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February 15, 2019

To the Board of Commissioners
and Executive Director
Housing Authority of the
County of Santa Cruz
Santa Cruz, California

We have audited the financial statements of the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the Housing Authority of the County of Santa Cruz, California (the Authority) for the year ended June 30, 2018. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards*, and the Uniform Guidance, as well as certain information related to the planned scope and timing of our audit.

<u>Our Responsibilities under U.S. Generally Accepted Auditing Standards, Government Auditing Standards, and the Uniform Guidance</u>
As stated in our engagement letter dated January 17, 2019, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over the financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with the Uniform Guidance.

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants. However, providing an opinion on compliance with those provision is not an objective of our audit. Also, in accordance with the Uniform Guidance, we examined, on a test basis, evidence about the Authority's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Compliance Supplement applicable to each of its major federal programs for the purpose of expressing an opnion on the Authority's compliance with those requirements. While our audit provided a reasonable basis for our opinion, it does not provide a legal determination on the Authority's compliance with those requirements.

Our responsibility for the supplementary information accompanying the financial statements, as described by professional standards, is to evaluate the presentation of the supplementary information in relation to the financial statements as a whole and to report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Planned Scope and Timing of the Audit

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit involved judgement about the number of transactions to be examined and the areas to be tested.

Our audit included obtaining an understanding of the entity and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. Material misstatements may result from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violation of laws or government regulations that are attributable to the entity or to acts by management or employees acting on behalf of the entity. We noted no material misstatement that required communication to you during our audit.

Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Issues

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Authority are described in Note 1 to the financial statements. As explained in Note 1.P., the Authority implemented GASB No. 75 *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions* during the current fiscal year. The implementation of this new GASB had a negative financial impact on the financial position of the Authority. A reduction to net position was recognized as of July 1, 2017, in the amount of $846,610. We noted no transactions entered into by the Authority during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the Authority's financial statements were:

- Depreciation on capital assets: Management's estimate of the useful lives of its capital assets is based on historical information about similar assets, the length of time the assets are expected to meet service and technology demands, and the Authority's maintenance policy for the assets.

These estimates have remained consistent for several years. We evaluated the key factors and assumption used to develop the depreciation estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

- Pension liability, deferred outflows of resources and deferred inflows of resources: Management's estimates were derived from actuarial valuations obtained from experts. We agreed the amounts recorded in the books of accounts and the other information contained in the pension footnote (Note 12) to the amounts reported in the "GASB 68 Accounting Valuation Reports" obtained from PERS, as of the measurement date of June 30, 2017.
- Other Postemployment Benefits (OPEB) liability, deferred outflows of resources and deferred inflows of resources: Management's estimates were derived from actuarial valuations obtained from experts. We agreed the amounts recorded in the books of accounts and the other information contained in the OPEB footnote (Note 13) to the amounts reported in the "Valuation of Retiree Health Benefits, Report of GASB 75 Actuarial Valuation as of July 1, 2017" prepared by North Bay Pension LLC.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the financial statements was the disclosure of related parties in Note 18 to the financial statements. This disclosure describes the Authority's relationship, including financial, with its related parties. Also of significance to the financial statement users are Notes 12 and 13, which describe the Authority's pension and OPEB plans.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

Disagreements with Management

For the purpose of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated February 15, 2019.

Management Consultation with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the government unit's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Matters or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the government unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition of our retention.

Other Matters

We applied certain limited procedures to the MD&A, which is required supplemental information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding 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 did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the Schedule of Expenditures of Federal Awards, the Financial Data Schedules, and the Statement of Completed Capital Fund Program Project, which accompany the financial statements but are not RSI. With respect to the supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

Restriction on Use

This information is intended solely for the use of the Board of Commissioners and the management of the Housing Authority of the County of Santa Cruz and is not intended to be and should not be used by anyone other than these specific parties.

Very Truly Yours,

Harn & Dolan

Harn & Dolan, CPA's

HOUSING AUTHORITY
OF THE COUNTY OF SANTA CRUZ
BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2018
(Including Auditors' Report Thereon)

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
BASIC FINANCIAL STATEMENTS
JUNE 30, 2018

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INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
Housing Authority of the
County of Santa Cruz
Capitola, California

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Housing Authority of the County of Santa Cruz, California (the Authority), as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the Authority'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 misstatements, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions 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 of 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 judgement, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Authority'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 Authority'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 opinions.

Opinions

In our opinion, based on our audit, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Housing Authority of the County of Santa Cruz, California, as of June 30, 2018, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Notes 1.P. and 13 , the Authority adopted the provisions of Government Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions*, as of July 1, 2017. Our opinions are 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 management's discussion and analysis on pages 4-11 and the supplementary information required for the pension and other postemployment benefit plans on pages 51-52 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.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Housing Authority of the County of Santa Cruz, California's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, and is not a required part of the basic financial statements. The accompanying Financial Data Schedules (CA072), shown on pages 56-63, are presented for purposes of additional analysis as required by *Uniform Financial Reporting Standards* issued by the U.S. Department of Housing and Urban Development and are not a required part of the basic financial statements. Finally, the accompanying Statement of Completed Capital Fund Program Project is presented for the purposes of additional analysis as required by the U.S. Department of Housing and Urban Development and is also not a required part of the basic financial statements.

The Schedule of Expenditures of Federal Awards, the Financial Data Schedules, and the Statement of Completed Capital Fund Program Project are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards, the Financial Data Schedules, and the Statement of Completed Capital Fund Program Project are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 15, 2019 on our consideration of the Housing Authority of the County of Santa Cruz, California'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 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 the Authority's internal control over financial reporting and compliance.

Harn & Dolan

February 15, 2019

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2018

The Management Discussion and Analysis (MD&A) is intended to serve as an introduction to the basic financial statements for the Housing Authority of the County of Santa Cruz (the "Authority"), and is designed to:

(a) Assist the reader in focusing on significant financial issues.
(b) Provide an overview of the Authority's financial activity.
(c) Identify changes in the Authority's financial position (its ability to address the next and subsequent years' challenges).
(d) Identify individual fund issues or concerns.

The MD&A is designed to focus on the current years activities, resulting changes and currently known facts, please read it in conjunction with the Authority's financial statements beginning on page 12. These statements include audited financial statement data for Merrill Road Associates, as of June 30, 2018, and for the year then ended, as a blended component unit. This component unit receives a separate audit report which can be obtained from the Authority using the information on page 11. The discussion and comparisons to follow will only include the Primary Government figures for the Housing Authority of the County of Santa Cruz.

Financial Highlights

During calendar year 2017 and 2018, Congress reduced proration factors for Administration Fees for the Housing Choice Voucher (HCV) Program compared to the levels for the two preceding years..

The assets of the Authority exceeded its liabilities at the close of the most recent fiscal year by $17,468,561 (net position). Of this amount, $4,440,311 (unrestricted net position) may be used to meet the Authority's ongoing obligations. The Authority's unrestricted net position decreased by $1,858,143, which contributed to an overall decrease in total net position of $1,541,946 during the year.

Total grant revenues increased by $1,632,739 (2.45%) from the prior fiscal year, due primarily to increases in HAP of $2,332,125.

The overall expenses of the Authority programs increased by $4,018,153 (5.92%) over the prior year. Most of this increase was attributable to increases in HAP and Administration.

During the fiscal year, the Authority made the decision to relocate the office headquarters to the Authority owned office building at 2160 41st Avenue in Capitola which offers a convenient mid-county location for program participants and staff alike. Due to space constraints at 2160 41st Avenue, the Authority has entered into an agreement to lease the building next door to accommodate administrative staff. The warehouse which previously served as the Authority's main office will be leased in its entirety, generating positive cash flows which will contribute to unrestricted cash reserves.

Overview of the Financial Statements

The Authority's basic financial statements comprise:
Fund financial statements – pages 12-16
Notes to financial statements – pages 17-49

This report also contains other Required Supplementary Information (RSI) other than the MD&A which can be found beginning on page 50 and Supplementary Information beginning on page 54.

Authority-Wide Financial Statements

The authority-wide financial statements (see pages 13-15) are designed to provide readers with a broad overview of the Authority's finances in a manner similar to a private-sector business.

These Statements include a Statement of Net Position, which is similar to a Balance Sheet. The Statement of Net Position reports all financial and capital resources for the Authority. The statement is presented in the format where assets equal liabilities plus net position. Assets and liabilities are presented in order of liquidity, and are classified as current (convertible into cash within one year), and non-current. Interfund receivables and payables of $714,241 have been eliminated for this presentation.

Net Position is reported in three broad categories:

Net Investment in Capital Assets - This component of net position consists of all capital assets, reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

Restricted Net Position - This component of net position consists of restricted assets, when constraints are placed on the asset by creditors (such as debt covenants), grantors, contributors, laws, and regulations.

Unrestricted Net Position - Consists of net position that does not meet the definition of the other two types of net position.

The Authority-wide financial statements also include a Statement of Activities, which is similar to an Income Statement. This Statement measures net revenue (expense) for each of the Authority's functions and reports by program. General revenue is reported separately. The activities for the enterprise funds are presented by federal program administered by the Authority. Interfund revenue and expenses in the amount of $1,991,321 have been eliminated for this presentation. Please see Note 1(I) for additional details.

Fund Financial Statements

A fund is a group of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Authority, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The Authority consists of exclusively Enterprise Funds. Enterprise funds utilize the full accrual basis of accounting. The Enterprise method of accounting is similar to accounting utilized by the private sector. Many of the funds maintained by the Authority are required by the Department of Housing and Urban Development. Others are segregated to enhance accountability and control.

The Statement of Net Position, presents information on the Authority's assets, liabilities, with the difference between the two reported as net position. Assets and liabilities are presented in order of liquidity, and are classified as current (convertible into cash within one year), and non-current.

The Statement of Revenues, Expenses and Changes in Fund Net Position includes operating revenues, such as rental income, operating expenses such as administrative, utilities, maintenance, and depreciation, and non-operating revenue and expenses such as grant revenue, investment income and interest expense. The focus of this statement is the changes in fund net position which is similar to net income or loss.

Finally, a Statement of Cash Flows is included, which discloses net cash provided by, or used for operating activities, non-capital financing activities, capital financing activities, and investing activities.

The Authority's Funds

Conventional Public Housing – Under the Conventional Public Housing Program, the Authority rents units that it owns to low-income households. The Conventional Public Housing Program is operated under an Annual Contributions Contract (ACC) with HUD. Public Housing Agencies are limited by law in the amount of rent collected to no more than 30 percent of a family's adjusted income. HUD provides Operating Subsidy to cover the gap between rents collected and annual operating expenses. This fund includes the activity of the Public Housing Capital Fund Program grants received to modernize or supplement the operating costs of the Conventional Public Housing Program.

Housing Choice Voucher Program – Under the Housing Choice Voucher Program, commonly referred to as Section 8 tenant-based assistance, the Authority administers contracts with independent landlords that own the property. The Authority subsidizes the family's rent through a Housing Assistance Payment (HAP) made to the landlord. The program is administered under an Annual Contributions Contract (ACC) with HUD. HUD provides Annual Contributions Funding to enable the Authority to structure a lease that sets the participants' rent between 30% and 40% of household income. HUD provides the Authority with two separate funding amounts; one for housing assistance payments and the other for administrative expenses to operate the program.

Business Activities – Represents a variety of activities and accumulated unrestricted reserves with miscellaneous revenues and expenses that are not related to specific funds or projects. This includes the Housing Authority owned office buildings. These funds collect rents in the form of an occupancy expense that is tracked and allocated to programs based on payroll dollars. The occupancy expense comprises the interest portion of debt service, taxes, insurance and the cost of repairs, building services, utilities and either the principal portion of debt service or depreciation.

Other Non-Major Funds – In addition to the major funds described above, the Authority also maintains the following non-major funds. These non-major funds account for federal dollars, but are funds that have assets, liabilities, revenues, or expenses of less than ten percent of the Authority's total assets, liabilities, revenues or expenses.

- Section 8 Moderate Rehabilitation Program
- Section 8 Moderate Rehabilitation Program - SRO
- Mainstream 5 Voucher Program
- Resident Opportunity and Supportive Services
- *HOME Investment Partnerships Program
- Shelter Plus Care Housing Program
- USDA Farm Labor Housing Programs
- Supportive Housing Program
- Other State and Local Programs
- *Community Development Block Grant (CDBG)

*The HOME and CDBG are sub-recipient grants from local jurisdictions.

AUTHORITY-WIDE STATEMENT

Statement of Net Position

The following table reflects the condensed Statement of Net Position compared to prior year. The Authority is engaged in only Business-Type Activities.

Table 1
STATEMENT OF NET POSITION

	2018	2017	Increase/(Decrease) Amount	%
Current assets	$ 11,947,420	$ 11,947,869	$ (449)	0.00%
Restricted assets	2,453,665	2,881,611	(427,946)	14.85%
Capital assets	13,600,260	13,209,720	390,540	2.96%
Other assets	19,504	19,504	-	0.00%
Total Assets	28,020,849	28,058,704	(37,855)	0.13%
Total Deferred Outflows	3,065,940	3,301,808	(235,868)	7.14%
Current liabilities	1,080,057	1,169,243	(89,186)	7.63%
Payable from restricted cash	358,488	442,576	(84,088)	19.00%
Long-term liabilities	11,399,331	9,800,216	1,599,115	16.32%
Total Liabilities	12,837,876	11,412,035	1,425,841	12.49%
Total Deferred Inflows	780,352	937,970	(157,618)	16.80%
Net investment in capital assets	10,824,728	10,264,812	559,916	5.45%
Restricted	2,203,522	2,447,241	(243,719)	9.96%
Unrestricted	4,440,311	6,298,454	(1,858,143)	29.50 %
Total Net Position	$ 17,468,561	$ 19,010,507	$(1,541,946)	8.11%

Major Factors Affecting the Statement of Net Position

Unrestricted Net Position decreased by $1,858,143 (29.50%) due to the implementation of GASB 75 (OPEB), pension accruals related to GASB 68, and building/tenant improvements at the new 41st Ave office location. This activity was accompanied by an increase in long-term liabilities of $1,599,115 (16.32%) due to increases in the Net Pension and OPEB Liabilities based on the OPEB and pension plan actuarial reports and employer allocations as reported by CalPERS. Restricted assets decreased by $427,946 (14.85%) due to a reduction in the excess HAP funds on hand. Net investment in capital assets increased as a result of the building and tenant improvements at the new office locations.

Table 2 presents details on the change in Unrestricted Net Position.

TABLE 2
CHANGE IN UNRESTRICTED NET POSITION

	2018	2017	Increase/(Decrease) Amount	%
Unrestricted Net Position - July 1:				
Housing Authority originally stated	$ 6,298,454	$ 4,617,736		
Prior period adjustment for OPEB	(846,610)	-		
Housing Authority restated	5,451,844	4,617,736	$ 834,108	18.06%
Net gain (loss)	(695,336)	1,780,863	(2,476,199)	139.04%
Adjustments:				
Depreciation (1)	660,584	582,680	77,904	13.37%
Excess HAP (accumulated) used (1) (2)	484,457	(337,971)	822,428	243.34%
Capital asset additions	(1,051,125)	(28,808)	(1,022,317)	-
Principal paid on debt	(205,167)	(203,632)	(1,535)	0.75%
Deposits into restricted funds	(148,508)	(181,143)	32,635	18.02%
Other restricted revenue (1)	(62,692)	(45,838)	(16,854)	36.77%
Change in restricted migrant funds	(48,774)	39,593	(88,367)	223.19%
Interest on restricted funds (1)	(5,134)	(5,019)	(115)	2.29%
Use of restricted funds for modernization	24,370	19,910	4,460	22.40%
Change in interest payable on long-term debt (1)	35,792	60,083	(24,291)	40.43%
Unrestricted Net Position - June 30	$ 4,440,311	$ 6,298,454	$(1,858,143)	29.50%

(1) Reported as revenue or expense and is included in net income (loss), but does not have an impact on unrestricted net position.

(2) Grants received from HUD in excess of HAP are restricted for future HAP expense. Conversely, excess HAP expenses will offset restricted net position rather than unrestricted net position.

While results of operations is a significant measure of the Authority's activities, the analysis of the changes in unrestricted net position provides a clearer change in financial well-being.

Statement of Revenues, Expenses and Changes in Net Position

The following table compares the revenues and expenses for the current and previous fiscal year. The Authority is only engaged in business-type activities.

