SANTA CRUZ METROPOLITAN TRANSIT DISTRICT

FINANCIAL STATEMENTS
WITH
INDEPENDENT AUDITOR'S REPORT

JUNE 30, 2017 AND 2016

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
JUNE 30, 2017 AND 2016

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FINANCIAL SECTION

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BROWN ARMSTRONG
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Santa Cruz Metropolitan Transit District
Santa Cruz, California

Report on the Financial Statements

We have audited the accompanying financial statements of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO), as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise Santa Cruz METRO's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to Santa Cruz METRO'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 Santa Cruz METRO'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, the financial statements referred to above present fairly, in all material respects, the respective financial position of Santa Cruz METRO as of June 30, 2017 and 2016, and the respective 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.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, Schedule of Changes in the Net Pension Liability and Related Ratios, and Schedule of Contributions, as well as the Schedule of Funding Progress for Santa Cruz METRO's Other Postemployment Benefit (OPEB) Plan, as noted in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board (GASB), 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 an opinion on the basic financial statements. The statements of operating expenses are presented for purposes of additional analysis and are not a required part of the basic financial statements. The 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 also not a required part of the basic financial statements.

The statements of operating expenses and the schedule of expenditures of federal awards 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 statements of operating expenses and the schedule of expenditures of federal awards 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 December 18, 2017, on our consideration of Santa Cruz METRO'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 Santa Cruz METRO's internal control over financial reporting and compliance.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

Bakersfield, California
December 18, 2017

Introduction

The following Management's Discussion and Analysis (MD&A) of activities and financial performance of Santa Cruz Metropolitan Transit District (Santa Cruz METRO) provides a narrative and analytical overview of the financial activities of Santa Cruz METRO with selected comparative information for the years ended June 30, 2017 and 2016. Following the MD&A are the basic financial statements of Santa Cruz METRO together with the notes thereto, which are essential for a full understanding of the data contained in the financial statements.

Activities and Highlights

Santa Cruz METRO is an independent special-purpose district in 1969 by the legislature of the State of California for the purpose of providing fixed route bus service to the general public in Santa Cruz County. Santa Cruz METRO assumed direct operation of federally mandated Americans with Disabilities Act (ADA) complementary paratransit (Paracruz) services in November 2004. Prior to 2004, the paratransit service was delivered under contract. Santa Cruz METRO also operates the Highway 17 (Commuter) Express bus service to Santa Clara County in cooperation with the Santa Clara Valley Transportation Authority (VTA), Amtrak, San Joaquin Joint Powers Authority (SJJPA), and the Capitol Corridor Joint Powers Authority (CCJPA). Overseeing the employees who work in the public interest, the Chief Executive Officer/General Manager coordinates the operation of Santa Cruz METRO according to the policy and direction of the governing Board of Directors, composed of eleven directors and two ex-officio directors as described in Note 1.A.

The Financial Statements

Santa Cruz METRO's basic financial statements are prepared using proprietary fund (enterprise fund) accounting that uses the same basis of accounting as private-sector business enterprises. Santa Cruz METRO reports its financial results using one enterprise fund under the accrual basis of accounting, which records revenue when earned and expenses when incurred.

The Statement of Net Position presents complete information on Santa Cruz METRO's assets and deferred outflows of resources, as well as liabilities and deferred inflows of resources, with the difference reported as net position. Changes in net position that occur over time may serve as an indicator of Santa Cruz METRO's financial position.

The Statement of Revenues, Expenses, and Changes in Fund Net Position reports the operating revenues and expenses, non-operating revenues and expenses, and capital grant contributions. Federal capital grant expenses are listed in the Schedule of Expenditures of Federal Awards and are included in the current year increase in capital assets.

The Statement of Cash Flows reports the sources and uses of cash for the fiscal year resulting from *operating* activities, *non-capital financing* activities (operating grants and sales tax receipts), *capital and related financing* activities (capital acquisitions and disposals), and *investing* activities (interest and rental receipts). The net result of these activities, added to the cash balances at the beginning of the year, reconciles to the cash balances (current plus restricted) at the end of the current fiscal year on the Statement of Net Position.

The Notes to the Financial Statements are an integral component of the report, as they provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes describe the nature of Santa Cruz METRO's operations and significant accounting policies as well as clarify financial information unique to Santa Cruz METRO.

Following the basic financial statements and footnotes is the Required Supplementary Information, which provides a schedule of changes in the net pension liability, schedule of contributions to Santa Cruz METRO's defined benefit pension plan, and a schedule of funding progress for other postemployment benefit (OPEB) obligations.

The Statement of Operating Expenses, located in the Supplementary Information section of the financial statements, reports expenses in greater detail.

Financial Highlights

- The assets and deferred outflows of resources of Santa Cruz METRO exceeded its liabilities and deferred inflows of resources at the close of the year ended June 30, 2017, by $20,367,531 (Total Net Position).

- Of this amount, $86,071,566 consisted of Net Investment in Capital Assets, which reflects investment in capital assets used for operational and administrative functions (e.g. facilities, vehicles, and equipment). Accordingly, these assets are not available for future spending.

- The remaining balance of Total Net Position represents Unrestricted Net Position, which decreased to $(65,704,035). The negative Unrestricted Net Position is the result, in part, of the District incurring increasing pension obligations (Net Pension Liability) that reached $54,722,128 by June 30, 2017, and increasing retiree medical benefits obligations (OPEB) in fiscal year 2017 totaling $33,663,105 at year end. These liabilities are required to be accounted for under Governmental Accounting Standards Board (GASB) Statement No. 68, and GASB Statement No. 45. Net Pension Liability represents a future long-term pension obligation, but for the most part does not significantly affect the District's ability to meet immediate (short-term) operational cash flow needs. Therefore, although the projected long-term pension and OPEB obligation costs have generated a deficit unrestricted net position balance on the financial statements, Santa Cruz METRO is able to utilize current, available funds to pay for ongoing obligations for pension and retiree medical expenses as they come due.

- Total passenger fares revenue decreased 2% during the year ended June 30, 2017, to $9.7 million compared to a 1% increase during the year ended June 30, 2016 over the previous year. The decrease in the current year was due primarily to service reductions implemented in September 2016. The increase in fares revenues in fiscal year 2016 was due to a fare increase on the Highway 17 commuter service implemented in September 2015, as well as an increase in contract fares revenue due to higher University of California, Santa Cruz (UCSC) enrollment and student ridership from the previous fiscal year.

- Operating expenses (excluding depreciation) increased 3.8% during the year ended June 30, 2017, to $51.8 million compared to a 1% increase during the year ended June 30, 2016 over the previous year. The increase in the current year was mainly attributable to the increase in provisions required for long-term pension and workers' compensation liabilities over prior year. In the prior year, the increase was attributable to settlement costs, increased costs for medical benefits, and the provision for other postemployment benefits for retirees.

- In 2017, Santa Cruz METRO's Capital Assets (after the application of accumulated depreciation) decreased $(424,065) compared to an increase in 2016 of $3.7 million over the previous year. Depreciable Asset additions and transfers were $28.5 million, offset by asset retirements and transfers of $2.7 million and an increase in accumulated depreciation of $4.3 million offset by a $2.7 million write-off of accumulated depreciation associated with retired assets. Asset additions were attributed primarily to the construction of the new Judy K. Souza Operations Facility. Capital Asset procurements are funded by a combination of federal, state, and local grants as well as Operating and Capital Reserves.

Financial Activities

The following discussion provides an overview of the financial activities related to operations (operating revenue and expense) and capital funding (contributions) received for facilities improvements and the purchase of capital equipment for the year ended June 30, 2017.

Operating Revenue and Expense:
Santa Cruz METRO utilizes five primary sources of revenue to operate its public transit services: passenger fares, sales and use taxes, local transportation funds (TDA), federal funds, and other non-transportation related revenues (including advertising income, investment income, and rental income). Operating expenses are classified into ten basic categories: labor and fringe benefits, services, mobile materials and supplies, other materials and supplies, utilities, insurance costs (casualty and liability), taxes, purchased transportations costs, miscellaneous expense, and leases and rental expenses. These categories are consistent with the Uniform System of Accounts (USOA) and National Transit Database (NTD) reporting.

As with many transit and public agencies across the region and throughout the state, Santa Cruz METRO continues to face financial challenges due to significant increases in operating and capital costs with no significant increases in operating or capital contributions; the growth in recurring revenues has not kept pace with the growth in recurring expenses.

- Federal bus transit funding is generated from gasoline and diesel fuel taxes. Federal gasoline and diesel fuel tax levels have been unchanged since 1993, therefore Federal assistance has remained relatively flat. The recurring costs for health benefits, retirement, services, materials and supplies, and utilities have significantly exceeded the annual Consumer Price Index (CPI) for the region since 2012.

- The California Transportation Development Act (TDA) consists of two programs: the State Transit Assistance (STA) program and the Local Transportation Fund (LTF). STA funding is derived from the statewide sales tax on diesel fuel. Since fiscal year 2014, STA funding has been on the decline. LTF funding is derived from a 0.25% general sales tax collected statewide. Since fiscal year 2012, LTF funding has been growing at a slow rate, and has not kept pace with increases in operating costs over that time.

Capital Program:
In fiscal year 2017, Santa Cruz METRO spent over $3.9 million in capital contributions on new and ongoing capital projects. These capital projects were funded by a variety of sources including the Federal Transit Administration (FTA), California Proposition 1B Transportation Bonds (Public Transportation Modernization, Improvement, and Service Enhancement Account (PTMISEA) and the Transit System Safety, Security, and Disaster Response Account (TSSSDRA)), State Transit Assistance (STA), the State-Local Partnership Program (SLPP), the State Transportation Improvement Program (STIP), FTA construction settlement funds, and Operating and Capital Reserves.

Operating buses and owning/maintaining transit facilities is a capital-intensive business. Funding Santa Cruz METRO's overall operation is a delicate balance between identifying the resources to operate the service and identifying the resources to purchase and maintain the vehicles and facilities with which to operate the service. Santa Cruz METRO needs to reduce its dependence on using capital-eligible funds and cash reserves in the operating budget, and concentrate on restoring these funding sources to the capital program in order to achieve a "state-of-good-repair" and ensure that new capital grant opportunities that require matching funds from reserves can be pursued. To that end, the Santa Cruz METRO Board of Directors (Board) adopted a Reserve Fund Policy that provides for the gradual restoration of FTA-STIC and STA funding to the capital program.

Noteworthy capital project activity this fiscal year includes:

- Judy K. Souza Operations Facility – The Operations facility opened for business on Friday, March 18, 2016, the official ribbon cutting event was held on Friday, May 6, 2016, and METRO received final occupancy on December 12, 2016. Activity continued on the project well into 2017 including a radio tower for the Land Mobile Radio System, an electronic access control system, security cameras, and an electric security gate. Ongoing projects include an upgrade to the mechanical platform, and pipe protection in the parking garage. It is estimated that this entire project will close out in December 2017, completing another phase of the District's MetroBase consolidated operations in the Harvey West area of Santa Cruz. This fiscal year activity was funded with a combination of Proposition 1B - Public Transportation Modernization Improvement and Service Enhancement Account (PTMISEA) funds, California Office of Emergency Services (Cal-OES) funds and local Operating and Capital Reserves.

- Transit Security Projects – The Cal-OES California Transit Security Grant (CTSG) funds were spent primarily on projects at the Judy K. Souza Operations Facility for enhanced security. See above for list of projects.

- Watsonville Transit Center Renovation – Located at the corner of Rodriguez Street and W. Lake Avenue, the Watsonville Transit Center began its existence as a bank and was later converted in 1994 to serve as Watsonville's primary multimodal transit center. The primary goal of the renovation project was to transform the current configuration into a smoother operating, visually open, and inviting transit center that is compatible with the downtown Watsonville area and able to meet our customer's needs. On June 27th, METRO hosted a Ribbon Cutting Event to celebrate recent building renovations and the opening of a new Customer Service Information Booth. All the same services as the Pacific Station Transit Center are now provided in a more convenient location for our South County riders, including in-person transit evaluations for ADA Paratransit (ParaCruz) applicants. Funding was provided by Operating and Capital Reserves. Another phase of this renovation project was the Exterior Repaint. That particular project was funded with Federal Transit Administration (FTA) § 5339 money and matched with State Transit Assistance (STA) funds.

- Reseal, Resurface Parking Lots - FTA § 5339 funds matched with STA funds were used to reseal, and resurface asphalt at the Pacific Station Transit Center, the upper parking lot at the Administrative Building on Vernon Street, the Scotts Valley Transit Center, and the Soquel Park and Ride lot to maintain the facilities in a state of good repair.

- Electric Bus & Infrastructure Project – Consulting work commenced on METRO's FTA § 5339 Low and No Emission Bus Program (Low No) project. The Low No program makes funding available nationwide to purchase battery-electric, fuel cell or hybrid-energy buses to accelerate the deployment and acceptance of advanced vehicle technologies to reduce greenhouse gas emissions. This project is in alignment with the District's "Electric Bus Implementation Strategy" adopted in September 2015. This grant funds three Over the Road Coaches (OTRCs) and the partnership with several vendors including The Center for Transportation and the Environment (CTE) for project management consulting services, BYD for the coaches (buses), and Momentum Dynamics for the on-route charging system. METRO matched this grant with PTMISEA funds and local Operating and Capital Reserves. The on-route charging equipment is scheduled to be installed the summer of 2018, and the buses are expected to be delivered by June of 2019.

