CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Manager
EMPLOYEE RELATIONS

June 24, 2011

Chris Platten
Wylie, McBride, Platten & Renner
2125 Canoas Garden Avenue, Suite 120
San Jose, CA 95125

RE: Fiscal Reform Plan, May 2, 2011

Dear Chris:

We are in receipt of the letter you send on behalf of IFPTE, Local 21, regarding the Fiscal Reform Plan. During our negotiation session with AEA, AMSP and CAMP on June 8, 2011 and June 14, 2011, we discussed the information request and provided some responses. The following is responsive to the information request.

<u>Page 37</u>

1. Who controls the assumptions used for both Plans' CAFRs? Is it the Board of Trustees?

   The Retirement Boards' actuaries provide recommendations on the actuarial assumptions that should be used for the actuarial valuations, and the Boards decide which actuarial assumptions to use to prepare the actuarial valuations.

2. Is the City responsible for the ARC (and the assumptions it is based on) in the City's CAFR? Is this any different now that in the past?

   The retirement board actuaries determine the Annual Required Contribution (ARC) based on the actuarial assumptions approved by the Boards. Pursuant to the City Charter, the cost split for the Normal Cost is 8:3 (City and employees) for the pension benefits. The cost for retiree healthcare benefits is split 50:50 (City and employees) as described in the San Jose Municipal Code.

   As you know, the City and employees are now phasing in to fully pre-fund retiree healthcare over five years.

3. Our understanding is that the investment assumption in the Federated plan dropped from 8.25% to 7.75% and now has been raised to 7.95%. Can you explain the rationale for this?

   The Federated City Employees' Retirement System Board previously had an earnings assumption of 8.25%. For the 2009 valuation, the Board adopted a 7.75% earnings assumption. The Board also adopted a 7.50% earnings assumptions for the 2010 valuation.

Page 38 Supplemental Retiree Benefit Reserve

4. Please provide a calculation of the net impact of the cost of the SRBR in terms of the impact on the discount rate. We have heard that it is worth 30 basis points but have seen no calculation.

   As of June 30, 2010, the SRBR balance for the Federated City Employees' Retirement System was $28.3 million. If these funds were to be put back into the system by June 30, 2011, it is estimated that the Fiscal Year 2012-2013, contributions could be offset by approximately $2.1 million.

5. Can you provide any legal guidance provided to you on how the SRBR might be amended or legal restrictions?

   The City does not have any information available in response to this inquiry.

Page 40 Retiree Health Care

6. Page 40 Retiree Health Care. We do not understand the table. How can a plan be 7% funded with $0.72 billion in unfunded liabilities based on Market Value (of assets) and 6% funded with $0.71 billion in unfunded liabilities based on Actuarial Value (of assets)?

   The Board's actuary Cheiron, prepared the June 30, 2010, Health Care Plan actuarial valuation that includes this information. If you are seeking further clarification on this information, a request would need to be made to the Federated City Employees' Retirement System Board.

7. Has there been any legal guidance provided on how the Retiree Health Care benefits might be amended or legal restrictions?

   On February 7, 2008, Jones Day issues a Memorandum to the City Attorney regarding Retiree Healthcare Benefits and Vested Rights. The City Council subsequently made this document public. Please find enclosed a copy of this memorandum.

8. Why now? Is there anything different now vs. 10 years ago?

As you know, effective June 28, 2009, the City and employees in the Federated Plan are phasing in to fully pre-fund retiree healthcare in five years. This is a change from 10 years ago, in which the retirement plan was partially pre-funding retiree healthcare.

Page 43

9. We just want to be clear that you want the City to pay (for new hires) no more than the 6.2% rate that private sector employers pay to Social Security. Please confirm.

   On May 24, 2011, the City Council approved a memorandum issued by the Mayor, Vice Mayor Nguyen and Council members Herrera and Liccardo. The memorandum included that new employee retirement benefits shall be limited to a hybrid plan that may consist of a combination of social security, defined benefits or defined contributions but the maximum City contribution in total shall not be less than 6.2% nor greater than 9% of base salary or 50% of the costs of the benefits, whichever is less.

10. On page 43 there is a reference to a "401k or 457 in the public sector." Are we correct that the 401k reference should really be to a 401(a) defined contribution plan? Is a 401(k) plan possible for all City employees (since generally public sector employers can not adopt a 401(k) plan)?

    Page 43 of the Fiscal Reform Plan was providing reference to a defined contribution plan, which in the public sector is a 457 Plan. There was reference to a 401k because the general public is more commonly familiar with this term.

Pages 44-45 and 48-50

11. Who creates these numbers? Assuming it was an actuary, we would like to see the details and know who the actuary is. We would like to see details including those described in ASOP 41 and understand all of the benefits valued (including disability benefits) and all of the decrements used. Do the responsible actuary and you believe that the assumptions used in these charts are reasonable?

    The Department of Retirement Services provided the cost estimates in the examples cited above. The examples include a 7.75% earnings assumption, which has been approved by the Federated Board. The Board's actuary, Cheiron, provided a presentation dated May 19, 2011, which references a recommended earnings assumption range of 6.75% to 7.75%.

Other

12. In addition to the foregoing, and following on the Mayor Reed's memorandum regarding a possible fiscal emergency, please provide a copy of projected fiscal year 2011 year end revenues and expenditures inclusive of transfers, and a present cash flow accounting for the city's general fund.

Please find enclosed two bi-monthly financial reports recently released by the City. These reports may also be located at the following:

http://www.sanjoseca.gov/clerk/CommitteeAgenda/PSFSS/20110421/PS20110421_c2.pdf
http://www.sanjoseca.gov/clerk/CommitteeAgenda/PSFSS/20110616/PS20110616c2.pdf

Sincerely,

Gina Donnelly
Deputy Director of Employee Relations

c: Nancy Ostrowski, IFPTE Local 21

Enclosures

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MEMORANDUM

CONFIDENTIAL PROTECTED BY ATTORNEY-CLIENT PRIVILEGE

TO:	Richard Doyle, Esq. City Attorney City of San Jose
FROM:	Kirstin D. Poirier-Whitley
DATE:	02/07/08
RE:	Retiree Health Benefits and Vested Rights

You have asked Jones Day to consider whether the City of San Jose (the "City") may change the retiree medical and dental benefits currently provided by the City in light of the constitutional prohibition on impairment of contractual obligations. This memorandum includes three parts: (1) a summary of the relevant facts, (2) a statement of the issues presented with corresponding summary conclusions, and (3) a more detailed analysis of the issues presented.

My analysis and conclusions are based on a review of the materials furnished to me by the City, which include: (1) the City Charter; (2) current and former Municipal Code provisions governing retiree medical and dental benefits; (3) the most recent "Benefits Fact Sheet" and "Handbook" for the Federated City Employees' Retirement System and the Police and Fire Department Retirement Plan; and (4) excerpts from the current Memorandum of Agreement ("MOA") between the City and each collective bargaining unit. It has been represented to me, and I have assumed for the purposes of this memorandum, that the provisions relating to retiree medical and dental benefits in any prior versions of the Benefits Fact Sheets, Handbooks and MOAs did not differ materially from the current versions that have been furnished to me. My analysis and conclusions are based only on the documents provided; consequently, to the extent that there are other documents that govern or describe the retiree medical and dental program and which include additional or different descriptions of the City's obligations, the analysis and conclusions set forth herein may not apply.

Because of the length of this memorandum, I have provided a table of contents below to aid in your review of the document.

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TABLE OF CONTENTS

Page

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I. FACTUAL BACKGROUND

A. City Charter Governing Retirement Benefits

Section 1500 of the San Jose City Charter (the "Charter") provides for the creation of a retirement plan or plans for the city employees and also states that "the Council may at any time, or from time to time, amend or change any retirement plan or plans or adopt or establish a new or different plan or plans for all or any officers or employees."

Charter Section 1503 provides that all retirement systems in existence when the Charter was adopted are valid and will continue until otherwise provided by ordinance. Like Section 1500, however, this section also expressly states that "the Council shall at all times have the power and right to repeal or amend any such retirement system or systems, and to adopt or establish a new or different plan or plans for all or any officers or employees."

Charter section 1504 guarantees minimum benefits and contributions for certain members of the City Police and Fire Departments. Under this section, pre-funding contributions must be made by the employees and the City in a ratio of three to eight. Additionally, Charter section 1504 requires that any retirement plan or system established for members of the Police and Fire departments must be actuarially sound.[1]

Charter section 1505 similarly guarantees minimum benefits and contributions for certain officers and employees of the City who are not members of the Police or Fire Departments. Under this section, pre-funding contributions must be made by the employees and the City in a ratio of three to eight.[2]

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[1] The guaranteed benefit is a monthly retirement allowance equal to fifty percent of his or her "final compensation" if the member completes twenty years of service and attains the age of fifty-five or completes twenty years of service and is disabled while employed by the City.

[2] The guaranteed benefit for service retirement is an annual retirement allowance equal to two percent of "final compensation" per year of "service" for the first twenty-five years of service plus one percent of such final compensation for each year of service above twenty-five years if the employee completes twenty-five or more years of service and attains the age of fifty-five or attains the age of seventy regardless of years of service. An officer or employee who has 10 years of service and is disabled also is entitled to certain minimum retirement benefits. It was represented to me that, because the terms "service" and "final compensation" are all defined with reference to the pre-1975 retirement plan ("Old Plan"), the City takes the position these minimum benefits apply only to the classification of employees covered by the Old Plan. I have not independently analyzed this issue.

In any event, the same restriction does not apply to the minimum contribution requirement. See Charter section 1505(f) (excluding individuals excluded under section 1501, officers and employees in the Police and Fire Departments, retirees, and persons in classifications excluded from participating in the Old Plan on the date the Charter was enacted).

B. Federated Retiree Health Plans

1. History of the Plan

In September 1984, the Council of the City of San Jose (the "Council") enacted ordinances granting medical benefits to members of the Federated Employees Retirement Plan (the "Federated Plan"), and in 1986, the Council approved ordinances adding dental benefits to the Federated Plan (collectively, the "Federated Retiree Health Plan"). Originally, the Federated Retiree Health Plan provided that a member retired for service or disability and who was entitled to credit for fifteen or more years of service (or five or more years of service for dental benefits) or who received a retirement allowance equal to at least thirty-seven and one-half percent of such member's compensation would be eligible to enroll in a medical or dental insurance plan sponsored by the City provided that the member retired upon leaving service and was enrolled in a health plan at that time. In addition, a member could only obtain medical coverage for a spouse if he or she was married at the time of retirement. Certain surviving spouses and children also were entitled to medical and dental benefits. Retired members and survivors were entitled to a subsidy equal to the premium for the lowest-cost medical insurance plan available to an employee of the City and for 100% of the cost of dental insurance offered as part of the City's employee benefits. These benefits were provided not only to active members and their families, but to existing retirees and survivors.

Since the Plan's enactment, a number of changes have been made. Most importantly, in 1988, the Council amended the Plan to extend retiree medical insurance to members who leave employment with enough service to have a nonforfeitable benefit but who cannot retire immediately upon leaving employment – i.e., "Deferred Vested Members." In 2006, the Council added a medical benefits account provision to address tax law issues and conformed other plan provisions.[3]

2. Current Provisions

Currently, the Federated Retiree Health Plan provides that a member who has retired for service or disability (whether immediately or on a deferred vested basis) and who is entitled to credit for fifteen or more years of service or who receives a retirement allowance equal to at least 37½% of such member's compensation (without regard to any offset for worker's compensation benefits) may enroll for medical insurance coverage in an eligible medical insurance plan. §§ 3.28.1950 and 3.28.1970.[4] In addition, Section 3.28.1960 generally provides that a member's

[3] Other minor changes not particularly relevant to the questions posed also were made. In 1986, the Plan was amended to provide that a worker's compensation offset is disregarded for the purposes of determining eligibility. In 1991, the Council amended the Plan to extend coverage to certain surviving spouses, and, in 1992, the Council amended the Plan to extend coverage to individuals who left employment pursuant to an early retirement incentive program. In 2002 and 2005 respectively, the Council amended the Plan to permit a spouse who is a guardian of a minor child to elect family medical coverage and to extend coverage to domestic partners.

[4] All section references are to the San Jose Municipal Code, unless otherwise indicated.

surviving spouse, domestic partner and/or child who is receiving a survivor or optional allowance under the Federated Plan is entitled to continue receiving medical benefits provided that the member dies while still employed or after retirement and, at the time of death, the member either had 15 years of service or was receiving a retirement allowance equal to 37½% of such member's compensation (without regard to any offset for worker's compensation benefits). It further provides that the portion of the premium to be paid from the medical benefits account "shall be the portion that represents an amount equivalent to the lowest of the premiums for single or family medical insurance coverage...which is available to an employee of the city at such time as said premium is due and owing." § 3.28.1980.

Sections 3.28.2000 and 3.28.2020 provide that a member who retires for service or disability and who is entitled to at least 5 years of service credit or an allowance equal to at least 37½ % of such member's compensation (without regard to any offset for worker's compensation benefits) may enroll for dental insurance coverage in an eligible dental insurance plan. In addition, Section 3.28.2010 generally provides that a member's surviving spouse, domestic partner and/or child who is receiving a survivor or optional allowance under the Federated Plan is entitled to continue receiving dental insurance provided that the member dies while still employed or after retirement and, at the time of death, the member either had 5 years of service or was receiving a retirement allowance equal to 37½% of such member's compensation (without regard to any offset for worker's compensation benefits). Section 3.28.2030 provides that the Plan pay 100% of the cost of the dental insurance provided to members and survivors. Members or their survivors may enroll only in an "eligible dental plan" which is a plan "with which the city has entered into a contract for the provision of dental benefits as part of the city's benefits to city employees." § 3.28.2040.

The Federated Retiree Health Plan is co-funded by employee and employer contributions in a specified ratio. Specifically, section 3.28.380(C) now provides that contribution rates to fund medical and dental benefits are established by the Board as determined by the Board's actuary and are borne by the City and the members of the Plan in a one-to-one ratio for medical benefits and an eight-to-three ratio for dental benefits. Although this co-funding ratio was first codified in 2006, it has been applied and reflected in the actuarial reports and other documentation connected with the Plan since inception.

As of August 2006, the Federated Retiree Health Plan provides that the City reserves its right to amend the Plan to limit medical or dental benefits as necessary to satisfy the requirements of Internal Revenue Code ("IRC") section 401(h), and more specifically that, in the event contributions required to fund the specified benefits would exceed the limits permitted by

IRC section 401(h), the portion of the premium to be paid by the Plan may be reduced as necessary to satisfy IRC section 401(h).[5] §§ 3.28.1995 and 3.28.2045.

C. Police and Fire Department Retiree Health Plans

1. History of the Plan

In June 1984, the Council enacted ordinances granting medical benefits to members of the Police and Fire Department Plan (the "Police and Fire Plan"), and in 1986, the Council approved ordinances adding dental benefits to the Police and Fire Plan (collectively, the "P&F Retiree Health Plan"). Originally, the P&F Retiree Health Plan provided that a member retired for service or disability and who was entitled to credit for fifteen or more years of service or who received a retirement allowance equal to at least 37½% of such member's compensation would be eligible to enroll in a medical insurance plan sponsored by the City provided that the member retired upon leaving service and was enrolled in a health plan at that time. In addition, a member could only obtain medical coverage for a spouse if he or she was married at the time of retirement. Retired members and survivors were entitled to a subsidy such that they would be required to pay no more for medical insurance than an active employee in the classification from which the member retired. A member was entitled to dental insurance benefits if he retired for service or disability; there was no minimum service or allowance level requirement. The Plan paid 100% of the premium for available dental insurance. Certain surviving spouses and children also were entitled to medical and dental benefits. These benefits were provided not only to active members and their families, but to existing retirees and survivors.

Since the Plan's enactment, a number of changes have been made. For example, in 1991, the Plan was amended to extend medical and dental coverage to a spouse where marriage occurs after retirement. In 1992, the Plan was amended to extend coverage to Deferred Vested Members separating from service after July 5, 1992 with 20 or more years of service and their survivors. In 1998, pursuant to an arbitration award, the Plan was amended to enhance the premium level paid for persons retiring after February 4, 1996 to be the same as that paid under the Federated Retiree Health Plan – i.e., the premium for the lowest-cost plan available. This change was also extended to individuals who had retired prior to February 4, 1996. In 2001, the Council added a medical benefits account provision to address tax law issues and add reimbursement for certain Medicare Part B payments. Coverage was extended to Deferred Vested Members who separated from service before July 5, 1992 and their survivors in May

[5] As you know, the contributions to the medical benefits account (plus contributions to fund life insurance protection) may not exceed 25% of total aggregate contributions (other than contributions for past service credits) to the retirement system.

2002. In 2006, the medical benefit account provision was reenacted in order to correct certain numbering errors.[6]

2. Current Provisions

Currently, Sections 3.36.1900 and 3.36.1920 provide that a member who (1) has retired for service or disability and either is entitled to credit for fifteen or more years of service or receives a retirement allowance equal to at least thirty-seven and one-half percent of such member's compensation, or (2) receives an allowance as a Deferred Vested Member with at least 20 years of service, may enroll for medical insurance coverage in an eligible medical insurance plan. If a retiree marries after retirement, he may add his spouse to coverage. § 3.36.1920C. In addition, Sections 3.36.1910 and 3.36.1920 generally provide that a member's surviving spouse, domestic partner and/or child is entitled to continue receiving medical benefits provided that either (1) the survivor is receiving a monthly allowance under part 8 of the Police and Fire Plan and, at the time of death, the member either had 15 years of service or was receiving a retirement allowance equal to 37½% of such member's compensation; or (2) the survivor is receiving a monthly allowance under part 11 of the Police and Fire Plan because of the death of a Deferred Vested Member with at least 20 years of service.

Sections 3.36.1930B and C provide that the portion of the premium to be paid from the medical benefits account beginning in 1998 shall be equivalent to the "lowest cost medical plan," but shall not exceed the actual premium for the eligible medical plan in which the member, former member or survivor enrolls." The "lowest cost medical plan" means that medical plan (single or family coverage as applicable) which is an "eligible medical plan" and which has the lowest monthly premium of all eligible medical plans then in effect. § 3.36.1930D. An eligible medical plan is a plan "with which the city has entered into a contract for the provision of hospital, medical, surgical and related benefits as part of the city's benefits to city employees." § 3.36.1940.

Sections 3.36.2000 and 3.36.2020 provide that a member who (1) became a member of the Plan prior to July 1, 1998 and retires for service or disability, (2) who is retired for service or disability and either has at least 15 years of service credit or an allowance equal to at least 37½% of such member's compensation, or (3) is receiving an allowance as a Deferred Vested Member with at least 20 years of service, may enroll for dental insurance coverage in an eligible dental insurance plan. Sections 3.36.2010 and 3.36.2020 generally provide that a member's surviving spouse, domestic partner and/or child receiving an allowance under parts 8 or 11 of the Police

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[6] Other minor changes not particularly relevant to the questions presented also were made. For example, in 1991, the Plan also was amended to make technical changes substituting the term "spouse" for the terms "husband" and "wife," and to extend medical coverage to certain individuals who had transferred from the Central Fire District. In 1998, the Plan was amended to impose additional eligibility requirements for dental benefits for individuals becoming members on and after July 1, 1998. In 2002 and 2006 respectively, the Council amended the Plan to permit a spouse who is a guardian of a minor child to elect family medical coverage and to extend coverage to domestic partners.

and Fire Plan is entitled to continue receiving dental insurance under certain conditions. Section 3.36.2030 provides that the Plan pay 100% of the cost of dental insurance provided to members and survivors. Members or their survivors may enroll only in an "eligible dental plan" which is a plan "with which the city has entered into a contract for the provision of dental benefits as part of the city's benefits to city employees." § 3.36.2040.

The P&F Retiree Health Plan is co-funded by employee and employer contributions in a specified ratio. Specifically, section 3.36.575(C) now provides that contribution rates to fund medical and dental benefits are established by the Board as determined by the Board's actuary and are borne by the City and the members of the Plan in a one-to-one ratio for medical benefits and a three-to-one ratio for dental benefits. Although this co-funding ratio was first codified in 2000, it has been applied and reflected in the actuarial reports and other documentation connected with the Plan since inception.

II. ISSUES PRESENTED AND SUMMARY OF CONCLUSIONS

Question 1. *Can changes be made to the retiree medical and dental benefits provided by the City of San Jose in light of the constitutional prohibition on the impairment of contractual obligations?*

As you know, both the United States and the California Constitutions prohibit the impairment of contractual obligations. Although the terms and conditions of public employment generally are controlled by statute or ordinance rather than by contract, the right to compensation already earned—particularly in the form of a pension—has been held to be vested and therefore protected under these constitutional provisions. A public employee's vested contractual right to pension benefits *accrues upon acceptance of employment.* By entering public service an employee obtains a vested contractual right to earn a pension on terms substantially equivalent to those then offered by the employer and to earn additional pension benefits pursuant to improved terms conferred during continued employment. The vested contractual right that accrues upon acceptance of employment includes promised survivor benefits.

Vested pension rights have been held to include, not only the benefits payable at retirement, but the scope of a member's contribution obligation as defined under the terms of the contract. In addition, courts have extended the application of the vested rights doctrine to benefits, other than traditional service pensions, that have served as an inducement for continued service and which, at least partially, already have been earned through the performance of service to the employer. Based on these authorities, a court likely would conclude that the constitutional protection applicable to traditional pension rights would also be applicable to the Federated and P&F Retiree Health Plans.

Not all benefit changes will impair vested contract rights, however. First, as a general rule, the City may modify vested rights before an employee retires if such alterations bear some material relation to the theory of a pension system and its successful operation *provided that any* *changes which result in disadvantage to the employees' vested rights are offset by comparable new advantages.* Because you have not identified any possible offsetting advantages that would accompany potential changes, I have not addressed how this "reasonable modification doctrine" would apply in this context.

Second, and more relevant to the City's inquiry, *any changes made to benefits that are consistent with, rather than in derogation of, the terms of the applicable "contract" should not impair vested rights.* Thus, as described in more detail below, determining whether a proposed change will impair the City's retiree medical and dental benefit "contract" with its employees involves a careful analysis of the terms of that contract. In this case, the "contract" between the City and its employees probably consists of the Municipal Code provisions setting forth the terms of the Federated and P&F Retiree Health Plans and, arguably, at least some of the overarching provisions of the Charter.

Of course, even if a change to retiree medical or dental benefits would not impair vested rights, some retirees or members might still argue that the City is estopped from altering their benefits. Given the lack of affirmative representations by the City regarding the duration or immutability of these benefits, I think members likely would have a difficult time making a persuasive argument in this regard.

Question 2. *Does the prohibition on impairment of contracts apply differently to different categories of retirement system members – i.e., retirees, current employees who have satisfied service eligibility requirements, current employees who have not satisfied service requirements, Deferred Vested Members and newly hired employees?*

As noted above, the terms of an employee's retirement benefits vest upon acceptance of employment. Thus, whether or not an employee has completed all of the service necessary for benefit eligibility generally has no bearing on that employee's vested contract rights. The only context in which an employee's years of completed service may be relevant is in connection with the analysis of a reserved right to amend as discussed under Question 3 below.

An employee does not have a vested right to benefits that are granted *after* the employee has left employment. Similarly, future employees generally do not have a vested right to any particular retirement benefits or to continuation of the retirement plan in operation prior to their employment. The employer generally is free to alter the terms of the benefits offered to new employees until they actually accept employment.

Once an employee has retired and begun receiving benefits, his or her benefits are no longer subject to the reasonable modification doctrine mentioned above. Changes, however, may still be made to the extent those changes are consistent with the terms of the contract governing those retirees.

Question 3. *What are the limitations, if any, on changes that may be made under the terms of the relevant "contract"?*

As noted above, benefits that are awarded after an employee leaves employment should not be constitutionally protected from impairment unless the individual exchanged other contractual rights for the new benefits. Accordingly, the City should be able to change the eligibility criteria, plan design or benefit level with regard to an employee who was first awarded coverage under the terms of the Plan after leaving City service – e.g., Deferred Vested Members under the Police and Fire Plan who left employment before 1992[7] or members of either the Police and Fire Plan or the Federated Plan who retired prior to the implementation of retiree health benefits in 1984 who were allowed to enroll– without impairing a vested contract right.

As also noted above, *any changes made to benefits that are consistent with, rather than in derogation of, the terms of the applicable "contract" should not impair vested rights.* More specifically, if the employer has expressly reserved its right to make changes to a plan member's benefits, any change made consistent with that reserved right should not impair vested contract rights. In accordance with this principle, the City may take the position that its Charter reserves the Council's right to amend any retirement benefits, including retiree medical benefits, and that *any* changes it makes to the Federated or P&F Retiree Health Plans pursuant to this reserved right would not impair vested contract rights.

Given that the Charter's reservation of right only expressly applies to "officers or employees," however, a court likely would conclude that the Charter provision does not apply to those who have already left employment – e.g., retirees and their families or survivors. Moreover, active and retired members alike may make persuasive arguments that the reservation of right in the Charter was intended to apply only to traditional pension benefits and not to post-retirement medical benefits. In conclusion, while the City has a reasonable basis for concluding that it has reserved its right to amend retiree health benefits at least with regard to active employees, there is a substantial risk that even active employees could successfully argue that the Charter's "reservation of right" is inapplicable to retiree health benefits.

In addition, even assuming that the reserved right to amend in Article XV of the Charter does apply to the retiree medical and dental benefits, members who already have performed enough service to qualify for these benefits when they retire may argue that their benefits and the conditions for receiving them may not be modified. Specifically, these members reasonably may argue that they have performed or "substantially" performed under the terms of the contract – i.e., that their benefits have been fully earned– and that their already earned benefits may not be modified notwithstanding any reservation of right. If this argument were successful, the reservation of rights clause would effectively preserve the City's right to modify the terms of a benefit only for those who have not done all or "substantially" all they have to do to earn it.

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[7] When coverage for Deferred Vested Members was added to the Federated Retiree Health Plan in 1988, it appears that coverage was added only for those who became Deferred Vested Members after the date of the change, and not retroactively. Accordingly, this analysis is not applicable to the Federated Retiree Health Plan.

Finally, even if a court concluded that the reservation of right to amend in Article XV of the Charter applies, the court might also require the City to be internally consistent and apply the contribution and funding provisions in Article XV to its retiree medical and dental benefits as well.

Assuming that the reservation of right in the Charter does not apply to the Federated or P&F Retiree Health Plans, there are a few changes that may nonetheless be consistent with the terms of the applicable "contract" and, accordingly, should not impair vested rights. These changes are discussed below in answer to Question 3. In any event, as noted above, future employees have no vested right to receive benefits under the current retiree medical and dental programs.

Question 3.A. *Assuming the reservation of right to amend in the Charter does not apply, may the City nevertheless change the number of years of service required before employees are eligible for benefits?*

Each current employee, retiree or Deferred Vested Member who accepted employment or continued in employment after the relevant Plan was adopted or became applicable to that individual likely has a vested right to receive benefits based on the years-of-service eligibility criteria in effect at that time. Even if an employee does not yet have sufficient service credit to qualify for benefits, he or she has a right to continue to earn benefits under these terms. Any change in the years of service requirement likely would constitute an impairment of contract (unless the detriment imposed were permissibly offset by comparable advantages in accordance with the "reasonable modification doctrine" discussed in section III.A.7.).

Question 3.B. *Assuming the reservation of right to amend in the Charter does not apply, may the City nevertheless change the level of benefit – i.e., the premium level – paid under the Federated and P&F Retiree Health Plans?*

The current ordinances for both Plans provide for payment of an amount equivalent to 100% of the lowest of the available premiums for single or family medical insurance coverage. The Federated Retiree Health Plan has offered this benefit level from its inception; the P&F Retiree Health Plan, however, did not offer this benefit level until 1998, when it was extended to individuals retiring after February 4, 1996, pursuant to an arbitration award, and also to retirees (and their family members) who left service before that date.

A court likely would conclude that current employees and most Deferred Vested Members and retirees have a vested right to receive this promised level of benefits, and that any change made to this level of benefit by the City would impair that vested right (unless the detriment imposed were permissibly offset by comparable advantages in accordance with the "reasonable modification doctrine" discussed in section III.A.7.). The City, however, may reasonably conclude that those retirees and Deferred Vested Members who are members of the P&F Retiree Health Plan and who left the City's service prior to 1998 have a vested right only in the premium amount under the terms of the Plan in existence when they left employment – i.e., a right to pay only as much as current employees in the job classification from which the member retired. Of course, notwithstanding the vested rights analysis, it appears that the City could not cut the benefit back to this level for people retiring between February 4, 1996 and 1998 without violating the arbitration award.

Question 3.C. *Assuming the reservation of right to amend in the Charter does not apply, may the City nevertheless change the level of funding provided by employees and the City?*

Under the current provisions of both the Federated and P&F Retiree Health Plans, contributions rates are established by the Board in consultation with its actuary. Thus, because the terms of the "contract" contemplate that the total contribution rate may vary, the Board should be free to increase the total contribution rate to be borne collectively by the City and the employees without impairing employees' vested rights.

Unlike the total contribution rate, however, the contribution *ratios* are express "contract" terms set forth under the provisions of the Plans. Thus, a court probably would conclude that the employees' right to contribute under the ratios currently set forth in the Municipal Code is vested and the City may not alter this ratio without impairing its contractual obligations (unless the detriment imposed were permissibly offset by comparable advantages in accordance with the "reasonable modification doctrine" discussed in section III.A.7.).

Question 3.D. *Assuming the reservation of right to amend in the Charter does not apply, may the City nevertheless alter the design of the medical and dental plans made available to retired members and their survivors?*

The current ordinances providing for retiree health benefits do not identify a specific medical or dental insurance plan design that must be offered to retired members, their families and survivors. Rather, these ordinances specify that the plans available to retirees will be those that are contracted for by the City as part of its employee benefits program for active employees. Thus, provided it makes similar changes to the plans made available to active employees, the City should be able to alter the design of the medical and dental insurance plans made available to its retirees without impairing the vested rights of current retirees, Deferred Vested Members, current employees or future employees. The City also could defend the somewhat more aggressive position that it may alter the design of dental and medical insurance offered under its retiree health plans but not those plans offered to active employees; however, there is a substantial risk that plan members could successfully challenge this position.

Question 4. *What impact does the Meyers-Milias-Brown Act and City Charter Section 1111 have on the City's ability to make changes to retiree health benefits?*

Health benefits are terms and conditions of employment that are subject to the meet and confer requirements of the Meyers-Milias-Brown Act. Thus, the City will be required to meet and confer in good faith about any proposed changes to the available benefits. A collective bargaining unit may not bargain away individual statutory or constitutional rights. Thus, even if the City and the union agree to certain modifications, such modifications would be impermissible if employees had a vested right in the benefit being modified.

III. LEGAL ANALYSIS

Whether the City may alter its existing retiree health program involves an analysis of several questions: (1) Are retiree health benefits the type of benefits that are constitutionally protected from impairment under the so-called "vested rights" doctrine; (2) if so, what is the scope of the benefits that are protected under the relevant "contract"? In addition, even if the employees and retirees do not have vested contractual rights with regard to retiree health benefits, the question remains whether the City may be estopped from changing the program with regard to current employees and retirees.

In that regard, the following analysis includes three parts: (1) an overview of the so-called "vested rights" doctrine, including an analysis of its application to retiree health benefits generally, (2) an analysis of the terms of the Federated and P&F Retiree Health Plans in light of "vested rights" principles, and (3) a discussion of estoppel considerations.

A. Overview of Vested Rights Doctrine

1. Pension Rights Vest Upon Acceptance of Employment

Both the United States and the California Constitutions prohibit the impairment of contractual obligations.[8] Although the terms and conditions of public employment generally are controlled by statute or ordinance rather than by contract,[9] the right to compensation already earned—particularly in the form of a pension—has been held to be vested and therefore protected under these constitutional provisions.[10]

It has been recognized that public pension benefits were created to serve "as an inducement to enter and continue in public employment"[11] and to "provide agreed subsistence to retired public servants who have fulfilled their employment contracts."[12] A public employee's vested contractual right to pension benefits *accrues upon acceptance of employment.*[13] Although

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[8] U.S. Const. art. I, § 10; Cal. Const. art. I, § 9.

[9] Markman v. County of Los Angeles, 35 Cal. App. 3d 132, 134-35 (1978).

[10] See, e.g., Allen v. Bd. of Admin., 34 Cal. 3d 114, 120 (1984).

[11] Quintana v. Bd. of Admin., 54 Cal. App. 3d 1018, 1021 (1976).

[12] Carman v. Alvord, 31 Cal. 3d 318, 325 n.4 (1982); Bellus v. City of Eureka, 69 Cal. 2d 336, 351 (1968).

[13] Allen v. Bd. of Admin., 34 Cal. 3d at 120.

"an employee does not earn the right to a full pension until he has completed the prescribed period of service, . . . he has actually earned some pension rights as soon as he has performed substantial services for his employer."[14] "By entering public service an employee obtains a vested contractual right to earn a pension on terms substantially equivalent to those then offered by the employer"[15] and to earn additional pension benefits pursuant to improved terms conferred during continued employment.[16] This means that the employee has a vested right not merely to preserve the pension benefits already earned, but also to continue to earn benefits under the terms previously promised through continued service.[17] Thus, whether an employee has earned enough service to make the benefits nonforfeitable and, thus, "vested" in that sense has no bearing on whether the benefits are constitutionally "vested" and protected from impairment.

The vested contractual rights that accrue upon acceptance of employment include promised survivor benefits. Although a public employee's survivor does not have a *separate and independent* vested right to survivor benefits prior to the employee's death,[18] such benefits are treated as part of the pension benefits offered to the employee in return for the employee's

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[14] Kern v. City of Long Beach, 29 Cal. 2d 848, 855 (1947).

[15] Carman, 31 Cal. 3d at 325.

[16] Betts v. Bd. of Admin., 21 Cal. 3d 859, 866 (1978) ("An employee's contractual pension expectations are measured by benefits which are in effect not only when employment commences, but which are thereafter conferred during the employee's subsequent tenure."); United Firefighters v. City of Los Angeles, 210 Cal. App. 3d 1095, 1102 (1989).

[17] Legislature v. Eu, 54 Cal. 3d 492, 530 (1991) ("We conclude that incumbent legislators had a vested right to earn additional pension benefits through continued service . . . "); Pasadena Police Officers Ass'n. v. City of Pasadena, 147 Cal. App. 3d 695, 703 (1983) ("[T]he employee has a vested right not merely to preservation of benefits already earned pro rata, but also, by continuing to work until retirement eligibility, to earn the benefits, or their substantial equivalent, promised during his prior service").

[18] Packer v. Bd. of Retirement of the Los Angeles County Peace Officers' Retirement System, 35 Cal. 2d 212, 215 (1950); see also Dickey v. Retirement Board of the City and County of San Francisco, 16 Cal. 3d 745, 749 fn. 2 (1976) (noting that right of wife of public employee to a pension does not vest on her husband's acceptance of employment but upon the happening of the contingency upon which her benefits are payable); Frazier v. Tulare County Bd. of Retirement, 42 Cal.App.3d 1046, 1049 (1974) (noting that neither employee's designated beneficiary nor his wife had a separate vested right to receive any benefits from the pension system since provisions for them were merely a part of the employee's pension right); Henry v. City of Los Angeles, 201 Cal. App. 2d 299 (1962) (finding that disadvantageous modification to widow's pension was unconstitutional because it was not accompanied by a comparable benefit).

services.[19] As a result, those benefits should be protected from impairment under the same principles applicable to the employee's own retirement benefits.[20]

A former employee, however, does not have a vested right to benefits granted after the employee leaves employment.[21] For example, in Pasadena Police Officers Ass'n v. City of Pasadena, the city amended its charter in 1969 to include a cost of living adjustment to retirement benefits.[22] The city sent an election form to its retirees allowing them to opt-in to the new system, effectively giving up their fixed pensions in favor of a system under which their benefits would be subject to a cost of living adjustment ("COLA"). The members experienced a substantial increase in their pension benefits as a result of opting in to the new system. The city amended its charter again in 1981 to cap the COLA at 2%. The COLA was uncapped when it was initially introduced in 1969. The city excepted from the 2% cap those employees who had retired between 1969, when the uncapped COLA was introduced, and 1981, when the COLA was capped. Retirees who had retired prior to 1969, and so were not covered by the exception, sued, arguing that they had a vested right to receive the COLA benefits which had been put into place in 1969.[23]

The court stated that employees who had retired prior to the COLA's enactment in 1969 "had no vested contractual right, based on *the contract in effect during their employment*, to continuation of the COLA benefit." (emphasis in original).[24] The court, however, went on to find that the members' election to opt-in to the new system had effectively created a new contract which was binding on the city. Therefore, the city could not reduce the COLA without infringing on the pensioners' rights under their contract with the city.[25]

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[19] Packer, 35 Cal. 2d at 215 (benefit to widow is "one of the elements of compensation held out to her husband."); Henry, 201 Cal. App. 2d at 313 ("[The widow's right to receive a pension following the demise of her husband] is an element of the husband's contractual compensation and earned by him by performing services for the city.")

[20] See Packer, 35 Cal. 2d at 216 (widow's pension was part of husbands' pension benefits and subject to reasonable modification); Henry, 201 Cal. App. 2d at 314 (same). For a discussion of the "reasonable modification doctrine, see Section III.A.7.

[21] Olson v. Cory, 27 Cal. 3d 532, 542 (1980) (stating that pensioners whose benefits are based on service that terminated prior to a change in the law have no vested right to benefits resulting from that change).

[22] 147 Cal. App. 3d 695 (1983).

[23] Id. at 701.

[24] Id. at 706.

[25] Id.

2. Pension Does Not "Mature" Until Conditions Are Satisfied

While the right to pension benefits vests upon employment, the right to immediate payment of those benefits does not necessarily mature until certain conditions have been satisfied. Events may occur that will prevent the benefit from maturing and the employee from becoming entitled to payment. For example, Miller v. State involved a challenge to an amendment to California Government Code Section 20981 that lowered the mandatory retirement age from age 70 to age 67.[26] The plaintiff was a civil servant who had been employed by the state for over 30 years. The pension that the plaintiff received as a result of being forced to retire at age 67 was substantially lower than that which he would have received had he retired at age 70. The plaintiff sued the state, arguing that he had a vested right in continuing to be employed by the state until age 70, based on the mandatory retirement age that was in effect when he began his employment with the state. The plaintiff additionally argued that the amendment unconstitutionally impaired his vested pension rights by forcing him to accept a pension substantially less than he would have received had he worked until age 70.

The court rejected the plaintiff's first argument, noting that public employment is held by statute not by contract and that no public employee has a vested contractual right to continued employment beyond that fixed by law.[27] Thus, the power of the legislature to reduce the tenure of a civil servant cannot be limited by contract.[28] The court also rejected the plaintiff's second argument that his pension rights were nevertheless impaired. The court instead found that the plaintiff's loss of pension benefits resulted from the occurrence of a condition subsequent to the accrual of those rights rather than from an impairment of those rights. The court noted that although the plaintiff's right to a pension was vested, he was not assured of receiving maximum benefits. Thus, "the power of the Legislature, unfettered by contract, reduced the mandatory age of retirement and thereby created the condition subsequent the occurrence of which not only terminated plaintiff's employment but also defeated his expectation of additional salary and a larger retirement allowance."[29]

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[26] 18 Cal. 3d 808 (1977).

[27] Id. at 813.

[28] Id. at 814.

[29] Id. at 817. The court reached a similar result in Tante v. Board of Administration of the Public Employees' Retirement System. 93 Cal. App. 3d 615 (1979). In this case, a public employee sued when his application to retire with retirement benefits when he turned 67 was declined because he had not yet served 5 years. On the date that the plaintiff became employed, Government Code section 20981 provided that state employees were required to retire upon attaining the age of 67. Three years after the plaintiff began his employment, this section was amended to require retirement at age 70 instead of age 67. Government Code section 20393 stated that only employees with 5 years of service or more were eligible for retirement benefits. Before the legislature increased the mandatory retirement age, however, the Board of Retirement's past practice had been to allow employees who reached the age of 67 without 5 years of service to receive a service retirement pension based on their years of service. The plaintiff argued that he had a vested right to receive a pension based on this practice. Id.

As indicated above, however, once the employee accepts employment, the employer may not alter the contract terms that an employee must satisfy for the benefits to mature.[30]

3. Benefits May Be Changed for New Hires

The contractual basis of the right to retirement benefits is "the exchange of an employee's services for the pension right offered by the statute."[31] Thus, in contrast to current employees and retirees, future employees generally do not have a vested right to any particular retirement benefits or to continuation of the retirement plan in operation prior to their employment.[32] The employer generally is free to alter the terms of the benefits offered to new employees – e.g., by amending statutory language -- until they actually accept employment, at which point their retirement benefit rights vest.[33] In other words, so long as the employer does not alter the applicable statutes or other contractual language, new employees will continue to acquire vested rights in the existing retirement program as they are hired.[34]

Although a governmental employer generally is free to amend or repeal a statute providing retirement benefits with regard to future employees, one court has suggested that an employer might contractually bind itself *not* to alter such statutory benefits. But, it went on to say that such "[a] promise not to change the character of a pension program as to new employees is a fundamental constraint on the freedom of action" of the applicable legislative body.[35] Accordingly, a court should not interpret a contractual provision as containing such a promise unless it has "no other reasonable choice" – that is, where the provision "clearly abdicates the legislative power to make changes in the pension system for prospective employees."[36]

(continued...)

at 617. The court held that the Board of Retirement's past generous policy did not create a vested interest and so the plaintiff was not entitled to receive a pension before he had accumulated five years of service. Id. at 619.

30 Legislature v. Eu, 54 Cal. 3d at 530; Pasadena Police Officers' Ass'n, 147 Cal. App. 3d at 703.

31 Claypool v. Wilson, 4 Cal. App. 4th 646, 670 (1992).

32 Legislature v. Eu, 54 Cal. 3d 492, 534 (1991); California Assoc. of Prof. Scientists ("CAPS") v. Schwarzenegger, 137 Cal. App. 4th 371, 383 (2006); Claypool v. Wilson, 4 Cal. App. 4th 646, 670 (1992); San Francisco Fire Fighters v. City and County of San Francisco, 152 Cal. App. 3d 113, 120 (1984); Whitmire v. City of Eureka, 29 Cal. App. 3d 28, 34 (1972); Estes v. City of Richmond, 249 Cal. App. 2d 538, 545 (1967).

33 See CAPS, 137 Cal. App. 4th at 385.

34 Id. at 385.

35 Id. at 383 (quoting Claypool, 4 Cal. App. 4th at 670).

36 Id. at 383-84. In the CAPS case, the state entered a memorandum of understanding ("MOU") with CAPS effective from July 1, 2003, through July 1, 2006. Section 8.8 of the MOU contained language providing that "[P]ursuant to Government Code [section] 21070.5, new employees who meet the criteria for CalPERS membership would be enrolled in the First Tier plan and have the right to be covered under the Second Tier plan within 180 days

To recap, under established vested rights principles, an employer generally is free to alter the retirement benefits that will be provided to new employees – e.g., by amending governing statutory language -- until those employees actually accept employment, provided that the employer has not clearly bargained away its right to do so.

4. Contribution Levels As Well As the Benefits Funded by Those Contributions May Become Vested

Vested pension rights have been held to include, not only the benefits payable at retirement, but the scope of a member's contribution obligation *as defined under the terms of the contract*. For example, in Allen v. City of Long Beach, the city attempted to make a number of changes to the pension rights of its employees.[37] One of these changes was to increase the amount of each employee's contribution from 2% of his salary to 10% of his salary. The court held that this change was unlawful because it substantially increased the cost of pension protection to the employee without any corresponding increase in the benefits he could expect to receive upon retirement.[38]

Contribution levels may be modified, however, if such modification is consistent with, rather than in derogation of, the terms of the contract (see discussion in section III.A.8.(c) below).

(continued...)

of the date of their appointment." In 2004, the state enacted a new law creating an alternate defined contribution retirement program effective during the first two years of employment for employees first hired after the effective date of the law. As part of the new law, a new subdivision (e) was added to section 21070.5, which provided that, for members subject to the new retirement program, the 180-day election period for electing Second Tier participation did not commence until the first day after the two years spent in the alternate retirement program.

CAPS alleged that application of the alternate retirement program to new employees conflicted with Section 8.8 of the MOU, and therefore violated the constitutional prohibitions on impairment of contracts. The court noted that "[w]hen a collective bargaining agreement purports to secure pension rights for future employees, it may well be that the federal and state contract clauses protect the rights of future employees," but concluded that it "need not decide that issue" because the MOU at issue did not contain such a promise.

The court concluded that section 8.8 of the MOU did not suggest the state was bargaining away its sovereign right to change the character of pension rights for future employees. The statutory provision addressed in the MOU was one that was applicable to employees in a bargaining unit only if incorporated in an MOU. Thus, the MOU language was necessary to make the statutory provision applicable to employees in the CAPS bargaining unit. The court reasoned further that, so long as the Legislature made no further changes to the applicable statute, CAPS' new employees had a right to First Tier benefits unless they timely elected Second Tier benefits. There was nothing in the MOU, however, that committed the Legislature to maintaining the same statutory benefits for all prospective CAPS employees through the effective period of the MOU. In other words, the MOU simply incorporated, and thereby made operative, one part of existing statutory retirement law, which was itself subject to future modification by the Legislature.

[37] 45 Cal. 2d 128, 130 (1955).

[38] Id. at 131.

5. Retiree Health Benefits Are Probably Constitutionally Protected from Impairment under the "Vested Rights" Doctrine.

It appears that, depending upon the nature and terms of the "contract" involved, retiree health benefits, like pension benefits, may become "vested" and constitutionally protected from impairment. Courts have extended the application of the vested rights doctrine to benefits, other than traditional service pensions, that have served as an inducement for continued service and which, at least partially, already have been earned through the performance of service to the employer.[39] For example, in California League of City Employee Ass'n v. Palos Verdes Library District,[40] the court held that employees had a contractual vested right to certain longevity benefits, which were awarded after a designated number of years of service. The court noted that the benefits were (a) important to the employees, (b) had been an inducement to remain employed, and (c) were a form of compensation already (at least partially) earned. The court reasoned that, with regard to employees who already had performed service toward the attainment of these benefits, "it would be grossly unfair to allow [the employer] to eliminate such benefits and reap the rewards of such long-time service without payment of an important element of compensation for such services."[41]

Following the reasoning in California League, Thorning v. Hollister School District,[42] is the first case in California to extend the vested rights doctrine to protect retirement health benefits. In Thorning, the court considered the decision by a school district board to eliminate retirement health benefits provided to retired board members under a declaration of policy previously adopted by the board. In 1988, during the terms of office of the plaintiffs and pursuant to Government Code section 53201, the school district adopted Policy No. 9250(a) as part of the "Bylaws of the Board." Policy No. 9250(a) provided: "Any members retiring from

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[39] Thorning v. Hollister Sch. Dist., 11 Cal. App. 4th 1598 (1992) (retiree health); Cal. League of City Employee Ass'ns v. Palos Verdes Library Dist., 87 Cal. App. 3d 135 (1978) (longevity benefits); Frank v. Board of Administration, 56 Cal. App. 3d 236 (1976) (industrial disability retirement benefits; "No reason exists in plaintiff's case to apply a different rule to disability retirement benefits than to service retirement benefits."); see also Youngman v. Nev. Irrigation Dist., 70 Cal. 2d 240 (1969) (not mentioning vested rights doctrine, but concluding that plaintiffs had stated a claim for a contractual right to salary increase under step classifications); Ivens v. Simon, 212 Cal. App. 2d 177 (1963) (same); cf. San Bernardino Public Employees Assn. v. City of Fontana, 67 Cal. App. 4th 1215, 1223-24 (1998) ("San Bernardino") (terms and conditions of employment set forth exclusively in an MOU of fixed duration cannot "become permanently and irrevocably vested" and may be changed upon expiration of the MOU); Creighton v. Regents of Univ. of Cal., 58 Cal. App. 4th 237, 243-45 (1997), rev. denied, 1998 Cal Lexis 51 (holding that early retirement was a one-time limited incentive for early retirement, accompanied by an express disclaimer, and could be withdrawn before acceptance without violating vested rights); Viehlehr v. State, 104 Cal. App. 3d 392 (1980) (change to statute governing the calculation of interest on withdrawn contributions was related to an employment right, not a retirement benefit or right, and was not protected under the contract clause).

[40] 87 Cal. App. 3d 135 (1978).

[41] Id. at 140.

[42] 11 Cal. App. 4th 1598 (1992) review denied, 1993 Cal. LEXIS 1557 (1993).

the [school district] Board after at least one full term shall have the option to continue the health and welfare benefits program if coverage is in effect at time of retirement, except that Board members who have served less than twelve (12) years, but at least one term shall pay the full cost of health and welfare benefits coverage." In July, 1990, the board revised this policy to provide that "[t]he Board *may* authorize payment of premiums for retired members who have served twelve (12) years or more." On November 27, 1990, the board voted to continue payment of health benefits for the plaintiffs for the next ten years. The plaintiff's terms ended as of December 1, and on December 11, 1990 the new board voted to suspend payment of plaintiffs' health benefits.

The court looked to Policy No. 9250(a) as adopted in 1988 as the governing contract setting forth the plaintiffs' rights to retirement health benefits. It concluded that the July, 1990 change in the Policy -- a change made prior to the plaintiffs' retirement -- could not diminish the benefits already awarded to the plaintiffs during their term of office.[43] Considering the three criteria established by the California League case, the court indicated that the rights set forth under the 1988 Policy were akin to pension benefits and concluded that they vested because they were a part of the compensation promised to the board members and, as such, were important to the board members as an inducement for their continued service on the board and a factor in their ultimate decision to retire. The court further concluded that, because the terms of the policy provided that only individuals with less than 12 years of service were required to contribute to the cost of coverage, the vested contractual right for the plaintiffs (who had more than 12 years of service) included the right to have the employer pay the cost of their coverage.[44]

Arguably, the scope of Thorning is limited given that it involved only *elected officials* of the school district, and not public employees generally. Although the general rule is that current salary benefits for public employees do not vest and may be changed by the employer[45] -- subject of course to collective bargaining restraints, as applicable -- there is an exception for elected or appointed officials. Salaries for elected or appointed officers vest for the term of office, although they may be changed for a new term.[46] Consequently, salaries, as well as deferred compensation, of elected officials may not be decreased during the term of office. In fact, in concluding that the 1990 revision to the Policy was not controlling, the Thorning court relied heavily on vested rights cases dealing with elected officials, citing them for the proposition that

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[43] Id. at 1606.

[44] Thorning, 11 Cal. App. 4th at 1598; accord 83 Op. Cal. Att'y Gen. 14 (2000) (city had vested contractual obligation to provide health benefits to former city council member under resolution adopted pursuant to Government Code section 53201); 67 Op. Cal. Att'y Gen. 510, 513 (1984) (health insurance benefits "conferred for life, in the nature of deferred compensation and as an inducement of continued service, pursuant to an official declaration of policy may not be discontinued").

[45] Butterworth v. Boyd, 12 Cal. 2d 140, 150 (1938).

[46] Olson v. Cory, 27 Cal. 3d 532 (1980).

salary and other elements of compensation conferred during a *term of public office* cannot be diminished during that term.[47]

Notwithstanding the facts and cited authorities in Thorning, Thorning's conclusion that retiree health benefits may vest upon acceptance of employment should be equally applicable to all public employees and retirees. Although the Thorning decision does cite vested rights cases addressing elected officials, these cases actually describe vested rights principles uniformly applicable to the pensions of all public employees. Moreover, Thorning does not expressly rely on plaintiffs' status as elected officials or to any distinction between elected officials and other public employees as a basis for its conclusion that retiree health benefits are a form of compensation that vests. Finally, the Thorning court ultimately analogizes retiree health benefits, not to salary, but to pension benefits which, as already noted, vest upon acceptance of employment for all public employees.[48]

The holding in Thorning also arguably is limited to retirees given the court's reasoning that the health benefits at issue were "of importance to the board members as an inducement for their continued service on the board and *as a factor in their decision to retire*."[49] The contractual change that the court invalidated, however, was the July 1990 change making retiree health benefits discretionary – which occurred prior to the plaintiffs' retirement.

Thorning's precedential value also might be questioned based on the fact that, roughly six years after Thorning was decided, the California League decision was criticized in San Bernardino Public Employees Assoc. v. Fontana.[50] Like California League, the San Bernardino case dealt with a form of longevity pay, as well as certain leave accruals, but it reached a contrary conclusion. The San Bernardino court criticized California League for determining that benefits acquire the protection of the contract clause whenever those benefits are "important" to employees. The primary basis for the court's decision in San Bernardino, however, was that the vested rights cases were factually distinguishable on the grounds that the longevity benefits before it were not a statutorily based right of retirement, but were terms and conditions of active employment contained in a collective bargaining agreement of fixed duration. Accordingly, the benefits at issue were not "permanently and irrevocably vested" but could be renegotiated when the bargaining agreements expired. Notwithstanding its criticism of California League, I do not believe that San Bernardino alters the fundamental conclusion that retiree health benefits are a form of deferred compensation that may vest upon acceptance of employment.

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[47] Citing to Olson, at 539 ("if salary benefits are diminished by the Legislature during a judge's term . . . the judge is nevertheless entitled to the contracted-for benefits during the remainder of such term.") and to Betts, 21 Cal. 3d at 863 & 866 (elements of compensation conferred during a term of public office become contractually vested).

[48] Allen v. Bd. of Admin., 34 Cal. 3d at 120.

[49] 11 Cal. App. 4th at 1607.

[50] 67 Cal. App. 4th 1215 (1998).

In summary, notwithstanding the foregoing considerations, and although there appears to be only one decision -- which is unpublished -- that cites Thorning with approval,[51] I believe that it would be difficult to argue that retiree health benefits are not elements of deferred compensation that, like pension benefits, may vest upon acceptance of employment.

6. Vested Rights May Not Be Bargained Away

Employer-employee relations between the City and its union-represented employees are governed by the Meyers-Milias-Brown Act ("MMBA").[52] Employee collective bargaining units are authorized to represent their members in all matters relating to employment conditions and employer-employee relations, including wages, hours and other "terms and conditions of employment."[53] Because the phrase "wages, hours and other terms and conditions of employment" in the MMBA tracks the language of the National Labor Relations Act ("NLRA"), California courts and the Public Employee Relations Board (which decides cases under the MMBA) look to National Labor Relations Board ("NLRB") decisions for guidance when applying the MMBA. Under the NLRA, pension and post-retirement health care benefits for current employees are "terms and conditions of employment" about which employers must negotiate and may not unilaterally change.[54] Nevertheless, a collective bargaining unit may not bargain away individual statutory or constitutional rights that "flow from sources outside the collective bargaining agreement itself,"[55] and collective bargaining agreements may not contain

[51] Mayers v. Orange Unified School District, 2003 Cal. App. Unpub. LEXIS 6346 (June 30, 2003).

As discussed later in this letter, another related case, Sappington v. Orange Unified School District, 119 Cal. App. 4th 949 (Cal. App. 4th Dist. 2004), rev. denied, decertification request denied, 2004 Cal. LEXIS 8870 (Sept. 15, 2004) found it unnecessary to determine whether the retiree health rights at issue were "vested" because the terms of the contract did not support the rights claimed by the plaintiffs. Two other cases that preceded Thorning did not expressly address vested rights, but concluded that the counties involved did not have a mandatory duty to provide certain retiree health benefits under the statute at issue. Ventura County Retired Employees' Ass'n v. County of Ventura, 228 Cal. App. 3d 1594, 1598-59 (1991) review denied, (1991) ("Ventura County"); Orange County Employees' Ass'n v. County of Orange, 234 Cal. App. 3d 833, 843-44 (1991) review denied (1991) ("Orange County").

[52] Gov. Code § 3500 et seq.

[53] Gov. Code § 3504.

[54] Allied Chemical and Alkali Workers of America v. Pittsburg Plate Glass, 404 U.S. 157, 159 (1971). And see, e.g., Betts, 21 Cal. 3d at 863 (a public employee's retirement benefit constitutes an element of compensation).

[55] See San Bernardino Public Employees Ass'n v. City of Fontana, 67 Cal. App. 4th 1215, 1225 (1998); Wright v. City of Santa Clara, 213 Cal. App. 3d 1503, 1506, (1989); Phillips v. State Pers. Bd., 184 Cal. App. 3d 651, 660, (1986) disapproved on other grounds in Coleman v. Dep't of Pers. Admin., 52 Cal. 3d 1102, 1123 n.8 (1991) (holding that a collective bargaining agreement could not waive an employee's right to due process); cf. Soc. Servs. Union v. Bd. of Supervisors, 222 Cal. App. 3d 279, 287 (1990) (because Labor Code expressly authorizes agreements between public employees and their employers for payment of health care costs through payroll deductions, such an agreement is not a waiver of rights under the State's wage exemption statutes).

provisions that abrogate fundamental constitutional rights.[56] Such constitutional rights include pension rights.[57]

California law is consistent with analogous private sector cases,[58] as well as cases in other states dealing with public employment rights,[59] which have followed the rule that vested contractual rights may not be bargained away without the consent of the employee. For example, the Court of Appeals for the Sixth Circuit stated in Yard-Man that while a union may

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56 Soc. Servs. Union, 222 Cal. App. 3d at 287; Phillips, 184 Cal. App. 3d at 660 (even though statute permitted the parties to a collective bargaining agreement to supplant existing procedures by which employees are discharged or disciplined, an employee's right to due process cannot be waived in a collective bargaining agreement).

57 San Bernardino, 67 Cal. App. 4th at 1221. In San Bernardino, a labor union sought to set aside provisions in several memoranda of understanding ("MOUs"), relating to reductions in personal leave accrual and longevity pay benefits. 67 Cal. App. 4th 1215. The court held that the fringe benefits at issue were the negotiable terms and conditions of employment, distinguishing them from vested rights such as pension rights. While the latter are entitled to contract clause protection, the former could not become irrevocably vested because they were a product of collective bargaining, and provided for in collective bargaining agreements of fixed duration, and no outside statutory source gave the employees additional protection or entitlement to future benefits. Id. at 1223-25.

58 See e.g., United Mine Workers Health & Retirement Funds v. Robinson, 455 U.S. 562, 575 n.14 (1982) ("under established contract principles, vested retirement rights may not be altered without the pensioner's consent"); Allied Chem. & Alkali Workers of Am. v. Pittsburgh Plate Glass Co., 404 U.S. 157, 182 n.20 (1971) (same); Weimer v. Kurz-Kasch, Inc., 773 F.2d 669 (6th Cir. 1985) (same); Williams v. WCI Steel Co., 170 F.3d 598, 605-06 (6th Cir. 1999) (language of prior agreements gave employees and retirees a vested contractual right to trust residue that could not be the subject of future collective bargaining); Bokunewicz v. Purolator Products, Inc., 907 F.2d 1396, 1401-02 (3rd Cir. 1990) (disabled employees' rights to disability pension was vested at time of closure agreement and, thus, union and employer were without power to negotiate those benefits away); UAW v. Yard-Man, Inc., 716 F.2d 1476 (6th Cir. 1983) (finding that retirees became vested in certain benefits upon retirement); Hurd v. Hutnik, 419 F. Supp. 630 (D.N.J. 1976) (where employer previously entered into a multi-employer pension plan, it may not enter into a new agreement with the union extinguishing the pension fund by eliminating further contributions to it without making provision for the financial protection of retired employees currently receiving pension benefits from the fund, due to vesting of the pensioners' right to lifetime benefits under state law); Hauser v. Farwell, Ozmun, Kirk & Co., 299 F. Supp. 387 (D. Minn. 1969) ("whereas a union may bargain as to prospective matters such as seniority rights, future conditions of employment, etc., it cannot bargain away the accrued or vested rights of its members" without their consent).