TABLE 3
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

			Increase/(Decrease)	
Revenues:	2018	2017	Amount	%
Rents	$ 2,474,421	$ 2,448,772	25,649	1.05 %
Grants	68,294,055	66,661,316	1,632,739	2.45 %
Interest	44,363	30,191	14,172	46.94 %
Other revenues	380,638	511,244	(130,606)	25.55 %
Total revenues	71,193,477	69,651,523	1,541,954	2.21 %
Expenses:				
Administration	5,887,941	4,516,027	1,371,914	30.38 %
Tenant services	984,542	993,274	(8,732)	0.88 %
Utilities	709,871	664,908	44,963	6.76 %
Maintenance	1,205,904	955,435	250,469	26.22 %
Extra ordinary maintenance	202,220	250,821	(48,601)	19.38 %
General	840,932	814,359	26,573	3.26 %
Housing assistance payments	61,338,929	59,006,804	2,332,125	3.95 %
Depreciation	660,584	582,680	77,904	13.37 %
Debt service – interest	57,890	86,352	(28,462)	32.96 %
Total expenses	71,888,813	67,870,660	4,018,153	5.92 %
Net increase (decrease) to net position	(695,336)	1,780,863	(2,476,199)	
Beginning net position, as originally stated	19,010,507	17,229,644		
Prior period adjustments:				
OPEB - GASB 75	(846,610)	-		
Beginning net position, as restated	18,163,897	17,229,644		
Ending net position	$ 17,468,561	$ 19,010,507		

Major Factors Affecting the Statement of Revenues, Expenses and Changes in Net Position

Total revenues increased by $1,541,954 (2.21%) over the prior fiscal year. Grant revenue increased by $1,632,739 primarily due to increased HAP. Other revenue experienced a decrease of $130,606 due in large part to the loss of commercial rental income during the construction at the 41st Avenue office building. The total expenses of the Authority's programs increased by $4,018,153 (5.92%) over the prior year, attributable mainly to increased HAP and Administration. Depreciation expense increased a result of the addition of depreciable capital assets. The increase in maintenance expense of $209,469 is mostly LIPH related.

DEBT ADMINISTRATION AND CAPITAL ASSETS

Debt Outstanding

As of year-end, the Authority had $1,915,516 in debt (bonds, notes, etc.) outstanding compared to $2,120,684 last year, a $205,168 decrease. A more detailed presentation of the Authority's debt, summarized below in Table 5, can be found in Note 7 to the basic financial statements.

TABLE 5
OUTSTANDING DEBT AT YEAR END

	2018	2017
Office Building Mortgage	$ 162,329	$ 347,072
USDA Farm Worker Housing	48,021	68,445
State of California HCD Loan (Brommer)	210,000	210,000
State of California HCD Loan (Merrill Road Associates)	1,195,167	1,195,167
Santa Cruz County RDA loan (Merrill Road Associates)	300,000	300,000
Total	$ 1,915,516	$ 2,120,684

Capital Assets

As of year-end, the Authority had $13,600,260 invested in a variety of capital assets as reflected in table 6, which represents a net increase of $390,540 from the end of last year, which is the result of $660,584 of depreciation expense, offset by $1,051,124 in additions. The $1,051,124 of capital additions consists of renovations at various Public Housing sites and building/tenant improvements at 41st Avenue offices, and levee improvements at the wastewater treatment facility at Tierra Alta Apartments. Table 7 summarizes the change in capital assets, which is presented in more detail in Note 6 to the basic financial statements.

TABLE 6
CAPITAL ASSETS AT YEAR END
(NET OF DEPRECIATION)

Business-type activities	2018	2017
Land and land rights	$ 8,130,532	$ 8,130,532
Buildings	35,785,685	34,819,032
Equipment	955,000	870,529
Accumulated depreciation	(31,270,957)	(30,610,373)
Total	$ 13,600,260	$ 13,209,720

TABLE 7
CHANGE IN CAPITAL ASSETS

Beginning Balance 7/1/2017	$ 13,209,720
Additions	1,051,124
Depreciation	(660,584)
Ending Balance 6/30/2018	$ 13,600,260

ECONOMIC FACTORS

Significant economic factors affecting the Authority are as follows:

- Federal Funding received from the Department of Housing and Urban Development
- Local labor supply and demand, which can affect salary and wage rates
- Local inflationary, recessionary and employment trends, which can affect resident incomes and therefore the amount of rental income
- Inflationary pressure on utility rates, supplies and other costs
- Increasing pension and OPEB liabilities and annual pension and OPEB contributions
- Local supply of available housing and the willingness of landlords to participate in the Housing Choice Voucher Program

OTHER POTENTIALLY SIGNIFICANT MATTERS

The following events are expected to have a significant effect on the financial position of the Authority.

(1) In recent years, the Housing Choice Voucher Program has received a flat fee for administrative expenses determined by HUD based on program size, historical lease up numbers, and available appropriations. As of January 1, 2009, HUD changed the method for calculating administrative fees for the Voucher Program back to a per unit leased fee. The rates are published by HUD, and subject to pro-rations based on available funding levels. These admin fee proration levels have a significant impact on the Authority's primary source of funding for administrative expenses in the largest program area.

(2) Funding for the Low Income Housing Program is provided through a combination of HUD's Operating Subsidy and the Capital Fund Program. These funding streams are subject to annual proration or reduction based on available appropriations. In recent years, HUD has expressed their desire to move away from the Low Income Public Housing program and focus more of their attention and funding on the Housing Choice Voucher Program. Consequently, HUD may reduce funding for the Operating Subsidy and Capital Fund Program in an effort to convince Housing Authorities to convert their Public Housing stock through RAD.

(3) The Government Accounting Standards Board (GASB) has issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions - an amendment of GASB 45*. See also Note 1.O. on page 27 for more details.

FINANCIAL CONTACT

The individual to be contacted regarding this report is:

Finance Director
Housing Authority of the County of Santa Cruz
2160 41st Avenue, Capitola, California 95010
(831) 454-9455

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
STATEMENT OF NET POSITION - PROPRIETARY FUNDS
JUNE 30, 2018

	Primary Government Business-type Activities
ASSETS	
Current assets:	
Cash and investments (Note 2)	$ 11,510,808
Due from other agencies	287,999
Tenant accounts receivable	26,248
Allowance for doubtful accounts	(11,957)
Accounts receivable - other	236,712
Allowance for doubtful accounts	(236,712)
Interest receivable	8,585
Prepaid expenses	125,737
Total current assets	11,947,420
Restricted assets:	
Restricted cash (Note 3)	2,453,665
Capital assets (Note 6):	
Land	8,130,532
Buildings	35,785,685
Equipment	955,000
Accumulated depreciation	(31,270,957)
Total capital assets	13,600,260
Other noncurrent assets:	
Long-term notes receivable (Note 5)	19,504
Total other noncurrent assets	19,504
Total assets	28,020,849
DEFERRED OUTFLOWS OF RESOURCES	
Pension plans (Note 12)	2,985,399
Other postemployment benefits (Note 13)	80,541
Total deferred outflows of resources	3,065,940

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
STATEMENT OF NET POSITION - PROPRIETARY FUNDS
JUNE 30, 2018
(Continued)

	Primary Government
	Business-type Activities
LIABILITIES	
Current liabilities:	
Accounts payable	$ 409,359
Due to other agencies	160,861
Accrued salaries	154,119
Payable from restricted assets:	
Tenant security deposits	209,076
Due to other agencies	94
Current portion of long-term debt (Note 7)	172,531
Current portion of compensated absences (Note 10)	73,349
Unearned revenue (Note 8)	109,838
Total current liabilities	1,289,227
Noncurrent liabilities:	
Long-term debt (Note 7)	1,742,986
Compensated absences (Note 10)	383,906
Payable from restricted assets:	
Family Self Sufficient escrow	149,318
Interest on long-term debt (Note 7)	860,015
Net pension liability (Note 12)	7,478,212
Net other postemployment liability (Note 13)	934,212
Total noncurrent liabilities	11,548,649
Total liabilities	12,837,876
DEFERRED INFLOWS OF RESOURCES	
Pension plan (Note 12)	768,414
Other postemployment benefits (Note 13)	11,938
Total deferred inflows of resources	780,352
NET POSITION	
Net position (Note 11):	
Net investment in capital assets	10,824,728
Restricted	2,203,522
Unrestricted	4,440,311
Total net position	$ 17,468,561

The accompanying notes are an integral part of this statement.

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2018

	Primary Government Business-type Activities
Operating revenue:	
Rents and other tenant revenue	$ 2,474,421
Other	380,638
Total operating revenue	2,855,059
Operating expenses:	
Administrative	5,887,941
Tenant services	984,542
Utilities	709,871
Maintenance	1,205,904
General	840,932
Housing assistance payments	61,338,929
Depreciation (Note 6)	660,584
Total operating expenses	71,628,703
Operating loss	(68,773,644)
Nonoperating revenue (expenses):	
Grants	68,294,055
Interest - unrestricted	39,258
Interest - restricted	5,105
Extra ordinary maintenance	(202,220)
Debt service - interest (Note 7)	(57,890)
Change in net position	(695,336)
Net position-beginning of the year, as originally stated	19,408,777
Prior period adjustments:	
Merrill Road Associates (Note 18)	(398,270)
Other postemployment benefits - GASB 75 (Note 13)	(846,610)
Net position-beginning of the year, as restated	18,163,897
Net position - end of year	$ 17,468,561

The accompanying notes are an integral part of this statement.

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2018

	Primary Government Business-type Activities
Cash flows from operating activities:	
Tenant receipts	$ 2,412,748
Other receipts	316,394
Migrant rent collected in deficit of disbursements to HCD	(5,005)
Payroll and benefit expenditures	(5,314,606)
Administrative expenditures	(490,522)
Tenant services expenditures	(808,478)
Utilities expenditures	(709,871)
Maintenance expenditures	(965,612)
General expenditures	(260,209)
Housing assistance payments	(61,304,617)
Net cash used by operating activities	(67,129,778)
Cash flows from noncapital financing activities:	
Operating grants received	68,331,477
Extra-ordinary maintenance expenditures	(202,220)
Net cash provided by noncapital financing activities	68,129,257
Cash flows from capital financing activities:	
Acquisition of capital assets	(1,051,125)
Principal paid on debt	(205,167)
Interest paid on debt	(22,098)
Net cash used by capital financing activities	(1,278,390)
Cash flows from investing activities:	
Interest receipts	34,791
Interest on restricted cash	5,199
Interest returned to granting agency	(330)
Net cash provided by investing activities	39,660
Net increase (decrease) to cash	(239,251)
Cash at beginning of year - Primary Government	13,814,057
Cash at beginning of year - Merrill Road Associates	389,667
Cash at end of year	$ 13,964,473
Cash and investments	$ 11,510,808
Restricted cash	2,453,665
Total	$ 13,964,473

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2018
(Continued)

	Primary Government Business-type Activities
Reconciliation of operating loss to net cash used by operating activities:	
Operating loss	$ (68,773,644)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Prior period adjustment for OPEB	(846,610)
Depreciation expense	660,584
Migrant rent collected in deficit of payments made to HCD	(5,005)
(Increase) Decrease in:	
Tenants accounts receivable	3,353
Prepaid expenses	11,896
Deferred outflows of resources	235,868
Increase (Decrease) in:	
Accounts payable	120,547
Due to other agencies	186
Accrued salaries	(3,234)
Compensated absences	25,884
Unearned revenues	(11,106)
Tenant security deposits	(11,730)
FSS escrows	(72,123)
Net pension liability	758,762
Net OPEB liability	934,212
Deferred inflows of resources	(157,618)
Net cash used by operating activities	$ (67,129,778)

Noncash Transactions:

- Interest expense of $35,855 was accrued on the loan payable by Merrill Road Associates to the State of California Housing and Community Development. Payments on this loan depend on the generation of surplus cash by the project. No payments were made on this loan during the current fiscal year.

The accompanying notes are an integral part of this statement.

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the Housing Authority of the County of Santa Cruz (the Authority) have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to government entities. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The following is a summary of the Authority's more significant accounting policies:

A. Organization

The Housing Authority of the County of Santa Cruz (the Authority) was established in 1969, by a resolution of the Santa Cruz County Board of Supervisors. The Authority is governed by a seven member Board of Commissioners. At-large commissioners are appointed for terms of four years and tenant commissioners are appointed for terms of two years by the Santa Cruz County Board of Supervisors.

B. Financial Reporting Entity

The Authority's basic financial statements include the accounts of all the Authority's operations. The criteria used in determining the scope of the financial reporting entity is based on provisions of Governmental Accounting Standards No. 61, *The Financial Reporting Entity*. The financial statements of the Authority include the financial activity of the Authority and any component units. The decision to include a potential component unit in the reporting entity was made based on the significance of their operations or financial nature and significance of their relationship with the Authority, including consideration of organizations for which the nature and significance of their relationship with the Authority are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. Based on the aforementioned criteria, the Authority has a blended component unit. The blended component unit, although a legally separate entity, is, in substance, part of the Authority's operations. The component unit is a follows:

Blended Component Unit:

Merrill Road Associates, A California Limited Partnership

Merrill Road Associates (the Partnership) was formed as a limited partnership on September 19, 1995, for the purpose of developing and operating a 15-unit affordable housing complex located in the unincorporated area in Santa Cruz County known as Aptos, California. The project qualified for federal low-income tax credits under Section 42 of the Internal Revenue Code. Such projects are regulated under terms of a regulatory agreement including rent charges, operating methods and other matters.

The managing general partner of the Partnership is Merrill Road Housing Corporation. The officers and directors of Merrill Road Housing Corporation are the same as the members of the Authority's Board of Commissioners. The Authority has guaranteed the General

Note 1 (continued)

Partner's obligation under the Operating Deficit Guarantee Agreement. The maximum obligation is limited to $65,765. The Authority was the developer of the project, earning a developer fee of $248,293 in 1998. As of September 30, 2011, Edison Housing Investment withdrew as the Limited Partner. Upon their withdrawal, the Authority was admitted as the new, and sole, Limited Partner. The Partnership has hired and executed a management agreement with the Authority to manage the property. The Authority loaned the Partnership funds and land to develop the project. The permanent loan totaled $451,509, bears no interest and requires annual payments only to the extent that the project generates surplus cash. The loan comes due in 2035. The principal balance on the land loan is $252,763. This loan bears 3% simple interest and requires annual payments only to the extent that the project generates surplus cash. The land loan is due in 2022.

Since the governing body of Merrill Road Associates is essentially the same as that of the Authority and since a financial benefit or burden relationship exists between Merrill Road Associates and the Authority, Merrill Road Associates has been included in the Authority's financial statements as a blended component unit. See also Note 18.

Complete audited financial statements are issued separately for this component unit and may be obtained from the Housing Authority of the County of Santa Cruz, 41st Avenue, Capitola, CA 95010.

C. <u>Basis of Presentation</u>

Business-type activities are financed in whole or in part by fees charged to external parties for goods or services. The Authority's activities are strictly business-type. The Authority has no fiduciary funds.

Fund Financial Statements:

Fund financial statements of the Authority are organized into funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for within a separate set of self-balancing accounts that comprise its assets, liabilities, net position, revenues, and expenses/expenditures as appropriate. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. The Authority considers all of its funds to be proprietary. An emphasis is placed on major funds. A fund is considered major if it is the primary operating fund of the Authority or if total assets, liabilities, revenues, or expenses of the individual fund are at least 10 percent of the Authority-wide total. The Authority considers all of its activity to be housing related and therefore, considers all the financial activity of the Authority to be one major fund, titled *Housing*. As such, the Authority has no non-major funds.

Note 1 (continued)

PROPRIETARY FUND TYPES

Enterprise Funds - Enterprise Funds are used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent is that costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. Enterprise funds are also used when the governing body has decided that periodic determination of revenues earned, expenses incurred, or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes. The Authority's funds are operated as enterprise funds.

