City of San José, California

Single Audit Reports

Basic Financial Statements with
Federal Compliance Section

For the Year Ended June 30, 2018

Certified
Public
Accountants

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FEDERAL COMPLIANCE SECTION

MGO Certified Public Accountants

Independent Auditor's Report

City Council
City of San José, California

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San José, California (City), as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the City of San José Federated City Employees' Retirement System and the City of San José Police and Fire Department Retirement Plan (collectively, "the Pension Trust Funds"), which represent 86.3 percent, 117.3 percent, and 47.1 percent, respectively, of the assets, fund balance/net position, and revenues/additions of the aggregate remaining fund information. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for the Pension Trust Funds, is based solely on the reports of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinions

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of June 30, 2018, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1.E. to the financial statements, effective as of July 1, 2017, the City adopted the provisions of Governmental Accounting Standards Board Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis; the schedules of revenues, expenditures, and changes in fund balance – budget and actual for the General Fund, Housing Activities, and Low and Moderate Income Housing Asset Fund; the schedule of employer contributions – defined benefit pension plans; the schedule of changes in the employer's net pension liability – defined benefit pension plans; the schedule of investment returns – defined benefit pension plans; the schedule of the City's proportionate share of the net pension liability and related ratios – CalPERS; the schedule of employer contributions – CalPERS; the schedule of changes in the employer's net OPEB liability and related ratios – postemployment healthcare plans; the schedule of employer contributions – postemployment healthcare plans; and the schedule of investment returns – postemployment healthcare plans, 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 and other auditors 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.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) and is not required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 16, 2018, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely 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 effectiveness of the City's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control over financial reporting and compliance.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 16, 2018

Management's Discussion and Analysis ("MD&A") provides an overview of the City of San José's ("City") activities and financial performance for the fiscal year ended June 30, 2018. Readers are encouraged to read the MD&A in conjunction with the basic financial statements that immediately follow, along with the letter of transmittal at the beginning of the Introductory Section, and with other portions of this Comprehensive Annual Financial Report ("CAFR"). All amounts have been rounded to the nearest one hundred thousand dollars and one tenth of a percent.

FINANCIAL HIGHLIGHTS

- The government-wide statement of net position for the City's governmental and business-type activities indicates that as of June 30, 2018, total assets and deferred outflows of resources exceed total liabilities and deferred inflows of resources by $3.939 billion. Of this amount, a deficit of $2.414 billion represents unrestricted net position, which is comprised of a deficit balance of $2.667 billion for governmental activities, and a positive balance of $252.9 million for business-type activities. In addition, the City's restricted net position totals $1.073 billion ($1.0 billion for governmental activities and $72.8 million for business-type activities) based on the restrictions imposed by the enabling legislations or debt covenants. Lastly, net position of $5.280 billion is the City's net investment in capital assets ($4.350 billion for governmental activities and $930.6 million for business-type activities).

- The net position decreased by $740.1 million or 15.8 percent during 2017-2018 to $3.939 billion from $4.679 billion primarily due to the implementation of GASB Statement No. 75 effective July 1, 2017. Expenses continued to exceed revenues although property tax and other tax related revenues and sales taxes shared revenues increased by $68.5 million over the prior year.

- Governmental funds reported a combined ending fund balance of $1.424 billion at June 30, 2018, which is $9.1 million or 0.6 percent more than the June 30, 2017 balance. The increase was attributable to an increase in the Low and Moderate Income Housing Asset Fund of $27.0 million, the Housing Activities Fund of $5.5 million, the Special Assessment Districts Fund of $2.3 million, the Nonmajor Governmental Funds of $11.2 million, and offset by decrease in the General Fund of $19.8 million and the San José Financing Authority Debt Service Fund of $17.1 million.

- Unassigned fund balance of governmental funds totals $82.5 million, which is 5.8 percent of combined governmental fund balances at June 30, 2018.

- Total long-term liabilities (excluding net pension and Other Postemployment Benefits (OPEB) – net OPEB Liability) decreased by $238.7 million to $2.546 billion at June 30, 2018, which represents a decrease of 8.6 percent compared to $2.785 billion at June 30, 2017. The primary factors leading to the decrease in long-term liabilities for governmental activities of $199.1 million was primarily due to the scheduled debt service payments of $58.9 million, refunding of two series of City of San José Financing Authority Bonds, $67.1 million Series 2001F Revenue Bonds and $23.9 million 2001A Revenue Bonds as part of the 2017 Tax Allocation Bond refunding. In addition, City of San José Financing Authority refunded $37.1 million 2008F Bonds in 2017-2018 with property sale proceeds. The primary factors leading to the decrease in long-term liabilities for business-type activities of $39.6 million was due to the scheduled debt service payments.

- Net pension liability increased by $181.4 million or 6.0 percent during 2017-2018 to $3.192 billion from $3.011 billion. Deferred outflows of resources related to pensions decreased by $116.9 million or 11.1 percent, and deferred inflows of resources related to pensions decreased by $2.2 million or 33.2 percent. The changes were mainly due to a net gain of $104.2 million between projected and actual investment earnings on the City of San José Police and Fire Department Retirement Plan and the City of San José Federated Employees' Retirement System, and an increase of $241.3 million to the total pension liability resulting from changes of assumptions and differences between expected and actual actuarial experience. More details on the net pension liability are included in the Note IV.A3 on page 128.

- In 2017-2018, the City implemented Governmental Accounting Standards Board (GASB) 75, which requires the City to report its net OPEB liability separately on the Government-Wide Statement of Net Position and the Proprietary Funds Statement of Fund Net Position. As of June 30, 2018, total net OPEB liability was $1.071 billion which included $957.6 million in governmental activities and $113.7 million in business-type activities.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

In addition, this report also contains other supplementary information.

Government-wide Financial Statements

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

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

The ***statement of activities*** presents information showing how the net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods. Examples include revenues pertaining to uncollected taxes and expenses pertaining to earned but unused vacation and sick leave.

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

The government-wide financial statements include the primary government of the City and four separate components for which the City is financially accountable.

Fund Financial Statements

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

Governmental funds account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental funds financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the City's capacity to finance its programs in the near future.

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

The governmental funds balance sheet and the governmental funds statement of revenues, expenditures and changes in fund balances present information separately for the General Fund, the Housing Activities Fund, the Low and Moderate Income Housing Asset Fund, the Special Assessment Districts Fund, and the San José Financing Authority Debt Service Fund which are all classified as major funds. These statements also report several individual governmental funds classified as nonmajor funds such as special revenue, debt service, and capital project funds, which are combined into a single, aggregated presentation. Individual fund data for each of the nonmajor governmental funds is provided in the form of combining statements elsewhere in this CAFR.

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

The City accounts for its public works program support, employee benefits, stores, and vehicle maintenance and operations as internal service funds. These services predominantly benefit governmental functions. Therefore, they are included as governmental activities in the government-wide financial statements. Individual fund data for each of the nonmajor internal service funds are provided in the form of combining statements elsewhere in this CAFR.

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

Notes to Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

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

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

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Analysis of net position: As noted earlier, net position may serve as a useful indicator of a government's financial position. As of June 30, 2018, the City's total assets and deferred outflows of resources exceed total liabilities and deferred inflows of resources by $3.939 billion. The following table is a condensed summary of the City's net position for governmental and business-type activities:

Statement of Net Position
June 30, 2018 and 2017
(in thousands)

	Governmental Activities		Business-type Activities		Totals	
	FY 2018	FY 2017	FY 2018	FY 2017	FY 2018	FY 2017
Assets:						
Current and other assets................	$ 1,726,090	$ 1,819,677	$ 881,034	$ 872,457	$ 2,607,124	$ 2,692,134
Capital assets..............................	5,316,928	5,439,984	2,123,324	2,061,572	7,440,252	7,501,556
Total assets...........................	7,043,018	7,259,661	3,004,358	2,934,029	10,047,376	10,193,690
Deferred outflows of resources:						
Loss on refundings of debt.............	721	905	8,616	9,686	9,337	10,591
Deferred outflows of resources related to pensions.....................	824,288	929,516	109,303	120,954	933,591	1,050,470
Deferred outflows of resources related to other postemployment benefits....................................	50,616	-	7,163	-	57,779	-
Total deferred outflows of resources	875,625	930,421	125,082	130,640	1,000,707	1,061,061
Liabilities:						
Current and other liabilities.............	200,994	198,169	90,074	96,180	291,068	294,349
Long-term liabilities.......................	1,233,965	1,433,028	1,312,194	1,351,802	2,546,159	2,784,830
Net pension liability......................	2,835,815	2,678,942	356,541	332,035	3,192,356	3,010,977
Net OPEB liability........................	957,581	436,180	113,684	42,284	1,071,265	478,464
Total liabilities........................	5,228,355	4,746,319	1,872,493	1,822,301	7,100,848	6,568,620
Deferred inflows of resources:						
Gain on refundings of debt.............	-	-	-	107	-	107
Deferred inflows of resources related to pensions.....................	3,980	5,982	513	742	4,493	6,724
Deferred inflows of resources related to other postemployment benefits....................................	3,415	-	125	-	3,540	-
Total deferred inflow of resources	7,395	5,982	638	849	8,033	6,831
Net position:						
Net investment in capital assets	4,349,559	4,391,069	930,631	814,473	5,280,190	5,205,542
Restricted	1,000,459	982,168	72,750	75,945	1,073,209	1,058,113
Unrestricted	(2,667,125)	(1,935,456)	252,928	351,101	(2,414,197)	(1,584,355)
Total net position.....................	$ 2,682,893	$ 3,437,781	$ 1,256,309	$ 1,241,519	$ 3,939,202	$ 4,679,300

At June 30, 2018, the City reported positive balances in net position on a total basis. Net investment in capital assets (infrastructure, land, buildings, other improvements, vehicles, and equipment, less outstanding debt used to acquire them and deferred inflow and outflow related to debt) of $5.280 billion comprises 134 percent of the City's total net position. These capital assets facilitate providing services to the San José community, but they are not liquid, and therefore they are not available for future spending. During 2017-2018, net investment in capital assets increased by $74.6 million primarily due to the depreciation expense of $303.1 million offset by additions (net) to capital assets of $241.8 million, and decrease of $135.9 million in the long-term debt related to purchase of capital assets. A portion of the City's net position, $1.073 billion or 27.2 percent, are subject to legal restrictions on their use, including $1.0 billion in governmental activities and $72.8 million in business-type activities. Of the total net position at June 30, 2018, a deficit balance of $2.414 billion or 61.3 percent represents unrestricted net position, which comprises a deficit balance of $2.667 billion for governmental activities, and a positive balance of $252.9 million for business-type activities. The primary factor contributing to the deficit unrestricted net position is the City's net pension and OPEB liabilities.

During 2017-2018, the City's total net position decreased by $740.1 million. Notable changes in the statement of net position between June 30, 2018 and June 30, 2017 include:

- Capital assets decreased by $61.3 million or 0.8 percent compared to the prior fiscal year. Governmental capital assets decreased by $123.1 million and business-type capital assets increased by $61.8 million. The decrease in governmental capital assets resulted from depreciation expense of $221.9 million for major infrastructure and other assets, partially offset by additions (net) to capital assets of $120.4 million, which included $47.7 million of additional capital projects and $34.9 million of contributed capital from donated infrastructure assets. The increase in business-type capital assets was primarily due to depreciation expense of $81.2 million, offset by additions to capital assets of $143.1 million primarily at the Airport and Wastewater Treatment Facility. As of June 30, 2018, the Airport completed construction of Gates 29 and 30 at Terminal B and infrastructure upgrades to its perimeter security technology.

- Current and other assets decreased by $85.0 million or 3.2 percent due to a decrease of $93.6 million for governmental activities offset by an increase of $8.6 million for business-type activities. The decrease in governmental activities is mainly due to the decrease in Successor Agency to the Redevelopment Agency (SARA) of the City of San Jose long-term receivables to the City with the refunding of 2001F Lease Revenue Bonds and 2001A Lease Revenue Bonds. The increase in current assets for business-type activities is mainly due to higher cash and investments resulting from revenues exceeding expenses.

- Total long-term liabilities (excluding net pension and OPEB liability) decreased by $238.7 million to $2.546 billion at June 30, 2018, which represents a decrease of 8.6 percent compared to $2.785 billion at June 30, 2017. The primary factors leading to the decrease in long-term liabilities for governmental activities of $199.1 million was primarily due to the scheduled debt service payments of $58.9 million, and refunding of $67.1 million Series 2001F Lease Revenue Bonds and $23.9 million 2001A Lease Revenue Bonds. In addition, the City of San José Financing Authority refunded $37.1 million 2008F Bonds in 2017-2018 with property sale proceeds. The primary factors leading to the decrease in long-term liabilities for business-type activities of $39.6 million were due to the scheduled debt service payments.

- Current and other liabilities decreased by $3.3 million or 1.1 percent due to an increase of $2.8 million for governmental activities offset by a decrease of $6.1 million for business-type activities.

- Net pension liability increased by $181.4 million or 6.0 percent during 2017-2018 to $3.192 billion from $3.011 billion. Deferred outflows of resources related to pensions decreased by $116.9 million or 11.1 percent, and deferred inflows of resources related to pensions decreased by $2.2 million or 33.2 percent. The changes were mainly due to a net gain of $104.2 million between projected and actual investment earnings on the Retirement Plans, and an increase of $241.3 million to the net pension liability resulting from changes of assumptions and differences between expected and actual actuarial experience. More details on the net pension liability are included in the Note IV.A3 on page 128.

- In 2017-2018, the City implemented GASB Statement No. 75, which requires the City to report its net OPEB liability in the Government-Wide Statement of Net Position. As of June 30, 2018, total net OPEB liability was $1.071 billion, which included $957.6 million in governmental activities and $113.7 million in business-type activities. As a result of the implementation of the standard, the prior year net OPEB obligation of $478.5 million under GASB Statement No. 45 was eliminated and replaced with the net OPEB liability.

- Unrestricted net position for governmental activities decreased by $731.7 million or 37.8 percent with a deficit balance of $2.67 billion at June 30, 2018. The primary factor contributing to the increased deficit unrestricted net position for governmental activities is the reporting of the City's net OPEB liability in the Government-Wide Statement of Net Position with the implementation of GASB Statement No. 75. For business-type activities, unrestricted net position decreased by $98.2 million or 28.0 percent with a positive balance of $252.9 million at June 30, 2018. This was also mainly due to the reporting of net OPEB liability on the Statement of Net Position in 2017-2018.

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

Statement of Activities
For the Years Ended June 30, 2018 and 2017
(in thousands)

	Governmental Activities		Business-type Activities		Totals	
	FY 2018	FY 2017	FY 2018	FY 2017	FY 2018	FY 2017
Revenues:						
Program revenues:						
Fees, fines, and charges for services	$ 419,189	$ 462,862	$ 532,975	$ 479,003	$ 952,164	$ 941,865
Operating grants and contributions	113,938	86,779	894	1,233	114,832	88,012
Capital grants and contributions	97,441	63,647	16,362	13,258	113,803	76,905
General revenues:						
Property and other taxes	461,964	431,138	-	-	461,964	431,138
Utility	120,234	121,046	-	-	120,234	121,046
Franchise	51,180	49,642	-	-	51,180	49,642
Transient occupancy taxes	48,854	45,511	-	-	48,854	45,511
Business taxes	70,673	54,159	-	-	70,673	54,159
Sales taxes shared revenue	226,337	207,695	-	-	226,337	207,695
State of California in-lieu	551	467	-	-	551	467
Unrestricted interest and investment income	6,688	9,062	6,322	3,955	13,010	13,017
Other revenue	36,485	4,459	4,961	19,211	41,446	23,670
Total revenues	1,653,534	1,536,467	561,514	516,660	2,215,048	2,053,127
Expenses:						
General government	132,157	127,090	-	-	132,157	127,090
Public safety	769,305	694,557	-	-	769,305	694,557
Community services	329,222	310,470	-	-	329,222	310,470
Sanitation	164,890	156,299	-	-	164,890	156,299
Capital maintenance	494,007	444,867	-	-	494,007	444,867
Interest and fiscal charges	57,002	54,844	-	-	57,002	54,844
Norman Y. Mineta San José International Airport	-	-	207,675	204,774	207,675	204,774
Wastewater Treatment System	-	-	203,272	192,302	203,272	192,302
Municipal Water System	-	-	49,156	42,647	49,156	42,647
Parking System	-	-	14,503	14,269	14,503	14,269
San Jose Clean Energy	-	-	1,116	-	1,116	-
Total expenses	1,946,583	1,788,127	475,722	453,992	2,422,305	2,242,119
Excess (deficiency) before transfers	(293,049)	(251,660)	85,792	62,668	(207,257)	(188,992)
Transfers	5,769	3,387	(5,769)	(3,387)	-	-
Change in net position	(287,280)	(248,273)	80,023	59,281	(207,257)	(188,992)
Net position at beginning of year	3,437,781	3,686,053	1,241,519	1,182,238	4,679,300	4,868,291
Change in accounting principle	(467,608)	-	(65,233)	-	(532,841)	-
Net position at beginning of year, as restated	2,970,173	3,686,053	1,176,286	1,182,238	4,146,459	4,868,291
Net position at end of year	$ 2,682,893	$ 3,437,780	$ 1,256,309	$ 1,241,519	$ 3,939,202	$ 4,679,299

Governmental activities: Net position for governmental activities decreased by $754.9 million or 22 percent during 2017-2018 from $3.438 billion to $2.683 billion. Total expenses increased by $158.5 million and total revenues increased by $117.1 million. The increase in revenues was not sufficient to offset total expenses resulting in a decrease in net position before transfers. The major factors contributing to the decrease in net position before transfers from June 30, 2017 to June 30, 2018 are as follows:

- Contributing factors resulting in increases to certain revenue categories are as follows: Property and other taxes revenue increased by $30.8 million or 7.2 percent due to an increase in assessed valuations based on a strong real estate market. Sales tax shared revenues were also $18.6 million or 9.0 percent higher compared to the prior year mainly due to the full year implementation of the Local Sales Tax that was approved by the voters in June 2016 and became effective in October 2016. Operating grants and contributions increased by $27.2 million or 31.3 percent primarily due to an increase of $20.5 million in the Low and Moderate Income Housing Asset Fund due to repayments of multi-family loans in 2017-2018 and an increase of $1.6 million in public safety grants due to UASI grant revenues being received in 2018 for the years of 2017 and 2016. Capital grants and contributions increased by $33.8 million in current year due to a $21.1 million increase in developer donated infrastructure projects, which included storm sewer, roadway, traffic, and land improvements, $6.0 million increase in Special Assessment District Funds and $5.7 million increase in Construction Excise Tax due to the receipt of new gas tax revenues from the SB1 Road Repair and Accountability Act of 2017. Transient occupancy tax receipts from guests staying in the City's local hotels increased by $3.3 million or 7.4 percent due to continuing higher occupancy and room rates. Business tax receipts were $16.5 million or 30.5 percent higher mainly because of the change in business tax rates as approved by voters in November 2016 and became effective on July 1, 2017. Other revenues increased by $32.0 million in the General Fund mainly due to the sale of Airport West property.

- Contributing factors resulting in decreases to certain revenue categories are as follows: Fees, fines, and charges for services decreased by $43.7 million or 9.4 percent, mainly due to the $36.0 million of a one-time proceeds from the HUD judgement award recorded in the Housing Activities Fund in 2016-2017. The General Fund charges for services decreased $18.2 million, which were partially offset by $3.0 million higher revenues at the Convention Center, and a higher $8.2 million in Construction Excise Tax fund due to an increase in collection of the Traffic Impact Fee.

- General government expenses increased $5.1 million or 4.0 percent during 2017-2018 mainly due to a $3.6 million increase in General Fund salary costs.

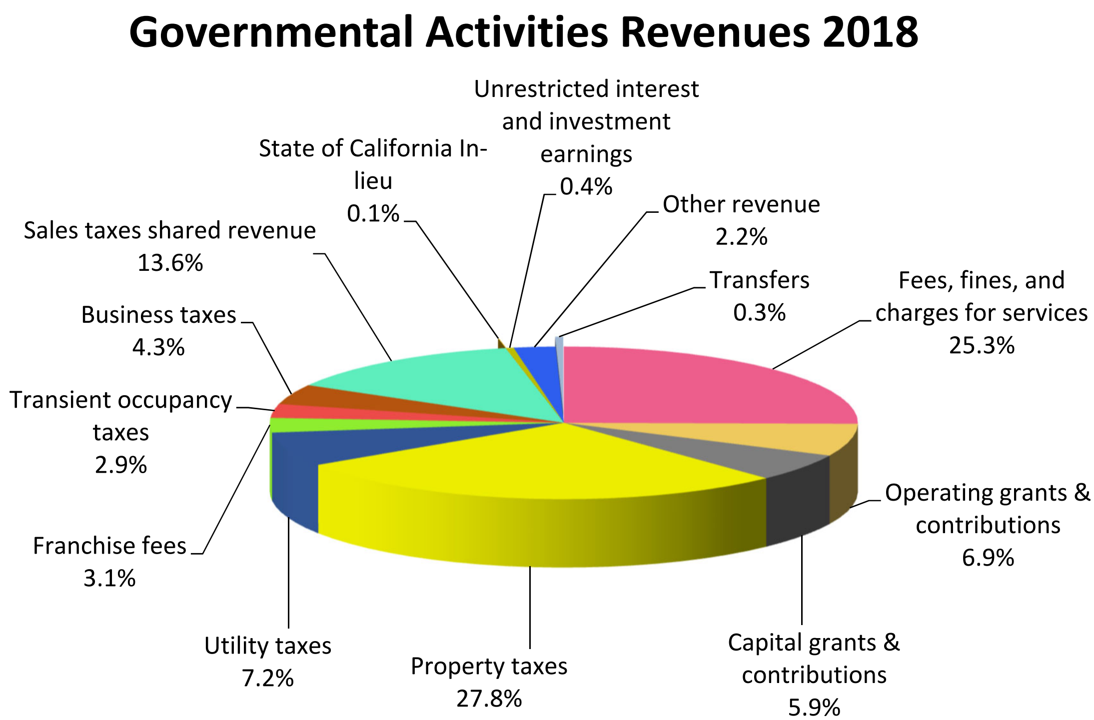
- Public safety expenses increased by $74.7 million or 10.8 percent primarily due to an increase in pension expense of $36.9 million, and higher salary and other related expenses of $57.1 million from filling vacant positions, offset by $11.8 million in lower workers' compensation expense.

- Community services expenses increased by $18.8 million or 6.0 percent mainly due to an increase in pension expense of $8.0 million and an increase of $11.7 million in labor and other costs associated with an increase in major events at the Convention Center during 2017-2018.

- Sanitation expenses increased by $8.6 million or 5.5 percent primarily due to an increase in pension expense of $1.9 million, an increase of $1.7 million in salary costs from additional positions, and an increase of $4.7 million in the Integrated Waste Management Fund due to 1) an increase in the Refuse Rate Index for the haulers contract, and 2) an increase in back end processing costs. As part of a multi-year effort, the City expanded the recycling of general solid waste items collected from the single-family households to minimize items going to the landfill.

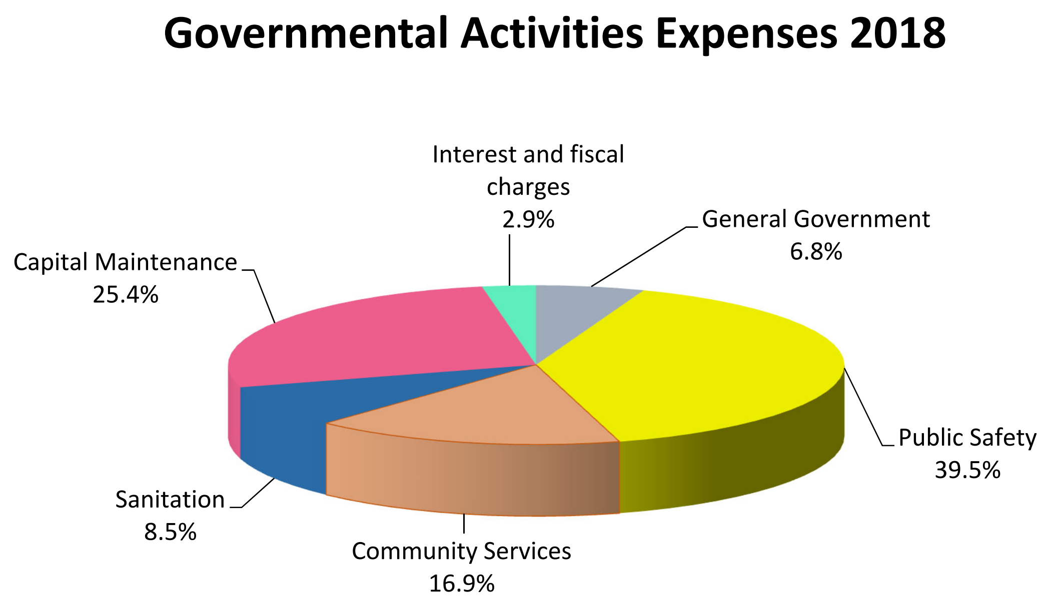
- Capital maintenance expenses increased by $49.1 million or 11 percent primarily due to an increase of $8.4 million in the General Fund which is explained in more detail in the General Fund section, an increase of $12.0 million in the Special Assessment Districts Fund due to the significant increase in expenditures related to the design costs at the Convention Center Exhibit Hall Lighting and Ceiling Upgrade Project, an increase in pension expense of $11.4 million, and an increase of $4.4 million in the Construction Excise Tax Funds related to the Route 101/Trimble/De La Cruz Interchange improvements.

- Interest and fiscal charges were up $2.2 million in 2017-2018 due to increase in variable interest rates on outstanding notes, bonds, and commercial paper.



The chart shows the primary components of governmental activities revenue sources for 2017-2018. Of the $1.659 billion in total revenues generated by governmental activities, 73.9 percent is attributable to four categories: fees, fines, and charges for services (25.3 percent), property taxes (27.8 percent), sales taxes shared revenue (13.6 percent), and utility taxes (7.2 percent).

The chart below shows the major categories of 2017-2018 expenses for governmental activities. Of the $1.946 billion in total expenses incurred by governmental activities, the categories accounting for 81.8 percent of the totals are: public safety (39.5 percent); capital maintenance (25.4 percent); and community services (16.9 percent).



Business-type activities: Business-type activities net position increased by $14.8 million or 1.2 percent to $1.256 billion in 2017-2018.

The notable components of the changes in net position for business-type activities in 2017-2018 are:

Airport Change in net position from current year activities showed an increase of $7.9 million in 2017-2018 compared to an increase of $2.8 million in 2016-2017. The combination of an increase in operating income and a decrease in net nonoperating expenses was more than the offset due to an increase in operating expenses, a decrease in capital contributions, and the restatement of beginning net position to reflect the changes in accounting principle resulting from the implementation of GASB Statement Number 75.

The Airport had a net operating income of $22.2 million, an increase of $4.1 million compared to prior year's operating income of $18.1 million. Operating revenues increased by 10.2 percent from $152.9 million in 2016-2017 to $168.6 million in 2017-2018, which was mainly due to an increase in general aviation attributable to growth in passenger traffic. A total of approximately 13.5 million passengers traveled through the Airport in 2017-2018 compared to approximately 11.5 million in 2016-2017, resulting in passenger traffic growth of 17.2 percent.

Operating expenses in 2017-2018 increased 8.6 percent, or $11.6 million, from $134.8 million in 2016-2017 to $146.4 million in 2017-2018. Increases were experienced in salaries and fringe benefits, pension expenses, higher costs for public safety employees, non-personnel expenses, and depreciation expenses.

Wastewater Treatment System net position increased by $8.7 million or 1.0 percent from $857.4 million to $866.1 million. The increase was primarily due to revenues exceeding expenses (before capital contributions) by $52.8 million, offset by a restatement of 2016-2017 net position of $46.6 million due to the financial reporting impact resulting from the implementation of the GASB Statement Number 75. The largest portion, $700.3 million or 80.9 percent, of the net position was its net investment in capital assets (e.g. land, buildings, and infrastructure) less outstanding debt that was used to acquire those assets. Approximately $157.2 million, or 18.2 percent of the total net position, constitutes unrestricted net position, which may be used to finance day-to-day operations without constraints established by debt covenants or other legal requirements.

Operating revenues increased $30.1 million primarily due to a 3.0 percent sewer rate increase effective July 1, 2017, higher contributions from outside users toward the Water Pollution Control Plant's (the Plant) ongoing maintenance, replacement and debt service costs by $19.2 million, and higher recycled-water revenue due to recycled-water rate increase by $1.5 million.

Total operating expenses increased by $11.3 million compared to the prior fiscal year. The increase was due to an increase of $7.7 million in pension expense; an increase of $3.2 million in personnel costs; an increase of $2.7 million in direct overhead costs; an increase of $6.0 million in sanitary sewer line condition assessment, rehabilitation, and preventive maintenance programs in the wastewater collection system; and an increase of $2.6 million of equalization payment to the Santa Clara Valley Water District for the Silicon Valley Advanced Water Purification center, offset by a $9.6 million decrease due to various Plant capital projects progressing from planning, feasibility or development phases to design and construction related work and a decrease of $2.6 million in Owner Controlled Insurance expenses to provide a centralized insurance program for losses associated with onsite construction of Capital Improvement Program at the Plant.

Net nonoperating revenues increased by $1.3 million primarily due to higher investment income and receipt of higher operating grants. Capital contributions increased by $2.6 million mainly due to an increase in donated assets from developers.

Municipal Water System net position decreased by $4.3 million or 5.0 percent from $87.8 million to $83.5 million. The decrease was due to a restatement of $5.1 million to the beginning net position related to the adoption of GASB Statement No. 75. Operating revenues of $48.6 million increased by $3.9 million or 8.8 percent due to increase in both user fee rates and total consumption. Operating expenses of $49.1 million increased by $6.5 million or 15.2 percent due to an increase in the cost of wholesale water for both portable and recycled water, and an increase in operations and maintenance costs, higher costs due to increased staffing, and higher salary and benefit costs.

Parking System net position increased by $3.7 million or 3.6 percent from $99.7 million to $103.4 million. Operating revenues were flat compared to the prior fiscal year. Nonoperating revenue decreased by $14.6 million or 78.9 percent. The decrease is due to the recording of a $13.5 million loan reinstatement between the City and Successor Agency to the Redevelopment Agency (SARA) as nonoperating revenue in 2016-2017. Operating expenses increased by $0.0234 million or 1.6 percent reflecting higher general and administrative costs.

San Jose Clean Energy (SJCE) is the newest enterprise fund established in 2017-2018 to account for revenues from the sale of electricity and the costs associated with the San Jose Clean Energy Program. There were no operating revenues in the current fiscal year. Operating expenses were $1.1 million which were mainly SJCE personnel and operations start-up costs. The deficit position is projected to improve in 2018-2019 when the SJCE programs are fully operational.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

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

As of June 30, 2018, the City's governmental funds reported combined fund balances of $1.424 billion compared to $1.415 billion balances in 2016-2017. The governmental fund balances are categorized as nonspendable, restricted, committed, assigned, or unassigned.

- $0.15 million consists of nonspendable fund balance related to advances and deposits that are not intended to convert into cash and long-term in nature and do not represent currently available resources.
- $979.6 million is reported as restricted fund balance that includes restrictions imposed by external parties or enabling legislation. This amount includes unspent bond proceeds, unspent grant revenues, and restricted tax revenues.
- $155.7 million is reported as committed fund balance that had been limited by formal Council action to a specific purpose.
- $206.3 million is reported as assigned fund balance that includes amounts that may be used for specific purposes, but do not meet the criteria to be classified as restricted or committed.
- $82.5 million is reported as unassigned fund balance that represents the residual classification for the City's General Fund and includes all spendable amounts not contained in the other classifications.

General Fund: The General Fund is the chief operating fund of the City. At June 30, 2018, the General Fund's unassigned fund balance is $82.5 million or 28.2 percent of the $293.0 million total General Fund balance. Comparing unassigned fund balance and total fund balance to total fund expenditures may be useful as a measure of the General Fund's capacity to liquidate future obligations. At June 30, 2018, unassigned fund balance represents 8.1 percent of total General Fund expenditures of $1.013 billion, while total fund balance represents 28.9 percent of total General Fund expenditures. At June 30, 2017, the same measures were 8.9 percent and 34.9 percent, respectively.

For the second time in five years, the revenue sources in 2017-2018 were not sufficient to cover all expenditures. The General Fund ending fund balance decreased by $19.8 million from $312.8 million to $293.0 million at June 30, 2018.

In 2017-2018, General Fund revenues of $978.8 million were $77.7 million or 8.6 percent higher than 2016-2017 revenues of $901.1 million. Taxes and special assessments revenues increased by $48.4 million or 9.3 percent. The increase was primarily attributed to the following revenue sources: increases of $29.6 million in property tax due to increased assessed valuations based on a strong real estate market as well as additional property tax distribution after the Successor Agency to the Redevelopment Agency bond refunding in December 2017 and higher excess Educational Revenue Augmentation Fund revenues; an increase of $1.5 million in franchise fee due to a growth in the electricity and gas utilities; an increase of $16.5 million in business tax due to changes in the City's business tax base rates as approved by voters in June 2016 and became effective on July 1, 2017; and an increase of $1.3 million in the transient occupancy tax allocated to the General Fund due to continued strong hotel occupancy and increases in average room rates in the City.

Sales taxes shared revenues increased by $18.6 million or 9.0 percent due primarily to the full year implementation of the Local Sales Tax that was approved by the voters in June 2016 and became effective in October 2016. During the past ten fiscal years, this revenue source has grown 77.1 percent from $127.8 million in tax receipts in 2008-2009 to $226.3 million in tax receipts in 2017-2018.

Charges for services revenues were $6.3 million or 13.6 percent higher compared to prior fiscal year primarily due to an increase in Planning and Public Works development related revenues and recreation program fee.

2017-2018 General Fund expenditures of $1.014 billion were $116.5 million or 13 percent higher than 2016-2017 expenditures of $896.9 million as discussed below:

General government expenditures increased by $4.9 million primarily due to increases in salary and benefit related costs.

Public safety expenditures increased by $57.1 million primarily due to filling vacant sworn positions, salary and pension cost increases, and acquisition of additional equipment.

Community services expenditures were $6.1 million higher mainly due to an increase in non-personnel costs.

Capital maintenance expenditures increased by $8.4 million due to increase spending on streets and road pavement activities, acquisition of fire apparatus, and upgrade of the police communication system,

Debt service payments were $38.4 million higher due to the refunding of City of San José Financing Authority Series 2008F bonds and HUD loans with proceeds from the sale of property.

Housing Activities Fund: The City's Housing Activities fund receives resources from the U.S. Department of Housing and Urban Development and the California Department of Housing and Community Development. At June 30, 2018, the fund's loan receivable balance (net), which represents loans to developers of various affordable housing projects and first time homebuyers, was $69.0 million. This balance includes loans to developers for various projects, including Ford and Monterey, Taylor Oaks Apartments, Donner Lofts, Japantown Seniors, The Metropolitan, Roundtable, Kings Crossing, Fourth Street Apartments, Peacock Commons, Archer Studios, Canoas Terrace, Curtner Studios, Homesafe, Markham Plaza, Plaza Del Sol, Corde Terra Village Senior, Willow Glen Senior Housing, Santa Clara Inn, and Second Street Studios. Restricted fund balance increased by $5.5 million to $133.2 million at June 30, 2018. The increase is primarily due to revenues from intergovernmental ($8.1 million), and investment and other revenues ($11.8 million) exceeding expenditures for community services ($14.4 million). Intergovernmental revenues decreased by $3.4 million or 29.3 percent compared to prior year due to less grant funds received from HOME Investment Partnership Program. Other revenue decreased by $36.0 million or 81.3 percent compared to prior year due to a one-time proceeds from the HUD judgment awarded to the City in 2016-2017.

Low and Moderate Income Housing Asset Fund: The Low and Moderate Income Housing Asset fund was created pursuant to the Redevelopment Dissolution Law to administer the housing assets and functions related to the Low and Moderate Income Housing Program retained by the City following the dissolution of the former Agency. At June 30, 2018, the fund's loan receivable balance (net) was $223.6 million. This balance consists mainly of loans to developers for various projects including Almaden Family Apartments, Belovida Apartments, Brookwood Terrace, Cinnabar Commons, Corde Terra Village, Las Ventanas, Oak Tree Village, Pollard Plaza, Terramina Square, Villas on the Park, Second Street Studios, and The Metropolitan (South). Restricted fund balance increased by $27.0 million to $379.3 million from $352.3 million. The increase is primarily due to repayments of developer loans.

Special Assessment Districts Fund: The Special Assessment Districts fund accounts for debt issuance and capital improvements related to the specific purposes of eight special assessment and community facilities districts located in different parts of the City. A total of $130.8 million in special assessment and special tax bonds were outstanding at June 30, 2018. All bonds are secured by special assessments or special taxes charged to the owners' real property in the district issuing the debt, except for the Special

Hotel Tax Revenue Bond, Series 2011, which are secured by a first lien on the Convention Center Facilities District No.2008-1 special tax revenues and any of the Available Transient Occupancy Tax (Available TOT as defined in the bond documents) as appropriated by City Council. The City is not obligated to advance available surplus funds from the City Treasury to cure any deficiency in the Redemption Fund for these bonds; provided, however, the City is not prevented, in its sole discretion, from so advancing funds.

Restricted fund balance increased by $2.3 million from $39.7 million to $42.0 million as of June 30, 2018. The 2017-2018 total revenues of $26.9 million were below total expenditures of $33.4 million for 2017-2018. The net transfers amount of $8.7 million resulted in a $2.3 million net positive change in fund balance. The higher expenditures of $12.9 million, or 63.0 percent compared to the prior fiscal year were related to the capital maintenance toward the Convention Center Exhibit Hall Lighting and Ceiling Upgrade Project and funded by the $15.0 million Commercial Paper note issuance from the City of San José Financing Authority.

City of San José Financing Authority Fund: The City's Financing Authority Debt Service Fund accounts for debt activity related to lease revenue bonds and commercial paper notes, which serves as a mechanism for financing City public improvements and other eligible purposes. Restricted fund balance decreased by $17.1 million from $28.5 million to $11.4 million as of June 30, 2018. The decrease was primarily due to a $15.0 million transfer of commercial paper proceeds to Convention Center Exhibit Hall Project, Flood Improvement Project, and Energy Conservation Project. In 2017-2018, this fund received $92.6 million proceeds from the sale of Successor Agency to the Redevelopment Agency (SARA) refunding bonds, which were used to refund 2001A and 2001F Bonds. In addition, the Authority also refunded $37.1 million 2008F Bonds in 2017-2018 with property sale proceeds.

Proprietary Funds: The City's proprietary funds provide the same type of information found in the government-wide financial statements for business-type activities, but in more detail. At June 30, 2018, the unrestricted net position was $41.9 million for the Airport, $157.2 million for the Wastewater Treatment System, $9.9 million for the Municipal Water System, $45.0 million for the Parking System, and negative $1.1 million for the San Jose' Clean Energy fund. Net position for proprietary funds increased from $1.242 billion at June 30, 2017 to $1.256 billion at June 30, 2018, resulting in an increase of $14.8 million or 1.2 percent.

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

GENERAL FUND BUDGETARY HIGHLIGHTS

The City's Charter requires the City Manager to submit balanced operating and capital budgets to the City Council prior to the beginning of a new fiscal year that begins each July 1 and ends on the following June 30. Council approved the 2017-2018 budgets in June 2017.

During the year ended June 30, 2018, there was a $48.5 million increase in the budgeted revenues between the original and final amended operating budget for the General Fund. The budgeted revenues increases were in all revenue categories except for licenses, permits and fines, and charges for service categories.

Actual budgetary basis expenditures of $1.051 billion were $124.2 million less than the amended budget and $274.4 million less than the original budget due to planned expenditures not occurring in the fiscal year ended June 30, 2018.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The City's capital assets, net of accumulated depreciation, for its governmental and business-type activities together amounted to $7.440 billion at June 30, 2018. This investment includes land, infrastructure, structures and improvements, vehicles, equipment, intangible assets, and construction in progress. The City's decision to depreciate infrastructure capital assets results in recording a large non-cash depreciation expense each year that offsets additions to capital assets. For the year end June 30, 2018, net capital assets decreased by $61.3 million ($123.1 million decreased in governmental activities and $61.8 million increased in business-type activities) compared to net capital assets at June 30, 2017. The decrease in capital assets of $123.1 million in governmental activities is primarily due to depreciation expense of $221.9 million and deletions of capital assets totaling $21.6 million, which included a $20.6 million land sale land at 1125 Coleman Avenue. These decreases were offset by acquisitions of capital assets of $120.4 million. The increase of $61.8 million in capital assets in the business-type activities resulted from depreciation expense of $81.2 million, offset by additions of capital projects of $107.6 million and additions of $35.4 million in other capital improvements at the Airport and the Wastewater Treatment Facility.

Total construction in progress (CIP) increased by $61.7 million from $168.8 million at June 30, 2017 to $230.5 million at June 30, 2018. Construction in progress for the governmental activities decreased by $2.4 million primarily due to more CIP additions being placed into service than new additions to CIP. Two of the larger assets placed into service included the expansion of Del Monte Park and Civic Auditorium HVAC rehabilitation, which resulted in a $9.5 million decrease in CIP. Business-type activities contributed an increase of $64.1 million to the total CIP as additions to the Airport and the Wastewater Treatment System totaling $102.1 million was offset by $36.5 million in Airport projects that were completed and placed in service. The completed Airport projects include the following: completion of infrastructure upgrades to its perimeter security technology and construction of Gates 29 and 30 at the Terminal B.

The City records infrastructure assets at historical cost in the government-wide financial statements and depreciates assets from acquisition date to the end of the current fiscal year as required by GASB Statement No. 34. For governmental fund financial statements recording purposes, capital asset purchases are recorded as expenditures, rather than capitalizing and recording related depreciation. Capital assets, net of depreciation, for governmental and business-type activities in the government-wide financial statements are presented below to illustrate changes between June 30, 2018 and June 30, 2017 (in thousands):

	Governmental activities		Business-type activities		Total	
	2018	2017	2018	2017	2018	2017
Land	$ 409,022	$ 413,533	$ 137,938	$ 134,926	$ 546,960	$ 548,459
Intangible assets	-	-	12,882	12,882	12,882	12,882
Construction in progress	46,570	48,995	183,980	119,839	230,550	168,834
Buildings	1,000,352	1,037,733	1,046,008	1,071,189	2,046,360	2,108,922
Improvements, other than buildings	224,407	214,072	650,662	636,328	875,069	850,400
Infrastructure	3,593,318	3,688,827	-	-	3,593,318	3,688,827
Furniture and fixtures, vehicles, equipment	43,259	36,824	91,854	86,408	135,113	123,232
Total capital assets	$5,316,928	$5,439,984	$2,123,324	$2,061,572	$7,440,252	$7,501,556

Commitments outstanding as of June 30, 2018, related to governmental and business-type activities construction in progress totaled approximately $32.4 million and $233.1 million, respectively. Additional information about the City's capital assets can be found in the Notes to Basic Financial Statements, Note III.D.

Net General Obligation Bonded Debt Limit

The City Charter limits bonded indebtedness for General Obligation bonds to 15 percent of the total assessed valuation of all real and personal property within the City. The total assessed value of taxable property on the City's 2017-2018 tax roll was $177.0 billion, which results in a total debt limit of $27.0 billion. As of June 30, 2018, the City had $347.3 million of Net General Obligation bonds outstanding which represents approximately 1.3% of the General Obligation bonds debt limit.

General Obligation Bonds and Other Bond Ratings

The City's current general obligation credit ratings are Aa1/AA+/AA+ from Moody's Investors Service ("Moody's"), Standard & Poor's ("S&P"), and Fitch Ratings ("Fitch"), respectively. These credit ratings have remained the same from the prior year, and the City continues to be one of the highest rated large cities (with population over 250,000) in California.

Moody's credit rating for the City of San José Financing Authority, lease revenue bond Series 2003A, 2006A, 2013A, and 2013B is Aa2. Moody rated 2011A lease revenue bonds at Aa3. S&P and Fitch both have an underlying rating of AA. The outlook for all the three agencies is stable.

For Norman Y. Mineta San José International Airport, S&P currently has an underlying rating of A with stable outlook, Moody's currently has an underlying rating of A2 with stable outlook. Fitch currently has an underlying rating on Airport Revenue Bonds at A- with stable outlook.

Sewer revenue bonds issued by the San Jose-Santa Clara Clean Water Financing Authority have current underlying ratings of AAA by S&P and Fitch, and a rating of Aa2 by Moody's. The outlook for all three agencies is stable.

Outstanding Debt

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

During 2017-2018, the City's outstanding long-term debt decreased by $244.2 million to $2.262 billion, comprised of $982.3 million of governmental activities and $1.279 billion of business-type activities. The balances at June 30, 2017 were $1.168 billion for governmental activities and $1.338 billion for business-type activities, for a total of $2.506 billion. The decrease of $244.2 million is primarily due to the scheduled debt service payments and redemption of the City of San José Financing Authority 2001A Bonds, 2001F Bonds, and 2008F Bonds.

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

	As of June 30, 2018	As of June 30, 2017	Net Change
Governmental Activities:			
General obligation bonds	$ 347,530	$ 367,469	$ (19,939)
HUD Section 108 loan	-	717	(717)
San José Financing Authority			
Lease revenue bonds	505,519	561,102	(55,583)
Lease revenue bonds with reimbursement agreement	-	78,680	(78,680)
Revenue bonds with pledge agreement	-	26,005	(26,005)
Special assessment bonds with limited governmental commitment	129,228	134,467	(5,239)
Sub-total	982,277	1,168,440	(186,163)
Business-Type Activities:			
Revenue bonds	1,277,755	1,331,448	(53,693)
State of CA-Revolving Fund Loan	1,772	6,125	(4,353)
Sub-total	1,279,527	1,337,573	(58,046)
Total:	$ 2,261,804	$ 2,506,013	$ (244,209)

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

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

- The City's General Fund completed 2017-2018 with better operating financial results than expected when the 2017-2018 Adopted Budget was developed. Although the local economic activity remains strong, the City still faces fiscal challenges on a long-term basis to achieve a more desirable level of budget stability while avoiding any reduction in services. In June 2018, the City Council approved a balanced General Fund budget for fiscal year 2018-2019. Given the availability of one-time funding and the modest funding made available, the Adopted 2018-2019 Budget follows City Council direction to focus on targeted, strategic spending as well as savings for the future. The budget takes a multi-year approach with one-time funding set aside in 2018-2019 to address the projected General Fund shortfall in 2019-2020. It also maintains existing service levels, enhanced service delivery in limited areas, and investment in infrastructure and technology. With limited resources, it is imperative that the City continues to innovate and leverage resources to achieve its service delivery goals.

- The 2018-2019 Adopted Budget includes modest increases to staffing levels to support a variety of activities and limited enhancements to other critical services. Overall, the level of staffing will increase by a net 163 (a total of 46 positions are one-time funded), from 6,250 full-time equivalent positions in the 2017-2018 Adopted Budget to 6,413 positions in the 2018-2019 Adopted Budget. This 2.6% increase still leaves City staffing well below its peak of almost 7,500 positions in 2001-2002 and well below the average of large cities.

- 2018-2019 redevelopment property tax revenues are forecast to be sufficient to pay debt service obligations of the SARA. With the issuance of $1.7 billion of Tax Allocation Refunding Bonds in 2017-2018 which refunded 23 series of tax allocation bonds and the City of San José Financing Authority's

Series 2001A Bonds and 2001F Bonds. The refunding put SARA into a "Sufficiency of Funds" situation, improve its cash flow, and accelerate distribution of residual revenues to other taxing agencies including the City.

- As reported in the GASB 67/68 Report as of June 30, 2018 prepared by the actuary for the Police and Fire Department Retirement Plan ("PFDRP"), the net position of the Defined Benefit Pension Plan was 73 percent of the total pension liability. The total pension liability was $4.534 billion, and the fiduciary net position was $3.293 billion, resulting in a net pension liability of $1.241 billion.

- As reported in the GASB 67/68 Report as of June 30, 2018 prepared by the actuary for the Federated City Employees' Retirement System ("FCERS"), the net position of the Defined Benefit Pension Plan was 50 percent of the total pension liability. The total pension liability was $3.923 billion, and the fiduciary net position was $1.973 billion, resulting in a net pension liability of $1.950 billion.

- For funding purposes, as of June 30, 2017, the most recent actuarial valuation date, PFDRP's Postemployment Healthcare Benefits (OPEB) Plan had a 21 percent actuarial funded ratio for postemployment healthcare benefits. The actuary reported total OPEB liability was $714.5 million and the fiduciary net position was $149.7 million, resulting in net OPEB liability of $564.8 million.

- For funding purposes, as of June 30, 2017, the most recent actuarial valuation date, FCERS's Postemployment Healthcare Benefit (OPEB) Plan had a 347 percent actuarial funded ratio for postemployment healthcare benefits. The actuary reported total OPEB liability for postemployment healthcare benefits was $766.8 million and the fiduciary net position was $260.4 million, resulting in a net OPEB liability of $506.4 million.

- For 2018-2019, the City's contribution rates for pension benefits and postemployment healthcare benefits, as a percentage of payroll are as follows:

	PFDRP (1)				FCERS (1)		
Contribution Rates	**Police Tier 1**	**Police Tier 2**	**Fire Tier 1**	**Fire Tier 2**	**Tier 1**	**Tier 2**	**Tier 2B**
Retirement Pension	97.55%	13.71%	98.49%	15.13%	99.16%	8.28%	8.28%
Postemployment Healthcare Benefits	11.0%	11.0% (2)	10.1%	10.1% (2)	7.2%	7.2%	7.2%

(1) The rates above are the Retirement Board adopted rates based on the June 30, 2017, actuarial valuations.

(2) Subsequent to the implementation of the revised Tier 2 pension benefits for sworn Police and Fire Tier 2 employees, the City Manager exercised his discretion, pursuant to the Municipal Code, to terminate the defined benefit retiree healthcare plan for these employees. Effective July 30, 2017, Police and Fire Tier 2 employees were no longer eligible for the defined benefit retiree healthcare plan and, as such, will not make contributions to the plan. The City continues to pay its contributions for the Tier 2 police and fire employees. Additional information about the City's Postemployment Healthcare Benefits appears in the Notes to Basic Financial Statements, Note IV. A.4 would not apply to FY 2018-2019.

- On June 24, 2008, the City Council adopted Ordinance No. 28332 amending Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for pension benefits and postemployment healthcare benefits to PFDRP and FCERS. The lump sum prepayment for the fiscal year ending June 30, 2019 was calculated to be actuarially equivalent to the biweekly payments that would otherwise have been the City's required contributions to the benefit pension plans and the postemployment healthcare plans. The Boards of Administration for PFDRP and FCERS approved the actuarially determined prepayment amount of $183.1 million for PFDRP, and $175.4 million for FCERS Tier 1 members. The prepayment for PFDRP and for FCERS Tier 1 members was paid by the City in July 2018.

FORWARD-LOOKING STATEMENTS AND REQUESTS FOR INFORMATION

Forward-Looking Statements

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

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

Requests for Information

This financial report is designed to provide our residents, taxpayers, customers, investors, and creditors with a general overview of the City's finances. All summaries of documents contained in this CAFR are made subject to the provisions of such documents and do not purport to be complete statements of any or all such provisions. Each reference in this CAFR to a document is qualified in its entirety by reference to such document, which is on file with the City.

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

Basic
Financial Statements

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City of San José
Statement of Net Position
June 30, 2018
($000's)

		Governmental Activities	Business-Type Activities	Total
ASSETS				
Equity in pooled cash and investments held in City Treasury	$	972,976	634,634	1,607,610
Receivables (net of allowances for uncollectibles)		147,044	34,364	181,408
Due from outside agencies		185	-	185
Inventories		1,145	697	1,842
Notes receivable		10,020	-	10,020
Loans receivable (net of allowances for uncollectibles)		296,913	-	296,913
Advances and deposits		532	2,816	3,348
Restricted assets:				
Equity in pooled cash and investments held in City Treasury		93,177	70,007	163,184
Cash and investments held with fiscal agent		102,869	111,230	214,099
Other cash and investments		20,764	2,204	22,968
Receivables (net of allowances for uncollectibles)		-	4,903	4,903
Prepaid bond insurance costs (net of accumulated amortization)		326	2,034	2,360
Long-term receivables from SARA		29,424	17,925	47,349
Other assets		50,715	220	50,935
Capital assets (net of accumulated depreciation):				
Nondepreciable		455,592	334,800	790,392
Depreciable		4,861,336	1,788,524	6,649,860
Total assets		7,043,018	3,004,358	10,047,376
DEFERRED OUTFLOWS OF RESOURCES				
Loss on refundings of debt		721	8,616	9,337
Deferred outflows of resources related to pensions		824,288	109,303	933,591
Deferred outflows of resources related to other postemployment benefits		50,616	7,163	57,779
Total deferred outflows of resources		875,625	125,082	1,000,707
LIABILITIES				
Accounts payable		46,557	32,583	79,140
Accrued liabilities		39,600	4,848	44,448
Interest payable		9,630	21,367	30,997
Due to outside agencies		484	-	484
Short-term notes payable		39,650	7,509	47,159
Unearned revenue		18,761	8,799	27,560
Advances, deposits, and reimbursable credits		8,515	4,968	13,483
Long-term payable to SARA		739	-	739
Loans payable		-	10,000	10,000
Other liabilities		37,058	-	37,058
Long-term obligations:				
Due within one year		112,957	46,521	159,478
Due in more than one year		1,121,008	1,265,673	2,386,681
Net pension liability		2,835,815	356,541	3,192,356
Net other postemployment benefits liability		957,581	113,684	1,071,265
Total liabilities		5,228,355	1,872,493	7,100,848
DEFERRED INFLOWS OF RESOURCES				
Deferred inflows of resources related to pensions		3,980	513	4,493
Deferred inflows of resources related to other postemployment benefits		3,415	125	3,540
Total deferred inflows of resources		7,395	638	8,033
NET POSITION				
Net investment in capital assets		4,349,559	930,631	5,280,190
Restricted for:				
Debt service		35,088	21,275	56,363
Capital projects		324,540	51,475	376,015
Community services		635,800	-	635,800
Public safety		5,031	-	5,031
Unrestricted (deficit)		(2,667,125)	252,928	(2,414,197)
Total net position	$	2,682,893	1,256,309	3,939,202

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

City of San José
Statement of Activities
For the Year Ended June 30, 2018
($000's)

		Program Revenues			Net (Expense) Revenue and Changes in Net Position		
Functions/Programs	**Expenses**	**Fees, Fines, and Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**	**Governmental Activities**	**Business -Type Activities**	**Total**
Governmental activities:							
General government	$ 132,157	29,565	1,229	-	(101,363)	-	(101,363)
Public safety	769,305	78,700	10,376	-	(680,229)	-	(680,229)
Community services	329,222	88,895	64,043	-	(176,284)	-	(176,284)
Sanitation	164,890	155,772	51	-	(9,067)	-	(9,067)
Capital maintenance	494,007	66,257	38,239	97,441	(292,070)	-	(292,070)
Interest and fiscal charges	57,002	-	-	-	(57,002)	-	(57,002)
Total governmental activities	**1,946,583**	**419,189**	**113,938**	**97,441**	**(1,316,015)**	**-**	**(1,316,015)**
Business -Type activities:							
Norman Y. Mineta San José International Airport	207,675	213,993	809	9,287	-	16,414	16,414
Wastewater Treatment System	203,272	252,722	85	5,009	-	54,544	54,544
Municipal Water System	49,156	48,615	-	2,066	-	1,525	1,525
Parking System	14,503	17,645	-	-	-	3,142	3,142
San José Clean Energy	1,116	-	-	-	-	(1,116)	(1,116)
Total business-type activities	**475,722**	**532,975**	**894**	**16,362**	**-**	**74,509**	**74,509**
Total	**$ 2,422,305**	**952,164**	**114,832**	**113,803**	**(1,316,015)**	**74,509**	**(1,241,506)**

	Governmental Activities	Business -Type Activities	Total
General revenues:			
Taxes and franchise fees:			
Property and other taxes	461,964	-	461,964
Utility	120,234	-	120,234
Franchise	51,180	-	51,180
Transient occupancy	48,854	-	48,854
Business taxes	70,673	-	70,673
Sales taxes shared revenue	226,337	-	226,337
State of California in-lieu	551	-	551
Unrestricted interest and investment income	6,688	6,322	13,010
Other revenue	36,485	4,961	41,446
Transfers	5,769	(5,769)	-
Total general revenues and transfers	**1,028,735**	**5,514**	**1,034,249**
Change in net position	**(287,280)**	**80,023**	**(207,257)**
Net position - beginning, as previously reported	3,437,781	1,241,519	4,679,300
Change in accounting principles	(467,608)	(65,233)	(532,841)
Net position - beginning, as restated	2,970,173	1,176,286	4,146,459
Net position - ending	**$ 2,682,893**	**1,256,309**	**3,939,202**

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

City of San José
Balance Sheet
Governmental Funds
June 30, 2018
($000's)

		General Fund	Housing Activities	Low and Moderate Income Housing Asset
ASSETS				
Equity in pooled cash and investments held in City Treasury	$	296,597	36,129	121,104
Receivables (net of allowance for uncollectibles)		72,915	2,875	1,894
Due from outside agencies		185	-	-
Due from other funds		1,797	-	-
Notes receivable		-	-	-
Loans receivables (net of allowance for uncollectibles)		1,241	68,997	223,592
Advances and deposits		153	-	-
Restricted assets:				
Equity in pooled cash and investments held in City Treasury		1,308	45,545	-
Cash and investments held with fiscal agent		682	-	-
Other cash and investments		-	-	-
Advances to other funds		3,297	-	-
Advances receivable from SARA		13,863	-	15,561
Other assets		-	2,300	26,901
Total assets	$	392,038	155,846	389,052
LIABILITIES				
Accounts payable	$	9,001	2,858	1,190
Accrued salaries, wages, and payroll taxes		33,975	87	269
Due to other funds		-	-	-
Due to outside agencies		372	-	-
Short-term notes payable		-	-	-
Unearned revenue		6,483	-	-
Advances, deposits, and reimbursable credits		7	-	-
Advances from other funds		-	-	-
Long-term advances from SARA		-	-	739
Other liabilities		36,736	-	-
Total liabilities		86,574	2,945	2,198
DEFERRED INFLOWS OF RESOURCES		12,442	19,719	7,550
FUND BALANCES				
Nonspendable		153	-	-
Restricted		1,057	133,182	379,304
Committed		97,809	-	-
Assigned		111,509	-	-
Unassigned		82,494	-	-
Total fund balances		293,022	133,182	379,304
Total liabilities, deferred inflows of resources and fund balances	$	392,038	155,846	389,052

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

Special Assessment Districts	San José Financing Authority Debt Service	Nonmajor Governmental Funds	Total Governmental Funds
-	109	500,907	954,846
33,265	-	35,755	146,704
-	-	-	185
-	-	2,300	4,097
-	10,000	20	10,020
-	-	3,083	296,913
5	-	374	532
11,160	-	35,164	93,177
30,675	44,336	27,176	102,869
-	-	20,283	20,283
-	-	-	3,297
-	-	-	29,424
-	-	1,904	31,105
75,105	54,445	626,966	1,693,452
240	-	33,155	46,444
3	-	4,084	38,418
-	-	4,097	4,097
-	112	-	484
-	39,650	-	39,650
-	-	11,600	18,083
1,578	-	6,930	8,515
-	3,297	-	3,297
-	-	-	739
317	-	5	37,058
2,138	43,059	59,871	196,785
30,950	-	1,730	72,391
-	-	-	153
42,017	11,386	412,676	979,622
-	-	57,892	155,701
-	-	94,797	206,306
-	-	-	82,494
42,017	11,386	565,365	1,424,276
75,105	54,445	626,966	1,693,452

City of San José
Reconciliation of the Governmental Funds Balance Sheet
to the Statement of Net Position
June 30, 2018
($000's)

Total fund balances-governmental funds (Page 27)		$ 1,424,276
Amounts reported for governmental activities in the statement of net position are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. These assets consist of:		
Land	$ 409,022	
Construction in progress	46,570	
Infrastructure assets	11,543,605	
Other capital assets	2,097,892	
Accumulated depreciation	(8,785,937)	
Total capital assets		5,311,152
Other long-term assets associated with the New Market Tax Credit (NMTC) financing program are not current financial resources, therefore, are not reported in governmental funds.		19,610
Long-term receivables are not available to pay for current period expenditures and, therefore, are reported as deferred inflows of resources in governmental funds.		41,441
Prepaid bond insurance costs are expended in governmental funds when paid, however, such costs are capitalized and amortized over the life of the corresponding bonds for purposes of the statement of net position.		326
Refunding of debt reported as deferred outflows/inflows of resources are not financial resources, therefore are not reported in the funds. Such costs are capitalized and amortized over the life of the corresponding bonds for purposes of the statement of net position.		721
Special assessments are reported as revenues when levied in government-wide financial statements. In governmental funds, these assessments are reported as deferred inflows of resources since they are not available.		30,950
Interest payable on long-term debt does not require the use of current financial resources and, therefore, interest payable is generally not accrued as a liability in the balance sheet of governmental funds.		(9,630)
Internal service funds are used by management to charge the cost of public works support, employee benefits, and vehicle maintenance and operations to individual funds. The assets and liabilities are included in governmental activities in the statement of net position.		20,656
Long-term obligations are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:		
Bonds, loan payables, and lease-purchase agreements	$ (998,788)	
Accrued vacation, sick leave and compensatory time	(73,285)	
Estimated liability for self-insurance	(135,326)	
Other	(23,323)	
Total long-term obligations		(1,230,722)
Net pension liability and pension related deferred outflows and inflows of resources are not due in the current period and therefore are not reported in the funds. These amounts consist of:		
Net pension liability	$ (2,835,815)	
Deferred outflows of resources	824,288	
Deferred inflows of resources	(3,980)	
		(2,015,507)
Other postemployment benefits liability and related deferred outflows and inflows of resources are not due in the current period and therefore are not reported in the funds. These amounts consist of:		
Net other postemployment benefits liability	$ (957,581)	
Deferred outflows of resources	50,616	
Deferred inflows of resources	(3,415)	
		(910,380)
Net position of governmental activities (Page 24)		$ 2,682,893

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

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City of San José
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2018
($000's)

		General Fund	Housing Activities	Low and Moderate Income Housing Asset
REVENUES				
Taxes and special assessments	$	568,391	-	-
Sales taxes shared revenue		226,337	-	-
Licenses, permits, and fines		74,859	-	-
Intergovernmental		11,773	8,142	-
Charges for current services		52,303	-	-
Rent		-	-	-
Investment income		2,228	3,621	26,558
Other revenue		42,905	8,226	9,335
Total revenues		978,796	19,989	35,893
EXPENDITURES				
Current:				
General government		100,732	-	-
Public safety		593,162	-	-
Community services		139,593	14,398	7,689
Sanitation		4,148	-	-
Capital maintenance		120,158	-	-
Capital outlay		14,264	-	-
Debt service:				
Principal		39,119	-	-
Interest and fiscal charges		2,184	-	-
Total expenditures		1,013,360	14,398	7,689
Excess (deficiency) of revenues over (under) expenditures		(34,564)	5,591	28,204
OTHER FINANCING SOURCES (USES)				
Proceeds from SARA refunding		-	-	-
Payment to refunded bond escrow agent		-	-	-
Proceeds from sale of capital assets		38,187	-	-
Transfers in		11,409	-	1,237
Transfers out		(34,842)	(69)	(2,469)
Total other financing sources (uses)		14,754	(69)	(1,232)
Net change in fund balances		(19,810)	5,522	26,972
Fund balances - beginning		312,832	127,660	352,332
Fund balances - ending	$	293,022	133,182	379,304

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

Special Assessment Districts	San José Financing Authority Debt Service	Nonmajor Governmental Funds	Total Governmental Funds
25,359	-	185,065	778,815
-	-	-	226,337
-	-	-	74,859
-	-	74,287	94,202
-	-	226,742	279,045
-	-	53,415	53,415
392	555	4,799	38,153
1,175	15,245	7,941	84,827
26,926	15,800	552,249	1,629,653
-	-	14,544	115,276
-	-	1,606	594,768
-	-	105,138	266,818
-	-	153,877	158,025
18,685	-	154,253	293,096
801	-	66,246	81,311
5,305	121,460	20,098	185,982
8,570	29,833	16,970	57,557
33,361	151,293	532,732	1,752,833
(6,435)	(135,493)	19,517	(123,180)
-	92,620	-	92,620
-	(1,705)	-	(1,705)
-	-	-	38,187
15,006	45,012	57,137	129,801
(6,287)	(17,538)	(65,476)	(126,681)
8,719	118,389	(8,339)	132,222
2,284	(17,104)	11,178	9,042
39,733	28,490	554,187	1,415,234
42,017	11,386	565,365	1,424,276

City of San José
Reconciliation of the Changes in Fund Balances of Governmental Funds
to the Statement of Activities
For the Year Ended June 30, 2018
($000's)

Net change in fund balances--total governmental funds (Page 31)		$ 9,042
Amounts reported for governmental activities in the statement of activities are different because:		
Capital outlays are reported as expenditures in governmental funds. However, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these amounts are:		
Capital outlay	$ 81,311	
Depreciation expense	(219,297)	
Excess of depreciation expense over capital outlay		(137,986)
The net effect of various miscellaneous transactions involving capital assets (i.e. sales, retirements, trade-ins, donations)		
Donated assets	$ 37,824	
Transfers from SARA	316	
Proceeds from sale of capital assets	(38,187)	
Gain on disposal of assets	16,817	
		16,770
Decrease in long-term receivables associated with lease, pledge revenue, and reimbursement arrangements from the private purpose trust fund are not current financial resources and therefore are not reported in the governmental funds.		(102,610)
Prepaid bond insurance costs are expended in governmental funds when paid, however, are capitalized and amortized over the life of the corresponding bonds for the purposes of the statement of activities.		(19)
Amortization of deferred outflows of resources resulting from the deferred loss on refunding of bonds		(185)
Repayment of long-term obligation principal is reported as an expenditure in governmental funds and, thus, has the effect of reducing fund balance because current financial resources have been used. For the government-wide statements, however, the principal payments reduce the liabilities in the statement of net position and do not result in an expense in the statement of activities. The City's long-term obligations were reduced because principal payments were made to bondholders and HUD.		184,192
Accrued interest payable on long-term debt is reported in the government-wide statement of activities, but does not require the use of current financial resources. Amortization of bond premiums and discounts should be expensed as a component of interest expense on the statement of activities. This amount represents the change in accrued interest payable and the amortization of bond premiums and discounts not reported in governmental funds.		
Decrease in accrued interest payable	$ 474	
Amortization of premiums and discounts on bonds issued	1,971	
Total net interest expense and amortization of discount/premium		2,445
Because some revenues will not be collected for several months after the City's fiscal year end, they are not considered "available revenues" and are reported as deferred inflows of resources in the governmental funds.		(4,269)
Internal service funds are used by management to charge the cost of public works support, employee benefits, and vehicle maintenance and operations to individual funds. The change in net position is included in governmental activities in the statement of activities.		(641)
Some items reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of:		
Net decrease in vacation, sick leave, and compensatory time	$ 897	
Net decrease in estimated liability for self-insurance	9,451	
Net decrease in other liabilities	2,324	
Total expenditures		12,672
Changes to net pension liability and pension related deferred outflows and inflows of resources do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.		(260,099)
Changes to other postemployment benefits liability and related deferred outflows and inflows of resources do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.		(6,592)
Change in net position of governmental activities (Page 25)		$ (287,280)

