SANTA CRUZ METROPOLITAN TRANSIT DISTRICT

FINANCIAL STATEMENTS
WITH
INDEPENDENT AUDITOR'S REPORT

JUNE 30, 2018 AND 2017

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
JUNE 30, 2018 AND 2017

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FINANCIAL SECTION

BROWN ARMSTRONG
ARMSTRONG
CERTIFIED
PUBLIC
ACCOUNTANTS

BAKERSFIELD OFFICE
(MAIN OFFICE)
4200 TRUXTUN AVENUE
SUITE 300
BAKERSFIELD, CA 93309
TEL 661.324.4971
FAX 661.324.4997
EMAIL info@bacpas.com

FRESNO OFFICE
10 RIVER PARK PLACE EAST
SUITE 208
FRESNO, CA 93720
TEL 559.476.3592

LAGUNA HILLS OFFICE
23272 MILL CREEK DRIVE
SUITE 255
LAGUNA HILLS, CA 92653
TEL 949.652.5422

STOCKTON OFFICE
1919 GRAND CANAL BLVD
SUITE C6
STOCKTON, CA 95207
TEL 888.565.1040

WWW.BACPAS.COM

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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, 2018 and 2017, 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, 2018 and 2017, 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.

Emphasis of a Matter

During the year ended June 30, 2018, Santa Cruz METRO adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*. Our opinion was not affected by the implementation.

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 Changes in the Net Other Postemployment Benefits (OPEB) Liability, and Schedule of Contributions - OPEB, 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 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 opinions on the financial statements that collectively comprise Santa Cruz METRO's 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 31, 2018, 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 the effectiveness of Santa Cruz METRO's 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 31, 2018

Introduction

The following Management's Discussion and Analysis (MD&A) of activities and financial performance of Santa Cruz Metropolitan Transit District (Santa Cruz METRO or the District) provides a narrative and analytical overview of the financial activities of Santa Cruz METRO with selected comparative information for the years ended June 30, 2018 and 2017. 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 formed 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 (Board), 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 Statements 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 Statements 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 Statements 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 Statements 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 Statements of Operating Expenses, located in the Supplementary Information section of the financial statements, report expenses in greater detail.

Financial Highlights

- The liabilities and deferred inflows of resources assets and deferred outflows of resources of Santa Cruz METRO exceeded its assets and deferred outflows of resources at the close of the year ended June 30, 2018, resulting in a Total Net Position (Deficit) of $(56,618,944).

- Of this amount, $84,442,069 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 Deficit represents Unrestricted Net Position (Deficit) of $(141,061,013). The Unrestricted Net Deficit is the result, in large part, of the District incurring increasing pension obligations (Net Pension Liability) that reached $60,072,122 by June 30, 2018, and increasing retiree medical benefits obligations (OPEB) in fiscal year 2018 totaling $106,945,439 at year end. These liabilities are required to be accounted for under Governmental Accounting Standards Board (GASB) Statement No. 68, and GASB Statement No. 75, which replaces GASB Statement No. 45, effective fiscal year 2018. 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 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 increased 17.6% during the year ended June 30, 2018, to $10.3 million compared to a 2% decrease during the year ended June 30, 2017, over the previous year. The increase in the current year resulted from an increase in contract fares revenue due to higher University of California, Santa Cruz (UCSC) negotiated fares rate, enrollment and student ridership from the previous fiscal year. A contract increase of 2.5% is budgeted for UCSC in fiscal year 2019. The decrease in fares revenues in fiscal year 2017 was due primarily to service reductions implemented in September 2016.

- Operating expenses (excluding depreciation) increased 3.2% during the year ended June 30, 2018, to $53,527,521 million compared to a 3.8% increase during the year ended June 30, 2017, over the previous year. The increase in the current year was mainly attributable to the increase in pension and settlement costs over the prior year. In the prior year, the increase was mainly attributable to the increase in provisions required for long-term pension and workers' compensation liabilities.

- In 2018, Santa Cruz METRO's Capital Assets (after the application of accumulated depreciation) decreased $215 thousand, compared to a decrease in 2017 of $424 thousand over the previous year. Depreciable Asset additions and transfers were $3.4 million, offset by asset retirements and transfers of $538 thousand and an increase in accumulated depreciation of $4.5 million offset by a $538 thousand write-off of accumulated depreciation associated with retired assets. Asset additions were attributed primarily to the purchase of revenue vehicles during fiscal year 2018. 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, 2018.

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, insurance and utilities have significantly exceeded the annual Consumer Price Index (CPI) for the region since 2012.

- The California Transportation Development Act (TDA) provides two major sources of funding for public transportation; the Local Transportation Fund (LTF) and the State Transit Assistance Fund (STA). These funds are for the development and support of public transportation needs that exist in California and are allocated to areas of each county based on population, taxable sales and transit performance. STA funding is derived from the statewide sales tax on diesel fuel. Since fiscal year 2014, STA funding has been on the decline. On April 28, 2017, Governor Brown signed Senate Bill (SB) 1 (Chapter 5, Statutes of 2017), known as the Road Repair and Accountability Act of 2017. SB 1 augments the base of the STA program essentially doubling the funding for this program.

Capital Program:
In fiscal year 2018, Santa Cruz METRO spent $2.9 million on the purchase of capital assets and on new and ongoing capital projects. A total of $2.6 million of these capital additions were paid for with capital grant contributions, funded by a variety of sources, including from the Federal Transit Administration (FTA), California Proposition 1B Transportation Bonds (Public Transportation Modernization, Improvement, and Service Enhancement Account (PTMISEA) and California Office of Emergency Services California Transit Security Grant Program (Cal-OES CTSGP), STA, STA State of Good Repair (STA-SGR), the State-Local Partnership Program (SLPP), the State Transportation Improvement Program (STIP), Measure D sales tax allocations. A total of $307 thousand of these capital purchases were made using Operating and Capital Reserve Funds.

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 adopted a new capital budget funding strategy in fiscal year 2018 that will result in an estimated $3 million per year to be dedicated to the annual capital budget. The strategy of creating a "Bus Replacement Fund" establishes an ongoing commitment to the Capital Budget and efforts to maintain the District's assets in a state of good repair.

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 Santa Cruz METRO received final occupancy on December 12, 2016. Follow-up activity continued on the project into 2018 including an upgrade to the mechanical platform, and pipe protection in the parking garage. This entire project will formally close out in December 2018, 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, Cal-OES funds and local Operating and Capital Reserves.

- Cameras on Buses: Santa Cruz METRO was one of the last public transit agencies in the nation operating without an onboard security surveillance system, however with funding from Cal-OES California Transit Security Grant Program funds (CTSGP) cameras were installed on Santa Cruz METRO's buses in fiscal year 2018. Having this type of equipment on Santa Cruz METRO's buses and paratransit vehicles is important to the safety and security of bus riders and employees, and fulfills Santa Cruz METRO's commitment to follow TDA triennial audit recommendations to install them. This project is to be completed in fiscal year 2019.

- Paracruz Vehicles: STIP and Measure D sales tax funds were used to purchase three (3) vehicles in fiscal year 2018. In fiscal year 2019 we will accept and pay for the (11) Paracruz vans on premises- that were purchased through the Bus and Bus Facilities FTA § 5339 Program funds and Measure D sales tax funds. Additionally, one (1) Paracruz van is being accepted/purchased in fiscal year 2019 with FTA §5310 funds.

- Transit Security Projects - The Cal-OES California Transit Security Grant Program (CTSGP) funds were spent primarily on the Cameras on Buses project referenced above

- Three (3) 2016 New Flyer Buses – Santa Cruz METRO entered into a lease-to-purchase agreement (capital lease) in fiscal year 2018 for three New Flyer Xcelsior buses. This purchase is part of Santa Cruz METRO's effort to replace and update its aging fleet. The principal portion of the monthly lease payments is funded by Measure D funds.

- Electric Bus & Infrastructure Project – Consulting work continues on Santa Cruz 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. Santa Cruz METRO matched this grant with PTMISEA funds and local Operating and Capital Reserves.

- Mid-Life Bus Engine Overhauls Campaign – The Mid-Life Bus Engine 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 by FTA § 5339 funds matched with Measure D funds; seven buses received a mid-life engine overhaul in fiscal year 2018.

- Bus Repaint Campaign – Santa Cruz METRO was able to repaint 21 buses this year. 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 was also funded with FTA § 5339 funds matched with Measure D funds.

- Non-Revenue Vehicle Replacements – The District was able to replace six Ford Focuses that are used as driver relief vehicles, one Ford 250 truck, and one aerial boom truck. The aerial boom truck allows staff to access cameras, windows, etc., eliminating the rental expense paid in the past for this specialized type of vehicle. These vehicles were purchased with FTA § 5339 funds matched with STA funds.

