5,265,000
9.	Small business loan program	253,121
	Total loans	41,060,368
	Accrued interest receivable	5,110,610
	Total loans and interest receivable	46,170,978
	Less allowance for doubtful accounts	(14,896,297)
	Loans receivable, net	$ 31,274,681

1. Over the years, parcels of land have been sold to commercial real estate developers in various mixed-use projects. In one downtown residential condominium project, a non-interest bearing promissory note was recorded in 2007 whereby the former Agency deferred a portion of the land sale until the first residential unit closed escrow. On April 26, 2011, the loan agreement was amended giving right to the developer to convert the project from for-sale to rental. The amended agreement also gave the developer the authority to subsequently convert any units back to for-sale units. The principal loan and interest are due and payable when all proceeds of sold condominium units exceed the invested capital threshold. As of June 30, 2012, the amount due from the developer was $1,728,360. A 100% provision for doubtful accounts was provided for the entire loan balance because the likelihood of the payment criteria being met is questionable in the foreseeable future.

2. In 1997 and 2007, the former Agency extended loans to developers using funds obtained from the U.S. Department of Housing and Urban Development Section 108 loan proceeds. These loans have a 20-year repayment schedule, bear interest at an annual rate of 3%, and require principal and interest payments to the SARA on a monthly basis. As of June 30, 2012, the amount due from the developers was $3,018,947. An allowance for doubtful accounts in the amount of $1,372,892 was made to account for the principal balance of a loan due to amounts in arrears.

3. In 1999, the former Agency extended a loan to a developer for rehabilitation of an apartment complex. The loan to the developer has a 19-year repayment schedule, bears interest at an annual rate of 3%, and requires principal and interest payments to the SARA on a monthly basis. As of June 30, 2012, the amount due from the developer was $384,798.

4. The former Agency relocated historic single-family homes to vacant lots in downtown San José. These homes were provided to families and a non-profit agency, which provided the interior and

exterior improvements. The loans are to be amortized and forgiven over a certain number of periods and to be paid only in the event of non-compliance with the terms and conditions of the agreements. At the time residential occupancy of the house ceases or the property is transferred to anyone other than the owner by any method other than inheritance, the unamortized portion of the loan shall become due and payable in full. Unpaid principal shall bear an interest rate of 8% per annum. The total loans of $3,261,585 have been offset with a 100% provision for doubtful accounts as it is anticipated that these loans will be forgiven or fully amortized over the period of the loan.

5. The former Agency extended various bank-assisted loans to aid first-time homebuyers and to aid with the rehabilitation of homes. The loans accrue interest at various interest rates and are due when the related properties are sold. As of June 30, 2012, the net amount due from such loans was $170,571. This amount has been offset with a 100% provision for doubtful accounts because of the indefinite timeline of repayment.

6. The former Agency extended various loans to property owners for the rehabilitation and improvements of commercial buildings. These loans accrue interest at various interest rates and are due within 10 to 25 years. At June 30, 2012, the total amount due from such loans was $10,434,480. An allowance for doubtful accounts in the amount of $3,097,889 was made for anticipated write-offs.

7. The former Agency entered into Disposition and Development Agreements with various developers for the construction of residential housing units in redevelopment project areas. The funding assistance extended by the former Agency was converted to loans bearing an interest rate ranging from 2% to 4% and the repayment of the loan is contingent upon the positive net cash flow of the project. As of June 30, 2012, the amount due from the developers was $16,543,506.

8. In May 2005, the former Agency amended and restated a Disposition and Development Agreement with a developer recognizing a loan for the rehabilitation of a historic hotel building. The loan has a 60-year repayment schedule, bears no interest, and requires principal payments to the Agency on a semi-annual basis starting in fiscal year 2020-2021. As of June 30, 2012, the amount due from the developer was $5,265,000. A 100% provision for doubtful accounts was provided for the entire loan balance due to the extended timeline before payments commence.

9. In June 2002, the former Agency Board approved the creation of the Small Business Loan Program to be administered by the City’s Office of Economic Development (OED) and to be funded by the former Agency with non-tax increment funds. The program offered reduced-rate loans to small businesses located in Downtown and Neighborhood Business Districts. The loans bear an interest rate of 3% with a 5-year term. In July 2008, administration of the program was transferred from OED to the former Agency. The former Agency has not funded the program since then. As of June 30, 2012, the outstanding loans totaled $253,121.

NOTE 5 – CAPITAL ASSETS

A summary of changes in the SARA's capital assets for the period from inception on February 1, 2012 through June 30, 2012, is as follows:

	February 1, 2012	Additions	Recategorized to Property Held for Resale	June 30, 2012
Capital assets, not being depreciated:				
Land	$ 66,036,260	$ -	$ (31,432,075)	$ 34,604,185
Construction in progress	976,695	-	-	976,695
Total capital assets, not being depreciated	67,012,955	-	(31,432,075)	35,580,880
Capital assets, being depreciated:				
Buildings	109,097,625	-	(20,510,000)	88,587,625
Building and other improvements	19,398,909	-	-	19,398,909
Equipment	1,144,956	-	-	1,144,956
Total capital assets, being depreciated	129,641,490	-	(20,510,000)	109,131,490
Less accumulated depreciation:				
Buildings	12,891,760	1,426,068	(2,051,000)	12,266,828
Building and other improvements	2,405,416	538,858	-	2,944,274
Equipment	950,437	74,710	-	1,025,147
Total accumulated depreciation	16,247,613	2,039,636	(2,051,000)	16,236,249
Total capital assets, being depreciated, net	113,393,877	(2,039,636)	(18,459,000)	92,895,241
Total capital assets, net	$ 180,406,832	$ (2,039,636)	$ (49,891,075)	$ 128,476,121

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

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

Depreciation expense for the period from inception (February 1, 2012) through June 30, 2012 was $2,039,636.

