

**Office of the City Auditor**

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**Report to the City Council  
City of San José**

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# **MEASURING SAN JOSÉ'S FINANCIAL CONDITION**

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**Report 16-01  
February 2016**

February 11, 2016

Honorable Mayor and Members  
Of the City Council  
200 East Santa Clara Street  
San José, CA 95113

## **Measuring San José's Financial Condition**

The financial condition of the City of San José government impacts the services that residents receive. San José residents rely on the City's ability to stay functioning and provide libraries, police responses, safe roads, sewage treatment, and more. Without healthy finances, those services are at risk.

After nearly a decade of General Fund deficits, the City has seen a moderate increase in revenues from a stronger economy. However, over that decade the City was forced to reduce many City programs including a significant reduction in staff. San José now employs about 5.7 people per 1,000 residents—fewer than its 28-year average of 7.1 and fewer than many other large California cities. This had a significant impact on the services that the City can deliver. In addition, San José receives less tax revenue per capita than many of its neighboring cities, and faces an estimated \$1.1 billion in deferred maintenance and infrastructure backlog and a \$3.3 billion unfunded liability for pension and retiree health benefits.

There are many ways to evaluate a city's financial health. The City prepares numerous financial and budgetary reports every year, many of which are listed at the end of this report. In addition, there are rating agency analyses, as well as a number of different proposed measures of financial condition (such as from ICMA).

This report explores one perspective on how to measure San José's financial condition. It does not give a grade to San José's financial condition, but rather looks at ten different aspects of the City's finances to see how the City was doing as of the end of the 2014-15 fiscal year. This includes the City's trend over the previous five years and how the City compared to other large California jurisdictions.

This report is meant for San José government leaders, decision makers, residents, businesses, and taxpayers. It provides financial context for the impacts on services and maintenance that San José has seen over the last decade. It simplifies the detailed information contained in the City's Comprehensive Annual Financial Report (CAFR) and gives residents a sense of how San José is faring compared to its peers.

In 2014 and 2015, *Governing* magazine published a two-part *Guide to Financial Literacy*. Part one of the guide looks at budget basics, investments, taxes, and more, while part two aims to provide public leaders with knowledge that will enable them to better determine their jurisdiction's financial health. The measures presented here are from that guide.

For purposes of this report, we've grouped the ten measures around three central questions: Can the City pay its bills now? Can the City's revenues cover its expenses? And, can the City pay its bills in the future? The ten measures, explained in more detail on pages 9-21 of this report, show the following:

### **Can the City pay its bills now?**

- #1. Building up Reserves: The City's General Fund unassigned fund balance reserves increased slightly compared to revenue.
- #2. Ability to Pay Expenses: The City had more cash available in its General Fund than it did in prior years.

### **Can the City's revenues cover its expenses?**

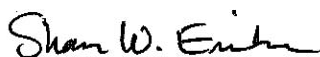
- #3. Change in Net Assets: The City's expenses for its governmental activities exceeded revenues.
- #4. Reliance on General Tax Dollars: A smaller portion of governmental activities required general tax dollar support.
- #5. Reliance on Grants and Aid: A smaller portion of the City's revenues were from grants and aid.

### **Can the City pay its bills in the future?**

- #6. Ability to Pay Obligations with Annual Revenues: Three years of revenue would be required to pay the City's obligations (this calculation includes the City's net pension liability, but does not include its obligation for retiree healthcare).
- #7. Amount Borrowed per Resident: The amount the City had borrowed in the form of bonds per resident decreased.
- #8. Ability of Governmental Funds to Make Bond Payments: The City was better able to make its bond payments from its governmental funds than it was five years ago.
- #9. Availability of Resources for Business-Type Activities to Make Bond Payments: Business-Type activities' ability to make their bond payments remained fairly constant.
- #10. Change in Value of Capital Assets: The value of the City's capital assets decreased over the last five years.

This is the first financial condition report produced by the Office of the City Auditor. It covers the City's 2010-11 through 2014-15 fiscal years, and includes comparisons to other California cities' CAFRs from fiscal year 2013-14. It includes no recommendations. We will present this report at the February 18, 2016 meeting of the Public Safety, Finance, and Strategic Support Committee. We would like to thank the Department of Finance, the City Attorney's Office, and the City Manager's Budget Office for their insight during preparation of this report.

Respectfully submitted,



Sharon W. Erickson  
City Auditor

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SE:lg

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This report is also available online at [www.sanjoseca.gov/audits](http://www.sanjoseca.gov/audits)

## Introduction

### What is financial condition?

Financial condition is the measure of how healthy a city's finances are at a particular point in time. A city is considered financially healthy if it can deliver the services its residents expect with the resources its residents provide, both now and in the future. A city that is financially healthy is prepared to respond to residents' needs as they change over time, while laying the groundwork for long-term projects that will impact services many years down the line. Additionally, a financially healthy city is prepared for unforeseen events that will impact its ability to deliver services to its residents.

This is similar to a person whose finances are in good shape. You want to meet your current needs—paying the mortgage, buying groceries, making car payments—while still planning for both short-term expenses (this summer's vacation) and long-term expenses (your retirement). Your needs might change over time as you have children or you begin to care for aging relatives. Additionally, you need to have a rainy day fund for when things happen unexpectedly, like if your car breaks down or you're out of work.

### How can you judge if a city has a good financial condition?

There is no single way to measure a government's financial condition. The most effective ways rely on looking at many different measures of a city's finances to create a picture of the overall financial condition. These measures of financial condition often use information from a city's audited financial statements, which includes revenues, expenditures, assets, and debts owed. The purpose of the measures is to alert government leaders and the public about the status of their city's finances.

The complexity of a city's financial condition is similar to your own. If you're trying to judge your own financial condition, you won't just look at your paycheck—you'll look at your retirement fund, your savings account, your mortgage and car payments, your credit card debt, and more.

In this report, we used ten measures that reflect different aspects of a city's finances. For these indicators, we show San José's data for the past five years as well as how San José compared to other large California cities.

### What happens if a city doesn't have a good financial condition?

Cities that have poor financial condition are not able to provide the services that residents want, either now or in the future. They're more susceptible to economic downturns—requiring cutbacks in services and maintenance—and they may have difficulty recovering from financial setbacks and economic downturns.

## Introduction

We've centered our discussion of financial condition on three basic questions and ten measures to evaluate financial condition. At the heart of each question is an evaluation of the City's ability to perform its key mission: providing services to residents of San José. All of the measures are calculated using data from San José's and other cities' audited financial statements.

### *Can the City pay its bills now?*

It's important that the City has enough cash and investments that can be quickly turned into cash to pay bills and respond to unexpected circumstances. If the City can't pay the bills, it has to cut services or cover costs with safety net reserves. Similarly, if you don't have enough money in your checking account to pay your rent, you may have to cut your other expenses to make ends meet.

### *Can the City's revenues cover its expenses?*

The City doesn't just need to pay bills now—it needs to make sure that the money it brings in regularly is enough to cover its annual expenses. If this doesn't happen, service levels won't be sustainable in the long term. In your finances, it's important that you can pay off your credit card today, but it's also important that your monthly income is enough to cover your mortgage, food, car payments, and other normal costs.

### *Can the City pay its bills in the future?*

The City will have bills in the future, and its current financial condition will influence its ability to pay them. For the long-term future, the City needs to make sure that its revenue sources are enough to cover long-term spending needs and provide services to a growing, changing population. For you, once you can pay your credit card debt today and your monthly income is enough to cover your costs, you have to think about costs you'll have in the future. You want enough cash to pay for your vacation next month, and you want to have plans in place for your retirement and your children's college funds.

Exploring these questions will provide you the context for understanding the level of service the City is able to provide its residents. To learn more about City services, read our [Annual Report on City Services](#).

### **The Governing Guide to Financial Literacy**

The *Governing Guide to Financial Literacy* is one of many resources that address the measurement and evaluation of a government's financial condition. The guide provides useful information about government finances as well as explanations of the type of measurement done in this report. For links to the guides, see the "Additional Resources and Information" section at the end of this report.