Comprehensive Operational Analysis and Service Changes:
In August 2015, Santa Cruz METRO began efforts on a Comprehensive Operational Analysis (COA). 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 2018, the Santa Cruz METRO fixed-route bus system consisted of 26 routes, and provided 5,048,512 rides with a fleet of 98 Compressed Natural Gas (CNG) and diesel buses, a decrease of 42,882 fixed-route rides (0.8%) 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 72,209 paratransit rides to mobility impaired patrons on 50 specially equipped minibuses and minivans during fiscal year 2018. This represents a 3.8% decrease in Paracruz ridership from the prior year (2,907 fewer paratransit rides), resulting primarily from the discontinuation of Demand Response-Taxi Paracruz service in fiscal year 2017. 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 financial crisis of 2007-2008.

A significant source of revenue for Santa Cruz METRO is retail sales and use tax in Santa Cruz County. Sales tax accounts for almost 50% of budgeted revenue while the TDA Local Transportation Fund (TDA-LTF), also funded by sales tax, provides an additional 13% to the budget. Santa Cruz METRO's actual sales tax receipts increased 4.4% in fiscal year 2018, and 3% in fiscal year 2017, while the TDA-LTF receipts increased by 6.7% and decreased by 0.54%, respectively.

Operating expenses continue to outpace the moderate increases anticipated in operating revenues and include pension costs, medical premiums, services, materials and supplies, legal and insurance costs, along with maintenance and repairs to aging vehicles and facilities. The District implemented the FTA's Transit Asset Management Plan in fiscal year 2018. Transit asset management (TAM) is a business model that prioritizes funding based on the condition of transit assets to achieve and maintain a state of good repair (SGR) for the nation's public transportation assets. The 2016 TAM Final Rule develops a framework for transit agencies to monitor and manage public transportation assets, improve safety, increase reliability and performance, and establish performance measures in order to help agencies keep their systems operating smoothly and efficiently. Hopefully, funding will be made available in the future to help the District achieve and maintain a state of good repair.

Despite the modest recovery experienced in the local economy, Santa Cruz METRO continues to employ cost control measures to balance its budget due to the reasons enumerated above.

Future Outlook

Santa Cruz METRO's fiscal year 2019 budget was again balanced without the expectation of drawing from reserves. This is another step in the right direction after many years of relying on reserves to balance the District's budget after the economic meltdown of 2007-2008. Sales tax and TDA-LTF revenues are expected to increase by 7.8% and 1.9%, respectively. Federal Operating Assistance is expected to increase by 5.6% and STA is budgeted at a 4.8% increase. As the economy continues to improve, the District expects to experience moderate increases in sales tax and related revenues of approximately 3% in fiscal year 2020 and for the next three (3) budget years. Passenger fare revenues continue to decline as ridership declines. This decline in ridership is not specific to Santa Cruz METRO. Nationwide transit ridership in March 2018 was 5.9% below March 2017, according to data published by the FTA. Following three years of steady declines, these numbers present a significant challenge to the nation's transit industry. Contributing factors include the low price of gas and low-cost ride-sharing transportation alternatives such as Uber and Lyft. Santa Cruz METRO is currently researching options to improve the passenger experience with the intention of retaining and hopefully growing ridership. Fiscal year 2019 operating expenses increased moderately at 3.5% with labor costs contributing 1.9% growth while non-labor costs contributed 11% growth. Repairs and maintenance costs to vehicles increased by 23% due to an aging fleet coupled with increased insurance costs of 25% due to global natural disaster losses and their impact on the insurance market. The employee training budget was increased fairly significantly as the District prepares to introduce electric buses to its existing CNG and diesel bus fleet.

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. Measure D is providing over $3 million dollars in revenue each year.

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 established 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. California Proposition 6, the ballot measure to overturn the tax and fee increases and repeal SB 1, was defeated in November 2018, helping to protect this vital investment in public transit and transportation.

Prior to the outcome of Proposition 6 and in response to this financial threat, Santa Cruz METRO was 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 2017-18 school year. UCSC increased its level of funding for student transit services for the 2016-17 academic year and increased it further for the 2017-18 academic year.

In the coming years, Santa Cruz METRO will seek to retain and attract new customers, particularly customers who have a transportation mode choice. With increased revenues through Measure D and SB 1, Santa Cruz METRO will work hard to improve the frequency of service on routes, improve span of service and possibly improve weekend service. A pilot project is currently underway for the Highway 17 Commuter Express route to test fare payment systems which will likely result in a mobile ticketing application option. The hope is to minimize boarding times and simplify the ticket purchase process.

Future Capital Needs & Bus Replacement Fund:

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 were achieved by using non-traditional capital-eligible FTA-STIC and STA funds and non-recurring revenues (Operating and Capital Reserves) to fill the budget gaps and cover operational costs.

Through the early 2000s, Santa Cruz METRO had always been able to acquire new buses to replace those that had reached their useful life of 12 years. Due to the extended recession, which limited funding availability and the elimination of the ability to acquire new buses through the federal earmark process, over half of Santa Cruz METRO's fleet is now beyond its useful life. Older buses are still operational, but have significantly increased maintenance costs.

To that end, in December 2018, Santa Clara Valley Transportation Authority (VTA), as part of a Highway 17 Express partnership, provided Santa Cruz METRO with 14 buses to supplement the District's fleet:

- Ten of these buses are hybrid diesel-electric and will become part of the Highway 17 Express fleet, replacing older buses.
- Four of the buses are articulated (longer buses with additional capacity) and will be used on the UCSC routes and replace the buses which are currently being leased.

Looking ahead, addressing the challenge of aging equipment and the attrition of rolling stock inventory continues to be a priority. 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 and well as pursue a combination of initiatives to manage the aging fleet including:

- Refurbishing existing buses to extend their useful life
- New buses to be funded by future grants; Santa Cruz METRO will become more competitive with increased available funds to match grant proposals
- Lease-to-purchase agreements
- Purchase of buses with Santa Cruz METRO capital funding

Santa Cruz METRO staff has analyzed the useful life status of the current fixed-route bus fleet, the District's financial capacity, and the bus manufacturing industry status and has developed a viable plan to reduce the average age of Santa Cruz METRO's fixed-route bus fleet while maintaining the number of buses to meet operational needs. The key component of the bus replacement plan is the budgetary strategy adopted for the fiscal year 2018 budget of committing $3 million annually in capital funding for a Bus Replacement Program. With the passage of Measure D and SB 1 (the Road Repair and Accountability Act of 2017), Santa Cruz METRO now has recurring revenue sources to fund this $3 million annual Bus Replacement Program to address Santa Cruz METRO's critical issue of operational buses beyond their intended useful life.

Santa Cruz METRO staff continue to pursue new grant opportunities that will help with these capital funding challenges, while further developing comprehensive funding strategies to replace and modernize its fleet. This grant application strategy resulted in Santa Cruz METRO being awarded five new buses last year; three of these buses are Federally-funded (Low-No) 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.

Fare Structure and Ticketing Initiatives:
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. New Single-Ride tickets were introduced in October 2018, to help shorten wait times while boarding the Highway 17 Express and local routes. It is anticipated that staff will be working closely with the Finance, Budget and Audit Committee to further develop and explore fare restructuring recommendations for the future.

Future Operational Improvements:
Intelligent Transportation System (ITS) – In October 2018, Santa Cruz METRO received funding from the State of California for an ITS which will contain the following subsystems:

- Automatic Vehicle Location (AVL)

AVL describes the use of computers and Global Positioning Systems (GPS) in dispatching and tracking transit vehicles. Transit agencies and its riders benefit from the improvements to service planning and customer service through real-time information. This technology will provide Santa Cruz METRO with much needed data that will be used to improve the accuracy of on-time performance, making for better system service. AVL will also significantly enhance the customer's experience by providing real-time information on bus arrival times and system disruptions. The successful passage of SB 1 has resulted in providing Santa Cruz METRO with state funds to purchase an AVL system for the fixed-route bus network in fiscal year 2019.

- Audio/Visual Annunciation System (AVAS)

AVAS provides automatic audio announcements and visual displays of destination and stop information for passengers with disabilities utilizing GPS to obtain a vehicles location on a path of travel. Santa Cruz METRO procured an AVAS in response to ADA related litigation in 2002. Santa Cruz METRO's current AVAS is no longer supported and is faced with dwindling parts availability. Therefore, an updated AVAS is deemed an essential element to this project.

Refurbishing Fleet: In October 2018, Santa Cruz METRO received funding from the State of California for refurbishing four older CNG buses, which will add 4-6 years to their useful life.