SUCCESSOR AGENCY TO THE
REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
(A Component Unit of the City of San José, California)

Notes to the Basic Financial Statements
For the Period From Inception (February 1, 2012) through June 30, 2012

NOTE 6 – DEBT

Long-term Debt

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

Type of Indebtedness	Purpose		Original Issue Amount	Issue Date	Maturity Date	Interest Rate Range	Annual Principal Installments		June 30, 2012 Balance
Tax Allocation Bonds (TAB):									
1993 Merged Refunding	Advance refunding	$	692,075	12/01/1993	08/01/2015	6.00%	$0-18,195	$	18,195
1997 Merged	Merged area project		106,000	03/27/1997	08/01/2028	5.38-5.63%	$10-715		5,810
1999 Merged	Merged area project		240,000	01/06/1999	08/01/2019	4.75%	$0-7,165		12,920
2002 Merged	Merged area project		350,000	01/24/2002	08/01/2015	4.00-4.50%	$0-11,290		13,165
2003 Merged	Merged area project		135,000	12/22/2003	08/01/2033	4.00-5.00%	$25- 34,100		127,545
2004 A Merged Refunding	Refunding TABs		281,985	05/27/2004	08/01/2019	4.23- 5.25%	$8,775-31,900		193,215
2005 A/B Merged Refunding	Refunding TABs		220,080	07/26/2005	08/01/2028	4.00- 5.00%	$0-26,210		198,115
2006 A/B Merged	Merged area project		81,300	11/14/2006	08/01/2035	4.50- 5.65%	$0-21,000		80,300
2006 C/D Merged Refunding	Refunding TABs		701,185	12/15/2006	08/01/2032	3.75-5.00%	$0-74,280		698,990
2007 A-T/B Merged	Merged area project		212,930	11/07/2007	08/01/2036	0-5.10%	$0-23,970		205,685
2008 A/B Merged	Merged area project		117,295	11/13/2008	08/01/2035	0–7.00%	$0-6,700		107,860
1997 Housing, Series E	Low-moderate income housing		17,045	06/23/1997	08/01/2027	5.75-5.85%	$340-3,670		17,045
2003 Housing, Series J/K	Low-moderate income housing		69,000	07/10/2003	08/01/2029	3.40- 5.25%	$230-3,505		40,815
2005 Housing Series A/B	Low-moderate income housing		129,720	06/30/2005	08/01/2035	0-5.46%	$0-8,300		120,300
2010 Housing Series A/B	Low-moderate income housing		67,405	04/15/2010	08/01/2035	0-5.5%	$0-6,305		62,220
2010 Housing Series C	Low-moderate income housing		93,000	04/29/2010	08/01/2035	Variable	$2,425-5,210		88,600
Total Tax Allocation Bonds									**1,990,780**
Other Long-term Debt:									
1996 Merged Area Revenue, Series A/B	Merged area projects		59,000	06/27/1996	07/01/2026	Variable	$2,000-4,000		46,000
2003 Merged Area Revenue, Series A/B	Merged area projects		60,000	08/27/2003	08/01/2032	Variable	$1,300-3,900		47,655
Pledge Agreement - Revenues Bonds 2001A	4th/San Fernando parking facility		48,675	04/10/2001	09/01/2026	4.13-5.25%	$1,740-3,205		33,435
Reimbursement Agreement - Refunding Revenue Bonds 2001F	Convention Center project		190,730	07/01/2001	09/01/2022	4.25-5.00%	$9,150-14,730		129,020
CSCDA 2005 ERAF Loan	Fund the State's ERAF Program		19,085	04/27/2005	08/01/2015	4.77-5.01%	$2,140-2,355		6,735
CSCDA 2006 ERAF Loan	Fund the State's ERAF Program		14,920	05/03/2006	08/01/2016	5.53-5.67%	$1,615-1,905		7,025
HUD Section 108 Loans	Merged area projects		5,200	02/11/1997	08/01/2016	Variable	$355-465		2,035
HUD Section 108 Loans (CIM)	Merged area projects		13,000	02/08/2006	08/01/2025	Variable	$600-1,135		11,830
HUD Section 108 Loans (Story & King)	Merged area projects		18,000	06/30/2006	08/01/2025	Variable	$785-1,570		15,880
City of San José SERAF Loan	Fund the State's SERAF Payment		64,816	2010-2011	06/30/2015	Variable	$12,873-52,499		65,371
Other Long-term Obligation-County Pass Through	Pass-through payment		23,562	06/30/2011	06/30/2017	Variable	$4,713		23,562
Total Other Long-term Debt									**388,548**
Total Long-term Debt								**$**	**2,379,328**

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

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

Historically, upon receipt of property tax increment, the former Agency calculated the 80% and 20% amounts of tax increment and would then transfer the 20% portion to the Low and Moderate Income Housing Fund held by the City, as required by the California Health and Safety Code. The previous requirement to bifurcate the tax increment into the 80% and 20% portions was eliminated in AB X1 26. However, in order to maintain compliance with bond indentures secured by both 80% and 20% tax increment, the SARA continues bifurcating tax increment into 80% and 20% portions on an ongoing basis and segregating the funds accordingly until all annual senior debt service obligations have been satisfied.

Merged Area Tax Allocation Bonds

The Merged Area Tax Allocation Bonds (TABs), which are comprised of Series 1993, Series 1997, Series 1999, Series 2002, Series 2003, Series 2004A, Series 2005A/B, Series 2006A/B, Series 2006C/D, Series 2007A-T/B and Series 2008A/B, are all secured primarily by a pledge of redevelopment property tax revenues (i.e., former tax increment), consisting of a portion of all taxes levied upon all taxable properties within each of the tax 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, 2012, assuming no growth in assessed value throughout the term of each constituent project area, the total accumulated 80% redevelopment property tax revenue through the period of the bonds would be approximately $2,762,521,000 (Urban Analytics, January 2012). These revenues have been pledged until the year 2036, the final maturity date of the bonds. The total principal and interest remaining on these Tax Allocation Bonds as of June 30, 2012 is approximately $2,631,090,000. The 80% redevelopment property tax revenue recognized during the reporting period February 1, 2012 through June 30, 2012 in the amount of $62,000,586 was transferred to the fiscal agent to cover the August 1, 2012 debt service. The total debt service payments (interest) on the Senior TABs amounted to $40,708,238 for the subject reporting period.

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

Housing Set-Aside Tax Allocation Bonds

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

As of June 30, 2012, assuming no growth in assessed value throughout the term of each constituent project area, the total accumulated 20% tax increment revenue through the period of the bonds would be approximately $699,534,000 (Urban Analytics, January 2012). These revenues have been pledged until the year 2035, the final maturity date of the bonds. The total principal and interest remaining on these Housing Set-Aside Tax Allocation Bonds as of June 30, 2012 is approximately $517,878,000. The 20% redevelopment property tax revenue recognized during the five-month period ended June 30, 2012 was $15,500,145. The total debt service payments on housing bonds (interest) amounted to $7,105,649 for the subject reporting period.