- Mid-Life Bus Engine Overhauls Campaign – The Bus Mid-life Overhauls campaign increases bus reliability and reduces maintenance cost during years 7 to 12, usually enabling an additional 2 years of lower maintenance cost. This project is funded with FTA § 5339 funds matched with STA funds; 7 buses received an overhaul this year.

- Bus Repaint Campaign – METRO was able to repaint 12 buses this year and has funding for approximately 8 additional buses. Bus exterior paint deteriorates through bus washing and sun UV fading. Repainting provides a protective seal for body seams, a good public image and enables ease of cleaning. This project is also funded with FTA § 5339 funds matched with STA funds.

- Non-Revenue Vehicle Replacements – New Bus and Bus Facilities FTA § 5339 Program funds were used to purchase a Ford T250 Cargo Van for use by METROs custodial staff; funds are available to purchase 8 additional replacement vehicles, including much needed driver relief vehicles.

Comprehensive Operational Analysis and Service Changes:
In August 2015, Santa Cruz METRO began efforts on a Comprehensive Operational Analysis. The study took a fresh look at Santa Cruz METRO's current service offering, and analyzed how best to provide a balanced level of service that properly serves the needs of the community while remaining within budgetary limitations. This study also focused on the needs at the customer level and included an in-depth survey of Santa Cruz METRO's riders and travel habits through a public outreach plan that included community meetings, informational "pop-up" events and customer input. The COA identified system-wide and chronic problems, as well as new service opportunities, through an extensive qualitative and quantitative analysis that was used to recommend service changes to the existing fixed-route service. From the information and recommendations provided by the study, the Board approved a modification/restructuring of the entire network of fixed-route bus service, reducing the amount of service by approximately 19% effective September 8, 2016.

Ridership:
At the end of fiscal year 2017, the Santa Cruz METRO fixed-route bus system consisted of 24 routes, and provided 5,091,394 rides with a fleet of 98 CNG and diesel buses, a decrease of 405,370 fixed-route rides (-7.4%) from the previous year. As with many transit agencies across the nation, ridership has eroded due to prolonged low fuel costs, necessary fare increases and service reductions implemented to improve operational efficiency, as well as the rising popularity and public usage of ride-sharing services such as Uber and Lyft.

Paracruz, Santa Cruz METRO's paratransit service, provided 75,116 paratransit rides to mobility impaired patrons on 36 specially equipped minibuses and minivans during fiscal year 2017. This represents a 12.4% decrease in Paracruz ridership from the prior year (10,652 fewer paratransit rides), resulting primarily from the Paracruz service realignment and fares restructure implemented in fiscal year 2016. Another factor contributing to the drop was the migration of some Paracruz passengers to fixed-route bus usage, as this service became comparatively more economical for certain passengers after the 2016 Paracruz fare and service changes.

Factors Effecting Financial Conditions

The Santa Cruz local economy has continued to recover after the global recession in the real estate and construction industry and the financial market meltdown. Beginning in 2007, the subprime mortgage lending crisis significantly reduced home sales across the nation and in Santa Cruz County.

A significant source of revenue for Santa Cruz METRO is retail sales and use tax in Santa Cruz County. The total increase over the last five years in retail sales and use tax in Santa Cruz County reflects a 4.29% annual average growth.

Although the local economy is in recovery, Santa Cruz METRO continues to employ strict cost control measures to balance its budget.

Future Outlook

Future Funding:
Local Santa Cruz County Measure D was approved in November 2016 by over 2/3 of Santa Cruz County voters in order to fund a comprehensive package of county-wide transportation improvements through a 0.5% sales and use tax levy on retail sales within Santa Cruz County for a thirty-year period, effective April 1, 2017. Santa Cruz METRO is allocated 16% of Measure D sales and use tax revenues collected, less administrative costs, to provide transit and paratransit service for seniors and people with disabilities. It is estimated that Measure D will generate up to $3 million dollars in new revenue each year.

Senate Bill 1 (SB 1) (Chapter 5, Beall, 2017), known as The Road Repair and Accountability Act of 2017, was signed into law in April 2017, providing a significant, stable and ongoing increase in state transportation funding for the first time in four years, generating an estimated $5.2 billion annually over the next decade for the State of California. Funding will be provided by a state-wide increase in gasoline and diesel taxes as well as an increase in vehicle registration fees. The passage of SB 1 establishes a new State of Good Repair (STA -SGR) program that funds capital projects that support public and community transportation services (e.g. transit and paratransit), with preference given to counties where local voters have approved taxes or fees dedicated to transportation in their community. It is estimated that STA-SGR will provide Santa Cruz METRO with approximately $737 thousand per year. Unfortunately, a campaign to overturn the tax and fee increases and repeal SB 1 is currently underway. It remains unclear if opponents will raise the necessary signatures or funds to qualify for a measure to be placed on the ballot in 2018; Santa Cruz METRO is monitoring the situation closely and will participate in an opposition campaign to protect this vital investment in public transit and transportation.

Through this financial challenge, Santa Cruz METRO has been able to dialogue with key funding partners in the community. Cabrillo College students voted to impose a mandatory transportation fee of $40 per student per semester effective Fall semester 2016 to sustain bus service that was scheduled to be eliminated due to the COA service restructuring. The fee provides each student with a bus pass valid seven days a week during the semester term, providing Santa Cruz Metro bus service throughout Santa Cruz County with transfers to Monterey-Salinas Transit. Cabrillo College students voted again in November 2017 to approve this transportation fee for the 2017-2018 school year. UCSC increased its level of funding for student transit services for the 2016-17 academic year and has committed to increase it further for the 2017-18 academic year.

Future Capital Needs:
The financial challenges facing Santa Cruz METRO are not unique. The Federal government's inability to agree on a long-term surface transportation funding program resulted in numerous short-term Continuing Resolutions and provided relatively flat Federal operating assistance since fiscal year 2010, which had placed public transit funding on perilous footing nationwide. In December 2015, President Obama signed the Fixing America's Surface Transportation (FAST Act) into law. This long-awaited successor to the Moving Ahead for Progress in the 21st Century Act (MAP-21) increases annual spending authority for transit programs across the nation through 2020. The bill includes important policy and structural changes to federal surface transportation programs that are intended to improve mobility, streamline capital project construction and acquisition, and increase the safety of public transportation systems across the country. As a result of the unreliable and flat Federal and State transit funding in the past several years, the annual balanced operating budgets have been achieved by using non-traditional capital-eligible FTA-STIC and STA funds and non-recurring revenues (Reserves) to fill the budget gaps and cover operational costs. These actions have created a significant backlog in the capital improvements program, depleted the source for a local match for Federal and State grants, and significantly eroded the District's Cash Reserves. Efforts are in place to replenish Operating and Capital reserves and address the anticipated backlog of $200 million in unfunded capital needs.

Looking ahead, addressing the challenge of aging equipment and the attrition of rolling stock inventory is a priority; over half of Santa Cruz METRO's fixed-route buses exceed the twelve year useful life expectancy. Therefore, Santa Cruz METRO has an immediate and urgent need to replace approximately sixty buses and eight paratransit vehicles. Thanks to the support from Santa Cruz County residents and State legislators, revenues resulting from Measure D and California State SB 1 will allow Santa Cruz METRO to identify local matching revenues with which to attempt to leverage State and Federal capital grants. This grant application strategy resulted in Santa Cruz METRO being awarded five new buses last year; three of these buses are Federally-funded (LoNo) zero emissions electric buses for Highway 17 commuter service, one State-funded (LCTOP) zero emissions electric bus for a circulator service in Watsonville, and one new CNG bus for fixed-route service. Santa Cruz METRO staff continues to pursue new grant opportunities that will help with these capital funding challenges, while developing a comprehensive funding strategy to replace and modernize its fleet.

Fare Structure Initiatives:
In an effort to increase operating revenue, reduce operating costs, and increase efficiency, the Board approved a fare restructuring of the Highway 17 (Commuter) Express, as well as service realignments and fare modifications for Paracruz service effective September 10, 2015. Presently, staff is analyzing the current fixed-route fare structure and will initiate a discussion with the Board related to their findings, as well as opportunities for fare payment technology improvements. It is anticipated that staff will be working closely with the Finance, Budget and Audit Committee in 2018 to develop and explore fare restructuring recommendations for the future.

Future Planning Initiatives:
On-board survey – a lack of data about riders' demographics, travel patterns, customer satisfaction, and technological capacity impacts the ability to make effective improvements. An on-board survey, Santa Cruz METRO's first since 2012, is planned to be implemented in fiscal year 2018, in order to learn more about these issues, along with matters related to fare payment methods.

Pacific Station Long-Term Planning – Staff will continue to investigate, in conjunction with the City of Santa Cruz, downtown service planning protocols and opportunities for cooperative facility development strategies.

Transportation Network Companies (TNC) – Many transit districts are starting to use TNCs such as Uber and Lyft to supplement their fixed-route and paratransit services. Staff is planning to investigate opportunities for METRO to use these types of services.

American Public Transit Association (APTA) Universities Conference – METRO is committed to hosting this significant APTA event in 2018, at which METRO can highlight its working relationships with UCSC, Cabrillo College, and San Jose State University. This APTA conference will allow Santa Cruz METRO to engage in collaborative networking, leverage knowledge, and learn about breakthroughs, lessons, and innovative and strategic approaches that are working for other national transit agencies.

Transportation Demand Management (TDM) – Staff is working with the City of Santa Cruz on concepts for a downtown employee bus pass as part of a TDM program.

Future Operational Improvements:
Automatic Vehicle Locators (AVL) – This technology will provide data that will be used to improve on-time performance. AVL uses global positioning satellite information that allows for electronic signs at bus stops and a smart phone application that will predict when the next bus will arrive. AVL will significantly enhance customer real-time information on bus arrival times, system disruptions and provide better system performance from better ridership data. Santa Cruz METRO is actively seeking state and federal grants to add an Automatic Vehicle Locator system to the fixed-route bus network. The AVL project was submitted to the Santa Cruz County Regional Transportation Commission (SCCRTC) for inclusion in their 2018 Regional Transportation Improvement Program (RTIP) budget in December 2017 and is at the staff and committee recommendation level.

Zero Emission Vehicles (ZEVs) – The addition of electric buses will help with the unfunded and ongoing need for replacement buses. In June 2016, Santa Cruz METRO was awarded a grant for the District's first electric bus from the Low Carbon Transit Operations Program (LCTOP) administered through Caltrans, to be run as a circulator in Watsonville. Santa Cruz METRO was awarded a FTA Lo No grant for three zero emissions buses in July 2016. Santa Cruz METRO was also awarded by SCCRTC a STB grant to purchase one CNG bus. These grants will provide funding not only for the electric buses but for the infrastructure needed to operate them. County residents will benefit from the renewed commitment by METRO to air quality and sustainability.

Financial Analysis

Following are the condensed comparative financial statements, which highlight key financial data. Certain significant year-to-year variances are discussed following the statements.

Statements of Net Position:

	2017	2016	2015	2017 to 2016 Increase/(Decrease) Amount	2017 to 2016 Increase/(Decrease) %	2016 to 2015 Increase/(Decrease) Amount	2016 to 2015 Increase/(Decrease) %
Assets							
Current Assets	$ 22,587,204	$ 23,342,903	$ 25,709,446	$ (755,699)	-3.2%	$ (2,366,543)	-9.2%
Capital Assets - Net	86,071,566	86,495,631	82,753,490	(424,065)	-0.5%	3,742,141	4.5%
Restricted Assets	8,354,300	9,177,768	14,463,480	(823,468)	-9.0%	(5,285,712)	-36.5%
Total Assets	$ 117,013,070	$ 119,016,302	$ 122,926,416	$ (2,003,232)	-1.7%	$ (3,910,114)	-3.2%
Deferred Outflows of Resources							
Pension Contributions	$ 13,585,398	$ 8,634,713	$ 3,903,126	$ 4,950,685	57.3%	$ 4,731,587	121.2%
Total Deferred Outflows of Resources	$ 13,585,398	$ 8,634,713	$ 3,903,126	$ 4,950,685	57.3%	$ 4,731,587	121.2%
Liabilities							
Current Liabilities	$ 6,909,520	$ 6,599,776	$ 7,315,473	$ 309,744	4.7%	$ (715,697)	-9.8%
Non-Current Liabilities	6,947,590	9,887,060	15,304,383	(2,939,470)	-29.7%	(5,417,323)	-35.4%
Other Long-Term Liabilities	91,066,828	76,736,756	69,040,678	14,330,072	18.7%	7,696,078	11.1%
Total Liabilities	$ 104,923,938	$ 93,223,592	$ 91,660,534	$ 11,700,346	12.6%	$ 1,563,058	1.7%
Deferred Inflows of Resources							
Pension Investment Earnings	$ 5,306,999	$ 7,973,400	$ 7,432,943	$ (2,666,401)	-33.4%	$ 540,457	7.3%
Total Deferred Inflows of Resources	$ 5,306,999	$ 7,973,400	$ 7,432,943	$ (2,666,401)	-33.4%	$ 540,457	7.3%
Net Position							
Net Investment in Capital Assets	$ 86,071,566	$ 86,495,631	$ 82,753,490	$ (424,065)	-0.5%	$ 3,742,141	4.5%
Unrestricted Net Position	(65,704,035)	(60,041,608)	(55,017,425)	(5,662,427)	-9.4%	(5,024,183)	9.1%
Total Net Position	$ 20,367,531	$ 26,454,023	$ 27,736,065	$ (6,086,492)	-23.0%	$ (1,282,042)	-4.6%

2017 vs 2016 Analysis

Key changes include:

- *Current assets* decreased by $756 thousand or 3.2% to $22.6 million, primarily due to decreases in grants receivables. As large capital projects have wound down since the previous year, so have the associated outstanding reimbursements from grantor agencies for those capital projects.

