

**CITY OF SAN JOSE, CALIFORNIA**

Single Audit Reports

Basic Financial Statements with  
Federal Compliance Section

For the Year Ended June 30, 2010



**CITY OF SAN JOSE, CALIFORNIA**

For the Year Ended June 30, 2010

***Table of Contents***

	<b><i>Page(s)</i></b>
<b>FINANCIAL SECTION</b>	
Independent Auditor's Report .....	1
Management's Discussion and Analysis (Required Supplementary Information – Unaudited) .....	3
Basic Financial Statements:	
Government-wide Financial Statements:	
Statement of Net Assets .....	22
Statement of Activities .....	23
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet .....	24
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets .....	26
Statement of Revenues, Expenditures and Changes in Fund Balances .....	28
Reconciliation of the Changes in Fund Balances of Governmental Funds to the Statement of Activities .....	30
Proprietary Funds:	
Statement of Fund Net Assets .....	32
Statement of Revenues, Expenses, and Changes in Fund Net Assets .....	34
Statement of Cash Flows .....	36
Fiduciary Funds:	
Statement of Fiduciary Net Assets .....	38
Statement of Changes in Fiduciary Net Assets .....	39
Notes to Basic Financial Statements .....	41
Required Supplementary Information (Unaudited):	
Schedule of Revenues, Expenditures and Changes in Fund Balances – Budget and Actual:	
General Fund .....	117
Housing Activities .....	118
Schedules of Funding Progress .....	119
Notes to Required Supplementary Information .....	120

**CITY OF SAN JOSE, CALIFORNIA**

For the Year Ended June 30, 2010

***Table of Contents (Continued)***

	<b><i>Page(s)</i></b>
<b>COMPLIANCE SECTION</b>	
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 <i>Government Auditing Standards</i> .....	123
Independent Auditor's Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and the Passenger Facility Charges Program and on Internal Control over Compliance in Accordance with OMB Circular A-133 .....	125
Schedule of Expenditures of Federal Awards.....	127
Schedule of Revenues and Expenditures of Passenger Facility Charges .....	133
Notes to the Schedule of Expenditures of Federal Awards and Schedule of Revenues and Expenditures of Passenger Facility Charges.....	135
Federal Awards Schedule of Findings and Questioned Costs .....	141
Passenger Facility Charges Schedule of Findings and Questioned Costs .....	142
Summary Schedule of Prior Audit Findings .....	143

City Council  
City of San José, California

### Independent Auditor's Report

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San José, California (the City), as of and for the year ended June 30, 2010, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San José, California, as of June 30, 2010, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note I.E. to the financial statements, as of July 1, 2009, the City adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, and GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*.

As described in Note IV.A., based on the most recent actuarial valuation as of June 30, 2009, the Police and Fire Department Retirement Plan's and the Federated City Employees' Retirement System's independent actuaries determined that, at June 30, 2009, the value of the defined benefit pension plans' actuarial accrued liability exceeded the actuarial value of their assets by \$393.9 million and \$729.6 million, respectively. The most recent actuarial value of assets as of June 30, 2009 does not reflect the impact of the Police and Fire Department Retirement Plan's \$600.0 million and the Federated City Employees' Retirement System's \$420.0 million of deferred investment losses for the defined benefit pension plans that will be recognized in future valuations. Also, as described in Note IV.A, based on the most recent actuarial valuation as of June 30, 2009, the independent actuaries determined that, at June 30, 2009, the value of the postemployment healthcare plan's actuarial accrued liability exceeded the actuarial value of its assets by \$706.0 million for the Police and Fire Department Retirement Plan and \$710.9 million for the Federated City Employees' Retirement System.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 22, 2010, 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, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis; the schedules of revenues, expenditures, and changes in fund balances – budget and actual for the General Fund and the Housing Activities Fund; and the schedules of funding progress listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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 and schedule of revenues and expenditures of passenger facility charges are presented for purposes of additional analysis as required by OMB Circular A-133 and the *Passenger Facility Charge Audit Guide for Public Agencies*, respectively, and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

  
Certified Public Accountants

Walnut Creek, California  
November 22, 2010

# Management's Discussion and Analysis

---

---

Management's Discussion and Analysis (MD&A) provides an overview of the City of San José's activities and financial performance for the fiscal year ended June 30, 2010. We encourage readers 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. All amounts have been rounded to the nearest one hundred thousand dollars and one tenth of a percent.

## FINANCIAL HIGHLIGHTS

- The government-wide Statement of Net Assets for the City's governmental and business-type activities indicate that as of June 30, 2010, total assets exceed total liabilities by \$6.030 billion. Of this amount, \$253.7 million are unrestricted net assets, which comprise \$307.2 million for business-type activities and a deficit unrestricted balance of \$53.5 million for governmental activities. In addition, the City's restricted net assets total \$648.4 million dedicated to specific purposes and the remaining net assets of \$5.128 billion is invested in capital assets, net of related debt.
- Total net assets decreased by \$391.5 million or 6.1 percent during 2009-2010 from \$6.422 billion to \$6.030 billion. Depreciation expense of \$437.9 million accounts for this decrease. Excluding depreciation, net assets increased by \$46.4 million.
- Governmental funds reported combined ending fund balances of \$1.199 billion at June 30, 2010, which are \$216.6 million or 15.3 percent less than the June 30, 2009 balances. The governmental funds that experienced decreases in fund balances for the year include the General Fund (\$40.3 million), Redevelopment Agency (\$114.3 million), Special Assessment Districts (\$7.5 million), and other nonmajor funds (\$107.0 million). Governmental funds that experienced increases in fund balance include Housing Activities (\$49.2 million) and the San José Financing Authority Debt Service Fund (\$3.2 million). Unreserved fund balance comprises \$460.7 million or 38.4 percent of combined governmental fund balances at June 30, 2010 and is available to meet the City's current and future spending needs pursuant to the legal restrictions regarding the use of the funds.
- Unreserved fund balance for the General Fund is \$143.6 million at June 30, 2010, which represents 21.0 percent of total General Fund expenditures during 2009-2010.
- Total noncurrent obligations decreased by \$52.0 million during 2009-2010 to \$5.220 billion at June 30, 2010, which represented a decrease of 1.0 percent compared to \$5.272 billion outstanding as of June 30, 2009. Primary factors leading to this decrease include a principal payment of \$50.0 million to the Bank of New York for the Housing Set-aside Term Loan, a reduction of \$14.5 million in accrued vacation, sick leave and compensatory leave and principal payments representing \$184.3 million on outstanding bonds and loans related to governmental and business-type activities. These decreases were offset by the issuance of \$160.4 million of Redevelopment Agency tax allocation bonds to finance low and moderate-income housing projects under the 20 percent housing program, and an increase of \$40.4 million in the City's net other postemployment benefits (NOPEBO) obligation.

## OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

In addition, this report also contains other supplementary information.

## Management's Discussion and Analysis (Continued)

---

---

### Government-wide Financial Statements

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

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

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

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

The government-wide financial statements include not only the primary government of the City of San José, but also a legally separate redevelopment agency and three legally separate financing authorities 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 of San José 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 of San José'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, Redevelopment Agency, Housing Activities, Special Assessment Districts, and the San José Financing Authority Debt Service, which are all classified as major funds. These statements also report several individual governmental funds classified as nonmajor funds such as special revenue, debt service, and capital projects funds, which are combined into a single, aggregated presentation. Individual fund data for each of the nonmajor governmental funds is provided in the form of *combining statements* elsewhere in this report.

## Management's Discussion and Analysis (Continued)

---

---

***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 of San José accounts for its airport, wastewater treatment, water supply, and parking management operations in proprietary funds.

***Fiduciary funds*** account for resources held for the benefit of City of San José 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 of San José programs.

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

**Required Supplementary Information** includes the budgetary schedules for General Fund and Housing Activities Fund. In addition, pension and other postemployment healthcare schedules present the City of San José's progress towards 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** referred to earlier provide information for nonmajor governmental funds and fiduciary funds and are presented immediately following the required supplementary information.

## Management's Discussion and Analysis (Continued)

### GOVERNMENT-WIDE FINANCIAL ANALYSIS

**Analysis of net assets:** As noted earlier, net assets may serve as a useful indicator of a government's financial position. For the City of San José, assets exceeded liabilities by \$6.030 billion as of June 30, 2010.

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

	Governmental Activities		Business-type Activities		Totals	
	FY 2010	FY 2009	FY 2010	FY 2009	FY 2010	FY 2009
<b>Assets:</b>						
Current and other assets..... \$	1,642,082	1,844,380	806,956	990,886	2,449,038	2,835,266
Capital assets.....	7,412,751	7,631,580	2,194,124	1,946,824	9,606,875	9,578,404
Total assets.....	<u>9,054,833</u>	<u>9,475,960</u>	<u>3,001,080</u>	<u>2,937,710</u>	<u>12,055,913</u>	<u>12,413,670</u>
<b>Liabilities:</b>						
Current and other liabilities.....	317,602	293,019	487,756	426,656	805,358	719,675
Long-term liabilities.....	4,061,122	4,095,351	1,158,967	1,176,719	5,220,089	5,272,070
Total liabilities.....	<u>4,378,724</u>	<u>4,388,370</u>	<u>1,646,723</u>	<u>1,603,375</u>	<u>6,025,447</u>	<u>5,991,745</u>
<b>Net assets:</b>						
Invested in capital assets, net of related debt.....	4,201,672	4,400,552	926,638	891,387	5,128,310	5,291,939
Restricted net assets.....	527,931	654,124	120,510	103,694	648,441	757,818
Unrestricted net assets.....	(53,494)	32,914	307,209	339,254	253,715	372,168
Total net assets..... \$	<u>4,676,109</u>	<u>5,087,590</u>	<u>1,354,357</u>	<u>1,334,335</u>	<u>6,030,466</u>	<u>6,421,925</u>

At June 30, 2010, the City of San José reported positive balances in all three categories of net assets on a total basis.

At \$5.128 billion, investment in capital assets (infrastructure, land, buildings, other improvements, vehicles, and equipment, less outstanding debt used to acquire them) comprise 85.0 percent of the City of San José's total net assets. These capital assets facilitate providing services to the San José community, they are not liquid, and therefore they are not available for future spending.

Of the total net assets, \$253.7 million or 4.2 percent represents unrestricted net assets, which comprises a positive balance of \$307.2 million for business-type activities and a deficit balance of \$53.5 million for governmental activities. However, a deficit balance of unrestricted net assets for governmental activities would not impair the City's near-term ability to carry out its functions. A large portion of the City's net assets, \$648.4 million or 10.8 percent, are subject to legal restrictions on their use.

During 2009-2010, the City of San José's total net assets decreased by \$391.5 million or 6.1 percent. The decrease in City expenses is 0.8% this year, compared to an increase of 4.5% in the prior year, which demonstrates the City's efforts to contain expenses. However, the unprecedented downturn in the economy is evident through continuous declines in revenues over the past three fiscal years.

## Management's Discussion and Analysis (Continued)

---

---

Notable changes in the statement of net assets between June 30, 2010 and June 30, 2009 include:

- Capital assets increased by \$28.5 million or 0.3 percent compared to the prior fiscal year. Governmental capital assets decreased by \$218.8 million, but were offset by an increase in business-type capital assets of \$247.3 million. The decrease in governmental capital assets resulted from asset additions of \$162.0 million less \$354.4 million in depreciation expense for major infrastructure and other assets and \$26.4 million from the sale of eight parcels of land for real estate development by the Redevelopment Agency (Agency). The increase in business-type capital assets was due primarily to the completion of the Norman Y. Mineta San José International Airport (Airport) Terminal B, which replaced the out of date and inadequately sized Terminal C. In addition, a Consolidated Rental Car Facility was put into service which provides Airport passengers improved access to rental car facilities and ground floor access to the Terminal B Concourse. In addition, significant Airport roadway system improvements were completed to reduce traffic conflicts and to provide direct access to each terminal.
- Current and other assets decreased by \$386.2 million or 13.6 percent due to decreases of \$202.3 million for governmental activities and \$183.9 million decreases for business-type activities. The decreases were primarily the result of reduced cash balances as governmental activities' bond proceeds were expended on parks, libraries, and public safety bond projects, and business-type activities bond proceeds were spent on the Airport's construction projects. The overall decreases have been partially offset by an increase in loan receivable balance by \$14.6 million resulting from issuance of low-income housing loans.
- Long-term liabilities decreased by a net amount of \$52.0 million or 1.0 percent. Reductions were the result of decreases in accrued liabilities such as accrued vacation, sick leave and compensatory leave (\$14.5 million) and pollution remediation obligation (\$2.8 million), and the reduction of the principal payments on the debt and loans (\$184.3 million). These decreases were offset by the issuance of the Redevelopment Agency's Housing Set-Aside Tax allocation bonds of \$160.4 million and the proceeds were used to refund its 2005 Series C&D bonds and pay off the \$50.0 million Bank of New York Housing Set-aside Term Loan. These net debt decreases were partially offset by an increase of \$40.4 million for net other postemployment benefits (NOPEBO) obligation and an increase of \$0.7 million for self-insurance obligations due to higher workers' compensation claims.
- Current and other liabilities for the City increased by \$85.7 million or 11.9 percent. This increase was primarily due to \$93.8 million increase in business activities short-term liabilities for commercial paper issued in connection with the Airport capital projects, and an increase of \$5.9 million in governmental activities short-term liabilities for commercial paper issued to support the City's various public improvements. The increase in short-term liabilities was also partially due to an increase of \$26.0 million for pass-through payments due from the Agency to the County of Santa Clara. The remaining increases represent advances, deposits, and reimbursable credits of \$3.6 million mainly due to the refunds owed to property owners as a result of over assessments of Special Districts, and other liabilities of \$3.2 million due to increases in accounts payable to vendors and payments for the operations of the Convention Center. Total increases were offset by a reduction of \$33.6 million in accounts payable and accrued liabilities mainly due to lower capital outlay costs related to the Airport expansion as compared to prior year and a decrease of \$0.8 million in interest payable as a result of lower interest rates. In addition, the City recognized \$13.5 million of previously unrecognized unearned revenue.
- Unrestricted net assets for governmental activities decreased by \$86.4 million or 262.5 percent resulting in a deficit of \$53.5 million in unrestricted net assets at year-end. A significant part of this reduction in unrestricted net assets is the result of continued under funding of the annual required contribution of the City's other postemployment benefits thereby increasing its net post employment benefit obligation (NOPEBO) and reducing net assets by an additional \$36.2 million in 2009-2010. At June 30, 2010, the City's NOPEBO balance is \$155.6 million. In addition, the Agency paid \$62.0 million to the County of Santa Clara for the Supplemental Education Revenue Augmentation Fund (SERAF) obligation as the result of State budgetary actions

## Management's Discussion and Analysis (Continued)

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

\* With the adoption of GASB Statement No. 51, the beginning balance of the net assets of the business-type activities has been restated.

### Statement of Activities For the Years Ended June 30, 2010 and 2009 (in thousands)

	Governmental Activities		Business-type Activities		Totals	
	FY 2010	FY 2009	FY 2010	FY 2009	FY 2010	FY 2009
<b>Revenues:</b>						
Program revenues:						
Fees, fines, and charges for services.....	\$ 291,708	297,788	323,476	327,374	615,184	625,162
Operating grants and contributions.....	110,926	115,965	1,149	9,326	112,075	125,291
Capital grants and contributions.....	49,926	26,306	46,237	18,618	96,163	44,924
General revenues:						
Property taxes.....	498,973	507,273	-	-	498,973	507,273
Utility taxes.....	108,151	93,619	-	-	108,151	93,619
Franchise fees.....	38,410	41,067	-	-	38,410	41,067
Transient occupancy taxes.....	17,250	19,261	-	-	17,250	19,261
Business license tax.....	34,952	38,597	-	-	34,952	38,597
Sales taxes shared revenue.....	123,312	127,802	-	-	123,312	127,802
State of California in-lieu.....	7,169	8,839	-	-	7,169	8,839
Unrestricted interest and investment earnings.....	5,010	34,092	1,192	18,434	6,202	52,526
Other revenue.....	35,786	40,372	-	-	35,786	40,372
Total revenues.....	<u>1,321,573</u>	<u>1,350,981</u>	<u>372,054</u>	<u>373,752</u>	<u>1,693,627</u>	<u>1,724,733</u>
<b>Expenses:</b>						
General government.....	137,159	172,077	-	-	137,159	172,077
Public safety.....	457,892	463,196	-	-	457,892	463,196
Community services.....	260,835	276,396	-	-	260,835	276,396
Sanitation.....	130,343	122,705	-	-	130,343	122,705
Capital maintenance.....	588,382	595,547	-	-	588,382	595,547
Interest and fiscal charges.....	161,734	166,672	-	-	161,734	166,672
Norman Y. Mineta San José International						
Airport.....	-	-	171,976	140,321	171,976	140,321
Wastewater Treatment System.....	-	-	140,831	126,788	140,831	126,788
Municipal Water System.....	-	-	24,355	25,416	24,355	25,416
Parking System.....	-	-	11,579	11,800	11,579	11,800
Total expenses.....	<u>1,736,345</u>	<u>1,796,593</u>	<u>348,741</u>	<u>304,325</u>	<u>2,085,086</u>	<u>2,100,918</u>
Excess (deficiency) before transfers	(414,772)	(445,612)	23,313	69,427	(391,459)	(376,185)
Transfers.....	3,291	5,285	(3,291)	(5,285)	-	-
Change in net assets.....	(411,481)	(440,327)	20,022	64,142	(391,459)	(376,185)
Net assets at beginning of year, as restated *	5,087,590	5,527,917	1,334,335	1,270,193	6,421,925	6,798,110
Net assets at end of year.....	<u>\$ 4,676,109</u>	<u>5,087,590</u>	<u>1,354,357</u>	<u>1,334,335</u>	<u>6,030,466</u>	<u>6,421,925</u>

## Management's Discussion and Analysis (Continued)

---

---

**Governmental activities:** Net assets for governmental activities decreased by \$411.5 million or 8.1 percent during 2009-2010 from \$5.088 billion to \$4.676 billion. Total revenues decreased by 2.2 percent compared to expenses that decreased by 3.4 percent. During 2008-2009, revenues and expenses increased by 5.5 percent and 6.6 percent, respectively.

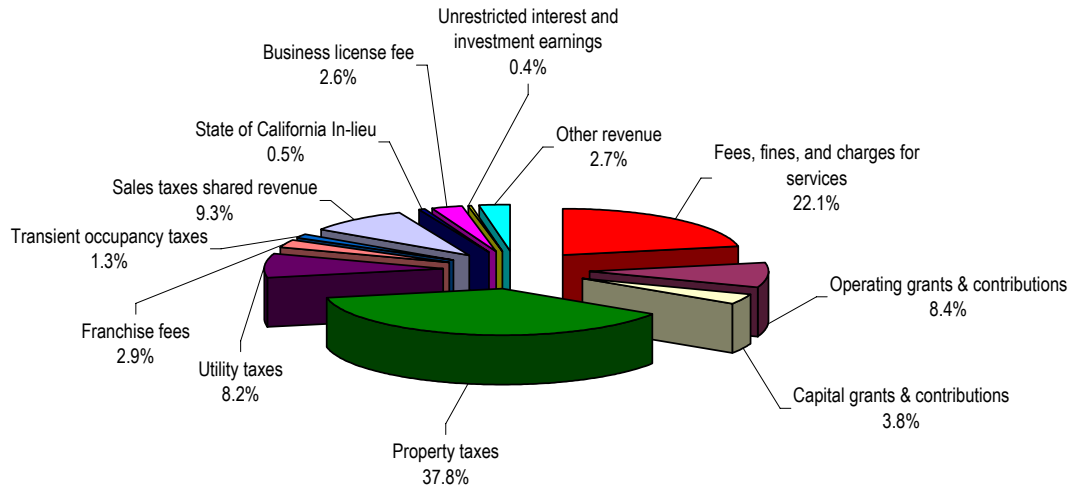
Significant elements of the decrease in net assets for governmental activities from June 30, 2009 to June 30, 2010 are as follows:

- Contributing factors resulting in the net decrease in total revenues are as follows; fees, fines, and charges for services decreased by \$6.1 million or 2.0 percent primarily due to lower developer revenues for in-lieu fees and associated revenue from low-income housing projects as well as reduced interest income on developer loans. Operating grants and contributions decreased by \$5.0 million or 4.3 percent principally due to a reduction in State grants received for street maintenance such as Proposition 1B revenues and Pedestrian Bicycle Facility revenues. Capital Grants and Contributions on the other hand increased by \$23.6 million or 89.8 percent, primarily due to increased donations of infrastructure assets (storm sewer, roadway and traffic systems) from private developers.
- The overall decrease in interest and investment income of \$29.1 million or 85.3 percent was due to lower cash balances combined with lower interest yields. The pre-payment of the City's contribution to its two retirement plans in July 2009 along with continuous declines in revenues during 2009-2010 resulted in significantly lower cash balances. In addition, the City's annualized investment interest yield for the City's investment pool declined from 2.7 percent as of June 30, 2009 to 1.5 percent as of June 30, 2010, reflecting the lower interest rate environment experienced in the capital markets during the year.
- Other revenue declines the City experienced due to persistent sluggish economy included sales tax revenue, which decreased by \$4.5 million or 3.5 percent compared to the previous year. Companies conducting business in the City also showed signs of stress as demonstrated by the closure of a number of business entities due to the economic downturn, which resulted in a decrease of \$3.6 million or 9.4 percent in the City's business license tax revenues. In addition, transient occupancy tax (TOT) receipts from transients staying in our local hotels decreased by \$2.0 million or 10.4 percent. For the fourteen largest hotels in the City, the average room rate decreased from \$130 to \$117. Although, the occupancy rate rose slightly from 53.8% to 55.9% during the year, this increase in occupancy was not sufficient to fully offset the negative impact TOT revenues experienced due to the decline in the hotels average room rate. Other revenue experienced a decrease of \$4.6 million or 11.4 percent primarily due to a reduction of housing development in the City as well as lower receipts from tobacco settlement revenue and lower City community facility revenues.
- Somewhat offsetting these decreases was an increase of \$14.5 million from utility tax primarily due to the first full year collection of the Telephone Line Tax (\$20.5 million) in 2009-2010, compared to the partial year collection in the prior year (\$7.9 million). In November 2008, voters approved the Telephone Line Tax (Measure J) to be effective April 1, 2009.
- General government expenses decreased by \$34.9 million or 20.3 percent between 2008-2009 and 2009-2010 primarily due to reclassifying workers' compensation claims of \$21.8 million for police and fire personnel to the public safety expenditure category. The remaining decreases in general governmental expenses attributable to the General Fund are explained in more detail in the governmental fund section later in this document.
- Public safety expenses experienced a net decrease of \$5.3 million or 1.1 percent. The decreases are primarily attributable to the General Fund and are explained in more detail in the governmental fund section later in this document.

## Management's Discussion and Analysis (Continued)

- Community services expenses decreased by \$15.6 million or 5.6 percent primarily due to lower labor costs which resulted from staff reductions in Planning & Building Development Fee Programs and reduced funding available to administer community services oriented programs.
- Sanitation expenses increased by \$7.6 million or 6.2 percent mainly due to higher garbage disposal contract costs that resulted from the amended agreement to pay for additional regulatory costs associated with disposal of residential and commercial solid waste.
- Depreciation expense for infrastructure and other capital assets was \$354.4 million, an increase of 1.2 percent from prior year.

### Governmental Activities Revenues 2010

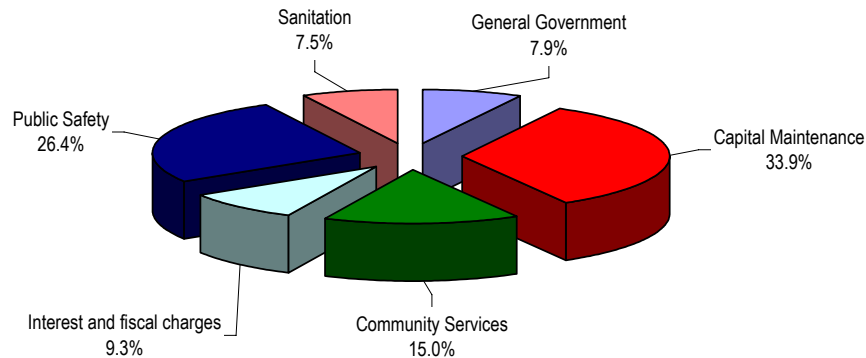


The chart above shows the primary components of governmental activities revenue sources for 2009-2010. Of the \$1.322 billion in total revenues generated by governmental activities, 69.2 percent is attributable to three categories: property taxes (37.8 percent); fees, fines, and charges for services (22.1 percent); and sales taxes (9.3 percent). The overall percentage of revenues to total revenues for these three main categories is consistent with 2008-2009 (69.1 percent). The experience in the other revenue categories had mixed results in 2009-2010; capital grants and contributions increased in relation to total revenues by 1.9 percent, from 1.9 percent in 2008-2009 to 3.8 percent in 2009-2010 and utility taxes increased by 1.3 percent from 6.9 percent in 2008-2009 to 8.2 percent of total revenue in 2009-2010. Unrestricted interest and investment earnings decreased from 2.5 percent of total revenue in 2008-2009 to 0.4 percent of total revenue in 2009-2010 due to carrying lower cash balances and lower investment interest yields due to declining market interest rates.

The chart below shows the principal categories of 2009-2010 expenses for governmental activities. Of the \$1.736 billion in total expenses generated by governmental activities, the categories accounting for 75.3 percent of the total are: capital maintenance (33.9 percent); public safety (26.4 percent); and community services (15.0 percent).

## Management's Discussion and Analysis (Continued)

### Governmental Activities Expenses 2010



**Business-type activities:** Business-type activities net assets increased by \$20.0 million or 1.5 percent to \$1.354 billion during 2009-2010.

The notable components of the increase/decrease in net assets for business-type activities during 2009-2010 are:

- The Norman Y. Mineta San José International Airport (Airport) net assets decreased by \$5.8 million or 1.3 percent. The Airport incurred an operating loss of \$38.3 million in 2009-2010, an increase in loss of \$28.5 million or 292.6 percent compared to the 2008-2009 loss of \$9.8 million. Operating revenues decreased by \$4.7 million or 4.1 percent reflecting the ongoing decline in passenger and flight activities at the Airport. Despite an increase in the Airport landing fee rate, the Airport's operating revenue decreased due to the reduction in the number of flights, a decline in passenger traffic and reduced non-airline revenues such as public parking fee, rental car lots fee and terminal buildings/concessions including food and beverage, news and gift shops and advertising. Total Airport 2009-10 operating expenses of \$149.5 million were \$23.8 million or 18.9 percent higher compared to 2008-2009, highlighted by the increase in depreciation and amortization of \$34.3 million, which were partially offset by a \$5.8 million or 7.6 percent decrease in operations and maintenance costs and \$4.7 million or 16.6 percent decrease in general and administrative costs. The Airport permanently ended airline and concession operations in Terminal C on June 29, 2010 and the final stage of demolition of this facility began in late July 2010 and will be completed in January 2011. As a result, Airport expenses for 2009-2010 include accelerated amortization of capital depreciation costs of \$25.9 million related to writing off the remaining unamortized depreciation for Terminal C capital facility costs. The Airport's 2009-2010 nonoperating expenses exceeded nonoperating revenues by \$2.2 million, which represented a decrease of \$23.1 million or 110.5 percent from 2008-2009. This net decrease was mainly due to a reduction of \$7.8 million in investment income, due to declining market interest rates in 2009-2010.

## Management's Discussion and Analysis (Continued)

---

---

- Wastewater Treatment System net assets increased by \$27.9 million or 4.0 percent from \$702.6 million to \$730.5 million. Operating revenues increased \$6.9 million or 4.5 percent from \$151.4 million in 2008-2009 to \$158.3 million in 2009-2010 primarily due to a 15% sewer rate increase effective July 1, 2009, offset by a \$5.7 million decrease in contributions from the City of Santa Clara and participating agencies to the Treatment Plant's costs, a \$1.4 million decrease in sewer connection fees, and a \$1.2 million decrease in reimbursements from tributary agencies for the joint sewer collection system. Total operating expenses increased by \$14.5 million or 11.8 percent primarily due to a \$6.1 million increase in various project costs to repair the aging Treatment Plant and sewer collection system, a \$2.7 million depreciation expense due to addition of depreciable assets (headwork) in the last month of 2008-2009 and depreciation period started from the beginning of 2009-2010. Net nonoperating revenues decreased by \$12.7 million primarily attributable to an \$8.4 million decrease in investment income. Capital contributions increased by \$6.1 million mainly due to a \$4.4 million increase in capital donations from developers and a \$4.2 million project costs reimbursement from the State Department of Transportation offset by the \$2.5 million decrease in the U.S. Bureau of Reclamation grants for construction of wastewater recycling activities.
- Municipal Water System net assets increased by \$0.2 million or 0.3 percent from \$82.7 million to \$82.9 million. Operating revenues of \$24.7 million decreased by \$1.1 million or 4.1 percent from \$25.8 million mainly due to reduced development activity in the service area, lower consumption of water due to below normal temperatures in summer and conservation efforts made by customers. In addition, operating expenses of \$24.3 million decreased \$1.0 million or 3.9 percent from \$25.3 million primarily due to lower operations and maintenance costs as a result of a reduction in program expenses attributed to economic factors.
- Parking System net assets decreased by \$2.3 million or 2.6 percent from \$90.5 million to \$88.2 million. Operating revenues decreased by \$0.6 million or 5.4 percent due primarily to lower activity at parking facilities as a result of the economic downturn. Operating expenses decreased by \$0.2 million or 1.9 percent reflecting reductions to operations and maintenance costs to offset revenue declines. Net nonoperating revenues decreased by \$0.6 million or 100.5 percent due to decline in investment income.

### 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, 2010, the City's governmental funds reported combined fund balances of \$1.199 billion, a decrease of \$216.6 million or 15.3 percent compared to the balance at June 30, 2009. Unreserved *fund balance* at \$460.7 million constitutes 38.4 percent of the combined balances and is available for spending at the City's discretion. The \$738.5 million remainder of the governmental fund balances is *reserved* to indicate that it is *not* available for new spending because the following portions have been committed to particular purposes:

- \$401.0 million for advances, loans, and other assets that are long-term in nature and thus do not represent currently available resources;
- \$147.7 million for contractual commitments of 2009-2010 carried into fiscal year 2010-2011;
- \$188.1 million for debt service payable in fiscal year 2009-2010; and
- \$1.7 million for restricted cash commitments.

Revenues and other financing sources for governmental functions totaled approximately \$1.896 billion in 2009-2010, a decrease of \$133.5 million or 6.6 percent from 2008-2009 primarily due to lower proceeds from long-term debt and long-term loans, a significant reduction in investment income due to reduced interest rates, lower collections of franchise fees, business license tax, and State revenues.

## Management's Discussion and Analysis (Continued)

---

---

**General Fund:** The General Fund is the chief operating fund of the City of San José. At June 30, 2010, its unreserved fund balance is \$143.6 million or 84.0 percent of the \$170.9 million total General Fund balance. Comparing both unreserved 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, 2010, unreserved fund balance represents 21.0 percent of total General Fund expenditures of \$683.5 million, while total fund balance represents 25.0 percent of total General Fund expenditures. This measure of financial health shows a decline from the prior fiscal year. At June 30, 2009, the same measures were 24.9 percent and 29.4 percent respectively of \$719.4 million in 2008-2009 expenditures and at June 30, 2008, the same measures were 32.7 percent and 39.6 percent respectively of \$699.1 million in 2007-2008 expenditures.

Consistent with prior year's performance, the revenue sources in 2009-10 were not sufficient to cover all expenditures. In order to meet the current expenditures, a combination of one-time revenues, use of reserves, and reduction in City services coupled with an offset of net transfers from the General Fund resulted in a \$40.3 million or 19.1 percent decrease to the General Fund ending fund balance during 2009-2010.

In 2009-2010, General Fund revenues of \$649.3 million were \$13.8 million or 2.1 percent lower than 2008-2009 revenues of \$663.1 million. General Fund revenue declined across all categories with the exception of a \$2.2 million increase in other revenue, which included net proceeds received from various litigation settlements. The Investment income category experienced the largest decrease from \$7.5 million in 2008-2009 to \$1.5 million in 2009-2010, a decrease of \$6 million or 79.9 percent. The decrease was primarily the result of lower interest yields due to the general decline in interest rates in the capital market and lower cash balances as a result of three primary factors; (1) the City's decision to prepay its annual employer contributions to the two retirement plans which resulted in net savings to the City due to a discount in contribution rates by prefunding at the beginning of the fiscal year 2009-2010; (2) the reduction of General Fund reserves as a means to partially offset the City's 2009-2010 General Fund budgetary funding gap; and (3) lower revenues to support operating costs.

Other variances in revenues included taxes and special assessments revenues which decreased by \$4.1 million, primarily due to a decrease in property taxes (\$8.7 million) from lower property assessment valuations, lower general and Proposition 172 sales tax collections (\$4.8 million) as a result of the economic downturn, reduction in franchise fees (\$2.7 million) due to a decrease in electric and gas fees as the result of a substantial drop in gas usage during the 2009 calendar year. The General Fund also experienced decreases in transient occupancy tax collections (\$0.9 million) and motor vehicle in-lieu fees (\$1.7 million) due to the prolonged recession and continuing economic downturn. These decreases were partially offset by an increase in utility taxes (\$14.5 million) due to the first full year collection of the Telephone Line Tax in 2009-2010, compared to the partial year collection in the prior year. Licenses and permits (\$2.3 million) declined primarily due to lower collections of building permits (\$1.2 million) and due to the economic slowdown and the elimination of the City's business tax administration fee (\$1.0 million). In addition, intergovernmental revenue decreased by \$3.5 million due to a reduction in the Federal interoperable grant (\$2.6 million) which ended in 2009 and the Federal Super Urban Area Security grant (\$1.2 million) being offset by slight increases in other grants and reimbursement revenue (\$0.3 million).

General Fund 2009-2010 expenditures of \$683.5 million were \$36.0 million or 5.0 percent lower than 2008-2009 expenditures of \$719.4 million. The decrease in total expenditures was primarily attributable to overall lower labor expenditures experienced in the following areas: staff reductions associated with planning and building activities and parks operations and recreation services, and rebalancing the development fee programs expenditures due to a significant decline of private development activity and decreases in street maintenance services. The decrease in general government expenditures of \$21.8 million resulted from reclassifying workers' compensation claims for police and fire personnel to the public safety expenditure category. Capital maintenance expenditures decreased by \$7.3 million primarily due to decreases in street maintenance repair (\$5.6 million) and decrease in development fee expenditures by \$1.7 million. Infrastructure and fixed asset capital outlay expenditures decreased by \$1.3 million due to deferrals of capital projects as a result of budgetary constraints. Offsetting these decreases was a \$8.0 million increase in public safety expenditures due to the recognition of expenditures for workers' compensation claims for Police (\$5.7 million) and a settlement (\$3.5 million) of two federal Fair Labor

## Management's Discussion and Analysis (Continued)

---

---

Standards Act ("FLSA") lawsuits brought by San José Fire Department employees and offset by the decrease in the Super Urban Area Security grant expenditures (\$1.2 million).

**Redevelopment fund:** The Redevelopment Agency (Agency) fund accounts for the activities of the Redevelopment Agency of the City of San José responsible for redeveloping and upgrading blighted areas. Fund balance for the Agency's governmental funds decreased \$114.3 million or 53.4 percent to \$99.5 million at June 30, 2010. A deficiency of revenues under expenditures of \$182.5 million was offset by other financing sources (net) of \$68.2 million, including housing set-aside tax allocation bond proceeds of \$160.4 million.

The following are some of the highlights for the Agency:

- Revenues decreased by \$2.2 million or 1.1 percent from \$212.8 million in the prior fiscal year to \$210.5 million. This decrease is due mainly to reduced investment income (\$3.2 million) due to lower cash balances and lower market yield on investments which is offset by slight increases in Taxes and Special Assessments, Intergovernmental (\$0.4 million) and Other Revenues (\$0.6 million).
- Expenditures increased \$99.0 million, or 33.7 percent from the prior fiscal year mainly due to increased debt service payments (\$65.3 million) primarily due to larger debt scheduled payments made for Housing Set-aside Tax Allocation Bonds and higher interest costs compared to prior fiscal year. Capital Maintenance costs (\$32.4 million) rose mainly due to the SERAF payment to the County of Santa Clara which was partially offset by a reduction to capital project activity due to deferral and elimination of several capital maintenance projects.
- Other financing sources (uses) decreased by \$19.7 million over other financing sources (uses) of \$88.0 million in 2008-2009. Comparing with prior fiscal year, net proceeds from bond issuance increased by (\$43.1 million), proceeds from the sale of capital assets increased by (\$25.3 million) and net increases of \$11.9 million in transfers in(out). This year's transfers-in includes \$62.7 million the Agency received from the City for a SERAF loan. These increases were offset primarily with the Agency's payment of \$56.7 million to bond escrow agent to refund the Housing Set-aside Tax Allocation Bonds Series 2005 C&D bonds.

Additional information about the Agency's finances appears in their separately issued financial statements.

**Housing fund:** The Housing Activities fund accounts for the City of San José's commitment to providing low and moderate income residents with a diverse range of safe and affordable housing opportunities. Objectives include preserving the existing affordable housing stock, increasing the supply of affordable housing, and providing services to homeless and at-risk populations. Twenty percent (20%) of the Redevelopment Agency's gross property tax increment and tax allocation bonds secured by the 20% gross tax increment revenues provide the housing fund's primary resources. As required by California State law, the 20% gross tax increment revenue is used solely for affordable housing. In addition, 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. The fund's loans receivable balance (net) which represents loans to developers of various affordable housing projects and First Time Home Buyers increased during the year by \$19.4 million or 6.7 percent to \$310.3 million as of June 30, 2010 due to an increase in loans to developers for various projects, including the Belovida, Markham Terrace, North Fourth Street, Cornerstone, and Brookwood housing projects. These additions to the loan receivable balance were offset by an increase in the valuation allowance in the Housing Activities Fund based on the City's annual review of the valuations and adjustments reflecting the terms of the loans. The Housing Activities fund also received an advance in the amount of \$12.9 million from the City of San José Financing Authority (derived from the Authority's issuance of its lease revenue commercial paper notes) to fund low and moderate income housing activities and programs.

## Management's Discussion and Analysis (Continued)

---

---

Total expenditures decreased by \$16.6 million to \$41.0 million from \$57.6 million in the prior fiscal year, which is primarily due to downward adjustment of the loan loss reserve based on reduction in the aggregate value of Housing loan portfolio.

**Special Assessment Districts fund:** The Special Assessment Districts fund accounts for debt issuance and capital improvements related to the specific purposes of seven special assessment and community facilities districts located in different parts of the City. A total of \$61.0 million in special assessment and special tax debt outstanding at June 30, 2010 is secured by special assessments or special taxes charged to the owners' real property in the district issuing the debt. The City of San José is not obligated to cure any deficiency or redeem any debt of special assessment districts. There was no new special assessment debt issued during 2009-2010.

There was no significant change noted in total expenditures for 2009-2010 compared to the prior fiscal year and the expenditures remained at \$12.7 million for both fiscal years.

**Financing Authority fund:** The City of San José Financing Authority Debt Service fund accounts for the issuance of commercial paper notes secured by lease revenues as a mechanism for financing City of San José public improvements such as, Phase II improvements of the City's Central Service Yard, non-construction costs for technology, furniture, equipment at City Hall, capital improvements at the City's HP Pavilion, procuring the consolidated utility billing system, and the loan to the Housing Activities Fund to fund low and moderate income housing activities and programs. The amount of commercial paper notes outstanding increased from \$47.6 million on June 30, 2009 to \$53.5 million on June 30, 2010, a net increase of \$5.9 million which represented payment of principal payments and the issuance of commercial paper notes to fund the loan to the Housing Activities Fund as described above.

Other financing sources and uses decreased by a net \$45.3 million or 53.6 percent to \$39.2 million. This net difference is the result of no new long-term debt financing sources and uses transactions during 2009-2010 as compared to a net \$40.0 million of new long-term debt financing sources and uses in 2008-2009. In addition, there was a \$7.6 million decrease in transfers-in partially offset by a \$2.4 million decrease in transfers-out.

### **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, 2010, the unrestricted net assets were \$76.8 million for the Norman Y. Mineta San José International Airport, \$199.0 million for the Wastewater Treatment System, \$11.3 million for the Municipal Water System and \$20.2 million for the Parking System. Net assets for proprietary funds grew from \$1.334 billion at June 30, 2009 to \$1.354 billion at June 30, 2010 and resulted in an increase of \$20.0 million or 1.5 percent.

In an updated report released September 14, 2009, Fitch Ratings downgraded the rating on \$1.035 billion of the City of San José's Airport Revenue Bonds from 'A+' to 'A-' (two rating notches). The rating outlook on the bonds remains negative. On July 16, 2009, Moody's Investors Service reaffirmed the A2 rating on the Airport Revenue Bonds, but revised the outlook from stable to negative. Standard and Poor's has not taken any action with respect its rating of 'A' which was assigned on July 16, 2007.

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

## Management's Discussion and Analysis (Continued)

---

---

### GENERAL FUND BUDGETARY HIGHLIGHTS

The City of San José Charter requires the City Manager to submit 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 2010-2011 budgets in June 2010.

During the fiscal year ended June 30, 2010, there was a \$14.1 million decrease in budgeted revenues between the original and final amended operating budget for the General Fund. The decrease reflected lower actual receipts in sales tax, franchise fees, licenses, permits and fines, charges for current services, and investment revenues, partially offset by improved actual receipts in property tax revenue, utility tax revenue and the other revenues category (primarily litigation settlements). In addition, there was a \$1.2 million increase in appropriations between the original and final amended operating budget for the General Fund primarily from grant funding received during the course of the fiscal year.

Actual budgetary basis expenditures of \$704.3 million were \$62.9 million less than the amended budget and \$61.7 million less than the original budget. Savings were experienced over all expenditure categories.

