

**HERCULES PUBLIC FINANCING AUTHORITY
(A COMPONENT UNIT OF THE
CITY OF HERCULES, CALIFORNIA)**

FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2018



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**HERCULES PUBLIC FINANCING AUTHORITY
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FINANCIAL SECTION

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INDEPENDENT AUDITORS' REPORT

Honorable Mayor and Members of City
Council of the City of Hercules
Hercules, California

Report on the Financial Statements

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Honorable Mayor and Members of City
Council of the City of Hercules
Hercules, California

Opinion

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

Emphasis of Matter

An Uncertainty Relating to the Outcome of the Repayment of Outstanding Loans

The Authority has outstanding loans of \$6.7 million owed by the former redevelopment agency (Agency), now a private purpose trust fund of the City. This outstanding loan represents approximately 20.61% of the Authority's assets. The written agreement between the Agency and the City to fund costs on behalf of the Agency was signed within two years of the creation of the Agency. Under Assembly Bill X1 26 (Redevelopment Dissolution Act), a written agreement between a redevelopment agency and the city that created it that provided loans or other startup funds for the redevelopment agency that were entered into within two years of the formation of the redevelopment agency are valid. The City is currently working with the State Department of Finance to determine the outcome of these loans. The possible outcome of this matter cannot presently be determined. Accordingly, no provision for any allowance for doubtful accounts has been made in the financial statements for possible forgiveness of these loans.

Other Matters

Required Supplementary Information

Management has omitted the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 28, 2018 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Authority's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.



CliftonLarsonAllen LLP

Roseville, California
December 28, 2018

**BASIC FINANCIAL STATEMENTS —
GOVERNMENT-WIDE FINANCIAL STATEMENTS**

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HERCULES PUBLIC FINANCING AUTHORITY
STATEMENT OF NET POSITION
JUNE 30, 2018

ASSETS

Current Assets:

Cash and Investments with Fiscal Agents	\$ 9,352,979
Interest Receivable	<u>592,745</u>
Total Current Assets	9,945,724

Noncurrent Assets:

Lease Receivable	15,421,478
Due from RDA Successor Agency	<u>6,703,250</u>
Total Noncurrent Assets	<u>22,124,728</u>

Total Assets	<u>32,070,452</u>
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LIABILITIES

Current Liabilities:

Due to City of Hercules	123,653
Accrued Interest Payable	<u>591,869</u>
Total Current Liabilities	715,522

Noncurrent Liabilities:

Due Within One Year	710,000
Due in More than One Year	<u>24,064,096</u>
Total Noncurrent Liabilities	<u>24,774,096</u>

Total Liabilities	<u>25,489,618</u>
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NET POSITION

Restricted for Debt Service	<u>6,580,834</u>
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Total Net Position	<u><u>\$ 6,580,834</u></u>
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See accompanying Notes to Basic Financial Statements.

**HERCULES PUBLIC FINANCING AUTHORITY
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2018**

EXPENSES

Interest and Fiscal Agent Charges \$ 1,555,711

PROGRAM REVENUES

Lease Revenue - Interest 1,471,816

NET PROGRAM REVENUES (EXPENSES)

(83,895)

GENERAL REVENUES

Investment Earnings 79,828

CHANGE IN NET POSITION

(4,067)

Net Position - Beginning of Year

6,584,901

NET POSITION - END OF YEAR

\$ 6,580,834

See accompanying Notes to Basic Financial Statements.

**BASIC FINANCIAL STATEMENTS —
FUND FINANCIAL STATEMENTS**

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**HERCULES PUBLIC FINANCING AUTHORITY
GOVERNMENTAL FUNDS
BALANCE SHEET
JUNE 30, 2018**

