



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Matt Cano

SUBJECT: SEE BELOW

DATE: June 4, 2018

Approved

Date

6/15/18

**SUBJECT: ANNUAL STATUS AND AUDIT REPORT ON THE PUBLIC SAFETY
BOND PROGRAM FOR FISCAL YEAR 2016-2017**

RECOMMENDATION

Accept the status and audit report for the Fiscal Year (FY) 2016-2017 Public Safety Bond Projects Program Fund.

OUTCOME

Acceptance of this report would conclude the Public Safety Bond Projects Oversight Committee's review of the status and audit of the Bond program in FY 2016-17.

BACKGROUND

On March 5, 2002, voters approved Measure O, San José 911, Fire, Police, Paramedic, and Public Safety Act, authorizing the City to issue general obligation bonds up to \$159,000,000. Consistent with bond requirements, the City established a Public Safety Bond Citizen Oversight Committee (COC) to conduct an annual public hearing and prepare an annual report informing the Council and the public of the appropriateness of bond expenditures, the progress of the various projects, and the results of the annual audit.

On May 10, 2018, the COC conducted a public hearing to review expenditures in the Public Safety Bond Program, specifically the Neighborhood Security Bond Program (NSB) for FY 2016-2017. City staff presented information to the COC regarding the appropriateness of bond expenditures and the progress of the various projects. The result of the NSB financial audit was also included in the information packet reviewed by the COC. The City Auditor gave a brief presentation to the COC explaining their report and answering questions.

This latest memorandum to the Mayor and Council provides an update on the status of the NSB project expenditures for FY 2016-2017.

The annual reports including audit and supporting documents, are prepared and completed approximately six-months after the close of the fiscal year. Reports are then finalized and presented at scheduled public hearings after which the packages are prepared for Council.

The attached report represents the COC's annual report to Council on their bond program for Council submission and acceptance.

ANALYSIS

I. Neighborhood Security Bond Program Project Status:

- a. **Project Status:** FY 2016-17 marked the 15th year of the City's implementation of the Public Safety Bond program which has resulted in the completion of upgrades to 19 fire stations, construction of eight new fire stations and the new Police Substation.
- b. **Project Financing and Expenditures:** A total of \$155.7 million in General Obligation (GO) Bonds have been issued to fund NSB projects through the fourth quarter of FY 2016-2017. In addition to bond revenue, interest earned, settlement proceeds, and fund transfers totaled approximately \$18.02 million, for total revenue of \$175.25 million. Approximately \$173.66 million of bond funds have been expended or encumbered as of June 30, 2017. The remaining authorization to issue GO bonds for public safety projects under the NSB Program is \$3.3 million. The balance of the funds will be used to complete the projects indicated below.
- c. **Project Unused Funds and Current/Upcoming Uses:** As described in the 2017-2018 Adopted Capital Budget and the 2018-2019 Proposed Capital Budget, the remaining bond funds have been reallocated to eligible fire station capital improvement projects that would otherwise be budgeted in the Fire C&C Fund due to the urgency to use the balance of the Neighborhood Security Act Bond Funds. The capital improvement projects will be prioritized based on previous life cycle and condition assessment reports performed by the Public Works Department in coordination with the Fire Department.

For City Council reference, the discussion within COC's annual report regarding Fire Station 37 requires minor clarification due to updated budget information. The 2019-2023 Proposed Capital Budget allocates \$4.6 million in funding to the Fire Station 37 Reserve from the Fire C&C Fund. With one-time costs to construct and outfit Fire Station 37 estimated at \$11.6 million (\$10.3 million of design and construction, \$800,000 for a new fire engine and related equipment, and \$540,000 for station fixtures, furniture and equipment) additional one-time funding of at least \$7.0 million

is required to fully deliver Fire Station 37. Further, approximately \$3.7 million will be needed annually for maintenance and operations.

The independent accounting firm of Grant Thornton, LLP completed its annual audits of the Bond Projects Fund in October for the fiscal year ending June 30, 2017. As part of the outside auditor's review, an examination is conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. In the opinion of Grant Thornton, LLP, the audit of the accompanying financial statements for the year ended June 30, 2017 ended in accordance with accounting principles generally accepted in the United States of America. Additionally, in the opinion of Grant Thornton, LLP, the City complied, in all material respects, with the requirements of Measure O during the period of July 1, 2016 to June 30, 2017.

EVALUATION AND FOLLOW-UP

Status reports on the project expenditures and performance of the Public Safety Bond Program projects are reported on an annual basis to the COCs and City Council.

