

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**

**700 H STREET, SUITE 3650  
SACRAMENTO, CALIFORNIA 95814-1280  
(916) 874-9039**

**BOARD OF DIRECTORS:**

**SUE FROST, CHAIR  
PATRICK KENNEDY, VICE CHAIR  
WILLIAM HORN, DIRECTOR**

**FLORENCE EVANS, SECRETARY  
BRITT FERGUSON, TREASURER/CONTROLLER**

**AGENDA**

**ANNUAL MEETING  
SEPTEMBER 25, 2018 AT 8:30 AM**

**700 H STREET, SUITE 2450  
BOARD OF SUPERVISORS AMERICAN RIVER CONFERENCE ROOM  
SACRAMENTO, CA**

**-And-**

**Telephone Conference  
1600 PACIFIC HIGHWAY, ROOM 166  
SAN DIEGO, CA 92101  
(619) 531-5413**

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**AGENDA ITEMS**

1. Approval of Minutes From Prior Meeting
2. Approval of Fiscal Year 2018-19 Recommended Budget
3. Presentation of Fiscal Year 2017-18 Audited Financial Report
4. Public Comments

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**  
**700 H STREET, SUITE 3650**  
**SACRAMENTO, CALIFORNIA 95814-1280**  
**(916) 874-9039**

*BOARD OF DIRECTORS:*

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*BRITT FERGUSON, TREASURER/CONTROLLER*

For the Agenda of:  
September 25, 2018  
8:30 a.m.

To: Board of Directors  
Tobacco Securitization Authority of Northern California

From: Britt Ferguson  
Treasurer/Controller

Subject: Approval Of Minutes From Prior Meeting, Approval Of Fiscal Year 2018-19  
Recommended Budget, And Presentation Of Fiscal Year 2017-18 Audited Financial  
Report.

**RECOMMENDATIONS:**

That the Board of Directors of the Tobacco Securitization Authority of Northern California (the Authority) take the following actions:

- 1.) Approve the attached September 26, 2017 minutes
- 2.) Adopt the recommended Fiscal Year 2018-19 budget
- 3.) Receive and file the Fiscal Year 2017-18 audited financial report prepared by Vavrinek, Trine, Day & Company LLP

**BACKGROUND:**

On October 10, 2000, the Sacramento County Board of Supervisors approved Joint Exercise of Powers Agreements with the County of San Diego to create two joint powers authorities for the express purpose of facilitating a tobacco revenues securitization for each county. The County of San Diego approved the agreements on October 17, 2000. The Tobacco Securitization Authority of Northern California is the governmental entity that issued bonds on behalf of Sacramento County. The Tobacco Securitization Authority of Southern California issued bonds on behalf of San Diego County.

On August 23, 2001, the Authority issued its Tobacco Settlement Asset-Backed Bonds, Series 2001, in the amount of \$199,620,000 (2001 Bonds), and maturing in June 2041, to securitize anticipated revenues from the national Tobacco Litigation Settlement (TLS). This allowed the County to sell its entire revenue stream from the TLS payments, thereby shifting all of the risk of the receipt of TLS payments to investors, in exchange for a large up-front payment in the form of bond proceeds, which funded an Endowment Fund and funding for capital projects.

On December 6, 2005, the Authority issued its Tobacco Settlement Asset-Backed Bonds, Series 2005 Refunding, in the amount of \$255,486,288 (2005 Bonds), and maturing in June 2045. This issuance refunded the 2001 Bonds and provided an additional \$63,225,245 in bond proceeds for capital projects.

### **DISCUSSION:**

#### Prior Meeting Minutes

The September 27, 2017 minutes of the prior meeting presented to the Authority for approval as Attachment 1.

#### Authority Budget

The Authority must annually approve a budget for the costs related to administering the securitization. The proposed budget for Fiscal Year 2018-19 presented to the Board for adoption as Attachment 2. Fiscal Year 2018-19 recommended budget of \$112,000 represent the routine, ongoing expenses of the Authority, including credit monitoring costs, audit services, continuing disclosure services, trustee services, and miscellaneous financial services. Financing of these expenditures will be from previous years' unspent funds and the current year's allowed amount of administrative costs from securitization revenues, as permitted by the bond issuance documents.

#### Annual Audit

The Authority contracted with Vavrinek, Trine, Day & Company LLP, an independent outside audit firm, to audit the financial records of the Authority for the fiscal year ending June 30, 2018. The written independent auditor's report is presented as Attachment 3, and reflects an opinion that the financial statements present fairly, in all material respects, the financial position of the Authority as of June 30, 2018, in conformity with accounting principles generally accepted in the United States of America.

#### Tobacco Settlement Asset-Backed Bonds

Annual Tobacco Litigation Settlement (TLS) payments are sent directly to the Bond Trustee, without passing through the County, and the Bond Trustee uses these TLS funds to pay debt service on the 2005 Bonds. The amount of annual TLS payments has been sufficient to pay both the debt service and to fund the Authority's annual budget needs for administration of the 2005 Bonds, and is expected to remain sufficient. In any years that there are more funds than required to pay debt service and administration costs, the Bond Trustee makes accelerated principal payments on the 2005 Bonds,

Approval Of Fiscal Year 2018-19 Recommended Budget, And Presentation Of Fiscal Year 2017-18  
Audited Financial Report  
Page 3 of 3

which has occurred every year since the 2005 Bonds were issued. Debt service on the 2005 Bonds is payable only from annual TLS payments, and bondholders do not have recourse to the County of Sacramento for payment of this debt service.

Respectfully submitted,

BRITT FERGUSON  
Authority Treasurer/Controller

Attachments:

1. Minutes from September 26, 2017 Authority Meeting
2. Fiscal Year 2018-19 Budget Recommendation
3. Fiscal Year 2017-18 Audited Financial Report

cc: Kristen Yates, County Debt Officer

**MINUTES OF THE MEETING OF THE  
BOARD OF DIRECTORS OF THE  
TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA  
September 26, 2017**

The meeting of the Board of Directors of the Tobacco Securitization Authority of Northern California was called to order on September 26, 2017 at 8:47 a.m. in the American River Conference Room of the Sacramento County Board of Supervisors' Office, 700 H Street, Suite 2450, Sacramento.

Director Patrick Kennedy called the meeting to order.

