CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: Lee Price
City Clerk

FROM: Julia H. Cooper

SUBJECT: **PRELIMINARY OFFICIAL STATEMENT AND APPENDIX A FOR THE CITY OF SAN JOSE GENERAL OBLIGATION BONDS, SERIES 2009 (PUBLIC SAFETY PROJECTS)**

DATE: May 22, 2009

As discussed in the staff report for the above-referenced financing dated May 18, 2009, the following documents are attached for filing in the packet for the City Council meeting on June 2, 2009:

- Preliminary Official Statement (POS)
- Appendix A to the POS

A hardcopy of the POS and Appendix A should be distributed to each Council Member. The POS and Appendix A should be posted on the City's agenda site, however, please remove the posting of these documents after the June 2, 2009 Council meeting as these are draft documents that are subject to change after the Council meeting.

The City Attorney's Office will post the legal documents discussed in the staff report (fiscal agent agreement, notice of intention to sell, official notice inviting bids, continuing disclosure certificate and the resolution) separately.

If there are questions that arise from members of the public, feel free to refer them to me or David Persselin at extension 5-7012.

Julia H Cooper

Julia H. Cooper
Deputy Director of Finance

Attachments
cc: Danielle Kenealey, City Attorney's Office (w/o attachments)

DRAFT

PRELIMINARY OFFICIAL STATEMENT DATED JUNE __, 2009

NEW ISSUE - FULL BOOK-ENTRY

RATINGS:
Moody's: ___
S&P: ___
Fitch: ___
(See "RATINGS" herein)

In the opinion of Jones Hall, A Professional Law Corporation, San Francisco, California, Bond Counsel, subject, however to certain qualifications described herein, under existing law, the interest on the Bonds is excluded from gross income for federal income tax purposes, and such interest is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. In the further opinion of Bond Counsel, such interest is exempt from California personal income taxes. See "TAX MATTERS" herein.

$9,000,000*
CITY OF SAN JOSE
General Obligation Bonds, Series 2009
(Public Safety Projects)

Dated: Date of Delivery **Due: September 1, as shown below**

The City of San José General Obligation Bonds, Series 2009 (Public Safety Projects) (the "Bonds" or the "Series 2009 Bonds"), in the aggregate principal amount of $9,000,000*, are being issued by the City of San José (the "City") to fund the acquisition of property and the construction and improvement of police and fire stations, public safety training facilities and 911 communications facilities.

The Bonds are general obligations of the City payable from ad valorem taxes, and the City Council is empowered and is obligated to levy *ad valorem* taxes for the payment of interest on, and principal of, the Bonds upon all property subject to taxation by the City without limitation of rate or amount (except certain personal property which is taxable at limited rates). The City will direct the County of Santa Clara (the "County") to collect such *ad valorem* taxes in such amounts and at such times as is necessary to ensure the timely payment of debt service on the Bonds.

The Bonds will be issued in book-entry form only, and will be initially issued and registered in the name of Cede & Co. as nominee of The Depository Trust Company, New York, New York (collectively referred to herein as "DTC"). Purchasers of the Bonds (the "Beneficial Owners") will not receive physical certificates representing their interest in the Bonds. The Bonds are issuable as fully registered securities in denominations of $5,000 or any integral multiple thereof. Interest on the Bonds will be payable on March 1, 2010 and semiannually thereafter on March 1 and September 1 of each year. Payments of principal of and interest on the Bonds will be paid by Wells Fargo Bank, National Association, as Fiscal Agent, to DTC for subsequent disbursement to DTC Participants which will remit such payments to the Beneficial Owners of the Bonds. (See "THE BONDS — Book-Entry-Only System").

The Bonds are subject to optional and mandatory redemption prior to maturity as described herein.

[The City has requested pre-qualification for a municipal bond insurance policy to guarantee the scheduled payment of the principal of and interest on all or a portion of the Bonds, any such policy to be purchased solely at the discretion of the winning purchaser of the Bonds.]

This cover page contains certain information for general reference only. It is not a summary of all the provisions of the Bonds. Prospective investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision.

MATURITY SCHEDULE*

Maturity (September 1)	Principal Amount	Interest Rate	Yield	CUSIP†	Maturity (September 1)	Principal Amount	Interest Rate	Yield	CUSIP†
2010					2025				
2011					2026				
2012					2027				
2013					2028				
2014					2029				
2015					2030				
2016					2031				
2017					2032				
2018					2033				
2019					2034				
2020					2035				
2021					2036				
2022					2037				
2023					2038				
2024					2039				

The Bonds are delivered when, as and if issued, subject to the approval of legality by Jones Hall, A Professional Law Corporation, San Francisco, California, Bond Counsel to the City. Jones Hall, A Professional Law Corporation, is also acting as Disclosure Counsel to the City. Certain legal matters are being passed upon for the City by the City Attorney. It is anticipated that the Bonds will be available for delivery through DTC on or about June __, 2009, in New York, New York.

The date of this Official Statement is June __, 2009.

* Preliminary, subject to change.

GENERAL INFORMATION ABOUT THIS OFFICIAL STATEMENT

No Offering May Be Made Except by this Official Statement. No dealer, broker, salesperson or other person has been authorized by the City to give any information or to make any representations other than as contained in this Official Statement, and, if given or made, such other information or representation must not be relied upon as having been given or authorized by the City or the Underwriter.

Use of this Official Statement. This Official Statement is submitted in connection with the sale of the Bonds described herein and may not be reproduced or used, in whole or in part, for any other purpose. This Official Statement does not constitute a contract between any Bond Owner and the City or the Underwriter.

Preparation of this Official Statement. The information contained in this Official Statement has been obtained from sources that are believed to be reliable, but this information is not guaranteed as to accuracy or completeness. Copies of documents referred to herein concerning the Bonds are available from the City of San José, Debt Management - Finance, San José City Hall, 200 East Santa Clara Street, San José, California 95113, Phone: (408) 535-7010. The City may impose a charge for copying, mailing and handling.

The City anticipates that the Underwriter will provide the following sentence for inclusion in this Official Statement: The Underwriter has reviewed the information in this Official Statement in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriter does not guarantee the accuracy or completeness of such information.

Estimates and Forecasts. When used in this Official Statement and in any continuing disclosure made by the City, 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.” 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. This Official Statement speaks only as of its date, and the information and expressions of opinion contained in this Official Statement are subject to change without notice. Neither the delivery of this Official Statement nor any sale of the Bonds will, under any circumstances, create any implication that there has been no change in the affairs of the City or any other party described in this Official Statement, since the date of this Official Statement.

Additionally, the City notes that the ratings set forth under the caption “RATINGS” represent the views of the rating agencies assigning such ratings at the time of assignment, and that such ratings may change in the future. There is no assurance that any such rating will continue for any given period of time or that such ratings will not be revised downward or withdrawn entirely by such organizations, if in their judgment circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Bonds.

Document Summaries. All summaries of documents contained in this Official Statement 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 Official Statement to a document is qualified in its entirety by reference to such document, which is on file with the City.

No Unlawful Offers or Solicitations. This Official Statement does not constitute an offer to sell or a solicitation of an offer to buy in any state in which such offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such offer or solicitation.

No Registration with the SEC. The issuance and sale of the Bonds have not been registered under the Securities Act of 1933 or the Securities Exchange Act of 1934, both as amended, and the Fiscal Agent Agreement has not been qualified under the Trust Indenture Act of 1939, as amended, in reliance upon exemptions provided thereunder.

Public Offering Prices. The Underwriter may offer and sell the Bonds to certain dealers and dealer banks and banks acting as agent at prices lower than the public offering prices stated on the cover page of this Official Statement, and the Underwriter may change public offering prices from time to time.

CITY OF SAN JOSE

City Council
Chuck Reed, Mayor
District 1: Pete Constant, Member
District 2: Ash Kalra, Member
District 3: Sam Liccardo, Member
District 4: Kansen Chu, Member
District 5: Nora Campos, Member
District 6: Pierluigi Oliverio, Member
District 7: Madison Nguyen, Member
District 8: Rose Herrera, Member
District 9: Judy Chirco, Vice Mayor/Member
District 10: Nancy Pyle, Member

City Officials
Debra Figone, City Manager
Richard Doyle, City Attorney
Lee Price, City Clerk
Scott P. Johnson, Director of Finance

City Staff
Julia H. Cooper, Deputy Director of Finance
Danielle Kenealey, Chief Deputy City Attorney
Karin Murabito, Senior Deputy City Attorney
David Persselin, Debt Administrator
Charlene Sun, Financial Analyst

PROFESSIONAL SERVICES

Bond Counsel/Disclosure Counsel
Jones Hall, A Professional Law Corporation
San Francisco, California

Financial Advisor
KNN Public Finance,
A Division of Zions First National Bank
Oakland, California

Fiscal Agent
Wells Fargo Bank, National Association
Los Angeles, California

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

TABLE OF CONTENTS

$9,000,000[*]
CITY OF SAN JOSE
General Obligation Bonds, Series 2009
(Public Safety Projects)

INTRODUCTION

This Official Statement, which includes the cover page and appendices hereto, provides information in connection with the sale of City of San José, California, General Obligation Bonds, Series 2009 (Public Safety Projects), in the principal amount of $9,000,000[*] (the "Bonds" or the "Series 2009 Bonds").

This Introduction is not a summary of this Official Statement. It is only a brief description of and guide to, and is qualified by, more complete and detailed information contained in the entire Official Statement, including the cover page and appendices hereto, and the documents summarized or described herein. A full review should be made of the entire Official Statement. The offering of Bonds to potential investors is made only by means of the entire Official Statement.

The City

The City of San José (the "City"), with a population as of January 1, 2009 of approximately 1,006,892 (as reported by the California Department of Finance), is the third largest city in California and the tenth largest city in the United States. The territory of the City encompasses approximately 178 square miles. Located at the southern end of the San Francisco Bay, San José is the county seat of the County of Santa Clara (the "County").

Sources of Payment for Bonds

The Bonds are general obligations of the City payable from *ad valorem* taxes levied by the City and collected by the County. The City Council is empowered and is obligated to annually levy *ad valorem* taxes for the payment of the Bonds and the interest thereon upon all property within the City subject to taxation by the City, without limitation of rate or amount (except with respect to certain personal property which is taxable at limited rates). See "THE BONDS – Security for the Bonds" herein.

Authority for Issuance of the Bonds

At the general election of the registered voters of the City held on March 5, 2002 (the "2002 Election"), more than two-thirds of the persons voting on Measure O (San José 911, Fire, Police, Paramedic and Neighborhood Security Act) ("Measure O (2002)") voted to authorize the issuance and sale of not to exceed $159,000,000 principal amount of general obligation bonds (the "Public Safety Bonds").

At the general election of the registered voters of the City held on November 7, 2000 (the "2000 Election"), more than two-thirds of the persons voting on Measure O (San José Neighborhood Libraries Bond) ("Measure O (2000)") and Measure P (San José Safe Neighborhood Parks and Recreation Bond) ("Measure P") voted to authorize the issuance

[*] Preliminary, subject to change.

and sale of not to exceed $211,790,000 and $228,030,000 respective principal amounts of general obligation bonds.

The Bonds are issued pursuant to the authorizations received under Measure O (2002), certain provisions of Chapter 14.28 of the San José Municipal Code (the "Act"), a resolution adopted by the City Council on June 2, 2009 and a Fiscal Agent Agreement dated as of June 1, 2009 (the "Fiscal Agent Agreement") between the City and Wells Fargo Bank, National Association, as fiscal agent (the "Fiscal Agent"). See "THE BONDS - Authority for Issuance" herein.

None of the Bonds are being issued pursuant to the authorization received under Measure O (2000) or Measure P.

Purpose of Issue

The Bonds, in the aggregate principal amount of $9,000,000[*], are being issued by the City to fund the acquisition of property and the construction of improvements to police and fire stations, public safety training facilities and 911 communications facilities.

Offering and Delivery of the Bonds

The Bonds are offered when, as and if issued, subject to approval of legality by Bond Counsel. It is anticipated that the Bonds will be available for delivery through DTC in New York, New York on or about June __, 2009.

Description of the Bonds

Registration - The Bonds will be issued in fully registered form only, registered in the name of Cede & Co. as nominee of The Depository Trust Company, New York, New York ("DTC"), and will be available to actual purchasers of the Bonds (the "Beneficial Owners") in the denominations set forth on the cover page hereof, under the book-entry system maintained by DTC only through brokers and dealers who are or act through DTC Participants as described herein. Beneficial Owners will not be entitled to receive physical delivery of the Bonds. See "THE BONDS - Book-Entry-Only System." In the event that the book-entry-only system described below is no longer used with respect to the Bonds, the Bonds will be registered in accordance with the Fiscal Agent Agreement described herein. See "THE BONDS - Registration, Transfer and Exchange of Bonds."

Denominations - Individual purchases of interests in the Bonds will be available to purchasers of the Bonds as fully registered securities in the denominations of $5,000 each or any integral multiple thereof.

Optional Redemption - The Bonds maturing on or before September 1, 20__, are not subject to redemption prior to their respective maturity dates. The Bonds maturing on or after September 1, 20__, may be redeemed without premium prior to maturity at the option of the City, in whole or in part on any date beginning on September 1, 20__. See "THE BONDS - Optional Redemption" herein.

[*] Preliminary, subject to change.

Mandatory Sinking Fund Redemption - The Bonds maturing on September 1, 20__ and September 1, 20__, are subject to mandatory sinking fund redemption beginning on September 1, 20__ and September 1, 20__, respectively. See "THE BONDS - Mandatory Sinking Fund Redemption" herein.

Payments - Interest on the Bonds accrues from the date of delivery, and is payable on March 1, 2010 and semiannually thereafter on each March 1 and September 1. Principal on the Bonds is payable on September 1, commencing September 1, 2010, in the amounts and years set forth on the cover page hereof.

[Bond Insurance

The successful bidder may purchase municipal bond insurance, if available, for some or all of the Bonds. However, the delivery of the Bonds shall not be conditioned upon the issuance of any such insurance. In the event that the winning bidder elects to obtain a policy of municipal bond insurance, the premium for such insurance and the costs of any related ratings will be paid by the bidder, and the City will not have any responsibility for payment of such premium and costs. The successful bidder must provide the amount of the policy premium, if any, within one hour of the award of the Bonds and also must provide the City with the municipal bond insurance commitment, if any, as well as information with respect to the municipal bond insurance policy and insurance provider for inclusion in the final Official Statement within two business days following the award of the bid by the City***. Failure of the insurer to issue its policy shall not justify failure or refusal by the successful bidder to accept delivery of, or pay for, the Bonds*****.]**

Continuing Disclosure

The City will covenant for the benefit of bondholders to make available certain financial information and operating data relating to the City and to provide notices of the occurrence of certain enumerated events, if material, in compliance with S.E.C. Rule 15c2-12(b)(5). See “CONTINUING DISCLOSURE” and APPENDIX D – "Form of Continuing Disclosure Certificate."

Other Information

This Official Statement speaks only as of its date, and the information contained herein is subject to change. Copies of documents referred to herein and information concerning the Bonds are available from City of San José, Debt Management - Finance, 200 East Santa Clara Street, San José, California 95113-1905. A charge will be made to cover the City's reasonable costs of duplication and delivery. In addition, documents are available for inspection during business hours at the address above, or at the principal corporate trust office of the Fiscal Agent in Los Angeles, California.

THE BONDS

Authority for Issuance

The Bonds are issued pursuant to the authorization received under Measure O (San José 911, Fire, Police, Paramedic and Neighborhood Security Act) ("Measure O (2002)"), certain provisions of Chapter 14.28 of the San José Municipal Code (the "Act"), a resolution adopted by the City Council on June 2, 2009, and the Fiscal Agent Agreement between Wells Fargo Bank, National Association (the "Fiscal Agent"), and the City dated as of June 1, 2009 (the "Fiscal Agent Agreement"). The Bonds are the fifth series of general obligation bonds that the City is issuing pursuant to Measure O (2002).

At the general election of the registered voters of the City held on March 5, 2002, more than two-thirds of the persons voting on Measure O (2002)voted to authorize the issuance and sale of not to exceed $159,000,000 principal amount of general obligation bonds. The issuance of general obligation bonds in accordance with Measure O (2002) was approved by 71.7% of the voters.

Additionally, at the general election of the registered voters of the City held on November 7, 2000, more than two-thirds of the persons voting on Measure O (San José Neighborhood Libraries Bond) ("Measure O (2000)") and Measure P (San José Safe Neighborhood Parks and Recreation Bond) ("Measure P") voted to authorize the issuance and sale of not to exceed $211,790,000 and $228,030,000 respective principal amounts of general obligation bonds. The issuance of general obligation bonds in accordance with Measure O (2000) was approved by 75.8% of the voters. The issuance of general obligation bonds in accordance with Measure P was approved by 78.7% of the voters.

The tables below set forth the amount of authorized and issued general obligation bonds issued pursuant to Measure O (2000), Measure P and Measure O (2002).

Measure O (2000) Bonds
Neighborhood Libraries Bond

	Amount	Date
Voter Authorization	$211,790,000	November 7, 2000
Series 2001 Bonds	31,000,000	June 6, 2001
Series 2002 Bonds	30,000,000	July 18, 2002
Series 2004 Bonds	58,300,000	July 14, 2004
Series 2005 Bonds	21,300,000	June 23, 2005
Series 2006 Bonds	60,000,000	June 29, 2006
Series 2008 Bonds	5,285,000	June 25, 2008
Authorized but Unissued	$5,905,000	

Measure P Bonds
Safe Neighborhood Parks and Recreation Bond

	Amount	Date
Voter Authorization	$228,030,000	November 7, 2000
Series 2001 Bonds	40,000,000	June 6, 2001
Series 2002 Bonds	46,715,000	July 18, 2002
Series 2004 Bonds	46,000,000	July 14, 2004
Series 2006 Bonds	45,400,000	June 29, 2006
Series 2007 Bonds	22,100,000	June 20, 2007
Series 2008 Bonds	27,815,000	June 25, 2008
Total	$228,030,000	

Measure O (2002) Bonds
911, Fire, Police, Paramedic and Neighborhood Security Act

	Amount	Date
Voter Authorization	$159,000,000	March 5, 2002
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 __, 2009
Authorized but Unissued	$3,325,000*	

* Preliminary, subject to change.

Purpose of Issue

The projects to be funded from the proceeds of the Bonds issued pursuant to the Measure O (2002) authorization (and all other general obligation bonds issued under the Measure O (2002) authorization) include the acquisition of property and construction of improvements in various locations in order to add and improve police and fire stations and public safety training facilities and to create 911 communications facilities (the "Public Safety Project").

Proceeds of the Bonds will also be used to fund the costs of issuance relating to the Bonds.

Security for the Bonds

The Bonds are general obligations of the City payable from ad valorem taxes levied by the City and collected by the County. The City Council is empowered and is obligated to levy *ad valorem* taxes upon all property within the City subject to taxation by the City, without limitation of rate or amount (except with respect to certain personal property which is taxed at limited rates), for the payment of the Bonds and the interest thereon, in accordance with all relevant provisions of law.

The City will direct the County of Santa Clara to collect such *ad valorem* taxes in such amounts and at such times as is necessary to ensure the timely payment of debt service. Such taxes, when collected, will be deposited into the debt service account for the Bonds (the "Series 2009 Debt Service Account"), which is maintained by the City and which is irrevocably pledged for the payment of principal of and interest on the Bonds when due.

The amount of the annual *ad valorem* tax levied by the City and collected by the County to repay the Bonds will be determined by the relationship between the assessed valuation of taxable property in the City and the amount of debt service due on the Bonds. A reduction in the assessed valuation of taxable property in the City caused by economic factors beyond the City's control, such as economic recession, slower growth, or deflation of land values, a relocation out of the City by one or more major property owners, or the complete or partial destruction of such property caused by, among other eventualities or possibilities, an earthquake and flood (discussed below) or other natural disaster, could cause a reduction in the assessed value of the City and necessitate an unanticipated increase in the annual tax levy. For further information regarding the City's tax base, overlapping debt and other matters concerning taxation, see APPENDIX A – "THE CITY OF SAN JOSE: DEMOGRAPHIC, ECONOMIC AND FINANCIAL INFORMATION." For further information regarding pending reductions in assessed valuations of property located in the City, please see APPENDIX A – "THE CITY OF SAN JOSE: DEMOGRAPHIC, ECONOMIC AND FINANCIAL INFORMATION – Major General Fund Revenue Sources, *Property Taxes and Assessed Valuations*" herein

Teeter Plan. The County operates on a Teeter Plan whereby taxing entities, including the City, receive 100% of their ad valorem tax levy assessed by the County. The Teeter Plan will remain in effect unless the County orders its discontinuance or unless the County receives a petition for its discontinuance joined in by resolutions adopted by at least two-thirds of the participating revenue districts in the County, in which event the Board of Supervisors of the County shall order discontinuance of the Teeter Plan effective at the commencement of the subsequent fiscal year. Additionally, the County may discontinue the procedures under the Teeter Plan with respect to any political subdivision in the County if the rate of secured property tax delinquency in that political subdivision in any year exceeds three percent (3%) of the total of all taxes and assessments levied on the secured rolls for that political subdivision. If the Teeter Plan is discontinued subsequent to its implementation, only those secured property taxes actually collected would be allocated to political subdivisions (including the City) for which the County acts as the tax-levying or tax-collecting agency. For further information, please see APPENDIX A – "THE CITY OF SAN JOSE: DEMOGRAPHIC, ECONOMIC AND FINANCIAL INFORMATION – Major General Fund Revenue Sources, *Property Taxes and Assessed Valuations*" herein.

<u>Under the Teeter Plan, the County funds current year delinquencies from certain moneys in its treasury, including, currently, tax payments from prior years' delinquencies. There can be no assurance that the County will continue to utilize the Teeter Plan with respect to the tax levy for the Bonds or for the City. Further, the amounts expected to be available to the County may not be sufficient to fund all delinquencies in current tax levies, in which case the City may not receive the full amount required for the payment of debt service on the Bonds on a timely basis.</u>

<u>Seismic Risk</u>. According to the safety element of the City's "2020 General Plan," (the "General Plan"), the City is located in a region of very high seismic activity. As described in the General Plan, the major earthquake faults in the region are the San Andreas fault, located near the crest of the Santa Cruz Mountains, and the Hayward and Calaveras fault systems located in the Diablo Range. Numerous other active and potentially active faults are located in the hills throughout the Santa Clara Valley, including among others, the Silver Creek Fault. A U.S. Geological Survey study, which was released in April, 2009, provides additional information regarding the Silver Creek Fault and charts its course throughout downtown San José and other parts of the City. The most recent significant earthquake in the San José area, which had a magnitude of 7.1, occurred on October 17, 1989. The extent of damage and the long term effects from an earthquake, particularly ongoing earthquake activity, may be difficult to determine immediately. Additionally, an earthquake resulting from movement at the Silver Creek Fault could cause substantial damage given its proximity to downtown San José and other parts of the City. Earthquakes can result in the hazards of surface rupture, landslides, ground shaking, liquefaction and seismically induced inundation.

<u>Flood Risk</u>. The City participates in the National Flood Insurance Program ("NIFP") administered by FEMA. Approximately 20,000 parcels within the 100-year flood (or base flood) boundary established by FEMA are located in the City. This represents approximately 10 percent of the total number of properties within the City. This can be extrapolated to estimate that roughly 10 percent of the area of the City may be inundated by flood waters of at least 1 foot in depth.

The City, per NFIP requirements, regulates new construction to protect new and redeveloped properties from the 100-year flood event. In addition, the Santa Clara Valley Water District (the "District") is in the process of improving the upper Guadalupe River and upon estimated completion in 2016 it is estimated that approximately 7,500 parcels will be removed from the 100-year flood boundary.

On January 6, 2009, the District issued a press release and notified City officials regarding the results of a preliminary evaluation report showing how Anderson Dam could be affected if a major earthquake were to occur on the Calaveras or Coyote Creek faults. Anderson Dam, located east of Morgan Hill, is an earth and rock fill structure constructed in

1950 supporting the Anderson Reservoir, the largest reservoir in Santa Clara County. The press release stated that: “The report indicates that a major earthquake could seriously damage the foundation of the dam. If the foundation were damaged, the top of the dam could theoretically slump down. If the reservoir were full at the time, there could be an uncontrolled release of water. However, since the staff is keeping the water level in the reservoir at less than 87% of its capacity, that type of event is highly unlikely.”

Information posted on the District’s website states that if the maximum amount of water were released from failure of the Anderson Dam, flooding would occur in the City and in areas to the north and south of the City. The press release also advised that the District will conduct a comprehensive study of Anderson Dam to determine its safety and that the Anderson Dam reservoir level will be kept lower than normal until “future engineering studies deem such a restriction is no longer warranted.” The District has since embarked upon an in-depth study to determine the seismic stability of the dam. Drilling is currently underway and over the next three months, crews plan to drill twenty different sites.

Payment of the Bonds

The Bonds will be issued in book-entry form only and will be initially issued and registered in the name of Cede & Co. Purchasers will not receive certificates representing their interest in the Bonds.

The Bonds shall be issued in the denomination of $5,000 each or any integral multiple thereof. The Bonds mature on September 1, in the years and amounts set forth on the cover page hereof. See the maturity schedule on the cover page hereof and "DEBT SERVICE SCHEDULE."

Interest on the Bonds accrues from the date of delivery, and is payable on March 1, 2010, and semiannually thereafter on March 1 and September 1 of each year (the "Interest Payment Dates"). Interest on the Bonds shall be calculated on the basis of a 360-day year comprised of twelve 30-day months. Each Bond shall bear interest from the Interest Payment Date next preceding the date of registration and authentication thereof unless (i) it is registered and authenticated as of an Interest Payment Date, in which event it shall bear interest from such date, or (ii) it is registered and authenticated prior to an Interest Payment Date and after the close of business on the fifteenth day of the month preceding such Interest Payment Date, in which event it shall bear interest from such Interest Payment Date, or (iii) it is registered and authenticated prior to February 15, 2010, in which event it shall bear interest from the date of delivery; *provided,* however, that if at the time of authentication of a Bond, interest is in default thereon, such Bond shall bear interest from the Interest Payment Date to which interest has previously been paid or made available for payment thereon.

Interest on the Bonds (including the final interest payment upon maturity or early redemption) is payable by check of the Fiscal Agent mailed on the Interest Payment Date to the owner thereof at such owner's address as it appears on the registration books maintained by the Fiscal Agent at the close of business on the fifteenth day of the month preceding the Interest Payment Date, or at such other address as the owner may have filed with the Fiscal Agent for that purpose; *provided* that an owner of $1,000,000 or more aggregate principal amount of Bonds, or the owner of all of the Bonds at the time outstanding, shall, at his or her option, receive payment of interest by wire transfer to an account in the United States of America designated by such owner to the Fiscal Agent no later than the fifteenth (15) day of the month immediately preceding the applicable Interest Payment Date. Principal of the

Bonds is payable in lawful money of the United States of America at the principal office of the Fiscal Agent.

Book-Entry-Only System

The Bonds will be initially registered in the name of "Cede & Co.," as nominee of The Depository Trust Company, New York, New York ("DTC") which has been appointed securities depository for the Bonds, and registered ownership may not thereafter be transferred except as provided in the Fiscal Agent Agreement. The Bonds are being issued in book-entry form only. Purchasers will not receive certificates representing their interests in the Bonds. Principal of and interest on the Bonds will be paid by the Fiscal Agent to DTC or its nominee, Cede & Co., which in turn is obligated to remit such principal and interest to its participants for subsequent disbursement to Beneficial Owners of the Bonds as described herein. See "APPENDIX E – DTC AND THE BOOK-ENTRY-ONLY SYSTEM" herein.

Fiscal Agent

Wells Fargo Bank, National Association, in Los Angeles, California, will act as the registrar, transfer agent, and fiscal agent for the Bonds. As long as DTC's book-entry method is used for the Bonds, the Fiscal Agent will send any notice of redemption or other notices to owners only to DTC. Any failure of DTC to advise any DTC Participant, or of any DTC Participant to notify any Beneficial Owner, of any such notice and its content or effect will not affect the validity or sufficiency of the proceedings relating to the redemption of the Bonds called for redemption or of any other action premised on such notice.

The Fiscal Agent, the City, and the Underwriter of the Bonds have no responsibility or liability for any aspects of the records relating to or payments made on account of beneficial ownership, or for maintaining, supervising or reviewing any records relating to beneficial ownership, of interests in the Bonds.

In the event that either (i) DTC determines not to continue to act as securities depository for the Bonds, or (ii) the City determines to terminate DTC as a securities depository for the Bonds, then the City will discontinue the book-entry system with DTC. If the City fails to identify another securities depository to replace DTC, then the Bonds shall no longer be required to be registered in the name of DTC, but shall be registered in whatever name or names the owners transferring or exchanging Bonds shall designate, in accordance with the provisions of the Fiscal Agent Agreement.

Optional Redemption

Bonds maturing on or before September 1, 20__, are not subject to redemption prior to their respective maturity dates. Bonds maturing on or after September 1, 20__, shall be subject to redemption prior to their respective maturity dates as a whole, or in part, on any date, from any moneys provided at the option of the City, in each case on and after September 1, 20__, at a redemption price equal to the principal amount of Bonds called for redemption, plus accrued interest to the date fixed for redemption, without premium.

