FINANCIAL CONDITION

Financial condition is the measure of how healthy a city's finances are at a particular point in time.

Unless otherwise noted, information in this chapter is from the City's audited Comprehensive Annual Financial Report (CAFR). Other chapters use adopted budget information. The CAFR differs from the City's annual Adopted Operating Budget in the timing and treatment of some revenues and expenditures.

In February 2016, this Office published our first report on financial condition. This chapter builds on those efforts by providing both background information about the City's finances and measures of financial condition. See this chapter's endnotes for definitions and links to the City's numerous financial documents. For more information, see *Measuring San José's Financial Condition*.

FINANCIAL CONDITION

WHAT IS FINANCIAL CONDITION?

Financial condition is the measure of how healthy a city's finances are at a particular point in time. A city is considered financially healthy if it can deliver the services its residents expect with the resources its residents provide, both now and in the future. A city that is financially healthy is prepared to respond to residents' needs as they change over time or when unforeseen events arive, while laying the groundwork for long-term projects that will impact services many years down the line.

Cities in poor financial condition are not able to provide the services that residents want, either now or in the future. They're more susceptible to economic downturns—requiring cutbacks in services and maintenance—and they may have difficulty recovering from financial setbacks.

WHAT MAKES UP THE CITY GOVERNMENT?

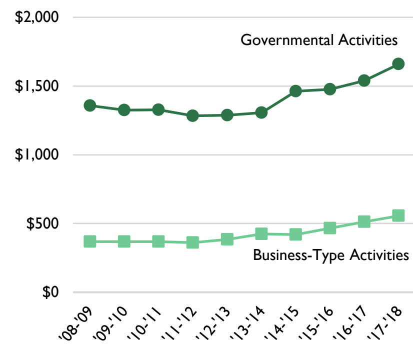
Most of what the City government does is considered to be a *governmental activity*, meaning that the programs and departments are funded by the public at large and can be used by everyone who lives in, works in, or travels to San José. This includes police, fire, libraries, roads, parks, and code enforcement. These governmental activities are primarily funded through the City's *General Fund* (the City's primary, unrestricted operating fund).

Many cities operate programs that don't receive general tax revenue to support their operations. These are called *business-type activities*. For example, the Mineta San José International Airport is supported through fees from airlines and passengers and rent from concessionaires.

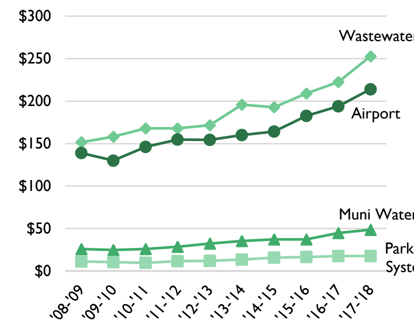
CITY REVENUES

The City received $2.22 billion in revenues in FY 2017-18. Governmental activity revenue totaled $1.66 billion, an 8 percent increase from the previous year. Business-type activities generated $556 million in FY 2017-18. All business-type activities generated more revenue than ten years ago.

Total City Revenues ($millions)

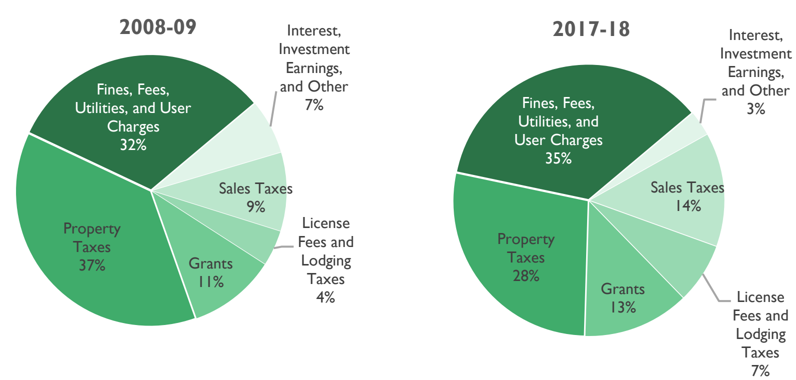


Business-Type Revenues by Source ($millions)



The City relies on a number of funding sources to support its operations. Most California cities generate the majority of their revenue from taxes and fees. Compared to ten years ago, a smaller portion of the City's revenues came from property taxes, while a larger portion came from sales taxes and fees, fines, utilities, and other charges.

Governmental Activity General and Program Revenues by Type



REVENUE PER CAPITA

The City's revenue per capita has increased over the last six years.