- *Capital assets – net* decreased by $424 thousand or 0.5% to $86.1 million, primarily due to increased depreciation of existing assets as well as the new Judy K. Souza Operations Facility. The rate of aging capital assets/expensing off the use of capital assets over their estimated period of utility is outpacing the rate of construction and procurement of new vehicles and equipment.

- *Restricted assets* decreased by $823 thousand or 9.0% to $8.4 million. Grant funds received from PTMISEA were spent on construction of the new Judy K. Souza Operations Facility.

- *Deferred outflows of resources* of $13.6 million in pension contributions were recognized in the current year through the application of GASB Statement No. 68.

- *Current liabilities* increased by $310 thousand or 4.7% to $6.9 million in total. The final settlement payout for the balance of construction costs of the Judy K. Souza Operations Facility was accrued at the end of fiscal year 2017 for $1,650,000. The resultant increase in current liabilities was offset by a significant decrease in construction retention payable and the estimated reserve for damage claims over the prior year.

- *Non-current liabilities* decreased by $2.9 million or 29.7% to $6.9 million due to the spending down of deferred PTMISEA grant funds on construction and capital acquisition during the year.

Grant funds received are restricted and reported as liabilities (unearned revenue) until spent on the specific purpose for which they were awarded.

- *Other long-term liabilities* increased by $14.3 million or 18.7% to $91.1 million primarily due to a $9.0 million increase in the net pension liability for Santa Cruz METRO's defined benefit pension plan, and a $5.3 million increase in the long-term obligation for other postemployment benefits for retirees.

- *Deferred inflows of resources* of $5.3 million in pension investment earnings were recognized in the current year through the application of GASB Statement No. 68.

Statements of Revenues, Expenses, and Changes in Fund Net Position:

	2017	2016	2017 to 2016 Increase/(Decrease) Amount	%
Operating Revenues	$ 9,720,871	$ 9,923,862	$ (202,991)	-2.0%
Operating Expenses	56,141,378	53,878,081	2,263,297	4.2%
Net Operating Loss	(46,420,507)	(43,954,219)	(2,466,288)	5.6%
Non-Operating Revenues	36,701,352	35,100,875	1,600,477	4.6%
Capital Grant Contributions	3,632,663	7,571,302	(3,938,639)	-52.0%
Decrease in Net Position	$ (6,086,492)	$ (1,282,042)	$ (4,804,450)	374.7%

	2016	2015	2016 to 2015 Increase/(Decrease) Amount	
Operating Revenues	$ 9,923,862	$ 9,796,024	$ 127,838	1.3%
Operating Expenses	53,878,081	54,939,475	(1,061,394)	-1.9%
Operating Loss	(43,954,219)	(45,143,451)	1,189,232	-2.6%
Non-Operating Revenues	35,100,875	34,812,002	288,873	0.8%
Capital Grant Contributions	7,571,302	9,270,417	(1,699,115)	-18.3%
Decrease in Net Position	$ (1,282,042)	$ (1,061,032)	$ (221,010)	20.8%

2017 vs 2016 Analysis

Operating Revenues (Passenger Fares) decreased by $203 thousand or 2% this year over the prior year as a result of the decrease in ridership due to the service reduction implemented in September 2016, as well as severe weather conditions in January and February 2017.

Operating Expenses increased by $2.3 million or 4.2% overall when compared to last year due primarily to an increase in employee-related expenses. The annual GASB 68 adjusting entry to pension expense increased approximately $2 million over the prior year adjustment. The annual accounting adjustment to Workers' Compensation Liabilities for actuarially-determined incurred but not reported (IBNR) claims and expenses contributed to the increase in Operating Expenses as well.

Non-Operating Revenues increased overall by $1.6 million or 4.6% over last year. Sales and use tax revenue increased by $2.0 million in fiscal year 2017, due to increased consumer spending and the accrual of the new sales tax allocation generated by local Measure D, which went into effect in April 2017. This increase in Non-Operating Revenue was offset by a decrease in STA funding over prior year due to recent changes in the STA program allocation formula, and a decrease in tax credit revenue due to the expiration of tax incentives for the purchase of alternative fuels.

Capital Grant Contributions are capital grant funds received for facilities improvements and the purchase of capital equipment including revenue vehicles. The receipt of capital grant funds can fluctuate year over year based on a variety of factors including project eligibility requirements, formula-based funding criteria, the economy, etc. Capital contributions decreased by 52% over last year primarily due to completion of the Judy K. Souza Operations.

Statements of Cash Flows:

	2017	2016	2017 to 2016 Change
Net Cash Used in Operating Activities	$ (34,366,265)	$ (42,965,652)	$ 8,599,387
Net Cash Provided by Non-Capital Financing Activities	35,801,841	34,897,175	904,666
Net Cash Provided by (Used in) Capital and Related Financing Activities	(2,038,501)	242,452	(2,280,953)
Net Cash Provided by Non-Transportation Activities	263,508	242,287	21,221
Net (Decrease) in Cash and Cash Equivalents	(339,417)	(7,583,738)	7,244,321
Cash and Cash Equivalents, Beginning of Year	24,400,125	31,983,863	(7,583,738)
Cash and Cash Equivalents, End of Year	$ 24,060,708	$ 24,400,125	$ (339,417)

	2016	2015	2016 to 2015 Change
Net Cash Used in Operating Activities	$ (42,965,652)	$ (39,649,655)	$ (3,315,997)
Net Cash Provided by Non-Capital Financing Activities	34,897,175	34,501,675	395,500
Net Cash Provided by Capital and Related Financing Activities	242,452	3,724,925	(3,482,473)
Net Cash Provided by Non-Transportation Activities	242,287	245,062	(2,775)
Net (Decrease) in Cash and Cash Equivalents	(7,583,738)	(1,177,993)	(6,405,745)
Cash and Cash Equivalents, Beginning of Year	31,983,863	33,161,856	(1,177,993)
Cash and Cash Equivalents, End of Year	$ 24,400,125	$ 31,983,863	$ (7,583,738)

Economic Factors and Next Year's Budget

State law requires the District to adopt an annual budget by resolution of the Board of Directors. In the spring preceding the start of each fiscal year, staff presents an annual budget based on established District goals, objectives and performance measures to the Board of Directors. The presentation may recommend using financial reserves to balance the budget when proposed expenses exceed projected revenues.

The Santa Cruz METRO Board approves the annual budget prior to implementation. Once adopted, the Board of Directors has the authority to amend the budget. While the legal level of budgetary control is at the entity level, the District maintains stricter control at departmental and line item levels to serve various needs. The Board has delegated the authority to transfer budget amounts between departments to the CEO/General Manager or his designee. However, any increase to the expense budget as a whole requires the approval of the Board.

During the fiscal year, the adopted Operating and Capital budgets are used as management tools to monitor revenues and expenses and evaluate operating performance at any given time period. The Board of Directors monitors budget-to-actual performance through monthly staff reports. Department managers monitor budget-to-actual performance on an accrual basis and meet with the CEO monthly to review significant variances.

The fiscal year 2018 budget was adopted by the Board on June 23, 2017, and is $1.4 million more than that of the previous year, which reflects a 3% growth over the previous year's budget. The Operating Budget is one of restrained optimism, planning for a future in which recent enacted local and state legislation will provide the District with a much-needed infusion of revenue. The District continues to work with its funding partners and employees to pursue its goals of excellent service. The Capital Budget contains projects necessary and essential to sustain the District's existing service and operating facilities.

These significant factors were considered as budget assumptions when preparing Santa Cruz METRO's budget for the fiscal year 2018:

- Expectation that passenger fare revenue will experience a 6% decrease from prior year budget due to the effect of service cuts.
- Expectation that sales and use tax revenues will increase at a moderate rate of 2.5% over the next 2 years.
- Expectation that Santa Cruz County Measure D will infuse approximately $3.0M of sales tax revenue funding into the annual budget for fiscal year 2018, the first full year of this new local sales tax ordinance.
- Bus service plans must continue to be sensitive to funding constraints and revenue projections due to economic uncertainty and legislative issues.
- Sensitivity to employee wages, health care benefits, workers' compensation, and pension benefits. Budget savings are expected from employee retirements, eliminated vacant positions due to service reductions, and reductions in Bus Operator overtime. California Public Employees Retirement System (CalPERS) retirement employer contribution rate increases from 22.17% to 24.20% for the fiscal year 2018. An average increase of 5% in medical insurance premiums is anticipated.
- Sensitivity to and monitoring of controllable costs and consumables.
- Continued efforts to identify efficiencies in costs.
- Anticipated increases in Special Transit (contract) fares revenue from Cabrillo College: over $948 thousand of anticipated funding annually with which to sustain Santa Cruz METRO services.
- Anticipated increases in Special Transit (contract) fares revenue from UCSC of $162 thousand.

Contacting Santa Cruz METRO's Financial Management

Santa Cruz METRO's financial report is designed to provide Santa Cruz METRO's Board of Directors, management, and the public with an overview of Santa Cruz METRO's finances. For additional information about this report, please contact Angela Aitken, Finance Manager, at 110 Vernon Street, Santa Cruz, CA 95060.

BASIC FINANCIAL STATEMENTS

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF NET POSITION
JUNE 30, 2017 AND 2016

	2017	2016
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 15,706,408	$ 15,222,357
Sales and Use Taxes, Grants, and Other Receivables	5,789,956	7,149,863
Inventory	600,565	598,963
Prepaid Expenses	490,275	371,720
Total Current Assets	22,587,204	23,342,903
RESTRICTED ASSETS		
Cash and Cash Equivalents	8,354,300	9,177,768
CAPITAL ASSETS		
Building and Improvements	76,065,867	47,711,978
Revenue Vehicles	46,181,700	48,522,953
Operations Equipment	6,396,280	6,431,866
Other Equipment	2,131,733	2,131,733
Other Vehicles	1,071,767	1,164,604
Office Equipment	3,901,469	3,933,237
Total Depreciated Capital Assets	135,748,816	109,896,371
Less Accumulated Depreciation	(64,463,790)	(62,836,549)
Total Depreciated Capital Assets Net of Accumulated Depreciation	71,285,026	47,059,822
Construction-in-Progress	3,190,229	27,839,498
Land	11,596,311	11,596,311
Total Capital Assets	86,071,566	86,495,631
Total Assets	117,013,070	119,016,302
DEFERRED OUTFLOWS OF RESOURCES		
Deferred Amounts from Pension Activities	$ 13,585,398	$ 8,634,713

The accompanying notes are an integral part of these financial statements.

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF NET POSITION (Continued)
JUNE 30, 2017 AND 2016

	2017	2016
LIABILITIES		
CURRENT LIABILITIES		
Accounts Payable and Accrued Liabilities	$ 2,164,097	$ 1,300,821
Accrued Payroll and Employee Benefits	3,930,006	4,112,185
Deferred Rent	3,050	2,959
Workers' Compensation Liabilities, Current	690,677	669,759
Other Accrued Liabilities	109,306	501,668
Security Deposit	12,384	12,384
Total Current Liabilities	6,909,520	6,599,776
NON-CURRENT LIABILITIES		
Unearned Revenue - Settlement Agreement	-	371,523
Unearned Revenue - State Transit Assistance	413,612	166,324
Unearned Revenue - PTMISEA Grant	4,620,355	7,531,104
Unearned Revenue - Proposition 1B Grant	955,066	1,108,817
Unearned Revenue - LCTOP	958,557	709,292
Total Non-Current Liabilities	6,947,590	9,887,060
OTHER LONG-TERM LIABILITIES		
Workers' Compensation Liabilities, Net of Current	2,681,595	2,570,035
Other Postemployment Benefit Liabilities	33,663,105	28,407,107
Net Pension Liability	54,722,128	45,759,614
Total Other Long-Term Liabilities	91,066,828	76,736,756
Total Liabilities	104,923,938	93,223,592
DEFERRED INFLOWS OF RESOURCES		
Deferred Amounts from Pension Activities	5,306,999	7,973,400
NET POSITION		
Net Investment in Capital Assets	86,071,566	86,495,631
Unrestricted Net Position	(65,704,035)	(60,041,608)
Total Net Position	$ 20,367,531	$ 26,454,023

The accompanying notes are an integral part of these financial statements.