The City shall provide notice to the Fiscal Agent of any such optional redemption at least forty-five (45) days prior to the date set for redemption. In the case of a redemption in part, a City representative shall designate to the Fiscal Agent, in a written request of the City, those maturities to be redeemed in whole or in part (including as a maturity, for such purposes, principal due on the Bonds on a particular September 1 as a result of a scheduled mandatory sinking fund redemption). In the event a City representative does not designate the maturities of the Bonds to be redeemed, the Fiscal Agent shall select Bonds for redemption on a proportionate basis among maturities. In the event a particular maturity of Bonds is to be redeemed in part only, the Fiscal Agent shall select the Bonds of such maturity to be redeemed by lot.

Mandatory Sinking Fund Redemption

The Bonds maturing September 1, 20__ and September 1, 20__ are subject to mandatory sinking fund redemption in part, by lot, prior to their stated maturity dates, on each September 1 on and after September 1, 20__ and September 1, 20__, respectively, at a redemption price equal to 100% of the principal amount thereof called for redemption, plus accrued interest to the redemption date, without premium, as follows:

$______________ Term Bond Maturing September 1, 20__

Redemption Date (September 1)	Principal Amount of Bonds to be Redeemed

$______________ Term Bond Maturing September 1, 20__

Redemption Date (September 1)	Principal Amount of Bonds to be Redeemed

*Maturity

Redemption Procedure

Regardless of whether the City has deposited funds sufficient for any redemption with the Fiscal Agent, the Fiscal Agent shall cause notice of any redemption to be mailed, first class mail, postage prepaid, at least thirty (30) days but not more than sixty (60) days prior to the date fixed for redemption, to the respective owners of any Bonds designated for redemption, at their addresses appearing on the registration books maintained by the Fiscal Agent and to the Securities Depositories and the Information Services (both as defined in the Fiscal Agent Agreement); but such mailing shall not be a condition precedent to such redemption and failure to mail or to receive any such notice shall not affect the validity of the proceedings for the redemption of such Bonds. The City shall have the right to cancel the notice of any optional redemption by providing written notice of such cancellation to the Fiscal Agent not less than five (5) days prior to the date set for redemption.

Such notice shall state the redemption date and the redemption price and the CUSIP numbers of the Bonds to be redeemed, and, if less than all of the then outstanding Bonds are to be called for redemption, shall designate the serial numbers of the Bonds to be redeemed by giving the individual number of each Bond or by stating that all Bonds between two stated numbers, both inclusive, or by stating that all of the Bonds of one or more maturities have been called for redemption, and shall require that such Bonds be then surrendered at the principal office of the Fiscal Agent for redemption at the said redemption price, giving notice also that further interest on such Bonds will not accrue from and after the redemption date. Any notice of optional redemption shall also state that it is subject to cancellation not less than five (5) days prior to the date set for redemption. In the event term bonds are redeemed in part, the City shall deliver a revised sinking fund schedule to the Fiscal Agent.

Partial Redemption of Bonds

Upon surrender of Bonds redeemed in part only, the City shall execute and the Fiscal Agent shall authenticate and deliver to the owner, at the expense of the City, a new Bond or Bonds, of the same maturity, of authorized denominations in aggregate principal amount equal to the unredeemed portion of the Bond or Bonds.

Effect of Redemption of Bonds

From and after the date fixed for redemption, if notice of such redemption shall have been duly given as provided in the Fiscal Agent Agreement and funds available for the payment of the principal of and interest (and premium, if any) on the Bonds so called for redemption shall have been duly provided, such Bonds so called shall cease to be entitled to any benefit under the Fiscal Agent Agreement other than the right to receive payment of the redemption price, and no interest shall accrue thereon on or after the redemption date specified in such notice.

Defeasance

The City shall have the option to pay and discharge the entire indebtedness on all or any portion of the Bonds (including the principal due on the Bonds on any date as a result of a scheduled mandatory sinking fund redemption) in any one or more of the following ways:

(a) by paying or causing to be paid the principal of, and interest and any premium on, such outstanding Bonds, as and when the same become due and payable;

(b) by depositing with the Fiscal Agent or another escrow agent, in trust, at or before maturity, money which, together with, in the event of a discharge of all of the Bonds, the amounts then on deposit in the funds and accounts provided for in the Fiscal Agent Agreement is fully sufficient to pay such outstanding Bonds, including all principal, interest and redemption premiums; or

(c) by irrevocably depositing with the Fiscal Agent or another escrow agent, in trust, cash and noncallable Defeasance Obligations (as defined below) in such amount as the City shall determine as confirmed by an independent certified public accountant will, together with the interest to accrue thereon and, in the event of a discharge of all of the Bonds, moneys then on deposit in the fund and accounts provided for in the Fiscal Agent Agreement, be fully sufficient to pay and discharge the indebtedness on such Bonds (including all principal, interest and redemption premiums) at or before their respective maturity dates.

If the City shall have taken any of the actions specified in (a), (b) or (c) above, and if such Bonds are to be redeemed prior to the maturity thereof notice of such redemption shall have been given as in the Fiscal Agent Agreement provided or provision satisfactory to the Fiscal Agent shall have been made for the giving of such notice, then, at the election of the City, and notwithstanding that any Bonds shall not have been surrendered for payment, the pledge of the funds and moneys provided for in the Fiscal Agent Agreement and all other obligations of the City under the Fiscal Agent Agreement with respect to such outstanding Bonds shall cease and terminate. Notwithstanding the foregoing, the obligation of the City to pay or cause to be paid to the owners of the Bonds not so surrendered and paid all sums due thereon and all amounts owing to the Fiscal Agent pursuant to the Fiscal Agent Agreement shall continue in any event.

"Defeasance Obligations" means any of the following which at the time acquired or made are legal investments for the City, under applicable State of California laws and the Investment Policy (unless compliance with the City Investment Policy is waived in writing by the Director of Finance of the City), for the moneys held hereunder then proposed to be invested therein:

(a) Cash;

(b) United States Treasury notes, bonds, bills or certificates of indebtedness or those for which the faith and credit of the United States are pledged for the payment of principal and interest ("Federal Securities");

(c) Direct obligations of the Treasury which have been stripped by the Treasury itself, CATS, TIGRS and similar securities;

(d) The interest component of Resolution Funding Corporation strips which have been stripped by request to the Federal Reserve Bank of New York in book entry form;

(e) Pre-refunded municipal bonds rated Aaa by Moody's and AAA by S&P, provided that, if the issue is rated only by S&P (i.e., there is no Moody's rating), then the pre-refunded municipal bonds must have been pre-refunded with cash, direct U.S. or U.S. guaranteed obligations, or AAA rated pre-refunded municipals; and

(f) Bonds, debentures, notes or other evidence of indebtedness issued or guaranteed by any of the following federal agencies and provided such obligations are backed by the full faith and credit of the United States of America (stripped securities are only permitted if they have been stripped by the agency itself): (i) direct obligations or fully guaranteed certificates of beneficial ownership of the U.S. Export-Import Bank; (ii) certificates of beneficial ownership of the Rural Economic Community Development Administration (formerly the Farmers Home Administration); (iii) obligations of the Federal Financing Bank; (iv) debentures of the Federal Housing Administration; (v) participation certificates of the General Services Administration; (vi) guaranteed Title XI financings of the U.S. Maritime Administration; and (vii) project notes, local authority bonds, new communities debentures and U.S. public housing notes and bonds of the U.S. Department of Housing and Urban Development.

(g) Investments agreements or guaranteed investment contracts with banks, insurance companies or other financial institutions (i) whose long term unsecured senior obligations are rated in the highest whole rating category by at least two of Moody's, S&P and Fitch, or (ii) whose obligations under such investment agreements or guaranteed investment contracts are guaranteed by entities whose long term unsecured senior obligations are rated in the highest whole rating category by at least two of

Moody's, S&P and Fitch; provided that, pursuant to such investment agreements or guaranteed investment contracts, the bank, insurance company or other financial institution shall be absolutely and unconditionally obligated to repay the moneys invested by the City and interest thereon at a guaranteed rate, without any right of recoupment, counterclaim or set off. The bank, insurance company or other financial institution may have the right to assign its obligations under any such investment agreement or guaranteed investment contract to another bank, insurance company or other financial institution; provided, however, that such assignee shall also be a bank, insurance company or other financial institution (iii) whose long term unsecured senior obligations are rated in the highest whole rating category by at least two of Moody's, S&P and Fitch, or (iv) whose obligations under such investment agreement or guaranteed investment contract are guaranteed by a bank, insurance company or financial institution whose unsecured senior obligations are rated in the highest whole rating category by at least two of Moody's, S&P and Fitch.

Registration, Transfer and Exchange of Bonds

The Fiscal Agent shall keep or cause to be kept sufficient books for the registration and transfer of the Bonds, which shall at all times be open to inspection by the City upon reasonable notice; and, upon presentation for such purpose, the Fiscal Agent shall, under such reasonable regulations as it may prescribe, register or transfer or cause to be registered or transferred, on said books, the Bonds.

Events of Defaults and Remedies

The following constitute Events of Default under the Fiscal Agent Agreement:

(a) if default shall be made by the City in the due and punctual payment of the principal of or redemption premium, if any, on any Bond when and as the same shall become due and payable, whether at maturity as therein expressed or by declaration or otherwise; or

(b) if default shall be made by the City in the due and punctual payment of any installment of interest on any Bond when and as such interest installment shall become due and payable.

Upon the occurrence of an Event of Default, any bondowner shall have the right, for the equal benefit and protection of all bondowners similarly situated:

(a) by mandamus, suit, action or proceeding, to compel the City and its members, officers, agents or employees to perform each and every term, provision and covenant contained in the Fiscal Agent Agreement and in the Bonds, and to require the carrying out of any or all such covenants and agreements of the City and the fulfillment of all duties imposed upon it; or

(b) by suit, action or proceeding in equity, to enjoin any acts or things which are unlawful, or the violation of any of the bondowners' rights.

Nothing in the Fiscal Agent Agreement, or in the Bonds, shall affect or impair the obligation of the City, which is absolute and unconditional, to pay the principal of and interest on the Bonds to the respective owners of the Bonds at the respective dates of maturity, or affect or impair the right of action, which is also absolute and unconditional, of such bondowners to institute suit to enforce such payment by virtue of the contract embodied in the Bonds. A waiver of any default by any bondowner shall not affect any subsequent default or impair any rights or remedies on the subsequent default. No delay or omission of any owner of any of the Bonds to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver of any such default or an acquiescence therein, and every power and remedy conferred upon the bondowners by the Fiscal Agent Agreement may be enforced and exercised from time to time and as often as shall be deemed expedient by the owners of the Bonds.

If a suit, action or proceeding to enforce any right or exercise any remedy be abandoned or determined adversely to the bondowners, the City and the bondowners shall be restored to their former positions, rights and remedies as if such suit, action or proceeding had not been brought or taken.

No remedy conferred upon the owners of Bonds under the Fiscal Agent Agreement shall be exclusive of any other remedy and that each and every remedy shall be cumulative and shall be in addition to every other remedy given hereunder or thereafter conferred on the bondowners.

Amendments to Fiscal Agent Agreement

The Fiscal Agent Agreement and the rights and obligations of the City and of the owners of the Bonds may be modified or amended at any time by a Supplemental Fiscal Agent Agreement pursuant to the affirmative vote at a meeting of owners, or with the written consent without a meeting, of the owners of at least a majority in aggregate principal amount of the Bonds then outstanding, exclusive of Bonds disqualified as provided in the Fiscal Agent Agreement. No such modification or amendment shall (i) extend the maturity of any Bond or reduce the interest rate thereon, or otherwise alter or impair the obligation of the City to pay the principal of, and the interest and any premium on, any Bond, without the express consent of the owner of such Bond, or (ii) permit the creation by the City of any pledge or lien upon the *ad valorem* taxes of the taxes superior to or on a parity with the pledge and lien created for the benefit of the Bonds (except as otherwise permitted by the Act, the laws of the State of California or the Fiscal Agent Agreement), or reduce the percentage of Bonds required for the amendment of the Fiscal Agent Agreement. Any such amendment may not modify any of the rights or obligations of the Fiscal Agent without its written consent.

The Fiscal Agent Agreement and the rights and obligations of the City and of the bondowners may also be modified or amended at any time by a Supplemental Fiscal Agent Agreement, without the consent of any owners, only to the extent permitted by law and only for any one or more of the following purposes:

(a) to add to the covenants and agreements of the City in the Fiscal Agent Agreement contained, other covenants and agreements thereafter to be observed, or to limit or surrender any right or power reserved to or conferred upon the City;

(b) to make such provisions for the purpose of curing any ambiguity, or of curing, correcting or supplementing any defective provision contained in the Fiscal Agent Agreement, or in regard to questions arising under the Fiscal Agent Agreement, as the City and the Fiscal Agent may deem necessary or desirable and not inconsistent with the Agreement, and which shall not adversely affect the rights of the owners of the Bonds; and

(c) to make such additions, deletions or modifications as may be necessary or desirable to assure compliance with Section 148 of the Code or otherwise as may be necessary to assure exclusion from gross income for federal income tax purposes of interest on the Bonds or to conform with the Regulations.

SOURCES AND USES OF FUNDS

The sources and uses of funds with respect to the Bonds will be applied as follows:

Sources of Funds	
Principal Amount of Bonds	$
Net Original Issue Premium	
Total Sources	$
Uses of Funds	
Deposit to Fire Subaccount	$
Deposit to Police Subaccount	
Underwriter's Discount	
Deposit to Costs of Issuance Account[1]	
Deposit to Bond Service Fund	
Total Uses	$

(1) Includes bond and disclosure counsel fees, financial advisor fees, rating fees, initial fees of the Fiscal Agent, fees of the City, printing expenses and other costs of issuance with respect to the Bonds. Deposit to the Costs of Issuance Account will be made from the Net Original Issue Premium.

DEBT SERVICE SCHEDULE

The following table shows the debt service schedule with respect to the Bonds.

Period Ending	Principal Payment[1]	Interest Payment	Semi-Annual Debt Service	Fiscal Year Debt Service
March 1, 2010				
September 1, 2010				
March 1, 2011				
September 1, 2011				
March 1, 2012				
September 1, 2012				
March 1, 2013				
September 1, 2013				
March 1, 2014				
September 1, 2014				
March 1, 2015				
September 1, 2015				
March 1, 2016				
September 1, 2016				
March 1, 2017				
September 1, 2017				
March 1, 2018				
September 1, 2018				
March 1, 2019				
September 1, 2019				
March 1, 2020				
September 1, 2020				
March 1, 2021				
September 1, 2021				
March 1, 2022				
September 1, 2022				
March 1, 2023				
September 1, 2023				
March 1, 2024				
September 1, 2024				
March 1, 2025				
September 1, 2025				
March 1, 2026				
September 1, 2026				
March 1, 2027				
September 1, 2027				
March 1, 2028				
September 1, 2028				
March 1, 2029				
September 1, 2029				
March 1, 2030				
September 1, 2030				
March 1, 2031				
September 1, 2031				
March 1, 2032				
September 1, 2032				
March 1, 2033				
September 1, 2033				
March 1, 2034				
September 1, 2034				
March 1, 2035				
September 1, 2035				
March 1, 2036				
September 1, 2036				
March 1, 2037				
September 1, 2037				
March 1, 2038				
September 1, 2038				
March 1, 2039				
September 1, 2039				
Total				

[1] Preliminary, subject to change.

CONSTITUTIONAL AND STATUTORY PROVISIONS AFFECTING CITY REVENUES AND APPROPRIATIONS

Principal of and interest on the Bonds are payable from the proceeds of an ad valorem tax levied by the City for the payment thereof (See "THE BONDS — Security for the Bonds" herein.) Articles XIIIA, XIIIB, XIIIC and XIIID of the Constitution, Propositions 62, 111, and 218 and 1A, and certain other provisions of law discussed below, are included in this section to describe the potential effect of these Constitutional and statutory measures on the ability of the City to levy taxes and spend tax proceeds for operating and other purposes, and it should not be inferred from the inclusion of such materials that these laws impose any limitation on the ability of the City to levy taxes for payment of the Bonds. The tax levied by the City for payment of the Bonds was approved by the City's voters in compliance with Article XIIIA and all applicable laws.

Article XIIIA of the State Constitution

On June 6, 1978, California voters approved Proposition 13 ("Proposition 13"), which added Article XIIIA to the State Constitution ("Article XIIIA"). Article XIIIA, as amended, limits the amount of any *ad valorem* tax on real property to one percent of the full cash value thereof, except that additional *ad valorem* taxes may be levied to pay debt service (i) on indebtedness approved by the voters prior to July 1, 1978, (ii) on bonded indebtedness approved by a two-thirds vote on or after July 1, 1978, for the acquisition or improvement of real property or (iii) bonded indebtedness incurred by a school district, community college district or county office of education for the construction, reconstruction, rehabilitation or replacement of school facilities, including the furnishing and equipping of school facilities or the acquisition or lease of real property for school facilities, approved by 55 percent of the voters voting on the proposition. Article XIIIA defines full cash value to mean "the county assessor's valuation of real property as shown on the 1975-76 tax bill under "full cash value," or thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment." This full cash value may be increased at a rate not to exceed two percent per year to account for inflation.

Article XIIIA has subsequently been amended to permit reduction of the "full cash value" base in the event of declining property values caused by damage, destruction or other factors, to provide that there would be no increase in the "full cash value" base in the event of reconstruction of property damaged or destroyed in a disaster, and in other minor or technical ways. For further information regarding pending reductions in assessed valuations of property located in the City, please see APPENDIX A – "THE CITY OF SAN JOSE: DEMOGRAPHIC, ECONOMIC AND FINANCIAL INFORMATION – Major General Fund Revenue Sources, *Property Taxes and Assessed Valuations*" herein.

Legislation Implementing Article XIIIA

Legislation has been enacted and amended a number of times since 1978 to implement Article XIIIA. Under current law, local agencies are no longer permitted to levy directly any property tax (except to pay voter-approved indebtedness). The one percent property tax is automatically levied by the County and distributed according to a formula among taxing agencies. The formula apportions the tax roughly in proportion to the relative shares of taxes levied prior to 1989.

Increases of assessed valuation resulting from reappraisals of property due to new construction, change in ownership or from the two percent annual adjustment are allocated among the various jurisdictions in the "taxing area" based upon their respective "situs." Any such allocation made to a local agency continues as part of its allocation in future years.

All taxable property is shown at full market value on the tax rolls. Consequently, the tax rate is expressed as $1 per $100 of taxable value. All taxable property value included in this Official Statement is shown at 100 percent of market value (unless noted differently) and all tax rates reflect the $1 per $100 of taxable value.

Article XIIIB of the State Constitution

In addition to the limits Article XIIIA imposes on property taxes that may be collected by local governments, certain other revenues of the State and most local governments are subject to an annual "appropriations limit" imposed by Article XIIIB which effectively limits the amount of such revenues those entities are permitted to spend. Article XIIIB, approved by the voters in June 1979, was modified substantially by Proposition 111 in 1990. The appropriations limit of each government entity applies to "proceeds of taxes," which consist of tax revenues, State subventions and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed "the cost reasonably borne by such entity in providing the regulation, product or service." "Proceeds of taxes" excludes tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on the appropriation of funds which are not "proceeds of taxes," such as reasonable user charges or fees, and certain other non-tax funds. Article XIIIB also does not limit appropriation of local revenues to pay debt service on Bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, and appropriation by the State of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990, levels. The appropriations limit may also be exceeded in case of emergency; however, the appropriations limit for the next three years following such emergency appropriation must be reduced to the extent by which it was exceeded, unless the emergency arises from civil disturbance or natural disaster declared by the Governor, and the expenditure is approved by two-thirds of the legislative body of the local government.

The State and each local government entity has its own appropriations limit. Each year, the limit is adjusted to allow for changes, if any, in the cost of living, the population of the jurisdiction, and any transfer to or from another government entity of financial responsibility for providing services. Proposition 111 requires that each agency's actual appropriations be tested against its limit every two years.

If the aggregate "proceeds of taxes" for the preceding two-year period exceeds the aggregate limit, the excess must be returned to the agency's taxpayers through tax rate or fee reductions over the following two years. The City has never exceeded its appropriations limit.

Article XIIIC and Article XIIID of the State Constitution

On November 5, 1996, the voters of the State approved Proposition 218, known as the "Right to Vote on Taxes Act." Proposition 218 adds Articles XIIIC and XIIID to the California Constitution and contains a number of interrelated provisions affecting the ability of the City to levy and collect both existing and future taxes, assessments, fees and charges. The interpretation and application of Proposition 218 will ultimately be determined by the courts with respect to a number of the matters discussed below, and it is not possible at this time to predict with certainty the outcome of such determination.

Article XIIIC requires that all new local taxes be submitted to the electorate before they become effective. Taxes for general governmental purposes of the City require a majority vote and taxes for specific purposes, even if deposited in the City's General Fund, require a two-thirds vote. The voter approval requirements of Proposition 218 reduce the flexibility of the City to raise revenues for the General Fund, and no assurance can be given that the City will be able to impose, extend or increase such taxes in the future to meet increased expenditure needs.

Article XIIID also adds several provisions making it generally more difficult for local agencies to levy and maintain property-related fees, charges, and assessments for municipal services and programs. These provisions include, among other things, (i) a prohibition against assessments which exceed the reasonable cost of the proportional special benefit conferred on a parcel, (ii) a requirement that assessments must confer a "special benefit," as defined in Article XIIID, over and above any general benefits conferred, (iii) a majority protest procedure for assessments which involves the mailing of notice and a ballot to the record owner of each affected parcel, a public hearing and the tabulation of ballots weighted according to the proportional financial obligation of the affected party, and (iv) a prohibition against fees and charges which are used for general governmental services, including police, fire or library services, where the service is available to the public at large in substantially the same manner as it is to property owners. If the City is unable to continue to collect these revenues, the services and programs funded with these revenues would have to be curtailed and/or the City's General Fund might have to be used to support them. The City is unable to predict whether or not in the future it will be able to continue all existing services and programs funded by the fees, charges and assessments in light of Proposition 218 or, if these services and programs are continued, which amounts (if any) would be used from the City's General Fund to continue to support these activities.

Article XIIIC also removes limitations on the initiative power in matters of reducing or repealing local taxes, assessments, fees or charges. No assurance can be given that the voters of the City will not, in the future, approve an initiative or initiatives which reduce or repeal local taxes, assessments, fees or charges currently comprising a substantial part of the City's General Fund.

Proposition 62

Proposition 62 is a statewide statutory initiative which added Sections 53720 to 53730 to the Government Code of the State and requires that all new local taxes be approved by the voters. Several State appellate courts have held that Proposition 62 does not apply to charter cities. The City is a charter city.

Proposition 1A

Proposition 1A, proposed by the Legislature in connection with the State's Fiscal Year 2004-05 Budget, approved by the voters in November 2004 and generally effective in Fiscal Year 2006-07, provides that the State may not reduce any local sales tax rate, limit existing local government authority to levy a sales tax rate or change the allocation of local sales tax revenues, subject to certain exceptions. Proposition 1A generally prohibits the State from shifting to schools or community colleges any share of property tax revenues allocated to local governments for any fiscal year, as set forth under the laws in effect as of November 3, 2004.

Any change in the allocation of property tax revenues among local governments within a county must be approved by two-thirds of both houses of the Legislature. Proposition 1A provides, however, that beginning in fiscal year 2008-09, the State may shift to schools and community colleges up to 8% of local government property tax revenues, which amount must be repaid, with interest, within three years, if the Governor proclaims that the shift is needed due to a severe state financial hardship, the shift is approved by two-thirds of both houses and certain other conditions are met. The State may also approve voluntary exchanges of local sales tax and property tax revenues among local governments within a county. Proposition 1A also provides that if the State reduces the motor vehicle license fee rate currently in effect, 0.65 percent of vehicle value, the State must provide local governments with equal replacement revenues. Further, Proposition 1A requires the State, beginning July 1, 2005, to suspend State mandates affecting cities, counties and special districts, excepting mandates relating to employee rights, schools or community colleges, in any year that the State does not fully reimburse local governments for their costs to comply with such mandates.

Proposition 1A may result in increased and more stable City revenues. The magnitude of such increase and stability is unknown and would depend on future actions by the State. However, Proposition 1A could also result in decreased resources being available for State programs. This reduction, in turn, could affect actions taken by the State to resolve budget difficulties. Such actions could include increasing State taxes, decreasing spending on other State programs or other action, some of which could be adverse to the City.

Possible Future Actions

In recent years several initiative measures have been adopted which affect property and other local taxes. There is no assurance that the California electorate or Legislature will not at some future time approve additional limitations.

TAX MATTERS

In the opinion of Jones Hall, A Professional Law Corporation, San Francisco, California, Bond Counsel, subject, however to certain qualifications set forth below, under existing law, the interest on the Bonds is excluded from gross income for federal income tax purposes, and such interest is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations.

The opinions set forth in the preceding paragraph are subject to the condition that the City comply with all requirements of the Code that must be satisfied subsequent to the issuance of the Bonds in order that such interest be, or continue to be, excluded from gross income for federal income tax purposes. The City has covenanted to comply with each such requirement. Failure to comply with certain of such requirements may cause the inclusion of such interest in gross income for federal income tax purposes to be retroactive to the date of issuance of the Bonds.

If the initial offering price to the public (excluding bond houses and brokers) at which a Bond is sold is less than the amount payable at maturity thereof, then such difference constitutes “original issue discount” for purposes of federal income taxes and State of California personal income taxes. If the initial offering price to the public (excluding bond houses and brokers) at which each Bond is sold is greater than the amount payable at maturity thereof, then such difference constitutes “original issue premium” for purposes of federal income taxes and

State of California personal income taxes. De minimis original issue discount and original issue premium is disregarded. Owners of Bonds with original issue discount or original issue premium, including purchasers who do not purchase in the original offering, should consult their own tax advisors with respect to federal income tax and State of California personal income tax consequences of owning such Bonds.

In the further opinion of Bond Counsel, interest on the Bonds is exempt from California personal income taxes.

Owners of the Bonds should also be aware that the ownership or disposition of, or the accrual or receipt of interest on, the Bonds may have federal or state tax consequences other than as described above. Bond Counsel expresses no opinion regarding any federal or state tax consequences arising with respect to the bonds other than as expressly describe above.

A copy of the proposed form of opinion of Bond Counsel is attached hereto as APPENDIX C.

APPROVAL OF LEGAL PROCEEDINGS

Certain legal matters incident to the authorization, issuance and sale of the Bonds are subject to the approval of Jones Hall, A Professional Law Corporation, San Francisco, California, Bond Counsel. Jones Hall, A Professional Law Corporation, San Francisco, California, is also serving as Disclosure Counsel in connection with the sale, issuance and delivery of the Bonds. Certain legal matters will be passed upon for the City by the City Attorney.

Copies of the approving opinion of Bond Counsel will be available at the time of delivery of the Bonds. The form of the opinion is set forth in APPENDIX C – "FORM OF OPINION OF BOND COUNSEL." Except as expressly described in certain opinions delivered to the City and the Underwriter, Bond Counsel is not passing upon and undertakes no responsibility for the accuracy, completeness or fairness of the information contained in the Official Statement. Bond Counsel and Disclosure Counsel will receive compensation that is contingent upon the sale, issuance and delivery of the Bonds.

FINANCIAL STATEMENTS

The City's Basic Financial Statements for Fiscal Year 2007-08 included in this Official Statement have been audited by Macias, Gini & O'Connell LLP, independent auditors, as stated in their report included in the Financial Statements. See APPENDIX B–"BASIC FINANCIAL STATEMENTS OF THE CITY OF SAN JOSE FOR THE FISCAL YEAR ENDED JUNE 30, 2008." Macias Gini & O'Connell LLP has not been requested to consent to the use or to the inclusion of its report in this Official Statement and has not reviewed this Official Statement.

CONTINUING DISCLOSURE

The City has covenanted in the Fiscal Agent Agreement that it will comply with and carry out all of the provisions of that certain Continuing Disclosure Certificate executed by the City and dated the date of issuance and delivery of the Bonds, as originally executed and as it may be amended from time to time in accordance with the terms thereof (the "Continuing Disclosure Certificate"). See “APPENDIX D — Form of Continuing Disclosure Certificate." Any Owner may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City to comply with its obligations under the Continuing Disclosure Certificate. These covenants have been made in order to assist the Underwriter in complying with Securities and Exchange Commission Rule 15c2-12(b)(5) (the "Rule").

The City has never failed to comply, in all material respects, with an undertaking under the Rule. However, when submitting Fiscal Year 2004-05 Annual Reports, the City filed all reports with its dissemination agents by the required dates specified in the City’s continuing disclosure agreements, but one dissemination agent neglected to meet its deadline for submission of one of the Fiscal Year 2004-05 Annual Reports to the Repositories by the deadline specified in the applicable continuing disclosure agreement.

LITIGATION AND SIGNIFICANT CLAIMS

No litigation is pending against the City with service of process accomplished or threatened in writing concerning the validity of the Bonds, or questioning the political existence of the City or seeking to restrain or enjoin the issuance or execution of the Bonds. The City will furnish to the purchaser of the Bonds a certificate as to the foregoing as of the time of the original delivery of the Bonds.

There are a variety of civil cases in which the City is a named defendant pending at any given time, including without limitation, the litigation described in Appendix A. See APPENDIX A: “THE CITY OF SAN JOSE: DEMOGRAPHIC, ECONOMIC AND FINANCIAL INFORMATION – Litigation and Significant Claims.” Additionally, there are numerous claims filed with the City or with other agencies in which the claimants allege that they have been damaged by the City. If these cases or these claims which develop into civil actions were determined adversely to the City, it is possible there could be an adverse effect on the City’s revenues and cash flow.