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## Introduction

### What makes up the City government?

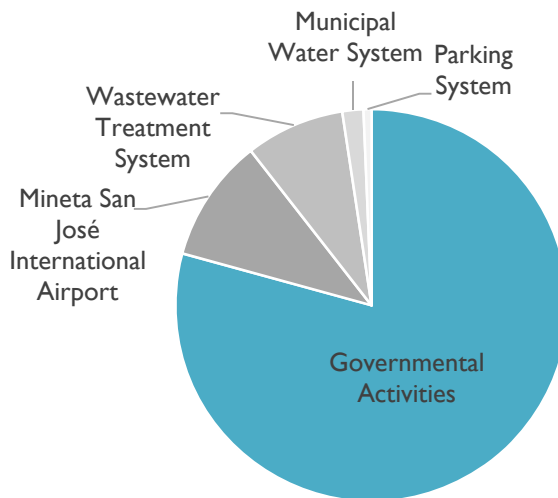
Most of what the City government does is considered to be a *governmental activity*, meaning that the programs and departments are funded by the public at large and can be used by everyone who lives in, works in, or travels to San José. Many of programs we think of as “government” fall into this category, such as police, fire, libraries, roads, parks, and code enforcement. Some of these activities are funded by fees. For example, in San José, you have to pay fees to get your garbage collected. These governmental activities are primarily funded through the City’s *General Fund* (the City’s primary, unrestricted operating fund).

However, many cities operate programs that don’t receive general tax revenue to support their operations. These are called *business-type activities*. For example, the Mineta San José International Airport is supported through fees from airlines and passengers and rent from concessionaires. These programs are paid for out of different funds (often called *enterprise funds* or *proprietary funds*) than what are used for governmental activities. That way, the City pays for business-type activity expenses with the revenue those activities generate.

As you can see below, most of the City’s expenses are considered within *governmental activities* (about \$1.54 billion out of the \$1.94 billion total in FY 2014-15). To measure San José’s financial condition, we looked at both the *governmental activities* and the *business-type activities*.

### City of San José Expenses (FY 2014-15)

*Governmental vs. Business-Type Activities*



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#### NOTES

Trust and Agency funds, including the Pension Trust Funds and the Successor Agency to the Redevelopment Agency, are not included in revenues.

**CAFR Source:** Government-wide Statement of Activities (For San José’s 2014-15 data, see CAFR page 23).

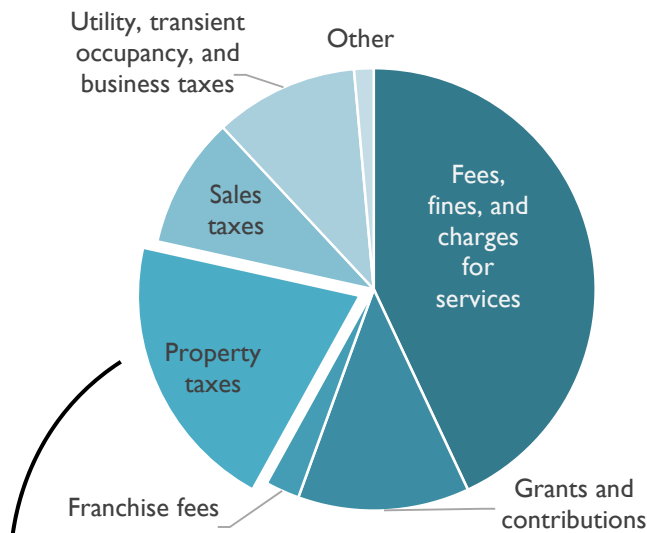
## Introduction

### Where does the City's money come from?

Cities generate revenue in different ways, and sources of revenue are unique to each individual City. Most California cities generate the majority of their revenue from taxes and fees for services. Some expenses are expected to be paid using tax dollars, such as police and fire services, while some programs generate revenue through fees or charges for service.

In fiscal year (FY) 2014-15, the City received **\$1.88 billion** in revenue from a variety of sources, as highlighted in the chart below. This includes revenue from activities like business permits and parking fines, as well as charges, including rent, for the use of Norman Y. Mineta San José International Airport and charges for the use of the regional Wastewater Treatment System.

#### City of San José Revenues (FY 2014-15)

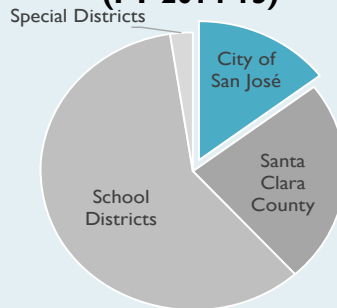


- About half of the fees, fines, and charges for services come from *business type activities*, primarily from the Mineta San José International Airport and the Wastewater Treatment System.
- Nearly three-quarters of the grants that the City received were for capital maintenance.
- Often, the City's revenues have restrictions on how they can be spent. For example, revenue generated by the Mineta San José International Airport must be spent on Airport operating and capital costs.

#### Who else gets your property taxes?

In 2014-15, property taxes made up only 20 percent of the City's revenues. That's partly because every \$100 of property taxes paid, the City of San José received less than \$15.

#### Property Tax Recipients (FY 2014-15)



#### NOTES

The City also doesn't receive 100 percent of the sales tax levied in Santa Clara County. The City receives less in tax revenue per capita than many other Santa Clara County cities. See: [Annual Report on City Services](#).

**CAFR Source:** Government-wide Statement of Activities and Statistical Section (For San José's 2014-15 data, see CAFR pages 23 and 225).

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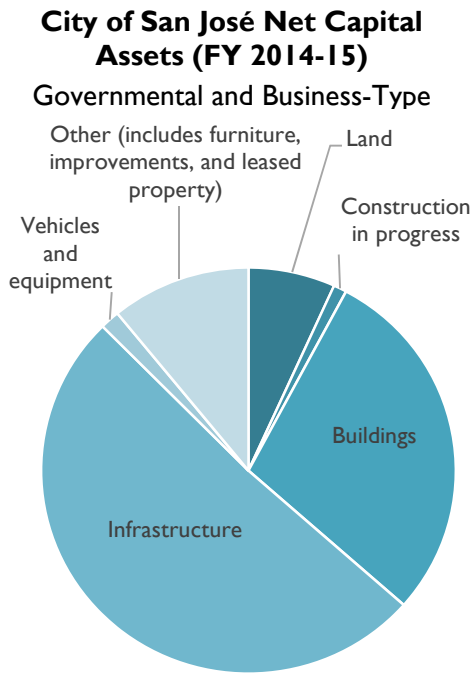
## Introduction

### What does the City government own?

The City of San José's annual budget for the fiscal year starting July 1, 2015 is **\$3.2 billion**. That includes both capital and operating budgets, and covers a large range of City services. The budget is the financial plan for how the City will keep running to provide services, pay obligations, and save for future expenses.

In addition to the money that runs the day-to-day operations, the City owns many tangible assets. With over 1 million residents and a footprint of nearly 200 square miles, San José has a wide variety of capital assets. Capital assets include land (such as parks), buildings (such as City Hall, libraries, and fire stations), vehicles (such as police cars and maintenance trucks), equipment, and infrastructure (such as roads, bridges, and sewers). Paying for and maintaining these assets play a critical role in the City's financial condition.

In FY 2014-15, the City's capital assets totaled **\$7.73 billion** (\$5.70 billion in governmental activities, \$2.03 billion in business-type activities). These are the *net capital assets*, which means that depreciation has been subtracted from their value. *Depreciation* accounts for the deterioration of capital assets and the eventual need to replace them. It is analogous to the decreasing value of a car each year. The amount by which the value decreases each year is the *depreciation expense*.



### Maintaining Capital Assets

Maintaining and improving the City's capital assets is an expensive endeavor, and one that often gets put on the back burner when a city faces financial setbacks. San José annually reports on how much money would be needed to fully address its deferred maintenance and infrastructure backlog. As of January 2016, the City estimated that the amount was \$1.1 billion, and that annual ongoing maintenance would total \$174 million.

