

**SANTA CLARA COUNTY  
TOBACCO SECURITIZATION  
CORPORATION**

(A Component Unit of the  
County of Santa Clara, California)

Independent Auditor's Report  
and Basic Financial Statements

For the Year Ended June 30, 2021



Certified  
Public  
Accountants

**SANTA CLARA COUNTY**  
**TOBACCO SECURITIZATION CORPORATION**  
(A Component Unit of the County of Santa Clara, California)  
For the Year Ended June 30, 2021

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## Independent Auditor's Report

Board of Directors  
Santa Clara County  
Tobacco Securitization Corporation  
San Jose, California

We have audited the accompanying financial statements of the Santa Clara County Tobacco Securitization Corporation (Corporation), a component unit of the County of Santa Clara (County), California, as of and for the year ended June 30, 2021, and the related notes to the financial statements, which collectively comprise the Corporation's basic financial statements as listed in the table of contents.

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

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

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Corporation as of June 30, 2021, and the changes in its net position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Emphasis of Matter***

As discussed in Note 3 to the financial statements, at June 30, 2021, the Corporation have deficit net position of \$235.6 million. Our opinion is not modified with respect to this matter.

***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.

*Macias Gini & O'Connell LLP*

Walnut Creek, California

November 5, 2021

**SANTA CLARA COUNTY**  
**TOBACCO SECURITIZATION CORPORATION**  
(A Component Unit of the County of Santa Clara, California)  
Statement of Net Position  
June 30, 2021

<b>Assets</b>	
Cash and cash equivalents	<u>\$ 688,020</u>
<b>Liabilities</b>	
Noncurrent liabilities:	
Loan payable	102,030,012
Interest payable	<u>134,242,726</u>
Total liabilities	<u>236,272,738</u>
<b>Net Position</b>	
Unrestricted	<u><u>\$ (235,584,718)</u></u>

See accompanying notes to basic financial statements.

**SANTA CLARA COUNTY**  
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(A Component Unit of the County of Santa Clara, California)  
Statement of Revenues, Expenses and Changes in Net Position  
For the Year Ended June 30, 2021

<b>Operating revenue:</b>	
Revenue received from the Authority	\$ 146,853
<b>Operating expenses:</b>	
Administrative and other	<u>83,580</u>
Operating income	<u>63,273</u>
<b>Nonoperating expenses:</b>	
Interest income	60
Loan interest expenses	<u>(13,373,019)</u>
Total net nonoperating expenses	<u>(13,372,959)</u>
Change in net position	(13,309,686)
<b>Net position, beginning of year</b>	<u>(222,275,032)</u>
<b>Net position, end of year</b>	<u><u>\$ (235,584,718)</u></u>

See accompanying notes to basic financial statements.

**SANTA CLARA COUNTY**  
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Statement of Cash Flows  
For the Year Ended June 30, 2021

<b>Cash flows from operating activities:</b>	
Cash receipts from the Authority	\$ 146,853
Cash payments to suppliers for goods and services	<u>(101,673)</u>
Net cash provided by operating activities	45,180
<b>Cash flows from investing activities:</b>	
Interest received	<u>60</u>
Net change in cash and cash equivalents	45,240
Cash and cash equivalents:	
Beginning of year	<u>642,780</u>
End of year	<u><u>\$ 688,020</u></u>
<b>Reconciliation of operating income to</b>	
<b>net cash provided by operating activities:</b>	
Operating income	\$ 63,273
Adjustments to reconcile change in operating income to	
net cash provided by operating activities:	
Decrease in accounts payable	<u>(18,093)</u>
Net cash provided by operating activities	<u><u>\$ 45,180</u></u>

See accompanying notes to basic financial statements.

**SANTA CLARA COUNTY**  
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Notes to Basic Financial Statements  
For the Year Ended June 30, 2021

**NOTE 1 – REPORTING ENTITY**

The Santa Clara County Tobacco Securitization Corporation (Corporation) was incorporated on December 21, 2006 by the Santa Clara County (County) as a nonprofit organization under the California nonprofit public benefit corporation law of the State of California.