As a city's population increases, it is beneficial if the city's revenues also increase to maintain or grow service delivery for the expanding number of residents. Otherwise, the city may have to cut services or find new revenue sources.

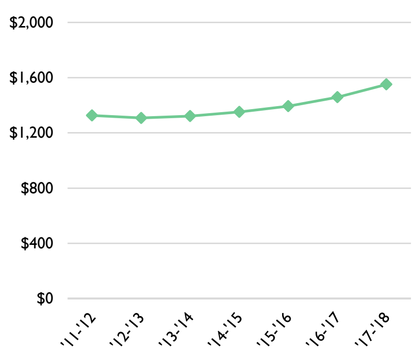
The City's revenues per capita have grown over the last six years. San José's revenue per capita was mid-range compared to other jurisdictions surveyed.

Revenues per capita in the measures below include all governmental activity revenue. This includes taxes, fees, fines, grants, and other charges. Some revenue sources have restrictions on how they can be spent.

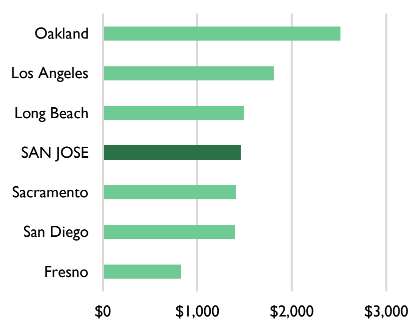
The graphs below compare governmental funds revenue to population. A higher ratio means that there was more revenue generated per capita.

*For this measure, a **higher** ratio indicates better financial condition.*

Revenues Per Capita



Comparison between Cities (FY 2016-17)

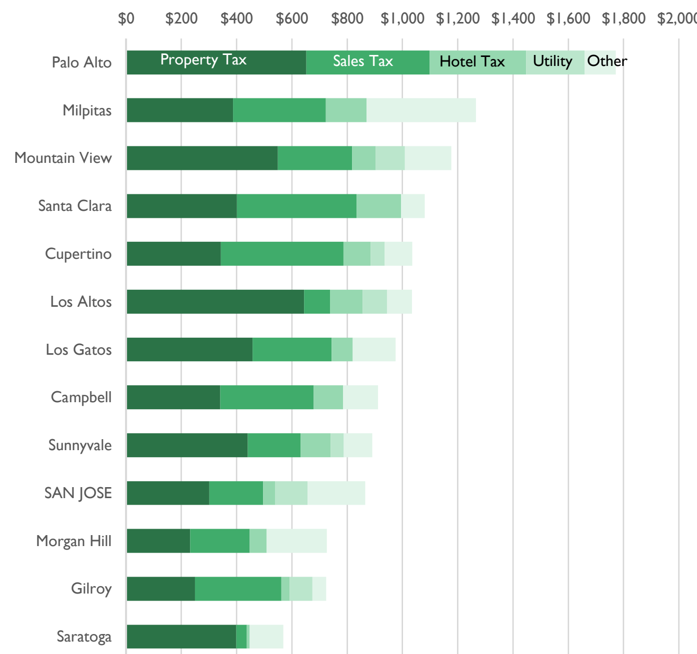


REVENUE PER CAPITA (CONTINUED)

Although voters approved increases to the City's sales tax and business tax in 2016, San José still received less tax revenue per capita than most of its neighboring cities (consistent with previous years). The City's tax revenues were only about $865 per capita in 2017-18. Of that, sales tax was only about $194. In contrast, Palo Alto received $1,770 in taxes per capita, of which $445 was from sales taxes.

The chart below shows only tax revenues. It doesn't include other sources of total governmental activity revenue that are included on the other charts on this page (such as fees and grants).

City Comparison of Tax Revenues Per Capita (2017)



