**SAN JOSE CLEAN ENERGY**
(An Enterprise Fund of the City of San José)

Independent Auditor's Report,
Financial Statements, and Required
Supplementary Information
For the Year Ended June 30, 2020

**SAN JOSE CLEAN ENERGY**
(An Enterprise Fund of the City of San José)
For the Year Ended June 30, 2020

***Table of Contents***

***Page***

**Independent Auditor's Report** ..... 1

**Financial Statements:**

Statement of Net Position ..... 3

Statement of Revenues, Expenses and Change in Fund Net Position ..... 4

Statement of Cash Flows ..... 5

Notes to Financial Statements ..... 6

**Required Supplementary Information (Unaudited)**

Schedule of the Proportionate Share of the Net Pension Liability ..... 39

Schedule of Employer Contributions – Defined Benefit Pension Plan ..... 39

Schedule of the Proportionate Share of the Net OPEB Asset ..... 41

Schedule of Employer Contributions – Postemployment Healthcare Plan ..... 41

Certified Public Accountants

# Independent Auditor's Report

Honorable City Council
San José Clean Energy
San José, California

## Report on the Financial Statements

We have audited the accompanying financial statements of the San José Clean Energy (SJCE), an enterprise fund of the City of San José, California (City), as of and for the year ended June 30, 2020, and the related notes to the financial statements, which collectively comprise SJCE's basic financial statements as listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

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

### *Auditor's Responsibility*

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

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

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

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the SJCE, as of June 30, 2020, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Emphasis of a Matter***

*Basis of Presentation*

As discussed in Note 1 to the financial statements, the financial statements of SJCE are intended to present the financial position, the changes in financial position and cash flows of only that portion of the business-type activities and major fund of the City that is attributable to the transactions of SJCE. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2020, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

***Other Matters***

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the schedule of the proportionate share of the net pension liability, the schedule of employer contributions – defined benefit pension plan, the schedule of the proportionate share of the net OPEB liability, and the schedule of employer contributions – postemployment healthcare plan identified as Required Supplementary Information in the accompanying table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated June 2, 2021 on our consideration of SJCE's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SCJE's internal control over financial reporting and compliance.

Macias Gini & O'Connell LLP

Walnut Creek, California
June 2, 2021

**SAN JOSE CLEAN ENERGY**
(An Enterprise Fund of the City of San José)
Statement of Net Position
June 30, 2020
($000's)

| | | |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Equity in pooled cash and investments held in City Treasury | $ | 28,802 |
| Receivables (net of allowance for uncollectibles) | | 50,698 |
| Total unrestricted current assets | | 79,500 |
| Restricted assets: | | |
| Equity in pooled cash and investments held in City Treasury | | 20,000 |
| Total current assets | | 99,500 |
| Noncurrent assets: | | |
| Net other postemployment benefits (OPEB) asset | | 715 |
| Total assets | | 100,215 |
| **DEFERRED OUTFLOWS OF RESOURCES** | | |
| Pension related items | | 2,069 |
| OPEB related items | | 234 |
| Total deferred outflows of resources | | 2,303 |
| **LIABILITIES** | | |
| Current liabilities: | | |
| Accounts payable | | 42,853 |
| Accrued salaries, wages, and payroll taxes | | 237 |
| Accrued vacation, sick leave and compensatory time | | 316 |
| Estimated liability for self-insurance | | 7,907 |
| Advances and deposits payable | | 858 |
| Notes payable | | 10,000 |
| Total current liabilities | | 62,171 |
| Noncurrent liabilities: | | |
| Net pension liability | | 1,156 |
| Total liabilities | | 63,327 |
| **DEFERRED INFLOWS OF RESOURCES** | | |
| Pension related items | | 78 |
| OPEB related items | | 153 |
| Total deferred inflows of resources | | 231 |
| **NET POSITION** | | |
| Restricted for debt service | | 20,000 |
| Unrestricted | | 18,960 |
| Total net position | $ | 38,960 |

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

**SAN JOSE CLEAN ENERGY**
(An Enterprise Fund of the City of San José)
Statement of Revenues, Expenses, and Changes in Fund Net Position
For the Year Ended June 30, 2020
($000's)

| | | |
|---|---|---|
| **OPERATING REVENUES** | | |
| Power sales | $ | 336,951 |
| **OPERATING EXPENSES** | | |
| Operations and maintenance | | 6,904 |
| Contract services | | 1,402 |
| Power purchases | | 285,073 |
| General and administrative | | 1,792 |
| Staff compensation | | 4,899 |
| Materials and supplies | | 32 |
| Total operating expenses | | 300,102 |
| Operating income | | 36,849 |
| **NONOPERATING REVENUES (EXPENSES)** | | |
| Investment income | | 1,014 |
| Interest expense | | (1,013) |
| Net nonoperating revenues (expenses) | | 1 |
| Income before transfers | | 36,850 |
| Transfers out | | (767) |
| Change in net position | | 36,083 |
| Total net position - beginning | | 2,877 |
| Net position - ending | $ | 38,960 |

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

**SAN JOSE CLEAN ENERGY**
(An Enterprise Fund of the City of San José)
Statement of Cash Flows
For the Year Ended June 30, 2020
($000's)

| | | |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Receipts from customers and users | $ | 328,538 |
| Payments to suppliers | | (285,404) |
| Payments to employees | | (4,847) |
| Net cash provided by operating activities | | 38,287 |
| **CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES** | | |
| Transfer to other funds | | (767) |
| Net cash used in noncapital financing activities | | (767) |
| **CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES** | | |
| Interest paid on debt | | (1,013) |
| Net cash used in capital financing activities | | (1,013) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Interest received | | 1,014 |
| Net cash provided by investing activities | | 1,014 |
| Net change in cash and cash equivalents | | 37,521 |
| Cash and cash equivalents - beginning | | 11,281 |
| Cash and cash equivalents - ending | $ | 48,802 |
| **Reconciliation of operating income to net cash provided by operating activities:** | | |
| Operating income | **$** | 36,849 |
| Increase in: | | |
| Accounts receivable | | (8,414) |
| Increase (decrease) in: | | |
| Accounts payable | | 7,826 |
| Accrued salaries, wages, and payroll taxes | | 67 |
| Accrued vacation, sick leave and compensatory time | | 190 |
| Estimated liability for self-insurance | | 1,117 |
| Net pension liability, deferred outflows/inflows of resources related to pension | | (32) |
| Net OPEB asset, deferred outflows/inflows of resources related to OPEB | | (174) |
| Advances and deposits payable | | 858 |
| Total changes | | 1,438 |
| Net cash provided by operating activities | $ | 38,287 |
| **Reconciliation of cash and cash equivalents to the statement of net position:** | | |
| Equity in pooled cash and investments held in City Treasury : | | |
| Unrestricted | $ | 28,802 |
| Restricted | | 20,000 |
| | $ | 48,802 |

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

## NOTE 1 – DESCRIPTION OF OPERATIONS

*Overview*

On May 16, 2017, the City of San José ("City") Council approved the establishment of San José Clean Energy ("SJCE"), a Community Choice Aggregation program with the goals of providing City residents and businesses with a choice of electricity providers while progressing towards meeting greenhouse gas emissions reduction goals. Under State law, the City may establish a Community Choice Aggregation ("CCA") program to purchase electricity on behalf of its residents and businesses. CCAs determine the source of electricity offered, set customer rates for energy, retain revenue, and determine spending priorities locally. The incumbent Investor Owned Utility ("IOU"), which is Pacific Gas and Electric ("PG&E") in the City, continues to charge customers to maintain the transmission and distribution infrastructure, deliver the energy, and bill customers. For these continued services, PG&E charges CCA customers the same delivery rates as PG&E customers and these charges are incorporated into the total CCA electric rates to its customers. PG&E also acts as the billing agent for SJCE, including SJCE charges as part of a single monthly customer bill. Customers make payment to PG&E, and PG&E remits the SJCE portion of payments to SJCE each business day.

CCAs provide many community benefits, including significant environmental and economic benefits. CCAs provide choice in electricity options with often a higher mix of renewable energy in their base power products than is available from the incumbent utility, at competitive rates. CCAs also allow local governmental entities to have more direct control over rates. As part of its approval to establish SJCE, the City Council directed staff to develop SJCE as a stand-alone enterprise fund to be operated by a new department to mitigate risk to the City's General Fund.

*Governance*

SJCE is governed by the City Council, which oversees operations and procurement, approves rates and provides policy direction to the City Manager, who is responsible for managing SJCE operations and ensuring program alignment with the policies established by the City Council. At its August 15, 2017 meeting, the City Council adopted an ordinance amending Title 2 of the San José Municipal Code to add the Community Energy Department to the City organizational structure to serve as the administrator of SJCE. The Director of Community Energy has overall responsibility for managing the day-to-day operations of SJCE and reports to the City Manager.

On October 24, 2017, the City Council adopted an ordinance to establish the Clean Energy Community Advisory Commission ("CECAC"). The CECAC is a public advisory committee that provides input on SJCE policies and programs, rate setting, and community outreach efforts. The CECAC provides advice to the Mayor and City Council, City Manager, and Director of Community Energy about all aspects of SJCE operations. Comprised of community members with a wide range of professional and technical disciplines, the CECAC is a forum that allows SJCE to outreach to the community. The CECAC reflects a CCA best practice, as effective public oversight helps to ensure the program is responsive to community needs, which in turn helps to minimize customer opt-outs. The CECAC convenes quarterly and meetings are open to the public.

On May 1, 2018, the City Council adopted the Energy Risk Management Policy and along with it, the creation of the Risk Oversight Committee ("ROC"). The ROC is a staff committee that serves as the highest level of organizational risk management and is responsible for overseeing compliance with risk management policies within SJCE. The ROC consists of seven voting members: The City Manager or his

## NOTE 1 – DESCRIPTION OF OPERATIONS (CONTINUED)

or her designee, the Director of Community Energy, the Director of Finance, the City Risk Manager, the Budget Director, the Community Energy Department Deputy Director of Power Resources, and the Community Energy Department Division Manager of Risk Management, Contracts and Administrative Services. The City Attorney provides legal advice to the ROC. The ROC convenes at least quarterly, or more frequently as needed, and is charged with managing and controlling risks associated with SJCE operations.

*Operations*

SJCE began providing electric generation service to City facilities in September 2018 in Phase I, the first of three phases. Phase II launch (residential and large commercial accounts) began in February 2019; and Phase III launch (small commercial customers) began in June 2019. As of June 30, 2020, SJCE serves over 325,000 customer accounts in the City with clean electricity at generation rates lower than those of PG&E while maintaining a low opt-out rate. An opt-out rate reflects the percent of customer accounts that choose to decline CCA service. As of June 30, 2020, SJCE maintains an opt-out rate below 2%. As the default energy provider for residents and business, SJCE provides the City with the ability to choose the source of energy and set the generation retail rates for power used in the City.