Sixty-two percent of the \$1.1 billion needed to clear the backlog was for transportation infrastructure, which includes roads. An additional 25 percent was for building facilities, pools, parks, and open spaces. This figure did not include the costs for new projects and maintenance at the Regional Wastewater Facility, which totaled an estimated \$1.4 billion.

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### NOTES

Assets are valued at cost minus accumulated depreciation. Some assets may be fully depreciated. Trust and Agency funds, including the Pension Trust Funds and the Successor Agency to the Redevelopment Agency, are not included.

**CAFR Source:** Capital Assets Note Disclosure (For San José's 2014-15 data, see CAFR page 71).



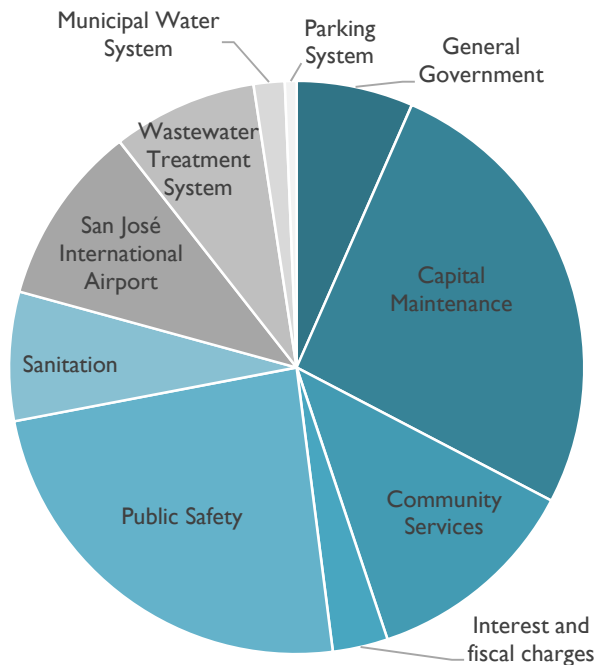
## Introduction

### Where does the City's money go?

The City has 20 departments and offices which offer numerous programs and services. The money that the City collects provides funding for police, fire, emergency medical services, an airport, a zoo, an animal shelter, parks, libraries, streets, sewers and wastewater treatment, garbage collection, stormwater protection, City facilities of all shapes and sizes, economic development, recreation programs, code enforcement, land-use planning, and a host of support services that make the extensive City operation work for its residents and businesses.

As previously noted, revenue sources are often restricted in how they can be spent. As a result, reducing expenses for one service does not necessarily mean that expenses can be increased for another service, because the revenue may not be transferable.

In FY 2014-15, the City expenses totaled **\$1.94 billion**, of which \$1.54 billion (79%) were from governmental activities. These expenses include depreciation expenses (described on the preceding page).



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#### NOTES

Trust and Agency funds, including the Pension Trust Funds and the Successor Agency to the Redevelopment Agency, are not included in expenses.

**CAFR Source:** Government-wide Statement of Activities (For San José's 2014-15 data, see CAFR page 23).

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## Introduction

### What does the City owe?

The City owes money in the form of short- and long-term obligations including debt.

Short-term obligations are due within the next year. This includes things like accrued wages that City employees have earned and *accounts payable* (money owed for supplies or for services rendered). These obligations totaled **\$278 million** as of June 30, 2015.

Long-term obligations are generally not due within the next year, but will need to be paid in the future. For example, the accrued vacation and sick leave that employees have earned but haven't taken is included as a long-term obligation. The purchase, construction, and renovation of City-owned facilities is usually financed using *debt* that the City has issued in the form of bonds. The payment of bond debt, called *debt service*, includes payment of principal and interest. As of June 30, 2015, the City owed \$2.6 billion in long-term debt (mostly in the form of bonds issued by the City or a related entity—see the box below), about half for governmental activities and about half for business-type activities. These long-term obligations, including debt, totaled **\$3.4 billion** as of June 30, 2015.

The City also has obligations for pensions and *other postemployment benefits* (OPEB), which includes healthcare for retired City employees. Beginning in 2014-15, the Governmental Accounting Standards Board (GASB) changed the rules for how governments calculate and present pension liabilities (requiring them to be included with other liabilities in the main financial statements). Similar rules for OPEB are to take effect for FY 2017-18. Until the new GASB rules take effect, OPEB liabilities are not included in calculations of long-term obligations in the main financial statements. As of June 30, 2014, independent actuaries determined the liabilities for pension plans and OPEB exceeded assets by **\$3.3 billion**.

### Who has to pay the City's debt?

Separate entities within the broad City organization are legally responsible for different parts of the City's debt. On the one hand, the City is not legally obligated to use the City's general revenues to pay the business-type obligations. On the other hand, the City's business-type revenues are restricted and may not be used to pay other debt obligations.

In 2011-12, the State of California dissolved cities' redevelopment agencies. San José's Redevelopment Agency debt and obligations transferred to the Successor Agency to the Redevelopment Agency. The liability for repayment of the Successor Agency's debt is limited to the redevelopment property tax revenue.

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### NOTES

The \$2.6 billion in long-term debt noted above includes some debt for which the City has limited obligation or is not legally liable. This includes City of San José Financing Authority lease revenue bonds; the City is responsible for making annual lease payments so long as there is beneficial use and occupancy of the leased facility. In addition to the \$2.6 billion noted above, the City manages, but is not liable for, long-term debt associated with the former Redevelopment Agency and conduit financing related to multi-family housing revenue bonds. In total, the City managed \$5.1 billion in debt.

**CAFR Source:** Summary of Long-Term Debt (For San José's 2014-15 data, see CAFR page 76).

### Introduction

The mission of the City Auditor's Office is to independently assess and report on City operations and services. The audit function is an essential element of San José's public accountability. Our reports provide the City Council, City management, and the general public with independent and objective information regarding the economy, efficiency, and effectiveness of City operations and services.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We limited our work to those areas specified in the "Audit Objective, Scope, and Methodology" section of this report.

#### Audit Objective, Scope, and Methodology

In accordance with the City Auditor's approved Fiscal Year 2015-16 Work Plan, we have completed the first annual report – Measuring San José's Financial Condition. The purpose of this report was to communicate the City's financial condition to the City Council and the public through graphics and standardized measures with benchmarking to other jurisdictions.

To measure the City of San José's financial condition, we:

- Collected data from the City of San José's Comprehensive Annual Financial Reports (CAFRs) from 2009-10 through 2014-15;
- Collected data from the 2013-14 CAFRs for the Cities of Los Angeles (population 3.96 million), San Diego (population 1.37 million), Fresno (population 520,000), Sacramento (population 480,000), Long Beach (population 473,000), and Oakland (population 411,000). These comprise all cities in California with a population over 400,000 except San Francisco, which is a city/county;
- Selected measures from *Governing Guide to Financial Literacy: Connecting Money, Policy and Priorities*<sup>1</sup> and *Governing Guide to Financial Literacy: Volume 2* by Justin Marlowe;<sup>2</sup>
- Reviewed a number of different methodologies for measuring financial condition, including: "The Ten-Point Test of Financial Condition" by Ken Brown,<sup>3</sup> "Revisiting Kenneth Brown's "10-Point Test" by Craig S. Maher and Karl Nollenberger,<sup>4</sup> and ICMA's *Evaluating Financial Condition: A Handbook for Local Government*.<sup>5</sup> We also reviewed financial condition reports from other jurisdictions, including Portland, OR and San Diego, CA. Following a review of available financial condition measures, we decided to use the ten measures presented in the *Governing Guide to Financial Literacy* cited above.

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<sup>1</sup> Marlowe, Justin. "Governing Guide to Financial Literacy: Connecting Money, Policy and Priorities." *Governing*, 2014. <http://www.governing.com/papers/A-Public-Official-s-Guide-to-Financial-Literacy.html>.