	Debt Service Funds			
	2003B PFA	2009 PFA	2010 PFA	
	Lease	Taxable	Wastewater	
	Revenue	Lease	Revenue	
	Bonds	Revenue	Bonds	Total
		Bonds		
ASSETS				
Cash with Fiscal Agents	\$ 314	\$ 1,904,380	\$ 7,448,285	\$ 9,352,979
Due from Other Funds	152,640	-	-	152,640
Lease Receivable	6,254,686	6,700,054	2,466,738	15,421,478
Interest Receivable	25,341	371,133	196,271	592,745
Advances to Successor RDA Agency	6,703,250	-	-	6,703,250
Total Assets	<u>\$ 13,136,231</u>	<u>\$ 8,975,567</u>	<u>\$ 10,111,294</u>	<u>\$ 32,223,092</u>
LIABILITIES				
Due to the City of Hercules	\$ -	\$ 123,653	\$ -	\$ 123,653
Due to Other Funds	-	152,640	-	152,640
Total Liabilities	<u>-</u>	<u>276,293</u>	<u>-</u>	<u>276,293</u>
DEFERRED INFLOWS OF RESOURCES				
Unavailable Revenue	6,280,027	7,071,187	2,663,009	16,014,223
FUND BALANCES				
Restricted for Debt Service	<u>6,856,204</u>	<u>1,628,087</u>	<u>7,448,285</u>	<u>15,932,576</u>
Total Liabilities, Deferred Inflows of Resources, and Fund Balances	<u>\$ 13,136,231</u>	<u>\$ 8,975,567</u>	<u>\$ 10,111,294</u>	<u>\$ 32,223,092</u>

See accompanying Notes to Basic Financial Statements.

**HERCULES PUBLIC FINANCING AUTHORITY
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO THE STATEMENT OF NET POSITION
JUNE 30, 2018**

Total Fund Balances - Government Funds	\$ 15,932,576
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Amounts reported for governmental activities in the statement of net position are different from those reported in the governmental funds because of the following:

Lease receivables are not available to pay for current period expenditures and, therefore are deferred in the governmental funds.	16,014,223
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Long-term liabilities are not due and payable in the current period and, therefore are not reported in the governmental funds. Interest on long-term debt is not accrued in governmental funds, but rather is recognized as an expenditure when due. All liabilities are reported in the statement of net position.

Bonds Outstanding	\$ (25,280,000)	
Unamortized Discount on Bonds Outstanding	505,904	
Accrued Interest on Long-Term Debt	<u>(591,869)</u>	
		<u>(25,365,965)</u>
Total Net Position - Governmental Activities		<u><u>\$ 6,580,834</u></u>

**HERCULES PUBLIC FINANCING AUTHORITY
GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
YEAR ENDED JUNE 30, 2018**

	Debt Service Funds			
	2003B PFA	2009 PFA	2010 PFA	
	Lease	Taxable	Wastewater	
	Revenue	Lease	Revenue	
	Bonds	Revenue	Bonds	Total
		Bonds		
REVENUES				
Use of Money and Property	\$ -	\$ 20,834	\$ 58,994	\$ 79,828
Lease Revenue	564,819	934,702	1,235,266	2,734,787
Total Revenues	564,819	955,536	1,294,260	2,814,615
EXPENDITURES				
Debt Service:				
Principal	255,000	165,000	260,000	680,000
Interest and Fiscal Agent Fees	311,929	750,940	474,950	1,537,819
Total Expenditures	566,929	915,940	734,950	2,217,819
NET CHANGE IN FUND BALANCE	(2,110)	39,596	559,310	596,796
Fund Balances - Beginning of Year	6,858,314	1,588,491	6,888,975	15,335,780
FUND BALANCES - END OF YEAR	<u>\$ 6,856,204</u>	<u>\$ 1,628,087</u>	<u>\$ 7,448,285</u>	<u>\$ 15,932,576</u>

See accompanying Notes to Basic Financial Statements.

**HERCULES PUBLIC FINANCING AUTHORITY
RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES TO
THE STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2018**

Net Change in Fund Balances - Governmental Funds	\$	596,796
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Amounts reported for governmental activities in the statement of activities are different because:

Lease receivables are reported as financial resources in the fund statements; however these amounts represent the change in the long-term investment in leases to the Hercules Public Financing Authority and decrease net position.		(1,262,971)
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Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore are not reported as expenditures in governmental funds. In addition, interest on long-term debt is not accrued in governmental funds.		
Change in Accrued Interest on Long-Term Debt		6,677

Long-term debt proceeds provide current financial resources for governmental funds, but issuing debt increases long-term liabilities in the statement of net position. Payment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net position.

Principal Repayments on Long Term Debt	\$	680,000
Amortization of Discounts and Refunding Losses		(24,569)

		655,431
Change in Net Position of Governmental Activities	\$	<u><u>(4,067)</u></u>

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**HERCULES PUBLIC FINANCING AUTHORITY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2018**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the Hercules Public Financing Authority (Authority) have been prepared in conformity with accounting principles generally accepted in the United States of America (USGAAP) as applied to governmental agencies. The Governmental Accounting Standards Boards (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant of the Authority's accounting policies are described below.