D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Measurement focus refers to what is being measured; basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

The Proprietary Fund Types are accounted for on an economic resources measurement focus using the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recorded at the time liabilities are incurred. Under this basis of accounting and measurement focus, the Authority applies all GASB pronouncements.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues result from providing goods and services related to the fund's ongoing operations. The principal operating revenue of the Authority's enterprise funds is dwelling rental income. Operating expenses are necessary costs that have been incurred in order to provide the good or service that is the primary activity of the fund. The principal operating expenses of the Authority's enterprise funds are employee salaries and benefits, housing assistance payments, utilities, and the costs to maintain the owned units. All revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

For the Housing Choice Voucher Program, when both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as they are needed. For the USDA, Supportive Housing, Merrill Road Associates, and Migrant Farm Labor Housing Programs, when both restricted and unrestricted resources are available for use, it is the Authority's policy to use unrestricted resources first, then restricted as they are needed. When restricted resources are intended to be used for any program other than the Housing Choice Voucher Program, prior approval is requested from the appropriate governmental entity. No approval is required to expend the restricted funds of the Housing Choice Voucher Program, which can only be used for housing assistance payments.

Note 1 (continued)

E. Cash and Investments

For the purpose of reporting cash flows, cash and cash equivalents include cash on hand, cash in checking accounts, interest-bearing deposits, and highly liquid investments (LAIF). Investments are stated at fair value, with the unrealized gain or loss reported as interest revenue.

The Authority pools cash and investments. Each program's share in this pool is displayed in the accompanying Financial Data Schedule as *cash and investments*. Interest income earned by the pooled investments is allocated to the various funds based on each fund's average cash and investment balance.

F. Capital Assets

Capital assets are valued at historical cost. Contributed capital assets are recorded at fair market value at the time received. Interest expense incurred during the development period is capitalized.

Capital assets, which include land, buildings, and equipment, acquired for Proprietary Funds are capitalized in the respective funds to which they apply. The Authority has an established capitalization policy which requires all acquisitions of property and equipment in excess of $5,000 be capitalized. Depreciation of exhaustible capital assets used by Proprietary Funds is charged as an expense against operations, and accumulated depreciation is reported on the Proprietary Funds' statement of net position. Depreciation has been provided over the estimated useful lives using the straight-line method of depreciation. Generally, buildings are being depreciated over a useful life of thirty years, modernization and site improvements over ten years, and dwelling and other equipment over five years. The exceptions are that the 41st Avenue administration building is being depreciated over 25 years, the remodeling of the building is being depreciated over 17-19 years, and the hard wired equipment in the building is being depreciated over 10 years. Salvage value on all depreciable equipment is assumed to be insignificant and therefore valued at $0.

G. Deferred Outflows/Inflows of Resources

In addition to assets, the Statement of Net Position will include a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense) until then. The Authority's deferred outflows consist of items associated with, and referred to, in the actuarial reports of the defined benefit pension plan and the other postemployment benefit (OPEB) plan; as well as payments made on behalf of employees to the defined benefit pension and OPEB plans after the measurement date of the actuarial reports. See Notes 12 and 13.

Note 1 (continued)

In addition to liabilities, the Statement of Net Position will include a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. The Authority's deferred inflows consist of items associated with, and referred to, in the actuarial reports of the defined benefit pension and OPEB plans. See Notes 12 and 13.

H. Net Position

Net position represents the difference between assets, deferred outflows of resources, liabilities, and deferred inflows of resources. Net position consists of net investment in capital assets, restricted net position, and unrestricted net position. Net investment in capital assets consists of capital assets, net of accumulated depreciation; reduced by the outstanding balances of any borrowing used for the acquisition, construction, or improvements of those assets; excluding interfund borrowing and including accrued interest. Net position is reported as restricted when there are limitations imposed on its use either through constitutional provisions or enabling legislation or through external restrictions imposed by creditors, grantors, or laws or regulations of other governments.

I. Interfund Transactions

Statement of Net Position:

Short-term amounts owed between funds are classified as "Due from/to other funds". As of June 30, 2018, the amounts owed between the various proprietary funds totaled $655,018. See also Note 4.

Long-term notes in the amount of $704,272 and interest on these notes of $170,570 are due from the Authority's blended component unit, Merrill Road Associates, to the Authority's Business Enterprise Fund. See also Notes 5 and 7.

These interfund assets and liabilities have been eliminated from the Statement of Net Position - Proprietary Funds. For further detail, please refer to the Financial Data Schedule included as supplementary information to this report.

Statement of Revenue, Expenses, and Changes in Fund Net Position:

The Authority accumulates various administrative overhead costs in a separate fund. These costs are allocated to all programs on a monthly basis, based on direct salaries. The total amount accumulated in this fund and allocated to all programs during the current fiscal year was $1,692,995.

Note 1 (continued)

The Authority accumulates the costs of maintaining the administrative office building and the IT equipment in a separate fund. These costs are allocated to all programs, based on direct salaries. The total amount accumulated in this fund and allocated to all programs during the current fiscal year was $210,039.

The Migrant Enterprise Funds and Merrill Road Associates paid administrative fees to the Business Activities Enterprise Fund in the amount of $50,370 and $9,554, respectively, for the fiscal year ended June 30, 2018. In addition, the Authority is entitled to partnership management fees in the amount of $12,000 from Merrill Road Associates. This amount was accrued and reported as revenue of the Business Activities Enterprise Fund.

The Authority owned Spruce Street unit is occupied by a participant of the Housing Choice Voucher Program. Housing assistance payments in the amount of $8,780 were made from the Housing Choice Voucher Program to the Business Activities Enterprise Fund.

The Authority made a land loan to Merrill Road Associates which earns interest at a rate of 3% per annum. Interest accrued on this loan in the amount of $7,583 during the current fiscal year.

Interfund operating transfers totaling $721,324 were made for a variety of purposes. The Public Housing Capital Fund Grant of $385,362 was transferred in its entirety to the Public Housing Program to fund operations, as allowed by the grant. The FEMA grant received from the California Office of Emergency Services of $103,610 was transferred to the USDA Enterprise Fund and the State and Local Enterprise Fund which had incurred the emergency repair costs associated with the wastewater treatment plant. The Public Housing and Housing Choice Voucher Programs transferred $118,344 to fund the deficit associated with their Family Self Sufficiency Program. The Business Activities Enterprise Fund transferred $31,130 to fund the deficit in the Shelter Plus Care/Continuum of Care Program. An intrafund transfer of $9,295 was made between programs contained within the Other State and Local Enterprise Fund. An intrafund transfer of $73,583 was made between funds contained within the Business Activities Enterprise Fund.

Total interfund revenue and expenses of $1,991,321 have been eliminated from the Statement of Revenue, Expenses, and Changes in Fund Net Position - Proprietary Funds. The transfers net to zero and are not reported on the Statement of Revenues, Expenses, and Changes in Fund Net Position - Proprietary Funds. For further detail, please refer to the Financial Data Schedule included as supplementary information to this report.

J. <u>Estimates</u>

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America require management to make estimates and assumptions that affect the reported amounts of assets, deferred outflows of resources, liabilities, and deferred inflows of resources; the disclosure of contingent assets and

Note 1 (continued)

liabilities at the date of the financial statements; and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

K. Encumbrances

Encumbrance accounting is not employed by the Authority.

L. Income Taxes

The Authority is exempt from Federal Income and California Franchise Taxes.

M. Grant Restrictions

The Authority has received loans and grants from the U.S. Department of Housing and Urban Development, the U.S. Department of Agriculture, and the California Department of Housing and Community Development to build and improve housing projects. These grants require that only individuals and families that meet various income, age and employment standards be aided.

Further, if the net position of the Authority's U.S. Department of Agriculture (USDA) programs exceed certain levels, the payments on the notes payable to the U.S. Department of Agriculture must be increased.

N. Pension Plan

The Authority participates in a cost-sharing multi-employer defined benefit retirement plan that is administered by CalPERS. Contributions to CalPERS are made on a current basis as required by the plan and are charged to expenditures. The Authority used actuarial reports supplied by CalPERS for the purpose of measuring the net pension liability, deferred outflows of resources, and deferred inflows of resources and expenses related to the plan. The valuation date of the latest actuarial report was June 30, 2017.

O. Postemployment Benefits Other than Pension (OPEB)

The Authority provides a defined benefit health care program to its retired employees and their dependents. The Authority has established a trust account to administer the funding of the OPEB plan. The Authority used actuarial valuation reports supplied by OPEB consultants for the purpose of measuring the net OPEB liability, deferred outflows and inflows of resources, and expenses related to the plan in accordance with GASB 75 *Accounting and Financial Reporting for Postemployment Benefits Other than Pension*. The valuation date of the latest actuarial report was July 1, 2017.

(Continued)

Note 1 (continued)

P. <u>New Accounting Pronouncements</u>

<u>Pronouncements Implemented During the Current Fiscal Year</u>

GASB Statement No. 74 *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* - The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. The requirements of this Statement improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that were presented by OPEB plans that are administered through trusts that meet the specific criteria. There was no financial impact as a result of the implementation of this Statement.

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions* - The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). The primary requirements of this Statement are the recognition of the entire OPEB liability and a more comprehensive measure of OPEB expense. The implementation of this Statement resulted in a restatement, decreasing beginning net position of the primary government by $846,610. See also footnote 13 to the basic financial statements.

<u>Pronouncements to be Implemented in Subsequent Years</u>
In June 2017, the GASB issued Statement No. 87, *Leases*. The implementation of GASB Statement No. 87 will occur in the next fiscal year. The objective of this statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. The statement requires the recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provision of the contract. The impact of this pronouncement is not know at this time.

Note 2 - CASH AND INVESTMENTS

Cash and investments as of June 30, 2018 are classified in the accompanying financial statements as follows:

Cash and investments	$ 11,510,808
Restricted cash	2,453,665
Total cash and investments	$ 13,964,473

Note 2 (continued)

Cash and investments as of June 30, 2018 consist of the following:

Cash on hand	$ 350
Demand deposits	13,964,123
Total cash and investments	$ 13,964,473

Investments Authorized by the Authority's Investment Policy

The Authority's investment policy allows surplus cash to be invested in HUD approved securities, all of which are backed by the full faith and credit of, or a guarantee of principal and interest by, the U.S. Government, a Government agency or issued by a Government-sponsored agency. The approved types of investments are:

- Direct obligations - Treasury Bills, Notes, and Bonds
- Obligations of Federal Government Agencies - GNMA, Small Business Administration Debentures, Tennessee Valley Authority Power bonds and notes, Maritime Administration bonds, notes, and obligations
- Securities of Government Sponsored agencies - FNMA, U.S. Postage Service bonds
- Demand and savings deposits
- Certificates of deposit

Disclosures Related to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market rates. The Authority considers the deposit with LAIF to be cash equivalent, due to the fact that it can be converted to cash within a twenty-four hour period. The Authority has an immaterial term deposit with Santa Cruz County Bank. The deposit has a term of less than one year. The penalty for early withdrawal is the loss of a portion of the interest earned on the account. The Authority does not consider this deposit to be an investment.

Disclosures Related to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder on the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. LAIF does not have a rating provided by a nationally recognized statistical rating organization.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the Authority's investment policy do not contain legal or policy

Note 2 (continued)

requirements that would limit the exposure to custodial credit risk for deposits, other than the following provision for deposits: The California Government Code requires California banks and savings and loan associations to secure the Authority's deposits not covered by federal deposit insurance by pledging mortgages or government securities as collateral. The market value of mortgages must equal at least 150% of the face value of deposits. The market value of government securities must equal at least 110% of the face value of deposits. Such collateral must be held in the pledging bank's trust department in a separate depository in an account for the Authority.

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (broker-dealer, etc) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Authority's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for investments. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as LAIF).

The Housing Authority of the County of Santa Cruz executed a "General Depository Agreement" with Santa Cruz County Bank on October 30, 2013. This agreement states that "any portion of the PHA funds not insured by a Federal insurance organization shall be fully (100%) and continuously collateralized with specific and identifiable U.S. Government or Agency securities prescribed by HUD. Such securities shall be pledged and set aside in accordance with applicable law or Federal regulation."

The Authority's exposure to custodial credit risk is as follows:

Demand deposits with banks fully insured - FDIC	$ 250,000
Demand deposits with Santa Cruz County Bank, in excess of the amount insured, but covered by the depository agreement	11,908,359
Deposits with LAIF, at market	1,805,764
Total deposits	$ 13,964,123

Investment in State Investment Pool

The Authority is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The LAIF is a special fund of the California State Treasury through which local governments may pool investments. Each government agency may invest up to $30,000,000 in each account in the fund. Investments in LAIF are highly liquid, as deposits can be converted to cash within twenty-four hours without loss of interest or principal. The full faith and credit of the State of California secure investments in LAIF.

Note 2 (continued)

At June 30, 2018, an account was maintained in the name of the Housing Authority of the County of Santa Cruz for $1,809,169. The total cost value of investment in LAIF was $1,809,169. The total fair value of investments in LAIF was $1,805,764. The fair value total includes an unrealized loss of $3,405. The loss was based on a fair value adjustment factor of 0.998126869 that was calculated by the State of California Treasurer's Office.

LAIF is a part of the State of California Pooled Money Investment Account (PMIA). At June 30, 2018, the fair value of the State of California Pooled Money Investment Account (PMIA), including accrued interest, was $88,949,144,131. The PMIA portfolio had securities in the form of structured notes totaling $825 million and asset-backed securities totaling $1,549.080 million. The PMIA has policies, goals and objectives for the portfolio to make certain that the goals of safety, liquidity, and yield are not jeopardized. These policies are formulated by investment staff and reviewed by both the PMIA and LAIF Advisory Boards on an annual basis.

During 2002, California Government code was added to the LAIF's enabling legislation stating that "the right of a city, county...special district...to withdraw its deposited money from the LAIF upon demand may not be altered, impaired, or denied in any way by any state official or state agency based upon the State's failure to adopt a State Budget by July 1 of each new fiscal year." In addition, it has been determined that the State of California cannot declare bankruptcy under Federal regulations. This allows other government code stating that "money placed with the state treasurer for deposit in the LAIF shall not be subject to ...transfer or loan...or impound or seizure by any state official or state agency" to stand.

Note 3 - RESTRICTED CASH

Restricted cash consists of funds that cannot be disbursed by the Authority unless approval is obtained from another government agency and funds held by the Authority on behalf of its clients. These balances are as follows:

Offset by restricted net position:	
USDA project replacement	$ 1,538,495
Merrill Road Associates project replacement	309,219
Housing Choice Voucher excess HAP funds	115,775
Brommer Street replacement	92,346
Buena Vista Migrant operating reserves	28,342
Mortgage Credit Certificate program deposit	11,000
Offset by payable from restricted assets:	
Tenant security deposits	209,076
FSS program participants' escrow funds	149,318
Interest due to HUD	94
Total restricted cash	$ 2,453,665

Note 3 (continued)

The amounts held for the replacement of the USDA, Brommer Street and Merrill Road Associates projects cannot be disbursed without the prior written approval of either the USDA, Rural Economic and Community Development Department or the State of California, Department of Housing and Community Development. Cash for the USDA replacement reserves is in deficit of the net position by $40,327. This amount was originally approved by the USDA for emergency repairs done to the levee systems of the wastewater treatment plant. Subsequently, the Authority received funding from Federal Emergency Management Agency and California Office of Emergency Services grants. The funds are expected to be returned to restricted cash during the next fiscal year.

With the exception of the cash held for tenant security deposits, the above balances are maintained in a separate savings account for each fund. These savings accounts earn interest ranging from 0.05% to 0.35% per annum. The interest earned on the FSS escrow funds is payable to the participants and is not shown in the financial statements as revenue. The cash held for tenant security deposits is co-mingled with the Authority's other cash.

Note 4 - INTERFUND BALANCES

The programs below owe the Business Activities fund the following as of June 30, 2018:

Shelter Plus Care	$ 43,442
Family Self Sufficiency	20,433
HOME	7,742
CDBG	14,755
Other State/Local	28,886
Merrill Road Associates	12,000
Business Activities	424,150
Total owed to Business Activities	$ 551,408

In addition, The FEMA Enterprise Fund owes a total of $103,610 to the USDA Enterprise Fund and the Buena Vista Migrant Enterprise Fund. The amount owed are $41,444 and $62,166, to each respective fund.