Source: 2017 State Controller's City Data and the U.S. Census Bureau

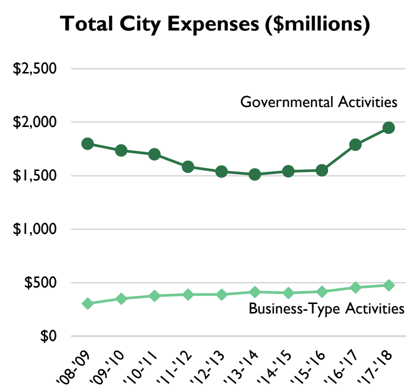
FINANCIAL CONDITION

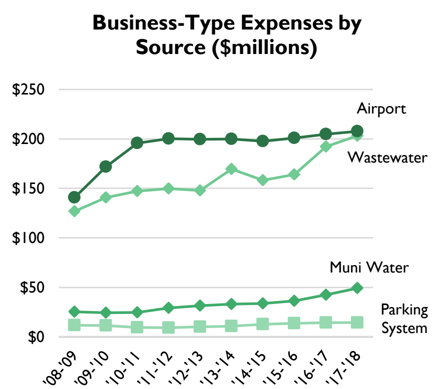
CITY EXPENSES

The City's total expenses increased in 2017-18 to $2.4 billion, surpassing the previous peak of $2.2 billion from last year. Governmental activity expenditures, 80 percent of the total, grew by 9 percent from last year. Expenses from business-type activities have steadily increased over the last ten years.

These expenses include non-cash expenses such as depreciation (see "City Capital Assets and Spending" later in this chapter). As previously noted, revenue sources are often restricted in how they can be spent. As a result, reducing expenses for one service does not necessarily mean that expenses can be increased for another service, because the revenue may not be transferable.

In 2017-18, expenditure growth included public safety personnel (including filling vacancies) and equipment costs, and higher debt service payments. In prior years, expenditure growth has also included expanded service delivery, and increased capital outlay and capital maintenance expenditures.





Note: In FY 2017-18, there were $1 million of expenses from San Jose Clean Energy.

EXPENDITURES PER CAPITA

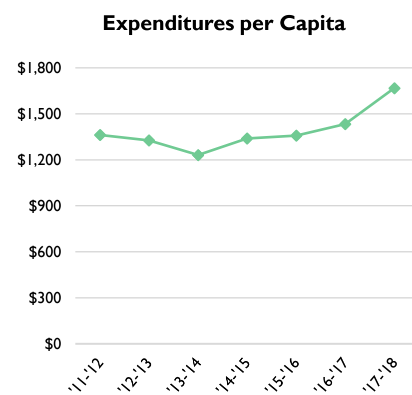
The City's expenditures per capita have increased over the last year.

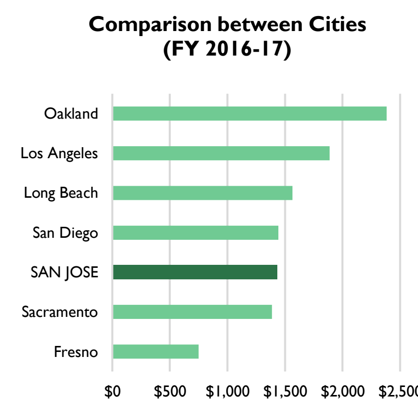
As a city adapts its service delivery over time and as its population changes, the amount of money expended per capita can shift. If the expenditures increase compared to population, it may indicate that new services were added, or that service delivery has become more expensive or less efficient.

The City's governmental funds expenditures per capita have grown over the past four years, following a low point in 2013-14. San José had relatively low expenditures per capita compared to other surveyed jurisdictions. The level and types of service offered may vary between cities.

The graphs below compare governmental funds expenditures to population. A lower ratio means that there were fewer expenditures per capita.

*For this measure, a **lower** ratio indicates a potentially lower level of service provided to residents.*





OPERATING SURPLUS/DEFICIT

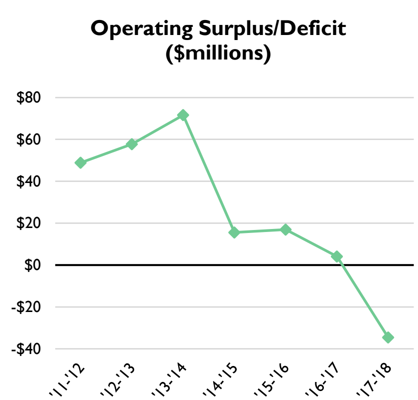
The City's General Fund had an operating deficit last year.

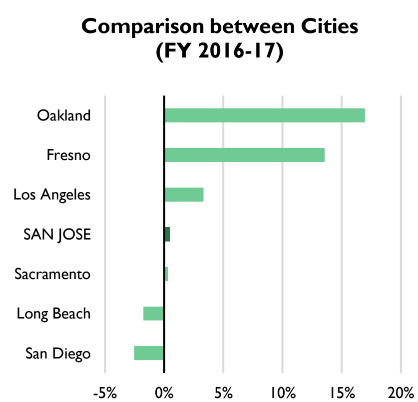
Ideally, a city's revenues will equal its expenditures; it will break even, rather than spending too little on services or too much. If the City spends too much on services, it has an operating deficit—it spent more than the revenues it brought in. Operating deficits that continue for years are unsustainable for a city's financial health.