A. Financial Reporting Entity

The Authority is a joint powers authority organized by the City of Hercules (City) and the Hercules Redevelopment Agency (Agency) on July 24, 2001, under the laws of the State of California. The Authority was organized to provide financing for public capital improvements and working capital for the City and the Agency through lease, acquisition, or construction of such public capital improvements. Administrative and related normal business expenditures incurred in the day-to-day operations of the Authority are provided by the City and are not included in the accompanying basic financial statements. Management believes that such expenditures are not material to the Authority's operations.

B. Basis of Accounting and Measurement Focus

The accounts of the Authority are organized and operated on the basis of funds, each of which is defined as a separate fiscal and accounting entity with a self-balancing set of accounts. These funds are established for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

Government-wide Financial Statements

The Authority's government-wide financial statements include a statement of net position and a statement of activities. These statements present summaries of governmental activities for the Authority.

The basic financial statements are presented on an "*economic resources*" measurement focus and the accrual basis of accounting. Accordingly, all of the Authority's assets and liabilities, including capital assets, as well as infrastructure assets, and long-term liabilities, are included in the accompanying statement of net position. The statement of activities presents changes in net position. Under the accrual basis of accounting, revenues are recognized in the period in which they are earned while expenses are recognized in the period in which the liability is incurred.

**HERCULES PUBLIC FINANCING AUTHORITY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2018**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Basis of Accounting and Measurement Focus (Continued)

Government-wide Financial Statements (Continued)

Governmental fund financial statements include a balance sheet and a statement of revenues, expenditures, and changes in fund balances for all major governmental funds. Accompanying schedules are presented to reconcile and explain the differences in net position as presented in these statements to the net position presented in the government-wide financial statements, and the difference in change in fund balance in the governmental funds to change in net position in the government-wide statements. The Authority has presented all major funds that met the qualifications for major fund reporting. All funds of the Authority are debt service funds.

The following is the description of the major funds:

2003B PFA Lease Revenue Bond Debt Service Fund only the debt component of the city fund, accounts for the accumulation of resources used for the payment of principal and interest on the bonds issued to cover the financing of the original City Hall debt issue and to generate additional resources to assist in the construction of a new library building.

2009 PFA Taxable Lease Revenue Bond Debt Service Fund only the debt component of the City fund, accounts for the accumulation of resources used for the payment of principal and interest on the bonds issued to cover the financing of the acquisition of certain commercial condominium properties, consisting of approximately 96,847 square feet located at 203-295 Linus Pauling Drive within the City.

2010 PFA Wastewater Revenue Bonds Debt Service Fund only the debt component of the City fund, accounts for the accumulation of resources used for the payment of principal and interest on the bonds issued to cover capital improvements to the City of Hercules' wastewater system.

Governmental funds are accounted for on a spending or "current financial resources" measurement focus and the modified accrual basis of accounting. Accordingly, only current assets and current liabilities are included on the balance sheet. The statement of revenues, expenditures, and changes in fund balances presents increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets. Under the modified accrual basis of accounting, revenues are recognized in the accounting period in which they become both measurable and available to finance expenditures of the current period. Accordingly, revenues are recorded when received in cash, except revenues which are subject to accrual (generally 60 days after year-end), which are recognized when due to the Authority.

HERCULES PUBLIC FINANCING AUTHORITY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2018

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Cash and Investment with Fiscal Agents

Cash and investments are held by fiscal agents for the redemption of bonded debt and maintaining required reserves.

The Authority participates in an investment pool managed by the state of California, titled Local Agency Investment Fund (LAIF) which has invested a portion of the pool funds in Structured Notes and Asset-Backed Securities. LAIF's investments are subject to credit and market risk with the full faith and credit of the State of California collateralizing these investments. In addition, these Structured Notes and Asset-Backed Securities are subject to market risk as to change in interest rates.

D. Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the appropriate activities. Bond premiums and discounts, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable premium or discount.

In the governmental fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, in the period in which they were paid/received. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuance are reported as other financing sources while discounts on debt issuance are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

E. Fund Balances

In the governmental funds, the following classifications describe the relative strength of the spending constraints placed on the purposes for which resources can be used:

Nonspendable Fund Balance – amounts that cannot be spent because they are either not spendable in form or legally or contractually required to remain intact.

