**CITY OF SAN JOSE, CALIFORNIA**

Single Audit Reports

Basic Financial Statements with
Federal and Airport Compliance Sections

For the Year Ended June 30, 2017

**CITY OF SAN JOSE, CALIFORNIA**
**For the Year Ended June 30, 2017**
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REPORT OF INDEPENDENT CERTIFIED
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Honorable City Council
City of San Jose, California

**Report on the financial statements**

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San Jose, California (the "City") as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's responsibility for the financial statements

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

Auditor's responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

### Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San Jose, California as of June 30, 2017, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### Other matters

#### *Required supplementary information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis; the schedules of revenues, expenditures, and changes in fund balance – budget and actual for the General Fund, Housing Activities Fund, and Low and Moderate Income Housing Asset Fund; the schedules of employer contributions – defined benefit pension plans; the schedule of changes in the employer's net pension liability – defined benefit pension plans; the schedule of investment returns – defined benefit pension plans; the schedule of the City's proportionate share of the net pension liability and related ratios – CalPERS; the schedule of employer contributions - CalPERS; and the schedules of funding progress – postemployment healthcare benefit plans, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a required part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. This required supplementary information is the responsibility of management. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America. These limited procedures consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

#### *Supplementary information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The schedule of expenditures of federal awards, as required by Title 2 *U.S. Code of Federal Regulations (CFR) Part 200,* Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, the schedule of passenger facility charge revenue and expenditures, as required by the *Passenger Facility Charge Audit Guide for Public Agencies*, and the schedule of customer facility charge revenues and expenditures, as required by the *California Civil Code Section 1936, as amended by Senate Bill 1192 and*

*Assembly Bill 359* are presented for purposes of additional analysis and is not a required part of the basic financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

**Other reporting required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report, November 16, 2017, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control over financial reporting and compliance.

GRANT THORNTON LLP

Grant Thornton LLP

San Jose, California
November 16, 2017 (except for our report on the schedule of passenger facility charge revenues and expenditures, and schedule of customer facility charge revenues and expenditures as to which the date is November 30, 2017)

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Management's Discussion and Analysis ("MD&A") provides an overview of the City of San José's ("City") activities and financial performance for the fiscal year ended June 30, 2017. Readers are encouraged to read the MD&A in conjunction with the basic financial statements that immediately follow, along with the letter of transmittal at the beginning of the Introductory Section, and with other portions of this Comprehensive Annual Financial Report ("CAFR"). All amounts have been rounded to the nearest one hundred thousand dollars and one tenth of a percent.

## FINANCIAL HIGHLIGHTS

- The government-wide statement of net position for the City's governmental and business-type activities indicates that as of June 30, 2017, total assets and deferred outflows of resources exceed total liabilities and deferred inflows of resources by $4.679 billion. Of this amount, a deficit of $1.584 billion represent unrestricted net position, which is comprised of a deficit balance of $1.935 billion for governmental activities, and a positive balance of $351.1 million for business-type activities. In addition, the City's restricted net position totals $1.058 billion ($982.2 million for governmental activities and $75.9 million for business-type activities) and is dedicated to specific purposes. Lastly, net position of $5.206 billion is the City's net investment in capital assets ($4.391 billion for governmental activities and $814.5 million for business-type activities).

- The net position decreased by $189.0 million or 3.9 percent during 2016-2017 to $4.679 billion from $4.868 billion. Expenses continued to exceed revenues although tax revenues and sales taxes shared revenues increased by $47.4 million over the past year.

- Governmental funds reported a combined ending fund balances of $1.415 billion at June 30, 2017, which is $48.0 million or 3.5 percent more than the June 30, 2016 balance. The increase was attributable to an increase in the Housing Activities Fund of $41.3 million, the Low and Moderate Income Housing Asset Fund of $3.9 million, the San José Financing Authority Debt Service Fund of $10.7 million, the Integrated Waste Management Fund of $1.1 million, the Nonmajor Governmental Funds of $1.8 million, and offset by decrease in the General Fund of $6.2 million and the Special Assessment Districts Fund of $4.5 million.

- Unassigned fund balance of governmental funds totals $79.9 million, which is 5.6 percent of combined governmental fund balances at June 30, 2017.

- Total long-term liabilities (excluding net pension liability) decreased by $67.3 million to $3.263 billion at June 30, 2017, which represents a decrease of 2.0 percent compared to $3.331 billion at June 30, 2016. The primary factors leading to the decrease in long-term liabilities for governmental activities of $41.2 million were due to the scheduled debt service payments of $56.4 million, offset by net increases in compensated absences liability of $4.3 million and other post-employment benefit costs ("OPEB") liability of $10.9 million. The primary factors leading to the decrease in long-term liabilities for business-type activities of $26.1 million were due to the scheduled debt service payments of $25.5 million.

- Net pension liability increased by $732.8 million or 32.2 percent during 2016-2017 to $3.011 billion from $2.278 billion. Deferred outflows of resources related to pensions increased by $522.6 million or 99.0 percent, and deferred inflows of resources related to pensions increased by $6.4 million or 1,871.8 percent. The changes were mainly due to a net loss of $414.5 million between projected and actual investment earnings on the San José Police & Fire Retirement Plan and the San José Federated Employees' Retirement Systems Plan ("Retirement Plans"), and an increase of $327.1 million to the total pension liability resulting from changes of assumptions and differences between expected and actual actuarial experience.

## OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

In addition, this report also contains other supplementary information.

### Government-wide Financial Statements

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

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

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

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

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

### Fund Financial Statements

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

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

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

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

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

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

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

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

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

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

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

**Analysis of net position:** As noted earlier, net position may serve as a useful indicator of a government's financial position. As of June 30, 2017, the City's total assets and deferred outflows of resources exceed total liabilities and deferred inflows of resources by $4.679 billion.

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

**Statement of Net Position**
**June 30, 2017 and 2016**
**(in thousands)**

| | Governmental Activities | | Business-type Activities | | Totals | |
|---|---|---|---|---|---|---|
| | FY 2017 | FY 2016 | FY 2017 | FY 2016 | FY 2017 | FY 2016 |
| **Assets:** | | | | | | |
| Current and other assets…………… | $ 1,819,677 | $ 1,762,904 | $ 872,457 | $ 858,111 | $ 2,692,134 | $ 2,621,015 |
| Capital assets……………………….. | 5,439,984 | 5,571,397 | 2,061,572 | 2,020,445 | 7,501,556 | 7,591,842 |
| Total assets…………………….. | 7,259,661 | 7,334,301 | 2,934,029 | 2,878,556 | 10,193,690 | 10,212,857 |
| **Deferred outflows of resources:** | | | | | | |
| Loss on refundings of debt………… | 905 | 1,090 | 9,686 | 3,397 | 10,591 | 4,487 |
| Deferred outflows of resources related to pensions………… | 929,516 | 468,238 | 120,954 | 59,620 | 1,050,470 | 527,858 |
| Total deferred outflows of resources | 930,421 | 469,328 | 130,640 | 63,017 | 1,061,061 | 532,345 |
| **Liabilities:** | | | | | | |
| Current and other liabilities………… | 198,169 | 176,594 | 96,180 | 90,803 | 294,349 | 267,397 |
| Long-term liabilities…………………. | 1,869,208 | 1,910,414 | 1,394,086 | 1,420,159 | 3,263,294 | 3,330,573 |
| Net pension liability………………… | 2,678,942 | 2,030,227 | 332,035 | 248,000 | 3,010,977 | 2,278,227 |
| Total liabilities……………………. | 4,746,319 | 4,117,235 | 1,822,301 | 1,758,962 | 6,568,620 | 5,876,197 |
| **Deferred inflows of resources:** | | | | | | |
| Gain on refundings of debt………… | - | - | 107 | 373 | 107 | 373 |
| Deferred inflows of resources related to pensions………… | 5,982 | 341 | 742 | - | 6,724 | 341 |
| Total deferred inflow of resources | 5,982 | 341 | 849 | 373 | 6,831 | 714 |
| **Net position:** | | | | | | |
| Net investment in capital assets | 4,391,069 | 4,478,760 | 814,473 | 766,107 | 5,205,542 | 5,244,867 |
| Restricted ……………………………. | 982,168 | 930,553 | 75,945 | 76,709 | 1,058,113 | 1,007,262 |
| Unrestricted …………………………. | (1,935,456) | (1,723,260) | 351,101 | 339,422 | (1,584,355) | (1,383,838) |
| Total net position……………….. | $ 3,437,781 | $ 3,686,053 | $ 1,241,519 | $ 1,182,238 | $ 4,679,300 | $ 4,868,291 |

At June 30, 2017, the City reported positive balances in net position on a total basis. Net investment in capital assets (infrastructure, land, buildings, other improvements, vehicles, and equipment, less outstanding debt used to acquire them) of $5.206 billion comprise 111.2 percent of the City's total net position. These capital assets facilitate providing services to the San José community, but they are not liquid, and therefore they are not available for future spending. During 2016-2017, net investment in capital assets decreased by $39.3 million primarily due to the depreciation expense of $299.3 million offset by additions (net) to capital assets of $209.0 million, and decrease of $81.9 million in the long-term debt. A portion of the City's net position, $1.058 billion or 22.6 percent, are subject to legal restrictions on their use, including $982.2 million in governmental activities and $75.9 million in business-type activities. Of the total net position at June 30, 2017, a deficit balance of $1.584 billion or 33.9 percent represents unrestricted net position, which comprises a deficit balance of $1.935 billion for governmental activities, and a positive balance of $351.1 million for business-type activities. The primary factor contributing to the deficit unrestricted net position is the City's net pension liability.

During 2016-2017, the City's total net position decreased by $189.0 million. Notable changes in the statement of net position between June 30, 2017 and June 30, 2016 include:

- Capital assets decreased by $90.3 million or 1.2 percent compared to the prior fiscal year. Governmental capital assets decreased by $131.4 million and business-type capital assets increased by $41.1 million. The decrease in governmental capital assets resulted from depreciation expense of $217.8 million for major infrastructure and other assets, partially offset by additions to capital assets of $92.6 million, which included transfers of $7.5 million of properties from the Successor Agency to the Redevelopment Agency of the City of San José (the "SARA") to the City for City's governmental use. The increase in business-type capital assets was primarily due to depreciation expense of $81.5 million, offset by additions to capital assets of $122.6 million primarily at the Airport and Wastewater Treatment Facility.

- Current and other assets increased by $71.1 million or 2.7 percent due to an increase of $56.8 million for governmental activities and also an increase of $14.3 million for business-type activities. The increase in governmental activities is mainly due to increases in cash and investments and receivables, as a result of the timing of payments for goods and services of $27.1 million and offset by the payoff of commercial paper notes in the amount of $15.2 million for governmental activities. The increase in current assets for business-type activities is mainly due to an increase in cash and investments, as a result of revenues exceeding expenses by $59.3 million.

- Total long-term liabilities (excluding net pension liability) decreased by $67.3 million to $3.263 billion at June 30, 2017, which represents a decrease of 2.0 percent compared to $3.331 billion at June 30, 2016. The primary factors leading to the decrease in long-term liabilities for governmental activities of $41.2 million were due to the scheduled debt service payments of $56.4 million, offset by net increases in compensated absences liability of $4.3 million and OPEB liability of $10.9 million. The primary factors leading to the decrease in long-term liabilities for business-type activities of $26.1 million were due to the scheduled debt service payments of $25.5 million.

- Current and other liabilities for the City increased by $27.0 million or 10.1 percent due to increases of $21.6 million for governmental activities and $5.4 million for business-type activities. The increases in governmental activities is mainly due to increase in accounts payable and accrued liabilities by $27.1 million, as a result of timing of invoice payments; and offset by the payoff of commercial paper notes in the amount of $15.2 million. The increase in business-type activities is mainly due to an increase in accounts payable and accrued liabilities by $22.2 million, as a result of timing of services payments; and offset by the Airport's payoff of commercial paper notes in the amount of $9.2 million and a decrease of interest payable of $7.3 million resulted from the refunding of Airport Revenue Bonds Series 2007A (AMT) and Series 2007B (non-AMT).

- Net pension liability increased by $732.8 million or 32.2 percent during 2016-2017 to $3.011 billion from $2.278 billion. Deferred outflows of resources related to pensions increased by $522.6 million or 99.0%, and deferred inflows of resources related to pensions increased by $6.4 million or 1,871.8%. The changes were mainly due to a net loss of $414.5 million between projected and actual investment earnings on the Retirement Plans, and an increase of $327.1 million to the net pension liability resulting from changes of assumptions and differences between expected and actual actuarial experience.

- Unrestricted net position for governmental activities decreased by $212.2 million or 12.3 percent with a deficit balance of $1.935 billion at June 30, 2017. The primary factor contributing to the deficit unrestricted net position for governmental activities is the City's net pension liability. For business-type activities, unrestricted net position increased by $11.7 million or 3.4 percent with a positive balance of $351.1 million at June 30, 2017. The net increase in unrestricted net position in business-type activities was primarily due to revenue exceeding expenses by $62.7 million. Primary factors contributing to the increase are $33.6 million increase in fees, fines, and charges for services, and $16.9 million increase in other revenue.

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

**Statement of Activities**
**For the Years Ended June 30, 2017 and 2016**
**(in thousands)**

| | Governmental Activities | | Business-type Activities | | Totals | |
|---|---|---|---|---|---|---|
| | FY 2017 | FY 2016 | FY 2017 | FY 2016 | FY 2017 | FY 2016 |
| **Revenues:** | | | | | | |
| Program revenues: | | | | | | |
| Fees, fines, and charges for services | $ 462,862 | $ 423,820 | $ 479,003 | $ 445,372 | $ 941,865 | $ 869,192 |
| Operating grants and contributions | 86,779 | 107,583 | 1,233 | 864 | 88,012 | 108,447 |
| Capital grants and contributions | 63,647 | 69,848 | 13,258 | 15,437 | 76,905 | 85,285 |
| General revenues: | | | | | | |
| Property and other taxes | 431,138 | 404,878 | - | - | 431,138 | 404,878 |
| Utility | 121,046 | 113,474 | - | - | 121,046 | 113,474 |
| Franchise | 49,642 | 48,949 | - | - | 49,642 | 48,949 |
| Transient occupancy taxes | 45,511 | 41,125 | - | - | 45,511 | 41,125 |
| Business taxes | 54,159 | 50,864 | - | - | 54,159 | 50,864 |
| Sales taxes shared revenue | 207,695 | 201,797 | - | - | 207,695 | 201,797 |
| State of California in-lieu | 467 | 410 | - | - | 467 | 410 |
| Unrestricted interest and investment income | 9,062 | 7,790 | 3,955 | 6,383 | 13,017 | 14,173 |
| Other revenue | 4,459 | 2,103 | 19,211 | 2,314 | 23,670 | 4,417 |
| Total revenues | 1,536,467 | 1,472,641 | 516,660 | 470,370 | 2,053,127 | 1,943,011 |
| **Expenses:** | | | | | | |
| General government | 127,090 | 122,363 | - | - | 127,090 | 122,363 |
| Public safety | 694,557 | 555,072 | - | - | 694,557 | 555,072 |
| Community services | 310,470 | 274,838 | - | - | 310,470 | 274,838 |
| Sanitation | 156,299 | 145,516 | - | - | 156,299 | 145,516 |
| Capital maintenance | 444,867 | 395,393 | - | - | 444,867 | 395,393 |
| Interest and fiscal charges | 54,844 | 56,768 | - | - | 54,844 | 56,768 |
| Norman Y. Mineta San José International Airport | - | - | 204,774 | 201,017 | 204,774 | 201,017 |
| Wastewater Treatment System | - | - | 192,302 | 163,985 | 192,302 | 163,985 |
| Municipal Water System | - | - | 42,647 | 36,246 | 42,647 | 36,246 |
| Parking System | - | - | 14,269 | 13,607 | 14,269 | 13,607 |
| Total expenses | 1,788,126 | 1,549,950 | 453,992 | 414,855 | 2,242,118 | 1,964,805 |
| Excess (deficiency) before transfers | (251,659) | (77,309) | 62,668 | 55,515 | (188,991) | (21,794) |
| Transfers | 3,387 | 3,680 | (3,387) | (3,680) | - | - |
| Change in net position | (248,272) | (73,629) | 59,281 | 51,835 | (188,991) | (21,794) |
| Net position at beginning of year | 3,686,053 | 3,759,682 | 1,182,238 | 1,130,403 | 4,868,291 | 4,890,085 |
| Net position at end of year | $3,437,781 | $3,686,053 | $1,241,519 | $1,182,238 | $4,679,300 | $ 4,868,291 |

**Governmental activities:** Net position for governmental activities decreased by $248.3 million or 6.7 percent during 2016-2017 from $3.686 billion to $3.438 billion. Total expenses increased by $238.2 million and total revenues increased by $63.8 million. The increase in revenues was not sufficient to offset total expenses resulting in a decrease in net position before transfers. Significant elements of the decrease in net position before transfers for governmental activities from June 30, 2016 to June 30, 2017 are as follows:

- Contributing factors resulting in increases to certain revenue categories are as follows: Fees, fines, and charges for services increased by $39.0 million or 9.2 percent, from a HUD judgment award of $36.0 million recorded in the Housing Activities Fund, an increase of $7.9 million in revenues from additional conference activities in the Convention Center, and offset by a decrease of $2.5 million in the Construction Excise Tax Fund due to a one-time collection of traffic impact fee for Trammel Crow's manufacturing building improvement in the amount of $4.3 million in FY 2015-2016, and a decrease of $1.7 million in the Integrated Waste Management Fund due to completion of the solar panel project and a significant reduction of late/lien revenue because of waste management billing conversion from the City to the County property tax roll collection. Property and other taxes revenue increased by $26.3 million or 6.5 percent due to an increase in assessed property tax valuations. Other revenues increased by $2.4 million or 112.0 percent due to an increase of $2.0 million in Special Assessment Districts Fund for the fees received from developers to operate St. James Park began in current fiscal year. Utility taxes increased by $7.6 million or 6.7 percent due to an increase in General Fund, which is explained in more detail in the General Fund section. Sales tax shared revenue increased by $5.9 million or 2.9 percent indicating a modest improvement in consumer spending. Transient occupancy tax receipts from guests staying in the City's local hotels increased by $4.4 million or 10.7 percent. For the fourteen largest hotels in the City, the average daily room rate increased by approximately 6.8 percent during the year indicating signs of continued economic recovery.

- Contributing factors resulting in decreases to certain revenue categories are as follows: Operating grants and contributions decreased by $20.8 million or 19.3 percent primarily due to a decrease of $17.1 million in interest repayment of developer loans in the Low and Moderate Income Housing Asset Fund, a decrease of $8.3 million in the General Fund related to the partial reinstatement of Supplemental Educational Revenue Augmentation Funds loan of $10.0 million plus accrued interest of $0.2 million were recognized in FY15-16 compared to $1.9 million accrued interest recorded in FY 2017, and offset by an increase of $4.6 million in community services in the Housing Activities Fund due to increase in HOME, Emergency Shelter, and Housing Opportunities for Persons with AIDS grant revenues and an increase of $2.2 million of the Community Development Block Grant Fund due to issuance of a new CDBG loan in the amount of $2.0 million resulted in an increase in CDBG grant revenue. Capital grants and contributions decreased by $6.2 million or 8.9 percent primarily due to the City purchased of capital assets from the SARA were $2.9 million less and donated capital assets received were $2.2 million less when compared to prior fiscal year, and a decrease of special hotel taxes due to set aside of special hotel taxes of $1.7 million received from non-annexed hotels for FY15-16 as liabilities in current fiscal year.

- General government expenses increased by $4.7 million or 3.9 percent during 2016-2017 due to an increase of $18.6 million in net pension liability, a write-off of construction-in-process in the amount of $6.0 million for various projects, and offset by a decrease of $4.5 million in the estimate for self-insurance liabilities.

- Public safety expenses increased by $139.5 million or 25.1 percent primarily due to an increase in pension expense of $111.3 million and an increase in the General Fund of $22.1 million, which is explained in more detail in the General Fund section.

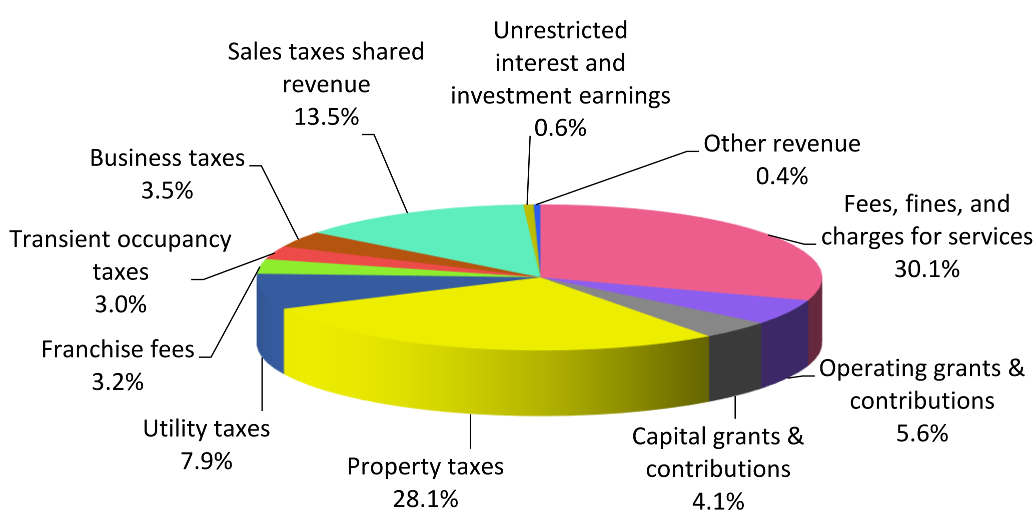
- Community services expenses increased by $35.6 million or 13.0 percent primarily due to an increase in pension expense of $18.2 million; an increase of $7.4 million in operating expenses in the Convention Center, which corresponded to increased conference activities and revenues in the Convention Center, an aggregated increase of $5.9 million in the Housing Activities, Low and Moderate Income Housing Asset, and Community Development Block Grant Funds due to increased loan loss allowance, an increase of $1.2 million in the Transient Occupancy Tax Fund due to an increase of $1.2 million reimbursement to Team San José for marketing and promotion activities, and an increase of $1.3 million in the General Fund, which is explained in more detail in the General Fund section.

- Sanitation expenses increased by $10.8 million or 7.4 percent primarily due to increase in pension expense of $4.7 million, and an increase of $5.8 million in the Integrated Waste Management Fund due to increases in operating costs for the solid waste recycling program.

- Capital maintenance increased by $49.5 million or 12.5 percent primarily due to an increase of $26.4 million in the General Fund which is explained in more detail in the General Fund section, an increase of $4.1 million in the Special Assessment Districts Fund due to the Route 101/Blossom Hill Road Interchange Project and the Convention Center renovation and expansion program, and an increase of $21.6 million in pension expense. These increases were offset by decreases of $8.1 million due to a one-time write off of loans to the SARA for the low income housing voucher program that was invalidated by SB 107 effective September 22, 2015.

- Interest and fiscal charges decreased by $1.9 million or 3.4 percent primarily due to the payoff and retirement of long-term obligations. The balance of debt payable for various bonds and loans decreased by $56.4 million or 4.6 percent from the prior year.

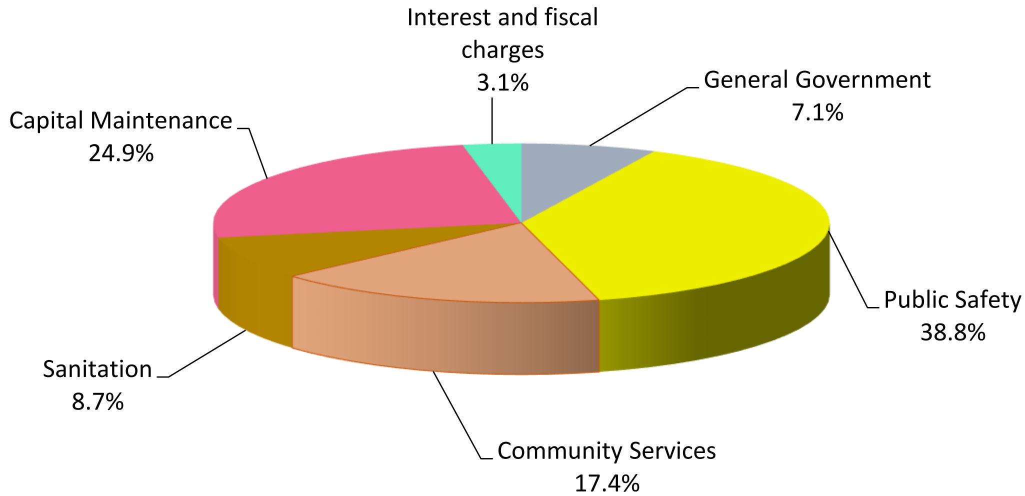
## Governmental Activities Revenues 2017




The chart shows the primary components of governmental activities revenue sources for 2016-2017. Of the $1.536 billion in total revenues generated by governmental activities, 79.6 percent is attributable to four categories: fees, fines, and charges for services (30.1 percent), property taxes (28.1 percent), sales taxes shared revenue (13.5 percent), and utility taxes (7.9 percent).

The chart below shows the principal categories of 2016-2017 expenses for governmental activities. Of the $1.788 billion in total expenses incurred by governmental activities, the categories accounting for 81.1 percent of the totals are: public safety (38.8 percent); capital maintenance (24.9 percent); and community services (17.4 percent).

## Governmental Activities Expenses 2017




**Business-type activities:** Business-type activities net position increased by $59.3 million or 5.0 percent to $1.242 billion during 2016-2017.

The notable components of the changes in net position for business-type activities during 2016-2017 are:

**Airport** net position increased by $2.8 million or 1.4 percent from $193.8 million to $196.6 million. The increase was primarily due to operating expenses and interest expenses exceeding operating and non-operating revenues by $7.3 million, offset by $10.1 million in capital contributions.

The Airport had a net operating income of $18.1 million, an increase of $5.9 million compared to prior year's operating income of $12.2 million. Operating revenues increased by $11.0 million or 7.7 percent, which was mainly due to an increase in general aviation attributable to growth in passenger traffic. A total of approximately 11.5 million passengers travelled through the Airport in FY 2017 compared to approximately 10.2 million in FY 2016, resulting in passenger traffic growth of 12.7 percent.

Operating expenses of $134.8 million increased by $5.1 million or 3.9 percent compared to the prior fiscal year due to increases in salaries and fringe benefits, recognition of additional pension expense due to the annual actuarial valuation of the Retirement Plans, partially offset by a decrease in the overhead costs. Nonoperating expenses exceeded nonoperating revenues by $25.4 million which represented a decrease of $0.4 million from the previous fiscal year. This decrease was mainly due to a decrease of $2.6 million in customer facility charges, a decrease of $1.4 million in other revenue, a decrease of $3.8 million in interest expenses, and decrease of $0.9 million in investment income, offset by an increase of $3.2 million in passenger facility charges, an increase of $0.7 million in operating grants, and an increase of $2.5 million in bond issuance costs.

**Wastewater Treatment System** net position increased by $32.9 million or 4.0 percent from $824.4 million to $857.4 million. The increase was primarily due to operating revenues exceeding operating expenses by $31.4 million. The largest portion, $606.5 million or 70.7 percent, of the net position was its net investment in capital assets (e.g. land, buildings, and infrastructures) less outstanding debt that was used to acquire those assets. Approximately $241.9 million, or 28.2 percent of the total net position, constitutes unrestricted net position, which may be used to finance day-to-day operations without constraints established by debt covenants or other legal requirements.

Operating revenues increased $13.6 million primarily due to a 5.5 percent sewer rate increase effective July 1, 2016 ($5.4 million), higher contributions from the Tributary Agencies toward the Water Pollution Control Plant's (the Plant) ongoing maintenance, replacement and debt service costs by $4.6 million, higher recycled-water revenue due to recycled-water rate increases by $1.8 million, and the $1.2 million capacity improvement fees received in current year from the San Jose Water Company to support the South Bay Water Recycling infrastructure.

Total operating expenses increased by $28.6 million compared to the prior fiscal year. The increase was due to an increase of $15.0 million in pension expense, an increase of $3.4 million in personnel costs, an increase of $1.8 million in direct overhead costs, and an increase of $4.7 million in master plan document review, sanitary sewer line condition assessment and rehabilitation of existing infrastructures to support ramp up in capital implementation activities to rebuild the aging infrastructures of the wastewater system; an increase of $2.8 million in newly purchased insurance policies for an Owner Controlled Insurance Program to provide a centralized insurance program for losses associated with onsite construction of Capital Improvement Program at the Plant; an increase of $1.6 million of equalization payment to the Santa Clara Valley Water District for the Silicon Valley Advanced Water Purification center; and offset by $1.3 million decrease in net OPEB obligations.

Net non-operating revenues decreased by $1.4 million primarily due to a decrease in fair value of investments. Capital contributions decreased by $6.6 million mainly due to a reduction of funding appropriated from the U.S. Bureau of Reclamation for construction of wastewater recycling facilities ($5.0 million) and a decrease in donated capital assets from developers ($1.6 million).

**Municipal Water System** net position increased by $2.7 million or 3.2 percent from $85.1 million to $87.8 million. Operating revenues of $44.7 million increased by $7.3 million or 19.6 percent due to increase in both user fee rates and total consumption. Operating expenses of $42.6 million increased by $6.4 million or 17.7 percent due to an increase in the cost of wholesale water, for both potable and recycled water, an increase in operations and maintenance related to Edenvale Reservior rehabilitation and Cadwallader Reservoir Rehabilitation as well as increased costs due to increase staffing and higher salary and benefit costs.

**Parking System** net position increased by $20.8 million or 26.4 percent from $78.9 million to $99.7 million. Operating revenues increased by $1.1 million or 6.7 percent primarily due to the increase in usage of smart meters in the downtown area and increased activity at the Convention Center parking facility resulting from a continued economic recovery. Operating expenses increased by $0.7 million or 4.9 percent reflecting higher general and administrative costs. Nonoperating revenue increased by $18.2 million or 5,632.8 percent due to gain of $14.4 million on loan reinstatement from the SARA and an increase of $4.0 million contributions to be restricted for the acquisition of certain properties to the north of the SAP Center for the use of public parking.

## 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, 2017, the City's governmental funds reported combined fund balances of $1.415 billion, an increase of $48.0 million or 3.5 percent compared to the balance at June 30, 2016. The governmental fund balances are categorized as nonspendable, restricted, committed, assigned, or unassigned.

- $0.5 million consists of nonspendable fund balance including prepaid items, advances and deposits, and other assets that are not intended to convert into cash and long-term in nature and do not represent currently available resources.
- $960.8 million is reported as restricted fund balance that includes restrictions imposed by external parties or enabling legislation. This amount includes unspent bond proceeds, unspent grant revenues, and restricted tax revenues.
- $155.3 million is reported as committed fund balance that had been limited by formal Council action to specific purposes.
- $218.7 million is reported as assigned fund balance that includes amounts that may be used for specific purposes, but do not meet the criteria to be classified as restricted or committed.
- $79.9 million is reported as unassigned fund balance that represents the residual classification for the City's General Fund and includes all spendable amounts not contained in the other classifications.

**General Fund:** The General Fund is the chief operating fund of the City. At June 30, 2017, the General Fund's unassigned fund balance is $79.9 million or 25.5 percent of the $312.8 million total General Fund balance. Comparing unassigned fund balance and total fund balance to total fund expenditures may be useful as a measure of the General Fund's capacity to liquidate future obligations. At June 30, 2017, unassigned fund balance represents 8.9 percent of total General Fund expenditures of $896.9 million, while total fund balance represents 34.9 percent of total General Fund expenditures. At June 30, 2016, the same measures were 7.6 percent and 37.3 percent, respectively.

For the first time in five years, the revenue sources in 2016-2017 were not sufficient to cover all expenditures. The General Fund ending fund balance decreased by $6.2 million from $319.0 million to $312.8 million at June 30, 2017.

In 2016-2017, General Fund revenues of $901.1 million were $29.4 million or 3.4 percent higher than 2015-2016 revenues of $871.7 million. Taxes and special assessments revenues increased by $26.4 million or 5.4 percent. The increase was primarily attributed to the following revenue sources: increases of $13.1 million in property tax due to increased property tax assessments; an increase of $7.6 million in utility tax due to increase in usage of electricity and gas, water, and one-time telecommunication users tax revenue adjustment; an increase of $3.3 million in marijuana business tax due to increase in gross receipts; and an increase of $1.7 million in Transient Occupancy Tax due to increase in hotel occupancy and the opening of two new hotels in the City.

Sales taxes shared revenue increased by $5.9 million or 2.9 percent due to an improving economy.

License, permits and fines increased by $5.3 million or 7.6 percent primarily due to increases in building inspection fees, marijuana business regulatory fees, and revenue for wireless project at East Side Union High School District.

2016-2017 General Fund expenditures of $896.9 million were $42.3 million or 5.0 percent higher than 2015-2016 expenditures of $854.6 million as discussed below.

General government expenditures increased by $3.8 million primarily due to increases in salary costs.

Public safety expenditures increased by $22.1 million primarily due to a one-time lump sum non-pensionable retention bonus to all sworn public safety employees and increase in salary costs.

Community services expenditures increased by $1.3 million mainly due to increase in salary costs.

Capital maintenance expenditures increased by $26.4 million due to increase spending in capital projects associated with streets and road pavement maintenance activities.

Capital outlay expenditures decreased by $12.3 million due to the purchase of additional vehicles, radios servers, fire apparatus and Spartan fire engines for police and fire departments in the prior fiscal year.

**Housing Activities Fund:** The City's Housing Activities fund receives resources from the U.S. Department of Housing and Urban Development and the California Department of Housing and Community Development. At June 30, 2017, the fund's loan receivable balance (net), which represents loans to developers of various affordable housing projects and first time homebuyers, was $71.2 million. This balance includes loans to developers for various projects, including Ford and Monterey, Taylor Oaks Apartments, Donner Lofts, Japantown Seniors, The Metropolitan, Northrup, Roundtable, Kings Crossing, Fourth Street Apartments, Peacock Commons, Archer Studios, Canoas Terrace, Curtner Studios, Homesafe, Markham Plaza, Plaza Del Sol, Verandas, Corde Terra Village Senior, Willow Glen Senior Housing, Santa Clara Inn, and Second Street Studios. 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. Restricted fund balance increased by $41.3 million to $127.7 million at June 30, 2017. The increase is primarily due to revenues from intergovernmental ($11.5 million), and investment and other revenues ($47.2 million) exceeding expenditures for community services ($17.3 million). Intergovernmental revenues increased by $4.6 million or 66.0 percent compared to prior year due to more grant funds received from HOME Investment Partnership Program and The Emergency Shelter Grant. Other revenue increased by $37.8 million or 592.1 percent compared to prior year due to proceeds from the HUD judgment awarded to the City of $36.0 million.

**Low and Moderate Income Housing Asset Fund:** The Low and Moderate Income Housing Asset fund was created pursuant to the Redevelopment Dissolution Law to administer the housing assets and functions related to the Low and Moderate Income Housing Program retained by the City following the dissolution of the former Agency. At June 30, 2017, the fund's loan receivable balance (net) was $228.0 million. This balance consists mainly of loans to developers for various projects including Almaden Family Apartments, Belovida Apartments, Brookwood Terrace, Cinnabar Commons, Corde Terra Village, Las Ventanas, Oak Tree Village, Pollard Plaza, Terramina Square, Villas on the Park, Second Street Studios, and The Metropolitan (South). Restricted fund balance increased by $3.9 million to $352.3 million from $348.5 million. The increase is primarily due to interest repayment of developer loans.

**Special Assessment Districts Fund:** The Special Assessment Districts fund accounts for debt issuance and capital improvements related to the specific purposes of eight special assessment and community facilities districts located in different parts of the City. A total of $136.1 million in special assessment and special tax bonds were outstanding at June 30, 2017. All bonds are secured by special assessments or special taxes charged to the owners' real property in the district issuing the debt, except for the Special Hotel Tax Revenue Bond, Series 2011, which are secured by a first lien on the Convention Center Facilities District No.2008-1 special tax revenues and any of the Available Transient Occupancy Tax (Available TOT as defined in the bond documents) that is appropriated by City Council. The City is not obligated to advance available surplus funds from the City Treasury to cure any deficiency in the Redemption Fund for these bonds; provided, however, the City is not prevented, in its sole discretion, from so advancing funds.

Restricted fund balance decreased by $4.6 million from $44.3 million to $39.7 million as of June 30, 2017. The decrease was primarily due to total expenditures for 2016-2017 increased by $3.8 million or 23.2 percent compared to the prior fiscal year primarily due to a significant increase of $3.9 million in capital maintenance for the Route 101/Blossom Hill Road interchange project and the Convention Center renovation and expansion which was funded by the Convention Center Special Hotel Tax Revenues.

**Financing Authority Fund**: The City's Financing Authority Debt Service Fund accounts for debt activity related to lease revenue bonds and commercial paper notes, which serves as a mechanism for financing City public improvements and other eligible purposes. Restricted fund balance increased by $10.7 million from $17.8 million to $28.5 million as of June 30, 2017. The increase was primarily due to $19.6 million transfer from Construction and Conveyance Tax Fund for Commercial Paper redemption related to improvements at San José Convention Center, and offset by $8.9 million transfer of commercial paper proceeds to the Energy Conservation Project and the Water Utility Meter Project.

**Integrated Waste Management Fund:** The Integrated Waste Management Fund ("IWM") accounts for activities related to the Integrated Waste Management Program, which includes garbage collection, recycling services and related billing operation. Committed fund balance increased by $1.1 million from $28.3 million to $29.4 million as of June 30, 2017. The increase was primarily due to operating revenues of $129.2 million exceeding operating expenses of $127.0 million, which was offset by $1.1 million in transfer out primarily used to pay down Lease Revenue Refunding Bonds, Series 2013A and 2013B.

**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, 2017, the unrestricted net position was $48.9 million for the Airport, $241.9 million for the Wastewater Treatment System, $15.2 million for the Municipal Water System and $45.1 million for the Parking System. Net position for proprietary funds increased from $1.182 billion at June 30, 2016 to $1.242 billion at June 30, 2017, resulting in an increase of $59.3 million or 5.0 percent.

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

## GENERAL FUND BUDGETARY HIGHLIGHTS

The City's Charter requires the City Manager to submit balanced operating and capital budgets to the City Council prior to the beginning of a new fiscal year that begins each July 1 and ends on the following June 30. Council approved the 2016-2017 budgets in June 2016.

During the fiscal year ended June 30, 2017, there was a $22.2 million increase in the budgeted revenues between the original and final amended operating budget for the General Fund. The budgeted revenues increase in all revenue categories except for sales taxes shared revenues.

Actual budgetary basis expenditures of $948.2 million were $89.0 million less than the amended budget and $273.6 million less than the original budget due to planned expenditures not occurring in the fiscal year ended June 30, 2017.

## CAPITAL ASSETS AND DEBT ADMINISTRATION

### Capital Assets

The City's capital assets, net of accumulated depreciation, for its governmental and business-type activities together amounted to $7.502 billion at June 30, 2017. This investment includes land, infrastructure, structures and improvements, vehicles, equipment, intangible assets, and construction-in-progress. The City's decision to depreciate infrastructure capital assets results in recording a large non-cash depreciation expense each year that offsets additions to capital assets. At June 30, 2017, net capital assets decreased by $90.3 million ($131.4 million decreased in governmental activities and $41.1 million increased in business-type activities) or 1.2 percent compared to net capital assets at June 30, 2016. The decrease in capital assets of $131.4 million in governmental activities is primarily due to depreciation expense of $217.8 million and deletions of capital assets totaling $6.1 million. These decreases were offset by acquisitions of capital assets of $85.1 million and transfers of land from the SARA in the amount of $7.4 million. The increase of $41.1 million in capital assets in the business-type activities resulted from depreciation expense of $81.5 million, offset by additions of capital assets of $122.6 million at the Airport and the Wastewater Treatment Facility.

Total construction-in-progress (CIP) increased by $82.9 million or 96.4 percent from $86.0 million at June 30, 2016 to $168.8 million at June 30, 2017. Construction-in-progress for the governmental activities increased by $17.6 million or 56.0 percent primarily due to more additions to CIP than CIP projects completed and placed into service. Among the larger capitalized projects included land improvements to Bramhall Park and Lake Cunningham, roadway improvements to Park Avenue; and construction of new traffic signals on Jackson Avenue, which resulted in $7.4 million increase in CIP. Among the larger infrastructure CIP additions were the installation of Large Trash Capture Devices as part of the Clean Water Act and Trash Free Waters initiative which increased CIP by $15.5 million. Business-type activities contributed an increase of $65.3 million or 120.0 percent to the total CIP as additions to the Airport and the Wastewater Treatment System totaling $79.4 million was offset by $14.4 million in projects that were completed and placed in service. Airport CIP additions included security upgrades to perimeter fencing, reconstruction of southeast ramp, and construction of Gates 29 and 30 at Terminal B.

The City records infrastructure assets at historical cost in the government-wide financial statements and depreciates assets from acquisition date to the end of the current fiscal year as required by GASB Statement No. 34. For governmental fund financial statements recording purposes, capital asset purchases are recorded as expenditures, rather than capitalizing and recording related depreciation. Capital assets, net of depreciation, for governmental and business-type activities in the government-wide financial statements are presented below to illustrate changes between June 30, 2017 and June 30, 2016 (in thousands):

| | Governmental activities | | Business-type activities | | Total | |
|---|---|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 |
| Land | $ 413,533 | $ 406,337 | $ 134,926 | $ 134,926 | $ 548,459 | $ 541,263 |
| Intangible assets | - | - | 12,882 | 12,882 | 12,882 | 12,882 |
| Construction in progress | 48,995 | 31,411 | 119,839 | 54,554 | 168,834 | 85,965 |
| Buildings | 1,037,733 | 1,077,897 | 1,071,189 | 1,103,732 | 2,108,922 | 2,181,629 |
| Improvements, other than buildings | 214,072 | 211,921 | 636,328 | 628,459 | 850,400 | 840,380 |
| Infrastructure | 3,688,827 | 3,808,903 | - | - | 3,688,827 | 3,808,903 |
| Furniture and fixtures, vehicles, equipment | 36,824 | 34,928 | 86,408 | 85,892 | 123,232 | 120,820 |
| Total capital assets | $5,439,984 | $5,571,397 | $2,061,572 | $2,020,445 | $7,501,556 | $7,591,842 |

Commitments outstanding as of June 30, 2017, related to governmental and business-type activities construction in progress totaled approximately $22.3 million and $173.7 million, respectively. Additional information about the City's capital assets can be found in the Notes to Basic Financial Statements, Note III.D.

**Net General Obligation Bonded Debt Limit**

The City Charter limits bonded indebtedness for General Obligation bonds to 15 percent of the total assessed valuation of all real and personal property within the City. The total assessed value of taxable property on the City's 2016-2017 tax roll was $166.5 billion, which results in a total debt limit of $25.0 billion. As of June 30, 2017, the City had $367.5 million of Net General Obligation bonds outstanding which represents approximately 1.5% of the General Obligation bonds debt limit.

**General Obligation Bonds and Other Bond Ratings**

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

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

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

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

**Outstanding Debt**

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

During 2016-2017, the City's outstanding long-term debt decreased by $81.9 million to $2.506 billion, comprised of $1.168 billion of governmental activities and $1.338 billion of business-type activities. The balances at June 30, 2016 were $1.225 billion for governmental activities and $1.363 billion for business-type activities, for a total of $2.588 billion. The decrease of $81.9 million is primarily due to the scheduled debt service payments.

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

| | As of June 30, 2017 | As of June 30, 2016 | Net Change |
|---|---|---|---|
| **Governmental Activities:** | | | |
| General obligation bonds | $ 367,469 | $ 387,403 | $ (19,934) |
| HUD Section 108 loan | 717 | 957 | (240) |
| San José Financing Authority | | | |
| Lease revenue bonds | 561,102 | 579,325 | (18,223) |
| Lease revenue bonds with | | | |
| reimbursement agreement | 78,680 | 89,730 | (11,050) |
| Revenue bonds with | | | |
| pledge agreement | 26,005 | 27,985 | (1,980) |
| Special assessment bonds with limited | | | |
| governmental commitment | 134,467 | 139,435 | (4,968) |
| Sub-total | 1,168,440 | 1,224,835 | (56,395) |
| **Business-Type Activities:** | | | |
| Revenue bonds | 1,331,448 | 1,352,717 | (21,269) |
| State of CA-Revolving Fund Loan | 6,125 | 10,399 | (4,274) |
| Sub-total | 1,337,573 | 1,363,116 | (25,543) |
| **Total:** | $ 2,506,013 | $ 2,587,951 | $ (81,938) |

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

## ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

- The City completed 2016-2017 with better operating financial results than expected when the 2016-2017 Adopted Budget was developed. Although the economic indicators in this region appear to have stabilized, the City still faces fiscal challenges on a long-term basis to achieve a more desirable level of budget stability while avoiding any reduction in services. In June 2017, the City Council approved a balanced General Fund budget for fiscal year 2017-2018 with a projected shortfall of ($10.0 million) and has a focus on achieving budget and service level stability, target investments to meet priority needs of the community, and to continue service delivery efficiencies.

- In order to maintain service level stability, the 2017-2018 Adopted Budget includes modest increases to staffing levels resulted in an increase of 91 positions (a total of 48 positions are one-time funded), from 6,159 full-time equivalent positions in the 2016-2017 Adopted Budget to 6,250 positions in the 2017-2018 Adopted Budget. This 1.5% increase still leaves City staffing well below its peak of almost 7,500 positions in 2001-2002.

- 2017-2018 redevelopment property tax revenues are forecast to be sufficient to pay debt service obligations of the SARA. The City does not plan to advance any money to the SARA in 2017-2018 to fund the debt service payments for the Convention Center and the 4th and San Fernando Street Garage.

- As reported in the GASB 67/68 Report as of June 30, 2017 prepared by actuaries for the Police and Fire Department Retirement Plan ("PFDRP"), the net position of the Defined Benefit Pension Plan was 72.6% of the total pension liability. The total pension liability was $4.534 billion, and the fiduciary net position was $3.293 billion resulting in a net pension liability of $1.241 billion.

- As reported in the GASB 67/68 Report as of June 30, 2017 prepared by actuaries for the Federated City Employees' Retirement System ("FCERS"), the net position of the Defined Benefit Pension Plan was 50.3% of the total pension liability. The total pension liability was $3.923 billion, and the fiduciary net position was $1.973 billion resulting in a net pension liability of $1.950 billion.

- For funding purposes, as of June 30, 2016, the most recent actuarial valuation date, PFDRP's Postemployment Healthcare Plan had a 17.4 percent actuarial funded ratio for postemployment healthcare benefits. The actuarial accrued liability for postemployment healthcare benefits was $778.9 million and the actuarial value of assets was $135.2 million resulting in a UAAL of $643.7 million.

- For funding purposes, as of June 30, 2016, the most recent actuarial valuation date, FCERS's Postemployment Healthcare Plan had a 29.6 percent actuarial funded ratio for postemployment healthcare benefits. The actuarial accrued liability for postemployment healthcare benefits was $764.3 million and the actuarial value of postemployment healthcare benefit assets was $225.8 million, resulting in a UAAL of $538.5 million.

- For 2017-2018, the City's contribution rates for pension benefits and postemployment healthcare benefits, as a percentage of payroll are as follows:

| | PFDRP (1) | | | | FCERS (1) | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Contribution Rates** | **Police Tier 1** | **Police Tier 2** | **Fire Tier 1** | **Fire Tier 2** | **Tier 1** | **Tier 1B** | **Tier 1C** | **Tier 2** | **Tier 2B** |
| Retirement Pension | 95.31% | 15.17% | 96.06% | 16.26% | 94.04% | 94.04% | 94.04% | 7.72% | 7.72% |
| Postemployment Healthcare Benefits | 10.31% | 10.31% (2) | 10.62% | 10.62% (2) | 9.41% | 12.66% | 12.86% | 9.41% | 12.66% |

(1) The rates above are the Retirement Board adopted rates based on the June 30, 2016, actuarial valuations and reflect changes subsequent to the latest study in order to incorporate provisions of the Alternative Pension Reform Framework and Measure F.

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

- On June 24, 2008, the City Council adopted Ordinance No. 28332 amending Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for pension benefits and postemployment healthcare benefits to PFDRP and FCERS. The lump sum prepayment for the fiscal year ending June 30, 2018 was calculated to be 33actuarially 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 $174.0 million for PFDRP, and $168.1 million for FCERS Tier 1 members. The prepayment for PFDRP and for FCERS Tier 1 members was paid by the City in July 2017.

All of these factors were considered in preparing the City's budget for 2017-2018.

## FORWARD-LOOKING STATEMENTS AND REQUESTS FOR INFORMATION

Forward-Looking Statements

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

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

Requests for Information

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

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

# Basic
# Financial Statements

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**City of San José**
**Statement of Net Position**
**June 30, 2017**
**($000's)**

| | | Governmental Activities | Business-Type Activities | Total |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Equity in pooled cash and investments held in City Treasury | $ | 954,437 | 612,999 | 1,567,436 |
| Receivables (net of allowances for uncollectibles) | | 140,367 | 28,971 | 169,338 |
| Due from outside agencies | | 341 | - | 341 |
| Inventories | | 983 | 697 | 1,680 |
| Loans receivable (net of allowances for uncollectibles) | | 305,172 | - | 305,172 |
| Advances and deposits | | 510 | 2,793 | 3,303 |
| Restricted assets: | | | | |
| Equity in pooled cash and investments held in City Treasury | | 93,371 | 86,446 | 179,817 |
| Cash and investments held with fiscal agent | | 111,129 | 109,417 | 220,546 |
| Other cash and investments | | 15,623 | 2,176 | 17,799 |
| Receivables (net of allowances for uncollectibles) | | - | 5,480 | 5,480 |
| Prepaid bond insurance costs (net of accumulated amortization) | | 346 | 2,598 | 2,944 |
| Long-term receivables from SARA | | 151,463 | 20,659 | 172,122 |
| Other assets | | 45,935 | 221 | 46,156 |
| Capital assets (net of accumulated depreciation): | | | | |
| Nondepreciable | | 462,528 | 267,647 | 730,175 |
| Depreciable | | 4,977,456 | 1,793,925 | 6,771,381 |
| Total assets | | 7,259,661 | 2,934,029 | 10,193,690 |
| **DEFERRED OUTFLOWS OF RESOURCES** | | | | |
| Loss on refundings of debt | | 905 | 9,686 | 10,591 |
| Deferred outflows of resources related to pensions | | 929,516 | 120,954 | 1,050,470 |
| Total deferred outflows of resources | | 930,421 | 130,640 | 1,061,061 |
| **LIABILITIES** | | | | |
| Accounts payable | | 68,934 | 41,630 | 110,564 |
| Accrued liabilities | | 36,536 | 4,440 | 40,976 |
| Interest payable | | 10,104 | 16,663 | 26,767 |
| Due to outside agencies | | 485 | - | 485 |
| Short-term notes payable | | 22,302 | 25,461 | 47,763 |
| Unearned revenue | | 17,918 | 3,045 | 20,963 |
| Advances, deposits, and reimbursable credits | | 8,227 | 4,741 | 12,968 |
| Long-term payable to SARA | | 790 | - | 790 |
| Other liabilities | | 32,873 | 200 | 33,073 |
| Long-term obligations: | | | | |
| Due within one year | | 119,138 | 61,144 | 180,282 |
| Due in more than one year | | 1,750,070 | 1,332,942 | 3,083,012 |
| Net pension liability | | 2,678,942 | 332,035 | 3,010,977 |
| Total liabilities | | 4,746,319 | 1,822,301 | 6,568,620 |
| **DEFERRED INFLOWS OF RESOURCES** | | | | |
| Gain on refundings of debt | | - | 107 | 107 |
| Deferred inflows of resources related to pensions | | 5,982 | 742 | 6,724 |
| Total deferred inflows of resources | | 5,982 | 849 | 6,831 |
| **NET POSITION** | | | | |
| Net investment in capital assets | | 4,391,069 | 814,473 | 5,205,542 |
| Restricted for: | | | | |
| Debt service | | 51,788 | 18,913 | 70,701 |
| Capital projects | | 325,050 | 57,032 | 382,082 |
| Community services | | 600,523 | - | 600,523 |
| Public safety | | 4,807 | - | 4,807 |
| Unrestricted (deficit) | | (1,935,456) | 351,101 | (1,584,355) |
| Total net position | $ | 3,437,781 | 1,241,519 | 4,679,300 |

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

## City of San José
## Statement of Activities
## For the Year Ended June 30, 2017
## ($000's)

| Functions/Programs | Expenses | Program Revenues: Fees, Fines, and Charges for Services | Program Revenues: Operating Grants and Contributions | Program Revenues: Capital Grants and Contributions | Net (Expense) Revenue and Changes in Net Position: Governmental Activities | Net (Expense) Revenue and Changes in Net Position: Business -Type Activities | Net (Expense) Revenue and Changes in Net Position: Total |
|---|---|---|---|---|---|---|---|
| Governmental activities: | | | | | | | |
| General government | $ 127,090 | 48,358 | 440 | - | (78,292) | - | (78,292) |
| Public safety | 694,557 | 23,164 | 6,869 | - | (664,524) | - | (664,524) |
| Community services | 310,470 | 177,436 | 49,954 | - | (83,080) | - | (83,080) |
| Sanitation | 156,299 | 143,062 | 24 | - | (13,213) | - | (13,213) |
| Capital maintenance | 444,867 | 70,842 | 29,492 | 63,647 | (280,886) | - | (280,886) |
| Interest and fiscal charges | 54,844 | - | - | - | (54,844) | - | (54,844) |
| **Total governmental activities** | **1,788,126** | **462,862** | **86,779** | **63,647** | **(1,174,838)** | **-** | **(1,174,838)** |
| Business -Type activities: | | | | | | | |
| Norman Y. Mineta San José International Airport | 204,774 | 194,057 | 1,169 | 10,120 | - | 572 | 572 |
| Wastewater Treatment System | 192,302 | 222,654 | 64 | 2,446 | - | 32,862 | 32,862 |
| Municipal Water System | 42,647 | 44,680 | - | 692 | - | 2,725 | 2,725 |
| Parking System | 14,269 | 17,612 | - | - | - | 3,343 | 3,343 |
| **Total business-type activities** | **453,992** | **479,003** | **1,233** | **13,258** | **-** | **39,502** | **39,502** |
| **Total** | **$ 2,242,118** | **941,865** | **88,012** | **76,905** | **(1,174,838)** | **39,502** | **(1,135,336)** |
| General revenues: | | | | | | | |
| Taxes and franchise fees: | | | | | | | |
| Property and other taxes | | | | | 431,138 | - | 431,138 |
| Utility | | | | | 121,046 | - | 121,046 |
| Franchise | | | | | 49,642 | - | 49,642 |
| Transient occupancy | | | | | 45,511 | - | 45,511 |
| Business taxes | | | | | 54,159 | - | 54,159 |
| Sales taxes shared revenue | | | | | 207,695 | - | 207,695 |
| State of California in-lieu | | | | | 467 | - | 467 |
| Unrestricted interest and investment income | | | | | 9,062 | 3,955 | 13,017 |
| Other revenue | | | | | 4,459 | 19,211 | 23,670 |
| Transfers | | | | | 3,387 | (3,387) | - |
| **Total general revenues and transfers** | | | | | **926,566** | **19,779** | **946,345** |
| **Change in net position** | | | | | **(248,272)** | **59,281** | **(188,991)** |
| Net position - beginning | | | | | 3,686,053 | 1,182,238 | 4,868,291 |
| **Net position - ending** | | | | | **$ 3,437,781** | **1,241,519** | **4,679,300** |

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

**City of San José**
**Balance Sheet**
**Governmental Funds**
**June 30, 2017**
**($000's)**

| | | General Fund | Housing Activities | Low and Moderate Income Housing Asset |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Equity in pooled cash and investments held in City Treasury | $ | 299,728 | 30,555 | 92,753 |
| Receivables (net of allowance for uncollectibles) | | 69,179 | 1,464 | 1,758 |
| Due from outside agencies | | 341 | - | - |
| Due from other funds | | 1,823 | - | - |
| Loans receivables (net of allowance for uncollectibles) | | 1,241 | 71,180 | 227,962 |
| Advances and deposits | | 170 | - | - |
| Restricted assets: | | | | |
| Equity in pooled cash and investments held in City Treasury | | 1,289 | 44,633 | - |
| Cash and investments held with fiscal agent | | 2,852 | - | - |
| Other cash and investments | | - | - | - |
| Advances to other funds | | 3,297 | - | - |
| Advances receivable from SARA | | 28,950 | - | 15,176 |
| Other assets | | - | 2,300 | 24,023 |
| Total assets | $ | 408,870 | 150,132 | 361,672 |
| **LIABILITIES** | | | | |
| Accounts payable | $ | 14,125 | 1,954 | 532 |
| Accrued salaries, wages, and payroll taxes | | 30,536 | 66 | 256 |
| Due to other funds | | - | - | - |
| Due to outside agencies | | 373 | - | - |
| Short-term notes payable | | - | - | - |
| Unearned revenue | | 6,302 | - | - |
| Advances, deposits, and reimbursable credits | | 7 | - | - |
| Advances from other funds | | - | - | - |
| Long-term advances from SARA | | - | - | 790 |
| Other liabilities | | 32,553 | - | - |
| Total liabilities | | 83,896 | 2,020 | 1,578 |
| **DEFERRED INFLOWS OF RESOURCES** | | 12,142 | 20,452 | 7,762 |
| **FUND BALANCES** | | | | |
| Nonspendable | | 170 | - | - |
| Restricted | | 690 | 127,660 | 352,332 |
| Committed | | 96,026 | - | - |
| Assigned | | 136,093 | - | - |
| Unassigned | | 79,853 | - | - |
| Total fund balances | | 312,832 | 127,660 | 352,332 |
| Total liabilities, deferred inflows of resources and fund balances | $ | 408,870 | 150,132 | 361,672 |

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

| Special Assessment Districts | San José Financing Authority Debt Service | Integrated Waste Management | Nonmajor Governmental Funds | Total Governmental Funds |
|---|---|---|---|---|
| - | 102 | 50,151 | 461,847 | 935,136 |
| 36,619 | - | 5,697 | 25,414 | 140,131 |
| - | - | - | - | 341 |
| - | - | - | 1,872 | 3,695 |
| - | - | - | 4,789 | 305,172 |
| 5 | - | - | 335 | 510 |
| 10,218 | - | - | 37,231 | 93,371 |
| 30,684 | 49,381 | - | 28,212 | 111,129 |
| - | - | - | 15,623 | 15,623 |
| - | - | - | - | 3,297 |
| - | 4,727 | - | - | 48,853 |
| 1 | 1 | - | - | 26,325 |
| 77,527 | 54,211 | 55,848 | 575,323 | 1,683,583 |
| 1,557 | 10 | 20,941 | 28,449 | 67,568 |
| 22 | - | 377 | 4,103 | 35,360 |
| - | - | - | 3,695 | 3,695 |
| - | 112 | - | - | 485 |
| - | 22,302 | - | - | 22,302 |
| - | - | - | 10,790 | 17,092 |
| 1,578 | - | 5,098 | 1,544 | 8,227 |
| - | 3,297 | - | - | 3,297 |
| - | - | - | - | 790 |
| 317 | - | 3 | - | 32,873 |
| 3,474 | 25,721 | 26,419 | 48,581 | 191,689 |
| 34,320 | - | - | 1,984 | 76,660 |
| 5 | - | - | 335 | 510 |
| 39,728 | 28,490 | - | 411,949 | 960,849 |
| - | - | 29,429 | 29,890 | 155,345 |
| - | - | - | 82,584 | 218,677 |
| - | - | - | - | 79,853 |
| 39,733 | 28,490 | 29,429 | 524,758 | 1,415,234 |
| 77,527 | 54,211 | 55,848 | 575,323 | 1,683,583 |

## City of San José
### Reconciliation of the Governmental Funds Balance Sheet
### to the Statement of Net Position
### June 30, 2017
### ($000's)

| | | | |
|---|---|---|---|
| **Total fund balances-governmental funds** (Page 25) | | $ | 1,415,234 |
| Amounts reported for governmental activities in the statement of net position are different because: | | | |
| Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. These assets consist of: | | | |
| Land | 413,533 | | |
| Construction in progress | 48,995 | | |
| Infrastructure assets | 11,479,037 | | |
| Other capital assets | 2,058,988 | | |
| Accumulated depreciation | (8,568,185) | | |
| Total capital assets | | | 5,432,368 |
| Other long-term assets associated with the New Market Tax Credit (NMTC) financing program are not current financial resources, therefore, are not reported in governmental funds. | | | 19,610 |
| Long-term receivables are not available to pay for current period expenditures and, therefore, are reported as deferred inflows of resources in governmental funds. | | | 42,340 |
| Long-term receivables associated with lease, pledge revenue agreements, and reimbursement arrangements from the private-purpose trust fund are not current financial resources and therefore are not reported in the governmental funds. | | | 102,610 |
| Prepaid bond insurance costs are expended in governmental funds when paid, however, such costs are capitalized and amortized over the life of the corresponding bonds for purposes of the statement of net position. | | | 346 |
| Refunding of debt reported as deferred outflows/inflows of resources are not financial resources, therefore are not reported in the funds. Such costs are capitalized and amortized over the life of the corresponding bonds for purposes of the statement of net position. | | | 905 |
| Special assessments are reported as revenues when levied in government-wide financial statements. In governmental funds, these assessments are reported as deferred inflows of resources since they are not available. | | | 34,320 |
| 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. | | | (10,104) |
| Internal service funds are used by management to charge the cost of public works support, employee benefits, and stores, vehicle, maintenance and operations to individual funds. The assets and liabilities are included in governmental activities in the statement of net position. | | | 21,297 |
| Long-term obligations are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of: | | | |
| Bonds, loan payables, and lease-purchase agreements | (1,186,303) | | |
| Accrued vacation, sick leave and compensatory time | (74,182) | | |
| Estimated liability for self-insurance | (144,777) | | |
| Net other postemployment benefits obligation | (436,180) | | |
| Other | (24,295) | | |
| Total long-term obligations | | | (1,865,737) |
| Net pension liability and pension related deferred outflows and inflows of resources are not due in the current period and therefore are not reported in the funds. These amounts consist of: | | | |
| Net pension liability | (2,678,942) | | |
| Deferred outflows of resources | 929,516 | | |
| Deferred inflows of resources | (5,982) | | |
| | | | (1,755,408) |
| **Net position of governmental activities** (Page 22) | | $ | 3,437,781 |