PUBLIC OUTREACH

The public hearing for the review of the Auditors report item, held on May 10, 2018, was posted on the City's Brown Act Board. This memorandum will be posted to the City's website for the June 26, 2018, City Council agenda.

COORDINATION

The Auditors reports and the corresponding memos have been coordinated with the Fire Department, Police Department, City Manager's Budget Office, Finance Department, and the City Auditor's Office.

COMMISSION RECOMMENDATION/INPUT

The COC for the Public Safety Bond Program approved the Auditors report as identified in their corresponding memo.

FISCAL/POLICY ALIGNMENT

The COC meet the legal commitment and requirement of implementing the review of the expenditures of the Bond Programs and provide the public with opportunities to understand, review and address any significant issues related to program expenditures.

HONORABLE MAYOR AND CITY COUNCIL

June 4, 2018

Subject: Annual Status and Audit Report for the Public Safety Bond Program Projects for FY 2016-2017

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CEQA

Not a Project, File No. PP17-009, Staff Reports, Assessments, Annual Reports, and Informational Memos that involve no approvals of any City action.

/s/

MATT CANO

Director of Public Works

For questions please contact Michael O'Connell, Deputy Director, Public Works Department at (408) 535-8300.

Attachments:

A. Public Safety Bond Program memorandum dated May 10, 2018.

B. Public Safety Bond Program Funds Accountants' Report for the Year Ended June 30, 2017.



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Citizen Oversight
Committee for the Public
Safety Bond Program

SUBJECT: SEE BELOW

DATE: May 10, 2018

COUNCIL DISTRICT: Citywide

**SUBJECT: ANNUAL FINANCIAL REPORT ON THE PUBLIC SAFETY BOND
PROGRAM FOR FISCAL YEAR 2016-2017**

RECOMMENDATION

Accept this report on the Public Safety Bond Program. Accept the Fiscal Year (FY) 2016-2017 Public Safety Bond Program Fund audit.

OUTCOME

This report to the Mayor and Council provides an update on the status of the Public Safety Bond Program at the end of its fifteenth fiscal year (2016-2017).

BACKGROUND

On March 5, 2002, voters approved Measure O, San José 911, Fire, Police, Paramedic, and Public Safety Act, authorizing the City to issue general obligation bonds up to \$159,000,000. Consistent with bond requirements, the City established a Public Safety Bond Citizen Oversight Committee (COC) to conduct an annual public hearing and prepare an annual report informing the Council and the public of the appropriateness of bond expenditures, the progress of the various projects, and the results of the annual audit.

On May 10, 2018, the COC conducted a public hearing to review expenditures in the Public Safety Bond Program, specifically the Neighborhood Security Bond Program (NSB) for FY 2016-2017. City staff presented information to the COC regarding the appropriateness of bond expenditures and the progress of the various projects. The result of the NSB financial audit was also included in the information packet reviewed by the COC. The City Auditor gave a brief presentation to the COC explaining their report and answering questions.

This latest memorandum to the Mayor and Council provides an update on the status of the NSB project expenditures for FY 2016-2017.

ANALYSIS

During the fifteenth fiscal year (2016-2017) of the NSB program, City staff has the following updates.

Land Acquisition

All planned land acquisitions have been completed for the program. As of this report, 13 projects have completed land acquisitions and one has been defunded. Through the end of the 2016-2017 fiscal year, the total expenditures and encumbrances related to land acquisition totaled approximately \$15.25 million for all funds.

Project Management & Design

During this fifteenth fiscal year, staff reports no continued work in relation to any projects. The remaining NSB funds are planned to be used for Fire Station Capital Improvement Projects.

Fire Station No. 37 is the final new station originally scheduled for construction as part of the NSB program. However, insufficient funding remains to complete the project, so it is on hold, and the remaining \$3.3 million in available NSB funding is proposed to fund critical Capital Improvement needs at various existing fire stations.

Due primarily to the unexpectedly high cost of construction during much of the NSB program, the decision to rebuild instead of remodel Fire Station No. 2 (net cost increase of approximately \$4.1 million), and the higher bid prices received for the construction of Fire Station No. 21, the FY 2016-2017 bond fund balance is \$3.3 million. With design and construction costs for Fire Station 37 estimated to be \$10.0 million (based on the 2018-2019 Proposed Budget), there is a projected construction shortfall of at least \$6.7 million. In addition, funding of approximately \$540,000 for various fixtures, furniture, and equipment (FF&E), and the purchase of a new fire engine and related equipment (approximately \$800,000) would be required. Combined, the total shortfall of one-time funds is estimated to be a minimum of \$8.0 million. This amount does not include the annual ongoing expense (Operating and Maintenance costs) of \$3.7 million.