<sup>2</sup> Marlowe, Justin (primary author). "Governing Guide to Financial Literacy, Volume 2." *Governing*, 2015. [www.governing.com/papers/A-Guide-to-Managing-Your-Jurisdiction-s-Financial-Health-1500.html](http://www.governing.com/papers/A-Guide-to-Managing-Your-Jurisdiction-s-Financial-Health-1500.html).

<sup>3</sup> Brown, Ken W. "The Ten-Point Test of Financial Condition: Toward an Easy-to-Use Assessment for Smaller Cities." *Government Finance Review* (December 1993): 21-26.

<sup>4</sup> Maher, Craig S. and Karl Nollenberger. "Revisiting Kenneth Brown's "10-Point Test." *Government Finance Review* (October 2009): 61-66.

<sup>5</sup> Groves, Sanford M. and Maureen Godsey Valente. *Evaluating Financial Condition: A Handbook for Local Government*. Revised by Karl Nollenberger. ICMA, 2003.

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# Ten Measures of Financial Condition

## **Explanation of Financial Measures**

To understand the City of San José's financial condition, it's important to first understand how we are measuring financial condition. The next two pages will explain what each measure means. On the following pages, you will find each measure explained in more detail with the City's five-year trend and a comparison of 2013-14 data to other California cities.

## **Acknowledgments**

The measures included in this report, as well as explanations paraphrased in this introduction, were presented in the *Governing Guide to Financial Literacy* series: *Governing Guide to Financial Literacy: Connecting Money, Policy and Priorities*, 2014 and *Governing Guide to Financial Literacy, Volume 2*, 2015. To read volume 1, please visit: <http://www.governing.com/papers/A-Public-Official-s-Guide-to-Financial-Literacy.html>. To read volume 2, please visit: [www.governing.com/papers/A-Guide-to-Managing-Your-Jurisdiction-s-Financial-Health-1500.html](http://www.governing.com/papers/A-Guide-to-Managing-Your-Jurisdiction-s-Financial-Health-1500.html).

The *Governing Guide to Financial Literacy* framework is adapted from Dean Michael Mead (2005), "A Manageable System of Economic Condition Analysis for Local Governments" in *Public Financial Management*, edited by Howard A. Frank (New York: CRC Press).

## 10 Measures of Financial Condition

	Measure	Explanation	Formula
<b>Can the City pay its bills now?</b>	#1 Building up Reserves	If you're able to stash away a portion of your annual income into your rainy day fund, it's a good indicator that you're financially healthy. Similarly, if a city is able to set aside a portion of its annual revenues to increase its <i>fund balance</i> , it indicates good financial health. <i>For this measure, a <b>higher</b> ratio indicates better financial condition.</i>	Unassigned General Fund Balance / Total General Fund Revenues
	#2 Ability to Pay Expenses	You need to have cash on hand to pay the expenses that'll come due quickly, like your monthly credit card bill or your mortgage payment. For a city, this means having more cash (and investments that can be turned into cash quickly) than the obligations that it owes. This measures the City's <i>liquidity</i> . <i>For this measure, a <b>higher</b> ratio indicates better financial condition.</i>	Total General Fund Cash and Investments / (General Fund Liabilities – Unearned Revenue)
<b>Can the City's revenues cover its expenses?</b>	#3 Change in Net Assets	At the end of the year, you want to see that the money you made covered the expenses you incurred—and that you had a little extra money left over. A city wants the same thing: a growth in <i>net position</i> indicates that the city can pay its expenses with its revenues and is able to make a little extra. This net growth shows an improving financial condition. <i>For this measure, a <b>higher</b> ratio indicates better financial condition.</i>	Change in Governmental Activities Net Position / Governmental Activities Net Position
	#4 Reliance on General Tax Dollars	A city charges for some services that it offers to its residents with the expectation that some or all of its costs will be covered by the fees charged. Other services are covered by the taxes received by the city. This <i>operating margin</i> indicates the degree to which the City relies on taxes rather than fees for services or other revenues. <i>For this measure, a <b>lower</b> ratio indicates more independent financial condition.</i>	(Net Revenue or Expense for Governmental Activities / Total Governmental Activities Expenses) X -1
	#5 Reliance on Grants and Aid	When young adults are first starting out, some may get financial help from their parents to make ends meet. While this might help pay the bills in the short term, if someone needs a large amount of help to cover basic costs in the long term, their own finances may not be healthy. Similarly, if a city relies heavily on grants or aid from another government agency—like the county, state, or federal governments—it indicates that in the long term, the city may have a hard time paying for its services on its own. If something happens to that revenue source, it could have serious effects on services. <i>For this measure, a <b>lower</b> ratio indicates more independent financial condition.</i>	Total Primary Government Operating Grants and Contributions / Total Primary Government Revenues

	Measure	Explanation	Formula
Can the City pay its bills in the future?	#6 Ability to Pay Obligations with Annual Revenues	When you're trying to improve your finances, you might want to look into how much of what you owe can be paid off with one year of your income. A city can measure the same thing: a financially healthy city is able to pay a larger portion of its outstanding obligations with its annual revenue. <i>For this measure, a <b>lower</b> ratio indicates better financial condition.</i>	$\frac{\text{Primary Government Liabilities} - \text{Unearned Revenues}}{\text{Primary Government Revenues}}$
	#7 Amount Borrowed per Resident	If you owe \$10,000 in debt and you're the only wage earner in your family, you're going to have a harder time paying off that debt than if your spouse is also working. Having two wage earners might also mean that you'll have an easier time borrowing money if banks think you're in a better position to pay it off. Similarly, a city that has \$2,000 of debt for every taxpayer is in better financial shape than a city that has \$8,000 of debt for every taxpayer. Lower debts per capita result in a smaller debt burden on taxpayers and a greater capacity for the city to borrow money if it needs it. <i>For this measure, a <b>lower</b> ratio indicates better financial condition.</i>	$\frac{\text{Total Outstanding Debt for the Primary Government}}{\text{Population}}$
	#8 Ability of Governmental Funds to Make Bond Payments	If you look at your finances and see that half of what you spend every month is going to pay off debts, you might be worried about your ability to save money and spend it on what matters to you. A city has debts and interest on debts to pay as well, and the lower the amount of these payments compared to all the other expenses it has, the better its financial condition. <i>For this measure, a <b>lower</b> ratio indicates better financial condition.</i>	$\frac{\text{Debt Service}}{\text{Noncapital Governmental Funds Expenditure}}$
	#9 Availability of Resources for Business-Type Activities to Make Bond Payments	A small business owner wants to make sure that, beyond her personal financial condition, that her small business is able to pay its debts and interest with its revenues. A city operates business-like activities (or <i>enterprise activities</i> ), like a sewage treatment plant or an airport, that are paid for by fees and are kept separate from programs that taxpayers fund, like libraries and the police. To have good financial condition, a city needs to be able to pay long-term debt for government activities (measure number 8) but also pay the debt and interest for its business-type activities. <i>For this measure, a <b>higher</b> ratio indicates better financial condition.</i>	$\frac{\text{(Enterprise Funds Operating Revenue} + \text{Interest Expense)}}{\text{Interest Expense}}$
	#10 Change in Value of Capital Assets	When you own a car, the value of the car over time decreases as the car ages, needs repairs, and gets to the end of its useful life. At some point, you wouldn't get any money if you sold the car (so essentially, the car has no monetary value). A city owns buildings and equipment that depreciate in value this way. Beyond just the city hall, a city might own police stations, fire stations, libraries, recycling and sewage treatment plants, roads, and pipes. A city needs to make sure that as these <i>capital assets</i> age, it is renovating or replacing them. <i>For this measure, a <b>higher</b> ratio indicates better financial condition.</i>	$\frac{\text{(Ending Net Value of Primary Government Capital Assets} - \text{Beginning Net Value)}}{\text{Beginning Net Value}}$

## Can the City pay its bills now?

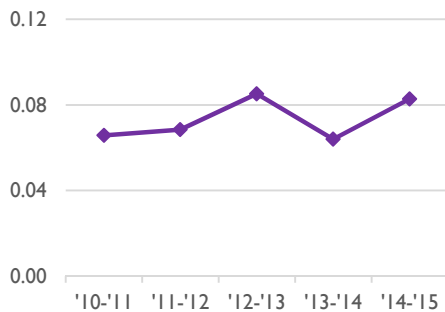
### #1 Building up Reserves

The City's General Fund unassigned fund balance reserves increased slightly compared to revenue.