### CAPITAL ASSETS AND DEBT ADMINISTRATION

#### Capital Assets

The City of San José's investment in capital assets, net of accumulated depreciation, for its governmental and business-type activities together amounted to \$9.607 billion at June 30, 2010. This investment includes land, infrastructure, structures and improvements, vehicles, equipment, intangible assets, and construction-in-progress. The City of San José's decision to depreciate infrastructure capital assets results in recording a large non-cash depreciation expense each year that offsets additions to capital assets. The result of the new additions less depreciation expense during 2009-2010 yielded a \$218.8 million decrease in governmental activities net capital assets offset by a \$247.3 million increase in business-type activities net capital assets resulting in an overall increase of \$28.5 million or 0.3 percent in net capital asset balances between June 30, 2009 and June 30, 2010. In addition, certain intangible assets have been determined to have indefinite useful lives. Therefore, as of July 1, 2009 the beginning balances of the capital assets of business-type activities have been restated and reclassified as of July 1, 2009 due to the adoption of GASB Statement No. 51.

Total construction-in-progress decreased by \$648.7 million or 57.9 percent from \$1.121 billion at June 30, 2009 to \$472.1 million at June 30, 2010. The construction-in-progress for the governmental activities increased by \$9.0 million mainly due to continued work on Parks, Libraries, and Public Safety projects. Business-type activities contributed a decrease of \$657.7 million to the total construction-in-progress primarily due to the completion of Airport projects that totaled \$927.1 million. The completed Airport projects include the following: the renovation and expansion of Terminal A which resulted in adequate number of aircraft gates, improved check-in positioning/queuing area and security checkpoints; the construction and completion of Terminal B replaced the outdated and inadequately sized Terminal C with the 380,000- square feet, three level concourse building which opened in June 2010; the Consolidation Rental Car Garage which provided an improved access to rental car facilities and reduced traffic on airport roadways; and the redesigned roadway system which improved the ground transportation system by enhancing the motorist way-finding by straightening the roadway alignment and displaying better road signage. The cancellation of Airport projects associated with Terminal C totaled approximately \$37.1 million. The reduction in the Airport construction-in-progress was mainly offset by the ongoing construction of capital projects of approximately \$301.2 million related to the Terminal Area Improvement Program, the public parking improvement project, the remainder of the rental car facility and the North Concourse building projects. Net increase to construction-in-progress for Wastewater Treatment Systems was \$5.3 million.

The City of San José 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

## Management's Discussion and Analysis (Continued)

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, 2009 and June 30, 2010 (in thousands):

	Governmental activities		Business-type activities		Total	
	2010	2009	2010	2009, as restated	2010	2009, as restated
Land	\$ 541,457	561,258	134,926	134,926	676,383	696,184
Intangible assets	-	-	12,882	12,882	12,882	12,882
Construction in progress	261,698	252,661	210,415	868,141	472,113	1,120,802
Buildings	1,049,521	989,452	1,294,630	371,470	2,344,151	1,360,922
Improvements, other than buildings	123,108	120,828	477,962	491,973	601,070	612,801
Infrastructure	5,401,177	5,667,443	-	-	5,401,177	5,667,443
Furniture and fixtures, vehicles, equipment	34,909	38,864	60,965	64,633	95,874	103,497
Property under capital leases	881	1,074	2,344	2,799	3,225	3,873
<b>Total capital assets</b>	<b>\$ 7,412,751</b>	<b>7,631,580</b>	<b>2,194,124</b>	<b>1,946,824</b>	<b>9,606,875</b>	<b>9,578,404</b>

Additional information about the City's capital assets can be found in Note III.D to the financial statements.

### General Fund Bonded Debt Limit

The City of San José Charter limits bonded indebtedness for General Obligation bonds to 15 percent of the total assessed valuation of all real and personal property within the City. The total assessed value on the City's 2009-2010 tax roll was \$127.103 billion, which results in a net total debt capacity of \$19.065 billion. As of June 30, 2010, the City had \$500.0 million of General Obligation bonds outstanding.

### General Obligation Bond Rating

During May 2010, the City received confirmation of its general obligation bond ratings from the three major rating agencies: Aaa from Moody's Investors Service; AAA from Standard & Poor's; and AAA from Fitch Ratings. San José remains the highest rated large city (with populations over 250,000) within the State of California.

### Outstanding Debt

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

At June 30, 2010, the City had \$3.674 billion of gross outstanding long-term debt related to governmental activities and \$1.131 billion related to business-type activities, for a total of \$4.805 billion. These amounts for the fiscal year ended June 30, 2009 were \$3.728 billion for governmental activities and \$1.151 billion for business-type activities, for a total of \$4.879 billion.

## Management's Discussion and Analysis (Continued)

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

	As of June 30, 2010	As of June 30, 2009	Net Change
<b>Governmental Activities:</b>			
General obligation bonds	\$ 499,970	519,320	(19,350)
HUD Section 108 loan	22,915	23,923	(1,008)
Lease revenue and revenue bonds	644,983	655,137	(10,154)
Special assessments	60,905	64,886	(3,981)
Redevelopment Agency	2,445,460	2,464,690	(19,230)
Sub-total	<u>3,674,233</u>	<u>3,727,956</u>	<u>(53,723)</u>
<b>Business-Type Activities:</b>			
Revenue bonds	1,096,035	1,112,320	(16,285)
State of CA-Revolving Fund Loan	34,487	38,254	(3,767)
Sub-total	<u>1,130,522</u>	<u>1,150,574</u>	<u>(20,052)</u>
<b>Total:</b>	<u>\$ 4,804,755</u>	<u>4,878,530</u>	<u>(73,775)</u>

Additional information about the City's long-term obligations appears in Note III.F. of the notes to the financial statements.

### ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

- The fiscal challenges faced in 2009-2010 are expected to continue in 2010-2011 and beyond until the local economy improves, primarily through healthy job growth. A set of 2010-2011 budget balancing strategies were developed through a comprehensive community outreach process and City Council Study Sessions including Council Priority Setting Study Session. In June 2010, the City Council approved a balanced General Fund budget for fiscal year 2010-2011, closing a funding gap of approximately \$118.5 million through a combination of service reductions and eliminations, reductions in employee total compensation, revenue increases, service delivery changes, use of reserves, and funding shifts.
- As part of the adoption of 2010-2011 budget, the adopted budget resulted in a new reduction of 783 positions from the 2009-2010 adopted budget. A total of 185 full-time employees either involuntarily separated from City services (170) or retired in lieu of termination (15) and an additional 21 part-time employees were laid off. The total number of City positions has decreased to 1994-1995 levels when San José population was 825,000.
- To preserve City services and prevent additional layoffs, six of the City's nine non public safety employee groups, along with unrepresented employees, the Mayor and the City Council agreed to a 10.0% reduction in total compensation (wages and benefits) with 5% considered to be ongoing. For those agreements subject to negotiation, as each of these agreements expire, the ongoing concessions will be subject to negotiation in future agreements. Police officers also agreed to a reduction of 3.82% in total compensation of which 0.67% was ongoing to prevent police layoffs of approximately 70 police positions in 2010-2011.
- As of June 30, 2009, the most recent actuarial valuation date, the Police and Fire Department Retirement Plan (PFDRP) was 86.7% funded for pension benefits. The actuarial accrued liability for pension benefits was \$2.963 billion, and the actuarial value of assets was \$2.570 billion resulting in an unfunded actuarial accrued liability (UAAL) of \$393.9 million. As of June 30, 2009, the most recent actuarial valuation date, the Federated City Employee's Retirement System (FCERS) was 70.7% funded for pension benefits. The actuarial accrued liability for benefits was \$2.486 billion and the actuarial value of assets was \$1.757 billion, resulting in an unfunded actuarial accrued liability (UAAL) of \$729.6 million.

## Management's Discussion and Analysis (Continued)

---

---

- As noted in the Trust and Agency Funds section of this document, the PFDRP's net assets experienced an increase of \$270.6 million in 2009-2010 following a \$516.0 million decline in net assets in the prior year primarily as a result of the appreciation of the fair value of investments caused by the partial recovery of the equity investment market. The FCERS' net assets experienced an increase of \$178.6 million in 2009-2010 following a \$334.1 million decline in net assets in the prior year primarily as a result of the appreciation of the fair value of investments caused by the partial recovery in the investment market.
- The Boards of Administration for PFDRP and FCERS have each decided to transition from biennial to annual valuations beginning June 30, 2010. The contribution rates effective June 27, 2010, for fiscal year 2010-2011, were based on the June 30, 2009 actuarial valuations for PFDRP and FCERS. It is anticipated that the annual required contribution rates calculated in the June 30, 2010, valuation reports for both the PFDRP and FCERS will become effective in 2011-2012 after the respective Boards' approval of the actuarial valuation reports.
- For 2010-2011, the City's contribution rates for both pension benefits and health and dental benefits, as a percentage of payroll, are as follows: for the Police members and Fire members of the PFDRP, 44.58% and 44.16%, respectively, and 29.59% for members of FCERS. These rates represent a significant increase in the City's contribution rates compared to the rates in effect in 2009-2010.
- On June 24, 2008, the City Council adopted ordinance No. 28332 amending Chapter 3.36 and 3.28 of Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for pension benefits and postemployment healthcare benefits to PFDRP and FCERS. The lump sum prepayment for 2010-2011 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 \$86.0 million and \$67.0 million to be paid by the City on July, 2, 2010, respectively.
- Contributions to the Postemployment Healthcare Plans are made by both the City and the participating members. Contributions to PFDRP for fiscal year ended June 30, 2010 for Fire members of PFDRP were based on the Board's 10-year cash flow funding policy. Effective June 28, 2009, the Police members of PFDRP and the bargaining units representing the FCERS's members entered into Memorandums of Agreement (MOAs) with the City to increase the contribution rates for retiree health and dental in order to phase-in to full funding of the GASB Statement No. 45 annual required contribution over the next 5 years; fiscal year 2009-2010 was the first year of the phase-in. The MOA between the City and Police members of the PFDRP further provided that PFDRP member contribution rate shall not have an incremental increase of more than 1.25% and 1.35% of pensionable pay in each year for the Police members and City, respectively. Additionally, the MOA with PFDRP members provided that if the retiree healthcare contributions exceed 10% of Police member and 11% of City contributions, respectively, (excluding the implicit rate subsidy) the parties shall meet and confer on how to address the contributions above 10% and 11%. The MOA between the City and the bargaining units representing the members of FCERS provided that the five year phase-in of the ARC will not have an incremental increase of more than 0.75% of pensionable pay in each fiscal year for the FCERS members or the City. Notwithstanding these limitations on incremental increases, the agreements with members of FCERS further provide that by the end of the five year phase-in the City and the members "shall be contributing the full Annual Required Contribution in the ratio currently provided" in the relevant sections of the San José Municipal Code. The contributions are not currently sufficient to provide adequate assets to pay benefits when due in accordance with the requirements of GASB Statement No. 45. The contribution rates for the Postemployment Healthcare Plans for the City and the participating employees for fiscal year 2010 were based on actuarial valuations dated June 30, 2007, except for the period June 27, 2010 through June 30, 2010, which were based on the June 30, 2009 valuation.

## Management's Discussion and Analysis (Concluded)

---

---

- As of June 30, 2009, the most recent actuarial valuation date, the Police and Fire Department Retirement Plan (PFDRP) was 7.3% funded for other postemployment benefits. The actuarial accrued liability for benefits was \$761.6 million, and the actuarial value of assets was \$55.6 million resulting in an unfunded actuarial accrued liability (UAAL) of \$706.0 million. As of June 30, 2009, the most recent actuarial valuation date, the Federated City Employee's Retirement System (FCERS) was 10.7% funded for other postemployment benefits. The actuarial accrued liability for benefits was \$796.4 million and the actuarial value of assets was \$85.6 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$710.9 million.
- The City Council placed three ballot measures on the November 2010 ballot which were approved by the voters. Measure U allows the City of San José to adopt an ordinance to add a new chapter 4.66 to Title 4 of the San José Municipal Code to impose a tax on marijuana businesses in the City up to a rate of 10% of gross receipts. Measure V amends the City Charter's arbitration procedure for public safety bargaining groups requires the Arbitration Board to prioritize factors such as the City's ability to pay for compensation without reducing other services and prescribes other changes in the arbitration process. Measure W amends the City's Charter to allow the City Council by an ordinance to exclude officers and employees hired after the ordinance's effective date from existing retirement plans and to create new retirement plans that would not be required to meet the minimum benefits established in the City Charter. In addition, the Charter currently only requires that the Police and Fire Department Retirement Plan be actuarially sound. Measure W would require that any new or different retirement plan established by the City Council also be actuarially sound.
- In June 2010, San José resident voters approved Measure K which increased the Cardroom Tax rate on gross revenues from 13% to 15%, allowed each cardroom to seek City approval to increase the number of tables from 40 to 49, removed the limit on the number of permissible card games to allow any card game permissible under State law consistent with City regulations, and increased the betting limit from \$200 to that allowed under State law.
- A 6.0% rate increase to the Sewer Service and Use Charge was approved, increasing the average residential payment by \$1.86 per month, from \$31.00 to \$32.86 effective as of July 2010. This increase will support the continued rehabilitation and replacement of infrastructure at the Wastewater treatment Plant and in the sanitary sewer collection systems. Municipal Water rate increase of 3.75% was also approved effective as of July 2010.
- San José's average unemployment rate for calendar year 2009 increased from 6.7 percent to 12.2 percent over the prior year, but the City's rate was slightly lower than the average unemployment rate for the State. The City's average unemployment rate for calendar year 2009 was 12.2 percent, which is lower than the statewide average of 12.3 percent.

All of these factors were considered in preparing the City's budget for 2010-2011.

### REQUEST FOR INFORMATION

This financial report is designed to provide our residents, taxpayers, customers, investors, and creditors with a general overview of the City's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Director of Finance, 200 E. Santa Clara Street, San José, CA 95113.

---

Basic Financial Statements

**City of San José**  
**Statement of Net Assets**  
**June 30, 2010**  
**(\$000's)**

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total</u>
<b>ASSETS</b>			
Equity in pooled cash and investments	\$ 628,384	321,742	950,126
Other cash and investments	7	-	7
Receivables (net of allowances for uncollectibles)	157,916	18,436	176,352
Due from outside agencies	3,311	128	3,439
Internal balances	(13,805)	13,805	-
Inventories	739	1,087	1,826
Loans receivable (net of allowances for uncollectibles)	350,917	250	351,167
Advances and deposits	722	6,871	7,593
Other assets	21,970	160	22,130
Restricted assets:			
Equity in pooled cash and investments	66,789	102,718	169,507
Cash and investments held with fiscal agent	325,056	324,002	649,058
Other cash and investments	49,981	-	49,981
Receivables (net of allowances for uncollectibles)	-	4,822	4,822
Deferred bond issuance costs (net of accumulated amortization)	50,095	12,935	63,030
Capital assets (net of accumulated depreciation):			
Nondepreciable	803,155	358,223	1,161,378
Depreciable	6,609,596	1,835,901	8,445,497
Total assets	<u>9,054,833</u>	<u>3,001,080</u>	<u>12,055,913</u>
<b>LIABILITIES</b>			
Accounts payable	61,382	38,766	100,148
Accrued liabilities	42,319	4,673	46,992
Interest payable	54,313	18,517	72,830
Due to outside agencies	51,735	-	51,735
Short-term notes payable	53,530	417,348	470,878
Unearned revenue	18,245	3,365	21,610
Advances, deposits, and reimbursable credits	21,836	5,087	26,923
Other liabilities	14,242	-	14,242
Noncurrent obligations:			
Due within one year	172,104	28,735	200,839
Due in more than one year	3,889,018	1,130,232	5,019,250
Total liabilities	<u>4,378,724</u>	<u>1,646,723</u>	<u>6,025,447</u>
<b>NET ASSETS</b>			
Invested in capital assets, net of related debt	4,201,672	926,638	5,128,310
Restricted for:			
Debt service	113,833	15,046	128,879
Capital projects	217,590	105,464	323,054
Community services	192,702	-	192,702
Public safety	3,806	-	3,806
Unrestricted	(53,494)	307,209	253,715
Total net assets	<u>\$ 4,676,109</u>	<u>1,354,357</u>	<u>6,030,466</u>

The notes to the financial statements are an integral part of this statement.

**City of San José**  
**Statement of Activities**  
**For the Year Ended June 30, 2010**  
**(\$000's)**

Functions/Programs	Program Revenues				Net (Expense) Revenue and Changes in Net Assets		Total
	Expenses	Fees, Fines, and Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business -Type Activities	
Governmental activities:							
General government	\$ 137,159	29,986	20	-	(107,153)	-	(107,153)
Public safety	457,892	20,343	8,005	-	(429,544)	-	(429,544)
Community services	260,835	75,208	56,548	-	(129,079)	-	(129,079)
Sanitation	130,343	135,099	95	-	4,851	-	4,851
Capital maintenance	588,382	31,072	46,258	49,926	(461,126)	-	(461,126)
Interest and fiscal charges	161,734	-	-	-	(161,734)	-	(161,734)
<b>Total governmental activities</b>	<b>1,736,345</b>	<b>291,708</b>	<b>110,926</b>	<b>49,926</b>	<b>(1,283,785)</b>	<b>-</b>	<b>(1,283,785)</b>
Business -Type activities:							
Norman Y. Mineta San José							
International Airport	171,976	130,030	1,149	34,722	-	(6,075)	(6,075)
Wastewater Treatment System	140,831	158,256	-	11,381	-	28,806	28,806
Municipal Water System	24,355	24,732	-	134	-	511	511
Parking System	11,579	10,458	-	-	-	(1,121)	(1,121)
<b>Total business-type activities</b>	<b>348,741</b>	<b>323,476</b>	<b>1,149</b>	<b>46,237</b>	<b>-</b>	<b>22,121</b>	<b>22,121</b>
<b>Total</b>	<b>\$ 2,085,086</b>	<b>615,184</b>	<b>112,075</b>	<b>96,163</b>	<b>(1,283,785)</b>	<b>22,121</b>	<b>(1,261,664)</b>
General revenues:							
Taxes:							
Property and other taxes					498,973	-	498,973
Utility					108,151	-	108,151
Franchise					38,410	-	38,410
Transient occupancy					17,250	-	17,250
Business license					34,952	-	34,952
Sales taxes shared revenue					123,312	-	123,312
State of California in-lieu					7,169	-	7,169
Unrestricted interest and investment earnings					5,010	1,192	6,202
Other revenue					35,786	-	35,786
Transfers					3,291	(3,291)	-
<b>Total general revenues and transfers</b>					<b>872,304</b>	<b>(2,099)</b>	<b>870,205</b>
<b>Change in net assets</b>					<b>(411,481)</b>	<b>20,022</b>	<b>(391,459)</b>
<b>Net assets - beginning, as restated</b>					<b>5,087,590</b>	<b>1,334,335</b>	<b>6,421,925</b>
<b>Net assets - ending</b>					<b>\$ 4,676,109</b>	<b>1,354,357</b>	<b>6,030,466</b>

The notes to the financial statements are an integral part of this statement.

**City of San José**  
**Balance Sheet**  
**Governmental Funds**  
**June 30, 2010**  
**(\$000's)**

	<u>General Fund</u>	<u>Redevelopment Agency</u>	<u>Housing Activities</u>
<b>ASSETS</b>			
Equity in pooled cash and investments held in City Treasury	\$ 173,830	55,671	56,180
Other cash and investments	-	-	-
Receivables (net of allowance for uncollectibles)	47,409	1,931	4,066
Due from outside agencies	3,168	-	51
Due from other funds	3,026	22	10,001
Inventories	-	-	-
Loans receivables (net of allowance for uncollectibles)	2,392	32,836	310,306
Advances and deposits	285	267	-
Restricted assets:			
Equity in pooled cash and investments held in City Treasury	758	-	6,575
Cash and investments held with fiscal agent	-	143,820	-
Other cash and investments	11	48,211	-
Advances to other funds	3,957	1,080	52,721
Other assets	-	-	21,118
Total assets	<u>\$ 234,836</u>	<u>283,838</u>	<u>461,018</u>
<b>LIABILITIES AND FUND BALANCES</b>			
Liabilities:			
Accounts payable	\$ 9,923	7,448	1,971
Accrued salaries, wages, and payroll taxes	35,983	364	514
Due to other funds	1	11,361	91
Due to other agencies	876	50,859	-
Short-term notes payable	-	-	-
Deferred revenue	4,432	32,608	34,480
Advances, deposits, and reimbursable credits	7	1,699	-
Advances from other funds	500	79,960	13,471
Other liabilities	12,227	-	-
Total liabilities	<u>63,949</u>	<u>184,299</u>	<u>50,527</u>
Fund balances:			
Reserved for:			
Encumbrances	20,635	18,169	45,300
Noncurrent advances, loans and other assets	6,634	4,930	356,358
Debt service	-	133,869	-
Restricted cash commitments	-	-	-
Unreserved reported in:			
General fund	143,618	-	-
Special revenue funds	-	-	8,833
Debt service funds	-	-	-
Capital projects funds	-	(57,429)	-
Total fund balances	<u>170,887</u>	<u>99,539</u>	<u>410,491</u>
Total liabilities and fund balances	<u>\$ 234,836</u>	<u>283,838</u>	<u>461,018</u>

The notes to the financial statements are an integral part of this statement.

<b>Special Assessment Districts</b>	<b>San José Financing Authority Debt Service</b>	<b>Nonmajor Governmental Funds</b>	<b>Total Governmental Funds</b>
-	-	342,703	628,384
-	-	7	7
60,975	-	43,535	157,916
-	-	92	3,311
-	70	19,942	33,061
-	-	739	739
-	-	5,383	350,917
5	-	165	722
20,872	23	38,561	66,789
10,723	55,845	114,668	325,056
-	-	1,759	49,981
-	12,891	13,119	83,768
-	-	852	21,970
<u>92,575</u>	<u>68,829</u>	<u>581,525</u>	<u>1,722,621</u>
-	454	41,586	61,382
1	-	5,457	42,319
-	-	21,672	33,125
-	-	-	51,735
-	53,530	-	53,530
60,905	-	15,358	147,783
8,643	-	11,487	21,836
-	3,327	251	97,509
-	-	2,015	14,242
<u>69,549</u>	<u>57,311</u>	<u>97,826</u>	<u>523,461</u>
111	-	63,462	147,677
5	12,891	20,152	400,970
18,016	-	36,209	188,094
-	-	1,759	1,759
-	-	-	143,618
-	-	271,198	280,031
-	(1,373)	-	(1,373)
4,894	-	90,919	38,384
<u>23,026</u>	<u>11,518</u>	<u>483,699</u>	<u>1,199,160</u>
<u>92,575</u>	<u>68,829</u>	<u>581,525</u>	<u>1,722,621</u>

**City of San José**  
**Reconciliation of the Governmental Funds Balance Sheet**  
**to the Statement of Net Assets**  
**June 30, 2010**  
**(\$000's)**

**Total fund balances-governmental funds** (Page 24) \$ 1,199,160

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. These assets consist of:

Land	541,457	
Construction in progress	261,698	
Infrastructure assets	11,340,293	
Other capital assets	1,664,624	
Accumulated depreciation	(6,395,321)	
Total capital assets	7,412,751	7,412,751

Long-term receivables are not available to pay for current period expenditures and, therefore, are deferred on the modified accrual basis. 68,633

Bond issuance costs are expended in governmental funds when paid, however, are capitalized and amortized over the life of the corresponding bonds for purposes of the statement of net assets.  
 Deferred charges, net of amortization 50,095

Special Assessments are reported as revenue when levied in government-wide financial statements. In governmental funds, these assessments are reported as deferred revenue (a liability) since they are not available. 60,905

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. (54,313)

Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:

Bonds and notes payable	(3,678,406)	
Accreted interest on capital appreciation bonds	(1,431)	
Accrued vacation, sick leave and compensatory time	(83,120)	
Estimated liability for self insurance	(131,785)	
Net other postemployment obligation	(155,570)	
Other	(10,810)	
Total long-term liabilities	(4,061,122)	(4,061,122)

**Net assets of governmental activities** (Page 22) \$ 4,676,109

The notes to the financial statements are an integral part of this statement.

This page intentionally left blank

**City of San José**  
**Statement of Revenues, Expenditures**  
**and Changes in Fund Balances**  
**Governmental Funds**  
**For the Year Ended June 30, 2010**  
**(\$000's)**

	<b>General Fund</b>	<b>Redevelopment Agency</b>	<b>Housing Activities</b>
<b>REVENUES</b>			
Taxes and special assessments	\$ 490,054	202,409	-
Licenses, permits, and fines	81,983	-	-
Intergovernmental	12,823	475	14,635
Charges for current services	28,055	-	-
Rent	-	1,176	-
Investment income	1,514	1,899	10,405
Other revenue	34,853	4,559	3,314
Total revenues	<u>649,282</u>	<u>210,518</u>	<u>28,354</u>
<b>EXPENDITURES</b>			
Current:			
General government	76,718	15,608	-
Public safety	427,021	-	-
Community services	126,815	-	40,937
Sanitation	1,672	-	-
Capital maintenance	46,161	122,718	29
Capital outlay	3,940	27,714	-
Debt service:			
Principal	1,008	116,115	-
Interest and fiscal charges	146	109,835	-
Bond issuance costs	-	1,068	-
Total expenditures	<u>683,481</u>	<u>393,058</u>	<u>40,966</u>
Deficiency of revenues under expenditures	<u>(34,199)</u>	<u>(182,540)</u>	<u>(12,612)</u>
<b>OTHER FINANCING SOURCES (USES)</b>			
Bonds issued	-	160,405	-
Premiums on bonds	-	22	-
Payment to refunded bond escrow agent	-	(56,735)	-
Proceeds from sale of capital assets	-	33,647	-
Transfers in	22,662	70,654	133,008
Transfers out	<u>(28,769)</u>	<u>(139,744)</u>	<u>(71,161)</u>
Total other financing sources (uses)	<u>(6,107)</u>	<u>68,249</u>	<u>61,847</u>
Net change in fund balances	(40,306)	(114,291)	49,235
Fund balances - beginning	<u>211,193</u>	<u>213,830</u>	<u>361,256</u>
Fund balances - ending	<u>\$ 170,887</u>	<u>99,539</u>	<u>410,491</u>

The notes to the financial statements are an integral part of this statement.

<b>Special Assessment Districts</b>	<b>San José Financing Authority Debt Service</b>	<b>Nonmajor Governmental Funds</b>	<b>Total Governmental Funds</b>
9,788	-	104,728	806,979
-	-	-	81,983
-	-	73,594	101,527
-	-	280,109	308,164
-	-	18,500	19,676
9	196	1,618	15,641
326	-	15,036	58,088
<u>10,123</u>	<u>196</u>	<u>493,585</u>	<u>1,392,058</u>
-	-	143,245	235,571
-	-	1,573	428,594
-	-	65,603	233,355
-	-	128,442	130,114
5,103	-	105,385	279,396
-	-	94,483	126,137
3,981	11,785	19,350	152,239
3,665	24,415	24,729	162,790
-	-	-	1,068
<u>12,749</u>	<u>36,200</u>	<u>582,810</u>	<u>1,749,264</u>
<u>(2,626)</u>	<u>(36,004)</u>	<u>(89,225)</u>	<u>(357,206)</u>
-	-	-	160,405
-	-	-	22
-	-	-	(56,735)
-	-	-	33,647
545	40,335	43,073	310,277
<u>(5,386)</u>	<u>(1,097)</u>	<u>(60,829)</u>	<u>(306,986)</u>
<u>(4,841)</u>	<u>39,238</u>	<u>(17,756)</u>	<u>140,630</u>
(7,467)	3,234	(106,981)	(216,576)
<u>30,493</u>	<u>8,284</u>	<u>590,680</u>	<u>1,415,736</u>
<u>23,026</u>	<u>11,518</u>	<u>483,699</u>	<u>1,199,160</u>

**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, 2010**  
**(\$000's)**

**Net change in fund balances—total governmental funds** (Page 28) \$ (216,576)

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	126,137	
Depreciation expense	(354,414)	
Excess of depreciation expense over capital outlay		(228,277)

The net effect of various miscellaneous transactions involving capital assets (i.e. sales, retirements, trade-ins, donations)

Donated assets	35,854	
Proceeds from sale of capital assets	(33,647)	
Disposal of assets	7,241	
		9,448

Bond issuance costs are expended in governmental funds when paid, however, are capitalized and amortized over the life of the corresponding bonds for the purposes of the statement of activities.

Bond issuance costs	1,068	
Amortization and refunding of bond issuance costs	(3,313)	
Total bond issuance costs, net of amortization		(2,245)

Repayment of long-term obligation principal is reported as an expenditure in governmental funds and, thus, has the effect of reducing fund balance because current financial resources have been used. For the government-wide statements, however, the principal payments reduce the liabilities in the statement of net assets and do not result in an expense in the statement of activities. The City's long-term obligations were reduced because principal payments were made to bondholders and HUD.

208,974

Accrued interest expense on long-term debt is reported in the government-wide statement of activities, but does not require the use of current financial resources. Amortization of bond premiums, discounts and deferred amounts on refunding should be expensed as a component of interest expense on the statement of activities. This amount represents the net accrued interest expense and the amortization of bond premiums, discounts and deferred amounts on refunding not reported in governmental funds.

Accrued interest on capital appreciation bonds	(146)	
Net premium on bonds issued	(22)	
Decrease in accrued interest expense	629	
Amortization of deferred amounts, premiums and discounts	162	
Total net interest expense and amortization of discount/premium		623

Bond proceeds provide current financial resources to governmental funds, however, issuing debt increases long-term liabilities in the statement of net assets.

(160,405)

Because some revenues will not be collected for several months after the City's fiscal year ends, they are not considered "available" revenue and are deferred in the governmental funds. Deferred revenues increased by this amount this year.

4,111

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 accrued landfill postclosure costs	465	
Net decrease in pollution remediation obligation	2,781	
Net increase in net OPEB obligation	(36,249)	
Net decrease in vacation, sick leave, and compensatory time	13,801	
Net increase in estimated liability for self-insurance	(8,343)	
Net decrease in arbitrage liability	411	
Total additional expenditures		(27,134)

**Change in net assets of governmental activities** (Page 23)

**\$ (411,481)**

The notes to the financial statements are an integral part of this statement.

This page intentionally left blank

**City of San José**  
**Statement of Fund Net Assets**  
**Proprietary Funds**  
**June 30, 2010**  
**(\$000's)**

	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total
<b>ASSETS</b>					
Current assets:					
Equity in pooled cash and investments held in City Treasury	\$ 65,928	227,652	15,237	12,925	321,742
Receivables (net of allowance for uncollectibles)	12,913	3,339	2,044	140	18,436
Due from outside agencies	-	128	-	-	128
Due from other funds	14	1,050	-	-	1,064
Prepaid expenses, advances and deposits	149	-	-	-	149
Inventories	-	1,087	-	-	1,087
Total unrestricted current assets	<u>79,004</u>	<u>233,256</u>	<u>17,281</u>	<u>13,065</u>	<u>342,606</u>
Restricted assets:					
Equity in pooled cash and investments held in City Treasury	47,597	53,090	-	2,031	102,718
Cash and investments held with fiscal agent	317,509	6,493	-	-	324,002
Receivables (net of allowances for uncollectibles)	4,822	-	-	-	4,822
Prepaid expenses, advances and deposits	11	-	-	-	11
Total restricted current assets	<u>369,939</u>	<u>59,583</u>	<u>-</u>	<u>2,031</u>	<u>431,553</u>
Total current assets	<u>448,943</u>	<u>292,839</u>	<u>17,281</u>	<u>15,096</u>	<u>774,159</u>
Noncurrent assets:					
Deferred bond issuance costs (net of accumulated amortization)	12,220	715	-	-	12,935
Loan receivable	250	-	-	-	250
Advances and deposits	6,871	-	-	-	6,871
Advances to other funds	-	6,425	-	8,483	14,908
Capital assets (net of accumulated depreciation):					
Nondepreciable	250,277	88,269	605	19,072	358,223
Depreciable	1,250,753	467,254	71,063	46,831	1,835,901
Total noncurrent assets	<u>1,520,371</u>	<u>562,663</u>	<u>71,668</u>	<u>74,386</u>	<u>2,229,088</u>
Total assets	<u>1,969,314</u>	<u>855,502</u>	<u>88,949</u>	<u>89,482</u>	<u>3,003,247</u>

The notes to the financial statements are an integral part of this statement.

**City of San José**  
**Statement of Fund Net Assets**  
**Proprietary Funds**  
**June 30, 2010**  
**(\$000's)**

	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total
<b>LIABILITIES</b>					
Current liabilities:					
Accounts payable	\$ 5,010	9,143	1,667	778	16,598
Accrued liabilities	1,628	2,748	174	123	4,673
Interest payable	7	356	-	-	363
Due to other funds	-	-	1,000	-	1,000
Short-term notes payable	417,348	-	-	-	417,348
Accrued vacation, sick leave and compensatory time	2,189	3,016	142	175	5,522
Estimated liability for self-insurance	560	1,300	156	-	2,016
Advances and deposits payable	951	-	-	2	953
Unearned revenue	3,365	-	-	-	3,365
Loans payable	-	3,836	-	-	3,836
Pollution remediation obligation	330	-	-	-	330
Total current liabilities unrestricted	<u>431,388</u>	<u>20,399</u>	<u>3,139</u>	<u>1,078</u>	<u>456,004</u>
Current liabilities payable from restricted assets:					
Accounts payable and accrued liabilities	22,168	-	-	-	22,168
Interest payable	17,871	283	-	-	18,154
Accrued vacation, sick leave and compensatory time	39	-	-	-	39
Current portion of bonds payable	11,961	4,647	-	-	16,608
Pollution remediation obligation	384	-	-	-	384
Total current liabilities payable from restricted assets	<u>52,423</u>	<u>4,930</u>	<u>-</u>	<u>-</u>	<u>57,353</u>
Total current liabilities	<u>483,811</u>	<u>25,329</u>	<u>3,139</u>	<u>1,078</u>	<u>513,357</u>
Noncurrent liabilities:					
Accrued vacation, sick leave and compensatory time	1,292	1,834	-	-	3,126
Estimated liability for self-insurance	2,403	3,030	-	-	5,433
Advances from other funds	-	-	1,167	-	1,167
Advance contributions from participating agencies	-	3,001	-	-	3,001
Advances, deposits and reimbursable credits	-	-	1,133	-	1,133
Loans payable	-	30,651	-	-	30,651
Bonds payable (net of premium/discount and deferred loss on refunding)	1,023,304	53,645	-	-	1,076,949
Net other postemployment benefit obligation	5,740	7,514	570	249	14,073
Total noncurrent liabilities	<u>1,032,739</u>	<u>99,675</u>	<u>2,870</u>	<u>249</u>	<u>1,135,533</u>
Total liabilities	<u>1,516,550</u>	<u>125,004</u>	<u>6,009</u>	<u>1,327</u>	<u>1,648,890</u>
<b>NET ASSETS</b>					
Invested in capital assets, net of related debt	314,664	474,403	71,668	65,903	926,638
Restricted for debt service	6,766	6,249	-	2,031	15,046
Restricted for capital projects and other agreements	54,583	50,881	-	-	105,464
Unrestricted	76,751	198,965	11,272	20,221	307,209
Total net assets	<u>\$ 452,764</u>	<u>730,498</u>	<u>82,940</u>	<u>88,155</u>	<u>1,354,357</u>

**City of San José**  
**Statement of Revenues, Expenses, and Changes in Fund Net Assets**  
**Proprietary Funds**  
**For the Year Ended June 30, 2010**  
**(\$000's)**

	<b>Norman Y. Mineta San José International Airport</b>	<b>Wastewater Treatment System</b>	<b>Municipal Water System</b>	<b>Parking System</b>	<b>Total</b>
<b>OPERATING REVENUES</b>					
Charges for services	\$ 41,902	130,662	24,723	10,458	207,745
Rentals and concessions	62,371	2,921	-	-	65,292
Customer transportation fees	6,021	-	-	-	6,021
Service connection, engineering and inspection	-	1,649	-	-	1,649
Contributions	-	15,202	-	-	15,202
Other	914	7,819	-	-	8,733
Total operating revenues	<u>111,208</u>	<u>158,253</u>	<u>24,723</u>	<u>10,458</u>	<u>304,642</u>
<b>OPERATING EXPENSES</b>					
Operations and maintenance	70,582	88,157	20,883	4,831	184,453
General and administrative	23,624	25,216	940	4,080	53,860
Depreciation and amortization	55,288	23,744	2,483	2,464	83,979
Materials and supplies	-	275	-	204	479
Total operating expenses	<u>149,494</u>	<u>137,392</u>	<u>24,306</u>	<u>11,579</u>	<u>322,771</u>
Operating income (loss)	<u>(38,286)</u>	<u>20,861</u>	<u>417</u>	<u>(1,121)</u>	<u>(18,129)</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>					
Passenger facility charges	17,043	-	-	-	17,043
Operating grants	1,149	-	-	-	1,149
Investment income	311	868	16	(3)	1,192
Land and building rental	-	3	-	-	3
Interest expense	(10,749)	(3,213)	(49)	-	(14,011)
Contributions refunded to participating agencies	-	(220)	-	-	(220)
Loss on disposal of capital assets	(11,733)	(6)	-	-	(11,739)
Other revenues, net	1,779	-	9	-	1,788
Net nonoperating revenues (expenses)	<u>(2,200)</u>	<u>(2,568)</u>	<u>(24)</u>	<u>(3)</u>	<u>(4,795)</u>
Income (loss) before capital contributions and transfers	<u>(40,486)</u>	<u>18,293</u>	<u>393</u>	<u>(1,124)</u>	<u>(22,924)</u>
Capital contributions	34,722	11,381	134	-	46,237
Transfers in	-	-	-	11	11
Transfers out	(15)	(1,776)	(290)	(1,221)	(3,302)
Changes in net assets	<u>(5,779)</u>	<u>27,898</u>	<u>237</u>	<u>(2,334)</u>	<u>20,022</u>
Net assets - beginning, as restated	<u>458,543</u>	<u>702,600</u>	<u>82,703</u>	<u>90,489</u>	<u>1,334,335</u>
Net assets - ending	<u>\$ 452,764</u>	<u>730,498</u>	<u>82,940</u>	<u>88,155</u>	<u>1,354,357</u>

The notes to the financial statements are an integral part of this statement.

This page intentionally left blank

**City of San José**  
**Statement of Cash Flows**  
**Proprietary Funds**  
**For the Year Ended June 30, 2010**  
**(\$000's)**

	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Receipts from customers and users	\$ 110,467	143,776	25,435	10,524	290,202
Payments to suppliers	(60,781)	(50,450)	(17,744)	(6,915)	(135,890)
Payments to employees	(33,379)	(60,924)	(4,239)	(2,335)	(100,877)
Other receipts	2,157	15,201	-	-	17,358
Net cash provided by operating activities	<u>18,464</u>	<u>47,603</u>	<u>3,452</u>	<u>1,274</u>	<u>70,793</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>					
Transfer from other funds	-	-	-	11	11
Transfer to other funds	(15)	(1,776)	(290)	(1,221)	(3,302)
Advances to other funds	-	(4,307)	(700)	(1,683)	(6,690)
Subsidies from operating grants	1,276	-	-	-	1,276
Advances, deposits and credits paid	-	-	(41)	-	(41)
Net cash provided by (used in) by noncapital and related financing activities	<u>1,261</u>	<u>(6,083)</u>	<u>(1,031)</u>	<u>(2,893)</u>	<u>(8,746)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>					
Passenger facility charges received	17,037	-	-	-	17,037
Proceeds from commercial paper	98,887	-	-	-	98,887
Principal payment on commercial paper	(5,100)	-	-	-	(5,100)
Subsidies from capital grants	35,785	8,273	-	-	44,058
Acquisition and construction of capital assets	(311,097)	(23,233)	(383)	(670)	(335,383)
Proceeds from capital assets	-	72	-	-	72
Principal paid on debt	(11,645)	(8,407)	-	-	(20,052)
Interest paid on debt	(56,258)	(3,038)	-	-	(59,296)
Advances, deposits and credits received	3,078	-	-	-	3,078
Net cash used in capital and related financing activities	<u>(229,313)</u>	<u>(26,333)</u>	<u>(383)</u>	<u>(670)</u>	<u>(256,699)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Proceeds from sales and maturities of investments	188,524	-	-	-	188,524
Purchase of investments	(46,124)	-	-	-	(46,124)
Interest and dividends received (paid)	16,933	1,587	46	(4)	18,562
Land and building rentals	-	4	-	-	4
Net cash provided by (used in) investing activities	<u>159,333</u>	<u>1,591</u>	<u>46</u>	<u>(4)</u>	<u>160,966</u>
Net change in cash and cash equivalents	<u>(50,255)</u>	<u>16,778</u>	<u>2,084</u>	<u>(2,293)</u>	<u>(33,686)</u>
Cash and cash equivalents - beginning	171,656	264,487	13,153	17,249	466,545
Cash and cash equivalents - ending	<u>\$ 121,401</u>	<u>281,265</u>	<u>15,237</u>	<u>14,956</u>	<u>432,859</u>

The notes to the 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, 2010**  
**(\$000's)**

	<b>Norman Y. Mineta San José International Airport</b>	<b>Wastewater Treatment System</b>	<b>Municipal Water System</b>	<b>Parking System</b>	<b>Total</b>
<b>Reconciliation of operating income (loss) to net cash provided by operating activities:</b>					
Operating income (loss)	\$ (38,286)	20,861	417	(1,121)	(18,129)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:					
Depreciation and amortization	55,288	23,744	2,483	2,464	83,979
Other nonoperating revenues	1,779	-	9	-	1,788
Decrease (increase) in:					
Accounts receivable	139	517	703	66	1,425
Due from outside agencies	-	208	-	-	208
Inventories	-	(42)	-	-	(42)
Prepaid expenses, advances and deposits	3,130	-	-	-	3,130
Increase (decrease) in:					
Accounts payable and accrued liabilities	(3,828)	1,412	(286)	(197)	(2,899)
Accrued vacation, sick leave and compensatory time	(476)	(187)	(26)	(17)	(706)
Estimated liability for self-insurance	(334)	(1,219)	(9)	-	(1,562)
Unearned revenue	(532)	-	-	-	(532)
Advances and deposits payable	10	-	-	1	11
Other liabilities	1,574	2,309	161	78	4,122
Total adjustments	<u>56,750</u>	<u>26,742</u>	<u>3,035</u>	<u>2,395</u>	<u>88,922</u>
Net cash provided by operating activities	<u>\$ 18,464</u>	<u>47,603</u>	<u>3,452</u>	<u>1,274</u>	<u>70,793</u>
<b>Reconciliation of cash and cash equivalents to the statement of net assets:</b>					
Equity in pooled cash and investments held in City Treasury					
Unrestricted	\$ 65,928	227,652	15,237	12,925	321,742
Restricted	47,597	53,090	-	2,031	102,718
Cash and investments held with fiscal agent	317,509	6,493	-	-	324,002
Less investments not meeting the definition of cash equivalents	(309,633)	(5,970)	-	-	(315,603)
Cash and cash equivalents	<u>\$ 121,401</u>	<u>281,265</u>	<u>15,237</u>	<u>14,956</u>	<u>432,859</u>
<b>Noncash noncapital, capital and related financing, and investing activities:</b>					
Loss on disposal of capital assets	\$ 11,733	6	-	-	11,739
Acquisition of capital assets on accounts payable and accrued liabilities	23,826	-	-	-	23,826
Capitalized interest	30,649	-	-	-	30,649
Contributions from developers	-	5,703	134	-	5,837
Amortization of deferred charges and other charges	483	232	-	-	715
Change in fair value of investments	268	101	-	-	369

The notes to the financial statements are an integral part of this statement.