To meet SJCE customer demands for renewable energy, SJCE procures energy from power generators or electric service providers and, to balance the City's supply with real-time demand, purchases and sells power on the California Independent System Operator ("CAISO") day-ahead and spot markets. PG&E still provides the transmission and distribution of electricity to SJCE customers, sets rates for those services, and handles the monthly billing process.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### *(a) Basis of Presentation and Accounting*

The financial statements are prepared in accordance with generally accepted accounting principles ("GAAP"). The Governmental Accounting Standards Board ("GASB") is responsible for establishing GAAP for state and local governments through its pronouncements. SJCE operations are accounted for as a governmental enterprise fund and are reported using the economic resources measurement focus and the accrual basis of accounting – similar to business enterprises. Accordingly, revenues are recognized when they are earned, and expenses are recognized when liabilities are incurred. Enterprise fund-type operating statements present increases (revenues) and decreases (expenses) in total net position.

### *(b) Use of Estimates*

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

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### *(c) Equity in Pooled Cash and Investments Held in City Treasury*

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

Pooled cash and investments in the City Treasury are considered to be cash and cash equivalents for purposes of the accompanying statement of cash flows. Pooled cash and investments represent deposits and investments held in the City's cash management pool. This cash management pool possesses the characteristics of a demand deposit account; therefore, investments in this pool are considered to be cash equivalents. The SJCE also considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

### *(d) Accounts Receivable*

Accounts receivable reflects invoices issued by PG&E on behalf of SJCE to SJCE customers during the reporting period but not yet paid and electricity estimated to have been delivered but not yet billed net of an allowance for uncollectible accounts. As the billing agent for SJCE, PG&E collects payments from SJCE customers and remits the electricity generation portion of those payments to the City. PG&E undertakes activities to collect on delinquent SJCE balances until fifty-one (51) days after the final bill is sent to customer (i.e., after customer account is closed), at which time any outstanding SJCE balance is transferred to SJCE.

### *(e) Defined Benefit Plans*

1. Pension

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pension, and pension expense, information about the fiduciary net position of the SJCE's participation in the Federated City Employees' Retirement System ("FCERS") and additions to/deductions from the FCERS' fiduciary net position have been determined on the same basis as they are reported by the FCERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms. FCERS' investments are reported at fair value. While the City reports its pension plan managed by FCERS as a single employer defined benefit pension plan, SJCE recognizes a proportionate share of its participation in FCERS based on the SJCE pension contributions relative to the total City pension contributions to FCERS. For more information regarding SJCE retirement benefits, please refer to Note 9 and the Required Supplementary Information (RSI) section.

2. Other Postemployment Benefits

For purpose of measuring the net Other Postemployment Benefits ("OPEB") liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the SJCE's participation in the FCERS and additions

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

to/deductions from the FCERS' fiduciary net position have been determined on the same basis as they are reported by the FCERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms. FCERS investments are reported at fair value. While the City reports its OPEB plan managed by FCERS as a single employer defined benefit OPEB plan, SJCE recognizes a proportionate share of its participation in the FCERS OPEB plan based on the SJCE OPEB contributions relative to the total City OPEB contributions to FCERS. For more information regarding SJCE OPEB benefits, please refer to Note 10 and the RSI section.

### *(f)* Net Position

Net position is classified in the following three components:

*Net Investment in Capital Assets* groups all capital assets into one component of net position. Accumulated depreciation reduces the balance in this category. SJCE did not have any capital assets or capital-related borrowings as of June 30, 2020.

*Restricted Net Position* consists of the constraints placed on net asset use by external creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

*Unrestricted Net Position* consists of the remaining balance of net position not subject to the aforementioned categorizations.

When both restricted and unrestricted resources are available for use, it is SJCE policy to use unrestricted resources first and then restricted resources, as needed.

### *(g) Operating Revenues and Expenses*

Enterprise funds distinguish operating revenues and expenses from nonoperating items. SJCE defines its operating revenues as charges for electric sales, which are earned when electricity is provided to customers. Operating expenses are mainly incurred through the purchase of energy and other power resources and also include the cost of services and administrative expenses. All revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

### *(h) Revenue Recognition*

SJCE recognizes revenue on the accrual basis of accounting. This includes invoices issued by PG&E to customers on behalf of SJCE during the reporting period, and electricity estimated to have been delivered but not yet invoiced. Management estimates that a portion of the billed amounts will be uncollectible. An allowance for doubtful accounts has been assumed to reflect the amount of SJCE receivables that SJCE estimates will be uncollectible. This allowance ensures SJCE receivables are not overstated and that outstanding balances deemed uncollectible are accurately recorded in the correct period for financial reporting purposes. Efforts are made to pursue the timely collection of delinquent accounts.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### *(i) Significant Agreements with Outside Parties*

SJCE maintains several significant professional services agreements with the following outside parties:

- *Calpine Energy Solutions, LLC ("Calpine")*: Provides data management and security, reporting functions, management of a customer information system and call center, billing administration, and coordination with PG&E on behalf of SJCE. On February 27, 2018, City Council approved the original Professional Services Agreement for Data Management and Customer Call Center Services with Calpine for a period of two years from the date of execution in an amount not to exceed $5,783,800, and up to two (2) one-year agreement extension options, each for an additional $4,950,000 for a total contract amount not to exceed $15,683,800. On February 11, 2020, the Professional Services Agreement with Calpine was amended, reducing rates and modifying service terms and increasing the maximum compensation to $22,000,000 through February 28, 2025.

- *Northern California Power Authority ("NCPA")*: Provides wholesale energy services to support SJCE operations. These services include power supply scheduling, portfolio management, and optimization services. On March 27, 2018, City Council approved the original Professional Services Agreement for Wholesale Energy Services with NCPA for a period of two years and five months from the date of execution in an amount not to exceed $1,400,000 and up to two (2) one-year agreement extension options, for a total contract amount not to exceed $2,725,000.

- *PG&E*: The services that PG&E provides SJCE, including customer switching, meter reading, and billing services, are delineated in PG&E Electric Schedule E-CCA. The recurring monthly charges are $0.35 per customer meter per month, or approximately $1,365,000 for SJCE with 325,000 customer accounts.

## NOTE 3 – EQUITY IN POOLED CASH AND INVESTMENTS HELD IN CITY TREASURY

SJCE's cash as of June 30, 2020 is classified in the financial statements as follows (in thousands):

| | | |
|---|---|---|
| Unrestricted Equity in pooled cash and investments held in City Treasury: | $ | 28,802 |
| Restricted Equity in pooled cash and investments held in City Treasury: | | 20,000 |
| Total: | $ | 48,802 |

### *(a) Nature of Cash Account*

SJCE maintains all of its funds as cash deposits in the City pooled cash and investments held in the City Treasury. The pool is managed by the City Treasurer, and SJCE has an equity share in the pool as reflected in the Enterprise fund's accounting records. Funds from the operating account are used to disburse funds for operations and capital outlays, under the direction of SJCE. The receipts account is in the name of the City and is under the custodianship of the City. All revenues collected by SJCE are deposited into the operating account as received.

A restricted cash account with a balance of $20.0 million is maintained to comply with the terms of a financial services agreement entered into with Barclays Bank PLC (please refer to Note 8).

### *(b) Pooled Cash and Investments*

The City Council adopted an investment policy ("Investment Policy") on April 2, 1985 related to the City cash and investment pool, which is subject to annual review and was reviewed and amended on March 9, 2021. The Investment Policy specifically prohibits trading securities for the sole purpose of speculating or taking an un-hedged position on the future direction of interest rates. Per the Investment Policy, the investments conform to Sections 53600 et seq. of the California Government Code and the applicable limitations contained within the Investment Policy.

SJCE invests funds subject to the Investment Policy. According to the Investment Policy, SJCE is permitted to invest in the City cash and investment pool, the State of California Local Agency Investment Fund ("LAIF"), obligations of the U.S. Treasury or U.S. Government Agencies, time deposits, investment agreements, money market mutual funds invested in U.S. Government securities, along with various other permitted investments.

SJCE maintains all of its cash in the City's cash and investment pool. As of June 30, 2020, SJCE's share of the City cash and investment pool totaled $48,802,000. It is not possible to disclose relevant information about SJCE's separate portion of the cash and investment pool, as there are no specific investments belonging to SJCE itself. Information regarding the characteristics of the entire investment pool can be found in the City's June 30, 2020 Comprehensive Annual Financial Report. A copy of that report may be obtained by visiting the City's website at www.sanjoseca.gov or by contacting the City's Finance Department, 200 East Santa Clara Street, 13th Floor, San José, CA, 95113.

Interest Rate Risk – Interest rate risk is the risk that changes in market rates will adversely affect the fair value of an investment. Generally, debt investments with fixed coupons for longer periods are subject to more variability in their value as a result of changing interest rates. The City manages its exposure to interest rate risk by capping the average weighted maturity of the investment

## NOTE 3 – EQUITY IN POOLED CASH AND INVESTMENTS HELD IN CITY TREASURY (CONTINUED)

portfolio at two years. Also, the City sets the maximum maturity for every investment at the time of purchase by asset class, with the longest not to exceed five years.

In practice, the City purchases a combination of shorter-term and longer-term investments and times the cash flows to meet liquidity needs for operations. The average maturity of the City's pooled cash and investments at June 30, 2020, was approximately 672 days.

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

Concentration of Credit Risk – It is not possible to disclose relevant information about SJCE's separate portion of the cash and investment pool, as there are no specific investments in the City's cash and investment pool belonging to SJCE itself. The Investment Policy sets forth the policies regarding concentration of credit risk.

As of June 30, 2020, the City's pooled investments in the City Treasury have investments that represent 5% or more of the total pooled investments in the following:

| | |
|---|---|
| Federal Home Loan Mortgage Corporation | 12.85% |
| Federal National Mortgage Association | 9.19% |
| International Bank for Reconstruction and Development | 5.97% |
| Federal Home Loan Banks | 5.76% |
| Federal Farm Credit Banks | 5.13% |
| Federal Agricultural Mortgage Corporation | 5.01% |

Foreign Currency Risk – The risk that changes in exchange rates will adversely affect the fair value of an investment. As of June 30, 2020, the City's Policy does not permit investments in the pool to hold foreign currency; as such the investments in the City's investment pool were not subject to foreign currency risk.

## NOTE 4 – CAPITAL ASSETS

There are no capital assets in SJCE as of June 30, 2020.