Zero Emission Buses (ZEBs) – In early 2017, the Santa Cruz METRO Board renewed their commitment to air quality and sustainability by adopting a resolution to achieve a fully zero emissions bus fleet by 2040. To that end, Santa Cruz METRO has secured funding that will purchase seven zero emissions 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.
- In July 2016, Santa Cruz METRO was awarded a FTA 5339(c) Low-No grant for three zero emissions buses
- In October 2018, the California Transportation Commission approved an allocation of State Transportation Improvement Program (STIP)/Local Partnership Program (LPP) funding to Santa Cruz METRO for the purchase of two electric buses.
- In June 2018, the fiscal year 2017 and fiscal year 2018 LCTOP awards - in combination- were approved to fund one ZEB.

These grants will provide funding not only for the electric buses but for some of the infrastructure needed to operate them. Currently, an order is in progress with Proterra for four ZEBs with a delivery commitment to Santa Cruz METRO of February 2020.

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:

	2018	2017	2016	2018 to 2017 Increase/(Decrease) Amount	%	2017 to 2016 Increase/(Decrease) Amount	%
Assets							
Current Assets	$ 28,260,602	$ 22,587,204	$ 23,342,903	$ 5,673,398	25.1%	$ (755,699)	-3.2%
Capital Assets - Net	85,856,420	86,071,566	86,495,631	(215,146)	-0.2%	(424,065)	-0.5%
Restricted Assets	8,513,085	8,354,300	9,177,768	158,785	1.9%	(823,468)	-9.0%
Total Assets	$ 122,630,107	$ 117,013,070	$ 119,016,302	$ 5,617,037	4.8%	$ (2,003,232)	-1.7%
Deferred Outflows of Resources							
Pension & OPEB Contributions	$ 16,717,218	$ 13,585,398	$ 8,634,713	$ 3,131,820	23.1%	$ 4,950,685	57.3%
Total Deferred Outflows of Resources	$ 16,717,218	$ 13,585,398	$ 8,634,713	$ 3,131,820	23.1%	$ 4,950,685	57.3%
Liabilities							
Current Liabilities	$ 6,735,562	$ 6,909,520	$ 6,599,776	$ (173,958)	-2.5%	$ 309,744	4.7%
Non-Current Liabilities	9,339,794	6,947,590	9,887,060	2,392,204	34.4%	(2,939,470)	-29.7%
Other Long-Term Liabilities	170,972,880	91,066,828	76,736,756	79,906,052	87.7%	14,330,072	18.7%
Total Liabilities	$ 187,048,236	$ 104,923,938	$ 93,223,592	$ 82,124,298	78.3%	$ 11,700,346	12.6%
Deferred Inflows of Resources							
Pension & OPEB deferrals	$ 8,918,033	$ 5,306,999	$ 7,973,400	$ 3,611,034	68.0%	$ (2,666,401)	-33.4%
Total Deferred Inflows of Resources	$ 8,918,033	$ 5,306,999	$ 7,973,400	$ 3,611,034	68.0%	$ (2,666,401)	-33.4%
Net Position							
Net Investment in Capital Assets	$ 84,442,069	$ 86,071,566	$ 86,495,631	$ (1,629,497)	-1.9%	$ (424,065)	-0.5%
Unrestricted Net Position	(141,061,013)	(65,704,035)	(60,041,608)	(75,356,978)	-114.7%	(5,662,427)	-9.4%
Total Net Position	$ (56,618,944)	$ 20,367,531	$ 26,454,023	$ (76,986,475)	-378.0%	$ (6,086,492)	-23.0%

2018 vs 2017 Analysis

Key changes include:

Current assets increased by $5.7 million, or 25.1%, to $28.3 million, primarily due to an infusion of funds from Measure D sales tax revenues as well as an increase in grants receivables for STA funding at year-end.

- *Capital assets – net* decreased by $215 thousand, or 0.2%, to $85.9 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* increased by $159 thousand, or 1.9%, to $8.5 million. Even though PTMISEA restricted monies were spent down on Metrobase projects during fiscal year 2018, this first full year of Measure D funding resulted in creating a net increase of unearned and restricted cash at year-end.

- *Deferred outflows of resources* totaling $16.7 million reflect $3.8 million in OPEB retiree medical, dental and vision insurance premium contributions and $12.9 million in pension contributions that were recorded in the current year as required by GASB Statements No. 75 and No. 68, respectively.

- *Current liabilities* decreased by $174 thousand, or 2.5%, to $6.7 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 the prior year (fiscal year 2017). This resulted in a comparative decrease in 2018 fiscal year-end liabilities, which was offset, to a lesser degree, by an increase in current liabilities from the new Capital Lease (current portion) debt that was incurred in fiscal year 2018 (to purchase three (3) CNG buses).

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- *Non-current liabilities* increased by $2.4 million, or 34.4%, to $9.3 million due to the receipt of Measure D sales tax allocations, STA and LCTOP grant funding. Capital grant funds and subsidies 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 $79.9 million, or 87.7%, to $171.0 million. The majority of this increase ($73.3 million) is due to the sharp increase in the actuarially-determined liability for OPEB that resulted from the first year implementation of GASB Statement No. 75 in fiscal year 2018.

- *Deferred inflows of resources* of $8.9 million in pension investment earnings and OPEB deferrals were recognized in the current year through the application of GASB Statement No. 68 and No. 75, respectively.

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

			2018 to 2017 Increase/(Decrease)	
	2018	2017	Amount	%
Operating Revenues	$ 10,280,559	$ 9,720,871	$ 559,688	5.8%
Operating Expenses	58,054,672	56,141,378	1,913,294	3.4%
Net Operating Loss	(47,774,113)	(46,420,507)	(1,353,606)	2.9%
Non-Operating Revenues	40,580,481	36,701,352	3,879,129	10.6%
Capital Grant Contributions	2,594,506	3,632,663	(1,038,157)	-28.6%
Decrease in Net Position	$ (4,599,126)	$ (6,086,492)	$ 1,487,366	-24.4%

			2017 to 2016 Increase/(Decrease)	
	2017	2016	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%

2018 vs 2017 Analysis

Operating Revenues (Passenger Fares) increased by $560 thousand, or 5.8%, this year over the prior year as a result of an increase in contract fares revenue due to a higher UCSC negotiated fares rate, increases in enrollment and student ridership from the previous fiscal year

Operating Expenses increased by $1.9 million, or 3.4%, overall when compared to last year due to several factors: increases in settlement claims costs, a year-end accrual for a remittance for 2015 alternative fuel tax rebate over-payments received, and increases in the annual adjusting entries for pension and OPEB expenses.

Non-Operating Revenues increased overall by $3.9 million, or 10.6%, over last year, primarily due to the growth of two revenue sources. Sales and use tax revenue increased by $1.9 million in fiscal year 2018, as a result of increased consumer spending and the first full year of the new sales tax allocation generated by local Measure D. Also, an increase in STA funding of $1.5 million over prior year - generated by the passage of SB 1 - additionally contributed to the overall increase in Non-Operating Revenues.

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 $1.0 million, or 28.6%, over last year primarily due to the winding down of various capital projects.

Statements of Cash Flows:

	2018	2017	2018 to 2017 Change
Net Cash Used in Operating Activities	$ (37,051,184)	$ (34,366,265)	$ (2,684,919)
Net Cash Provided by Non-Capital Financing Activities	39,956,902	35,801,841	4,155,061
Net Cash Provided by (Used in) Capital and Related Financing Activities	774,168	(2,038,501)	2,812,669
Net Cash Provided by Non-Transportation Activities	283,038	263,508	19,530
Net Increase (Decrease) in Cash and Cash Equivalents	3,962,924	(339,417)	4,302,341
Cash and Cash Equivalents, Beginning of Year	24,060,708	24,400,125	(339,417)
Cash and Cash Equivalents, End of Year	$ 28,023,632	$ 24,060,708	$ 3,962,924

	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)

Economic Factors and Next Year's Budget

State law requires Santa Cruz METRO to adopt an annual budget by resolution of the Board. 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. 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 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. 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 2019 Operating budget was adopted by the Board on June 22, 2018, totaling $49,995,359, representing a 4.0% growth over that of the previous year. 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 of $21,972,877 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 2019:

- Expectation that passenger fare revenue will experience an 8.2% decrease from prior year budget primarily due to decreased fixed-route ridership.
- Expectation that sales and use tax revenues will increase at a rate of 8.4% over the next year.
- Expectation that Santa Cruz County Measure D will infuse approximately $3.2 million of sales tax revenue funding into the annual budget for fiscal year 2019.
- Revenues generated from the passage of SB 1 to increase 4.8%
- 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 23.656% to 26.803% for the fiscal year 2019. 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.
- No anticipated increases in Special Transit (contract) fares revenue from Cabrillo College.
- Anticipated increases in Special Transit (contract) fares revenue from UCSC of $175 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, 2018 AND 2017