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

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**City of San José**
**Statement of Revenues, Expenditures**
**and Changes in Fund Balances**
**Governmental Funds**
**For the Year Ended June 30, 2017**
**($000's)**

| | | General Fund | Housing Activities | Low and Moderate Income Housing Asset |
|---|---|---|---|---|
| **REVENUES** | | | | |
| Taxes and special assessments | $ | 519,976 | - | - |
| Sales taxes shared revenue | | 207,695 | - | - |
| Licenses, permits, and fines | | 75,173 | - | - |
| Intergovernmental | | 11,132 | 11,512 | - |
| Charges for current services | | 46,049 | - | - |
| Rent | | - | - | - |
| Investment income | | 2,222 | 3,065 | 13,622 |
| Other revenue | | 38,821 | 44,126 | 1,694 |
| Total revenues | | 901,068 | 58,703 | 15,316 |
| **EXPENDITURES** | | | | |
| Current: | | | | |
| General government | | 95,861 | - | - |
| Public safety | | 536,068 | - | - |
| Community services | | 133,409 | 17,349 | 10,977 |
| Sanitation | | 2,444 | - | - |
| Capital maintenance | | 111,737 | - | - |
| Capital outlay | | 14,535 | - | - |
| Debt service: | | | | |
| Principal | | 1,526 | - | - |
| Interest and fiscal charges | | 1,328 | - | - |
| Total expenditures | | 896,908 | 17,349 | 10,977 |
| Excess (deficiency) of revenues over (under) expenditures | | 4,160 | 41,354 | 4,339 |
| **OTHER FINANCING SOURCES (USES)** | | | | |
| Proceeds from sale of capital assets | | 157 | - | - |
| Transfers in | | 20,461 | - | - |
| Transfers out | | (30,985) | (71) | (467) |
| Total other financing sources (uses) | | (10,367) | (71) | (467) |
| Net change in fund balances | | (6,207) | 41,283 | 3,872 |
| Fund balances - beginning | | 319,039 | 86,377 | 348,460 |
| Fund balances - ending | $ | 312,832 | 127,660 | 352,332 |

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

| Special Assessment Districts | San José Financing Authority Debt Service | Integrated Waste Management | Nonmajor Governmental Funds | Total Governmental Funds |
|---|---|---|---|---|
| 19,370 | - | - | 182,073 | 721,419 |
| - | - | - | - | 207,695 |
| - | - | - | - | 75,173 |
| - | - | - | 64,978 | 87,622 |
| - | - | 128,470 | 76,928 | 251,447 |
| - | - | 519 | 50,319 | 50,838 |
| 221 | 302 | 225 | 2,774 | 22,431 |
| 197 | 18,830 | - | 5,796 | 109,464 |
| 19,788 | 19,132 | 129,214 | 382,868 | 1,526,089 |
| | | | | |
| - | - | - | 14,992 | 110,853 |
| - | - | - | 1,219 | 537,287 |
| - | - | - | 96,432 | 258,167 |
| - | - | 126,512 | 22,354 | 151,310 |
| 6,666 | - | - | 140,796 | 259,199 |
| - | - | 53 | 53,609 | 68,197 |
| | | | | |
| 5,035 | 29,495 | 428 | 19,655 | 56,139 |
| 8,745 | 29,176 | - | 17,854 | 57,103 |
| 20,446 | 58,671 | 126,993 | 366,911 | 1,498,255 |
| | | | | |
| (658) | (39,539) | 2,221 | 15,957 | 27,834 |
| | | | | |
| - | - | - | 17,445 | 17,602 |
| 16 | 59,186 | - | 48,426 | 128,089 |
| (3,893) | (8,982) | (1,093) | (80,035) | (125,526) |
| (3,877) | 50,204 | (1,093) | (14,164) | 20,165 |
| | | | | |
| (4,535) | 10,665 | 1,128 | 1,793 | 47,999 |
| | | | | |
| 44,268 | 17,825 | 28,301 | 522,965 | 1,367,235 |
| 39,733 | 28,490 | 29,429 | 524,758 | 1,415,234 |

## 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, 2017
### ($000's)

| | | | |
|---|---|---|---|
| **Net change in fund balances--total governmental funds** (Page 29) | | $ | 47,999 |
| 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 | 68,197 | | |
| Depreciation expense | (215,223) | | |
| Excess of depreciation expense over capital outlay | | | (147,026) |
| The net effect of various miscellaneous transactions involving capital assets (i.e. sales, retirements, trade-ins, donations) | | | |
| Donated assets | 13,917 | | |
| Transfers from SARA | 7,448 | | |
| Proceeds from sale of capital assets | (17,602) | | |
| Gain on disposal of assets | 11,555 | | |
| | | | 15,318 |
| Decrease in long-term receivables associated with lease, pledge revenue, and reimbursement arrangements from the private purpose trust fund are not current financial resources and therefore are not reported in the governmental funds. | | | (13,125) |
| Prepaid bond insurance costs are expended in governmental funds when paid, however, are capitalized and amortized over the life of the corresponding bonds for the purposes of the statement of activities. | | | (19) |
| Amortization of deferred outflows of resources resulting from the deferred loss on refunding of bonds | | | (185) |
| Repayment of long-term obligation principal is reported as an expenditure in governmental funds and, thus, has the effect of reducing fund balance because current financial resources have been used. For the government-wide statements, however, the principal payments reduce the liabilities in the statement of net position and do not result in an expense in the statement of activities. The City's long-term obligations were reduced because principal payments were made to bondholders and HUD. | | | 54,425 |
| Accrued interest payable on long-term debt is reported in the government-wide statement of activities, but does not require the use of current financial resources. Amortization of bond premiums and discounts should be expensed as a component of interest expense on the statement of activities. This amount represents the change in accrued interest payable and the amortization of bond premiums and discounts not reported in governmental funds. | | | |
| Decrease in accrued interest payable | 474 | | |
| Amortization of premiums and discounts on bonds issued | 1,970 | | |
| Total net interest expense and amortization of discount/premium | | | 2,444 |
| Because some revenues will not be collected for several months after the City's fiscal year ends, they are not considered "available revenues" and are reported as deferred inflows of resources in the governmental funds. | | | 2,138 |
| Internal service funds are used by management to charge the cost of public works support, employee benefits, and vehicle, maintenance and operations to individual funds. The change in net position is included in governmental activities in the statement of activities. | | | (2,130) |
| Some items reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of: | | | |
| Net increase in net OPEB obligation | (10,864) | | |
| Net increase in vacation, sick leave, and compensatory time | (4,125) | | |
| Net increase in estimated liability for self-insurance | (2,306) | | |
| Net decrease in other liabilities | 2,262 | | |
| Total expenditures | | | (15,033) |
| Changes to net pension liability and pension related deferred outflows and inflows of resources do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds. | | | (193,078) |
| **Change in net position of governmental activities** (Page 23) | | $ | (248,272) |

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

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## City of San José
## Statement of Fund Net Position
## Proprietary Funds
## June 30, 2017
## ($000's)

| | Enterprise Funds | | | | | |
|---|---|---|---|---|---|---|
| | Norman Y. Mineta San José International Airport | Wastewater Treatment System | Municipal Water System | Parking System | Total | Internal Service Funds |
| **ASSETS** | | | | | | |
| Current assets: | | | | | | |
| Equity in pooled cash and investments held in City Treasury | $ 134,911 | 423,938 | 23,908 | 30,242 | 612,999 | 19,302 |
| Receivables (net of allowance for uncollectibles) | 14,402 | 6,257 | 8,029 | 283 | 28,971 | 236 |
| Prepaid expenses, advances and deposits | 172 | - | - | - | 172 | - |
| Inventories | - | 697 | - | - | 697 | 983 |
| Total unrestricted current assets | 149,485 | 430,892 | 31,937 | 30,525 | 642,839 | 20,521 |
| Restricted assets: | | | | | | |
| Equity in pooled cash and investments held in City Treasury | 75,860 | 8,496 | - | 2,090 | 86,446 | - |
| Cash and investments held with fiscal agent | 109,417 | - | - | - | 109,417 | - |
| Other cash and investments | - | 2,176 | - | - | 2,176 | - |
| Receivables (net of allowances for uncollectibles) | 5,480 | - | - | - | 5,480 | - |
| Prepaid expenses, advances and deposits | 49 | - | - | - | 49 | - |
| Total restricted assets | 190,806 | 10,672 | - | 2,090 | 203,568 | - |
| Total current assets | 340,291 | 441,564 | 31,937 | 32,615 | 846,407 | 20,521 |
| Noncurrent assets: | | | | | | |
| Prepaid bond insurance (net of accumulated amortization) | 2,598 | - | - | - | 2,598 | - |
| Advances and deposits | 2,793 | - | - | - | 2,793 | - |
| Long-term receivable from SARA | - | - | - | 20,659 | 20,659 | - |
| Capital assets (net of accumulated depreciation): | | | | | | |
| Nondepreciable | 114,764 | 128,324 | 5,232 | 19,327 | 267,647 | - |
| Depreciable | 1,187,894 | 505,425 | 67,402 | 33,204 | 1,793,925 | 7,616 |
| Total noncurrent assets | 1,308,049 | 633,749 | 72,634 | 73,190 | 2,087,622 | 7,616 |
| Total assets | 1,648,340 | 1,075,313 | 104,571 | 105,805 | 2,934,029 | 28,137 |
| **DEFERRED OUTFLOWS OF RESOURCES** | | | | | | |
| Loss on refundings of debt | 9,686 | - | - | - | 9,686 | - |
| Deferred outflows of resources related to pensions | 30,220 | 80,604 | 7,386 | 2,744 | 120,954 | - |
| Total deferred outflows of resources | $ 39,906 | 80,604 | 7,386 | 2,744 | 130,640 | - |

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

**City of San José**
**Statement of Fund Net Position**
**Proprietary Funds**
**June 30, 2017**
**($000's)**

| | | Enterprise Funds | | | | | |
|---|---|---|---|---|---|---|---|
| | | Norman Y. Mineta San José International Airport | Wastewater Treatment System | Municipal Water System | Parking System | Total | Internal Service Funds |
| **LIABILITIES** | | | | | | | |
| Current liabilities: | | | | | | | |
| Accounts payable | $ | 7,537 | 25,744 | 3,146 | 560 | 36,987 | 1,367 |
| Accrued liabilities | | 1,070 | 2,978 | 303 | 89 | 4,440 | 1,176 |
| Interest payable | | 32 | 68 | - | - | 100 | - |
| Short-term notes payable | | 25,461 | - | - | - | 25,461 | - |
| Accrued vacation, sick leave and compensatory time | | 1,586 | 4,029 | 126 | 107 | 5,848 | - |
| Estimated liability for self-insurance | | 634 | 567 | 128 | - | 1,329 | - |
| Advances and deposits payable | | 1,438 | - | - | 91 | 1,529 | - |
| Unearned revenue | | 3,045 | - | - | - | 3,045 | 826 |
| Loans payable | | - | 4,353 | - | - | 4,353 | - |
| Total current liabilities unrestricted | | 40,803 | 37,739 | 3,703 | 847 | 83,092 | 3,369 |
| Current liabilities payable from restricted assets: | | | | | | | |
| Accounts payable and accrued liabilities | | 4,643 | - | - | - | 4,643 | - |
| Interest payable | | 16,460 | 103 | - | - | 16,563 | - |
| Current portion of bonds payable, net | | 44,344 | 5,270 | - | - | 49,614 | - |
| Other current liabilities | | 200 | - | - | - | 200 | - |
| Total current liabilities payable from restricted assets | | 65,647 | 5,373 | - | - | 71,020 | - |
| Total current liabilities | | 106,450 | 43,112 | 3,703 | 847 | 154,112 | 3,369 |
| Noncurrent liabilities: | | | | | | | |
| Accrued vacation, sick leave and compensatory time | | 612 | 665 | 61 | 51 | 1,389 | 3,471 |
| Estimated liability for self-insurance | | 2,219 | 2,794 | 650 | - | 5,663 | - |
| Advance contributions from participating agencies | | - | 1,724 | - | - | 1,724 | - |
| Advances, deposits and reimbursable credits | | - | - | 1,488 | - | 1,488 | - |
| Loans payable | | - | 1,772 | - | - | 1,772 | - |
| Bonds payable (net of premium/discount) | | 1,265,988 | 15,846 | - | - | 1,281,834 | - |
| Net pension liability | | 102,069 | 206,626 | 16,280 | 7,060 | 332,035 | - |
| Net other postemployment benefits obligation | | 14,026 | 25,505 | 1,905 | 848 | 42,284 | - |
| Total noncurrent liabilities | | 1,384,914 | 254,932 | 20,384 | 7,959 | 1,668,189 | 3,471 |
| Total liabilities | | 1,491,364 | 298,044 | 24,087 | 8,806 | 1,822,301 | 6,840 |
| **DEFERRED INFLOWS OF RESOURCES** | | | | | | | |
| Gain on refundings of debt | | 107 | - | - | - | 107 | - |
| Deferred inflows of resources related to pensions | | 186 | 496 | 43 | 17 | 742 | - |
| Total deferred inflows of resources | | 293 | 496 | 43 | 17 | 849 | - |
| **NET POSITION** | | | | | | | |
| Net investment in capital assets | | 82,800 | 606,508 | 72,634 | 52,531 | 814,473 | 7,616 |
| Restricted for debt service | | 14,684 | 2,139 | - | 2,090 | 18,913 | - |
| Restricted for capital projects and other agreements | | 50,224 | 6,808 | - | - | 57,032 | 1,595 |
| Unrestricted | | 48,881 | 241,922 | 15,193 | 45,105 | 351,101 | 12,086 |
| Total net position | $ | 196,589 | 857,377 | 87,827 | 99,726 | 1,241,519 | 21,297 |

# City of San José
# Statement of Revenues, Expenses, and Changes in Fund Net Position
## Proprietary Funds
## For the Year Ended June 30, 2017
## ($000's)

| | Enterprise Funds | | | | | |
|---|---|---|---|---|---|---|
| | Norman Y. Mineta San José International Airport | Wastewater Treatment System | Municipal Water System | Parking System | Total | Internal Service Funds |
| **OPERATING REVENUES** | | | | | | |
| Charges for services | $ 60,079 | 163,069 | 44,680 | 17,612 | 285,440 | 120,155 |
| Rentals and concessions | 20,207 | 9,795 | - | - | 30,002 | - |
| Service connection, engineering and inspection | 62,901 | 3,572 | - | - | 66,473 | - |
| Operating contributions from participating agencies | - | 44,058 | - | - | 44,058 | - |
| Other | 9,748 | 2,160 | - | - | 11,908 | - |
| Total operating revenues | 152,935 | 222,654 | 44,680 | 17,612 | 437,881 | 120,155 |
| **OPERATING EXPENSES** | | | | | | |
| Operations and maintenance | 65,336 | 131,997 | 37,888 | 4,806 | 240,027 | 120,582 |
| General and administrative | 23,057 | 30,604 | 2,024 | 5,359 | 61,044 | - |
| Depreciation | 46,449 | 28,349 | 2,735 | 3,940 | 81,473 | 2,608 |
| Materials and supplies | - | 350 | - | 164 | 514 | - |
| Total operating expenses | 134,842 | 191,300 | 42,647 | 14,269 | 383,058 | 123,190 |
| Operating income (loss) | 18,093 | 31,354 | 2,033 | 3,343 | 54,823 | (3,035) |
| **NONOPERATING REVENUES (EXPENSES)** | | | | | | |
| Passenger facility charges | 23,096 | - | - | - | 23,096 | - |
| Customer facility charges | 18,026 | - | - | - | 18,026 | - |
| Operating grants | 1,169 | - | - | - | 1,169 | - |
| Investment income | 1,591 | 2,111 | 127 | 126 | 3,955 | 112 |
| Interest expense | (67,440) | (956) | - | - | (68,396) | - |
| Bond issuance costs | (2,492) | - | - | - | (2,492) | - |
| Contributions for maintenance reserves | - | 64 | - | - | 64 | - |
| Loss on disposal of capital assets | - | (46) | - | - | (46) | (89) |
| Gain on loan reinstatement from SARA | - | - | - | 14,374 | 14,374 | - |
| Other revenues, net | 637 | 172 | 11 | 4,017 | 4,837 | 58 |
| Net nonoperating revenues (expenses) | (25,413) | 1,345 | 138 | 18,517 | (5,413) | 81 |
| Income (loss) before capital contributions and transfers | (7,320) | 32,699 | 2,171 | 21,860 | 49,410 | (2,954) |
| Capital contributions | 10,120 | 2,446 | 692 | - | 13,258 | - |
| Transfers in | - | - | 1,200 | 31 | 1,231 | 1,007 |
| Transfers out | (34) | (2,206) | (1,327) | (1,051) | (4,618) | (183) |
| Changes in net position | 2,766 | 32,939 | 2,736 | 20,840 | 59,281 | (2,130) |
| Net position - beginning | 193,823 | 824,438 | 85,091 | 78,886 | 1,182,238 | 23,427 |
| Net position - ending | $ 196,589 | 857,377 | 87,827 | 99,726 | 1,241,519 | 21,297 |

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

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**City of San José**
**Statement of Cash Flows**
**Proprietary Funds**
**For the Year Ended June 30, 2017**
**($000's)**

| | Enterprise Funds | | | | | |
|---|---|---|---|---|---|---|
| | Norman Y. Mineta San José International Airport | Wastewater Treatment System | Municipal Water System | Parking System | Total | Internal Service Funds |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | | | |
| Receipts from customers and users | $ 153,715 | 194,015 | 42,928 | 21,715 | 412,373 | - |
| Cash received from interfund services provided | - | - | - | - | - | 120,217 |
| Payments to suppliers | (56,359) | (52,555) | (29,675) | (7,841) | (146,430) | (96,742) |
| Payments for employees | (27,190) | (80,325) | (7,717) | (2,306) | (117,538) | (21,780) |
| Other receipts | 699 | 27,914 | - | - | 28,613 | - |
| Net cash provided by operating activities | 70,865 | 89,049 | 5,536 | 11,568 | 177,018 | 1,695 |
| **CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES** | | | | | | |
| Transfer from other funds | - | - | 1,200 | 31 | 1,231 | 1,007 |
| Transfer to other funds | (34) | (2,206) | (1,327) | (1,051) | (4,618) | (183) |
| Operating grants | 1,113 | - | - | - | 1,113 | - |
| Payments from other funds | - | - | 53 | - | 53 | - |
| Net cash provided by (used in) noncapital and related financing activities | 1,079 | (2,206) | (74) | (1,020) | (2,221) | 824 |
| **CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES** | | | | | | |
| Passenger facility charges received | 22,239 | - | - | - | 22,239 | - |
| Customer facility charges received | 17,919 | - | - | - | 17,919 | - |
| Proceeds from issuance of bonds | 7,324 | - | - | - | 7,324 | - |
| Prepaid bond insurance | (83) | - | - | - | (83) | |
| Capital grants received | 7,064 | 342 | - | - | 7,406 | - |
| Acquisition and construction of capital assets | (29,830) | (77,837) | (5,074) | (503) | (113,244) | (2,996) |
| Proceeds from capital assets | - | - | - | - | - | 5 |
| Principal payment on commercial paper | (9,211) | - | - | - | (9,211) | - |
| Principal paid on debt | (24,700) | (10,130) | - | - | (34,830) | - |
| Bond issuance cost paid | (2,292) | - | - | - | (2,292) | - |
| Interest paid on debt | (75,158) | (1,122) | - | - | (76,280) | - |
| Advances and deposits received | 174 | - | - | - | 174 | - |
| Net cash used in capital and related financing activities | (86,554) | (88,747) | (5,074) | (503) | (180,878) | (2,991) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | | | |
| Proceeds from sales and maturities of investments | 46,854 | - | - | - | 46,854 | - |
| Purchase of investments | (77,826) | - | - | - | (77,826) | - |
| Interest received | 1,986 | 1,362 | 76 | - | 3,424 | 112 |
| Land and building rentals | - | 89 | - | 126 | 215 | - |
| Net cash provided by (used in) investing activities | (28,986) | 1,451 | 76 | 126 | (27,333) | 112 |
| Net change in cash and cash equivalents | (43,596) | (453) | 464 | 10,171 | (33,414) | (360) |
| Cash and cash equivalents - beginning | 319,600 | 435,063 | 23,444 | 22,161 | 800,268 | 19,662 |
| Cash and cash equivalents - ending | $ 276,004 | 434,610 | 23,908 | 32,332 | 766,854 | 19,302 |

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

**City of San José**
**Statement of Cash Flows**
**Proprietary Funds**
**For the Year Ended June 30, 2017**
**($000's)**

| | Enterprise Funds | | | | | |
|---|---|---|---|---|---|---|
| | **Norman Y. Mineta San José International Airport** | **Wastewater Treatment System** | **Municipal Water System** | **Parking System** | **Total** | **Internal Service Funds** |
| **Reconciliation of operating income (loss) to net cash provided by operating activities** | | | | | | |
| Operating income (loss) | $ 18,093 | 31,354 | 2,033 | 3,343 | 54,823 | (3,035) |
| Adjustments to reconcile operating income (loss) to net cash provided by operating activities: | | | | | | |
| Depreciation and amortization | 46,449 | 28,349 | 2,735 | 3,940 | 81,473 | 2,608 |
| Other nonoperating revenues | 699 | 12 | 11 | 4,017 | 4,739 | 58 |
| Decrease (increase) in: | | | | | | |
| Accounts receivable | 468 | (738) | (1,763) | 87 | (1,946) | 3 |
| Inventories | - | (37) | - | - | (37) | 12 |
| Prepaid expenses, advances and deposits | (1) | 7 | - | - | 6 | - |
| Increase (decrease) in: | | | | | | |
| Accounts payable and accrued liabilities | (125) | 13,828 | 1,408 | (420) | 14,691 | 1,067 |
| Accrued salaries, wages, and payroll | - | 667 | 103 | 28 | 798 | - |
| Accrued vacation, sick leave and compensatory time | - | 248 | 12 | 9 | 269 | 157 |
| Estimated liability for self-insurance | - | (91) | 75 | - | (16) | - |
| Unearned revenue | (562) | - | - | - | (562) | 825 |
| Net pension liability, deferred outflows and inflows of pension related resources | 5,866 | 16,014 | 981 | 583 | 23,444 | - |
| Net other postemployment benefit obligation | - | - | (59) | - | (59) | - |
| Advances and deposits payable | (22) | - | - | (1) | (23) | - |
| Other liabilities | - | (564) | - | (18) | (582) | - |
| Net cash provided by operating activities | $ 70,865 | 89,049 | 5,536 | 11,568 | 177,018 | 1,695 |
| **Reconciliation of cash and cash equivalents to the statement of net position:** | | | | | | |
| Equity in pooled cash and investments held in City Treasury | | | | | | |
| Unrestricted | $ 134,911 | 423,938 | 23,908 | 30,242 | 612,999 | 19,302 |
| Restricted | 75,860 | 8,496 | - | 2,090 | 86,446 | - |
| Cash and investments held with fiscal agent | 109,417 | - | - | - | 109,417 | - |
| Other cash and investments | - | 2,176 | - | - | 2,176 | - |
| Less investments not meeting the definition of cash equivalents | (44,184) | - | - | - | (44,184) | - |
| Cash and cash equivalents | $ 276,004 | 434,610 | 23,908 | 32,332 | 766,854 | 19,302 |
| **Noncash noncapital, capital and related financing, and investing activities:** | | | | | | |
| Change in operating grants receivable | $ (56) | - | - | - | (56) | - |
| Disposal of capital assets | - | 46 | - | - | 46 | (94) |
| Bond refunding | 683,505 | - | - | - | 683,505 | - |
| Capital contributions from developers | - | 2,104 | 692 | - | 2,796 | - |
| Amortization of bond discount/premium, and prepaid | | | - | | | |
| bond insurance costs | (362) | 167 | - | - | (195) | - |
| Amortization of deferred outflows/inflows of resources related to bond refundings | 154 | 71 | - | - | 225 | - |
| Change in capital related payables | (6,606) | - | - | - | (6,606) | - |
| Change in capital related receivables | (3,056) | - | - | - | (3,056) | - |
| Change in fair value of investments | (758) | - | - | - | (758) | - |
| Gain on loan reinstatement from SARA | - | - | - | 14,374 | 14,374 | - |

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

## City of San José
## Statement of Fiduciary Net Position
## Fiduciary Funds
## June 30, 2017
## ($000's)

| | Pension Trust Funds | Private Purpose Trust Funds | Agency Fund |
|---|---|---|---|
| **ASSETS** | | | |
| Current assets: | | | |
| Equity in pooled cash and investments held in City Treasury | $ - | 154 | 4,557 |
| Cash and investments | - | 17,656 | - |
| Investments of retirement plans: | | | |
| Investments, excluding securities lending collateral: | | | |
| Fixed income | 1,014,241 | - | - |
| Collective short-term investments | 429,405 | - | - |
| Absolute return | 504,135 | - | - |
| Global equity | 2,044,145 | - | - |
| Private equity | 232,448 | - | - |
| International currency contracts, net | (1,550) | - | - |
| Global tactical asset | 325,119 | - | - |
| Private debt | 295,541 | - | - |
| Real assets | 768,749 | - | - |
| Total investments of retirement systems | 5,612,233 | - | - |
| Receivables: | | | |
| Accrued investment income | 5,437 | - | 19 |
| Employee contributions | 3,009 | - | - |
| Employer contributions | 18,010 | - | - |
| Due from the City of San José | - | 57 | - |
| Due from the County of Santa Clara | - | 13,130 | - |
| Other | 70,946 | 276 | - |
| Restricted cash and investments held with fiscal agent | - | 162,238 | - |
| Total current assets | 5,709,635 | 193,511 | 4,576 |
| Noncurrent assets: | | | |
| Advances to the City of San José | - | 790 | - |
| Accrued interest | - | 900 | - |
| Loans receivable, net | - | 4,693 | - |
| Advances and deposits | - | 6 | - |
| Property held for resale | - | 32,392 | - |
| Capital assets: | | | |
| Nondepreciable | - | 60,751 | - |
| Depreciable, net | 3,027 | 59,555 | - |
| Total noncurrent assets | 3,027 | 159,087 | - |
| Total assets | 5,712,662 | 352,598 | 4,576 |
| **DEFERRED OUTFLOWS OF RESOURCES** | | | |
| Loss on refundings of debt | $ - | 23,654 | |

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

**City of San José**
**Statement of Fiduciary Net Position**
**Fiduciary Funds**
**June 30, 2017**
**($000's)**

| | Pension Trust Funds | Private Purpose Trust Funds | Agency Fund |
|---|---|---|---|
| **LIABILITIES** | | | |
| Current liabilities: | | | |
| Accounts payable | $ - | 6,540 | - |
| Accrued salaries and benefits | - | 243 | - |
| Due to the City of San José | - | 174 | |
| Due to brokers | 33,301 | - | - |
| Accrued interest payable | - | 33,507 | - |
| Pass through payable to the County of Santa Clara | - | 2,624 | - |
| Unearned revenue | - | 156 | - |
| Other liabilities | 3,260 | 9 | 4,576 |
| Total current liabilities | 36,561 | 43,253 | 4,576 |
| Long-term liabilities: | | | |
| Due within one year | - | 202,459 | - |
| Due in more than one year | - | 1,738,200 | - |
| Total noncurrent liabilities | - | 1,940,659 | - |
| Total liabilities | 36,561 | 1,983,912 | 4,576 |
| **NET POSITION** | | | |
| Held in trust for: | | | |
| Employees' pension benefits | 5,266,049 | - | |
| Employees' postemployment healthcare benefits | 410,052 | - | |
| Redevelopment dissolution and other purposes | - | (1,607,660) | |
| Total net position (deficit) | $ 5,676,101 | (1,607,660) | |

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

## City of San José
## Statement of Changes in Fiduciary Net Position
## Fiduciary Funds
## For the Year Ended June 30, 2017
## ($000's)

| ADDITIONS | | Pension Trust Funds | Private Purpose Trust Funds |
|---|---|---|---|
| Redevelopment property tax revenues | $ | - | 284,566 |
| Investment income: | | | |
| Interest | | 24,594 | 1,012 |
| Dividends | | 33,939 | - |
| Net rental income | | 2,418 | 333 |
| Net change in fair value of plan investments | | 439,542 | - |
| Investment expenses | | (32,255) | - |
| Total investment income (loss) | | 468,238 | 1,345 |
| Contributions: | | | |
| Employer | | 328,012 | - |
| Employees | | 72,750 | - |
| Total contributions | | 400,762 | - |
| Charges for current services | | | 660 |
| Development fees | | - | 244 |
| Gain on sale of revenue participation | | - | 12,350 |
| Gain on sales of property and other assets | | - | 1,233 |
| Grant revenue | | - | 6,476 |
| Other | | - | 2,852 |
| Total additions | | 869,000 | 309,726 |
| **DEDUCTIONS** | | | |
| General and administrative | | 9,439 | 2,391 |
| Project expenses | | - | 1,765 |
| Pass through amounts to the County of Santa Clara | | - | 38,709 |
| Capital contributions to the City of San José | | - | 7,448 |
| Parking Fund loan reinstatement | | - | 13,528 |
| Depreciation | | - | 2,077 |
| Allowance for loan losses | | - | 504 |
| Interest on debt | | - | 90,204 |
| Health insurance premiums | | 55,806 | - |
| Refunds of contributions | | 1,627 | - |
| Retirement and other benefits: | | | |
| Death benefits | | 23,483 | - |
| Retirement benefits | | 354,352 | - |
| Total deductions | | 444,707 | 156,626 |
| Change in net position | | 424,293 | 153,100 |
| Net position restricted for pension, postemployment healthcare benefits and other purposes: | | | |
| Beginning of year | | 5,251,808 | (1,760,760) |
| End of year | $ | 5,676,101 | (1,607,660) |

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

## INDEX TO THE NOTES

## I. Summary of Significant Accounting Policies

### A. Reporting Entity

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

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

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

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

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

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

- **San José Diridon Development Authority** – The San José Diridon Development Authority (the "Diridon Authority") was created in March 2011 by a Joint Exercise of Powers Agreement between the City and the Agency. The Diridon Authority was created for the purposes of overseeing the development of properties within the area of the City surrounding the San José Diridon Station, and is authorized to issue bonds for this purpose. The Diridon Authority is governed by an 11-member Governing Board, which consists of the members of the City Council. The Diridon Authority did not have any activity in fiscal year 2016-17.

Separate financial reports for City departments and component units for the fiscal year 2016-17, containing additional information and more detailed information regarding financial position, changes in financial position, and, where applicable, cash flows, are available from the City's Director of Finance, 200 East Santa Clara Street; 13th Floor, San José, CA 95113-1905, for the following:

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

### B. Financial Statement Presentation

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

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

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

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

The City reports the following major governmental funds:

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

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

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

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

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

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

The City reports the following major enterprise funds:

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

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

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

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

The City also reports the following types of funds:

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

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

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

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

### C. Measurement Focus and Basis of Accounting

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

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

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

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

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

### D. Use of Estimates

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

### E. New Pronouncements

During the year ended June 30, 2017, the City implemented the following Governmental Accounting Standards Board (the “GASB”) Statements:

In June 2015, the GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. This statement establishes requirements for defined benefit pensions that are not within the scope of Statement No. 68, as well as for the assets accumulated for purposes of providing those pensions. In addition, it establishes requirements for defined contribution pensions that are not within the scope of Statement No. 68. It also amends certain provisions of Statement No. 67, *Financial Reporting for Pension Plans*, and Statement No. 68 for pension plans and pensions that are within their respective scopes. The application of Statement No. 73 did not have any effect on the City’s financial statements.

In June 2015, the GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* ("OPEB"). This statement replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57*, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, as amended, Statement No. 43, and Statement No. 50, *Pension Disclosures*. The City has implemented these changes in the Pension Trust Funds in Note IV.A.4.

In August 2015, the GASB issued Statement No. 77, *Tax Abatement Disclosures*. This statement requires governments that enter into tax abatement agreements to disclose the following information about the agreements:

- Brief descriptive information, such as the tax being abated, the authority under which tax abatements are provided, eligibility criteria, the mechanism by which taxes are abated, provisions for recapturing abated taxes, and the types of commitments made by tax abatement recipients.
- The gross dollar amount of taxes abated during the period.
- Commitments made by a government, other than to abate taxes, as part of a tax abatement agreement.

The application of Statement No. 77 did not have a significant impact on the City's financial statements.

In December 2015, the GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans.* This statement amends the scope and applicability of Statement No. 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer. The application of Statement No. 78 did not have any effect on the City's financial statements.

In January 2016, the GASB issued Statement No. 80, *Blending Requirements for Certain Component Units-an amendment of GASB Statement No.14*. This statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The application of Statement No. 80 did not have any effect on the City's financial statements.

In March 2016, the GASB issued Statement No. 82, *Pension Issues-An Amendment of GASB Statement No.67, No. 68, and No. 73.* This statement clarifies that a deviation, as the term is used in Actuarial Standards of Practice issued by the Actuarial Standards Board, from the guidance in an Actuarial Standard of Practice is not considered to be in conformity with the requirements of Statement 67, Statement 68, or Statement 73 for the selection of assumptions used in determining the total pension liability and related measures. The application of Statement No. 82 did not have a significant effect on the City's financial statements.

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

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. This statement replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended*, and No. 57, for OPEB. This statement addresses accounting and financial reporting for OPEB and establishes standards for recognizing and measuring liabilities, deferred outflows/inflows of resources, and expenses/expenditures. Application of Statement No. 75 is effective for the City's fiscal year ending June 30, 2018.

In March 2016, the GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements.* This statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. An irrevocable split-interest agreement is one type of split-interest agreement used by donors to provide resources to two or more beneficiaries, including governments. Under an irrevocable split-interest agreement, the donor does not reserve, or confer to another person, the right to terminate the agreement at will and have the donated resources returned to the donor or a third party. This statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This statement requires that a government recognize revenue when the resources become applicable to the reporting period. Application of Statement No. 81 is effective for the City's fiscal year ending June 30, 2018.

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

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

In March 2017, the GASB issued Statement No. 85, *Omnibus 2017*. This statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). Application of Statement No. 85 is effective for the City's fiscal year ending June 30, 2018.

In May 2017, the GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*. This statement provides guidance for transactions in which cash and other monetary assets acquired with only existing resources, resources other than the proceeds of refunding debt, are placed in an irrevocable trust for the sole purpose of extinguishing debt. This statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. Application of Statement No. 86 is effective for the City's fiscal year ending June 30, 2018.

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

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

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

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

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

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

***3. Deposits and Investments***

Investments are accounted for in accordance with the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, as amended. This statement requires governmental entities to report investments at fair value in the statement of net position or balance sheet and to recognize the corresponding change in fair value of investments in the year in which the change occurred.

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

- Level 1 - Investments whose values are based on quoted prices (unadjusted) for identical assets in active markets that a government can access at the measurement date.

- Level 2 - Investments with inputs – other than quoted prices included within Level 1 – that are observable for an asset, either directly or indirectly.

- Level 3 - Investments classified as Level 3 have unobservable inputs for an asset and may require a degree of professional judgment.

**Pooled Cash and Investments held in City Treasury.** The City reports its investments held in the City Treasury at fair value. The fair value is based on quoted market information obtained from fiscal agents or other sources. Income from some investments is assigned to the General Fund. The assignment of the income from these investments is supported by legal or contractual provisions approved by the City Council. For the year ended June 30, 2017, the total investment income from these investments assigned and transferred to the General Fund was approximately $768,000.

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

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

### *4. Inventories*

Inventories of proprietary funds are valued at the lower of cost (first-in/first-out) or market.

### *5. Loans Receivable, net*

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

### *6. Special Assessment Districts*

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

### *7. Advances and Deposits*

Amounts deposited in connection with eminent domain proceedings are reported as advances and deposits. In the governmental fund statements, non-current portions of these are offset equally by either a credit or a classification of fund balance in the nonspendable, restricted or committed account.

### *8. Other Assets*

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

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

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

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

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

### *10. Restricted Assets*

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

### *11. Capital Assets*

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

Capital assets are defined as assets with an initial individual cost of more than $5,000 for general capital assets and $100,000 for major infrastructure assets, and an estimated useful life in excess of one year. Such assets are recorded at historical cost if purchased or constructed. Donated capital assets are recorded at acquisition value at the time received. Capital outlay is recorded as expenditures of the governmental funds and as assets in the government-wide financial statements to the extent the City's capitalization threshold is met. Interest incurred during the construction phase of capital assets of business-type activities is reflected in the capitalized value of the asset constructed, net of interest earned on the invested proceeds of tax-exempt debt over the same period. Amortization of assets acquired under capital leases is based on the shorter of the lease term, when the lease does not transfer ownership or include a bargained purchase option or the estimated useful life of the asset and is included in depreciation and amortization.

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

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

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

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

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

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

Employees in FCERS who retire with at least 15 years of service, or 20 years for police officers and firefighters in PFDRP, may be eligible to receive, upon retirement, sick leave payouts based on percentages of accumulated unused sick leave hours as determined by the respective collective bargaining agreements for represented employees. Similar terms are applicable to eligible unrepresented employees. The tables below summarize the eligibility terms for sick leave payout and the terms governing the amount of the payout.

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

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

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

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

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

### *13. Interfund Transactions*

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

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

### *14. Self-Insurance*

The City is self-insured for workers' compensation, general liability, auto liability, and certain other risks, except as described in Note III.F.13. The City's workers' compensation activities are funded and accounted for separately in the fund financial statements based upon the activities of each fund. The current portion of claims liability is accounted for in the General Fund and the enterprise funds on the basis of settlements reached or judgments entered within the current fiscal year. In the government-wide financial statements and the enterprise fund financial statements, the estimated liability for all self-insurance liability claims is recorded as a liability.

### *15. Deferred Outflows/Inflows of Resources*

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

### *16. Pensions*

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

### *17. Net Position*

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

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

- *Restricted Net Position* – This category represents net position that 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, 2017, the government-wide statement of net position reported restricted net position of $982,168,000 in governmental activities and $75,945,000 in business-type activities. Of these amounts $328,060,000 and $21,770,000, respectively are restricted by enabling legislation.

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

### *18. Fund Balances*

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

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

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

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

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

Intent is expressed by (a) the City Council or (b) the City Manager to which the City Council has delegated the authority to assign amounts to be used for specific purposes.

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

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

### *19. Property Taxes*

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

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

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

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

The City’s net assessed valuation for the year ended June 30, 2017, was approximately $161.4 billion, an increase of approximately 7.0% from the previous year. The City’s tax rate was approximately $0.177 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).

### *20. Wastewater Treatment System*

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

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

In 1959, the City and the City of Santa Clara entered into an agreement to jointly own and operate the Plant. Under the agreement, the City serves as the administering agency and is responsible for operating and maintaining the Plant. The cities share in the capital and operating costs on a pro rata basis determined by the ratio of each city's assessed valuation to the sum of both cities' assessed valuations. Annually, these percentages are determined and applied to the capital and operating costs on an accrual basis. For the fiscal year ended June 30, 2017, the City's portion of the capital and operating costs was approximately 81.1% and the City's interest in the net position of the Plant was approximately 77.9%.

## II. Stewardship, Compliance, and Accountability

### A. Deficit Net Position

Prior to February 1, 2012, the California Redevelopment Law provided tax increment financing as a source of revenue to redevelopment agencies to fund redevelopment activities. Once a redevelopment area was adopted, the former Agency could only receive tax increment to the extent that it could show on an annual basis that it had incurred indebtedness that must be repaid with tax increment. Due to the nature of the redevelopment financing, the former Agency liabilities exceeded assets. Therefore, the Agency historically carried a deficit, which was expected to be reduced as future tax increment revenues were received and used to reduce its outstanding long-term debt. This deficit was transferred to the SARA on February 1, 2012. At June 30, 2017, the SARA has a deficit of $1,608,145,000, which will be reduced when future redevelopment property tax revenues are distributed from the Redevelopment Property Tax Trust Fund administered by the County's Auditor-Controller to pay SARA's annual enforceable obligations.

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

At June 30, 2017, the City reports a deficit unrestricted net position in its Statement of Net Position – governmental activities in the amount of $1,935,456,000. This deficit is primarily due to the City's accrual of certain long-term liabilities, such as the net pension liability, 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 OPEB obligations for OPEB costs in which the actuarial annual required contributions are greater than the amount paid into the OPEB plans to date (see Note IV.A.4.3)

## III. Detailed Notes on All Funds

### A. Cash, Deposits and Investments

As of June 30, 2017, total City cash, deposits and investments, at fair value, are as follows (dollars in thousands):

| | Governmental Activities | Business-Type Activities | Fiduciary Funds: Pension Trust | Fiduciary Funds: Private Purpose Trust | Fiduciary Funds: Agency | Carrying Value |
|---|---|---|---|---|---|---|
| Equity in pooled cash and investments | $ 954,437 | $ 612,999 | $ - | $ 154 | $ 4,557 | $ 1,572,147 |
| Cash and investments | - | - | - | 17,656 | - | 17,656 |
| Restricted assets: | | | | | | |
| Equity in pooled cash and investments | 93,371 | 86,446 | - | - | - | 179,817 |
| Cash and investments held with fiscal agent | 111,129 | 109,417 | - | 162,238 | - | 382,784 |
| Other cash and investments | 15,623 | 2,176 | - | - | - | 17,799 |
| Investments of retirement systems | - | - | 5,612,233 | - | - | 5,612,233 |
| Total deposits and investments | $ 1,174,560 | $ 811,038 | $ 5,612,233 | $ 180,048 | $ 4,557 | 7,782,436 |
| Deposits | | | | | | 12,471 |
| Investments | | | | | | 7,769,965 |
| Total deposits and investments | | | | | | $ 7,782,436 |

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

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

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

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

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

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

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

In practice, the City purchases a combination of shorter-term and longer-term investments and times the cash flows to meet liquidity needs for operations. The average maturity of the City's pooled cash and investments at June 30, 2017, was approximately 513 days.

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

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

At June 30, 2017, the City's pooled and fiscal agent investments in LAIF was approximately $263,217,000 and the SARA's investments in LAIF was approximately $36,437,000. The weighted average maturity of LAIF was 194 days at June 30, 2017. The total amount recorded by all public agencies in LAIF at June 30, 2017 was approximately $22.8 billion. LAIF is part of the State's Pooled Money Investment Account ("PMIA"). The PMIA is not registered with the Securities Exchange Commission ("SEC"), but is required to invest according to California Government Code. The total amount recorded by all public agencies in PMIA at June 30, 2017 was approximately $77.6 billion and of that amount, 60.79% was invested in U.S. Treasuries and agencies, 27.73% in depository securities, 10.60% in commercial paper, 0.83% in loans, and 0.05% in mortgages.

**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 June 7, 2016, 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 Policy was last reviewed and approved, with no changes, on March 7, 2017. The following table identifies the investment types that are authorized by the Policy as of June 30, 2017:

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

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

Other restrictions on investments are summarized as follows:

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

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

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

- Deposits up to the Federal Deposit Insurance Corporation ("FDIC") of $10,000,000 may be invested in, but are not limited to, banks and savings and loans with offices located in the San José area and deposits shall not exceed the net worth of that depository. Depositories must have a short-term rating of "P1, A1, or F1" or better by two of the three nationally recognized rating services: Moody's, S&P, or Fitch, respectively. The outstanding debt of the bank or its holding company must be rated "A3, A-, or A-" or higher by Moody's, S&P, or Fitch, respectively. Deposits shall be collateralized in the manner prescribed by State law for depositories.

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

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

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

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

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

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

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

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

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

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

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

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

The following schedule indicates the interest rate risk, credit quality risk and concentration of credit risk of the City's investments, as of June 30, 2017 (dollars in thousands). The credit ratings listed are for Moody's and S&P, respectively.

| Type of Investment | Credit Rating | Maturity: Under 30 Days | Maturity: 31 - 180 Days | Maturity: 181 - 365 Days | Maturity: 1 - 5 Years | Carrying Value |
|---|---|---|---|---|---|---|
| Pooled investments in the City Treasury: | | | | | | |
| Treasury Notes | AAA / AAA | $ - | $ - | $ - | $ 35,000 | $ 35,000 |
| Federal Farm Credit Banks | AAA / AA+ | 15,000 | 20,010 | - | 43,068 | 78,078 |
| Federal Home Loan Banks | AAA / AA+ | 40,000 | 29,954 | 22,107 | 120,790 | 212,851 |
| Federal Home Loan Banks - Callable | AAA / AA+ | - | - | - | 3,492 | 3,492 |
| Federal Home Loan Mortgage Corporation | AAA / AA+ | 20,000 | 9,998 | 14,963 | 37,241 | 82,202 |
| Federal Home Loan Mortgage Corporation - Callable | AAA / AA+ | - | 9,987 | 3,999 | - | 13,986 |
| Federal National Mortgage Association | AA+ / AAA | - | 34,985 | 28,640 | 39,557 | 103,182 |
| Federal National Mortgage Association - Callable | AA+ / Aaa | - | - | 10,993 | - | 10,993 |
| Farmer MAC | N/A | - | - | - | 74,822 | 74,822 |
| Farmer MAC -Discount | N/A | 10,000 | - | - | - | 10,000 |
| Muni Bonds | A-1 / A+ | - | - | - | 148,857 | 148,857 |
| Supranational | AAA / AAA | 25,000 | 9,996 | 10,002 | 167,939 | 212,937 |
| Corporate Medium Term Notes | A-1 / A | - | 30,543 | 70,429 | 319,250 | 420,222 |
| Commercial paper | N/A | 9,998 | 34,868 | - | - | 44,866 |
| Negotiable certificate of deposit | N/A | 110,001 | 58,165 | 30,012 | - | 198,178 |
| Money market mutual funds | N/A | 13 | - | - | - | 13 |
| California local agency investment fund | Not Rated | - | - | 108,617 | - | 108,617 |
| Total pooled investments in the City Treasury | | 230,012 | 238,506 | 299,762 | 990,016 | 1,758,296 |
| Investments with fiscal agents: | | | | | | |
| Treasury Notes | N/A | - | 4,974 | 2,088 | - | 7,062 |
| Federal Agricultural Mortage Corporation | N/A | - | - | - | 10,704 | 10,704 |
| Federal Farm Credit Banks | Aaa / AA+ | - | - | - | 6,971 | 6,971 |
| Federal Home Loan Banks | Aaa / AA+ | - | - | - | 26,505 | 26,505 |
| Federal Home Loan Banks - Discount | N/A | - | 2,273 | - | - | 2,273 |
| Federated Treasury Obligation | N/A | 1,473 | - | - | - | 1,473 |
| First American Govt Obligation | N/A | 3,058 | - | - | - | 3,058 |
| First American Treasury Obligation | N/A | 153 | - | - | - | 153 |
| Money market mutual funds | Aaa / AAA | 7,073 | - | - | - | 7,073 |
| California local agency investment fund | Not Rated | - | - | 154,600 | - | 154,600 |
| Total investments with fiscal agents | | 11,757 | 7,247 | 156,688 | 44,180 | 219,872 |
| Total Citywide investments (excluding Retirement Systems and the SARA) | | $ 241,769 | $ 245,753 | $ 456,450 | $ 1,034,196 | 1,978,168 |
| Trust Funds: | | | | | | |
| Total investments in Retirement Systems (See page 68) | | | | | | 5,612,233 |
| Total investments in the SARA (See page 162) | | | | | | 179,564 |
| Total investments | | | | | | $ 7,769,965 |

**Fair Value Measurement Categorization.** The City categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The State of California Local Agency Investment Fund and Money Market Mutual Fund are valued by net asset value.

The City has the following recurring fair value measurements as of June 30, 2017:

| | | Fair Value Measurements Using | | |
|---|---|---|---|---|
| | Carrying Value 6/30/2017 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Pooled investments in the City Treasury: | | | | |
| Investments by fair value level: | | | | |
| Treasury Notes | $ 35,000 | $ 35,000 | $ - | $ - |
| Federal Farm Credit Banks | 78,078 | - | 78,078 | - |
| Federal Home Loan Banks | 212,851 | 39,841 | 173,010 | - |
| Federal Home Loan Banks - Callable | 3,492 | - | 3,492 | - |
| Federal Home Loan Mortgage Corporation | 82,202 | 44,960 | 37,242 | - |
| Federal Home Loan Mortgage Corporation - Callable | 13,986 | - | 13,986 | - |
| Federal National Mortgage Association | 103,182 | 54,932 | 48,250 | - |
| Federal National Mortgage Association - Callable | 10,993 | - | 10,993 | - |
| Farmer MAC | 74,822 | - | 74,822 | - |
| Farmer MAC - Discount | 10,000 | 10,000 | - | - |
| Muni Bonds | 148,857 | 19,946 | 128,911 | - |
| Supranational | 212,937 | - | 212,937 | - |
| Corporate Medium Term Notes | 420,222 | 161,949 | 258,273 | - |
| Commercial paper | 44,866 | - | 44,866 | - |
| Negotiable certificate of deposit | 198,178 | - | 198,178 | - |
| Money market mutual funds | 13 | 13 | - | - |
| Total investments by fair value level | 1,649,679 | 366,641 | 1,283,038 | - |
| Investments not subject to fair value hierarchy: | | | | |
| California local agency investment fund | 108,617 | | | |
| Total investments not subject to fair value hierarchy | 108,617 | | | |
| Total pooled investments in the City Treasury | 1,758,296 | 366,641 | 1,283,038 | - |
| Investments with fiscal agents: | | | | |
| Investments by fair value level: | | | | |
| Treasury Notes | 7,062 | 7,062 | - | - |
| Federal Agribultural Mortgage Corporation | 10,704 | - | 10,704 | - |
| Federal Farm Credit Banks | 6,971 | - | 6,971 | - |
| Federal Home Loan Banks | 26,505 | 10,119 | 16,386 | - |
| Federal Home Loan Banks - Discount | 2,273 | - | 2,273 | - |
| Federated Treasury Obligation | 1,473 | 1,473 | - | - |
| First American Gov't Obligation | 3,058 | 3,058 | - | - |
| First American Treasury Obligation | 153 | 153 | - | - |
| Money market mutual funds | 7,073 | 7,073 | - | - |
| Total investments by fair value level | 65,272 | 28,938 | 36,334 | - |
| Investments not subject to fair value hierarchy: | | | | |
| California local agency investment fund | 154,600 | | | |
| Total investments not subject to fair value hierarchy | 154,600 | | | |
| Total investments with fiscal agents | 219,872 | 28,938 | 36,334 | - |
| Total Citywide investments (excluding Retirement Systems and the SARA) | 1,978,168 | $ 395,579 | $ 1,319,372 | $ - |
| Trust Funds: | | | | |
| Total investments in Retirement Systems (See page 68) | 5,612,233 | | | |
| Total investments in the SARA (See page 162) | 179,564 | | | |
| Total investments | $ 7,769,965 | | | |

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

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

**Custodial Credit Risk.** Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the City will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker - dealer) to a transaction, the City will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code requires that a financial institution secure its deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by the depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged governmental securities and/or first trust deed mortgage notes held in the collateral pool must be at least 110% and 150% of the City's deposits, respectively. The collateral is held by the pledging financial institution's trust department and is considered held in the City's name. As of June 30, 2017, the City's deposits were collateralized at 110%. All investments in the City Treasury were in the City's name. Neither deposits nor investments held by the City were subject to custodial credit risk.

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

As of June 30, 2017, the City's pooled investments in the City Treasury have investments in U.S. Agencies that represents 5% or more of the total pooled investments in the following:

| | |
|---|---|
| Federal Home Loan Banks | 12.30% |
| International Bank for Reconstruction & Development | 9.80% |
| Federal National Mortgage Association | 6.50% |
| Federal Home Loan Mortgage Corp | 5.50% |

In addition, the following major funds hold investments with trustees that represent 5% or more of the funds' investments outside the City Treasury as of June 30, 2017:

| | |
|---|---|
| Airport: | |
| Federal Home Loan Banks | 12.06% |

**Foreign Currency Risk.** The risk that changes in exchange rates will adversely affect the fair value of an investment. As of June 30, 2017, the City's Policy does not permit investments in the pool to hold foreign currency; as such the investments in the City's investment pool were not subject to foreign currency risk.

### *2. Retirement Systems*

**Investment Policies –** The City's Municipal Code delegates authority to the Boards of Administration of PFDRP and FCERS (the "Retirement Boards") to invest monies of the respective plans as provided in the Municipal Code. Each Retirement Board has adopted detailed investment guidelines consistent with the limitations set forth in the Municipal Code. At June 30, 2017, the Retirement Systems' investment target asset allocations are as follows:

| | PFDRP - Pension | | |
|---|---|---|---|
| Asset Class | Minimum Allocation | Target Asset Allocation | Maximum Allocation |
| Global equity | 25% | 31% | 50% |
| Real assets | 12% | 17% | 25% |
| Global fixed income | 10% | 16% | 30% |
| Private debt | 5% | 11% | 15% |
| Global tactical asset allocation | - | 10% | 10% |
| Private equity | 3% | 8% | 13% |
| Absolute return | 2% | 6% | 12% |
| Cash | - | 1% | 10% |

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

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

*Note: The real assets category includes allocations to commodities, real estate, and other inflation-linked assets. The absolute return/global tactical asset category is currently comprised of three global tactical asset allocation managers who run unconstrained global portfolios.*

The fair value of the separate real estate properties are based on annual independent appraisals. As of June 30, 2017, the PFDRF no longer owned any assets that were separate real estate properties. On June 2, 2017, the PFDRF sold the Progress Point building located in O'Fallon Missouri for $12,959,000 before closing costs. The sale resulted in a net realized loss of $10,165,000.

| | FCERS - Pension | | |
|---|---|---|---|
| **Asset Class** | **Minimum Allocation** | **Target Asset Allocation** | **Maximum Allocation** |
| Global equity | 20% | 28% | 36% |
| Private equity | 4% | 9% | 14% |
| Global fixed income | 9% | 19% | 29% |
| Private debt | - | 5% | 10% |
| Absolute return | 6% | 11% | 16% |
| Global tactical asset allocation/ Opportunistic | - | 5% | 8% |
| Real assets | 15% | 23% | 30% |
| Cash | - | - | 10% |

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

| | FCERS - Postemployment Healthcare | | |
|---|---|---|---|
| **Asset Class** | **Minimum Allocation** | **Target Asset Allocation** | **Maximum Allocation** |
| Global equity | 40% | 47% | 54% |
| Fixed income | 20% | 30% | 40% |
| Real assets | 15% | 23% | 30% |

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

At June 30, 2017, the Retirement Systems held the following investments (dollars in thousands):

| | PFDRP | FCERS | Total |
|---|---|---|---|
| Securities and other: | | | |
| Fixed income: | | | |
| Global fixed income | $ 549,054 | $ 465,187 | $ 1,014,241 |
| Collective short term investments | 287,658 | 141,747 | 429,405 |
| Total fixed income | 836,712 | 606,934 | 1,443,646 |
| Absolute return | 251,543 | 252,592 | 504,135 |
| Global equity | 1,124,182 | 919,963 | 2,044,145 |
| Global tactical asset allocation | 325,119 | - | 325,119 |
| Private equity | 170,786 | 61,662 | 232,448 |
| Private debt | 219,768 | 75,773 | 295,541 |
| Real assets | 495,825 | 272,924 | 768,749 |
| International currency contracts, net | (916) | (634) | (1,550) |
| Total investments | $ 3,423,019 | $ 2,189,214 | $ 5,612,233 |

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

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

The following tables provide the segmented time distribution for fixed income investments based on expected maturity (in months and years) as of June 30, 2017 (dollars in thousands):

| | PFDRP | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 0 - 3 months | 3 - 6 months | 6 months - 1 year | 1 - 5 years | 5 - 10 years | More than 10 years | Total Fair Value | Total Cost |
| Global fixed income: | | | | | | | | |
| Commingled Funds | $ 25,522 | $ - | $ 69,270 | $ 182,550 | $ 56,392 | $ 150,139 | $ 483,873 | $ 440,730 |
| Mortgage - backed securities | - | - | - | - | 1,894 | 41,477 | 43,371 | 43,796 |
| Corporate bonds | - | - | - | 84 | - | - | 84 | 58 |
| Other debt securities | - | - | - | 1,431 | 8,943 | 11,352 | 21,726 | 21,648 |
| Total global fixed income | 25,522 | - | 69,270 | 184,065 | 67,229 | 202,968 | 549,054 | 506,232 |
| Collective short-term investments | 287,658 | - | - | - | - | - | 287,658 | 287,658 |
| Total fixed income | $ 313,180 | $ - | $ 69,270 | $ 184,065 | $ 67,229 | $ 202,968 | $ 836,712 | $ 793,890 |

| | FCERS | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 0 - 3 months | 3 - 6 months | 6 months - 1 year | 1 - 5 years | 5 - 10 years | More than 10 years | Total Fair Value | Total Cost |
| Global fixed income: | | | | | | | | |
| Commingled Funds | $ 38,283 | $ - | $ - | $ 125,865 | $ 47,627 | $ 95,988 | $ 307,763 | $ 294,400 |
| Corporate Bonds | - | - | - | 1 | - | - | 1 | 1 |
| Mortgage-Backed Securities | - | - | - | - | 1,813 | 38,656 | 40,469 | 35,906 |
| Other Debt Securities | - | - | - | 1,331 | 8,306 | 10,655 | 20,292 | 20,725 |
| U.S. Treasury Inflation-Protected Securities | - | - | - | 76,494 | 20,168 | - | 96,662 | 98,830 |
| Total global fixed income | 38,283 | - | - | 203,691 | 77,914 | 145,299 | 465,187 | 449,862 |
| Collective short-term investments | 141,747 | - | - | - | - | - | 141,747 | 141,566 |
| Total fixed income | $ 180,030 | $ - | $ - | $ 203,691 | $ 77,914 | $ 145,299 | $ 606,934 | $ 591,428 |

***Custodial Credit Risk*** – Custodial credit risk is the risk that the Retirement Systems will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party, if that outside party fails. The Retirement Systems do not have a policy regarding custodial credit risk. As of June 30, 2017, all of the Retirement Systems' investments are held in the Retirement Systems' names, and/or are not exposed to custodial credit risk.

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

Please note that the following table reflects only securities held in the Retirement System' names. The table provides information for the portfolio as of June 30, 2017 concerning credit risk (dollars in thousands) and reflect only securities held in the Retirement Systems' names.

| | PFDRP | | FCERS | |
|---|---|---|---|---|
| S&P quality rating | Fair Value | Fair value as a % of fixed income investments | Fair Value | Fair value as a % of fixed income investments |
| AAA | $ 363 | 0.04% | $ 332 | 0.05% |
| AA+ | 4,627 | 0.55% | 101,048 | 16.65% |
| A+ | 1,724 | 0.21% | 1,580 | 0.26% |
| A | 428 | 0.05% | 392 | 0.06% |
| BBB+ | 1,832 | 0.22% | 1,676 | 0.28% |
| BBB | 6,333 | 0.76% | 5,652 | 0.93% |
| BBB- | 503 | 0.06% | 503 | 0.08% |
| BB+ | 1,431 | 0.17% | 1,331 | 0.22% |
| BB | 749 | 0.09% | 749 | 0.12% |
| BB- | 499 | 0.06% | 499 | 0.08% |
| B+ | 527 | 0.06% | 484 | 0.08% |
| B | 1,554 | 0.19% | 1,423 | 0.23% |
| B- | 476 | 0.06% | 436 | 0.07% |
| CCC | 3,556 | 0.42% | 3,726 | 0.61% |
| CC | 760 | 0.09% | 720 | 0.12% |
| D | 6,821 | 0.82% | 6,310 | 1.04% |
| Not rated | 804,529 | 96.15% | 480,073 | 79.10% |
| Total | $ 836,712 | 100.00% | $ 606,934 | 100.00% |

***Foreign Currency Risk*** – This is the risk that changes in the exchange rates will adversely affect the fair value of underlying investments. To mitigate this risk, the Retirement Systems' investment policies permit individual investment managers to mitigate the impact of currency fluctuation on the underlying asset value. The Retirement Systems' investment managers enter into international forward currency contracts, which are commitments to purchase or sell stated amounts of international currency. The Retirement Systems utilize these contracts to control exposure and facilitate the settlement of international security purchase and sale transactions. At June 30, 2017, the Retirement Systems' net positions in these contracts are recorded at fair value as international currency contract investments. The fair values of international currency contracts are determined by quote currency prices from national exchanges. The Retirement Systems' commitments relating to international currency contracts are settled on a net basis.