Restricted Fund Balance – amounts with constraints placed on their use by those external to the Authority, including creditors, grantors, contributors or laws and regulations of other governments. It also includes constraints imposed by law through constitutional provisions or enabling legislation.

Committed Fund Balance – amounts that can only be used for specific purposes determined by formal action of the Authority's highest level of decision-making authority (the board of directors) and that remain binding unless removed in the same manner. The underlying action that imposed the limitation needs to occur no later than the closer of the reporting period.

**HERCULES PUBLIC FINANCING AUTHORITY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2018**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Fund Balances (Continued)

Assigned Fund Balance – amounts that are constrained by the Authority's intent to be used for specific purposes. The intent can be established at either the highest level of decision-making or by a body or an official designed for that purpose.

Unassigned Fund Balance – the residual classification that includes amounts not contained in the other classifications.

The Authority's board establishes, modifies, or rescinds fund balance commitments and assignments by passage of a resolution. When restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, followed by the unrestricted, committed, assigned and unassigned resources as they are needed.

F. Net Position

In the government-wide financial statements, net position may be classified in the following categories:

Net Investment in Capital Assets – This amount consists of capital assets net of accumulated depreciation and reduced by outstanding debt that was attributed to the acquisition, construction, or improvement of the assets.

Restricted Net Position – This amount is restricted by external creditors, grantors, contributors, or laws or regulations of other governments.

Unrestricted Net Position (Deficit) – This amount is all net position that does not meet the definition of "net investment in capital assets" or "restricted net position."

When an expense is incurred for purposes for which both restricted and unrestricted net position are available, the Authority's policy is to apply restricted net position first.

G. Use of Estimates

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires Authority's management to make estimates and assumptions that affect certain amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE 2 CASH AND INVESTMENTS

The Agency pools its cash and investments with the City in order to achieve a higher return on investment. Certain funds, which are held and invested by independent outside custodians through contractual agreements, are not pooled.

**HERCULES PUBLIC FINANCING AUTHORITY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2018**

NOTE 2 CASH AND INVESTMENTS (CONTINUED)

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

Investments Held with Fiscal Agent	\$ 9,352,979
Total Cash and Investments	<u>\$ 9,352,979</u>

The investments made by the Agency are limited to those allowable under state statutes and the Authority's investment policy and may include the following types of investments:

Certificates of Deposit	Government Agency Securities
Bankers Acceptances	Treasury Bills and Notes
Commercial Papers	Passbook Savings Accounts
Repurchase Agreements	Mutual Funds
Medium-Term Corporate Notes	State of California Local Agency Investment Fund

Investments Authorized by Debt Agreements

Investment of debt proceeds held by trustees is governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Authority's investment policy. The table below identifies the investment types that are authorized for investments held by trustees. The table also identifies certain provisions of the debt agreements that address interest rate risk, credit risk, and concentration of credit risk.

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
Local Agency Investment Fund (State Pool)	N/A	\$50 Million	\$50 Million
U.S. Treasury Obligations	30 Years	20%	None
U.S. Government Agency Issues	30 Years	20%	None
Insured Deposits with Banks and Savings and Loans	N/A	None	None
Bankers Acceptance (Must be Dollar Denominated)	6 Months	40%	30%
Commercial Paper	6 Months	15%	10%
Negotiable Time Certificates of Deposits	5 Years	30%	\$100,000
Nonnegotiable Time Certificates of Deposits	5 Years	30%	\$100,000
Federally Insured Time Deposits	1 Year	20%	None
Repurchase Agreements	30 Days	None	None
Reverse Repurchase Agreements	92 Days	20%	None
Medium-Term Notes	5 Years	30%	15%
Mutual Funds	N/A	20%	None
Money Market Funds	N/A	None	None
Insured or Passbook Savings Accounts	N/A	None	\$100,000
Guaranteed Investment Contracts	N/A	None	None

**HERCULES PUBLIC FINANCING AUTHORITY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2018**

NOTE 2 CASH AND INVESTMENTS (CONTINUED)

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. A method the Authority utilizes to manage its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments, thereby timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flows and liquidity needed for operations.

Information about the sensitivity of the fair values of the Authority's investments (including investments held by bond trustees) to market interest rate fluctuations is provided by the following table, which shows the distribution of the Authority's investments by maturity:

Investment Type	Remaining Maturity (in Months)		
	Totals	12 Months or Less	More Than 60 Months
Held by Debt Trustees:			
Money Market Funds	\$ 9,352,979	\$ 9,352,979	\$ -
Totals	<u>\$ 9,352,979</u>	<u>\$ 9,352,979</u>	<u>\$ -</u>

Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

Interest rate risk is the market value fluctuation due to overall changes in interest rates. It is mitigated by limiting the average maturity of the Authority's portfolio not to exceed three years.