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

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City of San José
Statement of Fund Net Position
Proprietary Funds
June 30, 2018
($000's)

	Enterprise Funds						
	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	San José Clean Energy	Total	Internal Service Funds
ASSETS							
Current assets:							
Equity in pooled cash and investments held in City Treasury	$ 149,223	425,612	24,752	35,047	-	634,634	18,130
Receivables (net of allowance for uncollectibles)	18,881	5,764	9,411	308	-	34,364	340
Prepaid expenses, advances and deposits	126	-	-	-	-	126	-
Inventories	-	697	-	-	-	697	1,145
Total unrestricted current assets	168,230	432,073	34,163	35,355	-	669,821	19,615
Restricted assets:							
Equity in pooled cash and investments held in City Treasury	59,817	8,070	-	2,120	-	70,007	-
Cash and investments held with fiscal agent	102,144	-	-	-	9,086	111,230	-
Other cash and investments	-	2,204	-	-	-	2,204	481
Receivables (net of allowances for uncollectibles)	4,903	-	-	-	-	4,903	-
Prepaid expenses, advances and deposits	94	-	-	-	-	94	-
Total restricted assets	166,958	10,274	-	2,120	9,086	188,438	481
Total current assets	335,188	442,347	34,163	37,475	9,086	858,259	20,096
Noncurrent assets:							
Prepaid bond insurance (net of accumulated amortization)	2,034	-	-	-	-	2,034	-
Advances and deposits	2,816	-	-	-	-	2,816	-
Long-term receivable from SARA	-	-	-	17,925	-	17,925	-
Capital assets (net of accumulated depreciation):							
Nondepreciable	97,159	211,402	3,235	23,004	-	334,800	-
Depreciable	1,178,503	506,470	70,323	33,228	-	1,788,524	5,776
Total noncurrent assets	1,280,512	717,872	73,558	74,157	-	2,146,099	5,776
Total assets	1,615,700	1,160,219	107,721	111,632	9,086	3,004,358	25,872
DEFERRED OUTFLOWS OF RESOURCES							
Loss on refundings of debt	8,616	-	-	-	-	8,616	-
Deferred outflows of resources related to pensions	27,068	71,897	7,789	2,549	-	109,303	-
Deferred outflows of resources related to other postemployment benefits	1,754	4,801	469	139	-	7,163	-
Total deferred outflows of resources	$ 37,438	76,698	8,258	2,688	-	125,082	-

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

City of San José
Statement of Fund Net Position
Proprietary Funds
June 30, 2018
($000's)

		Enterprise Funds						
		Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	San José Clean Energy	Total	Internal Service Funds
LIABILITIES								
Current liabilities:								
Accounts payable	$	4,304	23,708	2,953	1,160	130	32,255	113
Accrued liabilities		1,223	3,110	318	141	56	4,848	1,182
Interest payable		1	90	-	-	-	91	-
Short-term notes payable		7,509	-	-	-	-	7,509	-
Accrued vacation, sick leave and compensatory time		1,739	3,768	203	188	16	5,914	-
Estimated liability for self-insurance		634	469	142	-	-	1,245	-
Advances and deposits payable		1,584	-	-	92	-	1,676	-
Unearned revenue		7,340	-	-	-	-	7,340	678
Loans payable		-	1,772	-	-	-	1,772	-
Total current liabilities unrestricted		24,334	32,917	3,616	1,581	202	62,650	1,973
Current liabilities payable from restricted assets:								
Accounts payable and accrued liabilities		328	-	-	-	-	328	-
Interest payable		21,196	80	-	-	-	21,276	-
Unearned revenue		1,459	-	-	-	-	1,459	-
Due to other funds		-	-	-	-	0	-	-
Current portion of bonds payable, net		32,500	5,090	-	-	-	37,590	-
Total current liabilities payable from restricted assets		55,483	5,170	-	-	-	60,653	-
Total current liabilities		79,817	38,087	3,616	1,581	202	123,303	1,973
Noncurrent liabilities:								
Accrued vacation, sick leave and compensatory time		590	611	-	-	-	1,201	3,243
Estimated liability for self-insurance		2,388	2,676	753	-	-	5,817	-
Advance contributions from participating agencies		-	1,639	-	-	-	1,639	-
Advances, deposits, and reimbursable credits		-	-	1,653	-	-	1,653	-
Loans payable		-	-	-	-	10,000	10,000	-
Notes payable		-	18,490	-	-	-	18,490	-
Bonds payable (net of premium/discount)		1,229,409	10,756	-	-	-	1,240,165	-
Net pension liability		108,167	221,898	19,000	7,476	-	356,541	-
Net other postemployment benefits liability		28,086	76,245	7,453	1,900	-	113,684	-
Total noncurrent liabilities		1,368,640	332,315	28,859	9,376	10,000	1,749,190	3,243
Total liabilities		1,448,457	370,402	32,475	10,957	10,202	1,872,493	5,216
DEFERRED INFLOWS OF RESOURCES								
Deferred inflows of resources related to pensions		128	338	36	11	-	513	-
Deferred inflows of resources related to other postemployment benefits		31	84	8	2	-	125	-
Total deferred inflows of resources		159	422	44	13	-	638	-
NET POSITION								
Net investment in capital assets		100,587	700,254	73,558	56,232	-	930,631	5,776
Restricted for debt service		17,015	2,140	-	2,120	-	21,275	-
Restricted for capital projects and other agreements		44,999	6,476	-	-	-	51,475	-
Unrestricted		41,921	157,223	9,902	44,998	(1,116)	252,928	14,880
Total net position	$	204,522	866,093	83,460	103,350	(1,116)	1,256,309	20,656

City of San José
Statement of Revenues, Expenses, and Changes in Fund Net Position
Proprietary Funds
For the Year Ended June 30, 2018
($000's)

	Enterprise Funds						
	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	San José Clean Energy	Total	Internal Service Funds
OPERATING REVENUES							
Charges for services	$ 70,820	172,690	48,615	17,645	-	309,770	131,143
Rentals and concessions	22,375	11,335	-	-	-	33,710	-
Service connection, engineering and inspection	65,290	4,572	-	-	-	69,862	-
Operating contributions from participating agencies	-	63,276	-	-	-	63,276	-
Other	10,096	849	-	-	-	10,945	-
Total operating revenues	168,581	252,722	48,615	17,645	-	487,563	131,143
OPERATING EXPENSES							
Operations and maintenance	73,816	135,230	44,029	4,289	360	257,724	131,829
General and administrative	25,118	37,572	2,304	8,037	723	73,754	-
Depreciation	47,486	29,226	2,823	1,679	-	81,214	2,631
Materials and supplies	-	537	-	498	33	1,068	-
Total operating expenses	146,420	202,565	49,156	14,503	1,116	413,760	134,460
Operating income (loss)	22,161	50,157	(541)	3,142	(1,116)	73,803	(3,317)
NONOPERATING REVENUES (EXPENSES)							
Passenger facility charges	27,048	-	-	-	-	27,048	-
Customer facility charges	18,364	-	-	-	-	18,364	-
Operating grants	809	-	-	-	-	809	-
Investment income	2,842	3,105	186	189	-	6,322	128
Interest expense	(61,305)	(656)	-	-	-	(61,961)	-
Bond issuance costs	50	-	-	-	-	50	-
Contributions for maintenance reserves	-	85	-	-	-	85	-
Loss on disposal of capital assets	-	(51)	-	-	-	(51)	(101)
Gain on loan reinstatement from SARA	-	-	-	3,590	-	3,590	-
Other revenues, net	994	140	105	132	-	1,371	-
Net nonoperating revenues (expenses)	(11,198)	2,623	291	3,911	-	(4,373)	27
Income (loss) before capital contributions and transfers	10,963	52,780	(250)	7,053	(1,116)	69,430	(3,290)
Capital contributions	9,287	5,009	2,066	-		16,362	-
Transfers in	220	-	-	31	-	251	2,850
Transfers out	-	(2,468)	(1,040)	(2,512)	-	(6,020)	(201)
Changes in net position	20,470	55,321	776	4,572	(1,116)	80,023	(641)
Net position - beginning, as previously reported	196,589	857,377	87,827	99,726	-	1,241,519	21,297
Change in accounting principles	(12,537)	(46,605)	(5,143)	(948)	-	(65,233)	-
Net position - beginning, as restated	184,052	810,772	82,684	98,778	-	1,176,286	21,297
Net position - ending	$ 204,522	866,093	83,460	103,350	(1,116)	1,256,309	20,656

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

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CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

City of San José
Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2018
($000's)

	Enterprise Funds						
	Norman Y. Mineta San José International Airport	**Wastewater Treatment System**	**Municipal Water System**	**Parking System**	**San José Clean Energy**	**Total**	**Internal Service Funds**
CASH FLOWS FROM OPERATING ACTIVITIES							
Receipts from customers and users	$ 168,106	215,764	47,377	17,752	-	448,999	-
Cash received from interfund services provided	-	-	-	-	-	-	131,039
Payments to suppliers	(60,296)	(65,860)	(35,464)	(8,555)	(334)	(170,509)	(108,990)
Payments for employees	(29,723)	(86,676)	(8,662)	(3,014)	(580)	(128,655)	(24,622)
Other receipts	1,733	37,883	-	-	-	39,616	-
Net cash provided by (used in) operating activities	79,820	101,111	3,251	6,183	(914)	189,451	(2,573)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES							
Transfer from other funds	-	-	-	31	-	31	2,850
Transfer to other funds	-	(2,468)	(1,040)	(2,512)	-	(6,020)	(201)
Operating grants	809	-	-	-	-	809	-
Payments from other funds	-	-	166	-	-	166	-
Decrease in long-term receivable from SARA	-	-	-	6,324	-	6,324	-
Net cash provided by (used in) noncapital and related financing activities	809	(2,468)	(874)	3,843	-	1,310	2,649
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES							
Passenger facility charges received	27,915	-	-	-	-	27,915	-
Customer facility charges received	18,211	-	-	-	-	18,211	-
Capital grants received	10,535	351	-	-	-	10,886	-
Acquisition and construction of capital assets	(26,610)	(108,742)	(1,681)	(5,380)	-	(142,413)	(892)
Proceeds from commercial paper	-	-	-	-	10,000	10,000	-
Proceeds from line of credit	-	18,490	-	-	-	18,490	-
Principal payment on commercial paper	(17,952)	-	-	-	-	(17,952)	-
Principal paid on debt	(41,900)	(9,498)	-	-	-	(51,398)	-
Bond issuance cost paid	(150)	-	-	-		(150)	-
Interest paid on debt	(62,113)	(781)	-	-	-	(62,894)	-
Advances and deposits returned	(22)	-	-	-	-	(22)	-
Net cash provided by (used in) capital and related financing activities	(92,086)	(100,180)	(1,681)	(5,380)	10,000	(189,327)	(892)
CASH FLOWS FROM INVESTING ACTIVITIES							
Proceeds from sales and maturities of investments	39,291	-	-	-	-	39,291	-
Purchase of investments	(39,291)	-	-	-	-	(39,291)	-
Interest received	2,972	2,653	148	189	-	5,962	127
Land and building rentals	-	160	-	-	-	160	-
Net cash provided by investing activities	2,972	2,813	148	189	-	6,122	127
Net change in cash and cash equivalents	(8,485)	1,276	844	4,835	9,086	7,556	(689)
Cash and cash equivalents - beginning	276,006	434,610	23,908	32,332	-	766,856	19,300
Cash and cash equivalents - ending	$ 267,521	435,886	24,752	37,167	9,086	774,412	18,611

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

City of San José
Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2018
($000's)

	Enterprise Funds						
	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	San José Clean Energy	Total	Internal Service Funds
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities							
Operating income (loss)	$ 22,161	50,157	(541)	3,142	(1,116)	73,803	(3,317)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:							
Depreciation	47,486	29,226	2,823	1,679	-	81,214	2,631
Other nonoperating revenues	1,733	-	105	132	-	1,970	-
Decrease (increase) in:							
Accounts receivable	(5,478)	925	(1,344)	(25)	-	(5,922)	(103)
Inventories	-	-	-	-	-	-	(162)
Prepaid expenses, advances and deposits	(2)	-	-	-	-	(2)	-
Increase (decrease) in:							
Accounts payable and accrued liabilities	(1,143)	(2,034)	(193)	600	130	(2,640)	(1,247)
Accrued salaries, wages, and payroll	-	131	15	52	56	254	-
Accrued vacation, sick leave and compensatory time	-	(315)	16	31	16	(252)	(227)
Estimated liability for self-insurance	169	(215)	116	-	-	70	-
Unearned revenue	5,754	-	-	-	-	5,754	(148)
Net pension liability, deferred outflows and inflows of pension related resources	9,193	23,819	2,310	606	-	35,928	-
Net other postemployment benefit liability, deferred outflows and inflows of postemployment benefits resources	(200)	(583)	(56)	(35)	-	(874)	-
Advances and deposits payable	147	-	-	1	-	148	-
Net cash provided by (used in) operating activities	$ 79,820	101,111	3,251	6,183	(914)	189,451	(2,573)
Reconciliation of cash and cash equivalents to the statement of net position:							
Equity in pooled cash and investments held in City Treasury							
Unrestricted	$ 149,223	425,612	24,752	35,047	-	634,634	18,130
Restricted	59,817	8,070	-	2,120	-	70,007	-
Cash and investments held with fiscal agent	58,481	-	-	-	9,086	67,567	-
Other cash and investments	-	2,204	-	-	-	2,204	481
Cash and cash equivalents	$ 267,521	435,886	24,752	37,167	9,086	774,412	18,611
Noncash noncapital, capital and related financing, and investing activities:							
Disposal of capital assets	$ -	51	-	-	-	51	-
Capital contributions from developers	-	4,658	2,066	-	-	6,724	-
Amortization of bond discount/premium, and prepaid bond insurance costs	(6,004)	125	-	-	-	(5,879)	-
Amortization of deferred outflows/inflows of resources related to bond refundings	963	-	-	-	-	963	-
Change in capital related payables	6,120	-	-	-	-	6,120	-
Change in capital related receivables	1,249	-	-	-	-	1,249	-
Change in fair value of investments	(518)	-	-	-	-	(518)	-

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

City of San José
Statement of Fiduciary Net Position
Fiduciary Funds
June 30, 2018
($000's)

	Pension Trust Funds	Private Purpose Trust Funds	Agency Fund
ASSETS			
Current assets:			
Equity in pooled cash and investments held in City Treasury	$ -	172	3,845
Cash and investments	-	14,870	-
Investments of retirement plans:			
Investments:			
Fixed income	1,716,019	-	-
Collective short-term investments	239,038	-	-
Absolute return	471,373	-	-
Global equity	2,125,530	-	-
Private equity	363,487	-	-
International currency contracts, net	(2,716)	-	-
Global tactical asset	12,179	-	-
Private debt	288,043	-	-
Real assets	766,283	-	-
Total investments of retirement systems	5,979,236	-	-
Receivables:			
Accrued investment income	18,117	-	21
Employee contributions	2,718	-	-
Employer contributions	6,196	-	-
Other	17,791	1,941	-
Restricted cash and investments held with fiscal agent	-	138,278	-
Total current assets	6,024,058	155,261	3,866
Noncurrent assets:			
Advances to the City of San José	-	739	-
Accrued interest	-	984	-
Loans receivable, net	-	4,215	-
Advances and deposits	-	106	-
Property held for resale	-	33,457	-
Capital assets:			
Nondepreciable	-	47,677	-
Depreciable, net	3,509	57,478	-
Total noncurrent assets	3,509	144,656	-
Total assets	6,027,567	299,917	3,866
DEFERRED OUTFLOWS OF RESOURCES			
Loss on refundings of debt	$ -	44,466	

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

City of San José
Statement of Fiduciary Net Position
Fiduciary Funds
June 30, 2018
($000's)

	Pension Trust Funds	Private Purpose Trust Funds	Agency Fund
LIABILITIES			
Current liabilities:			
Accounts payable	$ -	3,129	-
Due to brokers	17,898	-	-
Accrued interest payable	-	23,183	-
Unearned revenue	-	145	-
Other liabilities	4,368	7	3,866
Total current liabilities	22,266	26,464	3,866
Long-term liabilities:			
Due within one year	-	117,476	-
Due in more than one year	-	1,674,637	-
Total noncurrent liabilities	-	1,792,113	-
Total liabilities	22,266	1,818,577	3,866
NET POSITION			
Held in trust for:			
Employees' pension benefits	5,565,524	-	
Employees' postemployment healthcare benefits	439,777	-	
Redevelopment dissolution and other purposes	-	(1,474,194)	
Total net position (deficit)	$ 6,005,301	(1,474,194)	

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

City of San José
Statement of Changes in Fiduciary Net Position
Fiduciary Funds
For the Year Ended June 30, 2018
($000's)

ADDITIONS		**Pension Trust Funds**	**Private Purpose Trust Funds**
Redevelopment property tax revenues	$	-	200,357
Investment income:			
Interest		42,615	1,476
Dividends		33,966	-
Net rental income		56	305
Net change in fair value of plan investments		324,125	-
Investment expenses		(30,387)	-
Total investment income		370,375	1,781
Contributions:			
Employer		372,261	-
Employees		76,014	-
Total contributions		448,275	-
Charges for current services		-	298
Development fees		-	152
Gain on sale of revenue participation		-	22,697
Gain on sales of property and other assets		-	1,914
Grant revenue		-	4,208
Other		-	3,194
Total additions		818,650	234,601
DEDUCTIONS			
General and administrative		10,616	2,356
Project expenses		-	689
Pass through amounts to the County of Santa Clara		-	41,916
Depreciation		-	2,077
Allowance for loan losses		-	57
Interest on debt		-	54,040
Health insurance premiums		57,410	-
Refunds of contributions		1,453	-
Retirement and other benefits:			
Death benefits		25,072	-
Retirement benefits		373,505	-
Veba transfer		21,394	-
Total deductions		489,450	101,135
Change in net position		329,200	133,466
Net position restricted for pension, postemployment healthcare benefits and other purposes:			
Beginning of year		5,676,101	(1,607,660)
End of year	$	6,005,301	(1,474,194)

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

INDEX TO THE NOTES

I. Summary of Significant Accounting Policies

A. Reporting Entity

The City of San José, California (the "City"), was chartered on March 25, 1850, and has operated under a Council–Manager form of government since 1916. The City has defined its reporting entity in accordance with generally accepted accounting principles ("GAAP") in the United States of America, which provide guidance for determining which governmental activities, organizations, and functions should be included in the reporting entity. In evaluating how to define the City for financial reporting purposes, management has considered all potential component units. The primary criteria for including a potential component unit within the reporting entity are the governing body's financial accountability or whether the nature and significance of the relationship with the primary government is misleading to exclude.

A primary government is considered to be financially accountable, if it appoints a voting majority of an organization's governing body and it is able to impose its will on the organization, or if there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the primary government. A primary government may also be financially accountable if an organization is fiscally dependent on the primary government regardless of whether the organization has a separately elected governing board, a governing board appointed by a higher level of government, or a jointly appointed board, and there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the primary government. Based upon the application of these criteria, the following is a brief description of each component unit included within the City's reporting entity. All such component units have been "blended" (or in the case of the Successor Agency to the Redevelopment Agency of the City of San José reported as a fiduciary fund) as though they are part of the primary government because the component unit's governing body is substantially the same as the City's primary government and there is a financial benefit or burden relationship between the City and the component unit, management of the City has operational responsibilities for the component unit, and/or the component units provide services entirely, or almost entirely, to the City or otherwise exclusively, or almost exclusively, benefits the City, even though it does not provide services directly to it, or the City is entirely or almost entirely responsible for the repayment of the debt of the component unit.

- **Successor Agency to the Redevelopment Agency of the City of San José** – The Successor Agency to the Redevelopment Agency of the City of San José (the "SARA") was created by State statute, referred to in these notes as the Redevelopment Dissolution Law, to serve as a custodian for the assets and to wind down the affairs of the SARA. The SARA is subject to the direction and oversight of a board consisting of the Mayor and the other members of the City Council (the"SARA Board").. The SARA is also, pursuant to the Redevelopment Dissolution Law, subject to the direction and oversight of an Oversight Board. Through June 30, 2018, the Oversight Board is comprised of seven member representatives from local government bodies: two appointed by the Mayor; two appointed by the County of Santa Clara (the "County"); one appointed by the County Superintendent of Education; one appointed by the Chancellor of California Community Colleges; and one appointed by the largest special district taxing entity in the Merged Project Area (currently the Santa Clara Valley Water District).

  Beginning July 1, 2018, pursuant to Health and Safety Code section 34179(j), the individual oversight boards within Santa Clara County no longer existed and were combined into one county-wide Oversight Board. The county-wide Oversight Board as of July 1, 2018 is comprised of seven member representatives with one member appointed by each of the following: County Board of Supervisors, the city selection committee established pursuant to Section 50270 of the Government Code, the independent special district selection committee established pursuant to Section 56332 of the Government Code, the County Superintendent of Education, the Chancellor of the California Community Colleges, a public appointment made the County Board of Supervisors, and the recognized employee organization representing the largest number of successor agency employees in the county. The county-wide Oversight Board is staffed by the County of Santa Clara Auditor-Controller and tasks have been delegated among the County Finance Agency, the Office of the County Executive, the Clerk of the Board of Supervisors, and Office of the County Counsel.

In general, the SARA's assets can only be used to pay enforceable obligations in existence at the date of dissolution, February 1, 2012 (including the completion of any unfinished projects that were subject to legally enforceable contractual commitments). The SARA is only allocated revenue in the amount that is necessary to meet the enforceable obligations of the former Redevelopment Agency of the City of San José (the "Agency") each year until all enforceable obligations of the Agency have been paid in full and all assets have been liquidated. Based upon the nature of the SARA's custodial role, the SARA is reported in a fiduciary fund (private purpose trust fund).

- **San José – Santa Clara Clean Water Financing Authority** – The San José **–** Santa Clara Clean Water Financing Authority (the "Clean Water Financing Authority") was created pursuant to a Joint Exercise of Powers Agreement between the City and the City of Santa Clara. The purpose was to finance the acquisition of, and additions and improvements to the existing San José – Santa Clara Water Pollution Control Plant (the "Plant"), currently known as the San José – Santa Clara Regional Wastewater Facility (the "RWF"). The Clean Water Financing Authority is governed by a five-member Board of Directors; three are members of the San José City Council and two are members of the City Council of the City of Santa Clara. The Clean Water Financing Authority and the cities of San José and Santa Clara entered into an Improvement Agreement and subsequent amendments to the Improvement Agreement (the "Improvement Agreement"), which requires each city to make base payments that are at least equal to each city's allocable share of debt service requirements of the Clean Water Financing Authority's outstanding revenue bonds. Under the Improvement Agreement, the City of San José is entirely responsible for the repayment of the Clean Water Financing Authority's outstanding revenue bonds. The Clean Water Financing Authority is blended in the Wastewater Treatment System Enterprise Fund for financial reporting purposes.

- **City of San José Financing Authority** – The City of San José Financing Authority (the "Financing Authority") was created by a Joint Exercise of Powers Agreement between the City and the Agency. The Financing Authority was created for the purpose of facilitating the financing of public improvements and facilities within the City and is authorized to issue bonds for this purpose. The Financing Authority is governed by an 11-member Governing Board, which consists of the members of the City Council. The Financing Authority is blended in the San José Financing Authority Debt Service Fund for financial reporting purposes.

- **San José Diridon Development Authority** – The San José Diridon Development Authority (the "Diridon Authority") was created in March 2011 by a Joint Exercise of Powers Agreement between the City and the Agency. The Diridon Authority was created for the purposes of overseeing the development of properties within the area of the City surrounding the San José Diridon Station, and is authorized to issue bonds for this purpose. The Diridon Authority is governed by an 11-member Governing Board, which consists of the members of the City Council. The Diridon Authority did not have any activity in fiscal year 2017-18.

Separate financial reports for City departments and component units for the fiscal year 2017-18, containing additional information and more detailed information regarding financial position, changes in financial position, and, where applicable, cash flows, are available from the City's Director of Finance, 200 East Santa Clara Street; 13th Floor, San José, CA 95113-1905, for the following:

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

B. Financial Statement Presentation

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

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

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

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

The City reports the following major governmental funds:

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

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

The ***Low and Moderate Income Housing Asset Fund*** is a special revenue fund that was created to administer the housing assets and functions related to the Low and Moderate Income Housing Program retained by the City following the dissolution of the Agency on February 1, 2012. This fund is primarily funded by loan repayment program income generated from the former Agency's housing assets.

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

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

The City reports the following major enterprise funds:

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

The ***Wastewater Treatment System Fund*** accounts for the financing, construction and operations of the Plant, the regional water reclamation program (known as South Bay Water Recycling), and the San José Sewage Collection System and the Clean Water Financing Authority.

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

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

The ***San José Clean Energy Fund*** accounts for the City's Community Choice Energy program known as San José Clean Energy ("SJCE"), which allows the City to procure electricity for the City and businesses and residents in San José with more renewable energy options.

The City also reports the following types of funds:

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

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

The ***Private Purpose Trust Funds*** account for the custodial responsibilities that are assigned to the SARA with the passage of the Redevelopment Dissolution Law and for the James Lick Fund, which holds resources in trust for the support of the EMQ Families First Agency (a.k.a. Eastfield Ming Quong).

The ***Agency Fund*** accounts for assets held by the City in a custodial capacity with respect to the San José Arena.

C. Measurement Focus and Basis of Accounting

The basis of accounting determines when transactions are reported in the financial statements. The government-wide, proprietary and fiduciary funds (excluding agency funds) financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Agency funds do not have a measurement focus but are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Non-exchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property and sales taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenues from sales and use, transient occupancy and utility user taxes are recognized when the underlying transactions take place. Revenues from grants, entitlements and donations are recognized in the fiscal year in which all eligibility requirements have been satisfied.

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

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

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

Under the terms of grant agreements, the City funds certain programs by a combination of specific cost-reimbursement grants, categorical block grants and general revenues. Thus, when program expenses are incurred, there are both restricted and unrestricted net position available to finance the program. It is the City’s policy to first apply restricted cost-reimbursement grant resources to such programs, followed by restricted categorical block grants, and then by unrestricted general revenues.

D. Use of Estimates

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

E. New Pronouncements

During the year ended June 30, 2018, the City implemented the following Governmental Accounting Standards Board (the "GASB") Statements:

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (other postemployment benefits or OPEB)*. This statement replaces the requirements of Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Pla*ns. The scope of this statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. The GASB Statement No. 75 requires the liability for OPEB obligations, known as the net OPEB liability (NOL), to be recognized on the Statement of Net Position. In addition, an OPEB expense is to be recognized in the Statement of Activities and the statement of changes in net position of proprietary and fiduciary funds. The OPEB expense in GASB Statement No. 75 is no longer equal to the annual required contribution and has shorter amortization periods. There is a recognition of OPEB expense that incorporates deferred outflows of resources and deferred inflows of resources related to OPEB over a defined, closed period, rather than a choice between an open or closed period. For defined benefit OPEB, this statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. This statement requires that the notes to financial statements of a single employer that sponsors an OPEB plan include descriptive information, such as the types of benefits provided and the number and classes of employees covered by the benefit terms. This statement also requires that a single employer that sponsors an OPEB plan to present in Required Supplementary Information the sources of changes in the net OPEB liability and the components of the net OPEB liability and related ratios.

As of July 1, 2017, the City restated the beginning net position to record the beginning deferred OPEB contributions and net OPEB liability as follows (dollars in thousands):

	Governmental Activities	Business-Type Activities	Total
Net position - beginning, as previously reported	$ 3,437,781	$ 1,241,519	$ 4,679,300
Change in accounting principles	(467,608)	(65,233)	(532,841)
Net Position - beginning, as restated	**$ 2,970,173**	**$ 1,176,286**	**$ 4,146,459**

In March 2016, the GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements.* This statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. An irrevocable split-interest agreement is one type of split-interest agreement used by donors to provide resources to two or more beneficiaries, including governments. Under an irrevocable split-interest agreement, the donor does not reserve, or confer to another person, the right to terminate the agreement at will and have the donated resources returned to the donor or a third party. This statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This statement requires that a government recognize revenue when the resources become applicable to the reporting period. The application of Statement No. 81 did not have any effect on City's financial statements.

In March 2017, the GASB issued Statement No. 85, *Omnibus 2017*. This statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). The application of Statement No. 85 did not have any effect on the City's financial statements.

In May 2017, the GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*. This statement provides guidance for transactions in which cash and other monetary assets acquired with only existing resources, resources other than the proceeds of refunding debt, are placed in an irrevocable trust for the sole purpose of extinguishing debt. This statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. The application of Statement No. 86 did not have any effect on the City's financial statements**.**

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

In November 2016, the GASB issued Statement No. 83, *Certain Asset Retirement Obligations.* This statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). This statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs, requires the measurement of an ARO to be based on the best estimate of the current value of outlays expected to be incurred, and requires the current value of a government's AROs to be adjusted for the effects of general inflation or deflation at least annually. Application of Statement No. 83 is effective for the City's fiscal year ending June 30, 2019.

In January 2017, the GASB issued Statement No. 84, *Fiduciary Activities*. This statement establishes criteria for identifying fiduciary activities of all state and local governments and describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private purpose trust funds, and (4) custodial funds. The statement also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. Application of Statement No. 84 is effective for the City's fiscal year ending June 30, 2020.

In June 2017, the GASB issued Statement No. 87, *Leases*. This statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provision of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. Application of Statement No. 87 is effective for the City's fiscal year ending June 30, 2021.

In April 2018, the GASB issued Statement No. 88, *Certain Disclosures Related to Debt, Including Borrowings and Direct Placements*. This statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit, assets pledged as collateral for the debt, terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequencs, and significant subjective acceleration clauses. Application of Statement No. 88 is effective for the City's fiscal year ending June 30, 2019.

In June 2018, the GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period.* This statement requires that interest costs incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund. The City has updated the Capitalized Interest policy to no longer capitalize interest for the Wastewater Treatment System Fund which had an immaterial impact to the financial statements. Application of Statement No. 89 is effective for the City's fiscal year ending June 30, 2021, and will be applied to all remaining funds in subsequent years.

In August 2018, the GASB issued Statement No. 90, *Majority Equity Interests – an Amendment of GASB Statements No. 14 and No. 61*, to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. This statement requires that a component unit in which a government has a 100 percent equity interest account for its assets, deferred outflows of resources, liabilities, and deferred inflows of resources at acquisition value at the date the government acquired a 100 percent equity interest in the component unit. Application of Statement No. 90 is effective for the City's fiscal year ending June 30, 2020.

F. Assets, Deferred Outflows of Resources, Liabilities, Deferred Inflows of Resources, and Net Position or Equity

1. Cash and Cash Equivalents

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

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

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

3. Deposits and Investments

Investments are accounted for in accordance with the provisions of GASB Statement No. 72, *Fair Value Measurement and Application,* the City categorizes its fair value measurements within the fair value hierarchy established by GAAP in the United States of America. The following levels indicate the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:

- Level 1 - Investments whose values are based on quoted prices (unadjusted) for identical assets in active markets that a government can access at the measurement date.
- Level 2 - Investments whose values are based on inputs – other than quoted prices included within Level 1 – that are observable for an asset, either directly or indirectly.
- Level 3 - Investments whose values are based on unobservable inputs for an asset and may require a degree of professional judgment.

Pooled Cash and Investments held in City Treasury. The City reports its investments held in the City Treasury at fair value. The fair value is based primarily on quoted market information and using pricing applications and models obtained from fiscal agents or other sources. Income from some investments is assigned to the General Fund. The assignment of the income from these investments is supported by legal or contractual provisions approved by the City Council. For the year ended June 30, 2018, the total investment income from these investments assigned and transferred to the General Fund was approximately $1,327,000.

Retirement Systems. The Retirement Systems' investment policies authorize various types of investments. These investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price on the last business day of the fiscal year at current exchange rates, if applicable. Investments that do not have an established market, such as private equity, commingled real estate funds and certain pooled fund investments, are reported at estimated fair value based on the most recently available investor reports or audited financial statements issued by the manager of those funds. The fund manager provides an estimated unrealized gain/loss of the fund based on the most recently available audited financial statements and other fund information. Purchases and sales of securities are reflected on the date of trade. Investment income is recognized as earned. Rental income from real estate activity is recognized as earned, net of expenses.

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

4. Inventories

Inventories of proprietary funds are reported at cost.

5. Loans Receivable, net

Long-term loans receivable, which consist of the principal amount of the loan plus accrued borrower's deferred interest is reported in the governmental fund statements with an offset to restricted fund balance as resources are not available for expenditure. Long-term loans receivable reported in the governmental activities on the government-wide statement of net position is not offset by unavailable revenue as it is recorded on an accrual basis at its net realizable value based on an estimate of uncollectible amounts for loan losses.

6. Special Assessment Districts

Special assessments are recorded as receivables when liens are placed on properties. Special assessments not considered available are recorded as receivables and offset by deferred inflows of resources in the governmental fund financial statements. In general, special assessment and special tax bonds are fully secured by liens against the privately owned properties benefited by the improvements for which the bonds were issued. There is no reserve for delinquent receivables since priority liens exist against the related properties and management believes full value will ultimately be received by the City. Surplus funds remaining at the completion of a special assessment district project are disposed of in accordance with the City Council's resolutions and with the applicable laws of the State of California. A liability is recorded for the balance remaining until a final legal determination has been made.

7. Advances and Deposits

Amounts deposited mainly in connection with eminent domain proceedings are reported as advances and deposits. In the governmental fund statements, non-current portions of these are offset equally by either a credit or a classification of fund balance in the nonspendable, restricted or committed account. In the Business-type activities, the amount is related to the deposit with the insurance company to fund the potential claims under the Airport's Owner Controller Insurance Program (OCIP).

8. Other Assets

Other assets primarily consist of real properties acquired outright and/or through foreclosure in connection with the housing rehabilitation program and an asset associated with the City's New Market Tax Credit Financing ("NMTCF") program. These assets are recorded at the lower of cost or estimated net realizable value.

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

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

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

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

10. Restricted Assets

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

11. Capital Assets

Capital assets include land, buildings, improvements, vehicles and equipment, infrastructure, and all other tangible and intangible assets that are used in operations and that have initial useful lives in excess of one year. Capital assets are reported in the applicable governmental or business-type activity columns in the government-wide statement of net position, the proprietary funds' statements of net position, and the private purpose trust fund's statement of fiduciary net position.

Capital assets are defined as assets with an initial individual cost of more than $5,000 for general capital assets and $100,000 for major infrastructure assets, and an estimated useful life in excess of one year. Such assets are recorded at historical cost if purchased or constructed. Donated capital assets are recorded at acquisition value at the time received. Capital outlay is recorded as expenditures of the governmental funds and as assets in the government-wide financial statements to the extent the City's capitalization threshold is met. For Norman Y. Mineta San José International Airport Fund, interest incurred during the construction phase of capital assets is reflected in the capitalized value fo the asset constructed, net of interest earned on the investment proceeds of taxable and tax-exempt debt over the same period. For the Wastewater Treatment System Fund, interest cost incurred before the end of a construction period is recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement. Amortization of assets acquired under capital leases is based on the shorter of the lease term, when the lease does not transfer ownership or include a bargained purchase option or the estimated useful life of the asset and is included in depreciation.

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

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

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

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

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

Vacation hours may be accumulated up to two times an employee's annual accrual rate, which will vary by years of service and bargaining unit, but it generally does not exceed a maximum of 400 hours for non-sworn employees and 360 hours for employees represented by the San José Police Officer's Association ("SJPOA"). Employees represented by the International Association of Firefighters, Local 230 ("IAFF"), may accumulate vacation hours up to 400 hours for employees on a 40-hour workweek and 576 hours for employees on a 56-hour workweek.

Employees in FCERS who retire with at least 15 years of service, or 20 years for police officers and firefighters in PFDRP, may be eligible to receive, upon retirement, sick leave payouts based on percentages of accumulated unused sick leave hours as determined by the respective collective bargaining agreements for represented employees. Similar terms are applicable to eligible unrepresented employees. Eligibility for sick leave payouts depends on the employee's hire date.

The tables below summarize the eligibility terms for sick leave payout and the terms governing the amount of the payout.

Bargaining Unit		Hire Date (on or after)	Eligible for Sick Leave Payout?
Association of Building, Mechanical, and Electrical Inspectors	ABMEI	September 30, 2012	No
Association of Engineers and Architects, IFPTE Local 21	AEA	September 30, 2012	No
Association of Legal Professionals	ALP	September 30, 2012	No
Association of Maintenance Supervisory Personnel, IFPTE Local 21	AMSP	September 30, 2012	No
City Association of Management Personnel, IFPTE Local 21	CAMP	September 30, 2012	No
Confidential Employees' Organization, AFSCME Local 101	CEO	September 30, 2012	No
International Brotherhood of Electrical Workers, Local No. 332	IBEW	September 30, 2012	No
International Union of Operating Engineers, Local No. 3	OE#3	September 30, 2012	No
Municipal Employees' Federation, AFSCME Local 101	MEF	September 30, 2012	No
San José Police Officers' Association	SJPOA	July 7, 2013	No
San José Fire Fighters, IAFF Local 230	IAFF	September 14, 2014	No
Unrepresented Employees	Unit 99 Unit 81/82	September 30, 2012	No

Bargaining Unit		Hire Date (on or before)	Sick Leave Balance[1] Frozen as of:	Rate of Pay[2] Frozen as of:
Association of Building, Mechanical, and Electrical Inspectors	ABMEI	September 29, 2012	June 22, 2013	June 22, 2013
Association of Engineers and Architects, IFPTE Local 21	AEA	September 29, 2012	June 22, 2013	June 22, 2013
Association of Legal Professionals	ALP	September 29, 2012	June 22, 2013	June 22, 2013
Association of Maintenance Supervisory Personnel, IFPTE Local 21	AMSP	September 29, 2012	June 22, 2013	June 22, 2013
City Association of Management Personnel, IFPTE Local 21	CAMP	September 29, 2012	June 22, 2013	June 22, 2013
Confidential Employees' Organization, AFSCME Local 101	CEO	September 29, 2012	June 22, 2013	June 22, 2013
International Brotherhood of Electrical Workers, Local No. 332	IBEW	September 29, 2012	June 22, 2013	June 22, 2013
International Union of Operating Engineers, Local No. 3	OE#3	September 29, 2012	June 22, 2013	June 22, 2013
Municipal Employees' Federation, AFSCME Local 101	MEF	September 29, 2012	June 22, 2013	June 22, 2013
San José Police Officers' Association	SJPOA	July 6, 2013	July 6, 2013	July 6, 2013
San José Fire Fighters, IAFF Local 230	IAFF	September 13, 2014	June 20, 2015	June 21, 2014
Unrepresented Employees	Unit 99 Unit 81/82	September 29, 2012	June 22, 2013	June 22, 2013

[1] *For purposes of Sick Leave Payout. Employees will continue to accrue sick leave hours after the "Sick Leave Balance Frozen as of" date, but such accrued sick leave may not be used for sick leave payout purposes. If an employee reduces their sick leave balance below what it was as of the "Sick Leave Balance Frozen as of" date, such employee will not be able to restore their sick leave balance for sick leave payout purposes.*

[2] *For purposes of Sick Leave Payout. Employees may receive pay increases subsequent to the "Rate of Pay Frozen as of" date, but the employee's sick leave payout will be based on their rate of pay as of the "Rate of Pay Frozen as of" date.*

Compensatory time is generally provided to employees who work overtime and earn compensatory time off at the rate of one and one half the number of overtime hours worked in lieu of pay. The Fair Labor Standards Act ("FLSA") provides that general employees may accrue up to 240 hours of compensatory time, and employees responsible for law enforcement or fire suppression such as those represented by SJPOA, IAFF, and in the Public Safety Communication Dispatcher classifications may accrue up to 480 hours of compensatory time.

13. Interfund Transactions

Interfund transactions are reflected as loans, services provided, reimbursements and/or transfers. Loans and balances related to unsettled service transactions are reported as receivables and payables as appropriate, are subject to elimination upon consolidation of similar fund types. The current portion of interfund loans and unsettled service transactions are reported as "due to/from other funds" and the non-current portion is reported as "advances to/from other funds". Any residual balances outstanding between the governmental activities and the business-type activities are reported in the government-wide financial statements as "internal balances".

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

14. Self-Insurance

The City is self-insured for workers' compensation, general liability, auto liability, and certain other risks, except as described in Note III.F.12. The City's workers' compensation activities are funded and accounted for separately in the fund financial statements based upon the activities of each fund. The current portion of claims liability is accounted for in the General Fund and the enterprise funds on the basis of settlements reached or judgments entered within the current fiscal year. In the government-wide financial statements and the enterprise fund financial statements, the estimated liability for all self-insurance liability claims is recorded as a liability.

15. Deferred Outflows/Inflows of Resources

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

16. Pensions

For purposes of measuring the net pension liability and deferred outflows/inflows of resources related to pensions and pension expense, the fiduciary net position of the City's defined benefit retirement plans (PFDRP, FCERS, and the California Public Employees' Retirement System ("CalPERS")), and additions to/deductions from the Retirement Systems' and CalPERS' fiduciary net positions have been determined on the same basis as they are reported by the plans. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

17. Other Postemployment Benefits (OPEB)

For purpose of measuring the net OPEB liability, deferred outflows/inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the PFDRP and FCERS OPEB plans and additions to/deductions from the OPEB Plan's fiduciary net position have been determined on the same basis as they are reported by the plans. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms. Investments are reported at fair value.

18. Net Position

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

- *Net Investment In Capital Assets* **–** This category groups all capital assets, including infrastructure, into one component of net position. Accumulated depreciation and the outstanding balances of debt and deferred outflows/inflows of resources associated with the debt that are attributable to the acquisition, construction, or improvement of these assets reduce the balance in this category.

- *Restricted Net Position* – This category represents net position that has external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation. At June 30, 2018, the government-wide statement of net position reported restricted net position of $1,000,459,000 in governmental activities and $72,750,000 in business-type activities. Of these amounts $326,287,000 and $24,365,000, respectively are restricted by enabling legislation.

- *Unrestricted Net Position* – This category represents net amounts that do not meet the criteria for "restricted" or "net investment in capital assets". When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, and then use unrestricted resources as needed.

19. Fund Balances

Under GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, the financial statements reporting for governmental funds classify fund balances based primarily on the extent to which the City is bound to honor constraints on the specific purposes for which those funds can be spent. Fund balance for the City's governmental funds consists of the following categories:

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

- *Restricted Fund Balance* – includes amounts reported as restricted when constraints placed on the use of resources are either (1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or (2) imposed by law through constitutional provisions or enabling legislation.

- *Committed Fund Balance* – includes amounts that have been limited to specific purposes as defined in the City Charter or through adoption of an ordinance by the City Council, the highest level of decision making authority of the City. These commitments may be changed or lifted, but only by the same formal action that was used to impose the constraint originally. City Council action to commit fund balance must occur within the fiscal reporting period while the amount committed may be subsequently determined.

- *Assigned Fund Balance* – includes amounts that are intended to be used by the City for specific purposes that are neither restricted nor committed through City Council budgetary action, which include the approval of appropriations and revenue sources pertaining to the next fiscal year's budget. On June 21, 2011, the City Council adopted a resolution establishing the City's *Governmental Fund Balance Financial Reporting Policy*, which states that assigned fund balances are intended to be used for specific purposes through City Council budgetary actions. Intent is expressed by (a) the City Council or (b) the City Manager to which the City Council has delegated the authority to assign amounts to be used for specific purposes.

- *Unassigned Fund Balance* – includes amounts within the General Fund, the residual resources, either positive or negative, in excess of what can be properly classified in one of the other four fund balance categories. Unassigned amounts are technically available for any purpose. Other governmental funds may only report a negative unassigned balance that was created after classification in one of the other four fund balance categories.

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

20. Property Taxes

Property taxes are collected on behalf of and remitted to the City by the County of Santa Clara (the County). The amount of property tax levied is restricted by Article 13A of the California State Constitution (commonly referred to as Proposition 13). The County assesses property values, levies, bills, and collects the related property taxes as follows:

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

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

General property taxes are based either on a flat 1% rate applied to the fiscal 1976 full value of the property or on 1% of the sales price of the property on sales transactions and construction that occur after the fiscal 1976 valuation. The assessed value increases each year by an inflationary rate not to exceed the percentage change for the California Consumer Price Index (CPI), or 2%, whichever is less."

The City's net assessed valuation for the year ended June 30, 2018, was approximately $171.3 billion, an increase of approximately 6.1% from the previous year. The City's tax rate was approximately $0.175 per $100 of assessed valuation, which included the 1% basic levy and additional levies for general obligation bonds Measures "O" and "P" (2000) and Measure "O" (2002).

21. Wastewater Treatment System

The Wastewater Treatment System is an enterprise of the City and is comprised of the Plant, including South Bay Water Recycling and the San José Sewage Collection System. The Clean Water Financing Authority was established to provide financing for the capital programs of the Plant including the regional water reclamation program.

The Plant provides wastewater treatment services to the City and to six other sewage collection agencies. The City's sewer service rates pay for the City's share of the Plant operations, maintenance, and administration and capital costs.

In 1959, the City and the City of Santa Clara entered into an agreement to jointly own and operate the Plant. Under the agreement, the City serves as the administering agency and is responsible for operating and maintaining the Plant. The cities share in the capital and operating costs on a pro rata basis determined by the ratio of each city's assessed valuation to the sum of both cities' assessed valuations. Annually, these percentages are determined and applied to the capital and operating costs on an accrual basis. For the fiscal year ended June 30, 2018, the City's portion of the capital and operating costs was approximately 80.7% and the City's interest in the net position of the Plant was approximately 81.5%.

II. Stewardship, Compliance, and Accountability

A. Deficit Net Position

Prior to February 1, 2012, the California Redevelopment Law provided tax increment financing as a source of revenue to redevelopment agencies to fund redevelopment activities. Once a redevelopment area was adopted, the former Agency could only receive tax increment to the extent that it could show on an annual basis that it had incurred indebtedness that must be repaid with tax increment. Due to the nature of the redevelopment financing, the former Agency liabilities exceeded assets. Therefore, the Agency historically carried a deficit, which was expected to be reduced as future tax increment revenues were received and used to reduce its outstanding long-term debt. This deficit was transferred to the SARA on February 1, 2012. At June 30, 2018, the SARA has a deficit of $1,471,744,000, which will be reduced when future redevelopment property tax revenues are distributed from the Redevelopment Property Tax Trust Fund administered by the County’s Auditor-Controller to pay SARA’s annual enforceable obligations.

B. Deficit Unrestricted Net Position – Governmental Activities

At June 30, 2018, the City reported negative balances in unrestricted net position for its governmental activities in the amount of $2,667,125,000 after adjusting for implementation of GASB Statement No. 68 for Accounting and Financial Reporting for Pension since FY2015 and GASB Statement No. 75 for Accounting and Financial Reporting for OPEB in FY2018.

III. Detailed Notes on All Funds

A. Cash, Deposits and Investments

As of June 30, 2018, total City cash, deposits and investments, at fair value, are as follows (dollars in thousands):

			Fiduciary Funds			
	Governmental Activities	Business-Type Activities	Pension Trust	Private Purpose Trust	Agency	Carrying Value
Equity in pooled cash and investments	$ 972,976	$ 634,634	$ -	$ 172	$ 3,845	$ 1,611,627
Cash and investments	-	-	-	14,870	-	14,870
Restricted assets:						
Equity in pooled cash and investments	93,658	70,007	-	-	-	163,665
Cash and investments with fiscal agents	102,869	111,230	-	138,278	-	352,377
Other cash	20,283	2,204	-	-	-	22,487
Investments of retirement systems	-	-	5,979,236	-	-	5,979,236
Total deposits and investments	$ 1,189,786	$ 818,075	$ 5,979,236	$ 153,320	$ 3,845	$ 8,144,262
Deposits						$ 7,791
Investments						8,136,471
Total deposits and investments						$ 8,144,262

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

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

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

Investments of Retirement Systems. The Retirement Systems' funds are invested pursuant to policy guidelines established by the respective Boards. The objective of each investment policy is to maximize the expected return of the funds at an agreed upon level of risk. The Retirement Boards have established percentage guidelines for types of investments to ensure the portfolio is diversified.

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

1. Governmental and Business-Type Activities

Interest Rate Risk. Interest rate risk is the risk that changes in market rates will adversely affect the fair value of an investment. Generally, debt investments with fixed coupons for longer terms are subject to more variability in their value as a result of changing interest rates. The City manages its exposure to interest rate risk by capping the weighted average maturity of the investment portfolio at two years. Also, the City sets the maximum maturity for every investment at the time of purchase by asset class, with the longest not to exceed five years.

In practice, the City purchases a combination of shorter-term and longer-term investments and times the cash flows to meet liquidity needs for operations. The average maturity of the City's pooled cash and investments at June 30, 2018, was approximately 520 days.

Credit Quality Risk. Credit risk is the risk that an issuer of an investment will not fulfill its obligations to the holder of the investment. When investing, the City applies the Prudent Investor Standard and acts with care, prudence and diligence to safeguard the principal, maintain liquidity and seek reasonable yields. The City's investment policy has strict rating requirements. The City manages credit risk by selecting high quality securities, diversifying the portfolio and establishing monitoring procedures.

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

At June 30, 2018, the City's pooled and fiscal agent investments in LAIF was approximately $248,161,000 and the SARA's investments in LAIF was approximately $14,004,850. The weighted average maturity of LAIF was 193 days at June 30, 2018. The total amount recorded by all public agencies in LAIF at June 30, 2018 was approximately $22.5 billion. LAIF is part of the State's Pooled Money Investment Account ("PMIA"). The PMIA is not registered with the Securities and Exchange Commission ("SEC"), but is required to invest according to the California Government Code. The total amount recorded by all public agencies in PMIA at June 30, 2018 was approximately $88.8 billion and of that amount, 66.37% was invested in U.S. Treasuries and agencies, 24.33% in depository securities, 8.44% in commercial paper, and 0.83% in loans.

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

The City Council adopted an investment policy related to the City's cash and investment pool (the "Policy") on April 2, 1985, which is subject to annual review and was reviewed and amended on March 6, 2018. The Policy specifically prohibits trading securities for the sole purpose of speculating or taking an un-hedged position on the future direction of interest rates. Per the Policy, the investments conform to Sections 53600 et seq. of the California Government Code and the applicable limitations contained within the Policy.

The following table identifies the investment types that are authorized by the Policy as of June 30, 2018:

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

* *Represents where the Policy is more restrictive than the California Government Code.*

Other restrictions on investments are summarized as follows:

- Purchases of United States government agency securities are limited to issues of Federal Agriculture Mortgage Corporation (Farmer Mac), Federal Farm Credit Banks, Federal Home Loan Banks, Federal Home Loan Mortgage Corporation, and the Federal National Mortgage Association. Investment in Farmer Mac may not exceed 10% of the total portfolio.

- Purchases of Supranationals are limited to International Bank for Reconstruction and Development, International Finance Corporation and Inter-American Development Bank. Securities shall be rated “Aa3, AA or AA” or higher by Moody’s, S&P, or Fitch, respectively. No rating may be lower than any of the ratings listed in the preceding sentence at the time of purchase

- Purchases of Bankers’ Acceptances (“BAs”) are limited to issues by domestic U.S. or foreign banks. The outstanding debt of the bank or its holding company must be rated “A3, A-, or A-” or higher by Moody’s, S&P, or Fitch, respectively. No rating may be lower than any of the ratings listed in the preceding sentence at the time of purchase.

- Deposits up to $10,000,000 may be invested in, but are not limited to, banks and savings and loans with offices located in the San José area and deposits shall not exceed the net worth of that depository. Depositories must have a short-term rating of “P1, A1, or F1” or better by two of the three nationally recognized rating services: Moody’s, S&P, or Fitch, respectively. The outstanding debt of the bank or its holding company must be rated “A3, A-, or A-” or higher by

Moody's, S&P, or Fitch, respectively. Deposits shall be either insured by the Federal Deposit Insurance Corporation ("FDIC") or collateralized in the manner prescribed by State law for depositories.

- Commercial paper eligible for investment must be rated "P1, A1 or F1" or better by two of the three nationally recognized rating services; Moody's, S&P, or Fitch, respectively. Issuing corporations must be organized and operating within the United States, have total assets in excess of $500,000,000 and shall issue debt, other than commercial paper, if any, that is rated "A3, A- or A-" or higher, by Moody's, S&P, or Fitch, respectively.

- Negotiable certificates of deposit are limited to banks and savings and loans with an issuer short-term rating of "P1, A1, F1" or better by two of the three nationally recognized rating services: Moody's, S&P, or Fitch, respectively. The outstanding debt of the bank or its holding company must be rated "A3, A-, or A-" or higher by Moody's, S&P or Fitch, respectively. No rating may be lower than any of the ratings listed in the preceding sentence at the time of purchase.

- Repurchase agreements are to be executed only with primary dealers of the Federal Reserve Bank of New York and financial institutions, which have entered into the City's Master Repurchase Agreement and any subsequent amendments to the Master Repurchase Agreement. Securities accepted as collateral for the repurchase agreement are limited to U.S. Treasury or U.S. Federal Government Agencies permitted under the Policy. The market value of the securities that have been accepted as collateral shall, at the time of transfer, equal at least 102 percent of face value of the repurchase agreement. For other than overnight investments, the securities transferred shall be marked to market on a daily basis and maintained at a market value to at least 102 percent of the repurchase agreement's face value.

- Reverse repurchase agreements under the Policy are limited to the lesser of $25,000,000 or 20% of the portfolio value and to those occasions where unanticipated short-term cash requirements can be met more advantageously by initiating a reverse repurchase agreement than by selling a security into the secondary market prior to maturity.

- Corporate medium term notes eligible for investment must be rated "A3, A- or A-" or better by two of the three nationally recognized rating services; Moody's, S&P, or Fitch, respectively.

- Funds invested in LAIF, a State of California managed investment pool, may be made up to the maximum dollar amount per separate legal entity in conformity with account balance limits authorized by the California State Treasurer. The current maximum amount authorized by the State Treasurer is $65,000,000.

- Investments in money market mutual funds are limited to those funds registered with the SEC and for which either one of the credit criteria are met: (1) obtained the highest ranking or highest letter and numerical rating provided by no less than two nationally recognized rating services or (2) retained an investment advisor registered with the SEC or exempt from the SEC registration requirements with no less than five years of experience investing in securities and obligations authorized by California Government Code Section 53601 and managing money market mutual funds with assets under management in excess of $500,000,000. Investments by the funds are restricted to U.S. Treasury and U.S. Government Agency backed securities permitted under the Policy and must be maintained at no less than $1.00 per share.

- Municipal bonds under the Policy are limited to a total of no more than 20% of the portfolio value. The Policy establishes four municipal bond categories: (1) bonds issued by the City or its agencies (as defined in the Policy), (2) by the State of California, (3) by other California local agencies, and (4) by any of the other 49 states. Eligible securities must be rated "A3, A- or A-" or better by two of the three nationally recognized rating services; Moody's, S&P, or Fitch, respectively.

- Investment agreements may be used for the investment of bond proceeds in accordance with the permitted investment provisions of the specific bond indentures and in accordance with other safeguards outlined in the Policy to reduce the risk associated with a provider's inability to meet its contractual obligations.

- Mortgage backed securities and collateralized mortgage obligations must be issued by a U.S. government agency and must be AAA rated or better by a nationally recognized rating service.

- Asset backed securities must be AAA rated or better by a nationally recognized rating service. The issuer of any asset backed security must have an "A3, A- or A-" rating or better by Moody's, S&P, or Fitch, respectively, of its underlying debt.

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

The following schedule indicates the interest rate risk, credit quality risk and concentration of credit risk of the City's investments, as of June 30, 2018 (dollars in thousands). The credit ratings listed are for Moody's and S&P, respectively.

		Maturity				
Type of Investment	Credit Rating	Under 30 Days	31 - 180 Days	181 - 365 Days	1 - 5 Years	Carrying Value
Pooled investments in the City Treasury:						
Treasury Notes	AAA / N/A	$ 10,000	$ -	$ 10,808	$ 70,195	$ 91,003
Treasury Discounts	N/A	-	9,970	-	-	9,970
Federal Home Loan Banks	AAA / AA+	-	3,492	-	144,008	147,500
Federal Home Loan Banks - Callable	AAA / AA+	-	-	-	9,996	9,996
Federal National Mortgage Association	AAA / N/A	-	-	-	20,018	20,018
Federal National Mortgage Association - Callable	AAA / AA+	-	-	9,927	29,439	39,366
Federal Farm Credit Bank Bonds	AAA / AA+	7,000	5,986	-	31,811	44,797
Federal Home Loan Mortgage Corporation	AAA / AA+	-	-	-	67,533	67,533
Federal Home Loan Mortgage Corporation - Callable	AAA / AA+	-	-	-	27,458	27,458
Farmer MAC Interest Bearing	N/A	50,000	-	9,890	73,977	133,867
Supranational	AAA / AAA	54,973	23,475	39,130	103,602	221,180
Corporate Medium Term Notes	AAA / A-	-	87,881	108,293	193,776	389,950
Corporate Floaters	A-1 / A+	-	-	20,063	10,077	30,140
Negotiable Certificates of Deposit	N/A	25,000	74,956	50,002	-	149,958
Commercial Paper	N/A	47,696	59,745	-	-	107,441
Municipal Bonds	A-1 / AAA	4,600	10,072	5,120	184,080	203,872
Money Market Mutual Funds	N/A	15	-	-	-	15
California Local Agency Investment Fund	Not Rated	-	-	103,569	-	103,569
Total pooled investments in the City Treasury		199,284	275,577	356,802	965,970	1,797,633
Investments with fiscal agents:						
Treasury Bill	N/A	-	3,659	-	-	3,659
Federal Agricultural Mortgage Corporation	N/A	5,396	-	-	5,317	10,713
Federal Farm Credit Banks	Aaa / AA+	6,999	-	-	-	6,999
Federal Home Loan Banks	Aaa / AA+	-	-	6,894	19,057	25,951
Federated Treasury Obligation	N/A	1,769	-	-	-	1,769
First American Government Obligation	N/A	6,200	-	-	-	6,200
First American Treasury Obligation	N/A	2,541	-	-	-	2,541
Money Market Mutual Funds	Aaa / AAA	4,918	-	-	-	4,918
California Local Agency Investment Fund	Not Rated	-	-	144,592	-	144,592
Total investments with fiscal agents		27,823	3,659	151,486	24,374	207,342
Total Citywide investments (excluding Retirement Systems and the Trust Funds:		$ 227,107	$ 279,236	$ 508,288	$ 990,344	2,004,975
Total investments in Retirement Systems (See page 69)						5,979,236
Total investments in the SARA (See page 164)						152,260
Total investments						$ 8,136,471

Fair Value Measurement Categorization. The City categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. Money Market Mutual Funds and LAIF are valued by net asset value. The inputs and technicques used for securities are not necessarily an indication of risk associated with investing in these securities. The City's investment in Money Market Mutual Funds and LAIF are not subject to fair value hierarchy.

The City has the following recurring fair value measurements as of June 30, 2018:

		Fair Value Measurement Using		
	Carrying Value 6/30/18	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Pooled Investment in the City Treasury				
Investments by fair value level				
Treasury Notes	$ 91,003	$ -	$ 91,003	$ -
Treasury Discounts	9,970	-	9,970	-
Federal Home Loan Banks	147,500	-	147,500	-
Federal Home Loan Banks - Callable	9,996	-	9,996	-
Federal National Mortgage Association	20,018	-	20,018	-
Federal National Mortgage Association - Callable	39,366	-	39,366	-
Federal Farm Credit Bank Bonds	44,797	-	44,797	-
Federal Home Loan Mortgage Corporation	67,533	-	67,533	-
Federal Home Loan Mortgage Corporation - Callable	27,458	-	27,458	-
Farmer MAC Interest Bearing	133,867	-	133,867	-
Supranational	221,180	-	187,693	33,487
Corporate Medium Term Notes	389,950	-	389,950	-
Corporate Floaters	30,140	-	30,140	-
Negotiable Certificates of Deposit	149,958	-	149,958	-
Commercial Paper	107,441	-	107,441	-
Municipal Bonds	203,872	-	203,872	-
Total Investments by fair value level	1,694,049	-	1,660,562	33,487
Investment not subject to fair value hierarchy				
California Local Agency Investment Fund	103,569			
Money Market Mutual Funds	15			
Total Investments not suject to fair value hierarchy	103,584			
Total Pooled Investments in the City Treasury	1,797,633	-	1,660,562	33,487
Investments with fiscal agents:				
Investments by fair value level:				
Treasury Bill	3,659	3,659	-	-
Federal Agricultural Mortgage Corporation	10,713	-	10,713	-
Federal Farm Credit Banks	6,999	-	6,999	-
Federal Home Loan Banks	25,951	-	25,951	-
Federated Treasury Obligation	1,769	-	1,769	-
First American Government Obligation	6,200	-	6,200	-
First American Treasury Obligation	2,541	-	2,541	-
Total Investments by fair value level:	57,832	3,659	54,173	-
Investment not subject to fair value hierarchy				
California Local Agency Investment Fund	144,592			
Money Market Mutual Funds	4,918			
Total Investments not suject to fair value hierarchy	149,510			
Total Investments with fiscal agents	207,342	3,659	54,173	-
Total Citywide investments (excluding Retirement Systems and the SARA)	2,004,975	$ 3,659	$ 1,714,735	$ 33,487
Trust Funds:				
Total investments in Retirement Systems (See page 69)	5,979,236			
Total investments in the SARA (See page 164)	152,260			
Total investments	$ 8,136,471			

Securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Government agency securities classified in Level 2 of the fair value hierarchy are valued using Interactive Data (IDC) institutional bond pricing techniques. Corporate notes and Supranational classified in Level 2 of the fair value hierarchy are valued using evaluated pricing applications and models, which gather the information from market sources and integrate relative credit information, observed market movements, and sector news. Commercial paper classified in Level 2 of the fair value hierarchy are valued using a matrix pricing technique based upon yields and effective maturity. Muni bonds classified in Level 2 of the fair value hierarchy are valued using JJ Kenny municipal pricing technique. Negotiable certificates of deposit classified in Level 2 of the fair value hierarchy are valued using IDC CD pricing, a Multi-dimensional relational model and/or Option Adjusted Spread (OAS).

The State of California Local Agency Investment Fund is part of the State's Pooled Money Investment Account that allows cities, counties and special districts to place money into the fund. LAIF operating account allows a maximum of 15 transactions per account in a calendar month. The transaction amount shall be no less than $5,000 and in increments of a thousand dollars. LAIF allocates interest earnings once every quarter. The interest earnings can be withdrawn in exact amount at any time. LAIF bond accounts have no restrictions on the amounts allowed on deposit, but are limited to one withdrawal every 30 days.

Custodial Credit Risk. Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the City will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker - dealer) to a transaction, the City will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code requires that a financial institution secure its deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by the depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged governmental securities and/or first trust deed mortgage notes held in the collateral pool must be at least 110% and 150% of the City's deposits, respectively. The collateral is held by the pledging financial institution's trust department and is considered held in the City's name. As of June 30, 2018, the City's deposits were collateralized at 110%. All investments in the City Treasury were in the City's name. Neither deposits nor investments held by the City were subject to custodial credit risk.

Concentration of Credit Risk. Concentration of credit risk is the risk that the failure of any one issuer would place an undue financial burden on the City. The City mitigates the concentration of credit risk by diversifying the portfolio and limiting investments in any one issuer to no more than 5% of the total portfolio unless discussed otherwise in the above table. Investments issued by or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are exempt from this requirement.

As of June 30, 2018, the City's pooled investments in the City Treasury have investments in U.S. Agencies that represents 5% or more of the total pooled investments in the following:

Federal Home Loan Banks	8.76%
International Bank for Reconstruction & Development	8.48%
Federal Agriculture Mortgage Corporation	7.45%
Federal Home Loan Mortgage Corporation	5.28%

In addition, the following major funds hold investments with trustees that represent 5% or more of the funds' investments outside the City Treasury as of June 30, 2018:

Airport:	
Federal Home Loan Banks	12.52%

Foreign Currency Risk. The risk that changes in exchange rates will adversely affect the fair value of an investment. As of June 30, 2018, the City's Policy does not permit investments in the pool to hold foreign currency; as such the investments in the City's investment pool were not subject to foreign currency risk.

2. Retirement Systems

Investment Policies – The City's Municipal Code delegates authority to the Boards of Administration of PFDRP and FCERS (the "Retirement Boards") to invest monies of the respective plans as provided in the Municipal Code. Each Retirement Board has adopted detailed investment guidelines consistent with the conditions and limitations set forth in the Municipal Code. At June 30, 2018, the Retirement Systems' investment target asset allocations are as follows:

	PFDRP - Pension		
Asset Class	**Minimum Allocation**	**Target Asset Allocation**	**Maximum Allocation**
Global equity	25%	34%	50%
Global fixed income	10%	28%	30%
Real assets	12%	16%	25%
Private debt	5%	8%	15%
Private equity	3%	8%	13%
Absolute return	2%	6%	12%
Global tactical asset allocation	-	-	10%
Cash	-	-	10%

Note: The real assets category includes allocations to real estate, commodities, and other infrastructure assets. The absolute return category includes allocations to relative value and global macro hedge funds.

	PFDRP - Postemployment Healthcare		
Asset Class	**Minimum Allocation**	**Target Asset Allocation**	**Maximum Allocation**
Global equity	25%	43%	50%
Real assets	12%	22%	25%
Global tactical asset allocation	-	20%	25%
Global fixed income	5%	15%	25%
Cash	-	-	5%

Note: The real assets category includes allocations to commodities, real estate, and other infrastructure assets. The global tactical asset category is currently comprised of two global tactical asset allocation managers who run unconstrained global portfolios.

Asset Class	FCERS - Pension Minimum Allocation	Target Asset Allocation	Maximum Allocation
Global equity	20%	28%	36%
Private equity	4%	9%	14%
Global fixed income	23%	33%	43%
Private debt	2%	6%	10%
Absolute return	6%	11%	16%
Global tactical asset allocation/ Opportunistic	-	-	5%
Real assets	8%	13%	18%
Cash	-	-	10%

Note: The absolute return and global tactical asset allocation/opportunistic asset class includes allocations to global macro and relative value hedge fund strategies and managers with unconstrained global mandates. In addition, during times of significant market dislocations, opportunistic mandates would be allocated to this asset class. The real assets asset class includes allocations to real estate, commodities, infrastructure and natural resources.