Variable-Rate Demand Bonds

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

The daily and weekly rates are the rates that result in the market value of the bonds being equal to 100% of the principal amount outstanding. The average interest rate for the daily and weekly rates for June 30, 2012, was 0.18% for the 1996 Series A and 0.22% for the 1996 Series B, respectively. The total debt service (interest) on 1996 Bonds amounted to $24,000 for the five-month period ended June 30, 2012.

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

The 2003 Merged Area Revenue Bonds have a variable rate of interest at a weekly rate, until converted to bear interest at another variable rate or fixed rate at the option of the SARA. The weekly rates are the rates that result in the market value of the bonds being equal to 100% of the outstanding principal and accrued interest. The rates for June 30, 2012 were 0.18% for the 2003 Series A and 0.22% for the 2003 Series B, respectively. The total debt service (interest) on 2003 Merged Area Revenue Bonds amounted to $33,000 for the five-month period ended June 30, 2012.

The scheduled redemption of the variable-rate demand bonds is incorporated in the annual requirements to maturity schedules. The former Agency issued these bonds to provide variable-rate exposure to the debt portfolio and to provide additional flexibility with respect to restructuring or redeeming the debt issued for certain projects. 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 variable-rate demand bonds are as follows:

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

* Expiration date of these credit facilities were extended by the JPMorgan Chase Bank (see below).

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. The remarketing agents are required to use their best efforts to remarket the bonds and, to the extent that bonds are not remarketed, the bond trustees are authorized to draw on the credit facilities in the amounts required to pay the purchase price of bonds tendered.

In connection with the issuance of the 1996 and 2003 Bonds, the former Agency obtained four letters of credit (LOCs) as credit facilities from the credit facility provider, JPMorgan Chase Bank (JPMorgan), for the bonds. On May 24, 2012, the Oversight Board for the SARA approved the extension of the LOCs from a July 1, 2012 expiration date to an expiration date of July 1, 2013. However, as a result of the uncertainty surrounding the amount of redevelopment property tax revenues to be distributed to the SARA, in June 2012, JPMorgan notified the SARA and the City of its inability to proceed with a one year extension of the LOCs. On June 8, 2012, the last date provided for under the bond documents, an extension was finalized through September 1, 2012.

On June 28, 2012, the SARA received an additional transfer of $6,944,321 from the Trust Fund held by County. This distribution in conjunction with previous distributions provided for sufficient funds to be transferred to U.S. Bank, the fiscal agent for the JPMorgan subordinate bonds. As a result of these actions on August 7, 2012, JPMorgan agreed to extend the expiry of the existing term of the LOCs from September 1, 2012 to March 1, 2013. Negotiations are presently under way to extend the forbearance agreement. The SARA cannot predict the outcome of the negotiations.

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

The SARA is required to pay the credit facility provider an annual commitment fee for each credit facility ranging from 2.1% to 3.0%, based on the terms of the applicable reimbursement agreement and the outstanding principal amount of the bonds supported by the credit facility. In addition, in fiscal year 2010, the former Agency made the required deposit with JPMorgan, a liquidity reserve in the amount of $5 million 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 Letters of Credit (see Note 5 - Capital Assets).

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

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

The Series 2010C bears an interest rate at 1-month LIBOR, two London Business Days before the 1st day of each month plus 280 basis points, with a final maturity date of August 1, 2035. The average weekly interest rate for the Series 2010C as of June 30, 2012 was 3.05%.

4th and San Fernando Streets Parking Facility Agency Pledge Agreement

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

At June 30, 2012, the SARA has an outstanding obligation, per Agency Pledge Agreement, of $33,435,000.

Convention Center Refunding Reimbursement Agreement

In July 2001, the Financing Authority issued the Convention Center Lease Revenue Refunding Bonds, Series 2001 F (tax exempt) and Series 2001 G (taxable) amounting to $186,150,000 and $4,580,000, respectively. The bonds were issued to refund the 1993 Revenue Bonds, Series C. The net proceeds were placed in an irrevocable trust to provide future debt service payments on the refunded bonds. As a result, the 1993 bonds were considered defeased and the liabilities have been removed from the financial statements. As of June 30, 2012, there were no defeased bonds outstanding.

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

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

Over the years, the former Agency has been sporadically required to make payments to the State of California's Educational Revenue Augmentation Fund (ERAF) through the County of Santa Clara. To finance the 2006 and 2005 ERAF payments, the former Agency participated in the California Redevelopment Association/Educational Revenue Augmentation Fund (CRA/ERAF) Loan Program. This loan was assumed by the SARA. The loans are secured by all of the SARA's revenues but are subordinate to senior and junior debt obligations. As of June 30, 2012, the 2006 loan has a balance of $7,025,000, bears a fixed interest rate from 5.53% to 5.67% on remaining interest payments, and matures on August 1, 2016. The 2005 loan has a balance of $6,735,000 as of June 30, 2012, bears a fixed interest rate from 4.77% to 5.01%, and matures on August 1, 2015.

HUD Section 108 Loans

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

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

As of June 30, 2012, the outstanding loans assumed by the SARA, due to HUD, aggregated to $29,745,000. The notes payable to HUD mature annually through August 2025 and bear interest at 20 basis points above the LIBOR index. The average rate for June 2012 was 0.67%. The HUD loans are secured by several City and former Agency owned capital assets (South Hall, Jose Theater, East Santa Clara development site, Arena Lot D) with an aggregate gross value of $35,096,000 as of June 30, 2012, and CDBG grants that were awarded or will be awarded to the City.

Supplemental Educational Revenue Augmentation Funds (SERAF) Loan

On July 24, 2009, the State Legislature passed Assembly Bill (AB) 26 X4, which required redevelopment agencies statewide to deposit a total of $2.05 billion of property tax increment into the county held Supplemental Educational Revenue Augmentation Funds (SERAF) to be distributed to meet the State's Proposition 98 obligations to schools. The former Agency's SERAF obligation was $62.2 million in fiscal year 2009-2010 and $12.8 million in fiscal year 2010-2011. Payments were made by May 10 of each respective fiscal year.

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

In June 2012, the State legislature passed AB 1484 providing clean up language related to the dissolution of redevelopment agencies. This bill provided guidance for interest rates and the repayment of SERAF loans made between cities and redevelopment agencies. This loan agreement will have to be amended to comply with these guidelines. Additionally, AB X1 26 states that all prior loans made between the City and the former Agency, except for loans made from the Low and Moderate Income Housing Fund for payment of SERAF, are invalidated on February 1, 2012. As such, the $10,000,000 funded by City special funds and the accumulated interest and monitoring fees in the amount $77,917 is invalidated under this provision and is recorded as part of the SARA's extraordinary item.