	2018	2017
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 19,510,547	$ 15,706,408
Sales and Use Taxes, Grants, and Other Receivables	7,457,858	5,789,956
Inventory	722,933	600,565
Prepaid Expenses	569,264	490,275
Total Current Assets	28,260,602	22,587,204
RESTRICTED ASSETS		
Cash and Cash Equivalents	8,513,085	8,354,300
CAPITAL ASSETS		
Building and Improvements	76,426,089	76,065,867
Revenue Vehicles	48,319,563	46,181,700
Operations Equipment	6,570,546	6,396,280
Other Equipment	2,131,733	2,131,733
Other Vehicles	1,244,205	1,071,767
Office Equipment	3,962,129	3,901,469
Total Depreciated Capital Assets	138,654,265	135,748,816
Less Accumulated Depreciation	(68,452,779)	(64,463,790)
Total Depreciated Capital Assets Net of Accumulated Depreciation	70,201,486	71,285,026
Construction-in-Progress	4,058,623	3,190,229
Land	11,596,311	11,596,311
Total Capital Assets	85,856,420	86,071,566
Total Assets	122,630,107	117,013,070
DEFERRED OUTFLOWS OF RESOURCES		
Deferred Amounts from Other Postemployment Benefits (OPEB)	3,784,611	-
Deferred Amounts from Pension Activities	12,932,607	13,585,398
Total Deferred Outflows of Resources	$ 16,717,218	$ 13,585,398

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

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF NET POSITION (Continued)
JUNE 30, 2018 AND 2017

	2018	2017
LIABILITIES		
CURRENT LIABILITIES		
Accounts Payable and Accrued Liabilities	$ 1,528,697	$ 2,164,097
Accrued Payroll and Employee Benefits	4,069,796	3,930,006
Deferred Rent	3,141	3,050
Workers' Compensation Liabilities, Current	710,917	690,677
Other Accrued Liabilities	166,714	109,306
Security Deposit	12,384	12,384
Capital Lease	243,913	-
Total Current Liabilities	6,735,562	6,909,520
NON-CURRENT LIABILITIES		
Unearned Revenue - State Transit Assistance (STA)	1,003,033	413,612
Unearned Revenue - PTMISEA Grant	4,776,955	4,620,355
Unearned Revenue - Proposition 1B Grant	409,201	955,066
Unearned Revenue - Measure D	1,560,667	-
Unearned Revenue - LCTOP	1,589,938	958,557
Total Non-Current Liabilities	9,339,794	6,947,590
OTHER LONG-TERM LIABILITIES		
Workers' Compensation Liabilities, Net of Current	2,784,881	2,681,595
Capital Lease	1,170,438	-
OPEB	106,945,439	33,663,105
Net Pension Liability	60,072,122	54,722,128
Total Other Long-Term Liabilities	170,972,880	91,066,828
Total Liabilities	187,048,236	104,923,938
DEFERRED INFLOWS OF RESOURCES		
Deferred Amounts from OPEB	6,520,486	-
Deferred Amounts from Pension Activities	2,397,547	5,306,999
Total Deferred Inflows of Resources	8,918,033	5,306,999
NET POSITION (DEFICIT)		
Net Investment in Capital Assets	84,442,069	86,071,566
Unrestricted Net Position	(141,061,013)	(65,704,035)
Total Net Position (Deficit)	$ (56,618,944)	$ 20,367,531

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, 2018 AND 2017

	2018	2017
OPERATING REVENUES		
Passenger Fares	$ 4,483,352	$ 4,791,959
Special Transit Fares	5,797,207	4,928,912
Total Operating Revenues	10,280,559	9,720,871
OPERATING EXPENSES		
Wages, Salaries, and Employee Benefits	45,022,896	44,578,599
Purchased Transportation Services	-	100,760
Materials and Supplies	3,135,709	3,171,221
Other Expenses	5,368,916	3,993,351
Depreciation	4,527,151	4,297,447
Total Operating Expenses	58,054,672	56,141,378
Net Operating Loss	(47,774,113)	(46,420,507)
NON-OPERATING REVENUES (EXPENSES)		
Sales and Use Taxes	22,796,094	20,869,028
Transportation Development Act (TDA) Assistance	6,767,933	6,804,838
State Transit Assistance (STA)	3,196,463	1,671,333
Federal Transit Administration (FTA) Section 5307 Operating Assistance	6,568,455	6,286,136
FTA Section 5311 Rural Operating Assistance	170,428	168,738
Alternative Fuel Tax Credit	354,826	284,419
Planning Grants	-	9,749
Interest Income	141,653	133,298
Rental Income	141,385	130,210
Other Revenue	433,750	342,926
Gain on Sale and Disposal of Property, Equipment, and Inventory	9,494	677
Total Non-Operating Revenues (Expenses)	40,580,481	36,701,352
Net Loss Before Capital Contributions	(7,193,632)	(9,719,155)
CAPITAL CONTRIBUTIONS		
Grants Restricted for Capital Expenditures	2,594,506	3,632,663
NET POSITION		
Change in Net Position	(4,599,126)	(6,086,492)
Net Position, Beginning of Year	20,367,531	26,454,023
Prior Period Adjustment	(72,387,349)	-
Total Net Position (Deficit), Beginning of Year, as restated	(52,019,818)	26,454,023
Total Net Position (Deficit), End of Year	$ (56,618,944)	$ 20,367,531

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, 2018 AND 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from Customers	$ 10,268,086	$ 10,575,093
Payments to Employees	(41,128,720)	(39,372,302)
Payments to Suppliers	(9,283,883)	(6,914,484)
Payments from (to) Other	3,093,333	1,345,428
Net Cash Used in Operating Activities	(37,051,184)	(34,366,265)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Operating Grants Received, Including Sales and Use Taxes	39,956,902	35,801,841
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from Sale of Property and Equipment	9,494	3,319
Capital Grants Received	3,662,328	1,834,204
Capital Expenditures	(4,312,005)	(3,876,024)
Acquisition of Capital Lease	1,533,558	-
Payments Made on Capital Lease	(119,207)	-
Net Cash Provided by (Used in) Capital and Related Financing Activities	774,168	(2,038,501)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment and Rental Income Received	283,038	263,508
NET DECREASE IN CASH AND CASH EQUIVALENTS	3,962,924	(339,417)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	24,060,708	24,400,125
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 28,023,632	$ 24,060,708
FINANCIAL STATEMENT PRESENTATION:		
Cash and cash equivalents	$ 19,510,547	$ 15,706,408
Cash and cash equivalents - Restricted	8,513,085	8,354,300
Total cash and investments	$ 28,023,632	$ 24,060,708

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

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF CASH FLOWS (Continued)
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

	2018	2017
RECONCILIATION OF NET OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES		
Net Operating Loss	$ (47,774,113)	$ (46,420,507)
Adjustments to Reconcile Net Operating Loss to Net Cash Used in Operating Activities:		
Depreciation	4,527,151	4,297,447
Changes in Assets and Liabilities:		
(Increase)/Decrease in Receivables	(12,473)	854,222
(Increase) in Inventory	(122,368)	(1,602)
(Increase) in Prepaid Expenses	(78,989)	(118,555)
Increase/(Decrease) in Accounts Payable and Accrued Liabilities	(635,400)	863,276
Increase in Net Pension Liabilities	3,093,333	1,345,428
Increase in OPEB	3,630,860	5,255,998
Increase/(Decrease) in Other Liabilities	320,815	(441,972)
Net Cash Used in Operating Activities	$ (37,051,184)	$ (34,366,265)

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. The Board of Directors (Board) consisting 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, 2018, the directors were as follows:

Chairperson:	Bruce McPherson		
Vice Chair:	Cynthia Chase		
Members:	Ed Bottorff	John Leopold	Trina Coffman-Gomez
	Jimmy Dutra	Donna Lind	J. Dan Rothwell
	Donald Norm Hagen	Cynthia Mathews	Mike Rotkin
Ex-Officio:	Davon Thomas	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, 2018, 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 appointed the Corporation's Board of Directors.

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 $2,594,583 and $3,632,663 for the fiscal years ended June 30, 2018 and 2017, 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.

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

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, 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:

F. Restricted Assets (Continued)

	2018	2017
Cash and Cash Equivalents		
Proposition 1B PTMISEA Grant	$ 4,776,955	$ 6,270,355
Proposition 1B OHS CTSGP Grant	409,201	955,066
STA Grant	778,601	413,612
Measure D	1,578,202	-
LCTOP	970,126	715,267
Total Restricted Assets	$ 8,513,085	$ 8,354,300

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 Receipts

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, 2018 and 2017, were $21,526,675 and $20,338,220, respectively.

H. Sales and Use Taxes Receipts (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 receipts were \$3,362,419 and \$530,808 for the fiscal years ended June 30, 2018 and 2017, respectively. During fiscal year 2018, \$1,269,419 of Measure D funds were earned and spent on Operating expenses, and \$532,333 of Measure D funds were earned and spent on Capital projects. During fiscal year 2017, \$530,808 of Measure D funds were earned and spent on Operating expenses. At June 30, 2018, \$1,560,667 of Measure D funds were unspent and recorded as unearned (deferred) revenue.