**City of San José**  
**Statement of Fiduciary Net Assets**  
**Fiduciary Funds**  
**June 30, 2010**  
**(\$000's)**

	<b>Pension Trust Funds</b>	<b>James Lick Private Purpose Trust Fund</b>	<b>Agency Funds</b>
<b>ASSETS</b>			
Equity in pooled cash and investments held in City Treasury	\$ -	94	2,149
Investments of retirement plans:			
Investments, excluding securities lending collateral:			
Fixed income	1,968,960	-	-
Domestic equity	582,976	-	-
International equity	466,589	-	-
Pooled international equity	530,753	-	-
Private equity	176,329	-	-
International currency contracts, net	984	-	-
Commodities	(5,699)	-	-
Real estate	259,186	-	-
Securities lending cash collateral investment pool	557,801	-	-
Total investments	4,537,879	-	-
Receivables (net of allowances for uncollectibles):			
Accrued investment income	14,696	-	7
Employee contributions	2,997	-	-
Employer contributions	7,151	-	-
Other	29,974	-	-
Total assets	4,592,697	94	\$ 2,156
<b>LIABILITIES</b>			
Due to brokers	83,561	-	-
Securities lending collateral, due to borrowers	562,117	-	-
Other liabilities	11,335	-	2,156
Total liabilities	657,013	-	\$ 2,156
<b>NET ASSETS</b>			
Held in trust for:			
Employees' pension benefits	3,776,853	-	
Employees' postemployment healthcare benefits	158,831	-	
Other purpose	-	94	
Total net assets	\$ 3,935,684	94	

The notes to the financial statements are an integral part of this statement.

**City of San José**  
**Statement of Changes in Fiduciary Net Assets**  
**Fiduciary Funds**  
**For the Year Ended June 30, 2010**  
**(\$000's)**

	<b>Pension Trust Funds</b>	<b>James Lick Private Purpose Trust Fund</b>
	<u>          </u>	<u>          </u>
<b>ADDITIONS</b>		
Investment income:		
Interest	\$ 64,510	3
Dividends	30,851	-
Net rental income	8,970	-
Net change in fair value of plan investments	433,166	-
Investment expenses	(14,628)	-
Total investment income	<u>522,869</u>	<u>3</u>
Securities lending income:		
Securities lending income	10,969	-
Securities lending rebates and expenses	(908)	-
Total securities lending income	<u>10,061</u>	<u>-</u>
Contributions:		
Employer	135,192	-
Employees	59,957	-
Total contributions	<u>195,149</u>	<u>-</u>
Total additions	<u>728,079</u>	<u>3</u>
<b>DEDUCTIONS</b>		
General and administrative	5,842	-
Health insurance premiums	44,767	-
Refunds of contributions	1,415	-
Retirement and other benefits:		
Death benefits	14,101	-
Retirement benefits	212,715	-
Total deductions	<u>278,840</u>	<u>-</u>
Change in net assets	449,239	3
Net assets held in trust for pension and postemployment healthcare benefits:		
Beginning of year	<u>3,486,445</u>	<u>91</u>
End of year	<u>\$ 3,935,684</u>	<u>94</u>

The notes to the financial statements are an integral part of this statement.

This page intentionally left blank

# Notes to Basic Financial Statements

June 30, 2010

---

---

## INDEX TO THE NOTES

<b>I. Summary of Significant Accounting Policies</b>	
A. Reporting Entity .....	42
B. Financial Statement Presentation .....	43
C. Measurement Focus and Basis of Accounting .....	45
D. Use of Estimates .....	46
E. New Pronouncements .....	46
F. Assets, Liabilities, and Net Assets or Equity .....	47
<b>II. Stewardship, Compliance, and Accountability</b>	
A. Deficit Fund Balances .....	53
B. Deficit Unrestricted Net Assets – Governmental Activities .....	54
<b>III. Detailed Notes on all Funds</b>	
A. Cash, Deposits, and Investments .....	54
B. Receivables, Net of Allowances .....	69
C. Loans Receivable .....	69
D. Capital Assets .....	71
E. Leases .....	73
F. Long-term Debt and Other Obligations .....	76
G. Interfund Transactions .....	91
<b>IV. Other Information</b>	
A. Defined Benefit Retirement Plans .....	97
B. Defined Contribution Retirement Plan .....	108
C. Commitments and Contingencies .....	109
D. Subsequent Events .....	112

# Notes to Basic Financial Statements

June 30, 2010

---

## I. Summary of Significant Accounting Policies

### A. Reporting Entity

The City of San José, California (the "City"), was chartered on March 25, 1850, and has operated under a Council-Manager form of government since 1916. The City has defined its reporting entity in accordance with generally accepted accounting principles ("GAAP") in the United States of America, which provide guidance for determining which governmental activities, organizations, and functions should be included in the reporting entity. In evaluating how to define the City for financial reporting purposes, management has considered all potential component units. The primary criterion for including a potential component unit within the reporting entity is the governing body's financial accountability. A primary government is financially accountable if it appoints a voting majority of a component unit's governing body and it is able to impose its will on the component unit, or if there is a potential for the component unit to provide specific financial benefits to, or impose specific financial burdens on, the primary government. A primary government may also be financially accountable if a component unit is fiscally dependent on the primary government regardless of whether the component unit has a separately elected governing board, a governing board appointed by a higher level of government, or a jointly appointed board. Based upon the application of these criteria, the following is a brief description of each component unit included within the City's reporting entity. All such component units have been "blended" as though they are part of the primary government because the component unit's governing body is substantively the same as the City's primary government, and/or the component units provide services entirely, or almost entirely, to the City or otherwise exclusively, or almost exclusively, benefits the City, even though it does not provide services directly to it.

- **Redevelopment Agency of the City of San José** – The Redevelopment Agency of the City of San José (the "Agency") was created by the City Council with the authority and responsibility for redeveloping and upgrading blighted areas of the City. The members of the City Council are also members of the Agency's Board of Directors and, as such, are authorized to transact business and exercise their power to plan, engineer, and carry out projects of the Agency.
- **Parking Authority of the City of San José** – The Parking Authority of the City of San José (the "Parking Authority") was created by the City Council to provide funding through debt issuance for parking facilities constructed on City-owned land. Such parking facilities are leased to the City. Members of the City Council are also members of the Parking Authority's Board of Directors.
- **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 of San José and the City of Santa Clara. The purpose was to finance the acquisition of, and additions and improvements to the existing San José – Santa Clara Water Pollution Control Plant (the Plant). The Clean Water Financing Authority is governed by a five-member Board of Directors, three are members of the City Council of the City of San José and two are members of the City Council of the City of Santa Clara. The Clean Water Financing Authority and the cities of San José and Santa Clara subsequently entered into an Improvement Agreement, which requires each city to make base payments that are at least equal to each city's allocable share of debt service requirements of the Clean Water Financing Authority's outstanding revenue bonds.

# Notes to Basic Financial Statements

June 30, 2010

---

- **City of San José Financing Authority** – The City of San José Financing Authority (the “Authority”) was created by a Joint Exercise of Powers Agreement between the City and the Agency. The 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 Authority is governed by an 11-member Governing Board, which consists of the members of the City Council.

Separate financial reports for the fiscal year ended June 30, 2010, containing additional information and more detailed information regarding financial condition and change in financial position, are available from the City’s Director of Finance, 200 East Santa Clara Street; 13<sup>th</sup> Floor, San José, CA 95113-1905, for the following:

- Federated City Employees’ Retirement System (the “FCERS”)
- Police and Fire Department Retirement Plan (the “PFDRP”)
- Redevelopment Agency of the City of San José
- 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 assets and the statement of activities) display information about the primary government (the “City”) and its component units. These statements include the financial activities of the overall government, except for fiduciary activities. Eliminations have been made to minimize the double counting of internal activities. For example, the direct expenses 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, which is included in the government-wide financial statements, presents a comparison between direct expenses and program revenues for each business-type activity of the City and each function of the City’s governmental activities. Direct expenses are those that are specifically associated with a business-type activity or governmental function and; therefore, are clearly identifiable to a particular activity or function. Program revenues include 1) fees, fines and charges paid by the recipients of goods or services offered by the programs, and 2) grants and contributions that are restricted to meet the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are instead presented as general revenues.

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

# Notes to Basic Financial Statements

June 30, 2010

---

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

The City reports the following major governmental funds:

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

The **Redevelopment Agency Fund** is a capital projects fund that accounts for administrative, operating, low-to-moderate income housing program, debt and construction activities necessary to carry out responsibilities for redeveloping and upgrading blighted areas in the City.

The **Housing Activities Fund** is a special revenue fund that accounts for the City's affordable housing activities.

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

The **City of San José Financing Authority Fund** is a debt service fund that accounts for the debt activities related to capital projects funded with 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 City's sewer system, the San José – Santa Clara Water Pollution Control Plant (the Plant) and the regional water reclamation program.

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

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

The City reports the following fiduciary fund types:

The **Pension Trust Funds** account for the accumulated resources to be used for retirement annuity and postemployment healthcare payments to members of the Federated City Employees' Retirement System ("FCERS") and the Police and Fire Department Retirement Plan ("PFDRP" and collectively, the "Retirement System").

The **James Lick Private Purpose Trust Fund** is used to account for resources legally held in trust for use towards the support of the Eastfield Home of Benevolence (orphanage). All resources of the fund, including any earnings on invested resources, are used to support the organization's activities.

The **Agency Funds** account for assets held by the City in a custodial capacity on behalf of the San José Arena and the Health Care Financing Administration.

# Notes to Basic Financial Statements

June 30, 2010

---

## C. Measurement Focus and Basis of Accounting

The basis of accounting determines when transactions are reported on the financial statements. The government-wide, proprietary and fiduciary funds (excluding agency funds) financial statements are reported using the economic resources measurement focus. The government-wide, proprietary funds and fiduciary funds financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Non-exchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property and sales taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenues from sales and use, transient occupancy and utility user tax are recognized when the underlying transactions take place. Revenues from grants, entitlements and donations are recognized in the fiscal year in which all eligibility requirements have been satisfied.

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

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

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

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

# Notes to Basic Financial Statements

June 30, 2010

---

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board (GASB). Governments also have the option of following subsequent private-sector guidance for business-type activities and enterprise funds, subject to the same limitation. The City has elected not to follow subsequent private-sector guidance.

## D. Use of Estimates

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

## E. New Pronouncements

During the year ended June 30, 2010, the City implemented the following GASB Statements:

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2009.

In prior years, the Airport recorded amortization of its intangible assets following the guidance of Accounting Principles Board (APB) Opinion No. 17, *Intangible Assets*, and computed annual amortization on its intangible assets over a 50-year estimated useful life. Upon adoption of GASB 51, the Airport identified its intangible assets as having indefinite useful lives. As a result, beginning net assets and capital assets of the City's Business-Type Activities and the Airport major enterprise fund have been restated by \$5,643,000.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. The Statement establishes accounting and financial reporting standards for all state and local governments that enter into derivative instruments. GASB 53, requires derivative instruments be reported at fair value, with a few specific exceptions, on the statement of net assets. The classification depends on whether they represent assets or liabilities. Changes in fair values of investment derivatives should be reported within the investment revenue classification on the changes in fund net assets. The Statement also provides a comprehensive framework for the measurement, recognition, and disclosure of derivative instrument transactions. The statement describes the general circumstances under which a derivative instrument is classified as an investment derivative or a hedging derivative instrument. Pursuant to the requirements of this statement, the City has provided a summary of derivative instrument activities during the reporting period and the related risks as discussed in Note III.A.2.

# Notes to Basic Financial Statements

June 30, 2010

---

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

In March 2010, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. Application of this Statement is effective for the City's fiscal year ending June 30, 2011.

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*. This statement updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. Application of this Statement is effective for the City's fiscal year ending June 30, 2011.

## **F. Assets, Liabilities, and Net Assets or Equity**

### **1. Cash and Cash Equivalents**

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

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

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

### **3. Deposits and Investments**

Investments are accounted for in accordance with the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.

This Statement requires governmental entities to report investments at fair value in the statement of net assets or balance sheet and to recognize the corresponding change in fair value of investments in the year in which the change occurred.

**Pooled Cash and Investments held in City Treasury.** The City reports its investments held in City Treasury at fair value. The fair value is based on quoted market information obtained from fiscal agents or other sources. Income from some investments is assigned to the General Fund. The assignment of the income from these investments is supported by legal or contractual provisions approved by the City Council. For the fiscal year ended June 30, 2010, the total investment income from these funds assigned and transferred to the General Fund was approximately \$2,844,000.

# Notes to Basic Financial Statements

June 30, 2010

---

**Retirement Systems.** The Retirement Systems investment policies authorize various types of investments. These investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price on the last business day of the fiscal year at current exchange rates, if applicable. Investments that do not have an established market are reported at estimated fair value based on the most recently available investor reports or audited financial statements issued by the manager of those funds. The fund manager provides an estimated unrealized gain/loss of the fund based on the most recently audited financial statements and other fund information. The fair value of separate real estate properties is based on annual independent appraisals. In addition, per the Retirement Systems' Real Estate Investment Guidelines, mortgage loans at fair value on the separate real estate properties are not allowed to exceed 50% of the property's fair value. Purchases and sales of securities are reflected on the date of trade. Investment income is recognized as earned. Rental income from real estate activity is recognized as earned, net of expenses.

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

#### **4. Inventories**

Inventories of proprietary funds are valued at the lower of cost (first-in/first-out) or market. In the governmental funds, inventory items are valued at average cost. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased.

#### **5. Special Assessment Districts**

Special assessments are recorded as receivables when they become a lien on property. Special assessments not considered available are recorded as receivables and offset by deferred revenues in the governmental fund financial statements. The special assessment and special tax bonds are fully secured by liens against the privately owned properties benefited by the improvements for which the bonds were issued. There is no reserve for delinquent receivables since priority liens exist against the related properties and hence the City's management believes 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 assessment bond laws of the State of California. A liability is recorded for the balance remaining until a final legal determination has been made.

#### **6. Advances and Deposits**

Amounts deposited in connection with eminent domain proceedings and special assessment surpluses are reported as advances and deposits. In the governmental fund statements, non-current portions of these are offset equally by either a deferred credit or a fund balance reserve account to indicate they do not constitute expendable financial resources available for appropriation.

#### **7. Other Assets**

Other assets primarily consist of real properties acquired outright and/or through foreclosure in connection with the housing rehabilitation program. These assets are recorded at the lower of cost or estimated net realizable value.

# Notes to Basic Financial Statements

June 30, 2010

---

## **8. Bond Issuance Costs, Original Issue Discounts and Premiums and Deferred Amounts on Refundings**

In the government-wide financial statements and the proprietary fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds. Bonds payable are reported net of the applicable bond premium or discount and deferred amounts on refundings. Bond issuance costs are deferred and are amortized over the term of the related debt. Gains or losses occurring from advance refundings, completed subsequent to June 30, 1993, are deferred and amortized into expense for both business-type activities and proprietary funds. For governmental activities, they are deferred and amortized into expense if they occurred subsequent to June 30, 2001.

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

## **9. Restricted Assets**

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

## **10. Capital Assets**

Capital assets include land, buildings, improvements, vehicles and equipment, infrastructure and all other tangible and intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Capital assets are reported in the applicable governmental or business-type activity columns in the government-wide financial statements and the proprietary funds' statement of net assets. 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 or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the time received. Capital outlay is recorded as expenditures of the governmental funds and as assets in the government-wide financial statements to the extent the City's capitalization threshold is met. Interest incurred during the construction phase of capital assets of business-type activities is reflected in the capitalized value of the asset constructed, net of interest earned on the invested proceeds over the same period. Amortization of assets acquired under capital leases is based on the shorter of the lease term or the estimated useful life of the asset and is included in depreciation and amortization.

Buildings and improvements, infrastructure, and vehicles and equipment 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 on 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 road, bridges, drainage systems, and lighting systems.

# Notes to Basic Financial Statements

June 30, 2010

---

## **11. Compensated Absences – Accrued Vacation, Sick Leave, and Compensatory Time**

Vacation, sick leave, compensatory time, and related benefits are accrued as determined by the agreement between the City and the respective employees' collective bargaining group. For governmental funds, compensated absence obligations are recorded in the appropriate governmental funds when due. The portion not currently due is recorded in the government-wide financial statements. For enterprise 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 enterprise funds.

Vacation pay may be accumulated up to two times the annual accrual rate, not to exceed a maximum of 400 hours for non-sworn employees.

Employees represented by the San José Police Officer's Association (SJPOA) may carry over to the next payroll calendar year not more than 200 hours of unused vacation leave. Employees represented by the International Association of Firefighters, Local 230 may carryover to the next payroll calendar year not more than 200 hours of unused vacation leave for employees on a 40-hour workweek and 240 hours for those employees on a 56-hour workweek.

Employees in the Federated City Employees' Retirement System who retire with at least 15 years of service or 20 years for police officers and firefighters in the Police and Fire Department Retirement Plan are eligible to receive, upon retirement, sick leave payouts based on percentages of accumulated sick hours as determined by the respective collective bargaining agreements.

## **12. Inter-fund Transactions**

Inter-fund transactions are reflected as loans, services provided, reimbursements and/or transfers. Loans and balances related to unsettled service transactions are reported as receivables and payables as appropriate, are subject to elimination upon consolidation of similar fund types, and are referred to as either "due to/from other funds" (i.e., the current portion of inter-fund loans and unsettled service transactions) or "advances to/from other funds" (i.e., the non-current portion of inter-fund loans). Any residual balances outstanding between the governmental activities and the business-type activities are reported in the government-wide financial statements as "internal balances". Advances to other funds, as reported in the fund financial statements, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not available financial resources.

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

# Notes to Basic Financial Statements

June 30, 2010

---

## 13. Self-Insurance

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

## 14. Net Assets/Fund Equity

The government-wide and proprietary fund financial statements utilize a net assets presentation. Net assets are categorized as invested in capital assets (net of related debt), restricted, and unrestricted.

- *Invested In Capital Assets, Net of Related Debt* - This category groups all capital assets, including infrastructure, into one component of net assets. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction, or improvement of these assets reduce the balance in this category.
- *Restricted Net Assets* – This category represents net assets that have external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation. At June 30, 2010, the government-wide statement of net assets reported restricted assets of \$527,931,000 in governmental activities and \$120,510,000 in business-type activities. Of these amounts \$297,563,000 and \$74,857,000, respectively are restricted by enabling legislation.
- *Unrestricted Net Assets* – This category represents net assets of the City, not restricted for any project or other purpose.

In the governmental fund financial statements, reserves and designations segregate portions of fund balance that are either not available or have been earmarked for specific purposes. The various reserves are based on third-party restrictions and designations are established by actions of the City Council and management and can be increased, reduced or eliminated by similar actions.

Reservations of fund balance are described as follows:

- *Encumbrances* - to reflect the outstanding contractual obligations for which goods and services have not been received.
- *Non-current advances, loans, other assets, and cash commitments* - to reflect the portion of assets that are not currently available as a spendable resource.
- *Debt service* - to reflect the funds held by trustees or other fiscal agents for future payment of principal and interest related to bond issue. These funds are not available for general operations.

Portions of unreserved fund balance may be designated to indicate tentative plans for financial resource utilization in a future period. Such plans or intent are subject to change and have not been legally authorized or may not result in expenditures. Fund balance designations include:

# Notes to Basic Financial Statements

## June 30, 2010

- *Contingencies* - to reflect management's intent to expend certain funds for future unanticipated needs.
- *Future projects* - to reflect management's intent to expend certain funds approved for capital projects in prior years but not yet completed.

The unreserved governmental funds balance designations at June 30, 2010 are composed of the following (dollars in thousands):

	General Fund	Redevelopment Agency	Housing Activities	Special Assessment Districts	San Jose Financing Authority	Nonmajor Funds	Total
Unreserved, designated for:							
Future projects	\$ 34,292	-	3,186	-	-	76,023	\$ 113,501
Contingencies	53,316	-	-	-	-	-	53,316
Undesignated	56,010	(57,429)	5,647	4,894	(1,373)	286,094	293,843
Total unreserved fund balances	<u>\$ 143,618</u>	<u>(57,429)</u>	<u>8,833</u>	<u>4,894</u>	<u>(1,373)</u>	<u>362,117</u>	<u>\$ 460,660</u>

### 15. Property Taxes

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

The County assesses property values, levies, bills, and collects the related property taxes as follows:

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

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

General property taxes are based either on a flat 1% rate applied to the fiscal 1976 full value of the property or on 1% of the sales price of the property on sales transactions and construction that occur after the fiscal 1976 valuation. Assessed values on properties (exclusive of increases related to sales and construction) can rise at a maximum of 2% per year depending on increases in the consumer price index.

The City's net assessed valuation for the fiscal year ended June 30, 2010, was approximately \$123.0 billion, a decrease of approximately 2% from the previous year. The City's tax rate was approximately \$0.191 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).

# Notes to Basic Financial Statements

June 30, 2010

---

**Proposition 1A Borrowing By The State of California.** Under the provisions of Proposition 1A and as part of the 2009-10 budget package passed by the California State legislature on July 29, 2009, the State of California borrowed 8% of the amount of property tax revenue, including those property taxes associated with the in-lieu motor vehicle license fee, the triple flip in-lieu sales tax and supplemental property tax apportioned to cities, counties and special districts (excluding redevelopment agencies). The State is required to repay this borrowing plus interest by June 30, 2013. After repayment of this initial borrowing, the California legislature may consider only one additional borrowing within a ten year period.

Authorized with the 2009-2010 State budget package, the Proposition 1A securitization program was instituted by the California Statewide Communities Development Authority ("California Communities"), a joint power authority sponsored by the California State Association of Counties and the League of California Cities, to enable local governments to sell their Proposition 1A receivables to California Communities. Under the Securitization Program, California Communities, acting solely as a conduit for the State of California, simultaneously purchased the Proposition 1A receivables and issued bonds ("Prop 1A Bonds") to provide local agencies with cash proceeds in two equal installments, on January 15, 2010 and May 3, 2010. The purchase price paid to the local agencies equaled 100% of the amount of the property tax reduction. All transaction costs of the issuance and interest were paid by the State of California. Participating local agencies have no obligation on the bonds and no credit exposure to the State.

The City participated in the Securitization Program and accordingly, property taxes have been recorded in the same manner as if the State had not exercised its rights under Proposition 1A. The receivable sale proceeds were equal to the book value and, as a result, no gain or loss was recorded. The amount of this borrowing pertaining to the City was \$20,467,000.

## **16. Wastewater Treatment System**

The Wastewater Treatment System is an enterprise of the City and is comprised of the San José – Santa Clara Water Pollution Control Plant (the Plant), including South Bay Water Recycling and the San José Sewage Collection System.

The Plant provides wastewater treatment services to the City of San José and to six other sewage collection agencies. The Clean Water Financing Authority was established to provide financing for the capital programs of the Plant including the regional water reclamation program. The City's sewer service rates pay for the City's share of the Plant operations, maintenance, and administration and capital costs.

In 1959, the City and the City of Santa Clara entered into an agreement to jointly own and operate the Plant. Under the agreement, the City of San José 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, 2010, the City's portion of the capital and operating costs was approximately 81.0% and, based on operations through the fiscal year ended June 30, 2010, the City's interest in the net assets of the Plant was approximately 82.8%.

## **II. Stewardship, Compliance, and Accountability**

### **A. Deficit Fund Balances**

Deficit fund balances of \$272,000 and \$369,000 were reported in non-major capital projects Fiber Optics Development Fund and the Civic Center Improvement Fund, respectively. The deficit fund

# Notes to Basic Financial Statements

## June 30, 2010

balance for the Fiber Optics Development Fund will be eliminated with future transfers from the General Fund. The Civic Center Improvement Fund deficits will be eliminated with transfers made from future commercial paper proceeds.

### B. Deficit Unrestricted Net Assets – Governmental Activities

At June 30, 2010, the City reports a deficit unrestricted net assets in its Statement of Net Assets – governmental activities in the amount of \$53,494,000. This deficit is due to a number of factors. A primary factor for this net deficit is due to debt issued by the Agency due to the nature of tax increment financing method allowed under California law whereby a redevelopment agency issues bonds or incurs long-term debt to finance its redevelopment and housing projects by pledging future tax increment revenues. In addition, the City’s accrual of certain long-term liabilities, such as compensated absences and estimated claims, that are recognized as expenses under the accrual basis of accounting as the liabilities are incurred; however, these expenses are not budgeted (funded) until the liabilities are anticipated to come due; and the City’s recognition of other postemployment benefit (OPEB) obligations for OPEB costs in which the actuarial annual required contributions are greater than the amount funded into the OPEB plans to date. Pursuant to the City’s latest agreements with most of its bargaining units, the funding to fully fund the OPEB’s annual required contributions will be phased in over a five year period (see Note IV.A.).

### III. Detailed Notes on All Funds

#### A. Cash, Deposits and Investments

As of June 30, 2010, total City cash, deposits and investments, at fair value, are as follows (dollars in thousands):

	Governmental Activities	Business-type Activities	Fiduciary Funds			Carrying Value
			Pension Trust	Private-Purpose Trust	Agency	
Equity in pooled cash and investments	\$ 628,384	321,742	-	94	2,149	\$ 952,369
Other cash and investments	7	-	-	-	-	7
Restricted investments:						
Equity in pooled cash and investments	66,789	102,718	-	-	-	169,507
Cash and investments with fiscal agents	325,056	324,002	-	-	-	649,058
Other cash and investments	49,981	-	-	-	-	49,981
Investments of retirement plans	-	-	4,537,879	-	-	4,537,879
Total deposits and investments	<u>\$ 1,070,217</u>	<u>748,462</u>	<u>4,537,879</u>	<u>94</u>	<u>2,149</u>	<u>6,358,801</u>
Deposits *						21,189
Investments						6,337,612
Total deposits and investments						<u>\$ 6,358,801</u>

\* The deposits primarily consist of restricted Agency deposits in the amount of \$23,207,000 held in Bank of the West.

**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 statement of net assets as “Equity in pooled cash and investments held in City Treasury.”

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

Other 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

# Notes to Basic Financial Statements

June 30, 2010

---

either in accordance with bond covenants, and are pledged for payment of principal, interest, and specified capital improvements or in accordance with trust and grant agreements.

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

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

## ***1. Governmental and Business-Type Activities***

**Interest Rate Risk.** Interest rate risk is the risk that changes in market rates will adversely affect the fair value of an investment. Generally, the longer the time of maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. Additionally, the fair values of the investments may be highly sensitive to interest rate fluctuations. One of the ways that the City manages its exposure to interest rate risk is by purchasing a combination of shorter-term and longer-term investments and by timing the cash flows from the maturities so that a portion is maturing or coming close to maturing evenly over time, as necessary to provide the cash flow and liquidity needs for operations.

The City has the ability and generally has the intention to hold all investments until their respective maturity dates. The average maturity of the City's pooled cash and investments as of June 30, 2010, was approximately 122 days. The Investment Policy does not prohibit the sale of securities prior to maturity. However any portfolio restructuring requires prior conceptual approval in writing from the City Manager and the Director of Finance. Section 14.2 of the Investment Policy further defines the parameters with respect to restructuring the portfolio.

**Credit Quality Risk.** Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This risk is measured by the assignment of a rating by a nationally recognized statistical rating organization. The City's Investment Policy has mitigated credit risk by limiting investments to the safest type of securities, by prequalifying financial institutions, by diversifying the portfolio and by establishing monitoring procedures.

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

As of June 30, 2010, the City's investment in LAIF was approximately \$301,935,000. The weighted average maturity of LAIF was 203 days. The total amount recorded by all public agencies in LAIF pool at that date was approximately \$23.3 billion. Of that amount, 94.58% was invested in non-derivative financial products and 5.42% in structured notes and asset backed securities.

## Notes to Basic Financial Statements

**June 30, 2010**

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

The City Council adopted an investment policy (the "Policy") on April 2, 1985, as amended on December 8, 2009, related to the City's cash and investment pool, which is subject to annual review. The Policy specifically prohibits trading securities for the sole purpose of speculating or taking an un-hedged position on the future direction of interest rates. Per the Policy the investments conform to Sections 53600 et seq. of the California Government Code and the applicable limitations contained within the Policy.

The following table identifies the investment types that are authorized for the City's Investment Policy as of June 30, 2010:

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage of Dollar of Portfolio</u>	<u>Maximum Investment in One Issuer</u>
U.S. Treasury Obligations	5 years	None	None
U.S. Government Agency Issues	5 years	None	None
Bankers' Acceptances	180 days	25%	5%
Insured Time Deposits	3 years	\$10 million	5%
Uninsured Time Deposits	18 months	\$10 million	5%
Commercial Paper	270 days	20%	5%
Negotiable Certificates of Deposit	180 days	25%	5%
Repurchase Agreements	10 days	None	None
Reverse Repurchase Agreements	30 days	\$25 million or 20% (Whichever is less)	None
Corporate Notes	3 years	15%	5%
Local Agency California Investment Fund	None	None	None
Money Market Mutual Funds	None	15%	5%
California Municipal Bonds - Category 1	5 years	15%	5%
California Municipal Bonds - Category 2	5 years	5%	5%
California Municipal Bonds - Category 3	5 years	10%	5%
Investment Agreements	None	None	None

Other restrictions on investments are summarized as follows:

- Purchases of United States government agency securities are limited to issues of Federal Farm Credit Banks (FFCB), the Federal Home Loan Banks (FHLB), Federal Home Loan Mortgage Corporation (FHLMC), the Federal National Mortgage Association (FNMA), and Student Loan Marketing Association (SLMA).
- The purchase of bankers' acceptances (BAs) are limited to issues by domestic U.S. or foreign banks, which must be rated by Fitch Ratings as follows: an issuer rating of "B" or better for domestic U.S. banks, "C" or better for California banks or "A/B" or better for foreign banks. Additionally, foreign BAs must be in U.S. dollar denominations.
- Insured and uninsured time deposits are limited to issuances from banks and savings and loans with offices located in the San José area and deposits shall not exceed the net worth of that depository. Additionally, concerning uninsured time deposits, depositories must have an issuer rating of "B" or better by Fitch Ratings and be collateralized in a manner prescribed by state law for depositories.

## Notes to Basic Financial Statements

June 30, 2010

---

- Investments in commercial paper are limited to investments in domestic corporations with the highest ranking or with the highest letter and number rating as provided for by the three nationally recognized rating services. Issuing corporations must be organized and operating within the U.S. and have total assets in excess of \$500,000,000.
- Negotiable certificates of deposit are limited to banks and savings and loans with an issuer rating of "A/B" or better by Fitch Ratings and may not exceed the net worth of the issuing institution.
- Repurchase agreements are to be executed only with primary dealers of the Federal Reserve Bank of New York and financial institutions, which have entered into the City's Master Repurchase Agreement and any subsequent amendments to the Master Repurchase Agreement. Securities accepted as collateral for the repurchase agreement are limited to U.S. Treasury or U.S. Federal Government Agencies permitted under the Policy. The market value of the securities that have been accepted as collateral shall, at the time of transfer, equal at least 102 percent 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 repurchase agreement's face value.
- Reverse repurchase agreements under the Policy are limited to the lesser of \$25,000,000 or 20% of the portfolio value and to those occasions where unanticipated short-term cash requirements can be met more advantageously by initiating a reverse repurchase agreement than by selling a security into the secondary market prior to maturity. Corporate notes eligible for investment must be rated "A" or better by two of the three nationally recognized rating services.
- Funds invested in Local Agency Investment Fund, a State of California managed investment pool, may be made up to the maximum dollar amount of \$50,000,000 per separate legal entity in conformity with account balance limits authorized by the California State Treasurer.
- Investments in money market mutual funds are limited to those funds registered with the Securities and Exchange Commission (SEC) and for which either one of the credit criteria are met: (1) obtained the highest ranking or highest letter and numerical rating provided by no less than two nationally recognized rating services or (2) retained an investment advisor registered with the SEC or exempt from the SEC registration requirements with no less than five years experience investing in securities and obligations authorized by California Government Code Section 53601 and managing money market mutual funds with assets under management in excess of \$500,000,000. Investments by the funds are restricted to U.S. Treasury and U.S. Government Agency backed securities permitted under the Policy and be maintained at no less than \$1.00 per share.
- California municipal bonds under the Policy are limited to a total of no more than 20% of the portfolio value. The Policy establishes three California municipal bond categories (1 through 3): bonds issued by the City or its agencies (as defined in the Policy), by the State of California, and by other California local agencies, respectively. Eligible securities must be rated "AA" or better by two nationally recognized rating services. For category 3, a rating of "AAA" through credit enhancements is also permitted.
- 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.

# Notes to Basic Financial Statements

## June 30, 2010

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 and the City Council within one business day.

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, 2010. The credit ratings listed are for Moody's Investors Services and Standard and Poor's, respectively. Certain investments, such as obligations, which are backed by the full faith and credit of the United States Government, are exempt from credit rating disclosures (dollars in thousands):

Type of Investment	Credit Rating	Maturity				Carrying Value
		Under 30 Days	31 - 180 Days	181 - 365 Days	1 - 5 Years	
Pooled investments in the City Treasury:						
U.S. Treasury bills	Exempt	\$ 114,900	-	-	-	114,900
Federal Farm Credit Banks *	Aaa / AAA	-	31,547	10,175	20,759	62,481
Federal Farm Credit Banks - Callable *	Aaa / AAA	-	-	-	10,106	10,106
Federal Home Loan Banks *	Aaa / AAA	-	105,489	29,320	-	134,809
Federal Home Loan Banks - Callable *	Aaa / AAA	-	-	-	21,750	21,750
Federal Home Loan Banks - Discount *	P-1 / A-1+	44,750	45,572	21,810	-	112,132
Federal Home Loan Mortgage Corporation *	Aaa / AAA	10,013	64,313	-	-	74,326
Federal Home Loan Mortgage Corporation - Discount *	P-1 / A-1+	-	49,994	14,967	-	64,961
Federal National Mortgage Association - Discount *	P-1 / A-1+	40,000	94,955	118,433	-	253,388
Commercial paper - Discount	P-1 / A-1+	75,991	18,961	-	-	94,952
Medium-term notes	Aaa / AAA	-	-	5,054	25,753	30,807
Negotiable certificate of deposit	P-1 / A-1	54,999	-	-	-	54,999
California local agency investment fund	Not Rated	-	-	100,000	-	100,000
Total pooled investments in the City Treasury		<u>340,653</u>	<u>410,831</u>	<u>299,759</u>	<u>78,368</u>	<u>1,129,611</u>
Investments with fiscal agents:						
U.S. Treasury bills	Exempt	57,244	-	11,565	-	68,809
Federal Home Loan Banks **	Aaa / AAA	-	-	2,662	29,938	32,600
Federal Home Loan Banks - Discount **	P-1 / A-1+	-	4,540	-	-	4,540
Federal Home Loan Mortgage Corporation - Discount	P-1 / A-1+	-	90	810	-	900
Federal National Mortgage Association **	Aaa / AAA	23,383	-	23,519	-	46,902
Federal National Mortgage Association - Discount **	P-1 / A-1+	-	182	-	-	182
Commercial paper	P-1 / A-1+	31,573	-	-	-	31,573
Investment agreements ***	Not rated	6,144	233,565	-	-	239,709
Money market mutual funds	AAA	29,631	13,341	-	-	42,972
California local agency investment fund	Not Rated	-	-	180,856	-	180,856
Total investments with fiscal agents		<u>147,975</u>	<u>251,718</u>	<u>219,412</u>	<u>29,938</u>	<u>649,043</u>
Other Investments:						
California local agency investment fund	Not Rated	-	-	21,079	-	21,079
Total other investments		<u>-</u>	<u>-</u>	<u>21,079</u>	<u>-</u>	<u>21,079</u>
Total City-wide investments (excluding Retirement Systems)		<u>\$ 488,628</u>	<u>662,549</u>	<u>540,250</u>	<u>108,306</u>	<u>1,799,733</u>
Retirement Systems:						
Total investments in Retirement Systems						<u>4,537,879</u>
Total investments						<u>\$ 6,337,612</u>

\* Investments with these issuers represent more than 5% of the City's pooled investments held in the City's Treasury.

\*\* Investments with these issuers represent more than 5% of the City's investments held outside the City's Treasury pool.

\*\*\* The City holds investment agreements in the amount of \$239,709,000 issued by Citigroup which represents more than 5% of the City's investments held outside of the City's Treasury pool.

# Notes to Basic Financial Statements

June 30, 2010

**Custodial Credit Risk.** Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the City will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker - dealer) to a transaction, the City will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code requires that a financial institution secure its deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by the depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged governmental securities and/or first trust deed mortgage notes held in the collateral pool must be at least 110% and 150% of the City's deposits, respectively. The collateral is held by the pledging financial institution's trust department and is considered held in the City's name. The investments held by the City were not subject to custodial credit risk at June 30, 2010.

**Foreign Currency Risk.** The risk that changes in exchange rates will adversely affect the fair value of an investment. As of June 30, 2010, 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 Retirement Systems Boards of Administration to reinvestment moneys of the Retirement Systems as provided in the Municipal Code. The Boards have adopted detailed investment guidelines consistent with the limitations set forth in the Municipal Code. Following the market crash of 2008, the Boards approved a new asset allocation that improved the diversification of the Retirement Systems' portfolio structure from the prior one. The Retirement Systems' investment asset allocations are as follows:

	<u>Type of Investment</u>	<u>Policy Limits and Descriptions</u>
PFDRP	Equity - Target of 40%	Minimum of 30% and maximum of 50% of the fair value of the aggregate portfolio. U.S. Large Cap - Target 18% U.S. Small Cap - Target 5% Non U.S. Developed Markets - Target 12% Non U.S. Emerging Markets - Target 5%
	Fixed Income - Target of 25%	Minimum of 15% and maximum of 35% of the fair value of the aggregate portfolio. Core Fixed Income - Target 5% U.S. Treasury Inflation Protected Securities (TIPS) - Target 10% Long Duration Fixed Income - Target 5% Opportunistic Credit - Target 5%
	Alternative Assets - Target of 35%	Minimum of 10% and maximum of 60% of the fair value of the aggregate portfolio. Funds allotted to the alternatives asset class are temporarily invested in other asset classes. Private Equity - Target 5% Real Estate - Target 10% Inflation-Linked Assets - Target 10% Absolute Return - Target 5% Opportunistic - Target 5%
FCERS	Global Equity - Target 49%	Minimum of 43% and maximum of 55% of the fair value of the aggregate portfolio.
	Fixed Income - Target 20%	Minimum of 15% and maximum of 25% of the fair value of the aggregate portfolio.
	Alternatives - Target of 31%	Minimum of 26% and maximum of 36% of the fair value of the aggregate portfolio. Real Estate - Target 5% Real Assets - Target 10% Hedge Funds - Target 5% Private Equity - Target 6% Opportunistic - Target 5%

## Notes to Basic Financial Statements

**June 30, 2010**

PFDRP's investment policy authorizes PFDRP to invest in domestic equity, international equity, emerging market equity, domestic fixed income, global (international) fixed income, long duration fixed income U.S. Treasury Inflation Protected Securities (TIPS), high yield/credit opportunities, international currency contracts, private equity, real estate, derivatives, securities lending, and short-term investments. FCERS's investment policy authorizes FCERS to invest in global equity; global fixed income; alternatives including real estate, real assets, hedge funds, private equity, and opportunistic assets; short-term investments; and securities lending.

As of June 30, 2010, PFDRP's separate real estate properties include: apartment complexes in Houston, TX and Colorado Springs, CO; office buildings in Denver, CO, O'Fallon, MO, San Jose, CA, near Chicago, IL, and in Anchorage, AK; and warehouses near Minneapolis, MN. As of June 30, 2010, the office buildings in O'Fallon, MO and Anchorage, AK had mortgage loans payable of approximately \$20,400,000 which do not exceed 50% of the assets as allowed in PFDRP's Real Estate Investment Guidelines. As of June 30, 2010, FCERS held a warehouse located in Northern California with no outstanding mortgage loans.

At June 30, 2010, the Retirement Systems held the following investments (dollars in thousands):

	<u>PFDRP</u>	<u>FCERS</u>	<u>Total</u>
Securities and other:			
Fixed income:			
Domestic fixed income	\$ 863,001	\$ 642,269	\$ 1,505,270
Collective short-term investments	204,362	63,202	267,564
International fixed income	32,005	6,890	38,895
Corporate convertible bonds	-	45,540	45,540
Pooled fixed income bond funds	91,501	20,190	111,691
Total fixed income	<u>1,190,869</u>	<u>778,091</u>	<u>1,968,960</u>
Domestic equity	468,971	114,005	582,976
International equity	278,087	188,502	466,589
Pooled international equity	137,759	392,994	530,753
Private equity	106,298	70,031	176,329
International currency contracts, net	499	485	984
Commodities	(5,699)	-	(5,699)
Real estate	189,070	70,116	259,186
Securities lending cash collateral investment pool	384,569	173,232	557,801
Total investments	<u>\$ 2,750,423</u>	<u>\$ 1,787,456</u>	<u>\$ 4,537,879</u>

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.

## Notes to Basic Financial Statements

**June 30, 2010**

As of June 30, 2010, PFDRP's investments include \$442,000 of asset backed securities, \$30,733,000 of bank loan securities, and \$400,000 of U.S. denominated convertible bonds that were floating rate securities tied to the London Interbank Offered Rate (LIBOR) or the 3-month Prime rate. PFDRP also has exposure of approximately \$242,348,000 in commodity swaps that are tied to 3-month Treasury bill rates as described in the Derivatives discussion.