Asset Class	FCERS - Postemployment Healthcare Minimum Allocation	Target Asset Allocation	Maximum Allocation
Global equity	40%	55%	54%
Fixed income	20%	28%	40%
Real assets	15%	17%	30%

Note: The real assets asset class allocates to commodities, natural resources, infrastructure, and real estate.

At June 30, 2018, the Retirement Systems held the following investments (dollars in thousands):

	PFDRP	FCERS	Total
Securities and other:			
Fixed income:			
Global fixed income	$ 981,478	$ 734,541	$ 1,716,019
Collective short-term investments	209,760	29,278	239,038
Total fixed income	1,191,238	763,819	1,955,057
Absolute return	217,322	254,051	471,373
Global equity	1,253,918	871,612	2,125,530
Global tactical asset allocation	12,179	-	12,179
Private equity	295,125	68,362	363,487
Private debt	209,259	78,784	288,043
Real assets	467,537	298,746	766,283
International currency contracts, net	(2,885)	169	(2,716)
Total investments	$ 3,643,693	$ 2,335,543	$ 5,979,236

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

Interest Rate Risk – The fair value of fixed income investments fluctuate in response to changes in market interest rates. Increases in prevailing interest rates generally translate into decreases in fair value of those instruments. The fair value of interest-sensitive instruments may also be affected by the creditworthiness of the issuer, prepayment options, and other general interest rate conditions. Certain fixed income investments have call provisions that could result in shorter maturity periods. The Retirement Systems do not have a policy regarding interest rate risk. However, the Retirement Systems do settle on a transaction plus one day basis (T+1), therefore limiting the Retirement Systems' exposure to counterparty risk.

The following tables provide the segmented time distribution for fixed income investments based on expected maturity (in months and years) as of June 30, 2018 (dollars in thousands):

	PFDRP							
	0 - 3 months	3 - 6 months	6 months - 1 year	1 - 5 years	5 - 10 years	More than 10 years	Total Fair Value	Total Cost
Global fixed income:								
Commingled funds	$ 100,296	$ -	$ -	$ 164,491	$ 583,027	$ 48,719	$ 896,533	$ 842,622
Corporate bonds	-	-	-	53	-	-	53	189
Mortgage-backed securities	-	-	-	-	1,163	53,366	54,529	55,698
Other debt securities	-	-	-	-	16,115	14,248	30,363	30,517
Total global fixed income	100,296	-	-	164,544	600,305	116,333	981,478	929,026
Collective short-term investments	209,760	-	-	-	-	-	209,760	209,580
Total fixed income	$ 310,056	$ -	$ -	$ 164,544	$ 600,305	$ 116,333	$ 1,191,238	$ 1,138,606

	FCERS							
	0 - 3 months	3 - 6 months	6 months - 1 year	1 - 5 years	5 - 10 years	More than 10 years	Total Fair Value	Total Cost
Global fixed income:								
Commingled funds	$ 40,067	$ -	$ -	$ 186,811	$ 222,553	$ 38,679	$ 488,110	$ 478,026
Corporate bonds	-	-	-	1	-	-	1	1
Mortgage-backed securities	-	-	-	-	703	61,052	61,755	62,770
Other debt securities	-	-	-	-	16,517	17,148	33,665	33,797
U.S. Treasury Inflation-protected securities	-	-	-	151,010	-	-	151,010	154,284
Total global fixed income	40,067	-	-	337,822	239,773	116,879	734,541	728,878
Collective short-term investments	29,278	-	-	-	-	-	29,278	29,252
Total fixed income	$ 69,345	$ -	$ -	$ 337,822	$ 239,773	$ 116,879	$ 763,819	$ 758,130

Custodial Credit Risk – Custodial credit risk is the risk that the Retirement Systems will not be able to recover the value of their investments or collateral securities that are in the possession of an outside party, if that outside party fails. The Retirement Systems do not have a policy regarding custodial credit risk. As of June 30, 2018, all of the Retirement Systems' investments are held in the Retirement Systems' names, and/or are not exposed to custodial credit risk.

Credit Quality Risk – The Retirement Systems' investment policies allow for investments in a wide variety of domestic and international debt securities that may carry a high rating, low rating, or be unrated. Investment managers may, as part of their investment strategy, invest in securities where the issuer's ability or willingness to pay is limited. At times, these debt securities may be converted into other debt, equity, or hybrid securities that have different risk and return characteristics than the securities initially purchased. The Retirement Systems may hedge against the possible adverse effects of currency fluctuations on the Retirement Systems' portfolios of international fixed income obligations when it is considered appropriate. This is typically achieved using forward currency contracts. Short-term investments may consist of commercial paper rated at least A1 or P1, repurchase agreements, short-term U.S. securities, and other money market investments. Nationally recognized statistical rating organizations provide ratings of debt securities' quality based on a variety of factors, such as the financial condition of the issuers, which provide investors with some idea of the issuer's ability to meet its obligations.

The table provides information for the portfolios as of June 30, 2018 concerning credit risk (dollars in thousands) and reflect only securities held in the Retirement Systems' names.

	PFDRP		FCERS	
S&P quality rating	**Fair Value**	**Fair value as a % of fixed income investments**	**Fair Value**	**Fair value as a % of fixed income investments**
AAA	$ 278	0.02%	$ 255	0.03%
AA+	8,480	0.71%	159,561	20.89%
AA-	-	-	484	0.06%
A+	1,307	0.11%	1,197	0.16%
A	3,811	0.32%	4,887	0.64%
A-	-	-	1,962	0.26%
BBB+	1,158	0.10%	1,222	0.16%
BBB	5,710	0.48%	5,418	0.71%
BBB-	3,156	0.26%	2,840	0.37%
BB	2,895	0.24%	2,723	0.36%
BB-	1,173	0.10%	1,263	0.17%
B+	511	0.04%	516	0.07%
B	1,984	0.17%	1,814	0.24%
B-	392	0.03%	359	0.05%
CCC	2,024	0.17%	1,860	0.24%
CC	1,797	0.15%	1,615	0.21%
D	3,243	0.27%	2,697	0.35%
Not rated	1,153,319	96.83%	573,146	75.03%
Total	$ 1,191,238	100.00%	$ 763,819	100.00%

Foreign Currency Risk – This is the risk that changes in the exchange rates will adversely affect the fair value of underlying investments. To mitigate this risk, the Retirement Systems' investment policies permit individual investment managers to mitigate the impact of currency fluctuation on the underlying asset value. The Retirement Systems' investment managers enter into international forward currency contracts, which are commitments to purchase or sell stated amounts of international currency. The Retirement Systems utilize these contracts to control exposure and facilitate the settlement of international security purchase and sale transactions. At June 30, 2018, the Retirement Systems' net positions in these contracts are recorded at fair value as international currency contract investments. The fair values of international currency contracts are determined by quoted currency prices from national exchanges. The Retirement Systems' commitments relating to international currency contracts are settled on a net basis.

The following tables provide information as of June 30, 2018, concerning the fair value of investments that are subject to foreign currency risk (dollars in thousands):

	PFDRP				
Currency Name	Cash	Global Equity	International Currency Contracts, Net	Real Assets	Total Exposure
Australian dollar	$ (10)	$ 7,440	$ (120)	$ -	$ 7,310
Canadian dollar	(30)	17,124	(209)	-	16,885
China yuan reminbl	-	-	231	-	231
Denmark krone	-	9,374	-	-	9,374
Euro currency	816	37,221	(824)	21,550	58,763
Hong Kong dollar	55	7,603	-	-	7,658
Japanese yen	293	25,225	(1,620)	-	23,898
Korean (South) won	-	13,624	-	-	13,624
New Zealand dollar	-	267	-	-	267
Norwegian krone	-	1,999	-	-	1,999
Singapore dollar	-	247	(93)	-	154
Swedish krona	8	3,865	(47)	-	3,826
Swiss franc	-	24,302	(50)	-	24,252
United Kingdom pound	222	37,584	(153)	-	37,653
Total	$ 1,354	$ 185,875	$ (2,885)	$ 21,550	$ 205,894

	FCERS					
Currency Name	Cash	Global Equity	International Currency Contracts, Net	Private Equity	Real Assets	Total Exposure
Australian dollar	$ 11	$ 3,913	$ 26	$ -	$ -	$ 3,950
Brazilian real	-	57	-	-	-	57
British pound	51	22,033	44	-	-	22,128
Canadian dollar	18	7,507	(7)	-	-	7,518
Chile peso	-	93	-	-	-	93
China yuan renminbi	-	-	135	-	-	135
Colombian peso	-	5	-	-	-	5
Danish krone	-	5,457	-	-	-	5,457
Euro currency	71	17,563	(50)	1,583	7,980	27,147
Hong Kong dollar	24	3,011	-	-	-	3,035
Hungarian forint	-	11	-	-	-	11
Indonesian rupiah	-	61	-	-	-	61
Israeli shekel	-	70	-	-	-	70
Japanese yen	113	13,479	30	-	-	13,622
Korean won	-	8,192	-	-	-	8,192
Malaysian ringgit	-	249	-	-	-	249
Mexican peso	-	74	-	-	-	74
New Zealand dollar	-	47	-	-	-	47
Norwegian krone	-	1,547	-	-	-	1,547
Philippine peso	-	3	-	-	-	3
Polish zloty	-	39	-	-	-	39
Singapore dollar	-	349	-	-	-	349
South African rand	-	48	-	-	-	48
Swedish krona	(5)	2,369	-	-	-	2,364
Swiss franc	-	14,276	(9)	-	-	14,267
Taiwanese new dollar	-	38	-	-	-	38
Thai baht	-	38	-	-	-	38
Total	$ 283	$ 100,529	$ 169	$ 1,583	$ 7,980	$ 110,544

Investment Concentration Risk – The Retirement Systems' investment policies specify that investments shall be diversified with the intent to minimize the risk of large investment losses. The total portfolio shall be constructed in a way to provide prudent diversification with regard to the concentration of holdings in individual asset classes, issues, issuers, geographies or industries. In addition, assets will be assigned to a variety of investment managers that employ a range of investment management strategies. No single investment management firm shall be authorized to manage more than 10% of the applicable plan's assets without approval by the applicable Retirement Board, with the exception of passive management, where the applicable plan's assets are not held in the applicable plan's name at the applicable plan's custodial bank. In such cases, the investment management firm can manage no more than 20% of the applicable plan's assets without approval by the applicable Retirement Board. As a general rule, assets placed with an investment manager should not represent more than 10% of the total assets of the applicable plan managed by that firm, without approval of the applicable Retirement Board. As of June 30, 2018, none of the Retirement Systems held investments in any one issuer, excluding U.S. Government guaranteed investments that represented 5% or more of the total applicable plan's net position or total investments.

Derivatives – The Retirement Systems' investment policies allow for investments in derivative instruments that comply with the Retirement Systems' objectives of providing a cost effective means of managing portions of a portfolio and to manage risk through hedging activities. The Retirement Systems are currently authorized to use derivative strategies to equitize cash during portfolio transitions until physical securities are in place, and to reproduce or replicate a physical holding that corresponds to the applicable Retirement Board's approved policy benchmark. In addition to the Retirement Systems' internal derivative policies, it is understood that the mandates of certain investment managers retained by the Retirement Systems may use derivatives.

Derivative investments are reported at fair value. Derivative instruments traded on a national or international exchange are valued at the last reported sales price on the last business day of the fiscal year at current exchange rates, if applicable. Futures contracts are marked-to-market at the end of each trading day, and the settlement of gains or losses occur on the following business day through variation margins. As a result, futures have no fair value as of June 30, 2018. The fair value of international currency forwards represents the unrealized gain or loss on the related contracts, which is calculated based on the difference between the specified contract exchange rate and the exchange rate at the end of the reporting period.

The fair values and notional amounts for a portion of derivative instruments outstanding as of June 30, 2018, classified by type, and the changes in fair value of such derivative instruments for the year then ended as reported in the financial statements are as follows (amounts in thousands):

PFDRP

	Net Appreciation/(Depreciation) in Fair Value of Investments through June 30, 2018		Fair Value at June 30, 2018		Notional
Investment Derivative Instruments	Classification	Amount	Classification	Amount	Amount/Shares
Foreign currency forwards	Investment income	$ (3,542)	International currency contracts, net	$ (2,885)	$ 360,253
Futures options bought/written	Investment income	(5)	Fixed income - collective short-term investments	-	57,113
Rights / Warrants	Investment income	(34)	Global equity	-	-
Total derivative instruments		$ (3,581)		$ (2,885)	

FCERS

	Net Appreciation/(Depreciation) in Fair Value of Investments through June 30, 2018		Fair Value at June 30, 2018		Notional
Investment Derivative Instruments	Classification	Amount	Classification	Amount	Amount/Shares
Foreign currency forwards	Investment income	$ 956	Foreign currency contracts, net	$ 169	$ 53,923
Future options bought/written	Investment income	(5,386)	Fixed income - collective short-term investments	-	17,853
Rights / Warrants	Investment income	(37)	Global equity	-	-
Total derivative instruments		$ (4,467)		$ 169	

Derivative investments are also subject to counterparty credit risk (non-exchange traded). The following describes the risks applicable to the investment derivative instruments that are reported as of June 30, 2018.

Counterparty Credit Risk – The Retirement Systems are exposed to credit risk on derivative instruments that are in asset positions and non-exchange traded. The Retirement Systems' investments in forward currency contracts bear counterparty credit risk in that parties to the contracts may fail to perform according to the terms of the contract.

As of June 30, 2018, PFDRP had total commitments in forward currency contracts to purchase and sell international currencies were $360,253,000, with fair values of $357,111,000 and $359,996,000, respectively, held by counterparties with an S&P rating of at least AA-.

As of June 30, 2018, FCERS had total commitments in forward currency contracts to purchase and sell international currencies were $53,923,000, with fair values of $53,926,000 and $53,757,000, respectively, held by counterparties with an S&P rating of at least A and above.

Fair Value Measurements – The Retirement Systems categorize its fair value measurement within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

The Retirement Systems have the following recurring fair value measurements as of June 30, 2018:

PFDRP		Fair Value Measurement Using			
(In Thousands)	Total	Level 1	Level 2	Level 3	Net Asset Value (NAV)
Investments by fair value level					
Global equity	$ 1,253,918	$ 412,732	$ -	$ -	$ 841,186
Private equity	295,125	-	-	2,737	292,388
Global fixed income	981,478	33,754	83,654	500	863,570
Collective short-term investments	209,760	209,760	-	-	-
Private debt	209,259	-	10,268	17,001	181,990
Real assets	467,537	7,142	-	-	460,395
International currency contracts, net	(2,885)	(2,885)	-	-	-
Global tactical asset allocation	12,179	12,179	-	-	-
Absolute return	217,322	-	-	-	217,322
Total investments measured at fair value	**$ 3,643,693**	**$ 672,682**	**$ 93,922**	**$ 20,238**	**$ 2,856,851**

FCERS		Fair Value Measurement Using			
(In Thousands)	Total	Level 1	Level 2	Level 3	Net Asset Value (NAV)
Investments by Fair Value Level					
Global equity	$ 871,612	$ 257,663	$ -	$ -	$ 613,949
Private equity	68,362	-	-	2,737	65,625
Global fixed income	734,541	164,636	94,637	500	474,768
Collective short-term investments	29,278	29,278	-	-	-
Private debt	78,784	-	5,134	17,001	56,649
Real assets	298,746	-	-	-	298,746
International currency contracts, net	169	169	-	-	-
Absolute return	254,051	-	-	-	254,051
Total investments measured at fair value	**$ 2,335,543**	**$ 451,746**	**$ 99,771**	**$ 20,238**	**$ 1,763,788**

Equity and Fixed Income Securities

Equity securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets issued by pricing vendors for these securities. Debt and equity securities classified in Level 2 of the fair value hierarchy are valued using prices determined by the use of matrix pricing techniques maintained by the various pricing vendors for these securities. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices for similar securities that are observable in the market place. Debt and equity securities classified in Level 3 are securities whose inputs to valuation techniques are unobservable by the market place. Many of these securities are priced by the issuers or industry groups for these securities. Fair value is defined as the quoted market value on the last trading day of the period. These prices are obtained from various pricing sources by the custodian bank for PFDRP or FCERS as applicable.

Alternative Investments

Alternative investments include global equity, private equity, global fixed income, private debt, real assets, global tactical asset allocation, and absolute return investments. These are investments for which exchange quotations are not readily available and are valued at estimated fair value, as determined in good faith by the General Partner (GP) of each investment firm retained by the Retirement Systems. These investments are initially valued at cost with subsequent adjustments that reflect third party transactions, financial operating results and other factors deemed relevant by the GP. The assets in the Retirement Systems' alternative investment programs are classified as Level 3 assets or at the NAV Level. A more detailed explanation of the Level 3 and NAV valuation methodologies follows.

Investments in non-public equity securities are valued by the GP using one or more valuation methodologies outlined in GASB Statement No.72, *Fair Value Measurements*, depending upon the availability of data required by each methodology. In some cases, the GP may use multiple approaches to estimate a valuation range. For the immediate time period following a transaction, the determination of the fair value for equity securities, in which no liquid trading market exists, can generally be approximated based on the transaction price (absent any significant developments). Thereafter, or in the interim, if significant developments relating to such portfolio company or industry occur which may suggest a material change in value, the GP should value each investment by applying generally accepted valuation methods including: (1) the market approach (such as market transaction and comparable public company multiples, which are based on a measurement of the company's historical and projected financial performance with typical metrics including enterprise value/latest 12 months earnings before interest, taxes, depreciation and amortization ("EBITDA") or projected fiscal year EBITDA) or (2) the income or discounted cash flow approach.

The determination of fair value using these methodologies should take into consideration a range of factors, including but not limited to, the price at which the investment was acquired, the nature of the investment, local market conditions, trading values on public exchanges for comparable securities, current and projected operating performance and financing transactions subsequent to the acquisition of the investment. Because of the subjective nature of estimated fair value of the private investments, such value may differ significantly from the values that would have been used had a ready market existed for these investments. These financial instruments have been classified as Level 3 or NAV in the fair value hierarchy.

The following tables present the category, fair value, unfunded commitments, redemption frequency and redemption notice period for investments for which fair value is presented using the NAV as of June 30, 2018:

PFDRP

Investments Measured at the NAV as of June 30, 2018 (In Thousands)	Fair Value	Unfunded Commitments	Redemption Frequency (if Currently Eligible)	Redemption Notice Period
Global equity	$ 841,186	$ -	Daily, Monthly, Quarterly	1 - 90 Days
Private equity	292,388	245,295	N/A	N/A
Global fixed income	863,570	-	Daily, Monthly, Quarterly	1 - 60 Days
Private debt	181,990	156,854	N/A	N/A
Real assets	460,395	126,108	Monthly, Quarterly, N/A (Closed-end funds)	3 - 90 Days, N/A (Closed-end funds)
Absolute return	217,322	-	Weekly, Monthly, Quarterly	14 - 75 Days
Total investments measured at the NAV	**$ 2,856,851**	**$ 528,257**		

FCERS

Investments Measured at the NAV as of June 30, 2018 (In Thousands)	Fair Value	Unfunded Commitments	Redemption Frequency (if Currently Eligible)	Redemption Notice Period
Global equity	$ 613,949	$ -	Daily, Monthly, Quarterly	1 - 90 Days
Private equity	65,625	223,213	N/A	N/A
Global fixed income	474,768	-	Daily, Quarterly	1 - 60 Days
Private debt	56,649	72,854	N/A	N/A
Real assets	298,746	71,234	Monthly, Quarterly, Annual, N/A (Closed-end funds)	3 - 180 Days, N/A (Closed-end funds)
Absolute return	254,051	-	Weekly, Monthly, Quarterly	14 - 75 Days
Total investments measured at the NAV	**$ 1,763,788**	**$ 367,301**		

B. Receivables, Net of Allowances

At June 30, 2018, receivables of the City's major individual funds and nonmajor funds taken in aggregate, including the applicable allowance for uncollectible accounts, are as follows (dollars in thousands):

Receivables – Governmental Activities:	General Fund	Housing Activities	Low and Moderate Income Housing Asset	Special Assessment Districts	Nonmajor Funds	Internal Service Funds	Total Governmental Activities
Taxes	$ 54,281	$ -	$ -	$ -	$ 10,187	$ -	$ 64,468
Accrued interest	1,986	303	1,869	113	4,009	98	8,378
Grants	3,081	2,504	-	-	10,437	-	16,022
Special assessments	-	-	-	30,950	-	-	30,950
Other	39,965	68	25	2,207	14,918	252	57,435
Less: allowance for uncollectibles	(26,398)	-	-	(5)	(3,796)	(10)	(30,209)
Total receivables, net	$ 72,915	$ 2,875	$ 1,894	$ 33,265	$ 35,755	$ 340	$ 147,044

Receivables – Business-Type Activities:	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total Business-Type Activities
Accounts	$ 19,029	$ 4,223	$ 10,429	$ 181	$ 33,862
Accrued interest	1,398	2,128	146	190	3,862
Grants	3,783	-	-	-	3,783
Less: allowance for uncollectibles	(426)	(587)	(1,164)	(63)	(2,240)
Total receivables, net	$ 23,784	$ 5,764	$ 9,411	$ 308	$ 39,267

Special assessment receivables in the amount of $30,950,000 are not expected to be collected within the subsequent year.

C. Loans Receivable, Net of Allowances

The composition of the City's loans receivable balance for governmental funds, net of the allowance for uncollectible accounts, as of June 30, 2018 is as follows (dollars in thousands):

Type of Loan	General Fund	Housing Activities	Low and Moderate Income Housing Asset	Nonmajor Governmental Funds	Total Governmental Activities
Housing Program Developer, rehabilitation, second mortgage and relocation loans	$ -	$ 52,397	$ 493,542	$ -	$ 545,939
Loans funded by federal grants	-	74,745	-	5,430	80,175
Economic development, real estate developer and other loans	1,241	-	-	-	1,241
Less: allowance for uncollectibles	-	(58,145)	(269,950)	(2,347)	(330,442)
Total loans, net	$ 1,241	$ 68,997	$ 223,592	$ 3,083	$ 296,913

The City uses funds generated from the loan repayment program income as well as other state and federal funding sources to offer financial assistance to qualified developers, individuals, and families by providing loans at "below market" interest rates.

Typical loans and related terms are summarized as follows:

Loan Type	Interest Rates	Due
New construction and permanent	0 - 4%	up to 55 years
Multi-unit rental rehabilitation	3%	5 or more years
First time home buyer	4%	7 to 40 years
Home improvement	3 - 6%	1 to 30 years

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

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

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

In accordance with City policy, loans are funded at below market rates of interest and include amortized net cash flow deferred repayment terms. This policy exists to enhance the well-being of the recipients or beneficiaries of the financial assistance, who, as described above, are very low, low, or moderate-income individuals or families, or developers of housing for such individuals or families. Accordingly, for financial statement purposes, the City has established an allowance account against the loans receivable balance containing a present value discount. The present value discount gives recognition to the economic cost of providing loans at interest rates below market, and represents an estimate of the present value of projected net cash flows to the City from the loan portfolio. The present value discount attributable to the loans will be recognized as interest income only as such loans are repaid in full because of the deferred nature of the loan portfolio and the high level of uncertainty relating to the likelihood that cash flows will occur as projected. The difference between the individual outstanding loan balances and the calculated net present value of the loans results in the allowance for present value discount. Losses are recognized as an addition to the allowance and any subsequent recoveries are deducted from the allowance.

The City's management believes the combined amount of the aforementioned risk and present value discount allowances is adequate to reflect the net realizable value of the Community Development Block Grant ("CDBG") loans, Home Investment Partnership Program ("HOME") loans, and Low and Moderate Income Housing Asset Fund loans receivable as of June 30, 2018.

In the normal course of operations for housing programs, the City has outstanding commitments to extend credit, which have been encumbered as of June 30, 2018. These commitments involve elements of credit and interest rate risk similar to those described above for outstanding loans receivable. As of June 30, 2018, amounts committed to extend credit under normal lending agreements totaled approximately $6,303,000.

D. Capital Assets

1. Summary Schedule

The following is a summary of capital assets activity for the fiscal year ended June 30, 2018 (dollars in thousands):

	Balance July 1, 2017	Additions	Deletions	Transfers	Balance June 30, 2018
Governmental activities:					
Capital assets, not being depreciated:					
Land	$ 413,533	$ 16,744	$ 21,255	$ -	$ 409,022
Construction in progress	48,995	47,746	-	(50,171)	46,570
Total capital assets, not being depreciated	462,528	64,490	21,255	(50,171)	455,592
Capital assets, being depreciated:					
Buildings	1,648,741	718	-	4,758	1,654,217
Improvements, other than buildings	260,722	3,680	-	14,430	278,832
Infrastructure	11,479,037	40,094	-	24,474	11,543,605
Vehicles and equipment	129,643	11,401	4,432	6,509	143,121
Furnitures and fixtures	27,498	-	-	-	27,498
Total capital assets, being depreciated	13,545,641	55,893	4,432	50,171	13,647,273
Less accumulated depreciation for:					
Buildings	611,008	42,857	-	-	653,865
Improvements, other than buildings	46,650	7,775	-	-	54,425
Infrastructure	7,790,210	160,077	-	-	7,950,287
Vehicles and equipment	93,368	11,048	4,176	-	100,240
Furnitures and fixtures	26,949	171	-	-	27,120
Total accumulated depreciation	8,568,185	221,928	4,176	-	8,785,937
Total capital assets, being depreciated, net	4,977,456	(166,035)	256	50,171	4,861,336
Governmental activities capital assets, net	$5,439,984	$(101,545)	$ 21,511	$ -	$ $ 5,316,928
Business-type Activities:					
Capital assets, not being depreciated:					
Land	$ 134,926	$ 3,012	$ -	$ -	$ 137,938
Intangible assets	12,882	-	-	-	12,882
Construction in progress	119,839	104,628	47	(40,440)	183,980
Total capital assets, not being depreciated	267,647	107,640	47	(40,440)	334,800
Capital assets, being depreciated:					
Buildings	1,658,208	929	101	14,055	1,673,091
Improvements, other than buildings	1,246,257	30,826	-	15,009	1,292,092
Vehicles and equipment	264,175	3,671	417	11,376	278,805
Total capital assets, being depreciated	3,168,640	35,426	518	40,440	3,243,988
Less accumulated depreciation for:					
Buildings	587,019	40,114	50	-	627,083
Improvements, other than buildings	609,929	31,501	-	-	641,430
Vehicles and equipment	177,767	9,600	416	-	186,951
Total accumulated depreciation	1,374,715	81,215	466	-	1,455,464
Total capital assets, being depreciated, net	1,793,925	(45,789)	52	40,440	1,788,524
Business-type activities capital assets, net	$2,061,572	$ 61,851	$ 99	$ -	$ 2,123,324

2. Depreciation

Depreciation expense charged to various governmental and business-type activities of the City for the fiscal year ended June 30, 2018 is as follows (dollars in thousands):

Governmental activities:		
General government	$	9,357
Public safety		8,186
Capital maintenance		166,945
Community services		34,809
Capital assets held by City's internal service funds		2,631
Total depreciation expense - governmental activities	$	221,928
Business-type activities:		
Norman Y. Mineta San José International Airport	$	47,486
Wastewater Treatment System		29,227
Municipal Water System		2,823
Parking System		1,679
Total depreciation expense - business-type activities	$	81,215

3. Capitalized Interest

Interest costs that are related to the acquisition of buildings and improvements and equipment acquired with tax-exempt and taxable debt are capitalized for business-type activities. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project, with interest earned on invested taxable and tax-exempt debt proceeds over the same period. Capitalized interest cost is prorated to completed projects based on the completion date of each project. In FY 2018, the City incurred a total of $845,000 of interest costs related to the acquisition of Plant assets under the Wastewater Treatment business-type activities previously accounted for in accordance with GASB Statement No. 62. The City has updated the Capitalized Interest policy to no longer capitalize interest for Wastewater Treatment System Fund.

4. Construction Commitments

Commitments outstanding as of June 30, 2018, related to governmental and business-type activities construction in progress totaled approximately $32,370,000 and $233,051,000, respectively.

E. Leases

1. Operating Leases as Lessee

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

Governmental Activities

The City has ongoing commitments under operating lease agreements for business equipment, office facilities and land necessary for City operations, which expire at various dates through 2022. Each governmental fund includes the expenditures related to such lease agreements. There are both cancelable and non-cancelable lease agreements. Rental expenditures reported by the General Fund and the Nonmajor Governmental Funds under these operating lease agreements for the year ended June 30, 2018 amounted to approximately $2,041,000 and $73,000, respectively.

The future minimum lease payments anticipated under the existing lease commitments, as of June 30, 2018, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	General Fund	Nonmajor Governmental Funds	Total Govermental Activities
2019	$ 1,838	$ 44	$ 1,882
2020	583	-	583
2021	275	-	275
2022	85	-	85
Totals	$ 2,781	$ 44	$ 2,825

Business-Type Activities

Airport Gas-Powered Buses. In September 2009, the City entered into a restated operating lease and maintenance agreement for ten compressed natural gas ("CNG") powered buses for the Airport. The term of the agreement is from December 2007 to May 2017. In May 2017, the restated agreement was amended to extend through May 2019, with a one year option to extend. Rental and maintenance expense for the Airport buses for the year ended June 30, 2018 was $1,399,000.

Future Minimum Payments. The future minimum lease and maintenance payments required under the existing agreement for the ten CNG powered buses, as of June 30, 2018, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	Operating Leases
2019	$ 774
Total minimum lease payments	$ 774

2. Operating Leases as Lessor

Governmental Activities

The City also leases building space, facilities, and/or the privilege of operating a concession to tenants and concessionaries resulting in the receipt of annual rents that are not specifically described.

Business-Type Activities - Airport

Airline-Airport Lease and Operating Agreements. The City has entered into an Airline-Airport Lease and Operating Agreement with the various passenger and cargo airlines serving the Airport. The airline lease agreement, which took effect on December 1, 2007, was originally set to expire on June 30, 2012. In August 2011, the City Council authorized the Director of Aviation to extend the term for five years through June 30, 2017. On May 23, 2017, the City Council authorized the Director of Aviation, or Interim Director of Aviation, as applicable, to extend the term for two years through June 30, 2019, which allows the airlines to continue to conduct operations and occupy leased space through the extended term. Pursuant to the City Council authorization, the Agreement was extended for two years until June 30, 2019, with Article 11 amended to remove the Municipally-Funded Air Service Incentive Program, and other provisions were added as required under federal law and regulations. The existing rates and charges structure remained unchanged through the extended term. Negotiations for a new agreement with the airlines are currently underway. The current agreement shall terminate upon execution of a new Airline Lease and Operating Agreement between City and the airlines.

The key provisions in the airline lease agreement include compensatory rate making for the terminal cost center and residual rate making for the airfield cost center. The terminal rate per square foot is calculated based on expenses allocable to the Terminal for each fiscal year divided by the total amount of rentable terminal space. Should there be any net remaining revenues after all other obligations are satisfied, the airlines share of the net remaining revenues shall be applied as a credit to the airline terminal rate for the following fiscal year, thus reducing the rates. The landing fee rate is calculated by dividing the expenses allocable to the airfield, offset by airfield revenues, other than landing fees, by the projected aggregated maximum gross landed weight for all aircraft carrying passengers or cargo in commercial service at the Airport during the fiscal year.

For the year ended June 30, 2018, the Airport's revenues as defined in its lease agreement exceeded its expenditures and reserve requirements by approximately $25,530,000. The surplus for year ended June 30, 2018 will be distributed in accordance with the revenue sharing provisions of the lease agreement and/or used in the budget balancing actions for FY 2019.

Other Airport Leases. In December 2013, the City entered into a ground lease and operating agreement with Signature Flight Support Corporation (Signature), which constructed a full-service, fixed based facility on 29-acres of the Airport's west side. The term of the agreement is for 50 years from December 12, 2013 to December 11, 2063. The base ground rental is subject to a consumer price index adjustment annually and by appraisal every five years. The base ground rental rate effective December 12, 2017 is $2.36 per square foot per year. Rental revenues from the ground lease with Signature were $3,009,000 for the year ended June 30, 2018.

The City also enters into leases with concessionaires, cargo carriers, and other business entities for building space and/or the privilege of operating a concession at the Airport. As of June 30, 2018, the remaining terms of these operating leases range from one month to 20 years. The leases with concessionaires are generally based on the greater of a percentage of their sales or a minimum annual guaranteed amount. Rental revenues from the aforementioned operating leases were $93,172,000 for the year ended June 30, 2018.

The future minimum rentals to be received from the Airport operating leases, as of June 30, 2018, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	Amount
2019	$ 89,056
2020	38,257
2021	18,100
2022	17,528
2023	16,620
2024 - 2028	69,522
2029 - 2033	50,050
2034 - 2038	51,787
2039 - 2043	30,807
2044 - 2048	34,412
2049 - 2053	39,582
2054 - 2058	45,530
2059 - 2063	52,371
2064 - 2065	5,458
Total	$ 559,080

These future minimum rentals are based upon annual rates and charges currently agreed to by the airlines and other tenants. As of June 30, 2018, leased assets to tenants had historical costs of $1,046,516,000 and accumulated depreciation of $252,262,000.

Pursuant to the terms of individual agreements entered into with the City, every airline, operator, tenant or any other entity or person, which is party to an agreement with the City authorizing them to conduct business at the Airport, is required to maintain a security deposit on file with the City. The deposit shall be in a form and amount acceptable to the Director of Aviation, often in the form of irrevocable letter of credit, surety bond, cashier's check or other form acceptable to the Director of Aviation. The Director of Aviation has the authority to revise the amount of security deposit at any time to protect the interests of the City. Each deposit must be maintained in full force and effect during the entire term of the agreement to ensure faithful performance by the other party of all the covenants, terms and conditions of the agreement. Security deposits in the form of cashier's checks are recorded as advances and deposits payable on the accompanying statements of net position. The Airport maintains on file copies of all security deposits, in the form of letter of credit or surety bond, which are not recorded in the financial statements. The amount on file as of June 30, 2018 totaled $34,906,000.

Potential Claim. The passenger airlines that currently operate at the Airport have a potential unasserted claim against the City for overpayment of terminal rents by the airlines. The overpayment of terminal rents by the passenger airlines has resulted from the City's annual calculation of terminal rents in a manner that is not consistent with the terms of the current Lease and Operating Agreement between the passenger airlines and the City. Specifically, from fiscal year 2008 to the year ended June 30, 2017, the City had not included the City office and administrative space at the terminals that should be counted as "Rentable Terminal Space" under the terms of the Airline Lease Agreement for the purpose of calculating terminal rents to be charged to the passenger airlines.

The statute of limitations for claims against a government entity such as the City is one (1) year pursuant to California Government Code Section 911.2. If the airlines file a claim, the City will raise the limitation period as a defense.

At this time it is impossible to predict the outcome of this potential unasserted claim, the possible loss or range of loss, or whether the unasserted claim will be made and if made, when it would be resolved.

F. Long-Term Debt and Other Obligations

1. Summary Schedule of Long-Term Debt

The following is a summary of long-term debt of the City as of June 30, 2018 (dollars in thousands, unless otherwise noted):

	Purpose	Issue Amount	Issue Date	Final Maturity	Range of Interest Rates	Range of Principal Payments ($ millions)	Balance June 30, 2018
Governmental Activities							
City of San Jose							
General Obligation Bonds:							
Series 2001 (Libraries and Parks)	Community Facilities	$ 71,000	06/06/2001	09/01/2031	5.00-5.13%	2.37	$ 33,110
Series 2002 (Libraries, Parks, Public Safety)	Community Facilities	116,090	07/18/2002	09/01/2032	5.00%	3.87	58,040
Series 2004 (Libraries, Parks, Public Safety)	Community Facilities	118,700	07/14/2004	09/01/2034	5.00%	3.96	67,270
Series 2005 (Libraries and Public Safety)	Community Facilities	46,300	06/23/2005	09/01/2035	4.00-4.50%	1.55	27,810
Series 2006 (Libraries and Parks)	Community Facilities	105,400	06/29/2006	09/01/2036	4.38-5.00%	3.52	66,785
Series 2007 (Parks and Public Safety)	Community Facilities	90,000	06/20/2007	09/01/2037	4.00-4.75%	3.00	60,000
Series 2008 (Libraries and Parks)	Community Facilities	33,100	06/25/2008	09/01/2038	4.00-5.00%	1.10	23,155
Series 2009 (Public Safety)	Community Facilities	9,000	06/25/2009	09/01/2039	4.00-5.00%	0.30	6,600
							342,770
City of San Jose Financing Authority							
Lease Revenue Bonds:							
Series 2003A (Central Service Yard)	Refunding	22,625	09/18/2003	10/15/2023	4.20-4.70%	1.30-1.61	8,695
Series 2006A (Civic Center Project)	Refunding	57,440	06/01/2006	06/01/2039	4.25-5.00%	0.17-17.44	52,850
Series 2007A (Recreational Facilities)	Refunding	36,555	06/28/2007	08/15/2030	4.25-4.75%	1.22-2.22	20,770
Series 2008C (Hayes Mansion)	Refunding	10,915	06/26/2008	06/01/2027	Variable	0.11-4.57	10,915
Series 2008D (Taxable) (Hayes Mansion)	Refunding	47,390	06/26/2008	06/01/2023	Variable	3.30-3.90	17,545
Series 2008E-1 (Taxable) (Ice Centre)	Refunding	13,015	07/03/2008	06/01/2025	Variable	0.91-1.26	7,460
Series 2008E-2 (Taxable) (Ice Centre)	Refunding	13,010	07/03/2008	06/01/2025	Variable	0.91-1.26	7,450
Series 2011A (Convention Center)	Convention Center	30,985	04/12/2011	05/01/2042	4.00-5.75%	0.64-2.17	29,345
Series 2013A (Civic Center Project)	Refunding	305,535	05/28/2013	06/01/2039	4.00-5.00%	5.30-21.33	286,465
Series 2013B (Civic Center Garage Project)	Refunding	30,445	06/19/2013	06/01/2039	3.00-5.00%	0.84-1.91	27,390
							468,885
Special Assessment Bonds							
Series 24Q (Hellyer-Piercy)	Public Infrastructure	27,595	06/26/2001	09/02/2023	5.70-5.88%	1.54-2.03	10,670
Special Tax Bonds							
CFD No. 1 (Capitol Expressway Auto Mall)	Public Infrastructure	4,100	11/18/1997	11/01/2022	5.70%	0.24-0.30	1,325
CFD No. 6 (Great Oaks-Route 85)	Public Infrastructure	12,200	12/18/2001	09/01/2023	5.75-6.00%	0.66-0.87	4,555
CFD No. 9 (Bailey/Highway 101)	Public Infrastructure	13,560	02/13/2003	09/01/2032	6.10-6.65%	0.39-0.95	9,405
CFD No. 10 (Hassler-Silver Creek)	Public Infrastructure	12,500	07/23/2003	09/01/2023	5.00-5.25%	0.74-0.94	4,995
Series 2011 (Convention Center)	Public Infrastructure	107,425	04/12/2011	05/01/2042	5.00-6.50%	2.03-7.71	99,815
							130,765
Total Government Activities - Bonds Payable							**$ 942,420**
Business-Type Activities							
Norman Y. Mineta San Jose International Airport							
Revenue Bonds:							
Series 2011A-1 (AMT)	Refunding	150,405	07/28/2011	03/01/2034	5.00-6.25%	3.36-21.12	$ 125,455
Series 2011A-2 (Non-AMT)	Refunding	86,380	07/28/2011	03/01/2034	4.00-5.25%	1.91-12.22	72,140
Series 2011B (Taxable)	Refunding	271,820	12/14/2011	03/01/2041	4.70-6.75%	1.95-27.33	260,095
Series 2014A (AMT)	Refunding	57,350	10/07/2014	03/01/2026	3.38-5.00%	0.14-9.18	56,040
Series 2014B (Non-AMT)	Refunding	28,010	10/07/2014	03/01/2028	3.10-5.00%	7.98-10.37	28,010
Series 2014C (Non-AMT)	Refunding	40,285	10/07/2014	03/01/2031	5.00%	7.30-8.86	40,285
Series 2017A (AMT)	Refunding	473,595	04/11/2017	03/01/2047	4.00-5.00%	4.01-35.15	459,450
Series 2017B (Non-AMT)	Refunding	150,675	04/11/2017	03/01/2047	3.00-5.00%	1.28-11.18	146,170
							1,187,645
Clean Water Financing Authority							
Revenue Bonds:							
Series 2009A	Refunding	21,420	01/29/2009	11/15/2020	3.50%	4.97-5.41	15,550
Regional Wastewater Facility							
State of California - Revolving Fund Loan	Wastewater Facilities	73,566	06/24/1997	05/01/2019	Variable	1.77	1,772
							17,322
Total Business-Type Activities - Bonds and Loan Payable							**$ 1,204,967**
Grand Total							**$ 2,147,387**

2. Debt Compliance

There are a number of limitations and restrictions contained in the various bond indentures. The City believes it is in compliance with all significant limitations and restrictions for which non-compliance would adversely affect its ability to pay debt service.

3. Legal Debt Limit and Margin

The City Charter limits bonded indebtedness for General Obligation bonds to 15 percent of the total assessed valuation of all real and personal property within the City. The total assessed value of taxable property on the City's 2017-2018 tax roll was $177.0 billion, which results in a total debt limit of $26.6 billion. As of June 30, 2018, the City had $347,530,000 of General Obligation bonds outstanding which represents approximately 1.3% of the General Obligation bonds' debt limit.

4. Arbitrage

The Tax Reform Act of 1986 instituted certain arbitrage restrictions with respect to the issuance of tax-exempt bonds after August 31, 1986. Arbitrage regulations deal with the investment of all tax-exempt bond proceeds at an interest yield greater than the interest yield paid to bondholders. Generally, all interest paid to bondholders can be retroactively rendered taxable if applicable rebate liabilities are not reported and paid to the Internal Revenue Service ("IRS") at least every five years. During the current year, the City performed calculations to determine the rebate liabilities for the City's tax-exempt bond issues listed above. However, as no bond issue with a positive rebate liability was due for a fifth-year payment, there was no rebate liability outstanding as of June 30, 2018.

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

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

As of June 30, 2018, the City has recorded approximately $30,950,000 of deferred inflows of resources and related special assessments receivables in the Special Assessment Districts Fund. These balances consist primarily of property tax assessments and/or special taxes to be collected in the future by the County of Santa Clara for future debt service of the special assessment districts and the community facilities districts.

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

6. Conduit Debt

The City has issued multi-family housing revenue bonds to provide funds for secured loans to builders of multi-family housing projects. The purpose of the program is to provide needed rental housing for low to moderate-income households. To comply with IRS requirements in order to meet the tax-exempt status, the owner is required to set aside a certain percentage of all units built for very low to moderate-income households. The bonds are payable solely from payments made on the related secured loans. These tax-exempt housing bonds have maturity dates that are due at various dates through March 1, 2052. As of June 30, 2018, the outstanding conduit multi-family housing revenue bonds issued by the City aggregated approximately $479,267,000.

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

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

Included in long-term debt is $43,370,000 of variable-rate bonds, comprised of three series (Series 2008C, Series 2008D and Series 2008E) issued by the Financing Authority. The Financing Authority issued these bonds to provide variable-rate exposure to the debt portfolio and to provide additional flexibility with respect to restructuring or redeeming the debt issued for certain projects. The source of repayment for each of these series is from lease payments from the City to the Financing Authority for the City's lease of the Dolce Hayes Mansion (Series 2008C and Series 2008D) and the Ice Centre (Series 2008E).

Effective December 18, 2013, the Financing Authority directly placed the Series 2008C/D/E Bonds with U.S. Bank National Association ("U.S. Bank") and in connection with the direct placement, the City, the Financing Authority and U.S Bank entered into separate continuing covenant agreements for the private placement of the Series 2008C/D Bonds and the Series 2008E Bonds. The scheduled redemption of these bonds is incorporated in the Annual Requirements to Maturity schedules (see Note III.F.9.).

The principal balances of the Financing Authority's variable-rate bonds as of June 30, 2018 are as follows (dollars in thousands):

	Privately-Placed Bonds				
	Balance June 30, 2018	Purchaser	Agreement Expiration	Fixed Fee/ Spread	Interest Index Rate
City of San José Financing Authority:					
Lease Revenue Bonds:					
Series 2008C (Hayes Mansion)	$ 10,915	U.S. Bank	12/3/2018	0.430%	SIFMA (Weekly)
Series 2008D (Taxable) (Hayes Mansion)	17,545	U.S. Bank	12/3/2018	0.470%	1-Month LIBOR
Series 2008E (Taxable) (Ice Centre)	14,910	U.S. Bank	12/13/2019	0.530%	1-Month LIBOR
Total variable-rate lease revenue bonds	$ 43,370				

Prior to the execution of the continuing covenant agreements on December 18, 2013 (for the Series 2008C, 2008D, and 2008E bonds) the variable-rate lease revenue bonds were publicly-marketed "demand" bonds supported by credit facilities and payable upon demand of the bondholder at a purchase price equal to principal plus accrued interest. Subsequently, the credit facilities were cancelled and the bonds were sold directly to U.S. Bank and are no longer remarketed on the open market.

The Financing Authority is required to pay a fixed fee, or spread, ranging from 0.43% to 0.53% (as noted above) based on the terms of the applicable governing document. Per the terms of the applicable governing document, the spread is subject to increase in the event that the long-term unenhanced ratings of the Financing Authority's lease revenue bonds are downgraded. The applicable interest rate index plus the fixed fee comprise the combined interest rate that is applied to outstanding principal and billed to the Financing Authority monthly. As of June 30, 2018, the private placements of each series expire as set forth in the table above.

In June 2018, the extension date of the private placements of the Series 2008C/D bonds was successfully extended to December 3, 2018, in anticipation of the sale of the underlying leased asset, the Dolce Hayes Mansion. In connection with the extensions of the private placements for the Series 2008C/D bonds, minor amendments were made to the transaction documents to clarify some terms and to reflect amended pricing. The fixed fee component of the interest associated with the outstanding bonds increased from 39 basis points ("bps") (or 0.39%) to 43 bps (or 0.43%) for the tax-exempt 2008C Bonds. The spread for the taxable 2008D bonds remains at 47 bps. The variable interest rate on the bonds will continue to be determined by the SIFMA index for the Series 2008C bonds and 1-month LIBOR index rate for the Series 2008D. The City Council approved the sale of Dolce Hayes Manson in June 18 and the City signed a Purchase and Sale Agreement (PSA) with JMA Ventures, LLC, for its sale on August 7, 2018. On November 6, 2018, the City Council authorized staff to negotiate certain amendments to the terms of the PSA. The parties intend to complete the transfer at closing that is scheduled to occur in January 2019. The Purchaser shall have the right to extend the date of closing for a period up to 60 days until February 28, 2019 in the event they are unable to obtain the ABC License and collective bargaining agreement. Because the tentative closing date for the Dolce Hayes Mansion exceeds the extension date of December 3, 2018 for the private placement of the Series 2008C/D bonds, the City has requested U.S. Bank to extend the December 3, 2018 initial purchase date for 179 days. As part of that June 2018 extension, the City Council and Financing Authority Board also approved the ability to enter into subsequent 179 day extensions and allow minor changes to the terms of the existing agreements. The sale proceeds of the Dolce Hayes Mansion will redeem the Series 2008C/D bonds in full.

Pursuant to the respective continuing covenant agreement, the Series 2008C/D/E Bonds will be subject to mandatory tender upon expiration of the respective agreement, at which time the Financing Authority has the obligation to purchase the bonds unless the City negotiates an extension with the applicable bank or remarkets the bonds with a different purchaser or credit facility provider. If the City fails to remarket the bonds, and assuming no events of default have occurred, the unremarketed bonds will function similar to a term loan, and will be amortized over a three-year period and will bear interest per a formula with a minimum rate of 8% per annum for the Series 2008C/D/E Bonds. Lease payments may not exceed the fair market rental value of the leased properties under State law, so the principal may be amortized over multiple years in such case.

For the Series 2008C/D/E Bonds, the continuing covenant agreements applicable to the Bonds specify that the City would be obligated to make lease payments during an amortization period to repay U.S. Bank to the extent of the fair rental value of the applicable leased property and, to the extent the amount due remains unpaid, it shall continue the obligation of the City, pursuant to the applicable lease, to be paid on or before the expiration of the three-year amortization period. Additionally, each of the continuing covenant agreements specifies other terms in order to promote prompt repayment to the applicable bank.

In April 2018, the City sold the 19 acres of the Airport West (FMC) property for $37.5 million following the purchaser's exercise of its option to purchase. The purchaser had previously purchased 40.8 of acres of the Airport West property. The Airport West property was initially purchased in two phases starting in 2005, with a combination of proceeds from lease revenue bonds issued by the Financing Authority and HUD Section 108 loan as part of a 75-acre acquisition to facilitate airport expansion and economic development projects. During the financial crisis of 2008, the Authority refunded the 2005 Bonds with the Series 2008F Lease Revenue Bonds (the "2008F Bonds"). The sale proceeds were applied to redeem the outstanding balance of the Financing Authority's 2008F Bonds ($37 million) and outstanding balance of the HUD Section 108 Loan ($0.5 million).

8. Summary of Changes in Long-term Obligations

Governmental Activities - The changes in long-term obligations for the year ended June 30, 2018 are as follows (dollars in thousands):

	July 1, 2017	*(a)* Prior Period Adjustment	Restated Beginning Balance July 1, 2017	Additional Obligations, Interest Accretion and Net Increases	Current Maturities, Retirements, and Net Decreases	June 30, 2018	Amounts Due Within One Year
Governmental Activities:							
Long-term debt payable:							
General Obligation bonds	$ 362,430	$ -	$ 362,430	$ -	$ (19,660)	$ 342,770	$ 19,660
Issuance premiums/discounts:							
For issuance premiums	5,039	-	5,039	-	(279)	4,760	149
HUD Section 108 loan	717	-	717	-	(717)	-	-
San Jose Financing Authority							
Lease revenue bonds	522,710	-	522,710	-	(53,825)	468,885	19,775
Issuance premiums/discounts:							
For issuance premiums	38,954	-	38,954	-	(1,781)	37,173	1,780
For issuance discounts	(562)	-	(562)	-	23	(539)	(23)
Lease revenue bonds with reimbursement agreement (Convention Center)	78,680	-	78,680	-	(78,680)	-	-
Revenue bonds with pledge agreement (Fourth Street and San Fernando Garage)	26,005	-	26,005	-	(26,005)	-	-
Special assessment and special tax bonds with limited governmental commitment	136,070	-	136,070	-	(5,305)	130,765	5,580
Issuance premiums/discounts:							
For issuance discounts	(1,603)	-	(1,603)	-	66	(1,537)	(66)
Total long-term debt payable	1,168,440	-	1,168,440	-	(186,163)	982,277	46,855
Other Long-term obligations:							
Hayes Mansion construction loan	1,200	-	1,200	-	-	1,200	-
Lease-purchase agreements	16,663	-	16,663	-	(1,352)	15,311	1,420
NMTC Financing Obligation	18,832	-	18,832	-	(438)	18,394	449
Accrued vacation, sick leave and compensatory time	77,654	-	77,654	51,403	(52,529)	76,528	42,632
Accrued landfill postclosure costs	5,115	-	5,115	-	(465)	4,650	465
Estimated liability for self-insurance	144,777	-	144,777	15,325	(24,776)	135,326	21,136
Net other postemployment benefits (OPEB) obligation	436,180	(436,180)	-	-	-	-	-
Pollution remediation obligation	348	-	348	-	(69)	279	-
Total other long-term obligations	700,769	(436,180)	264,589	66,728	(79,629)	251,688	66,102
Governmental activities long-term obligations	$ 1,869,209	$ (436,180)	$ 1,433,029	$ 66,728	$ (265,792)	$ 1,233,965	$ 112,957

(a) Removed out from the list due to the implementation of GASB Statement No.75. It is now shown as a separate line item on the Statement of Net Position

General Obligation Bonds are issued pursuant to a two-thirds majority voter authorization. In 2000 and 2002, San José voters approved three ballot measures (Measures O and P in 2000 and Measure O in 2002) that authorized the total issuance of $598,820,000 of general obligation ("GO") bonds for library, parks and public safety projects. GO bonds are secured by a pledge of the City to levy ad valorem property taxes without limitation of rate or amount. The ad valorem property tax levy is calculated for each fiscal year to generate sufficient revenue to pay 100% of annual debt service net of other available funding sources. As of June 30, 2018, the City of San José had issued $589,590,000 of GO bonds with proceeds split for three purposes: library projects ($205,885,000), parks and recreation projects ($228,030,000), and public safety projects ($155,675,000). Total principal and interest remaining on the bonds as of June 30, 2018 is approximately $490,744,000, with the final payment due on September 1, 2039.

The City did not issue any GO bonds in FY 2018. A total of $9,230,000 of the authorization remains un-issued for the library ($5,905,000) and public safety programs ($3,325,000). The proceeds of those bonds would be used to fund a portion of the library and public safety projects approved by voters in November 2000 and March 2002. The timing, size, and purpose of the issuance of this final series will depend upon the expenditure and encumbrance needs of the various projects to be financed.

Lease Revenue/Revenue Bonds are issued by the Financing Authority primarily to finance various capital improvements, which are leased to the City and are secured by lease revenue from "lessee" departments in the General Fund and Nonmajor Governmental Funds. The lease revenue for each fiscal year is generally equal to 100% of annual debt service net of other available funding sources. Total principal and interest remaining on these bonds as of June 30, 2018 are approximately $734,045,000, with the final payment due on May 1, 2042.

In December 2017, SARA issued $1.67 billion in Tax Allocation Refunding Bonds, consisting one taxable series (Series 2017A-T) and two tax-exempt series (Series 2017A and 2017B). The Series 2017 A-T, refunded two series of the bonds issued by the Financing Authority that were obligations of the Successor Agency: the Financing Authority's Revenue Bonds, Series 2001A (4th & San Fernando Parking Facility Project) (the "2001A Bonds") and the Financing Authority's Lease Revenue Bonds, Series 2001F (Convention Center Refunding Project) (the "2001F Bonds").

Special Assessment and Special Tax Bonds are issued by the City to finance public improvements in special assessment or tax districts established by the City and are secured by assessments or special taxes levied on properties located within the special districts. The assessments and special taxes, as applicable, are calculated for each fiscal year to generate sufficient revenue to pay 100% of annual debt service net of other available funding sources. Total principal and interest remaining on the bonds as of June 30, 2018 is approximately $237,230,000, with the final payment due on May 1, 2042.

Lease-Purchase Agreement (Energy Conservation Equipment) On May 20, 2014, the City Council authorized the execution of a master equipment lease-purchase agreement (the "Agreement") with Banc of America Public Capital Corp ("Bank") under which the City could enter into separate schedules for the acquisition, purchase, financing, and leasing of energy conservation equipment to be installed at City-owned facilities in a principal amount not to exceed $30,000,000 with the Bank or one of its affiliates, collectively the "Lessor". The schedules are referred to as "Leases". The financing was secured as a result of the Energy Services Agreement that the City entered into with Chevron Energy Solutions to design the projects and procure the equipment to be acquired and installed. In August 2014, Chevron Energy Solutions was acquired by Oaktree Capital Management, and the organization began operation as OpTerra Energy Services (OpTerra) on September 1, 2014. A Consent to Assignment agreement among the City, Chevron, and OpTerra was executed to allow the assignment of the Energy Services Agreement from Chevron to OpTerra.

The City entered into a $19,300,000 taxable Lease with the Lessor on May 29, 2014 to finance the acquisition and installation of energy conservation equipment at City-owned facilities including community centers, pools, joint community centers/libraries, the South Service Yard, the Museum of Art, and, most significantly, for the replacement of streetlights. Due to unanticipated cost increases of the streetlight replacement project, most of the Lease proceeds were expended on the streetlight replacement project that was accepted by the City in June 2017. The unexpended Lease proceeds in the approximate amount of $2,852,000 that remained at the completion of the streetlight replacement project were used to pay debt service on the Lease through calendar year 2018.

The other projects anticipated to be funded under the Lease will be financed through the Finance Authority's Lease Revenue Commercial Paper Program described in Note III.F.10. The total blended interest rate for the 20-year taxable Lease is 5.01%, and interest rates ranged from 3.21% for improvements with 5-year useful lives to 6.01% for improvements with 20-year useful lives. Total principal and interest outstanding on the Lease as of June 30, 2018 is approximately $19,419,000, with the final payment due on June 1, 2034.

The future lease payments anticipate to be paid under the lease agreement, as of June 30, 2018, are as follows (in thousands):

Fiscal Year Ending June 30,	Principal	Interest
2019	$ 1,420	$ 750
2020	1,460	678
2021	1,500	605
2022	1,576	529
2023	1,656	449
2024 - 2028	6,792	963
2029 - 2033	767	130
2034 - 2038	140	5
Total	$ 15,311	$ 4,109

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

Business-Type Activities - The changes in long-term obligations for the year ended June 30, 2017 are as follows (dollars in thousands):

	July 1, 2017	*(a)* Prior Period Adjustment	Restated Beginning Balance July 1, 2017	Additional Obligations and Net Increases	Current Maturities, Retirements, and Net Decreases	June 30, 2018	Amounts Due Within One Year
Business-Type Activities:							
Norman Y. Mineta San Jose International Airport:							
Revenue bonds	$1,229,545		$1,229,545		$ (41,900)	$1,187,645	$ 28,915
Issuance premiums/discounts:							
For issuance premiums	87,350		87,350		(7,803)	79,547	3,818
For issuance discounts	(6,563)		(6,563)	-	1,280	(5,283)	(233)
Clean Water Financing Authority:							
Revenue bonds	20,695		20,695	-	(5,145)	15,550	4,965
Issuance premiums/discounts:							
For issuance premiums	421		421	-	(125)	296	125
Regional Wastewater Facility:							
State of California - Revolving Fund Loan	6,125		6,125	-	(4,353)	1,772	1,772
Notes payable	-		-	18,490	-	18,490	-
Accrued vacation, sick leave and compensatory time	7,237		7,237	5,231	(5,353)	7,115	5,914
Estimated liability for self-insurance	6,992		6,992	1,102	(1,032)	7,062	1,245
Net other postemployment benefits (OPEB) obligation	42,284	(42,284)	-	-	-	-	-
Business-type long-term obligations	$1,394,086	$ (42,284)	$1,351,802	$ 24,823	$ (64,431)	$1,312,194	$ 46,521

(a) Removed out from the list due to the implementation of GASB Statement No.75. It is now shown as a separate line item on the Statement of Net Position

Airport Revenue Bonds are issued primarily to finance the construction of capital improvements at the Norman Y. Mineta San José International Airport. Pursuant to the Airport's Master Trust Agreement, the City has irrevocably pledged the general airport revenues and certain other funds held or made available under the Airport's Master Trust Agreement, first to the payment of maintenance and operation costs of the Airport, and second to the payment of principal and premium, if any, and interest on the bonds. General airport revenues generally include all revenues, income, receipts, and monies derived by the City from the operation of the Airport with the exception of certain expressly excluded revenues.

The net revenues available to pay debt service (as defined in the Master Trust Agreement) for the year ended June 30, 2018 totaled $166,435,000, which is composed of $88,278,000 of net general airport revenues and $78,157,000 of other available funds. Other available funds included surplus carryover of $34,043,000, rolling debt service coverage of $18,339,000, Customer Facility Charges ("CFC") revenues of $18,364,000, and $7,411,000 released from the 2007 Reserve Account upon the repayment of the final maturity of the Series 2007 Bonds on March 1, 2018. The bond debt service paid from the general airport revenues and other available funds amounted to $78,974,000, which is net of $24,792,000 of bond debt service paid from the accumulated passenger facility charges ("PFC") funds.

The City has covenanted in the Master Trust Agreement that net revenues available to pay debt service for each fiscal year plus certain other available funds held or made available under the Master Trust Agreement will be at least 125% of annual debt service for such fiscal year. Under the Master Trust Agreement, "debt service" means for any specified period the sum of (a) the interest falling due on any then outstanding current interest bonds, assuming that all principal installments are paid when due, but excluding any interest funded from the proceeds of any series of bonds and applied toward payment of interest on such bonds, and (b) the principal installments payable on any then outstanding bonds. Under the Master Trust Agreement, annual debt service excludes Available PFC Revenues for such fiscal year. Total principal and interest remaining on the bonds is $2,227,585,000, with the final payment due on March 1, 2047.

As of June 30, 2018, the Required Reserve in the General Account of the Bond Reserve Fund secures the Series 2011A-1, 2011A-2, 2014A, 2014B, 2014C, 2017A, and 2017B Bonds. No additional deposit into the General Account of the Bond Reserve Fund was required upon expiration on March 1, 2018 of the surety bond issued by Ambac Indemnity Corporation (currently known as Ambac Assurance Corporation, the principal operating subsidiary of Ambac Financial Group Inc., "Ambac") in the approximate amount of $4,300,000. A separate reserve account in the Bond Reserve Fund secures the Series 2011B Bonds.

San José-Santa Clara Clean Water Financing Authority Sewer Revenue Bonds are issued primarily to finance the construction of capital improvements at the Plant and the City has pledged its net system revenues as security for its obligations under the Improvement Agreement to make base payments and additional payments with respect to the Clean Water Financing Authority sewer revenue bonds. The net system revenues available to pay debt service in the year ended June 30, 2018 totaled approximately $60,432,000. Bond debt service, plus debt service on the State Revolving Fund Loans (subordinate to the outstanding Clean Water Financing Authority sewer revenue bonds), payable from net system revenues in the fiscal year totaled approximately $10,344,000. The City has covenanted in the Improvement Agreement that net system revenues will be at least 115% of its allocable percentage of annual debt service on the outstanding parity obligations under the Improvement Agreement. The City's allocable percentage of annual debt service is currently 100%. Total principal and interest remaining on (1) the bonds as of June 30, 2018 is approximately $16,577,000, with the final payment due on November 15, 2020 and (2) the loans as of June 30, 2018 is approximately $1,804,000 with the final payment due on May 1, 2019.

9. Annual Requirements to Maturity

The annual requirements to amortize all bonds and loans outstanding as of June 30, 2018 are as follows (dollars in thousands):

	Governmental Activities					
	City of San Jose General Obligation Bonds		City of San Jose Financing Authority Bonds [1,2,3]		Special Assessment & Tax Bonds with Limited Governmental Commitment	
Fiscal Year Ending June 30,	Principal	Interest	Principal	Interest	Principal	Interest
2019	$ 19,660	$ 16,078	$ 19,775	$ 21,698	$ 5,580	$ 7,918
2020	19,660	15,175	19,565	20,898	5,885	7,613
2021	19,660	14,260	20,595	20,076	6,205	7,287
2022	19,660	13,333	21,505	19,325	6,550	6,936
2023	19,660	12,400	21,915	18,413	6,915	6,568
2024 - 2028	98,285	47,769	103,280	78,497	21,380	28,552
2029 - 2033	95,880	23,754	102,665	55,414	23,600	22,347
2034 - 2038	48,605	5,149	124,645	28,319	26,525	14,530
2039 - 2043	1,700	56	34,940	2,520	28,125	4,714
Total	$ 342,770	$ 147,974	$ 468,885	$ 265,160	$ 130,765	$ 106,465

	Governmental Activities		Business-Type Activities					
	Lease-Purchase Agreement		Airport Revenue Bonds [3]		Wastewater Treatment System Revenue Bonds and Loans		San José-Santa Clara Regional Wastewater Facility	
Fiscal Year Ending June 30,	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2019	$ 1,420	$ 750	$ 28,915	$ 63,586	$ 4,965	$ 559	$ 1,772	$ 32
2020	1,460	678	31,040	62,218	5,175	352	-	-
2021	1,500	605	33,205	60,702	5,410	116	-	-
2022	1,576	529	34,975	59,035	-	-	-	-
2023	1,656	449	24,630	57,296	-	-	-	-
2024 - 2028	6,792	963	143,635	265,848	-	-	-	-
2029 - 2033	767	130	227,505	219,476	-	-	-	-
2034 - 2038	140	5	241,655	150,670	-	-	-	-
2039 - 2043	-	-	249,600	79,023	-	-	-	-
2044 - 2048	-	-	172,485	22,086	-	-	-	-
Total	$ 15,311	$ 4,108	$ 1,187,645	$ 1,039,940	$ 15,550	$ 1,027	$ 1,772	$ 32

[1] Projected interest payments for variable rate debt are based on the following rates in effect on June 30, 2018:
- Financing Authority Lease Revenue Bonds: Series 2008C (1.940%), Series 2008D (2.453%) and Series 2008E (2.513%)

[2] Includes fixed spread/fee in addition to index rate in effect on June 30, 2018. Does not include projection of future spreads/fees or expenses.

[3] Does not include commercial paper notes.

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

10. New Debt Issuances and Short-Term Debt Activities

Governmental Activities

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

The City's Commercial Paper ("CP") Program utilizes a lease revenue financing structure. Under this program, the Financing Authority is able to issue commercial paper notes ("CP Notes") at prevailing interest rates for periods of maturity not to exceed 270 days. The CP Notes are secured by a pledge of lease revenues from various City assets and supported by two direct-pay letters of credit ("LOCs") provided by State Street Bank and Trust Company ("State Street") and U.S. Bank National Association ("U.S. Bank") (together, the "Banks") pursuant to Letter of Credit and Reimbursement Agreements by and among the Financing Authority, the City, and each Bank, as amended ("together, the Reimbursement Agreements"). Per the terms of the respective Reimbursement Agreements, each Bank's LOC was scheduled to expire on November 30, 2018 (the "Letter of Credit Expiration Date"). See Note IV.D.5 for discussion of the extension of the expiration date of each Bank's LOC and the increase to the stated amount of each Bank's LOC that occurred in August 2018.

This program was initially established on January 13, 2004, whereby the City Council and the Financing Authority each adopted a resolution authorizing the issuance of the Financing Authority tax-exempt lease revenue commercial paper notes in an amount not to exceed $98,000,000. Since 2004, the City Council and the Financing Authority have taken actions to modify the program, including increasing the program's capacity and authorizing the issuance of taxable lease revenue commercial paper notes. As of June 30, 2018, the maxium principal amount of commercial paper notes authorized to be issued is $85 million.

The Financing Authority issues the CP Notes under State law pursuant to an Amended and Restated Trust Agreement, as amended and supplemented between the Financing Authority and Wells Fargo Bank, National Association (as amended and supplemented, the "Trust Agreement") and an Amended and Restated Issuing and Paying Agent Agreement between the Financing Authority and Wells Fargo Bank, National Association. Barclays Capital Inc. currently serves as the dealer for the CP Notes pursuant to an Amended and Restated Commercial Paper Dealer Agreement. The City has leased to the Financing Authority various City-owned facilities pursuant to a Site Lease, as amended (the "Site Lease"). The Financing Authority subleased these same facilities back to the City pursuant to a Sublease, as amended (the "Sublease") in exchange for the rental payments, which support repayment of the CP Notes. The facilities subject to the Site and Sublease (pursuant to the Sixth Amendments to the Site Lease and to the Sublease, both dated as of September 1, 2018, are: the Animal Care Center, Fire Station No. 1, Fire Station No. 3, the Police Communications Center, the South San José Police Substation, and the Tech Museum (the "Pledged Properties").

