COUNTY OF SANTA CLARA
STATE OF CALIFORNIA

COMPREHENSIVE
ANNUAL
FINANCIAL
REPORT

FISCAL YEAR ENDED JUNE 30, 2006

JOHN V. GUTHRIE
DIRECTOR OF FINANCE
November 28, 2006

To the Members of the Board of Supervisors, and
The Citizens of the County of Santa Clara

State law requires that every general-purpose local government publish within six months of the close of each fiscal year a complete set of audited financial statements. This Comprehensive Annual Financial Report (CAFR) is published to fulfill that requirement for the fiscal year ended June 30, 2006.

Management assumes full responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive internal control framework it established for this purpose. Because the cost of internal control should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

Macias Gini & O'Connell LLP, Certified Public Accountants, have issued an unqualified ("clean") opinion on the County of Santa Clara’s financial statements for the year ended June 30, 2006. The independent auditors’ report is located at the front of the financial section of this report.

Management’s discussion and analysis (MD&A) immediately follows the independent auditors’ report and provides a narrative introduction, overview, and analysis of the financial statements. MD&A complement this letter of transmittal and should be read in conjunction with it.

Profile of the Government

The County of Santa Clara (the County) is located at the southern end of the San Francisco Bay and occupies an area of 1,316 square miles. The County was established by an act of State legislation in 1850 and was one of the original 27 counties in the State. The County is named after Mission Santa Clara, which was established in 1777, and named for Saint Clara of Assisi, Italy. The name Clara means "clear" or "bright."

The County has been steadily growing for the last thirty years. According to the U.S. Census Bureau, the population of the County has grown more than 60 percent since 1970. It is the sixth most populated county in California. Santa Clara County was home to more than 1.7 million residents in 2005, nearly 5 percent of the State’s population. There are 15 incorporated cities located in the County and over 94 percent of the County residents live in those cities. The County seat is located in San Jose, which is the 3rd largest city in California, and is the largest city in the Bay Area.

The County operates under a Home Rule Charter adopted by the voters of the County. Policymaking and legislative authority is vested in the County Board of Supervisors (the Board), which consists of an elected supervisor from each of the County’s five districts. The Board is responsible among other things, for passing ordinances, adopting the budget, appointing committees and appointing the County Executive and non-elected department heads. Supervisors are elected to four-year staggered terms (e.g. two in 2006 and three in 2008). The County has three elected department heads responsible for the offices of the Assessor, the District Attorney, and the Sheriff. All elected officials serve four-year terms. The members of the Board of Supervisors are limited to three terms.
The County, with over 15,000 full-time equivalent employees, provides a full range of services to its residents. These services include the general government (administration and finance), public protection (law enforcement, detention, and criminal prosecution), roads maintenance, health, public assistance, fire protection, libraries, sanitation, and general aviation airports. The County’s operations include various component units which provide specific services County-wide or to distinct geographic areas within the County. They are legally separate entities for which the County is financially accountable as their governing boards are substantially the same as the County Board. Because of this governing board relationship and the exclusivity of county services, financial operations of some component units are blended in the County’s basic financial statements. These component units are the Santa Clara County Central Fire Protection District, South Santa Clara County Fire Protection District, Los Altos Hills County Fire Protection District, Santa Clara County Vector Control Special District, County Sanitation Districts 2 - 3, Santa Clara County Financing Authority, and the Santa Clara County—El Camino Hospital District Hospital Facilities Authority. The Housing Authority of the County of Santa Clara and the FIRST 5 Santa Clara County are reported as discretely presented component units.

**Factors Affecting the Financial Condition**

The following information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the County operates.

**Economy**

Santa Clara County is the largest member of the economic region, called the Silicon Valley—a world leader in development of new technologies and industries. In a little over three decades, the Valley’s economy has transitioned from being sustained first by agriculture, next by manufacturing, then by services, followed by high technology, and finally launching into an economy of high-productivity and cutting-edge innovation. During this period, the Valley’s economy has moved from employing Brown to Blue to White to Gold Collared workers. The region’s major industry clusters are software, semiconductor, hardware, innovation services, biomedical, and electronic components. The Valley is the number one region garnering the largest amount of venture capital in recent years. It represents 26 percent of all U.S. venture capital investment.

Recent economic indicators show that after some years of economic downturn, the Valley’s economy has shown signs of moderate recovery. In 2005, the unemployment rate dropped sharply, falling 1.1 percentage points to 5.5 percent, just above the state’s rate of 5.4 percent for the same year. The Valley added jobs for the first time since 2001. Productivity of the region’s work force is more than twice the national average. Taxable sales continue to show signs of positive growth. Sales of single-family homes are declining while inventory for the homes are rising. Unlike the previous years, the appreciation of median price of single-family homes has been moderate.

The County’s budget has structural shortfalls and a moderate economic recovery will not be enough to cure those shortfalls. The County’s revenue growth, for the past few years, has fallen short of its rising costs, and this trend is expected to continue in the future. Decisions necessitated by circumstances in the last 10 years such as enhanced retirement benefits for safety employees, and the construction of a new hospital required for seismic purposes have significantly escalated the overall cost of County services. The cost of health care impacts both the cost of health insurance for employees and the General Fund subsidy to Santa Clara Valley Medical Center, which provides health care to a large population of under-or-uninsured patients. In addition, the County’s revenue stream is limited by the State of California’s fiscal problems and continues to see a reduction in the level of State support of the County’s General Fund services. The FY07 deficit was estimated at $164.6 million. The FY07 budget used the following strategies to solve the budget deficit:

- $123.8 million - One-time funding for ongoing operations
- $ 40.8 million - Departmental reductions
The department reductions of $40.8 million represent a combination of spending reductions and revenue solutions. The budget included a net reduction of 39 full-time equivalent (FTE) positions that will affect the departments' service level capacity.

**Long-term financial planning**

1. The County's largest discretionary revenue source, secured property taxes, grew 8.8 percent in FY06. This tax source is projected to grow 9.5 percent in FY07 and is projected to grow at a reduced rate in future years of approximately 8.0 percent. The growth in other revenues is not as significant. The expenditures for salaries and benefits, which are about half of County's total operating costs are projected based on agreements with major bargaining units and labor organizations, as well as the projected increase in retirement and health insurance costs. Other expenditures are projected based on the departments' business needs.

2. For FY07, the County has set aside $87.7 million in contingency reserves. Contingency reserve is a major unobligated reserve budgeted in the General Fund, and its use is limited by the Board's policy. A reserve for economic uncertainty tends to grow during good economic times and become depleted following downturns in the business cycle. The contingency reserve is funded with one-time funds, as is the serve for economic uncertainty. These reserves are re-examined each year.

3. The 10-year capital improvement plan (CIP) projects future capital needs for the County. It identifies how the County plans to fund its capital projects over the ten-year period. The FY07 budget includes $133.8 million for various long-term capital projects. Some of these projects are funded through debt financing. The budget also included $10.0 million in one-time funds for new projects, such as the Security Master Plan and Life Cycle Infrastructure Investment Program.

4. In FY07, the County plans to issue approximately $100 million in debt to provide funds for the Valley Health Clinic in Milpitas, a new building in San Jose to consolidate the three Fleet facilities to one location, and the remainder for seismic retrofitting of the Courthouse in Los Gatos. In addition, the County will act as the conduit issuer for a $6 million Housing Authority lease revenue Bond. The County also plans to undertake a securitization financing of approximately $100 million, which secured by future pledge Tobacco Settlement revenues.

**Relevant Financial Policies**

**Use of Fund Balance**

Any undesignated General Fund balance at the fiscal year end is treated as a one-time source of funding. The Board policy discourages using the one-time funds for ongoing operations and limits their appropriation only to meet the one-time expenditures. The only exception is the use of one-time reserves to ease the transition to downsized and/or reorganized operations.

**Contingency Reserves**

Use of contingency reserves is restricted to support costs on one-time basis for the following purposes:

- When the County is impacted by an unanticipated reduction in State and/or Federal grants and aid.
- When the County faces economic recession or depression and the County must take budget action before the beginning of any fiscal year.
- When the County is impacted by a natural disaster.
- When the County is presented with an unanticipated or unbudgeted lease expense that is necessary for the delivery of local services.
- When the County is affected by unforeseen events that require the allocation of funds.

The County can use contingency reserves to support ongoing costs, as a financing mechanism, when presented with critical program initiatives that have a time requirement that cannot be deferred.
Capital Project Financing
The County has a long-term capital improvement plan (CIP) that identifies how the County plans to fund both its 'pay-as-you-go' and its debt financed capital improvement projects over the ten-year period. This plan includes: a) all capital projects being considered for a possible future bond issue; b) all capital projects that would be deferred to a subsequent bond issue; and c) all 'pay-as-you-go' projects set for design and construction over the next ten years. While the plan covers a ten-year period, it is updated annually to reflect ongoing changes as new projects are added; existing projects modified, and completed projects deleted from the plan document. The ten-year CIP does not appropriate funds; rather it serves as a budgeting tool, identifying those capital budget appropriations to be made through the adoption of the County's annual budget.