RATINGS

The Bonds have received ratings of "___" by Moody's Investors Service, "___" by Standard & Poor's Rating Services ("S&P"), and "___" by Fitch.

Such ratings reflect only the view of such organizations and an explanation of the significance of such ratings may be obtained from Moody's Investors Service, 99 Church Street, New York, NY 10007, (212) 553-0300; Standard & Poor's Rating Services, 55 Water Street, New York, NY 10041, (212) 438-2124; and Fitch, One State Street Plaza, New York, NY 10004, (800) 753-4824. There is no assurance that any such rating will continue for any given period of time or that such ratings will not be revised downward or withdrawn entirely by such organizations, if in their judgment circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Bonds.

FINANCIAL ADVISOR

The City has retained KNN Public Finance, A Division of Zions First National Bank, Oakland, California, as Financial Advisor in connection with the authorization and delivery of the Bonds. The Financial Advisor is not obligated to undertake, and has not undertaken to make, an independent verification or to assume responsibility for the accuracy, completeness or fairness of the information contained in the Official Statement. The fees and expenses of the Financial Advisor are contingent upon the successful issuance and delivery of the Bonds.

UNDERWRITER

The Bonds were purchased by ____________________ (the "Underwriter") pursuant to a competitive sale held on June __, 2009. The Underwriter has agreed to purchase the Bonds at a price of $___________ (representing the aggregate principal amount of the Bonds of $__________, *plus* a net original issue premium of $____________, and *less* an underwriter's discount of $______________), such price being ______% of the principal amount of the Bonds. The Bonds may be offered and sold to certain dealers and others at prices lower than the offering prices stated on the inside cover page herein. The offering prices may be changed from time to time.

ADDITIONAL INFORMATION

Quotations from and summaries and explanations of the Bonds, the Fiscal Agent Agreement providing for issuance of the Bonds, and the constitutional provisions, statutes and other documents referenced herein, do not purport to be complete, and reference is made to said documents, constitutional provisions and statutes for full and complete statements of their provisions.

Some of the data contained herein has been taken or constructed from City records. Appropriate City officials, acting in their official capacities, have reviewed this Official Statement and have determined that, as of the date hereof, the information contained herein is, to the best of their knowledge and belief, true and correct in all material respects and does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made herein, in light of the circumstances under which they were made, not misleading. This Official Statement has been approved by the City Council.

CITY OF SAN JOSE, CALIFORNIA

By:______________________________
Title: City Manager

APPENDIX B

BASIC FINANCIAL STATEMENTS FOR THE FISCAL YEAR ENDED JUNE 30, 2008

APPENDIX E
DTC AND THE BOOK-ENTRY-ONLY SYSTEM

The following description of the Depository Trust Company ("DTC"), the procedures and record keeping with respect to beneficial ownership interests in the Bonds, payment of principal, interest and other payments on the Bonds to DTC Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interest in the Bonds and other related transactions by and between DTC, the DTC Participants and the Beneficial Owners is based solely on information provided by DTC. Accordingly, no representations can be made concerning these matters and neither the DTC Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters, but should instead confirm the same with DTC or the DTC Participants, as the case may be.

Neither the City nor the Fiscal Agent take any responsibility for the information contained in this Appendix.

No assurances can be given that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners (a) payments of interest, principal or premium, if any, with respect to the Bonds, (b) certificates representing ownership interest in or other confirmation or ownership interest in the Bonds, or (c) redemption or other notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Bonds, or that they will so do on a timely basis, or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Appendix. The current "Rules" applicable to DTC are on file with the Securities and Exchange Commission and the current "Procedures" of DTC to be followed in dealing with DTC Participants are on file with DTC.

1. The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for the securities (the "Bonds"). The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for the Bonds, in the aggregate principal amount of such issue, and will be deposited with DTC. If, however, the aggregate principal amount of any issue exceeds $500 million, one certificate will be issued with respect to each $500 million of principal amount and an additional certificate will be issued with respect to any remaining principal amount of such issue.

2. DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instrument from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations.

DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org. *The information contained on this Internet site is not incorporated herein by reference.*

3. Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

4. To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

5. Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the security documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners, in the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

6. Redemption notices shall be sent to DTC. If less than all of the Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

7. Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the City as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

8. Redemption proceeds, distributions, and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the City or the Fiscal Agent on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, the Fiscal Agent, or the City, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the City or the Fiscal Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

9. DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the City or the Fiscal Agent. Under such circumstances, in the event that a successor securities depository is not obtained, Bond certificates are required to be printed and delivered.

10. The City may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered to DTC.

11. The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the City believes to be reliable, but the City takes no responsibility for the accuracy thereof.

APPENDIX A

THE CITY OF SAN JOSE: DEMOGRAPHIC, ECONOMIC AND FINANCIAL INFORMATION

Table of Contents

APPENDIX A

THE CITY OF SAN JOSE: DEMOGRAPHIC, ECONOMIC AND FINANCIAL INFORMATION

Introduction to Appendix A

Appendix A is the part of the Official Statement that provides investors with information concerning the City of San José (the "City"). Investors are advised to read the entire Official Statement, including Appendix A, to obtain information essential to making an informed investment decision.

When used in this Appendix A and in any continuing disclosure made by the City, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," "forecast," "expect," and "intend," and similar expressions identify "forward looking statements." 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 also subject to such risks and 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. This Appendix A speaks only as of its date, and the information and expressions of opinion contained in this Official Statement are subject to change without notice.

Appendix A summarizes sections of the City's Comprehensive Annual Financial Report for the Year Ended June 30, 2008 (included in this Official Statement as Appendix B), the City's Comprehensive Annual Debt Report for the Year Ended June 30, 2008, the City's Adopted Budgets for Fiscal Year ("FY") 2008-09, the City's Proposed Budgets for FY 2009-10, as well as the most recent Actuarial Valuation Reports for the City's Federated City Employees Retirement Plan and the City's Police and Fire Department Retirement Plan. Investors can obtain copies of the Debt Report, the budget and retirement plan documents by writing to the following addresses:

Comprehensive Annual Debt Report	City Budget
Debt Management City of San José - Finance 200 East Santa Clara Street San José, CA 95113-1905	City Manager's Budget Office City of San José 200 East Santa Clara Street San José, CA 95113-1905

Federated City Employees' Retirement System	Police and Fire Department Retirement Plan
Board of Administration Federated City Employees' Retirement System 1737 North First Street, Suite 580 San José, CA 95112	Board of Administration Police and Fire Department Retirement Plan 1737 North First Street, Suite 580 San José, CA 95112

General Description

The City is the tenth largest city in the United States and the third largest city in California (the "State"), with a January 1, 2009 population estimated at 1,006,892, according to the California Department of Finance. The territory of the City encompasses approximately 178 square miles. Located at the southern end of the San Francisco Bay, the City is the county seat of the County of Santa Clara (the "County").

Having originated as a Spanish pueblo established in 1777, the City is the oldest city in the State. From a former rich agricultural setting, San José has become the capital of the innovative, high-technology based Silicon Valley - so named for the principal material used in producing semiconductors. During the 1980s and 1990s the City experienced an expansion in manufacturing, service, retail and tourism industries. With the dot-com collapse in the last recession in the early 2000s, Silicon Valley was one of the first and most deeply impacted regions in the nation. This has not been the case in this recession. Until the last quarter of 2008, Silicon Valley was somewhat less impacted than other areas in the state of California and the nation. However, the deep global recession has now enveloped this region as well, as evidenced by increasing job losses, rising unemployment, steep declines in home prices, rising foreclosures, and rising commercial vacancy rates. For additional information regarding the recent economic environment, see "Demographic and Economic Information – *Economic Overview*."

Demographic and Economic Information

Introduction

The information provided in the section entitled "Demographic and Economic Information" has been collected from sources that the City believes to be reliable and is the most current information available from those sources. Because it is difficult to obtain complete and timely regional economic and demographic information, the City's economic condition may not be fully apparent in all of the publicly available regional economic statistics provided herein, but the City has included this information to provide context about the City's finances. For current estimates regarding the City's General Fund revenue sources, see "Budget – *City's FY 2009-10 Proposed Budget*" and "Major General Fund Sources of Revenue."

Economic Overview

As stated earlier, the City has experienced significant economic downturn since the fourth quarter of 2008. This is evidenced in several key economic indicators such as unemployment rates and median home prices. The unemployment rates at the local, State, and national levels have all gone up significantly in recent months to some of the highest rates in decades. The unemployment rate in the San José metropolitan area continues to increase with a rate of 12.0% in March 2009 compared to 5.8% in March 2008.

Real estate performance in Santa Clara County also remains extremely weak with a significant increase in the number of foreclosures. In the last quarter of 2008, approximately 3,000 San José homes received a new foreclosure filing. For the three-month period between October to December 2008, approximately 1.7% of the home ownership units in the County are in some state of foreclosure. The vacancy rates for office space in San José also increased over 60%, from 10.8% in the fourth quarter of 2007 to 17.5% in the fourth quarter of 2008.

Following the nationwide trend, local home prices have declined sharply over the last year. The median home price for single family homes within the City, for example, has dropped 39% from $670,000 in February 2008 to $406,500 in February 2009. The February 2009 figure represents the lowest median home price within the City since winter 2000. With the significant decline in home prices, however, there has been a recent increase in the number of sales to more historical levels. The local economy is expected to continue to face significant challenges. On an overall basis, this region's economy is expected to continue to contract sharply for the remainder of 2009 and continue weak economic performance into 2010.

Population

City residents account for over half of the population of the County, which is the most populous of the San Francisco Bay Area counties. While the period from 1960 to 1980 was characterized by extremely rapid population growth in both the City and County, the last two decades reflect a trend of slower but steady growth. Table 1 shows the population of the City, the County and the State according to the U.S. Census for the years 1960, 1970, 1980, 1990 and 2000 and according to the California Department of Finance for the years 2001 through 2009.

Table 1
CITY, COUNTY AND STATE POPULATION STATISTICS

	City of San José	Annual % Change	County of Santa Clara	Annual % Change	State of California	Annual % Change
1960	204,196		642,315		15,717,204	
1970	459,913	8.46%	1,064,714	5.18%	19,953,134	2.42%
1980	629,442	3.19	1,295,071	1.98	23,667,902	1.72
1990	782,248	2.20	1,497,577	1.46	29,760,021	2.32
2000	894,943	1.35	1,682,585	1.17	33,871,648	1.30
2001	905,540	1.18	1,701,385	1.12	34,430,970	1.65
2002	915,706	1.12	1,715,329	0.82	35,063,959	1.84
2003	922,950	0.79	1,726,183	0.63	35,652,700	1.68
2004	929,959	0.76	1,738,654	0.72	36,199,342	1.53
2005	941,609	1.25	1,753,041	0.83	36,676,931	1.32
2006	953,058	1.22	1,771,610	1.06	37,086,191	1.12
2007	968,287	1.60	1,798,242	1.50	37,472,074	1.04
2008	985,307	1.76	1,829,480	1.74	37,883,992	1.10
2009	1,006,892	2.19	1,857,621	1.54	38,292,687	1.08

Source: U.S. Census (1960-2000), California Department of Finance (2001-2009).

Employment

Table 2 sets forth employment figures for the City and the County and unemployment rates for the City, the County, the State and the United States for the five most recent years. The City's unemployment rate has risen since 2007 as a result of the economic downturn across the United States. The City's unemployment rate has increased from 6.0% in 2005 to 12.0% as of March 2009.

Table 2
SANTA CLARA COUNTY
ESTIMATED AVERAGE ANNUAL EMPLOYMENT AND UNEMPLOYMENT OF RESIDENT LABOR FORCE

Civilian Labor Force *(in thousands)*	**2005**	**2006**	**2007**	**2008**	**2009**(1)
City of San José					
Employed	403	414	419	429	415
Unemployed	26	22	22	31	57
Total(2)	429	436	441	460	472
County of Santa Clara					
Employed	779	797	807	827	801
Unemployed	45	37	40	53	97
Total(2)	824	834	855	880	898
Unemployment Rates					
City	6.0%	5.0%	5.3%	6.7%	12.0%
County	5.5	4.5	4.7	6.0	10.8
State	5.4	4.9	5.4	7.2	11.5
United States	5.1	4.6	4.6	5.8	9.0

(1) Preliminary, not seasonally adjusted; data are for March 2009.
(2) Totals may not add due to independent rounding.
Source: California Employment Development Department, Labor Market Information Division.

The City occupies the geographic center of Silicon Valley. The high technology industry component of the City's economy is diversified in research, development, manufacturing, marketing and management. Development of high technology has been supported by the area's proximity to Stanford University, San José State University, Santa Clara University and other institutions of higher education, and such research and development facilities as SRI International (formerly the Stanford Research Institute), the Stanford Linear Accelerator Center (SLAC) and NASA Ames Research Center.

While the County is known worldwide as "Silicon Valley," the silicon-based semiconductor industry is only a part of the industrial picture. Other industries include information systems, solar, computers, peripherals, instruments, software and a wide array of communication electronics.

Table 3 displays the composition of employment in the San José-Sunnyvale-Santa Clara Metropolitan Statistical Area by general category for the most recent three years available.

Table 3
SAN JOSE-SUNNYVALE-SANTA CLARA METROPOLITAN STATISTICAL AREA
EMPLOYMENT BY CATEGORY
ANNUAL AVERAGES

	2006	**Percent of Total**	**2007**	**Percent of Total**	**2008**	**Percent of Total**
Farm	6,200	0.69%	6,700	0.73%	6,100	0.66%
Natural Resources & Mining	300	0.03	300	0.03	300	0.03
Construction	46,800	5.21	47,200	5.14	44,200	4.80
Manufacturing	163,700	18.24	166,700	18.16	168,000	18.24
Wholesale Trade	38,300	4.27	39,800	4.34	40,600	4.41
Retail Trade	85,800	9.56	86,400	9.41	84,600	9.18
Transport Warehousing, Utilities	13,000	1.45	13,500	1.47	13,300	1.44
Information	37,500	4.18	39,600	4.31	41,700	4.53
Financial Activities	37,100	4.13	37,200	4.05	34,800	3.78
Professional & Business Services	172,000	19.16	178,300	19.42	178,700	19.40
Educational & Health Services	100,400	11.19	103,200	11.24	107,500	11.67
Leisure & Hospitality	75,200	8.38	76,800	8.37	78,200	8.49
Other Services	24,800	2.76	25,100	2.73	25,300	2.75
Government	96,400	10.74	97,200	10.59	97,800	10.62
Total[(1)]	**897,500**		**918,000**		**921,100**	

(1) Totals may not add due to independent rounding.
Source: California Employment Development Department, Labor Market Information Division.

Major Employers

Table 4 shows fifteen selected major employers in San José, ranked by the number of their employees, estimated as of March 2009. Because there is no official source for this information, it has been gathered by the City's Office of Economic Development on an informal basis and the City can provide no assurances as to the accuracy of the information.

Table 4
SELECTED MAJOR SAN JOSE EMPLOYERS
As of March 2009

	Company/Organization	**Type of Industry**	**Approximate Number of Employees**
1.	Santa Clara County	Government	15,360
2.	Cisco Systems	Computer Equipment	11,600
3.	IBM Corporation	Computer Equipment	7,460
4.	City of San José	Government	6, 472[1]
5.	San José State University	Education	3,100
6.	eBay/Paypal	On-Line Auction	3,000
7.	Hitachi	Storage Software	2,900
8.	San José Unified School District	Education	2,690
9.	Xilinx	Semiconductor	2,340
10.	Sanmina-SCI	Semiconductor Equipment	2,170
11.	Kaiser Permanente	Health Care	2,120
12.	Adobe Systems Inc.	Computer Software	2,000
13.	Good Samaritan Health System	Health Care	1,850
14.	KLA-Tencor Corporation	Semiconductor Equipment	1,770
15.	Cadence Design Systems Inc.	Computer Software	1,560

(1) Reflects the City's full-time equivalent authorized positions included in the 2009-2010 Proposed Budget.
Source: City of San José, Office of Economic Development.

Household Income

"Household Income" includes the income of the householder and all other people 15 years and older in the household, whether or not they are related to the householder. The median is based on the income distribution of all households, including those with no income. Table 5 shows the top ten "Median Household Income" for places with 250,000 or more people in 2007, among which the City ranked second.

Table 5
2007 TOP TEN MEDIAN HOUSEHOLD INCOME
FOR PLACES WITH 250,000 OR MORE PEOPLE

1. Plano, Texas	$84,492
2. San José, California	**76,963**
3. Anchorage municipality, Alaska	68,726
4. San Francisco, California	68,023
5. San Diego, California	61,863
6. Virginia Beach, Virginia	61,462
7. Seattle, Washington	57,849
8. Anaheim, California	57,059
9. Riverside, California	55,999
10. Honolulu CDP, Hawaii	55,536
U.S. Median	$50,740

Source: U.S. Census Bureau, 2007 American Community Survey.

Retail Sales

Table 6 sets forth a history of taxable sales for the City from calendar year 2003 through 2007 by the California State Board of Equalization. A comparison of the total taxable sales in the City between the first quarter of calendar year 2007 and the first quarter of calendar year 2008 (the most recent data available), shows an increase of $8 million, or 0.30%. However, more recent data indicates a decline in sales tax receipts. The City Manager's Budget Office received sales tax data for the third quarter of calendar year 2008, which shows that sales tax receipts declined 0.4% as compared to the third quarter of calendar year 2007. For more current information regarding sales tax receipts, see "Major General Fund Revenue Sources – *Sales and Use Taxes*."

Table 6
CITY OF SAN JOSE
TAXABLE SALES
(in thousands)

	2003	2004	2005	2006	2007
Apparel Stores	$ 372,107	$ 428,926	$ 476,095	$ 514,552	$ 537,902
General Merchandise Stores	1,145,069	1,192,548	1,273,994	1,332,598	1,425,777
Food Stores	397,685	396,216	401,720	409,257	427,237
Eating and Drinking Establishments	898,859	977,463	1,046,629	1,128,192	1,206,390
Home Furnishings and Appliances	336,072	342,719	363,119	364,657	360,402
Building Materials and Farm Implements	737,588	833,766	853,656	875,354	781,551
Auto Dealers and Auto Supplies	1,463,891	1,553,456	1,573,954	1,584,002	1,548,373
Service Stations	744,517	872,202	1,021,176	1,128,236	1,245,967
Other Retail Stores	1,362,282	1,349,032	1,417,102	1,576,089	1,700,093
Retail Stores Total	$ 7,458,070	$ 7,946,328	$ 8,427,445	$ 8,912,937	$ 9,233,692
All Other Outlets	3,373,127	3,190,904	3,279,248	3,357,103	3,542,272
Total All Outlets	$10,831,197	$11,137,232	$11,706,693	$12,270,040	$12,775,964

Source: California State Board of Equalization.

Construction Activity

A history of construction valuation and new dwelling units for the most recent five calendar years appears in Table 7 below. More information regarding building permits and fees is set forth below in the section entitled "Major General Fund Revenue Sources – *Licenses, Permits and Miscellaneous Taxes*."

Table 7
CITY OF SAN JOSE
CONSTRUCTION VALUATION AND NEW DWELLING UNITS
(in thousands)[(1)]

	2004	2005	2006	2007	2008
Valuation:[(1)]					
Residential	$ 538,738	$ 505,954	$ 484,307	$ 344,457	$ 280,491
Non-Residential ..	360,355	399,149	404,053	674,025	534,754
Total[(2)]	$ 899,093	$ 905,103	$ 888,360	$ 1,018,482	$ 815,425
New Dwelling Units:					
Single Family......	960	831	611	462	254
Multi-Family.......	2,017	1,951	2,362	1,708	1,716
Total[(2)]	2,977	2,782	2,973	2,170	1,970

(1) Valuation figures are adjusted to 2008 dollars per Bureau of Labor Statistics Consumer Price Index, San José-San Francisco-Oakland, and all items index.
(2) Totals may not add due to independent rounding.
Source: City of San José, Department of Planning, Building and Code Enforcement as of January 7, 2009.

Education

For the school year 2007-08, an estimated 269,942 students were enrolled in the County's 241 elementary schools; 58 middle schools and junior high schools; 49 high schools; 45 K-12, community, alternative, special education, continuation and juvenile hall schools and 26 charter schools. For the current school year 2008-09, an estimated 262,020 students were enrolled in the County. In addition, there are a number of private schools serving the residents of the County. The County has seven community colleges (within four community college districts: Foothill-DeAnza, Gavilan Joint, San José-Evergreen, and West Valley-Mission). Major universities in the County include Stanford University, Santa Clara University, and San José State University.

The City is served by 18 of the 33 public school districts in the County. These school districts cross municipal boundaries. Principal public school systems serving the City are the San José Unified School District (grades K-12), with an estimated enrollment for school year 2008-09 of 31,934, and the East Side Union High School District with an estimated enrollment for school year 2008-09 of 26,295.

Transportation

The San José area is served by a network of freeways providing regional, national and international access. U.S. 101, a major north-south highway between San Francisco and Los Angeles, provides access to the deepwater seaports at San Francisco and Redwood City, and to air passenger and cargo facilities at Norman Y. Mineta San José International Airport (the "Airport") and San Francisco International Airport.

Interstate 880 connects San José with the Oakland International Airport and the Port of Oakland. Interstates 280 and 680 provide access to the peninsula and eastern regions of the San Francisco Bay Area, respectively, and State Route 17 serves to connect San José with the Pacific Coast at Santa Cruz. Additional freeways serving the local area are State Routes 85, 87 and 237. During the past two decades, approximately $1.8 billion has been invested by the State and the County to expand and improve the area freeway system.

The Santa Clara Valley Transportation Authority (the "VTA") provides public transit service throughout Santa Clara County, servicing 326 square miles of urbanized area. Transit services are readily accessible to residents of the City, as most residences and businesses in the City are within a quarter mile of bus or light rail service. According to the VTA Comprehensive Annual Financial Report ("VTA CAFR") for fiscal year ended June 30, 2008, VTA's bus network is comprised of 77 bus routes, over 3,789 bus stops, 818 bus shelters, and 8 park-and-ride bus lots. VTA also partners with Altamont Commuter Express (ACE) and Caltrain to provide commuter rail service, with Santa Cruz Metro to provide regional bus service from Santa Cruz to Downtown San José, and with the Dumbarton Express for bus services between the East Bay to northern Santa Clara County work centers and communities. In addition, VTA offers light rail and ACE Train bus shuttles to various worksites and locations.

In the November 2000 election, the voters of the County approved a 30-year, one-half cent sales tax that commenced collection in 2006 upon the expiration of a previously approved one-half cent sales tax. This sales tax will finance various transit projects, including the Silicon Valley Rapid Transit Project (the "SVRT") which is proposed to extend the Bay Area Rapid Transit ("BART") system to the City. BART is a heavy rail rapid transit system currently serving Alameda, Contra Costa, and San Francisco Counties and the northern portions of San Mateo County.

In November 2008, California voters passed Proposition 1A providing $9 billion in initial funding for a statewide high-speed rail system. The proposed first phase of the line would stretch between San Francisco and Anaheim with stations in San José, Gilroy, Merced, Fresno, and Bakersfield, and Los Angeles at an estimated cost of $33 billion. Also, in November 2008, Santa Clara County voters approved a one-eighth of one percent retail sales and use tax as proposed by the VTA to be used for the following specific purpose: to be used by BART to operate, maintain and improve the 16-mile BART extension from Fremont to the County of Santa Clara, with stations in Milpitas, San José, and Santa Clara, connecting with Caltrain from Gilroy to San Francisco, and establishing a People Mover to the Airport. Per the terms of the ballot measure, the tax will be collected only if sufficient State and federal funds are secured to match local construction dollars.

The Airport is located on approximately 1,050 acres of land approximately two miles north of Downtown San José, between the Bayshore Freeway (Highway 101) and Interstate 880. The Airport is a commercial service and general aviation airport and is classified by the FAA as a "medium hub" (an airport that enplanes at least 0.25% but less than 1.0% of the total number of passenger boardings at all commercial service airports in the United States).

Through the first three quarters of FY 2008-09, the Airport served approximately 3.3 million enplaned passengers and accommodated 119,948 operations (takeoffs and landings) compared with 3.9 million enplaned passengers and 139,430 operations for the first three quarters of FY 2007-08. According to preliminary traffic statistics published by the Airports Council International-North America ("ACI-NA"), in calendar year 2008, the Airport was the 41st busiest airport in North America in terms of total passengers and the 55th busiest in terms of total cargo.

In November 2005, the San José City Council approved a comprehensive plan to replace and upgrade the terminal facilities at the Airport. The Terminal Area Improvement Program (the "TAIP") is scheduled to be completed in two phases. The first phase of the TAIP includes, but not limited to, a new Terminal B, upgrades for the existing Terminal A and improvements to the roadway system, and a new consolidated rental car and public parking garage. Some of the Phase 1 major milestones reached as of May 2009 include the completion of six levels of the consolidated rental care garage and the opening of the ticketing lobbies at the new Terminal A

Pursuant to the Airport's lease agreement with its tenant airlines, projects in Phase 2 of the Program have been pre-approved, but construction is contingent on meeting certain activity-based benchmarks. Specifically, the Airport must reach 217 scheduled flights on any one day, or must enplane or deplane at least 12.2 million passengers in any given fiscal year in order to begin Phase 2. Phase 2 of the Program includes an expansion of Terminal B and construction of a new South Concourse facility, adding a total of 12 gates.

San José Municipal Government

The City is governed by the City Council, consisting of a Mayor and ten other council members. The Mayor is elected at large for a four-year term. Council members are elected by district for staggered four-year terms. The Mayor and the council members are limited to two consecutive four-year terms. The City is a charter city, which means the City, through its charter (the "Charter"), may regulate municipal affairs, subject only to restrictions and limitations provided in the Charter; in matters other than municipal affairs or of statewide concern, the City is subject to State law.

The City Council appoints the City Manager who is responsible for the operation of all municipal functions except the offices of City Attorney, City Clerk, City Auditor and Independent Police Auditor. The officials heading these offices are appointed by the City Council and carry out the policies set forth by the City Council.

The City provides a full range of services contemplated by statute or charter, including those functions delegated to cities under State law. These services are organized in five key lines of business - Community and Economic Development, Environmental and Utility Services, Neighborhood Services, Public Safety, Transportation and Aviation Services and Strategic Support. These cross-departmental service areas provide a forum for strategic planning and investment decisions within the context of the Mayor and City Council policy priorities. Plans, policies, and investment decisions are then carried out through departmental core and operational services.

Budget

State Budget

In recent years, the State has experienced significant budget challenges. The State retains the power to reduce revenues from property tax, sales and use taxes, Motor Vehicle License Fees and other revenues payable to the City, and has used such power in recent years to address its budget deficits. Although the passage of Proposition 1A in November 2004 is expected to somewhat constrain the State's ability to divert City revenues in the future, an understanding of the State budget process remains important to understanding the City's financial condition.

State Budget Process. The State's fiscal year begins on July 1 and ends on June 30. The State Constitution requires the Governor to submit a budget for each fiscal year to the Legislature by the immediately preceding January 10 (the "Governor's Budget").

Next, the Legislature considers the Governor's Budget. The Constitution requires the Legislature to pass a budget bill by June 15; however, the Legislature has regularly missed this date in recent years. As a result of the passage of Proposition 58, the Balanced Budget Amendment, in March 2004, beginning with FY 2004-05, the Legislature may not pass a budget bill in which State General Fund expenditures exceed estimated State General Fund revenues and fund balances.

Because more than half of the State's General Fund income is derived from the April 15 personal income tax, the Governor submits a "May Revised Budget" by May 14. The Legislature typically waits for the May Revised Budget before making final budget decisions. Once the Budget Bill has been approved by a two-thirds vote of each house of the Legislature, it is sent to the Governor for approval.

March 2004 Ballot Measures. In order to address a projected deficit of approximately $14 billion dollars in FY 2004-05, the State Legislature placed both Propositions 57 and 58 on the statewide ballot at the March 2, 2004, primary election. The voters passed both Propositions 57 and 58, as described below.

- The California Economic Recovery Bond Act ("Proposition 57"), which authorized the State to issue up to $15 billion of economic recovery bonds to finance the negative State General Fund reserve balance as of June 30, 2004 and other State General Fund obligations undertaken prior to June 30, 2004. Proposition 57 also called for local sales and use taxes to be redirected from local governments to the State, including 0.25% that would otherwise be available to the City, to pay debt service on the economic recovery bonds, and for an increase in local governments' share of local property tax by a like amount. It should be noted that the City continues to record this as sales and use tax revenue.

- The Balanced Budget Amendment ("Proposition 58"), which required the State to adopt and maintain a balanced budget and establish an additional reserve, and restricted future long-term deficit-related borrowing.

During FY 2003-04, the State sold a total of $10.9 billion of the economic recovery bonds, with an additional $3.2 billion sold in FY 2007-08. As of April 1, 2009, the State has $8.7 billion of economic recovery bonds outstanding. Revenue from the 0.25% sales and use taxes securing these bonds was diverted from local governments, including the City, to the State commencing July 1, 2004 but backfilled with an increased allocation of property tax. These revenues will continue to be diverted until the economic recovery bonds (and any additional bonds authorized by Proposition 57) are paid.

