



County of Santa Cruz

COUNTY ADMINISTRATIVE OFFICE

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SUSAN MAURIELLO, J.D., COUNTY ADMINISTRATIVE OFFICER

March 6, 2014

AGENDA: March 11, 2014

BOARD OF DIRECTORS

Santa Cruz County Public Financing Authority
701 Ocean Street
Santa Cruz, California 95060

2014 REFUNDING CERTIFICATES OF PARTICIPATION ISSUANCE

Dear Members of the Board:

Elsewhere on today's agenda, the Board of Supervisors is being asked to take various actions to facilitate the acceptance of a Board of State and Community Corrections SB 1022 Adult Local Criminal Justice Program (SB 1022 Program) grant in the amount of \$24.6 million to construct justice facilities at the Rountree Medium Detention site. This letter to the Santa Cruz County Public Financing Authority (PFA) is a companion letter outlining those actions required by the PFA.

In order to make the site available to the State for them to issue lease revenue bonds, it is necessary to provide clear title to the land under the construction site. Currently, the Rountree property has been used as security for various projects including the construction of the medium security detention facility and others.

The County used Rountree to secure the following outstanding lease revenue bonds and CERTS by entering into lease agreements with the Santa Cruz County PFA.

- Certificates of Participation, Series 1996;
- Lease Revenue Bonds, Series 2001B;
- Refunding Certifications of Participation, Series 2005, which refunds the series 1995A Bonds;
- Certifications of Participation, Series 2006; and
- Certifications of Participation, Series 2008.

To facilitate the release of Rountree from the various lease agreements, your Board must take the following actions:

1. Amend the lease agreements for the Series 2005, 2006, and 2008 CERTS;
2. Amend the lease agreement for the 1996 CERTS; and
3. Refinance the Series 2001B bonds.

2.

Lease Amendments

Amendments to provisions in the lease agreements in connection with the 2005, 2006 and 2008 CERTS require the substitution of an asset in order to release the Rountree property. These CERTS were secured by the Rountree and Water Street detention facilities when they were issued. Instead, it is proposed that the Blaine Street Women's Detention Facility be used as the substitute property for the Rountree site in these CERTS issues.

As Ambac Assurance Corporation (Ambac) provides bond insurance on the 2005 and 2006 CERTS, Ambac's consent is required for the substitution, which was provided on March 6, 2014.

The lease agreement related to the County's 1996 CERTS will also require an amendment to remove the security provided by Rountree. Under the agreement, a substitution of an asset is not required. This amendment requires the consent of National Public Finance Guarantee (National), as they are the bond insurer. National provided consent to the required amendment.

Refunding Certificates of Participation

The release of Rountree from the Series 2001B lease agreements will require a refunding of this transaction. The refunding of the Series 2001B bonds will not result in a significant debt service savings or additional costs, but will provide the necessary release of the lien on Rountree to meet the State requirements. Ambac is also the bond insurer on the Series 2001B bonds and, as required, has consented to the refunding.

The table below provides the estimated size of the refunding of the Series 2001B bonds with the County's 2014 Refunding Certification of Participation (2014 CERTS) including bond reserve funds and costs of issuance.

Reserve Fund	\$ 520,000
Costs of Issuance	168,000
Underwriting	30,000
Prepay 2001 Bonds	<u>5,382,000</u>
Total	\$ 6,100,000

The new financing requires a lease of an asset from the PFA to the County. Water Street and Blaine Street will secure the 2014 CERTS. The County's lease payments to the PFA are used as a revenue stream to secure repayment. The repayment of the 2014 CERTS will be the same term as the existing Series 2001B bonds maturing in August 2031. Final costs will be determined when the 2014 CERTS are sold, which is anticipated in mid-April. The closing is expected to occur within a 90-day window provided by the State to meet all award conditions.

A debt service reserve fund, which is equal to one year's debt service payment, is required to increase bondholders' security and make the 2014 CERTS more marketable. The debt service reserve fund is held by the trustee, earns interest, and is returned to the County to make the last payment on the 2014 CERTS.

The County's financial advisor, Harrell & Company, solicited underwriting proposals from Stifel, Nicolaus & Company, Inc (Stifel), Citigroup, Piper Jaffray, and Raymond James. After evaluation of the proposals submitted, Stifel was selected as underwriter. Their proposal provided considerable detail regarding the methods that would enable the County to obtain the lowest possible interest rates on the financing.

Authorizing Resolutions and Method of Sale

There are two resolutions required for financing approval by the Board of Directors of the PFA. In connection with the delivery of the 2014 CERTS, the PFA's resolution:

- ✓ authorizes the execution and delivery of a Trust Agreement, a Third Supplement to Sub-Sublease Agreement, an Amendment No. 1 to Sublease, an Escrow Agreement, and an Assignment Agreement.

In connection with the substitution of Blaine Street for the Rountree Facility, the PFA's resolution also:

- ✓ authorizes the execution and delivery of an Amendment No. 1 to 2005 Assignment Agreement, Amendment No. 1 to 2006 Assignment Agreement and Amendment No. 1 to 2008 Assignment Agreement.

In connection with the release of Rountree from the 1996 lease, the second PFA resolution authorizes the execution and delivery of a Second Amendment to Lease Agreement and Amendment No. 1 to Assignment Agreement.

Other actions required by the Board of Supervisors appear elsewhere on this agenda.

Recommendation

It is RECOMMENDED that your Board adopt the attached resolutions and approve the Preliminary Official Statement.

Very truly yours,



SUSAN A. MAURIELLO
Executive Director
Santa Cruz County Public Financing Authority

Attachments

cc: Auditor-Controller
County Counsel
Rutan & Tucker
Harrell & Company Advisors
Fulbright & Jaworski
Phil Wowak, Sheriff - Coroner

4.

**BEFORE THE BOARD OF DIRECTORS
OF THE SANTA CRUZ COUNTY PUBLIC FINANCING AUTHORITY,
COUNTY OF SANTA CRUZ, STATE OF CALIFORNIA**

RESOLUTION NO. _____

On the motion of Board Member _____
duly seconded by Board Member _____
the following resolution is adopted:

**A RESOLUTION OF THE BOARD OF DIRECTORS
OF THE SANTA CRUZ COUNTY PUBLIC
FINANCING AUTHORITY APPROVING CERTAIN
DOCUMENTS AND AGREEMENTS RELATING TO
A SUBSTITUTION OF PROJECT AND THE
ISSUANCE AND SALE OF 2014 REFUNDING
CERTIFICATES OF PARTICIPATION**

WHEREAS, the County of Santa Cruz ("County") has previously financed the acquisition and construction of various public facilities and properties from the proceeds of the \$11,900,000 Santa Cruz County Public Financing Authority Lease Revenue Bonds, 2011 Series B (the "2001 Bonds"), which 2001 Bonds are secured by lease payments payable by the County under a Lease Agreement dated as of July 15, 1995 and amended as of October 1, 2001 (as amended, the "Lease Agreement"), between the Santa Cruz County Public Financing Authority (the "Authority") as lessor and the County as lessee;

WHEREAS, the County has determined to refinance its obligations with respect to the Lease Agreement and the 2001 Bonds, and in connection therewith, release certain property leased pursuant to the Lease Agreement from the lien of the Lease Agreement;

WHEREAS, the County proposes to accomplish the refinancing from the proceeds of 2014 Refunding Certificates of Participation to be issued in the maximum principal amount of \$6,500,000 (the "Certificates"), and the Board of Directors wishes at this time to approve the execution, delivery and sale of the Certificates and all documents relating thereto;

WHEREAS, in order to secure payment of the Certificates, the County proposes to amend and supplement that certain Sub-Sublease Agreement described below; and

WHEREAS, the County and the Authority entered into a Sublease Agreement dated as of May 1, 2005 (the "Sublease Agreement") pursuant to which the County subleased certain real property in the County of Santa Cruz (the "Leased Property") to the Authority;

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WHEREAS, the County and the Authority entered into a Sub-Sublease Agreement dated as of May 1, 2005 (the "Sub-Sublease Agreement") pursuant to which the Authority sub-subleased the Leased Property back to the County;

WHEREAS, pursuant to an Assignment Agreement dated as of May 1, 2005 (the "2005 Assignment Agreement") by and between the Authority and The Bank of New York Trust Company, N.A., as predecessor-in-interest to the Bank of New York Mellon Trust Company, N.A., as trustee (the "Trustee") the Authority assigned certain of its rights under the Sub-Sublease Agreement in connection with the execution and delivery on June 1, 2005 of \$10,580,000 2005 Certificates of Participation;

WHEREAS, the County and the Authority entered into a First Supplement to Sub-Sublease Agreement dated as of August 1, 2006 (the "First Supplement");

WHEREAS, pursuant to an Assignment Agreement dated as of August 1, 2006 (the "2006 Assignment Agreement") by and between the Authority and The Bank of New York Trust Company, N.A., as predecessor-in-interest to the Trustee, the Authority assigned certain of its rights under the Sub-Sublease Agreement as amended and supplemented by the First Supplement in connection with the execution and delivery on August 17, 2006 of \$9,000,000 2006 Certificates of Participation;

WHEREAS, the County and the Authority entered into a Second Supplement to Sub-Sublease Agreement dated as of June 1, 2008 (the "Second Supplement");

WHEREAS, pursuant to an Assignment Agreement dated as of June 1, 2008 (the "2008 Assignment Agreement") by and between the Authority and the Trustee, the Authority assigned certain of its rights under the Sub-Sublease Agreement as amended and supplemented by the Second Supplement in connection with the execution and delivery on August 1, 2008 of \$4,625,000 2008 Certificates of Participation;

WHEREAS, the County and the Authority desire to provide for a deletion of a portion of the Leased Property (the "Former Project") from from the Sublease Agreement and Sub-Sublease Agreement as more particularly described in Exhibit A and to substitute other facilities for such Former Project (the "Substitute Project") pursuant to Section 6.5 of the Sub-Sublease Agreement;

WHEREAS, the conditions specified in Section 4.09 of the Lease Agreement and Section 6.5 of the Sub-Sublease Agreement to be satisfied prior to such deletion and substitution have been so satisfied; and

WHEREAS, in connection therewith, the County and the Authority find it desirable to amend the Sublease, the Sub-Sublease Agreement, the 2005 Assignment Agreement, the 2006 Assignment Agreement and the 2008 Assignment Agreement to release the Former Project and include the Substitute Project more particularly described in Exhibit B hereto.

NOW, THEREFORE, the Board of Directors of the Santa Cruz County Public Financing Authority does hereby resolve as follows:

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Section 1. Recitals. The above recitals are hereby declared to be true and correct.

Section 2. Approval of Financing Plan and Related Agreements.

The Board approves the refinancing plan described above. The agreements set forth below are hereby approved and the Executive Director, the Assistant Executive Director, and their written designees are hereby authorized and directed to execute and deliver the agreements set forth below, in the form currently on file with the Secretary of the Authority or with such amendments and modifications as approved by the Executive Director or the Assistant Executive Director, their signature being conclusive proof of said approval:

1. Amendment No. 1 to Sublease Agreement, dated as of March 1, 2014, by and between the County and the Authority (the "Amendment No. 1 to Sublease Agreement");

2. Third Supplement to Sub-Sublease, dated as of March 1, 2014, by and between the County and the Authority (the "Third Supplement to Sub-Sublease");

3. Amendment No. 1 to 2005 Assignment Agreement, dated as of March 1, 2014, by and between the Authority and The Bank of New York Mellon Trust Company, N.A. (the "Amendment No. 1 to 2005 Assignment Agreement");

4. Amendment No. 1 to 2006 Assignment Agreement, dated as of March 1, 2014, by and between the Authority and The Bank of New York Mellon Trust Company, N.A. (the "Amendment No. 1 to 2006 Assignment Agreement"); and

5. Amendment No. 1 to 2008 Assignment Agreement, dated as of March 1, 2014, by and between the Authority and The Bank of New York Mellon Trust Company, N.A. (the "Amendment No. 1 to 2008 Assignment Agreement");

6. Assignment Agreement, dated as of March 1, 2014, by and between the Authority and The Bank of New York Mellon Trust Company, N.A. (the "2014 Certificates Assignment Agreement").

7. Escrow Agreement, dated as of March 1, 2014, by and among the County of Santa Cruz (the "County"), the Authority and The Bank of New York Mellon Trust Company, N.A., as Escrow Bank (the "2001 Bonds Escrow Agreement").

The Chairperson, Vice-Chairperson, Executive Director or Assistant Executive Director is authorized and directed for and in the name and on behalf of the Authority to execute, and the Secretary is hereby authorized and directed to attest to, the final form of each of the foregoing documents. The schedule of lease payments attached to the Third Supplement to Sub-Sublease shall correspond to the payments of principal and interest represented by the Certificates, to be determined upon the sale thereof.

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Section 3. Official Actions. The Chairperson, the Vice-Chairperson, Executive Director, Assistant Executive Director, Secretary, Authority Counsel, and all other officers of the Authority are each authorized and directed in the name and on behalf of the Authority to make any and all assignments, certificates, requisitions, agreements, notices, consents, instruments of conveyance, warrants and other documents, which they or any of them might deem necessary or appropriate in order to consummate any of the transactions contemplated by the agreements and documents approved pursuant to this Resolution. Whenever in this resolution any officer of the Authority is authorized to execute or countersign any document or take any action, such execution, countersigning or action may be taken on behalf of such officer by any person designated by such officer to act on his or her behalf in the case such officer shall be absent or unavailable.

Section 4. Effective Date. This Resolution shall become effective upon its approval.

IN WITNESS WHEREOF, this Resolution is adopted and approved
the __ day of _____, 2014.

Chairperson of the Board of Directors of the
Santa Cruz County Public Financing
Authority

(SEAL)

ATTEST:

Secretary, Santa Cruz County Public Financing Authority

APPROVED AS TO FORM:

Bond Counsel

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8.

EXHIBIT A

The Former Project is comprised of (1) the County's main detention facility located on Water Street in the City of Santa Cruz ("Mail Jail") and (2) the County's medium detention facility located on Rountree Lane ("Rountree Facility") in the City of Watsonville. The portion of the Former Project to be deleted from the Sublease Agreement and Sub-Sublease Agreement is the Rountree Facility. The Main Jail will comprise a portion of the Substitute Property.

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EXHIBIT B

The Substitute Project is comprised of (1) the County's main detention facility located on Water Street in the City of Santa Cruz ("Mail Jail") and (2) the County's women's detention facility located on Blaine Street in the City of Santa Cruz, adjacent to the Main Jail.

10.

**BEFORE THE BOARD OF DIRECTORS
OF THE SANTA CRUZ COUNTY PUBLIC FINANCING AUTHORITY, STATE
OF CALIFORNIA**

RESOLUTION NO. _____

On the motion of Supervisor _____
duly seconded by Supervisor _____
the following resolution is adopted:

**RESOLUTION OF THE BOARD OF DIRECTORS OF
THE SANTA CRUZ COUNTY PUBLIC FINANCING
AUTHORITY APPROVING CERTAIN
DOCUMENTS RELATING TO THE REMOVAL OF
THE ROUNTREE JAIL INFIRMARY FROM THE
LIEN OF THE \$24,855,000 1996 REFUNDING
CERTIFICATES OF PARTICIPATION (CAPITAL
FACILITIES PROJECT)**

WHEREAS, in 1991 the Santa Cruz County Public Financing Authority (the "Authority") intended to assist the County of Santa Cruz (the "County") by financing the acquisition, construction and installation of certain real property and capital facilities, and in connection therewith had agreed to acquire, construct and install certain capital facilities in consideration of the County's leasing certain capital facilities to the Authority pursuant to that certain Site and Facilities Lease, dated as of June 1, 1991, by and between the County, as lessor, and the Authority, as lessee, and recorded June 13, 1991 in the Official Records of Santa Cruz County, as Instrument No. 36266, Book 4850, Page 719 (the "Original Site Lease"), as amended by that certain First Amendment to Site and Facilities Lease, dated as of December 1, 1996, by and among the Authority and the County (the "Site Lease Amendment") (collectively, the "Site Lease"); and

WHEREAS, the County had determined in 1996 that it was in the best interests of the County to provide for the refinancing of certain capital facilities, including the refinancing of the County's existing obligations under a prior financing of certain capital facilities; and

WHEREAS, the County had determined, and hereby represents that certain capital facilities serves an essential governmental purpose; and

WHEREAS the Authority and the County entered into that certain Lease Agreement, dated as of June 1, 1991 and recorded June 13, 1991 in the Official Records as Instrument No. 36267, Book 4850, Page 732 (the "Original Lease Agreement") pursuant to which the Authority subleased certain capital facilities back to the County; and

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WHEREAS, the Authority and the County amended the Original Lease Agreement pursuant to the First Amendment to Lease Agreement, dated as of December 1, 1996 (the "First Amendment to Lease Agreement") (the "Original Lease Agreement as amended by the First Amendment to Lease Agreement shall collectively be referred to as the "Lease Agreement"); and

WHEREAS, to the purpose of obtaining the moneys required for the financing and refinancing of certain capital facilities, the Authority assigned and transferred certain of its rights under the Lease Agreement to Wells Fargo Bank, National Association, as trustee under that certain Trust Agreement (the "Trust Agreement"), dated as of December 1, 1996, by and among the Authority, the County and The Bank of New York Mellon Trust Company, N.A., as successor in interest to Wells Fargo Bank, National Association (the "Trustee"), pursuant to the Assignment Agreement, as defined below, and the Trustee agreed to executed and deliver certificates of participation, each evidencing a direct, undivided fractional interest in the lease payments made by the County under the Lease Agreement, to provide the moneys required under the Trust Agreement to be deposited by the Authority; and

WHEREAS, in order to secure payment of the \$24,855,000 1996 Refunding Certificates of Participation (Capital Facilities Project) (the "1996 Certificates"), the County leased the Health Services Agency building and Rountree Jail Infirmary (the "Project") to the Authority pursuant to the Site Lease and the Authority leased back certain capital facilities to the County pursuant to the Lease Agreement; and

WHEREAS, the County and/or the Authority now propose to amend the Lease Agreement, the Assignment Agreement, and the Site Lease to release the Rountree Jail Infirmary property from the lien of the Lease Agreement, Site Lease and the Assignment Agreement (the "Release"); and

WHEREAS in connection with the Release, the County and/or the Authority propose to amend the Lease Agreement, the Site Lease and the Assignment Agreement dated as of June 1, 1991 as amended and supplemented by the First Amendment to Assignment Agreement dated as of December 1, 1996 (as amended, the "Assignment Agreement") to revise the description of certain capital facilities thereunder.

NOW, THEREFORE, BE IT RESOLVED by the Board of Directors of the Santa Cruz County Public Financing Authority as follows:

Section 1. Approval of Documents. The Board of Directors approves the Release of the Rountree Jail Infirmary from the Lease Agreement, the Site Lease, and the Assignment Agreement, all as defined herein, and formally removes the Rountree Jail Facility property from the lien of the Lease Agreement, the Site Lease, and the Assignment Agreement relating to the \$24,855,000 1996 Refunding Certificates of Participation (Capital Facilities Project). To that end, the Board of Directors approves the execution and delivery by the Executive Director or Assistant Executive Director of any and all documents determined to be necessary and appropriate by Special Counsel to implement and facilitate the Release, as defined herein, including, without limitation, a Second Amendment to Lease Agreement (Capital Facilities Project), a Second

Amendment to Site and Facilities Lease (Capital Facilities Project)[, and a Second Amendment to Assignment Agreement?] , all in a form to be approved by Special Counsel.

Section 2. Official Actions. The Chairperson, the Vice-Chairperson, Executive Director, Assistant Executive Director, Clerk, Chief Deputy Clerk, County Counsel, and all other officers of the Authority are hereby authorized and directed in the name and on behalf of the Authority to make any and all assignments, certificates, requisitions, agreements, notices, consents, instruments of conveyance, warrants and other documents, which they or any of them might deem necessary or appropriate in order to consummate the Release approved pursuant to this Resolution. Whenever in this resolution any officer of the Authority is authorized to execute or countersign any document or take any action, such execution, countersigning or action may be taken on behalf of such officer by any person designated by such officer to act on his or her behalf in the case such officer shall be absent or unavailable.

Section 3. Effective Date. This Resolution takes effect from and after the date of its passage and adoption.

PASSED AND ADOPTED at a regular meeting of the Board of Directors of the Santa Cruz County Public Financing Authority on the ___ day of _____, 2014, by the following called vote:

AYES:

NOES:

ABSENT:

ABSTAIN:

Chairperson, Board of Directors
Santa Cruz County Public Financing
Authority

ATTEST:

Chief Deputy Clerk, Santa Cruz County
Public Financing Authority

APPROVED AS TO FORM:

Special Counsel

This Preliminary Official Statement and the information contained herein are subject to completion or amendment. Under no circumstances shall this Preliminary Official Statement constitute an offer to sell or a solicitation of an offer to buy nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification of the securities laws of such jurisdiction.

NEW ISSUE RATINGS

BOOK-ENTRY-ONLY

Moody's: _____

S&P: _____

See "CONCLUDING INFORMATION - Ratings on the Certificates" herein).

In the opinion of Rutan & Tucker, LLP, Costa Mesa, California, Special Counsel, subject, however, to certain qualifications described in this Official Statement, under present law, interest with respect to the Certificates is excludable from gross income of the owners thereof for federal income tax purposes and is not included as an item of tax preference in computing the federal alternative minimum tax for individuals and corporations but interest with respect to the Certificates is taken into account, however, in computing an adjustment used in determining the federal alternative minimum tax for certain corporations. In addition, in the opinion of Special Counsel, interest with respect to the Certificates is exempt from personal income taxation imposed by the State of California. See "LEGAL MATTERS - Tax Matters" herein.

SANTA CRUZ COUNTY

STATE OF CALIFORNIA

\$6,100,000*

2014 REFUNDING CERTIFICATES OF PARTICIPATION

**Evidencing Direct, Undivided Fractional Interests of the Owners
Thereof in Lease Payments to Be Made by the
COUNTY OF SANTA CRUZ, CALIFORNIA
as Rental for Certain Property Pursuant to a
Sub-Sublease Agreement with the
SANTA CRUZ COUNTY PUBLIC FINANCING AUTHORITY**



Dated: Date of Delivery

Due: August 1, as Shown on the Inside Front Cover.

The cover page contains certain information for quick reference only. It is not a summary of the issue. Potential investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision. See "RISK FACTORS" herein for a discussion of special risk factors that should be considered in evaluating the investment quality of the Certificates.

The County of Santa Cruz (the "County") 2014 Refunding Certificates of Participation (the "Certificates") are being executed and delivered to (i) refinance certain obligations of the County, (ii) fund a reserve fund for the Certificates and (iii) pay the costs incurred in connection with the execution and delivery of the Certificates. The Certificates evidence direct, undivided fractional interests in supplemental lease payments ("Lease Payments") to be made by the County to the Santa Cruz County Public Financing Authority (the "Authority") as rental for certain real property and the improvements thereon (referred to herein as the "Leased Property") consisting of the County's Water Street and Blaine Street detention facilities pursuant to a Sub-Sublease Agreement, dated May 1, 2005 as previously amended and supplemented, including as amended and supplemented by a Third Supplement to Sub-Sublease dated as of March 1, 2014, each by and between the County and the Authority (as amended and supplemented, the "Lease Agreement"), as described herein. See "THE LEASED PROPERTY" herein. The County is required under the Lease Agreement to make Lease Payments in each fiscal year in consideration of the use and possession of the Leased Property from any source of available funds, including certain funds held under a trust agreement, as described herein, and insurance or condemnation awards, in an amount sufficient to pay the annual principal and interest due with respect to the Certificates, subject to abatement, as described herein. See "SOURCES OF PAYMENT FOR THE CERTIFICATES" and "RISK FACTORS" herein.

Interest represented by the Certificates is payable on August 1, 2014, and semiannually thereafter on February 1 and August 1 of each year until maturity or earlier prepayment. See "THE CERTIFICATES - General Provisions" and "THE CERTIFICATES - Prepayment" herein.

THE CERTIFICATES DO NOT CONSTITUTE AN OBLIGATION OF THE AUTHORITY OR THE COUNTY FOR WHICH THE AUTHORITY OR THE COUNTY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE AUTHORITY OR THE COUNTY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION. THE OBLIGATION OF THE COUNTY TO MAKE LEASE PAYMENTS UNDER THE LEASE AGREEMENT DOES NOT CONSTITUTE AN OBLIGATION OF THE COUNTY FOR WHICH THE COUNTY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE COUNTY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION. NEITHER THE CERTIFICATES NOR THE OBLIGATION OF THE COUNTY TO MAKE LEASE PAYMENTS CONSTITUTES AN INDEBTEDNESS OF THE AUTHORITY, THE COUNTY, THE STATE OF CALIFORNIA OR ANY POLITICAL SUBDIVISION THEREOF WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION. THE AUTHORITY HAS NO TAXING POWER.

The Certificates are offered, when, as and if executed and delivered, subject to the approval as to their legality by Rutan & Tucker, LLP, Costa Mesa, California, Special Counsel. Certain legal matters will be passed on for the County by the County Counsel, and by Fulbright & Jaworski LLP, a member of Norton Rose Fulbright, Los Angeles, California, as Disclosure Counsel. It is anticipated that the Certificates, in book-entry form, will be available for delivery on or about April 8, 2014 through the facilities of The Depository Trust Company (see "APPENDIX E - DTC AND THE BOOK-ENTRY-ONLY SYSTEM" herein).

The date of the Official Statement is _____, 2014.

* Preliminary, subject to change.

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\$6,100,000*

2014 CERTIFICATES OF PARTICIPATION
Evidencing Direct, Undivided Fractional Interests of the Owners
Thereof in Lease Payments to Be Made by the
COUNTY OF SANTA CRUZ, CALIFORNIA
as Rental for Certain Property Pursuant to a
Sub-Sublease Agreement with the
SANTA CRUZ COUNTY PUBLIC FINANCING AUTHORITY

MATURITY SCHEDULE

(Base CUSIP®† 801820)

Maturity Date	Principal	Interest	Reoffering	
<u>August 1</u>	<u>Amount</u>	<u>Rate</u>	<u>Yield</u>	<u>CUSIP®†</u>
2014				
2015				
2016				
2017				
2018				
2019				
2020				
2021				
2022				
2023				
2024				
2025				
2026				
2027				
2028				
2029				
2030				
2031				

* Preliminary, subject to change.

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GENERAL INFORMATION ABOUT THIS OFFICIAL STATEMENT

Use of Official Statement. This Official Statement is submitted in connection with the offer and sale of the Certificates referred to herein and may not be reproduced or used, in whole or in part, for any other purpose. This Official Statement is not to be construed as a contract with the purchasers of the Certificates.

Estimates and Forecasts. When used in this Official Statement and in any continuing disclosure by the Authority or the County in any press release and in any oral statement made with the approval of an authorized officer of the District or any other entity described or referenced herein, the words or phrases “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimate,” “project,” “forecast,” “expect,” “intend” and similar expressions identify “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated in such forward-looking statements. Any forecast is subject to such uncertainties. Inevitably, some assumptions used to develop the forecasts will not be realized and unanticipated events and circumstances may occur. Therefore, there are likely to be differences between forecasts and actual results, and those differences may be material.

Limit of Offering. No dealer, broker, salesperson or other person has been authorized by the Authority or the County to give any information or to make any representations in connection with the offer or sale of the Certificates other than those contained herein and if given or made, such other information or representation must not be relied upon as having been authorized by the Authority, the County, the Financial Advisor or the Underwriter. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the Certificates by a person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale.

Involvement of Underwriter. The Underwriter has submitted the following sentence for inclusion in this Official Statement: The Underwriter has reviewed the information in this Official Statement in accordance with, and as a part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriter does not guarantee the accuracy or completeness of such information.

Information Subject to Change. The information and expressions of opinions herein are subject to change without notice and neither delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Authority or the County or any other entity described or referenced herein since the date hereof. All summaries of the documents referred to in this Official Statement are made subject to the provisions of such documents, respectively, and do not purport to be complete statements of any or all of such provisions.

Stabilization of Prices. In connection with this offering, the Underwriter may over-allot or effect transactions which stabilize or maintain the market price of the Certificates at a level above that which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time. The Underwriter may offer and sell the Certificates to certain dealers and others at yields or prices lower than the public offering yields or prices set forth on the inside front cover page hereof and said public offering prices may be changed from time to time by the Underwriter.

COUNTY OF SANTA CRUZ, CALIFORNIA**COUNTY GOVERNING BOARD**

John Leopold, *Supervisor, 1st District*
Zach Friend, *Supervisor, 2nd District*
Neal Coonerty, *Supervisor, 3rd District*
Greg Caput, *Supervisor, 4th District*
Bruce McPherson, *Supervisor, 5th District*

COUNTY STAFF

Susan A. Mauriello, *County Administrative Officer*
Carol D. Kelly, *Assistant County Administrative Officer*
Mary Jo Walker, *Auditor-Controller*
Fred Keeley, *Treasurer-Tax Collector*
Dana McRae, *County Counsel*

PROFESSIONAL SERVICES**Special Counsel**

Rutan & Tucker, LLP
Costa Mesa, California

Disclosure Counsel

Fulbright & Jaworski LLP, a member of Norton Rose Fulbright
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OFFICIAL STATEMENT

\$6,100,000*

**2014 REFUNDING CERTIFICATES OF PARTICIPATION
Evidencing Direct, Undivided Fractional Interests of the Owners
Thereof in Lease Payments to Be Made by the
COUNTY OF SANTA CRUZ, CALIFORNIA
as Rental for Certain Property Pursuant to a
Sub-Sublease Agreement with the
SANTA CRUZ COUNTY PUBLIC FINANCING AUTHORITY**

This Official Statement which includes the cover page and appendices (the "Official Statement"), is provided to furnish certain information concerning the sale, execution and delivery of 2014 Refunding Certificates of Participation (the "Certificates"), in the aggregate principal amount of \$6,100,000*, representing the direct, undivided fractional interests of owners thereof in Lease Payments (defined below) to be made by the County of Santa Cruz, California (the "County"), as rental for certain property pursuant to a Sub-Sublease Agreement as more fully described herein (the "Lease Agreement") with the Santa Cruz County Public Financing Authority (the "Authority").

INTRODUCTION

This Introduction contains only a brief description of this issue and does not purport to be complete. The Introduction is subject in all respects to more complete information in the entire Official Statement and the offering of the Certificates to potential investors is made only by means of the entire Official Statement and the documents summarized herein. Potential investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision (see "RISK FACTORS" herein).