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

For purposes of measuring the net pension liability, deferred outflows/inflows of resources related to pension, and pension expense, information about the fiduciary net position of Santa Cruz METRO's California Public Employees' Retirement System (CalPERS) plan (Plan) and additions to/deductions from the Plan's fiduciary net position have been determined on the same basis as reported by CalPERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

N. Other Postemployment Benefits (OPEB)

For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of Santa Cruz METRO's plan (OPEB Plan) and additions to/deductions from the OPEB Plan's fiduciary net position have been determined on the same basis. For this purpose, benefit payments are recognized when currently due and payable in accordance with the benefit terms. Investments are reported at fair value. Generally accepted accounting principles require that the reported results must pertain to liability and asset information within certain defined timeframes.

O. 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.

P. Implementation of GASB Statements

GASB Statement No. 75 – *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions.* The provisions of this statement are effective for fiscal years beginning after June 15, 2017. Santa Cruz METRO has implemented the provisions of GASB Statement No. 75 in the current year. As a result of this implementation, Santa Cruz METRO reported a prior period adjustment to net position in the amount of $72,387,425 and recognized a net OPEB liability and deferred outflow of resources associated with OPEB as of June 30, 2018. See Note 17 for a detailed discussion of the effects of Santa Cruz METRO's current and prior period financial statements as a result of the adoption of this standard.

GASB Statement No. 81 – *Irrevocable Split-Interest Agreement.* The requirements of this statement are effective for reporting periods beginning after December 15, 2016. There was no effect on Santa Cruz METRO's accounting and financial reporting as a result of implementing this standard.

GASB Statement No. 85 – *Omnibus 2017*. The requirements of this statement are effective for periods beginning after June 15, 2017. There was no effect on Santa Cruz METRO's accounting and financial reporting as a result of implementing this standard.

GASB Statement No. 86 – *Certain Debt Extinguishment Issues.* The requirements of this statement are effective for periods beginning after June 15, 2017. There was no effect on Santa Cruz METRO's accounting and financial reporting as a result of implementing this standard.

Q. Future GASB 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.

GASB Statement No. 84 – *Fiduciary Activities*. The requirements for this statement are effective for fiscal years beginning after December 15, 2018. Santa Cruz METRO believes the statement will not apply.

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 1 – <u>OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES</u> (Continued)

GASB Statement No. 88 – *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements.* The requirements of this statement are effective for periods beginning after June 15, 2018. Santa Cruz METRO has not fully judged the effect of implementation of GASB Statement No. 88 as of the date of the basic financial statements.

GASB Statement No. 89 – *Accounting for Interest Cost Incurred before the End of a Construction Period.* 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. 89 as of the date of the basic financial statements.

GASB Statement No. 90 – *Majority Equity Interests and amendment of GASB Statements No. 14 and No. 61.* The requirements of this statement are effective for periods beginning after December 15, 2018. Santa Cruz METRO has not fully judged the effect of implementation of GASB Statement No. 90 as of the date of the basic financial statements.

NOTE 2 – <u>CASH AND CASH EQUIVALENTS</u>

Total cash and cash equivalents, (restricted and unrestricted), consist of the following at June 30, 2018 and 2017:

	2018	2017
Cash on Hand	$ 15,084	$ 15,341
Demand Deposits	380,137	497,006
Certificate of Deposit (CD)	110,050	100,000
Deposits in Santa Cruz County Pooled Investment Fund	27,518,361	23,448,361
	$ 28,023,632	$ 24,060,708

<u>Cash on Hand and Cash in Banks</u>

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**.

NOTE 2 – CASH AND CASH EQUIVALENTS (Continued)

Cash on Hand and Cash in Banks (Continued)

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:

2018

		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	$ 27,518,361	$ 27,518,361	$ -	$ -	$ -

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 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:

2018

				Rating as of Year-End		
Investment Type	Amount	Minimum Legal Rating	Exempt From Disclosure	AAA	Aa	Not Rated
Santa Cruz County Pooled Investment Fund	$ 27,518,361	N/A	$ -	$ -	$ -	$ 27,518,361

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

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, 2018 or 2017.

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.

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.

NOTE 2 – CASH AND CASH EQUIVALENTS (Continued)

Cash on Hand and Cash in Banks (Continued)

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.

Santa Cruz METRO has the following recurring fair value measurements as of June 30, 2018 and 2017:

2018

		Fair Value Measurement Using		
Investments by fair value level		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)	$ 110,050	$ 110,050	$ -	$ -
Total investments measured at fair value	110,050	$ 110,050	$ -	$ -
Investments measured at amortized cost:				
Santa Cruz County Pooled Investment Fund	27,518,361			
Total pooled and directed investments	$ 27,628,411			

2017

		Fair Value Measurement Using		
Investments by fair value level		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			

NOTE 2 – CASH AND CASH EQUIVALENTS (Continued)

Cash on Hand and Cash in Banks (Continued)

Fair Value Measurements (Continued)

Investments in the Santa Cruz County Pooled Investment Fund pool totaling $27,518,361 and $23,448,361 as of June 30, 2018 and 2017, respectively, are measured at amortized cost, which approximates fair value.

NOTE 3 – RECEIVABLES

Receivables at June 30 are as follows:

	2018	2017
Federal Grants	$ 792,757	$ 478,405
State Grants	1,929,881	923,644
Sales and Use Tax Revenue	4,033,526	3,679,108
Other	701,694	708,799
	$ 7,457,858	$ 5,789,956

NOTE 4 – CHANGES IN CAPITAL ASSETS

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

June 30, 2018

	Balance July 1, 2017	Additions and Transfers	Retirements and Transfers	Balance June 30, 2018
Non-Depreciated Assets				
Land	$ 11,596,311	$ -	$ -	$ 11,596,311
Construction-in-Progress	3,190,229	4,315,667	(3,447,273)	4,058,623
Total Non-Depreciated Assets	14,786,540	4,315,667	(3,447,273)	15,654,934
Depreciated Assets				
Building and Improvements	76,065,867	360,222	-	76,426,089
Revenue Vehicles	46,181,700	2,450,930	(313,067)	48,319,563
Operations Equipment	6,396,280	175,130	(864)	6,570,546
Other Equipment	2,131,733	-	-	2,131,733
Other Vehicles	1,071,767	306,234	(133,796)	1,244,205
Office Equipment	3,901,469	151,094	(90,434)	3,962,129
Total Depreciated Assets	135,748,816	3,443,610	(538,161)	138,654,265
Less Accumulated Depreciation	(64,463,790)	(4,527,150)	538,161	(68,452,779)
Depreciated Assets Net of Accumulated Depreciation	71,285,026	(1,083,540)	-	70,201,486
Total Capital Assets	$ 86,071,566	$ 3,232,127	$ (3,447,273)	$ 85,856,420

Depreciation expense at June 30, 2018, was $4,527,151.

NOTE 4 – CHANGES IN CAPITAL ASSETS (Continued)

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.

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:

	2018	2017
Federal Grants	$ 552,748	$ 373,234
State Grants	1,509,425	2,968,872
Measure D	532,333	-
Other - Settlement Agreement Proceeds	-	290,557
Total Capital Grants	$ 2,594,506	$ 3,632,663

NOTE 6 – COMMITMENTS

Santa Cruz METRO leases a number of its facilities under operating leases through August 2018. For the years ended June 30, 2018 and 2017, rental costs relating to the leases were $173,925 and $219,034, 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
2019	$ 154,927	$ 139,085	$ 15,842
2020	160,456	140,566	19,890
2021	165,270	141,670	23,600
2022	27,679	80,286	(52,607)
2023	-	41,394	(41,394)
2024-2027	-	35,654	(35,654)
	$ 508,332	$ 578,655	$ (70,323)

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 of the district pays a premium commensurate with the level of coverage requested and shares in surpluses and deficits proportionate to their participation in CalTIP.

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

	2018	2017
Total Assets	$ 30,061,842	$ 29,754,341
Total Liabilities	20,215,367	21,321,678
Fund Balance	$ 9,846,475	$ 8,432,663
Total Revenues	$ 11,960,679	$ 13,797,663
Total Expenditures	10,546,867	11,020,349
Net Increase in Fund Balance	$ 1,413,812	$ 2,777,314

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, 2018, all settlement funds have been expended.

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 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 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 were 311 and 315 active plan members in the Plan as of June 30, 2018 and 2017, respectively, who were required to contribute a percentage of their annual covered salary. 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. Beginning in fiscal year 2018, CalPERS changed how they bill/collect employer contributions. The total minimum required employer contribution is now the sum of the Plan's Normal Cost Rate (expressed as a percentage of payroll) plus the Employer Unfunded Accrued Liability (UAL) Contribution Amount (billed monthly in dollars). The required employer contribution for fiscal year 2018 was 8.911% of covered payroll plus twelve (12) monthly payments of $254,857. The required employer contribution rate for fiscal year 2017 was 22.165% of covered payroll. 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.