The following tables provide information as of June 30, 2017, concerning the fair value of investments that are subject to foreign currency risk (dollars in thousands):

**PFDRP**

| Currency Name | Cash | Global Equity | International Currency Contracts, Net | Real Assets | Total Exposure |
|---|---|---|---|---|---|
| Australian Dollar | $ - | $ 3,679 | $ (59) | $ - | $ 3,620 |
| Canadian Dollar | - | 5,868 | (151) | - | 5,717 |
| China Yuan Reminbl | - | - | (94) | - | (94) |
| Denmark Krone | - | 5,266 | - | - | 5,266 |
| Euro Currency | 182 | 17,956 | (545) | 15,080 | 32,673 |
| Hong Kong Dollar | 19 | 1,659 | - | - | 1,678 |
| Japanese Yen | - | 13,317 | 328 | - | 13,645 |
| Korean (South) Won | - | 7,957 | - | - | 7,957 |
| Norwegian Krone | - | 1,795 | - | - | 1,795 |
| Singapore Dollar | - | 81 | - | - | 81 |
| Swedish Krona | - | 3,022 | (16) | - | 3,006 |
| Swiss Franc | - | 14,310 | (104) | - | 14,206 |
| United Kingdom Pound | - | 30,428 | (275) | - | 30,153 |
| Total | $ 201 | $ 105,338 | $ (916) | $ 15,080 | $ 119,703 |

**FCERS**

| Currency Name | Cash | Global Equity | International Currency Contracts, Net | Private Equity | Real Assets | Total Exposure |
|---|---|---|---|---|---|---|
| Australian Dollar | $ - | $ 2,095 | $ (30) | $ - | $ 13,709 | $ 15,774 |
| Brazilian Real | - | - | (65) | - | 619 | 554 |
| British Pound | - | 21,450 | (131) | - | 28,083 | 49,402 |
| Canadian Dollar | - | 3,932 | (53) | - | 31,900 | 35,779 |
| Chile Peso | - | - | - | - | 665 | 665 |
| China Yuan Renminbi | - | - | (115) | - | - | (115) |
| Colombian Peso | - | - | - | - | 13 | 13 |
| Danish Krone | - | 5,203 | - | - | - | 5,203 |
| Euro Currency | 452 | 13,005 | (244) | 2,252 | 28,677 | 44,142 |
| Hong Kong Dollar | - | 945 | - | - | 7,465 | 8,410 |
| Hungarian Forint | - | - | - | - | 109 | 109 |
| Indonesian Rupiah | - | - | - | - | 1,044 | 1,044 |
| Israeli Shekel | - | - | - | - | 819 | 819 |
| Japanese Yen | - | 7,963 | 8 | - | 3,421 | 11,392 |
| Korean Won | - | 6,808 | - | - | 442 | 7,250 |
| Malaysian Ringgit | - | - | - | - | 1,846 | 1,846 |
| Mexican Peso | - | - | - | - | 1,003 | 1,003 |
| New Zealand Dollar | - | - | - | - | 569 | 569 |
| Norwegian Krone | - | 1,411 | - | - | 2,421 | 3,832 |
| Philippine Peso | - | - | - | - | 89 | 89 |
| Polish Zloty | - | - | - | - | 546 | 546 |
| Singapore Dollar | - | 46 | - | - | 2,555 | 2,601 |
| South African Rand | - | - | - | - | 871 | 871 |
| Swedish Krona | - | 1,725 | (4) | - | 690 | 2,411 |
| Swiss Franc | - | 10,881 | - | - | 536 | 11,417 |
| Taiwanese new dollar | - | - | - | - | 327 | 327 |
| Thailand Baht | - | - | - | - | 428 | 428 |
| Total | $ 452 | $ 75,464 | $ (634) | $ 2,252 | $ 128,847 | $ 206,381 |

***Investment Concentration Risk –*** The Retirement Systems' investment policies specify that investments shall be diversified with the intent to minimize the risk of large investment losses. The total portfolio shall be constructed in a way to provide prudent diversification with regard to the concentration of holdings in individual asset classes, issues, issuers, geographies or industries. The Retirement Systems' investment policies state that in addition, assets will be assigned to a variety of investment managers that employ a range of investment management strategies. No single investment management firm shall be authorized to manage more than 10% of the applicable plan's assets without approval by the applicable Retirement Board, with the exception of passive management, where the applicable plan's assets are not held in the applicable plan's name at the applicable plan's custodial bank. In such cases, the investment management firm can manage no more than 20% of the applicable plan's assets without approval by the applicable Retirement Board. In addition as a general rule, assets placed with an investment manager should not represent more than 10% of the total assets of the applicable plan managed by that firm, without approval of the applicable Retirement Board. As of June 30, 2017, none of the Retirement Systems held investments in any one issuer, excluding U.S. Government guaranteed investments that represented 5% or more of the total applicable plan's net position or total investments.

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

Derivative investments are reported at fair value. Derivative instruments traded on a national or international exchange are valued at the last reported sales price on the last business day of the fiscal year at current exchange rates, if applicable. 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 available audited financial statements and other fund information. 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, 2017. The fair value of international currency forwards represents the unrealized gain or loss on the related contracts, which is calculated based on the difference between the specified contract exchange rate and the exchange rate at the end of the reporting period.

The fair values and notional amounts for a portion of derivative instruments outstanding as of June 30, 2017, classified by type, and the changes in fair value of such derivative instruments for the year then ended as reported in the financial statements are as follows (amounts in thousands):

**PFDRP**

| Investment Derivative Instruments | Net Appreciation/(Depreciation) in Fair Value of Investments through June 30, 2017 – Classification | Net Appreciation/(Depreciation) in Fair Value of Investments through June 30, 2017 – Amount | Fair Value at June 30, 2017 – Classification | Fair Value at June 30, 2017 – Amount | Notional Amount/Shares |
|---|---|---|---|---|---|
| Foreign currency forwards | Investment income | $ (976) | International currency contracts, net | $ (916) | $ 136,293 |
| Futures options bought/written | Investment income | 11,732 | Fixed income (domestic and foreign) | - | 27,005 |
| Rights / Warrants | Investment income | (16) | Global equity | 24 | 73 |
| Total derivative instruments | | $ 10,740 | | $ (892) | |

**FCERS**

| Investment Derivative Instruments | Net Appreciation/(Depreciation) in Fair Value of Investments through June 30, 2017 – Classification | Net Appreciation/(Depreciation) in Fair Value of Investments through June 30, 2017 – Amount | Fair Value at June 30, 2017 – Classification | Fair Value at June 30, 2017 – Amount | Notional Amount/Shares |
|---|---|---|---|---|---|
| Foreign currency forwards | Investment income | $ (1,388) | Foreign currency contracts, net | $ (634) | $ 60,007 |
| Future options bought/written | Investment income | 9,747 | Fixed income, collective short-term investments | - | (927) |
| Rights / Warrants | Investment income | (39) | Global equity | 24 | 90 |
| Total derivative instruments | | $ 8,320 | | $ (610) | |

Derivative investments are subject to counterparty credit risk (non-exchange traded). The following describes the risks applicable to the investment derivative instruments that are reported as of June 30, 2017.

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

As of June 30, 2017, PFDRP had total commitments in forward currency contracts to purchase and sell international currencies of $136,293,000 and $136,293,000, respectively, with fair values of $136,393,000 and $137,308,000, respectively, held by counterparties with an S&P rating of at least AA-.

As of June 30, 2017, FCERS had total commitments in forward currency contracts to purchase and sell international currencies of $60,007,000 and $60,007,000, respectively, with fair values of $60,035,000 and $60,669,000, respectively, held by counterparties with an S&P rating of at least A and above.

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

The Retirement Systems have the following recurring fair value measurements as of June 30, 2017:

| PFDRP (In Thousands) | Total | Fair Value Measurement Using Level 1 | Level 2 | Level 3 | Net Asset Value (NAV) |
|---|---|---|---|---|---|
| **Investments by fair value level** | | | | | |
| Global equity | $ 1,124,182 | $ 286,088 | $ - | $ - | $ 838,094 |
| Private equity | 170,786 | - | - | 4,519 | 166,267 |
| Global fixed income | 549,054 | 16,380 | 65,098 | - | 467,576 |
| Collective short term investments | 287,658 | 287,658 | - | - | - |
| Private debt | 219,768 | - | - | 17,559 | 202,209 |
| Real assets | 495,825 | 6,982 | - | - | 488,843 |
| International currency contracts, net | (916) | (916) | - | - | - |
| Global tactical asset allocation | 325,119 | 207,125 | - | - | 117,994 |
| Absolute return | 251,543 | - | - | - | 251,543 |
| **Total investments measured at fair value** | **$ 3,423,019** | **$ 803,317** | **$ 65,098** | **$ 22,078** | **$ 2,532,526** |

| FCERS (In Thousands) | Total | Fair Value Measurement Using Level 1 | Level 2 | Level 3 | Net Asset Value (NAV) |
|---|---|---|---|---|---|
| **Investments by Fair Value Level** | | | | | |
| Global equity | $ 919,963 | $ 441,932 | $ - | $ - | $ 478,031 |
| Private equity | 61,662 | - | - | 4,519 | 57,143 |
| Global fixed income | 465,187 | 118,098 | 60,760 | - | 286,329 |
| Collective short term investments | 141,747 | 141,747 | - | - | - |
| Private debt | 75,773 | - | - | 17,559 | 58,214 |
| Real assets | 272,924 | - | - | - | 272,924 |
| International currency contracts, net | (634) | (634) | - | - | - |
| Absolute return | 252,592 | - | - | - | 252,592 |
| **Total investments measured at fair value** | **$ 2,189,214** | **$ 701,143** | **$ 60,760** | **$ 22,078** | **$ 1,405,233** |

### Equity and Fixed Income Securities

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

### Alternative Investments

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

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

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

The following tables present the category, fair value, unfunded commitments, redemption frequency and redemption notice period for investments for which fair value is presented using the NAV as of June 30, 2017:

**PFDRP**

| Investments Measured at the NAV as of June 30, 2017 (In Thousands) | Fair Value | Unfunded Commitments | Redemption Frequency (if Currently Eligible) | Redemption Notice Period |
|---|---|---|---|---|
| Global equity | $ 838,094 | $ - | Daily, Monthly, Quarterly | 1 - 90 Days |
| Private equity | 166,267 | 81,527 | Daily, N/A | 1 Day, N/A |
| Global fixed income | 467,576 | - | Daily, Monthly, Quarterly | 1 - 60 Days |
| Private debt | 202,209 | 123,778 | N/A | N/A |
| Real assets | 488,843 | 115,469 | Monthly, Quarterly, N/A (Closed-end funds) | 3 - 90 Days, N/A (Closed-end funds) |
| Global tactical assets allocation | 117,994 | - | Monthly | 1 - 5 Days |
| Absolute return | 251,543 | - | Weekly, Monthly, Quarterly | 14 - 75 Days |
| **Total investments measured at the NAV** | **$ 2,532,526** | **$ 320,774** | | |

**FCERS**

| Investments Measured at the NAV as of June 30, 2017 (In Thousands) | Fair Value | Unfunded Commitments | Redemption Frequency (if Currently Eligible) | Redemption Notice Period |
|---|---|---|---|---|
| Global equity | $ 478,031 | $ - | Daily, Monthly, Quarterly | 1 - 90 Days |
| Private equity | 57,143 | 14,132 | N/A | N/A |
| Global fixed income | 286,329 | - | Daily, Quarterly | 1 - 60 Days |
| Private debt | 58,214 | 51,755 | N/A | N/A |
| Real assets | 272,924 | 62,402 | Monthly, Quarterly, Annual, N/A (Closed-end funds) | 3 - 180 Days, N/A (Closed-end funds) |
| Absolute return | 252,592 | - | Weekly, Monthly, Quarterly | 14 - 75 Days |
| **Total investments measured at the NAV** | **$ 1,405,233** | **$ 128,289** | | |

## B. Receivables, Net of Allowances

At June 30, 2017, receivables of the City's major individual funds and nonmajor funds taken in aggregate, including the applicable allowance for uncollectible accounts, are as follows (dollars in thousands):

| Receivables – Governmental Activities: | General Fund | Housing Activities | Low and Moderate Income Housing Asset | Special Assessment Districts | Intergrated Waste Management | Nonmajor Funds | Internal Service Funds | Total Governmental Activities |
|---|---|---|---|---|---|---|---|---|
| Taxes | $ 55,039 | $ - | $ - | $ - | $ - | $ 9,062 | $ - | $ 64,101 |
| Accrued interest | 1,440 | 246 | 1,733 | 50 | 82 | 3,352 | 75 | 6,978 |
| Grants | 822 | 1,197 | - | - | - | 6,379 | - | 8,398 |
| Special assessments | - | - | - | 34,320 | - | - | - | 34,320 |
| Other | 39,782 | 24 | 25 | 2,254 | 8,203 | 7,787 | 171 | 58,246 |
| Less: allowance for uncollectibles | (27,904) | (3) | - | (5) | (2,588) | (1,166) | (10) | (31,676) |
| Total receivables, net | $ 69,179 | $ 1,464 | $ 1,758 | $ 36,619 | $ 5,697 | $ 25,414 | $ 236 | $ 140,367 |

| Receivables – Business-Type Activities: | Norman Y. Mineta San José International Airport | Wastewater Treatment System | Municipal Water System | Parking System | Total Business-Type Activities |
|---|---|---|---|---|---|
| Accounts | $ 14,207 | $ 5,168 | $ 9,085 | $ 212 | $ 28,672 |
| Accrued interest | 1,010 | 1,676 | 108 | 134 | 2,928 |
| Grants | 5,032 | - | - | - | 5,032 |
| Less: allowance for uncollectibles | (367) | (587) | (1,164) | (63) | (2,181) |
| Total receivables, net | $ 19,882 | $ 6,257 | $ 8,029 | $ 283 | $ 34,451 |

Special assessment receivables in the amount of $34,320,000 are not expected to be collected within the subsequent year.

## C. Loans Receivable, Net of Allowances

The composition of the City's loans receivable balance for governmental activities, net of the allowance for uncollectible accounts, as of June 30, 2017 is as follows (dollars in thousands):

| Type of Loan | General Fund | Housing Activities | Low and Moderate Income Housing Asset | Nonmajor Governmental Funds | Total Governmental Activities |
|---|---|---|---|---|---|
| Housing Program Developer, rehabilitation, second mortgage and relocation loans | $ - | $ - | $ 509,444 | $ - | $ 509,444 |
| Loans funded by federal grants | - | 80,450 | - | 8,110 | 88,560 |
| Economic development, real estate developer and other loans | 1,241 | 55,119 | - | - | 56,360 |
| Less: allowance for uncollectibles | - | (64,389) | (281,482) | (3,321) | (349,192) |
| Total loans, net | $ 1,241 | $ 71,180 | $ 227,962 | $ 4,789 | $ 305,172 |

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

Typical loans and related terms are summarized as follows:

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

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

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

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

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

The City's management believes the combined amount of the aforementioned risk and present value discount allowances is adequate to reflect the net realizable value of the Community Development Block Grant ("CDBG") loans, Home Investment Partnership Program ("HOME") loans, and Low and Moderate Income Housing Asset Fund loans receivable as of June 30, 2017.

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, 2017. These commitments involve elements of credit and interest rate risk similar to those described above for outstanding loans receivable. As of June 30, 2017, amounts committed to extend credit under normal lending agreements totaled approximately $9,387,000.

## D. Capital Assets

### *1. Summary Schedule*

The following is a summary of capital assets activity for the fiscal year ended June 30, 2017 (dollars in thousands):

| | Balance July 1, 2016 | Additions | Deletions | Transfers | Balance June 30, 2017 |
|---|---|---|---|---|---|
| **Governmental activities:** | | | | | |
| Capital assets, not being depreciated: | | | | | |
| Land | $ 406,337 | $ 7,448 | $ 252 | $ - | $ 413,533 |
| Construction in progress | 31,411 | 55,872 | 5,971 | (32,317) | 48,995 |
| Total capital assets, not being depreciated | 437,748 | 63,320 | 6,223 | (32,317) | 462,528 |
| Capital assets, being depreciated: | | | | | |
| Buildings | 1,646,123 | 938 | - | 1,680 | 1,648,741 |
| Improvements, other than buildings | 251,398 | 973 | - | 8,351 | 260,722 |
| Infrastructure | 11,440,581 | 16,170 | - | 22,286 | 11,479,037 |
| Vehicles and equipment | 127,367 | 11,014 | 8,738 | - | 129,643 |
| Furnitures and fixtures | 27,354 | 144 | - | - | 27,498 |
| Total capital assets, being depreciated | 13,492,823 | 29,239 | 8,738 | 32,317 | 13,545,641 |
| Less accumulated depreciation for: | | | | | |
| Buildings | 568,226 | 42,782 | - | - | 611,008 |
| Improvements, other than buildings | 39,477 | 7,173 | - | - | 46,650 |
| Infrastructure | 7,631,678 | 158,532 | - | - | 7,790,210 |
| Vehicles and equipment | 93,005 | 9,183 | 8,820 | - | 93,368 |
| Furnitures and fixtures | 26,788 | 161 | - | - | 26,949 |
| Total accumulated depreciation | 8,359,174 | 217,831 | 8,820 | - | 8,568,185 |
| Total capital assets, being depreciated, net | 5,133,649 | (188,592) | (82) | 32,317 | 4,977,456 |
| Governmental activities capital assets, net | $ 5,571,397 | $(125,272) | $ 6,141 | $ - | $ 5,439,984 |
| **Business-type Activities:** | | | | | |
| Capital assets, not being depreciated: | | | | | |
| Land | $ 134,926 | $ - | $ - | $ - | $ 134,926 |
| Intangible assets | 12,882 | - | - | - | 12,882 |
| Construction in progress | 54,554 | 82,695 | - | (17,410) | 119,839 |
| Total capital assets, not being depreciated | 202,362 | 82,695 | - | (17,410) | 267,647 |
| Capital assets, being depreciated: | | | | | |
| Buildings | 1,650,404 | (27) | 27 | 7,858 | 1,658,208 |
| Improvements, other than buildings | 1,208,060 | 32,258 | - | 5,939 | 1,246,257 |
| Vehicles and equipment | 254,186 | 7,720 | 1,344 | 3,613 | 264,175 |
| Total capital assets, being depreciated | 3,112,650 | 39,951 | 1,371 | 17,410 | 3,168,640 |
| Less accumulated depreciation for: | | | | | |
| Buildings | 546,672 | 40,359 | 12 | - | 587,019 |
| Improvements, other than buildings | 579,601 | 30,328 | - | - | 609,929 |
| Vehicles and equipment | 168,294 | 10,786 | 1,313 | - | 177,767 |
| Total accumulated depreciation | 1,294,567 | 81,473 | 1,325 | - | 1,374,715 |
| Total capital assets, being depreciated, net | 1,818,083 | (41,522) | 46 | 17,410 | 1,793,925 |
| Business-type activities capital assets, net | $ 2,020,445 | $ 41,173 | $ 46 | $ - | $ 2,061,572 |

### *2. Depreciation*

Depreciation expense charged to various governmental and business-type activities of the City for the fiscal year ended June 30, 2017 is as follows (dollars in thousands):

| | | |
|---|---|---|
| **Governmental activities:** | | |
| General government | $ | 9,336 |
| Public safety | | 7,874 |
| Capital maintenance | | 164,239 |
| Community services | | 33,774 |
| Capital assets held by City's internal service funds | | 2,608 |
| Total depreciation expense - governmental activities | $ | 217,831 |
| **Business-type activities:** | | |
| Norman Y. Mineta San José International Airport | $ | 46,449 |
| Wastewater Treatment System | | 28,349 |
| Municipal Water System | | 2,735 |
| Parking System | | 3,940 |
| Total depreciation expense - business-type activities | $ | 81,473 |

### *3. Capitalized Interest*

Interest costs that are related to the acquisition of buildings and improvements and equipment acquired with tax-exempt and taxable debt are capitalized for business-type activities. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project, with interest earned on invested tax-exempt debt proceeds over the same period. Capitalized interest cost is prorated to completed projects based on the completion date of each project. There was no capitalized interest cost for the fiscal year ended June 30, 2017.

### *4. Construction Commitments*

Commitments outstanding as of June 30, 2017, related to governmental and business-type activities construction in progress totaled approximately $22,268,000 and $173,731,000, respectively.

## E. Leases

### *1. Operating Leases as Lessee*

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

**Governmental Activities**

The City has ongoing commitments under operating lease agreements for business equipment, office facilities and land necessary for City operations, which expire at various dates through 2022. Each governmental fund includes the expenditures related to such lease agreements. There are both cancelable and non-cancelable lease agreements. Rental expenditures reported by the General Fund and the Nonmajor Governmental Funds under these operating lease agreements for the fiscal year ended June 30, 2017 amounted to approximately $1,531,000 and $333,000, respectively.

The future minimum lease payments anticipated under the existing lease commitments, as of June 30, 2017, are as follows (dollars in thousands):

| Fiscal Year Ending June 30, | General Fund | Nonmajor Governmental Funds | Total Govermental Activities |
|---|---|---|---|
| 2018 | $ 1,750 | $ 86 | $ 1,836 |
| 2019 | 1,388 | - | 1,388 |
| 2020 | 552 | - | 552 |
| 2021 | 275 | - | 275 |
| 2022 | 85 | - | 85 |
| Totals | $ 4,050 | $ 86 | $ 4,136 |

**Business-Type Activities**

**Airport Gas-Powered Buses.** In September 2009, the City entered into a restated operating lease and maintenance agreement for ten compressed natural gas (“CNG”) powered buses for the Airport. The term of the agreement is from December 2007 to May 2017. In May 2017, the restated agreement was amended to extend through May 2019, with a one-year option to extend. Rental and maintenance expense for the Airport buses for the fiscal year ended June 30, 2017 was approximately $1,323,000.

**Future Minimum Payments.** The future minimum lease and maintenance payments required under the existing agreement for the ten CNG powered buses, as of June 30, 2017, are as follows (dollars in thousands):

| Fiscal Year Ending June 30, | Operating Leases |
|---|---|
| 2018 | $ 844 |
| 2019 | 774 |
| Total minimum lease payments | $ 1,618 |

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

**Governmental Activities**

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

**Business-Type Activities - Airport**

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

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

For the fiscal year ended June 30, 2017, the Airport's revenues as defined in its lease agreement exceeded its expenditures and reserve requirements by approximately $34,031,000. The surplus for fiscal year ended June 30, 2017 will be distributed in accordance with the revenue sharing provisions of the lease agreement as described above and/or used in the budget balancing actions for fiscal year 2018.

**Other Airport Leases.** In December 2013, the City entered into a ground lease and operating agreement with Signature Flight Support Corporation (Signature), which constructed a full-service, fixed based facility on 29-acres of the Airport's west side. The term of the agreement is for 50 years from December 12, 2013 to December 11, 2063. Signature paid interim ground rental equal to 50% of the base ground rental until November 2015, when the last certificate of occupancy was received. From November 2015, and continuing throughout the term of the agreement, Signature will pay 100% of the base ground rental based upon the actual square footage of premises occupied. The base ground rental is subject to a consumer price index adjustment annually and by appraisal every five years. The base ground rental rate effective December 12, 2016 is $2.29 per square foot per year. Rental revenues from the ground lease with Signature were $2,911,000 for the fiscal year ended June 30, 2017.

The City 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. As of June 30, 2017, the remaining terms of these operating leases range from one month to 21 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 $85,961,000 for the fiscal year ended June 30, 2017.

The future minimum rentals to be received from the Airport operating leases, as of June 30, 2017, are as follows (dollars in thousands):

| Fiscal Year Ending June 30, | Amount |
|---|---|
| 2018 | $ 82,016 |
| 2019 | 80,184 |
| 2020 | 36,292 |
| 2021 | 10,873 |
| 2022 | 11,005 |
| 2023 - 2027 | 53,272 |
| 2028 - 2032 | 52,716 |
| 2033 - 2037 | 56,296 |
| 2038 - 2042 | 37,782 |
| 2043 - 2047 | 37,279 |
| 2048 - 2052 | 44,225 |
| 2053 - 2057 | 52,465 |
| 2058 - 2062 | 62,241 |
| 2063 - 2064 | 20,903 |
| Total | $ 637,549 |

These future minimum rentals are based upon annual rates and charges currently agreed to by the airlines and other tenants. As of June 30, 2017, leased assets to tenants had historical costs of $1,033,403,000 and accumulated depreciation of $227,789,000.

Pursuant to the terms of individual agreements entered into with the City, every airline, operator, tenant or any other entity or person, which is party to an agreement with the City authorizing them to conduct business at the Airport, is required to maintain a security deposit on file with the City. The deposit shall be in a form and amount acceptable to the Director of Aviation, often in the form of irrevocable letter of credit, surety bond, cashier's check or other form acceptable to the Director of Aviation. The Director of Aviation has the authority to revise the amount of security deposit at any time to protect the interests of the City. Each deposit must be maintained in full force and effect during the entire term of the agreement to ensure faithful performance by the other party of all the covenants, terms and conditions of the agreement. Security deposits in the form of cashier's checks are recorded as advances and deposits payable on the accompanying statement of net position. The Airport maintains on file copies of all security deposits, in the form of letter of credit or surety bond, which are not recorded in the financial statements. The amount on file as of June 30, 2017 totaled $50,218,000.

**Potential Claim.** The passenger airlines that currently operate at the Airport have a potential unasserted claim against the City for overpayment of terminal rents by the airlines. The overpayment of terminal rents by the passenger airlines has resulted from the City's annual calculation of terminal rents in a manner that is not consistent with the terms of the current Lease and Operating Agreement between the passenger airlines and the City. Specifically, from Fiscal Year 2008 to the current fiscal year, the City has not included the City office and administrative space at the terminals that should be counted as "Rentable Terminal Space" under the terms of the Airline Lease and Operating Agreement for the purpose of calculating terminal rents to be charged to the passenger airlines. The statute of limitations for claims against a government entity such as the City is one (1) year pursuant to California Government Code Section 911.2. If the airlines file a claim, the City will therefore take a position that the City is only liable to the passenger airlines for one year's overpayment of terminal rents in the approximate amount of $2,500,000.

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

## F. Long-Term Debt and Other Obligations

### *1. Summary Schedule of Long-Term Debt*

The following is a summary of long-term debt of the City as of June 30, 2017 (dollars in thousands, unless otherwise noted):

| | Purpose | Issue Amount | Issue Date | Final Maturity | Range of Interest Rates | Range of Principal Payments ($ millions) | Balance June 30, 2017 |
|---|---|---|---|---|---|---|---|
| Governmental Activities | | | | | | | |
| City of San Jose | | | | | | | |
| General Obligation Bonds: | | | | | | | |
| Series 2001 (Libraries and Parks) | Community Facilities | $ 71,000 | 06/06/2001 | 09/01/2031 | 5.00-5.13% | 2.37 | $ 35,475 |
| Series 2002 (Libraries, Parks, Public Safety) | Community Facilities | 116,090 | 07/18/2002 | 09/01/2032 | 5.00% | 3.87 | 61,910 |
| Series 2004 (Libraries, Parks, Public Safety) | Community Facilities | 118,700 | 07/14/2004 | 09/01/2034 | 4.25-5.00% | 3.96 | 71,230 |
| Series 2005 (Libraries and Public Safety) | Community Facilities | 46,300 | 06/23/2005 | 09/01/2035 | 4.00-4.50% | 1.55 | 29,355 |
| Series 2006 (Libraries and Parks) | Community Facilities | 105,400 | 06/29/2006 | 09/01/2036 | 4.00-5.00% | 3.52 | 70,300 |
| Series 2007 (Parks and Public Safety) | Community Facilities | 90,000 | 06/20/2007 | 09/01/2037 | 4.00-4.75% | 3.00 | 63,000 |
| Series 2008 (Libraries and Parks) | Community Facilities | 33,100 | 06/25/2008 | 09/01/2038 | 4.00-5.00% | 1.10 | 24,260 |
| Series 2009 (Public Safety) | Community Facilities | 9,000 | 06/25/2009 | 09/01/2039 | 4.00-5.00% | 0.30 | 6,900 |
| | | | | | | | 362,430 |
| HUD Section 108 Note (FMC) | Economic Development | 25,810 | 02/10/2005 | 08/01/2024 | Variable | 0.24 | 717 |
| City of San Jose Financing Authority | | | | | | | |
| Lease Revenue Bonds: | | | | | | | |
| Series 2001F (Convention Center) | Refunding | 186,150 | 07/01/2001 | 09/01/2022 | 5.00% | 11.60-14.73 | 78,680 |
| Series 2003A (Central Service Yard) | Refunding | 22,625 | 09/18/2003 | 10/15/2023 | 4.13-4.70% | 1.25-1.61 | 9,940 |
| Series 2006A (Civic Center Project) | Refunding | 57,440 | 06/01/2006 | 06/01/2039 | 4.25-5.00% | 0.17-17.44 | 52,850 |
| Series 2007A (Recreational Facilities) | Refunding | 36,555 | 06/28/2007 | 08/15/2030 | 4.13-4.75% | 1.22-2.22 | 22,890 |
| Series 2008C (Hayes Mansion) | Refunding | 10,915 | 06/26/2008 | 06/01/2027 | Variable | 0.11-4.57 | 10,915 |
| Series 2008D (Taxable) (Hayes Mansion) | Refunding | 47,390 | 06/26/2008 | 06/01/2023 | Variable | 3.10-3.90 | 20,640 |
| Series 2008E-1 (Taxable) (Ice Centre) | Refunding | 13,015 | 07/03/2008 | 06/01/2025 | Variable | 0.85-1.26 | 8,310 |
| Series 2008E-2 (Taxable) (Ice Centre) | Refunding | 13,010 | 07/03/2008 | 06/01/2025 | Variable | 0.85-1.26 | 8,300 |
| Series 2008F (Taxable) (Land Acquisition) | Refunding | 67,195 | 06/11/2008 | 06/01/2034 | Variable | 1.43-3.17 | 37,050 |
| Series 2011A (Convention Center) | Convention Center | 30,985 | 04/12/2011 | 05/01/2042 | 3.50-5.75% | 0.62-2.17 | 29,960 |
| Series 2013A (Civic Center Project) | Refunding | 305,535 | 05/28/2013 | 06/01/2039 | 4.00-5.00% | 5.30-21.33 | 293,665 |
| Series 2013B (Civic Center Garage Project) | Refunding | 30,445 | 06/19/2013 | 06/01/2039 | 3.00-5.00% | 0.80-1.91 | 28,190 |
| Revenue Bonds: | | | | | | | |
| Series 2001A (4th & San Fernando Garage) | Parking Facility | 48,675 | 04/10/2001 | 09/01/2026 | 4.63-5.25% | 2.08-3.21 | 26,005 |
| | | | | | | | **627,395** |
| Special Assessment Bonds | | | | | | | |
| Series 24Q (Hellyer-Piercy) | Public Infrastructure | 27,595 | 06/26/2001 | 09/02/2023 | 5.60-5.88% | 1.5-2.03 | 12,125 |
| Special Tax Bonds | | | | | | | |
| CFD No. 1 (Capitol Expressway Auto Mall) | Public Infrastructure | 4,100 | 11/18/1997 | 11/01/2022 | 5.63-5.70% | 0.23-0.30 | 1,550 |
| CFD No. 6 (Great Oaks-Route 85) | Public Infrastructure | 12,200 | 12/18/2001 | 09/01/2023 | 5.63-6.00% | 0.62-0.87 | 5,175 |
| CFD No. 9 (Bailey/Highway 101) | Public Infrastructure | 13,560 | 02/13/2003 | 09/01/2032 | 6.00-6.65% | 0.37-0.95 | 9,775 |
| CFD No. 10 (Hassler-Silver Creek) | Public Infrastructure | 12,500 | 07/23/2003 | 09/01/2023 | 4.88-5.25% | 0.70-0.94 | 5,695 |
| Series 2011 (Convention Center) | Public Infrastructure | 107,425 | 04/12/2011 | 05/01/2042 | 5.00-6.50% | 1.94-7.71 | 101,750 |
| | | | | | | | **136,070** |
| **Total Government Activities - Bonds and Notes Payable** | | | | | | | **$ 1,126,612** |
| Business-Type Activities | | | | | | | |
| Norman Y. Mineta San Jose International Airport | | | | | | | |
| Revenue Bonds: | | | | | | | |
| Series 2007A (AMT) | Airport Facilities | $ 545,755 | 09/13/2007 | 03/01/2018 | 5.50% | 7.03 | $ 7,025 |
| Series 2011A-1 (AMT) | Refunding | 150,405 | 07/28/2011 | 03/01/2034 | 5.00-6.25% | 3.36-21.12 | 129,305 |
| Series 2011A-2 (Non-AMT) | Refunding | 86,380 | 07/28/2011 | 03/01/2034 | 4.00-5.25% | 1.91-12.22 | 74,340 |
| Series 2011B (Taxable) | Refunding | 271,820 | 12/14/2011 | 03/01/2041 | 4.22-6.75% | 1.54-27.33 | 261,635 |
| Series 2012A (Non-AMT) | Refunding | 49,140 | 11/08/2012 | 03/01/2018 | 1.53% | 8.59 | 8,585 |
| Series 2014A (AMT) | Refunding | 57,350 | 10/07/2014 | 03/01/2026 | 2.00-5.00% | 0.05-9.18 | 56,090 |
| Series 2014B (Non-AMT) | Refunding | 28,010 | 10/07/2014 | 03/01/2028 | 3.10-5.00% | 7.98-10.37 | 28,010 |
| Series 2014C (Non-AMT) | Refunding | 40,285 | 10/07/2014 | 03/01/2031 | 5.00% | 7.30-8.86 | 40,285 |
| Series 2017A (AMT) | Refunding | 473,595 | 04/11/2017 | 03/01/2047 | 4.00-5.00% | 4.01-35.15 | 473,595 |
| Series 2017B (Non-AMT) | Refunding | 150,675 | 04/11/2017 | 03/01/2047 | 2.00-5.00% | 1.28-11.18 | 150,675 |
| | | | | | | | **1,229,545** |
| Clean Water Financing Authority | | | | | | | |
| Revenue Bonds: | | | | | | | |
| Series 2009A | Refunding | 21,420 | 01/29/2009 | 11/15/2020 | 3.50% | 4.97-5.41 | 20,695 |
| State of California - Revolving Fund Loan | Wastewater Facilities | 73,566 | 06/24/1997 | 05/01/2019 | Variable | 1.77-4.35 | 6,125 |
| | | | | | | | **26,820** |
| **Total Business-Type Activity - Bonds and Loan Payable** | | | | | | | **$ 1,256,365** |
| **Grand Total** | | | | | | | **$ 2,382,977** |

### *2. Debt Compliance*

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

### *3. Legal Debt Limit and Margin*

The City Charter limits bonded indebtedness for General Obligation bonds to 15 percent of the total assessed valuation of all real and personal property within the City. The total assessed value of taxable property on the City's 2016-2017 tax roll was $166.5 billion, which results in a total debt limit of $25.0 billion. As of June 30, 2017, the City had $367,469,000 of General Obligation bonds outstanding which represents approximately 1.5% of the General Obligation bonds' debt limit.

### *4. Arbitrage*

The Tax Reform Act of 1986 instituted certain arbitrage restrictions with respect to the issuance of tax-exempt bonds after August 31, 1986. Arbitrage regulations deal with the investment of all tax-exempt bond proceeds at an interest yield greater than the interest yield paid to bondholders. Generally, all interest paid to bondholders can be retroactively rendered taxable if applicable rebate liabilities are not reported and paid to the Internal Revenue Service ("IRS") at least every five years. During the current year, the City performed calculations to determine the rebate liabilities for the City's tax-exempt bond issues listed above. However, as no bond issue with a positive rebate liability was due for a fifth-year payment, there was no rebate liability outstanding as of June 30, 2017.

### *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, 2017, the City has recorded approximately $34,320,000 of deferred inflows of resources and related special assessments receivables in the Special Assessment Districts Fund. These balances consist primarily of property tax assessments and/or special taxes to be collected in the future by the County of Santa Clara for future debt service of the special assessment districts and the community facilities districts.

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

### *6. Conduit Debt*

The City has issued multi-family housing revenue bonds to provide funds for secured loans to builders of multi-family housing projects. The purpose of the program is to provide needed rental housing for low to moderate-income households. To comply with IRS requirements in order to meet the tax-exempt status, the owner is required to set aside a certain percentage of all units built for very low to moderate-income households. The bonds are payable solely from payments made on the related secured loans. These tax-exempt housing bonds have maturity dates that are due at various dates through March 1, 2052. As of June 30, 2017, the outstanding conduit multi-family housing revenue bonds issued by the City aggregated approximately $448,788,000.

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

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

Included in long-term debt is $85,215,000 of variable-rate bonds, comprised of four series (Series 2008C, Series 2008D, Series 2008E and Series 2008F) issued by the Financing Authority. The Financing Authority issued these bonds to provide variable-rate exposure to the debt portfolio and to provide additional flexibility with respect to restructuring or redeeming the debt issued for certain projects. The source of repayment for each of these series is from lease payments from the City to the Financing Authority for the City's lease of the Dolce Hayes Mansion (Series 2008C and Series 2008D), the Ice Centre (Series 2008E) and real property located at 1125 Coleman Avenue in San José (Series 2008F), also known as the Airport West Property.

Effective December 18, 2013, the Financing Authority directly placed the Series 2008C/D/E Bonds with U.S. Bank National Association ("U.S. Bank") and in connection with the direct placement, the City, the Financing Authority and U.S Bank entered into separate continuing covenant agreements for the private placement of the Series 2008C/D Bonds and the Series 2008E Bonds. Effective June 26, 2014, the Financing Authority directly placed the Series 2008F Bonds with Bank of America, N.A. ("BofA") and in connection with the direct placement, the City, the Financing Authority and BofA entered into a continuing covenant agreement for the private placement of the Series 2008F Bonds. The scheduled redemption of these bonds is incorporated in the Annual Requirements to Maturity schedules (see Note III.F.9.).

The principal balances of the Financing Authority's variable-rate bonds as of June 30, 2017 are as follows (dollars in thousands):

| | Privately-Placed Bonds | | | | |
|---|---|---|---|---|---|
| | Balance June 30, 2017 | Purchaser | Agreement Expiration | Fixed Fee/ Spread | Interest Index Rate |
| City of San José Financing Authority: | | | | | |
| Lease Revenue Bonds: | | | | | |
| Series 2008C (Hayes Mansion) | $ 10,915 | U.S. Bank | 12/11/2017 | 0.390% | SIFMA (Weekly) |
| Series 2008D (Taxable) (Hayes Mansion) | 20,640 | U.S. Bank | 12/11/2017 | 0.470% | 1-Month LIBOR |
| Series 2008E (Taxable) (Ice Centre) | 16,610 | U.S. Bank | 12/13/2019 | 0.530% | 1-Month LIBOR |
| Series 2008F (Taxable) (Land Acquisition) | 37,050 | Bank of America, N.A. | 06/27/2018 | 0.575% | 1-Month LIBOR |
| Total variable-rate lease revenue bonds | $ 85,215 | | | | |

Prior to the execution of the continuing covenant agreements on December 18, 2013 (for the Series 2008C, 2008D, and 2008E bonds) and June 26, 2014 (for the Series 2008F bonds), the variable-rate lease revenue bonds were publicly-marketed "demand" bonds supported by credit facilities and payable upon demand of the bondholder at a purchase price equal to principal plus accrued interest. Subsequently, the credit facilities were cancelled and the bonds were sold directly to U.S. Bank and BofA and are no longer remarketed on the open market.

The Financing Authority is required to pay a fixed fee, or spread, ranging from 0.390% to 0.575% (as noted above) based on the terms of the applicable governing document. Per the terms of the applicable governing document, the spread is subject to increase in the event that the long-term unenhanced ratings of the Financing Authority's lease revenue bonds are downgraded. The applicable interest rate index plus the fixed fee comprise the combined interest rate that is applied to outstanding principal and billed to the Financing Authority monthly. As of June 30, 2017, the private placements of each series expire as set forth in the table above.

In June 2017, the extensions of private placements of these four series to the dates listed in the above table were implemented. The extension dates of the private placements of the Series 2008C/D bonds and the Series 2008F bonds are December 11, 2017 and June 27, 2018, respectively, in anticipation of the sale of the underlying leased assets: the Dolce Hayes Mansion and the Airport West Property. The sale of the Dolce Hayes Mansion, anticipated to close prior to June 30, 2017, was terminated and the City has issued a request for proposals for the sale of the property. The Airport West Property is subject to an option agreement for its purchase with an expiration date of December 31, 2017. The City is unable to predict whether the sale of either of these properties will be consummated.

In connection with the extensions of the private placements for these bonds, minor amendments were made to the transaction documents to clarify some terms and to reflect lower pricing on two series of the bonds. The fixed fee component of the interest associated with the outstanding bonds will decrease from 53 basis points ("bps") (or 0.53%) to 0.39% for the tax-exempt 2008C Bonds and 0.47% for the taxable 2008D Bonds. The fixed fee component of the interest rate payable on the taxable Series 2008E and 2008F bonds will remain at 0.53% and 0.575%, respectively. The variable interest rate on the bonds will continue to be determined by the commonly accepted SIFMA index for the Series 2008C bonds and 1-month LIBOR index rate for the Series 2008D, Series 2008E and Series 2008F.

Pursuant to the respective continuing covenant agreement, the Series 2008C/D/E Bonds and the Series 2008F Bonds will be subject to mandatory tender upon expiration of the respective agreement, at which time the Financing Authority has the obligation to purchase the bonds unless the City negotiates an extension with the applicable bank or remarkets the bonds with a different purchaser or credit facility provider. If the City fails to remarket the bonds, and assuming no events of default have occurred, the unremarketed bonds will function similar to a term loan, and will be amortized over a three year period and will bear interest per a formula with a minimum rate of 8% per annum for the Series 2008C/D/E Bonds and 7.5% per annum for the Series 2008F Bonds. Lease payments may not exceed the fair market rental value of the leased properties under State law, so the principal may be amortized over multiple years in such case.

For the Series 2008F Bonds, the continuing covenant agreement specifies that the lease payments payable by the City during an amortization period will increase up to the maximum annual rent of $14,925,000 and, if that amount is insufficient to repay BofA during the amortization period, BofA may require an appraisal of the leased property to re-determine the lease payments up to the then fair rental value of the leased property. Similarly, the continuing covenant agreements applicable to the Series 2008C/D/E Bonds specify that the City would be obligated to make lease payments during an amortization period to repay U.S. Bank to the extent of the fair rental value of the applicable leased property and, to the extent the amount due remains unpaid, it shall continue the obligation of the City, pursuant to the applicable lease, to be paid on or before the expiration of the three-year amortization period. Additionally, each of the continuing covenant agreements specifies other terms in order to promote prompt repayment to the applicable bank.

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

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

| | July 1, 2016 | Additional Obligations, Interest Accretion and Net Increases | Current Maturities, Retirements, and Net Decreases | June 30, 2017 | Principal Amounts Due Within One Year |
|---|---|---|---|---|---|
| **Governmental Activities:** | | | | | |
| Long-term debt payable: | | | | | |
| General Obligation bonds | $ 382,085 | $ - | $ (19,655) | $ 362,430 | $ 19,660 |
| Issuance premiums/discounts: | | | | | |
| For issuance premiums | 5,318 | - | (279) | 5,039 | 149 |
| HUD Section 108 loan | 957 | - | (240) | 717 | 239 |
| San Jose Financing Authority | | | | | |
| Lease revenue bonds | 539,175 | - | (16,465) | 522,710 | 18,205 |
| Issuance premiums/discounts: | | | | | |
| For issuance premiums | 40,735 | - | (1,781) | 38,954 | 1,780 |
| For issuance discounts | (584) | - | 22 | (562) | (23) |
| Lease revenue bonds with reimbursement agreement agreement (Convention Center) | 89,730 | - | (11,050) | 78,680 | 11,595 |
| Revenue bonds with pledge agreement (Fourth Street and San Fernando Garage) | 27,985 | - | (1,980) | 26,005 | 2,075 |
| Special assessment and special tax bonds with limited governmental commitment | 141,105 | - | (5,035) | 136,070 | 5,305 |
| Issuance premiums/discounts: | | | | | |
| For issuance discounts | (1,671) | - | 68 | (1,603) | (66) |
| Total long-term debt payable | 1,224,835 | - | (56,395) | 1,168,440 | 58,919 |
| Other Long-term obligations: | | | | | |
| Hayes Mansion construction loan | 1,200 | - | - | 1,200 | - |
| Lease-purchase agreements | 17,949 | - | (1,286) | 16,663 | 667 |
| NMTC Financing Obligation | 19,260 | - | (428) | 18,832 | 439 |
| Accrued vacation, sick leave and compensatory time | 73,372 | 46,430 | (42,149) | 77,653 | 38,322 |
| Accrued landfill postclosure costs | 5,580 | - | (465) | 5,115 | 465 |
| Estimated liability for self-insurance | 142,471 | 22,833 | (20,527) | 144,777 | 20,326 |
| Net other postemployment benefits (OPEB) obligation | 425,316 | 10,864 | - | 436,180 | - |
| Pollution remediation obligation | 431 | - | (83) | 348 | - |
| Total other long-term obligations | 685,579 | 80,127 | (64,938) | 700,768 | 60,219 |
| Governmental activities long-term obligations | $ 1,910,414 | $ 80,127 | $ (121,333) | $ 1,869,208 | $ 119,138 |

**General Obligation Bonds** are issued pursuant to a two-thirds majority voter authorization. In 2000 and 2002, San José voters approved three ballot measures (Measures O and P in 2000 and Measure O in 2002) that authorized the total issuance of $598,820,000 of general obligation ("GO") bonds for library, parks and public safety projects. GO bonds are secured by a pledge of the City to levy ad valorem property taxes without limitation of rate or amount. The ad valorem property tax levy is calculated for each fiscal year to generate sufficient revenue to pay 100% of annual debt service net of other available funding sources. As of June 30, 2017, the City of San José had issued $589,590,000 of GO bonds with proceeds split for three purposes: library projects ($205,885,000), parks and recreation projects ($228,030,000), and public safety projects ($155,675,000). Total principal and interest remaining on the bonds as of June 30, 2017 is approximately $527,363,000, with the final payment due on September 1, 2039.

The City did not issue any GO bonds in fiscal year 2017. A total of $9,230,000 of the authorization remains un-issued for the library ($5,905,000) and public safety programs ($3,325,000). The proceeds of those bonds would be used to fund a portion of the library and public safety projects approved by voters in November 2000 and March 2002, respectively. The timing, size, and purpose of the issuance of this final series will depend upon the expenditure and encumbrance needs of the various projects to be financed.

**Lease Revenue/Revenue Bonds** are issued by the Financing Authority primarily to finance various capital improvements and, with the exception of the 2001A Bonds, the financed capital improvements are to be leased to the City and are secured by lease revenue from "lessee" departments in the General Fund, Non-major Governmental Funds, and the SARA. The lease revenue for each fiscal year is generally equal to 100% of annual debt service net of other available funding sources. Total principal and interest remaining on these bonds as of June 30, 2017 are approximately $935,671,000, with the final payment due on May 1, 2042.

The outstanding balance remaining on these aforementioned bonds includes payments for the 2001A and 2001F bonds, which are payable through a pledge agreement (2001A) and a reimbursement agreement (2001F) by the Agency, which were assumed by the SARA. A description of these bonds is as follows:

- **Convention Center Lease Revenue Bonds with Reimbursement Agreement.** In connection with the issuance of the 2001F Convention Center Refunding Bonds, the Agency and the City entered into the Second Amended and Restated Reimbursement Agreement, which was assumed by the SARA, under which the SARA is obligated to use redevelopment property tax or other revenues to reimburse the City for lease payments made to the Financing Authority for the project. The Series 2001F bonds (tax-exempt) mature on September 1, 2022 and have an outstanding balance of $78,680,000 as of June 30, 2017.

- **4th and San Fernando Parking Facility Project Pledge Agreement.** In March 2001, the Financing Authority issued Revenue Bonds, Series 2001A in the amount of $48,675,000 to finance the construction of the Fourth Street and San Fernando Parking Facility Project. The Agency entered into an Agency Pledge Agreement with the Financing Authority, which was assumed by the SARA, whereby the payments are payable from and secured by surplus "Agency Revenues". Under the terms of the Agency Pledge Agreement, SARA's payments are limited in each year to an amount equal to the annual debt service due on the bonds minus surplus revenues generated by the parking facility. Surplus Agency Revenues consist of (i) estimated tax increment revenues, which are pledged to the payment of the former Agency's outstanding tax allocation bonds and deemed to be "Surplus" in the current fiscal year in accordance with the resolution, or indenture pursuant to which the outstanding tax allocation bonds were issued; plus (ii) all legally available revenues of SARA.

  SARA makes payments on the Financing Authority Series 2001A bonds pursuant to the amortization schedule attached as Exhibit A to the Agency Pledge Agreement. However, the City records debt payments pursuant to the annual debt service schedule, which results in a timing difference in the amount of $2,075,000 for balances outstanding as of June 30, 2017. At June 30, 2017, the Financing Authority's bonds payable is $26,005,000, whereas the corresponding receivable from the SARA is $23,930,000.

**Special Assessment and Special Tax Bonds** are issued by the City to finance public improvements in special assessment or tax districts established by the City and are secured by assessments or special taxes levied on properties located within the special districts. The assessments and special taxes, as applicable, are calculated for each fiscal year to generate sufficient revenue to pay 100% of annual debt service net of other available funding sources. Total principal and interest remaining on the bonds as of June 30, 2017 is approximately $250,740,000, with the final payment due on May 1, 2042.

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

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

The other projects that were to be funded under the Lease will be financed through the Finance Authority's Lease Revenue Commercial Paper Program described in Note III.F.11. The total blended interest rate for the 20-year taxable Lease was 5.01%, and interest rates ranged from 3.21% for improvements with 5-year useful lives to 6.01% for improvements with 20-year useful lives. Total principal and interest remaining on the Lease as of June 30, 2017 is approximately $21,589,000, with the final payment due on June 1, 2034.

The future minimum lease payments anticipate under the lease agreement, as of June 30, 2017, are as follows (in thousands):

| Fiscal Year Ending June 30, | Principal | Interest |
|---|---|---|
| 2018 | $ 1,352 | 819 |
| 2019 | 1,420 | 750 |
| 2020 | 1,460 | 678 |
| 2021 | 1,500 | 605 |
| 2022 | 1,576 | 529 |
| 2023 - 2027 | 8,242 | 1357 |
| 2028 - 2032 | 839 | 171 |
| 2033 - 2037 | 274 | 17 |
| 2038 - 2042 | - | - |
| 2043 - 2047 | - | - |
| Total | $ 16,663 | $ 4,926 |

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

General Fund and all Special Revenue Funds where employee salaries charged will be used to liquidate the liability for compensated absences and net OPEB obligations.

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

| | July 1, 2016 | Additional Obligations and Net Increases | Current Maturities, Retirements, and Net Decreases | June 30, 2017 | Amounts Due Within One Year |
|---|---|---|---|---|---|
| **Business-Type Activities:** | | | | | |
| Norman Y. Mineta San Jose International Airport: | | | | | |
| Revenue bonds | $ 1,313,480 | $ 624,270 | $ (708,205) | $ 1,229,545 | $ 41,900 |
| Issuance premiums/discounts: | | | | | |
| For issuance premiums | 21,739 | 66,558 | (947) | 87,350 | 2,518 |
| For issuance discounts | (9,640) | - | 3,077 | (6,563) | (74) |
| Clean Water Financing Authority: | | | | | |
| Revenue bonds | 26,550 | - | (5,855) | 20,695 | 5,145 |
| Issuance premiums/discounts: | | | | | |
| For issuance premiums | 588 | - | (167) | 421 | 125 |
| State of California - Revolving Fund Loan | 10,399 | - | (4,274) | 6,125 | 4,353 |
| Accrued vacation, sick leave and compensatory time | 7,154 | 6,753 | (6,670) | 7,237 | 5,848 |
| Estimated liability for self-insurance | 6,963 | 1,066 | (1,037) | 6,992 | 1,329 |
| Net other postemployment benefits (OPEB) obligation | 42,926 | - | (642) | 42,284 | - |
| Business-type long-term obligations | $ 1,420,159 | $ 698,647 | $ (724,720) | $ 1,394,086 | $ 61,144 |

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

The net revenues available to pay debt service in fiscal year ended June 30, 2017 totaled $156,577,000, which is composed of $78,701,000 of net general airport revenues and $77,876,000 of other available funds. Other available funds include surplus carryover of $37,279,000, rolling debt service coverage of $18,277,000, CFC revenues of $18,026,000, and unspent Series 2007B bond proceeds of $4,295,000. The bond debt service paid from the general airport revenues and other available funds amounted to $70,871,000, which is net of $24,789,000 of bond debt service paid from the accumulated passenger facility charges ("PFC") funds.

The City has covenanted in the Master Trust Agreement that net revenues available to pay debt service for each fiscal year plus certain other available funds held or made available under the Master Trust Agreement will be at least 125% of annual debt service for such fiscal year. Under the Master Trust Agreement, "debt service" means for any specified period the sum of (a) the interest falling due on any then outstanding current interest bonds, assuming that all principal installments are paid when due, but excluding any interest funded from the proceeds of any series of bonds and applied toward payment of interest on such bonds, and (b) the principal installments payable on any then outstanding bonds. Under the Master Trust Agreement, annual debt service excludes Available PFC Revenues for such fiscal year. Total principal and interest remaining on the bonds is $2,331,351,000, with the final payment due on March 1, 2047.

As of June 30, 2017, the Reserve Requirement in the General Account of the Bond Reserve Fund is satisfied, in part, by approximately $4,300,000 surety bond from Ambac Indemnity Corporation (currently known as Ambac Assurance Corporation, the principal operating subsidy of Ambac Financial Group Inc., “Ambac”) expiring on March 1, 2018. After expiration of the Ambac surety bond, it is expected that the Reserve Requirement will be met as satisfied in the General Account of the Bond Reserve Fund due to a decrease in the maximum annual debt service as a result of the issuance of the Series 2017A and 2017B Bonds unless the General Account is drawn upon to pay principal or interest on the Airport Revenue Bonds secured by the General Account or is made available to pay to any additional bonds in accordance with the terms of the Master Trust Agreement. The Required Reserve in the General Account of the Bond Reserve Fund secures the Series 2011A-1, 2011A-2, 2012A, 2014A, 2014B, 2014C, 2017A, and 2017B Bonds. According to the Master Trust Agreement, in the event that the Ambac surety bond for any reason terminates 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 (as defined in the Master Trust Agreement) under the Master Trust Agreement, or depositing cash to the General Account in up to twelve equal monthly installments.

Ambac's rating was reduced or withdrawn subsequent to the deposit of the surety bond into the General Account. The Master Trust Agreement does not require that the rating of any surety bond held in the General Account be maintained after the date of deposit.

**San José-Santa Clara Clean Water Financing Authority Sewer Revenue Bonds** are issued primarily to finance the construction of capital improvements at the Plant and the City has pledged its net system revenues as security for its obligations under the Improvement Agreement to make base payments and additional payments with respect to the Clean Water Financing Authority sewer revenue bonds. The net system revenues available to pay debt service in the fiscal year ended June 30, 2017 totaled approximately $65,139,000. Bond debt service, plus debt service on the State Revolving Fund Loans (subordinate to the outstanding Clean Water Financing Authority sewer revenue bonds), payable from net system revenues in the fiscal year totaled approximately $11,252,000. The City has covenanted in the Improvement Agreement that net system revenues will be at least 115% of its allocable percentage of annual debt service on the outstanding parity obligations under the Improvement Agreement. The City’s allocable percentage of annual debt service is currently 100%. Total principal and interest remaining on (1) the bonds as of June 30, 2017 is approximately $22,458,000, with the final payment due on November 15, 2020 and (2) the loans as of June 30, 2017 is approximately $6,268,000 with the final payment due on May 1, 2019.

### *9. Annual Requirements to Maturity*

The annual requirements to amortize all bonds and loans outstanding as of June 30, 2017 are as follows (dollars in thousands):

| | Governmental Activities | | | | | |
|---|---|---|---|---|---|---|
| | City of San Jose General Obligation Bonds and HUD [1] | | City of San Jose Financing Authority Bonds [1,2,3] | | Special Assessment & Tax Bonds with Limited Governmental Commitment | |
| Fiscal Year Ending June 30, | Principal | Interest | Principal | Interest | Principal | Interest |
| 2018 | $ 19,899 | $ 16,966 | $ 31,875 | $ 27,136 | $ 5,305 | $ 8,204 |
| 2019 | 19,899 | 16,082 | 35,610 | 25,804 | 5,580 | 7,918 |
| 2020 | 19,899 | 15,176 | 36,180 | 24,311 | 5,885 | 7,613 |
| 2021 | 19,660 | 14,260 | 38,025 | 22,763 | 6,205 | 7,287 |
| 2022 | 19,660 | 13,333 | 39,795 | 21,251 | 6,550 | 6,936 |
| 2023 - 2027 | 98,290 | 52,531 | 145,710 | 86,069 | 24,370 | 29,848 |
| 2028 - 2032 | 98,255 | 28,526 | 112,945 | 60,925 | 22,205 | 23,752 |
| 2033 - 2037 | 61,485 | 7,827 | 124,900 | 34,320 | 25,850 | 16,180 |
| 2038 - 2042 | 6,100 | 243 | 62,355 | 5,698 | 34,120 | 6,932 |
| Total | $ 363,147 | $ 164,945 | $ 627,395 | $ 308,276 | $ 136,070 | $ 114,670 |

| | Business-Type Activities | | | |
|---|---|---|---|---|
| | Airport Revenue Bonds [3] | | Wastewater Treatment System Revenue Bonds and Loans | |
| June 30, | Principal | Interest | Principal | Interest |
| 2018 | $ 41,900 | $ 61,866 | $ 9,498 | $ 847 |
| 2019 | 28,915 | 63,586 | 6,737 | 591 |
| 2020 | 31,040 | 62,218 | 5,175 | 352 |
| 2021 | 33,205 | 60,702 | 5,410 | 116 |
| 2022 | 34,975 | 59,035 | - | - |
| 2023 - 2027 | 136,885 | 272,934 | - | - |
| 2028 - 2032 | 206,225 | 230,893 | - | - |
| 2033 - 2037 | 243,305 | 164,589 | - | - |
| 2038 - 2042 | 262,500 | 93,368 | - | - |
| 2043 - 2047 | 210,595 | 32,616 | - | - |
| Total | $1,229,545 | $ 1,101,806 | $ 26,820 | $ 1,906 |

*[1] Projected interest payments for variable rate debt are based on the following rates in effect on June 30, 2017:*
*- HUD Loan (1.40178%)*
*- Financing Authority Lease Revenue Bonds: Series 2008C (1.300%), Series 2008D (1.581%), Series 2008E (1.581%), and Series 2008F (1.6255%)*

*[2] Includes fixed spread/fee in addition to index rate in effect on June 30, 2017. Does not include projection of future spreads/fees or expenses.*

*[3] Does not include commercial paper notes.*

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

### *10. Ambac Surety Bonds Held in Bond Reserve Funds*

Ambac issued a reserve fund surety bond that is on deposit in the Airport General Account of the Bond Reserve Fund, securing the Series 2011A-1, Series 2011A-2, Series 2012A, Series 2014A/B/C, and Series 2017A/B Airport Revenue Bonds. See discussion in Note III.F.8.

Ambac 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$^{th}$ and San Fernando Parking Facility) (the "CSJFA Series 2001A Bonds"). According to the Indenture of Trust for the CSJFA Series 2001A Bonds, prior to the expiration of the surety bond, the Financing Authority is to (1) replace the surety bond with a new Qualified Reserve Account Credit Instrument (as defined in the Indenture of Trust) or (2) deposit or cause to be deposited with the trustee an amount of moneys equal to the Reserve Requirement (as defined in the Indenture of Trust), to be derived from Revenues (as defined in the Indenture of Trust). In the event that the Financing Authority fails to do either of the above, then the trustee is to draw on the surety bond before such expiration to provide moneys to fund the reserve in the amount of the Reserve Requirement.

Ambac also has issued reserve fund surety bonds securing the Agency's Senior Tax Allocation Bonds Series 1999, Series 2005B, and Series 2006D. For further information see Note IV.C.3.

On May 1, 2013, Ambac emerged from bankruptcy protection which had been filed under Chapter 11 of the Bankruptcy Code. Starting in March 2010, certain of the policy liabilities of Ambac were allocated to a segregated account which has been subject to a plan of rehabilitation. Policy obligations not allocated to such segregated account, including the obligations in respect of the surety bonds provided by Ambac on deposit in the bond reserve funds described above, are not subject to, and therefore will not be impacted by such rehabilitation proceeding. No assurance can be made regarding the claims paying ability of Ambac on the surety bonds described above.

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

**<u>Governmental Activities</u>**

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

The City's Commercial Paper ("CP") Program utilizes a lease revenue financing structure. Under this program, the Financing Authority is able to issue commercial paper notes ("CP Notes") at prevailing interest rates for periods of maturity not to exceed 270 days. The CP Notes are secured by a pledge of lease revenues from various City assets and additionally supported by two direct-pay letters of credit ("LOCs") provided by State Street Bank and Trust Company ("State Street") and U.S. Bank National Association ("U.S. Bank") (together, the "Banks"). Letter of Credit and Reimbursement Agreements by and among the Financing Authority, the City and each Bank expire on November 30, 2018 (the "Letter of Credit Expiration Date").

This program was initially established on January 13, 2004, whereby the City Council and the Financing Authority each adopted a resolution authorizing the issuance of the Financing Authority tax-exempt lease revenue commercial paper notes in an amount not to exceed $98,000,000. Since 2004, the City Council and the Financing Authority have taken actions to modify the program, including increasing the program's capacity and authorizing the issuance of taxable lease revenue commercial paper notes. On February 12, 2013, the City Council and the Financing Authority approved a reduction of the capacity of the lease revenue commercial paper program from $116,000,000 to $85,000,000, with each Bank's LOC providing $42,500,000 in capacity.

The Financing Authority issues the CP Notes under State law pursuant to an Amended and Restated Trust Agreement between the Financing Authority and Wells Fargo Bank, National Association (as amended and supplemented, the "Trust Agreement") and an Amended and Restated Issuing and Paying Agent Agreement between the Financing Authority and Wells Fargo Bank, National Association. Barclays Capital Inc. currently serves as the dealer for the CP Notes pursuant to an Amended and Restated Commercial Paper Dealer Agreement. The City has leased to the Financing Authority various City-owned facilities pursuant to a Site Lease, as amended (the "Site Lease"). The Financing Authority subleased these same facilities back to the City pursuant to a Sublease, as amended (the "Sublease") in exchange for the rental payments, which support repayment of the CP Notes. The facilities subject to the Site and Sublease (pursuant to the Fifth Amendments to the Site Lease and to the Sublease, both dated as of November 1, 2015, are: the Animal Care Center, Fire Station No. 1, Fire Station No. 3, the Police Communications Center, the South San José Police Substation, and the Tech Museum (the "Pledged Properties").

The annual commitment fee payable to each Bank equals 0.52% per annum of the daily average Stated Amount of the Letter of Credit; provided, however, that in the event that the long-term unenhanced lease revenue debt ratings of the City are downgraded as specified in the agreements with the Banks, the annual commitment fee shall increase from a range of 0.62% to a maximum of 2.37%, depending on the level of rating downgrade.

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

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

As of June 30, 2017, $9,809,000 of tax-exempt commercial paper notes was outstanding at an interest rate of 0.90% and $12,493,000 of taxable commercial paper notes was outstanding at an interest rate of 1.25%. The changes in commercial paper notes during the fiscal year ended June 30, 2017 are as follows (dollars in thousands):

| July 1, 2016 | Deletions | June 30, 2017 |
|---|---|---|
| $37,517 | $15,215 | $22,302 |

**2016 Tax and Revenue Anticipation Note**

The City issued a short-term note (the "2016 Note") to facilitate the prefunding of employer retirement contributions in fiscal 2017. The $100,000,000 note was purchased by Bank of America, N.A. on July 1, 2016 at a variable interest rate. Security for repayment of the 2016 Note was a pledge of the City's 2016-2017 secured property tax plus all other legally available General Fund revenues available to the City, if required. The City fully repaid the 2016 Note on April 9, 2017.