The interest associated with the $64.8 million loan from the Low and Moderate Income Housing Fund has been recalculated from origination at the interest rate earned by LAIF as required by AB 1484. As such, $2.9 million of accumulated interest was written off as of February 1, 2012 and recorded as part of the SARA's extraordinary item.

Tax Sharing Agreement with the County of Santa Clara

1983 and 2001 Settlement Agreement

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

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

March 16, 2011 Settlement Agreement

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

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

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

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

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

During the year ended June 30, 2012, the former Agency and the SARA did not have sufficient tax increment revenues to make the fiscal year 2011-2012 pass-through payment. The amount of pass-through payments due to the County at June 30, 2012 is $15,719,157. The interest rate for any late pass-through payment for fiscal years 2011-12 and beyond will be as follows: (a) the rate of return earned by the County Treasurer Investment Pool for the relevant time period (“County Pool Rate”) for the first year the payments are overdue; (b) the County Pool Rate plus 3% additional interest rate penalty for the second year the payment is overdue; (c) the County Pool Rate plus 6% additional interest rate penalty for the third year the payment is overdue; and (d) the County Pool Rate plus 9% additional interest rate penalty for the fourth year and any additional years the payments are overdue, provided however that in no event shall the interest rate exceed 10% in any year.

Debt Service Requirements

The debt service requirements for all debt are based upon a fixed rate of interest, except 1996 Merged Area Revenue Bonds, Series A/B, 2003 Merged Area Revenue Bonds, Series A/B, 2010 Housing Set-Aside Bonds, Series C, and HUD Section 108 Loans, which bear interest at variable rates. Interest on the 1996 Merged Area Revenue Bonds Series A/B, 2003 Merged Area Revenue Bonds, Series A/B, and 2010 Housing Set-Aside Bonds, Series C may be set at different interest rate calculation modes, including daily, weekly, monthly and fixed rates. Interest on the 2010 Housing Set-Aside Bonds

Series C and HUD Section 108 loans is adjusted monthly, two days before the first day of each month to a variable interest rate equal to 172 basis points above the applicable LIBOR rate for the 2010 Housing Set-Aside Bonds Series C and 20 basis points for the HUD Section 108 Loan. The SERAF Loan bears interest at variable rates based on the LAIF rate.

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

Bond issues	Effective interest rate
1996 Merged Area Revenue, Series A	0.18000%
1996 Merged Area Revenue, Series B	0.22000%
2003 Merged Area Revenue, Series A	0.18000%
2003 Merged Area Revenue, Series B	0.22000%
2010 Housing Set-Aside, Series C	3.05000%
HUD Section 108 loans	0.66685%
SERAF Loan – (LAIF)	0.36000%

The annual requirements to amortize outstanding tax allocation bonds and other long-term debt outstanding as of June 30, 2012, including mandatory sinking fund payments, are as follows (in thousands):

Year Ending	Merged Tax Allocation Bonds		Housing Tax Allocation Bonds*		Merged Area Revenue Bonds**		Pledge and Other Agreements	
June 30	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2013	$ 51,590	$ 80,095	$ 9,845	$ 14,874	$ 3,300	$ 178	$ 10,890	$ 7,813
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
2018-22	359,105	292,227	69,420	56,589	25,320	597	75,945	16,814
2023-27	418,880	193,479	82,320	39,118	29,065	325	26,665	1,897
2028-32	382,560	92,977	77,915	19,357	16,140	121	-	-
2033-37	215,680	18,632	45,155	3,803	3,900	1	-	-
Total	$ 1,661,800	$ 969,290	$ 328,980	$ 188,898	$ 93,655	$ 1,860	$ 162,455	$ 52,193

Year Ending	Obligations with 3rd Parties		Obligations with the City		Total	
June 30	Principal	Interest	Principal	Interest	Principal	Interest
2013	$ 5,495	$ 926	$ -	$ 235	$ 81,120	$ 104,121
2014	10,487	718	-	236	90,092	100,283
2015	10,812	498	52,499	237	146,806	96,190
2016	8,672	261	12,872	49	109,339	91,684
2017	6,888	135	-	-	99,188	87,321
2018-22	14,698	479	-	-	544,488	366,706
2023-27	10,015	110	-	-	566,945	234,929
2028-32	-	-	-	-	476,615	112,455
2033-37	-	-	-	-	264,735	22,436
Total	$ 67,067	$ 3,127	$ 65,371	$ 757	$ 2,379,328	$ 1,216,125

* Assumes the 2010C Housing Set-Aside Tax Allocation Bonds would not be payable on demand on November 15, 2012 upon the expiration of the Wells Fargo Forbearance Agreement and the bank's tender date of April 29, 2013 (see Note 6 above). The scheduled redemption of these bonds is incorporated in the annual requirements to maturity schedules.

** Assumes the merged area revenue bonds would not be payable on demand upon expiration of the LOC on March 1, 2013. The scheduled redemption of these bonds is incorporated in the annual requirements to maturity schedules.

Conduit Debt

In August 1997, the former Agency served as the conduit issuer of $10,595,000 in Multifamily Housing Revenue Bonds in order to provide funds for a mortgage loan to a private developer for rental housing project on the Agency-owned land in the Japantown Redevelopment Project Area. The Agency has no obligation for these bonds as they are secured primarily by fully modified pass-through mortgage-backed securities guaranteed as a timely payment of principal and interest by the Government National Mortgage Association. The bonds were issued for the purpose of expanding the community's supply of low to moderate-income housing. Additionally, the loan is secured on a nonrecourse basis and is insured by the Federal Housing Authority pursuant to and in accordance with the provisions of Section 221(d) (4) of the National Housing Act. As of June 30, 2012, the outstanding balance was $9,260,000.

NOTE 7 – REDEVELOPMENT PROPERTY TAX TRUST FUND

On June 1, 2012, the County Auditor-Controller made the first distribution of funds from the Trust Fund to the SARA, in the amount of $61.7 million, which was substantially less than the SARA's projection of $81.1 million. The discrepancy was based on different interpretations as to how the redevelopment property tax revenues are to be distributed under the Redevelopment Dissolution Law. Additionally, the County Auditor-Controller determined that property tax overrides should not be considered redevelopment property tax revenues. These issues are currently the subject of a lawsuit filed by the SARA against the County Auditor-Controller on June 26, 2012 and discussed in more detail in Note 10.