Debt Management
The debt management policy sets forth certain debt management objectives for the County and establishes overall parameters for issuing and administering the County’s debt. The Board supports the Administration’s effort to limit issuance of short-term debt to cover cyclical cash flow needs. The policy allows for the issuance of long-term debt to finance major capital improvements. However, the County historically has required a careful assessment of capital improvement priorities, capital costs, annual debt service capacities, and annual operating and maintenance costs on the scheduled improvement in advance of incurring the indebtedness.

Cash Management

- Commingled Pool—the County's pooled deposits and investments are governed by California Government Code and by a County investment policy. This policy is reviewed annually by the County Treasury Oversight Committee and approved annually by the Board of Supervisors. The County Board of Supervisors, the Treasury Oversight Committee, and the Internal Audit Division monitor adherence to the statutes and policies through monthly audits and reports. The County's investment policy stipulates, among other items, approved investment categories, maturity limits and credit rating minimums for County investments. The objectives of the policy, in order of priority, are safety of principal, maintenance of liquidity, and attainment of a market rate of return, which considers risk constraints and cash flow requirements.

- Government Code Sections 53620-53622 grant the County authority to invest the assets of the County Retiree Health Trust in a form or type of investment deemed prudent by the governing body. Accordingly, the County's investment policy allows the purchase of securities with final maturities of 30 years or less and a Moody's credit rating of A3 or higher. Additionally, up to 67 percent of the assets (minus near term-liability pay-outs) of the County Retiree Health Trust may be invested in equities through mutual funds or through the direct purchase of common stocks by a money management firm(s) approved by the Board of Supervisors. The County Retiree Health Trust is reported as an Internal Service Fund in the financial statements, and will be converted to an irrevocable trust as part of the implementation of GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits other Than Pensions, in the next couple of years.

Multi-Year Financial Forecasting
The County’s Proposed Budget includes a five-year financial forecast of projected budgetary deficit focusing on the types of solutions required to solve the deficit.

Major Initiatives
In the County’s Proposed Budget, the County Executive outlines various major programs (initiatives), accomplishments and challenges aligned with the County’s Strategic Plan. That document is available via the Internet at http://www.sccgov.org/portal/site/scc. Some of the initiatives included in the recommended budget are included here.
Contingency Reserves
The Board has made a commitment to increase the General Fund contingency reserves to 5.0 percent of the Fund’s revenues, net of pass-throughs, by July 1, 2007. The Board has established targets to set the reserve at 2.5 percent of General Fund revenues in FY05, 3.0 percent in FY06 and 4.0 percent in FY07, all net of pass-throughs. The FY07 recommended budget set aside $82.4 million or 4.25 percent of contingency reserves. Additionally, the Board approved $5.3 million to increase the FY07 General Fund contingency reserves at $87.7 million or 4.7 percent of the Fund’s revenues, net of pass-through. In doing so, the Board exceeded its 4.0 percent target for FY07.

General Fund Subsidy to SCVMC
Santa Clara Valley Medical Center (SCVMC), a County operated public hospital is the largest and busiest hospital and clinic system (outside of Kaiser) in the South Bay and is, in many respects, what holds together the entire hospital system, public and private. The Board has adopted an Open Door Policy to provide high quality, cost-effective healthcare to all residents regardless of their ability to pay. Since revenues from treating a largely under- or uninsured patient population cannot cover the cost of providing patient care services, SCVMC depends on an operating subsidy from the General Fund for its operations. This General Fund subsidy is comprised of three basic elements: pass-through revenues, unreimbursed County services (e.g. medical care for inmates and employee physicals), and the General Fund grant. The FY07 budget includes a General Fund subsidy of $166.9 million to SCVMC.

Equity in Workforce Reductions
As stated earlier, the County’s budget has structural shortfalls. The FY07 budget includes $164.6 million in deficit solutions, raising the cumulative total of deficit solutions since FY03 to $802.7 million. These solutions include department reductions, revenue enhancements, and the use of one-time funding for ongoing operations to ensure continuity of essential County services. The General Fund has eliminated over 1,200 FTE positions over the past five years. In deleting those positions, the County Executive maintained his commitment to the Board, labor unions, and employees to pay close attention to reductions that are “vertically appropriate;” improvement in the Countywide staff-to-supervisor ratio, and balance in reductions across the Board policy committee areas. The position eliminations have come from all levels of County hierarchy. The FY07 recommended budget aim at keeping the percentage of executives, managers and supervisors and line staff relatively unchanged. Executive Management positions are the same, Manager and Supervisor positions will be slightly reduced, and the percentage of line staff positions is slightly increased. The countywide ratio of staff-to-supervisor has improved from a base of 10.2:1 in the FY06 budget to 10.6:1 in the FY07 budget.

Health and Hospital Strategic Facilities Plan
In 1994, Senate Bill 1953 (SB1953) was signed into law as an amendment to the Alfred E. Alquist Hospital Seismic Safety Act of 1993. The objective of this Act is to assure that acute care hospital buildings are remaining intact after a seismic event by the year 2013, and also capable of continued operations of acute care medical services by the year 2030. As a result of the seismic requirements, the County is required to make substantial changes to the SCVMC campus or will be force to reduce the number of available inpatient beds. The estimated total cost to comply with SB1953 is approximately $1.2 billion. One of the major capital initiatives in the coming years will be the seismic retrofitting of the SCVMC inpatient facilities. The long-term financial plan for this project considers the use of one-time funds and grants as well as issuance of bonds to complete this project.

Other Information

Certificate of Achievement
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the County for its comprehensive annual financial report for the fiscal year ended June 30, 2005. This was the seventh consecutive year the County has achieved this prestigious award. In order to be awarded a Certificate of Achievement, the government must publish an
easily readable and efficiently organized CAFR. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current CAFR continues to meet the Certificate of Achievement Program’s requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgments
The preparation of the comprehensive annual financial report and its timely issuance is the result of a concentrated, dedicated, and coordinated effort of the staff of the Controller-Treasurer Department and the cooperation and assistance of all County agencies and departments. We would like to acknowledge the role played by the Board of Supervisors in developing and following policies, which enhance the current and future fiscal stability of the County.

Respectfully submitted,

[Signature]
John V. Guthrie
Director of Finance

[Signature]
Peter Kutras, Jr.
County Executive
The Board of Supervisors  
County of Santa Clara  
San Jose, California  

Independent Auditors' Report

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate discretely presented component units and remaining fund information of the County of Santa Clara, California, (the County), as of and for the fiscal year ended June 30, 2006, which collectively comprise the County's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the County's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the FIRST 5 Santa Clara County; the County Sanitation District 2 – 3 of Santa Clara County; the Santa Clara County Vector Control District; and the Santa Clara County Central Fire Protection District, and Los Altos Hills County Fire District (collectively, “Fire Districts”), which represent the following percentages of assets, net assets and revenues as of and for the fiscal year ended June 30, 2006:

<table>
<thead>
<tr>
<th>Opinion Unit</th>
<th>Assets</th>
<th>Net Assets</th>
<th>Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governmental activities</td>
<td>2.3%</td>
<td>2.7%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Business-type activities</td>
<td>1.4%</td>
<td>19.2%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Aggregate discretely presented component units and remaining fund information</td>
<td>4.1%</td>
<td>4.4%</td>
<td>1.2%</td>
</tr>
</tbody>
</table>

Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the
accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate discretely presented component units and remaining fund information of the County as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated November 28, 2006, on our consideration of the County's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financing reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The management’s discussion and analysis, schedule of funding progress and budgetary comparison schedule – General Fund as listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the County’s basic financial statements. The introductory section, other supplementary information section and the statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The other supplementary information have been subjected to the auditing procedures applied by us and other auditors in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of other auditors, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Macieski & Company, LLP
Certified Public Accountants
Walnut Creek, California

November 28, 2006
As management of the County of Santa Clara (the County), we offer readers of the County's financial statements this narrative overview and analysis of the financial activities of the County for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal, which can be found on pages i to vi of this report.

**FINANCIAL HIGHLIGHTS**

- The assets of the County exceeded its liabilities by $1.8 billion (net assets) for the year. Of this amount, $1.1 billion (unrestricted net assets) may be used to meet the County's ongoing obligations to its citizens and creditors, and $138.0 million (restricted net assets) may be used for the County's ongoing obligations related to programs with external restrictions. The County's net assets invested in capital assets, net of related debt were $619.7 million. (See further detail in Table 1 on page 6).

- The County's total net assets increased by $27.2 million for the year. (See further detail in Table 2 on page 8).

- At June 30, 2006, the County governmental funds reported combined fund balances of $991.7 million, an increase of $10.9 million from prior year. Approximately 78.2 percent of the combined fund balances, $775.8 million, is available to meet the County's current and future needs (unreserved fund balance), which represents a $68.8 million decrease from prior year.