In 2017-18, the total operating deficit was $35 million. General Fund expenditures grew by 13 percent while revenues grew by only 8.6 percent. The operating deficit was due in large part to a significant increase in debt service payments. The effect of the operating deficit on the City's fund balances was partly offset by the sale of capital assets.

The graph to the below left shows the difference between the City's General Fund total revenues and expenditures. The graph to the below right expresses this as a comparison ratio (surplus or deficit divided by revenues).

For this measure, a ***higher*** *number indicates a better financial condition.*





ABILITY TO PAY EXPENSES

The City had less cash available in its General Fund compared to the liabilities owed than it did in prior years.

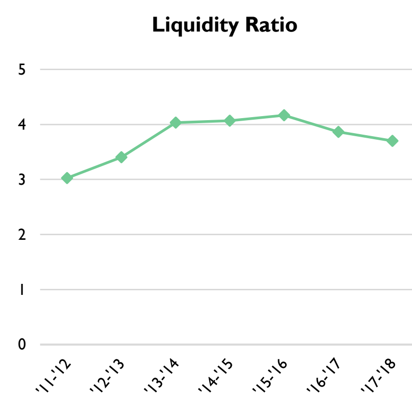
Cash and investments that can be quickly turned into cash enable the City to pay bills that will come due in the short term (within one year or sooner).

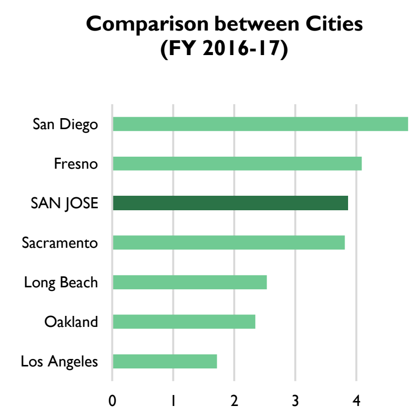
The amount the City had in its treasury in cash and investments compared to the liabilities owed decreased in 2017-18. Still, as of June 30, 2018, the City's cash and investments were about four times the amount that it owed within the next year.

In 2016-17, San José's ratio of cash to liabilities was relatively high compared to other cities surveyed. This means that San José was in a comparatively good position to pay short-term obligations with cash and investments compared to other cities.

The graphs below show the amount of money that the City has in cash and investments compared to the amount of short-term obligations the City owes, all within the General Fund. A higher ratio shows a better ability to pay short-term obligations.

For this measure, a ***higher*** *ratio indicates better financial condition.*





FINANCIAL CONDITION

BUILDING UP RESERVES

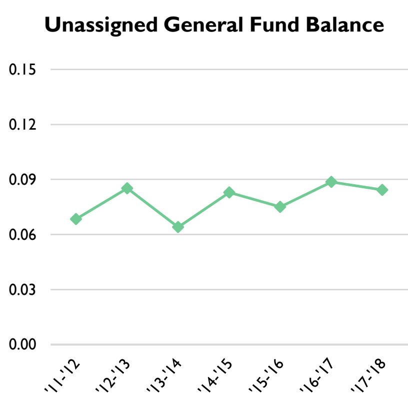
The City's General Fund unassigned fund balance reserves decreased compared to revenue.

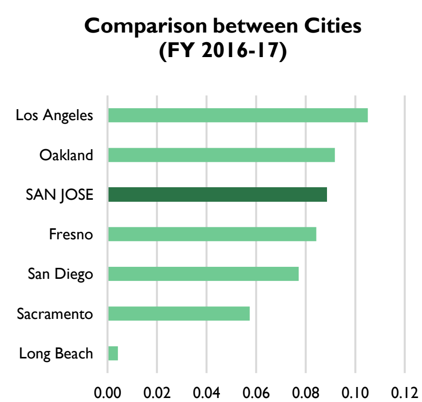
The City has several different reserves set aside. Of these reserves, the *unassigned fund balance* has the fewest restrictions on how it can be used. Within the unassigned fund balance are the City's safety net reserves: money that's set aside to pay for services and salaries when revenues take a turn for the worse.

San Jose's General Fund unassigned fund balance ratio has remained relatively consistent over the past seven years, with a slight decrease in 2017-18. In 2016-17, the City's ratio was on the higher end compared to other jurisdictions.

The graphs below compare the money in the *General Fund* unassigned fund balance to total General Fund revenues. A higher ratio means that there was more money saved as compared to the revenues that were brought in.

