

# Northern California Energy Authority

**Financial Statement**  
*as of December 31, 2019 and 2018*  
and  
**Report of**  
**Independent Auditors**

**NORTHERN CALIFORNIA ENERGY AUTHORITY**  
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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
Northern California Energy Authority  
Sacramento, California

We have audited the accompanying financial statements of Northern California Energy Authority, a component unit of Sacramento Municipal Utility District, as of and for the year ended and one month ended December 31, 2019 and 2018, respectively, and the related notes to the financial statements, which collectively comprise Northern California Energy Authority's basic financial statements as listed in the table of contents.

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

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

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

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 over financial reporting relevant to Northern California Energy Authority'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 Northern California Energy Authority'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 Northern California Energy Authority as of December 31, 2019 and 2018, and the respective changes in financial position and cash flows thereof for the year then ended and one month then ended, respectively, in accordance with accounting principles generally accepted in the United States of America.

**Other Matter**

*Required Supplementary Information*

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

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
February 21, 2020

**NORTHERN CALIFORNIA ENERGY AUTHORITY  
MANAGEMENT'S DISCUSSION AND ANALYSIS - UNAUDITED  
For the Year and One Month Ended December 31, 2019 and 2018**

**Using this Financial Report**

This annual financial report for Northern California Energy Authority (Agency) consists of management's discussion and analysis and the financial statements, including notes to the financial statements. The basic Financial Statements consist of the Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position and the Statements of Cash Flows.

The Agency's accounting records are maintained in accordance with Generally Accepted Accounting Principles for proprietary funds as prescribed by the Governmental Accounting Standards Board. The Agency's accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission.

**Overview of the Financial Statements**

The following discussion and analysis of the financial performance of the Agency provides an overview of the financial activities for the year and one month ended December 31, 2019 and 2018. This discussion and analysis should be read in conjunction with the Agency's financial statements and accompanying notes, which follow this section.

The Statements of Net Position provides information about the nature and amount of resources and obligations at a specific point in time.

The Statements of Revenues, Expenses and Changes in Net Position reports all of the Agency's revenues and expenses during the period indicated.

The Statements of Cash Flows reports the cash provided and used by operating activities, as well as other cash sources such as investment income and debt financing, and other cash uses such as payments for debt service.

The Notes to Financial Statements provide additional detailed information to support the financial statements.

**Nature of Operations**

The Agency is a joint powers authority (JPA) formed by the Sacramento Municipal Utility District (SMUD) and the Sacramento Municipal Utility District Financing Authority (SFA) in 2018. SFA is a JPA formed by SMUD and the Modesto Irrigation District (collectively, Members). The Agency was formed for the purpose of prepaying for a fixed quantity supply of natural gas and electricity to be delivered over a thirty-year period by J. Aron & Company LLC (J. Aron) under a Prepaid Commodity Sales Agreement between the Agency and J. Aron. The Agency then sells the natural gas and electricity to SMUD. The Agency issued bonds in December 2018 and gas sales started in June 2019.

SMUD purchases all the natural gas and electricity delivered to the Agency pursuant to the Commodity Supply Contract between SMUD and the Agency. The Agency has no employees and SMUD contributes to the Agency the actual costs of providing general and administrative services.

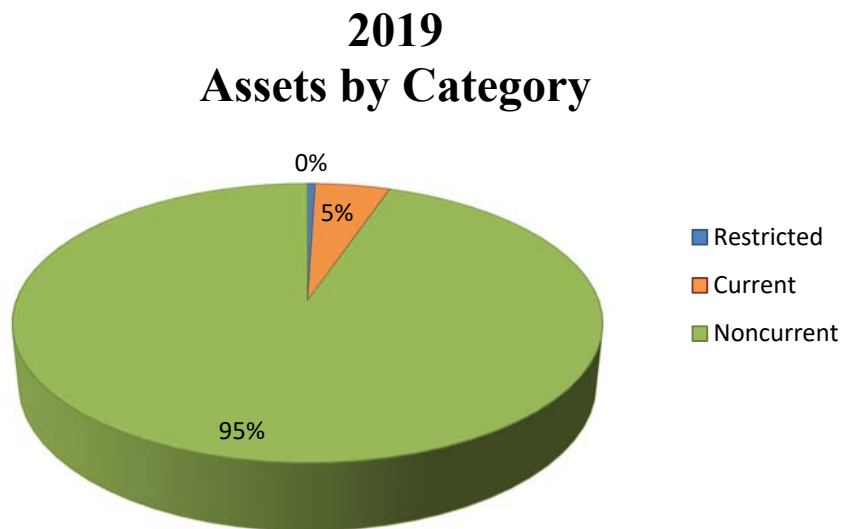
The Agency's Commission is comprised of SMUD's Board of Directors. The Agency is a separate legal entity; however, due to the extent of its operational and financial relationship with SMUD, it is included in the financial statements of SMUD.