As a means of maintaining liquidity and minimizing interest rate risk, the Authority's investment policy limits are as follows:

<u>Maturity</u>	<u>Percent of Portfolio</u>
Up to One Year	10% Minimum
One Year to Five Years	60% Maximum
More than Five Years	30% Maximum

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the Authority's investment policy, or debt agreements, and the actual rating as of fiscal year end for each investment type.

**HERCULES PUBLIC FINANCING AUTHORITY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2018**

NOTE 2 CASH AND INVESTMENTS (CONTINUED)

Disclosures Relating to Credit Risk (Continued)

Investment Type	Amount	Maximum Legal Rating	Exempt from Disclosure	S&P Rating as of Fiscal Year End	
				AAAm	Not Rated
Held by Debt Trustees:					
Money Market Funds	\$ 9,352,979	N/A	\$ -	\$ 9,352,979	\$ -
Total	<u>\$ 9,352,979</u>		<u>\$ -</u>	<u>\$ 9,352,979</u>	<u>\$ -</u>

Concentration of Credit Risk

At June 30, 2018, the Authority held the following investments, by issuer, which exceeded 5% of the net investments or 10% of its net investment for mutual funds.

<u>Issuer</u>	<u>Type</u>	<u>Amount</u>
Federated Treasury Obligation	Mutual Funds	\$ 9,352,979

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Authority's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits. The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The fair value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure the Authority's deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

See the City of Hercules' Annual Financial Report for more information relating to custodial credit risk for amounts reported as cash and investments pooled with the City.

The Authority's investments are carried at fair value as required by accounting principles generally accepted in the United States of America. The Authority adjusts the carrying value of its investments to reflect their fair value at each fiscal year-end, and it includes the effects of these adjustments in investment income for that fiscal year.

HERCULES PUBLIC FINANCING AUTHORITY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2018

NOTE 2 CASH AND INVESTMENTS (CONTINUED)

Investment in State Investment Pool

The Authority is a voluntary participant in the Local Agency Investment Fund (LAIF), which is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the Authority's investment in this pool is reported in the accompanying financial statements at amounts based upon the City's pro-rata share of the fair value provided by LAIF for the entire portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

NOTE 3 LEASE RECEIVABLE

The Authority has entered into several noncancelable lease agreements with the City as part of its issuances of debt. These agreements call for the Authority to receive lease amounts that are structured to be sufficient in timing and amount to meet the Authority's related debt service payments. Interest earned on the lease payment account and other monies held by the trustee are applied to the lease payments made by the City.

Future estimated minimum lease payments to be received are as follows:

<u>Year Ending</u>	2003B PFA Lease Revenue Bonds	2009 PFA Taxable Lease Revenue Bonds	2010 PFA Wastewater Revenue Bonds	Total
2019	\$ 567,340	\$ 911,140	\$ 732,075	\$ 2,210,555
2020	563,590	913,365	733,631	2,210,586
2021	564,805	908,465	734,175	2,207,445
2022	565,735	911,140	733,288	2,210,163
2023	565,731	907,371	731,288	2,204,390
2024-2028	2,816,906	4,527,781	3,646,088	10,990,775
2028-2033	2,807,588	4,492,343	3,631,156	10,931,087
2034-2038	558,625	5,327,780	3,613,625	9,500,030
2039-2043	-	-	2,158,625	2,158,625
Subtotal	9,010,320	18,899,385	16,713,951	44,623,656
Less: Discount	-	(345,926)	(159,978)	(505,904)
Less: Unearned Income	(2,755,320)	(9,949,385)	(6,638,950)	(19,343,655)
Less: Fiscal Agent Cash	(314)	(1,904,380)	(7,448,285)	(9,352,979)
Net Investment in Lease Receivable	<u>\$ 6,254,686</u>	<u>\$ 6,699,694</u>	<u>\$ 2,466,738</u>	<u>\$ 15,421,118</u>

HERCULES PUBLIC FINANCING AUTHORITY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2018

NOTE 4 CAPITAL LEASE – SALES TYPE

On August 14, 2008, the City of Hercules and Bio-Rad Laboratories, Inc. (Bio-Rad) entered into a lease agreement, which Bio-Rad agreed to lease from the City of Hercules, the premises, consisting of the land located in the City of Hercules, County of Contra Costa, State of California, commonly known as the Venture Commerce Center located at 203-295 Linus Pauling Drive, including five (5) buildings consisting of approximately 96,847 rentable square feet, together with the parking lot and associated improvements serving the buildings.