**Business-Type Activities**

**Airport Revenue Refunding Bonds**

On April 11, 2017, the City issued $624,270,000 of City of San José, California Airport Revenue Refunding Bonds, Series 2017A (AMT) and Series 2017B (non-AMT) to (1) refund outstanding fixed-rate Airport Revenue Bonds Series 2007A (AMT) and Series 2007B (non-AMT) (2) make a deposit into the General Account of the Bond Reserve Fund and (3) pay costs of issuance. The Series 2017A and 2017B Bonds refunded all but one maturity of the Series 2007A and all of the outstanding Series 2007B (collectively, the "Refunded Bonds"). This transaction was a restructuring to eliminate the debt service "spike" that occurred from 2033-2037, creating level debt service from 2035-2037. Even with the restructuring, significant savings were achieved with $83,232,000 in present value savings (12.17% of the refunded bonds). The City completed the refunding to reduce the total debt service payments over the next 30 years by $27,524,000 (prior debt service of $1,266,431,000 and the refunding debt service of $1,238,907,000). The Series 2017A/B Bonds are limited obligations of the City payable solely from and secured by a pledge of General Airport Revenues generated by the Airport, certain funds and accounts held by the Trustee or made available under the Master Trust Agreement, after the payment of Maintenance and Operation Costs.

The Series 2017A Bonds were issued in a principal amount of $473,595,000 with fixed coupon interest rates ranging from 4% to 5% and have a final maturity date of March 1, 2047. The Series 2017B Bonds were issued in a principal amount of $150,675,000 and have fixed coupon rates between 2% and 5%, with a final maturity on March 1, 2047. The Series 2017A Bonds maturity in 2042 were issued with a bond insurance policy from Build America Mutual (the "Insured Bonds"). The bond insurance policy was purchased at a cost of 0.15% of the total principal and interest payments of the insured bonds through the optional redemption date in 2027, equal to $83,000. If the Insured Bonds are not called for redemption in 2027, a premium of 0.05% of the principal and interest will be payable annually thereafter while the Insured Bonds are outstanding.

**Airport Commercial Paper Notes Payable**

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

In February 2014, the City entered into a letter of credit ("LOC") and reimbursement agreement (the Reimbursement Agreement) with Barclays Bank PLC ("Barclays"). Pursuant to the Reimbursement Agreement, Barclays issued a $65,000,000 LOC supporting the Subordinated Commercial Paper Notes, effective on February 11, 2014. On September 16, 2015, the City reduced the LOC stated amount from $65,000,000 to approximately $41,000,000. The LOC provided by Barclays has been extended to February 9, 2018, and can be extended or terminated earlier pursuant to its terms.

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

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

In connection with the LOC issued by Barclays, the City entered into a separate fee letter to specify the facility fee rate and other charges payable by the Airport. The facility fee rate under the fee letter was established based on the underlying credit rating of the Airport Revenue Bonds and is applied to the stated amount of the LOC. The facility fee rate is subject to increase in the event that the underlying credit rating of the Airport Revenue Bonds is withdrawn, suspended, or downgraded or upon an event of default under the Reimbursement Agreement. The facility fee rate in effect is 0.425% as of June 30, 2017.

The change in Airport commercial paper notes payable during fiscal year 2017 was as follows (dollars in thousands):

| July 1, 2016 | Deletions | June 30, 2017 | Interest Rate |
|---|---|---|---|
| $34,672 | $9,211 | $25,461 | 0.92% - 1.45% |

### *12. Landfill Postclosure Costs*

The City has five closed landfills for which postclosure and monitoring services may be required for approximately a 30 year period, which began in fiscal year 1996, coinciding with the closure of the last landfill. An estimated liability of $5,115,000 related to the closed landfills is recorded in the government-wide Statement of Net Position as of June 30, 2017. The City's Environmental Compliance Officer performs an annual evaluation of the aforementioned liability. Actual costs may be higher due to inflation, changes in technology, or changes in regulations. The City does not own or operate any open landfills at this time.

### *13. Estimated Liability for Self-Insurance*

The City is exposed to various risks of losses related to torts, errors and omissions, general liability, injuries to employees, unemployment claims, and employee health and dental insurance. During fiscal year 2016, the City maintained an all-risk property policy including boiler and machinery exposures, coverage for loss due to business interruption and flood. The City did not carry earthquake insurance as it was not available at reasonable rates. A summary of insurable coverage for the policy period October 1, 2016 to October 1, 2017 is provided below:

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

For the policy period of October 1, 2016 to October 1, 2017, the City maintained an airport liability policy covering the Airport, including operation of vehicles on premises, which provides a $200,000,000 combined single limit for bodily injury and property damage subject to a deductible of $0 each occurrence and annual aggregate, with a sublimit of $50,000,000 each occurrence and in the annual aggregate for personal injury, and a sublimit of $100,000,000 each occurrence and in the annual aggregate for war liability. A separate automobile policy provided coverage for the off-premise operations of scheduled Airport vehicles including shuttle bus fleets with a limit of $1,000,000 per occurrence, combined single limit for bodily injury and property damage, and no deductible. Physical damage coverage was available for the Airport Shuttle Bus Fleet and is subject to a $10,000 comprehensive and $25,000 collision deductible. As part of general support services, the City charges the Airport for the cost of liability and property insurance coverage. Settled claims have not exceeded the City's commercial insurance coverage in any of the past three years.

For the policy period of December 18, 2016 to October 1, 2017, the City purchased government fidelity/crime coverage for City losses arising from employee bad acts. Coverage is for financial or property losses and provides a $5,000,000 per occurrence limit for losses resulting from employee theft, forgery or alteration and inside the premises- theft of money and securities, and provides for a $1,000,000 per occurrence limit for computer fraud, funds transfer fraud, money orders, and counterfeit money. All claims have a $100,000 deductible per occurrence.

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

With respect to the general liability accrual, the City has numerous unsettled lawsuits filed or claims asserted against it as of June 30, 2017. The City Attorney and, with respect to workers' compensation claims, the City's Department of Human Resources have reviewed these claims and lawsuits in order to evaluate the likelihood of an unfavorable outcome to the City and to arrive at an estimate of the amount or range of potential loss to the City. The City has included a provision for losses in its claims liability for loss contingencies that are both probable and can be reasonably estimated.

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

| | | |
|---|---|---|
| Liability as of June 30, 2015 | $ | 154,028 |
| Claims and changes in estimates during 2016 | | 15,271 |
| Claims payments | | (19,865) |
| Liability as of June 30, 2016 | | 149,434 |
| Claims and changes in estimates during 2017 | | 23,898 |
| Claims payments and other adjustments | | (21,564) |
| Liability as of June 30, 2017 | $ | 151,768 |

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

The City was also required to establish a claims loss reserve for the North Concourse Project in the aggregate amount of $3,900,000 available in a cash working fund. The full amount of the claims loss reserve had been deposited with the insurance carrier and was recorded as advances and deposits in the accompanying Airport enterprise fund statement of net position. The claims loss reserve funds are available to Chartis to pay claims within the City's deductible of up to $250,000 per occurrence to an aggregate maximum loss exposure within coverage limits to the City of $3,900,000. The City was able to negotiate the return of a large portion of the unused claims reserve in advance of the 10-year coverage term. Since March 2010, Chartis has returned $2,627,000 to the Airport. The balance of the North Concourse reserve fund as of June 30, 2017 is $827,000.

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

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

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

The liability under the TAIP OCIP is based upon an estimated payroll of $92,500,000 for the covered projects and a construction period of 45 months, commencing on March 15, 2007 through December 31, 2010. The terms of the TAIP OCIP require the City to fund a claims loss reserve fund with Chartis in the amount of $8,900,000. The claims loss reserve fund is available to Chartis to pay claims within the City's deductible subject to an aggregate maximum loss exposure within coverage limits to the City of $8,900,000. The City was able to negotiate to fund 74% of the claims loss reserve and interest generated remains in the fund. The full amount of $6,500,000 was deposited with Chartis in fiscal year 2009 and was recorded as advances and deposits in the accompanying Airport enterprise fund statement of net position. Since August 2013, as part of the annual loss reserve analysis by Chartis, a total amount of $1,636,000 has been returned to the Airport. The balance of the TAIP reserve fund as of June 30, 2017 is $1,966,000.

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

On June 30, 2017, the City bound certain liability insurance coverage for the major components of the San José-Santa Clara Regional Wastewater Facility Capital Improvement Program through an owner-controlled insurance program ("RWF OCIP") with the primary carrier Old Republic General Insurance Corporation ("Old Republic"). The RWF OCIP is a single insurance program that the City sponsors and provides commercial general liability, excess liability and worker's compensation insurance coverage for construction jobsite risks of the project owner, general contractors and all subcontractors associated with construction at the designated project site. In addition, the City procured builder's risk, contractor's pollution liability, and owners protective indemnity insurance to cover liabilities associated with the work.

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

| Coverages | RWF Capital 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 | $100 million | None |

The premiums of the RWF OCIP are calculated based on the estimated payroll of construction valued at $535,000,000 for the covered capital improvement projects to be enrolled over the next sixty-eight months and for work to be performed up to December 31, 2022.

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

The City implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The City did not have a net OPEB obligation at transition, July 1, 2007. The PFDRP and FCERS calculated a net OPEB obligation in accordance with GASB 45 as discussed in Note IV.A.4. At June 30, 2017, the City recorded net OPEB obligations totaling $478,464,000 in the government-wide financial statements, of which $436,180,000 is in governmental activities and $42,284,000 is in business-type activities.

### *15. Pollution Remediation Obligations*

The City is currently responsible for the management and cleanup of pollution remediation activities at several City sites including three active leaking petroleum storage tank sites: Fire Station #5, Las Plumas Warehouse, Family Shelter. Although the City has significant experience in estimating these types of cleanups, the calculation of the expected outlays related to this pollution remediation is based on estimates provided by both City engineers and consultants hired by the City. The amount of the estimated pollution remediation liability assumes that there will be no major increases in the cost of providing these cleanup services. As of June 30, 2017, the government-wide statement of net position reported a net pollution remediation obligation in the amount of $348,000 in governmental activities.

### *16. New Market Tax Credit ("NMTC") Financing Obligation*

In connection with the City's NMTC financing transaction to construct the San José Environmental Innovation Center ("EIC"), the City has a long-term lease obligation for its possession and beneficial use of the EIC facility. This master lease agreement commenced on November 8, 2011 has a 35-year term with a one-time renewal option of 10 years. Rental payment made by the City for the use of the EIC facility for the year ended June 30, 2017 was $428,000.

The future minimum lease payments anticipated under the master lease agreement, as of June 30, 2017, are as follows (in thousands):

| Fiscal Year Ending June 30, | | Amount |
|---|---|---|
| 2018 | $ | 438 |
| 2019 | | 449 |
| 2020 | | 461 |
| 2021 | | 472 |
| 2022 | | 484 |
| 2023 - 2027 | | 2,609 |
| 2028 - 2032 | | 2,955 |
| 2033 - 2037 | | 3,345 |
| 2038 - 2042 | | 3,785 |
| 2043 - 2047 | | 3,835 |
| Total | $ | 18,832 |

**G. Interfund Transactions**

The composition of interfund balances as of June 30, 2017, with explanations of transactions, is as follows (dollars in thousands):

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

| Receivable Fund | Payable Fund | | Amount | |
|---|---|---|---|---|
| General Fund | Nonmajor Governmental Funds | $ | 1,823 | (1) |
| Nonmajor Governmental Funds | Nonmajor Governmental Funds | | 1,872 | (2) |
| | | $ | 3,695 | |

*(1) $1,389 represents accrual of gas tax transfers and $434 represents accrual of construction and conveyance tax transfer.*

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

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

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

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

### *3. Long-term Receivables from SARA*

On July 24, 2009, the State Legislature passed AB 26X4, which required redevelopment agencies statewide to deposit a total of $2,050,000,000 of property tax increment in county Supplemental Educational Revenue Augmentation Funds ("SERAF") to be distributed to meet the State's Proposition 98 obligations to schools. The Agency's SERAF obligation was $62,200,000 in fiscal year 2009-2010 ("2010 SERAF Obligation") and $12,800,000 in fiscal year 2010-2011 ("2011 SERAF Obligation"). Payments were made by May 10 of each respective fiscal year.

On May 4, 2010, the Agency and the City entered into a loan agreement where the City agreed to loan the Agency through two separate payments (May 2010 and May 2011) a combined amount of $74,816,000 to pay the 2010 SERAF Obligation and the 2011 SERAF Obligation ("SERAF Loan"). The sources of the SERAF Loan to pay the 2010 SERAF Obligation ($62,000,000) were $40 million from the City's Low and Moderate Income Housing Fund that had been made available following the issuance of the 2010 Housing Series C Bonds, which was specifically authorized by the legislation, and idle moneys from City special funds ($10,000,000) and $12,000,000 from the Financing Authority's Commercial Paper Program. The source of the SERAF Loan to pay the 2011 SERAF Obligation was $12,816,000 from the City's Low and Moderate Income Housing Fund. The Low and Moderate Income Housing Fund was subsequently renamed as the Low and Moderate Income Housing Asset Fund.

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

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

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

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

As of June 30, 2017, this portion of the SERAF Loan has an outstanding principal and accumulated accrued interest balance of $22,816,000 and $4,502,000, respectively bears a simple interest rate of 3%.

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

As of June 30, 2017, total long-term receivables from SARA are as follows (dollars in thousands):

| **Description** | | | | |
|---|---|---|---|---|
| Advances receivable from SARA: | | | | |
| SERAF Loan | $ | 27,318 | (1) | |
| Housing obligations funded by commerical paper proceeds | | 4,727 | (2) | |
| Other long-term receivables from SARA: | | | | |
| Revenue bonds with pledge agreement | | 23,930 | (3) | |
| Lease revenue bonds with reimbursement agreement | | 78,680 | (4) | |
| Parking Fund Loans | | 14,335 | (5) | |
| Reimbursement advance | | 23,132 | (6) | * |
| Total long-term receivables from SARA | $ | 172,122 | | |

(1) *The amount includes $15,176,000 from Low and Moderate Income Housing Asset Fund and $12,142,000 from the General Fund.*

(2) *The Financing Authority has a receivable from SARA, which assumed the obligation from the Low and Moderate Income Housing Asset Fund, related to the commercial paper proceeds used for housing activities in the amount of $4,591,000 and accrued interest from the Financing Authority of $136,000.*

(3) *The Financing Authority has a long-term receivable related to the Series 2001A (4th and San Fernando Streets Parking Facility Project) pledge agreement.*

(4) *The Financing Authority has a long-term receivables related to the Series 2001F (Convention Center) reimbursement agreement.*

(5) *The Parking Fund Loans were reinstated in FY16-17, see Note IV.C.4.*

(6) *The long-term receivables relate to advances to SARA under the Reimbursement Agreement are as follows: $6,324,000 from the Parking System for the 2001A bond debt service payments and accrued interest; $9,949,000 from the General Fund for the 2001F bond debt service payments and accrued interest; $1,640,000 and $5,219,000 from the General Fund for ERAF payments and administrative costs for SARA, respectively.*

* *The amount includes $7,087,000 and $173,000 from the General Fund and the Low and Moderate Income Housing Asset Fund, respectively, for administrative and support service costs. An allowance for collectability was recorded for both amounts.*

### *4. Long-term Advances from SARA*

The City has a payable and SARA has a receivable related to an Agency advance of a portion of a loan made by the City's Housing Department to a third party for a transitional housing project. The SARA is entitled to 24.5% of the total loan repayment and therefore has a long-term receivable of $790,000 due from the City as of June 30, 2017.

### *5. Transfers in/Transfers out*

Transfers are indicative of funding for capital projects, lease payments or debt service and subsidies of various City operations. The following schedules summarize the City's transfer activity for the year ended June 30, 2017 with explanations of transactions (dollars in thousands):

**Between governmental and business-type activities:**

| Transfer from | Transfer to | Amount | |
|---|---|---|---|
| Housing Activities | Parking System | $ 31 | (1) |
| San José Financing Authority Debt Service | Municipal Water System | 1,200 | (2) |
| Norman Y. Mineta San José International Airport | General Fund | 34 | (3) |
| Wastewater Treatment System | General Fund | 109 | (4) |
| | Nonmajor Governmental Funds | 2,097 | (5) |
| Municipal Water System | General Fund | 561 | (6) |
| | San José Financing Authority Debt Service | 627 | (7) |
| | Nonmajor Governmental Funds | 139 | (8) |
| Parking System | General Fund | 848 | (9) |
| | Nonmajor Governmental Funds | 198 | (10) |
| | Internal Service Funds | 5 | (11) |
| | | $ 5,849 | |

*(1) Transfer for costs associated with availability of public usage facilities in San José downtown.*

*(2) Transfer for Water Meter Project.*

*(3) Transfer for payroll system upgrade costs.*

*(4) Transfer for administrative costs.*

*(5) Transfer for City Hall debt service payments.*

*(6) Transfer for late fee collections from water utility customers.*

*(7) Transfer for repayment for commercial paper.*

*(8) Transfer for City Hall debt service payments.*

*(9) Transfer of $140 for coordination and development of the Diridon Station Area Plan, $210 for San José Downtown Association, $1 for payroll system upgrade and $497 for SAP Meters.*

*(10) Transfer of $120 for City Hall debt service payments and $78 for the Downtown Property and Business Improvement District payments.*

*(11) Transfer for operating expenses.*

### Between governmental activities:

| Transfer from | Transfer to | Amount | |
|---|---|---|---|
| General Fund | San José Financing Authority Debt Service | $ 1,899 | (1) |
| | Nonmajor Governmental Funds | 28,084 | (2) |
| | Internal Service Funds | 1,002 | (3) |
| Housing Activities | General Fund | 1 | (4) |
| | Nonmajor Governmental Funds | 39 | (5) |
| Low & Moderate Income Housing Asset Fund | General Fund | 7 | (6) |
| | Nonmajor Governmental Funds | 460 | (7) |
| Special Assessment Districts | General Fund | 150 | (8) |
| | San José Financing Authority Debt Service | 3,743 | (9) |
| San José Financing Authority Debt Service | General Fund | 7,766 | (10) |
| | Special Assessment Districts | 16 | (11) |
| Integrated Waste Management | General Fund | 315 | (12) |
| | Nonmajor Governmental Funds | 778 | (13) |
| Nonmajor Governmental Funds | General Fund | 10,657 | (14) |
| | Nonmajor Governmental Funds | 16,461 | (15) |
| | San José Financing Authority Debt Service | 52,917 | (16) |
| Internal Service Funds | General Fund | 13 | (17) |
| | Nonmajor Governmental Funds | 170 | (18) |
| | | $ 124,478 | |

*(1) Transfer for debt service payment for the 2008F bond series*
*(2) Transfer of $19,052 for City Hall debt service, $9,032 for debt service payments, operations, and subsidies*
*(3) Transfer to fund vehicle and fleet replacement purchases*
*(4) Transfer for planning and administrative expenditures*
*(5) Transfer for production, improvement, or preservation of low- and moderate-income housing*
*(6) Transfer for planning and administrative expenditures*
*(7) Transfer for City Hall debt service payment*
*(8) Transfer for administrative expenses*
*(9) Transfer for interest, principal and fees for the Series 2011 Convention Center bonds payments*
*(10) Transfer for Energy Savings and Conservation Program*
*(11) Transfer for interest, principal, and fees for payments*
*(12) Transfer of $300 for uncollected & unrestricted construction deposits and $15 for payroll system upgrade*
*(13) Transfer for City Hall debt service payment*
*(14) Various transfer for operations, interest earnings, and capital projects*
*(15) Transfer of $2,327 for City Hall debt service payments and $14,134 for operations, capital projects, and project savings*
*(16) Transfer of $9,284 for fees reimbursement and $43,633 for debt service payments*
*(17) Transfer for City Hall debt service payment*
*(18) Transfer for interest, principal and fees for payments*

### H. Deferred Inflows of Resources

As of June 30, 2017, total deferred inflows of resources in the governmental funds related to the following unavailable resources (dollars in thousands):

| | | |
|---|---|---|
| General Fund SERAF loans receivable | $ | 12,142 |
| Housing Activities loans receivable | | 20,452 |
| Low and Moderate Income Housing Asset loans receivable | | 7,762 |
| Special Assessments receivables | | 34,320 |
| Community Development Block Grant (CDBG) loans receivable | | 1,984 |
| Total deferred inflows of resources | $ | 76,660 |

## I. Governmental Fund Balances

As of June 30, 2017, total fund balances for the City's major and nonmajor governmental funds are as follows (dollars in thousands):

| | General Fund | Housing Activities | Low & Moderate Income Housing Asset Fund | Special Assessment Districts | San José Financing Authority Debt Service | Integrated Waste Management | Nonmajor Governmental Funds | Total Governmental Funds |
|---|---|---|---|---|---|---|---|---|
| **Nonspendable:** | | | | | | | | |
| Advances & Deposits | $ 170 | $ - | $ - | $ 5 | $ - | $ - | $ 335 | $ 510 |
| Subtotal | 170 | - | - | 5 | - | - | 335 | 510 |
| **Restricted for:** | | | | | | | | |
| Affordable Housing | - | 127,660 | 352,332 | - | - | - | - | 479,992 |
| Animal Shelter Project | 51 | - | - | - | - | - | - | 51 |
| Capital Projects & Improvements | 331 | - | - | 39,728 | - | - | 235,642 | 275,701 |
| Emplyoment/ Training Services | - | - | - | - | - | - | 1,220 | 1,220 |
| Drug Abuse Prevention & Control | - | - | - | - | - | - | 4,095 | 4,095 |
| Community Development Services | 7 | - | - | - | - | - | 5,969 | 5,976 |
| Crime Prevention & Control | 301 | - | - | - | - | - | - | 301 |
| Library Services & Facilities | - | - | - | - | - | - | 11,078 | 11,078 |
| Small Business Loans | - | - | - | - | - | - | 7 | 7 |
| Parks, Recreation, & Neighborhood Development | - | - | - | - | - | - | 73,259 | 73,259 |
| Underground Utility Projects | - | - | - | - | - | - | 7,345 | 7,345 |
| Storm Drainage Projects | - | - | - | - | - | - | 39,910 | 39,910 |
| Supplemental Law Enforcement Services | - | - | - | - | - | - | 22 | 22 |
| Debt Service | - | - | - | - | 28,490 | - | 33,402 | 61,892 |
| Subtotal | 690 | 127,660 | 352,332 | 39,728 | 28,490 | - | 411,949 | 960,849 |
| **Committed to:** | | | | | | | | |
| Building Development Fee Program | 18,095 | - | - | - | - | - | - | 18,095 |
| Capital Projects and Improvements | 8,434 | - | - | - | - | - | 1,615 | 10,049 |
| Parks, Recreation, & Neighborhood Development | - | - | - | - | - | - | 1,869 | 1,869 |
| Developement Enhancement | - | - | - | - | - | - | 298 | 298 |
| Convention Center, Auditorium, Theaters | - | - | - | - | - | - | 15,579 | 15,579 |
| Employee Compensation Planning | 8,691 | - | - | - | - | - | - | 8,691 |
| Fire Development Fee Program | 8,222 | - | - | - | - | - | - | 8,222 |
| Development Fee Program Technology | 1,093 | - | - | - | - | - | - | 1,093 |
| Residential Program Administration | - | - | - | - | - | - | 2,074 | 2,074 |
| Government Functions/Services | 28,513 | - | - | - | - | - | - | 28,513 |
| Public Safety | 3,160 | - | - | - | - | - | - | 3,160 |
| Community Development Services | 8,157 | - | - | - | - | - | 8,455 | 16,612 |
| Fee Supported Programs- Public Works | 5,234 | - | - | - | - | - | - | 5,234 |
| Salaries & Benefits | 6,070 | - | - | - | - | - | - | 6,070 |
| Sanitation Projects | 357 | - | - | - | - | 29,429 | - | 29,786 |
| Subtotal | 96,026 | - | - | - | - | 29,429 | 29,890 | 155,345 |
| **Assigned to:** | | | | | | | | |
| Financing Authority Debt Service | 3,297 | - | - | - | - | - | - | 3,297 |
| SARA Debt Service | 28,715 | - | - | - | - | - | - | 28,715 |
| Developement Enhancement | - | - | - | - | - | - | 20 | 20 |
| Community & Culture Projects | - | - | - | - | - | - | 3,760 | 3,760 |
| Hayes Mansion Operations | - | - | - | - | - | - | 10,655 | 10,655 |
| Loans to Other Agencies | 1,582 | - | - | - | - | - | - | 1,582 |
| Capital Projects & Improvements | - | - | - | - | - | - | 68,149 | 68,149 |
| Government Functions/Services | 102,499 | - | - | - | - | - | - | 102,499 |
| Subtotal | 136,093 | - | - | - | - | - | 82,584 | 218,677 |
| **Unassigned** | 79,853 | - | - | - | - | - | - | 79,853 |
| **Total Fund Balance** | **$ 312,832** | **$ 127,660** | **$ 352,332** | **$ 39,733** | **$ 28,490** | **$ 29,429** | **$ 524,758** | **$ 1,415,234** |

**City Reserves Policy.** The City Council-approved Operating Budget and Capital Improvement Program Policy (Policy Number 1-18) incorporates direction on contingency funding, including general purpose reserves, the Cash Reserve Fund and the Emergency Reserve Fund. Within the

General Fund, general purpose reserves are to be set aside as a safety net for general city operations. Currently, the General Fund Contingency Reserve, the General Fund Budget Stabilization Reserve, and the General Fund Workers' Compensation/General Liability Catastrophic Reserve are available for general purposes. Each of these reserves is described below. With the exception of the General Fund Contingency Reserve Fund, use of these reserves requires a majority vote of the City Council..

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

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

The section of Council Policy 1-18 addressing contingency funds was amended in June 2013.

The ***General Fund Contingency Reserve Fund*** was created to meet unexpected circumstances arising from financial and/or public emergencies that require immediate funding that cannot be met by any other means. The policy established a minimum of three percent of the General Fund operating budget as the reserve balance. Any use of the General Fund Contingency Reserve shall require a two-third vote of approval by the City Council. As of June 30, 2017, the contingency amount accounts for $36,000,000 of the unassigned fund balance.

The ***General Fund Budget Stabilization Reserve*** may be maintained at a level as determined by the City Council to be adequate. The purpose of this reserve is to provide budget stability when there are fluctuations that result in lower than projected revenues and/or higher than projected expenditures that cannot be re-balanced within the existing budget resources in any given year. This reserve is intended to provide a buffer, or bridge funding, to protect against reducing service levels when these fluctuations occur. As of June 30, 2017, the budget stabilization reserve accounts for $16,300,000 of the unassigned fund balance.

The ***General Fund Workers' Compensation/General Liability Catastrophic Reserve*** may be may be maintained at a level as determined by the City Council to be adequate. The purpose of this reserve is to provide funding for potential workers' compensation or general liability claims that exceed the budgeted amounts as the City, for the most part, is self-insured. As of June 30, 2017, the workers' compensation and general liability catastrophic reserve accounts for $15,000,000 of the unassigned fund balance.

The ***Cash Reserve Fund*** was created for the payment of any authorized expenditures of the City for any fiscal year in anticipation of and before the collection of taxes and other revenues of the City for such fiscal year, and for the payment of authorized expenses of the City for any fiscal year, which became due and payable and must be paid prior to the receipt of tax payments and other revenues for such fiscal year. A reserve shall be built up in said fund from any available sources other than restricted sources in an amount which the Council deems sufficient for said purposes. As of June 30, 2017, the cash reserve amount accounts for $6,000 of the unassigned fund balance.

The ***Emergency Reserve Fund*** was created for the purpose of meeting any public emergency involving or threatening the lives, property or welfare of the people of the City or property of the City. A reserve shall be built up in said fund from any available sources, other than restricted sources, in an amount which the Council deems desirable. As of June 30, 2017, the emergency reserve amount accounts for $1,616,000 of the unassigned fund balance.

## IV. Other Information

### A. Defined Benefit Retirement Plans

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

#### *1. General Information about the Pension Plans*

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

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

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

**Benefits**

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

The contribution and benefit provisions and all other requirements are established by the City Charter and the City's Municipal Code. Amendments or changes to contribution requirement and benefits terms are approved by the City Council.

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

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

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

The Public Safety and Federated Frameworks (the "Frameworks") include, among other things, revised Tier 2 pension benefits that include increased pension benefits for Tier 2 employees while preserving the 50/50 cost sharing between the City and Tier 2 employees; closing the defined benefit retiree healthcare benefit to new employees, as well as agreement on a new lowest cost medical plan associated with retiree healthcare; and continuing the elimination of the Supplemental Retiree Benefit Reserve (SRBR). The Frameworks also included an agreement that a ballot measure would be placed on November 8, 2016, election for the voters to replace Measure B as described below. On November 8, 2016, the voters approved the Alternative Pension Reform Act known as Measure F. Measure F included, among other things, prohibiting any enhancements to defined retirement benefits without voter approval; codifying the Tier 2 pension benefit; closing the defined benefit retiree healthcare plan; and prohibiting retroactive defined retirement benefit enhancements.

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

In Fiscal Year 2016-2017, prior to June 18, 2017, FCERS had Tier 1, Tier 2, Tier 2B, and Tier 2C. Tier 2, Tier 2B and Tier 2C have the same reduced pension benefits as compared to Tier 1. Tier 2 has the same retiree healthcare (medical and dental) benefits as Tier 1. Tier 2B does not have retiree healthcare benefits; however, the City was responsible for the contributions that both the City and the Tier 2B members would have otherwise paid for retiree healthcare had those employees been eligible. Tier 2C has retiree dental benefits but no retiree medical benefits. Prior to June 18, 2017, the PFDRP had Tier 1 and Tier 2 for both police and fire members with reduced pension benefits for the Tier 2 police and fire members as compared to the Tier 1 members, and the same retiree healthcare (medical and dental benefits) as Tier 1.

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

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

| Tier | Hire Date | Pension | Retiree Healthcare | |
|---|---|---|---|---|
| | | | **Defined Benefit Retiree Healthcare (Medical/Dental)** | **VEBA[2]** |
| Tier 1 | ▪ On or before September 29, 2012<br>▪ Former Tier 1 who did not take a return of contributions | Tier 1 | Medical/Dental | Opt-In[3] |
| Tier 1A | ▪ Former Tier 1 rehired on or after September 30, 2012, through September 27, 2013[1]<br>▪ Former Tier 1 rehired after September 28, 2013, but before June 18, 2017 with 15+ years of City service[1] | Tier 1 | Medical/Dental | Opt-In[3] |
| Tier 1B | ▪ Former Tier 1 rehired after September 27, 2013, but before June 18, 2017 with less than 5 years of City service[1] | Tier 1 | Not eligible | Opt-In[3] |
| Tier 1 Classic | ▪ "Classic" membership with CalPERS/reciprocal agency hired on or after June 18, 2017 | Tier 1 | Not eligible | Mandatory[4][5] |
| Tier 1C | ▪ Former Tier 1 rehired before June 18, 2017 having between 5 and 15 years of City service[1] | Tier 1 | Dental only | Opt-In[3] |
| Tier 2 (or Tier 2A) | ▪ Hired on or after September 30, 2012, through September 26, 2013 | Tier 2 | Medical/Dental | Opt-In[3][5] |
| Tier 2B | ▪ Hired on and after September 27, 2013 and have not met City's eligibility for retiree healthcare | Tier 2 | Not eligible | Mandatory[4][5] |
| **Notes** | *(1) Employees in these Tiers are responsible for 50% of the amortization costs for having any prior years of service in Tier 2 changed to Tier 1.*<br>*(2) The City is in the process of implementing a defined contribution Voluntary Employees' Beneficiary Association (VEBA) for retiree healthcare, subject to approval by the IRS. Unrepresented employees may be eligible to opt in to the VEBA but will not be eligible to make ongoing contributions to the VEBA.*<br>*(3) Employees in these Tiers will be provided a one-time irrevocable election to remain in the defined benefit retiree healthcare (medical and dental) plan or opt in to the defined contribution VEBA.*<br>*(4) Employees in these Tiers will be mandatorily placed into the VEBA once it is implemented.*<br>*(5) There may be current Tier 2 employees who have "Classic" membership with CalPERS and these employees may be moved to Tier 1 subject to the identification of these employees and confirmation of "Classic" membership with CalPERS or another reciprocal agency. In addition, these employees may be eligible for the one-time irrevocable election to remain in the defined benefit retiree healthcare (medical and dental) plan or opt in to the defined contribution VEBA depending on whether they were Tier 2(2A) or Tier 2B.* | | | |

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

| | | | Retiree Healthcare | |
|---|---|---|---|---|
| **Tier** | **Hire Date** | **Pension** | **Defined Benefit Retiree Healthcare (Medical/Dental)** | **<u>VEBA</u>[2]** |
| Police Tier 1 | ▪ Before August 4, 2013, or rehired former Tier 1 who did not take a return of contributions[1]<br>▪ "Classic" membership with CalPERS/reciprocal agency hired on or after June 18, 2017[1] | Tier 1 | Medical/Dental | Opt-In[3] |
| Police Tier 1 Rehire | ▪ Rehired former Tier 1 who did not take a return of contribution rehired or reinstated on or after August 4, 2013 and June 18, 2017[1] | Tier 1 | Medical/Dental | Opt-In |
| Police Tier 1 Classic | ▪ "Classic" membership with CalPERS/reciprocal agency hired between August 4, 2013 and June 18, 2017[1] [4] | Tier 1 | Medical/Dental | Mandatory[4] |
| Fire Tier 1 | ▪ Before January 2, 2015 or<br>▪ Former Tier 1 who did not take a return of contributions[1]<br>▪ "Classic" membership with CalPERS/reciprocal agency hired on or after June 18, 2017[1] | Tier 1 | Medical/Dental | Opt-In |
| Fire Tier 1 Rehire | ▪ Rehired former Tier 1 who did not take a return of contribution rehired or reinstated on or after August 4, 2013 and June 18, 2017[1] | Tier 1 | Medical/Dental | Opt-In |
| Fire Tier 1 Classic | ▪ "Classic" membership with CalPERS/reciprocal agency hired between January 2, 2015 and June 18, 2017[1] | Tier 1 | Medical/Dental | Mandatory[4] |
| Police Tier 2 | ▪ On or after August 4, 2013 | Tier 2 | Medical/Dental | Mandatory[4] |
| Fire Tier 2 | ▪ On or after January 2, 2015 | Tier 2 | Medical/Dental | Mandatory[4] |
| **Notes** | [1] *Employees in these Tiers are responsible for 50% of the amortization costs for having any prior years of service in Tier 2 changed to Tier 1.*<br>[2] *The City is in the process of implementing a defined contribution <u>Voluntary Employees' Beneficiary Association (VEBA)</u> for retiree healthcare, subject to approval by the IRS. Unrepresented employees may be eligible to opt in to the VEBA but will not be eligible to make ongoing contributions to the VEBA.*<br>[3] *Employees in these Tiers will be provided a one-time irrevocable election to remain in the defined benefit retiree healthcare (medical and dental) plan or opt in to the defined contribution VEBA.*<br>[4] *Employees in these Tiers will be mandatorily placed into the VEBA once it is implemented.* | | | |

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

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

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

| | Police Tier 1 | Police Tier 2 |
|---|---|---|
| ***Disability Retirement (Service Connected)*** | | |
| Minimum Service | None | None |
| Allowance | <20 years of service: 50% of final compensation<br>Next 21-30 years of service: 4% per year of service X final compensation (90% max) | An individual who is granted a service connected disability retirement is entitled to a monthly allowance equal to the greater of:<br><br>50% of Final compensation<br><br>A service retirement allowance, if he or she qualified for such or<br><br>An actuarially reduced factor, as determined by the plan's actuary, for each quarter year that his or her service age is less than 50 years, multiplied by number of years of service subject to the applicable formula, if not qualified for a service retirement. |
| ***Disability Retirement (Non-Service Connected)*** | | |
| Minimum Service | 2 years of service | 5 years of service |
| Allowance | <20 years of service: 32% of final compensation plus 1% for each full year in excess of 2. (50% max)<br>>20 years of service: 2.5% x first 20 years of service x final compensation<br>Next 21-30 years of service: 4% per year of service X final compensation (90% max) | An individual who is granted a non service connected disability retirement is entitled to a monthly allowance equal to the greater of:<br><br>If less than age 50: 1.8% per year of service or<br><br>if older than age 50: The amount of service pension benefit as calculated based upon the service pension formula. |

| | Fire Tier 1 | Fire Tier 2 |
|---|---|---|
| ***Disability Retirement (Service Connected)*** | | |
| Minimum Service | None | None |
| Allowance | <20 years service: 50% of final compensation<br><br>Beginning of 21st year of service: 3% per year of service X final compensation (90% max) | An individual who is granted a service connected disability retirement is entitled to monthly allowance equal to the greater of :<br><br>50% of final compensation<br><br>A service retirement allowance, if he or she qualified for such or<br><br>An actuarially reduced factor, as determined by the plan's actuary, for each quarter year that his or her service age is less than 50 years, multiplied by the number of years of service subject to the applicable formula, if not qualified for a service retirement |
| ***Disability Retirement (Non-Service Connected)*** | | |
| Minimum Service | 2 years of service | 5 years of service |
| Allowance | <20 years of service: 32% of final compensation plus 1% for each full year in excess of 2 (50% max)<br><br>Beginning of 21st year of service: 3% per year of service X final compensation (90% max) | An individual who is granted a non service connected disability retirement is entitled to a monthly allowance equal to the greater of:<br><br>If less than age 50: 1.8% per year of service or<br><br>If older than age 50: the amount of service pension benefit as calculated based upon the service pension formula |

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

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

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

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

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

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

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

| | FCERS | | | | |
|---|---|---|---|---|---|
| | Tier 1 & 1A | Tier 1B | Tier 1C (2) | Tier 2 (3) | Tier 2B (1) |
| *Pension* | | | | | |
| Service Required to Leave Contributions in System | 5 years | | | 5 years Federated City Service<br>Years of Service (Year of Service = 2080 hours worked in the applicable 12 month period | |
| **Service Retirement:** | | | | | |
| Age/Years of Service | 55 with 5 years' service<br>30 years' service at any age | | | 62 years with 5 years Federated City Service<br>May retire on or after 55 years with 5 years Federated City Service. A reduction factor of 5.0% per year for each year between age fifty five (55) and the Tier 2 member's age at retirement before age 62, prorated to the closest month. | |
| Deferred Vested | 55 with 5 years service<br>(This applies to members who separate from City service before retirement and leave their contributions in the retirement system.) | | | May commence on or after 55 years with 5 years Federated City Service with actuarial equivalent reduction<br><br>(This applies to members who separate from City service before retirement and leave their contributions in the retirement system.) Can begin at age 55 with reduction factor of 5.0% per year for each year between age fifty five and the Tier 2 member's age at retirement before age 62, prorated to the closest month. | |
| Allowance | 2.5% x Years of Service x Final Compensation (75.0% max)<br><br>If separation takes place prior to July 1, 2001, Final Compensation is highest average monthly salary during 36 consecutive months<br><br>If separation takes place on or after July 1, 2001, Final Compensation is highest average monthly salary during 12 consecutive months | | | 2.0% x Years of Federated City Service x Final Compensation (70.0% max)<br><br>"Final Compensation" is the average monthly (or biweekly) base pay for the highest 3 consecutive Years of Federated City Service Excludes premium pay or any other forms of additional compensation | |
| Final Compensation | Highest one-year average | | | Highest three-year average | |
| ***Disability Retirement (Service Connected)*** | | | | | |
| Minimum Service | None | | | None | |
| Allowance | 40.0% of Final Compensation plus 2.5% x Years of Service in excess of 16 years x Final Compensation (Maximum 75.0% of Final Compensation) | | | 2.0% x Years of Federated City Service x Final Compensation.<br>(Minimum of 40.0% and maximum of 70.0% of Final Compensation) | |

| | FCERS | | | | |
|---|---|---|---|---|---|
| | Tier 1 & 1A | Tier 1B | Tier 1C [2] | Tier 2 [3] | Tier 2B [1] |
| ***Disability Retirement (Non-Service Connected)*** | | | | | |
| Minimum Service | 5 years | | | 5 Years Federated City Service | |
| Allowance | 40.0% of Final Compensation plus 2.5% x Years of Service in excess of 16 years x Final Compensation (Maximum 75.0% of Final Compensation)<br>If under 55 years old, subtract 0.5% for every year under age 55.<br><br>For those entering the System 9/1/98 or later, the calculation is as follows: 20.0% of Final Compensation for up to 6 years of service. Add 2.0% for each year of service in excess of 6 years but less than 16 years.<br>Add 2.5% for each year of service in excess of 16 years of service. (Maximum 75.0% of Final Compensation) | | | 2.0% x Years of Federated City Service x Final Compensation.<br><br>(Minimum of 20.0% and maximum of 70.0% of Final Compensation) | |
| ***Reciprocity*** | | | | | |
| Reciprocity | As of December 9, 1994, the City of San José Federated City Employees' Retirement System adopted a reciprocal agreement with CalPERS. This may result in improved benefits for members who transfer between this retirement system and CalPERS or certain other public agency retirement systems that also have reciprocal agreements with CalPERS. Please call the Retirement Department or CalPERS for more information. | | | | |
| ***Cost of Living Adjustments*** | | | | | |
| Cost of Living Adjustments | Retirees are eligible for a 3.0% annual cost of living adjustment (COLA). Regular COLA's are compounded and paid each April. There is no prorating of COLA. | | | Retirees are eligible for annual cost of living adjustment (COLA) limited to the lesser of the increase in the Consumer Price Index (San Jose-San Francisco-Oakland, U.S. Bureau of Labor Statistics index, CPIU, December to December), or a back loaded 2.0% COLA per fiscal year. The back loaded COLA shall be calculated as follows:<br><br>i. Service at retirement of 1-10 years: 1.25% per year<br>ii. Service at retirement of 1-10 years and hired before June 16, 2017: 1.5%<br>iii. Service at retirement of 11-20 years: 1.5% per year<br>iv. Service at retirement of 21-25 years: 1.75% per year<br>v. Service at retirement of 26 years and above: 2.0% per year<br>The first COLA will be prorated based on the number of months retired. | |

*(1) Employees hired on and after September 27, 2013. Members who have not met the City's eligibility for either retiree healthcare prior to September 27, 2013, will NOT be eligible for retiree healthcare benefits. Spouses, domestic partners and dependents will also be ineligible for retiree healthcare benefits. Employees in this Tier will be mandatorily placed into the VEBA once it is implemented.*

*(2) Employees rehired before June 18, 2017 having between 5 and 15 years of City service. Employees in this Tier will be provided a one-time irrevocable election to remain in the defined benefit retiree healthcare (medical and dental) plan or opt-in to the defined contribution VEBA. At age 65, members of the FCERS who remain in the defined benefit plan will be required to enroll in Medicare Parts A & B. If a member does not meet this requirement within 6 months of the date member turns 65, health care benefits will cease until such requirements are met.*

*(3) Employees hired on or after September 30, 2012, through September 26, 2013. Employees in this Tier will be provided a one-time irrevocable election to remain in the defined benefit retiree healthcare (medical and dental) plan or opt-in to the defined contribution VEBA. At age 65, members of the FCERS who remain in the defined benefit retiree healthcare plan will be required to enroll in Medicare Parts A & B. If a member does not meet this requirement within 6 months of the date member turns 65, health care benefits will cease until such requirements are met.*

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

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

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

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

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

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

**Employees Covered -** The current membership in the Defined Benefit Pension Plans as of June 30, 2017, is as follows:

| FCERS | Tier 1 | Tier 2 | Tier 2B | Tier 2C | Totals |
|---|---|---|---|---|---|
| Defined Benefit Pension Plan: | | | | | |
| Retirees and beneficiaries currently receiving benefits[1] | 4,114 | - | 1 | - | 4,115 |
| Terminated vested members not yet receiving benefits | 1,037 | 65 | 250 | - | 1,352 |
| Active members | 1,991 | 164 | 1,255 | - | 3,410 |
| Total | 7,142 | 229 | 1,506 | - | 8,877 |

| | Police | | Fire | | |
|---|---|---|---|---|---|
| PFDRP | Tier 1 | Tier 2 | Tier 1 | Tier 2 | Totals |
| Defined Benefit Pension Plan: | | | | | |
| Retirees and beneficiaries currently receiving benefits[1] | 1,336 | - | 856 | - | 2,192 |
| Terminated vested members not yet receiving benefits | 239 | 49 | 39 | 6 | 333 |
| Active members | 747 | 150 | 586 | 61 | 1,544 |
| Total | 2,322 | 199 | 1,481 | 67 | 4,069 |

*(1) The number of combined domestic relation order recipients is not included in the count above as their benefit payment is included in the retiree member count.*

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

### *2. Contributions*

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

On June 24, 2008, the City Council adopted Ordinance No. 28332 amending Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for pension to PFDRP and FCERS. Subsequently, in October 2014, the Boards of Administration for PFDRP and FCERS approved implementing an incremental reduction approach to determining the "actuarial equivalence" for the City's prefunding of its contribution when the economic expansion has exceeded 58 months in duration and/or the S&P 500 has returns in excess of 130%. This approach was undertaken to ensure that as business expansions and/or market valuations mature and exceed historic norms, the Retirement Systems reduce the City's incentive to prefund its contributions when market valuations and/or economic expansions are beyond historic norms. The incremental reduction to the discount rate to be applied to the discount rate to the City's prefunding of its contribution is 15% per year, up to a maximum of 45%, which was the reduction to the discount rate that was applied to calculate the actuarially determined prepayment amount for the Tier 1 members to be paid by the City at the beginning of the fiscal year ended June 30, 2017.

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

The contribution rates for the Defined Benefit Pension Plans for the City and the participating employees for the fiscal year ended June 30, 2017 were based on the actuarial valuations performed as of June 30, 2015, except for the period of June 18 through June 30, 2017, which were based on the June 30, 2016 valuation. Both valuations were performed before the implementation of the Measure F and the Frameworks. The contribution rates in effect and the amounts contributed to the pension plans for the fiscal year ended June 30, 2017 are as follows (dollars in thousands):

| | PFDRP | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | City(1) | | | | Participants | | | |
| **Defined Benefit Pension Plan** | **Police Tier 1** | **Police Tier 2** | **Fire Tier 1** | **Fire Tier 2** | **Police Tier 1** | **Police Tier 2** | **Fire Tier 1** | **Fire Tier 2** |
| Actuarial Rate: | | | | | | | | |
| 06/18/17-06/30/17 | 95.31% | 15.17% | 96.06% | 16.26% | 10.88% | 15.17% | 11.38% | 16.26% |
| 07/01/16-06/17/17 | 80.40% | 10.97% | 81.61% | 10.61% | 10.59% | 10.97% | 11.07% | 10.61% |

| | FCERS | | | |
|---|---|---|---|---|
| | City(1) | | Participants | |
| **Defined Benefit Pension Plan** | **Tier 1(1)** | **Tier 2** | **Tier 1** | **Tier 2** |
| Actuarial Rate: | | | | |
| 06/18/17-06/30/17 | 94.04% | 7.72% | 6.60% | 7.72% |
| 07/01/16-06/17/17 | 78.06% | 6.04% | 6.47% | 6.04% |

(1) *For Tier 1 members, the actual contribution rates paid by the City for PFDRP and FCERS for fiscal year ended June 30, 2017 differed due to the City funding the actuarially determined contribution amount based on the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll, for the fiscal year.*

| | Annual Pension Contribution | | |
|---|---|---|---|
| **Defined Benefit Pension Plan** | **City** | **Participants** | **Total** |
| PFDRP | $ 136,957 | $ 20,580 | $ 157,537 |
| FCERS | $ 138,483 | $ 17,227 | $ 155,710 |

In fiscal year 2010-2011, the Retirement Systems' Boards approved the establishment of a "floor funding method", commencing with fiscal year 2011-2012, setting the City's funding policy contribution amount to be the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll, for the fiscal year.

In January and February 2016, the Retirement Systems' Boards approved a "split unfunded actuarially accrued liability (UAAL)/normal cost" methodology to calculate the payment of actuarially determined contribution ("ADC") for FCERS and PFDRP Tier 1 pension benefits. This methodology includes the UAAL portion of the City's contribution to be a dollar amount as recommended by the Retirement Systems' actuary in the applicable annual valuation report and approved by the Boards (adjusted for interest based on time of contribution) and the Normal Cost (including administrative expense) portion to be the greater of: the dollar amount recommended by the Retirement Systems' actuary in the applicable annual valuation report and approved by the Boards (adjusted for time of contribution); or, the Normal Cost contribution rates from the applicable actuarial valuation multiplied by the actual payroll during the given fiscal year. The resolutions of the Boards setting the pension contribution rates for the fiscal year ended June 30, 2017 provide that the employer's contribution rates are calculated as described above.

The "split UAAL/normal cost methodology" does not apply to Tier 2 members of PFDRP and FCERS.

The City's ADC for PFDRP determined in the June 30, 2015 valuation for the fiscal year ended June 30, 2017 was the greater of $132,202,000 (if paid at the beginning of the fiscal year) or 80.40% for Police Tier 1 members and 81.61% for Fire Tier 1 of actual payroll for the fiscal year, if actual payroll exceeds the actuarial payroll. The actual Tier 1 payroll for the fiscal year of $171,199,000 was greater than the actuarial payroll of $167,327,000, ($94,977,000 for Police Tier 1 and $72,350,000 for Fire Tier 1), resulting in an annual contribution of $135,088,000, for the fiscal year ending June 30, 2017, including current and prior year contribution accruals and the additional amount based on the split UAAL/normal cost methodology.

On May 5, 2016, the PFDRP Board approved a funding policy for Police Tier 2 and Fire Tier 2 setting the Police Tier 2 annual determined contribution (ADC) to be 10.97% of actual payroll and Fire Tier 2 annual determined contribution to be 10.61% of actual payroll for the fiscal year ended June 30, 2017. The actual payroll for Police Tier 2 for the fiscal year of $11,873,000 resulted in an annual contribution of $1,326,000, including year end accruals, contributions receivable and other adjustments. The actual payroll for Fire Tier 2 for the fiscal year of $5,014,000 resulted in an annual contribution of $543,000, including year end accruals, contributions receivable and prior year contribution adjustments.

The City's ADC for FCERS Tier 1 determined in the June 30, 2015 valuation for fiscal year ended June 30, 2017 was the greater of $130,175,000 (if paid at the beginning of the fiscal year) or 78.06% of actual Tier 1 payroll for the fiscal year, if actual payroll exceeds the actuarial payroll. The actual Tier 1 payroll for the fiscal year of $177,171,000 was greater than the actuarial payroll of $170,792,000, resulting in an additional contribution of $2,573,000 as of June 30, 2016, which includes current and prior year contribution accruals as well as the additional amount based on the split UAAL/normal cost methodology.

The FCERS Board approved ADC for FCERS Tiers 2 for fiscal year ending June 30, 2017 was 6.04% of actual payroll, as determined in the June 30, 2015 valuation. The actual payroll for Tier 2 for the fiscal year ended June 30, 2017 was $93,890,000, resulting in a contribution of $5,671,000, excluding year end contributions receivable and prior year contribution adjustments. Actual employer contributions for the fiscal year ended June 30, 2017 were $5,735,000.

### *3. Net Pension Liability*

The City's net pension liability for each Defined Pension Plan is measured as the total pension liability, less the pension plans' fiduciary net position as of the measurement date of June 30, 2016. The City's net pension liability as of June 30, 2017 of each of the Defined Pension Plan is measured as of June 30, 2016, using an annual actuarial valuation as of June 30, 2015 and rolled forward to June 30, 2016 using standard update procedures by the actuary for the respective plans. In summary, the City's net pension liability at June 30, 2017 is as follows (dollars in thousands):

| | | |
|---|---|---|
| PFDRP | $ | 1,176,447 |
| FCERS | | 1,833,268 |
| CalPERS | | 1,262 |
| Total net pension liability | $ | 3,010,977 |

**Changes in Net Pension Liabilities -** The components of the net pension liabilities of the PFDRP and FCERS plans (i.e., the PFDRP's and FCERS's liabilities determined in accordance with GASB Statement No. 68 less the plans' fiduciary net positions) as of the measurement date, June 30, 2016, were as follows[1] (dollars in thousands):

| | Increase (Decrease) | | |
|---|---|---|---|
| **PFDRP** | **Total Pension Liability (a)** | **Plan Fiduciary Net Position (b)** | **Net Pension Liability (a-b)** |
| Balance at 6/30/2015 | $ 3,976,512 | $ 3,110,065 | $ 866,447 |
| Changes for the Year: | | | |
| Service costs | 74,531 | - | 74,531 |
| Interest | 274,488 | - | 274,488 |
| Contributions-employer | - | 132,480 | (132,480) |
| Contributions-employees | - | 21,508 | (21,508) |
| Expected return on assets | - | 216,424 | (216,424) |
| Difference between expected and actual experience | (8,673) | - | (8,673) |
| Net difference between projected and actual investment earnings | - | (245,631) | 245,631 |
| Changes of assumptions | 90,179 | - | 90,179 |
| Benefit payments, including refunds of member contributions | (186,939) | (186,939) | - |
| Administrative expenses | - | (4,256) | 4,256 |
| Net changes | 243,586 | (66,414) | 310,000 |
| Balance at 6/30/2016 | $ 4,220,098 | $ 3,043,651 | $ 1,176,447 |

[1] *The schedules of changes in the net pension liability as of June 30, 2017 are presented in the Required Supplementary Information.*

| FCERS | Increase (Decrease) Total Pension Liability (a) | Plan Fiduciary Net Position (b) | Net Pension Liability (a-b) |
|---|---|---|---|
| Balance at 6/30/2015 | $ 3,341,250 | $ 1,930,507 | $ 1,410,743 |
| Changes for the Year: | | | |
| Service costs | 49,011 | - | 49,011 |
| Interest | 229,610 | - | 229,610 |
| Contributions-employer | - | 124,723 | (124,723) |
| Contributions-employees | - | 15,920 | (15,920) |
| Expected return on assets | - | 133,876 | (133,876) |
| Difference between expected and actual experience | 39,720 | - | 39,720 |
| Net difference between projected and actual investment earnings | - | (168,887) | 168,887 |
| Changes of assumptions | 205,875 | - | 205,875 |
| Benefit payments, including refunds of member contributions | (173,318) | (173,318) | - |
| Administrative expenses | - | (3,941) | 3,941 |
| Net changes | 350,898 | (71,627) | 422,525 |
| Balance at 6/30/2016 | $ 3,692,148 | $ 1,858,880 | $ 1,833,268 |

**Sensitivity of the Net Pension Liabilities to Changes in Discount Rates -** The discount rates used to measure the total pension liabilities were 7.00%, for both the PFDRP and FCERS plans for the valuations dated June 30, 2015. It is assumed that PFDRP and FCERS members' contributions and City's contributions will be made based on the actuarially determined rates based on the funding policy of each board. Based on those assumptions, the PFDRP's and FCERS's fiduciary net positions are expected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments were applied to all periods of projected benefit payments to determine the total pension liabilities.

The following presents the net pension liabilities, calculated using the discount rates of 7.00% in effect as of the measurement date, as well as what the net pension liabilities would be if they were calculated using discount rates that are one percentage point lower (6.00%) or one percentage point higher (8.00%) than the rates used, for the PFDRP and FCERS plans, respectively (dollars in thousands):

| PFDRP - Sensitivity Analysis | 1% Decrease (6.00%) | Measurement Date Rate (7.00%) | 1% Increase (8.00%) |
|---|---|---|---|
| Total pension liability | $ 4,848,735 | $ 4,220,098 | $ 3,713,368 |
| PFDRP fiduciary net position | 3,043,651 | 3,043,651 | 3,043,651 |
| Net pension liabiltiy | $ 1,805,084 | $ 1,176,447 | $ 669,717 |
| PFDRP fiduciary net position as a percentage of the total pension liability | 62.8% | 72.1% | 82.0% |

| FCERS - Sensitivity Analysis | 1% Decrease (6.00%) | Measurement Date Rate (7.00%) | 1% Increase (8.00%) |
|---|---|---|---|
| Total pension liability | $ 4,212,657 | $ 3,692,148 | $ 3,268,777 |
| FCERS fiduciary net position | 1,858,880 | 1,858,880 | 1,858,880 |
| Net pension liabiltiy | $ 2,353,777 | $ 1,833,268 | $ 1,409,897 |
| FCERS fiduciary net position as a percentage of the total pension liability | 44.1% | 50.3% | 56.9% |

For their respective actuarial valuations as of June 30, 2016, both FCERS and PFDRP utilized a discount rate of 6.875%. For more details on the current discount rate, please refer to the separately issued annual reports of FCERS and PFDRP.

**Pension Plans Fiduciary Net Position** – Detailed information about the pension plans' fiduciary net position is available in the separately issued FCERS and PFDRP annual reports.

**Pension Expense** – For the year ended June 30, 2017, the City recognized pension expenses as follows (dollars in thousands):

| | FCERS | PFDRP | Total |
|---|---|---|---|
| Service costs | $ 49,011 | $ 74,531 | $ 123,542 |
| Interest | 229,610 | 274,488 | 504,098 |
| Difference between expected and actual experience | 16,491 | 2,123 | 18,614 |
| Changes of assumptions | 95,794 | 33,807 | 129,601 |
| Contributions-employee | (15,920) | (21,508) | (37,428) |
| Expected return on assets | (133,876) | (216,424) | (350,300) |
| Current year amortization of net difference between projected and actual investment earnings | 37,185 | 57,380 | 94,565 |
| Administrative expenses | 3,941 | 4,256 | 8,197 |
| **Total pension expense** | **$ 282,236** | **$ 208,653** | **$ 490,889** |

**Deferred outflows/inflows of resources –** As of June 30, 2017, the City reported deferred outflows of resources related to pensions from the following sources (dollars in thousands):

**Schedule of Deferred Inflows and Outflows of Resources - PFDRP**

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Contributions subsequent to measurement date | $ 136,957 | $ - |
| Differences between expected and actual experience | 12,875 | 6,503 |
| Changes in assumptions | 101,421 | - |
| Net difference between projected and actual earnings on pension plan investments | 262,695 | - |
| **Total** | **$ 513,948** | **$ 6,503** |

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

| Measurement year ended June 30: | | |
|---|---|---|
| 2018 | $ | 93,310 |
| 2019 | | 93,310 |
| 2020 | | 134,739 |
| 2021 | | 49,129 |
| 2022 | | - |
| Thereafter | | - |
| | $ | **370,488** |

**Schedule of Deferred Inflows and Outflows of Resources - FCERS**

| | Deferred Outflows of Resources | | Deferred Inflows of Resources | |
|---|---|---|---|---|
| Contributions subsequent to measurement date | $ | 138,711 | $ | - |
| Differences between expected and actual experience | | 32,982 | | - |
| Changes in assumptions | | 191,587 | | - |
| Net difference between projected and actual earnings on pension plan investments | | 172,799 | | - |
| **Total** | **$** | **536,079** | **$** | **-** |

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

| Measurement year ended June 30: | | |
|---|---|---|
| 2018 | $ | 149,470 |
| 2019 | | 149,470 |
| 2020 | | 64,651 |
| 2021 | | 33,777 |
| 2022 | | - |
| Thereafter | | - |
| | $ | **397,368** |

As of June 30, 2017, $136,957,000 and $138,711,000 reported as deferred outflows of resources related to contributions subsequent to the measurement date for the PFDRP and FCERS, respectively, will be recognized as a reduction of the net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows of resources related to pensions will be recognized as pension expense shown in the tables above (dollars in thousands).

**Long-term Expected Rate of Return on Plan Investments -** The assumption for the long-term expected rates of return on PFDRP and FCERS investments of 7.0% for the valuations dated June 30, 2015 was selected by estimating the median nominal rates of return based on long-term capital market assumptions provided by the PFDRP's and FCERS's investment consultants, including nominal expected rates of return for each of the asset classes, and reducing the estimated median by a margin so that there is estimated to be a greater than 50 percent probability of achieving the returns.

Best estimates of geometric real rates of return for each major asset class included in the target asset allocation for each plan as of the measurement date of June 30, 2016, are summarized in the following tables:

| | PFDRP | |
|---|---|---|
| | **Target Asset Allocation** | **Long-Term Expected Real Rate of Return** |
| Global equity | 31% | 5.0% |
| Private equity | 8% | 6.3% |
| Global fixed income | 16% | 1.8% |
| Private debt | 11% | 4.8% |
| Real assets | 17% | 3.6% |
| Absolute return | 6% | 3.3% |
| Global tactical asset allocation | 10% | 3.5% |
| Cash | 1% | 0.0% |
| Total | 100% | |

| | FCERS | |
|---|---|---|
| | **Target Asset Allocation** | **Long-Term Expected Real Rate of Return** |
| Global equity | 28% | 7.5% |
| Private equity | 9% | 9.4% |
| Global fixed income | 19% | 4.0% |
| Private debt | 5% | 6.9% |
| Real assets | 23% | 6.5% |
| Absolute return | 11% | 6.0% |
| Global tactical asset allocation/ Opportunistic | 5% | 5.0% |
| Cash | 0% | 2.3% |
| Total | 100% | |

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

#### *4. Actuarial Methods and Assumptions*

The significant actuarial methods and assumptions used to compute the total pension liability as of June 30, 2017 are from the actuarial valuation report with a valuation date of June 30, 2015. The assumptions do not take into the consideration of the changes to the Retirement Systems per Measure F and the Frameworks:

| | PFDRP | FCERS |
|---|---|---|
| **Description** | **Method/Assumption** | **Method/Assumption** |
| Measurement date | June 30, 2016 | June 30, 2016 |
| Valuation date | June 30, 2015 | June 30, 2015 |
| Inflation rate | 3.00% | 2.50% |
| Discount rate | 7.00% per annum (net of investment expenses) | 7.00% per annum |
| Post-retirement mortality<br>(a) Service: | CalPERS 2009 Healthy Annuitant Mortality Table multiplied by 0.948 for males and 1.048 for females and projected using Scale MP-2015 on a generational basis from base year of 2009. | Healthy annuitants: 0.952 for males and 0.921 for females, times the CalPERS 2009 Healthy Annuitant Mortality Table. Healthy non-annuitants: 0.919 for males and 0.918 for females, times the CalPERS 2009 Employee Mortality Table. Disabled annuitants: 1.051 for males and 1.002 for females, times the CalPERS 2009 Ordinary Disability Mortality Table. Mortality is projected from 2009 on a generational base using the MP-2015 scale. |
| (b) Disability: | CalPERS 2009 Industrial Disability Mortality Table for males multiplied by 0.903 and projected using SOA MP-2015 on a generational basis from base year of 2009. | |
| Rates of service retirement, withdrawal, death, disability retirements | Based upon the June 30, 2015, actuarial experience analysis | Tables based on current experience |
| Salary increases | | |
| Wage Inflation | 3.25% for all years | The base wage inflation assumption of 2.85% plus a merit / longevity increase based on years of service ranging from 4.50% at hire to 0.25% for members with 14 or more years of service. |
| Merit Increase | Merit component added based on an individual year's of service ranging from 6.75% to 1.00% | For the amortization schedule, payroll is assumed to grow 2.85% per year. |
| Cost of Living Adjustment | Tier 1 – 3% per year<br>Tier 2 – 1.5% per year | Tier 1 – 3% per year<br>Tier 2 – 1.5% per year |

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

**Plan Description.** The Mayor and members of the City Council are eligible to participate in the 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 Fund provides retirement, disability and death benefits based on the employee's years of service, age and final compensation. Benefit provisions and other requirements are established by the California Public Employees' Retirement Law, employer contract with CalPERS and by City resolution. Retiree health benefits are not provided to Mayor/Councilmembers. CalPERS issues publicly available reports that include a full description of the pension plans regarding benefit provisions, assumptions and membership information.