The City has several different reserves set aside. Of these reserves, the *unassigned fund balance* has the fewest restrictions on how it can be used. Within the unassigned fund balance are the City's safety net reserves: money that's set aside to pay for services and salaries when revenues take a turn for the worse. Just like it is better if you're able to save a portion of your annual income, having the ability to set aside a larger portion of its annual revenues in fund balances indicates that a city has a better financial condition.

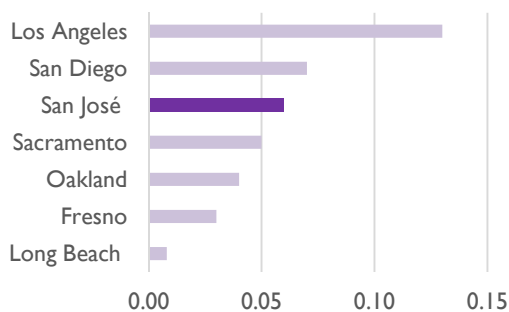
The graphs below compare the money in the *General Fund* unassigned fund balance to total General Fund revenues. A higher ratio means that there was more money saved as compared to the revenues that were brought in. *For this measure, a higher ratio indicates better financial condition.*

**City of San José Unassigned General Fund Balance Ratio**



- The General Fund unassigned fund balance ratio has remained relatively consistent over the past five years.

**Comparison of Unassigned General Fund Balance Ratios (FY 2013-14)**



- San José's General Fund unassigned fund balance ratio was comparable to other jurisdictions.

#### NOTES

- This measure focuses on General Fund unassigned fund balance. Unassigned fund balance includes contingency reserves and budget stabilization reserves (designed to buffer against financial shocks) and certain earmarked reserves (set aside for a purpose but potentially available in a catastrophic need). This measure shows short-run financial position.
- **Formula:** Unassigned General Fund Balance / Total General Fund Revenues
- **CAFR Source:** Governmental Funds Balance Sheet; Governmental funds Statement of Revenues, Expenditures, and Changes in Fund Balance (For San José's 2014-15 data, see CAFR pages 24 and 28).

## Can the City pay its bills now?

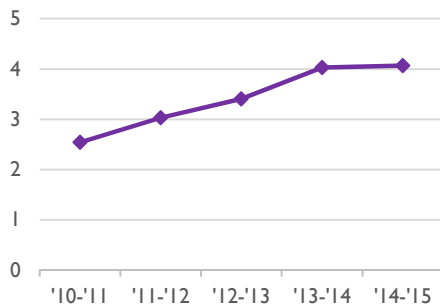
### #2 Ability to Pay Expenses

The City had more cash available in its General Fund than it did in prior years.

Cash and investments that can be quickly turned into cash enable the City to pay bills that will come due in the short term (within one year or sooner). Just like you want enough money in your bank account to pay your monthly credit card bill and mortgage payment, the City should have sufficient cash and liquid investments to cover the obligations that it must pay soon.

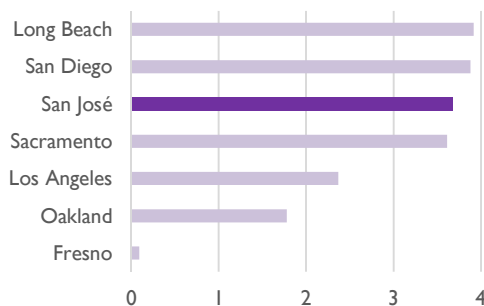
The graphs below show the amount of money that the City has in its Treasury in cash and investments compared to the amount of short-term obligations the City owes, all within the General Fund. A higher ratio shows a better ability to pay short-term obligations. *For this measure, a higher ratio indicates better financial condition.*

City of San José Liquidity Ratio



- The amount that the City had in its Treasury in cash and investments to cover its liabilities has been increasing over the last five years.
- This is a positive trend indicating the City is in a better position to pay obligations in the short term. As of June 30, 2015, the City's cash and investments were 4 times the amount that it owed within the next year.

Comparison of Liquidity Ratios (FY 2013-14)



- San José had an above average ratio of cash-to-liabilities compared to other cities surveyed. This means that San José was in a comparatively good position to pay short-term obligations with cash and investments compared to other cities.

#### NOTES

- This measure considers cash and investments held in the City Treasury in the General Fund, as compared to liabilities. It is important to note that measures of cash and investments are a snapshot as of a given date. As a result, information could change the following day as cash flows in and out in revenues and bills paid.
- **Formula:** Total General Fund Cash and Investments / (General Fund Liabilities – General Fund Unearned Revenue).
- **CAFR Source:** Governmental Funds Balance Sheet (For San José's 2014-15 data, see CAFR page 24).



## Can the City's revenues cover its expenses?

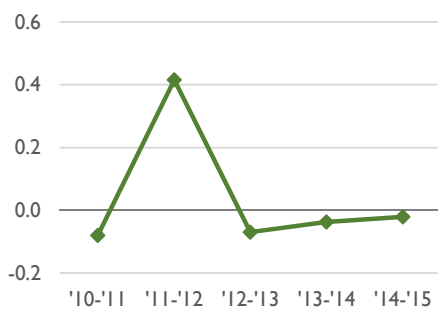
### #3 Change in Net Assets

The City's expenses for its governmental activities exceeded revenues.

Revenues from the City's programs ideally should cover the expenses that the City incurs for those programs—otherwise, the City will have to make ends meet by dipping into other savings, and it won't be able to save money for projects and safety net reserves. Similarly, if you're consistently finding that your income isn't enough to pay your bills and taxes, you might be taking a hard look at your own finances.

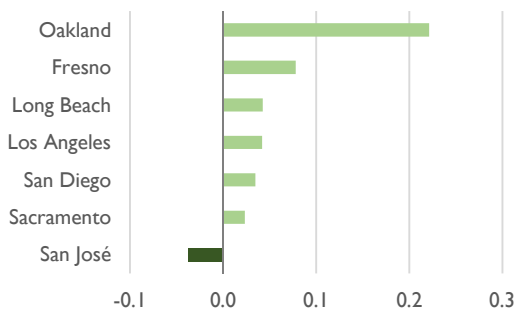
The graphs below show the change in the City's net position from the previous year to the current year. A higher ratio shows that the City had more revenues to cover expenses. The measure takes into account depreciation expense. *For this measure, a **higher** ratio indicates better financial condition.*

**City of San José Change in Net Position**



- The City's expenses (including depreciation on its capital assets) exceeded its revenues in FY 2014-15 by nearly \$80 million.
- The large spike in 2011-12 is due to a change in accounting for obligations following the dissolution of the Redevelopment Agency. As noted in the introduction, redevelopment agencies were dissolved by the State across California.

**Comparison of Growth in Net Position (FY 2013-14)**



- San José is the only city surveyed that had expenses exceed revenues (resulting in a decline in net position) in FY 2013-14.
- The two cities larger than San José, San Diego and Los Angeles, had net position growth below 5 percent in FY 2013-14.

**NOTES**

- This measure considers only governmental activities. Business type activities are not included. In FY 2013-14 Oakland received a transfer of excess tax allocation bond proceeds from the Oakland Redevelopment Successor Agency that accounted for half of its change in net position.
- **Formula:** Change in Governmental Activities Net Position / Governmental Activities Net Position
- **CAFR Source:** Government-wide Statement of Activities (For San José's 2014-15 data, see CAFR page 23).