Given the funding shortfall, the Mayor's June Budget Message for Fiscal Year 2016-2017, as approved by the City Council in June 2016, funded approximately \$1.0 million as a down-payment for the future construction of the long-needed Fire Station No. 37. The City also established a dedicated reserve in the Construction Tax and Property Conveyance Tax Fund: Fire Protection Purposes (Fund 392) for the construction of Fire Station No. 37. However, sufficient funding for construction of Fire Station No. 37 will not be available for the foreseeable future. The Mayor's March Budget Message for Fiscal Year 2018-2019 directed staff to analyze options for creating a new bond measure that could be taken to the voters in November 2018 and would include funding for Fire Station No. 37 as well as other critical capital needs. Staff will be analyzing options to address infrastructure needs including the construction of Fire Station No. 37, and will report back to the City Council in May.

Construction

No Construction activities occurred during this fifteenth fiscal year of the Bond program. The last project, Fire Station No.21, was completed in December 2015, and dedicated to the public on January 23, 2016.

Program “Sunk Costs”

As reflected in prior reports, staff have advised the COC that certain expended bond funds have not resulted in completed capital projects and therefore must be classified as “Sunk Costs.”

While these costs were for valid expenses on project feasibility, scope verification, and preliminary design activities, the related projects were not pursued for various reasons.

Through the end of FY 2016-17, the total sunk costs expended program-wide remained at approximately \$2.34 million on a total of nine different projects. This equates to approximately 1.4% of the \$173.6 million in bond funds expended for this program through FY 2016-2017. Upon a decision regarding whether to restart the Fire Station No. 37 project, staff will update this report as appropriate.

Project Financing and Expenditures

A total of \$155.7 million in General Obligation (GO) Bonds have been issued to fund NSB projects through the fourth quarter of FY 2016-2017. In addition to bond revenue, interest earned, settlement proceeds, and fund transfers totaled approximately \$18.02 million, for total revenue of \$175.25 million.

Approximately \$173.66 million of bond funds have been expended or encumbered as of June 30, 2017. The remaining authorization to issue GO bonds for public safety projects under the NSB Program is \$3.3 million as funding needs arise.

The following table shows the total revenues, expenditures, and encumbrances through June 30, 2017 for Neighborhood Security Bond fund (Fund 475).

Fiscal Year	Bond Proceeds, Interest & Fund Transfers	Expended & Encumbered ^(a)	Balance
2002-03	40,660,080	2,190,303	
2003-04	660,429	8,952,788	
2004-05	40,418,700	4,527,979	
2005-06	1,976,090	15,856,570	
2006-07	71,062,716	22,305,605	
2007-08	4,454,065	26,389,996	
2008-09	10,870,793	44,423,501	
2009-10	842,635	26,270,091	
2010-11	147,260	7,614,751	
2011-12	53,152	4,370,863	

2012-13	723,799	2,058,543	
2013-14	631,699	1,592,325	
2014-15	1,184,577	4,628,175	
2015-16	1,341,588	1,948,327	
2016-17(b)	218,137	530,640	
Totals:	\$175,245,720	\$173,660,457	\$ 1,585,263

(a) As of June 30, 2017, these numbers include transfers between funds as well as settlement proceeds and have been audited.

(b) Encumbrances included in 2016-2017 only.

Not included in the preceding table is the additional \$12.63 million from non-bond funding sources that have been authorized by Council as of June 30, 2015 to augment the program. As of June 30, 2015, a total of \$12.40 million of these funds have been expended and encumbered, leaving \$0.23 million remaining.

External Auditor's Report

The independent accounting firm Grant Thornton LLP (GT) completed its audit of the NSB Project expenditures for the 2016-17 fiscal year. In its report dated October 13, 2017, GT did not identify any significant issues and indicated that the City had "in all material aspects" complied with the requirements of Measure O.

The independent auditor's report for the 2016-17 NSB expenditures is attached. (See Attachment A). The NSB report is also posted on the Office of the City Auditor's website (<http://www.sanjoseca.gov/DocumentCenter/View/72791>) where the complete audit report can be found.

Conclusion

As the NSB program completed its fifteenth fiscal year, expenditures and encumbrances (funds "committed") program-wide are continuing to wind down. The \$173.66 million in total NSB funds committed through the fourth quarter of the 2016-2017 fiscal year represents an approximate 0.9% rise in overall use of bond funds when compared to the prior fifteen fiscal years combined.