Note 5 - NOTES RECEIVABLE

The following is a summary of the Authority's changes in notes receivable for the fiscal year ended June 30, 2018:

	Balance 7/1/2017	Loans Made	Payments Received	Balance 6/30/2018	S/T Portion
MRA Land Loan	$ 252,763	$ -	$ -	$ 252,763	$ -
MRA Permanent Loan	451,509	-	-	451,509	-
Arroyo Verde	19,504	-	-	19,504	-
Totals	$ 723,776	$ -	$ -	$ 723,776	$ -

Note 5 (continued)

The notes from Merrill Road Associates, a California limited partnership (MRA) are secured by deeds of trust on the property owned by MRA. The land loan accrues interest at the rate of three percent per annum. The permanent loan bears no interest. Annual principal and interest payments on these notes depend on the generation of surplus cash from operations by the project for each calendar year. Interest has been accrued on the land loan in the amount of $170,570. Of this amount, $7,583 was recorded as revenue in the current period. No payments were received for these loans during the current fiscal year. Surplus cash, in the amount of $46,317, has been generated over the past four accounting periods and is distributable to the Authority for payment on the land loan. Therefore, $46,317 of interest receivable is considered to be short-term. As explained in Note 18, the Authority considers MRA to be a blended component unit of the Authority. Therefore, these loans and the interest on these loans are eliminated from the Statement of Net Position - Proprietary Funds and the interest has been eliminated from the Statement of Revenue, Expenses, and Changes in Fund Net Position - Proprietary Funds.

Loans have been made by the Authority to moderate and lower income, first-time homebuyers, qualified to purchase homes in the Arroyo Verde housing development. These loans are secured by deeds of trust. Payment on the loans are deferred until the property is sold or transferred, the borrower defaults on the note, or the first and second liens are refinanced. Interest on each loan is based on the appreciation of the property at the time of the payoff.

Note 6 - CAPITAL ASSETS

Capital asset activity for the year ending June 30, 2018 is as follows:

	Balance 7/1/2017	Additions	Adjustments Transfers	Balance 6/30/2018
Capital assets, not being depreciated:				
Land	$ 7,090,601	$ -	$ 1,039,931	$ 8,130,532
Construction-in-progress	-	-	-	-
Total capital assets, not being depreciated	7,090,601	-	1,039,931	8,130,532
Capital assets depreciated:				
Buildings	32,066,324	966,652	2,752,708	35,785,685
Equipment	844,329	84,472	26,200	955,000
Total capital assets being depreciated	32,910,653	1,051,124	2,778,908	36,740,685
Total capital assets	40,001,254	1,051,124	3,818,839	44,871,217
Accumulated depreciation:				
Buildings	(28,316,788)	(653,765)	(1,433,446)	(30,403,999)
Equipment	(832,739)	(6,819)	(27,400)	(866,958)
Total accumulated depreciation	(29,149,527)	(587,354)	(1,460,846)	(31,270,957)
Total capital assets depn, net	3,761,126	463,770	1,318,062	5,469,728

(Continued)

Note 6 (continued)

Total capital assets, net	$ 10,851,727	$ 463,770	$ 2,357,993	$ 13,600,260

The changes by project are as follows:

	Balance 7/1/2017	Additions	Adjustments Transfers	Balance 6/30/2018
Capital assets:				
Public Housing	$ 24,760,003	$ 232,756	$ -	$ 24,992,759
USDA	5,747,212	123,021	-	5,870,233
Supportive Housing	803,554	-	-	803,554
Business	8,690,485	695,347	-	9,385,832
Blended Component Unit:				
Merrill Road Associates	-	-	3,818,839	3,818,839
	$ 40,001,254	$ 1,051,124	$ 3,818,839	$ 44,871,217
Depreciation:				
Public Housing	$ (18,965,321)	$ (310,557)	$ -	(19,275,878)
USDA	(5,458,809)	(52,500)	-	(5,511,309)
Supportive Housing	(421,989)	(12,722)	-	(434,711)
Business	(4,303,408)	(211,575)	-	(4,514,983)
Blended Component Unit				
Merrill Road Associates	-	(73,230)	(1,460,846)	(1,534,076)
	$ (29,149,527)	$ (660,584)	$ (1,460,846)	$ (31,270,957)

The majority of the adjustment is the inclusion of Merrill Road Associates into the Primary Government as a blended component unit. This is a change from the prior year, when the Partnership was included in the financial statements as a discretely presented component unit and reported in its own column.

Note 7 - LONG-TERM DEBT

Following is a summary of the Authority's changes in long-term debt for the year ended June 30, 2018:

	Balance 7/1/2017	Additions	Deletions	Balance 6/30/2018	Short-term Portion	Interest Payable
Office building mortgage	$ 347,072	$ -	$ (184,742)	$ 162,330	$ 162,330	-
U.S. Department of Agriculture	68,445	-	(20,425)	48,020	10,201	-
State of California HCD loans	210,000	-	-	210,000	-	82,134
	625,517	-	(205,167)	420,350	172,531	82,134
Blended Component Units:						
State of California, RHCP	1,195,167	-	-	1,195,167	-	777,881
Santa Cruz County RDA	300,000	-	-	300,000	-	-
Authority permanent loan	451,509	-	-	451,509	-	-
Authority land loan	252,763	-	-	252,763	-	170,570
	2,199,439	-	-	2,199,439	-	948,451
	$ 2,824,956	$ -	$ (205,167)	$ 2,619,789	$ 172,531	$ 1,030,585

(Continued)

Note 7 (continued)

Following is a schedule of debt payment requirements to maturity for the above long-term debt, other than the interfund debt and the loan due to the Santa Cruz County RDA:

Year Ending	Mortgage		USDA Notes		HCD Loans		
June 30	Principal	Interest	Principal	Interest	Principal	Interest	Total
2019	$ 162,330	$ 4,276	$ 10,201	$ 489	$ -	$ -	$ 177,296
2020	-	-	10,258	383	-	-	10,641
2021	-	-	10,361	280	-	-	10,641
2022	-	-	9,501	177	-	-	9,678
2023	-	-	7,699	99	-	-	7,798
2037	-	-	-	-	1,195,167	1,434,200	2,629,367
2057	-	-	-	-	210,000	346,500	556,500
	$ 162,330	$ 4,276	$ 48,020	$ 1,428	$1,405,167	$1,780,700	$ 3,401,921

The U.S. Department of Agriculture notes accrue interest at 1% per annum and require monthly payments of $886. Interest expenses in the amount of $577 was incurred, paid, and shown as nonoperating expense for the fiscal year ended June 30, 2018.

On March 29, 2004, the Authority borrowed $2,000,000 to purchase an administrative building located on Mission Street in Santa Cruz. The note is amortized over fifteen years, requires monthly payments of $16,658 and accrues interest at a rate of 5.75% per annum. Interest of $15,158 was incurred, paid, and included as nonoperating expenses for the year ended June 30, 2018.

The Authority signed a promissory note with the California Department of Housing and Community Development dated October 31, 2001. This $210,000 note carries a simple interest rate of 3% per annum. The payment of principal and interest on this note is deferred until November 30, 2056; or until the project generates surplus cash, to the extent of 80% of surplus cash generated, paid first to outstanding interest, than to principal. Interest totaling $82,134 has been accrued and reported as a long-term liability as of June 30, 2018. Of this amount, $6,300 was incurred and expensed during the current fiscal year. Interest in the amount of $6,363 was paid on this loan during the current fiscal year.

Blended Component Unit - Merrill Road Associates:
On September 15, 1995, Merrill Road Associates, a California Limited Partnership (the Partnership), entered into a promissory note with the State of California, Department of Housing and Community Development, Rental Housing Construction Program (RHCP). The note, for $1,195,167, is secured by a deed of trust on the property owned by the Partnership, bears simple interest at a rate of 3% per annum, and is due 40 years from the anniversary of the Initial Assisted Unit Date. This maturity date was calculated to be September 1, 2036. Payments are due annually on this loan only to the extent of surplus cash earned by the project. For the year ended June 30, 2018, interest of $35,855 was accrued and no payments were made on this loan.

Note 7 (continued)

Management does not consider any portion of this loan, nor the interest accrued on this loan, to be short-term.

In September 1996, the Partnership received a $300,000 loan from the Santa Cruz County Redevelopment Agency (RDA). This loan is unsecured, bears simple interest at a rate of 8% per annum, and was intended to be forgiven if the Authority exercised the option to purchase the property after 20 years and maintained the units according to the RHCP loan provisions for an additional 20 years. The option to purchase was exercised in 2011. No forgiveness has occurred on this loan. However, since it is assumed that the loan will be forgiven at some future date, no interest has accrued on this loan.

During the development of the Partnership's property the Authority transferred land to the Partnership with a value, net of the general partner contribution, of $252,763 and provided gap funding in the amount of $451,509. The land loan bears simple interest at a rate of 3% per annum and the permanent loan bears no interest. The land loan is due September 15, 2022, while the permanent loan is due September 15, 2035. Payments of principal and interest are due on these loans annually, but only to the extent of surplus cash generated by the project. For the year ended June 30, 2018 interest of $7,583 was accrued for the land loan and no payments were made on either loan. Surplus cash has been generated by the project for each of the last 4 years. It is anticipated that this surplus cash, totaling $46,317, will be distributed to the Authority during the next fiscal year and applied towards the interest due on the land loan. As explained in Note 18, the Authority considers the Partnership to be a blended component unit of the Authority. Therefore, these loans and the interest on these loans are eliminated from the Statement of Net Position - Proprietary Funds and the interest has been eliminated from the Statement of Revenue, Expenses, and Changes in Fund Net Position - Proprietary Funds.

Note 8 - UNEARNED REVENUE

Unearned revenue consists of:

Prepaid rent - Public Housing	$ 12,380	
USDA	3,552	
Migrant Center	612	
Brommer Street	133	
Merrill Road Associates	8	$ 16,685
Funds held for the City of Capitola		93,153
		$ 109,838

(Continued)

Note 9 - DEFERRED COMPENSATION PLAN

The Authority offers its employees a deferred compensation plan created in accordance with Internal Revenue Code 457. The plan, available to all permanent employees, permits them to defer a portion of their current salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, and rights are held in trust for the exclusive benefit of participants and their beneficiaries.

The Authority maintains two plans which are administered by Mass Mutual Financial Group and the California Public Employees' Retirement System. A total of $3,077,508 is being held by these companies/agencies on behalf of the Authority's employees. These funds are not recorded as assets of the Authority since they are held in trust for the exclusive benefit of participants and their beneficiaries and are not subject to claims of the Authority's general creditors.

Note 10 - COMPENSATED ABSENCES

It is the Authority's policy to permit employees to accumulate earned but unused vacation leave, which will be paid to employees upon separation from the Authority's service or used in future periods. The Authority permits employees to accumulate earned but unused sick leave. This leave will either be used in future periods or paid to employees upon separation from the Authority in the amount of 50%, after five years of service; 75%, after ten years of service; and 100%, after fifteen years of service, of the value of the unused sick leave. Accrued vacation and vested sick leave have been valued by the Authority; allocated to all the programs, including Merrill Road Associates; and recorded as "Compensated Absences". As of June 30, 2018, accrued vacation and vested sick leave were valued at $457,255. Of this amount, $383,906 considered by management to be a long-term liability.

Note 11 - NET POSITION

A. Net Investment in Capital Assets

Net investment in capital assets consist of the following:

Capital assets, net of depreciation (see Note 6)	$ 13,600,260
Long-term debt (see Note 7)	(2,619,789)
Omit interfund debt	704,272
Accrued interest on long-term debt (See Note 7)	(1,030,585)
Omit interest on interfund debt	170,570
Net investment in capital assets	$ 10,824,728

Note 11 (continued)

B. Restricted Net Position

Net position is reported as restricted when constraints placed on its use are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or imposed by law through constitutional provisions or enabling legislation.

The Authority has reported the following as restricted net position:

USDA replacement reserve	$ 1,578,822
Excess Housing Choice Voucher HAP funding	115,775
Brommer Street replacement reserve	92,346
Buena Vista Migrant operating reserves	96,360
Funds held on deposit for MCC guarantees	11,000
Blended Component Unit:	
Merrill Road Associates replacement reserves	217,245
Merrill Road Associates operating reserves	91,974
	$ 2,203,522

The current excess HAP funding balance is made up of the following:

Balance as of June 30, 2017	$ 537,540
Excess funding used	(484,457)
FSS forfeitures and fraud recovery	62,692
Balance as of June 30, 2018	$ 115,775

Except for the Buena Vista operating reserves and the USDA replacement reserves, the restricted reserves are fully funded (see Note 3). The replacement reserves are imposed on the Authority by the USDA or HCD for the future replacement or renovation of certain capital assets. These reserves can not be used without the prior written approval of the appropriate agency. The migrant operating reserves can only be used to cover the costs of operations at the Buena Vista Migrant Center and can not be used without the prior written approval of HCD. These reserves are not fully funded due to receivable from HCD. The final amount is a performance deposit for the Authority's Mortgage Credit Certificate program.

C. Deficit Unrestricted Net Position

Although the Authority does consider all of its activities to be housing and reports all activity under one Enterprise Fund in the basic financial statements, the Authority does administer many federal, state, and local grants. The Authority's Business Enterprise Fund administers the Authority's activity that is not attributable to any grants. This fund administers the Authority's commercial rental property, including the current administrative office on 41st

Note 11 (continued)

Avenue and its former administrative office on Mission Street. This fund also administers the Authority's pension and OPEB plans. These plans have deficit unrestricted net position of $5,261,227 and $865,609, respectively. Management does not expect these plans to report positive unrestricted net position in the near future. The pension and OPEB plans are funded as required on a current basis. As the plans are funded, expense is allocated to all of the Authority's federal, state, and local programs based on the direct salaries attributable to each program. Annual actuarial reports are received to determine the change in liability and the affect the change may have on the unrestricted net position. The Business Enterprise Fund holds these actuarially determine balances. NPL/NOL is allocated to all programs for FDS purposes only, based on direct salaries.

Note 12 - DEFINED BENEFIT PENSION PLAN

A. Plan Description

All eligible Authority employees participate in the California Public Employees Retirement System (PERS), a cost-sharing multi-employer public employee defined benefit pension plan. A full description of the pension plan benefit provisions, assumptions for funding purposes but not accounting purposes, and membership information is listed in the June 30, 2017 Annual Actuarial Valuation Report. Details of the benefits provided can be obtained in Appendix B of this report. This report is a publicly available report that can be obtained at CalPERS' website under Forms and Publications.

The Authority's plan is made up of 4 tiers. Tier 1, 3% at 60 covers all employees hired before March 5, 2006. Tier 2, 2% at 55 covers all employees hired between March 5, 2006 and July 29, 2012. Tier 3, 2% at 60 covers all employees hired between July 29, 2012 and January 1, 2013. Tier 4, 2% at 62 covers all employees hired after January 1, 2013. The fourth tier is the result of State legislation AB 340, the Public Employees' Pension Reform Act (PEPRA). The number of employees across all four tiers as of the June 30, 2018 valuation date was 51 active, 9 transferred, 32 separated, and 35 retired.

B. Funding Policy

The total plan contributions are determined through the CalPERS' annual actuarial valuation process. The plan's actuarially determined rate is based on the estimated amount necessary to pay the Plan's allocated share of the risk pool's costs of benefits earned by employees during the year, and any unfunded accrued liability. The employer is required to contribute the difference between the actuarially determined rate and the contribution rate of the employees. Employer contribution rates may change if plan contracts are amended. The contribution requirements of plan members and the Authority are established and may be amended by PERS.