FY 2004-05 Budget Act. Governor Schwarzenegger signed the FY 2004-05 Budget Act on July 31, 2004. The major impact of the State Budget on City General Fund revenues for FY 2004-05 was an estimated reduction of $11.4 million comprised of $11.1 million of reduced Motor Vehicle License Fee property tax replacement revenues and $300,000 of lost interest earnings. This reduction, approximately 2.0% of the City's estimated General Fund revenues, was part of a larger structural reform strategy approved by voters in November 2004 as Proposition 1A, which limited these reductions to FY 2004-05 and FY 2005-06.

The FY 2004-05 Budget Act, related legislation and Proposition 1A implemented an understanding negotiated between Governor Schwarzenegger and local government officials concerning the State's control over local government revenues, commonly referred to as the State-Local Agreement ("State-Local Agreement"). These changes include:

- Motor Vehicle License Fee (MVLF). The MVLF rate was reduced from 2% to 0.65% of the market value of the vehicle. The State is required by statute to replace the reduction in MVLF revenues with a corresponding amount of property tax revenues. For FY 2004-05 and FY 2005-06, the replacement property tax revenue to local governments was reduced by $700 million. As stated above, the City's estimated share of this reduction was $11.1 million in both FY 2004-05 and FY 2005-06. See "Major General Fund Revenues Sources – *Miscellaneous Revenues* – Revenue from the State" for a more complete discussion of Motor Vehicle License Fees.

- Sales and Use Taxes. The State cannot reduce the local sales and use tax rate or change the allocation of local sales and use tax revenues. This does not impact the redirection of sales and use tax revenues to repay the economic recovery bonds issued under Proposition 57. However, under Proposition 1A, once the economic recovery bonds are repaid, the redirection of the 0.25% portion of the local sales and use taxes from local governments to the State must end. See "Major General Fund Revenues Sources – *Sales and Use Taxes*."

- Property Taxes. The State is prohibited from shifting to schools or community colleges any share of property tax revenues allocated to local governments under the laws in effect as of November 3, 2004. Any change in the allocation of property tax revenues from one local government recipient to another would require a two-thirds vote of both houses of the State Legislature. In addition, the State cannot reduce the property tax revenues diverted to cities and counties as replacement for the sales and use tax revenues redirected to the State to pay debt service on the bonds authorized by Proposition 57. See "Major General Fund Revenues Sources – *Property Taxes and Assessed Valuations*."

- State Borrowing of Property Tax Revenues. Beginning in FY 2008-09, the State has the ability to divert up to 8% of local property tax revenues for State purposes only if: (i) the Governor declares such action to be necessary due to a State fiscal emergency; (ii) two-thirds of both houses of the Legislature approve the action; (iii) the amount diverted is required by statute to be repaid within three years; (iv) the State does not owe funds, including the MVLF gap repayment and any repayment for past property tax revenue diversions, to local agencies, and (v) such property tax revenue diversions do not occur in more than two fiscal years during any period of ten consecutive fiscal years.

- Re-allocation of Redevelopment Agency Revenues. In both FY 2004-05 and FY 2005-06, the State directed county auditors to shift the allocation of $250 million in property tax revenue from redevelopment agencies statewide to "educational revenue augmentation funds" ("ERAFs") to support schools. The impact to the City's Redevelopment Agency (the "Agency") in FY 2004-05 was $18,626,954 and in FY 2005-06 was $14,500,614. These payments were made through the Agency's participation in the California Statewide Communities Development Authority (CSCDA) ERAF Loan Program. Although the primary source of repayment is the Agency tax increment or other revenues, if the Agency fails to make a scheduled payment on its ERAF Loan the County Auditor will be directed to transfer the first available ad valorem property tax revenues of the City to make the payment. Payments on the ERAF loan are due semi-annually each March 1 and November 1 in an amount sufficient to pay debt service on the next succeeding August 1 and February 1, respectively. The Agency's annual loan payment is approximately $4.5 million. The final loan payment will be due on March 1, 2016. The Agency has made its required payments to date. See "Major General Fund Revenues Sources – *Revenue from Local Agencies*" for information about moneys transferred by the Agency of the City to the City's General Fund.

FY 2005-06 Budget Act. The Governor signed the FY 2005-06 Budget Act on July 11, 2005 (the "FY 2005-06 State Budget"). The impact of the FY 2005-06 State Budget on the City was consistent with the State-Local Agreement in that the revenue to the City from the MVLF property tax replacement revenues was reduced by $11.1 million and reimbursements to local governments for jail booking fees were eliminated.

FY 2009-10 Budget Act. The Governor signed the FY 2009-10 Budget Act on February 20, 2009 (the "FY 2009-10 State Budget"). In order to balance the FY 2009-10 State Budget, the legislature proposed several revenue and borrowing solutions of approximately $6 billion in aggregate that were contingent on voter approval in a May 19, 2009 special election. On May 14, 2009, the Governor sent two versions of his May Revised Budget to the State legislature: the first version contemplating the passage of the May 19^{h} ballot measures and a second version contemplating the rejection of the May 19^{th} ballot measures. Although the first version of the May Revised Budget did not include any proposals that would have materially impacted the City, the second version of the May Revised Budget included a proposal to borrow up to 8% of local government property tax revenues as allowed under the State-Local Agreement. See "Budget – *State Budget* – FY 2004-05 Budget Act." On May 19, 2009, all of the ballot measures related to closing the State budget gap were rejected. If the State amends the FY 2009-10 Budget Act to include borrowing 8% of local government property tax revenues, the City Manager's Office estimates that the impact to the City would be a reduction in Property Tax Revenues of approximately $20 million.

City's FY 2008-09 Budget

On June 17, 2008, the Mayor and City Council approved the 2008-2009 Operating and Capital Budgets for the City of San José (the "2008-2009 Adopted Budget"), which serves as the City's financial plan for the fiscal year that runs from July 1, 2008 through June 30, 2009. At its adoption, the 2008-2009 Adopted Budget totaled $3.3 billion.

The 2008-2009 Adopted Budget was based on the underlying assumption of minimal economic growth in San José, which, as described below, has not been the case. For FY 2008-09, the City faced a seventh year of General Fund shortfalls as the growth in revenues had not kept pace with the growth in expenditures. The 2008-2009 Adopted Budget closed a $29.6 million funding gap in the City's General Fund by identifying additional funding sources of $34.2 million, offset by additional uses of $4.6 million. Of the $34.2 million, it includes the use of $19.6 million of reserves. In this budget, a significant effort was made to solve the budget deficit with ongoing solutions (86%) and to align one-time revenues with one-time expenditures.

On February 10, 2009, the City Council approved the 2008-2009 Mid-Year Budget Review Report and the associated recommended budget actions. The budget actions rebalanced a number of funds with economically sensitive revenues; most significantly, the General Fund and Airport Funds. In the General Fund, net downward adjustments of $9.0 million were made to revenues with a corresponding net downward adjustment in expenditures. General Fund expenditures were reduced primarily through the implementation of Cost/Position Management Plans ($9.4 million) and the elimination of a $5.8 million Street Maintenance and Repair Reserve.

Cost/Position Management Plans are strategies to reduce current year expenditures by delaying the filling of vacant positions and reducing non-personal/equipment expenditures in order to (i) generate additional fund balance to offset current and potentially subsequent year revenue shortfalls and (ii) preserve sufficient position vacancies to provide redeployment flexibility. The Street Maintenance and Repair Reserve was established in October 2008, per City Council policy, with one-half of the General Fund's net available fund balance and was intended to supplement the FY 2008-09 funding for street maintenance of $40.2 million, for an aggregate funding amount of $46.0 million. This Reserve was liquidated to address General Fund rebalancing/ending fund balance needs.

The 2008-2009 Mid-Year Budget Review also included the net elimination of 88.5 positions; comprised of the addition of 6.0 positions in the Environmental Services Department offset by the elimination of 52.0 positions in the Airport Department, 3.0 positions in the Fire Department, 2.0 positions in the Police Department, 28.5 positions in the Public Works Department, and 9.0 positions in the Transportation Department. This is in addition to the 52 positions eliminated in the Planning and Building Development Fee Programs by City Council action on January 27, 2009. In addition to General Fund budget actions, the 2008-2009 Mid-Year Budget Review also included budget actions in several special and capital funds. For example, expenditures were reduced in the Airport Maintenance and Operations Fund primarily through the elimination of 52 positions, of which 6 were filled, and reductions in non-personnel/equipment funding. Significant budget reductions were also brought forward in several capital funds based on lower development-related taxes that primarily support the Traffic Capital Program and lower Construction and Conveyance Tax receipts.

On April 8, 2009, the City Manager's Budget Office released the Monthly Financial Report for January/February 2009, which reported that the severe and unprecedented slowdown in the economy continued to greatly impact revenue collections in the General Fund as well as several other operating and capital funds. The 2008-2009 Mid-Year Budget Review Report included budget actions taken to address these adverse impacts to City revenues. After taking into consideration these budget actions, revenues and expenditures were generally expected to meet the revised budget estimates and the year-end fund balance target.

City's FY 2009-10 Proposed Budget

On November 19, 2008, the City Manager's Budget Office prepared a preliminary forecast for FY 2009-10 which projected a $59.1 million General Fund shortfall (excluding the development fee program). On February 27, 2009, the City Manager released the FY 2010-14 Five-Year Forecast (the "Forecast") which increased the projected FY 2009-10 shortfalls from $59.1 million to $61.2 million. The $2.1 million increase to the projected shortfall resulted from the combined impact of (i) downward adjustments to the revenue estimates of $17.5 million, reflecting the deteriorating economic environment, and (ii) downward adjustments to the base expenditure estimates of $15.4 million based on updated information and a more thorough analysis of base costs.

The Forecast projected that the General Fund will continue to experience persistent budget shortfalls, with deficits totaling $102.8 million projected through the first three years and surpluses of $6.5 million and $10.1 million projected in the last two years of the Forecast. For 2010-2011, it is important to note that increases to the City's contributions to its two pension plans are almost inevitable in light of the investment losses incurred by both plans and will increase the shortfall that year. Estimates for these shortfalls are included in Table 8. See "Pension Plans – *Projections of Contribution Rates and Funded Status for Federated Plan*" and "Pension Plans – *Projections of Contribution Rates and Funded Status for Police and Fire Plan*".

In addition to analyzing the fiscal impact of supporting existing operations in the Five-Year Forecast, the City Administration, at the direction of the City Council, has analyzed the fiscal impact of other unmet needs. This has resulted in a broader definition of a General Fund structural deficit. The General Fund structural deficit is composed of three major components: a deficit due to the fact that operational costs (mainly personnel costs) are rising faster than operational revenues; a deficit in the funded status of the retiree health plan of both of the City's pension plans; and an infrastructure and maintenance backlog (mostly street maintenance) of $5.9 million annually keyed to the City's inability to completely fund replacement and renewal projects. When these costs are included, the General Fund Structural Deficit as of February 2009 was calculated at $115.7 million for the five-year period from 2009-2010 through 2013-2014. The structural deficit calculation assumes that the City cures the deficit entirely with ongoing solutions in each component each fiscal year. It is not a cumulative projection. The estimate for the infrastructure and maintenance costs does not address the one-time backlog projected at over $457 million in the General Fund ($825 million all funds). The Forecast does not include any plan to address these one-time needs.

The Forecast was built on the assumption that the severe recession will continue to impact the region through at least 2009 and probably beyond. With the economically sensitive revenues adjusted downward significantly, expenditure levels of existing General Fund programs are expected to exceed revenue sources in the first three years of the Forecast. The result is projections for persistent General Fund shortfalls in three of the five years of the Forecast.

On April 20, 2009, the City Manager released the 2009-2010 Proposed Capital Budget and 2010-2014 Capital Improvement Program and on May 1, 2009, the City Manager released the FY 2009-10 Proposed Operating Budget (together comprising the "2009-2010 Proposed Budget" or "Proposed Budget"). The 2009-2010 Proposed Budget for the City totals $2.6 billion and represents the financial plan for the fiscal year that runs from July 1, 2009 through June 30, 2010. The Proposed Budget includes a General Fund shortfall estimate of $77.5 million (excluding the development fee program). The development fee program shortfall was estimated at $6.7 million, which increased the total General Fund shortfall estimate to $84.2 million. The $16.3 million increase in the General Fund shortfall from the February 2009 Forecast was attributable primarily to revised property tax estimates driven by the reassessment of properties within the City by the County Assessor. See "Major General Fund Revenues Sources – *Property Taxes and Assessed Valuations*."

In the Proposed Budget, the General Fund shortfall was closed by identifying $35.4 million in additional sources, including use of $20.4 million of reserves and 2009-2010 Beginning Fund Balance to address one-time expenditure, and significantly decreasing expenditures by $48.8 million. The Proposed Budget is balanced based on recommendations for 1) service reductions and eliminations; 2) revenue increases, use of reserves, and funding shifts; 3) costs savings and new service delivery models; and 4) initial steps to flatten the management structure of the organization.

The revenue estimates for the 2009-2010 Proposed Budget were built on an assumption that the regional economy would continue to contract for the remainder of 2009 and that there would be continued weak economic performance into 2010. The current economic downturn is expected to deeply impact the City's largest General Fund revenue sources, Property Tax and Sales Tax, during the upcoming year. Property Tax is expected to decline approximately 7% in 2009-2010 driven by the drop in property assessments. Sales Tax receipts are also expected to decline sharply with a drop of 7% projected in 2008-2009 and an additional 5% decline in 2009-2010. Other General Fund categories that are expected to be significantly impacted include Transient Occupancy Tax, development fees, and interest earnings.

While collections for the City's largest General Fund revenue sources, most notably Property Tax and Sales Tax, are tied directly to economic conditions, there are a number of revenues that are primarily driven by other factors. For instance, growth in the Utility Tax and Franchise Fee categories is typically more heavily impacted by rate changes than economic growth. Collections from local, State and federal agencies are driven by the availability of grant and reimbursement funding, which does not necessarily track the economic cycle.

As part of the FY 2009-10 budget balancing strategies, the total employee count is expected to be reduced to a level roughly equivalent to the City's FY 1997-98 employee count. In the intervening years, the City population has grown to 1,006,892, representing an increase of approximately 13.7%. Since 2002, when the harshest impact of the economic downturn hit the City budget, the net reduction of City positions totals 1,000, representing a decrease of approximately 13.7%. The 2009-2010 Proposed Budget includes a net reduction of 513 positions from the 2008-2009 Adopted Budget. Of the 513 positions, 166 positions were eliminated from Council actions taken during FY 2008-09, many of which were temporary positions.

Similar to the development of the FY 2008-2009 Adopted Budget, the 2009-2010 Proposed Budget is balanced with assumptions about events that have yet to occur, but which could have significant financial impacts on the Proposed Budget. Among these are potential revenue reductions by the State and the as yet unknown cost of new negotiated salary compensation and benefit increases with four of the thirteen bargaining/employee groups.

If the State amends the FY 2009-10 Budget Act to include borrowing 8% of local government property tax revenues as allowed under the State-Local Agreement, the City Manager's Office estimates that the impact to the City would be a reduction in Property Tax Revenues of approximately $20 million. See "Budget – *State Budget* – FY 2009-10 Budget Act." In order to address this additional General Fund revenue shortfall, the City would bring forward options for City Council's consideration including: 1) borrowing funds under the joint powers authority that the State proposes to establish for this purpose, 2) borrowing from other City funds, or 3) addressing the FY 2009-10 resulting shortfall with further expenditure reductions and/or use of reserves.

The City is negotiating salary compensation and benefit increases with four of the thirteen bargaining/employee groups including the International Association of Firefighters (IAFF, Local 230); Association of Maintenance Supervisory Personnel (AMSP); Association of Engineers and Architects (AEA); and Association of Building, Mechanical and Electrical Inspectors (ABMEI). These bargaining/employee groups represent approximately 17.9% of City employees. See "Labor Relations" for more information regarding the status of the City's agreements with bargaining/employee groups.

The 2009-2010 Proposed Budget also includes a series of "Tier 2" proposals that are available should the City Council wish to solve 100% of the budget deficit with ongoing solutions, or to address changes to the balanced Proposed Budget resulting from: substitutions made to recommended actions; potential State actions should the May ballot measures fail; and/or increased employee compensation costs that are beyond the City's control. The Tier 2 proposals include further service reductions and eliminations across the City; including, but not limited to, reductions and eliminations in service delivery departments such as public safety, libraries, and parks.

In addition to presenting a balanced spending plan for FY 2009-10, the 2009-2010 Proposed Budget also included updated 2010-2014 General Fund Forecast figures that incorporated the 2009-2010 Proposed Budget balancing actions as well early projections on potential increases to the City's contributions to the two pension plans. Table 8 summarizes the updated Forecast shortfall, which totals $270.5 million through FY 2013-14.

Table 8
CITY OF SAN JOSE
2010-2014 GENERAL FUND FORECAST UPDATE
(in millions)

	2009-10	2010-11	2011-12[1]	2012-13[1]	2013-14[1]	Total
Projected Base Budget Shortfall (Feb. 2009 Forecast)[2]	$ (61.2)	$ (36.7)	$ (4.9)	$ 6.5	$ 10.1	$ (86.2)
Property Tax/Sales Tax/Other	(16.3)					(16.3)
2009-2010 One-Time Solutions		(2.9)				(2.9)
Potential Pension Plan Increase (Police & Fire/Federated)		(51.7)	(38.7)	(36.0)	(38.7)	(165.1)
Total Incremental Deficit	**$ (77.5)**	**$ (91.3)**	**$ (43.6)**	**$ (29.5)**	**$ (28.6)**	**$ (270.5)**
Total Cumulative Deficit	**$ (77.5)**	**$ (168.8)**	**$ (212.4)**	**$ (241.9)**	**$ (270.5)**	**$ (270.5)**

(1) Funding for cost-of-living salary increases not factored into the last three years of the Forecast. These increases are being treated as a resource allocation policy decision.
(2) Does not include Development Fee Programs. Includes City's share of General Fund annual required contribution for retiree health care benefits and City's share to fully pre-fund the ARC (See "Other Postemployment Benefits – *Phase-In Funding of the ARC for Both Pension Plans*"). Also includes committed additions previously agreed upon by City Council, such as operating and maintenance funding for capital projects coming on line and the addition of 25 officers annually through 2011-2012; however, funding for 25 additional officers has not been included in the 2009-2010 Proposed Operating Budget.
Source: City of San José 2009-2010 Proposed Operating Budget.

The Mayor and City Council held a number of budget study sessions and conduct several public hearings on the Proposed Budget during the month of May. The Mayor will release his FY 2009-10 June Budget Message on June 5, 2009. On June 16, 2009, following a public hearing on June 15, 2009, the City Council will review and take action on the Mayor's June Budget. Final adoption of the 2009-2010 Operating and Capital Budgets is scheduled for June 23, 2009. The 2009-2010 Proposed Budget for the General Fund is summarized in Table 9.

Table 9
CITY OF SAN JOSE
GENERAL FUND BUDGET SUMMARIES
FY 2007-08, FY 2008-09, FY 2009-10 *(in thousands)*[1]

SOURCE OF FUNDS	2007-2008 Actuals	2008-2009 Modified Budget[2]	2009-2010 Proposed Budget[3]
FUND BALANCE			
Encumbrance Reserve	$ 28,678	$ 41,648	$ 41,648
Carryover	247,630	223,651	70,843
Total Fund Balance	276,308	265,299	112,491
GENERAL REVENUES			
Property Tax[4]	203,718	207,392	193,468
Sales and Use Tax	154,002	146,313	135,795
Transient Occupancy Tax	9,560	8,918	6,553
Franchise Fees	41,064	41,621	41,422
Utility Taxes	82,254	83,690	84,959
Telephone Line Tax[5]	0	0	21,600
Licenses and Permits	74,059	71,515	70,862
Fines and Forfeitures	15,601	15,156	17,996
Revenue from Use of Money and Property	17,890	10,753	8,205
Revenue from Local Agencies	49,127	51,217	50,128
Revenue from the State Government[4]	12,314	12,000	8,820
Revenue from the Federal Government	7,409	5,897	222
Departmental Charges	30,842	28,648	30,439
Other Revenue	23,416	21,174	15,462
Total General Revenue	721,257	704,294	685,931
INTERFUND TRANSFERS AND REIMBURSEMENTS			
Overhead Reimbursements	37,680	34,927	37,825
Transfers to the General Fund[5]	51,105	51,082	27,579
Reimbursements for Services	17,698	18,773	17,035
Total Interfund Transfers and Reimbursements	106,484	104,781	82,439
TOTAL SOURCE OF FUNDS	$ 1,104,049	$ 1,074,374	$ 880,862
USE OF FUNDS			
DEPARTMENTAL			
General Government	$ 76,866	$87,716	$79,875
Public Safety	438,259	452,075	445,256
Capital Maintenance	60,595	67,324	63,617
Community Services	127,717	123,027	109,274
Total Departmental	703,437	730,142	698,021
NON-DEPARTMENTAL			
Citywide	93,992	132,633	77,974
Capital Expenditures	10,947	27,126	3,296
Transfers to Other Funds	30,374	38,887	25,603
Encumbrance Reserve	28,678	41,648	41,648
Earmarked Reserves[6]	0	66,717	5,596
Contingency Reserve[6]	0	30,941	28,723
Ending Fund Balance	0	6,280	0
Total Non-Departmental and Reserves	163,991	337,952	182,840
TOTAL USE OF FUNDS	$ 867,428	$1,074,374	$ 880,862

(1) Totals may not add due to independent rounding.
(2) 2008-2009 Modified Budget through March 31, 2009.
(3) Beginning Fund Balance amounts shown in the 2009-2010 Proposed Budget are estimates, as the FY 2008-09 actual ending fund balance amounts were not available at the time the Proposed Budget was prepared.
(4) Property tax revenue received in-lieu of Motor Vehicle License Fee Revenue per the State-Local Agreement is budgeted as Property Tax Revenue, rather than as Revenue from the State.
(5) The Telephone Line Tax was approved by voters on November 4, 2008. On April 1, 2009 the City began collecting the Telephone Line Tax and simultaneously discontinued collection of the Emergency Communications System Support (ECSS) Fee. The ECSS fee was categorized as a transfer to the General Fund. See the "Major General Fund Revenues Sources – *Miscellaneous Revenues* – Telephone Line Tax" and "Major General Fund Revenues Sources – *Interfund Transfers and Reimbursements*."
(6) Actual application of Earmarked and Contingency Reserve amounts are reflected in the Use of Funds categories to which they were applied. At year end, the unexpended Reserve amounts are rebudgeted to the next fiscal year.

Source: City of San José 2009-2010 Proposed Operating Budget.

Land Annexation

In 2006, the City and the County entered into a settlement agreement that requires, among other things, that the City make good faith efforts to initiate and complete the processing of annexations into the City of existing County pockets that are 150 acres or less by April 15, 2011. Additionally, under the settlement agreement, the City agreed to make good faith efforts to initiate the annexation process for County pockets greater than 150 acres by April 15, 2011.

The City has a program in place to process the annexations of County pockets of 150 acres or less over the course of FY 2006-07 through FY 2010-11, with the smaller pockets processed in advance of the larger ones. In the event all of these proposed annexations of 150 acres or less are completed, the City's population would increase by approximately 16,000 residents, or 1.6% of the current population, and the City's acreage would increase by approximately 1,500 acres of land, or 1.3% of the current land area. As of May 2009, the City had completed the annexations of County pockets totaling approximately 672 acres. Under current State law (which sunsets in 2014) annexations of County pockets that are 150 acres or less do not require an election of the residents.

The City has not yet initiated the annexation process for any County pockets greater than 150 acres in size. The City estimates that there are 8 pockets of this size, totaling approximately 3,500 acres. Under current State law, annexation of County pockets greater than 150 acres may, in some cases, require an election of the residents.

The City anticipates that these annexations will result in a net cost for providing ongoing services for fire, police, street maintenance and other City services. In the event that the City Council determines to upgrade facilities, such as streets, to City's current standards, the City will incur additional costs. In FY 2008-09, $85,000 was added in the General Fund to cover the costs associated with maintaining public streets and related infrastructure, such as streetlights, sidewalks, traffic signs, roadway markings, and trees in the County pockets that were annexed. The 2009-2010 Proposed Budget includes additional funding of $116,000 for these costs, which is less than the $298,000 included in the 2010-2014 General Fund Forecast for this purpose. The 2010-2014 General Fund Forecast also factors in the transportation-related annexation costs. In FY 2010-11 and each of the remaining years of the Forecast, this amount totals $478,000.

Major General Fund Revenue Sources

Following is a discussion of the City's principal General Fund revenue sources: Sales and Use Taxes; Property Taxes; Licenses, Permits and Miscellaneous Taxes; Utility Taxes; and Revenue from Local Agencies. In the 2008-2009 Modified Budget, these top five sources of revenue total approximately $560.1 million, representing 79.5% of General Fund general revenues. For FY 2009-10, the Proposed Budget projects these top five sources to total approximately $535.2 million, representing 78.0% of the City's projected General Fund general revenues. It is important to note that for the purpose of this presentation, general revenues, referred to for brevity in the following sections as General Fund revenues, correspond to the items shown under the General Revenues category in Table 9, and do not include Interfund Transfers and Reimbursements, which are discussed separately below. The 2008-2009 Modified Budget represents the 2008-2009 Adopted Budget and any subsequent budget adjustments as approved by City Council through March 31, 2009.

Property Taxes and Assessed Valuations

The assessed valuation of property is established by the County Assessor and reported at 100% of the full cash value as of January 1, except for public utility property, which is assessed by the State Board of Equalization.

The County collects the ad valorem property taxes. Taxes arising from the 1% levy are apportioned among local taxing agencies based on a formula established by State law in 1979. Under this formula, the City receives a base year allocation plus an allocation based on growth in assessed value (consisting of new construction, change of ownership and inflation). Taxes relating to voter-approved indebtedness are allocated to the relevant taxing agency. Beginning in FY 1990-91 (with the adoption of new State legislation), the County deducts the pro-rata cost of collecting property taxes from the City's allocation.

The California Community Redevelopment Law authorizes redevelopment agencies to receive the allocation of tax revenues resulting from increases in assessed valuations of properties within designated project areas. In effect, the other local taxing authorities realize tax revenues from such properties only on base-year valuations that are frozen at the time a redevelopment project area is created. The tax revenues resulting from increases in assessed valuations flow to the redevelopment areas. The City has created redevelopment project areas pursuant to California law. Generally, funds must be spent within the redevelopment areas in which the tax increment revenues were generated, and may only be spent on projects that qualify under California redevelopment law. Table 10 sets forth a ten-year history of the City's assessed valuation.

Table 10
CITY OF SAN JOSE
HISTORICAL END OF FISCAL YEAR ASSESSED VALUE OF PROPERTY
(in thousands)

Fiscal Year	Gross Assessed Valuation[1]	Percentage Change
1998-99	$ 58,440,635	11.35%
1999-00	63,947,881	9.42
2000-01	57,175,296	(10.59)
2001-02	63,975,252	11.89
2002-03	67,915,616	6.16
2003-04	73,077,977	7.60
2004-05	77,532,649	6.10
2005-06	85,234,836	9.93
2006-07	93,616,483	9.83
2007-08	101,093,290	7.99

(1) Valuations as of the end of the fiscal year.
Source: City of San José Comprehensive Annual Financial Report for Fiscal Year Ended June 30, 2008.

Under current County policy, the City's allocation of total ad valorem taxes is received in approximately the following cumulative percentages: 40% by mid-December, 50% by the first week of January, 85% by the third week of April, 90% by the end of April and 100% by the end of June. Property Tax receipts collected for the City by the County are set forth in Table 11.

The County Board of Supervisors approved the implementation of an alternative method of distribution of tax levies and collections and of tax sale proceeds (a "Teeter Plan"), as provided for in Section 4701 et seq. of the California Revenue and Taxation Code. Under the Teeter Plan, the County apportions secured property taxes on an accrual basis when due (irrespective of actual collections) to its local political subdivisions, including the City, for which the County acts as the tax-levying or tax-collecting agency. The County then receives all future delinquent payments, penalties and interest. The Teeter Plan was effective in the County beginning the fiscal year commencing July 1, 1993.

The Teeter Plan is applicable to all tax levies for which the County acts as the tax-levying or tax-collecting agency, or for which the County treasury is the legal depository of tax collections. As adopted by the County, the Teeter Plan excludes Mello-Roos Community Facilities Districts and special assessment districts that provide for accelerated judicial foreclosure of property for which special taxes or assessments are delinquent.

The Teeter Plan is to remain in effect unless the County Board of Supervisors orders its discontinuance or unless, prior to the commencement of any fiscal year of the County (which commences on July 1), the Board of Supervisors receives a petition for its discontinuance joined in by resolutions adopted by at least two-thirds of the participating revenue districts in the County, in which event the Board of Supervisors is to order discontinuance of the Teeter Plan effective at the commencement of the subsequent fiscal year. The Board of Supervisors may, by resolution adopted no later than July 15 of the fiscal year for which it is to apply, after holding a public hearing on the matter, discontinue the procedures under the Teeter Plan with respect to any political subdivision in the County if the rate of secured property tax delinquency in that political subdivision in any year exceeds 3% of the total of all taxes and assessments levied on the secured rolls for that political subdivision. If the Teeter Plan were discontinued subsequent to its implementation, only those secured property taxes actually collected would be allocated to political subdivisions (including the City) for which the County acts as the tax-levying or tax-collecting agency..