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

The CalPERS plans' provisions and benefits in effect at June 30, 2017, are summarized as follows:

| | **Classic Plan** | **PEPRA Plan** |
|---|---|---|
| Hire date | Prior to January 1, 2013 | On or after January 1, 2013 |
| Benefit formula | 2% @ 55 | 2% @ 62 |
| Benefit vesting schedule | 5 years of service | 5 years of service |
| Benefit payments | Monthly for life | Monthly for life |
| Retirement age | 50-63 | 52-67 |
| Monthly benefits, as a % of eligible compensation | 1.426% to 2.418% | 1.0% to 2.5% |
| Required employee contribution rates | 7.00% | 6.25% |
| Required employer contribution rates | 8.377% + $106,932 for unfunded liability | 6.56% |

As of June 30, 2017, there were three current San José City Council members enrolled in the Classic Plan and five current members in PEPRA Plan.

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

For the year ended June 30, 2017, the amount contributed to the CalPERS plans' were as follows (dollars in thousands):

| | Classic Plan | PEPRA | Total |
|---|---|---|---|
| Contributions - employer | $ 136 | $ 26 | $ 162 |
| Contributions - employee | 26 | 25 | 51 |
| Total | $ 162 | $ 51 | $ 213 |

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

Information in this section is derived from the GASB Statement No. 68 Accounting Valuation Report for miscellaneous risk pool at the measurement date of June 30, 2016 prepared by CalPERS.

As of June 30, 2017, the City reported net pension liabilities of $1,262,000 for its proportionate shares of the net pension liability of the Plan. The proportion was determined based on the City's shares of actuarial accrued liability and market value of assets as of June 30, 2015.

The City's net pension liability for the Plan is measured as the proportionate share of the net pension liability. The net pension liability of the Plan is measured as of June 30, 2016, and the total pension liability for the Plan used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2015 rolled forward to June 30, 2016 using standard update procedures by CalPERS' actuary. The City's proportion of the net pension liability was actuarially determined at the valuation date. The City's proportionate share of the net pension liability as of June 30, 2015 and 2016 was as follows (dollars in thousands):

| | Classic Plan |
|---|---|
| Proportion - June 30, 2015 | $ 1,037 |
| Proportion - June 30, 2016 | 1,262 |
| Change - Increase (Decrease) | $ 225 |

For the year ended June 30, 2017, the City recognized pension expense of $141,000. At June 30, 2017, the City reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (in thousands):

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Pension contributions subsequent to measurement date | $ 162 | $ - |
| Differences between actual and expected experience | 4 | (1) |
| Changes in assumptions | - | (39) |
| Change in employer's proportion and differences between the employer's contributions and the employer's proportionate share of contributions | - | (181) |
| Net differences between projected and actual earnings on plan investments | 277 | - |
| Total | $ 443 | $ (221) |

$162,000 reported as deferred inflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2018. Other amounts reported as deferred inflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows (in thousands):

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

| Measurement year ended June 30: | |
|---|---|
| 2018 | $ (50) |
| 2019 | (38) |
| 2020 | 78 |
| 2021 | 70 |
| 2022 | - |
| Thereafter | - |
| | $ 60 |

***Actuarial Assumptions*** – The total pension liability in the June 30, 2015 actuarial valuations was determined for the Classic and PEPRA Plans using the following actuarial assumptions:

Information in this section is derived from the GASB 68 Accounting Valuation Report for miscellaneous risk pool at the measurement date of June 30, 2016 prepared by CalPERS.

| | Classic Plan |
|---|---|
| Valuation Date | June 30, 2015 |
| Measurement Date | June 30, 2016 |
| Actuarial Cost Method | Entry-Age Normal Method |
| Actuarial Assumptions Discount Rate | 7.65% |
| Inflation | 2.75% |
| Salary Increases | Varies by Entry Age and Service |
| Mortality Rate Table (1) | Derived using CalPERS' Membership Data for all Funds |
| Post Retirement Benefit Increase | Contract COLA up to 2.75% until Purchasing Power Protection Allowance Floor on Purchasing Power Applies, 2.75% thereafter |

(1) The mortality table used was developed based on CalPERS' specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB. For more details on this table, please refer to the CalPERS 2014 experience study report.

All other actuarial assumptions used in the June 30, 2015 valuation were based on the results of an actuarial experience study for the period from 1997 to 2011, including updates to salary increase, mortality and retirement rates. Further details of the Experience Study can be found on CalPERS' website.

***Change of Assumption*** – There were no changes of assumptions during the measurement period ended June 30, 2016. Deferred inflows of resources for changes of assumptions presented represents the unamortized portion of the changes of assumptions related to prior measurement periods.

***Discount Rate*** – The discount rate used to measure the total pension liability was 7.65 percent for the Plan. To determine whether the municipal bond rate should be used in the calculation of the discount rate for the plan, the amortization and smoothing periods recently adopted by the CalPERS Board were used. For the CalPERS Plans, the crossover test was performed for a miscellaneous agent rate plan and a safety agent rate plan selected as being more at risk of failing the crossover test and resulting in a discount rate that would be different from the long-term expected rate of return on pension investments. Based on the testing of the rate plans, the tests revealed the assets would not run out. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability for the CalPERS Plans. The crossover test results are presented in a detailed report called "GASB Crossover Testing Report" that can be obtained from the CalPERS website under the GASB 68 section.

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

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Using historical returns of all the funds' asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

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

| Asset Class | Current Target Allocation | Real Return Years 1 - 10(1) | Real Return Years 11+(2) |
|---|---|---|---|
| Global Equity | 51% | 5.25% | 5.71% |
| Global Debt Securities | 20% | 0.99% | 2.43% |
| Inflation Sensitive | 6% | 0.45% | 3.36% |
| Private Equity | 10% | 6.83% | 6.95% |
| Real Estate | 10% | 4.50% | 5.13% |
| Infrastructure and Forestland | 2% | 4.50% | 5.09% |
| Liquidity | 1% | -0.55% | -1.05% |
| Total | 100% | | |

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

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

| **Classic Plan -Sensitivity Analysis** | **1% Decrease (6.65%)** | **Measurement Date Discount Rate (7.65%)** | **1% Increase (8.65%)** |
|---|---|---|---|
| Net pension liabiltiy | $ 1,967 | $ 1,262 | $ 680 |

***Pension Plan Fiduciary Net Position*** – Detailed information about the pension plan's fiduciary net position is available in the separately issued CalPERS financial reports.

### A. 3. Defined Contribution Retirement Plan

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

An eligible employee must sign an irrevocable election form on his or her first day of employment with the City electing to participate in 401(a) plan. If no irrevocable election form is signed, the employee will be automatically placed into the Tier 2 defined benefit plan.

Both eligible employees and the City are required to contribute 3.75% of participants' annual compensation. The City's contributions for each employee (and interest allocated to the employee's account) are fully vested upon the employee entering the 401(a) plan. The City contracts with an advisor to manage the 401(a) plan with all assets being held in trust by a third party custodian in the name of each of the Plan's participants. Each of the 401(a) plan's participants directs the investments of their separate account. The City must authorize changes to the 401(a) plan.

There were 74 participants in the 401(a) plan as of June 30, 2017. In 2016-2017, the City and the participating employees contributed $139,000 to the 401(a) plan. As of June 30, 2017, the balance of the 401(a) plan was $864,000.

### A. 4. Postemployment Healthcare Plans

#### *1. Plan Description*

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

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

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

The current membership in the Postemployment Healthcare Plans as of June 30, 2017, is as follows:

| | Police | | Fire | | |
|---|---|---|---|---|---|
| **PFDRP** | **Tier 1** | **Tier 2** | **Tier 1** | **Tier 2** | **Totals** |
| Postemployment Healthcare Plan: | | | | | |
| Retirees and beneficiaries currently receiving benefits* | 1,251 | - | 810 | - | 2,061 |
| Terminated vested members not yet receiving benefits | 12 | - | 1 | - | 13 |
| Active members | 747 | 150 | 586 | 61 | 1,544 |
| Total | 2,010 | 150 | 1,397 | 61 | 3,618 |

* *The number of combined domestic relations order recipients is not included in the count above, as their benefit payment is included in the member's count.*

| FCERS | Tier 1 | Tier 2 | Tier 2B | Tier 2C | Totals |
|---|---|---|---|---|---|
| Postemployment Healthcare Plan: | | | | | |
| Retirees and beneficiaries currently receiving benefits** | 3,535 | - | - | - | 3,535 |
| Terminated vested members not yet receiving benefits | 158 | - | - | - | 158 |
| Active members | 1,991 | 164 | - | - | 2,155 |
| Total | 5,684 | 164 | - | - | 5,848 |

*** Payees that have health and/or dental coverage.*

### *2. OPEB Funding Policy Under GASB Statement No. 45*

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. For Postemployment Healthcare Plans, examples include assumptions about future employment, mortality, and investment return. Experience studies are performed by the Board's actuary to determine appropriate revisions to the actuarial assumptions, as actual results are compared with past expectations and new estimates are made about the future. For PFDRP, the last experience study was performed in November 2015, and the next experience study is scheduled to be conducted in calendar year 2017. For FCERS, the last experience study was performed in November 2015, and the next experience study is scheduled to be conducted in calendar year 2019.

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.

Contributions to the Postemployment Healthcare Plans are made by both the City and the participating members. For the FCERS Postemployment Healthcare Plan, the annual contributions for health costs are shared 50/50 and the annual contributions for dental costs are split 8:3 between the City and the employee. For the PFDRP Postemployment Healthcare Plan, the annual contribution for healthcare costs is shared 50/50 and the annual contribution for dental costs are split 3:1 between the City and the employee.

On June 24, 2008, the City Council adopted Ordinance No. 28332 amending Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for postemployment healthcare benefits to PFDRP and FCERS. Subsequently, in October 2014, the Boards of Administration for PFDRP and FCERS approved implementing an incremental reduction approach to determining the "actuarial equivalence" for the City's prefunding of its contribution when the economic expansion has exceeded 58 months in duration and/or the S&P 500 has returns in excess of 130%. This approach was undertaken to ensure that as business expansions and/or market valuations mature and exceed historic norms, the Retirement Systems reduce the City's incentive to prefund its contributions when market valuations and/or economic expansions are beyond historic norms. The incremental reduction to the discount rate to be applied to the discount rate to the City's prefunding of it contribution is 15% per year, up to a maximum of 45%, which was the reduction to the discount rate that was applied to calculate the actuarially determined prepayment amount for the Tier 1 members to be paid by the City at the beginning of the fiscal year ended June 30, 2017.

As noted above in Note IV A.1, the City and its bargaining units entered into the Public Safety and Federated Frameworks related to the settlement of litigation concerning Measure B in the fiscal year ended June 30, 2016. Both Frameworks provided, among other provisions, for the closure of the Postemployment Healthcare Plans to new employees and an agreement on a new lowest cost medical plan associated with retiree healthcare.

**Funding Policy for FCERS**

Effective June 28, 2009, the bargaining units representing the FCERS members entered into agreements ("Retiree Healthcare Agreements") with the City to increase contribution rates for retiree health and dental benefits in order to phase-in full funding of the GASB Statement No. 45 annual required contributions ("ARC") over a five-year period ending in fiscal year 2012-2013. The Retiree Healthcare Agreements also provide that the five-year phase-in of the ARC will not have an incremental increase of more than 0.75% of pensionable pay in each fiscal year for the employee or City contributions. Notwithstanding these limitations on incremental increases, the Retiree Healthcare Agreements further provided that, by the end of the five-year phase-in, the City and the employees shall be contributing the full ARC in the ratio currently provided in the relevant sections of the San José Municipal Code.

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

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

**Funding Policy for PFDRP**

Both the Police and Fire members of PFDRP have entered into agreements with the City to phase-in the contribution of the full ARC. Effective June 26, 2011, the Fire members entered into an agreement with the City to phase-in to fully contribute the ARC over a five-year period that expired at the conclusion of fiscal year 2015-2016. Effective June 28, 2009, the Police members of the PFDRP entered into an agreement with the City to increase the contribution rates for retiree health and dental in order to phase-in to full funding of the ARC over the five-year period ending at the end of fiscal year 2013-2014.

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

On February 24, 2015, the City and the Police bargaining unit agreed to roll back the Police employee contributions rates from a total of 10.0% to 9.51% and the employer contribution rates from a total of

11.0% to 10.31%, effective March 15, 2015, and through fiscal year 2016-2017. These were the rates in effect for the year ended June 30, 2014, which shall remain frozen until implementation of the terms of the Public Safety Framework.

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

**Rates and Contributions for Fiscal Year 2016-2017**

In fiscal year ended June 30, 2011, the Retirement Systems' Boards approved an establishment of a "floor funding method" for payment of the ARC for postemployment healthcare benefits to address unexpected shortfalls in contributions that may result when payroll does not grow at the rate assumed by the actuaries. The "floor funding method" interprets the ARC as the greater of the annual dollar contribution amount established in the valuation, or the ARC that would result from applying the employer contribution rate determined from that same valuation to the actual emerging payroll of Retirement Systems members throughout the fiscal year.

The resolutions adopted by the Retirement Systems' Boards setting the contribution rates for fiscal year June 30, 2016 provide that the employer's contribution rates may be adjusted in order to achieve a minimum dollar contribution for that fiscal year. The "floor funding method" does not apply to PFDRP Police Tier 2 and Fire Tier 2 or FCERS Tier 2, Tier 2B, and Tier 2C members.

The contribution amount for the City for Police Tier 1 and Fire Tier 1 members determined in the June 30, 2015 valuation for fiscal year ending June 30, 2017, was the greater of $17,063,000 (if paid at the beginning of the fiscal year), or 10.31% for Police Tier 1 members and 10.62% for Fire Tier 1 members, of actual payroll for the fiscal year. The total actuarial payroll for Police Tier 1 and Fire Tier 1 members for the fiscal year was $167,327,000 ($94,977,000 for Police Tier 1 and $72,350,000 for Fire Tiers 1 members). The actual payroll for the fiscal year of $171,199,000 was greater than the actuarial payroll of $167,327,000, resulting in an annual contribution of $18,910,000, as of June 30, 2017, including the implicit subsidy, current and prior year contribution accruals but including the additional accrual based on the floor methodology.

The contribution amount for the City for FCERS Tier 1 determined in the June 30, 2015 valuation for fiscal year ending June 30, 2017 was the greater of $15,692,000 (if paid at the beginning of the fiscal year) or 9.41% of actual payroll for the fiscal year, if actual payroll exceeds the actuarial payroll. The actual Tier 1 payroll for the fiscal year of $177,171,000 was greater than the actuarial payroll of $170,792,000 resulting in an additional annual contribution of $4,807,000, which includes current and prior year contribution accruals and adjustments, as well as the additional amount based on the floor methodology.

In May 2015, the PFDRP Board approved a funding policy for Police Tier 2 and Fire Tier 2, setting the Police Tier 2 annual required contribution to be 10.31% based on actual payroll, and Fire Tier 2 annual required contribution to be 10.62% based on actual payroll. The actual payroll for Police Tier 2 for the fiscal year 2016-2017 was $11,873,000, resulting in an annual contribution of $1,224,000, including year-end accrual, contributions receivables and prior year contribution adjustments. The actual payroll for Fire Tier 2 for the fiscal year 2016-2017 of $5,014,000, resulting in an annual contribution of $533,000, excluding year end accruals, contributions receivables and prior year contribution adjustments.

The actual payroll for FCERS Tier 2 for the fiscal year ending June 30, 2017 was $93,890,000, allocated to Tiers 2, 2B and 2C in the amount of, $14,630,000, $77,525,000, and $1,735,000, respectively. The contribution rate for Tiers 2, 2B and 2C for fiscal year ending June 30, 2017 was

9.41%, 12.66%, and 12.86%, respectively, as determined in the June 30, 2015 valuation. Actual employer contributions for the fiscal year ending June 30, 2017 were $11,406,000, allocated to Tiers 2, 2B and 2C in the amount of $1,377,000, $9,806,000 and $223,000, respectively, excluding year end accruals, contributions receivable and prior year contribution adjustments.

The contribution rates in effect for PFDRP and the FCERS for the fiscal year ended June 30, 2017 are as follows:

| **PFDRP** | **City - Board Adopted** | | **Member** | |
|---|---|---|---|---|
| | **Police** | **Fire** | **Police** | **Fire** |
| Actuarial Rate: | | | | |
| Postemployment Healthcare Plan: | | | | |
| 07/01/16 - 06/30/17 | 10.31% | 10.62% | 9.51% | 9.74% |

| **FCERS** | **City - Board Adopted*** | | | **Member** | |
|---|---|---|---|---|---|
| | **Tier 1* and Tier 2** | **Tier 2B** | **Tier 2C** | **Tier 1 and Tier 2** | **Tier 2C** |
| Actuarial Rate: | | | | | |
| Postemployment Healthcare Plan: | | | | | |
| 07/01/16 - 06/30/17 | 9.41% | 12.66% | 12.86% | 8.76% | 0.39% |

** The actual contribution rates paid by the City for fiscal year ended June 30, 2017 differed for Tier 1 due to the City funding the actuarially determined contribution amount based on the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll, for the fiscal year.*

### *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, 2017, were as follows (dollars in thousands):

| | **PFDRP** | **FCERS** |
|---|---|---|
| Annual required contribution | $ 33,381 | $ 35,598 |
| Interest on net OPEB obligation | 16,322 | 12,645 |
| Adjustment to annual required contribution | (13,736) | (15,242) |
| Annual OPEB cost | 35,967 | 33,001 |
| Contributions made | (20,667) | (31,905) |
| Implicit rate subsidy | (1,597) | (4,577) |
| Increase in net OPEB obligation | 13,703 | (3,481) |
| Net OPEB obligation – beginning of year | 276,647 | 191,595 |
| Net OPEB obligation – end of year | $ 290,350 | $ 188,114 |

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

| | Fiscal Year Ended | Annual OPEB Cost | Total Employer Contributions | Percent Annual OPEB Cost Contributed | Net OPEB Obligation |
|---|---|---|---|---|---|
| **PFDRP** | 6/30/15 | $ 35,798 | $ 22,958 | 64% | $ 262,462 |
| | 6/30/16 | 35,250 | 21,065 | 60% | 276,647 |
| | 6/30/17 | 35,967 | 22,264 | 62% | 290,350 |
| **FCERS** | 6/30/15 | $ 33,306 | $ 31,093 | 93% | $ 187,066 |
| | 6/30/16 | 39,424 | 34,895 | 89% | 191,595 |
| | 6/30/17 | 33,001 | 36,482 | 111% | 188,114 |

***4. OPEB Funded Status and Funding Progress under GASB Statement No. 45***

The specific funding status for each OPEB plan is summarized in the table below, as of June 30, 2016, the most recent actuarial valuation date, PFDRP and FCERS was 17.4% and 29.6% funded, respectively (dollars in thousands).

| | Actuarial Valuation Date | Actuarial Value of Assets | Accrued Liability (AAL) | UAAL | Funded Ratio | Annual Covered Payroll | Percentage of Covered Payroll |
|---|---|---|---|---|---|---|---|
| PFDRP | 6/30/2016 | $ 135,207 | $ 778,871 | $ 643,664 | 17.4% | $ 194,072 | 332% |
| FCERS | 6/30/2016 | 225,845 | 764,261 | 538,416 | 29.6% | 266,823 | 202% |

As of June 30, 2016, the most recent actuarial valuation of PFDRP's Postemployment Health Plan, which combines the 401(h) and the 115 subtrusts within the valuation, shows the Postemployment Healthcare Plan's Unfunded Actuarial Accrued Liability ("UAAL") increased by $18,476,000 primarily due the change in discount rate, the change in health assumptions, and the change in demographic experience. The discount rate used for GASB purposes decreased from 6.00% used in the June 30, 2015 valuation to 5.90% used in the June 30, 2016 OPEB valuation. The Postemployment Healthcare Plan's discount rate is based on a blended rate between the expected return on the City's unrestricted assets (3.00%) and the expected return on the PFDRP's invested assets (6.875%) resulting in a blended discount rate of 5.90%. Changes in health assumptions refers to the changes in expected current and future healthcare claims and expense costs based on the 2016 and 2017 medical premium experience as well as the change in the pre-Medicare plan offerings. This item also includes the effect of updating the claims cost trend assumptions, and plan and tier election percentage for future retirees. Change in demographic experience refers to the change in actual data and elections from June 30, 2015 to June 30, 2016 as compared to the changes expected in the prior valuation.

As of June 30, 2016, the most recent valuation of FCER's Postemployment Health Plan, the UAAL decreased by $69,496,000 primarily due to the change in the discount rate, changes in health assumptions and demographic experience. The OPEB discount rate increased from 6.10% used in the June 30, 2015 OPEB valuation to 6.60% used in the June 30, 2016 OPEB valuation. The Plan's OPEB discount rate is based on a blended rate that ranges between the expected return on the City's unrestricted assets (3.0%) and the expected return on the Plan's invested assets (6.875%) resulting in a blended discount rate of 6.6%. Change in health assumptions refers to the change in expected current and future healthcare claims and expense costs based on the 2016 and 2017 medical premium experience as well as the change in the pre-Medicare plan offerings. This item also includes the effect of updating the claims cost trend assumptions, and plan and tier election percentages for future retirees. Change in demographic experience refers to the change in actual data and elections from June 30, 2015 to June 30, 2016 as compared to the changes expected in the prior valuations.

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

***5. OPEB Actuarial Methods and Assumptions under GASB Statement No. 45***

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 contribution rates for fiscal year ended June 30, 2017, were based on the actuarial valuations performed on June 30, 2015.

The significant actuarial methods and assumptions used to compute the actuarially determined PFDRP and FCERS's OPEB annual required contributions and the funded status as of June 30, 2015 are as follows:

| | PFDRP | FCERS |
|---|---|---|
| Description | Method/Assumption | Method/Assumption |
| Valuation date | June 30, 2015 | June 30, 2015 |
| Actuarial cost method | Entry age normal, level of percent of pay | Entry age normal cost method |
| Amortization method | 30 years, level percent of pay | Level dollar |
| Remaining amortization period | 30 years as of June 30, 2014, open | 20-year layered, closed, level percentage of payroll with the 06/30/2009 UAAL amortized over a closed 30-year period. |
| Actuarial asset valuation method | 5 year smoothed market with a 80% to 120% Market Value Corridor | Market value |
| **Actuarial Assumptions:** | | |
| Discount rate* | 6.00% | 6.10% |
| Projected total payroll increases: | | |
| Wage inflation: | 3.25% for FY 2015 and for all years | 2.85% |
| Merit increase: | Merit component added based on an individual's years of service ranging from 6.75% to 1.00% | The assumption of 2.85% wage inflation plus a rate increase for merit / longevity increase based on years of service ranging from 4.50% at hire to 0.25% for members with 14 or more year of service. |
| **Healthcare cost trend rate:** | | |
| Medical | Future medical inflation assumed to be at a rate of 8.50% to 4.25% per annum graded down over a 14 year period for medical-pre age 65 and 6.50% to 4.25% per annum graded down over a 14 year period for medical-post age 65. | The valuation assumes that future medical inflation will be at a rate of 8.5% to 4.25% per annum graded down over a 15 year period for medical-pre age 65 and 6.50% to 4.25% per annum graded down over a 14 year period for medical-post age 65. |
| Dental | Dental inflation is assumed to be 4.00% | Dental inflation is assumed to be 4.00% |

* *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.*

***6. PFDRP OPEB: Net OPEB Liability Under GASB Statement No. 74***

As the City's Pension Trust Funds implemented GASB Statement No. 74 in fiscal year 2016-2017, the note below is presented for additional disclosures required by GASB Statement No. 74. The Net OPEB liablity presented below is not reflected on the City's government-wide financial statements as the City will implement GASB Statement No. 75 in fiscal year 2017-2018.

The total OPEB liability as of June 30, 2017, is based on results of an actuarial valuation date of June 30, 2016, and rolled-forward using generally accepted actuarial procedures. The components of the net OPEB liability of the PFDRP (i.e., the PFDRP's liability determined in accordance with GASB Statement No. 74 less the plan fiduciary net position) as of June 30, 2017, were as follows (dollars in thousands):

| | | |
|---|---|---|
| Total OPEB liability | $ | 714,517 |
| Less: PFDRP fiduciary net position | | 149,681 |
| Net OPEB liability | $ | 564,836 |
| | | |
| PFDRP fiduciary net position as a percentage of the total OPEB liability | | 20.9% |

The assumption for the long-term expected rate of return on OPEB plan investments of 6.875% for the valuation year ending June 30, 2016 was selected by estimating the median nominal rate of return based on long-term capital market assumptions provided by the plan's investment consultant, including nominal expected rates of return for each asset class, and reducing the estimated median by a margin so that there is estimated to be a greater than 50 percent probability of achieving the return. Best estimates of geometric real rates of return for each major asset class included in the PFDRP's target asset allocation as of June 30, 2017, are summarized in the following table:

| Asset Class | Target Asset Allocation | Long-Term Expected Real Rate of Return |
|---|---|---|
| Global equity | 43% | 5.3% |
| Fixed income | 15% | 1.0% |
| Real assets | 22% | 2.8% |
| GTAA/Opportunistic | 20% | 2.1% |
| Cash | - | 0.2% |

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

***Sensitivity of the net OPEB liability to changes in discount rate***. In accordance with GASB No. 74 regarding the disclosure of the sensitivity of the net OPEB liability to changes in the discount rate, the following presents the net OPEB liability of the City, calculated using the discount rate of 6.875%, as well as what the City's net OPEB liability would be if it were calculated using a discount rate that is 1.00% lower (5.875%) or 1.00% higher (7.875%) than the current rate:

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

***Sensitivity of the net OPEB liability to changes in the healthcare cost trend rates.*** The following presents the net OPEB liability, as well as what the net OPEB liability would be if it were calculated using healthcare cost trend rates that were 1.0% lower (7.5% decreasing to 3.25%) or 1.0% higher (9.5% decreasing to 5.25%) than the current healthcare cost trend rates (dollar amounts in thousands):

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

### *7. FCERS OPEB: Net OPEB Liability Under GASB Statement No. 74*

As the City's Pension Trust Funds implemented GASB Statement No. 74 in fiscal year 2016-2017, the note below is presented for additional disclosures required by GASB Statement No. 74. The Net OPEB liability presented below is not reflected on the City's government-wide financial statements as the City will implement GASB Statement No. 75 in fiscal year 2017-2018.

The total OPEB liability as of June 30, 2017, is based on results of an actuarial valuation date of June 30, 2016, and rolled-forward using generally accepted actuarial procedures. The components of the net OPEB liability of the FCERS (i.e., the FCERS's liability determined in accordance with GASB Statement No. 74 less the plan fiduciary net position) as of June 30, 2017, were as follows (dollars in thousands):

| | |
|---|---|
| Total OPEB liability | $ 766,801 |
| Less: FCERS fiduciary net position | 260,370 |
| Net OPEB liability | $ 506,431 |
| FCERS fiduciary net position as a percentage of the total OPEB liability | 34.0% |

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

Best estimates of geometric real rates of return for each major asset class included in FCERS's target asset allocation as of June 30, 2017, (see the discussion of the FCERS's investment policy) are summarized in the following table:

| Asset Class | Target Asset Allocation | Long-Term Expected Real Rate of Return |
|---|---|---|
| Global equity | 46% | 5.3% |
| Fixed income | 30% | 0.8% |
| Real assets | 23% | 3.4% |
| Cash | - | 0.2% |

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

**Sensitivity of the net OPEB liability to changes in discount rate.** In accordance with GASB No. 74 regarding the disclosure of the sensitivity of the net OPEB liability to changes in the discount rate, the following presents the net OPEB liability of the City, calculated using the discount rate of 6.875%, as well as what the City's net OPEB liability would be if it were calculated using a discount rate that is 1.00% lower (5.875%) or 1.00% higher (7.875%) than the current rate:

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

**Sensitivity of the net OPEB liability to changes in the healthcare cost trend rates.** The following presents the net OPEB liability, as well as what the net OPEB liability would be if it were calculated using healthcare cost trend rates that were 1.0% lower (7.5% decreasing to 3.25%) or 1.0% higher (9.5% decreasing to 5.25%) than the current healthcare cost trend rates (dollar amounts in thousands):

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

## B. Commitments and Contingencies

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

**Purchase Commitments**. As of June 30, 2017, the Airport was obligated for purchase commitments of approximately $20,000,000 primarily for the runway incursion study, perimeter security technology infrastructure, southeast ramp reconstruction, Terminal B gates 29 and 30, and various operating and maintenance agreements. The Airport has projected that it will expend or encumber approximately $129,000,000 on capital projects during the next five fiscal years. It is anticipated that funding for such capital projects will be provided primarily by proceeds from federal grants, bond proceeds, and other Airport revenues.

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

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

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

*Cost Allocations* - The City uses both direct and indirect methodologies to allocate costs to the Airport. The FAA auditors found the direct cost allocations to be acceptable. The FAA contends that the City's indirect methodology does not correlate to the cost of services actually provided by the City to the Airport. Consequently, the auditors have recommended that the City re-allocate its costs charged to the Airport for fiscal years 2005 through 2010 using an allocation methodology that reflects services actually provided to the Airport and repay any overcharges to the Airport, with interest. The City believes the allocation methodology used to allocate costs to the Airport is in compliance with federal cost allocation guidance. In an effort to resolve the issue, the City proposed and implemented a cap on the indirect cost allocations for certain City departments at 10%, which was the approximate rate charged to the Airport in pre-capital intensive years. This resulted in a total credit of $5,600,000 that would be applied equally to the Airport cost allocation plan over a seven year period beginning in fiscal year 2012-2013. The City also proposed to adjust its indirect cost allocation methodology in an effort to address FAA concerns, including removal of debt expenditures from the relative expenditures base, continuing with the 10% cap, and monitoring a rolling five-year average of the relative expenditure base to smooth out expenditure fluctuations, which were implemented in fiscal year 2015-2016.

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

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

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

The City believes that it has viable defenses to any potential claim by the FAA with regard to Guadalupe Gardens. The FAA ADO's 2002 approval of the Guadalupe Gardens Master Plan constituted an official FAA approval of the City's reuse of the parcels acquired with proceeds from FAA noise compatibility grants, and the approval expressly provides that the entire Guadalupe Gardens is necessary for the continuing aeronautical purpose of runway and approach protection.

Having received official FAA approval of its reuse of the parcels, the City believes it is under no obligation to take any further action to secure further FAA approval of its continuing use of the Guadalupe Gardens. However, the City cannot predict the final outcome of any such potential claim by the FAA.

### *2. San José – Santa Clara Regional Wastewater Facility*

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

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

In June 1997, the RWQCB and the City approved the Proposed Revision to the South Bay Action Plan, which described the projects necessary to reduce average dry weather effluent flow from the Plant to below 120 million gallons per day and protect salt marsh habitat for endangered species in the South Bay as required by RWQCB Order 94-117. These projects include expanding the Phase I non-potable reuse system by extending additional piping, placing greater emphasis on water conservation programs, reducing infiltration inflow, augmenting stream flow, and creating wetlands. The estimated cost for implementing these projects was $127,500,000. As of June 30, 2017, $116,716,000 has been expended or encumbered on the expansion of Phase I of the SBWR. These costs were funded by the City, Santa Clara, and the tributary agencies using the Plant through a combination of State Revolving Fund Loans, Sewage Treatment Plant Connection Fees, federal grants, and cash contributions.

In fiscal year 2015-2016, the City and the Santa Clara Valley Water District (“SCVWD”) accepted a report that had been commissioned by both the City and the SCVWD related to SBWR, entitled: “South Bay Water Recycling Strategic and Master Planning (“Strategic Report”). The Strategic Report contemplates near term projects (fiscal years 2017 to 2021) at an estimated cost of $49 million and long term improvements and expansion of the existing system (fiscal years 2020 to 2035) at an estimated cost of $243.2 million for long-term nonpotable reuse projects and an additional $522 million for long-term potable use projects. No specific plan for the development or source of financing of the other near term improvements, nor the long-term improvements identified in the Strategic Report has been developed to date. Further, the responsibility for the development of the long-term improvements has not been established and may involve the formation of a separate entity responsible for the oversight and funding of these improvements.

**Plant Master Plan.** In November 2013, the City Council approved the Plant Master Plan (“PMP”), a 30-year planning-level document focused on long-term rehabilitation and modernization of the Plant. The PMP recommends more than 114 capital improvement projects to be implemented over a 30-year planning period at an estimated investment level of approximately $2 billion. On September 24, 2013, the City Council approved a consultant agreement with MWH Americas, Inc. to assist and support the City in developing and implementing this Capital Improvement Program (“CIP”). Over the last year, City staff has worked with program management and financial consultants to develop a long-term funding strategy to provide sustained funding for implementing the CIP program. On June 2, 2015, a funding strategy was recommended to and approved by the City Council. An update to the strategy was approved by the City Council on January 12, 2016. For the next five years, the

City's portion of the funding for the Adopted CIP is programmed into the 2018-2022 sewer rate models with moderate rate increases beginning 2015-2016.

Revenues for the 2018-2022 Adopted CIP are derived from several sources: utilization of available resources in the City of San José Sewer Service and Use Charge sub-fund and Sewage Treatment Plant Connection Fee sub-fund; contributions from the City of Santa Clara and other tributary agencies for the treatment of sewage from their respective jurisdictions by the Plant; interest earnings; Calpine Metcalf Energy Center Facilities repayments; federal grants from the U.S. Bureau of Reclamation; and bond and commercial paper proceeds.

Contributions from the City of Santa Clara and the tributary agencies are made pursuant to agreements with each agency based on the anticipated operation and maintenance, and capital budget. The tributary agencies' proportional contribution for the operation and maintenance cost is based on the amount and characteristics of the sewage discharged into the Plant. Each tributary agency's capital contribution is based on each agency's reserved capacity in the Plant. The balance of the Plant budget is shared between the cities of San José and Santa Clara based on the respective City's assessed property value relative to the total assessed property value in both jurisdictions. In the 2018-2022 Adopted CIP, contributions from the City of Santa Clara and other agencies are approximately $313,973,000.

The prior CIP assumed the use of short-term financing (i.e. commercial paper program) and State of California Revolving Fund ("SRF") loans. The City had applied for SRF for the Digester and Thickener Facilities Upgrade Project. However, while working with the SWRCB's finance and legal staff on the Master Resolution for the loan, City staff had identified several terms and conditions that would presented a challenge to the City. One of the requirements would result in the City being unable to access short-term financing. Elimination of short-term financing options would severely constrains the City's financing options for the remaining CIP projects. In addition, there were other terms that the City was unable to meet, which would adversely affect the City's ability to manage a large debt program.

Currently, staff is developing a short-term financing and a long-term bond financing plan for San José's share of the CIP's cost. The City plans to gradually build required operating reserves in anticipation of securing long-term bonds independently. The 2018-2022 Adopted CIP assumes the need to issue bonds in 2019-2020.

Pursuant to an agreement executed between San José and Santa Clara in 1959 (the "1959 Agreement"), San José is co-owner and administering agency of the San José Santa Clara Water Pollution Control Plant ("Plant"). The Plant also provides wastewater treatment services to other neighboring agencies through five outside user agreements ("Master Agreements"). On January 22, 2016 and September 7, 2016, San José, as the administering agency, received claims from these outside user agencies (City of Milpitas, West Valley Sanitation District, Cupertino Sanitary District, Burbank Sanitary District, and CSD 2-3 ("Tributary Agencies") alleging a breach of contract and inequity under the Master Agreements. The administrative claims primarily arise out of disagreements regarding the interpretation of how the capital cost to rehabilitate the Plant as generally described in the Plant Master Plan should be apportioned, and whether the Master Agreements must be amended to require the Tributary Agencies to pay for their respective portions of the capital cost. The Tributary Agencies have fully paid their portion of the capital cost for the projects to rehabilitate the Plant to date.

The Master Agreements require that any allegation of breach of contract or inequity ("Claim") be filed with the legislative bodies of the agencies that committed the alleged breach, and with the Treatment Plant Advisory Committee ("TPAC"). TPAC is an advisory body, comprised of representatives of San

José, Santa Clara and three of the Tributary Agencies that was established by the Master Agreements to provide policy and budget guidance to San José, as the Plant's administering agency.

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

TPAC conducted a hearing on March 24, 2016, and issued its report on June 9, 2016 to deny the January 22, 2016 Claim. The Tributary Agencies disagreed with the report, and requested a joint meeting of the legislative agencies of the City, Santa Clara and all the Tributary Agencies. San José, Santa Clara, and the Tributary Agencies agreed to mediate the Claims and potential amendments to the Master Agreements but were unable to reach a resolution. On May 19, 2017, TPAC conducted a hearing on the Tributary Agencies' September 7, 2016 Claim, and issued its report on September 14, 2017 to deny the September 7, 2016 Claim. On June 13, 2017, the City, Santa Clara and the Tributary Agencies agreed to waive the hearings before the joint legislative bodies for both Claims. The City cannot predict the outcome or the timeline for resolution of these Claims.

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

SCVWD and the City agreed to capital investment towards the construction of the SVWTF in the amount of $70,000,000 and $11,000,000, respectively, as of the date of the signed agreement on March 2, 2010. SCVWD determines the operational and maintenance budget for the SVWTF, and operates the facility. Separate formulas were established to determine each party's respective share of the annual operation and maintenance cost for the SVWTF following the first full fiscal year the SVWTF becomes operational, which was fiscal year 2014-2015. The formula provides that for each fiscal year when the SBWR is operating at a net loss, the City would pay to the SCVWD an amount to support SCVWD's operational cost up to $2,000,000. In the event that the SBWR operates at net revenue, the City would share its revenue with the District with the first 50% towards the District's costs and the second 50% divided between the two agencies based on their respective capital investment in the recycled water infrastructure. In 2010, the City's estimated investment in SBWR system and SVWTF was $250,000,000; and the SCVWD's estimated investment in SVWTF is $70,000,000.

Under the Integration Agreement, commencing in January 2016, the City and SCVWD are to provide the other agency with audited financial statements for the prior fiscal years (June 30, 2015 – June 30, 2016) for the operation of the SBWR and the SVWTF. Since the definition of net operating cost and revenue under the Integration Agreement excludes certain costs and revenues that might otherwise be considered in either party's overall budget, each party must prepare a separate statement following the publication of each party's annual audited financial statements, to establish each party's respective cost share for the operation of the SVWTF. The City and SCVWD have each provided the other with its audited financial statements for the operations of the SBWR and the SVWTF, respectively, for the fiscal year ended June 30, 2016. In January 2018 the audit report for the second year of full operations or Fiscal Year Ended June 30, 2017 will be completed and issued as per the terms of the Integration Agreement in January 2018.

### *3. Bay Area Water Supply and Conservation Agency*

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

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

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

BAWSCA's annual debt service amount for fiscal year 2016-2017 is $24,674,000. The City's annual bond surcharge for fiscal year 2016-2017 was estimated to be $979,000 based the City's actual wholesale water use in fiscal year ended June 30, 2015. The annual surcharge for each agency is based upon the actual wholesale water purchase percentage from the last full year for which date is available with an annual reconciliation based upon the actual water purchased. A true-up adjustment based on the actual fiscal year ended June 30, 2015 water use is included in the fiscal year 2016-2017 bond surcharge. The current best projection on the City's annual surcharge for the future is $1,050,000.

### *4. New Market Tax Credit*

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

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

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

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

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

After November 2018, the City has the option to purchase 100% interest in the Chase SJEIC Investment Fund, LLC for the greater of $1,100 or any amount still owed to the CDEs by the EIC QALICB, Inc. under the indemnification agreement between the CDEs and the EIC QALICB. If the City exercises its option to purchase 100% interest in the Investment Fund following a tax credit recapture, the City's potential liability would be $10,412,000 not including any other fees or penalties and costs that may be incurred.

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

As of June 30, 2017, PFDRP had unfunded commitments to contribute capital for private debt investments in the amount of $123,778,000, private equity investments in the amount of $81,527,000 and real assets investments in the amount of $115,469,000. FCERS had unfunded commitments to contribute capital for private market fund investments in the amount of $128,289,000.

### 6. *Federal Financial Assistance Programs*

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

Although the City's grant programs are audited in accordance with the provisions of the Single Audit Act Amendments of 1996 for the fiscal year ended June 30, 2017, these programs are still subject to financial and compliance audits by Federal auditors, and to resolution of identified findings and questioned costs. At this time, the amount of expenditures, if any, which may be disallowed by the granting agencies cannot be determined.

### *7. Encumbrances*

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

As of June 30, 2017, total governmental fund encumbrance balances for the City are as follows (dollars in thousands):

| | | |
|---|---|---|
| General Fund | $ | 48,886 |
| Housing Activities | | 6,112 |
| Low and Moderate Income Housing Asset | | 6,965 |
| Special Assessment Districts | | 16,431 |
| Integrated Waste Management | | 1,982 |
| Nonmajor governmental funds | | 78,251 |
| Total governmental funds | $ | 158,627 |

### *8. Lawsuits and Other Proceedings Related to Measure B*

Significant portions of Measure B are currently subject to legal challenges by individual employees, bargaining units representing current employees and retirees that were filed in the Santa Clara County Superior Court and consolidated under the caption of San José Police Officers' Association v. City of San José, Board of Administration for Police and Fire Department (the "SJPOA Caption"). In addition to the cases under the SJPOA caption, there are other cases challenging Measure B that are pending in the Sixth District Court of Appeal and the Santa Clara Superior Court and administrative proceedings related to Measure B pending before the California Public Employment Board ("PERB").

As discussed below, the City and the bargaining units representing current employees reached agreements to resolve the Measure B litigation and the PERB proceedings. The settlement terms included placement of a measure on the November 8, 2016 ballot, designated as Measure F, to amend the City Charter's provisions related to retirement benefits, which the voters approved. Pursuant to the Frameworks and Measure F, the appeal of the Measure B lawsuit under the SJPOA caption and PERB charges filed by the bargaining units will be dismissed or withdrawn. This has not yet been completed due to the settlement negotiations with the San José Retired Employees

Association. These settlement negotiations have concluded and have resulted in a settlement agreement described below.

***Cases Under SJPOA Caption***

On April 30, 2014, a consolidated judgment for the cases under the SJPOA Caption was filed ("Consolidated Judgment").

Various parties challenging Measure B under the SJPOA Caption have filed notices of appeal of the Consolidated Judgment and the City Council authorized filing a notice of appeal. The appeal is pending in the Sixth District, California Court of Appeal.

***Writ and Quo Warranto Actions***

In addition to these cases, the SJPOA filed a petition for a writ of mandamus alleging that the City violated the Meyers-Milias-Brown Act by failing to meet and confer in good faith with respect to the City's placement of Measure B on the ballot in June 2012. The SJPOA sought an order preventing the City from proceeding with the Charter changes approved in Measure B, but that request was denied by the Court. This case remains pending in the Superior Court.

On April 15, 2013, the California Attorney General issued an opinion granting the SJPOA's application to bring a Quo Warranto action on behalf the People of the State of California alleging that the City violated the Meyers-Milias-Brown Act by failing to meet and confer in good faith with respect to the City's placement of Measure B on the ballot in June 2012. The SJPOA filed its complaint in the Quo Warranto action on April 29, 2013 and the City subsequently filed its answer. The status of this case is discussed below.

***PERB Proceedings Related to Measure B***

Various bargaining units have filed unfair practice charges against the City with PERB related to the placement of Measure B on the June 2012 ballot.

The administrative law judges' decisions were in the process of being reviewed by the entire PERB Board. The parties stipulated to a stay of the PERB process pending the efforts to resolve all of the Measure B litigation, including these PERB cases.

***Measure B - Settlement Frameworks***

In August 2015, the City Council formally approved an Alternative Pension Reform Settlement Framework agreement with the SJPOA and Local 230 ("Public Safety Settlement Framework"). Subsequently, in December 2015 and January 2016, the City and the nine bargaining units with members in FCERS agreed to an Alternative Pension Reform Settlement Framework related to Measure B ("Federated Settlement Framework"). All of the bargaining units that were litigants in the lawsuits under the SJPOA Caption as well as the three bargaining units that were not litigants in these lawsuits have agreed to the Federated Settlement Framework.

The Public Safety Settlement Framework includes provisions that would make the following changes, among others, to the PFDRP:

- modifies Tier 2 pension benefits for sworn employees to levels similar to other San Francisco Bay Area agencies to attract and retain sworn employees;

- allows Tier 1 employees who terminated employment with the City and either subsequently returned or who return in the future to return as members of Tier 1;

- preserves 50/50 risk sharing with employees in Tier 2 through the cost sharing of a 50/50 split in normal costs and any future unfunded liability associated with the Tier 2 benefit subject to a ramp up of 0.33% increments per year for employee contributions towards unfunded liability costs until the costs are shared 50/50;

- closes the retiree healthcare defined benefit plan to new and existing Tier 2 employees, and allows an opt-out for Tier 1 employees into a defined contribution Voluntary Employee Beneficiary Association ("VEBA") subject to legal and IRS approval;

- implements a new lowest cost healthcare plan in order to reduce retiree healthcare costs;

- continues the elimination of the SRBR, and in lieu of the SRBR, establishes a "Guaranteed Purchasing Power" provision, to apply prospectively, in order to maintain the monthly allowance for current and future Tier 1 retirees at 75% of the purchasing power in effect as of the date of retirement; and

- reinstates the PFDRP's previous definition of disability, which is comparable to other agencies and creates an Independent Medical Panel appointed by the Retirement Board, which will determine disability eligibility instead of the Retirement Board.

The Federated Settlement Framework includes provisions that would make the following changes, among others, to the FCERS:

- modifies Tier 2 pension benefits for non-sworn employees to levels similar to other San Francisco Bay Area agencies to attract and retain non-sworn employees;

- provides allows Tier 1 employees who terminated employment with the City and either subsequently returned or who return in the future to return as members of Tier 1;

- preserves 50/50 risk sharing with employees in Tier 2 through the cost sharing of a 50/50 split in normal costs and any future unfunded liability associated with the Tier 2 benefit subject to a ramp up of 0.33% increments per year for employee contributions towards unfunded liability costs until the costs are shared 50/50;

- closes the defined benefit retiree healthcare plan to new and existing Tier 2 employees, and allows an opt-out for Tier 1 employees and Tier 2 employees in the OE#3 and ABMEI bargaining units who are contributing to the defined benefit retiree healthcare plan into a defined contribution VEBA subject to legal and IRS approval;

- new and current Tier 2 employees (except those represented by OE#3 and ABMEI who are making contributions into the defined benefit plan) will be automatically placed into a defined contribution VEBA;

- implements a new lowest cost healthcare plan in order to reduce retiree healthcare costs;

- continues the elimination of the SRBR, and, in lieu of the SRBR, establishes a "Guaranteed Purchasing Power" provision, to apply prospectively, in order to maintain the monthly allowance for current and future Tier 1 retirees at 75% of the purchasing power in effect as of the date of retirement;

- reinstates the FCERS's previous definition of disability, which is comparable to other agencies; and creates an Independent Medical Panel to be appointed by the FCERS Retirement Board, which will determine disability eligibility instead of the FCERS Retirement Board.

The provisions of the Federated Settlement Framework apply to unrepresented employees except that unrepresented new and current Tier 2 employees will not be mandated or eligible to make contributions into a VEBA.

Both Frameworks included an agreement to place a Charter amendment on the November 2016 ballot that includes the following: (1) a requirement for voter approval of defined benefit pension enhancements; (2) a requirement for actuarial soundness; (3) prohibiting retroactivity of defined benefit pension enhancements; and (4) other provisions within the Settlement Frameworks that the parties mutually agree to include. Further, under both Settlement Frameworks, the parties agreed to seek stays of the appeal of the case under the SJPOA Caption as well as the PERB proceedings.

Under the Frameworks, the City agreed to pay the litigants attorneys' fees: $1,500,000 to SJPOA and Local 230 and $1,257,000 for the non-sworn litigants. The City has made these payments. Further, the City agreed to binding arbitration to resolve any additional claims for attorneys' fees of the SJPOA and Local 230, and OE#3 and the bargaining units represented by IFPTE, Local 21 (AEA, AMSP and CAMP) related to the Measure B litigation and administrative proceedings. The bargaining units represented by AFSCME (MEF and CEO) do not have this right under the Federated Settlement Framework. To date, none of the bargaining units have made additional requests for attorneys' fees. However, one bargaining unit has indicated an interest in pursuing binding arbitration over additional attorney's fees. In the event the City and this bargaining unit proceed to arbitration, the City is unable to predict the outcome of such arbitration proceeding.

***San José Retired Employees Association Litigation***

In July 2014, the San José Retired Employees Association (the "Retirees' Association"), along with four individually named retirees, filed, and subsequently served, a verified complaint against the City in the Santa Clara County Superior Court. The complaint alleges that the City changed the basic retiree healthcare benefit to a new plan that "fundamentally alters" the nature and quality of the benefit provided to retirees, because the plan has increased co-pays and deductibles. The complaint further alleged that the affected retirees had a vested right to the plan in existence when they were employed by the City, and to the premium amount paid by the City for their healthcare benefit. The action seeks monetary damages for the increase in co-pays, deductibles and premium payments made by the affected retirees, as well as injunctive and writ relief prohibiting the City from continuing to provide the new health benefit to retirees.

The City filed a demurrer to the complaint, however, this litigation is currently stayed, by stipulation of the parties, to allow for settlement negotiations. On November 7, 2017, the City Council approved a settlement agreement with the Retirees' Association and the individual plaintiffs. The settlement agreement provides for the dismissal of the respective appeals in the Measure B litigation under the SJPOA caption by the Retirees' Association and the City, the dismissal by the Retirees' Association of its stayed lawsuit with prejudice and the dismissal of the stayed lawsuit by the individual plaintiffs without prejudice. The settlement agreement includes the following terms among others:

- continues the elimination of the SRBR, and, in lieu of the SRBR, establishes a "Guaranteed Purchasing Power" provision, to apply prospectively, in order to maintain the monthly allowance for current and future Tier 1 retirees at 75% of the purchasing power in effect as of the date of retirement;

- provides for the implementation of a new lowest cost healthcare plan for retirees who are members of the FCERS or PFDRP defined benefit retiree healthcare plan and additionally provides that the lowest cost plan for current and future retirees will be permanently set such that it is neither higher nor lower than the "Silver" level as specified in the Affordable Care Act ("ACA") in effect as of July 2015. The settlement agreement further specifies that the healthcare plan must provide at least 70% (the "floor") but no more than 79% (the "ceiling") of the current ACA "Silver" definition;

- allows retirees who are members of the FCERS or PFDRP defined benefit retiree healthcare plan to be eligible for in-lieu premium credit of 25% for the monthly premium of the lowest cost healthcare plan and dental plan;

- provides for the City's payment of partial cost reimbursement, not to exceed $1.25 million for all reimbursements, for healthcare premium costs for those retirees or their surviving beneficiaries who receive a pension of $54,000 or less and who were enrolled in a pre-Medicare healthcare plan between January 2013 and December 2016; and

- specifies that the Retirees' Association will have the right to tender to the City defense of any lawsuit brought by a retiree member against the Retirees' Association challenging the settlement agreement; and

- provides that the City will pay the attorneys' fees of the Retirees' Association related to Measure B in the amount of $500,000.

***Quo Warranto Action Following Approval of Settlement Frameworks***

In March 2016, a Santa Clara Superior Court judge signed the stipulated judgment and findings filed by the City and SJPOA in the Quo Warranto action, invalidating the resolution placing Measure B on the ballot and declaring the Measure null and void. A former City councilmember, a taxpayer, and a taxpayer's association ("the Third Parties") filed a motion to intervene in the Quo Warranto action, however the Judge had already signed the stipulated judgment and found that the motion was untimely. The Third Parties appealed that denial to the Sixth District Court of Appeal, and sought a stay of the trial court action which has been granted by the appellate court. The Third Parties also sought a reconsideration of the trial court's granting of the judgment; however the judge found that she no longer had jurisdiction to hear the motion for reconsideration because of the pending appeal and stay.

The appeal is fully briefed and oral argument in the case may be heard in January 2018, although no date has been set. The issues in the case are procedural as the substantive terms of Measure B were superseded by Measure F.

***9. Overpayment of Pensions***

During fiscal year 2015-2016 FCERS submitted an invoice to the City in amount of $882,000 with a payment date of July 1, 2016. The invoiced amount represents amounts of monthly benefit payments plus interest calculated at the rate of 7% per annum which were erroneously paid by the Department of Retirement Services (currently the Office of Retirement Services) to certain retired members of FCERS in excess of limits established under Internal Revenue Code Section 415. The Office of Retirement Services corrected the errors going forward as of July 1, 2015. The City disputes any obligation for these amounts but had determined, at one time, to pay the overpayment and interest under protest. However, the City has not paid the disputed amounts because before it could do so, the FCERS filed and served a lawsuit against the City seeking payment. The City subsequently filed a cross-complaint against FCERS.

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

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

With regards to the FLSA issues, the PFDRP Board approved correcting the ongoing benefit payments in the February 2017 benefit payment. In June 2017, the PFDRP Board approved the process to collect past over-payments to begin with the August 2017 benefit payments. In September 2017, the PFDRP Board voted to send the City a letter seeking the balance of the monies owed but not recovered from the retirees for overpayments related to the FLSA. In November 2017, the PFDRP Board voted to send a single letter to the City seeking the balance of monies owed but not recovered from the retirees arising from the FLSA issue and the other issues. As reported by the Office of Retirement Services staff to the PFDRP Board, the amount related to the FLSA issue, plus interest, is approximately $1.2 million and the amount related to the non-FLSA issues, plus interest, is approximately $1 million. In November 2017, the Office of Retirement Services staff reported to the PFDRP Board that the amount of underpayments to retirees, plus interest, is approximately $355,000.

With respect to each of the matters described in this Note IV.B.9, the City is unable to predict the final resolution.

***10. Consent Decree with San Francisco Baykeeper***

San Francisco Baykeeper ("Baykeeper") filed a lawsuit in federal district court against the City in February, 2015, and served its complaint on the City in April, 2015. Baykeeper's complaint alleged violations of the federal Clean Water Act. Specifically, the complaint alleged that the City was not in compliance with trash reduction requirements under its Municipal Separate Storm Sewer System

(MS4) Stormwater Permit ("Stormwater Permit"), and that there were discharge violations of sewage from the City's Sanitary Sewer System that infiltrated into the MS4.

In order to settle the lawsuit, the City and Baykeeper agreed to a ten year consent decree that was approved by the court in August, 2016 ("Consent Decree"). The Consent Decree's terms will require the City to:

- Comply with trash provisions of the current Stormwater Permit including installing full trash capture devices, supporting additional creek cleanup efforts, and monitoring of trash in receiving waters;

- Rehabilitate, replace, or repair 65 miles of high risk sanitary sewer system pipes at an average of 6.5 miles per year, based on the City's existing program with some changes in the priority of segments of this work;

- Monitor and report fecal indicator bacteria ("FIB") in receiving waters for a five-year period;

- Comply with green infrastructure planning as required in the Stormwater Permit, adding FIB as a pollutant for planning purposes;

- Bring forward new revenue measure options for Council consideration by December 2017;

- Appropriate, contingent upon the receipt of sufficient new revenues, $100,000,000 over a ten-year period for various green infrastructure projects with the goal of reducing pollutants and/or flows from the City's urban areas into receiving waters, with expenditures anticipated to occur as follows:

  - Identify and design $25,000,000 in total projects by September 2024;

  - Award $25,000,000 in total projects by September 2025;

  - Identify and design an additional $10,000,000 ($35,000,000 in the aggregate) in total projects by September 2025;

  - Award an additional $10,000,000 ($35,000,000 in the aggregate) in total projects by the termination date of the consent decree;

  - Identify and design an additional $15,000,000 ($50,000,000 aggregate) in total projects by the termination date of the consent decree.

The Consent Decree also provides for ongoing oversight by Baykeeper and a dispute resolution process. The Consent Decree specifies limits on Baykeeper's ability to pursue additional litigation against the City during the Consent Decree's term and litigation fees that can be claimed by Baykeeper for dispute resolution are capped at $200,000.

In addition to the expenditures outlined above, the City has or will incur the following expenditures during the Consent Decree's term: (1) lump sum payment of attorney's fees and costs to Baykeeper in the amount of $425,000, which payment has been made; (2) ongoing oversight costs payable to Baykeeper in the amount of $10,000 per year for a total of $100,000; and (3) $200,000 per year for 5 years (a total of $1,000,000) for supplemental environmental mitigation to be administered by the San José Parks Foundation for trash clean up grants, habitat restoration, or projects that generally improve the water quality in the Guadalupe and Coyote creeks and associated watershed areas.

In May 2017, Baykeeper and the City entered into a First Amendment to the Consent Decree that was subsequently approved by the U.S. District Court in August 2017 ("First Amendment"). The First Amendment extends the deadline for one of the City's obligations under the Consent Decree and specifies that the City will make payments of the annual funding of $200,000 during years two through five for the supplemental mitigation projects directly to two organizations instead of to the San José Parks Foundation.

***11. Workers' Compensation Program Audit***

In 2016, the City's Workers' Compensation Program underwent two audits by the State's Department of Industrial Relations (DIR): a routine three-tier Profile Audit Review (PAR) of randomly selected claims conducted every five years and a Target Utilization Review audit triggered by workers' complaints regarding the City's utilization review and procedures for requests for authorization of medical treatment of work-related injuries and illnesses. Since June 2013, a combination of in-house City staff and a Third Party Administrator (TPA) has administered the City's workers' compensation claims. The City's utilization review process is conducted by the TPA.

The PAR audit, consisting of three tiers, proceeded to a more comprehensive Full Compliance Audit with an additional and expanded selection of files, including denied claims. The City failed each of the three tiers of the Full Compliance Audit, resulting in the State DIR assessing the following amounts, which arise from the City's delay in processing claims: (1) a penalty in the amount of $142,000; (2) additional disability payments in the amount of $16,000 and (3) additional medical and medical legal payments owed to providers in the approximate amount of $16,000, on which interest at the rate of 7% per annum continues to accrue until the date of payment. The City made the payment of the assessed amounts in December 2016. The DIR will be monitoring the City's claim review process through calendar year 2018.

The City is subject to a re-audit in approximately December 2018 and must pass the re-audit or its ability to retain its status as a self-insured employer may be jeopardized. Additionally, failure to pass two consecutive Full Compliance Audits would expose the City to the risk of assessment of a civil penalty, currently a one-time payment in an amount not to exceed $100,000. In the event that the City were unable to retain its status as a self-insured employer, the City would be required to procure workers' compensation insurance coverage for its employees, including employees assigned to the Airport Department. The City believes that the purchase of workers' compensation insurance coverage will be significantly more expensive than a self-insured program.

The Target Utilization Review audit reviewed files from the first phase of the routine audit, but with a focus on the City's utilization review process and procedure. This audit commenced in late October 2016 and concluded in January 2017. Only the portion of the City's Workers' Compensation Program administered by the in-house City staff was subject to the Full Compliance Audit. Both the in-house staff and the TPA were subject to the Target Utilization Review. The in-house program was assessed penalties of $3,000 for three (3) failures to respond to requests for medical treatment. The City received the final Audit report on January 5, 2017 and payment was issued by January 31, 2017.

In addition to these audits, the State DIR's Administrative Director of the Division of Workers' Compensation issued an Order to Show Cause, assessing $120,000 in administrative penalties for the City's failure to properly address independent medical review appeals of utilization review non-certifications of medical treatment requests in 24 claims. The penalties have been assessed, primarily, for failure to timely provide responsive documents to the company under contract with the State that performs independent medical review. The penalties are assessed at the rate of $500 per day for each day the response is untimely, up to a maximum of $5,000 per claim. The City paid the penalties in November 2016.

The City believes the failures identified in the Full Compliance Audit are largely attributable to the staffing levels in the City's Workers' Compensation Program. While the adjuster caseloads for the TPA are within an industry standard of 150 cases per adjuster, the adjuster caseloads for the in-house staff are above this level, with caseloads that have periodically reached close to or in excess of 500 cases per adjuster. To address the in-house staffing needs and compliance with State law requirements, the following adjustments have been made: all four (4) budgeted Workers Compensation Adjuster positions have been filled with permanent staff rather than temporary employees, which the City believes should improve the recruitment and retention of adjusters; and four (4) temporary adjuster and administrative support positions have been added to address the current workload and backlog issues. In addition, the City filled a management position within the City's Workers' Compensation Program which the City believes will improve day-to-day management of the program. The City believes that these positions within the City's Workers' Compensation Program will reduce the current caseload, enable the City's in-house staff to address and correct the State audit findings, and better manage new claims and ensure compliance with State requirements.