At the same time, the Committee members have previously and consistently expressed our major concerns to the Council about the planned and actual mothballing and non-usage of the Police Substation prior to and after it was completed. We were encouraged when the substation was eventually put into use at all, even though it was a partial utilization of the building. We were surprised to learn that as May 2108 the substation is being fully utilized by the department, albeit not at all for the main use promised to voters who supported the passage of the bond, i.e. A Police Substation serving the Foothill and Southern divisions.

May 10, 2018

Subject: Annual Financial Report on the Public Safety Bond Program

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The building of the substation was the largest single expenditure of the Public Safety Bond and the failure of the City to utilize the building for its main intent means the City has not yet met its responsibilities to the voters. We are aware and supportive of the March 20, 2018 memo by Council members Khamis and Jimenez which provided funding options that would allow the substation to serve in its intended capacity. We are also aware of and saddened by the lack of support for any funding options by the Council at the March Budget meeting. We understand that the 2018-2019 budget must be carefully considered while weighing both competing demands and limited resources, however we do not understand the failure of the City to meet its responsibilities and promises regarding public safety made to and passed by voters 15 years ago. We urge you to revisit this issue and dedicate the necessary funds to fulfill the City's obligations in this regard in the 2018-2019 budget.

Of the NSB program projects as of this report, 29 have been completed or achieved "Beneficial Occupancy," one is on hold, and 13 have acquired real estate for new or temporary facilities. Staff will continue to provide updates to the COC on the status of the projects and their expenditures as they progress

PUBLIC OUTREACH

- ☐ **Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- ☐ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- ☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

Although this action does not meet any of the criteria above, this memorandum will be posted on the City's website for the City Council agenda. The June 12, 2018 public hearing for the review of this item was posted on the City's Brown Act board. No members of the public attended or submitted questions at the hearing.

COORDINATION

This memo has been coordinated with the City Attorney's Office, the City Manager's Budget Office, the Police Department, the Fire Department, and the Finance Department.

HONORABLE MAYOR AND CITY COUNCIL

May 10, 2018

Subject: Annual Financial Report on the Public Safety Bond Program

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CEQA

Not a project, File No. PP10-069(a) Staff Reports.

A handwritten signature in black ink, reading "Phyllis Lazzarini". The signature is fluid and cursive, with the first name "Phyllis" and last name "Lazzarini" clearly distinguishable.

PHYLLIS LAZZARINI Chairperson,
Public Safety Bond – Citizen Oversight Committee

Attachment

CITY OF SAN JOSÉ
NEIGHBORHOOD SECURITY BOND PROJECTS FUND
(A Fund of the City of San José)

Reports of Independent Certified Public Accountants,
Financial Statements and
Other Supplementary Information

For the Year Ended June 30, 2017

CITY OF SAN JOSÉ
NEIGHBORHOOD SECURITY BOND PROJECTS FUND
(A Fund of the City of San José)
For the Year Ended June 30, 2017

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**REPORT OF INDEPENDENT CERTIFIED PUBLIC
ACCOUNTANTS**

City Council
Members of the Neighborhoods Commission
City of San José, California

Grant Thornton LLP
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San Jose, CA 95113
T 408.275.9000
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www.GrantThornton.com

Report on the financial statements

We have audited the accompanying financial statements of the Neighborhood Security Bond Projects Fund (the “Fund”), a fund of the City of San José (the “City”), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Fund’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 an opinion 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 Fund’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 Fund’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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Neighborhood Security Bond Projects Fund as of June 30, 2017, and the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of matter

As discussed in Note 2 to the financial statements, the financial statements present only the Neighborhood Security Bond Projects Fund and do not purport to, and do not, present fairly the financial position of the City as of June 30, 2017, and the changes in its financial position, for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other matters

Supplementary information

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Fund. The accompanying Statements of Revenues, Expenditures, and Changes in Fund Balance by fiscal year for the period July 18, 2002 through June 30, 2017 are presented for purposes of additional analysis and are 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 fiscal 2016 and 2017 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 fiscal 2016 and 2017 supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The financial statements of the Fund as of and for the periods ended June 30, 2003 through June 30, 2015 were audited by other auditors. Those auditors expressed unmodified opinions on those 2003-2015 financial statements in their report dated October 9, 2015. Those auditors' reports also stated that the Statements of Revenues, Expenditures, and Changes in Fund Balance by Fiscal Year for the period July 18, 2002 through June 30, 2015 were fairly stated, in all material respects, in relation to the financial statements as a whole.