The County

The County of Santa Cruz was incorporated in 1850. It has a general law form of government. It is located on the coast of California, between the San Francisco Bay area and the Monterey Bay Peninsula, 74 miles south of San Francisco (see "SANTA CRUZ COUNTY" herein).

Security and Sources of Repayment

In 2001, the Authority issued \$11,900,000 Lease Revenue Bonds, 2001 Series B (the "2001 Bonds") for the purpose of acquiring and constructing various facilities throughout the County. In connection with the issuance of the 2001 Bonds, the County leased certain detention facilities and related land (the "Leased Property") as described more fully herein, to the Authority under a Site Lease dated as of July 15, 1995 as amended by an Amendment No. 1 to Site Lease dated as of October 1, 2001 (the "2001 Site Lease"), and the Authority concurrently leased the Leased Property back to the County under a Lease Agreement dated as of July 15, 1995 (the "1995 Lease") as amended by an Amendment No. 1 to Lease Agreement dated as of October 1, 2001 (the "2001 Lease").

In 2005, the County executed and delivered its 2005 Refunding Certificates of Participation (the "2005 Certificates") for the purpose of refinancing obligations of the County with respect to the 1995 Lease. In order to provide funds for such purposes, the County subleased the Leased Property to the Authority under a Sublease Agreement dated as of May 1, 2005 (the "Sublease") under which the

* Preliminary, subject to change.

Authority agreed to pay the County an up-front sublease payment which was sufficient to provide for such refinancing. In turn, the Authority sub-subleased the Leased Property back to the County under a Sub-Sublease Agreement dated as of May 1, 2005 (the "2005 Lease Agreement"). Under the 2005 Lease Agreement, the County is obligated to pay certain lease payments (the "2005 Lease Payments") which are sufficient to provide for payment of principal and interest represented by the 2005 Certificates when due.

In 2006, the County executed and delivered its 2006 Certificates of Participation (the "2006 Certificates") to finance additional public improvements. In order to provide funds for such purposes, the County supplemented the 2005 Lease Agreement pursuant to a First Supplement to Sub-Sublease dated as of August 1, 2006 (the "2006 Supplement"). Under the 2006 Supplement, the County agreed to pay supplemental lease payments (the "2006 Lease Payments") which are equal to the principal and interest represented by the 2006 Certificates.

In 2008, the County executed and delivered its 2008 Certificates of Participation (the "2008 Certificates") to finance additional public improvements. In order to provide funds for such purposes, the County supplemented the 2005 Sub-Sublease Agreement pursuant to a Second Supplement to Sub-Sublease dated as of June 1, 2008 (the "2008 Supplement"). Under the 2008 Supplement, the County agreed to pay supplemental lease payments (the "2008 Lease Payments") which are equal to the principal and interest represented by the 2008 Certificates.

The purpose of the Certificates is to provide funds which will refinance the 2001 Lease and 2001 Bonds. In order to provide funds for such purposes, the County will supplement the 2005 Lease Agreement pursuant to a Third Supplement to Sub-Sublease dated as of March 1, 2014 (the "Lease Supplement"). Under the Lease Supplement, the Authority agrees to deposit funds which are sufficient to refinance the 2001 Lease, in consideration of which the County agrees to pay supplemental lease payments (the "2014 Lease Payments") which are equal to the principal and interest represented by the Certificates. The proceeds from the sale of the Certificates will also be used fund a reserve fund for the Certificates and to pay the costs of issuance of the Certificates (see "THE FINANCING PLAN" herein).

Collectively, the 2005 Lease Payments, the 2006 Lease Payments, the 2008 Lease Payments and the 2014 Lease Payment are referred to herein as the "Lease Payments."

The Certificates are being executed and delivered pursuant to a Trust Agreement dated as of March 1, 2014 (the "Trust Agreement"), by and among the County, the Authority and The Bank of New York Mellon Trust Company, N.A., as trustee (the "Trustee"). For a summary of the Trust Agreement, see "APPENDIX A - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - TRUST AGREEMENT" herein. Certain capitalized terms used in this Official Statement and not otherwise defined have the meanings given them in "APPENDIX A."

The Lease Payments are payable by the County from any source of legally available funds of the County, including certain funds held under the Trust Agreement and investment earnings thereon, and the net proceeds of insurance or condemnation awards (see "SOURCES OF PAYMENT FOR THE CERTIFICATES," "APPENDIX A - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - LEASE AGREEMENT," and "FINANCIAL INFORMATION" herein).

In general, the County is required under the 2005 Lease Agreement, as supplemented by the 2006 Supplement, the 2008 Supplement and the Lease Supplement (as so supplemented, the "Lease Agreement") to pay to the Trustee specified amounts for use and possession of the Leased Property which amounts are calculated to be sufficient in both time and amount to pay, when due, the principal and interest payable with respect to the Certificates, the 2005 Certificates, the 2006 Certificates and the 2008 Certificates. The County is also required to pay any taxes and assessments levied on the Leased Property and all costs of maintenance and repair of the Leased Property. The County has covenanted in the Lease Agreement to take such actions as may be necessary to include all Lease Payments in its annual budgets and to make the necessary annual appropriations for all such Lease Payments subject to complete or partial abatement of such Lease Payments resulting from a taking of the Leased Property (either in whole or in part) under the

powers of eminent domain or resulting from damage or loss of all or any portion of the Leased Property. Except for the Authority's right, title and interest in and to the Lease Agreement which have been assigned to the Trustee, no funds or properties of the Authority or the County are pledged to or otherwise liable for the obligations of the Authority (see "RISK FACTORS" herein).

The Lease Agreement is, in the opinion of Special Counsel, a valid and binding obligation of the County enforceable against the County in accordance with its terms, except to the extent enforceability thereof may be limited by bankruptcy, insolvency, moratorium and other similar laws affecting creditors' rights heretofore or hereinafter enacted and may be subject to the exercise of judicial discretion in accordance with general principles of equity or otherwise in appropriate cases (see "RISK FACTORS - The Lease Payments - Limited Recourse on Default" herein). The form of Special Counsel's opinion is attached hereto as "APPENDIX D."

The obligation of the County to pay Lease Payments does not constitute an obligation for which the County is obligated to levy or pledge any form of taxation or for which the County has pledged any form of taxation. The obligation of the County to pay Lease Payments does not constitute a debt or liability of the State of California or of any political subdivision thereof within the meaning of any constitutional or statutory debt limitation or restriction.

Tax Exemption

In the opinion of Rutan & Tucker, LLP, Costa Mesa, California, ("Special Counsel"), under existing statutes, regulations, rulings and judicial decisions, and assuming certain representations and compliance with certain covenants and requirements described herein, the interest (and original issue discount) due with respect to the Certificates is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of calculating the federal alternative minimum tax imposed on individuals and corporations, but interest with respect to the Certificates is taken into account, however, in computing an adjustment used in determining the federal alternative minimum tax for certain corporations. In the further opinion of Special Counsel, the interest (and original issue discount) due with respect to the Certificates is exempt from State of California personal income tax. See "LEGAL MATTERS - Tax Matters" herein.

Professional Services

The legal proceedings relating to the execution and delivery of the Certificates are subject to the approving opinion of Rutan & Tucker, LLP, Costa Mesa, California, Special Counsel. Certain legal matters will be passed on for the County by Dana McRae, County Counsel and by Fulbright & Jaworski LLP, a member of Norton Rose Fulbright, Los Angeles, California, as Disclosure Counsel.

The Bank of New York Mellon Trust Company, N.A., serves as Trustee under the Trust Agreement. The Trustee will act on behalf of the Certificate Owners for the purpose of receiving all moneys required to be paid to the Trustee, to allocate, use and apply the same, to hold, receive and disburse the Lease Payments and other funds held under the Trust Agreement, and otherwise to hold all the offices and perform all the functions and duties provided in the Trust Agreement to be held and performed by the Trustee.

Harrell & Company Advisors, LLC (the "Financial Advisor") advised the County as to the financial structure and certain other financial matters relating to the Certificates.

The County's audited general purpose financial statements for the fiscal year ended June 30, 2013, attached hereto as "APPENDIX B" have been audited by Marcum LLP, Irvine, California. The County's audited financial statements are public documents and are included within this Official Statement without the prior approval of the auditor. Accordingly, the auditor has not performed any post-audit of the financial condition of the County.

Offering of the Certificates

Authority for Execution and Delivery. The Certificates are to be executed and delivered pursuant to the Trust Agreement, and have been authorized by a resolution adopted by the Board of Supervisors of the County on _____, 2014. The Lease Agreement is entered into in accordance with the laws of the State of California (the "State"), and particularly Section 37350 of the Government Code of the State.

Offering and Delivery of the Certificates. The Certificates were sold to Stifel, Nicolaus & Company, Inc. The Certificates are offered, when, as and if executed and delivered, subject to the approval as to their legality by Rutan & Tucker, LLP, Costa Mesa, California, Special Counsel. It is anticipated that the Certificates, in book-entry form, will be available for delivery in New York, New York on April 8, 2014 through the facilities of The Depository Trust Company. See "APPENDIX E – DTC AND THE BOOK-ENTRY-ONLY SYSTEM."

Information Concerning this Official Statement

This Official Statement speaks only as of its date. The information set forth herein has been obtained by the County with the assistance of Harrell & Company Advisors, LLC, (the "Financial Advisor,") from sources which are believed to be reliable and such information is believed to be accurate and complete, but such information is not guaranteed as to accuracy or completeness, nor has it been independently verified and is not to be construed as a representation by the Financial Advisor or the Disclosure Counsel. Statements contained in this Official Statement which involve estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended as such and are not to be construed as representations of fact. The information and expressions of opinion herein are subject to change without notice and the delivery of this Official Statement shall not, under any circumstances, create any implication that there has been no change in the information or opinions set forth herein or in the affairs of the County since the date hereof.

Availability of Legal Documents. The summaries and references contained herein with respect to the Trust Agreement, the Lease Agreement, the Assignment Agreement, the Certificates and other statutes or documents do not purport to be comprehensive or definitive and are qualified by reference to each such document or statute, and references to the Certificates are qualified in their entirety by reference to the form thereof included in the Trust Agreement. Copies of the documents described herein are available for inspection during the period of initial offering of the Certificates at the offices of the Financial Advisor. Copies of these documents may be obtained after delivery of the Certificates at the trust office of the Trustee, The Bank of New York Mellon Trust Company, N.A., Los Angeles, California or from the County at Government Center, 701 Ocean Street, Santa Cruz, California 95060, telephone (831) 454-2100.

THE CERTIFICATES

General Provisions

Payment of the Certificates. Interest represented by the Certificates is payable at the rates per annum set forth on the inside front cover page hereof. Said interest will represent the portion of Lease Payments designated as interest and coming due on each Interest Payment Date. The share of the portion of Lease Payments designated as interest with respect to any Certificate will be computed by multiplying the portion of Lease Payments designated as principal with respect to such Certificates by the rate of interest represented by such Certificates. Interest represented by the Certificates and the Lease Payments will be computed on the basis of a year consisting of 360 days and twelve 30-day months. Principal with respect to the Certificates is payable from the principal component of Lease Payments allocable to the Certificates on August 1 in each of the years and in the amounts set forth on the inside front cover page hereof.

Each Certificate will be dated as of the date of original delivery of the Certificates (the "Date of Delivery"), and interest with respect to the Certificates will be payable from the Interest Payment Date next preceding the date of execution thereof, unless (a) it is executed following the 15th day of the month preceding an Interest Payment Date (a "Record Date") and on or before such Interest Payment Date, in which event interest with respect thereto will be payable from such Interest Payment Date; or (b) it is executed on or before the first Record Date, in which event interest represented thereby will be payable from the Date of Delivery. Notwithstanding the foregoing, if, as of the date of any Certificate, interest represented by such Certificate is in default, interest represented by such Certificate will be payable from the Interest Payment Date to which interest has previously been paid or made available for payment with respect to such Certificate.

Book-Entry-Only System. The Depository Trust Company ("DTC"), New York, New York, will act as securities depository for the Certificates. The Certificates will be issued as fully registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. Interest on and principal of the Certificates will be payable when due by wire of the Trustee to DTC which will in turn remit such interest and principal to DTC Participants (as defined herein), which will in turn remit such interest and principal to Beneficial Owners (as defined herein) of the Certificates (see "APPENDIX E – DTC AND THE BOOK-ENTRY-ONLY SYSTEM" herein). As long as DTC is the registered owner of the Certificates and DTC's book-entry method is used for the Certificates, the Trustee will send any notices to certificate owners only to DTC.

Discontinuance of Book-Entry System. DTC may discontinue providing its services as securities depository with respect to the Certificates at any time by giving reasonable notice to the County or the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, Certificates are required to be printed and delivered as described in the Trust Agreement. The County may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, the Certificates will be printed and delivered as described in the Trust Agreement. In addition, the following provisions shall apply: interest represented by each Certificate will be paid on each Interest Payment Date by check of the Trustee mailed on such Interest Payment Date by first class mail, to the person appearing on the registration books of the Trustee as the Owner thereof as of the close of business on the preceding Record Date, at such Owner's address as it appears on the registration books of the Trustee; provided however, that at the written request of the Owner of Certificates in an aggregate principal amount of at least \$1,000,000, which request is on file with the Trustee as of any Record Date, interest with respect to such Certificates shall be paid on each succeeding Interest Payment Date by wire transfer in immediately available funds to such account within the United States of America as shall be specified in such request. The principal and prepayment price represented by any Certificate at maturity or upon prepayment will be payable upon presentation and surrender of such Certificate at the Office of the Trustee in San Francisco, California, or at such place as may be designated by the Trustee.

Prepayment

Optional Prepayment. The Certificates maturing on or before August 1, 2024 are not subject to prepayment prior to maturity. The Certificates maturing on or after August 1, 2025 are subject to prepayment prior to maturity at the option of the County, on any date on or after August 1, 2024, as a whole or in part among maturities designated by the County and by lot within a maturity, from any source of available funds at a prepayment price equal to 100% of the principal amount thereof to be prepaid, without a premium, together with accrued interest thereon to the date fixed for prepayment.

Prepayment From Net Proceeds of Insurance or Condemnation. The Certificates are subject to mandatory prepayment as a whole, on any date, or in part on any Interest Payment Date, from net hazard or title insurance proceeds not used to repair or replace any portion of the Leased Property damaged or destroyed, or from condemnation proceeds received with respect to any portion of the Leased Property and elected by the County to be used for such purpose, pro-rata among maturities, at a prepayment price equal to the principal amount of the Certificates to be prepaid, plus accrued interest thereon to the date fixed for prepayment, without premium. Because the 2005 Certificates, the 2006 Certificates, the 2008 Certificates and the Certificates are secured by lease payments payable under the Lease Agreement, any net proceeds will be applied on a pro-rata basis to prepay the 2005 Lease Payments, the 2006 Lease Payments, the 2008 Lease Payments and the Lease Payments and, therefore, the 2005 Certificates, the 2006 Certificates, the 2008 Certificates and the Certificates. There can be no assurance that such proceeds will be adequate to prepay all of the Certificates, the 2005 Certificates, the 2006 Certificates and the 2008 Certificates (see "SOURCES OF PAYMENT FOR THE CERTIFICATES - Insurance Relating to the Leased Property" and "RISK FACTORS - The Lease Payments - Insurance" herein).

Notice of Prepayment. When prepayment is authorized or required, the Trustee is required to give written notice to the respective Certificate Owners of any Certificates designated for prepayment at their addresses appearing on the Certificate registration books, to the Securities Depositories and to one or more of the Information Services, all as provided in the Trust Agreement, by first class mail, postage prepaid, no less than 20, nor more than 60, days prior to the date fixed for prepayment. Neither failure to receive such notice nor any defect in the notice so mailed will affect the validity of the proceedings for prepayment of such Certificates or the cessation of accrual of interest from and after the prepayment date.

Rescission of Notice. The County has the right to rescind any notice of the optional prepayment of Certificates by written notice to the Trustee on or prior to the date fixed for prepayment. Any notice of optional prepayment will be cancelled and annulled if for any reason funds will not be or are not available on the date fixed for prepayment for the payment in full of the Certificates then called for prepayment, and such cancellation will not constitute an Event of Default. The County and the Trustee have no liability to the Owners or any other party related to or arising from such rescission of prepayment. The Trustee shall mail notice of such rescission of prepayment in the same manner as the original notice of prepayment was sent.

Effect of Prepayment. Interest represented by the Certificates (or portions thereof) called for prepayment will cease to accrue on the date fixed for prepayment and such Certificates (or portions thereof) will cease to be entitled to any benefit or security under the Trust Agreement and the Owners of such Certificates will have no rights in respect thereof except to receive payment of the prepayment price thereof. The Trust Agreement contains no provisions requiring any publication of notice of prepayment, and Certificate Owners must maintain a current address on file with the Trustee to receive any notices of prepayment.

Partial Prepayment. In the event only a portion of any Certificate is called for prepayment, then upon surrender of such Certificate the Trustee will execute and deliver to the Certificate Owner thereof, at the expense of the County, a new Certificate or Certificates of authorized denominations equal in aggregate principal amount equal to the unprepaid portion of the Certificate surrendered and of the same interest rate and the same maturity.

Scheduled 2014 Lease Payments

The following is a schedule of annual 2014 Lease Payments, and therefore the scheduled annual payments of principal and interest represented by the Certificates.

Certificate Year Ending			
<u>August 1</u>	<u>Principal</u>	<u>Interest</u>	<u>Annual Total</u>
2014			
2015			
2016			
2017			
2018			
2019			
2020			
2021			
2022			
2023			
2024			
2025			
2026			
2027			
2028			
2029			
2030			
2031			
Total			

23.

Scheduled Lease Payments

The following is a schedule of total annual Lease Payments.

Certificate					
Year Ending	2005 Lease	2006 Lease	2008 Lease	2014 Lease	Total Lease
<u>August 1</u>	<u>Payments</u>	<u>Payments</u>	<u>Payments</u>	<u>Payments</u>	<u>Payments</u>
2014					
2015					
2016					
2017					
2018					
2019					
2020					
2021					
2022					
2023					
2024					
2025					
2026					
2027					
2028					
2029					
2030					
2031					
2032					
2033					
2034					
2035					
2036					
Total					

55

THE FINANCING PLAN

The Authority issued the 2001 Bonds in the principal amount of \$11,900,000, of which \$6,220,000 currently remains outstanding. On the Delivery Date, the County will irrevocably deposit a portion of the proceeds from the Certificates with the Trustee as escrow bank (the "Escrow Bank"), pursuant to an Escrow Agreement, dated as of March 1, 2014 (the "Escrow Agreement"), by and between the County, the Authority and the Escrow Bank. The deposit will be in an amount sufficient to pay interest with respect to the 2001 Bonds on August 1, 2014, and to pay the prepayment price with respect to the 2001 Bonds pursuant to an optional prepayment thereof on August 1, 2014.

Special Counsel will deliver an opinion at closing to the effect that, assuming the sufficiency of the amounts deposited under the Escrow Agreement, the 2001 Bonds will be discharged and no longer be Outstanding and will not be secured by the Lease Agreement or the Lease Payments due thereunder (see "CONCLUDING INFORMATION - Verifications of Mathematical Computations.") Amounts on deposit with the Escrow Bank are not available to pay debt service with respect to the Certificates.

Estimated Sources and Uses of Funds

Under the provisions of the Trust Agreement, the Trustee will receive the proceeds from the sale of the Certificates and will apply them as follows:

Sources of Funds

Par Amount of Certificates
Funds Held Under the 2001 Lease
Net Premium
Available Funds

Uses of Funds

Escrow Fund
Reserve Fund ⁽¹⁾
Underwriter's Discount
Costs of Issuance Fund ⁽²⁾
Total Uses

⁽¹⁾ - An amount equal to the Reserve Requirement (see "SOURCES OF PAYMENT FOR THE CERTIFICATES – Reserve Fund").

⁽²⁾ Expenses include fees and expenses of Special Counsel, the Financial Advisor, Disclosure Counsel and Trustee, rating fees, costs of printing the Official Statement, and other costs of delivery of the Certificates.

THE LEASED PROPERTY

Description of the Leased Property

The Leased Property consists of the land and improvements which constitute the Water Street Men's Detention Facility and the Blaine Street Women's Detention Facility of the County. The appraised value of such land and improvements is at least equal to \$23,350,000 million, which is in excess of the combined principal amount of the outstanding 2005 Certificates, the 2006 Certificates, the 2008 Certificates and the Certificates. The following is a brief description of these facilities.

Water Street Detention Facility

The Water Street Detention Facility serves as the County's primary adult men's detention facility. Phases I and II of this facility were designed and constructed to operate as a single maximum security facility. The first phase was completed in 1982 and the second phase was completed in 1986. The two phases together total 71,000 square feet, located on approximately 5.65 acres of land fronting on Water Street in the City of Santa Cruz (the "Site"). In calendar year 2013, this facility had an average daily population of ___ individuals and various law enforcement agencies in the County brought 390 individuals to this facility for booking. The facility is located in a flood zone designation AE subject to inundation by 100-year shallow flooding.

Blaine Street Lane Detention Facility

The Blaine Street Women's Detention Facility is also located on the Site. This women's minimum/medium jail facility is 8,166 square feet and was also built in 1986. The facility has a rated inmate capacity of 32 inmates and an average daily population in 2013 of 16 individuals.

Additional Obligations Payable from Lease Payments

The County may amend and supplement the Lease Agreement for the purpose of providing additional lease payment obligations of the County thereunder which secure additional bonds, certificates of participation or other debt instruments. Such provision is currently being utilized by the County in connection with the Certificates, through the execution and delivery of the Lease Supplement which provides for supplemental lease payments under the Lease Agreement, constituting the Lease Payments which are evidenced by the Certificates. The County covenants in the Lease Agreement not to incur any such additional lease obligations under the Lease Agreement unless the Leased Property has a value at least equal to the principal amount of the outstanding obligations which are secured by such lease payments, including the 2005 Certificates, the 2006 Certificates, the 2008 Certificates, the Certificates and the additional bonds, certificates or other debt instruments.

SOURCES OF PAYMENT FOR THE CERTIFICATES

General

Each Certificate represents a direct, undivided fractional interest in the Lease Payments to be made by the County (except certain right to indemnification) to the Authority under the Lease Agreement, consisting of the supplemental lease payments which the County is obligated to pay under the Lease Supplement. Under the Assignment Agreement, the Authority has assigned all of its rights under the Lease Agreement, including its rights to receive 2014 Lease Payments from the County and its remedies under the Lease Agreement to the Trustee for the benefit of the Owners of the Certificates. The 2014 Lease Payments are calculated to be sufficient to pay, when due, the annual principal of and interest due with respect to the Certificates.

Principal and interest with respect to the Certificates will be paid from the 2014 Lease Payments payable by the County for the use and possession of the Leased Property, insurance or condemnation Net Proceeds received in respect to the Leased Property to the extent that such Net Proceeds are not used for repair or replacement, interest or other income derived from the investment of the funds held by the Trustee under the Trust Agreement, or, in certain instances, from the Reserve Fund established by the Trust Agreement.

Lease Payments; Abatement

The County is required to pay to the Authority specified amounts for use of the Leased Property, which are equal to the principal of and interest due with respect to the Certificates, the 2005 Certificates, the 2006 Certificates and the 2008 Certificates. The Lease Payments payable under the Lease Agreement are in addition to the 2005 Lease Payments, the 2006 Lease Payments and the 2008 Lease Payments which the County has agreed to pay for the use and possession of the Leased Property under the 2005 Lease Agreement, 2006 Supplement and 2008 Supplement. The Lease Agreement requires the County to make Lease Payments to the Authority fifteen days preceding each Interest Payment Date. Under the Assignment Agreement, the Authority has assigned its rights to receive 2014 Lease Payments to the Trustee for the benefit of the Certificate Owners, as a result of which all 2014 Lease Payments will be made by the County directly to the Trustee. The Trust Agreement requires that the 2014 Lease Payments as are necessary to pay the principal and interest with respect to the Certificates then coming due and payable will be deposited in the Lease Payment Fund maintained by the Trustee under the Trust Agreement.

The County covenants in the Lease Agreement to take such action as may be necessary to include all Lease Payments in its annual budgets and to make annual appropriations for all such Lease Payments. The Lease Agreement provides that the several actions required by such covenants are deemed to be and shall be construed to be duties imposed by law and that it is the duty of each and every public official of the County to take such action and do such things as are required by law in the performance of the official duty of such official to enable the County to carry out and perform the covenants in the Lease Agreement agreed to be carried out and performed by the County.

The Lease Agreement provides that Lease Payments for any portion of the Leased Property will be abated during any period in which there is substantial interference with the County's use of such portions of the Leased Property because of damage, destruction or condemnation of such portions. The amount of such abatement will be an amount such that the resulting Lease Payments represent fair consideration for the use and occupancy of the portions of the Leased Property not taken, damaged or destroyed. Such abatement will continue for the period commencing with such taking, damage or destruction and ending with the substantial completion of the work of replacement, repair or reconstruction. In the event of any such damage or destruction, the Lease Agreement will continue in full force and effect and the County waives any right to terminate the Lease Agreement by virtue of such damages, destruction and taking. Notwithstanding the foregoing, there shall be no abatement of Lease Payments under the Lease Agreement to the extent that the proceeds of rental interruption insurance or amounts in the Lease Payment Fund or the

Reserve Fund are available to pay Lease Payments which would otherwise be abated under the Lease Agreement. Any such abatement will be allocated on a pro-rata basis between the 2005 Lease Payments, the 2006 Lease Payments, the 2008 Lease Payments and the 2014 Lease Payments.

During any period of abatement of 2014 Lease Payments, the Trustee may pay principal and interest with respect to the Certificates allocable to such portions of the Leased Property from moneys on deposit in the Reserve Fund, and, if available, a pro-rata share of proceeds of insurance or condemnation award. The County's reduced rental payments will constitute the total Lease Payments. The reduced Lease Payments may not be sufficient to pay principal and interest with respect to the Certificates, the 2005 Certificates, the 2006 Certificates and the 2008 Certificates in the amounts and at the rates set forth therein. In the event and to the extent the Lease Payments are subject to abatement, there could be insufficient amounts to pay principal of and interest on the 2005 Certificates, the 2006 Certificates, the 2008 Certificates and the Certificates in full, and such insufficiency would not constitute a default by the County under the Trust Agreement, the Lease Agreement or otherwise.

The obligation of the County to make Lease Payments does not constitute an indebtedness of the County for which the County is obligated to levy or pledge any form of taxation or for which the County has levied or pledged any form of taxation. Neither the Certificates nor the obligation of the County to make Lease Payments constitutes an indebtedness of the County, the State of California, or any of its political subdivisions within the meaning of any constitutional or statutory debt limitation or restriction.

Reserve Fund

A Reserve Fund has been established under the Trust Agreement to be held by the Trustee to further secure the timely payment of principal and interest represented by the Certificates. The reserve requirement is an amount equal to the lesser of (a) 10% of the initial offering price to the public of the Certificates as determined by the Internal Revenue Code, (b) maximum amount of 2014 Lease Payments coming due in the current or any future Fiscal Year, or (c) 125% of average annual 2014 Lease Payments as of the date of issuance (the "Reserve Requirement") and will initially be funded in the amount of \$_____. Except as described below, amounts in the Reserve Fund are to be used only to make 2014 Lease Payments with respect to the Certificates to the extent the amounts in the Lease Payment Fund are insufficient for such purpose. All interest or income received on the investment of the Reserve Fund is required to be retained in the Reserve Fund in the event that amounts on deposit in the Reserve Fund is less than the Reserve Requirement. All interest or income received on the investment of the Reserve Fund will be transferred to the Lease Payment Fund to the extent the Reserve Requirement is satisfied. Amounts in the Reserve Fund are not pledged or available to make payments with respect to, the 2005 Certificates, the 2006 Certificates or the 2008 Certificates.

Insurance Relating to the Leased Property

The Lease Agreement requires the County to maintain or cause to be maintained with respect to the Leased Property, comprehensive general public liability and property damage insurance and fire insurance with extended coverage. Such insurance must include earthquake coverage, but only if earthquake coverage is available at reasonable cost from reputable insurers in the reasonable opinion of the County and only with respect to structures. The County is also required to maintain rental interruption insurance covering loss of the use of any part of the Leased Property in an amount equal to the maximum aggregate amount of Lease Payments scheduled to be payable in any twenty-four month period (see "APPENDIX A - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - LEASE AGREEMENT - Insurance" and "RISK FACTORS - The Lease Payments - Insurance" herein). Although the County currently maintains earthquake insurance with respect to the Leased Property, (see "THE LEASED PROPERTY"), damage from earthquakes may not be covered in future years.

In the event the Leased Property is damaged or destroyed, the County may apply the net proceeds of any insurance award (except that included for the purposes of rental interruption) to replace, repair, restore, modify or improve (collectively, "repair") the Leased Property, or if repairing the Leased Property is not economically feasible, or in the best interest of the County, to prepay the Certificates, the 2005 Certificates, the 2006 Certificates and the 2008 Certificates. In the event the Leased Property has been damaged or destroyed and the County directs the Trustee to apply insurance proceeds arising from such damage or destruction to the payment or prepayment of Lease Payments, then the Trustee shall apply such proceeds to the redemption of Certificates as described under the caption "THE CERTIFICATES - Prepayment - Prepayment From Net Proceeds of Insurance or Condemnation" herein. The amount of the Lease Payments will be adjusted or abated (but only after all available moneys have been depleted) during any period in which damage or destruction to the Leased Property or condemnation of the Leased Property substantially interferes with the County's use and possession thereof.

If there are not sufficient insurance proceeds to complete repair of the Leased Property, the Lease Payment schedule will be proportionally reduced in accordance with the Lease Agreement. Such reduced Lease Payments may not be sufficient to pay principal and interest with respect to the Certificates, the 2005 Certificates, the 2006 Certificates and the 2008 Certificates. Such reduction would not constitute a default under either the Trust Agreement or the Lease Agreement.

Reentering and Reletting

If the County defaults in performance of its obligations under the Lease Agreement, the Trustee, as assignee of the Authority, may re-enter and relet the Leased Property and may enforce the Lease Agreement and hold the County liable for all Lease Payments on an annual basis while re-entering and reletting the Leased Property. Such re-entry and reletting shall not effect a surrender of the Lease Agreement. The County, in the event of default, waives all rights to any rentals received by the Trustee through reletting of the Leased Property. The County agrees to pay all costs, loss or damage howsoever occurring.