*For this measure, a **higher** ratio indicates better financial condition.*





NET ASSETS PER CAPITA

The City's net position has declined.

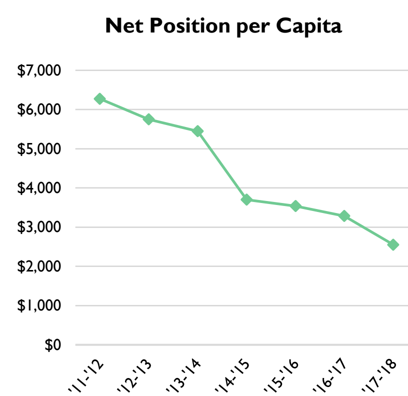
Revenues from the City's programs ideally should cover the expenses that the City incurs for those programs—otherwise, the City will have to make ends meet by dipping into other savings, and it won't be able to save money for projects and safety net reserves.

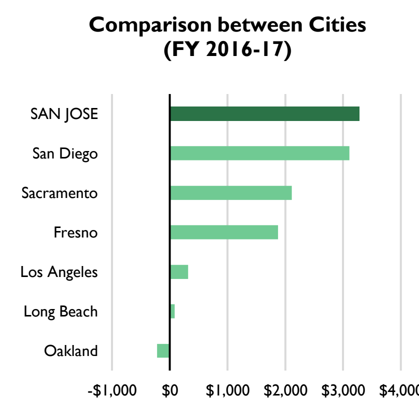
The City's expenditures for governmental activities (all funds, including depreciation on its capital assets) exceeded its revenues in 2017-18 by over $287 million. As a result, the City's net position declined.

Nonetheless, San José had a higher net position per capita for governmental activities than other surveyed cities in 2016-17. As noted previously, cities may provide a varying range of services to residents. A change in accounting practices due to the addition of net pension liability contributed to the decline between 2013-14 and 2014-15. Similarly, in 2017-18, the City began adding the liability for other post-employment benefits (OPEB).

The graphs below show the City's net position per capita for governmental activities. A higher ratio means the City had more resources to provide services per resident.

*For this measure, a **higher** ratio indicates better financial condition.*





CITY OBLIGATIONS AND DEBT

The City owes money in the form of short- and long-term obligations including debt.

Short-term obligations are due within the next year. This includes things like accrued wages that City employees have earned and accounts payable (money owed for supplies or for services rendered). Short-term obligations totaled **$291 million** as of June 30, 2018.

Long-term obligations are generally not due within the next year, but will need to be paid in the future. For example, the accrued vacation and sick leave that employees have earned but haven't taken is included as a long-term obligation. The purchase, construction, and renovation of City-owned facilities is usually financed using debt that the City has issued in the form of bonds. The payment of bond debt, called debt service, includes payment of principal and interest.

As of June 30, 2018, the City owed $2.1 billion in bonds and loans payable (issued by the City or a related entity—see the box below). Of this debt, 44 percent was for governmental activities and 56 percent was for business-type activities.

One component of the City's total obligations are for pensions and other post-employment benefits (OPEB), which includes healthcare for retired City employees. As of June 30, 2018, the liabilities for pension plans **and** OPEB exceeded assets by more than **$4 billion.** While pension liabilities have been included with other liabilities in the main financial statements since 2014-15, OPEB liabilities are now also included as of 2017-18.

These long-term obligations, including debt, pension liabilities, and OPEB liabilities, totaled **$6.8 billion** as of June 30, 2018. For more information, see the Finance Department and Retirement Services chapters.

Who has to pay the City's debt?
Separate entities within the broad City organization are legally responsible for different parts of the City's debt. On the one hand, the City is not legally obligated to use the City's general revenues to pay the business-type obligations. On the other hand, the City's business-type revenues are restricted and may not be used to pay other debt obligations.

ABILITY TO PAY OBLIGATIONS

More than three years of revenue would be required to pay the City's obligations.

A city the size of San José has both short- and long-term obligations that must be paid in the future, such as accounts payable and notes payable. The fewer number of years of annual revenue needed to pay the City's obligations, the better the City's financial condition.

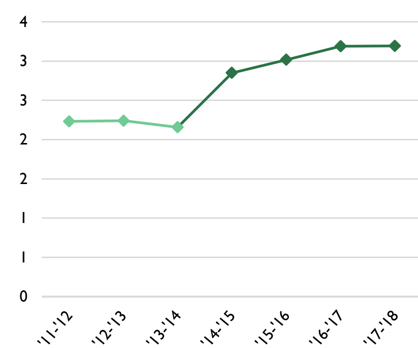
In 2017-18, more than three years of revenues would be required to pay the City's obligations. In 2014-15, the City began including its net pension liability, which totaled nearly $1.7 billion that year, to the calculation of total liabilities. *For this reason, 2011-12 through 2013-14 are shown in a lighter color.* OPEB liabilities, totaling $1.1 billion, were added in 2017-18.