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

#### *1. Cash and Investments Held by SARA*

The SARA's cash and investments consist of the following at June 30, 2017 (dollars in thousands):

| | |
|---|---|
| Cash and investments | $ 17,326 |
| Restricted cash and investments | 162,238 |
| Total cash and investments | $ 179,564 |

A summary of SARA's cash and investments at June 30, 2017 is as follows:

| | Moody's Credit Rating | Maturity ( in Days) Under 30 | 31-180 | 181-365 | Balance at June 30 |
|---|---|---|---|---|---|
| Investments: | | | | | |
| Federal Home Loan Banks - Discount | Aaa | $ 85,116 | $ - | $ - | $ 85,116 |
| State of California Local Agency Investment fund | Not Rated | - | - | 36,437 | 36,437 |
| US Treasury Bill | Aaa | 33,030 | - | - | 33,030 |
| Money Market Mutual Fund | Aaa | - | 9,217 | - | 9,217 |
| First American Treasury Obligation Fund | Aaa | - | 5,310 | - | 5,310 |
| Subtotal investments | | $ 118,146 | $ 14,527 | $ 36,437 | 169,110 |
| Certificates of Deposit | | | | | 4,029 |
| Bank Deposits | | | | | 6,425 |
| Total Cash & Investments | | | | | $ 179,564 |

The SARA categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The State of California Local Agency Investment Fund and Money Market Mutual Fund are valued by net asset value. The SARA has the following recurring fair value measurements as of June 30, 2017:

| | Fair Value Measurements Using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at June 30 |
| Investments by Fair Value Level: | | | | |
| Federal Home Loan Banks - Discount | $ - | $ 85,116 | $ - | $ 85,116 |
| First American Treasury | - | 5,310 | - | 5,310 |
| Money Market Mutual Fund | 8,393 | 824 | - | 9,217 |
| US Treasury Bill | 33,030 | - | - | 33,030 |
| Total Investments by Fair Value Level | $ 41,423 | $ 91,250 | $ - | 132,673 |
| State of California Local Agency Investment Fund | | | | $ 36,437 |
| Total Investments | | | | $ 169,110 |

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

### *2. Property Held for Resale by SARA*

Property held for resale is recorded as an asset at the lower of cost or net realizable value. The SARA recorded certain capital assets originally received from the Agency as property held for resale. On September 8, 2014, the State Department of Finance ("DOF") approved the Long-Range Property Management Plan ("LRPMP"), which specifies the disposition of SARA properties. The SARA properties designated for sale under the LRPMP are to be sold in accordance with the Asset Disposition Schedule and the Disposition Process For Sale of Properties, both of which are subject to the approval of the Oversight Board.

A summary of changes of the property held for resale during the year ended June 30, 2017 is as follows:

| Property Description | July 1, 2016 | Addition | Disposal | June 30, 2017 |
|---|---|---|---|---|
| N. San Pedro Housing site (1) | $ 29,473 | $ 6,071 | $ (3,152) | $ 32,392 |
| Total Property Held for Resale | $ 29,473 | $ 6,071 | $ (3,152) | $ 32,392 |

*(1) The valuation is based on the construction cost incurred. The asset is in construction.*

In April 2017, the SARA sold Terraine Street property to San Pedro Life I, LLC for $5,180,000. The property had the net book value of $3,152,000 and the SARA recognized a gain of $2,022,000, after closing costs of $5,000. Fifty percent of the net sale proceeds in the amount of $2,587,000 was owed to the County under the 2011 Settlement Agreement, which was applied against the accrued interest.

### *3. Capital Assets Held by SARA*

The following is a summary of capital assets activity for the year ended June 30, 2017 (dollars in thousands):

| | July 1, 2016 | Addition | Disposal/ Transfer | June 30, 2017 |
|---|---|---|---|---|
| Capital assets, not being depreciated: | | | | |
| Land | $ 72,579 | $ - | $ (12,805) | $ 59,774 |
| Construction in progress | 977 | - | - | 977 |
| Total capital assets, not being depreciated | 73,556 | - | (12,805) | 60,751 |
| Capital assets, being depreciated: | | | | |
| Buildings | 82,610 | - | - | 82,610 |
| Building and other improvements | 108 | - | - | 108 |
| Equipment | 1,145 | - | - | 1,145 |
| Total capital assets, being depreciated | 83,863 | - | - | 83,863 |
| Less accumulated depreciation: | | | | |
| Buildings | 21,032 | 2,070 | - | 23,102 |
| Building and other improvements | 54 | 7 | - | 61 |
| Equipment | 1,145 | - | - | 1,145 |
| Total accumulated depreciation | 22,231 | 2,077 | - | 24,308 |
| Total capital assets, being depreciated, net | 61,632 | (2,077) | - | 59,555 |
| Total capital assets, net | $ 135,188 | $ (2,077) | $ (12,805) | $ 120,306 |

Various Agency-owned real estate assets with an aggregate book value of $13,377,000 are used to secure Letters of Credit obtained from JPMorgan Chase Bank (“JPMorgan”) supporting the Agency’s 1996 and 2003 variable rate revenue bonds. In addition, the Convention Center – South Hall, José Theatre, and Arena Lot 5A were used as collateral to secure HUD Section 108 loans obtained from the U.S. Department of Housing and Urban Development.

On August 27, 2015, the SARA Oversight Board approved a revised Asset Disposition Schedule for the non-governmental purpose properties listed on the LRPMP, and approved the Disposition Process For Sale of Properties, which requires the sale of assets either through an open and competitive solicitation process or through a direct sale to the affected taxing entities or a non-profit organization. Additional amendments to the Asset Disposition Schedule were approved by the SARA Oversight Board on January 14, 2016, April 28, 2016 and October 27, 2016.

On October 10, 2013, the SARA Oversight Board approved the transfer of government purpose assets with the book value of $9,890,000 at June 30, 2014 to the City. The transfer of these properties was reviewed and approved by the DOF. The SARA transferred seven properties with the book value of $2,442,000 in July 2015, and the remaining properties with the book value of $7,448,000 transferred in August 2016.

In FY 2017, the SARA disposed the following properties:

- In July 2016, the SARA sold one property (92 South Montgomery Street) to Imwalle Annex HBD, LLC for $613,000. The property had the net book value of $1,364,000 and the SARA recognized a loss of $754,000 after transaction costs.

- In August 2016, the SARA sold one property (300 South Almaden Boulevard) to the County of Santa Clara for $96,000. The property had the net book value of $1,304,000 and the SARA recognized a loss of $1,209,000 after transaction costs.

- In August 2016, the SARA sold one property (226 Balbach Street) to the City for $2,400,000. The property had the net book value of $2,375,000 and the SARA recognized a net gain of $23,000 after transaction costs. The net proceeds were $2,398,000, of which $1,915,000 was used to pay down the 2003A Revenue Bond, $480,000 was used to pay the accrued interest owed to the County under the 2011 Settlement Agreement, and the remaining $3,000 was deposited in the 1996 Special Fund for future debt service payment.

- In December 2016, the SARA sold one property (501 Vine Street) to Bee and Bell, LLC for $876,000. The property had the book value of $311,000 and the SARA recognized a gain of $561,000 after transaction costs. The net proceeds were $872,000, of which $697,000 was used to pay down the 2003A Revenue Bond, $174,000 was used to pay the accrued interest owed to the County under the 2011 Settlement Agreement, and $1,000 was used to pay the San Jose Water Company.

- In February 2017, the SARA sold one property (Almaden Landscape Strip) for $508,000. The parcel was a remnant of a parcel purchased by the Agency in 1984. The SARA records did not provide acquisition value of the property. Therefore, the proceeds on the sale of this property were recognized as a gain in the amount of $505,000 after transaction costs.

- In March 2017, the SARA sold one property (30 Eastwood Street) for $88,000. The property had the book value of $4,000 and the SARA recognized a gain of $83,000 after transaction costs. The net proceeds were $87,000, of which $68,000 was used to pay down the 2003A Revenue Bond, $17,000 was used to pay the accrued interest owed to the County under the 2011 Settlement Agreement, and the remaining $2,000 was deposited in the 1996 Special Fund for future debt service payment.

### *4. Summary of SARA's Long-Term Debt*

The following is a summary of long-term debt of the SARA as of June 30, 2017 (dollars in thousands, unless otherwise noted):

| Type of Indebtedness | Purpose | Original Issue Amount | Issue Date | Maturity Date | Interest Rate Range | Annual Principal Installments | June 30, 2017 Balance |
|---|---|---|---|---|---|---|---|
| **Senior Tax Allocation Bonds:** | | | | | | | |
| 1997 Merged | Merged area project | $106,000 | 3/27/1997 | 8/1/2028 | 5.50 - 5.62% | $10 - 715 | $ 4,030 |
| 1999 Merged | Merged area project | 240,000 | 1/6/1999 | 8/1/2019 | 4.75% | $0 - 7,165 | 12,920 |
| 2003 Merged | Merged area project | 135,000 | 12/22/2003 | 8/1/2033 | 4.00 - 5.00% | $25 - 34,100 | 124,840 |
| 2004 Merged Refunding Series A | Refunding TABs | 281,985 | 5/27/2004 | 8/1/2019 | 4.44 - 5.25% | $15,000 - 31,900 | 77,440 |
| 2005 Merged Refunding Series A | Refunding TABs | 220,080 | 7/26/2005 | 8/1/2028 | 4.20 - 5.25% | $295 - 26,210 | 109,570 |
| 2006 Merged Series A-T | Merged area project | 14,300 | 11/14/2006 | 8/1/2022 | 5.65% | $0 - 6,000 | 13,300 |
| 2006 Merged Series B | Merged area project | 67,000 | 11/14/2006 | 8/1/2035 | 4.50 - 5.00% | $0 - 21,000 | 67,000 |
| 2006 Merged Refunding Series C | Refunding TABs | 423,430 | 12/15/2006 | 8/1/2032 | 3.75 - 5.00% | $0 - 74,280 | 423,430 |
| 2006 Merged Refunding Series D | Refunding TABs | 277,755 | 12/15/2006 | 8/1/2023 | 4.00 - 5.00% | $830 - 67,330 | 260,325 |
| 2007 Merged Series A-T | Merged area project | 21,330 | 11/7/2007 | 8/1/2017 | 5.10% | $2,670 | 2,670 |
| 2007 Merged Series B | Merged area project | 191,600 | 11/7/2007 | 8/1/2036 | 4.25 - 5.00% | $0 - 23,970 | 191,600 |
| 2008 Merged Series A | Merged area project | 37,150 | 11/13/2008 | 8/1/2018 | 6.50% | $4,355 - 4,600 | 8,955 |
| 2008 Merged Series B | Merged area project | 80,145 | 11/13/2008 | 8/1/2035 | 6.25 - 7.00% | $0 - 6,700 | 80,145 |
| 1997 Housing Series E | Low-moderate income housing | 17,045 | 6/23/1997 | 8/1/2027 | 5.75 - 5.85% | $475 - 3,670 | 15,100 |
| 2003 Housing Series J | Low-moderate income housing | 55,265 | 7/10/2003 | 8/1/2024 | 4.70 - 5.25% | $2,015 - 3,505 | 22,275 |
| 2003 Housing Series K | Low-moderate income housing | 13,735 | 7/10/2003 | 8/1/2029 | 4.00 - 4.40% | $275 - 460 | 4,670 |
| 2005 Housing Series A | Low-moderate income housing | 10,445 | 6/30/2005 | 8/1/2024 | 3.75 - 5.00% | $0 - 2,270 | 10,445 |
| 2005 Housing Series B | Low-moderate income housing | 119,275 | 6/30/2005 | 8/1/2035 | 5.10 - 5.46% | $695 - 8,300 | 92,885 |
| 2010 Housing Series A-1 | Low-moderate income housing | 54,055 | 4/15/2010 | 8/1/2035 | 5.00 - 5.50% | $1,235 - 6,305 | 54,055 |
| 2010 Housing Series A-2 | Low-moderate income housing | 2,655 | 4/15/2010 | 8/1/2017 | 5.00% | $495 | 495 |
| **Total Senior Tax Allocation Bonds** | | | | | | | 1,576,150 |
| **Subordinate Tax Allocation Bonds (TAB):** | | | | | | | |
| 1996 Merged Area Revenue Series A | Merged area projects | 29,500 | 6/27/1996 | 7/1/2026 | Variable | $1,500 - 2,000 | 16,900 |
| 1996 Merged Area Revenue Series B | Merged area projects | 29,500 | 6/27/1996 | 7/1/2026 | Variable | $1,500 - 2,000 | 16,900 |
| 2003 Merged Area Revenue Series A | Merged area projects | 45,000 | 8/27/2003 | 8/1/2028 | Variable | $5 - 2,015 | 10,835 |
| 2003 Merged Area Revenue Series B | Merged area projects | 15,000 | 8/27/2003 | 8/1/2032 | Variable | $0 - 3,900 | 15,000 |
| 2010 Housing Series C | Low-moderate income housing | 93,000 | 4/29/2010 | 8/1/2035 | Variable | $2,725 - 5,210 | 74,885 |
| **Total Subordinate Tax Allocation Bonds** | | | | | | | 134,520 |
| **Other Long-Term Debt:** | | | | | | | |
| Pledge Agreement - Revenue Bonds 2001A | 4th/San Fernando parking facility | 48,675 | 4/10/2001 | 9/1/2026 | 4.63 - 5.25% | $2,075 - 3,205 | 23,930 |
| Reimbursement Agreement - Refunding Revenue Bonds 2001F | Convention Center project | 190,730 | 7/1/2001 | 9/1/2022 | 5.00% | $11,595 - 14,730 | 78,680 |
| HUD Section 108 Loan | Merged area projects | 5,200 | 2/11/1997 | 8/1/2016 | Variable | $0 | - |
| HUD Section 108 Loan (CIM) | Merged area projects | 13,000 | 2/8/2006 | 8/1/2025 | Variable | $775 - 1,135 | 8,490 |
| HUD Section 108 Loan (Story & King) | Merged area projects | 18,000 | 6/30/2006 | 8/1/2027 | Variable | $1,025 - 1,570 | 11,510 |
| City of San José (SERAF) Loan | Fund the State's SERAF Payment | 12,816 | 2010-2011 | 6/30/2020 | 3.00% | $0 - 15,176 | 15,176 |
| City of San José (SERAF) Loan | Fund the State's SERAF Payment | 10,000 | 2010-2011 | 6/30/2020 | 3.00% | $0 - 12,142 | 12,142 |
| City of San José - Commercial Paper Program | Fund the housing projects | 14,227 | 2010-2012 | 6/30/2018 | Variable | $4,727 | 4,727 |
| City of San José - Parking Fund Loans | Fund debt service | 13,528 | 2006-2011 | 6/30/2020 | 3.00% | $0 - 13,528 | 14,335 |
| Other Long-Term Obligation - County Settlement Agreement | Settlement Agreement | 25,290 | 6/30/2011 | 6/30/2018 | Variable | $9,424 | 11,120 |
| City of San José - Reimbursement Agreement | Reimbursement Agreement | 30,392 | 2012-2017 | 6/30/2018* | LAIF Rate | $0 - 30,392 | 30,392 |
| **Total Other Long-Term Debt** | | | | | | | 210,502 |
| **Total Long-Term Debt** | | | | | | | $ 1,921,172 |

* *See Long Term Reimbursement Agreement below for additional disclosures.*

A summary of the changes in long-term debt and other obligations for the year ended June 30, 2017 follows (in thousands):

| | June 30, 2016 | Additions | Reductions | June 30, 2017 | Amount Due One Year |
|---|---|---|---|---|---|
| Senior Tax Allocation Bonds: | | | | | |
| 1997 Merged | $ 4,425 | $ - | $ (395) | $ 4,030 | $ 415 |
| 1999 Merged | 12,920 | - | - | 12,920 | - |
| 2003 Merged | 125,745 | - | (905) | 124,840 | 885 |
| 2004 Merged Refunding Series A | 106,705 | - | (29,265) | 77,440 | 30,540 |
| 2005 Merged Refunding Series A | 122,705 | - | (13,135) | 109,570 | 26,210 |
| 2006 Merged Series A-T | 13,300 | - | - | 13,300 | - |
| 2006 Merged Series B | 67,000 | | - | 67,000 | - |
| 2006 Merged Refunding Series C | 423,430 | - | - | 423,430 | - |
| 2006 Merged Refunding Series D | 272,885 | - | (12,560) | 260,325 | 830 |
| 2007 Merged Series A-T | 5,200 | - | (2,530) | 2,670 | 2,670 |
| 2007 Merged Series B | 191,600 | - | - | 191,600 | - |
| 2008 Merged Series A | 13,085 | - | (4,130) | 8,955 | 4,355 |
| 2008 Merged Series B | 80,145 | - | - | 80,145 | - |
| 1997 Housing Series E | 15,540 | - | (440) | 15,100 | 475 |
| 2003 Housing Series J | 25,030 | - | (2,755) | 22,275 | 2,885 |
| 2003 Housing Series K | 4,935 | - | (265) | 4,670 | 275 |
| 2005 Housing Series A | 10,445 | - | - | 10,445 | - |
| 2005 Housing Series B | 96,595 | - | (3,710) | 92,885 | 3,885 |
| 2010 Housing Series A-1 | 54,055 | - | - | 54,055 | 1,235 |
| 2010 Housing Series A-2 | 2,155 | - | (1,660) | 495 | 495 |
| Subtotal Senior Tax Allocation Bonds | 1,647,900 | - | (71,750) | 1,576,150 | 75,155 |
| Subordinate Tax Allocation Bonds: | | | | | |
| 1996 Merged Series A | 18,300 | - | (1,400) | 16,900 | 1,500 |
| 1996 Merged Series B | 18,300 | - | (1,400) | 16,900 | 1,500 |
| 2003 Merged Revenue Series A | 24,910 | - | (14,075) | 10,835 | 1,595 |
| 2003 Merged Revenue Series B | 15,000 | - | - | 15,000 | - |
| 2010 Housing Series C | 77,945 | - | (3,060) | 74,885 | 74,885 |
| Subtotal Subordinate Tax Allocation Bonds | 154,455 | - | (19,935) | 134,520 | 79,480 |
| Other Long -Term Debt: | | | | | |
| Pledge Agreement - Revenue Bonds 2001A | 26,005 | - | (2,075) | 23,930 | 2,170 |
| Reimb Agreement - Refunding Rev Bonds 2001F | 89,730 | - | (11,050) | 78,680 | 11,595 |
| HUD Section 108 Loan | 465 | - | (465) | - | - |
| HUD Section 108 Loan (CIM) | 9,230 | - | (740) | 8,490 | 775 |
| HUD Section 108 Loan (Story & King) | 12,480 | - | (970) | 11,510 | 1,025 |
| City of San José - SERAF Loans (Principal) | 22,816 | - | - | 22,816 | - |
| City of San José - SERAF Loans (Interest) | 430 | 4,072 | - | 4,502 | - |
| City of San José - Commercial paper program | 9,477 | - | (4,750) | 4,727 | 4,727 |
| City of San José - Parking Fund Loans (Principal) | - | 13,528 | - | 13,528 | - |
| City of San José - Parking Fund Loans (Interest) | - | 807 | - | 807 | - |
| Other Long-Term Obligation - County Settlement Agreement (Principal) | 18,850 | - | (9,426) | 9,424 | 9,424 |
| Other Long-Term Obligation - County Settlement Agreement (Interest) | 6,440 | 919 | (5,663) | 1,696 | 1,696 |
| City of San José - Reimbursement agreement (Principal) | 28,408 | 1,571 | - | 29,979 | 12,898 |
| City of San José - Reimbursement agreement (Interest) | 109 | 304 | - | 413 | 233 |
| Subtotal Other Long-Term Debt | 224,440 | 21,201 | (35,139) | 210,502 | 44,543 |
| Subtotal Long-Term Debt before Unamortized | 2,026,795 | 21,201 | (126,824) | 1,921,172 | 199,178 |
| Issuance Premium (discount), Net | 22,808 | - | (3,321) | 19,487 | 3,281 |
| Total Long-Term Obligations | $ 2,049,603 | $ 21,201 | $ (130,145) | $ 1,940,659 | $ 202,459 |

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

Total Redevelopment Property Tax Trust Fund ("RPTTF") revenue distributed by the County in current year was $180,138,000, which was used to pay debt service and debt related expenses on Senior and Subordinate Merged Area Tax Allocation Bonds, Senior and Subordinate Housing Set-Aside Tax Allocation Bonds, City of San José Financing Authority Series 2001A, and City of San José Financing Authority Series 2001F. During the year ended June 30, 2017, the County withheld $63,514,000 in RPTTF for payments of its prior year's pass-through payments.

**Senior Merged Area Tax Allocation Bonds ("Senior TABs")** are comprised of Series 1997, Series 1999, Series 2003, Series 2004A, Series 2005A, Series 2006A-T, Series 2006B, Series 2006C, Series 2006D, Series 2007A-T, 2007B, Series 2008A, and 2008B, are all secured primarily by a pledge of redevelopment property tax revenues (i.e., former tax increment), consisting of a portion of all taxes levied upon all taxable properties within each of the tax generating redevelopment project areas constituting the Merged Area Redevelopment Project, and are equally and ratably secured on a parity with each TAB series.

Redevelopment property tax revenues have been pledged until the year 2036, the final maturity date of the Senior TABs. The total principal and interest remaining on these Tax Allocation Bonds as of June 30, 2017 is $1,973,540,000.

The 80% redevelopment property tax revenue recognized and received for non-housing senior debt during the year ended June 30, 2017 in the amount of $132,782,000 was transferred to the fiscal agent to cover current and future debt service and the reserve requirement. The total debt service payments on the Senior TABs amounted to $131,391,000 for the year ended June 30, 2017.

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

Redevelopment property tax revenues have been pledged until the year 2035, the final maturity date of the bonds. The total principal and interest remaining on these Senior Housing Set-Aside Tax Allocation Bonds as of June 30, 2017 is $298,526,000. The 20% redevelopment property tax revenue recognized and received for the Senior Housing Set-Aside Tax Allocation Bonds during the year ended June 30, 2017 in the amount of $19,790,000 was transferred to the fiscal agent to cover current and future debt service and the reserve requirement. The total debt service payments on Senior Housing Set-Aside Tax Allocation Bonds amounted to $19,604,000 for the year ended June 30, 2017.

**Subordinate Tax Allocation Bonds – Variable-Rate**

**1996 Merged Area Revenue Bonds** – In June 1996, the Agency issued the 1996 Merged Area Redevelopment Project Revenue Bonds, Series A and B, each in the principal amount of $29,500,000, to provide additional proceeds to finance various redevelopment projects in the Merged

Project Area. The 1996A and 1996B Bonds (the "1996A/B Bonds") are subordinate to the debt service payments of the Senior TABs.

The 1996 A/B Bonds currently have a flexible rate of interest in a callable commercial paper mode. The total interest on the 1996 A/B Bonds amounted to $246,000 for the year ended June 30, 2017. At June 30, 2017, the interest rate was 0.93% for the 1996A Bonds and 0.93% for the 1996B Bonds.

**2003 Merged Area Revenue Bonds** – In August 2003, the Agency issued Merged Area Revenue Bonds Series A in the principal amount of $45,000,000 and Series B in the principal amount of $15,000,000. The proceeds of the bonds were used mainly to finance redevelopment projects within the Merged Area. The 2003A and 2003B Bonds (the "2003A/B Bonds") are ratably and equally secured by a pledge of the subordinated revenues and are subordinate to the debt service payment of the Senior TABs.

The 2003 A/B Bonds currently have a flexible rate of interest in a callable commercial paper mode. The total interest on 2003 A/B Bonds was $287,000 for the year ended June 30, 2017. As of June 30, 2017, the interest rate was 1.25% for the taxable 2003A Bonds and 0.93% for the 2003B Bonds.

These variable-rate revenue bonds (1996A/B and 2003A/B Bonds) are payable upon maturity at a purchase price equal to principal plus accrued interest. The SARA's remarketing agents are required to use their best efforts to remarket the bonds and, to the extent that bonds are not remarketed, the SARA's trustees are authorized to draw on the credit facilities in the amounts required to pay the purchase price of bonds tendered and have not otherwise been remarketed.

In March 2017, the SARA sold its Revenue Participation Interest in the Marriott Hotel located at 301 Market Street to the County of Santa Clara for an appraised value of $12,350,000. The net proceeds of $12,350,000 were disbursed as follows: 1) $9,880,000 to JPMorgan/US Bank to pay outstanding debt for the 2003A Revenue Bonds, and 2) $2,470,000 to the County of Santa Clara to pay the accrued interest owed to the County in connection with the 2011 Settlement Agreement.

The credit facilities that support the variable-rate bonds are as follows:

| | Balance June 30, 2017 (in thousands) | Credit Facility Description: Provider | Credit Facility Description: Expiration Date |
|---|---|---|---|
| Redevelopment Agency Revenue Bonds: | | | |
| 1996 Merged Series A | $ 16,900 | JPMorgan Chase Bank, N. A. | 3/31/2018 |
| 1996 Merged Series B | 16,900 | JPMorgan Chase Bank, N. A. | 3/31/2018 |
| 2003 Merged Revenue Series A | 10,835 | JPMorgan Chase Bank, N. A. | 3/31/2018 |
| 2003 Merged Revenue Series B | 15,000 | JPMorgan Chase Bank, N. A. | 3/31/2018 |
| Total Variable Rate Revenue Bonds | $ 59,635 | | |

In connection with the 1996A/B Bonds and 2003A/B Bonds, on May 6, 2013, JPMorgan and the SARA entered into an Amended and Restated Reimbursement Agreement, which provided JPMorgan letters of credit ("LOCs") as credit enhancements for each series of bonds. The Amended and Restated Reimbursement Agreement was subsequently amended effective June 1, 2016, by a Second Amendment to the Amended and Restated Reimbursement Agreement ("JPMorgan Second Amendment"). Pursuant to the JPMorgan Second Amendment, JPMorgan delivered amendments to the LOCs for each series of bonds that extended the LOCs' terms from March 31, 2017 to March 31, 2018. JPMorgan required the interest rate to continue as a flexible rate in callable commercial paper mode.

In the event the LOCs are not renewed or a substitute LOC cannot be obtained from another financial institution, JPMorgan would be required to acquire the Bonds under the terms of the Amended and Restated Reimbursement Agreement and the applicable Indenture. After JPMorgan acquires the bonds, the full amount of the outstanding 1996A/B Bonds and 2003A/B Bonds and any other amounts due and owing under the Amended and Restated Reimbursement Agreement will become "due and payable" from the Successor Agency to JPMorgan either immediately or in one year from such date if certain conditions are met, with interest owed for such interim one year period at the Bank Rate, which is equal to the Base Rate as defined below for the first ninety (90) days and the Base Rate plus 1% thereafter. If insufficient funds exist to pay the amount due and payable, whether in one year or immediately, the interest rate on the amount owed to JPMorgan under the Amended and Restated Reimbursement Agreement increases to the Default Rate, which is equal to the Base Rate plus 3%. "Base Rate" means on any day the greatest of (a) the Prime Rate plus 1.5%; (b) the Federal Funds Rate for such day plus 2%; and (c) 8.5%.

The SARA is required to pay JPMorgan an annual commitment fee for each credit facility based on the outstanding principal amount of the bonds supported by the credit facility. The JPMorgan Second Amendment lowered the annual commitment fee from 2.55% to 2.10%. JPMorgan also holds a liquidity reserve as an added source of security for the bank. Parcels of the former Agency owned land ("Pledged Properties") are also used to secure the LOCs.

The JPMorgan Second Amendment reduced the liquidity reserve requirement to $4,000,000 from $5,000,000 without provision for adjustment for debt service coverage levels stated in prior agreements. The liquidity reserve balance is $4,007,000 as of June 30, 2017.

The JPMorgan Second Amendment retains the Pledged Properties requirement and continues to require the SARA to dispose of Pledged Properties as expeditiously as possible and in a manner aimed at maximizing value pursuant to the Long Range Property Management Plan. The JPMorgan Second Amendment provides for the application of 80% of net proceeds from the sale of Pledged Properties towards the redemption of principal of the 1996A/B and 2003A/B Bonds. The JPMorgan Second Amendment also provides for payment of the remaining 20% of net proceeds from the sale of Pledged Properties to the County of Santa Clara to reduce the SARA's obligation under the 2011 Settlement Agreement. Upon payment in full to the County of the SARA's obligations under the 2011 Settlement Agreement, the County's lien on any remaining Pledged Projects would be released and, upon the sale of any of the remaining Pledged Properties, 100% of the net sales proceeds would be used towards the redemption of principal on the 1996 A/B and 2003 A/B Bonds.

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

On April 1, 2017, SARA entered into a Third Amended and Restated Continuing Covenant Agreement with Wells Fargo Bank to extend the Mandatory Purchase Date to April 27, 2018 from April 28, 2017. Pursuant to the Third Supplement to Fiscal Agent Agreement (the "Fiscal Agent Agreement"), the interest rate is equal to the sum of basis points of 1.32% plus an applicable spread of 0.85%. At June 30, 2017, the all-in interest rate was 2.17%.

Redevelopment property tax revenues have been pledged until the year 2035, the final maturity date of the 2010C Bonds. The total principal and projected interest remaining on the 2010C Bonds as of June 30, 2017 is $89,575,000. The 20% redevelopment property tax revenue recognized and received for the 2010C Bonds during the year ended June 30, 2017 in the amount of $4,922,000 was transferred to the fiscal agent to cover current and future debt service and the reserve requirement. The total debt service payments on the 2010C Bonds amounted to $4,346,000 for the year ended June 30, 2017.

If the Mandatory Purchase Date is not extended, or the SARA does not exercise its option under the Fiscal Agent Agreement to redeem the 2010C Bonds on or prior to the Mandatory Purchase Date, the SARA is required to pay the Purchase Price of the 2010C Bonds on the Mandatory Purchase Date; provided, however, if on the Mandatory Purchase Date the conditions set forth below are satisfied, the SARA shall not be required to pay the Purchase Price for the 2010C Bonds on the Mandatory Purchase Date except to the extent of available proceeds from the remarketing of the 2010C Bonds. In the event that the conditions set forth below are satisfied on the Mandatory Purchase Date, the available proceeds from the remarketing of the 2010C Bonds shall, to the extent available, be applied to pay the Purchase Price for the 2010C Bonds and that portion of 2010C Bonds for which the Purchase Price cannot be paid from such proceeds shall instead be repaid in accordance with the amortization provisions set forth in the Fiscal Agent Agreement, such that the Purchase Price of the 2010C Bonds shall be paid to Wells Fargo Bank in full on the third anniversary of the Mandatory Purchase Date, subject to the earlier remarketing, repayment, acceleration, prepayment or redemption of the 2010C Bonds.

The Purchase Price of the 2010C Bonds is due and payable in full on the Mandatory Purchase Date unless on such date the following conditions are satisfied: (A) no default shall have occurred and be continuing and (B) the SARA shall be deemed to have made on and as of such date each of the representations and warranties of the Agency made in the Continuing Covenant Agreement and in any certificate or document delivered in connection with the Continuing Covenant Agreement and each such representation and warranty shall continue to be accurate and complete in all material respects on and as of such date.

**4th and San Fernando Parking Facility Project Pledge Agreement** - In March 2001, the City of San José Financing Authority (the “Financing Authority”), issued Revenue Bonds, Series 2001A in the amount of $48,675,000 to finance the construction of the Fourth Street and San Fernando Parking Facility Project. The Agency entered into an Agency Pledge Agreement with the Financing Authority, which was assumed by the SARA, whereby the payments are payable from and secured by surplus “Agency Revenues”. Under the terms of the Agency Pledge Agreement, SARA’s payments are limited in each year to an amount equal to the annual debt service due on the bonds minus surplus revenues generated by the parking facility. Surplus Agency Revenues consist of (i) estimated tax increment revenues, which are pledged to the payment of the former Agency’s outstanding tax allocation bonds and deemed to be “Surplus” in the current fiscal year in accordance with the resolution, or indenture pursuant to which the outstanding tax allocation bonds were issued; plus (ii) all legally available revenues of the Agency.

As of June 30, 2017, the Series 2001A bonds have an outstanding balance of $23,930,000.

**Convention Center Refunding Reimbursement Agreement** - In July 2001, the Financing Authority issued the Convention Center Lease Revenue Refunding Bonds, Series 2001F (tax-exempt) and Series 2001G (taxable) amounting to $186,150,000 and $4,580,000, respectively. The bonds were issued to refund the 1993 Revenue Bonds, Series C. The Series 2001G Bonds have been paid off and only the Series 2001F Bonds remain outstanding.

In connection with the issuance of the 2001 Convention Center Refunding Bonds, the Agency and the City entered into the Second Amended and Restated Reimbursement Agreement under which the Agency is obligated to use redevelopment property tax revenues or other revenues to reimburse the City for lease payments made to the Financing Authority for the project. The Second Amended and Restated Reimbursement Agreement was assumed by the SARA.

The Series 2001F bonds mature in 2022 and have an outstanding balance of $78,680,000 at June 30, 2017.

**HUD Section 108 Loans** – In 1997, the Agency received loan proceeds of $5,200,000 under the provisions of the U.S. Department of Housing and Urban Development ("HUD") Section 108. The proceeds were used to finance the following downtown projects: Security Building, Bassler & Haynes, Beach Buildings ("Eu Bldgs"), and the Masson Building. The loan was paid in full on August 1, 2016.

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

As of June 30, 2017, the outstanding loans due to HUD total $20,000,000. The notes payable to HUD mature annually through August 2027 and bear interest at 20 basis points above the monthly LIBOR index. The average rate for the fiscal year 2017 was 1.10%. The HUD loans are secured by the City owned Fairmont Hotel Parking Garage, several SARA owned capital assets (Convention Center – South Hall, José Theatre, and Arena Lot 5A) and CDBG grant funds that are awarded to the City. The loans are being repaid by the City through CDBG funds due to insufficiency of redevelopment property tax revenues. During the year ended June 30, 2017, the SARA received $2,024,000 from the City's CDBG fund to fund debt service of the HUD 108 loans.

**Supplemental Educational Revenue Augmentation Funds (SERAF) Loan** – On July 24, 2009, the State Legislature passed AB 26 X4, which required redevelopment agencies statewide to deposit a total of $2,050,000,000 of property tax increment in county Supplemental Educational Revenue Augmentation Funds ("SERAF") to be distributed to meet the State's Proposition 98 obligations to schools. The Agency's SERAF obligation was $62,200,000 in fiscal year 2009-2010 ("2010 SERAF Obligation") and $12,800,000 in fiscal year 2010-2011 ("2011 SERAF Obligation"). Payments were made by May 10 of each respective fiscal year.

On May 4, 2010, the Agency and the City entered into a loan agreement where the City agreed to loan the Agency through two separate payments (May 2010 and May 2011) a combined amount of $74,816,000 to pay the 2010 SERAF Obligation and the 2011 SERAF Obligation ("SERAF Loan"). The sources of the SERAF Loan to pay the 2010 SERAF Obligation ($62,000,000) were $40 million from the City's Low and Moderate Income Housing Fund that had been made available following the issuance of the 2010 Housing Series C Bonds, which was specifically authorized by the legislation, and idle moneys from City special funds ($10,000,000) and $12,000,000 from the Financial Authority's Commercial Paper Program. The source of the SERAF Loan to pay the 2011 SERAF Obligation was $12,816,000 from the City's Low and Moderate Income Housing Fund. The Low and Moderate Income Housing Fund was subsequently renamed as the Low and Moderate Income Housing Asset Fund.

The Redevelopment Dissolution Law provides that all prior loans made between the City and the Agency, except for loans made from the Low and Moderate Income Housing Asset Fund for payment of SERAF, were invalidated as of February 1, 2012, but may be reinstated once certain conditions related to dissolution are met by the SARA as more particularly discussed below in the Parking Fund

Loans section. As such, the $10,000,000 used to pay a portion of the 2010 SERAF Obligation and its related accumulated interest in the amount $160,000 from the City made by funds other than the Low and Moderate Income Housing Asset Fund was invalidated under this provision and was recorded as part of the SARA's extraordinary items in 2012. In addition, interest accrued in excess of the LAIF rates pursuant to the Redevelopment Dissolution Law in the amount of $2,940,000 was also invalidated in 2012.

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

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

On May 26, 2016, the Oversight Board approved a partial reinstatement of the SERAF Loan used to pay the 2010 SERAF Obligation to restore the moneys originally loaned from the City's special funds in the amount of $10,000,000 and also approved the repayment schedule for the source of funds used to pay the 2011 SERAF Obligation in the amount of $12,816,000 plus accrued interest. The Oversight Board determined that the remaining portion of the SERAF Loan used to pay the 2010 SERAF Obligation in the amount of $52,000,000 plus accrued interest in the amount of $905,000 is not an enforceable obligation and directed the SARA to remove that portion of the loan from its financial statements. These actions were subsequently approved by the Successor Agency Board on June 28, 2016. As of June 30, 2017, this portion of the SERAF Loan has an outstanding principal and accumulated accrued interest balance of $22,816,000 and $4,502,000, respectively bears a simple interest rate of 3%.

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

**Commercial Paper Obligation** – As discussed above, the City and the Agency entered into a SERAF Loan, a portion of which was funded by the Financing Authority's issuance of $12,000,000 of commercial paper notes through the Financing Authority's Commercial Paper Program and deposited the funds in the Low and Moderate Income Housing Asset Fund. The Oversight Board and the SARA Board approved the inclusion of this obligation along with accrued interest and fees totaling $14,227,000 as an enforceable obligation of the SARA, on May 26, 2016 and June 28, 2016, respectively. A payment of $4,750,000 was made by the SARA in June 2017. The repayment of the commercial paper proceeds is reported in the ROPS 17-18 in the amount of $4,727,000 as of June 30, 2017.

**Parking Fund Loans** – Effective February 1, 2012, all redevelopment agencies in the State of California were dissolved pursuant to AB XI 26, and with narrow exceptions, loans between cities and their redevelopment agencies were invalidated by AB XI 26, which was subsequently amended by AB 1484 and SB 107 (collectively, "Dissolution Legislation"). However, with the approval of AB 1484 in June 2012, certain loans may be reinstated as enforceable obligations of the Successor Agency contingent upon the following: 1) a finding by the California Department of Finance (DOF) that certain specified audits of the Successor Agency have been completed (evidenced by a Finding of Completion), and 2) a finding by the Oversight Board of the Successor Agency that these loans were for legitimate redevelopment purposes. If a loan is reinstated pursuant to these provisions of AB 1484, the loan terms need to be revised to conform to statutory criteria for interest calculations and repayment priorities.

The Parking Fund Loans were reinstated as enforceable obligations on ROPS 17-18 in accordance with Health and Safety Code Section 34191.4 (b) with Oversight Board approval on January 12, 2017. The DOF approved the Parking Fund Loans on March 28, 2017. Because the loans are reinstated City loans, the principal outstanding will accrue 3% interest and be paid on a future ROPS after the SARA can show sufficiency for one year. As of June 30, 2017, the Parking Fund Loans have outstanding principal and accumulated accrued interest balance of $13,528,000 and $807,000, respectively.

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

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

The Amended Agreement provides that the payments due to the County from the Agency are subordinate to all the SARA's debt. The County and SARA settled litigation related to the Amended Agreement in August 2017.

At July 1, 2016, the amount due to the County was $47,006,000. During the year ended June 30, 2017, the County withheld $63,514,000 in RPTTF for payments of its prior years' pass-through payments. In addition, during the fiscal year 2016-2017, the SARA accrued pass-through amounts of $38,683,000 and an interest reduction of $895,000. Prior to settlement of PERS Levy Lawsuit, the County applied PERS levies settlement amount of $18,656,000 to pay down the pass-through payable to the County of Santa Clara. The total amount due to the County under the pass-through agreement at June 30, 2017 is $2,624,000.

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

Pursuant to the 2011 Settlement Agreement, the Agency agreed to pay the County $21,500,000 of County tax-exempt bond proceeds by March 30, 2011, pay an additional $5,000,000 of unrestricted funds, and transfer title to certain property to the County, resulting in a remaining amount of

$23,560,000 owed to the County. The Agency agreed to make payment in five installments no later than June 30 of 2014, 2015, 2016, 2017 and 2018.

As security for payments due to the County of Santa Clara under the County Settlement Agreement executed in March 2011 (“2011 Settlement Agreement”), the Agency also (i) executed and recorded for the benefit of the County, a subordinated Deed of Trust on various Agency-owned real estate assets, (ii) assigned to the County one-half (1/2) of the Agency sales proceeds from the sale of the North San Pedro properties under two separate Disposition and Development Agreements with private developers, and (iii) executed and recorded for the benefit of the County a Deed of Trust against the North San Pedro properties.

The SARA had sufficient redevelopment property tax revenues to pay the FY2015 ($4,712,000) and the FY2016 ($4,712,000) installments in the fiscal year 2017. As of June 30, 2017, the accrued 2017 and 2018 pass-through settlement payments and accumulated accrued interest owed are $9,424,000 and $1,696,000, respectively.

***Debt Service Requirements*** – The debt service requirements for all debt are based upon a fixed rate of interest, except 1996 Merged Area Revenue Bonds Series A and B, 2003 Merged Area Revenue Bonds Series A and B, 2010 Housing Set-Aside Bonds Series C, and HUD Section 108 Loans, which bear interest at variable rates. For purposes of calculating the annual debt service requirements for variable rate debt at June 30, 2017, the following assumed effective rates have been used:

| Debt | Effective Interest Rate |
|---|---|
| 1996 Merged Area Revenue, Series A | 0.93% |
| 1996 Merged Area Revenue, Series B | 0.93% |
| 2003 Merged Area Revenue, Series A | 1.25% |
| 2003 Merged Area Revenue, Series B | 0.93% |
| 2010 Housing Set-Aside, Series C | 2.17% |
| HUD Section 108 Loan | 1.40% |

The annual requirements to amortize outstanding tax allocation bonds and other long-term debt outstanding at June 30, 2017, including mandatory sinking fund payments, are as follows (in thousands):

| Year Ending | Merged Tax Allocation | | Housing Tax Allocation Bonds (1) | | Merged Area Revenue Bonds (2) | | Pledge and Other Agreements | |
|---|---|---|---|---|---|---|---|---|
| June 30 | Principal | Interest | Principal | Interest | Principal | Interest | Principal | Interest |
| 2018 | $ 65,905 | $ 65,374 | $ 12,510 | $ 11,907 | $ 4,595 | $ 919 | $ 13,765 | $ 4,783 |
| 2019 | 68,205 | 62,138 | 13,165 | 11,369 | 4,675 | 1,088 | 14,450 | 4,077 |
| 2020 | 71,330 | 58,668 | 13,840 | 10,800 | 4,765 | 1,209 | 15,155 | 3,340 |
| 2021 | 74,950 | 54,959 | 14,560 | 10,191 | 5,245 | 1,241 | 15,895 | 2,565 |
| 2022 | 78,715 | 51,088 | 15,345 | 9,547 | 5,735 | 1,087 | 16,680 | 1,750 |
| 2023-2027 | 418,880 | 193,479 | 82,320 | 37,274 | 19,620 | 3,351 | 26,665 | 1,598 |
| 2028-2032 | 382,560 | 92,977 | 77,915 | 18,511 | 11,100 | 1,619 | - | - |
| 2033-2037 | 215,680 | 18,632 | 45,155 | 3,692 | 3,900 | 20 | - | - |
| Total | $ 1,376,225 | $ 597,315 | $ 274,810 | $ 113,291 | $ 59,635 | $ 10,534 | $ 102,610 | $ 18,113 |

| Year Ending | Obligations with 3rd Parties | | Obligations with the City | | Total | |
|---|---|---|---|---|---|---|
| June 30 | Principal | Interest | Principal | Interest | Principal | Interest |
| 2018 | $ 11,224 | $ 2,073 | $ 17,625 | $ 233 | $ 125,624 | $ 85,289 |
| 2019 | 1,890 | 424 | - | - | 102,385 | 79,096 |
| 2020 | 1,990 | 442 | - | - | 107,080 | 74,459 |
| 2021 | 2,100 | 388 | - | - | 112,750 | 69,345 |
| 2022 | 2,205 | 323 | - | - | 118,680 | 63,794 |
| 2023-2027 | 10,015 | 554 | - | - | 557,500 | 236,256 |
| 2028-2032 | - | - | - | - | 471,575 | 113,108 |
| 2033-2037 | - | - | 53,425 | 5,489 | 318,160 | 27,832 |
| Total | $ 29,424 | $ 4,204 | $ 71,050 | $ 5,722 | $ 1,913,754 | $ 749,179 |

(1) *Assumes the 2010C Bonds would not be payable upon demand in the event that there is not a further extension of the April 28, 2018 Mandatory Purchase Date. The scheduled redemption of these bonds is incorporated in the annual requirements to maturity schedules.*

(2) *Assumes the 1996 A/B and 2003 A/B Bonds would not be payable on demand upon expiration of the LOCs on March 31, 2018. The scheduled redemption of these bonds is incorporated in the annual requirements to maturity schedules.*

**Ambac Assurance Surety Bonds Held in Bond Reserve Funds** – Ambac Assurance, a subsidiary of Ambac Financial ("Ambac"), is the surety provider for SARA's Senior Tax Allocation Bonds Series 1999, and Series 2006D According to the indenture for these bonds, in the event that such surety bond for any reason lapses or expires, and the remaining amount on deposit in the Bond Reserve Fund (as defined in the indenture) is less than the Bond Reserve Requirement (as defined in the indenture), the SARA is to address such shortfall by (i) delivering to the trustee a replacement surety bond, insurance policy or letter of credit or (ii) by making the required deposits to the Bond Reserve Fund.

On May 1, 2013, Ambac Financial emerged from bankruptcy protection which had been filed under Chapter 11 of the Bankruptcy Code in November 2010. Starting in March 2010, certain of the policy liabilities of Ambac were allocated to a segregated account which has been subject to a plan of rehabilitation. Policy obligations not allocated to such segregated account, including the obligations in respect of the surety bonds provided by Ambac on deposit in the bond reserve funds described above, not subject to, and therefore will not be impacted by such rehabilitation proceeding. No assurance can be made regarding the claims paying ability of Ambac on surety bonds described above.

**National Public Finance Guarantee Surety Bonds** – National Public Financial Guarantee ("NPFG") is the surety provider for SARA's Tax Allocation Bonds 1997, 2003, 2004A, 2005A, and 2006C. According to the indenture for these bonds, in the event that such surety bond for any reason lapses or expires, and the remaining amount on deposit in the Bond Reserve Fund (as defined in the indenture) is less than the Bond Reserve Requirement (as defined in the indenture), SARA is to address such shortfall by (i) delivering to the trustee a replacement surety bond, insurance policy or letter of credit or (ii) by making the required deposits to the Bond Reserve Fund. NPFG is also the surety provider for Housing Set-Aside Tax Allocation Bonds 1997E and 2005AB. According to the Fiscal Agent Agreement for these bonds, in the event that such surety bond for any reason lapses, expires or is no longer in effect, and the remaining amount on deposit in the Reserve Account (as defined in the Fiscal Agent Agreement) is less than the Reserve Requirement (as defined in the Fiscal Agent Agreement), the SARA is to address such shortfall by (i) delivering to the trustee a qualified surety bond, or letter of credit or (ii) by making the required cash deposits to the Reserve Account.

On June 26, 2017, Standard & Poor's Rating Service ("S&P") downgraded the insurance financial strength rating of NPFG to "A" from "AA-".

**Long Term Reimbursement Agreement** – When redevelopment property tax revenues are not sufficient to cover the SARA's enforceable obligations, the City Council has committed other sources of funding to cover costs related to the following obligations: agreements associated with the City of San José Financing Authority Lease Revenue Bonds, Series 2001F (Convention Center) and City of San José Financing Authority Revenue Bonds, Series 2001A (4$^{th}$ and San Fernando Parking Facility Project); Education Revenue Augmentation Fund ("ERAF") payments; and the SARA annual administrative budget and City support service expenses. On September 26, 2013 (as amended on August 27, 2015), the City and the SARA entered into an Amended and Restated Long-Term Reimbursement Agreement in order to establish an obligation for the SARA to repay the City for these advances.

Effective September 22, 2015, with the passage of SB 107, a city may loan funds to a Successor Agency that receives an insufficient distribution from the RPTTF and an enforceable obligation shall be deemed to be created for such loans. The receipt and use of such funds shall be reflected on the ROPS and subject to the approval of the Oversight Board. The interest payable on any such loan shall be calculated on a fixed annual simple basis at a rate not to exceed the most recently published interest rate for funds deposited into the Local Agency Investment Fund during the previous fiscal quarter. The repayment of such loan shall be subordinate to other approved enforceable obligations. Given the relevant provisions of SB 107, a reimbursement agreement is no longer necessary to establish the obligation to repay such loan.

**Administrative Advances from the City** – During the year ended June 30, 2017, the SARA incurred $607,000 of direct administrative costs and $823,000 of indirect general and administrative costs for support services of designated City employees allocated to the SARA administrative activities and $16,000 for rent of City office space. As of June 30, 2017, the SARA has recorded a payable due to the City for direct administrative services and indirect City supporting services in the amounts of $5,219,000 and $5,950,000, respectively. Since administrative costs are subordinated to all SARA enforceable obligations, these costs will likely not be paid to the City until all other enforceable obligations are satisfied.

### *5. Commitments and Contingencies Related to SARA*

#### *Risk Management*

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

The SARA does not have any claims liabilities outstanding at June 30, 2017.

#### *Environmental Land Remediation Obligation*

A review of the SARA's property during the year ended June 30, 2017 reveals that there is no current pollution remediation required based on their current uses (i.e. surface parking and other uses), except the Miraido property and Convention Center South Hall Site as discussed below. In the unlikely possibility, given dissolution, a land remediation obligation occurs on a property due to a change in the purpose (i.e., convert to housing or retail project), the SARA will prepare estimates and comply with the provisions of GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*.

**Miraido Property -** On December 2, 2010, the Agency received a Notice of Responsibility from the County for soil remediation at the Miraido Village Site located at 520 North 6th Street in San José. The Agency as owner of the underlying land leased the site under a ground lease (the "Ground Lease") to the Japantown Development Limited Partnership ("Miraido"). Miraido constructed an apartment complex on the Ground Lease site. The Agency received a Notice of Responsibility as an additional responsible party. The cleanup process is currently underway with Miraido's consultant working with the Santa Clara County Department of Environmental Health on finalizing the details of the cleanup process. As of June 30, 2017, Miraido's consultant at the direction of Miraido is continuing to mitigate the environmental contamination of the site.

Miraido is responsible for all cleanup activities under its Ground Lease with the Agency. Miraido's consultant has estimated that the cost to achieve case closure is approximately $450,000 at Miraido's cost, with which the SARA's consultant concurs. Under the Ground Lease, Miraido is required to indemnify the SARA if the SARA incurs any costs as a result of the condition of the property. As of June 30, 2017, the SARA has not incurred any cleanup cost. Miraido's failure to indemnify the SARA as required under the Ground Lease would constitute a default under the Ground Lease.

The Miraido Property was sold in "as-is" condition in July 2017.

**Convention Center South Hall Site** – The South Hall Site is contaminated with gasoline and diesel products. The San Francisco Regional Water Quality Control Board ("Regional Board") has requested a Site Management Plan be prepared for the site. The Regional Board also requested a residential deed restriction be placed on the South Hall Site. A Phase I and Phase II study of the South Hall Site was prepared for the Agency indicating site contamination. There are no immediate plans to prepare a Site Management Plan. The extent and cost of mitigating the contamination is unknown.

### Arbitrage Obligation

Subsequent to the dissolution of the former Agency, the SARA Board appointed the City Director of Finance as the SARA's Chief Financial Officer. The Chief Financial Officer directed a comprehensive review of compliance with regulatory and tax compliance of the SARA's debt portfolio. As a result of that review, it was determined that arbitrage rebate calculations were required for a number of the outstanding tax-exempt bonds in SARA's debt portfolio. The City on behalf of the SARA has engaged the services of a rebate consultant. Staff of both the SARA and the City are working with the rebate consultant to complete the calculations. The SARA may owe arbitrage rebate to the IRS, but at this point the amount due is undetermined.

### Contractual Commitments

At June 30, 2017, the SARA had $5,576,000 for contracted obligations and commitments. In addition, the SARA has unpaid contractual obligations in the amount of $5,321,000 due to the insufficiency of revenues.

### *Litigation Against County Auditor-Controller SARA*

The City, on its own behalf, and the SARA filed a lawsuit on June 26, 2012, entitled *City of San Jose as Successor Agency to the San Jose Redevelopment Agency v. Vinod Sharma, County of Santa Clara, et al.,* Case No. 34-2012-8000190, in the Superior Court for Sacramento County ("PERS Levy Lawsuit"). The suit seeks to compel the County Auditor Controller to disburse funds to the Successor Agency which the Agency previously received as tax increment. In June 2012, the County began withholding a portion of defined tax increment claiming the withheld amounts were special levies, including a contribution to the County's employees' retirement program (the "PERS Levy") and a levy for the benefit of the Santa Clara Valley Water District (the "Water District Levy"). The County asserted that, although it previously disbursed these funds to the Redevelopment Agency as tax increment, the Agency was never entitled to receive funds attributable to these levies. The lawsuit will also determine the priority of the County's pass-through payments under the Amended Agreement.

The Sacramento Superior Court ruled that the County Auditor Controller could not withhold funds attributable to the PERS Levy from the Successor Agency and the Redevelopment Dissolution Law did not require the County to subordinate its pass through payments to any Agency debt other than secured bond debt. The Superior Court did not rule on the Water District Levy.

The City and County both appealed the Superior Court decision to the Third District Court of Appeal, Case No. C074539 ("Court of Appeal"). The Court of Appeal held oral argument on September 26, 2016. On November 3, 2016, the Court of Appeal issued a decision finding that the PERS Levy tax increment was wrongfully withheld by the County prior to September 22, 2015, and the issue of the withholding of that increment after that date to the present is to be the subject of a further trial court hearing. In addition, the appellate court found that the County's pass through agreement was subordinate to bond debt of the Agency, but not other Agency debt based upon the express provisions of the Redevelopment Dissolution Law.

The County subsequently submitted a petition for review to the California Supreme Court and, on February 1, 2017, the California Supreme Court denied the County's petition for review.

In August 2017, the SARA, the City, and the County entered into a Settlement Agreement resolving the PERS Levy Lawsuit ("2017 Settlement Agreement"). At the time the 2017 Settlement Agreement was entered into by the parties, the County was holding $31,866,000 attributable to the PERS Levy and the Water District Levy. Pursuant to the 2017 Settlement Agreement, the City was reimbursed $12,898,000 for the debt-related SARA expenses paid FY2012-2015, the Santa Clara Valley Water

District was paid $312,000 for the AB1290 portion, and the remaining $18,656,000 was used to pay down the County Pass-through obligations as of June 30, 2017. As a result, the SARA's financials statements as of June 30, 2017 reflected the reduction of $18,656,000 to the pass-through payables to the Couty.

### D. Subsequent Events

#### 1. Tax and Revenue Anticipation Note

On July 3, 2017, the City entered into the Note Purchase Agreement with Bank of America, N.A. (the "Bank") under which the Bank agreed to purchase the City's short-term note in the full principal amount of $150,000,000 (the "2017 Note") in accordance with the terms of the Note Purchase Agreement. The transaction was needed for cash flow borrowing purposes to facilitate the prefunding of the City's retirement contributions. Pursuant to the Note Purchase Agreement, the City issued and the Bank purchased the 2017 Note bearing interest at a variable rate based on a LIBOR rate, plus a margin of 0.350% for Bank fees. Under the Note Purchase Agreement, at the City's option on any interest payment date, the City may prepay the 2017 Note in whole or in part, with partial prepayment of principal not less than $5,000,000 and in $1,000,000 increments in excess thereof. Security for repayment of the 2017 Note is a pledge of the City's 2017-2018 secured property tax revenues (excluding property taxes levied for general obligation bonds) and all other legally available General Fund revenues of the City, if required. The 2017 Note has a stated maturity of June 29, 2018.

#### 2. Successor Agency to the Redevelopment Agency of the City of San José

In July 2017, the SARA sold the Miraido Property to AFE Urban, Inc. (the buyer) for $2,800,000. With a net book value of $5,350,000, the SARA recognized a net loss of $2,560,000 after transaction costs. The SARA received net proceeds of $2,790,000. JPMorgan and the County each waived their respective liens on the Miraido project and the proceeds were used to partially call bonds associated with development of the Miraido project. The bonds involved were the Series 1996AB, 1997, 1999, 2004A, 2005A, and 2006CD. The SARA's interest as landlord under the Ground Lease and its right to receive Participation Rent was transferred to the buyer and the SARA would no longer receive any repayment of the financial improvement assistance in the amount of $11,659,000.

#### 3. City of San José Financing Authority Subordinate Wastewater Revenue Notes

On October 19, 2017, pursuant to a Credit Agreement dated as of October 1, 2017 by and among the City, the City of San José Financing Authority (the "Authority"), and Wells Fargo Bank, National Association (the "Bank"), the Authority issued to the Bank (i) a subordinate tax-exempt wastewater revenue note in an amount not to exceed $300 million and (ii) a subordinate taxable wastewater revenue note in an amount not to exceed $300 million outstanding at any one time. The credit agreement effectively established an interim financing program under a three-year contract that enables the issuance of subordinate wastewater revenue notes that can be outstanding at any one time in an amount not to exceed $300 million to finance capital improvements at the San José-Santa Clara Regional Wastewater Facility (the "RWF"). Advances on the notes will be made on a regular basis to reimburse the City for capital costs incurred at the RWF. Upon issuance of the notes, $174,500 was advanced under the tax-exempt note to pay for transactional closing costs. Additional periodic advances are anticipated to be made beginning in December 2017. The source of repayment of the notes, including associated fee and interest costs, are installment payments made to the Authority from pledged net system revenues received by the City related to the wastewater treatment system, pursuant to a Subordinate Installment Purchase Contract, dated as of October 1, 2017, by and between the City and Authority, and City Resolution No. 78382, which provides for the allocation and pledge of net system revenues to secure the payment of wastewater revenue obligations. Payments on the notes are subordinate to payments on previously issued, currently outstanding obligations payable from net system revenues (the San José- Santa Clara Clean Water Financing Authority, Sewer Revenue Refunding Bonds, Series 2009A (the “CWFA 2009A Bonds”) and the State Revolving Fund loan) and will be subordinate to payments on long-term bonds issued in the future. Based on the current ratings of the CWFA 2009A Bonds, the current fee rate for undrawn amounts under the notes is 0.25%, and the current cost for amounts advanced is (i) 0.35% plus 70% of 1-month LIBOR for tax-exempt notes and (ii) 0.45% plus 100% of 1-month LIBOR for the taxable note.

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## City of San José
## Required Supplementary Information (Unaudited)
## For the Year Ended June 30, 2017

### General Fund
### Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
### ($000's)

| | | Budgeted Amounts | | Actual Amounts Budgetary Basis Variance with Final Budget | Actual Amounts Budgetary | Budgetary to GAAP | Actual Amounts |
|---|---|---|---|---|---|---|---|
| | | Original | Final | Over (Under) | Basis | Differences | GAAP Basis |
| **REVENUES** | | | | | | | |
| Taxes: | | | | | | | |
| Property | $ | 271,737 | 276,537 | (149) | 276,388 | - | 276,388 |
| Utility | | 117,364 | 118,964 | 2,081 | 121,045 | - | 121,045 |
| Franchise | | 48,917 | 49,817 | (175) | 49,642 | - | 49,642 |
| Business Tax | | 48,800 | 53,550 | 609 | 54,159 | - | 54,159 |
| Other | | 16,952 | 18,000 | 275 | 18,275 | - | 18,275 |
| State of California in-lieu | | 435 | 460 | 7 | 467 | - | 467 |
| Sales taxes shared revenue | | 224,696 | 211,896 | (4,201) | 207,695 | - | 207,695 |
| Licenses, permits and fines | | 66,483 | 76,183 | (1,010) | 75,173 | - | 75,173 |
| Intergovernmental | | 8,375 | 12,884 | (1,752) | 11,132 | - | 11,132 |
| Charges for current services | | 42,722 | 44,797 | 1,252 | 46,049 | - | 46,049 |
| Other revenues | | 31,219 | 35,928 | 2,893 | 38,821 | - | 38,821 |
| Investment income | | 2,391 | 3,266 | 525 | 3,791 | (1,569) | 2,222 (1) |
| Total revenues | | 880,091 | 902,282 | 355 | 902,637 | (1,569) | 901,068 |
| **EXPENDITURES** | | | | | | | |
| Current: | | | | | | | |
| General government | | 168,653 | 133,018 | (26,016) | 107,002 | (11,141) | 95,861 (2) |
| Public safety | | 575,692 | 554,096 | (14,867) | 539,229 | (3,161) | 536,068 (2) |
| Community services | | 154,206 | 150,664 | (9,098) | 141,566 | (8,157) | 133,409 (2) |
| Sanitation | | 4,934 | 4,873 | (2,072) | 2,801 | (357) | 2,444 (2) |
| Capital maintenance | | 214,807 | 176,615 | (36,431) | 140,184 | (28,447) | 111,737 (2) |
| Capital outlay | | - | 14,535 | - | 14,535 | - | 14,535 |
| Debt service: | | | | | | | |
| Principal | | 101,564 | 1,526 | - | 1,526 | - | 1,526 |
| Interest | | 1,883 | 1,863 | (535) | 1,328 | - | 1,328 |
| Total expenditures | | 1,221,739 | 1,037,190 | (89,019) | 948,171 | (51,263) | 896,908 |
| Excess (deficiency) of revenues over expenditures | | (341,648) | (134,908) | 89,374 | (45,534) | 49,694 | 4,160 |
| **OTHER FINANCING SOURCES (USES)** | | | | | | | |
| Procees for sale of capital assets | | 102,500 | 2,500 | (2,344) | 156 | - | 157 |
| Operating transfers in | | 12,554 | 12,554 | 7,907 | 20,461 | - | 20,461 |
| Operating transfers-out | | (28,796) | (28,854) | (2,130) | (30,984) | - | (30,985) |
| Total other financing sources (uses) | | 86,258 | (13,800) | 3,433 | (10,367) | - | (10,367) (1) |
| Net change in fund balances | | (255,390) | (148,708) | 92,807 | (55,901) | 49,694 | (6,207) |
| | | | | | | - | |
| Fund balance - beginning | | 258,944 | 258,944 | - | 258,944 | 60,095 | 319,039 |
| Beginning encumbrance | | - | - | - | 39,758 | (39,758) | - |
| Fund balance - ending | $ | 3,554 | 110,236 | 92,807 | 242,801 | 70,031 | 312,832 |

**Explanation of differences:**

(1) Gain or loss in fair value of investments are not formally budgeted transactions.