**FINANCIAL POSITION**

**Statements of Net Position Summary**  
(Dollars in thousands)

	December 31,		Change	
	2019	2018	2019 vs. 2018	
<b>Assets</b>				
Restricted assets	\$ 2,840	\$ 2,478	\$ 362	14.6%
Current assets	27,096	22,027	5,069	23.0%
Noncurrent assets	535,991	539,238	(3,247)	-0.6%
Total assets	<u>\$ 565,927</u>	<u>\$ 563,743</u>	<u>\$ 2,184</u>	0.4%
<b>Liabilities</b>				
Long-term debt - net	\$ 561,820	\$ 566,893	\$ (5,073)	-0.9%
Current liabilities	10,876	1,449	9,427	650.6%
Noncurrent liabilities	77	-0-	77	100.0%
Total liabilities	<u>572,773</u>	<u>568,342</u>	<u>4,431</u>	0.8%
<b>Net position</b>				
Restricted	13,165	20,394	(7,229)	-35.4%
Unrestricted	(20,011)	(24,993)	4,982	19.9%
Total net position	<u>(6,846)</u>	<u>(4,599)</u>	<u>(2,247)</u>	-48.9%
Total liabilities and net position	<u>\$ 565,927</u>	<u>\$ 563,743</u>	<u>\$ 2,184</u>	0.4%

The following chart shows the breakdown of the Agency’s assets by category:



## 2019 compared to 2018

### ASSETS

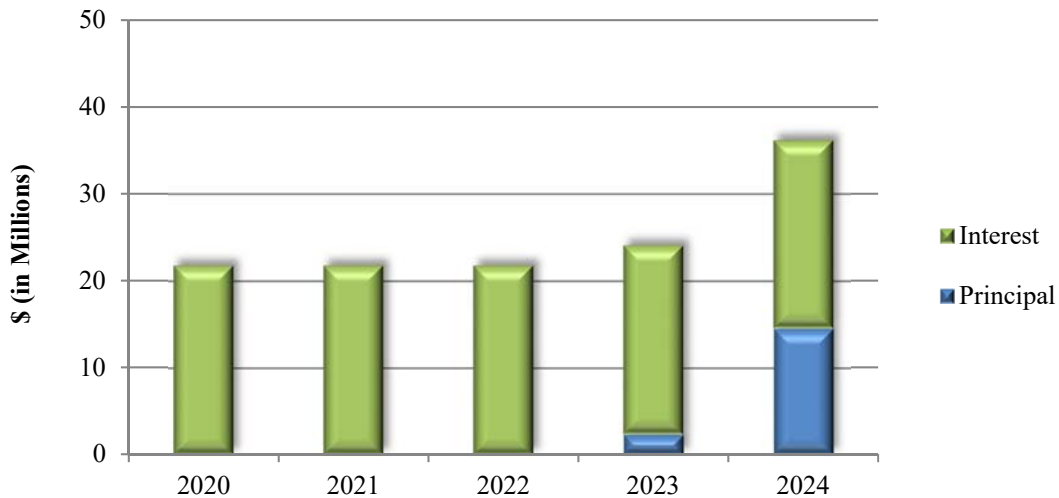
- Current Assets increased primarily due to higher debt service fund balance, receivable from Member for gas sales, and Prepaid Gas Supply.
- The Agency's main asset is its Prepaid Gas Supply, of which the noncurrent portion was \$536.0 million at December 31, 2019. Noncurrent Assets decreased due to the amortization of the Prepaid Gas Supply for gas delivered in 2019. The Prepaid Gas Supply (current and noncurrent portion) was about 95 percent of the Agency's assets at December 31, 2019.

### LIABILITIES & NET POSITION

- Long-Term Debt - net decreased due to the amortization of bond premium. The Agency currently has bonds outstanding in the amount of \$539.6 million with maturities through 2049. The Agency's bonds are rated "A3" by Moody's and "A" by Fitch.

The following chart summarizes the debt service requirements of the Agency for the next five years:

## Debt Service Requirements



- Current Liabilities increased due to higher accrued interest for the 2018 Bonds.



## 2018

### ASSETS

- Current Assets were \$22.0 million, primarily comprised of the debt service fund balance as a result of issuance of \$539.6 million bonds in December 2018.
- The Agency's main asset is its Prepaid Gas Supply, of which the noncurrent portion was \$539.2 million.

### LIABILITIES & NET POSITION

- In December 2018, the Agency issued \$539.6 million of 2018 Commodity supply revenue bonds to fund the purchase of the Prepaid Gas Supply from J. Aron. The Agency currently has bonds outstanding in the amount of \$539.6 million with maturities through 2049.