Table 11
CITY OF SAN JOSE
PROPERTY TAX RECEIPTS
(in thousands)

Fiscal Year	Property Tax Receipts	Percentage of General Fund Revenues	Percentage Change (Y/Y)
2005-06[1]........	$ 166,560	25.2 %	15.6 %
2006-07[2]........	189,683	27.1	13.9
2007-08[2]........	203,718	28.2	7.4
2008-2009 Modified Budget[2]	207,392	29.4	1.8
2009-2010 Proposed Budget[2][3]	193,468	28.2	(6.7)

(1) Includes motor vehicle license fee (MVLF) property tax replacement revenue, less $11.1 million in FY 2005-06 reflecting the impact of the State's FY 2005-06 Budget Act. See "Budget – *State Budget* –FY 2004-05 Budget Act."
(2) Includes motor vehicle license fee (MVLF) property tax replacement revenue. See "Budget – *State Budget* – FY 2004-05 Budget Act."
(3) If the State amends the FY 2009-10 Budget Act to include borrowing 8% of local government property tax revenues as allowed under the State-Local Agreement, then property tax receipts in FY 2009-10 would be reduced by approximately $20 million. See "Budget – *State Budget* – FY 2009-10 Budget Act" and "Budget – *City's FY 2009-10 Proposed Budget*."
Source: City of San José 2009-2010 Proposed Operating Budget.

Under California law, property owners are entitled to an assessment based on the lower of the fair market value of their property as of property tax lien date (January 1) or the assessed value as determined at the time of purchase or construction, and increased by no more than two percent annually. A reduction of a property's assessed valuation may occur upon the request of the property owner or the County Assessor may unilaterally reduce the assessed valuations of properties in response to declining market values. In the event a property owner's request for a reduction in assessed value is denied, the property may file an appeal.

On April 3, 2009, the County Tax Assessor issued a press release providing preliminary guidance related to property value reassessments and the impact on the 2009-2010 assessment roll. The press release indicated that the decline in the assessment roll for the City may exceed 4% and that the decline was attributable to a combination of factors including changes in ownership in a declining market, new construction, and the 2 percent California CPI limit allowed by Proposition 13.

In preparing its budget, the City forecasts property taxes based on each of the specific categories of receipts (secured and unsecured, current and delinquent receipts, supplemental, and State replacement funds). Secured Property Tax receipts are based on the County Assessor's estimate of growth or reduction in assessed valuation, adjusted for estimates in growth, if any, for redevelopment project areas. Estimates of other property tax receipts are primarily based on historical collections. The estimate of Property Tax receipts in FY 2009-10 takes into account the County Tax Assessor's April 2009 projection regarding the reduction in assessed valuations of property located in the City. Table 12 presents a list of the ten largest taxpayers for FY 2008-09, based on secured assessed valuations, within the City.

Table 12
CITY OF SAN JOSE
TEN LARGEST LOCAL SECURED PROPERTY TAXPAYERS
(in thousands)

Name	Assessed Property Valuation	Percentage of Total
Cisco Technology Inc	$ 1,186,167	1.02%
Blackhawk Parent LLC	979,669	0.84
The Irvine Company	749,807	0.65
Hitachi Ltd	619,013	0.53
Legacy Partners	522,359	0.45
VF Mall LLC	482,459	0.42
Carr NP Properties LLC	400,777	0.34
eBay Inc	379,997	0.33
FRIT San José Town & Country Village LLC	324,965	0.28
Essex Portfolio LP	302,232	0.26
Total Top 10 secured assessed property valuation, FY 2008-09	$ 5,947,445	5.12%
Total City of San José secured assessed property valuation, FY 2008-09	$ 116,171,917	

Source: California Municipal Statistics, Inc.

Sales and Use Taxes

The sales tax is an excise tax imposed on retailers for the privilege of selling tangible personal property. The use tax is an excise tax imposed on a person for the storage, use or other consumption of tangible personal property purchased from any retailer. The proceeds of sales and use taxes (collectively, "Sales Tax") imposed within the boundaries of the City are distributed by the State to various agencies as shown below in Table 13. The total Sales Tax rate for the County of Santa Clara currently is 9.25% and is allocated as follows:

Table 13
CITY OF SAN JOSE
SALES TAX RATES[1]

State – General State – Fiscal Fund	6.00%
State – Fiscal Recovery Fund	0.25
State – Local Revenue Fund	0.50
Local – City of San José	0.75
Local – Santa Clara County	0.25
Public Safety Fund (Proposition 172)	0.50
Sub-Total Statewide Sales and Use Tax	8.25
Santa Clara County Transit District (SCCT)	0.50
Santa Clara County Valley Transportation Authority (SCVT)	0.50
Total	9.25%

(1) The 0.125% increase in sales tax approved by voters in November 2008 to support BART has not yet been implemented. See "Demographic and Economic Information - *Transportation.*"
Source: California State Board of Equalization.

The City's budgeting forecast of Sales Tax receipts is based on State officials' estimates and the forecast of local economists. In addition to the 0.75% Sales Tax to be received by the City in FY 2009-10, the City's budgeting forecast also includes the 0.50% Sales Tax extension under Proposition 172 approved by voters on the November 1993 ballot, property tax in-lieu payments to reimburse the City for reduction in Sales Tax receipts resulting from the passage of Proposition 57, and the redirection of sales tax revenues to pay the State's economic recovery bonds. Table 14 shows Sales Tax receipts and their respective percentage of General Fund revenues since FY 2005-06.

Table 14
CITY OF SAN JOSE
SALES TAX RECEIPTS
(in thousands)

Fiscal Year	Sales Tax Receipts[1]	Percentage of General Fund Revenues	Percentage Change (Y/Y)
2005-06	$ 140,327	21.2 %	5.4 %
2006-07	149,327	21.4	6.9
2007-08	154,002	21.4	2.7
2008-2009 Modified Budget	146,313	20.8	(5.0)
2009-2010 Proposed Budget	135,795	19.8	(7.2)

(1) Includes property tax in-lieu payments to reimburse the City for reduction in Sales Tax receipts resulting from the passage of Proposition 57 and the redirection of sales tax revenues to pay the State's economic recovery bonds.
Source: City of San José 2009-2010 Proposed Operating Budget.

Utility Taxes

The Utility Tax is charged to all users of a given utility (electricity, gas, water, and telephone) other than the corporation providing the utility (e.g., a utility company's consumption of all utilities used in the production or supply of its service is not taxed). Except as described below with respect to the City's new telephone utility user's tax, the consumers of these services pay a tax a the rate of 5% of the utility charges to the utility company that acts as a collection agent for the City. The utility company collects the tax from consumers on a monthly basis and is required to remit that amount to the City by the 25th of the following month. The tax is not applicable to State, County, or City agencies. Also, per State law, insurance companies and banks are exempted from the tax.

On November 4, 2008, voters approved Measure K, a ballot measure that replaced the existing tax on telephone service with an updated telecommunications user's tax. The updated telecommunication user's tax took effect on April 1, 2009 and reduces the 5.0% tax rate to 4.5%, and applies the tax to all intrastate, interstate and international communications services regardless of technology used to provide such services, such as private communication services, voice mail, paging, and text messaging, and continues to tax existing communication services including landline, wireless, Voice over Internet Protocol (VoIP), and bundled services, where taxable and non-taxable services are bundled together.

In connection with placement of the telecommunications user's tax measure on the November ballot, the City Council directed the Finance Department to continue working with large business partners to determine if the new telecommunications user's tax would create a disproportionate financial impact on large businesses and, if so, to provide a mitigation plan to the Council if the ballot measure were approved by the voters. On February 24, 2009, the City Council approved the Finance Department's proposed mitigation plan, and adopted an ordinance amending the new voter approved telecommunications user's tax to cap the maximum amount of telecommunications user's tax payable by customers that meet certain threshold requirements in order to mitigate any disproportionate financial impact on customers. The ordinance went into effect on April 3, 2009, and expires on December 31, 2012, unless extended by the City Council.

In 2007, the California Court of Appeals held that the City of Los Angeles ("Los Angeles") had violated Proposition 218 in its application of its telephone utility user's tax on wireless telephone calls when Los Angeles changed its taxing methodology without voter approval. See *AB Cellular LA LLC v. City of Los Angeles* (2007) 150 Cal.App.4th 747 ("*AB Cellular*"). Since *AB Cellular* was decided, Los Angeles, like the City, sought and obtained voter approval of a ballot measure which reduced and modernized its telephone utility user's tax in order to address, in part, the issues raised by *AB Cellular*. However, in light of the published *AB Cellular* decision, the City could be subject to potential refund claims in connection with revenues derived from wireless calls under the City's former telephone utility user's tax. Even though the City has a tax refund ordinance which limits the refund period to one year, the courts have not definitively ruled on whether claimants can be limited to a one year refund period or may be able to claim a refund for a three year period (which corresponds to the otherwise applicable statute of limitations).

For FY 2006-07, the City's telephone utility user's tax revenue derived from wireless calls was approximately $16.7 million, and for FY 2007-08 the revenue derived from wireless calls was approximately $16.8 million. The City estimates that for FY 2008-09 through March 31, 2009 the tax revenue derived from wireless calls will be approximately $14.8 million. See "Litigation and Significant Claims" for more information regarding claims seeking refunds of the City's former telephone utility user's tax.

Table 15 shows Utility Tax receipts and their respective percentage of General Fund revenues since FY 2005-06.

Table 15
CITY OF SAN JOSE
UTILTY TAX RECEIPTS
(in thousands)

Fiscal Year	Utility Tax Receipts[1]	Percentage of General Fund Revenues	Percentage Change (Y/Y)
2005-06	$ 75,489	11.4 %	3.3 %
2006-07	79,129	11.3	4.8
2007-08	82,254	11.4	3.9
2008-2009 Modified Budget	83,690	11.9	1.7
2009-2010 Proposed Budget	84,959	12.4	1.5

Source: City of San José 2009-2010 Proposed Operating Budget.

Licenses, Permits and Miscellaneous Taxes

This category comprises six major subcategories: business taxes, cardroom taxes, disposal facility taxes, fire permits, building permits and miscellaneous other licenses and permits. Table 16 shows Licenses, Permits and Miscellaneous Taxes receipts and their respective percentage of General Fund revenues since FY 2005-06.

Two cardroom clubs exist in the City. The City imposes an annual "base tax" on each cardroom permittee in an annual minimum amount of $150 per year, plus an additional tax in the amount of $18 per employee based on the average number of employees, not to exceed a maximum of $25,000. In addition, if the annual gross revenue of the cardroom exceeds $10,000, the City imposes a tax equal to 13% of the cardroom's gross revenues. Cardroom tax collections are expected to be approximately $13.2 million in both FY 2008-09 and FY 2009-10, assuming no change in the operation of the cardrooms in those fiscal years.

Table 16
CITY OF SAN JOSE
LICENSES, PERMITS AND OTHER MISCELLANEOUS TAX RECEIPTS
(in thousands)

Fiscal Year	Licenses, Permits and Other Tax Receipts	Percentage of General Fund Revenues	Percentage Change (Y/Y)
2005-06	$ 75,857	11.5 %	3.7 %
2006-07	74,561	10.6	(1.7)
2007-08	74,059	10.3	(0.7)
2008-2009 Modified Budget	71,515	10.2	(3.4)
2009-2010 Proposed Budget	70,862	10.3	(0.9)

Source: City of San José 2009-2010 Proposed Operating Budget.

Revenue from Local Agencies

Revenue from Local Agencies includes reimbursements from the Redevelopment Agency, central fire district payments, and paramedic program payments. The 2009-2010 Proposed Budget of $50.1 million includes $35.1 million from the Agency which covers the following expenses: reimbursement for City staff providing services to Agency projects ($13.9 million); debt service payments on the City of San José Financing Authority Lease Revenue Bonds, Series 2001F Convention Center Refunding Project, (the "Convention Center Bonds"), ($14.7 million); and payment for eligible City expenditures in redevelopment project areas ($6.6 million). The Agency additionally pays for debt service, in an annual amount of approximately $3.3 million on the City of San José Financing Authority Revenue Bonds, Series 2001A (4th & San Fernando Parking Facility Project) (the "Parking Project Bonds"), which is not a General Fund obligation, and therefore is not reflected in the Revenue from Local Agencies budget category. The remaining $15.0 million in the 2009-2010 Proposed Budget is from the following sources: central fire district payments ($6.9 million); paramedic programs payments ($1.8 million); Senior Nutrition Program reimbursement ($1.0 million); and other miscellaneous payments ($5.3 million).

In light of increasing dependence on tax increment revenue from the Agency to support City services provided for redevelopment purposes, the City's General Fund has become significantly exposed to changes in the Agency's fiscal health with respect to repayment of debt service on the Convention Center Bonds, the Parking Project Bonds, and the Agency's payments to the City for City services. Additionally, pursuant to the terms of the Agency's ERAF Loan, the Agency's loan payments are approximately $4.5 million per year through FY 2015-16. In the event that the Agency has insufficient funds to make any of its ERAF Loan payments, the County Auditor is required to deduct the payment from the City's first available ad valorem property taxes.

To the extent that assessed valuations of property located in redevelopment areas are reduced by the County Assessor or through the assessment appeal process, then the tax increment revenues will also be reduced which may have an impact on the Agency's ability to make the payments described above. See "Major General Fund Revenues Sources – *Property Taxes and Assessed Valuations*." In 1986, pursuant to redevelopment law requirements, the City Council adopted an ordinance imposing a limit on the amount of total tax increment revenue the Agency may collect (the "tax increment cap"). The revenue ceiling was set at $7.6 billion. The Agency has provided a covenant to its bondholders that it will annually monitor the tax increment collected. In December 2008, based on tax increment collected to date, the Agency estimated that it will no longer issue bonds after issuing bonds in FY 2009-10 unless its Redevelopment Plans can be amended to increase the tax increment cap. As such, the Agency's Adopted 2008-2009 Capital Budget and Two Year Spending Plan does not project spending after FY 2009-10. If the Agency cannot issue bonds after FY 2009-10 it will result in a significant reduction in redevelopment project activity.

On April 21, 2009, the City Council adopted an ordinance amending the various redevelopment plans to, among other things, increase the tax increment cap to $15 billion. Any legal challenges to the validity of such an amendment must be brought within 60 days of adoption of the ordinance amending the plans.

If the proposed plan amendment is legally challenged, the Agency would not be able to issue debt during the pendency of any litigation, and it could also adversely affect the Agency's ability to spend tax increment on anything other than the payment of existing debt and obligations, including reimbursing the City for the $14.3 million annual payment for the Convention Center Bonds (which represent a General Fund obligation) and the $3.4 million annual payment for the Parking Project Bonds (which, as explained above, do not represent a General Fund obligation) as well as certain City capital projects in redevelopment areas. Table 17 shows Revenue from Local Agencies and their respective percentage of General Fund revenues since FY 2005-06.

Table 17
CITY OF SAN JOSE
REVENUE FROM LOCAL AGENCIES
(in thousands)

Fiscal Year	Revenue from Local Agencies	Percentage of General Fund Revenues	Percentage Change (Y/Y)
2005-06	$ 43,014	6.5 %	(4.5)%
2006-07	45,314	6.5	5.3
2007-08	49,127	6.8	8.4
2008-2009 Modified Budget	51,217	7.3	4.3
2009-2010 Proposed Budget	50,128	7.3	(2.1)

Source: City of San José FY 2009-2010 Proposed Operating Budget.

Miscellaneous Revenues

The following provides a discussion of the remaining General Fund revenues. Included in this category are Revenue from the State; Telephone Line Tax, Franchise Fees; Departmental Charges (permits, fees for use); Revenue from Use of Money and Property (interest income); Transient Occupancy Tax; Fines, Forfeitures and Penalties; Revenue from the Federal Government; and Other Revenues. In the 2008-2009 Modified Budget, these combined sources of revenue total approximately $144.2 million, representing 20.5% of General Fund revenues. In the 2009-2010 Proposed Budget, these combined sources total approximately $150.7 million, representing 22.0% of General Fund revenues.

Revenue from the State. Revenue from the State consists of Motor Vehicle License Fees ("MVLF"), Airplane in-lieu taxes and State grants.

Commencing in FY 2004-05, as a result of the State-Local Agreement, the MVLF rate is reduced from 2% to 0.65% of the market value of the vehicle. Also commencing in FY 2004-05, by State statute, the State is required to allocate to cities and counties property tax revenues in order to make up the difference in revenues as a result of the MVLF rate reduction from 2% to 0.65%. In FY 2006-07 and thereafter, the replacement property taxes will increase at rates corresponding to the rate of increase, if any, in each jurisdiction's gross assessed property value. Additionally, per the amendments to the State Constitution enacted by the passage of Proposition 1A in November 2004, if the MVLF is reduced below 0.65%, then the State must replace the corresponding revenues to cities and counties. Beginning with the 2004-2005 Modified Budget, the MVLF replacement property tax revenue is reflected in the City's budget as Property Tax Revenue, rather than Revenue from the State.

Revenue from the State in the 2008-2009 Modified Budget is approximately $12.0 million, representing 1.7% of General Fund revenues and a decrease of 2.5% from FY 2007-08. Revenue from the State in the 2009-2010 Proposed Budget is approximately $8.8 million, representing 1.3% of budgeted General Fund revenues and a decrease of 26.5% from the 2008-2009 Modified Budget.

Telephone Line Tax. On November 4, 2008, voters approved Measure J, a ballot measure that replaced the existing Emergency Communications System Support (ECSS) Fee with a Telephone Line Tax. The City began collecting the Telephone Line Tax and simultaneously discontinued collecting the ECSS fee on April 1, 2009. The Telephone Line Tax is imposed at the rate of $1.57 per telephone line and $11.82 per commercial trunk line. These rates are lower than the comparable ECSS Fee rates of $1.75 per telephone line and $13.13 per commercial trunk line. The Telephone Line Tax is shown as a new General

Fund revenue line item in the 2009-2010 Proposed Budget whereas the ECSS Fee was shown in prior budget documents as a transfer from the ECSS Fee Fund to the General Fund. See "Major General Fund Revenues Sources – *Interfund Transfers and Reimbursements*."

The City collected ECSS revenues of $21.3 million for FY 2006-07 and $23.8 million for FY 2007-08. For FY 2008-09, the City has collected ECSS fees of $16.6 million and is projecting Telephone Line Tax revenues of $6.4 million, for an aggregate total of $23.0 million. This will result in a shortfall of approximately $1 million as compared to the $24.0 million in the 2008-2009 Modified Budget. The FY 2009-10 Proposed Budget projects revenues from Telephone Line Tax revenues to total approximately $21.6 million, representing 2.6% of budgeted General Fund revenues.

<u>Franchise Fees.</u> Franchise Fees are collected mainly from utility providers for the use of public rights-of-way. Franchise Fees total approximately $41.6 million in the 2008-2009 Modified Budget, representing 5.9% of General Fund revenues and an increase of 1.4% from FY 2007-08. The 2009-2010 Proposed Budget projects revenues from Franchise Fees to total approximately $41.4 million, representing 6.0% of budgeted General Fund revenues and a decrease of 0.5% from the 2008-2009 Modified Budget. Franchise Fees include revenues from electricity, gas and water utility services, commercial solid waste, cable television, and City-Generated Towing and nitrogen pipelines. Actual collections are subject to significant fluctuations from the impact of weather conditions and/or rate changes.

There is an ongoing dispute between Pacific Gas and Electric Company ("PG&E") and the City with respect to the amounts remitted to the City by PG&E for sales of gas and electricity by third party energy service providers to customers in San José ("Surcharges"). The amount in dispute for the period of 2002 through 2005 is approximately $5 million, excluding penalties and interest. In June 2002, the City and PG&E entered into a stipulation in order for the City to pursue its claim outside of PG&E's then pending bankruptcy proceedings. In December 2005, the City sued PG&E for breach of PG&E's franchise agreement, among other claims. The dispute concerns the application of a State statute to the calculation and remittance of the Surcharges. PG&E contends that the State statute permitted PG&E to remit Surcharges to the City that were calculated at a lower rate than the rate specified in its franchise agreement. The trial court ruled in favor of PG&E's motion for summary judgment. Judgment was entered against the City and the City appealed. The appeal is currently pending in the California Court of Appeals.

<u>Departmental Charges.</u> Departmental Charges are approximately $28.6 million in the 2008-2009 Modified Budget, representing 4.1% of General Fund revenues and a decrease of 7.1% from FY 2007-08. The 2009-2010 Proposed Budget projects revenues from Departmental Charges to total approximately $30.4 million, representing 4.4% of budgeted General Fund revenues and an increase of 6.3% from the 2008-2009 Modified Budget.

<u>Revenue from Use of Money and Property.</u> Revenue from Use of Money and Property in the 2008-2009 Modified Budget increased to approximately $10.8 million, representing 1.5% of General Fund revenues and a decrease of 39.9% from FY 2007-08. The 2009-2010 Proposed Budget projects these revenues to total approximately $8.2 million, representing 1.2% of budgeted General Fund revenues and a decrease of 23.7% from the 2008-2009 Modified Budget.

<u>Transient Occupancy Tax.</u> General Fund revenue from the Transient Occupancy Tax in the 2008-2009 Modified Budget is approximately $8.9 million, representing 1.3% of General Fund revenues and a decrease of 6.7% from FY 2007-08. The 2009-2010 Proposed Budget projects revenue from the Transient Occupancy Tax to total approximately $6.6 million, representing 1.0% of budgeted General Fund revenues and a decrease of 26.5% from the 2008-2009 Modified Budget.

Fines, Forfeitures and Penalties. Revenues from Fines, Forfeitures and Penalties in the 2008-2009 Modified Budget are approximately $15.2 million, representing 2.2% of General Fund revenues and a decrease of 2.8% from FY 2007-08. The 2009-2010 Proposed Budget projects revenues from Fines, Forfeitures and Penalties to total approximately $18.0 million, representing 2.6% of budgeted General Fund revenues and an increase of 18.7% from the 2008-2009 Modified Budget.

Revenue from the Federal Government. Revenue from the Federal Government is in the form of various grants received by the City. Revenue from the Federal Government in the 2008-2009 Modified Budget is estimated to be approximately $5.9 million, representing 0.8% of General Fund revenues and a decrease of 20.4% from FY 2007-08. The revenue estimates in this category include only those grant proceeds that are obligated to be paid in the fiscal year. The federal grants payable in FY 2009-10 is estimated at $0.2 million.

Other Revenue. Other Revenue in the 2008-2009 Modified Budget is approximately $21.2 million, representing 3.0% of General Fund revenues and a decrease of 9.6% from FY 2007-08. The 2009-2010 Proposed Budget projects these revenues to be approximately $15.5 million, representing 2.3% of budgeted General Fund revenues and a decrease of 27.0% from the 2008-2009 Modified Budget. Major categories included in Other Revenue are lease payments from the Airport for the debt service on the City of San José Financing Authority Taxable Lease Revenue Bonds, Series 2008F (Land Acquisition Refunding Project), HP Pavilion revenues (parking, arena and suite rentals, and naming rights), investment program reimbursements, Public, Educational and Governmental Access ("PEG Access") Facilities payment from Comcast, and other miscellaneous revenues.

Interfund Transfers and Reimbursements

This source of revenue to the General Fund is estimated at $103.8 million for FY 2008-09. This includes Overhead Reimbursements ($34.3 million), Transfers to the General Fund ($51.7 million) and Reimbursement for Services ($17.8 million). Historically, one of the largest sources of revenue is the transfer from the Emergency Communications System Support (ECSS) Fee Fund, projected to be $26.0 million in FY 2008-09. The ECSS Fee became effective on January 1, 2005, and was enacted to fund approximately 80% of the cost of operating, maintaining and upgrading the City's 911 emergency communication system. The ECSS Fee was charged on landline and cellular telephones with a billing address in the City. On November 4, 2008, the voters approved a measure to replace the ECSS Fee with a Telephone Line Tax, which became effective on April 1, 2009. See "Major General Fund Revenues Sources – *Miscellaneous* Revenues – Telephone Line Tax."

Lawsuits challenging similar fees imposed by other jurisdictions including Union City and, Santa Cruz County have been brought, alleging, among other theories, that these fees violate Proposition 218. In 2008, the California Court of Appeals for the First District held that Union City's fee violated Proposition 218 in that Union City's fee was a special tax that had not been approved by the voters. See *Bay Area Cellular Telephone Company et al., v. City of Union City* (2008) 162 Cal.App.4th 686 ("*Bay Area Cellular*"). The First District Court of Appeals' decision in *Bay Area Cellular* is in conflict with an earlier but unpublished decision involving Santa Cruz County's fee in which the Sixth District Court of Appeals upheld the imposition of the fee. However, the Sixth District Court of Appeals' unpublished decision may not be cited as authority by other litigants.

The ECSS ordinance, in accordance with State law, provides for a one-year period for filing refund claims. To date, no claims have been filed against the City. In the event that the City's ECSS Fee was challenged and a court determined that it violated Proposition 218 or was otherwise unenforceable, and if claims were filed, the City could be liable for refunds of the ECSS Fees. While the City's ECSS ordinance provides for a one year refund period, the courts have not definitively ruled on whether claimants can be limited to a one year refund period or may be able to claim a refund for a three year period (which corresponds to the otherwise applicable statute of limitations).

In addition to the revenue generated from the ECSS Fee, it is projected that $2.0 million will be transferred from the ECSS Fee Fund Ending Fund Balance to the General Fund in FY 2008-09 to cover eligible one-time expenses budgeted in FY 2008-09. In FY 2009-10, a transfer of $2.6 million from the ECSS Fee Fund to the General Fund is included in the 2009-2010 Proposed Budget to reimburse the General Fund for eligible expenditures incurred through FY 2008-09.

The City collected ECSS revenues of $21.3 million for FY 2006-07 and $23.8 million for FY 2007-08. For FY 2008-09, the City has collected ECSS fees of $16.6 million and is projecting Telephone Line Tax revenues of $6.4 million, for an aggregate total of $23.0 million. This will result in a shortfall of approximately $1 million as compared to the $24.0 million in the 2008-2009 Modified Budget. The 2009-2010 Proposed Budget projects revenues from Telephone Line Tax revenues to total approximately $21.6 million, representing 2.6% of budgeted General Fund revenues.

City's Financial Condition; Limitation on Sources of Revenues

There are limitations on the ability of the City to increase revenues payable to the General Fund. Legal limitations generally restrict the ability of cities to raise or increase taxes without voter approval and to increase fees in excess of the amount needed to provide the service or facilities with respect to which such fees are charged, and increases to property-related fees may be subject to majority protest pursuant to Proposition 218. Additional limitations may also be imposed through legislation or initiatives. Furthermore, existing revenues may be subject to certain risk factors. See "Major General Fund Revenue Sources" for more information.

Financial Operations

Financial Statements

Since FY 2001-02, the City has prepared its audited Basic Financial Statements (referred to as General Purpose Financial Statements in previous years) in accordance with Governmental Accounting Standards Board Statement No. 34 (GASB 34). The Basic Financial Statements provide both government-wide financial statements with a long-term perspective on the City's activities while retaining the more traditional fund-based financial statements that focus on near-term inflows, outflows, and balances of spendable financial resources. The government-wide financial statements report on a full accrual basis and include comprehensive reporting of the City's infrastructure and other fixed assets.

Tables 18 and 19 on the following pages summarize financial information contained in the City's General Purpose Basic Financial Statements as of June 30 for FY 2003-04 through FY 2007-08. The tables include information solely on the General Fund of the City and the debt service funds that are funded from General Fund revenues.

Table 18
GENERAL FUND
BALANCE SHEET
FY 2003-04 through FY 2007-08

	2003-04	2004-05	2005-06	2006-07	2007-08
ASSETS					
Cash and Pooled Investments	$ 160,880,388	$ 177,335,733	$ 221,735,443	$ 226,712,766	$246,586,004
Other Investments	--	--	--	--	--
Receivables:					
Taxes	33,739,040	26,904,245	27,619,359	32,078,847	30,970,055
Accrued Interest	1,927,201	2,101,442	3,392,856	4,860,345	4,947,699
Grants	785,236	1,443,154	2,619,467	6,600,384	4,825,492
Loans	2,650,000	2,141,459	2,141,459	2,391,459	2,141,459
Other	14,340,556	15,552,300	17,295,305	15,816,332	17,085,710
Due from Other Funds	2,363,769	3,219,488	10,598,356	34,744,681	19,165,611
Due from Outside Agency	227,937	194,910	245,706	1,896,469	2,765,396
Advances to Other Funds	3,733,754	3,676,030	3,634,522	3,607,282	3,337,934
Advances and Deposits	44,034	116,461	73,761	12,961	12,961
Restricted Assets:					
Cash and Pooled Investments	1,075,617	1,052,978	975,019	932,700	1,023,761
Other Investments	11,371	11,371	79,834	85,526	--
Other Assets	1,032,200	--	--	--	346,736
TOTAL ASSETS	$ 222,811,103	$ 233,749,571	$ 290,411,087	$ 329,739,752	$333,208,818
LIABILITIES AND FUND EQUITY					
LIABILITIES					
Accounts Payable	$ 7,284,004	$ 9,132,077	$ 13,212,020	$ 10,132,718	$10,718,772
Accrued Salaries, Wages and Payroll Taxes	14,359,500	16,384,086	18,990,589	20,929,575	25,862,423
Due to Other Funds	660,240	264,182	44,052	131,338	1,169,051
Due to Outside Agency	535,574	504,787	488,794	301,846	529,138
Deferred Revenue	5,184,201	5,699,248	8,634,963	6,946,365	7,483,910
Advance, Deposits, and Reimbursement Credits	7,203	7,203	7,203	7,203	7,203
Advances from Other Funds	--	--	604,350	250,000	250,000
Other Liabilities	11,441,299	9,726,575	11,459,625	10,443,662	10,055,511
TOTAL LIABILITIES	$ 39,472,021	$ 41,718,158	$ 53,441,596	$ 49,142,707	$56,076,008
FUND EQUITY					
Fund Balances:					
Reserved for Encumbrances	$ 23,153,824	$ 22,517,227	$ 26,362,154	$ 28,678,478	$41,648,273
Reserved for Non-current Advances and Loans	6,427,788	6,998,299	6,904,595	7,029,928	6,862,851
Unreserved:					
Designated for Contingencies	32,466,675	47,022,980	75,972,562	67,176,372	63,839,981
Designated for Future Projects	68,611,596	56,644,732	68,555,104	91,849,562	69,029,254
Undesignated	52,679,199	58,848,175	59,175,076	85,862,705	95,752,451
TOTAL FUND EQUITY	$ 183,339,082	$ 192,031,413	$ 236,969,491	$ 280,597,045	$277,132,810
TOTAL LIABILITIES AND FUND EQUITY	$ 222,811,103	$ 233,749,571	$ 290,411,087	$ 329,739,752	$333,208,818

Sources: City of San José Comprehensive Annual Financial Reports, FY 2003-04 through FY 2007-08.