Note 12 (continued)

Participants in the Authority's first tier are required to contribute 8% of their annual covered salary, participants in the second and third tier contribute 7%, while participants of the fourth tier contribute 6.25%. Employer rates are as follows:

	1st Tier	2nd Tier	3rd Tier	4th Tier
Employer rates:				
2017/2018	13.545%	9.599%	7.200%	6.533%
2018/2019	14.369%	10.152%	7.634%	6.842%
2019/2020	15.206%	10.868%	8.081%	6.985%
2020/2021 (projected)	16.1%	11.6%	8.7%	7.5%

In addition, CalPERS requires employer contributions toward the Authority's unfunded liability and side fund as a dollar amount paid either in 12 monthly payments or as a lump sum at the beginning of the year. The Authority has historically chosen to pay the lump sum at the beginning of each fiscal year. The dollar amounts of these contributions are projected by CalPERS to be as follows:

	1st Tier	2nd Tier	3rd Tier	4th Tier
2017/2018	289,046	7,778	53	22
2018/2019	367,888	12,646	3,389	1,090
2019/2020	451,895	29,253	3,616	6,140
2020/2021 (projected)	538,000	32,000	4,000	6,700

The amounts contributed to the pension plan agreed the amounts required for the fiscal year ended June 30, 2018, as follows:

	Employer Contribution	Employee Contribution	Total
Tier 1	$ 551,615	$ 155,079	$ 706,694
Tier 2	85,182	56,446	141,628
Tier 3	12,890	12,481	25,371
Tier 4	42,116	40,271	82,387
Total required contributions made	691,803	264,277	956,080
Miscellaneous employee contributions	-	2,272	2,272
Total payments made to PERS	$ 691,803	$ 266,549	$ 958,352

Funding Trend

Fiscal year:	Employer Contribution	Employee Contribution	Total
June 30, 2017	$ 620,373	$ 250,280	$ 870,653
June 30, 2016	965,608	252,627	1,218,235
June 30, 2015	2,523,285	267,051	2,790,336
June 30, 2014	804,089	265,370	1,069,459
June 30, 2013	801,980	269,547	1,071,527
June 30, 2012	877,294	286,935	1,164,229
June 30, 2011	740,767	278,023	1,018,790

Note 12 (continued)

Funding Trend (continued)

Fiscal year:	Employer Contribution	Employee Contribution	Total
June 30, 2010	$ 690,587	$ 267,692	$ 958,279
June 30, 2009	639,987	258,123	898,110
June 30, 2008	619,132	246,206	865,338

For the above ten years ended June 30, 2018, the Authority made 100% of the actuarially determined contributions. The 2015 contribution included a $1,685,034 lump sum payment to reduce the net pension liability and lower the future payments required by CalPERS.

C. Actuarial Methods and Assumptions

The total pension liabilities/(assets) were determined by actuarial valuations as of June 30, 2016, by fund, which were rolled forward to June 30, 2017, using the following assumptions:

Actuarial assumptions	
Discount Rate	7.15%
Inflation	2.75%
Salary increases	Varies by entry age and service
Mortality rate tables	Derived using CalPERS membership data for all funds
Post retirement benefits increase	Contract COLA up to 2.75% until PPPA floor on purchasing power applies, 2.75% thereafter
1997-2011	Period upon which actuarial experience survey assumptions were based

The actuarial assumptions and methods used to set the 2016 and 2017 actuarially determined contributions were as follows:

Actuarial cost method	Individual Entry Age Normal
Amortization method	Level percentage of payroll and direct rate smoothing
Remaining amortization periods	Differs by employer rate plan, but no more than 30 years
Asset valuation method	Market value
Salary increases	Varies based on entry age and service
Inflation	2.75%
Investment rate of return	7.50%

The mortality table used was developed based on CalPERS specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB.

Changes of Assumption - In fiscal year 2016-2017, the financial reporting discount rate was reduced from 7.65 percent to 7.15 percent. In December 2016, the CalPERS Board approved lowering the funding discount rate used from 7.5 percent to 7.0 percent, which is to be phased-in over a three-year period, beginning with the June 30, 2016, valuation reports. The

Note 12 (continued)

funding discount rate includes a 15 basis-point reduction for administrative expenses, and the remaining decrease is consistent with the change in the financial reporting discount rate.

Discount Rate - The discount rate used to measure the total pension liability as of June 30, 2017 was 7.15%. The financial reporting discount rates are not adjusted for administrative expenses and are consistent with the funding discount rates at the end of the three-year funding discount rate phase-in period. To determine whether the municipal bond rate should be used in the calculation of the discount rate, the amortization and smoothing periods adopted by the Board in 2013 were used. For the Plan, the crossover test was performed for a miscellaneous agent rate plan and a safety rate plan selected as being more at risk of failing the crossover test and resulting in a discount rate that would be different from the long-term expected rate of return on pension investments. Based on the testing of the plans, the tests revealed the assets would not run out. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which expected future real rates of return (expected returns, net of pension plan investment expenses and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, CalPERS staff took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Using historic returns of all the funds' asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set to equal to the single equivalent rate calculated above and adjusted to account for assumed administrative expenses.

The table below reflects long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation:

Asset Class:	Assumed Asset Allocation	Real Return Years 1 - 10	Real Return Years 11+
Global equity	47.0%	4.90%	5.38%
Fixed income	19.0%	0.80%	2.27%
Inflation sensitive	6.0%	0.60%	1.39%
Private equity	12.0%	6.60%	6.63%
Real estate	11.0%	2.80%	5.21%
Infrastructure and forestland	3.0%	3.90%	5.36%
Liquidity	2.0%	(0.40)%	(0.90)%

(Continued)

Note 12 (continued)

D. Net Pension Liability

The following table shows the changes in net pension liability recognized over the measurement period for the risk pool:

	Total Pension Liability	Fiduciary Net Position	Net Pension Liability
Balance as of June 30, 2016	$ 14,397,353,530	$ 10,923,476,287	$ 3,473,877,243
Service Cost	391,832,080	-	391,832,080
Interest on total pension liability	1,077,608,396	-	1,077,608,396
Changes in benefit terms	1,932,029	-	1,932,029
Changes of assumptions	907,027,295	-	907,027,295
Difference between expected and actual experience	(102,359,669)	-	(102,359,669)
Net plan to plan resource movement	-	(26,049,676)	26,049,676
Contribution - Employer	-	456,855,300	(456,855,300)
Contribution - Employee	-	168,218,719	(168,218,719)
Net investment income	-	1,225,227,907	(1,225,227,907)
Benefit payments, including refunds	(656,846,259)	(656,846,259)	-
Administrative expenses	-	(16,382,497)	16,382,497
Net changes during June 30, 2017	1,619,193,872	1,151,023,494	468,170,378
Balance as of June 30, 2017	$ 16,016,547,402	$ 12,074,499,781	$ 3,942,047,621

The Authority's proportionate share of the risk pool's total pension liability, fiduciary net position, and net pension liability are as follows:

	Total Pension Liability	Fiduciary Net Position	Net Pension Liability
Balance as of June 30, 2014	$ 26,368,790	$ 19,694,701	$ 6,674,089
Percentage of the pool	0.201112%	0.185110%	0.270043%
Balance as of June 30, 2015	$ 27,456,183	$ 22,128,324	$ 5,327,859
Percentage of the pool	0.201299%	0.203086%	0.194202%
Balance as of June 30, 2016	$ 28,826,381	$ 22,106,931	$ 6,719,450
Percentage of the pool	0.200220%	0.202380%	0.193428%
Balance as of June 30, 2017	$ 32,223,692	$ 24,745,480	$ 7,478,212
Percentage of the pool	0.201190%	0.204940%	0.189704%

Sensitivity of the net pension liability to changes in the discount rate

The following presents the net pension liability of the plan as of June 30, 2017 calculated using the discount rate of 7.15%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower or higher than the current rate:

	1% decrease 6.15%	Current Discount rate 7.15%	1% increase 8.15%
Risk pool's net pension liability	$ 6,145,073,915	$ 3,942,047,621	$ 2,117,461,486
Authority's proportionate share	$ 11,910,480	$ 7,478,212	$ 3,807,327

(Continued)

Note 12 (continued)

E. Deferred Outflows and Inflows of Resources

The Authority has recorded the following deferred outflows and inflows of resources based on the actuarial report and the schedules of employer allocations by rate plan prepared by CalPERS. The measurement date of these reports and schedules was June 30, 2017. The deferred outflows also include contributions made to CalPERS subsequent to the measurement date of June 30, 2017, but prior to the Authority's fiscal year end of June 30, 2018.

	Deferred Outflows of resources	Deferred Inflows of resources
Miscellaneous risk pool:		
Changes in assumptions	$ 668,335,902	$ 50,961,251
Difference between expected and actual experiences	5,386,488	77,171,360
Net difference between projected and actual earnings on investments	151,150,027	-
	824,872,417	128,132,611
Authority's allocation basis	0.201190%	0.201190%
Authority's proportionate share	1,659,560	257,790
Authority specific adjustments:		
Changes in employer's proportions	199,304	277,851
Net difference between prorated employer contributions and actual employer contributions	434,732	232,773
Authority contributions made between June 30, 2017 and June 30, 2018	691,803	-
	$ 2,985,399	$ 768,414

Amounts reported as deferred outflows and deferred inflows of resources, other than the contributions made after the measurement date, will be recognized in future pension expense as follows:

Measurement period:	Deferred outflow (Inflow) of resources
2019	$ 457,499
2020	786,535
2021	461,698
2022	(180,550)

The amounts reported as deferred outflows of resources related to pensions, contributions made after the measurement date of June 30, 2017, should have the effect of reducing net pension liability during the next actuarial measurement period.

(Continued)

Note 12 (continued)

F. Pension Expense

The following is a breakdown of the plan's pension expense, as well as the Authority's proportionate share of the pension expense, for the measurement period ended June 30, 2017:

	Risk Pool Amount	Authority's Share
Service Cost	$ 391,832,080	$ 625,520
Interest on total pension liability	1,077,608,396	2,168,040
Change in benefit terms	1,932,029	-
Recognized change in assumptions	174,989,828	352,062
Recognized differences between expected and actual experience	(21,232,141)	(42,717)
Net plan to plan resource movement	26,049,676	-
Employee contributions	(168,218,719)	(248,618)
Projected earnings on pension plan investments	(776,525,126)	(1,562,291)
Recognized differences between projected and actual earning on plan investments	(3,070,912)	(6,178)
Recognized change in employer's proportion	-	(138,358)
Recognized difference between the employer's contribution and the employer's proportionate share of contribution	-	416,997
Administrative expense	16,382,497	32,960
Total pension expense	$ 719,747,608	$ 1,597,417

See also page 51 and 52 for the Required Supplementary Information for PERS. These schedules present multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Note 13 - POST RETIREMENT HEALTHCARE BENEFITS

Plan Description: The Authority provides post-retirement pre-Medicare healthcare benefits for retirees. These benefits are provided for those retirees, as well as their surviving spouses, who are enrolled in a medical plan at the time of retirement and file an application for monthly retirement benefits through PERS at the time of separation. The Authority will contribute the minimum employer contribution required by CalPERS. Coverage may be continued for the retiree's and surviving spouse's lifetime. No dental, vision, or other post-retirement benefits are provided to retired employees or surviving spouses. The plan may be amended by action of the Authority. The plan does not issue a stand alone financial report.

Benefits: The Authority has contracted with CalPERS to provide medical benefits to qualified retirees and their surviving spouses. The Authority makes actual payments of $128 per month in 2017 and $133 per month in 2018, per eligible retiree, to the healthcare benefit provider. The plan minimum payments are expected to increase on an annual basis. Eligible retirees pay the

Note 13 (continued)

remaining monthly balance due for insurance. Active employees make no payments toward OPEB until retirement.

Eligibility: Eligibility for retiree medical benefits are extended to those retirees, as well as their surviving spouses, who are enrolled in a medical plan at the time of retirement and file an application for monthly retirement benefits through PERS at the time of separation. Further eligibility requires the employee to retire after age 50 and with at least 5 years of service. As of June 30, 2018, thirteen employees were eligible and receiving these benefits. The Authority had another 56 employees who are eligible for the program, but are not receiving benefits due to the fact that they are not retired from the Authority as of June 30, 2018.

Contributions: The Authority has established a trust account with CalPERS to administer the funding of the projected benefits of the OPEB plan. Monthly, the Authority makes healthcare premium payments for its current retirees to its CalPERS medical benefit provider. These monthly payments are limited to the monthly amounts noted in the section above titled "Benefits". The retiree contributes any amount exceeding these established plan limits. The Authority then makes deposits into their CalPERS trust account for the difference between the actuarially determined annual OPEB cost and the out-of-pocket payments made to CalPERS health.

The contributions are as follows:

	6/30/2017	6/30/2018
Contributions made to CalPERS trust	$ 22,593	$ 60,183
Payments made to CalPERS for retiree premiums	19,862	20,358
	$ 42,455	$ 80,541

OPEB Liabilities, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources related to OPEB:

The Actuarial Present Value of Projected Benefit Payments (APVPBP) for all current and former employees, as of July 1, 2017, is $1,677,699. This is the amount that the Authority would theoretically have to set aside to fully fund all those future benefits. The Total OPEB Liability (TOL) is the portion of the APVPBP which has been earned by the current and former employees, to date, based on the years of service already completed. TOL for the Authority as of June 30, 2017, is valued at $1,376,023. As of June 30, 2017, the Authority has accumulated $441,631 in an irrevocable trust toward this liability. The change to these amounts for the fiscal year ended June 30, 2017 is as follows:

(Continued)

Note 13 (continued)

	Total OPEB Liability	Plan Fiduciary Net Position	Net OPEB Liability
Values as of June 30, 2016	$ 1,268,703	$ 379,639	$ 889,064
Service Costs	45,176	-	45,176
Interest	81,826	-	81,826
Employer contributions	-	42,455	(42,455)
Net investment income	-	39,593	(39,593)
Benefits paid to retirees	(19,862)	(19,862)	-
Administrative expenses	-	(194)	194
Values as of June 30, 2017	$ 1,375,843	$ 441,631	$ 934,212

The Authority implemented GASB Statement No. 75 *Accounting and Financial Reporting for Postemployment Benefits Other Than Pension*, during the current fiscal year. This Statement established standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense. To comply with this Statement and recognize the full amount of the TOL, the Authority reported a prior period adjustment of $846,610.

The following presents the net OPEB liability of the plan as of June 30, 2017 calculated using the discount rate of 6.5%, as well as what the net OPEB liability would be if it were calculated using a discount rate that is 1 percentage point lower or higher than the current rate:

	1% decrease 5.5%	Current Discount rate 6.5%	1% increase 7.5%
Net OPEB Liability	$ 1,174,479	$ 934,392	$ 743,788

The following presents the net OPEB liability of the plan as of June 30, 2017 calculated using the healthcare cost trend rate of 5%, as well as what the net OPEB liability would be if it were calculated using a healthcare cost trend rate that is 1 percentage point lower or higher than the current rate:

	1% decrease 4.0%	Healthcare Trend rate 5.0%	1% increase 6.0%
Net OPEB Liability	$ 741,812	$ 934,392	$ 1,179,138

The components of OPEB expense for the fiscal year ended June 30, 2018 are as follows:

Service Costs	$ 45,176
Interest	81,826
Expected investment return	(24,670)
Administrative expenses	194
Recognition of differences between projected and actual earnings on investments	(2,985)
Total OPEB expense June 30, 2018	$ 99,541

(Continued)

Note 13 (continued)

The difference between the OPEB expense and the actual contributions made are subsidized premiums. Recent changes to the accounting rules require that actuarial valuations dated after March 2015 must incorporate "age-specific claim costs", which recognize that the true cost of health care increases with age. The amount of subsidized premiums allocated to the fiscal year ended June 30, 2018 was $19,000. The APVPBP of $1,677,699 consists of $973,803 value of promised benefits to retires employees and $703,896 value of future subsidized premiums.

As of June 30, 2018, based on the valuation date of June 30, 2017, the Authority reported deferred outflows and deferred inflows of resources as follows:

	Deferred Outflows	Deferred Inflows
Differences between projected and actual earnings on OPEB plan investments	$ -	$ 11,938
Employer contributions made July 2017 thru June 2018	80,541	-
	$ 80,541	$ 11,938

The deferred outflow and deferred inflows of resources, other than the employer contributions noted above, will be recognized in future pension expense as follows:

Measurement period:	
2019	$ (2,985)
2020	(2,985)
2021	(2,985)
2022	(2,983)

The amount reported as deferred outflows of resources related to employer contributions made July 2017 through June 2018, should have the effect of reducing net pension liability during the next actuarial measurement period.

Actuarial Assumptions: The following assumptions as of July 1, 2017, were selected by the Authority in accordance with the requirements of GASB 75:

Discount Rate	6.50% (a decrease from the prior rate of 7.28%)
Funding Method	Entry age actuarial cost method, with normal costs calculated as a level percentage of payroll, as required by GASB 75.
Turnover (withdrawal)	2014 CalPERS OPEB Assumptions Model
Mortality	2014 CalPERS OPEB Assumptions Model
Medical costs trend	5% increase per year after 2018 (a change from the prior rate of 4%)
Minimum contribution	4% increase per year after 2018
Coverage elections	75% of eligible employees are assumed to elect coverage upon retirement
Retirement	2014 CalPERS OPEB Assumptions Model

Note 13 (continued)

Payroll growth	Total payroll is assumed to increase 3.25% per year in the future
Inflation	Inflation in future years is assumed to be 2.75% per year
Age-specific medical claims	The estimated per person medical costs during 2017-2018 are as follows: Age 40 - $ 4,786 Age 45 - $ 9,053 Age 50 - $11,184 Age 55 - $13,793 Age 60 - $16,076 Age 64 - $17,248 These age-specific rates were developed so as to reproduce in the aggregate the same total premium that would be paid to carriers for all current employees and all current retirees. These are the amounts used to compute the value of "subsidized premiums".