### RESULTS OF OPERATIONS

#### Summary of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

	Year Ended	One Month Ended	Change	
	December 31,	December 31,	2019 vs. 2018	
	2019	2018		
Operating revenues	\$ 16,438	\$ -0-	\$ 16,438	100.0%
Operating expenses	(2,682)	(4,045)	1,363	33.7%
Operating income	13,756	(4,045)	17,801	440.1%
Interest income - net	589	-0-	589	100.0%
Interest on debt	(16,680)	(555)	(16,125)	-2905.4%
Change in net position before contributions	(2,335)	(4,600)	2,265	49.2%
Member contributions	88	1	87	8700.0%
Change in net position	(2,247)	(4,599)	2,352	51.1%
Net position - beginning of year	(4,599)	-0-	(4,599)	-100.0%
Net position - end of year	\$ (6,846)	\$ (4,599)	\$ (2,247)	-48.9%

#### 2019 compared to 2018

- Operating revenues represent proceeds from gas sales to Member and gas swap settlements which started in June 2019.
- Operating expenses were \$2.7 million, primarily comprised of amortization of Prepaid Gas Supply.
- Interest expense increased due to a full year of interest incurred on the 2018 Bonds.

## 2018

- Operating Expense were \$4.0 million, primarily comprised of bond issuance costs.

**NORTHERN CALIFORNIA ENERGY AUTHORITY  
STATEMENTS OF NET POSITION**

	December 31,	
	2019	2018
<b>ASSETS</b>		
<b>RESTRICTED ASSETS</b>		
Debt service funds	\$ 20,965,159	\$ 18,080,000
Other restricted funds	3,076,479	3,763,185
Less current portion	(21,201,638)	(19,364,705)
Total restricted assets	2,840,000	2,478,480
<b>CURRENT ASSETS</b>		
Restricted cash and cash equivalents	10,952,908	763,185
Restricted investments	10,248,730	18,601,520
Receivables:		
Gas sales to Member	2,365,920	-0-
Accrued interest and other	244,032	-0-
Prepaid gas supply	3,247,134	2,661,781
Prepayments	36,940	-0-
Total current assets	27,095,664	22,026,486
<b>NONCURRENT ASSETS</b>		
Prepaid gas supply	535,991,085	539,238,219
Total noncurrent assets	535,991,085	539,238,219
<b>TOTAL ASSETS</b>	<b>\$ 565,926,749</b>	<b>\$ 563,743,185</b>
<b>LIABILITIES AND NET POSITION</b>		
<b>LONG-TERM DEBT - net</b>	<b>\$ 561,820,089</b>	<b>\$ 566,893,224</b>
<b>CURRENT LIABILITIES</b>		
Accounts payable	-0-	724,000
Accrued interest	10,876,425	725,095
Total current liabilities	10,876,425	1,449,095
<b>NONCURRENT LIABILITIES</b>		
Arbitrage rebate liability	76,431	-0-
Total noncurrent liabilities	76,431	-0-
TOTAL LIABILITIES	572,772,945	568,342,319
<b>NET POSITION</b>		
Restricted	13,165,213	20,394,090
Unrestricted	(20,011,409)	(24,993,224)
TOTAL NET POSITION	(6,846,196)	(4,599,134)
<b>COMMITMENTS AND CONTINGENCIES (Notes 6 and 7)</b>		
<b>TOTAL LIABILITIES AND NET POSITION</b>	<b>\$ 565,926,749</b>	<b>\$ 563,743,185</b>

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

**NORTHERN CALIFORNIA ENERGY AUTHORITY**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION**

	Year Ended December 31, 2019	One Month Ended December 31, 2018
<b>OPERATING REVENUES</b>		
Gas sales to Member	\$ 9,112,470	\$ -0-
Gas swap settlement, net	7,326,018	-0-
Total operating revenues	16,438,488	-0-
<b>OPERATING EXPENSES</b>		
Prepaid gas amortization	2,661,781	-0-
Administrative and general	20,359	4,045,457
Total operating expenses	2,682,140	4,045,457
<b>OPERATING INCOME (LOSS)</b>	13,756,348	(4,045,457)
<b>NON-OPERATING REVENUES (EXPENSES)</b>		
Interest income - net	588,159	-0-
Interest on debt	(16,679,715)	(555,172)
Total non-operating revenues (expenses)	(16,091,556)	(555,172)
<b>CHANGE IN NET POSITION BEFORE CONTRIBUTIONS</b>	(2,335,208)	(4,600,629)
Member contributions	88,146	1,495
<b>CHANGE IN NET POSITION</b>	(2,247,062)	(4,599,134)
<b>NET POSITION - BEGINNING OF YEAR</b>	(4,599,134)	-0-
<b>NET POSITION - END OF YEAR</b>	\$ (6,846,196)	\$ (4,599,134)