Table 19
GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
FY 2003-04 through FY 2007-08

	2003-04	2004-05	2005-06	2006-07	2007-08
REVENUES					
Taxes:					
Property Taxes	$ 96,582,328	$ 146,941,749	$ 168,523,127	$ 191,825,613	$203,718,290
Sales Taxes	130,697,574	133,113,434	140,327,107	149,962,080	154,001,942
Utility Taxes	68,454,701	73,081,153	75,488,559	79,129,154	82,254,430
State of California in-lieu Tax[1]	41,455,033	6,011,302	5,817,221	5,910,847	9,244,157
Franchise Taxes	31,712,351	33,721,621	36,759,857	40,415,138	41,063,799
Miscellaneous Taxes	5,711,809	6,408,705	7,688,090	8,600,000	9,560,000
Total Taxes	374,613,796	399,277,964	434,603,961	475,842,832	499,842,618
Licenses, Permits, and Fines	83,630,890	86,517,500	90,351,138	88,611,157	89,655,944
Grants	10,105,250	9,022,374	12,231,773	20,487,739	12,762,108
Subventions	--	--	--	--	--
Charges for Current Services	27,409,778	28,067,256	27,847,331	29,624,325	30,533,402
Interest and Other Revenues	26,940,124	36,536,238	37,515,096	59,718,885	61,613,611
TOTAL REVENUES	$ 522,699,838	$ 559,421,332	$ 602,549,299	$ 674,284,938	$694,407,683
EXPENDITURES					
Current:					
General Government	$ 67,746,951	$ 72,429,603	$ 78,504,837	$ 86,047,864	$86,907,472
Public Safety	317,202,147	332,540,461	341,794,392	368,839,637	416,255,089
Capital Maintenance	40,382,461	37,722,771	37,666,933	43,303,338	50,678,104
Community Services	127,453,426	125,850,098	124,057,227	129,063,357	141,877,817
Sanitation	1,661,991	1,521,806	1,735,317	1,832,698	1,896,091
Other Expenditures	--	--	--	--	--
Capital Outlay	7,888,038	8,691,850	27,288,306	3,921,801	1,468,606
Debt Service[2]:					
Principal	53,237	8,184	--	--	--
Interest	2,093	161	--	--	--
TOTAL EXPENDITURES	$ 562,390,344	$ 578,764,934	$ 611,047,012	$ 633,008,695	$699,083,179
Excess (Deficiency) of Revenues over Expenditures	$ (39,690,506)	$ (19,343,602)	$ (8,497,713)	$ 41,276,243	$(4,675,496)
OTHER FINANCING SOURCES (USES)					
Transfers In	$ 33,020,925	$ 35,686,257	$ 43,814,163	$ 38,072,779	$39,192,371
Loan Proceeds	--	341,930	25,093,930	--	373,930
Transfers Out	(7,644,315)	(7,992,252)	(15,472,302)	(35,721,468)	(38,355,040)
Capital Lease Financing Proceeds	--	--	--	--	--
TOTAL OTHER FINANCING SOURCES (USES)	$ 25,376,610	$ 28,035,935	$ 53,435,791	$ 2,351,311	$1,211,261
Excess (Deficiency) of Revenues and Other Sources over Expenditures and Other Uses	$ (14,313,896)	$ 8,692,333	$ 44,938,078	$ 43,627,554	(3,464,235)
Fund Balance - July 1	197,652,976	183,339,080	192,031,413	236,969,491	280,597,045
Residual Equity Transfer	--	--	--	--	--
Fund Balance - June 30	$ 183,339,080	$ 192,031,413	$ 236,969,491	$ 280,597,045	$277,132,810

(1) Includes MVLF in-lieu. See "Budget – *State Budget* – FY 2004-05 Budget Act."
(2) Excludes debt service funds of the Redevelopment Agency and other debt service funds.
Sources: City of San José Comprehensive Annual Financial Reports, FY 2003-04 through FY 2007-08.

Financial and Accounting Information

The accounts of the City are organized on the basis of funds, each of which is considered a separate accounting entity. The fund financial statements provide information about the City's funds, including fiduciary funds. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are separately aggregated and reported as non-major funds. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures (or expenses) as appropriate. Government resources are allocated and accounted for in individual funds based on the purposes for which they are to be spent and the means by which spending activities are controlled. Separate statements for each fund category – governmental, proprietary and fiduciary – are presented.

All governmental funds are accounted for using the modified accrual basis of accounting. Their revenues are recognized when they become measurable and available. Taxpayer-assessed income, gross receipts and other taxes are considered "measurable" when in the hands of intermediary collecting governments and are recognized as revenue at that time. Anticipated refunds of such taxes are recorded as liabilities and reductions of revenue when they are measurable and their validity seems certain. Expenditures are recognized when a liability is incurred. Exceptions to this general rule include: (1) accumulated unpaid vacation, sick pay, and other employee amounts which are not accrued; and (2) principal and interest on general long-term debt which is recognized when due. All proprietary funds are accounted for using the accrual basis of accounting. Their income is recognized when it is earned and expenses are recognized when they are incurred.

Insurance and Self-Insurance Programs

The City reassesses its insurance coverage annually. Therefore, the City makes no representations that these insurance coverages will be maintained in the future.

The City self insures for liability (other than for the Airport and the Water Pollution Control Plant), personal injury, and workers' compensation. The City currently maintains an all-risk property insurance policy with coverage for City property, including coverage for boiler and machinery exposures. This policy also provides coverage for loss due to business interruption or flood. The City generally does not carry earthquake insurance. A summary of these coverages is provided in Table 20.

Table 20
CITY OF SAN JOSE
SUMMARY OF CITYWIDE INSURANCE COVERAGE
(For Policy period October 1, 2008 – October 1, 2009)

	Coverage Per Occurrence	Deductible Per Occurrence
Property, including Business Interruption[1]	$ 1 billion	$ 100,000
Flood		
Flood Zones A and V	$ 25 million	$ 500,000[2]
Flood Zone B	$ 50 million	$ 100,000[2]
All Other Flood Zones	$ 100 million	$ 100,000[2]

[1] The policy limit for property damage caused by terrorism is $5 million per occurrence and in aggregate.
[2] Deductible applies per location affected.
Source: City of San José, Human Resources Department - Risk Management.

The City has airport liability policies covering the Airport, which provide a $200 million each occurrence combined single limit for bodily injury and property damage, with a $25 million each occurrence limit for personal injury, subject to a per occurrence deductible of $100,000 and in the aggregate. The City also maintains an automobile liability policy covering vehicles associated with the Airport and Water Pollution Control Plant operations. The limit of liability is $1 million for each occurrence for liability, and the City is self-insured for physical damage.

Workers' Compensation and Third Party Liability Claims. As noted above, the City is self-insured and self-administered for workers' compensation with claims paid on a "pay as you go" basis. The City budgets for workers' compensation payouts based on prior year payout history. Over the five-year period of FY 2003-04 through FY 2007-08, the City experienced workers' compensation payouts ranging from a low of $15.3 million to a high of $19.8 million, with the payout from the General Fund averaging approximately 88 percent of the total. The City is also self-insured for third party liability claims other than those involving the Airport and the Water Pollution Control Plant, as described above. All third party liability claims are pursued through the City Attorney's Office. There is an emergency reserve fund of $10,000,000 in the General Fund for both liability and workers' compensation claims.

Unemployment Insurance. The City self-insures to the limits required by State statute. The City budgets for each year's anticipated unemployment insurance claims. By policy, the City also funds a reserve of the same amount in each fiscal year.

Airport Coverages For Phase 1 of the Airport Development Program

Airport Owner-Controlled Insurance Program – North Concourse Project. On March 31, 2004, the City bound certain liability insurance coverages for the major components of the North Concourse project through an owner-controlled insurance program from American International Group, now AIU Holdings, Inc. and AIU LLC ("AIU"). An owner-controlled insurance program ("OCIP") is a single insurance program that provides insurance coverage for construction job site risks of the project owner, general contractors, and all subcontractors associated with construction at the designated project site. The specific coverages, limits, and deductibles are summarized in Table 21 below.

Table 21
CITY OF SAN JOSE
SUMMARY OF AIRPORT OWNER-CONTROLLED
INSURANCE PROGRAM – NORTH CONCOURSE PROJECT

Coverages	Limit	Deductible Per Occurrence
General Liability	$2 million per occurrence $4 million aggregate	$ 250,000
Workers' Compensation	Statutory	$ 250,000
Employers' Liability	$2 million per accident	$ 250,000
Excess Liability	$150 million	

Source: City of San José.

The North Concourse Project has been completed and the policies expired December 31, 2008. Close-out procedures on the North Concourse have begun. All remaining work associated with opening of the facility is either covered by the TAIP (Terminal Area Improvement Project) OCIP as described in the separate section below or is addressed in the contracts for work not covered by the TAIP OCIP by requiring the contractors performing such work to provide insurance coverage naming the City as an additional insured.

The City was also required to establish a claims loss reserve fund for the North Concourse Project in the aggregate principal amount of $3.6 million with an additional $300,000 available in a cash working fund. The claims loss reserve was used to fund the deductible amount of up to $250,000 per occurrence, to a maximum loss exposure to the City of $3.9 million.

Airport Owner-Controlled Insurance Program – Terminal Area Improvement Program. On March 15, 2007, the City bound certain liability insurance coverages for the major components of the Terminal Area Improvement Program through another OCIP (the "TAIP OCIP") procured through AIU. The terms of the TAIP OCIP require the City to fund a claims loss reserve fund with AIU in the amount of $8.9 million which AIU has permitted the City to fund incrementally. Currently, the claims loss reserve fund has a balance of $6.532 million. The specific coverages, limits, and deductibles are summarized in Table 22.

Table 22
CITY OF SAN JOSE
SUMMARY OF AIRPORT OWNER-CONTROLLED
INSURANCE PROGRAM – TERMINAL AREA IMPROVEMENT PROGRAM

Coverages	**Limit**	**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	

Source: City of San José.

Builders' Risk and Owner's and Contractor's Protective Professional Indemnity, Including Contractor's Pollution Liability Policies.

Terminal Area Improvement Program. On July 23, 2007, the City bound the builders' risk coverage for the Terminal Area Improvement Program projects through December 31, 2010 (construction is scheduled for completion on December 31, 2010). The limit on the coverage is $480,539,721 and the budgeted construction cost for the Terminal Area Improvement Program projects is $600,717,460.

Hensel Phelps, under its design-build agreement with the City for the TAIP, has provided a contractor's protective professional liability insurance ("CPPI") policy specific to its design work on the Terminal Area Improvement Program. The CPPI affords vicarious liability coverage for the City and the contractor's pollution liability policy names the City as an additional insured. The limit on the coverage is $5,000,000.

Litigation and Significant Claims

The City is involved in a variety of pending actions. Additionally, there are a number of claims filed against the City. The pending or threatened litigation, described below, is the most significant in terms of potential risk of loss, using a threshold of $10 million.

Significant Litigation

Litigation Related to Watson Park. The City has been sued by fifteen family members alleging damages totaling $19,400,000 (the "Plaintiffs"). The Plaintiffs currently or previously have resided at, or have visited, a home in San José that is located adjacent to the City-owned Watson Park. Watson Park, which was formerly a landfill site, has been closed to the public since 2005, due to the discovery of hazardous materials in the park. The City has undertaken hazardous remediation work at Watson Park and at the homes that are located adjacent to Watson Park, including the home involving the Plaintiffs. The Plaintiffs allege that each has suffered injuries as a result of contamination at the subject home. The City is unable to predict the outcome of this litigation.

The Department of Toxics Substances Control ("DTSC"), the regulatory agency with jurisdiction over the cleanup of Watson Park and the adjacent residential properties, has advised the City that in addition to the remediation that has already been performed on the residential properties and remains to be performed on Watson Park, land use restrictions will need to be recorded against both Watson Park and the residential properties. These restrictions generally prohibit the property owners from disturbing soil on their properties below the level at which the lead contaminated soil was capped, except pursuant to a soil management plan approved by DTSC.

For the purpose of making a settlement offer to the property owners concerning any potential liability for property damages associated with the lead contamination, including the execution and recordation of the land use restrictions, the City has offered to pay the owners of the nine properties, including the property owners involved in the litigation mentioned above, a total of $205,000.

None of the property owners has accepted the City's offer. An attorney representing the owners of seven of the properties has rejected the City's offer on behalf of his clients and has informed the City that his clients will obtain their own appraisals of the impacts on property values due to the remaining contamination and proposed land use restrictions. In September 2008 the City received a summary appraisal for two of the seven properties represented by this attorney and property related compensation demands for those two owners totaling $530,862. On April 27, 2009 the City and the seven properties represented by this attorney participated in a mediation related to the compensation demand of these property owners and discussions continue with the attorney for the property owners. The City is unable to predict the outcome of the current or any future negotiations with the property owners or whether the property owners will pursue litigation against the City related to any diminution in value of their properties.

<u>Water Company Litigation.</u> A private water company in San José sued both the City and the Agency claiming that they have illegally used their respective authority to deny permits, licenses and other authorizations to the water company and its potential customers, in an effort to cause property owners and developers to use the City's Municipal Water System instead of the private water company in two areas of the City. The water company alleged that the City and/or the Agency inversely condemned the water company's property, interfered with its contracts and business opportunities, and violated various provisions of the State Water Code. The water company subsequently agreed to dismiss its case without prejudice while the parties attempt to settle the matter. If a settlement is not reached by the end of the year, the water company can re-file the lawsuit. Discovery concerning the water company's alleged damages was not completed before the case was dismissed. If the effort to reach a settlement fails, and the water company re-files its case and ultimately prevails, the City and the Agency are unable to predict the nature or amount of the damages that can be proven.

<u>Significant Tax Refund Claims</u>

Before Measure K was approved by the voters, the City imposed a Telephone utility user's tax ("UUT") on every person in the City using intrastate telephone communication services. The City's former Telephone UUT is described above in Major General Fund Revenue Sources – *Utility Taxes*. The City's former Telephone UUT, like the telephone utility tax imposed by many other jurisdictions, linked imposition of the tax to the Federal Excise Tax ("FET") and was written before the introduction of new communications technologies and changes to federal law. Utility user's taxes imposed by other California cities that contain language similar to that in the City's former Telephone UUT have been the subject of legal controversy. The City's current Telephone UUT removed outdated language that was the subject of lawsuits in other jurisdictions. However, if the City's former Telephone UUT were challenged, the outdated language could subject the City to significant tax refund claims. On May 25, 2006, the U.S. Treasury Department issued Notice 2006-50 in which it announced it was conceding the legal dispute over whether it should be applying the FET to long distance and bundled telephone communication services, where the charges for the services are based on time only and not time and distance. Consequently, effective August 1, 2006, the IRS no longer applies the FET to long distance and bundled services. A bundled service is local and long distance service provided under a single plan that does not separately state the charges for local telephone service.

On June 27, 2006, in response to Notice 2006-50, the City Council adopted an urgency ordinance which went into effect the same day reaffirming its intent to continue its long-standing practice of applying its Telephone UUT in a manner consistent with the IRS' interpretation of the FET prior to the issuance of Notice 2006-50. The City Council subsequently adopted an identical regular ordinance which became effective on September 8, 2006. The ordinances clarified that the City was not changing its application of its Telephone UUT based on the IRS' decision to discontinue taxing long distance and bundled services in order to resolve legal disputes with telephone customers. Rather, the City would continue to tax intrastate local, long distance, and bundled services based on the IRS' interpretation of the FET prior to May 25, 2006. In light of the *AB Cellular* decision discussed above in "Major General Fund Revenue Sources – *Utility Taxes*," there is a risk that if the City's application of its former Telephone UUT were challenged, a court could rule that the actions the City took in June 2006 violate Proposition 218.

Following the Council's actions in June 2006 with respect to the ordinances, on July 24, 2006, the City's Director of Finance gave notice to approximately 200 telecommunication carriers doing business in the City that the City would continue to apply its Telephone UUT to intrastate telephone communication services consistent with the IRS's interpretation of the FET prior to May 25, 2006. One carrier objected to the July 24 notice, but continues to collect and remit the Telephone UUT to the City, without waiving its rights to seek refunds and other appropriate relief.

On January 29, 2007, the U.S. Treasury Department issued Notice 2007-11, which states that Notice 2006-50 does not affect the ability of state or local governments to impose or collect telecommunication taxes under their respective statutes of government. However, the City is unable to determine at this time what impact, if any, Notice 2007-11 might have on future requests for refunds in connection with revenues derived from the City's former Telephone UUT.

Prior to the IRS's issuance of Notice 2006-50, two telephone customers filed claims with the City seeking refunds of the City's Telephone UUT. Collectively, the two customers seek refunds in the amount of approximately \$2.7 million, claiming among other things, that the City's former Telephone UUT was erroneously applied to package or bundled plans where the charges are exempt under the FET and, accordingly, under the City's former Telephone UUT. On June 2, 2008, the City received a third claim from a telephone customer, seeking a refund of the City's former Telephone UUT in an unspecified amount for what appears to be a one year period between May 2007 and May 2008 on the grounds that it was being charged a tax on communication services which were not subject to the FET and, therefore, not subject to the City's former Telephone UUT. In addition, the telephone customer claimed that the City's post IRS Revenue Notice 2006-50 modification of its former Telephone UUT is unenforceable because it violates Proposition 218.

To date, the City has not taken action on these claims and the claimants have not pursued litigation against the City. However, lawsuits have been filed challenging the authority of other California cities to impose taxes on package or bundled plans where the charges are exempt under the FET, including lawsuits filed against the City of Los Angeles, the County of Los Angeles, and the City of Long Beach. In light of Federal Court decisions regarding the exemption of bundled telephone service plans from the FET and the litigation described herein, the City may be presented with additional requests for refunds in connection with its former Telephone UUT.

Even though the City has a tax refund ordinance which limits the refund period to one year, the courts have not definitively ruled on whether claimants can be limited to a one year refund period or may be able to claim a refund for a three year period (which corresponds to the otherwise applicable statute of limitations).

The City's Telephone UUT revenue (including revenues from landline and wireless calls) for FY 2008-09 is estimated at approximately $27.6 million. Telephone UUT revenue in the 2009-2010 Proposed Budget is expected to decline approximately 4% to $26.5 million. At this time, the City is unable to separately estimate the Telephone UUT revenues derived from long-distance and bundled services from local service. Further, the City is unable to estimate the amount of Telephone UUT revenues that may be subject to refund based on the claim that the telephone service provided was not subject to the FET under the former Telephone UUT.

Labor Relations

Overview

The 2009-2010 Proposed Budget includes approximately 6,472 full-time equivalent authorized positions, including 311 full-time equivalent positions not represented by a bargaining unit. On January 9, 2009, the City Manager notified City employees that staff reductions and layoffs would be required in FY 2008-09 and FY 2009-10 in order to maintain balanced budgets. Under the City's layoff rules, affected employees may retain a different City job through the "bumping" process, or be offered the opportunity for "redeployment" in lieu of layoff. To date, two employees have been separated from City service in FY 2008-09. It is anticipated that during the FY 2009-10, the City will eliminate 285 filled positions and 228 vacant positions, totaling 513 positions compared to the 2008-2009 Adopted Budget. The Association of Building, Mechanical and Electrical Inspectors ("ABMEI") recently agreed to take a 10% reduction in hours and pay for FY 2009-2010, effective June 28, 2009. It is anticipated that the agreement will save up to five inspection services jobs. The new agreement, which will go to the City Council for approval on June 9, 2009, includes that there will be no negative impact to the retirement fund because of the reduction in hours to avoid creating an unfunded liability.

The City has ten recognized employee bargaining units. The representation and agreement dates are shown in Table 23. All bargaining units have current agreements with the exception of Operating Engineers, Local #3 ("OE#3"). The bargaining units that have agreements expiring in FY 2009-10 are the ABMEI, International Brotherhood of Electrical Workers ("IBEW"), City Association of Management Personnel ("CAMP"), and San José Police Officers' Association ("POA"). Employees not represented by a bargaining unit will not receive any compensation changes during the FY 2009-10.

Table 23
CITY OF SAN JOSE
SUMMARY OF LABOR AGREEMENTS

	Agreement Expiration Date	Full-Time Equivalent Employment
Operating Engineers, Local #3 (OE#3)	04/17/2009	789
Association of Maintenance Supervisory Personnel (AMSP)	06/27/2009	85
Association of Engineers and Architects (AEA)[(1)]	06/30/2009	230
International Association of Firefighters (IAFF, Local 230)	06/30/2009	726
Assoc. of Building, Mechanical and Electrical Inspectors (ABMEI)	12/10/2009	57
International Brotherhood of Electrical Workers (IBEW)	03/06/2010	80
City Association of Management Personnel (CAMP)	06/30/2010	407
San José Police Officers' Association (POA)	06/30/2010	1,355
Municipal Employees Federation (MEF)	06/30/2011	2,219
Confidential Employees' Organization (CEO)	09/17/2011	213
Total		6,161

(1) The City has two separate agreements with AEA; the first agreement is related to employees of Unit 41 and Unit 42 and the second agreement is related to employees in Unit 43. Both agreements expire on June 30, 2009.

Source: City of San José, Office of Employee Relations, City Manager's Budget Office.

Under California law, sworn police and fire employees are not permitted to strike. The City Charter provides that police and fire bargaining units have the right to binding interest arbitration of labor disputes once either the City or the applicable bargaining unit declares that the negotiations are at impasse. AEA, CEO, IBEW, MEF, and OE#3 have "no strike" clauses during the terms of their respective agreements. As of mid-May 2009, no agreement has been reached on a successor Memorandum of Agreement ("MOA") between the City of San José and OE#3.

The ABMEI MOA allows the City to notify ABMEI in writing once during the term of the 2007 – 2009 Agreement of its desire to reopen negotiations regarding retiree healthcare benefits. Upon such notice being given, the duly authorized representatives of the parties shall meet and confer in good faith in an effort to reach a mutual agreement with respect to retiree healthcare benefits. If no agreement is reached, the parties will follow the impasse procedures set forth in the City of San Jose's EmployerEmployee Relations Resolution (#39367) and the MeyersMiliasBrown Act. The parties understand that this means that, notwithstanding any other provision of this agreement, the City will have the right to unilaterally implement in the event that no agreement is reached at the conclusion of negotiations and mandatory impasse procedures. The parties also agree that, after declaration of impasse with respect to negotiations over a modification of retiree healthcare benefits, if the City provides notification of implementation, ABMEI has the right to engage in a strike, or such other protected concerted activities on the employees' own time provided such other protected concerted activities do not impede the performance of the employees' assigned duties. Protected concerted activities shall not include partial strikes (such as refusing to work overtime, engaging in a slowdown or accepting some work tasks and refusing to perform others), intermittent strikes and sitdown strikes.

Recently Approved Agreements

The City concluded negotiations with CEO and POA and the respective members have approved the new agreements. The City Council adopted the resolutions approving the terms of the agreements with CEO and POA and authorized the City Manager to execute the agreements with a term of September 21, 2008 – September 17, 2011 for CEO and July 1, 2008 to June 30, 2010 for POA. The ongoing increased annual direct cost of the CEO agreement is approximately $824,846 in the first year, approximately $342,339 in the second year, and approximately $463,354 in the third year. The ongoing increased annual direct cost of the POA agreement is approximately $11.2 million in the first full year of implementation, and approximately $4.5 million in the second year. The cost estimates for both agreements do not include the currently unknown cost increases for healthcare for active employees, increased retirement contributions, and retiree healthcare costs that will be incurred during the term of these agreements.

Status of Current Negotiations

The General Fund Earmarked Reserves for the 2009-2010 Proposed Budget includes a $2.1 million reserve for GASB 43/45 Liability (Retiree Healthcare) and $1.2 million reserve for Salary and Benefit to mitigate the potential fiscal impact pending the outcomes of the negotiations of the contracts with bargaining groups with contracts that expired on June 30, 2009. The Salary and Benefit reserve includes funding for employer contribution rates for health benefits, effective January 1, 2010.

The City's Charter specifies the procedures for binding arbitration of labor disputes between the City and its public safety bargaining units. These procedures would apply in the event that the City and IAFF are unable to reach agreement and impasse is declared. Under the City's Charter, the City and the bargaining unit each select one arbitrator who in turn select a third neutral arbitrator. The neutral arbitrator serves as the Chair of the three-person arbitration board ("Arbitration Board").

The Arbitration Board, at the conclusion of the proceedings, directs each of the parties to submit a last settlement offer on each of the disputed issues. The Arbitration Board is required to decide separately each issue by majority vote by selecting the last offer of settlement on that issue it finds most nearly conforms with those factors traditionally taken into consideration in the determination of wages, hours and other terms of public and private employment. These factors include, but are not limited to: changes in the average consumer price index for goods and services, the wages, hours, and other terms and conditions of employment of other employees performing similar services, and the financial condition of the City and its ability to meet the cost of the award. Because each issue is voted on separately by the Arbitration Board, it is possible that even if the City were to prevail on most of the issues presented, it would still face significant increased costs.

Once the Arbitration Board renders its decision, the Charter provides that the decision is not binding for a ten-day period. During this period, the parties may, by mutual agreement, amend the Arbitration Board's decision. The parties may also agree to extend the ten-day period. Upon the expiration of the ten-day period or the extended period, without amendment by the parties, the Arbitration Board's decision becomes final and binding on the parties. Both parties have responsibility to effectuate the award.

Pension Plans

General

All regular full-time City employees participate in one of two public employee retirement plans established pursuant to the City Charter: the Federated City Employees' Retirement System (the "Federated Plan") and the Police and Fire Department Retirement Plan (the "Police and Fire Plan" and together with the Federated Plan, the "Pension Plans"). Both Pension Plans are structured as defined benefit plans in which retirement benefits are based upon salary and length of service. Both Pension Plans pay cost-of-living increases and all or a portion of health and dental insurance premiums for retirees who qualify.

Participation by covered employees in the Pension Plans is mandatory; employees contribute a percentage of their salaries to the applicable Pension Plan, and the City provides funding through contributions equal to a percentage of its full-time employee covered payroll. The contribution rates for the City and employees are based upon actuarial calculations that take into consideration a number of assumptions, including assumed investment earnings on the valuation assets of the Pension Plans that are used to pay benefits. Each Pension Plan is administered by its own Board of Administration, and day-to-day operations are carried out by the City's Director of the Department of Retirement Services and by the Director's staff.

The information presented hereafter regarding retirement benefits and postretirement healthcare and dental benefits for the Pension Plans excludes assets, liabilities and costs associated with the Supplemental Retiree Benefit Reserves (SRBRs) for the Pension Plans which are described below.

Summary of Pension Plans

A summary of Pension Plan characteristics and actuarial results as of June 30, 2007 is presented below in Table 24. The summary excludes assets, liabilities, and costs associated with the Supplemental Retiree Benefit Reserves, health and dental benefits for both Pension Plans.

Table 24
CITY OF SAN JOSE
SUMMARY OF PENSION PLAN CHARACTERISTICS AND ACTUARIAL RESULTS
As of June 30, 2007

	Federated Plan	Police and Fire Plan
Membership		
Active	3,942	2,136
Deferred	673	71
Retired + Beneficiaries	2,691	1,477
Total	7,306	3,684
Covered Payroll	$ 291,404,606	$ 227,734,449
Calculation of Unfunded Actuarial Accrued Liability (UAAL)[1]		
Actuarial Accrued Liability	$ 1,960,942,729	$ 2,372,385,616
Actuarial Value of Assets	1,622,851,000	2,365,789,857
UAAL	$ 338,091,729	$ 6,595,759
Funded Ratio[1]	82.76%	99.72%
Employer Cost (% of covered payroll)		
Retirement Benefits[2]	18.31%	22.48%
Health and Dental Benefits[3]	5.25	4.19[4]
Total	23.56%	26.67%
Member Cost (% of payroll)		
Retirement Benefits[2]	4.28%	8.33%
Health and Dental Benefits[3]	4.65	3.78[4]
Total	8.93%	12.11%

(1) UAAL and Funded Ratio calculations exclude health, dental, and Supplemental Retiree Benefit Reserves assets and benefits for both Plans.
(2) Indicated contribution rates apply to FY 2008-09 and FY 2009-10. For the Police and Fire Plan, the rates for the employer and member as shown are a blend of the different rates calculated for police officer members and fire department members.
(3) The contribution rates for health and dental benefits only provide partial funding of the liabilities for these benefits.
(4) The Police and Fire Plan Board adopted the Health and Dental contribution rates from the 2005 valuation report in lieu of adopting the lower rates proposed in the actuarial valuation report for the Police and Fire Plan as of June 30, 2007.
Sources: *Report of the Actuarial Valuation of Federated City Employees' Retirement System as of June 30, 2007, dated January 2, 2008; and City of San José Police and Fire Department Retirement Plan Actuarial Valuation Report as of June 30, 2007, dated January 31, 2008.*

It should be noted that recent market turmoil has adversely impacted the investment portfolio of both Pension Plans since June 30, 2007. The net rate of return on the market value for FY 2007-08 was negative 4.0% for the Federated Plan and negative 6.0% for the Police and Fire Plan. For the

period from July 1, 2008 to March 31, 2009, the Federated Plan experienced a negative net rate of return of negative 25.6%, while the Police and Fire Plan experienced a negative 27.2% net rate of return.