## NOTE 5 – ACCOUNTS RECEIVABLE

The accounts receivable balance at June 30, 2020 was $50.7 million and is net of an allowance for estimated uncollectible amounts. Management estimated the uncollectible amounts to be $3.2 million at June 30, 2020, using its allowance calculation methodology based on comparable industry standards.

## NOTE 6 – ACCOUNTS PAYABLE

Accounts payable essentially represent the unpaid bills. These are bills for goods and services received by the organization prior to the end of its fiscal year. The SJCE accrual of $42.9 million was primarily due to electrical power purchased and received from outside parties but not paid as of June 30, 2020.

## NOTE 7 – NOTES PAYABLE TO THE CITY OF SAN JOSÉ FINANCING AUTHORITY

The City of San José Financing Authority ("CSJFA"), through its commercial paper ("CP") program, provided a $10.0 million advance of funds to SJCE to fund start-up costs. However, SJCE does not rely on contributions from other City funds to support ongoing operations. Funds for ongoing operations are provided by the sale of electricity to SJCE customers. As of June 30, 2020, $10.0 million of Notes Payable was outstanding at an interest rate of 0.28%. As disclosed in Note 13(c), the SJCE subsequently paid off the $10.0 million notes payable.

## NOTE 8 – CLEAN ENERGY REVOLVING CREDIT AGREEMENT (Long-term Direct Borrowings)

On September 25, 2018, the City Council authorized the City Manager, the Director of Finance, the Assistant Director of Finance or their authorized designees to negotiate, execute, and deliver a Revolving Credit Agreement ("Credit Agreement") by and between the City and Barclays Bank PLC ("Bank"), and a promissory note ("Note"), evidencing the City's obligations thereunder in the aggregate principal amount not to exceed $50.0 million for the purpose of the financing start-up costs of the SJCE program, purchase power and, in the case of standby letters of credit, secure payments under power purchase agreements and other costs associated with the Community Energy Implementation Plan. There are no amounts outstanding under this Credit Agreement at June 30, 2020. The Note qualifies as a "Direct Borrowing" under GASB Statement No. 88.

Effective on November 27, 2018, the Bank and the City entered into the Credit Agreement providing a credit facility in the form of a commitment by the Bank to (i) issue revolving loans to the City under the Revolving Line of Credit Facility in an aggregate principal amount not to exceed $20.0 million ("Revolving Line of Credit Facility Sublimit") for the period commencing November 27, 2018 and ending no later than November 26, 2021, with all outstanding revolving loans thereunder due and payable to the Bank on November 27, 2021, and (ii) issue standby letters of credit for the account of the City under the Standby Letter of Credit Facility in an aggregate principal amount not to exceed $35.0 million ("Standby Letter of Credit Facility Sublimit") for the period commencing November 27, 2018 and ending no later than October 28, 2023, with all unrepaid draws under such letters of credit due and payable to the Bank on November 27, 2023; provided, however, that the aggregate principal amount outstanding under the Revolving Line of Credit Facility and the Standby Letter of Credit Facility shall not to exceed $50.0 million at any one time ("Aggregate Commitment"). The City's obligations under the Credit Agreement are secured solely by a pledge and lien on revenues of SJCE, including revenues deposited in an operating reserve account held by the City pursuant to the Credit Agreement.

On April 30, 2019, the City Council authorized the City Manager, the Director of Finance, the Assistant Director of Finance or their authorized designees to negotiate, execute and deliver the First Amendment to the Revolving Credit Agreement with the Bank to increase the sublimit for the Revolving Line of Credit Facility thereunder from an aggregate principal amount not to exceed $20.0 million to $30.0 million, increase the sublimit for the Standby Letter of Credit Facility thereunder from an aggregate principal

**NOTE 8 – CLEAN ENERGY REVOLVING CREDIT AGREEMENT (Long-term Direct Borrowings) (CONTINUED)**

amount not to exceed $35.0 million to $65.0 million, increase the Aggregate Commitment to issue revolving loans and standby letters of credit from an aggregate principal amount not to exceed $50.0 million to $80.0 million outstanding at any one time, and increase certain fees payable by the City to the Bank in connection with the credit facilities under the Credit Agreement and to clarify that the City is allowed to draw on the revolving line of credit to fund the operating reserve account as discussed herein. Effective May 10, 2019, the Bank and the City entered into the First Amendment to the Revolving Credit Agreement to issue revolving loans and standby letters of credit for the purposes and within the limits mentioned above. The City's obligations under the First Amendment to the Revolving Credit Agreement continue to be secured solely by a pledge and lien on revenues of SJCE, including revenues deposited in an operating reserve account held by the City pursuant to the Credit Agreement.

Unchanged by the terms of the First Amendment to the Revolving Credit Agreement, the City agreed, among other things, that, so long as the Bank has any commitment thereunder or any amount payable thereunder remains unpaid from and including: (a) August 31, 2019, to but excluding November 15, 2019, to maintain not less than $10.0 million in an operating reserve account held by the City established pursuant to and identified under the Credit Agreement ( "Operating Reserve Account") at all times during such period; (b) November 15, 2019, to but excluding December 31, 2019, to maintain not less than $15.0 million in the Operating Reserve Account at all times during such period; and (c) December 31, 2019 and thereafter, to maintain at all times $20.0 million in the Operating Reserve Account (collectively, "Operating Reserve Requirement"). The City met the operating reserve requirement in August, November, and December 2019 by transferring funds when required. On December 31, 2019, the operating reserve had $20.0 million in the operating reserve account. The City has complied with the terms of the Revolving Credit Agreement by maintaining $20.0 million in the Operating Reserve commencing December 31, 2019.

Events of default under the Credit Agreement include, among others: (i) default under any of the underlying Financing Documents (as defined in the Credit Agreement), (ii) non-payment, (iii) breach of various covenants, (iv) bankruptcy, (v) breach of representations and warranties (vi) failure to maintain the required debt service coverage ratio (which, commencing with the fiscal quarter ended March 31, 2020, and as of the last day of each fiscal quarter thereafter, shall be not less than 2.00 to 1), (vii) failure to maintain the required amounts in the Operating Reserve Account, as discussed above, (viii) the long-term, unenhanced ratings by any of the Rating Agencies on any general-obligation bonded indebtedness of the City is withdrawn or suspended (but excluding withdrawals or suspensions if the Rating Agency stipulates in writing that the rating action is being taken for non-credit related reasons) or reduced below "A1" (or its equivalent) by Moody's, "A+" (or its equivalent) by S&P, or "A+" (or its equivalent) by Fitch; (ix) the dissolution or termination of SJCE, (x) one or more final, unappealable judgments or orders for the payment of money in excess of certain threshold amounts (i.e., $2.0 million through December 30, 2019, and $5.0 million thereafter) where such judgment or order remains unsatisfied and unstayed for a period of 60 days and which is payable from revenues of SJCE, (xi) PG&E defaults in the performance of its agreement with the City for billing services related to charges for the cost of energy provided by SJCE, (xii) any event of default under any Other Credit Agreement (as defined in the Credit Agreement) secured by revenues of SJCE, (xiii) a Material Adverse Effect (as defined in the Credit Agreement) occurs with respect to SJCE or the City's ability to repay its obligations under the Credit Agreement; (xiv) failure to pay when due any principal of or interest on any Debt (as defined in the Credit Agreement) secured by revenues of SJCE, (xv) failure to pay when due any amount owing under any power purchase agreement, unless the City disputes payment in good faith, or (xvi) if Debt secured by revenues of SJCE has been accelerated or required to be prepaid prior to its maturity.

**NOTE 8 – CLEAN ENERGY REVOLVING CREDIT AGREEMENT (Long-term Direct Borrowings) (CONTINUED)**

When an event of default occurs, the Bank may exercise all of its rights and remedies available to it under the Credit Agreement and as otherwise permitted by law. The Bank's rights and remedies include, among others, taking one or more of the following actions: (i) declare the commitment and the obligation of the Bank to make Credit Extensions to be terminated, (ii) by written notice to City, declare the outstanding amount of the obligations of the City under the Credit Agreement to be immediately due and payable, (iii) require the City to cash collateralize 105% of the letter of credit obligations (broadly defined to include the amounts available to be drawn under any letters of credit plus any amounts drawn by beneficiaries under such letters of credit but which are not reimbursed by the City as required under the Credit Agreement ("Unreimbursed Amounts") as applicable, (iv) and at the expense of the City, cure any event of default; provided, however that the Bank shall have no obligation to effect such a cure. Upon the occurrence and during the continuance of an event of default under the Credit Agreement, any outstanding loan amounts or Unreimbursed Amounts will accrue interest at the Default Rate as defined in the Credit Agreement. Certain other per annum rates payable by the City under the Credit Agreement also increase upon the occurrence and during the continuance of an event of default. In the case of bankruptcy where the City obtains an entry of order for relief under the Bankruptcy Code, the obligation of the Bank to make Credit Extensions shall automatically terminate and all unpaid principal amounts of all outstanding loans and Unreimbursed Amounts and all interest and other amounts payable to the Bank by the City shall automatically become due and payable, and City shall be required to cash collateralize 105% of the aggregate amount available to be drawn under all outstanding Letters of Credit plus the aggregate of all Unreimbursed Amounts, without further action by the Bank.

The Credit Agreement is made up of a line of credit and standby letter of credit structure and the following rates apply. The commitment fee rate for the credit facility is 1.00%. The line of credit interest rate is based on the LIBOR rate, which is LIBOR plus 2.90% (applicable spread). The standby letter of credit issuance rate is 1.95% and the draw rate is LIBOR plus 2.90%. If an event of default occurs, the rates are increased by an additional 4.00% until the event of default is resolved.

**NOTE 9 – DEFINED BENEFIT RETIREMENT PLAN**

***(a) General Information***

The City sponsors and administers a single employer defined benefit retirement system, FCERS, which with the exception of certain unrepresented employees covers all full-time and certain part-time employees of the City. The FCERS provides general retirement benefits under a single employer Defined Benefit Pension Plan, as well as the Postemployment Healthcare Plan Unrepresented executive management and professional employees who are hired directly into a position in the City's unrepresented executive management unit (Unit 99) and who are first hired on or after January 20, 2013, have a one-time irrevocable election to either participate in a defined contribution plan 401(a) plan that excludes participation in retiree healthcare or become a Tier 2 member in the FCERS; to be eligible, an employee must not have previously been a member of the FCERS. All full-time and certain part-time employees in the Community Energy Department participate in the FCERS.

The FCERS is administered by the Chief Executive Officer of the Office of Retirement Services, an employee of the City, who serves at the pleasure of the Board of Administration for the FCERS.

**NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)**

The separately issued annual report of FCERS, together with various chapters in Title 3 of the City Municipal Code, provides more detailed information about the FCERS, and may be obtained from the City of San José Office of Retirement Services, 1737 North First Street, Suite 600, San José, California 95112 or at http://www.sjretirement.com. The SCJE presents the related defined benefit disclosures of FCERS as a participant in a cost-sharing arrangement with the City.

***(b) Benefits Provided***

FCERS provides general retirement benefits including pension. death, and disability benefits to members. FCERS benefits are based on average final compensation, years of service, and cost of living increases as specified by the City Municipal Code. The contribution and benefit provisions and all other requirements are established by the City Charter and the City Municipal Code.

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

On December 15, 2015 and January 12, 2016, the City and the bargaining units representing employees in the FCERS reached a settlement agreement on the Federated Alternative Pension Reform Settlement Framework ("Federated Framework"). The terms of the Federated Framework also applied to unrepresented employees, including unrepresented management and executive employees in Unit 99. The Federated Framework includes among other things, revised Tier 2 pension benefits that include increased pension benefits for Tier 2 employees while preserving the 50/50 cost sharing between the City and Tier 2 employees; closing the defined benefit retiree healthcare benefit to new employees, as well as agreement on a new lowest cost medical plan associated with retiree healthcare; allowing Tier 1 and some Tier 2 employees to opt out of the applicable Postemployment Healthcare Plan to a Voluntary Employee Benefit Association ("VEBA") for retiree healthcare subject to legal and Internal Revenue Service approval (which has since been received); allowing Tier 1 employees who terminated employment with the City and

[1] SRBR was a reserve that represented funds permitted by status to be set aside from the Retirement Fund's net investment earnings to provide supplemental benefits to eligible retirees and beneficiaries.

**NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)**

either subsequently returned or who return in the future to return as Tier 1 employees; and either subsequently returned or who return in the future to return as Tier 1 employees; and continuing the elimination of the SRBR. The Federated Framework also included an agreement that a ballot measure would be placed on the November 8, 2016 election for the voters to replace Measure B. On November 8, 2016, the voters approved the Alternative Pension Reform Act known as Measure F. Measure F included, among other things, prohibiting any enhancements to defined retirement benefits without voter approval, codifying the Tier 2 pension benefit, closing the defined benefit retiree healthcare plan, and prohibiting retroactive defined retirement benefit enhancements.

The specific terms of FCERS are set forth in the City Municipal Code. FCERS has different benefit Tiers. Prior to June 18, 2017, FCERS had Tier 1, Tier 2, Tier 2B, and Tier 2C. Tier 2, Tier 2B, and Tier 2C had the same reduced pension benefits as compared to Tier 1. Tier 2 had the same retiree healthcare (medical and dental) benefits as Tier 1. Tier 2B originally consisted of employees who were newly hired or rehired on or after September 27, 2013 and were not eligible for the defined benefit; however, the City was responsible for the contributions that both the City and the Tier 2B members would have otherwise paid for retiree healthcare had those employees been eligible. Tier 2C had retiree dental benefits but no retiree medical benefits.

Tier 2C included employees who were previously Tier 1 members that separated from City service and returned on or after September 30, 2012, but before June 18, 2017. The Federated Framework provided that all previous Tier 1 employees who were placed in Tier 2 would be classified as Tier 1. As a result, employees in Tier 2C have subsequently been moved to Tier 1.

Subsequent ordinances amending the City Municipal Code implementing the terms of Measure F and the Federated Framework have since been adopted by the City Council and the changes described below became effective on June 18, 2017, which was the commencement date of the first pay period of FY 18. As implementation issues arise, minor modifications are being made to the provisions of FCERS in the City Municipal Code to address these issues.

## NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)

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

**FCERS Membership Tiers**

| Tier | Hire Date | Pension | Defined Benefit Retiree Healthcare (Medical/Dental) |
|---|---|---|---|
| **Tier 1** | • On or before September 29, 2012<br>• Former Tier 1 rehired on or after June 18, 2017 who did not take a return of contributions | Tier 1 | Medical/Dental[2][4] |
| **Tier 1 Rehire** | • Former Tier 1 rehired on or after September 30, 2012 through June 17, 2017 | Tier 1[1] | Medical/Dental[2][4][5] |
| **Tier 1 Classic** | • "Classic" membership with California Public Employees' Retirement System ("CalPERS")/reciprocal agency hired on or after September 30, 2012, but before September 27, 2013 | Tier 1[6] | Medical/Dental |
| | • "Classic" membership with CalPERS/reciprocal agency hired on or after September 27, 2013 | Tier 1[6] | Not Eligible[3][4] |
| **Tier 2 (or Tier 2A)** | • Hired/rehired/reinstated on or after September 30, 2012, but before September 27, 2013 | Tier 2 | Medical/Dental[2][4] |
| **Tier 2B** | • Hired/rehired/reinstated after September 27, 2013 and have not met City's eligibility for retiree healthcare | Tier 2 | Not Eligible[3][4] |

[1] Employees in these tiers are responsible for 50% of the amortization costs for having any prior years of service in Tier 2 changed to Tier 1.

[2] Employees in these tiers were provided a one-time irrevocable election to remain in the Federated Healthcare Plan or opt into the Federated VEBA. Employees that opted into the Federated VEBA are not eligible for Federated Healthcare Plan. The Federated VEBA was implemented on March 25, 2018.

[3] Employees in these tiers were mandatorily placed into the Federated VEBA.

[4] Unrepresented employees were eligible to opt into the Federated VEBA but are not eligible to make ongoing contributions to the Federated VEBA.

[5] All Tier 1 rehires formerly in Tier 2B and Tier 2C who opted to remain in the Federated Healthcare Plan began contributing to the Federated Healthcare Plan on March 25, 2018.

[6] Employees in these tiers are responsible for 50% of the amortization costs for any prior years of service in Tier 2 changed to Tier 1 for all employees in the "Classic" tier regardless of start date.

## NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)

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

| | FCERS | | | |
|---|---|---|---|---|
| | **Tier 1 [1]** | **Tier 1 Classic [2]** | **Tier 2A [3]** | **Tier 2B [4]** |
| *Pension* | | | | |
| Service required to leave contributions in retirement system | 5 years | | 5 years Federated City Service (Year of Service = 2080 hours worked in the applicable 12-month period) | |
| **Service Retirement:** | | | | |
| Age/Years of Service | 55 with 5 years service<br>30 years service at any age | | 62 years with 5 years Federated City Service<br>May retire on or after 55 years with 5 years Federated City Service. A reduction factor of 5% per year for each year between age 55 and the Tier 2 member's age at retirement before age 62, prorated to the closest month. | |
| "Deferred Vested" retirement | 55 with 5 years service<br>(This applies to members who separate from City service before retirement and leave their contributions in the retirement system.) | | May commence on or after 55 years with 5 years Federated City Service with actuarial equivalent reduction (This applies to members who separate from City service before retirement and leave their contributions in the retirement system.)<br>Can begin at age 55 with reduction factor of 5% per year for each year between age 55 and the Tier 2 member's age at retirement before age 62, prorated to the closest month. | |
| Allowance | 2.5% x Years of Service x Final Compensation (75.0% max)<br>Final Compensation is the highest average monthly earnable pensionable salary during 12 consecutive months, capped at 108% of the second highest 12 comsecutive months.<br><br>If separation takes place prior to July 1, 2001, Final Compensation is highest average monthly salary during 36 consecutive months<br><br>If separation takes place on or after July 1, 2001, Final Compensation is highest average monthly salary during 12 consecutive months | | 2.0% x Years of Federated City Service x Final Compensation (70.0% max)<br><br>"Final Compensation" is the average monthly (or biweekly) base pay for the highest 3 consecutive Years of Federated City Service<br><br>Excludes premium pay or any other forms of additional compensation | |
| ***Disability Retirement (Service Connected)*** | | | | |
| Minimum Service | None | | None | |
| Allowance | 40% of Final Compensation plus 2.5% x Years of Service in excess of 16 years x Final Compensation (Maximum 75% of Final Compensation) | | 2% x Years of Federated City Service x Final Compensation (Minimum of 40.0% and maximum of 70.0% of Final Compensation) | |

## NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)

| | FCERS (continued) | | | |
|---|---|---|---|---|
| | **Tier 1 (1)** | **Tier 1 Classic (2)** | **Tier 2A (3)** | **Tier 2B (4)** |
| ***Disability Retirement (Non-Service Connected)*** | | | | |
| Minimum Service | 5 years | | 5 years | |
| Allowance | 20% of Final Compensation for up to 6 years of service.<br>Add 2% for each year of service in excess of 6 years but less than 16 years.<br>Add 2.5% for each year of service in excess of 16 years of services.<br>(Maximum 75% of Final Compensation)<br><br>For those who entered the Retirement System on 8/31/98 or before, the calculation is as follows:<br>40% of Final Compensation plus 2.5% x Years of Service in excess of 16 years x Final Compensation<br>(Maximum 75% of Final Compensation)<br>If under 55 years old, subtract 0.5% for every year under age 55 | | 2% x Years of Federated City Service x Final Compensation.<br>(Minimum of 20% and maximum of 70.0% of Final Compensation) | |
| ***Reciprocity*** | | | | |
| Reciprocity | As of December 9, 1994, the City of San José Federated City Employees' Retirement System adopted a reciprocal agreement with CalPERS. This may result in improved benefits for members who transfer between this retirement system and CalPERS or certain other public agency retirement systems that also have reciprocal agreements with CalPERS. Final eligibility for reciprocity is determined at the time of retirement. | | | |
| ***Cost-of-Living Adjustments (COLA)*** | | | | |
| Cost-of-Living adjustments | Retirees are eligible for a 3% annual cost-of-living adjustment (COLA). Regular COLAs are compounded and paid each April. There is no prorating of COLA. | | Retirees are eligible for annual cost-of-living adjustment (COLA) limited to the lesser of the increase in the Consumer Price Index (San José-San Francisco-Oakland, U.S. Bureau of Labor Statistics index, CPI-U, December to December), or a back loaded 2.0% COLA per fiscal year. The back loaded COLA shall be calculated as follows:<br><br>i. Service at retirement of 1-10 years: 1.25% per year<br>ii. Service at retirement of 1-10 years and hired before June 16, 2017: 1.5%<br>iii. Service at retirement of 11-20 years: 1.5% per year<br>iv. Service at retirement of 21-25 years: 1.75% per year<br>v. Service at retirement of 26 years and above: 2.0% per year<br><br>The first COLA will be prorated based on the number of months retired. | |