- At June 30, 2006, the County's unreserved fund balance for the General Fund was $554.0 million or 30.3 percent of total General Fund expenditures.

- The County's investments in capital assets increased by $55.7 million or 5.3 percent. (See further detail in Table 5 on page 16).

- The County’s total long-term debt, net of debt service principal pay-off of $90.1 million for the year, increased by $116.4 million or 14.7 percent during the current fiscal year. (See further detail in Table 6 on page 17).

**OVERVIEW OF THE FINANCIAL STATEMENTS**

Management's discussion and analysis are intended to serve as an introduction to the County's basic financial statements. The County's basic financial statements comprise three components 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the basic financial statements. Required supplementary information is included in addition to the basic financial statements.

**Government-wide Financial Statements**

The government-wide financial statements are designed to provide readers with a broad overview of County finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all County assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the County is improving or deteriorating.
The statement of activities presents information showing how net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in the government-wide statements for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

The government-wide financial statements distinguish functions of the County that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the County include general government, public protection, public ways and facilities, health and sanitation, public assistance, education and recreation and culture. The business-type activities of the County include a hospital—Santa Clara Valley Medical Center (SCVMC), three airports (Reid Hillview; Palo Alto and South County) and two sanitation districts (County Sanitation Districts 2-3).

Component units are included in the basic financial statements and consist of legally separate entities for which the County is financially accountable. Because of the governing board relationship and the exclusivity of County services, the financial operations of some component units are blended in the County’s basic financial statements. These component units are the Santa Clara County Central Fire Protection District, South Santa Clara County Fire District, Los Altos Hills County Fire District, Santa Clara County Vector Control District, County Sanitation Districts 2-3 of Santa Clara County, Santa Clara County Financing Authority, and the Santa Clara County-El Camino Hospital District Hospital Facilities Authority. The Housing Authority of Santa Clara County and the FIRST 5 Santa Clara County are reported as discrete component units of the County.

The government-wide financial statements can be found on pages 21 - 23 of this report.

Fund Financial Statements
A fund is a grouping of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The County, like other state and local governments, uses fund accounting to ensure and demonstrate finance-related legal compliance. All of the funds of the County can be divided into three categories: governmental funds, proprietary funds and fiduciary funds.

Governmental funds
Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental funds financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the County’s near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, the readers may better understand the long-term impact of the government’s near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The County maintains 25 individual governmental funds. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures and changes in fund balances for the General Fund. Data from other governmental funds are combined into a single aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining statements and schedules elsewhere in this report.

The governmental funds financial statements can be found on pages 24 – 27 of this report.
Proprietary funds

The County maintains two kinds of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The County uses enterprise funds to account for one hospital—Santa Clara Valley Medical Center (SCVMC), three airports (Reid Hillview, Palo Alto and South County) and two sanitation operations (County Sanitation District 2-3). *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the County's various functions. The County uses internal service funds to account for its information services, fleet management, insurance claims, printing services, unemployment insurance, worker's compensation, employee benefits and retirees' healthcare. The internal service funds have been allocated between the governmental activities and business-type activities based on the relative percentage of use of the internal service funds in these activities.

Proprietary fund statements provide the same type of information as the business-type activities column in the government-wide financial statements, but in more detail. The proprietary fund financial statements provide separate information for the SCVMC, which is considered a major fund. The financial statements of the nonmajor enterprise funds (Airport and Sanitation District) are combined into a single aggregated presentation. Similarly, the County's eight internal service funds are combined into a single aggregated presentation in the proprietary funds financial statements. Individual fund data for the enterprise funds and the internal service funds is provided in the form of *combining statements* section of this report.

The proprietary funds financial statements can be found on pages 28 - 31 of this report.

Fiduciary funds

The *Fiduciary Funds* are used to account for resources held for the benefit of parties outside the County. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the County’s own programs. The accounting used for fiduciary funds is much like that used for proprietary funds except for agency funds.

The fiduciary funds financial statements can be found on pages 32 - 33 of this report.

Notes to the Basic Financial Statements

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found on pages 35 - 83 of this report.

Required Supplementary Information

The required supplementary information is presented concerning the County’s progress in funding its obligation to provide pension benefits to its employees and the County General Fund budgetary comparison schedule. The County adopts an annual appropriated budget for its General Fund. A budgetary comparison schedule has been provided for the General Fund to demonstrate compliance with this budget. Required supplementary information can be found on pages 85 - 98 of this report.

Combining Statements and Schedules

The combining and individual fund statements and schedules referred to earlier provide information for nonmajor governmental funds, nonmajor enterprise funds, internal service funds, and certain fiduciary funds and are presented immediately following the required supplementary information. Combining and individual fund statements and schedules can be found on pages 101 - 162 of this report.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

The County’s assets exceeded its liabilities by $1.8 billion at June 30, 2006. As stated earlier, net assets may serve over time as a useful indicator of a government’s financial position. When applicable, prior year numbers have been reclassified to make them comparable to the current year.
Table 1—Net Assets (in thousands)

<table>
<thead>
<tr>
<th></th>
<th>Governmental Activities</th>
<th>Business-type Activities</th>
<th>Total</th>
<th>Total Dollar Change</th>
<th>Total Percent Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current and other assets</td>
<td>$1,745,630</td>
<td>$1,786,957</td>
<td>$319,177</td>
<td>$396,516</td>
<td>$2,064,816</td>
</tr>
<tr>
<td>Capital assets</td>
<td>819,611</td>
<td>885,388</td>
<td>237,942</td>
<td>327,855</td>
<td>1,057,558</td>
</tr>
<tr>
<td>Total assets</td>
<td>2,565,241</td>
<td>2,682,345</td>
<td>557,124</td>
<td>724,371</td>
<td>3,122,374</td>
</tr>
<tr>
<td>Current and other liabilities</td>
<td>162,085</td>
<td>189,108</td>
<td>73,066</td>
<td>73,087</td>
<td>235,151</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>600,334</td>
<td>616,726</td>
<td>489,618</td>
<td>602,076</td>
<td>1,089,952</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>762,419</td>
<td>805,831</td>
<td>562,684</td>
<td>675,163</td>
<td>1,352,135</td>
</tr>
</tbody>
</table>

Net assets:
- Invented in capital assets, net of related debt: $671,131, 598,143 (25,988), 21,329, 645,466, 619,672, (25,794), (4.0%)
- Restricted net assets: 81,606, 98,931, 25,608, 39,026, 107,214, 137,957, 30,743, 28.7%
- Unrestricted net assets: 1,060,094, 1,079,440, (5,346), (11,347), 1,044,591, 1,069,099, 23,502, 2.2%
- Total net assets: $1,822,831, $1,778,514, (5,317), $49,208, $1,357,271, $1,382,722, $26,451, 1.6%

Assets
The County’s total assets increased by $184.3 million or 5.9 percent primarily due to the following:

**Governmental activities.** Total assets for the governmental activities increased by $17.1 million or 0.7 percent—an increase of $51.3 million in current and other assets and a decrease of $34.2 million in capital assets. The increases in current and other assets were due to the following reasons: 1) issuance of the 2006 Lease Revenue Series I bonds attributable to a $16.9 million increase in restricted cash and investments; 2) advanced payment from the County Measure B program to Valley Transportation Authority (VTA) for various transit related projects accounted for $3.8 million increase in other assets; and 3) increase in cash collection from advances to SCVMC and receivables from other governmental agencies contributed to the remaining increases. Capital assets used to support governmental activities decreased by $34.2 million or 4.2 percent; depreciable capital assets increased by $3.0 million, while non-depreciable capital assets decreased by $37.3 million. Changes in capital assets will be discussed in the Capital Assets section on page 15.

**Business-type activities.** Total assets for the business-type activities increased by $167.2 million or 30.0 percent mainly due to issuance of the 2006 Lease Revenue Series I and J bonds for construction of two new valley health center facilities. Bond proceeds expended for construction activities resulted in an $89.9 million increase in capital assets. Bond proceeds not yet spent are reported as restricted cash and investments, which increased by $78.8 million.

Liabilities
The County's total liabilities increased by $155.9 million or 11.8 percent mainly due to the following:

**Governmental activities.** Total liabilities for the governmental activities increased by $43.4 million—$27.0 million in current and other liabilities and $16.4 million in long-term liabilities. The increases in current and other liabilities included $8.0 million in accrued salaries and benefits and $19.0 million in other current payables. Changes in long-term liabilities consisted of $8.7 million in long-term debts and $7.7 million in other long-term liabilities. The increases in other long term liabilities primarily came from a $7.2 million increase in accrued vacation and sick leave due to increased leave balances and the higher average hourly rate. Changes in long-term debt will be discussed in the Long-Term Debt section on page 17.