San José had more liabilities compared to revenues than all other cities surveyed in 2016-17.

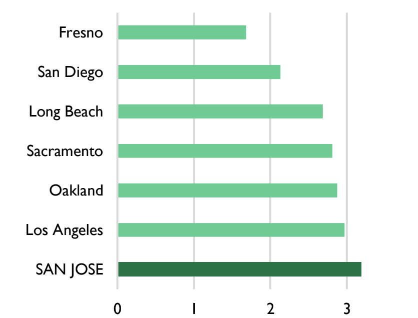
The graphs below compare the City's short- and long-term obligations to the City's annual revenues (including all governmental and business-type activities). A lower ratio shows that the City was able to pay a larger portion of its debts with annual revenues.

*For this measure, a **lower** ratio indicates better financial condition.*

Near-Term Solvency Ratio



Comparison between Cities (FY 2016-17)



Note: 2011-12 through 2013-14 do not include net pension liability; 2017-18 includes OPEB liabilities.

FINANCIAL CONDITION

AMOUNT BORROWED PER RESIDENT

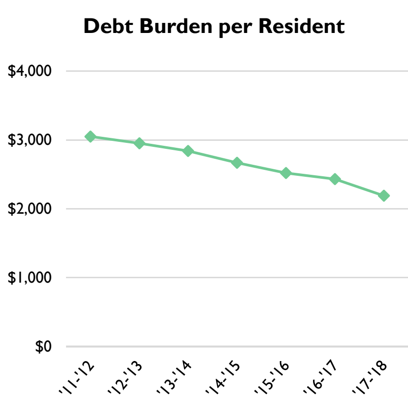
The amount the City had borrowed per resident decreased.

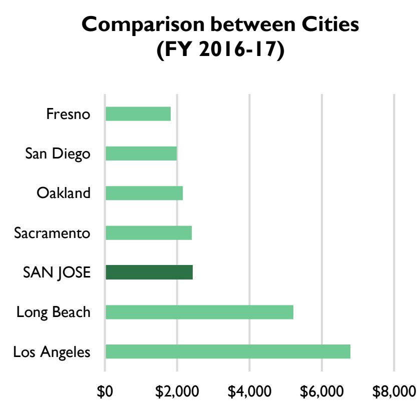
Having a low amount borrowed per resident would put the City in a better position, and potentially make it easier to borrow more money should the need arise.

2017-18 saw the lowest amount borrowed per resident than in the previous seven years. The City's single largest source of long-term debt in the form of bonds was related to capital improvements at Mineta San José International Airport, for which the outstanding debt totaled $1.2 billion as of June 30, 2018 (to be repaid with Airport revenues). For more information, see the Airport and Finance chapters. In November 2018, San José residents passed Measure T, which authorizes the City to issue up to $650 million of General Obligation bonds for various public improvements.

San José's debt burden per resident (including business-type activities) was mid-range of other cities surveyed. A city's debt is highly dependent on what range of services a city offers.

> The graphs below show the amount (including business-type activities) the City borrowed per resident. A lower ratio indicates that the City has less borrowed per capita.
>
> *For this measure, a **lower** ratio indicates better financial condition.*





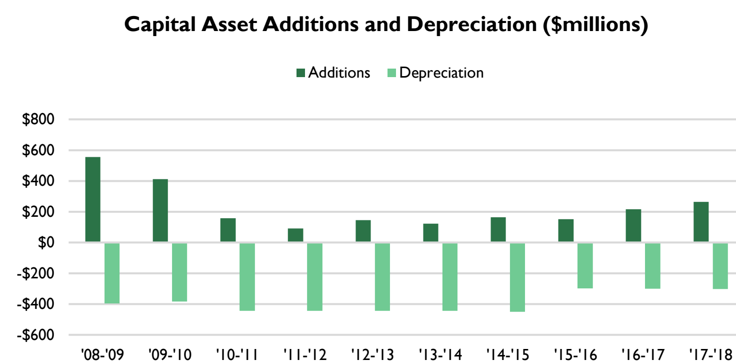
CAPITAL ASSETS AND SPENDING

The City owns a variety of capital assets—land, buildings, vehicles, equipment, infrastructure (e.g., roads, bridges, sewers), and other assets with a useful life beyond one year. Capital assets also include construction projects currently being built but not yet completed (referred to as construction in progress). Paying for and maintaining these assets play a critical role in the City's financial condition.