***(1)*** *Federated Tier 1 applies to employees hired on or before September 29, 2012.*

***(2)*** *Employees with "Classic" membership from a CalPERS or reciprocal agency hired by the City of San José, on or after June 18, 201. A CalPERS "Classic" member is a member who previously worked for a CalPERS or other reciprocal*

## NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)

*agency and meets the following criteria: 1. First established CalPERS membership or membership in a CalPERS reciprocal agency prior to January 1, 2013, 2. AND is hired by the City of San José after a break in service of less than six months 3. AND did not have concurrent (overlapping) service with the other agency. City of San José Reciprocity Election Form must be submitted within thirty (30) days of the first day of employment with the City. Employees in Tier 1 Classic are not eligible for the defined benefit retiree healthcare plan.*

***(3)*** *Tier 2A applies to Employees hired between September 30, 2012 and September 27, 2013.*

***(4)*** *Tier 2B are employees who were newly hired after September 27, 2013.*

## NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)

| | Tier 1/Tier 1 Classic |
|---|---|
| ***Death Before Retirement*** | |
| Non-service-connected death with less than 5 years of service | Return of employee contributions, plus death benefit:<br>1/12 of compensation in year prior to death x years of service (Benefit may not exceed 50.0% of the salary earned in year prior to death.) |
| Greater than 5 years of service or service connected death | To surviving spouse/domestic partner:<br>Years of Service x 2.5% x Final Compensation<br>(40% minimum, 75% maximum, except that "deferred vested" members not eligible for 40% minimum)<br><br>If no surviving spouse/domestic partner, to surviving children:<br>1 Child: 25% of spousal/domestic partnership allowance<br>2 Children: 50% of spousal/domestic partnership allowance<br>3 Children: 75% of spousal/domestic partnership allowance<br><br>If no surviving spouse/domestic partner or surviving children: Return of employee contributions, plus death benefit: 1/12 of compensation in year prior to death x years of service (benefit may not exceed 50% of the salary earned in year prior to death.) |
| ***Death After Retirement*** | |
| Standard allowance to surviving spouse/domestic partner or children<br><br>(Minimum 5 years of service) | To surviving spouse/domestic partner:<br>50% of retiree's allowance<br><br>If no surviving spouse/domestic partner, to surviving children:<br>1 Child: 25% of spousal/domestic partnership allowance<br>2 Children: 50% of spousal/domestic partnership allowance<br>3 Children: 75% of spousal/domestic partnership allowance<br><br>If no surviving spouse/domestic partner or surviving children:<br>estate or beneficiary will receive the difference between employee contributions (including interest) and the total paid to member by the retirement system at the time of death. |
| ***Optional Settlements*** | Retiree may choose an optional settlement at retirement that reduces the allowance to provide a survivorship allowance to a designated beneficiary or a higher survivorship allowance to their spouse/domestic partner. |
| ***Special Death Benefit*** | $500 death benefit paid to estate or designated beneficiary in addition to benefits above. |

*Note: For death before retirement, the survivorship allowance to surviving spouse/domestic partner lasts until death or remarriage. However, it will last until death if member was at least 55 with at least 20 years of service at the time of death, or 30 years of service regardless of age. For death after retirement, the survivorship allowance to surviving spouse/domestic partner lasts until death. If there is an allowance payable to a surviving spouse/domestic partner, no allowance will be paid to surviving children. Surviving children receive a monthly survivorship allowance only when there is no surviving spouse/domestic partner.*

## NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)

| | Tier 2A and 2B |
|---|---|
| ***Death Before Retirement*** | |
| Non-service connected death not eligible for Retirement | Return of employee contributions, plus interest. |
| Eligible for Retirement | To surviving spouse/domestic partner:<br>2.0% x Years of Federated Service x Final Compensation (70% max)<br>40% minimum, 70% maximum, except that "deferred vested" members not eligible for 40% minimum)<br><br>If no surviving spouse/domestic partner, to surviving children until age 18:<br>1 Child: 25% of spousal/domestic partnership allowance<br>2 Children: 50% of spousal/domestic partnership allowance<br>3 Children: 75% of spousal/domestic partnership allowance<br>4 or more children: Split equal share of 75% of spousal/domestic partnership allowance<br><br>If no surviving spouse/domestic partner or surviving children: Return of employee contributions, plus death benefit: 1/12 of compensation in year prior to death x years of service (benefit may not exceed 50% of the salary earned in year prior to death.) |
| ***Death After Retirement*** | |
| Survivorship allowance to surviving spouse/domestic partner or children that was elected by the member at retirement.<br><br>(Minimum 5 years of service) | To surviving spouse/domestic partner:<br>50% of Retiree's Allowance<br><br>If no surviving spouse/domestic partner, to surviving children until age 18:<br>1 Child: 25% of spousal/domestic partnership allowance<br>2 Children: 50% of spousal/domestic partnership allowance<br>3 Children: 75% of spousal/domestic partnership allowance<br><br>If no surviving spouse/domestic partner or surviving children: estate or beneficiary will receive the difference between employee contributions (including interest) and the total paid to member by the retirement system at the time of death. |
| ***Optional Settlements*** | Retiree may choose an optional settlement at retirement that reduces the allowance to provide a survivorship allowance to a designated beneficiary or a higher survivorship allowance to their spouse/domestic partner. |

*Note: For death before retirement, the survivorship allowance to surviving spouse/domestic partner lasts until death, remarriage, or establishment of a domestic partnership if member was at least 62 with at least 20 years of service (or 55 with a reduction factor of 5.0%) at the time of death. For death after retirement, the survivorship allowance to surviving spouse/domestic partner lasts until death.*

### *(c) Contributions*

This subsection provides information related to contributions paid by SJCE for pension benefits provided by FCERS.

**NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)**

On June 24, 2008, the City Council adopted Ordinance No. 28332 amending Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for pension benefits to FCERS.

Subsequently, in October 2014, the FCERS Board approved implementing an incremental reduction approach to determining the "actuarial equivalence" for the City's prefunding of its contribution when the economic expansion has exceeded 58 months in duration and/or the S&P 500 has returns in excess of 130%. This approach was undertaken to ensure that as business expansions and/or market valuations mature and exceed historic norms, FCERS reduces the City's incentive to prefund its contributions when market valuations and/or economic expansions are beyond historic norms. The incremental reduction is to be applied to the discount rate of the City's prefunding of its contribution. The incremental reduction is 15% per year, up to a maximum of 45%, which was the reduction to the discount rate that was applied to calculate the actuarially determined prepayment amount for the Tier 1 members to be paid by the City at the beginning of the year ended June 30, 2020. However, the City elected to not prefund its actuarially determined contribution for Tier 1 members for the year ended June 30, 2020.

As noted above, the San José Municipal Code has been amended to set forth the terms of Measure F and the Frameworks regarding, among other issues, Tier 2 pension benefits for members in FCERS. The contribution rates for FCERS Tier 2 members are calculated based on a 50/50 split of all costs, including the unfunded actuarial liability ("UAL"). However, the member's UAL contribution rate cannot increase by more than .33% of pay each year. Currently, FCERS Tier 1 members split normal cost with approximately 72.7% paid by the City and approximately 27.3% paid by Tier 1 members. The responsibility for funding the UAL is generally not shared with the Tier 1 employees. Tier 1 members who were former Tier 1 members and then rehired as Tier 2 members or who had "Classic" membership with a CalPERS/reciprocal agency are responsible for 50% of the amortization costs for the prior years of service as Tier 2 members.

In FY 11, the FCERS Board approved the establishment of a "floor funding method", commencing with FY 12, setting the City's funding policy contribution amount to be the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll, for the fiscal year.

In February 2016, the FCERS Board approved the City's request that the floor methodology for Tier 1 pension contributions be used only for the annual employer normal cost contribution (which includes administrative expenses) and that the annual employer UAL contribution be set at the dollar amount recommended by the actuary and adopted by the Board in the annual actuarial valuation report beginning FY 17. The "floor funding method" does not apply to FCERS Tier 2A and Tier 2B members.

## NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)

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

The contribution rates for the Defined Benefit Pension Plan for the City and the participating employees for the year ended June 30, 2020 were based on the actuarial valuation performed as of June 30, 2018. SJCE's contributions paid during the year ended June 30, 2020 were $1,429,000. The contribution rates in effect and the amounts contributed to the pension plan for the year ended June 30, 2020 are as follows:

| | FCERS | | | |
|---|---|---|---|---|
| | City (1) | | Participants (2) | |
| Defined Benefit Pension Plan | Tier 1 | Tier 2 | Tier 1 | Tier 2 |
| Actuarial Rate: | | | | |
| 06/28/20-06/30/20 | 19.82% | 7.92% | 7.22% | 7.92% |
| 07/01/19-06/27/20 | 19.34% (3) | 8.33% | 7.06% | 8.33% |

*(1) Under Measure F, certain Tier 2 members who had previous Tier 1 service with a reciprocal employer were reclassified to Tier 1. Ordinance No. 30145, which became effective October 12, 2018, amended the Municipal Code to reflect these changes. Effective 3/24/2019, reclassified Tier 1 members paid an additional 1.96% in contributions, members with prior Federated Service reclassified to Tier 1 paid an additional 0.87% in contributions, and Classic Tier 1 members paid an additional 0.47% in contributions.*

*(2) Under Measure F, certain Tier 2 members who had previous Tier 1 service or prior service with a reciprocal employer were reclassified to Tier 1. Ordinance No. 30183, which became effective January 4, 2019, amended the Municipal Code to reflect these changes. Effective 3/24/19, reclassified Tier 1 members paid an additional 3.00% in contributions. Classic Tier 1 members paid an additional 1.46% effective 8/12/18.*

*(3) Contributions are structured as a normal cost, plus a payment on the Unfunded Actuarial Liability (UAL). City contributions are administered as a contribution rate plus a minimum dollar amount based on actuarial payroll.*

### *(d) Net Pension Liability*

The City's net pension liability for FCERS Plan is measured as the total pension liability, less the pension plan fiduciary net position as of the measurement date of June 30, 2019. The City's net pension liability as of June 30, 2020 is measured as of June 30, 2019, using an annual actuarial valuation as of June 30, 2018 and rolled forward to June 30, 2019 using update procedures by the actuary. In summary, the SJCE proportionate share of the City's net pension liability at June 30, 2020 is $1,156,000 based on SJCE's share of 0.47%. In FY 2019, the City did not charge SJCE any net pension liability.