Authority Board Secretary Florence Evans called roll and established a quorum.

Present: Supervisor Sue Frost (Sacramento), Supervisor Patrick Kennedy (Sacramento), Supervisor William Horn (San Diego)

Absent: None

Meeting attendees:

Britt Ferguson, Treasurer/Controller of the Authority

Robyn Drivon, County Counsel

Kristen Yates, County Debt Officer

Youa Xiong, County Executive Management Analyst

Ben Lamera, Sacramento County Treasurer-Auditor/Controller

Mark Aspesi, Senior Accounting Manager

Karlee Ransom, VTD (Authority's external auditor)

**1. Nomination of Member to the Northern Authority Board**

Director Kennedy moved to nominate Supervisor Sue Frost as member and chairperson, seconded by Director Horn and carried by unanimous vote of the Board.

**2. Approval of Minutes From Prior Meeting**

Director Kennedy moved to approve the minutes of the October 4, 2016 meeting as submitted, seconded by Director Horn and carried by unanimous vote of the Board.

**3. Approval of Fiscal Year 2017-18 Recommended Budget**

Director Kennedy moved to approve the Fiscal Year 2017-18 budget as submitted, seconded by Director Horn and carried by unanimous vote of the Board.

**4. Presentation of Fiscal Year 2016-17 Audited Financial Report**

Karlee Ransom, VTD External Auditor, reported a clean audit with no exceptions.

Received and filed; no Board action taken.

**5. Adjournment**

Director Kennedy moved to adjourn the meeting, seconded by Director Frost and carried by unanimous vote of the Board.

**Meeting adjourned at 8:52 a.m.**

**Respectfully submitted,**



**FLORENCE EVANS, Secretary  
Tobacco Securitization Authority  
of Northern California**

ATTACHMENT 2

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA  
FISCAL YEAR 2018-19 BUDGET REQUEST (FUND 062A)**

<b>Expenditure Description</b>	<b>Fiscal Year 2017-18 Actual</b>	<b>Fiscal Year 2018-19 Request</b>
<b>Administrative Services</b>		
Credit Monitoring-Moody's	10,000	10,000
Credit Monitoring-Standard & Poor's	10,000	10,000
Other Misc. Services/Contingency	14,530	20,000
<b>Accounting Services</b>		
Audit Services	5,772	6,500
Continuing Disclosure-BondLogistix	40,000	40,000
Trustee-Bank of New York	4,550	5,500
Treasury/Trustee Services	5,389	20,000
<b>Total Expenditures:</b>	<b>90,241</b>	<b>112,000</b>
<b>FY 2018-19 Financing Required:</b>		<b>112,000</b>

**TOBACCO SECURITIZATION AUTHORITY  
OF NORTHERN CALIFORNIA**

(A Component Unit of the  
County of Sacramento, California)

Independent Auditors' Reports,  
Basic Financial Statements, and  
Required Supplementary Information

For the Year Ended June 30, 2018



**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA  
FOR THE YEAR ENDED JUNE 30, 2018**

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**VAVRINEK, TRINE, DAY & CO., LLP**  
Certified Public Accountants

VALUE THE *difference*

## INDEPENDENT AUDITORS' REPORT

Board of Directors  
Tobacco Securitization Authority of Northern California  
Sacramento, California

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the governmental activities and each major fund of the Tobacco Securitization Authority of Northern California (Authority), a component unit of the County of Sacramento, California, as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

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

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

### ***Auditors' Responsibility***

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

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

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

## ***Opinions***

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Authority, as of June 30, 2018, and the respective changes in financial position, for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## ***Other Matters***

### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3–7 and 22, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated August 27, 2018, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Authority'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 the Authority's internal control over financial reporting and compliance.

*Vavrinick, Trine, Day & Co. LLP*

Sacramento, California  
August 27, 2018

## TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA MANAGEMENT'S DISCUSSION AND ANALYSIS

The Tobacco Securitization Authority of Northern California (Authority) is a public entity created by a Joint Exercise of Powers Agreement (Agreement) effective as of July 16, 2001, between Sacramento County (County) and San Diego County. A three-member board of directors, (the Board) made up of two members of the Sacramento County Board of Supervisors and one member from San Diego County, governs it. The Authority was created for the purpose of empowering the Authority to finance the payments to be received by the County from the nation-wide Tobacco Settlement Agreement (Payments) for such purposes, but not limited to, issuance, sale, execution and delivery of Bonds secured by those Payments or the lending of money based on thereof, or to securitize, sell, purchase or otherwise dispose of some or all of such Payments of the County.

The Authority is a public entity legally separate and apart from the County, and is considered a blended component unit of the County due to the operational relationship between the Authority and the County. The debts and liabilities of the Authority belong solely to it, and neither the Counties of Sacramento or San Diego are in any way responsible for those liabilities.

As management of the Authority, we offer readers of our financial statements this narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2018.

### **Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to the Authority's basic financial statements. The Authority's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the basic financial statements. This report also contains other required supplementary information in addition to the basic financial statements themselves.

**Government-Wide Financial Statements** – The *government-wide financial statements* are designed to provide readers with a broad overview of the Authority's finances, in a manner similar to a private sector business.

The *Statement of Net Position* presents information on all of the Authority's assets, deferred inflow of resources, liabilities and deferred inflow of resources with the difference reported as *net position*.

The *Statement of Activities* presents information showing how the Authority's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus revenues and expenses are reported in the statement for some items that will only result in cash flows in future fiscal periods.

The government-wide financial statements can be found on pages 8 and 9 of this report.

**Fund Financial Statements** – A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Authority, like other local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Fund financial statements report essentially the same functions as those reported in the government-wide financial statements. However, unlike the government-wide financial statements, fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate the comparison between governmental funds and government wide statements.

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The Authority adopts an annual appropriated budget for its General Fund. There is no annual appropriated budget for its Debt Service Fund. A budgetary comparison statement has been provided for the fund to demonstrate compliance with the budget.

The fund financial statements can be found on pages 10 and 11 of this report.

**Notes to the Basic Financial Statements** – The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the basic financial statements can be found on pages 12 through 21 of this report.