At the end of fiscal year 2017-18 the City owned $7.4 billion of capital assets. This figure represents the historical purchase or constructed cost less normal wear and tear from regular use (referred to as *depreciation*).

Capital assets used for governmental activities totaled $5.3 billion and assets used in business-type activities such as the Airport, wastewater treatment, and other business-type activities totaled $2.1 billion.

In 2017-18, the City added $263 million in capital assets; however, these were offset by $303 million in depreciation. Among the additions were capital projects at the Wastewater Treatment Facility and the Airport.



CAPITAL ASSETS AND SPENDING (CONTINUED)

On an annual basis, the City administration prepares a status report on the deferred maintenance and infrastructure backlog. In January 2018, staff reported that the City faced an estimated $1.4 billion deferred maintenance and infrastructure backlog, with an estimated additional $112 million needed annually in order to maintain the City's infrastructure in a sustained functional condition. The transportation system (e.g., streets, street lighting) is most affected by the backlog.

Infrastructure Backlog (all funds as of January 2018, $millions)

	Current Backlog of Deferred Needs	Annual Ongoing Unfunded Needs
Airport	$5.9	*none*
Building Facilites*	$154.5	$18.9
City Facilities Operated by others	$2.7	*TBD*
Sports Facilities	*TBD*	*TBD*
Convention Center/Cultural Facilities	$75.7	*TBD*
Fleet	$8.2	$1.4
Parks, Pools, and Open Space	$177.2	$32.5
Sanitary Sewer	*TBD*	$1.5
Service Yards	$26.1	$4.8
Storm Sewer	$223.5	*TBD*
Information Technology**	$21.2	$0.3
Radio Communications	*none*	*none*
Transportation Infrastructure	$696.7	$52.6
Regional Wastewater Facility	*none*	*none*
Water Utility	*none*	*none*
Total	**$1,392**	**$112**

Source: Status Report on Deferred Maintenance and Infrastructure Backlog, 2018
** Annual ongoing is for Parks buildings only, remaining facilities TBD.*
*** Information Technology needs within departments not managed by the IT Department are not included in this estimate.*

CHANGE IN VALUE OF CAPITAL ASSETS

The value of the City's capital assets decreased over the last six years.

Most of the City's capital assets decrease in value over time because of depreciation. If the City doesn't replace or renovate its capital assets, the value over time decreases.

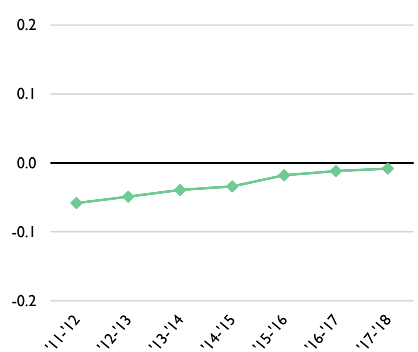
Though the City's capital asset value ratio was increasing, the value of the City's capital assets (net of depreciation) on June 30, 2018 was about $61 million less than when the year started (about 0.8 percent below the value on July 1, 2017). The negative ratio indicates that the City's assets decreased in value—that is, the value at the end of the year was less than the value at the beginning of the year. This indicates that the depreciation of capital assets was greater than the value of capital assets added, and that some capital assets may need to be renovated or replaced.

San José was one of two cities surveyed that had its capital assets decrease in value in 2016-17.

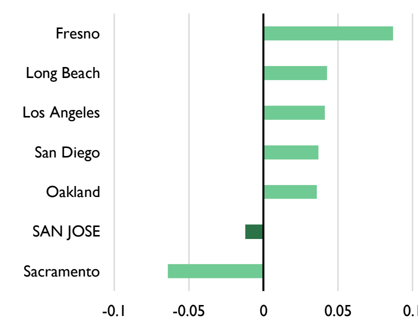
The graphs below show the difference in the value of capital assets at the end of the year, divided by the value at the beginning of the year.

*For this measure, a **higher** ratio indicates better financial condition.*

Capital Asset Value Ratio



Comparison between Cities (FY 2016-17)



ENDNOTES

What Makes Up the City Government: Trust and Agency funds, including the Pension Trust Funds and the Successor Agency to the Redevelopment Agency, are not included in revenues.