By June 28, 2012, the SARA received a total property tax distribution for June 2012 of $77.5 million. In addition to the total June 2012 Trust Fund distribution of $77.5 million, the SARA recognized $4.7 million of other tax revenues for the five-month period ended June 30, 2012.

NOTE 8 –TRANSACTIONS WITH THE CITY OF SAN JOSE

City Expenditures

The SARA incurred $291,662 of general and administrative costs for support services of designated City employees allocated to the SARA administrative activities and $41,667 for rent of City office space.

Due from the City

The former Agency entered into Annual Cooperation Agreements to assist in funding various projects constructed on its behalf by the City and to reimburse the City for the actual salaries and fringe benefits of City employees who work under the supervision of the former Agency's Executive Director or designee, as well as other City staff in providing support services to the former Agency. As of June 30, 2012, the SARA has a receivable amount of $123,765 to recognize the total reimbursements due from the City.

The SARA is also due $726,214 from the City's Housing Activities Fund for reimbursement of prepaid housing administrative expenses at June 30, 2012.

Advances to the City

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

Due to the City

At June 30, 2012, the SARA has a payable to the City in the amount of $199,994 to reimburse the City for support services ($174,994) and for office rent ($25,000).

Other City Commitments

In the event that future redevelopment property tax revenues are not sufficient to cover the former Agency'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 2001 F (Convention Center) and City of San José Financing Authority Revenue Bonds, Series 2001 A (4^{th} and San Fernando Streets Parking Facility Project); U.S. Housing and Urban Development (HUD) 108 loans and Education Revenue Augmentation Fund (ERAF) payments; and the SARA annual administrative budget and City support service expenses. For additional information regarding long-term debt, please refer to Note 6.

NOTE 9 – COMMITMENTS AND CONTINGENCIES

Risk Management

The SARA is exposed to various risks of loss related to torts, theft, damage to and destruction of assets, errors and omissions, general liabilities, workers' compensation, and unemployment claims for which the SARA carries commercial insurance policies. Claim expenses and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated using actuarial methods or other estimating techniques. The technique to estimate claims is based on many complex factors, such as inflation, changes in legal doctrines, past settlements, and damages awarded. Accordingly, claims are reevaluated periodically to consider the effects of inflation, recent claim settlement trends (including frequency and amount of pay-outs), and other economic and social factors. The estimated claims liability includes amounts of incremental claims adjustment expense related to specific claims and other claims adjustments expenses, if any, regardless of whether allocated to specific claims.

Environmental Land Remediation Obligation

A review of the SARA's property during the five-month period ended June 30, 2012 reveals that there is no current pollution remediation required based on their current uses (i.e. surface parking and other uses), except the Adobe property and the Miraido property as discussed below. If in the future when a land remediation obligation occurs to a property due to a change in the purpose (i.e. convert to housing or retail project), the SARA will prepare estimates and comply with the provisions of GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations.*

Adobe Property - In prior years, the former Agency entered a Disposition and Development Agreement with Adobe Systems, Inc. for development of office towers and underground parking garage on land owned by the former Agency in the downtown area. After the parking garage was in operation, it was found that water has been accumulating in the parking ground area. To prevent ground water intrusion, accumulation and contamination in the area, a permanent dewatering and ground water treatment and discharge system (Groundwater Treatment System) was installed that cleanses the water from volatile organic compounds prior to discharging to the Guadalupe River. The cost for the operation and maintenance, sampling and reporting for the Groundwater Treatment System is approximately $95,000 per year based on the annual change in the consumer price index. Projected over four years, the cost would be $337,000, which has been recognized as a liability as of June 30, 2012. Although the former Agency sold the land to Adobe during the year ended June 30, 2011, the SARA is liable to maintain the treatment system and remedy the property from contamination.

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

Miraido is responsible for all cleanup activities and expected to be reimbursed by the State of California LUST fund in an amount up to $500,000. Miraido's consultant has estimated that the cost to achieve case closure is approximately $400,000, with which the former Agency's consultant concurs. Under the Ground Lease, Miraido is required to indemnify the former Agency if Miraido fails to complete the cleanup process and the former Agency incurs any cleanup costs as a result of such failure. As of June 30, 2012, neither the former Agency nor the SARA has incurred any cleanup costs and Miraido has been conducting the cleanup as required under the Ground Lease.

Ambac Bankruptcy

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

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

Encumbrances

At June 30, 2012, the SARA had encumbered $5,546,817 for contracted obligations.

Defined Contribution Retirement Plan

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

The total payroll in the five-month period ended June 30, 2012 for the SARA's direct employees were $457,000. Both the SARA and the participating employees made contributions to the Plan amounting to $39,000 and $8,000, respectively.

Leases

A schedule by years of future minimum rental payments required under the SARA's non-cancelable operating leases for office facilities, business equipment, and property as of June 30, 2012, is as follows (in thousands):

Year Ending June 30	Minimum payments	
2013	$	1,742,529
2014		1,304,527
2015		942,813
2016		827,067
2017		846,018
2018-2021		3,100,548
Total	$	8,763,502

The total rent expense for operating leases in the five-month period ended June 30, 2012 was $487,000.

Dissolution Legislation "True up" Process

The provisions of AB 1484, which was a trailer bill to the FY 2012-13 State budget, required that the County Auditor-Controller determine if the tax revenues received by the former Agency in January 2012 (before dissolution) were in excess of the amount spent by the former Agency and the SARA on enforceable obligations as defined by the Redevelopment Dissolution Law during the period from

January 1 through June 30, 2012. If there was an excess, the SARA must remit the residual amounts to the County by July 12, 2012, for allocation to the taxing entities. This is referred to as the "true up" process. Due to the manner in which some of the former Agency's bond obligations were categorized on the Recognized Obligation Payment Schedule (ROPS) during this period, the County Auditor-Controller's calculations indicated that there was a $39.3 million "overpayment" of tax revenues to the former Agency. On July 9, 2012, the Oversight Board of the SARA approved corrections to the previously approved ROPS to clarify that there were no residual tax revenues to distribute to the taxing entities from the Trust Fund.

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

NOTE 10 – LITIGATION

Litigation/Unpaid Claims

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

There are two lawsuits outstanding as of June 30, 2012. If the cases result in an unfavorable ruling against the SARA, there is a potential loss to the SARA of $600,000.