The Corporation was formed for the purposes of purchasing the County's future Tobacco Settlement Revenue (TSR) under the Master Settlement Agreement (Agreement) signed in November 1998 between 46 states, including the State of California, and the four major tobacco companies. Under its agreement with the County, the Corporation has title to all payments due the County under the Agreement noted above, the Memorandum of Understanding (MOU), the Agreement Regarding Interpretation of Memorandum of Understanding (ARIMOU) and the Consent Decree and all other agreements and understandings that are due the County, including any interest thereon, between the State of California and the tobacco companies.

The Corporation is a separate legal entity that is an integral part of the County. The Corporation is administered by its Board of Directors consisting of three directors designated by the Board of Supervisors of the County, of which two of them are employees of the County and one is of them an independent director as defined in the Corporation's bylaws. The County exercises significant financial and management control over the Corporation. The Corporation provide services entirely to the County. The Corporation and the County have a financial and operational relationship which requires that the Corporation's financial statements be blended into the County's financial statements. Therefore, the Corporation is considered a blended component unit of the County, and its financial activities are included into the County's basic financial statements.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Measurement Focus, Basis of Accounting and Financial Statement Presentation***

The Corporation's basic financial statements are prepared using the economic resources measurement focus and 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, which is in accordance with accounting principles generally accepted in the United States of America.

The statement of net position, the statement of revenues, expenses and changes in net position, and the statement of cash flows display information about the Corporation. These statements include the financial activities of the overall organization. Operating revenues and expenses generally result from providing services in connection with the Corporation's principal ongoing operations including revenues received from the Silicon Valley Tobacco Securitization Authority (Authority) and administrative expenses incurred. All revenues and expenses not meeting this definition are reported as nonoperating revenues.

During fiscal year 2007, the Corporation has elected to recognize the purchase of the future TSR from the County as an expense under the provisions of Bulletin 2004-1 totaling \$139,254,709 using funds borrowed from the Authority of \$100,000,067 (Tobacco Settlement Asset-Backed Bonds proceeds of \$102,030,012, net of cost of issuance of \$1,929,945 and deposit into the operating account of \$100,000) and a grant obtained from the County of \$39,254,642.



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Notes to Basic Financial Statements  
For the Year Ended June 30, 2021

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

***Cash and Cash Equivalents***

The Corporation considers all highly liquid cash and investments with maturity of three months or less when purchased to be cash equivalents.

***Use of Estimates***

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

***Income Taxes***

The Corporation is recognized as a not for profit organization under the provisions of the Internal Revenue Code Section 501(c)(3), hence, no provision for federal or State income taxes have been recognized in the financial statements.

**NOTE 3 – DEFICIT NET POSITION**

At June 30, 2021, the Corporation has a deficit net position of \$235.6 million. The deficit is expected to reduce primarily through the receipt of TSR due to the County on and after January 1, 2026.

**NOTE 4 – CASH AND CASH EQUIVALENTS**

Statutes and bond indenture authorize the Corporation to invest in obligations of the U.S. Treasury, agencies and instrumentalities, collateralized time deposits, negotiable certificates of deposits, repurchase agreements, commercial paper, medium-term corporate notes, municipal obligations, guaranteed investment contracts, and mutual funds as permitted by the California Government Code.

***Interest Rate Risk***

State law limits investment maturities to five years as a means of managing entities' exposure to fair value losses arising from increasing interest rates. At June 30, 2021, the Corporation's investments in the amount of \$688,020 are invested in money market mutual funds with a weighted average maturity of less than three months.

***Credit Risk***

The Corporation does not have a credit risk policy. The Corporation's investment in money market mutual funds as of June 30, 2021 is rated Aaa-mf by Moody's Investors Service.