Note 14 - INTRA-AUTHORITY RENT

In October 2004, the Authority moved into its new administrative building on Mission Street. Its staff was consolidated in the new building upon vacating the two previously occupied administrative buildings. The rent for the Mission Street building is an allocation of actual costs incurred to maintain the building, including debt service payments and omitting depreciation. These costs are allocated based on direct salaries charged to the Authority's programs. The amounts charged for the current fiscal year are as follows:

Housing Choice Voucher	$ 158,821
Public Housing	30,702
USDA	8,880
Mainstream Voucher	2,468
Section 8 Moderate Rehabilitation	746
Supportive Housing	603
CDBG	578
HOME	554
Section 8 Moderate Rehabilitation - SRO	195
Shelter Plus Care	99
Other State and Local	1,278
Business	5,115
Total Authority wide revenue/expense	$ 210,039

Rent revenue was recorded in the Business Enterprise Fund. Office rent expenditures were recorded in the above noted Enterprise Funds. These interfund type transactions were eliminated in the Statement of Revenues, Expenses and Changes in Fund Net Position.

Note 15 - INTRA-AUTHORITY HAP

A tenant of the Authority's Housing Choice Voucher Program (CFDA #14.871) has chosen to live in a housing unit owned by the Authority. This Housing Assistance Payment (HAP) is recorded as expenditures of the Housing Choice Voucher Program Enterprise Fund and revenue of the Business Enterprise Fund. These transactions totaled $8,780 for the fiscal year ended June 30, 2018. This interfund type transaction was eliminated in the Statement of Revenues, Expenses and Changes in Fund Net Position.

(Continued)

Note 16 - LEASES

A. The Authority leased office space owned in the City of Capitola to two tenants. These commercial leases terminated on December 31, 2017. The Authority has since utilized the space for its administrative operations. The combined monthly lease payments were approximately $15,200. Rent for the year of $96,040 was reported as revenue of the Business Enterprise Fund.

B. The Authority leases approximately 40% of its office building, located on Mission Street in Santa Cruz. This commercial lease commenced on September 15, 2014 and has a 10 year term. The monthly lease payments are approximately $11,000 per month, plus 39.38% of common area operating costs. Rent for the year of $143,034 was reported as revenue of the Business Enterprise Fund. The future rental revenue is expected to be approximately $132,000 for each of the next 5 years.

Note 17 - CONTINGENT LIABILITIES

A. <u>Grants</u>
The Authority has received funds from various federal, state, and local grant programs. It is possible that at some future date it may be determined that the Authority was not in compliance with applicable grant requirements. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time although the Authority does not expect such disallowed amounts, if any, to materially affect the financial statements.

B. <u>Litigation</u>
The Authority is involved in various matters of litigation. It is the Authority's opinion that these matters of litigation will not have a material effect, if any, on the financial position of the Authority.

Note 18 - RELATED PARTIES

Merrill Road Associates

Organization:

Merrill Road Associates (MRA), a California limited partnership, was organized on September 15, 1995, with Merrill Road Housing Corporation (MRHC), a California nonprofit public benefit corporation, as the general partner. On September 15, 1996, Edison Capital Housing Investments, a California corporation, became the sole limited partner.

The purpose of MRA is to acquire, construct, own, hold for investment, operate, manage, lease or sell partnership property for low and very low income persons. MRA currently owns and

(Continued)

Note 18 (continued)

operates a fifteen unit apartment complex in Aptos, California. The project qualified for federal low income tax credits under section 42 of the Internal Revenue Code, for which the compliance period ended in 2011. The project continues to operate under restrictions and compliance requirements of the California Department of Housing and Community Development (HCD) through the Rental Housing Construction Program (RHCP).

The Authority shares common board members with MRHC which is the general partner of MRA. Also the Authority was the developer of the project, the initial limited partner and currently administers the project for MRA. Accordingly, prior to September 30, 2011, the Authority could exercise significant influence over MRA.

On September 30, 2011, Edison Capital Investments withdrew as the Limited Partner of MRA and the Authority was admitted as the new Limited Partner. Based on this action and considering all of the prior activity between the two organizations, the Authority considers MRA to be a blended component unit of the Authority.

An audit was conducted on this entity as of and for the year ended June 30, 2018 by Harn & Dolan, CPA's. The opinions were not modified. This audit report may be obtained by contacting the Authority at the address on page 12. Modifications were made to the audited financial statements to conform with the reporting categories of the Authority. Specifically, equity reported in the audit was converted to the three categories of net position in conformity with the Authority's reporting practices.

Condensed Financial Statements:

The condensed financial statement for the year ended June 30, 2018 are as follows:

STATEMENT OF NET POSITION

Current assets	$ 74,728
Restricted assets	324,590
Property and equipment	2,284,763
Total assets	$ 2,684,081
Current liabilities	$ 16,314
Payable from restricted assets	15,372
Long-term liabilities	3,153,792
Total liabilities	3,185,478
Net investment in capital assets	11,715
Restricted net position	309,219
Unrestricted net position	(822,331)
Net position	(501,397)
Total liabilities and net position	$ 2,684,081

(Continued)

Note 18 (continued)

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

Rental revenue	$ 164,184
Interest and other revenue	1,564
Total revenue	165,748
Administration	41,692
Partnership management fee	12,000
Utilities	20,411
Maintenance and operating	59,551
Insurance and taxes	18,554
Depreciation	73,230
Total expenses	225,438
Operating gain (loss)	(59,690)
Debt service interest	(43,437)
Change in net position	(103,127)
Net position at the beginning of the year	(398,270)
Net position at the end of the year	$ (501,397)

STATEMENT OF CASH FLOWS

Operating activities	$ 34,694
Noncapital financing activities	(27,554)
Investing activities	541
Net change to cash	7,681
Cash at the beginning of the year	389,667
Cash at the end of the year	$ 397,348

Interfund Accounting Issues:

MRHC pays the Authority a management fee of $12,000 per year, to the extent of the Partnership's surplus cash. MRHC owes the Authority $12,000, payable from the Partnership's surplus cash, as of June 30, 2018. MRA reimburses the Authority for various costs paid by the Authority on its behalf. As of June 30, 2018, MRA owes the Authority $0 for this activity. Also, as noted in Note 5 to the basic financial statements, MRA owes the Authority $874,842 in principal and interest, for two loans secured by deeds of trust on the project.

Deficit Net Position:

This blended component unit has a deficit net position of $501,397, including a deficit unrestricted net position of $822,331. This deficit is an increase over the prior year's deficit balance in total net position of $398,270.

(Continued)

Note 18 (continued)

Reclassification of Component Unit

During the prior year, the Authority considered this entity to be a discretely presented component unit of the Authority and reported the MRA in a separate column to distinguish it from the primary government. During the current fiscal year, the Authority reassessed its relationship with this entity and concluded that it would be more accurately reported as a blended component unit of the Authority. Several factors indicate that the MRA, although a separate legal entity, is closely related to the Authority and should be reported as a blended component unit. The main factor appears to be the fact that the governing bodies of these two entities are made up of the same individuals. Due to this change in designation, the MRA is no longer reported in a separate column, but is included in the column titled "Primary Government". A prior period adjustment is recorded in the amount of $398,270 which represents MRA's deficit net position as of June 30, 2017, as reported on the Statement of Activities in the prior year's financial statements.

Note 19 - INSURANCE

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters for which the Authority caries insurance.

The Authority is a member of the Housing Authority Risk Retention Pool (HARRP). HARRP was established by public housing authorities participating in an intergovernmental cooperation agreement pursuant to specific statues in Oregon, Washington, California and Nevada for the purpose of operating and maintaining a cooperative program of risk management and loss indemnification. HARRP offers property, general liability, automobile, fidelity, and officers' liability insurance to participants. There were 90 member public housing authorities at December 31, 2017. The relationship between the Authority and HARRP is such that HARRP is not a component unit of the Authority for financial reporting purposes.

The Authority paid premiums to HARRP totaling approximately $67,000 for property, general liability, automobile, errors and omissions, and fidelity for the policy term of the year ended December 31, 2018. The loss limits for the various types of insurance were "stated value" for property with a $2,500 deductible per occurrence ($300,000 mold claim sub limit); $2,000,000 for general liability ($2,000,000 aggregate) with no deductible per occurrence; $2,000,000 for errors and omissions with a 10% co-pay deductible; $1,000,000 for automobile with actual cash value for comprehensive and collision coverage and a $250 and $500 deductible, respectively; $100,000 for fidelity with a $1,000 deductible. The Authority is also insured through a private insurance company for umbrella insurance which brings all limits up to $5,000,000 with a $10,000 deductible. The Authority paid private insurance companies approximately $15,000 for this coverage.

REQUIRED SUPPLEMENTARY INFORMATION

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
REQUIRED SUPPLEMENTARY INFORMATION
AS OF JUNE 30, 2018

Schedule of Proportionate Share of Net Pension Liability for CalPERS Defined Benefit Retirement Plan

Measurement Date	Total Pension Liability	Fiduciary Net Position	Net Pension Liability	Funded Ratio	Covered Payroll	NPL/Payroll Ratio
PERF C Public Agency Cost Sharing Plan:						
6/30/14	30,829,966,631	24,607,502,515	6,222,464,116	79.82%		
6/30/15	31,771,217,402	24,907,305,871	6,863,911,531	78.40%		
6/30/16	33,358,627,624	24,705,532,291	8,653,095,333	74.06%		
6/30/17	37,161,348,332	27,244,095,376	9,917,252,956	73.31%		
Miscellaneous Risk Pool in total:						
6/30/13	$ 12,374,543,647	$ 9,097,875,216	$ 3,276,668,431	73.5%		
6/30/14	13,110,948,452	10,639,461,174	2,471,487,278	81.1%		
6/30/15	13,639,503,084	10,896,036,068	2,743,467,016	79.9%		
6/30/16	14,397,353,530	10,923,476,287	3,473,877,243	75.9%		
6/30/17	16,016,547,402	12,074,499,781	3,942,047,621	75.4%		
Authority's Proportionate Share ($):						
6/30/13	$ 24,885,431	$ 16,887,565	$ 7,997,866	67.9%	$ 3,495,580	228.8%
6/30/14	26,368,790	19,694,701	6,674,089	74.7%	3,430,738	194.5%
6/30/15	27,456,183	22,128,324	5,327,860	80.6%	3,460,606	154.0%
6/30/16	28,826,381	22,106,931	6,719,450	76.7%	3,328,404	201.9%
6/30/17	32,223,692	24,745,480	7,478,212	76.8%	3,326,175	224.8%
Authority's Proportionate Share (%):						
6/30/13	0.20110%	0.18562%	0.24408%			
6/30/14	0.20112%	0.18511%	0.27004%			
6/30/15	0.20130%	0.20309%	0.19420%			
6/30/16	0.20022%	0.20238%	0.19343%			
6/30/17	0.20119%	0.20494%	0.18970%			

This schedule is required to present ten years of information. The information above is presented for the years currently available. A full ten-year trend will be built as the information becomes available in the future.

Schedule of Employer Contributions for CalPERS

Fiscal Year Ended	Actuarially Determined Contributions	Contribution in relation to ADC	Contribution Deficiency (Excess)	Covered Employee Payroll	Contributions to Payroll Ratio
6/30/14	$ 804,089	$ 804,089	$ -	$ 3,430,738	23.44%
6/30/15	838,251	2,523,285	(1,685,034)	3,460,606	72.91%
6/30/16	965,609	965,609	-	3,328,404	29.01%
6/30/17	620,373	620,373	-	3,326,175	18.65%
6/30/18	691,803	691,803	-	3,567,491	19.39%

This schedule is required to present ten years of information. The information above is presented for the years currently available. A full ten-year trend will be built as the information becomes available in the future.

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
REQUIRED SUPPLEMENTARY INFORMATION
AS OF JUNE 30, 2018
(Continued)

The actuarial methods and assumptions used to set the actuarially determined contributions (ADC) were as follows:

ADC for fiscal year	June 30, 2018 and 2017
Actuarial cost method	Individual Entry Age Normal Cost Method
Remaining amortization Periods	Differs by employer rate plan, but no more than 30 years
Asset valuation method	Market valuation of assets
Inflation	2.75%
Salary increases	Varies by entry age and service
Payroll growth	3.00%
Investment rate of return	7.50%, net of pension plan investments and administrative expenses
Retirement age	Probabilities are based on the 2010 CalPERS experience study of the period 1997-2007
Mortality	Probabilities of mortality are based on the 2010 CalPERS experience study of the period 1997-2007

Schedule of Changes in the Net OPEB Liability and Related Ratios

	Total OPEB Liability	Plan Fiduciary Net Position	Net OPEB Liability
Values as of June 30, 2016	$ 1,268,703	$ 379,639	$ 889,064
Service Costs	45,176	-	45,176
Interest	81,826	-	81,826
Employer contributions	-	42,455	(42,455)
Net investment income	-	39,593	(39,593)
Benefits paid to retirees	(19,862)	(19,862)	-
Administrative expenses	-	(194)	194
Values as of June 30, 2017	$ 1,375,843	$ 441,631	$ 934,212

Plan fiduciary net position as a percentage of total OPEB liability	32.09%
Covered payroll	3,326,175
Net OPEB liability as a % of covered payroll	28.09%

Schedule of Employer Contributions for OPEB

Fiscal Year Ended	Actuarially Determined Contributions	Contribution in relation to ADC	Contribution Deficiency (Excess)	Covered Employee Payroll	Contributions to Payroll Ratio
6/30/18	$ 80,541	$ 80,541	$ -	$ 3,326,175	23.44%

This schedule is required to present ten years of information. The information above is presented for the years currently available. A full ten-year trend will be built as the information becomes available in the future.

- The Proportionate Share of Net Pension Liability presents the Authority's portion of CalPERS Miscellaneous Risk Pool NPL as a dollar value as well as a percentage. The funded ratio represents the Authority's proportionate share of the Plan's Fiduciary Net Position as a percentage of the Authority's proportionate share of the Total Pension Liability. GASB 68 requires this schedule to include ten-year trend analysis. The trend analysis is intended to aid the reader in determining the financial health of the pension plan. The schedule contains all currently known information and will be built prospectively as the information becomes available, until the ten year requirement has been met. The Miscellaneous Risk Pool information is provided by CalPERS in its "GASB 68 Accounting Valuation Report for the measurement date of June 30, 2017". The Authority's proportionate share is calculated using information provided by CalPERS in its "Schedule of Employer Allocations and Collective Pension Amounts for the fiscal year ended June 30, 2017".

- The Schedule of Employer Contributions to CalPERS presents information regarding the Authority's required contributions to CalPERS, the amounts actually contributed, and any excess or deficiency to the contributions required. This schedule reports only employer required contributions. See also Footnote 12 to the Basic Financial Statements for the contributions, both employer and employee, for the current fiscal year. GASB 68 requires this schedule to include ten-year trend analysis. The trend analysis is intended to aid the reader in determining the financial health of the pension plan. The schedule contains all currently known information and will be built prospectively as the information becomes available, until the ten year requirement has been met.

- The Schedule of Employer Contributions to OPEB presents information regarding the Authority's required contributions to their OPEB plan, the amounts actually contributed, and any excess or deficiency to the contributions required. This schedule reports only employer required contributions. The amounts noted are based on the Plan's calendar year and not on the Authority's fiscal year end of March 31. See also Footnote 12 to the Basic Financial Statements for the contributions, both employer and employee, for the current fiscal year. GASB 75 requires this schedule to include ten-year trend analysis. The trend analysis is intended to aid the reader in determining the financial health of the pension plan. The schedule contains all currently known information and will be built prospectively as the information becomes available, until the ten year requirement has been met. The information for this schedule was obtained from information contained in "Housing Authority of County of Santa Cruz, Valuation of Retiree Health Benefits, Report of GASB 75 Actuarial Valuation as of July 1, 2017."

- There were no changes to the benefit terms that applied to the Authority's plans.