Pending Litigation Against County Auditor-Controller

On June 1, 2012, the SARA received notification from the County Auditor-Controller that the County would be distributing approximately $61.7 million of property tax into its Trust Fund. Prior to the County's notification, the SARA anticipated receipt of approximately $81.1 million. The $19.4 million difference was primarily attributable to the County prioritizing its subordinate pass-through payment in the amount of $15.7 million as senior to all other former Agency indebtedness, including outstanding bonds and changing the calculation of what constitutes redevelopment property tax revenues by deducting pre-1989 tax overrides historically provided as property tax. The tax-overrides represent approximately $3.7 million for this distribution period and $7.2 million annually.

On June 26, 2012, the SARA filed suit in Sacramento Superior Court challenging the County Auditor-Controller's actions. The SARA alleges, among other things, that the County Auditor-Controller actions were in violation of its Pass-Through Agreement with the former Agency and violated various bond indentures of the former Agency. The SARA has requested, among other things, that the court order the County Auditor-Controller to: (i) distribute to the SARA all amounts held in the SARA's Trust Fund; (ii) to distribute from the SARA's Trust Fund all funds necessary to comply with bond covenants of the former Agency; (iii) to distribute to the SARA the entire amount of tax revenue that would have been allocated to the former Agency if it had not been dissolved; and (iv) not to withhold payment of any tax revenues until the SARA's enforceable obligations have been paid. The SARA also requested from the Court a declaration that: (i) AB X1 26 requires the County Auditor-Controller to disburse to the SARA all tax revenues pledged as security for the former Agency's debt and all tax revenue the former Agency would have received had it not been dissolved without deduction of additional amounts representing tax overrides; (ii) to the extent any provision of AB X1 26 authorizes the County Auditor-Controller to withhold, deduct, or use tax revenue pledged as security for the former Agency's debt for a purpose other than payment of the secured debt, such provision violates the California Constitution and the United States Constitution; and (iii) the Pass-Through Agreement requires the County to allocate and distribute to the SARA the entire amount of tax revenue that would have been allocated to the former Agency if it had not been dissolved; and (iv) the payment of any funds to the County is subordinate to the payment of the SARA's enforceable obligations.

Pending the outcome of this lawsuit, the County Auditor-Controller placed the disputed tax overrides ($3.7 million) in a special impound account.

NOTE 11 – SUBSEQUENT EVENTS

Findings of the Agreed-Upon Procedures Report

Pursuant to the California Health and Safety Code section 34182, the County Auditor-Controller was responsible to cause the performance of procedures to establish the former Agency's assets and liabilities, to document pass-through obligations, and to document the amount and terms of indebtedness incurred by the former Agency. The County issued its Agreed-Upon Procedures Report (AUP) on October 5, 2012 and submitted it to the State Controller's Office (SCO) and the State Department of Finance (DOF). Other than as a reference for the DOF and the SCO, the AUP has no consequence in the dissolution process. The report identified the following issues, which are disputed by the City and the SARA:

SERAF Loan – The AUP questions a portion ($54 million) of SARA's total SEFAF obligation funded by the former Agency's Low and Moderate Income Housing Fund, argument that it should not be classified as an obligation to the City's Low and Moderate Income Housing Fund. The City's position is that cash was used to fund the SERAF loan, therefore the obligation for repayment of the $54 million remains. As such, the SARA has not removed these obligations from its financial statements at June 30, 2012. The DOF has raised concerns with the SERAF loan in its review of housing assets transfers based on previous discussion with County Auditor-Controller. This is now the subject of a meet and confer meeting between the City and the DOF.

Unencumbered Housing Cash – In February 2012, a cash transfer of program income, which consists of loan repayments, development deposits and lease revenues, in the amount of $10.2 million was made from the Low and Moderate Income Housing Fund held by the City to the City's Affordable Housing Investment Fund. The City asserts that the $10.2 million transfer of program income are Housing Assets and therefore may be transferred to the City's Affordable Housing Investment Fund as the Housing Successor. To date, the independent accounting firm approved by the County Auditor-Controller has not finalized its "due diligence review" required by Section 34179.5 of the California Health and Safety Code used to determine the balance available for transfer to the SARA from the Low and Moderate Income Housing Fund held by the City. As such, the SARA has not included this transfer back to the SARA in its financial statements at June 30, 2012.

Property Transfers – The County Auditor-Controller also stated that numerous properties transferred to the San José Diridon Development Authority in the amount of $29.1 million and the City in the amount of $109.7 million in early 2011 are subject to being ordered transferred back to the SARA by the SCO as required under Health and Safety Code Section 34167.5. To date, the State Controller has not finalized its review of asset transfers made by the former Agency. As such, the SARA has not included these transfers of property back to the SARA in its financial statements at June 30, 2012.

SUCCESSOR AGENCY TO THE
REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
(A Component Unit of the City of San José, California)
Combining Schedule of Fiduciary Net Assets
June 30, 2012

	Governmental Subfunds						Accrual	Redevelopment
		Special	Debt Service		Capital		Adjustments	Obligation
	General	Revenue	Housing	Merged	Projects	Total	(Note B)	Retirement Fund
Assets								
Current assets:								
Cash and investments	$ 1,197,862	$ 4,347,529	$ -	$ -	$ 1,420,037	$ 6,965,428	$ -	$ 6,965,428
Receivables:								
Due from the City of San José	123,765	726,214	-	-	-	849,979	-	849,979
Other	154,976	-	-	-	363,832	518,808	-	518,808
Restricted deposit in transit to fiscal agent	-	-	16,629,830		-	16,629,830	-	16,629,830
Restricted cash and investments	-	-	9,991,248	124,127,023	3,250,800	137,369,071	-	137,369,071
Total current assets	1,476,603	5,073,743	26,621,078	124,127,023	5,034,669	162,333,116	-	162,333,116
Noncurrent assets:								
Advances to the City of San José	-	-	-	-	280,280	280,280	-	280,280
Loans receivable, net	-	-	-	-	31,274,681	31,274,681	-	31,274,681
Deposits	1,202	-	-	-	154,113	155,315	-	155,315
Deferred charges	-	-	-	-	-	-	30,939,554	30,939,554
Property held for resale	-	-	-	-	-	-	22,473,641	22,473,641
Capital assets:								
Nondepreciable	-	-	-	-	-	-	35,580,880	35,580,880
Depreciable, net	-	-	-	-	-	-	92,895,241	92,895,241
Total noncurrent assets	1,202	-	-	-	31,709,074	31,710,276	181,889,316	213,599,592
Total assets	1,477,805	5,073,743	26,621,078	124,127,023	36,743,743	194,043,392	181,889,316	375,932,708
Liabilities								
Current liabilities:								
Accounts payable	21,044	-	-	-	1,392,542	1,413,586	-	1,413,586
Accrued salaries and benefits	3,477	-	-	-	67,635	71,112	-	71,112
Accrued interest payable	-	-	-	-	-	-	41,682,429	41,682,429
Due to the City of San José	-	-	-	-	199,994	199,994	-	199,994
Pass-through payable to the County of Santa Clara	-	-	-	-	15,719,157	15,719,157	-	15,719,157
Deferred revenues	-	-	-	-	29,549,976	29,549,976	(29,549,976)	-
Unearned revenues	-	-	-	-	2,339,444	2,339,444	-	2,339,444
Deposits, retentions, and other payables	9,400	-	-	-	626,000	635,400	-	635,400
Total current liabilities	33,921	-	-	-	49,894,748	49,928,669	12,132,453	62,061,122
Noncurrent liabilities:								
Due within one year	-	-	88,600,000	93,655,000	-	182,255,000	75,893,696	258,148,696
Due in more than one year	-	-	-	-	-	-	2,119,105,493	2,119,105,493
Total noncurrent liabilities	-	-	88,600,000	93,655,000	-	182,255,000	2,194,999,189	2,377,254,189
Total liabilities	33,921	-	88,600,000	93,655,000	49,894,748	232,183,669	2,207,131,642	2,439,315,311
Fund balances/Net assets held in trust	$ 1,443,884	$ 5,073,743	$ (61,978,922)	$ 30,472,023	$ (13,151,005)	$ (38,140,277)	$ (2,025,242,326)	$ (2,063,382,603)