Due to the fact that the Leased Property serves essential governmental purposes and the specialized nature of the Leased Property, it is unlikely that the Trustee could readily re-lease it for rents which are sufficient to enable it to pay principal and interest represented by the Certificates, the 2005 Certificates and the 2006 Certificates in full when due, or that a court would permit such remedy to be exercised on a timely basis.

Encumbrances; Substitution of Property

The County and the Authority may not create any mortgage, pledge, lien, charge or encumbrance upon the Leased Property other than "Permitted Encumbrances." The County has the right under the Lease Agreement, however, to delete or substitute for portions of the Leased Property an alternate Leased Property subject to the satisfaction of certain requirements. Such requirements for substitution of property under the Lease Agreement include the requirements that the County obtain an appraisal report prepared by an MAI appraiser demonstrating that the market value of the new property is not less than the principal amount of the Outstanding Certificates, 2005 Certificates, 2006 Certificates, 2008 Certificates, and Additional Debt, if any.

THE AUTHORITY

The Authority is a joint exercise of powers authority organized and existing under and by virtue of the Joint Powers Act. The County of Santa Cruz, pursuant to Resolution No. 152-90 adopted on March 6, 1990, and the Santa Cruz County Redevelopment Agency, pursuant to Resolution No. 153-90 adopted on March 6, 1990, formed the Authority by the execution of a Joint Exercise of Powers Agreement.

The Authority is governed by a five-member Board which consists of all members of the County Board of Supervisors. The Chairman of the Authority is selected from among the Board Members. The County Administrative Officer acts as the Executive Director, the Assistant County Administrative Officer acts as the Assistant Executive Director, the Clerk of the Board acts as the Secretary and the County Auditor-Controller acts as the Treasurer of the Authority.

SANTA CRUZ COUNTY

General Information

Santa Cruz County is situated at the northern tip of Monterey Bay, 65 miles south of San Francisco, 35 miles north of Monterey, and 35 miles south of the Silicon Valley. The County is the gateway to the Monterey Bay National Marine Sanctuary, has 29 miles of beaches and includes seven state parks and seven state beaches. It is the second smallest county in California in land area, containing a total of 440 square miles. Two-thirds of the County is considered to be forest land by the U.S. Department of Agriculture. There are four incorporated cities in the County of Santa Cruz: Capitola, Santa Cruz, Scotts Valley and Watsonville. The City of Santa Cruz was incorporated as a city in 1866. It is the county seat of the County and is the location of the Santa Cruz campus of the University of California. The City of Watsonville, established in 1868, lies 18 miles southeast of the City of Santa Cruz. It is the trading and shipping center for the Pajaro River Valley, a fertile agricultural region. The City of Watsonville is the center of the County's agriculture region transporting fresh and processed farm crops to worldwide destinations. Watsonville's economy has been diversifying with an influx of electronics, manufacturing, and service firms. The City of Capitola stretches along the coast east and south of the City of Santa Cruz. It was incorporated in 1949 and is a tourist destination. The City of Scotts Valley, incorporated in 1966, lies north of the City of Santa Cruz and includes community commercial areas serving local residents and a mix of industrial sites that have supported light manufacturing and research development firms predominantly in the electronics and technology industries.

Unincorporated communities in Santa Cruz County include: Live Oak, an urban coastal area, between City of Santa Cruz and the City of Capitola; Soquel, which lies inland between Capitola and Santa Cruz; Aptos; south of Soquel, Felton; Ben Lomond and Boulder Creek, which are located in the San Lorenzo Valley between the City of Santa Cruz and Big Basin State Park; Davenport, which is located on the coast north of the City of Santa Cruz; Freedom, which is adjacent to and north of the City of Watsonville; and the Pajaro Valley, an agricultural area surrounding the City of Watsonville.

Government Organization

The County was incorporated in 1850 as one of the original 27 counties of the State with the City of Santa Cruz as the County seat. It has a general law form of government. A five-member Board of Supervisors elected to four-year terms serves as the legislative body. Also elected are the Auditor-Controller, District Attorney-Public Administrator, Sheriff-Coroner, Registrar of Voters-Clerk, Assessor-Recorder, and Treasurer-Tax Collector. The County Administrative Officer and County Counsel are appointed by the Board of Supervisors.

The members of the Board of Supervisors, the expiration dates of their terms and key administrative personnel are set forth in the charts below.

BOARD OF SUPERVISORS

<u>Board Member</u>	<u>Term Expires</u>
John Leopold, Supervisor, 1st District	January 2017
Zach Friend, Supervisor, 2nd District	January 2017
Neal Coonerty, Supervisor, 3rd District	January 2015
Greg Caput, Supervisor, 4th District	January 2015
Bruce McPherson, Supervisor, 5th District	January 2017

KEY ADMINISTRATIVE PERSONNEL

Susan A. Mauriello	County Administrative Officer
Mary Jo Walker	Auditor-Controller
Fred Keeley	Treasurer-Tax Collector
Dana McRae	County Counsel
Carol D. Kelly	Assistant County Administrative Officer

The Board of Supervisors approved the consolidation of the Auditor-Controller and Treasurer-Tax Collector elected officer beginning January 5, 2015.

Governmental Services

Criminal Justice System

The County criminal justice system is supported primarily by local County revenues. In addition to the Sheriff, Adult and Juvenile Detention, the Probation Department, the District Attorney and the Public Defender, the County is responsible for the facilities of the State Courts. In addition to countywide law enforcement services, the Sheriff provides narcotics enforcement, investigation of arson, homicides, consumer fraud and crime scene investigation, and acts as coroner for the County and all incorporated cities. The Sheriff operates three jail facilities throughout the County.

General Government

The County is responsible for the administration of the property tax system, including property assessment, assessment appeals, collection of taxes and distribution of taxes to cities, former redevelopment agencies, special districts, local school districts and the County. A second major function is the County's voter registration and election system.

Emergency Services

The County coordinates an entire emergency network to handle floods, fires, earthquakes and other major disasters. The Santa Cruz County Flood Control and Water Conservation District provides flood control and water conservation planning. The Santa Cruz County Fire Department is responsible for fire protection and first responder emergency medical services, provided from twelve fire stations. The County is a participant in a joint powers emergency communications agency which provides public safety dispatchers who coordinate multi-agency mutual aid response, as well as dispatch the Sheriff's Department, ambulance/paramedic services and most fire protection agencies operating within the County.

Health and Human Services

The County's Health Services Agency was established to provide central administration for various health-related programs operated or sponsored by the County. These programs include mental health, public health, medical outpatient clinics, medical care for indigents and drug and alcohol treatment services. Most programs operated by the Health Services Agency are mandated by State law and are funded through State subsidies, grants and fees for services. State and federal laws also mandate that counties provide certain human services including Aid to Families with Dependent Children, CalFresh program, Adult Protective Services, public guardian, Child Protective Services, foster care and adoption services and job training. Implementation of the Patient Protection and Affordable Care Act ("Affordable Care Act") will be provided by the County's Human Services Department (social services) and by the Health Services Agency.

Culture and Recreation

The Parks, Open Space and Cultural Services Division of the Department of Public Works ("POSCS") is responsible for maintenance of the County's park system, and currently operates 59 separate park sites totaling 225 acres with 10 soccer fields, 10 baseball fields, and 4 public pools. POSCS offers a wide variety of recreational and cultural programs, events and services year-round.

Community Information

Public school education is available through 35 elementary schools, 21 secondary schools and 10 unified school districts as well as numerous charter and alternative education programs. The University of California (the "University") established its Santa Cruz campus in 1965. The University is structured into ten independent undergraduate colleges and offers graduate study in 41 academic fields. Eight of the colleges are self-contained educational and residential communities. The Lick Observatory, a multi-campus research facility for astronomers, is headquartered at the University. University sponsored activities form an important part of the cultural life of Santa Cruz County. The 2,000-acre campus, set among redwood groves and meadows, lies on the northwest boundary of the City of Santa Cruz.

Cabrillo Community College ("Cabrillo"), a two-year, publicly supported institution, offers a broad curriculum which includes liberal arts, business, engineering, nursing and allied health technologies, and vocational education. Cabrillo is located in the community of Aptos.

Santa Cruz County also hosts the Seymour Marine Discovery Center, the Long Marine Laboratory, the National Marine Fisheries Service, the Oiled Wildlife Veterinary Care and Research Center, and the Monterey Bay National Marine Sanctuary Exploration Center.

There are two full service hospitals in the County. Santa Cruz Dominican Hospital is located in the Santa Cruz area and Watsonville Community Hospital is located in Watsonville. A maternity and outpatient surgery center, Sutter Hospital, is also located in the County. While jobs in health services will continue to expand, a restructuring of service delivery from inpatient to outpatient care will require fewer registered nurses and facility support personnel, but more medical assistants, technicians and home health aides.

Cultural amenities include Open Studios, the Tannery Arts Center, the Santa Cruz County Symphony, the Cabrillo Music Festival, Shakespeare Santa Cruz, the McPherson Museum of Art and History, the University of California Performing Arts Center, the Henry J. Mello Performing Arts Center and the Cabrillo College Visual & Performing Arts Complex.

Transportation

Six major State highways connect Santa Cruz with adjacent counties. Highway 1 leads along the coast from San Francisco south to the City of Santa Cruz and on to Monterey. Highways 9 and 17 traverse the County from the City of Santa Cruz across the Santa Cruz Mountains into Santa Clara County. Watsonville is joined with Santa Clara County by Highway 152 and with San Benito County by Highway 129. Highways 17, 152 and 129 connect with U.S. 101, a major north-south route. Highway 236 provides access to Big Basin State Park.

Air cargo and passenger flight services are provided at the Norman Y. Mineta San José International Airport, 32 miles east; Monterey Peninsula Airport, 43 miles south; and San Francisco International Airport, 60 miles northeast. Watsonville Municipal Airport provides private and executive air transportation facilities and air cargo.

Bus transportation is provided through the Santa Cruz Metropolitan Transit District for inter-urban and local inter-community service. Greyhound Bus Lines provide service to other local areas and additional transcontinental service with connections to Amtrak.

Population

Approximately 50.9% of the County's population lives in the County's four incorporated cities: Capitola, Santa Cruz, Scotts Valley and Watsonville.

**TABLE NO. 1
COUNTY OF SANTA CRUZ
POPULATION
INCORPORATED CITIES AND UNINCORPORATED COMMUNITIES
2009 – 2013**

Year	Incorporated Cities		Unincorporated Communities		Santa Cruz County	
	Population	Percentage Change	Population	Percentage Change	Population	Percentage Change
2009	131,638		129,254		260,892	
2010	132,628	0.8%	129,924	0.5%	262,552	0.6%
2011	133,975	1.0%	129,979	0.0%	263,954	0.5%
2012	134,879	0.7%	130,471	0.4%	265,350	0.5%
2013	135,650	0.6%	131,012	0.4%	266,662	0.5%
% Increase Between						
2009 - 2013		3.0%		1.4%		2.2%

The population in the incorporated cities in Santa Cruz County is set forth in the following table:

Year	Capitola	Santa Cruz	Scotts Valley	Watsonville	Total
2009	9,861	59,357	11,520	50,900	131,638
2010	9,924	59,871	11,587	51,246	132,628
2011	9,923	61,245	11,581	51,226	133,975
2012	9,957	61,825	11,613	51,484	134,879
2013	9,988	62,372	11,678	51,612	135,650
% Increase Between					
2009 - 2013	1.3%	5.1%	1.4%	1.4%	3.0%

Source: *State of California, Department of Finance, "E-4 Population Estimates for Cities, Counties and the State, 2001-2010, with 2000 & 2010 Census Counts" Sacramento, California, November 2012, and "E-4 Population Estimates for Cities, Counties, and the State, 2011-2013, with 2010 Census Benchmark" Sacramento, California, May 2013.*

The County is adjacent to Santa Clara and Monterey Counties. The following table sets forth the population for Santa Cruz County, Santa Clara County and Monterey County between 2009 and 2013.

TABLE NO. 2
POPULATION
COUNTIES OF SANTA CRUZ, SANTA CLARA AND MONTEREY
2009 - 2013

Year	SANTA CRUZ COUNTY		SANTA CLARA COUNTY		MONTEREY COUNTY	
	Population	Percentage Change	Population	Percentage Change	Population	Percentage Change
2009	260,892		1,767,204		412,233	
2010	262,552	0.6%	1,781,427	0.8%	415,108	0.7%
2011	263,954	0.5%	1,794,337	0.7%	416,968	0.4%
2012	265,350	0.5%	1,813,696	1.1%	419,586	0.6%
2013	266,662	0.5%	1,842,254	1.6%	421,494	0.5%
% Increase Between						
2009 - 2013		2.2%		4.2%		2.2%

Source: *State of California, Department of Finance, "E-4 Population Estimates for Cities, Counties and the State, 2001-2010, with 2000 & 2010 Census Counts" Sacramento, California, November 2012, and "E-4 Population Estimates for Cities, Counties, and the State, 2011-2013, with 2010 Census Benchmark" Sacramento, California, May 2013.*

Per Capita Personal Income

Per capita personal income information for the County, the State of California and the United States are summarized in the following table.

TABLE NO. 3
PER CAPITA PERSONAL INCOME
SANTA CRUZ COUNTY, CALIFORNIA AND UNITED STATES
2008 – 2012

Year	Santa Cruz County ⁽¹⁾	State of California ⁽¹⁾	United States ⁽¹⁾
2008	\$50,446	\$43,609	\$40,873
2009	46,584	41,569	39,357
2010	46,925	42,297	40,163
2011	50,138	44,666	42,298
2012	52,442	46,477	43,735

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

⁽¹⁾ Per capita personal income was computed using Census Bureau midyear population estimates. Estimates for 2010-2012 reflect county population estimates available as of March 2013.

Note: All state and local area dollar estimates are in current dollars (not adjusted for inflation). Estimates for 2001 forward reflect the results of the comprehensive revision to the national income and product accounts (NIPAs) released in July 2013. This will create a temporary break in BEA's time series for earlier years.

Last updated: November 21, 2013 - new estimates for 2012; revised estimates for 2001-2011.

Employment and Industry

Services

Analysis prepared by the Santa Cruz County Workforce Investment Board identified five major economic clusters that contribute significantly to the regional economy: technology, tourism, lifestyle enterprises, agriculture, and environmental technology.

The services sector is the largest economic sector in the County, and includes a wide range of activity. Hotels, other lodging places, business and finance services, personal services, automotive repairs services, amusement and recreation, and health services are all part of this sector. The sector includes employers such as Plantronics, which develops computer software and business computer applications, and Bluetooth Mobile headsets, the Santa Cruz Beach Boardwalk (employing 1,600 in the high season) and Dominican Hospital (about 1,000 employees), as well as very small software development and business service firms employing 10 or fewer.

New information technologies and the County's proximity to Silicon Valley are factors that contribute to growth in the areas of computer, networking services, and software development, and the County's location on the Monterey Bay National Marine Sanctuary contributes to growth in marine sciences' research and development.

Agriculture

Agriculture is the region's largest industry. The gross value of crops has increased steadily in recent years, as some segments of the industry have adapted successfully to changing consumer tastes, adopted new technologies and taken advantage of growing overseas markets. The agriculture economy has become highly diversified, producing over 2,000 kinds of crops in Santa Cruz County. According to the County's Agriculture Commissioner, the largest producers are strawberries, raspberries, cut flowers, nursery and landscape plants and vegetables.

Tourism

Santa Cruz County is an important vacation and recreation area. Miles of coastline and accessible beaches border the second largest Marine Sanctuary in the world, an amusement park and other attractions, acres of redwood forest land, multiple State Parks, U-pick farms, wineries, and the presence of a diverse music and art scene, all in close proximity to the Bay Area.

Commercial

In addition to traditional commercial and retail businesses, Santa Cruz County is home to many recreation and personal lifestyle businesses started by local entrepreneurs with nationally-recognized brands and products, including O'Neill Wetsuits, Santa Cruz Skateboards, Annieglass, Odwalla Juices, Driscoll Berries, Santa Cruz Guitars, Marmot Clothing and Equipment, and Santa Cruz Bicycles. The County also has a diverse and productive arts community anchored by the Tannery Arts Center in Santa Cruz, the Visual, Applied and Performing Arts Division at Cabrillo College, and the Digital Arts and New Media Program at the University of California, Santa Cruz.

Santa Cruz County is located in the Santa Cruz-Watsonville Metropolitan Statistical Area ("MSA"). As of December 2013, seven major job categories constitute 87.5% of the work force. These are government (22.9%), service producing (16.4%), educational and health services (14.3%), leisure and hospitality (11.5%), professional and business services (10.2%), manufacturing (6.1%), and farm (6.1%). The December 2013 unemployment rate in the Santa Cruz-Watsonville MSA was 9.2% (not seasonally adjusted to account for agricultural employment). The State of California December 2013 unemployment rate (unadjusted) was 7.9%. The employment in the Santa Cruz-Watsonville MSA is presented in the following table.

TABLE NO. 4
SANTA CRUZ-WATSONVILLE MSA
WAGE AND SALARY WORKERS BY INDUSTRY ⁽¹⁾
(in thousands)

Industry	2009	2010	2011	2012	2013
Government	20.3	21.0	18.9	22.1	22.4
Other Services	3.6	3.5	3.7	3.7	3.6
Leisure and Hospitality	10.2	10.0	10.3	11.5	11.2
Educational and Health Services	13.2	13.9	14.0	14.1	14.0
Professional and Business Services	9.1	9.3	9.3	10.0	10.0
Financial Activities	3.3	3.2	3.0	3.3	3.3
Information	1.0	0.9	0.9	0.8	0.8
Transportation, Warehousing and Utilities	1.4	1.5	1.3	1.5	1.5
Service Producing					
Retail Trade	11.7	11.8	11.6	12.2	12.5
Wholesale Trade	3.5	3.5	3.4	3.5	3.5
Manufacturing					
Nondurable Goods	2.5	2.9	2.5	2.6	2.8
Durable Goods	2.8	3.0	3.0	3.0	3.1
Goods Producing					
Mining, Logging and Construction	<u>2.9</u>	<u>2.8</u>	<u>2.9</u>	<u>3.1</u>	<u>3.1</u>
Total Nonfarm	85.5	87.3	84.8	91.4	91.8
Farm	<u>6.0</u>	<u>5.9</u>	<u>5.1</u>	<u>5.6</u>	<u>6.0</u>
Total (all industries)	<u>91.5</u>	<u>93.2</u>	<u>89.9</u>	<u>97.0</u>	<u>97.8</u>

Source: State of California Employment Development Department, Labor Market Information Division, "Industry Employment & Labor Force - by month, March 2012 Benchmark."

(1) Annually, as of December.

The principal employers operating within the County during the Fiscal Year ended June 30, 2013 are as follows:

**TABLE NO. 5
COUNTY OF SANTA CRUZ
PRINCIPAL EMPLOYERS**

Name of Company	Number of Employees ⁽¹⁾	Product/Service
University of California at Santa Cruz	1,000-4,999	Education
County of Santa Cruz	1,000-4,999	County Services
Pajaro Valley Unified School District	1,000-4,999	Education
Dominican Hospital	1,000-4,999	Hospital
Santa Cruz Beach Boardwalk	1,000-4,999	Amusement/Recreation
Cabrillo College	500-999	Education
City of Santa Cruz	500-999	City Services
Threshold Enterprises	500-999	Manufacturing
Watsonville Community Hospital	500-999	Hospital
West Marine	500-999	Retail
Plantronics	500-999	Telephone Apparatus Manufacturer
Santa Cruz City School District	500-999	Education

Source: County of Santa Cruz Comprehensive Annual Financial Report, Fiscal Year ended June 30, 2013.

⁽¹⁾ Number of Employees reflects an average range based on California Employment Development Department data.

Commercial Activity

The following table summarizes the volume of retail and food services sales and taxable transactions for the County for 2007 through 2011 (the most recent year for which statistics are available). The County's sales tax receipts increased by approximately 6.2% for Fiscal Year 2011/12 and by approximately 8.4% in 2012/13.

TABLE NO. 6
COUNTY OF SANTA CRUZ
TOTAL TAXABLE TRANSACTIONS
 (in \$ thousands)
 2007 - 2011

Year	Retail and Food Services (\$000's)	% Change	Retail and Food Services Permits	Total Taxable Transactions (\$000's)	% Change	Issued Sales Permits
2007	2,385,543		3,719	3,195,786		8,568
2008	2,211,878	(7.3%)	3,807	3,031,072	(5.2%)	8,614
2009	1,956,754	(11.5%)	5,557	2,638,469	(13.0%)	8,092
2010	2,079,236	6.3%	5,711	2,731,832	3.5%	8,222
2011	2,248,131	8.1%	5,823	2,893,395	5.9%	8,301

Source: California State Board of Equalization, "Taxable Sales in California."

The following table sets forth taxable transactions in the County of Santa Cruz and surrounding counties for 2007 through 2011 (the most recent year for which statistics are available).

TABLE NO. 7
TOTAL TAXABLE TRANSACTIONS
COUNTY OF SANTA CRUZ AND SURROUNDING COUNTIES
 (in \$ thousands)
 2007 - 2011

County	2007	2008	2009	2010	2011	% Change from 2007 - 2011
SANTA CRUZ	\$ 3,195,786	\$ 3,031,072	\$ 2,638,469	\$ 2,731,832	\$ 2,893,395	(9.5%)
San Mateo	13,326,306	13,137,913	11,327,022	11,966,338	13,020,643	(2.3%)
Santa Clara	33,663,448	32,274,306	27,427,709	30,523,322	33,431,217	(0.7%)
San Benito	550,032	504,523	422,942	449,872	486,490	(11.6%)
Monterey	5,680,652	5,399,594	4,705,845	4,955,562	5,312,732	(6.5%)

Source: California State Board of Equalization, "Taxable Sales in California."

Taxable transactions by type of business for the County are summarized below for 2007 through 2011 (the most recent year for which statistics are available).

TABLE NO. 8
COUNTY OF SANTA CRUZ
TAXABLE TRANSACTIONS BY TYPE OF BUSINESS
(in \$ thousands)
2007 – 2011

	2007	2008	2009	2010	2011
<i>Retail and Food Services</i>					
Motor Vehicle and Parts Dealers	\$ 341,717	\$ 248,129	\$ 202,343	\$ 217,152	\$ 257,320
Furniture and Home Furnishings Stores	73,331	57,776	42,214	42,656	47,221
Electronics and Appliance Stores	43,465	46,476	60,553	63,183	66,499
Building Material, Garden Supplies	283,731	240,523	200,782	243,660	247,364
Food and Beverage Stores	236,194	225,836	210,528	215,102	226,249
Health and Personal Care Stores	83,576	85,288	91,471	89,147	96,753
Gasoline Stations	252,183	290,255	238,382	283,133	349,163
Clothing and Accessories Stores	115,004	120,243	128,188	133,381	139,153
Sporting Goods, Hobby, Books, Music	87,901	72,756	78,106	79,066	81,319
General Merchandise	305,958	273,635	232,232	235,293	238,918
Miscellaneous Store Retailers	223,765	207,397	127,037	126,282	128,820
Nonstore Retailers	-	-	13,172	13,818	14,918
Food Services and Drinking Places	<u>338,718</u>	<u>343,564</u>	<u>331,746</u>	<u>337,363</u>	<u>354,433</u>
Total Retail and Food Services	2,385,543	2,211,878	1,956,754	2,079,236	2,248,131
<i>All Other Outlets</i>					
	<u>810,243</u>	<u>819,194</u>	<u>681,715</u>	<u>652,596</u>	<u>645,264</u>
Total All Outlets	<u>\$3,195,786</u>	<u>\$3,031,072</u>	<u>\$2,638,469</u>	<u>\$2,731,832</u>	<u>\$2,893,395</u>

Source: California State Board of Equalization, "Taxable Sales in California."

Note: In 2009, the classification of some categories were changed and are not directly comparable with prior years.

Building Activity

The following table summarizes building activity valuations for the County for the five calendar years from 2008 through 2012.

TABLE NO. 9
COUNTY OF SANTA CRUZ
BUILDING ACTIVITY AND VALUATION
(in \$ thousands)
2008 – 2012

	2008	2009	2010	2011	2012
Residential	\$100,176	\$ 54,300	\$ 61,446	\$ 58,010	\$ 68,932
Non-Residential	<u>66,206</u>	<u>50,809</u>	<u>40,841</u>	<u>40,165</u>	<u>51,671</u>
Total Valuation	<u>\$166,382</u>	<u>\$105,109</u>	<u>\$102,287</u>	<u>\$ 98,175</u>	<u>\$120,603</u>
No. of New Dwelling Units:					
Single-Dwelling	194	107	92	79	80
Multi-Dwelling	<u>63</u>	<u>2</u>	<u>23</u>	<u>111</u>	<u>173</u>
Total New Units	257	109	115	190	253

Source: County of Santa Cruz Comprehensive Annual Financial Report.

FINANCIAL INFORMATION

Economic Conditions and Outlook

The County, like many other municipal entities, was not immune to the effects of the most recent economic recession. Like many municipal entities throughout the nation, the County's General Fund revenues were hampered as a result of declining assessed values and depressed consumer spending. The County's Budget for Fiscal Year 2013/14 ("Budget") continued to reflect the slow economic recovery.

A 3.1% decline in Fiscal Year 2009/10 assessed values marked the first decline in the County since it began tracking property tax growth in 1968. Assessed value declined further by 0.6%, 0.1% and 0.9% for Fiscal Years 2010/11, 2011/12 and 2012/13. Assessed values increased by 3.9% in 2013/14 as a result of allowed inflationary increases and the recapture of some of the market value reductions in real estate in prior years as discussed under the caption "Taxable Property and Assessed Valuation" below.

Sales tax receipts were also affected by the downturn, declining by 10% in both Fiscal Years 2008/09 and 2009/10. However, sales tax receipts increased by 9% in Fiscal Year 2010/11, 6% in Fiscal Year 2011/12 and 9% for Fiscal Year 2012/13. In addition, actual sales tax for Fiscal Year 2013/14 is expected to exceed amounts budgeted, which were based on the estimated Fiscal Year 2012/13 revenues.

Tourism is important to the Santa Cruz economy. After a brief period of weaker tourist spending, tourism in the Santa Cruz area is recovering with a 12% increase in transient occupancy tax collections in Fiscal Year 2011/12 due to both increasing occupancy and audit compliance procedures. In November 2012, voters approved a 1.5% increase to the transient occupancy tax rate which is expected to increase revenue by 13% in Fiscal Year 2013/14.

The County continues to employ strict cost control measures to reduce budget imbalances, including employee furloughs and concessions, service and program reductions and staffing cuts. With respect to staffing costs in prior years, employees were offered other available positions to the extent possible if positions eliminated were not vacant. In Fiscal Year 2012/13, County employees agreed to continue the furlough program, although at a level that was 2.3% lower than prior years. Furloughs ranged from 12 days (4.62%) to 13.5 days (5.2%) depending on the bargaining unit. The County's agreement with its largest employee bargaining unit was negotiated in September 2013 for a 3-year term and includes a reduced furlough to 6.5 days (2.5%) for the first 12 months, and the elimination of the furlough in future years. For the Fiscal Year 2013/14 Proposed Budget, the County had assumed either a continuation of the existing furlough, or an equivalent dollar amount of concessions.

One factor not in the control of the County, and not estimated at this time, are the impacts of the federal sequestration spending cuts which, with respect to the County, target discretionary programs such as substance abuse prevention and treatment block grants, HIV screening and Workforce Investment Act grants. The County has made and continues to make supplemental budget changes as details are available, and to reduce programs in line with any funding cuts.

Despite the difficult economic climate, the County was able to increase its committed, assigned and unassigned General Fund reserves during Fiscal Year 2010/11 from \$30.4 million to \$35.2 million and during Fiscal Year 2011/12 from \$35.2 million to \$38.4 million. Such reserves decreased during Fiscal Year 2012/13 to \$37 million, but not as much as originally anticipated. See "Financial Statements – GASB Statement No. 54" below for a discussion of General Fund fund balance reserves by category. The final Fiscal Year 2013/14 Budget projects General Fund reserves declining by \$9.8 million to \$28.3 million by the end of Fiscal Year 2013/14, a level consistent with the County's fund balance policy of 7% of General Fund revenue. See "Fiscal Year 2013/14 Budget Assumptions" below.

Budgetary Process and Administration

In accordance with the provisions of Chapter 1, Division 3, Title 3, of the Government Code of the State of California, the County prepares and adopts a budget for each fiscal year. Prior to July 1, the County Administrative Officer is required to submit to the Board of Supervisors (the “Board”) a proposed budget for the fiscal year commencing the following July 1. The budget includes proposed expenditures and the means of financing them. On or before August 20, public hearings are conducted to obtain public comments. On or before October 1, the budget is legally enacted by adoption of a resolution.

The Board approves all transfers of budgeted appropriation amounts between budget units within any fund or between expenditure objects.

Budgetary control is maintained at the object level. Object levels are appropriation totals for salaries and employee benefits, services and supplies. All budgetary changes during the budget year require Board action. No increase in the aggregate appropriations can be made unless the County receives written certification of additional revenue from the sources of such revenue.

Budget Policy

The County has adopted Budget Principles. The Budget Principles contain principles designed to provide overall guidance in the preparation, adoption, implementation and evaluation of the annual budget. The major principles include:

- encouraging public input,
- balanced budgeting,
- targeting the use of Fund Balance for one-time costs and cyclical rather than structural budgetary imbalances,
- maintaining prudent reserves for cashflow, and for unforeseen or emergency events,
- prioritizing funding decisions,
- responding to changing conditions,
- developing strategic approach to address unfunded liabilities,
- maintaining a five-year Capital Improvement Program, and
- seeking cost recovery.

Fund Balance Policy

The County believes that sound financial management principles require that sufficient funds be retained by the County to provide a stable financial base at all times. To retain this stable financial base, the County needs to maintain unrestricted fund balance sufficient to fund cash flows of the County and to provide financial reserves for unanticipated expenditures and/or revenue shortfalls of an emergency nature. Committed, assigned and unassigned fund balances (described below under “Financial Statements - GASB Statement No. 54”) are considered unrestricted.

The purpose of the County’s fund balance policy is to maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures.

The County has adopted a policy to achieve and maintain committed and assigned fund balance categories of no less than 7% of the upcoming year's estimated General Fund revenues.