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

A. General Information About the Pension Plan

Funding Policy (Continued)

The Plan's provisions and benefits in effect at June 30, 2018, 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 Normal Cost Contribution Rates	8.911%	8.911%
Required Monthly Employer Dollar UAL Payment	$254,857/month	$254,857/month

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%

Employees Covered – At June 30, 2018 and 2017, the following employees were covered by the benefit terms for the Plan:

	2018	2017
Inactive Employees or Beneficiaries Currently Receiving Benefits	356	332
Inactive Employees Entitled to but not yet Receiving Benefits	180	174
Active Employees	311	315
Total	847	821

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, 2017, using an annual actuarial valuation as of June 30, 2016, rolled forward to June 30, 2017, using standard update procedures. A summary of principal assumptions and methods used to determine the net pension liability is shown below.

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

B. Net Pension Liability (Continued)

Actuarial Assumptions – The total pension liabilities in the June 30, 2016 and 2015 actuarial valuations were determined using the following actuarial assumptions:

Valuation Date	June 30, 2016	June 30, 2015
Measurement Date	June 30, 2017	June 30, 2016
Actuarial Cost Method	Entry Age Normal	Entry Age Normal
Actuarial Assumptions:		
Discount Rate	7.15%	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, 2016 and 2015 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.

Discount Rate – The discount rate used to measure the total pension liabilities for June 30, 2018 and 2017, was 7.15% and 7.65%, respectively. 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 7.15% and 7.65% discount rate for 2018 and 2017, respectively, is adequate and the use of the municipal bond rate calculation is not necessary. The long-term expected discount rate 7.15% and 7.65% for 2018 and 2017, respectively, 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 7.15% and 7.65% investment return assumption used in this accounting valuation for 2018 and 2017, respectively is net of administrative expenses. Administrative expenses are assumed to be 15 basis points. An investment return excluding administrative expenses would have been 8.15% and 8.65% for 2018 and 2017, respectively. 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 2018-19 fiscal year. CalPERS will continue to check the materiality of the difference in calculation until such time as it has changed its methodology.

B. Net Pension Liability (Continued)

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.

2017 Measurement Date

Asset Class	New Strategic Allocation	Real Return Years 1 - 10 [a]	Real Return Years 11+ [b]
Global Equity	47.0%	4.90%	5.38%
Global Fixed Income	19.0%	0.80%	2.27%
Inflation Sensitive	6.0%	0.60%	1.39%
Private Equity	12.0%	6.60%	6.63%
Real Estate	11.0%	2.80%	5.21%
Infrastructure and Forestland	3.0%	3.90%	5.36%
Liquidity	2.0%	(0.40%)	(0.90%)
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.

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

B. Net Pension Liability (Continued)

2016 Measurement Date

Asset Class	New Strategic Allocation	Real Return Years 1 - 10 [a]	Real Return Years 11+ [b]
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	100.00%		

[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, 2016 [1]	$ 163,336,937	$ 108,614,809	$ 54,722,128
Changes in the year:			
Service Cost	3,422,455	-	3,422,455
Interest on the Total Pension Liability	12,002,686	-	12,002,686
Differences between Actual and Expected Experience	(1,952,270)	-	(1,952,270)
Changes in Assumptions	9,337,059	-	9,337,059
Net plan to plan resource movement	-	107	(107)
Contribution - Employer	-	4,047,221	(4,047,221)
Contribution - Employee (Paid by Employer)	-	-	-
Contribution - Employee	-	1,556,993	(1,556,993)
Net Investment Income [2]	-	12,015,977	(12,015,977)
Administrative Expenses	-	(160,362)	160,362
Benefit Payments, Including Refunds of Employee Contributions	(9,126,454)	(9,126,454)	-
Net Changes	13,683,476	8,333,482	5,349,994
Balance at June 30, 2017 [1]	$ 177,020,413	$ 116,948,291	$ 60,072,122

[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, 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 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:

2017	
1% Decrease Net Pension Liability	$ 82,322,608
Current Discount Rate Net Pension Liability	$ 60,072,122
1% Increase Net Pension Liability	$ 41,533,585

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

C. Changes in the Net Pension Liability (Continued)

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

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, 2018 and 2017, Santa Cruz METRO recognized a pension expense of $7,780,109 and $5,216,311, respectively. At June 30, 2018 and 2017, Santa Cruz METRO reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

2018

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension Contributions Subsequent to Measurement Date	$ 4,686,776	$ -
Differences between Actual and Expected Experience	74,512	(1,805,727)
Changes in Assumptions	6,669,328	(591,820)
Net Differences between Projected and Actual Earnings on Plan Investments	1,501,991	-
Total	$ 12,932,607	$ (2,397,547)

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)

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

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

The $4,686,776 and $3,870,883 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	
2018	$ 1,407,225
2019	3,939,726
2020	1,704,352
2021	(1,203,019)
Total	$ 5,848,284

E. Payable to the Pension Plan

At June 30, 2018 and 2017, Santa Cruz METRO reported a payable of $0 for the outstanding amount of contributions to the Plan required for the years ended June 30, 2018 and 2017.

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, 2018 and 2017, 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 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 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:

	2018	2017
Workers' Compensation Liabilities:		
Unpaid Claims, Beginning of Fiscal Year	$ 3,372,272	$ 3,239,794
Other Adjustments (Including IBNRs)	(347,227)	(530,114)
Claim Payments	470,753	662,592
Unpaid Claims Liability, End of Fiscal Year	$ 3,495,798	$ 3,372,272

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 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, 2018, Santa Cruz METRO applied for and received proceeds of $0 and earned interest of $60,860 from the State's PTMISEA account for construction funding for the Consolidated MetroBase Project. Additionally, Santa Cruz METRO received settlements of $224,998. During the fiscal year ended June 30, 2018, qualifying expenditures of $129,259 were incurred and the remaining balance of $4,776,955, 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, 2018

	2018
Balance - beginning of the year	$ 4,620,355
Receipts:	
Grant received	-
Settlements received	224,999
Interest accrued 7/1/2017 through 6/30/2018	60,860
Expenses:	
MetroBase Construction	(106,569)
LoNo Spending	(22,690)
Balance - end of year	$ 4,776,955

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.

	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

NOTE 15 – OPEB

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 Public Employees' Medical and Hospital Care Act (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.

Employees covered – As of the June 30, 2017 valuation, the following current and former employees were covered by the benefit terms for the OPEB plan:

	2018
Inactive Employees or Beneficiaries Currently Receiving Benefits	277
Inactive Employees Entitled to but not yet Receiving Benefits	79
Active Employees	295
Total	651

Contributions – The contribution requirements of plan members and Santa Cruz METRO are established and may be amended by Santa Cruz METRO's Board. These contributions are neither mandated nor guaranteed. Santa Cruz METRO has retained the right to unilaterally modify its payment for retiree health care benefits. Refer to the table above for the contribution requirements. For the year ended June 30, 2018, Santa Cruz METRO contributed $3,784,611. Employees are not required to contribute to the OPEB plan.

Net OPEB Liability – Santa Cruz METRO's net OPEB liability was measured as of June 30, 2017 and the total OPEB liability used to calculate the net OPEB liability was the Plan Fiduciary Net Position of the OPEB trust held with CalPERS. The following actuarial methods and assumptions were used:

Reporting Date	June 30, 2018
Valuation Date	June 30, 2016
Measurement Date	June 30, 2017
Actuarial Cost Method	Entry Age Normal
Actuarial Assumptions:	
Discount Rate	7.15%
Inflation	2.75%
Salary Increases	3.00%
Investment Rate of Return	7.50%
Mortality Rate	Derived using CalPERS' Membership Data for all Funds [1]
Pre-Retirement Turnover	Derived using CalPERS' Membership Data for all Funds [2]

[1] Pre-retirement mortality information was derived from data collected during 1997 to 2011 CalPERS Experience Study dated January 2014 and post-retirement mortality information was derived from the 2007 to 2011 CalPERS Experience Study. The Experience Study Reports may be accessed on the CalPERS website www.calpers.ca.gov under Forms and Publications.