Other reporting required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report, dated October 13, 2017, on our consideration of the Fund'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 Fund's internal control over financial reporting and compliance.



San José, California
October 13, 2017

CITY OF SAN JOSÉ
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Balance Sheet

June 30, 2017

	<u>June 30, 2017</u>
Assets	
Restricted assets:	
Equity in pooled cash and investments	
held in the City Treasury	\$ 1,480,493
Investments held with fiscal agents	<u>437,201</u>
	<u>1,917,694</u>
 Liabilities and Fund Balance	
Liabilities:	
Advances, deposits, and reimbursable credits	<u>12,612</u>
Total liabilities	<u>12,612</u>
 Fund balance:	
Restricted for Neighborhood Security Bond Projects	<u>1,905,082</u>
Total liabilities and fund balance	<u>\$ 1,917,694</u>

See accompanying notes to the financial statements.

CITY OF SAN JOSÉ
NEIGHBORHOOD SECURITY BOND PROJECTS FUND
(A Fund of the City of San José)
Statement of Revenues, Expenditures, and Changes in Fund Balance
For the Year Ended June 30, 2017

	<u>June 30, 2017</u>
Revenues:	
Investment income	\$ 3,971
Other	214,167
Total revenues	<u>218,138</u>
Expenditures:	
Capital outlay:	
South San José police substation	
Fire Station 21	10,822
Total expenditures	<u>10,822</u>
Excess (deficiency) of revenues over (under) expenditures	<u>207,316</u>
Other Financing Sources (Uses)	
Transfer out	(200,000)
Total other financing sources (uses)	<u>(200,000)</u>
Change in fund balance	7,316
Fund balance, beginning of year	1,897,766
Fund balance, end of year	<u><u>\$ 1,905,082</u></u>

See accompanying notes to the financial statements.

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)
Notes to the Financial Statements
For the Year Ended June 30, 2017

NOTE 1 – BACKGROUND

In March 2002, registered voters of the City of San José (“City”) approved Measure O (2002), the San José 911, Fire, Police, Paramedic and Neighborhood Security Act, authorizing the issuance and sale of general obligation bonds (“Neighborhood Security Bonds”) not to exceed \$159,000,000 to be used to fund the construction of fire and police stations, training facilities and 911 communications facilities and the cost of land acquisition for the improvements to neighborhood security facilities throughout the City.

The table below sets forth the amount of Neighborhood Security Bonds authorized and issued pursuant to Measure O (2002):

	Amount	Date
Voter authorization	\$ 159,000,000	March 5, 2002
Bonds issued:		
Series 2002 Bonds	39,375,000	July 18, 2002
Series 2004 Bonds	14,400,000	July 14, 2004
Series 2005 Bonds	25,000,000	June 23, 2005
Series 2007 Bonds	67,900,000	June 20, 2007
Series 2009 Bonds	9,000,000	June 25, 2009
Total bonds issued	<u>155,675,000</u>	
Authorized but unissued	<u>\$ 3,325,000</u>	

As of June 30, 2017, the outstanding project approved by the City Council to be funded by the bond proceeds, which remains to be completed, is the Fire Station 21 – Relocation project.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements present only the financial position and the changes in financial position of the Neighborhood Security Bond Projects Fund (“Fund”) and do not purport to, and do not, present fairly the City’s financial position as of June 30, 2017 and the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

A capital projects fund (governmental fund) is used to account for the City’s Neighborhood Security Bond Projects activities. Capital projects funds are used to account for financial resources (e.g., bond proceeds and investment income) that are restricted, committed, or assigned to expenditures for capital outlays, including the acquisition of land or acquisition and construction of major governmental facilities.

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Notes to the Financial Statements - Continued

For the Year Ended June 30, 2017

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Accounting

The Fund's activity is reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. The City considers revenues to be available if collected within 60 days of the end of the current fiscal period. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. However, expenditures related to vacation, sick leave, claims and judgments are recorded only when payment is due.

Restricted Cash and Investments

Cash and investments that are restricted for specified uses by bond covenants or other requirements are classified as restricted. The Fund's restricted cash and investments are held in fiscal agent accounts to be spent only on authorized capital projects. The Fund's restricted cash and investments are subject to the requirements of the City's adopted investment policy and the bond indenture. The fair value of investments is based on quoted market information obtained from fiscal agents or other sources.