**Government-Wide Financial Analysis**

Net position may serve over time as a useful indicator of a government's financial position. Net position of the Authority was approximately (\$22.9) million at fiscal year-end 2017 and was approximately (\$24.77) million in the current year. In both years, the primary asset/deferred outflow of resources of the Authority (83%) is a receivable for future tobacco settlement revenues and the majority of the Authority's liabilities (99.6%) are the outstanding bonds. Both amounts will decrease in tandem as Tobacco Settlement collections are received and the bonds are paid. However, a portion of the debt consists of Capital Appreciation Bonds, and for the next few years they will actually increase in amount, increasing the outstanding debt during that time.

Deferred outflows of resources decreased by \$3,481,886 during the year ended June 30, 2018. This was a result of a decrease of \$3,053,516 in tobacco settlement rights and a decrease of \$428,370 in the deferred amount on refunding. Total liabilities decreased \$396,425 during the year ended June 30, 2018. The decrease was primarily a result of a principal payment in the amount of \$3,630,000 which was offset by \$118,841 in amortized bond discount and \$3,072,344 in accreted interest. Net position decreased by \$1,862,759 during the year ended June 30, 2018, compared to a decrease of \$2,978,607 during the year ended June 30, 2017. The decrease in net position is primarily the result of an increase in accreted interest related to the Capital Appreciation Bonds.

**Net Position – Governmental Activities**

	<u>2018</u>	<u>2017</u>
Current and other assets	\$ 29,517,351	\$ 28,294,649
Deferred outflows of resources	<u>205,415,372</u>	<u>208,897,258</u>
Long-term liabilities	258,713,825	259,153,000
Other liabilities	<u>987,300</u>	<u>944,550</u>
Total liabilities	<u>259,701,125</u>	<u>260,097,550</u>
Unrestricted net position (deficit)	<u>\$ (24,768,402)</u>	<u>\$ (22,905,643)</u>

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

**Changes in Net Position**

	<u>2018</u>	<u>2017</u>
General revenues:		
Use of money and property	\$ 228,492	\$ 76,458
Tobacco settlement revenues	<u>16,234,771</u>	<u>12,839,083</u>
Total general revenues	<u>16,463,263</u>	<u>12,915,541</u>
Program Expenses:		
Interest	\$ 11,480,390	\$ 11,525,753
Fiscal charges	3,773,288	1,482,254
Accreted interest	<u>3,072,344</u>	<u>2,886,141</u>
Total program expenses	<u>18,326,022</u>	<u>15,894,148</u>
Change in net position	(1,862,759)	(2,978,607)
Net position, beginning of year	<u>(22,905,643)</u>	<u>(19,927,036)</u>
Net position, end of year	<u>\$ (24,768,402)</u>	<u>\$ (22,905,643)</u>

**Governmental activities**

The Authority does not have business type activities and so the analysis presented above for the government-wide financial statements also represents an analysis of the Authority's governmental activities.

**Financial Analysis of the Authority's Governmental Funds**

As noted earlier, the Authority uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

For the year-ended June 30, 2018, the Authority reported ending fund balances of \$21.9 million compared to \$21.9 million as of June 30, 2017. Activities were limited to interfund transfers on the Authority's outstanding debt, (based on collections from the Tobacco Settlement by the Corporation), payment of principal and interest, banking costs, and other administrative expenses.

**General Fund Budgetary Highlights**

There were no changes in the original budget during the year. Pledged tobacco settlement proceeds and the subsequent transfers out were not budgeted as the amount the Authority eventually received was not known until actually received.

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

**Debt Administration**

Tobacco Settlement Asset-Backed Bonds, Series 2001 Bonds were originally issued August 16, 2001, for the purpose of allowing the Authority to finance and secure a specific level of receipts in lieu of the actual payments to be received by the County of Sacramento from the nation-wide Tobacco Settlement Agreement (the Payments). The settlement was based on a number of lawsuits by states and local governments against the various tobacco corporations to recover the cost of health and related other costs attributed to smoking. A Master Settlement Agreement was created among the impacted parties, which delineated the receipts the County would be entitled to receive from the settlement.

The Series 2005 Bonds are all issued as Turbo Term Bonds and are subject to payment from Sinking Fund Installments, if applicable. Turbo Redemptions occur when all excess revenues after the payment of operating expenses, interest, and rated principal are used to retire term bonds early in order of maturity. The Principal or Accreted Value of a Series 2005 Senior Bond must be paid by its stated Maturity Date to avoid an Event of Default under the Indenture. Under the Indenture, 100% of all Collections which are in excess of the requirements for, among other things, the periodic funding of Operating Expenses, Sinking Fund Installments, Turbo Term Bond Maturities, and replenishment of the Senior Liquidity Reserve Account are applied to the mandatory redemption of the Series 2005 Bonds at the principal amount or Accreted Value thereof on each Distribution Date in accordance with the Payment Priorities.

The proceeds will be used for two purposes: 1) the first series of bonds are for certain construction projects, and to purchase clean air refuse vehicles; and 2) the second series is an endowment to fund various county and community primarily health related activities.

On December 6, 2005, the Authority issued a second series of Tobacco Settlement Asset-Backed bonds totaling \$255,486,288. Proceeds of the financing, after issue discount and underwriter's discount, were \$248,983,008. From those proceeds, \$168,639,395 was placed in escrow to refund the outstanding Series 2001 indentured debt, \$15,750,127 was used to fund a liquidity reserve account, \$1,368,240 was used to pay for cost of issuance, and the remaining proceeds of \$63,225,245 was transferred to the Corporation.

The proceeds received by the Authority were loaned to the Corporation. The Corporation in turn agreed to make a grant of the funds to the County for one or more specific construction projects of benefit to the County or its residents.

- \$219,685,000 for three issues of Senior Current Interest (Turbo) Bonds. The first for \$45,825,000, issued at 97.107% of par with an interest rate of 4.75% with maturities in June 2023 and the last expected Turbo payment in 2015. The second is for \$87,290,000 issued at 98.116% of par with an interest rate of 5.375% with maturity in June 2038 and last expected Turbo payment in 2024. The third issue was for \$86,570,000 issued at 98.025% of par with an interest rate of 5% with a maturity of June 2045 and a last expected Turbo payment in 2028.
- \$12,468,721 for Senior Convertible Capital Appreciation (Turbo) Bonds. Face amount \$14,235,000 yield of 5.4% maturity in June 2027 with a last expected Turbo payment in 2017.
- \$11,674,044 for First Subordinate Capital Appreciation (Turbo) Bonds. Face amount \$115,975,000 yield of 5.9% maturity in June 2045 and last expected Turbo payment in 2030.
- \$11,658,523 for Second Subordinate Capital Appreciation (Turbo) Bonds. Face amount \$157,335,000 yield of 6.7%, maturity June 2045 and last expected Turbo payment in 2033.