**Business-type activities.** Total liabilities for the business-type activities increased by $112.5 million mainly due to the issuance of $116.1 million of 2006 Lease Revenue Series I and J bonds for reasons explained above.
Net Assets

The largest portion of the County’s net assets (58.5%) represents unrestricted net assets of $1.1 billion, which may be used to meet the County’s ongoing obligations to citizens and creditors. Another significant portion of the County’s net assets of $619.7 million (33.9%) reflects its investment in capital assets (e.g., land, building and improvements, infrastructure, and equipment and vehicles) net of accumulated depreciation, less any related outstanding debt used to acquire those assets. The County uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the County’s investment in its capital assets is reported net of related debt, the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The remaining $138.0 million (7.6%) of the County’s net assets represents resources that are subject to external restrictions on how they may be used.

At the end of the current fiscal year, the County reported positive balances in all categories of net assets, for the government as a whole, as well as for its governmental activities. The Unrestricted net assets for the business-type had a deficit of $11.3 million because the SCVMC revenues fell short of its operating expenses for the year.

![Net Assets](image)

The County’s net assets increased by $27.2 million or 1.5 percent for the year. This change in net assets is explained below in the context of the County’s governmental and business-type activities.

Governmental activities

The governmental activities decreased the County’s net assets by $26.3 million. Revenues exceeded expenses by $212.7 million. Net transfers of $239.0 million to the business-type activities fully offset these excess revenues and have contributed to 100.0 percent of the decrease in net assets.

As an arm of the state government, the County provides various mandated services, such as public assistance, public health, and mental health. Revenues directly generated by or attributable to a specific governmental function are called program revenues. These include charges for services and restrictive (program specific) grants and contributions, both operating and capital. The following chart shows the County’s program revenues and expenses for the year. The general revenues—taxes (property, business, and sales), unrestricted grants, and investment income are not included in this chart. These general revenues are not be shown by program, but are available to support the program activities countywide.
Changes in the County's net assets from its governmental activities are explained in the context of changes in revenues and expenses:

### Table 2—The Change in Net Assets (in thousands)

<table>
<thead>
<tr>
<th>Revenues:</th>
<th>2005</th>
<th>2006</th>
<th>2005</th>
<th>2006</th>
<th>Total</th>
<th>Total</th>
<th>Dollar Change</th>
<th>Percent Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Program revenues:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Charges for services</td>
<td>237,046</td>
<td>238,319</td>
<td>4,928</td>
<td>534,091</td>
<td>656,333</td>
<td>772,410</td>
<td>116,077</td>
<td>17.7%</td>
</tr>
<tr>
<td>Operating grants and contributions</td>
<td>934,070</td>
<td>1,021,337</td>
<td>108,239</td>
<td>14,264</td>
<td>1,041,399</td>
<td>1,035,601</td>
<td>-6,798</td>
<td>-0.6%</td>
</tr>
<tr>
<td>Capital grants and contributions</td>
<td>5,212</td>
<td>6,181</td>
<td>6,000</td>
<td>15,885</td>
<td>11,412</td>
<td>22,046</td>
<td>10,634</td>
<td>92.8%</td>
</tr>
<tr>
<td>General revenues:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property taxes</td>
<td>586,999</td>
<td>639,557</td>
<td>-</td>
<td>-</td>
<td>586,999</td>
<td>639,557</td>
<td>52,558</td>
<td>9.0%</td>
</tr>
<tr>
<td>Sales and use taxes</td>
<td>148,753</td>
<td>123,625</td>
<td>9,611</td>
<td>9,663</td>
<td>158,364</td>
<td>133,287</td>
<td>25,077</td>
<td>(15.8)%</td>
</tr>
<tr>
<td>Other taxes</td>
<td>102,911</td>
<td>60,255</td>
<td>-</td>
<td>-</td>
<td>102,911</td>
<td>60,255</td>
<td>42,656</td>
<td>(41.4)%</td>
</tr>
<tr>
<td>Unrestricted grants and contributions</td>
<td>22,497</td>
<td>22,055</td>
<td>-</td>
<td>-</td>
<td>22,497</td>
<td>22,055</td>
<td>442</td>
<td>(2.0)%</td>
</tr>
<tr>
<td>Unrestricted investment income</td>
<td>39,841</td>
<td>53,136</td>
<td>4,872</td>
<td>2,740</td>
<td>44,714</td>
<td>55,876</td>
<td>11,162</td>
<td>25.0%</td>
</tr>
<tr>
<td>Gain on sale of capital assets</td>
<td>8,707</td>
<td>4,300</td>
<td>-</td>
<td>-</td>
<td>8,707</td>
<td>4,300</td>
<td>4,407</td>
<td>(50.6)%</td>
</tr>
<tr>
<td>Other revenue</td>
<td>57,148</td>
<td>51,173</td>
<td>-</td>
<td>-</td>
<td>57,148</td>
<td>51,173</td>
<td>5,975</td>
<td>(10.9)%</td>
</tr>
<tr>
<td>Total revenues</td>
<td>2,142,206</td>
<td>2,219,944</td>
<td>548,210</td>
<td>576,624</td>
<td>2,690,416</td>
<td>2,796,568</td>
<td>106,152</td>
<td>3.9%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Program expenses:</th>
<th>2005</th>
<th>2006</th>
<th>2005</th>
<th>2006</th>
<th>Total</th>
<th>Total</th>
<th>Dollar Change</th>
<th>Percent Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>General government</td>
<td>171,077</td>
<td>192,708</td>
<td>-</td>
<td>-</td>
<td>171,077</td>
<td>192,708</td>
<td>21,631</td>
<td>12.6%</td>
</tr>
<tr>
<td>Public protection</td>
<td>639,554</td>
<td>664,477</td>
<td>-</td>
<td>-</td>
<td>639,554</td>
<td>664,477</td>
<td>24,923</td>
<td>3.9%</td>
</tr>
<tr>
<td>Public ways and facilities</td>
<td>140,842</td>
<td>110,554</td>
<td>-</td>
<td>-</td>
<td>140,842</td>
<td>110,554</td>
<td>(30,288)</td>
<td>(21.5)%</td>
</tr>
<tr>
<td>Health and sanitation</td>
<td>334,667</td>
<td>369,511</td>
<td>-</td>
<td>-</td>
<td>334,667</td>
<td>369,511</td>
<td>34,844</td>
<td>10.4%</td>
</tr>
<tr>
<td>Public assistance</td>
<td>561,519</td>
<td>606,717</td>
<td>-</td>
<td>-</td>
<td>561,519</td>
<td>606,717</td>
<td>44,798</td>
<td>8.0%</td>
</tr>
<tr>
<td>Education</td>
<td>25,253</td>
<td>26,157</td>
<td>-</td>
<td>-</td>
<td>25,253</td>
<td>26,157</td>
<td>804</td>
<td>3.2%</td>
</tr>
<tr>
<td>Recreation and culture</td>
<td>23,214</td>
<td>25,105</td>
<td>-</td>
<td>-</td>
<td>23,214</td>
<td>25,105</td>
<td>1,891</td>
<td>8.1%</td>
</tr>
<tr>
<td>Interest on long-term liabilities</td>
<td>6,607</td>
<td>12,032</td>
<td>-</td>
<td>-</td>
<td>6,607</td>
<td>12,032</td>
<td>5,425</td>
<td>82.1%</td>
</tr>
<tr>
<td>SCVMC</td>
<td>-</td>
<td>-</td>
<td>659,863</td>
<td>756,638</td>
<td>659,863</td>
<td>756,638</td>
<td>96,775</td>
<td>14.7%</td>
</tr>
<tr>
<td>Airport</td>
<td>-</td>
<td>-</td>
<td>3,473</td>
<td>3,534</td>
<td>3,473</td>
<td>3,534</td>
<td>61</td>
<td>1.8%</td>
</tr>
<tr>
<td>Sanitation District</td>
<td>-</td>
<td>-</td>
<td>1,634</td>
<td>1,903</td>
<td>1,634</td>
<td>1,903</td>
<td>269</td>
<td>16.0%</td>
</tr>
<tr>
<td>Total expenses</td>
<td>1,903,233</td>
<td>2,007,261</td>
<td>664,970</td>
<td>762,100</td>
<td>2,568,303</td>
<td>2,796,568</td>
<td>201,158</td>
<td>7.8%</td>
</tr>
</tbody>
</table>

| Excess (deficiency) before transfers | 238,973 | 212,683 | (116,360) | (185,476) | 122,213 | 27,207 | (95,066) | (77.7)% |
| Transfers | (100,271) | (239,000) | 100,271 | 239,000 | - | - | - | n/a |
| Increase (decrease) in net assets | 138,702 | (25,317) | (16,489) | 53,524 | 122,213 | 27,207 | (95,066) | (77.7)% |

| Net assets, beginning of year, as previously reported | 1,564,129 | 1,802,831 | 13,265 | (5,560) | 1,677,394 | 1,797,271 | 119,877 | 7.1% |
| Prior period adjustment | - | - | (2,336) | 1,244 | (2,336) | 1,244 | 3,580 | (153.3)% |
| Net assets, beginning of year, as restated | 1,664,129 | 1,802,831 | (10,932) | (4,316) | 1,674,058 | 1,798,515 | 123,457 | 7.4% |

| Net assets, end of year | $1,892,831 | $1,726,514 | (5,560) | 49,208 | $1,797,271 | $1,825,722 | $26,451 | 1.6% |

### Revenues

The County's revenue for its governmental activities increased by $77.7 million or 3.6 percent to $2.2 billion. The program revenues increased by $90.5 million or 7.7 percent, while general revenues decreased by $12.8 million or 1.3 percent. Over the past three years, the County's program revenues from its governmental...
activities have contributed about 57.0 percent of the cost of running those governmental programs. The general revenues support the programs by covering the remaining 43.0 percent of the costs.