As of June 30, 2010, FCERS's investments include \$32,453,000 of bank loan securities that were floating rate securities tied to LIBOR or the 3-month Prime rate. FCERS also has exposure on its fully collateralized commodity and infrastructure swaps with a notional amount of approximately \$68,000,000 that are tied to various indices as described in the Derivatives discussion.

The following tables provide the segmented time distribution for fixed income investments based on expected maturity as of June 30, 2010, concerning the fair value of investments and interest rate risk (dollars in thousands):

<b>Police and Fire Department Retirement Plan</b>								
	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
<b>Domestic fixed income:</b>								
Asset backed securities	\$ -	\$ -	\$ -	\$ 238	\$ 581	\$ 841	\$ 1,660	\$ 1,383
Bank loans	-	138	1,709	28,180	1,726	-	31,753	29,752
Collateralized mortgage obligations	-	-	-	1,328	3,005	27,254	31,587	30,145
Corporate bonds	-	-	1,156	48,177	37,195	97,984	184,512	166,898
FHLMC	-	-	-	-	2,940	11,019	13,959	13,414
FNMA	-	-	-	-	4,929	36,850	41,779	40,978
State and local obligations	-	-	-	-	-	7,596	7,596	7,321
U.S. TIPS	-	-	-	124,935	127,106	81,765	333,806	324,654
U.S. Treasury securities	-	11,150	19,968	131,737	30,516	22,978	216,349	212,911
Collective short-term investments	204,362	-	-	-	-	-	204,362	204,366
<b>Total domestic fixed income</b>	<b>204,362</b>	<b>11,288</b>	<b>22,833</b>	<b>334,595</b>	<b>207,998</b>	<b>286,287</b>	<b>1,067,363</b>	<b>1,031,822</b>
<b>International fixed income:</b>								
International corporate bonds	-	-	-	316	393	-	709	721
USD denominated convertible bonds	-	-	-	-	5,760	1,102	6,862	7,092
USD denominated corporate bonds	-	-	732	9,102	6,334	8,266	24,434	23,902
<b>Total international fixed income</b>	<b>-</b>	<b>-</b>	<b>732</b>	<b>9,418</b>	<b>12,487</b>	<b>9,368</b>	<b>32,005</b>	<b>31,715</b>
Pooled fixed income bond funds	-	-	-	-	-	91,501	91,501	82,212
<b>Total fixed income</b>	<b>\$ 204,362</b>	<b>\$ 11,288</b>	<b>\$ 23,565</b>	<b>\$ 344,013</b>	<b>\$ 220,485</b>	<b>\$ 387,156</b>	<b>\$ 1,190,869</b>	<b>\$ 1,145,749</b>

<b>Federated City Employees' Retirement System</b>								
	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
<b>Domestic fixed income:</b>								
Asset backed securities	\$ -	\$ -	\$ -	\$ 941	\$ -	\$ -	\$ 941	\$ 783
Bank loans	-	207	1,847	30,280	2,058	-	34,392	32,213
Corporate bonds	-	-	1,161	31,768	19,479	4,394	56,802	51,187
FHLMC	-	-	-	15,126	4,581	-	19,707	19,404
FNMA	-	-	-	6,797	4,287	-	11,084	10,838
Other U.S. Government agency	-	-	-	13,638	-	-	13,638	13,659
U.S. TIPS	-	-	-	94,203	98,065	65,255	257,523	249,660
U.S. Treasury securities	-	-	9,322	172,802	66,058	-	248,182	242,688
Collective short-term investments	63,202	-	-	-	-	-	63,202	63,223
<b>Total domestic fixed income</b>	<b>63,202</b>	<b>207</b>	<b>12,330</b>	<b>365,555</b>	<b>194,528</b>	<b>69,649</b>	<b>705,471</b>	<b>683,655</b>
<b>International fixed income:</b>								
USD denominated corporate bonds	-	-	-	4,505	1,889	496	6,890	5,572
Corporate convertible bonds	1,260	-	461	30,255	1,981	11,583	45,540	46,065
Pooled fixed income bond funds	-	-	-	-	20,190	-	20,190	19,500
<b>Total fixed income</b>	<b>\$ 64,462</b>	<b>\$ 207</b>	<b>\$ 12,791</b>	<b>\$ 400,315</b>	<b>\$ 218,588</b>	<b>\$ 81,728</b>	<b>\$ 778,091</b>	<b>\$ 754,792</b>

**Custodial Credit Risk** – The Retirement Systems do not have a policy regarding custodial credit risk. As of June 30, 2010 all of the Retirement Systems' investments, excluding invested securities lending collateral, are held in the Retirement Systems' names, and/or are not exposed to custodial credit risk. Securities lending collateral are invested in the lending agent's investment fund (see discussion on securities lending below).

## Notes to Basic Financial Statements

June 30, 2010

**Credit Quality Risk** – PFDRP’s investment policy dictates that all domestic and international bonds and notes in which PFDRP’s assets are invested, and which mature one year or more from the date of original issues, are required to carry a rating of “BBB” or better by two of the following three services: Standard & Poor’s (S&P), Moody’s Investors’ Service (Moody’s), or Fitch Ratings (Fitch). In the event that ratings are provided by only two agencies and the third is non-rated, the more conservative (lowest) rating will be assigned. If only one agency assigns a rating, that rating will be used; or, if unrated, the security shall be of equivalent quality in the judgment of the investment manager to a similar domestic issue. Investment managers may, with prior written authorization from PFDRP, invest a maximum of 20% of their fixed income portfolio in bonds or notes that are rated B or BB. If bonds are downgraded below the minimum credit quality allowable in the PFDRP’s investment policy at the time of purchase, the investment manager is permitted to hold up to 2% of the PFDRP’s portfolio managed by the individual manager, using the lowest of S&P, Moody’s, and Fitch’s rating in the event of a split-rated security.

FCERS’s investment policy dictates that assets shall generally be invested in investment grade, marketable, fixed-income securities. Domestic fixed income investment grade shall be defined as being rated Baa/BBB or better by Moody’s or S&P. “Yankee” bonds issued by foreign countries and denominated in U.S. dollars are allowed so long as they are rated Baa/BBB or better by Moody’s or S&P. If a security is not rated by Moody’s or S&P, the equivalent rating determined by the investment manager’s research department will be used. Should a current holding fall below this standard, the manager shall notify FCERS of the downgrade and confer with FCERS staff as to whether the security will continue to be held or disposed. Up to 10% investment in BB or B securities will be permitted with written authorization of FCERS’s Board. The investment managers employed to manage fixed-income securities will have discretion in the day-to-day management of the funds under their control.

The Retirement Systems may hedge against the possible adverse effects of currency fluctuations on the Retirement Systems’ portfolios of international fixed income obligations when it is considered appropriate. This is typically achieved using forward currency contracts. Short-term investments may consist of commercial paper rated at least A1 or P1, repurchase agreements, short-term U.S. securities, and other money market investments.

The following table provides information as of June 30, 2010 concerning credit risk (dollars in thousands):

S&P quality Rating	PFDRP		FCERS	
	Fair Value	Fair value as a % of fixed income investments	Fair Value	Fair value as a % of fixed income investments
AAA	\$ 46,246	7.2%	\$ 48,920	18.0%
AAA	41,913	6.5%	1,004	0.4%
A	76,578	12.0%	9,449	3.5%
BBB	45,351	7.1%	15,744	5.8%
BB	29,462	4.6%	47,007	17.3%
B	21,456	3.3%	35,986	13.2%
CCC & below	3,375	0.5%	3,929	1.4%
Not rated	376,333	58.7%	110,348	40.5%
Total investments exposed to credit risk	640,714	100.0%	272,387	100.0%
Exempt *	550,155		505,704	
Total fixed income investments	\$ 1,190,869		\$ 778,091	

\* Investments issued or explicitly guaranteed by the U.S. government are not considered to have credit risk and are considered exempt.

## Notes to Basic Financial Statements

**June 30, 2010**

**Foreign Currency Risk** – This is the risk that changes in the exchange rates will adversely affect the fair value of an investment. To mitigate this risk, the Retirement Systems' investment policies permit individual investment managers to defensively hedge currency to mitigate the impact of currency fluctuation on the underlying asset value.

The following tables provide information as of June 30, 2010, concerning the fair value of investments and foreign currency risk (dollars in thousands):

<b>Police and Fire Department Retirement Plan</b>						
Currency Name	Cash	Private Equity	Equity	Fixed Income	Pending Foreign Currency Exchanges	Total Exposure
Australian Dollar	\$ 1	\$ -	\$ 1,405	\$ -	\$ 27	\$ 1,433
Brazilian Real	4	-	7,156	70	226	7,456
British Pound Sterling	-	-	46,173	-	27	46,200
Canadian Dollar	-	-	6,114	-	132	6,246
Chilean Peso	-	-	605	-	-	605
Danish Krone	-	-	2,715	-	18	2,733
Egyptian Pound	-	-	509	-	-	509
Euro Currency	1,017	-	68,024	639	(1)	69,679
Hong Kong Dollar	41	-	8,509	-	2	8,552
Indian Rupee	-	-	5,032	-	-	5,032
Indonesian Rupiah	-	-	3,831	-	-	3,831
Israeli Shekel	38	-	1,501	-	-	1,539
Japanese Yen	398	-	61,745	-	33	62,176
Malaysian Ringgit	-	-	220	-	-	220
Mexican Peso	4	-	1,320	-	-	1,324
New Taiwan Dollar	870	-	1,810	-	-	2,680
New Zealand Dollar	-	-	674	-	-	674
Norwegian Krone	-	-	1,801	-	18	1,819
Singapore Dollar	-	-	1,682	-	26	1,708
South African Rand	-	-	2,712	-	-	2,712
South Korean Won	-	-	2,214	-	-	2,214
Swedish Krona	-	-	2,501	-	(7)	2,494
Swiss Franc	-	-	17,339	-	(2)	17,337
Thailand Baht	-	-	338	-	-	338
Turkish Lira	-	-	1,475	-	-	1,475
<b>Total</b>	<b>\$ 2,373</b>	<b>\$ -</b>	<b>\$ 247,405</b>	<b>\$ 709</b>	<b>\$ 499</b>	<b>\$ 250,986</b>

<b>Federated City Employees' Retirement System</b>						
Currency Name	Cash	Private Equity	Equity	Fixed Income	Pending Foreign Currency Exchanges	Total Exposure
Australian Dollar	\$ 2	\$ -	\$ 12,512	\$ -	\$ -	\$ 12,514
Brazilian Real	-	-	1,599	-	-	1,599
British Pound Sterling	86	-	33,283	2,247	(4,548)	31,068
Canadian Dollar	165	-	-	-	(329)	(164)
Danish Krone	-	-	3,055	-	-	3,055
Euro Currency	969	3,363	46,744	3,241	(2,051)	52,266
Hong Kong Dollar	74	-	6,762	738	(732)	6,842
Indian Rupee	-	-	-	-	(501)	(501)
Indonesian Rupiah	-	-	749	-	-	749
Japanese Yen	-	-	41,932	2,286	(2,171)	42,047
Malaysian Ringgit	2	-	974	-	-	976
Mexican Peso	-	-	412	-	-	412
Norwegian Krone	26	-	3,070	-	(1,448)	1,648
Polish Zloty	5	-	334	-	-	339
Singapore Dollar	13	-	3,423	-	-	3,436
South African Rand	2	-	1,154	-	-	1,156
South Korean Won	7	-	2,015	-	-	2,022
Swedish Krona	42	-	4,835	-	(316)	4,561
Swiss Franc	24	-	11,675	1,260	(1,201)	11,758
Thailand Baht	15	-	541	-	-	556
Turkish Lira	-	-	385	-	-	385
<b>Total</b>	<b>\$ 1,432</b>	<b>\$ 3,363</b>	<b>\$ 175,454</b>	<b>\$ 9,772</b>	<b>\$ (13,297)</b>	<b>\$ 176,724</b>

## Notes to Basic Financial Statements

June 30, 2010

**Concentration of Credit Risk** – PFDRP’s investment policy does not limit the amount that can be invested in a single issuer. However, it limits the aggregate amount that can be invested in each class of investments, limits the portion of the total PFDRP assets that a manager can hold in a single security with the exception of government backed securities to 5%, and limits the PFDRP assets placed with an investment manager to represent no more than 10% of that manager’s total assets. FCERS’s investment policy limits investment managers to no more than 10% of FCERS’s assets under their management to be invested in securities of any single issuer with the exception of U.S. Government and its agencies. As of June 30, 2010, PFDRP held Wisconsin Treasury notes of \$130,853,000, which represented 5.7% of total PFDRP’s net assets.

**Derivatives** – The Retirement Systems’ investment policies allow for investments in derivative instruments that comply with the Retirement Systems’ basic objective of achieving the highest return on investment funds, consistent with safety, and in accordance with accepted investment practices. Due to the level of volatility associated with certain derivative investments in general, The Retirement Systems specifically prohibit investment managers from using derivative or synthetic securities that expose the Retirement Systems to potentially high price volatility or are leveraged, or whose marketability may become severely limited. Derivative investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price on the last business day of the fiscal year at current exchange rates, if applicable. Investments that do not have an established market are reported at estimated fair value based the most recently available investor reports or audited financial statements issued by the manager of those funds. The fund manager provides an estimated unrealized gain/loss of the fund based on the most recently available audited financial statements and other fund information. The fair value of derivative investments that are not exchange traded, such as swaps, rights and to-be-announced (TBA) securities is determined by the Retirement Systems’ custodians based on the base market value of similar instruments. To-be-announced (TBA) securities derivative investment fair value is reported net of trade payable and represents the unrealized gain or loss on the related contracts. 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, 2010. The fair value of international currency forwards represents the unrealized gain or loss on the related contracts, which is calculated as the difference between the specified contract exchange rate and the exchange rate at the end of the reporting period.

The fair values and notational amounts of derivative instruments outstanding as of June 30, 2010, classified by type, and the changes in fair value of such derivative instruments for the years then ended as reported in the financial statements are as follows (amounts in thousands):

<b>Police and Fire Department Retirement Plan</b>					
Investment Derivative Instruments	Net Appreciation (Depreciation) in Fair Value of Investments through June 30, 2010		Fair Value at June 30, 2010		Notional Amount
	Classification	Amount	Classification	Amount	
Commodity swaps	Investment income/ (loss)	\$ (3,096)	Commodities	\$ (5,699)	\$ 242,348
Futures long/short (domestic and foreign)	Investment income/ (loss)	225	Fixed income (domestic and foreign)	-	-
Futures options bought/written	Investment income/ (loss)	107	Fixed income (domestic and foreign)	-	-
International currency forwards	Investment income/ (loss)	2,604	International currency contracts, net	494	-
Rights	Investment income/ (loss)	24	International equity	8	241
To Be Announced (TBA) Securities *	Investment income/ (loss)	2,442	Domestic fixed income	192	28,708
Total derivative instruments		\$ 2,306		\$ (5,005)	

<b>Federated City Employees' Retirement System</b>					
Investment Derivative Instruments	Net Appreciation (Depreciation) in Fair Value of Investments through June 30, 2010		Fair Value at June 30, 2010		Notional Amount
	Classification	Amount	Classification	Amount	
Commodity swaps	Investment income/ (loss)	\$ 1,606	Commodity swaps	\$ -	\$ 34,000
Infrastructure swaps	Investment income/ (loss)	-	Infrastructure swaps	-	33,902
Foreign currency forwards	Investment income/ (loss)	1,301	Foreign currency contracts, net	485	-
Future options bought/written	Investment income/ (loss)	222	Fixed income - collective short-term investments	-	-
Rights	Investment income/ (loss)	184	Equity (domestic and foreign)	67	-
Total derivative instruments		\$ 3,313		\$ 552	

\* TBA securities fair value reported net of trade payable.

## Notes to Basic Financial Statements

June 30, 2010

---

Derivative investments are subject to certain types of risks, including counterparty credit risk (non-exchange traded), interest rate risk, and foreign currency risk. The following describes the risks applicable to the investment derivative instruments that are reported as of June 30, 2010:

**Counterparty Credit Risk** – The Retirement Systems are exposed to credit risk on derivative instruments that are in asset positions and non-exchange traded.

As of June 30, 2010, PFDRP held rights with a fair value of \$8,000 and a notional value of \$241,000 held by unrated counterparties. PFDRP also held To-Be-Announced (TBA) securities with a fair value of \$192,000 and a notional value of \$28,708,000 all purchased in the over the counter market from broker-dealers with credit ratings of A or better. Additionally, PFDRP had outstanding commodity swaps with a fair value of negative \$5,698,000 and notional value of \$242,348,000 held by three counterparties with AAA ratings. PFDRP's investments in forward currency contracts bear credit risk in that parties to the contracts may fail to perform according to the terms of the contract. As of June 30, 2010, total commitments in forward currency contracts to purchase and sell international currencies were \$18,077,000 and \$18,077,000 respectively, with fair values of \$17,607,000 and \$18,101,000, respectively, held by counterparties with an S&P rating of at least AA-.

FCERS entered into commodity and infrastructure swaps with individual notional values of \$34,000,000 held by counterparties with A+ ratings. FCERS's investments in forward currency contracts bear credit risk in that parties to the contracts may fail to perform according to the terms of the contract. As of June 30, 2010, total commitments in forward currency contracts to purchase and sell international currencies were \$17,748,000 and \$17,263,000 respectively, with fair values of \$17,748,000 and \$17,263,000, respectively, held by counterparties with an S&P rating of at least AA-.

**Interest Rate Risk** – The Retirement Systems had exposure to interest rate risk on its fully collateralized commodity and infrastructure swaps. The fair values of the commodity swaps were marked-to-market daily based on their applicable indices, with unrealized gains and losses collateralized to minimize counterparty risk. As of June 30, 2010, FCERS invested in commodity swaps with a notional amount of \$34,000,000 and receives total return Dow Jones UBS Commodity Index and pays the 3-month Treasury bill rate plus a pay spread of 12.75 bps. The commodity swap was executed in April 2010 and matures in May 2011 with a monthly reset frequency. FCERS also invested in infrastructure swaps with a notional amount of approximately \$34,000,000 in which it receives the total return S&P Global Infrastructure Index, net of the 3-month US London Interbank Offered Rate plus 25 bps. The infrastructure swap was executed in April 2010 and matures in May 2011 with a quarterly reset frequency. As of June 30, 2010, PFDRP had outstanding commodity swaps with a notional value of \$242,348,000 that are tied to 3-month Treasury bill rates. 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 Retirement Systems' exposure to counterparty risk.

## Notes to Basic Financial Statements

**June 30, 2010**

As of June 30, 2010, FCERS derivative instruments had maturity dates of less than one year. The following table provides the segmented time distribution for PFDRP's derivative instruments based on expected maturity (in years) as of June 30, 2010, concerning the fair value of derivative investments and interest rate risk (dollars in thousands):

	PFDRP		Total
	0 - 1 Year	More than 10 years	
Investment Derivative Instruments:			
To Be Announced (TBA) securities	\$ -	\$ 192	\$ 192
Commodity swaps	(5,699)	-	(5,699)
Total investment derivative instruments	\$ (5,699)	\$ 192	\$ (5,507)

TBAs and commodity swaps are highly sensitive to changes in interest rates. The table below details the reference rate, fair value and notational amount of these derivative instruments as of June 30, 2010 (dollars in thousands):

Reference Rate	PFDRP	
	Total Fair Value	Notional Amount
To Be Announced (TBA) securities:		
5.5% fixed	\$ -	\$ 5,605
6.5% fixed	192	23,103
Total TBA securities	192	28,708
Commodity swaps:		
Receive Dow Jones UBS Commodity Index, Pay 3-month Treasury Bill rate plus a pay spread between 4-6 bps	(5,699)	242,348
Total investment derivative instruments	\$ (5,507)	\$ 271,056

**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, 2010, the Retirement Systems' net position in these contracts is recorded at fair value as international currency contract investments. The fair values of international currency contracts are determined by quoted currency prices from national exchanges. The Retirement Systems' commitments relating to forward currency contracts are settled on a net basis.

The following tables provide information as of June 30, 2010, concerning the fair value of forward currency contracts and foreign currency risk (dollar in thousands):

Currency Name	Pending Foreign Currency Exchanges			Rights
	PFDRP	FCERS	Total	FCERS
Australian Dollar	\$ 27	\$ -	\$ 27	\$ -
Brazilian Real	225	-	225	-
British Pound Sterling	25	105	130	-
Canadian Dollar	132	13	145	-
Danish Krone	18	-	18	-
Euro Currency	-	223	223	61
Hong Kong Dollar	2	3	5	-
Indian Rupee	-	18	18	-
Japanese Yen	33	(108)	(75)	-
Norwegian Krone	15	144	159	6
Singapore Dollar	26	-	26	-
Swedish Krona	(6)	31	25	-
Swiss Franc	(3)	56	53	-
Total	\$ 494	\$ 485	\$ 979	\$ 67

## Notes to Basic Financial Statements

June 30, 2010

---

**Securities Lending.** The municipal code and the investment policies, adopted by the Boards of the Retirement Systems, permit the use of a securities lending program with its principal custodian banks (Custodians). The Retirement Systems do not have a threshold for securities lending. The investment policy of FCERS requires that loan maturities cannot exceed one year, and no more than 15% of the portfolio can be lent longer than six months. The custodial agreements with the Retirement Systems' custodians authorize such custodian to loan securities in the Retirement Systems' investment portfolio under such terms and conditions, as the custodians deem advisable and to permit the loaned securities to be transferred into the name of the borrowers. The Retirement Systems receive a fee from the borrower for the use of the loaned securities. As of June 30, 2010, the Retirement Systems' had no exposure to borrower credit risk related to the securities lending transactions as the custodians are responsible for the replacement of the loaned securities with other securities of the same issuer, class and denomination, or if such securities are not available on the open market, the custodian is required to credit the Retirement Systems' account with the market value of such unreturned loaned securities if the loaned securities are not returned by the borrower. All securities loan agreements can be terminated on demand within a period specified in each agreement by either the Retirement Systems or borrowers.

Securities lending collateral represents investments in an investment pool purchased with cash collateral, as well as securities collateral that may not be pledged or sold without a default by the borrower. Securities lending transactions collateralized with securities that cannot be pledged or sold without borrower default are not reported as assets and liabilities in the fiduciary statement of net assets. The Retirement Systems do not match the maturities of investments made with cash collateral with the securities on loan.

PFDRP authorized State Street Bank and Trust to invest and reinvest cash collateral in State Street's Quality D Short-term Investment Fund which seeks to maintain an average effective duration of 90 days or a maximum option-adjusted duration for variable rate securities of 2.5 years or less at the time of purchase, and all fixed rates instruments must have an option-adjusted duration not to exceed 18 months at the time of purchase. At the time of purchase, all securities with maturities of 13 months or more must qualify as first-tier securities and all securities with maturities in excess of 13 months will (a) be rated A or better by at least two NRSROs, or (b) if rated only one NRSRO, be rated "A" or better by such NRSRO, or (c) if unrated, be determined by State Street to be of comparable quality. As of June 30, 2010, the cash collateral pool totaled \$39.8 billion and the weighted average maturity was 29.64 days. The cash collateral pool included asset backed securities (22% of the pool), certificates of deposit (42%), corporate securities (2%), bank notes (9%), asset backed commercial paper (9%), and other securities (16%). As of June 30, 2010, the underlying securities loaned by PFDRP as a whole amounted to approximately \$379,912,000. The cash collateral and the non-cash collateral totaled \$388,885,000 and \$1,361,000, respectively, at carrying cost. The net asset value (NAV) of the cash collateral pool as of June 30, 2010 for PFDRP was at \$0.9889 or \$384,569,000 on a mark to market basis. The NAV of less than \$1.00 is due to the decline in the fair value of assets held by the cash collateral pool. The NAV of \$0.9889 of the cash collateral pool results in an unrealized loss of approximately \$4,316,000 for PFDRP. The unrealized loss of \$4,316,000 is reflected in the securities lending income earnings in the statement of changes in plan net assets. PFDRP is exposed to market risk including the possible loss of principal value in the cash collateral pool due to the fluctuation in the market value of the assets held by the cash collateral pool.

FCERS authorized The Northern Trust Company to invest and reinvest cash collateral in Northern Trust's pooled investment vehicle, which must have weighted average life of 60 days or less. Securities with maturities of 13 months or more must have a rating of A or better. Securities with maturities of less than 13 months are rated at least P-3. As of June 30, 2010, the size of the cash collateral pooled vehicle was \$34.5 billion and the weighted average life of 24 days. The cash collateral investments included time deposits (13% of the pool), repurchase agreements (22%),

## Notes to Basic Financial Statements

**June 30, 2010**

asset backed securities (12%), certificates of deposit (23%), variable rate securities (4%) and commercial paper and other bank notes (26%). As of June 30, 2010, the underlying securities loaned by FCERS as a whole amounted to approximately \$168,822,000. The cash collateral and the non-cash collateral totaled \$173,232,000 and \$96,000, respectively. As of June 30, 2010, FCERS settled and remitted realized losses of \$278,000 to the Northern Trust Core USA Fund.

The Retirement Systems are exposed to investment risk including the possible loss of principal values in the cash collateral pools due to the fluctuation in the market value of the assets held by the cash collateral pools.

The loaned securities as of June 30, 2010 consisted of U.S. Treasury securities, U.S. government agency securities, domestic corporate bonds, international corporate bonds, international government bonds, domestic equity securities, and international equity securities. In return, the Retirement Systems receive collateral in the form of cash or securities equal to at least 102% for domestic and 105% for international of the market value of transferred securities plus accrued interest for reinvestment.

The following table provides information concerning securities lent and collateral received as of June 30, 2010 (dollars in thousands):

	<u>PFDRP</u>	<u>FCERS</u>	<u>Total Fair Value</u>
<b>Type of Investment Lent</b>			
For Cash Collateral:			
U.S. treasury notes and bonds	\$ 218,540	98,047	\$ 316,587
U.S. government agency securities	-	9,862	9,862
Domestic corporate bonds	44,856	19,945	64,801
Domestic equity securities	94,589	33,759	128,348
International equity securities	20,605	7,113	27,718
Total Lent for Cash Collateral	<u>378,590</u>	<u>168,726</u>	<u>547,316</u>
For Non-Cash Collateral:			
International equity securities	-	96	96
Domestic equity securities	1,322	-	1,322
Total Lent for Non-Cash Collateral	<u>1,322</u>	<u>96</u>	<u>1,418</u>
Total Securities Lent	<u>\$ 379,912</u>	<u>168,822</u>	<u>\$ 548,734</u>
<b>Type of Collateral Received</b>			
Cash Collateral	<u>\$ 384,569</u>	<u>173,232</u>	<u>\$ 557,801</u>
Non-Cash Collateral:			
For lent international equity securities	-	95	95
For lent domestic equity securities	1,361	-	1,361
Total Non-Cash Collateral	<u>1,361</u>	<u>95</u>	<u>1,456</u>
Total Collateral Received	<u>\$ 385,930</u>	<u>173,327</u>	<u>\$ 559,257</u>

# Notes to Basic Financial Statements

June 30, 2010

## B. Receivables, Net of Allowances

Receivables at year-end of the City's major individual funds and nonmajor funds taken in aggregate, including the applicable allowances for uncollectible accounts are as follows (dollars in thousands):

Receivables – Governmental Activities:	General Fund	Redevelopment Agency	Housing Activities	Special Assessment Districts	Total Nonmajor Funds	Governmental Activities
Taxes	\$ 29,403	-	-	-	4,496	\$ 33,899
Accrued interest	578	240	1,434	70	2,404	4,726
Grants	2,679	81	2,401	-	16,251	21,412
Special assessments	-	-	-	60,905	-	60,905
Other	23,703	1,610	234	-	23,939	49,486
Less: allowance for uncollectibles	(8,954)	-	(3)	-	(3,555)	(12,512)
Total receivables, net	<u>\$ 47,409</u>	<u>1,931</u>	<u>4,066</u>	<u>60,975</u>	<u>43,535</u>	<u>\$ 157,916</u>

Business-Type Activities:	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total Business-Type Activities
Accounts	\$ 9,174	1,986	2,571	103	\$ 13,834
Accrued interest	1,211	773	48	47	2,079
Grants	7,892	985	-	-	8,877
Less: allowance for uncollectibles	(542)	(405)	(575)	(10)	(1,532)
Total receivables, net	<u>\$ 17,735</u>	<u>3,339</u>	<u>2,044</u>	<u>140</u>	<u>\$ 23,258</u>

Special assessment receivables in the amount of \$60,975,000 are not expected to be collected within the subsequent year.

## C. Loans Receivable

The composition of the City's loans receivable as of June 30, 2010 is as follows (dollars in thousands):

Type of Loan	General Fund	Redevelopment Agency	Housing Activities	Nonmajor Funds	Total Governmental Activities
20% Housing Program Developer, rehabilitation, second mortgage and relocation loans	\$ -	-	554,753	-	\$ 554,753
Loans funded by federal grants	-	-	47,257	7,620	54,877
Economic development, real estate developer and other loans	2,392	45,688	45,551	765	94,396
Less: allowance for uncollectibles	-	(12,852)	(337,255)	(3,002)	(353,109)
Total loans, net	<u>\$ 2,392</u>	<u>32,836</u>	<u>310,306</u>	<u>5,383</u>	<u>\$ 350,917</u>

California Community Redevelopment Law requires that at least 20% of the incremental tax revenues generated from certain redevelopment project areas be used to increase, improve, and preserve the affordable housing stock for families and individuals with very low, low, and moderate incomes. In response to this requirement, the City established its 20% Housing Program to offer financial assistance to qualified developers, families, and individuals by providing loans at "below market" rates.

# Notes to Basic Financial Statements

June 30, 2010

---

Typical loans and related terms are summarized as follows:

<u>Loan Type</u>	<u>Interest Rate</u>	<u>Due</u>
New Construction and Permanent	0 - 4%	up to 55 years
Multi-unit rental rehabilitation	3%	5 or more years
Take-out (first time homebuyer)	4%	7 to 40 years
Home improvement	3 - 6%	1 to 30 years

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

The City has also invested in multi-family rental housing projects serving low to moderate income individuals through subordinate loans with terms of up to 55 years. Generally, these loans are to be repaid through fixed payments or net cash flow payments from project operations and the term and potential risk of each loan varies. Because of the net cash flow feature of these subordinate loans, earnings and repayments are not as definite as with other loans receivable. 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 through charges to the allowance and any subsequent recoveries are added to 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 20% Housing Program loans receivable as of June 30, 2010.

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, 2010. These commitments involve elements of credit and interest rate risk similar to those described above for outstanding loans receivable. As of June 30, 2010, amounts committed to extend credit under normal lending agreements totaled approximately \$43,254,000.

# Notes to Basic Financial Statements

## June 30, 2010

### D. Capital Assets

#### 1. Summary Schedule

The following is a summary of capital assets activity for the fiscal year ended June 30, 2010 (dollars in thousands):

	Balance July 1, 2009, as restated	Additions	Deletions	Transfers	Balance June 30, 2010
<b>Governmental activities:</b>					
Capital assets, not being depreciated:					
Land	\$ 561,258	6,567	26,368	-	\$ 541,457
Construction in progress	252,661	100,465	-	(91,428)	261,698
Total capital assets, not being depreciated	<u>813,919</u>	<u>107,032</u>	<u>26,368</u>	<u>(91,428)</u>	<u>803,155</u>
Capital assets, being depreciated:					
Buildings	1,288,136	11,720	-	84,389	1,384,245
Improvements, other than buildings	128,380	1,536	-	3,023	132,939
Infrastructure	11,301,028	35,249	-	4,016	11,340,293
Vehicles and equipment	117,129	6,454	16,029	-	107,554
Furnitures and fixtures	26,507	-	-	-	26,507
Property under capital leases	13,379	-	-	-	13,379
Total capital assets, being depreciated	<u>12,874,559</u>	<u>54,959</u>	<u>16,029</u>	<u>91,428</u>	<u>13,004,917</u>
Less accumulated depreciation for:					
Buildings	298,684	36,040	-	-	334,724
Improvements, other than buildings	7,552	2,279	-	-	9,831
Infrastructure	5,633,585	305,531	-	-	5,939,116
Vehicles and equipment	94,195	7,716	15,991	-	85,920
Furnitures and fixtures	10,577	2,655	-	-	13,232
Property under capital leases	12,305	193	-	-	12,498
Total accumulated depreciation	<u>6,056,898</u>	<u>354,414</u>	<u>15,991</u>	<u>-</u>	<u>6,395,321</u>
Total capital assets, being depreciated, net	<u>6,817,661</u>	<u>(299,455)</u>	<u>38</u>	<u>91,428</u>	<u>6,609,596</u>
Governmental activities capital assets, net	<u>\$ 7,631,580</u>	<u>(192,423)</u>	<u>26,406</u>	<u>-</u>	<u>\$ 7,412,751</u>
<b>Business-type Activities:</b>					
Capital assets, not being depreciated:					
Land	\$ 134,926	-	-	-	\$ 134,926
Intangible assets	12,882	-	-	-	12,882
Construction in progress	868,141	320,902	37,051	(941,577)	210,415
Total capital assets, not being depreciated	<u>1,015,949</u>	<u>320,902</u>	<u>37,051</u>	<u>(941,577)</u>	<u>358,223</u>
Capital assets, being depreciated:					
Buildings	632,938	11,150	10,673	940,105	1,573,520
Improvements, other than buildings	880,071	7,664	896	1,274	888,113
Vehicles and equipment	178,798	2,891	1,014	128	180,803
Property under capital leases	13,406	-	-	-	13,406
Total capital assets, being depreciated	<u>1,705,213</u>	<u>21,705</u>	<u>12,583</u>	<u>941,507</u>	<u>2,655,842</u>
Less accumulated depreciation for:					
Buildings	261,468	53,413	35,991	-	278,890
Improvements, other than buildings	388,098	22,948	895	-	410,151
Vehicles and equipment	114,165	6,680	937	(70)	119,838
Property under capital leases	10,607	455	-	-	11,062
Total accumulated depreciation	<u>774,338</u>	<u>83,496</u>	<u>37,823</u>	<u>(70)</u>	<u>819,941</u>
Total capital assets, being depreciated, net	<u>930,875</u>	<u>(61,791)</u>	<u>(25,240)</u>	<u>941,577</u>	<u>1,835,901</u>
Business-type activities capital assets, net*	<u>\$ 1,946,824</u>	<u>259,111</u>	<u>11,811</u>	<u>-</u>	<u>\$ 2,194,124</u>

\* With the adoption of GASB Statement No. 51, the intangible assets have been determined to have indefinite useful life and the beginning balance of the capital assets of Business-type Activities has been restated and reclassified.

# Notes to Basic Financial Statements

June 30, 2010

---

---

## 2. Depreciation

Depreciation expense charged to various governmental and business-type activities of the City for the fiscal year ended June 30, 2010 is as follows (dollars in thousands):

<b>Governmental activities:</b>	
General government	\$ 14,032
Public safety	6,569
Capital maintenance	306,267
Community services	<u>27,546</u>
Total depreciation expense governmental activities	<u>\$ 354,414</u>
<b>Business-type activities:</b>	
Norman Y. Mineta San José International Airport	\$ 54,805
Wastewater Treatment System	23,744
Municipal Water System	2,483
Parking System	<u>2,464</u>
Total depreciation expense business-type activities	<u>\$ 83,496</u>

## 3. Intangible Assets

As discussed in Note I.E., on July 1, 2009, the City implemented GASB Statement No. 51. In addition, to the Airport's habitation rights and navigation/relocation easements amortization restatement, the City performed an analysis of its intangible assets with the following results:

- Internally generated intangible assets – Various computer software used by the City have been purchased and customized to meet specifications required by the City's operational needs. The City's various software was modified using more than minimal incremental effort before they were put in operation and therefore considered internally generated for purposes of this statement. As permitted by GASB Statement No. 51, the City did not elect retroactive reporting for its internally generated intangible assets and as a result, there was no amortization expense recorded during the fiscal year ended June 30, 2010, related to these acquisitions.
- Trademarks and patents – The City owns service marks filed with the California Secretary of State for San Jose Smart Start and the US Patent & Trademark Office (USPTO) in connection with Airport and Work2Future. Due to the insignificant amount of costs associated with the service marks, the City elected to not capitalize them.

## 4. Capitalized Interest

Interest costs that related to the acquisition of buildings and improvements and equipment acquired with tax-exempt and taxable debt are capitalized for business-type activities. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project, with interest earned on invested tax-exempt debt proceeds over the same period. Capitalized interest cost is prorated to completed projects based on the completion date of each project. For the year ended June 30, 2010, the total amount of interest capitalized in the Airport Enterprise Fund, net of allowable interest earned of temporary investment proceeds, was approximately \$30,649,000.

# Notes to Basic Financial Statements

## June 30, 2010

### 5. Construction Commitments

Commitments outstanding as of June 30, 2010, related to governmental and business-type activities construction in progress totaled approximately \$26,507,000 and \$93,032,000, 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, Nonmajor Governmental Funds and the Redevelopment Agency Fund under these operating lease agreements for the fiscal year ended June 30, 2010 amounted to approximately \$1,883,000, \$1,277,000 and \$3,740,000 respectively.

The future minimum lease payments anticipated under the existing lease commitments, as of June 30, 2010, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	General Fund	Redevelopment Agency	Nonmajor Governmental Funds	Total Governmental Activities
2011	\$ 2,035	\$ 3,082	\$ 1,205	\$ 6,322
2012	1,630	3,030	1,197	5,857
2013	1,377	2,689	947	5,013
2014	728	2,625	96	3,449
2015	57	2,265	-	2,322
2016-2020	114	3,335	-	3,449
2021-2022	-	188	-	-
Totals	<u>\$ 5,941</u>	<u>\$ 17,214</u>	<u>\$ 3,445</u>	<u>\$ 26,412</u>

#### Business-Type Activities

**Airport Office Lease.** The City leases the Airport's office space under a lease agreement which, as amended, expires in December 2014. The City decided to terminate the lease agreements effective November 30, 2010. In accordance with the provisions of the lease agreement, a termination payment in the amount of \$905,000, equal to six months of rent is required and is scheduled to be paid in July 2010. Rental expense for the Airport's office space was approximately \$2,498,000 for the year ended June 30, 2010.

# Notes to Basic Financial Statements

## June 30, 2010

**Airport Gas-Powered Buses.** In December 2007, the City entered into an operating lease and maintenance agreement of fourteen compressed natural gas powered buses for the Airport. The term of the agreement is from August 1, 2008 to July 31, 2015. In September 2009, the agreement was amended to add ten buses for the period of June 30, 2010 to May 31, 2017. Rental expenses for the Airport buses for the year ended June 30, 2010 was approximately \$3,089,000.

**Future Minimum Payments.** The future minimum payments anticipated under these commitments, as of June 30, 2010, are as follows (dollars in thousands):

Fiscal Year	Ending	Operating
June 30,	Leases	Leases
2011	\$	2,224
2012		2,227
2013		2,230
2014		2,233
2015		2,236
2016-2017		1,832
Total	\$	12,982

### **2. Operating Leases as Lessor**

The City also leases building space, facilities, and/or the privilege of operating a concession to tenants and concessionaries resulting in receipt of annual rents, which are described as follows:

#### **Governmental Activities**

In October 1991, the City entered into a 15-year agreement (the initial term) with the San José Arena Management Corporation (the Manager), an unrelated entity, regarding the management, operations, and maintenance of the San José Arena, and use of the San José Arena by the San José Sharks, a franchise of the National Hockey League. The agreement was subsequently amended on December 19, 2000 extending the agreement for an additional 10 years (the extended term). The initial term commenced on October 24, 1991 and terminated on July 31, 2008. The extended term commenced on August 1, 2008 and terminates on July 31, 2018. As part of the amended agreement, the Manager is required to pay the City annual minimum rental and hockey rental payments of \$1,642,000 and \$1,460,000, respectively, as defined by the agreement. In the fiscal year ended June 30, 2010, the City received approximately \$5,353,000 from the Manager. As of June 30, 2010, leased assets had total historic cost of approximately \$118,114,000 and accumulated depreciation of approximately \$44,604,000.

#### **Business-Type Activities**

**Airline-Airport Lease and Operating Agreements.** The City entered into an Airline-Airport lease and operating agreement with various passenger and cargo airlines (Signatory Airlines) serving the Airport. The airline lease agreement, which took effect on December 1, 2007, is scheduled to expire on June 30, 2012 and may be extended for one additional five-year term by mutual agreement of the City and the Signatory 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 airline lease agreement also includes a revenue sharing provision to evenly divide net unobligated Airport revenues between the Airport and the airlines currently operating at the Airport after each fiscal year. In any fiscal year in which there are net unobligated Airport revenues and all

## Notes to Basic Financial Statements

June 30, 2010

---

requirements of the City's Airport financing documents have been satisfied, the remaining net unobligated Airport revenues are to be evenly divided between the City and the airlines. If net revenues exceed the projected levels outlined in the Airport Forecast identified in the new airline lease agreement, then the airlines share of the difference will be deposited into the Rate Stabilization Fund up to a cap of \$9,000,000. Once the Rate Stabilization Fund has been fully funded or in the event that the actual net revenues do not exceed the projected net revenues, the airlines share of net revenues shall be applied as a credit to the airline terminal revenue requirement for the following fiscal year, thus reducing terminal rental rates for the following fiscal year. The first \$1,000,000 of City's share of any net revenues shall be retained by the Airport in a discretionary fund to be used for any lawful Airport purpose. The remaining balance of City's share shall be applied to the capital costs of the Airport's Master Plan Program. For the fiscal year ended June 30, 2010, the Airport's revenues as defined in its lease agreement exceeded its expenditures and reserve requirements by approximately \$35,486,000. The surplus received during the fiscal year ended June 30, 2010 will be distributed in accordance of the revenue sharing provisions of the airline lease agreement.

**Other Leases.** The Airport also enters into leases with concessionaires, airline carriers, and other business entities for building space and/or the privilege of operating a concession at the Airport. The terms of these operating leases range from one month to twenty-nine 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 \$60,964,000 for the fiscal year ended June 30, 2010.

The future minimum rentals to be received from the aforementioned operating leases, as of June 30, 2010, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	Amount
2011	\$ 77,988
2012	104,829
2013	42,159
2014	41,961
2015	37,695
2016-2020	185,893
2021-2025	16,534
2026-2030	15,544
2031-2035	12,698
2036-2040	7,041
Total	<u>\$ 542,342</u>

These future minimum rentals are based upon annual rates and charges agreed to by the airlines and other tenants. In addition to the future minimum rentals disclosed above, the Airport expects to receive approximately \$1,202,000 from month-to-month rentals in fiscal year ending June 30, 2011. As of June 30, 2010, leased assets had historic costs of approximately \$1,001,525,000 and accumulated depreciation of approximately \$48,747,000.