While the pension or other retiree rights in many of these federal cases became vested upon retirement, the reasoning therein would be applicable to the vested rights of active employees as well; the key being that the rights in question were vested, not how or to whom they became vested.

59 See, e.g., Welter v. City of Milwaukee, 571 N.W.2d 459, 464 (Wis. Ct. App. 1997) rev. denied, 217 Wis. 2d 519 (1998) ("The City's argument that the officers should be deemed to have consented to the modification of their vested retirement-system rights because the concessions were agreed to by their unions ignores that a union may not bargain away the vested rights of its members without the express consent of those members."); In re Morris Sch. Dist. Bd. of Educ., 718 A.2d 762 (1998) cert. denied, 156 N.J. 407 (1998) (noting that "[i]n a variety of factual settings, courts have held that a union has no authority on behalf of its membership to bargain away various forms of deferred compensation earned during the terms of prior collective bargaining agreements absent knowing consent by those who would be adversely affected").

choose to forego certain benefits in future negotiations in favor of more immediate compensation, "it may not...bargain away retiree benefits which have already vested in particular individuals."[60] Such rights, the court stated, are interminable once vested.[61]

7. Reasonable Modification Doctrine: Benefits May Be Modified Before Retirement If Comparable Offsetting Advantages Provided

Any statutory benefit is subject to the implied qualification that the governing body may make modifications and changes to the statute.[62] The employee does not have an absolute right to any "fixed or definite benefits, but only to a substantial or reasonable pension."[63] Thus, "vested contractual pension rights *may be modified prior to retirement* for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system."[64] Nonetheless, "[such] modifications must be reasonable," and to be sustained as such, a modification must satisfy a two-pronged test: first, any resulting disadvantage to a member must be accompanied by comparable, offsetting advantages; and second, the modification of the member's pension rights "must bear some material relation to the theory of a pension system and its successful operation . . . ."[65] The City has not asked that we consider any specific proposed "comparable advantages" under this "reasonable modification" doctrine.

8. The Scope of the Vested Right Is Limited By the Terms of the Relevant Contract.

As already noted above, the rights of City employees and retirees to retiree health benefits under the terms of the applicable contract most likely became constitutionally "vested" – i.e., protected from impairment – upon their acceptance of employment with the City. This does

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[60] 716 F.2d at 1482 n.8.

[61] Id.

[62] Kern, 29 Cal. 2d at 855.

[63] Id.

[64] Int'l Ass'n of Firefighters v. City of San Diego, 34 Cal. 3d 292, 300-01 (1983) (internal citations omitted). Courts have concluded that retirees, unlike active employees, are not subject to the reasonable modification doctrine. Terry v. City of Berkeley, 41 Cal. 2d 698, 702-03 (1953); Claypool v. Wilson, 4 Cal. App. 4th 646, 664 (1992).

In addition, under limited circumstances not relevant here, impairment of a contractual obligation may be justified. See Olson v. Cory, 27 Cal. 3d 532, 539 (1980) (four factors warranting legislative impairment of vested rights: : (1) the enactment serves to protect basic interests of society, (2) there is an emergency justification for the enactment, (3) the enactment is appropriate for the emergency, and (4) the enactment is designed as a temporary measure, during which time the vested contract rights are not lost but merely deferred for a brief period, interest running during the temporary deferment).

[65] Id.

not necessarily mean, however, that the City is without any discretion to make changes. In accordance with the legal considerations discussed below, the City's ability to modify its retiree health program will depend upon the terms of the governing contract.[66]

(a) Documents that Constitute the "Contract"

For a right to vest, it must be created under a valid contract; "the contract clause does not protect expectations based upon legal theories other than contract."[67] This "contract" between the employer and employee generally consists of the statute, ordinance or other official action of the governing body of the employer that sets forth the terms of the benefit the employer agrees to provide.[68] Although we have not found any case that squarely addresses the issue, it also appears that the "contract" may include an MOA under which the members are third-party beneficiaries, and that the rights set forth in the MOA may also be constitutionally protected, at least for the duration of the MOA.[69]

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[66] Int'l Ass'n of Firefighters v. City of San Diego, 34 Cal. 3d 292 (1983), 302; Kern, 29 Cal. 2d at 850 (the nature and extent of employer's obligation must be ascertained from the language of the pension provisions and judicial construction of those provisions or similar provisions at the time the contractual relationship was established); Lyon v. Flourney, 271 Cal. App. 2d 774, 783 (1969) ("it is necessary to perceive the terms of the contract and to utilize those terms to measure the claimed impairment"); see also Thorning, 11 Cal. App. 4th at 1607-08 (looking to the terms of the board's declaration of policy to determine whether the vested contractual right included the right to have the employer pay for the cost of coverage). This is consistent with the approach taken by courts determining whether amendments may be made to retiree welfare benefit plans sponsored by private employers under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). See Cinelli v. Sec. Pac. Corp., 61 F.3d 1437, 1441 (9th Cir. 1995) ("[a]n employer may amend or terminate [retiree life insurance] benefits pursuant to the terms of the plan at any time"); Stearns, 297 F.3d at 711-12 (well settled that an unambiguous reservation-of-rights provision is sufficient without more to defeat a claim that retirement welfare benefits are vested); Gable v. Sweetheart Cup Co., 35 F.3d 851, 856 (4th Cir. 1994) (plan document did not contain a promise to vest retiree medical benefits; employer expressly reserved the right to modify or terminate the participant's benefits); Sprague v. Gen. Motors Corp., 133 F.3d 388, 401 (6th Cir. 1998) (en banc) (plaintiffs' retiree medical benefits were not vested; plan stated that the terms of the plan were subject to change); Frahm v. Equitable Life Assurance Soc'y, 137 F.3d 955, 960 (7th Cir. 1998) (written terms of the retiree medical plan are the effective terms).

[67] Walsh v. Bd. of Admin., 4 Cal. App. 4th 682, 696-97 (1992).

[68] See, e.g., Int'l Ass'n of Firefighters, 34 Cal. 3d at 302 (looking to city charter and ordinance); Ventura County, 228 Cal. App. 3d at 1598-99 (looking to the Government Code to determine employer's obligations); Orange County, 234 Cal. App. 3d at 843-44 (same); Thorning, 11 Cal. App. 4th at 1607-08 (looking to official declaration of policy issued pursuant to Government Code); 83 Op. Cal. Att'y Gen. 14 (2000) (benefits provided pursuant to city resolution adopted under Government Code).

[69] Compare California Assoc. of Prof. Scientists ("CAPS") v. Schwarzenegger, 137 Cal. App. 4th 371 (2006); San Bernardino, 67 Cal. App. 4th 1215 (1998); Mayers, 2003 Cal. App. Unpub. LEXIS 6346 (considering as part of the "amorphous" implied-in-fact contract collective bargaining agreements and MOUs).

The CAPS case noted that none of the vested rights authorities it cited addressed a situation involving collective bargaining agreements, but stated that if a collective bargaining agreement purports to secure rights even for *future* employees, it may well be that the those *future* employees have contract clause protection. It found it

Other than one unpublished case which suggests that informal communications (as well as course of conduct) might constitute part of an amorphous, implied-in-fact contract,[70] we have not found any California cases in which participants argued or courts held that a *vested right* was created by a statement in an employee communication. Generally, the cases that address employee communications analyze the promises or misstatements under an estoppel theory.[71] This may be explained, in part, by the relatively informal process to which internal employee communications are subject when compared to the official, legislative process involved when a public entity adopts an ordinance, resolution or statute.[72]

In this case, the "contract" between the City and its employees probably consists of the Municipal Code sections which establish the Federated and P&F Retiree Health Plans and, as discussed in section III.B.1 below, arguably includes at least some of the overarching provisions of the Charter as well. Although the MOAs between the City and the relevant collective bargaining units arguably might be considered part of this "contract," the language of the MOAs contains virtually no substantive terms and merely references the relevant statutory provisions. Additionally, for purposes of this advice letter, discussion of employee communication materials generally will be addressed in the context of a potential claim under promissory estoppel or

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(continued...)

unnecessary to decide the issue because the contract at issue did not promise to leave the pension rights of future employees unchanged.

The San Bernardino court was addressing in-service, longevity benefits that were established by MOU and distinguished them from statutorily-based retirement benefits. It concluded that, at least for active employees, benefits set forth exclusively in an MOU of fixed duration cannot "become permanently and irrevocably vested" and may be changed upon expiration of the MOU. The employees in that case had no legitimate expectation that the benefits would continue unless they were renegotiated.

[70] Mayers, 2003 Cal. App. Unpub. LEXIS 6346. In addition, California courts have found the existence of implied or unilateral contracts on the basis of informal employment documents in cases that did not involve employee benefits. See, e.g., Hepp v. Lockheed-California Co., 86 Cal. App. 3d 714, 719 (1978) (triable issue of fact whether company's rules and policies regulating rehiring of employees laid off for lack of work were intended as a positive inducement for employees to take and continue employment); Scott v. Pacific Gas and Electric Co., 11 Cal. 4th 454, 465 (1995) (discipline guidelines in policy manual created implied contract not to demote employee without good cause).

[71] See Int'l Ass'n of Firefighters, 34 Cal. 3d 292 (analyzing summary plan description under estoppel rather than vested rights analysis); Crumpler v. Bd. of Admin., 32 Cal. App. 3d 567 (1973) (employer estopped from retroactively reclassifying misclassified employees, but such employees had no vested right in an erroneous classification).

[72] See Int'l Ass'n of Firefighters, 34 Cal. 3d at 306 (Kaus, J., concurring) ("without some substantial showing of actual harm, it would be ludicrous if carefully crafted pension legislation could be effectively amended by a bureaucrat's somewhat inept attempt at summarization"). See also Wallace v. State Personnel Bd., 168 Cal. App. 2d 543, 546-47 (1959) (court refused to give effect to narrow interpretation in the Personnel Transaction Manual of the evidence required to prove the necessity for sick leave under the Government Code; the relevant section of the manual was never adopted as a rule by the Personnel Board and hence can be considered as nothing more than an administrative directive for the guidance of department heads).

equitable estoppel. They also are referenced briefly in the discussion of the retiree health "contract" where relevant to show extrinsic evidence of the City's intent with regard to the terms of that contract.

(b) Contract Terms and Reasonable Expectations Generally

Whether a proposed change impairs a vested right will depend upon how the member's rights are defined under the terms of the governing contract.[73] In other words, the nature and extent of the City's obligation must be ascertained from the language of the governing provisions—i.e., the City Charter and the Municipal Code[74]—and judicial construction of those provisions or similar provisions at the time the contractual relationship was established.[75] "[I]t is necessary to perceive the terms of the contract and to utilize those terms to measure the claimed impairment."[76] It is the reasonable expectations of the employee that are protected.[77]

When construing the scope of the governing statutes, the primary task is to ascertain the Legislature's intent.[78] If the language is clear and unambiguous, there is no need for construction or resort to other evidence of Legislative intent.[79] On the other hand, if a statute is ambiguous, courts typically will consider evidence of intent beyond the language and examine the history and background of the statute in an attempt to ascertain the most reasonable interpretation.[80] Moreover, even where the language is clear, courts still may analyze whether the literal meaning of a statute comports with its purpose.[81] "The intent prevails over the letter, and the letter will, if possible, be read as to conform to the spirit of the act."[82] Examples of cognizable legislative history include different versions of the bill, analysis by legislative party

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[73] Int'l Ass'n of Firefighters v. City of San Diego, 34 Cal. 3d 292, 302 (1981); Kern, 29 Cal. 2d at 850.

[74] See., e.g., Int'l Ass'n of Firefighters, 34 Cal. 3d at 302 (looking to city charter and ordinance); Ventura County, 228 Cal. App. 3d 1594 at 1598-99 (looking to the Government Code to determine employer's obligations); Orange County, 234 Cal. App. 3d at 843-44 (same); Thorning, 11 Cal. App. 4th at 1607-08 (looking to official declaration of policy issued pursuant to Government Code); 2000 Cal. AG Lexis 3 (January 28, 2000) (benefits provided pursuant to city resolution adopted under Government Code).

[75] Kern, 29 Cal. 2d at 850.

[76] Lyon v. Flournoy, 271 Cal. App. 2d 774, 783 (1969), appeal dismissed, 396 U.S. 274 (1970).

[77] Allen v. Bd. of Admin., 34 Cal. 3d at 120; Ass'n of Blue Collar Workers v. Wills, 187 Cal. App. 3d 780 (1986) (right vested was "reasonable expectation" that city would meet its statutory obligation to fund past-service liability).

[78] Brown v. Kelly, 48 Cal. 3d 711, 724 (1989).

[79] Lundgren v. Deukmejian, 45 Cal. 3d 727, 735 (1988).

[80] Watts v. Crawford, 10 Cal. 4th 743, 751 (1995).

[81] Lundgren, 45 Cal. 3d at 735.

[82] Id.

caucuses, analysis of the Legislative Analyst, analysis prepared for and by various legislative committees, and the Legislative Counsel's Digest.[83] Statements reflecting the subjective opinions of interested parties or individual Legislators which are not shared or made known to the Legislature as a whole are disregarded.[84]

Although any ambiguity or uncertainty in retirement legislation must be resolved in favor of the petitioner, the construction must be consistent with the clear language and purposes of the statute.[85] This rule of liberal construction is "applied for the purpose of effectuating the obvious legislative intent and should not blindly be followed so as to eradicate the clear language and purpose of the statute and allow eligibility for those for whom it was obviously not intended."[86]

A number of cases in the retiree health context similarly illustrate how carefully the terms of the relevant "contract" must be parsed. Two recent cases involving the Orange Unified School district have similarly concluded that the contract at issue did not guarantee the plaintiff retirees 100% employer-paid coverage. In 1976, the Orange Unified School District's governing board adopted Policy 4244.2, which provided: "The district shall underwrite the cost of the district's Medical Hospital Insurance Program for all employees who retire from the district provided they have been employed in the district for the equivalent of ten (10) years or longer." Based on the facts outlined in both cases it appears that district had the following history with regard to changing health benefits: Between 1977 and 1997, the district offered retirees 100% district-paid coverage under an "ever-changing combination of HMOs, indemnity plans, and PPOs" (although, in 1992, the school district ended eligibility for post-retirement health benefits for new hires). In 1994, the school district stopped fully subsidizing the premiums for coverage of active employees and active classified employees were required to pay part of the premium to enroll in the more expensive PPO plan. Sometime in the late 1990's, the district also began imposing a charge on retirees (a so-called "buy-up") for the PPO plan. The district continued to offer a 100% district-paid HMO option.

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[83] See, e.g., Dubois v. Workers' Compensation Appeals Board, 5 Cal. 4th 382, 393 (1993)(legislative committee reports); Hogoboom v. Superior Court, 51 Cal. App. 4th 653, 670 (2d App. Dist. 1996)(Legislative Counsel's Digest and committee reports); Regents of the University of California v. Superior Court, 225 Cal. App. 3d 972 (2d App. Dist. 1990) (reviewing committee analysis which included committee staff analyses, summary prepared for a committee hearing, Legislative Analyst's analysis and analysis of the Senate Democratic Caucus); Kaufman & Broad Communities, Inc. v. Performance Plastering, Inc., 133 Cal. App. 4th 26 (3rd App. Dist. 2005), rev. denied 2006 Cal LEXIS 5193 (April 26, 2006) (listing documents constituting cognizable and inadmissible legislative history and various citations largely from the Third Appellate District supporting those lists; cognizable legislative history includes, for example, different versions of the bill, reports of the legislative analyst, committee reports and analysis, Legislative Counsel's Digest, party caucus analysis, statements of sponsors communicated to the Legislature as a whole, enrolled bill reports).

[84] See, e.g., Quintano v. Mercury Casualty Co., 11 Cal. 4th 1049 (1995); Kaufman, 133 Cal. App. 4th at 37.

[85] Ventura County Deputy Sheriff's Ass'n v. Board of Retirement, 16 Cal. 4th 483, 490 (1997).

[86] Barrett v. Stanislaus County Employees Retirement Ass'n, 189 Cal. App. 3d 1593, 1608-09 (1987).

In Sappington, the "buy-up" charge for the PPO option was challenged by a class of retirees who had been administrative employees prior to their retirement. The Sappington court agreed with the trial court that the 1976 board policy did not create a vested right to free PPO coverage. Rather, the court held that all the district promised retirees was to provide a medical insurance program in which they could enroll, and to subsidize their costs for enrolling in one of the plans offered. The court looked to the Webster's dictionary definition of "underwrite" and concluded that the statement in the board policy that the district will "underwrite the cost" of the district's health program for eligible retirees did not constitute a promise to pay the *entire* cost for enrolling in a district health plan. In addition, the reference to the district's "Medical and Hospital Insurance Program" was a "generic" term that failed to specify the type of health benefit plan or level of benefits promised. The court concluded that "the language is so broad it appears to obligate the district only to provide *a program* – there is no requirement that the program include any particular kind of insurance."

Finally, the court dismissed the plaintiff's claim that the District's practice of providing a choice between free HMO or PPO coverage for 20 years, which the plaintiffs accepted, was evidence that the parties had interpreted the District's policy to *require* free PPO coverage. The court noted that this position was unsupported by the language of the policy and that the plaintiffs failed to cite any evidence that they, as a group, had a reasonable expectation that they would always receive free PPO coverage. "Generous benefits that exceed what is promised in a contract are just that: generous. They reflect a magnanimous spirit, not a contractual mandate."[87] The Court of Appeal did not reach the issue of whether the District was obligated by the board policy to provide at least one fully-paid health plan for retirees, as was implicitly found by the trial court, because it was not at issue on appeal.

In Mayers, an unpublished opinion, the former president of the classified employees' union brought a class action challenging the imposition of premium sharing for the PPO option on retirees and seeking declaratory and injunctive relief. In that case, the trial court and Court of Appeal reviewed a number of documents, including the 1976 board policy, a series of collective bargaining agreements between the District and the classified employees, memoranda of understanding and various letters to individual retirees to determine whether the retirees were entitled to free health care during retirement.

The trial court noted that no single document could be called a contract between the parties, noting that the board policy was a "policy" rather than a contract, and the collective bargaining agreements each had language that only obligated the District to pay retiree health benefits for the duration of the contract, and questioning whether the letters had been written by someone with authority to bind the District. The trial court determined that, pursuant to the terms of this amorphous "contract," the District should be enjoined from treating the classified retirees different from active employees regarding the selection of and participation in the medical plans offered by the District. The effect of the trial court's ruling was that, since the

[87] Sappington v. Orange Unified School Dist., 119 Cal. App. 4th at 955.

District was requiring active employees to pay a portion of the premium for PPO coverage, it could also require retirees to pay a portion of the premium for such coverage.

The Court of Appeal affirmed the trial court's conclusion that Orange Unified School District retirees who had been classified employees with the District were only entitled to the same health benefits as provided active classified employees, and that there was no continuing duty for the District to provide these retirees with a free-enrollment PPO plan if the District did not do the same for its active classified employees. The appellate court concluded that school District employees did not have a statutorily based vested right to retirement health benefits. The court cited section 7002.5(a) of the Education Code and the opinions in Ventura County and Orange County which, as discussed below, concluded that section 53205.2 of the Government Code does not mandate the provision of health plans for retirees that are equal to those given to active employees. The Mayer court also characterized the retirees' rights as having emanated from an "implied-in-fact contract based on the long-term conduct of the parties" and concluded that the retirees did not carry their burden of proving that there was no substantial evidence supporting the trial court's interpretation of this "contract." The appellate court agreed with the trial court's conclusion that the statement in the board rules that the District "shall underwrite the cost of the District's Medical and Hospital Insurance Program" for all employees who retire from the District with 10 years or more of service did not obligate the District to underwrite the "entire cost" of the health insurance coverage. Finally, the Mayer court would not be baited into answering the question that was at the heart of the appeal: Whether the District could eliminate all health coverage for retirees if it eliminated the coverage for the active employees.

(c) Reserved Discretion to Make Changes

If, under the terms of the contract, the employer or other entity charged with implementing the benefits program has discretionary authority to alter the benefit, action taken consistent with such reserved discretion is not an action that impairs vested rights.[88] The fact that retirement benefits are subject to modification under certain enumerated circumstances,

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[88] Int'l Ass'n of Firefighters, 34 Cal. 3d at 302; Walsh, 4 Cal. App. 4th at 700; Pasadena Police Officers' Ass'n v. City of Pasadena, 147 Cal. App. 3d 695 (1983); and see San Bernardino, 67 Cal. App. 4th ay 1223-25 (benefits could not have become permanently and irrevocably vested as a matter of contract law, because the benefits were earned on a year-to-year basis under an MOU of limited duration that expired under its own terms; employees had no legitimate expectation that the benefits would continue unless renegotiated); Creighton v. Regents of the Univ. of Cal., 58 Cal. App. 4th 237, 245 (1997), rev. denied, 1998 Cal. LEXIS 51 (one-time offer of special incentives for early retirement, accompanied by an express disclaimer that vested rights were created, is not governed by vested rights doctrine); Ventura County, 228 Cal. App. 3d at 1598-99; Orange County, 234 Cal. App. 3d at 843-44; 80 Op. Cal. Att'y Gen. 119 (1997) (noting that benefits granted pursuant to Government Code sections 53200-53210 might be adjusted upward or downward during a term of office depending on the conditions established by the city council in providing for such benefits).

however, does not mean that the benefits are not constitutionally "vested" and protected from impairment absent those circumstances.[89]

Only a handful of cases addressing employer discretion, however, deal with express reservations of right to amend benefits. For example, in Legislature v. Eu, the Court struck down an initiative provision which would have terminated the Legislators' Retirement Law (LRL) for certain legislators. The Legislature had reserved its right to limit retirement benefits for legislators through the *legislative* process. But the Court concluded that the reserved right of the Legislature to make changes to the LRL did not mean the rights under the LRL were inchoate and unprotected from impairment by the *initiative* process. In other words, the mere existence of the limited reservation of right did not preclude the benefits from being constitutionally vested absent the exercise of that reserved right.[90]

On the other hand, in Walsh v. Board of Administration, the court looked to the same reservation of right and affirmed judgment against a state senator who challenged the *legislative* repeal of an early retirement provision in the LRL. The court noted that, throughout Walsh's service, the Constitution contained an express reservation of the power of the Legislature to limit the retirement benefits of legislators before their retirement.[91] Specifically, it provided: "The Legislature may, prior to their retirement, limit the retirement benefits payable to members of the Legislature who serve during or after the term commencing in 1967."[92] The court noted that Walsh's benefits had not been abrogated or eliminated, and concluded that the denial of early retirement benefits was within the Legislature's reserved power to "limit" benefits.[93] The court distinguished the Eu case, noting that the Eu decision was based on the fact that the right to limit benefits was reserved to the Legislature, and not to the people through the initiative process.[94]

Some courts have considered employer discretion which, although not expressly stated in the form of a reservation of right to amend, is implicit in the terms of the contract.

First, several cases involving health benefits have concluded that the governing statute did not mandate the provision of benefits, but instead made their availability subject to the discretion of the employer.[95] In Ventura County Retired Employees' Ass'n v. County of Ventura, the court addressed a claim that Government Code section 53205.2 required the county to

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[89] Legislature v. Eu, 54 Cal. 3d 492, 529 (1991).

[90] Id.

[91] 4 Cal. App. 4th at 700.

[92] Id. at 700-01.

[93] Id. at 701-02.

[94] Id. at 704.

[95] See Ventura County, 228 Cal. App. 3d at 1598-9; Orange County, 234 Cal. App. 3d at 843-44.

provide health care benefits to retirees that were equal to those provided to active employees. This section provided that the county "shall give preference to such health benefit plans as do not terminate upon retirement of the employees affected, and which provide the same benefits for retired persons as for active personnel at no increase in costs to the retired person . . . ." The court concluded that, under this section and sections 53202 and 53202.1, the county's decision to furnish health care benefits to retirees was purely discretionary.[96] Moreover, the court determined that the county was not obligated to subsidize the premium costs for any retiree health benefits it did offer given that Government Code section 53205 provided that the county "may authorize payment of all, or such portion as it may elect, of the premiums . . . for health and welfare benefits of . . . employees [and] retirees."[97] In other words, under the Government Code provisions on which they were relying, the retirees did not have a right -- contractual or otherwise -- to health benefits and premiums equal to those offered to active employees.

Addressing the same Government Code provisions, and following the analysis of the Ventura County court, the court in Orange County Employees' Ass'n v. County of Orange, noted that the use of the word "preference" in the statute implies the exercise of judgment and stated that if the Legislature had intended the county to select or approve a particular kind of plan, it could have done so.[98] The court concluded that the statute imposed a mandatory duty to exercise discretion in implementing the provisions of the statute, not a duty to select a cost-equalizing plan.[99]

Similarly, in International Association of Firefighters v. the City of San Diego, the California Supreme Court concluded that, in an actuarially based retirement system, members' contribution rates can be adjusted in accordance with revised actuarial assumptions and factors

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[96] 228 Cal. App. 3d at 1598-99. Government Code section 53202 permits a local agency to contract with one or more admitted insurers or health maintenance organizations, as the local agency determines to be in the best interest of itself, its officers and its employees electing to accept the benefits.

[97] Id. at 1599.

[98] Orange County, 234 Cal. App. 3d at 842.

[99] Id. at 843.

At first blush, the Ventura County and Orange County cases appear to be in direct conflict with the Thorning decision because they all involve health benefit plans offered pursuant to the same provisions of the Government Code, but reach different conclusions. The Thorning court, however, looked beyond the authorizing statute to the official policy issued by the employer pursuant to that statute to conclude that the employer had committed to provide retiree health benefits. In contrast, in both Ventura County and Orange County, the court did not address, and there did not appear to be at issue, any "contract" other than the Government Code that governed the permissible conduct of the counties. Rather, the issue was whether the statute itself imposed a duty which could be compelled by mandamus. See 76 Op. Cal. Att'y Gen. 119 (May 5, 1993) (noting that its opinion at 67 Op. Cal. Att'y Gen. 510 involved a discussion of vesting where there is an official declaration of policy and indicating through a "but see" cite that the Ventura County and Orange County cases contained a different analysis); cf. 80 Op. Cal. Att'y Gen. 119 (noting that section 53200-53210 do not expressly authorize or prohibit decreases in health and welfare benefits).

that are intrinsic to the system, even though the change incidentally shifted the relative contribution rates of employer and employee.[100] In that case, the governing terms of the system as set forth in the City charter and ordinances provided that the normal rates of contribution shall be such as to provide a specified annuity at retirement according to the tables adopted by the Board of Administration. The plan provisions further provided that the Board "shall adopt such mortality, service and other tables and interest as it deems necessary and make such revisions in rates of contribution of members as it deems necessary to provide the benefits for which the rates for normal contributions are required to be calculated." The court concluded that there was no express provision freezing the rate of employee contributions.[101] In fact, "[r]ather than being foreign to the City's retirement system, modification of the contribution rates of both employees and City is intrinsic to the ordinances basing those rates on actuarial factors which can be revised."[102] Accordingly, the Court concluded that the revision in contributions was made pursuant to, and not in derogation of, the governing charter and ordinances.[103] "Change in contribution is implicit in the operation of City's system and is expressly authorized by that system and no vested right is impaired by effecting such change."[104]

Alternatively, an employer can expressly forgo its right to change a contribution amount. The court in Teachers' Retirement Board v. Genest concluded that the members of the California State Teachers' Retirement System had a vested enforceable right to state contributions to a supplemental account of 2.5% of creditable compensation required by Assembly Bill 1102.[105] The Department of Finance ("DOF") attempted to argue that it was not required to make the contributions if the system was actuarially sound. The DOF argued that, because the statute required that the State make the contributions "for the purposes of making the supplemental payments under Section 24415," then it did not need to contribute funds unless the system would be unable to make the supplemental payments.[106] In rejecting the DOF's argument, the court noted that former Government Code section 22954 expressly reserved the Legislature's right to reduce state contributions to the supplemental account. However, AB 1102 repealed this section and added a section which expressly stated that it was "the intent of the Legislature in enacting this section to establish the supplemental payments pursuant to Section 24415 as vested

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[100] Int'l Ass'n of Firefighters, 34 Cal. 3d at 300, 302-03.

[101] 34 Cal. 3d at 303.

[102] Id. at 300.

[103] Id. at 302.

[104] Id. at 303.

[105] 154 Cal. App. 4th 1012 (2007).

[106] Id. at 1029.

benefits."[107] The court noted that the Legislature would not have repealed the language reserving its rights to reduce its contributions if it intended to continue to reserve the right.[108]

(d) Full or Substantial Performance

Even where the employer has reserved discretion to make changes to a plan, however, the employer still may be precluded from changing the benefits of employees who have completed performance under the terms of the contract. For example, in Creighton v. Regents of the University of California (the "Regents"),[109] the court considered an early retirement window program that provided for the crediting of additional age and service credit. The Regents originally authorized the program on May 21, 1993 for individuals who elected, during a window between July 1 and October 1, 1993, to retire on November 1, 1993. As originally authorized, it granted an additional 5 years of service credit upon early retirement. On July 16, 1993, however, the Regents revised the program to provide for only 3 years of service credit. The plaintiffs elected to participate after July 16, 1993 and retired on November 1, 2003. Plaintiffs then claimed that reducing the years of service credit granted from 5 to 3 impaired their vested contract rights.

The court first noted that the early retirement benefit was different in kind from the normal pension benefit because it was a one-time, limited offer to induce foreshortened service, not continued service.[110] More importantly, the governing document contained an express disclaimer providing that the crediting of additional age and service credit and the payments associated therewith "shall not be a vested or accrued Plan benefit."[111] Thus, the court concluded that this was not the type of benefit which vested immediately. Nevertheless, the court concluded that upon an eligible employee's formal acceptance of the program and subsequent retirement – i.e., upon full performance – the contract terms would vest.[112] In this case, the change was permissible because it was made before the contract rights vested.

Some cases outside the context of the constitutionally based "vested rights doctrine" similarly suggest that an employer may not be able to modify benefits to the extent the employee already has satisfied (or "substantially" satisfied) the conditions for receiving those benefits. Although this issue has not been analyzed in the area of retiree health, there are several analogous cases addressing accrued vacations and severance pay. For example, in Kistler v. Redwoods Community College Dist., school administrators whose contracts were expiring were

[107] Id. at 1030.

[108] Id. at 1031.

[109] 58 Cal. App. 4th 237.

[110] Id. at 243-44.

[111] Id. at 244.

[112] Id. at 245.

informed that their administrative contracts would not be renewed, but they would be assigned to faculty positions instead.[113] The plaintiffs had accrued large amounts of vacation pay as administrators, but would not be permitted to use or accrue vacation pay when they were teachers. They were directed to use up their accrued vacation pay by taking time off with pay prior to leaving their administrative positions. The court held that the defendant could not force them to do this. The court stated that this was necessary to "recognize the vested, accrued nature of vacation pay as wages, earned and payable, but receipt of which is delayed."[114]

In the seminal case of Suastez v. Plastic Dress-Up Co.,[115] the California Supreme Court noted that "'there is an "increasingly complex use of compensation in the form of 'fringe benefits,' some types of which inherently are not payable until a time subsequent to the work which earned the benefits . . . " [citation]'." Finding that an employee "has earned some vacation rights 'as soon as he has performed substantial services for his employer'," the court held that the right to a paid vacation, when offered in an employer's policy or contract of employment, constitutes deferred wages for services rendered and a proportionate right to a paid vacation "vests" as the employee's labor is rendered.[116] The court further noted that, "Courts have allowed recovery for vacation despite the fact that contract eligibility requirements were not met, if the employee had *substantially performed*."[117]

The substantial performance doctrine recently was utilized by a federal court when deciding that an employer could not change the terms of a severance pay plan on the eve of a layoff because the right to severance benefits vests upon the employee's 'substantial performance' of the employment contract, which may occur well before termination."[118] The court noted that "employment benefit plans are unilateral contractual offers by the employer which an employee accepts by 'substantially performing' his or her employment."[119] Thus, "[w]here an employee has substantially performed, and a unilateral contract for employment

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[113] 15 Cal. App. 4th 1326 (1993).

[114] Id. at 1333.

[115] 31 Cal.3d 774, 780 (1982).

[116] Id.

[117] Id. at 783 (emphasis added)

In fact, a variation of this "substantial performance" doctrine was relied upon in the development of the modern, constitutionally-based vested rights doctrine that is the main focus of this memorandum. See Kern v. City of Long Beach, 29 Cal.2d 848, 855 (1947) ("It is true that an employee does not earn the right to a full pension until he has completed the proscribed period of service, but he actually has earned some pension rights *as soon as he has performed substantial services* for his employer.") (Emphasis added).

[118] In Re Global, Inc., No. 01-039-LPS, 2007 WL 4403146, at *11 (D. Del. December 12, 2007) (applying Wisconsin law).

[119] Id.

benefits has thereby been formed, the employee's right to the offered employment benefits has vested. Once the benefits have vested, the employer may not unilaterally change the terms of the employment benefit."

These cases may be cited for the proposition that an employee benefit (such as health insurance during retirement) is fully earned when the employee has done all he/she had to do to earn the benefit – that is, work for the required number of years, until the required age, and retire. They also might be cited for the more nebulous proposition that an employee benefit is likewise fully earned when the employee has done "substantially" all he or she had to do to earn the benefit. Thus, it might be argued that once an employee has fully (or substantially) performed under the contract – i.e., once the benefit has been fully earned – the benefit cannot be modified or eliminated even if the employer has reserved the right to do so.

B. Analysis of the City's "Contract" With Its Employees, Former Employees and Retirees

As indicated above, the "contract" between the City and its employees probably consists of the Municipal Code sections which establish the Federated and P&F Retiree Health Plans and, as discussed in section III.B.1 below, arguably includes at least some of the overarching provisions of the Charter as well. The terms of this "contract" govern the scope of the vested rights of the City's employees, Deferred Vested Members and retirees.

1. The City Arguably Has Reserved the Right to Modify Retiree Health Benefits Prior to Retirement and, Thus, Is Not Impairing Vested Contractual Rights By Making Any of the Proposed Changes.

(a) Principles of Construction

The city charter is the supreme law of the city and supersedes all inconsistent municipal ordinances, rules or regulations.[120] The same rules of statutory interpretation that apply to statutory provisions also apply to local charter provisions.[121] While the interpretation of statutes by the administrative body charged with enforcing them is entitled to great deference, it is only one factor among many that a court takes into consideration when determining a statute's meaning.[122] The language of the statute itself is the first interpretative tool courts will use because it is the best indicator of legislative intent.[123] Only if the language is ambiguous will courts turn to extrinsic aids such as administrative construction to aid in interpretation.[124]

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[120] Stuart v. Civil Service Comm'n, 174 Cal.App.3d 201, 207 (1985).

[121] Giles v. Horn, 100 Cal. App. 4th 206, 221 (2002).

[122] Yamaha Corp. of America v. State Bd. of Equalization, 19 Cal. 4th 1, 12 (1998).

[123] Hoechst Celanese Corp. v. Franchise Tax Bd., 25 Cal. 4th 508, 519 (2001).

[124] Id.

When a statute is ambiguous, "[c]onsistent administrative construction of a statute over many years, particularly when it originated with those charged with putting the statutory machinery into effect, is entitled to great weight."[125] When there has been no consistent administrative construction of a statute over many years, such deference is not required.[126] Additionally, an administrative body may adopt a new interpretation of a statute and reject the old interpretation.[127] Courts also will interpret charter provisions "with reference to the entire scheme of law of which it is part so that the whole may be harmonized and retain effectiveness."[128] In doing so, courts must avoid an interpretation of a statute that renders part of the statute meaningless or inoperative.[129]

Although any ambiguity or uncertainty in retirement legislation must be resolved in favor of the petitioner, the construction must be consistent with the clear language and purposes of the statute.[130] This rule of liberal construction is "applied for the purpose of effectuating the obvious legislative intent and should not blindly be followed so as to eradicate the clear language and purpose of the statute and allow eligibility for those for whom it was obviously not intended."[131]

(b) Analysis of City Charter

As noted above, Sections 1500 and 1503 of Article XV of the City Charter grant the City Council broad discretion to design and adopt retirement plans, subject to certain minimum benefit limitations. In addition to giving the Council discretion in establishing retirement plans, these sections also give the Council power to amend or otherwise change those plans with regard to "all or any officers or employees."

It may be argued that, under the plain language of the Charter, any retirement plan benefits that are more generous than the minimum benefits that may be required under sections 1504 and 1505 of the City Charter -- including any retiree health benefits -- are subject to the Council's expressly reserved right to amend those benefits under Charter section 1500. Because the Charter reserves the right to amend the terms of its retirement plans, the Council would be acting consistently with the "contract" between the City and the employees when modifying its retiree health program and, thus, as in Walsh and similar to International Ass'n of Firefighters,

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125 Mason v. Retirement Bd. of City and County of San Francisco 111 Cal. App. 4th 1221, 1228 (2003); Thornton v. Carlson, 4 Cal. App. 4th 1249, 1257 (1992).

126 City of Los Angeles v. Superior Court, 40 Cal. App. 4th 593, 603 fn. 12 (1995).

127 Hudson v. Bd. of Admin., 59 Cal. App. 4th 1310, 1326 (1997).

128 Mason, 111 Cal. App. 4th at 1229.

129 Hassan v. Mercy American River Hospital, 31 Cal. 4th 709, 716 (2003).

130 Ventura County Deputy Sheriff's Ass'n v. Board of Retirement, 16 Cal. 4th 483, 490 (1997).

131 Barrett v. Stanislaus County Employees Retirement Ass'n, 189 Cal. App. 3d 1593, 1608-09 (1987).

no contract rights would be impaired. Given this express reservation of rights, employees could not have a reasonable expectation that the existing retiree health benefits would necessarily remain unmodified (or in existence at all).

At a minimum, however, retirees and Deferred Vested Members (and their survivors) have a strong argument that the reservation of right in the City Charter does not authorize changes affecting them because it does not expressly reference retirees or other former employees. Rather, because the Charter references only "officers or employees," to the extent it has reserved the Council's right to make changes, it has done so only with regard to active employees. As the California Supreme Court indicated in Eu, a reservation of right to amend must be exercised in strict accordance with its terms to be effective. The mere existence of a reserved right to amend does not prevent benefits from being protected from impairment absent the proper exercise of that reserved right. Moreover, they may argue that a reservation of right may not be relied upon to alter their benefits in any event because they have completed their required performance under the terms of the contract and, thus, those benefits have been fully "earned" and cannot be forfeited.

In addition, active employees and retirees alike may argue that the reservations of right in Sections 1500 and 1503 must be harmonized with the other provisions of Article XV. Specifically, the minimum substantive benefit requirements in Sections 1504(a) and 1505(a) and (b) address only traditional pension benefits. Thus, it is reasonable to infer that the voters' intention was to address such traditional pension benefits when adopting all of Article XV. Furthermore, they may allege that this inference is further supported by the fact that a retiree health program was not among the benefits provided by the City when the Charter was adopted in 1965 and, thus, could not have been a variety of benefit contemplated by the voters when they referred to "retirement plans" and "retirement systems."

Moreover, active employees and retirees alike may argue that, because the scope of the reservation of right to amend in the Charter is ambiguous, it is appropriate to look to extrinsic evidence of its meaning. In particular, the City's own application of its Charter shows that Article XV of the Charter – including the reserved right to amend – was intended to apply to only traditional pension benefits like the minimum benefits set forth in Sections 1504 and 1505 and is not part of the "contract" governing the Federated or P&F Retiree Health Plan. Specifically, they may argue that the City itself has never treated its retiree health program as a "retirement plan" subject to Article XV of its Charter. For example, the contribution ratios established for the retiree health program are not consistent with the contribution ratios for current service (i.e., normal cost ratios) required by the Charter. Furthermore, it appears that the P&F Retiree Health Plan is not maintained on an actuarially sound basis consistent with the Charter provisions applicable to police and firefighter retirement plans.

A possible counterargument is that the City generally has treated the Federated and P&F Retiree Health Plans as part and parcel of the overarching "retirement plan" or "retirement system" – i.e., the Federated Plan and the Police and Fire Plan respectively – as evidenced by the fact that the Retiree Health Plans are enacted within the Municipal Code Chapters which govern the respective retirement systems. A description of the Retiree Health Plans also is included in the respective Handbooks describing retirement benefits generally. Moreover, the medical benefits account through which the retiree health benefits are now funded is necessarily part of the qualified retirement plan under applicable tax law.[132] Finally, in any case under the terms of the applicable retirement system where a person is entitled to a return of employee contributions, such contributions shall include employee contributions to the medical benefits account, with the refund to be paid from the pension assets, not the assets of the medical benefits account.[133]

In addition, with regard to the City's failure to apply *all* of Article XV to the Retiree Health Plans, it may be argued that the reservation of rights language in Article XV applies to any and all retirement plans – including Retiree Health Plans – but that the requirements for contributions and funding apply only to traditional pension benefits. There is no real textual support in the Charter, however, for drawing this distinction given that the reservation of right provisions refer to "retirement plans" and "retirement systems" and the contribution and funding requirements likewise refer to "retirement plans" and "retirement systems." Normally, when the same terms are used multiple times within the same statutory scheme those terms will be interpreted to have a consistent meaning.[134] Thus, even if a court concluded that the reservation of right to amend in Article XV of the Charter applies, the court might also require the City to be internally consistent and apply the contribution ratio and actuarial funding provisions in Article XV to its retiree medical and dental benefits.

Furthermore, the City has never relied on this reservation of rights to change its retiree health program and, in fact, recently added more limited reservations of right to amend the Retiree Health Plans. Specifically, Sections 3.28.1995, 3.28.2045, 3.36.1950 and 3.36.2050 provide that the City reserves the right to limit medical benefits and alter the cost allocation for dental benefits as necessary to satisfy the requirements of IRC Section 401(h). Employees may argue that the most reasonable inference is that the City has not reserved its right to amend its retiree health benefits for any other reason. Arguably, if the City had the right to limit retiree health benefits under the reservation of right in Article XV of the Charter, there would be no need for a specific provision in the Municipal Code stating that the City has the right to alter medical and dental benefits to satisfy 401(h) requirements. In fact, interpreting the Article XV reservation of right to apply to retiree health benefits would render the Municipal Code provisions extraneous, contrary to accepted principles of statutory construction. Thus, the presence of Sections 3.28.1995, 3.28.2045, 3.36.1950 and 3.36.2050 further supports the conclusion that the Council did not view the Charter as allowing it to amend the retiree health benefits at any time or for any reason.

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[132] IRC § 401(h); §§ 3.28.380.A. and 3.36.575.A.

[133] §§ 3.28.380.F. and 3.36.575.F.

[134] Hassan, 31 Cal. 4th at 716. ("[W]ords should be given the same meaning throughout a code unless the Legislature has indicated otherwise.")

Finally, members may point to the fact that the City has never communicated this reserved right to amend retiree health benefits to members as evidence that Sections 1500 and 1503 of the Charter do not apply to these benefits.

It may be argued that there is no official written interpretation or policy regarding the scope of Article XV and that the conduct cited does not amount to a long-standing administrative construction of the statute. Absent other evidence of the voters' intent to the contrary, however, a court might conclude that the reasonable inference to be drawn from the City's conduct is that it has not ever viewed Article XV as applying.

It also might be argued that, even assuming the City previously took the position that some provisions of Article XV of the Charter did not apply to retiree health benefits, it may adopt a new interpretation of the Charter. A court might still conclude, however, that the City's changed interpretation is unreasonable in light of other considerations.

In sum, there is a reasonable argument that the City has reserved its right to amend the Federated and P&F Retiree Health Plans in the Charter. Retirees and Deferred Vested Members, however, have a strong argument that the reservation of right to amend *by its own terms* applies only to active employees and not to them. Additionally, City employees may argue that (1) the City has never treated the Federated or P&F Retiree Health Plan as subject to Article XV of the Charter; and (2) the inclusion of a provision in the Municipal Code allowing for specific changes to the Federated Retiree Health Plan ordinances to ensure compliance with Code section 401(h) suggests that the City has not reserved its right to make any other changes. Thus, there is a substantial risk that members could successfully argue that the reserved right to amend in Article XV is inapplicable to the Retiree Health Plans.

In addition, even assuming that the reserved right to amend in Article XV of the Charter does apply to the Retiree Health Plans, members who already have performed enough service to qualify for medical or dental benefits when they retire may argue that their benefits and the conditions for receiving them may not be modified. Specifically, relying on the Creighton, Kistler and Suastez cases discussed above, they reasonably may argue that they have performed all necessary services to earn these benefits – that is, that they have performed or "substantially" performed under the contract – and that their rights may not be modified notwithstanding any reservation of right. If this argument were successful, the reservation of rights clause would effectively preserve the City's right to modify the terms of a benefit only for those who have not done all or "substantially" all they have to do to earn it.

Finally, if a court concluded that the reservation of right to amend in Article XV of the Charter does apply, that court might also require the City to be internally consistent and apply the contribution and funding provisions in Article XV to its retiree medical and dental benefits.

2. To the Extent the City Has Not Reserved Its Right to Amend Retiree Health Benefits, Some Changes Still May Be Consistent with the Terms of the "Contract."

Even if active employees may successfully argue that their rights to receive benefits under the current Municipal Code provisions are not subject to a general reserved right to make changes, and notwithstanding the fact that retired employees do not appear to be subject to that reserved right in any event, certain of the proposed changes are arguably still within the scope of contractual rights granted by the City. Most of the proposed changes, however, probably would constitute impairment of vested contractual rights absent the City conferring offsetting advantages. You have asked us to consider the following proposed changes: (1) an increase in the number of years of service required for an employee to be eligible to receive retiree health benefits; (2) a change in the level of benefits – i.e., premium payments -- provided; (3) an increase in the amount of the contributions paid by employees to pre-fund retiree health benefits; and (4) a change in the plan design of the medical or dental insurance programs.

Before discussing each of these features individually, however, it is important to revisit the rule that benefits which are awarded after an employee leaves employment are not constitutionally protected from impairment unless the individual exchanged other contractual rights for the new benefits.[135] Accordingly, the City should be able to change the eligibility criteria, plan design or benefit level with regard to an employee who was first awarded coverage under the terms of the Plan after leaving City service – e.g., Deferred Vested Members under the Police and Fire Plan who left employment before 1992, but who first were given eligibility in 2002[136] or members of either the Police and Fire Plan or the Federated Plan who retired prior to the implementation of retiree health benefits in 1984 who were allowed to enroll– without impairing a vested contract right.

(a) Years of Service Requirement

As noted above, members are eligible for retiree health benefits only if the member retires for service or disability and, at the time of such retirement is entitled to 15 or more years of service or is otherwise entitled to a retirement allowance equal to 37½% of his final compensation (without regard to any reduction for workers compensation). With the exception of adding eligibility for Deferred Vested Members as discussed above, the service requirements have essentially been the same since the inception of the retiree health program. Thus, each member who accepted employment or continued in employment after the relevant Plan was adopted or became applicable to that individual, if later, likely has a vested right to receive

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135 See Kern, 29 Cal. 2nd at 856; California League, 87 Cal. App. 3d at 140; Thorning, 11 Cal. App. 4th at 1607; San Bernardo Public Employees' Ass'n, 67 Cal. App. 4th at 1215.

136 When coverage for Deferred Vested Members was added to the Federated Retiree Health Plan in 1988, it appears that coverage was added only for those who became Deferred Vested Members after the date of the change, and not retroactively. Accordingly, this analysis is not applicable to the Federated Retiree Health Plan.

benefits based on the years-of-service eligibility criteria in effect at that time. Even if an employee does not yet have sufficient service credit to qualify for benefits, he or she has a right to continue to earn benefits under these terms. Any change in the years-of-service requirement likely would constitute an impairment of such employee's contract absent the implementation of an offsetting advantage.

A possible counterargument is that, like the State in Miller, the City is merely altering a member's required period of service in a way that affects the maturation of the member's benefit and, thus, is not impairing a vested right. Such an argument, however, is unlikely to persuade a court. In Miller, the plaintiff's right to receive maximum pension benefits was subject to certain conditions and contingencies – i.e. age and service requirements. Although the reduction in the mandatory retirement age resulted in the plaintiff being unable to satisfy all the conditions for him to receive the maximum benefit, *the conditions themselves – i.e., the age and service retirement formula provisions -- were not changed to his detriment*. Additionally, the court in Miller focused on the fact that public employees have no contractual right to continued employment. In contrast, if the City were to increase the years of service requirement, it would not simply be altering an employment right, but would be changing the condition – i.e., the contract term -- itself and, thus, almost certainly would impermissibly infringe on a vested right.

(b) Benefit Level

As noted above, the Plans provide for payment of an amount equivalent to the lowest of the premiums for single or family medical insurance coverage (as applicable) which is available to an employee of the City at the time the premium is paid. Sections 3.28.1980B & 3.36.1930B. Likewise, the Plans provide for payment of 100% of the premiums for dental insurance coverage. Sections 3.28.2030 & 3.36.2030. In this memorandum, these premium benefit levels are referred to collectively as the "100% Premium Benefit." These terms have remained essentially unchanged since inception for the Federated Retiree Health Plan, but first became a term of the P&F Retiree Health Plan in 1998. This change was a benefit enhancement to the P&F Retiree Health Plan and was extended not just to current employees (and retirees covered by the arbitration), but to members who terminated employment prior to 1997. Prior to 1998, the P&F Plan provided that a retired member was required to pay a premium for medical insurance coverage in the same amount as was paid by a current city employee in the classification from which the member retired.

Thus, each member who accepted employment or continued in employment after the applicable plan first provided for this premium payment likely acquired a vested right to receive the 100% Premium Benefit upon satisfaction of the eligibility conditions. Any change in the promised 100% Premium Benefit level likely would be treated by a court as an impairment of such employee's contract.

Retirees and Deferred Vested Members who are members of the P&F Plan and who left the City's service prior to 1998, however, should not have a vested right to the 100% Premium

Benefit. As discussed above, members do not have a vested right in any increase in benefit level that they enjoy after separating from City service. Thus, these members would have a vested right only in the premium amount under the terms of the Plan in existence when they left employment – i.e., a right to pay only as much as current employees in the job classification from which the member retired. Of course, notwithstanding the vested rights analysis, it appears that the City could not cut the benefit back to this level for people retiring between February 4, 1996 and 1998 without violating the arbitration award.

As noted above, both Retiree Health Plans now reserve the right to change the portion of the premium paid by the Plan if necessary to satisfy the funding restrictions of IRC section 401(h). We are not aware of any facts which suggest that IRC section 401(h) limitations have been reached, and thus it does not appear that this provision has been triggered. In addition, each of these provisions arguably could not be applied to alter the rights of individuals who became members prior to that date that provision was added without impairing their vested contract rights.

(c) Amount of Funding Paid by Employees and by the City

As noted in the Factual Background section of this memorandum, under Sections 3.28.380 and 3.36.575, contribution rates "shall be established by the Board as determined by the Board's actuary . . ." Pursuant to this language, each Board should be free to increase the total contribution rate to be borne by the City and employees if doing so would be consistent with the recommendation of that Board's actuary. In fact, I understand that each Board has done so in the past. As in International Ass'n of Firefighters, such changes are consistent with, rather than in derogation of, the terms of the applicable "contract" and, thus, should not impair employees' vested rights.

Unlike the statutory provisions in International Ass'n of Firefighters, however, the discretion granted under these sections does not appear to permit the Board or Council to adjust **the ratio** of City contributions and member contributions. Rather Sections 3.28.380 and 3.36.575 provide that the total contributions shall be borne by the City and employees in specified ratios: eight-to-three for dental benefits and one-to-one for medical benefits. Thus, given these fixed ratios, as in the Allen case, employees would almost certainly be successful in arguing that their rights to contribute under these ratios are vested and cannot be changed. Although these ratios were not codified until 2001 (for the P&F Retiree Health Plan) and 2006 (for the Federated Retiree Health Plan), current employees' vested contract rights include not only the provisions of the "contract" in effect when they became employed, but additional benefits conferred during employment. Moreover, as noted in the Factual Background section, even before codification, these ratios are reflected in materials dating back to the original adoption of the Federated and P&F Retiree Health Plans. Thus, a court likely would treat the employees' rights to contribute under the ratios currently set forth in the Plan as vested, and any action by the City to alter this ratio as an impairment of its contractual obligations.

It might be argued that the ratio provisions govern only contributions to fund current service (i.e., the so-called normal cost), and that any unfunded liability could be shifted to employees without violating these provisions. Unlike the Charter, however, which states that the specified contribution ratios relate to current service, Sections 3.38.380 and 3.36.575 do not limit the ratios to current service contributions. Thus, employees could reasonably take the position that any past service liabilities could not be funded using less favorable ratios.

(d) Plan Design Change for Benchmark and Other Options

As indicated above, the Federated Retiree Health Plan provides for a payment equal to the lowest cost premium for a medical insurance plan (single or family as applicable) "*which is available to an employee of the city* at such time as said premium is due and owing." Section 3.28.1980. It further provides that payment will only be made for an "eligible medical plan" or an "eligible dental plan" which are defined to mean a medical or dental plan respectively with which the City has contracted "*as part of the city's benefits to city employees.*" Sections 3.28.1980, 3.28.1990 (emphasis added).

The P&F Retiree Health Plan likewise provides payment only for the lowest-price "eligible medical plan" and "eligible dental plan" which are defined to mean a medical or dental plan respectively with which the City has contracted "*as part of the city's benefits to city employees.*" §§ 3.36.1940 and 3.36.2040.

Thus, the terms of the plan do not specify a health insurance plan design that must be provided, but simply state that the health insurance plan(s) available to retirees will be ones that are contracted for by the City as part of its employee benefits program. In other words, the City should be able to alter the design of the benchmark plan and other health insurance plans that it offers to its employees and retirees – for example, by changing covered services, co-payments or deductibles – consistent with the terms of the governing "contract" and, thus, without impairing vested rights.

In addition, the City arguably may make design changes to its retiree health plans without making similar changes to plans provided to active employees. In support of this position, it may be argued that the requirement that the plans be "part of the city's benefits to employees" simply means that, in order for the Plan to pay the retiree health premium, the plan in which the member enrolls must be among those contracted for by the City in connection with its employee benefits program. Arguably, such language does not mean that the retiree health plan(s) for which the City contracts must be identical to the plans offered to active employees.

Members, however, may make a reasonable argument that the requirement that a retiree health plan be "part of the city's benefits to city employees" means that the retiree health plans offered will be the same as those offered to active employees. In fact, this position is consistent with representations made in the Police & Fire Department Retirement Plan Handbook to Deferred Vested Members. Handbook page 83. Members covered by the Federated Retiree

Health Plan in particular may argue that section 3.28.1980 specifically requires the City to offer a benchmark plan "*which is available to an employee of the city.*" In other words, they may argue that the City cannot create a low-cost alternative that applies only to retirees for the purposes of setting the benchmark. Thus, members may successfully argue that the City cannot make design changes to the benchmark medical plan (or other retiree insurance plans) without making equivalent changes to plans offered to active employees.

C. The Doctrine of Estoppel

1. Applicable Legal Principles

A government body in California may be bound under the doctrine of equitable estoppel where justice and right require it, if being bound is not otherwise harmful to some specific public interest or policy, or an expansion of the authority of a public official.[137] The following elements would have to be established for equitable estoppel against the City: (i) the City must be apprised of the facts; (ii) the City must intend that its conduct be acted upon, or must act in a way that the participants had a right to believe it was so intended; (iii) the participants must be ignorant of the true state of facts; and (iv) they must rely upon the City's conduct to their injury.[138] Good faith conduct of public officers or employees does not excuse inaccurate information given negligently.[139]

Related to equitable estoppel is promissory estoppel, defined as follows: "A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise."[140] Unlike equitable estoppel, the representation is promissory, not a misstatement of an existing fact.[141]

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[137] Crumpler, 32 Cal. App. 3d at 580; Fleice v. Chualar Union Elem. Sch. Dist., 206 Cal. App. 3d 886, 893 (1988) (finding no room to apply the estoppel doctrine where teacher had been erroneously classified as tenured but was later reclassified and her employment not renewed, because estoppel would have the court ordering a public agency to do what it had no statutory power to do).

[138] Crumpler, 32 Cal. App. 3d at 581.

[139] Id. at 582.

[140] See Frebank Co. v. White, 152 Cal. App. 2d 522, 525 (1957) (citing Restatement of Contracts, § 90).

[141] A related, alternative claim might be one for fiduciary breach based upon an affirmative misrepresentation or failure to disclose. See Hittle v. Santa Barbara County Employees' Retirement Ass'n, 39 Cal. 3d 374, 393-94 (1985) (pension plan trustees have a fiduciary obligation to inform members fully and fairly of the plan and its various options and features); and see, e .g., In re Unisys Corp. Retiree Medical Benefit "ERISA" Litigation, 2006 U.S. Dist. Lexis 72026 (granting injunctive relief based on conclusion that plaintiff's detrimentally relied upon affirmative misrepresentations or inadequate disclosure notwithstanding the fact that the SPD contained an express reservation of right to amend) , on remand from 242 F.3d 497 (3rd Cir. 2001) ("A judgment remains to be

Although estoppel generally is based upon affirmative conduct, silence in the face of a duty to speak may support an estoppel in some circumstances.[142]

An estoppel binds not only the immediate parties to a transaction but those in privity with them.[143] "Privity is generally defined as the relationship in which a person is so identified in interest with another that he is said to represent the same legal right; its discernment resting upon a case-by-case examination."[144] Consistent with this concept of privity, if the representation or conduct relied upon was committed by a party other than the government entity to be estopped, the proof necessary for estoppel generally includes proof of an agency relationship between the government entity to be estopped and the person or entity that made the promise or act on which the estoppel is based.[145]

In International Ass'n of Firefighters, the California Supreme Court declined to estop the city from increasing safety members' rates of contribution for the retirement fund, because it found no misrepresentation in the retirement handbook issued to the safety members.[146] While the handbook assured safety members that their rates of contribution would not change with their age as they grow older, the court concluded "this is not to say...that all rates could not be adjusted at some future time to reflect either changes in benefit provisions of the system or increased earnings of the...Fund."[147] The court held that this statement would not reasonably induce a safety member to believe that these were the only factors that could affect his or her rates, but were instead merely examples. Justice Kaus, concurring, determined that as there was no showing of any employee accepting employment or remaining on the job in reliance on the statement, the requisite element of harm was missing.[148]

(continued...)

made as to whether a reasonable fiduciary in Unisys' position would have foreseen that its conduct towards the various plaintiffs would result in important decision making on their part based upon a mistaken belief that they possessed guaranteed lifetime benefits.").

142 Moore v. State Board of Control, 112 Cal. App. 4th 371, 384 (2003); Lix v. Edwards, 82 Cal. App. 3d at 580 (trustees had a fiduciary obligation to provide notice of result of break in employer contributions).

143 Crumpler, 32 Cal. App. 3d at 582.

144 Id. at 583.

145 Moore, 112 Cal. App. 4th at 385.

146 34 Cal. 3d 292.

147 Id. at 304-05.

148 Id. at 306. As for the relation between the plan document and the handbook, Justice Kaus stated "without some substantial showing of actual harm, it would be ludicrous if carefully crafted pension legislation could be effectively amended by a bureaucrat's somewhat inept attempt at summarization."