The annual commitment fee payable to each Bank equals 0.42% per annum of the daily average Stated Amount of the Letter of Credit; provided, however, that in the event that the long-term unenhanced lease revenue debt ratings of the City are downgraded as specified in the agreements with the Banks, the annual commitment fee shall increase from a range of 0.52% to a maximum of 2.37%, depending on the level of rating downgrade.

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

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

As of June 30, 2018, $7,190,000 of tax-exempt commercial paper notes was outstanding at an interest rate of 1.50% and $32,460,000 of taxable commercial paper notes was outstanding at an interest rate of 2.38%. The changes in commercial paper notes during the fiscal year ended June 30, 2018 are as follows (dollars in thousands):

July 1, 2017	Additions	Deletions	June 30, 2018
$22,302	$27,538	$10,190	$39,650

2017 Tax and Revenue Anticipation Note

The City issued a short-term note (the "2017 Note") to facilitate the prefunding of employer retirement contributions in FY 2018. The $150,000,000 note was purchased by Bank of America, N.A. on July 3, 2017 at a variable interest rate. Security for repayment of the 2017 Note was a pledge of the City's 2017-2018 secured property tax plus all other legally available General Fund revenues available to the City, if required. The City fully repaid the 2017 Note on May 14, 2018.

Business-Type Activities

Airport Commercial Paper Notes Payable

In November 1999, the City authorized the issuance from time to time of Subordinated Commercial Paper Notes (the Subordinated Commercial Paper Notes) that are secured by a lien on Surplus Revenues (which are General Airport Revenues remaining after the payment of maintenance and operation costs of the Airport and the payment of debt service on the Airport Revenue Bonds and the funding of any reserve funds established for the Airport Revenue Bonds). In 2008, the City authorized the Subordinated Commercial Paper Notes to be issued in an aggregate principal amount of up to $600,000,000 outstanding at any one time. The Subordinated Commercial Paper Notes may be issued at prevailing interest rates for periods of maturity not to exceed 270 days.

In February 2014, the City entered into a letter of credit ("LOC") and reimbursement agreement (the Reimbursement Agreement) with Barclays Bank PLC ("Barclays"). Pursuant to the Reimbursement Agreement, Barclays issued a $65,000,000 LOC supporting the Subordinated Commercial Paper Notes, effective on February 11, 2014. On September 16, 2015, the City reduced the LOC stated amount from $65,000,000 to approximately $41,000,000. The LOC provided by Barclays was extended to February 8, 2019, and can be extended or terminated earlier pursuant to its terms. See Note IV.D.7 for discussion of the termination and substitution of the LOC issued by Barclays in September 2018.

The terms of the Barclays LOC are specified in the Reimbursement Agreement. In general, Barclays agrees to advance funds to the issuing and paying agent for the Subordinated Commercial Paper Notes to pay the principal and interest on maturing Subordinated Commercial Paper Notes in an amount not to exceed the stated amount of the LOC. In the event that the commercial paper dealer is unable to find investors to purchase Subordinated Commercial Paper Notes to repay the advance from Barclays, the City is obligated to pay interest to Barclays based on a formula specified in the Reimbursement Agreement and repay principal in accordance with the schedule and the terms also specified in the Reimbursement Agreement.

An event of default under the Reimbursement Agreement would entitle Barclays to demand that no additional Subordinated Commercial Paper Notes be issued, that the City reimburse Barclays immediately for draws under the LOC and that all other amounts owed by the City to Barclays be accelerated and become due immediately. Events of default under the Reimbursement Agreement include, among others: a default under the Master Trust Agreement or the issuing and paying agent agreement for the Subordinated Commercial Paper Notes; non-payment; a breach of a covenant; bankruptcy; and ratings events including a suspension or withdrawal of the long-term, unenhanced debt rating assigned to the Airport Revenue Bonds (other than where the Airport Revenue Bonds shall continue to be rated by any two of Moody's, Fitch, or S&P), or downgrades by any of Moody's, Fitch or S&P of its ratings on the Airport Revenue Bonds below "Baa2," "BBB" and "BBB," respectively for a period of 120 consecutive calendar days. All amounts payable by the City to Barclays under the Reimbursement Agreement are secured by a lien on the Surplus Revenues held in the Subordinated Debt Account of the Surplus Revenue Fund, including the earnings on such Surplus Revenues, which lien is subordinate to the lien of the Airport Revenue Bonds.

In connection with the LOC issued by Barclays, the City entered into a separate fee letter to specify the facility fee rate and other charges payable by the Airport. The facility fee rate under the fee letter was established based on the underlying credit rating of the Airport Revenue Bonds and is applied to the stated amount of the LOC. The facility fee rate is subject to increase in the event that the underlying credit rating of the Airport Revenue Bonds is withdrawn, suspended, or downgraded or upon an event of default under the Reimbursement Agreement. The facility fee rate in effect is 0.425% as of June 30, 2018.

The change in Airport commercial paper notes payable during fiscal year 2018 was as follows (dollars in thousands):

July 1, 2017	Deletions	June 30, 2018	Interest Rate
$25,461	$17,952	$7,509	1.40%

City of San José Financing Authority Subordinate Wastewater Revenue Notes

On October 19, 2017, pursuant to a Credit Agreement dated as of October 1, 2017 ("Credit Agreement") by and among the City, the Financing Authority, and Wells Fargo Bank, National Association (the "Bank"), the Financing Authority issued to the Bank (i) a subordinate tax-exempt wastewater revenue note in an amount not to exceed $300 million and (ii) a subordinate taxable wastewater revenue note in an amount not to exceed $300 million outstanding at any one time. The Credit Agreement effectively established an interim financing program under a three-year contract that enables the issuance of subordinate wastewater revenue notes that can be outstanding at any one time in an amount not to exceed $300 million to finance capital improvements at the RWF. Advances on the notes will be made on a regular basis to reimburse the City for capital costs incurred at the RWF. Upon issuance of the notes, $174,500 was advanced under the tax-exempt note to pay for transactional closing costs. Additional periodic advances were made during FY 2018 in the amount of $18,316,000. The balances of the notes payable will be repaid or refinanced during fiscal year 2020.

The source of repayment of the notes, including associated fee and interest costs, are installment payments made to the Financing Authority from pledged net system revenues received by the City related to the wastewater treatment system, pursuant to a Subordinate Installment Purchase Contract, dated as of October 1, 2017, by and between the City and the Financing Authority, and City Resolution No. 78382, which provides for the allocation and pledge of net system revenues to secure the payment of wastewater revenue obligations. Payments on the notes are subordinate to payments on previously issued, currently outstanding obligations payable from net system revenues (the San José- Santa Clara Clean Water Financing Authority, Sewer Revenue Refunding Bonds, Series 2009A (the "CWFA 2009A Bonds") and the State Revolving Fund loan) and will be subordinate to payments on long-term bonds issued in the future. Based on the current ratings of the CWFA 2009A Bonds, the current fee rate for undrawn amounts under the notes is 0.25%. In June 2018, the City Council and the Financing Authority Board authorized amendments to the Credit Agreement, specifically the margin rate factor, as result of reduction in the federal corporate tax rate from 35% to 21% enacted by The Tax Cuts and Jobs Act in December, 2017. The Financing Authority Board also authorized the amendment and restatement of the fee letter agreement between the Financing Authority and the Bank. The margin rate factor is a common provision in bank credit facility agreements where tax-exempt notes are in direct placement or ownership by a bank. The margin rate factor serves to adjust the rate of a tax-exempt note upon changes in the federal corporate tax rate, thereby preserving the economic benefit of the bank owning a tax-exempt note. The Credit Agreement had a margin rate factor based on the 35% federal corporate tax, which left unchanged would increase interest costs to the City by 22%. The amendment to the Credit Agreement authorized in June 2018 changed the formula for calculating the interest rate on amounts advanced under the tax-exempt note from (i) 0.35% plus 70% of 1-month LIBOR to (i) 0.39% plus 80% of 1-month LIBOR, effectively reducing the increase in interest cost from 22% to 14%. The provisions in the Credit Agreement related to the calculation of interest on amounts advanced under the taxable note were not changed by amendment to the Credit Agreement (0.45% plus 100% of 1-month LIBOR) since the margin rate factor only applies to the tax-exempt note. The fee rate for undrawn amounts under the notes remains at 0.25%.

11. Landfill Postclosure Costs

The City has five closed landfills for which postclosure and monitoring services may be required for approximately a 30 year period, which began in fiscal year 1996, coinciding with the closure of the last landfill. An estimated liability of $4,650,000 related to the closed landfills is recorded in the government-wide Statement of Net Position as of June 30, 2018. The City's Environmental Compliance staff performs an annual evaluation of the aforementioned liability. Actual costs may be higher due to inflation, changes in technology, or changes in regulations. The City does not own or operate any open landfills at this time.

12. Estimated Liability for Self-Insurance

The City is exposed to various risks of losses related to torts, errors and omissions, general liability, injuries to employees, unemployment claims, and employee health and dental insurance. During fiscal year 2017-2018, the City maintained an all-risk property policy including boiler and machinery exposures, coverage for loss due to business interruption and flood. The City did not carry earthquake insurance as it was not available at reasonable rates. A summary of insurable coverage for the policy period October 1, 2017 to October 1, 2018 is provided below:

Coverages	Limit per Occurence	Deductible Per Occurrence
Property, including Business Interruption	$1 billion	$100,000
Flood Zone, Special Flood Hazard Area as defined by the Federal Emergency Management Agency (FEMA)	$25 million per occurrence and annual aggregate	5% of values at risk ($1 million minimum deductible)
Flood, Other Locations	$100 million per occurrence and annual aggregate	$100,000

For the policy period of October 1, 2017 to October 1, 2018, the City maintained an Airport Liability policy covering the Airport including Control Tower Operators, which provides a $200,000,000 combined single limit for bodily injury and property damage subject to a deductible of $0 each occurrence and annual aggregate, with a sublimit of $50,000,000 each occurrence and in the annual aggregate for personal injury, and a limit of $200,000,000 each occurrence and in the annual aggregate as respects to war liability.

In addition, the Airport Liability policy also provides excess liability coverage with a limit of $50,000,000 in excess of the underlying limit of $1,000,000, which is provided by a separate automobile policy issued to provide coverage for the off-premise operations of scheduled Airport vehicles including shuttle bus fleets with a limit of $1,000,000 per occurrence, combined single limit for bodily injury and property damage, and no deductible. Physical damage coverage was available for the Airport Shuttle Bus Fleet and is subject to a $10,000 comprehensive and $25,000 collision deductible. As part of general support services, the City charges the Airport for the cost of liability and property insurance coverage. Settled claims have not exceeded the City's commercial insurance coverage in any of the past 3 years.

For the policy period of October 1, 2017 to October 1, 2018, the City purchased government fidelity/crime coverage for City losses arising from employee bad acts. Coverage is for financial or property losses and provides a $5,000,000 per occurrence limit for losses resulting from employee theft, forgery or alteration and inside the premises- theft of money and securities, and provides for a $1,000,000 per occurrence limit for computer fraud, funds transfer fraud, money orders, and counterfeit money. All claims have a $100,000 deductible per occurrence.

Claims liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. The result of the process to estimate the claims liability is not an exact amount as it depends on many complex factors, such as inflation, changes in legal doctrines, newly discovered information and damage awards. Accordingly, claims are reevaluated periodically to consider the effects of inflation, recent claims settlement trends (including frequency and amount of pay-outs), economic and social factors, newly discovered information and changes in the law. The estimate of the claims liability also includes increases or decreases to previously reported unsettled claims. The workers' compensation estimate includes allocated loss adjustment expenses, which represent the direct cost associated with the defense of individual claims, which may be years into the future and have been discounted to their present value using a rate of 3.1% for the amounts recorded.

With respect to the general liability accrual, the City has numerous unsettled lawsuits filed or claims asserted against it as of June 30, 2018. The City Attorney and, with respect to workers' compensation claims, the City's Department of Human Resources have reviewed these claims and lawsuits in order to evaluate the likelihood of an unfavorable outcome to the City and to arrive at an estimate of the amount or range of potential loss to the City. The City has included a provision for losses in its claims liability for loss contingencies that are both probable and can be reasonably estimated.

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

Liability as of June 30, 2016	$	149,434
Claims and changes in estimates during 2017		23,899
Claims payments		(21,564)
Liability as of June 30, 2017		151,769
Claims and changes in estimates during 2018		16,427
Claims payments and other adjustments		(25,808)
Liability as of June 30, 2018	$	142,388

Owner Controlled Insurance Programs - On March 31, 2004, the City bound certain liability insurance coverage for the major components of the Airport's North Concourse Project through an owner-controlled insurance program ("OCIP") with Chartis, formerly American International Group ("AIG"), AIU Holdings, Inc. and AIU LLC ("AIU"). The OCIP is a single insurance program that provides commercial general liability, excess liability and worker's compensation insurance coverage for construction jobsite risks of the project owner, general contractors and all subcontractors associated with construction at the designated project site.

The City was also required to establish a claims loss reserve for the North Concourse Project in the aggregate amount of $3,900,000 available in a cash working fund. The full amount of the claims loss reserve had been deposited with the insurance carrier and was recorded as advances and deposits in the accompanying Airport enterprise fund statements of net position. The claims loss reserve funds are available to Chartis to pay claims within the City's deductible of up to $250,000 per occurrence to an aggregate maximum loss exposure within coverage limits to the City of $3,900,000. The City was able to negotiate the return of a large portion of the unused claims reserve in advance of the 10-year coverage term. Since March 2010, Chartis has returned $2,627,000 to the Airport. The balance of the North Concourse reserve fund as of June 30, 2018 is $835,000.

The North Concourse Project has been completed and the policies expired December 31, 2008. Closeout procedures on the North Concourse Project are in process. Chartis will continue to hold the remaining funds in the claims loss reserve fund until such time as the exposure to risk of claims ceases or the City opts to cash out the remaining funds in exchange for accepting responsibility for potential future claims.

On March 15, 2007, the City obtained additional liability insurance through Chartis for major components of the Airport's Terminal Airport Improvement Program ("TAIP") through another OCIP (the TAIP OCIP). The coverage for this program is as follows:

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

The liability under the TAIP OCIP is based upon an estimated payroll of $92,500,000 for the covered projects and a construction period of 45 months, commencing on March 15, 2007 through December 31, 2010. The terms of the TAIP OCIP require the City to fund a claims loss reserve fund with Chartis in the amount of $8,900,000. The claims loss reserve fund is available to Chartis to pay claims within the City's deductible subject to an aggregate maximum loss exposure within coverage limits to the City of $8,900,000. The City was able to negotiate to fund 74% of the claims loss reserve and interest generated remains in the fund. The full amount of $6,500,000 was deposited with Chartis in fiscal year 2009 and was recorded as advances and deposits in the accompanying Airport enterprise fund statement of net position. Since August 2013, as part of the annual loss reserve analysis by Chartis, a total amount of $1,636,000 has been returned to the Airport. The balance of the TAIP reserve fund as of June 30, 2018 is $1,981,000.

The TAIP Project has been completed and the policies expired on June 30, 2011. Chartis will continue to hold the remaining funds in the claims loss reserve until such time as the exposure to risk of claims ceases or the City opts to cash out the remaining funds in exchange for accepting responsibility for potential future claims.

On June 30, 2017, the City bound certain liability insurance coverage for the major components of the San José-Santa Clara Regional Wastewater Facility Capital Improvement Program through an owner-controlled insurance program ("RWF OCIP") with the primary carrier Old Republic General

Insurance Corporation ("Old Republic"). The RWF OCIP is a single insurance program that the City sponsors and provides commercial general liability, excess liability and worker's compensation insurance coverage for construction jobsite risks of the project owner, general contractors and all subcontractors associated with construction at the designated project site. In addition, the City procured builder's risk, contractor's pollution liability, and owners protective indemnity insurance to cover liabilities associated with the work.

The City was also required to establish and post a cash collateral fund of $2,657,000, to be paid in five annual installments and subject to the Old Republic's quarterly requests to adjust based on expenditure of funds up to the maximum aggregate loss of $4,385,000. The cash collateral fund is available to Old Republic to pay claims within the City's deductible of up to $250,000 per occurrence to an aggregate maximum loss exposure within coverage limits to the City of $4,385,000.

	RWF Capital Improvement Projects	
Coverages	**Limits**	**Deductible Per Occurrence**
General Liability	$2 million per occurrence/ $4 million aggregate	$250,000
Workers' Compensation	Statutory	$250,000
Employers' Liability	$1 million per accident	$250,000
Excess Liability	$100 million	None

The premiums of the RWF OCIP are calculated based on the estimated hard cost of construction valued at $535,000,000 for the covered capital improvement projects to be enrolled and for work to be performed up to March 30, 2023.

13. Pollution Remediation Obligations

The City is currently responsible for the management and cleanup of pollution remediation activities at several City sites including three active leaking petroleum storage tank sites: Fire Station #5, Las Plumas Warehouse, Family Shelter. Although the City has significant experience in estimating these types of cleanups, the calculation of the expected outlays related to this pollution remediation is based on estimates provided by both City engineers and consultants hired by the City. The amount of the estimated pollution remediation liability assumes that there will be no major increases in the cost of providing these cleanup services. As of June 30, 2018, the government-wide statement of net position reported a net pollution remediation obligation in the amount of $279,000 in governmental activities.

14. New Market Tax Credit ("NMTC") Financing Obligation

In connection with the City's NMTC financing transaction to construct the San José Environmental Innovation Center ("EIC"), the City has a long-term lease obligation for its possession and beneficial use of the EIC facility. This master lease agreement commenced on November 8, 2011 has a 35-year term with a one-time renewal option of 10 years. Rental payment made by the City for the use of the EIC facility for the year ended June 30, 2018 was $439,000.

The future minimum lease payments anticipated under the master lease agreement, as of June 30, 2018, are as follows (in thousands):

Fiscal Year Ending June 30,	Amount
2019	$ 449
2020	461
2021	472
2022	484
2023	496
2024 - 2028	2,674
2029 - 2033	3,029
2034 - 2038	3,429
2039 - 2043	3,880
2044 - 2047	3,020
Total	$ 18,394

G. Interfund Transactions

The composition of interfund balances as of June 30, 2018, with explanations of transactions, is as follows (dollars in thousands):

1. Due from/Due to other funds

Receivable Fund	Payable Fund	Amount	
General Fund	Nonmajor Governmental Funds	$ 1,797	(1)
Nonmajor Governmental Funds	Nonmajor Governmental Funds	2,300	(2)
		$ 4,097	

(1) $1,251 represents accrual of gas tax transfers and $546 represents accrual of construction and conveyance tax transfer.

(2) Represents short-term borrowing for working capital.

2. Advances to/Advances from other funds

Receivable Fund	Payable Fund	Amount	
General Fund	San José Financing Authority Debt Service	$ 3,297	(1)
		$ 3,297	

(1) Represents a $3,297 loan to support the Rancho Del Pueblo golf course

3. Long-term Receivables from SARA

On July 24, 2009, the State Legislature passed AB 26X4, which required redevelopment agencies statewide to deposit a total of $2,050,000,000 of property tax increment in county Supplemental Educational Revenue Augmentation Funds ("SERAF") to be distributed to meet the State's Proposition 98 obligations to schools. The Agency's SERAF obligation was $62,248,000 in FY 2010 ("2010 SERAF Obligation") and $12,816,000 in FY 2011 ("2011 SERAF Obligation"). Payments were made by May 10 of each respective fiscal year.

On May 4, 2010, the Agency and the City entered into a loan agreement where the City agreed to loan the Agency through two separate payments (May 2010 and May 2011) a combined amount of $75,063,000 to pay the 2010 SERAF Obligation and the 2011 SERAF Obligation ("SERAF Loan").

The sources of the SERAF Loan to pay the 2010 SERAF Obligation ($62,248,000) were $40 million from the City's Low and Moderate Income Housing Fund that had been made available following the issuance of the 2010 Housing Series C Bonds, which was specifically authorized by the legislation, and idle moneys from City special funds ($10,000,000) and $12,000,000 from the Financing Authority's Commercial Paper Program. The source of the SERAF Loan to pay the 2011 SERAF Obligation was $12,816,000 from the City's Low and Moderate Income Housing Fund. The Low and Moderate Income Housing Fund was subsequently renamed as the Low and Moderate Income Housing Asset Fund.

The Redevelopment Dissolution Law provides that all prior loans made between the City and the Agency, except for loans made from the Low and Moderate Income Housing Asset Fund for payment of SERAF, were invalidated as of February 1, 2012, but may be reinstated once certain conditions related to dissolution are met by the SARA as more particularly discussed below in Note IV.C.4. As such, the $10,000,000 used to pay a portion of the 2010 SERAF Obligation and its related accumulated interest in the amount $160,000 from the City made by funds other than the Low and Moderate Income Housing Asset Fund was invalidated under this provision and was recorded as part of the SARA's extraordinary items in 2012. In addition, interest accrued in excess of the LAIF rates pursuant to the Redevelopment Dissolution Law in the amount of $2,940,000 was also invalidated in 2012.

The remaining source of the SERAF Loan used to pay the 2010 SERAF Obligation ($40 million of 2010 Series C Housing Bonds and $12 million from the Financing Authority's Commercial Paper program, (See Note IV.C.4) were assumed by the SARA and were listed in the ROPS as enforceable obligations. The source of funds used to pay the 2011 SERAF Obligation was determined to be a housing asset and was transferred to the City as the Successor Housing Agency and was also listed on the ROPS as an enforceable obligation.

On February 15, 2013, the DOF determined that a significant portion of the SERAF Loan used to pay a portion of the 2010 SERAF Obligation ($40 million of 2010 Housing Series C Bonds and $12 million from the Financing Authority's Commercial Paper program) should not be reported in the ROPS as an enforceable obligation since the sources of the SERAF Loan were already listed on the ROPS.

On May 26, 2016, the Oversight Board approved a partial reinstatement of the SERAF Loan used to pay the 2010 SERAF Obligation to restore the moneys from the City's special funds in the amount of $10,000,000 and also approved the repayment schedule for the source of funds used to pay the 2011 SERAF Obligation in the amount of $12,816,000 plus accrued interest. The Oversight Board determined that the remaining portion of the SERAF Loan used to pay the 2010 SERAF Obligation in the amount of $52,000,000 plus accrued interest in the amount of $905,000 is not an enforceable obligation and directed the SARA to remove that portion of the loan from its financial statements. These actions were subsequently approved by the Successor Agency Board on June 28, 2016.

On May 17, 2017, the DOF approved the ROPS 17-18, which included the SERAF loans from the City in the principal amount of $22,816,000.

As of June 30, 2018, the remaining portion of the SERAF Loan has an outstanding principal and accumulated accrued interest balance of $22,816,000 and $5,187,000, respectively, and bears a simple interest rate of 3%.

As of June 30, 2018, total long-term receivables from SARA are as follows (dollars in thousands):

Description		
Advances receivable from SARA:		
SERAF Loan	$ 28,003	(1)
Other long-term receivables from SARA:		
Parking Fund Loans	17,925	(2)
Reimbursement advance	1,421	(3)
Total long-term receivables from SARA	$ 47,349	

(1) The amount includes $15,561,000 from Low and Moderate Income Housing Asset Fund and $12,442,000 from the General Fund.
(2) The Parking Fund Loans were reinstated in FY 16-17. See note IV.C.4
(3) The long-term receivables relate to advances to SARA under the Reimbursement Advance are as follows: $1,421,000 for direct and indirect administrative and support costs are subordinated to all SARA enforceable obligations. All other enforceable obligations under the Reimbursement Advance were repaid in FY17-18.

4. Long-term Advances from SARA

The City has a payable and SARA has a receivable related to an Agency advance of a portion of a loan made by the City's Housing Department to a third party for a transitional housing project. The SARA is entitled to 24.5% of the total loan repayment and therefore has a long-term receivable in the amount of $739,000 due from the City as of June 30, 2018.

5. Transfers in/Transfers out

Transfers are indicative of funding for capital projects, lease payments or debt service and subsidies of various City operations. The following schedules summarize the City's transfer activity for the year ended June 30, 2018 with explanations of transactions (dollars in thousands):

Between governmental and business-type activities:

Transfer from	Transfer to	Amount	
Housing Activities	Parking System	$ 31	(1)
Wastewater Treatment System	Nonmajor Governmental Funds	2,468	(2)
Municipal Water System	General Fund	250	(3)
	San José Financing Authority Debt Service	589	(4)
	Nonmajor Governmental Funds	201	(5)
Parking System	General Fund	1,565	(6)
	Nonmajor Governmental Funds	947	(7)
General Fund	Norman Y. Mineta San José International Airport	220	(8)
		$ 6,271	

(1) Transfer for costs associated with availability of public usage facilities in San José downtown.
(2) Transfer for City Hall debt service payments.
(3) Transfer for late fee collections from water utility customers as General Fund revenues.
(4) Transfer for repayment of commercial paper.
(5) Transfer for City Hall debt service payments.
(6) Transfer of $40 for 4th of July Fireworks, $210 for San Jose Downtown Association, and $1,315 for strategic support.
(7) Transfer of $119 for City Hall debt service payments, $78 for the Downtown Property and Business Improvement District, and $750 for costs associated with the Diridon Integrated Station.
(8) Transfer for local sale taxes for jet fuel.

Between governmental activities:

Transfer from	Transfer to	Amount	
General Fund	San José Financing Authority Debt Service	$ 1,245	(1)
	Nonmajor Governmental Funds	30,527	(2)
	Internal Service Funds	2,850	(3)
Housing Activities	Nonmajor Governmental Funds	38	(4)
Low & Moderate Income Housing Asset Fund	Nonmajor Governmental Funds	2,469	(5)
Special Assessment Districts	General Fund	150	(6)
	San José Financing Authority Debt Service	6,137	(7)
San José Financing Authority Debt Service	General Fund	466	(8)
	Special Assessment Districts	15,000	(9)
	Nonmajor Governmental Funds	2,072	(10)
Nonmajor Governmental Funds	General Fund	8,946	(11)
	Low & Moderate Income Housing Asset Fund	1,237	(12)
	Special Assessment Districts	6	(13)
	Nonmajor Governmental Funds	18,246	(14)
	San José Financing Authority Debt Service	37,041	(15)
Internal Service Funds	General Fund	32	(16)
	Nonmajor Governmental Funds	169	(17)
		$ 126,631	

(1) Transfer for debt service payment for the 2008F bond series.
(2) Transfer of $19,839 for City Hall debt service, $10,657 for debt service payments, operations, and subsidies, and $31 for SJ Municipal Stadium.
(3) Transfer to fund vehicle and fleet replacement purchases.
(4) Transfer for production, improvement, or preservation of low- and moderate-income housing.
(5) Transfer for City Hall debt service payment.
(6) Transfer for planning and administrative expenditures.
(7) Transfer for interest, principal and fees for the Series 2011 Convention Center bonds payments.
(8) Transfer for Energy Savings and Conservation Program
(9) Transfer of proceeds of commercial paper to fund the Convention Center facility.
(10) Transfer of funds for the issuance of commercial paper for the Taxable Flood Improvement Project.
(11) Transfer for operations, interest earnings and capital projects.
(12) Transfer for a sale of land.
(13) Transfer of funds to subsidize the debt service payments for two Community Facilities Districts.
(14) Transfer of $3,093 for City Hall debt service payments and $15,153 for operations, capital projects, and project savings.
(15) Transfer of $8,203 for fees reimbursement, $21,214 for debt service payments, and $7,624 various revenue.
(16) Transfer for City Hall debt service payment.
(17) Transfer for interest, principal and fees payments.

H. Deferred Inflows of Resources

As of June 30, 2018, total deferred inflows of resources in the governmental funds related to the following unavailable resources (dollars in thousands):

Description		
General Fund SERAF loans receivable	$	12,442
Housing Activities loans receivable		19,719
Low and Moderate Income Housing Asset loans receivable		7,550
Special Assessments receivables		30,950
Community Development Block Grant (CDBG) loans receivable		1,730
Total deferred inflows of resources	$	72,391

I. Governmental Fund Balances

As of June 30, 2018, total fund balances for the City's major and nonmajor governmental funds are as follows (dollars in thousands):

	General Fund	Housing Activities	Low & Moderate Income Housing Asset	Special Assessment Districts	San José Financing Authority Debt Service	Nonmajor Governmental Funds	Total Governmental Funds
Nonspendable:							
Advances & Deposits	$ 153	$ -	$ -	$ -	$ -	$ -	$ 153
Subtotal	153	-	-	-	-	-	153
Restricted for:							
Affordable Housing	-	133,182	379,304	-	-	-	512,486
Capital Projects & Improvements	1,057	-	-	42,017	-	231,234	274,308
Emplyoment/ Training Services	-	-	-	-	-	1,191	1,191
Drug Abuse Prevention & Control	-	-	-	-	-	3,917	3,917
Community Development Services	-	-	-	-	-	4,518	4,518
Library Services & Facilities	-	-	-	-	-	10,849	10,849
Small Business Loans	-	-	-	-	-	7	7
Parks, Recreation, & Neighborhood Development	-	-	-	-	-	78,947	78,947
Underground Utility Projects	-	-	-	-	-	7,859	7,859
Storm Drainage Projects	-	-	-	-	-	40,762	40,762
Supplemental Law Enforcement Services	-	-	-	-	-	60	60
Debt Service	-	-	-	-	11,386	33,332	44,718
Subtotal	1,057	133,182	379,304	42,017	11,386	412,676	979,622
Committed to:							
Building Development Fee Program	22,419	-	-	-	-	-	22,419
Capital Projects and Improvements	18,847	-	-	-	-	1,652	20,499
Parks, Recreation, & Neighborhood Development	-	-	-	-	-	2,429	2,429
Developement Enhancement	-	-	-	-	-	280	280
Convention Center, Auditorium, Theaters	-	-	-	-	-	12,323	12,323
Employee Compensation Planning	18,981	-	-	-	-	-	18,981
Fire Development Fee Program	6,980	-	-	-	-	-	6,980
Development Fee Program Technology	1,093	-	-	-	-	-	1,093
Residential Program Administration	-	-	-	-	-	2,030	2,030
Government Functions/Services	8,785	-	-	-	-	-	8,785
Public Safety	4,279	-	-	-	-	-	4,279
Community Development Services	6,290	-	-	-	-	8,548	14,838
Fee Supported Programs- Public Works	4,913	-	-	-	-	-	4,913
Salaries & Benefits	5,000	-	-	-	-	-	5,000
Sanitation Projects	222	-	-	-	-	30,630	30,852
Subtotal	97,809	-	-	-	-	57,892	155,701
Assigned to:							
Financing Authority Debt Service	3,297	-	-	-	-	-	3,297
SARA Debt Service	13,863	-	-	-	-	-	13,863
Developement Enhancement	-	-	-	-	-	20	20
Community & Culture Projects	-	-	-	-	-	4,734	4,734
Hayes Mansion Operations	-	-	-	-	-	11,043	11,043
Loans to Other Agencies	1,242	-	-	-	-	-	1,242
Capital Projects & Improvements	-	-	-	-	-	79,000	79,000
Government Functions/Services	93,107	-	-	-	-	-	93,107
Subtotal	111,509	-	-	-	-	94,797	206,306
Unassigned	82,494	-	-	-	-	-	82,494
Total Fund Balance	**$ 293,022**	**$ 133,182**	**$ 379,304**	**$ 42,017**	**$ 11,386**	**$ 565,365**	**$ 1,424,276**

City Reserves Policy. The City Council-approved Operating Budget and Capital Improvement Program Policy (Policy Number 1-18) incorporates direction on contingency funding, including general purpose reserves, the Cash Reserve Fund and the Emergency Reserve Fund. Within the General Fund, general purpose reserves are to be set aside as a safety net for general city operations. Currently, the General Fund Contingency Reserve, the General Fund Budget

Stabilization Reserve, and the General Fund Workers' Compensation/General Liability Catastrophic Reserve are available for general purposes. Each of these reserves is described below. With the exception of the General Fund Contingency Reserve Fund, use of these reserves requires a majority vote of the City Council.

Within capital project and special revenue funds, general purpose reserves may be set aside as a safety net for city operations pertaining to the respective fund or to provide stability for customer rates when there are fluctuations to revenues and expenditures.

The Policy also identifies the Cash Reserve Fund and the Emergency Reserve Fund, which are mandated by the City Charter described below.

The section of Council Policy 1-18 addressing contingency funds was amended in June 2015.

The ***General Fund Contingency Reserve Fund*** was created to meet unexpected circumstances arising from financial and/or public emergencies that require immediate funding that cannot be met by any other means. The policy established a minimum of three percent of the General Fund operating budget as the reserve balance. Any use of the General Fund Contingency Reserve shall require a two-third vote of approval by the City Council. As of June 30, 2018, the contingency amount accounts for $36,500,000 of the unassigned fund balance.

The ***General Fund Budget Stabilization Reserve*** may be maintained at a level as determined by the City Council to be adequate. The purpose of this reserve is to provide budget stability when there are fluctuations that result in lower than projected revenues and/or higher than projected expenditures that cannot be re-balanced within existing budget resources in any given year. This reserve is intended to provide a buffer, or bridge funding, to protect against reducing service levels when these fluctuations occur. As of June 30, 2018, the budget stabilization reserve accounts for $16,300,000 of the unassigned fund balance.

The ***General Fund Workers' Compensation/General Liability Catastrophic Reserve*** may be maintained at a level as determined by the City Council to be adequate. The purpose of this reserve is to provide funding for potential workers' compensation or general liability claims that exceed the budgeted amounts as the City, for the most part, is self-insured. As of June 30, 2018, the workers' compensation and general liability catastrophic reserve accounts for $15,000,000 of the unassigned fund balance.

The ***Cash Reserve Fund*** was created for the payment of any authorized expenditures of the City for any fiscal year in anticipation of and before the collection of taxes and other revenues of the City for such fiscal year, and for the payment of authorized expenses of the City for any fiscal year, which became due and payable and must be paid prior to the receipt of tax payments and other revenues for such fiscal year. A reserve shall be built up in said fund from any available sources other than restricted sources in an amount which the Council deems sufficient for said purposes. As of June 30, 2018, the cash reserve amount accounts for $6,000 of the unassigned fund balance.

The ***Emergency Reserve Fund*** was created for the purpose of meeting any public emergency involving or threatening the lives, property or welfare of the people of the City or property of the City. A reserve shall be built up in said fund from any available sources, other than restricted sources, in an amount which the Council deems desirable. As of June 30, 2018, the emergency reserve amount accounts for $1,335,000 of the unassigned fund balance.

IV. Other Information

A. Defined Benefit Retirement Plans

A. 1. City Sponsored Defined Benefit Pension Plan

1. General Information about the Pension Plans

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

The Retirement Systems are administered by the Chief Executive Officer of the Office of Retirement Services, an employee of the City, who serves at the pleasure of the Boards of Administration for the Retirement Systems. The compensation paid to the Chief Executive Officer and the investment professional staff within the Office of Retirement Services is set by the City Council. The Boards of Administration in recommending to the City Council the compensation amounts for these positions are required under the City Charter to consider compensation of equivalent positions in comparable United States public pension plans.

The separately issued annual reports of PFDRP and FCERS, together with various chapters in Title 3 of the City's Municipal Code, provide more detailed information about the Retirement Systems. Those reports may be obtained from the City of San José Office of Retirement Services, 1737 North First Street, Suite 600, San José, California 95112.

Benefits

The Defined Benefit Pension Plans provide general retirement benefits including pension, death, and disability benefits to members. The contribution and benefit provisions and all other requirements are established by the City Charter and the City's Municipal Code. Benefits are based on average final compensation, years of service, and cost-of-living increases as specified by the City's Municipal Code.

On June 5, 2012, San José voters adopted Measure B, which enacted the Sustainable Retirement Benefits and Compensation Act ("Measure B"). Measure B amended the City Charter to, among other changes, (1) increase pension contribution requirements for current employees effective June 23, 2013; (2) require the City to establish an alternative voluntary plan with reduced benefits for current employees (the "Voluntary Election Plan" or "VEP") subject to Internal Revenue Service (IRS) approval; (3) place limitations on disability retirements; (4) authorize the City Council to temporarily suspend the cost of living adjustments if the City Council adopts a resolution declaring a fiscal and service level emergency; (5) require the elimination of the Supplemental Retirement Reserve within the Retirement Systems; (6) codify in the City Charter contribution requirements for current employees for the retiree health and dental benefits and provide for a reservation of rights for the City Council to terminate or modify any retiree healthcare plan; (7) require the establishment of Tier 2 plans for new employees within the Retirement Systems; and (8) reserve to the voters the right to approve future changes to retirement benefits. Measure B has subsequently been the subject of various forms of litigation and the City Council directed the City Administration to settle the litigation with the City's eleven (11) bargaining units. The legal challenges to Measure B are resolved. The settlement of the legal challenges brought by or on behalf of the City's active employees is discussed below.

On August 25, 2015, the City Council approved the terms of the Alternative Pension Reform Settlement Framework (Public Safety Framework) for the two sworn bargaining units, the San Jose Police Officers' Association (SJPOA) and the San Jose Fire Fighters, International Association of Fire Fighters, Local 230 (IAFF).

On December 15, 2015 and January 12, 2016, the City and the bargaining units representing employees in FCERS reached a settlement agreement on the Federated Alternative Pension Reform Settlement Framework (Federated Framework). The terms of the Federated Framework also applied to unrepresented employees, including unrepresented management and executive employees in Unit 99.

The Public Safety and Federated Frameworks (the "Frameworks") include, among other things, revised Tier 2 pension benefits that include increased pension benefits for Tier 2 employees while preserving the 50/50 cost sharing between the City and Tier 2 employees; closing the defined benefit retiree healthcare benefit to new employees, as well as agreement on a new lowest cost medical plan associated with retiree healthcare; allowing Tier 1 and some Tier 2 employees to opt out of the applicable Postemployment Healthcare Plan to a Voluntary Employee Benefit Association for retiree healthcare subject to legal and Internal Revenue Service approval (which has since been received); allowing Tier 1 employees who terminated employment with the City and either subsequently returned or who return in the future to return as Tier 1 employees; and continuing the elimination of the Supplemental Retiree Benefit Reserve (SRBR). The Frameworks also included an agreement that a ballot measure would be placed on November 8, 2016, election for the voters to replace Measure B as described below. On November 8, 2016, the voters approved the Alternative Pension Reform Act known as Measure F. Measure F included, among other things, prohibiting any enhancements to defined retirement benefits without voter approval; codifying the Tier 2 pension benefit; closing the defined benefit retiree healthcare plan; and prohibiting retroactive defined retirement benefit enhancements.

The specific terms of PFDRP and FCERS are set forth in the Municipal Code. Both have different benefit tiers.

Prior to June 18, 2017, FCERS had Tier 1, Tier 2, Tier 2B, and Tier 2C. Tier 2, Tier 2B and Tier 2C had the same reduced pension benefits as compared to Tier 1. Tier 2 had the same retiree healthcare (medical and dental) benefits as Tier 1. Tier 2B originally consisted of employees who were newly hired or rehiredon or after September 27, 2013, and they were not eligible for the defined benefit retiree health care benefits; however, the City was responsible for the contributions that both the City and the Tier 2B members would have otherwise paid for retiree health care had those employees been eligible. Tier 2C had retiree dental benefits but no retiree medical benefits. Prior to June 18, 2017, the PFDRP had Tier 1 and Tier 2 for both police and fire members with reduced pension benefits for the Tier 2 police and fire members as compared to the Tier 1 members, and until July 30, 2017, Tier 1 and Tier 2 members of PFDRP had the same retiree healthcare (medical and dental benefits). The City Manager on August 2, 2017 exercised his discretion under the Municipal Code to terminate the PFDRP Postemployment Healthcare Plan for Police and Fire Tier 2 employees. On August 3, 2017, the PFDRP Board took action to terminate the PFDRP Postemployment Healthcare Plan for Tier 2 Police and Fire employees effective July 30, 2017. As of July 30, 2017, the City's contribution rate to the PFDRP Postemployment Healthcare Plan for Police and Fire Tier 2 employees did not change; however, the contribution rates made by the Police and Fire Tier 2 employees were reduced to 0%.

Subsequent ordinances amending the Municipal Code implementing the terms of Measure F and the Frameworks have since been adopted by the City Council and the changes described below became effective on June 18, 2017, which was the commencement date of the first pay period of Fiscal Year 2017-2018. As implementation issues arise, minor modifications to the provisions of PFDRP and FCERS in the Municipal Code have been made to address these issues.

Effective June 18, 2017, the FCERS has several Tiers as follows:

Tier	Hire Date	Pension	Defined Benefit Retiree Healthcare (Medical/Dental)
Tier 1	▪ On or before September 29, 2012 ▪ Former Tier 1 rehired on or after June 18, 2017 who did not take a return of contributions[(1)]	Tier 1	Medical/Dental[(2)(4)]
Tier 1 Rehire	▪ Former Tier 1 rehired on or after September 30, 2012 through June 17, 2018[(1)]	Tier 1	Medical/Dental[(2)(4)(5)]
Tier 1 Classic	▪ "Classic" membership with CalPERS/reciprocal agency hired on or after June 18, 2017	Tier 1	Not eligible[(3)(4)]
Tier 2 (or Tier 2A)	▪ Hired/rehired/reinstated on or after September 30, 2012	Tier 2	Medical/Dental[(2)(4)]
Tier 2B	▪ Hired/rehired/reinstated after September 27, 2013 and have not met City's eligibility for retiree healthcare	Tier 2	Not eligible[(3)(4)]
Notes	(1) *Employees in these tiers are responsible for 50% of the amortization costs for having any prior years of service in Tier 2 changed to Tier 1.* (2) *Employees in these tiers were provided a one-time irrevocable election to remain in the FCERS Postemployment Healthcare Plan or opt in to the defined contribution Voluntary Employees' Beneficiary Association (VEBA). Please note that those who opted in to the VEBA are no longer eligible for FCERS Postemployment healthcare Plan. The VEBA was implemented on March 25, 2018.* (3) *Employees in these tiers were mandatorily placed into the VEBA.* (4) *Unrepresented employees were eligible to opt in to the VEBA but are not eligible to make ongoing contributions to the VEBA.* (5) *All Tier 1 rehires formerly in Tier 1B and Tier 1C who opted to remain in the FCERS Postemployment Healthcare Plan began contributing to retiree healthcare on March 25, 2018.*		

Effective June 18, 2017, the PFDRP has several Tiers as follows:

Tier	Hire Date	Pension	Defined Benefit Retiree Healthcare (Medical/Dental)
Police Tier 1	▪ Before August 4, 2013 ▪ Former Tier 1 rehired on or after June 18, 2017 who did not take a return of contributions[1] ▪ "Classic" membership with CalPERS/reciprocal agency hired on or after June 18, 2017[1]	Tier 1	Medical/Dental[2][4]
Police Tier 1 Rehire	▪ Tier 1 employee rehired between August 4, 2013 through June 17, 2017.	Tier 1	Medical/Dental[2][4]
Fire Tier 1	▪ Before January 2, 2015 ▪ Former Tier 1 rehired on or after June 18, 2017 who did not take a return of contributions[1] ▪ "Classic" membership with CalPERS/reciprocal agency hired on or after June 18, 2017[1]	Tier 1	Medical/Dental[2][4]
Fire Tier 1 Rehire	▪ Tier 1 employee rehired between January 2, 2015 through June 17, 2017.	Tier 1	Medical/Dental[2][4]
Tier 1 Classic	▪ "Classic" membership with CalPERS/reciprocal agency hired on or after June 18, 2017	Tier 1	Not eligible
Police Tier 2	▪ On or after August 4, 2013	Tier 2	Not Eligible[3][4]
Fire Tier 2	▪ On or after January 2, 2015	Tier 2	Not Eligible[3][4]
Notes	*(1) Employees in these tiers are responsible for 50% of the amortization costs for having any prior years of service in Tier 2 changed to Tier 1.* *(2) Employees in these Tiers were provided a one-time irrevocable election to remain in the PFDRP Postemployment Healthcare Plan or opt in to the defined contribution Voluntary Employees' Beneficiary Association (VEBA).Please note that those who opted in to the VEBA are no longer eligible for the PFDRP Postemployment Healthcare Plan. The VEBA was implemented on March 25, 2018.* *(3) Employees in these tiers were mandatorily placed into the VEBA.* *(4) Unrepresented employees were eligible to opt in to a VEBA but are not eligible to make ongoing contributions to the VEBA.*		

The following tables summarize the pension, disability, and death benefits for the members:

	PFDRP		
	Police Tier 1	**Police Tier 1 Classic**	**Police Tier 2**
Pension			
Service required to leave contributions in retirement plan	10 years of service (20 years must have elapsed from date of entry into retirement system to collect pension)	10 years of service (20 years must have elapsed from date of entry into retirement system to collect pension)	5 years service with the City in the Police and Fire Department Plan (Years of Service = 2080 hours worked within applicable 12-month period)
Service Retirement			
Age/Years of Service	50 with 25 years of service 55 with 20 years of service 30 years of service at any age (with reciprocity, must be 50 years of age) Mandatory retirement at 70 years of age	50 with 25 years of service 55 with 20 years of service 30 years of service at any age (with reciprocity, must be 50 years of age) Mandatory retirement at 70 years of age	57 with 5 years of service with the City in the Plan 50 with 5 years of service with the City in the Plan A reduction factor of 7.0% per year for each year between age 57 and Tier 2 member's age at retirement, prorated to the closest month
Early Retirement	50-54 with 20 years of service (Discounted pension) Allowance reduced pursuant to Municipal Code Section 3.36.810	50-54 with 20 years of service (Discounted pension) Allowance reduced pursuant to Municipal Code Section 3.36.810	N/A
Deferred Vested Retirement	55 with 10 years of service only if 20 years have elapsed from date of membership. (Qualifying members can begin receiving benefits at age 50 with least 25 years of service.)	55 with 10 years of service only if 20 years have elapsed from date of membership. (Qualifying members can begin receiving benefits at age 50 with at least 25 years of service.)	At least 5 years of service with the City in the Plan (This applies to members who separate from City service before retirement and leave their contributions in the retirement system.) Can begin at age 50 with reduction fact of 7.0% per year for each year between age 57 and the Tier 2 member's age at retirement, prorated to the closest month.
Allowance	First 20 years of service: 50% of final compensation (2.5% per year) Next 21-30 years service: 4% per year of service X final compensation (90% max) Years of service (year of service = 2080 hours worked)	First 20 years of service: 50% of final compensation (2.5% per year) Next 21-30 years service: 4% per year of service X final compensation (90% max) Years of service (year of service = 2080 hours worked)	First 20 years of service: 2.4% per year of service x Final Compensation Beginning of 21st year of service: 3.0% per year of service x Final compensation Beginning of 26th year of service: 3.4% per year of service x Final compensation Final Compensation is the average annual base pay plus any premium pays authorized by ordinance for the highest 3 consecutive years of service Maximum benefit is 80% of Final compensation
Reciprocity			
Reciprocity	As of September 30, 1994, the City of San Jose adopted a reciprocal agreement with CALPERS. This may result in improved benefits for members who transfer between CALPERS and this retirement plan.	As of September 30, 1994, the City of San Jose adopted a reciprocal agreement with CALPERS. This may result in improved benefits for members who transfer between CALPERS and this retirement plan.	As of September 30, 1994, the City of San Jose adopted a reciprocal agreement with CALPERS. This may result in improved benefits for members who transfer between CALPERS and this retirement plan.
Cost of Living Adjustments			
Cost of Living Adjustments	Retirees are eligible for a 3% annual cost-of-living adjustment (COLA). Regular COLAs are compounded and paid each February. There is no proration of COLA.	Retirees are eligible for a 3% annual cost-of-living adjustment (COLA). Regular COLAs are compounded and paid each February. There is no proration of COLA.	Retirees are eligible for annual cost-of-living adjustment (COLA) limited to the increase in the Consumer Price Index (San Jose-San Francisco-Oakland, U.S. Bureau of Labor Statistics index, CPI-U, December to December), capped at 2.0% per fiscal year. The first COLA will be prorated based on the number of months retired.
Final Compensation	Highest one-year average	Highest one-year average	Highest three-year average

	PFDRP		
	Fire Tier 1	**Fire Tier 1 Classic**	**Fire Tier 2**
Pension			
Service required to leave contributions in retirement system	10 years of service (20 years must have elapsed from date of entry into Retirement System to collect pension)	10 years of service (20 years must have elapsed from date of entry into Retirement System to collect pension)	5 years of service with the City in the Plan (Year of Service = 2080 hours worked in the applicable 12-month period)
Service Retirement			
Age/Years of Service	50 with 25 years of service 55 with 20 years of service 30 years of service at any age (with reciprocity, must be 50 years of age) Mandatory retirement at 70 years of age	50 with 25 years of service 55 with 20 years of service 30 years of service at any age (with reciprocity, must be 50 years of age) Mandatory retirement at 70 years of age	57 with 5 years of service with the City in the Plan. 50 with 5 years of service with the City in the Plan. A reduction factor of 7% per year for each year between age 57 and the Tier 2 member's age at retirement, prorated to the closest month
Early Retirement	50-54 with 20 years of service (discounted pension) Allowance reduced pursuant to Municipal Code Section 3.36.810	50-54 with 20 years of service (discounted pension) Allowance reduced pursuant to Municipal Code Section 3.36.810	N/A
Deferred Vested	55 with 10 years of service only if 20 years have elapsed from date of membership. (Qualifying member can begin receiving benefits at age 50 with least 25 years of service.)	55 with 10 years of service only if 20 years have elapsed from date of membership. (Qualifying member can begin receiving benefits at age 50 with least 25 years of service.)	At least 5 years of service with the City in the Plan. (This applies to members who separate from City service before retirement and leave their contributions in the retirement system.) Can begin at age 50 with reduction factor of 7% per year for each year between age 57 and the Tier 2 member's age at retirement, prorated to the closest month.
Allowance	First 20 years of service: 50% of final compensation (2.5% per year) Beginning of 21st year of service: 3% per year of service X final compensation (90% max) – All years convert to 3% after 20 years of service. Years of service (year of service = 2080 hours worked)	First 20 years of service: 50% of final compensation (2.5% per year) Beginning of 21st year of service: 3% per year of service X final compensation (90% max) – All years convert to 3% after 20 years of service. Years of service (year of service = 2080 hours worked)	First 20 years of service: 2.4% per year of service x final compensation Beginning of 21st year of service: 3.0% per year of service x final compensation Beginning of 26th year of service: 3.4% per year of service x final compensation Final Compensation is the average annual base pay plus any premium pays authorized by ordinance for the highest 3 consecutive years of service Maximum benefit is 80% of final compensation
Reciprocity			
Reciprocity	As of September 30, 1994, the City of San Jose adopted a reciprocal agreement with CALPERS. This may result in improved benefits for members who transfer between CALPERS and this retirement plan.	As of September 30, 1994, the City of San Jose adopted a reciprocal agreement with CALPERS. This may result in improved benefits for members who transfer between CALPERS and this retirement plan.	As of September 30, 1994, the City of San Jose adopted a reciprocal agreement with CALPERS. This may result in improved benefits for members who transfer between CALPERS and this retirement plan.
Cost of Living Adjustments			
Cost of Living Adjustments	Retirees are eligible for a 3% annual cost of living adjustment (COLA). Regular COLA's are compounded and paid each February. There is no proration of COLA.	Retirees are eligible for a 3% annual cost of living adjustment (COLA). Regular COLA's are compounded and paid each February. There is no proration of COLA.	Retirees are eligible for annual cost-of-living adjustment (COLA) limited to the increase in the Consumer Price Index (San Jose-San Francisco-Oakland, U.S. Bureau of Labor Statistics index, CPI-U, December to December), capped at 2.0% per fiscal year. The first COLA will be prorated based on the number of months retired.
Final Compensation	Highest one-year average	Highest one-year average	Highest three-year average

	Police Tier 1	Police Classic Tier 1	Police Tier 2
Disability Retirement (Service Connected)			
Minimum Service	None	None	None
Allowance	<20 years of service: 50% of final compensation Next 21-30 years of service: 4% per year of service X final compensation (90% max)	<20 years of service: 50% of final compensation Next 21-30 years of service: 4% per year of service X final compensation (90% max)	An individual who is granted a service connected disability retirement is entitled to a monthly allowance equal to the greater of: 50% of Final compensation A service retirement allowance, if he or she qualified for such or An actuarially reduced factor, as determined by the plan's actuary, for each quarter year that his or her service age is less than 50 years, multiplied by number of years of service subject to the applicable formula, if not qualified for a service retirement.
Disability Retirement (Non-Service Connected)			
Minimum Service	2 years of service	2 years of service	5 years of service
Allowance	<20 years of service: 32% of final compensation plus 1% for each full year in excess of 2. (50% max) >20 years of service: 2.5% x first 20 years of service x final compensation Next 21-30 years of service: 4% per year of service X final compensation (90% max)	<20 years of service: 32% of final compensation plus 1% for each full year in excess of 2. (50% max) >20 years of service: 2.5% x first 20 years of service x final compensation Next 21-30 years of service: 4% per year of service X final compensation (90% max)	An individual who is granted a non service connected disability retirement is entitled to a monthly allowance equal to the greater of: If less than age 50: 1.8% per year of service or if older than age 50: The amount of service pension benefit as calculated based upon the service pension formula.
Medical Benefits/Voluntary Employees' Beneficiary Association (VEBA)			
Eligibility	Retired for disability or service directly from active service with 15 years of San Jose service or receive allowance that is at least 37.5% of final compensation. Also eligible if member separates from service after 7/5/92 but prior to retirement with 20 years of San Jose service and leaves contributions and former member receives allowance (i.e., applies & qualifies for retirement).	Defined Contribution Plan - All Tier 1 Classic employees will make mandatory contributions of 4% into the Voluntary Employees' Beneficiary Association (VEBA).	Defined Contribution Plan: All Tier 2 employees will make mandatory contributions of 4% into the Voluntary Employees' Beneficiary Association (VEBA).
Premium	Retirement System pays 100% of lowest cost plan that is available to active City employees. If member does not choose the lowest cost plan, member pays the difference between that premium and the premium of the lowest cost plan.	None	None
Medical Eligibility	At age 65, members will be required to enroll in Medicare parts A & B. If a member does not meet this requirement within 6 months of the date member turns 65, health care benefits will cease until such requirement are met.	None	None

	Fire Tier 1	Fire Tier 1 Classic	Fire Tier 2
Disability Retirement (Service Connected)			
Minimum Service	None	None	None
Allowance	<20 years service: 50% of final compensation Beginning of 21st year of service: 3% per year of service X final compensation (90% max)	<20 years service: 50% of final compensation Beginning of 21st year of service: 3% per year of service X final compensation (90% max)	An individual who is granted a service connected disability retirement is entitled to monthly allowance equal to the greater of : 50% of final compensation A service retirement allowance, if he or she qualified for such or An actuarially reduced factor, as determined by the plan's actuary, for each quarter year that his or her service age is less than 50 years, multiplied by the number of years of service subject to the applicable formula, if not qualified for a service retirement
Disability Retirement (Non- Service Connected)			
Minimum Service	2 years of service	2 years of service	5 years of service
Allowance	<20 years of service: 32% of final compensation plus 1% for each full year in excess of 2 (50% max) Beginning of 21st year of service: 3% per year of service X final compensation (90% max)	<20 years of service: 32% of final compensation plus 1% for each full year in excess of 2 years (50% max) Beginning of 21st year of service: 3% per year of service X final compensation (90% max)	An individual who is granted a non service connected disability retirement is entitled to a monthly allowance equal to the greater of: If less than age 50: 1.8% per year of service or If older than age 50: the amount of service pension benefit as calculated based upon the service pension formula
Medical Benefits / Voluntary Employees' Beneficiary Association (VEBA)			
Eligibility	Retired for disability or service directly from active service with 15 years of San Jose service or receive allowance that is at least 37.5% of final compensation. Also eligible if member separates from service after 7/5/92 but prior to retirement with 20 years of San Jose service and leaves contributions and former member receives allowance (i.e., applies & qualifies for retirement).	Defined Contribution Plan - All Tier 1 Classic employees will make mandatory contributions of 4% into the Voluntary Employees' Beneficiary Association (VEBA)	Defined Contribution Plan: All Tier 2 employees will make mandatory contributions of 4% into the Voluntary Employees' Beneficiary Association (VEBA).
Premium	Retirement System pays 100% of lowest cost plan that is available to active City employees. If member does not choose the lowest cost plan, member pays the difference between that premium and the premium of the lowest cost plan.	N/A	N/A

The following table summarizes the survivorship pension benefits for the PFDRF members. Please consult the Municipal Code for complete information.

	Police Tier 1/Tier 1 Classic
Death Before Retirement	
Nonservice-connected death with less than 2 years of service	Return of contributions, plus interest, to surviving spouse/domestic partner, surviving children, or estate or $1,000, whichever is greater
Nonservice-connected death with more than 2 years of service, but not eligible for a service retirement	To surviving spouse/domestic partner: 24.0% + 0.75% for each year in excess of 2 years x final compensation (37.5% maximum) and to surviving children: 1 Child: Final compensation x 25.0% 2 Children: Final compensation x 37.5% 3 Children: Final compensation x 50.0% If no surviving spouse/domestic partner nor surviving children: Return of contributions, plus interest, to estate or $1,000 whichever is greater
Death before retirement, but while eligible for service retirement - Non-Service Connected Death	To surviving spouse/domestic partner: 37.5% to 42.5% of member's final compensation depending on years of service For example: Member's benefit = 76.0% Survivorship benefit = 38.0% of final compensation Member's benefit = 80.0% Survivorship benefit = 40.0% of final compensation Member's benefit = 82.0% Survivorship benefit = 41.0% of final compensation Member's benefit = 85.0% Survivorship benefit = 42.5% of final compensation and to surviving children: 1 Child: Final compensation x 25.0% 2 Children: Final compensation x 37.5% 3 Children: Final compensation x 50.0% If no surviving spouse/domestic partner nor surviving children: Return of contributions, plus interest, to estate or $1,000, whichever is greater
Service-connected death regardless of year of service	To surviving spouse/domestic partner: 37.5% to 42.5% of member's final compensation depending on years of service and to surviving children: 1 Child: Final compensation x 25.0% 2 Children: Final compensation x 50.0% 3 Children: Final compensation x 75.0% If no surviving spouse/domestic partner nor surviving children: Return of contributions, plus interest, to estate or $1,000 whichever is greater
Death After Retirement	
Service-connected disability	To surviving spouse/domestic partner: 37.5% to 42.5% of member's final compensation depending on years of service And to surviving children: 1 Child: Final compensation x 25.0% 2 Children: Final compensation x 37.5% 3 Children: Final compensation x 50.0% If no surviving spouse/domestic partner nor surviving children: $1,000 death benefit to estate
Nonservice-Connected Disability	To surviving spouse/domestic partner: Final compensation x 24.0% + 0.75% for each year in excess of 2 years (37.5% maximum) and to surviving children: 1 Child: Final compensation x 25.0% 2 Children:Final compensation x 37.5% 3 Children: Final compensation x 50.0% If no surviving spouse/domestic partner nor surviving children: $1,000 death benefit to estate
Optional Settlements	Retiree may choose an optional settlement at retirement that reduces their allowance to provide a higher survivorship allowance to their spouse/domestic partner.
Post-Retirement Marriage	If a retiree marries after retirement, the retiree can elect to take a reduction of on his pension benefit in order to allow for a survivorship benefit to the surviving spouse/domestic partner.

	Police Tier 2
Death Before Retirement	
Nonservice-connected death - not eligible for retirement and less than two years of service	Greater of: (1) Return of contributions, plus interest, to surviving spouse/domestic partner; where there is no surviving spouse/domestic partner to member's surviving children, or where there are no surviving children either, to the member's estate or (2) $1,000, whichever is greater
Nonservice-connected death - not eligible for retirement and two or more years of service	To surviving spouse/domestic partner: 24.0% of final compensation + 0.75% of final compensation for each year in excess of 2 compensation (37.5% maximum) There is an 80.0% cap on final compensation that can be paid to survivors. And to surviving children: If 1 Child: Final compensation x 25.0% If 2 Children : Final compensation x 37.5% If 3 or more Children: Final compensation x 50.0% If no surviving spouse/domestic partner nor surviving children, to the estate: Return of contributions, plus interest, or $1,000 whichever is greater
Death before retirement, but while eligible for service retirement - Non-service connected death	To surviving spouse/domestic partner: 37.5% to 42.5% of member's final compensation depending on the years of service For example: Member's benefit = 76.0% survivorship benefit = 38.0% of final compensation Member's benefit = 80.0% survivorship benefit = 40.0% of final compensation Member's benefit = 82.0% survivorship benefit = 41.0% of final compensation Member's benefit = 85.0% survivorship benefit = 42.5% of final compensation and to surviving children: If 1 Child: Final compensation x 25.0% If 2 Children: Final Compensation x 37.5% If 3 or more Children: Final Compensation x 50.0% If no surviving spouse/domestic partner nor surviving children, to the estate: Return of contributions, plus interest, or $1,000, whichever is greater
Service-Connected Death	
Service-connected death	To surviving spouse/domestic partner: 37.5% to 42.5% of member's final Compensation depending on years of service There is an 80.0% cap on final compensation that can be paid to survivors and the children: If 1 Child: Final compensation x 25.0% If 2 Children: Final Compensation x 50.0% If 3 or more Children: Final compensation x 75.0% If no surviving spouse/domestic partner nor surviving children, to the estate: Return contributions, plus interest, or $1,000 whichever is greater

	Police Tier 2
Death After Retirement	
Service retirees	To surviving spouse/domestic partner: Survivorship allowance equal to 50.0% joint and survivor annuity as determined by the plan's actuaries.
Optional Settlements	
Optional settlements	Retiree may choose an optional settlement at retirement that reduces their allowance to provide a higher survivorship allowance to their spouse/domestic partner.
Post- Retirement Marriage	
Post- retirement Marriage	If a retiree marries after retirement, the retiree can elect to take a reduction on his pension benefit in order to allow for a survivorship benefit to the surviving spouse/domestic partner.

	Fire Tier 1/ Tier 1 Classic
Death Before Retirement	
Service-connected death regardless of years of service	To surviving spouse/domestic partner 37.5% to 45.0% of member's final compensation depending on years of service And to surviving children: 1 Child: Final compensation x 25.0% 2 Children: Final compensation x 50.0% 3 Children: Final compensation x 75.0% If no surviving spouse/domestic partner nor surviving children: Return of contributions, plus interest, to estate or $1,000 whichever is greater
Nonservice-connected death with less than 2 years of service	Return of contributions, plus interest, to surviving spouse/domestic partner, surviving children, or estate or $1,000, whichever is greater
Nonservice-connected death with more than 2 years of service, but not eligible for a service retirement	To surviving spouse/domestic partner: 24.0% + 0.75% for each year in excess of 2 years x final compenstion (45.0% maximum) And to surviving children: 1 Child: Final compensation x 25.0% 2 Children: Final compensation x 37.5% 3 Children: Final compensation x 50.0% If no surviving spouse/domestic partner nor surviving children: Return of contributions, plus interest, to estate or $1,000, whichever is greater
Death before retirement, but while eligible for service retirement nonservice-connected death	To surviving spouse/domestic partner 37.5% to 45.0% of member's final compensation depending on years of service For example: Member's benefit = 81.0% Survivorship benefit = 40.5% of final compensation Member's benefit = 84.0% Survivorship benefit = 42.0% of final compensation Member's benefit = 87.0% Survivorship benefit = 43.5% of final compensation Member's benefit = 90.0% Survivorship benefit = 45.0% of final compensation And to surviving children: 1 Child: Final compensation x 25.0% 2 Children: Final compensation x 37.5% 3 Children: Final compensation x 50.0% If no surviving spouse/domestic partner nor surviving children: Return of contributions, plus interest, to estate or $1,000, whichever is greater

	Fire Tier 1/ Tier 1 Classic
Death After Retirement	
Service retirees service-connected death	To surviving spouse/domestic partner: 37.5% to 45.0% of member's final compensation depending on years of service and to surviving children: 1 Child: Final compensation x 25.0% 2 Children: Final compensation x 37.5% 3 Children: Final compensation x 50.0% If no surviving spouse/domestic partner nor surviving children: $1,000 death benefit to estate
Nonservice-connected disability	To surviving spouse/domestic partner: Final compensation x 24.0% + 0.75% for each year in excess of 2 years (37.5% maximum) and to surviving children: 1 Child: Final compensation x 25.0% 2 Children: Final compensation x 37.5% 3 Children: Final compensation x 50.0% If no surviving spouse/domestic partner nor surviving children: $1,000 death benefit to estate
Optional Settlements	
Optional settlements	Retiree may choose an optional settlement at retirement that reduces their allowance to provide a higher survivorship allowance to their spouse/domestic partner.
Post-Retirement Marriage	
Post-retirement marriage	If a retiree marries after retirement, the retiree can elect to take a reduction of their pension benefit in order to allow for a survivorship benefit to the surviving spouse/domestic partner.

	Fire Tier 2
Death Before Retirement	
Service connected death regardless of years of service	To surviving spouse/domestic partner: 37.5% to 45.0% of member's final compensation depending on the years of service and to surviving children: If 1 Child: Final compensation x 25.0% If 2 Children: Final compensation x 50.0% If 3 or more surviving Children: Final compensation x 75.0% There is an 80.0% cap on final compensation that can be paid to survivors If no surviving spouse/domestic partner nor surviving children, to the estate: Return of contributions, plus interest, or $1,000, whichever is greater.
Nonservice-connected death not eligible for retirement and less than two years of service	Greater of: (1) Return of contributions, plus interest, to surviving spouse/domestic partner; where there is no surviving spouse/domestic partner to member's surviving children, or where there are no surviving children either, to the member's estate, or (2)$1,000, whichever is greater
Nonservice-connected death not eligible for retirement and two or more years of service	To surviving spouse/domestic partner: 24.0% + 0.75% for each year in excess of 2 years x final compensation and the surviving children: If 1 Child: Final compensation x 25.0% If 2 Children: Final compensation x 37.5% If 3 or more children: Final compensation x 50.0% There is an 80.0% cap on final compensation that can be paid to survivors If no surviving spouse/domestic partner nor surviving children to the estate: Return contributions, plus interest, or $ 1,000 whichever is greater
Nonservice-connected death eligible for Retirement	To surviving spouse/domestic partner: 37.5% to 45.0% of member's final compensation depending on the years of service For example: Member's benefit = 81.0% Survivorship benefit = 40.5% of final compensation Member's benefit = 84.0% Survivorship benefit = 42.0% of final compensation Member's benefit = 87.0% Survivorship benefit = 43.5% of final compensation Member's benefit = 90.0% Survivorship benefit = 45.0% of final compensation And to surviving children: If 1 Child: Final compensation x 25.0% If 2 Children: Final compensation x 37.5% If 3 or more Children: Final compensation x 50.0% If no surviving spouse/domestic partner nor surviving children, to the estate: Return contributions, plus interest, or $1,000, whichever is greater
Death After Retirement	
Service Retirees	To surviving spouse/domestic partner Survivorship allowance equal to 50.0% joint and survivor annuity as determined by the Plan's actuaries
Non-service connected disability retirees	To surviving spouse/domestic partner: Survivorship allowance equal to 50.0% joint and survivor annuity as determined by the Plan's actuaries
Optional Settlements	
Optional settlements	Retiree may choose an optional settlement at retirement that reduces their allowance to provide a higher survivorship allowance to their spouse/domestic partner
Post-Retirement Marriage	
Post-Retirement Marriage	If a retiree marries after retirement, the retiree can elect to take a reduction on their pension benefit in order to allow for a survivorship benefit to the surviving spouse/domestic partner.