The discount rate used to measure the total pension liability was 6.75% for the valuation dated June 30, 2018. It is assumed that FCERS members' contributions and City's contributions will be made based on the actuarially determined rates based on the funding policy of the FCERS Board. Based on those assumptions, the FCERS' fiduciary net position is expected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate

## NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)

of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

### Sensitivity of the Proportionate Share of the Net Pension Liability to Changes in Discount Rates

The following presents the SJCE proportionate share of the net pension liability, calculated using the discount rate of 6.75% in effect as of the measurement date, as well as what the proportionate share of the net pension liability would be if it was calculated using discount rates that are one percentage point lower (5.75%) or one percentage point higher (7.75%) than the rate used for the FCERS plan (in thousands):

| FCERS - Sensitivity Analysis | 1% Decrease (5.75%) | Measurement Date Discount Rate (6.75%) | 1% Increase (7.75%) |
|---|---|---|---|
| Proportionate share of net pension liabiltiy | $ 1,407 | $ 1,156 | $ 951 |

### Pension Fiduciary Net Position

The FCERS issues a publicly available financial report that may be obtained from the Office of Retirement Services, 1737 North First Street, Suite 600, San José, CA 95112-4505 or at https://www.sjretirement.com. The SCJE presents the related defined benefit disclosures of FCERS as a participant in a cost-sharing arrangement with the City.

**Pension Expense and Deferrals** – For the year ended June 30, 2020, SJCE recognized a negative pension expense of $32,000 in FCERS. As of June 30, 2020, SJCE reported its proportionate share of the City's deferred outflows and inflows of resources related to pension from the following sources (in thousands):

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Contributions subsequent to measurement date | $ 1,429 | $ - |
| Differences between expected and actual experience | 41 | 41 |
| Changes in assumptions | 192 | 37 |
| Net difference between projected and actual earnings on pension plan investments | 407 | - |
| **Total** | **$ 2,069** | **$ 78** |

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

| Fiscal Year Ending June 30: | Deferred Outflows/(Inflows) of Resources |
|---|---|
| 2021 | $ 269 |
| 2022 | 109 |
| 2023 | 125 |
| 2024 | 59 |
| | **$ 562** |

## NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)

As of June 30, 2020, $1,429,000 reported as deferred outflows of resources related to contributions subsequent to the measurement date for the FCERS, will be recognized as a reduction of the net pension liability in the year ending June 30, 2021. Other amounts reported as deferred outflows of resources related to pensions will be recognized as pension expense shown in the tables above.

**Recognition of Deferred Outflows and Deferred Inflows of Resources for FCERS**

Gains and losses related to changes in total pension liability and fiduciary net position are recognized in pension expense systematically over time.

One fifth of the net earnings is recognized in the first year when the gain or loss occurred. The remaining amounts are categorized as deferred outflows and deferred inflows of resources related to pension and are to be recognized in future pension expense.

The recognition period differs depending on the source of the gain or loss:

| | |
|---|---|
| Net difference between projected and actual earnings on pension plan investments | 5 Years |
| All other amounts | Expected average remaining service lifetime (EARSL) (5.0 Years at June 30, 2019 measurement date) |

**Long-term Expected Rate of Return on Plan Investments –** The assumption for the long-term expected rates of return on FCERS investments of 6.75% for the valuation dated June 30, 2018 was selected by estimating the median nominal rates of return based on long-term capital market assumptions adopted by the FCERS Board, including nominal expected rates of return for each of the asset classes, and reducing the estimated median by a margin so that there is estimated to be a greater than 50 percent probability of achieving the returns.

Best estimates of geometric real rates of return for each major asset class included in the FCERS target asset allocation are summarized in the following tables:

## NOTE 9 – DEFINED BENEFITS RETIREMENT PLAN (CONTINUED)

| | FCERS | |
|---|---|---|
| | **Target Asset Allocation** | **Long-Term Expected Real Rate of Return** |
| Public equity | 30% | 6.2% |
| Private equity | 10% | 7.3% |
| Core real estate | 5% | 3.1% |
| Immunized cash flows | 5% | 0.8% |
| Venture / growth capital | 5% | 7.2% |
| Emerging market bonds | 3% | 2.6% |
| Growth real estate | 3% | 5.3% |
| Market neutral strategies | 7% | 2.7% |
| Private debt | 4% | 4.6% |
| Private real assets | 3% | 6.7% |
| Treasury inflation-protected securities | 2% | 1.0% |
| Commodities | 3% | 2.3% |
| Short-term investment grade bonds | 20% | 0.8% |

The separately issued annual report of FCERS provides more information about the most recent long-term expected rates of return on plan investments.

### *Actuarial Methods and Assumptions*

The significant actuarial methods and assumptions used to compute the total pension liability as of June 30, 2020 are from the actuarial valuation report with a valuation date of June 30, 2018.

| | FCERS |
|---|---|
| **Description** | **Method/Assumption** |
| Measurement date | June 30, 2019 |
| Valuation date | June 30, 2018 |
| Inflation rate | 2.50% |
| Discount rate | 6.75% per annunm |
| Post-retirement mortality | |
| (a) Healthy annuitants: | 0.952 for males and 0.921 for females, times the CalPERS 2009 Healthy Annuitant Mortality Table. |
| (b) Disability: | 1.051 for males and 1.002 for females, times the CalPERS 2009 Ordinary Disability Mortality Table. Mortality is projected from 2009 on a generatiaonal basis using the MP-2018 scale. |
| Rates of service retirement, withdrawal, death, disability retirements | Tables based on current experience |
| Salary increases | |
| Wage Inflation | The base wage inflation assumption of 3.25% plus a merit / longevity increase based on years of service ranging from 4.50% at hire to 0.25% for members with 14 or more years of service. |
| Merit Increase | For the amortization schedule, payroll is assumed to grow 3.25% per year. |
| Cost-of-Living Adjustment | Tier 1 – 3% per year<br>Tier 2 - 1.25% to 2.00% depending on years of service |

## NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (OPEB)

### *(a) General Information*

In addition to the FCERS Defined Benefit Pension Plan, the City also sponsors and administers a single employer FCERS Postemployment Healthcare Plan, which includes an Internal Revenue Code (IRC) 115 Trust. The Postemployment Healthcare Plan covers eligible full-time and certain part-time employees of the City, and are accounted for in the Pension Trust Funds of the City.

Generally, the defined benefit Postemployment Healthcare Plan provides medical and dental benefits to eligible retirees and their beneficiaries. Benefits are 100% of the premium cost for the lowest priced medical insurance plan available to an active City employee, and 100% of the premium cost for a dental insurance plan available to an active City employee.

Per the terms of the Framework discussed in Note 9, the City established a VEBA for retiree healthcare for the members of the FCERS in FY 18. The City does not make contributions into the VEBA and the VEBA is not subject to the jurisdiction of the FCERS Board.

In November 2017, the Internal Revenue Service and City entered into a Closing Agreement whereby FCERS Tier 1 and some FCERS Tier 2 members were eligible for an irrevocable opt-out of the applicable Postemployment Healthcare Plan into a VEBA. The transfer of their retiree healthcare contributions (medical and dental) from the applicable Postemployment Healthcare Plan to their individual VEBA accounts remained subject to Internal Revenue Service approval. The VEBA opt-in election period was October 18, 2017 through December 15, 2017. In February 2018, the Internal Revenue Service issued favorable private letter rulings with respect to the transfer of retiree healthcare contributions from the Postemployment Healthcare Plan for those employees opting into a VEBA and in March 2018, the retiree healthcare contributions of members who opted in to a VEBA were transferred from the applicable Postemployment Healthcare Plan into their individual VEBA accounts. The Internal Revenue Service also approved allowing eligible employees who are rehired by the City during calendar years 2018 through 2022 to opt into the applicable VEBA and transfer the retiree healthcare contributions from the applicable Postemployment Healthcare Plan to their individual VEBA accounts.

### *(b) Contributions*

Contribution amounts to the Postemployment Healthcare Plan for both the City and the participating members are based upon agreements between the City and the bargaining units. With the implementation of Measure F, ADC was calculated beginning with the year ended June 30, 2019. The FCERS transitioned into annual valuations beginning June 30, 2010, from biennial actuarial valuations.

On June 24, 2008, the City Council adopted Ordinance No. 28332 amending Title 3 of the San José Municipal Code to provide the City with the option to make lump sum prepayments of City required contributions for postemployment healthcare benefits to FCERS.

Subsequently, in October 2014, the Board of Administration of FCERS approved implementing an incremental reduction approach to determining the “actuarial equivalence” for the City’s prefunding of its contribution when the economic expansion has exceeded 58 months in duration and/or the S&P 500 has

**NOTE 10– OTHER POSTEMPLOYMENT BENEFITS (CONTINUED)**

returns in excess of 130%. This approach was undertaken to ensure that as business expansions and/or market valuations mature and exceed historic norms, FCERS reduces the City's incentive to prefund its contributions when market valuations and/or economic expansions are beyond historic norms. The incremental reduction is 15% per year, up to a maximum of 45%, which was the reduction to the discount rate that was applied to calculate the actuarially determined prepayment amount for the participating members to be paid by the City at the beginning of year ended June 30, 2020. However, the City elected to not prefund its actuarially determined contribution for Tier 1 members for the year ended June 30, 2020.

The FCERS Board on February 15, 2018 approved a contribution policy for the respective Postemployment Healthcare Plan that sets the City's contribution as a flat dollar amount.

***(c) Funding Policy***

Historically, member and City contributions to the Postemployment Healthcare Plan were negotiated through collective bargaining and was not actuarially determined. Until the City entered into agreements with various bargaining groups in 2009 and prior to implementation of Measure F, contributions for the health and dental benefits for both the City and the participating employees of the Postemployment Healthcare Plan were based upon an actuarially determined percentage of employees' base salary sufficient to provide adequate assets to pay benefits when due over the next 15 years for FCERS. From 2009 until the implementation of Measure F, the City had been in the process of phasing in payment of the annual required contribution (ARC) for the retiree health and dental benefits provided by Postemployment Healthcare Plan as calculated pursuant to GASB Statement No. 43 and GASB Statement No. 45 then in effect. However, the contribution rates for the City and members of the Postemployment Healthcare Plan were capped before the full ARC was reached.

The annual contribution costs for the Postemployment Healthcare Plan benefits are allocated to both the City and the active employee members. Contributions to the Postemployment Healthcare Plan for both the City and the participating members are based upon agreements between the City and the bargaining units. With the implementation of Measure F, member contributions are fixed as a percentage of pay and the City's contribution toward the explicit subsidy (premium subsidy) is an ADC determined by the Postemployment Healthcare Plan. The ADC for the Postemployment Healthcare Plan is the normal cost plus the amortization payment on the unfunded actuarial liability, less expected member contributions. The City has an option to limit its ADC for the Postemployment Healthcare Plan to a fixed percentage of the payroll of all active members of the pension plan. The ADC for the Postemployment Healthcare Plan is calculated beginning with FY 19.