## Can the City's revenues cover its expenses?

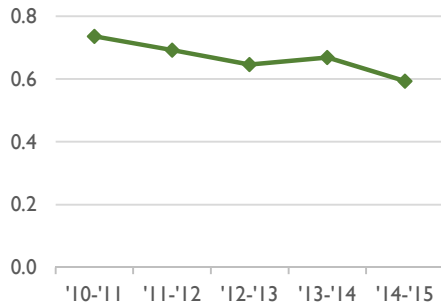
### #4 Reliance on General Tax Dollars

A smaller portion of governmental activities required general tax dollar support.

The City collects revenues from fees, charges, fines, and grants to support some of its programs. Some programs however, such as public safety, are typically funded by general tax dollars.

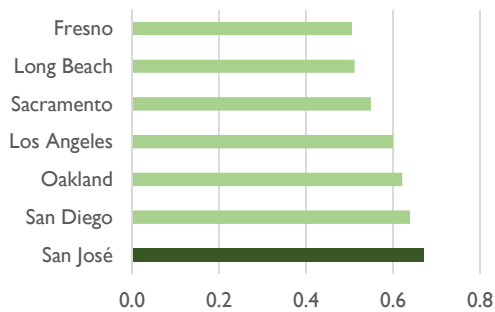
This measure shows the extent to which basic government services were supported by general tax dollars. A lower ratio indicates that the City's services were supported through service fees and required less general taxpayer support. For this measure, a **lower** ratio indicates more independent financial condition.

City of San José Operating Margin Ratio



- The decreasing trend indicates that the City's governmental activities were recovering more of their costs through fees, fines, grants, and charges. In 2014-15, 59 percent of services were supported by general tax dollars.
- Like the previous measure, the City's performance is impacted by depreciation as well as capital maintenance.

Comparison of Operating Margin Ratios (FY 2013-14)



- San José relied more heavily on general tax dollars than other jurisdictions in 2013-14.

#### NOTES

- This measure considers only governmental activities. Business type activities, such as the Mineta San José International Airport and the Wastewater Treatment System, are not included. In some cases, services may be funded through a specific tax, instead of a fee.
- **Formula:** (Net Revenue or Expense for Governmental Activities / Total Governmental Activities Expenses) X -1
- **CAFR Source:** Government-wide Statement of Activities (For San José's 2014-15 data, see page 23).

## Can the City's revenues cover its expenses?

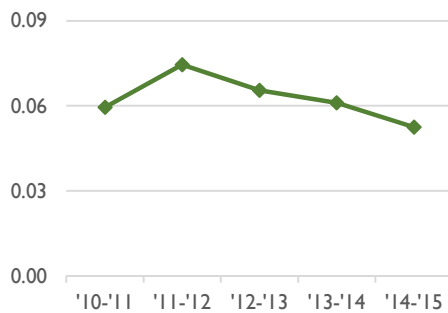
### #5 Reliance on Grants and Aid

A smaller portion of the City's revenues were from grants and aid.

The City receives grants and intergovernmental aid from other government agencies, such as the state and federal governments. While the City welcomes grants and aid to support City services, the less reliant the City is on money from those sources, the more independent the City's financial condition is. Similarly, receiving financial help from your parents when you're a young adult can be critical to making ends meet, but you're in better shape if you're able to pay for your own expenses in the long term.

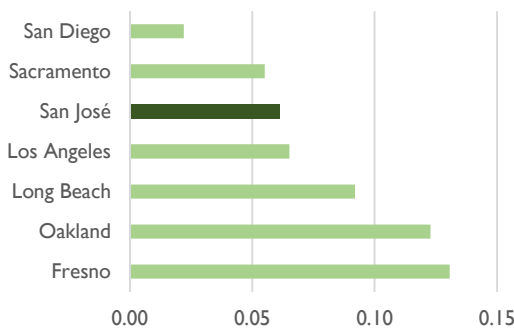
The graphs below compare the amount of money received through grants and aid to the total revenues received by the City. A lower ratio shows that the City had a larger portion of its revenues coming from its own sources, namely fees, charges, and taxes. For this measure, a **lower** ratio indicates more independent financial condition.

**City of San José Own Source Revenue Ratio**



- Following a rise in 2011-12, the portion of San José's revenues that came from grants and aid has decreased.
- In 2014-15, the ratio of grants and aid to total revenue hit a five-year low at 0.05. This means that in 2014-15, the City was less reliant on grants and aid than in any of the prior four years.

**Comparison of Own Source Revenue Ratios (FY 2013-14)**



- The portion of San José's revenues that came from grants and aid was comparable to other cities surveyed.

**NOTES**

- This measure shows primary government grants and revenue, which include governmental activities and business-type activities.
- **Formula:** Total Primary Government Operating Grants and Contributions / Total Primary Government Revenues
- **CAFR Source:** Government-wide Statement of Activities (For San José's 2014-15 data, see CAFR page 23).

## Can the City pay its bills in the future?

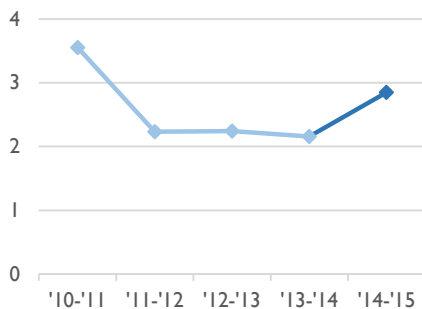
### #6 Ability to Pay Obligations with Annual Revenues

Three years of revenue would be required to pay the City's obligations.

A city the size of San José has both short-term and long-term obligations that must be paid in the future, such as accounts payable and notes payable. The fewer number of years of annual revenue needed to pay the City's obligations, the better the City's financial condition. Similarly, if you determine that you could pay all your debts with all of one year's salary instead of two, you would feel more financially secure.

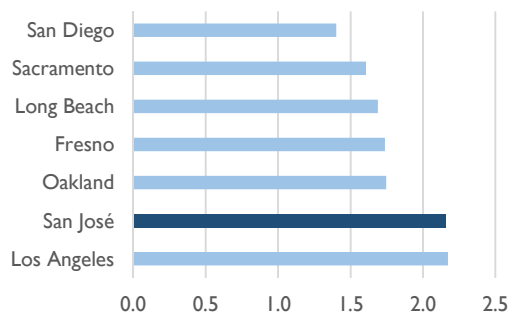
The graphs below compare the City's short-term and long-term obligations to the annual revenues received by the City. This includes all governmental and business-type activities. A lower ratio shows that the City was able to pay a larger portion of its debts with annual revenues. *For this measure, a **lower** ratio indicates better financial condition.*

**City of San José Near-Term Solvency Ratio**



- In 2014-15, the City began including its net pension liability, which totaled nearly \$1.7 billion, to the calculation of total liabilities. *For this reason, 2010-11 through 2013-14 is shown in a lighter color.*
- In 2011-12, following dissolution of the Redevelopment Agency, the Agency's obligations were removed from the City's main financial statements and transferred to the Successor Agency.

**Comparison of Near-Term Solvency Ratios (FY 2013-14)**



- San José had more liabilities compared to revenues than most other cities surveyed.
- *Because data presented was for 2013-14, net pension liabilities were not included in this comparison.*

#### NOTES

- Other Postemployment Benefits (OPEB) are not included. For details on OPEB, Redevelopment Agency dissolution, limitations on the liability for obligations, and restrictions on the use of revenue to pay debt, see the Introduction section.
- **Formula:** (Primary Government Liabilities - Unearned Revenues) / Primary Government Revenues
- **CAFR Source:** Government-wide Statement of Net Position and Statement of Activities (For San José's 2014-15 data, see CAFR pages 22 and 23).

## Can the City pay its bills in the future?

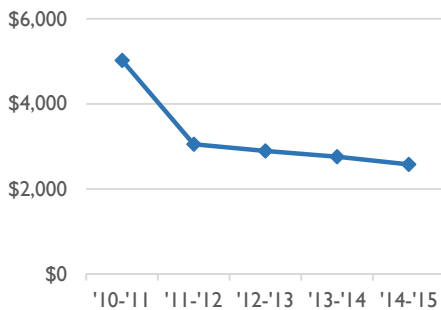
### #7 Amount Borrowed per Resident

The amount the City had borrowed in the form of bonds per resident decreased.