# Notes to Basic Financial Statements

## June 30, 2010

### 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, 2010 (dollars in thousands):

	Purpose	Issue Amount	Issue Date	Final Maturity	Range of Interest Rates	Principal Payments (millions)	Balance June 30, 2010
<b>Governmental Activities:</b>							
City of San Jose:							
General Obligation Bonds:							
Series 2001 (Libraries and Parks)	Community Facilities	\$ 71,000	06/06/2001	09/01/2031	4.75-5.125%	2.37	\$ 52,040
Series 2002 (Libraries, Parks, Public Safety)	Community Facilities	116,090	07/18/2002	09/01/2032	4.00-5.00%	3.87	89,000
Series 2004 (Libraries, Parks, Public Safety)	Community Facilities	118,700	07/14/2004	09/01/2034	4.00-5.00%	3.96	98,925
Series 2005 (Libraries and Public Safety)	Community Facilities	46,300	06/23/2005	09/01/2035	3.00-7.50%	1.54-1.55	40,140
Series 2006 (Libraries and Parks)	Community Facilities	105,400	06/29/2006	09/01/2036	4.00-5.00%	3.51-3.52	94,870
Series 2007 (Parks and Public Safety)	Community Facilities	90,000	06/20/2007	09/01/2037	4.00-8.00%	3.00	84,000
Series 2008 (Libraries and Parks)	Community Facilities	33,100	06/25/2008	09/01/2038	4.00-5.00%	1.10-1.11	31,995
Series 2009 (Public Safety)	Community Facilities	9,000	06/25/2009	09/01/2039	4.00-6.00%	0.00-0.30	9,000
							<u>499,970</u>
HUD Section 108 Note	Economic Development	25,810	02/10/2005	08/01/2024	Variable	1.01-2.22	<u>22,915</u>
City of San Jose Financing Authority:							
Lease Revenue Bonds:							
Series 1993B (Community Facilities)	Community Facilities	18,045	04/13/1993	11/15/2013	5.90-6.00%	0.25-0.31	2,243
Series 1997B (Fire, Childcare, Library Land)	Community Facilities	9,805	07/29/1997	08/01/2012	4.75-4.875%	0.37-0.41	1,165
Series 2002B (Civic Center Project)	Civic Center	292,425	11/14/2002	06/01/2037	3.75-5.25%	0.16-33.45	291,820
Series 2003A (Central Service Yard)	Refunding	22,625	09/18/2003	10/15/2023	3.10-4.70%	0.94-1.61	17,465
Series 2006A (Civic Center Project)	Refunding	57,440	06/01/2006	06/01/2039	4.00-5.00%	0.00-17.44	57,440
Series 2007A (Recreational Facilities)	Refunding	36,555	06/28/2007	08/15/2030	4.125-4.75%	0.91-2.22	33,435
Series 2008A (Civic Center)	Refunding	60,310	08/14/2008	06/01/2039	Variable	0.00-21.89	56,920
Series 2008B (Civic Center Garage)	Refinancing	36,580	07/10/2008	06/01/2039	Variable	0.70-1.89	35,280
Series 2008C (Hayes Mansion)	Refunding	10,915	06/26/2008	06/01/2027	Variable	0.00-4.57	10,915
Series 2008D (Taxable) (Hayes Mansion)	Refunding	47,390	06/26/2008	06/01/2025	Variable	1.30-4.20	45,080
Series 2008E (Taxable) (Ice Centre)	Refunding	28,070	07/03/2008	06/01/2025	Variable	1.06-2.52	26,025
Series 2008F (Taxable) (Land Acquisition)	Refunding	67,195	06/11/2008	06/01/2034	Variable	0.00-4.81	67,195
							<u>644,983</u>
Special Assessment Bonds with Limited Governmental Commitment:							
Special Assessment Bonds:							
Series 24K (Seismic Retrofit)	Seismic Retrofit	823	06/29/1993	09/02/2013	8.50%	0.01	30
Series 24Q (Hellyer-Percy)	Public Infrastructure	27,595	06/26/2001	09/02/2023	4.90-5.875%	0.98-2.05	20,550
Series 24R (2002 Consolidated Refunding)	Consolidated Refunding	13,940	07/03/2002	09/02/2015	3.50-4.375%	1.01-1.21	6,145
Special Tax Bonds:							
CFD No. 1 (Capitol Expressway Auto Mall)	Public Infrastructure	4,100	11/18/1997	11/01/2022	5.30-5.70%	0.15-0.30	2,820
CFD No. 6 (Great Oaks-Route 85)	Public Infrastructure	12,200	12/18/2001	09/01/2023	4.50-6.00%	0.47-0.97	9,695
CFD No. 9 (Bailey/Highway 101)	Public Infrastructure	13,560	02/13/2003	09/01/2032	4.70-6.65%	0.25-0.95	11,860
CFD No. 10 (Hassler-Silver Creek)	Public Infrastructure	12,500	07/23/2003	09/01/2023	3.80-5.25%	0.50-0.94	9,805
							<u>60,905</u>
Redevelopment Agency:							
Tax Allocation Bonds:							
Series 1993 (Merged Area Refunding)	Advance Refundings	692,075	12/15/1993	02/01/2024	6.00%	0.00-18.20	46,650
Series 1997 (Merged Area)	Redevelopment Projects	106,000	03/27/1997	08/01/2028	5.375-5.625%	0.01-0.72	6,400
Series 1999 (Merged Area)	Redevelopment Projects	240,000	01/06/1999	08/01/2031	4.75%	0.00-7.17	12,920
Series 2002 (Merged Area)	Redevelopment Projects	350,000	01/24/2002	08/01/2032	4.00-4.50%	0.00-11.29	22,565
Series 2003 (Merged Area)	Redevelopment Projects	135,000	12/22/2003	08/01/2033	4.00-5.00%	0.00-34.10	127,545
Series 2004A (Merged Area)	Refunding	281,985	05/27/2004	08/01/2019	2.80-5.25%	8.78-31.90	222,525
Series 2005A (Merged Area)	Refunding	152,950	07/25/2005	08/01/2028	4.30-5.00%	0.30-26.21	147,865
Series 2005B (Merged Area)	Refunding	67,130	07/25/2005	08/01/2015	4.40-5.00%	4.23-21.56	67,130
Series 2006A (Taxable) (Merged Area)	Redevelopment Projects	14,300	11/14/2006	08/01/2022	5.65%	1.80-6.00	13,300
Series 2006B (Merged Area)	Redevelopment Projects	67,000	11/14/2006	08/01/2035	4.50-5.00%	1.00-21.00	67,000
Series 2006C (Merged Area)	Refunding	423,430	12/15/2006	08/01/2032	3.75-5.00%	12.00-74.28	423,430
Series 2006D (Merged Area)	Refunding	277,755	12/15/2006	08/01/2023	4.00-5.00%	0.56-67.33	276,745
Series 2007A (Taxable) (Merged Area)	Redevelopment Projects	21,330	11/07/2007	08/01/2017	5.10%	1.66-2.67	17,790
Series 2007B (Merged Area)	Redevelopment Projects	191,600	11/07/2007	08/01/2036	4.25-5.00%	1.53-23.97	191,600
Series 2008A (Merged Area)	Redevelopment Projects	37,150	12/17/2008	08/01/2018	5.25-6.50%	3.03-4.60	34,120
Series 2008B (Merged Area)	Redevelopment Projects	80,145	11/13/2008	08/01/2035	6.25-7.00%	2.60-6.70	80,145
							<u>1,757,730</u>
Revenue Bonds (Subordinate):							
Series 1996A (Merged Area)	Redevelopment Projects	29,500	06/27/1996	07/01/2026	Variable	0.80-2.00	25,000
Series 1996B (Merged Area)	Redevelopment Projects	29,500	06/27/1996	07/01/2026	Variable	0.80-2.00	25,000
Series 2003A (Taxable) (Merged Area)	Redevelopment Projects	45,000	08/27/2003	08/01/2028	Variable	1.30-3.10	35,000
Series 2003B (Merged Area)	Redevelopment Projects	15,000	08/27/2003	08/01/2032	Variable	0.00-3.90	15,000
							<u>100,000</u>

# Notes to Basic Financial Statements

## June 30, 2010

	Purpose	Issue Amount	Issue Date	Final Maturity	Range of Interest Rates	Principal Payments (millions)	Balance June 30, 2010
<b>Governmental Activities (continued):</b>							
Redevelopment Agency (continued):							
City of San Jose Financing Authority Revenue Bonds (Subordinate):							
Series 2001A (4th & San Fernando)	Parking Facility	\$ 48,675	04/10/2001	09/01/2026	3.90-5.25%	1.49-3.21	\$ 38,255
Series 2001F (Convention Center)	Refunding	186,150	07/26/2001	09/01/2022	4.00-5.00%	7.42-14.73	145,895
							<u>184,150</u>
HUD Section 108 Note (Masson/Dr. Eu/Security)	Redevelopment Projects	5,200	02/11/1997	08/01/2016	Variable	0.29-0.47	2,670
HUD Section 108 Note (CIM Block 3/Central Place)	Redevelopment Projects	13,000	02/08/2006	08/01/2025	Variable	0.00-1.14	13,000
HUD Section 108 Note (Story/King Retail)	Redevelopment Projects	18,000	06/30/2006	08/01/2025	Variable	0.67-1.57	17,330
							<u>33,000</u>
CSCDA - 2005 ERAF Loan	Redevelopment Projects	19,085	04/27/2005	08/01/2015	4.59-5.01%	1.87-2.36	10,725
CSCDA - 2006 ERAF Loan	Redevelopment Projects	14,920	05/03/2006	08/01/2016	5.44-5.67%	1.38-1.91	10,010
							<u>20,735</u>
Housing Set-Aside Tax Allocation Bonds:							
Series 1997E (AMT) (Merged Area)	Affordable Housing	17,045	06/23/1997	08/01/2027	5.75-5.85%	0.34-3.67	17,045
Series 2003J (Taxable) (Merged Area)	Afford. Housing/Refunding	55,265	07/10/2003	08/01/2024	4.125-5.25%	2.02-3.51	40,475
Series 2003K (Merged Area)	Afford. Housing/Refunding	13,735	07/10/2003	08/01/2029	3.00-4.40%	0.23-1.07	8,015
Series 2005A (Merged Area)	Refunding	10,445	06/30/2005	08/01/2024	3.75-5.00%	0.97-2.27	10,445
Series 2005B (Taxable) (Merged Area)	Refunding	119,275	06/30/2005	08/01/2035	4.37-5.46%	0.70-8.30	113,460
Series 2010A-1 (Merged Area)	Afford. Housing/Refunding	54,055	04/29/2010	08/01/2035	5.00-5.50%	1.24-6.30	54,055
Series 2010A-2 (Merged Area)	Afford. Housing/Refunding	2,655	04/29/2010	08/01/2017	4.00-5.00%	0.50-1.66	2,655
Series 2010B (Taxable) (Merged Area)	Afford. Housing/Refunding	10,695	04/29/2010	08/01/2015	1.36-4.88%	1.09-3.78	10,695
							<u>256,845</u>
Housing Set-Aside Tax Allocation Bonds (Subordinate):							
Series 2010C (Taxable) (Merged Area)	Afford. Housing/Refunding	93,000	04/29/2010	08/01/2035	Variable	2.10-5.21	93,000
Total Governmental Activities - Bonds, Certificates of Participation and Notes Payable							<u>\$3,674,233</u>
<b>Business-type Activities:</b>							
Norman Y. Mineta San Jose International Airport:							
Revenue Bonds:							
Series 1998A (AMT)	Refunding	14,015	01/27/1998	03/01/2018	4.50-4.75%	0.73-1.09	\$ 7,290
Series 2001A	Runway Construction	158,455	08/14/2001	03/01/2031	4.00-5.25%	3.68-10.06	135,160
Series 2002A	Refunding	53,600	01/09/2003	03/01/2018	4.00-5.375%	0.00-9.29	53,600
Series 2002B (AMT)	Refunding	37,945	01/09/2003	03/01/2012	4.00-5.00%	2.38-6.55	8,925
Series 2004C (AMT)	Airport Facilities	75,730	06/24/2004	03/01/2026	4.625-5.25%	1.00-10.59	73,730
Series 2004D	Airport Facilities	34,270	06/24/2004	03/01/2028	5.00%	0.00-12.56	34,270
Series 2007A (AMT)	Airport Facilities	545,755	09/13/2007	03/01/2047	5.00-6.00%	0.00-73.50	545,755
Series 2007B	Airport Facilities	179,260	09/13/2007	03/01/2037	4.25-5.00%	0.00-28.80	179,260
							<u>1,037,990</u>
Clean Water Financing Authority:							
Revenue Bonds:							
Series 2005A	Refunding	54,020	10/05/2005	11/15/2016	3.25-5.00%	4.64-5.80	36,625
Series 2009A	Refunding	21,420	01/29/2009	11/15/2020	3.00-5.00%	0.00-5.41	21,420
							<u>58,045</u>
State of California - Revolving Fund Loan	Wastewater Facilities	73,566	Various	05/01/2019	Various	1.77-3.77	34,487
Total Business-type Activities - Bonds and Loan Payable							<u>\$1,130,522</u>
Grand Total							<u>\$4,804,755</u>

## 2. Debt Compliance

There are a number of limitations and restrictions contained in the various bond indentures. The City believes it is in compliance with all significant limitations and restrictions.

## 3. Legal Debt Limit and Margin

The City's legal debt limit (as defined by Section 1216 of the City Charter) and debt margin as of June 30, 2010, are approximately \$19,065,437,000 and \$18,565,467,000, respectively.

In accordance with the California Community Redevelopment Law, the Agency establishes its own legal debt limit and a separate tax increment limit, based primarily on the aggregate of all future projected tax increment revenues from existing redevelopment areas. On April 7, 2009, the City

# Notes to Basic Financial Statements

June 30, 2010

---

Council/Agency Board approved the amendment to the Agency's Redevelopment Plans for the Merged Project Area by increasing the tax increment limit from \$7.6 billion to \$15.0 billion and to establish a single limit of \$7.6 billion for the bonded indebtedness that may be outstanding at any one time. The additional tax increment revenues will provide additional capital to the Agency to continue to implement blight-eliminating, economic development, and housing projects in the City's redevelopment project areas. On May 5, 2009, the City Council/Agency Board approved the amendment to the Agency's Redevelopment Plan for the Strong Neighborhoods Initiative (SNI) Redevelopment Project by authorizing the collection of tax increment from portion of the SNI project called Diridon Area.

#### **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 tax-exempt bond issues listed above. However, as no bond issue with a positive rebate liability was due for a fifth-year payment, the rebate amount calculated has been recorded as a liability to the IRS. The rebate liability amount is recorded as a liability in the Governmental Activities column of the government-wide statements in the amount of \$275,000.

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

All obligations of the City under the Special Assessment and Special Tax Bonds are not considered general obligations of the City, but are considered limited obligations, payable solely from the assessments/special taxes and from the certain funds pledged therefore under the Paying Agent Agreement or Fiscal Agent Agreement. Neither the faith and credit nor the taxing power of the City, or any political subdivision thereof, is pledged to the payment of the bonds. The City is not obligated to advance available surplus funds from the City Treasury to cure any deficiency in the Redemption Fund for these bonds; provided, however, the City is not prevented, in its sole discretion, from so advancing funds. As of June 30, 2010, the City has recorded approximately \$60,905,000 of deferred revenue and related special assessments receivables in the Special Assessment Districts Fund. These balances consist primarily of property tax assessments and/or special taxes to be collected in the future by the County of Santa Clara for future debt service of the special assessment districts and the community facilities districts.

On May 25, 2010, the City Council approved staff recommendations for surplus funds held by the City related to expired special assessment districts. Surplus funds of \$11,105,000 as of June 30, 2009, were documented and a disposition plan for these funds was adopted. All funds were transferred and accounted for in fiscal year 2009-2010 according to the disposition plan. Surplus funds of \$4,410,000, plus investment income, consisting primarily of bond proceeds for the construction of district improvements, were transferred to the General Fund. Surplus funds of \$6,695,000, plus investment income, consisting primarily of property assessments and bond reserve funds, are to be disbursed as refunds to eligible past assessees within three years. Unclaimed funds in amounts unforeseeable will become the property of the City after the one-year (assessments) and three-year (reserve) claim periods.

# Notes to Basic Financial Statements

June 30, 2010

## 6. Conduit Debt

The City has issued multifamily housing revenue bonds to provide funds for secured loans to builders of multifamily housing projects. The purpose of the program is to provide needed rental housing for low to moderate-income households. To comply with Internal Revenue Service requirements in order to meet the tax-exempt status, the owner is required to set aside certain percentage of all units built for very low and low income households. The bonds are payable solely from payments made on the related secured loans. These tax-exempt housing bonds have maturity dates that are due at various dates through January 1, 2047. As of June 30, 2010, the outstanding conduit multifamily housing revenue bonds issued by the City aggregated approximately \$519,119,000. In addition, the outstanding conduit multifamily housing revenue bonds issued by the Agency are \$38,000,000 for the 101 San Fernando/Century Center Redevelopment Project Area and \$9,677,000 for the Japantown Redevelopment Project Area. On July 9, 2010, the Agency sold the Century Center Redevelopment Project Area and the Agency no longer serves as the conduit issuer for these bonds.

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

## 7. Variable-Rate Demand Bonds

Included in long-term debt is \$341,415,000 of variable-rate demand bonds issued by the City of San José Financing Authority (Authority) and the Agency. The City 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 City has entered into credit facilities that support the variable-rate demand bonds. Under the reimbursement agreements related to these credit facilities, the trustee is authorized to draw an amount sufficient to pay the purchase price of bonds that have been tendered and have not otherwise been remarketed. The scheduled redemption of these bonds is incorporated in the Annual Requirements to Maturity schedules (see Note III.F.9.).

The credit facilities that support the City's variable-rate bonds as of June 30, 2010 are as follows (dollars in thousands):

	Balance June 30, 2010	Credit Facility Description	
		Provider	Expiration Date
City of San José Financing Authority:			
Lease Revenue Bonds:			
Series 2008A (Civic Center)	\$ 56,920	Scotiabank/CalSTRS	09/30/2010
Series 2008B (Civic Center Garage)	35,280	Bank of America, N.A./CalSTRS	09/30/2010
Series 2008C (Hayes Mansion)	10,915	Scotiabank/CalSTRS	09/30/2010
Series 2008D (Taxable) (Hayes Mansion)	45,080	Scotiabank/CalSTRS	09/30/2010
Series 2008E (Taxable) (Ice Centre)	26,025	Bank of America, N.A./CalSTRS	09/30/2010
Series 2008F (Taxable) (Land Acquisition)	67,195	Bank of America, N.A.	06/11/2011
Total variable rate lease revenue bonds	<u>241,415</u>		
Redevelopment Agency:			
Revenue Bonds:			
Series 1996A (Merged Area)	25,000	JPM organ Chase Bank, N.A.	11/26/2010
Series 1996B (Merged Area)	25,000	JPM organ Chase Bank, N.A.	11/26/2010
Series 2003A (Taxable) (Merged Area)	35,000	JPM organ Chase Bank, N.A.	11/26/2010
Series 2003B (Merged Area)	15,000	JPM organ Chase Bank, N.A.	11/26/2010
Total variable-rate revenue bonds	<u>100,000</u>		
Total variable-rate demand bonds	<u>\$ 341,415</u>		

## Notes to Basic Financial Statements

June 30, 2010

---

**City of San José Financing Authority Variable-Rate Demand Lease Revenue Bonds.** The Authority's \$241,415,000 variable-rate demand lease revenue bonds are payable upon demand of the bondholder at a purchase price equal to principal plus accrued interest. The Authority's remarketing agents are required to use their best efforts to remarket the bonds and, to the extent that bonds are not remarketed, the Authority's trustees are authorized to draw on the credit facilities in the amounts required to pay the purchase price of bonds tendered.

The Authority's repayment of unreimbursed draws made on the credit facilities bear interest at varying rates with the principal amortization amounts and periods ranging from 3 to 5 years. The interest rate on and principal amortization schedule of an unreimbursed draw are determined by the take-out provisions of the applicable reimbursement agreement, which will remain in effect until all principal of an unreimbursed draw is amortized. For example, if a draw occurs on June 30, 2010, then the take-out provision will remain in effect until June 30, 2013 or June 30, 2015, depending on the agreement. If the unreimbursed draws represent a significant portion of the outstanding debt, the principal will generally be amortized over multiple years because, under State law, lease payments may not exceed the fair rental value for the leased property. Per the terms of the reimbursement agreements, the providers of the credit facilities have the right to require an appraisal of the applicable leased property to increase the amount of the rent payable.

The Authority is required to pay the credit facility providers an annual commitment fee for each credit facility ranging from 0.60% to 1.25%, based on the terms of the applicable reimbursement agreement and the outstanding principal amount of the bonds supported by the credit facility. As of June 30, 2010, the letters of credit supporting Series 2008 ABCDE had an expiration date of September 30, 2010. These letters of credit were subsequently renewed and/or replaced by new letters of credit with a new three year term expiring in 2013 as discussed in Note IV.D.: Subsequent Events.

**Redevelopment Agency Variable-Rate Revenue Demand Bonds.** The Agency's \$100,000,000 variable-rate revenue demand bonds (1996 and 2003 Bonds) are payable upon demand of the bondholder at a purchase price equal to principal plus accrued interest. The Agency's remarketing agents are required to use their best efforts to remarket the bonds and, to the extent that bonds are not remarketed, the Agency's trustees are authorized to draw on the credit facilities in the amounts required to pay the purchase price of bonds tendered.

In connection with the issuance of the 1996 and 2003 Bonds, the Agency obtained letters of credit as credit facilities for the bonds. At June 30, 2010, the letters of credit were set to expire on November 26, 2010 but have been extended through November 25, 2011 as discussed in Note IV.D.: Subsequent Events. The Agency's repayment of unreimbursed draws made on the credit facilities bear interest at varying rates with the principal amortized from the date of the draw to the expiration of the credit facility. As of November 22, 2010, there have been no draws under the credit facilities. Under the terms of an Amendment to Reimbursement Agreements with JP Morgan Chase that amended both the 2003 and 1996 Reimbursement Agreements, the Agency directed the Bond Trustee to redeem the \$5,300,000 of the 1996 Bonds in November 2009, which reduced the aggregate amount of the 2003 Bonds and 1996 Bonds to \$100,000,000.

The Agency is required to pay the credit facility providers an annual commitment fee for each credit facility ranging from 2.10% to 2.30%, based on the terms of the applicable reimbursement agreement and the outstanding principal amount of the bonds supported by the credit facility.

# Notes to Basic Financial Statements

## June 30, 2010

### 8. Summary of Changes in Long-term Obligations

**Governmental Activities** - The changes in long-term obligations for the year ended June 30, 2010, are as follows (dollars in thousands):

	July 1, 2009	Additional Obligations, Interest Accretion and Net Increases	Current Maturities, Retirements, and Net Decreases	June 30, 2010	Amounts Due Within One Year
<b>Governmental Activities:</b>					
Long-term debt payable:					
General Obligation bonds	\$ 519,320	-	(19,350)	499,970	\$ 19,650
HUD Section 108 loan	23,923	-	(1,008)	22,915	1,038
San Jose Financing Authority					
Lease revenue bonds	653,351	-	(9,799)	643,552	6,309
Accreted interest on capital appreciation bonds	1,786	146	(501)	1,431	521
Special Assessment bonds with limited governmental commitment	64,886	-	(3,981)	60,905	3,521
Redevelopment Agency					
Revenue bonds	301,250	-	(17,100)	284,150	12,765
HUD Section 108 notes payable	33,955	-	(955)	33,000	1,580
Merged Area tax allocation bonds	1,802,235	-	(44,505)	1,757,730	46,730
Housing Set-Aside tax allocation bonds	253,270	160,405	(63,830)	349,845	11,405
California Statewide Communities Development Authority - ERAF loan	23,980	-	(3,245)	20,735	3,405
Housing Set-Aside Term Loan	50,000	-	(50,000)	-	-
Total long-term debt payable	<u>3,727,956</u>	<u>160,551</u>	<u>(214,274)</u>	<u>3,674,233</u>	<u>106,924</u>
Less deferred amounts:					
For refunding gain (loss)	(50,156)	-	3,964	(46,192)	(3,964)
For issuance premiums	59,089	22	(4,237)	54,874	4,305
For issuance discounts	(4,389)	-	111	(4,278)	(111)
Total deferred amounts	<u>4,544</u>	<u>22</u>	<u>(162)</u>	<u>4,404</u>	<u>230</u>
Total long-term debt payable and deferred amounts	<u>3,732,500</u>	<u>160,573</u>	<u>(214,436)</u>	<u>3,678,637</u>	<u>107,154</u>
Other Long-term obligations:					
Hayes Mansion construction loan	1,200	-	-	1,200	-
Arbitrage liability	686	-	(411)	275	-
Accrued vacation, sick leave and compensatory time	96,921	34,727	(48,528)	83,120	48,307
Accrued landfill postclosure costs	8,835	-	(465)	8,370	465
Estimated liability for self-insurance	130,942	29,395	(28,552)	131,785	16,108
Net other postemployment benefits (OPEB) obligation	119,321	36,249	-	155,570	-
Pollution remediation obligation	4,946	505	(3,286)	2,165	70
Total other long-term obligations	<u>362,851</u>	<u>100,876</u>	<u>(81,242)</u>	<u>382,485</u>	<u>64,950</u>
Governmental activities long-term obligations	<u>\$ 4,095,351</u>	<u>261,449</u>	<u>(295,678)</u>	<u>4,061,122</u>	<u>\$ 172,104</u>

**General Obligation Bonds** are issued pursuant to a two-thirds majority voter authorization and the City of San José voters approved to finance the construction of and improvements to libraries, parks and public safety facilities throughout the City. In 2000 and 2002, the voters approved three ballot measures (Measures 2000 O and P and 2002 Measure O) that authorize total issuance of \$598,820,000 of general obligation (“GO”) bonds for library, parks and public safety projects. General obligation 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, 2010, the City of San José had issued \$589,590,000 of GO bonds

## Notes to Basic Financial Statements

June 30, 2010

---

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, 2010 is \$808,348,000, with the final payment due on September 1, 2039.

The City plans to issue the final series of GO bonds in February 2011. A total of \$9,230,000 of the authorization remains un-issued for the libraries and public safety programs. The proceeds of those bonds would be used to fund a portion of the libraries and public safety projects approved by voters in November 2000 and March 2002. The timing, size, and purpose of the bond issue will depend upon the expenditure and encumbrance needs of the various projects to be financed.

**Lease Revenue Bonds** are issued primarily to finance various capital improvements to be leased to the City and are secured by lease rental revenue from "lessee" departments in the General Fund and Nonmajor Funds. The lease rental revenue for each fiscal year is generally equal to 100% of annual debt service net of other available funding sources. Total principal, interest, and accreted value remaining on the bonds are estimated to be \$1,026,155,000, with the final payment due on June 1, 2039.

**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 is \$91,173,000, with the final payment due on September 1, 2032.

**Redevelopment Agency's Merged Area Tax Allocation Bonds** are issued primarily to finance redevelopment projects and are secured primarily by a pledge of tax increment revenues consisting of a portion of all taxes levied upon all taxable properties within each of the redevelopment project areas constituting the Merged Area Redevelopment Project. The total projected tax increment revenue through the period of the bonds is approximately \$3,445,839,000<sup>1</sup>. These revenues have been pledged until the year 2036, the final maturity date of the bonds. The total principal and interest remaining on these Tax Allocation Bonds is \$2,894,701,000 which is 84 percent of the total projected tax increment revenues. The pledged tax increment revenue recognized during the fiscal year ended June 30, 2010 was \$161,927,000 as compared to total debt service of \$131,899,000.

**Redevelopment Agency's Variable Rate Revenue Bonds** are issued primarily to finance redevelopment projects within the Merged Area Redevelopment Project. The bonds are ratably and equally secured by a pledge of the subordinated revenues and are subordinate to the Merged Area Tax Allocation Bonds of the Agency.

**Redevelopment Agency Housing Set-Aside Tax Allocation Bonds** are issued primarily to finance affordable housing projects and are secured by a pledge of and lien upon the 20% tax increment revenue set-aside for the low and moderate income housing fund. The total projected 20% tax increment revenue through the period of the bonds is approximately \$861,460,000. These revenues have been pledged until the year 2035, the final maturity date of the bonds. The total principal and interest remaining on these Housing Set-Aside Tax Allocation Bonds is \$556,986,000, which is 65 percent of the total projected 20% tax increment revenues. The pledged tax increment revenue recognized during the fiscal year ended June 30, 2010 was \$40,482,000 as compared to total debt service of \$19,537,000.

**Other Long-Term Obligations** payments are primarily made from general revenues recorded in the General Fund.

---

<sup>1</sup> Per the Fiscal Consultant Report for the Redevelopment Agency of the City of San José Merged Area Redevelopment Project Housing Set-Aside Tax Allocation Bonds Series 2010A (Tax-Exempt) and Series 2010B (Taxable) dated April 15, 2010 (page 26).

## Notes to Basic Financial Statements

**June 30, 2010**

**Business-Type Activities** - The changes in long-term obligations for the year ended June 30, 2010, are as follows (dollars in thousands):

	July 1, 2009	Additional Obligations and Net Increases	Current Maturities, Retirements, and Net Decreases	June 30, 2010	Amounts Due Within One Year
<b>Business-Type Activities:</b>					
Norman Y. Mineta San Jose International Airport:					
Revenue bonds	\$ 1,049,635	-	(11,645)	1,037,990	\$ 12,120
Deferred amounts:					
For refunding	(2,627)	-	563	(2,064)	(479)
For issuance premiums	5,392	-	(302)	5,090	363
For issuance discounts	(5,793)	-	42	(5,751)	(43)
Clean Water Financing Authority:					
Revenue bonds	62,685	-	(4,640)	58,045	4,790
Deferred amounts:					
For refunding	(2,137)	-	380	(1,757)	(379)
For issuance premiums	2,240	-	(236)	2,004	236
State of California - Revolving Fund Loan	38,254	-	(3,767)	34,487	3,836
Accrued vacation, sick leave and compensatory time	9,394	5,214	(5,921)	8,687	5,561
Estimated liability for self-insurance	9,011	273	(1,835)	7,449	2,016
Net other postemployment benefits (OPEB) obligation	9,951	4,122	-	14,073	-
Pollution remediation obligation	714	660	(660)	714	714
Business-type long-term obligations	<u>\$ 1,176,719</u>	<u>10,269</u>	<u>(28,021)</u>	<u>1,158,967</u>	<u>\$ 28,735</u>

**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 of and premium, if any, and interest on the bonds. General airport revenues generally include all revenues, income, receipts and moneys derived by the City from the operation of the Airport with the exception of certain expressly excluded revenues. The net revenues available to pay debt service in the current fiscal year totaled \$75,536,000, which is composed of \$30,603,000 of net general airport revenues and \$44,933,000 of other available funds. Bond debt service payable from general airport revenues in the current fiscal year totaled \$26,779,000, which is net of \$4,588,000 of bond debt service paid from the passenger facility charges and \$33,431,000 of bond debt service paid from the capitalized interest accounts established in conjunction with the issuance of the 2007 Airport Revenue Bonds. The City has covenanted in the Master Trust Agreement that net revenues available to pay debt service for each fiscal year will be at least 125% of annual debt service for such fiscal year plus any other available funds (as defined in the Master Trust Agreement). Annual debt service, as defined in the Master Trust Agreement, is equal to Debt Service of a given fiscal year excluding interest funded from the proceeds and applied toward the payment of interest, less the Available PFC Revenues (as defined in the Master Trust Agreement) for such fiscal year. Total principal and interest remaining on the bonds is \$2.06 billion, with the final payment due on March 1, 2047.

**San José-Santa Clara Clean Water Financing Authority Sewer Revenue Bonds** are issued primarily to finance the construction of capital improvements at the San José-Santa Clara Water Pollution Control Plant and the City has pledged its net systems revenues as security for its obligations under the improvement agreement to make base payments and additional payments with respect to the outside revenue bonds. The net system revenues available to pay debt service in the current fiscal year totaled \$45,476,000. Bond debt service payable from net system revenues in the current fiscal year totaled \$6,981,000. The City has covenanted in the Improvement Agreement that net system revenues will be at least 115% of its allocable percentage of annual debt service. The City's allocable percentage of annual debt service is currently 100%. Total principal and interest remaining on the bonds is \$70,937,000, with the final payment due on November 15, 2020.

# Notes to Basic Financial Statements

## June 30, 2010

### 9. Annual Requirements to Maturity

The annual requirements to amortize all bonds, notes, and certificates of participation outstanding as of June 30, 2010, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	Governmental Activities					
	City of San Jose General Obligation Bonds and HUD Loan [1]		City of San Jose Financing Authority Lease Revenue and Reassessment Revenue Bonds [1,2,3,4]			
	Principal	Interest	Principal	Accreted Interest	Interest	
2011	\$ 20,688	\$ 23,251	\$ 6,309	\$ 521	\$ 20,268	
2012	20,724	22,408	9,160	540	20,159	
2013	20,770	21,536	10,373	557	20,006	
2014	20,826	20,640	11,275	-	19,819	
2015	20,887	19,761	12,385	-	19,568	
2016 - 2020	105,661	85,303	80,595	-	92,711	
2021 - 2025	108,179	62,135	113,995	-	80,000	
2026 - 2030	98,270	38,174	114,825	-	62,263	
2031 - 2035	83,405	14,949	146,965	-	38,597	
2036 - 2040	23,475	1,633	137,670	-	7,595	
<b>Total</b>	<b>\$ 522,885</b>	<b>\$ 309,789</b>	<b>\$ 643,552</b>	<b>\$ 1,618</b>	<b>\$ 380,986</b>	

Fiscal Year Ending June 30,	Governmental Activities					
	Special Assessment Bonds with Limited Governmental Commitment		Redevelopment Agency Redevelopment Project Bonds and HUD Loans [1,3]		Redevelopment Agency Housing Set-Aside Bonds [1]	
	Principal	Interest	Principal	Interest	Principal	Interest
2011	\$ 3,521	\$ 3,241	\$ 64,480	\$ 95,313	\$ 11,405	\$ 13,908
2012	3,627	3,079	68,050	92,290	9,460	14,389
2013	3,733	2,908	71,205	89,099	9,845	14,050
2014	3,879	2,727	74,995	85,655	10,310	13,683
2015	4,010	2,535	78,720	81,996	10,795	13,274
2016 - 2020	18,100	9,766	431,210	352,023	62,735	59,087
2021 - 2025	17,940	4,254	492,000	242,090	77,395	44,039
2026 - 2030	3,435	1,484	453,325	131,237	84,895	25,733
2031 - 2035	2,660	273	312,160	44,297	63,280	8,775
2036 - 2040	-	-	49,470	1,338	9,725	202
<b>Total</b>	<b>\$ 60,905</b>	<b>\$ 30,268</b>	<b>\$ 2,095,615</b>	<b>\$ 1,215,340</b>	<b>\$ 349,845</b>	<b>\$ 207,141</b>

Fiscal Year Ending June 30,	Business-Type Activities			
	Airport Revenue Bonds [4]		Wastewater Treatment System Revenue Bonds and Loans	
	Principal	Interest	Principal	Interest
2011	\$ 12,120	\$ 53,356	\$ 8,626	\$ 2,816
2012	12,620	52,801	8,850	2,569
2013	13,165	52,211	9,101	2,310
2014	21,795	51,550	9,369	2,048
2015	22,855	50,446	9,643	1,736
2016 - 2020	123,765	233,765	41,532	4,326
2021 - 2025	145,080	200,377	5,410	116
2026 - 2030	159,980	159,900	-	-
2031 - 2035	251,885	118,651	-	-
2036 - 2040	217,840	36,557	-	-
2041 - 2045	38,200	12,748	-	-
2046 - 2047	18,685	1,698	-	-
<b>Total</b>	<b>\$ 1,037,990</b>	<b>\$ 1,024,061</b>	<b>\$ 92,532</b>	<b>\$ 15,920</b>

- (1) Projected interest payments for the variable rate series of bonds are based on the following rates in effect on June 30, 2010. Financing Authority Lease Revenue Bonds: Series 2008A (0.18%), Series 2008B (0.19%), Series 2008C (0.16%), Series 2008D (0.33%), Series 2008E (0.32%), Series 2008F (0.32%). Redevelopment Agency Revenue Bonds: Series 1996A (0.18%), Series 1996B (0.15%), Series 2003A (0.34%), Series 2003B (0.17%). Redevelopment Agency Housing Set-Aside Tax Allocation Bonds: Series 2010C (2.095%). HUD Section 108 Notes: City of San Jose and Redevelopment Agency Loans (0.74%). Each series may be set at different interest rate calculation modes, including daily, weekly, monthly, and long rates.
- (2) Amount shown is accreted value payable in each period. As of June 30, 2010, \$1,431,000 of value had accreted on the outstanding capital appreciation bonds, which combined with the \$643,552,000 principal amount of outstanding lease revenue bonds totals \$644,983,000 of outstanding lease revenue debt.
- (3) Projected debt service payments for the City of San Jose Financing Authority Series 2001A Parking Revenue Bonds and Series 2001F Lease Revenue Bonds are included in the Agency Redevelopment Project category, reflecting that the Agency is the primary source of payment for those bonds.
- (4) Does not include notional amortization of outstanding commercial paper notes.

## Notes to Basic Financial Statements

June 30, 2010

---

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

### **10. New Debt Issuances and Short-Term Debt Activities**

#### **Governmental Activities**

**Redevelopment Agency of the City of San José Housing Set-Aside Tax Allocation Bonds, Series 2010A (tax-exempt), Series 2010B (taxable) and 2010C (variable rate taxable).** On April 15, 2010, the Agency issued three series of housing set-aside tax allocation bonds Series 2010A (tax-exempt), Series 2010B (taxable) and 2010C (variable rate taxable) amounting to \$56,710,000, \$10,695,000 and \$93,000,000, respectively. The proceeds of the bonds were used to refund the Housing Set-Aside Tax Allocation Bonds Series 2005C and 2005D (\$56,735,000); to pay-off the term loan with Bank of New York (\$42,500,000), which was used as interim source of funding for the acquisition, construction or rehabilitation of low and moderate-income housing projects; to make \$40,000,000 of low and moderate income housing set-aside funds available to pay the California State mandated Supplemental Educational Revenue Augmentation Fund (SERAF) obligation (see Note III.G.2) program costs (\$40,000,000); to fund housing set-aside projects (\$10,001,000); and to fund the reserve account and pay the costs of issuance related to the Series 2010 bonds. The 2010 Housing Set-Aside Tax Allocation Bonds were issued in parity with other outstanding Housing Set-Aside Tax Allocation Bonds issued by the Agency and are secured by a pledge of Housing Set-Aside Amounts, which are 20% of tax increment revenues required to be deposited into the Low and Moderate Income Housing Fund.

The principal and interest payment of the Housing Set-Aside Tax Allocation Bonds, Series 2005C and D were supported by the Letter of Credit under a Reimbursement Agreement with Bank of New York. The Letter of Credit expired on June 29, 2009. In September 2008, Bank of New York announced that it has stopped issuing new letters or lines of credits in connection with municipal obligations (Credit Facilities) and that it would not renew existing credit facilities upon their expiration. Due to a lack of a replacement letter of credit, the bonds become a term loan payable in twenty quarterly installments. In fiscal year 2009-2010, the Agency refunded the Housing Set-Aside Tax Allocation Bonds, Series 2005C and 2005D through the issuance of the 2010C Bonds. The variable rate Housing Set-Aside Tax Allocation Bonds, Series 2010C were directly purchased by Wells Fargo Bank. Because the bonds were directly purchased, the bond indenture does not require a credit facility to support the debt service payments until the bond's tender date of April 29, 2013, or such other date agreed to in writing by the Agency and Wells Fargo Bank.

**City of San José Financing Authority Lease Revenue Commercial Paper Notes Payable.** The Authority is authorized to issue commercial paper notes at prevailing interest rates for periods of maturity not to exceed 270 days. The commercial paper notes are secured by a pledge of lease revenues from various City assets and additionally secured by a letter of credit provided by State Street Bank and Trust Company and the California State Teachers' Retirement System (CalSTRS).

As of June 30, 2010, \$34,302,000 of tax-exempt commercial paper notes were outstanding at an interest rate of 0.37% and \$19,228,000 of taxable commercial paper notes were outstanding at interest rates ranging from 0.40% to 0.45%. The changes in commercial paper notes during the fiscal year ended June 30, 2010 are as follows (dollars in thousands):

July 1, 2009	Additions	Deletions	June 30, 2010
\$47,581	\$14,721	\$8,772	\$53,530

# Notes to Basic Financial Statements

June 30, 2010

---

This program was initially established on January 13, 2004, whereby the City Council and the City of San José Financing Authority (the Authority) each adopted a resolution authorizing the issuance of the Authority tax-exempt lease revenue commercial paper notes in an amount not to exceed \$98,000,000. This commercial paper program was initially established as a mechanism for financing public improvements of the City including the offsite parking garage for the new Civic Center and non-construction costs for technology, furniture, equipment and relocation services for the new Civic Center.

On June 21, 2005, the City Council and the Authority each adopted a resolution authorizing the issuance of taxable lease revenue commercial paper notes, under the same \$98,000,000 not to exceed limitation as the tax-exempt notes. This subsequent authorization permits the Authority to issue taxable commercial paper notes to pay for expenses otherwise authorized under the commercial paper program, but ineligible to be paid from tax-exempt commercial paper proceeds. The City Council and the Authority approved an expansion of the capacity of the lease revenue commercial paper program from \$98,000,000 to \$116,000,000 on November 15, 2005.

## **Business-Type Activities**

### **Airport Commercial Paper Notes Payable**

Under the Airport's Commercial Paper Notes program, the Airport is able to issue commercial paper notes at prevailing interest rates for periods of maturity not to exceed 270 days. The commercial paper is secured by a subordinate pledge of the Airport's revenues and additionally secured by letters of credit.