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN FUND NET POSITION
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016

	2017	2016
OPERATING REVENUES		
Passenger Fares	$ 4,791,959	$ 5,785,820
Special Transit Fares	4,928,912	4,138,042
Total Operating Revenues	9,720,871	9,923,862
OPERATING EXPENSES		
Wages, Salaries, and Employee Benefits	44,578,599	41,743,933
Purchased Transportation Services	100,760	71,470
Materials and Supplies	3,171,221	3,397,701
Other Expenses	3,993,351	4,749,192
Depreciation	4,297,447	3,915,785
Total Operating Expenses	56,141,378	53,878,081
Net Operating Loss	(46,420,507)	(43,954,219)
NON-OPERATING REVENUES (EXPENSES)		
Sales and Use Taxes	20,869,028	18,871,648
Transportation Development Act (TDA) Assistance	6,804,838	6,377,491
State Transit Assistance (STA)	1,671,333	2,636,432
Federal Transit Authority (FTA) Section 5307 Operating Assistance	6,286,136	5,448,200
FTA Section 5311 Rural Operating Assistance	168,738	177,787
Alternative Fuel Tax Credit	284,419	972,922
Planning Grants	9,749	89,278
Interest Income	133,298	100,891
Rental Income	130,210	141,396
Other Revenue	342,926	283,250
Gain on Sale and Disposal of Property, Equipment, and Inventory	677	1,580
Total Non-Operating Revenues (Expenses)	36,701,352	35,100,875
Net Loss Before Capital Contributions	(9,719,155)	(8,853,344)
CAPITAL CONTRIBUTIONS		
Grants Restricted for Capital Expenditures	3,632,663	7,571,302
NET POSITION		
Change in Net Position	(6,086,492)	(1,282,042)
Total Net Position, Beginning of Year	26,454,023	27,736,065
Total Net Position, End of Year	$ 20,367,531	$ 26,454,023

The accompanying notes are an integral part of these financial statements.

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from Customers	$ 10,575,093	$ 9,230,910
Payments to Employees	(39,372,302)	(42,770,413)
Payments to Suppliers	(6,914,484)	(8,682,877)
Payments from (to) Other	1,345,428	(743,272)
Net Cash Used in Operating Activities	(34,366,265)	(42,965,652)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Operating Grants Received, Including Sales and Use Taxes	35,801,841	34,897,175
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from Sale of Property and Equipment	3,319	193,976
Capital Grants Received	1,834,204	7,898,798
Capital Expenditures	(3,876,024)	(7,850,322)
Net Cash Provided by (Used in) Capital and Related Financing Activities	(2,038,501)	242,452
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment and Rental Income Received	263,508	242,287
NET DECREASE IN CASH AND CASH EQUIVALENTS	(339,417)	(7,583,738)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	24,400,125	31,983,863
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 24,060,708	$ 24,400,125
RECONCILIATION OF NET OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES		
Net Operating Loss	$ (46,420,507)	$ (43,954,219)
Adjustments to Reconcile Net Operating Loss to Net Cash Used in Operating Activities:		
Depreciation	4,297,447	3,915,785
Changes in Assets and Liabilities:		
(Increase)/Decrease in Receivables	854,222	(692,952)
(Increase)/Decrease in Inventory	(1,602)	61,896
(Increase)/Decrease in Prepaid Expenses	(118,555)	163,069
Increase/(Decrease) in Accounts Payable and Accrued Liabilities	863,276	(686,479)
Increase/(Decrease) in Net Pension and OPEB Liabilities	6,601,426	(743,272)
(Decrease) in Other Liabilities	(441,972)	(1,029,480)
Net Cash Used in Operating Activities	$ (34,366,265)	$ (42,965,652)

The accompanying notes are an integral part of these financial statements.

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Organization

The Santa Cruz Metropolitan Transit District (Santa Cruz METRO) was formed February 9, 1969, following a favorable election in conformity with Section 9800 et. seq. of the Public Utilities Code (PUC). The transit system serves the general public in the cities of Santa Cruz, Watsonville, Scotts Valley, and Capitola and the unincorporated areas of Santa Cruz County. A Board of eleven directors and two ex-officio directors representing the University of California, Santa Cruz and Cabrillo College govern Santa Cruz METRO. At June 30, 2017, the directors were as follows:

Chairperson:	Jimmy Dutra		
Vice Chair:	Bruce McPherson		
Members:	Ed Bottorff	John Leopold	Oscar Rios
	Cynthia Chase	Donna Lind	J. Dan Rothwell
	Donald Norm Hagen	Cynthia Mathews	Mike Rotkin
Ex-Officio:	Donna Blitzer	Liber McKee	

Santa Cruz METRO also serves the Highway 17 corridor into Santa Clara County to provide a commuter express service through a memorandum of understanding with the San Joaquin Joint Powers Authority (SJJPA), the Capitol Corridor Joint Powers Authority (CCJPA), and the Santa Clara Valley Transportation Authority (VTA). Amtrak Thruway bus service is also provided by Santa Cruz METRO on the same corridor.

B. Reporting Entity

Santa Cruz METRO and the Santa Cruz Civic Improvement Corporation (the Corporation) have a financial and operational relationship, which meets the reporting entity definition criteria of Governmental Accounting Standards Board (GASB) Statement No. 14, as amended by GASB Statement No. 39, *The Financial Reporting Entity*, for inclusion of the Corporation as a blended component unit of Santa Cruz METRO. Accordingly, the financial activities of the Corporation have been included in the basic financial statements of Santa Cruz METRO. For the year ending June 30, 2017, these activities were minimal.

Scope of Public Service:

The Corporation is a nonprofit, public benefit corporation incorporated under the laws of the State of California and recorded by the Secretary of State in July 1986. The Corporation was formed for the sole purpose of providing financial assistance to Santa Cruz METRO for the construction and acquisition of major capital facilities.

The following are those aspects of the relationship between Santa Cruz METRO and the Corporation which satisfy GASB Statement No. 14/39 criteria.

Accountability:

1. Santa Cruz METRO's Board of Directors appointed the Corporation's Board of Directors.

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Reporting Entity (Continued)

2. Santa Cruz METRO is able to impose its will upon the Corporation based on the following:

   - All major financing arrangements, contracts, and other transactions of the Corporation must have the consent of Santa Cruz METRO.

   - Santa Cruz METRO exercises significant influence over operations of the Corporation as it is anticipated that Santa Cruz METRO will be the sole lessee of all facilities owned by the Corporation. Likewise, it is anticipated that Santa Cruz METRO's lease payments will be the sole revenue source of the Corporation.

3. The Corporation provides specific financial benefits or imposes specific financial burdens on Santa Cruz METRO based upon the following:

   - Santa Cruz METRO has assumed a "moral obligation," and potentially a legal obligation, for any debt incurred by the Corporation.

C. Basis of Accounting and Presentation

Santa Cruz METRO is accounted for as a Business-Type Activity, as defined by GASB Statement No. 34, *Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments*, and its basic financial statements are presented on the accrual basis of accounting. Under this method, revenues are recognized when they are earned, and expenses are recognized when they are incurred.

Santa Cruz METRO adopted GASB Statement No. 34 as amended by GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, as of and for the year ended June 30, 2003, and applied those standards on a retroactive basis. GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into three net position categories; namely, net investment in capital assets, restricted net position, and unrestricted net position.

Contributed Capital/Reserved Retained Earnings:

Santa Cruz METRO receives grants from the Federal Transit Authority (FTA) and other agencies of the U.S. Department of Transportation, state, and local transportation funds for the acquisition of transit-related equipment and improvements. Prior to July 1, 2001, capital grants were recognized as donated capital to the extent that project costs under the grant had been incurred. Capital grant funds earned, less amortization equal to accumulated depreciation of the related assets, were included in contributed capital. As required by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, Santa Cruz METRO changed its method of accounting for capital grants from capital contributions to reserved non-operating revenues. In accordance with GASB Statement No. 33, capital grants are required to be included in the determination of net income (loss) resulting in an increase in net revenue of $3,632,663 and $7,571,302 for the fiscal years ended June 30, 2017 and 2016, respectively.

Under GASB Statement No. 34, contributed capital and reserved retained earnings are presented in the net position section as net investment in capital assets.

C. Basis of Accounting and Presentation (Continued)

Proprietary Accounting and Financial Reporting:

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of Santa Cruz METRO are passenger fares and special transit fares. Operating expenses for Santa Cruz METRO include wages, purchased transportation, materials and supplies, depreciation/amortization on capital assets, and other expenses. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Net Position:

Net position represents the residual interest in Santa Cruz METRO's assets after liabilities are deducted. In accordance with GASB Statement No. 34, the fund equity section on the statements of net position was combined to report total net position and present it in three broad components: net investment in capital assets, restricted, and unrestricted. Net position invested in capital assets includes capital assets net of accumulated depreciation. Net position is restricted when constraints are imposed by third parties or by law through constitutional provisions or enabling legislation. All other net position is unrestricted.

When both restricted and unrestricted resources are available for use, generally it is Santa Cruz METRO's policy to use restricted resources first, and then unrestricted resources as they are needed.

D. Cash and Cash Equivalents

Santa Cruz METRO considers all highly liquid investments with a maturity date within three months of the date acquired to be cash equivalents. Santa Cruz METRO deposits funds into an external investment pool maintained by Santa Cruz County. These deposits are considered cash equivalents. The Santa Cruz County Pooled Investment Fund is authorized to invest in obligations of the U.S. Treasury agencies and instrumentalities, commercial paper rated A-1 by Standard and Poor's Corporation or P-1 by Moody's Commercial Paper Record, bankers' acceptances, repurchase agreements, and the State Treasurer's investment pool. Cash and cash equivalents are stated at fair value. For purposes of the statements of cash flows, Santa Cruz METRO considers all highly liquid investments (including restricted assets) to be cash equivalents.

E. Inventory

Inventory is carried at cost using the first-in/first-out (FIFO) method. Inventory held by Santa Cruz METRO consists of spare bus parts and operating supplies that are consumed by Santa Cruz METRO and are not for resale purposes.

F. Restricted Assets

Certain assets are classified as restricted assets on the statements of net position because their use is subject to externally imposed stipulations, either by laws or regulations.

The cash resulting from a design and construction settlement agreement, as described in Note 8, represents proceeds restricted by the FTA. Grants from the State Transit Assistance (STA) program, Proposition 1B Public Transportation Modernization, Improvement, and Service Enhancement Account (PTMISEA), Proposition 1B Office of Homeland Security (OHS), California Transit Security Grant Program (CTSGP), and the Low Carbon Transit Operations Program (LCTOP) are restricted for capital expenditures. Restricted assets at June 30 are as follows:

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. Restricted Assets (Continued)

	2017	2016
Cash and Cash Equivalents		
FTA Grant	$ -	$ 371,523
Proposition 1B PTMISEA Grant	6,270,355	7,531,104
Proposition 1B OHS CTSGP Grant	955,066	1,108,817
STA Grant	413,612	166,324
LCTOP	715,267	-
Total Restricted Assets	$ 8,354,300	$ 9,177,768

G. Property and Equipment

Property and equipment are recorded at cost. Depreciation for all such assets is computed on a straight-line basis. Estimated useful lives of assets are as follows:

Buildings and improvements	20-39 years
Revenue vehicles	12 years
Other vehicles and equipment	3-10 years

Depreciation expense on assets acquired with capital grant funds are transferred to net position, net investment in capital assets, after being charged to operations.

Major improvements and betterments to existing facilities and equipment are capitalized. Costs for maintenance and repairs, which do not extend the useful lives of the applicable assets, are charged to expense as incurred. Upon disposition, costs and accumulated depreciation are removed from the accounts and resulting gains or losses are included in operations.

Santa Cruz METRO completed and capitalized the Scotts Valley Transit Center in fiscal year 1999. The cost of this facility totaled $4,063,634, which was funded by federal, state, and local funds. The former Scotts Valley Redevelopment Agency, a political subdivision of the State of California, was one of Santa Cruz METRO's funding sources for this project and the Successor Agency has retained an interest in the property. The title to the property is retained by both Santa Cruz METRO and the Successor Agency as tenants in common with each party holding an individual interest in proportion to each party's financial participation in the project. The Successor Agency's portion of the property is 13.87%. The Successor Agency's portion is not recorded in Santa Cruz METRO's basic financial statements.

H. Sales and Use Taxes Revenues

1979 Gross Sales Tax (1/2-cent): In June 1978, voters in Santa Cruz County approved Measure G which changed the basis of transit support for Santa Cruz METRO from property tax to a ½-cent sales and use tax effective January 1979. This 0.5% sales and use tax levied on all taxable sales in Santa Cruz County is collected and administered by the California State Board of Equalization. Actual receipts of sales and use tax for the fiscal years ended June 30, 2017 and 2016, were $20,338,220 and $18,871,648, respectively. During the fiscal years ended June 30, 2017 and 2016, sales and use tax revenue of $0 and $840,903, respectively, were used as the local match for capital projects funded by the State-Local Partnership Program (SLPP), as required by this formula program.

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

H. Sales and Use Taxes (Continued)

2017 Net Sales Tax (Measure D): This local ordinance to fund a comprehensive package of county-wide transportation improvements, passed in November 2016 by over 2/3 of Santa Cruz County voters. The transportation tax measure levies a 0.5% sales and use tax on retail sales within Santa Cruz County for a thirty-year period, effective April 1, 2017. Measure D sales and use tax receipts are administered by the Santa Cruz County Regional Transportation Commission according to the Expenditure Plan identified in the ordinance. Santa Cruz METRO is allocated 16% of Measure D sales and use tax receipts collected, net of administrative costs, to provide transit and paratransit service for seniors and people with disabilities. Measure D sales and use tax revenue was $530,808 for the fiscal year ended June 30, 2017.

Additionally, Santa Cruz METRO is allocated, through the Santa Cruz County Regional Transportation Commission, a portion of the 0.025% sales and use tax levied by the Transportation Development Act (TDA).

I. Operating Assistance Grants

Operating assistance grants are recognized as revenue in the grant period when earned.