The information presented to public employees in California must be read as a whole for estoppel to apply.[149] In Lee v. Board of Administration, retirement pamphlets distributed to members of the California Public Employee Retirement System ("CalPERS") indicated to members that each member possessed the power to effectively designate any person he or she desired as a beneficiary. The court determined that the pamphlets, though far from complete, made clear that the information provided therein was general and simplified, and "[did] not purport to be the definitive statement of the retirement law," and thus held that estoppel would not lie where the retirement pamphlets contained such express caveats.[150]

In cases brought under ERISA, courts generally look to the written statements and representations made to former employees *in effect at the time that they retired* to determine what retiree health benefits were promised to retirees and *whether the employer adequately reserved the right to modify or terminate the retiree health plan.* Statements that the employer may change or terminate the plan are referred to herein as "reservation of rights." For example, in Sprague v General Motors Corp.,[151] the employee communications described the retiree health plan as a "lifetime" benefit that would be "provided at GM's expense." However, the employee communications also put plan participants on notice of GM's right to change or terminate the health care plan at any time. The court, relying on these unambiguous "reservation of rights" in the employee communication materials or the plan, concluded that retirees had no vested right under ERISA to fully subsidized retiree health benefits and no valid claim under the principles of estoppel.[152]

In the ERISA context, ambiguity in the summary plan description ("SPD") must be resolved in favor of the employee and made binding against the drafter.[153] Although the beneficiary's view of the SPD is important, the correct interpretation must focus on the entire SPD or it will "represent an unrealistically narrow view of how a reasonably prudent employee would read and review this important document."[154] But if the employer publishes an inaccurate SPD and an employee *relies on that plan description to his or her detriment,* the employer will be bound by that inaccuracy.[155]

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149 Lee v. Bd. of Admin., 130 Cal. App. 3d 122, 134 (1982).

150 Id. at 134-35; but see Hittle, 39 Cal. 3d at 393-94 (pension plan trustees have a fiduciary obligation to inform members fully and fairly of the plan and its various options and features).

151 133 F.3d 388 (6th Cir. 1998).

152 Id. at 403-04; see also Stearns v. NCR Corp., 297 F3d at 711-12 (well settled that an unambiguous reservation-of-rights provision is sufficient without more to defeat a claim that retirement welfare benefits are vested).

153 Wise v. El Paso Natural Gas Co., 986 F.2d 929, 939 (5th Cir. 1993) (ERISA welfare plan).

154 Id.

155 Grosz-Salomon v. Paul Revere Life Ins. Co., 237 F.3d 1154, 1162 (9th Cir. 2001).

In addition, in the ERISA context, how and when a "reservation of rights" is communicated may be important. Even if a reservation of rights appears in an SPD, the existence of that reservation of rights also may need to be communicated contemporaneously with other, separately-provided information about the duration and cost of retiree health benefits in order to prevent that other information from being misleading.[156]

2. Analysis of City Communication Materials

The following analysis is a limited discussion of the claims that employees and retirees might make based on the communication materials that were provided by the City. These materials include a Benefits Fact Sheet and a Handbook for both the Federated Plan and the Police and Fire Plan. The outcome of any actual dispute could differ dramatically depending on employee and retiree communications that may be produced but that were previously unknown to the City or were not available for us to examine.

In order to estop the City from altering the benefits currently offered to employees and/or retirees, current and retired employees would have to show either a misstatement of fact or a promise on the part of the City indicating these benefits would not be changed. It is unlikely that employees could make this showing with regard to the underlying health plans or the contribution amounts that they are required to pay. The Handbook specifies only that "The Retirement fund pays the full premium for the lowest cost medical plan." Nowhere does the Handbook specify the actual amount of such premiums. Additionally, the contribution amounts are not discussed in the Handbook. Additionally, the Handbook itself implies that retirement benefits are subject to change, noting that "retirement benefits are subject to the meet and confer process under the Meyers-Milias-Brown Act which requires employers to meet with employees to confer about changes in wages, hours, or terms and conditions of employment. Proposed changes in retirement benefits are discussed during negotiations between City representatives and representatives of the recognized employee bargaining organizations."

Although it appears that employees would have a difficult time arguing that the City affirmatively told them that their retiree health benefits would remain the same for their lifetimes, they might make a colorable argument that the City had a duty to disclose its right to make changes to those benefits. It does not appear that the City indicated that it could alter its funding obligations, its contribution ratio, the eligibility requirements, or the level of benefits provided under the Plans. Thus, employees could argue that the City's failure to disclose this alleged right was misleading in light of the Handbook and Summary Sheet, both of which suggest that the City will continue to provide the enumerated retiree health benefits.

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[156] In re Unisys, 2006 U.S. Dist. Lexis 72026, conclusions of law 13-36 (notwithstanding reservation of rights in SPD, statements regarding duration and cost of benefits were misleading because company failed to qualify those statements with the caveat that the company could modify or terminate the benefits at any time; a reference to the right to terminate made at the same time the company communicated cost and duration of benefits in connection with retirement decisions would have made the representations complete as opposed to a "half-truth").

Assuming that employees or retirees could demonstrate a promise or misrepresentation concerning the duration and immutability of their benefits, the case law suggests that they also would have to prove their reliance on the promise or representation. It is not clear, however, what showing of reliance will be required—that the employees or retirees continued to work based on the descriptions of benefits,[157] that they didn't go to work for someone else who did have this benefit, that they retired based on the promise, that they retired earlier than they otherwise might have, that they did not get another job after retirement, or they changed their position in some other way.[158] Reliance will be a factual question to be resolved at the trial court level.[159]

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157 See Baillargeon v. Dept. of Water and Power, 69 Cal. App. 3d 670, 676-79 (1977) (holding that the plaintiff had adequately stated a claim for estoppel with regard to certain supplemental disability benefits where she alleged that she relied on certain statements concerning those benefits "in continuing her employment and in not accepting other employment.").

Where the employee's continued service is correctly viewed as bargained for consideration, however, the action is one for breach of contract (express or implied) and there is no need to resort to the doctrine of estoppel. See Youngman v. Nev. Irrigation Dist., 70 Cal. 2d 240, 250 (1969).

Under analogous circumstances, several California courts have held that a unilateral contract is or may be created when an employee continues in employment after the employer promises a benefit or working condition. See Hunter v. Sparling, 87 Cal. App. 2d 711 (1948) (continued employment was consideration for offer of pension); Newberger v. Rifkind, 28 Cal. App. 3d 1070 (1972). (remaining in employment constituted acceptance and consideration for stock option); Chinn v. China National Aviation Corp., 138 Cal. App. 2d 98 (1955) (employer's "regulation" providing for severance pay was an offer of a unilateral contract that was accepted when the employee, who had previously notified the employer of his intention to quit, remained in his job because of the offer); Hepp v. Lockheed-California Co., 86 Cal. App. 3d 714, 719 (1978) (issue of fact whether employee provided consideration by continuing in employment in reliance on defendant's "policy" of recalling employees who had been laid off). However, in Hunter v. Sparling, the court also found that the employer's offer of a pension was enforceable on promissory estoppel grounds, because the employee had turned down other offers of employment in order not to lose his pension; the court stated that "under such circumstances" the doctrine of promissory estoppel is applicable, suggesting that something more than merely continuing in employment may be necessary for the promise to be enforceable under the doctrine. 87 Cal. App. at 725.

158 See, e.g., In re Unisys, 2006 U.S. Dist. Lexis 72026, conclusions of law 37-55 (detrimental reliance was established by evidence that employees would not otherwise have retired at that time, and could have been established by proving that other employment or benefit opportunities were declined or that other important financial decisions were made).

159 Walsh v. Bd. Of Admin., 4 Cal. App. 4th 682, 708 (1992).

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: PUBLIC SAFETY, FINANCE AND STRATEGIC SUPPORT COMMITTEE

FROM: Jennifer A. Maguire

SUBJECT: **BI-MONTHLY FINANCIAL REPORT FOR JANUARY/FEBRUARY 2011**

DATE: April 11, 2011

Approved Dawn Artra Date 4/11/11

The Bi-Monthly Financial Report for January/February 2011 was jointly prepared by the City Manager's Budget Office and the Finance Department and is presented for the Public Safety, Finance and Strategic Support Committee's review.

OVERVIEW

Through February, the City's overall financial position remains relatively stable, although on careful watch. The Administration will continue to closely monitor economic conditions and the performance in the City's funds and will bring forward any required budget adjustments to the City Council for the remainder of the year as part of the 2010-2011 Year-End Clean-Ups Memorandum that will be agendized for June 21, 2011. Following are key highlights in this report:

- A number of the General Fund revenues had been tracking below Modified Budget levels through the first half of the year. Consequently, the City Council approved actions as part of the Mid-Year Budget Review to address an estimated $10.0 million General Fund net revenue shortfall, including use of the City's Economic Uncertainty Reserve ($4.0 million), transfers from other funds and increased revenues ($3.6 million), and expenditure shifts and transfers ($2.4 million). The use of the Economic Uncertainty Reserve provided a significant portion of the balancing strategy, leaving that Reserve with a balance of $5.0 million. In addition, as part of Mid-Year, the City Council approved actions to set aside expenditure savings to establish a 2010-2011 Ending Fund Balance Reserve of $8.5 million to better position the City for the 2011-2012 budget process.

- Property Tax receipts in the General Fund are currently anticipated to meet the 2010-2011 budgeted estimates based on the most recent projections provided by the County of Santa Clara.

- As part of the Mid-Year Budget Review actions, the City Council approved an increase of $3.2 million to the 2010-2011 Sales Tax revenue estimate to reflect better than anticipated first quarter performance. Additionally, in March 2011, preliminary second quarter results were received that also exceeded expectations. With one-time accounting adjustments to

OVERVIEW (Cont'd.)

reflect prior-year collections and the "Triple Flip" true-up payment from the State for 2009-2010, year-over-year General Sales Tax growth is estimated to be approximately 8.8% by year end. This compares to an actual decline in collections of 3.5% in 2009-2010.

- Many departments are currently experiencing or are expected to experience higher than budgeted personal services expenditures due to unbudgeted vacation sell-back expenses and/or vacation and compensatory time payouts associated with employee separations from retirements or layoffs (June 26, 2011) that are anticipated to occur by year-end. Departments will absorb these additional costs to the extent possible through savings from the employee turnover, overtime controls, and/or identifying potential offsets through non-personal/equipment appropriation savings. However, additional funding may need to be distributed to some departments by the end of the fiscal year to prevent appropriation over-runs.

- The City's challenging economic environment has resulted in weak or volatile performance in the Construction and Conveyance Tax Funds and the Municipal Golf Course Fund. Several of the other Special Revenue funds, however, are seeing improved performance: the Airport funds, funds that account for development-related taxes and fees (Construction Excise Tax Fund and Building and Structure Tax Fund) and the Transient Occupancy Tax Fund. The financial performance of these funds will be carefully monitored during the year to determine if any adjustments are necessary.

- The Administration will continue to report to the City Council any and all significant developments through this reporting process.

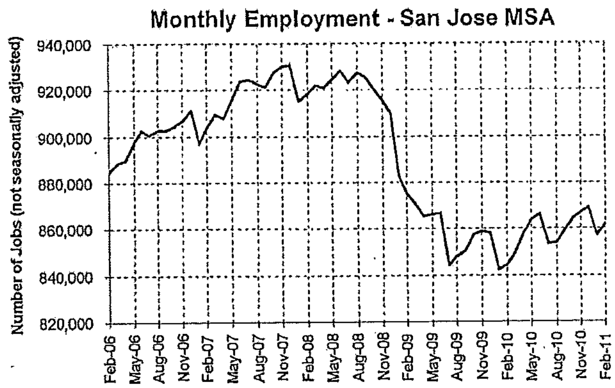
Economic Environment

U.S. Gross Domestic Product (GDP) appears to be increasing at a moderate pace, with growth of 3.1% for the quarter ending December 31, 2010. This is an improvement over the low growth rates in the previous two quarters (1.7% and 2.6%), and has contributed to some improvement in the unemployment rate: the seasonally-adjusted February 2011 U.S. unemployment rate of 8.9% has dropped to its lowest level since April 2009. The most recent Federal Reserve statement noted that "...the economic recovery is on a firmer footing, and overall conditions in the labor market appear to be improving gradually."

Despite the encouraging economic news, The Conference Board Consumer Confidence Index, which had improved in February, decreased in March. According to Lynn Franco, Director of The Conference Board Consumer Research Center, "Consumers' inflation expectations rose significantly in March and their income expectations soured, a combination that will likely impact spending decisions. On the other hand, consumers' assessment of current conditions improved, indicating that while the short-term future may be uncertain, the economy continues to expand."

OVERVIEW (Cont'd.)

Although still well below the recent peak of 930,500 jobs experienced in December 2007, employment in the San Jose Metropolitan Statistical Area (MSA) has somewhat recovered over the past 13 months from the January 2010 low of 842,300. The February 2011 employment level of 861,800 was (2.1%) above the February 2010 employment level of 844,400.



The San José metropolitan area continues to experience double-digit unemployment, although the February 2011 unemployment rate of 10.6% represents a slight decline from the January 2011 rate of 10.8%. The February 2011 figure is also lower than the 11.9% rate experienced a year ago. The February 2011 unemployment rate in this region is less than the unadjusted unemployment rate for the State, but remains above the nation, which has a current unadjusted unemployment rate of 9.5%.

Unemployment Rate (Unadjusted)

	Feb. 2010	Jan. 2011	Feb. 2011
San Jose Metropolitan Statistical Area*	11.9%	10.8%	10.6%
State of California	12.8%	12.7%	12.3%
United States	10.4%	9.8%	9.5%

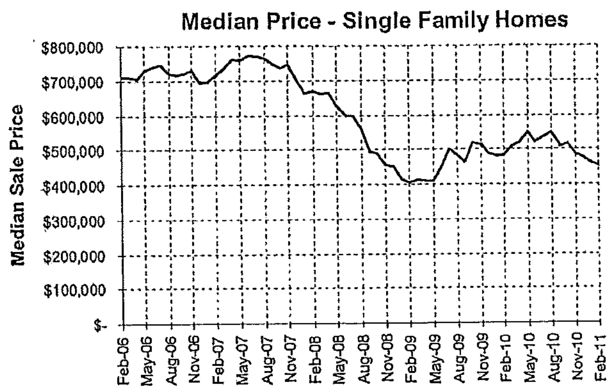
* San Benito and Santa Clara Counties
Source: California Employment Development Department.

Through February, the level of construction permit activity compared with the prior year at this time varies significantly across the three types of construction. Industrial construction remained significantly below prior year levels, with the $50.6 million of industrial permits issued this year showing a 35.6% drop from the prior year valuation of $78.6 million. Conversely, the total valuation of commercial permits issued so far this year is $147.2 million, 23.4% above the prior year valuation of $119.2 million. Although the 2,177 residential permits issued through February were over seven times higher than the 292 permits issued at this time last year, this dramatic spike was almost entirely attributable to two very large development projects in late 2010 in North San Jose.

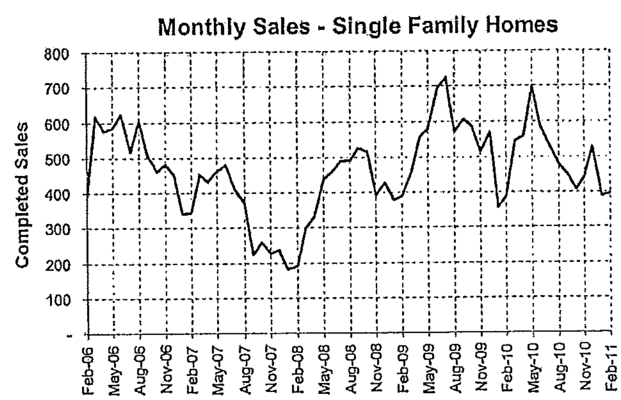
This permit activity drives the revenue collection in several construction tax categories and is an indicator of future activity for several other categories, such as the storm and sanitary sewer system fees. Additionally, over the last ten years, the construction industry has provided approximately 5% of the region's jobs; so any reduction in permit activity is expected to contribute to a slow recovery in local employment.

OVERVIEW (Cont'd.)

Discouragingly, the February 2011 median home price of $455,000 for single family homes within the City fell 6.2% below the February 2010 median of $485,000. February marked the fifth month in a row that the median home price decreased from the same month in the prior year.



Another indicator of the continuing challenges in the local real estate market is the increase in the amount of time to complete a transaction. The average days-on-market totaled 88 in February 2011, close to the peak of 90 days-on-market in June 2009. Additionally, the 3,614 total property transfers (completed sales) for single family homes for July 2010 through February 2011 fell 16.2% below the 4,315 completed sales for July 2009 through February 2010. Beyond weak consumer confidence and continuing high unemployment, an important factor that could also be acting as a drag on the housing market is uncertainty related to when the "shadow inventory" of foreclosed properties will be put on the market by lenders.



The slow pace of recovery from the economic recession continues to dampen growth in the City's economically sensitive revenue categories. As a result, collections in many of these areas, such as Sales Tax and Property Tax, are expected to remain well below levels experienced in recent years. Economic conditions will continue to be closely monitored, and any necessary budget re-balancing actions that may result from any negative impacts on overall City revenues will be brought forward before the end of the year.

GENERAL FUND

REVENUES

General Fund revenues through February 2011 totaled $539.8 million. Although this represents an increase of $113.4 million from the February 2010 level of $426.4 million, the 2011 total includes $75.0 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes in July ($40.0 million) and October ($35.0 million) 2010. Adjusting for the TRANs issuance, General Fund revenues through February 2011 totaled $464.8 million – an increase of $38.4 million (9.0%) from the February 2010 level.

Collections were higher than the prior year in most of the revenue categories, including Sales Tax, Transient Occupancy Tax, Telephone Line Tax, Franchise Fees, Utility Tax, Licenses and Permits, Fines, Forfeits and Penalties, Revenue from Local Agencies, Revenue from the Federal Government, Departmental Charges, Transfers, and Reimbursements for Services. The revenue categories tracking below the prior year level include Property Tax, Use of Money and Property, Revenue from the State, Other Revenue (excluding the TRANs), and Overhead.

In the development of the 2010-2011 Adopted Budget, it was assumed that collections in some of the economically sensitive categories, such as Sales Tax, would show slight improvement in 2010-2011, while other revenue categories, such as Property Tax, were expected to decline. Through December 2010, General Fund revenues were tracking below expected levels due to lower collections in several categories, with the largest variances in Utility Taxes, Franchise Fees, Cardroom Tax, Use of Money and Property (interest earnings), and Airplane In-Lieu Tax. Accordingly, as part of the Mid-Year Budget Review actions, net downward adjustments of $10.0 million to revenue estimates were approved, offset by the use of the Economic Uncertainty Reserve ($4.0 million), transfers from other funds and increased revenues ($3.6 million), and expenditure shifts and transfers ($2.4 million).

Based on collections through February, it is anticipated that General Fund revenues will meet the overall modified budget estimate by year-end. However, continued close monitoring of 2010-2011 performance will be necessary to determine if additional adjustments to these revenue estimates will be necessary during the remainder of the year.

The following discussion highlights General Fund revenue activities through February.

KEY GENERAL FUND REVENUES

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Property Tax	**$ 194,909,000**	**$ 101,941,895**	**$ 108,673,440**

The Property Tax category consists of Secured Property Tax, Unsecured Property Tax, SB 813 Property Tax (retroactive collections back to the point of sale for reassessments of value due to property resale), and Homeowners Property Tax Relief. Through February, $101.9 million was

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

received. The 6.2% decrease from the prior year collection level of $108.7 million was the result of lower collections in all Property Tax categories.

Secured Property Tax accounts for $91.5 million of the $101.9 million in Property Tax revenue received through February 2011. For 2010-2011, the Adopted Budget estimate for Secured Property Taxes of $183.4 million allowed for a 1.3% decline from the 2009-2010 actual collections. In August 2010, the County of Santa Clara provided a preliminary Secured Property Tax estimate of $182.1 million for 2010-2011 that indicated a drop of 2.0% from the actual 2009-2010 collection level. Based on that updated estimate, a $1.3 million reduction to the Secured Property Tax revenue estimate was approved by the City Council as part of the 2009-2010 Annual Report actions, bringing the budget estimate to $182.1 million. That adjustment allows for a 2.0% decline in 2010-2011 from actual 2009-2010 receipts. Because tax roll adjustments are still occurring and will continue to take place until the end of May 2011, the Budget Office will continue to work with the County to revise the revenue estimate for the Secured Property Tax category as necessary.

The largest payment in the Unsecured Property Tax category is received in October of each year. Receipts of $9.9 million are tracking to end the year at $11.0 million, which would exceed the budgeted estimate of $10.2 million by approximately $800,000. This collection level represents a decline of 10.5% from the actual 2009-2010 receipts of $12.3 million. The 2010-2011 Unsecured Property Tax revenue estimate of $10.2 million allows for a 16.7% decline from the prior year.

For the SB 813 Property Tax category, no payments have been received for 2010-2011 because, according to the County, the net collections through February 2011 are less than the unprocessed negative supplemental taxes accumulated from 2009-2010 and 2010-2011. The 2010-2011 Adopted Budget estimate of $3.3 million anticipated an increase of 10.2% from the $3.0 million collected in 2009-2010. In August 2010, the County of Santa Clara provided a preliminary SB 813 Property Tax estimate of $1.5 million for 2010-2011 that indicated a drop of 50% from the actual 2009-2010 collection level. Based on that updated estimate, a $1.8 million reduction to the SB 813 Property Tax revenue estimate was approved by the City Council as part of the 2009-2010 Annual Report actions, bringing the budget estimate to $1.5 million. That adjustment allows for a 50.7% decline in 2010-2011 from actual 2009-2010 receipts. Depending on the impact of the negative supplemental tax adjustments through the remainder of the year, an additional downward adjustment may be necessary.

It is anticipated that Homeowners Property Tax Relief revenue will be received at approximately the budgeted level of $1.1 million.

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Sales Tax	**$ 134,679,000**	**$ 68,654,636**	**$ 63,440,262**

The Sales Tax category includes General Sales Tax and Proposition 172 Sales Tax.

General Sales Tax receipts through February of $66.4 million are tracking 8.5% above the prior year collection level of $61.2 million. This reflects actual performance for the first quarter along with a "triple flip" payment and advances from the State. This also reflects the effect of a Sales Tax recording error that understated the fourth quarter General Sales Tax for 2008-2009 and correspondingly overstated the first quarter General Sales Tax for 2009-2010. As part of the Mid-Year Budget Review actions, the City Council approved an increase of $3.2 million to the revenue estimate to reflect the improved first quarter General Sales Tax performance.

While not reflected in the figures through February, the City has received preliminary information on the City's Sales Tax performance in the second quarter that shows an increase of 10.4% from the same quarter in 2009-2010 (last fiscal year, this quarter was down 5.3%). This represents sales activity from October through December 2010. While cash receipts were up 10.4%, Sales Tax collections on an economic basis were up somewhat less, by 9.2%. The City's Sales Tax consultant, MuniServices, LLC, provided economic performance data, which is considered to be a more accurate measure of the actual sales tax activity in San José for a particular period than the cash receipts. This analysis measures sales tax receipts, excluding state and county pools, and adjusts for anomalies, payments to prior periods, and late payments. On an economic basis, the increase in the most recent quarter was the result of increases in all sectors except Miscellaneous.

Sales Tax Revenue Economic Performance
2nd Quarter 2010-2011

Economic Sector	% of Total Revenue	% Change from 2nd Quarter 2009-2010
General Retail	30.8%	+ 6.3%
Business to Business	26.4%	+19.3%
Transportation	19.3%	+ 7.6%
Food Products	14.7%	+ 3.0%
Construction	8.1%	+ 8.4%
Miscellaneous	0.7%	- 14.9%
Total	**100.0%**	**+ 9.2%**

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

The modified budget estimate of $130.9 million, reflecting actual results from the first quarter of 2010-2011, allowed for a 6.1% increase in 2010-2011 from actual 2009-2010 cash receipts and anticipated that the remaining three quarters of the fiscal year would experience approximately 1% growth from the prior year. With one-time accounting adjustments to reflect prior-year collections and the "Triple Flip" true-up payment from the State for 2009-2010, year-over-year growth is estimated to be approximately 8.8% by year end.

It is important to note that the Sales Tax growth in the first two quarters of 2010-2011 was built on the prior-year quarters in which Sales Tax declined by 18.2% (down 12.8% on an adjusted basis) and 5.3%. Because the Sales Tax receipts for the remaining two quarters of 2010-2011 will be compared with prior-year quarters in which collections increased (13.0% for the third and fourth quarters), it would be premature to suggest adjustments to the growth assumptions for the remaining two quarters of 2010-2011. Economic data and other indicators of the City's Sales Tax performance will continue to be closely monitored to determine if any adjustments are necessary to the budgeted estimate by year-end.

Through February, the Proposition 172 Sales Tax receipts of $2.2 million were tracking at the prior year collection level. The 2010-2011 budget estimate, however, allows for a drop of 3.2%. Based on year-to-date collection trends, it is likely receipts in this category will end the year above the budgeted estimate.

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Transient Occupancy Tax	**$ 6,684,000**	**$ 3,907,775**	**$ 3,542,348**

Through February, Transient Occupancy Tax (TOT) collections of $3.9 million were tracking 10.3% above the prior year collection level of $3.5 million for the same period. The 2010-2011 Adopted Budget assumed an increase of 2.0% from the 2009-2010 estimated level; however, the budget now allows for a decline of 3.1% based on higher than anticipated 2009-2010 collections. It is anticipated that TOT receipts will achieve or exceed the budgeted revenue estimate of $6.7 million by year-end.

Through February, the average hotel occupancy rate at the 14 major hotels was 57.6%, a significant improvement from the 53.2% occupancy rate for the same period in 2009-2010. For the same 14 hotels, the average daily room rate through February was $118.72, up slightly from the $117.00 room rate for the same period in 2009-2010. The year-to-date average revenue-per-available-room (RevPAR) metric of $68.34 represents an increase of 9.7% from the prior year level. TOT receipts will be closely monitored as the year progresses, and budget adjustments will be brought forward for City Council consideration, if necessary.

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Utility Tax	**$ 87,432,000**	**$ 51,321,228**	**$ 47,098,781**

Through February 2011, Utility Tax receipts of $51.3 million reported in the City's financial management system were up 9.0% from last year's collection level of $47.1 million. In several Utility Tax categories, however, large payments for last February 2010 were received too late to be included in the February 2010 month-end accounting close. Adjusting for those payments, Utility Tax receipts through February of $51.3 million were just equal to the prior year collection level. To meet the 2010-2011 budgeted estimate, receipts can decline 0.2% from the prior year. If current collection trends continue, overall collections for this category could fall below the budgeted estimate.

In the Electric Utility Tax category, collections of $23.9 million were tracking 3.0% above the prior year level of $23.2 million (adjusting for a large February 2010 payment that was posted after the month-end accounting close); however, growth of 3.6% is needed to meet the Electric Utility Tax budget estimate of $39.2 million. The 2010-2011 Adopted Budget incorporated rate increases that were scheduled to become effective in January 2011. However, in October 2010, Pacific Gas and Electric Company (PG&E) filed a settlement agreement with the California Public Utilities Commission (CPUC) that would significantly reduce those rate increases and consequently reduce the City's 2010-2011 Electric Utility Tax revenue. Although no final decision from the CPUC has been made, it is clear that electric rates will not experience the level of growth built into the revenue estimate. Based on current trends, collections could fall below the budgeted estimate.

In the Gas Utility Tax category, receipts of $4.7 million were tracking 2.2% above the prior year level of $4.6 million (adjusting for a large February 2010 payment that was posted after the month-end accounting close). In February 2011, in conjunction with the 2010-2011 Mid-Year Budget Review, the City Council approved a $2.0 million decrease to the budget estimate for this category. The budgeted estimate of $8.6 million requires growth of 0.6% from the actual 2009-2010 collection level. Collections in the next several months will provide a much better indicator of receipts in this category since approximately two-thirds of the revenue in this category is typically collected in the second half of the year.

In the Water Utility Tax category, receipts of $4.9 million were tracking 10.9% below the prior year level of $5.5 million (adjusting for a large February 2010 payment that was posted after the month-end accounting close). In February 2011, in conjunction with the 2010-2011 Mid-Year Budget Review, the City Council approved a $600,000 decrease to the budget estimate for this category. The budgeted estimate of $9.0 million requires growth of 3.6% from the actual 2009-2010 collection level. A rate increase of 3.1% was implemented in January 2011, and this

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

category is always subject to fluctuations related to the amount of precipitation received, particularly in the spring. This category may also be impacted by conservation efforts. At this point, collections could fall below the budgeted estimate.

Collections in the Telephone Utility Tax category of $17.8 million were tracking 1.2% below the prior year collection level of $18.0 million. According to the City's Utility Tax consultant, the lower level of collections reflects a combination of the following factors: (1) continuing migration from land-line service to less-expensive wireless service; (2) intense price competition among wireless service providers; and (3) increased use of service plans that bundle voice service with data service, which qualifies for a federal exemption from the Telephone Utility Tax. In February 2011, in conjunction with the 2010-2011 Mid-Year Budget Review, the City Council approved a $2.9 million decrease to the budget estimate for this category. The budgeted estimate of $30.6 million allows for a 5.9% decline from the actual 2009-2010 collection level. Based on current collection trends, this category is anticipated to achieve the budgeted revenue estimate by year end.

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Licenses and Permits	**$ 68,198,220**	**$ 52,685,592**	**$ 43,630,670**

Through February, Licenses and Permits revenue of $52.7 million tracked 20.8% above the prior year level of $43.6 million. The 2010-2011 budget estimate anticipates growth over the 2009-2010 collection level of 3.4%. Categories that exceeded the prior year included Business Tax, Cardroom Tax, Building Permits, Fire Permits, and Miscellaneous Licenses and Permits. These positive variances were partially offset by lower collections in the Disposal Facility Tax category. Following is a discussion of the major components of this category.

In the Business Tax category, revenues of $8.9 million through February were tracking 4.3% above the prior year level of $8.6 million. Growth of 1.1% from the 2009-2010 actual collection level is necessary to meet the budgeted Business Tax estimate of $11.0 million.

Cardroom Tax receipts of $8.3 million through February were 12.6% above the prior year level of $7.3 million. Receipts were expected to increase from $12.5 million in 2009-2010 to $17.7 million in 2010-2011 based on the Cardroom Tax ballot measure, approved by the voters in June 2010, that increased the Cardroom Tax rate from 13% to 15% and increased the maximum number of card tables from 80 to 98. However, current year activity levels are lower than anticipated when the 2010-2011 Adopted Budget was developed. In February 2011, in conjunction with the 2010-2011 Mid-Year Budget Review, the City Council approved a $3.9 million decrease to the budget estimate for this category. The budgeted estimate of $13.8 million allows for a 10.5% increase from the actual 2009-2010 collection level. Collections are currently projected to meet the revised budget estimate.

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

Disposal Facility Tax revenue of $6.6 million through February is tracking 2.3% below the prior year level of $6.7 million. In the development of the 2010-2011 Adopted Budget, it was assumed that collections would remain flat at the 2009-2010 estimated collection level based on the assumption that reductions associated with waste diversion would offset any increase in economic activity. However, receipts are continuing to experience declines reflecting the combination of the slow economic recovery and diversion efforts. In February 2011, in conjunction with the 2010-2011 Mid-Year Budget Review, the City Council approved a $300,000 decrease to the budget estimate for this category. The budgeted estimate of $11.3 million allows for a 2.7% decrease from the actual 2009-2010 collection level. Collections are currently projected to meet the revised budget estimate.

Building Permit receipts of $15.6 million through February were tracking well above both the 2010-2011 year-to-date estimate of $9.9 million, and the prior year-to-date collection level of $10.0 million. Revenues in all plan check and permit categories are tracking above estimated levels. Strong revenue receipts are entirely driven by a spike in residential permits in December. The December housing unit permit count of 1,641 was only the third time in the last decade that the count exceeded 1,000 units. Following this spike, a return to slower residential activity occurred through January and February. February also saw a continuation of moderate commercial and slow industrial permit activity. Despite this slow activity projected for the remainder of 2010-2011, given the strong residential performance in the first half of the year, Building Permit receipts are on track to exceed the budgeted revenue estimate of $16.2 million. Due to higher than anticipated Building activity, the revenue estimate was increased by $477,000 in the Mid-Year Review. This allocation was approved to support temporary staff resources and assisted with General Fund rebalancing by offsetting General Fund resources previously allocated to support Development Services in 2010-2011.

Through February, Fire Permit collections of $5.9 million were tracking above estimated levels and 31.9% above the prior year receipts of $4.4 million. Development-related collections of $2.9 million are 54.5% above levels received through February 2010, and almost 35% above current year estimates due to higher than projected collections in architectural and engineering systems (fire sprinkler and alarm systems) plan review and inspections. Development Fee Program revenue is currently projected to exceed the budgeted estimate by $1.1 million. The estimate for Development Fee revenue was increased by $208,000 in the 2010-2011 Mid-Year Budget Review to reflect higher than anticipated activity and to assist with General Fund rebalancing by offsetting General Fund resources that were allocated to support Development Services in the 2010-2011 Adopted Budget. The Fire Non-Development Fee Program is currently tracking above estimated levels with higher than estimated collections in the Annual Renewable Permits. At this time, collections are projected to meet the budgeted revenue estimate of $4.5 million in the Non-Development Fee Program. The City Manager's Budget Office and Fire Department will continue to monitor both development and non-development revenues closely.

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Revenue from Local Agencies	**$ 45,682,351**	**$ 30,104,422**	**$ 26,224,772**

This category includes reimbursement from the Redevelopment Agency for City services, grants from various agencies, reimbursement for fire suppression services in unincorporated County pockets, and reimbursement for emergency medical services. Revenues through February of $30.1 million were above the prior year level of $26.2 million primarily due to differences in the timing of payments and budgeted reimbursements.

The budgeted reimbursements from the San Jose Redevelopment Agency total $15.0 million for City services and an additional $15.0 million for the Convention Center debt service payments. It is currently anticipated that the City will be reimbursed for all eligible expenses. Through February, the City has received $21.6 million from the Redevelopment Agency to reimburse the City for eligible expenditures, somewhat above the prior year level of $19.9 million due to the receipt of the Agency's reimbursement for San José BEST one month earlier than last year. The 2010-2011 budget for the Redevelopment Agency was approved by the Agency Board in November 2010.

Through February, payments totaling $2.5 million have been received from the Central Fire District for fire services provided by the City. The current-year collections are tracking 15.3% below the prior-year level of $3.0 million. In February 2011, in conjunction with the 2010-2011 Mid-Year Budget Review, the City Council approved a $540,000 decrease to the budget estimate for this category. The budgeted estimate of $5.1 million allows for a decline of 15.3% from the actual 2009-2010 collection level. The reduction to the revenue estimate, based on information from the Central Fire District staff, is due to the drop in Property Tax receipts and the impact of annexations by the City.

Overall, the other reimbursements from various agencies are tracking within estimated levels through February. Revenues in this category are projected to end the year close to the budgeted estimates, and the City Manager's Budget Office will bring forward any necessary adjustments.

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Departmental Charges	**$ 29,610,267**	**$ 20,430,040**	**$ 14,198,022**

Through February, Departmental Charges revenues of $20.4 million were tracking 43.9% above the 2009-2010 collection level of $14.2 million. This level of growth exceeds the 8.5% increase over the prior year required to meet the 2010-2011 budget estimate. This increase from the prior year is due primarily to the increase in collections in the Parks, Recreation and Neighborhood

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

Services Department (PRNS) associated with the timing of the re-opening of the Happy Hollow Park and Zoo.
The Miscellaneous Departmental Charges category, which is budgeted at $5.2 million, includes the Solid Waste Enforcement Fee with a budgeted estimate of $3.5 million, various Animal Control Fees budgeted at $708,000, and other miscellaneous fees budgeted at $992,000. Solid Waste Enforcement Fee revenues of $1.5 million were tracking as anticipated, reaching 62.0% of the budgeted estimate of $3.5 million. It is projected that this fee will end the year within the budgeted estimate. Animal Care and Services Departmental Charges are budgeted at $708,000 and include Animal Control Fees for a variety of services. Collections through February of $426,000 are within anticipated levels and are expected to reach the budgeted level at year-end.

Through February, Police revenues of $1.2 million were tracking 6.6% below the expected level and 1.7% below the prior year level. The lower than anticipated revenue collections can be attributed to lower collections for Impounded Vehicle Releases, Photostats (Police Records/Reports), and miscellaneous revenue. These lower than anticipated collections are partially offset by higher collections in Police Officer Standards and Training (POST), Special Events Permits, and Police Officers Attending Civil Court. The Police Department and City Manager's Budget Office will continue to closely monitor performance, and at this time, revenue is tracking to end the year approximately $125,000 below estimated levels.

Public Works revenues through February of $3.4 million are 65.4% above the prior year level of $2.0 million, but the volatile nature of development activity should temper any inclination to consider this large increase as indicative of a trend. To meet the 2010-2011 budget estimate of $4.3 million, collections levels must increase 2.4% above the prior year levels. At this point in time, it is anticipated that the Public Works Fee Program will end the year above the estimated level.

Transportation fee collections through February totaled $795,000, up 56.9% from the prior year amount of $507,000. This collection level exceeds the budgeted estimate of $779,000. The year-over-year increase primarily results from recognizing Department of Transportation reimbursements for special event costs as Departmental Charges revenue rather than including those reimbursements in an aggregated special events item reported in the Other Revenue category as was done in prior years.

Library departmental revenue of $535,000 is tracking well below expected levels through February due to lower than projected fine revenue. Based on prior year performance and current collection trends, Library revenues may fall below the revenue estimate of $1.9 million by year-end. If necessary, a year-end adjustment will be brought forward.

Through February, Planning fee revenue of $1.7 million was 3.9% above prior year-to-date collections, and 18% above estimated year-to-date revenue levels. Should this trend continue,

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

the Planning fee program is on track to reach the $2.4 million revenue estimate. This estimate represents a 12% reduction from the prior year actuals, given projections of very slow activity for 2010-2011. While receipts through February are tracking to meet the budgeted revenue estimate, continued slow activity remains a concern, and a balance of $368,000 will be available in the Planning Fee Program Reserve should a revenue shortfall occur. The City Manager's Budget Office and the Department will continue to monitor Development Fee Program revenues closely, and bring forward additional adjustments if necessary.

Through February, PRNS Departmental Charges revenue of $9.1 million is well ahead of the 2009-2010 level of $5.3 million, primarily due to Happy Hollow Park and Zoo (HHPZ), which was not yet open in February 2010. With an overall revenue target of $13.1 million, year to date collections have achieved approximately 69% of the budgeted estimate. Categories with higher than anticipated collections include Fee Activity, Parking, and After-School Recreation. It is anticipated at this time that overall year end collections will meet or exceed the budgeted revenue estimate.

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Transfers and Reimbursements	**$ 93,339,330**	**$ 69,688,704**	**$ 58,117,635**

This category includes overhead reimbursements from operating and capital funds, transfers, and other reimbursements. Transfers and Reimbursement collections of $69.7 million through February were tracking above the prior year level of $58.1 million due primarily to one-time transfers from the Healthy Neighborhoods Venture Fund, the Construction Excise Tax Fund, the Integrated Waste Management Fund, and the Construction and Conveyance Tax Fund. Those additional transfer revenues have been partially offset by lower levels of overhead reimbursements.

Overhead associated with operating funds and special funds is currently budgeted at $23.7 million. In addition, overhead associated with capital funds is budgeted at $10.6 million for a total revenue estimate of $34.3 million. Through February, overhead collections of $29.6 million were tracking within estimated levels.

Transfers from other funds collections of $34.8 million are currently tracking slightly below the budget estimate of $41.7 million, primarily due to lower than anticipated interest earnings transfers from other funds to the General Fund that have already been adjusted downwards once this year. As part of the Mid-Year Budget Review actions, the City Council approved adjustments in this category which increased one-time transfers from other funds to offset revenue estimate reductions in other categories and which reduced the estimates for interest earnings transfers from other funds. It is anticipated that collections in this category could fall slightly below the budgeted estimate by year-end.

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

The budget estimate for the Reimbursements for Services category is $17.4 million, of which $16.6 million is expected to be generated from the three Gas Tax Funds. Gas Tax revenues through February were tracking approximately $1.0 million below the budgeted estimate, and the City Manager's Budget Office will continue to monitor Gas Tax revenues closely and bring forward adjustments if necessary.

Overall, collections in the Transfers and Reimbursements category are expected to fall below the budgeted estimate by as much as $1.0 million by year-end. The City Manager's Budget Office will continue to monitor the collections in this category closely and bring forward any necessary adjustment.

EXPENDITURES

Through February, General Fund expenditures of $595.3 million were 13.4% above the prior year level of $525.1 million. Encumbrances of $28.9 million were 17.4% below the prior year level of $35.0 million. Expenditures and encumbrances ($624.2 million) through February constitute 65.4% of the total 2010-2011 revised budgeted uses of funds ($954.1 million, excluding reserves). Overall, cumulative departmental and non-departmental expenditures are tracking within budgeted levels.

It should be noted that the City Council approved actions as part of the Mid-Year Budget Review to capture $8.5 million of current year savings in the 2010-2011 Ending Fund Balance reserve. These savings have been factored into the General Fund Forecast for 2011-2012.

Many departments are currently experiencing or are expected to experience higher than budgeted personal services expenditures due to unbudgeted vacation sell-back expenses and/or vacation and compensatory time payouts associated with employee separations from retirements or layoffs (June 26, 2011) that are anticipated to occur by year-end. Implementation of Internal Revenue Service rules related to taxation of vacation days sold back to the City by eligible employees has impacted vacation sellback expenses in several departments. Departments will absorb these additional costs to the extent possible through savings from the employee turnover, overtime controls, and/or identifying potential offsets through non-personal/equipment appropriation savings.

Net-zero budget adjustments were approved as part of the Mid-Year Budget Review to reflect transfers between appropriations to address projected Personal Services expenditure overages for the following departments: City Attorney's Office, City Manager's Office, Fire Department, General Services Department, and the Information Technology Department. However, additional funding may need to be distributed to some departments by the end of the fiscal year to prevent appropriation over-runs.

GENERAL FUND (Cont'd.)

KEY GENERAL FUND EXPENDITURES

Department	2010-2011 Budget	YTD Actual	Prior YTD Actual
Police	**$ 298,287,587**	**$ 182,883,305**	**$ 185,573,270**

On an overall basis, Police Department expenditures are tracking slightly below estimated levels. Personal Services expenditures of $173.7 million are tracking under anticipated levels (62.7% compared to the par of 64.0%). Through the end of February, the Department had 32 sworn vacancies, offset by two temporary sworn personnel, one Police Lieutenant position and one Police Officer position, funded by Urban Area Security Initiative (UASI) grants. Overtime expenditures of $5.9 million through February tracked below anticipated levels with 47.8% expended. The compensatory time balance at the end of February 2011 was 187,874 hours for sworn personnel. This represents a decrease of 5,475 hours (2.8%) from the December 2010 balance of 193,349, and a 36,094 hour decrease (16.1%) compared to the February 2010 balance of 223,968. The overall reduction in compensatory time balance can be attributed to a number of factors including higher than normal attrition in 2009-2010 (leading to compensatory time balances being paid out at the time of separation as demonstrated by higher expenditures in full-time salaries), and additional overtime controls implemented during 2009-2010, which have continued through 2010-2011.

The overtime management process requires preapproval by a supervisor and additional timesheet coding is required to determine the type of usage in order to readily identify mandatory versus discretionary usage. This process has been useful in reducing discretionary overtime expenditures. Continued active management of the overtime budget and earned compensatory time is necessary to ensure overall personal services expenditures remain within budgeted levels. The Budget Office and Police Department will continue to closely monitor Personal Services to ensure expenditures are within appropriated levels by year-end.

A total of $12.8 million (60.1%) of the Department's Non-Personal/Equipment budget was expended or encumbered through February. Excluding the remaining balances for centrally-determined details, including electricity, gas, and vehicle operation and replacement, the Department has approximately $4.5 million, or 39.6% of the non-centrally-determined appropriation, available for the remainder of the fiscal year. The Budget Office and the Department will monitor expenditures closely to ensure expenditures are within appropriated levels by year-end.

Department	2010-2011 Budget	YTD Actual	Prior YTD Actual
Fire	**$ 154,206,091**	**$ 98,851,942**	**$ 97,517,514**

GENERAL FUND (Cont'd.)

KEY GENERAL FUND EXPENDITURES (Cont'd.)

Overall, expenditures for the Fire Department were tracking slightly above budgeted estimates through February, with 64.1% expended. Although Personal Services expenditures through February of $94.7 million were tracking at 64.4% of budget (slightly above the par level of 64.0%), cost saving measures implemented by the Department are anticipated to bring expenditures within the current appropriation level by year-end. The Fire Department's Non-Personal/Equipment budget of $7.1 million was 71.9% expended or encumbered through February. These expenditures are also expected to end the year within the budgeted allocation.

Personal Services expenditures are tracking above estimated levels because there are insufficient overtime savings to offset the higher salary and benefit costs. Expenditures for salaries and benefits tracked higher than estimates largely due to higher than budgeted expenditures related to leave balance payouts for 49 Firefighters laid off at the end of July ($134,000) and leave balance payouts for retirees through February ($741,000).

Overtime expenditures of $6.2 million tracked below par levels (53.9% compared to the par of 64.0%) through February. Although overtime expenditures tracked below par levels, the level of overtime savings currently being generated is not as high as anticipated due to a higher sworn absence rate in 2010-2011 through February of 17.0% compared to the 2009-2010 absence rate for the same period of 13.7%. Through the end of February, the Department had 38 sworn vacancies. When relief staffing can not meet vacancies in duty positions, absences are filled by overtime. Higher absences in 2010-2011 are primarily the result of more sworn positions being absent from line duty due to illness, modified duty, or disability than previously experienced in 2009-2010. To address higher expenditures, the Department will continue implementing overtime control measures for activities not related to minimum staffing. These cost control measures are expected to bring expenditures within the budgeted appropriation. The Fire Department will continue to closely monitor and control expenditures to minimize any potential overage and the Budget Office will bring forward a year-end clean-up, if necessary.

Through February, the Fire Department was staffed with 174 filled Firefighter Paramedic positions (160 front-line Firefighter Paramedics, 5 Supervisors, and 9 support) compared to the 139 front-line Firefighter Paramedics that are necessary to fully staff all apparatus. The Department projects it will have no issues maintaining the target staffing level of 139 front-line Firefighter Paramedics. As part of the City Council's approval of Department Absence and Vacancy Rates (March 2010), it should be noted that the number of sworn administrative staff in the Department through February was 30, which is within the authorized number of 34.

GENERAL FUND (Cont'd.)

KEY GENERAL FUND EXPENDITURES (Cont'd.)

Department	2010-2011 Budget	YTD Actual	Prior YTD Actual
City Attorney's Office	**$ 11,415,510**	**$ 7,305,179**	**$ 8,416,401**

Personal services expenditures of $7.1 million are tracking above estimated levels, while non-personal/equipment expenditures and encumbrances of $498,000 are tracking below estimated levels. Additional actions to clean-up personal service expenditures in the City Attorney's Office are anticipated before year end.

Through February, the personal services appropriation is tracking at 66.4% expended, which is 2.4% (or $257,000) above the par level of 64.0%. This is due to a number of factors, including insufficient vacancies to meet a budgeted vacancy factor of 0.5% and vacation sellback of $125,000 (all funds) through February. In addition, salaries reallocated to alternative funding sources as part of the 2010-2011 balancing strategies of the Attorney's Office have not been implemented as originally planned ($275,000). The 2010-2011 Adopted Operating Budget included the reallocation of staff from the General Fund and the Workforce Investment Act (WIA) Fund to the False Claims Act appropriation and the Municipal Solar Grant Program. The current workload associated with these projects has not occurred at the levels approved as part of the 2010-2011 Adopted Budget; therefore the City Attorney has assigned staff to unbudgeted General Fund legal work. In addition, the personal services expenditures continue to track high in special funding sources such as the WIA Fund. Should a solution for the higher than budgeted expenditures in these other funding sources not be identified, the General Fund could be negatively impacted further. An overage is anticipated by year end and expenditures continue to be monitored closely.

Non-personal/equipment expenditures are below par through February despite the reallocation of $150,000 in funding to personal services in the 2010-2011 Mid-Year Review. Additional savings in this appropriation will most likely be necessary to offset the higher than anticipated expenditures in personal services.

CONTINGENCY RESERVE

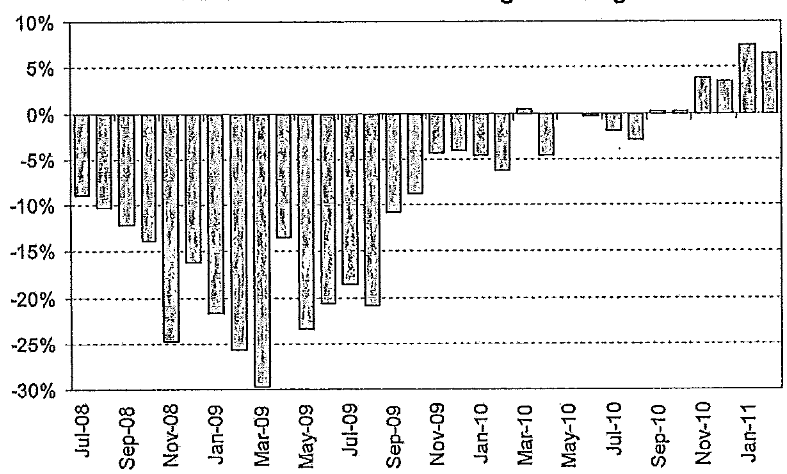
The General Fund Contingency Reserve remains at $29.3 million through February, with no revisions through the first eight months of the fiscal year.

OTHER FUNDS

Airport Funds

On a fiscal year-to-date basis, the Norman Y. Mineta San José International Airport has enplaned and deplaned 5.5 million passengers, an increase of 1.9% from the figures reported through February of the prior year. This is the sixth consecutive month passenger activity has increased compared to the same period a year ago (passenger activity in February 2011 was 7% above activity in February 2010) as shown in the chart below. However, the number of passenger operations (landings and takeoffs) fell in February, and the fiscal year-to-date total trailed the prior year by 8.8%.

SJC Year over Year Passenger Change



Fiscal year-to-date mail, freight and cargo totaled 63.4 million pounds, which represents a 14.9% decrease from 2009-2010. Landed Weights were below estimates by 4.9%, and Taxicab Operations exceeded last fiscal year by 2.1%. Passenger Facility Charge revenues exceeded last fiscal year by less than 1% (0.4%).

Overall revenue performance at the Airport for the eight months ending February 2011 tracked above the budget estimate by 2.6%. Airline rates and charges, primarily landing fees and terminal rentals, tracked at 3.1% above the budget estimate. Airfield revenues exceeded projections by 12.3% primarily due to increased in-flight kitchen and ground concession revenues. The terminal concessions and miscellaneous rents category also performed above expected levels by 2.9%, and the parking and roadway category was 4.5% higher than the estimated budget principally due to higher public parking and rental car concession activity. Other general and non-aviation revenues were slightly below the budget estimate by 2.4% because of lower than expected interest income. The Airport anticipates ending the year with overall revenue levels above estimates.

Year-to-date Personal Services expenditures through February were 63.5% of budget, which were in line with the budget benchmark of 64.0%. Staff retirements are expected to result in additional savings. Non-Personal/Equipment expenditures through February were 48.0% of

OTHER FUNDS (Cont'd.)

budget compared to the benchmark of 58.8%. Current encumbrances of $8.4 million bring total Personal Services and Non-Personal/Equipment commitments to $44.8 million or 65.8% of the budget.

In the Airport Customer Facility and Transportation Fee Fund, Personal Services and Non-Personal/Equipment expenditures combined are tracking below the budget estimate (at 41.9% of budget).

Construction and Conveyance Tax Funds

Construction and Conveyance (C&C) Tax revenues are currently expected to meet budgeted estimates by year-end. Collections through February 2011 totaled $12.4 million (62% of the 2010-2011 estimate of $20.0 million), which represents a decline of almost 5.1% from the $13.0 million collected last year through February 2010. The City has since received March Conveyance Tax receipts totaling $1.17 million, which represents a 13.3% decrease from the $1.35 million received in March 2010. Although tax revenues are tracking lower than last year, the adopted C&C Tax estimate allowed for an 11.1% drop from the 2009-2010 collection level. Overall, tax revenues can decline by an additional 6% and still meet the adopted C&C tax estimate by year-end. Due to the volatile nature of this tax revenue, staff will continue to monitor receipts closely.

Nearly 99% of the total Construction and Conveyance Taxes are comprised of conveyance receipts, a tax based on the value of property transfers. Although the housing market appeared to be recovering during the first several months of the fiscal year, that trend has now reversed itself. From October 2010 through February 2011, the median home price has been decreasing compared to the same month in the prior year, and the median single-family home price in February 2011 of $455,000 decreased by 6.2% from the February 2010 median single-family home price of $485,000. Another indication of the slow housing market is that the average days-on-market for single-family and multi-family dwellings increased from 65 days in February 2010 to 192 days in February 2011. The average days-on- market for last year was 70 days compared to 105 days for this year. This average is trending upward as the number of days increased dramatically from 87 days in December to 204 days in January and 192 days in February. One bright spot in the real estate data is the number of property transfers (sales) for all types of residences which totaled 574 in February, representing an increase of approximately 13% from the 510 sales that occurred in the same month in the prior year.

Other Construction-Related Revenues

Through February, permit valuation for residential and commercial construction activity is above prior year levels; however, permit valuation for industrial construction activity is below prior year levels. Residential permit activity in the month of December spiked to its highest level in over a decade (1,641 units), and year-to-date permit valuation for residential activity totals $351.3 million, which is higher than prior year-to date collections of $77.2 million. This surge in

OTHER FUNDS (Cont'd.)

activity was primarily due to two very large development projects in the North San José area and should not be interpreted as a sustainable trend. Commercial activity was slow in February, with permit valuation at $13.8 million; however, permit valuation year-to-date totaled $147.2 million which is tracking higher than at this point last year ($119.2 million). Industrial permit activity for new construction was slow with valuation at $6.4 million through February, compared to $54.4 million collected through the same period last year, and the permit activity for alterations was high with valuation at $44.2 million through February, compared to $24.2 million collected through the same period last year. Overall, industrial permit activity remains lower than prior year-to-date collections. These permit activities drive the revenue collections in several categories, including the Construction Excise Tax, the Building and Structure Construction Tax, and the Residential Construction Tax, and are an indicator of future activity for several other categories, such as the storm and sanitary sewer system fees.

Through February, actual receipts for the ten revenue sources monitored for this report totaled $23.0 million, which represents a significant increase from the $8.0 million collected through the same period last year. Six of the ten revenue categories are currently exceeding budgeted levels as a result of the high revenue collections in December. Following is a discussion of the performance for the individual revenue categories:

- *Building and Structure Construction Tax* – Receipts through February totaled $7.4 million, which exceeds the 2010-2011 revenue estimate of $4.5 million. This collection level is over double prior year collections ($3.3 million) through February. This significant increase is due to a high collection level in December as a result of residential permits pulled prior to new building code implementation as well as two new housing developments in the North San José area. It should be noted that this higher revenue collection is not at a sustainable level. The 2011-2012 Proposed Budget will factor in the higher actual collections in 2010-2011 and a sustainable revenue estimate for 2011-2012.

- *Construction Excise Tax* – Receipts of $11.1 million are significantly higher than the $4.1 million collected during the same period last year. This collection level exceeds the 2010-2011 revenue estimate of $6.0 million. This large increase is due to a high collection level in December as a result of residential permits pulled prior to new building code implementation as well as two new housing developments in the North San José area. It should be noted that this higher revenue collection is not at a sustainable level. The 2011-2012 Proposed Budget will factor in the higher actual collections in 2010-2011 and a sustainable revenue estimate for 2011-2012.

- *Residential Construction Taxes* –Receipts totaled $181,000, which exceeds the current 2010-2011 estimate of $60,000, and is significantly higher than the receipts received through the same period last year ($13,000).

- *Municipal Water Service Connection Fees* – Receipts totaled $20,000, representing a decrease of 55.8% compared to the $46,000 collected through the same period last year. Because Municipal Water Service Connection Fees recover actual costs to install new

OTHER FUNDS (Cont'd.)

services, this lower collection level is offset by lower costs. This collection level is 11.4% of the current 2010-2011 revenue estimate of $175,000.

- *Municipal Water Major Facilities Fees* – Receipts totaled $416,000 through February, which was unanticipated. No estimated revenue collection for 2010-2011 was assumed in the development of the 2010-2011 Adopted Budget. These revenues will be programmed in the 2011-2012 Proposed Budget.
- *Municipal Water Advance System Design Fees* – Receipts totaled $42,000 through February, which represents a significant increase compared to the revenues collected through the same period last year ($8,000). This collection level is 83.1% of the current 2010-2011 revenue estimate of $50,000.
- *Municipal Water Meter Installation Fees* – Receipts totaled $39,000, representing a significant increase compared to the $7,000 collected through the same period last year. This collection level is 78.8% of the current 2010-2011 revenue estimate of $50,000.
- *Sanitary Sewer Fees* – Fees totaled $442,000, which exceeds the current 2010-2011 estimate of $350,000. This collection level is significantly higher than the fees collected through the same period last year ($151,000).
- *Storm Drain Fees* – Storm Drain Fees totaled $64,000, which represents 64.2% of the current 2010-2011 estimate of $100,000. This collection level is 6.3% higher than the fees received through the same period last year ($60,000).
- *North San José Traffic Impact Fee Fund* – Receipts totaled $3.3 million through February, which was unanticipated. No estimated revenue collection for 2010-2011 was assumed in the development of the 2010-2011 Adopted Budget as a result of the volatility of development activity in this area; however, as part of the 2010-2011 Mid-Year Budget Review, recommendations were approved to recognize $2.3 million of actual revenues received.

Convention and Cultural Affairs Fund

The Convention and Cultural Affairs Fund accounts for Team San José's (TSJ) operation of the City's Convention and Cultural Facilities. Extensive expenditure reductions were approved as part of the 2010-2011 Adopted Operating Budget to ensure the long-term health of the fund.

Revenues through February are tracking ahead of anticipated levels. While operating revenues of $8.7 million have been recognized, additional revenues of $1.2 million have been reported by TSJ but not yet recognized in the fund. With a budgeted year-end revenue estimate of $13.9 million, it is now anticipated that revenues will reach $16.1 million. A portion of this additional revenue will be used to cover the associated operating expenses.

OTHER FUNDS (Cont'd.)

Expenditures in the Non-Personal/Equipment category, which support food and beverage expenses, parking, the Broadway series, all variable labor costs, administration, and various other costs, are tracking within anticipated levels. While the appropriation is currently within expected levels, TSJ projects that year-end expenditures will exceed the budgeted level of $16.9 million due to additional activity at the Convention Center and other cultural facilities, which TSJ projects will be more than offset by additional revenue. At this time, an increase of $300,000 at year-end is anticipated to bring the appropriation in line with anticipated expenditures.

Expenditures in the personal services and Workers' Compensation categories are tracking well above anticipated levels and it is anticipated that year-end increases will be required. The projected overage of $250,000 in the personal services category is due primarily to unbudgeted compensation time payouts and overtime expenses and is expected to result in year-end expenses of $2.0 million in this appropriation. The projected overage of $150,000 in the Workers' Compensation category is due to a higher level of claims than experienced in prior years and is expected to result in year-end expenses of $300,000 in this appropriation. It is anticipated that the increases for both of these appropriations will be offset by the recognition of additional revenue at year-end.

Municipal Golf Course Fund

Revenues booked into the Municipal Golf Course Fund represent collections at the courses. In the case of the San Jose Municipal Golf Course the City receives a fixed percentage of the operator's gross revenues regardless of the operator's costs. For the Los Lagos and Rancho del Pueblo courses, the City receives the net of any expenses incurred by the operators. In months where revenues are not sufficient to cover the operator's expenses, the Municipal Golf Course Fund covers the difference.