	FCERS				
	Tier 1 & 1A*	Tier 1B or Tier 1 Classic**	Tier 1C***	Tier 2	Tier 2B
Pension					
Service Required to Leave Contributions in System	5 years			Years of Service (Year of Service = 2080 hours worked in the applicable 12 month period	
Service Retirement:					
Age/Years of Service	55 with 5 years' service 30 years' service at any age			62 years with 5 years Federated City Service May retire on or after 55 years with 5 years Federated City Service. A reduction factor of 5% per year for each year between age fifty five (55) and the Tier 2 member's age at retirement before age 62, prorated to the closest month.	
"Deferred Vested" retirement	55 with 5 years service (This applies to members who separate from City service before retirement and leave their contributions in the retirement system.)			May commence on or after 55 years with 5 years Federated City Service with actuarial equivalent reduction (This applies to members who separate from City service before retirement and leave their contributions in the retirement system.) Can begin at age 55 with reduction factor of 5% per year for each year between age fifty five and the Tier 2 member's age at retirement before age 62, prorated to the closest month.	
Allowance	2.5% x Years of Service x Final Compensation (75.0% max) If separation takes place prior to July 1, 2001, Final Compensation is highest average monthly salary during 36 consecutive months If separation takes place on or after July 1, 2001, Final Compensation is highest average monthly salary during 12 consecutive months			2.0% x Years of Federated City Service x Final Compensation (70.0% max) "Final Compensation" is the average monthly (or biweekly) base pay for the highest 3 consecutive Years of Federated City Service Excludes premium pay or any other forms of additional compensation	
Disability Retirement (Service Connected)					
Minimum Service	None			None	
Allowance	40% of Final Compensation plus 2.5% x Years of Service in excess of 16 years x Final Compensation (Maximum 75% of Final Compensation)			2% x Years of Federated City Service x Final Compensation. (Minimum of 40.0% and maximum of 70.0% of Final Compensation)	

	FCERS				
	Tier 1 & 1A*	Tier 1B or Tier 1 Classic**	Tier 1C***	Tier 2	Tier 2B
Disability Retirement (Non-Service Connected)					
Minimum Service	5 years			5 Years Federated City Service	
Allowance	40% of Final Compensation plus 2.5% x Years of Service in excess of 16 years x Final Compensation (Maximum 75.0% of Final Compensation) If under 55 years old, subtract 0.5% for every year under age 55. For those entering the System 9/1/98 or later, the calculation is as follows: 20% of Final Compensation for up to 6 years of service. Add 2% for each year of service in excess of 6 years but less than 16 years. Add 2.5% for each year of service in excess of 16 years of service. (Maximum 75% of Final Compensation)			2% x Years of Federated City Service x Final Compensation. (Minimum of 20% and maximum of 70.0% of Final Compensation)	
Reciprocity					
Reciprocity	As of December 9, 1994, the City of San José Federated City Employees' Retirement System adopted a reciprocal agreement with CalPERS. This may result in improved benefits for members who transfer between this retirement system and CalPERS or certain other public agency retirement systems that also have reciprocal agreements with CalPERS. Please call the Retirement Department or CalPERS for more information.				
Cost-of-Living Adjustments(COLA)					
Cost-of-living adjustments	Retirees are eligible for a 3% annual cost of living adjustment (COLA). Regular COLA's are compounded and paid each April. There is no prorating of COLA.			Retirees are eligible for annual cost of living adjustment (COLA) limited to the lesser of the increase in the Consumer Price Index (San Jose-San Francisco-Oakland, U.S. Bureau of Labor Statistics index, CPIU, December to December), or a back loaded 2.0% COLA per fiscal year. The back loaded COLA shall be calculated as follows: i. Service at retirement of 1-10 years: 1.25% per year ii. Service at retirement of 1-10 years and hired before June 16, 2017: 1.5% iii. Service at retirement of 11-20 years: 1.5% per year iv. Service at retirement of 21-25 years: 1.75% per year v. Service at retirement of 26 years and above: 2.0% per year The first COLA will be prorated based on the number of months retired.	

** Tier 1 applies to employees hired on or before September 29, 2012, or former Tier 1 members who were rehired on or after June 18, 2017, who did not take a return of contributions. Tier 1A applies to employees rehired on or after September 30, 2012 through September 27, 2013, and employees rehired after September 27, 2013 with 15 or more years of service, but before June 18, 2017.*

*** Tier 1B applies to employees rehired after September 27, 2013 with less than 5 years of service, but before June 18, 2017. Tier 1B employees are not eligible for the defined benefit retiree healthcare plan. Employees with "Classic" membership from a CalPERS or reciprocal agency hired by the City of San Jose on or after June 18, 2017. Employees in Tier 1 Classic are not eligible for the defined benefit retiree healthcare plan.*

**** Tier 1C applies to employees rehired after September 27, 2013 with between 5 and 15 years of service, but before June 18, 2017. Tier 1C employees are not eligible for the defined benefit retiree medical plan.*

The following table summarizes the survivorship pension and health benefits for the FCERS members. Please consult the Municipal Code for complete information.

	Federated Tier 1, 1A, 1B, and 1C
Death Before Retirement	
Nonservice-Connected Death with less than 5 years of service	Return of employee contributions, plus death benefit: 1/12 of compensation in year prior to death x years of service (benefit may not exceed 50.0% of the salary earned in year prior to death.)
Greater than 5 years of service or Service-Connected Death	To surviving spouse/domestic partner: Years of Service x 2.5% x Final Compensation (40.0% minimum, 75.0% maximum, except that "deferred vested" members not eligible for 40.0% minimum) If no surviving spouse/domestic partner, to surviving children: 1 Child: 25.0% of spousal/domestic partnership allowance 2 Children: 50.0% of spousal/domestic partnership allowance 3 Children: 75.0% of spousal/domestic partnership allowance If no surviving spouse/domestic partner or surviving children: Return of employee contributions, plus death benefit: 1/12 of compensation in year prior to death x years of service (benefit may not exceed 50.0% of the salary earned in year prior to death.)
Death After Retirement	
Standard allowance to surviving spouse/domestic partner or children (Minimum 5 years of service)	To surviving spouse/domestic partner: 50.0% of Retiree's Allowance If no surviving spouse/domestic partner, to surviving children: 1 Child: 25.0% of spousal/domestic partnership allowance 2 Children: 50.0% of spousal/domestic partnership allowance 3 Children: 75.0% of spousal/domestic partnership allowance If no surviving spouse/domestic partner or surviving children: estate or beneficiary will receive the difference between employee contributions (including interest) and the total paid to member by the retirement system at the time of death.
Optional Settlements	Retiree may choose an optional settlement at retirement that reduces the allowance to provide a survivorship allowance to a designated beneficiary or a higher survivorship allowance to their spouse/domestic partner.
Special Death Benefit	$500 death benefit paid to estate or designated beneficiary in addition to benefits above.

Note: For death before retirement, the survivorship allowance to surviving spouse/domestic partner lasts until death or remarriage. For members who were at least 55 and had at least 20 years of service at the time of death, or 30 years of service regardless of age, the survivorship allowance to surviving spouse/domestic partner lasts until death.

Note: If there is an allowance payable to a surviving spouse/domestic partner, no allowance will be paid to surviving children. Surviving children receive a monthly survivorship allowance only when there is no surviving spouse/domestic partner.

	Federated Tier 2 and 2B
Death Before Retirement	
Nonservice- Connected Death Not Eligible for Retirement	Return of employee contributions, plus interest.
Eligible for Retirement	To surviving spouse/domestic partner: 2.0% x Years of Federated Service x Final Compensation (70.0% max) If no surviving spouse/domestic partner, to surviving children until age 18: 1 Child: 25.0% of spousal/domestic partnership allowance 2 Children: 50.0% of spousal/domestic partnership allowance 3 Children: 75.0% of spousal/domestic partnership allowance If no surviving spouse/domestic partner or surviving children: Return of employee contributions, plus death benefit: 1/12 of compensation in year prior to death x years of service (benefit may not exceed 50.0% of the salary earned in year prior to death.) Employees killed in the line of duty – To surviving spouse/domestic partner: Monthly benefit equivalent to 50.0% of Final Compensation.
Death After Retirement	
Survivorship allowance to surviving spouse/domestic partner or children that was elected by the member at retirement. (Minimum 5 years of service)	To surviving spouse/domestic partner: 50.0% of Retiree's Allowance If no surviving spouse/domestic partner, to surviving children until age 18: 1 Child: 25.0% of spousal/domestic partnership allowance 2 Children: 50.0% of spousal/domestic partnership allowance 3 Children: 75.0% of spousal/domestic partnership allowance If no surviving spouse/domestic partner or surviving children: estate or beneficiary will receive the difference between employee contributions (including interest) and the total paid to member by the retirement system at the time of death.
Optional Settlements	Retiree may choose an optional settlement at retirement that reduces the allowance to provide a survivorship allowance to a designated beneficiary or a higher survivorship allowance to their spouse/domestic partner.

Note: For death before retirement, the survivorship allowance to surviving spouse/domestic partner lasts until death, remarriage, or establishment of a domestic partnership if member was at least 65 with at least 20 years of service (or 55 with a reduction factor of 5.0%) at the time of death. For death after retirement, the survivorship allowance to surviving spouse/domestic partner lasts until death.

Employees Covered - The current membership in the Defined Benefit Pension Plans as of June 30, 2018, is as follows:

FCERS	Tier 1 Pension Only(2)	Tier 1 Pension & Medical(3)	Tier 2 Pension Only(2)	Tier 2 Pension & Medical(3)	Totals
Defined Benefit Pension Plan:					
Retirees and beneficiaries currently receiving benefits(1)	595	3,627	3	-	4,225
Terminated vested members not yet receiving benefits	858	164	412	-	1,434
Active members	193	1,662	1,610	89	3,554
Total	1,646	5,453	2,025	89	9,213

(1) The combined domestic relations orders are not included in the count above as their benefit payment is included in the retiree member count.
(2) Includes VEBA participants who are eligible for the catastrophic disability medical benefits only from the Postemployment Healthcare Plan.
(3) Eligible for full retiree medical benefits.

	Retirees and Beneficiaries (1)		Terminated Vested Members not yet Receiving Benefits		Active Members		
PFDRP	Tier 1	Tier 2	Tier 1	Tier 2	Tier 1	Tier 2	Totals
Police							
Pension & Medical (2)	1,272	-	16	-	684	-	1,972
Pension only (3)	101	-	211	53	33	258	656
Police Total	1,373	-	227	53	717	258	2,628
Fire							
Pension & Medical (2)	830	-	-	-	534	-	1,364
Pension only (3)	47	-	39	4	27	103	220
Fire Total	877	-	39	4	561	103	1,584
Total	2,250	-	266	57	1,278	361	4,212

(1) Retiree counts do not include combined DROs.
(2) Members are eligible for full retiree medical benefits.
(3) Includes VEBA participants who are eligible for the catastrophic disability medical benefits only from the Postemployment Healthcare Plan.

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

2. Contributions

Under GASB Statement No. 68, the City's and the participating employees' contributions to the Defined Benefit Pension Plans are based upon an actuarially determined percentage of each employee's pensionable and earnable salary to arrive at an actuarially determined contribution ("ADC") sufficient to provide adequate assets to pay benefits when due.

On June 24, 2008, the City Council adopted Ordinance No. 28332 amending Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for pension to PFDRP and FCERS. Subsequently, in October 2014, the Boards of Administration for PFDRP and FCERS approved implementing an incremental reduction approach to determining the "actuarial equivalence" for the City's prefunding of its contribution when the economic expansion has exceeded 58 months in duration and/or the S&P 500 has returns in excess of 130%. This approach was undertaken to ensure that as business expansions and/or market valuations mature and exceed historic norms, the Retirement Systems reduce the City's incentive to prefund its contributions when market valuations and/or economic expansions are beyond historic norms. The incremental reduction to be applied to the discount rate to the City's prefunding of its contribution is 15% per year, up to a maximum of 45%, which was the reduction to the discount rate that was applied to calculate the actuarially determined prepayment amount for the Tier 1 members to be paid by the City at the beginning of the fiscal year ended June 30, 2018.

As noted above, the San José Municipal Code has been amended to set forth the terms of Measure F and the Frameworks regarding, among other issues, Tier 2 pension benefits for members in PFDRP and FCERS. The contribution rates for PFDRP and FCERS Tier 2 members are calculated based on a 50/50 split of all costs, including unfunded actuarial accrued liability (UAAL). Currently, PFDRP and FCERS Tier 1 members split normal cost with approximately 72.7% paid by the City and approximately 27.3% paid by Tier 1 members. The responsibility for funding the UAAL is generally not shared with the Tier 1 employees.

The contribution rates for the Tier 1 Defined Benefit Pension Plans for the City and the participating employees for the fiscal year ended June 30, 2018 were based on the actuarial valuations performed as of June 30, 2016. Both valuations were performed before the implementation of the Measure F and the Frameworks. The Boards' actuary completed two separate actuarial reports for the implementation of the Tier 2 changes under Measure F for fiscal year ending on June 30, 2018. The PFDRP Tier 2 actuarial report was completed on May 4, 2017 and the FCERS Tier 2 actuarial report was completed on May 18, 2017.

In FY 2011, the Retirement Systems' Boards approved the establishment of a "floor funding method", commencing with FY 2012, setting the City's funding policy contribution amount to be the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll, for the fiscal year. The "floor funding method" applies to both PFDRP and FCERS except PFDRP Police Tier 2 and Fire Tier 2 or FCERS Tier 2, Tier 2B, and Tier 2C members.

In January and February 2016, the Retirement Systems' Boards approved the City's request that the floor methodology for Tier 1 pension contributions be used only for the annual employer Normal Cost contribution (which includes administrative expenses) and that the annual employer Unfunded Accrued Liability (UAL) contribution be set at the dollar amount recommended by the actuary and adopted by the Board in the annual actuarial valuation report beginning FY 2017. The "floor funding method" applies to both PFDRP and FCERS except PFDRP Police Tier 2 and Fire Tier 2 or FCERS Tier 2, Tier 2B, and Tier 2C members.

The contribution rates in effect and the amounts contributed to the pension plans for the fiscal year ended June 30, 2018 are as follows (dollars in thousands):

	PFDRP							
	City(1)				Participants			
Defined Benefit Pension Plan	**Police Tier 1**	**Police Tier 2**	**Fire Tier 1**	**Fire Tier 2**	**Police Tier 1**	**Police Tier 2**	**Fire Tier 1**	**Fire Tier 2**
Actuarial Rate:								
07/01/17-06/30/18	95.31%	15.17%	96.06%	16.26%	10.88%	15.17%	11.38%	16.26%

	FCERS			
	City(1)		Participants	
Defined Benefit Pension Plan	**Tier 1(1)**	**Tier 2**	**Tier 1**	**Tier 2**
Actuarial Rate:				
07/01/17-06/30/18	94.04%	7.72%	6.60%	7.72%

(1) The actual contribution rates paid by the City for the fiscal year ended June 30, 2018 differed from what is above for Tier 1 due to the City funding the actuarially determined contribution amount based on the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll, for the fiscal year.

	Annual Pension Contribution		
Defined Benefit Pension Plan	**City**	**Participants**	**Total**
PFDRP	$ 157,712	$ 23,841	$ 181,553
FCERS	$ 156,770	$ 20,501	$ 177,271

3. Net Pension Liability

The City's net pension liability for each Defined Pension Plan is measured as the total pension liability, less the pension plans' fiduciary net position as of the measurement date of June 30, 2017. The City's net pension liability as of June 30, 2018 of each of the Defined Pension Plan is measured as of June 30, 2017, using an annual actuarial valuation as of June 30, 2016 and rolled forward to June 30, 2017 using standard update procedures by the actuary for the respective plans. In summary, the City's net pension liability at June 30, 2018 is as follows (dollars in thousands):

PFDRP	$ 1,240,519
FCERS	1,950,418
CalPERS	1,419
Total net pension liability	$ 3,192,356

Changes in Net Pension Liabilities - The components of the net pension liabilities of the PFDRP and FCERS plans (i.e., the PFDRP's and FCERS's liabilities determined in accordance with GASB Statement No. 68 less the plans' fiduciary net positions) as of the measurement date, June 30, 2017, were as follows[1] (dollars in thousands):

[1] *The schedules of changes in the net pension liability as of June 30, 2018 are presented in the Required Supplementary Information.*

PFDRP	Increase (Decrease) Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (a-b)
Balance at 6/30/2016	$ 4,220,098	$ 3,043,651	$ 1,176,447
Changes for the Year:			
Service costs	72,760	-	72,760
Interest	290,961	-	290,961
Changes of benefit terms	5,752	-	5,752
Contributions-employer	-	136,957	(136,957)
Contributions-employees	-	20,580	(20,580)
Net investment income	-	292,733	(292,733)
Difference between expected and actual experience	67,557	-	67,557
Changes of assumptions	72,680	-	72,680
Benefit payments, including refunds of member contributions	(196,032)	(196,032)	-
Administrative expenses	-	(4,632)	4,632
Net changes	313,678	249,606	64,072
Balance at 6/30/2017	$ 4,533,776	$ 3,293,257	$ 1,240,519

FCERS	Increase (Decrease) Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (a-b)
Balance at 6/30/2016	$ 3,692,148	$ 1,858,880	$ 1,833,268
Changes for the Year:			
Service costs	51,887	-	51,887
Interest	249,387	-	249,387
Changes of benefit terms	12,132		12,132
Contributions-employer	-	138,483	(138,483)
Contributions-employees	-	17,227	(17,227)
Net investment income	-	146,012	(146,012)
Difference between expected and actual experience	40,853	-	40,853
Changes of assumptions	60,233	-	60,233
Benefit payments, including refunds of member contributions	(183,430)	(183,430)	-
Administrative expenses	-	(4,380)	4,380
Net changes	231,062	113,912	117,150
Balance at 6/30/2017	$ 3,923,210	$ 1,972,792	$ 1,950,418

Sensitivity of the Net Pension Liabilities to Changes in Discount Rates - The discount rates used to measure the total pension liabilities were 6.875%, for both the PFDRP and FCERS plans for the valuations dated June 30, 2016. It is assumed that PFDRP and FCERS members' contributions and City's contributions will be made based on the actuarially determined rates based on the funding policy of each board. Based on those assumptions, the PFDRP's and FCERS's fiduciary net positions are expected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments were applied to all periods of projected benefit payments to determine the total pension liabilities.

The following presents the net pension liabilities, calculated using the discount rates of 6.875% in effect as of the measurement date, as well as what the net pension liabilities would be if they were calculated using discount rates that are one percentage point lower (5.875%) or one percentage point higher (7.875%) than the rates used, for the PFDRP and FCERS plans, respectively (dollars in thousands):

PFDRP - Sensitivity Analysis	**1% Decrease (5.875%)**	**Measurement Date Rate (6.875%)**	**1% Increase (7.875%)**
Total pension liability	$ 5,213,524	$ 4,533,776	$ 3,986,598
PFDRP fiduciary net position	3,293,257	3,293,257	3,293,257
Net pension liabiltiy	$ 1,920,267	$ 1,240,519	$ 693,341
PFDRP fiduciary net position as a percentage of the total pension liability	63.2%	72.6%	82.6%

FCERS - Sensitivity Analysis	**1% Decrease (5.875%)**	**Measurement Date Rate (6.875%)**	**1% Increase (7.875%)**
Total pension liability	$ 4,480,433	$ 3,923,210	$ 3,470,615
FCERS fiduciary net position	1,972,792	1,972,792	1,972,792
Net pension liabiltiy	$ 2,507,641	$ 1,950,418	$ 1,497,823
FCERS fiduciary net position as a percentage of the total pension liability	44.0%	50.3%	56.8%

Pension Expense – For the year ended June 30, 2018, the City recognized pension expense as follows (dollars in thousands):

	FCERS	**PFDRP**	**Total**
Service costs	$ 51,886	$ 72,760	$ 124,646
Interest	249,388	290,961	540,349
Benefit changes	12,132	5,752	17,884
Difference between expected and actual experience	30,109	19,012	49,121
Changes of assumptions	115,873	51,977	167,850
Contributions-employee	(17,227)	(20,580)	(37,807)
Expected return on assets	(126,714)	(207,793)	(334,507)
Current year amortization of net difference between projected and actual investment earnings	33,326	40,392	73,718
Administrative expenses	4,380	4,632	9,012
Total pension expense	**$ 353,153**	**$ 257,113**	**$ 610,266**

Deferred outflows/inflows of resources – As of June 30, 2018, the City reported deferred outflows of resources related to pensions from the following sources (dollars in thousands):

Schedule of Deferred Inflows and Outflows of Resources - PFDRP

	Deferred Outflows of Resources	Deferred Inflows of Resources
Contributions subsequent to measurement date	$ 157,712	$ -
Differences between expected and actual experience	59,251	4,338
Changes in assumptions	122,123	-
Net difference between projected and actual earnings on pension plan investments	137,363	-
Total	**$ 476,449**	**$ 4,338**

Amounts reported as deferred outflows and deferred inflows of resources will be recognized in pension expense as follows:

Measurement year ended June 30:

2018	$ 111,382
2019	152,811
2020	67,198
2021	(16,992)
	$ **314,399**

Schedule of Deferred Inflows and Outflows of Resources - FCERS

	Deferred Outflows of Resources	Deferred Inflows of Resources
Contributions subsequent to measurement date	$ 156,770	$ -
Differences between expected and actual experience	43,727	-
Changes in assumptions	135,947	-
Net difference between projected and actual earnings on pension plan investments	120,176	-
Total	**$ 456,620**	**$ -**

Amounts reported as deferred outflows and deferred inflows of resources will be recognized in pension expense as follows:

Measurement year ended June 30:

2018	$ 179,306
2019	94,487
2020	29,918
2021	(3,861)
	$ **299,850**

As of June 30, 2018, $157,712,000 and $156,770,000 reported as deferred outflows of resources related to contributions subsequent to the measurement date for the PFDRP and FCERS, respectively, will be recognized as a reduction of the net pension liability in the year ending June 30,

2019. Other amounts reported as deferred outflows of resources related to pensions will be recognized as pension expense shown in the tables above (dollars in thousands).

Long-term Expected Rate of Return on Plan Investments - The assumption for the long-term expected rates of return on PFDRP and FCERS investments of 6.875% for the valuations dated June 30, 2016 was selected by estimating the median nominal rates of return based on long-term capital market assumptions provided by the PFDRP's and FCERS's investment consultants, including nominal expected rates of return for each of the asset classes, and reducing the estimated median by a margin so that there is estimated to be a greater than 50 percent probability of achieving the returns.

Best estimates of geometric real rates of return for each major asset class included in the target asset allocation for each plan as of the measurement date of June 30, 2017, are summarized in the following tables:

	PFDRP	
	Target Asset Allocation	**Long-Term Expected Real Rate of Return**
Global equity	31%	5.0%
Private equity	8%	7.0%
Global fixed income	16%	1.0%
Private debt	11%	4.0%
Real assets	17%	3.0%
Absolute return	6%	3.0%
Global tactical asset allocation/ Opportunistic	10%	2.0%
Cash	1%	0.0%
Total	100%	

	FCERS	
	Target Asset Allocation	**Long-Term Expected Real Rate of Return**
Global equity	28%	4.6%
Private equity	9%	7.0%
Global fixed income	19%	1.0%
Private debt	5%	4.3%
Real assets	23%	3.7%
Absolute return	11%	3.0%
Global tactical asset allocation/ Opportunistic	5%	2.1%
Cash	0%	0.2%
Total	100%	

The separately issued annual reports of PFDRP and FCERS provide more information about the most recent long-term expected rates of return on plan investments.

4. Actuarial Methods and Assumptions

The significant actuarial methods and assumptions used to compute the total pension liability as of June 30, 2018 are from the actuarial valuation report with a valuation date of June 30, 2016.

	PFDRP	FCERS
Description	**Method/Assumption**	**Method/Assumption**
Measurement date	June 30, 2017	June 30, 2017
Valuation date	June 30, 2016	June 30, 2016
Inflation rate	2.75%	2.50%
Discount rate	6.875% per annum (net of investment expenses)	6.875% per annum
Post-retirement mortality (a) Service:	CalPERS 2009 Healthy Annuitant Mortality Table multiplied by 0.948 for males and 1.048 for females and projected using Scale MP-2015 on a generational basis from base year of 2009.	Healthy annuitants: 0.952 for males and 0.921 for females, times the CalPERS 2009 Healthy Annuitant Mortality Table. Healthy non-annuitants: 0.919 for males and 0.918 for females, times the CalPERS 2009 Employee Mortality Table. Disabled annuitants: 1.051 for males and 1.002 for females, times the CalPERS 2009 Ordinary Disability Mortality Table. Mortality is projected from 2009 on a generational base using the MP-2015 scale.
(b) Disability:	CalPERS 2009 Industrial Disability Mortality Table for males multiplied by 0.903 and projected using SOA MP-2015 on a generational basis from base year of 2009.	
Rates of service retirement, withdrawal, death, disability retirements	Based upon the June 30, 2015, actuarial experience analysis	Tables based on current experience
Salary increases		
Wage Inflation	3.25% for all years	The base wage inflation assumption of 2.85% plus a merit / longevity increase based on years of service ranging from 4.50% at hire to 0.25% for members with 14 or more years of service.
Merit Increase	Merit component added based on an individual year's of service ranging from 6.75% to 1.00%	For the amortization schedule, payroll is assumed to grow 2.85% per year.
Cost of Living Adjustment	Tier 1 – 3% per year Tier 2 – 2% per year	Tier 1 – 3% per year Tier 2 – 1.5% per year

A. 2. California Public Employees' Retirement System (CalPERS)

Plan Description. The Mayor and members of the City Council are eligible to participate in the the State of California's Public Employees' Retirement System ("CalPERS") Public Agency Cost-Sharing Multiple-Employer Defined Benefit Pension Plan (the "Plan"). CalPERS acts as a common investment and administrative agent for various local and state governmental agencies within the State of California. The Plan provides retirement, disability and death benefits based on the employee's years of service, age and final compensation. Benefit provisions and other requirements are established by the California Public Employees' Retirement Law, employer contract with CalPERS and by City resolution. Retiree health benefits are not provided to Mayor/Councilmembers. CalPERS issues publicly available reports that include a full description of the pension plans regarding benefit provisions, assumptions and membership information. Reports can be found on CalPERS' website at https://www.calpers.ca.gov/page/home.

Benefits Provided. CalPERS provides service retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees, and beneficiaries. Benefits are based on a final average compensation period of 36 months. Members with five years of total service are eligible to retire at age 50 for Classic members and at age 52 for the Public Employees' Pension Reform Act of 2013 plan ("PEPRA") members with statutorily reduced benefits. The death benefit is one of the following: the Basic Death Benefit, the 1957 Survivor Benefit, or the Optional Settlement 2W Death Benefit. The cost of living adjustments for the plan are applied as specified by the Public Employees' Retirement Law, California Government Code Sections 20000-21703.

The CalPERS Plan's provisions and benefits in effect at June 30, 2018, are summarized as follows:

	Classic Rate Plan	PEPRA Rate Plan
Hire date	Prior to January 1, 2013	On or after January 1, 2013
Benefit formula	2% @ 55	2% @ 62
Benefit vesting schedule	5 years of service	5 years of service
Benefit payments	Monthly for life	Monthly for life
Retirement age	50-63	52-67
Monthly benefits, as a % of eligible compensation	1.426% to 2.418%	1.0% to 2.5%
Required employee contribution rates	7.00%	6.25%
Required employer contribution rates	8.418% + $118,978 for unfunded liability	6.533%

As of June 30, 2018, there were three current San José City Council members enrolled in the Classic rate plan and five current members in PEPRA rate plan.

Contributions. Section 20814(c) of the California Public Employees' Retirement Law requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. Funding contributions are determined annually on an actuarial basis as of June 30 by CalPERS. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by public employees during the year, with an additional amount to finance any unfunded accrued liability.

For the year ended June 30, 2018, the amount contributed to the CalPERS plan was as follows (dollars in thousands):

	Classic Rate Plan	PEPRA Rate Plan	Total
Contributions - employer	$ 152	$ 32	$ 184
Contributions - employee	23	30	53
Total	$ 175	$ 62	$ 237

Pension Liabilities, Pension Expense and Deferred Outflows/Inflows of Resources Related to Pensions

Information in this section is derived from the GASB Statement No. 68 Accounting Valuation Report for the miscellaneous risk pool at the measurement date of June 30, 2017 prepared by CalPERS. As of June 30, 2018, the City reported a net pension liability of $1,418,000 for its proportionate share of the net pension liability of the Plan. The proportion was determined based on the City's shares of actuarial accrued liability and market value of assets as of June 30, 2016.

The City's net pension liability for the Plan is measured as the proportionate share of the net pension liability. The net pension liability of the Plan is measured as of June 30, 2017, and the total pension liability for the Plan used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2016 rolled forward to June 30, 2017 using standard update procedures by CalPERS' actuary. The City's proportion of the net pension liability was actuarially determined at the valuation date. The City's proportionate share and propotionate percentage of the net pension liability as of June 30, 2016 and 2017 was as follows (dollars in thousands):

	Plan	
Proportion - June 30, 2016	$ 1,262	0.03634%
Proportion - June 30, 2017	1,419	0.03597%
Change - Increase (Decrease)	$ 157	(0.00037%)

For the year ended June 30, 2018, the City recognized pension expense of $196,000. At June 30, 2018, the City reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (in thousands):

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension contributions subsequent to measurement date	$ 184	$ -
Differences between actual and expected experience	2	(27)
Changes in assumptions	234	(17)
Change in employer's proportion and differences between the employer's contributions and the employer's proportionate share of contributions	-	(111)
Net differences between projected and actual earnings on plan investments	102	-
Total	$ 522	$ (155)

$184,000 reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows (in thousands):

Amounts reported as deferred outflows and deferred inflows of resources will be recognized in pension expense as follows:

Measurement year ended June 30:	
2019	$ 1
2020	118
2021	95
2022	(31)
	$ 183

Actuarial Assumptions – The total pension liability in the June 30, 2016 actuarial valuation was determined for the Plan using the following actuarial assumptions:

Information in this section is derived from the GASB 68 Accounting Valuation Report for miscellaneous risk pool at the measurement date of June 30, 2017 prepared by CalPERS.

	Plan
Valuation Date	June 30, 2016
Measurement Date	June 30, 2017
Actuarial Cost Method	Entry-Age Normal Method
Actuarial Assumptions	
Discount Rate	7.15%
Inflation	2.75%
Salary Increases	Varies by Entry Age and Service
Mortality Rate Table (1)	Derived using CalPERS' Membership Data for all Funds
Post Retirement Benefit Increase	Contract COLA up to 2.75% until Purchasing Power Protection Allowance Floor on Purchasing Power Applies, 2.75% thereafter

(1) The mortality table used was developed based on CalPERS-specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB. For more details on this table, please refer to the April 2014 CalPERS Experience Study and Review of Actuarial Assumptions report (based on CalPERS demographic data from 1997 to 2011) available online at https://www.calpers.ca.gov/docs/forms-publications/calpers-experience-study-2014.pdf

Other significant actuarial assumptions used in the June 30, 2016, valuation were based on the results of the actuarial experience study for the period from 1997 to 2011.

Change of Assumption – In FY 2017, the financial reporting discount rate for the Plan was lowered from 7.65 percent to 7.15 percent. Deferred outflows of resources for changes of assumptions presented in the Schedule of Collective Pension Amounts represent the unamortized portion of this assumption change.

Discount Rate – The discount rate used to measure the total pension liability was 7.15 percent and reflects the long-term expected rate of return for the Plan net of investment expenses and without reduction for administrative expenses. To determine whether the municipal bond rate should be used in the calculation of the discount rate for public agency plans, the amortization and smoothing periods recently adopted by the CalPERS Board in 2013 were used. For the Plan, the crossover test was performed for a miscellaneous agent rate plan and a safety agent rate plan selected as being more at risk of failing the crossover test and resulting in a discount rate that would be different from the long-term expected rate of return on pension investments. Based on the testing of the plans, the tests revealed the assets would not run out. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability for the Plan. The crossover test results can be found on CalPERS' website at https://www.calpers.ca.gov/page/employers/actuarial-services/gasb

The long-term expected rate of return on pension plan investments was determined using a building-block method in which expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Using historical returns of all the funds' asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11+ years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the rounded single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set to equal to the single equivalent rate calculated above and adjusted to account for assumed administrative expenses.

The table below reflects the long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation.

Asset Class	Current Target Allocation	Real Return Years 1 - 10(1)	Real Return Years 11+(2)
Global Equity	47%	4.90%	5.38%
Global Debt Securities	19%	0.80%	2.27%
Inflation Sensitive	6%	0.60%	1.39%
Private Equity	12%	6.60%	6.63%
Real Estate	11%	2.80%	5.21%
Infrastructure and Forestland	3%	3.90%	5.36%
Liquidity	2%	-0.40%	-0.90%
Total	100%		

(a) An expected inflation of 2.5% used for this period.
(b) An expected inflation of 3.0% used for this period.

Sensitivity of the Proportionate Share of the Net Pension Liability to Changes in the Discount Rate – The following presents the City's proportionate share of the net pension liability for the Plan, calculated using the discount rate for the Plan, as well as what the City's proportionate share of the net pension liability would be if it were calculated using discount rate that is 1-percentage point lower or 1-percentage point higher than the current rate (in thousands):

Sensitivity Analysis	**1% Decrease (6.15%)**	**Measurement Date Discount Rate (7.15%)**	**1% Increase (8.15%)**
Net pension liabiltiy	$ 2,210	$ 1,418	$ 762

Pension Plan Fiduciary Net Position – Detailed information about the pension plan's fiduciary net position is available in the separately issued CalPERS financial reports. Reports can be found on CalPERS' website at http://www.calpers.ca.gov/page/home.

A. 3. Defined Contribution Retirement Plan

In December 2012, the City adopted Ordinance No. 29184 amending Title 3 of the San José Municipal Code to amend various Sections of Chapter 3.28 and to add a new Chapter 3.49 for the purpose of establishing an option between the Tier 2 defined benefit plan and a defined contribution 401(a) plan that excludes participation in retiree healthcare, for Unclassified Executive Management and Professional Employees (Unit 99) who are hired on or after January 20, 2013. An employee is eligible to participate in the 401(a) plan if the employee is hired directly into Unit 99 on or after January 20, 2013 and must not have previously been a member of either of the City's defined benefit plans. An eligible employee must sign an irrevocable election form on his or her first day of employment with the City electing to participate in the 401(a) plan. If no irrevocable election form is signed, the employee will be automatically placed into the Tier 2 defined benefit plan.

Both eligible employees and the City are required to contribute 3.75% of participants' annual compensation. The City's contributions for each employee (and interest allocated to the employee's account) are fully vested upon the employee entering the 401(a) plan. The City contracts with an advisor to manage the 401(a) 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 401(a) plan's participants directs the investments of their separate account. The City must authorize changes to the 401(a) plan.

There were 94 participants in the 401(a) plan as of June 30, 2018. In FY 2018, the City and the participating employees contributed $139,000 to the 401(a) plan. As of June 30, 2018, the balance of the 401(a) plan was $1,247,000.

A. 4. Postemployment Benefit Plans Other than Pension Plans

1. General Information about the Postemployment Healthcare Plans

In addition to the Defined Benefit Pension Plans, the City also sponsors and administers two single employer defined benefit postemployment healthcare plans, the Police and Fire Department Postemployment Healthcare Plans (PFDRP), which includes a Postemployment Healthcare 401(h) Plan, the Police Department Postemployment Healthcare Plan (Section 115 Trust) and the Fire Department Postemployment Healthcare Plan (Section 115 Trust) and the Federated City Employees' Postemployment Healthcare Plan (FCERS), which includes 401(h) Plan and a Section 115 Trust, together the Postemployment Healthcare Plans. These Postemployment Healthcare Plans cover eligible full-time and certain part-time employees of the City, and are accounted in the Pension Trust Funds.

Generally, the defined benefit Postemployment Healthcare Plans provide medical and dental benefits to eligible retirees and their beneficiaries. Benefits are 100% of the premium cost for the lowest priced medical insurance plan available to an active City employee, and 100% of the premium cost for a dental insurance plan available to an active City employee.

Per the terms of the Frameworks discussed in Note IV A.1, the City established two separate Voluntary Employee Beneficiary Associations (VEBA) for retiree healthcare for the members of the PFDRP and FCERS in fiscal year 2017-2018. The City does not make contributions into the VEBAs and the VEBAs are not subject to the jurisdiction of the Retirement Boards.

In November 2017, the Internal Revenue Service and City entered into a Closing Agreement whereby Tier 1 members of both PFDRP and FCERS and some Tier 2 members of FCERS were eligible for an irrevocable opt-out of the applicable Postemployment Healthcare Plan into a VEBA. The transfer of their retiree healthcare contributions (medical and dental) from the applicable Postemployment Healthcare Plan to their individual VEBA accounts remained subject to Internal Revenue Service approval. The VEBA opt-in election period was October 18, 2017 through December 15, 2017. In February 2018, the Internal Revenue Service issued favorable private letter rulings with respect to the transfer of retiree healthcare contributions from both the PFDRP and FCERS Postemployment Healthcare Plans for those employees opting into a VEBA and in March 2018, the retiree healthcare contributions of members who opted in to a VEBA were transferred from the applicable Postemployment Healthcare Plan into their individual VEBA accounts. The Internal Revenue Service also approved allowing eligible employees who are rehired by the City during calendars years 2018 through 2022 to opt into the applicable VEBA and transfer the retiree healthcare contributions from the applicable Postemployment Healthcare Plan to their individual VEBA accounts.

The amounts transferred from the Postemployment Healthcare Plans to the individual VEBA accounts at June 30, 2018 are as follows (dollars in thousands):

PFDRP	$	7,897
FCERS		13,497
Total VEBA transfer	$	21,394

The current membership in the Postemployment Healthcare Plans as of June 30, 2018, is as follows:

	Retirees and Beneficiaries (1)		Terminated Vested Members not yet Receiving Benefits		Active Members		
PFDRP	**Tier 1 (2)**	**VEBA (3)**	**Tier 1**	**VEBA (3)**	**Tier 1**	**VEBA (3)**	**Totals**
Police	1,272	-	16	-	684	291	2,263
Fire	830	-	-	-	534	130	1,494
Total	2,102	-	16	-	1,218	421	3,757

(1) The combined domestic relations orders are not included in the count above as their benefit payment is included in the retiree member count.
(2) Payees that have health and/or dental coverage.
(3) Eligible for catastrophic disability benefits only

FCERS	**Tier 1 (1)**	**Tier 2A (1)**	**Totals**
Retirees and beneficiaries currently receiving benefits (2)	3,627	-	3,627
Terminated vested members not yet receiving benefits	164	-	164
Active members	1,662	89	1,751
Total	5,453	89	5,542

(1) Eligible for full retiree medical benefits.
(2) Payees that have health and/or dental coverage.

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

2. Contributions

Contribution amounts to the Postemployment Healthcare Plans for both the City and the participating members are based upon agreements between the City and the bargaining units. With the implementation of Measure F, Actuarially Determined Contributions ("ADC") will be calculated beginning with the fiscal year ending June 30, 2019. The Retirement Systems transitioned to annual valuations beginning June 30, 2010, from biennial actuarial valuations.

On June 24, 2008, the City Council adopted Ordinance No. 28332 amending Title 3 of the San Jose Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for postemployment healthcare benefits to PFDRP and FCERS.

Subsequently, in October 2014, the Boards of Administration for PFDRP and FCERS approved implementing an incremental reduction approach to determining the "actuarial equivalence" for the City's prefunding of its contribution when the economic expansion has exceeded 58 months in duration and/or the S&P 500 has returns in excess of 130%. This approach was undertaken to ensure that as business expansions and/or market valuations mature and exceed historic norms, the Retirement Systems reduce the City's incentive to prefund its contributions when market valuations and/or economic expansions are beyond historic norms. The incremental reduction to be applied to the discount rate to the City's prefunding of its contribution is 15% per year, up to a maximum of 45%, which was the reduction to the discount rate that was applied to calculate the actuarially determined prepayment amount for the Tier 1 members to be paid by the City at the beginning of the fiscal year ended June 30, 2018.

In FY 2011, the Retirement Systems' Boards approved the establishment of a "floor funding method", commencing with fiscal year 2011-2012, setting the City's funding policy contribution amount to be the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll, for the fiscal year. The "floor funding method" applies to both PFDRP and FCERS except PFDRP Police Tier 2 and Fire Tier 2 or FCERS Tier 2, Tier 2B, and Tier 2C members.

Funding Policy for PFDRP

The City and the unions representing employees in the PFDRP had negotiated a phase in of contribution rates to the full Annual Required Contribution as defined under GASB 45, up to the caps shown below.

Effective June 28, 2009, the Police members of the PFDRP entered into an agreement with the City to increase the contribution rates for retiree health and dental in order to phase-in to full funding of the ARC over the five-year period ending at the end of FY 2014.

Effective June 26, 2011, the Fire members entered into an agreement with the City to phase-in to fully contribute the ARC over a five-year period that expired at the conclusion of FY 2016.

In both agreements, the City and members of the PFDRP agreed that the member and City cash contribution rate shall not have an incremental increase of more than 1.25% and 1.35%, of pensionable pay in each year for the members and City, respectively.

On February 24, 2015, the City and the Police bargaining unit agreed to roll back the Police employee contributions rates from a total of 10.0% to 9.51% and the employer contribution rates from a total of 11.0% to 10.31%, effective March 15, 2015, and through FY 2017. These were the rates in effect for the year ended June 30, 2014, which shall remain frozen until implementation of the terms of the Public Safety Framework.

For the Fire members, the contribution rates for the year ended June 30, 2016, the last year of the phase in, were to remain frozen until implementation of the terms of the Public Safety Framework.

As noted elsewhere, on August 25, 2015, the City Council approved the terms of the Public Safety Framework, which included closing the defined benefit retiree healthcare benefit to new employees, agreement on a new lowest cost medical plan associated with retiree healthcare, and an agreement that a ballot measure would be placed on the November 8, 2016, ballot.

The Public Safety Framework allowed Tier 1 members in the PFDRP a one-time irrevocable election to remain in the defined benefit Postemployment Healthcare Plan or opt in to the defined contribution Voluntary Employee Beneficiary Association (VEBA). Under the terms of the Public Safety Framework, the Tier 1 members in PFDRP who opted to remain in the defined benefit Postemployment Healthcare Plan will contribute eight percent (8%) of pay and the City will continue to pay the phased-in contribution rate until the beginning of FY2019, subject to a cap of eleven percent (11%) of payroll of all active members of PFDRP.

On November 8, 2016, the Alternative Pension Reform Act, or Measure F, was passed. Measure F significantly changed the benefits and contribution agreement between the City and its employees, including amending the City Charter to prohibit enhancements to defined retirement benefits without voter approval and closing the defined benefit retiree healthcare plan to new employees.

Effective March 25, 2018, pursuant to the Public Safety Framework, the Tier 1 members in the PFDRP who opted to remain in the defined benefit Postemployment Healthcare Plan began to contribute eight percent (8.0%) of pay while the City continued to pay the phased-in contribution rate until the beginning of FY 2019; at that time, City will pay a contribution determined by the Board, subject to a cap of 11% of payroll of all active members of PFDRP.

The contribution rates in effect in fiscal year 2017-2018 are shown below:

PFDRP	City - Board Adopted		Member			
	Police Tier 1 / Tier 2	Fire Tier 1 / Tier 2	Police Tier 1	Police Tier 2	Fire Tier 1	Fire Tier 2
Actuarial Rate:						
Postemployment Healthcare Plan:						
03/25/2018 - 06/30/2018	10.31%	10.62%	8.00%	-	8.00%	-
07/30/2017 - 03/24/2018	10.31%	10.62%	9.51%	-	9.74%	-
07/01/2017 - 07/29/2017	10.31%	10.62%	9.51%	9.51%	9.74%	9.74%

Funding Policy for FCERS

The City and unions had negotiated a phase in of contribution rates to the full Annual Required Contribution as defined under GASB 45. However, as the rates became higher, the bargaining parties agreed to freeze the rates at the level shown below.

Effective June 28, 2009, the bargaining units representing the FCERS members entered into agreements ("Retiree Healthcare Agreements") with the City to increase contribution rates for retiree health and dental benefits in order to phase-in full funding of the GASB Statement No. 45 annual required contributions ("ARC") over a five-year period ending in FY 2013. The Retiree Healthcare Agreements also provide that the five-year phase-in of the ARC will not have an incremental increase of more than 0.75% of pensionable pay in each fiscal year for the employee or City contributions. Notwithstanding these limitations on incremental increases, the Retiree Healthcare Agreements further provided that, by the end of the five-year phase-in, the City and the employees shall be contributing the full ARC in the ratio currently provided in the relevant sections of the San José Municipal Code.

Effective June 18, 2013, the bargaining units representing the FCERS members entered into an amendment to the Retiree Healthcare Agreements that extended the incremental increase limitation of not more than 0.75% of pensionable pay for the fiscal year ended June 30, 2014. The 0.75% limitation was initially extended to December 20, 2014, and then to December 2015. In December 2015, the FCERS Board approved extension of the FY 2015 healthcare rates until the implementation of the Federated Framework. Pursuant to subsequent agreements with the Federated bargaining units, the City did not implement the full ARC rates and instead opted to extend the rates in effect for FY 2015 until the implementation of the Federated Framework. The FCERS Board approved the extension of the phase-in rates in March 2016.

On August 27, 2013, San Jose City Council adopted Ordinance No. 29283 to exclude FCERS Tier 2 members hired on and after September 27, 2013, from retiree medical and dental benefits (referred to as Tier 2B members) but the City shall bear and pay an amount equal to the additional costs incurred by the FCERS for that portion of the unfunded liability as determined by the actuary for the FCERS that the City and Tier 2B members would have otherwise paid as contributions had those employees been eligible for the retiree healthcare defined benefit.

On December 15, 2015 and January 12, 2016, the City and the bargaining units representing employees in FCERS reached a settlement agreement on the Federated Alternative Pension Reform Settlement Framework (Federated Framework). The terms of the Federated Framework also applied to unrepresented employees, including unrepresented management and executive employees in Unit 99. The Federated Framework included, an agreement on a new lowest cost medical plan associated with retiree healthcare, and an agreement that a ballot measure would be placed on the November 8, 2016, ballot. The defined benefit retiree healthcare plan was already closed to new Federated employees based on the action taken by City Council in 2013.

The Federated Framework allowed Tier 1 and Tier 2 members in FCERS a one-time irrevocable election to remain in the defined benefit Postemployment Healthcare Plan or opt in to the defined contribution VEBA. Under the terms of the Federated Framework, the Tier 1 and Tier 2 members in FCERS who opted to remain in the defined benefit Postemployment Healthcare Plan will contribute seven and one-half percent (7.5%) of pay and the City will continue to pay the phased-in contribution rate until the beginning of FY 2019, subject to a cap of fourteen percent (14%) of payroll of all active members of FCERS.

On November 8, 2016, the Alternative Pension Reform Act, or Measure F, was passed. Measure F significantly changed the benefits and contribution agreement between the City and its employees, including amending the City Charter to prohibit enhancements to defined retirement benefits without voter approval and closing the defined benefit retiree healthcare plan to new employees.Effective March 25, 2018, and under the terms of the Federated Framework, the Tier 1 and Tier 2 members in FCERS who opted to remain in the defined benefit Postemployment Healthcare Plan began to contribute seven and one-half percent (7.5%) of pay, and the City continued to pay the phased-in contribution rate until the beginning of FY 2019. At that time, the City will pay a contribution determined by the Federated Board, subject to a cap of fourteen (14%) of payroll of all active members of FCERS.

The contribution rates in effect in FY 2018 are shown below:

	Tier 1 and Tier 2	Tier 1B	Tier 2B	Tier 1C	Tier 1 and Tier 2	Tier 1B	Tier 1C
Actuarial Rate:							
Postemployment Healthcare Plan:							
03/25/2018 - 06/30/2018	9.41%	8.91%	12.66%	12.86%	7.50%	7.50%	N/A
07/01/2017 - 03/24/2018	9.41%	8.91%	12.66%	12.86%	8.76%	N/A	0.39%

3. Net OPEB Liability

The significant actuarial methods and assumptions ued to compute the net OPEB liability as of June 30, 2018 are from the actuarial valuation report with a measurement date of June 30, 2017.

Actuarial Methods and Assumptions

	PFDRP	FCERS
Measurement Date	June 30, 2017	June 30, 2017
Valuation Date	June 30, 2016	June 30, 2016
Actuarial Cost Method:	Entry Age Normal, level of percentage of pay	Entry Age Normal, level of percentage of pay
Actuarial Assumptions:		
Inflation Rate	2.75%	2.50%
Discount Rate	6.875%	6.875%
Merit Increase	Merit component added based on an individual's years of service ranging from 6.75% to 1.00%	Merit component added based on an individual's years of service ranging from 4.5% at hire to 0.25%.
Wage Inflation Rate	3.25% for FY2017 and for all years	2.85%
Investment Rate of Return	6.875%	6.875%
Mortality Rate*	Mortality is projected from 2009 on a generational basis using the MP-2015 scale.	Mortality is projected from 2009 on a generational basis using the MP-2015 scale.
Pre-Retirement Turnover**	Please see below table	Please see below table
Healthcare Trend Rate	Future medical inflation assumed to be at a rate of 8.5% to 4.25% per annum graded down over a 14 year period for medical-pre age 65 and 6.5% to 4.25% per annum graded down over 14 year period for medical-post age 65.	The valuation assumes that future medical inflation will be at a rate of 8.5% to 4.25% per annum graded down over a 14 year period for medical-pre age 65 and 6.5% to 4.25% per annum graded down over a 14 year period for medical-post age 65.
Dental Inflation Rate	4.00%	4.00%

Actuarial Methods and Assumptions – PDFRP Mortality Rates

Category	Male	Female
Healthy Annuitant	0.948 times the CalPERS 2009 Healthy Annuitant Mortality Table (Male).	1.048 times the CalPERS 2009 Healthy Annuitant Mortality table (Female).
Healthy Non-Annuitant	0.948 times the CalPERS 2009 Employee Mortality Table (Male).	1.048 times the CalPERS 2009 Employee Mortality Table (Female).
Disabled Annuitant	0.903 times the CalPERS 2009 Industrial Disability Mortality Table (Male).	0.903 times the CalPERS 2009 Industrial Disability Mortality Table (Female).

** Rates of Pre-Retirement Turnover. Sample rates of termination are shown in the following table.

	Rate of Termination	
Service	Police	Fire
0	16.00%	25.00%
1	11.75	7.00
2	9.85	3.50
3	8.35	1.75
4	7.00	1.25
5	5.75	1.00
6	4.75	0.90
7	4.00	0.80
8	3.50	0.70
9	3.50	0.60
10	3.50	0.50
11	3.50	0.50
12	3.00	0.50
13	2.50	0.50
14	2.00	0.50
15+	2.00	0.50

Termination rates do not apply once a member is eligible for unreduced retirement.

The assumption for the long-term expected rate of return on OPEB plan investments of 6.875% for the valuation year ended June 30, 2016 was selected by estimating the median nominal rate of return based on long-term capital market assumptions adopted by the Boards, including nominal expected rates of return for each asset class, and reducing the estimated median by a margin so that there is estimated to be a greater than 50 percent probability of achieving the return.

Best estimates of geometric real rates of return for each major asset class included in the PFDRP's target asset allocation as of valuation date as June 30, 2016, are summarized in the following table:

Asset Class	Target Asset Allocation	Long-Term Expected Real Rate of Return
Global equity	43.0%	5.3%
Fixed income	15.0%	1.0%
Real assets	22.0%	2.8%
GTAA/Opportunistic	20.0%	2.1%
Cash	-	0.2%

Actuarial Methods and Assumptions – FCERS Mortality Rates

Category	Male	Female
Healthy Annuitant	0.952 times the CalPERS 2009 Healthy Annuitant Mortality Table	0.921 times the CalPERS 2009 Healthy Annuitant Mortality Table
Healthy Non-Annuitant	0.919 times the CalPERS 2009 Employee Mortality Table	0.918 times the CalPERS 2009 Employee Mortality Table
Disabled Annuitant	1.051 times the CalPERS 2009 Ordinary Disability Mortality Table	1.002 times the CalPERS 2009 Ordinary Disability Mortality Table

** Rates of Pre-Retirement Turnover. Sample rates of termination are shown in the following table.

	Rate of Termination		
Age	0 Years of Service	1-4 Years of Service	5 or more Years of Service
20	18.00%	17.50%	9.00%
25	18.00	15.50	9.00
30	18.00	13.50	7.00
35	18.00	11.50	5.50
40	18.00	9.50	4.50
45	18.00	8.00	3.50
50	18.00	7.00	3.00
55	18.00	6.00	3.00
60	18.00	5.00	0.00
65	0.00	0.00	0.00

Withdrawal/terminations do not apply once a member is eligible for retirement

The assumption for the long-term expected rate of return on pension plan investments of 6.875% for the valuation year ended June 30, 2016, was selected by estimating the median nominal rate of return based on long-term capital market assumptions adopted by the FCERS Board, including nominal expected rates of return for each asset class, and reducing the estimated median by a margin so that there is estimated to be a greater than 50 percent probability of achieving the return.

Best estimates of geometric real rates of return for each major asset class included in FCERS's target asset allocation as of valuation date as June 30, 2016, (see the discussion of the FCERS's investment policy) are summarized in the following table:

Asset Class	**Target Asset Allocation**	**Long-Term Expected Real Rate of Return**
Global equity	46.0%	5.3%
Fixed income	30.0%	0.8%
Real assets	23.0%	3.4%
Cash	-	0.2%

Discount Rate for PFDRP and FCERS

The discount rate used to measure the total OPEB liability was 6.875% for the measurement year ending June 30, 2017 and is based on the long-term expected rate of return on investments. It is assumed that PFDRP/FCERS member contributions and City contributions will continue at the current contribution rates and that the City will contribute the implicit subsidy. Based on those assumptions, the PFDRP's and FCERS's fiduciary net positions are expected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return of 6.875% on OPEB plan investments for PFDRP and FCERS was applied to all periods of projected benefit payments to determine the total OPEB liability.

Change in the OPEB Liability

The changes in the net OPEB liability for the Postemployment Healthcare Plans are as follows (dollar amounts in thousands):

PFDRP	Increase (Decrease)		
	Total OPEB Liability (a)	Plan Fiduciary Net Position (b)	Net OPEB Liability (a) - (b)
Balance at June 30, 2017 (Valuation Date June 30, 2016)	$ 676,430	$ 123,427	$ 553,003
Changes recognized for the measurement period:			
Service cost	16,112	-	16,112
Interest	46,774	-	46,774
Contributions - employer	-	20,667	(20,667)
Contributions - employees	-	18,116	(18,116)
Net investment income	-	12,453	(12,453)
Benefit payments including refunds of member contributions	(24,799)	(24,799)	-
Administrative expense	-	(182)	182
Net changes	38,087	26,255	11,832
Balance at June 30, 2018 (Measurement Date June 30, 2017)	$ 714,517	$ 149,682	$ 564,835

FCERS	Increase (Decrease)		
	Total OPEB Liability (a)	Plan Fiduciary Net Position (b)	Net OPEB Liability (a) - (b)
Balance at June 30, 2017 (Valuation Date June 30, 2016)	$ 736,721	$ 225,846	$ 510,875
Changes recognized for the measurement period:			
Service cost	11,109	-	11,109
Interest	49,978	-	49,978
Contributions - employer	-	31,905	(31,905)
Contributions - employees	-	16,827	(16,827)
Net investment income	-	17,041	(17,041)
Benefit payments including refunds of member contributions	(31,007)	(31,007)	-
Administrative expense	-	(242)	242
Net changes	30,080	34,524	(4,444)
Balance at June 30, 2018 (Measurement Date June 30, 2017)	$ 766,801	$ 260,370	$ 506,431

Sensitivity of the Net OPEB Liability to Changes in Discount Rates

The following presents the net OPEB liability of the City if it were calculated using discount rates that are one percentage point lower or one percentage point higher than the current rate, for the measurement period ended June 30, 2017:

PFDRP

	1% Decrease (5.875%)	Current Discount Rate (6.875%)	1% Increase (7.875%)
Total OPEB liability	$ 824,501	$ 714,517	$ 626,078
PFDRP fiduciary net position	149,682	149,682	149,682
Net OPEB liability	$ 674,819	$ 564,835	$ 476,396
Percentage of the Total OPEB Liability	18.2%	20.9%	23.9%

FCERS

	1% Decrease (5.875%)	Current Discount Rate (6.875%)	1% Increase (7.875%)
Total OPEB liability	$ 877,863	$ 766,801	$ 676,758
FCERS fiduciary net position	260,370	260,370	260,370
Net OPEB liability	$ 617,493	$ 506,431	$ 416,388
Percentage of the Total OPEB Liability	29.7%	34.0%	38.5%

Sensitivity of the Net OPEB Liability to Changes in the Health Care Cost Trend Rates

The following presents the net OPEB liability of the City if it were calculated using health care cost trend rates that are one percentage point lower or one percentage point higher than the current rate, for the measurement period ended June 30, 2017:

PFDRP

	1% Decrease (7.5% decreasing to 3.25%)	Health Care Cost Trend Rates (8.5% decreasing to 4.25%)	1% Increase (9.5% decreasing to 5.25%)
Total OPEB liability	$ 615,232	$ 714,517	$ 839,004
Fiduciary net position	149,682	149,682	149,682
Net OPEB liability	$ 465,550	$ 564,835	$ 689,322
Percentage of the total OPEB liability	24.3%	20.9%	17.8%

FCERS

	1% Decrease (7.5% decreasing to 3.25%)	Healthcare Cost Trend Rates (8.5% decreasing to 4.25%)	1% Increase (9.5% decreasing to 5.25%)
Total OPEB liability	$ 666,629	$ 766,801	$ 891,030
Fiduciary net position	260,370	260,370	260,370
Net OPEB liability	$ 406,259	$ 506,431	$ 630,660
Percentage of the total OPEB liability	39.1%	34.0%	29.2%

OPEB Fiduciary Net Position

The City issues the publicly available financial reports that may be obtained from the Office of Retirement Services, 1737 North First Street, Suite 600, San Jose, CA 95112-4505.

Recognition of Deferred Outflows and Deferred Inflows of Resources for PFDRP and FCERS

Gains and losses related to changes in total OPEB liability and fiduciary net position are recognized in OPEB expense systematically over time.

One fifth of the net earnings is recognized in the first year when the gain or loss occurred. The remaining amounts are categorized as deferred outflows and deferred inflows of resources related to OPEB and are to be recognized in future OPEB expense.

The recognition period differs depending on the source of the gain or loss:

Net difference between projected and actual earnings on OPEB plan investments	5 Years
All other amounts	Expected average remaining service lifetime (EARSL) (6.0 Years at June 30, 2017)

PFDRP

For the year ended June 30, 2018, the City recognized OPEB expense of $9,918,000. As of June 30, 2018, the City reported deferred outflows and inflows of resources related to OPEB from the following sources (dollar amounts in thousands):

PFDRP	Deferred Outflows of Resources	Deferred Inflows of Resources
OPEB contributions subsequent to measurement date	$ 25,382	$ -
Net difference between projected and actual earnings on OPEB plan investments	-	2,802
Total	$ 25,382	$ 2,802

The $25,382,000 reported as deferred outflows of resources related to contributions subsequent to the June 30, 2017 measurement date will be recognized as a reduction of the net OPEB liability during the year ending June 30, 2019.

The City's contribution for the Postemployment Healthcare Plan during the year ended June 30, 2018 was as follows (dollar amounts in thousands). The Tier 1 contribution amount was calculated using the Board's approved funding policy (referred as the "floor methodology" in Note IV. A.4.2).

Fiscal year		**2018**			
Actuarial valuation year		**2016**			
	Police Tier 1	**Fire Tier 1**	**Police Tier 2**	**Fire Tier 2**	**Total**
Actual payroll	$ 100,590	$ 73,092	$ 19,736	$ 7,533	$ 200,951
Actuarial payroll	91,421	75,647	-	-	167,068
Actual payroll in excess of actuarial payroll	9,169	-	-	-	9,169
Normal cost rate for healthcare portion of total City rate	4.09%	-	-	-	-
Additional contributions due to the Floor Methodology	375	-	-	-	375
Prefunded contribution amount (BOY)	9,252	7,886	-	-	17,138
Regular contributions paid throughout the year	-	-	2,004	804	2,808
Implicit Subsidy	3,699	2,017	-	-	5,716
Adjustments and accruals	(412)	(307)	46	18	(655)
Total Contributions for the fiscal year	**$ 12,914**	**$ 9,596**	**$ 2,050**	**$ 822**	**$ 25,382**

Other amounts reported as deferred outflows/(inflows) of resources related to OPEB will be recognized as expense as follows (dollar amounts in thousands):

Year Ending June 30:	Deferred Inflows of Resources
2019	$ (700)
2020	(700)
2021	(700)
2022	(702)
	$ (2,802)

FCERS

For the fiscal year ended June 30, 2018, the City recognized a negative OPEB expense of $4,199,000. As of year ended June 30, 2018, the City reported deferred outflows of resources related to OPEB from the following sources (dollar amounts in thousands):

	Deferred Outflows of Resources	Deferred Inflows of Resources
OPEB contributions subsequent to measurement date	$ 32,397	$ -
Net difference between projected and actual earnings on OPEB plan investments	-	738
Total	$ 32,397	$ 738

The $32,397,000 reported as deferred outflows of resources related to contributions subsequent to the June 30, 2017 measurement date will be recognized as a reduction of the net OPEB liability during the year ending June 30, 2019.

The City's contributions for the Postemployment Healthcare Plan during the year ended June 30, 2018 was as follows (dollar amounts in thousands). The Tier 1 contribution amount was calculated using the Board's approved funding policy (referred as the "floor methodology" in Note IV. A.4.2).

Fiscal year		**2018**	
Actuarial valuation year		**2016**	
	Tier 1	**Tier 2**	**Total**
Actuarial payroll	$ 165,552	$ -	$ 165,552
Actual payroll	166,797	117,783	284,580
Actual payroll in excess of actuarial payroll	1,245	-	1,245
Normal cost rate for healthcare portion of total City rate	2.89%	-	-
Additional contributions due to the Floor Methodology	36	-	36
Prefunded contribution amount (BOY)	15,292	-	15,292
Regular contributions paid throughout the year	-	14,372	14,372
Implicit Subsidy	3,818	-	3,818
Adjustments and accruals	(1,239)	118	(1,121)
Total Contributions for the fiscal year	**$ 17,907**	**$ 14,490**	**$ 32,397**

Other amounts reported as deferred outflows/(inflows) of resources related to OPEB will be recognized as expense as follows (dollar amounts in thousands):

Year Ending June 30:	Deferred Inflows of Resources
2019	$ (185)
2020	(185)
2021	(185)
2022	(183)
	$ (738)

B. Commitments and Contingencies

1. Norman Y. Mineta San José International Airport

Purchase Commitments. As of June 30, 2018, the Airport was obligated for purchase commitments of approximately $22,900,000 primarily for the zero emission buses, Terminal B expansion ramp, perimeter security technology infrastructure, and various operating and maintenance agreements. The Airport has projected that it will expend or encumber approximately $263,100,000 on capital projects during the next five fiscal years. It is anticipated that funding for such capital projects will be provided primarily by proceeds from federal grants, commercial paper proceeds, and other Airport revenues.

Master Plan. In 1997, after extensive planning and environmental studies and reports, the City Council approved the new Master Plan. In a Record of Decision issued on December 6, 1999, the FAA conditionally approved a new Airport Layout Plan (“ALP”) for the Airport displaying the Master Plan projects and unconditionally approved all of the near-term projects. Both the Master Plan and the ALP have been amended several times since 1997 and currently are intended to provide facility improvements needed to accommodate forecast demand in the year 2027 for commercial passenger service, air cargo, and general aviation. Implementation of the Master Plan has been ongoing, collectively comprising improvements to the Airport’s terminal facilities, roadways, parking facilities, and airfield facilities, and includes 1.075 million square feet of passenger terminal facilities comprised of up to 49 gates; parking and garage facilities comprised of up to 16,200 public parking spaces, 2,600 employee parking spaces, and 10,000 rental-car parking spaces (including 2,000 ready-return spaces); air cargo facilities; ground transportation, roadway, and other access improvements; and airfield improvements. In the fall of 2005, and in recognition of how current market conditions were impacting passenger growth, the Airport and its airline tenants reexamined the Master Plan and developed the Terminal Area Improvement Program (“TAIP”), a program for implementing the Master Plan by aligning ongoing and planned construction activities with available fiscal resources, taking into account revised passenger growth projections. In June 2006, the City Council approved an amendment to the Master Plan to incorporate the TAIP and other Airport Development Program (“ADP”) revisions. Funding for Master Plan projects is from several sources, including grants, PFC, airline rates and charges, airport revenue bonds, and subordinated commercial paper proceeds.

In June 2010, the City Council approved the most recent amendment to the Master Plan that updated projected aviation demand and facility requirements. This amendment to the Master Plan modified specific components of the ADP. Pursuant to the amended Master Plan, the former interim long-term public parking and employee parking lots on the northwest side of the Airport (which have been relocated to the east side terminal area) are designated for development of facilities to accommodate projected growth in general aviation demand. The 29-acre Signature fixed based operations facility is located in this portion of the Airport, and an additional 15 acres north of the FAA air traffic control tower remains available for future general aviation development opportunities.

FAA Audit of Use of Revenue. Federal law requires all airport owners that receive federal assistance, such as the City, to use airport revenues for the capital or operating costs of the Airport. As a general rule, any use of airport revenues by an airport owner for costs that cannot properly be considered airport capital or operating costs is deemed to be improper revenue diversion. On June 2, 2010, auditors from the FAA provided the City with a draft of its audit findings alleging improper use of Airport revenues by the City in three areas of expenditure. On August 14, 2015, as the result of discussions and correspondence with City staff, the FAA notified the City that it has closed two of the three audit issues. The remaining audit issue is described below.

Cost Allocations - The City uses both direct and indirect methodologies to allocate costs to the Airport. The FAA auditors found the direct cost allocations to be acceptable. The FAA contends that the City's indirect methodology does not correlate to the cost of services actually provided by the City to the Airport. Consequently, the auditors have recommended that the City re-allocate its costs charged to the Airport for fiscal years 2005 through 2010 using an allocation methodology that reflects services actually provided to the Airport and repay any overcharges to the Airport, with interest. The City believes the allocation methodology used to allocate costs to the Airport is in compliance with federal cost allocation guidance. In an effort to resolve the issue, the City proposed and implemented a cap on the indirect cost allocations for certain City departments at 10%, which was the approximate rate charged to the Airport in pre-capital intensive years. This resulted in a total credit of $5,600,000 that would be applied equally to the Airport cost allocation plan over a seven year period beginning in FY 2013 and ending in FY 2019. The City also has adjusted its indirect cost allocation methodology in an effort to address FAA concerns, including removal of debt expenditures from the relative expenditures base started in FY 2016, continuing with the 10% cap, and monitoring a rolling five-year average of the relative expenditure base to smooth out expenditure fluctuations.