The estimated impact on the projected contribution rates and funded ratio of both Pension Plans, due in part to the poor market performance, is discussed below in *Projections of Contribution Rates and Funded Status for Police and Fire Plan* and *Projections of Contribution Rates and Funded Status for the Federated Plan.*

Service Retirement Formulas

The service retirement formulas for both the Police and Fire Plan and the Federated Plan are described below.

Federated Plan. An employee may retire at age 55 with five or more years of service or at any age with 30 years of service. The calculation of the retirement annuity is Final Average Salary (defined below) multiplied by 2.5% per year of service (maximum benefit is 75% of Final Average Salary). For Federated Plan members who retire on or after July 1, 2001, Final Average Salary is the average annual compensation earnable for the highest 12 consecutive months, not to exceed 108% of the second highest 12 consecutive months. For Federated Plan members who retired prior to July 1, 2001, Final Average Salary is the highest compensation earnable during any three consecutive years of service.

Police and Fire Plan. An employee who reaches normal retirement age of 55 with 20 years of service; an employee of age 50 with 25 years of service; an employee of any age with 30 years of service; or an employee of age 70 with no service requirement is entitled to a monthly retirement allowance equal to Final Average Salary (defined below) multiplied by 2.5%, multiplied by years of service up to 30 years (maximum benefit is 75% of final average salary) if the employee retired prior to February 4, 1996. If the employee retired after February 4, 1996, but prior to February 4, 2000, the monthly allowance consists of Final Average Salary multiplied by 2.5% for the first 20 years of service and by 3% for the next ten years (maximum benefit is 80% of final average salary). If the employee retired after February 4, 2000, the monthly allowance consists of Final Average Salary multiplied by 2.5% for the first 20 years of service, by 3% for the next 5 years of service, and by 4% for the next 5 years of service (maximum benefit is 85% of Final Average Salary). Final Average Salary is the highest 12 consecutive months of compensation, not to exceed 108% of compensation paid to the employee during the 12 months immediately preceding the last 12 months of service. Final Average Salary excludes overtime pay and expense allowances. Effective July 1, 2006, police officer members of the Police and Fire Plan receive an increased retirement benefit.

Increase in Retirement Benefits for Police Officer Members. As the result of an agreement between the City and the San José Police Officers' Association ("POA"), members of the Police and Fire Plan who are employed in law enforcement and who retire on or after July 1, 2006, will receive retirement benefits based on an enhanced formula. For these members, the retirement benefits will be 2.5% of Final Average Salary for each of the first twenty years of service credit, plus 4% of Final Average Salary for each year of service credit between 21 and 30 years, subject to a limit of 90% of Final Average Salary.

Increase in Retirement Benefits for Fire Department Members. The City and the International Association of Firefighters, Local 230 ("IAFF, Local 230") proceeded to binding arbitration as required under the City's Charter to resolve various labor disputes. The arbitration board made its award public on August 11, 2007. The arbitration board's award provides that: "Effective July 1, 2008, the service retirement formula will be changed to 3% of final compensation for [sic] year of service once an employee completes twenty (20) years of service to a maximum of 90%."

At its meeting on May 6, 2008, the City Council approved an ordinance implementing this benefit enhancement. The ordinance became effective on June 20, 2008 and the enhanced benefit became effective as of July 1, 2008.

Contributions and their Calculation

The City's actuarially determined contributions have two components, the "normal cost" and the amortized amount of the unfunded actuarial accrued liability ("UAAL"). Normal cost is the portion of the contribution that covers the present value of benefits that the City will be expected to fund that are attributable to current service by covered employees. The covered employees also contribute a portion of the normal cost. The amortization of the UAAL represents the current year's portion of the unfunded actuarial accrued liability costs (i.e., the UAAL) attributable to past years' employment that is charged to the City. The UAAL typically results from investment losses and gains and changes in actuarial assumptions, benefit improvements and other experiences that differ from those anticipated by the actuarial assumptions. Currently, the Pension Plans use the "entry age normal cost method" to calculate the annual normal cost rates of contribution.

Actuarial Valuations

The actuarial valuations for both Pension Plans are prepared on a biennial basis, and, in each actuarial valuation for each of the Pension Plans, the applicable actuary recommends contribution rates for the two fiscal years beginning after the completion of that actuarial valuation. When approved by the respective boards of administration of the Pension Plans, these become the City's and the employees' legally required contribution rates for the fiscal year beginning one year after the valuation date and for the next following fiscal year. For example, the recommended contributions contained in each of the actuarial reports for the Pension Plans as of June 30, 2007 apply to contributions by the City and the employees for the fiscal years beginning July 1, 2008, and July 1, 2009.

UAAL

The UAAL is an estimate based on a series of assumptions that operate on demographic data of the Pension Plan's membership. This process is utilized to determine, as of the date of the calculation, the sufficiency of the assets in the Pension Plan for funding, as of the date of calculation, the accrued costs attributable to currently active, vested terminated (i.e., the deferred members) and retired employees. The funding sufficiency is typically expressed as the ratio of the actuarial valuation of assets to the actuarial accrued liabilities. If the actuarially calculated funding level of a plan is less than 100%, it implies that the plan has a UAAL. Examples of the actuarial assumptions that are used in this process are the assumed rate of earnings on the assets of the plan into the future, the assumed future pay increases for current employees, the assumed rates of disability, the assumed retirement ages of active employees, the assumed marital status at retirement, and the post-employment life expectancies of retirees and beneficiaries. If the plan experience differs from adopted assumptions, the actual contributions could be more or less than the amounts required to pay off the UAAL.

Actuarially Assumed Investment Rates of Return

The net rate of return that is assumed by each Pension Plan's actuary represents the rate that would generate sufficient funds to pay benefits. Consequently, the investment portfolio for the Police and Fire Plan and the Federated Plan need to earn at the gross rate of 8.9% and 9.15%, respectively, in order to pay investment manager fees, administrative expenses and benefits not reserved for, such as the Supplemental Retiree Benefit Reserve transfers. The investment portfolio must earn the gross rates in order to have the net rate available for benefit payments, i.e. in order to break even.

The Pension Plans' investment consultants have provided a median rate of return that that is consistent with the approved asset allocations for each of the Pension Plans. As shown in Table 25, these return rates are significantly below the actuarially assumed investment rates of return. If the actuarial assumed rate of return for the Police and Fire Plan were reduced from 8.0% to 7.5% the UAAL for the retirement benefit would increase by approximately $200 million and the City's annual contribution rate for the retirement benefit would increase by approximately 9% of Police and Fire payroll. A similar impact would be expected for the Federated Plan if the actuarially assumed rate of return were reduced from 8.25% to 7.75%.

Table 25
CITY OF SAN JOSE
ACTURIALLY ASSUMED INVESTMENT RATES OF RETURN

	Actuarial Assumed Rate of Return (Net)	Actuarial Assumed Rate of Return (Gross)	Investment Consultant Forward looking Median Rate of Return (Gross)
Police and Fire Plan	8.00%	8.90%	7.50%
Federated Plan	8.25%	9.15%	7.25%

Sources: City of San José, Retirement Services Department.

"Smoothing" Methodology

When measuring assets for determining the UAAL, many pension plans, including each of the Pension Plans, "smooth" gains and losses to reduce the volatility of contribution rates. If in the two-year period prior to the biennial actuarial valuation the actual net investment return on the Pension Plan's assets is lower or higher than the actuarial assumed rate of return (8.25% for Federated Plan and 8.00% for Police and Fire Plan), then 20% of the shortfall or excess is recognized each year when determining the recommended contribution rates are in that actuarial valuation. This results in the smoothing or spreading of that shortfall or excess over a five-year period. The impact of this will result in "smoothed" assets which are lower or higher than the market value of assets depending upon whether the remaining amount to be smoothed is either a net gain or a net loss. For the Police and Fire Plan, past practice has been to limit the smoothed assets to be no greater than 120% and no less than 80% of the market value of assets. Under this practice, any investment gains or losses that would cause the smoothed assets to fall outside of this 80-120% market value corridor would be recognized immediately rather than be smoothed over the next five years. As of June 30, 2007, as a consequence of smoothing, there were approximately $132.8 million in net gains yet to be realized for the Federated Plan,. Similarly for the Police and Fire Plan, there were approximately $294.3 million in net gains yet to be realized under smoothing method as of June 30, 2007. It is anticipated that future actuarial valuations will incorporate investment portfolio performance and both gains and losses will be "smoothed" as described above. In addition for the Police and Fire Plan, if the market corridor practice remains in place, it is anticipated that some of the recent investment losses would not be smoothed.

Amortization Method and Period

Various plans use differing amortization periods for paying off (or "amortizing") a UAAL. The Federated Plan uses a 30-year open or rolling amortization period which means that in each actuarial valuation, the UAAL is amortized over a 30-year period following each valuation period. With respect to all unfunded liabilities attributable to periods on or before June 30, 2003, the Police and Fire Plan uses an amortization period which ends on June 30, 2017. With respect to all unfunded liabilities attributable to periods after June 30, 2003, the Police and Fire Plan amortizes such unfunded liabilities through a layered amortization method in which unfunded liabilities experienced between biennial valuation dates are amortized over a period ending 16 years following each applicable valuation date. The amortization period could be changed at any time by the boards of the respective Pension Plans, as could the other assumptions and certain methodologies. Such changes could cause the City's obligations to the Pension Plans to be higher or lower in any particular year the board may take this action. The contribution to the UAAL as of the end of a given year (as reflected in an actuarial valuation report) is amortized as a level percentage of payroll.

Actuarial Methods and Assumptions

Investors are cautioned that, in considering the amount of the UAAL, the funded ratio, and the calculations of normal cost as reported by the Pension Plan and the resulting amounts of required contributions by the City, this is "forward looking" information. Such "forward looking" information reflects the judgment of the Board of Administration of the respective Pension Plans and their actuaries as to the amount of assets which the Pension Plan will be required to accumulate to fund future benefits over the lives of the currently active employees, vested terminated employees, existing retired employees, and their beneficiaries. These judgments are based upon a variety of assumptions, one or more of which may prove to be inaccurate or that may change with the future experience of the Pension Plans. The more significant actuarial methods and assumptions used in the calculations of employer and employee contributions for each Pension Plan are summarized in Table 26.

Table 26
CITY OF SAN JOSE
SUMMARY OF KEY ACTUARIAL METHODS AND ASSUMPTIONS
As of June 30, 2007

	Federated Plan	Police and Fire Plan
Actuarial Methods		
Actuarial Cost Method	Entry Age Normal Cost Method	Entry Age Normal Cost Method
Amortization Method	Level Percentage of Payroll	Level Percentage of Payroll
Amortization Period	Open 30-year	Varies[1]
Asset Valuation Method	5-year Smoothed Market (without corridor)	5-year Smoothed Market (with corridor)
Actuarial Assumptions		
Investment Annual Rate of Return[2]	8.25%	8.00%
Annual Cost-of-Living Adjustments for Retirees	3.0%	3.0%
Salary Increases	Salary increase rates are based on years of service as described in the Federated Experience Study as follows: The base annual rate of salary increase is comprised of a 4.00% inflation rate plus 0.25% for wage inflation for a total rate of 4.25%. 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.	Salary increase rates are based on years of service as described in the Police and Fire Experience Study as follows: The base annual rate of salary increase is comprised of a 3.50% inflation rate plus 0.50% for wage inflation for a total rate of 4.00%. This is added to a rate increase for merit/longevity set at 5% for the first five years of service; 2% for years 6 and 7; and 1% for year 8 and beyond.
Active Service, withdrawal, death, disability service retirement	Based on June 30, 2007 Experience Study.	Based on the June 30, 2007 Experience Analysis.
Postretirement Mortality (non-disabled retirees)	1994 Group Annuity Mortality Table (sex distinct)	RP-2000 combined healthy mortality table for males with no collar adjustment, projected for 10 years, set back three years. RP-2000 combined healthy mortality table for females with no collar adjustment, projected for 10 years, set forward one year.

(1) With respect to all unfunded liabilities attributable to periods on or before June 30, 2003, the Police and Fire Plan uses an amortization period which ends on June 30, 2017. With respect to all unfunded liabilities attributable to periods after June 30, 2003, the Police and Fire Plan amortizes such unfunded liabilities through a layered amortization method in which unfunded liabilities experienced between biennial valuation dates are amortized over a period ending 16 years following each applicable valuation date.

(2) The Retirement Services Department has clarified that the Investment Annual Rate of Return is a net rate of return and does not take into account the amounts necessary to fund the administrative and operating expenses of the Pension Plans, the investment management fees, and transfers to the Supplemental Retiree Benefit Reserves for both Plans.

Sources: Report of the Actuarial Valuation of Federated City Employees' Retirement System as of June 30, 2007, dated January 2, 2008; and City of San José Police and Fire Department Retirement Plan Actuarial Valuation Report as of June 30, 2007, dated January 31, 2008.

Funding Status and Contribution Rates For Retirement Benefits

A description of the current funding status of the retirement benefits provided by both Pension Plans is summarized below. As set forth above, the funding ratio for each Pension Plan does not take into account the assets and liabilities related to health and dental benefits or the SRBR for such Pension Plan. The Schedules of the Funding Progress for both Pension Plans are set forth in the Required Supplementary Information Section of the City's Basic Financial Statements for the Fiscal Year Ended June 30, 2008, which is attached as Appendix B to this Official Statement.

The Federated Plan Retirement Benefits. The most recent actuarial valuation of the Federated Plan, as of June 30, 2007, was performed by Gabriel, Roeder, Smith & Company (the "Federated Plan Actuary") and summarized by the Federated Plan Actuary in its report dated January 2, 2008 (the "2007 Federated Actuarial Report"). In the 2007 Federated Actuarial Report, the Federated Plan Actuary concluded that the funded ratio of the Federated Plan as of June 30, 2007, was 82.76%, up from 80.90% as of June 30, 2005. This increase in the funded ratio was primarily attributable to better-than-expected investment returns on the actuarial assets in 2006 and 2007 and the impact of smoothing. Over the last 10 fiscal years, the funded ratio has ranged from a low of 80.90% as of June 30, 2005, to a high of 98.9% as of June 30, 2001. As of June 30, 2007, the Federated Plan had a UAAL of approximately $338.1 million as compared to a UAAL of $326.9 million in the Actuarial Report completed as of June 30, 2005. As of June 30, 2007, the Federated Plan had an actuarial value of assets, exclusive of assets in the health and dental reserve, equal to $1,622.9 million and actuarial accrued liabilities of $1,960.9 million. However, see the discussion below regarding the projected funding status of both Pension Plans in *Projections of Contribution Rates and Funded Status for Police and Fire Plan* and *Projections of Contribution Rates and Funded Status for the Federated Plan.*

Federated Experience Study. On October 19, 2007, the Federated Plan Actuary delivered its Report of an Experience Investigation (the "Federated Experience Study") and reported findings and recommendations from its investigation of the experience of the Federated Plan during the period from July 1, 2001, through June 30, 2007. Based on this investigation, the Federated Plan Actuary did not recommend any changes to the actuarial assumptions used to prepare the retirement valuation. The current assumptions were approved by the Board of the Federated Plan and implemented in the Actuarial Report as of June 30, 2007. Although there had been a slight increase in UAAL occurred due to (1) salaries increasing slightly more than expected and (2) slightly fewer deaths than expected, the Federated Plan Actuary did not recommend any changes in assumptions.

Retirement Benefit Contributions Paid by City. For the five fiscal years ended June 30, 2004 through 2008, exclusive of contributions for health and dental benefits, the City has contributed the following amounts to the Federated Plan: $39.534 million, $41.552 million, $41.267 million, $51.004 million, and $54.958 million respectively.

Contribution Rates. The contribution rates for both the City and the members of the Federated Plan that were established by the 2007 Federated Actuarial Report and the prior report, dated as of June 30, 2005, for both retirement benefits and health and dental care benefits are summarized below in Table 27. The contribution rates applicable to FY 2009 and FY 2010 are the rates established by the 2007 Federated Actuarial Report with respect to the retirement benefit. Increased contribution rates for health and dental benefits, effective in FY 2010, are discussed below in *Contribution Rates for Phase-In of ARC for Federated Plan.*

Table 27
CITY OF SAN JOSE
FEDERATED CITY EMPLOYEES' RETIREMENT PLAN
CHANGES IN CONTRIBUTION RATES
(As Percentage of Covered Payroll)

	June 30, 2005	June 30, 2007
Employer Cost[1]		
Retirement[2]		
Normal Cost Rate	11.37%	11.41%
Rate of Contribution to UAAL	6.79	6.90
Total Retirement	18.16%	18.31%
Health and Dental[3]	3.82	5.25
	21.98%	23.56%
Member Cost[1]		
Retirement[2]	4.26%	4.28%
Health and Dental[3]	3.32	4.65
	7.58%	8.93%
Total Cost	29.56%	32.49%

(1) Represents a percentage of covered payroll. The total covered payroll for employees covered by the Federated Plan as of June 30, 2007, was $291,404,606.

(2) Required annual contributions under the Federated Plan are allocated between the City and the Members of the Federated Plan as follows: (a) the Current Service Rate (the cost of funding liabilities for service after July 1, 1975), as required by the City Charter, is shared 8/3 between the City and the Members; (b) the Current Service Deficiency Rate (the amortization of the funding deficiency for service after July 1, 1975, not covered by the Current Service Rate) is borne entirely by the City; (c) the Prior Service Rate (the difference in costs between the benefit structure in place prior to July 1, 1975, and the benefit structure implemented as of July 1, 1975, for service performed before July 1, 1975, including any cost for gains or losses associated with liabilities for service before July 1, 1975) is shared 58/42 between the City and the Members; (d) the Early Retirement Incentive Program Rates (the cost for funding additional benefits granted to certain retiring employees) is borne entirely by the City; and (e) the Reciprocity Rate (the cost of prefunding the liability associated with the adoption of reciprocal benefits with other public pension plans) is borne entirely by the City.

(3) Required annual contributions for health and dental insurance under the Federated Plan represent the cost for funding, as a level percentage of payroll, based upon a 15-year projection of premiums. For health insurance, the cost is shared 50/50 by the City and the Members, and for dental insurance, the cost is shared 8/3 by the City and the Members.

Source: Report of the Actuarial Valuation of the San José Federated City Employee's Retirement System as of June 30, 2007, dated January 2, 2008.

Police and Fire Department Retirement Plan. The most recent actuarial valuation of the Police and Fire Plan, as of June 30, 2007, was performed by The Segal Company (the "Police and Fire Plan Actuary" or "Segal") and summarized by the Police and Fire Plan Actuary in its report dated January 31, 2008 (the "2007 Police and Fire Report"). In the 2007 Police and Fire Report, the Police and Fire Plan Actuary concluded that the funded ratio of the Police and Fire Plan as of June 30, 2007, was 99.72%, up from 97.81% as of June 30, 2005. This increase in the funded ratio is primarily attributable to favorable investment returns during the two year period ended June 30, 2007. Over the last ten years, the funded ratio has ranged from a low of 97.8% as of June 30, 2005, to a high of 114.8% as of June 30, 2001, taking into account benefit improvements adopted in 1998 and 2000 and the December 2001 implementation of the Police and Fire SRBR (as defined and explained below). As of June 30, 2007, the Police and Fire Plan had the UAAL of approximately $6.6 million as compared to the UAAL of approximately $44.3 million in the Actuarial Report completed as of June 30, 2005. As of June 30, 2007, the Police and Fire Plan had an actuarial value of pension assets equal to approximately $2.366 billion, not including the Police and Fire SRBR, and actuarial accrued liabilities of approximately $2.372 billion. As discussed above, as of June 30, 2007, the Police and Fire Plan had deferred gains of approximately $294.3 million that had not yet been recognized by the asset smoothing method. However, see the discussion below regarding the projected funding status of both Pension Plans in *Projections of Contribution Rates and Funded Status for Police and Fire Plan* and *Projections of Contribution Rates and Funded Status for the Federated Plan.*

Police and Fire Experience Study. On October 9, 2007, Segal issued its Experience Analysis as of July 1, 2007 (the "Police and Fire Experience Study"), in which it reported its findings and recommendations based on its analysis of the experience of the Police and Fire Plan during the period from July 1, 2005, to June 30, 2007. The board of the Police and Fire Plan approved the change of several of the actuarial assumptions used by Segal in the preparation of the Actuarial Report as of June 30, 2007. The Police and Fire Plan's UAAL as of June 30, 2007, was approximately $6.6 million as compared to the UAAL of approximately $44.3 million in the Actuarial Report completed as of June 30, 2005.

Retirement Benefit Contributions Paid by City. For the five fiscal years ended June 30, 2004 through 2008, exclusive of contributions for health and dental benefits, the City has contributed to the Police and Fire Plan: $24.412 million, $41.835 million, $43.473 million, $46.625 million, and $56.372 million respectively.

Contribution Rates. The contribution rates for both the City and the members of the Police and Fire Plan for both retirement and health and benefits that were established by the 2007 Police and Fire Report and the prior report, dated as of June 30, 2005, are summarized below in Table 28. Increased contribution rates for health and dental benefits, effective in FY 2010, are discussed below in *Contribution Rates for Phase-In of ARC for Police Members of the Police and Fire Plan.*

Table 28
CITY OF SAN JOSE
POLICE AND FIRE DEPARTMENT RETIREMENT PLAN CHANGES IN CONTRIBUTION RATES
(As Percentage of Covered Payroll)

	June 30, 2005[1]	**June 30, 2007**[2]
Employer Cost[3]		
Retirement[4]		
Normal Cost Rate	19.79%	22.02%
Rate of Contribution to UAAL	1.63	0.46
Total Retirement	21.42%	22.48%
Health and Dental[5]	4.19	4.19
Total City	25.61%	26.67%
Member Cost[3]		
Retirement	7.48%	8.33%
Health and Dental[5]	3.78	3.78
Total Member	11.26%	12.11%
Total Cost	36.87%	38.78%

(1) Contribution rates were calculated based on the actuarial assumptions used to prepare the Police and Fire Report as of June 30, 2005. The indicated contribution rates do not take into consideration the charge to the Supplemental Retiree Benefit Reserve (which resulted in a decrease of 0.39% in the City's contribution rate for FY 2006-07).

(2) Contribution rates were calculated based on the actuarial assumptions used to prepare the Police and Fire Report as of June 30, 2007. The rates shown were approved by the Board of Administration for the Police and Fire Plan on June 5, 2008.

(3) Represents a percentage of payroll. Total covered payroll was $227,734,449 as of June 30, 2007.

(4) Required annual contributions under the Police and Fire Plan consist of (i) the Normal Cost (the annual cost that if paid annually from a Member's first year of membership through the year of retirement would accumulate to the amount necessary to fully fund the Member's retirement benefits) and (ii) the cost to pay a portion of the UAAL. The Normal Cost, which is shared 8/3 between the City and the Members, has been calculated using an assumed investment earnings rate of 8%, across-the-board salary increases of 0.5% in addition to merit and longevity increases, inflation at the rate of 3.5% per annum, together with other actuarial assumptions adopted by the Police and Fire Board.

(5) Required annual contributions for health and dental insurance under the Police and Fire Plan (including cost of Medicare Part B reimbursement up to the maximum subsidy for health premiums). Contributions represent the cost for funding based upon a cashflow projection of expected premium subsidy cost and future payroll over the next 10 years. The cost for health insurance is shared equally by the City and the Members; the cost of dental insurance is shared 75/25 between the City and the Members. The Board of Administration for the Police and Fire Plan approved maintaining the contribution rate from the Police and Fire Report as of June 30, 2005 and not lowering the rate as recommended in the 2007 Police and Fire Report.

Source: City of San José Police and Fire Department Retirement Plan Actuarial Valuation Report as of June 30, 2007, dated January 31, 2008.

Supplemental Retiree Benefit Reserves

Both Pension Plans include a Supplemental Retiree Benefit Reserve ("SRBR") The terms of each SRBR are described below.

Federated SRBR. Within the assets of the Federated Plan, there is a Supplemental Retiree Benefit Reserve (the "Federated SRBR"). As of June 30, 2008, $27.678 million were on deposit in the Federated SRBR. After the end of each fiscal year, the Board of Administration of the Federated Plan determines the amount of excess earnings (i.e., earnings of the retirement fund after accounting for any investment losses recognized during the year and any administrative costs, and after crediting interest and income to the various accounts and reserves). To the extent there are excess earnings, 90% of the net earnings are transferred to the Plan's General Reserve, and 10% of the net earnings are transferred to the Federated SRBR. At the end of each fiscal year, to the extent that the amount on deposit in the Federated SRBR satisfies certain thresholds, the Federated Plan pays each retiree a lump-sum payment as a supplemental benefit.

A subsequent administrative review of the June 30, 2008, SRBR balance and excess earnings calculation was performed by the Plan's staff that resulted in an adjusted SRBR balance of approximately $19.881 million. The balance adjustment was due to the treatment of unrealized gain/losses, interest crediting, and the inclusion of the Retiree Medical Benefit Fund in the excess earnings calculation. The issues identified resulted in an overstated SRBR balance and over-distribution of SRBR payments for prior fiscal years. The Federated Board has since reviewed the issues and adopted a resolution restating excess earnings for fiscal years 1996-1999 and 2005-2008 resulting in a corrected June 30, 2008, SRBR balance of approximately $19.881 million.

<u>Police and Fire SRBR</u>. Within the assets of the Police and Fire Plan, there is a Supplemental Retiree Benefit Reserve (the "Police and Fire SRBR"). As of June 30, 2008, $27.7 million was on deposit in the Police and Fire SRBR. The Police and Fire SRBR was originally funded through a one-time transfer from the valuation assets of the Police and Fire Plan calculated as of the end of the fiscal year ending June 30, 1999, in the amount of $19,110,300. After that transfer, the Police and Fire SRBR is funded from interest and certain earnings of the Police and Fire Plan, as follows. After the end of each fiscal year, the Board of Administration for the Police and Fire Plan determines the amount of net earnings (i.e. earnings of the retirement fund after accounting for any investment gains and losses recognized during the year and any administrative costs, and after crediting interest and income to the various accounts and reserves). To the extent that the net earnings exceed the net actuarial assumed earnings rate of 8%, the Board declares "excess earnings." Ninety percent of excess earnings are re-invested into valuation assets, and the remaining 10% are transferred to the Police and Fire SRBR. At the end of each calendar year, from the earnings credited to the Police and Fire SRBR, the Police and Fire Plan pays each retiree and each person receiving survivor benefits, a lump-sum payment as a supplemental benefit. For the fiscal year ended June 30, 2008, the amount transferred to the Police and Fire SRBR was $4,580,577. The earnings credited to the SRBR as of June 30, 2008 were determined to be $2,889,186 and this amount was available for distribution during FY 2008-09.

In years where the City's contribution rate will increase as a result of poor investment return on the Police and Fire Plan's assets, as was the case for FY 2004-05 and FY 2006-07, the Police and Fire SRBR accrued principal amount is charged 10% of the City's increased contribution rate, not exceeding 5% of the accrued principal balance of the Police and Fire SRBR. The City's contribution rate for FY 2004-05 was reduced by 0.45% as a result of a charge of $955,515 to the Police and Fire SRBR (5% of the principal balance of approximately $19.1 million as of June 30, 2003). In addition, the City's contribution rate for FY 2006-07 was reduced by 0.39% as a result of a charge to the Police and Fire SRBR. No such reduction of the City's contribution rate occurred in FY 2007-08 and no reductions of the City's contribution rate will occur in FY 2008-09 and FY 2009-10.

<u>Other Postemployment Benefits</u>

<u>Overview.</u> In April 2004, the Governmental Accounting Standards Board ("GASB") issued Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans. Statement No. 43 establishes uniform financial reporting standards for postemployment healthcare and other nonpension benefits ("OPEB") plans. The approach followed in Statement No. 43 is generally consistent with the approach adopted for defined benefit pension plans with modifications to reflect differences between pension plans and OPEB plans. Statement No. 43 became effective for the City's OPEB Plans for the fiscal year ending June 30, 2007.

Additionally, in June 2004, GASB issued Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, which addresses how state and local governments should account for and report their costs and obligations related to OPEB. Statement No. 45 generally requires that employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Statement No. 45's provisions may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial accrued liability is required to be amortized over future periods. Statement No. 45 also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. Statement No. 45 became effective for the City's fiscal year ending June 30, 2008.