General Fund Revenues and Expenditures

The revenues in tables that follow are categorized as:

- Taxes, detailed in Table No. 18 "Tax Revenues by Source," which includes general property tax, property tax in-lieu of motor vehicle license fees, sales tax, property tax in-lieu of sales tax and transient occupancy taxes;
- Licenses and Permits, which includes construction and grading permits, franchise fees (cable, utility, trash) and food vendor permits;
- Fines and Forfeitures, which includes municipal and vehicle code violations and criminal fines;
- Revenue from Use of Money, which includes interest income and rent and concessions;
- Intergovernmental Revenue, detailed in Table No. 20 "State and Federal Aid" which includes Proposition 172 sales tax, motor vehicle license fees, and state and federal reimbursements for health and welfare services;
- Charges for Services, comprised of outpatient clinic fees (42%), County overhead charges (4%), property tax administration fees (4%), consumer fraud penalties and other charges such as booking fees, court filing fees, fees for dispatch services and alarm response, recoding fees, plan checking, building inspection, park and recreation fees and other municipal services (50%); and
- Miscellaneous Revenue.

The expenditures in Table No. 10 that follows are categorized by governmental function. Each function generally includes salaries and benefits, services and supplies and other charges.

Salaries and benefits include direct personnel costs, pension and post-retirement benefits, health insurance costs and workers' compensation and unemployment insurance costs.

Services and supplies include non-personnel operating costs and contract professional services, of which approximately 43.5% relates to the Health Services Agency operations and 13.6% relates to the Human Services department.

Other charges primarily consist of non-personnel related costs, of which approximately 34.9% is related to health services and 50.4% is associated with social services.

Operating transfers reflected in the financial statements consist primarily of debt service payments. However, for budget purposes, the County includes inter-department cost allocations in the "transfers out" line. These transfers are eliminated in preparing the audited financial statements.

Fiscal Year 2013/14 Budget Assumptions

The County's Proposed Budget for 2013/14 reflected the County's assessment of the continuing impact of the recession on revenues.

Some key assumptions incorporated into the 2013/14 Budget are as follows:

- Property tax would increase 1.4% from 2012/13 estimated actual figures;

- Property tax In-Lieu of Vehicle License fees would increase 1.6% from 2012/13 estimated actual figures;
- Sales tax would remain level with 2012/13 estimated actual sales tax.
- Transient occupancy tax would increase 14% compared with 2012/13 estimated actual transient occupancy tax primarily due to a tax rate increase of 1.5% approved by voters. Estimated actual 2012/13 transient occupancy tax was expected to be relatively equal to transient occupancy tax received in 2011/12, after an increase of 12.2% from 2010/11.
- Additional expenses relating to realignment of programs from the State level to the County level would be offset by revenue from the State.
- The County would make further adjustments to its budget if required as a result of the adoption of the State's final 2013/14 budget. See "RISK FACTORS - State Budget" herein.
- The elimination of 8.75 vacant positions and 2.15 filled positions.
- The addition of 55 positions required for the implementation of the Affordable Care Act ("ACA").
- Mid-year opening of the County's Behavioral Health Center ("BHC") facility, replacing acute psychiatric care services previously provided for by Dominican Hospital.

After budget hearings, the County made adjustments to the proposed budget revenues and expenditures. Revenues were increased by \$6.4 million primarily for expected increases in reimbursable ACA expenditures on salaries, or for reimbursable costs for carryover items rebudgeted from Fiscal Year 2012/13. Expenditures were increased \$9.8 million, of which \$7.5 million were carryover of encumbered but unexpended funds from Fiscal Year 2012/13 and \$3.7 million were increased salary and benefits for additional ACA personnel. A reserve for contingencies of \$1.27 million was also added. These increased costs were offset by a \$2.5 million increase in related cost allocations. The 2013/14 Budget shown in Table No. 10 reflects these adjustments.

Mid-Year Update and Estimates for Fiscal Year 2014/15

The County's tax revenues for Fiscal Year 2013/14 are expected to increase by \$2.1 million over budgeted amounts, due to better than projected property tax, sales tax and transient occupancy tax receipts. An additional \$1 million in budget savings are expected by year end due to cost savings and liquidation of prior year encumbrances no longer needed for current year appropriations.

Using the Fiscal Year 2013/14 Budget as the basis for Fiscal Year 2014/15 budgeting, the County expects that the \$9.8 million deficit originally projected in the Fiscal Year 2013/14 Budget would be offset by a \$1.7 million reduction in costs in Fiscal Year 2014/15 for the elimination of one-time expenditures included in the Fiscal Year 2013/14 Budget, together with a further \$3.5 million in tax revenue growth over and above the growth projected in Fiscal Year 2013/14 (for a total increase in tax revenues of \$5.6 million compared to the Fiscal Year 2013/14 Budget), a small increase in expenditures and the use of the additional \$3.1 million in unanticipated tax receipts in Fiscal Year 2013/14.

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TABLE NO. 10
COUNTY OF SANTA CRUZ
GENERAL FUND REVENUES AND EXPENDITURES

	FY 2011/12	FY 2012/13	FY 2012/13	FY 2013/14
	<u>Actual</u>	<u>Budget</u>	<u>Actual</u>	<u>Final Budget</u>
<u>Revenues</u>				
Taxes	\$ 88,406,635	\$ 87,291,909	\$ 88,390,337	\$ 89,969,942
Licenses, Permits and Franchises	10,355,966	10,264,567	9,819,321	10,410,289
Fines and Forfeitures	4,660,530	4,565,517	4,418,159	5,483,063
Use of Money and Property	1,720,668	1,715,859	1,079,143	1,746,961
Intergovernment Revenues	198,723,877	206,092,439	208,953,957	207,890,368
Charges for Current Services	54,524,658	51,992,902	43,279,759	50,640,823
Other Revenues	2,058,972	4,049,294	3,554,348	3,251,942
Other Financing Sources	85,423	-	268,390	-
Transfers In ⁽¹⁾	<u>2,569,154</u>	<u>29,736,614</u>	<u>2,073,089</u>	<u>26,987,150</u>
Total Revenues	363,105,883	395,709,101	361,836,503	396,380,538
<u>Expenditures</u>				
General Government	26,597,298	32,537,467	27,919,587	32,100,120
Public Protection	106,679,270	119,699,407	113,965,861	122,036,303
Public Ways and Facilities	190,609	222,411	219,847	217,364
Health and Sanitation	107,809,876	120,196,721	107,549,603	126,908,117
Public Assistance	98,996,195	105,289,933	101,042,337	110,836,591
Education	108,666	123,418	115,398	121,549
Recreation and Culture	5,800,735	5,906,733	5,663,542	6,162,351
Debt Service	364,502	247,502	182,978	-
Transfers Out ⁽²⁾	13,619,810	22,137,770	6,777,255	6,569,729
Other Financing Uses	137,065	-	-	-
Appropriation for Contingency	<u>-</u>	<u>406,634</u>	<u>-</u>	<u>1,271,948</u>
Total Expenditures	360,304,026	406,767,996	363,436,408	406,224,072
Net Change in Fund Balances	2,801,857	(11,058,895)	(1,599,905)	(9,843,534)
Beginning Unreserved Fund Balance	35,249,423	42,168,827	38,429,388	38,169,460
Change in Reserves	<u>378,108</u>	<u>-</u>	<u>195,765</u>	<u>-</u>
Ending Unreserved Fund Balance	\$ 38,429,388	\$ 31,109,932	\$ 37,025,248	\$ 28,325,926

(1) For budget purposes, the County budgets as "transfers in" revenues that the County receives for public health, mental health and social services that are required to be recorded first in a trust fund and transferred in or "realigned" for the intended General Fund purpose. These transfers are eliminated in preparing the audited financial statements.

(2) For budget purposes, the County budgets as "transfers out" the cost allocation which offsets the cost of services provided by various General Fund departments to other General Fund functions. These transfers are eliminated in preparing the audited financial statements. The primary transfers out shown in the audited financial statements are for the payment of debt service.

Ad Valorem Property Taxes

Taxes are levied for each fiscal year on taxable real and personal property which is situated in the County as of the preceding January 1. For assessment and collection purposes, property is classified either as "secured" or "unsecured," and is listed accordingly on separate parts of the assessment roll. The "secured roll" is that part of the assessment roll containing State assessed property and real property having a tax lien which is sufficient, in the opinion of the assessor, to secure payment of the taxes. Other property is assessed on the "unsecured roll."

Property taxes on the secured roll are due in two installments, on November 1 and February 1 of the fiscal year. If unpaid, such taxes become delinquent on December 10 and April 10, respectively, and a 10% penalty attaches to any delinquent payment. In addition, property on the secured roll with respect to which taxes are delinquent is sold to the State on or about June 30 of the fiscal year. Such property may thereafter be redeemed by payment of the delinquent taxes and the delinquency penalty, plus a redemption penalty of 1½% per month to the time of redemption. If taxes are unpaid for a period of five years or more, the property is subject to sale by the County Tax Collector.

Property taxes on the unsecured roll become delinquent, if unpaid on August 31. A 10% penalty attaches to delinquent taxes on property on the unsecured roll, and an additional penalty of 1½% per month begins to accrue on November 1 of the fiscal year. The County has four ways of collecting delinquent unsecured personal property taxes: (1) a civil action against the taxpayer; (2) filing a certificate in the office of the County Clerk specifying certain facts in order to obtain a judgment lien on certain property of the taxpayer; (3) filing a certificate of delinquency for record in the County Recorder's Office, in order to obtain a lien on certain property of the taxpayer; and (4) seizure and sale of personal property, improvements or possessory interests belonging or assessed to the assessee.

The Teeter Plan

The County has adopted an alternate procedure authorized in Chapter 3, Part 8, Division 1 of the Revenue and Taxation Code of the State of California (comprising Sections 4701 through 4717, inclusive) commonly referred to as the "Teeter Plan," for distribution of certain property tax levies on the secured roll.

Pursuant to the Teeter Plan, the County adopted Resolution 541-93 on October 5, 1993 adopting the Teeter Plan. Generally, the Teeter Plan provides for a tax distribution procedure by which secured roll taxes are distributed to taxing agencies within the County included in the Teeter Plan on the basis of the tax levy, rather than on the basis of actual tax collections. The County then receives all future delinquent tax payments, penalties and interest, and a complex tax redemption distribution system for all participating taxing agencies is avoided. All taxing agencies within the County are participating in the Teeter Plan. The County anticipates property taxes to be apportioned during each December, April and June, with the balance of the levy to be apportioned on or before June 30 each year. The overall historical and estimated delinquency rates in the County are as follows:

2007/08	5.15%
2008/09	5.61%
2009/10	5.29%
2010/11	3.98%
2011/12	3.90%
2012/13	3.64%
2013/14	3.50% (Estimate)

In addition, pursuant to the Teeter Plan, the County is required to establish a tax losses reserve fund to cover losses which may occur in the amount of tax liens as a result of special sales of tax-defaulted property (*i.e.*, if the sale price of the property is less than the amount owed). The appropriate amount in the fund is determined by one of two methods: (1) an amount not less than 1% of the total amount of taxes and assessments levied on the secured roll for a particular year for entities participating in the Teeter Plan, or (2) an amount not less than 25% of the total delinquent secured taxes and assessments calculated as of the end of the fiscal year for entities participating in the Teeter Plan. The County's tax losses reserve fund is fully funded in accordance with the County's most current election (on October 29, 2013) to be governed by the second alternative at \$4,389,583, as of June 30, 2013. Accordingly, any additional penalties and interest that otherwise would be credited to the tax losses reserve fund are available to be credited to the County's General Fund.

Taxable Property and Assessed Valuation

Set forth in the tables below are assessed valuation for secured and unsecured property and tax levies and collections within the County. Article XIII A of the California Constitution prescribes the method for determining the full cash value of real property and the maximum ad valorem tax on real property. The full cash value, once established, is subject to annual adjustment to reflect inflation at a rate not to exceed 2% or a reduction in the California Consumer Price Index. There may also be declines in valuations if the California Consumer Price Index is negative.

Proposition 8 provides for the assessment of real property at the lesser of its originally determined (base year) full cash value compounded annually by the inflation factor, or its full cash value as of the lien date, taking into account reductions in value due to damage, destruction, obsolescence or other factors causing a decline in market value. Reductions based on Proposition 8 do not establish new base year values, and the property may be reassessed as of the following lien date up to the lower of the then-current fair market value or the factored base year value. The County saw Proposition 8 reductions in property values between 2009 and 2013 as described below in Table No. 11. See "RISK FACTORS - Constitutional Limitation on Taxes and Expenditures - Article XIII A" and "- Proposition 8 Adjustments" herein.

**TABLE NO. 11
COUNTY OF SANTA CRUZ
GROSS ASSESSED VALUE OF ALL TAXABLE PROPERTY
(INCORPORATED CITIES AND UNINCORPORATED COUNTY AREAS)**

Fiscal Year	Secured	Unsecured	Total	Change
2008/09	\$33,586,675,030	\$861,576,055	\$34,448,251,085	
2009/10	32,531,716,741	865,264,771	33,396,981,512	(3.1%)
2010/11	32,390,764,838	801,371,482	33,192,136,320	(0.6%)
2011/12	32,332,270,918	767,714,452	33,099,985,370	(0.3%)
2012/13	32,033,769,082	767,064,323	32,800,833,405	(0.9%)
2013/14	33,301,783,628	764,939,349	34,066,722,978	3.9%

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There are approximately 96,000 taxable secured parcels and 8,000 taxable unsecured parcels in the County. Under Proposition 8 (see "RISK FACTORS - Constitutional Limitation on Taxes and Appropriations - Proposition 8 Adjustments,") the County Assessor reduced the 2009/10 assessed value of approximately 18,000 properties throughout the County, the 2010/11 assessed value of 18,253 properties throughout the County, the 2011/12 assessed value of approximately 21,000 properties throughout the County and the 2012/13 assessed values of 26,271 properties throughout the County.

The largest taxpayers in the County for the 2012/13 Fiscal Year are shown below.

Taxpayers	Type of Business	2012/13 Assessed Valuation	% of Total Assessed Valuation 2012/13
Pacific Gas & Electric Company	Gas & Electric Utility	\$225,458,856	0.69%
Santa Cruz Seaside Company	Amusement Park	67,868,390	0.21
Macerich Partnership L P	Commercial Real Estate	61,199,999	0.19
Neven Development LLC	Hospital	58,289,484	0.18
Pacific Bell Telephone Co.	Telephone Utility	52,153,174	0.16
S C Beach Hotel Partners LLC	Hotel	44,143,577	0.13
Cypress Point RE Investors LLC	Real Estate	39,811,821	0.12
George Ow, Jr. et al	Real Estate	37,515,680	0.11
Safeway Inc.	Food Retailer	37,439,682	0.11
SC Shaffer Road Investors	Real Estate	<u>34,433,102</u>	<u>0.10</u>
		\$658,313,765	2.00%

Source: County of Santa Cruz Comprehensive Annual Financial Report, Fiscal Year ended June 30, 2013.

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Prior to Fiscal Years ending June 30, 2010, the County reported General Fund property tax levies and collections separately. Beginning with Fiscal Years ending June 30, 2010, the County reports tax collection data on a County-wide basis for secured taxes only as set forth in Table No. 12.

TABLE NO. 12
COUNTY OF SANTA CRUZ
SECURED TAX LEVIES AND COLLECTIONS
(in \$ thousands)

Fiscal Year Ended June 30	Total Secured Tax Levy for Fiscal Year ⁽¹⁾	Collections within the Fiscal Year of the Levy		Collections in Subsequent Years	Total Tax Collections	Percentage of Levy
		Amount	Percentage of Levy			
2009	\$402,589	\$387,153	96.2%	\$13,808	\$400,961	99.6%
2010	395,628	383,707	97.0	10,095	393,802	99.5
2011	394,498	385,099	97.6	5,658	390,757	99.1
2012	395,546	388,135	98.1	4,190	392,325	99.2
2013	399,146	393,223	98.5	-	393,223	98.5

Source: County of Santa Cruz Comprehensive Annual Financial Report.

⁽¹⁾ Includes secured tax levy for the County, school districts, cities and special districts in the County under the supervision of independent governing boards.

Redevelopment Agencies

The California Redevelopment Law (Part 1 of Division 24 of the Health & Safety Code of the State) authorized the redevelopment agency of any city or county to receive an allocation of tax revenues resulting from increases in assessed values of properties within designated redevelopment project areas (the "incremental value") occurring after the year the project area was formed. In effect, local taxing authorities, such as the County, realized tax revenues only on the assessed value of such property at the time the redevelopment project was created for the duration of such redevelopment project. There have been 6 redevelopment projects formed in the County (some of the 11 original redevelopment projects that had been formed have been merged). Table No. 13 sets forth total assessed valuations and redevelopment agency incremental values.

The State Legislature approved a bill, AB XI 26, during the 2011/12 State budget process. AB XI 26 eliminated redevelopment agencies State-wide. The California Redevelopment Association and the League of California Cities filed a petition with the California Supreme Court (the "Court"), requesting the Court to review the constitutionality of AB XI 26. On December 29, 2011, the Court issued its opinion and upheld AB XI 26. As a result of the decision, all California redevelopment agencies, including the County's Redevelopment Agency and other redevelopment agencies formed by cities within the County, were dissolved as of February 1, 2012. Certain tax revenues allocable to the former redevelopment agency will continue to be available to the County, as successor agency to the County's Redevelopment Agency, to pay certain obligations of the former redevelopment agency, and some of those revenues may be redirected to other taxing agencies, such as the County, school districts, and cities. This is also true for the former redevelopment agencies formed by cities within the County. Any General Fund impact resulting from AB XI 26 (and subsequent Legislation AB 1484 were incorporated into the County's 2012/13 and 2013/14 budgets.

**TABLE NO. 13
COUNTY OF SANTA CRUZ
TOTAL AND NET PROPERTY TAX VALUATIONS**

Fiscal Year	Total Assessed Valuation	Redevelopment/ Successor Agency Incremental Value	Net Value
2008/09	\$34,448,251,085	\$4,541,432,808	\$29,906,818,277
2009/10	33,396,981,512	4,121,255,800	29,275,725,712
2010/11	33,192,136,319	4,477,971,205	28,714,165,114
2011/12	33,099,985,370	4,501,523,187	28,598,462,183
2012/13	32,800,833,405	4,434,487,308	28,366,346,097
2013/14	34,066,722,978	4,589,607,105	29,477,115,873

Source: County of Santa Cruz Auditor-Controller.

State Legislative Shifts of Property Tax Allocation

Beginning in 1992/93, the State has required that local agencies including counties remit a portion of property taxes received to augment school funding. These funds are deposited in each county's Education Revenue Augmentation Fund ("ERAF"). These property taxes are permanently excluded from the County's property tax revenues.

On November 2, 2004, California voters approved Proposition 1A, which amended the State Constitution to significantly reduce the State's authority over major local government revenue sources. Under Proposition 1A, the State may not (i) reduce local sales tax rates or alter the method of allocating the revenue generated by such taxes, (ii) shift property taxes from local governments to schools or community colleges, (iii) change how property tax revenues are shared among local governments without two-third approval of both houses of the State Legislature, or (iv) decrease Vehicle License Fees revenues without providing local governments with equal replacement funding. Beginning in Fiscal Year 2008/09, the State was permitted to shift to schools and community colleges a limited amount of local government property tax revenue if certain conditions are met, including (a) a proclamation by the Governor that the shift is needed due to a severe financial hardship of the State, and (b) approval of the shift by the State Legislature with a two-thirds vote of both houses. Under such a shift, the State must repay local governments for their property tax losses, with interest, within three years. Proposition 1A does allow the State to approve voluntary exchanges of local sales tax and property tax revenues among local governments within a county. The first shift occurred in 2008/09. 2012/13 was the first year that another shift was allowable, but the State has not implemented another borrowing yet.

In addition, certain other provisions in the State budget have resulted in a realignment of property tax revenues. See "RISK FACTORS - State Budget" herein and "Other Local Taxes - Sales and Use Taxes" and "Property Tax In Lieu of Motor Vehicle License Fee" below.

Other Local Taxes

In addition to ad valorem taxes on real property, the County receives the following local taxes:

Transient Occupancy Taxes. The County levies a transient occupancy tax on hotel and motel bills. In November 2012, voters approved an increase in this tax rate from 9.5% to 11%.

Property Transfer Taxes. A documentary stamp tax is assessed for recordation of real property transfers.

Sales and Use Taxes. Sales tax is collected and distributed by the State Board of Equalization. Each local jurisdiction receives an amount equal to 1% of taxable sales within their jurisdiction.

On March 2, 2004, voters approved a bond initiative formally known as the "California Economic Recovery Act." This act authorized the issuance of \$15 billion in bonds to finance the 2002/03 and 2003/04 State budget deficits, which would be payable from a fund to be established by the redirection of tax revenues through the Triple Flip as described more fully below.

Under the "Triple Flip," one-quarter of local governments' 1% share of the sales tax imposed on taxable transactions within their jurisdiction will be redirected to the State. In an effort to eliminate the adverse impact of the sales tax revenue redirection on local government, the legislation provides for property taxes in the ERAF to be redirected to local government. Because the ERAF moneys were previously earmarked for schools, the legislation provides for schools to receive other state general fund revenues. It is expected that the swap of sales taxes for property taxes would terminate once the deficit financing bonds were repaid, which is currently expected to occur in approximately 11 years. The County treats the Triple Flip property tax revenue as sales tax in its financial statements.

Property Tax In-Lieu of Motor Vehicle License Fee. The payments of property tax in-lieu of Motor Vehicle license fees ("VLF") are a State backfill from property tax revenues for a portion of the VLF fees collected statewide.

**TABLE NO. 14
COUNTY OF SANTA CRUZ
TAX REVENUES BY SOURCE**

	2009/10	2010/11	2011/12	2012/13	Budgeted 2013/14
Transient Occupancy Tax	\$ 3,511,320	\$ 4,101,086	\$ 4,604,773	\$ 4,515,035	\$ 5,211,895
Property Transfer Tax	1,629,814	1,708,708	1,528,127	1,935,643	1,649,200
Other Taxes	74,197	72,392	72,433	72,030	72,318
Sales Tax	7,212,290	7,892,028	8,378,175	9,128,896	9,159,106
Property Tax In Lieu – VLF	24,524,086	24,374,489	24,306,240	24,087,484	24,476,534
Regular Property Taxes ⁽¹⁾	<u>50,205,282</u>	<u>50,505,157</u>	<u>49,516,888</u>	<u>48,651,249</u>	<u>49,400,889</u>
Total Tax Revenues	<u>\$87,156,989</u>	<u>\$88,653,860</u>	<u>\$88,406,636</u>	<u>\$88,390,337</u>	<u>\$89,969,942</u>

Source: County of Santa Cruz.

⁽¹⁾ Does not reflect amounts paid by the State in-lieu of sales tax. Property taxes paid in lieu of sales tax under the "Triple Flip" are included in the Sales Tax figures.

State and Federal Funds

A significant source of the County's revenues comes from State and federal funds. Payment of State funds depends on the adoption by the State of its budget, including the appropriations therein providing for local assistance. These revenues are shown in the accompanying financial statements as "intergovernmental revenues" (see "RISK FACTORS - State Budget" herein). The following table sets forth the State and federal funds the County receives:

**TABLE NO. 15
COUNTY OF SANTA CRUZ
STATE AND FEDERAL FUNDS**

Source	2009/10	2010/11	2011/12	2012/13	Budgeted 2013/14
State Aid:					
In Lieu Taxes	\$ 7,672,632	\$ 7,717,316	\$ 6,299,094	\$ 5,763,959	\$ 5,632,384
Proposition 172	12,638,966	13,589,482	14,073,114	15,749,467	15,703,892
All Other State Aid	<u>82,818,123</u>	<u>84,213,607</u>	<u>93,128,935</u>	<u>100,499,153</u>	<u>114,378,844</u>
Total	\$103,129,721	\$105,520,405	\$113,501,143	\$122,012,579	\$135,715,120
Federal Aid	<u>\$ 72,206,956</u>	<u>\$ 73,850,098</u>	<u>\$ 69,172,495</u>	<u>\$ 68,554,670</u>	<u>\$ 72,175,248</u>
Total All Gov't Agencies	<u>\$175,336,677</u>	<u>\$179,370,503</u>	<u>\$182,673,638</u>	<u>\$190,567,249</u>	<u>\$207,890,368</u>

Source: County of Santa Cruz Annual Budget.

The significant categories of state aid include additional taxes in-lieu of VLF for a portion of fees realigned to the Health Services Agency, Proposition 172 (sales tax dedicated to public safety uses) and reimbursement for programs such as AFDC, IHSS, Medi-Cal, food stamps, Short/Doyle medical and mental health services, AB 109 realignment, and AB 118 food programs. The significant categories of federal aid include various health programs, foster care programs, AFDC, adoption assistance program, food stamps and child welfare programs.

Other Revenue Sources

Licenses and Permits. These revenues consist primarily of building construction permit fees and franchise fees. The County levies franchise fees on its cable television, trash collection and utility franchises.

Fines, Forfeitures and Penalties. These revenues include parking citations, municipal court fines, asset seizure proceeds and other fines for municipal code violations.

Use of Money and Property. These revenues consist primarily of investment earnings and rental/concession income.

Charges for Services. The County charges recording fees, booking fees, court filing fees, fees for dispatch services and alarm response, plan checking, building inspection and other municipal services.

Short-Term Tax Exempt Obligations

The following table presents a five-year history of the County's temporary borrowings. All such notes have been repaid on their respective maturity dates.

<u>Fiscal Year</u>	<u>TRAN Amount</u>
2009/10	\$50,000,000
2010/11	50,000,000
2011/12	48,000,000
2012/13	50,000,000
2013/14	50,000,000

Source: County of Santa Cruz.

Long-Term Tax Exempt Obligations

General Obligation Debt. As of the date hereof, the County has no long-term general obligation bonded indebtedness outstanding and has never defaulted on any of its bonded indebtedness previously issued. The County has no authorized but unissued general obligation debt.

Lease Obligations. The County has made use of various lease arrangements with joint powers authorities and non-profit corporations to finance capital projects and purchase equipment through the issuance of certificates of participation and lease revenue bonds. Upon expiration of these leases, title to the projects or equipment vests in the County. There are currently nine outstanding certificates of participation and lease revenue bonds aggregating \$65.2 million in principal amounts. All issues are fixed rate obligations. The County also leases other assets under both operating and capital leases.

In March 2014, the County and the Santa Cruz County Capital Facilities Authority (the "CFA") approved the issuance by the CFA of 2014 Lease Revenue Bonds (Public Facilities Project) ("2014 Bonds"), in an amount not-to-exceed \$14,000,000. The CFA expects to issue approximately \$12,500,000. The 2014 Bonds will be secured by lease payments to be paid by the County to the CFA. The 2014 Bonds will mature in 2035, and the annual payments are expected to be approximately \$1,065,000 through 2030, of which \$575,000 will be reimbursed by the County Disposal Sites CSA 9C enterprise fund ("CSA 9C"), and \$575,000 thereafter, also reimbursed by CSA 9C.

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TABLE NO. 16
COUNTY OF SANTA CRUZ
SUMMARY OF LONG- AND INTERMEDIATE-TERM OBLIGATIONS
(in \$ millions)

	Original Issue	Principal Outstanding as of 1/1/14	Estimated 2013/14 Payments	Final Maturity
1996 Certificates of Participation	\$ 24.855	\$15.550	\$1.705	2026
2001 Series B Lease Revenue Bonds ⁽¹⁾	11.900	6.220	0.521	2031
2002 Certificates of Participation	5.640	1.960	0.162	2032
2004 Certificates of Participation ⁽²⁾	23.000	14.095	1.816	2024
2005 Refunding Certificates of Participation	10.580	5.465	0.865	2020
2006 Certificates of Participation ⁽³⁾	9.000	6.685	0.667	2036
2008 Certificates of Participation	4.625	3.040	0.467	2023
2011 Certificates of Participation	5.605	5.460	0.388	2036
2012 Use Payments	1.885	1.768	0.136	2034
Capital Leases	6.401	4.956	0.500	
TOTAL LONG- AND INTERMEDIATE-TERM OBLIGATIONS ⁽⁴⁾	<u>\$103.491</u>	<u>\$65.199</u>	<u>\$7.227</u>	

⁽¹⁾ To be refunded with the proceeds of the Certificates.

⁽²⁾ Approximately \$800,000 annual debt service will be reimbursed by the Santa Cruz County Flood Control and Water Conservation District and the Pajaro Storm Maintenance District.

⁽³⁾ Approximately \$417,000 of the 2006 Certificates of Participation is paid from General Fund sources and the balance from County Service Area 9 funds.

⁽⁴⁾ Does not include the approximate \$12.5 million lease revenue bonds expected to be issued in April 2014.

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Retirement Programs

Plan Description. The County contributes to the California Public Employees Retirement System ("PERS"), an agent multiple-employer public employee defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provisions and all other requirements are established by State statute and County ordinance. Copies of PERS' annual financial report may be obtained from their Executive Office located at 400 P Street, Sacramento, California 95814.

California Public Employees' Pension Reform Act of 2013. On September 12, 2012, the Governor signed into law the California Public Employees' Pension Reform Act of 2013 (the "Reform Act"), which makes changes to both PERS and California State Teachers' Retirement System ("CalSTRS"), most substantially affecting new employees hired after January 1, 2013 (the "Implementation Date"). For non-safety PERS participants hired after the Implementation Date, the Reform Act changes the normal retirement age by increasing the eligibility for the 2% age factor from age 55 to 62 and increases the eligibility requirement for the maximum age factor of 2.5% to age 67. Among the other changes to PERS and CalSTRS, the Reform Act also: (i) requires all new participants enrolled in PERS and CalSTRS after the Implementation Date to contribute at least 50% of the total annual normal cost of their pension benefit each year as determined by an actuary, (ii) requires CalSTRS and PERS to determine the final compensation amount for employees based upon the highest annual compensation earnable averaged over a consecutive 36-month period as the basis for calculating retirement benefits for new participants enrolled after the Implementation Date, and (iii) caps "pensionable compensation" for new participants enrolled after the Implementation Date at 100% of the federal Social Security contribution and benefit base for members participating in Social Security or 120% for members not participating in social security, while excluding previously allowed forms of compensation under the formula such as payments for unused vacation, annual leave, personal leave, sick leave, or compensatory time off. Ultimately, the Reform Act will reduce the County's long-term pension obligation as existing employees retire and new employees are hired to replace them.

Funding Policy. Active plan members are required by State statute to contribute 7% and 9% of annual covered salary for miscellaneous and safety employees respectively. The County currently makes the contributions required of County employees on their behalf and for their account for Service Employees International Union ("SEIU") employees only (approximately 68% of all County employees), other employees pay their own contributions. The County will phase out its 7% contribution of the employees' share for the Tier 1 SEIU employees over the next two years, but will provide those employees with offsetting salary adjustments. The County is required to contribute at an actuarially determined rate established by PERS. Separately funded plans have been established for each employee group. Benefit provisions and all other requirements are established by State statute and County contracts with employee bargaining groups.