The City will pay the implicit subsidy on a pay-as-you go basis as part of active health premiums. An implicit subsidy for retiree health benefits exists because the medical experience for retirees under age 65 are pooled with the experience for active employees, thereby resulting in a lowering of the premium paid for retirees under age 65. The implicit subsidy is included in the actuarial valuation of the Postemployment Healthcare Plan. The implicit subsidy is shown as both a contribution and payment from the Postemployment Healthcare Plan. However, the implicit subsidy is not actually contributed to or paid from the Postemployment Healthcare Plan. Rather, it is paid directly by the City on a pay-as-you-go basis as a part of active member health plan premiums. The actuary for the Postemployment Healthcare Plan separately calculates the total unfunded actuarial liability being the aggregate unfunded actuarial liability for both implicit and explicit subsidies, and the unfunded actuarial liability for only the explicit subsidy.

**NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (CONTINUED)**

The unfunded actuarial liability for the explicit subsidy is used to calculate the City ADC to the Postemployment Healthcare Plan.

As of March 25, 2018, members remaining in the FCERS Postemployment Healthcare Plan contribute 7.5% of pay. The City continued to pay the phased-in contribution rate until the beginning of FY 19, when it commenced paying the ADC as determined by the FCERS Board subject to a cap of 14% of payroll of all active members of FCERS.

The contributions to the FCERS Postemployment Healthcare Plan for the SJCE and the participating employees for the year ended June 30, 2020 are shown below:

| | Tier 1 | Tier 2 | Tier 1 and Tier 2 |
|---|---|---|---|
| Actuarial Rate: | | | |
| Postemployment Healthcare Plan: | | | |
| 07/01/2019 - 06/30/2020 | * | * | 7.50% |

** In February 2018, the Board approved the contribution policy that sets the City healthcare contributions as a flat dollar amount, beginning with fiscal year 2019. The City's contribution for FCERS Postemployment Healtcare Plan during the year ended June 30, 2020 of contributions that covered Tier 1 and Tier 2 in the amount of $21,246,777 was for the City as a whole. The SJCE's contributions paid during the year ended June 30, 2020 were $115,000.*

***(d) Net OPEB Liability / (Asset)***

The City's net OPEB liability for the Postemployment Healthcare Plan is measured as the total OPEB liability, less the plan fiduciary net position as of the June 30, 2019 measurement date. The City's net OPEB liability as of June 30, 2020 for FCERS Postemployment Healthcare Plan is measured as of June 30, 2019, using an annual actuarial valuation as of June 30, 2018 and rolled forward to June 30, 2019 using standard update procedures by the actuary for the plan. In summary, the SJCE proportionate share of the City's net OPEB liability is a net OPEB asset at June 30, 2020 of $715,000 based on SJCE's share of 0.73%, which was changed from 0.56% in FY 19.

## NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (CONTINUED)

### Actuarial Methods and Assumptions

| | **FCERS** |
|---|---|
| Measurement Date | June 30, 2019 |
| Valuation Date | June 30, 2018 |
| Actuarial Cost Method: | Entry Age Normal, level of percentage of pay |
| Actuarial Assumptions: | |
| Discount Rate | 6.75% per annum |
| Inflation Rate | 2.50% |
| Merit Increase | Merit component added based on an individual's years of service ranging from 4.50% at hire to 0.25%. |
| Wage Inflation Rate | 3.25% |
| Rate of Mortality* | Mortality is projected from 2009 on a generational basis using the MP-2018 scale. |
| Pre-Retirement Turnover** | Please see below table |
| Healthcare Trend Rate - Medical | The valuation assumes that future medical inflation will be at a rate of 8.00% to 4.25% per annum graded down over a 15 year period for medical pre-age 65 and 6.00% to 4.25% per annum graded down over a 15 year period for medical post-age 65. |
| Healthcare Trend Rate - Dental | Dental inflation is assumed to be 3.5% |

* Actuarial Methods and Assumptions – FCERS Mortality Rates

| Category | Male | Female |
|---|---|---|
| Healthy Annuitant | 0.952 for males times the CalPERS 2009 Healthy Annuitant Mortality Table | 0.921 for females times the CalPERS 2009 Healthy Annuitant Mortality Table |
| Disabled Annuitant | 1.051 for males times the CalPERS 2009 Ordinary Disabilty Mortality Table | 1.002 for females times the CalPERS 2009 Ordinary Disabilty Mortality Table |

The assumption for the long-term expected rate of return on OPEB plan investments of 6.75% for the valuation year ended June 30, 2018, was selected by estimating the median nominal rate of return based on long-term capital market assumptions adopted by the FCERS Board, including nominal expected rates of return for each asset class, and reducing the estimated median by a margin so that there is estimated to be a greater than 50 percent probability of achieving the return.

## NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (CONTINUED)

Best estimates of geometric real rates of return for each major asset class included in FCERS's target asset allocation as of June 30, 2019 measurement date are summarized in the following table. The assets were invested in a 115 trust account because the 401(h) account within the pension fund was depleted during FY 19.

| Asset Class | Target Asset Allocation | Long-Term Expected Real Rate of Return |
|---|---|---|
| Public equity | 56.0% | 6.1% |
| Short-term investment grade bonds | 29.0% | 0.8% |
| Core real estate | 10.0% | 4.3% |
| Commodities | 5.0% | 2.3% |
| Cash | 0.0% | 0.3% |

### Discount Rate for FCERS

The discount rate used to measure the total OPEB liability was 6.75% for the measurement year ended June 30, 2019 and is based on the long-term expected rate of return on investments. It is assumed that FCERS member contributions remain fixed at 7.5% of pay for employees eligible to participate in the Postemployment Healthcare Plan and the City contributes the actuarially determined contribution toward the explicit subsidy up to a maximum of 14% of the total payroll. In addition, the City pays the implicit subsidy on a pay-as-you-go basis. Based on those assumptions, the FCERS' fiduciary net position is expected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on OPEB plan investments for FCERS was applied to all periods of projected benefit payments to determine the total OPEB liability.

### Sensitivity of the Net OPEB Asset to Changes in Discount Rates

The following presents the SJCE's proportionate share of the City's net OPEB liability for FCERS, as well as what the SJCE's proportionate share of the net OPEB liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the measurement date rate.

As of June 30, 2020, the SJCE's share of the City's net OPEB liability was based on 0.73% of the SJCE's proportion of the City's net OPEB liability for FCERS at the measurement date, June 30, 2019:

| | 1% Decrease (5.75%) | Measurment Date Discount Rate (6.75%) | 1% Increase (7.75%) |
|---|---|---|---|
| Net OPEB Asset | $ (782) | $ (715) | $ (593) |

## NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (CONTINUED)

### Sensitivity of the Net OPEB Asset to Changes in the Health Care Cost Trend Rates

The following presents the SJCE proportionate share of the City's net OPEB liability for FCERS, as well as what the SJCE proportionate share of the net OPEB liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the measurement date rate.

As of June 30, 2020, the SJCE share of the City's net OPEB liability was based on 0.73% of the SJCE proportion of the City's net OPEB liability for FCERS at the measurement date, June 30, 2019:

| | 1% Decrease | Measurement Date Health Care Cost Trend Rates | 1% Increase |
|---|---|---|---|
| **Net OPEB Asset** | $ (643) | $ (715) | $ (782) |

### OPEB Fiduciary Net Position

The FCERS issues a publicly available financial report that may be obtained from the Office of Retirement Services, 1737 North First Street, Suite 600, San José, CA 95112-4505 or at https://www.sjretirement.com. The SCJE presents the related defined benefit disclosures of FCERS as a participant in a cost-sharing arrangement with the City.

### Recognition of Deferred Outflows and Deferred Inflows of Resources for FCERS

Gains and losses related to changes in total OPEB liability and fiduciary net position are recognized in OPEB expense systematically over time. One fifth of the net earnings is recognized in the first year when the gain or loss occurred. The remaining amounts are categorized as deferred outflows and deferred inflows of resources related to OPEB and are to be recognized in future OPEB expense.

The recognition period differs depending on the source of the gain or loss:

| | |
|---|---|
| Net difference between projected and actual earnings on OPEB plan investments | 5 Years |
| All other amounts | Expected average remaining service lifetime (EARSL) (5.0 Years at June 30, 2019 measurement date) |

## NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (CONTINUED)

For the year ended June 30, 2020, the SJCE recognized a negative OPEB expense of $174,000. As of June 30, 2020, the SJCE reported deferred outflows and inflows of resources related to OPEB from the following sources (dollar amounts in thousands):

| **FCERS** | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| OPEB contributions subsequent to measurement date | $ 115 | $ - |
| Difference between expected and actual experience | - | 52 |
| Changes in assumptions | 45 | 101 |
| Net difference between projected and actual earnings on OPEB plan investments | 74 | - |
| **Total** | $ 234 | $ 153 |

The $115,000 reported as deferred outflows of resources related to contributions subsequent to the June 30, 2019 measurement date will be recognized as an addition to the net OPEB asset during the year ending June 30, 2021.

Other amounts reported as deferred outflows/(inflows) of resources related to OPEB will be recognized as expense as follows (dollar amounts in thousands):

| Fiscal Year Ending June 30: | Deferred Outflows/(Inflows) of Resources |
|---|---|
| 2021 | $ (49) |
| 2022 | 5 |
| 2023 | 6 |
| 2024 | 4 |
| | $ (34) |

## NOTE 11– PURCHASE COMMITMENTS

In the ordinary course of business, SJCE enters into various power purchase agreements of different duration (i.e., short-, medium-, and long-term) to acquire renewable and other power supply products. The price and volume of purchased power may be fixed or variable. Variable pricing is generally based on the market price of either natural gas or electricity on the date of delivery. Variable volume is generally associated with contracts to purchase energy from as-available resources such as solar, wind, and hydro-electric facilities.

SJCE has a 20-year power purchase agreement with EDP Renewables and, when construction finishes in 2022, City residents will receive renewable energy from Sonrisa Solar Park in Fresno County. SJCE also has a 12-year and a 15-year agreement with Terra-Gen; customers will receive energy from projects built in Kern County that will be operational in 2021 and 2022. These long-term agreements will supply the City with approximately 950,000 MWh of energy annually, which is projected to meet over 20% of its energy

**NOTE 11– PURCHASE COMMITMENTS (CONTINUED)**

consumption needs. Prices for these long-term agreements are lower than short-term agreements, so it is expected that SJCE's operational costs will decrease over time.

**NOTE 12 – CONTINGENCIES**

*Claims and Litigation*

SJCE is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters. SJCE funds the costs of salaries and benefits, including the cost of workers' compensation coverage, for employees in the Community Energy Department.