Fund Balance

Under Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, the balance sheets of 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. The Fund only has restricted fund balance at June 30, 2017. Restricted fund balance represents amounts when constraints placed on use of resources are either: (1) externally imposed by creditors (such as through debt covenants), grantors, contributions, or laws or regulations of other governments; or (2) imposed by law through constitutional provisions or enabling legislation.

Other Revenues

During the year ended June 30, 2017, the City received \$214,167 from a settlement related to the construction of Fire Station 24. This settlement establishes a Transfer to the General Fund appropriation to transfer \$200,000 of the revenue received to the General Fund. In 2012-2013 Year-End Budget Review, the General Fund fronted \$200,000 for the City to retain a new contractor in order to complete the construction of Fire Station 24 while the dispute with the original contractor continued.

Use of Estimates

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

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Notes to the Financial Statements - Continued

For the Year Ended June 30, 2017

NOTE 3 – RESTRICTED CASH AND INVESTMENTS

A summary of the Fund's restricted cash and investments at June 30, 2017 are as follows:

Type of Investment	Fair Value	Moody's Credit Risk Rating	Weighted-Average Maturity
City of San Jose Cash and Investment Pool	\$ 1,480,493	Unrated	513 days
Wells Fargo Treasury Money Market Mutual Fund	437,201	Aaa	44 days
Total restricted cash and investments	<u>\$ 1,917,694</u>		

The Fund has investments subject to provisions of the bond indentures of its various bond issues. According to the bond indentures, the City is permitted to invest in the City's cash and investment pool, the State of California Local Agency Investment Fund ("LAIF"), obligations of the U.S. Treasury or U.S. government agencies, time deposits, money market mutual funds invested in U.S. government securities, along with various other investments.

The Fund maintains its investments in the City's cash and investment pool. Income and losses arising from the investment activity of pooled cash are allocated to the participating funds on a monthly basis, based on their proportionate shares of the average weekly cash balance. Information regarding the characteristics of the entire investment pool can be found in the City's basic financial statements for the year ended June 30, 2017. A copy of that report may be obtained by contacting the City's Finance Department, 200 East Santa Clara Street, 13th Floor, San José, CA, 95113 or can be found at the City's Finance Department Website at <http://www.sanjoseca.gov/>.

Investment in the City's investment pool reflects a balance of \$1,480,493 at June 30, 2017. The amounts held in the City's investment pool can be withdrawn upon demand. The weighted-average maturity of the City's investment pool is 513 days. Income earned or losses arising from investments in the City's cash and investment pool are allocated on a monthly basis by the City's Finance Department to the Fund based on the average weekly cash balances.

Government Code Section 16429.1 authorizes each local government agency to invest funds in the LAIF administered by the California State Treasurer. The total amount recorded by all public agencies in LAIF at June 30, 2017 was approximately \$22.8 billion. LAIF is part of the State's Pooled Money Investment Account ("PMIA"). 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 US Treasuries and agencies, 27.73% in depository securities, 10.60% in commercial paper, 0.83% in loans, and 0.05% in mortgages. The Local Investment Advisory Board (Board) has oversight responsibility for LAIF. The Board consists of five members as designated by State statute. The value of the pool shares in LAIF, which may be withdrawn, is determined on an amortized cost basis, which is different than the fair value of the Fund's position in the pool.

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Notes to the Financial Statements - Continued

For the Year Ended June 30, 2017

NOTE 3 – RESTRICTED CASH AND INVESTMENTS (Continued)

Credit Risk

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

Concentration Credit Risk

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

Interest Rate Risk

Interest rate risk is the risk that changes in market rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market rates. The City has mitigated interest rate risk by establishing policies over liquidity, including maturity limits by investment classification. These limits, for investments other than external investment pools and money market mutual funds, are as short as 10 days and as long as 5 years.

Fair Value Measurement Categorization

The Fund categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The Fund participates in the City's investment pool and has cash balances reported of \$1,480,493 at June 30, 2017 and is reported at fair value. The Fund cash balance invested in the Wells Fargo Money Market Mutual Fund is reported at level 1 as listed in the table below. Securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Assets such as Mutual Funds that have daily closing price and are actively traded are classified as a Level 1 input.