For Tier 3 active plan members in miscellaneous and safety plans, the State statute requires a contribution of 6.25% and 10% of annual covered salary. Sheriff Safety employees in Tier 3 continue to contribute 9% of annual covered salary.

PERS set contribution rates for 2010/11 based on a 4.9% negative return on investments which occurred in 2007/08. For the Fiscal Year 2008/09, the PERS portfolio had lost more than 23% of its value. This loss began affecting PERS contribution rates in 2011/12. A history of the PERS annual portfolio rate of return is shown below. From July 1, 2013 to October 31, 2013, the PERS portfolio rate of return was 8.1%. Future earnings performance and adjustments of assumptions may increase or decrease future contribution rates for plan participants, including the County.

PERS HISTORICAL INVESTMENT RETURNS

<u>Year Ending June 30</u>	<u>Rate of Return</u>
2004	16.7
2005	12.6
2006	12.3
2007	19.1
2008	(4.9)
2009	(23.4)
2010	11.6
2011	20.9
2012	1.0
2013	13.2

Source: California Public Employees' Retirement System.

The County's percentage of payroll for PERS payments for each retirement account for 2006/07 through 2013/14 and estimates for 2014/15 through 2019/20 are shown in the table below. These rates do not include the employees' contribution rates.

<u>Fiscal Year</u>	<u>Miscellaneous</u>	<u>Safety</u>	<u>Sheriff Safety</u>
2006/07	11.926%	14.606%	24.226%
2007/08	12.301	14.239	25.424
2008/09	12.197	14.201	25.642
2009/10	12.051	13.784	25.823
2010/11	12.150	13.989	25.145
2011/12	13.776	17.046	28.749
2012/13	14.253	17.381	29.153
2013/14	15.099	19.094	30.534
2014/15	16.084	20.292	34.020
2015/16*	17.200	21.800	35.300
2016/17*	18.400	23.400	36.600
2017/18*	19.500	24.900	38.000
2018/19*	20.700	26.500	39.300
2019/20*	21.800	28.000	40.600

* Projected by PERS based on various assumptions, including an investment return of 7.5%.

In March 2012, PERS voted to decrease the investment rate of return used in future actuarial valuations from 7.75% to 7.5%. This change was implemented over a two year period beginning with the 2013/14 rates.

In April 2013, PERS voted to raise employer rates roughly 50% over the next seven years, replacing current actuarial methods. Over five years, the new method increases employer rates to the level needed to project 100% funding in 30 years.

Also in April 2013, PERS approved a recommendation to change the amortization and smoothing policies. Prior to this change, PERS employed an amortization and smoothing policy, which spread investment returns over a 15-year period while experience gains and losses were amortized over a rolling 30-year period. Effective with the June 30, 2013 valuations, PERS will no longer use an actuarial value of assets and will employ an amortization and smoothing policy that will spread rate increases or decreases over a 5-year period, and will amortize all experience gains and losses over a fixed 30-year period.

The new amortization and smoothing policy will be used for the first time in the June 30, 2013 actuarial valuations. These valuations will be performed in the fall of 2014 and will affect employer contribution rates for the Fiscal Year 2015/16.

PERS has told plan participants to expect that the new method would result in contribution rates from 3 to 6% (of pay) higher than the current methods would have produced at the end of either the six or seven-year period.

In February 2014, PERS adopted new demographic assumptions regarding improved mortality rates. According to PERS, this could result in rates as much as 2% to 5% higher. The impact would be phased in and, if implemented, would affect rates for the Fiscal Year 2016/17.

Benefit Tiers. In 2012 the County established two tiers of benefits for employees in each of the employee plans, based on date of hire. Benefits were reduced for employees in the Safety and Safety Sheriff's Plans hired on or after June 9, 2012. Benefits were reduced for employees in the Miscellaneous Plan hired on or after December 17, 2012. Effective January 1, 2013 State law went into effect with a third tier. The third-tier benefit levels in place for new hires on or after January 1, 2013 are 2% of salary per year of service at age 62 based on 3 year salary average for Miscellaneous Plan employees, and 2% of salary per year of service at age 57 based on 3 year salary average for Safety and Safety Sheriff employees. Ultimately, the new benefits will reduce the County's long-term pension obligation as existing employees retire and new employees are hired to replace them.

Annual Pension Costs. A ten-year history of the County's required annual pension costs and % of annual pension costs contributed is shown in the table below. The required contribution was determined as part of an annual actuarial valuation using the entry age normal actuarial cost method. The most recent actuarial assumptions included (a) 7.50% investment rate of return (net of administrative expenses); (b) projected salary increases of 3.30% to 14.20% for miscellaneous employees, 3.30% to 14.20% for safety employees and 3.30% to 14.20% for sheriff safety employees depending on age, service, and type of employment, and (c) 2.75% per year cost-of-living adjustments. Both (a) and (b) included an inflation component of 2.75%. The actuarial value of PERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a fifteen-year period. PERS unfunded actuarial accrued liabilities (or surplus) is being amortized as a level percentage of projected payroll on a closed basis. The average remaining amortization period at June 30, 2013 was ___ years for miscellaneous employees and ___ years for safety employees for prior and current service unfunded liability.

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**TEN YEAR TREND INFORMATION FOR EMPLOYER CONTRIBUTIONS
(ALL PLANS COMBINED)**

<u>Fiscal Year</u>	<u>Annual Pension Cost (APC)</u>	<u>% of APC Contributed</u>	<u>Net Pension Obligation (Unfunded)</u>
2003/04	\$17,534,000	100%	-
2004/05	26,000,000	100	-
2005/06	31,465,000	100	-
2006/07	31,079,000	100	-
2007/08	33,186,000	100	-
2008/09	33,906,000	100	-
2009/10	32,055,000	100	-
2010/11	31,075,000	100	-
2011/12	33,261,000	100	-
2012/13	34,366,000	100	-

Source: County of Santa Cruz Comprehensive Annual Financial Report.

Set forth below is a ten-year analysis of the actuarial value of assets as a percentage of the actuarial accrual liability and the unfunded actuarial accrued liability as a percentage of the annual covered payroll as of June 30 of each year indicated for the County's combined employee groups.

**HISTORICAL FUNDING PROGRESS (ACTUARIAL VALUE)
(ALL PLANS COMBINED)**

<u>Actuarial Valuation Date June 30</u>	<u>Actuarial Valuation of Assets</u>	<u>Entry Age Actuarial Accrued Liability</u>	<u>Unfunded Actuarial Accrued Liability</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>Unfunded Liability as a Percent of Covered Payroll</u>
2003	\$505,849,810	\$ 584,956,648	\$ 79,106,838	86.5%	\$141,293,484	56.0%
2004	543,786,166	640,929,153	97,145,987	84.8	145,451,167	66.8
2005	593,842,088	703,842,376	110,000,288	84.4	148,852,557	73.9
2006	651,395,532	761,510,789	110,115,257	85.5	154,484,172	71.3
2007	717,379,652	830,141,101	112,761,449	86.4	164,873,127	68.4
2008	777,973,719	896,535,343	118,561,624	86.8	172,139,238	68.9
2009	822,938,140	984,786,909	161,848,769	83.6	171,978,231	94.1
2010	868,801,973	1,048,317,826	179,515,853	82.9	171,873,659	104.4
2011	918,402,837	1,117,365,270	198,962,433	82.2	166,062,673	119.8
2012	963,284,767	1,174,156,138	210,871,371	82.0	162,680,146	129.6

Source: County of Santa Cruz Comprehensive Annual Financial Report.

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Set forth below is a three-year analysis of the actuarial value of assets as a percentage of the actuarial accrual liability and the unfunded actuarial accrued liability as a percentage of the annual covered payroll as of June 30 of each year indicated for each of the County's three individual employee groups:

Safety Employees

Actuarial Valuation Date June 30	Actuarial Valuation of Assets	Entry Age Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	Unfunded Liability as a Percent of Covered Payroll
2010	\$109,419,543	\$124,165,627	\$14,746,084	88.1%	\$15,479,038	95.3%
2011	114,873,164	133,199,435	18,326,271	86.2	14,825,926	123.6
2012	119,179,623	139,059,550	19,879,927	85.7	15,751,689	126.2

Source: County of Santa Cruz Comprehensive Annual Financial Report.

Sheriff Safety Employees

June 30 Actuarial Valuation Date	Actuarial Valuation of Assets	Entry Age Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	Unfunded Liability as a Percent of Covered Payroll
2010	\$76,572,047	\$100,814,044	\$24,241,997	76.0%	\$12,459,589	194.1%
2011	81,994,903	108,356,979	26,362,076	75.7	12,207,567	215.9
2012	87,538,086	119,721,273	32,183,187	73.1	12,620,185	255.0

Source: County of Santa Cruz Comprehensive Annual Financial Report.

Miscellaneous Employees

June 30 Actuarial Valuation Date	Actuarial Valuation of Assets	Entry Age Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	Unfunded Liability as a Percent of Covered Payroll
2010	\$682,810,383	\$823,338,155	\$140,527,772	82.9%	\$143,904,632	97.7%
2011	721,534,770	875,808,856	154,274,086	82.4	139,029,180	111.0
2012	756,567,058	915,375,315	158,808,257	82.7	134,308,272	118.2

Source: County of Santa Cruz Comprehensive Annual Financial Report.

A historical comparison of actuarial value of assets to the market value of assets in the plans is shown below.

**TEN YEAR TREND INFORMATION FOR ASSET VALUES
(ALL PLANS COMBINED)**

June 30 Actuarial Valuation Date	Actuarial Valuation of Assets	Market Value of Assets	% of Actuarial Value to Market Value	Funded Ratio (Actuarial)	Funded Ratio (Market)
2003	\$505,849,810	\$459,863,463	110.0%	86.5%	78.6%
2004	543,786,166	535,186,217	101.6	84.8	83.5
2005	593,842,088	609,553,702	97.4	84.4	86.6
2006	651,395,532	690,018,325	94.4	85.5	90.6
2007	717,379,652	829,701,681	86.5	86.4	99.9
2008	777,973,719	791,447,525	98.3	86.8	88.3
2009	822,938,140	600,699,472	137.0	83.6	61.0
2010	868,801,973	681,707,068	127.4	82.9	65.0
2011	918,402,837	817,959,264	112.3	82.2	73.2
2012	963,284,767	804,508,253	119.7	72.0	68.5

Source: California Public Employees' Retirement System.

GASB Statement No. 68. On June 25, 2012, GASB approved two new standards ("Statements") with respect to pension accounting and financial reporting standards for state and local governments and pension plans. The new Statements, No. 67 and No. 68, will replace GASB Statement No. 27 and most of Statements No. 25 and No. 50. The changes will impact the accounting treatment of pension plans in which state and local governments participate. Major changes include: 1) the inclusion of unfunded pension liabilities on the government's balance sheet (currently, such unfunded liabilities are typically included as notes to the government's financial statements); 2) more components of full pension costs will be shown as expenses regardless of actual contribution levels; 3) lower actuarial discount rates will be required to be used for underfunded plans in certain cases for purposes of the financial statements; 4) closed amortization periods for unfunded liabilities will be required to be used for certain purposes of the financial statements; and 5) the difference between expected and actual investment returns will be recognized over a closed five-year smoothing period. In addition, according to GASB, Statement No. 68 means that, for pensions within the scope of the Statement, a cost-sharing employer that does not have a special funding situation is required to recognize a net pension liability, deferred outflows of resources, deferred inflows of resources related to pensions and pension expense based on its proportionate share of the net pension liability for benefits provided through the pension plan. Because the accounting standards do not require changes in funding policies, the full extent of the effect of the new standards on the County is not known at this time. The reporting requirements for pension plans will take effect for the fiscal year beginning July 1, 2013 and the reporting requirements for government employers, including the County, will take effect for the fiscal year beginning July 1, 2014.

Deferred Compensation Plan

The County offers all of its full-time employees a deferred compensation plan (the Deferred Compensation Plan) created in accordance with Section 457 of the Internal Revenue Code. The Deferred Compensation Plan permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or emergency. Employees direct the investment of plan assets into certificates of deposits and various mutual funds. The County has insignificant administrative duties.

As of December 31, 2013 ~~June 30, 2013~~, the Deferred Compensation Plan's assets of \$132,501,891 were on deposit with a third party administrator independent of the County.

Other Post Employment Benefits

Plan Description. Employees of the County who retire through PERS, their spouse, and eligible dependents may receive health plan coverage through the Public Employees' Medical & Hospital Care Program (PEMHCA) Plan (Plan). CA Gov. Code 22892 of the Public Employees' Medical and Hospital Care Act establishes the contracting agencies' minimum health premium contribution. The monthly employer contribution amount will be determined through PERS regulations and requirements along with a county reimbursement amount as set by relevant longevity schedules which are incorporated in each representation units memorandum of understanding

In subsequent years, the monthly retiree contributions shall increase upon CalPERS calculated adjustments based upon the medical care component of the Consumer Price Index-Urban (CPI-U).

Eligibility. All of the County's employees became participants in accordance with the Memorandum of Understanding ("MOU") as negotiated by each group or bargaining unit. In order to receive benefits, eligible employees must meet the minimum requirements defined in their MOU. PEMHCA Plan – the Plan is eligible to Plan members who retire directly from the County through CalPERS at age 50 with at least 5 years of service.

As of January 1, 2012 and March 1, 2014, respectively, the numbers of participants in the Plans were 3,183 and 3,000, of which 1,072 and 1,053 were retirees and 2,111 and 1,947 were active.

Funding Policy. The contribution requirements for the County are established by a Memorandum of Understanding as negotiated by each group or bargaining unit. The required contribution is based on projected pay-as-you-go financing requirements. For Fiscal Year 2012/13, the County contributed \$4,591,534 to the plan. The County's expected contribution for Fiscal Year 2013/14 is \$4.88 million.

Annual OPEB Cost and Net OPEB Obligation. The County's Annual Other Post-Employment Benefits ("OPEB") cost (expense) is calculated based on the *Annual Required Contribution of the Employer* ("ARC"), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excesses) over a period not to exceed thirty years. The following table shows the components of the County's annual OPEB cost for the Fiscal Years 2010/11 through 2012/13, the amount actually contributed to the Plan, and changes in the County's net OPEB obligation to the Plan:

	<u>2010/11</u>	<u>2011/12</u>	<u>2012/13</u>
Annual required contribution	\$22,809,000	\$11,254,000	\$12,106,000
Interest on net OPEB obligation	2,747,004	3,574,000	3,866,271
Amortization of Net OPEB obligation	<u>0</u>	<u>(3,574,000)</u>	<u>(4,177,000)</u>
Annual OPEB cost (expense)	25,556,004	11,254,000	11,795,271
Contributions made	<u>(4,818,714)</u>	<u>(4,822,914)</u>	<u>(4,591,534)</u>
Increase in net OPEB obligation	20,737,290	6,431,086	7,203,737
Net OPEB obligation - beginning of year	<u>61,044,534</u>	<u>81,781,824</u>	<u>88,212,910</u>
Net OPEB obligation - end of year	\$81,781,824	\$88,212,910	\$95,416,647

The County reduced the Plan benefits in 2011, which resulted in a decrease in the accrued actuarial liability and the ARC.

The County has been contributing to its OPEB costs on a pay-as-you-go basis. The County's annual OPEB costs, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the last 4 years is as follows:

<u>Fiscal Year</u>	<u>Annual OPEB Cost</u>	<u>Annual Contribution</u>	<u>% of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
2009/10	\$20,173,502	\$3,998,945	19.8%	\$61,044,534
2010/11	25,556,004	4,818,714	18.9	81,781,824
2011/12	11,254,000	4,822,914	42.9	88,212,910
2012/13	11,795,271	4,591,534	38.9	95,416,647

The County's pay-as-you-go contribution to OPEB costs is estimated to be \$5.2 million for Fiscal Year 2013/14. This estimated OPEB contribution is factored in to the County's 2013/14 budget.

Funded Status and Funding Progress. The following table sets forth the schedule of funding progress for the Plan:

<u>Valuation Date</u>	<u>Entry Age Actuarial Accrued Liability</u>	<u>Actuarial Value of Assets</u>	<u>UAAL</u>	<u>Funded Ratio ⁽¹⁾</u>	<u>Annual Covered Payroll</u>	<u>UAAL as a % of Covered Payroll</u>
1/1/2007	\$216,766,000	\$ -	\$216,766,000	0.00%	\$153,807,000	140.9%
1/1/2009	181,575,000	-	181,575,000	0.00	161,577,000	112.4
1/1/2012	127,836,000	-	127,836,000	0.00	154,788,000	82.6

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend rate. Amounts determined regarding the funded status of the Plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress above presents trend information about whether the actuarial value of Plan assets is increasing or decreasing over time relative to the Actuarial Accrued Liabilities for benefits.

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

Actuarial assumptions involve estimates and assumptions that extend far into the future. These assumptions are subject to future revisions as new facts become known.

In the January 1, 2012 actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions include a 4.5% investment rate of return which is based on the expected return on funds invested in County investments, and an annual healthcare cost trend of actual premiums initially and reduced to an ultimate rate of 5% thereafter. The actuarial assumption for inflation was 3%, and the aggregate payroll increases were 3.25%. The Unfunded Actuarial Accrued Liability ("UAAL") is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization as of June 30, 2012 was 28 years.

Employee Relations and Collective Bargaining

County employees are represented by ten bargaining units, the principal one being Service Employees International Union (Local 521) which represents approximately 68% of all County employees. Most County employees are covered by negotiated agreements.

<u>Bargaining Unit</u>	<u>Expiration Date</u>
Middle Management	September 16, 2017
District Attorney Association	June 30, 2017
Sheriff's Correctional Officers	Expired
Law Enforcement Middle Management	June 30, 2014-2016
Law Enforcement	June 30, 2014 2016
Sheriff Supervisory	June 30, 2014 2016
General Representation Unit	September 23, 2016
District Attorney Inspectors	June 30, 2016
Physicians' Representation Unit	September 11, 2016
Probation Association	Expired

Self-Insurance Program

The County is self-insured for its general and auto liability, workers' compensation, medical malpractice and employees' dental coverage. Excess coverage is purchased through the California State Association of Counties Excess Insurance Authority. Each self-insurance program is described below.

Workers' Compensation. Under the Workers' Compensation Self-Insurance Program the County is liable for the first \$500,000 and carries catastrophic insurance coverage for any amount required by statute. At June 30, 2013, this program had estimated future liabilities of \$34.5 million.

Dental. The County's self-insurance dental program had estimated future liability for dental benefits of \$96,053 as of June 30, 2013.

Liability and Property. The County is self-insured with excess insurance for the general liability program. At June 30, 2013, the County had estimated future liabilities totaling \$12.1 million which included estimates for known claims and losses incurred but not reported discounted for present value.

Unemployment Insurance. The estimated future liabilities at June 30, 2013 were \$91,466.

Claims Liabilities. The change in the balance of claims liabilities during the fiscal years ended June 30, 2013, and two prior years for all Self-Insurance Internal Service Funds combined is as follows:

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Unpaid claims and claim adjustment expenses, beginning of the fiscal year	\$35,296,149	\$36,861,428	\$44,287,352
Incurring claims and claim adjustment expenses	13,092,624	23,928,174	15,843,711
Claim payments	<u>(11,527,345)</u>	<u>(16,502,250)</u>	<u>(13,378,635)</u>
Unpaid claims and claim adjustment expenses, end of the fiscal year	<u>\$36,861,428</u>	<u>\$44,287,352</u>	<u>\$46,752,428</u>

Self-Insurance Funds. The County has established separate self-insurance funds. Summary financial information for the self-insurance funds is shown in Table No. 17. The County's Worker's Compensation Self-Insurance Fund accounts for the negative fund balance shown in Table No. 17. However, of the \$31.8 million of estimated future liabilities in the fund, the County expects that almost half of such claims, if required to be paid, will be reimbursed by the State or federal government, because the claims relate to employees whose programs are funded by the State or federal government. As of June 30, 2013, the Self-Insurance funds held a total of \$23.2 million in cash.

TABLE NO. 17
COUNTY OF SANTA CRUZ
SELF INSURANCE FUNDS

	<u>2009/10</u>	<u>2010/11</u>	<u>2011/12</u>	<u>2012/13</u>
Operating Revenues:				
Charges for Services	\$ 14,337,709	\$ 14,254,377	\$ 15,895,034	\$ 17,489,284
Other Revenues	<u>999,072</u>	<u>973,339</u>	<u>18,204</u>	<u>32,750</u>
Total Operating Revenues	15,336,781	15,227,716	15,913,238	17,522,034
Operating Expenses:				
Salaries and Employee Benefits	1,132,007	977,416	1,163,742	1,151,897
Services and Supplies	2,899,541	2,879,829	3,470,812	3,823,391
Insurance and Compensation Claims	<u>11,735,027</u>	<u>13,092,624</u>	<u>16,502,250</u>	<u>13,378,635</u>
Total Operating Expenses	15,766,575	16,949,869	21,136,804	18,353,923
Operating Income (Loss)	(429,794)	(1,722,153)	(5,223,566)	(831,889)
Non-Operating Revenues:				
Interest and Investment Income	<u>176,114</u>	<u>110,018</u>	<u>106,994</u>	<u>(8,494)</u>
Net Income	(253,680)	(1,612,135)	(5,116,572)	(840,383)
Net Assets – Beginning	<u>(16,250,218)</u>	<u>(16,503,898)</u>	<u>(18,116,033)</u>	<u>(23,232,605)</u>
Net Assets – Ending	(\$16,503,898)	(\$18,116,033)	(\$23,232,605)	(\$24,072,988)

Source: County of Santa Cruz Comprehensive Annual Financial Reports.

County Treasurer's Investment Pool

As of December 31, 2013, the market value of the County Treasurer's investment pool was \$707,426,053, compared to a book value of \$708,390,171. The diversification of the County Treasurer's investment pool's assets as of such date is shown in the following table.

<u>Type of Investment</u>	<u>% of Combined Pool</u>
U.S. Government Agencies	29.59%
U.S. Treasuries	38.05
Medium-Term Notes	7.34
Money Market Mutual Funds	6.35
Local Agency Investment Fund/Checking	8.08
Negotiable CDs	<u>10.59</u>
	100.00%

The weighted average maturity of all County Treasurer's investment pool moneys was 499 days. The current yield of the County Treasurer's investment pool at December 31, 2013 was 0.312%.

In general, all depositors in the County Treasurer's investment pool are required by law to deposit their funds in the County Treasurer's investment pool. This includes the County, school districts and other special districts in the County.

Financial Statements

The County's accounting policies conform to generally accepted accounting principles and reporting standards set forth by the State Controller. The audited financial statements also conform to the principles and standards for public financial reporting established by the National Council of Government Accounting and the Governmental Accounting Standards Board.

Basis of Accounting and Financial Statement Presentation. The government-wide financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when payment is due.

The County retained the firm of Marcum LLP Certified Public Accountants, Irvine, California, to examine the general purpose financial statements of the County as of and for the year ended June 30, 2013. See "INTRODUCTION - Professional Services." The following tables summarize the Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balance of the County's General Fund for the last four fiscal years. The County received a Certificate of Achievement for Excellence in Financial Reporting for the Fiscal Year ended June 30, 2013. **GASB Statement No. 54.**

The County was required to implement GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definition, for the Fiscal Year ending June 30, 2011. GASB No. 54 establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

The initial distinction that is made in reporting fund balance information is identifying amounts that are considered nonspendable, which are amounts that cannot be spent because they are either (a) not spendable in form or (b) legally or contractually required to be maintained intact. GASB No. 54 also provides for additional classification as "restricted," "committed," "assigned," and "unassigned" based on the relative strength of the constraints that control how specific amounts can be spent.

Restricted - Restricted fund balance includes amounts with constraints placed on their use that are either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or (b) imposed by law through constitutional provisions or enabling legislation. The County currently has only a minor amount of "Restricted" fund balance.

Committed - Committed fund balance includes amounts that can only be used for a specific purpose determined by formal action of the Board of Supervisors and that remain binding unless removed in the same manner. The establishment of a "committed" fund balance requires the passage of a resolution by a simple majority vote before June 30 of the applicable fiscal year.

The Board of Supervisors established a separate Committed fund balance account known as the Reserve for Working Capital. Funding of the Reserve for Working Capital is established by resolution during the annual budget process. The purpose of the reserve is to assist the County in maintaining a minimal fund balance. Any use of funds requires a four-fifths vote of the Board of Supervisors appropriating the funds and a resolution of the Board of Supervisors declaring a Fiscal Emergency.

The Board of Supervisors has also established a separate Committed fund balance account known as the Reserve for Economic Uncertainty. Funding of the Reserve for Working Capital is established by resolution during the annual budget process. The reserve is to be used only during recessions or periods of economic distress as measured by periods of time when the local unemployment rate exceeds 8% and/or the rate of inflation exceeds the growth in property taxes. Any use of funds requires a four-fifths vote of the Board of Supervisors appropriating the funds.

The Board of Supervisors has also established a separate Committed fund balance account known as the Reserve for Natural Disasters. Funding of the Reserve for Natural Disasters is established by resolution during the annual budget process. The purpose of the reserve is to fund extraordinary operating costs, legal costs and cashflow associated with delays in State and federal reimbursements for any natural disaster. Any use of funds requires a four-fifths vote of the Board of Supervisors appropriating the funds.

As of June 30, 2013, the County has “committed” fund balances as follows:

Committed to:

Working Capital	\$ 6,000,000
Economic Uncertainty	4,857,787
Natural Disasters	1,251,089
General Government	1,133,234
Public Protection	2,391,987
Public Ways and Facilities	2,564
Health and Sanitation	639
Public Assistance	492,042
Recreation and Cultural Services	<u>37,253</u>
Total committed fund balance	\$16,166,595

Assigned - Assigned fund balance includes amounts that are constrained by the County’s intent to be used for specific purposes. The Board of Supervisors has the authority to assign funds for a specific purpose, or change or remove an assignment, with a simple majority vote.

The County Administrative Officer also has the authority to assign funds for specific purposes, and to change or remove the assignment, which action is to be reported to the Board of Supervisors at their next meeting. An appropriation of existing fund balance to eliminate a projected budgetary deficit in the subsequent year’s budget may be classified as Assigned fund balance.

The County Administrative Offices has established and the Board of Supervisors has approved establishment of Assigned fund balance for federally qualified health program. The amount is for revenue already recognized in the General Fund but assigned to (1) provide a cushion to mitigate risk associated with mental health managed care programs, (2) provide an audit reserve for disallowed mental health costs, and (3) hold for possible future repayment of grant funds.

As of June 30, 2013, the County has “assigned” fund balances as follows:

<u>Assigned to:</u>	
Federally qualified health program	\$14,229,750
Eliminate projected budgetary deficit	
in subsequent year’s budget	5,174,625
Liabilities	1,052,278
Human services	<u>400,000</u>
Total assigned fund balance	\$20,856,653

The total estimated General Fund revenues for Fiscal Year 2013/14 are \$396,380,538. A 7% fund balance reserve would equal \$27,746,637. As of June 30, 2013, the combined balance of the General Fund fund balance committed for the Reserve for Working Capital, the Reserve for Economic Uncertainty, the Reserve for Natural Disasters and assigned for federally qualified health program totals \$26,338,626, and total committed and assigned fund balances totaled \$37,023,248.

GASB Statement No. 68.

On June 25, 2012, GASB approved two new standards (“Statements”) with respect to pension accounting and financial reporting standards for state and local governments and pension plans. The new Statements, No. 67 and No. 68, will replace GASB Statement No. 27 and most of Statements No. 25 and No. 50. The changes will impact the accounting treatment of pension plans in which state and local governments participate. Major changes include: 1) the inclusion of unfunded pension liabilities on the government’s balance sheet (currently, such unfunded liabilities are typically included as notes to the government’s financial statements); 2) more components of full pension costs will be shown as expenses regardless of actual contribution levels; 3) lower actuarial discount rates will be required to be used for underfunded plans in certain cases for purposes of the financial statements; 4) closed amortization periods for unfunded liabilities will be required to be used for certain purposes of the financial statements; and 5) the difference between expected and actual investment returns will be recognized over a closed five-year smoothing period. In addition, according to GASB, Statement No. 68 means that, for pensions within the scope of the Statement, a cost-sharing employer that does not have a special funding situation is required to recognize a net pension liability, deferred outflows of resources, deferred inflows of resources related to pensions and pension expense based on its proportionate share of the net pension liability for benefits provided through the pension plan. Because the accounting standards do not require changes in funding policies, the full extent of the effect of the new standards on the County is not known at this time. The reporting requirements for pension plans will take effect for the fiscal year beginning July 1, 2013 and the reporting requirements for government employers, including the County, will take effect for the fiscal year beginning July 1, 2014.

TABLE NO. 18
COUNTY OF SANTA CRUZ
GENERAL FUND
BALANCE SHEET
As of June 30

	2010	2011	2012	2013
Assets				
Cash and Investments	\$102,541,391	\$ 68,136,786	\$105,370,800	\$115,202,052
Receivables, Net	20,098,514	24,958,457	26,693,872	26,171,957
Due from Other Funds	409,524	43,443	26,451	18,384
Deposits with Others	92,000	90,000	90,000	90,000
Inventory	28,144	21,643	25,481	27,616
Prepays	1,448,057	1,436,757	1,474,186	1,343,166
Land Held for Resale	-	2,043,970	1,689,135	1,689,135
Total Assets	\$124,617,630	\$ 96,731,056	\$135,369,925	\$144,542,310
Liabilities				
Payables	\$ 17,248,827	\$ 21,213,641	\$ 17,636,876	\$ 15,289,636
Tax and Revenue Anticipation Notes Payable	50,997,222	(1)	33,658,167 (2)	50,997,222
Due to Other Funds	544,557	-	-	-
Unearned Revenue	27,124,235 (3)	36,150,445	41,906,055	37,686,530
Total Liabilities	\$ 95,914,841	\$ 57,364,086	\$ 93,201,098	\$103,973,388
Fund Balances (4)				
Reserved For:				
Encumbrances	\$ 4,203,012	\$ -	\$ -	\$ -
Advances and Loans	-	-	-	-
Inventory, Prepays and Imprest Cash	1,524,945	-	-	-
Working Capital	5,400,000	-	-	-
Nonspendable	-	4,117,547	3,739,439	3,543,674
Unreserved:				
Designated:				
Health Services Facility	499,600	-	-	-
Designated for Economic Uncertainty	394,393	-	-	-
Liabilities Reserve	1,200,000	-	-	-
Emergency Reserve	1,251,089	-	-	-
Restricted	-	-	1,000	2,000
Committed	-	12,846,730	13,706,385	16,166,595
Assigned	-	22,231,367	24,722,003	20,856,653
Unassigned	-	171,326	-	-
Mental Health and Medicruz	14,229,750 (3)	-	-	-
Total Fund Balances	\$ 28,702,789	\$ 39,366,970	\$ 42,168,827	\$ 40,568,922
Total Liabilities and Fund Liabilities	\$124,617,630	\$ 96,731,056	\$135,369,925	\$144,542,310

Source: County of Santa Cruz Comprehensive Annual Financial Reports.