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

**NORTHERN CALIFORNIA ENERGY AUTHORITY  
STATEMENTS OF CASH FLOWS**

	Year Ended December 31, <u>2019</u>	One Month Ended December 31, <u>2018</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from gas sales to Member	\$ 6,746,550	\$ -0-
Receipts from others	7,081,986	-0-
Payments to vendors	(693,153)	(3,319,962)
Net cash provided by (used in) operating activities	<u>13,135,383</u>	<u>(3,319,962)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Proceeds from bond issuance, net of premium	-0-	567,063,147
Prepaid gas supply expenditures	-0-	(541,900,000)
Interest payments on long-term debt	(11,601,520)	-0-
Net cash provided by (used in) noncapital financing activities	<u>(11,601,520)</u>	<u>25,163,147</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Sale of investments	19,952,185	-0-
Purchase of investments	(11,960,915)	(21,080,000)
Interest received	664,590	-0-
Net cash provided by (used in) investing activities	<u>8,655,860</u>	<u>(21,080,000)</u>
Net increase in cash and cash equivalents	10,189,723	763,185
Cash and cash equivalents - beginning of year	763,185	-0-
Cash and cash equivalents - end of the year	<u>\$ 10,952,908</u>	<u>\$ 763,185</u>
<b>CASH AND CASH EQUIVALENTS INCLUDED IN:</b>		
Restricted cash and cash equivalents	\$ 10,952,908	\$ 763,185
Cash and cash equivalents - end of the year	<u>\$ 10,952,908</u>	<u>\$ 763,185</u>
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>		
Operating income (loss)	\$ 13,756,348	\$ (4,045,457)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Amortization of prepaid gas supply	2,661,781	-0-
Changes in operating assets and liabilities:		
Receivables	(2,609,952)	-0-
Prepaid expenses	(36,940)	-0-
Payables and accruals	(635,854)	725,495
Net cash provided by (used in) operating activities	<u>\$ 13,135,383</u>	<u>\$ (3,319,962)</u>
<b>SUPPLEMENTAL DISCLOSURE OF NONCASH AND RELATED FINANCING ACTIVITIES</b>		
Amortization of debt related premiums	\$ 5,073,135	\$ 169,923
Contributions from Member	88,146	1,495

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

**NORTHERN CALIFORNIA ENERGY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**As of and for the Year and One Month Ended December 31, 2019 and 2018**

**NOTE 1. ORGANIZATION AND OPERATIONS**

The Northern California Energy Authority (Agency) is a joint powers authority (JPA) formed by the Sacramento Municipal Utility District (SMUD) and the Sacramento Municipal Utility District Financing Authority (SFA) pursuant to the California Government Code (collectively, Members). SFA is a JPA formed by SMUD and the Modesto Irrigation District. The purpose of the Agency is to prepay for a supply of a fixed quantity of natural gas and electricity (commodity) to be delivered over a thirty-year period (Commodity Project) by J. Aron & Company LLC (J. Aron) under a Prepaid Commodity Sales Agreement (Prepaid Agreement) between the Agency and J. Aron. The Prepaid Agreement terminates on May 31, 2049. J. Aron is obligated to make payments to the Agency for any shortfall of commodity not delivered or taken under the Prepaid Agreement for any reason, including force majeure.

The Agency has entered into a Commodity Supply Contract (CSC) with SMUD that provides for the sale of all commodities delivered to the Agency over the term of the Prepaid Agreement. SMUD is obligated to pay the Agency for the quantities of commodity delivered under the CSC and to pay damages for commodity that SMUD fails to take pursuant to the terms of the CSC. SMUD has no obligation to pay for commodity that the Agency fails to deliver. The Agency anticipates that SMUD will be the only project participant with respect to the Commodity Project during the term of the Prepaid Agreement. However, in the event of a default by SMUD under the CSC, the Agency has agreed to terminate the CSC and may enter into a replacement CSC with one or more municipal utilities on substantially the same terms as the CSC.

The Agency has no employees. The Commodity Project is operated by SMUD's staff. SMUD is obligated to contribute to the Agency the actual costs of providing administrative and general services. SMUD contributed \$88.1 thousand in 2019 and \$1.5 thousand in 2018 for administrative and general services provided to the Agency by SMUD.

The JPA agreement will remain in effect until terminated by a supplemental written agreement of the parties; provided, that in no event shall the JPA agreement terminate while any contracts between the Agency and either of the parties or other parties are in effect, or while any bonds or notes of the Agency are outstanding. Commodity Project revenues and the subsequent payments of principal and interest related to the Agency's long-term debt are dependent upon the continued delivery of commodity to the Commodity Project under the Prepaid Agreement. Various termination events are specified in the Prepaid Agreement. Upon the occurrence of any such event, the Prepaid Agreement may be terminated by the Agency or J. Aron. If the Prepaid Agreement is terminated, J. Aron will be required to pay a scheduled termination payment to the Agency. Any termination of the Prepaid Agreement will result in the extraordinary mandatory redemption of the Agency's long-term debt. Neither SFA nor SMUD has any obligation or liability to the Agency beyond that specifically provided for in the JPA agreement or the Commodity Project agreement.