Through February, revenues generated at the golf courses are far behind 2009-2010 collections through the same period. Revenues from San Jose Municipal Golf Course of $337,000 are $46,000 below the 2009-2010 level of $383,000. Net revenues from the Los Lagos course of $40,000 are $199,000 below the 2009-2010 level of $239,000. Revenue shortfalls are primarily due to decreased activity levels at the courses. The Rancho Del Pueblo course is not a revenue contributor to the fund, and year to date net costs at the course are $56,000 greater than last year through February 2011. The prolonged economic downturn is generally assumed to be responsible for decreased rounds of play. As revenues decrease, expenditures related to revenue shortfalls have increased since the courses experience greater or more frequent months when expenses outstrip revenues. Through February, expenditures are $209,000 higher than the 2009-2010 year to date level. In response to lower activity levels at the golf courses, decreases to the revenue estimates and increases to the expenditure appropriations were approved by the City Council as part of the 2010-2011 Mid-Year Budget Review. These changes were intended to bring the budget in line with anticipated activity. It is anticipated at this time that these actions

OTHER FUNDS (Cont'd.)

will be sufficient and the fund will end the year within estimated levels, however activity will continue to be closely monitored.

Transient Occupancy Tax Fund

Through February 2011, receipts recorded in the TOT Fund of $5.9 million are 10.3% above the prior year collection level for the same period. The 2010-2011 budget assumed an increase of 2% from the 2009-2010 estimated level, however the budget now allows for a decline of 3.1% based on higher than anticipated 2009-2010 collections. It is anticipated that TOT receipts will achieve or exceed the budgeted revenue estimate of $10.0 million by year-end.

The 2010-2011 allocations to the three recipient organizations (Convention and Cultural Affairs Fund, Convention and Visitors Bureau, Cultural Grants/Programs and Services) are anticipated to be fully expended by the end of the year.

Through February, the average hotel occupancy rate at the 14 major hotels was 57.6%, a significant improvement from the 53.2% occupancy rate for the same period in 2009-2010. For the same 14 hotels, the average daily room rate through February was $118.72, up slightly from the $117.00 room rate for the same period in 2009-2010. The year-to-date average revenue-per-available-room (RevPAR) metric of $68.34 represents an increase of 9.7% from the prior year level. TOT receipts will be closely monitored as the year progresses, and budget adjustments will be brought forward for City Council consideration, if necessary.

CONCLUSION

The slow pace of recovery from the economic recession continues to dampen growth in the City's economically sensitive revenue categories. For the General Fund, revenues are tracking very close to the estimated levels with no surplus anticipated at year-end. Expenditures are tracking within budget and, with adjustments in specific areas, should end the year with a minimal amount of savings. As previously discussed, the City Council approved actions as part of the Mid-Year Budget Review to capture $8.5 million of current year savings in the 2010-2011 Ending Fund Balance reserve. These savings have been factored into the General Fund Forecast for 2011-2012.

The administration will continue to very closely monitor economic conditions, the State's budget situation, the City's economically sensitive revenues, and expenditure levels, and bring forward budget recommendations if necessary. As always, staff will continue to report to the City Council any and all significant developments through this reporting process.

Jennifer A. Maguire
JENNIFER A. MAGUIRE
Budget Director

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

FINANCE DEPARTMENT

Monthly Financial Report

Financial Results for the 8 Months Ended February 28, 2011
Fiscal Year 2010-11
(UNAUDITED)

Finance Department, City of San José
Monthly Financial Report
Financial Results for the 8 Months Ended February 28, 2011
Fiscal Year 2010-11
(UNAUDITED)

Table of Contents

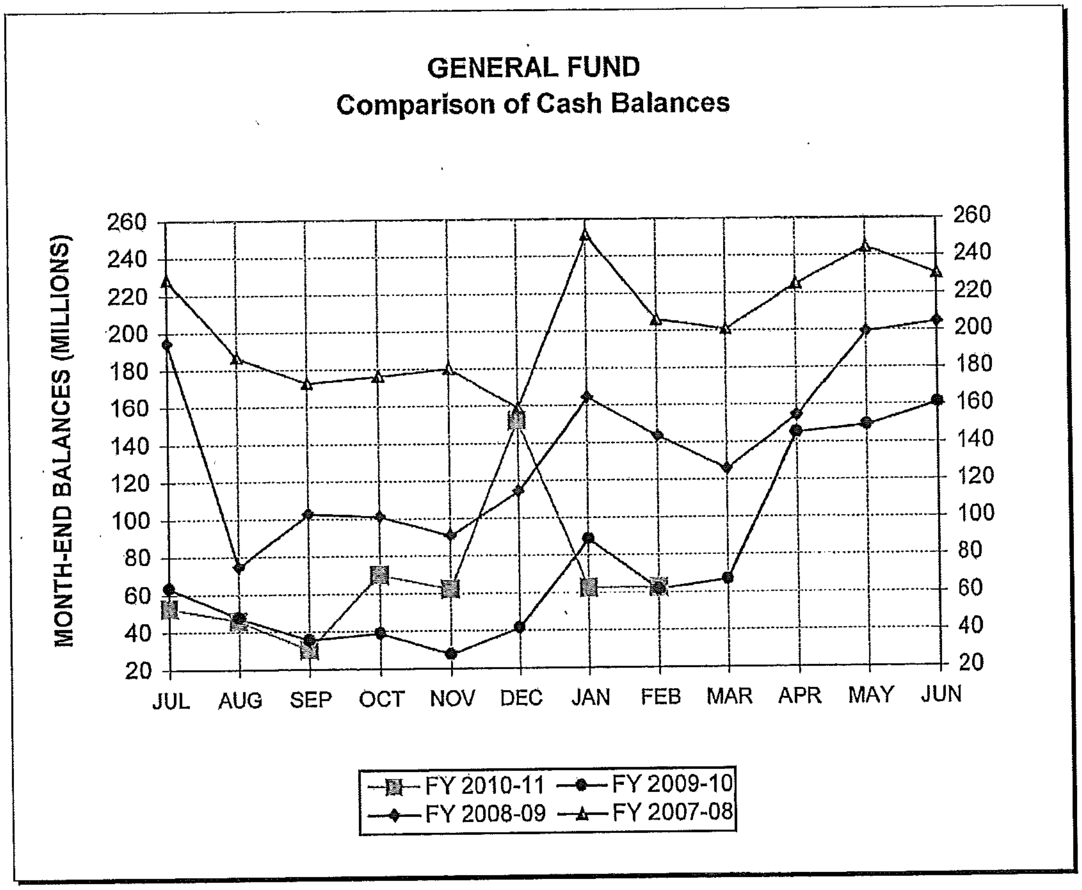
Finance Department, City of San José
Monthly Financial Report
Financial Results for the 8 Months Ended February 28, 2011
Fiscal Year 2010-11
(UNAUDITED)

Table of Contents

Page Reference

Submitted by:

SCOTT P. JOHNSON
Director, Finance Department



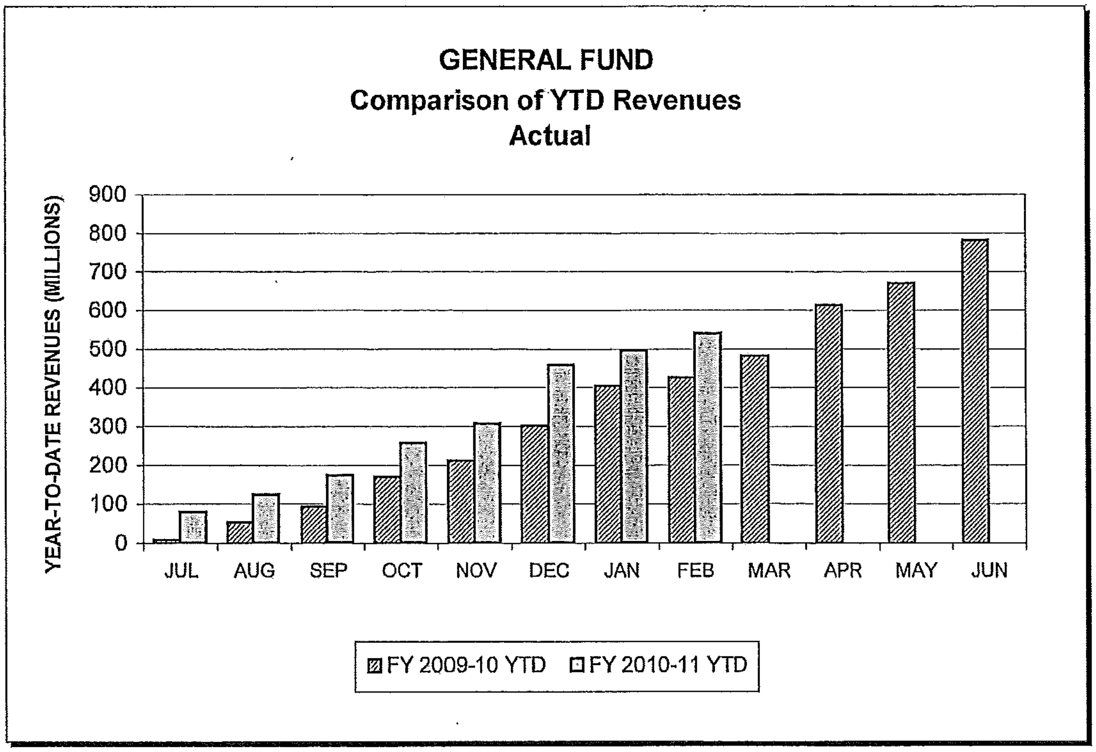
GENERAL FUND MONTHLY CASH BALANCES

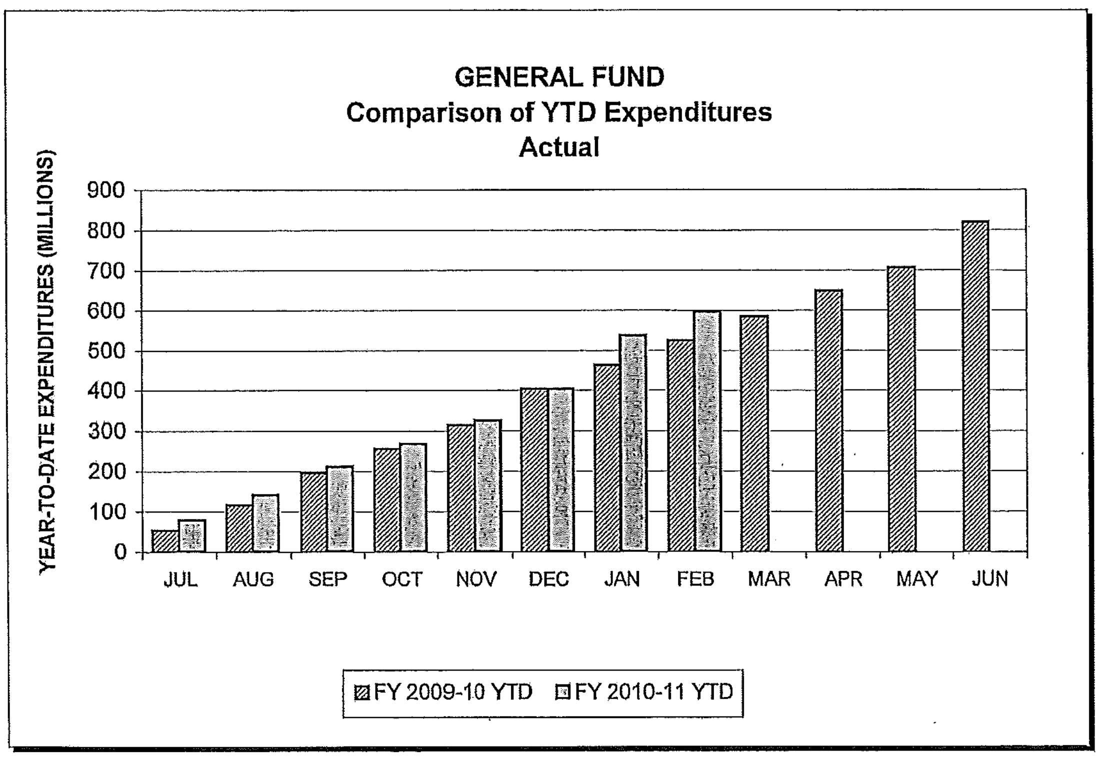
MONTH	FY 2010-11	FY 2009-10	FY 2008-09	FY 2007-08
JULY (1)	$ 52,614,304	$ 63,344,537	$ 194,527,843	$ 228,551,607
AUGUST (1)	45,992,983	47,689,216	74,677,718	186,835,010
SEPTEMBER	30,525,385	35,662,298	102,811,355	173,043,887
OCTOBER	70,246,706	38,946,966	101,433,688	176,617,539
NOVEMBER	62,333,059	27,736,074	90,892,525	180,164,388
DECEMBER (2)	152,493,162	41,491,217	114,535,815	159,164,830
JANUARY (3)	62,749,463	88,749,418	164,539,700	251,792,153
FEBRUARY	62,572,017	61,606,869	143,802,507	205,882,438
MARCH		66,979,823	125,900,953	200,763,696
APRIL		145,213,763	154,701,704	225,008,853
MAY		149,064,276	199,321,150	244,545,422
JUNE		161,013,785	204,474,123	230,556,706

Note: (1) The General Fund cash balance decrease in July 2010 (also in August 2008 and July 2009) was mainly due to the Council's direction to annually pre-fund the employer share of retirement contribution in a lump-sum to achieve budgetary savings to the City.

Note: (2) The General Fund cash balance increase in December 2010 was mainly due to the timing of the receipt of $88.5 million in Property Tax revenue and $16.7 million in Sales Tax revenue. These revenues were posted in January in the prior three fiscal years.

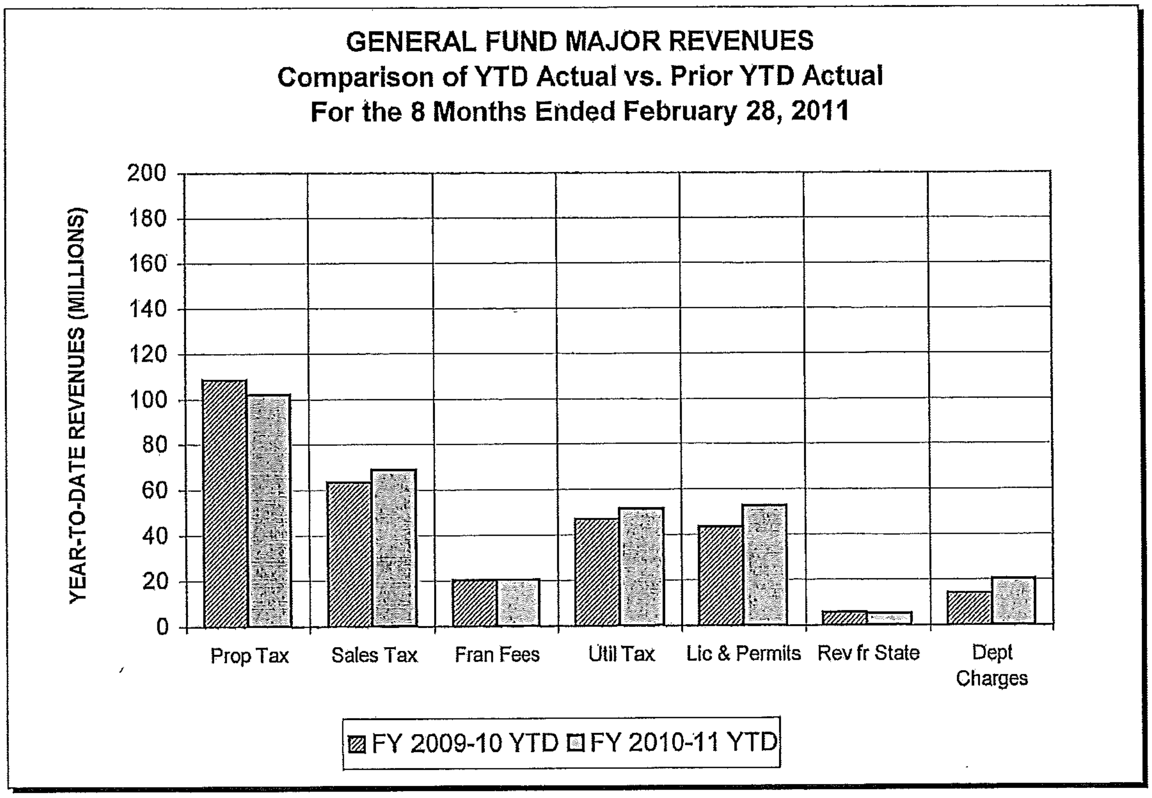
Note: (3) The General Fund cash balance decrease in January 2011 was mainly due to the repayment of the Tax and Revenue Anticipation Note (TRAN) in the amount of $75 million.

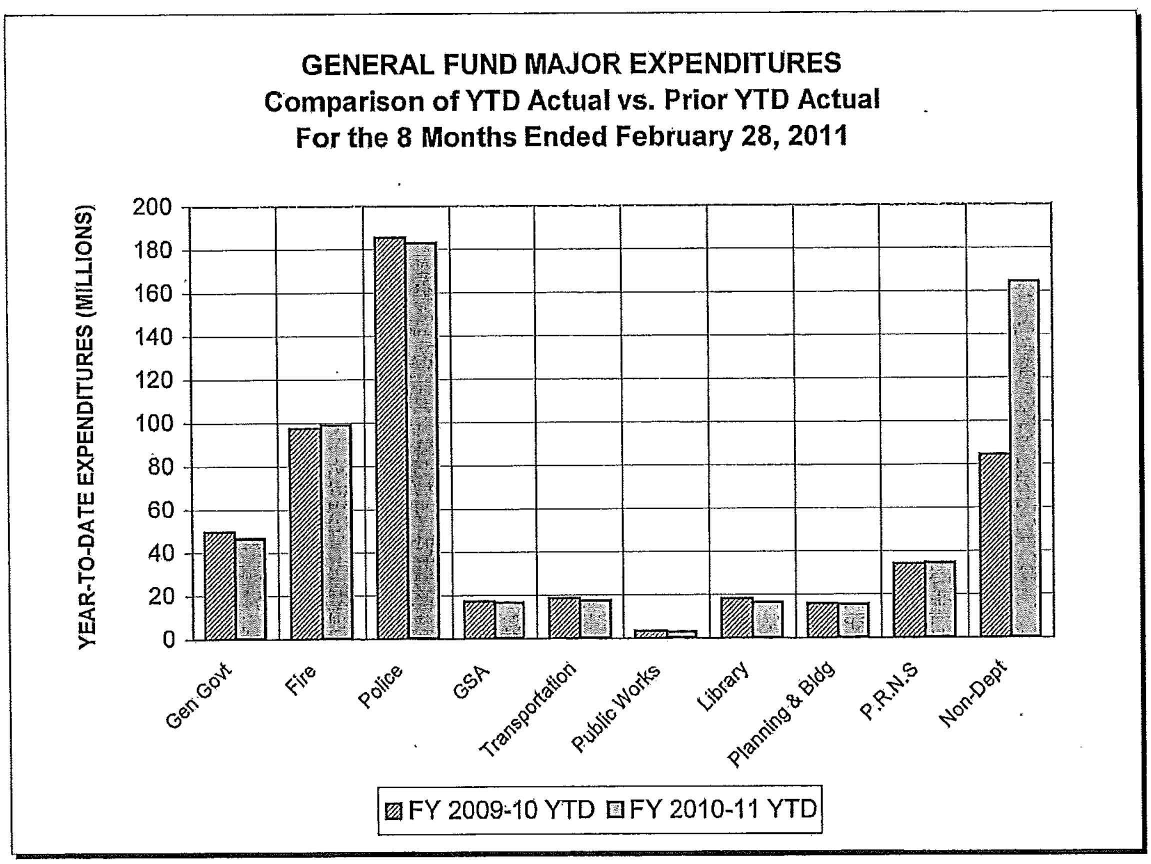




General Fund Revenue includes issuance of Tax and Revenue Anticipation Notes (TRANs) in the amount of $75 million ($40 million in July 2010 and $35 million in October 2010) for cash flow borrowing.

General Fund Expenditures includes repayment of TRANs in the amount of $75 million in January 2011.


GENERAL FUND MAJOR REVENUES
Comparison of YTD Actual vs. Prior YTD Actual
For the 8 Months Ended February 28, 2011
YEAR-TO-DATE REVENUES (MILLIONS)
200
180
160
140
120
100
80
60
40
20
0
Prop Tax
Sales Tax
Fran Fees
Util Tax
Lic & Permits
Rev fr State
Dept Charges
FY 2009-10 YTD
FY 2010-11 YTD


GENERAL FUND MAJOR EXPENDITURES
Comparison of YTD Actual vs. Prior YTD Actual
For the 8 Months Ended February 28, 2011
YEAR-TO-DATE EXPENDITURES (MILLIONS)
200
180
160
140
120
100
80
60
40
20
0
Gen Govt
Fire
Police
GSA
Transportation
Public Works
Library
Planning & Bldg
P.R.N.S
Non-Dept
FY 2009-10 YTD
FY 2010-11 YTD

CITY OF SAN JOSE
GENERAL FUND SOURCE AND USE OF FUNDS
FUND BALANCE, REVENUE, TRANSFERS & REIMBURSEMENTS
FOR THE 8 MONTHS ENDED FEBRUARY 28, 2011
(UNAUDITED)
($000's)

	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	CUR YTD ACTUAL	CUR YTD ACTUAL % OF BUDGET	PRIOR YTD ACTUAL	PRIOR YTD % OF PRIOR YEAR-END ACTUAL	PRIOR YEAR-END BUDGETARY BASIS ACTUAL	CUR YTD LESS PRIOR YTD ACTUAL	% CHANGE CUR YTD ACTUAL LESS PRIOR YTD ACTUAL
Fund Balance											
Prior Year Encumbrances	$ -	-	16,706	16,706	16,706	100.00%	24,107	107.51%	22,422	(7,401)	-30.70%
Liquidation of c/o Encumbrance	-	-	-	-	-	-	-	-	-	-	-
Available Balance	134,807	6,591	-	141,398	141,398	100.00%	173,213	100.00%	173,213	(31,815)	-18.37%
Total Fund Balance	134,807	6,591	16,706	158,104	158,104	100.00%	197,320	100.86%	195,635	(39,216)	-19.87%
General Revenues											
Property Tax	199,052	(4,143)	-	194,909	101,942	52.30%	108,673	53.75%	202,186	(6,731)	-6.19%
Sales Tax (Note 1)	127,232	7,447	-	134,679	68,655	50.98%	63,440	49.86%	127,238	5,215	8.22%
Telephone Line Tax	20,525	-	-	20,525	11,945	58.20%	11,007	53.69%	20,500	938	8.52%
Transient Occupancy Tax	6,684	-	-	6,684	3,908	58.47%	3,542	51.33%	6,900	366	10.33%
Franchise Fees	43,121	(850)	-	42,271	20,413	48.29%	20,247	52.71%	38,410	166	0.82%
Utility Tax	92,932	(5,500)	-	87,432	51,321	58.70%	47,099	53.73%	87,651	4,222	8.96%
Licenses and Permits	71,727	(3,529)	-	68,198	52,686	77.25%	43,631	66.12%	65,985	9,055	20.75%
Fines, Forfeits and Penalties	17,130	790	-	17,920	11,900	66.41%	9,973	62.34%	15,998	1,927	19.32%
Use of Money and Property	3,050	(383)	-	2,667	1,973	73.98%	2,023	63.40%	3,191	(50)	-2.47%
Revenue from Local Agencies	45,613	69	-	45,682	30,104	65.90%	26,225	54.56%	48,067	3,879	14.79%
Revenue from State of Cal.	19,190	(272)	-	18,918	4,975	26.30%	5,906	50.27%	11,749	(931)	-15.76%
Revenue from Federal Government	15,438	4,829	-	20,267	4,537	22.39%	1,063	19.35%	5,493	3,474	326.81%
Departmental Charges (Note 2)	29,581	29	-	29,610	20,430	69.00%	14,198	52.04%	27,282	6,232	43.89%
Other Revenues (Note 3)	13,420	76,446	-	89,866	85,347	94.97%	11,267	41.69%	27,023	74,080	657.50%
Total General Revenues	704,695	74,933	-	779,628	470,136	60.30%	368,294	53.56%	687,673	101,842	27.65%
Transfers & Reimbursements											
Overhead Reimbursements	33,868	435	-	34,303	29,627	86.37%	33,243	82.02%	40,530	(3,616)	-10.88%
Transfers from Other Funds	37,553	4,129	-	41,682	34,794	83.47%	20,371	54.32%	37,504	14,423	70.80%
Reimbursements for Services	17,348	6	-	17,354	5,268	30.36%	4,504	26.63%	16,916	764	16.96%
Total Transfers & Reimburse	88,769	4,570	-	93,339	69,689	74.66%	58,118	61.21%	94,950	11,571	19.91%
Total Sources	$ 928,271	86,094	16,706	1,031,071	697,929	67.69%	623,732	63.76%	978,258	74,197	11.90%

Note 1 - State Budget Balancing actions resulted in the "Triple Flip", which suspended a portion of local governments' Sales and Use Tax and Motor Vehicle License Fee revenues and replaced them with local property tax revenues.
The 2010-2011 impact through February 2011 is approximately $3.1 million.

Note 2 - See Supplemental Schedule on Page 7.

Note 3 - Includes issuance of Tax and Revenue Anticipation Notes (TRANs) in the amount of $75 million ($40 million in July 2010 and $35 million in October 2010) for cash flow borrowing.

CITY OF SAN JOSE
GENERAL FUND SOURCE AND USE OF FUNDS
EXPENDITURES
FOR THE 8 MONTHS ENDED FEBRUARY 28, 2011
(UNAUDITED)
($000's)

	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	CUR YTD ACTUAL % OF BUDGET	PRIOR YTD ACTUAL(1)	PRIOR YTD % OF PRIOR YEAR-END ACTUAL	PRIOR YEAR-END BUDGETARY BASIS ACTUAL	CUR YTD LESS PRIOR YTD ACTUAL(1)	% CHANGE CUR YTD ACTUAL LESS PRIOR YTD ACTUAL
General Government												
Mayor and Council	$ 10,222	(74)	105	10,253	4,793	71	46.75%	5,083	65.60%	7,749	(290)	-5.71%
City Attorney	11,545	(425)	296	11,416	7,305	255	63.99%	8,416	64.33%	13,083	(1,111)	-13.20%
City Auditor	1,961	(56)	4	1,909	1,172	5	61.39%	1,537	72.64%	2,116	(365)	-23.75%
City Clerk (2)	4,750	(743)	10	4,017	3,117	42	77.60%	1,354	65.66%	2,062	1,763	130.21%
City Manager	10,391	128	510	11,029	6,500	717	58.94%	6,954	64.48%	10,785	(454)	-6.53%
Finance	11,435	(84)	304	11,655	6,957	520	59.69%	7,171	63.71%	11,255	(214)	-2.98%
Information Technology	15,301	168	681	16,150	8,869	816	54.92%	10,027	64.71%	15,496	(1,158)	-11.55%
Human Resources	7,335	(155)	56	7,236	4,517	348	62.42%	4,893	63.55%	7,699	(376)	-7.68%
Redevelopment Agency	1,707	(157)	-	1,550	900	-	58.06%	1,247	65.77%	1,896	(347)	-27.83%
Independent Police Auditor	831	40	-	871	512	1	58.78%	419	60.37%	694	93	22.20%
Office of Economic Development	2,968	(47)	144	3,065	1,730	95	56.44%	2,512	68.92%	3,645	(782)	-31.13%
Total General Government	78,446	(1,405)	2,110	79,151	46,372	2,870	58.59%	49,613	64.87%	76,480	(3,241)	-6.53%
Public Safety												
Fire	153,332	583	291	154,206	98,852	942	64.10%	97,518	63.91%	152,579	1,334	1.37%
Police	297,499	(693)	1,482	298,288	182,883	3,548	61.31%	185,573	64.05%	289,709	(2,690)	-1.45%
Total Public Safety	450,831	(110)	1,773	452,494	281,735	4,490	62.26%	283,091	64.01%	442,288	(1,356)	-0.48%
Capital Maintenance												
General Services	25,596	(4)	399	25,991	16,463	1,583	63.34%	17,203	64.69%	26,593	(740)	-4.30%
Transportation	28,227	53	649	28,929	17,300	1,431	59.80%	18,549	63.05%	29,418	(1,249)	-6.73%
Public Works	5,091	(35)	-	5,056	2,819	9	55.76%	3,292	69.04%	4,768	(473)	-14.37%
Total Capital Maintenance	58,914	14	1,048	59,976	36,582	3,023	60.99%	39,044	64.24%	60,779	(2,462)	-6.31%

(1) Does not include encumbrance balance.
(2) Mainly due to a total of $1.93 million in Elections expenditures for the cost of June 8, 2010 and November 2, 2010 elections.

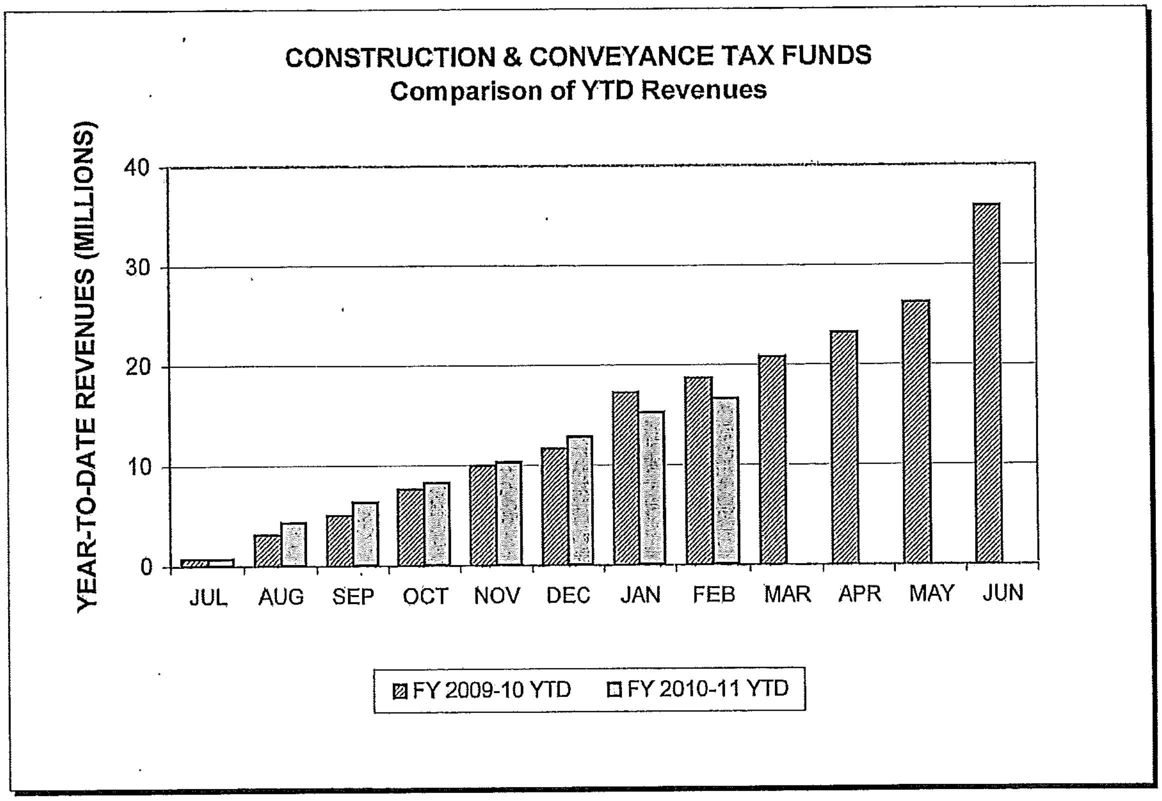
CITY OF SAN JOSE
GENERAL FUND SOURCE AND USE OF FUNDS
EXPENDITURES
FOR THE 8 MONTHS ENDED FEBRUARY 28, 2011
(UNAUDITED)
($000's)

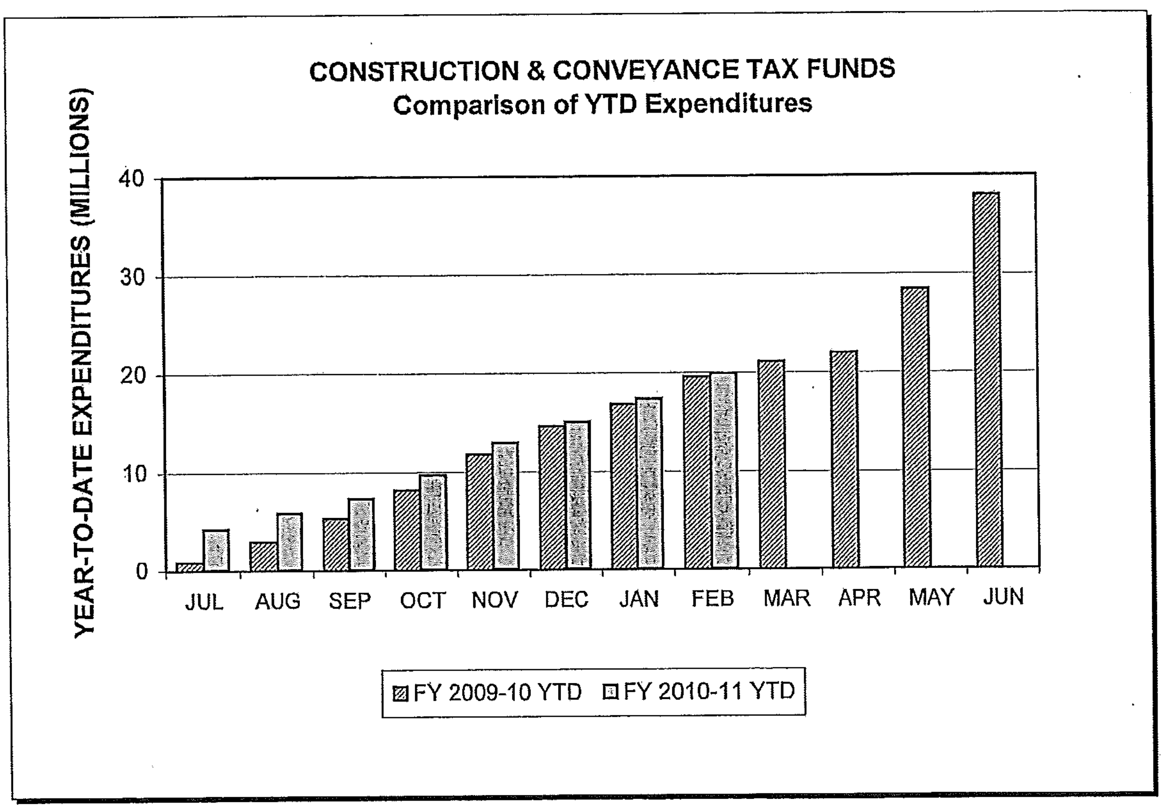
	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	CUR YTD ACTUAL % OF BUDGET	PRIOR YTD ACTUAL(1)	PRIOR YTD % OF PRIOR YEAR-END ACTUAL	PRIOR YEAR-END BUDGETARY BASIS ACTUAL	CUR YTD LESS PRIOR YTD ACTUAL(1)	% CHANGE CUR YTD ACTUAL LESS PRIOR YTD ACTUAL
Community Service												
Library	26,258	(992)	92	25,358	16,477	295	64.98%	18,387	61.60%	29,851	(1,910)	-10.39%
Planning, Bldg & Code Enf.	25,476	95	160	25,731	15,406	355	59.87%	15,708	66.63%	23,575	(302)	-1.92%
Park, Rec & Neigh Svcs	57,735	(1,345)	348	56,738	34,326	2,856	60.50%	34,169	61.29%	55,749	157	0.46%
Environmental Services	610	67	40	717	338	107	47.14%	328	54.30%	604	10	3.05%
Total Community Services	110,079	(2,175)	640	108,544	66,547	3,613	61.31%	68,592	62.48%	109,779	(2,045)	-2.98%
Total Dept. Expenditures	$ 698,270	(3,676)	5,571	700,165	431,236	13,996	61.59%	440,340	63.88%	689,326	(9,104)	-2.07%
Non-Dept Expenditures												
City-wide Expenditures:												
Econ & Neighborhood Develop.	$ 24,914	1,521	1,343	27,778	17,701	1,665	63.72%	17,682	70.82%	24,966	19	0.11%
Environmental & Utility Services	11,588	1,517	-	13,105	2,266	1,630	17.29%	1,110	75.51%	1,470	1,156	104.14%
Public Safety	21,731	4,526	659	26,916	12,860	289	47.78%	11,062	60.62%	18,248	1,798	16.25%
Recreation & Cultural Services	13,910	107	878	14,895	8,559	4,227	57.46%	6,653	57.01%	11,670	1,906	28.65%
Transportation Services	4,512	459	338	5,309	2,223	406	41.87%	2,236	55.65%	4,018	(13)	-0.58%
Strategic Support (2)	42,250	78,798	1,990	123,038	88,945	2,344	72.29%	14,733	46.16%	31,915	74,212	503.71%
Total City-wide Expenditures	118,905	86,928	5,208	211,041	132,554	10,561	62.81%	53,476	57.95%	92,287	79,078	147.88%
Capital Contributions	8,935	(714)	5,927	14,148	3,007	4,348	21.25%	6,681	53.07%	12,588	(3,674)	-54.99%
Transfers to Other Funds	29,039	(505)	-	28,534	28,534	-	100.00%	24,632	96.88%	25,425	3,902	15.84%
Total Non-Dept Expenditures	156,879	85,709	11,135	253,723	164,095	14,909	64.67%	84,789	65.07%	130,300	79,306	93.53%
Reserves												
Contingency Reserves	29,309	-	-	29,309	-	-	0.00%	-	0.00%	-	-	0.00%
Earmarked Reserves	43,813	4,061	-	47,874	-	-	0.00%	-	0.00%	-	-	0.00%
Total Reserves	73,122	4,061	-	77,183	-	-	0.00%	-	0.00%	-	-	0.00%
Total Uses	$ 928,271	86,094	16,706	1,031,071	595,331	28,905	57.74%	525,129	64.07%	819,626	70,202	13.37%

(1) Does not include encumbrance balance.
(2) Includes repayment of Tax and Revenue Anticipation Note (TRAN) in the amount of $75 million in January 2011.

CITY OF SAN JOSE
GENERAL FUND SOURCE AND USE OF FUNDS
FOR THE 8 MONTHS ENDED FEBRUARY 28, 2011
SUPPLEMENTAL SCHEDULE - DEPARTMENTAL REVENUES
(UNAUDITED)
($000's)

		ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	CUR YTD ACTUAL	CUR YTD ACTUAL % OF BUDGET	PRIOR YTD ACTUAL	PRIOR YTD % OF PRIOR YEAR-END ACTUAL	PRIOR YEAR-END BUDGETARY BASIS ACTUAL	CUR YTD LESS PRIOR YTD ACTUAL	% CHANGE CUR YTD ACTUAL LESS PRIOR YTD ACTUAL
Police	$	1,921	-	-	1,921	1,154	60.07%	1,174	60.42%	1,943	(20)	-1.70%
Public Works		4,325	-	-	4,325	3,381	78.17%	2,044	48.38%	4,225	1,337	65.41%
Transportation		739	40	-	779	795	102.05%	506	51.06%	991	289	57.11%
Library		1,916	-	-	1,916	535	27.92%	806	49.97%	1,613	(271)	-33.62%
Planning, Bldg & Code Enf		2,500	(112)	-	2,388	1,652	69.18%	1,590	58.50%	2,718	62	3.90%
Parks Rec & Neigh Svcs		12,685	420	-	13,105	9,053	69.08%	5,323	48.22%	11,039	3,730	70.07%
Miscellaneous Dept Charges		5,495	(319)	-	5,176	3,860	74.57%	2,755	57.96%	4,753	1,105	40.11%
Total Departmental Revenues	$	29,581	29	-	29,610	20,430	69.00%	14,198	52.04%	27,282	6,232	43.89%


CONSTRUCTION & CONVEYANCE TAX FUNDS
Comparison of YTD Revenues
YEAR-TO-DATE REVENUES (MILLIONS)
40
30
20
10
0
JUL
AUG
SEP
OCT
NOV
DEC
JAN
FEB
MAR
APR
MAY
JUN
FY 2009-10 YTD
FY 2010-11 YTD

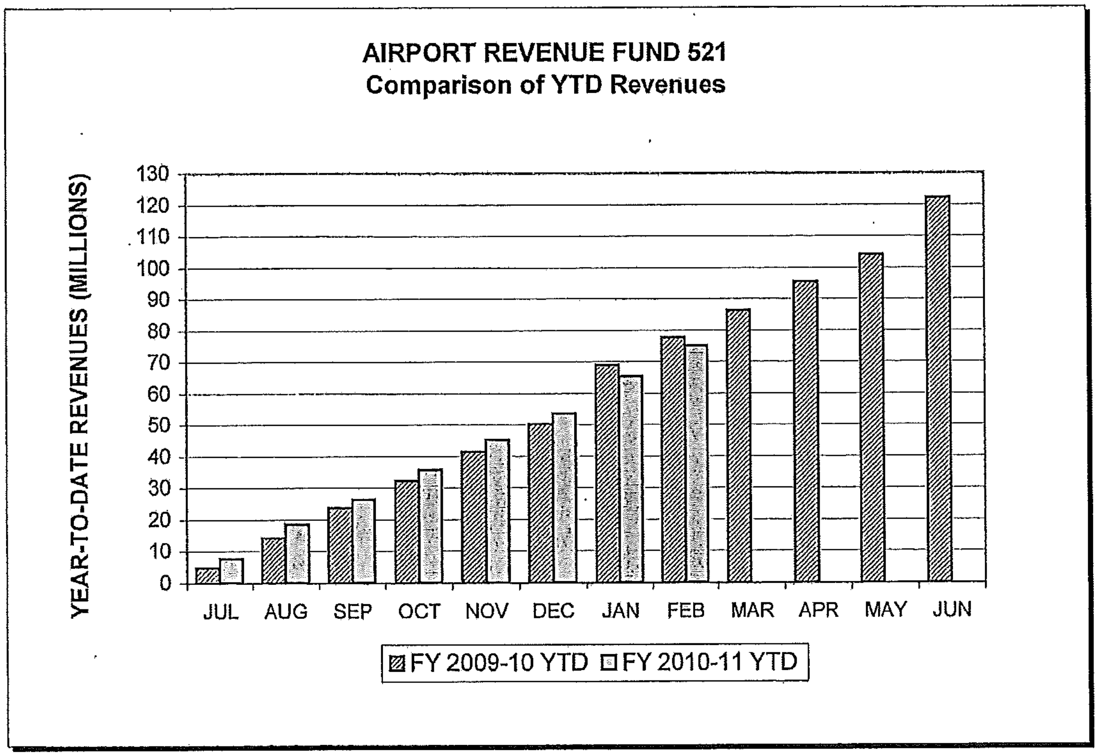

CONSTRUCTION & CONVEYANCE TAX FUNDS
Comparison of YTD Expenditures
YEAR-TO-DATE EXPENDITURES (MILLIONS)
40
30
20
10
0
JUL
AUG
SEP
OCT
NOV
DEC
JAN
FEB
MAR
APR
MAY
JUN
FY 2009-10 YTD
FY 2010-11 YTD

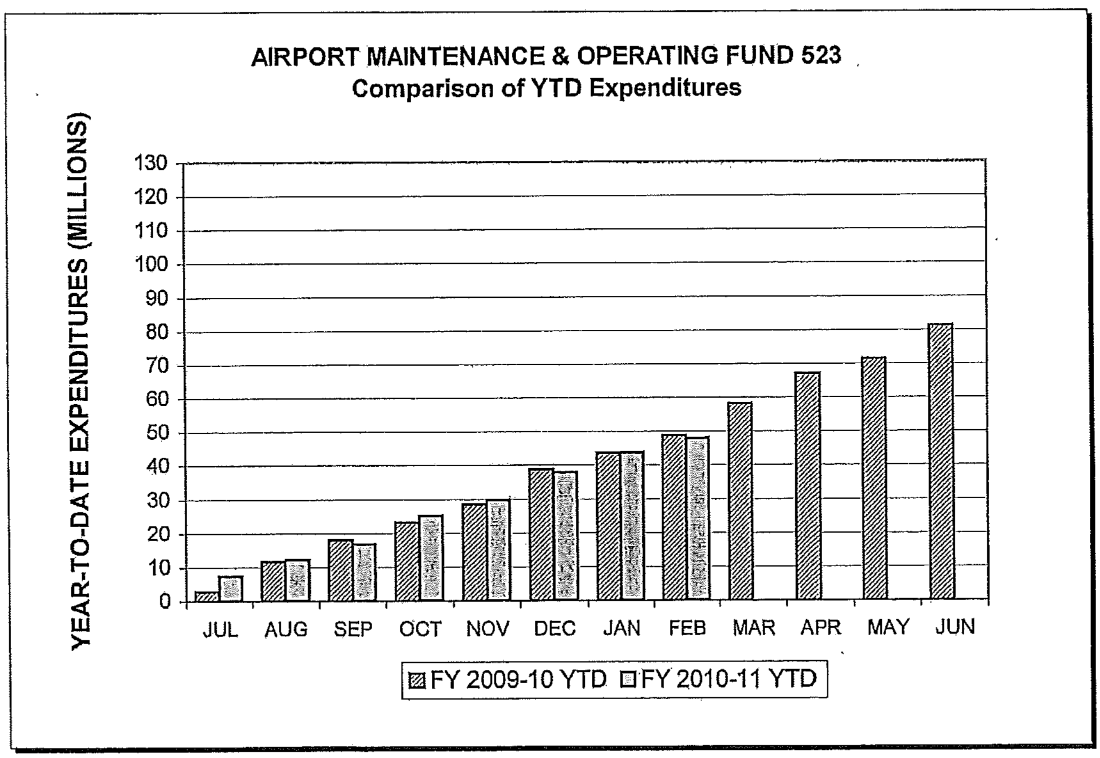
CITY OF SAN JOSE
SPECIAL REVENUE FUNDS
SOURCE AND USE OF FUNDS
FOR THE 8 MONTHS ENDED FEBRUARY 28, 2011
(UNAUDITED)
($000's)

	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	PRIOR Y-T-D ACTUAL
Construction/Conveyance Tax							
Prior Year Encumbrance	$ -	-	8,295	8,295	8,295	N/A	7,799
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	62,292	14,574	-	76,866	76,866	N/A	80,147
Revenues	31,261	819	-	32,080	16,557	N/A	18,680
Total Sources	93,553	15,393	8,295	117,241	101,718	N/A	106,626
Total Uses	93,553	15,393	8,295	117,241	19,858	10,735	19,573
Gas Tax							
Prior Year Encumbrance	-	-	-	-	-	N/A	-
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	-	-	-	-	-	N/A	-
Revenues	16,626	-	-	16,626	5,036	N/A	4,260
Total Sources	16,626	-	-	16,626	5,036	N/A	4,260
Total Uses	16,626	-	-	16,626	5,036	0	4,260
Building and Structures							
Prior Year Encumbrance	-	-	5,071	5,071	5,071	N/A	3,737
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	6,385	4,125	-	10,510	10,510	N/A	15,589
Revenues	22,997	2,493	-	25,490	11,027	N/A	6,908
Total Sources	29,382	6,618	5,071	41,071	26,608	N/A	26,234
Total Uses	29,382	6,618	5,071	41,071	8,067	6,262	10,849
Residential Construction							
Prior Year Encumbrance	-	-	-	-	-	N/A	-
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	311	648	-	959	959	N/A	1,310
Revenues	65	135	-	200	184	N/A	28
Total Sources	376	783	-	1,159	1,143	N/A	1,338
Total Uses	$ 376	783	-	1,159	32	0	55

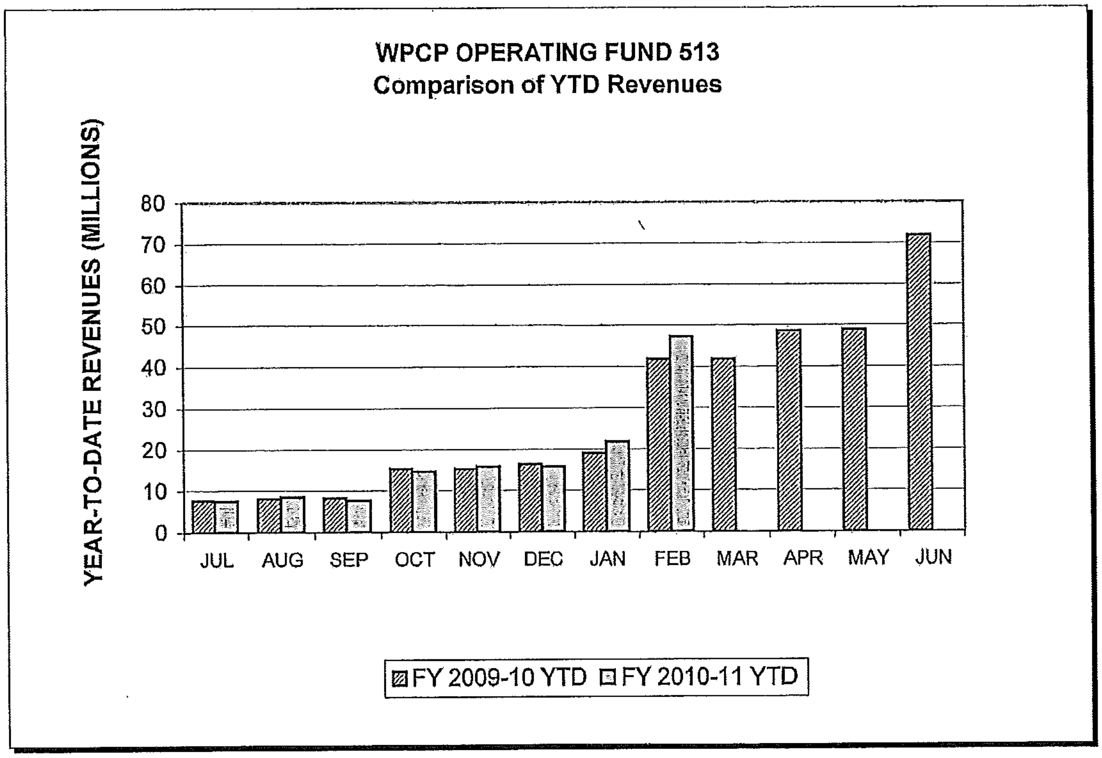
CITY OF SAN JOSE
SPECIAL REVENUE FUNDS
SOURCE AND USE OF FUNDS
FOR THE 8 MONTHS ENDED FEBRUARY 28, 2011
(UNAUDITED)
($000's)

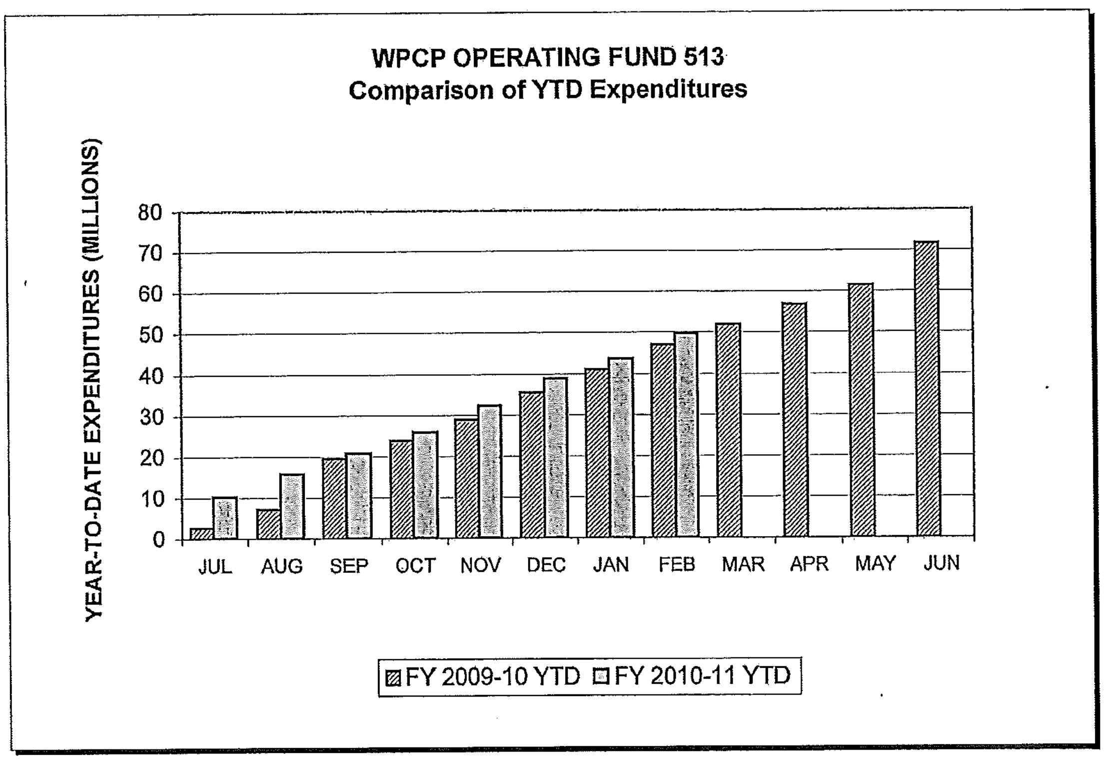
	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	PRIOR Y-T-D ACTUAL
Transient Occupancy Tax							
Prior Year Encumbrance	$ -	-	196	196	196	N/A	314
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	2,737	629	-	3,366	3,366	N/A	1,417
Revenues	10,034	(4)	-	10,030	5,939	N/A	5,384
Total Sources	12,771	625	196	13,592	9,501	N/A	7,115
Total Uses	12,771	625	196	13,592	6,386	444	5,718
Conventions, Arts & Entertainment							
Prior Year Encumbrance	-	-	510	510	510	N/A	345
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	6,130	197	-	6,327	6,327	N/A	9,891
Revenues	19,195	241	-	19,436	11,477	N/A	12,783
Total Sources	25,325	438	510	26,273	18,314	N/A	23,019
Total Uses	25,325	438	510	26,273	13,705	671	17,454
Golf							
Prior Year Encumbrance	-	-	7	7	7	N/A	7
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	817	257	-	1,074	1,074	N/A	1,188
Revenues	1,940	(302)	-	1,638	1,396	N/A	1,677
Total Sources	2,757	(45)	7	2,719	2,477	N/A	2,872
Total Uses	2,757	(45)	7	2,719	2,155	7	1,946
Other Funds							
Prior Year Encumbrance	-	-	57,824	57,824	57,824	N/A	54,760
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	187,195	25,775	-	212,970	212,970	N/A	223,045
Revenues	444,011	20,170	-	464,181	260,351	N/A	252,655
Total Sources	631,206	45,945	57,824	734,975	531,145	N/A	530,460
Total Uses	$ 631,206	45,945	57,824	734,975	256,077	118,278	262,577



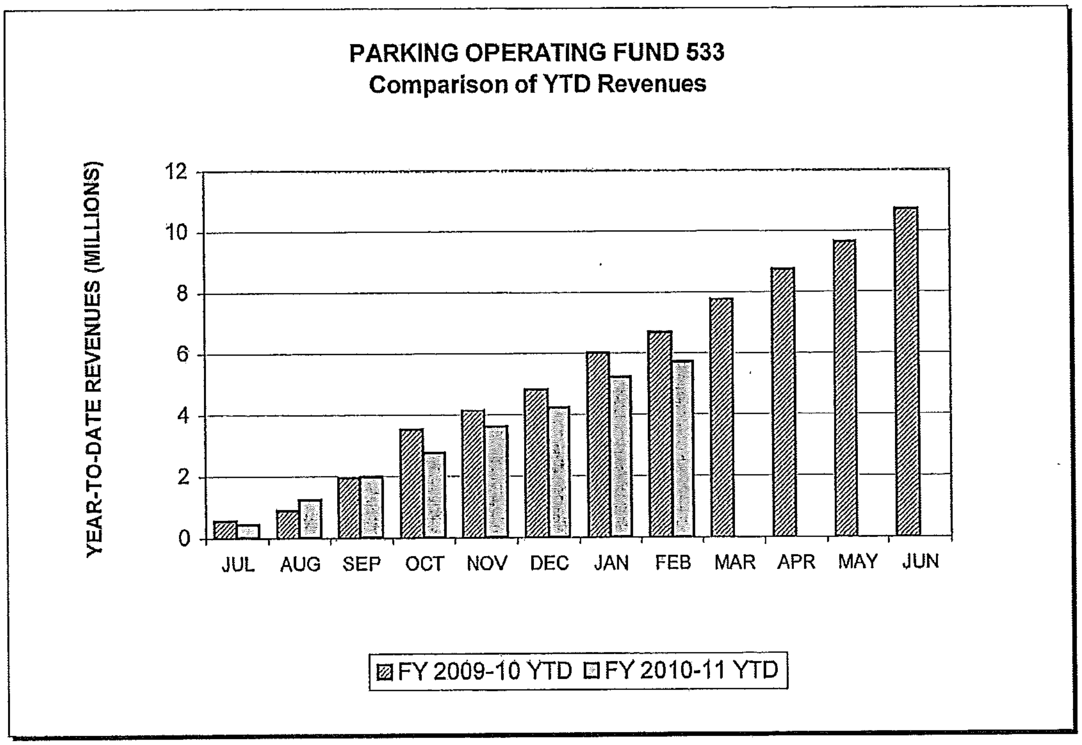


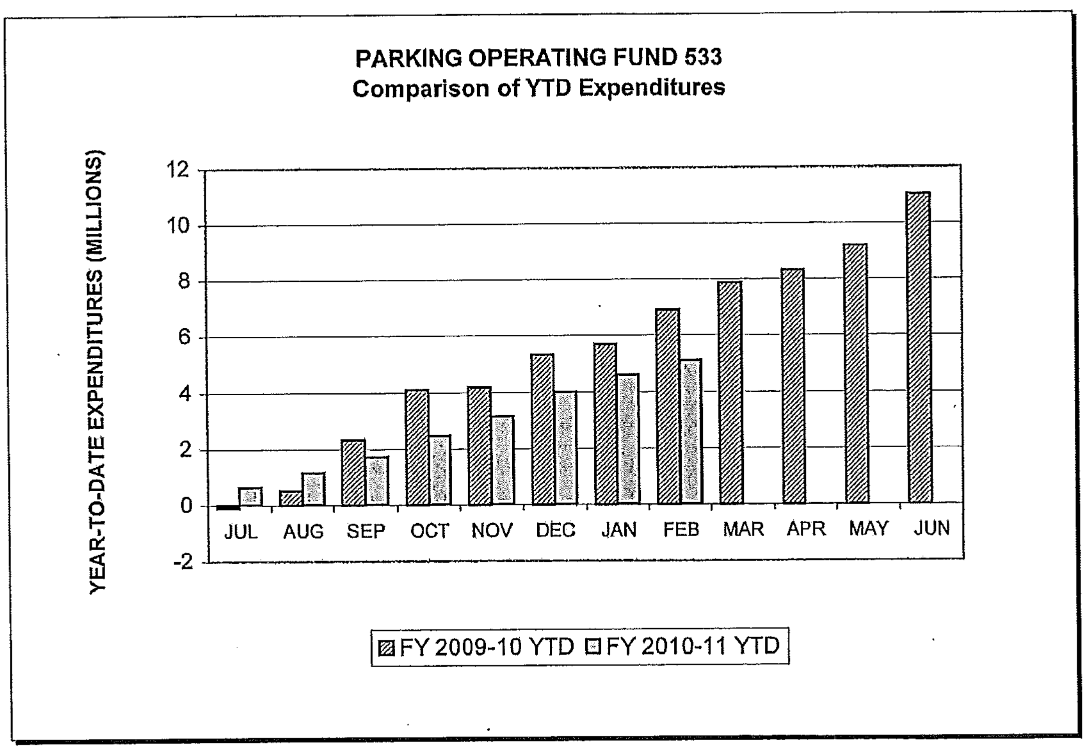
Note: The graphs above include the airport revenue fund (521) and operating fund (523) only.