- (1) The County's tax and revenue anticipation notes for Fiscal Year 2010/11 matured on June 30, 2011.
- (2) \$15,000,000 of the total \$48,000,000 tax and revenue anticipation notes issued matured on March 31, 2012.
- (3) The County recognized certain deferred revenues in Fiscal Year 2009/10 and designated a portion of fund balance for certain health service costs; such amounts are now included in Assigned Fund Balance.
- (4) See "GASB Statement No. 54" above.

TABLE NO. 19
COUNTY OF SANTA CRUZ
GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
For the year ended June 30

	2010	2011	2012	2013
Revenues:				
Taxes	\$ 87,156,987	\$ 88,653,860	\$ 88,406,635	\$ 88,390,337
Licenses and Permits	9,246,818	9,046,275	10,355,966	9,819,321
Fines, Forfeits and Penalties	5,180,367	5,180,066	4,660,530	4,418,159
Use of Money and Property	1,778,940	1,583,053	1,720,668	1,079,143
Aid from Other Governments	201,982,839	192,247,551	198,723,877	208,953,957
Charges for Services	47,438,213	51,824,875	54,524,658	43,279,759
Other	<u>3,405,555</u>	<u>4,056,259</u>	<u>2,058,972</u>	<u>3,554,348</u>
Total Revenues	<u>\$356,189,719</u>	<u>\$352,591,939</u>	<u>\$360,451,306</u>	<u>\$359,495,024</u>
Expenditures:				
Current:				
General Government	\$ 25,114,281	\$ 24,801,509	\$ 26,597,298	\$ 27,919,587
Public Protection	107,399,908	105,940,805	106,679,270	113,965,861
Public Ways and Facilities	197,129	201,314	190,609	219,847
Health and Sanitation	102,047,638	104,190,892	107,809,876	107,549,603
Public Assistance	99,775,414	98,932,035	98,996,195	101,042,337
Education	157,187	117,724	108,666	115,398
Recreation and Culture	6,276,595	5,822,538	5,800,735	5,663,542
Interest and Fiscal Charges	<u>389,282</u>	<u>2,876</u>	<u>364,502</u>	<u>182,978</u>
Total Expenditures	<u>\$341,357,434</u>	<u>\$340,009,693</u>	<u>\$346,547,151</u>	<u>\$356,659,153</u>
Excess of Revenues Over				
(Under) Expenditures	<u>\$ 14,832,285</u>	<u>\$ 12,582,246</u>	<u>\$ 13,904,155</u>	<u>\$ 2,835,871</u>
Other Financing Sources (Uses):				
Inception of Capital Lease	\$ -	\$ 123,484	\$ 80,266	\$ 35,766
Capital Contributions	-	-	-	232,624
Sale of Capital Assets	-	-	5,157	-
(Loss) on Land Held for Resale	-	-	(137,065)	-
Operating Transfers In	2,734,556	4,712,314	2,569,154	2,073,089
Operating Transfers Out	<u>(6,325,784)</u>	<u>(6,753,863)</u>	<u>(13,619,810)</u>	<u>(6,777,255)</u>
Total Other Financing Sources (Uses)	<u>\$ (3,591,228)</u>	<u>\$ (1,918,065)</u>	<u>\$ (11,102,298)</u>	<u>\$ (4,435,776)</u>
Net Change in Fund Balances	<u>\$ 11,241,057</u>	<u>\$ 10,664,181</u>	<u>\$ 2,801,857</u>	<u>(\$ 1,599,905)</u>
Fund Balance - Beginning	<u>\$ 17,461,732</u>	<u>\$ 28,702,789</u>	<u>\$ 39,366,970</u>	<u>\$ 42,168,827</u>
Fund Balance - Ending	<u>\$ 28,702,789</u>	<u>\$ 39,366,970</u>	<u>\$ 42,168,827</u>	<u>\$ 40,568,922</u>

Source: County of Santa Cruz Comprehensive Annual Financial Reports.

RISK FACTORS

The purchase of the Certificates involves investment risk. If a risk factor materializes to a sufficient degree, it could delay or prevent payment of principal and/or interest represented by the Certificates. Such risk factors include, but are not limited to, the following matters and should be considered, along with other information in this Official Statement, by potential investors.

The Lease Payments

County's Lease Payments and Other Payments. The County's Lease Payments and other payments due under the Lease Agreement (including the costs of improvement, repair and maintenance of the Leased Property and taxes, other governmental charges and assessments levied against the Leased Property) are not secured by any pledge of taxes or other revenues of the County but are payable from yearly appropriations of any funds lawfully available to the County. If the County's revenue sources are less than its total obligations, the County could choose to fund other services before making Lease Payments and other payments due under the Lease Agreement. The same result could occur if, because of State Constitutional limits on expenditures, the County is not permitted to appropriate and spend all of its available revenues (see "Constitutional Limitation on Taxes and Expenditures" herein). To the extent these types of events or other events adversely affecting the funds available to the County occur in any year, the funds available to make Lease Payments may be decreased.

The County has the capacity to enter into other obligations which may constitute additional charges against its revenues. To the extent that additional obligations are incurred by the County, the funds available to the County to make Lease Payments may be decreased.

Abatement. Except to the extent that amounts are available (i) in the Reserve Fund or the Lease Payment Fund under the Trust Agreement, or (ii) from proceeds of rental interruption insurance. The amount of Lease Payments due under the Lease Agreement will be adjusted or abated during any period in which by reason of damage or destruction to the Leased Property or eminent domain proceedings there is substantial interference with the use and possession of the Leased Property. The amount of such abatement shall be such that the resulting Lease Payments, exclusive of the amounts described above, do not exceed the fair rental value for the use and possession of the portion of the Leased Premises not damaged, destroyed, interfered with or taken. Such abatement shall continue for the period commencing with such damage, destruction, interference or taking and ending with the substantial completion of the replacement or work of repair or the removal of the title defect causing such interference with use. The Lease Agreement shall continue in full force and effect following an event of abatement and the County waives any right to terminate the Lease by virtue of an abatement event. Notwithstanding the provisions of the Lease Agreement and the Trust Agreement specifying the extent of abatement in the event of the County's failure to have use and possession of all or a portion of the Leased Property by the County, such provisions may be superseded by operation of law, and, in such event, the resulting Lease Payments of the County may not be sufficient to pay all of that portion of the remaining principal and interest represented by the Certificates, the 2005 Certificates, the 2006 Certificates and the 2008 Certificates.

In the event that such funds are insufficient to make all payments with respect to the Certificates during the period that the Leased Property, or portion thereof, is being restored, then all or a portion of such payments may not be made and no remedy is available to the Trustee or the Owners under the Lease or Trust Agreement for nonpayment under such circumstances. Failure to pay principal, premium, if any, or interest on the Certificates as a result of abatement of the County's obligation to make Lease Payments under the Lease Agreement is not an event of default under the Trust Agreement or the Lease Agreement. In the event that Lease Payments are abated due to damage caused by earthquake or flood, such abatement may continue indefinitely, as no insurance for such damages is required under the Lease Agreement and the County cannot be compelled to repair or replace the damaged Leased Property or to prepay the Certificates but has covenanted in the Lease Agreement to use its best efforts to repair or replace the Leased Premises from

other lawfully available funds to the extent that the Net Proceeds are insufficient. See "APPENDIX A - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - Lease Agreement - Abatement."

Insurance. The Lease Agreement obligates the County to obtain and keep in force various forms of insurance, to assure repair or replacement of the Leased Property in the event of damage or destruction to the Leased Property (see "APPENDIX A - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - LEASE AGREEMENT - Insurance" herein). The Lease Agreement does not require earthquake or flood insurance unless the County, in its reasonable discretion, determines that such coverage is available from reputable insurers at commercially reasonable rates. The County makes no representation as to the ability of any insurer to fulfill its obligations under any insurance policy provided for in the Lease Agreement. In addition, certain risks, such as damage from earthquakes, may not be covered by such property insurance (see "SOURCES OF PAYMENT FOR THE CERTIFICATES - Insurance Relating to the Leased Property" herein).

In the event the Leased Property is partially or completely damaged or destroyed due to any uninsured or underinsured event, it is likely that Lease Payments will be partially or completely abated. Apart from the Net Proceeds of insurance, the County and the Authority will have no obligation to expend any funds to repair or replace such damaged or destroyed property. If any Leased Property so damaged or destroyed is not repaired or replaced within the period during which the proceeds of rental interruption insurance or amounts in the Reserve Fund are available, any such abatement could prevent the County from making timely Lease Payments.

Discovery of a Hazardous Substance That Would Limit the Beneficial Use of the Leased Property. In general, the owners and lessees of a parcel may be required by law to remedy conditions of the property relating to the releases or threatened releases of hazardous substances. The federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 sometimes referred to as CERCLA or the Superfund Act, is the most well-known and widely applicable of these laws but California laws with regard to hazardous substances are also stringent and similar. Under many of these laws, the owner (or lessee) is obligated to remedy a hazardous substance condition of property whether or not the owner (or lessee) had any involvement in creating or handling the hazardous substance. The effect, therefore, should the Leased Property be affected by a hazardous substance, might be to limit the beneficial use of the Leased Property upon discovery and during remediation.

Limited Recourse on Default; No Acceleration

If an event of default occurs and is continuing under the Lease Agreement, there is no remedy of acceleration of any Lease Payments which have not come due and payable in accordance with the Lease Agreement. The County will continue to be liable for Lease Payments as they become due and payable in accordance with the Lease Agreement if the Trustee does not terminate the Lease Agreement, and the Trustee would be required to seek a separate judgment each year for that year's defaulted Lease Payments. Any such suit for money damages would be subject to limitations on legal remedies against counties in California, including a limitation on enforcement of judgments against funds or property needed to serve the public welfare and interest. In addition, the enforcement of any remedies provided in the Lease Agreement and the Trust Agreement could prove both expensive and time-consuming. The County is not aware of any such conditions on the Lease Property.

The Lease Agreement permits the Trustee to take possession of and re-lease the Leased Property in the event of a default by the County under the Lease Agreement. However, due to the fact that the Leased Property serves essential governmental purposes and, the specialized nature of the Leased Property, it is unlikely that the Trustee could readily re-lease it for rents which are sufficient to enable it to pay principal and interest represented by the Certificates, the 2005 Certificates and the 2006 Certificates in full when due or that a court would permit such remedy to be exercised on a timely basis.

State Budget

The following information concerning the State's budgets has been obtained from publicly available information which the County believes to be reliable; however, the County does not guaranty the accuracy or completeness of this information and has not independently verified such information. Furthermore, it should not be inferred from the inclusion of this information in this Official Statement that the principal of or interest with respect to the Certificates is payable by or the responsibility of the State of California.

State Budget. Information about the State budget and State spending is available at various State-maintained websites. Text of proposed and adopted budgets may be found at the website of the State Department of Finance, www.dof.ca.gov, under the heading "California Budget." An impartial analysis of the budget is posted by the Office of the Legislative Analyst ("LAO") at www.lao.ca.gov. In addition, various State official statements, many of which contain a summary of the current and past State budgets may be found at the website of the State Treasurer, www.treasurer.ca.gov. *None of the websites or webpages referenced above is in any way incorporated into this Official Statement. They are cited for informational purposes only. The County makes no representation whatsoever as to the accuracy or completeness of any of the information on such websites.*

According to the State Constitution, the Governor of the State (the "Governor") is required to propose a budget to the State Legislature (the "Legislature") by no later than January 10 of each year, and a final budget must be adopted by the vote of each house of the Legislature no later than June 15, although this deadline has been routinely breached in the past. The State budget becomes law upon the signature of the Governor, who may veto specific items of expenditure.

Prior to Fiscal Year 2010/11, the State budget had to be adopted by a two-thirds vote of each house of the Legislature. However, in November 2010, the voters of the State passed Proposition 25, which reduced the vote required to adopt a budget to a majority vote of each house and which provided that there would be no appropriation from the current budget or future budget to pay any salary or reimbursement for travel or living expenses for members of the Legislature for the period during which the budget was presented late to the Governor.

Governor's Proposed 2014/15 State Budget. The Governor's proposed 2014/15 State Budget (the "Proposed 2014/15 Budget") was released on January 9, 2014 and includes: (i) spending of \$154.9 billion from all funds, including \$106.8 billion from the General Fund; (ii) a proposed reduction in the State's long-term debt by more than \$11 billion in 2014/15, fully eliminating such long-term debt by 2017/18; (iii) proposed repayment of approximately \$6 billion in deferred payments to K-12 schools; (iv) a contribution of \$1.6 billion to a "rainy day fund" to protect against future economic downturns; (v) an increase in K-12 school funding levels of \$3,410 per student through fiscal year 2017/18, including an increase of more than \$2,188 per student in fiscal year 2014/15 over fiscal 2011/12 levels; and (vi) \$670 million in new General Fund spending to fund the expansion of Medi-Cal benefits, including mental health, substance use disorder, adult dental, and specialized nutrition services. In addition, the Proposed 2014/15 Budget projects \$217.8 billion in retirement-related unfunded liabilities. Combined with the other liabilities, the total long term State liabilities stand at \$354.5 billion.

The LAO's Overview of the Proposed 2014/15 Budget (the "LAO Overview"), released January 13, 2014, generally praised the Proposed 2014/15 Budget including the Governor's focus on deferrals and other means of lowering the State's "wall of debt." The LOA Overview includes a revenue forecast of \$6.4 billion in higher revenues for the State in Fiscal Years 2012/13 and 2013/14 combined, offset by \$5 billion in increased expenditures, almost entirely due to greater required spending for schools and community colleges. Combined with a projected \$3.2 billion operating surplus for the State in Fiscal Year 2014/15, the LAO projects that, absent any changes to current laws and policies, the State would end Fiscal Year 2014/15 with a \$5.6 billion reserve. The LAO Overview assumes continued economic growth in future years and that State General Fund revenues will grow faster than expenditures through 2017/18, when the State's projected operating surpluses reach \$9.6 billion. The LAO notes that the State's temporary personal

income tax rate increases under Proposition 30 expire at the end of 2018, resulting in a more gradual ramping down of these revenues over the last two fiscal years of the LAO forecast.

Despite the large surplus projected by the LAO over the forecast period, the LAO also notes that the fiscal recovery is dependent on a number of assumptions including continuing economic growth and steady growth in stock prices. The LAO cautions that (i) an economic downturn within the next few years could result in a return to operating deficits, (ii) volatility of capital gains could depress annual revenues, and (iii) the LAO forecast assumes the State repays liabilities with payment schedules set in current law. Other liabilities, including certain items on the Governor's "wall of debt" and the State's retirement liabilities (particularly those related to the California State Teachers' Retirement System), remain unpaid under the LAO forecast. If additional payments are made in the future to repay these liabilities or to provide inflation adjustments to universities, the courts, State employees, and other programs, the operating surpluses in the LAO forecast would fall significantly below the LAO's projections.

The LAO also notes that the 2013/14 State Budget assumed that Fiscal Year 2012/13 would end with a \$254 million reserve, however the LAO's General Fund revenue forecast for Fiscal Year 2012/13 projects \$1.65 billion in higher revenues for Fiscal year 2012/13, principally due to personal income tax collections. The LAO's higher revenue forecast results in \$1.75 billion in additional General Fund expenditures under the Proposition 98 minimum guarantee. The LAO recognizes that the 2013/14 State Budget assumed the State would end Fiscal Year 2013/14 with a reserve of \$1.1 billion, while the LAO estimates that reserve to be \$2.4 billion.

The LAO forecasts that Proposition 98 General Fund spending will be \$3.1 billion higher than the amount provided in the Proposed 2014/15 Budget due to the LAO's forecast of higher State revenues. The LAO notes that per-student spending would rise from \$7,936 in the current fiscal year to \$8,724 in Fiscal Year 2014/15, an increase of \$788 or 10 percent, while the Proposed 2014/15 Budget includes a lower per-student spending increase from \$8,469 to \$9,194 for Fiscal Year 2014/15.

Potential Impact of State of California Financial Condition on the County. For several fiscal years during the recent recession the State faced a structural deficit that resulted in substantial annual deficits and reductions in expenditures. Although the State is projecting a budget surplus in the current fiscal year, the State is still facing continuing financial challenges and unfunded long-term liabilities of more than \$200 billion, which could result in future reductions or deferrals in amounts payable to the County. The State's financial condition and budget policies affect local public agencies throughout California. To the extent that the State budget process results in reduced revenues to the County, the County will be required to make adjustments to its budget. State budget policies can also impact conditions in the local economy and could have an adverse effect on the local economy and the County's major revenue sources.

No prediction can be made by the County as to whether the State will encounter budgetary problems in future fiscal years, and if it were to do so, it is not clear what measures would be taken by the State to balance its budget, as required by law. In addition, the County cannot predict the final outcome of future State budget negotiations, the impact that such budgets will have on County finances and operations or what actions will be taken in the future by the State Legislature and the Governor to deal with changing State revenues and expenditures. There can be no assurance that actions taken by the State to address its financial condition will not materially adversely affect the financial condition of the County. Current and future State budgets will be affected by national and State economic conditions and other factors, including the current economic downturn, over which the County has no control.

Enforcement of Remedies

The enforcement of any remedies provided in the Lease Agreement and the Trust Agreement could prove both expensive and time consuming. The rights and remedies provided in the Lease Agreement and the Trust Agreement may be limited by and are subject to the limitations on legal remedies against counties, including State constitutional limits on expenditures, and limitations on the enforcement of judgments

against funds needed to serve the public welfare and interest; by federal bankruptcy laws, as now or hereafter enacted; applicable bankruptcy, insolvency, reorganization, moratorium, or similar laws relating to or affecting the enforcement of creditors' rights generally, now or hereafter in effect (see "- Bankruptcy of the County" below); equity principles which may limit the specific enforcement under State law of certain remedies; the exercise by the United States of America of the powers delegated to it by the Constitution; the reasonable and necessary exercise, in certain exceptional situations, of the police powers inherent in the sovereignty of the State and its governmental bodies in the interest of serving a significant and legitimate public purpose; and the limitations on remedies against municipal entities in the State. Bankruptcy proceedings or the exercise of powers by the federal or State government, if initiated, could subject the Owners of the Certificates to judicial discretion and interpretation of their rights in bankruptcy or otherwise, and consequently may entail risks of delay, limitation or modification of their rights.

The legal opinions to be delivered concurrently with the delivery of the Certificates (including Special Counsel's legal opinion) will be qualified, as to the enforceability of the Certificates, the Trust Agreement, the Lease Agreement, the Assignment Agreement and other related documents, by bankruptcy, insolvency, reorganization, moratorium, arrangement, fraudulent conveyance and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to the limitation on legal remedies against counties in the State. See "- Bankruptcy of the County" below.

Bankruptcy of the County

In addition to the limitations on remedies contained in the Trust Agreement and the Lease Agreement, the rights and remedies in the Lease Agreement may be limited and are subject to the provisions of federal bankruptcy laws, as now or hereafter enacted, and to other laws or equitable principles that may affect the enforcement of creditors' rights.

Under Chapter 9 of the Bankruptcy Code (Title 11, United States Code) (the "Bankruptcy Code"), which governs bankruptcy proceedings of public entities such as the County, no involuntary bankruptcy petition may be filed against a public entity. However, upon satisfaction of certain prerequisite conditions, a voluntary bankruptcy petition may be filed by the County. The filing of a bankruptcy petition results in a stay against enforcement of certain remedies under agreements to which the bankrupt entity is a party. A bankruptcy filing by the County could thus limit remedies under the Lease Agreement. A bankruptcy debtor may choose to assume or reject executory contracts and leases, such as the Lease Agreement. However, a debtor may not assume or reject executory contracts to loan money or to make a financial accommodation, such as the Trust Agreement. In the event of rejection of a lease by debtor lessee, the leased property is returned to the lessor and the lessor has a claim for a limited amount of the resulting damages.

Under the Trust Agreement, the Trustee holds a security interest in the revenues in the funds pledged thereunder, including 2014 Lease Payments, for the benefit of the Owners of the Certificates, but such security interest arises only when the 2014 Lease Payments are actually received by the Trustee following payment by the County. The Leased Property itself is not subject to a security interest, mortgage or any other lien in favor of the Trustee for the benefit of Owners. In the event of a bankruptcy filed by the County and the subsequent rejection of the Lease Agreement by the County, the Trustee would recover possession of the Leased Property and would have a claim for damages against the County. The Trustee's claim would constitute a secured claim only to the extent of revenues in the possession of the Trustee; the balance of such claim would be unsecured.

In a bankruptcy of the County, if a material unpaid liability is owed to PERS or any other pension system (collectively the "Pension Systems") on the filing date, or accrues thereafter, such circumstances could create additional uncertainty as to the County's ability to make Lease Payments. Given that municipal pension systems in California are usually administered pursuant to state constitutional provisions and, as applicable, other state and/or city or county law, the Pension Systems may take the position, among other possible arguments, that their claims enjoy a higher priority than all other claims, that Pension Systems

have the right to enforce payment by injunction or other proceedings outside of a County bankruptcy case, and that Pension System claims cannot be the subject of adjustment or other impairment under the Bankruptcy Code because that would purportedly constitute a violation of state statutory, constitutional and/or municipal law. It is uncertain how a bankruptcy judge in a County bankruptcy would rule on these matters. In addition, this area of law is presently very unsettled because issues of pension underfunding claim priority, pension contribution enforcement, and related bankruptcy plan treatment of such claims (among other pension-related matters) are presently the subject of litigation in the Chapter 9 cases of several California municipalities, including the Cities of Stockton and San Bernardino.

Constitutional Limitation on Taxes and Expenditures

State Initiative Measures Generally. Under the California Constitution, the power of initiative is reserved to the voters for the purpose of enacting statutes and constitutional amendments. Voters have exercised this power through the adoption of Proposition 13 ("Article XIII A") and similar measures, the most recent of which were approved as Propositions 22 and 26 in the general election held on November 2, 2010.

Any such initiative may affect the collection of fees, taxes and other types of revenue by local agencies such as the County. Subject to overriding federal constitutional principles, such collection may be materially and adversely affected by voter-approved initiatives, possibly to the extent of creating cash-flow problems in the payment of outstanding obligations such as the Lease Agreement.

Article XIII A. Article XIII A of the California Constitution limits the taxing powers of California public agencies. Article XIII A provides that the maximum ad valorem tax on real property cannot exceed 1% of the "full cash value" of the property, and effectively prohibits the levying of any other ad valorem property tax except for taxes above that level required to pay debt service on voter-approved general obligation bonds. "Full cash value" is defined as "the County assessor's valuation of real property as shown on the 1975/76 tax bill under 'full cash value' or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment." The "full cash value" is subject to annual adjustment to reflect inflation at a rate not to exceed 2% or a reduction in the consumer price index or comparable local data. Article XIII A has subsequently been amended to permit reduction of the "full cash value" base in the event of declining property values caused by substantial damage, destruction or other factors, and to provide that there would be no increase in the "full cash value" base in the event of reconstruction of property damaged or destroyed in a disaster and in other special circumstances. There may also be declines in valuations if the California Consumer Price Index is negative.

The foregoing limitation does not apply to ad valorem taxes or special assessments to pay the interest and prepayment charges on any indebtedness approved by the voters before July 1, 1978 or any bonded indebtedness for the acquisition or improvement of real property approved by two-thirds of votes cast by the voters voting on the proposition.

In the general election held November 4, 1986, voters of the State of California approved two measures, Propositions 58 and 60, which further amend the terms "purchase" and "change of ownership," for purposes of determining full cash value of property under Article XIII A, to not include the purchase or transfer of (1) real property between spouses, and (2) the principal residence and the first \$1,000,000 of other property between parents and children. Proposition 60 amends Article XIII A to permit the Legislature to allow persons over age 55 who sell their residence and buy or build another of equal or lesser value within two years in the same city, to transfer the old residence's assessed value to the new residence. In the March 26, 1996 general election, voters approved Proposition 193, which extends the parents-children exception to the reappraisal of assessed value. Proposition 193 amended Article XIII A so that grandparents may transfer to their grandchildren whose parents are deceased, their principal residences, and the first \$1,000,000 of other property without a reappraisal of assessed value.

Because the Revenue and Taxation Code does not distinguish between positive and negative changes in the California Consumer Price Index used for purposes of the inflation factor, there was a decrease of 0.237%

in 2009/10 – applied to the 2010/11 tax roll – reflecting the actual change in the California Consumer Price Index, as reported by the State Department of Finance. For each fiscal year since Article XIII A has become effective (the 1978/79 Fiscal Year), the annual increase for inflation has been at least 2% except in eight fiscal years (including for the future Fiscal Year 2014/15) as shown below:

<u>Tax Roll</u>	<u>Percentage</u>	<u>Tax Roll</u>	<u>Percentage</u>
1981/82	1.000%	2004/05	1.867%
1995/96	1.190%	2010/11	(0.237)%
1996/97	1.110%	2011/12	0.753%
1998/99	1.853%	2014/15	0.454%

Proposition 8 Adjustments. Proposition 8, approved in 1978, provides for the assessment of real property at the lesser of its originally determined (base year) full cash value compounded annually by the inflation factor, or its full cash value as of the lien date, taking into account reductions in value due to damage, destruction, obsolescence or other factors causing a decline in market value. Reductions based on Proposition 8 do not establish new base year values, and the property may be reassessed as of the following lien date up to the lower of the then-current fair market value or the factored base year value. The State Board of Equalization has approved this reassessment formula and such formula has been used by county assessors statewide. The County has seen Proposition 8 reductions in property values since 2009. See “FINANCIAL INFORMATION - Taxable Property and Assessed Valuation” herein.

Article XIII B. On November 6, 1979, California voters approved Proposition 4, or the Gann Initiative, which added Article XIII B to the California Constitution. Article XIII B limits the annual appropriations of the State and any city, county, city and county, school district, authority or other political subdivision of the State. The “base year” for establishing such appropriations limit is the 1978/79 Fiscal Year, and the limit is to be adjusted annually to reflect changes in population, consumer prices and certain increases in the cost of services provided by public agencies.

Appropriations subject to Article XIII B include generally the proceeds of taxes levied by or for the entity and the proceeds of certain State subventions, refunds of taxes, benefit payments from retirement, unemployment insurance and disability insurance funds. “Proceeds of taxes” include, but are not limited to, all tax revenues, certain State subventions, and the proceeds to an entity of government, from (1) regulatory licenses, user charges and user fees, to the extent that such charges and fees exceed the costs reasonably borne in providing the regulation, product or service, and (2) the investment of tax revenues. Article XIII B includes a requirement that if an entity’s revenues in any year exceed the amounts permitted to be spent, the excess would have to be returned by revising tax rates or fee schedules within the next two subsequent fiscal years.

In the June 1990 election, the voters approved Proposition 111 amending the method of calculation of State and local appropriations limits. Proposition 111 made several changes to Article XIII B. First, the term “change in the cost of living” was redefined as the change in the California per capita personal income (“CPCPI”) for the preceding year. Previously, the lower of the CPCPI or the United States Consumer Price Index was used. Second, the appropriations limit for the fiscal year was recomputed by adjusting the 1986/87 limit by the CPCPI for the three subsequent years. Third and lastly, Proposition 111 excluded appropriations for “qualified capital outlay for fiscal 1990/91 as defined by the legislature” from proceeds of taxes.

Section 7910 of the Government Code requires the County to adopt a formal appropriations limit for each fiscal year. The County’s appropriations limit for 2013/14 is \$423,774,995. The County’s appropriations subject to the limit for 2013/14 are \$113,178,689. Based on this, the appropriations limit is not expected to have any impact on the ability of the County to continue to budget and appropriate the Lease Payments as required by the Lease Agreement.

Proposition 62. Proposition 62 was a statutory initiative adopted in the November 1986 general election. Proposition 62 added Sections 53720 to 53730, inclusive, to the California Government Code. It confirmed the distinction between a general tax and special tax, established by the State Supreme Court in 1982 in *City and County of San Francisco v. Farrell*, by defining a general tax as one imposed for general governmental purposes and a special tax as one imposed for specific purposes. Proposition 62 further provided that no local government or district may impose (i) a general tax without prior approval of the electorate by majority vote or (ii) a special tax without such prior approval by two-thirds vote. It further provided that if any such tax is imposed without such prior written approval, the amount thereof must be withheld from the levying entity's allocation of annual property taxes for each year that the tax is collected. By its terms, Proposition 62 applies only to general and special taxes imposed on or after August 1, 1985. Proposition 62 was generally upheld in *Santa Clara County Local Transportation Authority v. Guardino*, a California Supreme Court decision filed September 28, 1995.

Proposition 218. On November 5, 1996, California voters approved Proposition 218 – Voter Approval for Local Government Taxes – Limitation on Fees, Assessments, and Charges – Initiative Constitutional Amendment. Proposition 218 added Articles XIIC and XIID to the California Constitution, imposing certain vote requirements and other limitations on the imposition of new or increased taxes, assessments and property-related fees and charges. Proposition 218 states that all taxes imposed by local governments shall be deemed to be either general taxes or special taxes. Special purpose districts, including school districts, have no power to levy general taxes. No local government may impose, extend or increase any general tax unless and until such tax is submitted to the electorate and approved by a majority vote. No local government may impose, extend or increase any special tax unless and until such tax is submitted to the electorate and approved by a two-thirds vote.

Proposition 218 also provides that no tax, assessment, fee or charge shall be assessed by any agency upon any parcel of property or upon any person as an incident of property ownership except: (i) the ad valorem property tax imposed pursuant to Article XIII and Article XIIC of the California Constitution, (ii) any special tax receiving a two-thirds vote pursuant to Section 4 of Article XIIC the California Constitution, and (iii) assessments, fees, and charges for property related services as provided in Article XIID. Proposition 218 added voter requirements for assessments and fees and charges imposed as an incident of property ownership, other than fees and charges for sewer, water, and refuse collection services. In addition, all assessments and fees and charges imposed as an incident of property ownership, including sewer, water, and refuse collection services, are subjected to various additional procedures, such as hearings and stricter and more individualized benefit requirements and findings. The effect of such provisions will presumably be to increase the difficulty a local agency will have in imposing, increasing or extending such assessments, fees and charges.