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

During the year, the Authority's long-term liabilities decreased by a net amount of \$439,175 as a result of the current year amortization of the deferred bond discount totaling \$118,481 and the accretion of interest totaling \$3,072,344, offset by principal reduction of (\$3,630,000) due to a turbo redemption payment. The ending balance of the Authority's long-term liabilities at June 30, 2018 is \$258,713,825.

The current bond credit ratings issued by Moody's Investors Service for both the Series 2005 A-1 Senior Current Interest Bonds and the Series 2005 A-2 Senior Convertible Bonds are B2 and B3 respectively.

**Economic Factors and Next Year's Budget**

The bond covenants relating to the borrowing restrict the Authority's annual administrative budget to approximately \$199,000 per year. Bond rating services fees are estimated to be \$20,000. The other significant fee is \$40,000 for continuing disclosure services from Bond Logistix, LLC. Along with the annual budget of the Corporation (a blended component unit of the Authority) of approximately \$87,000, the total annual budget of the Authority is approximately \$112,000.

The bond repayment is subject to a debt repayment schedule and can be accelerated, dependent upon greater than expected receipts from the nation-wide Tobacco Settlement Lawsuit pool. The actual receipts are predicated upon U.S. cigarette sales (for the annual gross amount available for distribution) and certain demographic factors (which determine the amount any litigant receives). The current year receipts of settlement proceeds were adequate to allow for accelerated repayment of principal.

**Requests for Information**

This financial report is designed to provide a general overview of the Authority's finances for all those interested. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

Tobacco Securitization Authority of Northern California  
Attention: Kristen Yates  
700 H Street  
Sacramento, California, 95814



**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**  
**STATEMENT OF NET POSITION – GOVERNMENTAL ACTIVITIES**  
**JUNE 30, 2018**

	<u>Governmental Activities</u>
<b>ASSETS</b>	
Current assets:	
Cash and investments	\$ 22,009,539
Tobacco settlement revenues receivable	<u>7,507,812</u>
Total assets	<u>29,517,351</u>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>	
Tobacco settlement rights (net of accumulated amortization of \$39,592,618)	195,598,549
Deferred amount on refunding	<u>9,816,823</u>
Total deferred outflows of resources	<u>205,415,372</u>
<b>LIABILITIES</b>	
Current liabilities:	
Accounts payable	44,970
Accrued interest	942,330
Bonds payable	<u>3,975,000</u>
Total current liabilities	<u>4,962,300</u>
Noncurrent liabilities:	
Bonds payable	<u>254,738,825</u>
Total liabilities	<u>259,701,125</u>
<b>NET POSITION</b>	
Unrestricted	<u>(24,768,402)</u>
Total net position (deficit)	<u>\$ (24,768,402)</u>

See accompanying notes to the basic financial statements.

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA  
 STATEMENT OF ACTIVITIES – GOVERNMENTAL ACTIVITIES  
 FOR THE YEAR ENDED JUNE 30, 2018**

	<u>Governmental Activities</u>
PROGRAM EXPENSES	
Interest and fiscal charges	\$ <u>18,326,022</u>
Total program expenses	<u>18,326,022</u>
GENERAL REVENUES	
Use of money and property	228,492
Tobacco settlement revenue	<u>16,234,771</u>
Total general revenues	<u>16,463,263</u>
Change in net position	<u>(1,862,759)</u>
Net position (deficit), beginning of year	<u>(22,905,643)</u>
Net position (deficit), end of year	<u>\$ (24,768,402)</u>

See accompanying notes to the basic financial statements.

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**  
**BALANCE SHEET – GOVERNMENTAL FUNDS**  
**JUNE 30, 2018**

	<u>General</u>	<u>Debt Service</u>	<u>Total Governmental Funds</u>
<b>ASSETS</b>			
Cash and investments	\$ 534,336	\$ 21,475,203	\$ 22,009,539
Tobacco settlement revenues receivable	<u>7,507,812</u>		<u>7,507,812</u>
Total assets	<u>\$ 8,042,148</u>	<u>\$ 21,475,203</u>	<u>\$ 29,517,351</u>
<b>LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND FUND BALANCES</b>			
Liabilities:			
Account payable	\$ 44,970		\$ 44,970
Total liabilities	<u>44,970</u>		<u>44,970</u>
Deferred inflows of resources			
Unavailable tobacco settlement revenue	<u>7,507,812</u>		<u>7,507,812</u>
Total deferred inflows of resources	<u>7,507,812</u>		<u>7,507,812</u>
Fund balances:			
Restricted for:			
Debt service reserve fund		15,791,502	15,791,502
Debt service payment		5,683,701	5,683,701
Operating expenses per bond indenture	<u>489,366</u>		<u>489,366</u>
Total fund balances	<u>489,366</u>	<u>21,475,203</u>	<u>21,964,569</u>
Total liabilities, deferred inflows of resources and fund balances	<u>\$ 8,042,148</u>	<u>\$ 21,475,203</u>	<u>\$ 29,517,351</u>

Amounts reported in the statement of net position are different because:

Total fund balance – total governmental funds: \$21,964,569

Deferred outflows of resources, such as tobacco settlement rights, and deferred amounts on refunding are not current financial resources and therefore are not reported in the governmental funds:

Tobacco settlement rights	195,598,549
Deferred amount on refunding	9,816,823

Revenue is classified as deferred inflows of resources in the governmental funds when it is not received within the Authority's period of availability and considered to be available. The availability criteria does not apply to the government-wide statements and therefore, the revenue is recognized.

Tobacco settlement revenue	7,507,812
----------------------------	-----------

Long-term liabilities, including bonds payable and related discount are not due and payable in the current period and therefore are not reported in the governmental funds. Interest on long-term debt is not accrued in governmental funds, but rather is recognized as an expenditure when it is due. Accrued interest is reported in the statement of net position:

Bonds payable	\$ (232,526,288)	
Bond discount	3,189,128	
Accreted interest	(29,376,665)	
Accrued interest payable	<u>(942,330)</u>	
		<u>(259,656,155)</u>
<b>TOTAL NET POSITION OF GOVERNMENTAL ACTIVITIES</b>		<u>\$ (24,768,402)</u>

See accompanying notes to the basic financial statements.