The Agency's Commission is comprised of SMUD's Board of Directors. The Agency is a separate legal entity; however, it is also included in the financial statements of SMUD as a component unit of SMUD's financial reporting entity because of the extent of its operational and financial relationships with SMUD.

## NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Method of Accounting.** The accounting records of the Agency are maintained in accordance with Generally Accepted Accounting Principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB). The Agency's accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission. The financial statements are reported 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. Commodity sale revenues and purchase costs that are directly related to delivery of commodity are reported as operating revenues and expenses. All other revenues and expenses are reported as non-operating revenues and expenses.

**Use of Estimates.** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S.) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates.

**Restricted Assets.** The Agency's restricted assets are comprised of U.S. government securities and a guaranteed investment contracts which use is limited for specific purposes pursuant to the Indenture of Trust (Indenture) requirements. The Indenture specifies the flow of cash into the various Agency funds and dictates when they may become unrestricted.

**Cash and Cash Equivalents.** Cash and cash equivalents include all debt instruments purchased with an original maturity of 90 days or less and all investments in money market funds.

**Receivable from Member.** The Agency records as a Receivable from Member the amounts due from SMUD for the purchase of commodity from the Commodity Project.

**Prepaid Gas Supply.** The Agency has prepaid for delivery of a natural gas supply with the proceeds from revenue bonds. The Agency provides for amortization on the historical cost of the Prepaid Gas Supply on a net present value (NPV) basis in which the change in the NPV of the Prepaid Agreement for the remaining term of its contract life from the beginning of the period to the end of the period is the amortization charged for the period. When the Agency amortizes its Prepaid Gas Supply, the amortization is recorded against the current portion of Prepaid Gas Supply.

**Derivative Financial Instruments.** The Agency enters into a forward contract (commodity price swap agreement) to manage its exposure to market volatility of commodity prices. The Agency does not enter into these agreements for trading purposes. Due to the termination provisions of these agreements, they have no fair value, and therefore, there is no mark-to-market and the Agency does not record these derivative financial instruments on its Statement of Net Position. The Agency is exposed to the risk of early termination of the Prepaid Agreement if the counterparties default or if the swap agreements are terminated. Net swap payments received or paid are reported as a component of Operating Revenues in the Statement of Revenues, Expenses and Changes in Net Position.

**Commodity Price Swap Agreement.** The Agency uses a forward contract to hedge the impact of market volatility on gas commodity process for its Commodity Supply Contract.

**Net Position.** The Agency classifies its Net Position into two components as follows:

- Restricted - This component of net position consists of assets with constraints placed on their use, either externally or internally. Constraints include those imposed by debt indentures (excluding amounts considered in net capital), grants or laws and regulations of other governments, by law through constitutional provisions or enabling legislation, or by the Commission. These restricted assets are reduced by liabilities and deferred inflows of resources related to those assets.
- Unrestricted - This component of net position consists of net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that do not meet the definition of “Restricted.”

**Gas Sales to Member.** Gas sales to Member are recorded as revenues when the gas is delivered.

**Operating Expenses.** Operating expenses include the cost of sales and services, administrative expenses and amortization on Prepaid Commodity Supply assets and are recorded when incurred.

**Member Contributions.** Amounts contributed by SMUD for the actual costs of providing administrative and general services are recorded as Member Contributions.

**Reclassifications.** Certain amounts in the 2018 Financial Statements have been reclassified in order to conform to the 2019 presentation.

**Subsequent Events.** Subsequent events for the Agency have been evaluated through February 21, 2020, which is the date that the financial statements were available to be issued.

**Recent Accounting Pronouncements.** In January 2017, GASB issued Statement of Governmental Accounting Standards (SGAS) No. 84, “*Fiduciary Activities*” (GASB No. 84). This statement establishes standards of accounting and financial reporting for fiduciary activities. GASB No. 84 establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. The statement of fiduciary net position reports the assets, deferred outflows of resources, liabilities, deferred inflows of resources, and fiduciary net position of the fiduciary activities. The statement of changes in fiduciary net position reports the additions to and deductions from the fiduciary fund(s). This statement also provides for the recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. This statement is effective for the Agency in 2019. The Agency has assessed the financial statement impact of adopting the new statement, and the Agency has no fiduciary activities to report.

In June 2017, GASB issued SGAS No. 87, “*Leases*” (GASB No. 87). The objective of this statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. GASB No. 87 requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under GASB No. 87, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources. The lease liability should be measured at the present value of payments expected to be made during the lease term. As payments are made the lease liability is reduced and an outflow of resources (interest expense) is recognized for the interest on the liability. The lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset. The lease receivable should be measured at the present value of the lease payments expected to be received during the lease term. Any payments received are first allocated to accrued interest receivable and then to lease receivable.