As explained in the Introduction, cities issue debt for a variety of reasons. Having a low amount borrowed per resident would put the City in a better position, and potentially make it easier to borrow more money should the need arise. Similarly, if you're working to pay off debts, it would be easier if you had multiple wage earners in your household to help shoulder the burden.

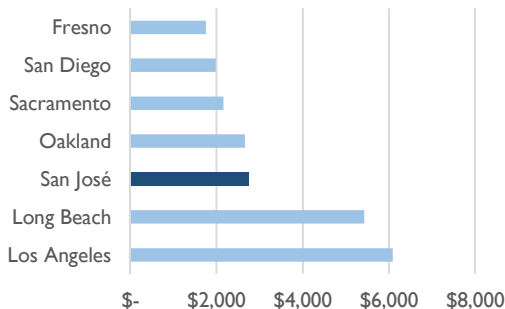
The graphs below show the amount of bonded debt the City holds per resident; the only debt shown here is in the form of bonds that the City (or a related entity) issued and must repay. As explained in the introduction, not all debt included here is legally obligated to be paid with the City's general revenues. *For this measure, a lower ratio indicates better financial condition.*

**City of San José Debt Burden per Resident**



- 2014-15 saw the lowest amount of bonded debt per resident than in the previous five years. The large drop in 2011-12 was partly due to the removal of the Redevelopment Agency debt from the City's main financial statements following its dissolution (and subsequent transfer of debt to the Successor Agency).

**Comparison of Debt Burden per Resident (FY 2013-14)**



- The City's single largest source of long-term debt in the form of bonds was related to capital improvements at Mineta San José Airport, for which the outstanding debt totaled \$1.4 billion as of June 30, 2015 (repaid by Airport revenues).
- San José's debt burden per resident was midrange of other cities surveyed. A city's debt is highly dependent on what range of services a city offers.
- The amount of the City of Los Angeles' debt per resident was more than 2 times that of San José.

#### NOTES

- This measure reflects all primary government bonded debt, which includes governmental and business-type activities. Population estimates are from the State of California, Department of Finance. Trust and Agency funds, including the Pension Trust Funds and the Successor Agency to the Redevelopment Agency, are not included.
- **Formula:** Total Outstanding Debt for the Primary Government / Population
- **CAFR Source:** Management Discussion and Analysis, Long-Term Debt and Other Obligations Note Disclosure and Statistical Section (For San José's 2014-15 data, see CAFR pages 18, 76, and 233).

## Can the City pay its bills in the future?

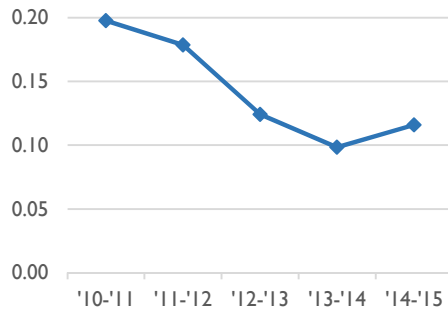
### #8 Ability of Governmental Funds to Make Bond Payments

The City was better able to make its bond payments from its governmental funds than it was five years ago.

If a large portion of the City's expenses go towards paying debt principal and interest, it shows that the City is less able to spend money on services and capital improvements. If you review your yearly spending and find that a large percentage of everything you spent was paying debt, it probably means you weren't saving as much as you might want, or spending the money in ways that could improve your quality of life.

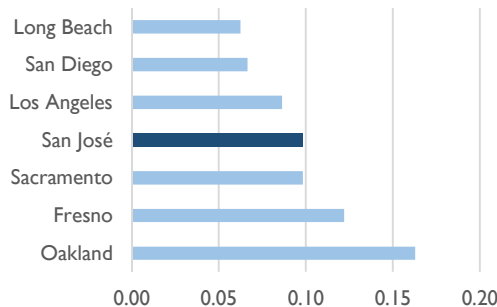
The graphs below compare the City's *debt service* (payments on debt principal and interest) to all its non-capital government expenditures. As with the previous graph, the only debt shown here is in the form of bonds that the City (or a related entity) issued and must repay. *For this measure, a lower ratio indicates better financial condition.*

**City of San José General Government Coverage Ratio**



- The decline from 2010-11 through 2013-14 indicated a positive trend.
- The amount of debt service paid in total, particularly the amount of debt principal paid, increased in 2014-15.

**Comparison of General Government Coverage Ratios (FY 2013-14)**



- San José's ratio was comparable to other cities surveyed. It was higher than the two cities larger than San José.

**NOTES**

- This measure includes all governmental funds, including but not limited to the General Fund. The calculation of expenditures excludes capital outlay costs.
- **Formula:** Debt Service / Noncapital Governmental Funds Expenditures
- **CAFR Source:** Statement of Revenues, Expenditures, and Changes in Fund Balances (Governmental Funds) and accompanying reconciliation to the Statement of Activities (For San José's 2014-15 data, see CAFR pages 28-30).

## Can the City pay its bills in the future?

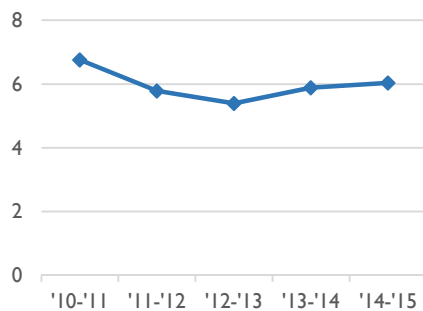
### #9 Availability of Resources for Business-Type Activities to Make Bond Payments

Business-Type activities' ability to make their bond payments remained fairly constant.

Just like the City's governmental services need to pay their debts (i.e., bonds) in the long term, the City's *business-type activities* need to do so as well. The City's business-type activities include the Mineta San José International Airport, the Wastewater Treatment System, the Municipal Water System, and the Parking System.

This measure compares the interest expense owed on debts annually to the ongoing, typical operating revenues from which that expense will be paid. This is similar to a small business owner making sure that the interest payments on the mortgage for her office aren't too large compared to the revenues she brings in each year. *For this measure, a higher ratio indicates better financial condition.*

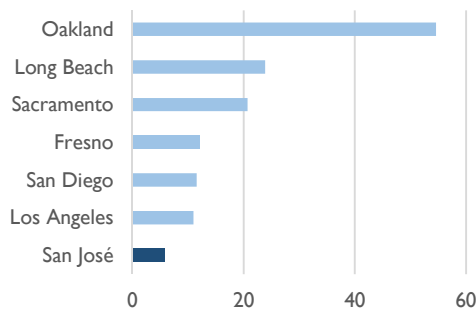
City of San José Enterprise Coverage Ratio



- The ratio of revenues to interest expense remained fairly constant over the past five years for the City's business-type activities, with a slight increase over the past two years. This is a positive trend.

- By far, the largest contributor to the interest expense is the Mineta San José International Airport. Of the \$74 million interest expense in 2014-15, \$72 million was the responsibility of the Airport.

Comparison of Enterprise Coverage Ratios (FY 2013-14)



- San José's business-type activities had a relatively small amount of revenue compared to the interest expense.

- *Cities may have different business-type activities, which influences their ratios.*

#### NOTES

- This measure groups all business-type revenues together. In reality, the bonds secured by specific revenue sources met the coverage ratios required under the applicable bond documents. Though Oakland has a high ratio, its business-type operating revenues and interest expense were much smaller than other jurisdictions.
- **Formula:** (Enterprise Funds Operating Revenue + Interest Expense) / Interest Expense
- **CAFR Source:** Proprietary Funds Statement of Revenues, Expenditures, and Changes in Net Position (For San José's 2014-15 data, see CAFR page 34).