On August 14, 2015, the FAA accepted the corrective actions that the City has already taken, however, the FAA, disagrees with the City's inclusion of capital expenditures in the allocation of indirect costs. The City will continue discussions with the FAA, but cannot predict the final outcome of the audit.

On May 3, 2018, the City received a letter from the FAA in which the FAA requested a copy of the City's FY 2017 indirect cost allocation plan to substantiate indirect charges to the Airport in order to finalize the FAA's financial compliance review. The City responded to the FAA on July 20, 2018 with copies of the requested information and clarified actions taken by the City to date to implement the FAA's recommendations. The City will continue discussions with the FAA, but cannot predict the final outcome of the audit.

Potential Claim from FAA Regarding Reuse of Guadalupe Gardens - In early 2002, the City Council approved a Master Plan for Guadalupe Gardens, consisting of approximately 120 acres of mostly vacant, City-owned property located south of the Airport, much of which falls within an FAA-established safety zone. The City acquired the Guadalupe Gardens properties using FAA grants for airport approach protection and noise compatibility, and the FAA grant agreements consequently required FAA approval of any planned City-use of the properties acquired with grant proceeds. By letter dated August 9, 2002, addressed to the City's Director of Aviation, the FAA San Francisco Airport District Office ("ADO") approved the City's Master Plan for reuse of Guadalupe Gardens for runway and approach protection, and the City finalized the Master Plan in reliance upon the FAA approval.

During discussions regarding proposals to develop certain portions of the Guadalupe Gardens, the FAA has taken the position that the City must dispose of any portion of the Guadalupe Gardens that is no longer needed for noise compatibility purposes. Citing provisions of federal law that require recipients of FAA grants for acquisition of land for noise compatibility purposes to dispose of any such acquired land when no longer needed by the airport owner for noise compatibility purposes, the FAA contends that the FAA ADO erred in its 2002 approval of the Guadalupe Gardens Master Plan and that the City is obligated to prepare an inventory of the Guadalupe Gardens to identify those parcels that were acquired by the City with noise compatibility grant proceeds. This inventory would then be used to prepare for FAA review and approval of a disposition plan for those parcels no longer needed by the City for noise compatibility. Proceeds of the sale of the parcels proportionate to the FAA grant share of the original purchase price would be required to be used for other approved noise compatibility projects at the Airport or returned to the FAA.

The City believes that it has viable defenses to any potential claim by the FAA with regard to Guadalupe Gardens. The FAA ADO's 2002 approval of the Guadalupe Gardens Master Plan constituted an official FAA approval of the City's reuse of the parcels acquired with proceeds from FAA noise compatibility grants, and the approval expressly provides that the entire Guadalupe Gardens is necessary for the continuing aeronautical purpose of runway and approach protection. Having received official FAA approval of its reuse of the parcels, the City believes it is under no obligation to take any further action to secure further FAA approval of its continuing use of the Guadalupe Gardens. However, the City cannot predict the final outcome of any such potential claim by the FAA.

2. San José – Santa Clara Regional Wastewater Facility

Plant Master Plan. In November 2013, the City Council approved the Plant Master Plan ("PMP"), a 30-year planning-level document focused on long-term rehabilitation and modernization of the Plant. The PMP recommends more than 114 capital improvement projects to be implemented over a 30-year planning period at an estimated investment level of approximately $2 billion. On September 24, 2013, the City Council approved a consultant agreement with MWH Americas, Inc. to assist and support the City in developing and implementing this Capital Improvement Program ("CIP"). On June 2, 2015, a funding strategy was recommended to and approved by the City Council. An update to the strategy was approved by the City Council on January 12, 2016. For the next five years, the City's portion of the funding for the San Jose-Santa Clara Regional Wastewater Facility ("Plant") Adopted CIP is programmed into the City's 2019-2023 CIP budget. The City's 2018-2019 approved operating budget includes a 3% increase in the Sewer Service and Use Charge rate for FY2019.

Revenues for the 2019-2023 Adopted CIP are derived from several sources: utilization of available resources in the City of San José Sewer Service and Use Charge sub-fund and Sewage Treatment Plant Connection Fee sub-fund; contributions from the City of Santa Clara and other tributary agencies for the treatment of sewage from their respective jurisdictions by the Plant; interest earnings; Calpine Metcalf Energy Center Facilities repayments; federal grants from the U.S. Bureau of Reclamation; and bond and commercial paper proceeds.

Pursuant to an agreement executed between San José and Santa Clara in 1959 (the "1959 Agreement"), San José is co-owner and administering agency of the Plant. The Plant also provides wastewater treatment services to other neighboring agencies through five outside user agreements ("Master Agreements") with City of Milpitas, West Valley Sanitation District, Cupertino Sanitary District, Burbank Sanitary District, and CSD 2-3 (the "Tributary Agencies"). Contributions from the City of Santa Clara and the Tributary Agencies are made pursuant to agreements with each agency based on the anticipated operation and maintenance, and capital budget. The Tributary Agencies' proportional contribution for the operation and maintenance cost is based on the amount and characteristics of the sewage discharged into the Plant. Each Tributary Agency's capital contribution is based on each agency's reserved capacity in the Plant. The balance of the Plant budget is shared between the cities of San José and Santa Clara based on the respective City's assessed property value relative to the total assessed property value in both jurisdictions. In the 2018-2022 Adopted CIP, contributions from the City of Santa Clara and other agencies are approximately $317,300,000.

Currently, a short-term financing has been put into place (see Note III.F.10) and staff has developed a long-term bond financing plan for San José's share of the CIP's cost. The City plans to gradually build required operating reserves in anticipation of securing long-term bonds independently. The 2019-2023 Adopted CIP assumes the need to issue bonds in 2021-2022.

On January 22, 2016 and September 7, 2016, San José, as the administering agency, received claims from the Tributary Agencies alleging a breach of contract and inequity under the Master Agreements. The administrative claims primarily arise out of disagreements regarding the interpretation of how the capital cost to rehabilitate the Plant as generally described in the Plant Master Plan should be apportioned, and whether the Master Agreements must be amended to require the Tributary Agencies to pay for their respective portions of the capital cost.

The Master Agreements require that any allegation of breach of contract or inequity (“Claim”) be filed with the legislative bodies of the agencies that committed the alleged breach, and with the Treatment Plant Advisory Committee (“TPAC”). TPAC is an advisory body, comprised of representatives of San José, Santa Clara and three of the Tributary Agencies that was established by the Master Agreements to provide policy and budget guidance to San José, as the Plant’s administering agency.

The Master Agreements specify the procedures for consideration of the Claims. TPAC is required to conduct a hearing regarding a claim within two (2) months. TPAC is then required to prepare a full report of its findings and recommendations to the San José and Santa Clara City Councils. The report is advisory. If any of the parties to the claim disagree with the report, the legislative bodies of the agencies that are parties to the claim are required to meet jointly within two (2) months of receiving the report. If the joint meeting fails to resolve the claim, the agency alleging the claim can file a lawsuit in court after giving the other party or parties to the claim three (3) months to cure the breach or alleged breach.

TPAC conducted a hearing on March 24, 2016, and issued its report on June 9, 2016 to deny the January 22, 2016 Claim. The Tributary Agencies disagreed with the report, and requested a joint meeting of the legislative agencies of the City, Santa Clara and all the Tributary Agencies. San José, Santa Clara, and the Tributary Agencies agreed to mediate the Claims and potential amendments to the Master Agreements but were unable to reach a resolution. On May 19, 2017, TPAC conducted a hearing on the Tributary Agencies’ September 7, 2016 Claim, and issued its report on September 14, 2017 to deny the September 7, 2016 Claim. On June 13, 2017, the City, Santa Clara and the Tributary Agencies agreed to waive the hearings before the joint legislative bodies for both Claims.

The Tributary Agencies filed a complaint against the City and Santa Clara on March 23, 2018, and served both cities on May 18, 2018. The allegations in the complaint are substantially similar to the claims raised and heard through the administrative hearing process. The Tributary Agencies allege the City breached their respective contracts, which set the terms for treating the Agencies’ wastewater by, among other allegations, charging them for expenditures they allege the contracts do not authorize and concealing how the funds are used. They also allege the City breached the implied covenant of good faith and fair dealing and violated certain California Constitutional provisions limiting local agencies’ imposition of property related fees, charges and taxes. The Tributary Agencies further allege their payments resulted in unjust enrichment to the City and Santa Clara, and that the court should provide declaratory relief in support of their allegations.

The City and Santa Clara filed a demurrer to the complaint on August 9, 2018. The most recent case management conference was on August 10, 2018. The hearing on the demurrer is scheduled for December 17, 2018. The Tributary Agencies have fully paid their portion of the capital cost for the projects to rehabilitate the Plant to date. The City cannot predict the outcome or the timeline for resolution of the complaint.

South Bay Water Recycling Program. The South Bay Water Recycling ("SBWR") project is a regional water reclamation program to recycle highly treated wastewater for irrigation and industrial uses in the cities of San José, Santa Clara, and Milpitas, California. This program is part of an action plan, developed by the City and other agencies tributary to the Plant and adopted by the Regional Water Quality Control Board ("RWQCB"), to control the amount of effluent discharged by the Plant into San Francisco Bay.

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

In June 1997, the RWQCB and the City approved the Proposed Revision to the South Bay Action Plan, which described the projects necessary to reduce average dry weather effluent flow from the Plant to below 120 million gallons per day and protect salt marsh habitat for endangered species in the South Bay as required by RWQCB Order 94-117. These projects include expanding the Phase I non-potable reuse system by extending additional piping, placing greater emphasis on water conservation programs, reducing infiltration inflow, augmenting stream flow, and creating wetlands. The estimated cost for implementing these projects was $127,500,000. As of June 30, 2018, $116,711,000 has been expended or encumbered on the expansion of Phase I of the SBWR. These costs were funded by the City, Santa Clara, and the tributary agencies using the Plant through a combination of State Revolving Fund Loans, Sewage Treatment Plant Connection Fees, federal grants, and cash contributions.

In FY 2016, the City and the Santa Clara Valley Water District ("SCVWD") accepted a report that had been commissioned by both the City and the SCVWD related to SBWR, entitled: "South Bay Water Recycling Strategic and Master Planning ("Strategic Report"). The Strategic Report contemplates near term projects (fiscal years 2017 to 2021) at an estimated cost of $49 million and long-term improvements and expansion of the existing system (fiscal years 2020 to 2035) at an estimated cost of $243.2 million for long-term nonpotable reuse projects and an additional $522 million for long-term potable use projects. No specific plan for the development or source of financing of the other near term improvements, nor the long-term improvements identified in the Strategic Report has been developed to date. Further, the responsibility for the development of the long-term improvements has not been established and may involve the formation of a separate entity responsible for the oversight and funding of these improvements.

Recycled Water Facilities and Programs Integration Agreement between the City of San José and the Santa Clara Valley Water District ("SCVWD"). The City and the SCVWD entered into an agreement on March 2, 2010 ("Integration Agreement") to collaborate on design, construction and operation of an advanced treated recycled water facility and related facilities now called the Silicon Valley Water Treatment Facility ("SVWTF"). In 2003, the City and SCVWD began collaborating on design, construction and operation of an advanced treated recycled water facility and related facilities, to be located on lands owned by the Plant, in order to demonstrate the treatment capability of a local facility to produce highly purified water that could be blended with existing recycled water to expand irrigation and industrial uses. The City, as the administering agency for the Plant, and the SCVWD desired to financially support the production and use of recycled water in Santa Clara County consistent with each party's separate and distinct interests: for wastewater treatment and disposal for the City, and water quality and supply for the SCVWD, as well as to coordinate and cooperate to achieve the most cost effective, environmentally beneficial utilization of recycled water to meet both agencies' needs. The term of the Integration Agreement is from July 1, 2010 through June 30, 2050, and co-terminus with the Ground Lease and Property Use Agreement between the City and SCVWD for construction and operation of the SVWTF on Plant lands.

SCVWD and the City agreed to capital investment towards the construction of the SVWTF in the amount of $70,000,000 and $11,000,000, respectively, as of the date of the signed agreement on March 2, 2010. SCVWD determines the operational and maintenance budget for the SVWTF, and operates the facility. Separate formulas were established to determine each party's respective share of the annual operation and maintenance cost for the SVWTF following the first full fiscal year the SVWTF becomes operational, which was FY 2015. The formula provides that for each fiscal year when the SBWR is operating at a net loss, the City would pay to the SCVWD an amount to support SCVWD's operational cost up to $2,000,000. In the event that the SBWR operates at net revenue, the City would share its revenue with the District with the first 50% towards the District's costs and the second 50% divided between the two agencies based on their respective capital investment in the recycled water infrastructure. In 2010, the City's estimated investment in SBWR system and SVWTF was $250,000,000; and the SCVWD's estimated investment in SVWTF is $70,000,000.

Under the Integration Agreement, commencing in January 2016, the City and SCVWD are to provide the other agency with audited financial statements for the prior fiscal years for the operation of the SBWR and the SVWTF. Since the definition of net operating cost and revenue under the Integration Agreement excludes certain costs and revenues that might otherwise be considered in either party's overall budget, each party must prepare a separate statement following the publication of each party's annual audited financial statements, to establish each party's respective cost share for the operation of the SVWTF. The City and SCVWD have each provided the other with its audited financial statements for the operations of the SBWR and the SVWTF, respectively, for the FY 2016 and FY 2017 with no adjustment to share cost. In January 2019, the audit report for the third year of full operations or year ended June 30, 2018 will be completed and issued as per the terms of the Integration Agreement.

3. Bay Area Water Supply and Conservation Agency

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

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

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

BAWSCA's annual debt service amount for FY 2018 is $24,675,000. The City's annual bond surcharge for FY 2018 was estimated to be $1,047,000 based the City's actual wholesale water use in the year ended June 30, 2016. The annual surcharge for each agency is based upon the actual wholesale water purchase percentage from the last full year for which date is available with an annual reconciliation based upon the actual water purchased. A true-up adjustment based on the actual year ended June 30, 2016 water use is included in the FY 2018 bond surcharge. The current best projection on the City's annual surcharge for the future is $902,000.

4. New Market Tax Credit

In November 2011, the City participated in the federal New Markets Tax Credit program ("NMTC") to secure additional funds to finance the construction of the Environmental Innovation Center ("EIC") on City owned property. The NMTC program allocates community development entities ("CDEs") tax credits to be claimed by investors when the investment is made available for community development in the form of a loan. The following describes the City's participation in the financing transaction.

The City caused the formation of an independent nonprofit entity called the EIC QALICB, Inc. to be the recipient of the loan for the construction of the EIC. The City and EIC QALICB, Inc. entered into a ground lease of the EIC for a term of 99 years and the City then leased back the EIC from the EIC QALICB, Inc. for a term of 35 years, beginning November 8, 2011. JP Morgan Chase Bank, N.A. formed Chase Community Equity, LLP, to be a 99.9% member of the Chase NMTC SJEIC Investment Fund, LLC, and provided the Chase NMTC SJEIC Investment Fund, LLC with an initial investment of $7,705,000. Chase NMTC SJEIC Investment Fund, LLC then borrowed $19,610,000 from the City, and invested the total amount of $26,699,000 in three CDEs. The CDEs loaned the EIC QALICB, Inc. $25,945,000 to construct the EIC. In exchange for JP Morgan Chase Bank's participation in the NMTC transaction, JP Morgan Chase Bank can claim a tax credit of $10,412,000 against federal income taxes over a seven year compliance period through November 2018.

The City's loan to Chase NMTC SJEIC Investment Fund, LLC ($19,610,000) was comprised of a one-day loan ($8,022,000) to the City, and funds originally set aside by the City for construction of the EIC ($11,588,000). The City was able to repay the one-day loan once the EIC QALICB, Inc. paid the City for the ground lease ($8,022,000). The EIC QALICB, Inc. paid for the ground lease from its loan proceeds ($25,945,000). The remainder of the loan proceeds ($16,078,000) paid for the construction of the EIC, and to fund reserves to pay the CDEs and JP Morgan Chase Bank for costs to comply with NMTC requirements during the seven year compliance period.

The EIC QALICB relies on the City's master lease rent to meet the loan repayments. The loan is secured by the EIC QALICB's ground lease. In the event of a loan default, the lenders may foreclose on the loan and assume the ground lease subject to the master lease with the City. Under the master lease, the City did not have an obligation to remit rent payments until it had beneficial use of the property. The master lease does not provide for an automatic extension of the lease term in the event that the City fails to make rent payments to the EIC QALICB. In order to be able to make the payments on the loan in the absence of rent payments from the City, the EIC QALICB had set aside sufficient funds in reserve to meet its loan repayment obligations during construction.

Pursuant to the New Markets Tax Credit financing, the EIC QALICB, Inc. agreed to indemnify the JP Morgan Chase Bank, and the CDEs against a recapture of the tax credits by the Internal Revenue Service in the amount of $10,412,000 and for any other fees or penalties and costs that may be incurred. The events that would trigger a recapture of the tax credits are limited to: (1) the EIC QALICB, Inc. failing to qualify as an entity eligible for the NMTC program, (2) redemption by the City or JP Morgan Chase of any portion of its investment, (3) changes in the NMTC program resulting in less tax credits to JP Morgan Chase, (4) City engaging in prohibited use of the EIC, (5) failure to invest the funds in the construction of the project, and (6) any willful misconduct or gross negligence or fraud causing a recapture or disallowance. The risk of a tax credit recapture event is remote because the EIC QALICB, Inc. has used all the proceeds from the financing into the construction of the EIC, and all parties to the financing have a vested interest in meeting the NMTC program requirements.

Chase Community Equity, LLP and Community Development Properties New Markets MM, Inc. put their collective 100% membership interest in the Chase NMTC SJEIC Investment Fund, LLC for sale to the City for $1,010 as a conclusion of the compliance period on Novermber 8, 2018. The City Council approved the purchase and the Investment Fund's redemption of its interest in the CDEs. The initial actions to unwind the NMTC closed on November 9, 2018. In connection with the closing, the following occurred. The City became the sole member of the Investment Fund, and holder the notes on the loan to the EIC QALICB, Inc. secured by a leasehold deed of trust to the EIC. The Investment Fund assigned the notes and leasehold deed of trust to the City as satisfaction of the leverage loan. It is anticipated that prior to Fedruary 1, 2019, in exchange for the EIC QALICB's agreement to terminate the Ground Lease and Master leases, the Investment Fund will forgive the loan to the EIC QALICB. Once the City has possession of the EIC, the Investment Fund can be dissolved, and the EIC QALICB may file the necessary forms to unincorporate. If the leases and loan are maintained, the EIC QALICB and the City, in turn as the master tenant, will be required to begin paying principal on the loan estimated to be $599,000 annually in 2019 through 2053. The potential principal payment exceeds the rental revenue to the EIC QALICB from the Master Lease with the City.

5. Retirement Systems – Unfunded Commitments

As of June 30, 2018, PFDRP had unfunded commitments to contribute capital for private debt investments in the amount of $156,854,000, private equity investments in the amount of $245,295,000 and real assets investments in the amount of $126,108,000. FCERS had unfunded commitments to contribute capital for private market fund investments in the amount of $367,301,000.

6. *Federal Financial Assistance Programs*

The City participates in a number of federally assisted grant programs, primarily with the U.S. Department of Housing and Urban Development (HUD), the Federal Aviation Administration (FAA), the US Department of Transportation, and the US Department of Labor. These programs are subject to program compliance audits by the grantors or their representatives.

Although the City's grant programs are audited in accordance with the provisions of the Single Audit Act Amendments of 1996 for the year ended June 30, 2018, these programs are still subject to financial and compliance audits by Federal auditors, and to resolution of identified findings and questioned costs. At this time, the amount of expenditures, if any, which may be disallowed by the granting agencies cannot be determined.

7. Encumbrances

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

As of June 30, 2018, total governmental fund encumbrance balances for the City are as follows (dollars in thousands):

General Fund	$	38,575
Housing Activities		4,890
Low and Moderate Income Housing Asset		5,337
Special Assessment Districts		1,193
San José Financing Authority Debt Service		1
Nonmajor governmental funds		99,906
Total governmental funds	$	149,902

8. Overpayment of Pensions

On November 30, 2016, twenty-one individuals who are retired members of FCERS and their spouses, a surviving spouse of a FCERS retiree and an association representing FCERS retired members or to-be-retired FCERS members, their qualified spouses, domestic partners, dependents and beneficiaries (the "Claimants") filed a claim against the City and the FCERS Board and have since filed a lawsuit against the City. The lawsuit arises from the limitations on pension payments payable by tax-qualified retirement plans imposed by Internal Revenue Code Section 415 ("Section 415"). The lawsuit alleges that the City has failed to provide the Claimants with their fully-earned vested retirement pension benefits as a result of the application of Section 415 limitations. The lawsuit further alleges that the City should have established a separate plan as allowed under Section 415 or should have taken other lawful action as appropriate to pay Claimants the amount of the compensation that would exceed the Section 415 limitations. The lawsuit sets forth a number of theories on which Claimants base their claim for relief, including but not limited to, impairment of vested rights, breach of fiduciary duty, equitable and promissory estoppel, fraud, misrepresentation, conspiracy to defraud or misrepresentation and abuse of discretion.

PFDRP's Board has also been discussing on-going benefit adjustments and recoupment of overpayments related to the Fair Labor Standards Act ("FLSA") and other pensionable pay corrections at their monthly meetings since December 1, 2016. These include non-pensionable FLSA pay issues related to the incorrect inclusion of non-pensionable earnings as pensionable for Fire members from 1998 to 2008 due to the City's payroll system programming; and non-FLSA pay issues such as Holiday-in-Lieu corrections, Higher Class Pay being erroneously counted as pensionable pay, disability pays which should have been pensionable, and lump sum retroactive pay not being spread to the correct pay periods.

With regard to the FLSA issues, the PFDRP Board approved correcting the ongoing benefit payments in the February 2017 benefit payment. In June 2017, the PFDRP Board approved the process to collect past over-payments to begin with the August 2017 benefit payments. In September 2017, the PFDRP Board voted to send the City a letter seeking the balance of the monies owed but not recovered from the retirees for overpayments related to the FLSA. In November 2017, the PFDRP Board voted to send a single letter to the City seeking the balance of monies owed but not recovered from the retirees arising from the FLSA issue and the other issues. In a letter sent to the City Manager, dated November 30, 2017, the Office of Retirement Services demanded that that the City make payment to the PFDRP prior to December 31, 2017 in the amount of $2,215,000 (including interest calculated at the rate of 7% per annum through December 31, 2017) for the overpayments related to the FLSA issue ($1,214,000) and the other pensionable pay issues ($1,000,000). This matter has not been resolved.

The Office of Retirement Services has also been working on pensionable pay corrections involving members of FCERS Tier 1 plan. According to a Memorandum dated August 8, 2018 to the FCERS Board there has been overpayment of retirement benefits paid to certain retirees, due to errors in the City's reporting of pensionable pay that was then used in the members' benefit calculation. The total number of overpaid beneficiaries and members is 351.

At the August 16, 2018 FCERS Board meeting, the Board members voted, to the extent possible, to stop the overpayments made to members immediately and also voted to not seek repayment from the impacted retirees, but to instead have the overpayment added to the unfunded liability of FCERS Tier 1 plan, which is repaid from the City's contributions. Office of Retirement Services staff projected that overpayment amount would total approximately $1,783,000 as of August 31, 2018.

With respect to each of the matters described in this Note IV.B.8, the City is unable to predict the final resolution.

9. Consent Decree with San Francisco Baykeeper

San Francisco Baykeeper ("Baykeeper") filed a lawsuit in federal district court against the City in February, 2015, and served its complaint on the City in April, 2015. Baykeeper's complaint alleged violations of the federal Clean Water Act. Specifically, the complaint alleged that the City was not in compliance with trash reduction requirements under its Municipal Separate Storm Sewer System (MS4) Stormwater Permit ("Stormwater Permit"), and that there were discharge violations of sewage from the City's Sanitary Sewer System that infiltrated into the MS4.

In order to settle the lawsuit, the City and Baykeeper agreed to a consent decree that was approved by the court in August, 2016 ("Consent Decree"). The Consent Decree's terms will require the City to:

- Comply with trash provisions of the current Stormwater Permit including installing full trash capture devices, supporting additional creek cleanup efforts, and monitoring of trash in receiving waters;
- Rehabilitate, replace, or repair 65 miles of high risk sanitary sewer system pipes at an average of 6.5 miles per year, based on the City's existing program with some changes in the priority of segments of this work;
- Monitor and report fecal indicator bacteria ("FIB") in receiving waters for a five-year period;
- Comply with green infrastructure planning as required in the Stormwater Permit, adding FIB as a pollutant for planning purposes;
- Bring forward new revenue measure options for Council consideration by December 2017;
- Appropriate, contingent upon the receipt of sufficient new revenues, $100,000,000 over a ten-year period for various green infrastructure projects with the goal of reducing pollutants and/or flows from the City's urban areas into receiving waters, with expenditures anticipated to occur as follows:
    - Identify and design $25,000,000 in total projects by September 2024;
    - Award $25,000,000 in total projects by September 2025;
    - Identify and design an additional $10,000,000 ($35,000,000 in the aggregate) in total projects by September 2025;
    - Award an additional $10,000,000 ($35,000,000 in the aggregate) in total projects by the termination date of the consent decree;
    - Identify and design an additional $15,000,000 ($50,000,000 aggregate) in total projects by the termination date of the consent decree.

The Consent Decree also provides for ongoing oversight by Baykeeper and a dispute resolution process. The Consent Decree specifies limits on Baykeeper's ability to pursue additional litigation against the City during the Consent Decree's term and litigation fees that can be claimed by Baykeeper for dispute resolution are capped at $200,000.

In addition to the expenditures outlined above, the City has or will incur the following expenditures during the Consent Decree's term: (1) lump sum payment of attorney's fees and costs to Baykeeper in the amount of $425,000, which payment has been made; (2) ongoing oversight costs payable to Baykeeper in the amount of $10,000 per year for a total of $100,000; and (3) $200,000 per year for five years (a total of $1,000,000) for supplemental environmental mitigation to be administered by the San José Parks Foundation for trash clean up grants, habitat restoration, or projects that generally improve the water quality in the Guadalupe and Coyote creeks and associated watershed areas.

In May 2017, Baykeeper and the City entered into a First Amendment to the Consent Decree that was subsequently approved by the U.S. District Court in August 2017 ("First Amendment"). The First Amendment extends the deadline for one of the City's obligations under the Consent Decree and specifies that the City will make payments of the annual funding of $200,000 during years two through five for the supplemental mitigation projects directly to two organizations instead of to the San José Parks Foundation.

On December 19, 2017, the City Council considered a report from City staff concerning potential new revenue sources to fund the green infrastructure requirements specified in the Baykeeper Consent Decree described above. The potential revenues sources identified by City staff include general obligation bonds and a parcel tax, both of which would require voter approval by a two-thirds margin.

On August 10, 2018, the City Council approved placement of a measure on the November 2018 ballot, designated as Measure T, seeking voter authorization of up to $650 million of general obligation bonds for various public improvements, including those that would prevent flooding and water contamination. Some of the green infrastructure improvements required by the Baykeeper Consent Decree would be eligible for funding if the voters approve Measure T by the required two-thirds margin. However, there are a number of different types of improvements that would be eligible for funding if Measure T were to pass, including an allocation of at least $300 million for street improvements. The City is unable to predict whether the voters will approve Measure T and the amount of general obligation bonds that the City would issue. Additionally, if Measure T were to pass, it is unknown the amount of funding that would be allocated to the green infrastructure improvements required by the Baykeeper Consent Decree. In any event, there are obligations under the Baykeeper Consent Decree that would be ineligible for funding from general obligation bond proceeds and staff continues to assess additional funding mechanisms.

Under State Law, the Santa Clara County Registrar of Voters must complete the canvass of the vote and certify and submit the electron results to the County Board of Supervisors by December 6, 2018. As of the date of this document, the Santa Clara County Registrar of Voters has not completed the ballot counting for Measure T. From the ballots counted to date, the votes cast in favor of Measure T exceed the two-thirds margin for approval.

10. San José Retired Employees Association Settlement Agreement

In July 2014, the San José Retired Employees Association (the "Retirees' Association"), along with four individually named retirees, filed, and subsequently served, a verified complaint against the City in the Santa Clara County Superior Court. The complaint alleges that the City changed the basic retiree healthcare benefit to a new plan that "fundamentally alters" the nature and quality of the benefit provided to retirees, because the plan has increased co-pays and deductibles. The complaint further alleged that the affected retirees had a vested right to the plan in existence when they were employed by the City, and to the premium amount paid by the City for their healthcare benefit. The action seeks monetary damages for the increase in co-pays, deductibles and premium payments made by the affected retirees, as well as injunctive and writ relief prohibiting the City from continuing to provide the new health benefit to retirees.

The City filed a demurrer to the complaint, however, this litigation is currently stayed, by stipulation of the parties, to allow for settlement negotiations. On November 7, 2017, the City Council approved a settlement agreement with the Retirees' Association and the individual plaintiffs. The settlement agreement provides for the dismissal of the respective appeals in the Measure B litigation under the SJPOA caption by the Retirees' Association and the City, the dismissal by the Retirees' Association of its stayed lawsuit with prejudice and the dismissal of the stayed lawsuit by the individual plaintiffs without prejudice. The settlement agreement includes the following terms among others:

- continues the elimination of the SRBR, and, in lieu of the SRBR, establishes a "Guaranteed Purchasing Power" provision, to apply prospectively, in order to maintain the monthly allowance for current and future Tier 1 retirees at 75% of the purchasing power in effect as of the date of retirement;

- provides for the implementation of a new lowest cost healthcare plan for retirees who are members of the FCERS or PFDRP defined benefit retiree healthcare plan and additionally provides that the lowest cost plan for current and future retirees will be permanently set such that it is neither higher nor lower than the "Silver" level as specified in the Affordable Care Act ("ACA") in effect as of July 2015. The settlement agreement further specifies that the healthcare plan must provide at least 70% (the "floor") but no more than 79% (the "ceiling") of the current ACA "Silver" definition;

- allows retirees who are members of the FCERS or PFDRP defined benefit retiree healthcare plan to be eligible for in-lieu premium credit of 25% for the monthly premium of the lowest cost healthcare plan and dental plan;

- provides for the City's payment of partial cost reimbursement, not to exceed $1.25 million for all reimbursements, for healthcare premium costs for those retirees or their surviving beneficiaries who receive a pension of $54,000 or less and who were enrolled in a pre-Medicare healthcare plan between January 2013 and December 2016; and

- specifies that the Retirees' Association will have the right to tender to the City defense of any lawsuit brought by a retiree member against the Retirees' Association challenging the settlement agreement; and

- provides that the City will pay the attorneys' fees of the Retirees' Association related to Measure B in the amount of $500,000.

11. Workers' Compensation Program Audit

In 2016, the City's Workers' Compensation Program underwent two audits by the State's Department of Industrial Relations (DIR): a routine three-tier Profile Audit Review (PAR) of randomly selected claims conducted every five years and a Target Utilization Review audit triggered by workers' complaints regarding the City's utilization review and procedures for requests for authorization of medical treatment of work-related injuries and illnesses. At the time of the audits the program was administered as a hybrid – a combination of the City team and Third Party Administrator (TPA). The hybrid program was the result of a series of Council directed actions. In October 2012, the City Council approved the staff recommendation that the City begin the Pilot Program for a TPA to handle a portion of claims administration, as well as bill review, utilization review and medical case management for all claims, and for in-house staff to handle the remaining claims administration. In June 2015, the City Council approved an extension of the hybrid Pilot Program to allow additional time to evaluate the performance of the hybrid Pilot Program. An extension to June 30, 2018, was granted in November 2016, given the change in TPA from Athens to Intercare.

The PAR audit, consisting of three tiers, proceeded to a more comprehensive Full Compliance Audit with an additional and expanded selection of files, including denied claims. The City failed each of the three tiers of the Full Compliance Audit, resulting in the State DIR assessing the following amounts, which arise from the City's delay in processing claims: (1) a penalty in the amount of $142,000; (2) additional disability payments in the amount of $16,000; and (3) additional medical and medical legal payments owed to providers in the approximate amount of $16,000, on which interest at the rate of 7% per annum continues to accrue until the date of payment. The City made the payment of the assessed amounts in December 2016. The DIR will be monitoring the City's claim review process through calendar year 2018.

The City is subject to a re-audit in December 2018 and must pass the re-audit or its ability to retain its status as a self-insured employer may be in jeopardy. Additionally, failure to pass two (2) consecutive Full Compliance Audits would expose the City to the risk of assessment of a civil penalty, currently a one-time payment in an amount not to exceed $100,000. In the event that the City were unable to retain its status as a self-insured employer, the City would be required to procure workers' compensation insurance coverage for its employees. All research suggests that the purchase of workers' compensation insurance coverage will be significantly more expensive than a self-insured program.

The Target Utilization Review audit reviewed files from the first phase of the routine audit with a focus on the City's utilization review process and procedure. This audit commenced in late October 2016 and concluded in January 2017. Only the portion of the City's Workers' Compensation Program administered by the in-house City staff was subject to the Full Compliance Audit. Both the in-house staff and the TPA were subject to the Target Utilization Review. The in-house program was assessed penalties of $3,000 for three (3) failures to respond to requests for medical treatment. The City received the final Audit report on January 5, 2017 and payment was issued by January 31, 2017.

In addition to these audits, the State DIR's Administrative Director of the Division of Workers' Compensation issued an Order to Show Cause, assessing $120,000 in administrative penalties for the City's failure to properly address independent medical review appeals of utilization review non-certifications of medical treatment requests in 24 claims. The penalties have been assessed, primarily, for failure to timely provide responsive documents to the company under contract with the State that performs independent medical review. The penalties are assessed at the rate of $500 per day for each day the response is untimely, up to a maximum of $5,000 per claim. The City paid the penalties in November 2016.The City failed this audit due in part to staffing challenges. It should be noted that the City's TPA at the time passed the same routine audit in 2016.

In June 2018, the City Council approved the staff recommendation to provide all Worker's Compensation claims administration through a TPA and that the transition on July 1, 2018. It is worth noting that the State may proceed with the re-audit regardless of the City Council's decision about service delivery. Therefore, the City's recommendation at the time was not related to the State re-audit scheduled for 2018.

The City's Workers' Compensation Program is one component of the City's overall health and safety efforts for employees, and the City's first goal is to prevent injuries and accidents. The ultimate goal and policy objective is to provide the most effective service to the City's injured workers and to acknowledge that there are ongoing limitations and challenges with the City's ability to provide the necessary services.

The City began the process of transferring the entire Workers' Compensation Program administration to its current TPA, Intercare, effective July 1, 2018, and has completed the transition. The City will conduct a request for proposals (RFP) for the Workers' Compensation program in the current fiscal year to ensure a contract with a TPA is in place by July 1, 2019.

12. Tax Abatement Disclosure

As of June 30, 2018, the City provides tax abatements through four programs - the Business Cooperation Program, Storefronts Assistance Grant Program, Incentive Grant Agreements, and the Downtown High-rise Incentive Program:

1. **Business Cooperation Program** (BCP) is designed to provide incentives for anyone conducting business in the City to obtain a Use Tax Direct Payment Permit from the State of California Board of Equalization pursuant to the State Sales and Use Tax Regulation 1699.6; or establish a point of sale in the City by changing their business operations for business-to-business transaction. The BCP is also designed to provide incentives for anyone constructing or building in the City to obtain a Sub Seller's Permit for their job site in San Jose from the State of California Department of Tax and Fee Administration (previously the Board of Equalization) pursuant to State regulations and procedures.

   Pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law (California Revenue and Taxation Code Section 7200 et.seq.), the City receives 1% of all sales taxes collected from transactions occurring in the City. However, unless a taxpayer obtains certain permits from the State Board of Equalization specifying the location of the first use of a taxed purchase or final sale, the local use tax collected on a transaction will be allocated to a County-wide pool or another jurisdiction. Based on the City's Ordinances No. 28640 and No. 29408, the City in partnership with participating companies, and Municipal Revenue Advisors (Consultant) work together to ensure that the City receives the full 1% local share of tax.

   The benefit derived by the City from having businesses obtain Use Tax Direct Pay Permit, Sub Seller's Permit, or Seller's Permit (Permits) for point of sales transaction in San Jose is that the business reports the local use tax component to the jurisdiction in which the property is located at the time the State use tax is reported, thus ensuring that the City receives the entire local component of the use tax. The City rebates participating companies a rebate in the amount of 20% - 30% of the net new revenue received. The City also compensates the Consultant 20% of the net new revenue received.

   Abatements are obtained through a rebate claim form filed by a tax payer, including proof that the City is properly identified in the permit as the jurisdiction in which the property acquired under the permit is first functionally used, stored or consumed, or sold from the City in business to business transaction, and evidence of the amount of use tax paid to the State.

2. **Storefronts Assistance Grant Program** is an incentive program designed to fill ground-floor vacant parcels in City-designated Neighborhood Business Districts (NBD's), Strong Neighborhood Initiative (SNI) areas, and the Downtown area. The program also supports existing retail businesses in these areas with permit costs related to adding outdoor seating. To address vacant storefronts, the City implemented an incentive package to lower barriers to entry for small business. The City Council approved the implementation of the Program in 2013, and through the budget process, City Council allocated up to $250,000 to reimburse eligible businesses for City permit fees and taxes in FY 2018.

   This program is structured as assistant grants at a maximum amount of up to $15,000 for vacant storefronts, and a maximum amount of $5,000 for existing businesses to offset the cost of City permit fees and business taxes on a reimbursement basis. The grant agreements include a three-year occupancy requirement for recapturing abated taxes and fees. If the business vacates any portion of the premises prior to the third anniversary of the permit issuance date, the business is required to reimburse the City a prorated portion of the grant assistance received.

3. **Incentive Grant Agreements** provide assistance to companies developing new technologies that create economic opportunities for future generations. By facilitating business retention and expansion, the City fosters an environment in which driving industry companies can grow and create jobs with good pay for residents. Through the Incentive Grant Agreements, the City assists companies with expedited permitting process, reimbursement of capital equipment acquisition, reimbursement of 50% of net new utility users tax revenue, or payment of City permit fees and taxes. Eligible projects are either companies relocating their global headquarters to the City or upgrading their manufacturing and research and development facilities. For agreements providing manufacturing permitting incentive, the grant agreements include a three-year occupancy requirement for recapturing abated taxes and fees. If the business vacates any portion of the premises within the third anniversary of the permit issuance date, the business is required to reimburse the City a prorated portion of the grant assistance received.

4. **Downtown High-Rise Residential Incentive Program** On December 13, 2016, the City Council extended the Downtown High-Rise Incentive Program for new construction of residential buildings of at least twelve (12) stories in height in the Downtown Planned Growth Area by passing the Ordinance No. 29847, entitled: *"A Ordinance of the Council of the City of San Jose Amending Section 4.46.036 of Chapter 4.46 and Section 4.47.089 of Chapter 4.47 of Title 4 of the San Jose Municipal Code to Expand the Suspension Program for the Collection Of A Portion of Construction Taxes on Downtown High Rise Developments".* The Program suspends 50% of construction taxes on high-rise developments in the Downtown Area and allows for payment of the taxes to be delayed until the issuance of the Certificate of Occupancy. The Program also sets the park impact in-lieu fees charged for residential downtown high-rise developments at 50% of the applicable park impact in-lieu fees for multi-family 5+ units in the Downtown Area and allows for payment of park impact in-lieu fees to be delayed until issuance of the Certificate of Occupancy.

   To qualify for this incentive, a high-rise residential development must meet each of the following:
   a) A completed application for a Development Permit has been filed with the City on or before December 31, 2017; and
   b) A building permit has been issued on or before July 31, 2018; and
   c) The developer shall retain contractors licensed by the State of California; and
   d) The developer shall employ only construction workers who possess necessary licenses and certifications required by the State; and
   e) The developer enters into a Project Completion Agreement with the City in a form approved by the City Attorney.

   In the event that a residential development that was eligible for the tax suspension has not received final inspection for eighty percent of the residential units within the Downtown High Rise Structure on or before December 31, 2020, then the full amount of the tax shall be paid to the City prior to scheduling additional inspections.

Tax Abatement Program	Amount of Taxes Abated (in thousands)
Business Cooperation Program (BCP)	$ 77
Storefronts Assistance Grant Program	-
Incentive Grant Agreements	27
Downtown High-Rise Residential Incentive Program	-

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

1. Cash and Investments Held by SARA

The SARA's cash and investments consist of the following at June 30, 2018 (dollars in thousands):

Cash and investments	$ 14,540
Restricted cash and investments	138,278
Total cash and investments	$ 152,818

A summary of SARA's cash and investments at June 30, 2018 is as follows:

	Credit Rating	Maturity (in Days) Under 30	31-180	181-365	Balance at June 30
Investments:					
LAIF	Not Rated	$ -	$ -	$ 14,005	$ 14,005
Money Market Mutual Funds	Aaa	138,255	-	-	138,255
Subtotal investments		$ 138,255	$ -	$ 14,005	152,260
Certificates of Deposit					23
Bank Deposits					535
Total Cash and Investments					$ 152,818

The SARA categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The Money Market Mutual Funds and LAIF are valued by net asset value. The inputs and techniques used for securities are not necessarily an indication of risk associated with investing in these securities. The SARA's investments in Money Market Mutual Funds and LAIF are not subject to fair value hierarchy.

The LAIF is part of the State's Pooled Money Investment Account that allows cities, counties and special districts to place money into the fund. LAIF operating accounts allow a maximum of 15 transactions per account in a calendar month. The transaction amount shall be no less than $5,000 and in increments of a thousand dollars. LAIF allocates interest earnings once every quarter. The interest earnings can be withdrawn in exact amount at any time. LAIF bond accounts have no restrictions on the amounts allowed on deposit, but are limited to one withdrawal every 30 days.

2. Property Held for Resale by SARA

Property held for resale is recorded as an asset at the lower of cost or net realizable value. The SARA recorded certain capital assets originally received from the Agency as property held for resale. On September 8, 2014, the State Department of Finance ("DOF") approved the Long-Range Property Management Plan ("LRPMP"), which specifies the disposition of SARA properties. The SARA properties designated for sale under the LRPMP are to be sold in accordance with the Asset Disposition Schedule and the Disposition Process For Sale of Properties, both of which are subject to the approval of the Countywide Oversight Board.

A summary of changes of the property held for resale during the year ended June 30, 2018 is as follows:

Property Description	July 1, 2017	Addition	Disposal	Reclassification	June 30, 2018
N. San Pedro Housing site [1]	$ 32,392	$ 4,731	$ (4,643)	$ 977	$ 33,457

[1] *The valuation is based on the construction costs incurred. The asset is currently under construction.*

In November 2017, the SARA sold property commonly known as Blocks A & C to TM San Jose 78, LLC for $6,545,000. The property had the net book value of $4,643,000 and the SARA recognized a gain of $1,882,000, after closing costs of $20,000. The net sale proceeds were paid to the County under the 2011 Settlement Agreement (Note IV.C.4), which amount was applied against accrued interest.

Julian Street Realignment Construction Project has been reclassified from Construction in Progress.

3. Capital Assets Held by SARA

The following is a summary of capital assets activity for the year ended June 30, 2018 (dollars in thousands):

	July 1, 2017	Addition	Disposal	Reclassification	June 30, 2018
Capital assets, not being depreciated:					
Land	$ 59,774	$ 315	$ (12,412)	$ -	$ 47,677
Construction in progress	977	-	-	(977)	-
Total capital assets, not being depreciated	60,751	315	(12,412)	(977)	47,677
Capital assets, being depreciated:					
Buildings	82,610	-	-	-	82,610
Building and other improvements	108	-	-	-	108
Equipment	1,145	-	-	-	1,145
Total capital assets, being depreciated	83,863	-	-	-	83,863
Less accumulated depreciation:					
Buildings	23,102	2,070	-	-	25,172
Building and other improvements	61	7	-	-	68
Equipment	1,145	-	-	-	1,145
Total accumulated depreciation	24,308	2,077	-	-	26,385
Total capital assets, being depreciated, net	59,555	(2,077)	-	-	57,478
Total capital assets, net	$ 120,306	$ (1,762)	$ (12,412)	$ (977)	$ 105,155

Various Agency-owned real estate assets with an aggregate book value of $13,377,000 were used to secure Letters of Credit obtained from JPMorgan Chase Bank ("JPMorgan") supporting the Agency's 1996 and 2003 variable rate revenue bonds. The 1996 and 2003 bonds were paid in full from the SARA refunding bonds proceeds in December 2017 and all of the real-estate assets used as collateral for those bonds either have been or are being sold.

In addition, the Convention Center – South Hall, José Theatre, and Arena Lot 5A were used as collateral to secure HUD Section 108 loans obtained from the U.S. Department of Housing and Urban Development. Convention Center - South Hall was sold to the City of San José on October 10, 2018 and the HUD loans were paid in full from a portion of the sales proceeds. The other properties used as collateral are projected to be sold in FY 2019 as well.

On August 27, 2015, the Oversight Board approved a revised Asset Disposition Schedule for the non-governmental purpose properties listed on the LRPMP, and approved the Disposition Process For Sale of Properties, which requires the sale of assets either through an open and competitive solicitation process or through a direct sale to the affected taxing entities or a non-profit organization. Additional amendments to the Asset Disposition Schedule were approved by the Oversight Board on January 14, 2016, April 28, 2016, October 27, 2016, and April 13, 2017.

In FY 2018, the SARA disposed the following properties:

- In July 2017, the SARA sold one property (520 North 6th Street) to AFE Urban, Inc. for $2,800,000. The property had the book value of $5,350,000 and the SARA recognized a loss of $2,560,000 after transaction costs of $10,000. The SARA received net proceeds of $2,790,000, of which were used to partially call bonds associated with the development of the Miraido project. The bonds involved were the Series 1996A/B, 1997, 1999, 2004A, 2005A, and 2006C/D.

- In May 2016, pursuant to a Compensation Agreement, the SARA transferred to the City properties necessary for the construction of the Autumn Street extension with a book value of $316,000, with a condition which required the property to be reverted to SARA and sold if the property was no longer needed for public right of way. In May 2017, after construction of the Autumn Street extension, a portion of the property (Bulb parcel, Old W. Julian Street) was not required for the Autumn Street extension and was considered surplus to the needs of the City. Pursuant to the Compensation Agreement, the surplus parcel was to revert to the SARA and be sold. In August 2017, the City, SARA, and the buyer (Akatiff Revocable Trust) entered into a Purchase and Sale Agreement (PSA) to sell the surplus parcel to the buyer for the amount of $34,000. In September 2017, the property was transferred (Bulb parcel, Old Julian St) directly to the Akatiff Revocable Trust for $34,000. The SARA recognized a loss of $282,000. The net sale proceeds were delivered to SARA and used to pay enforceable obligations.

- In December 2017, the SARA sold one property (551 West Julian Street) to TC Agoge Associates, LLC for $650,000. The property had the book value of $976,000 and the SARA recognized a loss of $329,000 after transaction costs of $3,000. The net sale proceeds of $647,000 were used to pay the accrued interest owed to the County under the 2011 Settlement Agreement.

- In December 2017, the SARA sold one property (201 South 2nd Street) to 201 S. 2nd Ground Only LLC for $726,000. The property had the book value of $563,000 and the SARA recognized a gain of $160,000 after transaction costs of $3,000. The net sale proceeds of $723,000 were used to pay the accrued interest owed to the County under the 2011 Settlement Agreement.

- In December 2017, the SARA sold one property (1343 The Alameda) to Investment Property Exchange Services as Qualified Intermediary for Grizzly Hachett, LLC for $363,000. The property had the book value of $427,000 and the SARA recognized a loss of $66,000 after transaction costs of $2,000. The net sale proceeds were paid to the County under the 2011 Settlement Agreement, which amount was applied against accrued interest.

- In January 2018, the SARA sold one property (366 South 1st Street) to Two Fish Design for $1,050,000. The property had the book value of $1,076,000 and the SARA recognized a loss of $26,000. The net sale proceeds were delivered to SARA and used to pay enforceable obligations.

- In January 2018, the SARA sold one property (292 Stockton Avenue) to Diridon Hospitality LLC for $4,000,000. The property had the book value of $83,000 and the SARA recognized a gain of $3,904,000 after transaction costs of $13,000. The net sale proceeds were delivered to SARA and used to pay enforceable obligations.

- In May 2018, the SARA sold one property (1770 Alum Rock Ave) to the City for $221,000. The property had the book value of $369,000 and the SARA recognized a loss of $149,000 after transaction costs of $1,000. At the close of escrow, the net sale proceeds of $220,000 were remitted to the County Auditor Controller and were subsequently distributed to the appropriate local taxing entities per the Health and Safety Code.

- In June 2018, the SARA sold one property Market Gateway (525 South Market Street) to the County (the buyer) for $2,635,000. The property had the net book value of $3,254,000 and the SARA recognized a net loss of $621,000 after transaction costs of $2,000. At the close of escrow, the net sale proceeds of $2,633,000 were remitted to the County Auditor Controller and were subsequently distributed to the appropriate local taxing entities per the Health and Safety Code.

4. Summary of SARA's Long-Term Debt

The following is a summary of long-term debt of the SARA as of June 30, 2018 (dollars in thousands, unless otherwise noted):

Type of Indebtedness	Purpose	Original Issue Amount	Issue Date	Maturity Date	Interest Rate Range	Annual Principal Installments	June 30, 2018 Balance
Senior Tax Allocation Bonds:							
2017 Refunding Bonds Series A	Refunding - merged area projects	$ 79,825	12/21/2017	8/1/2035	5.00%	$0 - 53,810	$ 79,825
2017 Refunding Boonds Series A-T	Refunding - merged area projects	1,333,325	12/21/2017	8/1/2034	1.90-3.38%	$32,910 - 93,735	1,333,325
Total Senior Tax Allocation Bonds							1,413,150
Subordinate Tax Allocation Bonds:							
2017 Refunding Bonds Series B	Refunding - merged area projects	264,390	12/21/2017	8/1/2029	2.00-5.00%	$7,820 - 29,835	264,390
Other Long-Term Debt:							
HUD Section 108 Loan (CIM)**	Merged area projects	13,000	2/8/2006	8/1/2025	Variable	$775 - 1,135	7,715
HUD Section 108 Loan (Story & King)**	Merged area projects	18,000	6/30/2006	8/1/2027	Variable	$1,080 - 1,570	10,485
City of San José (SERAF) Loan	Fund the State's SERAF Payment	12,816	2010-2011	6/30/2020	3.00%	$0 - 15,561	15,561
City of San José (SERAF) Loan	Fund the State's SERAF Payment	10,000	2010-2011	6/30/2020	3.00%	$0 - 12,441	12,441
City of San José - Parking Fund Loans	Fund debt service	13,528	2006-2011	6/30/2020	3.00%	$0 - 13,528	17,925
City of San José - Reimbursement Agreement	Reimbursement Agreement *	1,421	2018	6/30/2019	LAIF Rate	$1,421	1,421
Total Other Long-Term Debt							65,548
Total Long-Term Debt							$ 1,743,088

* See Long-Term Reimbursement Agreement below for additional disclosures.
** Paid in full in October 2018.

A summary of the changes in long-term debt and other obligations for the year ended June 30, 2018 follows (in thousands):

	June 30, 2017	Additions	Reductions	June 30, 2018	June 2018 Amount Due One Year
Senior Tax Allocation Bonds:					
1997 Merged *	$ 4,030	$ -	$ (4,030)	$ -	$ -
1999 Merged *	12,920	-	(12,920)	-	-
2003 Merged *	124,840	-	(124,840)	-	-
2004 Merged Refunding Series A *	77,440	-	(77,440)	-	-
2005 Merged Refunding Series A *	109,570	-	(109,570)	-	-
2006 Merged Series A-T *	13,300	-	(13,300)	-	-
2006 Merged Series B *	67,000	-	(67,000)	-	-
2006 Merged Refunding Series C *	423,430	-	(423,430)	-	-
2006 Merged Refunding Series D *	260,325	-	(260,325)	-	-
2007 Merged Series A-T	2,670	-	(2,670)	-	-
2007 Merged Series B *	191,600	-	(191,600)	-	-
2008 Merged Series A *	8,955	-	(8,955)	-	-
2008 Merged Series B *	80,145	-	(80,145)	-	-
1997 Housing Series E *	15,100	-	(15,100)	-	-
2003 Housing Series J *	22,275	-	(22,275)	-	-
2003 Housing Series K *	4,670	-	(4,670)	-	-
2005 Housing Series A *	10,445	-	(10,445)	-	-
2005 Housing Series B *	92,885	-	(92,885)	-	-
2010 Housing Series A-1 *	54,055	-	(54,055)	-	-
2010 Housing Series A-2	495	-	(495)	-	-
2017 Refunding Bonds Series A	-	79,825	-	79,825	-
2017 Refunding Bonds Series A-T	-	1,333,325	-	1,333,325	85,725
Subtotal Senior Tax Allocation Bonds	1,576,150	1,413,150	(1,576,150)	1,413,150	85,725
Subordinate Tax Allocation Bonds:					
1996 Merged Series A *	16,900	-	(16,900)	-	-
1996 Merged Series B *	16,900	-	(16,900)	-	-
2003 Merged Revenue Series A *	10,835	-	(10,835)	-	-
2003 Merged Revenue Series B *	15,000	-	(15,000)	-	-
2010 Housing Series C *	74,885	-	(74,885)	-	-
2017 Refunding Bonds Series B	-	264,390	-	264,390	24,235
Subtotal Subordinate Tax Allocation Bonds	134,520	264,390	(134,520)	264,390	24,235
Other Long -Term Debt:					
Pledge Agreement - Revenue Bonds 2001A	23,930	-	(23,930)	-	-
Reimb Agreement - Refunding Rev Bonds 2001F	78,680	-	(78,680)	-	-
HUD Section 108 Loan (CIM)	8,490	-	(775)	7,715	810
HUD Section 108 Loan (Story & King)	11,510	-	(1,025)	10,485	1,080
City of San José - SERAF Loans (Principal)	22,816	-	-	22,816	-
City of San José - SERAF Loans (Interest)	4,502	684	-	5,186	-
City of San José - Commercial paper program	4,727	-	(4,727)	-	-
City of San José - Parking Fund Loans (Principal)	13,528	-	-	13,528	-
City of San José - Parking Fund Loans (Interest)	807	3,590	-	4,397	-
Other Long-Term Obligation - County Settlement Agreement (Principal)	9,424	-	(9,424)	-	-
Other Long-Term Obligation - County Settlement Agreement (Interest)	1,696	2,617	(4,313)	-	-
City of San José - Reimbursement agreement (Principal)	29,979	1,549	(30,107)	1,421	1,421
City of San José - Reimbursement agreement (Interest)	413	98	(511)	-	-
Subtotal Other Long-Term Debt	210,502	8,538	(153,492)	65,548	3,311
Subtotal Long-Term Debt before Unamortized	1,921,172	1,686,078	(1,864,162)	1,743,088	113,271
Issuance Premium (discount), Net	19,487	51,127	(21,589)	49,025	4,205
Total Long-Term Obligations	$ 1,940,659	$ 1,737,205	$ (1,885,751)	$ 1,792,113	$ 117,476

Total Redevelopment Property Tax Trust Fund ("RPTTF") revenue distributed by the County to the SARA in the FY 2018 was $155,705,000, which was used to pay debt service and debt related expenses on the Successor Agency Senior and Subordinate Tax Allocation Bonds and enforceable obligations. During the year ended June 30, 2018, the County withheld $44,652,000 in RPTTF for payments of its prior and current year's pass-through payments. During FY 2018, the outstanding principal and interest of County Settlement were paid in full.

2017 Tax Allocation Refunding Bonds

On December 21, 2017, the SARA issued the 2017 Refunding Bonds pursuant to an Indenture of Trust dated as of December 1, 2017 (the "2017 Indenture"), by and between the SARA and Wilmington Trust, National Association, as trustee ("Wilmington Trust"). The 2017 Refunding Bonds were issued in the aggregate principal amount of $1,677,540,000, in two senior series and one subordinate series: (i) $79,825,000 of the tax-exempt senior lien 2017 Series A Bonds (the "2017A Bonds"); (ii) $1,333,325,000 of taxable senior lien 2017 Series A-T Bonds (the "2017A-T Bonds") and collectively (the "2017 Senior Tax Allocation Refunding Bonds"); and (iii) $264,390,000 of tax-exempt subordinate lien 2017 Series B Bonds (the "2017 Subordinate Tax Allocation Refunding Bonds" or " 2017B Bonds").

Proceeds of the 2017 Refunding Bonds were used to (i) redeem and defease or prepay 23 series of Successor Agency Senior and Subordinate Tax Allocation Bonds, the 4th and San Fernando Parking Facility Pledge Agreement entered into in connection with the Financing Authority's Series 2001A Bonds and the Second Amended and Restated Reimbursement Agreement entered into in connection with the Financing Authority's Series 2001F and 2001G Bonds (paid in full in September 2018), all as listed in the previous table ("Refunded Obligations") and (ii) pay the costs of issuing the 2017 Refunding Bonds, including the cost of debt service reserve insurance policies. The refunding resulted in a difference between the reacquisition price (the amount required to repay previously issued debt in a refunding transaction) and the net carrying amount of the Refunded Obligations of $22,882,000. This difference is reported as deferred outflows of resources in the Statement of Fiduciary Net Position. The 2017 Refunding Bonds generated total debt service savings of $253,856,000 over the next eighteen years and net present value savings of $185,600,000 (discounted at the all-in true interest cost) or 10.82% of the Refunded Obligations.

The 2017 Refunding Bonds are secured and payable from Tax Revenues and certain funds and accounts held by Wilmington Trust. Tax Revenues is generally defined in the 2017 Indenture as the portion of property tax revenues collected in the Merged Project Area derived from incremental growth in assessed property values over the initial base year values in each of 17 component areas, less certain County administrative fees and the AB1290 statutory pass-through payment to the San José Unified School District and excluding the amounts collected pursuant to the pension override or State Water Project override provisions of the Redevelopment Dissolution Law. All other AB1290 statutory pass through payments and the negotiated pass-through payments to Santa Clara County are subordinate to the payment of debt service on the 2017 Refunding Bonds and other payment under the 2017 Indenture. Under the distribution provisions of the Redevelopment Dissolution Law, AB1290 statutory pass-through paymens and negotiated pass-through payments are made from funds on deposit in the RPTTF before funds are transferred to the SARA for the payment of enforceable obligations (including payment debt service on the 2017 Refunding Bonds) unless there are insufficient funds to pay such debt service and other payment obligations under the 2017 Indenture and certain other conditions are satisfied. Such condition include the timely filing of a Notice of Insufficiency by the SARA in accordance with the Redevelopment Dissolution Law and the concurrence by the State Controller that there are insufficient funds for such purpose. The SARA has convenanted in the 2017 Indenture to comply with the provisions of the Redevelopment Disolution Law related to placing its obligations under the 2017 Indenture on the recognized obligation payment schedules throughout the term of the 2017 Refunding Bonds and, if applicable, file a Notice of Insufficiency in the event that are insufficient Tax Revenues to make payment of debt service or other payment obligations under the 2017 Indenture.

The SARA has covenanted in the 2017 Indenture to take such actions as required under the Redevelopment Dissolution Law to include in each annual Recognized Obligation Payment Schedule the amount of debt service on the 2017 Refunding Bonds so as to enable the County Auditor-

Controller to distribute from the RPTTF to SARA on each January 2 and June 1 the amounts required for the SARA to pay principal of, and interest on, the 2017 Refunding Bonds coming due in the respective six-month period. These actions will include, without limitation, placing on the periodic Recognized Obligation Payment Schedule for approval by the Oversight Board and DOF the amounts to be held by the SARA as a reserve until the next six-month period, as contemplated by the Redevelopment Dissolution Law, that are necessary to comply with the 2017 Indenture.

A separate municipal bond debt service reserve policy issued by Build America Mutual Assurance Company ("BAM") was deposited in the Senior Bonds Reserve Account of the Bond Reserve Fund for the 2017 Senior Tax Allocation Refunding Bonds (the "2017 Senior Bonds Reserve Policy") and in the Subordinate Bonds Reserve account of the Bond Reserve Fund for the 2017 Subordinate Tax Allocation Bonds (the "2017 Subordinate Bonds Reserve Policy"). The 2017 Senior Bonds Reserve Policy is in the amount of $112,102,000, which is equal to the Senior Bonds Reserve Requirement under the 2017 Indenture. The 2017 Subordinate Bonds Reserve Policy is in the amount of $30,978,000, which is equal to the Subordinate Bonds Reserve Requirement under the 2017 Indenture.

The 2017 Senior Bonds Reserve Policy will terminate the earlier to occur of (i) the date on which the 2017 Senior Tax Allocation Refunding Bonds are no longer outstanding under the 2017 Indenture and (ii) August 1, 2035. The 2017 Subordinate Bonds Reserve Policy will terminate the earlier to occur of (i) the date on which the 2017 Subordinate Tax Allocation Refunding Bonds are no longer outstanding under the Indenture and (ii) August 1, 2029. Per the terms of the 2017 Indenture, the SARA is not obligated to replace either reserve policy or to fund either reserve account with cash if, at any time that the 2017 Senior Tax Allocation Refunding Bonds or 2017 Subordinate Tax Allocation Refunding Bonds are outstanding, amounts are not available under such policy or if the rating of the claims-paying ability of BAM is downgraded, suspended or withdrawn.

The 2017 Senior Tax Allocation Refunding Bonds were rated "AA" by Standard & Poor's and Fitch and the 2017 Subordinate Tax Allocation Refunding Bonds were rated "AA-" by Standard & Poor's and Fitch.

2017 Senior Tax Allocation Refunding Bonds - The 2017 Senior Tax Allocation Refunding Bonds were issued in two series – the tax-exempt 2017A Bonds and the taxable 2017A-T Bonds, with a parity senior lien on Tax Revenues. The 2017A Bonds are structured as two serial maturities in 2034 and 2035; both maturities bear interest at 5% per annum. The 2017A-T Bonds are structured as serial maturities in 2018 through and including 2029 and a term bond of $361,845,000 maturing in 2034 with mandatory payment of principal beginning on August 1, 2030 through final maturity on August 1, 2034. The 2017A-T Bonds bear interest at rates ranging from 1.898% to 3.375% per annum. The 2017A-T Bonds have nearly $183 million in par subject to call on or after August 1, 2027. The total debt service payments (interest only) on the 2017 Senior Tax Allocation Refunding Bonds was $4,795,000 for the year ended June 30, 2018. The principal and interest remaining on the 2017 Senior Tax Allocation Refunding Bonds as of June 30, 2018 is $1,836,507,000.

2017 Subordinate Tax Allocation Refunding Bonds - The 2017 Subordinate Tax Allocation Refunding Bonds are structured as serial tax-exempt bonds with maturities in 2018 through 2029; and bear interest at rates ranging from 2% to 5% per annum. The 2017 Subordinate Tax Allocation Refunding Bonds are callable on or after August 1, 2027 at par. In total, nearly $97 million in par is subject to this ten-year par call. The 2017 Subordinate Tax Allocation Refunding Bonds are payable from Tax Revenues on a subordinate basis to the 2017 Senior Tax Allocation Refunding Bonds. The debt service payment (interest only) on the 2017 Subordinate Tax Allocation Refunding Bonds was $1,449,000 for the year ended June 30, 2018. The principal and interest remaining on the 2017 Subordinate Tax Allocation Refunding Bonds as of June 30, 2018 is $339,415,000.

Senior Merged Area Tax Allocation – Bonds Redeemed in FY 2018 by the 2017 Refunding Bonds

Senior Merged Area Tax Allocation Bonds Series 1997, Series 1999, Series 2003, Series 2004A, Series 2005A, Series 2006A-T, Series 2006B, Series 2006C, Series 2006D, Series 2007B were redeemed on January 8, 2018. The proceeds of the 2017 Refunding Bonds in the amount of $1,248,677,000 paid the outstanding principal of $1,223,365,000 and the interest of $25,312,000 through an escrow account held by Union Bank. Prior to the issuance of the 2017 Refunding Bonds, the total principal and interest paid on the Senior TABs was $101,617,000 in FY 2018.

Senior Housing Set-Aside Tax Allocation – Bonds Redeemed in FY 2018 by the 2017 Refunding Bonds

Senior Housing Set-Aside Tax Allocation Bonds Series 2003J, 2003K, 2005A, and 2005B were redeemed January 8, 2018. The proceeds of the 2017A-T Bonds in the amount of $126,046,000 paid the outstanding principal of $123,230,000 and the interest of $2,816,000 through an escrow account held by Wells Fargo Bank. The Senior Housing Set-Aside Tax Allocation Bonds Series 1997E were redeemed on January 22, 2018. The proceeds of the 2017A-T Bonds in the amount of $15,016,000 paid the outstanding principal of $14,625,000 and the interest of $391,000 through an escrow account held by Wells Fargo Bank. Prior to the issuance of the 2017 Refunding Bonds, the total principal and interest paid on the Senior Housing TABs was $14,532,000 in FY 2018.

Subordinate Tax Allocation Bonds – Variable-Rate Redeemed in FY 2018 by 2017 Refunding Bonds

Subordinate Merged Area Revenue Bonds Series 1996A/B and Series 2003 A/B were redeemed on December 21, 2017. The proceeds of the 2017 Refunding Bonds in the amount of $54,543,000 paid the outstanding principal of $54,490,000 and the interest of $53,000 through an escrow account held by Union Bank. Prior to the issuance of the 2017 Refunding Bonds, the total principal and interest paid on the Subordinate TABs was $5,375,000 in the FY 2018.

Subordinate Housing Set-Aside Tax Allocation Variable Rate Bonds Series 2010C were redeemed on December 21, 2017. The proceeds of the 2017 Refunding Bonds in the amount of $71,841,000 paid the outstanding principal of $71,625,000 and the interest of $216,000. Prior to the issuance of the 2017 Refunding Bonds, the total principal and interest paid on the 2010C Bonds was $4,058,000 in FY 2018.

4th and San Fernando Parking Facility Project Pledge Agreement - In March 2001, the City of San José Financing Authority (the “Financing Authority”), issued Revenue Bonds, Series 2001A (“Authority Series 2001A Bonds”) in the amount of $48,675,000 to finance the construction of the Fourth Street and San Fernando Parking Facility Project. The Agency entered into an Agency Pledge Agreement with the Financing Authority, which was assumed by the SARA, whereby the payments are payable from and secured by surplus “Agency Revenues”.

The Authority Series 2001A bonds were redeemed on January 8, 2018. The 2017A-T Bonds proceeds of $24,352,000 paid the outstanding principal of $23,930,000 and the interest of $422,000 through an escrow account held by Wells Fargo Bank.