The term of this lease shall be for thirty (30) years, commencing on September 15, 2008 and ending on September 14, 2038, or terminated sooner pursuant to the terms of this lease. Bio-Rad Laboratories, Inc. has the option to terminate this lease anytime on or after the fifteenth (15th) anniversary date as to a portion or the entire premises by delivering to the City of Hercules not later than three (3) months prior to said fifteenth (15th) anniversary date or any applicable later termination date, a notice of such election.

The City of Hercules granted to Bio-Rad Laboratories, Inc. the option to purchase the premises. Bio-Rad Laboratories, Inc. may elect to exercise the Purchase Option by delivering to the City of Hercules written notice of such election within 30 days prior to either of the following dates: (1) the fifteenth (15th) anniversary date; (ii) the twentieth (20th) anniversary date; or (iii) the twenty-fifth (25th) anniversary date. If Bio-Rad Laboratories, Inc. has not elected to exercise the Purchase Option during the time period said above, then the Purchase Option shall automatically be deemed elected by Bio-Rad Laboratories, Inc. as of the expiration date unless Bio-Rad Laboratories, Inc. provides prior written notice to the City of Hercules within fifteen (15) days prior to the expiration date electing not to pursue the Purchase Option. If Bio-Rad Laboratories, Inc. elects to exercise the Purchase Option on the expiration date, the purchase price for the premises shall be one dollar (\$1.00).

Total lease revenue of \$26,723,100 will be received from Bio-Rad Laboratories, Inc. during the term of lease. The interest rate on the lease payments is 8.0381%. Monthly lease payments vary from \$55,300 to \$83,699 and will be received on the first day of each month without notice, offset, deduction, or demand, in advance, during the lease term.

HERCULES PUBLIC FINANCING AUTHORITY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2018

NOTE 5 LONG-TERM OBLIGATIONS

A summary of the Authority's long-term debt transactions for the fiscal year ended June 30, 2018, is presented below:

	Balance July 1, 2017	Additions	Deletions	Balance June 30, 2018	Amounts Due Within One Year
2003B PFA Lease Revenue Bonds	\$ 6,510,000	\$ -	\$ (255,000)	\$ 6,255,000	\$ 270,000
2009 PFA Taxable Lease Revenue Bonds	9,115,000	-	(165,000)	8,950,000	175,000
Discount on Issuance	(363,223)	-	17,297	(345,926)	-
2010 PFA Wastewater Revenue Bonds	10,335,000	-	(260,000)	10,075,000	265,000
Discount on Issuance	(167,250)	-	7,272	(159,978)	-
Total Long-Term Liabilities	<u>\$ 25,429,527</u>	<u>\$ -</u>	<u>\$ (655,431)</u>	<u>\$ 24,774,096</u>	<u>\$ 710,000</u>

2003B Public Financing Authority Lease Revenue Bonds

The Authority issued lease revenue bonds, series 2003B, dated October 15, 2003, totaling \$9,150,000. The purpose of the bonds was to refinance the 1994 Refunding Certificates of Participation and to finance a portion of the construction for a public library. The interest rates on the bonds range from 2.00% to 5.00%. The interest is payable semiannually on June 1 and December 1, commencing December 1, 2003. The bonds are subject to optional and mandatory early redemption provisions. The bonds are payable from and secured by revenues consisting primarily of the base rental payments of the facility lease. Principal is due annually beginning on December 1, 2005, in amounts ranging from \$170,000 to \$2,480,000. The bonds mature on December 1, 2033. The balance at June 30, 2018 is \$6,255,000.