J. Self-Insurance

Santa Cruz METRO is self-insured for the first $250,000 of general and vehicular liability. For settlements in excess of $250,000, Santa Cruz METRO has total coverage up to $25,000,000 per occurrence. The District also self-insures for vehicle physical damage coverage with a deductible option of $5,000 per vehicle and coverage up to $30,000,000 per occurrence. Additionally, Santa Cruz METRO is self-insured up to $350,000 for workers' compensation claims. Santa Cruz METRO has recorded a liability for estimated claims to be paid, including incurred but not reported claims (IBNR).

K. Employee Benefits

Annual and medical leave benefits are accrued when earned and reduced when used. Any paid medical leave accrued beyond 96 hours may, at the employee's option, be converted to annual leave and credited to the employee's annual leave schedule or paid in cash, depending on the bargaining unit, at 100% of the earned rate. Employees are paid accrued and unused annual leave at the time of separation from Santa Cruz METRO service.

L. Payroll

Santa Cruz METRO contracts with the Santa Cruz County Auditor-Controller to provide payroll processing services.

M. Pension Costs

Pension costs are expensed as incurred. These costs equal the actuarially determined annual contribution amount.

N. Use of Estimates

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

O. Implementation of Governmental Accounting Standards Board Statements

GASB Statement No. 74 – *Financial Reporting for Postemployment Benefits Other than Pension Plans.* The provisions of this statement are effective for fiscal years beginning after June 15, 2016. There was no effect on Santa Cruz METRO's accounting or financial reporting as a result of implementing this standard.

GASB Statement No. 77 – *Tax Abatement Disclosures.* The requirements of this statement are effective for reporting periods beginning after December 15, 2015. There was no effect on Santa Cruz METRO's accounting or financial reporting as a result of implementing this standard.

GASB Statement No. 78 – *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans.* The requirements of this statement are effective for fiscal years beginning after December 15, 2015. There was no effect on Santa Cruz METRO's accounting or financial reporting as a result of implementing this standard.

GASB Statement No. 79 – *Certain External Investment Pools and Pool Participants.* The requirements of this statement are effective for fiscal years beginning after June 15, 2015, except for the provisions in paragraphs 18, 19, 23–26, and 40, which are effective for reporting periods beginning after December 15, 2015. There was no effect on Santa Cruz METRO's accounting or financial reporting as a result of implementing this standard.

GASB Statement No. 80 – *Blending Requirements for Certain Component Units – an amendment of GASB Statement No. 14.* The requirements of this statement are effective for reporting periods beginning after June 30, 2016. There was no effect on Santa Cruz METRO's accounting or financial reporting as a result of implementing this standard.

GASB Statement No. 82 – *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73.* The requirements of this statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of paragraph 7 in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements of paragraph 7 are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. There was no effect on Santa Cruz METRO's accounting or financial reporting as a result of implementing this standard.

P. Future Governmental Accounting Standards Board Statements

GASB Statement No. 75 – *Accounting and Financial Reporting for Postemployment Benefits Other than Pension Plans.* The provisions of this statement are effective for fiscal years beginning after June 15, 2017. Santa Cruz METRO has not fully judged the effect of the implementation of GASB Statement No. 75 as of the date of the basic financial statements.

GASB Statement No. 81 – *Irrevocable Split-Interest Agreements.* The requirements of this statement are effective for reporting periods beginning after December 15, 2016. Earlier application is encouraged. Santa Cruz METRO has not fully judged the effect of implementation of GASB Statement No. 81 as of the date of the basic financial statements.

GASB Statement No. 83 – *Certain Asset Retirement Obligations*. The requirements of this statement are effective for the reporting periods beginning after June 15, 2018. Earlier application is encouraged. Santa Cruz METRO has not fully judged the effect of implementation of GASB Statement No. 83 as of the date of the basic financial statements.

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

P. Future Governmental Accounting Standards Board Statements (Continued)

GASB Statement No. 84 – *Fiduciary Activities*. The requirements for this statement are effective for fiscal years beginning after December 15, 2018. Santa Cruz METRO has not fully judged the effect of implementation of GASB Statement No. 84 as of the date of the basic financial statements.

GASB Statement No. 85 – *Omnibus 2017*. The requirements for this statement are effective for fiscal years beginning after June 15, 2017. This statement addresses practice issues that have been identified during implementation of various GASB Statements, including *Fair Value Measurement and Application*. Santa Cruz METRO has not fully judged the effect of implementation of GASB Statement No. 85 as of the date of the financial statements.

GASB Statement No. 86 – *Certain Debt Extinguishment Issues.* The requirements of this statement are effective for periods beginning after June 15, 2017. Santa Cruz METRO has not fully judged the effect of implementation of GASB Statement No. 86 as of the date of the basic financial statements.

GASB Statement No. 87 – *Leases.* The requirements of this statement are effective for periods beginning after December 15, 2019. Santa Cruz METRO has not fully judged the effect of implementation of GASB Statement No. 87 as of the date of the basic financial statements.

NOTE 2 – CASH AND CASH EQUIVALENTS

Total cash and cash equivalents, (restricted and unrestricted), consist of the following at June 30, 2017 and 2016:

	2017	2016
Cash on Hand	$ 15,341	$ 15,792
Demand Deposits	497,006	460,676
Certificate of Deposit (CD)	100,000	40,977
Deposits in Santa Cruz County Pooled Investment Fund	23,448,361	23,882,680
	$ 24,060,708	$ 24,400,125

NOTE 2 – CASH AND CASH EQUIVALENTS (Continued)

Cash on Hand and Cash in Banks

Investments Authorized by the California Government Code and Santa Cruz METRO's Investment Policy

The table below identifies the **investment types** that are authorized for Santa Cruz METRO by the California Government Code (or Santa Cruz METRO's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or Santa Cruz METRO's investment policy, where more restrictive) that address **interest rate risk**, **credit risk**, and **concentration of credit risk**.

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Bankers' Acceptances	180 days	None	None
Commercial Paper	270 days	None	None
Negotiable CDs	5 years	None	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	None	None
Medium-Term Notes	5 years	None	None
Mutual Funds	N/A	None	None
Money Market Mutual Funds	N/A	None	None
Mortgage Pass-Through Securities	5 years	None	None
Santa Cruz County Pooled Investment Funds	N/A	100%	None
Local Agency Investment Fund (LAIF)	N/A	None	None

Disclosures Relating 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 interest rates.

Information about the sensitivity of the fair values of Santa Cruz METRO's investments to market interest rate fluctuations is provided by the following table that shows the distribution of Santa Cruz METRO's investments by maturity:

2017

		Remaining Maturity (in Months)			
Investment Type	Amount	12 Months or Less	13 to 24 Months	25 to 60 Months	More Than 60 Months
Santa Cruz County Pooled Investment Fund	$ 23,448,361	$ 23,448,361	$ -	$ -	$ -

NOTE 2 – CASH AND CASH EQUIVALENTS (Continued)

Cash on Hand and Cash in Banks (Continued)

Disclosures Relating to Interest Rate Risk (Continued)

2016

		Remaining Maturity (in Months)			
Investment Type	Amount	12 Months or Less	13 to 24 Months	25 to 60 Months	More Than 60 Months
Santa Cruz County Pooled Investment Fund	$ 23,882,680	$ 23,882,680	$ -	$ -	$ -

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, Santa Cruz METRO's investment policy, and the actual rating as of year-end for each investment type. The column marked "exempt from disclosure" identifies those investment types for which GASB Statement No. 40 does not require disclosure as to credit risk:

2017

				Rating as of Year-End		
Investment Type	Amount	Minimum Legal Rating	Exempt From Disclosure	AAA	Aa	Not Rated
Santa Cruz County Pooled Investment Fund	$ 23,448,361	N/A	$ -	$ -	$ -	$ 23,448,361

2016

				Rating as of Year-End		
Investment Type	Amount	Minimum Legal Rating	Exempt From Disclosure	AAA	Aa	Not Rated
Santa Cruz County Pooled Investment Fund	$ 23,882,680	N/A	$ -	$ -	$ -	$ 23,882,680

Concentration of Credit Risk

The investment policy of Santa Cruz METRO contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. Santa Cruz METRO did not have any investments in any one issuer (other than external investment pools) that represent 5% or more of total Santa Cruz METRO's investments at June 30, 2017 or 2016.

NOTE 2 – <u>CASH AND CASH EQUIVALENTS</u> (Continued)

<u>Cash on Hand and Cash in Banks</u> (Continued)

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 custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) 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 Santa Cruz METRO's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The fair value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies.

Custodial Credit Risk

GASB Statement No. 40 requires that the following disclosure be made with respect to custodial credit risks relating to deposits and investments: None of Santa Cruz METRO's deposits with financial institutions in excess of federal depository insurance limits were held in uncollateralized accounts.

Investment in Santa Cruz County Pooled Investment Fund

Santa Cruz METRO is a voluntary participant in the Santa Cruz County Pooled Investment Fund. The fair value of Santa Cruz METRO's investment in this pool is reported in the accompanying basic financial statements at amounts based upon Santa Cruz METRO's pro-rata share of the fair value provided by Santa Cruz County for the entire Santa Cruz County portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by Santa Cruz County, which are recorded on an amortized cost basis.

Fair Value Measurements

Santa Cruz METRO categorizes its fair value measurements within the fair value hierarchy established by accounting principles generally accepted in the United States of America. These principles recognize a three-tiered fair value hierarchy, as follows:

- Level 1: Investments reflect prices quoted in active markets;
- Level 2: Investments reflect prices that are based on a similar observable asset, either directly or indirectly, which may include inputs in markets that are not considered to be active; and
- Level 3: Investments reflect prices based upon unobservable sources.

NOTE 2 – CASH AND CASH EQUIVALENTS (Continued)

Cash on Hand and Cash in Banks (Continued)

Fair Value Measurements (Continued)

Santa Cruz METRO has the following recurring fair value measurements as of June 30, 2017 and 2016:

2017

Investments by fair value level		Fair Value Measurement Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Certificate of Deposit (CD)	$ 100,000	$ 100,000	$ -	$ -
Total investments measured at fair value	100,000	$ 100,000	$ -	$ -
Investments measured at amortized cost:				
Santa Cruz County Pooled Investment Fund	23,448,361			
Total pooled and directed investments	$ 23,548,361			

2016

Investments by fair value level		Fair Value Measurement Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Certificate of Deposit (CD)	$ 40,977	$ 40,977	$ -	$ -
Total investments measured at fair value	40,977	$ 40,977	$ -	$ -
Investments measured at amortized cost:				
Santa Cruz County Pooled Investment Fund	23,882,680			
Total pooled and directed investments	$ 23,923,657			

Investments in the Santa Cruz County Pooled Investment Fund pool totaling $23,448,361 and $23,882,680 as of June 30, 2017 and 2016, respectively, are measured at amortized cost, which approximates fair value.

NOTE 3 – RECEIVABLES

Receivables at June 30 are as follows:

	2017	2016
Federal Grants	$ 478,405	$ 516,009
State Grants	923,644	2,027,053
Sales and Use Tax Revenue	3,679,108	3,067,100
Other	708,799	1,539,701
	$ 5,789,956	$ 7,149,863

NOTE 4 – CHANGES IN CAPITAL ASSETS

Facilities, property, and equipment at June 30 are summarized as follows:

June 30, 2017

	Balance July 1, 2016	Additions and Transfers	Retirements and Transfers	Balance June 30, 2017
Non-Depreciated Assets				
Land	$ 11,596,311	$ -	$ -	$ 11,596,311
Construction-in-Progress	27,839,498	3,876,024	(28,525,293)	3,190,229
Total Non-Depreciated Assets	39,435,809	3,876,024	(28,525,293)	14,786,540
Depreciated Assets				
Building and Improvements	47,711,978	28,358,183	(4,294)	76,065,867
Revenue Vehicles	48,522,953	50,393	(2,391,646)	46,181,700
Operations Equipment	6,431,866	116,717	(152,303)	6,396,280
Other Equipment	2,131,733	-	-	2,131,733
Other Vehicles	1,164,604	-	(92,837)	1,071,767
Office Equipment	3,933,237	-	(31,768)	3,901,469
Total Depreciated Assets	109,896,371	28,525,293	(2,672,848)	135,748,816
Less Accumulated Depreciation	(62,836,549)	(4,297,447)	2,670,206	(64,463,790)
Depreciated Assets Net of Accumulated Depreciation	47,059,822	24,227,846	(2,642)	71,285,026
Total Capital Assets	$ 86,495,631	$ 28,103,870	$ (28,527,935)	$ 86,071,566

Depreciation expense at June 30, 2017, was $4,297,447.

June 30, 2016

	Balance July 1, 2015	Additions and Transfers	Retirements and Transfers	Balance June 30, 2016
Non-Depreciated Assets				
Land	$ 11,596,311	$ -	$ -	$ 11,596,311
Construction-in-Progress	20,605,781	7,850,322	(616,605)	27,839,498
Total Non-Depreciated Assets	32,202,092	7,850,322	(616,605)	39,435,809
Depreciated Assets				
Building and Improvements	47,505,460	270,967	(64,449)	47,711,978
Revenue Vehicles	50,605,014	-	(2,082,061)	48,522,953
Operations Equipment	6,433,325	9,208	(10,667)	6,431,866
Other Equipment	2,061,303	112,701	(42,271)	2,131,733
Other Vehicles	1,178,619	-	(14,015)	1,164,604
Office Equipment	3,904,539	35,865	(7,167)	3,933,237
Total Depreciated Assets	111,688,260	428,741	(2,220,630)	109,896,371
Less Accumulated Depreciation	(61,136,862)	(3,915,785)	2,216,098	(62,836,549)
Depreciated Assets Net of Accumulated Depreciation	50,551,398	(3,487,044)	(4,532)	47,059,822
Total Capital Assets	$ 82,753,490	$ 4,363,278	$ (621,137)	$ 86,495,631

Depreciation expense at June 30, 2016, was $3,915,785.