Note: Graphs above are only for WPCP operating fund (513).





Accounting transfers that artifically increased revenues and expenditures by the same amount were included in Fund 533. An adjustment has been made to net out these transfers so that actual and operational revenues and expenditures can be compared to prior year amounts.

CITY OF SAN JOSE
ENTERPRISE FUNDS
SOURCE AND USE OF FUNDS
FOR THE 8 MONTHS ENDED FEBRUARY 28, 2011
(UNAUDITED)
($000's)

	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	PRIOR Y-T-D ACTUAL
Airport							
Prior Year Encumbrance	$ -	-	86,287	86,287	86,287	N/A	331,129
Liquidation of c/o Enc	-	-	-	-	-	N/A	-
Beginning Fund Balance	403,901	66,778	-	470,679	470,679	N/A	485,127
Revenues	341,905	7,110	-	349,015	211,448	N/A	270,496
Total Sources	745,806	73,888	86,287	905,981	768,414	N/A	1,086,752
Total Uses (Note 1)	745,806	73,888	86,287	905,981	263,385	86,369	355,218
Waste Water Treatment							
Prior Year Encumbrance	-	-	45,356	45,356	45,356	N/A	42,982
Liquidation of c/o Enc	-	-	-	-	-	N/A	-
Beginning Fund Balance	193,589	24,070	-	217,659	217,659	N/A	206,538
Revenues	274,221	(1,783)	-	272,438	208,170	N/A	202,323
Total Sources	467,810	22,287	45,356	535,453	471,185	N/A	451,843
Total Uses (Note 2)	467,810	22,287	45,356	535,453	151,231	53,516	124,431
Municipal Water							
Prior Year Encumbrance	-	-	767	767	767	N/A	894
Liquidation of c/o Enc	-	-	-	-	-	N/A	-
Beginning Fund Balance	11,265	2,032	-	13,297	13,297	N/A	11,088
Revenues	30,793	(100)	-	30,693	21,090	N/A	21,593
Total Sources	42,058	1,932	767	44,757	35,154	N/A	33,575
Total Uses	42,058	1,932	767	44,757	15,825	1,509	17,659
Parking							
Prior Year Encumbrance	-	-	730	730	730	N/A	1,504
Liquidation of c/o Enc	-	-	-	-	-	N/A	-
Beginning Fund Balance	11,391	1,730	-	13,121	13,121	N/A	14,220
Revenues	8,658	(90)	-	8,568	5,704	N/A	6,685
Total Sources	20,049	1,640	730	22,419	19,555	N/A	22,409
Total Uses	$ 20,049	1,640	730	22,419	5,110	974	6,907

Note 1 - All Airport Funds, including operating, revenue, capital and debt service.
Note 2 - All Waste Water Funds, including operating, revenue, capital and debt service.

CITY OF SAN JOSE
CAPITAL PROJECT FUNDS
SOURCE AND USE OF FUNDS
FOR THE 8 MONTHS ENDED FEBRUARY 28, 2011
(UNAUDITED)
($000's)

	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	PRIOR Y-T-D ACTUAL
Construction Excise							
Prior Year Encumbrance	$ -	-	7,270	7,270	7,270	N/A	5,798
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	10,949	7,850	-	18,799	18,799	N/A	20,238
Revenues	36,754	10,028	-	46,782	32,030	N/A	6,529
Total Sources	47,703	17,878	7,270	72,851	58,099	N/A	32,565
Total Uses	47,703	17,878	7,270	72,851	31,638	4,010	19,342
Redevelopment Projects							
Prior Year Encumbrance	-	-	2,756	2,756	2,756	N/A	4,431
Liquidation of c/o Enc	-	-	-	-	-	N/A	-
Beginning Fund Balance	2,172	1,053	-	3,225	3,225	N/A	9,514
Revenues	88	75	-	163	422	N/A	677
Total Sources	2,260	1,128	2,756	6,144	6,403	N/A	14,622
Total Uses	2,260	1,128	2,756	6,144	3,692	1,124	3,969
Other							
Prior Year Encumbrance	-	-	21,339	21,339	21,339	N/A	60,226
Liquidation of c/o Enc	-	-	-	-	-	N/A	-
Beginning Fund Balance	65,312	2,549	-	67,861	67,861	N/A	106,617
Revenues	14,787	(80)	-	14,707	2,316	N/A	2,874
Total Sources	80,099	2,469	21,339	103,907	91,516	N/A	169,717
Total Uses	$ 80,099	2,469	21,339	103,907	18,562	10,475	53,666

CITY OF SAN JOSE
OTHER FUND TYPES
SOURCE AND USE OF FUNDS
FOR THE 8 MONTHS ENDED FEBRUARY 28, 2011

(UNAUDITED)

($000's)

		ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	PRIOR Y-T-D ACTUAL
Trust and Agency								
Prior Year Encumbrance	$	-	-	18	18	18	N/A	3
Liquidation of c/o Enc		-	-	-	-	-	N/A	-
Beginning Fund Balance		2,257	153	-	2,410	2,410	N/A	2,301
Revenues		114	568	-	682	572	N/A	601
Total Sources		2,371	721	18	3,110	3,000	N/A	2,905
Total Uses	$	2,371	721	18	3,110	361	22	259

PSFSS Committee 06-16-11, Item (c)2
City Council: 08-02-11

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: PUBLIC SAFETY, FINANCE AND STRATEGIC SUPPORT COMMITTEE

FROM: Jennifer A. Maguire

SUBJECT: **BI-MONTHLY FINANCIAL REPORT FOR MARCH/APRIL 2011**

DATE: June 7, 2011

Approved Deanna A.L. Date 6/9/11

The Bi-Monthly Financial Report for March/April 2011 was jointly prepared by the City Manager's Budget Office and the Finance Department and is presented for the Public Safety, Finance and Strategic Support Committee's review.

OVERVIEW

Through April, the City's overall financial position continues to remain relatively stable, although on careful watch. All of the City's 116 budgeted funds are expected to end the year at or above estimated 2010-2011 levels. The Administration will continue to closely monitor economic conditions and the performance in the City's funds and will bring forward any recommended budget adjustments to the City Council on its June 21, 2011 agenda (Approval of Various Budget Actions for Fiscal Year 2010-2011) to ensure that individual appropriations remain within budgeted levels and to bring revenue estimates in line with current projections.

Following are key highlights in this report:

- In the General Fund, revenues are tracking close to modified budget levels, with collections expected to end the year at or slightly above budgeted estimates. Budget adjustments will be brought forward at year-end to align the revenue estimates for various revenue categories with the latest projections.

- Several departments are currently experiencing or are expected to experience higher than budgeted personal services expenditures due to unbudgeted vacation sell-back expenses and/or vacation and compensatory time payouts associated with employee separations from retirements or layoffs (June 26, 2011) that are anticipated to occur by year-end, as well as an increased retirement contribution amount that resulted from the transition to the fixed-payment "retirement floor" methodology which will be implemented in 2011-2012. Departments will absorb these additional costs to the extent possible through savings from the employee turnover, overtime controls, and/or identifying potential offsets through non-personal/equipment appropriation savings. However, additional funding may need to be distributed to some departments by the end of the fiscal year to prevent appropriation over-

OVERVIEW (Cont'd.)

runs. Additionally, year-end adjustments, such as net-zero shifts between departmental appropriations, will be brought forward to reflect actual performance as needed.

- In the General Fund, it is projected that there will be sufficient 2010-2011 Ending Fund Balance/2011-2012 Beginning Fund Balance to meet the estimate used in the 2011-2012 Proposed Operating Budget of $18.3 million (excluding reserves). This estimate relies on additional funding generated from expenditure savings, the liquidation of prior year carry-over encumbrances and anticipated limited amount of one-time revenues.

- Airport passenger activity has increased for eight consecutive months compared to the same period a year ago, and fiscal year-to-date passenger traffic is now 2.1% higher than the same period last year. However, the number of commercial passenger flights at SJC continues to decrease, and commercial operations are down 7.8% fiscal year-to-date, resulting in very full planes. The high cost of fuel is now a serious factor for airline route decisions, posing a challenge to bringing more flights to the Airport.

- Construction and Conveyance (C&C) Tax revenues are currently expected to exceed budgeted estimates by approximately $1.5 million by year-end. Collections through April 2011 totaled $15.2 million (76% of the 2010-2011 estimate of $20.0 million), which represents a decline of 5.5% from the $16.1 million collected last year through April 2010. The City has since received May Conveyance Tax receipts totaling $2.2 million, which represents a 12.6% increase from the $2.0 million received in May 2010.

- The Administration will continue to report to the City Council any and all significant developments through this reporting process. A full reconciliation of actual 2010-2011 financial performance will be provided in the 2010-2011 Annual Report that will be released on September 30, 2011.

Economic Environment

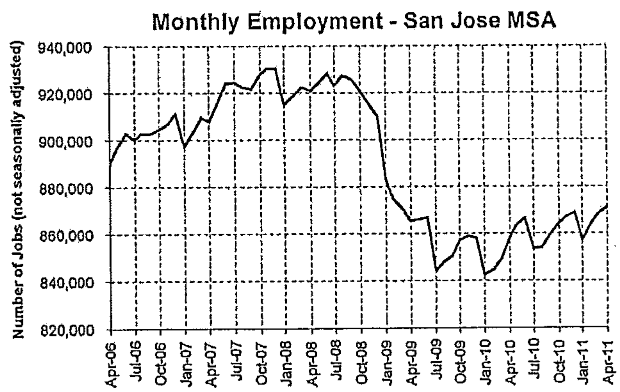
The U.S. Gross Domestic Product (GDP) appears to be increasing at a moderate pace, but a slowdown in the most recent quarter highlights the uneven rate of recovery from the recession that ended in mid-2009. Estimated low growth of 1.8% for the quarter that ended in March follows on more moderate growth of 3.1% for the quarter that ended in December. The overall increase in economic activity has contributed to some improvement in the unemployment rate: during the first four months of 2011 the seasonally-adjusted U.S. unemployment rate averaged just over 8.9%, its lowest level since the first quarter of 2009. The most recent Federal Reserve statement noted that "...the economic recovery is proceeding at a moderate pace and overall conditions in the labor market are improving gradually."

Despite the encouraging economic news, The Conference Board Consumer Confidence Index, which had improved in April, decreased in May. According to Lynn Franco, Director of The Conference Board Consumer Research Center, "Consumers are considerably more apprehensive

OVERVIEW (Cont'd.)

about future business and labor market conditions as well as their income prospects. Inflation concerns, which had eased last month, have picked up once again. On the other hand, consumers' assessment of current conditions declined only modestly, suggesting no significant pickup or deterioration in the pace of growth."

Although still well below the recent peak of 930,500 jobs experienced in December 2007, employment in the San Jose Metropolitan Statistical Area (MSA) has somewhat recovered over the past 15 months from the January 2010 low of 842,300. The April 2011 employment level of 871,300 was 1.6% above the April 2010 employment level of 857,900.



Unemployment Rate (Unadjusted)

	Apr. 2010	Mar. 2011	Apr. 2011
San Jose Metropolitan Statistical Area*	11.4%	10.6%	10.1%
State of California	12.2%	12.3%	11.7%
United States	9.5%	9.2%	8.7%

* San Benito and Santa Clara Counties
Source: California Employment Development Department.

The San José metropolitan area continues to experience double-digit unemployment, although the April 2011 unemployment rate of 10.1% represents a decline from the March 2011 rate of 10.6%. The April 2011 figure is also lower than the 11.4% rate experienced a year ago. The April 2011 unemployment rate in this region is less than the unadjusted unemployment rate for the State, but remains above the nation, which has a current unadjusted unemployment rate of 8.7%.

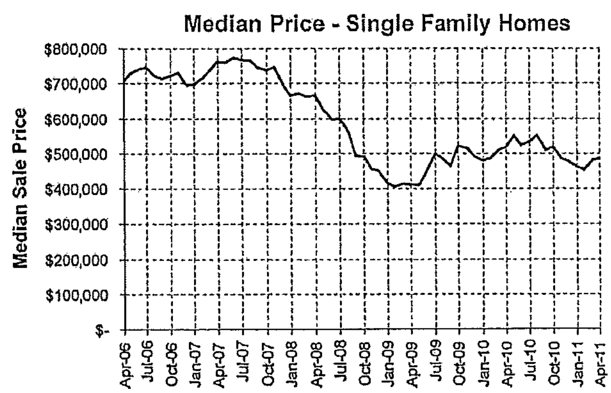
Through April, the level of construction permit activity compared with the prior year at this time varies significantly across the three types of construction. Industrial construction remained significantly below prior year levels, with the $64.2 million of industrial permits issued this year showing a 40.0% drop from the prior year valuation of $107.0 million. Conversely, the total valuation of commercial permits issued so far this year is $176.8 million, just 3.5% below the prior year valuation of $183.3 million. Although the 2,199 residential permits issued through April were six times higher than the 366 permits issued at this time last year, this dramatic spike was almost entirely attributable to two very large development projects in late 2010 in North San Jose.

This permit activity drives the revenue collection in several construction tax categories and is an indicator of future activity for several other categories, such as the storm and sanitary sewer system fees. Additionally, over the last ten years, the construction industry has provided

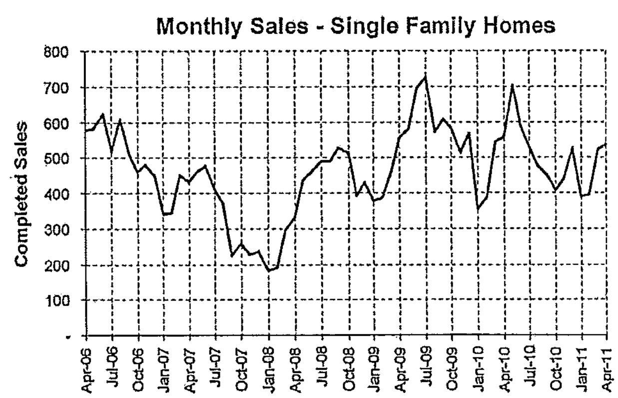
OVERVIEW (Cont'd.)

approximately 5% of the region's jobs; so any reduction in permit activity is expected to contribute to a slow recovery in local employment.

Although the April 2011 median home price of $485,000 for single family homes within the City improved slightly from the prior month, it fell 6.5% below the April 2010 median of $518,500. April marked the seventh month in a row that the median home price decreased from the same month in the prior year.



Another indicator of the continuing challenges in the local real estate market is the increase in the amount of time to complete a transaction. The average days-on-market totaled 90 in April 2011, equaling the peak of 90 days-on-market in June 2009. Additionally, the 4,671 total property transfers (completed sales) for single family homes for July 2010 through April 2011 fell 13.8% below the 5,418 completed sales for July 2009 through April 2010. Beyond weak consumer confidence and continuing high unemployment, an important factor that could also be acting as a drag on the housing market is uncertainty related to when the "shadow inventory" of foreclosed properties will be put on the market by lenders.



The slow pace of recovery from the economic recession continues to dampen growth in the City's economically sensitive revenue categories. As a result, collections in many of these areas, such as Sales Tax and Property Tax, are expected to remain well below levels experienced in recent years. This slow growth has been built into the revenue estimates. Economic conditions will continue to be closely monitored, and any necessary budget g actions to align the revenue estimates with actual performance will be brought forward before the end of the year.

GENERAL FUND

REVENUES

General Fund revenues through April 2011 totaled $722.2 million. Although this represents an increase of $108.4 million from the April 2010 level of $613.8 million, the 2011 total includes $75.0 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes in July ($40.0 million) and October ($35.0 million) 2010. Adjusting for the TRANs issuance, General Fund revenues through April 2011 totaled $647.2 million – an increase of $33.4 million (5.4%) from the April 2010 level.

Collections were higher than the prior year in most of the revenue categories, including Property Tax, Sales Tax, Transient Occupancy Tax, Telephone Line Tax, Franchise Fees, Licenses and Permits, Fines, Forfeits and Penalties, Use of Money and Property, Revenue from Local Agencies, Revenue from the Federal Government, Departmental Charges, and Transfers. The revenue categories tracking below the prior year level include Utility Tax, Revenue from the State, Other Revenue (excluding the TRANs), Overhead, and Reimbursements for Services.

Based on collections through April, it is anticipated that overall General Fund revenues will meet the overall modified budget estimate by year-end. However, continued close monitoring of 2010-2011 performance will be performed during the remainder of the year and adjustments to individual revenue estimates will be recommended as part of the Approval of Various Budget Actions for Fiscal Year 2010-2011 memorandum that will be considered by the City Council on June 21, 2011.

The following discussion highlights General Fund revenue activities through April.

KEY GENERAL FUND REVENUES

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Property Tax	**$ 194,909,000**	**$ 179,512,458**	**$ 178,710,867**

The Property Tax category consists of Secured Property Tax, Unsecured Property Tax, SB 813 Property Tax (retroactive collections back to the point of sale for reassessments of value due to property resale), and Homeowners Property Tax Relief. Through April, $179.5 million was received. The 0.4% increase from the prior year collection level of $178.7 million was the result of higher Secured Property Tax collections due to the timing of payments in 2009-2010. After adjusting for these timing differences, Property Tax receipts are expected to end the year below 2009-2010 levels, but within only 1.0% of the 2010-2011 modified budget estimate.

Secured Property Tax accounts for $167.8 million of the $179.5 million in Property Tax revenue received through April 2011. Based on information from the County of Santa Clara Controller-Treasurer's Office, Secured Property Tax receipts are expected to reach $181.8 million, which is slightly below the modified budget estimate of $182.1 million and reflects a projected decline of

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

2.1% from the prior year. As part of the 2009-2010 Annual Report actions, the City Council approved a $1.3 million reduction to the budget estimate for this category, bringing the estimate to $182.1 million, based on the revenue estimate from the County of Santa Clara Controller-Treasurer's Office at that time. That adjustment allowed for a 2.0% decline in 2010-2011 from actual 2009-2010 receipts.

The 2010-2011 collections are based on the value of property assessed on January 1, 2010, with any tax roll corrections. In developing this most recent estimate, the County has made a projection on the value of downward adjustments that will be made during the remainder of the year. Because the County will continue to incorporate tax roll adjustments through the end of June, when the 2010-2011 collection figures will be finalized, the Budget Office will continue to coordinate with the County to estimate collections in this category.

Unsecured Property Tax receipts totaled $10.9 million through April, which should reflect all of the payments that will be received this fiscal year. The actual collections have exceeded the budgeted estimate of $10.2 million by $700,000.

For the SB 813 Property Tax category, only one payment of $246,000 has been received through the month of April because, according to the County, the net collections through February 2011 were less than the unprocessed negative supplemental taxes accumulated from 2009-2010 and 2010-2011. In August 2010, the County of Santa Clara provided a preliminary SB 813 Property Tax estimate of $1.5 million for 2010-2011 that indicated a drop of 50% from the actual 2009-2010 collection level. Based on that updated estimate, a $1.8 million reduction to the SB 813 Property Tax revenue estimate was approved by the City Council as part of the 2009-2010 Annual Report actions, bringing the budget estimate from $3.3 million to $1.5 million. That adjustment allowed for a 50.7% decline in 2010-2011 from actual 2009-2010 receipts. The most recent projection from the County of Santa Clara in May 2011 indicates that SB 813 Property Tax revenues could fall as low as $1.2 million. Depending on the impact of the negative supplemental tax adjustments through the remainder of the year, an additional downward adjustment to the revenue estimate may be necessary.

It is anticipated that Homeowners Property Tax Relief revenue will be received at approximately the budgeted level of $1.1 million.

Overall, the higher Unsecured Property Tax receipts are expected to offset lower projected Secured Property Tax and potentially lower SB 813 Property Tax receipts. Property Tax collections are currently projected to end the year very close to the budget estimate, with a variance of less than 1%.

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Sales Tax	**$ 134,679,000**	**$ 101,452,119**	**$ 91,930,263**

The Sales Tax category includes General Sales Tax and Proposition 172 Sales Tax.

General Sales Tax receipts through April of $98.4 million are tracking 10.6% above the prior year collection level of $89.0 million. This reflects actual performance for the first two quarters along with "triple flip" payments and advances from the State. This also reflects the effect of a Sales Tax recording error that understated the fourth quarter General Sales Tax for 2008-2009 and correspondingly overstated the first quarter General Sales Tax for 2009-2010. During 2010-2011, two upward adjustments to the General Sales Tax revenue estimate totaling $7.4 million have been approved based on higher actual collections in 2009-2010 as well as higher than anticipated receipts in the first quarter of 2010-2011. Because receipts also exceeded expectations in the second quarter of 2010-2011, the General Sales Tax revenues are currently projected to exceed the modified budget estimate of $130.9 million by $3.2 million. A recommended year-end budget adjustment will be brought forward to recognize this additional revenue and will be used to offset lower collections in other revenue categories. This higher collection level was also assumed in the development of the 2011-2012 Proposed Budget.

As discussed in the January-February Bi-Monthly Financial Report, the Sales Tax growth in the first two quarters of 2010-2011 was built on the prior-year quarters in which Sales Tax declined by 18.2% (down 12.8% on an adjusted basis) and 5.3%. Because the Sales Tax receipts for the remaining two quarters of 2010-2011 will be compared with prior-year quarters in which collections increased (13.0% for the third and fourth quarters), it would be premature to suggest adjustments to the growth assumptions for the remaining two quarters of 2010-2011. Data on the third quarter performance is scheduled to be released within the next two weeks. If collections in the third quarter exceed current projections, the Mayor's June Budget Message for 2011-2012 directs the Administration to issue a Manager's Budget Addendum to the 2011-2012 Proposed Budget recognizing that additional revenue and restoring as many Police patrol officers as possible. For the last quarter, Sales Tax is accrued to 2010-2011 based on estimated collections as actual data for that quarter will not be received until September 2011.

Through April, the Proposition 172 Sales Tax receipts of $3.1 million were tracking 3.5% above the prior year collection level of $3.0 million. The 2010-2011 budget estimate of $3,8 million, however, allows for a drop of 3.2%. Based on year-to-date collection trends, it is likely receipts in this category will end the year above the budgeted estimate. Staff will continue to monitor these revenues closely and bring forward adjustments before the end of the year, if necessary.

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Transient Occupancy Tax	**$ 6,684,000**	**$ 5,151,905**	**$ 4,983,083**

Through April, Transient Occupancy Tax (TOT) collections of $5.2 million were tracking 3.4% above the prior year collection level of $5.0 million for the same period. The 2010-2011 Adopted Budget assumed an increase of 2.0% from the 2009-2010 estimated level; however, the budget now allows for a decline of 3.1% based on higher than anticipated 2009-2010 collections. It is anticipated that TOT receipts will at minimum achieve, but likely exceed, the budgeted revenue estimate of $6.7 million by year-end.

Through April, the average hotel occupancy rate at the 14 major hotels was 57.8%, an improvement from the 54.5% occupancy rate for the same period in 2009-2010. For the same 14 hotels, the average daily room rate through April was $119.68, up from the $117.06 room rate for the same period in 2009-2010. The year-to-date average revenue-per-available-room (RevPAR) metric of $69.26 represents an increase of 8.4% from the prior year level. TOT receipts will be closely monitored as the year progresses, and budget adjustments will be brought forward for City Council consideration, if necessary.

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Utility Tax	**$ 87,432,000**	**$ 65,988,795**	**$ 66,662,520**

Through April 2011, Utility Tax receipts of $66.0 million reported in the City's financial management system were down 1.0% from last year's collection level of $66.7 million. To meet the 2010-2011 budgeted estimate, receipts can decline 0.2% from the prior year. If current collection trends continue, overall collections for this category could fall below the budgeted estimate.

In the Electric Utility Tax category, collections of $29.7 million were tracking 3.5% above the prior year level of $28.7 million; however, slightly higher growth of 3.6% is needed to meet the Electric Utility Tax budget estimate of $39.2 million. The 2010-2011 Adopted Budget incorporated rate increases that were scheduled to become effective in January 2011. However, in October 2010, Pacific Gas and Electric Company (PG&E) filed a settlement agreement with the California Public Utilities Commission (CPUC) that would significantly reduce those rate increases and consequently reduce the City's 2010-2011 Electric Utility Tax revenue. Although no final decision from the CPUC has been made, it is clear that electric rates will not experience the level of growth built into the revenue estimate. Based on current trends, collections could

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

fall slightly below the budgeted estimate. Collections in this category will be closely monitored to determine if a year-end adjustment is necessary.

In the Gas Utility Tax category, receipts of $6.7 million were tracking 0.4% above the prior year level of $6.6 million. In February 2011, in conjunction with the 2010-2011 Mid-Year Budget Review, the City Council approved a $2.0 million decrease to the budget estimate for this category. The modified budgeted estimate of $8.6 million requires growth of 0.6% from the actual 2009-2010 collection level. Based on current trends, collections could fall below the budgeted estimate. Collections in this category will be closely monitored to determine if a year-end adjustment is necessary.

In the Water Utility Tax category, receipts of $6.5 million were tracking 1.1% below the prior year level of $6.6 million. In February 2011, as part of the 2010-2011 Mid-Year Budget Review, the City Council approved a $600,000 decrease to the budget estimate for this category. The modified budget estimate of $9.0 million requires growth of 3.6% from the actual 2009-2010 collection level. While collections are currently tracking below the modified budget level, a rate increase of 3.1% that was implemented in January 2011 may improve collections by the end of the year. It is important to note, however, that this category is always subject to fluctuations related to the amount of precipitation received, particularly in the spring. This category may also be impacted by conservation efforts. At this point, collections could fall below the budgeted estimate. Collections in this category will be closely monitored to determine if a year-end adjustment is necessary.

Collections in the Telephone Utility Tax category of $23.1 million were tracking 6.7% below the prior year collection level of $24.7 million. According to the City's Utility Tax consultant, the lower level of collections reflects a combination of the following factors: (1) continuing migration from land-line service to less-expensive wireless service; (2) intense price competition among wireless service providers; and (3) increased use of service plans that bundle voice service with data service, which qualifies for a federal exemption from the Telephone Utility Tax. In February 2011, in conjunction with the 2010-2011 Mid-Year Budget Review, the City Council approved a $2.9 million decrease to the budget estimate for this category. The budgeted estimate of $30.6 million allows for a 5.9% decline from the actual 2009-2010 collection level. Based on current collection trends and factoring in the impact of prior-year accruals, this category is anticipated to achieve the budgeted revenue estimate by year end.

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Licenses and Permits	**$ 68,198,220**	**$ 64,671,161**	**$ 54,948,684**

Through April, Licenses and Permits revenue of $64.7 million tracked 17.7% above the prior year level of $54.9 million. The 2010-2011 budget estimate anticipates growth over the 2009-

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

2010 collection level of 3.4%. Categories that exceeded the prior year included Business Tax, Cardroom Tax, Building Permits, Fire Permits, and Miscellaneous Licenses and Permits. These positive variances were partially offset by lower collections in the Disposal Facility Tax category. Following is a discussion of the major components of this category.

In the Business Tax category, revenues of $10.9 million through April were tracking 4.5% above the prior year level of $10.5 million. Growth of 1.1% from the 2009-2010 actual collection level is necessary to meet the budgeted Business Tax estimate of $11.0 million. Collections are currently expected to meet the budgeted estimate by year-end.

Cardroom Tax receipts of $10.8 million through April were 15.2% above the prior year level of $9.4 million. In February 2011, in conjunction with the 2010-2011 Mid-Year Budget Review, the City Council approved a $3.9 million decrease to the budget estimate for this category. The budgeted estimate of $13.8 million allows for a 10.5% increase from the actual 2009-2010 collection level. Collections are currently projected to meet or exceed the revised budget estimate.

Disposal Facility Tax revenue of $8.4 million through April is tracking 3.3% below the prior year level of $8.6 million. In February 2011, in conjunction with the 2010-2011 Mid-Year Budget Review, the City Council approved a $300,000 decrease to the budget estimate for this category. The modified budgeted estimate of $11.3 million allows for a 2.7% decrease from the actual 2009-2010 collection level. Based on current trends, collections could fall slightly below the budgeted estimate. Collections in this category will be closely monitored to determine if a year-end adjustment is necessary.

Building Permit receipts of $18.5 million through April were tracking well above both the 2010-2011 year-to-date estimate of $13.0 million, and the prior year-to-date collection level of $13.1 million. Revenues in all plan check and permit categories have exceeded or are tracking above estimated levels. Strong revenue receipts are entirely driven by a spike in residential permits in December. December housing unit permit count of 1,641 was only the third time in the last decade that the count exceeded 1,000 units. Following this spike, a return to slower residential activity occurred in January and continued through April. April also saw a continuation of moderate commercial and slow industrial permit activity. During May, Building had several North San Jose multifamily projects under Plan Review, as well as a few large alterations and additions to existing commercial/industrial projects. At least two multifamily projects are anticipated in mid-June. With this moderate activity projected for the remainder of 2010-2011, and given the strong residential performance in the first half of the year, Building Permit receipts have exceeded the revised budgeted revenue estimate of $16.2 million. The additional revenue surplus will be reallocated to the Building Fee Reserve to ensure sufficient resources are available for works in progress in the Building Fee Program.

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

Through April, Fire Permit collections of $7.8 million were tracking above estimated levels and 27.7% above the prior year receipts of $6.1 million. Development-related collections of $3.6 million are 47.0% above levels received through April 2010, and 34.7% above current year estimates due to higher than projected collections in architectural and engineering systems (fire sprinkler and alarm systems), plan review, and inspections. Development Fee Program revenue is currently projected to exceed the revised budgeted estimate by $1.1 million. The additional revenue will be placed in the Fire Program Fee Reserve and carried over to 2011-2012 to support Development related activity. The Non-Development Fee Program is currently tracking slightly lower than estimated levels with lower than estimated collections for annual renewable permits, partially offset by higher than estimated revenues for non-renewable inspections and miscellaneous revenues. At this time, collections are projected to meet the budgeted revenue estimate of $4.5 million in the Non-Development Fee Program, but could fall below estimated levels due to potential adjustments to the reserve for bad debt for this program. The City Manager's Budget Office and Fire Department will continue to monitor both development and non-development revenues closely.

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Revenue from Local Agencies	**$ 45,682,351**	**$ 36,084,574**	**$ 34,648,458**

This category includes reimbursement from the Redevelopment Agency for City services, grants from various agencies, reimbursement for fire suppression services in unincorporated County pockets, and reimbursement for emergency medical services. Revenues through April of $36.1 million were above the prior year level of $34.6 million.

The budgeted reimbursements from the San Jose Redevelopment Agency total $15.0 million for City services and an additional $15.0 million for the Convention Center debt service payments. It is currently anticipated that the City will be reimbursed for all eligible expenses. Through April, the City has received $26.2 million from the Redevelopment Agency to reimburse the City for eligible expenditures. The 2010-2011 budget for the Redevelopment Agency was approved by the Agency Board in November 2010.

Through April, payments totaling $2.5 million have been received from the Central Fire District for fire services provided by the City. The current-year collections are tracking 15.3% below the prior-year level of $3.0 million. In February 2011, in conjunction with the 2010-2011 Mid-Year Budget Review, the City Council approved a $540,000 decrease to the budget estimate for this category. The modified budget estimate of $5.1 million allows for a decline of 15.3% from the actual 2009-2010 collection level. The reduction to the revenue estimate, based on information from the Central Fire District staff, is due to the drop in Property Tax receipts and the impact of annexations by the City. Therefore, the year-end estimate is expected to be met.

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

Overall, the other reimbursements from various agencies are tracking within or above estimated levels through April. Revenues in this category are projected to end the year close to the budgeted estimates, and the City Manager's Budget Office will bring forward any necessary adjustments.

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Departmental Charges	**$ 29,610,267**	**$ 26,025,567**	**$ 20,329,489**

Through April, Departmental Charges revenues of $26.0 million were tracking 28.0% above the 2009-2010 collection level of $20.3 million. This level of growth exceeds the 8.5% increase over the prior year required to meet the 2010-2011 budget estimate. This increase from the prior year is due primarily to the increase in collections in the Parks, Recreation and Neighborhood Services Department (PRNS) associated with the timing of the re-opening of the Happy Hollow Park and Zoo, the increase in Public Works fee collections, and an increase in Miscellaneous Departmental Changes.

The Miscellaneous Departmental Charges category, which is budgeted at $5.2 million, includes the Solid Waste Enforcement Fee with a budgeted estimate of $3.5 million, various Animal Control Fees budgeted at $708,000, and other miscellaneous fees budgeted at $992,000. Solid Waste Enforcement Fee revenues of $2.7 million were tracking 30.7% above the prior year level of $2.1 million. With receipts at 77.1% of the budgeted estimate of $3.5 million through April, it is projected that this fee will end the year within the budgeted estimate. Animal Care and Services Departmental Charges are budgeted at $708,000 and include Animal Control Fees for a variety of services. Collections through April of $520,000 are tracking below anticipated levels and may fall below the budgeted level at year-end.

Through April, Police revenues of $1.5 million were tracking below (6.1%) expected levels of $1.6 million and at the same levels as the prior year, $1.5 million. The lower than anticipated revenue collections can be attributed to lower collections for Impounded Vehicle Releases, Photostats (Police Records/Reports), and Tow Service Dispatch. These lower than anticipated collections are partially offset by higher collections in Police Officer Standards and Training (POST), Restitution Permits, and Police Officers Attending Civil Court. The Police Department and City Manager's Budget Office will continue to closely monitor performance, and at this time, revenue is tracking to end the year approximately $120,000 below estimated levels.

Public Works Development Fee Program revenues through April of $4.2 million are 40.8% above the prior year level of $3.0 million due to increased activity in both the Development Fee and Utility Fee Programs. However, the volatile nature of development activity should temper any inclination to consider this large increase as indicative of a trend. It is anticipated that the Public Works Fee Program will exceed the budgeted estimate of $4.3 million by approximately

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

$1.0 million. Any net additional funding will be placed in the Public Works Fee Program Reserve as part of the year-end reconciliation.

Transportation fee collections through April totaled $927,000, up 32.7% from the prior year amount of $698,000. This collection level exceeds the budgeted estimate of $779,000. The year-over-year increase primarily results from recognizing Department of Transportation reimbursements for special event costs as Departmental Charges revenue rather than including those reimbursements in an aggregated special events item reported in the Other Revenue category as was done in prior years.

Adjusted for a delay in the posting of quarterly payments, Library departmental revenue of $880,000 is tracking well below expected levels through April due to lower than projected fine revenue. Based on prior year performance and current collection trends, Library revenues may fall below the revenue estimate of $1.9 million by year-end. If necessary, a year-end adjustment to this category will be brought forward.

Through April, Planning Development Fee Program revenue of $2.2 million was slightly above prior year-to-date collections, and 16% above estimated year-to-date revenue levels. Should this trend continue, the Planning fee program is on track to exceed the $2.4 million revenue estimate. This estimate represents a 12% reduction from the prior year actuals, given projections of very slow activity for 2010-2011. However, because overall slow activity levels remain a concern, the City Manager's Budget Office and the Department will continue to monitor Development Fee Program revenues closely for the remainder of the year.

Through April, Parks, Recreation, and Neighborhood Services Departmental Charges revenue of $11.7 million is well ahead of the 2009-2010 level of $8.3 million, primarily due to Happy Hollow Park and Zoo (HHPZ), which had just re-opened in March 2010. With an overall revenue target of $13.1 million, year to date collections have achieved approximately 89% of the budgeted estimate. Categories with higher than anticipated collections include Fee Activity, Parking, and After-School Recreation. It is anticipated at this time that overall year end collections will exceed the budgeted revenue estimate by approximately $1.5 million. A portion of the excess Fee Activity revenue, however, will be recommended to be allocated to support the Fee Activity-related expenses as part of the 2010-2011 year-end budget actions.

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Other Revenue	**$ 89,965,501**	**$ 87,781,043**	**$ 13,166,745**

The Other Revenue category contains a number of unrelated revenue sources. Other Revenue collections through April totaled $87.8 million. Although this represents an increase of $73.3 million from the April 2010 level of $13.2 million, the current year total includes $75.0 million

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes in July ($40.0 million) and October ($35.0 million) 2010. Adjusting for the TRANs issuance, Other Revenue collections through April 2011 totaled $12.8 million – a decrease of $300,000 (3.0%) from the prior year level.

Collections in this category are expected to end the year approximately $2.4 million above the budgeted estimate. Following is a discussion of the major sub-categories in the Other Revenue category:

Through April, the City has received $4.9 million in HP Pavilion Rental, Parking, Suite, and Naming revenue, which is approximately 4.9% above the budgeted estimate of $4.6 million.

Investment Cost Reimbursement and Banking Services revenues through April of $1.6 million and $761,000, respectively, are tracking within estimated levels. Any variances in these categories would be offset by a corresponding variance in related expenditures.

Through April, revenue from the Sale of Surplus Property totaled $6,000 which is well below the budgeted estimate of $1,800,000. Although the Office of Economic Development currently anticipates that a portion of this revenue will be received in 2010-2011, it is likely that revenues in this category will fall below the budgeted estimate.

One-time revenues, which were not anticipated as part of the 2010-2011 Adopted Budget, were received in this category during 2010-2011 and have been incorporated into the 2011-2012 Proposed Budget. These include the $2.0 million option payment from a developer for purchase of a portion of the Airport West property and a $70,000 gift from the Friends of the San José Mounted Unit.

Revenue	2010-2011 Estimate	YTD Actual	Prior YTD Collections
Transfers and Reimbursements	**$ 93,339,330**	**$ 79,234,790**	**$ 77,626,611**

This category includes overhead reimbursements from operating and capital funds, transfers, and other reimbursements. Transfers and Reimbursement collections of $79.2 million through April were tracking above the prior year level of $77.6 million due primarily to one-time transfers from the Healthy Neighborhoods Venture Fund, the Construction Excise Tax Fund, the Integrated Waste Management Fund, and the Construction and Conveyance Tax Fund. Those additional transfer revenues have been partially offset by lower levels of overhead reimbursements. Overall, collections in the Transfers and Reimbursements category are expected to fall below the budgeted estimate by as much as $1.0 million by year-end. The City Manager's Budget Office will continue to monitor the collections in this category closely and bring forward any necessary adjustment.

GENERAL FUND (Cont'd.)

KEY GENERAL FUND REVENUES (Cont'd.)

Overhead associated with operating funds and special funds is currently budgeted at $23.7 million, of which $23.6 million has been received through April. This budget estimate is below the 2009-2010 actual overhead reimbursements of $28.2 million from the operating funds and special funds based on the 2010-2011 overhead rates and the 2010-2011 staffing levels. In addition, overhead associated with capital funds is budgeted at $10.6 million, of which $8.8 million has been received through April. This budget estimate is also below the 2009-2010 actual overhead reimbursements from capital funds of $12.3 million due to a reduction in the number of capital projects. Overall, overhead collections of $32.4 million through April were tracking to meet the budgeted estimate of $34.3 million by year-end.

Transfers from other funds collections of $39.2 million are currently tracking slightly below the budget estimate of $41.7 million, primarily due to lower than anticipated interest earnings transfers from other funds to the General Fund. These transfers associated with interest earnings have already been adjusted downwards once this year. Additional downward adjustments may be necessary at year-end based on actual interest earnings in these funds.

The budget estimate for the Reimbursements for Services category is $17.4 million, of which $16.6 million is expected to be generated from the three Gas Tax Funds. Gas Tax revenues through April were tracking approximately $1.0 million below the budgeted estimate, and the City Manager's Budget Office will continue to monitor Gas Tax revenues closely and bring forward adjustments to this category, if necessary, by year end.

EXPENDITURES

Through April, General Fund expenditures of $711.5 million were 9.7% above the prior year level of $648.6 million. Encumbrances of $29.4 million were 9.7% above the prior year level of $26.8 million. Expenditures and encumbrances ($740.8 million) through April constitute 77.7% of the total 2010-2011 revised budgeted uses of funds ($953.5 million, excluding reserves). Overall, cumulative departmental and non-departmental expenditures are tracking within budgeted levels.

It should be noted that the City Council approved actions as part of the Mid-Year Budget Review to capture $8.5 million of current year savings in the 2010-2011 Ending Fund Balance reserve. These savings, along with additional expenditure savings, excess revenues, and the liquidation of prior year carry-over encumbrances totaling $9.8 million, for a grand total unrestricted ending fund balance estimate of $18.3 million, have been factored into the 2011-2012 Proposed Operating Budget for the General Fund.

Several departments are currently experiencing or are expected to experience higher than budgeted personal services expenditures due to unbudgeted vacation sell-back expenses and/or

GENERAL FUND (Cont'd.)

EXPENDITURES (Cont'd.)

vacation and compensatory time payouts associated with employee separations from retirements or layoffs (June 26, 2011) that are anticipated to occur by year-end, as well as an increased retirement contribution amount that resulted from the transition to the fixed-payment "retirement floor" methodology which will be implemented in 2011-2012. Departments will absorb these additional costs to the extent possible through savings from the employee turnover, overtime controls, and/or identifying potential offsets through non-personal/equipment appropriation savings.

Net-zero budget adjustments were approved as part of the Mid-Year Budget Review to reflect transfers between appropriations to address projected Personal Services expenditure overages for the following departments: City Attorney's Office, City Manager's Office, Fire Department, General Services Department, and the Information Technology Department. However, additional funding may need to be distributed to some departments by the end of the fiscal year to prevent appropriation over-runs. These year-end adjustments will be brought forward for City Council consideration on June 21, 2011.

KEY GENERAL FUND EXPENDITURES

Department	2010-2011 Budget	YTD Actual	Prior YTD Actual
Police	**$ 297,814,043**	**$ 227,640,923**	**$ 229,468,399**

On an overall basis, Police Department expenditures are tracking slightly below estimated levels. Personal Services expenditures of $214.6 million tracked under anticipated levels (77.5% compared to the par of 79.3%). Through the end of April, the Department had 48 sworn vacancies, offset by two temporary sworn personnel, one Police Lieutenant position and one Police Officer position, funded by Urban Area Security Initiative (UASI) grants. Overtime expenditures of $7.3 million through April tracked below anticipated levels with 59.3% expended. The compensatory time balance at the end of April 2011 was 190,482 hours for sworn personnel. This represents an increase of 2,608 hours (1.4%) from the February 2011 balance of 187,874, but a 29,187 hour decrease (13.3%) compared to the April 2010 balance of 219,669. The slight increase in the compensatory time balance from February can be attributed to a greater need for sworn personnel as the weather improves and more people are in Downtown for special events and other activities. However, the overall reduction in the compensatory time balance from the 2009-2010 level can be attributed to a number of factors including higher than normal attrition in 2009-2010 (leading to compensatory time balances being paid out at the time of separation as demonstrated by higher expenditures in full-time salaries), and additional overtime controls implemented during 2009-2010, which have continued through 2010-2011.

The overtime management process requires preapproval by a supervisor, and additional timesheet coding is required to determine the type of usage in order to readily identify mandatory

GENERAL FUND (Cont'd.)

KEY GENERAL FUND EXPENDITURES (Cont'd.)

versus discretionary usage. This process has been useful in reducing discretionary overtime expenditures. The Budget Office and Police Department will continue to closely monitor Personal Services to ensure expenditures are within appropriated levels by year-end.

A total of $15.6 million (75.2%) of the Department's Non-Personal/Equipment budget was expended or encumbered through April. Excluding the remaining balances for centrally-determined details, including electricity, gas, and vehicle operation and replacement, the Department has approximately $2.5 million, or 21.8% of the non-centrally-determined appropriation, available for the remainder of the fiscal year. The Budget Office and the Department will monitor expenditures closely to ensure expenditures are within appropriated levels by year-end.

Department	2010-2011 Budget	YTD Actual	Prior YTD Actual
Fire	**$ 154,206,091**	**$ 121,629,103**	**$ 120,504,133**

Overall, expenditures for the Fire Department were tracking at budgeted estimates through April, with 78.9% expended. Although Personal Services expenditures through April of $116.7 million were tracking at 79.4% of budget (slightly above the par level of 79.3%), cost saving measures implemented by the Department are currently anticipated to bring expenditures within the appropriation level by year-end. However, if additional retirements occur before the end of 2010-2011, the Personal Services appropriation may be over expended due to vacation and compensatory time payouts. The Fire Department's Non-Personal/Equipment budget of $7.1 million was 80.6% expended or encumbered through April. These expenditures are also expected to end the year within the budgeted allocation.

Personal Services expenditures are tracking within estimated levels because the overtime savings is just enough to offset the higher salary and benefit costs. Expenditures for salaries and benefits tracked higher than estimates largely due to higher than budgeted expenditures related to leave balance payouts for 49 Firefighters laid off at the end of July and leave balance payouts for retirees through 2010-2011. An increase to this appropriation may be required at year-end if higher than anticipated retirements occur in May and June that increase the gap between the budget for retiree payouts and actual payouts. The Department will be reviewing expenditures and encumbrances in its Non-Personal/Equipment appropriation and recommendations may be brought forward as part of the year-end clean-up actions that transfer funding from this appropriation to the Personal Services appropriation.

Overtime expenditures of $7.7 million tracked below par levels (67.1% compared to the par of 79.3%) through April. Although overtime expenditures tracked below par levels, the level of overtime savings currently being generated is not as high as anticipated due to a higher sworn absence rate in 2010-2011 compared to the 2009-2010 absence rate. Through the end of April,

GENERAL FUND (Cont'd.)

KEY GENERAL FUND EXPENDITURES (Cont'd.)

the Department had 39 sworn vacancies. When relief staffing can not meet vacancies in duty positions, absences are filled by overtime. Higher absences in 2010-2011 are primarily the result of more sworn positions being absent from line duty due to illness, modified duty, or disability than previously experienced in 2009-2010. To address higher expenditures, the Department will continue implementing overtime control measures for activities not related to minimum staffing.

Through April, the Fire Department was staffed with 172 filled Firefighter Paramedic positions (159 front-line Firefighter paramedics, 5 Supervisors, and 8 support) compared to the 139 front-line Firefighter Paramedics that are necessary to fully staff all apparatus. The Department projects it will have no issues maintaining the target staffing level of 139 front-line Firefighter Paramedics. As part of the City Council's approval of Department Absence and Vacancy Rates (March 2010), it should be noted that the number of sworn administrative staff in the Department through April was 27, which is within the authorized number of 34.

Department	2010-2011 Budget	YTD Actual	Prior YTD Actual
City Attorney's Office	**$ 11,415,510**	**$ 9,043,476**	**$ 10,422,138**

Personal services expenditures of $8.7 million are tracking above estimated levels, while non-personal/equipment expenditures and encumbrances of $543,000 are tracking below estimated levels. Additional actions to clean-up personal services expenditures in the City Attorney's Office are anticipated before year end.

Through April, the personal services appropriation is tracking at 82.2% expended, which is 3.66% (or $308,000) above the par level of 79.3%. The primary cause of the overage is that salaries reallocated to alternative funding sources as a 2010-2011 balancing strategy were not implemented as originally planned, accounting for approximately $275,000 of the overage. The 2010-2011 Adopted Operating Budget included the reallocation of City Attorney's Office staff from the General Fund and the Workforce Investment Act (WIA) Fund to the False Claims Act appropriation and the Municipal Solar Grant Program. The current workload associated with these projects has not occurred at the levels approved as part of the 2010-2011 Adopted Budget; therefore the City Attorney has assigned staff to unbudgeted General Fund legal work. Also, vacancies have been insufficient to meet a budgeted vacancy factor of 0.5% and vacation sellback expenses. Overall, an overage of roughly $500,000 in City Attorney's Office Personal Services is anticipated by year end and expenditures continue to be monitored closely.

Non-personal/equipment expenditures are below par through April despite the reallocation of $150,000 in funding to personal services in the 2010-2011 Mid-Year Review. Additional savings of $100,000 in this appropriation are anticipated to be used to partially offset the higher than anticipated expenditures in personal services.

GENERAL FUND (Cont'd.)

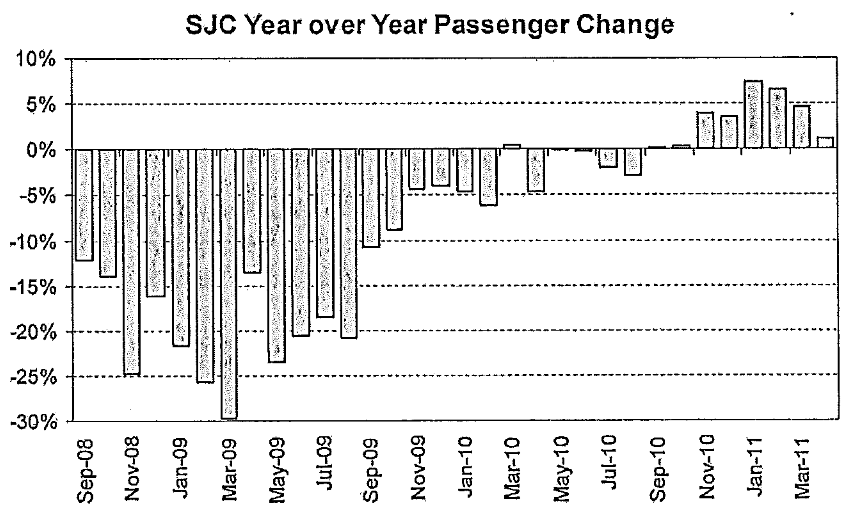
CONTINGENCY RESERVE

The General Fund Contingency Reserve remains at $29.3 million through April, with no revisions through the first ten months of the fiscal year.

OTHER FUNDS

Airport Funds

On a fiscal year-to-date basis, the Norman Y. Mineta San José International Airport has enplaned and deplaned 6.9 million passengers, an increase of 2.1% from the figures reported through April of the prior year. This is the eighth consecutive month passenger activity has increased compared to the same period a year ago (passenger activity in April 2011 was 1% above activity in April 2010) as shown in the chart below. However the number of passenger operations (landings and takeoffs) fell in April, and the fiscal year-to-date total continues to trail the prior year through April by 7.8%. Load factors (the number of passengers per available seat) increased 4.9% from what was reported for the period July through April 2010. In summary, the quantity of flights was down, yet the number of passengers on those flights increased.



Fiscal year-to-date mail, freight and cargo totaled 79.2 million pounds, which represented a 13.6% decrease from 2009-2010. Landed Weights were below estimates by 4.2%, and Taxicab Operations exceeded last fiscal year by 1.7%. Passenger Facility Charge revenues were below the prior year level by less than 1% (0.5%).

Overall revenue performance at the Airport for the ten months ending April 2011 tracked above the budget estimate by 1.6%. Airline rates and charges were 1.8% above the budget estimate. Airfield revenues exceeded budget projections by 10.0%, primarily due to increased in-flight kitchen and ground concession revenues. The terminal concessions and miscellaneous rents category also performed above expected levels by 4.3%, and the parking and roadway category was 4.9% higher than the estimated budget, primarily due to higher public parking and rental car concession activity. Landing fees and terminal rentals also performed above the budget estimate. Other general and non-aviation revenues, on the other hand, were slightly below the budget estimate (by 2.1%) due to lower than expected interest income. The Airport anticipates ending the year with overall revenue levels above estimated levels.

OTHER FUNDS (Cont'd.)

Year-to-date Personal Services expenditures through April were 78.0% of budget, which was slightly below the benchmark of 79.3%. Staff retirements are expected to result in additional savings. Non-Personal/Equipment expenditures through April totaled 61.0% of budget compared to the benchmark of 76.5%. Current encumbrances of $7.1 million bring total Personal Services and Non-Personal/Equipment commitments to $52.7 million or 77.4% of the budget.

In the Airport Customer Facility and Transportation Fee Fund, Personal Services and Non-Personal/Equipment expenditures combined tracked below the budget estimate (at 57.6% of budget).

Construction and Conveyance Tax Funds

Construction and Conveyance (C&C) Tax revenues are currently expected to exceed budgeted estimates by approximately $1.5 million by year-end. Collections through April 2011 totaled $15.2 million (76% of the 2010-2011 estimate of $20.0 million), which represents a decline of 5.5% from the $16.1 million collected last year through April 2010. The City has since received May Conveyance Tax receipts totaling $2.2 million, which represents a 12.6% increase from the $2.0 million received in May 2010. Although tax revenues are tracking slightly lower than last year, the adopted C&C Tax estimate allowed for an 11.1% drop from the 2009-2010 collection level.

Nearly 99% of the total Construction and Conveyance Taxes are comprised of conveyance receipts, a tax based on the value of property transfers, which are the main driver in this revenue category. The housing market appeared to be recovering during the first several months of the fiscal year, but that trend has now reversed itself. Although the April 2011 median home price of $485,000 for single family homes within the City improved slightly from the prior month, it fell 6.5% below the April 2010 median of $518,500. April marked the seventh month in a row that the median home price decreased from the same month in the prior year. Another indicator of the continuing challenges in the local real estate market is the increase in the amount of time to complete a transaction. The average days-on-market for all types of residences totaled 94 in April 2011, close to the peak of 97 days-on-market in June 2009. One bright spot in the real estate data is the number of property transfers (sales) for all types of residences which totaled 758 in April, representing a slight increase of approximately 1.2% from the 749 sales that occurred in the same month in the prior year.

Other Construction-Related Revenues

Through April, permit valuation for residential construction activity is above prior year levels; however, permit valuation for commercial and industrial construction activity is below prior year levels. Residential permit activity in the month of December spiked to its highest level in over a decade (1,641 units), and year-to-date permit valuation for residential activity totaled $370.1 million through April, which is significantly higher than prior year-to-date collections of $101.8

OTHER FUNDS (Cont'd.)

million. This surge in activity was primarily due to two very large development projects in the North San José area and should not be interpreted as a sustainable trend. Commercial activity was slow in April, with permit valuation at $16.4 million; and permit valuation year-to-date totaled $176.8 million, which is tracking slightly lower than at this point last year ($183.3 million). Industrial permit activity for new construction was also slow, with valuation at $7.9 million through April, compared to $65.6 million collected through the same period last year, and the permit activity for alterations was high, with valuation at $56.3 million through April, compared to $41.4 million collected through the same period last year. Overall, industrial permit activity remains well below prior year-to-date collections. These permit activities drive the revenue collections in several categories, including the Construction Excise Tax, the Building and Structure Construction Tax, and the Residential Construction Tax, and are an indicator of future activity for several other categories, such as the storm and sanitary sewer system fees.

Through April, actual receipts for the ten revenue sources monitored for this report totaled $25.6 million, which represents an increase of 120.9% from the $11.6 million collected through the same period last year. Seven of the ten revenue categories are currently exceeding budgeted levels primarily as a result of the high revenue collections in December. Following is a discussion of the performance for the individual revenue categories:

- *Building and Structure Construction Tax* – Receipts through April totaled $8.4 million, which well exceeds the 2010-2011 revenue estimate of $4.5 million. This collection level is over double prior year collections ($3.7 million) through April. This significant increase is due to a high collection level in December as a result of residential permits pulled for two new housing developments in the North San José area. It should be noted that this higher revenue collection is not at a sustainable level. The 2011-2012 Proposed Budget factored in the higher actual collections in 2010-2011 and a sustainable revenue estimate for 2011-2012.

- *Construction Excise Tax* – Receipts of $12.1 million almost doubled from the $6.1 million collected during the same period last year. This collection level well exceeds the 2010-2011 revenue estimate of $6.0 million. This significant increase is due to a high collection level in December as a result of residential permits pulled for two new housing developments in the North San José area. It should be noted that this higher revenue collection is not at a sustainable level. The 2011-2012 Proposed Budget factored in the higher actual collections in 2010-2011 and a sustainable revenue estimate for 2011-2012.

- *Residential Construction Taxes* – Receipts totaled $185,000, which well exceeds the current 2010-2011 estimate of $60,000, and is significantly higher than the receipts received through the same period last year ($17,000).

- *Municipal Water Service Connection Fees* – Receipts totaled $25,000, representing a decrease of 45.6% compared to the $46,000 collected through the same period last year. Because Municipal Water Service Connection Fees recover actual costs to install new services, this lower collection level is offset by lower costs. This collection level is 14.3% of the current 2010-2011 revenue estimate of $175,000.

OTHER FUNDS (Cont'd.)

- *Municipal Water Major Facilities Fees* – Receipts totaled $417,000 through April, which was unanticipated. No estimated revenue collection for 2010-2011 was assumed in the development of the 2010-2011 Adopted Budget. The additional revenues will be reconciled and allocated as part of the 2010-2011 Annual Report actions.

- *Municipal Water Advance System Design Fees* – Receipts totaled $44,000 through April, which represents a significant increase compared to the revenues collected through the same period last year ($8,000). This collection level is 88.5% of the current 2010-2011 revenue estimate of $50,000.

- *Municipal Water Meter Installation Fees* – Receipts totaled $45,000, representing a significant increase compared to the $7,000 collected through the same period last year. This collection level is 90.7% of the current 2010-2011 revenue estimate of $50,000.

- *Sanitary Sewer Fees* – Fees totaled $513,000, which well exceeds the current 2010-2011 estimate of $350,000. This collection level is significantly higher than the fees collected through the same period last year ($211,000). This higher collection level was also factored into the development of the 2011-2012 Proposed Budget.

- *Storm Drain Fees* – Storm Drain Fees totaled $106,000, which exceeds the current 2010-2011 estimate of $100,000. This collection level is 25.5% higher than the fees received through the same period last year ($85,000).

- *North San José Traffic Impact Fees* – Receipts totaled $3.7 million through April, which was unanticipated. No revenue collection was assumed in the development of the 2010-2011 Adopted Budget as a result of the volatility of development activity in this area; however, as part of the 2010-2011 Mid-Year Budget Review, recommendations were approved to recognize $2.3 million of actual revenues received. Any additional revenues received in 2010-2011 will be recognized and appropriated to the Reserve for North San Jose Traffic Impact Fees as part of the 2010-2011 cleanup actions.

Convention and Cultural Affairs Fund

The Convention and Cultural Affairs Fund accounts for Team San José's (TSJ) operation of the City's Convention and Cultural Facilities. Extensive expenditure reductions were approved as part of the 2010-2011 Adopted Operating Budget to ensure the long-term health of the fund. At the May 19, 2011, Public Safety, Finance and Strategic Support Committee meeting, the Team San José Quarterly Performance and Incentive Measure report was presented in which the need for additional resources before year-end was detailed, based on additional activity and revenue levels.

Revenues through April are tracking significantly ahead of anticipated levels. While operating revenues of $11.6 million have been recognized, additional revenues of $2.2 million have been reported by TSJ but not yet recognized in the fund. With a budgeted revenue estimate of $13.9

OTHER FUNDS (Cont'd.)

million, it is now anticipated that year-end revenues of approximately $17.8 million will exceed the budgeted estimate by $3.9 million. The primary drivers of the better than anticipated revenue collections are food and beverage sales (approximately $1.0 million higher than anticipated) and building rental (approximately $600,000 higher than anticipated) While operating revenues are significantly higher than anticipated, a portion of these revenues will be required to offset associated expenses. In addition to operating revenues, the Convention and Cultural Affairs Fund receives a portion of the revenue from the Transient Occupancy Tax Fund. The transfer of the budgeted amount of $5.0 million from the Transient Occupancy Tax Fund is expected by year-end.

Expenditures in the Non-Personal/Equipment category, which support food and beverage expenses, parking, the Broadway series, all variable labor costs, administration, and various other costs, are tracking higher than anticipated, due to increased activity at the Convention Center and other cultural facilities. Through April, the appropriation is approximately $110,000 higher than anticipated. TSJ projects that year-end expenditures will exceed the budgeted level of $16.9 million by $1.6 million due to additional activity and end the year with approximately $18.5 million in expenditures. As part of the year-end clean-up actions, a recommended increase of $1.6 million will be brought forward to bring the appropriation in line with anticipated expenditures. That increase would be more than offset by the associated additional revenue.