Program revenues increased as demand for public assistance and health related services increased and the cost of providing these services grew. The largest source of program revenues for the County's governmental activities is federal and state grants and contributions, both operating and capital. These revenues account for about 81.2 percent of the County's program revenues, and about 46.3 percent of its total revenues. For the year, revenues from grants and contributions increased by $89.2 million or 9.5 percent, while the revenues from charges for services increased by $1.3 million or 0.5 percent. Operating grants and contributions increased due to growth in revenues from public assistance, health administration, homeland security, traffic congestion relief, and other public safety related programs, while capital grants and contributions increased due to more state funding for various parks and recreation capital projects. Revenues from charges for services increased mainly because of change in County practice of charging the Courts for Criminal Justice Information Control (CJIC) services through direct billing instead of expense reimbursement.

The County's general revenues decreased by $12.8 million or 1.3 percent from the prior year. General revenues include taxes, investment earnings, unrestricted grants and contributions, and some miscellaneous revenues not directly related to governmental programs. General revenues support government programs by defraying costs, which those programs cannot cover from their own revenues. Tax revenues are the County's second largest revenue source—grants and contributions being the largest. The County earned $823.4 million in tax revenues (property tax, property tax in lieu of motor vehicle license fee, and sales tax) for the current year. This is approximately 86.3 percent of the general revenues, and 37.1 percent of the total current year revenues. These general revenues provide the Board of Supervisors (the Board) with most of its discretionary spending ability.

Property tax revenues increased by $52.6 million which reflected 9.0 percent growth in the real property assessed value. This increase included a $10.5 million growth in property tax swap for the motor vehicle license fee (MVLF) under SB1096. Higher property tax and supplemental tax ($13.4 million) revenues also contributed to the growth in property tax revenues. Unsecured business tax revenues fell by $1.5 million. Sales tax revenues decreased by $25.2 million as the Measure B program ended in March 2006. In FY 2005, the State reimbursed the County $42.9 million of the Motor Vehicle in Lieu (MVIL) backfill loan for earlier years. This was a one-time revenue source in FY 2005 only. Hence the other taxes of the current year were lower than last year by the same amount. Other revenues fell by $6.0 million or 10.5 percent due to a $1.5 million decrease in revenues from tobacco settlement and a $3.2 million revenue reduction from penalties on delinquent taxes. Reduction in various one-time revenues from FY 2005 caused the remaining $1.2 million decreases.

Investment earnings increased by $13.3 million. Higher interest rates and average daily cash balances increased the County's commingled investment pool investment earnings by $12.3 million. The commingled investment pool's average quarterly earnings rate increased from 2.1 percent last year to 3.8 percent in the
current year. The investment portfolio for the Retiree Healthcare Internal Service Fund earned $21.6 million for the current year, an increase of $2.3 million from last year due to market performance. This fund invests two-thirds of its available cash reserves in equity index funds, which continued to perform well. The S&P 500 index has increased by 6.6 percent from last year. The internal service funds are included in governmental activities in the government-wide financial statements.

**Expenses**

Expenses for the governmental activities increased by $104.0 million or 5.5 percent, and transfers to the business-type activities increased by $138.7 million to $239.0 million. With the exception of public ways and facilities, costs for all categories of governmental activities were higher for the year. Primary reasons for changes in expenses and transfers are explained below:

- Overall payroll costs increased by 9.8 percent from the prior year primarily due to escalating health insurance, employee retirement contribution, and workers’ compensation costs. The PERS rate for miscellaneous staff jumped from 5.0 percent to 11.7 percent, and for public safety staff rose from 22.4 percent to 25.2 percent. As a result, the County’s pension costs for the governmental activities increased by $44.2 million. Health insurance rates rose by 12.0 percent increasing healthcare costs by $14.0 million for the existing employees and $2.4 million for retirees. Workers’ compensation rate increased from 1.07 to 2.42 percent, which contributed to a $12.1 million in extra costs over prior year. Pay increases contributed additional $22.3 million or 3.5 percent from last year.

- Public assistance program costs increased by $44.8 million or 8.0 percent. In addition to the increase in payroll related costs, expenses for the implementation of a new computer welfare system, CalWIN, also largely contributed to the increases.

- Higher demand for health service programs and higher cost of supplies contributed to a $34.8 million or 10.4 percent increases for health and sanitation costs.

- Higher payroll and benefit costs contributed to increased expenses for the County’s general government ($21.6 million), public protection ($24.9 million), and education and recreation ($2.7 million) functions.

- Interest on long-term debt increased by $5.4 million or 82.1 percent mainly from higher interest expense for the 2005 Lease Revenue bonds issued at the end of FY 2005.

- Public ways and facilities were lower by $30.3 million or 21.5 percent because of reduction in the number of capital projects funded through the Measure B Transportation Improvement Program, which ended in March 2006.

- Transfers increased by $138.7 million to $239.0 million. This included an additional $81.8 million subsidy transfers from the General Fund to SCVMC for supporting its operations. The net transfers between the general capital improvement fund and SCVMC for capital construction projects related to the Valley Specialty Center and various valley health centers contributed the remaining $56.9 million increases.

The following chart shows the County’s expenses by functional category for the governmental activities.
Business-type activities

Business-type activities increased the County’s net assets by $53.5 million. The business-type activities had net expenses of $197.9 million before considering the transfer of operating subsidy and capital assets of $239.0 million from the governmental activities and general revenues of $12.4 million.

The largest of the County’s business-type activities, SCVMC, had $756.6 million in expenses and $558.7 million in program revenues for the year. This is about 99.0 percent of the program revenues of all business-type activities. Its program revenues increased by $30.0 million primarily due to increases in patient activity. Charge for services increased by $114.7 million, while operating grants and contributions revenues decreased by $94.0 million because the Medi-Cal Disproportionate Share Hospital program (SB855) and Emergency Services and Supplemental Payments program (SB1255) were incorporated into California’s Medi-Cal Hospital/Uninsured Care Demonstration Project in FY2006. The recording of the two programs changed from program revenues for services. SCVMC’s expenses increased by 96.8 million primarily due to increases in payroll costs, which was affected by the same factors as the governmental activities discussed earlier. Increase in medical supplies, insurance costs, and patient activities also contributed to the increases. SCVMC consists of a) Valley Medical Center—a 574-bed licensed acute-care hospital, and clinics for outpatient and ambulatory services and b) Valley Health Plan—a licensed HMO with 57,000 clients.

The other enterprise operations—airport and sanitation districts—are very small in size and did not change much in the year. The first chart below shows expenses and revenues by each business activity, while the second chart shows revenues by source for the business activities.

FINANCIAL ANALYSIS OF THE COUNTY’S FUNDS

The County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. When applicable, prior year numbers have been reclassified to make them comparable to the current year.

Governmental funds

The focus of the County’s governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the County’s financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government’s net resources available for spending at the end of the fiscal year. Types of governmental funds reporting by the County include the General Fund, special revenue funds, capital project funds, debt service funds, and a permanent fund.

At June 30, 2006, the County’s governmental funds reported total fund balances of $991.7 million, an increase of $10.9 million or 1.1 percent from the prior year. Approximately 78.2 percent of the combined fund balances, $775.8 million, constitutes the unreserved fund balance, which is available to meet the County’s current and future needs. The remainder of the fund balance is reserved to indicate that it is not available for new spending because it has been committed to: a) pay debt service - $64.9 million; b) reflect inventories and
the amount due from other funds that are long-term in nature and thus do not represent available spendable resources - $25.8 million; and c) liquidate contractual commitments of the period - $125.3 million.

For its governmental funds, the County's total revenues for the current fiscal year were $2.2 billion— an increase of $88.4 million or 4.2 percent over the last year. Total governmental fund expenditures increased by $242.2 million or 12.8 percent to $2.1 billion for the year. Primary reasons for this significant increase in revenues and expenditures for the governmental funds are explained in the framework of individual funds.

The General Fund is the chief operating fund of the County, and its unreserved fund balance was $554.0 million at June 30, 2006, while its total fund balance was $588.5 million, a $62.7 million decline from prior year due to an additional $81.8 million subsidy transfers to the SCVMC. As a measure of the General Fund's liquidity, it may be useful to compare both the unreserved fund balance and the total fund balance to total fund expenditures. The unreserved fund balance and the total fund balance represent 30.3 percent and 32.2 percent of the total General Fund expenditures, respectively.