	Carrying Value	Fair Value Measurements Using		
		Quote Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments:				
City of San Jose Cash and Investment Pool	\$ 1,480,493			
Investments by fair value level:				
Wells Fargo Treasury Money Market Mutual Fund	437,201	\$ 437,201	\$ -	\$ -
Total restricted cash & investments	<u>\$ 1,917,694</u>	<u>\$ 437,201</u>	<u>\$ -</u>	<u>\$ -</u>

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND
(A Fund of the City of San José)
Notes to the Financial Statements - Continued
For the Year Ended June 30, 2017

NOTE 4 – COMMITMENTS

At June 30, 2017, the Fund has related outstanding project construction encumbrances as follows:

Project	Fair Value
South San José Substation	\$ 14,436
Fire Station 21 Relocation	271,552
Total project encumbrances	<u>\$ 285,988</u>

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Statement of Revenues, Expenditures, and Changes in Fund Balance
For the Period July 18, 2002 Through June 30, 2017

	2003	2004	2005	2006	2007	2008	2009
Revenues:							
Investment income	\$ 1,883,039	\$ (19,507)	\$ 975,304	\$ 2,457,695	\$ 2,971,704	\$ 4,480,517	\$ 1,575,558
Intergovernmental	15,985	-	3,516	23,277	-	53,345	-
Other	-	-	-	-	5,804	1,638	-
Total revenues	1,899,024	(19,507)	978,820	2,480,972	2,977,508	4,535,500	1,575,558
Expenditures:							
Capital outlay:							
West Community Policing Center	70,470	883,494	122,776	957,277	1,687	-	-
South San Jose Police Substation	179,540	377,820	348,739	9,735,667	2,574,867	14,304,632	36,082,247
Fire Station 12 - Relocation	29,754	26,897	92,201	440,270	1,169,548	2,062,278	667,871
Fire Station 34	103,094	42,250	186,697	479,074	5,519,245	429,302	8,486
Fire Station 35	54,999	30,810	178,582	542,443	4,034,453	1,744,558	1,054
Fire Station Upgrades	841,968	3,778,809	1,513,869	1,296,646	634,971	370,999	21,043
Fire Training Center	514,334	471,868	31,600	19,581	424,012	365,954	101,873
Land Acquisition - Fire Stations	12,319	1,807,683	837,322	71,578	1,628,273	1,244,849	678,057
Central Community Police Station							
Exterior Improvement	46,224	277,158	-	-	-	-	-
Fire Station 25 - Relocation	-	123,604	174,437	790,976	4,015,770	503,414	(8,277)
Fire Station 17 - Relocation	-	141,647	122,727	393,669	866,247	2,475,700	684,731
Fire Station 23 - Relocation	-	79,182	12,420	(885)	-	-	-
Driver Safety Training Center	-	277,353	784	60,652	106,955	234,180	1,491
Fire Station 36	-	34,524	32,919	101,540	170,186	525,454	488,177
Fire Station 2 - Rebuild	-	-	45,527	161,100	192,336	365,212	1,988,703
Fire Station 21	-	-	28,367	23,206	14,570	17,461	146,267
Fire Station 19 - Relocation	-	-	-	76,699	181,362	741,318	2,194,558
Fire Station 37	-	-	-	-	-	76,089	45,349
Emergency Communication and Dispatch Center	-	-	33,132	204,710	231,834	89,442	880,006
East Community Policing Center	-	-	-	10,662	34,189	5,406	-
Program-Wide Administration	337,602	599,688	765,881	491,705	505,100	579,748	441,865
Debt service:							
Arbitrage rebate payment	-	-	-	-	-	254,000	-
Total expenditures	2,190,304	8,952,787	4,527,980	15,856,570	22,305,605	26,389,996	44,423,501
Deficiency of revenues under expenditure	(291,280)	(8,972,294)	(3,549,160)	(13,375,598)	(19,328,097)	(21,854,496)	(42,847,943)
Other Financing Sources:							
Transfers out	-	-	-	-	-	-	-
Bond proceeds	39,375,000	-	39,400,000	-	67,900,000	-	9,000,000
Change in fund balance	39,083,720	(8,972,294)	35,850,840	(13,375,598)	48,571,903	(21,854,496)	(33,847,943)
Fund balance, beginning of period	-	39,083,720	30,111,426	65,962,266	52,586,668	101,158,571	79,304,075
Fund balance, end of period	\$ 39,083,720	\$ 30,111,426	\$ 65,962,266	\$ 52,586,668	\$ 101,158,571	\$ 79,304,075	\$ 45,456,132

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Statement of Revenues, Expenditures, and Changes in Fund Balance - Continued
For the Period July 18, 2002 Through June 30, 2017