Proposition 218 also extended the initiative power to reducing or repealing any local taxes, assessments, fees and charges. This extension of the initiative power is not limited to taxes imposed on or after November 6, 1996, the effective date of Proposition 218, and could result in retroactive repeal or reduction in any existing taxes, assessments, fees and charges, subject to overriding federal constitutional principles relating to the impairment of contracts. . In fact, the County began levying a utility tax in 1991 and pursuant to Proposition 218, voters in the County qualified a measure to be placed on the March 2002 ballot to eliminate the utility tax. This measure was approved by the voters and the County stopped levying the utility tax in April 2002.

Proposition 218 provides that, effective July 1, 1997, fees that are charged “as an incident of property ownership” may not “exceed the funds required to provide the property related services” and may only be charged for services that are “immediately available to the owner of the property.”

In November 2012, voters in the County approved an increase in the transient occupancy tax rate from 9.5% to 11%.

The County does not expect the application of Proposition 218 will have a material adverse impact on its ability to pay Lease Payments.

Proposition 1A. Proposition 1A (“Proposition 1A”), proposed by the Legislature in connection with the 2004/05 Budget Act and approved by the voters in November 2004, restricts State authority to reduce major local tax revenues such as the tax shifts permitted to take place in Fiscal Years 2004/05 and 2005/06. Proposition 1A provides that the State may not reduce any local sales tax rate, limit existing local government authority to levy a sales tax rate or change the allocation of local sales tax revenues, subject to certain exceptions. Proposition 1A generally prohibits the State from shifting to schools or community colleges any share of property tax revenues allocated to local governments for any fiscal year, as set forth under the laws in effect as of November 3, 2004. Any change in the allocation of property tax revenues among local governments within a county must be approved by two-thirds of both houses of the Legislature.

Proposition 1A provides, however, that beginning in Fiscal Year 2008/09, the State may shift to schools and community colleges up to 8% of local government property tax revenues, which amount must be repaid, with interest, within three years, if the Governor proclaims that the shift is needed due to a severe state financial hardship, the shift is approved by two-thirds of both houses and certain other conditions are met. Such a shift may not occur more than twice in any 10-year period. The State may also approve voluntary exchanges of local sales tax and property tax revenues among local governments within a county.

For Fiscal Year 2009/10, 8% of the County’s property tax revenues were diverted to the State as a result of a Proposition 1A suspension. The County participated in a Proposition 1A Securitization Program (the “Program”) sponsored by the California Statewide Communities Development Authority. The Program allowed the County to exchange its anticipated State property tax receivable for cash.

Proposition 1A also provides that if the State reduces the vehicle license fee rate below 0.65% of vehicle value, the State must provide local governments with equal replacement revenues. Further, Proposition 1A requires the State to suspend State mandates affecting cities, counties and special districts, excepting mandates relating to employee rights, schools or community colleges, in any year that the State does not fully reimburse local governments for their costs to comply with such mandates.

Proposition 22. On November 2, 2010, voters in the State approved Proposition 22. Proposition 22, known as the “Local Taxpayer, Public Safety, and Transportation Protection Act of 2010,” eliminates or reduces the State’s authority to (i) temporarily shift property taxes from cities, counties and special districts to schools, (ii) use vehicle license fee revenues to reimburse local governments for State-mandated costs (the State will have to use other revenues to reimburse local governments), (iii) redirect property tax increment from redevelopment agencies to any other local government, (iv) use State fuel tax revenues to pay debt service on State transportation bonds, or (v) borrow or change the distribution of State fuel tax revenues.

Proposition 26. On November 2, 2010, voters in the State also approved Proposition 26. Proposition 26 amends Article XIII C of the State Constitution to expand the definition of “tax” to include “any levy, charge, or exaction of any kind imposed by a local government” except the following: (1) a charge imposed for a specific benefit conferred or privilege granted directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of conferring the benefit or granting the privilege; (2) a charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product; (3) a charge imposed for the reasonable regulatory costs to a local government for issuing licenses and permits, performing investigations, inspections, and audits, enforcing agricultural marketing orders, and the administrative enforcement and adjudication thereof; (4) a charge imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property; (5) a fine, penalty, or other monetary charge imposed by the judicial branch of government or a local government, as a result of a violation of law; (6) a charge imposed as a condition of property development; and (7) assessments and property-related fees imposed in accordance with the provisions of Article XIII D. Proposition 26 provides that the local government bears the burden of proving

by a preponderance of the evidence that a levy, charge, or other exaction is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity. The County does not expect the provisions of Proposition 26 to materially impede its ability to pay Lease Payments when due.

Future Initiatives. From time to time other initiative measures could be adopted, affecting the ability of the County to increase revenues and appropriations.

Early Prepayment Risk

Early payment of the 2014 Lease Payments and early prepayment of the Certificates may occur in whole or in part without premium, on any date if the Leased Property or a portion thereof is lost, destroyed or damaged beyond repair or taken by eminent domain and from the proceeds of title insurance (see "THE CERTIFICATES - Prepayment - Extraordinary Prepayment"), or if the County exercises its right to prepay 2014 Lease Payments in whole or in part pursuant to the provisions of the Lease Agreement and the Trust Agreement.

Loss of Tax Exemption

As discussed under the caption "LEGAL MATTERS - Tax Matters" herein, the interest component of the 2014 Lease Payments could become includable in gross income for purposes of federal income taxation retroactive to the date the Certificates were executed and delivered as a result of future acts or omissions of the County in violation of its covenants contained in the Trust Agreement and the Lease Agreement. Should such an event of taxability occur, the Certificates are not subject to special prepayment or any increase in interest rate and will remain outstanding until maturity or until prepaid under one of the prepayment provisions contained in the Trust Agreement.

In addition, Congress has considered in the past, is currently considering and may consider in the future, legislative proposals, including some that carry retroactive effective dates, that, if enacted, would alter or eliminate the exclusion from gross income for federal income tax purposes of interest on municipal bonds, such as the Certificates. Prospective purchasers of the Certificates should consult their own tax advisors regarding any pending or proposed federal tax legislation. The County can provide no assurance that federal tax law will not change while the Certificates are outstanding or that any such changes will not adversely affect the exclusion of the interest component of the 2014 Lease Payments from gross income for federal income tax purposes. If the exclusion of the interest component of 2014 Lease Payments from gross income for federal income tax purposes were amended or eliminated, it is likely that the market price for the Certificates would be adversely impacted.

IRS Audit of Tax-Exempt Bond Issues

The Internal Revenue Service has initiated an expanded program for the auditing of tax-exempt bond issues, including both random and targeted audits. It is possible that the Certificates will be selected for audit by the Internal Revenue Service. It is also possible that the market value of the Certificates might be affected as a result of such an audit of the Certificates (or by an audit of similar bonds).

Seismic Considerations

According to the Public Safety and Noise Element of the County's General Plan, the County is located in a seismically active region and could be impacted by a major earthquake originating from the numerous faults in the area. Surface rupture, ground shaking and liquefaction are the primary seismic risk to Santa Cruz County from a major earthquake along the San Andreas fault or within the Butano, Sargent, Zayante and Corralitos fault zones. Slope instability could result in landslides during ground shaking in some portions

of the County. The epicenter of the 7.1 magnitude Loma Prieta earthquake, which struck in 1989, was located approximately 10 miles east-northeast of the City of Santa Cruz. In Santa Cruz County, 674 dwelling units, 32 mobile homes and 310 businesses were destroyed in the earthquake, with an estimate of \$274 million in damages. By January 1991, the County had issued 7,460 building permits for reconstruction or repair of damaged structures. Repair of infrastructure was financed in part by a voter-approved one-half cent sales tax levied over six years.

The Leased Property is located in an area classified as Seismic Risk Zone 4 by the Uniform Building Code. Seismic Risk Zone 4 includes the greater San Francisco Bay Area and all of coastal California. It is the highest risk zone classification of the Uniform Building Code. If there were to be an occurrence of severe seismic activity in the County, there could be substantial damage to and interference with the County's right to use and occupy all or a portion of the Leased Property, which could result in Lease Payments being subject to abatement. See "The Lease Payments - Abatement" above. However, there was no damage to the Leased Property as a result of the Loma Prieta earthquake in 1989. Under the Lease Agreement, the County is required to obtain earthquake coverage only if it is available at reasonable cost from reputable insurers in the reasonable opinion of the County. The County currently maintains earthquake insurance on the Leased Property, (see "THE LEASED PROPERTY"), but may not maintain such coverage in the future.

A major earthquake could cause widespread destruction and significant loss of life in a populated area such as the County. If an earthquake were to substantially damage or destroy taxable property within the County, a reduction in taxable values of property in the County and a reduction in revenues available to the General Fund to make Lease Payments would be likely to occur. Seismic activity may also reduce or eliminate the use and occupancy of the Leased Property by the County. There is no assurance that, in the event of a natural disaster, sufficient County reserves or Federal Emergency Management Agency assistance would be available for the repair or replacement of any Leased Property.

Other Natural Hazards

The County has adopted a Natural Hazards Mitigation Plan. This plan includes a hazard analysis for earthquake, flood, landslide and fire risk, and is required to comply with Federal Emergency Management Agency requirements for disaster relief funding.

If such events described above under the caption "Seismic Conditions" or events described below occur, the County's emergency response to such an event may add unanticipated expenditures to the General Fund budget, some or all of which may not be reimbursed by federal or state disaster funding, and, if reimbursed, may not be received by the County in a timely manner. This could lead to reduced ability by the County to make Lease Payments. Such event could also result in substantial damage to properties in the County, which, in turn, could substantially reduce the value of such properties and could affect the ability or willingness of the property owners to pay their property taxes.

Wildfire Conditions. The County includes areas where there is high or extreme danger of wildfires during dry months and during periods of prolonged drought. In May 2008, 35 residences and several outbuildings were lost and 4,270 acres were burned in the Summit fire. In June 2008, 3 residences and several outbuildings were lost and 520 acres were burned in the Martin fire.

Flooding and Tsunamis. Portions of the County are located in a 100-year flood plain. A flood occurred in 1995 when storm water breached the protective levees of the Pajaro River, and flooded approximately 3,280 acres adjacent to the river. Portions of the County are located along the Pacific Ocean. The County could be subject to impacts from tsunamis in the event of an earthquake occurring off-shore.

Secondary Market Risk

There can be no assurance that there will be a secondary market for purchase or sale of the Certificates, and from time to time there may be no market for them, depending upon prevailing market conditions, the

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financial condition or market position of firms who may make the secondary market and the financial condition of the County.

LEGAL MATTERS

Enforceability of Remedies

The remedies available to the Trustee and the Owners of the Certificates upon an event of default under the Trust Agreement, the Lease Agreement, the Assignment Agreement or any other document described herein are in many respects dependent upon regulatory and judicial actions which are often subject to discretion and delay. Under existing law and judicial decisions, the remedies provided for under such documents may not be readily available or may be limited. The various legal opinions to be delivered concurrently with the delivery of the Certificates will be qualified to the extent that the enforceability of certain legal rights related to the Trust Agreement, the Lease Agreement, the Assignment Agreement and other pertinent documents is subject to limitations imposed by bankruptcy, reorganization, insolvency or other similar laws affecting the rights of creditors generally and by equitable remedies and proceedings generally.

Approval of Legal Proceedings

Rutan & Tucker, LLP, Costa Mesa, California, as Special Counsel, will render an opinion which states that the Lease Agreement represents valid and binding obligations of the County and is enforceable against the County in accordance with its terms. The legal opinion of Special Counsel will be subject to the effect of bankruptcy, insolvency, moratorium and other similar laws affecting creditors' rights and to the exercise of judicial discretion in accordance with general principles of equity. See "APPENDIX D" hereto for the proposed form of Special Counsel's opinion.

The County has no knowledge of any fact or other information which would indicate that the Trust Agreement, the Lease Agreement or the Certificates are not so enforceable against the County, except to the extent such enforcement is limited by principles of equity and by state and federal laws relating to bankruptcy, reorganization, moratorium or creditors' rights generally.

Certain legal matters will be passed on by Fulbright & Jaworski LLP, a member of Norton Rose Fulbright, Los Angeles, California, as Disclosure Counsel and for the County by the County Counsel. Fees payable to Special Counsel and Disclosure Counsel are contingent upon the sale and delivery of the Certificates.

Tax Matters

Federal tax law contains a number of requirements and restrictions which apply to the Certificates, including investment restrictions, periodic payments of arbitrage profits to the United States, requirements regarding the proper use of Certificate proceeds and the facilities financed therewith, and certain other matters. The County has covenanted to comply with all requirements that must be satisfied in order for the interest with respect to the Certificates to be excludable from gross income for federal income tax purposes. Failure to comply with certain of such covenants could cause interest with respect to the Certificates to become includable in gross income for federal income tax purposes retroactively to the date of issuance of the Certificates.

Subject to the County's compliance with the above referenced covenants, under present law, in the opinion of Rutan & Tucker, LLP, Special Counsel, interest with respect to the Certificates is excludable from the gross income of the owners thereof for federal income tax purposes, and is not included as an item of tax preference in computing the federal alternative minimum tax for individuals and corporations, but interest with respect to the Certificates is taken into account, however, in computing an adjustment used in determining the federal alternative minimum tax for certain corporations.

In rendering its opinions, Special Counsel will rely upon certifications of the County with respect to certain material facts within the County's knowledge. Special Counsel's opinion represents its legal judgment

based upon its review of the law and the facts that it deems relevant to render such opinion and is not a guarantee of a result.

The Code includes provisions for an alternative minimum tax ("AMT") for corporations in addition to the corporate regular tax in certain cases. The AMT, if any, depends upon the corporation's alternative minimum taxable income ("AMTI"), which is the corporation's taxable income with certain adjustments. One of the adjustment items used in computing the AMTI of a corporation (with certain exceptions) is an amount equal to 75% of the excess of such corporation's "adjusted current earnings" over an amount equal to its AMTI (before such adjustment item and the alternative tax net operating loss deduction). "Adjusted current earnings" would include certain tax exempt interest, including interest with respect to the Certificates.

Ownership of the Certificates may result in collateral federal income tax consequences to certain taxpayers, including, without limitation, corporations subject to the branch profits tax, financial institutions, certain insurance companies, certain S corporations, individual recipients of Social Security or Railroad Retirement benefits and taxpayers who may be deemed to have incurred (or continued) indebtedness to purchase or carry tax-exempt obligations. Prospective purchasers of the Certificates should consult their tax advisors as to applicability of any such collateral consequences.

The issue price (the "Issue Price") for each maturity of the Certificates is the price at which a substantial amount of such maturity of the Certificates is first sold to the public. The Issue Price of a maturity of the Certificates may be different from the price set forth, or the price corresponding to the yield set forth, on the inside front cover page hereof.

Owners of Certificates who dispose of Certificates prior to the stated maturity (whether by sale, redemption or otherwise), purchase Certificates in the initial public offering, but at a price different from the Issue Price, or purchase Certificates subsequent to the initial public offering, should consult their own tax advisors.

If a Certificate is purchased at any time for a price that is less than the Certificate's stated redemption price at maturity (the "Reduced Issue Price"), the purchaser will be treated as having purchased a Certificate with market discount subject to the market discount rules of the Code (unless a statutory de minimis rule applies). Accrued market discount is treated as taxable ordinary income and is recognized when a Certificate is disposed of (to the extent such accrued discount does not exceed gain realized) or, at the purchaser's election, as it accrues. Such treatment would apply to any purchaser who purchases a Certificate for a price that is less than its Revised Issue Price. The applicability of the market discount rules may adversely affect the liquidity or secondary market price of such Certificate. Purchasers should consult their own tax advisors regarding the potential implications of market discount with respect to the Certificates.

An investor may purchase a Certificate at a price in excess of its stated principal amount. Such excess is characterized for federal income tax purposes as "Certificate premium" and must be amortized by an investor on a constant yield basis over the remaining term of the Certificate in a manner that takes into account potential call dates and call prices. An investor cannot deduct amortized Certificate premium relating to a tax-exempt Certificate. The amortized Certificate premium is treated as a reduction in the tax-exempt interest received. As Certificate premium is amortized, it reduces the investor's basis in the Certificate. Investors who purchase a Certificate at a premium should consult their own tax advisors regarding the amortization of Certificate premium and its effect on the Certificate's basis for purposes of computing gain or loss in connection with the sale, exchange, redemption or early retirement of the Certificate.

There are or may be pending in the Congress of the United States legislative proposals, including some that carry retroactive effective dates, that, if enacted, could alter or amend the federal tax matters referred to above or affect the market value of the Certificates. It cannot be predicted whether or in what form any such proposal might be enacted or whether, if enacted, it would apply to Certificates issued prior to

enactment. Prospective purchasers of the Certificates should consult their own tax advisors regarding any pending or proposed federal tax legislation. Special Counsel expresses no opinion regarding any pending or proposed federal tax legislation.

The Internal Revenue Service (the "Service") has an ongoing program of auditing tax exempt obligations to determine whether, in the view of the Service, interest on such tax exempt obligations is includable in the gross income of the owners thereof for federal income tax purposes. It cannot be predicted whether or not the Service will commence an audit of the Certificates. If an audit is commenced, under current procedures the Service may treat the Issuer as a taxpayer and the Certificate owner may have no right to participate in such procedure. The commencement of an audit could adversely affect the market value and liquidity of the Certificates until the audit is concluded, regardless of the ultimate outcome.

Payments of interest on, and proceeds of the sale, redemption or maturity of, tax exempt obligations, including the Certificates, are in certain cases required to be reported to the Service. Additionally, backup withholding may apply to any such payments to any Certificate owner who fails to provide an accurate Form W-9 Request for Taxpayer Identification Number and Certification, or a substantially identical form, or to any Certificate owner who is notified by the Service of a failure to report any interest or dividends required to be shown on federal income tax returns. The reporting and backup withholding requirements do not affect the excludability of such interest from gross income for federal tax purposes.

In the further opinion of Special Counsel, interest with respect to the Certificates is exempt from California personal income taxes.

Ownership of the Certificates may result in other state and local tax consequences to certain taxpayers. Special Counsel expresses no opinion regarding any such collateral consequences arising with respect to the Certificates. Prospective purchasers of the Certificates should consult their tax advisors regarding the applicability of any such state and local taxes.

Special Counsel expects to deliver an opinion at the time of issuance of the Certificates in substantially the same form set forth in "APPENDIX D" hereto.

Absence of Litigation

The County and the Authority will furnish a certificate dated as of the date of delivery of the Certificates that there is not now known to be pending or threatened any litigation restraining or enjoining the execution or delivery of the Trust Agreement, the Lease Agreement or the sale or delivery of the Certificates or in any manner questioning the proceedings and authority under which the Trust Agreement, the Sublease and the Lease Agreement are to be executed or delivered or the Certificates are to be delivered or affecting the validity thereof.

CONCLUDING INFORMATION

Ratings on the Certificates

Standard & Poor's and Moody's Investors Service have assigned their municipal bond ratings of "___" and "___", respectively to the Certificates. Such ratings reflects only the views of the rating agencies and any desired explanation of the significance of such ratings should be obtained from the rating agencies. Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance such ratings will continue for any given period of time or that the ratings will not be revised downward or withdrawn entirely by the rating agencies, if in the judgment of the rating agencies, circumstances so warrant. Except as otherwise required in the Continuing Disclosure Certificate, the County undertakes no responsibility either to bring to the attention of the owners of any Certificates any downward revision or withdrawal of any rating obtained or to oppose any such revision or withdrawal. Any such downward revision or withdrawal of a rating may have an adverse effect on the market price of the Certificates. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time.

Underwriting

The Certificates were sold to _____ (the "Underwriter"). The Underwriter is offering the Certificates at the prices set forth on the inside front cover page hereof. The initial offering prices may be changed from time to time and concessions from the offering prices may be allowed to dealers, banks and others. The Underwriter has purchased the Certificates at a price equal to \$_____, which amount represents the principal amount of the Certificates (\$_____), plus an original issue premium of \$_____, and less an Underwriter's discount of \$_____. The Underwriter will pay certain of its expenses relating to the offering.

The Financial Advisor

The material contained in this Official Statement was prepared by the County with the assistance of the Financial Advisor who advised the County as to the financial structure and certain other financial matters relating to the Certificates. The information set forth herein has been obtained by the County from sources which are believed to be reliable, but such information is not guaranteed by the Financial Advisor as to accuracy or completeness, nor has it been independently verified. Fees paid to the Financial Advisor are contingent upon the sale and delivery of the Certificates.

Verifications of Mathematical Computations

Grant Thornton LLP will verify from the information provided to it the mathematical accuracy as of the date of the closing on the Certificates of (1) the computations contained in the provided schedules to determine that the deposits listed in the schedules prepared by the Financial Advisor, to be held in escrow, together with earnings thereon will be sufficient to pay, when due, the principal, prepayment premium and interest requirements of the 2001 Bonds, and (2) the computation of yield on the Certificates contained in the provided schedules used by Special Counsel in its determination that the interest with respect to the Certificates is exempt from federal taxation. Grant Thornton LLP will express no opinion on the assumptions provided to it, nor as to the exemption from taxation of the interest with respect to the Certificates.

Continuing Disclosure

The County will covenant to provide certain annual financial information (the "Annual Reports") and notices of the occurrence of certain enumerated events in accordance with Rule 15c2-12 of the Securities Exchange Act of 1934 as amended (the "Rule"). The Annual Reports and the notices will be filed by the County on the Electronic Municipal Market Access Website ("EMMA") operated by the Municipal Securities Rulemaking Board (www.emma.msrb.org). The required content of the Annual Reports and the specific nature of the notices of enumerated events and certain other terms of the continuing disclosure obligation are included in "APPENDIX C - FORM OF CONTINUING DISCLOSURE CERTIFICATE." These covenants will be made in order to assist the Underwriter in complying with the Rule. In the past five years the County has complied, in all material respects, with its undertakings to provide continuing disclosure under the Rule. The County has adopted disclosure compliance procedures and has assigned a specific person to coordinate and monitor compliance with the Rule.

Additional Information

The summaries and references contained herein with respect to the Trust Agreement, the Sublease, the Lease Agreement, the Assignment Agreement, the Certificates, statutes and other documents, do not purport to be comprehensive or definitive and are qualified by reference to each such document or statute and references to the Certificates are qualified in their entirety by reference to the form hereof included in the Trust Agreement. Copies of the Trust Agreement and the Lease Agreement are available for inspection during the period of initial offering on the Certificates at the offices of the Financial Advisor. Copies of these documents may be obtained after delivery of the Certificates from the County at Government Center, 701 Ocean Street, Santa Cruz, California 95060, telephone (831) 454-2100.

References

Any statements in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Official Statement is not to be construed as a contract or agreement between the County and the purchasers or Owners of any of the Certificates.

Execution

The execution of this Official Statement by the Assistant County Administrative Officer has been duly authorized by the County of Santa Cruz.

COUNTY OF SANTA CRUZ

By: _____
Assistant County Administrative Officer

APPENDIX A

SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

The following are brief summaries of the provisions of the Sublease, the Lease Agreement, the Trust Agreement and the Assignment Agreement. These summaries are not intended to be definitive. Reference is made to the actual documents (copies of which are available from the County) for the complete terms thereof.

DEFINED TERMS

The following terms have the following meanings, notwithstanding that any such terms may be elsewhere defined in this Official Statement. Any terms not expressly defined in this Summary but previously defined in this Official Statement have the respective meanings previously given.

“Additional Sublease Payment” means the amount of \$_____, which is payable by the Authority to the County on the Closing Date under the Lease Agreement, in consideration of the sublease of the Leased Property by the County to the Authority thereunder.

“Business Day” means a day other than a Saturday, Sunday or legal holiday, on which banking institutions are not closed in the State of California or in any state in which the Office of the Trustee is located.

“Closing Date” means _____, 2014, being the day when the Certificates, duly executed by the Trustee, are delivered to the original purchaser thereof.

“Federal Securities” means any of the following which at the time of investment are legal investments under the laws of the State of California for the funds purported to be invested therein: (a) direct general obligations of the United States of America (including obligations issued or held in book entry form on the books of the Department of the Treasury of the United States of America); and (b) obligations of any agency, department or instrumentality of the United States of America the timely payment of principal of and interest on which are fully guaranteed by the United States of America.

“First Supplement to Sub-Sublease” means the First Supplement to Sub-Sublease dated as of August 1, 2006 between the Authority and the County.

“Fiscal Year” means the twelve-month period beginning on July 1 of any year and ending on June 30 of the next succeeding year, or any other twelve-month period by the County as its fiscal year under written notice filed with the Trustee.

“Information Services” means the Electronic Municipal Market Access System (referred to as “EMMA”), a facility of the Municipal Securities Rulemaking Board (at <http://emma.msrb.org>) or, in accordance with then current guidelines of the Securities and Exchange Commission, such other addresses and/or such other national information services providing information with respect to called bonds as the County may designate in a Certificate of the County delivered to the Trustee.

“Lease Agreement” means the Sub-Sublease as amended by the First Supplement to Sub-Sublease, the Second Supplement to Sub-Sublease and the Third Supplement to Sub-Sublease.

“Lease Payment Date” means, with respect to any Interest Payment Date, the 15th calendar day (or, if such day is not a Business Day, on the immediately preceding Business Day) of the month immediately preceding such Interest Payment Date.

"Leased Property" means all of the real property described more fully in Appendix A attached to the Sublease and the Lease Agreement, and all related land, improvements and facilities. The Leased Property consists generally of County's Water Street detention facility and Blaine Street detention facility as described more fully elsewhere in this Official Statement.

"Moody's" means Moody's Investors Service, of New York, New York, its successors and their assigns, or any other nationally recognized securities rating agency designated by the County if such corporation is dissolved, liquidated or no longer performs the functions of a securities rating agency.

"Net Proceeds" means any insurance proceeds or eminent domain award (including any proceeds of sale to a governmental entity under threat of the exercise of eminent domain powers), paid with respect to the Leased Property, to the extent remaining after payment therefrom of all expenses incurred in the collection thereof.

"Office" means the corporate trust office of the Trustee in Los Angeles, California, and such office as the Trustee may designate in writing to the County from time to time as the place for transfer, exchange or payment of the Certificates.

"Owner," when used with respect to a Certificate, means the person in whose name the ownership of such Certificate is registered on the registration books maintained by the Trustee.

"Permitted Encumbrances" means, as of any time: (a) liens for general ad valorem taxes and assessments, if any, not then delinquent, or which the County may permit to remain unpaid under the Lease Agreement; (b) the Sublease, the Lease Agreement and the Assignment Agreement; (c) any right or claim of any mechanic, laborer, materialman, supplier or vendor which is secured by a lien on the Leased Property; (d) the exceptions disclosed in the title insurance policy with respect to the Leased Property issued as of the Closing Date by _____; and (e) easements, rights of way, mineral rights, drilling rights and other rights, reservations, covenants, conditions or restrictions which exist of record and which the County certifies in writing will not materially impair the use of the Leased Property for its intended purposes.

"Permitted Investments" means any of the following:

A. The following obligations may be used as Permitted Investments for all purposes, including defeasance investments in refunding escrow accounts.

- (1) Cash (insured at all times by the Federal Deposit Insurance Corporation),
- (2) Obligations of, or obligations guaranteed as to principal and interest by, the U.S. or any agency or instrumentality thereof, when such obligations are backed by the full faith and credit of the U.S. including:
 - U.S. treasury obligations
 - All direct or fully guaranteed obligations
 - Farmers Home Administration
 - General Services Administration
 - Guaranteed Title XI financing
 - Government National Mortgage Association (GNMA)
 - State and Local Government Series

Any security used for defeasance must provide for the timely payment of principal and interest and cannot be callable or prepayable prior to maturity or earlier redemption of the rated debt (excluding securities that do not have a fixed par value and/or whose terms do not promise a fixed dollar amount at maturity or call date).

B. The following Obligations may be used as Permitted Investments for all purposes other than defeasance investments in refunding escrow accounts.