The County's management designates (earmarks) unreserved fund balance to a particular function, project or activity. Fund balance may also be designated for long-term purposes. However, designated fund balance is available for appropriation at any time. Of the $553.9 million General Fund unreserved fund balance, $299.5 million or 54.1 percent is designated for future expenditures. The unreserved, undesignated fund balance for the General Fund at year-end was $254.4 million. The fund balance designations are listed below:

<table>
<thead>
<tr>
<th>Fund balance designated for:</th>
<th>Amount (Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Transportation improvement projects funded by Measure B</td>
<td>$ 150.6</td>
</tr>
<tr>
<td>(one-half percent Countywide sales tax) revenues</td>
<td></td>
</tr>
<tr>
<td>- Future operations of the Santa Clara Valley Medical Center</td>
<td>90.3</td>
</tr>
<tr>
<td>- Litigation Reserve</td>
<td>10.0</td>
</tr>
<tr>
<td>- Various contingencies designated by the Board of Supervisors</td>
<td>48.4</td>
</tr>
<tr>
<td>- Environment Resources Agency projects</td>
<td>0.2</td>
</tr>
<tr>
<td>Total General Fund designated fund balance</td>
<td>$ 299.5</td>
</tr>
</tbody>
</table>

General Fund revenues and expenditures for the year were $1.9 billion and $1.8 billion, respectively. While its revenues increased by $60.7 million or 3.2 percent for the year, its expenditures increased significantly by $184.0 million or 11.2 percent primarily due to payroll costs increases ($99.8 million) for the reasons discussed earlier on the countywide expenses, and due to increases in debt principal and interest payments ($73.9 million). The Fund's revenues by sources and expenditures by function as well as increases or decreases from the prior fiscal year are presented below:

<table>
<thead>
<tr>
<th>Revenues by source</th>
<th>FY 2005 Amount</th>
<th>Percent</th>
<th>FY 2006 Amount</th>
<th>Percent</th>
<th>Increase/(Decrease) Amount</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes</td>
<td>$ 637,241</td>
<td>34.1%</td>
<td>$ 659,213</td>
<td>34.1%</td>
<td>$ 21,972</td>
<td>3.4%</td>
</tr>
<tr>
<td>Licenses and permits</td>
<td>10,037</td>
<td>0.5%</td>
<td>11,882</td>
<td>0.6%</td>
<td>1,845</td>
<td>18.4%</td>
</tr>
<tr>
<td>Fines, forfeitures and penalties</td>
<td>45,625</td>
<td>2.4%</td>
<td>38,321</td>
<td>2.0%</td>
<td>(7,304)</td>
<td>(16.0%)</td>
</tr>
<tr>
<td>Interest and investment income</td>
<td>13,853</td>
<td>0.7%</td>
<td>19,939</td>
<td>1.0%</td>
<td>6,086</td>
<td>43.9%</td>
</tr>
<tr>
<td>Intergovernmental revenues</td>
<td>989,296</td>
<td>52.9%</td>
<td>1,037,252</td>
<td>53.7%</td>
<td>47,956</td>
<td>4.8%</td>
</tr>
<tr>
<td>Charges for services</td>
<td>134,464</td>
<td>7.2%</td>
<td>124,859</td>
<td>6.5%</td>
<td>(9,605)</td>
<td>(7.1%)</td>
</tr>
<tr>
<td>Other</td>
<td>40,021</td>
<td>2.1%</td>
<td>39,800</td>
<td>2.1%</td>
<td>(221)</td>
<td>(0.6%)</td>
</tr>
<tr>
<td>Total</td>
<td>$ 1,870,337</td>
<td>100.0%</td>
<td>$ 1,931,266</td>
<td>100.0%</td>
<td>$ 60,729</td>
<td>3.2%</td>
</tr>
</tbody>
</table>
Table 4—General Fund Expenditures by Function (in thousands)

<table>
<thead>
<tr>
<th>Expenditures by function</th>
<th>FY 2005</th>
<th></th>
<th>FY 2006</th>
<th></th>
<th>Increase/(Decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td></td>
<td>Amount</td>
<td></td>
<td>Percent</td>
</tr>
<tr>
<td>General government</td>
<td>$136,903</td>
<td>8.3%</td>
<td>$156,327</td>
<td>8.6%</td>
<td>$19,424</td>
</tr>
<tr>
<td>Public protection</td>
<td>532,644</td>
<td>32.4%</td>
<td>583,935</td>
<td>31.9%</td>
<td>51,291</td>
</tr>
<tr>
<td>Public ways and facilities</td>
<td>94,530</td>
<td>5.7%</td>
<td>59,661</td>
<td>3.3%</td>
<td>(34,869)</td>
</tr>
<tr>
<td>Health and sanitation</td>
<td>326,151</td>
<td>19.8%</td>
<td>346,283</td>
<td>18.9%</td>
<td>20,132</td>
</tr>
<tr>
<td>Public assistance</td>
<td>545,686</td>
<td>33.2%</td>
<td>599,749</td>
<td>32.8%</td>
<td>54,063</td>
</tr>
<tr>
<td>Debt service</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Principal retirement</td>
<td>5,098</td>
<td>0.3%</td>
<td>73,974</td>
<td>4.0%</td>
<td>68,876</td>
</tr>
<tr>
<td>Interest and fiscal charges</td>
<td>3,416</td>
<td>0.2%</td>
<td>8,502</td>
<td>0.5%</td>
<td>5,086</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>$1,644,428</td>
<td>100.0%</td>
<td>$1,828,431</td>
<td>100.0%</td>
<td>$184,003</td>
</tr>
</tbody>
</table>

General Fund revenues from all sources, except for fines, forfeitures and penalties, charges for services and other revenues, increased for the year. Its expenditures on all governmental functions, except for public ways and facilities, also increased. Combined debt service expenditures (principal and interest) increased due to larger amount of principal payments on outstanding bonds.

Our discussion on the County’s governmental activities identified key reasons for changes in its revenues and expenses that also help explain significant changes in the General Fund because it is the chief operating fund of the County, and its revenues and expenditures respectively cover 88.8 percent and 85.7 percent of the County’s total current year revenues and expenditures of all governmental funds. For this reason, we will briefly mention the points that were elaborated in our earlier discussion on the countywide revenues and expenses. This section will elaborate only those points that were not included in our earlier discussion.

- Pertinent reasons for the $22.0 million or 3.4 percent growth in tax revenues were explained in earlier discussion on the countywide governmental programs and activities.
- Licenses and permits increased by $1.8 million or 18.4 percent. This included an increased of $1.1 million in revenues from construction permits issued for new homes and remodeling projects. The remaining amount of increase came from higher fee charged by the Fire Marshal and Emergency Medical Services (EMS) programs. Fire Marshall increased the inspection and permit fees by about 25.0 percent, while the annual fee for EMS increased from $50,000 to $75,000.
- Fine, forfeiture and penalties decreased by $7.3 million or 16.0 percent due to a $3.2 million reduction in delinquent tax revenues transferred from the Tax Loss Reserve Fund to the General Fund. Reduction in various one-time revenues from FY 2005 caused the remaining $4.1 million decreases.
- Interest and investment income increased by $6.1 million or 43.9 percent due to higher interest rates and average daily cash balances. The commingled investment pool’s average quarterly earnings rate increased from 2.1 percent last year to 3.8 percent in the current year. Average daily cash balance increased 70.0 percent from $366.0 million to $623.0 million.
- Net revenues from intergovernmental sources increased by $48.0 million or 4.8 percent. Federal and state grants for public assistance and health administration related programs increased by $67.1 million due to increased demands for these services as well as higher costs to run these programs; public safety sales tax revenues increased by $6.8 million; and revenues collected from SB 90 mandated programs, Registrar of Voters, homeland security and other programs also increased by $14.5 million. These increases were offset by decline of $42.9 million in one-time revenues from Motor Vehicle in Lieu (MVIL) backfill loan.
- Charges for services decreased by $9.6 million or 7.1 percent. This included a reduction of $5.3 million in SB855 program revenues for reasons explained earlier on the countywide business-type activities, a $2.6 million decline in election service charges due to fewer elections held in this year, and a decrease of $2.0 million in booking fees as a result of the State legislation reducing fees charged to cities.
• Pertinent reasons for changes in General Fund expenditures are not different from what was explained in earlier discussion on the countywide governmental programs and activities.

• Operating subsidy (transfers) to the SCVMC increased by $81.8 million due to rising health service cost.

The fund balances for the non-major governmental funds increased by $73.6 million or 22.3 percent to $403.2 million. The following non-major governmental funds had significant increases in fund balances: County Library ($3.6 million), Vector Control ($3.3 million), Multiple Facilities Bonds ($18.1 million), Multiple Facilities Construction ($47.8 million) and Parks Acquisition and Development ($8.8 million). Morgan Hill Courthouse Construction fund had significant decrease in its fund balance ($10.1 million).