The long-term expected rate of return on OPEB plan investments was determined using a building block method in which expected future real rates of return (expected returns, net of OPEB plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	New Strategic Allocation	Real Return Years 1-10[a]	Real Return Years 11+ [b]
Global Equity	47.00%	4.90%	5.38%
Global Fixed Income	19.00%	0.80%	2.27%
Inflation Sensitive	6.00%	0.60%	1.39%
Private Equity	12.00%	6.60%	6.63%
Real Estate	11.00%	2.80%	5.21%
Infrastructure and Forestland	3.00%	3.90%	5.36%
Liquidity	2.00%	-0.40%	-0.90%
Total	100.00%		

NOTE 15 – OPEB (Continued)

Discount rate – The discount rate used to measure the total OPEB liability was 3.13%. The projection of cash flows used to determine the discount rate assumed that Santa Cruz METRO contributions will be sufficient to fully fund the obligation over a period not to exceed 30 years. Historic 30 year real rates of return for each asset class along with the assumed long-term inflation assumption were used to set the discount rate. The expected investment return was offset by the investment expenses of 15 basis points. Based on those assumptions, the OPEB Plan's fiduciary net position was projected to be available to make all projected OPEB payments for current active and inactive members and beneficiaries. Therefore, the long-term expected rate of return on OPEB Plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

Changes in the net OPEB Asset – The changes in the net OPEB asset for the Plan are as follows:

	Increase (Decrease)		
	Total OPEB Liability	Plan Fiduciary Net Position	Net OPEB Liability/(Asset)
Balance at June 30, 2017	$ 109,949,235	$ -	$ 109,949,235
Changes in the Year:			
Service Cost	5,708,352	-	5,708,352
Interest	3,047,381	-	3,047,381
Changes in Assumptions	(7,860,824)		(7,860,824)
Contribution - Employer	-	3,898,705	3,898,705
Contribution - Employee	-	-	-
Net Investment Income	-	-	-
Administrative Expenses	-	-	-
Benefit Payments	(3,898,705)	(3,898,705)	(7,797,410)
Net Changes	(3,003,796)	-	(3,003,796)
Balance at June 30, 2018	$ 106,945,439	$ -	$ 106,945,439

Sensitivity of the Net OPEB Liability to Changes in the Discount Rate – The following presents the net OPEB liability of Santa Cruz METRO if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the current rate, for measurement period ended June 30, 2017:

2017	
1% Decrease	2.13%
Net OPEB Liability	$ 125,320,088
Current Discount Rate	3.13%
Net OPEB Liability	$ 106,945,439
1% Increase	4.13%
Net OPEB Liability	$ 91,946,276

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

Recognition of Deferred Outflows and Deferred Inflows of Resources – Gains and losses related to changes in total OPEB liability and fiduciary net position are recognized in OPEB expense systematically over time. Amounts are first recognized in OPEB expense for the year the gain or loss occurs. The remaining amounts are categorized as deferred outflows and deferred inflows of resources related to OPEB and are to be recognized in future OPEB expense.

NOTE 15 – OPEB (Continued)

OPEB Expense and Deferred Outflows/Inflows of Resources Related to OPEB – For the fiscal year ended June 30, 2018, Santa Cruz METRO recognized OPEB expense of $7,415,395. As of fiscal year ended June 30, 2018, NVTA reported deferred outflows of resources related to OPEB from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
OPEB Contributions Subsequent to Measurement Date	$ 3,784,611	$ -
Differences between Actual and Expected Experience	-	-
Changes in Assumptions	-	6,520,486
Net Differences between Projected and Actual Earnings on Plan Investments	-	-
Total	$ 3,784,611	$ 6,520,486

The $3,784,611 reported as deferred outflows of resources related to contributions subsequent to the June 30, 2017 measurement date will be recognized as an increase to the net OPEB liability during the fiscal year ending June 30, 2019. In addition, future recognition of the deferred inflows of resources is shown below.

Fiscal Year Ended June 30	
2019	$ (1,340,388)
2020	(1,340,388)
2021	(1,340,388)
2022	(1,340,388)
2023	(1,158,934)
Total	$ (6,520,486)

NOTE 16 – CAPITAL LEASE

The following is a summary of Santa Cruz METRO's capital lease activity for the year ended June 30, 2018:

	Balance June 30, 2017	Additions	Payments Payments	Balance June 30, 2018	Due Within One Year
Capital Lease	$ -	$ 1,533,558	$ (119,207)	$ 1,414,351	$ 243,913
Total long-term debt	$ -	$ 1,533,558	$ (119,207)	$ 1,414,351	$ 243,913

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. At June 30, 2018, the outstanding balance was $1,414,351.

NOTE 16 – CAPITAL LEASE (Continued)

The annual requirements to amortize the capital lease payable outstanding, including interest, are as follows:

Fiscal Year	Principal	Interest	Total
2019	$ 243,913	$ 39,614	$ 283,527
2020	251,430	32,097	283,527
2021	259,182	24,347	283,529
2022	267,172	16,357	283,529
2023	275,409	893	276,302
2024-2028	117,245	-	117,245
Total	$ 1,414,351	$ 113,308	$ 1,527,659

NOTE 17 – PRIOR PERIOD ADJUSTMENT

A prior period adjustment was made to Net Position as follows:

Net Position June 30, 2017	$ 20,367,531
Implementation of GASB Statement No. 75 Change in Accounting Principle	(72,387,349)
Prior period adjustment	(72,387,349)
Restated net position at June 30, 2017	$ (52,019,818)

NOTE 18 – DEFICIT NET POSITION

As of June 30, 2018, Santa Cruz METRO had a deficit net position. The deficit was mostly due to the implementation of GASB Statement No. 75. Refer to Note 17.

NOTE 19 – SUBSEQUENT EVENTS

Subsequent events were evaluated by management through December 31, 2018, which is the date of issuance.

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, 2018
LAST 10 YEARS*

	Measurement Period 2016/17	Measurement Period 2015/16	Measurement Period 2014/15	Measurement Period 2013/14
Total Pension Liability				
Service Cost	$ 3,422,455	$ 3,160,455	$ 3,294,147	$ 3,200,114
Interest on Total Pension Liability	12,002,686	11,775,833	11,234,261	10,709,850
Differences between Expected and Actual Experience	(1,952,270)	162,174	(414,257)	-
Changes in Assumptions	9,337,059	-	(2,564,554)	-
Changes in Benefits	-	-	-	-
Benefit Payments, Including Refunds of Employee Contributions	(9,126,454)	(7,903,179)	(7,185,556)	(6,660,594)
Net Change in Total Pension Liability	13,683,476	7,195,283	4,364,041	7,249,370
Total Pension Liability - Beginning	163,336,937	156,141,654	151,777,613	144,528,243
Total Pension Liability - Ending (a)	$ 177,020,413	$ 163,336,937	$ 156,141,654	$ 151,777,613
Plan Fiduciary Net Position				
Net plan to plan resource movement	$ 107	$ -	$ -	$ -
Contributions - Employer	4,047,221	3,991,447	4,086,806	3,668,004
Contributions - Employee	1,556,993	1,603,071	1,645,356	1,573,391
Net Investment Income	12,015,977	608,702	2,493,939	16,262,179
Administrative Expense	(160,362)	(67,272)	(124,362)	-
Benefit Payments	(9,126,454)	(7,903,179)	(7,185,556)	(6,660,594)
Net Change in Plan Fiduciary Net Position	8,333,482	(1,767,231)	916,183	14,842,980
Plan Fiduciary Net Position - Beginning	108,614,809	110,382,040	109,465,857	94,622,877
Plan Fiduciary Net Position - Ending (b)	$ 116,948,291	$ 108,614,809	$ 110,382,040	$ 109,465,857
Net Pension Liability - Ending [(a) - (b)]	$ 60,072,122	$ 54,722,128	$ 45,759,614	$ 42,311,756
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	66.06%	66.50%	70.69%	72.12%
Covered-Employee Payroll	$ 19,343,552	$ 19,550,012	$ 19,490,839	$ 18,385,116
Net Pension Liability as a Percentage of Covered-Employee Payroll	310.55%	279.91%	234.77%	230.14%

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

Notes to Schedule:

Benefit changes. In 2018, 2017, 2016, and 2015, there were no benefit changes.

Changes in assumptions. In 2018, 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, 2018
LAST 10 YEARS*

	Fiscal Year 2016-17	Fiscal Year 2015-16	Fiscal Year 2014-15	Fiscal Year 2013-14
Actuarially Determined Contributions	$ 4,047,221	$ 3,991,447	$ 4,086,806	$ 3,668,004
Contributions in Relation to the Actuarially Determined Contributions	(4,047,221)	(3,991,447)	(4,086,806)	(3,668,004)
Contribution Deficiency (Excess)	$ -	$ -	$ -	$ -
Covered-Employee Payroll	$ 19,343,552	$ 19,550,012	$ 19,490,839	$ 18,385,116
Contributions as a Percentage of Covered-Employee Payroll	20.92%	20.42%	20.97%	19.95%

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

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF CHANGES IN THE NET OPEB LIABILITY AND RELATED RATIOS
FOR THE MEASUREMENT PERIOD ENDED JUNE 30

Measurement Period	2017
Total OPEB Liability	
Service Cost	$ 5,708,352
Interest	3,047,381
Actual and Expected Experience Difference	-
Changes in Assumptions	(7,860,824)
Changes in Benefits Terms	-
Benefit Payments	(3,898,705)
Net Change in Total OPEB Liability	(3,003,796)
Total OPEB Liability - Beginning	109,949,235
Total OPEB Liability - Ending (a)	$ 106,945,439
Plan Fiduciary Net Position	
Contributions - Employer	$ 3,898,705
Net Investment Income	-
Benefit Payments	(3,898,705)
Administrative Expenses	-
Net Change in Plan Fiduciary Net Position	-
Plan Fiduciary Net Position - Beginning	-
Plan Fiduciary Net Position - Ending (b)	$ -
Net OPEB Liability - Ending [(a) - (b)]	$ 106,945,439
Plan Fiduciary Net Position as a Percentage of the Total OPEB Liability	0.00%
Covered-Employee Payroll	$ 21,929,916
Net OPEB Liability as a Percentage of Covered-Employee Payroll	487.67%

Notes to the Schedule:

Historical information is required only for measurement periods for which GASB Statement No. 75 is applicable. Future years' information will be displayed up to 10 years as information becomes available.