(2) Encumbrances of funds for which formal budget are prepared.

See accompanying notes to the required supplementary information.

## Housing Activities
## Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
## ($000's)

| | Budgeted Amounts | | Actual Amounts Budgetary Basis Variance with Final Budget | Actual Amounts Budgetary | Budgetary to GAAP | Actual Amounts | |
|---|---|---|---|---|---|---|---|
| | Original | Final | Over (Under) | Basis | Differences | GAAP Basis | |
| Intergovernmental | $ 4,196 | 5,781 | 5,731 | 11,512 | - | 11,512 | |
| Investment income | 110 | 3,893 | (639) | 3,254 | (189) | 3,065 | (1) |
| Other revenues | 15,576 | 53,991 | (6,120) | 47,871 | (3,745) | 44,126 | (3) |
| Total revenues | 19,883 | 63,665 | (1,028) | 62,637 | (3,934) | 58,703 | |
| **EXPENDITURES** | | | | | | | |
| Current: | | | | | | | |
| Community services | 24,338 | 31,649 | (8,345) | 23,304 | (5,955) | 17,349 | (2), (3) |
| Total expenditures | 24,338 | 31,649 | (8,345) | 23,304 | (5,955) | 17,349 | |
| Excess (deficiency) of revenues over expenditures | (4,455) | 32,016 | 7,317 | 39,333 | 2,021 | 41,354 | |
| **OTHER FINANCING SOURCES (USES)** | | | | | | | |
| Transfers out | (40) | (71) | - | (71) | - | (71) | |
| Total other financing sources (uses) | (40) | (71) | | (71) | | (71) | |
| Net change in fund balances | (4,495) | 31,945 | 7,317 | 39,262 | 2,021 | 41,283 | |
| Fund balance - beginning | 28,951 | 28,951 | - | 28,951 | 57,426 | 86,377 | |
| Add beginning encumbrance balance | - | - | - | 8,528 | (8,528) | - | |
| Fund balances - ending | $ 24,456 | 60,896 | 7,317 | 76,741 | 50,919 | 127,660 | |

**Explanation of differences:**

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

See accompanying notes to the required supplementary information.

### Low and Moderate Income Housing Asset Fund
### Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
### ($000's)

| | Budgeted Amounts | | Actual Amounts Budgetary Basis Variance with Final Budget | Actual Amounts Budgetary | Budgetary to GAAP | Actual Amounts | |
|---|---|---|---|---|---|---|---|
| | Original | Final | Over (Under) | Basis | Differences | GAAP Basis | |
| **REVENUES** | | | | | | | |
| Investment income | $ 28,776 | 28,766 | (15,639) | 13,127 | 495 | 13,622 | (1) |
| Other revenues | 15,419 | 15,400 | (10,307) | 5,093 | (3,399) | 1,694 | (3) |
| Total revenues | 44,195 | 44,166 | (25,946) | 18,220 | (2,904) | 15,316 | |
| **EXPENDITURES** | | | | | | | |
| Current: | | | | | | | |
| Community services | 30,042 | 42,981 | (18,969) | 24,012 | (13,035) | 10,977 | (2), (3) |
| Total expenditures | 30,042 | 42,981 | (18,969) | 24,012 | (13,035) | 10,977 | |
| Excess (deficiency) of revenues over expenditures | 14,152 | 1,185 | (6,977) | (5,792) | 10,131 | 4,339 | |
| **OTHER FINANCING SOURCES (USES)** | | | | | | | |
| Transfers out | (463) | (467) | - | (467) | - | (467) | |
| Total other financing sources (uses) | (463) | (467) | - | (467) | - | (467) | |
| Net change in fund balances | 13,689 | 718 | (6,977) | (6,259) | 10,131 | 3,872 | |
| Fund balance - beginning | 44,217 | 44,217 | - | 44,217 | 304,243 | 348,460 | |
| Add beginning encumbrance balance | - | - | - | 2,639 | (2,639) | - | |
| Fund balances - ending | $ 57,906 | 44,935 | (6,977) | 40,597 | 311,735 | 352,332 | |

**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.

### Integrated Waste Management
### Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
### ($000's)

| | Budgeted Amounts Original | Budgeted Amounts Final | Actual Amounts Budgetary Basis Variance with Final Budget Over (Under) | Actual Amounts Budgetary Basis | Budgetary to GAAP Differences | Actual Amounts GAAP Basis | |
|---|---|---|---|---|---|---|---|
| **REVENUES** | | | | | | | |
| Charges for current services | $ 126,545 | 126,545 | 1,925 | 128,470 | - | 128,470 | |
| Rent | 510 | 510 | 9 | 519 | - | 519 | |
| Investment income | 232 | 232 | (7) | 225 | - | 225 | |
| Total revenues | 127,287 | 127,287 | 1,927 | 129,214 | - | 129,214 | |
| **EXPENDITURES** | | | | | | | |
| Current: | | | | | | | |
| Sanitation | 129,497 | 129,497 | (1,003) | 128,494 | (1,982) | 126,512 | (1) |
| Capital outlay | 53 | 53 | - | 53 | - | 53 | |
| Debt service: | | | | | | | |
| Principal | - | - | 428 | 428 | - | 428 | |
| Total expenditures | 129,550 | 129,550 | (575) | 128,975 | (1,982) | 126,993 | |
| Excess (deficiency) of revenues over expenditures | (2,263) | (2,263) | 2,502 | 239 | 1,982 | 2,221 | |
| **OTHER FINANCING SOURCES (USES)** | | | | | | | |
| Transfers out | - | - | (1,093) | (1,093) | - | (1,093) | |
| Total other financing sources (uses) | - | - | (1,093) | (1,093) | - | (1,093) | |
| Net change in fund balances | (2,263) | (2,263) | 1,409 | (854) | 1,982 | 1,128 | |
| Fund balance - beginning | 28,301 | 28,301 | - | 28,301 | - | 28,301 | |
| Add beginning encumbrance balance | - | - | 3,067 | 3,067 | (3,067) | - | |
| Fund balances - ending | $ 26,038 | 26,038 | 4,476 | 30,514 | (1,085) | 29,429 | |

**Explanation of differences:**
(1) Encumbrances of funds for which formal budget is prepared.

See accompanying notes to the required supplementary information.

# City of San José
# Required Supplementary Information (Unaudited)
# June 30, 2017

## Schedules of Employer Contributions – Defined Benefit Pension Plans

**PFDRP Schedule of Employer Contributions**

(Dollar Amounts in Thousands)

| | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|---|---|---|---|---|
| Actuarially determined contribution | $ 136,957 | $ 132,480 | $ 129,279 | $ 123,583 | $ 105,294 | $ 121,008 | $ 77,918 | $ 52,315 | $ 53,103 | $ 56,372 |
| Contributions in relation to the actuarially determined contributions | 136,957 | 132,480 | 129,279 | 123,583 | 105,294 | 121,008 | 77,918 | 52,315 | 53,103 | 56,372 |
| Contribution deficiency (excess) | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Covered-employee payroll | $ 188,177 | $ 186,874 | $ 180,226 | $ 180,083 | $ 180,333 | $ 184,750 | $ 222,464 | $ 239,570 | $ 243,196 | $ 240,503 |
| Contributions as a percentage of covered-employee payroll | 72.78% | 70.89% | 71.73% | 68.63% | 58.39% | 65.50% | 35.02% | 21.84% | 21.84% | 23.44% |

**Actuarial valuations have been performed biennially through June 30, 2007. Effective with the June 30, 2009 valuation, which determined contribution rates for fiscal year 2011, the plan transitioned to annual actuarial valuations.

| Fiscal Year | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010-09 |
|---|---|---|---|---|---|---|---|---|
| Valuation date | June 30, 2015 | June 30, 2014 | June 30, 2013 | June 30, 2012 | June 30, 2011 | June 30, 2010 | June 30, 2009 | June 30, 2007 |
| Actuarial cost method | Entry age | Entry age | Entry age | Entry age | Entry age | Entry age | Entry age | Entry age |
| Asset valuation method | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market |
| Amortization method | Actuarial gains and losses and plan changes are amortized over closed 16-year periods. Method and assumption changes are amortized over 20-year periods. All amortizations are a level percent of payroll. | | | | | | | |
| Discount rate | 7.00% | 7.00% | 7.125% | 7.125% | 7.25% | 7.50% | 7.75% | 8.00% |
| Salary increases | 3.25% plus merit component based on length of service ranging from 9.25% for new hires to 2.00% for members with 10 or more years of service. | 3.25% plus merit component based on length of service ranging from 9.25% for new hires to 2.00% for members with 10 or more years of service. | 2.00% for one year and 3.5% thereafter plus merit component based on length of service ranging from 9.25% for new hires to 2.00% for members with 10 or more years of service. | 0.00% for FY 2013 and 2014, and 3.50% thereafter plus merit component based on length of service ranging from 8.00% for new hires to 2.25% for members with 10 or more years of service. | 0.00% for FY 2013 and 2014, and 3.50% thereafter plus merit component based on length of service ranging from 8.00% for new hires to 2.25% for members with 10 or more years of service. | 0.00% for FY 2013 and 2014, and 3.50% thereafter plus merit component based on length of service ranging from 8.00% for new hires to 2.25% for members with 10 or more years of service. | 0.75% plus merit component based on length of service ranging from 9.75% for new hires to 6.00% for members with 8 or more years of service. | 0.75% plus merit component based on length of service ranging from 9.75% for new hires to 6.00% for members with 8 or more years of service. |
| Amortization payment growth rate | 3.25% | 3.25% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% |
| COLA | 3.0% for Tier 1, 1.5% for Tier 2 | 3.0% for Tier 1, 1.5% for Tier 2 | 3.0% for Tier 1, 1.5% for Tier 2 | 3.0% for Police Tier 1 & Fire, 1.5% for Police Tier 2 | 3.0% for Police Tier 1 & Fire, 1.5% for Police Tier 2 | 3% for Police Tier 1 & Fire | 3% for Police Tier 1 & Fire | 3% for Police and Fire |
| Mortality | Healthy annuitants: CalPERS 2009 Healthy Annuity Mortality Tables multiplied by 0.948 for males and 1.048 for females, with mortality improvements projected from 2009 using Scale MP-2015 on a generational basis Disabled annuitants: CalPERS 2009 Industrial Mortality Tables for Males multiplied by 0.903, with mortality improvements projected from 2009 using Scale MP-2015 on a generational basis. | RP-2000 combined healthy mortality table with no collar adjustment projected to 2010 using scale AA. Male rates are set back three years. | | | | RP-2000 combined healthy mortality table with no collar adjustment projected to 2010 using scale AA. Male rates are set back four years. | RP-2000 combined healthy mortality table with no collar adjustment projected to 2010 using scale AA. Male rates are set back three years and female rates are set forward one year. | |

**FCERS Schedule of Employer Contributions**

(Dollar Amounts in Thousands)

| | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|---|---|---|---|---|
| Actuarially determined contribution | $ 138,483 | $ 129,456 | $ 114,751 | $ 102,811 | $ 103,109 | $ 87,082 | $ 59,180 | $ 54,566 | $ 57,020 | $ 54,958 |
| Contributions in relation to the actuarially determined contributions | 138,483 | 124,723 | 114,751 | 107,544 | 103,109 | 87,082 | 59,180 | 54,566 | 57,020 | 54,958 |
| Contribution deficiency (excess) | $ - | $ 4,733 | $ - | $ (4,733) | $ - | $ - | $ - | $ - | $ - | $ - |
| Covered-employee payroll | $ 271,153 | $ 257,771 | $ 240,678 | $ 219,434 | $ 217,375 | $ 223,158 | $ 275,869 | $ 308,684 | $ 320,993 | $ 302,414 |
| Contributions as a percentage of covered-employee payroll | 51.07% | 48.39% | 47.68% | 49.01% | 47.43% | 39.02% | 21.45% | 17.68% | 17.76% | 18.17% |

| **Fiscal Year** | **2017** | **2016** | **2015** | **2014** | **2013** | **2012** | **2011** | **2010-09** |
|---|---|---|---|---|---|---|---|---|
| **Valuation date** | **June 30, 2015** | **June 30, 2014** | **June 30, 2013** | **June 30, 2012** | **June 30, 2011** | **June 30, 2010** | **June 30, 2009** | **June 30, 2007** |
| **Actuarial cost method** | Entry age | Entry age | Entry age | Entry age | Entry age | Entry age | Entry age | Entry age |
| **Asset valuation method** | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market |
| **Discount rate** | 7.00% | 7.00% | 7.25% | 7.50% | 7.95% | 7.95% | 7.75% | 8.25% |
| **Salary increases** | 2.85% plus merit component based on years of service | 2.85% plus merit component based on employee classification and years of service | 2.0% for five years and 2.85% thereafter plus merit component based on employee classification and years of service | The base annual rate of salary increase is 3.25% wage inflation rate plus a rate increase for merit/ longevity for years 0 to 15+ ranging from 4.50% to 0.25% at the 14th year of service | The base annual rate of salary increase is 3.90% wage inflation rate plus a rate increase for merit/ longevity for the first 5 years of service ranging from 5.75% to 0.25% at the 5th year of service | The base annual rate of salary increase is 3.90% wage inflation rate plus a rate increase for merit/ longevity for the first 5 years of service ranging from 5.75% to 0.25% at the 5th year of service | The base annual rate of salary increase is 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 5th year of service | 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 |
| **Amortization payment growth rate** | 2.85% | 2.85% | 2.43% | 3.25% | 3.90% | 3.90% | 3.83% | 4.25% |
| **COLA** | Tier 1: 3%<br>Tier 2: CPI, cap of 1.5% | Tier 1: 3%<br>Tier 2: CPI, cap of 1.5% | Tier 1: 3%<br>Tier 2: CPI, cap of 1.5% | Tier 1: 3%<br>Tier 2: CPI, cap of 1.5% | Tier 1: 3% | Tier 1: 3% | Tier 1: 3% | Tier 1: 3% |
| **Mortality** | Adjusted 2009 CalPERS mortality tables projected on a generational basis with the SOA MP-2015 projection scale | Sex distinct RP-2000 Combined Mortality projected to 2015 using Scale AA and setback two years | Sex distinct RP-2000 Combined Mortality projected to 2015 using Scale AA and setback two years | For healthy annuitants, the male and female RP-2000 combined employee and annuitant mortality tables projected to 2015 and set back two years. For disabled annuitants, the CalPERS oridnary disability table from their 2000-2004 study for miscellaneous employees | The 1994 group annuity mortality table set back three years for males and one year for females was used for healthy retirees and bene-ficiaries. The disabled mortality table used was the 1981 disability mortality table. | The 1994 group annuity mortality table set back three years for males and one year for females was used for healthy retirees and bene-ficiaries. The disabled mortality table used was the 1981 disability mortality table. | The 1994 group annuity mortality table set back three years for males and one year for females was used for healthy retirees and bene-ficiaries. The disabled mortality table used was the 1981 disability mortality table. | The 1994 Group Annuity Mortality Table was used for healthy retirees and bene-ficiaries. The disabled mortality table used was the 1981 Disability Mortality Table |

## Schedule of Changes in the Employer's Net Pension Liability – Defined Benefit Pension Plans

| (Dollar amounts in thousands): | PFDRP | | | |
|---|---|---|---|---|
| **Total pension liability** | **2017** | **2016** | **2015** | **2014** |
| Service cost (middle of year) | $ 72,760 | $ 74,531 | $ 74,895 | $ 75,030 |
| Interest (includes interest on service cost) | 290,961 | 274,488 | 262,737 | 251,701 |
| Changes of benefit terms | 5,752 | - | - | - |
| Differences between expected and actual experience | 67,557 | (8,673) | 21,457 | - |
| Changes of assumptions | 72,680 | 90,179 | 56,311 | - |
| Benefit payments, including refunds of member contributions | (196,032) | (186,939) | (176,253) | (167,397) |
| **Net change in total pension liability** | 313,678 | 243,586 | 239,147 | 159,334 |
| Total pension liability - beginning | 4,220,098 | 3,976,512 | 3,737,365 | 3,578,031 |
| Total pension liability - ending | $ 4,533,776 | $ 4,220,098 | $ 3,976,512 | $ 3,737,365 |
| **Plan fiduciary net position** | | | | |
| Contibutions - employer | $ 136,957 | $ 132,480 | $ 129,279 | $ 123,583 |
| Contibutions - member | 20,580 | 21,508 | 20,747 | 21,115 |
| Net investment income | 292,734 | (29,207) | (27,690) | 404,978 |
| Benefit payments, including refunds of member contributions | (196,032) | (186,939) | (176,253) | (167,397) |
| Administrative expense | (4,633) | (4,256) | (4,191) | (3,631) |
| **Net change in plan fiduciary net position** | 249,606 | (66,414) | (58,108) | 378,648 |
| **Plan fiduciary net position - beginning** | 3,043,651 | 3,110,065 | 3,168,173 | 2,789,525 |
| **Plan fiduciary net position - ending** | $ 3,293,257 | $ 3,043,651 | $ 3,110,065 | $ 3,168,173 |
| **Net pension liability - ending** | $ 1,240,519 | $ 1,176,447 | $ 866,447 | $ 569,192 |
| **Plan fiduciary net position as a percentage of the total pension liability** | 72.64% | 72.12% | 78.21% | 84.77% |
| **Covered employee payroll** | $ 188,177 | $ 186,874 | $ 180,226 | $ 180,083 |
| **Net pension liability as a percentage of covered employee payroll** | 659.23% | 629.54% | 480.76% | 316.07% |

| (Dollar amounts in thousands): | FCERS | | | |
|---|---|---|---|---|
| **Total pension liability** | **2017** | **2016** | **2015** | **2014** |
| Service cost (middle of year) | $ 51,887 | $ 49,011 | $ 46,795 | $ 43,334 |
| Interest (includes interest on service cost) | 249,387 | 229,610 | 221,690 | 214,487 |
| Changes of benefit terms | 12,132 | - | - | - |
| Differences between expected and actual experience | 40,853 | 39,720 | 13,005 | - |
| Changes of assumptions | 60,233 | 205,875 | 108,674 | - |
| Benefit payments, including refunds of member contributions | (183,430) | (173,318) | (164,562) | (155,936) |
| **Net change in total pension liability** | 231,062 | 350,898 | 225,602 | 101,885 |
| Total pension liability - beginning | 3,692,148 | 3,341,250 | 3,115,648 | 3,013,763 |
| Total pension liability - ending | $ 3,923,210 | $ 3,692,148 | $ 3,341,250 | $ 3,115,648 |
| **Plan fiduciary net position** | | | | |
| Contibutions - employer | $ 138,483 | $ 124,723 | $ 114,751 | $ 107,544 |
| Contibutions - member | 17,227 | 15,920 | 13,621 | 13,596 |
| Net investment income | 146,010 | (35,011) | (16,642) | 263,688 |
| Benefit payments, including refunds of member contributions | (183,430) | (173,318) | (164,562) | (155,936) |
| Administrative expense | (4,378) | (3,941) | (3,898) | (3,201) |
| **Net change in plan fiduciary net position** | 113,912 | (71,627) | (56,730) | 225,691 |
| **Plan fiduciary net position - beginning** | 1,858,880 | 1,930,507 | 1,987,237 | 1,761,546 |
| **Plan fiduciary net position - ending** | $ 1,972,792 | $ 1,858,880 | $ 1,930,507 | $ 1,987,237 |
| **Net pension liability - ending** | $ 1,950,418 | $ 1,833,268 | $ 1,410,743 | $ 1,128,411 |
| **Plan fiduciary net position as a percentage of the total pension liability** | 50.29% | 50.35% | 57.78% | 63.78% |
| **Covered employee payroll** | $ 271,153 | $ 257,771 | $ 240,678 | $ 219,434 |
| **Net pension liability as a percentage of covered employee payroll** | 719.31% | 711.20% | 586.15% | 514.24% |

## Schedule of Investment Returns – Defined Benefit Pension Plans

| | PFDRP | | | |
|---|---|---|---|---|
| | 2017 | 2016 | 2015 | 2014 |
| Annual money-weighted rate of return, net of investment expense | 9.68% | (0.85%) | (0.85%) | 13.0% |

| | FCERS | | | |
|---|---|---|---|---|
| | 2017 | 2016 | 2015 | 2014 |
| Annual money-weighted rate of return, net of investment expense | 7.53% | (0.79)% | (1.07)% | 7.49% |

*Schedules are intended to show information for 10 years. Additional years will be displayed as they become available.*

## Schedule of the City's Proportionate Share of the Net Pension Liability and Related Ratios – CalPERS

| (Dollar amounts in thousands): | 2017 | 2016 | 2015 |
|---|---|---|---|
| Measurement date: | June 30, 2016 | June 30, 2015 | June 30, 2014 |
| Proportion of the net pension liability | 0.03634% | 0.03783% | 0.01697% |
| Proportionate share of the net pension liability | $ 1,262 | $ 1,038 | $ 1,056 |
| Covered employee payroll | $ 756 | $ 589 | $ 692 |
| Proportionate share of the net pension liability as percentage of covered-employee payroll | 166.93% | 176.23% | 152.60% |
| Plan's fiduciary net position | 3,666 | 3,671 | 3,395 |
| Plan's fiduciary net position as a percentage of the total pension liability | 74.39% | 77.96% | 76.28% |

**Notes to Schedule:**

**Benefit changes.** In 2015, benefit terms were modified to base miscellaneous employee pensions on a final three-year average salary instead of a final five-year average salary

Schedule is intended to show information for 10 years commencing with the fiscal year ended June 30, 2015. Additional years will be displayed as they become available.

### Schedule of Employer Contributions – CalPERS

| (Dollar amounts in thousands) | 2017 | 2016 | 2015 |
|---|---|---|---|
| Actuarially determined contribution | $ 162 | $ 148 | $ 107 |
| Contributions in relation to the actuarially determined contributions | 162 | 156 | 107 |
| Contribution deficiency (excess) | $ - | $ (8) | $ - |
| Covered - employee payroll | $ 776 | $ 756 | $ 589 |
| Contributions as a percentage of covered employee payroll | 20.88% | 20.63% | 17.06% |

**Notes to Schedule:**

| | | | |
|---|---|---|---|
| **Valuation Date** | 6/30/2014 | 6/30/2013 | 6/30/2012 |
| **Actuarial Cost Method** | Entry Age Normal Cost Method | | |
| **Amortization Method** | Level Percentage of Payroll | | |
| **Asset Valuation Method** | Market Value | Market Value | 15 Year Smoothed Market |
| **Actuarial Assumptions:** | | | |
| **Discount Rate** | 7.5% (net of administrative expenses) | | |
| **Termination Liability Discount Rate** | 2.91% | 3.72% | 2.98% |
| **Salary Growth** | 3.20% to 12.20% | 3.30% to 14.20% | |
| | Depending on Age, Service and Type of Employment | | |
| **Inflation** | 2.75% | | |
| **Payroll Growth** | 3.00% | | |

Schedule is intended to show information for 10 years commencing with the fiscal year ended June 30, 2015. Additional years will be displayed as they occur.

### Schedules of Employer Contributions – Postemployment Healthcare Plans

Beginning in FYE 2010 for Police members and FYE 2012 for Fire members, actual contributions were intended to phase in to the full ARC as defined in the bargaining agreements and consistent with the parameters of GASB Statement No. 45, but the contribution rates were capped before the full ARC was reached. With the contribution rates capped, the ARC has been determined as the minimum amount that was consistent with the parameters of GASB Statement No. 45. No amount has been determined on an actuarial basis to fund the plan, and consequently the schedule of employer contributions is not provided.

Beginning in FYE 2010 for FCERS members, actual contributions were intended to phase in to the full ARC as defined in the bargaining agreements and consistent with the parameters of GASB Statement No. 45, but the contribution rates were capped before the full ARC was reached. With the contribution rates capped, the ARC has been determined as the minimum amount that was consistent with the parameters of GASB Statement No. 45. No amount has been determined on an actuarial basis to fund the plan, and consequently, the schedule of employer contributions is not provided.

## Schedule of Changes in the Employer's Net OPEB Liability – Postemployment Healthcare Plans

| (Dollar amounts in thousands): | **PFDRP** 2017 |
|---|---|
| **Total OPEB liability** | |
| Service cost (middle of year) | $ 16,112 |
| Interest (includes interest on service cost) | 46,774 |
| Benefit payments, including refunds of member contributions | (24,799) |
| **Net change in total OPEB liability** | 38,087 |
| Total OPEB liability - beginning | 676,430 |
| Total OPEB liability - ending | $ 714,517 |
| **Plan fiduciary net position** | |
| Contibutions - employer | $ 20,667 |
| Contibutions - member | 18,116 |
| Net investment income | 12,453 |
| Benefit payments, including refunds of member contributions | (24,799) |
| Administrative expense | (182) |
| **Net change in plan fiduciary net position** | 26,255 |
| **Plan fiduciary net position - beginning** | 123,427 |
| **Plan fiduciary net position - ending** | $ 149,682 |
| **Net pension liability - ending** | $ 564,835 |
| **Plan fiduciary net position as a percentage of the total OPEB liability** | 20.95% |
| **Covered employee payroll** | $ 188,177 |
| **Net OPEB liability as a percentage of covered employee payroll** | 300.16% |

| (Dollar amounts in thousands): | **FCERS** 2017 |
|---|---|
| **Total OPEB liability** | |
| Service cost (middle of year) | $ 11,109 |
| Interest (includes interest on service cost) | 49,977 |
| Benefit payments, including refunds of member contributions | (31,007) |
| **Net change in total OPEB liability** | 30,079 |
| Total OPEB liability - beginning | 736,721 |
| Total OPEB liability - ending | $ 766,800 |
| **Plan fiduciary net position** | |
| Contibutions - employer | $ 31,905 |
| Contibutions - member | 16,827 |
| Net investment income | 17,041 |
| Benefit payments, including refunds of member contributions | (31,007) |
| Administrative expense | (241) |
| **Net change in plan fiduciary net position** | 34,525 |
| **Plan fiduciary net position - beginning** | 225,845 |
| **Plan fiduciary net position - ending** | $ 260,370 |
| **Net pension liability - ending** | $ 506,430 |
| **Plan fiduciary net position as a percentage of the total OPEB liability** | 33.96% |
| **Covered employee payroll** | $ 271,153 |
| **Net OPEB liability as a percentage of covered employee payroll** | 186.77% |

## Schedule of Investment Returns – Postemployment Healthcare Plans

| | PFDRP |
|---|---|
| | 2017 |
| Annual money-weighted rate of return, net of investment expense | 7.17% |

| | FCERS |
|---|---|
| | 2017 |
| Annual money-weighted rate of return, net of investment expense | 7.20% |

*Schedules are intended to show information for 10 years. Additional years will be displayed as they become available.*

## City of San José
## Required Supplementary Information (Unaudited)
## June 30, 2017

### Schedules of Funding Progress – Postemployment Healthcare Benefit Plans
### ($000's)

#### Police and Fire Department Retirement Plan

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Accrued Liability (AAL) | Unfunded AAL | Funded Ratio | Annual Covered Payroll | Unfunded AAL as a Percentage of Covered Payroll |
|---|---|---|---|---|---|---|
| 6/30/14 | $ 93,605 | $ 706,709 | $ 613,104 | 13% | $ 188,189 | 326% |
| 6/30/15 | 114,565 | 739,753 | 625,188 | 15% | 184,733 | 338% |
| 6/30/16 | 135,207 | 778,871 | 643,664 | 17% | 194,072 | 332% |

#### Federated City Employees' Retirement System

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Accrued Liability (AAL) | Unfunded AAL | Funded Ratio | Annual Covered Payroll | Unfunded AAL as a Percentage of Covered Payroll |
|---|---|---|---|---|---|---|
| 6/30/14 | $ 199,776 | $ 729,406 | $ 529,630 | 27% | $ 234,677 | 226% |
| 6/30/15 | 209,761 | 817,673 | 607,912 | 26% | 251,430 | 242% |
| 6/30/16 | 225,845 | 764,261 | 538,416 | 30% | 266,823 | 202% |

## I. Budgetary Information

The adopted budget represents the financial and organizational plan by which the policies and programs approved by the City Council will be implemented. It includes: (1) the programs, projects, services and activities to be provided during the fiscal year; (2) estimated revenues available to finance the operating plan; and (3) the estimated spending requirements of the operating plan. The City Charter requires that the City establish a budgetary system for general operations and prohibits expending funds for which there is no legal appropriation.

The annual appropriation ordinance adopts the budget at the appropriation level by expenditure category (personal services, nonpersonal) within departments. Accordingly, the lowest level of budgetary control exercised by the City Council is the appropriation level within a department. The City's legal level of budgetary control is so detailed that it is not practical to demonstrate compliance within the Comprehensive Annual Financial Report itself. As a result, the City prepares a separate report to demonstrate compliance with its legal level of budgetary control.

Annual budgets are prepared for the General Fund and all Special Revenue Funds. Capital project budgets are based on a project time frame rather than a fiscal year time frame. Debt Service Funds appropriations were adopted by the Council when the formal bond resolutions were approved. Therefore, Capital Project Funds and Debt Service Funds are not reported on budgetary basis.

## II. Budgetary Results Reconciled to GAAP

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

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

- Year-end encumbrances are recognized as the equivalent of expenditures in the budgetary basis financial statements, while encumbered amounts are not recognized as expenditures on GAAP basis until the equipment, supplies or services are received.

- Certain loan transactions are recognized as expenditures for the budgetary basis but not for the GAAP basis. When these loans are made, they are recorded as receivables on a GAAP basis and as expenditures on a budgetary basis. When loan repayments are received, they are recorded as reductions to receivables on a GAAP basis, but are recognized as revenues on a budgetary basis.

- Net decreases were made to certain GAAP basis loans receivable to reflect carrying amounts at a discounted present value and allowances for bad debts. The discount is treated as an expenditure on a GAAP basis and is not included in the budgetary basis financial statements. In addition, the allowance for bad debts is not included in the budgetary basis financial schedules, but is an expenditure on a GAAP basis.

- Certain advances to the SARA are recognized as expenditures for the budgetary basis but not for the GAAP basis. When these advances are made, they are recorded as receivables on a GAAP basis and as expenditures on a budgetary basis. When repayments are received, they are recorded as reductions to advances to the SARA on a GAAP basis, but are recognized as revenues on a budgetary basis.

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

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

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

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

## III. Budget Revisions

On October 17 2017, the City Council approved certain fiscal year 2017 budget revisions that increased appropriations for various expenditure categories. The budget amounts presented in the accompanying schedules of revenues, expenditures, and changes in fund balances - budget and actual reflect such budget revisions.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

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Honorable City Council
City of San José, California

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San José, California (City) as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated November 16, 2017.

### Internal control over financial reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying schedule of findings, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies in the City's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency described in the accompanying schedule of findings as item 2017-001 to be a material weakness in the City's internal control.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings as items 2017-002 to 2017-006 to be significant deficiencies in the City's internal control.

### Compliance and other matters

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

### City's response to findings

The City's response to our findings, which is described in the accompanying Corrective Action Plan was not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on the City's response.

### Intended purpose

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

GRANT THORNTON LLP

Grant Thornton LLP

San Jose, California
November 16, 2017

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

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Honorable City Council
City of San José, California

**Report on compliance for each major federal program**

We have audited the compliance of City of San José, California (the "City") with the types of compliance requirements described in the U.S. Office of Management and Budget's *OMB Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2017. The City's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings.

Management's responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to the City's federal programs.

Auditor's responsibility

Our responsibility is to express an opinion on compliance for each of the City's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the City's compliance.

Opinion on each major federal program

In our opinion, the City complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2017.

## Report on internal control over compliance

Management of the City is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the City's internal control over compliance with the types of compliance requirements that could have a direct and material effect on each major federal program to design audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in the City's internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this Report on Internal Control Over Compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

GRANT THORNTON LLP

Grant Thornton LLP

San Jose, California
November 30, 2017

# CITY OF SAN JOSE, CALIFORNIA
## Schedule of Expenditures of Federal Awards
## Year Ended June 30, 2017

| Federal Grantor/Pass-Through Grantor/Program | Federal Catalog Number | Grant Identifying Number | Federal Expenditures | Amount Provided to Subrecipients |
|---|---|---|---|---|
| **U.S. Department of Agriculture Food and Nutrition Service** | | | | |
| Pass-through California Department of Education Nutrition Services Division: | | | | |
| Summer Food Service Program for Children | 10.559 | 05394-SFSP-43 | $ 43,623 | $ - |
| Total U.S. Department of Agriculture Food and Nutrition Service | | | 43,623 | - |
| **U.S. Department of Housing and Urban Development** | | | | |
| Direct programs: | | | | |
| CDBG - Entitlement Grants Cluster: | | | | |
| Community Development Block Grants/Entitlement Grants | 14.218 | B-15-MC-06-0021 | 3,805 | 2,776 |
| Community Development Block Grants/Entitlement Grants | 14.218 | B-16-MC-06-0021 | 10,901,085 | 3,057,428 |
| Subtotal CDBG - Entitlement Grants Cluster | | | 10,904,890 | 3,060,204 |
| Emergency Solutions Grant Program | 14.231 | E15-MC-06-0021 | 154,066 | 152,677 |
| Emergency Solutions Grant Program | 14.231 | E16-MC-06-0021 | 728,612 | 668,529 |
| Subtotal Emergency Solutions Grant Program | | | 882,678 | 821,206 |
| Home Investment Partnerships Program | 14.239 | M14-MC060215 | 72,540 | - |
| Home Investment Partnerships Program | 14.239 | M15-MC060215 | 256,263 | - |
| Home Investment Partnerships Program | 14.239 | M16-MC060215 | 9,101,899 | 1,266,181 |
| Subtotal Home Investment Partnerships Program | | | 9,430,702 | 1,266,181 |
| Housing Opportunities for Persons with AIDS | 14.241 | CAH15F004 | 817,616 | 795,537 |
| Housing Opportunities for Persons with AIDS | 14.241 | CAH16F004 | 158,792 | 136,378 |
| Housing Opportunities for Persons with AIDS | 14.241 | CAH130005 | 93,337 | 92,997 |
| Housing Opportunities for Persons with AIDS | 14.241 | CAH160004 | 328,080 | 318,706 |
| Housing Opportunities for Persons with AIDS | 14.241 | CAH150001 | 6,666 | - |
| Housing Opportunities for Persons with AIDS | 14.241 | CAH150002 | 60,000 | 60,000 |
| Subtotal Housing Opportunities for Persons with AIDS | | | 1,464,491 | 1,403,618 |
| Total U.S. Department of Housing and Urban Development | | | 22,682,761 | 6,551,209 |

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

# CITY OF SAN JOSE, CALIFORNIA
## Schedule of Expenditures of Federal Awards (Continued)
## Year Ended June 30, 2017

| Federal Grantor/Pass-Through Grantor/Program | Federal Catalog Number | Grant Identifying Number | Federal Expenditures | Amount Provided To Subrecipients |
|---|---|---|---|---|
| **U.S. Department of Justice** | | | | |
| Direct programs: | | | | |
| Community-Based Violence Prevention Program | 16.123 | 2015-PB-FX-K009 | 71,359 | 23,910 |
| Community-Based Violence Prevention Program | 16.123 | 2012-MU-FX-0011 | 55,834 | 48,352 |
| Subtotal Community-Based Violence Prevention Program | | | 127,193 | 72,262 |
| Part E - Developing, Testing and Demonstrating Promising New Programs | 16.541 | 2012-NY-FX-0002 | 28,439 | - |
| Missing Children's Assistance | 16.543 | 2014-MC-FX-K039 | 413,708 | - |
| Grants to Encourage Arrest Policies and Enforcement of Protection Orders Program | 16.590 | 2013-WE-AX-0033 | 357,585 | 119,343 |
| Bulletproof Vest Partnership Program | 16.607 | 2016 BVP | 395 | - |
| Edward Byrne Memorial Justice Assistance Grant Program | 16.738 | 2015-DJ-BX-0211 | 43,481 | - |
| Edward Byrne Memorial Justice Assistance Grant Program | 16.738 | 2014-DJ-BX-0066 | 15,187 | |
| Edward Byrne Memorial Justice Assistance Grant Program | 16.738 | 2013-DJ-BX-0642 | 37 | - |
| Subtotal Edward Byrne Memorial Justice Assistance Grant Program | | | 58,705 | - |
| Equitable Sharing Program | 16.922 | CA0431300 | 155,945 | - |
| Total U.S. Department of Justice | | | 1,141,970 | 191,605 |

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

| Federal Grantor/Pass-Through Grantor/Program | Federal Catalog Number | Grant Identifying Number | Federal Expenditures | Amount Provided To Subrecipients |
|---|---|---|---|---|
| **U.S. Department of Labor** | | | | |
| Pass-through State of California, Employment Development Department: | | | | |
| Workforce Investment Act (WIA)/Workforce Innovation and Opportunity Act (WIOA) Cluster: | | | | |
| WIA/WIOA Adult Program: | | | | |
| WIA/WIOA Adult | 17.258 | K698394202 | 744,639 | 350,955 |
| WIA/WIOA Adult | 17.258 | K698394500 | 650,000 | 342,616 |
| WIA/WIOA Adult | 17.258 | K7102072201 | 301,023 | 125,000 |
| WIA/WIOA Adult | 17.258 | K7102072202 | 1,096,258 | 73,298 |
| High Performing Boards | 17.258 | K71020721080 | 54,838 | - |
| Subtotal - WIA/WIOA Adult Program | | | 2,846,758 | 891,869 |
| WIA/WIOA Youth Activities | 17.259 | K698394301 | 1,238,818 | 591,332 |
| WIA/WIOA Youth Activities | 17.259 | K7102072301 | 1,276,530 | 741,384 |
| Subtotal - WIA/WIOA Youth Activities | | | 2,515,348 | 1,332,716 |
| WIA Dislocated Worker Formula Grants: | | | | |
| WIA DLW RD1 | 17.278 | K698394502 | 1,054,047 | 331,168 |
| WIA RR | 17.278 | K698394541 | 147,299 | - |
| WIA RR | 17.278 | K698394293 | 53,531 | - |
| WIA RR | 17.278 | K7102072292 | 31,264 | - |
| WIA RR | 17.278 | K7102072540 | 110,379 | - |
| WIA RR | 17.278 | K7102072293 | 37,105 | - |
| WIA RR | 17.278 | K7102072541 | 436,667 | - |
| WIA DLW | 17.278 | K7102072501 | 420,919 | 137,091 |
| WIA DLW | 17.278 | K7102072502 | 791,665 | 202,418 |
| WIA Assistance for Capacity Building | 17.278 | K6983941055 | 103,251 | - |
| WIA Assistance for Capacity Building | 17.278 | K6983941056 | 2,871 | - |
| WIA Assistance for Capacity Building | 17.278 | K6983941069 | 7,072 | - |
| Subtotal - WIA Dislocated Worker Formula Grants | | | 3,196,070 | 670,677 |
| Subtotal WIA Cluster | | | 8,558,176 | 2,895,262 |
| WIOA National Dislocated Worker Grants / WIA National Emergency Grants | 17.277 | K6983941028 | 245,781 | - |
| WIOA National Dislocated Worker Grants / WIA National Emergency Grants | 17.277 | K71020721091 | 12,552 | - |
| Subtotal - WIOA National Dislocated Worker Grants / WIA National Emergency Grants | | | 258,333 | - |
| Total U.S. Department of Labor | | | 8,816,509 | 2,895,262 |

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

# CITY OF SAN JOSE, CALIFORNIA
## Schedule of Expenditures of Federal Awards (Continued)
### Year Ended June 30, 2017

| Federal Grantor/Pass-Through Grantor/Program | Federal Catalog Number | Grant Identifying Number | Federal Expenditures | Amount Provided To Subrecipients |
|---|---|---|---|---|
| **U.S. Department of Transportation** | | | | |
| Direct programs: | | | | |
| Federal Aviation Administration: | | | | |
| Airport Improvement Program | 20.106 | 3-06-0226-083-2014 | (885,221) | - |
| Airport Improvement Program | 20.106 | 3-06-0226-084-2014 | 5,519 | - |
| Airport Improvement Program | 20.106 | 3-06-0226-085-2015 | 11,277 | - |
| Airport Improvement Program | 20.106 | 3-06-2226-086-2015 | 706,510 | - |
| Airport Improvement Program | 20.106 | 3-06-0226-087-2015 | 716,246 | - |
| Airport Improvement Program | 20.106 | 3-06-0226-088-2016 | 698,272 | - |
| Airport Improvement Program | 20.106 | 3-06-0226-089-2016 | 6,306,202 | - |
| Airport Improvement Program | 20.106 | 3-06-0226-090-2016 | 3,794,155 | - |
| Airport Improvement Program | 20.106 | 3-06-0226-092-2017 | 539,892 | - |
| Subtotal Airport Improvement Program | | | 11,892,852 | - |
| Highway Planning and Construction Cluster: | | | | |
| Pass-through California Department of Transportation: | | | | |
| Highway Planning and Construction: | | | | |
| TiMC (HPP 2017) $5.4M | 20.205 | HPLUL-5005(085) | 187,186 | - |
| Autumn Street Extension | 20.205 | TCSPL-5005 (122) | 2,483 | - |
| Pavement Maintenance - Federal | 20.205 | STPL-5005(134) | 3,088,335 | - |
| North First Street Bicycle Lane Improvements | 20.205 | HSIPL-5005(123) | 726,177 | - |
| OCALA Improvements | 20.205 | HSIPL-5005(135) | 846,313 | - |
| Park Avenue Bicycle Lane Improvements | 20.205 | HSIPL-5005(121) | 28,219 | - |
| Subtotal Highway Planning and Construction | | | 4,878,713 | - |
| Recreational Trails Program: | | | | |
| CMAQ Los Gatos Creek Reach | 20.219 | SCL110029 | 86,484 | - |
| Coyote Creek | 20.219 | SCL050083 | 21,585 | - |
| Subtotal Recreational Trails Program | | | 108,069 | - |
| Subtotal pass-through California Department of Transportation | | | 4,986,782 | - |

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

# CITY OF SAN JOSE, CALIFORNIA
## Schedule of Expenditures of Federal Awards (Continued)
### Year Ended June 30, 2017

| Federal Grantor/Pass-Through Grantor/Program | Federal Catalog Number | Grant Identifying Number | Federal Expenditures | Amount Provided To Subrecipients |
|---|---|---|---|---|
| **U.S. Department of Transportation (continued)** | | | | |
| Pass-through Metropolitan Transportation Commission: | | | | |
| Highway Planning and Construction: | | | | |
| Urban Village Planning for Stevens Creek & Santana Row, Valley Fair and Winchester Urban Villages | 20.205 | 660076 | 593,451 | - |
| Walk n' Roll (Non-Infrastructure) Phase 2 | 20.205 | CML-5005(128) | 334,937 | - |
| Walk n' Roll San Jose! (Infrastructure) | 20.205 | CML-5005(108) / CML-5005 (126) | 105,710 | - |
| Alameda "A Beautiful Way" Phase 2 | 20.205 | CML-5005(129) | 178,691 | - |
| Jackson Ave Complete Streets | 20.205 | CML-5005(125) | 974,951 | - |
| Pedestrian Oriented Signals | 20.205 | CML-5005(127) | 1,311,174 | - |
| Smart Intersections Program | 20.205 | CML-5005(139) | 30,517 | - |
| St. John Bike/Ped Phase 2 | 20.205 | CML-5005(131) | 207,908 | - |
| Almaden Vine Couplet | 20.205 | CML-5005(142) | 127,639 | - |
| SJ Transportation Demand Management | 20.205 | CMLNI-5005 (141) | 332,079 | - |
| San Carlos Multimodal Streetscape Improvements Phase 2 | 20.205 | STPCML-5005(104) | 19,073 | - |
| Safe Routes to School Program | 20.205 | CML-5005(133) | 54,632 | - |
| Park Avenue Multimodal Improvements | 20.205 | RPSTPLE-5005(130) | 1,201,461 | - |
| Park Avenue Multimodal Improvements | 20.205 | RPSTPLE-5005(132) | 856,903 | - |
| Subtotal pass-through Metropolitan Transportation Commission | | | 6,329,126 | - |
| Subtotal Highway Planning and Construction Cluster | | | 11,315,908 | - |
| Pass-through California Office of Traffic Safety: | | | | |
| State and Community Highway Safety | | | | |
| Selective Traffic Enforcement Program | 20.600 | PT1651 | 49,293 | - |
| Selective Traffic Enforcement Program | 20.600 | PT17112 | 72,297 | - |
| Subtotal pass-through Califoria Office of Traffic Safety | | | 121,590 | - |
| Total U.S. Department of Transportation | | | 23,330,350 | - |

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

**CITY OF SAN JOSE, CALIFORNIA**
**Schedule of Expenditures of Federal Awards (Concluded)**
**Year Ended June 30, 2017**

| Federal Grantor/Pass-Through Grantor/Program | Federal Catalog Number | Grant Identifying Number | Federal Expenditures | Amount Provided To Subrecipients |
|---|---|---|---|---|
| **National Endowment for the Arts** | | | | |
| Direct program: | | | | |
| Promotion of the Arts_Grants to Organizations and Individuals: | | | | |
| Our Town | 45.024 | 13-4292-7081 | 58,260 | 30,000 |
| Total National Endowment for the Arts | | | 58,260 | 30,000 |
| **U.S. Department of Health and Human Services Administration for Community Living** | | | | |
| Pass-through Santa Clara County Social Services : | | | | |
| Aging Cluster: | | | | |
| Special Programs for the Aging_Title III, Part C_Nutrition Services | 93.045 | 4300010957 | 332,567 | - |
| Nutrition Services Incentive Program | 93.053 | 4300010957 | 96,149 | - |
| Subtotal Aging Cluster | | | 428,716 | - |
| Total U.S. Department of Health and Human Services Administration for Community Living | | | 428,716 | - |
| **U.S. Department of Homeland Security** | | | | |
| Direct programs: | | | | |
| Staffing for Adequate Fire and Emergency Response (SAFER) | 97.083 | EMW-2014-FH-00769 | 1,723,968 | - |
| Pass-through Santa Clara County: | | | | |
| Emergency Management Performance Grants | 97.042 | 2016-0010 | 29,003 | - |
| Pass-through the Bay Area UASI: | | | | |
| Homeland Security Grant Program: | | | | |
| Urban Areas Security Initiative Grant | 97.067 | N/A | 147,000 | - |
| Urban Areas Security Initiative Grant | 97.067 | N/A | 270,074 | |
| Urban Areas Security Initiative Grant | 97.067 | 2015-00078 | 220,623 | - |
| Urban Areas Security Initiative Grant | 97.067 | 2016-0102 | 125,846 | - |
| Subtotal pass-through the Bay Area UASI | | | 763,543 | - |
| Total U.S. Department of Homeland Security | | | 2,516,514 | - |
| Total Federal Awards | | | $ 59,018,703 | $ 9,668,076 |

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

## (1) GENERAL

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

## (2) BASIS OF PRESENTATION

The accompanying schedule is presented using the modified accrual basis of accounting for program expenditures accounted for in the governmental funds and the accrual basis of accounting for program expenditures accounted for in the proprietary funds as described in Note I to the City's basic financial statements. The City did not elect to use the 10% de minimis cost rate as covered in U.S. Code of Federal Regulations, Title 2 section 200.414 Indirect (F&A) costs.

For reimbursable grants, the City recognizes revenues commencing on the date of grant approval (provided all eligibility requirements are met) since this is when the City is eligible to claim expenditures for reimbursements. Pass-through entity identifying numbers are presented where available.

## (3) RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS

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

## (4) RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Amounts reported in the SEFA agree to or can be reconciled with the amounts reported in the related federal financial reports.

## (5) AIRPORT EXPENDITURES

The Federal Aviation Administration (FAA) reimburses the Airport for approximately 80% of allowable Airport Improvement Program (AIP) grant expenditures. Total allowable AIP expenditures are presented in the accompanying SEFA.

During the year ended June 30, 2017, the Airport refunded to the FAA the amount of $875,598 for ineligible expenditures claimed related to the FIF Sterile Corridor Extension project under AIP Grant number 03-06-0226-083-2014. The expenditures ineligible for grant reimbursement in the amount of $885,221, of which $881,696 and $3,525 were reported in the SEFA for the years ended June 30, 2015 and 2016, respectively, was shown as a negative amount in the SEFA for the year ended June 30, 2017.

## (6) PROGRAM TOTALS

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

| CFDA Number - Program Title<br>Grant Identifying Number or Pass-through Grantor | Federal Expenditures |
|---|---|
| Highway Planning and Construction Cluster: | |
| CFDA No. 20.205 - Highway Planning and Construction | |
| Pass-through California Department of Transportation | $ 4,878,713 |
| Pass-through Metropolitan Transportation Commission | 6,329,126 |
| CFDA No. 20.205 - Highway Planning and Construction | 11,207,839 |
| CFDA No. 20.219 - Recreational Trails Program | |
| Pass-through California Department of Transportation | 108,069 |
| Total Highway Planning and Construction Cluster | $ 11,315,908 |

## (7) INTERNET CRIMES AGAINST CHILDREN (ICAC) GRANT

The following schedule represents expenditures and revenues for the Internet Crimes Against Children Task Force Program from the U.S. Department of Justice and the California Governor's Office of Emergency Services (Cal OES) for the year ended June 30, 2017.

| Program Title and Expenditure Category | Grant Number Grant Period | Cumulative Expense through 30-Jun-16 | Actual 7/1/16-6/30/17 Non-Match | Actual 7/1/16-6/30/17 Match | Cumulative Expense through 30-Jun-17 | Cumulative Program Revenue |
|---|---|---|---|---|---|---|
| Internet Crimes Against Children | 2014-MC-FX-K039 | | | | | |
| Task Force Program (Federal) | 7/01/2014 - 12/31/2017 | | | | | |
| Personal Services | | $ 318,767 | $ 224,096 | $ - | $ 542,863 | $ 542,863 |
| Operating Expenses | | 315,879 | 189,612 | - | 505,491 | 505,491 |
| Equipment | | 22,837 | - | - | 22,837 | 22,837 |
| Total | | $ 657,483 | $ 413,708 | $ - | $ 1,071,191 | $ 1,071,191 |
| Internet Crimes Against Children | IC-1608-7928 | | | | | |
| Task Force Program (State) | 07/01/2016 - 06/30/2017 | | | | | |
| Operating Expenses | | $ - | $ 75,855 | $ - | $ 75,855 | $ 75,855 |
| Equipment | | - | 123,685 | - | 123,685 | 123,685 |
| Total | | $ - | $ 199,540 | $ - | $ 199,540 | $ 199,540 |

**CITY OF SAN JOSE, CALIFORNIA**
**Schedule of Findings**
**Year Ended June 30, 2017**

## Section I Summary of Auditor's Results

Financial Statements

| | |
|---|---|
| Type of auditor's report issued: | Unmodified |
| Internal control over financial reporting: | |
| Material weakness(es) identified? | Yes |
| Significant deficiency(ies) identified? | Yes |
| Noncompliance material to the financial statements noted? | None reported |

Federal Awards

| | |
|---|---|
| Internal control over major programs: | |
| Material weakness(es) identified? | No |
| Significant deficiency(ies) identified? | None Reported |
| Type of auditor's report issued on compliance for major programs: | Unmodified |
| Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? | No |

Identification of major programs:

| Federal Domestic Catalog Number(s) | Name of Federal Program or Cluster |
|---|---|
| 20.205, 20.219 | Highway Planning and Construction Cluster |
| 20.106 | Airport Improvement Program |

| | |
|---|---|
| Dollar threshold used to distinguish between type A and type B programs: | $1,770,561 |
| Auditee qualified as a low-risk auditee? | Yes |

## Section II Financial Statement Findings

### Finding 2017-001 Controls over estimating loan loss reserves (Repeat Finding)

**Criteria**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with US GAAP. This includes the design, implementation, and maintenance of internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Internal controls over financial statement estimates are particularly important given the important judgements inherent in making those estimates.

**Condition**

The City maintains a Housing Activities Fund and Low and Moderate Income Housing Asset Fund with total loans to borrowers of $ 135 million and $ 509 million, respectively, at June 30, 2017. Of those loan balances, management recorded an allowance for uncollectible loans for 47% and 55%, respectively, of the gross loan balances in these two governmental funds which are maintained on the modified accrual basis of accounting. In addition to these reserves on loan principal, management also reserved 100% or $128 million of accrued interest on these loans as uncollectable at the government-wide level which is presented on the a full accrual basis of accounting. Management's estimates for the governmental funds were made using a methodology combining an allowance for collectability risk and an allowance for present value discount at 1%. Management's methodology is documented and has been consistently applied for several years but the assumptions were not supported by evidence of incurred losses on loans such as historical results, industry data, and actual performance of individual loans or current credit quality of the borrower. Many of these traditional measures of loan losses were not tracked by the City and, therefore, were not factored into the loan loss calculation.

US GAAP outlines use of an incurred loss model when estimating loan losses. Inherent in that model is that a loss has occurred as of the financial statement date for a loan loss reserve to be accrued. In other words, expected future losses are not accrued, no matter how likely. GASB Statement 34, in particular, notes that liabilities and losses should be recognized when transactions take place. In context, this is the equivalent of the notion of "incurred" – that is, the occurrence of the transaction is the triggering event for recognition of the transaction itself. The occurrence of the transaction (the loan) would give rise to the recognition of the asset – and then the other elements of the transaction (such as losses incurred) would be recognized as they are incurred over the asset's life. GASB Statement 62 outlines the accounting for loss contingencies including impairment of receivables and underscores the notion of incurred losses for events which occur as of the financial statement date that indicate a receivable has been impaired and for which an estimate of impairment is measurable. This incurred loss notion is made explicit in GASB 62.102 (emphasis added):

An estimated loss from a loss contingency (as defined in paragraph 96) should be accrued if both of the following conditions are met:

(a) Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it should be probable that one or more future events will occur confirming the fact of the loss.

(b) The amount of the loss can be reasonably estimated.

Management was asked to provide evidence supporting the reasonableness of assumptions applied in the estimate of uncollectible loans. For example, we inquired about the policy to record a 40% reserve on certain categories of loans. While management was able to share an 11-year old point system which has evolved to a blanket 40% reserve, neither that evolved point system nor the resulting 40% had any relationship to incurred loan losses on these loan portfolios. Therefore, management was not ultimately able to adequately support the assumptions applied even though they were able to demonstrate they had complied with their policy.

With respect to the 1% discount factor, a factor which represents 27% of the recorded reserves, management has characterized this as an opportunity cost discount in its loan loss policy (lost earnings by virtue of the monies being invested in loans instead of an investment portfolio). This same 1% was characterized differently in the footnotes to the financial statements as an adjustment for below market interest rates. Management was unable to explain how their 1% discount aligned with US GAAP but did relay on several occasions that they "make the market" on their loans and their actual interest rates of 0-6% and loan terms were market; not below market. In management's response below, however, management indicates "When this type of loan is made to developers and low income residents, the fair value of the loan receivable becomes less than its face value. In other words, this type of affordable housing loan receivable cannot be sold at its face value in the market." In this regard, we find the City's documentation and explanations about market vs. below-market interest rates and loan terms to conflict with one another and the concept of opportunity cost appears to have no support in US GAAP.

Most recently, management provided a memorandum dated November 1, 2017, which suggested the loan portfolio actually had no impaired loans but the reserve was intended to reflect the potential that as loans become due, they may be renegotiated to allow borrowers to further the housing program's objective of affordability. While we appreciate that renegotiations in future years may result in loan due date extensions or forgiveness of loans, we don't see how US GAAP would support the current accounting of future decisions and how those future decisions have any relationship to the 47% and 55% uncollectibility reserves which have evolved from the 11-year old point system.

Finally, management has shared with us discussions they've had with several other cities in California who have housing loans along with a State housing department. These other agencies have different loan loss reserve levels ranging from 0-100% of the loan balance. Management has interpreted this variety to be evidence of a widely recognized and prevalent industry standard in setting loan reserves. We view the dissimilar reserve results to indicate other agencies simply have different results after applying their policies. No evidence of a recognized and prevalent industry standard in establishing loan reserves was provided. Further, management has not articulated how the methodologies of each of these other agencies are used or their applicability to the City's particular loan portfolio. The City's assertion has, essentially, been that they can set the reserve by policy which is inconsistent with US GAAP.

We recommend management (1) clarify what they are trying to measure with the loan reserves, (2) align what they are trying to measure with US GAAP and (3) look to actual evidence of loan impairment for reserve analyses instead of old models which have no relationship to actual impairment in the portfolio.

We were able to independently develop an estimate within an acceptable range of the recorded balance to satisfy our audit objective.

### Cause

The assumptions used in developing the loan loss reserve are based on an internal policy and have not been supported by evidence of incurred losses consistent with the requirements of US GAAP.

### Effect or Potential Effect

Financial statements may be misstated if key assumptions in accounting estimates are not supported by quality evidence.

### Views of Responsible Officials

Management disagrees, see Management Corrective Action Plan (unaudited). We have reviewed the City's Response and, based on the Criteria, Condition, Cause and Effect discussed above, we believe our finding is still valid.

**Finding 2017-002 Untimely identification of errors and lack of or inaccuracies in account reconciliations (Repeat Finding)**

**Criteria**
Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). This includes the design, implementation, and maintenance of internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**Condition**
The City's preparation of its Comprehensive Annual Financial Report ("CAFR") is a responsibility centralized within the Finance Department who compiles and verifies financial data, accounting estimates and US GAAP application decisions maintained by that department along with those generated by the various departments within the City's decentralized structure.

The process of preparing an accurate CAFR is complicated by the variation in levels of supervisory review, reconciliation and processing flows within the finance and other departments along with the inconsistencies in accounting background among the departments.

We noticed several areas where this challenge was apparent:

- In the City's Municipal Water Fund and Integrated Waste Management Fund, a reconciliation between the CIS subsystem and general ledger balances were not completed as a normal procedure in the year-end close. In addition, a detailed supervisory review was not performed of the reconciliation prior to being provided for audit and we discovered additional errors which led to additional adjustments in accounts receivable and revenue. For the Municipal Water Fund, correcting adjustments with a net impact of $2,034,000 were posted and an additional $423,000 was identified but not corrected to decrease accounts receivable and revenues as a result of this reconciliation. An additional $338,000 of credits were identified within the receivable subledgers that were not reclassified to liabilities, therefore we proposed an adjustment to reclassify these amounts. For the Integrated Waste Management Fund, correcting adjustments with a net impact of $610,000 were posted to increase accounts receivable and revenues as a result of this reconciliation. An additional $1,680,000 of credits were identified within the receivable subledger that were not reclassified to liabilities, therefore we proposed an adjustment to reclassify these amounts.
- Within the Special Assessments Fund and Housing Activities Fund, we identified two instances where revenue was recorded in the incorrect period and this error was not identified in a timely manner by the City. The impact of these errors was to overstate revenue in fiscal 2017 that really belong in fiscal 2016 in the amounts of $1,171,000 and $1,539,000, respectively.
- In the City's Low and Moderate Housing Fund we identified a loan which had a forgiveness clause embedded in the agreement that was not fully reserved for when it should have been in accordance with the City's policy. As such, we proposed an adjustment to increase the reserve for this loan of $1,150,000.

We recommend that Management require at least annual reconciliations of all accounts between the subsystem and the general ledger ending balances. Furthermore we recommend increased training for preparers and reviewers of journal entries and reconciliations to assist in the timely identification of errors.

**Cause**
Account reconciliations are not always being performed or being performed accurately. Additionally, supervisory review had not identified the lack of reconciliations or errors in those reconciliations.

**Effect or Potential Effect**
Deficiencies in the design or operation of reconciliation controls can lead to errors in the financial statements.

**Views of Responsible Officials**
Management agrees, see Management Corrective Action Plan (unaudited).

**Finding 2017-003 Informational Technology: City-Wide Information Security Program (Repeat Finding)**

**Criteria**
Internal controls over financial reporting are reliant on information technology ("IT") controls which are designed effectively. In that regard, an effectively designed IT environment is one where an organization:
(a) develops, documents, and disseminates to appropriate personnel, policies that addresses purpose, scope, roles, responsibilities, management commitment, coordination among organizational entities, and compliance; and procedures to facilitate the implementation of the policy and associated controls; and,
(b) periodically reviews and updates the current policy and procedures.

**Condition**
Systems impacted: The specific information systems impacted by the below findings were provided separately to management. In addition, the Grant Thornton team met with individual system owners and points of contact to discuss the nuances of these findings which varied slightly based on information system use, architecture, and other factors.

An entity-wide information security management program is the foundation of a security control structure and a reflection of senior management's commitment to addressing security risks. Overall policies and plans are developed at the entity-wide level. System and application-specific procedures implement the entity-wide policy. Ongoing monitoring of control design, implementation, and operating effectiveness should also be applied so that the program includes continuous monitoring processes.

Critical within a well-established information security program are documented policies, procedures, and guidance, security roles and responsibilities identified and appropriately delineated across the organization, and performing ongoing evaluations to ensure that policies and controls intended to reduce risk are effective. Without these aspects, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. Grant Thornton noted weaknesses within Management's information security program; specifically:

- Management had not assigned security responsibilities associated with its decentralized control environment. For example, there was no assignment of a centralized Chief Information Security Officer ("CISO") and/or Information Security Officer(s). Further decentralized information systems did not have a Component Security Officer ("CSO") or individual that was assigned to ensure the system/location met overarching security requirements.
- Management had not finalized, published, and communicated formal policies and procedures related to information technology ("IT") control processes. Examples of draft policies and IT controls not formally documented include:

| Policies in draft | Not addressed in policy |
|---|---|

| | |
|---|---|
| Acceptable use | Baseline security configuration setting and monitoring |
| Access to network and systems | Auditable event and monitoring |
| Anti-virus | Application change & emergency change management |
| Business continuity and disaster recovery | Incident response |
| Data classification and handling | Vulnerability scanning |
| Encryption | Security training |
| Information security | Backup and data retention |
| Network security | |
| Password | |
| Secure system development | |

- Management did not have a processes implemented to perform continuous monitoring. Specifically, Management did not:

  - Perform periodic risk and vulnerability assessments, penetration testing, continuous monitoring through scanning or agent-based software tools, or perform other cybersecurity activities in order to identify, track and resolve security threats.
  - Perform security configuration management processes to establish and monitor platforms and software against best practices.