Convention Center Refunding Reimbursement Agreement - In July 2001, the Financing Authority issued the Convention Center Lease Revenue Refunding Bonds, Series 2001F (tax-exempt (“Authority 2001F Bonds”) and Series 2001G (taxable) in the amounts of $186,150,000 and $4,580,000, respectively, to refund the Authority’s 1993 Revenue Bonds, Series C. The Series 2001G Bonds were paid off prior to FY 2018.

In connection with the issuance of the 2001 Convention Center Refunding Bonds, the Agency and the City entered into the Second Amended and Restated Reimbursement Agreement under which the Agency is obligated to use redevelopment property tax revenues or other revenues to reimburse the City for lease payments made to the Financing Authority for the project. The Second Amended and Restated Reimbursement Agreement was assumed by the SARA.

The Financing Authority Series 2001F bonds were redeemed on January 8, 2018. The proceeds of the 2017A-T Bonds in the amount of $68,268,000 paid the outstanding principal of $67,085,000 and the interest of $1,183,000 from an escrow account held by U.S. Bank. Prior to the issuance of the 2017 Refunding Bonds, the total principal and interest paid on the 2001F Bonds was $13,562,000 in FY 2018.

As of June 30, 2018, the amounts to be paid from the escrow funds established for the Refunded Obligations are as follows (in thousands):

Redevelopment Agency Bonds Refunded in 2017 Escrow Accounts (December 21, 2017)	Amount	Redemption Date
RDA Tax Allocation Bonds Series 2008A	$ 4,600	8/1/2018
RDA Tax Allocation Bonds Series 2008B	80,145	8/1/2018
RDA Housing Set-Aside Tax Allocation Bonds Series 2010A-1	52,820	8/1/2020
Total	$ 137,565	

HUD Section 108 Loans – In 2006, the Agency received loan proceeds totaling $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, 2018, the outstanding loans due to HUD total $18,200,000. The notes payable to HUD mature annually through August 2025 and bear interest at 20 basis points above the monthly LIBOR index. The average rate for the FY 2018 was 1.72%. The HUD loans were secured by several SARA owned capital assets (Convention Center – South Hall, José Theatre, and Arena Lot 5A) and Community Development Block Grant (CDBG) funds that are awarded to the City. For the year ended June 30, 2018, the loans were repaid through CDBG funds due to insufficiency of redevelopment property tax revenues. During the year ended June 30, 2018, the SARA received $2,024,000 from the City's CDBG fund to fund debt service of the HUD 108 loans.

On October 10, 2018, the HUD 108 loans were repaid in full (see Note IV.D.4).

Supplemental Educational Revenue Augmentation Funds (SERAF) Loan – On July 24, 2009, the State Legislature passed AB 26 X4, which required redevelopment agencies statewide to deposit a total of $2,050,000,000 of property tax increment in a Supplemental Educational Revenue Augmentation Funds ("SERAF") to be distributed to meet the State's Proposition 98 obligations to schools. The Agency's SERAF obligation was $62,248,000 in FY 2010 ("2010 SERAF Obligation") and $12,816,000 in FY 2011 ("2011 SERAF Obligation"). Payments were made by May 10 of each respective fiscal year.

On May 4, 2010, the Agency and the City entered into a loan agreement where the City agreed to loan the Agency through two separate payments (May 2010 and May 2011) a combined amount of $75,063,000 to pay the 2010 SERAF Obligation and the 2011 SERAF Obligation ("SERAF Loan"). The sources of the SERAF Loan to pay the 2010 SERAF Obligation ($62,248,000) were $40 million from the City's Low and Moderate Income Housing Fund that had been made available following the issuance of the 2010 Housing Series C Bonds, which was specifically authorized by the legislation, and idle moneys from the City special funds ($10,000,000) and $12 million from the Financial

Authority's Commercial Paper Program. The source of the SERAF Loan to pay the 2011 SERAF Obligation was $12,816,000 from the City's Low and Moderate Income Housing Fund. The Low and Moderate Income Housing Fund was subsequently renamed as the Low and Moderate Income Housing Asset Fund.

The Redevelopment Dissolution Law provides that all prior loans made between the City and the Agency, except for loans made from the Low and Moderate Income Housing Asset Fund for payment of SERAF, were invalidated as of February 1, 2012, but may be reinstated once certain conditions related to dissolution are met by the SARA as more particularly discussed below in the Parking Fund Loans section. As such, the $10,000,000 used to pay a portion of the 2010 SERAF Obligation and its related accumulated interest in the amount $160,000 from the City special funds other than the Low and Moderate Income Housing Asset Fund was invalidated under this provision and was recorded as part of the SARA's extraordinary items in 2012. In addition, interest accrued in excess of the LAIF rates pursuant to the Redevelopment Dissolution Law in the amount of $2,940,000 were also invalidated in 2012.

The remaining source of the SERAF Loan used to pay the 2010 SERAF Obligation ($40 million of 2010 Series C Housing Bonds and $12 million from the Financing Authority's Commercial Paper program (See Commercial Paper Section below) were assumed by the SARA and were listed in the ROPS as enforceable obligations. The source of funds used to pay the 2011 SERAF Obligation was determined to be a housing asset and was transferred to the City as the Successor Housing Agency and was also listed on the ROPS as an enforceable obligation.

On February 15, 2013, the DOF determined that a significant portion of the SERAF Loan used to pay a portion of the 2010 SERAF Obligation ($40 million of 2010 Housing Series C Bonds and $12 million from the Financing Authority's Commercial Paper program) should not be reported in the ROPS as an enforceable obligation since the sources of the SERAF Loan were already listed on the ROPS.

On May 26, 2016, the Oversight Board approved a partial reinstatement of the SERAF Loan used to pay the 2010 SERAF Obligation to restore the moneys originally loaned from the City's special funds in the amount of $10,000,000 and also approved the repayment schedule for the source of funds used to pay the 2011 SERAF Obligation in the amount of $12,816,000 plus accrued interest. The Oversight Board determined that the remaining portion of the SERAF Loan used to pay the 2010 SERAF Obligation in the amount of $52,000,000 plus accrued interest in the amount of $905,000 is not an enforceable obligation and directed the SARA to remove that portion of the loan from its financial statements. These actions were subsequently approved by the Successor Agency Board on June 28, 2016.

On May 17, 2017, the DOF approved the ROPS 17-18, which included the SERAF loans from the City of San José in the principal amount of $22,816,000.

As of June 30, 2018, the remaining portion of the SERAF Loan has an outstanding principal and accumulated accrued interest balance of $22,816,000 and $5,187,000, respectively, and bears a simple interest rate of 3%.

Commercial Paper Obligation – As discussed above, the City and the Agency entered into a SERAF Loan, a portion of which was funded by the Financing Authority's issuance of $12,000,000 of commercial paper notes through the Financing Authority's Commercial Paper Program and deposited the funds in the Low and Moderate Income Housing Asset Fund. The Countywide Oversight Board and the SARA Board approved the inclusion of this obligation along with accrued interest and fees totaling $14,227,000 as an enforceable obligation on ROPS 15-16B of the SARA, on September 24, 2015. The final payment of $4,727,000 was made by the SARA in June 2018 and the obligation is paid in full.

Parking Fund Loans – Effective February 1, 2012, all redevelopment agencies in the State of California were dissolved pursuant to AB XI 26, and with narrow exceptions, loans between cities and their redevelopment agencies were invalidated by AB XI 26, which was subsequently amended by AB 1484 and SB 107 (collectively, "Dissolution Legislation"). However, with the approval of AB 1484 in June 2012, certain loans may be reinstated as enforceable obligations of the Successor Agency contingent upon the following: 1) a finding by the California Department of Finance (DOF) that certain specified audits of the Successor Agency have been completed (evidenced by a Finding of Completion), and 2) a finding by the Countywide Oversight Board of the Successor Agency that these loans were for legitimate redevelopment purposes. If a loan is reinstated pursuant to these provisions of AB 1484, the loan terms need to be revised to conform to statutory criteria for interest calculations and repayment priorities.

The Parking Fund Loans were reinstated as enforceable obligations on ROPS 17-18 in accordance with Health and Safety Code Section 34191.4 (b) with Countywide Oversight Board approval on January 12, 2017. The DOF approved the Parking Fund Loans on March 28, 2017. Because the loans are reinstated City loans, the principal outstanding will accrue 3% simple interest and be paid on ROPS 19-20. As of June 30, 2018, the Parking Fund Loans have outstanding principal and accumulated accrued interest balance of $13,528,000 and $4,397,000, respectively.

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

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

The Amended Agreement provides that the payments due to the County from the Agency are subordinate to all the SARA’s debt. The County and SARA settled litigation related to the Amended Agreement in August 2017.

As of August 1, 2017, the outstanding past due pass-through owed to the County was $2,627,000. For FY 2018, the pass-through amount owed plus the past due pass-through amount owed were paid in full from the January and June 2018 RPTTF distributions.

2011 Settlement Agreement – On March 16, 2011 the County, the Agency, and the City, along with the Diridon Authority, entered into a Settlement Agreement of a lawsuit filed by the County in which the County alleged, among other things, that the Agency had failed to make timely payment of the County Pass-Through Payment for FYS 2009, 2010, and 2011 in an aggregate amount, as of June 30, 2011, of $58,270,000 (“2011 Settlement Agreement”).

Pursuant to the 2011 Settlement Agreement, the Agency agreed to pay the County $21,500,000 of tax-exempt bond proceeds by March 30, 2011, pay an additional $5,000,000 of unrestricted funds, and transfer title to certain property to the County, resulting in a remaining amount of $23,560,000 owed to the County. The Agency agreed to make payment in five installments no later than June 30 of 2014, 2015, 2016, 2017 and 2018.

As security for payments due to the County under the 2011 Settlement Agreement, the Agency also (i) executed and recorded for the benefit of the County, a subordinated Deed of Trust on various Agency-owned real estate assets, (ii) assigned to the County one-half (1/2) of the Agency sales proceeds from the sale of the North San Pedro properties under two separate Disposition and Development Agreements with private developers, and (iii) executed and recorded for the benefit of the County a Deed of Trust against the North San Pedro properties.

The SARA paid the outstanding balances of the 2017 and 2018 pass-through settlement obligations with proceeds from the sale of the North San Pedro Properties and the January 2018 RPTTF distribution. The principal and interest of $9,424,000 and $4,313,000, respectively, was paid in FY 2018 and the SARA has no further obligations under the 2011 Settlement Agreement.

Debt Service Requirements – The debt service requirements for all debt are based upon a fixed rate of interest, except HUD Section 108 Loans, which bear interest at variable rates. For purposes of calculating the annual debt service requirements for variable rate debt at June 30, 2018, the following assumed effective rate has been used:

Debt	Effective Interest Rate
HUD Section 108 Loans	2.53%

The annual requirements to amortize outstanding tax allocation bonds and other long-term debt outstanding at June 30, 2018, including mandatory sinking fund payments, are as follows (in thousands):

Year Ending	Merged Tax Allocation		Obligations with 3rd Parties *		Obligations with the City		Total	
June 30	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2019	$ 109,960	$ 54,866	$ 1,890	$ 77	$ 1,421	$ -	$ 113,271	$ 54,943
2020	90,760	52,292	1,990	68	-	-	92,750	52,360
2021	93,250	49,704	2,100	59	-	-	95,350	49,763
2022	95,940	46,890	2,205	49	-	-	98,145	46,939
2023	98,880	43,842	2,315	38	-	-	101,195	43,880
2024-2028	546,645	165,176	7,700	46	-	-	554,345	165,222
2029-2033	472,435	74,308	-	-	-	-	472,435	74,308
2034-2038	169,670	11,304	-	-	36,344	9,584	206,014	20,888
Total	$ 1,677,540	$ 498,382	$ 18,200	$ 337	$ 37,765	$ 9,584	$ 1,733,505	$ 508,303

*Paid in full in October 2018

Long-Term Reimbursement Agreement – When redevelopment property tax revenues are not sufficient to cover the SARA's enforceable obligations, the City Council has committed other sources of funding to cover costs related to the following obligations: Education Revenue Augmentation Fund ("ERAF") payments; and the SARA annual administrative budget and City support service expenses. On September 26, 2013 (as amended on August 27, 2015), the City and the SARA entered into an Amended and Restated Long-Term Reimbursement Agreement in order to establish an obligation for the SARA to repay the City for these advances.

Effective September 22, 2015, with the passage of SB 107, a city may loan funds to a successor agency that receives an insufficient distribution from the RPTTF and an enforceable obligation shall be deemed to be created for such loans. The receipt and use of such funds shall be reflected on the ROPS and subject to the approval of the Oversight Board. The interest payable on any such loan shall be calculated on a fixed annual simple basis at a rate not to exceed the most recently published interest rate for funds deposited into the Local Agency Investment Fund during the previous fiscal quarter. The repayment of such loan shall be subordinate to other approved enforceable obligations. Given the relevant provisions of SB 107, a reimbursement agreement is no longer necessary to establish the obligation to repay such loan.

5. Commitments and Contingencies Related to SARA

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 a worker's compensation insurance policy, a property and casualty insurance policy, or is self-insured. 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 will include amounts of incremental claims adjustment expense related to specific claims.

The SARA does not have any claims liabilities outstanding at June 30, 2018.

Environmental Land Remediation Obligation

During the year ended June 30, 2010, a review of the property currently held by SARA, revealed that there was no current pollution remediation required based on their current uses (i.e. surface parking and other uses), except the Miraido property and Convention Center South Hall Site as discussed below. In the unlikely possibility, given dissolution, a land remediation obligation occurs on 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*.

Miraido Property - On December 2, 2010, the Agency received a Notice of Responsibility from the County for soil remediation at the Miraido Village Site located at 520 North 6th Street in San José. The Agency, as owner of the underlying land, leased the site under a ground lease (the "Ground Lease") to the Japantown Development Limited Partnership ("Miraido"). Miraido constructed an apartment complex on the Ground Lease site. The Agency received a Notice of Responsibility 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 on finalizing the details of the cleanup process.

Miraido was responsible for all cleanup activities under its Ground Lease with the Agency. Miraido's consultant has estimated that the cost to achieve case closure is approximately $450,000 at Miraido's cost, with which the SARA's consultant concurs. Under the Ground Lease, Miraido was required to indemnify the SARA if the SARA incurs any costs as a result of the condition of the property.

The Miraido Property was sold in "as-is" condition in July 2017.

Convention Center South Hall Site – The South Hall Site is contaminated with gasoline and diesel products. The San Francisco Regional Water Quality Control Board ("Regional Board") has requested a Site Management Plan be prepared for the site. The Regional Board also requested a residential deed restriction be placed on the South Hall Site. A Phase I and Phase II study of the South Hall Site was prepared for the Agency indicating site contamination. There are no immediate plans to prepare a Site Management Plan. The extent and cost of mitigating the contamination is unknown.

The South Hall Site was sold in "as-is" condition on October 10, 2018.

Arbitrage Obligation

The SARA paid positive arbitrage owed to the Internal Revenue Service from the SARA Refunding Bonds Series 2017 A-T proceeds from the cost of issuance account in December 2017. The total amount paid was $3,889,000. Positive arbitrage was earned from RDA 1999 Tax Allocation Bonds ($3,879,000) and RDA 1996 Subordinate Tax Allocation Bonds Series AB ($10,000).

Contractual Commitments

At June 30, 2018, the SARA had $750,000 for contracted obligations and commitments. In addition, the SARA has unpaid contractual obligations in the amount of $1,375,000.

Litigation Against County Auditor-Controller SARA

The City, on its own behalf, and the SARA filed a lawsuit on June 26, 2012, entitled *City of San Jose as Successor Agency to the San Jose Redevelopment Agency v. Vinod Sharma, County of Santa Clara, et al.,* Case No. 34-2012-8000190, in the Superior Court for Sacramento County ("PERS Levy Lawsuit"). The suit sought to compel the County Auditor-Controller to disburse funds to the SARA, which the Agency previously received as tax increment. In June 2012, the County began withholding a portion of defined tax increment claiming the withheld amounts were special levies, including a contribution to the County's employees' retirement program (the "PERS Levy") and a levy for the benefit of the Santa Clara Valley Water District (the "Water District Levy"). The County asserted that, although it previously disbursed these funds to the Agency as tax increment, the Agency was never entitled to receive funds attributable to these levies. The lawsuit also sought to determine the priority of the County's pass-through payments under the Amended Agreement.

The Sacramento Superior Court ruled that the County Auditor-Controller could not withhold funds attributable to the PERS Levy from the SARA and the Redevelopment Dissolution Law did not require the County to subordinate its pass-through payments to any Agency debt other than secured bond debt. The Superior Court did not rule on the Water District Levy.

In August 2017, the SARA, the City, and the County entered into a settlement Agreement resolving the PERS Levy Lawsuit ("2017 Settlement Agreement"). At the time the 2017 Settlement Agreement was entered into by the parties, the County was holding $31,866,000 attributable to the PERS Levy and the Water District Levy. Pursuant to the 2017 Settlement Agreement, the City was reimbursed $12,898,000 for the debt-related SARA expenses paid in FY 2012-2015, the Santa Clara Valley Water District was paid $312,000 for the AB1290 portion, and the remaining $18,656,000 was used to pay down the County pass-through obligations as of June 30, 2017.

D. Subsequent Events

1.Tax and Revenue Anticipation Note

On July 2, 2018, the City entered into a Note Purchase Agreement with Bank of America, N.A. (the "Bank") under which the Bank agreed to purchase the City's short-term note in the full principal amount of $150,000,000 (the "2018 Note") in accordance with the terms of the Note Purchase Agreement. The transaction was needed for cash flow borrowing purposes to facilitate the prefunding of the City's retirement contributions. Pursuant to the Note Purchase Agreement, the City issued and the Bank purchased the 2018 Note bearing interest at a variable interest rate based on a LIBOR index, plus a margin of 0.32% for Bank fees. Under the Note Purchase Agreement, at the City's option on any interest payment date, the City may prepay the 2018 Note in whole or in part, with partial prepayment of principal of not less than $5,000,000 and in $1,000,000 increments in excess thereof. Security for repayment of the 2018 Note is a pledge of the City's FY 2019 secured property tax revenues (excluding property taxes levied for general obligation bonds) and all other legally available General Fund revenues of the City, if required. The 2018 Note has a stated maturity of June 28, 2019.

2. City of San José Ballot Measures T and V

On August 10, 2018, the City Council approved resolutions which called for the submission to the electors of the City of San Jose in the next general election to be held on November 6, 2018, consideration of two ballot measures authorizing the issuance of general obligation bonds.

MEASURE T. Disaster Preparedness, Public Safety, and Infrastructure Bond – A ballot measure proposal calling for the issuance of $650 million General Obligation Bonds for the acquisition, construction, and completion of certain municipal improvements.

MEASURE V. Affordable Housing Bond – A ballot measure proposal calling for the issuance of $450 million General Obligation Bonds for the acquisition, construction, and completion of affordable housing in the City of San Jose.

Under State law, the Santa Clara County Registrar of Voters must complete the canvass of the vote and certify and submit the election results to the County Board of Supervisors by December 6, 2018. As of the date of this document, the Santa Clara County Registrar of Voters has not completed the ballot counting for Measures T and V. From the ballots counted to date, the votes cast in favor of Measure T exceed the two-thirds margin for approval and the votes cast in favor of Measure V are less than the required two-thirds margin.

3. Proposed Sale of Hayes Mansion

On August 7, 2018, the Financing Authority signed a Purchase and Sale Agreement (PSA) with JMA Venures, LLC, a Delaware limited liability company, to sell and transfer certain improved real property commonly known as the Hayes Mansion, and related rights, personal property, and intangible property. Concurrent with the closing of the sale of the Hayes Mansion to the Purchaser, the Financing Authority intends to transfer the property to the City and the City will consummate the sale of the Hayes Mansion to the Purchaser for a purchase price of $30,000,000 plus amounts to be determined in accordance with the PSA for the accounts receivable and food and beverage inventory and less the amount of the closing costs allocated to City under the PSA. On November 6, 2018, the City Council adopted a resolution authorizing staff to negotiate certain amendments to the terms of the PSA to facilitate Purchaser's property approval and continue toward the close of escrow and completion of the Hayes Mansion sale.

There are various milestones which the Purchaser must meet including: reviewing and approving all information related to the property, to conduct and approve various property inspections, obtain an Alcoholic Beverage License (ABC License), and fully execute collective bargaining agreements with the labor unions before the escrow close. Since executing the PSA, the Purchaser has worked diligently in good faith toward the purchase of the property, achieving several milestones, and investing considerable amount of time and funds into vetting the property and its investment suitability. Per PSA, the parties intend to complete the transfer at closing that is scheduled to occur in January 2019. The Purchaser shall have the right to extend the date of closing for a period up to 60 days until February 28, 2019 in the event they are unable to obtain the ABC License and collective bargaining agreement.

Ultimately, completing the proposed sale of Hayes Mansion will allow the City to eliminate all outstanding long-term bond debt against the property and eliminate the ongoing General Fund subsidy for debt service, which ranged from $2,000,000 to $6,000,000 per year since 2003.

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

On August 28, 2018, the SARA sold property commonly known as Block D to TM San Jose 78, LLC for $1,585,000. At the close of escrow, the net sale proceeds of $1,576,000 were remitted to the County Auditor-Controller and were subsequently distributed to the appropriate local taxing entities per the Health and Safety Code.

On September 19, 2018, the SARA sold property commonly known as Block E to First American Exchange Company, LLC as Qualified Intermediary for San Pedro Life I, LLC for $4,705,000. At the close of escrow, the net sale proceeds of $4,690,000 were remitted to the County Auditor-Controller and were subsequently distributed to the appropriate local taxing entities per the Health and Safety Code.

On September 27, 2018, the SARA sold property commonly known as Blocks B/F to 171 W. Julian Street Apartments Investors LLC for $10,289,000. At the close of escrow, the net sale proceeds of $10,259,000 were remitted to the County Auditor-Controller and were subsequently distributed to the appropriate local taxing entities per the Health and Safety Code.

On October 9, 2018, the SARA sold one property (490 South 1st Street) to San Jose Stage Company for $2,300,000. At the close of escrow, the net sale proceeds of $2,292,000 were remitted to the County Auditor-Controller and were subsequently distributed to the appropriate local taxing entities per the Health and Safety Code.

On October 10, 2018, the SARA sold one property (Convention Center South Hall Site) to the City for $47,000,000. The property was used as collateral for several HUD loans associated with the former Agency and the HUD loans ($16,310,000 principal plus $82,000 accrued interest) were paid in full at closing. The net sale proceeds of $30,594,000 were remitted to the County Auditor-Controller and were subsequently distributed to the appropriate local taxing entities per the Health and Safety Code.

5. City of San José Financing Authority Lease Revenue Commercial Paper Notes

On August 28, 2018, State Street Bank and Trust Company (“State Street”) and U.S. Bank National Association (“U.S. Bank” and together the “Banks”) each issued its direct-pay letter of credit (“LOC”) in the maximum available amount of $67,123,000 (the “Stated Amount”) (to cover principal of $62,500,000 and interest on the Financing Authority’s Lease Revenue Commercial Paper Notes at a rate of 10% for 270 days based on a 365 day year) with a term expiring on February 23, 2022, unless sooner terminated or extended pursuant to the terms of each LOC. Each Bank issued its respective LOC pursuant to an amendment to the Letter of Credit and Reimbursement Agreement, as previously amended, by and among the City, the Financing Authority and each Bank. In connection with each Bank's issuance of its LOC, other agreements governing the Financing Authority's Lease Revenue Commercial Paper Notes were amended, including the Amended and Restated Trust Agreement between the Financing Authority and Wells Fargo Bank, N.A. as previously amended and supplemented and the sublease between the Financing Authority and the City, as previously amended and the City, the Financing Authority and each Bank entered into a Fee Letter agreement. The increase to the stated amount of each LOC was for the purpose of increasing the principal amount of the Financing Authority's Lease Revenue Commercial Paper Notes from $85 million ot $125 million in order to finance the City's acquisition of the Convention Center - South Hall property described in Note IV.D.4.

6. Clean Energy Revolving Credit Agreement

On September 25, 2018, the City Council authorized the City Manager, the Director of Finance, the Assistant Director of Finance or their authorized designees to negotiate, execute, and deliver a Revolving Credit Agreement ("Credit Agreement") by and between the City and Barclays Bank PLC (the "Bank"), and a promissory note, evidencing the City's obligations thereunder. The Credit Agreement provided for a credit facility (the "Credit Facility") consisting of a revolving line of credit facility (the "Revolving Line of Credit") and a standby letter of credit facility (the "Standby Letter of Credit Facility"). Under the terms of the Credit Agreement, the Bank committed to (i) make loans on a revolving basis under the Revolving Line of Credit in an aggregate principal amount not to exceed $20 million at any time outstanding for a period of three (3) years from the date of the Credit Agreement is executed and delivered by the City (or November 27, 2021, assuming an effective date of November 27, 2018), and (ii) issue standby letters of credit under the Standby Letters of Credit Facility in an aggregate principal amount not to exceed $35 million for a period of five (5) years from the date the Credit Agreement is executed and delivered by the City (or November 27, 2023, assuming an effective date of November 27, 2018), provided that the aggregate principal amount outstanding under the Revolving Line of Credit and amounts available to be drawn under Standby Letters of Credit issued by the Bank do not exceed $50,000,000 at any one time outstanding.

Advances under the Revolving Line of Credit and Standby Letters of Credit issued by the Bank under the Credit Agreement will permit City of San José's Clean Energy program ("SJCE") to enter into power contracts and provide collateral for power purchase agreements during the ramp-up phases of the SJCE. Advances under the Revolving Line of Credit would also be used to fund start-up and long-term costs for working capital associated with the operation of SJCE, including the purchase of electrical power. The City's obligation to repay the advances under the Revolving Line of Credit and Standby letters of Credit are secured solely from revenues of SJCE.

7. Norman Y. Mineta San José International Airport

In September 2018, the City substituted the letter of credit supporting the Norman Y. Mineta San José International Airport Subordinated Commercial Paper Notes issued by Barclays Bank PLC with a letter of credit issued by Bank of America, N.A. ("BofA"). (See Note III.F.3). Pursuant to a Letter of Credit and Reimbursement Agreement between the City and BofA, BofA issued its irrevocable transferrable letter of credit in the initial stated amount of $81,658,000 (to cover principal of $75,000,000 and interest on the Subordinated Commercial Paper Notes accruing calculated at a rate of 12% for 270 days based on a 365 day year) that is scheduled to expire on September 10, 2021 unless sooner terminated or extended pursuant to its terms. The $75 million principal amount of the letter of credit issued by BofA is larger than the $38 million principal amount of the letter of credit issued by Barclays and was secured in order to provide additional capacity for the issuance of the Subordinated Commercial Paper Noted to finance proposed terminal area projects. In connection with BofA's issuance of its LOC, other agreements governing the Norman Y. Mineta San José International Airport Subordinated Commercial Paper Notes were executed, including the First Amendment to the Third and Amended and Restated Issuing and Paying Agreement between the City and U.S. Bank National Association and the Fourth Amended and Restated Dealer Agreement between the City and each of the dealers of the notes and a Fee Letter between the City and BofA.

The ratings of the outstanding Airport Subordinated Commercial Paper Notes, are "A-1", "P-1", and "F1+" by S&P, Moody's, and Fitch, respectively, based on the credit support provided by BofA pursuant to its LOC.

After fiscal year end 2018, Air China, Lufthansa, and Aeromexico airlines discontinued service from the Airport. Air China stopped service to Shanghai effective September 25, 2018, Lufthansa will cancel service to Frankfurt effective October 27, 2018, and Aeromexico will discontinue service to Guadalajara effective January 8, 2019. In FY 2018, the passengers that took flights on Air China, Lufthansa and Aeromexico airlines represented 1.6% of the total passengers that travelled through the Airport during the fiscal year. The Airport does not believe that the departure of these carriers will have a material impact on the operations or financial results of the Airport.

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General Fund
Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
($000's)

	Budgeted Amounts		Actual Amounts Budgetary Basis Variance with Final Budget	Actual Amounts Budgetary	Budgetary to GAAP	Actual Amounts	
	Original	Final	Over (Under)	Basis	Differences	GAAP Basis	
REVENUES							
Taxes:							
Property	$ 288,990	304,990	1,232	306,222	-	306,222	
Utility	121,320	121,320	(1,086)	120,234	-	120,234	
Franchise	50,813	50,813	367	51,180	-	51,180	
Business Tax	63,300	68,385	2,288	70,673	-	70,673	
Other	18,720	18,720	811	19,531	-	19,531	
State of California in-lieu	551	551	-	551	-	551	
Sales taxes shared revenue	228,000	230,000	(3,663)	226,337	-	226,337	
Licenses, permits and fines	75,115	74,606	253	74,859	-	74,859	
Intergovernmental	7,410	12,401	(628)	11,773	-	11,773	
Charges for current services	34,390	34,183	18,120	52,303	-	52,303	
Other revenues	39,396	60,535	(1,950)	58,585	(15,680)	42,905	(3)
Investment income	3,518	3,518	963	4,481	(2,253)	2,228	(1)
Total revenues	931,523	980,022	16,707	996,729	(17,933)	978,796	
EXPENDITURES							
Current:							
General government	165,982	165,848	(56,265)	109,583	(8,851)	100,732	(2)
Public safety	632,211	628,678	(31,237)	597,441	(4,279)	593,162	(2)
Community services	152,142	151,895	(6,012)	145,883	(6,290)	139,593	(2)
Sanitation	5,309	5,309	(940)	4,369	(221)	4,148	(2)
Capital maintenance	176,937	166,587	(27,602)	138,985	(18,827)	120,158	(2)
Capital outlay	-	14,264	-	14,264	-	14,264	
Debt service:							
Principal	189,804	39,691	(572)	39,119	-	39,119	
Interest	2,945	2,874	(690)	2,184	-	2,184	
Total expenditures	1,325,330	1,175,146	(123,318)	1,051,828	(38,468)	1,013,360	
Excess (deficiency) of revenues over expenditures	(393,807)	(195,124)	140,025	(55,099)	20,535	(34,564)	
OTHER FINANCING SOURCES (USES)							
Proceeds for sale of capital assets	38,187	38,187	-	38,187	-	38,187	
Transfers in	9,043	10,262	1,147	11,409	-	11,409	(1)
Transfers out	(32,445)	(34,347)	(495)	(34,842)	-	(34,842)	(1)
Total other financing sources (uses)	14,785	14,102	652	14,754	-	14,754	
Net change in fund balance	(379,022)	(181,022)	140,677	(40,345)	20,535	(19,810)	
					-		
Fund balance - beginning	242,801	242,801	-	242,801	70,031	312,832	
Add beginning encumbrance balance	-	-	-	48,886	(48,886)	-	
Fund balance - ending	$ (136,221)	61,779	140,677	251,342	41,680	293,022	

Explanation of differences:

(1) Gain or loss in fair value of investments are not formally budgeted transactions.
(2) Encumbrances of funds for which formal budgets are prepared.
(3) Due to repayment of long-term receivables from SARA.

See accompanying notes to the required supplementary information.

City of San José
Housing Activities Fund
Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
For the Year Ended June 30, 2018
($000's)

	Budgeted Amounts		Actual Amounts Budgetary Basis Variance with Final Budget	Actual Amounts Budgetary	Budgetary to GAAP	Actual Amounts	
	Original	Final	Over (Under)	Basis	Differences	GAAP Basis	
Intergovernmental	$ 4,321	10,295	(2,153)	8,142	-	8,142	
Investment income	220	305	3,611	3,916	(295)	3,621	(1)
Other revenues	10,646	12,092	(1,718)	10,374	(2,148)	8,226	(2)
Total revenues	15,187	22,692	(260)	22,432	(2,443)	19,989	
EXPENDITURES							
Current:							
Community services	20,766	36,678	(16,344)	20,334	(5,936)	14,398	(2)
Total expenditures	20,766	36,678	(16,344)	20,334	(5,936)	14,398	
Excess (deficiency) of revenues over expenditures	(5,579)	(13,986)	16,084	2,098	3,493	5,591	
OTHER FINANCING SOURCES (USES)							
Transfers out	(69)	(69)	-	(69)	-	(69)	
Total other financing sources (uses)	(69)	(69)		(69)		(69)	
Net change in fund balance	(5,648)	(14,055)	16,084	2,029	3,493	5,522	
Fund balance - beginning	127,660	127,660	-	127,660		127,660	
Add beginning encumbrance balance	-	-	-	6,112	(6,112)	-	
Adjustment	-	-	-	(9,346)	9,346	-	
Fund balance - ending	$ 122,012	113,605	16,084	126,455	6,727	133,182	

Explanation of differences:

(1) Gain or loss in fair value of investments are not formally budgeted transactions.

(2) Expenditures and repayments that increase and decrease certain loan receivables for which formal budgets are prepared.

See accompanying notes to the required supplementary information.

City of San José
Low and Moderate Income Housing Asset Fund
Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
For the Year Ended June 30, 2018
($000's)

	Budgeted Amounts		Actual Amounts Budgetary Basis Variance with Final Budget	Actual Amounts Budgetary	Budgetary to GAAP	Actual Amounts	
	Original	Final	Over (Under)	Basis	Differences	GAAP Basis	
REVENUES							
Investment income	650	650	26,524	27,174	(616)	26,558	(1)
Other revenues	11,500	11,500	6,418	17,918	(8,584)	9,335	(2)
Total revenues	12,150	12,150	32,942	45,092	(9,200)	35,893	
EXPENDITURES							
Current:							
Community services	36,405	40,144	(19,378)	20,766	(13,077)	7,689	(2)
Total expenditures	36,405	40,144	(19,378)	20,766	(13,077)	7,689	
Excess (deficiency) of revenues over expenditures	(24,255)	(27,994)	52,320	24,326	3,877	28,204	
OTHER FINANCING SOURCES (USES)							
Transfers in	-	1,237	-	1,237	-	1,237	
Transfers out	(2,469)	(2,469)	-	(2,469)	-	(2,469)	
Total other financing sources (uses)	(2,469)	(1,232)		(1,232)		(1,232)	
Net change in fund balance	(26,724)	(29,225)	52,320	23,094	3,877	26,972	
Fund balance - beginning	82,377	82,377	-	82,377	269,956	352,332	
Add beginning encumbrance balance	-	-	-	6,965	(6,965)	-	
Adjustment	-	-	-	3,888	(3,888)	-	
Fund balance - ending	$ 55,653	53,151	52,320	116,324	262,980	379,304	

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

See accompanying notes to the required supplementary information.

Schedule of Employer Contributions – Defined Benefit Pension Plans

PFDRP Schedule of Employer Contributions
(Dollar Amounts in Thousands)

	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
Actuarially determined contribution	$ 157,712	$ 136,957	$ 132,480	$ 129,279	$ 123,583	$ 105,234	$ 121,008	$ 77,918	$ 52,315	$ 53,103
Contributions in relation to the actuarially determined contribution	157,712	136,957	132,480	129,279	123,583	105,234	121,008	77,918	52,315	53,103
Contribution deficiency (excess)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Covered payroll	$ 203,164	$ 188,177	$ 186,874	$ 180,226	$ 180,083	$ 180,333	$ 184,750	$ 222,464	$ 239,570	$ 243,196
Contributions as a percentage of covered payroll	77.63%	72.78%	70.89%	71.73%	68.63%	58.36%	65.50%	35.02%	21.84%	21.84%

Fiscal Year	2018	2017	2016	2015	2014	2013	2012	2011	2010-2009
Valuation date	June 30, 2016	June 30, 2015	June 30, 2014	June 30, 2013	June 30, 2012	June 30, 2011	June 30, 2010	June 30, 2009	June 30, 2007**
Actuarial cost method	Entry age	Entry age	Entry age	Entry age	Entry age	Entry age	Entry age	Entry age	Entry age
Asset valuation method	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market
Amortization method	Actuarial gains and losses and plan changes are amortized over closed 15-year periods. Method and assumption changes are amortized over 20-year periods. All amortizations are a level percent of payroll.	Actuarial gains and losses and plan changes are amortized over closed 16-year periods. Method and assumption changes are amortized over 20-year periods. All amortizations are a level percent of payroll.					Actuarial gains and losses and plan changes are amortized over closed 16-year periods. Method and assumption changes are amortized over 16-year periods. All amortizations are a level percent of payroll.		Actuarial gains and losses and plan changes are amortized over closed 16-year periods. Method and assumption changes are amortized over 20-year periods. All amortizations are a level percent of payroll.
Discount rate	6.875%	7.00%	7.00%	7.125%	7.250%	7.50%	7.75%	8.00%	8.00%
Salary increases	3.25% plus merit component based on length of service ranging from 6.75% for new hires to 1.00% for members with 10 or more years of service.	3.25% plus merit component based on length of service ranging from 6.75% for new hires to 1.00% for members with 10 or more years of service.	3.25% plus merit component based on length of service ranging from 9.25% for new hires to 2.00% for members with 10 or more years of service.	2.00% for FY 2015, and 3.5% thereafter plus merit component based on length of service ranging from 9.25% for new hires to 2.00% for members with 10 or more years of service.	0.00% for FY 2014, and 3.50% thereafter plus merit component based on length of service ranging from 8.00% for new hires to 2.25% for members with 10 or more years of service.	0.00% for FY 2013, and 3.50% thereafter plus merit component based on length of service ranging from 8.00% for new hires to 2.25% for members with 10 or more years of service.	4.25% plus merit component based on length of service ranging from 5.50% for new hires to 1.75% for members with 8 or more years of service.	4.25% plus merit component based on length of service ranging from 5.50% for new hires to 1.75% for members with 8 or more years of service.	4.0% plus merit component based on length of service ranging from 4.0% for new hires to 1.0% for members with 8 or more years of service.
Amortization growth rate	3.25%	3.25%	3.25%	3.50%	3.50%	4.25%	4.25%	4.25%	4.00%
COLA	3.0% for Tier 1, 1.5% for Tier 2	3.0% for Tier 1, 1.5% for Tier 2	3.0% for Tier 1, 1.5% for Tier 2	3.0% for Police Tier 1 & Fire, 1.5% for Police Tier 2	3.0% for Police Tier 1 & Fire, 1.5% for Police Tier 2	3.0% for Police Tier 1 & Fire, 1.5% for Police Tier 2	3.0% for Police Tier 1 & Fire	3.0% for Police Tier 1 & Fire	3.0% for Police and Fire
Mortality	Healthy annuitants: CalPERS 2009 Healthy Annuity Mortality Tables multiplied by 0.948 for males and 1.048 for females, with mortality improvements projected from 2009 using Scale MP-2015 on a generational basis Disabled annuitants: CalPERS 2009 Industrial Mortality Tables for Males multiplied by 0.903, with mortality improvements projected from 2009 using Scale MP-2015 on a generational basis.	Healthy annuitants: CalPERS 2009 Healthy Annuity Mortality Tables multiplied by 0.948 for males and 1.048 for females, with mortality improvements projected from 2009 using Scale MP-2015 on a generational basis Disabled annuitants: CalPERS 2009 Industrial Mortality Tables for Males multiplied by 0.903, with mortality improvements projected from 2009 using Scale MP-2015 on a generational basis.	RP-2000 combined healthy mortality table with no collar adjustment projected to 2010 using scale AA. Male rates are set back three years.				RP-2000 combined healthy mortality table with no collar adjustment projected to 2010 using scale AA. Male rates are set back four years.	RP-2000 combined healthy mortality table with no collar adjustment projected to 2010 using scale AA. Male rates are set back four years and female rates are set forward one year.	RP-2000 combined healthy mortality table with no collar adjustment projected to 2010 using scale AA. Male rates are set back three years and female rates are set forward one year.

***Actuarial valuations have been performed biennially through June 30, 2007. Effective with the June 30, 2009, the System transitioned to annual actuarial valuations.*

FCERS Schedule of Employer Contributions
(Dollar Amounts in Thousands)

	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
Actuarially determined contribution	$ 156,770	$ 138,483	$ 129,456	$ 114,751	$ 102,811	$ 103,109	$ 87,082	$ 59,180	$ 54,566	$ 57,020
Contributions in relation to the actuarially determined contributions	156,770	138,483	124,723	114,751	107,544	103,109	87,082	59,180	54,566	57,020
Contribution deficiency (excess)	$ -	$ -	$ 4,733	$ -	$ (4,733)	$ -	$ -	$ -	$ -	$ -
Covered payroll	$ 290,504	$ 271,153	$ 257,771	$ 240,678	$ 219,434	$ 217,375	$ 223,158	$ 275,869	$ 308,684	$ 320,993
Contributions as a percentage of covered payroll	53.96%	51.07%	48.39%	47.68%	49.01%	47.43%	39.02%	21.45%	17.68%	17.76%

Fiscal Year	2018	2017	2016	2015	2014	2013	2012	2011	2010-09
Valuation date	June 30, 2016	June 30, 2015	June 30, 2014	June 30, 2013	June 30, 2012	June 30, 2011	June 30, 2010	June 30, 2009	June 30, 2007**
Actuarial cost method	Entry age	Entry age	Entry age	Entry age	Entry age	Entry age	Entry age	Entry age	Entry age
Asset valuation method	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market
Discount rate	6.875%	7.00%	7.00%	7.25%	7.50%	7.50%	7.95%	7.75%	8.25%
Salary increases	2.85% plus merit component based on years of service	2.85% plus merit component based on years of service	2.85% plus merit component based on years of service	2.0% for five years and 2.85% thereafter plus merit component based on employee classification and years of service	3.25% plus merit component based on years of service	3.25% plus merit component based on years of service	The base annual rate of salary increase is 3.90% wage inflation rate plus a rate increase for merit/ longevity for the first 5 years of service ranging from 5.75% to 0.25% at the 5th year of service	The base annual rate of salary increase is 3.67% wage inflation rate plus 0.41% for wage inflation for a total rate of 4.08%. This is added to a rate increase for merit/longevity for the first 5 years of service raging from 5.50% to 0.75% at the 5th year of service	The base annual rate of salary increase is 3.67% wage inflation rate plus 0.41% for wage inflation for a total rate of 4.08%. This is added to a rate increase for merit/longevity for the first 5 years of service raging from 5.50% to 0.75% at the 5th year of service
Amortization growth rate	2.85%	2.85%	2.85%	2.43%	3.25%	3.25%	3.90%	3.83%	4.25%
COLA	Tier 1: 3% Tier 2: CPI, cap of 1.5%	Tier 1: 3% Tier 2: CPI, cap of 1.5%	Tier 1: 3% Tier 2: CPI, cap of 1.5%	Tier 1: 3% Tier 2: CPI, cap of 1.5%	Tier 1: 3% Tier 2: CPI, cap of 1.5%	Tier 1: 3%	Tier 1: 3%	Tier 1: 3%	Tier 1: 3%
Mortality	Adjusted 2009 CalPERS mortality tables projected on a generational basis with the SOA MP-2015 projection scale	Adjusted 2009 CalPERS mortality tables projected on a generational basis with the SOA MP-2015 projection scale	Sex distinct RP-2000 Combined Mortality projected to 2015 using Scale AA and setback two years	Sex distinct RP-2000 Combined Mortality projected to 2015 using Scale AA and setback two years	Sex distinct RP-2000 Combined Mortality projected to 2015 using Scale AA and setback two years	Sex distinct RP-2000 Combined Mortality projected to 2015 using Scale AA and setback two years	The 1994 group annuity mortality table set back three years for males and one year for females was used for healthy retirees and beneficiaries. The disabled mortality table used was the 1981 disability mortality table.	The 1994 group annuity mortality table set back three years for males and one year for females was used for healthy retirees and beneficiaries. The disabled mortality table used was the 1981 disability mortality table.	The 1994 group annuity mortality table was used for healthy retirees and beneficiaries. The disabled mortality table used was the 1981 disability mortality table.

*** Actuarial valuations were performed biennially through June 30, 2007. Effective June 30, 2009, the System transitioned to annual actuarial valuations.*

Schedule of Changes in the Employer's Net Pension Liability – Defined Benefit Pension Plans

(Dollar amounts in thousands):			PFDRP		
Total pension liability	**2018**	**2017**	**2016**	**2015**	**2014**
Service cost (middle of year)	$ 75,481	$ 72,760	$ 74,531	$ 74,895	$ 75,030
Interest (includes interest on service cost)	300,378	290,961	274,488	262,737	251,701
Changes of benefit terms	178	5,752	-	-	-
Differences between expected and actual experience	33,082	67,557	(8,673)	21,457	-
Changes of assumptions	(100,328)	72,680	90,179	56,311	-
Benefit payments, including refunds of member contributions	(206,630)	(196,032)	(186,939)	(176,253)	(167,397)
Net change in total pension liability	102,161	313,678	243,586	239,147	159,334
Total pension liability - beginning	4,533,776	4,220,098	3,976,512	3,737,365	3,578,031
Total pension liability - ending	$ 4,635,937	$ 4,533,776	$ 4,220,098	$ 3,976,512	$ 3,737,365
Plan fiduciary net position					
Contibutions - employer	$ 157,712	$ 136,957	$ 132,480	$ 129,279	$ 123,583
Contibutions - employee	23,841	20,580	21,508	20,747	21,115
Net investment income	233,475	292,734	(29,207)	(27,690)	404,978
Benefit payments, including refunds of member contributions	(206,630)	(196,032)	(186,939)	(176,253)	(167,397)
Administrative expense	(5,464)	(4,633)	(4,256)	(4,191)	(3,631)
Net change in plan fiduciary net position	202,934	249,606	(66,414)	(58,108)	378,648
Plan fiduciary net position - beginning	3,293,257	3,043,651	3,110,065	3,168,173	2,789,525
Plan fiduciary net position - ending	$ 3,496,191	$ 3,293,257	$ 3,043,651	$ 3,110,065	$ 3,168,173
Net pension liability - ending	$ 1,139,746	$ 1,240,519	$ 1,176,447	$ 866,447	$ 569,192
Plan fiduciary net position as a percentage of the total pension liability	75.41%	72.64%	72.12%	78.21%	84.77%
Covered payroll	$ 203,164	$ 188,177	$ 186,874	$ 180,226	$ 180,083
Net pension liability as a percentage of covered payroll	561.00%	659.23%	629.54%	480.76%	316.07%

(Dollar amounts in thousands):			FCERS		
Total pension liability	**2018**	**2017**	**2016**	**2015**	**2014**
Service cost (middle of year)	$ 59,628	$ 51,887	$ 49,011	$ 46,795	$ 43,334
Interest (includes interest on service cost)	265,199	249,387	229,610	221,690	214,487
Changes of benefit terms	1,781	12,132	-	-	-
Differences between expected and actual experience	16,512	40,853	39,720	13,005	-
Changes of assumptions	(15,582)	60,233	205,875	108,674	-
Benefit payments, including refunds of member contributions	(193,400)	(183,430)	(173,318)	(164,562)	(155,936)
Net change in total pension liability	134,138	231,062	350,898	225,602	101,885
Total pension liability - beginning	3,923,210	3,692,148	3,341,250	3,115,648	3,013,763
Total pension liability - ending	$ 4,057,348	$ 3,923,210	$ 3,692,148	$ 3,341,250	$ 3,115,648
Plan fiduciary net position					
Contibutions - employer	$ 156,770	$ 138,483	$ 124,723	$ 114,751	$ 107,544
Contibutions - employee	20,501	17,227	15,920	13,621	13,596
Net investment income	117,493	146,012	(35,011)	(16,642)	263,688
Benefit payments, including refunds of member contributions	(193,400)	(183,430)	(173,318)	(164,562)	(155,936)
Administrative expense	(4,823)	(4,380)	(3,941)	(3,898)	(3,201)
Net change in plan fiduciary net position	96,541	113,912	(71,627)	(56,730)	225,691
Plan fiduciary net position - beginning	1,972,792	1,858,880	1,930,507	1,987,237	1,761,546
Plan fiduciary net position - ending	$ 2,069,333	$ 1,972,792	$ 1,858,880	$ 1,930,507	$ 1,987,237
Net pension liability - ending	$ 1,988,015	$ 1,950,418	$ 1,833,268	$ 1,410,743	$ 1,128,411
Plan fiduciary net position as a percentage of the total pension liability	51.00%	50.29%	50.35%	57.78%	63.78%
Covered payroll	$ 290,504	$ 271,153	$ 257,771	$ 240,678	$ 219,434
Net pension liability as a percentage of covered payroll	684.33%	719.31%	711.20%	586.15%	514.24%

Schedule of Investment Returns – Defined Benefit Pension Plans

	PFDRP				
	2018	2017	2016	2015	2014
Annual money-weighted rate of return, net of investment expense	6.89%	9.68%	(0.85%)	(0.85%)	13.0%

	FCERS				
	2018	2017	2016	2015	2014
Annual money-weighted rate of return, net of investment expense	6.03%	7.53%	(0.79)%	(1.07)%	7.49%

The rate shown above is based on the Defined Benefit and 401(h) only and does not include the 115 subtrusts. Schedules are intended to show information for 10 years. Additional years will be displayed as they become available.

Schedule of the City's Proportionate Share of the Net Pension Liability and Related Ratios – CalPERS

(Dollar amounts in thousands):	2018	2017	2016	2015
Measurement date:	June 30, 2017	June 30, 2016	June 30, 2015	June 30, 2014
Proportion of the net pension liability	0.03597%	0.03634%	0.03783%	0.01697%
Proportionate share of the net pension liability	$ 1,419	$ 1,262	$ 1,038	$ 1,056
Covered payroll	$ 776	$ 756	$ 589	$ 692
Proportionate share of the net pension liability as percentage of covered payroll	182.86%	166.93%	176.23%	152.60%
Plan's fiduciary net position	$ 4,181	$ 3,666	$ 3,671	$ 3,395
Plan's fiduciary net position as a percentage of the total pension liability	84.84%	74.39%	77.96%	76.28%

Notes to Schedule:

Benefit changes. In 2015, benefit terms were modified to base miscellaneous employee pensions on a final three-year average salary instead of a final five-year average salary

Schedule is intended to show information for 10 years commencing with the fiscal year ended June 30, 2015. Additional years will be displayed as they become available.

Schedule of Employer Contributions – CalPERS

(Dollar amounts in thousands)	2018	2017	2016	2015
Actuarially determined contribution	$ 184	$ 162	$ 148	$ 107
Contributions in relation to the actuarially determined contributions	184	162	156	107
Contribution deficiency (excess)	$ -	$ -	$ (8)	$ -
Covered payroll	$ 822	$ 776	$ 756	$ 589
Contributions as a percentage of covered payroll	22.38%	20.88%	20.63%	17.06%

Notes to Schedule:

<table>
<tr><td>Valuation Date</td><td>6/30/2015</td><td>6/30/2014</td><td>6/30/2013</td><td>6/30/2012</td></tr>
<tr><td>Actuarial Cost Method</td><td colspan="4">Entry Age Normal Cost Method</td></tr>
<tr><td>Amortization Method</td><td colspan="4">Level Percentage of Payroll</td></tr>
<tr><td>Asset Valuation Method</td><td colspan="3">Market Value</td><td>15 Year Smoothed Market</td></tr>
<tr><td colspan="5">Actuarial Assumptions:</td></tr>
<tr><td>Discount Rate</td><td colspan="4">7.5% (net of administrative expenses)</td></tr>
<tr><td>Termination Liability Discount Rate</td><td>2.75%</td><td>2.91%</td><td>3.72%</td><td>2.98%</td></tr>
<tr><td rowspan="2">Salary Growth</td><td colspan="2">3.20% to 12.20%</td><td colspan="2">3.30% to 14.20%</td></tr>
<tr><td colspan="4">Depending on Age, Service and Type of Employment</td></tr>
<tr><td>Inflation</td><td colspan="4">2.75%</td></tr>
<tr><td>Payroll Growth</td><td colspan="4">3.00%</td></tr>
</table>

Schedule is intended to show information for 10 years commencing with the fiscal year ended June 30, 2015.
Additional years will be displayed as they occur.

Schedule of Changes in the Employer's Net OPEB Liability and Related Ratios for the Measurement Periods Ended June 30 – Postemployment Healthcare Plans

(Dollar amounts in thousands):	PFDRP	
Total OPEB liability	2018	2017
Service cost (middle of year)	$ 13,001	$ 16,112
Interest (includes interest on service cost)	45,314	46,774
Changes of benefit terms	(69,434)	-
Differences between expected and actual experience	14,877	-
Change of assumptions	21,243	-
Benefit payments, including refunds of member contributions	(27,686)	(24,799)
Net change in total OPEB liability	(2,685)	38,087
Total OPEB liability - beginning	714,517	676,430
Total OPEB liability - ending	$ 711,832	$ 714,517
Plan fiduciary net position		
Contibutions - employer	$ 25,382	$ 20,667
Contibutions - employees	16,127	18,116
Net investment income	7,070	12,453
Benefit payments, including refunds of member contributions	(27,686)	(24,799)
Administrative expense	(158)	(182)
VEBA transfer	(7,897)	-
Net change in plan fiduciary net position	12,838	26,255
Plan fiduciary net position - beginning	149,682	123,427
Plan fiduciary net position - ending	$ 162,520	$ 149,682
Net OPEB liability - ending	$ 549,312	$ 564,835
Plan fiduciary net position as a percentage of the total OPEB liability	22.83%	20.95%
Covered payroll	$ 203,164	$ 188,177
Net OPEB liability as a percentage of covered payroll	270.38%	300.16%

(Dollar amounts in thousands):	FCERS	
Total OPEB liability	2018	2017
Service cost (BOY)	$ 7,889	$ 11,109
Interest (includes interest on service cost)	42,669	49,978
Changes of benefit terms	(57,623)	-
Differences between expected and actual experience	(995)	-
Changes of assumptions	(77,795)	-
Benefit payments, including refunds of member contributions	(29,724)	(31,007)
Net change in total OPEB liability	(115,579)	30,080
Total OPEB liability - beginning	766,801	736,721
Total OPEB liability - ending	$ 651,222	$ 766,801
Plan fiduciary net position		
Contibutions - employer	$ 32,397	$ 31,905
Contibutions - employee	15,545	16,827
Net investment income	12,336	17,041
Benefit payments, including refunds of member contributions	(29,724)	(31,007)
Administrative expense	(170)	(242)
VEBA transfer	(13,497)	-
Net change in plan fiduciary net position	16,887	34,524
Plan fiduciary net position - beginning	260,370	225,846
Plan fiduciary net position - ending	$ 277,257	$ 260,370
Net OPEB liability - ending	$ 373,965	$ 506,431
Plan fiduciary net position as a percentage of the total OPEB liability	42.57%	33.96%
Covered payroll	$ 290,504	$ 271,153
Net OPEB liability as a percentage of covered payroll	128.73%	186.77%

Changes in assumptions. The discount rate was changed from 7.00% (net of administrative expense) to 6.875% for the measurement period ended June 30, 2017. Plan enrollment assumption were updated based on recent experience and the expected impact of added and dropped plans. The per person cost trends were moved forward one year.

Historical information is required only for measurement periods for which GASB 75 is applicable. Future years' information will be displayed up to 10 years as information become available.

Schedule of Employer Contributions – Postemployment Healthcare Plans

PFDRP Schedule of Employer Contributions
(Dollar Amounts in Thousands)
Last Ten Fiscal Years*

Fiscal Year Ended June 30	2018	2017
Actuarially Determined Contribution (ADC)	$ 25,382	$ 20,667
Contribution in relation to the ADC	(25,382)	(20,667)
Contribution deficiency (excess)	$ -	$ -
Covered payroll	$ 203,164	$ 188,177
Contribution as a percentage of covered payroll	12%	11%

**Actuarial methods and assumption used to set the actuarially determined contributions for Fiscal Year 2018 were from the June 30, 2016 actuarial valuation.*

Actuarial Cost Method	Entry Age normal, level of percent of pay
Amortization Method/Period	30 years, level percent of pay
Asset Valuation Method	5 year smoothed market with a 80% to 120% market value corridor
	Merit component added based on an individual's year of service ranging from 6.75% to 1.00%
Payroll Growth	3.25%
Investment Rate of Return	6.875% per annum
Health cost-trend rates	Future medical inflation assumed to be at a rate of 8.5% to 4.25% per annum graded down over a 14 year period for medical-pre age 65 and 6.5% to 4.25% per annum graded down over 14 year period for medical-post age 65. Dental inflation is assumed to be 4.00%
Retirement Age	1. Employees who retire with at least 15 years of service with the City, or with a monthly pension equal to at least 37.5% of final compensation.
	2. Tier 1 employees (hired before August 4, 2013) are eligible for unreduced service retirement at age 55 with 20 years of service, age 50 with 25 years of service, age 70 with no service requirement, or any age with 30 years of services. Reduced service retirement is available at age 50 with 20 years of service.
	3. Tier 2 employees (hired on or after August 4, 2013) are eligible for unreduced service retirement at age 60 with 10 years of service or reduced service retirement at age 50 with 10 years of service.
	4. Service credited through reciprocity agreements counts towards an employee's required service to retire, but only service with the City counts towards the required years of service to receive OPEB benefits.
	5. Employees who become disabled with at least 15 years of service or have a monthly pension equal to at least 37.5% of final compensation are eligible to elect medical coverage upon retirement.
	6. Spouses or domestic partners of retired members are allowed to participate if they were enrolled in the City's medical plan at the time of the member's retirement. Dependent children are eligible to receive coverage until the age of 26.
	7. Employees who separate from service after July 5, 1992 with 20 years of service, leaving contributions in the retirement plan, are eligible to elect medical and/or dental coverage upon retirement.
Mortality	Mortality rates for actives, retirees, beneficiaries, terminated vested, and reciprocals are based on the sex-distinct employee and annuitant mortality tables. For male and female, it is based on 0.948 and 1.048 respectively times the CALPERS 2009 Healthy Annuitant Mortality Table under the category of Healthy Annuitant and Healthy Non-Annuitant. For Male and Female under Disabled Annuitant, it is 0.903 times the CALPERS 2009 Industrial Disability Mortality Table. Future mortality improvements are reflected by applying SOA MP-2015 projection scale on a generational basis from the base year of 2009.

FCERS Schedule of Employer Contributions
(Dollar Amounts in Thousands)
Last Ten Fiscal Years*

Fiscal Year Ended June 30	2018	2017
Actuarially Determined Contribution (ADC)	$ 32,397	$ 31,905
Contribution in relation to the ADC	(32,397)	(31,905)
Contribution deficiency (excess)	$ -	$ -
Covered payroll	$ 290,504	$ 271,153
Contribution as a percentage of covered payroll	11%	12%

**Actuarial methods and assumption used to set the actuarially determined contributions for Fiscal Year 2018 were from the June 30, 2016 actuarial valuation.*

Methods and assumptions used to determine contributions:

Actuarial Cost Method	Entry Age normal cost method, level percent of pay
Amortization Method/Period	Level dollar
Asset Valuation Method	Market value
Merit increase	The assumption of 2.85% wage inflation plus a rate increase for merit/longevity increase based on years of service ranging from 4.50% at hire to 0.25% for members with 14 or more years of service.
Payroll Growth	2.85%
Investment Rate of Return	6.875% per annum
Health cost-trend rates	The valuation assumes that future medical inflation will be at a rate of 8.5% to 4.25% per annum graded down over a 15 year period for medical-pre age 65 and 6.5% to 4.25% per annum graded down over a 14 year period for medical-post age 65. Dental inflation is assumed to be 4.00%
Retirement Age	1. Employees who retire with at least 15 years of service with the City, or with a monthly pension equal to at least 37.5% of final compensation, are eligible to elect medical coverage upon retirement. 2. Tier 1 employees (hired before September 30, 2012) are eligible for retirement at age 55 with five years of service or at any age with 30 years of service. 3. Tier 2 employees (hired on or after September 30, 2012) are eligible for unreduced service retirement at age 65 with five years of service or reduced service retirement at age 55 with five years of service. 4. Service credited through reciprocity agreements counts towards an employee's required service to retire, but only service with the City counts towards the required years of service to receive OPEB benefits. 5. Employees who retires with less than 15 years of service can elect coverage, but receive no explicit subsidy. 6. Spouses or domestic partners of retired members are allowed to participate if they were enrolled in the City's medical plan at the time of the member's retirement. Dependent children are eligible to receive coverage until the age of 26. 7. Employees who become disabled with at least 15 years of service or have a monthly pension equal to at least 37.5% of final compensation are eligible to elect medical coverage upon retirement.
Mortality	Mortality rates for actives, retirees, beneficiaries, terminated vested, and reciprocals are based on the sex-distinct employee and annuitant CalPERS tables. For male and female, it is 0.952 and 0.921 respectively times the CalPERS 2009 Healthy Annunitant, 0.919 and 0.918 respectively times the CalPERS 2009 Employee Mortality Table for Healthy Non-Annuitant, and 1.051 and 1.002 respectively times the CalPERS 2009 Ordinary Disability Mortality Table for Disabled Annuitant. The CalPERS tables are from their 2014 experience study with a central experience year of 2009 and prior to the 20 year projection of those rates using Scale BB. Future mortality improvements are reflected by applying SOA MP-2015 projection scale on a generational basis from the base year of 2009.

Schedule of Investment Returns – Postemployment Healthcare Plans

	PFDRP	
	2018	2017
Annual money-weighted rate of return, net of investment expense	3.56%	7.17%

	FCERS	
	2018	2017
Annual money-weighted rate of return, net of investment expense	4.55%	7.20%

The rate shown above is based on the 115 subtrusts only and does not include the 401(h). Schedules are intended to show information for 10 years. Additional years will be displayed as they become available.

I. Budgetary Information

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

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

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

II. Budgetary Results Reconciled to GAAP

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

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

- Year-end encumbrances are recognized as the equivalent of expenditures in the budgetary basis financial schedules, while encumbered amounts are not recognized as expenditures on GAAP basis until the equipment, supplies or services are received.

- Certain loan transactions are recognized as expenditures for the budgetary basis but not for the GAAP basis. When these loans are made, they are recorded as receivables on a GAAP basis and as expenditures on a budgetary basis. When loan repayments are received, they are recorded as reductions to receivables on a GAAP basis, but are recognized as revenues on a budgetary basis.

- Net decreases were made to certain GAAP basis loans receivable to reflect carrying amounts at a discounted present value and allowances for bad debts. The discount is treated as an expenditure on a GAAP basis and is not included in the budgetary basis financial statements. In addition, the allowance for bad debts is not included in the budgetary basis financial schedules, but is an expenditure on a GAAP basis.

- Certain advances to the SARA are recognized as expenditures for the budgetary basis but not for the GAAP basis. When these advances are made, they are recorded as receivables on a GAAP basis and as expenditures on a budgetary basis. When repayments are received, they are recorded as reductions to advances to the SARA on a GAAP basis, but are recognized as revenues on a budgetary basis.

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

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

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

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

III. Budget Revisions

On October 16 2018, the City Council approved certain fiscal year 2018 budget revisions that increased appropriations for various expenditure categories. The budget amounts presented in the accompanying schedules of revenues, expenditures and changes in fund balances - budget and actual reflect such budget revisions.

Certified Public Accountants

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

City Council
City of San José, California

We have audited, in accordance with 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, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San José, California (City) as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated November 16, 2018, except for our reports on the schedule of passenger facility charge revenues and expenditures which was issued on January 30, 2019, the schedule of customer facility charge revenues and expenditures which was issued on February 20, 2019, and the schedule of expenditures of federal awards as to which the date is March 28, 2019.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as item numbers 2018-001, 2018-002, 2018-003, 2018-004, and 2018-005 to be significant deficiencies.

Compliance and Other Matters

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

City's Response to Findings

The City's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. The City's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Macias Gini & O'Connell LLP

Walnut Creek, California
November 16, 2018

MGO Certified Public Accountants

Independent Auditor's Report on Compliance for Each Major Federal Program and Report on Internal Control Over Compliance Required by the Uniform Guidance

City Council
City of San José, California

Report on Compliance For Each Major Federal Program

We have audited the City of San José's, California (City), compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the City's major federal programs for the year ended June 30, 2018. The City's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the City's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the City's compliance.

Opinion on Each Major Federal Program

In our opinion, the City complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2018.