See accompanying notes to the supplementary information.

SUCCESSOR AGENCY TO THE
REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
(A Component Unit of the City of San José, California)
Combining Schedule of Changes in Fiduciary Net Assets
For the Period from Inception (February 1, 2012) through June 30, 2012

	Governmental Subfunds						Accrual	Redevelopment
		Special	Debt Service		Capital		Adjustments	Obligation
	General	Revenue	Housing	Merged	Projects	Total	(Note C)	Retirement Fund
Revenues/Additions:								
Redevelopment property tax revenues	$ -	$ 15,500,145	$ -	$ 62,000,586	$ 4,735,492	$ 82,236,223	$ -	$ 82,236,223
Investment income	942	-	4,677	126,558	18,097	150,274	-	150,274
Rent	266,140	-	-	-	56,115	322,255	-	322,255
Other		-	14,600	-	172,599	187,199	390,677	577,876
Total revenues/additions	267,082	15,500,145	19,277	62,127,144	4,982,303	82,895,951	390,677	83,286,628
Expenditures/Deductions:								
General and administrative:								
Salaries, wages and benefits	-	-	-	-	588,589	588,589	-	588,589
Materials, supplies and other services	-	-	-	-	378,499	378,499	-	378,499
Project expenditures/expenses	-	-	-	-	816,060	816,060	-	816,060
Pass-through amounts to the County of Santa Clara	-	-	-	-	8,177,006	8,177,006	-	8,177,006
Loss on fair value of property held for resale	-	-	-	-	-	-	27,417,434	27,417,434
Depreciation	-	-	-	-	-	-	2,039,636	2,039,636
Debt service:								
Principal paid on debt	-	-	-	1,785,000	-	1,785,000	(1,785,000)	-
Interest on debt	-	-	7,105,649	45,472,269	-	52,577,918	(7,176,799)	45,401,119
Total expenditures/deductions	-	-	7,105,649	47,257,269	9,960,154	64,323,072	20,495,271	84,818,343
Excess (deficiency) of revenues over (under) expenditures	267,082	15,500,145	(7,086,372)	14,869,875	(4,977,851)	18,572,879	(20,104,594)	(1,531,715)
Other financing sources (uses):								
Proceeds/accretion of City's loans/advances	-	6,203,428	445,276	-	214,576	6,863,280	(6,863,280)	-
Reclassification of short-term variable rate demand bonds	-	-	-	(93,655,000)	-	(93,655,000)	93,655,000	-
Transfers in	-	-	16,629,830	7,173,399	-	23,803,229	(23,803,229)	-
Transfers out	-	(16,629,830)	-	-	(7,173,399)	(23,803,229)	23,803,229	-
Total other financing sources (uses)	-	(10,426,402)	17,075,106	(86,481,601)	(6,958,823)	(86,791,720)	86,791,720	-
Extraordinary item from Redevelopment Agency Dissolution	1,176,802	-	(71,967,656)	102,083,749	(1,214,331)	30,078,564	(2,091,929,452)	(2,061,850,888)
Change in fund balances/net assets	1,443,884	5,073,743	(61,978,922)	30,472,023	(13,151,005)	(38,140,277)	(2,025,242,326)	(2,063,382,603)
Fund balances/Net assets, beginning of period	-	-	-	-	-	-	-	-
Fund balances/Net assets, end of period	$ 1,443,884	$ 5,073,743	$ (61,978,922)	$ 30,472,023	$ (13,151,005)	$ (38,140,277)	$ (2,025,242,326)	$ (2,063,382,603)

See accompanying notes to the supplementary information.

Note A – Measurement Focus, Basis of Accounting and Basis of Presentation

Redevelopment Obligation Retirement Fund

The SARA's financial transactions are reported in the Redevelopment Obligation Retirement Fund and is presented as a private-purpose trust fund. The SARA is reported using the *economic resources measurement focus and the accrual basis of accounting*. Revenues are recognized when earned and expenses are recorded when a liability is incurred regardless of the timing of related cash flows.

The accompanying combining schedules of fiduciary net assets and changes in fiduciary net assets are presented to report the conversion of the SARA's internal record keeping basis of accounting with the presentation of the SARA as a private-purpose trust fund for reporting purposes in accordance with accounting principles generally accepted in the United States of America.

Governmental Subfund Financial Schedules

The accounts of the SARA are internally organized and operated on the basis of subfunds. A subfund is an independent fiscal and accounting entity with a self-balancing set of accounts. It uses fund accounting and segregates its subfunds according to their intended purpose, and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions.

Governmental subfund financial schedule is reported using the *current financial resources measurement focus and the modified accrual basis of accounting*. Under this method, revenues are recognized as soon as they are measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the SARA considers revenues to be available if they are collected within 60 days after the end of the current fiscal period. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to environmental claims and judgments are recorded only when payment is due. General capital assets acquisitions are reported as expenditures in governmental subfunds. Proceeds of long-term debt and capital leases are reported as other financing sources.