The deferred inflow of resources should be recognized as inflows of resources (revenue) in a systematic and rational manner over the term of the lease. The lessor should not derecognize the asset underlying the lease. A lease is defined as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under the leases guidance, unless specifically excluded in this statement. The lease term is defined as the period during which a lessee has a noncancellable right to use an underlying asset, plus the following periods, if applicable. A short-term lease is defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources (expenses) or inflows of resources (revenues), respectively, based on the payment provisions of the lease contract. This statement is effective for the Agency in 2020. The Agency is currently assessing the financial statement impact of adopting this statement.

In March 2018, GASB issued SGAS No. 88, "***Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements***" (GASB No. 88). The primary objective of this statement is to improve the information that is disclosed in notes to financial statements related to debt, including direct borrowings and direct placements. GASB No. 88 also clarifies which liabilities should be included when disclosing information related to debt. This statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. GASB No. 88 also requires additional information related to debt be disclosed, including unused lines of credits; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. This statement also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt. This statement is effective for the Agency in 2019. The Agency included additional note disclosures related to debt in Note 5.

In June 2018, GASB issued SGAS No. 89, "***Accounting for Interest Cost Incurred before the End of a Construction Period***" (GASB No. 89). The objectives of this statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. GASB No. 89 establishes accounting requirements for interest cost incurred before the end of a construction period. This statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity. The GASB has allowed that provided the criteria for regulated operations are met and the entity has elected regulatory accounting, qualifying interest cost may be capitalized as a regulatory asset. This statement is effective for the Agency in 2020. The Agency has assessed the financial statement impact of adopting the new statement, and since the Agency has no borrowings for construction, this statement has no impact on the Agency.

In August 2018, GASB issued SGAS No. 90, "***Majority Equity Interests***" (GASB No. 90). The objectives of this statement are (1) to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and (2) to improve the relevance of financial statement information for certain component units. GASB No. 90 defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method. For all other holdings of a majority equity interest, a government should report the legally separate organization as a component unit. The government should report an asset related to the majority equity interest using the equity method. This statement is effective for the Agency in 2019. The Agency has assessed the financial statement impact of adopting the new statement, and since the Agency does not have majority equity interests in any legally separate organizations, this statement has no impact on the Agency.



In May 2019, GASB issued SGAS No. 91, “*Conduit Debt Obligations*” (GASB No. 91). The objectives of this statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. A conduit debt obligation is defined as a debt instrument having all of the following characteristics: (a) there are at least three parties involved: (1) an issuer, (2) a third-party obligor, and (3) a debt holder or a debt trustee; (b) the issuer and the third-party obligor are not within the same financial reporting entity; (c) the debt obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer; (d) the third-party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance; and (e) the third-party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments). All conduit debt obligations involve the issuer making a limited commitment. Some issuers extend additional commitments or voluntary commitments to support debt service in the event the third party is, or will be, unable to do so. An issuer should not recognize a conduit debt obligation as a liability, however, an issuer should recognize a liability associated with an additional commitment or a voluntary commitment to support debt service if certain recognition criteria are met. This statement is effective for the Agency in 2021. The Agency is currently assessing the financial statement impact of adopting this statement.

### **NOTE 3. CASH, CASH EQUIVALENTS, AND INVESTMENTS**

**Cash Equivalents and Investments.** The Agency’s investments are governed by the California State and Municipal Codes and its Indenture, which allow Agency investments to include: obligations which are unconditionally guaranteed by the U.S. Government or its agencies or instrumentalities; direct and general obligations of the State or any local agency within the State; bankers’ acceptances; commercial paper; certificates of deposit; repurchase and reverse repurchase agreements; medium term corporate notes; Local Agency Investment Fund; and money market funds. The Agency’s investment policy also includes restrictions for investments relating to maximum amounts invested as a percentage of total portfolio and with a single issuer, maximum maturities, and minimum credit ratings.

**Credit Risk.** This is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. To mitigate the risk, the Agency limits investments to those rated at least, at the credit rating of the commodity supplier, or, if the commodity supplier is not rated, the guarantor of the commodity supplier which is currently Goldman Sachs.

**Custodial Credit Risk.** This is the risk that in the event of the failure of a depository financial institution or counterparty to a transaction, the Agency’s deposits may not be returned or the Agency will not be able to recover the value of its deposits, investments or securities that are in the possession of another party. The Agency does not have a deposit or investment policy for custodial credit risk. At December 31, 2019 and 2018, the Agency had money market funds of \$11.0 million and \$0.8 million which were uninsured and were held in trust for the benefit of the Agency.

**Concentration of Credit Risk.** This is the risk of loss attributed to the magnitude of an entity’s investment in a single issuer. The Agency places no limit on the amounts invested in any one issuer for federal agency securities. The Agency has concentrations of risk greater than five percent invested in J. Aron of 100 percent at December 31, 2019 and 2018.