NOTE 5 – CAPITAL GRANTS

Santa Cruz METRO receives grants from the FTA, which provides financing for the acquisition of rolling stock and construction of facilities. Santa Cruz METRO also receives grants under the State TDA primarily for the acquisition of rolling stock and support equipment, and purchase of furniture and fixtures.

A summary of federal and state grant activity for the years ended June 30 is as follows:

	2017	2016
Federal Grants	$ 373,234	$ 442,706
State Grants	2,968,872	6,287,693
Other - Settlement Agreement Proceeds	290,557	840,903
Total Capital Grants	$ 3,632,663	$ 7,571,302

NOTE 6 – COMMITMENTS

Santa Cruz METRO leases a number of its facilities under operating leases through August 2018. For the years ended June 30, 2017 and 2016, rental costs relating to the leases were $219,034 and $396,172, respectively. In addition, Santa Cruz METRO receives rent income from retail space in its transit centers. Minimum net lease payments for existing operating leases are as follows:

Year Ending June 30	Lease Commitments	Rental Income	Net
2018	$ 193,295	$ 141,752	$ 51,543
2019	32,968	134,056	(101,088)
2020	-	131,509	(131,509)
2021	-	132,708	(132,708)
2022	-	76,026	(76,026)
2023-2027	-	97,958	(97,958)
	$ 226,263	$ 714,009	$ (487,746)

NOTE 7 – JOINT VENTURES (JOINT POWERS AUTHORITY WITH CalTIP)

Santa Cruz METRO participates in a joint power authority (JPA), the California Transit Indemnity Pool (CalTIP). The relationship between Santa Cruz METRO and the JPA is such that the JPA is not a component unit of Santa Cruz METRO for financial reporting purposes.

CalTIP arranges for and provides property and liability insurance for its 34 members. CalTIP is governed by a board that controls the operations of CalTIP, including selection of management and approval of operating budgets, independent of any influence by the member districts. Each member district pays a premium commensurate with the level of coverage requested and shares in surpluses and deficits proportionate to their participation in CalTIP.

NOTE 7 – JOINT VENTURES (JOINT POWERS AUTHORITY WITH CalTIP) (Continued)

Condensed audited financial information of CalTIP for the years ended April 30 (most recent information available) is as follows:

	2017	2016
Total Assets	$ 29,754,341	$ 27,142,767
Total Liabilities	21,321,678	21,487,418
Fund Balance	$ 8,432,663	$ 5,655,349
Total Revenues	$ 13,797,663	$ 9,597,626
Total Expenditures	11,020,349	13,419,707
Net Decrease in Fund Balance	$ 2,777,314	$ (3,822,081)

CalTIP has not calculated Santa Cruz METRO's share of year-end assets, liabilities, or fund balance.

NOTE 8 – WATSONVILLE FLEET MAINTENANCE FACILITY SETTLEMENT RECEIPT

Santa Cruz METRO's fleet maintenance facility in Watsonville was damaged in the Loma Prieta earthquake (the earthquake) in October 1989. An engineering study concluded that the demolition of the existing facility and construction of a new facility was the most practical course of action. Therefore, the net book value of the facility was written off the books in a prior year.

In addition, due to design and construction deficiencies by the design and building contractors involved in the original project, Santa Cruz METRO initiated litigation against the contractors and came to a settlement agreement with said contractors on May 30, 1995. In accordance with this agreement, the contractors remitted $4,776,858 (including $171,538 in costs) to Santa Cruz METRO during fiscal year 1996, representing damages less attorney fees. FTA Section 3/5309 restricts the use of these proceeds, and the interest earned thereon. As of June 30, 2017, all settlement funds have been expended; the net restricted amount of $0 and $371,523 is reflected on the statements of net position as unearned revenue at June 30, 2017 and 2016, respectively.

NOTE 9 – CONTINGENCIES

Santa Cruz METRO has received state and federal funds for specific purposes that are subject to review and audit by grantor agencies. Although such audits could generate expenditure disallowances under the terms of the grants, Santa Cruz METRO believes that any required reimbursement will not be material.

Additionally, Santa Cruz METRO is party to various claims and litigation in the normal course of business. In the opinion of management and in-house counsel, any ultimate losses have been adequately provided for in the basic financial statements.

NOTE 10 – DEFINED BENEFIT PENSION PLAN

A. General Information About the Pension Plan

Plan Description

Santa Cruz METRO's defined benefit pension plan, the Miscellaneous Plan for Santa Cruz Metropolitan Transit District (the Plan), provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. The Plan is part of the Public Agency portion of the California Public Employees' Retirement System (CalPERS), an agent multiple-employer plan administered by CalPERS, which acts as a common investment and administrative agent for participating public employers with the State of California. A menu of benefit provisions, as well as other requirements, is established by state statutes within the Public Employees' Retirement Law. Santa Cruz METRO selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through Board of Directors action. CalPERS issues a separate comprehensive annual financial report. Copies of the CalPERS' annual financial report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, California 95814.

Funding Policy

There are 315 and 306 active plan members in the Plan as of June 30, 2017 and 2016, respectively, who are required to contribute a percentage of their annual covered salary. In lieu of salary increases and for employees who agreed to salary reductions in certain prior years, Santa Cruz METRO agreed to pay a portion of the employee contribution, based on formulas negotiated in their labor agreements. Santa Cruz METRO is also required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rates for the fiscal years ended June 30, 2017 and 2016 were 22.165% and 21.000%. The contribution requirements of the Plan members are established by state statute and the employer contribution rate is established and may be amended by CalPERS.

The Plan's provisions and benefits in effect at June 30, 2017, are summarized as follows:

Hire Date	Prior to January 1, 2013	On or after January 1, 2013
Benefit Formula	2.5%@55	2%@62
Benefit Vesting Schedule	5 years service	5 years service
Benefit Payments	monthly for life	monthly for life
Retirement Age	50	52
Monthly Benefits, as a Percentage of Eligible Compensation	2.000% - 2.500%	1.000%-2.500%
Required Employee Contribution Rates	8.000%	6.250%
Required Employer Contribution Rates	22.165%	22.165%

The Plan's provisions and benefits in effect at June 30, 2016, are summarized as follows:

Hire Date	Prior to January 1, 2013	On or after January 1, 2013
Benefit Formula	2.5%@55	2%@62
Benefit Vesting Schedule	5 years service	5 years service
Benefit Payments	monthly for life	monthly for life
Retirement Age	50	52
Monthly Benefits, as a Percentage of Eligible Compensation	2.000% - 2.500%	1.000%-2.500%
Required Employee Contribution Rates	8.000%	6.250%
Required Employer Contribution Rates	21.000%	21.000%

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

A. General Information About the Pension Plan (Continued)

Funding Policy (Continued)

Employees Covered – At June 30, 2017 and 2016, the following employees were covered by the benefit terms for the Plan:

	2017	2016
Inactive Employees or Beneficiaries Currently Receiving Benefits	332	310
Inactive Employees Entitled to but not yet Receiving Benefits	174	173
Active Employees	315	306
Total	821	789

B. Net Pension Liability

Santa Cruz METRO's net pension liability for the Plan is measured as the total pension liability, less the pension plan's fiduciary net position. The net pension liability of the Plan is measured as of June 30, 2016, using an annual actuarial valuation as of June 30, 2015, rolled forward to June 30, 2016, using standard update procedures. A summary of principal assumptions and methods used to determine the net pension liability is shown below.

Actuarial Assumptions – The total pension liabilities in the June 30, 2015 and 2014 actuarial valuations were determined using the following actuarial assumptions:

Valuation Date	June 30, 2015	June 30, 2014
Measurement Date	June 30, 2016	June 30, 2015
Actuarial Cost Method	Entry Age Normal	Entry Age Normal
Actuarial Assumptions:		
Discount Rate	7.65%	7.65%
Inflation	2.75%	2.75%
Payroll Growth	3.00%	3.00%
Projected Salary Increase	Varies by Entry Age and Service (1)	Varies by Entry Age and Service (1)
Investment Rate of Return	7.50% (2)	7.50% (2)
Mortality	Derived using (3) CalPERS' Membership Data for all Funds	Derived using (3) CalPERS' Membership Data for all Funds

(1) Depending on age, service, and type of employment.

(2) Net of pension plan investment expenses, including inflation.

(3) 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.

The underlying mortality assumptions and all other actuarial assumptions used in the June 30, 2015 and 2014 valuations were based on the results of a January 2014 actuarial experience study for the period 1997 to 2011. Further details of the Experience Study can found on the CalPERS website.

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

B. Net Pension Liability (Continued)

Discount Rate – The discount rate used to measure the total pension liabilities for June 30, 2017 and 2016, was 7.65%. To determine whether the municipal bond rate should be used in the calculation of a discount rate for the Plan, CalPERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. Based on the testing, none of the tested plans run out of assets. Therefore, the current 7.65% discount rate for 2017 and 2016 is adequate and the use of the municipal bond rate calculation is not necessary. The long-term expected discount rate 7.65% for 2017 and 2016 will be applied to all plans in the Public Employees Retirement Fund (PERF). The stress test results are presented in a detailed report that can be obtained from the CalPERS website.

According to Paragraph 30 of GASB Statement No. 68, the long-term discount rate should be determined without reduction for pension plan administrative expense. The 7.65% investment return assumption used in this accounting valuation for 2017 and 2016 is net of administrative expenses. Administrative expenses are assumed to be 15 basis points. An investment return excluding administrative expenses would have been 8.65% for 2017 and 2016. Using this lower discount rate has resulted in a slightly higher total pension liability and net pension liability. CalPERS checked the materiality threshold for the difference in calculation and did not find it to be a material difference.

CalPERS is scheduled to review all actuarial assumptions as part of its regular Asset Liability Management (ALM) review cycle that is scheduled to be completed in February 2018. Any changes to the discount rate will require the CalPERS Board of Administration action and proper stakeholder outreach. For these reasons, CalPERS expects to continue using a discount rate net of administrative expenses for GASB Statements No. 67 and No. 68 calculations through at least the 2017-18 fiscal year. CalPERS will continue to check the materiality of the difference in calculation until such time as it has changed its methodology.

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

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Using historical returns of all the funds' asset classes, expected compound 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 for each fund. 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 equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

The tables below reflect the 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. These rates of return are net of administrative expenses.

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

B. Net Pension Liability (Continued)

2016

Asset Class	New Strategic Allocation	Real Return Years 1 - 10 (1)	Real Return Years 11+(2)
Global Equity	47.0%	5.25%	5.71%
Global Fixed Income	19.0%	0.99%	2.43%
Inflation Sensitive	6.0%	0.45%	3.36%
Private Equity	12.0%	6.83%	6.95%
Real Estate	11.0%	4.50%	5.13%
Infrastructure and Forestland	3.0%	4.50%	0.05%
Liquidity	2.0%	(0.55%)	(1.05%)
Total	100.0%		

(a) An expected inflation of 2.5% used for this period.
(b) An expected inflation of 3.0% used for this period.

2015

Asset Class	New Strategic Allocation	Real Return Years 1 - 10 (1)	Real Return Years 11+(2)
Global Equity	51.00%	5.25%	5.71%
Global Fixed Income	19.00%	0.99%	2.43%
Inflation Sensitive	6.00%	0.45%	3.36%
Private Equity	10.00%	6.83%	6.95%
Real Estate	10.00%	4.50%	5.13%
Infrastructure and Forestland	2.00%	4.50%	5.09%
Liquidity	2.00%	(0.55%)	(1.05%)
Total	100.00%		

(a) An expected inflation of 2.5% used for this period.
(b) An expected inflation of 3.0% used for this period.

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

C. Changes in the Net Pension Liability

The changes in the net pension liability for the Plan follow:

	Increase (Decrease)		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability/(Asset)
Balance at June 30, 2015 [1]	$ 156,141,654	$ 110,382,040	$ 45,759,614
Changes in the year:			
Service Cost	3,160,455	-	3,160,455
Interest on the Total Pension Liability	11,775,833	-	11,775,833
Differences between Actual and Expected Experience	162,174	-	162,174
Changes in Assumptions	-	-	-
Changes in Benefit Terms	-	-	-
Contribution - Employer	-	3,991,447	(3,991,447)
Contribution - Employee (Paid by Employer)	-	-	-
Contribution - Employee	-	1,603,071	(1,603,071)
Net Investment Income [2]	-	608,702	(608,702)
Administrative Expenses	-	(67,272)	67,272
Benefit Payments, Including Refunds of Employee Contributions	(7,903,179)	(7,903,179)	-
Net Changes	7,195,283	(1,767,231)	8,962,514
Balance at June 30, 2016 [1]	$ 163,336,937	$ 108,614,809	$ 54,722,128

[1] The plan fiduciary net position includes receivables for employee service buybacks, deficiency reserves, fiduciary self-insurance, and other postemployment benefits (OPEB) expense. This may differ from the Plan assets reported in the funding actuarial valuation report.
[2] Net of administrative expenses.