Revenues for nonmajor governmental funds increased by $27.7 million or 12.9 percent for the year.

• Property taxes for the County library, Parks, and the fire districts increased by $12.2 million or 12.9 percent for reasons explained earlier.

• Revenues from licenses and permits increased by $0.8 million due to higher demand for governmental services.

• Investment income increased by $5.3 million or 45.4 percent for reasons explained earlier.

• Intergovernmental revenues increased by $9.5 million or 20.6 percent because the State resumed funding for the traffic congestion relief program that was suspended for two years. In the current year, the County received $5.5 million in revenues from this program. Increased funding from state tobacco tax ($1.5 million), state grant ($1.2 million) for parks capital projects, as well as funding from the Federal for housing and community developments ($0.8 million), and other miscellaneous funding ($0.4 million) also contributed to higher revenues.

• Charge for services increased by $2.7 million or 8.6 percent. This includes a $1.7 million increase from the Fire Districts resulted mostly from fee increases, which reflects its cost increases for providing services, primarily from employee retirement contribution and workers' compensation costs. Roads fund also had an increase of $1.0 million mainly from capital and road maintenance projects. The total increases in charge for services were offset by $2.7 million decrease in other revenues.

Expenditures for non-major governmental funds increased by $58.1 million or 23.4 percent for the year.

• Overall salaries and benefits expenditures increased by $8.7 million for reasons discussed earlier.

• Capital project expenditures increased by $47.7 million primarily due to increase in number of general capital improvement projects.

• Combined debt service (principal retirement and interest) expenditures increased by $1.8 million mainly from increased interest expenditures for the 2005 bonds and the issuance costs for the new 2006 bonds.

Non-major governmental funds' transfers in exceeded transfers out by $46.0 million for various capital projects undertaken by the General Capital Improvements, Parks, and Roads. The Multiple Facilities Construction Fund received $88.6 million in proceeds from the 2006 Lease Revenue Series I bonds for construction, furnishing and equipping of a new crime laboratory in San Jose and seismic retrofitting for the County courthouses.

Proprietary funds. The County's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

As of June 30, 2006, the County's net assets in its enterprise funds were $54.7 million. The investment in capital assets net of depreciation and related debt was $21.5 million. The restricted net assets of the enterprise funds were $39.0 million. These assets represent resources that are subject to external restrictions on how they may be used. The unrestricted net assets as of June 30, 2006 had a deficit balance of $5.8 million.

The net assets of the County's enterprise funds increased by $53.2 million for the year. Primary reasons for change in net assets are explained in the framework of individual enterprise funds.

SCVMC is the largest enterprise fund and its revenues and expenses comprise 99.3 percent of the total revenues and expenses for all enterprise funds. The other two enterprise funds—Airport and Sanitation District—are very small in comparison.
Net assets for SCVMC increased by $52.7 million, which included a $97.0 million transfer from the general capital improvement fund for various completed and in-progress capital construction projects. Its unrestricted net assets were a deficit of $14.2 million. Operating revenues increased by $20.7 million or 4.0 percent and expenses rose by $103.0 million or 16.3 percent. The net transfers were $239.0 million for the year. The primary reason for increased expenses were higher salary and benefit costs and increased cost of medical supplies and services due to rising prices and increased activity. The restricted net assets of SCVMC were $38.2 million at June 30, 2006. The net assets invested in capital assets, net of related debt were $7.2 million. There were no significant changes to the net assets for the airport and sanitation districts during the year.

**GENERAL FUND BUDGETARY HIGHLIGHTS**

The County's final budget appropriations for FY 2006 were $2.5 billion, which was $49.6 million or 2.1 percent higher than the original budget adopted by the Board. Occasionally, unexpected events may cause the County to commit its one-time reserves or use ongoing resources to pay for those unplanned events. The Board approves all supplemental appropriations. The difference between the original and final budgets represents supplemental appropriations approved by the Board for various new grants received by the County, or to pay for increased service level that was not expected when the original budget was approved.

General fund revenues and expenditures were less than budgetary estimates for the year. Estimated revenues for the year exceeded actual revenues by $19.2 million or 0.9 percent. While taxes, licenses and permits, interest and investment income, other financing sources, and inter-fund transfers surpassed their estimates, all other revenue sources came in lower than estimates. Final budgetary appropriations exceeded actual expenditures by $327.5 million or 13.3 percent for the year. The bulk of these cost savings resulted from unspent appropriations of a) $134.9 million in contingency reserves; b) $16.4 million in salaries and benefits costs due to elimination of vacant positions; c) $141.3 million in services and supplies costs for government programs—general government, public assistance, health and sanitation, and Measure B programs; d) $31.5 million in inter-fund transfers primarily for Measure B transportation improvement projects that have extended beyond current fiscal year and SCVMC subsidy; and e) $3.4 million in capital assets and debt service payments.

The General Fund budgetary comparison schedule starts on page 88 of this report.

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital assets**

As shown in Table 5 below, the County's investment in capital assets (net of accumulated depreciation) as of June 30, 2006 was $1.1 billion. This includes investment in land, buildings and improvements, leasehold improvements, infrastructure, equipment and vehicles, and construction in progress.

**TABLE 5-Capital Assets (Net of depreciation, in thousands)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>177,801</td>
<td>177,993</td>
<td>6,310</td>
<td>6,310</td>
<td>184,111</td>
<td>184,303</td>
<td>152</td>
<td>0.1%</td>
</tr>
<tr>
<td>Buildings &amp; improvements</td>
<td>306,386</td>
<td>302,167</td>
<td>186,933</td>
<td>196,980</td>
<td>493,319</td>
<td>499,147</td>
<td>5,828</td>
<td>1.2%</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>116,330</td>
<td>126,420</td>
<td>-</td>
<td>-</td>
<td>116,330</td>
<td>126,420</td>
<td>10,090</td>
<td>8.7%</td>
</tr>
<tr>
<td>Equipment and vehicles</td>
<td>40,498</td>
<td>37,659</td>
<td>19,427</td>
<td>22,102</td>
<td>59,925</td>
<td>59,761</td>
<td>(164)</td>
<td>(0.3%)</td>
</tr>
<tr>
<td>Leasehold improvements</td>
<td>-</td>
<td>-</td>
<td>1,350</td>
<td>1,087</td>
<td>1,350</td>
<td>1,087</td>
<td>(263)</td>
<td>(19.5%)</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>178,936</td>
<td>141,189</td>
<td>23,927</td>
<td>101,376</td>
<td>322,523</td>
<td>242,568</td>
<td>40,042</td>
<td>19.9%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$819,611</strong></td>
<td><strong>$785,388</strong></td>
<td><strong>$237,947</strong></td>
<td><strong>$327,855</strong></td>
<td><strong>$1,057,558</strong></td>
<td><strong>$1,113,243</strong></td>
<td><strong>$55,685</strong></td>
<td><strong>5.3%</strong></td>
</tr>
</tbody>
</table>

The County's net capital assets increased $55.7 million or 5.3 percent for the year. Net capital assets for the governmental activities decreased by 4.2 percent, while the business-type activities' net capital assets increased by 37.8 percent. Changes in capital assets by activity type were as follows:
Governmental Activities

The County acquired $101.9 million in new capital assets for its governmental activities, as follows:

- Equipment and vehicles — $6.8 million was spent for equipment and vehicles, including law enforcement and specialized vehicles, 911 dispatcher communication equipment, high-speed mail processors and optical scan readers for Registrar of Voters, data storage devices, and computer equipment. Expenditure also included live scan booking stations and Rapid Development Kit (RDK) for quick assessment and management of gaseous threat for the Sheriff Department, proteom array system for Public Health, self-check systems for various libraries, electric sprayers for Vector Control, and trail bulldozers for Parks.

- Specialized equipment for the Fire Departments was acquired for $1.5 million. This consisted of two fire engines and several fire hydrants.

- Construction in progress activities of $93.5 million were added for the year.
  - Capital improvement projects of $79.1 million undertaken by the County Facilities and Fleet (FAF) for the continued construction and improvement of Valley Specialty Center, various county business centers, Morgan Hill Courthouse, various valley health centers, the Crime Lab, juvenile facilities, jail and justice facilities, and other small projects.
  - Technology infrastructure improvement projects of $0.7 million.
  - Roads projects for $11.1 million consisted of bridge repairs and rehabilitation, pedestrian and bicycle routes improvements, signal synchronization programs, pavement management of Measure B projects, and the continued comprehensive study and planning for the County expressways.
  - Parks projects for $2.6 million included implementation of master plans for Alviso Marina Park, a water tank replacement at Sarin Park, road re-pavement and rehabilitation of an irrigation system at Vasona Park, and other improvements.