The terms of the agreement in effect during the fiscal year ended June 30, 2010 providing credit support for the Series A-1, Series A-2, Series B and Series C Notes call for unreimbursed draws to convert to a term loan if certain conditions are met on the Drawing Maturity Date (defined as the earlier of the termination date of the applicable Letter of Credit or 60 days following the unreimbursed draw) with principal repaid in ten equal semi-annual installments with payments occurring on the first business day of each March and September of each year. For the period from the date of the unreimbursed draw to the 60<sup>th</sup> day following the date of the unreimbursed draw, the interest rate is the Base Rate. Unless the unreimbursed draw is converted to a term loan, the interest rate from the 61<sup>st</sup> day until the date the unreimbursed draw is paid in full is the Default Rate (defined as the Base Rate from time to time in effect plus 2.00%). The term loan will bear interest at an interest rate equal to the Base Rate plus 0.50% from the conversion date through the 30<sup>th</sup> day, Base Rate plus 0.75% from the 31<sup>st</sup> day through the 60<sup>th</sup> day, and Base Rate plus 1.00% from the 61<sup>st</sup> day onward. For the purposes of this agreement, Base Rate is defined as the higher of (i) the Federal Funds rate plus 0.50% per annum and (ii) the bank's prime rate; provided, however, that the rate increases by 0.50% for each full rating category reduction on the Airport's bonds and an additional 1.00% if the rating on the Airport's bonds is withdrawn or suspended.

The terms of the agreement providing credit support for the Series D-1, Series D-2, Series and Series F Notes provide that unreimbursed draws be paid at the following interest rates: (i) Base Rate plus 1.00% from the Drawing Date through the 30<sup>th</sup> day; (ii) the greater of the Base Rate plus 1.50% and 12% from the 31<sup>st</sup> day through the 90<sup>th</sup> day; and (iii) the greater of the Base Rate plus 2.5% and 12% from the 91<sup>st</sup> day until the unreimbursed drawing is paid in full. However, if certain conditions specified in the agreement are met, then on the Drawing Maturity Date (defined as the earlier of the Letter of Credit's termination date or 90 days following the date of the unreimbursed draw), the unreimbursed draw will convert to a term loan. The principal of the term loan is required to be repaid in 20 equal quarterly installments on the first business day of each calendar quarter and the interest rate is the greater of the Base Rate plus 2.5% and 12%. For purposes of this agreement, Base Rate is defined as the higher of the Federal Funds rate plus 1.00% and the

## Notes to Basic Financial Statements

June 30, 2010

---

bank's prime rate.

The credit support, which expires December 2, 2010 as discussed in Note IV.D., for the Series A-1, Series A-2, Series B, and Series C commercial paper notes is provided severally but not jointly, by JPMorgan Chase Bank, Bank of America, and Dexia Credit Local. The credit support, which expires May 7, 2011, for the Series D-1, Series D-2, Series E, and Series F commercial paper notes is provided by Lloyds TSB Bank plc.

On June 30, 2010, \$15,205,000 of Series A-2 Notes were outstanding at interest rates ranging from 0.32% to 0.34%; \$148,771,000 of Series B Notes were outstanding at interest rates ranging from 0.36% to 0.38%; \$115,491,000 of Series C commercial paper notes were outstanding at interest rates ranging from 0.40% to 0.60%; and \$137,881,000 of Series F Notes were outstanding at an interest rate of 0.39%.

The change in Airport commercial paper notes payable during fiscal year 2010 is as follows (dollars in thousands):

<u>July 1, 2009</u>	<u>Additions</u>	<u>Deletions</u>	<u>June 30, 2010</u>
\$323,561	\$98,887	\$5,100	\$417,348

On November 2, 1999, the City Council adopted a resolution authorizing the issuance of City of San José, Norman Y. Mineta San José International Airport subordinated commercial paper notes in three series (Series A – Tax Exempt, Series B – Subject to AMT, and Series C – Taxable) in an amount not to exceed \$100 million. The City Council approved an expansion of the commercial paper program to \$200 million on June 20, 2006. Additional expansions were approved by City Council to \$450 million on January 9, 2007 and to \$600 million on March 25, 2008. This latest expansion also established three additional series of commercial paper (Series D – Tax Exempt, Series E – Subject to AMT, and Series F – Taxable). On September 1, 2009, the City Council adopted a resolution authorizing the issuance of tax-exempt private activity non-AMT commercial paper notes as provided for in the American Recovery and Reinvestment Act of 2009. At that time, the Series A Notes were redesignated as Series A-1 (Non-AMT) and Series A-2 (Non-AMT/Private Activity) and the Series D Notes were redesignated as Series D-1 (Non-AMT) and Series D-2 (Non-AMT/Private Activity).

### **11. Landfill Post-closure Costs**

The City has five closed landfills for which post-closure and monitoring services may be required for approximately a 30 year period which began in fiscal year 1996, coinciding with the closure of the last landfill. An estimated liability of \$8,370,000 related to the closed landfills is recorded in the government-wide financial statements as of June 30, 2010. The City's Environmental Compliance Officer performs an annual evaluation of the aforementioned liability. Actual costs may be higher due to inflation, changes in technology, or changes in regulations. The City does not own or operate any open landfills at this time.

# Notes to Basic Financial Statements

June 30, 2010

## 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 2009-2010, 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 is as follows:

<u>Coverages</u>	<u>Coverage per Occurrence</u>	<u>Deductible Per Occurrence</u>
Property, including Business Interruption (1)	\$ 1 billion	\$100,000
Flood Zone A and V	\$ 25 million	\$500,000 (2)
Flood Zone B	\$ 50 million	\$100,000 (2)
All Other Flood Zones	\$100 million	\$100,000 (2)

(1) The policy limit for property damage caused by terrorism is \$5 million per occurrence and in aggregate.

(2) Deductible applies per location affected.

During fiscal year 2009-2010, the City maintained an airport liability policy covering the Airport, which provides a limit of \$200,000,000 combined single limit for bodily injury and property damage with a \$25,000,000 each occurrence limit for personal injury subject to a per occurrence deductible of \$100,000 and an aggregate deductible of \$100,000. The Airport's \$200,000,000 liability policy specifically excluded war and terrorism from its coverage. During the past three years, there have been not been any instances that the amount of claim settlements exceeding the insurance coverage. A separate automobile policy provided coverage for the off-premise operations of Airport vehicles including shuttle bus fleets. Coverage included \$1,000,000 single combined limit per occurrence. Physical damage coverage was available for the Airport Shuttle Bus Fleet and is subject to a \$25,000 comprehensive and collision deductible. Settled claims have not exceeded the commercial coverage in any of the past three fiscal years. As part of general support services, the City charges the Airport for the cost of general liability coverage.

Claims liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. The result of the process to estimate the claims liability is not an exact amount as it depends on many complex factors, such as inflation, changes in legal doctrines, new discovered information and damage awards. Accordingly, claims are reevaluated periodically to consider the effects of inflation, recent claims settlement trends (including frequency and amount of pay-outs), economic and social factors, newly discovered information and changes in the law. The estimate of the claims liability also includes increases or decreases to previously reported unsettled claims.

With respect to the general liability accrual, the City has numerous unsettled lawsuits filed or claims asserted against it as of June 30, 2010. The City Attorney and, with respect to workers' compensation claims, the City's Risk Manager have reviewed these claims and lawsuits in order to evaluate the likelihood of an unfavorable outcome to the City and to arrive at an estimate of the amount or range of potential loss to the City. The City has included a provision for losses in its claims liability for loss contingencies that are both probable and can be reasonably estimated.

## Notes to Basic Financial Statements

**June 30, 2010**

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

Liability as of July 1, 2008	\$	155,063
Claims and changes in estimates during 2009		13,723
Claims payments		<u>(28,833)</u>
Liability as of June 30, 2009		139,953
Claims and changes in estimates during 2010		25,934
Claims payments		<u>(26,653)</u>
Liability as of June 30, 2010	\$	<u><u>139,234</u></u>

**Owner Controlled Insurance Programs** - On March 31, 2004, the City bound certain liability insurance coverage for the major components of the North Concourse Project through an owner-controlled insurance program (OCIP) from Chartis, formerly American International Group (AIG), AIU Holdings, Inc. and AIU LLC (AIU). An OCIP is a single insurance program that provides insurance coverage for construction jobsite risk of the project owner, general contractors and all subcontractors associated with construction at the designated project site. The North Concourse Project has been completed and the policies expired December 31, 2008. Closeout procedures on the North Concourse Project have been completed. All remaining work associated with opening of the facility is covered by Terminal Area Improvement Project ("TAIP"), Owner Controlled Insurance Program ("OCIP"), as described below, or is addressed in the contracts for work not covered by the TAIP OCIP by requiring the contractors performing such work to provide insurance coverage naming the City as an additional insured.

The City was also required to establish a claims loss reserve for the North Concourse Project in the aggregate amount of \$3,900,000 available in a cash working fund. The full amount of the claims loss reserve had been deposited with the insurance carrier and was recorded as advances and deposits in the accompanying statement of net assets. The claims loss reserve funds the deductible of up to \$250,000 per occurrence to a maximum loss exposure to the City of \$3,900,000. Due to the performance of this OCIP, the insurance carrier Chartis has agreed to return to the City \$2,517,000 of the loss fund in March 2010. Over the next 12 months Chartis will continue to review the loss reserve fund and future disbursements will be expected if no completed operation claims arise over the next 10 years.

On March 15, 2007, the City bound additional liability insurance through another OCIP for major components of the Airport's TAIP OCIP through Chartis. The coverage for this program is as follows:

Coverages	Terminal Area Improvement Projects	
	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. In the event that the actual payroll for the covered TAIP projects exceeds the estimated \$92,500,000 payroll or in the event the construction period extends beyond 45 months, the City will be obligated to pay increased premiums for the TAIP OCIP and, in addition, may be required to augment the claims loss reserve fund. The terms of the TAIP OCIP require the City to

## Notes to Basic Financial Statements

June 30, 2010

---

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. As of June 30, 2010, an amount of \$5,881,000 is deposited with Chartis and was recorded as advances and deposits in the accompanying statement of net assets.

### **13. Net Other Postemployment Benefits (OPEB) Obligation**

The City implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, prospectively and as such, the City did not have a net OPEB obligation at transition (i.e., July 1, 2007). The Police and Fire Department Retirement Plan (PFDRP) and the Federated City Employees' Retirement System (FCERS) calculated a net OPEB obligation in accordance with GASB 45 as discussed in Note IV.A.2. With the beginning of fiscal year 2009-2010, the City initiated a five-year phase-in to fully pre-fund retiree healthcare benefits for the majority of its employee units, with the exception of members of the San José Firefighters Union (International Association of Firefighters, Local 230). The phase-in plan will continue to result in an incremental increase in retiree healthcare contributions for both the City and its employees over the next four years. Phasing-in to fully pre-fund retiree healthcare benefits does not mean that the existing obligation is paid off immediately. It is projected that it will take approximately 30 years to pay off the existing unfunded retiree healthcare liability. At June 30, 2010, the City recorded net OPEB obligations totaling \$169,643,000 in the government-wide financial statements, of which \$155,570,000 are in governmental activities and \$14,073,000 are in business-type activities.

### **14. Pollution Remediation Obligations**

The City is currently responsible for the management and cleanup of pollution remediation activities at several City sites including five active leaking petroleum storage tank sites: Fire Stations #5 and #16, Las Plumas Warehouse, Family Shelter and the Airport, as discussed in Note IV.C.1. The Agency is obligated for the management and cleanup of one ground water accumulation and contamination site at the Adobe office building site. Although the City and Agency have 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 and engineers hired by the City and the Agency. 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, 2010, the government-wide statement of net assets reported net pollution remediation obligation in the amount of \$2,165,000 in governmental activities and \$714,000 in business-type activities.

## Notes to Basic Financial Statements

**June 30, 2010**

### G. Interfund Transactions

The composition of interfund balances as of June 30, 2010, with explanations of transactions, is as follows (dollars in thousands):

#### 1. Due from/Due to other funds

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Redevelopment Agency	\$ 1,360 (1)
	Nonmajor Governmental Funds	1,666 (2)
Redevelopment Agency	General Fund	1 (3)
	Housing Activities	21 (4)
Housing Activities	Redevelopment Agency	10,001 (5)
San José Financing Authority	Housing Activities	70 (6)
Nonmajor Governmental Funds	Nonmajor Governmental Funds	19,942 (7)
Airport Fund	Nonmajor Governmental Funds	14 (8)
Wastewater Treatment System	Nonmajor Governmental Funds	50 (9)
	Municipal Water System	1,000 (10)
		<u>\$ 34,125</u>

(1) \$633 represents reimbursement for services performed for the Agency, \$180 represents accrual of pooled cash fund discount and \$547 represents accrual for Project Service Memorandum contribution from the Agency.

(2) \$1,465 represents accrual of gas tax transfer and \$201 represents short-term borrowing for working capital.

(3) Represents accrual of fair value change in the pooled cash funds.

(4) Represents State Bulletin 813 year-end accrual.

(5) Represents remaining Series 2010C bond proceeds designated for future projects.

(6) Represents short-term borrowing for commercial paper fees and interest costs.

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

(8) Represents reimbursable expenses related to the Airport West project.

(9) Represents short-term portion of loan for Fiber Optics Conduit project

(10) Represents short-term portion of loan for the North Coyote Valley Water Project.

## Notes to Basic Financial Statements

**June 30, 2010**

### 2. Advances to/Advances from other funds

<b>Receivable Fund</b>	<b>Payable Fund</b>	<b>Amount</b>
General Fund	San José Financing Authority	\$ 3,327 (1)
	Redevelopment Agency	630 (2)
Redevelopment Agency	Housing Activities	580 (3)
	General Fund	500 (4)
Housing Activities	Redevelopment Agency	52,721 (2)
San José Financing Authority	Housing Activities	12,891 (5)
Nonmajor Governmental Funds	Redevelopment Agency	13,119 (2)
Parking System	Redevelopment Agency	8,483 (2)
Wastewater Treatment System	Nonmajor Governmental Funds	251 (6)
	Municipal Water System	1,167 (7)
	Redevelopment Agency	5,007 (2)
		\$ 98,676

- (1) \$30 represents a loan for Seismic District bond purchase and \$3,297 represents a loan to support the City-owned golf course.
- (2) See detailed Agency discussion below.
- (3) Represents discounted loan to the YWCA Villa Nueva Housing project.
- (4) Represents executive staff home loans.
- (5) Represents proceeds of the commercial paper notes loaned to the Housing Activities fund for the SERAF loan (see below).
- (6) Represents a long-term loan and interest for the Fiber Optics Conduit project and is scheduled to be paid by June 30, 2013.
- (7) Represents a loan for the North Coyote Valley Water Project.

## Notes to Basic Financial Statements

**June 30, 2010**

At June 30, 2010, the City has advances receivable from the Agency as follows (in thousands):

<u>Receivable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Property transfer	\$ 630
Housing Activities	SERAF principal	52,000
	SERAF interest and fees	721
Nonmajor Governmental Funds	SERAF principal	5,000
	SERAF interest and fees	7
	Parkland in-lieu voucher program	8,112
Parking System	Parking fund loans	8,483
Wastewater Treatment System	SERAF principal	5,000
	SERAF interest and fees	7
		<u>\$ 79,960</u>

**Property Transfer.** On April 20, 2010, the Agency and the City entered into a cooperation agreement, under which the City conveyed the real property located at 406 N. Autumn Street for the purchase price of \$630,000 to the Agency so the Agency can exchange the property for the other parcels with developers needed to form land assemblage necessary for the proposed City owned Autumn Street Extension Project. The Agency's obligation to pay the City the purchase price is due upon the Agency completing the exchange with the developer and upon City's notification to the Agency that City has issued a Certificate of Occupancy for private development on that property.

**Redevelopment Agency Supplemental Education Revenue Augmentation Fund (SERAF).** In July 2009 the State Legislature adopted, and the Governor signed, Assembly Bill No. 26x4, which mandated redevelopment agencies in the State make deposits to the SERAF accounts established in each State county treasury with deposits totaling \$1.7 billion for FY 2009-10 and \$350 million for FY 2010-11. The Agency was informed by the State Director of Finance that the total payable by May 10, 2010 was \$62.2 million and the Agency has estimated that the total amount payable by May 10, 2011 will be \$12.8 million.

To enable the Agency to make the SERAF payments to the State, the Agency entered into a loan agreement with the City (the "SERAF Loan") funded from the following sources:

- A total of \$65,000,000 from the Housing Activities Fund's Low and Moderate Income Housing program. The proceeds of two financing transactions were used to support various affordable housing projects and programs which freed up a corresponding amount in the Low and Moderate Housing Income funds to be loaned to the Agency: (1) \$40,000,000 from the issuance of Housing Set-Aside Tax Increment Allocation Bonds; and (2) \$25,000,000 initial principal from proceeds of City of San José Financing Authority Lease Revenue Commercial Paper Notes. Under the SERAF Loan Agreement, the Agency has the option to make interest payments on an ongoing basis, or to pay accrued interest upon final payment of the SERAF Loan in fiscal year 2015-2016. If the Agency elects to pay the accrued interest with its repayment of the outstanding principal of the SERAF Loan in fiscal year 2015-2016, the outstanding principal amount is projected to increase from \$25,000,000 to approximately \$35,000,000 by fiscal year 2015-2016. This is a General Fund backed program and therefore, to the extent that the Commercial Paper Notes are required to be redeemed for any reason, and the Agency is unable to repay the portion of the SERAF Loan funded from the Commercial Paper Notes, and the Housing Activities Fund is unable to repay, then the General Fund or any other legally available fund would be required to make the necessary

## Notes to Basic Financial Statements

June 30, 2010

---

payment. For fiscal year 2009-2010, the Housing Activities Fund advanced \$52,000,000 to the Agency.

- \$10,000,000 from various City funds (Subdivision Park Trust Special Revenue Fund; Community Facility Revenue Special Revenue Fund and the Wastewater Treatment System). To the extent that these funds require replenishment at any time due to the capital needs of the respective programs, and the Agency is unable to repay the Loan in whole or in part, the General Fund or any other legally available fund would be required to make the necessary payment.

In summary, at June 30, 2010, the City has advanced \$62,735,000 related to SERAF to the Agency representing principal of \$62,000,000 and accrued interest and fees of \$735,000.

**Parkland In-Lieu Voucher Program.** In June 2001 the Agency Board, in relation to Parkland Dedication Ordinance (PDO) and Park Impact Ordinance (PIO), adopted a resolution approving a Parkland In-Lieu Fee Low-Income Unit Voucher Program (Voucher Program) for the payment of subsidized parkland fees for low-income residential units by the Agency. On October 26, 2004, the Board extended the program until December 31, 2005. Under the PDO/PIO, developers of new residential projects are required to dedicate parkland, construct improvements and/or pay equivalent in-lieu fees for neighborhood and community-serving parks. Developers of low-income residential units were issued a voucher from the City's Housing Department to present to the City's Building Division in lieu of the payment of parkland fees, required by PDO and PIO. The Agency would then reimburse the City's Subdivision Parks Trust Fund in the amount of the voucher. As of June 30, 2010, the Agency owed the City \$8,112,000 related to the Voucher Program. On June 22, 2010, the Agency and the City entered a cooperation agreement whereby the Agency agreed to transfer the amounts owed to the City in fiscal year 2015-2016.

**Parking Fund Loans.** On April 12, 2005, the Agency entered into a loan agreement with the City in an amount of \$6,800,000 from the future facilities reserve within the City's Parking System Fund. The City advanced the loan to the Agency in two installments: \$3,400,000 on April 15, 2005, and \$3,400,000 on February 1, 2006. Interest on the loaned amounts originally accrued monthly on a compounded basis based on the City's investment portfolio's rate of return. The Agency used the loan proceeds for programs or projects contained in its Adopted Budget.

On June 12, 2007, the City Council/Agency Board amended the term of the loan to extend the loan maturity date to July 31, 2012, and removed the provision for any future interest beyond June 30, 2007, in exchange for the Agency promising to acquire property for a new downtown parking facility in the Almaden-Gateway Redevelopment Project Area.

Due to the economic downturn and the unexpected size of the payment the Agency is required by the State to make to the SERAF, the Agency made substantial reductions to its FY2009-10 Capital and Operating Budget and its 2010-2015 Capital Improvement Program. In order to assist the Agency in remitting the Agency's required payment to SERAF, the City has agreed to reimburse the Agency from the City's Parking Systems Fund two years of debt service payments to be made by the Agency on the 4<sup>th</sup> & San Fernando Parking Garage Revenue Bonds. On March 1, 2010, the City advanced to the Agency \$1,683,000, representing the March 1, 2010 debt service payment on these revenue bonds. Under the terms of the Second Amendment to Loan Agreement approved by the City Council on February 23, 2010 and executed on October 4, 2010, the Agency shall repay to the City the principal amount of the initial loan on or before June 30, 2015. If the principal payment is not made on or before June 30, 2015, interest will be calculated monthly on a compounded basis, at the rate earned on funds within the City's investment portfolio from July 1, 2007 to the final date of payment. The revised agreement further requires the Agency to pay the City the remaining loan on or before June 30, 2016, provided that the City and Agency acknowledge that an extension of the repayment due date may be necessary depending on City and Agency priorities at such time.

## Notes to Basic Financial Statements

June 30, 2010

### 3. Transfers in/Transfers out

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

#### Between Governmental and Business-type Activities:

Transfers from	Transfers to	Amount
San Jose Financing Authority	Parking System	\$ 11 (1)
Parking System	General Fund	598 (2)
	Redevelopment Agency	11 (3)
	Nonmajor Governmental Funds	612 (4)
Municipal Water System	Nonmajor Governmental Funds	131 (5)
	San José Financing Authority	159 (6)
Wastewater Treatment System	General Fund	138 (7)
	Nonmajor Governmental Funds	1,353 (8)
	San José Financing Authority	285 (9)
Airport Fund	Nonmajor Governmental Funds	15 (10)
		\$ 3,313

(1) Transfer for joint parking project.

(2) Transfer to the General Fund for miscellaneous non-downtown parking receipts.

(3) Transfer for refund of interest earned on surplus funds held by the fiscal agent.

(4) Transfer of \$450 for convention center parking receipts and \$162 for City Hall debt service payment.

(5) Transfer for City Hall debt service payments.

(6) Transfer for debt service payments.

(7) Transfer of \$71 for interest earnings, and rent of \$67 to the General Fund.

(8) Transfer of \$1,322 for City Hall debt service payments and \$31 for operations.

(9) Transfer for debt service payments.

(10) Transfer for operations.

# Notes to Basic Financial Statements

## June 30, 2010

**Between Funds within the Governmental Activities:**

<b>Transfers from</b>	<b>Transfers to</b>	<b>Amount</b>
General Fund	Special Assessment Districts	\$ 545 (1)
	San Jose Financing Authority	3,799 (2)
	Nonmajor Governmental Funds	24,425 (3)
Redevelopment Agency	General Fund	1,371 (4)
	Housing Activities	133,008 (5)
	San Jose Financing Authority	3,366 (6)
	Nonmajor Governmental Funds	1,999 (7)
Housing Activities	Redevelopment Agency	67,605 (8)
	Nonmajor Governmental Funds	858 (9)
	General Fund	2,602 (10)
	San Jose Financing Authority	96 (11)
Nonmajor Governmental Funds	Redevelopment Agency	3,038 (12)
	General Fund	13,425 (13)
	Nonmajor Governmental Funds	11,736 (14)
	San Jose Financing Authority	32,630 (15)
San Jose Financing Authority	Nonmajor Governmental Funds	1,070 (16)
	General Fund	16 (17)
Special Assessment Districts	General Fund	4,512 (18)
	Nonmajor Governmental Funds	874 (19)
		\$ 306,975

- (1) Transfer to Special Assessment Districts for construction project expenditure.
- (2) Debt service payments of \$372 for the 1997B bond series, \$775 for the 2003A bond series, \$1,984 for the 2008E bond series and \$668 for the 2008F bond series.
- (3) Transfer for various debt service payments, loan repayments, operations and subsidies.
- (4) \$354 for San Jose Arena pass-through payment, \$630 for property transfer (see discussion above), \$28 for rent received for the property at Keyes Street and \$359 for Watson Park Project Service Memorandum (PSM).
- (5) \$40,482 for 20% increment tax transfers as required under California Community Redevelopment Law, \$92,501 in bond proceeds and \$25 in interest earnings.
- (6) Debt service payment for 4th & San Fernando parking garage.
- (7) \$1,317 for capital projects and \$682 for capital project refund.
- (8) Transfer for debt service payments.
- (9) Transfer for City Hall debt service payments.
- (10) \$2,200 for acquisition of real estate property and \$402 for reimbursement on behalf of the Agency for fees associated with the SERAF loan.
- (11) Transfer for commercial paper redemption expenditure.
- (12) \$200 is for the Hillview Play Lot project, \$15 reimbursement of consulting services and \$2,823 is for various PSM refunds.
- (13) Various transfers for operations, interest earnings and capital projects.
- (14) Various transfers for debt service, operations and capital projects.
- (15) Various transfers for debt service payments.
- (16) Transfer of commercial paper proceeds.
- (17) Transfer to roll forward residual balance to the General Fund.
- (18) Transfer of interest earnings and residual fund balances to the General Fund.
- (19) Transfer for capital improvement program projects.

# Notes to Basic Financial Statements

June 30, 2010

## IV. Other Information

### A. Defined Benefit Retirement Plans

#### A. 1 City Sponsored Defined Benefit Pension Plans

##### 1. Plan Description

The City sponsors and administers two single employer defined benefit retirement systems, the Police and Fire Department Retirement Plan ("PFDRP") and the Federated City Employees' Retirement System ("FCERS"), and collectively, "the Retirement Systems"), which together cover all full-time and certain part-time employees of the City. The Retirement Systems provide general retirement benefits under single employer Defined Benefit Pension Plans, as well as the Postemployment Healthcare Plans. The Retirement Systems are accounted for in the Pension Trust Funds. The estimated payrolls for employees covered under both PFDRP and FCERS for the fiscal year ended June 30, 2010, were approximately \$243,196,000 and \$308,697,000, respectively. The City's total actual payroll for the fiscal year ended June 30, 2010, was approximately \$614,186,000.

The separately issued annual reports of PFDRP and FCERS, together with the City's municipal code provide more detailed information about the Retirement Systems. Those reports may be obtained from the City of San José Department of Retirement Services, 1737 North First Street, Suite 580, San José, California 95112.

The Defined Benefit Pension Plans provide general retirement benefits including pension, death, and disability benefits to members. Benefits are based on average final compensation, years of service, and limited required cost-of-living increases. The Defined Benefit Pension Plans are administered by the Director of Retirement, an employee of the City, under the direction of the City Manager and the Boards of Administration for the Retirement Systems. The contribution and benefit provisions and all other requirements are established by the City Charter and City ordinances.

The current membership in the Defined Benefit Pension Plans as of June 30, 2010, is as follows:

	<u>PFDRP</u>	<u>FCERS</u>
Defined Benefit Pension Plans:		
Retirees and beneficiaries currently receiving benefits	1,790	3,101
Terminated vested members not yet receiving benefits	78	626
Active members	<u>2,026</u>	<u>3,929</u>
Total	<u><u>3,894</u></u>	<u><u>7,656</u></u>

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

##### 2. Funding Policy

It has been the Retirement Systems' Boards policy to obtain actuarial valuations every two years. However, the Retirement Systems' Boards took action to obtain actuarial evaluations every year beginning June 30, 2010. Actuarial valuations of an ongoing plan involve estimates and assumptions about the probability of occurrence of events far into the future. For pension plans, the assumptions include those about future employment trends, mortality rates, level of salary increases, and investment rate of return. Actuarially determined amounts are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future.

# Notes to Basic Financial Statements

## June 30, 2010

The contributions to the Defined Benefit Pension Plans from the City and the participating employees are based upon an actuarially determined percentage of each employee's base salary sufficient to provide adequate assets to pay benefits when due.

On June 24, 2008, the City Council adopted ordinance No. 28332 amending Chapter 3.36 and 3.28 of Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for pension benefits to PFDRP and FCERS. The lump sum prepayment for fiscal year 2009-2010 was calculated to be actuarially equivalent to the biweekly payments that would otherwise have been the City's required contributions to the pension plans. The Boards of Administration for the PFDRP and FCERS approved the actuarially determined prepayment amount to be paid by the City on July 2, 2009.

The contribution rates for the Defined Benefit Pension Plans for the City and the participating employees for fiscal year 2009-2010 were established in accordance with actuarially determined requirements computed through actuarial valuations dated June 30, 2007, except for the period June 27, 2010 through June 30, 2010, which were based on the June 30, 2009 valuation. The contribution rates in effect and the amounts contributed to the pension plans for the fiscal year ended June 30, 2010 are as follows (dollars in thousands):

	PFDRP			FCERS		
	City	Participants	Total	City	Participants	Total
Actuarial Rate:						
Defined Benefit Pension Plan:						
7/01/09 - 6/26/10 (police members)	21.61% *	8.18%				
7/01/09 - 6/26/10 (fire members)	24.12% *	8.62%				
7/01/09 - 6/26/10				18.31% **	4.28%	
6/27/10 - 6/30/10 (police members)	38.32%	9.81%				
6/27/10 - 6/30/10 (fire members)	40.24%	10.09%				
6/27/10 - 6/30/10				23.18%	4.54%	
Annual Pension Contribution (in thousands):						
Defined Benefit Pension Plan	\$ 52,314	\$ 20,097	\$ 72,411	\$ 54,566	\$ 13,396	\$ 67,962

\* The actual contribution rate paid by the City was 20.83% and 23.25% for the Police and Fire members, respectively, as a result of the City exercising their option to make a lump sum prepayment for 26 pay periods of fiscal year 2010.

\*\* The actual contribution rate paid by the City was 17.63% for the Federated members as a result of the City exercising its option to make a lump sum prepayment for 26 pay periods of fiscal year 2010.

### 3. Annual Pension Cost and Net Pension Obligation

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

	Fiscal year ended	Annual Pension Cost (APC)	Percent APC Contributed	Net Pension Obligation
<b>PFDRP</b>	6/30/08	\$ 56,372	100%	\$ -
	6/30/09	53,103	100%	-
	6/30/10 *	52,314	100%	-
<b>FCERS</b>	6/30/08	51,718	106%	-
	6/30/09	57,020	100%	-
	6/30/10 *	54,566	100%	-

\* These amounts represent the annual pension cost factoring in the City's elected lump-sum prepayment. In the absence of the City's elected lump-sum prepayment, the annual required employer contributions based on the Boards of Administration of the Retirement Systems' adopted contribution rates for PFDRP and FCERS would be \$54,162,000 and \$56,590,000, respectively.

# Notes to Basic Financial Statements

June 30, 2010

---

## 4. Funded Status and Funding Progress

**PFDRP's Funded Status and Funding Progress.** As summarized in the table below, as of June 30, 2009, the most recent actuarial valuation date, PFDRP was 87% funded for pension benefits representing the difference between the actuarial value of assets and the actuarial accrued liabilities (AAL) resulted in an unfunded actuarial accrued liability (UAAL) of \$393,913,000. It should be noted that the UAAL does not reflect the impact of approximately \$600,000,000 of deferred net investment losses resulting from unfavorable net investment gains and losses from fiscal years 2006 through 2009. PFDRP's actuarial valuation uses a five-year smoothing method for investment returns. This means that, for actuarial valuation purposes, the annual gains or losses, as calculated at year-end, are smoothed (amortized) with the net gains and losses resulting from the prior four years. As of the June 30, 2009 actuarial valuation date, PFDRP's AAL increased by \$591,000,000 due to demographic experience losses and changes in actuarial assumptions as recommended by the PFDRP's Board's actuary in the June 30, 2009 experience study. PFDRP's UAAL increased from \$6,600,000 as of June 30, 2007 to \$393,900,000 as of June 30, 2009.

The change to the UAAL was primarily the result of:

- (a) unfavorable investment returns during fiscal years 2007-2008 and 2008-2009;
- (b) higher than expected salary increases,
- (c) earlier than expected retirements,
- (d) data corrections; and
- (e) changes in actuarial assumptions.

Changes in actuarial assumptions include the change in the PFDRP's 80-120% market value corridor to 70-130%, as approved by the Board on February 4, 2010 only for the valuation as of June 30, 2009, resulting in the immediate recognition of approximately \$45 million of investment losses for PFDRP's pension and health plans. The market value of assets corridor limits the smoothing of assets to be no greater than 130% and no less than 70% of the market value of assets as of June 30, 2009. Under this practice, any investment gains or losses that would cause the smoothed assets to fall outside of this 70-130% market value corridor would be recognized immediately rather than be smoothed over the next five years. The total unrecognized investment losses, for pension and health assets, were \$658,200,000 before the application of the 130% market value of assets corridor and \$613,300,000 after the application of the market value of assets corridor.

**FCERS's Funded Status and Funding Progress.** As summarized in the table below, as of the June 30, 2009 actuarial valuation date, FCERS was 71% funded on an actuarial basis for pension benefits. FCERS's UAAL of \$729,567,000 does not reflect the impact of approximately \$420,000,000 of deferred investment losses resulting from net investment gains and losses from fiscal years 2006 through 2009. FCERS's actuarial valuation uses a 5-year smoothing method for investment returns. This means that the current year's gains or losses, as calculated at year-end, are smoothed (amortized) with the results from the prior four years.

As of June 30, 2009, FCERS's most recent actuarial valuation, the funded status of FCERS decreased from 83% to 71%. The decrease in pension funding status was due to an increase in the AAL. The increase in the AAL was due to demographic experience losses and changes in actuarial assumptions as recommended by the Board actuary in the June 30, 2009 experience study.

## Notes to Basic Financial Statements

**June 30, 2010**

FCERS's June 30, 2009 actuarial valuation includes actuarial assumption changes approved by the FCERS's Board including phasing in the impact of changes in economic assumptions on contribution rates of the following over a 5-year period:

- (a) a reduction in the investment return assumption from 8.25%, net of expenses, to 7.75%, net of expenses;
- (b) a reduction in the underlying inflation assumption from 4.00% to 3.67%;
- (c) a reduction in the payroll growth assumption from 4.00% to 3.83%; and
- (d) a reduction in the ultimate salary increase assumption from 4.25% to 4.08%.

The impact of the economic assumption change increased the AAL by approximately \$142,000,000, and the total contribution requirement by 3.64% prior to the impact of the 5-year phase in changes. Changes in the pre-mortality and post-mortality demographic assumptions increased the AAL by \$87,300,000 and the total contribution requirement by 1.58%.

FCERS also adopted a 30/20 layered amortization methodology in the June 30, 2009 valuation. Previously FCERS amortized the UAAL over a 30-year open amortization basis. The UAAL as of June 30, 2009 will be amortized over a closed amortization period of 30 years. Each year subsequent to this valuation, any gains or losses will be amortized over a closed 20 year period. There is no impact of this change on the June 30, 2009 valuation as the amortization period of 30 years is the same under current and previous methods.

### Defined Benefit Pension Plans' Funded Status and Funding Progress Summary

	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded (Overfunded) AAL	Funded Ratio	Annual Covered Payroll	Unfunded AAL as a Percentage of Covered Payroll
PFDRP	6/30/09	\$ 2,569,569	\$ 2,963,482	\$ 393,913	86.7%	\$ 243,196	162.0%
FCERS	6/30/09	1,756,588	2,486,155	729,567	70.7%	308,697	236.3%

The Schedule of Funding Progress, presented as Required Supplementary Information (RSI) following the Notes to Basic Financial Statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

# Notes to Basic Financial Statements

## June 30, 2010

### 5. Actuarial Methods and Assumptions

PFDRP transitioned from biennial to annual valuations beginning June 30, 2010. The contributions rates for fiscal year ended June 30, 2010 were based on the actuarial valuation performed on June 30, 2007, except for the period June 27, 2010 through June 30, 2010, which were based on the June 30, 2009 valuation; the significant actuarial methods and assumptions used to compute the actuarially determined PFDRP's annual required contributions and the funded status are as follows:

<u>Description</u>	<u>Method/Assumption</u>	<u>Method/Assumption</u>
Valuation dates	June 30, 2007	June 30, 2009
Actuarial cost method	Entry age normal cost method	Entry age normal cost method
Amortization method for actuarial accrued liabilities	Level percentage of payroll	Level percentage of payroll
Remaining amortization period	10 years, closed for unfunded pension liabilities and 16 years, closed for gains and losses between valuations.	1) Outstanding balance of unfunded accrued liability calculated through June 30, 2003 valuation amortized over next 8 years; (2) Prior service cost for the February 4, 1996 benefit improvement amortized over the next 8 years; and (3) Future actuarial experience gains and losses, changes in assumptions, and benefit improvements amortized over 16 years from the date of each such event, beginning with June 30, 2005 valuation.
Actuarial asset valuation method	5 year smoothed market with a 80% to 120% Market Value Corridor	5 year smoothed market with a 70% to 130% Market Value Corridor
Investment rate of return	8.00% per annum, net of expenses	8.00% per annum, net of expenses
Postretirement mortality	RP-2000 Male Combined Healthy Mortality Table with no collar adjustment, projected 10 years (set back 3 years). RP-2000 Female Combined Healthy Mortality Table with no collar adjustment, projected 10 years (set forward 1 year).	RP-2000 Male Combined Healthy Mortality Table with no collar adjustment, projected 10 years (set back 4 years). RP-2000 Female Combined Healthy Mortality Table with no collar adjustment, projected 10 years.
Active service, withdrawal, death, disability service retirement	Based upon the June 30, 2007 experience study	Based upon the June 30, 2009 experience study
Salary increases	9.00% for the first 6 years of service, 6.00% for 6 – 8 years of service, and 5.00% for 8+ years of service. The total salary increase of 4.00% is for combined inflation and real across-the-board salary increase.	9.75% for the first 5 years of service, 6.75% for 6 – 7 years of service, and 6% for 8+ years of service. The total salary increase of 4.25% is for combined inflation and real across-the-board salary increase.
Cost-of-living adjustments on retirement allowances	3.00% per year	3.00% per year

## Notes to Basic Financial Statements

**June 30, 2010**

---

FCERS transitioned from biennial to annual valuations beginning June 30, 2010. The contributions rates for fiscal year ended June 30, 2010 were based on the actuarial valuation performed on June 30, 2007, except for the period June 27, 2010 through June 30, 2010, which were based on the June 30, 2009 valuation; the significant actuarial methods and assumptions used to compute the actuarially determined FCERS's annual required contributions and the funded status are as follows:

<u>Description</u>	<u>Method/Assumption</u>	<u>Method/Assumption</u>
Valuation dates	June 30, 2007	June 30, 2009
Actuarial cost method	Entry age normal cost method	Entry age normal cost method
Amortization method for actuarial accrued liabilities	Level percentage of payroll	Level percentage of payroll
Remaining amortization period	30 years, open	30 years, closed
Actuarial asset valuation method	5 year smoothed market	5 year smoothed market
Investment rate of return	8.25% per annum, net of expenses	7.75% per annum, net of expenses
Postretirement mortality	The 1994 Group Annuity Mortality Table 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 forward for females was used for healthy retirees and beneficiaries. The disabled mortality table used was the 1981 Disability Mortality Table
Active service, withdrawal, death, disability service retirement	Tables based upon current experience.	Tables based upon current experience.
Salary increases	The rate of annual salary increase for all members with at least 5 years of service is equal to 4.25% plus an added merit component for those with 0-4 years of service.	The base annual rate of salary increase is comprised of a 3.67% 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 ranging from 5.50% to 0.75% at the 5 <sup>th</sup> year of service.
Cost-of-living adjustments on retirement allowances	3.00% per year	3.00% per year

# Notes to Basic Financial Statements

June 30, 2010

## A. 2 Postemployment Healthcare Plans

### 1. Plan Description

In addition to the Defined Benefit Pension Plans, the City also sponsors and administers two single employer postemployment healthcare plans, the Police and Fire Department Postemployment Healthcare Plan and the Federated City Employees' Postemployment Healthcare Plan, which together cover eligible full-time and certain part-time employees of the City. The postemployment healthcare plans are accounted for in the Pension Trust Funds.

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

The Postemployment Healthcare Plans provide medical and dental benefits to eligible retirees. Benefits are 100% of the premium cost for the lowest priced medical insurance plan and 100% of the premium cost for dental insurance plan available to an active City employee. The Postemployment Healthcare Plans are administered by the Director of Retirement, an employee of the City, under the direction of the City Manager and Boards of Administration for the Retirement Systems. The contribution and benefit provisions and all other requirements are established by City Charter and City ordinances.

The current membership in the Postemployment Healthcare Plans as of June 30, 2010, is as follows:

	<u>PFDRP</u>	<u>FCERS</u>
Postemployment Healthcare Plans:		
Retirees and beneficiaries currently receiving benefits	1,712	2,795
Terminated vested members not yet receiving benefits	11	89
Active members	<u>2,026</u>	<u>3,929</u>
Total	<u><u>3,749</u></u>	<u><u>6,813</u></u>

### 2. OPEB Funding Policy

As stated above in the Defined Benefit Pension Plan section of this note, it has been the Retirement Systems' Boards policy to obtain actuarial valuations every two years. However, the Retirement Systems' Boards took action to obtain actuarial evaluations every year beginning June 30, 2010. Actuarial valuations of an ongoing plan involve estimates and assumptions about the probability of occurrence of events far into the future. For postemployment healthcare plans, the assumptions include those about future employment trends, mortality rates, level of salary increases, healthcare cost trend, and investment rates of return. Actuarially determined amounts are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future.

Projections of postemployment healthcare benefit costs for financial reporting purposes are based on the substantive plan as understood by the employer and plan members, and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and the plan members to that point.

On June 24, 2008, the City Council adopted ordinance No. 28332 amending Chapter 3.36 and 3.28 of Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for postemployment healthcare benefits to PFDRP and FCERS. The lump sum prepayment for fiscal year 2010 was calculated to be actuarially equivalent

## Notes to Basic Financial Statements

**June 30, 2010**

to the biweekly payments that would otherwise have been the City's required contributions to the postemployment healthcare plans. The Boards of Administration for PFDRP and FCERS approved the actuarially determined prepayment amount to be paid by the City on July, 2, 2009, respectively.