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

C. Changes in the Net Pension Liability (Continued)

	Increase (Decrease)		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability/(Asset)
Balance at June 30, 2014 [(1)]	$ 151,777,613	$ 109,465,857	$ 42,311,756
Changes in the year:			
Service Cost	3,294,147	-	3,294,147
Interest on the Total Pension Liability	11,234,261	-	11,234,261
Differences between Actual and Expected Experience	(414,257)	-	(414,257)
Changes in Assumptions	(2,564,554)	-	(2,564,554)
Changes in Benefit Terms	-	-	-
Contribution - Employer	-	4,086,806	(4,086,806)
Contribution - Employee (Paid by Employer)	-	-	-
Contribution - Employee	-	1,645,356	(1,645,356)
Net Investment Income [(2)]	-	2,493,939	(2,493,939)
Administrative Expenses	-	(124,362)	124,362
Benefit Payments, Including Refunds of Employee Contributions	(7,185,556)	(7,185,556)	-
Net Changes	4,364,041	916,183	3,447,858
Balance at June 30, 2015 [(1)]	$ 156,141,654	$ 110,382,040	$ 45,759,614

(1) The plan fiduciary net position includes receivables for employee service buybacks, deficiency reserves, fiduciary self-insurance, and other postemployment benefits (OPEB) expense. This may differ from the Plan assets reported in the funding actuarial valuation report.

(2) Net of administrative expenses.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate – The following presents the net pension liability of the Plan, calculated using the discount rate for the Plan, as well as what Santa Cruz METRO's net pension liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the current rate:

2016	
1% Decrease Net Pension Liability	$ 74,773,465
Current Discount Rate Net Pension Liability	$ 54,722,128
1% Increase Net Pension Liability	$ 37,952,701

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

C. Changes in the Net Pension Liability (Continued)

2015

1% Decrease Net Pension Liability	$	65,162,040
Current Discount Rate Net Pension Liability	$	45,759,614
1% Increase Net Pension Liability	$	29,530,278

Pension Plan Fiduciary Net Position – Detailed information about the Plan's fiduciary net position is available in the separately issued CalPERS financial reports.

D. Pension Expenses and Deferred Outflows/Inflows of Resources Related to Pensions

For the years ended June 30, 2017 and 2016, Santa Cruz METRO recognized a pension expense of $5,216,311 and $3,292,542, respectively. At June 30, 2017 and 2016, Santa Cruz METRO reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

2017

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension Contributions Subsequent to Measurement Date	$ 3,870,883	$ -
Differences between Actual and Expected Experience	118,343	(201,817)
Changes in Assumptions	-	(1,249,398)
Net Differences between Projected and Actual Earnings on Plan Investments	9,596,172	(3,855,784)
Total	$ 13,585,398	$ (5,306,999)

2016

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension Contributions Subsequent to Measurement Date	$ 4,035,814	$ -
Differences between Actual and Expected Experience	-	(491,717)
Changes in Assumptions	-	(1,906,976)
Net Differences between Projected and Actual Earnings on Plan Investments	4,598,899	(5,574,707)
Total	$ 8,634,713	$ (7,973,400)

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

D. Pension Expenses and Deferred Outflows/Inflows of Resources Related to Pensions (Continued)

The $3,870,883 and $4,035,814 reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the years ended June 30, 2018 and 2017, respectively. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows:

Measurement Period Ended June 30	
2017	$ 108,271
2018	184,653
2019	2,717,154
2020	1,397,438
Total	$ 4,407,516

E. Payable to the Pension Plan

At June 30, 2017 and 2016, Santa Cruz METRO reported a payable of $0 for the outstanding amount of contributions to the Plan required for the years ended June 30, 2017 and 2016.

NOTE 11 – DEFERRED COMPENSATION PLAN

Santa Cruz METRO offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 and provisions of the Government Code of the State of California. The plan, available to all Santa Cruz METRO employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, or unforeseeable emergency. Santa Cruz METRO employees participate in two such plans, the Great-West Life and Annuity Insurance (Great-West) plan and the other through CalPERS.

At June 30, 2017 and 2016, all amounts held under the Great-West plan and the CalPERS plan are held in trust and are not reflected on the accompanying statements of net position as required under GASB Statement No. 27, *Accounting Standards for Pensions by State and Local Governmental Employers*.

Complete financial statements for Great-West can be obtained from Great-West at P.O. Box 173764, Denver, Colorado 80217-3764. Complete financial statements for CalPERS can be obtained from CalPERS at Lincoln Plaza North, 400 Q Street, Sacramento, California 94229.

NOTE 12 – RISK MANAGEMENT

Santa Cruz METRO 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 Santa Cruz METRO carries commercial insurance. Santa Cruz METRO has also established limited risk management programs for workers' compensation, and general and vehicular liability, as described in Note 1.

Liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported (IBNR).

NOTE 12 – RISK MANAGEMENT (Continued)

The IBNR for workers' compensation was based on an actuarial study dated April 2016. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amount of payouts, and other economic and social factors. Changes in the balances of claims liabilities are as follows:

	2017	2016
Workers' Compensation Liabilities:		
Unpaid Claims, Beginning of Fiscal Year	$ 3,239,794	$ 4,403,314
Other Adjustments (Including IBNRs)	(530,114)	(1,832,581)
Claim Payments	662,592	669,061
Unpaid Claims Liability, End of Fiscal Year	$ 3,372,272	$ 3,239,794

NOTE 13 – TRANSPORTATION DEVELOPMENT ACT/CALIFORNIA CODE OF REGULATIONS

Santa Cruz METRO is subject to compliance with the TDA provisions; Sections 6634 and 6637 of the California Code of Regulations; and Sections 99267, 99268.1, and 99314.6 of the Public Utilities Code (PUC).

Section 6634

Pursuant to Section 6634, a transit claimant is precluded from receiving monies from the Local Transportation Fund (LTF) and the STA Fund in an amount which exceeds the claimant's operating costs, less fares, Federal funding and local support. Santa Cruz METRO did not receive TDA, STA, or LTF revenues in excess of the prescribed formula amounts.

Section 6637

Pursuant to Section 6637, a claimant must maintain its accounts and records in accordance with the Uniform System of Accounts and Records for Transit Operators adopted by the State Controller. Santa Cruz METRO did maintain its accounts and records in accordance with the Uniform System of Accounts and Records for Transit Operators.

Sections 99267, 99268.1, and 99314.6

Pursuant to the TDA, Santa Cruz METRO meets the 50% Expenditure Limitation required by PUC §99268 and does not use the Alternative Revenue Ratio to determine eligibility for TDA funds.

NOTE 14 – PUBLIC TRANSPORTATION MODERNIZATION, IMPROVEMENT, AND SERVICE ENHANCEMENT ACCOUNT (PTMISEA)

In November 2006, California voters passed a bond measure enacting the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006, Proposition 1B. Of the $19.925 billion of state general obligation bonds authorized, $4 billion was set aside by the State, as instructed by the statute, as PTMISEA. These funds are available to the California Department of Transportation for intercity rail projects and to transit operators in California for rehabilitation, safety, or modernization improvements; capital service enhancements or expansions; new capital projects; bus rapid transit improvements; or for rolling stock procurement, rehabilitation, or replacement.

The audit of public transportation operator finances, pursuant to Section 99245 of the PUC and required under the TDA, was expanded to include verification of receipt and appropriate expenditure of PTMISEA bond funds.

NOTE 14 – PUBLIC TRANSPORTATION MODERNIZATION, IMPROVEMENT, AND SERVICE ENHANCEMENT ACCOUNT (PTMISEA) (Continued)

The Santa Cruz County Regional Transportation Commission (SCCRTC) is responsible for allocating the Proposition 1B PUC Section 99313 funds in Santa Cruz County. In December 2007, the SCCRTC programmed 100% of its share of Section 99313 Proposition 1B PTMISEA funds (approximately $2.1 million) to Santa Cruz METRO for the Consolidated MetroBase Project. Funds audited include the SCCRTC share of PUC Section 99313 Proposition 1B transit funds that have been passed-through to Santa Cruz METRO.

During the fiscal year ended June 30, 2017, Santa Cruz METRO applied for and received proceeds of $0 and earned interest of $58,550 from the State's PTMISEA account for construction funding for the Consolidated MetroBase Project. During the fiscal year ended June 30, 2017, qualifying expenditures of $2,969,299 were incurred and the remaining balance of $4,620,335, including accrued interest, was deferred. Qualifying expenditures must be encumbered within three years from the date of the allocation and expended within three years from the date of encumbrance.

Schedule of PTMISEA Proposition 1B Grants
For the Year Ended June 30, 2017

	2017
Balance - beginning of the year	$ 7,531,104
Receipts:	
Grant received	-
Interest accrued 7/1/2016 through 6/30/2017	58,550
Expenses:	
MetroBase Construction	(2,969,299)
Balance - end of year	$ 4,620,355

During the fiscal year ended June 30, 2016, Santa Cruz METRO applied for and received proceeds of $0 and earned interest of $70,365 from the State's PTMISEA account for construction funding for the Consolidated MetroBase Project. During the fiscal year ended June 30, 2016, qualifying expenditures of $5,386,487 were incurred and the remaining balance of $7,531,104, including accrued interest, was deferred. Qualifying expenditures must be encumbered within three years from the date of the allocation and expended within three years from the date of encumbrance.

Schedule of PTMISEA Proposition 1B Grants
For the Year Ended June 30, 2016

	2016
Balance - beginning of the year	$ 12,847,226
Receipts:	
Grant received	-
Interest accrued 7/1/2015 through 6/30/2016	70,365
Expenses:	
MetroBase Construction	(5,386,487)
Balance - end of year	$ 7,531,104

NOTE 15 – POSTEMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

Plan Description

Santa Cruz METRO provides post-retirement CalPERS medical benefits to qualified retired employees age 50 and older (including eligible dependents) who have completed at least five years of CalPERS eligible service. Santa Cruz METRO pays medical premiums depending on bargaining union and PEMHCA contract requirements. If the retiree has ten years of Santa Cruz METRO eligible service, Santa Cruz METRO provides post-retirement dental and vision benefits for qualified retirees (including eligible dependents), and life insurance for the retiree only, until the retiree reaches age 65. The costs of providing these benefits are recognized when paid. Santa Cruz METRO has recognized approximately $3,116,390 and $2,806,852 of expense for these benefits for the years ending June 30, 2017 and 2016, respectively.

Annual OPEB Cost and Net OPEB Obligation

Santa Cruz METRO's annual OPEB cost (expense) is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. For fiscal years 2016-17 and 2015-16, Santa Cruz METRO's annual OPEB cost was $9,160,521 and $8,716,620, respectively. Santa Cruz METRO's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the years ended June 30, 2017 and 2016, were as follows:

	2017	2016
Annual required contribution	$ 9,507,715	$ 8,953,360
Interest on net OPEB obligation	1,136,284	929,790
Adjustments to annual required contribution	(1,483,478)	(1,166,530)
Annual OPEB cost	9,160,521	8,716,620
Implicit subsidy	(788,133)	(747,406)
Contributions made	(3,116,390)	(2,806,852)
Change in net OPEB obligation	5,255,998	5,162,362
Net OPEB obligation - beginning of year	28,407,107	23,244,745
Net OPEB obligation - end of year	$ 33,663,105	$ 28,407,107

Year Ended June 30,	Annual OPEB Cost	Actual Employer Contributions	Percentage of Annual OPEB Cost Contributed	Net Ending OPEB Obligation
2014	$ 6,823,903	$ 2,358,759	34.57%	$ 18,530,908
2015	$ 7,201,292	$ 2,487,455	34.54%	$ 23,244,745
2016	$ 8,716,620	$ 2,806,852	32.20%	$ 28,407,107
2017	$ 9,160,521	$ (3,116,390)	-34.02%	$ 33,663,105

NOTE 15 – POSTEMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS (Continued)

Funding Policy, Funded Status, and Funding Progress

Santa Cruz METRO's required contribution is based on pay-as-you-go financing requirements. For fiscal years 2016-17 and 2015-16, Santa Cruz METRO contributed $3,116,390 and $2,806,852, respectively, to the Plan.

As of June 30, 2015, the most recent actuarial valuation date, the projected actuarial accrued liability (AAL) for benefits was $92,633,342, all of which was unfunded.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and probability about the occurrence of future events far into the future. Amounts determined regarding the funded status of a plan and the annual required contributions of Santa Cruz METRO are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

The schedule of funding progress, presented as required supplementary information following the notes to the basic financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

Calculations of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with long-term perspective of the calculations.

The actuarial assumptions used for rates of employee turnover, retirement, and mortality, as well as economic assumptions regarding healthcare inflation and interest were based on a standard set of actuarial assumptions modified as appropriate for Santa Cruz METRO. Turnover, mortality, and retirement rates were taken from the CalPERS actuarial table for miscellaneous employees, which closely match Santa Cruz METRO experience. Healthcare inflation rates are based on the general health care environment. Actual healthcare premiums through 2017 were used and then projected to increase in future years; a 7.50% increase is projected for 2018, with annual increases gradually declining until reaching a flat 4.50% annual increase for 2023 and all years later. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over 30 years from June 30, 2008, with 22 years remaining as of June 30, 2017.

NOTE 16 – SUBSEQUENT EVENTS

Subsequent events were evaluated by management through December 18, 2017, which is the date of issuance. Santa Cruz METRO entered into a lease/purchase agreement with Key Government Finance, Inc. on November 21, 2017 for the purchase of three CNG buses. The terms of the lease/purchase call for monthly payments of $23,627 over a 72 month period beginning in December 2017, and include a 3.04% effective interest rate.