Future debt service requirements on the 2003B Public Financing Authority Lease Revenue bonds are:

<u>Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 270,000	\$ 309,509	\$ 579,509
2020	280,000	297,340	577,340
2021	295,000	283,590	578,590
2022	310,000	269,805	579,805
2023	325,000	255,735	580,735
2024-2028	1,865,000	956,525	2,821,525
2029-2033	2,365,000	432,325	2,797,325
2034	545,000	260,000	805,000
Total	<u>\$ 6,255,000</u>	<u>\$ 3,064,829</u>	<u>\$ 9,319,829</u>

HERCULES PUBLIC FINANCING AUTHORITY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2018

NOTE 5 LONG-TERM OBLIGATIONS (CONTINUED)

2009 Public Financing Authority Taxable Lease Revenue Bonds (Bio-Rad Project)

The Authority issued taxable lease revenue bonds, series 2009, dated July 29, 2009, totaling \$10,080,000. The purpose of the bonds was to finance the acquisition of certain commercial condominium properties, consisting of approximately 96,847 square feet located at 203-295 Units Pauling Drive within the City from the City, funding a reserve fund for the Bonds and to paying the costs of issuance of the Bonds. The interest rates on the bonds range from 6.00% to 8.40%. The interest is payable semiannually on January 1 and July 1, commencing January 1, 2010. The bonds are subject to optional special mandatory redemption, and mandatory sinking account redemption provisions. The bonds are payable from and secured by revenues consisting primarily of the base rental payments of the property lease. Principal is due annually beginning on July 1, 2010, in amounts ranging from \$165,000 to \$845,000. The bonds mature on July 1, 2038. The balance at June 30, 2018 is \$8,950,000.

Future debt service requirements on the 2009 Public Financing Authority Taxable Lease Revenue bonds are:

<u>Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 175,000	\$ 736,140	\$ 911,140
2020	190,000	723,365	913,365
2021	200,000	708,465	908,465
2022	220,000	691,140	911,140
2023	235,000	672,371	907,371
2024-2028	1,505,000	3,022,781	4,527,781
2029-2033	2,235,000	2,257,343	4,492,343
2034-2038	4,190,000	1,137,780	5,327,780
Total	<u>\$ 8,950,000</u>	<u>\$ 9,949,385</u>	<u>\$ 18,899,385</u>

**HERCULES PUBLIC FINANCING AUTHORITY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2018**

NOTE 5 LONG-TERM OBLIGATIONS (CONTINUED)

2010 Public Financing Authority Wastewater Revenue Bonds

The Authority issued revenue bonds, series 2010, dated August 1, 2010, totaling \$11,765,000. The purpose of the bonds was to finance improvements to the City's wastewater system, fund a reserve fund for the bonds, and pay the costs of issuances of the bonds. The interest rates on the bonds range from 2.00% to 5.130%. Principal is due annually beginning August 1, 2011, in amounts ranging from \$230,000 to \$700,000. The bonds mature on August 1, 2040. The balance at June 30, 2018 is \$10,075,000.

Future debt service requirements on the 2010 Public Financing Authority Wastewater Revenue Bonds are:

<u>Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	265,000	467,075	\$ 732,075
2020	275,000	458,631	733,631
2021	285,000	449,175	734,175
2022	295,000	438,288	733,288
2023	305,000	426,288	731,288
2024-2028	1,725,000	1,921,088	3,646,088
2029-2033	2,165,000	1,466,156	3,631,156
2034-2038	2,755,000	858,625	3,613,625
2039-2042	2,005,000	153,625	2,158,625
Total	<u>\$ 10,075,000</u>	<u>\$ 6,638,951</u>	<u>\$ 16,713,951</u>

NOTE 6 TRANSACTIONS WITH THE CITY OF HERCULES

Due To City of Hercules

At June 30, 2018, the Authority had the following due to the City:

General Fund	<u>\$ 123,653</u>
Total	<u>\$ 123,653</u>

NOTE 7 CONTINGENCIES

The Authority is not involved in any matters of litigation that have arisen in the normal course of conducting Authority business as of June 30, 2018. Additionally, the Authority's management believes that the Authority's insurance programs are sufficient to cover any potential losses should an unfavorable outcome materialize.

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

Honorable Mayor and Members of City
Council of the City of Hercules
Hercules, California

We have audited in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, the financial statements of the Hercules Public Financing Authority (Authority), a component unit of the City of Hercules, California (City) as of and for the fiscal year ended June 30, 2018, and the related notes to the financial statements, and have issued our report thereon dated December 28, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

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

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

Honorable Mayor and Members of City
Council of the City of Hercules
Hercules, California

Compliance and Other Matters

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

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

A handwritten signature in cursive script that reads "CliftonLarsonAllen LLP". The signature is written in black ink and is contained within a thin black rectangular border.

CliftonLarsonAllen LLP

Roseville, California
December 28, 2018