**Interest Rate Risk.** This is the risk that investments are exposed to fair value losses arising from increasing interest rates. Though the Agency has restrictions as to the maturities of some of the investments, it does not have a formal policy for interest rate risk. The Agency had no investments subject to this risk at December 31, 2019 and 2018. At December 31, 2019 and 2018, all investment funds were in guaranteed investment contracts that will terminate on June 30, 2024.

**Investment Agreement.** The Agency has entered into guaranteed investment contracts in which it has agreed to invest the debt service fund for a fixed rate of return of 3.4 percent, and the debt service reserve and the working capital funds for a guaranteed fixed rate of return of 3.6 percent with J. Aron. The agreements terminate on June 30, 2024.

The following schedules present credit risk by type of security held at December 31, 2019 and 2018. The credit ratings listed are from Standard & Poor's.

The Agency's cash, cash equivalents, and investments consist of the following:

	Credit Rating	December 31,	
		2019	2018
Cash and Cash Equivalents:			
Money market funds	AAAm	\$ 10,952,908	\$ 763,185
Total cash and cash equivalents		10,952,908	763,185
Investments:			
Guaranteed investment contracts	BBB+	13,088,730	21,080,000
Total investments		13,088,730	21,080,000
Total cash, cash equivalents, and investments		\$ 24,041,638	\$ 21,843,185

The Agency's cash, cash equivalents, and investments are classified in the Statements of Net Position as follows:

	December 31,	
	2019	2018
Cash, cash equivalents, and investments:		
Debt service funds:		
Debt service fund	\$ 16,965,159	\$ 14,080,000
Debt service reserve fund	4,000,000	4,000,000
Total debt service funds	20,965,159	18,080,000
Other restricted funds:		
Working capital fund	3,000,000	3,000,000
Revenue fund	76,479	-0-
Acquisition fund	-0-	763,185
Total other restricted funds	3,076,479	3,763,185
Total cash, cash equivalents, and investments	\$ 24,041,638	\$ 21,843,185

**NOTE 4. PREPAID GAS SUPPLY**

The Agency's prepaid gas supply is presented below:

	December 31,	
	2019	2018
Prepaid gas supply	\$ 539,238,219	\$ 541,900,000
Less: amounts due within one year	(3,247,134)	(2,661,781)
Total prepaid gas supply - noncurrent portion	\$ 535,991,085	\$ 539,238,219

The following summarizes prepaid gas supply activity for the year ended December 31, 2019:

	January 1, 2019	Additions	Amortization	December 31, 2019
Prepaid gas supply	\$ 541,900,000	\$ -0-	\$ (2,661,781)	\$ 539,238,219

The following summarizes prepaid gas supply activity for the year ended December 31, 2018:

	December 1, 2018	Additions	Amortization	December 31, 2018
Prepaid gas supply	\$ -0-	\$ 541,900,000	\$ -0-	\$ 541,900,000

The prepaid gas supply is the discounted NPV of the fixed monthly natural gas prices per million British Thermal Units (mmbtu) as specified in, and over the remaining term of, the Prepaid Agreement.

#### NOTE 5. LONG-TERM DEBT

The Agency issued \$539.6 million of 2018 Commodity Supply Revenue Bonds (Bonds) in December 2018 maturing in June 2049, with a mandatory tender purchase in June 2024. The Bonds have fixed interest rates of 4.0 percent to 5.0 percent.

The Agency's long-term debt is presented below:

	December 31,	
	2019	2018
2018 Commodity supply revenue bonds, fixed rates 4.00% - 5.00%, 2020-2049	\$ 539,615,000	\$ 539,615,000
Unamortized premiums	22,205,089	27,278,224
Less: amounts due within one year	-0-	-0-
Total long-term debt - net	<u>\$ 561,820,089</u>	<u>\$ 566,893,224</u>

The following summarizes long-term debt activity for the year ended December 31, 2019:

	January 1, 2019	Additions	Payments/ Amortizations	December 31, 2019
2018 Commodity supply revenue bonds	\$ 539,615,000	\$ -0-	\$ -0-	\$ 539,615,000
Unamortized premiums	27,278,224	-0-	(5,073,135)	22,205,089
Total long-term debt	<u>\$ 566,893,224</u>	<u>\$ -0-</u>	<u>\$ (5,073,135)</u>	<u>\$ 561,820,089</u>

The following summarizes long-term debt activity for the year ended December 31, 2018:

	December 1, 2018	Additions	Payments/ Amortizations	December 31, 2018
2018 Commodity supply revenue bonds	\$ -0-	\$ 539,615,000	\$ -0-	\$ 539,615,000
Unamortized premiums	-0-	27,448,147	(169,923)	27,278,224
Total long-term debt	<u>\$ -0-</u>	<u>\$ 567,063,147</u>	<u>\$ (169,923)</u>	<u>\$ 566,893,224</u>