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA  
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES –  
GOVERNMENTAL FUNDS  
FOR THE YEAR ENDED JUNE 30, 2018**

	<u>General</u>	<u>Debt Service</u>	<u>Total Governmental Funds</u>
<b>REVENUES</b>			
Use of money and property	\$ 4,927	\$ 223,565	\$ 228,492
Tobacco settlement revenues	<u>15,015,624</u>		<u>15,015,624</u>
Total revenues	<u>15,020,551</u>	<u>223,565</u>	<u>15,244,116</u>
<b>EXPENDITURES</b>			
Debt service:			
Principal		3,630,000	3,630,000
Interest and fiscal charges	<u>167,142</u>	<u>11,480,390</u>	<u>11,647,532</u>
Total expenditures	<u>167,142</u>	<u>15,110,390</u>	<u>15,277,532</u>
Excess (deficiency) of revenues over (under) expenditures	14,853,409	(14,866,825)	(33,416)
<b>OTHER FINANCING SOURCES (USES)</b>			
Transfers in		14,841,958	14,841,958
Transfers out	<u>(14,841,958)</u>		<u>(14,841,958)</u>
Total other financing sources (uses)	<u>(14,841,958)</u>	<u>14,841,958</u>	
Change in fund balances	11,451	(44,867)	(33,416)
Fund balances, beginning of year	<u>477,915</u>	<u>21,520,070</u>	<u>21,997,985</u>
Fund balances, end of year	<u>\$ 489,366</u>	<u>\$ 21,475,203</u>	<u>\$ 21,964,569</u>
Amounts reported in the statement of activities are different because:			
Net change in fund balance – total governmental funds:			\$ (33,416)
Tobacco settlement revenues are not considered "available" revenues, they are reported as deferred inflows of resources in the governmental funds. Unavailable revenues increased by this amount during the year.			1,219,147
The repayment of principal of long-term debt consumes the current financial resources of governmental funds, however, this transaction has no effect on net position.			3,630,000
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.			
Change in accrued interest		\$ (5,779)	
Change in accreted interest		(3,072,344)	
Amortization of deferred amount on refunding		(428,370)	
Amortization of bond discount		(118,481)	
Amortization of tobacco settlement rights		<u>(3,053,516)</u>	<u>(6,678,490)</u>
<b>CHANGE IN NET POSITION OF GOVERNMENTAL ACTIVITIES</b>			<u>\$ (1,862,759)</u>

See accompanying notes to the basic financial statements.

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2018**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Reporting Entity

The Tobacco Securitization Authority of Northern California (the Authority) was created by a Joint Exercise of Powers Agreement (the Agreement) effective as of July 16, 2001, between Sacramento County (the County) and San Diego County. A three-member board of directors, made up of two members of the Sacramento County Board of Supervisors and one member from San Diego County Board of Supervisors, governs the Authority. The Authority was created for the purpose of empowering the Authority to finance the payments to be received by the County of Sacramento from the nation-wide Tobacco Settlement Agreement (the Payments) for such purposes, but not limited to, issuance, sale, execution and delivery of Bonds secured by those Payments or the lending of money based on thereof, or to securitize, sell, purchase, or otherwise dispose of some or all of such Payments of the County. The Authority meets the criteria set forth in accounting principles generally accepted in the United States of America as a blended component unit of the County because the Authority is providing services solely to the County.

The Sacramento County Tobacco Securitization Corporation (the Corporation), a nonprofit public benefit organization as defined by Internal Revenue Code Section 501(c)(3), was incorporated August 21, 2001, and is a blended component unit of the Authority. The purpose of the Corporation is to purchase from the County its rights to receive tobacco settlement revenues, borrow monies necessary to pay the purchase price for such tobacco settlement revenues, secure such borrowing with the tobacco settlement revenues, receive tobacco settlement revenues and residual payments regarding tobacco settlement revenues of the County, and invest monies, make expenditures and otherwise distribute money for the benefit of the County and its residents. The Corporation meets the criteria set forth in accounting principles generally accepted in the United States of America for inclusion as a blended component unit of the Authority because of the financial benefit/burden relationship of their activities. Audited financial statements of the Corporation may be obtained by writing to the County of Sacramento, 700 H Street, Sacramento, California 95814.

Basis of Presentation and Accounting

*Government-Wide and Fund Financial Statements*

The Statement of Net Position and Statement of Activities display information about the overall Authority. Eliminations have been made to minimize the double counting of internal activities.

The Statement of Net Position is designed to display the financial position of the government.

The Statement of Activities presents a comparison between direct expenses, which are offset by general revenues for the Authority's governmental activity. Direct expenses are those that are specifically associated with the Authority. Program revenues may include 1) charges paid by the recipients of goods or services offered by the programs, and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program.

Revenues that are not classified as program revenues, including all tobacco settlement revenue and interest, are presented instead as general revenues.

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2018**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

The government-wide financial statements use the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses when the liability is incurred. When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as they are needed.

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under the current financial resources concept, sources, and uses of financial resources, including capital outlays, bond proceeds, and debt retirements are reflected in operations. Resources not available to finance expenditures and commitments of the current period are recognized as a deferred inflow of resources or a restriction of fund balance. Governmental funds are maintained on the modified accrual basis of accounting wherein revenues are recognized in the accounting period in which they become measurable and available. Because annual tobacco settlement revenues are based on cigarette sales from the preceding calendar year, the Authority accrues an estimate of tobacco settlement revenues derived from sales from January 1 to the fiscal year-end. Tobacco settlement revenues not received within sixty days after the end of the year are reported as deferred inflows of resources as they are not available.