Transfers of $130.9 million construction in progress comprised various completed ($64.9 million) and in progress ($66.0 million) projects during the year. The completed projects included $47.6 million in capitalized costs of various FAF capital projects (including $25.5 million for building and improvements, $0.7 million for equipment, and $21.4 million for Valley Health Center at Tully Road), $16.9 million of infrastructure projects undertaken by the Roads Department ($6.0 million for signal synchronization project and $6.0 million for expressway, highway, road, and bridge improvement projects) and Parks and Recreation ($3.8 million for Alviso Marina County Park master plan implementation and $1.1 million for park infrastructure improvements), and $0.3 million for technology improvement projects undertaken by the Information System Department. The in-progress projects undertaken by FAF were solely for SCVMC.

Retirement of $15.8 million depreciable capital assets included the San Martin Court House building impairment ($9.1 million), vehicles ($1.9 million), computer equipment ($2.0 million), and other equipment ($2.8 million)—including office equipment, movable medical equipment, live scan devices, and specialized equipment used by Fire Departments.

Business-type activities

Net capital assets for business-type activities increased by $89.9 million for the year. SCVMC spent $12.3 million for patient care equipment and $2.4 million on building improvements. The construction in progress includes $93.4 million for various buildings, building improvements, and fixed equipment at SCVMC, and $7.9 million for the aircraft hangar improvements at South County Airport and Palo Alto Airport.

Commitment of Resources for Construction Work in Progress

At June 30, 2006, the County had committed $31.4 million of its net assets from the governmental activities and $142.1 million of its net assets from the business-type activities for various uncompleted capital projects included in the construction in progress.

Additional information on the County’s capital assets can be found in Note 6 on page 55 of this report.
Long-term debt
The County’s long-term outstanding debt as of June 30, 2006 was $909.0 million as shown in Table 6 below:

<table>
<thead>
<tr>
<th></th>
<th>Governmental Activities</th>
<th>Business-type Activities</th>
<th>Total</th>
<th>Dollar Change</th>
<th>Percent Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lease revenue bonds (net of discounts and deferred loss on refunding)</td>
<td>$ 208,770</td>
<td>$ 288,130</td>
<td>$ 435,659</td>
<td>$ 543,387</td>
<td>$ 644,429</td>
</tr>
<tr>
<td>Special obligation bonds (net of premium)</td>
<td>142,868</td>
<td>71,626</td>
<td>-</td>
<td>142,868</td>
<td>71,626</td>
</tr>
<tr>
<td>Certificates of participation</td>
<td>805</td>
<td>550</td>
<td>-</td>
<td>805</td>
<td>550</td>
</tr>
<tr>
<td>Capital lease obligations</td>
<td>4,472</td>
<td>5,288</td>
<td>-</td>
<td>4,472</td>
<td>5,288</td>
</tr>
<tr>
<td>Total</td>
<td>$ 356,915</td>
<td>$ 365,594</td>
<td>$ 435,659</td>
<td>$ 543,387</td>
<td>$ 792,574</td>
</tr>
</tbody>
</table>

The County’s long-term debt, net of debt service principal pay-off of $90.1 million for the year, increased $116.4 million or 14.7 percent. The increase resulted from issuance of two new bonds in the aggregate amount of $203.7 million and a new capital lease agreement in the amount of $2.6 million.

In March 2006, the Santa Clara County Financing Authority (SCCFA) issued 2006 Lease Revenue bonds Series I ($149.7 million) and J ($54 million). These bond proceeds were to provide funds for (i) the site preparation, construction, furnishing and equipping of a new crime laboratory in San Jose, the Valley Health Clinics in Sunnyvale and Gilroy; (ii) the seismic retrofitting of the Santa Clara Courthouse; (iii) the payment of capitalized interest on the I and J bonds for the construction period through April 2009 and broker-dealer fees; (iv) funding of debt service reserve funds; and (v) the costs of bonds issuance.

In December 2005, the County entered into a new capital lease agreement with CalLease Public Funding Corporation to finance its acquisition of 127 new vehicles.

For its outstanding revenue bonds and certificates of participation, the County has maintained an AA rating from the Standard & Poor’s (S&P), and an Aa3 rating from the Moody’s Investors Service. S&P has also maintained the County’s general obligation bond rating to AA+. This combination of S&P ratings is the highest rating any large California County has ever achieved since Proposition 13 was passed in 1978. The County’s TRANS ratings are SP-1+ from Standard & Poors and MIG 1 from Moody’s. Each rating is the highest awarded for short-term notes.

Additional information on the County’s long-term debt can be found in Note 8 on page 60 of this report.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The FY 2007 budget assumes the financial climate in Santa Clara County continues to be one of a slow recovery from the downturn in 2001. The National and State economy continues to grow but at a slow pace, as consumers spending has somewhat slowed down, and the housing market and homebuilding have shown signs of weakening. The local economic indicators show that the Silicon Valley economy recovery rate is slower than that of the other economic regions in the State, particularly the central valley and the inland empire.

The County’s employment picture has continued to improve and its unemployment rate fell below the State average for the first time since 2001. The unemployment rate was 5.0 percent in June 2006, compared to 5.6 percent a year ago. In September 2006, it fell to 4.5 percent against the 4.8 percent rate for the State. Total labor force within the County’s geographical areas declined slightly. The real per capita income (a measure of wealth creation), and the average wage (an indicator of job quality) increased by 3.1 percent to $53,633, much higher than the national level of $34,602 in 2005. The productivity per employee increased
by 4.4 percent, which is 2.0 times the national average. The median household income at $84,987 is higher than the State and National average.

The Countywide taxable retail sales increased 8.2 percent to $27.8 billion in FY 2006, slightly below the statewide average growth rate of 8.6 percent. Public safety sales tax revenue increased by $7.3 million despite a 0.2 percent decline in the County’s share of the statewide taxable sales. The sales tax revenues are expected to grow, but at a slower pace.

Research and development (R&D) and office space occupancy rates—leading indicators of economic activity—continued to improve by a small margin. The vacancy rate for R&D space was 20.2 percent in June 2006 versus 21.0 percent a year ago. The office space vacancy rate was 15.8 percent in June 2006, and the vacancy rate for the warehouse space fell from 21.9 percent in 2005 to 17.0 percent in June 2006.

Major sources of revenue generated from the performance of the local economy are:

- Assessed values for real property up by 8.8 percent and the unsecured personal property values by 5.9 percent in FY 2006. These included the $24.7 million growth in secured property tax revenues and $12.4 million in property transfer and supplemental tax revenues. The FY 2007 budget assumes a 9.5 percent increase in secured property assessed values, which corresponds to an increase of $28 million in property tax revenues.

- Retail taxable sales have continued to grow countywide. The One-half Cent Transportation (Measure B) countywide tax decreased by $24.4 million or 17.0 percent as the program ended on March 30, 2006. The local unincorporated area sales tax increased by $0.5 million or 16.0 percent. The FY 2007 budget assumes a moderate increase in sales tax revenues.

The FY 2007 Countywide budget of $3.9 billion included over $164.6 million of deficit reduction solutions. Since FY 2003, the County has implemented $802.7 million in a combination of deficit solutions to meet the local budget requirements and the impacts of reduced state and federal funding. These deficit solutions include: use of one-time reserves; departmental target reductions; revenue enhancements; restructuring PERS rates; and savings from modified funding policies related to workers compensation and retiree health, and use of reserves at SCVMC.

The FY 2007 budget sets aside $87.8 million in reserves—$82.4 million in contingency reserves, and $4.9 million in reserves for economic uncertainty.

Operating reserve designations and the strategic reserve designations are part of the financial resources that are available to address unanticipated revenue shortfalls or unforeseen expenditures. These designations provide a primary defense against deficit spending and help maintain liquidity when budgeted draw downs become necessary.

Activity at SCVMC remains high with an average daily census of 350.9 or 2.3 percent above budget, and outpatient visits of 632,250 or 1.4 percent above budget. Outpatient visits are 2.6 percent higher than last fiscal year. Strong activity and an improving payer mix have allowed the SCVMC’s enterprise funds to operate within their budget plan, including use of the General Fund subsidy. The results of operations for the remainder of the fiscal year will be in large part determined by the health of other hospitals in the region, economic recovery, changes in Federal reimbursement regulations, and State budget decisions. The FY 07 budget includes General Fund subsidy of $166.9 million to SCVMC, which is comprised of three basic elements: pass-through revenues, un-reimbursed County services (e.g. medical care for inmates and employee physicals), and the General Fund grant.

As of June 30, 2006, the unreserved fund balance in the General Fund was $553.9 million. Of this amount, $299.5 million is designated but available for appropriation. The proposed and final budgets were adopted prior to July 1 of the new fiscal year.
Request for Information
This financial report is designed to provide a general overview of the County's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the County's Finance Agency, Controller-Treasurer Department, 70 West Hedding Street, 2nd Floor, East Wing, San Jose, CA 95110. This entire report is also available online at www.sccgov.org.