Expenditures in the personal services and Workers' Compensation categories continue to track above anticipated levels and it is anticipated that year-end increases will be required. The projected overage of $250,000 in the personal services category is due primarily to unbudgeted compensation time payouts and overtime expenses and is expected to result in year-end expenses of $2.0 million in this appropriation. The projected overage of $200,000 in the Workers' Compensation category is due to a higher level of claims than experienced in prior years and is expected to result in year-end expenses of $300,000 in this appropriation. It is anticipated that the increases for both of these appropriations will be offset by the recognition of additional revenue at year-end.

Other expenditures in this Fund are expected to end the year within anticipated levels. On an overall basis, total funding sources for this fund are expected to exceed the total funding uses, generating additional Unrestricted Ending Fund Balance above the modified budget level. This additional fund balance will help keep the Fund in sound fiscal condition during the Convention Center renovation period.

Municipal Golf Course Fund

Revenues booked into the Municipal Golf Course Fund represent collections at the courses. In the case of the San Jose Municipal Golf Course the City receives a fixed percentage of the operator's gross revenues regardless of the operator's costs. For the Los Lagos and Rancho del Pueblo courses, the City receives the net of any expenses incurred by the operators. In months

OTHER FUNDS (Cont'd.)

where revenues are not sufficient to cover the operator's expenses, the Municipal Golf Course Fund covers the difference.

Through April, revenues generated at the golf courses are far behind 2009-2010 collections through the same period. Revenues from the San Jose Municipal Golf Course of $420,000 are $50,000 below the 2009-2010 level of $470,000. Net revenues from the Los Lagos course of $52,000 are $216,000 below the 2009-2010 level of $268,000. The Rancho Del Pueblo course has no net revenues to contribute to the fund, and year to date net costs at the course are $56,000 greater than last year. These revenue shortfalls are primarily due to decreased activity levels at the courses due to the prolonged economic downturn and this year's unusually cool weather. The courses are also experiencing increased expenses due to higher labor rates resulting from prevailing and living wage adjustments, as well as increased rates for potable and non-potable water. Through April, total expenditures in the fund are $195,000 higher than the 2009-2010 year to date level.

The negative current-year revenue and expenditure trends in the Municipal Golf Course Fund were identified in the Mid-Year Budget Review, and the City Council approved actions at that time to bring the budgeted revenues and expenditures into alignment with the projected actual performance. Consequently, it is anticipated at this time that these actions will be sufficient and the fund will end the year within estimated levels.

Transient Occupancy Tax Fund

Through April 2011, receipts recorded in the TOT Fund of $7.8 million are 3.4% above the prior year collection level for the same period. The 2010-2011 budget assumed an increase of 2% from the 2009-2010 estimated level, however the budget now allows for a decline of 3.1% based on higher than anticipated 2009-2010 collections. It is anticipated that TOT receipts will exceed the budgeted revenue estimate of $10.0 million by year-end. The 2011-2012 Proposed Operating Budget incorporates a 2010-2011 TOT revenue estimate of $10.6 million, with the $600,000 difference between budgeted and estimated levels placed into a Reserve for Future Distribution. It is anticipated that these additional funds will be recommended for distribution as part of the 2010-2011 Annual Report based on the final TOT receipts.

The 2010-2011 allocations to the three recipient organizations (Convention and Cultural Affairs Fund, Convention and Visitors Bureau, Cultural Grants/Programs and Services) are anticipated to be fully expended by the end of the year.

Through April, the average hotel occupancy rate at the 14 major hotels was 57.8%, an improvement from the 54.5% occupancy rate for the same period in 2009-2010. For the same 14 hotels, the average daily room rate through April was $119.68, up from the $117.06 room rate for the same period in 2009-2010. The year-to-date average revenue-per-available-room (RevPAR) metric of $69.26 represents an increase of 8.4% from the prior year level.

CONCLUSION

The slow and uneven pace of recovery from the economic recession continues to dampen growth in the City's economically sensitive revenue categories.

As the 2010-2011 year-end approaches, the City's various operating and capital funds are currently tracking to meet overall year-end expectations as revised at the 2010-2011 Mid-Year Budget Review. As previously discussed, the City Council approved actions as part of the Mid-Year Budget Review to capture $8.5 million of current year savings in the 2010-2011 Ending Fund Balance reserve. These savings, along with additional expenditure savings, excess revenues, and the liquidation of prior year carry-over encumbrances totaling $9.8 million (for a total of $18.3 million), have been factored into the 2011-2012 Proposed Operating Budget for the General Fund. Also as discussed above, Sales Tax revenue for the third quarter will be received later in June. If the third quarter collections exceed current projections, the Mayor's June Budget Message for 2011-2012 directs the Administration to issue a Manager's Budget Addendum to the 2011-2012 Proposed Budget recognizing that additional revenue and restoring as many Police patrol officers as possible. Any additional revenues or expenditure savings will be reconciled and allocated as part of the 2010-2011 Annual Report.

A 2010-2011 year-end clean-up memorandum will be brought forward for City Council consideration on June 21, 2011, with recommended adjustments to align the budget with actual activity levels in the General Fund and various special and capital funds and to avoid overages in budgeted appropriations. As always, staff will continue to report to the City Council any significant developments impacting the City's financial condition.

Jennifer A. Maguire

JENNIFER A. MAGUIRE
Budget Director

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

FINANCE DEPARTMENT

Monthly Financial Report

Financial Results for the 10 Months Ended April 30, 2011
Fiscal Year 2010-11
(UNAUDITED)

Finance Department, City of San José
Monthly Financial Report
Financial Results for the 10 Months Ended April 30, 2011
Fiscal Year 2010-11
(UNAUDITED)

Table of Contents

Finance Department, City of San José
Monthly Financial Report
Financial Results for the 10 Months Ended April 30, 2011
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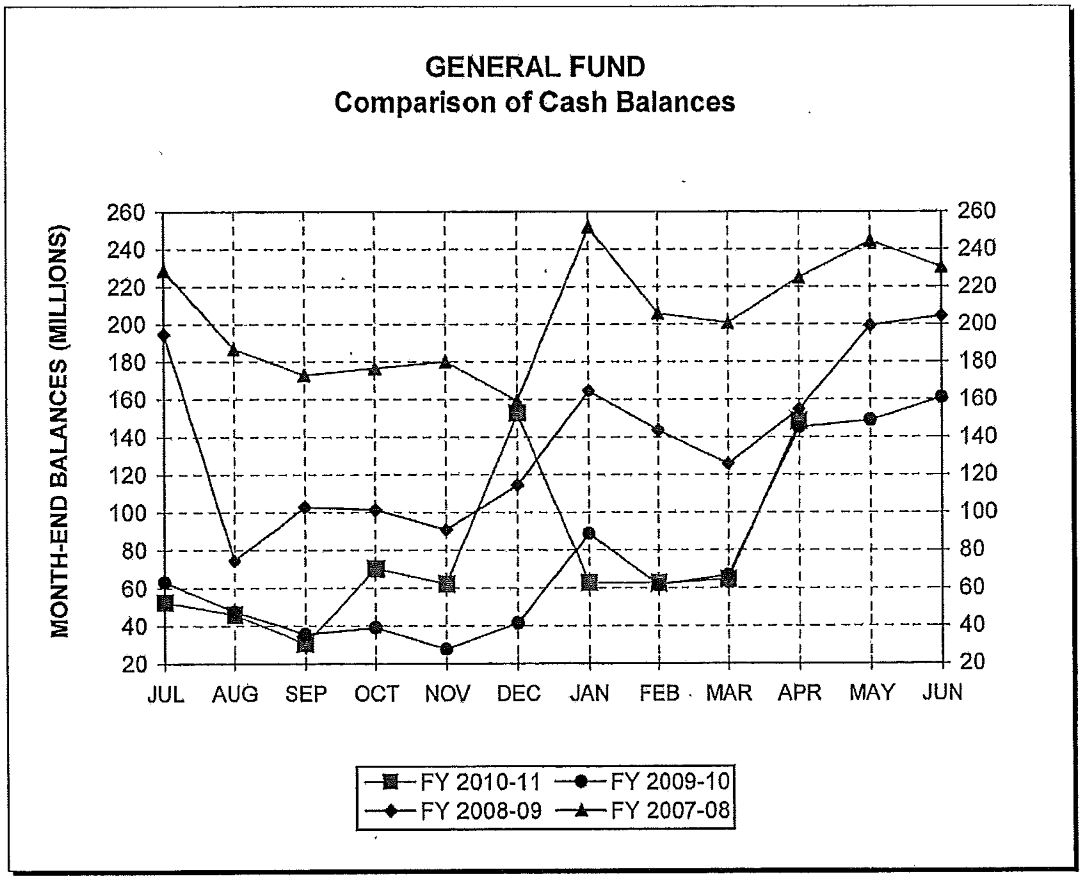
Table of Contents

Submitted by:

SCOTT P. JOHNSON
Director, Finance Department



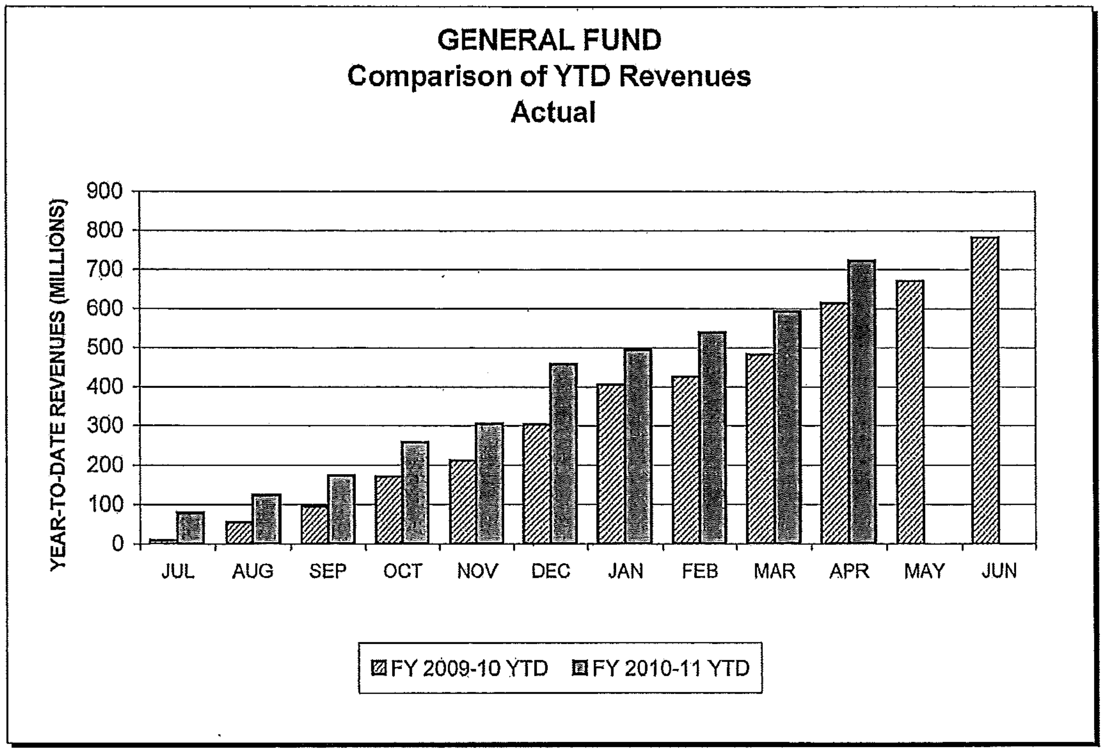
GENERAL FUND MONTHLY CASH BALANCES

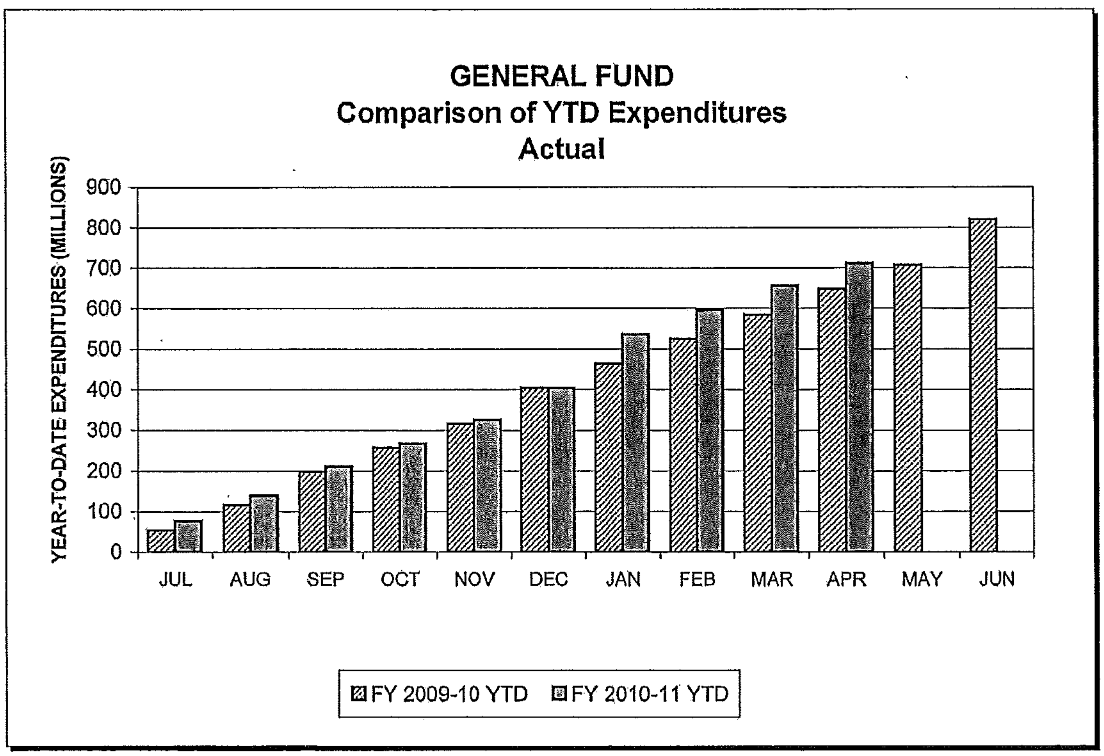
MONTH	FY 2010-11	FY 2009-10	FY 2008-09	FY 2007-08
JULY (1)	$ 52,614,304	$ 63,344,537	$ 194,527,843	$ 228,551,607
AUGUST (1)	45,992,983	47,689,216	74,677,718	186,835,010
SEPTEMBER	30,525,385	35,662,298	102,811,355	173,043,887
OCTOBER	70,246,706	38,946,966	101,433,688	176,617,539
NOVEMBER	62,333,059	27,736,074	90,892,525	180,164,388
DECEMBER (2)	152,493,162	41,491,217	114,535,815	159,164,830
JANUARY (3)	62,749,463	88,749,418	164,539,700	251,792,153
FEBRUARY	62,572,017	61,606,869	143,802,507	205,882,438
MARCH	64,768,564	66,979,823	125,900,953	200,763,696
APRIL	148,465,097	145,213,763	154,701,704	225,008,853
MAY		149,064,276	199,321,150	244,545,422
JUNE		161,013,785	204,474,123	230,556,706

Note: (1) The General Fund cash balance decrease in July 2010 (also in August 2008 and July 2009) was mainly due to the Council's direction to annually pre-fund the employer share of retirement contributions in a lump-sum to achieve budgetary savings to the City.

Note: (2) The General Fund cash balance increase in December 2010 was mainly due to the timing of the receipt of $88.5 million in Property Tax revenue and $16.7 million in Sales Tax revenue. In addition, these revenues were posted in January in the prior three fiscal years.

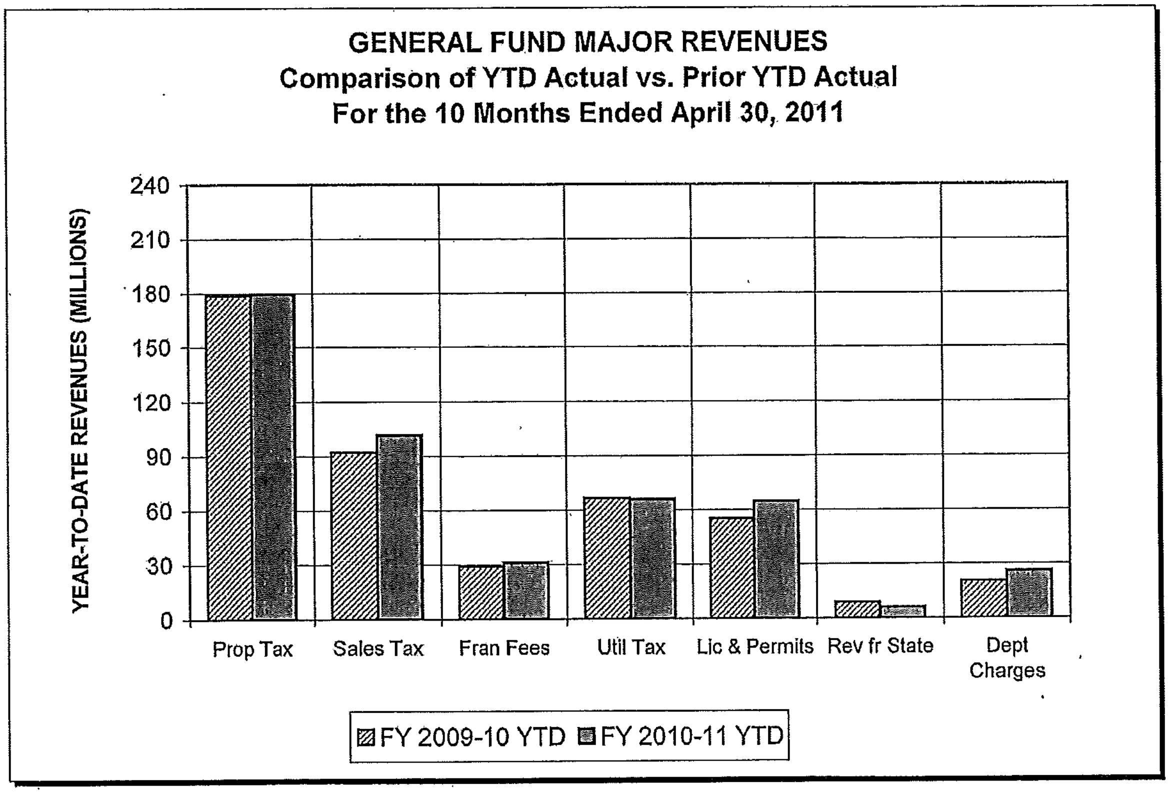
Note: (3) The General Fund cash balance decrease in January 2011 was mainly due to the repayment of the Tax and Revenue Anticipation Notes (TRANs) in the amount of $75 million.

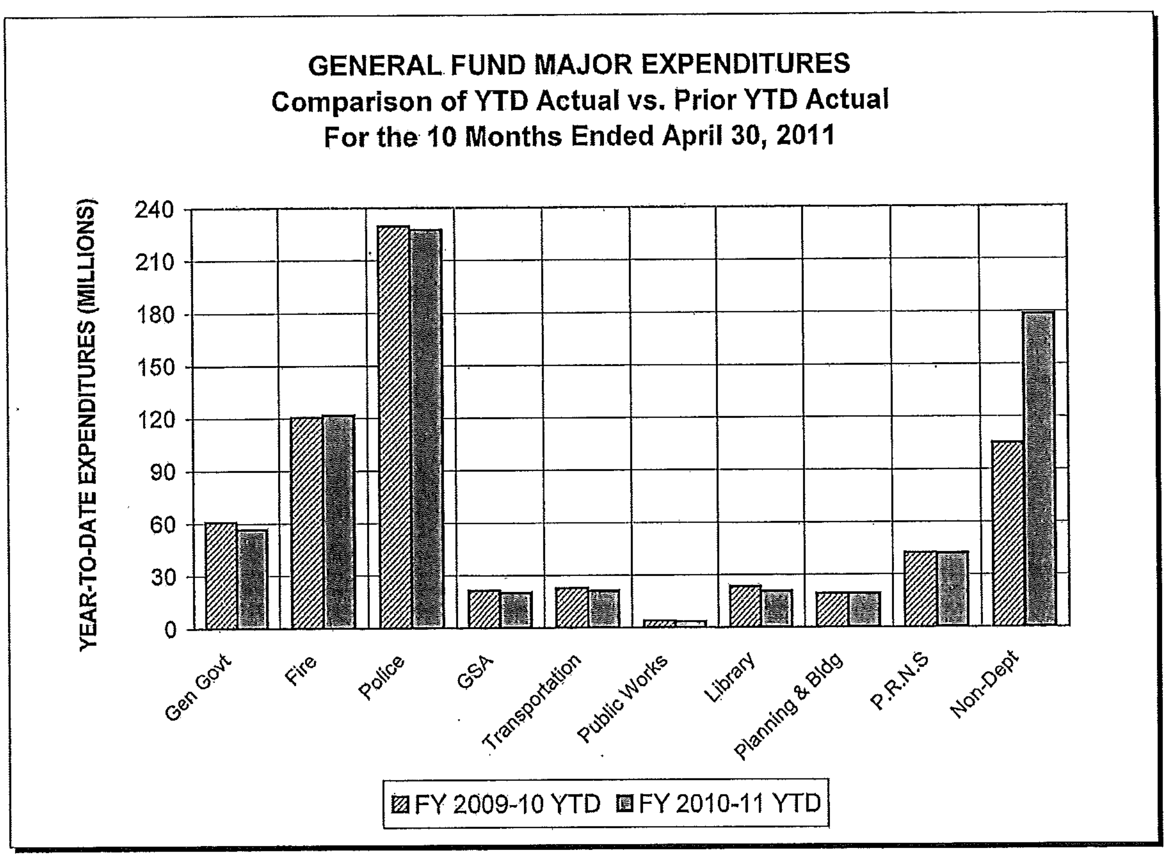




General Fund Revenue includes issuance of Tax and Revenue Anticipation Notes (TRANs) in the amoun of $75 million ($40 million in July 2010 and $35 million in October 2010) for cash flow borrowing.

General Fund Expenditures includes repayment of TRANs in the amount of $75 million in January 2011.


GENERAL FUND MAJOR REVENUES
Comparison of YTD Actual vs. Prior YTD Actual
For the 10 Months Ended April 30, 2011
YEAR-TO-DATE REVENUES (MILLIONS)
240
210
180
150
120
90
60
30
0
Prop Tax
Sales Tax
Fran Fees
Util Tax
Lic & Permits
Rev fr State
Dept Charges
FY 2009-10 YTD
FY 2010-11 YTD


GENERAL FUND MAJOR EXPENDITURES
Comparison of YTD Actual vs. Prior YTD Actual
For the 10 Months Ended April 30, 2011
YEAR-TO-DATE EXPENDITURES (MILLIONS)
240
210
180
150
120
90
60
30
0
Gen Govt
Fire
Police
GSA
Transportation
Public Works
Library
Planning & Bldg
P.R.N.S
Non-Dept
FY 2009-10 YTD
FY 2010-11 YTD

CITY OF SAN JOSE
GENERAL FUND SOURCE AND USE OF FUNDS
FUND BALANCE, REVENUE, TRANSFERS & REIMBURSEMENTS
FOR THE 10 MONTHS ENDED APRIL 30, 2011
(UNAUDITED)
($000's)

	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	CUR YTD ACTUAL	CUR YTD ACTUAL % OF BUDGET	PRIOR YTD ACTUAL	PRIOR YTD % OF PRIOR YEAR-END ACTUAL	PRIOR YEAR-END BUDGETARY BASIS ACTUAL	CUR YTD LESS PRIOR YTD ACTUAL	% CHANGE CUR YTD ACTUAL LESS PRIOR YTD ACTUAL
Fund Balance											
Prior Year Encumbrances	$ -	-	16,087	16,087	16,087	100.00%	23,629	105.38%	22,422	(7,542)	-31.92%
Liquidation of c/o Encumbrance	-	-	-	-	-	-	-	-	-	-	-
Available Balance	134,807	6,591	-	141,398	141,398	100.00%	173,213	100.00%	173,213	(31,815)	-18.37%
Total Fund Balance	134,807	6,591	16,087	157,485	157,485	100.00%	196,842	100.62%	195,635	(39,357)	-19.99%
General Revenues											
Property Tax	199,052	(4,143)	-	194,909	179,512	92.10%	178,711	88.39%	202,186	801	0.45%
Sales Tax (Note 1)	127,232	7,447	-	134,679	101,452	75.33%	91,930	72.25%	127,238	9,522	10.36%
Telephone Line Tax	20,525	-	-	20,525	15,509	75.56%	15,360	74.93%	20,500	149	0.97%
Transient Occupancy Tax	6,684	-	-	6,684	5,152	77.08%	4,983	72.22%	6,900	169	3.39%
Franchise Fees	43,121	(850)	-	42,271	30,967	73.26%	28,970	75.42%	38,410	1,997	6.89%
Utility Tax	92,932	(5,500)	-	87,432	65,989	75.47%	66,663	76.06%	87,651	(674)	-1.01%
Licenses and Permits	71,727	(3,529)	-	68,198	64,671	94.83%	54,949	83.27%	65,985	9,722	17.69%
Fines, Forfeits and Penalties	17,130	790	-	17,920	15,536	86.70%	12,962	81.02%	15,998	2,574	19.86%
Use of Money and Property	3,050	(383)	-	2,667	3,174	119.01%	2,336	73.21%	3,191	838	35.87%
Revenue from Local Agencies	45,613	69	-	45,682	36,085	78.99%	34,648	72.08%	48,067	1,437	4.15%
Revenue from State of California	19,190	(272)	-	18,918	5,900	31.19%	8,607	73.26%	11,749	(2,707)	-31.45%
Revenue from Federal Government	15,438	4,983	-	20,421	5,249	25.70%	2,568	46.75%	5,493	2,681	104.40%
Departmental Charges (Note 2)	29,581	29	-	29,610	26,026	87.90%	20,334	74.53%	27,282	5,692	27.99%
Other Revenues (Note 3)	13,420	76,546	-	89,966	87,781	97.57%	13,167	48.73%	27,023	74,614	566.67%
Total General Revenues	704,695	75,187	-	779,882	643,003	82.45%	536,188	77.97%	687,673	106,815	19.92%
Transfers & Reimbursements											
Overhead Reimbursements	33,868	435	-	34,303	32,387	94.41%	36,304	89.57%	40,530	(3,917)	-10.79%
Transfers from Other Funds	37,553	4,129	-	41,682	39,242	94.15%	29,014	77.36%	37,504	10,228	35.25%
Reimbursements for Services	17,348	6	-	17,354	7,605	43.82%	12,308	72.76%	16,916	(4,703)	-38.21%
Total Transfers & Reimburse	88,769	4,570	-	93,339	79,234	84.89%	77,626	81.75%	94,950	1,608	2.07%
Total Sources	$ 928,271	86,348	16,087	1,030,706	879,722	85.35%	810,656	82.87%	978,258	69,066	8.52%

Note 1 - State Budget Balancing actions resulted in the "Triple Flip", which suspended a portion of local governments' Sales and Use Tax and Motor Vehicle License Fee revenues and replaced them with local property tax revenues.
The 2010-2011 impact through April 2011 is approximately $13.7 million.
Note 2 - See Supplemental Schedule on Page 7.

CITY OF SAN JOSE
GENERAL FUND SOURCE AND USE OF FUNDS
EXPENDITURES
FOR THE 10 MONTHS ENDED APRIL 30, 2011
(UNAUDITED)
($000's)

	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	CUR YTD ACTUAL % OF BUDGET	PRIOR YTD ACTUAL(1)	PRIOR YTD % OF PRIOR YEAR-END ACTUAL	PRIOR YEAR-END BUDGETARY BASIS ACTUAL	CUR YTD LESS PRIOR YTD ACTUAL(1)	% CHANGE CUR YTD ACTUAL LESS PRIOR YTD ACTUAL
General Government												
Mayor and Council	$ 10,222	(74)	104	10,252	6,021	58	58.73%	6,258	80.76%	7,749	(237)	-3.79%
City Attorney	11,545	(426)	296	11,415	9,043	242	79.22%	10,422	79.66%	13,083	(1,379)	-13.23%
City Auditor	1,961	(55)	4	1,910	1,433	4	75.03%	1,716	81.10%	2,116	(283)	-16.49%
City Clerk (2)	4,750	(743)	10	4,017	3,427	42	85.31%	1,669	80.94%	2,062	1,758	105.33%
City Manager	10,391	128	488	11,007	7,948	652	72.21%	8,552	79.30%	10,785	(604)	-7.06%
Finance	11,435	(84)	301	11,652	8,603	401	73.83%	8,890	78.99%	11,255	(287)	-3.23%
Information Technology	15,301	168	674	16,143	10,817	1,330	67.01%	12,222	78.87%	15,496	(1,405)	-11.50%
Human Resources	7,335	(154)	56	7,237	5,562	270	76.86%	6,103	79.27%	7,699	(541)	-8.86%
Redevelopment Agency	1,707	(157)	-	1,550	1,051	-	67.81%	1,530	80.70%	1,896	(479)	-31.31%
Independent Police Auditor	831	40	-	871	642	1	73.71%	520	74.93%	694	122	23.46%
Office of Economic Development	2,968	(47)	144	3,065	2,150	106	70.15%	2,926	80.27%	3,645	(776)	-26.52%
Total General Government	78,446	(1,404)	2,077	79,119	56,697	3,106	71.66%	60,808	79.51%	76,480	(4,111)	-6.76%
Public Safety												
Fire	153,332	583	291	154,206	121,629	847	78.87%	120,504	78.98%	152,579	1,125	0.93%
Police	297,499	(693)	1,008	297,814	227,641	2,584	76.44%	229,468	79.21%	289,709	(1,827)	-0.80%
Total Public Safety	450,831	(110)	1,299	452,020	349,270	3,431	77.27%	349,972	79.13%	442,288	(702)	-0.20%
Capital Maintenance												
General Services	25,596	(5)	379	25,970	19,986	1,484	76.96%	21,228	79.83%	26,593	(1,242)	-5.85%
Transportation	28,227	54	648	28,929	20,942	1,276	72.39%	22,563	76.70%	29,418	(1,621)	-7.18%
Public Works	5,091	(35)	-	5,056	3,613	8	71.46%	3,950	82.84%	4,768	(337)	-8.53%
Total Capital Maintenance	58,914	14	1,027	59,955	44,541	2,768	74.29%	47,741	78.55%	60,779	(3,200)	-6.70%

(1) Does not include encumbrance balance.
(2) Mainly due to $1.93 million in Elections expenditures for for the cost of the June 8, 2010 and November 2, 2010 elections.

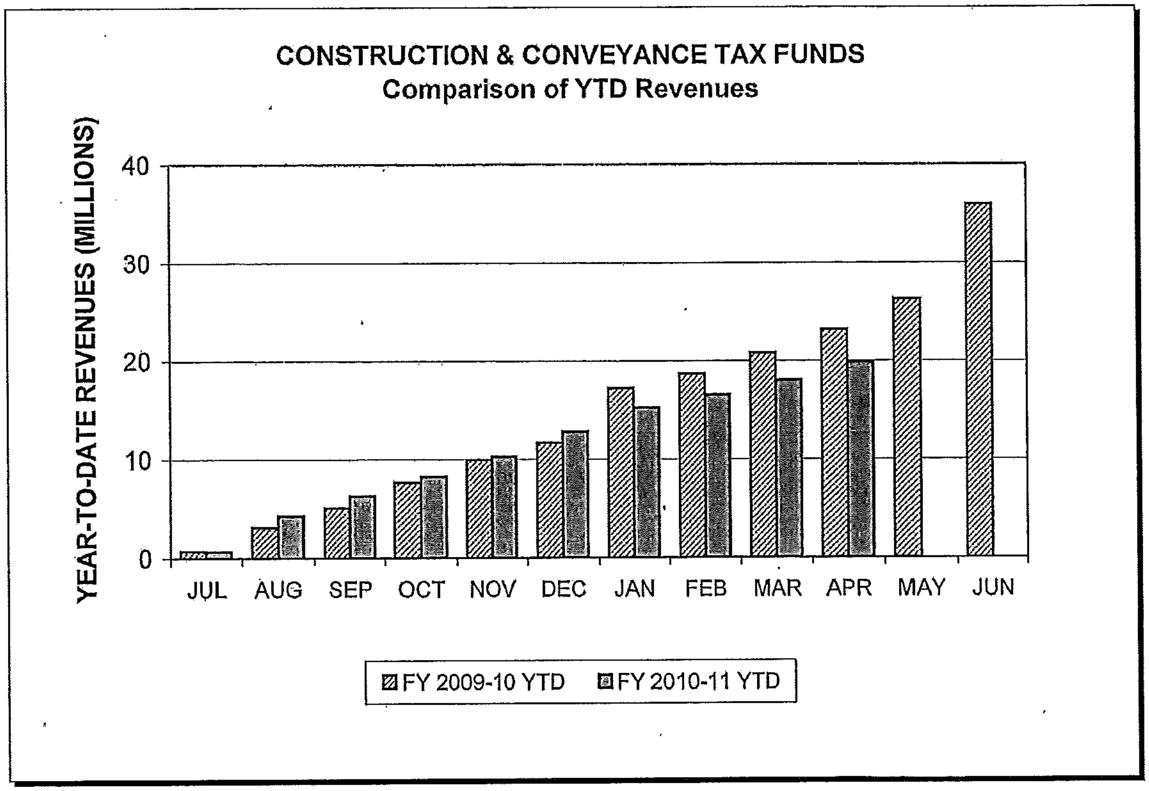
CITY OF SAN JOSE
GENERAL FUND SOURCE AND USE OF FUNDS
EXPENDITURES
FOR THE 10 MONTHS ENDED APRIL 30, 2011
(UNAUDITED)
($000's)

	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	CUR YTD ACTUAL % OF BUDGET	PRIOR YTD ACTUAL(1)	PRIOR YTD % OF PRIOR YEAR-END ACTUAL	PRIOR YEAR-END BUDGETARY BASIS ACTUAL	CUR YTD LESS PRIOR YTD ACTUAL(1)	% CHANGE CUR YTD ACTUAL LESS PRIOR YTD ACTUAL
Community Service												
Library	26,258	(992)	92	25,358	20,628	223	81.35%	23,236	77.84%	29,851	(2,608)	-11.22%
Planning, Bldg & Code Enf.	25,476	95	160	25,731	19,033	455	73.97%	18,999	80.59%	23,575	34	0.18%
Park, Rec & Neigh Svcs	57,735	(1,345)	327	56,717	42,174	2,519	74.36%	42,289	75.86%	55,749	(115)	-0.27%
Environmental Services	610	67	40	717	404	99	56.35%	551	91.23%	604	(147)	-26.68%
Total Community Services	110,079	(2,175)	619	108,523	82,239	3,296	75.78%	85,075	77.50%	109,779	(2,836)	-3.33%
Total Dept. Expenditures	$ 698,270	(3,675)	5,022	699,617	532,747	12,601	76.15%	543,596	78.86%	689,326	(10,849)	-2.00%
Non-Dept Expenditures												
City-wide Expenditures:												
Econ & Neighborhood Develop.	$ 24,914	1,621	1,343	27,878	22,088	2,289	79.23%	19,660	78.75%	24,966	2,428	12.35%
Environmental & Utility Services	11,588	1,517	-	13,105	2,713	3,125	20.70%	1,233	83.88%	1,470	1,480	120.03%
Public Safety	21,731	4,679	659	27,069	15,814	645	58.42%	15,094	82.72%	18,248	720	4.77%
Recreation & Cultural Services	13,910	107	878	14,895	10,620	3,457	71.30%	9,138	78.30%	11,670	1,482	16.22%
Transportation Services	4,512	459	338	5,309	3,244	825	61.10%	2,945	73.30%	4,018	299	10.15%
Strategic Support (2)	42,250	78,798	1,983	123,031	92,411	2,426	75.11%	22,925	71.83%	31,915	69,486	303.10%
Total City-wide Expenditures	118,905	87,181	5,201	211,287	146,890	12,767	69.52%	70,995	76.93%	92,287	75,895	106.90%
Capital Contributions	8,935	(714)	5,864	14,085	3,208	4,019	22.78%	9,294	73.83%	12,588	(6,086)	-65.48%
Transfers to Other Funds	29,039	(505)	-	28,534	28,616	-	100.29%	24,732	97.27%	25,425	3,884	15.70%
Total Non-Dept Expenditures	156,879	85,962	11,065	253,906	178,714	16,786	70.39%	105,021	80.60%	130,300	73,693	70.17%
Reserves												
Contingency Reserves	29,309	-	-	29,309	-	-	0.00%	-	0.00%	-	-	0.00%
Earmarked Reserves	43,813	4,061	-	47,874	-	-	0.00%	-	0.00%	-	-	0.00%
Total Reserves	73,122	4,061	-	77,183	-	-	0.00%	-	0.00%	-	-	0.00%
Total Uses	$ 928,271	86,348	16,087	1,030,706	711,461	29,387	69.03%	648,617	79.14%	819,626	62,844	9.69%

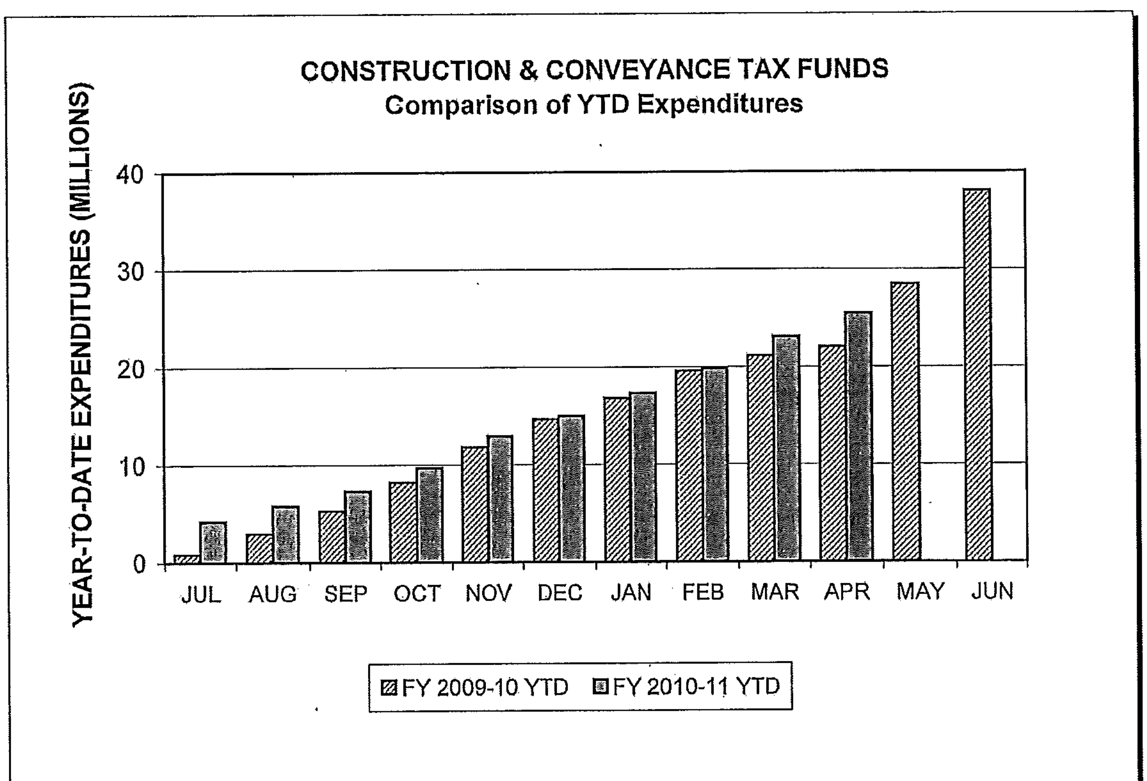
(1) Does not include encumbrance balance.
(2) Includes repayment of Tax and Revenue Anticipation Notes (TRANs) in the amount of $75 million in January 2011.

CITY OF SAN JOSE
GENERAL FUND SOURCE AND USE OF FUNDS
FOR THE 10 MONTHS ENDED APRIL 30, 2011
SUPPLEMENTAL SCHEDULE - DEPARTMENTAL REVENUES
(UNAUDITED)
($000's)

	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	CUR YTD ACTUAL	CUR YTD ACTUAL % OF BUDGET	PRIOR YTD ACTUAL	PRIOR YTD % OF PRIOR YEAR-END ACTUAL	PRIOR YEAR-END BUDGETARY BASIS ACTUAL	CUR YTD LESS PRIOR YTD ACTUAL	% CHANGE CUR YTD ACTUAL LESS PRIOR YTD ACTUAL
Police	$ 1,921	-	-	1,921	1,472	76.63%	1,474	75.86%	1,943	(2)	-0.14%
Public Works	4,325	-	-	4,325	4,222	97.62%	2,998	70.96%	4,225	1,224	40.83%
Transportation	739	40	-	779	927	119.00%	698	70.43%	991	229	32.81%
Library	1,916	-	-	1,916	880	45.93%	1,157	71.73%	1,613	(277)	-23.94%
Planning, Bldg & Code Enf	2,500	(112)	-	2,388	2,163	90.58%	2,122	78.07%	2,718	41	1.93%
Parks Rec & Neigh Svcs	12,685	421	-	13,106	11,716	89.39%	7,556	68.45%	11,039	4,160	55.06%
Miscellaneous Dept Charges	5,495	(320)	-	5,175	4,646	89.78%	4,329	91.08%	4,753	317	7.32%
Total Departmental Revenues	$ 29,581	29	-	29,610	26,026	87.90%	20,334	74.53%	27,282	5,692	27.99%



CONSTRUCTION & CONVEYANCE TAX FUNDS
Comparison of YTD Revenues
YEAR-TO-DATE REVENUES (MILLIONS)
40
30
20
10
0
JUL AUG SEP OCT NOV DEC JAN FEB MAR APR MAY JUN
FY 2009-10 YTD
FY 2010-11 YTD



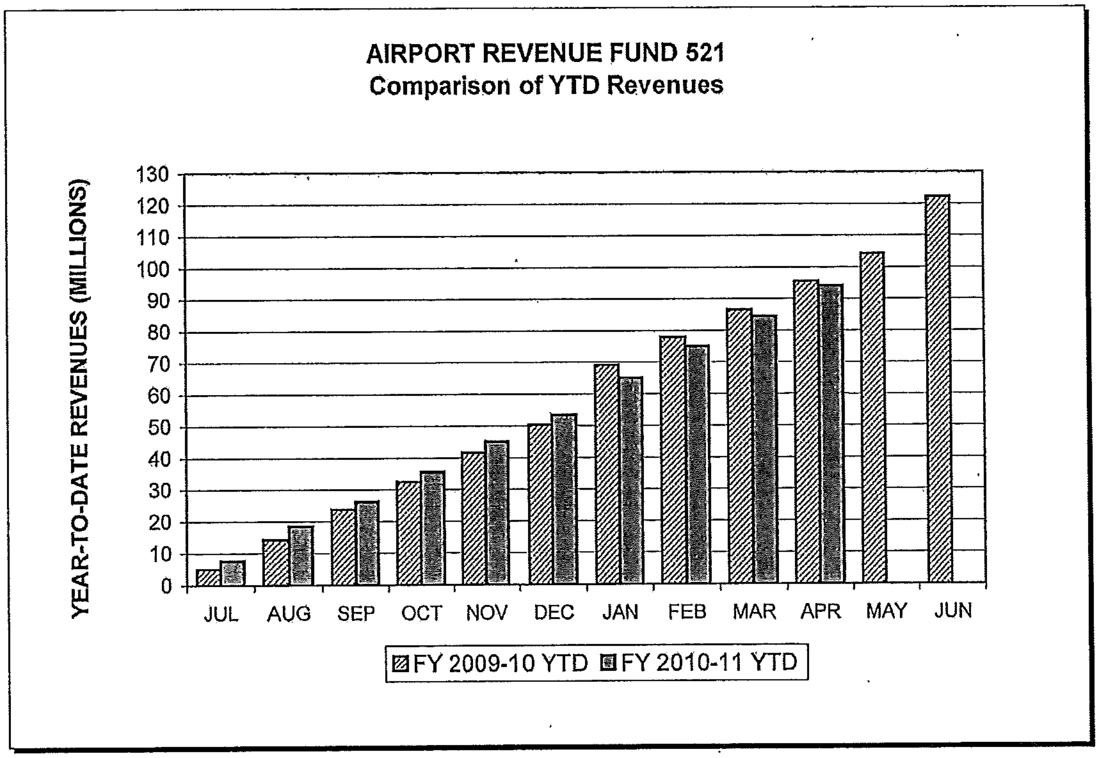
CONSTRUCTION & CONVEYANCE TAX FUNDS
Comparison of YTD Expenditures
YEAR-TO-DATE EXPENDITURES (MILLIONS)
40
30
20
10
0
JUL AUG SEP OCT NOV DEC JAN FEB MAR APR MAY JUN
FY 2009-10 YTD
FY 2010-11 YTD

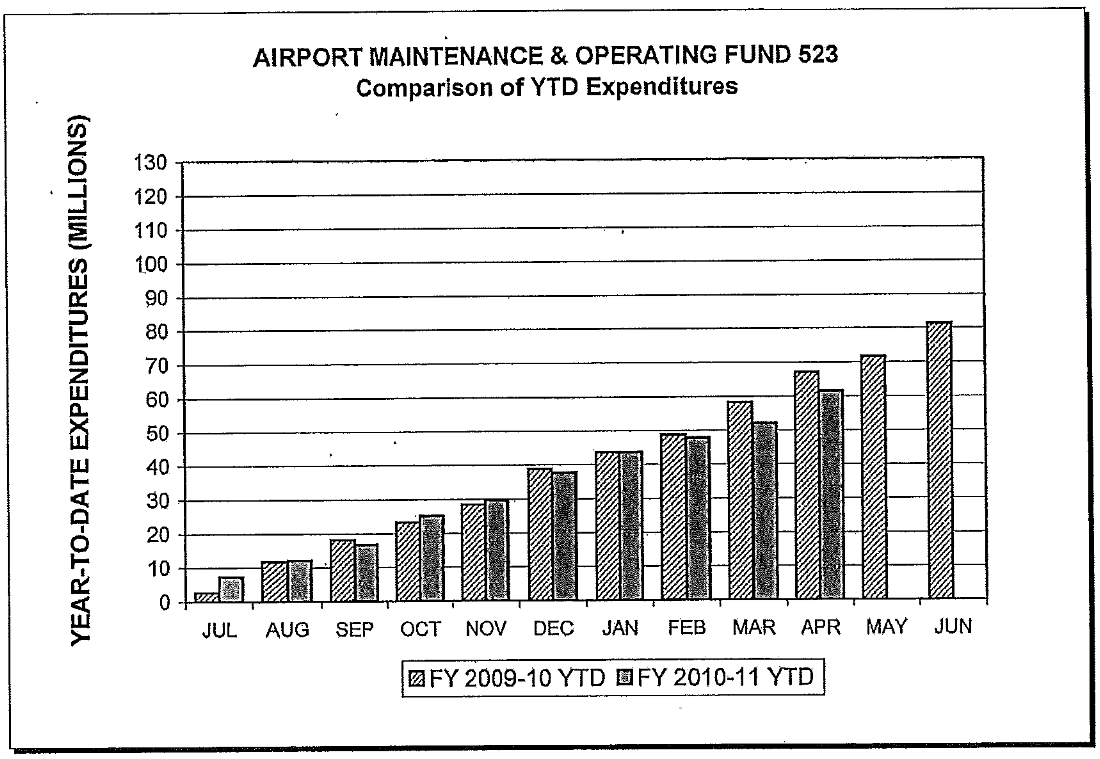
CITY OF SAN JOSE
SPECIAL REVENUE FUNDS
SOURCE AND USE OF FUNDS
FOR THE 10 MONTHS ENDED APRIL 30, 2011
(UNAUDITED)
($000's)

	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	PRIOR Y-T-D ACTUAL
Construction/Conveyance Tax							
Prior Year Encumbrance	$ -	-	8,000	8,000	8,000	N/A	7,532
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	62,292	14,574	-	76,866	76,866	N/A	80,147
Revenues	31,261	819	-	32,080	19,809	N/A	23,186
Total Sources	93,553	15,393	8,000	116,946	104,675	N/A	110,865
Total Uses	93,553	15,393	8,000	116,946	25,474	10,549	22,021
Gas Tax							
Prior Year Encumbrance	-	-	-	-	-	N/A	-
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	-	-	-	-	-	N/A	-
Revenues	16,626	-	-	16,626	7,269	N/A	11,949
Total Sources	16,626	-	-	16,626	7,269	N/A	11,949
Total Uses	16,626	-	-	16,626	7,269	0	11,949
Building and Structures							
Prior Year Encumbrance	-	-	5,070	5,070	5,070	N/A	3,664
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	6,385	4,125	-	10,510	10,510	N/A	15,589
Revenues	22,997	2,493	-	25,490	13,268	N/A	9,496
Total Sources	29,382	6,618	5,070	41,070	28,848	N/A	28,749
Total Uses	29,382	6,618	5,070	41,070	11,327	6,035	13,876
Residential Construction							
Prior Year Encumbrance	-	-	-	-	-	N/A	-
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	311	648	-	959	959	N/A	1,310
Revenues	65	135	-	200	189	N/A	34
Total Sources	376	783	-	1,159	1,148	N/A	1,344
Total Uses	$ 376	783	-	1,159	37	0	85

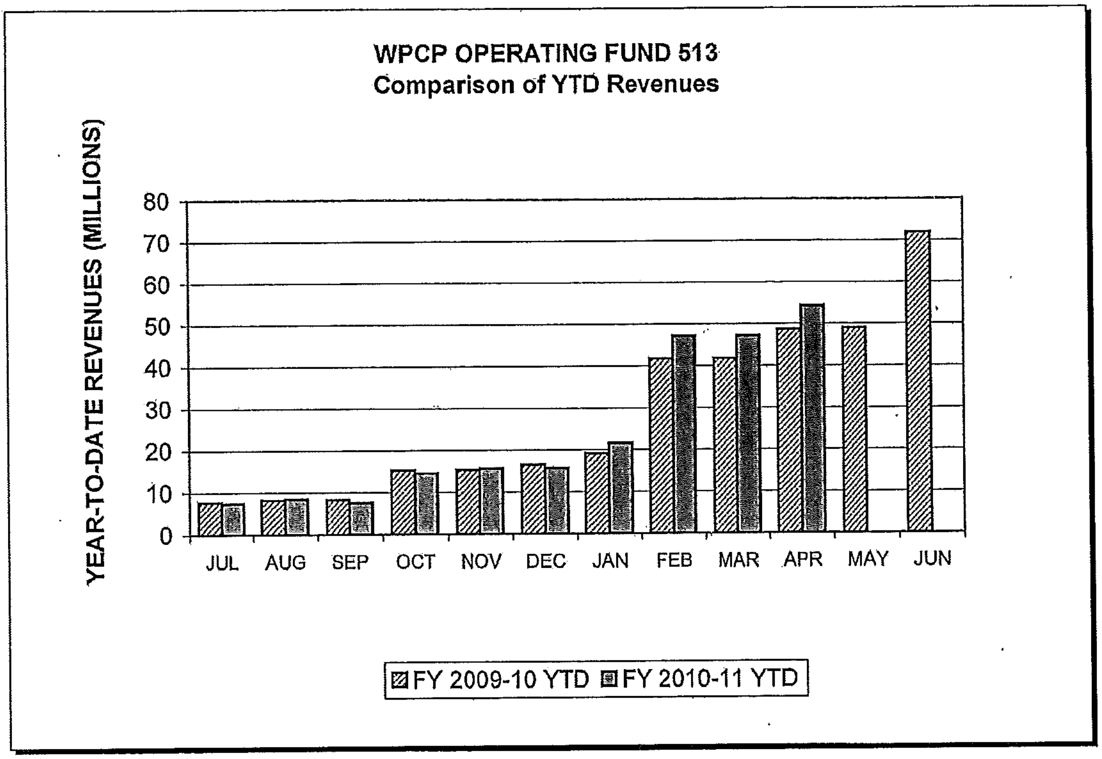
CITY OF SAN JOSE
SPECIAL REVENUE FUNDS
SOURCE AND USE OF FUNDS
FOR THE 10 MONTHS ENDED APRIL 30, 2011
(UNAUDITED)
($000's)

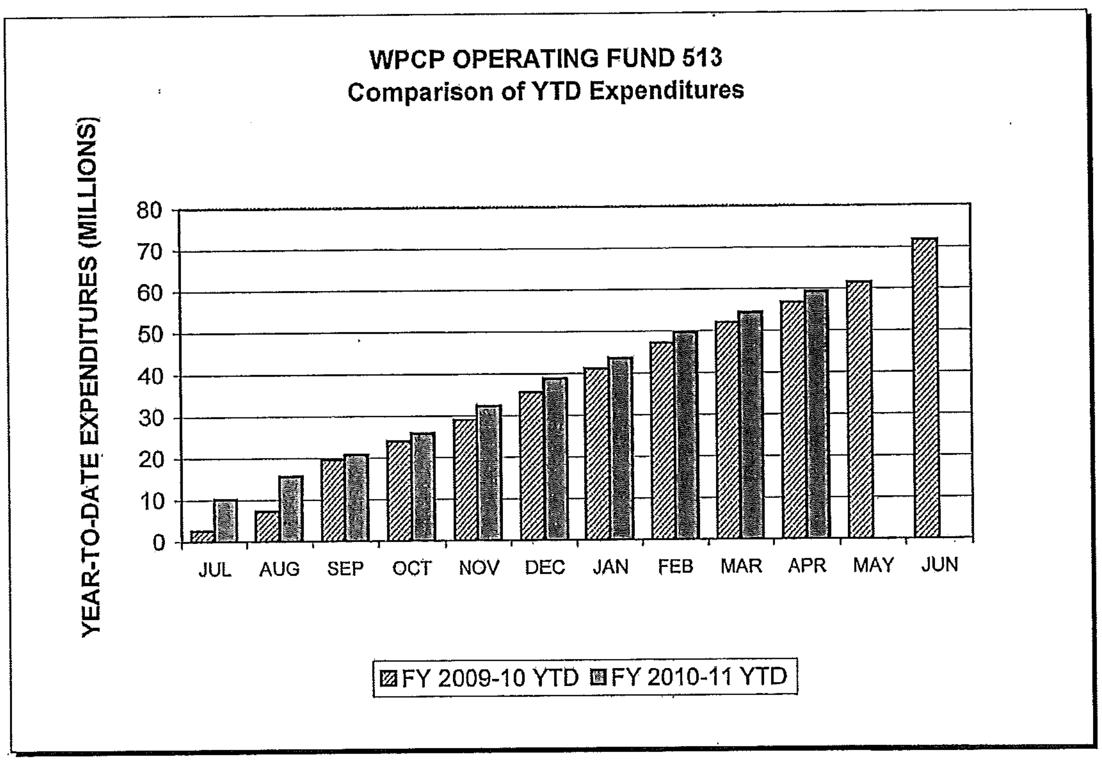
	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	PRIOR Y-T-D ACTUAL
Transient Occupancy Tax							
Prior Year Encumbrance	$ -	-	196	196	196	N/A	314
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	2,737	629	-	3,366	3,366	N/A	1,417
Revenues	10,034	(4)	-	10,030	7,806	N/A	7,554
Total Sources	12,771	625	196	13,592	11,368	N/A	9,285
Total Uses	12,771	625	196	13,592	8,194	444	5,818
Conventions, Arts & Entertainment							
Prior Year Encumbrance	-	-	510	510	510	N/A	345
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	6,130	197	-	6,327	6,327	N/A	9,891
Revenues	19,195	241	-	19,436	15,614	N/A	15,771
Total Sources	25,325	438	510	26,273	22,451	N/A	26,007
Total Uses	25,325	438	510	26,273	17,972	528	21,202
Golf							
Prior Year Encumbrance	-	-	7	7	7	N/A	7
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	817	257	-	1,074	1,074	N/A	1,188
Revenues	1,940	(302)	-	1,638	1,491	N/A	1,794
Total Sources	2,757	(45)	7	2,719	2,572	N/A	2,989
Total Uses	2,757	(45)	7	2,719	2,191	7	1,996
Other Funds							
Prior Year Encumbrance	-	-	57,418	57,418	57,418	N/A	54,346
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	187,195	25,775	-	212,970	212,970	N/A	223,045
Revenues	444,011	20,271	-	464,282	335,106	N/A	411,621
Total Sources	631,206	46,046	57,418	734,670	605,494	N/A	689,012
Total Uses	$ 631,206	46,046	57,418	734,670	310,157	93,716	361,693



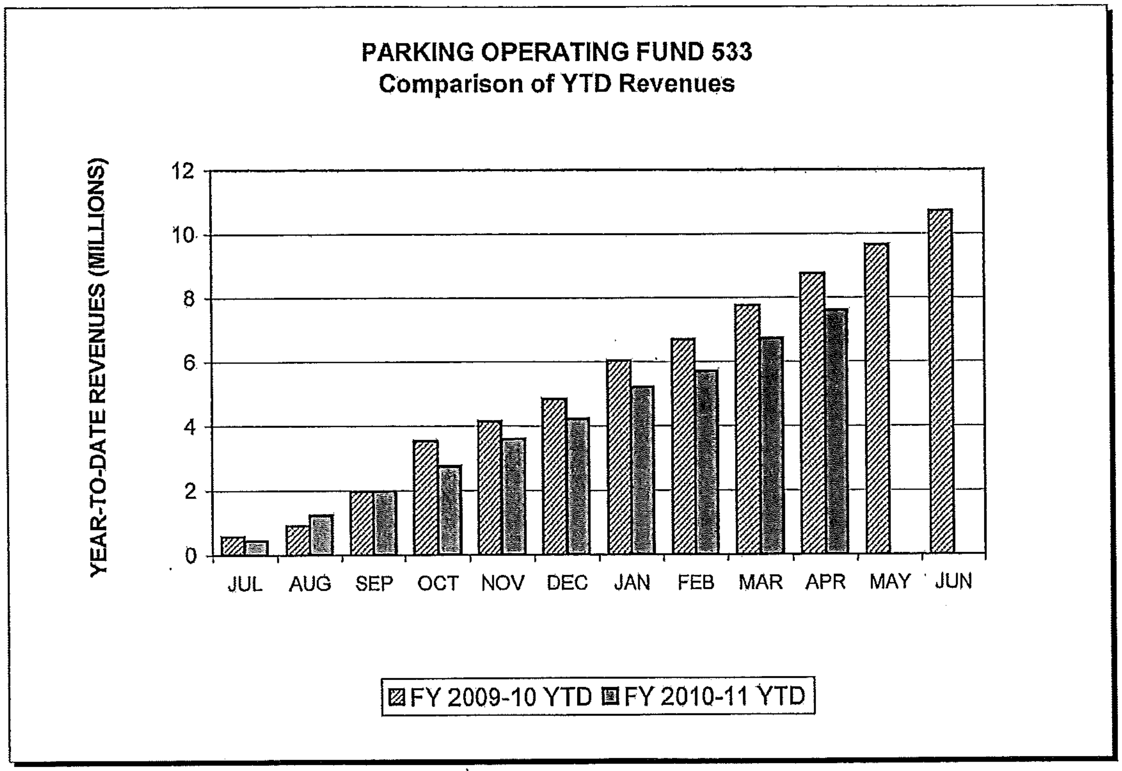


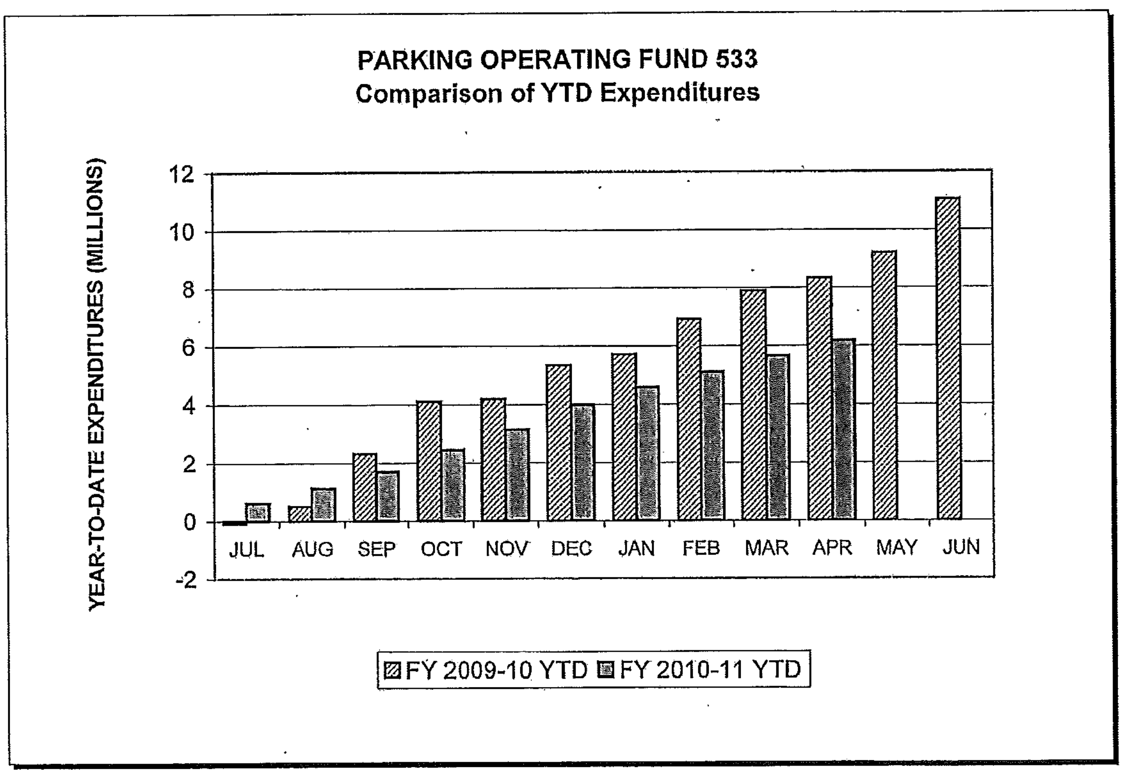
Note: The graphs above include the airport revenue fund (521) and operating fund (523) only.