The subfund financial schedule provides information about the SARA's subfunds. The SARA reports the following governmental subfunds:

- The *General* subfund is used to account for the SARA's general and administrative expenditures.
- The *Special Revenue* subfund is used to account for revenue sources that are legally restricted to expenditures for specified purposes. The purpose of this subfund is to account for that portion of the former tax increment revenue required to be used towards low and moderate-income housing.
- The *Housing Debt Service* subfund was established to account for the payment of interest and principal on the former Agency's merged area housing set-aside tax allocation bonds. The primary source of revenue for this subfund is the 20% allocation from the Redevelopment Property Tax Trust Fund.
- The *Merged Debt Service* subfund was established to account for the payment of interest and principal on the former Agency's merged area tax allocation bonds, revenue bonds, refunding revenue bonds, and other loans. The primary source of revenue for this subfund is the 80% allocation from the Redevelopment Property Tax Trust Fund.
- The *Capital Projects* subfund accounts for all revenues and costs of completing the former Agency's redevelopment projects.

Note B – Explanation of the Accrual Adjustments Between the Governmental Subfund Balance Sheet and the Redevelopment Obligation Retirement Fund

Total fund balance of the SARA's governmental subfunds differs from the net assets of the Redevelopment Obligation Retirement Fund primarily as a result of the long-term economic resources measurement focus of the private-purpose trust fund versus the current financial resources measurement focus of the governmental subfund balance sheet. The differences are as follows:

- Deferred charges (bond issuance costs) are expended in governmental subfunds when paid, and are capitalized and amortized over the life of the corresponding bonds for purposes of the Redevelopment Obligation Retirement Fund.
- Property held for resale are not considered to be available financial resources until receipt of proceeds from sale, therefore, are not reported in the balance sheet of governmental subfunds.
- Capital assets are not spendable current financial resources and, therefore, are not reported in the balance sheet of governmental subfunds.
- A significant portion of loans receivable are not available to pay for current period expenditures and, therefore, are deferred on the modified accrual basis of accounting.
- Interest payable on long-term debt does not require the use of current financial resources and, therefore, interest payable is not accrued as a liability in the balance sheet of governmental subfunds.
- Long-term liabilities are generally not due and payable in the current period and therefore, are not reported in the balance sheet of governmental subfunds.

Note C – Explanation of the Accrual Adjustments Between the Governmental SubFund Changes in Fund Balances and the Redevelopment Obligation Retirement Fund

The net change in fund balances for the governmental subfunds differs from the "change in net assets" as a result of the long-term economic resources measurement focus of the Redevelopment Obligation Retirement Fund versus the current financial resources measurement focus of the governmental subfunds. The differences are as follows:

- Revenues in the Redevelopment Obligation Retirement Fund that do not provide current financial resources are not reported as revenues in the governmental subfunds. For governmental subfunds, loans made that are not expected to be repaid in the near future are offset with deferred revenue, whereas, loans made are considered project expenditures and loans collected are considered current year revenue. However, in the Redevelopment Obligation Retirement Fund only interest earnings and bad debt expense are reported.
- The Redevelopment Obligation Retirement Fund records valuation adjustments to property held for resale as an expense, which does not require the use of current financial resources.
- Governmental subfunds report capital outlays as expenditures. However, in the Redevelopment Obligation Retirement Fund the cost of these assets is either allocated over their estimated useful lives and reported as depreciation expense or accumulated as capital costs transferred or sold to the City and/or third parties upon project completion.

- Repayment of long-term debt principal is reported as an expenditure in governmental subfunds and, thus, has the effect of reducing fund balance because current financial resources have been used. However, the principal payments reduce the liabilities in the Redevelopment Obligation Retirement Fund and do not result in an expense in the Redevelopment Obligation Retirement Fund. The SARA's long-term debt was reduced because principal payments were made.
- Accrued interest expense on long-term debt is reported in the Redevelopment Obligation Retirement Fund, but does not require the use of current financial resources. Amortization of bond premiums, discounts and deferred amounts on refunding is expensed as a component of interest expense in the Redevelopment Obligation Retirement Fund. This amount represents the net accrued interest expense and the amortization of bond premiums, discounts and deferred amounts on refunding not reported in governmental subfunds.
- Bond issuance costs are expended in governmental subfunds when paid, however, are capitalized and amortized over the life of the corresponding bonds for the purposes of the Redevelopment Obligation Retirement Fund.
- Some expenses reported in the Redevelopment Obligation Retirement Fund do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental subfunds.
- Proceeds from borrowing are reported as financing sources in governmental subfunds and, thus, contribute to the change in fund balance. In the Redevelopment Obligation Retirement Fund, however, issuing debt increases long-term liabilities and does not affect the operating schedules.
- Expenditures reported in the governmental subfunds but not to the Redevelopment Obligation Retirement Fund include reclassification of variable-rate demand bonds to a short-term obligation.

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Successor Agency of the
Redevelopment Agency of the City of San José
San José, California

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

We have audited the accompanying basic financial statements of the Successor Agency of the Redevelopment Agency of the City of San José (SARA), a component unit of the City of San José (City), California, as of June 30, 2012 and for the period from inception (February 1, 2012) through June 30, 2012, and have issued our report thereon dated November 19, 2012. Our report includes emphasis of a matter paragraphs referring to Note 6 to the basic financial statements related to the $88.6 million 2010 C Housing Set-Aside Tax Allocation Bonds Special Termination Event on June 8, 2012 and related to reporting the 1996 and 2003 Merged Area Redevelopment Project Revenue Bonds amounting to $93.7 million at June 30, 2012 as a current liability. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the SARA is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the SARA's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the SARA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the SARA's internal control over financial reporting.

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the SARA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results or our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

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

Macias Gini & O'Connell LLP

Walnut Creek, California
November 19, 2012

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

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

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

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

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

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

Management Response:

The last year has been a fiscally challenging year for the former Redevelopment Agency (Agency). The economic recession took a considerable toll on tax increment revenues and as early as 2010 the Agency began a significant reduction in workforce. At the beginning of fiscal year 2010-11, staffing levels were 92 with 9 devoted to financial operations and affairs of the Agency. By the time dissolution was final on February 1, 2012, the total staffing was 10 with only 4 devoted to the financial operations and affairs of the former Agency, now the Successor Agency to the Redevelopment Agency (SARA). It would not have been possible for the existing staff to successfully operate without the considerable staffing support received from City staff.

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

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