**Cause**
Due to budget constraints and significant reductions in ITD, Management has not developed or resourced an IT governance structure and processes that appropriately support the risks and threats associated with an organization of the City's size and with the added complexities of decentralization. Furthermore, while Management was in the process of finalizing and implementing City-wide policies and procedures over IT systems, they had not developed ongoing monitoring procedures to protect the integrity of financial data, nor were appropriate processes in place in order to monitor potential security threats.

**Effect or Potential Effect**
A lack of formal security responsibilities, as well as, policies and procedures related to security controls increases the risk that implementation of control activities may not be consistent throughout the divisions / components within the City.

Failure to perform network security vulnerabilities and penetration assessments increases the risk that the information system's security weaknesses are not identified and investigated in a timely fashion.
Failure to implement and monitor recommended security configuration and best practice settings increases the likelihood of misconfigurations that may be exploited.

Inadequate information security frameworks may lead to lapses in security requirements and consistent implementation across decentralized locations.

This could lead to errors, data loss, inappropriate access, and other risks with the potential to impair the confidentiality, integrity, and availability of systems and data. These issues may result in unauthorized access, use, disclosure, disruption, modification, or destruction of information and information systems, which may lead to misstatements on the financial statements.

**Views of Responsible Officials**

Management agrees, see Management Corrective Action Plan (unaudited).

**Finding 2017-004 Information Technology: Account Management, Password Configuration, Broad Privileged Access, Password Configuration, Shared Accounts, and Audit Logging / Monitoring (Repeat Finding)**

**Criteria**
Internal controls over financial reporting are reliant on information IT controls which are designed effectively. In that regard, an effectively designed IT environment is one where an organization maintains the following:

Account Management includes the following criteria:

a. Identifies and selects the types of information system accounts needed to support organizational missions / business functions;
b. Assigns account managers for information system accounts;
c. Establishes conditions for group and role membership;
d. Specifies authorized users of the information system, group and role membership, and access authorizations (i.e., privileges) and other attributes (as required) for each account;
e. Requires approvals by appropriate personnel for requests to create information system accounts;
f. Creates, enables, modifies, disables, and removes information system accounts in accordance with organization-defined procedures or conditions;
g. Monitors the use of information system accounts;
h. Notifies account managers when accounts are no longer required, when users are terminated or transferred, and when individual information system usage or need-to-know changes;
i. Authorizes access to the information system based on a valid access authorization, intended system usage, and other attributes as required by the organization;
j. Reviews accounts for compliance with account management requirements periodically; and,
k. Establishes a process for reissuing shared / group account credentials (if deployed) when individuals are removed from the group.
l. restrictions on the use of shared accounts such as defining the specific criteria that must be met in order to use a shared account and termination of the shared account credentials when members leave the group.

*Password Strength* the organization employs the principle of strong passwords, requiring credentials of reasonable complexity and inactivity-based log-out.

*Separation of Duties* the organization documents separation of duties of individuals and defines information system access authorizations to support separation of duties. Separation of duties addresses the potential for abuse of authorized privileges and helps to reduce the risk of malevolent activity without collusion. Separation of duties includes, for example: (i) dividing mission functions and information system support functions among different individuals and / or roles; (ii) conducting information system support functions with different individuals (e.g., system management, programming, configuration management, quality assurance and testing, and network security); and (iii) ensuring security personnel administering access control functions do not also administer audit functions.

*Least Privilege* the organization employs the principle of least privilege, allowing only authorized accesses for users (or processes acting on behalf of users) which are necessary to accomplish assigned tasks in accordance with organizational missions and business functions.

*Access Restrictions for Change* the organization defines, documents, approves, and enforces physical and logical access restrictions associated with changes to the information system. Organizations should maintain records of access to ensure that configuration change control is implemented and to support after-the-fact actions should organizations discover any unauthorized changes.

*Audit Events* the organization:

a. Determines that the information system is capable of auditing organization-defined auditable events;
b. Coordinates the security audit function with other organizational entities requiring audit-related information to enhance mutual support and to help guide the selection of auditable events;
c. Provides a rationale for why the auditable events are deemed to be adequate to support after-the-fact investigations of security incidents; and,
d. Determines that the organization-defined audited events are to be audited within the information system along with the frequency of (or situation requiring) auditing for each identified event.

*Audit Review, Analysis, and Reporting* the organization reviews and analyzes information system audit records periodically for indications of inappropriate or unusual activity and reports findings to the appropriate personnel or role within the organization. Information security-related auditing performed by organizations can include, for example, auditing that results from monitoring of account usage, remote access, wireless connectivity, mobile device connection, configuration settings, system component inventory, use of maintenance tools and nonlocal maintenance, physical access, temperature and humidity, equipment delivery and removal, communications at the information system boundaries, use of mobile code, and use of VoIP.

**Condition**

Systems impacted: The specific information systems impacted by the below findings were provided separately to management. In addition, the Grant Thornton team met with individual system owners and points of contact to discuss the nuances of these findings which varied slightly based on information system use, architecture, and other factors.

System authorization, access, and account management controls must be used to limit system activities to ensure legitimate use, least privilege, and segregation of duties. Access controls provide assurance that critical systems assets are safeguarded and that logical access to sensitive applications, system utilities, and data is provided only when authorized and appropriate. Further, broad or special (privileged) access privileges, such as those associated with operating / database system software, administrative accounts, and / or superusers, may allow normal controls to be overridden or otherwise circumvented. Additionally, a lack of logging and monitoring broad or privileged access may result in unusual or suspicious activity going unidentified. Grant Thornton noted the following. Grant Thornton noted Management should address the following:

**Account Management**

- Management did not have a process to consistently document and retain approvals related to initial authorization and ongoing changes to user's access for seven systems tested.
- Management did not perform periodic access recertification for users (including privileged users) and system accounts for 11 systems tested.

- Management did not define the timeframe in which a separated employee or contractor's access from the Network must be disabled after separation and the timeframe in which a reassigned employee's access must be reviewed and updated after reassignment.

**Password Configuration**

Grant Thornton noted that there was no consistent password policy City-wide for the systems identified above. As a result we noted that password security configuration settings were not consistently aligned with best practices across the network, platforms, and devices. Specifically, we noted information systems did not meet some or all of the following:

- Minimum length requirements
- Enforce the use of alpha numeric characters
- Restrict the use of common words; and,
- Apply password expiration

In addition, we noted that information systems did not log users out after a period of inactivity or lock users out after a set number of failed password attempts.

**Broad / Privileged User Accounts**

- For one system tested we noted the IT team had access to the operating system and the database.
- Management did not consistently segregate system management functions such as user and system administration from functional responsibilities for seven systems tested. Further system users had IT administrative responsibilities.
- We noted that an system / tool was utilized to make direct changes to production data for a system tested. This tool enables users to bypass transactions made via the applications in the normal course of business, circumvent manual controls in place and update data directly in the database. Per discussion with Management, users require approvals before making changes to data via this tool; however; there were no systematic restrictions that required approvals prior to the updates being made.

**Shared Accounts**

- We noted instances where systems utilized shared accounts which negate accountability of use. Specifically a shared account was used to make direct data changes via the tool described above and to transfer information into systems.

**Audit Logging and Monitoring**

- Management did not log and/or monitor activities associated with privileged user accounts (e.g. system administrators, user administrators, network administrators, operators, and developers) for four systems tested. Further one system had limitations which did not allow it to log activities.
- We noted a lack of formally defined auditable events (such as privileged use, invalid password attempts, key configuration changes, or changes made directly to financial data), investigation and analysis processes.

**Cause**

- Management had not implemented a policy and procedures that appropriately documents account management requirements as part of their internal control framework.
- Management had not defined City-wide password security configurations. Additionally, some information systems did not have the technical capability to enforce password configuration best practices.

- Management had not defined requirements for privileged user accounts, shared accounts, logging/ monitoring, and segregation of duties in policy and procedures.

**Effect or Potential Effect**

Account Management

- Without formally completing or approving access requests, changes or timely terminations of access, there is an increased risk of inappropriate or unauthorized access to information systems and financial data.
- Without a periodic review of user and system accounts, there is a greater probability that an access change made in error would not be identified in a timely manner.
- Without defining the requirements around logical and physical access removal for separated or reassigned employees and contractors, there is an increased risk that access will not be removed or will not be removed in a timely manner. This access may allow inappropriate access to execute system functions. This could also lead to a license violation issue.

Password Configuration

Failure to implement recommended security settings and best practices for passwords increases the likelihood of account compromise by malicious users

Broad / Privileged User Accounts

- Failure to effectively restrict access to applications based on job function and employ adequate segregation of duties increases the risk for abuse of system privileges, fraud, and inappropriate activity without collusion.
- Direct data changes bypass system transactions and controls and therefore increase the risk of inappropriate updates to data. This may impact the organization's ability to rely on the completeness, accuracy, and validity of financial data. Further, the use of shared user accounts on a production system reduces the audit and accountability of users within the system and password security. In other words, there is no traceability of user's activity to perform these changes to production data.

Shared Accounts

Shared accounts negate accountability of use in that Management is not able to identify the user that made changes.

Audit Logging and Monitoring

Failure to maintain adequate logging and monitoring of higher risk application events and privileged access increases the risk that suspicious activities may not be identified and investigated.

This could lead to errors, data loss, inappropriate access, and other risks with the potential to impair the confidentiality, integrity, and availability of systems and data. These issues may result in unauthorized access, use, disclosure, disruption, modification, or destruction of information and information systems, which may lead to misstatements on the financial statements.

**Views of Responsible Officials**

Management agrees, see Management Corrective Action Plan (unaudited).

**Finding 2017-005 Information Technology: Change Management (Repeat Finding)**

### Criteria

Internal controls over financial reporting are reliant on IT controls which are designed effectively. In that regard, an effectively designed IT environment is one where an organization:

a. Determines the types of changes to the information system that are configuration-controlled;
b. Reviews proposed configuration-controlled changes to the information system and approves or disapproves such changes with explicit consideration for security impact analyses;
c. Documents configuration change decisions associated with the information system;
d. Implements approved configuration-controlled changes to the information system;
e. Retains records of configuration-controlled changes to the information system for an organization-defined time period;
f. Audits and reviews activities associated with configuration-controlled changes to the information system; and,
g. Coordinates and provides oversight for configuration change control activities through an organization-defined configuration change control element (e.g., committee, board).

### Condition

Systems impacted: The specific information systems impacted by the below findings were provided separately to management. In addition, the Grant Thornton team met with individual system owners and points of contact to discuss the nuances of these findings which varied slightly based on information system use, architecture, and other factors.

Change management processes provide assurance that software, data, and other changes associated with information systems are approved and tested so they do not introduce functional or security risks. A disciplined process for testing, approving, and migrating changes between environments, including into production, is essential to ensure that systems operate as intended and that no unauthorized changes are implemented.

Grant Thornton noted that Management did not have a process to consistently document and retain evidence related to change management activities including change request and approval, scheduling, initiation, testing, implementation approvals and post-implementation review for eight systems tested. In addition, we noted that City personnel do not have access to source code for one system tested, which is handled by the vendor, but were responsible for user acceptance testing and certain approvals, which were not consistently documented and retained.

### Cause

As part of the internal controls framework, management has not incorporated a policy and procedure to periodically monitor and review the configuration items that are migrated to production. Additionally, IT personnel did not consistently document and retain evidence related to change management activities (e.g. change request and approval, scheduling, initiation, testing, implementation approvals and post-implementation review).

### Effect or Potential Effect

Without formally completing or approving change management activities for system changes, patches and modifications, there is an increased risk that change management controls will not be completed. Without effective control over changes that are migrated to the production environment, there is an increased risk that an inappropriate code change could be introduced into the production environment, potentially impacting the financial statement and related processes (i.e. cash accountability, financial reporting, etc.).

Inappropriate code change could have a negative impact on system functionality, availability, or ability to produce complete and accurate financial data. These issues may result in unauthorized access, use, disclosure, disruption, modification, or destruction of information and information systems, which may lead to misstatements on the financial statements.

**Views of Responsible Officials**
Management agrees, see Management Corrective Action Plan (unaudited).

**Finding 2017-006 Fair value of investments held in Retirement Plans under GASB 72 (applicable to Retirement Office) (Repeat Finding)**

**Criteria**
Establishing and maintaining an internal control structure is an important management responsibility. To provide reasonable assurance that an entity's objectives will be achieved, the internal control structure should be under ongoing supervision by management to determine that it is operating as intended and that it is modified as appropriate for changes in conditions.

**Condition**
As it relates to level 3 investments (which as of June 30, 2017 were all held through one manager), management established a policy to undertake periodic validation of the amounts provided by the investment manager by engaging a third party to complete an independent valuation of material level 3 investments. However, this independent valuation was not complete in time to support the preparation of the financial statements for the year ended June 30, 2017.

Reclassification adjustments related to the GASB Statement No. 72 leveling disclosures were identified in the System's financial statements. Therefore, a detailed review of the investments in each level category was not completed at the appropriate level of precision to identify misclassifications in the different fair value categories.

**Cause**
The Retirement Office did not have a process in place to ensure this evaluation was completed in a timely manner.

**Effect or Potential Effect**
Adjustments to leveling classification.

Management should develop and implement a comprehensive policy for fair value measurements which includes, but is not limited to:

- Documentation of the techniques used to value all investment security types
- Periodic review of SOC 1 reports covering the valuation controls in place at the custodian and third party investment managers.
- Selected validation of values provided by third parties using independent pricing sources applicable to the particular security types.
- Develop and implement a comprehensive review of the investments disclosed in each levelling category compared to the pricing sources applicable to the particular security types.

**Views of Responsible Officials**
Management agrees, see Management Corrective Action Plan (unaudited).

## Section III Federal Award Findings

None reported.

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CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

# Management Corrective Action Plan (Unaudited)

**Finding 2017-001 Controls over estimating loan loss reserves**
**(Repeat Finding)**

**Summary of Management's Response:**

Management had multiple discussions with Grant Thornton explaining and clarifying the affordable housing loan program and what the City is trying to measure with respect to the loan reserves. Management had explained to Grant Thornton why the current methodology for loan loss reserve is acceptable under GASB rules. The City has used this methodology for twenty-eight years and while this methodology may be "old model" it has withstood internal and regular audits. In addition, City staff had inquired with other cities in California and verified that there is a wide range of reserve rates used by other local governments, and the practice of estimating reserves based on each entity's analysis of their unique affordable housing loan programs in their communities is widely recognized and prevalent within local governments. Accordingly, to conclude that the City's loan reserve measurement does not align with US GAAP, would conclude that many governments are not in compliance with US GAAP.

Management disagrees with Grant Thornton that an incurred loss model (described in second paragraph under "Condition") must be used when estimating loan loss reserves. The incurred loss model is not specified in GASB Statements 34 or 62. The incurred loss model is a topic in FASB ASC 450, Contingencies. GASB 34 states "revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions should be recognized when the exchange takes place". Grant Thornton is interpreting this as equivalent to the incurred loss model described in FASB ASC topic 450. We disagree. GASB 62 states "an estimated loss from a loss contingency should be accrued if information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired at the date of the financial statements, and the amount of loss can be reasonably estimated". From an accounting perspective, an asset is impaired when its fair value is less than its book value. Unlike traditional mortgage loans, most of the City's affordable housing loans do not have fixed repayment schedules, requires payments due only in years when the projects report earning positive cash flow, and can be renegotiated to extend loan terms for continuing affordable housing purposes. When this type of loan is made to developers and low income residents, the fair value of the loan receivable becomes less than its face value. In other words, this type of affordable housing loan receivable cannot be sold at its face value in the market. Therefore, a loan loss reserve is established when an affordable housing loan is made.

As GASB does not have any statement addressing the method for estimating affordable housing loan loss reserves, GASB 76 allows a government to use practices that are widely recognized and prevalent in state and local government. The City's point system provides a fair and consistent way of estimating loan loss reserves. Reserves are based on loan type (e.g. construction, permanent), project type (e.g. multi-family, shelter, special needs), City's loan position (first, second, third, fourth), other lender/regulatory requirements, loan performance, strength of developer, and other unique issues to the project. Loan risks are reviewed annually for relevance. The City tracks actual loan loss event and accounts for it promptly: when an actual loss event occurs, the City writes off the loan receivable and related loan loss reserve.

The City's disagreement with Grant Thornton on this issue does not warrant a material weakness comment from Grant Thornton on the City's internal control as the City views its methodology to be consistent with GASB 76. The City has worked diligently to provide the documentation and reasoning behind its methodology; demonstrated its relevance; and inquired with its peer agencies, and the Government Finance Officers Association (GFOA), and Government Accounting Standards Board (GASB) regarding the appropriateness of its estimates. Furthermore, for the second year in a row, Grant Thornton was able to independently develop an estimate within an acceptable range of the recorded balance to satisfy its audit objective. This indicates that the risk of a material misstatement is remote.

**Management Response:**

The City's loan loss reserve is conservatively estimated to address the essence of the housing loan program – affordability and the loan loss reserve allowance is management's estimate of potential credit losses in the affordable housing loan portfolio. The City's loan loss reserve ensures that the City recognizes in its financial statements that these loans were made to ensure affordability for our extremely low, very low, low, and moderate income residents. Loan repayments depend on the negotiated structure of the deal. The City's developer loans are not typically structured like traditional mortgages with fixed payment terms. Instead, many of the loans are structured to have payments due only in years when the projects report earning positive cash flow, or "residual receipts". Some are focused so heavily on extremely low income and/or special need populations that they expect no positive cash flow during the entire affordability restriction period. As such, the City's loan loss reserve recognizes the possibility that some of these loans likely will not be fully repaid and/or may be renegotiated to extend affordability for our lowest income residents.

The City believes that the methodology for loan loss reserve is acceptable under GASB rules. The City has used this methodology for twenty-eight years and this methodology has withstood internal and regular external audits. The City's methodology includes a risk evaluation model and assigns points to various loan criteria: loan type, project type, City's loan position, other lender/regulatory requirements. Under the current methodology, project loans and individual borrower loans that make scheduled payments during a fiscal year are evaluated for both discount and risk factors. Other project loans and individual borrower loans are grouped together by loan type, payment type or other common factors for the purpose of calculating a global discount and risk factor on the aggregate total of the group.

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

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

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

In accordance with City policy, loans are funded at below market rates of interest and include amortized net cash flow deferred repayment terms. This policy exists to enhance the well-being of the recipients or beneficiaries of the financial assistance, who, as described above, are very low, low, or moderate-income individuals or families, or developers of housing for such individuals or families.

Accordingly, for financial statement purposes, the City has established an allowance account against the loans receivable balance containing a present value discount. The present value discount gives recognition to the economic cost of providing loans at interest rates below market, and represents an estimate of the present value of projected net cash flows to the City from the loan portfolio. The present value discount attributable to the loans will be recognized as interest income only as such loans are repaid in full because of the deferred nature of the loan portfolio and the high level of uncertainty relating to the likelihood that cash flows will occur as projected. The difference between the individual outstanding loan balances and the calculated net present value of the loans results in the allowance for present value discount. Losses are recognized as an addition to the allowance and any subsequent recoveries are deducted from the allowance.

Grant Thornton reported the same comment last year as significant deficiency because the City was unable to provide evidence to support the assumptions for estimating the loan loss reserve. The City, including the Housing Department, has experienced high personnel turnover in the last five years resulting in misplaced documentation. In August 2017, the City located the evidence supporting the assumptions applied in the estimate under the City's current methodology. In addition to providing the evidence, the City performed and provided additional analyses to demonstrate the relevance of the current methodology to the Housing loan portfolio. The City also inquired with peer agencies and had reached out to GFOA and GASB, both organizations stated that if the City has compelling evidence that the methodology is prevalent in the government industry and the City has applied that methodology on a consistent basis, the City does follow the requirements of USGAAP.

Management disagrees with Grant Thornton in its comment that the City's current methodology for estimating loan loss reserve is not consistent with the requirements of US GAAP. The City as governmental agency, is required to follow GASB Standards for accounting and financial reporting practices. The incurred loss model recommended by Grant Thornton, which is described in FASB ASC topic 450, Contingencies, is not specified in GASB statements. Pursuant to GASB Statement 76, if the accounting treatment for a transaction is not specified in GASB Statements, GASB Technical Bulletins, GASB Implementation Guides, and literature of the AICPA cleared by the GASB, a government entity can apply sources of nonauthoritative accounting literatures, such as FASB statements or practices that are widely recognized and prevalent in state and local government or others. No other government agency that the City inquired with uses incurred loss model in estimating their housing loan loss reserves and Grant Thornton was unable to provide a city or government agency that they audited that uses the incurred loss model that they recommend. Thus the City is hesitant to depart from GASB guidelines and move to incurred loss model for estimating loan loss reserves.

**Finding 2017-002 Untimely identification of errors and lack of or inaccuracies in account reconciliations**
**(Repeat Finding)**

**<u>Management Response:</u>**

Management concurs that account reconciliations between the subsystem and the general ledger should be performed at a regular basis (at least annually).

Due to some reporting functionality issues arising from the implementation of a new billing software at the end of June 2015, City staff was unable to maintain its previous process of monthly reconciliations. City staff has reconciled account balances on an annual basis for the fiscal years 2015-16 and 2016-17. The revenue management team, within the Finance Department is currently working with the software vendor to generate proper reports with more robust visibility as to the details of the billing cycles required to reconcile efficiently, and is in the testing phase of reconciling batch controls of the subledger to the general ledger on a monthly basis. The monthly reconciliation between the subsystem and the general ledger will be fully operational before the end of the fiscal year 2017-18.

In regard to the transactions recorded in the Housing Activity Fund and the Low and Moderate Housing Fund, account reconciliations are performed on a monthly basis and loan balances are reconciled against the subsystem on a quarterly basis. Management in the Housing Department will review journal entries and account reconciliations to identify errors in a timely manner. In addition, the Housing Department is in the process of reviewing older loans to ensure the terms entered in the database are up to date.

**Finding 2017-003 Informational Technology: City-Wide Information Security Program**
**(Repeat Finding)**

**<u>Management Response:</u>**

- The most focused area of effort for Management has been on PCI compliance. Since November 2016, the City completed security reviews through Verizon Enterprise Solutions and Trustwave in early 2017; worked across departments to complete documentation of access and controls; reviewed and updated access; and secured the network, data, and applications environment for almost all transactions governed by PCI requirements. A small number of documentation items are still due from departments and Parking-related processes will be covered under a new vendor and contract currently in procurement.
- Management created and funded a Cybersecurity Office and City Information Security Officer (CISO) position as part of the 2017-2018 City Budget. Responsibilities for information and systems security are now designated as a responsibility of the group and the City is in the process of staffing. Progress in some areas of security have been limited by staffing limits.
- The new Information and Systems Security Policy remains in draft pending the hiring of the CISO. Edits were made to the draft to include feedback from the Grant-Thornton audit, City Auditor's audit of General Controls, and to match the policy to the National Institute of Standards and Technology Cybersecurity Framework. Management has completion of the new policy associated with the on-boarding of the new CISO, allowing the individual to apply their expertise, help guide the policy through to approval, and then create the City's educational content based on it.

- BitSight conducted a high-level scan of systems, behaviors, diligence, and breaches as indicators for the City to focus efforts.
- Management, through the IT Department, completed a draft of a Cybersecurity Assessments and Advanced Services Request for Proposals (RFP) to cover monitoring, security assessments/audits, education and tracking, incident response, and Virtual Security Operations Center services in October. Staff will review the RFP with the Purchasing Division for publication by January 2018 and award by the end of fiscal year 2017-18.
- Recognizing the increased risks associated with the City's decentralized information and systems control environment, the new CISO will have Citywide authority. Further, the CISO will work with designees for specialized security requirements affecting decentralized information and systems, such as PCI-DSS, CJIS, and HIPAA. These designees will serve as Component Security Officers (CSO) managing least-permissive rights and periodic reviews for financial, public safety, and human resources systems.

**Finding 2017-004 Information Technology: Account Management, Password Configuration, Broad Privileged Access, Password Configuration, Shared Accounts, and Audit Logging/Monitoring <u>(Repeat Finding)</u>**

**<u>Management Response:</u>**

- Management, through the IT Department, addressed future Account Management through implementation and usage of GroupID, which allows for the ability to synchronize IT Roles-based Access Control (RBAC), authentication profiles, and related settings from the City's Human Resources Management Systems. New employee accounts are created and managed through a single process, initiated by the Human Resources Department. Work remains on reviewing and cleaning existing application accounts, as well as on legacy network accounts that have been managed by decentral IT staffs to date.
- Password controls are addressed in the draft Information and Systems Security Policy. Password policy settings—expiration, complexity, et al— have already been implemented and are being enforced through the City's Active Directory group policies. Work remains and will be a focus for the new cybersecurity staff, once hired.
- Broad/Privileged User Accounts have been audited. Shared accounts have not been audited, but are not an approved practice as of July 2017. Significant work remains and these items will be a focus area for the new cybersecurity staff, once hired.
- Audit Logging and Monitoring remain basic and ad hoc. The activity is included on the City's Cybersecurity Workplan, to be handled through the Cybersecurity Assessments and Advanced Services Request for Proposals (RFP), once awarded. Currently, logging for central IT systems is occurring through SolarWinds Log and Event manager, a basic SIEM tool. Practices still need to be improved for alerting or filtering. Because of the speed at which cybersecurity threats and TTPs are evolving, the IT Department plans on utilizing vSOC services for this function if it's financially feasible.

**Finding 2017-005 Information Technology: Change Management (Repeat Finding)**

**Management Response:**

Management, through the IT Department, has a standardized Change Management process, including recent addition of system security review. IT staff is progressing beyond upgrades and updates, which are currently conducted, to include:

- Formal approval processes with stakeholders;
- More in-depth security reviews;
- Use of standard access form with periodic auditing;
- Documenting all changes and auditing against the change log; and
- Broadening the Chance Management Board to include more stakeholders.

**Finding 2017-006 Fair value of investments held in Retirement Plans under GASB 72 (applicable to Retirement Office) (Repeating Finding)**

**Office of Retirement Services Response:**

Within the Office of Retirement Services, the Accounting division coordinated with the Investments division to ensure that investment securities were categorized according to the proper level per GASB 72. The process was initiated by the Accounting division and reviewed for any changes for the current year by the Investments division. In the process of transferring the data from one worksheet to another by Accounting, two line items each consisting of a different fund manager, out of 743 line items rolling up to 75 fund managers, were inadvertently put in the wrong spot; thus causing the reclassification identified by the auditors. In the future, ORS will implement a final review by the Investments division to ensure their changes are captured.

**Schedule of Prior Year Findings**

**Finding 2016-001 Risks of decentralized accounting functions, reduced finance department staffing levels**

**Criteria**

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

**Condition**

The City's preparation of its Comprehensive Annual Financial Report ("CAFR") is a responsibility centralized within the Finance Department who compiles and verifies financial data, accounting estimates and US GAAP application decisions maintained by that department along with those generated by the various departments within the City's decentralized structure.
The process of preparing an accurate CAFR is complicated by the variation in levels of supervisory review, reconciliation and processing flows within the finance and other departments along with the inconsistencies in accounting background among the departments. That coupled with employee turnover among finance functions and in the departments contributes to a challenge in maintaining an internal control environment to prepare an accurate CAFR.

We noticed several areas where this challenge was apparent:

- In the City's General Fund, we encountered an account entitled Other Liabilities with a balance of $30 million at June 30, 2016 for which there were no supporting_subsidiary ledgers to substantiate the composition of the recorded balances. In order to audit the recorded liabilities, we requested the creation of subsidiary ledgers for many of the accounts comprising the $30 million total. Once created and reviewed, , we noted a misapplication of cash receipts where amounts related to cash receipts were recorded as additions to other liabilities rather than reductions of receivables or recognized as revenue. This resulted in an overstatement of $4.1 million in other liabilities, $3.9 million in receivables and $0.2 million in revenue. See Appendix A.
- Pooled bank account reconciliation- some departmental reconciling items such as those for disbursements which had not cleared the bank (outstanding checks) were calculated as the difference between a multi-year summaries of expenses recorded and the a balance of disbursements which had not cleared the bank instead of being supported by a list of actual outstanding checks.
- Accounts receivable and advance/deposit payable, and accrued salaries and wages reconciliations- several departmental accounts receivable subsidiary ledgers provided did not agree to the general ledger, were not prepared timely and had not been through a supervisory review. Identified errors in these accounts are summarized in Appendix A.
- Schedule of Expenditures of Federal Awards- the review controls over this supplemental schedule to the financial statements did not identify errors in the expenditure data for two federal awards. The accuracy of this schedule is important to the annual federal compliance audit which uses this schedule as a basis for determining which federal programs are subject to audit in a given year.
- Loan loss reserve estimate- see following comment.

**Cause**
As noted in past audits and in other studies, the decentralized nature of accounting responsibilities and the turnover and staffing levels at the City contribute to the instances listed above. We understand the City has made strides in centralizing policies, providing employee training and examining efforts to hire and retain finance personnel. We commend the City for these efforts and encourage continued focus in this area and to ensure the maintenance of subsidiary ledgers and the complete reconciliation of those subsidiary ledgers to the general ledger.

**Effect or Potential Effect**
Errors such as those noted above are a risk in the current environment.

**Status:**
Some errors from 2016 did not repeat in 2017 but there were some similar errors as noted in Finding 2017-002.

**Finding 2016-002 Controls over estimating loan loss reserves**

**Criteria**
Management is responsible for the preparation and fair presentation of the financial statements in accordance with US GAAP. This includes the design, implementation, and maintenance of internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Internal controls over financial statement estimates are particularly important given the important judgements inherent in making those estimates.

**Condition**
The City maintains a Housing Activities Fund and Low and Moderate Income Housing Asset Fund with total loans to borrowers of $ 131,239 million and $ 506,215 million, respectively, at June 30, 2016. Of those loan balances, management recorded an allowance for uncollectible loans for 43% and 55%, respectively, of the gross loan balances in those funds. Management's estimates were made using a methodology combining an allowance for risk and an allowance for present value discount. Management's methodology is documented and has been consistently applied for several years but the assumptions were not supported by evidence of incurred losses on loans such as historical results, industry data, actual performance of individual loans or current credit quality of the borrower. US GAAP outlines use of an incurred loss model when estimating loan losses. Inherent in that model is that a loss has occurred as of the financial statement date for a loan loss reserve to be accrued. In other words, expected future losses are not accrued, no matter how likely. Management was asked to provide evidence supporting the reasonableness of assumptions applied in the estimate. For example, we inquired about the policy to record a 40% reserve on certain categories of loans. Management was not ultimately able to adequately support the assumptions applied even though they were able to demonstrate they had complied with their policy.
We recommend management review loan reserve methodology in the context of applicable accounting standards and enhance documentation supporting the basis for assumptions and rates applied to the loans to estimate the reserve. We were able to independently develop an estimate within an acceptable range of the recorded balance to satisfy our audit objective.

**Cause**
The assumptions used in developing the loan loss reserve are based on an internal policy and have not been supported by evidence of incurred loss rates consistent with US GAAP's incurred loss model.

**Effect or Potential Effect**
Financial statements may be misstated if key assumptions in accounting estimates are not supported by evidence.

**Status:**
See Finding 2017-001.

**Finding 2016-003 Informational Technology: City-Wide Information Security Program**

**Criteria**
Internal controls over financial reporting are reliant on information technology ("IT") controls which are designed effectively. In that regard, an effectively designed IT environment is one where an organization:
(a) develops, documents, and disseminates to appropriate personnel, policies that addresses purpose, scope, roles, responsibilities, management commitment, coordination among organizational entities, and compliance; and procedures to facilitate the implementation of the policy and associated controls; and,
(b) periodically reviews and updates the current policy and procedures.

**Condition**
Systems impacted: The specific information systems impacted by the below findings were provided separately to management. In addition, the Grant Thornton team met with individual system owners and points of contact to discuss the nuances of these findings which varied slightly based on information system use, architecture, and other factors.

An entity-wide information security management program is the foundation of a security control structure and a reflection of senior management's commitment to addressing security risks. Overall policies and plans are developed at the entity-wide level. System and application-specific procedures implement the entity-wide policy. Ongoing monitoring of control design, implementation, and operating effectiveness should also be applied so that the program includes continuous monitoring processes.
Critical within a well-established information security program are documented policies, procedures, and guidance, security roles and responsibilities identified and appropriately delineated across the organization, and performing ongoing evaluations to ensure that policies and controls intended to reduce risk are effective. Without these aspects, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. Grant Thornton noted weaknesses within Management's information security program; specifically:

- Management had not assigned security responsibilities associated with its decentralized control environment. For example, there was no assignment of a centralized Chief Information Security Officer ("CISO") and/or Information Security Officer(s). Further decentralized information systems did not have a Component Security Officer ("CSO") or individual that was assigned to ensure the system/location met overarching security requirements.
- Management had not finalized, published, and communicated formal policies and procedures related to information technology ("IT") control processes. Examples of draft policies and IT controls not formally documented include:

| Policies in draft | Not addressed in policy |
|---|---|
| Acceptable use | Baseline security configuration setting and monitoring |
| Access to network and systems | Auditable event and monitoring |
| Anti-virus | Application change & emergency change management |
| Business continuity and disaster recovery | Incident response |

| | |
|---|---|
| Data classification and handling | Vulnerability scanning |
| Encryption | Security training |
| Information security | Backup and data retention |
| Network security | |
| Password | |
| Secure system development | |

- Management did not have a processes implemented to perform continuous monitoring. Specifically, Management did not:
  - Perform periodic risk and vulnerability assessments, penetration testing, continuous monitoring through scanning or agent-based software tools, or perform other cybersecurity activities in order to identify, track and resolve security threats.
  - Perform security configuration management processes to establish and monitor platforms and software against best practices.

**Cause**
Due to budget constraints and significant reductions in ITD, Management has not developed or resourced an IT governance structure and processes that appropriately support the risks and threats associated with an organization of the City's size and with the added complexities of decentralization. Furthermore, while Management was in the process of finalizing and implementing City-wide policies and procedures over IT systems, they had not developed ongoing monitoring procedures to protect the integrity of financial data, nor were appropriate processes in place in order to monitor potential security threats.

**Effect or Potential Effect**
A lack of formal security responsibilities, as well as, policies and procedures related to security controls increases the risk that implementation of control activities may not be consistent throughout the divisions / components within the City.
Failure to perform network security vulnerabilities and penetration assessments increases the risk that the information system's security weaknesses are not identified and investigated in a timely fashion.
Failure to implement and monitor recommended security configuration and best practice settings increases the likelihood of misconfigurations that may be exploited.
Inadequate information security frameworks may lead to lapses in security requirements and consistent implementation across decentralized locations.
This could lead to errors, data loss, inappropriate access, and other risks with the potential to impair the confidentiality, integrity, and availability of systems and data. These issues may result in unauthorized access, use, disclosure, disruption, modification, or destruction of information and information systems, which may lead to misstatements on the financial statements.

**Status:**
See finding 2017-003.

**Finding 2016-004 Information Technology: Account Management, Password Configuration, Broad Privileged Access, Password Configuration, Shared Accounts, and Audit Logging/Monitoring**

**Criteria**
Internal controls over financial reporting are reliant on information IT controls which are designed effectively. In that regard, an effectively designed IT environment is one where an organization maintains the following:
Account Management includes the following criteria:

m. Identifies and selects the types of information system accounts needed to support organizational missions/business functions;
n. Assigns account managers for information system accounts;
o. Establishes conditions for group and role membership;
p. Specifies authorized users of the information system, group and role membership, and access authorizations (i.e., privileges) and other attributes (as required) for each account;
q. Requires approvals by appropriate personnel for requests to create information system accounts;
r. Creates, enables, modifies, disables, and removes information system accounts in accordance with organization-defined procedures or conditions;
s. Monitors the use of information system accounts;
t. Notifies account managers when accounts are no longer required, when users are terminated or transferred, and when individual information system usage or need-to-know changes;
u. Authorizes access to the information system based on a valid access authorization, intended system usage, and other attributes as required by the organization;
v. Reviews accounts for compliance with account management requirements periodically; and,
w. Establishes a process for reissuing shared/group account credentials (if deployed) when individuals are removed from the group.
x. restrictions on the use of shared accounts such as defining the specific criteria that must be met in order to use a shared account and termination of the shared account credentials when members leave the group.

*Password Strength* the organization employs the principle of strong passwords, requiring credentials of reasonable complexity and inactivity-based log-out.

*Separation of Duties* the organization documents separation of duties of individuals and defines information system access authorizations to support separation of duties. Separation of duties addresses the potential for abuse of authorized privileges and helps to reduce the risk of malevolent activity without collusion. Separation of duties includes, for example: (i) dividing mission functions and information system support functions among different individuals and/or roles; (ii) conducting information system support functions with different individuals (e.g., system management, programming, configuration management, quality assurance and testing, and network security); and (iii) ensuring security personnel administering access control functions do not also administer audit functions.

*Least Privileg*e the organization employs the principle of least privilege, allowing only authorized accesses for users (or processes acting on behalf of users) which are necessary to accomplish assigned tasks in accordance with organizational missions and business functions.

*Access Restrictions for Change* the organization defines, documents, approves, and enforces physical and logical access restrictions associated with changes to the information system. Organizations should maintain records of access to ensure that configuration change control is implemented and to support after-the-fact actions should organizations discover any unauthorized changes.

*Audit Events* the organization:

e. Determines that the information system is capable of auditing organization-defined auditable events;
f. Coordinates the security audit function with other organizational entities requiring audit-related information to enhance mutual support and to help guide the selection of auditable events;

g. Provides a rationale for why the auditable events are deemed to be adequate to support after-the-fact investigations of security incidents; and,

h. Determines that the organization-defined audited events are to be audited within the information system along with the frequency of (or situation requiring) auditing for each identified event.

*Audit Review, Analysis, and Reporting* the organization reviews and analyzes information system audit records periodically for indications of inappropriate or unusual activity and reports findings to the appropriate personnel or role within the organization. Information security-related auditing performed by organizations can include, for example, auditing that results from monitoring of account usage, remote access, wireless connectivity, mobile device connection, configuration settings, system component inventory, use of maintenance tools and nonlocal maintenance, physical access, temperature and humidity, equipment delivery and removal, communications at the information system boundaries, use of mobile code, and use of VoIP.

**Condition**

Systems impacted: The specific information systems impacted by the below findings were provided separately to management. In addition, the Grant Thornton team met with individual system owners and points of contact to discuss the nuances of these findings which varied slightly based on information system use, architecture, and other factors.

System authorization, access, and account management controls must be used to limit system activities to ensure legitimate use, least privilege, and segregation of duties. Access controls provide assurance that critical systems assets are safeguarded and that logical access to sensitive applications, system utilities, and data is provided only when authorized and appropriate. Further, broad or special (privileged) access privileges, such as those associated with operating /database system software, administrative accounts, and /or superusers, may allow normal controls to be overridden or otherwise circumvented. Additionally, a lack of logging and monitoring broad or privileged access may result in unusual or suspicious activity going unidentified. Grant Thornton noted the following. Grant Thornton noted Management should address the following:

**Account Management**

- Management did not have a process to consistently document and retain approvals related to initial authorization and ongoing changes to user's access for seven systems tested.
- Management did not perform periodic access recertification for users (including privileged users) and system accounts for 11 systems tested.
- Management did not define the timeframe in which a separated employee or contractor's access from the Network must be disabled after separation and the timeframe in which a reassigned employee's access must be reviewed and updated after reassignment.

**Password Configuration**

Grant Thornton noted that there was no consistent password policy City-wide for the systems identified above. As a result we noted that password security configuration settings were not consistently aligned with best practices across the network, platforms, and devices. Specifically, we noted information systems did not meet some or all of the following:

- Minimum length requirements
- Enforce the use of alpha numeric characters
- Restrict the use of common words; and,
- Apply password expiration

In addition, we noted that information systems did not log users out after a period of inactivity or lock users out after a set number of failed password attempts.

**Broad / Privileged User Accounts**

- For one system tested we noted the IT team had access to the operating system and the database.
- Management did not consistently segregate system management functions such as user and system administration from functional responsibilities for seven systems tested. Further system users had IT administrative responsibilities.
- We noted that an system / tool was utilized to make direct changes to production data for a system tested. This tool enables users to bypass transactions made via the applications in the normal course of business, circumvent manual controls in place and update data directly in the database. Per discussion with Management, users require approvals before making changes to data via this tool; however; there were no systematic restrictions that required approvals prior to the updates being made.

**Shared Accounts**

- We noted instances where systems utilized shared accounts which negate accountability of use. Specifically a shared account was used to make direct data changes via the tool described above and to transfer information into systems.

**Audit Logging and Monitoring**

- Management did not log and/or monitor activities associated with privileged user accounts (e.g. system administrators, user administrators, network administrators, operators, and developers) for four systems tested. Further one system had limitations which did not allow it to log activities.
- We noted a lack of formally defined auditable events (such as privileged use, invalid password attempts, key configuration changes, or changes made directly to financial data), investigation and analysis processes.

**Cause**

- Management had not implemented a policy and procedures that appropriately documents account management requirements as part of their internal control framework.
- Management had not defined City-wide password security configurations. Additionally, some information systems did not have the technical capability to enforce password configuration best practices.
- Management had not defined requirements for privileged user accounts, shared accounts, logging/ monitoring, and segregation of duties in policy and procedures.

**Effect or Potential Effect**

<u>Account Management</u>

- Without formally completing or approving access requests, changes or timely terminations of access, there is an increased risk of inappropriate or unauthorized access to information systems and financial data.
- Without a periodic review of user and system accounts, there is a greater probability that an access change made in error would not be identified in a timely manner.
- Without defining the requirements around logical and physical access removal for separated or reassigned employees and contractors, there is an increased risk that access will not be removed or will

not be removed in a timely manner. This access may allow inappropriate access to execute system functions. This could also lead to a license violation issue.

Password Configuration
Failure to implement recommended security settings and best practices for passwords increases the likelihood of account compromise by malicious users

Broad / Privileged User Accounts

- Failure to effectively restrict access to applications based on job function and employ adequate segregation of duties increases the risk for abuse of system privileges, fraud, and inappropriate activity without collusion.
- Direct data changes bypass system transactions and controls and therefore increase the risk of inappropriate updates to data. This may impact the organization's ability to rely on the completeness, accuracy, and validity of financial data. Further, the use of shared user accounts on a production system reduces the audit and accountability of users within the system and password security. In other words, there is no traceability of user's activity to perform these changes to production data.

Shared Accounts
Shared accounts negate accountability of use in that Management is not able to identify the user that made changes.

Audit Logging and Monitoring
Failure to maintain adequate logging and monitoring of higher risk application events and privileged access increases the risk that suspicious activities may not be identified and investigated.

This could lead to errors, data loss, inappropriate access, and other risks with the potential to impair the confidentiality, integrity, and availability of systems and data. These issues may result in unauthorized access, use, disclosure, disruption, modification, or destruction of information and information systems, which may lead to misstatements on the financial statements.

**Status:**
Some progress has been made among selected applications. In the aggregate a significant deficiency in internal control still exists. Refer to finding 2017-004.

**Finding 2016-005 Information Technology: Change Management**

**Criteria**
Internal controls over financial reporting are reliant on IT controls which are designed effectively. In that regard, an effectively designed IT environment is one where an organization:

h. Determines the types of changes to the information system that are configuration-controlled;
i. Reviews proposed configuration-controlled changes to the information system and approves or disapproves such changes with explicit consideration for security impact analyses;
j. Documents configuration change decisions associated with the information system;
k. Implements approved configuration-controlled changes to the information system;
l. Retains records of configuration-controlled changes to the information system for an organization-defined time period;

m. Audits and reviews activities associated with configuration-controlled changes to the information system; and,

n. Coordinates and provides oversight for configuration change control activities through an organization-defined configuration change control element (e.g., committee, board).

**Condition**

Systems impacted: The specific information systems impacted by the below findings were provided separately to management. In addition, the Grant Thornton team met with individual system owners and points of contact to discuss the nuances of these findings which varied slightly based on information system use, architecture, and other factors.

Change management processes provide assurance that software, data, and other changes associated with information systems are approved and tested so they do not introduce functional or security risks. A disciplined process for testing, approving, and migrating changes between environments, including into production, is essential to ensure that systems operate as intended and that no unauthorized changes are implemented.

Grant Thornton noted that Management did not have a process to consistently document and retain evidence related to change management activities including change request and approval, scheduling, initiation, testing, implementation approvals and post-implementation review for eight systems tested. In addition, we noted that City personnel do not have access to source code for one system tested, which is handled by the vendor, but were responsible for user acceptance testing and certain approvals, which were not consistently documented and retained.

**Cause**

As part of the internal controls framework, management has not incorporated a policy and procedure to periodically monitor and review the configuration items that are migrated to production. Additionally, IT personnel did not consistently document and retain evidence related to change management activities (e.g. change request and approval, scheduling, initiation, testing, implementation approvals and post-implementation review).

**Effect or Potential Effect**

Without formally completing or approving change management activities for system changes, patches and modifications, there is an increased risk that change management controls will not be completed. Without effective control over changes that are migrated to the production environment, there is an increased risk that an inappropriate code change could be introduced into the production environment, potentially impacting the financial statement and related processes (i.e. cash accountability, financial reporting, etc.).

Inappropriate code change could have a negative impact on system functionality, availability, or ability to produce complete and accurate financial data. These issues may result in unauthorized access, use, disclosure, disruption, modification, or destruction of information and information systems, which may lead to misstatements on the financial statements.

**Status:**

Some progress has been made among selected applications. In the aggregate a significant deficiency in internal control still exists. Refer to finding 2017-005.

**Finding 2016-006 Fair value of investments held in Retirement Plans under GASB 72(applicable to Retirement Office)**

**Criteria**
Establishing and maintaining an internal control structure is an important management responsibility. To provide reasonable assurance that an entity's objectives will be achieved, the internal control structure should be under ongoing supervision by management to determine that it is operating as intended and that it is modified as appropriate for changes in conditions.

**Condition**
Grant Thornton noted that the Retirement Office had not developed a comprehensive analysis of valuation techniques applied to its level 1 investments, level 2 investments, level 3 investments and investments measured using the net asset value and did not have a clearly articulated means of demonstrating how fair values recognized in the financial statements were validated.

GASB 72 became effective for the Retirement Office for the year ended June 30, 2016 with presentation of comparable 2015 information required. GASB 72 requires new disclosures in the financial statements regarding the inputs to the valuation techniques applied in determining the fair values of the investments in the Retirement Office's investment portfolios. This necessitates analysis by management of methods used by the custodian and investment managers to measure fair value and to undertake periodic validation of the amounts provided by those parties.

GASB 72 does not change the accounting treatment for the investments, but rather defines fair value and the way it is to be measured and recognized in financial statements, establishes new disclosure requirements and sets new expectations regarding related documentation. Historically the standard practice had been limited to accepting values provided by third parties on the basis of an expectation that they had effective controls over fair value measurements.

**Cause**
The Retirement Office did not have a process in place for fully implementing this new accounting standard.

**Effect or Potential Effect**
Clear support was not initially provided demonstrating management's understanding of valuation techniques and the related validation of amounts provided by the custodian and investment managers.

Management should develop and implement a comprehensive policy for fair value measurements which includes, but is not limited to:

- Documentation of the techniques used to value all investment security types
- Periodic review of SOC 1 reports covering the valuation controls in place at the custodian and third party investment managers.

Selected validation of values provided by third parties using independent pricing sources applicable to the particular security types.

**Status:**
See Finding 2017-006

**Finding 2016-007 Procurement under Federal Uniform Guidance**

Federal Award: WIA/WIOA Cluster, CFDA 17.258, 17.259, 17.277, 17.278

Federal Award: Airport Improvement Program, CFDA 20.106

**Criteria**
Pursuant to the U.S. Office of Management and Budget's ("OMB") Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards("Uniform Guidance") in 2 CFR 200, recipients of Federal awards must implement the policies and procedures applicable to Federal awards effective December 26, 2014 unless different provisions are required by statute or approved by OMB. For the procurement standards in 2 CFR 200.317 – 200.326, Federal award recipient entities may continue to comply with the procurement standards in previous OMB guidance for two additional fiscal years after this part goes into effect. If a Federal award recipient chooses to use the previous procurement standards for an additional two fiscal years before adopting the procurement standards in this part, the Federal award recipient must document this decision in their internal procurement policies.

**Condition**
We noted that the City did not document any decision to continue to use the procurement standards in the previous OMB guidance for an additional two fiscal years subsequent to the December 26, 2014 effective date of the new Uniform Guidance rules.

**Context**
The City had the ability to defer implementation of the new Uniform Guidance procurement rules outlined in 2 CFR 200 for two years but did not formally document the decision and it was unclear which rules the City was operating under for procurements on Federal grants and contracts after the December 26, 2014 implementation date.

**Questioned Costs**
$0

**Effect**
The City did not comply with the specific requirements of Uniform Guidance with respect to documenting its procurement policies.

**Cause**
Procurement personnel neglected to document the deferral of the implementation of the new rules.

**Recommendation**
We recommended and the City has since documented its decision to defer adoption of the new procurement standards until July 1, 2017.

**Status:**
Remediated

**Finding 2016-008 Evaluating controls over third party service providers**

**Criteria**
Management is responsible for the preparation and fair presentation of the financial statements in accordance with US GAAP. This includes the design, implementation, and maintenance of internal control relevant to the

preparation of financial statements that are free from material misstatement, whether due to fraud or error. Effective internal controls include the monitoring of third party service providers who process transactions on behalf of the City.

**Condition**
The City engages third party service providers for a variety of services including the valuation of investments held in defined contribution pension plans (Voya) and the collection and processing of claims information for workers compensation (Athens), among others. The use of third party providers requires an evaluation of the adequacy of controls at those providers and at design and assessment of adequacy of the City's controls around the use of third party information in financial reporting. This assessment is critical to establishing that third party information is materially correct and adequately supports the accounts and balances on which such information relies.

In order to perform this assessment, the City should request and evaluate the Service Organization Control ("SOC") reports of third party providers. A SOC report is an independent auditors report obtained by service providers which reflects the results of reviews and/or testing of the service providers' internal control environment relevant to the processes outsourced to those providers. The reports provide information to users to evaluate and mitigate risks around the use of such providers and the transmission and receipt of information important to supporting financial accounts and balances and provide recommended user control considerations for application in the user's (City's) own internal control environment.

SOC reports were available for the third parties valuing investments in the defined contribution pension plans and processing workers' compensation claims but were not collected, read or analyzed by the City.

**Cause**
The City was unaware of the existence of the SOC reports.

**Effect or Potential Effect**
The City may not be aware of reported internal control deficiencies at third party providers or fail to identify important controls which should be in place at the City as it liaises with those third parties.

**Status:**
Remediated

**Finding 2016-009 Financial Reporting Controls**

**Criteria**
Management is responsible for the preparation and fair presentation of the financial statements in accordance with US GAAP. This includes the design, implementation, and maintenance of internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Internal controls over financial reporting should include a documented reconciliation between the general ledger and the formal financial statements to show a roadmap of any top-level adjustments, reclassifications and any other post-closing journal entries made to convert from one presentation to the other.

**Condition**

The preparation of the financial statements requires mapping of trial balance accounts to the financial statement line items and disclosures. The City uses a software application to map the trial balance to financial statements for all funds except the Wastewater Fund. For the Wastewater Fund, the City applies a highly manual, undocumented process to map the trial balance to financial statements. Post-closing, top-sided and reclassification entries could also not be easily mapped to the financial statement presentation. Further, there was no indication of any supervisory review of the accuracy and consistency of the mapping applied.

We incurred a significant amount of time reconstructing the process of mapping in order to support our audit objective.

We recommend that management fully document the complicated mapping process for this fund in the future and ensure supervisory review of this process.

**Cause**

There was no policy to require documentation or supervisory review of the mapping of this fund from the general ledger to the financial statements.

**Effect or Potential Effect**

The lack of a documented reconciliation or supervisory review could result in an error in the financial statements.

**Status:**

Remediated

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Grant Thornton

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
ON COMPLIANCE WITH APPLICABLE REQUIREMENTS OF THE
PASSENGER FACILITY CHARGE PROGRAM AND ON INTERNAL
CONTROL OVER COMPLIANCE IN ACCORDANCE WITH THE
PASSENGER FACILITY CHARGE AUDIT GUIDE FOR PUBLIC AGENCIES

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Honorable City Council
City of San José, California

**Report on compliance for the Passenger Facility Charge Program**

We have audited the compliance of Normal Y. Mineta San José International Airport (a department of the City of San José) (the "Airport") with the types of compliance requirements described in the Passenger Facility Charge Audit Guide for Public Agencies (the "Guide"), issued by the Federal Aviation Administration ("FAA") that could have a direct and material effect on its passenger facility charge program (the "PFC program") for the year ended June 30, 2017.

Management's responsibility

Management is responsible for compliance with requirements described in the Guide as applicable to the Airport's PFC program.

Auditor's responsibility

Our responsibility is to express an opinion on compliance for the Airport's PFC program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the audit requirements of the Guide. Those standards and the Guide require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on the PFC program occurred. An audit includes examining, on a test basis, evidence about the Airport's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the PFC program. However, our audit does not provide a legal determination of the Airport's compliance.

Opinion on the PFC program

In our opinion, the Airport complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the PFC program for the year ended June 30, 2017.

## Report on internal control over compliance

Management of the Airport is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Airport's internal control over compliance with the types of compliance requirements that could have a direct and material effect on the PFC program to design audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the PFC program and to test and report on internal control over compliance in accordance with the 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 Airport's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in the Airport's internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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

Grant Thornton LLP

San José, California
November 30, 2017



Grant Thornton LLP
U.S. member firm of Grant Thornton International Ltd

## CITY OF SAN JOSE, CALIFORNIA
## Schedule of Passenger Facility Charge Revenue and Expenditures
## Year Ended June 30, 2017

| | Passenger Facility Charge Revenues | Interest Earned/(Loss) | Total Revenues | Expenditures on Approved Projects | Under (over) Expenditures on Approved Projects |
|---|---|---|---|---|---|
| **Fiscal year 2016-17 transactions:** | | | | | |
| Quarter ended September 30, 2016 | $ 3,006,112 | $ (21,961) | $ 2,984,151 | $ 11,275,037 | |
| Quarter ended December 31, 2016 | 5,384,508 | 19,655 | 5,404,163 | - | |
| Quarter ended March 31, 2017 | 5,148,872 | 37,032 | 5,185,904 | 13,513,486 | |
| Quarter ended June 30, 2017 | 9,557,565 | 8,668 | 9,566,233 | - | |
| | $ 23,097,057 | $ 43,394 | $ 23,140,451 | $ 24,788,523 | (1,648,072) |
| | | | Balance, beginning of year | | 16,331,643 |
| | | | Balance, end of year | | $ 14,683,571 |

**CITY OF SAN JOSE, CALIFORNIA**
**Notes to the Schedule of Passenger Facility Charge Revenue and Expenditures**
**Year Ended June 30, 2017**

## (1) GENERAL

The Schedule of Passenger Facility Charge Revenues and Expenditures presents only the activity of the Passenger Facility Charge (PFC) program of the Norman Y. Mineta San José International Airport (Airport), an enterprise fund of the City.

The Aviation Safety and Capacity Expansion Act of 1990 (Public Law 101-508, Title II, Subtitle B) authorized the imposition of PFCs and use of the resulting revenue on Federal Aviation Administration (FAA) approved projects. PFCs are fees imposed on enplaned passengers by the Airport for the purpose of generating revenue for Airport projects that increase capacity, increase safety, mitigate noise impact and enhance competition between and among air carriers in accordance with FAA approvals.

## (2) BASIS OF ACCOUNTING

The accompanying schedule is presented using the accrual basis of accounting as described in Note I to the City's basic financial statements.

## (3) RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS

Under the Airport's Master Trust Agreement, the Airport may for any period elect to designate any PFC revenues as "Available PFC Revenues" by filing with the Trustee a written statement designating the amount of such Available PFC Revenues and containing a statement that the Available PFC Revenues are legally available to be applied to pay bond debt service during such period. An amount of $24,788,523 from accumulated PFC Revenues had been designated as Available PFC Revenues for payment of eligible bond debt service in the year ended June 30, 2017.

## (4) RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Amounts reported in the Schedule of Passenger Facility Charge Revenues and Expenditures agree to or can be reconciled with the amounts reported to the FAA on the Passenger Facility Charge Quarterly Status Reports.

## (5) PFC APPROVED PROJECTS AND EXPENDITURES

The general description of the approved projects and the expenditures for the year ended June 30, 2017 are as follows:

| Passenger Facility Charge Project Number/Description | | Identifying Number | Passenger Facility Charge Approved Amount | Expenditures |
|---|---|---|---|---|
| #40A | Runway 12R/30L Reconstruction | 01-12-C-00-SJC | $ 72,022,700 | $ 3,647,361 |
| #40B | Runway 12R/30L Extension | 01-12-C-00-SJC | 38,671,724 | 1,650,666 |
| #52 | Taxiway Z - Apron Reconstruction ( Phase II) | 01-11-C-00-SJC | 825,000 | - |
| #53 | Terminal C Fire Protection | 01-11-C-00-SJC | 580,000 | - |
| #54 | Fiber Optic Cable to ARC & Fire Station 29 | 01-11-C-00-SJC | 87,345 | - |
| #55 | Green Island Bridge | 01-11-C-00-SJC | 825,000 | - |
| #56 | Replacement of AACS and CCTV | 01-11-C-00-SJC | 4,418,645 | - |
| #57 | Skyport Grade Separation | 01-11-C-00-SJC | 18,218,154 | - |
| #58 | Terminal Drive Improvements | 01-11-C-00-SJC | 1,146,165 | - |
| #59 | Replacement of PASSUR | 01-11-C-00-SJC | 221,000 | - |
| #60 | Terminal C Restroom | 01-11-C-00-SJC | 2,485,000 | - |
| #61 | Interim Air Cargo Ramp Extension | 01-11-C-00-SJC | 1,100,000 | - |
| #62 | Runway 30R/12L Reconstruction | 01-11-C-00-SJC | 84,105,103 | 3,906,779 |
| #63 | Noise Attenuation Category II & III | 01-11-C-00-SJC | 4,500,000 | - |
| #64 | Taxiway Y Extension | 01-11-C-00-SJC | 12,890,000 | 430,521 |
| #65 | Extended Noise Attenuation | 02-13-C-00-SJC | 61,589,000 | - |
| #67 | Terminal B - North Concourse | 06-15-C-00-SJC | 495,095,000 | 12,195,196 |
| #68 | Terminal B Extension, Phase I | 08-16-C-00-SJC | 110,159,000 | 2,958,000 |
| #69 | Roadway Improvements: Grade Separations | 08-16-C-00-SJC | 10,244,000 | - |
| | Total Passenger Facility Charge Projects | | $ 919,182,836 | $ 24,788,523 |

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# REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON COMPLIANCE WITH APPLICABLE REQUIREMENTS OF THE CUSTOMER FACILITY CHARGE PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH THE CUSTOMER FACILITY CHARGE PROGRAM

Honorable City Council
City of San José, California

## Report on compliance for the Customer Facility Charge Program

We have audited the compliance of Normal Y. Mineta San José International Airport (a department of the City of San José) (the "Airport") with the types of compliance requirements described in the California Government Code §50474.1-50474.3 (the "Code"), that could have a direct and material effect on its customer facility charge program (the "CFC program") for the year ended June 30, 2017.

### Management's responsibility

Management is responsible for compliance with requirements described in the Code as applicable to the Airport's CFC program.

### Auditor's responsibility

Our responsibility is to express an opinion on compliance for the Airport's CFC program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the audit requirements of the Code. Those standards and the Code 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 the CFC program occurred. An audit includes examining, on a test basis, evidence about the Airport's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the CFC program. However, our audit does not provide a legal determination of the Airport's compliance.

### Opinion on the CFC program

In our opinion, the Airport complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the CFC program for the year ended June 30, 2017.

**Report on internal control over compliance**

Management of the Airport is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Airport's internal control over compliance with the types of compliance requirements that could have a direct and material effect on the CFC program to design audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the CFC program and to test and report on internal control over compliance in accordance with the Code, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Airport's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in the Airport's internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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

Grant Thornton LLP

San José, California
November 30, 2017

**CITY OF SAN JOSE, CALIFORNIA**
**Schedule of Customer Facility Charges Revenues and Expenditures**
**Year Ended June 30, 2017**

| | |
|---|---|
| Revenues | |
| Customer facility charges | $ 19,957,095 |
| Facility rent | 112,207 |
| Investment income | 52,349 |
| Total revenues | 20,121,651 |
| Expenditures | |
| Transportation expenditures | 2,196,160 |
| Debt service expenditures | 18,138,094 |
| Total expenditures | 20,334,254 |
| Expenditures over revenues | $ (212,603) |

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

**CITY OF SAN JOSE, CALIFORNIA**
**Note to the Schedule of Customer Facility Charges Revenues and Expenditures**
**Year Ended June 30, 2017**

## (1) GENERAL

California Government Code §50474.1-50474.3 permits an airport sponsor to require rental car companies to collect from a renter a Customer Facility Charge (CFC) to finance, design and construct a consolidated airport rental car facility; to finance, design, construct, and operate common-use transportation systems that move passengers between airport terminals and those consolidated car rental facilities, and acquire vehicles for use in that system; and to finance, design, and construct terminal modifications solely to accommodate and provide customer access to common-use transportation systems.

From January 1, 2008 through November 30, 2011, the Airport imposed a CFC of $10.00 per rental contract. Pursuant to California Government Code §50474.1-50474.3, the City increased the CFC to $6.00 per contract day, to a maximum of five days, on each rental effective December 1, 2011, and further increased the per contract day CFC to $7.50 per contract day, to a maximum of five days, on each rental, commencing January 1, 2014.

## (2) BASIS OF ACCOUNTING

The accompanying schedule is presented using the accrual basis of accounting as described in Note I to the City's basic financial statements.

## (3) RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS

Expenditures of CFCs are reported in the City's basic financial statements as operating expenses or debt service payments in the Airport enterprise fund. CFC expenditures agree or can be reconciled with the amounts reported in the City's basic financial statements.