Macias Gini & O'Connell LLP
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Walnut Creek, CA 94596

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Report on Internal Control Over Compliance

Management of the City is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the City's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

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

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

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

Macias Gini & O'Connell LLP

Walnut Creek, California
March 28, 2019

City of San José, California
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2018

Federal Grantor/Pass-Through Grantor/Federal Program Name	Federal Catalog Number	Grant Identifying Number	Federal Expenditures	Amount Provided to Subrecipients
U.S. Department of Agriculture				
Pass-through California Department of Education Nutrition Services Division:				
Summer Food Service Program for Children	10.559	05394-SFSP-43	$ 43,623	$ -
Total U.S. Department of Agriculture			43,623	-
U.S. Department of Housing and Urban Development				
Direct programs:				
CDBG - Entitlement Grants Cluster:				
Community Development Block Grants/Entitlement Grants	14.218	B14 MC-06-0021	116,932	116,932
Community Development Block Grants/Entitlement Grants	14.218	B15 MC-06-0021	698,392	623,910
Community Development Block Grants/Entitlement Grants	14.218	B16 MC-06-0021	2,521,974	44,600
Community Development Block Grants/Entitlement Grants	14.218	B17 MC-06-0021	6,696,118	3,707,239
Subtotal CDBG - Entitlement Grants Cluster			10,033,416	4,492,681
Emergency Solutions Grant Program	14.231	E16-MC-06-0021	100,376	100,376
Emergency Solutions Grant Program	14.231	E17-MC-06-0021	603,357	568,496
Subtotal Emergency Solutions Grant Program			703,733	668,872
Home Investment Partnerships Program	14.239	M15 MC060215	1,002,189	926,671
Home Investment Partnerships Program	14.239	M16 MC060215	291,107	205,798
Home Investment Partnerships Program	14.239	M17 MC060215	805,821	777,947
Subtotal Home Investment Partnerships Program			2,099,117	1,910,416
Housing Opportunities for Persons with AIDS	14.241	CAH16-F004	120,249	109,525
Housing Opportunities for Persons with AIDS	14.241	CAH17-F004	883,262	875,156
Housing Opportunities for Persons with AIDS	14.241	CAH16-0004	357,736	356,065
Housing Opportunities for Persons with AIDS	14.241	CAH15-0001	17,875	14,989
Subtotal Housing Opportunities for Persons with AIDS			1,379,122	1,355,735
Total U.S. Department of Housing and Urban Development			14,215,388	8,427,704
U.S. Department of Justice				
Direct programs:				
Community-Based Violence Prevention Program	16.123	2015-PB-FX-K009	59,920	10,385
Missing Children's Assistance	16.543	2017-MC-FX-K020	179,630	-
Missing Children's Assistance	16.543	2016-MC-FX-K048	52,782	-
Missing Children's Assistance	16.543	2014-MC-FX-K039	144,997	-
Subtotal Missing Children's Assistance			377,409	-
Grants to Encourage Arrest Policies and Enforcement of Protection Orders Program	16.590	2013-WE-AX-0033	173,197	74,756
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2014-DJ-BX-0066	128	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2015-DJ-BX-0211	106,559	-
Subtotal Edward Byrne Memorial Justice Assistance Grant Program			106,687	-
Total U.S. Department of Justice			717,213	85,141

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

City of San José, California
Schedule of Expenditures of Federal Awards (Continued)
Year Ended June 30, 2018

Federal Grantor/Pass-Through Grantor/Federal Program Name	Federal Catalog Number	Grant Identifying Number	Federal Expenditures	Amount Provided to Subrecipients
U.S. Department of Labor				
Pass-through State of California, Employment Development Department:				
Workforce Innovation and Opportunity Act (WIOA) Cluster:				
WIOA Adult Program	17.258	K8106684201	$ 268,600	$ -
WIOA Adult Program	17.258	K8106684202	1,243,094	-
WIOA Adult Program	17.258	K8106684500	31,284	-
WIOA Adult Program	17.258	K7102072202	966,827	803,320
WIOA Adult Program	17.258	K71020721087	86,027	-
WIOA Adult Program	17.258	K71020721090	3,436	-
Subtotal - WIOA Adult Program			2,599,268	803,320
WIOA Youth Activities	17.259	K8106684301	1,254,732	150,793
WIOA Youth Activities	17.259	K7102072301	1,226,297	1,149,349
Subtotal - WIOA Youth Activities			2,481,029	1,300,142
WIOA Dislocated Worker Formula Grants	17.278	K8106684540	99,434	-
WIOA Dislocated Worker Formula Grants	17.278	K8106684541	407,664	-
WIOA Dislocated Worker Formula Grants	17.278	K8106684292	28,045	-
WIOA Dislocated Worker Formula Grants	17.278	K8106684293	47,210	-
WIOA Dislocated Worker Formula Grants	17.278	K7102072293	129,642	-
WIOA Dislocated Worker Formula Grants	17.278	K7102072541	151,453	116,727
WIOA Dislocated Worker Formula Grants	17.278	K8106684501	326,687	-
WIOA Dislocated Worker Formula Grants	17.278	K8106684502	151,517	-
WIOA Dislocated Worker Formula Grants	17.278	K7102072502	1,453,282	522,109
WIOA Dislocated Worker Formula Grants	17.278	K6983941055	19,933	-
WIOA Dislocated Worker Formula Grants	17.278	K6983941056	40,514	-
WIOA Dislocated Worker Formula Grants	17.278	K6983941069	12,928	-
Subtotal WIOA Dislocated Worker Formula Grants			2,868,309	638,836
Subtotal WIOA Cluster			7,948,606	2,742,298
WIOA National Dislocated Worker Grants / WIA National Emergency Grants	17.277	K6983941028	167,277	109,022
WIOA National Dislocated Worker Grants / WIA National Emergency Grants	17.277	K8106681091	170,944	78,117
WIOA National Dislocated Worker Grants / WIA National Emergency Grants	17.277	K71020721091	440,780	359,314
Subtotal - WIOA National Dislocated Worker Grants / WIA National Emergency Grants			779,001	546,453
Total U.S. Department of Labor			8,727,607	3,288,751

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

City of San José, California
Schedule of Expenditures of Federal Awards (Continued)
Year Ended June 30, 2018

Federal Grantor/Pass-Through Grantor/Federal Program Name	Federal Catalog Number	Grant Identifying Number	Federal Expenditures	Amount Provided to Subrecipients
U.S. Department of Transportation				
Direct programs:				
Airport Improvement Program	20.106	3-06-0226-086-2015	$ 322,956	$ -
Airport Improvement Program (Note 4)	20.106	3-06-0226-087-2015	(18,221)	-
Airport Improvement Program	20.106	3-06-0226-089-2016	1,538,259	-
Airport Improvement Program	20.106	3-06-0226-090-2016	1,995,853	-
Airport Improvement Program	20.106	3-06-0226-091-2017	644,032	-
Airport Improvement Program	20.106	3-06-0226-094-2017	308,631	-
Airport Improvement Program	20.106	3-06-0226-095-2017	4,146,170	-
Airport Improvement Program	20.106	3-06-0226-096-2018	114,393	-
Subtotal Airport Improvement Program			9,052,073	-
Highway Planning and Construction Cluster:				
Pass-through California Department of Transportation:				
Highway Planning and Construction:				
TiMC (HPP 2017) $5.4M	20.205	HPLUL-5005 (085)	240,518	-
E. Santa Clara Street Bridge at Coyote Creek	20.205	BRLS-5005 (089)	3,365	-
Autumn Street Extension	20.205	TCSPL-5005(122)	6,080	-
OCALA Improvements	20.205	HSIPL-5005(135)	1,013,750	-
North First Street Bicycle Lane Improvements	20.205	HSIPL-5005(123)	52,762	-
Park Avenue Bicycle Lane Improvements	20.205	HSIPL-5005(121)	48,740	-
McLaughlin Ave/Ped Bike Safety Enhancements	20.205	HSIP7-04-022	113,939	-
Senter Road Ped Safety Improvement	20.205	HSIP-5005(149)	39,901	-
North 1st Street Urban Village Area	20.205	5005(147)	3,447	-
Around Berryessa Bart Station	20.205	5005(148)	15,101	-
White Road Ped Safety Improvements	20.205	HSIPL-5005(150)	1,066	-
Subtotal Highway Planning and Construction			1,538,669	-
Recreational Trails Program:				
CMAQ Los Gatos Creek Reach	20.219	SCL110029	239,498	-
Subtotal Recreational Trails Program			239,498	-
Subtotal pass-through California Department of Transportation			1,778,167	-

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

City of San José, California
Schedule of Expenditures of Federal Awards (Continued)
Year Ended June 30, 2018

Federal Grantor/Pass-Through Grantor/Federal Program Name	Federal Catalog Number	Grant Identifying Number	Federal Expenditures	Amount Provided to Subrecipients
U.S. Department of Transportation (Continued)				
Pass-through Metropolitan Transportation Commission:				
Highway Planning and Construction:				
Park Avenue Multimodal Improvements	20.205	RPSTPLE-5005(130)	$ 582,842	$ -
St. John Street Multimodal Improvements Phase I	20.205	RPSTPLE-5005(132)	733,181	-
Smart Intersections Program	20.205	CML-5005(139)	587,610	-
Alameda "A Beautiful Way" Phase 2	20.205	CML-5005(129)	4,358,341	-
Almaden Vine Couplet	20.205	CML-5005(142)	127,639	-
Jackson Ave Complete Streets	20.205	CML-5005(125)	210,697	-
Pedestrian Oriented Signals	20.205	CML-5005(127)	462,035	-
Safe Routes to School Program	20.205	CML-5005(133)	12,945	-
St. John Bike/Ped Phase 2	20.205	CML-5005(131)	819,053	-
Walk n' Roll San Jose! Phase 2 (Non-infrastructure)	20.205	CML-5005(128)	328,110	-
Walk n' Roll San Jose! (Infrastructure) - Safe Access San Jose	20.205	CML-5005(108) CML-5005(126)	1,267	-
SJ Transportation Demand Management	20.205	CMLNI-5005(141)	206,374	-
Tully Road Corridor Safety Improvements	20.205	SCL-170029	16,091	-
Urban Village Planning for Stevens Creek & Santana Row, Valley Fair and Winchester Urban Villages	20.205	660076	197,662	-
McKee Road Corridor Safety Improvements	20.205	STPL5005(154)	9,478	-
Subtotal pass-through Metropolitan Transportation Commission			8,653,325	-
Subtotal Highway Planning and Construction Cluster			10,431,492	-
Pass-through California Office of Traffic Safety:				
State and Community Highway Safety	20.600	PT17112	88,194	-
State and Community Highway Safety	20.600	PT18075	79,478	-
Subtotal State and Community Highway Safety			167,672	-
Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608	PT17112	59,580	-
Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608	PT18075	59,957	-
Subtotal Minimum Penalties for Repeat Offenders for Driving While Intoxicated			119,537	-
National Highway Traffic Safety Administration (NHTSA) Discretionary Safety Grants and Cooperative Agreements	20.614	PS18027	110,192	-
Subtotal pass-through California Office of Traffic Safety			397,401	-
Total U.S Department of Transportation			19,880,966	-

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

City of San José, California
Schedule of Expenditures of Federal Awards (Concluded)
Year Ended June 30, 2018

Federal Grantor/Pass-Through Grantor/Federal Program Name	Federal Catalog Number	Grant Identifying Number	Federal Expenditures	Amount Provided to Subrecipients
National Endowment for the Humanities				
Pass-through California State Library:				
Grants to States	45.310	PG-252751-17	$ 8,159	$ -
Total National Endowment for the Humanities			8,159	-
U.S. Department of Health and Human Services				
Pass-through Santa Clara County Social Services:				
Aging Cluster:				
Special Programs for the Aging, Title III, Part C, Nutrition Services	93.045	4300010957	119,078	-
Nutrition Services Incentive Program	93.053	4300010957	41,657	-
Subtotal Aging Cluster			160,735	-
Total U.S. Department of Health and Human Services			160,735	-
U.S. Department of Homeland Security				
Direct programs:				
Staffing for Adequate Fire and Emergency Response (SAFER)	97.083	EMW-2004-FH-00769	1,217,365	-
Pass-through California Governor's Office of Emergency Services:				
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036	FEMA-4301-DR	137,871	-
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036	FEMA-4308-DR	1,088,932	-
Subtotal pass-through California Governor's Office of Emergency Services			1,226,803	-
Pass-through Santa Clara County:				
Emergency Management Performance Grants	97.042	2017-0007	4,200	-
Pass-through the Bay Area UASI:				
Homeland Security Grant Program	97.067	2016-0102	558,206	-
Homeland Security Grant Program	97.067	2017-0083	141,786	-
Homeland Security Grant Program	97.067	2016 NCRIC	88,583	-
Homeland Security Grant Program	97.067	2017 NCRIC	103,436	-
Homeland Security Grant Program	97.067	UASI Grant 2016	837,829	-
Homeland Security Grant Program	97.067	UASI Grant 2017	658,919	-
Subtotal pass-through the Bay Area UASI			2,388,759	-
Total U.S. Department of Homeland Security			4,837,127	-
Total Expenditures of Federal Awards			$ 48,590,818	$ 11,801,596

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

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(1) GENERAL

The accompanying Schedule of Expenditures of Federal Awards (SEFA) presents the activity of the federal award programs of the City of San José, California (the City). The City's reporting entity is defined in Note I to its basic financial statements. The SEFA includes all federal awards received directly from federal agencies and federal awards passed-through other governmental agencies.

(2) BASIS OF PRESENTATION

The accompanying schedule is presented using the modified accrual basis of accounting for program expenditures accounted for in the governmental funds and the accrual basis of accounting for program expenditures accounted for in the proprietary funds as described in Note I to the City's basic financial statements. The City did not elect to use the 10% de minimis cost rate as covered in U.S. Code of Federal Regulations, Title 2 section 200.414 Indirect (F&A) costs.

For reimbursable grants, the City recognizes revenues commencing on the date of grant approval (provided all eligibility requirements are met) since this is when the City is eligible to claim expenditures for reimbursements. Pass-through entity identifying numbers are presented where available.

(3) RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS

Expenditures of federal awards are reported in the City's basic financial statements as expenditures in the general, special revenue and capital projects funds and as expenses for non-capital expenditures and as additions to capital assets for capital related expenditures in the enterprise funds. Federal award expenditures agree or can be reconciled with the amounts reported in the City's basic financial statements.

(4) NORMAN Y. MINETA SAN JOSE INTERNATIONAL AIRPORT (AIRPORT) EXPENDITURES

The Federal Aviation Administration (FAA) reimburses the Airport for approximately 80% of allowable Airport Improvement Program (AIP) grant expenditures. Total allowable AIP expenditures are presented in the accompanying SEFA.

During the year ended June 30, 2018, the Airport discovered an expenditure overage related to the Perimeter Fence Line Upgrade project under AIP Grant number 3-06-0226-087-2015. The excess expenditures in the amount of $18,221 were subsequently transferred out; however, they were reported in the SEFA for the year ended June 30, 2017, and are reported as a negative amount in the SEFA for the year ended June 30, 2018.

(5) DISASTER GRANTS – PUBLIC ASSISTANCE (PRESIDENTIAL DECLARED DISASTERS)

The U.S. Department of Homeland Security reimburses the City for 75% of allowable costs funded by Disaster Grants – Public Assistance (Presidential Declared Disasters) (Programs), CFDA No. 97.036. During the fiscal year 2018, the Programs reported $1,226,803 in aggregate, of which $529,661 were incurred in fiscal year 2017. This is allowable and consistent with Public Assistance Funding. Federal Emergency Management Agency and California Governor's Office of Emergency Services issue Obligation Letters which were received at multiple times during 2018. It provides cost recognition and reimbursements for all response and recovery projects arising out of the 2017 Flood/Storm events in January and February of the same year.

(6) INTERNET CRIMES AGAINST CHILDREN (ICAC) GRANT

The following schedule represents expenditures and revenues for the Internet Crimes Against Children Task Force Program from the U.S. Department of Justice and the California Governor's Office of Emergency Services (Cal OES) for the year ended June 30, 2018.

Program Title and Expenditure Category	Grant Number Grant Period	Cumulative Expense through June 30, 2017	Actual 7/1/17-6/30/18 Non-match	Actual 7/1/17-6/30/18 Match	Cumulative Expense through June 30, 2018	Cumulative Program Revenue
Internet Crimes Against Children						
Task Force Program (Federal)	2014-MC-FX-K039					
Personnel Services	7/01/2014-12/31/2017	$ 542,863	$ 48,235	$ -	$ 591,098	$ 591,098
Operating Expenses		505,491	96,762	-	602,253	602,252
Equipment		22,837	-	-	22,837	22,837
Total		$ 1,071,191	$ 144,997	$ -	$ 1,216,188	$ 1,216,187
Internet Crimes Against Children						
Task Force Program (Federal)	2017-MC-FX-K020					
Personnel Services	7/01/17 - 09/30/19	$ -	$ 63,603	$ -	$ 63,603	$ 63,603
Operating Expenses		-	116,027	-	116,027	116,027
Equipment		-	-	-	-	-
Total		$ -	$ 179,630	$ -	$ 179,630	$ 179,630
Internet Crimes Against Children						
Task Force Program (State)	IC-1708-7928					
Personnel Services	7/01/17 - 06/30/18	$ -	$ -	$ -	$ -	$ -
Operating Expenses		-	199,901	-	199,901	199,901
Equipment		-	-	-	-	-
Total		$ -	$ 199,901	$ -	$ 199,901	$ 199,901

City of San José, California
Schedule of Findings and Questioned Costs
Year Ended June 30, 2018

Section I Summary of Auditor's Results

Financial Statements

Type of report issued on whether the financial statements were prepared in accordance with GAAP:	Unmodified
Internal control over financial reporting:	
♦ Material weakness(es) identified?	No
♦ Significant deficiency(ies) identified?	Yes
Noncompliance material to the financial statements noted?	No

Federal Awards

Internal control over major federal programs:	
♦ Material weakness(es) identified?	No
♦ Significant deficiency(ies) identified?	None reported
Type of auditor's report issued on compliance for major federal programs:	Unmodified
Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?	No

Identification of major federal programs:

Federal Domestic Catalog Number(s)	Name of Federal Program or Cluster
	CDBG – Entitlement Grants Cluster:
14.218	Community Development Block Grants/Entitlement Grants
14.239	Home Investment Partnerships Program
	Highway Planning and Construction Cluster:
20.205	Highway Planning and Construction
20.219	Recreational Trails Program
97.067	Homeland Security Grant Program

Dollar threshold used to distinguish between type A and type B programs:	$1,457,725
Auditee qualified as a low-risk auditee?	No

Section II Financial Statement Findings

Finding 2018-001 – Significant Deficiency
Risk Assessment of Internal Controls Over the Financial Reporting Process

Internal control is an integral process that is effected by the City's governing body, management and personnel and is designed to address risks and to provide reasonable assurance that in pursuit of the organization's goals, the following general objectives are being achieved:

- Executing orderly, ethical, economical, efficient and effective operations;
- Fulfilling accountability obligations;
- Complying with applicable laws, regulations, contracts and grant agreements; and
- Safeguarding resources against loss, misuse and damage.

Internal control is a dynamic integral process that should be continuously adapting to the changes the City is facing. Between 2006 and 2015, the City reduced its budgeted positions by 25 percent. This reduction and displacement of staff through the Civil Service Rules resulted in a significant disruption in the City's ability to maintain appropriate financial internal controls. Between 2015 and 2017, the City started to address its staffing challenges by filling vacant positions and adding three new personnel in the Finance Department. While the City has been successful in recruiting professionals to fill vacant positions over the past two years, it has been challenged with retaining these professionals. As such, the City has been continuously training and integrating new personnel into the City's complex accounting and financial reporting process. This rebuilding of staff has increased the workload of the remaining seasoned professionals.

In addition, late numerous and significant adjusting entries made by the City after the "close" of its financial records and preparation of final financial statements to be audited resulted in increased staff effort in re-performing reconciliations substantiating accounts and balances. Included in these adjusting entries:

- Insufficient review of closing entries resulting in numerous adjusting entries to correct errors after the "close" of its financial records.
- Insufficient review of complex government-wide reconciling journal entries resulting in post-closing adjusting entries. This includes decreasing capital assets for properties sold.
- Insufficient review of the complex SARA debt refunding impact to the City's financial statements. This resulted in not properly recognizing the pay off in the City's receivable from SARA, which had been incorrectly adjusted in the financing authority's records.
- Insufficient review of SARA's Redevelopment Property Tax Trust Fund revenues, resulting in an after the "close" adjusting entry of $18 million to report additional revenue and pass-through payments.
- Insufficient review of SARA's Land Held for Resale disposal of properties sold. This resulted in reporting property disposals and an adjustment to gain on properties sold, in the amount of $2.9 million.

The City has started to make investments in improving its financial reporting process over the past years; however, progress has been hampered by turnover of its recent hires. We recommend that the City evaluate the reasons for the increase in turnover and develop a plan to retain its personnel. In addition, the City should continue to incorporate the skills and experience of its new personnel assigned to key roles in the preparation of the annual financial statements to improve the efficiency of its financial reporting process, including cross-training to minimize the impacts of further turnover.

Management Response
Management agrees with MGO's comment and acknowledges that staffing turnover resulting from resignations, retirements, and extended leave in the Specialized Accounting and Financial Reporting Sections of the Finance Department, Accounting Division negatively impacted timely and accurate reconciliation of general ledger accounts and completion of audit documents. Newly hired accounting staff assigned to complete these tasks had little or no institutional knowledge in the City's accounting processes and was further hampered by the lack of detailed desk procedures in some of the program areas. The review of staff work was challenging given the training level of supervisory staff who were also new to their roles and were experiencing an overwhelming workload created by key vacancies. Most impactful were the resignations of the Division's Deputy Director in June 2018 and Principal Accountant overseeing Specialized Accounting in August 2018. These departures created a loss of effective senior leadership and significant institutional knowledge needed for a successful fiscal close.

As the Governance Report mentioned, the City substantially reduced its staffing levels from 2006 to 2015 in order to address its budget shortfall, which also impacted staffing levels in the Financial Reporting/Special Accounting sections. In 2008, the total staffing in these two sections was 20 positions and in 2018 the staffing level is 17, a reduction of 15%. These Accounting sections are responsible for recording citywide accounting and budget transactions, maintaining the general ledger database, coordinating the City's annual external audit process, and preparing and producing the Comprehensive Annual Financial Report (CAFR), in addition to approximately 20 stand-alone financial reports. Additional work includes producing the City's annual cost allocation plans. Further complicating the governmental financial reporting this year was the introduction of a new accounting pronouncement from the Governmental Accounting Standards Board (GASB), specifically GASB 75, and an increase in the volume and complexity of accounting and reporting for federally-funded programs associated with the 2017 flood damage in the City.

Staff believes that the staffing challenges coupled with increased workload has led to the high staff turnover with several departures to other City departments and to outside public agencies with better compensation packages when compared to the City. The table below shows average years of tenure of the Accounting Division's professional accounting classifications in the Financial Reporting/Special Accounting sections. The statistics indicate that an average tenure of professional accounting staff is less than two years, which negatively impacts staff's technical growth and the quality of work product as mentioned in the Governance Report.

	Years in Classification	Years with City
Accountant I/II	2.34	5.15
Senior Accountant	1.57	1.88
Supervising Accountant	1.00	2.32
Principal Accountant	0.94	0.94

Despite these challenges, the Finance Department is undertaking various steps to address the issues raised in the Governance Report.

1. The Department has recently filled the Deputy Director of Finance, Accounting, positon, which has been vacant since June 2018. In addition, the Accounting Division has completed the recruitment for two vacant Accountant positions in the Specialized Accounting section and the Department is prioritizing the recruitment of the Principal Accountant vacancy for the Specialized Accounting section.

2. The Department anticipates during FY 2018-19, the Division will be able to institute and implement changes to address internal control issues including the following:

   - Ensure proper training and cross training of professional accounting staff in core job assignments, including developing and maintaining detailed desk procedures;
   - Reconcile and review of accounting transactions, including review and approval by Supervising and Principal Accountants in a timely manner;
   - Plan and execute citywide fiscal year-end close activities and recording of accounting transactions in a timely manner;
   - Prepare and review audit documents and draft financial reports for the external auditor's review; and
   - Prepare a citywide audit completion schedule in consultation with the external auditors and conduct weekly or bi-weekly status meetings to ensure that tasks are completed by the targeted dates.

3. As the City has decentralized accounting operations, proper coordination among department accounting staff and the Accounting Division staff is critical for the successful execution of the audit process and completion of the CAFR and other reports. The Accounting Division will coordinate and prepare a detailed work plan that will list fiscal year-end milestones to be completed by department accounting staff and delivered to the Accounting Division within the time lines prescribed in the work plan. The Finance Department will ensure that department senior management is aware of fiscal year-end close responsibilities and the related deliverables.

4. As budget resources permit, the Finance Department will participate in the training opportunities in the governmental accounting and financial reporting areas to professional accounting staff offered by the Government Finance Officers Association (GFOA), California Society of Municipal Finance Officers (CSMFO) and Association of Government Accountants (AGA). Finance Accounting staff will be encouraged to attend local CSMFO chapter meetings to maintain professional relationship with their counterparts and to facilitate exchange of professional knowledge.

5. As the Governance Report mentioned and as shown in the table above, the Finance Department continues to face recruitment and retention challenges for professional accounting staff. To address this issue, the Finance Department is working with the Human Resources Department, Office of Employee Relations, and Budget Office to explore creating Finance-specific accounting classifications for its management classifications (Senior Accountant, Supervising Accountant, and Principal Accountant). The new classifications would be intended to recognize the specialized skill sets needed to perform citywide complex accounting and financial reporting functions performed by these classifications in the Finance Department. If implemented, the Department believes these changes may help with attraction and retention issues but addressing workload and responsibilities of positions within the Finance Department will be an ongoing challenge.

   Targeted Completion Date: June 30, 2019.

Finding 2018-002 – Significant Deficiency
Completeness of the Schedule of Expenditures of Federal Award

Criteria
Title 2 - Grants and Agreements, Subtitle A - Office of Management and Budget Guidance for Grants and Agreements, Chapter II - Office of Management and Budget Guidance, Part 200 - Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards - Subpart F - Audit Requirements Sec. 200.510 Financial Statements requires that the City prepare a schedule showing total expenditures for the year for each federal program.

Condition
During our audit, we noted the City's draft schedule of expenditures of federal awards (SEFA) included the Highway Planning and Construction Cluster expenditures that were overstated by $9,439,739 due to management oversight. Management included expenditures other than the federal portion in its grant inventory listing. The Highway Planning and Construction Cluster is managed by the City's Departments of Transportation, Planning, Building and Code Enforcement, and Parks, Recreation and Neighborhood Services.

These errors resulted in additional major programs for the fiscal year 2018 as the type A and type B threshold decreased. The City subsequently corrected the expenditures reported in its fiscal year 2018 SEFA.

Cause
The Departments of Transportation, Planning, Building and Code Enforcement, and Parks, Recreation and Neighborhood Services did not carefully review and submit all federal expenditures in the SEFA submitted to the City's Finance Department.

Effect or Potential Effect
The City's SEFA serves as the basis in determining the number of major programs required to be audited in a given fiscal year, and inaccuracies have the potential of affecting the programs selected for testing as major programs.

Recommendation
The City should continue to improve its process for reviewing expenditures reported in the SEFA by requiring department management to review and submit a detail listing of expenditures prior to being submitted to the Finance Department. In addition, the Finance Department should reconcile the detailed listing of expenditures to the SEFA for each significant federal program prior to the City submitting such detailed listing to its external auditors.

Management Response
The Department of Transportation management agreed with the overstatement of the Highway Planning and Construction Cluster expenditures reported on the initial grant inventory listing due to a human error. This deficiency is not related to a program deficiency nor does it constitute a violation of the federally-funded grant covenants. This finding is specifically related to internal control over financial reporting, and not related to federal awards compliance funding. To ensure the accuracy of reporting the expenditures of Federal Awards, the City will update the federal grant guidance document and implement the following steps to address this issue:

1. Departments will perform analytical review procedures (i.e. current year vs. prior year expenditure changes) of their grant inventory listings on a quarterly and annual basis for accuracy.

2. Departments will reconcile the federal expenditures reported on the grant inventory listing to amounts recorded in the City's Financial Management System (FMS). The Accounting Division staff will perform a detail review of reconciliation for each significant federal programs prior to their submission to the Auditors.

3. The Accounting Division will also provide training to its professional accounting staff in reviewing the grant inventory listing for reasonableness and perform analytical and due diligence procedures.

   Target Completion Date: June 30, 2019.

Finding 2018-003 – Significant Deficiency (Repeat of Prior Year Finding 2017-003)
Informational Technology: City-Wide Information Security Program

Criteria
Internal controls over financial reporting are reliant on information technology ("IT") controls which are designed effectively. In that regard, an effectively designed IT environment is one where an organization:

a) develops, documents, and disseminates to appropriate personnel, policies that addresses purpose, scope, roles, responsibilities, management commitment, coordination among organizational entities, and compliance; and procedures to facilitate the implementation of the policy and associated controls; and,

b) periodically reviews and updates the current policy and procedures.

Condition
Systems impacted: The specific information systems impacted by the below findings were provided separately to management. In addition, the previous audit team met with individual system owners and points of contact to discuss the nuances of these findings which varied slightly based on information system use, architecture, and other factors.

An entity-wide information security management program is the foundation of a security control structure and a reflection of senior management's commitment to addressing security risks. Overall policies and plans are developed at the entity-wide level. System and application-specific procedures implement the entity-wide policy. Ongoing monitoring of control design, implementation, and operating effectiveness should also be applied so that the program includes continuous monitoring processes.

Critical within a well-established information security program are documented policies, procedures, and guidance, security roles and responsibilities identified and appropriately delineated across the organization, and performing ongoing evaluations to ensure that policies and controls intended to reduce risk are effective. Without these aspects, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. Prior year auditor noted weaknesses within Management's information security program; specifically:

- Management had not assigned security responsibilities associated with its decentralized control environment. For example, there was no assignment of a centralized Chief Information Security Officer ("CISO") and/or Information Security Officer(s). Further decentralized information systems did not have a Component Security Officer ("CSO") or individual that was assigned to ensure the system/location met overarching security requirements.

- Management had not finalized, published, and communicated formal policies and procedures related to information technology ("IT") control processes. Examples of draft policies and IT controls not formally documented include:

Policies in draft	Not addressed in policy
Acceptable use	Baseline security configuration setting and monitoring
Access to network and systems	Auditable event and monitoring
Anti-virus	Application change & emergency change management
Business continuity and disaster recovery	Incident response
Data classification and handling	Vulnerability scanning
Encryption	Security training
Information security	Backup and data retention
Network security	
Password	
Secure system development	

- Management did not have processes implemented to perform continuous monitoring. Specifically, Management did not:

  - Perform periodic risk and vulnerability assessments, penetration testing, continuous monitoring through scanning or agent-based software tools, or perform other cybersecurity activities in order to identify, track and resolve security threats.

  - Perform security configuration management processes to establish and monitor platforms and software against best practices.

Cause
Due to budget constraints and significant reductions in ITD, Management has not developed or resourced an IT governance structure and processes that appropriately support the risks and threats associated with an organization of the City's size and with the added complexities of decentralization. Furthermore, while Management was in the process of finalizing and implementing City-wide policies and procedures over IT systems, they had not developed ongoing monitoring procedures to protect the integrity of financial data, nor were appropriate processes in place in order to monitor potential security threats.

Effect or Potential Effect
A lack of formal security responsibilities, as well as, policies and procedures related to security controls increases the risk that implementation of control activities may not be consistent throughout the divisions / components within the City.

Failure to perform network security vulnerabilities and penetration assessments increases the risk that the information system's security weaknesses are not identified and investigated in a timely fashion.

Failure to implement and monitor recommended security configuration and best practice settings increases the likelihood of misconfigurations that may be exploited.

Inadequate information security frameworks may lead to lapses in security requirements and consistent implementation across decentralized locations.

This could lead to errors, data loss, inappropriate access, and other risks with the potential to impair the confidentiality, integrity, and availability of systems and data. These issues may result in unauthorized access, use, disclosure, disruption, modification, or destruction of information and information systems, which may lead to misstatements on the financial statements.

Management Response
Through June 2018, the Information Technology Department (ITD) made progress in the following Information Security Program areas related to governance and controls:

- Cybersecurity Office Inception
  - In the City budget process, resourced a new cybersecurity program overseeing information and systems security for the entire organization.
  - In April 2018, the City hired the organization's first Chief Information Security Officer.
- Governance
  - Drafted the City Information Security Standards Handbook, containing the instruction on controls prescribed to securely manage City systems. The first version was released in November 2018, and subsequent updates will take place at least annually.
  - Drafted a new security policy to replace old and irrelevant policies, the new policy based on the National Institute of Standards and Technology (NIST) Cybersecurity Framework (CSF). As of June 30, 2018, the policy remained in coordination and review for authorization.
- Risk Management
  - Completed vulnerability scans of the City's main assets and airport assets.
  - Initiated new periodic checks of vulnerabilities utilizing a vulnerability scanning tool, focusing on systems in the City's secure network perimeter ("Demilitarized Zone" or "DMZ") and newly implemented systems.
  - Initiated assessment of the technology infrastructure against the newly created set of baseline controls as defined in the Information Security Standards Handbook.

Finding 2018-004 - Significant Deficiency (Repeat of Prior Year Finding 2017-004)
Information Technology: Account Management, Password Configuration, Broad Privileged Access, Password Configuration, Shared Accounts, and Audit Logging/Monitoring

Criteria
Internal controls over financial reporting are reliant on information IT controls which are designed effectively. In that regard, an effectively designed IT environment is one where an organization maintains the following:

Account Management includes the following criteria:

a. Identifies and selects the types of information system accounts needed to support organizational missions/business functions;
b. Assigns account managers for information system accounts;
c. Establishes conditions for group and role membership;
d. Specifies authorized users of the information system, group and role membership, and access authorizations (i.e., privileges) and other attributes (as required) for each account;
e. Requires approvals by appropriate personnel for requests to create information system accounts;
f. Creates, enables, modifies, disables, and removes information system accounts in accordance with organization-defined procedures or conditions;
g. Monitors the use of information system accounts;

h. Notifies account managers when accounts are no longer required, when users are terminated or transferred, and when individual information system usage or need-to-know changes;
i. Authorizes access to the information system based on a valid access authorization, intended system usage, and other attributes as required by the organization;
j. Reviews accounts for compliance with account management requirements periodically; and,
k. Establishes a process for reissuing shared/group account credentials (if deployed) when individuals are removed from the group.
l. Restrictions on the use of shared accounts such as defining the specific criteria that must be met in order to use a shared account and termination of the shared account credentials when members leave the group.

Password Strength the organization employs the principle of strong passwords, requiring credentials of reasonable complexity and inactivity-based log-out.

Separation of Duties the organization documents separation of duties of individuals and defines information system access authorizations to support separation of duties. Separation of duties addresses the potential for abuse of authorized privileges and helps to reduce the risk of malevolent activity without collusion. Separation of duties includes, for example: (i) dividing mission functions and information system support functions among different individuals and/or roles; (ii) conducting information system support functions with different individuals (e.g., system management, programming, configuration management, quality assurance and testing, and network security); and (iii) ensuring security personnel administering access control functions do not also administer audit functions.

Least Privilege the organization employs the principle of least privilege, allowing only authorized accesses for users (or processes acting on behalf of users) which are necessary to accomplish assigned tasks in accordance with organizational missions and business functions.

Access Restrictions for Change the organization defines, documents, approves, and enforces physical and logical access restrictions associated with changes to the information system. Organizations should maintain records of access to ensure that configuration change control is implemented and to support after-the-fact actions should organizations discover any unauthorized changes.

Audit Events the organization:

a. Determines that the information system is capable of auditing organization-defined auditable events;
b. Coordinates the security audit function with other organizational entities requiring audit-related information to enhance mutual support and to help guide the selection of auditable events;
c. Provides a rationale for why the auditable events are deemed to be adequate to support after-the-fact investigations of security incidents; and,
d. Determines that the organization-defined audited events are to be audited within the information system along with the frequency of (or situation requiring) auditing for each identified event.

Audit Review, Analysis, and Reporting the organization reviews and analyzes information system audit records periodically for indications of inappropriate or unusual activity and reports findings to the appropriate personnel or role within the organization. Information security-related auditing performed by organizations can include, for example, auditing that results from monitoring of account usage, remote access, wireless connectivity, mobile device connection, configuration settings, system component inventory, use of maintenance tools and nonlocal maintenance, physical access, temperature and humidity, equipment delivery and removal, communications at the information system boundaries, use of mobile code, and use of VoIP.

Condition

Systems impacted: The specific information systems impacted by the below findings were provided separately to management. In addition, the Grant Thornton team met with individual system owners and points of contact to discuss the nuances of these findings which varied slightly based on information system use, architecture, and other factors.

System authorization, access, and account management controls must be used to limit system activities to ensure legitimate use, least privilege, and segregation of duties. Access controls provide assurance that critical systems assets are safeguarded and that logical access to sensitive applications, system utilities, and data is provided only when authorized and appropriate. Further, broad or special (privileged) access privileges, such as those associated with operating /database system software, administrative accounts, and /or superusers, may allow normal controls to be overridden or otherwise circumvented. Additionally, a lack of logging and monitoring broad or privileged access may result in unusual or suspicious activity going unidentified. Grant Thornton noted the following. Grant Thornton noted Management should address the following:

Account Management

- Management did not have a process to consistently document and retain approvals related to initial authorization and ongoing changes to user's access for seven systems tested.
- Management did not perform periodic access recertification for users (including privileged users) and system accounts for 11 systems tested.
- Management did not define the timeframe in which a separated employee or contractor's access from the Network must be disabled after separation and the timeframe in which a reassigned employee's access must be reviewed and updated after reassignment.

Password Configuration

Grant Thornton noted that there was no consistent password policy City-wide for the systems identified above. As a result we noted that password security configuration settings were not consistently aligned with best practices across the network, platforms, and devices. Specifically, we noted information systems did not meet some or all of the following:

- Minimum length requirements
- Enforce the use of alpha numeric characters
- Restrict the use of common words; and,
- Apply password expiration

In addition, we noted that information systems did not log users out after a period of inactivity or lock users out after a set number of failed password attempts.

<u>Broad / Privileged User Accounts</u>

- For one system tested we noted the IT team had access to the operating system and the database.
- Management did not consistently segregate system management functions such as user and system administration from functional responsibilities for seven systems tested. Further system users had IT administrative responsibilities.
- We noted that a system / tool was utilized to make direct changes to production data for a system tested. This tool enables users to bypass transactions made via the applications in the normal course of business, circumvent manual controls in place and update data directly in the database. Per discussion with Management, users require approvals before making changes to data via this tool; however; there were no systematic restrictions that required approvals prior to the updates being made.

<u>Shared Accounts</u>

- We noted instances where systems utilized shared accounts which negate accountability of use. Specifically a shared account was used to make direct data changes via the tool described above and to transfer information into systems.

<u>Audit Logging and Monitoring</u>

- Management did not log and/or monitor activities associated with privileged user accounts (e.g. system administrators, user administrators, network administrators, operators, and developers) for four systems tested. Further one system had limitations which did not allow it to log activities.
- We noted a lack of formally defined auditable events (such as privileged use, invalid password attempts, key configuration changes, or changes made directly to financial data), investigation and analysis processes.

Cause

- Management had not implemented a policy and procedures that appropriately documents account management requirements as part of their internal control framework.
- Management had not defined City-wide password security configurations. Additionally, some information systems did not have the technical capability to enforce password configuration best practices.
- Management had not defined requirements for privileged user accounts, shared accounts, logging/ monitoring, and segregation of duties in policy and procedures.

Effect or Potential Effect

<u>Account Management</u>

- Without formally completing or approving access requests, changes or timely terminations of access, there is an increased risk of inappropriate or unauthorized access to information systems and financial data.
- Without a periodic review of user and system accounts, there is a greater probability that an access change made in error would not be identified in a timely manner.
- Without defining the requirements around logical and physical access removal for separated or reassigned employees and contractors, there is an increased risk that access will not be removed or will not be removed in a timely manner. This access may allow inappropriate access to execute system functions. This could also lead to a license violation issue.

<u>Password Configuration</u>

Failure to implement recommended security settings and best practices for passwords increases the likelihood of account compromise by malicious users

<u>Broad / Privileged User Accounts</u>

- Failure to effectively restrict access to applications based on job function and employ adequate segregation of duties increases the risk for abuse of system privileges, fraud, and inappropriate activity without collusion.
- Direct data changes bypass system transactions and controls and therefore increase the risk of inappropriate updates to data. This may impact the organization’s ability to rely on the completeness, accuracy, and validity of financial data. Further, the use of shared user accounts on a production system reduces the audit and accountability of users within the system and password security. In other words, there is no traceability of user's activity to perform these changes to production data.

<u>Shared Accounts</u>
Shared accounts negate accountability of use in that Management is not able to identify the user that made changes.

<u>Audit Logging and Monitoring</u>
Failure to maintain adequate logging and monitoring of higher risk application events and privileged access increases the risk that suspicious activities may not be identified and investigated.

This could lead to errors, data loss, inappropriate access, and other risks with the potential to impair the confidentiality, integrity, and availability of systems and data. These issues may result in unauthorized access, use, disclosure, disruption, modification, or destruction of information and information systems, which may lead to misstatements on the financial statements.

Management Response
The Information Security Standards Handbook, issued in November 2018, directs City functions on controls to securely manage and operate information systems in the City, including Account Management. Activities completed by June 30, 2018:

- Reviewed and refreshed separation of duties across IT applications, infrastructure, and cybersecurity functions. Procedures for the mentioned divisions will be reviewed to ensure checks and balances are maintained into the future. Reviewed and applied account management procedures and approvals allow the City to apply and enforce Least Privilege Principles, Need to Know, and Access Restrictions as stated in the Information Security Standards Handbook. This step is in preparation for an IT Security Assessment slated for FY 2019.
- Reviewed and reapplied group policy controls for password complexity and change frequency. Planned additional action for review and updates to staff access to software applications, network shares, and documents for completion by the end of December 2018.

The Information Security Standards Handbook has a section that specifies the basic events that each system must log. These events are in alignment with the National Institute Standards and Technology measures and are deemed new minimums.

The Cybersecurity Office initiated periodic reviews or firewall logs for anomalous perimeter security activity. Long-term, the City aims to implement a form of Security Operations Center to monitor and analyze all logs for critical risk alerting and fast response.

Finding 2018-005 – Significant Deficiency (Repeat of Prior Year Finding 2017-005)
Information Technology: Change Management

Criteria
Internal controls over financial reporting are reliant on IT controls which are designed effectively. In that regard, an effectively designed IT environment is one where an organization:

a. Determines the types of changes to the information system that are configuration-controlled;
b. Reviews proposed configuration-controlled changes to the information system and approves or disapproves such changes with explicit consideration for security impact analyses;
c. Documents configuration change decisions associated with the information system;
d. Implements approved configuration-controlled changes to the information system;
e. Retains records of configuration-controlled changes to the information system for an organization-defined time period;

f. Audits and reviews activities associated with configuration-controlled changes to the information system; and,
g. Coordinates and provides oversight for configuration change control activities through an organization defined configuration change control element (e.g., committee, board).

Condition

Systems impacted: The specific information systems impacted by the below findings were provided separately to management. In addition, the Grant Thornton team met with individual system owners and points of contact to discuss the nuances of these findings which varied slightly based on information system use, architecture, and other factors.

Change management processes provide assurance that software, data, and other changes associated with information systems are approved and tested so they do not introduce functional or security risks. A disciplined process for testing, approving, and migrating changes between environments, including into production, is essential to ensure that systems operate as intended and that no unauthorized changes are implemented.

Grant Thornton noted that Management did not have a process to consistently document and retain evidence related to change management activities including change request and approval, scheduling, initiation, testing, implementation approvals and post-implementation review for eight systems tested. In addition, we noted that City personnel do not have access to source code for one system tested, which is handled by the vendor, but were responsible for user acceptance testing and certain approvals, which were not consistently documented and retained.

Cause

As part of the internal controls framework, management has not incorporated a policy and procedure to periodically monitor and review the configuration items that are migrated to production. Additionally, IT personnel did not consistently document and retain evidence related to change management activities (e.g. change request and approval, scheduling, initiation, testing, implementation approvals and post-implementation review).

Effect or Potential Effect

Without formally completing or approving change management activities for system changes, patches and modifications, there is an increased risk that change management controls will not be completed. Without effective control over changes that are migrated to the production environment, there is an increased risk that an inappropriate code change could be introduced into the production environment, potentially impacting the financial statement and related processes (i.e. cash accountability, financial reporting, etc.). Inappropriate code change could have a negative impact on system functionality, availability, or ability to produce complete and accurate financial data. These issues may result in unauthorized access, use, disclosure, disruption, modification, or destruction of information and information systems, which may lead to misstatements on the financial statements.

Management Response:

The Information Technology Department (ITD) began a five-month process of improving change control processes in June 2018. In addition to review of configuration changes by the City's Change Advisory Board (CAB), a new organization-wide Change Control Board (CCB) was formed and maintains enterprise level visibility and communications channels for all major information and systems moves/adds/changes. Departments have new visibility into what is impacting their operations, communicate needs, and approve/reject changes. The CCB has been in operation since August 2018. Logs of all changes requests are available in a tracking system implemented in August 2018.

City of San José, California
Schedule of Findings and Questioned Costs (Concluded)
Year Ended June 30, 2018

Section III Federal Award Findings and Questioned Costs

None reported.

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Management Corrective Action Plan (Unaudited)

Finding 2018-001 – Significant Deficiency
Risk Assessment of Internal Controls Over the Financial Reporting Process

Management Response:

Management agrees with MGO's comment and acknowledges that staffing turnover resulting from resignations, retirements, and extended leave in the Specialized Accounting and Financial Reporting Sections of the Finance Department, Accounting Division negatively impacted timely and accurate reconciliation of general ledger accounts and completion of audit documents. Newly hired accounting staff assigned to complete these tasks had little or no institutional knowledge in the City's accounting processes and was further hampered by the lack of detailed desk procedures in some of the program areas. The review of staff work was challenging given the training level of supervisory staff who were also new to their roles and were experiencing an overwhelming workload created by key vacancies. Most impactful were the resignations of the Division's Deputy Director in June 2018 and Principal Accountant overseeing Specialized Accounting in August 2018. These departures created a loss of effective senior leadership and significant institutional knowledge needed for a successful fiscal close.

As the Governance Report mentioned, the City substantially reduced its staffing levels from 2006 to 2015 in order to address its budget shortfall, which also impacted staffing levels in the Financial Reporting/Special Accounting sections. In 2008, the total staffing in these two sections was 20 positions and in 2018 the staffing level is 17, a reduction of 15%. These Accounting sections are responsible for recording citywide accounting and budget transactions, maintaining the general ledger database, coordinating the City's annual external audit process, and preparing and producing the Comprehensive Annual Financial Report (CAFR), in addition to approximately 20 stand-alone financial reports. Additional work includes producing the City's annual cost allocation plans. Further complicating the governmental financial reporting this year was the introduction of a new accounting pronouncement from the Governmental Accounting Standards Board (GASB), specifically GASB 75, and an increase in the volume and complexity of accounting and reporting for federally-funded programs associated with the 2017 flood damage in the City.

Staff believes that the staffing challenges coupled with increased workload has led to the high staff turnover with several departures to other City departments and to outside public agencies with better compensation packages when compared to the City. The table below shows average years of tenure of the Accounting Division's professional accounting classifications in the Financial Reporting/Special Accounting sections. The statistics indicate that an average tenure of professional accounting staff is less than two years, which negatively impacts staff's technical growth and the quality of work product as mentioned in the Governance Report.

	Years in Classification	Years with City
Accountant I/II	2.34	5.15
Senior Accountant	1.57	1.88
Supervising Accountant	1.00	2.32
Principal Accountant	0.94	0.94

Despite these challenges, the Finance Department is undertaking various steps to address the issues raised in the Governance Report.

1. The Department has recently filled the Deputy Director of Finance, Accounting, positon, which has been vacant since June 2018. In addition, the Accounting Division has completed the recruitment for two vacant Accountant positions in the Specialized Accounting section and the Department is prioritizing the recruitment of the Principal Accountant vacancy for the Specialized Accounting section.

2. The Department anticipates during FY 2018-19, the Division will be able to institute and implement changes to address internal control issues including the following:

    - Ensure proper training and cross training of professional accounting staff in core job assignments, including developing and maintaining detailed desk procedures;
    - Reconcile and review of accounting transactions, including review and approval by Supervising and Principal Accountants in a timely manner;
    - Plan and execute citywide fiscal year-end close activities and recording of accounting transactions in a timely manner;
    - Prepare and review audit documents and draft financial reports for the external auditor's review; and
    - Prepare a citywide audit completion schedule in consultation with the external auditors and conduct weekly or bi-weekly status meetings to ensure that tasks are completed by the targeted dates.

3. As the City has decentralized accounting operations, proper coordination among department accounting staff and the Accounting Division staff is critical for the successful execution of the audit process and completion of the CAFR and other reports. The Accounting Division will coordinate and prepare a detailed work plan that will list fiscal year-end milestones to be completed by department accounting staff and delivered to the Accounting Division within the time lines prescribed in the work plan. The Finance Department will ensure that department senior management is aware of fiscal year-end close responsibilities and the related deliverables.

4. As budget resources permit, the Finance Department will participate in the training opportunities in the governmental accounting and financial reporting areas to professional accounting staff offered by the Government Finance Officers Association (GFOA), California Society of Municipal Finance Officers (CSMFO) and Association of Government Accountants (AGA). Finance Accounting staff will be encouraged to attend local CSMFO chapter meetings to maintain professional relationship with their counterparts and to facilitate exchange of professional knowledge.

5. As the Governance Report mentioned and as shown in the table above, the Finance Department continues to face recruitment and retention challenges for professional accounting staff. To address this issue, the Finance Department is working with the Human Resources Department, Office of Employee Relations, and Budget Office to explore creating Finance-specific accounting classifications for its management classifications (Senior Accountant, Supervising Accountant, and Principal Accountant). The new classifications would be intended to recognize the specialized skill sets needed to perform citywide complex accounting and financial reporting functions performed by these classifications in the Finance Department. If implemented, the Department believes these changes may help with attraction and retention issues but addressing workload and responsibilities of positions within the Finance Department will be an ongoing challenge.

    Targeted Completion Date: June 30, 2019.

Finding 2018-002 – Significant Deficiency
Completeness of the Schedule of Expenditures of Federal Award

<u>Management Response:</u>

The Department of Transportation management agreed with the overstatement of the Highway Planning and Construction Cluster expenditures reported on the initial grant inventory listing due to a human error. This deficiency is not related to a program deficiency nor does it constitute a violation of the federally-funded grant covenants. This finding is specifically related to internal control over financial reporting, and not related to federal awards compliance funding. To ensure the accuracy of reporting the expenditures of Federal Awards, the City will update the federal grant guidance document and implement the following steps to address this issue:

1. Departments will perform analytical review procedures (i.e. current year vs. prior year expenditure changes) of their grant inventory listings on a quarterly and annual basis for accuracy.
2. Departments will reconcile the federal expenditures reported on the grant inventory listing to amounts recorded in the City's Financial Management System (FMS). The Accounting Division staff will perform a detail review of reconciliation for each significant federal programs prior to their submission to the Auditors.

3. The Accounting Division will also provide training to its professional accounting staff in reviewing the grant inventory listing for reasonableness and perform analytical and due diligence procedures.
   Target Completion Date: June 30, 2019.

Finding 2018-003 – Significant Deficiency (Repeat of Prior Year Finding 2017-003)
Informational Technology: City-Wide Information Security Program

<u>Management Response:</u>

Through June 2018, the Information Technology Department (ITD) made progress in the following Information Security Program areas related to governance and controls:

- Cybersecurity Office Inception
    - In the City budget process, resourced a new cybersecurity program overseeing information and systems security for the entire organization.
    - In April 2018, the City hired the organization's first Chief Information Security Officer.
- Governance
    - Drafted the City Information Security Standards Handbook, containing the instruction on controls prescribed to securely manage City systems. The first version was released in November 2018, and subsequent updates will take place at least annually.
    - Drafted a new security policy to replace old and irrelevant policies, the new policy based on the National Institute of Standards and Technology (NIST) Cybersecurity Framework (CSF). As of June 30, 2018, the policy remained in coordination and review for authorization.

- Risk Management
    - Completed vulnerability scans of the City's main assets and airport assets.
    - Initiated new periodic checks of vulnerabilities utilizing a vulnerability scanning tool, focusing on systems in the City's secure network perimeter ("Demilitarized Zone" or "DMZ") and newly implemented systems.
    - Initiated assessment of the technology infrastructure against the newly created set of baseline controls as defined in the Information Security Standards Handbook.

Finding 2018-004 – Significant Deficiency (Repeat of Prior Year Finding 2017-004)
Information Technology: Account Management, Password Configuration, Broad Privileged Access, Password Configuration, Shared Accounts, and Audit Logging/Monitoring

Management Response:

The Information Security Standards Handbook, issued in November 2018, directs City functions on controls to securely manage and operate information systems in the City, including Account Management. Activities completed by June 30, 2018:

- Reviewed and refreshed separation of duties across IT applications, infrastructure, and cybersecurity functions. Procedures for the mentioned divisions will be reviewed to ensure checks and balances are maintained into the future. Reviewed and applied account management procedures and approvals allow the City to apply and enforce Least Privilege Principles, Need to Know, and Access Restrictions as stated in the Information Security Standards Handbook. This step is in preparation for an IT Security Assessment slated for FY 2019.
- Reviewed and reapplied group policy controls for password complexity and change frequency. Planned additional action for review and updates to staff access to software applications, network shares, and documents for completion by the end of December 2018.

The Information Security Standards Handbook has a section that specifies the basic events that each system must log. These events are in alignment with the National Institute Standards and Technology measures and are deemed new minimums.

The Cybersecurity Office initiated periodic reviews or firewall logs for anomalous perimeter security activity. Long-term, the City aims to implement a form of Security Operations Center to monitor and analyze all logs for critical risk alerting and fast response.

Finding 2018-005 – Significant Deficiency (Repeat of Prior Year Finding 2017-005)
Information Technology: Change Management

Management Response:

The Information Technology Department (ITD) began a five-month process of improving change control processes in June 2018. In addition to review of configuration changes by the City's Change Advisory Board (CAB), a new organization-wide Change Control Board (CCB) was formed and maintains enterprise level visibility and communications channels for all major information and systems moves/adds/changes. Departments have new visibility into what is impacting their operations, communicate needs, and approve/reject changes. The CCB has been in operation since August 2018. Logs of all changes requests are available in a tracking system implemented in August 2018.

City of San José, California
Summary Schedule of Prior Audit Findings
Year Ended June 30, 2018

Prior Years' Financial Statement Findings

The basic financial statements of the City of San José as of and for the year ended June 30, 2017, were audited by other auditors. The following Prior Year's Findings were written by those auditors and we are required to document the status of Prior Year's Findings.

STATUS OF PRIOR YEAR'S FINDINGS

Finding 2017-001 Controls over Estimating Loan Loss Reserves

Criteria
Management is responsible for the preparation and fair presentation of the financial statements in accordance with US GAAP. This includes the design, implementation, and maintenance of internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Internal controls over financial statement estimates are particularly important given the important judgements inherent in making those estimates.

Condition
The City maintains a Housing Activities Fund and Low and Moderate Income Housing Asset Fund with total loans to borrowers of $135 million and $509 million, respectively, at June 30, 2017. Of those loan balances, management recorded an allowance for uncollectible loans for 47% and 55%, respectively, of the gross loan balances in these two governmental funds which are maintained on the modified accrual basis of accounting. In addition to these reserves on loan principal, management also reserved 100% or $128 million of accrued interest on these loans as uncollectable at the government-wide level which is presented on the a full accrual basis of accounting. Management's estimates for the governmental funds were made using a methodology combining an allowance for collectability risk and an allowance for present value discount at 1%. Management's methodology is documented and has been consistently applied for several years but the assumptions were not supported by evidence of incurred losses on loans such as historical results, industry data, and actual performance of individual loans or current credit quality of the borrower. Many of these traditional measures of loan losses were not tracked by the City and, therefore, were not factored into the loan loss calculation.

US GAAP outlines use of an incurred loss model when estimating loan losses. Inherent in that model is that a loss has occurred as of the financial statement date for a loan loss reserve to be accrued. In other words, expected future losses are not accrued, no matter how likely. GASB Statement 34, in particular, notes that liabilities and losses should be recognized when transactions take place. In context, this is the equivalent of the notion of "incurred" – that is, the occurrence of the transaction is the triggering event for recognition of the transaction itself. The occurrence of the transaction (the loan) would give rise to the recognition of the asset –and then the other elements of the transaction (such as losses incurred) would be recognized as they are incurred over the asset's life. GASB Statement 62 outlines the accounting for loss contingencies including impairment of receivables and underscores the notion of incurred losses for events which occur as of the financial statement date that indicate a receivable has been impaired and for which an estimate of impairment is measurable. This incurred loss notion is made explicit in GASB 62.102 (emphasis added):

An estimated loss from a loss contingency (as defined in paragraph 96) should be accrued if both of the following conditions are met:

a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it should be probable that one or more future events will occur confirming the fact of the loss.

b. The amount of the loss can be reasonably estimated.

Management was asked to provide evidence supporting the reasonableness of assumptions applied in the estimate of uncollectible loans. For example, we inquired about the policy to record a 40% reserve on certain categories of loans. While management was able to share an 11-year old point system which has evolved to a blanket 40% reserve, neither that evolved point system nor the resulting 40% had any relationship to incurred loan losses on these loan portfolios. Therefore, management was not ultimately able to adequately support the assumptions applied even though they were able to demonstrate they had complied with their policy.

With respect to the 1% discount factor, a factor which represents 27% of the recorded reserves, management has characterized this as an opportunity cost discount in its loan loss policy (lost earnings by virtue of the monies being invested in loans instead of an investment portfolio). This same 1% was characterized differently in the footnotes to the financial statements as an adjustment for below-market interest rates. Management was unable to explain how their 1% discount aligned with US GAAP but did relay on several occasions that they "make the market" on their loans and their actual interest rates of 0-6% and loan terms were market; not below market. In management's response below, however, management indicates "When this type of loan is made to developers and low income residents, the fair value of the loan receivable becomes less than its face value. In other words, this type of affordable housing loan receivable cannot be sold at its face value in the market."

In this regard, we find the City's documentation and explanations about market vs. below-market interest rates and loan terms to conflict with one another and the concept of opportunity cost appears to have no support in US GAAP.

Most recently, management provided a memorandum dated November 1, 2017, which suggested the loan portfolio actually had no impaired loans but the reserve was intended to reflect the potential that as loans become due, they may be renegotiated to allow borrowers to further the housing program's objective of affordability. While we appreciate that renegotiations in future years may result in loan due date extensions or forgiveness of loans, we don't see how US GAAP would support the current accounting of future decisions and how those future decisions have any relationship to the 47% and 55% uncollectibility reserves which have evolved from the 11-year old point system.

Finally, management has shared with us discussions they've had with several other cities in California who have housing loans along with a State housing department. These other agencies have different loan loss reserve levels ranging from 0-100% of the loan balance. Management has interpreted this variety to be evidence of a widely recognized and prevalent industry standard in setting loan reserves. We view the dissimilar reserve results to indicate other agencies simply have different results after applying their policies. No evidence of a recognized and prevalent industry standard in establishing loan reserves was provided. Further, management has not articulated how the methodologies of each of these other agencies are used or their applicability to the City's particular loan portfolio. The City's assertion has, essentially, been that they can set the reserve by policy which is inconsistent with US GAAP.

We recommend management (1) clarify what they are trying to measure with the loan reserves, (2) align what they are trying to measure with US GAAP and (3) look to actual evidence of loan impairment for reserve analyses instead of old models which have no relationship to actual impairment in the portfolio.

We were able to independently develop an estimate within an acceptable range of the recorded balance to satisfy our audit objective.

Cause
The assumptions used in developing the loan loss reserve are based on an internal policy and have not been supported by evidence of incurred losses consistent with the requirements of US GAAP.

Effect or Potential Effect
Financial statements may be misstated if key assumptions in accounting estimates are not supported by quality evidence.

Management Response (Unaudited)

Summary of Management Response
Management had multiple discussions with Grant Thornton explaining and clarifying the affordable housing loan program and what the City is trying to measure with respect to the loan reserves. Management had explained to Grant Thornton why the current methodology for loan loss reserve is acceptable under GASB rules. The City has used this methodology for twenty-eight years and while this methodology may be "old model" it has withstood internal and regular audits. In addition, City staff had inquired with other cities in California and verified that there is a wide range of reserve rates used by other local governments, and the practice of estimating reserves based on each entity's analysis of their unique affordable housing loan programs in their communities is widely recognized and prevalent within local governments. Accordingly, to conclude that the City's loan reserve measurement does not align with US GAAP, would conclude that many governments are not in compliance with US GAAP.

Management disagrees with Grant Thornton that an incurred loss model (described in second paragraph under "Condition") must be used when estimating loan loss reserves. The incurred loss model is not specified in GASB Statements 34 or 62. The incurred loss model is a topic in FASB ASC 450, Contingencies. GASB 34 states "revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions should be recognized when the exchange takes place". Grant Thornton is interpreting this as equivalent to the incurred loss model described in FASB ASC topic 450. We disagree. GASB 62 states "an estimated loss from a loss contingency should be accrued if information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired at the date of the financial statements, and the amount of loss can be reasonably estimated". From an accounting perspective, an asset is impaired when its fair value is less than its book value. Unlike traditional mortgage loans, most of the City's affordable housing loans do not have fixed repayment schedules, requires payments due only in years when the projects report earning positive cash flow, and can be renegotiated to extend loan terms for continuing affordable housing purposes. When this type of loan is made to developers and low income residents, the fair value of the loan receivable becomes less than its face value. In other words, this type of affordable housing loan receivable cannot be sold at its face value in the market. Therefore, a loan loss reserve is established when an affordable housing loan is made.

As GASB does not have any statement addressing the method for estimating affordable housing loan loss reserves, GASB 76 allows a government to use practices that are widely recognized and prevalent in state and local government. The City's point system provides a fair and consistent way of estimating loan loss reserves. Reserves are based on loan type (e.g. construction, permanent), project type (e.g. multi-family, shelter, special needs), City's loan position (first, second, third, fourth), other lender/regulatory requirements, loan performance, strength of developer, and other unique issues to the project. Loan risks are reviewed annually for relevance. The City tracks actual loan loss event and accounts for it promptly: when an actual loss event occurs, the City writes off the loan receivable and related loan loss reserve. The City's disagreement with Grant Thornton on this issue does not warrant a material weakness comment from Grant Thornton on the City's internal control as the City views its methodology to be consistent with GASB 76. The City has worked diligently to provide the documentation and reasoning behind its methodology; demonstrated its relevance; and inquired with its peer agencies, and the Government Finance Officers Association (GFOA), and Government Accounting Standards Board (GASB) regarding the appropriateness of its estimates. Furthermore, for the second year in a row, Grant Thornton was able to independently develop an estimate within an acceptable range of the recorded balance to satisfy its audit objective. This indicates that the risk of a material misstatement is remote.

Management Response
The City's loan loss reserve is conservatively estimated to address the essence of the housing loan program –affordability and the loan loss reserve allowance is management's estimate of potential credit losses in the affordable housing loan portfolio. The City's loan loss reserve ensures that the City recognizes in its financial statements that these loans were made to ensure affordability for our extremely low, very low, low, and moderate income residents. Loan repayments depend on the negotiated structure of the deal. The City's developer loans are not typically structured like traditional mortgages with fixed payment terms. Instead, many of the loans are structured to have payments due only in years when the projects report earning positive cash flow, or "residual receipts". Some are focused so heavily on extremely low income and/or special need populations that they expect no positive cash flow during the entire affordability restriction period. As such, the City's loan loss reserve recognizes the possibility that some of these loans likely will not be fully repaid and/or may be renegotiated to extend affordability for our lowest income residents.

The City believes that the methodology for loan loss reserve is acceptable under GASB rules. The City has used this methodology for twenty-eight years and this methodology has withstood internal and regular external audits. The City's methodology includes a risk evaluation model and assigns points to various loan criteria: loan type, project type, City's loan position, other lender/regulatory requirements. Under the current methodology, project loans and individual borrower loans that make scheduled payments during a fiscal year are evaluated for both discount and risk factors. Other project loans and individual borrower loans are grouped together by loan type, payment type or other common factors for the purpose of calculating a global discount and risk factor on the aggregate total of the group. Loans are secured by first, second, third or lower in lien-property deeds of trust except for first time homebuyer loans, which are all secured by second deeds of trust. Interest and principal are typically due in installments, except for first time homebuyer loans, which do not require payments until their maturity dates.

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

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

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

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

Grant Thornton reported the same comment last year as significant deficiency because the City was unable to provide evidence to support the assumptions for estimating the loan loss reserve. The City, including the Housing Department, has experienced high personnel turnover in the last five years resulting in misplaced documentation. In August 2017, the City located the evidence supporting the assumptions applied in the estimate under the City's current methodology. In addition to providing the evidence, the City performed and provided additional analyses to demonstrate the relevance of the current methodology to the Housing loan portfolio. The City also inquired with peer agencies and had reached out to GFOA and GASB, both organizations stated that if the City has compelling evidence that the methodology is prevalent in the government industry and the City has applied that methodology on a consistent basis, the City does follow the requirements of US GAAP.

Management disagrees with Grant Thornton in its comment that the City's current methodology for estimating loan loss reserve is not consistent with the requirements of US GAAP. The City as a governmental agency, is required to follow GASB Standards for accounting and financial reporting practices. The incurred loss model recommended by Grant Thornton, which is described in FASB ASC topic 450, Contingencies, is not specified in GASB statements. Pursuant to GASB Statement 76, if the accounting treatment for a transaction is not specified in GASB Statements, GASB Technical Bulletins, GASB Implementation Guides, and literature of the AICPA cleared by the GASB, a government entity can apply sources of nonauthoritative accounting literatures, such as FASB statements or practices that are widely recognized and prevalent in state and local government or others. No other government agency that the City inquired with uses incurred loss model in estimating their housing loan loss reserves and Grant Thornton was unable to provide a city or government agency that they audited that uses the incurred loss model that they recommend. Thus the City is hesitant to depart from GASB guidelines and move to incurred loss model for estimating loan loss reserves.

Status
Corrected. Management formalized its loan loss reserve policies and procedures for loans made by the City's Housing Department. The Department's loan portfolio is comprised of several types of loans. The loan loss reserve represents the potential loss of value in the loan assets' value. The methodology for determining the loan loss reserve for the Housing Department's loan portfolio has, therefore, been broken down into individual categories of loan types. Each category was analyzed and a formula was applied to determine the loan loss reserve by category. The policy is consistent with GAAP, as promulgated by GASB.

Finding 2017-002 Untimely Identification of Errors and Lack of or Inaccuracies in Account reconciliations

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

Condition
The City's preparation of its Comprehensive Annual Financial Report ("CAFR") is a responsibility centralized within the Finance Department who compiles and verifies financial data, accounting estimates and US GAAP application decisions maintained by that department along with those generated by the various departments within the City's decentralized structure.

The process of preparing an accurate CAFR is complicated by the variation in levels of supervisory review, reconciliation and processing flows within the finance and other departments along with the inconsistencies in accounting background among the departments.

We noticed several areas where this challenge was apparent:

- In the City's Municipal Water Fund and Integrated Waste Management Fund, a reconciliation between the CIS subsystem and general ledger balances were not completed as a normal procedure in the yearend close. In addition, a detailed supervisory review was not performed of the reconciliation prior to being provided for audit and we discovered additional errors which led to additional adjustments in accounts receivable and revenue. For the Municipal Water Fund, correcting adjustments with a net impact of $2,034,000 were posted and an additional $423,000 was identified but not corrected to decrease accounts receivable and revenues as a result of this reconciliation. An additional $338,000 of credits were identified within the receivable subledgers that were not reclassified to liabilities, therefore we proposed an adjustment to reclassify these amounts. For the Integrated Waste Management Fund, correcting adjustments with a net impact of $610,000 were posted to increase accounts receivable and revenues as a result of this reconciliation. An additional $1,680,000 of credits were identified within the receivable subledger that were not reclassified to liabilities, therefore we proposed an adjustment to reclassify these amounts.
- Within the Special Assessments Fund and Housing Activities Fund, we identified two instances where revenue was recorded in the incorrect period and this error was not identified in a timely manner by the City. The impact of these errors was to overstate revenue in fiscal 2017 that really belong in fiscal 2016 in the amounts of $1,171,000 and $1,539,000, respectively.

- In the City's Low and Moderate Housing Fund we identified a loan which had a forgiveness clause embedded in the agreement that was not fully reserved for when it should have been in accordance with the City's policy. As such, we proposed an adjustment to increase the reserve for this loan of $1,150,000.

We recommend that Management require at least annual reconciliations of all accounts between the subsystem and the general ledger ending balances. Furthermore we recommend increased training for preparers and reviewers of journal entries and reconciliations to assist in the timely identification of errors.

Cause
Account reconciliations are not always being performed or being performed accurately. Additionally, supervisory review had not identified the lack of reconciliations or errors in those reconciliations.

Effect or Potential Effect
Deficiencies in the design or operation of reconciliation controls can lead to errors in the financial statements.

Status
While the City has corrected the three examples cited above, the financial reporting process continues to have certain deficiencies, as discussed in finding 2018-001.

Finding 2017-003 Informational Technology: City-Wide Information Security Program

Status
In process of implementation. The City hired a Chief Information Security Officer (CISO) during the fiscal year 2018. This finding was repeated in its entirety, and presented as current year finding 2018-003.

Finding 2017-004 Information Technology: Account Management, Password Configuration, Broad Privileged Access, Password Configuration, Shared Accounts, and Audit Logging/Monitoring

Status
In progress of implementation. This finding was repeated in its entirety, and presented as current year finding 2018-004.

Finding 2017-005 Information Technology: Change Management

Status
In progress of implementation. This finding was repeated in its entirety, and presented as current year finding 2018-005.

Prior Years' Federal Awards Findings

None reported.