Both Pension Plans provide eligible retirees with both health and dental benefits ("Health and Dental Benefits"). For health benefits, the Pension Plans pay that portion of the premium that is equivalent to the premium for the lowest-priced medical plan with which the City contracts for medical benefits for City employees; if the retiree elects a medical plan that is not the lowest-priced plan, the eligible retiree or survivor pays the difference between the portion paid by the applicable Pension Plan and that charged by the medical care provider. In the case of dental benefits, both Pension Plans pay the entire premium.

For the Federated Plan, per the San José Municipal Code, the City and the active employee members of the Federated Plan share the cost of health benefits at a ratio of 50/50, and, with respect to the dental benefits, they share that cost at a ratio of 8/3. For the Police and Fire Plan, per the San José Municipal Code, the City and the active employee members of the Police and Fire Plan share the cost of health benefits at a ratio of 50/50 and, for dental benefits, they share that cost at a ratio of 75/25.

Funding Policy. Until the City entered into agreements with various bargaining groups as described below, contributions for the Health and Dental Benefits for both the City and the participating employees of both Pension Plans were based upon an actuarially determined percentage of employees' base salary sufficient to provide adequate assets to pay benefits when due, over the next 10 years for the Police and Fire Plan, and over the next 15 years for the Federated Plan. The significant assumptions used to compute the actuarially determined contribution requirements are the same as those used to compute the actuarial accrued liability for the defined benefit pension plans; however, the actuary does not base the contribution requirements for the Health and Dental Benefits on a present value determination of all benefits (including those that will be paid beyond the next 10 years for Police and Fire and 15 years for Federated), such as the actuary does with the defined benefit pension plans.

Increased contribution rates for Health and Dental benefits for some, but not all of, the members of both Pension Plans that will become effective in FY 2010, are discussed below in *Contribution Rates for Phase-In of ARC for Federated Plan* and *Contribution Rates for Phase-In of ARC for POA Members of the Police and Fire Plan.*

Health and Dental Contributions Paid by City for Federated Plan. For the five fiscal years ended June 30, 2004 through 2008, the City contributed: $3.938 million, $5.996 million, $5.961 million, $10.728 million, and $11.560 million, respectively, to the Federated Plan for health and dental benefits.

Health and Dental Contributions Paid by City for Police and Fire Plan. For the five fiscal years ended June 30, 2004 through 2008, the City contributed: $4.492 million $6.418 million, $6.529 million, $9.082 million, and $10.618 million respectively, to the Police and Fire Plan for these health and dental benefits.

2006 Postemployment Healthcare Plan Valuations. All numbers stated in this section are based on the Entry Age Normal cost method.

The City's Federated Plan engaged the Federated Plan Actuary to perform an actuarial valuation, as of June 30, 2006, of the Federated Plan's Health and Dental Benefits. The calculations indicate a UAAL of $621.6 million, with a plan funded ratio of 12%. The annual required contribution ("ARC") to fund the liability amount is $38.5 million, with a normal cost of $12.7 million and an amortization payment of $25.8 million dollars. These liabilities and costs were based upon an assumed discount rate of 5.6%.[1]

The City's Police and Fire Plan engaged its actuary to perform an actuarial valuation, as of June 30, 2006, of its Health and Dental Benefits. The calculations indicate a UAAL of $812.8 million, with a funded ratio of 5%. The ARC to fund the liability amounts to $59.8 million as compared to a normal cost of $34.1 million based upon an assumed discount rate of 5.3%.

In the City's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2008 (the "2008 CAFR"), the City, consistent with GASB 45 for the initial year of implementation, elected to report a net OPEB obligation of zero at the beginning of the fiscal year for both Pension Plans. Based on the 2006 valuation, as of June 30, 2008, the net OPEB obligation for the Federated Plan as reported in the 2008 CAFR was $26.9 million, which is the $38.5 million ARC less the $11.6 million contribution made by the City. The net OPEB obligation for the Police and Fire Plan as reported in the 2008 CAFR was $50.7 million, which is the $61.3 million ARC less the $10.6 million contribution made by the City.

Phase-In Funding of the ARC for Both Pension Plans. In 2007 and 2008, the City engaged in a process to determine whether to implement a policy to fully pre-fund the ARC as calculated under GASB 45 for each of the Pension Plans. In connection with this process, the City retained outside counsel to provide advice regarding the legal restrictions on making changes to the Health and Dental Benefits of both retirees and active employees. In a March 2008 memorandum to City employees and retirees, the City Manager announced that because the Health and Dental Benefits can be considered a "vested" benefit, at such time the City Administration would not be recommending a change in these benefits as specified in the Municipal Code.

In June 2008, the City Council directed staff to develop, for City Council consideration, options to fully-pre-fund the ARC for Health and Dental Benefits of both Pension Plans over a multiple year period. The City subsequently entered into agreements with various bargaining groups related to the funding of the Health and Dental benefits Care Plan as described below.

Agreements Related to Federated Plan's Health and Dental Benefits. In April, 2009, the City reached agreements with ABMEI, AEA, AMSP, CAMP, IBEW, MEF, and CEO to phase in full pre-funding of the ARC over a five year period. The terms of these agreements will also apply to unrepresented employees. As of May 22, 2009, no agreement to full pre-fund retiree healthcare has been reached with OE#3.

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[1] The City also engaged an actuary, Bartel & Associates, LLC ("Bartel"), to perform an actuarial valuation, as of June 30, 2007, of the benefit values associated with retiree health benefits paid by the Federated Plan for purposes of labor negotiations with employees covered by the Federated Plan. A final report from Bartel dated July 23, 2007 indicates a UAAL as of June 30, 2007 of $837.8 million. Bartel informed the City that the difference between the UAAL as of June 30, 2006 calculated by the Federated Plan Actuary ($621.6 million) and the UAAL as of June 30, 2007 calculated by Bartel ($837.8 million) is attributable not only to the passage of one year but also to a more conservative set of assumptions.

These agreements provide that the initial unfunded retiree healthcare liability will be fully amortized over a thirty year period so that it will be paid by June 30, 2039. From time to time, the Federated Plan's actuary will update the contributions required to fully pre-fund the ARC by such date.

The 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 contributions and the City cash contribution rate will not have an incremental increase of more than 0.75% of pensionable pay in each fiscal year. For FY 2009-10, the additional increase is projected to be $2.15 million for the City. Notwithstanding these limitations on incremental increases, the agreements further provide that by the end of the five year phase-in the City and the members "shall be contributing the full Annual Required Contribution." in the ratio currently provided" in the relevant sections of the San José Municipal Code.

The agreements also provide that commencing in January 2010, the City will be discussing with ABMEI, AEA, AMSP, CAMP, IBEW, MEF, and CEO issues related to retiree healthcare benefits for future employees and a medical reimbursement program for future retirees.

Agreement Related to Police and Fire Plan's Postemployment Health Care Plan. In February 2009, the City reached an agreement with the POA to fully pre-fund the ARC with respect to the police members over a five year period, subject to the limitations described below. The agreement provides that the initial unfunded retiree healthcare liability will be fully amortized over a thirty year period so that it will be paid by June 30, 2039. From time to time, the Police and Fire Plan's actuary will update the contributions required to fully pre-fund retiree healthcare. As of May 22, 2009, no agreement has been reached with IAFF, Local 230 to fully pre-fund the ARC.

The agreement provides that the five year phase-in of the annual required contributions for police members in the Police and Fire Plan will not have an incremental increase of more than 1.25% of pensionable pay in each fiscal year for the employee contributions and City cash contribution will not have an incremental increase of more than 1.35% of pensionable pay in each fiscal year. For FY 2009-10, the additional increase is projected to be $2.1 million for the City. If at any time the plan member cash contribution rate exceeds 10% of pensionable pay or the City cash contribution rate exceeds 11% of pensionable pay (excluding implicit subsidy), the City and the POA will meet and confer on how to address any retiree healthcare contributions above 10% of pensionable pay for plan members or 11% of pensionable pay for the City. Such discussions will include alternatives to reduce retiree healthcare costs. These limitations may preclude full pre-funding of the ARC within the five year period.

The agreement also provides that on or before September 1, 2009, the City and the POA shall establish a labor/management committee to research and consider approaches to mitigating the cost to both parties of active employee and retiree healthcare benefits. The committee shall study, in addition to any other approaches it deems appropriate, issues of plan design, co-pays and deductibles and a second tier for new employees, and other cost mitigation strategies.

Contribution Rates for Phase-In of ARC for Federated Plan. On May 14, 2009, the Federated Plan's Board approved the contribution rates for the City and the members of the Federated Plan to implement the agreements to phase-in full pre-funding of the ARC. The approved contribution rates, expressed as a percentage of payroll, are 5.07% for the employees and 5.70% for the City. These rates are effective only for FY 2010. Contribution rates for subsequent fiscal years will require approval by the Federated Plan Board. The approved contribution rate will apply to the members of OE#3 only if OE#3 and the City reach an agreement regarding their application to OE#3 members.

Contribution Rates for Phase-In of ARC for Police Members of the Police and Fire Plan. On May 7, 2009, the Police and Fire Board approved new contribution rates for the City and the police members of the Police and Fire Plan. These rates are effective for FY 2010. Contribution rates for subsequent fiscal years will require approval by the Police and Fire Board.

The approved contribution rates, expressed as a percentage of payroll, are 6.04% for the employees and 6.66% for the City. The contribution rates were based on the 2006 valuation of the Police and Fire Plan's Health and Dental Benefits prepared by Segal. Segal had prepared a valuation of the Police and Fire Plan's Health and Dental Benefits, dated as of June 30, 2007, but those valuation results were not used in calculating the contribution rates for FY 2010 as the valuation had assumed that both the Police and Fire Department members would participate in the cost-shared assumed in the valuation.

<u>Health and Dental Benefits Valuations for Purposes of Financial Reporting</u>. The Boards for both Pension Plans have directed their respective actuaries to prepare valuations of their respective Health and Dental Benefits that comply with the provisions of GASB 43 and GASB 45 for purposes of the 2009 CAFR for the City and for the respective CAFRs for the Pension Plans.

<u>Projected City Costs.</u> If the City chooses to fully-prefund Health and Dental Benefits for members of both Pension Plans, the contribution amounts over the next five-year period of a phase-in of the annual required contributions are projected to be $12,932,000 in FY 2009-10 and are projected to increase to $30,689,000 in FY 2013-14 for a cumulative total of approximately $107,476,000 for the five-year period.

<u>Police and Fire Plan</u>. The City's total proposed employer contribution with respect to retirement, including health and dental benefits, to the Police and Fire Plan for FY 2009-10 is approximately $61.7 million. In addition, a portion of the $2.1 million that is held in reserve for the GASB 43/45 Liability (Retiree Healthcare) will be transferred to the Police and Fire Plan as part of the City's 1st year of a 5-year plan to phase-in the City's share of the annual required contribution for retiree healthcare benefits for Fire sworn employees. The City's share for the first year's costs of Police sworn employees is already included in the $61.7 million budget. The City's contribution is 100% paid by the General Fund, with a small portion reimbursed by the Airport. In FY 2008-09, it is estimated that the City's contribution will be approximately $58.7 million.

<u>Federated Plan</u>. The City's total employer contribution with respect to retirement, including health and dental benefits, to the Federated Plan for FY 2009-10 is approximately $69.2 million. In addition, a portion of the $2.1 million that is held in reserve for the GASB 43/45 Liability (Retiree Healthcare) will be transferred to the Federated Plan as part of the City's 1st year of a 5-year plan to phase-in the City's share of the annual required contribution for retiree healthcare benefits. In FY 2008-09, the City's contribution was approximately $66.2 million.

<u>Projections of Contribution Rates and Funded Status for Police and Fire Plan</u>

In March, 2009, Segal prepared 20-year projections of the contribution rates for the retirement benefits and Health and Dental Benefits for Police and Fire members, starting with the results from its 2007 Police and Fire Report and its valuation of the Police and Fire Plan's Health and Dental Benefits, dated as of June 30, 2007. As noted above, the results of the valuation of the Police and Fire Plan's Health and Dental Benefits, dated as of June 30, 2007 were not used in the calculation of the contribution rates Health and Dental Benefits for FY 2010.

The main purpose of these projections was to analyze the impact on the contribution rates of unfavorable market rates of return after June 30, 2007. The projections also showed the impact of different scenarios; one scenario showed the impact of a decrease in the investment return assumption, another scenario showed the impact of a change in the asset smoothing method, other scenarios showed the impact of additional investment losses.

These projections illustrate that by the June 30, 2013 valuation date, the total employer plus member contribution rates for the retirement and Health and Dental Benefits combined could exceed 100% of payroll, compared to 38.78% as of June 30, 2007. In addition, it is projected that the funded percentage for the Retirement Plan could drop from almost 100% as of June 30, 2007 to a level ranging between 63% and 77% as of June 30, 2013.

As shown above in Table 24, the UAAL for the Police and Fire Plan was about $7 million as of June 30, 2007, excluding health, dental and SRBR assets and benefits. Based on Segal's projection study, the UAAL may increase to as much as $1.5 billion as of June 30, 2013.

Segal notes that projections, by their nature, are not a guarantee of future results. The modeling projections are intended to serve as estimates for future financial outcomes that are based on the information available at the time the modeling is undertaken and completed, and the agreed-upon assumptions and methodologies described in Segal's March 25, 2009 and March 30, 2009 letters. Emerging results may differ significantly if the actual experience proves to be different from these assumptions or if alternative methodologies are used. Actual experience may differ due to such variables as demographic experience, the economy, stock market performance, and the regulatory environment.

Projections of Contribution Rates and Funded Status for the Federated Plan

The Retirement Services Department has projected that as a result of the investment losses incurred from July 1, 2008 to March 31, 2009 and the phase-in of fully prefunding the ARC, a significant increase in the level of the City's contribution is expected. The total employer plus member contribution rates for both retirement benefits and the Postemployment Healthcare Plan combined could exceed 100% of payroll as of June 13, 2013, as compared to 32.49% as of June 30, 2007. In addition, it is projected that the funded percentage for retirement benefits could drop from almost 82.8% as of June 30, 2007 to a level as low as 50% as of June 30, 2013. These projections are based on the assumptions and methodology currently employed by the Federated Actuary.

Report on the Financial Status of the Pension Plans

On January 13, 2009, the City Council considered and accepted a report from the Director of the Department of Retirement Services regarding the financial status of the Pension Plans (the "Status Report"). The Status Report was prepared at the direction of a City Council committee in light of the investment losses sustained by the Pension Plans during the period from January 1, 2008 to November 30, 2008.

The Status Report provided the following information:

- Throughout the five-year period ending on September 30, 2008, the Federated Plan's investment performance has ranked in the second and third quartiles of the Independent Consultants Cooperative Universe and the fund universe prepared by Wilshire's Trust Universe Comparison Service and the Police and Fire Plan's investment performance has ranked in all four quartiles of these benchmarks.

- Throughout the same five-year period, both Pension Plans consistently underperformed the "Policy Index" return established by the Federated Plan's Board. The Policy Index return is the return that the asset allocation would have achieved with passive managers who attempt to replicate the benchmark applicable to the particular type of investment. Active management of the Federated Plan's investments has resulted in a lower investment return than the Policy Index return.

Additionally, the Status Report reported that over the 10-year period ending on September 30, 2008, the Federated Plan and the Police and Fire Plan, in the aggregate, underperformed the earnings that would have been achieved at their respective actuarially assumed rates of return by approximately $1.7 billion of which approximately $0.7 billion predates the losses sustained in the third quarter of 2008. The Status Report concluded that large underperformance over a period of ten years or longer is an indication that the actuarial assumed rates of return are inappropriately high. Further, the adoption of more conservative assumed rates of return would increase the normal cost and the immediate UAAL contribution rate of the Pension Plans. However, it may reduce the potential for additional increases to the UAAL in future valuations.

The approval of the actuarial assumed rate of return for each Pension Plan rests with its respective board. At this time, it is unknown whether either board will consider modifying the actuarial assumed rate of return.

Investment Policy and Practices of the City

The City and its related entities are required to invest all funds under the Director of Finance's control in accordance with principles of sound treasury management and in accordance with the provisions of the California Government Code, the Charter, the City Municipal Code and the City Investment Policy (the "Policy"). The Policy was originally adopted by the City Council on April 2, 1985 (Resolution No. 58200) and is reviewed annually by the City Council. The City Council [will review] the proposed revisions to the Policy on June 2, 2009. Proposed revisions to the City's Investment Policy include: updating job titles of the City Investment Officials; adding language in the authorized investments section to clarify and modify certain percent restrictions; removing the requirement that the average maturity of the investment portfolio not exceed two years; updating of the List of the Primary Government Securities Dealers; and making other clarifying changes. Upon approval of the City Council, the Investment Policy will be submitted to The Association of Public Treasurers of the United States and Canada ("APT US & C") for recertification that the policy is a professionally accepted policy based on the standards developed by APT US & C.

The primary objectives of the Policy, in their order of priority, are to (1) provide for the safe preservation of principal, (2) ensure that there is sufficient liquidity for operating needs, and (3) attain the maximum yield possible as long as investment practices are consistent with the first two stated objectives.

Current Investment Portfolio

As of March 31, 2009, the book value of the City's pooled investment fund was $1,018,386,338, while the market value was $1,039,731,933. The composition of this fund, including the weighted average days to maturity and yield, is provided in Table 29. The General Fund portion of the pool was approximately 16.40% as of March 31, 2009.

With respect to potential loss of principal on any of the City's investments, the Policy limits the composition of the holdings within the Investment Portfolio. Those limitations include the ability to hold medium-term notes within the criteria enumerated in the Policy. The City's holdings as of March 31, 2009 included $29,919,250 medium term notes. These notes were purchased under the FDIC's Temporary Loan Guarantee Program which offers "full faith and credit of the US Government", and meets the criteria in the Policy. The Finance Department's investment staff continues to focus investment decisions in accordance with the Policy's primary investment objectives as described above in "Investment Policy and Practices of the City".

Table 29
CITY OF SAN JOSE POOLED INVESTMENT FUND
GENERAL POOL INVESTMENTS(4)
As of March 31, 2009

	Book Value	Percent of Portfolio	Market Value	Weighted Average Days to Maturity	Weighted Average Yield
U.S. Treasury Bills and Notes...	$ 0	0.0%	$ 0	0	0.000%
Federal Agency Securities(1)......	820,803,999	80.6	842,298,283	428	3.409
Medium Term Notes (corp.)......	29,919,250	2.9	29,919,250	954	2.859
Bankers Acceptance	0	0.0	0	0	0.000
Commercial Paper.....................	47,663,089	4.7	47,649,335	69	0.887
Repurchase Agreements............	0	0.0	0	0	0.000
Neg. Certificate of Deposit........	40,000,000	3.9	39,865,064	82	1.305
Money Market Mutual Fund	0	0.0	0	0	0.000
State of California LAIF(2)	80,000,000	7.9	80,000,000	1	1.822
Total(3)	$ 1,018,386,338	100.0%	$1,039,731,933	380	3.075%

(1) Composed only of Federal Home Loan Bank (FHLB), Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC), and Federal Farm Credit Bank (FFCB) securities.
(2) Estimated based upon City's participation in the Local Agency Investment Fund (LAIF). Weighted average yield for LAIF is based upon the most recently reported quarterly earnings rate.
(3) Totals may not add due to independent rounding.
(4) Excludes funds invested in separate, segregated accounts as part of City held invested funds; excludes bond proceeds held by fiscal agents/trustees.
Source: City of San José, Finance Department.

Debt Management Policy

The City Council adopted a Debt Management Policy for the City on May 21, 2002 (Resolution #70977). The policy allocates responsibility for debt management activities to the Finance Department, describes the purposes for which debt may be issued, and establishes overall parameters for issuing and administering the City's debt.

Bonded and Other Indebtedness

The City may issue general obligation bonds for the acquisition and improvement of real property subject to the approval of the voters voting on the bond proposition. In accordance with all relevant provisions of law, the City is obligated to levy ad valorem taxes upon all property within the City subject to taxation by the City, without limitation of rate or amount (except with respect to certain personal property that is taxed at limited rates), for the payment of all outstanding general obligation bonds and the interest thereon. The City is obligated to direct the County of Santa Clara to collect such ad valorem taxes in such amounts and at such times as is necessary to ensure the timely payment of debt service on the general obligation bonds (See "Major General Fund Revenue Sources – Property Taxes and Assessed Valuations" herein). As of June 30, 2009, the City anticipates having issued $589,890,000 in general obligation bonds. Table 30 below summarizes the various voter authorizations for general obligation bonds.

Table 30
CITY OF SAN JOSE
GENERAL OBLIGATION BONDS
Projected as of June 29, 2009

Date of Election	Projects	Amount Authorized	Amount Issued	Amount Authorized but Unissued
11/07/2000	San José Neighborhood Libraries Bonds	$ 211,790,000	$ 205,885,000	$ 5,905,000
11/07/2000	San José Neighborhood Parks and Recreation Bonds	228,030,000	228,030,000	0
03/05/2002	San José 911, Fire, Police and Paramedic Neighborhood Security Act	159,000,000	155,675,000[(1)]	3,325,000
Total		$ 598,820,000	$ 589,590,000	$ 9,230,000

(1) Includes $9 million in General Obligation Bonds, Series 2009 to be issued on or around June 25, 2009.
Source: City of San José, Finance Department.

The City may enter into long-term lease obligations without first obtaining voter approval. The City has entered into various lease arrangements under which the City must make annual payments to occupy public buildings or use equipment necessary for City operations. Securities have been issued which certificate these lease arrangements.

As of June 30, 2009, the City anticipates it will have approximately $864.7 million in non-voter approved bonded or certificated lease obligations outstanding. Table 31 on the following page summarizes the projected bonded and certificated General Fund lease obligations payable out of the revenues and general funds of the City as of June 30, 2009. The City has never failed to pay principal of or interest on any debt or any lease obligation when due.

Table 31
CITY OF SAN JOSE
BONDED AND CERTIFICATED GENERAL FUND LEASE OBLIGATIONS
Projected as of June 30, 2009

Issuer/Issue	Issue Date	Project	Amount Issued	Amount Outstanding	Final Maturity
City of San José Financing Authority					
Lease Revenue Bonds, Series 1993B[1]	04/13/93	Community Facilities	$ 18,044,854	$ 2,907,170	11/15/12
Lease Revenue Bonds, Series 1997B	07/29/97	Child Care Facilities, Fire Apparatus, Library Land Refinancing	9,805,000	1,560,000	08/01/12
Lease Revenue Bonds, Series 2001E	03/29/01	Communication Center Refunding Project	18,610,000	4,040,000	05/01/10
Lease Revenue Bonds, Series 2001F	07/26/01	Convention Center Refunding Project	186,150,000	153,310,000	09/01/22
Lease Revenue Bonds, Series 2002B	11/14/02	Civic Center	292,425,000	291,980,000	06/01/37
Lease Revenue Bonds, Series 2003A	09/18/03	Central Service Yard Refunding	22,625,000	18,400,000	10/15/23
Taxable and Tax-Exempt Lease Revenue Commercial Paper Notes[2]	01/13/04	Multiple Projects	116,000,000	56,331,000	N/A
Lease Revenue Bonds, Series 2006A	06/01/06	Civic Center Refunding	57,440,000	57,440,000	06/01/39
Lease Revenue Bonds, Series 2007A	06/28/07	Recreational Facilities Refunding	36,555,000	34,340,000	08/15/30
Lease Revenue Bonds, Series 2008A[3]	08/14/08	Civic Center Refunding Project	60,310,000	56,820,000	06/01/39
Lease Revenue Bonds, Series 2008B[3]	07/10/08	Civic Center Garage Refunding Project	36,580,000	35,975,000	06/01/39
Lease Revenue Bonds, Series 2008C[3]	06/26/08	Hayes Mansion Refunding Project	10,915,000	10,915,000	06/01/27
Taxable Lease Revenue Bonds, Series 2008D[3]	06/26/08	Hayes Mansion Refunding Project	47,390,000	46,380,000	06/01/25
Taxable Lease Revenue Bonds, Series 2008E[3]	07/03/08	Ice Center Refunding Project	28,070,000	27,085,000	06/01/25
Taxable Lease Revenue Bonds, Series 2008F[3]	06/11/08	Land Acquisition Refunding Project	67,195,000	67,195,000	06/01/34
			$ 1,008,114,854	$ 864,678,170	

[1] Includes Capital Appreciation Bonds at an accreted value as of June 30, 2009.
[2] Value presented as "Amount Issued" is the authorized amount. Amount outstanding is an estimate and may change pending actual interest rate through June 30, 2009.
[3] Variable rate bonds.
Source: City of San José, Finance Department.

In addition, the City and its departments have issued bonds or entered into installment purchase contracts secured by and payable out of loans and installment sale contracts, in order to provide conduit financing for single and multi-family housing, industrial development, and 501(c)(3) non-profit corporations. Such bonds and certificates of participation are not secured by any City general funds or revenues.

Overlapping Bonded Debt

Contained within the City are overlapping local agencies providing public services. These local agencies have outstanding bonds issued in the form of general obligation, lease revenue, and special assessment bonds. A statement of the overlapping debt of the City, prepared by California Municipal Statistics, Inc., as of April 30, 2009, is shown on the following page in Table 32. The City makes no representations as to the completeness or accuracy of such statement.

Table 32
CITY OF SAN JOSE
STATEMENT OF DIRECT AND OVERLAPPING DEBT

DIRECT AND OVERLAPPING TAX AND ASSESSMENT DEBT:	% Applicable	Debt 4/30/09
Foothill-De Anza Community College District	4.481%	$ 21,614,072
Gavilan Joint Community College District	7.486	5,602,148
San José-Evergreen Community College District	87.114	214,711,725
West Valley Community College District	27.185	21,852,662
Milpitas Unified School District	0.0002	102
Morgan Hill Unified School District	18.968	13,184,475
San José Unified School District	97.686	522,300,653
Santa Clara Unified School District	4.003	11,292,663
Campbell Union High School District	59.366	83,486,406
East Side Union High School District	94.525	452,724,856
Fremont Union High School District	9.587	19,948,630
Los Gatos-Saratoga Joint Union High School District	0.654	413,001
Alum Rock Union School District	74.132	59,704,350
Berryessa Union School District	94.195	41,133,102
Burbank School District	16.030	1,440,507
Cambrian School District	67.287	13,154,571
Campbell Union School District	45.109	45,740,321
Cupertino School District	15.990	19,853,027
Evergreen School District	99.489	125,876,878
Evergreen School District Community Facilities District No. 92-1	100.000	4,345,000
Franklin-McKinley School District	98.229	60,747,101
Los Gatos Union School District	1.470	1,270,080
Moreland School District	76.112	54,061,949
Mount Pleasant School District	86.936	8,011,145
Oak Grove School District	99.820	64,990,116
Orchard School District	100.000	25,901,846
Union School District	72.056	55,814,419
City of San José	**100.000**	**510,320,000**
City of San José Community Facilities Districts	100.000	35,535,000
City of San José Special Assessment Bonds	100.000	29,350,814
Santa Clara Valley Water District Benefit Assessment District	39.046	61,142,131
TOTAL DIRECT AND OVERLAPPING TAX AND ASSESSMENT DEBT		$ 2,585,523,750
DIRECT AND OVERLAPPING GENERAL FUND DEBT:		
Santa Clara County General Fund Obligations	39.046%	$ 344,528,238
Santa Clara County Pension Obligations	39.046	151,957,201
Santa Clara County Board of Education Certificates of Participation	39.046	5,817,854
Foothill-De Anza Community College District Certificates of Participation	4.481	1,175,142
San José Unified School District Certificates of Participation	97.686	116,368,498
Santa Clara Unified School District Certificates of Participation	4.003	519,589
East Side Union High School District Benefit Obligations	94.525	30,205,464
Los Gatos-Saratoga Joint Union High School District Certificates of Participation	0.654	71,057
Cupertino Union School District Certificates of Participation	15.990	379,763
Franklin-McKinley School District Certificates of Participation	98.229	5,677,636
City of San José General Fund Obligations	**100.000**	**814,911,850**
Santa Clara County Vector Control District	39.046	1,669,217
Midpeninsula Regional Open Space Park District General Fund Obligations	0.016	18,668
TOTAL GROSS DIRECT AND OVERLAPPING GENERAL FUND OBLIGATION DEBT		$ 1,473,300,177
Less: San José Unified School District self-supporting Qualified Zone Academy Bonds		13,579,135
San José Convention Center Lease Revenue Bonds (100% self-supporting from tax increment revenues)[(1)]		**153,310,000**
TOTAL NET DIRECT AND OVERLAPPING GENERAL FUND DEBT		$ 1,306,411,042
GROSS COMBINED TOTAL DEBT[(2)]		$ 4,058,823,927
NET COMBINED TOTAL DEBT		$ 3,891,934,792
Ratios to 2008-09 Assessed Valuation:		
Direct Debt ($510,320,000)	**0.41%**	
Total Direct and Overlapping Tax and Assessment Debt	2.08%	
Ratios to Adjusted Assessed Valuation:		
Gross Combined Direct Debt ($1,325,231,850)	**1.25%**	
Net Combined Direct Debt ($1,171,921,850)	**1.11%**	
Gross Combined Total Debt	3.84%	
Net Combined Total Debt	3.68%	
STATE SCHOOL BUILDING AID REPAYABLE AS OF 6/30/08:		$ 0

(1) Supported from surplus tax increment revenues pursuant to a Reimbursement Agreement between the City and the Redevelopment Agency.
(2) Excludes tax and revenue anticipation notes, enterprise revenue, mortgage revenue and tax allocation bonds and non-bonded capital lease obligations.
Source: California Municipal Statistics, Inc.