Contributions to the Postemployment Healthcare Plans are made by both the City and the participating members. Contributions to PFDRP for fiscal year ended June 30, 2010 for Fire members of PFDRP were based on the Board's 10-year cash flow funding policy. Effective June 28, 2009, the Police members of PFDRP and the bargaining units representing the FCERS's members entered into Memorandums of Agreement (MOAs) with the City to increase the contribution rates for retiree health and dental in order to phase-in to full funding the GASB Statement No. 43 annual required contribution over the next 5 years; fiscal year 2009-2010 was the first year of the phase-in. The MOA between the City and Police members of the PFDRP further provided that PFDRP member contribution rate shall not have an incremental increase of more than 1.25% and 1.35% of pensionable pay in each year for the Police members and City, respectively. Additionally, the MOA with PFDRP members provided that if the retiree healthcare contributions exceed 10% of Police member and 11% of City contributions, respectively, (excluding the implicit rate subsidy) the parties shall meet and confer on how to address the contributions above 10% and 11%. The MOA between the City and the bargaining units representing the members of FCERS provided that the five year phase-in of the ARC will not have an incremental increase of more than 0.75% of pensionable pay in each fiscal year for the FCERS members or the City. Notwithstanding these limitations on incremental increases, the agreements with members of FCERS further provide that by the end of the five year phase-in the City and the members "shall be contributing the full Annual Required Contribution in the ratio currently provided" in the relevant sections of the San José Municipal Code. The contributions are not currently sufficient to provide adequate assets to pay benefits when due in accordance with the requirements of GASB Statement No. 43.

The contribution rates for the Postemployment Healthcare Plans for the City and the participating employees for fiscal year 2010 were based on actuarial valuations dated June 30, 2007, except for the period June 27, 2010 through June 30, 2010, which were based on the June 30, 2009 valuation. The contribution rates in effect and the amounts contributed to the PFDRP and the FCERS for the fiscal year ended June 30, 2010, are as follows (dollars in thousands):

	PFDRP			FCERS		
	City	Participants	Total	City	Participants	Total
Actuarial Rate:						
Postemployment Healthcare Plan:						
7/01/09 - 6/26/10 (police members)	5.28% *	4.78%				
7/01/09 - 6/26/10 (fire members)	4.19%	3.78%				
7/01/09 - 6/26/10				5.70% **	5.07%	
6/27/10 - 6/30/10 (police members)	6.26% *	5.76%				
6/27/10 - 6/30/10 (fire members)	3.92% *	3.61%				
6/27/10 - 6/30/10				6.41% **	5.76%	
Annual OPEB Contribution (in thousands):						
Postemployment Healthcare Plan	\$ 11,284	\$ 10,650	\$ 21,934	\$ 17,027	\$ 15,815	\$ 32,842

\* The actual contribution rate paid by the City was 5.09% and 4.04% for the Police and Fire members respectively as a result of the City exercising their option to make a lump sum prepayment for 26 pay periods of fiscal year 2010.

\*\* The actual contribution rate paid by the City was 5.49% for the Federated members as a result of the City exercising its option to make a lump sum prepayment for 26 pay periods of fiscal year 2010.

## Notes to Basic Financial Statements

**June 30, 2010**

### 3. Annual Other Postemployment Benefit (OPEB) Cost and Net OPEB Obligation

The City's annual other postemployment benefit cost and net OPEB obligation for PFDRP and FCERS as of and for the fiscal year ended June 30, 2010, were as follows (dollars in thousands):

	PFDRP	FCERS
Annual required contribution *	\$ 50,438	\$ 38,599
Interest on net OPEB obligation	4,778	2,999
Adjustment to annual required contribution	(16,680)	(2,184)
Annual OPEB cost	38,536	39,414
Contributions made	(11,732)	(17,598)
Implicit rate subsidy	(4,262)	(3,987)
Increase in net OPEB obligation	22,542	17,829
Net OPEB obligation – beginning of year	84,512	44,760
Net OPEB obligation – end of year	\$ 107,054	\$ 62,589

\* The annual required contribution is net of employees' contributions toward normal cost.

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

	Fiscal year ended	Annual OPEB Cost	Total Employer Contributions	Percent Annual OPEB Cost Contributed	Net OPEB Obligation
<b>PFDRP</b>	6/30/08	\$ 61,344	\$ 10,618	17%	\$ 50,726
	6/30/09	46,334	12,548	27%	84,512
	6/30/10	38,536	15,994	42%	107,054
<b>FCERS</b>	6/30/08	38,513	11,560	30%	26,953
	6/30/09	33,725	15,918	47%	44,760
	6/30/10	39,414	21,585	55%	62,589

### 4. OPEB Funded Status and Funding Progress

As summarized in the table below, as of June 30, 2009, the most recent actuarial valuation date, PFDRP and FCERS was 7% and 11% funded on an actuarial basis for other postemployment benefits (OPEB), respectively. Changes to the UAAL for each OPEB Plan were primarily the result of unfavorable investment returns during the last two years and changes in the actuarial assumptions as noted above under the description of funded status for each respective Defined Benefit Pension Plan in addition to the changes in the healthcare trend rate assumptions. The specific funding status for each OPEB plan is summarized in the table below, as of the June 30, 2009 valuation date:

	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL	Funded Ratio	Annual Covered Payroll	AAL as a Percentage of Covered Payroll
PFDRP	6/30/09	\$ 55,618	\$ 761,604	\$ 705,986	7.3%	\$ 243,196	290.3%
FCERS	6/30/09	85,564	796,448	710,884	10.7%	308,697	230.3%

# Notes to Basic Financial Statements

## June 30, 2010

The Schedule of Funding Progress, presented as Required Supplementary Information following the Notes to Basic Financial Statements, presents information about whether the actuarial value of plan assets increased or decreased in fiscal year 2010 over the transition year in relation to the actuarial accrued liability for benefits. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

### **5. OPEB Actuarial Methods and Assumptions**

The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrual liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The contributions rates for fiscal year ended June 30, 2010 were based on the actuarial valuation performed on June 30, 2007, except for the period June 27, 2010 through June 30, 2010, which were based on the June 30, 2009 valuation.

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

<u>Description</u>	<u>Method/Assumption</u>	<u>Method/Assumption</u>
Valuation date	June 30, 2007	June 30, 2009
Actuarial cost method	Entry age normal cost method	Entry age normal cost method
Amortization method for actuarial accrued liabilities	Level percentage of payroll	Level percentage of payroll
Remaining amortization period	30 years, level of percent of pay 30 years as of June 30, 2007, open	30 years, level of percent of pay 30 years as of June 30, 2009, open
Actuarial asset valuation method	5 year smoothed market with a 80% to 120% Market Value Corridor	5 year smoothed market with a 70% to 130% Market Value Corridor
Discount rate*	6.4%	6.7%
Projected payroll increases	The total salary increase of 4.00% is for combined inflation (3.50%) and real across-the-board salary increase (0.50%).	The total salary increase of 4.25% is for combined inflation (3.50%) and real across-the-board salary increase (0.75%).
Healthcare cost trend rate: Medical	12% in the 2007-2008 plan year, 10% in 2008-2009, 8.25% in 2009-2010, decreasing by 0.50% for each year for 7 years until it reaches an ultimate rate of 5%.	Projected premiums for FY2009-2010 and 8.25% beginning FY2010-2011, decreasing by 0.50% for each year for 7 years until it reaches an ultimate rate of 5%.
Dental	5%	5%

\* Determined as a blended rate of the expected long-term investment returns on plan assets and on the City's investments, based on the funded level of the plan at the valuation date.

## Notes to Basic Financial Statements

**June 30, 2010**

---

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

<u>Description</u>	<u>Method/Assumption</u>	<u>Method/Assumption</u>
Valuation date	June 30, 2007	June 30, 2009
Actuarial cost method	Entry age normal cost method	Entry age normal cost method
Amortization method for actuarial accrued liabilities	Level percentage of payroll	Level percentage of payroll
Remaining amortization period	30 years, closed	30 years, closed
Actuarial asset valuation method	Market value	Market value
Discount rate*	6.6%	6.7%
Inflation rate	4.0%	3.67%
Projected payroll increases	4.0%	3.83%
Healthcare cost trend rate:		
Medical	The valuation assumes that future medical inflation will be at a rate of 8% per annum graded down each year in 0.5% increments to an ultimate rate of 4.5%.	The valuation assumes that future medical inflation will be at a rate of 10% per annum graded down each year in 0.5% increments to an ultimate rate of 4.5% for medical pre-age 65 and 7.5% per annum graded down each year in .25% increments to an ultimate rate of 4.5% for medical post-age 65.
Dental	Dental inflation is assumed to be 6% graded down to 4% over a nine year period.	Dental inflation is assumed to be 5% graded down to 4% over a four year period.

\* Determined as a blended rate of the expected long-term investment returns on plan assets and on the City's investments, based on the funded level of the plan at the valuation date.

# Notes to Basic Financial Statements

June 30, 2010

---

## A. 3 California Public Employees' Retirement System (CalPERS)

**Plan Description.** The Mayor and members of the City Council are eligible to participate in the Public Employees' Retirement Fund (Fund) of the State of California's Public Employees' Retirement System (CalPERS), a cost-sharing multiple-employer plan. CalPERS acts as a common investment and administrative agent for various local and state governmental agencies within the State of California. The City's CalPERS plan is under the CalPERS Miscellaneous 2% at 55 Risk Pool. The Fund provides retirement, disability and death benefits based on the employee's years of service, age and final compensation. Employees vest after five years of service. Benefit provisions and other requirements are established by State statute and by City resolution. CalPERS issues a separate comprehensive annual financial report, copies of which may be obtained from the CalPERS Executive Offices, Lincoln Plaza East, 400 Q Street, Sacramento, California 95814.

**Funding Policy.** The City is required to contribute the actuarially determined amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the Fund's Board of Administration. The required employer contribution rate for the year ended June 30, 2010 was 15.337%. The contractual employee cost sharing is 0%, cost-of-living adjustments are 2.0% per year, and benefits are based on final average compensation period of 36 months. The total contribution requirements for local agencies are established established and may be amended by CalPERS. The City's contributions to CalPERS for the years ended June 30, 2010, 2009, and 2008 were \$127,000, \$133,000, and \$130,000, respectively, equal to the required contributions for each year.

## B. Defined Contribution Retirement Plan

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

The Agency's total payroll in fiscal year ended June 30, 2010 for all non-civil service employees was approximately \$8,264,000. Contributions to the Retirement Plan during the year ended June 30, 2010, made by both the Agency and the participating employees, amounted to approximately \$710,000 and \$270,000, respectively.

# Notes to Basic Financial Statements

June 30, 2010

---

## C. Commitments and Contingencies

### 1. *Norman Y. Mineta San José International Airport*

**Purchase Commitments.** As of June 30, 2010, the Airport was obligated for purchase commitments of approximately \$71,100,000, primarily for the Terminal Area Improvement Program projects, the public parking improvement project, and the remainder of the costs of the rental car facility and the North Concourse building projects. Additionally, the Airport has projected that it will expend or encumber approximately \$197,885,000 on proposed capital projects during the next five fiscal years. It is anticipated that funding for such capital projects will be provided primarily by proceeds from passenger facility charges (PFC), federal grants, bond proceeds and other Airport revenues.

**Fuel Storage Facility.** In 1985, the Airport and a fuel supplier with a fuel storage facility adjacent to the City owned fuel tank farm facility discovered a fuel leak whereby petroleum products had been released into the soil and ground water from either or both of the City owned facility and/or the other fuel supplier facility. The Airport and a fuel supplier with a fuel storage facility adjacent to the City owned facility agreed to share the costs of a study to develop an acceptable cleanup program for the contaminated site. The cleanup program submitted to the Santa Clara Valley Water District, the responsible regulatory authority, was approved and the cleanup program commenced during the fiscal year ended June 30, 1991. Under an operating agreement, the Airport implemented a groundwater extraction system to control the migration of the contamination and begin efforts to remediate the contamination. Under the agreement and until 1998 when the agreement expired but the fuel supplier continued the work.

In November 2009, the City entered into an agreement with the fuel supplier for coordinated corrective actions at the existing fuel tank farms at a cost to the city not to exceed \$1,000,000 and authorizing the Director of Aviation to approve additional expenditures in excess of \$1,000,000 subject to appropriation of funds by City Council. The agreement provides for a 50%-50% cost sharing responsibility for actual future costs until successful closure of the site. The agreement also required the City to pay its 50% share of the past costs that the fuel supplier has incurred during the period after expiration of the prior agreement and before the new agreement was in place. During the year ended June 30, 2010, the Airport paid \$660,000.

The fuel supplier is responsible for administering the new agreement including retaining a corrective action contractor. The agreement is also structured to facilitate potential reimbursement from the State Water Resources Control Board Underground Storage Tank Commingled Plume Fund (the "Fund"). Reimbursement from the Fund is potentially available up to \$1,500,000 for each party.

Due to the proximity of the closed City jet fuel farm to the adjacent fuel supplier jet fuel farm that was still active, and the apparently stable contaminant plume, the regulators approved a waiver to allow the City tanks to be left in place until such time as a completely new fuel farm could be built, thereby allowing the fuel supplier site to be closed, and investigation/remediation to be done on both sites at once. The latest waiver request was approved through May 31, 2011. The new jet fuel farm had finally been constructed across Highway 101 and was placed in service in December 2009. The fuel supplier fuel farm was subsequently closed upon commencement of the new fuel farm.

The fuel supplier is currently conducting investigation of the combined site in preparation of the site's final remediation plan. One component of the investigation is the subsurface condition underneath the aboveground storage tanks (ASTs) and underground storage tanks (USTs) at both the fuel supplier and the City fuel farms. The fuel supplier has recently demolished its fuel farm and removed its USTs, and sampling the soil underneath its site. However, the demolition of the City fuel farm and removal of the USTs will not take place until the third quarter of 2010 calendar year.

# Notes to Basic Financial Statements

June 30, 2010

---

The completion of the remediation plan is contingent upon sampling and testing of the subsurface soil condition of the City fuel farm site. Once the plan is completed, it will be submitted to the County for its review and approval. The implementation of the remediation plan will commence after its approval by the County.

With the adoption of GASB Statement No. 49, the Airport has accrued \$714,000 as of June 30, 2010 to cover the estimated remaining costs of its portion of the interim remediation system. In the absence of a remediation plan by the corrective action contractor, the Airport has insufficient information to reasonably estimate the future remediation costs. Based on presently available information, the Airport's management does not anticipate that the full cost of remediation of the fuel storage facility will have a significant impact on the Airport's financial position or change in financial position.

**Acoustical Treatment Program.** The Airport has an Acoustical Treatment Program (ACT) to comply with the requirements of Title 21 of the California Noise Standard. The program provides acoustical treatment to residences in the noise impact areas surrounding the Airport, at no cost to the property owners. The program is primarily funded by grants from the Federal Aviation Administration (FAA) and by PFC revenues. The Airport expended approximately \$788,000 on noise attenuation projects during the fiscal year ended June 30, 2010. The Airport completed its ACT program during the fiscal year ended June 30, 2010.

**Master Plan.** The Airport Master Plan consists of a program of facility improvements designed to fully accommodate commercial aviation demand (passengers and cargo) projected for the year 2017, with development phased as demand warrants and is determined to be financially feasible. The Master Plan was originally adopted by the City of San José in June 1997 and approved by the Federal Aviation Administration (FAA) in December 1999. In June 2006, the City Council approved revisions to the Airport Master Plan regarding implementation of the Terminal Area Improvement Program (TAIP). The current Program consists of two phases that total approximately \$1.6 billion. Phase 1 of the Program has a total budget of approximately \$1.3 billion and construction of most of the projects is scheduled to be completed near the end of 2009-2010, with some projects to be completed in 2010-2011. Construction of the Phase 2 projects is contingent upon satisfying specified activity-based triggers. Funding for Master Plan projects is from several sources, including grants, PFCs, airline rates and charges, airport revenue bonds, and subordinated commercial paper proceeds.

## **2. Redevelopment Agency (Agency)**

**Supplemental Educational Revenue Augmentation Funds.** On July 24, 2009, the State Legislature passed Assembly Bill (AB) 26 x4, which requires redevelopment agencies statewide to deposit a total of \$2.05 billion of property tax increment in county Supplemental Educational Revenue Augmentation Funds (SERAF) to be distributed to meet the State's budget deficit. The Agency's SERAF obligation was \$62,200,000 in fiscal year 2009-2010 and will be \$12,800,000 in fiscal year 2010-2011. Payments are to be made by May 10 of each respective fiscal year. Accordingly, the first payment was made on May 10, 2010, to the County of Santa Clara and the next payment is scheduled to be made on May 10, 2011.

On October 20, 2009, the California Redevelopment Association (CRA) together with two redevelopment agencies has filed a lawsuit in Sacramento Superior Court challenging the constitutionality of AB 26 x4. The Agency is part of a certified class in this lawsuit against the Director of the California Department of Finance and County Auditors' statewide. On May 4, 2010, the Sacramento Superior Court found that the \$2.05 billion State take of redevelopment funds does not violate the Constitution. This case is now on appeal.

## Notes to Basic Financial Statements

June 30, 2010

---

As discussed in Note III.G.2., on May 4, 2010, the Agency, the Authority, and the City entered into a loan agreement under which the Agency will borrow a combined amount of \$75,000,000 (initial principal amount) to make the SERAF payments in May 2010 and May 2011. As of June 30, 2010, the Agency borrowed principal of \$62,000,000 under the loan agreement. Pursuant to the agreement, the Agency is obligated to repay the principal, all unpaid interest, fees, and bond issuance costs in two installments on June 30, 2015 and June 30, 2016.

**Tax Sharing Agreement with the County of Santa Clara.** In 1983, the Agency and the County of Santa Clara (the County) entered into a tax sharing agreement under which the Agency would pay a portion of tax increment revenue generated in the Merged Area and part of the Rincon de los Esteros Project Area (the County Pass-Through Payment). On December 16, 1993, the Agency, the County, and the City entered into a Settlement Agreement, which continued the County Pass-Through Payment. On May 22, 2001, the County, the City, and the Agency approved an Amended and Restated Agreement (the "Amended Agreement"). In September 2009, the Agency informed the County that due to the SERAF requirement and insufficient tax increment revenues, it did not have sufficient unrestricted funds to make the fiscal year 2009-10 pass-through payment. The Agency further informed the County that it has reserved restricted funds for the fiscal year 2008-2009 pass-through payments (\$21,300,000) pending negotiations regarding the payment. The 2001 Amended Agreement provides that the obligation to make these payments to the County is subordinate to "all of the Agency's loans, bonds or other indebtedness, and any pledge of or lien on Merged Area tax increment in order to secure such loans, bonds, other indebtedness, current and future, pursuant to the provisions of the Health and Safety Code." The 2001 Amended Agreement further provides that "a material change in state or federal laws or regulations affecting the Agency's redevelopment program which, for example, reduces bonding capabilities, changes the fiscal relationship of Agency to affected taxing entities, or in any way detrimentally impacts or substantially increases the Agency's financial program, the Agreement shall be renegotiated. Should there be any change in the law as specified, the parties shall meet in good faith to amend the Agreement to address the provisions which are affected by the change in law, only." The 2001 Amended Agreement further provides that in the event that the subordinate nature of the County Obligation, or a material change in the law, "either reduce(s) or delay(s) the receipt of amounts of taxes to be received by the County under Tax Allocation Agreement, Agency shall recognize its obligation, in the case of a reduction, to pay such tax amounts or delayed tax payments at a future time, together with interest thereon at the rate of ten (10%) percent per annum from the date such tax amounts would have been paid until actually paid." The 2001 Amended Agreement states if the County believes that the Agreement has been violated by the Agency, the parties "shall meet in order to resolve the issue in good faith. If the parties are unable to reach agreement, the dispute must be submitted to a mediator within 90 days of the date that impasse has been reached." The parties have participated in mediation and have been meeting in good faith to attempt to resolve the issue of funds owned by the Agency to the County pursuant to the 2001 Amended Agreement.

On August 20, 2010, the County submitted an invoice to the Agency in the amount of \$45,200,000, which included the fiscal year 2008-2009 pass-through amount of \$21,300,000, the fiscal year 2009-2010 amount of \$19,200,000 and interest of \$4,700,000. In addition, the Agency also accrued \$2,072,000 for County administration fees. The City, Agency and County are continuing negotiations of the terms of repayment. The parties expect that the timeframe for repayment will exceed 12 months.

# Notes to Basic Financial Statements

June 30, 2010

---

### **3. San José – Santa Clara Water Pollution Control Plant**

For fiscal year 2011-2015, the Five Year capital improvement program includes approximately \$18,000,000.00, the South Bay Water Recycling (SBWR) project, a regional water reclamation program to recycle highly treated wastewater for irrigation and industrial uses in the cities of San José, Santa Clara, and Milpitas, California. This program is part of an action plan, developed by the City and other agencies tributary to the Plant and adopted by the Regional Water Quality Control Board (RWQCB), to control the amount of effluent discharged by the Plant into San Francisco Bay.

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

In June 1997, the RWQCB and the City approved the Proposed Revision to the South Bay Action Plan, which described the projects necessary to reduce average dry weather effluent flow from the Plant to below 120 million gallons per day (mgd) 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, of which \$109,094,000 has been expended or encumbered. These estimated costs are to be funded by the City and other tributary agencies through a combination of State Revolving Fund Loans, Sewage Treatment Plant Connection Fees, federal grants, and cash contributions.

### **4. Retirement Systems – Unfunded Commitments**

As of June 30, 2010, the PFDRP and FCERS had unfunded commitments to contribute capital for private fund investments in the amount of \$59,726,000 and \$53,824,000, respectively.

### **5. Federal Financial Assistance Programs**

The City participates in a number of federally assisted grant programs, primarily with the Department of Housing and Urban Development, Federal Aviation Administration, the Department of Transportation, the Department of Homeland Security, the Department of Labor, and the Department of Justice. These programs are subject to program compliance audits by the grantors or their representatives.

Although the City's grant programs are audited in accordance with the provisions of the Single Audit Act Amendments of 1996 for the fiscal year ended June 30, 2010, 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.

### **D. Subsequent Events**

#### **1. Tax and Revenue Anticipation Note**

On July 1, 2010, the City issued a short-term note for cash flow borrowing purposes to facilitate the prefunding of employer retirement contributions. The Initial Note Portion of \$40,000,000 was purchased by JP Morgan Chase Bank, N.A. on the closing date of the financing, July 1, 2010. At the City's discretion, additional borrowings may occur under the terms of the 2010 Note and the Note Purchase Agreement; specifically, at any time up to the Commitment Termination Date of

# Notes to Basic Financial Statements

## June 30, 2010

June 30, 2011 and up to the Unutilized Commitment amount of \$35,000,000. On October 8, 2010, the City drew down the remaining Unutilized Commitment in the amount of \$35,000,000 per the Note Purchase Agreement. Security for repayment of the 2010 Note is a pledge of the City's 2010-2011 secured property tax revenues received on and after April 1, 2011 plus all other legally available General Fund revenues of the City, if required. The final maturity for the 2010 Note is June 30, 2011 and the repayment of the 2010 Note has been budgeted in fiscal year 2010-2011 and is anticipated to be paid in January 2011 after the first half of secured property tax revenues is received from the County Auditor-Controller and General Fund cash balances begin to rise.

### 2. Credit Facilities Renewals and Extensions

#### **a. City of San José Financing Authority Lease Revenue Bonds, Series 2008 ABCDE Letters of Credit Renewal**

As discussed in Note III.F.7.; Variable-rate Demand Bonds, the principal and interest payment of the Series 2008 ABCDE Lease Revenue Bonds were supported by the letters of credit issued under Reimbursement Agreements with Scotiabank and CalSTRS and CalSTRS and Bank of America N.A. The letters of credit were set to expire on September 30, 2010. Failure to extend or replace the letters of credit would have caused the City to redeem the bonds pursuant to the term out provisions detailed under the Reimbursement Agreements.

The City and the Authority obtained new letters of credit for the Series 2008 ABCDE Bonds in October 2010. The provider and the term of the letters of credit are summarized below for each series (dollars in thousands):

	Balance		Credit Facility Description	
	November 22, 2010		Provider	Expiration Date
City of San José Financing Authority:				
Lease Revenue Bonds:				
Series 2008A (Civic Center)	\$ 56,920		Union Bank	10/21/2013
Series 2008B-1 (Civic Center Garage)	17,640		Bank of America, N.A.	10/21/2013
Series 2008B-2 (Civic Center Garage)	17,640		Union Bank	10/21/2013
Series 2008C (Hayes Mansion)	10,915		US Bank	10/21/2013
Series 2008D (Taxable) (Hayes Mansion)	45,080		US Bank	10/21/2013
Series 2008E-1 (Taxable) (Ice Centre)	13,012		Bank of America, N.A.	10/21/2013
Series 2008E-2 (Taxable) (Ice Centre)	13,013		US Bank	10/21/2013
Total	<u>\$ 174,220</u>			

## Notes to Basic Financial Statements

June 30, 2010

---

### ***b. Redevelopment Agency Variable-Rate Revenue Bonds Letter of Credit Renewal***

As discussed in Note III.F.7.; Variable-Rate Demand Bonds, the principal and interest payment of the 1996 and 2003 Merged Area Revenue Bonds are supported by the letters of credit under reimbursement agreements with JP Morgan-Chase Bank N.A. The letters of credit were set to expire on November 26, 2010. Failure to extend or replace the letters of credit would require the Agency to redeem the bonds upon the expiration date of the letters of credit.

To avoid the need to redeem the 1996 and 2003 Merged Area Revenue Bonds on November 26, 2010, JP Morgan-Chase Bank N.A. has agreed to extend the 1996 and 2003 letters of credit to November 25, 2011, under the terms of an amendment to reimbursement agreements that amends both the 1996 and 2003 reimbursement agreements. The amendment includes the following basic terms:

1. The extension of the 2003 Letters of Credit with annual fee of 1.93% (a decrease from 2.3% on the 2003 Letters of Credit and a decrease from 2.1% on the 1996 Letters of Credit).
2. No new debt obligations, senior, parity, or subordinate may be incurred by the Agency during the term of the Letters of Credit.
3. A Liquidity Reserve in the amount of \$5,000,000 will be set-aside as an added source of security for JP Morgan-Chase Bank N.A. This reserve would be funded in two installments, the first due at execution of the amendment and the second installment due on or before July 1, 2011.
4. The Agency will hire a real estate consultant to develop strategies designed to enhance the Agency's revenues and increase the value of its assets. The Agency will make its best effort to hire this consultant, at Agency expense, by December 31, 2010.

### ***c. Airport Commercial Paper Notes Payable Credit Facilities Extension***

The City has negotiated a 2-month extension of the Airport's Commercial Paper Notes Payable credit facilities and the extension terms were approved by the City Council at its November 9, 2010 meeting. The amendment to the agreement and letters of credit discussed include extension of the expiration date from December 2, 2010 to February 2, 2011, removal of Dexia Credit Local as a party to the agreement, reduction of the amount of available credit from \$450,000,000 to \$283,000,000, and amendments on other agreement terms. Management anticipates bringing forward a recommendation related to two-year and three-year replacement credit facilities for the City Council's consideration in early 2011.

### **3. Impact of Filing for Bankruptcy Protection for Ambac Financial Group Inc.**

On November 9, 2010, Ambac Financial Group Inc. (Ambac Financial) filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. Ambac Financial is a holding company whose affiliates provide financial guarantees and financial services to its customers.

Ambac Assurance Corporation (Ambac Assurance), a subsidiary of Ambac Financial, has issued a reserve fund surety bond for the Redevelopment Agency's Series 1999 and 2005B tax allocation bonds and the Series 2006D tax allocation refunding bonds. According to the bond indenture for each of these series of bonds, in the event that such surety bond for any reason lapses or expires, the Redevelopment Agency must immediately (1) deliver a letter of credit, or (2) deliver to the trustee a surety bond or an insurance policy, or (3) make the required deposits to the bond reserve fund.

## Notes to Basic Financial Statements

June 30, 2010

---

It is uncertain at this time whether the Ambac Financial bankruptcy will cause the financial guaranty insurance policies or the reserve fund surety bonds to lapse or expire. If such an event does occur, the Agency will be required to take one of the three actions documented above in order to maintain compliance with the bond indenture.

Ambac Assurance has also issued a reserve fund surety bond that is on deposit in the General Account of the Bond Reserve Fund, securing the Airport's Series 1998A, 2001A, 2002A, and 2002B revenue bonds. According to the Master Trust Agreement for these bonds, in the event that such surety bond for any reason terminates or expires, and the remaining amount on deposit in the General Account is less than the Required Reserve, the Airport is to address such shortfall by delivering to the trustee a surety bond or a letter of credit meeting the criteria of a Qualified Reserve Facility under the Master Trust Agreement, or depositing cash to the General Account in up to twelve equal monthly installments.

Ambac Assurance has also issued a reserve fund surety bond that is on deposit in the reserve fund established for the City of San José Financing Authority Revenue Bonds, Series 2001A (4<sup>th</sup> and San Fernando Parking Garage) (the "CSJFA Series 2001A Bonds"). According to the Indenture of Trust for the CSJFA Series 2001A Bonds, prior to the expiration of the surety bond, the Authority is to (1) replace the surety bond with a new Qualified Reserve Account Credit Instrument (as defined in the Indenture of Trust) or (2) deposit or cause to be deposited with the trustee an amount of moneys equal to the Reserve Requirement (as defined in the Indenture of Trust), to be derived from Revenues (as defined in the Indenture of Trust). In the event that the Authority fails to do either of the above, then the trustee is to draw on the surety bond before such expiration to provide moneys to the fund the reserve in the amount of the Reserve Requirement.

It is uncertain at this time whether the Ambac Financial bankruptcy will cause the reserve fund surety bonds to lapse or expire. If such an event does occur, it is uncertain whether and when the Airport or the Authority would be required to take one of the actions described above in order to maintain compliance with the respective bond indenture.

Required Supplementary Information

# Required Supplementary Information

## June 30, 2010

**City of San José**  
**General Fund**  
**Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual**  
**For the Year Ended June 30, 2010**  
**(\$000's)**

	Budgeted Amounts		Actual Amounts Budgetary Basis Variance with Final Budget Over (Under)	Actual Amounts Budgetary Basis	Budgetary to GAAP Differences	Actual Amounts GAAP Basis
	Original	Final				
<b>REVENUES</b>						
Taxes:						
Property	\$ 198,249	202,179	7	202,186	-	202,186
Sales	135,795	127,375	(137)	127,238	-	127,238
Utility	106,559	107,839	312	108,151	-	108,151
State of California in-lieu	6,906	6,727	442	7,169	-	7,169
Franchise	41,422	38,579	(169)	38,410	-	38,410
Other	6,553	6,553	347	6,900	-	6,900
Licenses, permits and fines	89,208	81,047	936	81,983	-	81,983
Intergovernmental	27,775	26,389	(13,566)	12,823	-	12,823
Charges for current services	31,205	27,817	238	28,055	-	28,055
Investment Income	10,257	5,222	403	5,625	(4,111)	1,514 (1)
Other revenues	26,422	36,550	(1,697)	34,853	-	34,853
Total revenues	<u>680,351</u>	<u>666,277</u>	<u>(12,884)</u>	<u>653,393</u>	<u>(4,111)</u>	<u>649,282</u>
<b>EXPENDITURES</b>						
Current:						
General government	100,903	104,922	(22,078)	82,844	(6,126)	76,718 (2), (3)
Public safety	441,704	440,479	(10,885)	429,594	(2,573)	427,021 (2)
Capital maintenance	77,512	77,064	(22,262)	54,802	(8,641)	46,161 (2)
Community services	138,734	137,710	(7,427)	130,283	(3,468)	126,815 (2)
Sanitation	2,214	2,014	(294)	1,720	(48)	1,672 (2)
Capital outlay	3,864	3,940	-	3,940	-	3,940
Debt service:						
Principal	1,008	1,008	-	1,008	-	1,008
Interest	146	146	-	146	-	146
Total expenditures	<u>766,085</u>	<u>767,283</u>	<u>(62,946)</u>	<u>704,337</u>	<u>(20,856)</u>	<u>683,481</u>
Excess (deficiency) of revenues over expenditures	<u>(85,734)</u>	<u>(101,006)</u>	<u>50,062</u>	<u>(50,944)</u>	<u>16,745</u>	<u>(34,199)</u>
<b>OTHER FINANCING SOURCES (USES)</b>						
Transfers in	13,029	21,701	331	22,032	(630)	22,662 (4)
Transfers out	<u>(29,151)</u>	<u>(29,445)</u>	<u>(676)</u>	<u>(28,769)</u>	<u>-</u>	<u>(28,769)</u>
Total other financing sources (uses)	<u>(16,122)</u>	<u>(7,744)</u>	<u>(345)</u>	<u>(6,737)</u>	<u>(630)</u>	<u>(6,107)</u>
Net change in fund balance	(101,856)	(108,750)	49,717	(57,681)	16,115	(40,306)
Fund balance- beginning	173,254	173,254	-	173,254	37,939	211,193
Beginning encumbrance	-	-	-	25,824	(25,824)	-
Fund balance - ending	<u>\$ 71,398</u>	<u>64,504</u>	<u>49,717</u>	<u>141,397</u>	<u>28,230</u>	<u>170,887</u>

**Explanation of differences:**

- (1) Gain or loss in fair value of investments are not formally budgeted transactions.
- (2) Encumbrances of funds for which formal budget is prepared.
- (3) Expenditures and repayments that increase and decrease certain loan receivables for which formal budget is prepared.
- (4) Property transaction with the Redevelopment Agency is not budgeted.

See accompanying notes to the required supplementary information.

(Continued)

# Required Supplementary Information

## June 30, 2010

**City of San José**  
**Housing Activities**  
**Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual**  
**For the Year Ended June 30, 2010**  
**(\$000's)**

	Budgeted Amounts		Actual Amounts Budgetary Basis Variance with Final Budget Over (Under)	Actual Amounts Budgetary Basis	Budgetary to GAAP Differences	Actual Amounts GAAP Basis	
	Original	Final					
<b>REVENUES</b>							
Intergovernmental	\$ 28,423	27,324	(12,689)	14,635	-	14,635	
Investment income	9,510	9,510	1,914	11,424	(1,019)	10,405	(1)
Other revenues	10,565	5,565	1,870	7,435	(4,121)	3,314	(3)
Total revenues	<u>48,498</u>	<u>42,399</u>	<u>(8,905)</u>	<u>33,494</u>	<u>(5,140)</u>	<u>28,354</u>	
<b>EXPENDITURES</b>							
Current:							
Capital maintenance	3	29	-	29	-	29	
Community services	158,249	118,577	(19,919)	98,658	(57,721)	40,937	(2), (3)
Total expenditures	<u>158,252</u>	<u>118,606</u>	<u>(19,919)</u>	<u>98,687</u>	<u>(57,721)</u>	<u>40,966</u>	
Excess (deficiency) of revenues over expenditures	<u>(109,754)</u>	<u>(76,207)</u>	<u>11,014</u>	<u>(65,193)</u>	<u>52,581</u>	<u>(12,612)</u>	
<b>OTHER FINANCING SOURCES (USES)</b>							
Transfers in	128,614	146,082	(13,074)	133,008	-	133,008	
Transfers out	(71,080)	(124,138)	977	(123,161)	52,000	(71,161)	
Total other financing sources (uses)	<u>57,534</u>	<u>21,944</u>	<u>(12,097)</u>	<u>9,847</u>	<u>52,000</u>	<u>61,847</u>	
Net change in fund balance	(52,220)	(54,263)	(1,083)	(55,346)	104,581	49,235	
Fund balance - beginning	26,212	26,212	-	26,212	335,044	361,256	
Beginning encumbrance	-	-	-	37,962	(37,962)	-	
Fund balance - ending	<u>\$ (26,008)</u>	<u>(28,051)</u>	<u>(1,083)</u>	<u>8,828</u>	<u>401,663</u>	<u>410,491</u>	

**Explanation of differences:**

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

See accompanying notes to the required supplementary information.

(Continued)

## Required Supplementary Information

June 30, 2010

### Schedule of Funding Progress (\$ in 000's)

#### Police and Fire Department Retirement Plan - Defined Benefit Pension Plan

Actuarial Valuation Date (4)	Actuarial Value of Assets (1)	Actuarial Accrued Liability (AAL) (2)	Unfunded (Overfunded) AAL	Funded Ratio	Annual Covered Payroll (3)	(Overfunded) Unfunded AAL as a Percentage of Covered Payroll
6/30/05	\$ 1,983,090	2,027,432	44,342	98%	210,018	21%
6/30/07	(5) 2,365,790	2,372,386	6,596	100%	227,734	3%
6/30/09	2,569,569	2,963,482	393,913	87%	243,196	162%

#### Federated City Employees' Retirement System - Defined Benefit Pension Plan

Actuarial Valuation Date (4)	Actuarial Value of Assets (1)	Actuarial Accrued Liability (AAL) (2)	Unfunded AAL	Funded Ratio	Annual Covered Payroll (3)	Unfunded AAL as a Percentage of Covered Payroll
6/30/05	\$ 1,384,454	1,711,370	326,916	81%	286,446	114%
6/30/07	1,622,851	1,960,943	338,092	83%	291,405	116%
6/30/09	1,756,588	2,486,155	729,567	71%	308,697	236%

- (1) Excludes accounts payable, postemployment healthcare plan assets, and supplemental retiree benefit reserves.  
 (2) Excludes postemployment healthcare liability.  
 (3) Annual covered payroll represents the actuarial estimate of annual covered payroll for the subsequent year.  
 (4) Actuarial valuations have been performed biennially through June 30, 2009. Effective June 30, 2010, the Plan will transition to annual valuations.  
 (5) After reflection of benefit improvements effective July 1, 2008 for Police members.

#### Police and Fire Department Retirement Plan - Postemployment Healthcare Benefit Plan

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) (6)	Unfunded AAL	Funded Ratio	Annual Covered Payroll	Unfunded AAL as a Percentage of Covered Payroll
6/30/06	\$ 38,381	851,217	812,836	5%	218,521	372%
6/30/07	45,393	666,228	620,835	7%	227,734	273%
6/30/09	55,618	761,604	705,987	7%	243,196	290%

#### Federated City Employees' Retirement System - Postemployment Healthcare Benefit Plan

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) (6)	Unfunded AAL	Funded Ratio	Annual Covered Payroll	Unfunded AAL as a Percentage of Covered Payroll
6/30/06	\$ 81,288	702,939	621,651	12%	275,559	226%
6/30/07	96,601	616,749	520,148	16%	271,833	191%
6/30/09	85,564	796,448	710,884	11%	308,697	230%

- (6) The decrease in the actuarial accrued liability from 6/30/06 valuation to 6/30/07 valuation for both the Plan and the System is largely due to an increase in the sharing of benefit costs for the members as a result of the negotiations between the City and the members' unions.

(Continued)

## Notes to Required Supplementary Information

June 30, 2010

---

---

### 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.

Annual budgets are prepared for the General Fund and all special revenue funds except for the following:

- Developer Fees
- William F. Prusch, Jr.
- Special Assessment Special Services
- Emergency Reserve

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 CAFR itself. As a result, the City prepares a separate report to demonstrate compliance with its legal level of budgetary control.

Capital project budgets are based on a project time frame rather than a fiscal year time frame and therefore are not included. Debt Service Funds appropriations were adopted by the Council when the formal bond resolutions were approved.

### II. Budgetary Results Reconciled to GAAP

The budgetary process is based upon accounting for certain transactions on a basis other than the accounting principles generally accepted in the United States (GAAP) basis. The results of operations are presented in the accompanying budget and actual comparison schedules in accordance with the budgetary process (budgetary basis) to provide a meaningful comparison with the budget.

The major differences between the budgetary basis actual and GAAP basis are as follows:

- Year-end encumbrances are recognized as the equivalent of expenditures in the budgetary basis financial statements, while encumbered amounts are not recognized as expenditures on the 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 for the GAAP basis and as expenditures for the budgetary basis. When loan repayments are received, they are recorded as reductions to receivables for the GAAP basis, but are recognized as revenues for the budgetary basis.

(Continued)

## Notes to Required Supplementary Information

June 30, 2010

---

---

- 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 for the GAAP basis and is not included in the budgetary basis financial statements. In addition, the allowance for bad debts is not included in the budgetary basis financial statements, but is an expenditure for the GAAP basis.
- Certain accounts such as the change in fair value of investments included in the City's GAAP basis amounts, for which no formal budgets are prepared, are excluded from the budgetary basis financial statements.
- The Community Facility Revenue non-major special revenue fund has been blended to include the financial operations of the Dolce Hayes Mansion. Formal budgets are not prepared for this financial activity and is excluded from the budgetary basis financial statements.
- Certain line of credit transactions are recognized as expenditures in the budgetary basis financial schedules but are recorded as an asset in the GAAP basis financial statements. When the outside agency drawsdown on the line of credit, the City records an asset, advances to other agencies, in the GAAP basis financial statements and an expenditure on the budgetary basis financial schedules. When the outside agency pays down the line of credit, the City records a reduction to its assets in the GAAP basis financial statements and revenues on the budgetary basis financial schedules.
- Certain grant revenues received in advance are recognized on the budgetary basis financial statements, but are deferred and not recognized as revenue on the GAAP basis financial statements. This process normally creates a variance in recognized revenue from the prior year to the current year.

### III. Budget Revisions

On September 28, 2010, the City Council approved certain fiscal 2010 budget revisions that increased appropriations for various expenditure categories. The budget amounts presented in the accompanying schedule of revenues, expenditures, and changes in fund balances - budget and actual (budgetary basis) reflect such budget revisions.

(Concluded)

This page intentionally left blank

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

City Council  
City of San José, California

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San José, California (the City) as of and for the year ended June 30, 2010, which collectively comprise the City's basic financial statements, and have issued our report thereon dated November 22, 2010. Our report contains an explanatory paragraph describing the City's adoption of the provisions of Governmental Accounting Standards Board (GASB) Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, and GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, and an emphasis of a matter paragraph regarding that the City's defined benefit pension plans' and postemployment healthcare plans' unfunded actuarially accrued liabilities. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

*Internal Control Over Financial Reporting*

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

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.


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

*Compliance and Other Matters*

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

We noted certain matters that we reported to management of the City in a separate letter dated November 22, 2010.

This report is intended solely for the information and use of the City Council, the City's management, and federal awarding agencies and pass-through entities and the State Controller's Office, and is not intended to be and should not be used by anyone other than these specified parties.

  
Certified Public Accountants

Walnut Creek, California  
November 22, 2010

**Independent Auditor’s Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and the Passenger Facility Charges Program and on Internal Control over Compliance in Accordance with OMB Circular A-133**

City Council  
City of San José, California

*Compliance*

We have audited the City of San José’s, California (City), compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* and the *Passenger Facility Charge Audit Guide for Public Agencies* issued by the Federal Aviation Administration (*PFC Guide*) that could have a direct and material effect on each of the City’s major federal programs and the passenger facility charges program, respectively, for the year ended June 30, 2010. The City’s major federal programs are identified in the summary of auditor’s results section of the accompanying Federal Awards Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs and the passenger facility charges program is the responsibility of the City’s management. Our responsibility is to express an opinion on the City’s compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; OMB Circular A-133 and the *PFC Guide*. Those standards, OMB Circular A-133 and the *PFC Guide* require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program and the passenger facility charges program occurred. An audit includes examining, on a test basis, evidence about the City’s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the City’s compliance with those requirements.