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF CONTRIBUTIONS
FOR THE YEAR ENDED JUNE 30, 2018
LAST 10 YEARS*

	Fiscal Year 2018
Actuarially Determined Contributions	$ 3,898,705
Contributions in Relation to the Actuarially Determined Contributions	(3,898,705)
Contribution Deficiency (Excess)	$ -
Covered-Employee Payroll	$ 21,929,916
Contributions as a Percentage of Covered-Employee Payroll	17.78%

Notes to the Schedule:
Actuarial methods and assumptions used to set the actuarially determined contributions for fiscal year 2018 were from the June 30, 2017 actuarial valuation.

Methods and assumptions used to determine contributions:

Actuarial Cost Method	Entry Age Normal
Asset Valuation Method	Market Value
Discount Rate	7.15%
Inflation	2.75%
Salary Increases	3.00%
Investment Rate of Return	7.50%
Mortality Rate	Derived using CalPERS' Membership Data for all Funds (1)
Pre-Retirement Turnover	Derived using CalPERS' Membership Data for all Funds (2)

(1) Pre-retirement mortality information was derived from data collected during 1997 to 2011 CalPERS Experience Study dated January 2014 and post-retirement mortality information was derived from the 2007 to 2011 CalPERS Experience Study. The Experience Study Reports may be accessed on the CalPERS website www.calpers.ca.gov under Forms and Publications.

* Fiscal year 2018 was the 1st year of implementation; therefore, only one year is shown.

SUPPLEMENTARY INFORMATION

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF OPERATING EXPENSES
FOR THE YEARS ENDED JUNE 30, 2018 and 2017

	2018	2017
Labor		
Operators' salaries and wages	$ 8,268,866	$ 7,989,496
Other salaries and wages	7,367,973	6,938,437
Overtime	3,090,876	3,470,460
	18,727,715	18,398,393
Fringe Benefits		
Absence with pay	3,594,668	3,587,305
Pension plans	4,686,776	3,870,883
Vision, medical, and dental plans	6,408,324	10,379,365
Workers' compensation insurance	594,279	795,070
Disability insurance	334,220	321,079
Other fringe benefits	168,110	625,078
Other postemployment benefits	10,508,804	6,601,426
	26,295,181	26,180,206
Services		
Accounting	87,661	84,476
Administrative and banking	387,189	369,684
Professional and technical services	1,024,675	874,072
Security	499,252	490,351
Outside repairs	1,138,627	958,900
Other services	93,472	85,248
	3,230,876	2,862,731
Materials and Supplies Consumed		
Fuels and lubricants	1,566,002	1,808,694
Tires and tubes	185,340	184,066
Vehicle parts	958,537	780,545
Other materials and supplies	427,088	398,429
	3,136,967	3,171,734
Utilities	579,259	533,399
Casualty and Liability Costs	696,292	107,928
Taxes and Licenses	41,918	43,407
Purchased Transportation Services		
Paratransit	-	100,760
Miscellaneous Expenses	481,951	222,761
Equipment and Facility Lease	337,362	222,612
Depreciation		
Property acquired with operator funds	4,527,151	304,039
Property acquired by federal, state, or TDA funds	-	3,993,408
	4,527,151	4,297,447
Total Operating Expenses	$ 58,054,672	$ 56,141,378

OTHER SCHEDULES AND REPORTS

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2018

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 Administration (FTA)				
Cluster Defined by the Department of Transportation				
Section 3/5309 Consolidation				
Pacific Station Expansion FY2006 (Design/Engineering)	20.500	CA-04-0021	$ -	$ 10,925
Section 9/5307				
Operating Assistance	20.507	CA-2018-049	-	6,568,455
Section 5339				
FY13 Bus & Bus Facilities (Caltrans)	20.507	644908	-	174,568
FY14 Bus & Bus Facilities	20.507	CA-2017-038-00		188,925
FY16 Bus & Bus Facilities	20.507	CA-2017-070-00		57,838
FY16 Low No Discretionary	20.507	CA-2017-071-00	-	118,596
			-	539,927
Section 18/5311-5317				
Rural Operating Assistance - 5311	20.509	64BO17-00534	-	170,428
Section 18/5310				
Caltrans FY14 5310	20.513	SA-64AC16-00069	-	1,898
Total Expenditures of Federal Awards			$ -	$ 7,291,633

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.

BROWN
ARMSTRONG

CERTIFIED
PUBLIC
ACCOUNTANTS

BAKERSFIELD OFFICE
(MAIN OFFICE)

4200 TRUXTUN AVENUE
SUITE 300
BAKERSFIELD, CA 93309
TEL 661.324.4971
FAX 661.324.4997
EMAIL info@bacpas.com

FRESNO OFFICE

10 RIVER PARK PLACE EAST
SUITE 208
FRESNO, CA 93720
TEL 559.476.3592

LAGUNA HILLS OFFICE

23272 MILL CREEK DRIVE
SUITE 255
LAGUNA HILLS, CA 92653
TEL 949.652.5422

STOCKTON OFFICE

1919 GRAND CANAL BLVD
SUITE C6
STOCKTON, CA 95207
TEL 888.565.1040

WWW.BACPAS.COM

REGISTERED with the Public Company Accounting Oversight Board and MEMBER of the American Institute of Certified Public Accountants

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, 2018, 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 31, 2018.

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 31, 2018

BROWN ARMSTRONG
CERTIFIED PUBLIC ACCOUNTANTS

BAKERSFIELD OFFICE
(MAIN OFFICE)
4200 TRUXTUN AVENUE
SUITE 300
BAKERSFIELD, CA 93309
TEL 661.324.4971
FAX 661.324.4997
EMAIL info@bacpas.com

FRESNO OFFICE
10 RIVER PARK PLACE EAST
SUITE 208
FRESNO, CA 93720
TEL 559.476.3592

LAGUNA HILLS OFFICE
23272 MILL CREEK DRIVE
SUITE 255
LAGUNA HILLS, CA 92653
TEL 949.652.5422

STOCKTON OFFICE
1919 GRAND CANAL BLVD
SUITE C6
STOCKTON, CA 95207
TEL 888.565.1040

WWW.BACPAS.COM

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, 2018. 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, 2018.

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 31, 2018

BROWN
ARMSTRONG
CERTIFIED
PUBLIC
ACCOUNTANTS

BAKERSFIELD OFFICE
(MAIN OFFICE)
4200 TRUXTUN AVENUE
SUITE 300
BAKERSFIELD, CA 93309
TEL 661.324.4971
FAX 661.324.4997
EMAIL info@bacpas.com

FRESNO OFFICE
10 RIVER PARK PLACE EAST
SUITE 208
FRESNO, CA 93720
TEL 559.476.3592

LAGUNA HILLS OFFICE
23272 MILL CREEK DRIVE
SUITE 255
LAGUNA HILLS, CA 92653
TEL 949.652.5422

STOCKTON OFFICE
1919 GRAND CANAL BLVD
SUITE C6
STOCKTON, CA 95207
TEL 888.565.1040

WWW.BACPAS.COM

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, 2018, and have issued our report thereon dated December 31, 2018.

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 (TDA). 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 TDA 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, 2018, Santa Cruz METRO received $0 from the State's PTMISEA funds. As of June 30, 2018, PTMISEA interest received and funds expended were verified in the course of our audit as follows:

	2018
Balance - beginning of the year	$ 4,620,355
Receipts:	
Grant received	-
Settlements received	224,999
Interest accrued 7/1/2017 through 6/30/2018	60,860
Expenses:	
MetroBase Construction	(106,569)
LoNo Spending	(22,690)
Balance - end of year	$ 4,776,955

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.

Restriction on Use

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 31, 2018

FINDINGS AND QUESTIONED COSTS SECTION

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2018

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, 2017) Findings and Current Year Status Follows

None.