The estimated workers' compensation liabilities at year-end are determined using actuarial methods or other estimating techniques. The claims payment and liability include an estimate of allocated loss adjustment expense and claims that have been incurred but not yet reported.

*COVID-19 Impacts*

As a result of the negative economic impacts to many of SJCE residential and commercial customers due to COVID-19, SJCE increased its allowance for doubtful accounts by $3.2 million for the year ended June 30, 2020. In response to COVID-19, PG&E began offering flexible payment plan options and suspended service disconnections for non-payment to provide customers with financial relief as they grapple with the economic challenges that resulted from COVID-19.

*Pending Regulatory Matters*

As of June 30, 2020, SJCE carried $7.9 million in estimated liabilities associated with penalties levied by the California Public Utilities Commission ("CPUC") for deficiencies in satisfying certain State of California year-ahead resource adequacy obligations for calendar years 2019 and 2020. The 2019 penalty levied against SJCE was $6.8 million while the 2020 penalty totaled $1.1 million. As of June 30, 2020, these penalties were under appeal with the CPUC. Subsequently, the $6.8 million penalty for 2019 was paid in October 2020 (see Note 13 – Subsequent Events) while the $1.1 million penalty for 2020 will likely remain outstanding until fall 2021, as SJCE is continuing to contest/appeal the 2020 penalty with the CPUC. The final CPUC decision on the 2020 penalty is not expected until the second half of calendar year 2021.

*Power Charge Indifference Adjustment*

The CPUC and SJCE, along with other CCAs, are participating in proceedings before the CPUC to determine the Power Charge Indifference Adjustment (PCIA), which is a fee PG&E charges CCA customers to account for the net costs for energy PG&E procured prior to those customers joining a CCA's service. While the outcome of this decision is unknown, an increase or decrease in the rate will change the total amount paid by SJCE customers.

## NOTE 13 – SUBSEQUENT EVENTS

(a) In September 2020, SJCE finalized a 15-year long-term power purchase agreement with Pattern Energy Group LP that will supply SJCE customers with up to approximately 950,000 MWh of renewable energy annually beginning in 2021.

(b) In October 2020, SJCE paid $6.8 million to the CPUC as a penalty payment for deficiencies in satisfying certain State of California year-ahead resource adequacy obligations for calendar year 2019 and filed a petition for rehearing. SJCE was not able to purchase the State mandated amount of resource adequacy for 2019 due to unfavorable market conditions. This payment reduced the estimated liability for claims and judgments by the same amount, leaving a remaining estimated liability associated with penalties levied by the CPUC of $1.1 million, which reflects the penalty levied by the CPUC for deficiencies in satisfying certain year-ahead resource adequacy obligations for calendar year 2020. SJCE appealed the 2020 penalty with the CPUC. On March 29, 2021, the Administrative Law Judge in the proceeding issued a draft resolution denying the City's appeal in its entirety. As part of the public comment period, the City submitted comments on the draft resolution on May 19, 2021. On May 28, 2021, the CPUC served its revised resolution which adopted the draft resolution denying the City's appeal in its entirety. The matter moves to the June 3, 2021 consent calendar, where it is expected the CPUC will adopt the final resolution. The City will have 45 days to pay the penalty once the resolution is issued.

(c) In December 2020, SJCE paid off the $10 million short-term notes payable that had been provided by the City of San José Financing Authority to fund SJCE start-up costs, with interest of $15,697.

(d) In January 2021, SJCE executed a Joint Powers Agreement to become a member of a newly formed California Community Power Agency ("CC Power") Joint Powers Authority that includes several other CCAs. Joining CC Power provides SJCE the option to participate in larger projects that help ensure grid reliability such as long duration storage projects and could also assist with resource adequacy compliance obligations.

(e) The City's Investment Policy was approved with amendments on March 9, 2021. The existing policy of the City to invest public funds in a manner to meet the City objectives, in order of priority, safety of invested funds, maintenance of sufficient liquidity to meet cash flow needs; and attainment of a rate of return consistent with the first two objectives, while conforming to the provisions of California Government Code Sections 53600 et seq., the Charter of the City of San Jose, the City of San Jose Municipal Codes, and the policy. The amendment changed the social responsibility language to prohibit direct investments in fossil fuels; increased sector limit of municipal bonds from 20% to 30%, and extended the temporary modification on weighted average maturity to July 1, 2022.

This page intentionally left blank.

## Schedule of the Proportionate Share of the Net Pension Liability

(Dollar Amounts in Thousands)

| | 2020 | 2019 |
|---|---|---|
| Proportion of the collective net pension liability | 0.47% | 0.47% |
| Proportionate share of the collective net pension liability | $ 1,156 | $ - |
| Covered payroll | $ 2,181 | $ 1,627 |
| Proportionate share of the collective net pension liability as percentage of covered payroll | 53.00% | 0.00% |
| Plan fiduciary net position as a percentage of the total pension liability | 51.07% | 50.41% |

## Schedule of Employer Contributions – Defined Benefit Pension Plan

(Dollar Amounts in Thousands)

| | 2020 | 2019 |
|---|---|---|
| Actuarially determined contribution | $ 1,429 | $ 804 |
| Contribution in relation to the actuarially determined contributions | 1,429 | 804 |
| Covered payroll | $ 2,336 | $ 2,181 |
| Contributions as a percentage of covered payroll | 61.18% | 36.86% |

| **Fiscal year** | **June 30, 2020** | **June 30, 2019** |
|---|---|---|
| **Valuation date** | **June 30, 2018** | **June 30, 2017** |
| **Actuarial cost method** | Entry age | Entry age |
| **Asset valuation method** | 5-year smoothed market | 5-year smoothed market |
| **Discount rate** | 6.75% | 6.875% |
| **Salary increases** | 3.25% plus merit component based on years of service | 3.25% plus merit component based on years of service |
| **Amortization growth rate** | 3.00% | 3.00% |
| **Amortization method** | Unfunded actuarial liability as of June 30, 2009 was amortized over a closed 30-year period commencing June 30, 2009. Gains, losses and plan changes are amortized over 20-year periods, and assumption changes are amortized over 25-year periods. Tier 2's Unfunded Actuarial Liability as of June 30, 2017 is amortized over a 10-year period. | Unfunded actuarial liability as of June 30, 2009 was amortized over a closed 30-year period commencing June 30, 2009. Gains, losses and plan changes are amortized over 20-year periods, and assumption changes are amortized over 25-year periods. Tier 2's Unfunded Actuarial Liability as of June 30, 2017 is amortized over a 10-year period. |
| **Mortality** | Adjusted 2009 CalPERS mortality tables projected on a generational basis with the SOA MP-2018 projection scale | Adjusted 2009 CalPERS mortality tables projected on a generational basis with the SOA MP-2017 projection scale |

**Note to Schedules**

As a cost-sharing enterprise fund of the City of San José (City), SJCE is required to recognize a liability for its proportionate share of the City's collective net pension liability. SJCE recognizes pension expense and reports deferred outflows of resources and deferred inflows of resources related to pension for its proportionate shares of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions.

The schedules present information to illustrate changes in SJCE's proportionate share of the net pension liability and contributions over a 10-year period when the information is available. SJCE commenced operations in fiscal year 2018.

## Schedule of the Proportionate Share of the Net OPEB Asset

(Dollar Amounts in Thousands)

| | 2020 | 2019 |
|---|---|---|
| Proportion of the collective net OPEB asset | 0.73% | 0.73% |
| Proportionate share of the collective net OPEB asset | $ 715 | $ 742 |
| Covered payroll | $ 2,181 | $ 1,627 |
| Proportionate share of the collective net OPEB asset as percentage of covered payroll | 32.78% | 45.61% |
| Plan fiduciary net position as a percentage of the total OPEB asset | 46.67% | 43.81% |

## Schedule of Employer Contributions – Postemployment Healthcare Plan

(Dollar Amounts in Thousands)

| | 2020 | 2019 |
|---|---|---|
| Actuarially determined contribution | $ 115 | $ 148 |
| Contribution in relation to the actuarially determined contributions | 115 | 148 |
| Covered payroll | $ 2,336 | $ 2,181 |
| Contributions as a percentage of covered payroll | 4.92% | 6.79% |

**Methods and assumptions used to determine contributions:**

| | | |
|---|---|---|
| Fiscal Year | 6/30/2020 | 6/30/2019 |
| Valuation Date | 6/30/2018 | 6/30/2017 |
| Timing | Actuarially determined contribution rates are calculated based on the actuarial valuation one year prior to the beginning of | Actuarially determined contribution rates are calculated based on the actuarial valuation one year prior to the beginning of |
| Actuarial Cost Method | Individual entry age | Individual entry age |
| Asset Valuation Method | Market value of assets | Market value of assets |
| Amortization Method | 20-year layered amortization as a level dollar amount with 3-year phase-in and phase-out | 25-year layered amortization as a level dollar amount with 3-year phase-in and phase-out |
| Discount rate | 6.750% | 6.875% |
| Amortization growth rate | 3.00% | 3.25% |
| Ultimate rate of medical inflation | 4.250% | 4.250% |
| Salary increases | 3.25% plus merit component based on years of service | 3.25% plus merit component based on years of service |
| Mortality | Adjusted 2009 CalPERS mortality tables projected on a generational basis with the SOA MP-2018 projection scale | Adjusted 2009 CalPERS mortality tables projected on a generational basis with the SOA MP-2018 projection scale |

A complete description of the methods and assumptions used to determine contributions for the year ended June 30, 2020 and June 30, 2019 can be found in the June 30, 2018 and June 30, 2017 actuarial valuation report, respectively.

**Changes in assumptions**. The discount rate was changed from 6.875% (net of administrative expense) to 6.75% for FCERS for the measurement period ended June 30, 2019, Plan enrollment assumptions were

updated based on recent experience and the expected impact of added and dropped plans. The per person cost trends were moved forward one year. Historical information is required only for measurement periods for which GASB 75 is applicable. Future years' information will be displayed up to 10 years as information become available.

**Note to Schedules**

As a cost-sharing enterprise fund of the City, SJCE is required to recognize a liability / (asset) for its proportionate share of the City's collective net Other Postemployment Benefits (OPEB) liability. SJCE recognizes OPEB expense and reports deferred outflows of resources and deferred inflows of resources related to OPEB for its proportionate shares of collective OPEB expense and collective deferred outflows of resources and deferred inflows of resources related to OPEB.

The schedules present information to illustrate changes in the SJCE's proportionate share of the net OPEB liability (asset) and contributions over a 10-year period when the information is available. SJCE commenced operations in fiscal year 2018.