The Authority reports the following major governmental funds:

- The *General Fund* is used to account for all revenues and expenditures necessary to carry out the basic governmental activities of the Authority that are not accounted through the Debt Service Fund. For the Authority, the General Fund includes such activities as the collection of tobacco settlement revenues, the administration of the bond debt and proceeds, and the transferring of funds to the Debt Service Fund necessary to make required debt service payments. The Corporation has been blended with the activity of the General Fund.
- The *Debt Service Fund* is used to account for the principal and interest payments on the Authority's Tobacco Settlement Asset Backed Bonds and the receipt of funds from the General Fund necessary to meet annual debt service requirements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amount reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Deferred Outflows of Resources

In addition to assets, the statement of net position reports a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period(s) and so will not be recognized as an expense/expenditure until then.

Fund Balance Reporting

When expenditures are incurred for purposes for which both restricted and unrestricted (committed, assigned, or unassigned) fund balances are available, the Authority's policy is to first apply restricted fund balance. When expenditures are incurred for purposes for which committed, assigned, or unassigned fund balances are available, the Authority's policy is to first apply committed fund balance, then assigned fund balance, and finally unassigned fund balance.

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2018**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Only the Board has the authority to assign unrestricted fund balance amounts where the Authority's intent is for those amounts to be used for specific purposes.

The Board of Directors, as the highest level of decision-making authority, may commit fund balance for specific purposes pursuant to constraints imposed by formal actions taken, such as a resolution. These committed amounts cannot be used for any other purpose unless the Board removes or changes the specified use through the same type of formal action taken to establish the commitment. Board action to commit fund balance needs to occur within the fiscal reporting period; but the amount, if any, which will be subject to the constraint, may be determined at a subsequent period.

Deficit Net Position

As of June 30, 2018, the Authority's Governmental Activities had deficit net position of (\$24,768,402). This deficit in net position represents the annual accretion of interest on the First and Second Subordinate Capital Appreciation (Turbo) Bonds with final maturity dates of June 2045. The deficit in net position will continue to increase annually as long as the projected Tobacco Settlement Revenues, as described in the Official Statement, continue to decline.

Fair Value Measurement

The Authority categorizes the fair value measurements of its investments based on the hierarchy established by generally accepted accounting principles. The fair value hierarchy, which has three levels, is based on the valuation inputs used to measure an asset's fair value: Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

**NOTE 2 – CASH AND INVESTMENTS**

The Authority maintains a separate checking account in the name of the Authority. At June 30, 2018, the reported amount of the Authority's deposits was \$171,321. Of the bank balance, \$171,321 was covered by Federal depository insurance. The Corporation maintains a separate checking account in the name of the Corporation. At June 30, 2018, the reported amount of the Corporation's deposits was \$98,115. Of the bank balance, \$98,115 was covered by Federal depository insurance.

Cash and investments at June 30, 2018, are held by the trustee. All cash and investments at June 30, 2018, are stated at fair value.

Cash and investments are comprised of the following at June 30, 2018:

Deposits held by trustee	\$ 269,436
Investments held by trustee	<u>21,740,103</u>
Total Cash and Investments	<u>\$ 22,009,539</u>

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2018**

**NOTE 2 – CASH AND INVESTMENTS (Continued)**

Investments

Money held by the indenture trustee may be invested in eligible investments as directed by the bond indenture. Eligible investments mean any of the following:

- a) bonds, notes, and other evidences of indebtedness of the State, and securities unconditionally guaranteed as to the payment of principal and interest by the State;
- b) revenue bonds, revenue notes, or other evidences of indebtedness issued by agencies or authorities of the State;
- c) bonds, notes, and other evidences of indebtedness of any county, city, district, authority or other public body in the State;
- d) bonds, notes, and other obligations of the United States, and securities unconditionally guaranteed as to the payment of principal and interest by the United States with a remaining maturity not greater than five years, except in the case of savings bonds, which may have a longer maturity;
- e) savings accounts, time deposits, or certificates of deposit in any bank, savings bank, trust company, savings and loan association, or credit union authorized to do business as such in the State;
- f) defeasance collateral;
- g) direct obligations of, or obligations guaranteed as to timely payment of principal and interest by, the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, Federal Home Loan Bank, the Federal Farm Credit System, or the Tennessee Valley Authority;
- h) demand and time deposits in or certificates of deposit of, or bankers' acceptances issued by, any bank or trust company, savings and loan association, or savings bank, payable on demand or on a specified date no more than three months after the date of issuance thereof, if such deposits or instruments are rated at least A-1+ by S&P, P-1 by Moody's and F1 by Fitch;
- i) certificates, notes, warrants, bonds, obligations, or other evidences of indebtedness of a State or a political subdivision thereof, rated by each rating agency maintaining a rating thereon, in one of its three highest ratings categories;
- j) commercial, or finance company paper that is rated A-1 by S&P, P-1 by Moody's and F1 by Fitch, if rated by Fitch;
- k) repurchase obligations rated at least A-1+ by S&P, P-1 by Moody's and F1 by Fitch (if payable on demand or on a specified date no more than three months after the date of issuance), or rated by each rating agency maintaining a rating thereon in one of its two highest long term rating categories;
- l) corporate securities rated at least A-1+ by S&P, P-1 by Moody's and F1 by Fitch, if rated by Fitch;
- m) taxable or tax-exempt money market funds which funds are regulated investment companies;
- n) investment agreements or guaranteed investment contracts rated, or with any financial institution or corporation whose senior long-term debt obligations are rated, or guaranteed by a financial institution whose senior long-term debt obligations are rated, at the time such agreement or contract is entered into, by each rating agency maintaining a rating thereon in one of its three highest rating categories;
- o) that certain investment agreement for funds held in the senior liquidity reserve account, dated the closing date, among Bayerische Landesbank, acting through its New York branch, the issuer and the trustee; and
- p) other obligations or securities that are non-callable and that are acceptable to each rating agency;

Provided that eligible investments shall not include any obligations of the County.



**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2018**

**NOTE 2 – CASH AND INVESTMENTS (Continued)**

Custodial Credit Risk

This is the risk that in the event a financial institution or counterparty fails, the Authority would not be able to recover the value of its deposits and investments. The California Government Code requires that a financial institution secure deposits made by state and local governments by pledging securities in an undivided collateral pool held by a depository regulated by the public agencies. The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure state and local government deposits by pledging first trust deed mortgage notes having a value of 150% of the secured deposits. Accordingly, the Authority's deposits are not exposed to custodial credit risk.

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. The policy, per the bond indenture, is that investments shall mature or are so redeemable in an amount sufficient to make payments as required by the indenture. Information about the sensitivity of the fair values of the Authority's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the Authority's investments by maturity.