The annual debt service requirements to maturity for the Bonds are as follows at December 31, 2019:

Year	Principal	Interest	Total
2020	\$ -0-	\$ 21,752,850	\$ 21,752,850
2021	-0-	21,752,850	21,752,850
2022	-0-	21,752,850	21,752,850
2023	2,320,000	21,752,850	24,072,850
2024	14,505,000	21,636,850	36,141,850
2025-2029	92,665,000	97,562,000	190,227,000
2030-2034	71,740,000	79,522,000	151,262,000
2035-2039	110,480,000	62,362,600	172,842,600
2040-2044	108,060,000	41,907,400	149,967,400
2045-2049	<u>139,845,000</u>	<u>17,337,200</u>	<u>157,182,200</u>
Total	<u>\$ 539,615,000</u>	<u>\$ 407,339,450</u>	<u>\$ 946,954,450</u>

Interest in the preceding table includes interest requirements at current fixed rate coupon of 4 percent to 5 percent until mandatory remarketing date on July 1, 2024, and percent fixed rate after mandatory remarketing. Principal in the preceding table includes known principal payments until mandatory remarketing date and the amortization schedule after mandatory remarketing date.

The Agency had pledged future net revenues to repay \$539.6 million at December 31, 2019 and 2018, for Bonds issued in December 2018. Proceeds from the Bonds were used to purchase the Commodity Project from J. Aron at a price of \$541.9 million with the remaining amounts used to fund the appropriate accounts for the Agency. The Bonds, payable through 2049, are secured solely by a pledge of and lien on the trust estate under the Indenture which includes bond proceeds, rights under the GSC, revenues, any termination payment and any investment income. Annual principal and interest payments on the Bonds are expected to require approximately 100 percent of the Agency's net revenues. The total principal and interest remaining to be paid on the Bonds is \$947.0 million and \$958.6 million at December 31, 2019 and 2018, respectively. Gas deliveries started in June 2019. Total gross revenues were \$17.1 million for 2019. Debt service payments on the Bonds are made semi-annually on January 1 and July 1.

The ability of the Agency to pay related principal and interest payments associated with the Bonds is contingent upon the continued successful operation of the Commodity Project. If the Prepaid Agreement were to terminate, a termination payment would be received into the trust estate from J. Aron. The amount of the termination payment, together with the amounts required to be on deposit in certain funds and accounts held by the trustee, has been calculated to provide a sum sufficient to pay the redemption price of the Bonds upon early termination of the Prepaid Agreement. The amount of termination payment declines over time as J. Aron performs its commodity delivery obligations under the Prepaid Agreement. Agency Members are not obligated to pay debt service costs if the Commodity Project is unable to operate pursuant to the Prepaid Agreement or if revenues generated by the Commodity Project are insufficient to meet debt service obligations.

**Terms of Debt Indenture.** The debt indenture contains a provision that in an event of default, the holders of the majority of the debt outstanding are entitled to declare the outstanding amounts due immediately.

## NOTE 6. COMMITMENTS

**Commodity Price Swap Agreement.** The Agency has entered into a floating-to-fixed natural gas and electricity commodity price swap agreement (Commodity Swap Agreement) with a counterparty for the purpose of fixing the variable price on the Agency's commodity sales to SMUD under the CSC. The Agency pays an index-based commodity price over the thirty-year period and receives a fixed commodity price as specified in the Commodity Swap Agreement, for notional quantities of commodity at a pricing point corresponding to the daily contract quantity and the delivery point under the Prepaid Agreement. The Commodity Swap Agreement terminates on July 1, 2049. The total notional amount of the Commodity Swap Agreement remaining at December 31, 2019 and 2018 was 116.1 million mmbtu and 9.9 million MWh, and 120.8 million mmbtu and 9.9 million MWh, respectively. Presently, the Commodity Swap Agreement is an average of 17,972 mmbtu per calendar day. Actual daily commodity deliveries will vary month to month, changing on the first day of the month. Early termination of the Commodity Swap Agreement would occur upon termination of the Prepaid Agreement for any reason whatsoever. Upon early termination, the Commodity Swap Agreement would have no value to either party.

## NOTE 7. CONTINGENCIES

**General Contingencies.** The Agency's ability to make principal and interest payments on its Bonds is contingent upon the continued delivery of commodity to the Commodity Project under the Prepaid Agreement. The Members are not obligated to make principal and interest debt service payments in the event the Commodity Project does not operate and there are insufficient funds to pay the bondholders. The Agency expects that the commodity will continue to be delivered as planned.

In the normal operation of business, the Agency is party to various claims, legal actions and complaints. Management and the Agency's legal counsel believe that there are no material loss contingencies that would have a material adverse impact on the financial position of the Agency.