In our opinion, the City complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs and the passenger facility charges program for the year ended June 30, 2010.

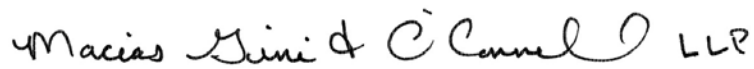
*Internal Control Over Compliance*

Management of the City is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs and the passenger facility charges program. In planning and performing our audit, we considered the City’s internal control over compliance with the requirements that could have a direct and material effect on a major federal program and the passenger facility charges program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133 and the *PFC Guide*, 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 and the passenger facility charges program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program and the passenger facility charges program will not be prevented, or detected and corrected, on a timely basis.

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

This report is intended solely for the information and use of the City Council, the City's management, the Federal Aviation Administration, federal awarding agencies and pass-through entities, and the State Controller's Office, and is not intended to be and should not be used by anyone other than these specified parties.

  
Certified Public Accountants  
Walnut Creek, California

November 22, 2010

**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Expenditures of Federal Awards  
Year Ended June 30, 2010

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures	
				Federal Grant	Other
<b>U.S. Department of Commerce</b>					
Economic Adjustment Assistance	11.307	Prior Year Ending Loan Balance	\$ -	\$ 416,329	\$ -
Total U.S. Department of Commerce			-	416,329	-
<b>U.S. Department of Housing and Urban Development</b>					
CDBG - Entitlement Grants Cluster:					
Community Development Block Grants/Entitlement Grants	14.218	B08-09 MC-06-0021	20,010,094	10,864,238	-
Housing and Economic Recovery Act 2008 - Neighborhood Stabilization Program I	14.218	B08-MN-06-0008	5,882,222	4,444,708	-
ARRA - Community Development Block Grant ARRA Entitlement Grants (CDBG-R)	14.253	B09-MY-06-0021	2,700,463	412,881	-
Community Development Block Grants/Entitlement Grants	14.218	Prior Year Ending Loan Balance	-	6,764,380	-
Subtotal CDBG - Entitlement Grants Cluster			28,592,779	22,486,207	-
Emergency Shelter Grants Program	14.231	S08-MC-060021	463,354	(6,282)	-
Emergency Shelter Grants Program	14.231	S09 MC-060021	442,619	442,619	-
			905,973	436,337	-
Home Investment Partnerships Program	14.239	M03-04 MC06215	10,503,406	432,999	-
Home Investment Partnerships Program	14.239	M07-08 MC06215	10,311,927	1,339,884	-
Home Investment Partnerships Program	14.239	M09 MC06215	5,390,365	2,541,245	-
Home Investment Partnerships Program	14.239	Prior Year Ending Loan Balance	-	43,829,806	-
Subtotal Home Investment Partnerships Program			26,205,698	48,143,934	-
Housing Opportunities for Persons with AIDS	14.241	CA-H07-F0-04	738,982	8,181	-
Housing Opportunities for Persons with AIDS	14.241	CA-H08-F0-04	765,180	221,219	-
Housing Opportunities for Persons with AIDS	14.241	CA-H107-0003	1,226,500	457,545	-
Housing Opportunities for Persons with AIDS	14.241	CA-H09-F0-04	796,679	593,470	-
Subtotal Housing Opportunities for Persons with AIDS			3,527,341	1,280,415	-
Pass-through County of Santa Clara					
ARRA - Neighborhood Stabilization Program II	14.256	B-09-CN-CA-0054	19,139,324	26,060	-
ARRA - Homelessness Prevention and Rapid Re-Housing Program	14.257	S-09-MY-06-0021	4,128,763	885,181	-
Total U.S. Department of Housing and Urban Development			82,499,878	73,258,134	-
<b>U.S. Department of Interior</b>					
Pass-through Bureau of Reclamation					
ARRA - Water Reclamation and Reuse Program	15.504	R10AC20R43	6,310,000	1,076,994	1,365,796
Total U.S. Department of Interior			6,310,000	1,076,994	1,365,796
<b>U.S. Department of Justice</b>					
Pass-through Office of Justice Programs:					
Missing Children's Assistance	16.543	2008-MC-CX-K002	1,342,837	302,851	-
Edward Byrne Memorial State and Local Law					
Enforcement Assistance Discretionary Grants Program	16.580	2007-DD-BX-0005	394,890	132,915	-
Edward Byrne Memorial State and Local Law					
Enforcement Assistance Discretionary Grants Program	16.580	2008-JL-FX-0161	469,494	158,793	-
Edward Byrne Memorial State and Local Law					
Enforcement Assistance Discretionary Grants Program	16.580	2008-VT-BX-0005	300,000	108,560	161,914
Edward Byrne Memorial State and Local Law					
Enforcement Assistance Discretionary Grants Program	16.580	2009-D1-BX-0108	250,000	95,016	-
Subtotal Edward Byrne Memorial State and Local Law			1,414,384	495,284	161,914
Enforcement Assistance Discretionary Grants Program					
Community Capacity Development Office	16.595	2008-WS-QX-0184	150,000	106,453	89,408
Community Capacity Development Office	16.595	2009-WS-QX-0052	142,000	32,149	-
Subtotal Community Capacity Development Office			292,000	138,602	89,408

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges

**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Expenditures of Federal Awards (Continued)  
Year Ended June 30, 2010

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures	
				Federal Grant	Other
<b>U.S. Department of Justice (continued)</b>					
Pass-through OJP Community Capacity Development Office - Santa Clara County DA's Office					
Community Capacity Development Office	16.595	2007-WS-Q7-0024/2008-WS-QX-0142	40,625	16,062	-
Bulletproof Vest Partnership Program	16.607	2008 1121-0235	42,089	42,089	-
Public Safety Partnership and Community Policing Grants	16.710	2009CSWX0023	447,773	163,420	-
Public Safety Partnership and Community Policing Grants	16.710	2009CKWX0131	695,000	242,613	-
Subtotal Public Safety Partnership and Community Policing Grants			1,142,773	406,033	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2006-DJ-BX-0883	270,939	4,176	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2007-DJ-BX-0531	307,530	178,886	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2008-DJ-BX-Q220	100,818	37,006	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2009-DJ-BX-0349	585,860	270,435	-
Subtotal Edward Byrne Memorial Justice Assistance Grant Program			1,265,147	490,503	-
Pass-through County of Santa Clara					
Edward Byrne Memorial Justice Assistance Grant Program	16.738	DC09200430	183,187	182,476	-
Subtotal Edward Byrne Memorial Justice Assistance Grant Program			1,448,334	672,979	-
ARRA - Internet Crimes Against Children Task Force Program (ICAC)	16.800	2009-SN-B9-K017	863,930	145,697	-
ARRA - Edward Byrne Memorial Justice Assistance Grant (JAG) Program	16.804	2009-SB-B9-0976	1,372,716	5,832	-
Pass-through California Emergency Management Agency					
ARRA - Edward Byrne Memorial Justice Assistance Grant (JAG) Program	16.804	ZH09017928	375,000	2,990	-
Subtotal Edward Byrne Memorial Justice Assistance Grant (JAG) Program			1,747,716	8,822	-
Total U.S. Department of Justice			8,334,688	2,228,419	251,322
<b>U.S. Department of Labor</b>					
Pass-through State of California, Employment Development Department					
ARRA - Employment Service/Wagner-Peyser Funded Activities	17.207	K078494144	99,273	40,661	-
Workforce Investment Act (WIA) Cluster:					
WIA Adult Program	17.258	K074173201	637,275	637,275	-
WIA Adult Program	17.258	K074173202	3,034,237	1,225,974	-
WIA RR	17.258	K074173540	179,430	179,430	-
WIA RR	17.258	K074173541	538,291	530,816	-
WIA 15% LLL CB	17.258	R970569441	15,500	3,814	-
WIA CDC 15% RD1	17.258	R970569442	10,000	10,000	-
WIA Youth Activities	17.259	K074173301	3,851,009	2,314,696	-
WIA Youth Activities	17.259	R970569301	3,713,904	2,168,749	-
WIA DLW	17.260	K074173501	1,207,233	1,207,233	-
WIA DLW2	17.260	K074173502	3,048,277	2,225,590	-
WIA Dislocated Workers AD RND 2	17.260	R970569500	2,454,184	1,830,510	-
ARRA - WIA Adult Program	17.258	R970569102	2,026,103	1,873,396	-
ARRA - WIA Youth Activities	17.259	R970569103	4,744,413	4,025,920	-
ARRA - WIA Dislocated Workers	17.260	R970569105	4,448,400	2,873,473	-
ARRA - RR 25%	17.260	K074173108	902,329	246,895	-
ARRA - RR FM	17.260	R970569106	638,390	371,086	-
Subtotal WIA Cluster			31,448,975	21,724,857	-
WIA Pilots, Demonstrations, and Research Projects	17.261	EA-20121-10-60-A-6	95,000	8,941	-
WIA Pilots, Demonstrations, and Research Projects	17.261	EA-18597-09-60-A-6	315,392	175,791	-
Subtotal Work Wise-Improving Job Performance			410,392	184,732	-
Total U.S. Department of Labor			31,958,640	21,950,250	-

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges

**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Expenditures of Federal Awards (Continued)  
Year Ended June 30, 2010

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures	
				Federal Grant	Other
<b>U.S. Department of Transportation</b>					
Federal Aviation Administration:					
Airport Improvement Program	20.106	3-06-0226-64	1,000,000	(12,031)	(2,898)
Airport Improvement Program	20.106	3-06-0226-67	6,000,000	409,053	98,520
Airport Improvement Program	20.106	3-06-0226-68	870,372	15,913	4,197
Airport Improvement Program	20.106	3-06-0226-70	3,000,000	70,841	17,062
Airport Improvement Program	20.106	3-06-0226-71	1,039,286	(4,314)	(1,039)
Airport Improvement Program	20.106	3-06-0226-72	622,816	20,640	11,997
Airport Improvement Program	20.106	3-06-0226-73	4,628,099	3,106,568	748,213
Airport Improvement Program	20.106	3-06-0226-74	814,371	814,371	196,140
Airport Improvement Program	20.106	3-06-0226-76	4,055,182	3,985,533	1,057,067
Airport Improvement Program	20.106	3-06-0226-77	2,000,000	1,980,475	476,995
ARRA - Airport Improvement Program	20.106	3-06-0226-75	5,178,291	5,127,742	-
Subtotal Airport Improvement Program			29,208,417	15,514,791	2,606,254
Highway Planning and Construction Cluster:					
Pass-through California Department of Transportation:					
Federal-Aid Highway Program:					
TIMC (HPP 2017) \$5.4M	20.205	HPP2017	5,400,000	311,862	77,966
SVSC ITS Enhancement	20.205	ITS99-5005(058)	1,187,204	263,373	-
Safe Routes to School (SRTS)	20.205	SRTSL-5005(091)	770,366	308,073	-
Minidoka Avenue Sidewalk Improvement	20.205	SRTSL-5005(097)	746,000	117,727	11,440
SVSC West Corridor - Stevens Creek - CMAQ	20.205	CML-5005(064)	4,748,000	156,628	20,293
Community Design and Transportation	20.205	CML-5005(094)	1,300,000	683,853	96,504
TEA-21-ITS: New CC TMC (Web II)	20.205	ITS03-5005(073)	579,123	15,873	15,873
Federal Street Maintenance	20.205	SCL 050028	16,300,666	201,486	31,537
E. Santa Clara Street Bridge at Coyote Creek	20.205	BRLZ-5005(089)	50,000	2,575	334
Regional Signal Timing Program (RSTP)	20.205	n/a	47,700	47,700	98,488
ARRA- Resurfacing Project	20.205	ESPL-5005(096)	15,414,200	6,475,590	-
Subtotal Federal-Aid Highway Program			46,543,259	8,584,740	352,435
Recreational Trails Program:					
SAFETEA-LU Trail: Bay Reach 7/9 (aka Reach 9B)	20.219	SCL 050082 HPLUL-5005(086)	675,000	219,447	54,862
SAFETEA-LU Trail: Coyote Creek (237 to Story Road)	20.219	SCL 050083 HPLUL-5005(087)	1,317,999	431,480	107,870
SAFETEA-LU Trail: Almaden Express Pedestrian Bridge	20.219	SCL 050089 DEMO05-5005(088)	496,000	177,078	302
Subtotal Recreational Trails Program			2,488,999	828,005	163,034
Subtotal pass-through California Department of Transportation			49,032,258	9,412,745	515,469
Pass-through Metropolitan Transportation Commission					
Housing Incentive Program - SJSU to Japantown Ped Corridor	20.205	CML-5005(093)	1,554,500	1,030,565	133,521
HBRR - Willow Glen Way Bridge	20.205	BRLS 5005(038)	3,428,354	-	2,656
Subtotal pass-through Metropolitan Transportation Commission			4,982,854	1,030,565	136,177
Pass-through Valley Transportation Authority					
CMAQ Trail: Lower Guadalupe River (Gold Street - 880)	20.219	SCL 050081 VTP 2030-30-B3 #B31	1,377,000	217,941	53,976
Subtotal Highway Planning and Construction Cluster			55,392,112	10,661,251	705,622

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges

**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Expenditures of Federal Awards (Continued)  
Year Ended June 30, 2010

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures	
				Federal Grant	Other
<b>U.S. Department of Transportation (continued)</b>					
State and Community Highway Safety					
Pass-through California Office of Traffic Safety					
2009 Sobriety Checkpoint Mini-Grant	20.600	SC09372	107,246	33,696	-
2010 Sobriety Checkpoint Mini-Grant	20.600	SC10372	146,937	109,751	-
2009 Click it or Ticket Grant	20.600	CT-09372	45,054	2,799	-
2010 Click it or Ticket Grant	20.600	CT-10372	28,559	25,210	-
Avoid the 13	20.600	AL0980	153,119	60,532	-
Elk Grove Police Department - Street Racing	20.600	PT0816	5,400	1,873	-
Subtotal State and Community Highway Safety			486,315	233,861	-
Total U.S. Department of Transportation			85,086,844	26,409,903	3,311,876
<b>National Endowment for the Humanities</b>					
Promotion of the Humanities_Public Programs					
Pass-through American Library Association					
Voices from the Writers Project	45.164	LR-50037-09	2,500	2,500	-
African American Baseball Exhibit	45.164	LT-50052-08	2,500	866	-
Subtotal Promotion of the Humanities_Public Programs			5,000	3,366	-
Grants to States Program:					
Pass-through California State Library					
Inclusive Early Literacy Services	45.310	40-7320	39,910	36,219	-
Staff Education 2009-10	45.310	40-7374	25,791	25,791	-
Outreach to Adult Education Students	45.310	40-7482	4,950	4,950	-
Teens and Library Collections	45.310	40-7483	4,950	4,950	-
Self Directed Interest Groups	45.310	40-7142	20,000	14,254	-
Libraries as Community Resources	45.310	40-7089	39,933	3,085	-
California of Past Digital Storytelling	45.310	40-7306	5,000	5,000	-
Subtotal Grants to States Program			140,534	94,249	-
Total National Endowment for the Humanities			145,534	97,615	-
<b>U.S. Small Business Administration</b>					
Silicon Valley Small Business Assistance Portal	59.000	SBAHQ-09-I-0217	245,643	5,450	-
Total U.S. Small Business Administration			245,643	5,450	-
<b>Environmental Protection Agency</b>					
Congressionally Mandated Projects					
Brownfields Assessment and Cleanup Cooperative Agreements	66.202	XP-96942501-0	673,000	71,470	285,880
	66.818	BF-96922201-2	200,000	71,556	-
Total Environmental Protection Agency			873,000	143,026	285,880
<b>U.S. Department of Energy</b>					
ARRA - Renewable Energy Research Development					
ARRA - Energy Efficiency and Renewable Energy Information Dissemination, Outreach, Training and Technical Analysis/Assistance	81.087	DE-EE0002075	1,101,636	18,464	-
ARRA - Energy Efficiency and Conservation Block Grants	81.117	DE-FC36-08GO18099	200,000	120,666	104,397
	81.128	EE0000881	8,840,600	212,271	-
Total U.S. Department of Energy			10,142,236	351,401	104,397
<b>U.S. Department of Education</b>					
Fund for the Improvement of Education	84.215	U215K080307	191,593	50,489	-
Fund for the Improvement of Education	84.215	U215K080308	277,074	111,965	-
Total U.S. Department of Education			468,667	162,454	-

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges

**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Expenditures of Federal Awards (Continued)  
Year Ended June 30, 2010

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures	
				Federal Grant	Other
<b>U.S. Department of Health and Human Services</b>					
Pass-through from Council on Aging - Silicon Valley					
Aging Cluster:					
Special Programs for the Aging_Title III, Part B _ Grants for Supportive Services and Senior Centers	93.044	Contract 1200 (2009)	2,700	2,700	-
Nutrition Services Incentive Program	93.053	Contract 1200	48,000	43,931	-
Subtotal Aging Cluster			50,700	46,631	-
Social Services Research and Demonstration	93.647	90XPO27401	191,593	98,775	-
Pass-through from County of Santa Clara:					
ARRA - Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program	93.714	N/A	2,458,225	140,624	-
Total U.S. Department of Health and Human Services			2,700,518	286,030	-
<b>Corporation for National and Community Services</b>					
Retired and Senior Volunteer Program	94.002	09SRPCA014	185,812	84,313	256,879
Senior Companion Program	94.016	09SCPCA007	128,033	128,033	180,233
Total Corporation for National and Community Services			313,845	212,346	437,112
<b>U.S. Department of Homeland Security</b>					
National Explosives Detection Canine Team Program	97.072	HSTS0208HCAN452	501,500	200,500	564,285
Law Enforcement Officer Reimbursement Agreement Program	97.090	HSTS0208HSLR344	1,093,638	364,421	760,782
Airport Checked Baggage Screening Program	97.100	HSTS04-08-H-CT1234	20,660,000	5,717,708	441,870
ARRA - TSA Airport Checked Baggage Inspection System Program	97.117	HSTS04-09H-REC161	20,916,360	13,479,872	1,497,762
Pass-through the County of Santa Clara					
Emergency Management Performance Grants	97.042	n/a	50,978	50,978	50,978
Homeland Security Cluster:					
Pass-through the County of Santa Clara					
FY 07 Urban Areas Security Initiative	97.008	2007-2008 FIPS 075-95017	1,000,000	85,516	31,819
FY 08 Urban Areas Security Initiative	97.008	2008-0006 FIPS 075-95017	1,433,385	903,835	-
FY 08 Urban Areas Security Initiative	97.008	n/a	1,472,972	1,448,698	-
Homeland Security Grant Program	97.067	n/a	426,227	305,135	-
FY08 State Homeland Security Grant Program	97.067	n/a	196,143	97,767	1,300
FY07 State Homeland Security Grant Program	97.067	2007-0008 FIPS 085-00000	123,085	4,469	-
FY07 Metropolitan Medical Response System	97.071	2007-0008 FIPS 085-00000	258,145	221,914	-
FY08 Metropolitan Medical Response System	97.071	2008-0006 FIPS 085-00000	321,221	2,860	-
Subtotal pass-through the County of Santa Clara			5,231,178	3,070,194	33,119
Pass-through San Mateo County Northern California Regional Intelligence Center					
FY 2009-10 Northern California Regional Intelligence Center	97.008	n/a	335,189	204,090	-
Subtotal Homeland Security Cluster			5,566,367	3,274,284	33,119
Total U.S. Department of Homeland Security			48,788,843	23,087,763	3,348,796
Total Federal Awards			\$ 277,868,336	\$ 149,686,114	\$ 9,105,179
<b>State of California - Internet Crimes Against Children State Grant Program</b>					
Internet Crimes Against Children Grant	n/a	IC07017928	\$ 500,000	\$ -	\$ 114,016

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges

This Page Left Intentionally Blank.

**CITY OF SAN JOSE, CALIFORNIA**  
Schedule of Revenues and Expenditures of Passenger Facility Charges  
Year Ended June 30, 2010

Passenger Facility Charges Project Number/Description	Identifying Number	Passenger Facility Charges Project Amount	Expenditures	Revenue Recognized
<b>Total Passenger Facility Charges Collection Revenues</b>				
Passenger Facility Charges Collections				\$ 17,043,463
Interest Earned on PFC Program				30,763
<b>Passenger Facility Charges Projects</b>				
#1	Communication Center Upgrade	\$ 528,691	\$ -	-
#2	Fire Truck Replacement	599,826	-	-
#3	Handlift Replacement	103,000	-	-
#4	Noise Attenuation	47,792,121	-	-
#5	Noise Monitoring System Upgrade	184,000	-	-
#6	Noise Remedy/Land Acquisition	5,133,000	47,555	-
#7	Security Access Control System	1,032,000	-	-
#40a	Runway 30L Reconstruction	72,022,700	-	-
#40b	Runway 30L Extension	38,671,724	-	-
#52	Taxiway Z - Apron Reconstruction ( Phase II)	825,000	-	-
#53	Terminal C Fire Protection	580,000	-	-
#54	Fiber Optic Cable to ARC & Fire Station 29	87,345	-	-
#55	Green Island Bridge	825,000	-	-
#56	Replacement of AACS and CCTV	4,418,645	-	-
#57	Skyport Grade Separation	18,218,154	-	-
#58	Terminal Drive Improvements	1,146,165	-	-
#59	Replacement of PASSUR	221,000	-	-
#60	Terminal C Restroom	2,485,000	-	-
#61	Interim Air Cargo Ramp Extension	1,100,000	-	-
#62	Runway 30R/12L Reconstruction	84,105,103	-	-
#63	Noise Attenuation Category II & III	4,500,000	13,749	-
#64	Taxiway Y Extension	12,890,000	-	-
#65	Extended Noise Attenuation	61,589,000	299,517	-
#67	Terminal B - North Concourse	495,095,000	4,588,000	-
#68	Terminal B Extension, Phase I	110,159,000	-	-
#69	Roadway Improvements: Grade Separations	10,244,000	-	-
Total Passenger Facility Charges Projects		<u>\$ 974,555,474</u>	<u>\$ 4,948,821</u>	<u>\$ 17,074,226</u>

See accompanying notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges

This Page Left Intentionally Blank.

## CITY OF SAN JOSE, CALIFORNIA

### Notes to the Schedule of Expenditures of Federal Awards and Schedule of Revenues and Expenditures of Passenger Facility Charges

Year Ended June 30, 2010

#### **(1) GENERAL**

The accompanying Schedule of Expenditures of Federal Awards (SEFA) presents the activity of the federal award programs of the City of San José, California (the City). The City's reporting entity is defined in Note I to its basic financial statements. The SEFA includes all federal awards received directly from federal agencies and federal awards passed-through other governmental agencies. In addition, the SEFA includes local, state and other expenditures matched along with the federal award expenditures.

The Schedule of Revenues and Expenditures of Passenger Facility Charges (PFCs) presents only the activity of the passenger facility charges program of the Norman Y. Mineta San José International Airport (Airport), an enterprise fund of the City. PFCs are fees imposed on enplaned passengers by the Airport for the purpose of generating revenue for Airport projects that increase capacity, increase safety, mitigate noise impact and enhance competition between and among air carriers in accordance with Federal Aviation Administration (FAA) approvals.

#### **(2) BASIS OF PRESENTATION**

The accompanying schedules are presented using the modified accrual basis of accounting for program expenditures accounted for in the governmental funds and the accrual basis of accounting for program expenditures accounted for in the proprietary funds as described in Note I to the City's basic financial statements, with the exception of the City's loan programs (see Note 7). For reimbursable grants, except for the San José Water Reclamation & Reuse Program as discussed in Note 8, which revenues are recognized upon Congressional appropriations, the City recognizes revenues commencing on the date of grant approval since this is when the City is eligible to claim expenditures for reimbursements. As a result, prior year expenditures are included in the current year SEFA because these expenditures only become eligible when the grant was approved. Negative amounts shown on the SEFA represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years. Pass-through entity identifying numbers are presented where available.

#### **(3) RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS**

Expenditures of federal awards are reported in the City's basic financial statements as expenditures in the general, special revenue and capital projects funds and as expenses for non-capital expenditures and as additions to capital assets for capital related expenditures in the enterprise funds. Federal award expenditures agree or can be reconciled with the amounts reported in the City's basic financial statements.

#### **(4) RELATIONSHIP TO FEDERAL FINANCIAL REPORTS**

Amounts reported in the SEFA and Schedule of Revenues and Expenditures of Passenger Facility Charges agree to or can be reconciled with the amounts reported in the related federal financial reports.

#### **(5) AIRPORT EXPENDITURES**

The FAA reimburses the Airport for approximately 80% of allowable Airport Improvement Program (AIP) grant expenditures, except for the American Recovery and Reinvestment Act (ARRA) funded grant expenditures, which reimburses 100% of the Airport's allowable costs. The remaining unreimbursed portion of grant expenditures, if eligible, are reimbursed from PFC revenues. Total allowable AIP expenditures are presented in the accompanying SEFA.

## CITY OF SAN JOSE, CALIFORNIA

### Notes to the Schedule of Expenditures of Federal Awards and Schedule of Revenues and Expenditures of Passenger Facility Charges (Continued)

Year Ended June 30, 2010

#### (5) AIRPORT EXPENDITURES (Continued)

The accompanying Schedule of Revenues and Expenditures of Passenger Facility Charges includes approximately 20% of expenditures reimbursed by PFC revenue for AIP approved projects and 100% for non-AIP approved projects.

The U.S. Department of Homeland Security reimburses the Airport for approximately 90% of allowable ARRA funded CFDA No. 97.117 TSA Airport Checked Baggage Screening Program (Program) grant expenditures. During the fiscal year 2010, the Program incurred \$13,479,872, of which \$2,802,634 were incurred in fiscal year 2009. This is allowable and consistent with the grant agreement executed in September 2009, which provides a provision that the cost recognition date for the Program be effective in April 2009.

#### (6) AMOUNTS PROVIDED TO SUBRECIPIENTS

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

<u>Program Title</u>	<u>Federal Catalog Number</u>	<u>Provided to Subrecipients</u>
Community Development Block Grants/Entitlement Grants	14.218	\$2,833,192
Emergency Shelter Grants Program	14.231	441,811
Home Investment Partnerships Program	14.239	347,801
Housing Opportunities for Persons with AIDS	14.241	1,075,592
ARRA - Homeless Prevention and Rapid Re-housing Program	14.257	858,775
Workforce Investment Act (WIA) Adult Program	17.258	1,363,402
Workforce Investment Act (WIA) Youth Activities	17.259	1,168,762
Workforce Investment Act (WIA) Dislocated Workers	17.260	1,235,079
ARRA - Workforce Investment Act (WIA) Adult Program	17.258	326,959
ARRA - Workforce Investment Act (WIA) Youth Activities	17.259	572,479
ARRA - Workforce Investment Act (WIA) Dislocated Workers	17.260	200,000

#### (7) LOANS OUTSTANDING

The City participates in certain federal award programs that sponsor revolving loan programs, which are administered by the City. These programs maintain servicing and trust arrangements with the City to collect loan repayments. The funds are returned to the programs upon repayment of the principal and interest. The federal government has imposed certain continuing compliance requirements with respect to the loans under the Community Development Block Grants/Entitlement Grants (CDBG), the HOME Investment Partnership Program (HOME), and Economic Adjustment Assistance program. In accordance with Subpart B, Section 205 of the Office of Management and Budget Circular A-133, the City has reported the outstanding balance of loans from previous years that have continuing compliance requirements as of June 30, 2010 along with the value of total outstanding and new loans made during the current year in the schedule.

**CITY OF SAN JOSE, CALIFORNIA**

Notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges (Continued)

Year Ended June 30, 2010

**(7) LOANS OUTSTANDING (Continued)**

The following is a summary of the loan programs maintained by the City and their balances at June 30, 2010:

<u>Program Title</u>	<u>CFDA Number</u>	<u>Amount Outstanding</u>	<u>Prior year loans with continuing compliance requirements</u>	<u>New loans</u>
Economic Adjustment Assistance	11.307	\$ 416,329	\$ 416,329	\$ -
Community Development Block Grants/Entitlement Grants	14.218	7,203,892	6,764,380	439,512
HOME Investment Partnerships Program	14.239	<u>47,256,779</u>	<u>43,829,806</u>	<u>3,426,973</u>
		<u>\$ 54,877,000</u>	<u>\$ 51,010,515</u>	<u>\$ 3,866,485</u>

**(8) SAN JOSE AREA WATER RECLAMATION & REUSE PROGRAM**

The San José Area Water Reclamation & Reuse Program, now known as South Bay Water Recycling, assists the City and tributary agencies of the San José-Santa Clara Water Pollution Control Plant in protecting endangered species habitats, achieving federally mandated water quality standards and reducing reliance on area surface, ground water, and imported water supplies. The U.S. Department of Interior – Bureau of Reclamation awarded the City \$32.5 million in federal fiscal year 1995 and approved an increase of \$2.5 million in federal fiscal year 2000. Funding for subsequent years, for a total of \$35 million in Phase 1A funding for the South Bay Water Recycling Program, is contingent upon subsequent Congressional appropriations acts. As a result of the timing of the subsequent funding approvals, the City requests reimbursements for costs incurred in prior fiscal years.

As of September 30, 2010, Congress appropriated \$31,650,300 towards the Phase 1A obligation. In addition, on April 30, 2010, the U.S. Department of Interior – Bureau of Reclamation awarded the City \$6.31 million from the American Recovery and Reinvestment Act of 2009 (ARRA) towards the \$14.78 million Phase 1C program, of which \$3.35 million was allocated in lieu of reimbursement for Phase 1A, essentially completing the federal obligation for that phase for the program. This additional grant increased the federal share of Phase 1C from 25% to 44% of the project cost. During fiscal year 2010, the program incurred expenditures of \$1,076,994.

Furthermore, in June 2010 the Council authorized the City Manager to enter into a third agreement with the Bureau of Reclamation to fund 25% of the \$82.85 million SBWR Phase 1B project, or \$20.7 million. The first part of this Agreement R10AP20057 is expected to be executed by November 30, 2010 for an initial grant amount of \$1.011 million.

**CITY OF SAN JOSE, CALIFORNIA**

Notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges (Continued)

Year Ended June 30, 2010

**(9) PROGRAM TOTALS**

The SEFA does not summarize all programs that receive funding from various funding sources or grants by Catalog of Federal Domestic Assistance (CFDA) number. The following table summarizes these programs by CFDA numbers.

CFDA Number - Program Title Grant Identifying Number or Pass-through Grantor	Federal Expenditures
WIA Cluster, pass-through State of California Employment Development Department	
CFDA No. 17.258 - WIA Adult Program	
K074173201	\$ 637,275
K074173202	1,225,974
K074173540	179,430
K074173541	530,816
R970569441	3,814
R970569442	10,000
R970569102 - American Recovery and Reinvestment Act of 2009	<u>1,873,396</u>
CFDA No. 17.258 - WIA Adult Program Total	<u>4,460,705</u>
CFDA No. 17.259 - WIA Youth Activities Program	
K074173301	2,314,696
R970569301	2,168,749
R970569103 - American Recovery and Reinvestment Act of 2009	<u>4,025,920</u>
CFDA No. 17.259 - WIA Youth Activities Program Total	<u>8,509,365</u>
CFDA No. 17.260 - WIA Dislocated Workers Program	
K074173501	1,207,233
K074173502	2,225,590
R970569500	1,830,510
R970569105 - American Recovery and Reinvestment Act of 2009	2,873,473
K074173108 - American Recovery and Reinvestment Act of 2009	246,895
R970569106 - American Recovery and Reinvestment Act of 2009	<u>371,086</u>
CFDA No. 17.260 - WIA Dislocated Workers Program Total	<u>8,754,787</u>
Total WIA Cluster	<u>\$ 21,724,857</u>
Highway Planning Cluster:	
CFDA No. 20.205 - Federal-Aid Highway Program	
Pass-through California Department of Transportation	\$ 8,584,740
Pass-through Metropolitan Transportation Commission	<u>1,030,565</u>
CFDA No. 20.205 - Federal-Aid Highway Program	<u>9,615,305</u>
CFDA No. 20.219 - Recreational Trails Program	
Pass-through California Department of Transportation	828,005
Pass-through Valley Transportation Authority	<u>217,941</u>
CFDA No. 20.219 - Recreational Trails Program	<u>1,045,946</u>
Total Highway Planning Cluster	<u>\$ 10,661,251</u>

**CITY OF SAN JOSE, CALIFORNIA**

Notes to the Schedule of Expenditures of Federal Awards and  
Schedule of Revenues and Expenditures of Passenger Facility Charges (Continued)

Year Ended June 30, 2010

**(10) INTERNET CRIMES AGAINST CHILDREN (ICAC) STATE GRANT**

The following schedule represents expenditures for the Internet Crimes Against Children Task Force Program from the U.S. Department of Justice and the State of California Governor's Office of Emergency Service (OES) for the year ended June 30, 2010. This information is included in the City's Single Audit Report at the request of OES.

Program Title and Expenditure Category	Grant Number Grant Period	Expense	Actual 7/1/09-6/30/10		Expense	Revenue
		through June 30, 2009	Non-match	Match	through June 30, 2010	
Internet Crimes Against Children Task Force Program (Federal)	2008 MC CX K002					
Personnel Services	7/1/08 - 12/31/2011	\$ 63,173	\$ 144,768	\$ -	\$ 207,941	\$ 144,768
Operating Expenses		209,420	96,842	-	306,262	96,842
Equipment		76,902	61,241	-	138,143	61,241
Total		<u>\$ 349,495</u>	<u>\$ 302,851</u> <sup>1</sup>	<u>\$ -</u>	<u>\$ 652,346</u>	<u>\$ 302,851</u>
Internet Crimes Against Children Task Force Program (State)	IC07017928					
Personnel Services	1/1/2008-6/30/2010	\$ -	\$ -	\$ -	\$ -	\$ -
Operating Expenses		261,329	34,860	-	296,189	34,860
Equipment		54,209	79,156	-	133,365	79,156
Total		<u>\$ 315,538</u>	<u>\$ 114,016</u> <sup>2</sup>	<u>\$ -</u>	<u>\$ 429,554</u>	<u>\$ 114,016</u>

1 Amount is reported as federal expenditures in the SEFA under CFDA number 16.543 for the Missing Children's Assistance Grant from the U.S. Department of Justice.

2 Amount is reported as other expenditures in the SEFA under the State of California - Internet Crimes Against Children Task Force Program. This grant is a State grant from the Law Enforcement and Victim Services Division of the Governor's Office of Emergency Services.

**(11) CALIFORNIA DEPARTMENT OF AGING (CDA) GRANT**

The terms and conditions of agency contracts with CDA require agencies to display state-funded expenditures discretely along with the related federal expenditures. The following schedule is presented to comply with these requirements.

Federal Grantor/ Pass-through Grantor/ Program Title	CFDA Number	Grant/ Contract Number	Expenditures	
			State	Federal
<b>U.S. Department of Health and Human Services</b>				
<i>Pass through the Council on Aging - Silicon Valley</i>				
Special Programs for the Aging_Tilte III, Part B_Grants for Supportive Services and Senior Centers	93.044	1200 (2009)	\$ -	\$ 2,700
<i>Pass through the Council on Aging - Silicon Valley</i>				
Nutrition Services Incentive Program	93.053	1200	-	43,931
Total Expenditures of State and Federal Awards			<u>\$ -</u>	<u>\$ 46,631</u>

## CITY OF SAN JOSE, CALIFORNIA

### Notes to the Schedule of Expenditures of Federal Awards and Schedule of Revenues and Expenditures of Passenger Facility Charges (Continued)

Year Ended June 30, 2010

#### (12) SUBSEQUENT EVENTS

On July 12, 2010, the FAA executed a federal grant agreement, 3-06-0226-78 (Agreement) with the City. The estimated project cost is \$8,261,209, of which FAA agreed to reimburse 80.59% of the allowable, allocable and reasonable costs of Taxiway W (B-C) and connector Taxiway C (Projects) including design and construction management in addition to construction costs but not to exceed a total reimbursement of \$6,657,708. Although this grant agreement was executed in fiscal year 2010-2011, the FAA AIP regulations provide a provision for the Airport to claim the design costs that were incurred in FY 2009-10. Upon execution of the FAA grant agreement, the City has prepared information for reimbursement requests for eligible expenditures incurred in fiscal year 2009-10 and recognition of the related revenues from the date of the grant approval (July 12, 2010) will be reported in subsequent years' City financial statements.

On September 23, 2010, the FAA executed a federal grant agreement, 3-06-0226-79 (Agreement) with the City. The estimated project cost is \$2,786,362, of which FAA agreed to reimburse 80.59% of the allowable, allocable and reasonable costs of Taxiway W (D-L) including rehabilitation of Taxiways G and J from Taxiways V to W (Project) for the design costs but not to exceed a total reimbursement of \$2,245,529. Although this grant agreement was executed in fiscal year 2010-2011, the FAA AIP regulations provide a provision for the Airport to claim the design costs that were incurred in FY 2009-10. Upon execution of the FAA agreement, the City has prepared information for reimbursement requests for eligible expenditures incurred in fiscal year 2009-10 and recognition of the related revenues from the date of the grant approval (September 23, 2010) will be reported in subsequent years' City financial statements.

**CITY OF SAN JOSE, CALIFORNIA**

Federal Awards Schedule of Findings and Questioned Costs

Year Ended June 30, 2010

**Section I Summary of Auditor's Results**

*Financial Statements*

Type of auditor's report issued on the basic financial statements of the City: Unqualified

Internal control over financial reporting:

- ◆ Material weakness (es) identified? No
- ◆ Significant deficiencies identified that are not considered to be material weaknesses? None reported.

Noncompliance material to the financial statements noted? No

*Federal Awards*

Internal control over major programs:

- ◆ Material weakness (es) identified? No
- ◆ Significant deficiencies identified that are not considered to be material weaknesses? None reported.

Type of auditor's report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? No

Identification of major programs:

Federal Domestic Catalog Number(s)	Name of Federal Program or Cluster
14.218, 14.253	CDBG - Entitlement Grants Cluster
14.257	ARRA - Homelessness Prevention and Rapid Re-Housing Program
15.504	Water Reclamation and Reuse Program
17.258, 17.259, 17.260	WIA Cluster
20.106	Airport Improvement Program
20.205, 20.219	Highway Planning and Construction Cluster
97.117	ARRA - TSA Airport Checked Baggage Inspection System Program

Dollar threshold used to distinguish between type A and type B programs: \$2,959,032

Auditee qualified as a low-risk auditee? Yes

**Section II Financial Statement Findings**

None reported.

**Section III Federal Award Findings and Questioned Costs**

None reported.

**CITY OF SAN JOSE, CALIFORNIA**

Passenger Facility Charges Schedule of Findings and Questioned Costs

Year Ended June 30, 2010

**Section I Summary of Auditor's Results**

*Financial Statements*

Type of auditor's report issued on the basic financial statements of the City: Unqualified

Internal control over financial reporting:

- ◆ Material weakness (es) identified? No
- ◆ Significant deficiencies identified that are not considered to be material weaknesses? None reported.

Noncompliance material to the financial statements noted? No

*Passenger Facility Charges*

Internal control over Passenger Facility Charges:

- ◆ Material weakness (es) identified? No
- ◆ Significant deficiencies identified that are not considered to be material weaknesses? None reported.

Type of auditor's report issued on compliance for the Passenger Facility Charges program: Unqualified

**Section II Financial Statement Findings**

None reported.

**Section III Passenger Facility Charges Findings and Questioned Costs**

None reported.

**CITY OF SAN JOSE, CALIFORNIA**

Summary Schedule of Prior Audit Findings

Year Ended June 30, 2010

**Reference Number: 2009-A – Accounting for Variable Rate Demand Obligations**

Audit Finding: During our audit, we proposed an audit adjustment to record \$5.3 million as a fund liability as of June 30, 2009 related to the mandatory reduction to the credit facility on its variable-rate tax allocation bonds

We recommend the City evaluate the financial and operational implications should conditions related to the availability of credit facilities worsen in the future. Additionally, we suggest expanding the traditional finance focused monitoring efforts related to bond obligations (e.g., covenant compliance and disclosure) to include coordination with the City's GAAP reporting unit to ensure changes impacting classifications or display are properly considered and reflected in the financial statements.

Status of Corrective Action: Corrected.

**Reference Number: 2009-B – Housing Loan Reserves Calculations**

Audit Finding: During our audit, we noted that the City recorded both an offset to the inclusionary and developer loans' receivable balance and a valuation allowance in the amount of \$11.5 million. As a result, the fund balance of the Housing Activities Fund was understated by \$11.5 million at June 30, 2009. In addition, we noted that the Housing Department's loan portfolio analysis included errors in the maturity dates, which led to potential understatement of the loan portfolio's discount reserve by \$0.9 million.

We recommend the Finance Department continue to train its financial statement preparers and reviewers on the recording of its loan balances and allowances on these balances and its related deferred revenues and reserved fund balances.

Status of Corrective Action: Corrected.

**CITY OF SAN JOSE, CALIFORNIA**

Summary Schedule of Prior Audit Findings

Year Ended June 30, 2010

<b>Reference Number:</b>	<b>2009-1 – Schedule of Expenditures of Federal Awards (SEFA) Completeness</b>
Federal Catalog Number/ Program Name:	U.S. Department of Health and Human Services Special Programs for the Aging_ Title III, Part B_ Grants for Supportive Services and Senior Centers, CFDA 93.044 Pass-through Council on Aging of Silicon Valley  Corporation for National and Community Services Senior Companion Program, CFDA 94.016
Audit Finding:	During our audit, we noted that the City included misstatements in its final draft schedule of SEFA for the above programs, resulting in the SEFA not being accurate.  The City should develop a grants manual to provide guidance to grant administrators in City departments. In addition to completing the grants manual, we recommend the City develop and implement a mandatory single audit training program that is conducted at least annually. The training program should address expectations of the single audit, provide for changes and updates in available resources and requirements, and provide guidance and updates on identification of funding source and on when to record revenues and expenditures in the general ledger. In addition, the City should improve its process in requiring the preparation and review of each grant reconciliation of its expenditures required in the SEFA to the general ledger and related revenues.
Status of Corrective Action:	Corrected during the year ended June 30, 2010.