Note: Graphs above are only for WPCP operating fund (513).


PARKING OPERATING FUND 533
Comparison of YTD Revenues
YEAR-TO-DATE REVENUES (MILLIONS)
12
10
8
6
4
2
0
JUL
AUG
SEP
OCT
NOV
DEC
JAN
FEB
MAR
APR
MAY
JUN
FY 2009-10 YTD
FY 2010-11 YTD


PARKING OPERATING FUND 533
Comparison of YTD Expenditures
YEAR-TO-DATE EXPENDITURES (MILLIONS)
12
10
8
6
4
2
0
-2
JUL
AUG
SEP
OCT
NOV
DEC
JAN
FEB
MAR
APR
MAY
JUN
FY 2009-10 YTD
FY 2010-11 YTD

CITY OF SAN JOSE
ENTERPRISE FUNDS
SOURCE AND USE OF FUNDS
FOR THE 10 MONTHS ENDED APRIL 30, 2011

(UNAUDITED)

($000's)

	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	PRIOR Y-T-D ACTUAL
Airport							
Prior Year Encumbrance	$ -	-	77,530	77,530	77,530	N/A	325,235
Liquidation of c/o Enc	-	-	-	-	-	N/A	-
Beginning Fund Balance	403,901	66,778	-	470,679	470,679	N/A	485,127
Revenues	341,905	7,110	-	349,015	297,989	N/A	323,915
Total Sources	745,806	73,888	77,530	897,224	846,198	N/A	1,134,277
Total Uses	745,806	73,888	77,530	897,224	332,100	64,709	439,529
(Note 1)							
Waste Water Treatment							
Prior Year Encumbrance	-	-	44,394	44,394	44,394	N/A	42,966
Liquidation of c/o Enc	-	-	-	-	-	N/A	-
Beginning Fund Balance	193,589	24,070	-	217,659	217,659	N/A	206,538
Revenues	274,221	(1,783)	-	272,438	222,608	N/A	215,118
Total Sources	467,810	22,287	44,394	534,491	484,661	N/A	464,622
Total Uses	467,810	22,287	44,394	534,491	171,234	48,398	143,040
(Note 2)							
Municipal Water							
Prior Year Encumbrance	-	-	757	757	757	N/A	892
Liquidation of c/o Enc	-	-	-	-	-	N/A	-
Beginning Fund Balance	11,265	2,032	-	13,297	13,297	N/A	11,088
Revenues	30,793	(100)	-	30,693	25,750	N/A	24,141
Total Sources	42,058	1,932	757	44,747	39,804	N/A	36,121
Total Uses	42,058	1,932	757	44,747	20,174	1,749	19,966
Parking							
Prior Year Encumbrance	-	-	724	724	724	N/A	1,468
Liquidation of c/o Enc	-	-	-	-	-	N/A	-
Beginning Fund Balance	11,391	1,730	-	13,121	13,121	N/A	14,220
Revenues	8,658	(90)	-	8,568	7,606	N/A	8,750
Total Sources	20,049	1,640	724	22,413	21,451	N/A	24,438
Total Uses	$ 20,049	1,640	724	22,413	6,171	2,081	8,324

Note 1 - All Airport Funds, including operating, revenue, capital and debt service.

Note 2 - All Waste Water Funds, including operating, revenue, capital and debt service.

CITY OF SAN JOSE
CAPITAL PROJECT FUNDS
SOURCE AND USE OF FUNDS
FOR THE 10 MONTHS ENDED APRIL 30, 2011
(UNAUDITED)
($000's)

	ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	PRIOR Y-T-D ACTUAL
Construction Excise							
Prior Year Encumbrance	$ -	-	7,239	7,239	7,239	N/A	5,794
Liquidation of c/o Enc.	-	-	-	-	-	N/A	-
Beginning Fund Balance	10,949	7,850	-	18,799	18,799	N/A	20,238
Revenues	36,754	10,028	-	46,782	36,683	N/A	12,190
Total Sources	47,703	17,878	7,239	72,820	62,721	N/A	38,222
Total Uses	47,703	17,878	7,239	72,820	33,433	5,893	22,561
Redevelopment Projects							
Prior Year Encumbrance	-	-	2,756	2,756	2,756	N/A	4,431
Liquidation of c/o Enc	-	-	-	-	-	N/A	-
Beginning Fund Balance	2,172	1,053	-	3,225	3,225	N/A	9,514
Revenues	88	75	-	163	158	N/A	1,203
Total Sources	2,260	1,128	2,756	6,144	6,139	N/A	15,148
Total Uses	2,260	1,128	2,756	6,144	3,977	938	6,774
Other							
Prior Year Encumbrance	-	-	21,193	21,193	21,193	N/A	60,214
Liquidation of c/o Enc	-	-	-	-	-	N/A	-
Beginning Fund Balance	65,312	2,549	-	67,861	67,861	N/A	106,617
Revenues	14,787	(80)	-	14,707	2,334	N/A	3,612
Total Sources	80,099	2,469	21,193	103,761	91,388	N/A	170,443
Total Uses	$ 80,099	2,469	21,193	103,761	22,122	8,862	67,069

CITY OF SAN JOSE
OTHER FUND TYPES
SOURCE AND USE OF FUNDS
FOR THE 10 MONTHS ENDED APRIL 30, 2011

(UNAUDITED)

($000's)

		ADOPTED FY 2010-11 BUDGET	YTD BUDGET AMENDMENTS	C/O ENCUMBR	REVISED FY 2010-11 BUDGET	YEAR-TO-DATE ACTUAL	YEAR-TO-DATE ENCUMBR	PRIOR Y-T-D ACTUAL
Trust and Agency								
Prior Year Encumbrance	$	-	-	15	15	15	N/A	3
Liquidation of c/o Enc		-	-	-	-	-	N/A	-
Beginning Fund Balance		2,257	154	-	2,411	2,411	N/A	2,301
Revenues		114	568	-	682	1,202	N/A	803
Total Sources		2,371	722	15	3,108	3,628	N/A	3,107
Total Uses	$	2,371	722	15	3,108	638	6	363

Review Notes to MFR
Period 10 CP11 – as of April 30, 2011

General Fund Revenues: Pages 3 and 4

10.36% increase in Sales Tax Revenue ($9.52M)

- $8.29M increase due to higher VLF/Triple Flip apportionments for January
- $903k increase due to higher VLF/Triple flip apportionment for May

17.69% increase in Licenses and Permits revenue ($9.72M)

- $1.34M increase in New Residential Building Permits revenue
- $304k increase in All Other Building Permits revenue
- $1.43M increase in Cardroom Business Tax
- $470k increase in Current Business Tax
- $1.29M increase in Building Plan Check revenue
- $699k increase in Architectural Plan Review revenue
- $885k increase in Electrical Permits
- $623k increase in Mechanical Permits
- $423k increase in Plumbing Permits
- $433k increase in Permit Processing Fees
- $388k increase in Multiple Housing Permits
- $285k increase in Annual Renewable Permits revenue
- $287k decrease in Disposal Facility Tax revenue

19.86% increase in Fines and Forfeitures ($2.57M)

- $930k increase in Admin Citations Fines and Penalties
- $645k increase in Other Penalties
- $479k increase in Parking Fines – Contractors revenue
- $303k increase in Franchise Tax Board Collections revenue (new for CP11)
- $264k increase in Parking Fines – DMV revenue

4.15% increase in Revenue from Local Agencies ($1.44M)

- $1.25M increase in SB720 Automated Fingerprint Identification System (AFIS) revenue
- $344k increase in CAL-ID Contributions
- $297k increase in Childcare Portables Debt Service (from CSJFA 1997B SJ Unified Childcare Facilities)
- $457k decrease in central Fire District payments
- $123k decrease in Alum Rock Branch Cost Share revenue
- $27k decrease in Reimbursements from RDA

31.45% decrease in Revenue from the State ($2.71M)

- $1.51M decrease in revenue from Airplanes
- $675k decrease in Martin Park Gas Cutoff Grant revenue (non-existent in CP11)
- $600k decrease in Watson Phase 1 Improvement Grant revenue
- $175k decrease in OES Reimbursement for Strike Teams

- $175k increase in Motor Vehicle In-Lieu revenue
- $280k increase in 911 Emergency Comm Reimbursement revenue

104.40% increase in Revenue from Federal Government ($2.68M)

- $1.41M increase in ARRA Energy Efficiency Conservation Block (EECBG) Grant revenue
- $405k increase in DOE SAC 2 Grant Revenue (ARRA)
- $667k increase in 2009 COPS Technology Program revenue
- $606k increase in Summer Youth & Teen Nutrition revenue (non-existent in CP10)
- $405k decrease in UASI-0405 Grant revenue
- $244k decrease in Homeland Security Grant revenue

566.67% increase in Other Revenue ($74.61M)

- $75.0M increase in of Tax and Revenue Anticipation Notes (TRANs) Proceeds – $40M in July 2010 and $35M in October 2010
- $315k increase in Willow Senior Center Fire Damage revenue
- $314k increase in Kaiser & Blue Shield Wellness revenue
- $215k increase in Litigation Settlements
- $432k decrease in SB90 Reimbursement revenues
- $422k decrease in Investment Cost Reimbursement
- $339k decrease in Unclaimed Credit Balance revenue
- $326k decrease in A/R Interest & Misc revenue
- $276k decrease in Sale of Real Properties deposits

<u>Departmental Revenues</u>: Page 7

40.83% increase in Public Works Departmental Revenue ($1.22M)

- $401k increase in Residential & Non-Residential Engineering revenue
- $325k increase in Utility Excavations revenue
- $118k increase in Streetlight Design & Inspection revenue

23.94% decrease in Library Departmental Revenue ($277k) – $267k of which is due to the decrease in Fines and Fees revenue

55.064% increase in Parks & Rec Departmental Revenue ($4.16M)

- $3.84M increase related to the re-opening of Happy Hollow Park & Zoo in March 2010
- $601k increase in Parking Fees revenue
- $664k decrease in Family Camp related revenue

<u>General Fund Expenditures</u>: Pages 5 and 6

105.33% increase in City Clerk Departmental expenditures ($1.76M)

- $903k Elections expenditures posted in July 2010 (for cost of June 8, 2010 election)
- $1.03M Elections expenditures posted in January 2011 (November 2, 2010 election)
- $114k decrease in Personal expenditures

23.46% increase in Independent Police Auditor expenditures ($122k) – mainly due to the hiring of the new IPA in May 2010 (no acting IPA since Dec 2008)

0.93% increase in Fire Departmental expenditures ($1.13M)
- $2.01M increase in Personal expenditures
- $896k decrease in Non-Personal expenditures

12.35% increase in City-Wide Economic & Neighborhood Development expenditures ($2.43M)
- $3.89M increase in Convention Center Lease payments
- $297k decrease in Convention/Visitor Marketing expenditures
- $163k decrease in San Jose Green Vision expenditures
- $147k decrease in Arts Grants Multi-year Stability expenditures
- $147k decrease in Mexican Heritage Plaza Maintenance & Ops expenditures
- $111k decrease in Small Business Chambers expenditures (none in CP11 as of yet)
- $108k decrease in Technology Center Subsidy expenditures

120.03% increase in City-Wide Environmental & Utility Services expenditures ($1.48M)
- $1.61M increase in ARRA Energy Efficiency Conservation Block Grant expenditures
- $481k increase in ARRA Solar Market Transformation Grant expenditures
- $477k decrease in Commercial Solid Waste Fee expenditure (nothing paid in CP11)
- $296k decrease in Garbage Disposal Contract fees (nothing budgeted for/paid in CP11)

4.77% increase in City-wide Public Safety expenditures ($720k)
- $767k increase in Workers' Compensation claims (Fire & Police)
- $748k increase in 2009/2010 COPS Technology Grant expenditures
- $367k increase in Mobile ID Services expenditures
- $137k increase in Silicon Valley Interoperability expenditures
- $1.24M decrease in SUASI grants expenditures

16.22% increase in City-wide Recreation and Cultural Services expenditures ($1.48M)
- $1.08M increase in Healthy Neighborhood Volunteer Fund expenditures (new for CP11)
- $1.05M increase in Children's Health Initiative expenditures (new for CP11
- $847k increase in NHVF-Senior Services expenditures (new for CP11)
- $659k increase in Workers' Comp Claims expenditures
- $481k increase in Summer Youth Nutrition Program expenditures (new for CP11)
- $721k decrease in Parks Maintenance Enhancement expenditures
- $629k decrease in Community Action and Pride expenditures
- $530k decrease in Summer Safety Initiative expenditures
- $286k decrease in SNI (Expanded) expenditures

303.10% increase in City-Wide Strategic Support expenditures ($69.49M)
- $75.00M increase due to the repayment of the TRAN in January 2011
- $2.37M decrease in Property Tax Admin expenditures (none in CP11 to-date)
- $1.98M decrease in Communi8ty Center Debt Service Payments (none in CP11 to-date)
- $936k decrease in Sick Leave Payment Upon Retirement expenditures

6.3

CHEIRON CLASSIC VALUES, INNOVATIVE ADVICE

Presentation to the Board of Administration Federated City Employees' Retirement System

July 1, 2005 – June 30, 2010 Experience Study

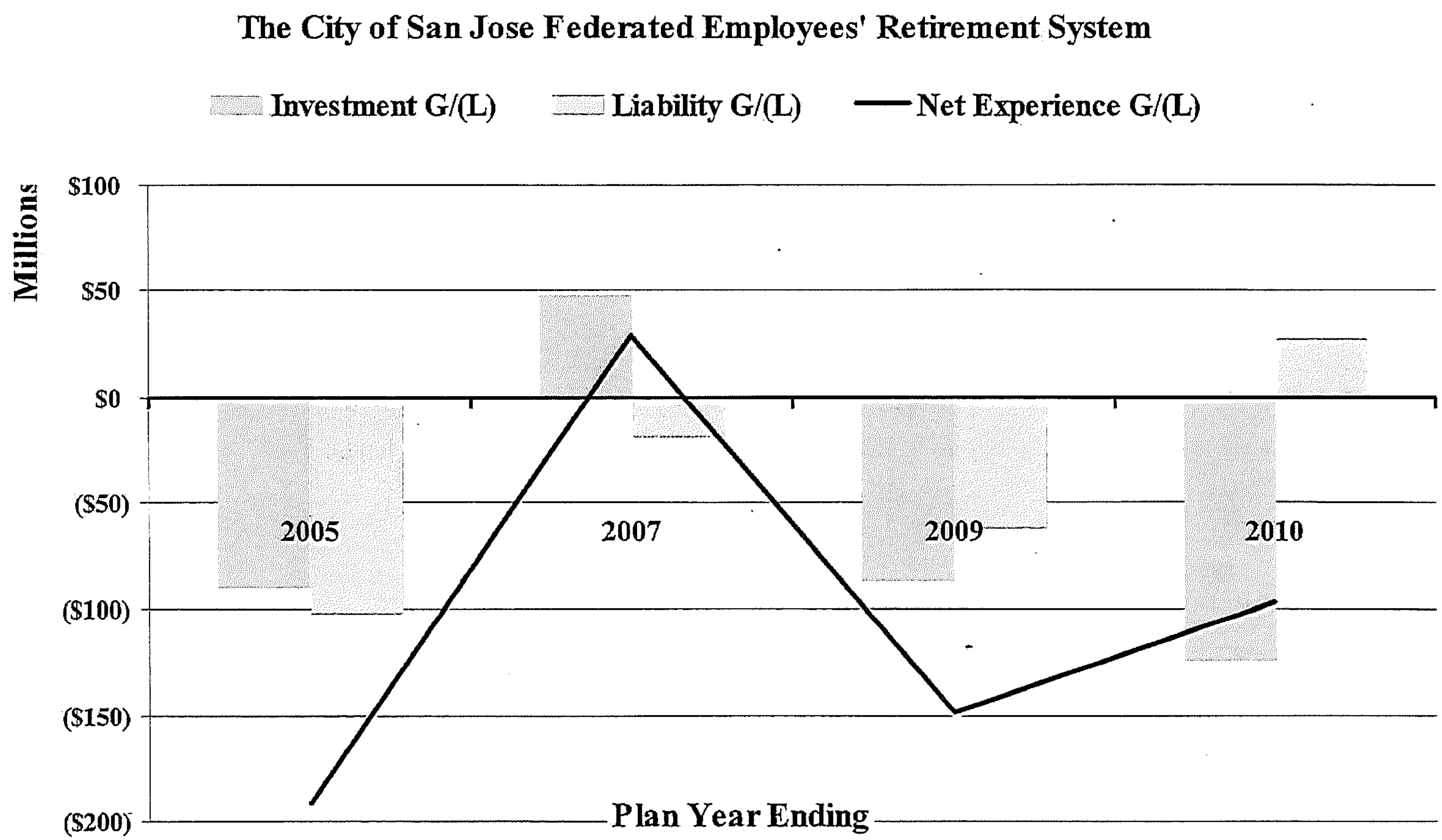
Gene Kalwarski, FSA
Bill Hallmark, ASA

May 19, 2011

Agenda

- Overview
- Economic Assumptions
- Demographic Assumptions
- Board Decisions

Overview
Historical Gains and Losses



- Total liability loss = $156 million
- Total investment loss = $253 million
- Total net loss = $409 million

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Overview
Impact of Recommendations

Estimated Cost Increase Recommended Demographic Assumption Changes			
Assumption	**City**	**Member**	**Total**
Termination / Refund Rates	1.8%	0.3%	2.1%
Mortality Rates	0.7%	0.1%	0.8%
Administrative Expenses	0.5%	0.2%	0.7%
Other	-0.2%	-0.1%	-0.3%
Total	2.8%	0.5%	3.3%

Estimated Cost Increase Recommended Range of Economic Assumption Changes									
	City			**Member**			**Total**		
	Min	**Rec[1]**	**Max**	**Min**	**Rec[1]**	**Max**	**Min**	**Rec[1]**	**Max**
Wage Inflation / Investment Return	1.4%	6.1%	11.1%	0.0%	0.6%	1.4%	1.4%	6.7%	12.5%
SRBR	0.8%	1.3%	1.9%	0.3%	0.5%	0.7%	1.1%	1.8%	2.6%
Total	2.2%	7.4%	13.0%	0.3%	1.1%	2.1%	2.5%	8.5%	15.1%

[1] Recommendations are subject to a discussion of the Board's risk preferences

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Economic Assumptions
Wage Inflation

- Growth in national average wages has been 2.9% over the last 10 years and 4.2% over the last 20 years
- Growth in average salary for Federated members has been 3.84% over the last 19 years and 2.7% over the last 5 years
- While private sector wages may rebound from the recession over the next several years, we expect any rebound in public sector wages to be delayed for some time
- Our recommended range is 3.25% to 4.00%
- Subject to the Board's risk preferences, we recommend a long-term wage inflation assumption of 3.5%

Economic Assumptions
Investment Return

Expected Distribution of Average Annual Gross Investment Returns

Percentile	30 Years
5%	12.04%
25%	9.29%
50%	7.42%
75%	5.58%
95%	2.99%

- We assume any active management fees are incurred only with the expectation of achieving additional returns, so no reduction is made for investment expenses
- Administrative expenses are now added to the normal cost instead of subtracted from the return
- Recommended range = 6.75% to 7.75%

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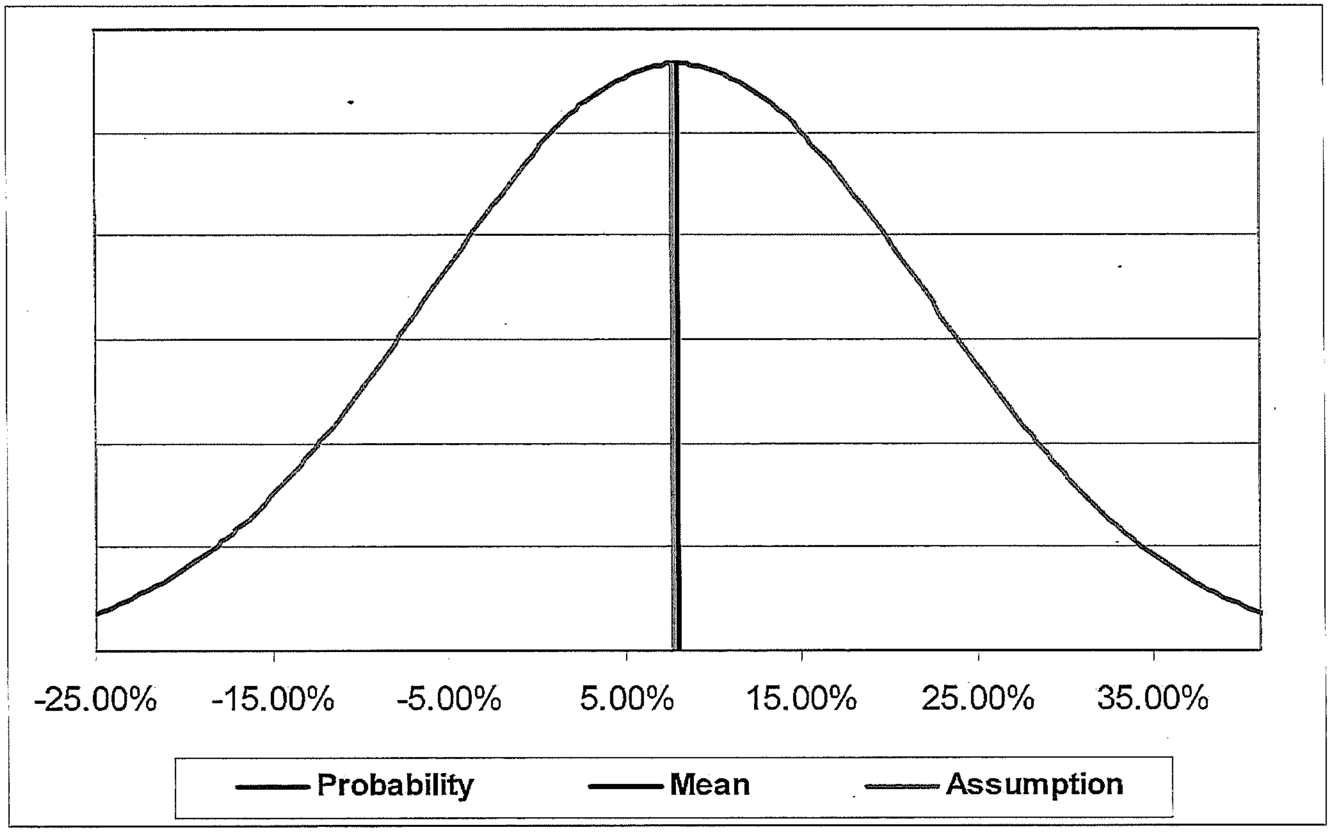
Assess the Board's Risk Preference



Investment returns have a 50-50 chance of not being realized

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Economic Assumptions
Impact of Investment Return

Impact on June 30, 2010 Valuation Results Under Alternate Assumptions

	Investment Return Assumption				
	6.75%	**7.00%**	**7.25%**	**7.50%**	**7.75%**
City Contribution Rate	39.2%	36.8%	34.4%	32.0%	29.7%
Member Contribution Rate	5.9%	5.6%	5.3%	5.0%	4.7%
Funded Status	60%	62%	64%	66%	68%

Projected 6/30/2035 Valuation Results Under Alternate Assumptions

	Investment Return Assumption					
	Current	**6.75%**	**7.00%**	**7.25%**	**7.50%**	**7.75%**
Median City Contribution Rate	28%	14%	17%	20%	23%	26%
Probability City Contribution Rate Exceeds 30%	47%	37%	38%	40%	42%	45%
Median Funded Status	97%	111%	108%	105%	102%	100%
Probability Funded Status is Below 80%	32%	21%	23%	26%	28%	30%

Subject to the risk preferences of the Board, we recommend an investment return assumption of 7.25%

Economic Assumptions
SRBR

Expected Annual Transfer to SRBR Under Alternate Assumptions					
	Investment Return Assumption				
	6.75%	7.00%	7.25%	7.50%	7.75%
Median Transfer (% of Assets)	0.24%	0.24%	0.24%	0.23%	0.22%
Average Transfer (% of Assets)	0.55%	0.54%	0.54%	0.53%	0.52%

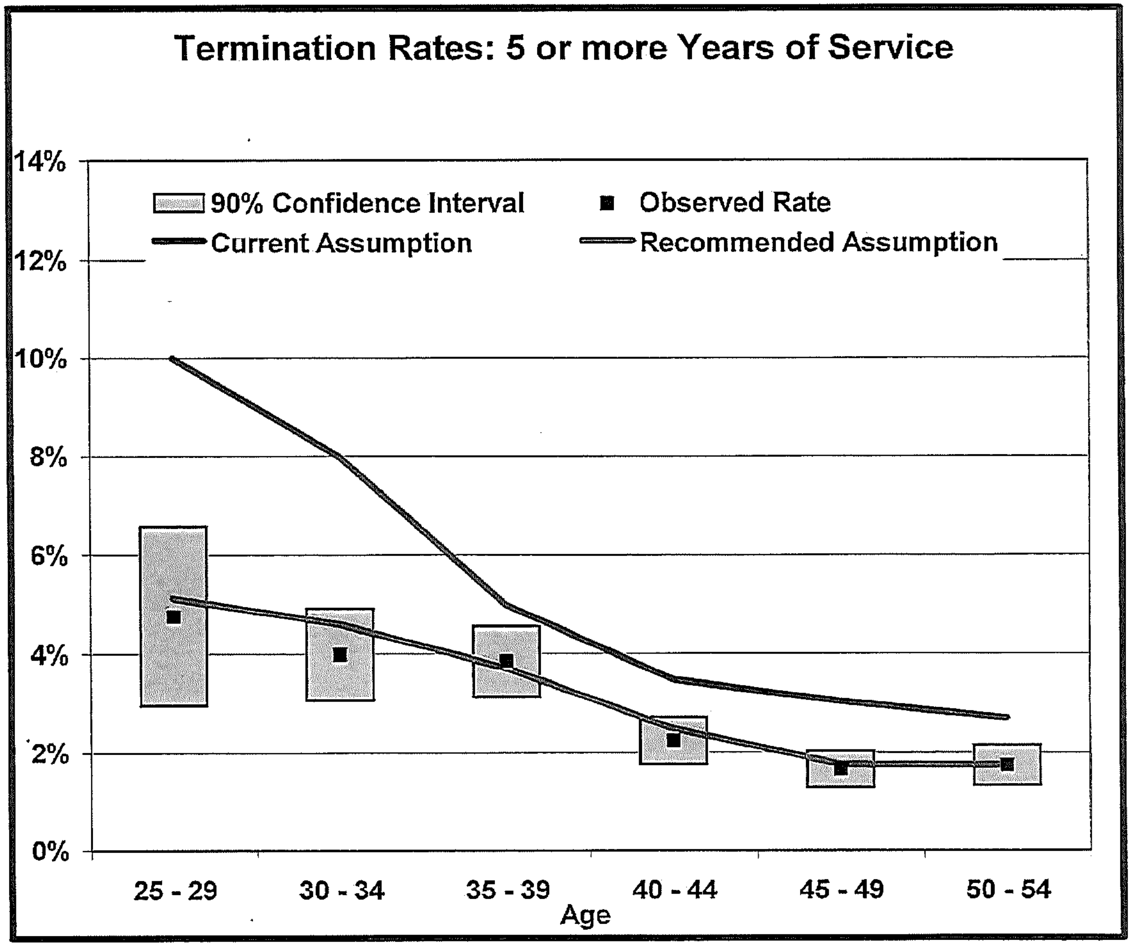
- SRBR receives 10% of any excess earnings in retirement fund (not COLA fund)
- Because SRBR is never credited with less than 0%, there is also an implicit transfer when actual earnings are less than 0%
- Many years, there is no transfer, but in some years the transfer is quite large
- Recommended range = 0.24% to 0.54% of assets with a recommendation subject to the Board's risk preference of 0.35%
- Assumed amount is added to the normal cost (as opposed to a reduction in the earnings assumption which would affect the threshold for excess earnings)
- Based on 6/30/2010 valuation, would increase total contribution rate by 1.2% of pay to 2.7% of pay with a recommended increase of 1.8% of pay

Demographic Assumptions
Termination Rates

- Recommend separation of termination assumption into three groups based on service
  - First year of service
  - 1 to 4 years of service
  - 5+ years of service

Termination Rates					
Service	Actual	Current Expected	Recommended Expected	Current A/E Ratio	Recommended A/E Ratio
0	101	22	100	4.545	1.012
1 – 4	250	138	248	1.810	1.007
5 +	298	491	314	0.606	0.949
Total	649	651	662	0.997	0.980

Demographic Assumptions
Termination Rates



Age	Current	Recommended
25	10.000%	5.30%
30	8.000%	4.62%
35	5.250%	3.74%
40	3.500%	2.51%
45	3.250%	1.77%
50	2.750%	1.75%

Current A/E Ratio: 0.607 Recommended A/E Ratio: 0.950

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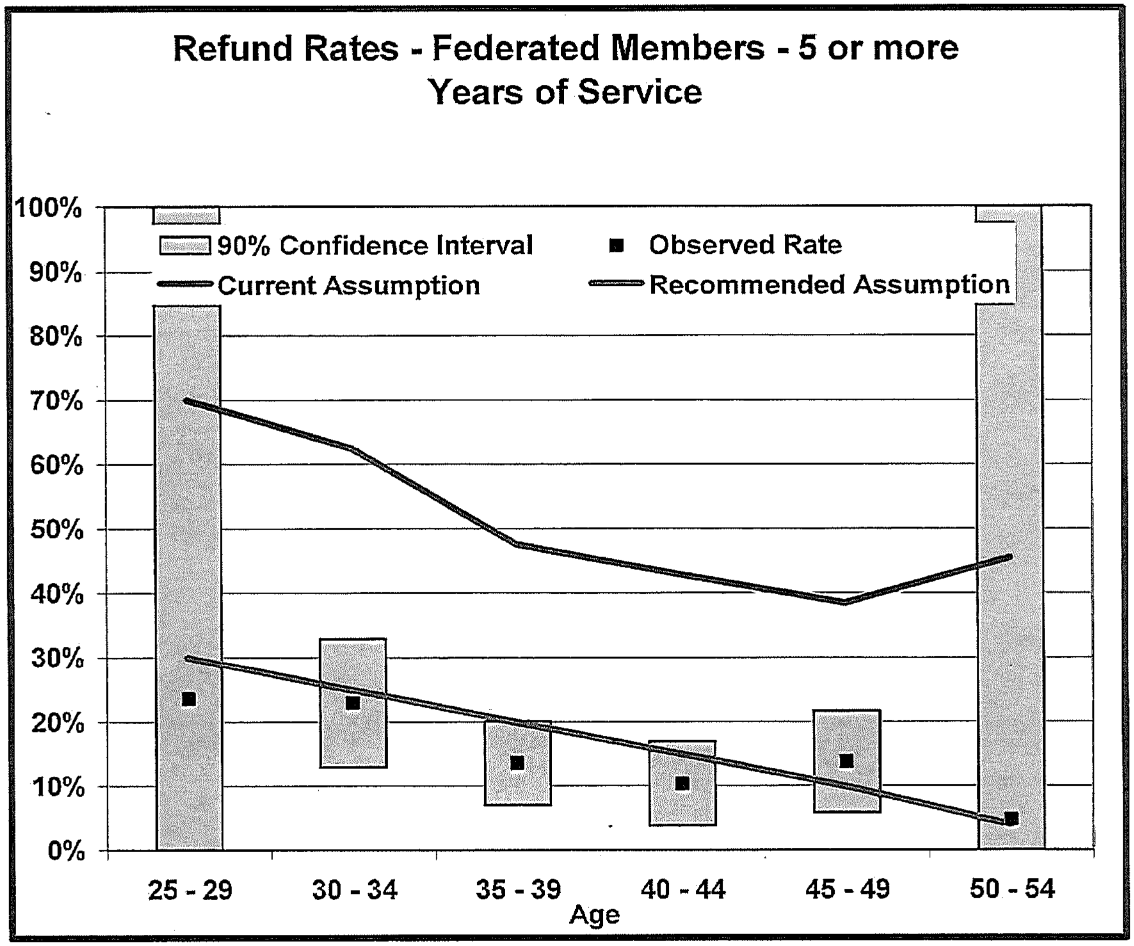
Demographic Assumptions
Refund Rates



Age	Current	Recommended
25 - 29	70.00%	30.00%
30 - 34	62.50%	25.00%
35 - 39	47.62%	20.00%
40 - 44	42.86%	15.00%
45 - 49	38.46%	10.00%
50 - 54	45.45%	4.00%

Current A/E Ratio: 0.284 Recommended A/E Ratio: 0.844

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Demographic Assumptions
Mortality

Group	Actual Deaths	Current Expected	Recommended Expected	Current A/E Ratio	Recommended A/E Ratio
Active Employees					
• Male	14	23.5	17.8	60%	79%
• Female	15	12.8	11.1	117%	135%
Healthy Annuitants					
• Male	156	154.1	147.2	101%	106%
• Female	139	134.6	128.9	103%	108%
Disabled Annuitants					
• Male	22	29.7	26.5	74%	83%
• Female	9	14.8	8.8	61%	102%

- Active employee and disabled annuitant data isn't credible, so followed standard tables (Healthy annuitant and CalPERS tables respectively)
- Healthy annuitant margins for mortality improvement in prior study virtually disappeared. Proposed assumption restores some margin for improving mortality

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Discussion

CHEIRON

Board Decisions

- Adopt demographic assumption changes
- Adopt wage inflation assumption
  - 3.25% to 4.00% (3.50%[1])
- Adopt investment return assumption
  - 6.75% to 7.75% (7.25%[1])
- Adopt SRBR assumption
  - 0.24% of assets to 0.55% of assets (0.35%[1])

[1] Recommendations, subject to a discussion of the Board's risk preferences, are shown in parenthesis

City of San Jose
Federated City Employees'
Retirement System

Experience Analysis

Produced by Cheiron

May 2011

Table of Contents

LETTER OF TRANSMITTAL

May 12, 2011

Retirement Board of the Federated
City Employees' Retirement System
1737 North First Street, Suite 580
San Jose, CA 95112

Dear Members of the Board:

At your request, we have completed an experience analysis of the assumptions used in the valuations of the City of San Jose Federated City Employees' Retirement System (SJFCERS) and the Federated Retiree Health Care Plan. The economic assumptions studied were the investment return and wage inflation. The demographic analysis compares assumed versus actual experience for the five-year period from July 1, 2005 through June 30, 2010.

This report presents the results of our analysis as well as recommendations for the assumptions to be used in performing the July 1, 2011 actuarial valuations. In preparing our report, we relied without audit, on information (some oral and some written) supplied by the City of San Jose Department of Retirement Services. This information includes, but is not limited to, the plan provisions, employee data, and financial information.

We hereby certify that, to the best of our knowledge, this report and its contents, which are work products of Cheiron, Inc., are complete and accurate and have been prepared in accordance with generally recognized and accepted actuarial principles and practices which are consistent with the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this report. This report does not address any contractual or legal issues. We are not attorneys and our firm does not provide any legal services or advice.

Cheiron's experience study was prepared exclusively for the Retirement Board of the Federated City Employees' Retirement System for a specific and limited purpose. It is not for the use or benefit of any third party for any purpose. Any third party recipient of Cheiron's work product (other than the Fund's auditor, attorney, third party administrator or other professional when providing professional services to the fund or any governmental agency to which this certification is required to be submitted by law or regulation) who desires professional guidance should not rely upon Cheiron's work product, but should engage qualified professionals for advice appropriate to its own specific needs.

We are available to answer any questions about the contents of this report or the process used in our analysis.

Sincerely,
Cheiron

William R. Hallmark, ASA, EA, MAAA
Consulting Actuary

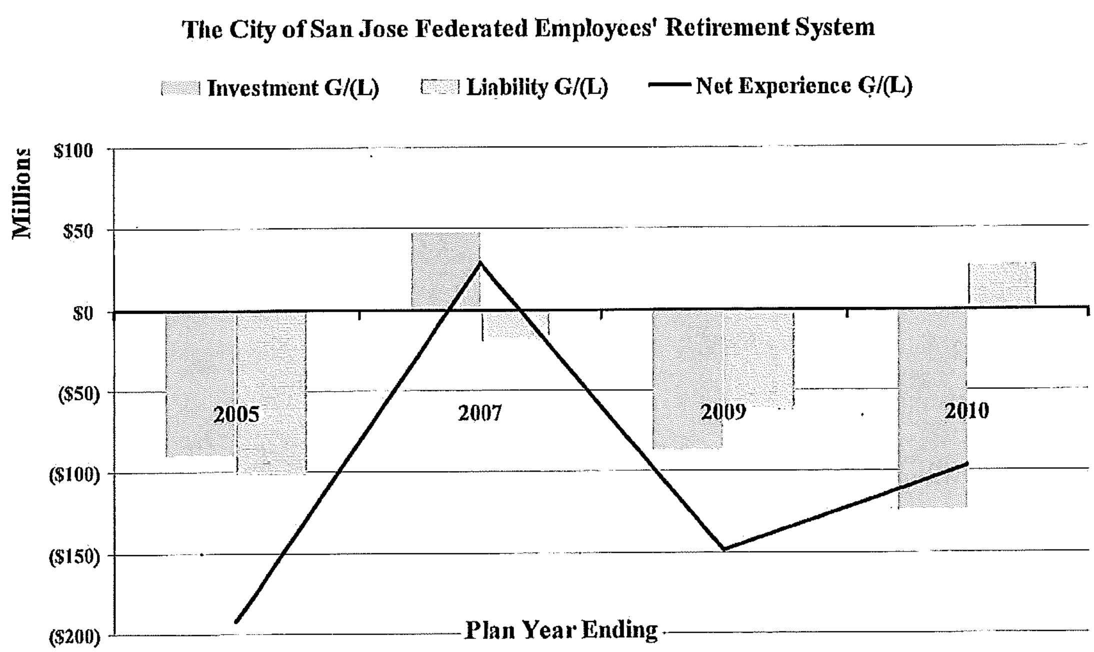
Gene Kalwarski, FSA, EA, MAAA
Principal Consulting Actuary

CITY OF SAN JOSE FEDERATED EMPLOYEES' RETIREMENT SYSTEM
EXPERIENCE ANALYSIS

SECTION I
EXECUTIVE SUMMARY

Actuarial assumptions (economic and demographic) are intended to be long-term in nature, and should be both individually reasonable, as well as consistent in the aggregate. The purpose of this experience analysis is to evaluate whether or not the current assumptions adequately reflect the long-term expectations for the City of San Jose Federated Employees' Retirement System (SJFERS), and if not, then recommend any adjustments that might be needed. It is important to note that frequent and significant changes in the actuarial assumptions from year-to-year are not typically implemented, unless there are known fundamental changes in expectations of the economy, or with respect to SJFERS' membership or assets, that would warrant such frequent or significant change.

The chart below shows the gains and losses reported in the last four actuarial valuations. The total liability loss over the seven-year period has been approximately $156 million, which averages $22 million per year. On the investment side, investment losses have totaled about $253 million which average to about $36 million per year. Taken together, the total plan experience had been a new loss averaging over $58 million per year, which represents 99% of the total contributions (City and member) made over the same period.



While there have been some assumption changes made as a result of the 2007 and 2009 experience studies, based on the historical losses, we would expect additional assumption changes to increase the short-term costs of the plan and reduce the likelihood of future actuarial losses.

SECTION I
EXECUTIVE SUMMARY

SUMMARY OF ECONOMIC ASSUMPTION ANALYSIS

The specific economic assumptions analyzed in this report are wage inflation, investment return, and liability for future transfers to the Supplemental Retiree Benefit Reserve (SRBR). These assumptions have a significant impact on the contribution rates in the short-term and the risk of negative outcomes in the long-term.

We recommend reductions in the wage inflation and investment return assumptions. In addition, we recommend that the liability for future transfers to the SRBR be advance funded. For all of these assumptions, we have developed a recommended range for the Board to consider in the context of its tolerance for long-term risk. The table below shows the recommended range for each of these assumptions. Please note that these recommendations are without receiving Board input as to their risk preference on funding this Plan.

Recommended Ranges for Economic Assumptions			
Assumption	**Minimum**	**Recommendation**[1]	**Maximum**
Wage Inflation	3.25%	3.50%	4.00%
Investment Return	6.75%	7.25%	7.75%
SRBR Cost (% of assets)	0.24%	0.35%	0.55%

In setting the wage inflation assumption, a balance should be struck between the short-term expectations while revenues recover from the recession and the long-term expectations after the economy has returned to a more normal pattern.

We generally recommend an investment return assumption that is lower than the median expected return (7.42%) in order to create some margin of conservatism. However, we also recognize the significant short-term impact such a change would have on contribution rates, and an assumption of 7.75% is within reason. Over time, we would encourage the adoption of an assumption below the median expected return.

As shown in Table II-6 later in the report, the various investment return assumptions combined with a 3.5% wage inflation assumption would have produced City contribution rates of 29.7% to 39.2% if they had been applied in the June 30, 2010 actuarial valuation. These rates compare to the City contribution rate of 28.3% from that valuation, resulting in estimated increases from 1.4% of payroll to 10.9% of payroll.

Assets are transferred to the SRBR whenever the actual earnings for the fund exceed the assumed investment return. In addition, there is an effective transfer when the actual return is less than zero because the SRBR is never credited with less than 0% interest. Given the volatile investment portfolio, it is reasonable to assume that some portion of the investment return will be diverted to the SRBR instead of supporting the basic retirement benefits. If the transfers to the

[1] Recommendations are subject to a discussion of the Board's risk preferences

SECTION I
EXECUTIVE SUMMARY

SRBR were recognized as a reduction in the investment return assumption, it would also increase the likelihood of excess earnings and a transfer to the SRBR.

Instead, we recommend adding to the normal cost, an estimate of the annual transfer to the SRBR. The minimum recommended assumption represents the median expected transfer (i.e., half the time the transfer will be larger and half the time the transfer will be smaller). The maximum recommended assumption represents the average expected transfer. Since there will be many years where there is no transfer and some years with a very large transfer, the average is significantly higher than the median. When the percentage of assets shown above is converted to a percentage of payroll using the June 30, 2010 actuarial valuation data, the increase in City contribution rates ranges from 0.8% of payroll to 1.9% of payroll.

The table below summarizes the range of cost impacts based on the recommended range of economic assumptions in this report.

Estimated Cost Increase
Recommended Range of Economic Assumption Changes

	City			Member			Total		
	Min	Rec[2]	Max	Min	Rec[2]	Max	Min	Rec[2]	Max
Wage Inflation / Investment Return	1.4%	6.1%	11.1%	0.0%	0.6%	1.4%	1.4%	6.7%	12.5%
SRBR	0.8%	1.3%	1.9%	0.3%	0.5%	0.7%	1.1%	1.8%	2.6%
Total	2.2%	7.4%	13.0%	0.3%	1.1%	2.1%	2.5%	8.5%	15.1%

SUMMARY OF DEMOGRAPHIC ASSUMPTION ANALYSIS

The specific demographic assumptions analyzed in this report are merit salary increases, retirement rates, mortality rates, disability rates, termination rates, refund rates, administrative expenses and family composition. The details of the analysis for each of these assumptions are provided later in the report, but the most significant recommended changes are for termination, refund, and mortality rates.

The current assumptions for termination from active employment and refunds (withdrawals) are set by age with no reference to service. Most studies have found, including this one, that rates of termination from active employment are much higher in the first few years of service. Consequently, we are proposing separate termination assumptions by age for an employee's first year of service, from one to four years of service, and for five or more years of service. As summarized in the table below, this change results in higher assumed termination rates for the first four years of service and lower assumed termination rates for five or more years of service.

[2] Recommendations are subject to a discussion of the Board's risk preference

SECTION I
EXECUTIVE SUMMARY

Termination Rates					
Service	Actual	Current Expected	Recommended Expected	Current A/E Ratio	Recommended A/E Ratio
0	101	22	100	4.545	1.012
1 – 4	250	138	248	1.810	1.007
5 +	298	491	314	0.606	0.949
Total	649	651	662	0.997	0.980

Once a vested member terminates employment before retirement, they can choose to get a refund of their employee contributions with interest or to wait until they are eligible to retire to commence their benefits. The current assumption was analyzed by age with no reference to service. Instead, we have just analyzed refund rates for members with 5 or more years of service. We assume non-vested members elect a refund, but assume much lower rates of refund for older members with 5 or more years of service.

Mortality rates have continued to improve, and we are proposing some improvement in the assumptions. However, because the improvement since the last experience study was larger than we would normally expect, we have not recommended the full margin for future mortality improvements that was in the prior study. We will need to examine this assumption carefully in the next study to determine if the recent improvement in mortality is sustained.

The table below summarizes the estimated cost impact of the recommended changes to demographic assumptions.

Estimated Cost Increase Recommended Demographic Assumption Changes			
Assumption	**City**	**Member**	**Total**
Termination / Refund Rates	1.8%	0.3%	2.1%
Mortality Rates	0.7%	0.1%	0.8%
Administrative Expenses	0.5%	0.2%	0.7%
Other	-0.2%	-0.1%	-0.3%
Total	2.8%	0.5%	3.3%

The body of this report provides additional detail and support for our conclusions and recommendations.

SECTION II – ECONOMIC ASSUMPTIONS
WAGE INFLATION

In our analysis of economic assumptions, we first develop a recommended range for each assumption considering historical experience of the plan and the market in general, assumptions used by other public systems, and, most importantly, future expectations for each assumption. To recommend a specific assumption within the recommended range, we consider the Board's risk preferences, the impact of each assumption on the risks of the plan, and the consistency of all of the economic assumptions.

Long-term price inflation rates are the foundation of many other economic assumptions. In a growing economy, wages and investments are expected to grow at the underlying inflation rate plus some additional *real growth rate,* whether it reflects productivity in terms of wages or risk premiums in terms of investments. However, because retiree benefits are indexed at a fixed 3 percent regardless of price inflation, we do not develop an explicit price inflation assumption.

WAGE INFLATION

Wage inflation can be thought of as the annual across-the-board increase in wages. Individuals often receive wage increases in excess of the wage inflation rate, and we study these increases as a part of the merit salary scale assumption. Wage inflation generally exceeds price inflation by some margin reflecting the history of increased purchasing power.

Wage inflation is used in the actuarial valuation as the minimum expected salary increase for an individual and, for purposes of amortizing the unfunded actuarial liability, the rate at which payroll is expected to grow over the long-term assuming no change in the number of active employees.

Table II-1 shows the increase in national average wages (as reported by the Social Security Administration) compared to inflation for various time periods.

SECTION II – ECONOMIC ASSUMPTIONS
WAGE INFLATION

TABLE II-1

	National Average Wages		
	Growth in National Average Wages	CPI-U	Real Wage Growth
1959 - 2009	4.8	4.1	0.8
1969 - 2009	5.0	4.5	0.5
1979 - 2009	4.3	3.5	0.8
1989 - 2009	3.6	2.7	0.9
1999 - 2009	2.9	2.5	0.4
1959 - 1969	4.3	2.5	1.8
1969 - 1979	6.9	7.4	-0.5
1979 - 1989	5.8	5.1	0.7
1989 - 1999	4.2	2.9	1.3
1999 - 2009	2.9	2.5	0.4

Growth in national average wages has varied significantly over different time periods, but for the last 20 years, it has generally ranged from about 3% to 4%. For the 2010 Trustees Report, the Social Security Administration projected a long-term average annual growth rate in average US earnings to range from 3.6% to 4.4% with an intermediate assumption of 4.0%. Over the near term, higher growth rates are projected by Social Security as they expect the economy to recover from the recession.

The annual increase in average wages for SJFCERS' members is shown in Table II-2 for each of the last 10 actuarial valuations. The average annual increase over the period was 3.84%, but for the last five years experience has been about 2.7%.

SECTION II – ECONOMIC ASSUMPTIONS
WAGE INFLATION

TABLE II-2

	Annual Growth in Average Salary Federated Members			
Valuation	Payroll	Actives	Average Salary	Annual Growth Rate
June 30, 1991	135,849,000	3,528	38,506	
June 30, 1993	145,781,000	3,360	43,387	**6.15%**
June 30, 1995	153,918,000	3,397	45,310	**2.19%**
June 30, 1997	176,284,000	3,642	48,403	**3.36%**
June 30, 1999	193,650,000	3,694	52,423	**4.07%**
June 30, 2001	252,696,000	4,466	56,582	**3.89%**
June 30, 2003	292,961,371	4,479	65,408	**7.52%**
June 30, 2005	286,445,861	4,148	69,056	**2.75%**
June 30, 2007	291,404,606	3,942	73,923	**3.46%**
June 30, 2009	323,020,387	4,079	79,191	**3.50%**
June 30, 2010	300,811,165	3,818	78,788	**-0.51%**
	From July 1, 1991 to June 30, 2010			**3.84%**

While private sector wages may rebound from the recession as projected by the Social Security Administration, we expect any rebound in public sector wages to be delayed for some time. In the long-run, however, we expect the difference in the rate of wage growth to disappear.

We suggest a reasonable range for the long-term wage inflation assumption from 3.25% to 4.0%. In the short-term, a lower assumption could be used, and we recommend the use of a 3.50% assumption to reflect this phenomenon.

SECTION II – ECONOMIC ASSUMPTIONS
EXPECTED RETURN ON INVESTED ASSETS

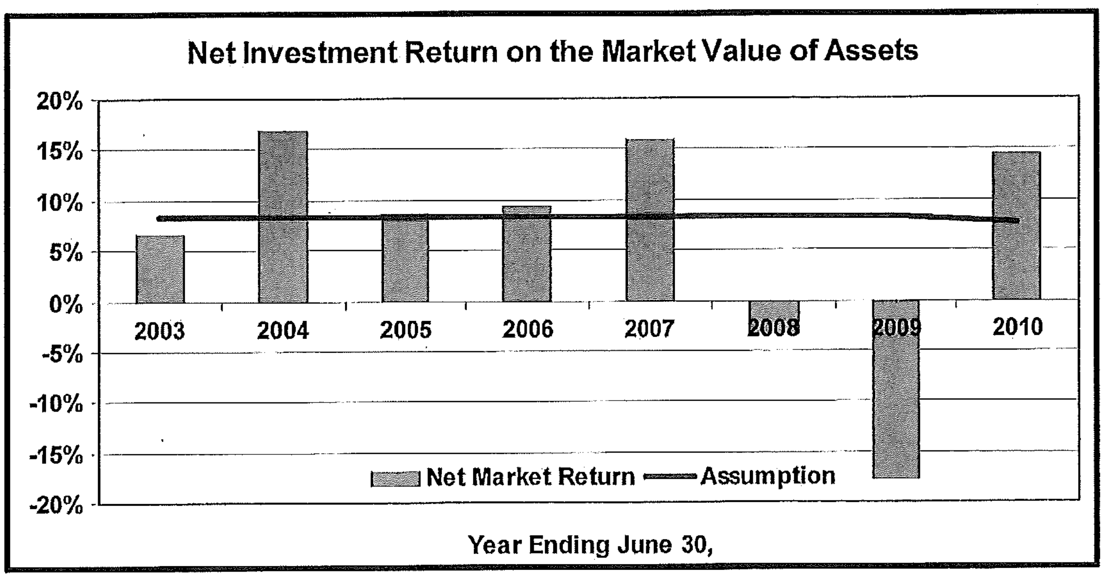
The assumption for investment return is generally the most significant of all the assumptions employed in the actuarial valuation. Over the long-term, the investment return depends on factors such as the underlying rate of inflation, the economic conditions in the U.S. and abroad, the time horizon of the investments, and the particular mix of asset classes in the Fund's portfolio.

HISTORICAL RETURNS

Historical returns are just one factor to be considered when setting investment return assumptions. One must temper this "historical" look with future expectations, the latter being the key ingredient for appropriate assumption setting, particularly when the asset allocation has changed.

Table II-3 below shows the historical returns achieved by the trust over the past 8 years. The average dollar-weighted return over the period was 5.73%.

Table II-3



SJFCERS' TARGET ASSET ALLOCATION

The target asset allocation of the SJFCERS pension investments portfolio will have a significant impact on the investment return experienced by the plan. The target allocation provided by the Retirement Services Department is shown in Table II-4 below.

SECTION II – ECONOMIC ASSUMPTIONS
EXPECTED RETURN ON INVESTED ASSETS

Table II-4

Target Asset Allocation

Equity	49.0%	Hedge Funds	5.0%
Fixed Income	20.0%	Private Equity	6.0%
Opportunistic	5.0%	Real Estate	5.0%
		Real Assets	10.0%

FUTURE EXPECTATIONS

Based on information provided by the Retirement Services Department, we understand the portfolio is expected to provide a median geometric gross return of 7.42% with a standard deviation of 15.29%.[3] The Retirement Services Department further provided the information in Table II-5 showing the probability of various gross average annual investment returns over a 30-year time horizon.

TABLE II-5

Expected Distribution of Average Annual Gross Investment Returns

Percentile	30 Years
5%	12.04%
25%	9.29%
50%	7.42%
75%	5.58%
95%	2.99%

We understand that these expected gross investment returns are based on generic expectations for each asset class. As such, it would be appropriate to subtract passive investment expenses of 15 to 25 basis points from these expectations. Additional expenses for active management may be incurred with the expectation of obtaining additional investment return equal to or in excess of the expectation for the passive investment strategy. Consequently, we do not believe it is appropriate to reduce these expected returns for the active management expenses expected to be incurred.

[3] We replicated the results in Table II-5 based on an arithmetic return of 8.48% and a standard deviation of 15.29% which produces a median geometric return of 7.42%.

SECTION II – ECONOMIC ASSUMPTIONS
EXPECTED RETURN ON INVESTED ASSETS

In the past, administrative expenses have also been deducted from the investment return assumption. However, since administrative expenses are not a function of the amount of assets held, we recommend that a separate administrative expense assumption be developed and added to the annual normal cost. The development of this assumption and our recommendation can be found in the demographic section of this report.

Based on the information above, we believe a reasonable range for the expected return on assets to be from 6.75 percent to 7.75 percent depending on the level of risk tolerance acceptable to the Board. Lower expected return assumptions result in higher short-term contribution rates, but a greater likelihood of achieving the expected return and producing actuarial gains instead of losses.

To illustrate the dynamics of different investment return assumptions, Table II-6 below shows the City and member contribution rates and the funded status that would have been produced in the June 30, 2010 actuarial valuation for different assumptions. By comparison, the City contribution rate calculated under the current assumptions was 28.34% of payroll, the Member contribution rate was 4.68% of payroll, and the funded status was 69%.

TABLE II-6

Impact on June 30, 2010 Valuation Results Under Alternate Assumptions					
	Investment Return Assumption				
	6.75%	**7.00%**	**7.25%**	**7.50%**	**7.75%**
City Contribution Rate	39.2%	36.8%	34.4%	32.0%	29.7%
Member Contribution Rate	5.9%	5.6%	5.3%	5.0%	4.7%
Funded Status	60%	62%	64%	66%	68%

The table above illustrates the short-term impact of alternate assumptions, but the risk of a plan can be better illustrated by considering long-term projections and the likelihood that certain risk thresholds may be exceeded. These risk thresholds are matters of policy for the Board and City as opposed to strict actuarial calculations. For illustrative purposes, Table II-7 shows various 25–year projections under the alternative investment return assumptions and a 3.5% wage inflation assumption. All of these probability projections are based on a stochastic model with the investment return and standard deviation assumptions shown above in Table II-5.

SECTION II – ECONOMIC ASSUMPTIONS
EXPECTED RETURN ON INVESTED ASSETS

TABLE II-7

Projected 6/30/2035 Valuation Results Under Alternate Assumptions

	Investment Return Assumption					
	Current	**6.75%**	**7.00%**	**7.25%**	**7.50%**	**7.75%**
Median City Contribution Rate	28%	14%	17%	20%	23%	26%
Probability City Contribution Rate Exceeds 30%	47%	37%	38%	40%	42%	45%
Median Funded Status	97%	111%	108%	105%	102%	100%
Probability Funded Status is Below 80%	32%	21%	23%	26%	28%	30%

Lower investment return assumptions reduce the probability of higher contribution rates and lower funded status in the long-term, but also increase the likelihood of excess earnings and the payment of additional benefits through the SRBR. The next section analyzes the impact on the SRBR of various investment return assumptions.

SECTION II – ECONOMIC ASSUMPTIONS
SRBR LIABILITY

The Supplemental Retiree Benefit Reserve (SRBR) receives 10 percent of any excess earnings in a given year. Excess earnings are defined as actual investment earnings less interest credited to member accounts and interest up to the assumed rate that is credited to the SRBR and the General Reserve. Once excess earnings are transferred to the SRBR, they can only be used to provide additional benefits to retirees. They cannot be transferred back to the General Reserve to support the Basic or COLA benefits. In addition, the SRBR is never credited with less than 0% interest, so if actual earnings are less than 0%, there is an effective transfer to the SRBR.

In prior valuations, the SRBR benefits have not been explicitly valued. The assets held in the SRBR have been carved out of valuation assets, but no liability has been recognized for the contingency of future transfers to the SRBR.