2010	2011	2012	2013	2014	2015	2016	2017	Total
\$ 373,090	\$ 100,409	\$ 53,152	\$ 33,799	\$ 16,699	\$ 13,860	\$ 11,588	\$ 3,971	\$ 14,930,878
471,321	44,851	-	250,000	-	-	-	-	862,295
224	-	-	-	-	1,170,717	1,329,999	214,167	2,722,549
844,635	145,260	53,152	283,799	16,699	1,184,577	1,341,587	218,138	18,515,722
-	-	-	-	-	-	-	-	2,035,704
19,919,027	2,954,253	987,371	96,995	207,779	285,821	301,129	-	88,355,887
239,355	-	7,429	-	-	-	-	-	4,735,603
-	-	-	-	-	-	-	-	6,768,148
-	-	-	-	-	-	-	-	6,586,899
-	-	-	18,103	8,953	-	-	-	8,485,361
202,773	-	2,959	-	-	-	-	-	2,134,954
-	3,470	-	-	-	-	-	-	6,283,551
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	323,382
-	-	-	-	-	-	-	-	5,599,924
59,044	-	681	4,518	-	-	-	-	4,748,964
-	-	-	-	-	-	-	-	90,717
-	-	-	-	-	-	-	-	681,415
684,950	2,770,694	2,870,789	301,107	322,833	-	-	-	8,303,173
1,946,674	295,368	93,744	-	-	-	-	-	5,088,664
141,105	167,752	401,603	1,038,814	435,260	4,337,279	1,647,198	10,822	8,409,704
2,310,508	131,853	39,930	25,024	-	-	-	-	5,701,252
348,850	610,160	29,104	778	(5,000)	-	-	-	1,105,330
40,675	-	-	-	-	-	-	-	1,479,799
-	-	-	-	-	-	-	-	50,257
377,131	354,053	264,400	133,204	7,500	5,075	-	-	4,862,952
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	254,000
26,270,092	7,287,603	4,698,010	1,618,543	977,325	4,628,175	1,948,327	10,822	172,085,640
(25,425,457)	(7,142,343)	(4,644,858)	(1,334,744)	(960,626)	(3,443,598)	(606,740)	207,316	(153,569,918)
-	-	-	-	-	-	-	(200,000)	(200,000)
-	-	-	-	-	-	-	-	155,675,000
(25,425,457)	(7,142,343)	(4,644,858)	(1,334,744)	(960,626)	(3,443,598)	(606,740)	7,316	1,905,082
45,456,132	20,030,675	12,888,332	8,243,474	6,908,730	5,948,104	2,504,506	1,897,766	-
\$ 20,030,675	\$ 12,888,332	\$ 8,243,474	\$ 6,908,730	\$ 5,948,104	\$ 2,504,506	\$ 1,897,766	\$ 1,905,082	\$ 1,905,082



**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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City Council
Members of the Neighborhoods Commission
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 Neighborhood Security Bond Projects Fund (the “Fund”), a fund of the City of San José (the “City”), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Fund’s basic financial statements, and have issued our report thereon dated October 13, 2017.

Internal control over financial reporting

In planning and performing our audit of the financial statements, we considered the Fund’s internal control over financial reporting (“internal control”) to design audit procedures that are appropriate in the circumstances for the purpose of expressing an 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 Fund’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 Fund’s financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in the Fund’s internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and other matters

As part of obtaining reasonable assurance about whether the Fund'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*.

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 Fund'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 Fund's internal control and compliance. Accordingly, this report is not suitable for any other purpose.



San José, California
October 13, 2017

**REPORT OF INDEPENDENT CERTIFIED PUBLIC
ACCOUNTANTS ON COMPLIANCE WITH MEASURE O**

City Council
Members of the Neighborhoods Commission
City of San José, California

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We have examined the City of San José's (the "City") compliance with certain provisions of Measure O (2002) for the year ended June 30, 2017 as follows:

- Bond proceeds were used for the construction of fire and police stations, training facilities, and 911 communications facilities and the cost of land acquisition for these improvements.
- Bond proceeds will be deposited in a special account.
- A citizen's oversight committee was established and reviews annual reports of the expenditures of the bond proceeds.

Management is responsible for the City's compliance with those requirements. Our responsibility is to express an opinion on the City's compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included 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 examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on the City's compliance with the specified requirements.

In our opinion, the City complied, in all material respects, with the aforementioned requirements for the year ended June 30, 2017.

This report is intended solely for the information and use of the City Council, the Neighborhoods Commission, the City Auditor, and the City's management and is not intended to be and should not be used by anyone other than these specified parties.



San José, California
October 13, 2017