REQUIRED SUPPLEMENTARY INFORMATION

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF CHANGES IN THE NET PENSION LIABILITY AND RELATED RATIOS
FOR THE YEAR ENDED JUNE 30, 2017
LAST 10 YEARS*

	Measurement Period 2015/16	Measurement Period 2014/15	Measurement Period 2013/14
Total Pension Liability			
Service Cost	$ 3,160,455	$ 3,294,147	$ 3,200,114
Interest on Total Pension Liability	11,775,833	11,234,261	10,709,850
Differences between Expected and Actual Experience	162,174	(414,257)	-
Changes in Assumptions	-	(2,564,554)	-
Changes in Benefits	-	-	-
Benefit Payments, Including Refunds of Employee Contributions	(7,903,179)	(7,185,556)	(6,660,594)
Net Change in Total Pension Liability	7,195,283	4,364,041	7,249,370
Total Pension Liability - Beginning	156,141,654	151,777,613	144,528,243
Total Pension Liability - Ending (a)	$ 163,336,937	$ 156,141,654	$ 151,777,613
Plan Fiduciary Net Position			
Contributions - Employer	$ 3,991,447	$ 4,086,806	$ 3,668,004
Contributions - Employee	1,603,071	1,645,356	1,573,391
Net Investment Income	608,702	2,493,939	16,262,179
Administrative Expense	(67,272)	(124,362)	-
Benefit Payments	(7,903,179)	(7,185,556)	(6,660,594)
Net Change in Plan Fiduciary Net Position	(1,767,231)	916,183	14,842,980
Plan Fiduciary Net Position - Beginning	110,382,040	109,465,857	94,622,877
Plan Fiduciary Net Position - Ending (b)	$ 108,614,809	$ 110,382,040	$ 109,465,857
Net Pension Liability - Ending [(a) - (b)]	$ 54,722,128	$ 45,759,614	$ 42,311,756
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	66.50%	70.69%	72.12%
Covered-Employee Payroll	$ 19,550,012	$ 19,490,839	$ 18,385,116
Net Pension Liability as a Percentage of Covered-Employee Payroll	279.91%	234.77%	230.14%

* Fiscal year 2015 was the 1st year of implementation; therefore, only three years are shown.

Notes to Schedule:

Benefit changes. In 2017, 2016, and 2015, there were no benefit changes.

Changes in assumptions. In 2017, 2016, and 2015, amounts reported as changes in assumptions resulted primarily from adjustments to expected retirement ages of miscellaneous employees.

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF CONTRIBUTIONS
FOR THE YEAR ENDED JUNE 30, 2017
LAST 10 YEARS*

	Fiscal Year 2015-16	Fiscal Year 2014-15	Fiscal Year 2013-14
Actuarially Determined Contributions	$ 3,991,447	$ 4,086,806	$ 3,668,004
Contributions in Relation to the Actuarially Determined Contributions	(3,991,447)	(4,086,806)	(3,668,004)
Contribution Deficiency (Excess)	$ -	$ -	$ -
Covered-Employee Payroll	$ 19,550,012	$ 19,490,839	$ 18,385,116
Contributions as a Percentage of Covered-Employee Payroll	20.42%	20.97%	19.95%

* Fiscal year 2015 was the 1st year of implementation; therefore, only three years are shown.

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF FUNDING PROGRESS
OTHER POSTEMPLOYMENT BENEFITS
JUNE 30, 2017

Supplementary information is intended to show the progress made towards funding benefit obligations. Required three-year supplemental information, available to date, for Santa Cruz METRO is as follows:

Actuarial Valuation Date*	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b - a)/c]
6/30/2011	$ -	$ 59,164,000	$ 59,164,000	0.00%	$ 15,925,000	371.52%
6/30/2013	-	72,397,782	72,397,782	0.00%	18,682,878	387.51%
6/30/2015	-	92,633,342	92,633,342	0.00%	22,889,000	404.71%

*****Based on the latest actuarial valuation

SUPPLEMENTARY INFORMATION

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF OPERATING EXPENSES
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016

	2017	2016
Labor		
Operators' salaries and wages	$ 7,989,496	$ 9,118,832
Other salaries and wages	6,938,437	7,389,571
Overtime	3,470,460	2,862,939
	18,398,393	19,371,342
Fringe Benefits		
Absence with pay	3,587,305	3,673,177
Pension plans	3,870,883	4,035,814
Vision, medical, and dental plans	10,379,365	10,221,768
Workers' compensation insurance	795,070	(494,459)
Disability insurance	321,079	335,184
Other fringe benefits	625,078	182,017
Other postemployment benefits	6,601,426	4,419,090
	26,180,206	22,372,591
Services		
Accounting	84,476	90,728
Administrative and banking	369,684	370,218
Professional and technical services	874,072	695,273
Security	490,351	484,187
Outside repairs	958,900	968,490
Other services	85,248	81,205
	2,862,731	2,690,101
Materials and Supplies Consumed		
Fuels and lubricants	1,808,694	1,920,348
Tires and tubes	184,066	244,067
Vehicle parts	780,545	880,917
Other materials and supplies	398,429	511,068
	3,171,734	3,556,400
Utilities	533,399	534,875
Casualty and Liability Costs	107,928	877,037
Taxes and Licenses	43,407	38,146
Purchased Transportation Services		
Paratransit	100,760	71,470
Miscellaneous Expenses	222,761	244,882
Equipment and Facility Lease	222,612	205,452
Depreciation		
Property acquired with operator funds	304,039	280,162
Property acquired by federal, state, or TDA funds	3,993,408	3,635,623
	4,297,447	3,915,785
Total Operating Expenses	$ 56,141,378	$ 53,878,081

OTHER SCHEDULES AND REPORTS

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2017

Federal Grantor / Pass-Through Grantor / Program or Cluster Title	Federal CFDA No.	Pass-Through Entity Identifying Number	Passed Through to Subrecipients	Total Federal Expenditures
U.S. DEPARTMENT OF TRANSPORTATION				
Direct Programs:				
Federal Transit Authority (FTA)				
Cluster Defined by the Department of Transportation				
Section 3/5309 Consolidation				
Pacific Station Expansion FY2006 (Design/Engineering)	20.500	CA-04-0021	$ -	$ 5,273
Section 9/5307				
Operating Assistance	20.507	CA-2016-018	-	6,286,136
Section 5339				
Bus & Bus Facilities	20.507	644908	-	287,980
LoNo Discretionary	20.507	1675-2017-3	-	78,275
			-	366,255
Section 18/5311-5317				
Rural Operating Assistance - 5311	20.509	64BO17-00429	-	168,738
Section 18/5310				
Caltrans FY 13/14 5310	20.513	SA-64AC16-00069	-	1,706
Total Expenditures of Federal Awards			$ -	$ 6,828,108

See accompanying notes to schedule of expenditures of federal awards.

NOTE 1 – GENERAL

The accompanying Schedule of Expenditures of Federal Awards presents the activity of all federal financial assistance programs of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO). Federal financial assistance received directly from federal agencies, as well as federal financial assistance passed through other governmental agents, is included on the schedule.

NOTE 2 – BASIS OF ACCOUNTING

The accompanying Schedule of Expenditures of Federal Awards has been prepared on the accrual basis of accounting. Federal capital grant funds are used to purchase property, plant, and equipment. Federal grants receivable are included in capital and operating grants receivable, which also includes receivables from state and local grant sources.

NOTE 3 – INDIRECT COST RATE

Santa Cruz METRO has elected not to use the 10 percent de minimis indirect cost rate allowed under the Uniform Guidance.

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BROWN ARMSTRONG
Certified Public Accountants

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

To the Board of Directors
Santa Cruz Metropolitan Transit District
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, the financial statements of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise Santa Cruz METRO's basic financial statements, and have issued our report thereon dated December 18, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Santa Cruz METRO'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Santa Cruz METRO's internal control. Accordingly, we do not express an opinion on the effectiveness of Santa Cruz METRO'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 Santa Cruz METRO'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 Santa Cruz METRO's financial statements are free of material misstatement, 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 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 Santa Cruz METRO's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Santa Cruz METRO's internal control and compliance. Accordingly, this report is not suitable for any other purpose.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

Bakersfield, California
December 18, 2017

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BROWN ARMSTRONG
Certified Public Accountants

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

To the Board of Directors
Santa Cruz Metropolitan Transit District
Santa Cruz, California

Report on Compliance for Each Major Federal Program

We have audited the Santa Cruz Metropolitan Transit District's (Santa Cruz METRO) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Compliance Supplement* that could have a direct and material effect on each of Santa Cruz METRO's major federal programs for the year ended June 30, 2017. Santa Cruz METRO'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 federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Santa Cruz METRO'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 Santa Cruz METRO'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 Santa Cruz METRO's compliance.

Opinion on Each Major Federal Program

In our opinion, Santa Cruz METRO 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, 2017.

Report on Internal Control Over Compliance

Management of Santa Cruz METRO 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 of compliance, we considered Santa Cruz METRO'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 an 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 Santa Cruz METRO'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 purpose 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 purpose.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

Bakersfield, California
December 18, 2017

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BROWN ARMSTRONG
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH THE STATUTES, RULES, AND REGULATIONS OF THE CALIFORNIA TRANSPORTATION DEVELOPMENT ACT AND THE ALLOCATION INSTRUCTIONS AND RESOLUTIONS OF THE TRANSPORTATION COMMISSION

To the Board of Directors
Santa Cruz Metropolitan Transit District
Santa Cruz, California

We have audited, 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 U.S. Office of Management and Budget (OMB) *Compliance Supplement,* the financial statements of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO) as of and for the year ended June 30, 2017, and have issued our report thereon dated December 18, 2017.

Compliance

As part of obtaining reasonable assurance about whether Santa Cruz METRO's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. Additionally, we performed tests to determine that allocations made and expenditures paid by Santa Cruz METRO were made in accordance with the allocation instructions and resolutions of the Transportation Commission and in conformance with the California Transportation Development Act. Specifically, we performed each of the specific tasks identified in the California Code of Regulations Sections 6666 and 6667 that are applicable to Santa Cruz METRO. In connection with our audit, nothing came to our attention that caused us to believe Santa Cruz METRO failed to comply with the statutes, rules, and regulations of the California Transportation Development Act and the allocation instructions and resolutions of the Transportation Commission. 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.

Also as part of our audit, we performed tests of compliance to determine whether certain state funds were received and expended in accordance with the applicable bond act and state accounting requirements.

Other Matters

In November 2006, California voters passed a bond measure enacting the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006 (Proposition 1B). Of the $19.925 billion of state general obligation bonds authorized, $4 billion was set aside by the State as instructed by statute as the Public Transportation Modernization, Improvement, and Service Enhancement Account (PTMISEA). These funds are available to the California Department of

Transportation for intercity rail projects and to transit operators in California for rehabilitation, safety, or modernization improvements; capital service enhancements or expansions; new capital projects; bus rapid transit improvements; or for rolling stock procurement, rehabilitation, or replacement.

During the fiscal year ended June 30, 2017, Santa Cruz METRO received $0 from the State's PTMISEA funds. As of June 30, 2017, PTMISEA interest received and funds expended were verified in the course of our audit as follows:

Schedule of PTMISEA Proposition 1B Grants
For the Year Ended June 30, 2017

	2017
Balance - beginning of the year	$ 7,531,104
Receipts:	
Grant received	-
Interest accrued 7/1/2016 through 6/30/2017	58,550
Expenses:	
MetroBase Construction	(2,969,299)
Balance - end of year	$ 4,620,355

The results of our tests indicated that, with respect to the items tested, Santa Cruz METRO complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that Santa Cruz METRO had not complied, in all material respects, with those provisions.

Purpose of this Report

The purpose of this report is solely to describe the scope of our internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Santa Cruz METRO's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

This report is intended solely for the information and use of management and the Board of Directors of Santa Cruz METRO, the California Department of Transportation, the State Controller's Office, and officials of applicable grantor agencies. However, this report is a matter of public record and its distribution is not limited.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

Bakersfield, California
December 18, 2017

FINDINGS AND QUESTIONED COSTS SECTION

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2017

I. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:	Unmodified			
Internal control over financial reporting:				
Material weakness identified?	__	Yes	X	No
Reportable conditions identified that are not considered to be material weaknesses?	__	Yes	X	None reported
Noncompliance material to financial statements noted?	__	Yes	X	No

Federal Awards

Internal control over major federal programs:				
Material weakness identified?	__	Yes	X	No
Reportable conditions identified that are not considered to be material weaknesses?	__	Yes	X	None reported
Type of auditor's report issued on compliance for major programs:	Unmodified			
Any audit findings disclosed that are required to be reported in accordance with the Uniform Guidance?	__	Yes	X	No

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Clusters
20.500	Federal Transit Capital Investment Grants – Section 3
20.507	Federal Transit Formula Grants – Section 9

Dollar threshold used to distinguish type A and B programs:	$750,000			
Auditee qualified as low risk auditee?	X	Yes	__	No

II. Findings Relating to Financial Statements Required Under Generally Accepted Government Auditing Standards

None.

III. Federal Award Findings and Questioned Costs

None.

IV. State Award Findings and Questioned Costs

None.

V. A Summary of Prior Audit (all June 30, 2016) Findings and Current Year Status Follows

None.