## Can the City pay its bills in the future?

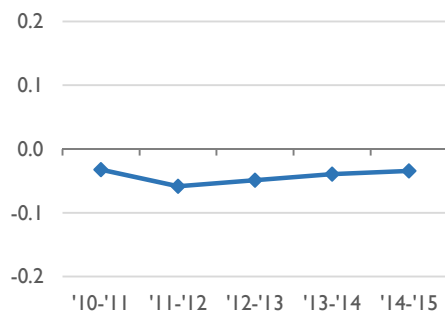
### #10 Change in Value of Capital Assets

The value of the City’s capital assets decreased over the last five years.

Capital assets, as described in the introduction to this report, include buildings, land, vehicles, and public infrastructure. Most of the City’s capital assets decrease in value over time because of depreciation, just like your car probably is worth less now than when you bought it. If the City doesn’t replace or renovate its capital assets, the value over time decreases.

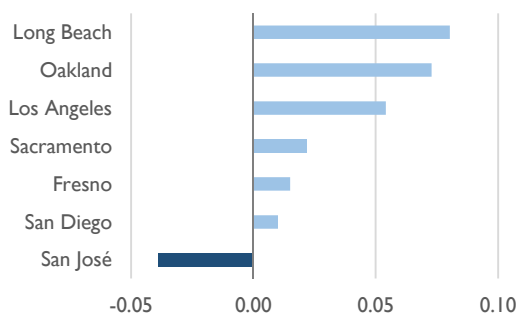
The graphs below show the difference in the value of capital assets at the end of the year, divided by the value at the beginning of the year. The negative ratio indicates that the City’s assets decreased in value—that is, the value at the end of the year was less than the value at the beginning of the year. This indicates that the depreciation of capital assets was greater than the value of capital assets added, and that some capital assets may need to be renovated or replaced. *For this measure, a **higher** ratio indicates better financial condition.*

**City of San José Capital Asset Value Ratio**



- Though the City’s ratio was increasing, the City’s capital assets still ended the year on June 30, 2015 with a book value of about \$270 million less than when the year started (about 3.4 percent below the value on July 1, 2014).

**Comparison of Capital Asset Value Ratio (FY 2013-14)**



- San José’ was the only city surveyed that had its capital assets decrease in value in 2013-14. That year, the City had \$119.2 million in net additions to capital assets and \$444.9 million in depreciation expense.

#### NOTES

- This measure represents the net value of all primary government capital assets, which includes those owned by governmental activities and business-type activities. Land, intangible assets, and construction in progress are not depreciated.
- **Formula:** (Ending Net Value of Primary Government Capital Assets - Beginning Net Value) / Beginning Net Value
- **CAFR Source:** Capital Assets Note Disclosure and Reconciliation of the Changes in Fund Balances for Governmental Funds to the Statement of Activities (For San José’s 2014-15 data, see CAFR page 71)



## Conclusion

This informational report provides one way to understand financial condition using ten measures proposed in the 2015 *Governing Guide to Financial Literacy*. As stated in that guide, financial health is more than a grade, it's about whether a local government has sufficient resources to deliver the services its residents expect. Knowing about financial condition is everyone's responsibility, but it's complicated to evaluate. The purpose of this report is to provide explanations of some measures of financial condition. It's part of an ongoing conversation about financial health and service delivery in the City. To learn more, see the resources listed on the following pages.

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## Additional Resources and Information

### Resources to Learn More about City Finances and Financial Condition

*Governing Guide to Financial Literacy: Connecting Money, Policy and Priorities*, 2014 by Justin Marlowe, published by Governing. [www.governing.com/papers/A-Public-Official-s-Guide-to-Financial-Literacy.html](http://www.governing.com/papers/A-Public-Official-s-Guide-to-Financial-Literacy.html).

*Governing Guide to Financial Literacy, Volume 2* by Justin Marlowe (primary author), published by Governing. [www.governing.com/papers/A-Guide-to-Managing-Your-Jurisdiction-s-Financial-Health-1500.html](http://www.governing.com/papers/A-Guide-to-Managing-Your-Jurisdiction-s-Financial-Health-1500.html).

*What You Should Know about Your Local Government's Finances: A Guide to Financial Statements* by Dean Michael Mead, published by Governmental Accounting Standards Board of the Financial Accounting Foundation.

### City of San José Reports for Additional Information

The City of San José prepares numerous financial and budgetary documents during the fiscal year.

The **Comprehensive Annual Financial Report (CAFR)** provides the City's audited financial statements, notes to those statements, the City Management's Discussion and Analysis of the financial information and trends, as well as other essential information. All measures included in this report were calculated using data from the City's CAFRs. To access the City's CAFRs, visit the [Finance Department's Report Homepage](#).<sup>6</sup>

The **Comprehensive Annual Debt Report** contains information such as recent debt issued by the City and the outstanding debt portfolio. The Annual Debt Report is a key document to better understand the City's debt, which is relevant for several measures presented in this report. To access the City's Annual Debt Reports, visit the [Finance Department's Report Homepage](#).<sup>7</sup>

The City's **Annual Adopted Operating Budget** details how the City will pay for services and operations. The City is required to produce a balanced budget, meaning that expenses need to equal revenues. The Adopted Operating Budget contains key information about the City's budgets and performance, broken down by broad areas of City service delivery and City departments. It also contains information about the sources and uses of operating funds. To access the latest Adopted Operating Budget, visit the [City Manager's Budget Office 2015-16 adopted budget homepage](#).<sup>8</sup>

The City Manager's Budget Office also prepares an **Annual Adopted Capital Budget** and a **Five Year Capital Improvement Program** to outline how the City will maintain and grow its capital assets. This document provides detailed information about the planned capital investments in the City's assets such as buildings, parks, and transportation infrastructure. To access the latest Adopted Capital Budget and Capital Improvement Program, visit the [City Manager's Budget Office 2015-16 adopted budget homepage](#).<sup>9</sup>

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<sup>6</sup> <http://www.sanjoseca.gov/index.aspx?NID=759>

<sup>7</sup> <http://www.sanjoseca.gov/index.aspx?NID=759>

<sup>8</sup> <http://www.sanjoseca.gov/index.aspx?nid=4628>

<sup>9</sup> <http://www.sanjoseca.gov/index.aspx?nid=4628>

## Measuring San José's Financial Condition

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The **Annual Report** provides unaudited information on the financial status of the City at the end of each fiscal year. The focus of the Annual Report is a comparison of actual revenue collections and expenditures to projections and appropriations included in the budget. This report also provides information about each City fund, including the status of the year-end reserve levels. To access the latest annual report, visit the [City Manager's Budget Office 2014-15 Annual Report homepage](#).<sup>10</sup>

The **Five Year Forecast** includes projected revenues and expenditures for the General Fund and revenue projections for the Capital Improvement Program. To access the latest Five Year Forecast for years 2016-2020, visit the [City Manager's Budget Office Five Year Forecast homepage](#).<sup>11</sup>

The **Fees and Charges Report** documents the majority of the fees and charges within the General Fund and selected fees within other funds. Some fees for enterprise activities, such as the Airport, are not included as they are approved separately. To access the latest Fees and Charges report, visit the [City Manager's Budget Office Adopted Fees and Charges homepage](#).<sup>12</sup>

The City prepares an annual **Status Report of Deferred Maintenance and Infrastructure Backlog** that analyzes the unfunded infrastructure and ongoing maintenance needs of 15 programs within the City. To read the 2016 report, see the [City's memo to the Transportation and Environment Committee](#).<sup>13</sup>

This office prepares an annual report on the services provided by the City. It includes background information on the City's staffing and budget, and covers every City department. To read the FY 2014-15 report, see the [City Auditor's Annual Report on City Services homepage](#).<sup>14</sup>

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<sup>10</sup> <http://www.sanjoseca.gov/index.aspx?nid=4649>

<sup>11</sup> <http://www.sanjoseca.gov/DocumentCenter/View/40697>

<sup>12</sup> <https://www.sanjoseca.gov/index.aspx?NID=2723>

<sup>13</sup> [http://sanjose.granicus.com/MetaViewer.php?meta\\_id=556388](http://sanjose.granicus.com/MetaViewer.php?meta_id=556388)

<sup>14</sup> <http://www.sanjoseca.gov/index.aspx?NID=321>