***Concentration of Credit Risk***

Concentration of credit risk is the risk that the failure of any one issuer would place an undue financial burden on the Corporation. Investments issued by or explicitly guaranteed by the U.S. Government and investments in mutual funds, external investment pools, and other pooled investments are exempt from this requirement, as they are normally diversified themselves.

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**NOTE 4 – CASH AND CASH EQUIVALENTS (Continued)**

***Fair Value Hierarchy***

The Corporation categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the assets. Level 1 inputs are quoted prices in an active market for identical assets; Level 2 inputs are significant other observable inputs; and Level 3 inputs are significant unobservable inputs. The inputs and techniques used for valuing securities are not necessarily an indication of risk associated with investing in those securities. The Corporation’s investments in money market mutual funds are exempt from fair value measurement disclosures.

**NOTE 5 – LOAN AND INTEREST PAYABLE**

In November 1998, the Attorney General of 46 states, including the State of California, signed a master settlement agreement (Agreement) with four major tobacco companies. The Agreement is the largest civil settlement in U.S. history, which is estimated to provide \$206 billion in tobacco settlement payments in exchange for the release of all past, present, and future claims related to the use of tobacco products. Pursuant to the MOU and the ARIMOU, the State of California agreed to distribute a portion of its share of the settlement to its counties based on population. Under the formula, the County will receive approximately \$1.3 billion over fifty years starting in fiscal year 2007.

In accordance with the Loan Agreement, the Corporation has granted to the Authority a security interest in all right, title, and interest of the Corporation in, to and under the following property: 1) the Sold County Tobacco Assets as defined in the indenture purchased from the County; 2) to the extent permitted by law, corresponding present or future rights, if any, of the Corporation to enforce or cause the enforcement of payment of purchased Sold County Tobacco Assets pursuant to the MOU and the ARIMOU; 3) corresponding rights of the Corporation under the Purchase and Sale Agreement dated January 1, 2007; and 4) all proceeds of any and all of the foregoing.

At June 30, 2021, the loan and interest payable owed to the Authority was \$102,030,012 and \$134,242,726, respectively, which represents payments to be made from the Corporation for debt service payments of the Tobacco Settlement Asset-Backed Bonds of the Authority. The loan interest rates and repayment schedule matches the interest rates and annual future principal and interest payments schedule of the Tobacco Settlement Asset-Backed Bonds of the Authority and has a final maturity date of June 1, 2056.

A summary of the changes in loan and interest payable during the fiscal year ended June 30, 2021 is as follows:

	Balance June 30, 2020	Addition	Balance June 30, 2021	due within one year
Loan payable	\$ 102,030,012	\$ -	\$ 102,030,012	\$ -
Interest payable	120,869,707	13,373,019	134,242,726	-
Total	<u>\$ 222,899,719</u>	<u>\$ 13,373,019</u>	<u>\$ 236,272,738</u>	<u>\$ -</u>

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Notes to Basic Financial Statements  
For the Year Ended June 30, 2021

**NOTE 5 – LOAN AND INTEREST PAYABLE (Continued)**

Annual future loan principal and interest payments as of June 30, 2021, are as follows:

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2022	\$ -	\$ -	\$ -
2023	-	-	-
2024	-	-	-
2025	-	-	-
2026	-	-	-
2027-2031	-	-	-
2032-2036	43,604,066	178,570,934	222,175,000
2037-2041	11,339,137	66,320,863	77,660,000
2042-2046	-	-	-
2047-2051	18,025,118	158,674,882	176,700,000
2052-2056	29,061,691	648,788,309	677,850,000
	<u>\$ 102,030,012</u>	<u>\$ 1,052,354,988</u>	<u>\$ 1,154,385,000</u>

The Corporation is considered to be in default for if the Corporation fails to pay all payments related to sold County Tobacco Assets to the trustee and deposit the funds into the collection account established under the indenture. If an event of default has occurred and is continuing, the Authority may, by written notice to the Corporation exercise any right, power or remedy available to it by law, either by suit in equity or by action at law, or both.