- Change to assumptions - CalPERS pension plans - In fiscal year 2016-2017, the financial reporting discount rate was reduced from 7.65 percent to 7.15 percent. In December 2016, the CalPERS Board approved lowering the funding discount rate used from 7.5 percent to 7.0 percent, which is to be phased-in over a three-year period, beginning with the June 30, 2016, valuation reports.

SUPPLEMENTARY INFORMATION

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2018

Federal Grantor	CFDA Number	Passed Thru to Subrecipients	Expenditures
Department of Housing and Urban Development (HUD)			
Direct Programs:			
Housing Choice Voucher Cluster:			
Housing Choice Voucher Program	14.871	$ -	$ 63,628,262
Mainstream Voucher Program	14.879	-	1,248,720
Subtotal HCV Cluster		-	64,876,982
Section 8 Moderate Rehabilitation Single Room Occupancy	14.249	-	92,983
Continuum of Care Program - Shelter Plus Care	14.267	-	476,149
Continuum of Care Program - Brommer Street TH	14.267	23,334	55,600
Public and Indian Housing Program	14.850	-	563,967
Lower Income Housing Assistance Program			
- Section 8 Moderate Rehabilitation	14.856	-	450,982
Public Housing Capital Fund Program	14.872	-	385,362
Family Self Sufficiency Program	14.896	-	137,946
Passed thru the County of Santa Cruz:			
HOME Investment Partnership Act			
Grant #15-HOME-10632	14.239	-	105,572
Passed thru the City of Santa Cruz:			
HOME Investment Partnership Act			
Grant HOME #M-17-MC060236	14.239	-	50,000
Community Development Block Grant			
Grant CDBG #B-17-MC-060024	14.218	-	12,500
Passed thru the City of Capitola:			
Community Development Block Grant			
Grant #14-CDBG-9877	14.228	-	10,752
Subtotal HUD		23,334	67,218,795
United States Department of Agriculture (USDA)			
Direct Programs:			
Rural Rental Assistance Payments Program	10.427	-	64,616
U.S. Department of Homeland Security - Federal Emergency Management Agency (FEMA)			
Passed thru the California Governor's Office of Emergency Services:			
Public Assistance Grant			
Grant number FEMA-4308-DR-CA, Cal OES ID: 087-92040	97.036	-	103,610
Total federal awards expended		$ 23,334	$ 67,387,021

The accompanying Independent Auditors' Report and notes are an integral part of this schedule.

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
JUNE 30, 2018

1. BASIS OF PRESENTATION

The schedule of expenditures of federal awards includes the federal award activity of the Housing Authority of the County of Santa Cruz, California, under programs of the federal government for the year ended June 30, 2018. The information in this schedule is presented for purposes of additional analysis as required by Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the Authority it is not intended to and does not present the financial position, changes in net position, or cash flows of the Authority.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures on the schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited to reimbursement.

Housing Choice Voucher Program - expenditures represent HUD funding to the extent that the funding has been expended by the Authority. HUD funding for this program was received as two types (1) HAP funding and (2) funding for administrative costs.

The following represents a comparison of the funding to the actual expenditures. Noted in bold are the amounts reported as expenditures of Federal awards, these Federal awards have been both received and expended.

	HUD Funding	Program Expenditures	Federal funds Expended
Housing Assistance Payments (HAP)	$ 58,660,099	$ **59,144,556**	$ **59,144,556**
Administrative Costs /FSS /Homeownership	**4,483,706**	4,500,282	**4,483,706**
	$ 63,143,805	$ 63,644,838	$ **63,628,262**

Excess HAP funding is reported as restricted net position as required by HUD (See Note 11 to the Basic Financial Statements).

Section 8 Moderate Rehabilitation, Section 8 Moderate Rehabilitation Single Room Occupancy, and Mainstream Voucher Programs - expenditures represent each programs' operating expenditures in their entirety, including operating transfers out; regardless of the amount of HUD annual contributions earned.

Continuum of Care - expenditures reported agree with the HUD grants earned for the year.

Public and Indian Housing and the Rural Rental Assistance Payments Programs expenditures reported consist only of the operating/rental subsidy amount received from HUD/USDA for the fiscal year.

Public Housing Capital Fund Program - expenditures agree with actual revenues and expenditures, including operating transfers made to the Public Housing Program, for the fiscal year.

Family Self Sufficiency Program, CDBG Program, HOME Investment Partnership Act and FEMA - expenditures consist only of the Federal grant funds received.

3. INDIRECT COST RATE

The Authority has elected not to use the 10% de minimus indirect cost rate allowed under the Uniform Guidance.

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
STATEMENT OF COMPLETED CAPITAL FUND PROGRAM PROJECTS
ANNUAL CONTRIBUTIONS CONTRACT SF-1621
JUNE 30, 2018

CA01P07250117

Funds approved	$ 385,362
Funds expended	385,362
Excess of funds approved	$ -
Funds advanced	$ 385,362
Funds expended	385,362
Excess of funds advanced	$ -

The accompanying Independent Auditors' Report and notes are an integral part of this statement.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Commissioners
Housing Authority of the
County of Santa Cruz
Capitola, California

We have audited, 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, the financial statements of the business-type activities of the Housing Authority of the County of Santa Cruz, California, as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the Housing Authority of the County of Santa Cruz, California's basic financial statements and have issued our report thereon dated February 15, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Housing Authority of the County of Santa Cruz, California's internal control over financial reporting (internal control) to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Housing Authority of the County of Santa Cruz, California's internal control. Accordingly, we do not express an opinion on the effectiveness of the Housing Authority of the County of Santa Cruz, California's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Authority's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Housing Authority of the County of Santa Cruz, California's financial statements are free of material misstatements, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests and those of other auditors disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Harn & Dolan

February 15, 2019

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

To the Board of Commissioners
Housing Authority of the
County of Santa Cruz
Capitola, California

Report on Compliance for Each Major Federal Program

We have audited the Housing Authority of the County of Santa Cruz, California's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Housing Authority of the County of Santa Cruz, California's major federal programs for the year ended June 30, 2018. The Housing Authority of the County of Santa Cruz, California's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Housing Authority of the County of Santa Cruz, California's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Housing Authority of the County of Santa Cruz, California's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Housing Authority of the County of Santa Cruz, California's compliance.

Opinion on Each Major Federal Program

In our opinion, the Housing Authority of the County of Santa Cruz, California complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2018.

Report on Internal Control Over Compliance

Management of the Housing Authority of the County of Santa Cruz, California is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit, we considered the Housing Authority of the County of Santa Cruz, California's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Housing Authority of the County of Santa Cruz, California's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purposes described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purposes.

Harn & Dolan

February 15, 2019

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
STATUS OF PRIOR AUDIT FINDINGS
JUNE 30, 2018

The previous audit report for the year ended June 30, 2017 contained no audit findings.

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2018

Section I - Summary of Auditors' Results

<u>Financial Statements</u>

Type of auditors' report issued:	unmodified
Is a "going concern" emphasis-of-matter paragraph included in the audit report?	no
Internal control over financial reporting:	
Significant deficiencies identified?	no
Significant deficiencies identified also considered to be material weaknesses?	none reported
Noncompliance material to financial statements noted?	no

<u>Federal Awards</u>

Does the auditors' report include a statement that the auditee's financial statements include departments, agencies, or other organizational units expending $750,000 or more in Federal awards that have separate Uniform Guidance audits which are not included in this audit?	no
Dollar threshold used to distinguish between Type A and Type B programs	$2,021,611
Auditee qualified as low-risk auditee?	yes
Identification of major programs:	
Housing Voucher Cluster:	
Housing Choice Voucher Program	14.871
Mainstream Voucher	14.879
Type of auditors' report issued on compliance for major programs:	unmodified
Any audit findings disclosed that are required to be reported in accordance With Uniform Guidance part 200.516?	no
Internal control over major programs:	
Significant deficiencies identified?	no
Significant deficiencies identified also considered to be material weaknesses?	none reported
Any known questioned costs	no
Were prior audit findings related to direct funding shown in the Summary of Prior Audit Findings	no

Section II - Financial Statement Findings

none

Section III - Federal Award Findings

none

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
BROMMER STREET TRANSITIONAL HOUSING ENTERPRISE FUND
CONTRACT NO. 99-FMTW-009
FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2018
(Including Auditors' Report Thereon)

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
BROMMER STREET TRANSITIONAL HOUSING ENTERPRISE FUND
CONTRACT NO. 99-FMTW-009
FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2018

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INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
Housing Authority of the
County of Santa Cruz
Santa Cruz, California

Report on the Financial Statements
We have audited the accompanying financial statements of the Brommer Street Transitional Housing Enterprise Fund of the Housing Authority of the County of Santa Cruz, California, HCD contract number 99-FMTW-009, as of and for the years ended June 30, 2018 and 2017, and the related notes to the 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 misstatements, 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 and the requirements of the *Audited Financial Statement Handbook for Multifamily Rental Housing of the California Department of Housing and Community Development and the California Housing Finance Agency (HCD/CalHFA)*. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, 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 Authority'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 Authority'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 Brommer Street Transitional Housing Enterprise Fund of the Housing Authority of the County of Santa Cruz, California, as of June 30, 2018 and 2017, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter
As discussed in Note 1, the financial statements present only the Brommer Street Transitional Housing Enterprise Fund and do not purport to, and do not present fairly the financial position of the Housing Authority of the County of Santa Cruz, California, as of June 30, 2018 and 2017, the changes in its financial position, or its cash flows for the years then ended in accordance with accounting principles generally accepted in the United State of America. Our opinion was not modified with respect to this matter.

Other Matters
Other Information
Our audit was conducted for the purpose of forming an opinion on the financial statements of the Brommer Street Transitional Housing Enterprise Fund of the Housing Authority of the County of Santa Cruz, California, taken as a whole. The accompanying supplemental information on pages 16-18, as required by HCD, is presented for the purposes of additional analysis, and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

Other Reporting
In accordance with *Government Auditing Standards* and the requirements of the *Audited Financial Statement Handbook for Multifamily Rental Housing of the California Department of Housing and Community Development and the California Housing Finance Agency (HCD/CalHFA)*, we have also issued a report dated February 15, 2019, on our consideration of the Housing Authority of the County of Santa Cruz, California's internal control over financial reporting as it relates to the Brommer Street Transitional Housing Enterprise Fund and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and the requirements of the *Audited Financial Statement Handbook for Multifamily Rental Housing of the California Department of Housing and Community Development and the California Housing Finance Agency (HCD/CalHFA)*, in considering the Authority's internal control over financial reporting and compliance.

Harn & Dolan

February 15, 2019

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
BROMMER STREET TRANSITIONAL HOUSING ENTERPRISE FUND
CONTRACT NO. 99-FMTW-009
STATEMENT OF NET POSITION
JUNE 30

	2018	2017
ASSETS		
Current assets:		
Cash (Note 2)	$ 30,727	$ 26,158
Due from HUD	9,745	8,576
Tenant accounts receivable	695	2
Allowance for doubtful accounts	(620)	-
Prepaid expenses	394	434
Total current assets	40,941	35,170
Restricted assets:		
Restricted cash (Note 2)	94,264	91,659
Capital assets (Note 3):		
Land	289,000	289,000
Site improvements and buildings (net of accumulated depreciation of $434,711 and $421,989)	79,843	92,565
Total capital assets	368,843	381,565
Total assets	504,048	508,394
DEFERRED OUTFLOWS OF RESOURCES		
Pension plan (Note 1.N.)	-	3,969

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
BROMMER STREET TRANSITIONAL HOUSING ENTERPRISE FUND
CONTRACT NO. 99-FMTW-009
STATEMENT OF NET POSITION
JUNE 30
(continued)

	2018	2017
LIABILITIES		
Current liabilities:		
Accounts payable	$ 7,881	$ 6,570
Accrued salaries and related costs	217	200
Current portion of compensated absences	64	71
Prepaid rent	133	-
Total current liabilities	8,295	6,841
Payable from restricted assets:		
Tenant security deposits	1,918	1,850
Noncurrent liabilities:		
Long-term portion of compensated absences	1,570	1,472
Net pension liability (Note 1.N.)	-	11,582
Long-term debt (Note 4)	210,000	210,000
Deferred interest on long-term debt (Note 4)	82,134	82,197
Total liabilities	303,917	313,942
DEFERRED INFLOWS OF RESOURCES		
Pension plan (Note 1.N.)	-	1,641
NET POSITION		
Net investment in capital assets (Note 5.A.)	76,709	89,368
Restricted (Note 5.B.)	92,346	89,809
Unrestricted	31,076	17,603
Total net position	$ 200,131	$ 196,780

The accompanying Independent Auditors' Report and notes are an integral part of this statement.

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
BROMMER STREET TRANSITIONAL HOUSING ENTERPRISE FUND
CONTRACT NO. 99-FMTW-009
STATEMENT OF REVENUE, EXPENSES, AND CHANGES IN FUND NET POSITION
FOR THE FISCAL YEAR ENDED JUNE 30

	2018	2017
Operating revenue:		
Rent	$ 22,588	$ 17,694
Other	936	1,608
Total operating revenue	23,524	19,302
Operating expenses:		
Administrative	12,728	10,983
Tenant services	23,334	23,334
Utilities	7,208	6,694
Maintenance	17,426	14,005
Taxes and insurance	5,484	4,506
Depreciation (Note 3)	12,722	15,449
Total operating expenses	78,902	74,971
Operating income (loss)	(55,378)	(55,669)
Nonoperating revenue (expenses):		
Grants	55,600	50,501
Interest on operating accounts	38	26
Interest on restricted funds	137	132
Interest expense (Note 4)	(6,300)	(6,300)
Net income (loss) before transfers	(5,903)	(11,310)
Transfers (Note 1.N.)	9,254	-
Change in net position	3,351	(11,310)
Net position - beginning of year	196,780	208,090
Net position - end of year	$ 200,131	$ 196,780

The accompanying Independent Auditors' Report and notes are an integral part of this statement.

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
BROMMER STREET TRANSITIONAL HOUSING ENTERPRISE FUND
CONTRACT NO. 99-FMTW-009
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30

	2018	2017
Cash flows from operating activities:		
Tenant receipts	$ 22,096	$ 16,978
Other receipts	936	1,608
Payroll and benefit expenditures	(14,113)	(13,484)
Administrative expenditures	(3,403)	(2,259)
Tenant services expenditures	(23,334)	(23,334)
Utility expenditures	(7,208)	(6,694)
Maintenance expenditures	(14,622)	(13,869)
Insurance expenditures	(1,421)	(1,484)
Net cash used by operating activities	(41,069)	(42,538)
Cash flows from noncapital financing activities:		
Operating grants received	54,431	57,914
Net cash provided by noncapital financing activities	54,431	57,914
Cash flows from financing activities:		
Principal paid on debt	-	-
Interest paid on debt	(6,363)	-
Net cash used by capital financing activities	(6,363)	-
Cash flows from investing activities:		
Interest on operating cash	38	26
Interest on restricted cash	137	132
Net cash provided by investing activities	175	158
Net change in cash	7,174	15,534
Cash at beginning of year	117,817	102,283
Cash at end of year	$ 124,991	$ 117,817
Cash	$ 30,727	$ 26,158
Restricted cash	94,264	91,659
Cash at end of year	$ 124,991	$ 117,817

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
BROMMER STREET TRANSITIONAL HOUSING ENTERPRISE FUND
CONTRACT NO. 99-FMTW-009
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30
(Continued)

	2018	2017
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	$ (55,378)	$ (55,669)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	12,722	15,449
(Increase) decrease in:		
Tenant accounts receivable	(73)	(2)
Prepaid expenses	40	(11)
Increase (decrease) in:		
Accounts payable - vendors	1,311	(1,030)
Accrued payroll	17	(299)
Compensated absences	91	428
Tenant security deposits	68	(208)
Prepaid rent	133	(506)
Net pension liability	-	3,796
Net deferred outflows/inflows	-	(4,486)
Net cash used by operating activities	$ (41,069)	$ (42,538)

Non-cash transaction - Deferred outflows of resources, deferred inflows of resources, and net pension liability were transferred to the Authority Business Enterprise Fund. See also Note 1.N.

The accompanying Independent Auditors' Report and notes are an integral part of this statement.

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. General Information

The Housing Authority of the County of Santa Cruz (the Authority) was established in 1969 by a resolutions of the Santa Cruz County Board of Supervisors. The Authority is governed by a seven member Board of Commissioners. At-large commissioners are appointed for terms of four years and tenant commissioners are appointed for terms of two years by the Santa Cruz County Board of Supervisors.