(1) Obligations of any of the following federal agencies which obligations represent the full faith and credit of the United States of America, including:

- Export-Import Bank
- Rural Economic Community Development Administration
- U.S. Maritime Administration
- Small Business Administration
- U.S. Department of Housing & Urban Development (PHAs)
- Federal Housing Administration
- Federal Financing Bank

(2) Direct obligations of any of the following federal agencies which obligations are not fully guaranteed by the full faith and credit of the United States of America:

- Senior debt obligations issued by the Federal National Mortgage Association (FNMA) or Federal Home Loan Mortgage Corporation (FHLMC)
- Obligations of the Resolution Funding Corporation (REFCORP)
- Senior debt obligations of the Federal Home Loan Bank System

(3) U.S. dollar denominated deposit accounts, federal funds and bankers' acceptances with domestic commercial banks, including the Trustee and its affiliates, which have a rating on their short term certificates of deposit on the date of purchase of "P-1" by Moody's and "A-1" or "A-1+" by S&P and maturing not more than 360 calendar days after the date of purchase. (Ratings on holding companies are not considered as the rating of the bank);

(4) Commercial paper which is rated at the time of purchase in the single highest classification, "P1" by Moody's and "A-1+" by S&P and which matures not more than 270 calendar days after the date of purchase;

(5) Investments in a money market fund rated "AAAm" or "AAAm-G" or better by S&P, including funds for which the Trustee or its affiliates provide investment advisory or other management services;

(6) Pre-refunded Municipal Obligations defined as follows: any bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state which are not callable at the option of the obligor prior to maturity or as to which irrevocable instructions have been given by the obligor to call on the date specified in the notice; and

(A) which are rated, based on an irrevocable escrow account or fund (the "escrow"), in the highest rating category of Moody's or S&P or any successors thereto; or

(B) (i) which are fully secured as to principal and interest and redemption premium, if any, by an escrow consisting only of cash or obligations described in paragraph A(2) above, which escrow may be applied only to the payment of such principal of and interest and redemption premium, if any, on such bonds or other obligations on the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable instructions, as appropriate,

and (ii) which escrow is sufficient, as verified by a nationally recognized independent certified public accountant, to pay principal of and interest and redemption premium, if any, on the bonds or other obligations described in this paragraph on the maturity date or dates specified in the irrevocable instructions referred to above, as appropriate;

(7) Municipal obligations rated "Aaa/AAA" or general obligations of States with a rating of "A2/A" or higher by both Moody's and S&P;

(8) Investment agreements with a domestic or foreign bank or corporation the long-term debt of which or, in the case of a guaranteed corporation the long-term debt, or, in the case of an insurance company, the long-term debt paying ability, of the guarantor is rated at least "AA" by S&P and "Aa" by Moody's; provided that, by the terms of the investment agreement:

(A) interest payments are to be made to the Trustee at times and in amounts as necessary to pay debt service (or, if the investment agreement is for the Project Fund, construction draws) on the Certificates;

(B) the invested funds are available for withdrawal without penalty or premium, at any time upon not more than seven days' prior notice; the County and the Trustee hereby agree to give or cause to be given notice in accordance with the terms of the investment agreement so as to receive funds thereunder with no penalty or premium paid;

(C) the investment agreement shall state that it is the unconditional and general obligation of, and is not subordinated to any other obligation of, the provider thereof;

(D) the County and the Trustee receives the opinion of domestic counsel (which opinion shall be addressed to the County and the Trustee) that such investment agreement is legal, valid, binding and enforceable upon the provider in accordance with its terms and of foreign counsel (if applicable) in form and substance acceptable, and addressed to the County, and the Trustee;

(E) the investment agreement shall provide that if during its term

(1) the provider's rating by either S&P or Moody's falls below "AA-" or "Aa3", respectively, the provider shall, at its option, within 10 days of receipt of publication of such downgrade, either (i) collateralize the investment agreement by delivering or transferring in accordance with applicable state and federal laws (other than by means of entries on the provider's books) to the Trustee or a third party acting solely as agent therefor (the "Holder of the Collateral") collateral free and clear of any third-party liens or claims the market value of which collateral is maintained at levels and upon such conditions as would be acceptable to S&P and Moody's to maintain an "A" rating in an "A" rated structured financing (with a market value approach); or (ii) repay the principal of and accrued but unpaid interest on the investment; and

(2) the provider's rating by either S&P or Moody's is withdrawn or suspended or falls below "A-" or "A3", respectively, the provider must, at the direction of the County or the Trustee, within 10 days of receipt of such direction, repay the principal of and accrued but unpaid

interest on the investment, in either case with no penalty or premium to the County or Trustee;

(F) The investment agreement shall state and an opinion of counsel shall be rendered, in the event collateral is required to be pledged by the provider under the terms of the investment agreement at the time such collateral is delivered, that the Holder of the Collateral has a perfected first priority security interest in the collateral, any substituted collateral and all proceeds thereof (in the case of bearer securities, this means the Holder of the Collateral is in possession); and

(G) The investment agreement must provide that if during its term

(1) the provider shall default in its payment obligations, the provider's obligations under the investment agreement shall, at the direction of the County or the Trustee be accelerated and amounts invested and accrued, but unpaid interest thereon shall be repaid to the County or Trustee, as appropriate; and

(2) the provider shall become insolvent, not pay its debts as they become due, be declared or petition to be declared bankrupt, etc. ("event of insolvency"), the provider's obligations shall automatically be accelerated and amounts invested and accrued, but unpaid interest thereon shall be repaid to the County or Trustee, as appropriate.

(9) The State of California's Local Agency Investment Fund ("LAIF") established by Government Code Section 16429.1. The Trustee may restrict investments in LAIF if required to keep money available for the purposes of the Trust Agreement.

"Record Date" means the close of business on the 15th day of the month preceding each Interest Payment Date, whether or not such 15th day is a Business Day.

"Reserve Requirement" means, as of the date of calculation thereof, an amount equal to the lesser of (a) 10% of the initial offering price to the public of the Certificates as determined by the Internal Revenue Code, (b) maximum amount of 2014 Lease Payments coming due in the current or any future Fiscal Year, or (c) 125% of average annual 2014 Lease Payments as of the date of issuance.

"Second Supplement to Sub-Sublease" means the Second Supplement to Sub-Sublease dated as of June 1, 2008 between the Authority and the County.

"Securities Depositories" means The Depository Trust Company, 711 Stewart Avenue, Garden City, New York 11530, Fax-(516) 227-4171; and, in accordance with then current guidelines of the Securities and Exchange Commission, such other addresses and/or such other securities depositories as the County may designate in a written request of the County delivered to the Trustee.

"Surety Bond" means an irrevocable standby or direct pay letter of credit or surety bond issued by a commercial bank or insurance company and deposited with the Trustee pursuant to the Trust Agreement, provided that all of the following requirements are met at the time the County determines delivery thereof to the Trustee: (a) the long-term credit rating of such bank or the claims paying rating of such insurance company is AA or better from each Rating Agency which then maintains a rating on the Certificates; (b) such letter of credit or surety bond has a term of at least twelve (12) months; (c) such letter of credit or surety bond has a stated amount at least equal to the portion of the Reserve Requirement with respect to which funds are proposed to be released pursuant to the Trust Agreement; and (d) the Trustee is authorized pursuant to the terms of such letter of credit or surety bond to draw thereunder an amount equal to any

deficiencies which may exist from time to time in the Lease Payment Fund or the purpose of making payments required pursuant to the Lease Agreement or the Trust Agreement.

“S&P” means Standard & Poor’s Rating Services, of New York, New York, its successors and assigns, or any other nationally recognized securities rating agency designated by the County if such corporation is dissolved, liquidated or no longer performs the functions of a securities rating agency.

“Special Counsel” means any attorney or firm of attorneys of nationally recognized expertise with respect to legal matters relating to obligations the interest on which is excludable from gross income pursuant to Section 103 of the Tax Code.

“Tax Code” means the Internal Revenue Code of 1986 as in effect on the Closing Date, or (except as otherwise referenced in the Trust Agreement) as it may be amended to apply to obligations issued on the Closing Date, together with applicable temporary and final regulations promulgated, and applicable official public guidance published, under said Code.

“Third Supplement to Sub-Sublease” means the Third Supplement to Sub-Sublease dated as of March 1, 2014 between the Authority and the County.

SUBLEASE

The County subleases the Leased Property to the Authority under the Amended Sublease. The term of the Amended Sublease commences as of the date of recordation of the Sublease in the office of the Santa Cruz County Recorder. The Amended Sublease will end, and the right of the Authority thereunder to possession of the Leased Property will thereupon cease, on the date on which the Lease Agreement terminates in accordance with its terms.

The Authority agrees to pay the Additional Sublease Payment to the County as and for additional rental of the Leased Property under the Amended Sublease. The Additional Sublease Payment is due and payable upon the execution and delivery of the Amended Sublease, and will be paid by the Authority from a portion of the proceeds of sale of the Certificates under the Trust Agreement. No other amounts of rental are due and payable by the Authority for the use and occupancy of the Leased Property under the Amended Sublease.

The Authority agrees, upon the termination of the Amended Sublease, to quit and surrender the Leased Property in the same good order and condition as the Leased Property was in at the time of commencement of the term hereof, reasonable wear and tear excepted, and agrees that all buildings, improvements and structures then existing upon the Leased Property will remain thereon and title thereto will vest thereupon in the County for no additional consideration.

LEASE AGREEMENT

Sub-Sublease of Leased Property

The Authority sub-subleases the Leased Property back to the County under the Lease Agreement. The Lease Agreement commences on the Closing Date and terminates on the date on which the Certificates are paid or deemed to have been paid in full, except under certain circumstances such as the taking of all or any portion of the Leased Property in eminent domain proceedings. Under any circumstances, the Lease Agreement terminates ten years following the final stated maturity date of the Certificates.

Lease Payments

The County agrees to pay semiannual Lease Payments, subject to abatement as described below, as the rental for the use and occupancy of the Leased Property under the Lease Agreement. On each Lease Payment Date, the County is obligated to deposit with the Trustee the full amount of the Lease Payments

coming due and payable on the next Interest Payment Date, to the extent required to be paid by the County under the Lease Agreement. Any amount on deposit in the Lease Payment Fund on any Lease Payment Date is required to be credited towards the payment then required to be deposited by the County with the Trustee.

The County is required to pay the Lease Payments from any source of available funds, subject to the provisions of the Lease Agreement relating to abatement due to damage or eminent domain with respect to the Leased Property. The County agrees to take such actions as may be necessary to include all Lease Payments required to be paid by it under the Lease Agreement in its annual budgets and to appropriate such Lease Payments in each Fiscal Year during the term of the Lease Agreement. In addition, the County agrees to pay compensation due to the Trustee and all costs and expenses of auditors, engineers and accountants, and costs of issuance to the extent not paid out of Certificate proceeds.

Abatement of Lease Payments

The Lease Payments are subject to abatement under the Lease Agreement during any period in which due to damage or destruction of the Leased Property in whole or in part, due to material title defect in any portion of the Leased Property or due to taking in eminent domain proceedings of the Leased Property in whole or in part, there is substantial interference with the County's use and occupancy of all or any portion thereof. The amount of such abatement will be determined by the County such that the resulting Lease Payments represent fair consideration for the use and occupancy of the portions of the Leased Property not damaged or destroyed. In the event of such abatement, the County will have no obligation to pay abated Lease Payments and there is no remedy available to Certificate Owners arising from such abatement.

Additional Rent

In addition to the Lease Payments, the County agrees to pay when due, as additional rental for the Leased Property, certain amounts including all costs and expenses incurred by the Authority to comply with the provisions of the Trust Agreement and amounts due and owing to the Trustee.

Maintenance, Utilities, Taxes and Modifications

The County, at its own expense, has agreed to maintain or cause to be maintained the Leased Property in good repair; the Authority has no responsibility for such maintenance. The County is also obligated to pay all taxes and assessments charged to the Leased Property. The County has the right under the Lease Agreement to remodel the Leased Property and to make additions, modifications and improvements to the Leased Property, so long as those additions, modifications and improvements are of a value which is not substantially less than such value of the Leased Property immediately prior to making the additions, modifications and improvements. The County will not permit any mechanic's or other lien to be established or to remain against the Leased Property, except that the County has the right in good faith to contest any such lien.

Insurance

The Lease Agreement requires the County to maintain or cause to be maintained the following insurance against risk of physical damage to the Leased Property and other risks for the protection of the Certificate Owners, the Authority and the Trustee:

Public Liability and Property Damage Insurance. The County is required to maintain or cause to be maintained throughout the term of the Lease Agreement, but only if and to the extent available from reputable insurers at reasonable cost in the reasonable opinion of the County, a standard comprehensive general insurance policy or policies in protection of the Authority, the County, and their respective members, officers, agents, employees and assigns. Said policy or policies must provide for indemnification of said parties against direct or contingent loss or liability for damages for bodily and personal injury, death or

property damage occasioned by reason of the operation of the Leased Property. Such policy or policies must provide coverage in such liability limits and be subject to such deductibles as the County deems adequate and prudent. Such insurance may be maintained as part of or in conjunction with any other insurance coverage carried by the County, and may be maintained in whole or in part in the form of self-insurance by the County, or in the form of the participation by the County in a program of pooled insurance. The proceeds of such liability insurance will be applied toward extinguishment or satisfaction of the liability with respect to which the proceeds of such insurance have been paid.

Fire and Extended Coverage Insurance. The County is required to maintain, or cause to be maintained, throughout the term of the Lease Agreement, casualty insurance against loss or damage to all buildings which constitute a part of the Leased Property, in an amount at least equal to the lesser of (a) 100% of the replacement value of the insured buildings, or (b) 100% of the aggregate principal amount of the outstanding Certificates, the 2005 Certificates, the 2006 Certificates and the 2008 Certificates. Such insurance must, as nearly as practicable, cover loss or damage by fire, explosion, windstorm, riot, aircraft, vehicle damage, smoke and such other hazards as are normally covered by such insurance, and shall include earthquake coverage if such coverage is available at reasonable cost from reputable insurers in the reasonable opinion of the County. Such insurance shall be subject to such deductibles as are customarily maintained by municipalities with respect to works and properties of a like character, but in any case shall not exceed 5% of the coverage amount. Such insurance may be maintained as part of or in conjunction with any other insurance coverage carried by the County, (and may be maintained in whole or in part in the form of the participation by the County in a program of pooled insurance). Such insurance may not be maintained by the County in the form of self-insurance. The Net Proceeds of any such insurance will be deposited by the Trustee in the Insurance and Condemnation Fund and applied at the election and direction of the County either to the repair or reconstruction of the damaged Leased Property or to the prepayment of the Lease Payments and the corresponding prepayment of outstanding Certificates, the 2005 Certificates, the 2006 Certificates and the 2008 Certificates.

Rental Interruption Insurance. The County is required to maintain, throughout the term of the Lease Agreement, rental interruption or use and occupancy insurance to cover loss, total or partial, in an amount at least equal to the maximum Lease Payments coming due and payable during the current or any future twenty-four month period, as a result of any of the hazards covered in the fire and extended coverage insurance described above. Such insurance may be maintained as part of or in conjunction with any other insurance coverage carried by the County (and may be maintained in whole or in part in the form of the participation by the County in a program of pooled insurance). Such insurance may not be maintained by the County in the form of self-insurance. The Net Proceeds of such insurance will be paid to the Trustee and deposited in the respective lease payment funds on a pro-rata basis, and will be credited towards the payment of the Lease Payments which would otherwise be abated as a result of insured damage to or destruction of the Leased Property.

Title Insurance. On or before the Closing Date the County will, at its expense, (a) cause the Assignment Agreement, the Sublease and the Lease Agreement, or a memorandum thereof in form and substance approved by Special Counsel, to be recorded in the office of the Santa Cruz County Recorder with respect to the Leased Property, and (b) obtain a CLTA title insurance policy insuring the County's subleasehold estate in the Leased Property, subject only to Permitted Encumbrances, in an amount equal to the aggregate original principal amount of the Certificates. All Net Proceeds received under such title insurance policy will be deposited by the Trustee in the Lease Payment Fund and be credited towards the prepayment of the remaining Lease Payments.

All policies of insurance (other than the policy of public liability and property damage insurance) must provide that the Net Proceeds thereof are payable to the Trustee for application as provided in the Lease Agreement and the Trust Agreement. If the County maintains public liability insurance in whole or in part in the form of self-insurance, the County must cause to be filed annually with the Trustee, within 90 days following the close of each Fiscal Year, a statement of the County's risk manager or an independent insurance adviser engaged by the County identifying the extent of such self-insurance and stating such

person's determination that the County maintains sufficient reserves with respect thereto. In the event that any such insurance is provided in the form of self-insurance by the County, the County is not obligated to make any payment with respect to any insured event except from such reserves.

Option to Prepay

The County has the option to prepay the 2014 Lease Payments or post a security deposit to pay the 2014 Lease Payments, in whole or in part, in the amounts and on the dates set forth in the Lease Agreement. The optional prepayment dates and prices have been determined to correspond to the optional prepayment dates and prices applicable to the Certificates under the Trust Agreement.

Assignment; Subleases

The Authority has assigned certain of its rights under the Lease Agreement to the Trustee, including but not limited to its rights to receive the Lease Payments, under the Assignment Agreement. The County may not assign any of its rights in the Lease Agreement. The County may sublease all or a portion of the Property only with the prior written consent of the Authority, and only under the conditions contained in the Lease Agreement, including the condition that such sublease not cause the interest component of the Lease Payments to become subject to federal or State of California personal income taxes.

Amendment of Lease Agreement

The Authority and the County may at any time amend or modify any of the provisions of the Lease Agreement, but only: (a) with the prior written consents of the bond insurer of the 2005 Certificates and 2006 Certificates and the Owners of a majority in aggregate principal amount of the outstanding Certificates; or (b) with the prior written consent of the bond insurer of the 2005 Certificates and 2006 Certificates but without the consent of the Trustee or any of the Certificate Owners, if such amendment or modification is for any one or more of the following purposes:

- (a) to incorporate additional covenants and agreements of the County or to limit or surrender any rights or power therein reserved to or conferred upon the County;
- (b) to cure any ambiguity, or cure, correct or supplement any defective provision contained in the Lease Agreement, to conform to the original intention of the County and the Authority;
- (c) to amend any provision thereof relating to the Tax Code, if in the opinion of Special Counsel such amendment will not adversely affect the exclusion from gross income of interest represented by any of the Certificates under the Tax Code;
- (d) to amend the description of the Leased Property to reflect accurately the property originally intended to be included therein;
- (e) To substitute an alternative facility for the Leased Property with a fair market value, as determined by a MAI appraiser, with notice to Standard & Poor's.
- (f) in any respect whatsoever as the Authority and the County may deem necessary or desirable, if in the opinion of Special Counsel such modifications or amendments do not materially adversely affect the interests of the Owners of the Certificates; or
- (g) to provide for additional Lease Payments securing Additional Certificates as described elsewhere in this Official Statement.

Events of Default; Remedies

Each of the following constitutes an event of default under the Lease Agreement:

- (a) Failure by the County to pay any Lease Payment or other payment required to be paid under the Lease Agreement at the time specified in the Lease Agreement.
- (b) Failure by the County to observe and perform any covenant, condition or agreement on its part to be observed or performed, other than as referred to in the preceding clause (a), for a period of 30 days after written notice specifying such failure and requesting that it be remedied has been given to the County by the bond insurer of the 2005 Certificates and 2006 Certificates, the Authority or the Trustee; *provided, however*, that if the County notifies the Authority and the Trustee that in its reasonable opinion the failure stated in the notice can be corrected, but not within such 30 day period, such failure will not constitute an event of default if the County commences to cure such failure within such 30 day period and thereafter diligently and in good faith cures such failure in a reasonable period of time.
- (c) Certain events relating to the bankruptcy of the County.

Upon the occurrence and continuance of any event of default described above, the Authority has the right to terminate the Lease Agreement or, with or without such termination, re-enter, take possession of and re-let the Leased Property. When the Authority does not elect to terminate the Lease Agreement, the County remains liable to pay all Lease Payments as they come due and liable for damages resulting from such event of default. Any amounts collected by the Authority from the reletting of the Leased Property will be credited towards the County's unpaid Lease Payments. Any net proceeds of re-leasing or other disposition of the Leased Property are required to be deposited in the Lease Payment Fund and applied to Lease Payments in order of payment date. Under the Assignment Agreement, the Authority assigns all of its rights with respect to remedies in an event of default to the Trustee, so that all such remedies will be exercised by the Trustee, the bond insurer of the 2005 Certificates and 2006 Certificates and the Certificate Owners as provided in the Trust Agreement.

The Trustee has no right to accelerate Lease Payments and, due to the governmental purposes which are served by the use of the Leased Property, it is uncertain whether a court would permit the exercise of the remedies of re-entry, repossession or re-letting.

TRUST AGREEMENT

Trustee

The Trustee is appointed under the Trust Agreement and is authorized to prepare, execute and deliver the Certificates thereunder, and to act as a depository of amounts held thereunder. The Trustee is required to make deposits into and withdrawals from funds, and invest amounts held under the Trust Agreement in accordance with the County's instructions.

Establishment of Funds

The Trust Agreement creates the Lease Payment Fund, the Reserve Fund and the Costs of Issuance Fund. The Trust Agreement also establishes the Insurance and Condemnation Fund to be held in trust by the Trustee for the benefit of the Certificate Owners, which is described below under the heading "Application of Insurance and Eminent Domain Proceeds."

Lease Payment Fund. There will be deposited in the Lease Payment Fund, when received by the Trustee, all 2014 Lease Payments and prepayments thereof (except reimbursement for funds drawn from the Reserve Fund, as described below). Moneys on deposit in the Lease Payment Fund will be used to pay principal, interest and premium (if any) represented by the Certificates. Any earnings on investment of moneys in the Lease Payment Fund will remain therein and will be credited towards payment of the next 2014 Lease Payments. Any surplus remaining in the Lease Payment Fund after the payment of all Certificates, or after provision for their payment has been made, will be paid to the County.

Costs of Issuance Fund. The Trustee will deposit a portion of the proceeds of the Certificates in the Costs of Issuance Fund, to be expended to pay costs of issuance relating to the Certificates. All amounts remaining on deposit in the Costs of Issuance Fund and not required to pay costs of issuing the Certificates will be transferred to the Lease Payment Fund to be applied as a credit towards the 2014 Lease Payment next required to be paid by the County.

Reserve Fund. The Trustee will establish a special fund designated as the "Reserve Fund" to be held by the Trustee in trust for the benefit of the County and the Owners of the Certificates, as a reserve for the payment when due of the 2014 Lease Payments on behalf of the County. The Reserve Fund will be maintained by the County in an amount equal to the Reserve Requirement. The Trustee will transfer all amounts on deposit in the Reserve Fund at any time in excess of the Reserve Requirement, including amounts derived from the investment of amounts in the Reserve Fund which are not required to be retained therein to maintain the Reserve Requirement, to the Lease Payment Fund semiannually on or before each Lease Payment Date.

If on any Interest Payment Date the moneys available in the Lease Payment Fund do not equal the amount of the 2014 Lease Payment then coming due and payable, the Trustee will apply the moneys available in the Reserve Fund to make such payments on behalf of the County by transferring the amount necessary for this purpose to the Lease Payment Fund. Upon receipt of any delinquent 2014 Lease Payment with respect to which moneys have been advanced from the Reserve Fund, such 2014 Lease Payment shall be deposited in the Reserve Fund to the extent of such advance.

Application of Insurance and Eminent Domain Proceeds

Any Net Proceeds of insurance collected by the County in the event of accident to or destruction of the Leased Property will be paid to the Trustee under the Lease Agreement and deposited by the Trustee on a pro-rata basis promptly upon receipt thereof in a special fund designated as the "Insurance and Condemnation Fund."

If the County determines and notifies the Trustee in writing of its determination, within 45 days following the date of such deposit, that the replacement, repair, restoration, modification or improvement of such improvements is not economically feasible or in the best interests of the County, then such Net Proceeds will be promptly transferred by the Trustee to the Lease Payment Fund and applied to the prepayment of Lease Payments and the corresponding prepayment of Certificates, 2005 Certificates, 2006 Certificates and 2008 Certificates. In the event of damage or destruction of the Leased Property in full, such Net Proceeds may be transferred to the Lease Payment Fund to be used to prepay outstanding Certificates, 2005 Certificates, 2006 Certificates and 2008 Certificates only if such Net Proceeds, together with other available moneys, are sufficient to cause the corresponding prepayment of all Lease Payments.

Any Net Proceeds deposited in the Insurance and Condemnation Fund and not applied to prepay the Lease Payments and the Certificates, 2005 Certificates, 2006 Certificates and 2008 Certificates will be applied to replace, repair, restore, modify or improve the Leased Property. Payments will be made by the Trustee for such purpose upon receipt of written requisitions of the County filed with the Trustee. Any balance of the Net Proceeds remaining after the County files a written certificate with the Trustee stating that such work has been completed will be paid to the County.

If all or any part of the Leased Property is taken by eminent domain proceedings (or sold to a government threatening to exercise the power of eminent domain) the Net Proceeds therefrom will be deposited with the Trustee in the Insurance and Condemnation Fund and will be applied and disbursed by the Trustee either to replace the Leased Property or prepay the Lease Payments and the Certificates, 2005 Certificates, 2006 Certificates and 2008 Certificates, as set forth in the Trust Agreement.

Investment of Funds

The Trustee is required to invest and reinvest all moneys held under the Trust Agreement, at the written direction of the County, in Permitted Investments maturing not later than the date moneys are expected to be required for expenditure. All income or profit on any investments of funds held by the Trustee under the Trust Agreement will be deposited in the respective funds from which such investments were made, except that all amounts derived from the investment of amounts in the Reserve Fund will be transferred to the Lease Payment Fund to the extent not required to be retained in the Reserve Fund to maintain the Reserve Requirement. Permitted Investments will be valued at the market value thereof in accordance with the procedures set forth in the Trust Agreement, except that Permitted Investments credited to the Reserve Fund will be valued at the cost thereof.

Remedies Upon Event of Default

Exercise of Remedies; Limitation on Certificate Owners' Rights. Upon the occurrence of an event of default by the County under the Lease Agreement, the Trustee has the right to exercise any and all remedies available at law or under the Lease Agreement. The Trustee is granted the power to control the proceedings in the event of a default for the equal benefit of the Certificate Owners and the Owners of the 2005 Certificates, 2006 Certificates and 2008 Certificates, and no Certificate Owner has the right to institute any suit, action or proceeding at law or in equity, unless (a) such Owner has previously notified the Trustee of the occurrence of an event of default, (b) the Owners of a majority in aggregate principal amount of the outstanding Certificates have requested the Trustee in writing to exercise its powers, (c) said Owners have tendered the Trustee reasonable indemnity against the costs, expenses and liabilities to be incurred in complying with such request, and (d) the Trustee has failed to comply with such request for 60 days after receipt of such request and tender of such indemnity.

Application of Amounts Collected. Any amounts collected by the Trustee in an event of default are required to be applied first to the payment of the fees and expenses of the Trustee incurred in connection with such event of default and second to the payment of principal and interest represented by the Certificates (including interest on overdue installments of interest at the net effective rate of interest per annum then represented by the outstanding Certificates, but only to the extent funds are available for such purpose after payment of all other overdue amounts), ratably if necessary. Upon an event of default, the Trustee has a first lien on the amounts held under the Trust Agreement for its fees, charges and expenses.

Amendment of Trust Agreement

The Trust Agreement may be amended by agreement among the parties thereto without the consent of the Owners of the Certificates, but only:

- (a) to add to the covenants and agreements of any party, other covenants to be observed, or to surrender any right or power reserved to the Authority or the County,
- (b) to cure, correct or supplement any ambiguous or defective provision,
- (c) in regard to questions arising under the Lease Agreement, as the parties may deem necessary or desirable and which amendment does not, in the opinion of Special Counsel, materially adversely affect the interests of the Owners of the Certificates,

- (d) if and to the extent permitted in the opinion of Special Counsel filed with the Trustee, the County and the Authority, to delete or modify any provisions relating to the exclusion from gross income of interest represented by the Certificates under the Tax Code,
- (e) to issue additional debt pursuant to the Lease Agreement,
- (f) to conform to any amendments of the Lease Agreement which are permitted to be made under the terms of the Lease Agreement as described above.

Any other amendment requires the approval of Owners of a majority in aggregate principal amount of the Certificates then outstanding, provided that no such amendment may (a) extend the maturity or time of interest payment, or reduce the interest rate, amount of principal or premium payable on, any Certificate without such Owner's consent; (b) reduce the percentage of Owners of Certificates required to consent to any amendment or modification; or (c) modify any of the Trustee's rights or obligations without its consent.

Defeasance

Upon payment of the outstanding Certificates in whole, or upon the deposit of cash or non-callable Federal Securities with the Trustee sufficient with other available funds to retire the obligations represented by such Certificates at or before maturity, all rights thereunder of the Owners of such Certificates and all obligations of the Authority, the Trustee and the County with respect to the Certificates ceases and terminates, except only the obligation of the Trustee to pay or cause to be paid, from Lease Payments paid by or on behalf of the County from funds so deposited, all sums represented thereby when due.

ASSIGNMENT AGREEMENT

The Authority and the Trustee will enter into the Assignment Agreement under which the Authority assigns and sets over to the Trustee, for the benefit of the Owners of the Certificates, substantially all of the Authority's rights under the Lease Agreement (subject to certain exceptions), including the right of the Authority to receive and collect 2014 Lease Payments, its right to receive and collect proceeds of condemnation and insurance awards and the right to exercise rights and remedies of the Authority in the Lease Agreement to enforce 2014 Lease Payments, subject to the provisions of the Trust Agreement.

APPENDIX B
COUNTY AUDITED FINANCIAL STATEMENTS

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APPENDIX C
FORM OF CONTINUING DISCLOSURE CERTIFICATE

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APPENDIX D
FORM OF SPECIAL COUNSEL OPINION

APPENDIX E

DTC AND THE BOOK-ENTRY-ONLY SYSTEM

The following description of the Depository Trust Company ("DTC"), the procedures and record keeping with respect to beneficial ownership interests in the Certificates, payment of principal, interest and other payments on the Certificates to DTC Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interest in the Certificates and other related transactions by and between DTC, the DTC Participants and the Beneficial Owners is based solely on information provided by DTC. Accordingly, no representations can be made concerning these matters and neither the DTC Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters, but should instead confirm the same with DTC or the DTC Participants, as the case may be.

Neither the issuer of the Certificates (the "Issuer") nor the trustee, fiscal agent or paying agent appointed with respect to the Certificates (the "Agent") take any responsibility for the information contained in this Appendix.

No assurances can be given that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners (a) payments of interest, principal or premium, if any, with respect to the Certificates, (b) certificates representing ownership interest in or other confirmation or ownership interest in the Certificates, or (c) redemption or other notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Certificates, or that they will so do on a timely basis, or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Appendix. The current "Rules" applicable to DTC are on file with the Securities and Exchange Commission and the current "Procedures" of DTC to be followed in dealing with DTC Participants are on file with DTC.

1. The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for the Certificates (the "Securities"). The Securities will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Security certificate will be issued for each issue of the Securities, each in the aggregate principal amount of such issue, and will be deposited with DTC. If, however, the aggregate principal amount of any issue exceeds \$500 million, one certificate will be issued with respect to each \$500 million of principal amount, and an additional certificate will be issued with respect to any remaining principal amount of such issue.

2. DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has a Standard & Poor's rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange

Commission. More information about DTC can be found at www.dtcc.com. *The information contained on this Internet site is not incorporated herein by reference.*

3. Purchases of Securities under the DTC system must be made by or through Direct Participants, which will receive a credit for the Securities on DTC's records. The ownership interest of each actual purchaser of each Security ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Securities are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Securities, except in the event that use of the book-entry system for the Securities is discontinued.

4. To facilitate subsequent transfers, all Securities deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Securities with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Securities; DTC's records reflect only the identity of the Direct Participants to whose accounts such Securities are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

5. Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Securities may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Securities, such as redemptions, tenders, defaults, and proposed amendments to the Security documents. For example, Beneficial Owners of Securities may wish to ascertain that the nominee holding the Securities for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

6. Redemption notices shall be sent to DTC. If less than all of the Securities within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

7. Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Securities unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to Issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Securities are credited on the record date (identified in a listing attached to the Omnibus Proxy).

8. Redemption proceeds and distributions on the Securities will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from Issuer or Agent, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, Agent, or Issuer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption

proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of Issuer or Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

9. DTC may discontinue providing its services as depository with respect to the Securities at any time by giving reasonable notice to Issuer or Agent. Under such circumstances, in the event that a successor depository is not obtained, Security certificates are required to be printed and delivered.

10. Issuer may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Security certificates will be printed and delivered to DTC.

11. The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that Issuer believes to be reliable, but Issuer takes no responsibility for the accuracy thereof.