<u>Investment Type</u>	<u>Credit Rating (Moody's/S&amp;P)</u>	<u>Maturity</u>	<u>NAV</u>
		<u>Under 30 days</u>	<u>as of June 30, 2018</u>
Investments held by trustee:			
Money market mutual funds	AAA-mf/AAAm	\$ <u>21,740,103</u>	\$ <u>21,740,103</u>

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.

The Authority's policy is dictated by the bond indenture as noted previously. The previous table presents those ratings for the Authority's investments.

Fair Value Measurements

The Authority categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets, Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. As of June 30, 2018, the Authority held no individual investments. All funds are invested in money market funds.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Authority's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2018**

**NOTE 2 – CASH AND INVESTMENTS (Continued)**

The valuation of 2a7 Money Market Mutual funds held by the Authority is at one-dollar net asset value (NAV) per share. The total fair value of these at June 30, 2018 was \$21,740,103, with \$0 unfunded commitments. The redemption frequency is daily and redemption notice period of intra-daily. This type of investment primarily invests in short term U.S. Treasury and government securities (including repurchase agreements collateralized by U.S. Treasury and government agency securities).

**NOTE 3 – LONG-TERM DEBT**

On December 1, 2005, the Authority issued \$255,486,288 of refunding bonds to provide resources to purchase U.S. Government State and Local Government Series securities that were placed in an irrevocable trust for the purpose of generating resources for all future debt service payments of \$176,080,000 to refund the Series 2001 Bonds and to provide additional funds to be used by the County on selected projects. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the Statement of Net position. The Series 2005 Bonds are payable solely from pledged Tobacco Settlement Revenues and interest earnings on amounts on deposit.

The Authority issued \$219,685,000 for the Series 2005A-1 Senior Current Interest Bonds. The first Series A-1 Term Bonds are for \$45,825,000 with an interest rate of 4.75%, final early (Turbo) redemption date of June 1, 2015, with a due date of June 1, 2023. The second Series A-1 Term Bonds are for \$87,290,000 with an interest rate of 5.375%, final Turbo redemption date of June 1, 2024, with a due date of June 1, 2038. The third Series A-1 Term Bonds are for \$86,570,000 with an interest rate of 5.5%, final Turbo redemption date of June 1, 2028, with a due date of June 1, 2045.

The Authority issued \$12,468,721 for the Series 2005A-2 Senior Convertible Bonds with an interest rate of 5.4%, final Turbo redemption date of June 1, 2017, with a due date of June 1, 2027.

The Authority issued \$11,674,044 for the Series 2005B First Subordinate Capital Appreciation Bonds with an interest rate of 5.9%, final Turbo redemption date of June 1, 2030, with a due date of June 1, 2045.

The Authority issued \$11,658,523 for the Series 2005C Second Subordinate Capital Appreciation Bonds with an interest rate of 6.7%, final Turbo redemption date of June 1, 2033, with a due date of June 1, 2045.

Future debt service requirements at June 30, 2018, are as follows:

<u>Years Ended June 30,</u>	<u>Principal</u>	<u>Interest</u>
2019	\$ 3,975,000	\$ 11,307,965
2020	4,080,000	11,119,153
2021	4,325,000	10,925,353
2022	4,980,000	10,719,915
2023	5,400,000	10,483,365
2024-2028	25,983,721	49,843,618
2029-2033	31,130,000	40,490,750
2034-2038	42,645,000	30,967,325
2039-2043	58,035,000	17,817,250
2044-2045	<u>51,972,567</u>	<u>252,352,058</u>
Total	<u>\$ 232,526,288</u>	<u>\$ 446,026,751</u>

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2018**

**NOTE 3 – LONG-TERM DEBT (Continued)**

The following summarizes the long-term debt activity during the year:

	Balance July 1, 2017	Additions	Retirements	Balance June 30, 2018	Due Within One Year
Tobacco bonds payable	\$ 236,156,288		\$ (3,630,000)	\$ 232,526,288	\$ 3,975,000
Accreted interest	26,304,321	\$ 3,072,344		29,376,665	
Less Deferred Amounts:					
Bond discount	(3,307,609)		118,481	(3,189,128)	
Governmental Activities – Long Term Debt	<u>\$ 259,153,000</u>	<u>\$ 3,072,344</u>	<u>\$ (3,511,519)</u>	<u>\$ 258,713,825</u>	<u>\$ 3,975,000</u>

Accreted Interest

The accreted interest balance at June 30, 2018, represents accreted interest on the 2005A-2 Senior Convertible Bonds, 2005B Capital Appreciation Bonds and 2005C Capital Appreciation Bonds, originally issued for \$12,468,721, \$11,674,044, and \$11,658,523, respectively. Total unaccreted interest totaled \$222,367,048 at June 30, 2018.

**NOTE 4 – TOBACCO SETTLEMENT RIGHTS**

In November 1998, 46 states (including California), six other United States jurisdictions and participating cigarette manufactures entered into a Master Settlement Agreement (MSA) in settlement of certain cigarette smoking litigation. The MSA calls for the cigarette manufacturers to make annual payments to the settling states, beginning in 2000, and continuing in perpetuity. The State of California (State) entered into a separate Memorandum of Understanding (MOU) with all California counties and certain affected cities regarding the distribution and use of the State's share of Tobacco Settlement Revenues (TSRs). The MOU calls for 45% of the State's allocation to be distributed to the counties and certain affected cities based on population.

During the year ended June 30, 2002, the County entered into a purchase and sales agreement with the Sacramento County Tobacco Securitization Corporation (Corporation), a separate legal entity, whereby the County sold its rights, title, and interest in, to, and under the MSA and the MOU to the Corporation in exchange for cash consideration of \$171,965,922. At the same time, the Corporation also entered into a loan agreement, with the Authority, to borrow the funds necessary to purchase those rights from the County. In return, the Corporation is obligated to pay all TSRs it receives to the Authority. The obligation to the Authority is limited to the Corporation's interest in the Tobacco Settlement Rights.

During the year ended June 30, 2006, the Corporation was able to borrow an additional \$63,225,245 from the Authority. These funds were granted by the Corporation to the County in accordance with a grant agreement dated November 15, 2005.