The Authority owns and operates this six unit project in Santa Cruz, California. The Authority has received grant funding from the U.S. Department of Housing and Urban Development (HUD) restricting the use of this project. Under the HUD Continuum of Care Program grant, the project provides transitional housing to families meeting certain requirements over a limited amount of time, not to exceed two years. The Authority has contracted with the County of Santa Cruz to provide case-management services and to transition the project's residents into permanent housing by the end of their lease term. The project was modernized in 2001 with the help of a $210,000 loan from the State of California, Department of Housing and Community Development (HCD), Families Moving to Work Program. The loan and regulatory agreements, signed with HCD, require that only individuals and families that meet various income, age and employment standards be aided.

B. Basis of Presentation

The financial statements include only the accounts and transactions of the Housing Authority of the County of Santa Cruz's (the Authority) Brommer Street Transitional Housing Enterprise Fund. The Authority administers several federal, state, and local housing programs, including the Brommer Street Transitional Housing Enterprise Fund. The financial statements are not intended to present the financial position of the Authority as a whole and the changes in its financial position and cash flows in conformity with accounting principles generally accepted in the United States of America.

The Brommer Street Transitional Housing Project is reported as a Proprietary Fund Type, Enterprise Fund. Enterprise Funds are used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent is that costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. Enterprise Funds are also used when the governing body has decided that periodic determination of revenues earned, expenses incurred, or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

Note 1 (continued)

C. Measurement Focus/Basis of Accounting

Measurement focus refers to what is being measured; basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of measurement made, regardless of the measurement focus applied.

The Proprietary Fund Types are accounted for on an economic resources measurement focus using the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recorded at the time liabilities are incurred. Under this basis of accounting and measurement focus, the Authority applies all GASB pronouncements.

When the Authority incurs an expense for which both restricted and unrestricted resources may be used, it is the Authority's policy to use restricted resources first and then unrestricted resources as needed. Any use of restricted funds for this program requires the prior approval of HCD.

D. Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America require management to make estimates and assumptions that affect the reported amounts of assets, deferred outflows of resources, liabilities, and deferred inflows of resources; the disclosure of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates

E. Cash and Cash Equivalents

For the purpose of the cash flows, the Authority considers all of their cash and investments, including restricted cash, to be cash and cash equivalents. The Authority considers all of their investments to be highly liquid or short-term in nature; and therefore, cash equivalents.

F. Interfund Activity

Short-term amounts owed between the Brommer Street Transitional Housing Enterprise Fund and the Authority's other funds, if any, are classifies as "Due to/from other funds". The operating costs mainly associated with salaries and benefits are paid by another of the

Note 1 (continued)

Authority's Enterprise Funds. These costs are allocated to appropriate funds as the transactions occur. Reimbursement is made back to the fund initiating the transactions on a frequent basis.

G. Capital Assets

Typically, capital assets are valued at historical cost and contributed capital assets are recorded at fair market value at the time received. The capital assets associated with the Brommer Street Transitional Housing Enterprise Fund were valued based on historical cost.

Capital assets acquired for Proprietary Funds are capitalized in the respective funds to which they apply. Depreciation of exhaustible capital assets used by Proprietary Funds is charged as an expense against operations, and accumulated depreciation is reported on the Proprietary Fund's Statement of Net Position. Depreciation has been provided over the estimated useful lives using the straight-line method of depreciation. Dwelling structures are being depreciated over a useful life of thirty years, modernization over ten years, and dwelling equipment over five years. Salvage value on all depreciable assets is assumed to be insignificant and therefore valued at $0.

H. Deferred Outflows/Inflows of Resources

In addition to assets, the Statement of Net Position will include a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense) until then. The Authority's deferred outflows consist of items associated with, and referred to, in the actuarial report of the defined benefit pension plan; as well as payments made on behalf of employees to the defined benefit pension plan after the measurement date of the actuarial report. See also Note 1.N.

In addition to liabilities, the Statement of Net Position will include a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. The Authority's deferred inflows consist of items associated with, and referred to, in the actuarial report of the defined benefit pension plan. See also Note 1.N.

Note 1 (continued)

I. Net Position

Net position represent the difference between assets and liabilities. Net investment in capital assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowing used for the acquisition, construction, or improvement of those assets. Net position is reported as restricted when there are limitations imposed on its use either through constitutional provisions or enabling legislation or through external restrictions imposed by creditors, grantors, or laws or regulations of other governments.

J. Operating Revenue and Expenses

Proprietary funds distinguish *operating* revenue and *operating* expenses from *nonoperating* items. Operating revenues are those revenues that are generated directly from the primary activity of the proprietary funds. For this program, these revenues are typically rental charges. Operating expenses are necessary costs that have been incurred in order to provide the good or service that is the primary activity of the fund. Operating expenses include payroll, benefits, utilities, maintenance costs, and depreciation. All revenue and expenses not meeting these definitions are reported as nonoperating.

K. Income Taxes

The Authority is exempt from Federal Income and California Franchise Taxes.

L. Encumbrances

Encumbrance accounting is not employed by the Authority.

M. Regulatory Agreement

On October 31, 2001, the Authority entered into a Families Moving to Work Program (FMTW) Regulatory Agreement, Loan Number 99-FMTW-099. Under this agreement, the State of California, Department of Housing and Community Development (HCD) provided funding for the modernization of 6 residential housing units, all of which were to be occupied by low income households, located in Santa Cruz, California. The Authority is required to maintain cash reserves for replacements. The project's annual budget must be approved by HCD. This agreement expires November 30, 2056.

Note 1 (continued)

N. PENSION PLAN

The Authority participates in a cost-sharing multi-employer defined benefit retirement plan that is administered by CalPERS. Contributions to CalPERS are made on a current basis as required by the plan and are charged to expenditures. The Authority used actuarial reports supplied by CalPERS for the purpose of measuring the net pension liability, deferred outflows of resources, and deferred inflows of resources related to the plan. The valuation date of the latest actuarial report was June 30, 2017. For further information, please refer to the Authority-wide audit report for the fiscal year ended June 30, 2018, which can be obtained by contacting the Finance Director of the Housing Authority of the County of Santa Cruz at 2160 41st Avenue, Capitola, California 95010.

During the current year, the Authority implemented GASB 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*. During implementation, the Authority reassessed their allocation method utilized to spread the costs of pension and OPEB benefits equitably to all of the Authority's programs. Management determined that, for a number of their smaller programs, including the Brommer Street Transitional Housing Enterprise Fund; the deferred outflows of resources, the deferred inflows of resources and the associated liabilities will be held by the Authority's Business Enterprise Fund. The annual pension and OPEB costs will be allocated to all programs based on direct salaries incurred during the fiscal year. To implement this new policy, deferred outflows and inflows of resources and net pension liability, for a total of $9,254, was transferred to the Business Enterprise Fund.

Note 2 - CASH AND RESTRICTED CASH

The cash for this project is deposited with Santa Cruz County Bank. Cash and the restricted cash held for tenant security deposits is co-mingled with other cash of the Authority in a checking account. The replacement reserve cash is being held in a money market account earning interest at a rate of 0.15% per annum.

Restricted cash consists of the following:

	6/30/2018	6/30/2017
Security deposits	$ 1,918	$ 1,850
Replacement reserves (see also Note 5.B.)	92,346	89,809
	$ 94,264	$ 91,659

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
BROMMER STREET TRANSITIONAL HOUSING ENTERPRISE FUND
CONTRACT NO. 99-FMTW-009
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2018

(Continued)

Note 3 - CAPITAL ASSETS

The Authority calculates depreciation on a straight-line basis with the useful lives of fixed assets being - 30 years for dwelling structures, 10 years for modernization, and 5 years for equipment.

The following is a summary of the Brommer Street Transitional Housing project's changes in capital assets and changes in depreciation for the fiscal year ended June 30, 2018:

	Historical Cost			Accumulated Depreciation			Net
	Balance 6/30/17	Changes	Balance 6/30/18	Balance 6/30/17	Changes	Balance 6/30/18	
Land	$ 289,000	$ -	$ 289,000	$ -	$ -	$ -	$ 289,000
Site improv.	42,555	-	42,555	(42,555)	-	(42,555)	-
Buildings	471,999	-	471,999	(379,434)	(12,722)	(392,156)	79,843
Total	$ 803,554	$ -	$ 803,554	$ (421,989)	$ (12,722)	$ (434,711)	$ 368,843

Note 4 - LONG-TERM DEBT

The following is a summary of the changes in long-term debt, and interest on the debt, for the fiscal year ended June 30, 2018:

	Balance 6/30/2017	Additions	Payments	Balance 6/30/2018	Short-term Portion
HCD - principal	$ 210,000	$ -	$ -	$ 210,000	$ -
HCD - Interest	$ 82,197	$ 6,300	$ (6,363)	$ 82,134	$ -

On October 31, 2001, the Authority entered into an agreement with the State of California, Department of Housing and Community Development (HCD) to borrow $210,000 for the purpose of modernization on property owned by the Authority known as Brommer Street Transitional Housing. The note earns simple interest at a rate of 3% per annum, is due November 30, 2056, and requires annual payments only to the extent that the project has net cash flows as determined by the Regulatory Agreement. The Authority incurred $6,300 in interest expense on this loan during each of the fiscal years ended June 30, 2018 and 2017. Interest payments of $6,363 and $0 have been made on this loan during the fiscal years ended June 30, 2018 and 2017, respectively. No principal payments on this note are expected to be made over the next five years.

Note 5 - NET POSITION

A. Net Investment in Capital Assets

Net investment in capital assets, consists of the following:

	6/30/2018	6/30/2017
Capital assets, net of depreciation (See also Note 3)	$ 368,843	$ 381,565
Long term debt (See also Note 4)	(210,000)	(210,000)
Interest payable on long-term debt (See also Note 4)	(82,134)	(82,197)
Net investment in capital assets	$ 76,709	$ 89,368

B. Restricted Net Position

Net position is reported as restricted when constraints placed on net position use are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or imposed by law through constitutional provisions or enabling legislation. The project's restricted net position consists of replacement reserves required to be maintained by the regulatory agreement.

The activity for the past two years was as follows:

	6/30/2018	6/30/2017
Beginning balance - July 1,	$ 89,809	$ 87,277
Increases to reserves:		
• Regular annual contribution	2,400	2,400
• Interest earned on account	137	132
Decreases to reserves:		
	-	-
Ending balance - June 30,	$ 92,346	$ 89,809

As of June 30, 2018 and 2017, funds were on deposit with Santa Cruz County Bank earning 0.15% interest per annum. Restricted net position is fully funded. These reserves can not be used without the prior written approval of HCD.

SUPPLEMENTARY INFORMATION

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
BROMMER STREET TRANSITIONAL HOUSING ENTERPRISE FUND
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SUPPLEMENTARY INFORMATION REQUIRED BY HCD

Schedule of Operating Revenue for the year ended

		6/30/2018	6/30/2017
5120	Rent Revenue	$ 22,588	$ 17,694
5390	HUD grant revenue	55,600	50,501
5410	Interest on project operations	38	26
5440	Interest on replacement reserves	137	132
5910	Laundry and vending	332	593
5920	Tenant charges - damages & cleaning fees	604	1,015
5000T	Total Revenue	$ 79,299	$ 69,961

Schedule of Operating Expenses for the year ended

		6/30/2018	6/30/2017
6210	Advertising and marketing	$ -	$ 32
6310	Office salaries	2,375	2,311
6311	Office expense	63	22
6312	Office rent	603	664
6330	Manager salaries	6,330	6,413
6340	Legal expense	24	27
6350	Audit expense	1,584	83
6370	Bad debt	620	-
6390	Miscellaneous administration	1,129	1,431
6263T	Total Administrative Expenses	12,728	10,983
6450	Electricity	712	788
6451	Water	2,465	2,060
6452	Gas	106	90
6453	Sewer	3,925	3,756
6400T	Total Utility Expenses	7,208	6,694
6510	Payroll	1,493	1,166
6515	Supplies - general	1,077	2,512
6520	Contracts	11,086	6,742
6525	Garbage removal	3,770	3,585
6500T	Total Operating and Maintenance Expenses	17,426	14,005
6720	Property and liability insurance	828	856
6722	Worker's compensation	633	617
6723	Health insurance and other benefits	4,023	3,033
6700T	Total Taxes and Insurance Expenses	5,484	4,506
6990	Other service expenses	23,334	23,334
6000T	Total Operating Expenses	$ 66,180	$ 59,522

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
BROMMER STREET TRANSITIONAL HOUSING ENTERPRISE FUND
CONTRACT NO. 99-FMTW-009
SUPPLEMENTARY INFORMATION REQUIRED BY HCD
FOR THE YEAR ENDED JUNE 30, 2018
(Continued)

		6/30/2018	6/30/2017
Reconciliation of Previous Schedules to Changes in Net Position			
5000T	Total revenue	$ 79,299	$ 69,961
6000T	Total cost of operations	(66,180)	(59,522)
5060	Operating income before depreciation	13,119	10,439
6600	Depreciation	(12,722)	(15,449)
6830	Interest on notes payable (long-term)	(6,300)	(6,300)
3250	Net loss (page 5)	$ (5,903)	$ (11,310)
Surplus Cash Computation and the Distribution of Surplus Cash			
5000T	Total revenue	$ 79,299	$ 69,961
6000T	Total cost of operations	(66,180)	(59,522)
5060	Operating income before depreciation	13,119	10,439
	Adjustments:		
5440	Interest earned on restricted deposits	(137)	(132)
	Adjusted operating income	12,982	10,307
	Other activity:		
	Replacement reserve deposits	(2,400)	(2,400)
	Replacement reserve withdrawn and expensed	-	-
	Operating cash flow/surplus cash	$ 10,582	$ 7,907

Per the Regulatory Agreement, borrower distribution is the lessor of:

8% gross rental income ($21,828 for 2018)	$ 1,746
8% gross rental income ($19,302 for 2017)	$ 1,544
or $50 per unit per month (6 units)	$ 3,600

	6/30/2018	6/30/2017
Surplus cash - borrower distribution	$ 1,746	$ 1,544
Surplus cash - repayment of interest on HCD loan	8,836	6,363
Distribution of surplus cash for the year ended June 30, 2018	$ 10,582	$ 7,907

Cash on Hand and in Banks

See Note 2

Property and Equipment

See Note 3

Debt Service

See Note 4

Replacement Reserve Account

See Note 5.B.

Taxes

The Authority is exempt from Federal Income and California Franchise Taxes.

Tenant Security Deposits

Tenant security deposits were fully funded as of June 30, 2018. The account does not earn interest. See also Note 2.

Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses are being paid on a current basis.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Commissioners
Housing Authority of the
County of Santa Cruz
Santa Cruz, California

We have audited, in accordance with the 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 of America, the financial statements of the Brommer Street Transitional Housing Enterprise Fund of the Housing Authority of the County of Santa Cruz, as of and for the year ended June 30, 2018, and the related notes to the financial statements, that comprise this Fund's financial statements, and have issued our report thereon dated February 15, 2019.

Internal Control Over Financial Reporting
In planning and performing our audit of the financial statements, we considered the Housing Authority of the County of Santa Cruz, California's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Housing Authority of the County of Santa Cruz, California's internal control. Accordingly, we do not express an opinion on the effectiveness of the Housing Authority of the County of Santa Cruz's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Brommer Street Transitional Housing Enterprise Fund financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those in charge with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of the Brommer Street Transitional Housing Enterprise Fund of the Housing Authority of the County of Santa Cruz, California, are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and terms of the regulatory agreement with HCD, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Authority's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Harn & Dolan

February 15, 2019

HOUSING AUTHORITY OF THE COUNTY OF SANTA CRUZ
BROMMER STREET TRANSITIONAL HOUSING ENTERPRISE FUND
CONTRACT NO. 99-FMTW-009
JUNE 30, 2018

AUTHORITY'S CERTIFICATION

We hereby certify that we have examined the accompanying financial statements, notes, and supplemental information of the Brommer Street Transitional Housing Enterprise Fund of the Housing Authority of the County of Santa Cruz, as of and for the years ended June 30, 2018 and 2017, and to the best of our knowledge and belief, these financial statements, notes, and supplementary information are complete and accurate.

Signature	Executive Director Title	3/7/19 Date
Signature	Finance Director Title	3/7/19 Date