City Revenues: The City also doesn't receive 100 percent of the sales tax levied in Santa Clara County. The City receives less in tax revenue per capita than many other Santa Clara County cities. CAFR Source: Government-wide Statement of Activities and Statistical Section (unless otherwise noted).

Revenue per Capita: This measure includes all governmental funds. Note: for all measures, San Francisco is not included as a benchmark city because it is a City/County structure. Formula: Total government funds revenues / Population. CAFR Source: Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances, and Statistical Section

City Expenses: Trust and Agency funds, including the Pension Trust Funds and the Successor Agency to the Redevelopment Agency, are not included in expenses. CAFR Source: Government-wide Statement of Activities

Expenditures per Capita: This measure includes all governmental funds. Formula: Total government funds expenditures / Population. CAFR Source: Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances, and Statistical Section

Operating Surplus/Deficit: This measure includes only the General Fund. Formula: General Fund revenues – General Fund expenditures (for San José 5-year chart); (General Fund revenues – General Fund expenditures) / General Fund revenues (for comparison with other cities). CAFR Source: Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances

Ability to Pay Expenses: This measure considers cash and investments held in the City Treasury in the General Fund, as compared to liabilities. It is important to note that measures of cash and investments are a snapshot as of a given date. As a result, information could change the following day as cash flows in and out in revenues and bills paid. Formula: Total General Fund Cash and Investments / (General Fund Liabilities – General Fund Unearned Revenue). CAFR Source: Governmental Funds Balance Sheet

Building up Reserves: This measure focuses on General Fund unassigned fund balance. Unassigned fund balance includes contingency reserves and budget stabilization reserves (designed to buffer against financial shocks) and certain earmarked reserves (set aside for a purpose but potentially available in a catastrophic need). This measure shows short-run financial position. Formula: Unassigned General Fund Balance / Total General Fund Revenues. CAFR Source: Governmental Funds Balance Sheet; Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balance

Net Assets per Capita: This measure considers only governmental activities. Business type activities are not included. Formula: Governmental Activities Net Position / Population. CAFR Source: Government-wide Statement of Activities and Statistical Section

ENDNOTES (CONTINUED)

City Obligations and Debt: The $2.1 billion in bonds and loans payable noted on this page includes some debt for which the City has limited obligation or is not legally liable. This includes City of San José Financing Authority lease revenue bonds; the City is responsible for making annual lease payments so long as there is beneficial use and occupancy of the leased facility. In addition to the $2.1 billion noted on this page, the City manages, but is not liable for, long-term debt associated with the former Redevelopment Agency and conduit financing related to multi-family housing revenue bonds. In total, the City managed $4.4 billion in debt. CAFR Source: Summary of Long-Term Debt

Ability to Pay Obligations: Other Post-employment Benefits (OPEB) are included for 2017-18 data. Formula: (Primary Government Liabilities - Unearned Revenues) / Primary Government Revenues. CAFR Source: Government-wide Statement of Net Position and Statement of Activities

Amount Borrowed per Resident: This measure reflects all primary government bonded debt, which includes governmental and business-type activities. Population estimates are from the State of California, Department of Finance. Trust and Agency funds, including the Pension Trust Funds and the Successor Agency to the Redevelopment Agency, are not included. Formula: Total Outstanding Debt for the Primary Government / Population. CAFR Source: Statistical Section

Capital Assets: Assets are valued at cost minus accumulated depreciation. Some assets may be fully depreciated. Trust and Agency funds, including the Pension Trust Funds and the Successor Agency to the Redevelopment Agency, are not included. CAFR Source: Capital Assets Note Disclosure

Change in Value of Capital Assets: This measure represents the net value of all primary government capital assets, which includes those owned by governmental activities and business-type activities. Land, intangible assets, and construction in progress are not depreciated. Formula: (Ending Net Value of Primary Government Capital Assets - Beginning Net Value) / Beginning Net Value. CAFR Source: Capital Assets Note Disclosure and Reconciliation of the Changes in Fund Balances for Governmental Funds to the Statement of Activities

ADDITIONAL REPORTS FOR MORE INFORMATION

The City of San José prepares numerous financial and budgetary documents during the fiscal year. The **Comprehensive Annual Financial Report (CAFR)** provides the City's audited financial statements, notes to those statements, the City Management's Discussion and Analysis of the financial information and trends, as well as other essential information. All measures included in this chapter were calculated using data from the City's CAFR. The **Comprehensive Annual Debt Report** contains information such as recent debt issued by the City and the outstanding debt portfolio. The Annual Debt Report is a key document to better understand the City's debt, which is relevant for several measures presented in this report.
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