The amortized Tobacco Settlement Rights was \$195,598,549 at June 30, 2018.

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2018**

**NOTE 5 – CONTINGENCIES AND CONCENTRATION OF RISK**

The Corporation purchased the County's rights, title, and interest in future TSRs. The Corporation financed the purchase of future TSRs through a loan agreement with the Authority. In return, the Corporation is obligated to pay all TSRs it receives to the Authority. The Authority has issued bonds payable primarily from pledged TSRs to be received from the Corporation. There are a number of risks associated with receipts of such TSRs, including litigation affecting the participating manufacturers and possible bankruptcy as a result thereof, increased growth of non participating manufacturer's market share, a decline in cigarette consumption materially beyond forecasted levels, reduction in investment earnings due to unforeseen market conditions, and other future adjustments to the calculation of the TSRs.

The Authority's financial existence is contingent upon receiving the TSRs from the Corporation. The risk of non-collection of the TSRs is considered remote; however, no assurance can be given as to the timing of the collections of TSRs. No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2005 Bonds will be as assumed, or that the other assumptions underlying the bond structuring assumptions, including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the bond structuring assumptions, the amount of TSRs available to make Turbo Redemption Payments will be affected and the resulting weighted average lives of the Turbo Term Bonds will vary. Any reinvestment risks from faster amortization or extension risks from slower amortization of the Series 2005 Term Bonds than anticipated will be borne entirely by the Holders of the Turbo Term Bonds. In addition, future increases in the rate of inflation above 3% per annum in the absence of other factors would materially shorten the life of the Series 2005 Bonds. No assurance can be given that these structuring assumptions, upon which the projections of the Series 2005 Bonds Turbo Redemptions are based, will be realized.

In February 2014, the Authority's Series 2005 A-2 Senior Convertible Bonds were upgraded from Caa1 to B3 by Moody's Investors Service. In July 2016, the Authority's Series 2005 A-1 Senior current Interest Bonds were upgraded from B3 to B2 by Moody's Investors Service.

**NOTE 6 – RISK MANAGEMENT**

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

During the year ended June 30, 2018, the Authority did not reduce insurance coverage from coverage levels in place as of June 30, 2017. No settlements have exceeded coverage levels in place during 2016, 2017, and 2018.

**NOTE 7 – FUTURE ACCOUNTING PRONOUNCEMENTS**

The Governmental Accounting Standards Board (GASB) releases new accounting and financial reporting standards which may have a significant impact on the Authority's financial reporting process. Future new standards which may impact the Authority include the following:

GASB Statement No. 83 – In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*. This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2018**

**NOTE 7 – FUTURE ACCOUNTING PRONOUNCEMENTS (Continued)**

should recognize a liability based on the guidance in this Statement. This Statement also requires disclosure of information about the nature of a government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018, or the 2018-2019 fiscal year. Earlier application is encouraged. The Authority has not determined the effect of the statement.

GASB Statement No. 84 - In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018, or the 2019-2020 fiscal year. The Authority has not determined the effect of the statement.

GASB Statement No. 87 – In June 2017, GASB issued Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The Statement is effective for the reporting periods beginning after December 15, 2019, or 2020-2021 fiscal year. The Authority has not determined the effect of the statement.

GASB Statement No. 88 – In April 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*. The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. This Statement is effective for reporting periods beginning after June 15, 2018, or 2018-2019 fiscal year. The Authority has not determined the effect of the statement.

GASB Statement No. 89 – In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*. The objectives of this Statement are to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and to simplify accounting for interest cost incurred before the end of a construction period. This Statement is effective for reporting periods beginning after December 15, 2019, or 2020-2021 fiscal year. The Authority has not determined the effect of the statement.

**REQUIRED SUPPLEMENTARY INFORMATION**

**TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA  
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE – BUDGET  
AND ACTUAL – GENERAL FUND  
FOR THE YEAR ENDED JUNE 30, 2018**

	Original Budget	Final Budget	Actual Amount	Variance Final Budget Positive (Negative)
<b>REVENUES</b>				
Use of money and property	\$	\$	4,927	\$ 228,492
Tobacco settlement revenues			<u>15,015,624</u>	<u>15,015,624</u>
Total revenues			<u>15,020,551</u>	<u>15,244,116</u>
<b>EXPENDITURES</b>				
Debt service:				
Interest and fiscal charges	<u>199,000</u>	<u>199,000</u>	167,412	<u>31,588</u>
Excess of revenues (deficiency) over (under) expenditures	(199,000)	(199,000)	14,853,409	15,052,409
<b>OTHER FINANCING USES</b>				
Transfer out			<u>(14,841,958)</u>	<u>(14,841,958)</u>
Change in fund balance	(199,000)	(199,000)	11,451	210,451
Fund balance, beginning of year	<u>252,188</u>	<u>252,188</u>	<u>477,915</u>	
Fund balance, end of year	<u>\$ 53,188</u>	<u>\$ 53,188</u>	<u>\$ 489,366</u>	<u>\$ 210,451</u>

**Note to Required Supplementary Information:**

The Authority is required to prepare a budget each year for its general fund based on estimates of revenues and expected expenditures. The budget is adopted on a basis consistent with accounting principles generally accepted in the United States of America. All changes to the budget during the year are reflected in these financial statements and require the approval of the governing board. All unencumbered annual appropriations lapse at the end of each fiscal year.

The Authority does not budget for Tobacco Settlement Revenues (TSRs) and debt service expenditures because no assurance can be given as to the timing of the collections of TSRs and that actual cigarette consumption in the United States will be as projected. Additionally, no assurance can be given that the assumptions underlying the bond structuring assumptions, including adjustments and offsets, will not apply to payments due under the Master Settlement Agreement, will be consistent with future events.

## **OTHER REPORT**





VAVRINEK, TRINE, DAY & CO., LLP  
Certified Public Accountants

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

Board of Directors  
Tobacco Securitization Authority of Northern California  
Sacramento, 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 governmental activities and each major fund of the Tobacco Securitization Authority of Northern California (the Authority), a component unit of the County of Sacramento, California, as of and for the year ended June 30, 2018 and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated August 27, 2018.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Authority'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 the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

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

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

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Authority's financial statements are free from 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 the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Vavrinik, Trine, Day & Co. LLP*

Sacramento, California  
August 27, 2018