We recommend a different approach. First, instead of reducing the valuation assets by the amount of assets in the SRBR, we believe a liability should be recognized equal to those assets. Mathematically, there is little difference between these methods, but from an accounting standpoint, our recommended method more accurately reflects the true liabilities of the plan.

Second, we believe a liability should also be recognized for the contingent liability of future transfers of assets to the SRBR. The investment return assumption reflects a median expected return on a volatile investment portfolio. A portion of the positive volatility of this portfolio, however, is already committed to providing additional benefits through the SRBR.

To estimate this liability, we used a stochastic model with the investment return and standard deviation assumptions described above in Table II-5. Based on this model, Table II-10 below shows the estimated average annual transfer to the SRBR as a percentage of total assets based on valuation interest assumptions of 6.75%, 7.00%, 7.25%, 7.50% and 7.75%.

TABLE II-10

Expected Annual Transfer to SRBR Under Alternate Assumptions					
	Investment Return Assumption				
	6.75%	7.00%	7.25%	7.50%	7.75%
Median Transfer **(% of Assets)**	0.24%	0.24%	0.24%	0.23%	0.22%
Average Transfer **(% of Assets)**	0.55%	0.54%	0.54%	0.53%	0.52%

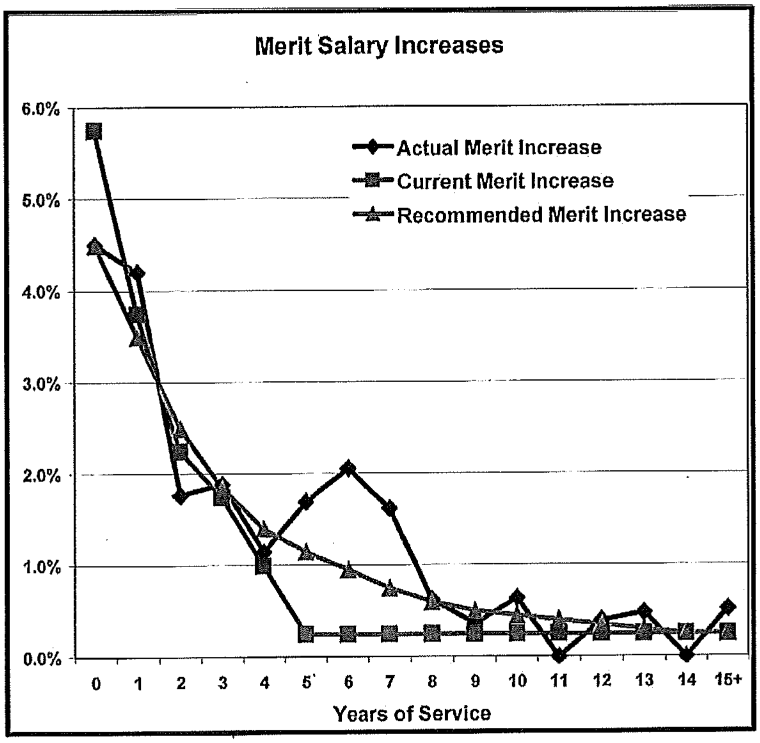
As a result, we recommend that between 0.24% and 0.55% of assets be added to the normal cost to account for future transfers to the SRBR. As of the 2010 actuarial valuation, this assumption would increase the City contribution rate by from 0.8% of payroll to 1.9% of payroll, and would increase member contributions by from 0.3% of payroll to 0.7% of payroll.

SECTION III – DEMOGRAPHIC ASSUMPTIONS
MERIT SALARY INCREASES

Wage inflation is one of two components of total individual salary increases. In this section, the analysis develops the merit component of salary increases. Generally, newer employees are more likely to earn a step increase or receive a promotion, so their salary increases tend to be greater than those for longer service employees.

The merit salary increase assumption is added to the wage inflation assumption to calculate the total salary increase expected for an individual. To analyze the merit component, the actual national average wage growth as measured by the increase in Social Security national average wages for the period of the experience study is subtracted from the total salary increase. For this period, the increase in national average wages was almost identical to the increase in average wages for Federated employees.

The chart below shows the current assumption (red line) compared to the actual experience (blue line) and the recommended assumption (green line).



Service	Current	Recommended
0	5.75%	4.50%
1	3.75%	3.50%
2	2.25%	2.50%
3	1.75%	1.85%
4	1.00%	1.40%
5	0.25%	1.15%
6	0.25%	0.95%
7	0.25%	0.75%
8	0.25%	0.60%
9	0.25%	0.50%
10	0.25%	0.45%
11	0.25%	0.40%
12	0.25%	0.35%
13	0.25%	0.30%
14	0.25%	0.25%
15+	0.25%	0.25%

Compared to the current assumption, the recommended assumption reflects lower salary increases in the first two years of employment followed by higher salary increases until 14 years of service.

SECTION III – DEMOGRAPHIC ASSUMPTIONS
RETIREMENT RATES

RATES OF RETIREMENT

In this section, we develop our analysis of rates of retirement. As with the current assumptions, we recommend separate assumptions for employees with less than 30 years of service and with 30 or more years of service.

For each membership group studied, we determined the ratio of the actual number of retirements at each age compared to the expected number of retirements. If the assumption is perfect, this ratio will be 100%. In addition, we calculated the 90% confidence interval, which represents the range within which the true retirement rate falls with 90% confidence. We generally propose assumption changes when the current assumption is outside the 90% confidence interval of the observed experience. However, adjustments are made to account for differences between future expectations and historical experience, to account for the past experience represented by the current assumption, and to maintain a neutral to slight conservative bias in the selection of the assumption.

Normal Retirement assumptions for Federated employees start at age 55 with 5 years of service or at any age with 30 years of service. Once a Federated employee reaches age 70, we assume 100% probability of retirement.

Table III-1 shows the calculation of actual to expected ratios for Federated employees with less than 30 years of service, and Chart III-1 shows the information graphically along with the 90% confidence interval.

The data shows slightly higher actual retirement rates than expected under the current assumption. The recommended assumption reduces the aggregate A/E ratio prior to age 70 from 1.211 to 1.026.

SECTION III – DEMOGRAPHIC ASSUMPTIONS
RETIREMENT RATES

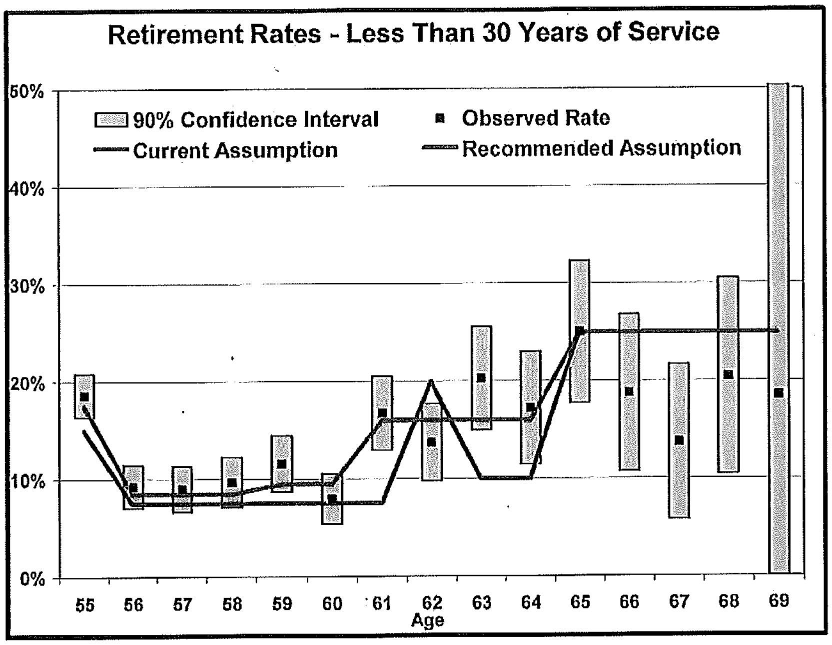
Table III-1

Retirement Rates - Less than 30 Years of Service

Age	Exposed	Total Actual Retirements	Actual Rates	Current Expected Retirements	Recommended Expected Retirements	Current A/E Ratio	Recommended A/E Ratio
55	829	154	18.6%	124.4	145.1	124%	106%
56	465	43	9.2%	34.9	39.5	123%	109%
57	401	36	9.0%	30.1	34.1	120%	106%
58	361	35	9.7%	27.1	30.7	129%	114%
59	337	39	11.6%	25.3	32.0	154%	122%
60	301	24	8.0%	22.6	28.6	106%	84%
61	263	44	16.7%	19.7	42.1	223%	105%
62	204	28	13.7%	40.8	32.6	69%	86%
63	158	32	20.3%	15.8	25.3	203%	127%
64	116	20	17.2%	11.6	18.6	172%	108%
65	96	24	25.0%	24.0	24.0	100%	100%
66	64	12	18.8%	16.0	16.0	75%	75%
67	51	7	13.7%	12.8	12.8	55%	55%
68	44	9	20.5%	11.0	11.0	82%	82%
69	27	5	18.5%	6.8	6.8	74%	74%
Subtotal	3717	512	13.8%	422.7	499.0	121%	103%
70+	74	13	17.6%	74.0	74.0	18%	18%
TOTAL	3791	525	13.8%	496.7	573.0	106%	92%

SECTION III – DEMOGRAPHIC ASSUMPTIONS
RETIREMENT RATES

Chart III-1



Age	Current	Recommended
55	15.0%	17.5%
56	7.5%	8.5%
57	7.5%	8.5%
58	7.5%	8.5%
59	7.5%	9.5%
60	7.5%	9.5%
61	7.5%	16.0%
62	20.0%	16.0%
63	10.0%	16.0%
64	10.0%	16.0%
65	25.0%	25.0%
66	25.0%	25.0%
67	25.0%	25.0%
68	25.0%	25.0%
69	25.0%	25.0%

Current A/E Ratio: 1.211 Recommended A/E Ratio: 1.026

Table III-2 shows the calculation of actual to expected ratios for Federated employees with 30 or more years of service, and Chart III-2 shows the same information graphically along with the 90% confidence interval. Because there are fewer employees with 30 or more years of service, the data was grouped into 5-year age-bands in order to have sufficient data to calculate a reliable confidence interval.

The retirement rates experienced for members under age 55 with 30 or more years of service are higher than expected under the current assumption. The recommended assumptions increase the assumed rates of retirement for members under age 55 and reduce the A/E ratio from 1.067 to 0.982.

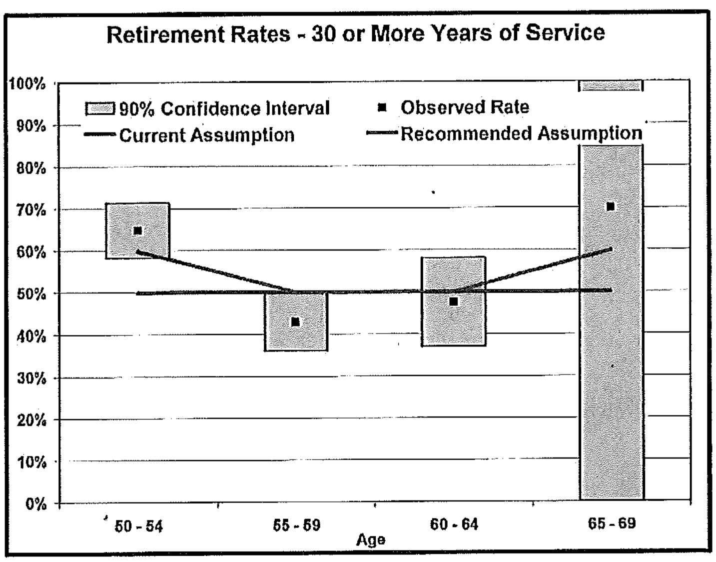
SECTION III – DEMOGRAPHIC ASSUMPTIONS
RETIREMENT RATES

Table III-2

Retirement Rates - 30 or more years of service

Age	Exposed	Total Actual Retirements	Actual Rates	Current Expected Retirements	Recommended Expected Retirements	Current A/E Ratio	Recommended A/E Ratio
50	34	20	58.8%	17.0	20.4	118%	98%
51	25	18	72.0%	12.5	15.0	144%	120%
52	28	17	60.7%	14.0	16.8	121%	101%
53	24	17	70.8%	12.0	14.4	142%	118%
54	34	22	64.7%	17.0	20.4	129%	108%
55	35	17	48.6%	17.5	17.5	97%	97%
56	30	11	36.7%	15.0	15.0	73%	73%
57	30	12	40.0%	15.0	15.0	80%	80%
58	30	14	46.7%	15.0	15.0	93%	93%
59	17	7	41.2%	8.5	8.5	82%	82%
60	15	5	33.3%	7.5	7.5	67%	67%
61	17	8	47.1%	8.5	8.5	94%	94%
62	13	5	38.5%	6.5	6.5	77%	77%
63	10	7	70.0%	5.0	5.0	140%	140%
64	6	4	66.7%	3.0	3.0	133%	133%
Subtotal	348	184	52.9%	174.0	188.5	106%	98%
65+	12	8	66.7%	7.0	8.0	114%	100%
TOTAL	360	192	53.3%	181.0	196.5	106%	98%

Chart III-2



Age	Current	Recommended
50	50.0%	60.0%
51	50.0%	60.0%
52	50.0%	60.0%
53	50.0%	60.0%
54	50.0%	60.0%
55	50.0%	50.0%
56	50.0%	50.0%
57	50.0%	50.0%
58	50.0%	50.0%
59	50.0%	50.0%
60	50.0%	50.0%
61	50.0%	50.0%
62	50.0%	50.0%
63	50.0%	50.0%
64	50.0%	50.0%
65	50.0%	60.0%
66	50.0%	60.0%
67	50.0%	60.0%
68	50.0%	60.0%
69	50.0%	60.0%

Current A/E Ratio: 1.067 Recommended A/E Ratio: 0.982

SECTION III – DEMOGRAPHIC ASSUMPTIONS
MORTALITY RATES

MORTALITY RATES

Mortality assumptions are developed separately for active employees, healthy annuitants, and disabled annuitants. Within each of these groups, mortality rates are developed separately for males and females. Unlike most of the other demographic assumptions that rely exclusively on the experience of the plan, for mortality, standard mortality tables are used with standard modifications so that the aggregate experience matches the plan's experience.

In general, members are living longer than projected by the current assumption, and given the history of mortality improvements, the recommended assumptions build in some margin, particularly for healthy annuitants, to anticipate future improvements in mortality.

For each group studied, we determined the ratio of the actual number of deaths for each 5-year age grouping compared to the expected number of deaths. If the assumption is perfect, this ratio will be 100%. In addition, we calculated the 90% confidence interval, which represents the range within which the true retirement rate falls with 90% confidence.

We generally propose assumption changes when the A/E ratio for the current assumption is less than 100% for active employees or less than 110% for annuitants. We also try to recommend the same or a related table for active employees and healthy annuitants.

Active Employee Mortality

As shown in the following tables, there were only 14 active male deaths and 15 active female deaths during the experience study period. The data is not fully credible, so we are proposing the same tables as those for healthy annuitants,

The current assumptions are based on the 1994 Group Annuity Mortality Tables setback three years for males and one year for females. The recommended assumptions are based on variations of the RP 2000 Combined Mortality Table as follows:

Active male	Male combined employee and annuitant table projected to 2015, setback 2 years
Active female	Female combined employee and annuitant table projected to 2015, setback 2 years

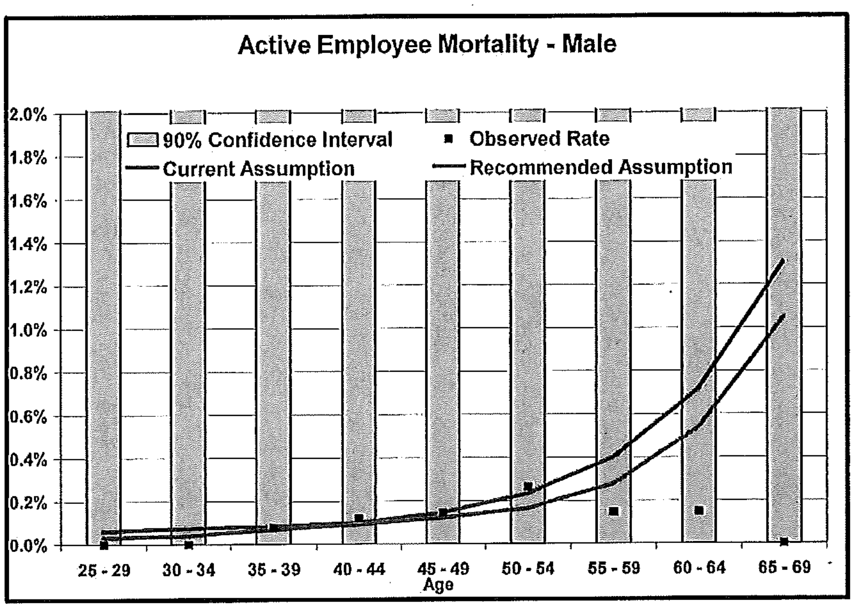
SECTION III – DEMOGRAPHIC ASSUMPTIONS
MORTALITY RATES

Table III-3

Active Employee Mortality - Male

Age	Exposed	Total Actual Deaths	Actual Rates	Current Expected Deaths	Recommended Expected Deaths	Current A/E Ratio	Recommended A/E Ratio
<25	98	0	0.0%	0.0	0.0	0%	0%
25-29	538	0	0.0%	0.3	0.2	0%	0%
30-34	1006	0	0.0%	0.8	0.4	0%	0%
35-39	1304	1	0.1%	1.1	0.9	90%	107%
40-44	1678	2	0.1%	1.7	1.6	117%	123%
45-49	2078	3	0.1%	3.1	2.6	98%	117%
50-54	1891	5	0.3%	4.5	3.2	112%	157%
55-59	1373	2	0.1%	5.4	3.7	37%	53%
60-64	674	1	0.1%	4.6	3.5	22%	29%
65-69	167	0	0.0%	2.0	1.6	0%	0%
Subtotal	10709	14	0.1%	23.5	17.8	60%	79%
70+	39	0	0.0%	0.0	0.0	0%	0%
TOTAL	10846	14	0.1%	23.5	17.8	60%	79%

Chart III-3



Age	Current	Recommended
25	0.056%	0.030%
30	0.073%	0.037%
35	0.084%	0.059%
40	0.089%	0.088%
45	0.125%	0.110%
50	0.190%	0.146%
55	0.321%	0.215%
60	0.568%	0.414%
65	1.015%	0.810%
70	1.803%	1.446%

Current A/E Ratio:	0.596	Recommended A/E Ratio:	0.788

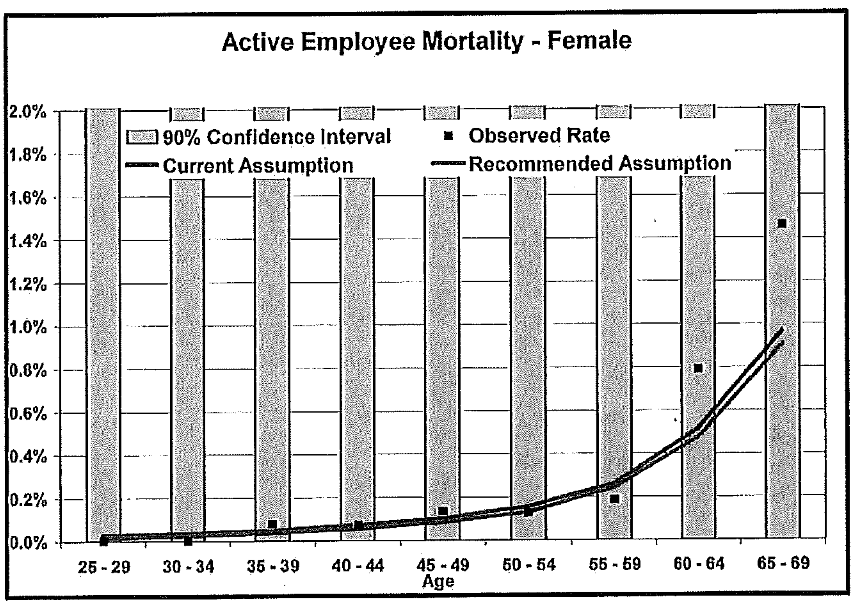
SECTION III – DEMOGRAPHIC ASSUMPTIONS
MORTALITY RATES

Table III-4

Active Employee Mortality - Female

Age	Exposed	Total Actual Deaths	Actual Rates	Current Expected Deaths	Recommended Expected Deaths	Current A/E Ratio	Recommended A/E Ratio
<25	136	0	0.0%	0.0	0.0	0%	0%
25-29	706	0	0.0%	0.2	0.1	0%	0%
30-34	998	0	0.0%	0.4	0.2	0%	0%
35-39	1282	1	0.1%	0.7	0.5	150%	194%
40-44	1354	1	0.1%	1.0	0.8	96%	129%
45-49	1488	2	0.1%	1.6	1.3	128%	152%
50-54	1670	2	0.1%	2.5	2.1	80%	96%
55-59	1067	2	0.2%	2.7	2.5	73%	79%
60-64	506	4	0.8%	2.4	2.3	164%	176%
65-69	137	2	1.5%	1.3	1.2	158%	169%
Subtotal	9108	14	0.2%	12.8	11.1	109%	127%
70+	38	1	2.6%	0.0	0.0	0%	0%
TOTAL	9282	15	0.2%	12.8	11.1	117%	135%

Chart III-4



Age	Current	Recommended
25	0.029%	0.016%
30	0.033%	0.020%
35	0.045%	0.034%
40	0.065%	0.048%
45	0.092%	0.075%
50	0.131%	0.109%
55	0.208%	0.184%
60	0.386%	0.364%
65	0.762%	0.709%
70	1.271%	1.247%

Current A/E Ratio: 1.094 Recommended A/E Ratio: 1.266

SECTION III – DEMOGRAPHIC ASSUMPTIONS
MORTALITY RATES

Healthy Annuitant Mortality

As shown in the tables and charts below, mortality rates for healthy annuitants are approximately equal to the current assumptions. However, given the trend toward longer life expectancies and that this assumption is applied to active employees many years in the future, we have recommended reduced assumptions to provide some margin for future mortality improvement. In the prior experience study, the current assumptions provided a reasonable margin for mortality improvement, but the data for this experience study shows a significant improvement over the prior study. We are not proposing as much margin as in the prior study as we are concerned that the change between studies may be an anomaly. We will need to re-examine this assumption with the next experience study to determine if the rate of mortality improvement is sustained. If so, we would likely recommend an additional margin for future mortality improvement at that time.

The current assumptions are based on the 1994 Group Annuity Mortality Tables setback three years for males and one year for females. The recommended assumptions are based on variations of the RP 2000 Combined Mortality Table as follows:

Annuitant male	Male combined employee and annuitant table projected to 2015, setback 2 years
Annuitant female	Female combined employee and annuitant table projected to 2015, setback 2 years

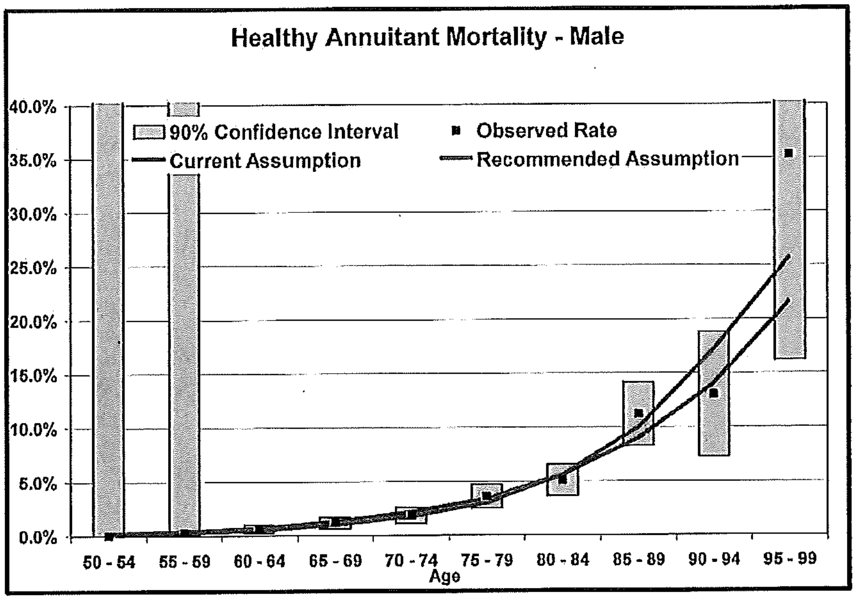
Table III-5

Healthy Annuitant Mortality - Male

Age	Exposed	Total Actual Deaths	Actual Rates	Current Expected Deaths	Recommended Expected Deaths	Current A/E Ratio	Recommended A/E Ratio
<50	20	0	0.0%	0.0	0.0	0%	0%
50-54	130	0	0.0%	0.3	0.2	0%	0%
55-59	981	3	0.3%	4.1	2.9	73%	103%
60-64	1269	8	0.6%	9.1	6.9	88%	117%
65-69	1195	14	1.2%	15.5	12.5	90%	112%
70-74	968	18	1.9%	21.1	17.2	85%	104%
75-79	775	28	3.6%	26.4	23.7	106%	118%
80-84	627	32	5.1%	35.0	35.0	91%	92%
85-89	312	35	11.2%	26.9	29.6	130%	118%
90-94	92	12	13.0%	12.4	15.2	97%	79%
95+	17	6	35.3%	3.3	4.0	180%	149%
Subtotal	6366	156	2.5%	154.1	147.2	101%	106%
TOTAL	6386	156	2.4%	154.1	147.2	101%	106%

SECTION III – DEMOGRAPHIC ASSUMPTIONS
MORTALITY RATES

Chart III-5



Age	Current	Recommended
50	0.190%	0.146%
55	0.321%	0.215%
60	0.558%	0.414%
65	1.015%	0.810%
70	1.803%	1.446%
75	2.848%	2.422%
80	4.517%	4.349%
85	7.553%	7.953%
90	11.567%	13.968%
95	18.228%	22.337%
100	26.882%	31.060%

Current A/E Ratio:	1.013	Recommended A/E Ratio:	1.060

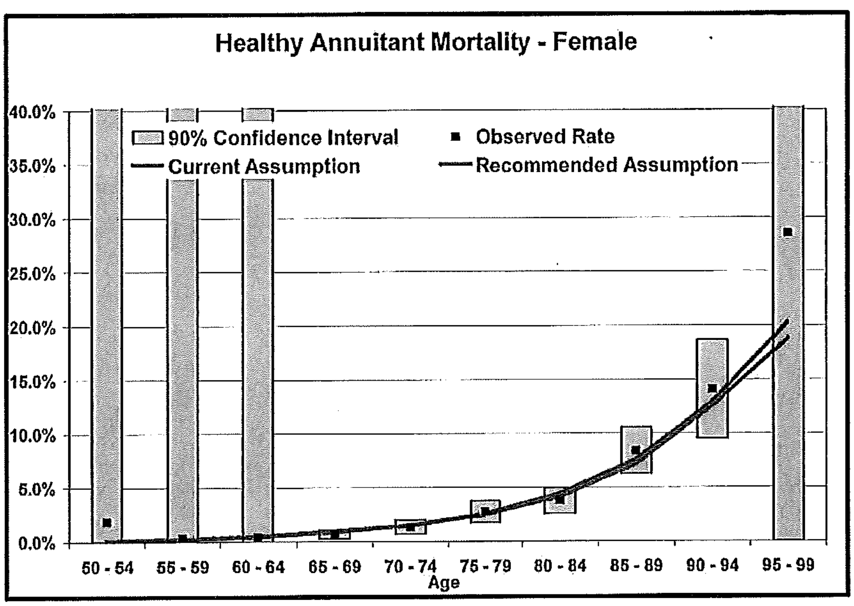
SECTION III – DEMOGRAPHIC ASSUMPTIONS
MORTALITY RATES

Table III-6

Healthy Annuitant Mortality - Female

Age	Exposed	Total Actual Deaths	Actual Rates	Current Expected Deaths	Recommended Expected Deaths	Current A/E Ratio	Recommended A/E Ratio
<50	91	1	1.1%	0.1	0.0	1602%	2064%
50-54	107	2	1.9%	0.2	0.1	1128%	1343%
55-59	801	3	0.4%	2.2	2.1	136%	144%
60-64	1098	5	0.5%	5.7	5.3	88%	95%
65-69	1025	7	0.7%	9.9	9.3	71%	76%
70-74	819	11	1.3%	12.4	12.6	89%	87%
75-79	729	20	2.7%	18.7	18.4	107%	108%
80-84	690	26	3.8%	30.5	28.6	85%	91%
85-89	452	38	8.4%	33.6	31.6	113%	120%
90-94	156	22	14.1%	18.9	18.4	116%	120%
95+	14	4	28.6%	2.5	2.4	161%	168%
Subtotal	**5891**	**138**	**2.3%**	**134.5**	**128.8**	**103%**	**107%**
TOTAL	**5982**	**139**	**2.3%**	**134.6**	**128.9**	**103%**	**108%**

Chart III-6



Age	Current	Recommended
50	0.131%	0.109%
55	0.208%	0.184%
60	0.386%	0.364%
65	0.762%	0.709%
70	1.271%	1.247%
75	2.038%	2.067%
80	3.536%	3.384%
85	6.098%	6.626%
90	10.459%	10.104%
95	17.068%	16.539%
100	26.671%	22.061%

Current A/E Ratio:	1.026	Recommended A/E Ratio:	1.071

SECTION III – DEMOGRAPHIC ASSUMPTIONS
MORTALITY RATES

Disabled Annuitant Mortality

The current mortality assumptions for disabled annuitants are based on the 1981 Disability Mortality Table. This table is now somewhat out of date, and based on our analysis, doesn't appear to reflect the mortality rates of San Jose's disabled retirees. However, with only 31 deaths reported during the experience period, the data is not robust. As a result, the recommended assumption uses the current CalPERS ordinary disability mortality tables for miscellaneous employees. We believe it is reasonable to assume that the mortality rates for disabled retirees in this plan are similar to the rates exhibited by the much larger CalPERS plan.

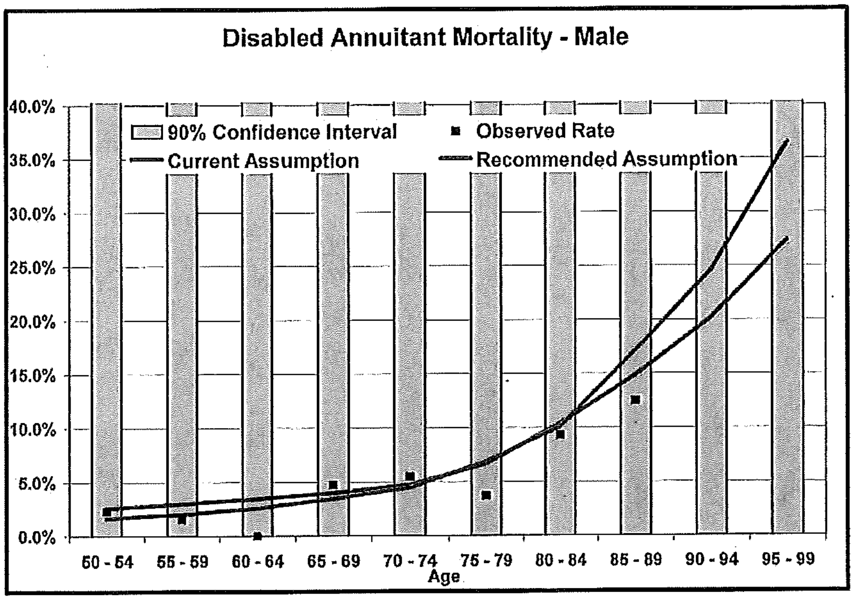
Table III-7

Disabled Annuitant Mortality - Male

Age	Exposed	Total Actual Deaths	Actual Rates	Current Expected Deaths	Recommended Expected Deaths	Current A/E Ratio	Recommended A/E Ratio
<50	72	0	0.0%	1.5	1.1	0%	0%
50-54	86	2	2.3%	2.2	1.5	89%	135%
55-59	125	2	1.6%	3.8	2.6	53%	78%
60-64	90	0	0.0%	3.1	2.3	0%	0%
65-69	105	5	4.8%	4.2	3.7	119%	136%
70-74	73	4	5.5%	3.5	3.3	116%	123%
75-79	54	2	3.7%	3.5	3.7	57%	54%
80-84	43	4	9.3%	4.4	4.3	91%	93%
85-89	24	3	12.5%	3.5	4.1	85%	74%
90-94	0	0	0.0%	0.0	0.0	0%	0%
95+	0	0	0.0%	0.0	0.0	0%	0%
Subtotal	600	22	3.7%	28.3	25.4	78%	87%
TOTAL	672	22	3.3%	29.7	26.5	74%	83%

SECTION III – DEMOGRAPHIC ASSUMPTIONS
MORTALITY RATES

Chart III-7



Age	Current	Recommended
50	2.440%	1.632%
55	2.840%	1.936%
60	3.300%	2.293%
65	3.790%	3.174%
70	4.370%	3.870%
75	5.630%	6.001%
80	8.740%	8.388%
85	13.010%	14.035%
90	17.950%	21.554%
95	24.120%	31.025%
100	32.980%	45.905%

Current A/E Ratio:	0.778	Recommended A/E Ratio:	0.867

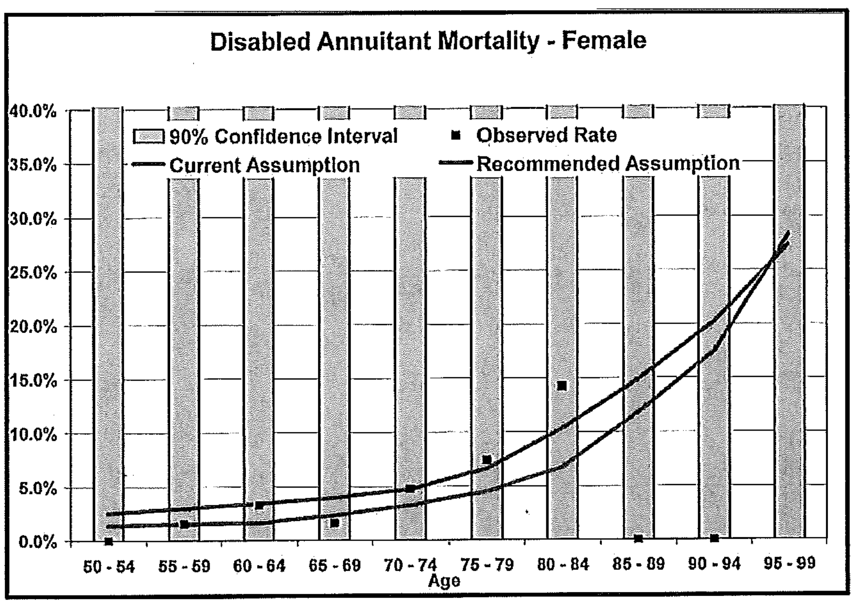
SECTION III – DEMOGRAPHIC ASSUMPTIONS
MORTALITY RATES

Table III-8

Disabled Annuitant Mortality - Female

Age	Exposed	Total Actual Deaths	Actual Rates	Current Expected Deaths	Recommended Expected Deaths	Current A/E Ratio	Recommended A/E Ratio
<50	69	0	0.0%	1.4	0.6	0%	0%
50-54	60	0	0.0%	1.6	0.9	0%	0%
55-59	65	1	1.5%	2.0	1.0	51%	96%
60-64	61	2	3.3%	2.1	1.0	94%	195%
65-69	62	1	1.6%	2.5	1.5	40%	67%
70-74	42	2	4.8%	2.0	1.4	100%	145%
75-79	27	2	7.4%	1.7	1.2	118%	170%
80-84	7	1	14.3%	0.7	0.4	149%	235%
85-89	1	0	0.0%	0.2	0.1	0%	0%
90-94	4	0	0.0%	0.8	0.7	0%	0%
95+	0	0	0.0%	0.0	0.0	0%	0%
Subtotal	329	9	2.7%	13.4	8.2	67%	110%
TOTAL	398	9	2.3%	14.8	8.8	61%	102%

Chart III-8



Age	Current	Recommended
50	2.440%	1.245%
55	2.840%	1.580%
60	3.300%	1.628%
65	3.790%	1.969%
70	4.370%	3.019%
75	5.530%	3.916%
80	8.740%	5.555%
85	13.010%	9.577%
90	17.950%	14.949%
95	24.120%	23.055%
100	32.980%	37.662%

Current A/E Ratio: 0.670 Recommended A/E Ratio: 1.096

SECTION III – DEMOGRAPHIC ASSUMPTIONS
DISABILITY RATES

DISABILITY RATES

This section analyzes the incidence of disability by the age of the employee. We determined the ratio of the actual number of disabilities at each age compared to the expected number of disabilities. If the assumption is perfect, this ratio will be 100%. In addition, we calculated the 90% confidence interval, which represents the range within which the true disability rate falls with 90% confidence. We generally propose assumption changes when the current assumption is outside the 90% confidence interval of the observed experience. However, adjustments are made to account for differences between future expectations and historical experience, to account for the past experience represented by the current assumption, and to maintain a neutral to slight conservative bias in the selection of the assumption. Because the incidence of disability is generally low, particularly at younger ages, the analysis groups the experience into 5-year age bands in order to get sufficient data on which to base an assumption.

As shown in the table and chart below, the incidence of disability for ages 50 and older is generally lower than the current assumptions, and we have recommended reduced assumptions.

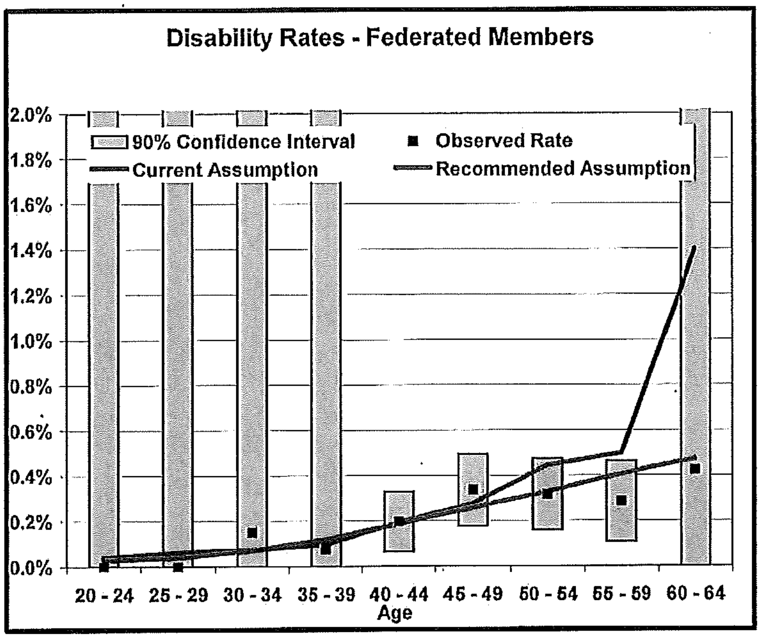
Table III-9

Disability Rates

Age	Exposed	Total Actual Disabilities	Actual Rates	Current Expected Disabilities	Recommended Expected Disabilities	Current A/E Ratio	Recommended A/E Ratio
<30	1478	0	0.00%	0.9	0.6	0%	0%
30-34	2004	3	0.15%	1.5	1.5	201%	205%
35-39	2586	2	0.08%	2.5	3.2	79%	63%
40-44	3032	6	0.20%	6.0	5.8	100%	103%
45-49	3566	12	0.34%	9.9	9.3	122%	129%
50-54	3461	11	0.32%	15.4	11.4	71%	96%
55-59	2440	7	0.29%	12.2	9.9	57%	71%
60-64	1180	5	0.42%	15.3	5.6	33%	90%
Subtotal	**19747**	**46**	**0.23%**	**63.8**	**47.2**	**72%**	**97%**
65+	381	0	0.00%	2.1	0.5	0%	0%
TOTAL	**20128**	**46**	**0.23%**	**65.9**	**47.7**	**70%**	**96%**

SECTION III – DEMOGRAPHIC ASSUMPTIONS
DISABILITY RATES

Chart III-9



Age	Current	Recommended
20	0.040%	0.030%
25	0.060%	0.033%
30	0.070%	0.056%
35	0.090%	0.098%
40	0.150%	0.162%
45	0.250%	0.232%
50	0.400%	0.302%
55	0.500%	0.376%
60	1.000%	0.455%
65	2.000%	0.504%
70	0.000%	0.000%

Current A/E Ratio:	0.72	Recommended A/E Ratio:	0.97

PROPORTION OF DUTY AND NON-DUTY DISABILITIES

When a member suffers from a disability that nature of the disablement determines the benefit amount they will receive while disabled. The current assumption is that 50% of disabilities are duty related and 50% are non-duty related.

During the experience study period, there were 46 disabilities, of which 25 were duty related and 21 were non-duty related. We recommend no change in this assumption.

SECTION III – DEMOGRAPHIC ASSUMPTIONS
TERMINATION RATES

TERMINATION RATES

Rates of termination from active employment have a significant impact on the cost of the plan. The current assumption is based on solely on the age of the member. Large termination studies have shown that there is a significant difference in termination rates for employees in their first few years of employment. Consequently, we analyzed and recommend separate rates for the first year of employment, from one to four years of employment, and for five or more years of employment.

We determined the ratio of the actual number of terminations at each age compared to the expected number of terminations. If the assumption is perfect, this ratio will be 100%. In addition, we calculated the 90% confidence interval, which represents the range within which the true termination rate falls with 90% confidence. We generally propose assumption changes when the current assumption is outside the 90% confidence interval of the observed experience. However, adjustments are made to account for differences between future expectations and historical experience, to account for the past experience represented by the current assumption, and to maintain a neutral to slight conservative bias in the selection of the assumption.

The tables and charts below show the actual experience compared to the current and recommended assumptions. Because the current assumption was intended for all years of employment, there are significant differences between the current and recommended assumptions.

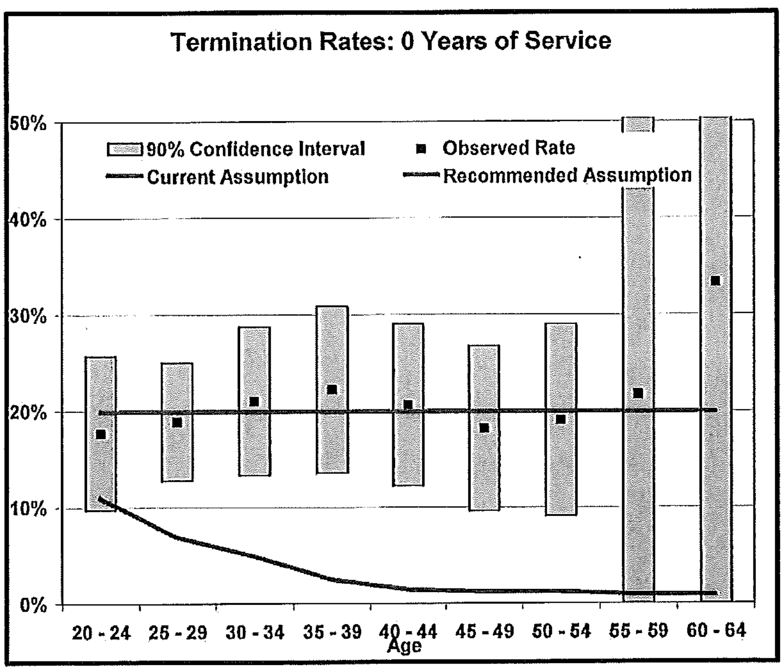
SECTION III – DEMOGRAPHIC ASSUMPTIONS
TERMINATION RATES

Table III-10

Termination Rates: 0 Years of Service

Age	Exposed	Total Actual Terminations	Actual Rates	Current Expected Terminations	Recommended Expected Terminations	Current A/E Ratio	Recommended A/E Ratio
20-24	62	11	17.7%	6.8	12.4	161%	89%
25-29	111	21	18.9%	7.8	22.2	270%	95%
30-34	76	16	21.1%	3.8	15.2	421%	105%
35-39	63	14	22.2%	1.6	12.6	889%	111%
40-44	63	13	20.6%	0.9	12.6	1376%	103%
45-49	55	10	18.2%	0.7	11.0	1455%	91%
50-54	42	8	19.0%	0.5	8.4	1524%	95%
55-59	23	5	21.7%	0.2	4.6	2174%	109%
60-64	9	3	33.3%	0.1	1.8	3333%	167%
Subtotal	504	101	20.0%	22.4	100.8	450%	100%
65+	1	1	100.0%	0.0	0.0	0%	0%
TOTAL	505	102	20.2%	22.4	100.8	454%	101%

Chart III-10



Age	Current	Recommended
20	11.000%	20.00%
25	7.000%	20.00%
30	5.000%	20.00%
35	2.500%	20.00%
40	1.500%	20.00%
45	1.250%	20.00%
50	1.250%	20.00%
55	1.000%	20.00%
60	1.000%	20.00%

Current A/E Ratio: 4.500 Recommended A/E Ratio: 1.002

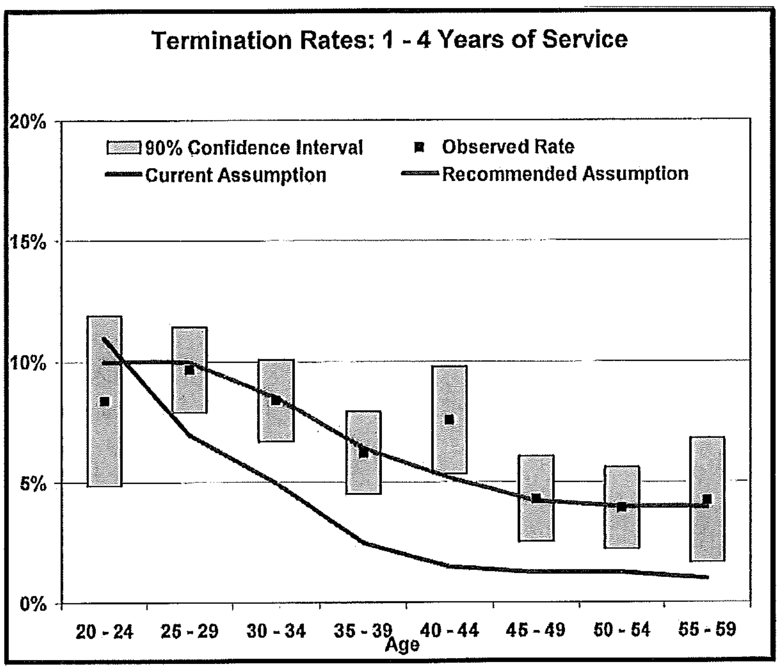
SECTION III – DEMOGRAPHIC ASSUMPTIONS
TERMINATION RATES

Table III-11

Termination Rates: 1 - 4 Years of Service

Age	Exposed	Total Actual Terminations	Actual Rates	Current Expected Terminations	Recommended Expected Terminations	Current A/E Ratio	Recommended A/E Ratio
20-24	167	14	8.4%	18.4	16.7	76%	84%
25-29	755	73	9.7%	52.8	75.5	138%	97%
30-34	727	61	8.4%	36.4	62.3	168%	98%
35-39	547	34	6.2%	13.7	35.5	249%	96%
40-44	383	29	7.6%	5.7	19.9	505%	145%
45-49	349	15	4.3%	4.4	14.8	344%	101%
50-54	357	14	3.9%	4.5	14.3	314%	98%
55-59	165	7	4.2%	1.6	6.6	424%	106%
60-64	68	3	4.4%	0.7	2.7	441%	110%
65+	12	0	0.0%	0.0	0.0	0%	0%
TOTAL	3530	250	7.1%	138.1	248.3	181%	101%

Chart III-11



Age	Current	Recommended
20	11.000%	10.00%
25	7.000%	10.00%
30	5.000%	8.52%
35	2.500%	6.44%
40	1.500%	5.20%
45	1.250%	4.24%
50	1.250%	4.00%
55	1.000%	4.00%

Current A/E Ratio:	1.797	Recommended A/E Ratio:	1.006

CITY OF SAN JOSE FEDERATED EMPLOYEES' RETIREMENT SYSTEM
EXPERIENCE ANALYSIS

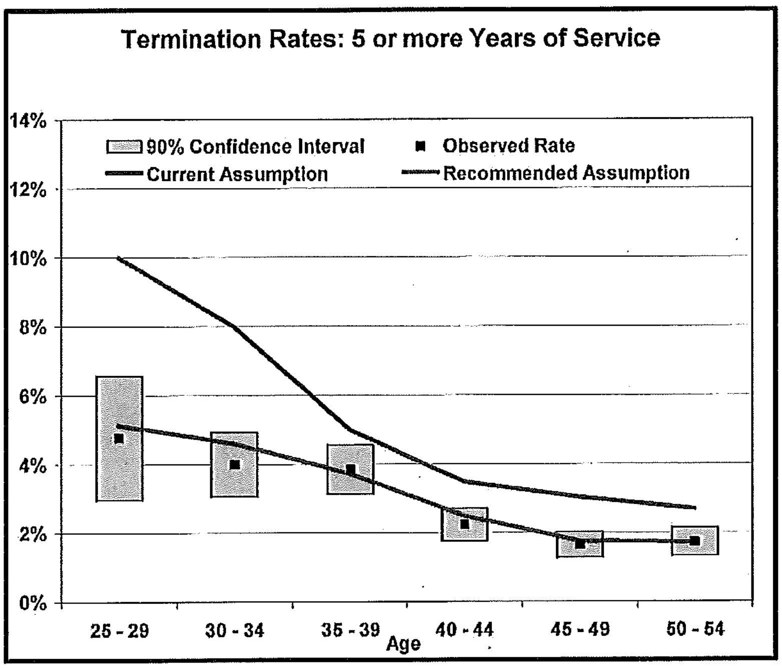
SECTION III – DEMOGRAPHIC ASSUMPTIONS
TERMINATION RATES

Table III-12

Termination Rates - 5 or more Years of Service

Age	Exposed	Total Actual Terminations	Actual Rates	Current Expected Terminations	Recommended Expected Terminations	Current A/E Ratio	Recommended A/E Ratio
20-24	5	0	0.0%	0.7	0.3	0%	0%
25-29	378	18	4.8%	37.8	19.2	48%	94%
30-34	1201	48	4.0%	96.1	55.0	50%	87%
35-39	1976	76	3.8%	98.5	73.4	77%	104%
40-44	2586	58	2.2%	90.5	64.2	64%	90%
45-49	3147	52	1.7%	95.9	55.7	54%	93%
50-54	2649	46	1.7%	71.9	46.4	64%	99%
55+	0	0	0.0%	0.0	0.0	0%	0%
TOTAL	11942	298	2.5%	491.4	314.1	61%	95%

Chart III-12



Age	Current	Recommended
25	10.000%	5.30%
30	8.000%	4.62%
35	5.250%	3.74%
40	3.500%	2.51%
45	3.250%	1.77%
50	2.750%	1.75%

Current A/E Ratio: 0.607 Recommended A/E Ratio: 0.950

SECTION III – DEMOGRAPHIC ASSUMPTIONS
REFUND RATES

REFUND RATES

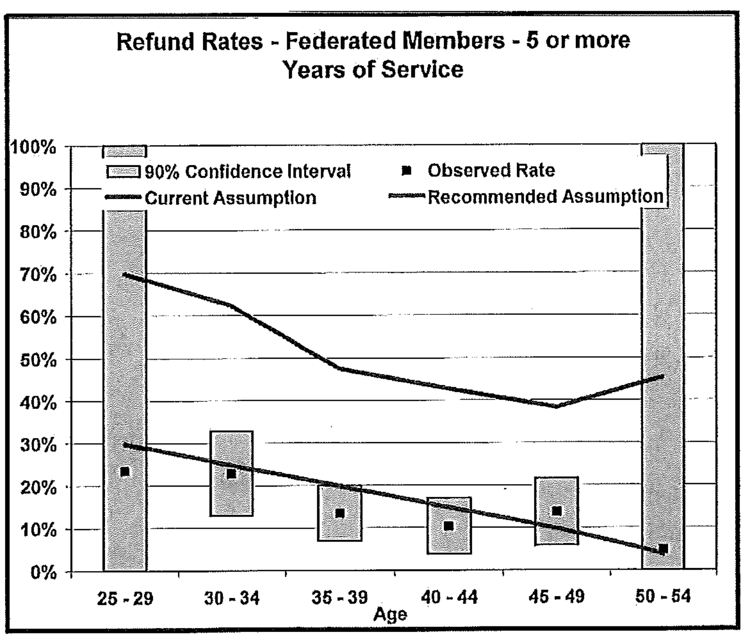
When a vested member terminates employment, they have the option of receiving a refund of contributions with interest or a deferred annuity. The charts below show that the rate of electing a refund during the experience study period was significantly less than the current assumption. As a result, we are proposing lower rates of refunds, increasing the actual to expected ratio from 0.284 to 0.844.

Table III-13

Refund Rates - 5 or more Years of Service

Age	Exposures	Total Actual Refunds	Actual Rates	Current Expected Refunds	Recommended Expected Refunds	Current A/E Ratio	Recommended A/E Ratio
25-29	17	4	23.5%	11.9	5.1	34%	78%
30-34	48	11	22.9%	30.0	12.0	37%	92%
35-39	74	10	13.5%	35.2	14.8	28%	68%
40-44	58	6	10.3%	24.9	8.7	24%	69%
45-49	51	7	13.7%	19.6	5.1	36%	137%
50-54	42	2	4.8%	19.1	1.7	10%	119%
TOTAL	290	40	13.8%	140.7	47.4	28%	84%

Chart III-13



Age	Current	Recommended
25 - 29	70.00%	30.00%
30 - 34	62.50%	25.00%
35 - 39	47.62%	20.00%
40 - 44	42.86%	15.00%
45 - 49	38.46%	10.00%
50 - 54	45.45%	4.00%

SECTION III – DEMOGRAPHIC ASSUMPTIONS
RECIPROCITY AND FAMILY COMPOSITION

RECIPROCITY

If an employee terminates employment and works for a reciprocal employer, the employee's retirement benefit is ultimately based on the employee's service with the City of San Jose and Final Compensation based on employment with any reciprocal employer. The current assumption is that 30% of terminating employees work for reciprocal employers and receive salary increases equal to the payroll growth assumption. We propose lowering the reciprocity assumption to 20% based on recent experience.

FAMILY COMPOSITION

Members who are married or have a domestic partner at the time of retirement are entitled to an unreduced 50% joint and survivor annuity. The analysis examines the data for all retirements since July 1, 2005. As shown in the table below, we are recommending some minor adjustments to this assumption based on the experience.

Gender	Members Receiving Joint and Survivor Benefits	Total Retiree Count	Actual Percent Receiving J&S Benefits	Current Assumption	Recommended Assumption
Male	368	471	78%	75%	80%
Female	246	395	62%	55%	60%

In addition, spouses/domestic partners of male retirees are assumed to be 3 years younger than the retiree, and spouses/domestic partners of female retirees are assumed to be 3 years older than the retiree. However, our analysis showed that spouses/domestic partners of female retirees to be only 1.9 years younger than the retiree. We are proposing changing the assumption for the age of spouses/domestic partners of female retirees to be 2 years younger than the retiree.

SECTION III – DEMOGRAPHIC ASSUMPTIONS
ADMINISTRATIVE EXPENSES

ADMINISTRATIVE EXPENSES

Currently administrative expenses are included as part of the investment return assumption. We are recommending to explicitly value the administrative expenses as a percentage of payroll. The table below shows the historical administrative expenses as a percentage of payroll with an average of 0.70%. We recommend adding the administrative expenses to the normal cost of the system at a rate of 0.70% of payroll.

Administrative Expense Analysis
Federated Members

Fiscal Year End	Expenses	Covered Payroll*	Percent of Payroll
June 30, 2005	1,588,000	277,939,000	0.57%
June 30, 2006	1,790,000	274,592,000	0.65%
June 30, 2007	1,845,000	280,575,000	0.66%
June 30, 2008	2,358,000	310,266,000	0.76%
June 30, 2009	2,108,000	320,912,000	0.66%
June 30, 2010	2,641,000	308,697,000	0.86%

* Reported in Federated City Employees' Retirement Systems' Comprehensive Annual Financial Reports

1. **Investment Return Assumption**

   Assets are assumed to earn 7.95% net of investment and administrative expenses.

2. **Interest Credited to Member Contributions**

   3.00%, compounded annually.

3. **Salary Increase Rate**

   Wage inflation component 3.90%

   In addition, the following merit component is added based on an individual member's years of service:

Table B-1
Salary Merit Increases

Years of Service	Merit/ Longevity
0	5.75%
1	3.75
2	2.25
3	1.75
4	1.00
5+	0.25

4. **Family Composition**

   Percentage married is shown in the following Table B-2. Women are assumed to be three years younger than men.

Table B-2
Percentage Married

Gender	Percentage
Males	75%
Females	55%

5. **Rates of Withdrawal/Termination**

   Sample rates of withdrawal/termination are show in the following Table B-3.

Table B-3
Rates of Termination/Withdrawal

Age	Withdrawal	Vested Termination
20	11.00%	0.00%
25	7.00	3.00
30	5.00	3.00
35	2.50	2.75
40	1.50	2.00
45	1.25	2.00
50	1.25	1.50
55	1.00	0.00
60	1.00	0.00
65	0.00	0.00

* Withdrawal/termination rates do not apply once a member is eligible for retirement

30% of terminating employees are assumed to subsequently work for a reciprocal employer and receive 3.9% pay increases per year.

6. Rates of Disability

Sample disability rates of active participants are provided in Table B-4.

Table B-4
Rates of Disability at Selected Ages

Age	Disability
20	0.04%
25	0.06
30	0.07
35	0.09
40	0.15
45	0.25
50	0.40
55	0.50
60	1.00
65	2.00
70	0.00

50% of disabilities are assumed to be duty related, and 50% are assumed to be non-duty.

7. Rates of Mortality for Healthy Lives

Mortality rates for actives, retirees, beneficiaries, terminated vested and reciprocals are based on the sex distinct 1994 Group Annuity Mortality Tables setback three years for males and one year for females.

Table B-5
Rates of Mortality for Active and Retired Healthy Lives at Selected Ages

Age	Male	Female
20	0.043%	0.028%
25	0.056	0.029
30	0.073	0.033
35	0.084	0.045
40	0.089	0.065
45	0.125	0.092
50	0.190	0.131
55	0.321	0.208
60	0.558	0.386
65	1.015	0.762
70	1.803	1.271
75	2.848	2.038
80	4.517	3.536

8. Rates of Mortality for Retired Disabled Lives

Mortality rates for disabled retirees are based on the 1981 Disability Mortality Table.

Table B-6
Rates of Mortality for Disabled Lives at Selected Ages

Age	Male	Female
20	0.660%	0.660%
25	0.960	0.960
30	1.220	1.220
35	1.480	1.480
40	1.760	1.760
45	2.080	2.080
50	2.440	2.440
55	2.840	2.840
60	3.300	3.300
65	3.790	3.790
70	4.370	4.370
75	5.530	5.530
80	8.740	8.740

9. Rates of Retirement

Rates of retirement are based on age according to the following Table B-7.

Table B-7
Rates of Retirement by Age

Age	Retirement
50	0.00%
51	0.00
52	0.00
53	0.00
54	0.00
55	15.00
56	7.50
57	7.50
58	7.50
59	7.50
60	7.50
61	7.50
62	20.00
63	10.00
64	10.00
65	25.00
66	25.00
67	25.00
68	25.00
69	25.00
70 & over	100.00

The probability of retirement increased to 50% each year after completion of 30 years of service and attainment of age 50.