Sacramento Municipal Utility District Financing Authority

Financial Statements

as of December 31, 2018 and 2017

and

Report of Independent Auditors

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Sacramento Municipal Utility District Financing Authority
Sacramento, California

Report on the Financial Statements

We have audited the accompanying financial statements of Sacramento Municipal Utility District Financing Authority which comprise the Statements of Net Position as of December 31, 2018 and 2017, and the related Statements of Revenues, Expenses and Changes in Net Position, and Statements of Cash Flows for the years then ended and the related notes to the financial statements.

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 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 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 the Sacramento Municipal Utility District Financing 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 the Sacramento Municipal Utility District Financing 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 Sacramento Municipal Utility District Financing Authority at December 31, 2018 and 2017, and the changes in its financial position and its cash flows for the years then ended, 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 financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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 15, 2019

SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS - UNAUDITED
For the Years Ended December 31, 2018 and 2017

Using this Financial Report

This annual financial report for Sacramento Municipal Utility District Financing 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 years ended December 31, 2018 and 2017. 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 provide 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 report all of the Agency's revenues and expenses during the periods indicated.

The Statements of Cash Flows report 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 and capital additions.

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

Nature of Operations

The Agency is a joint powers authority formed by the Sacramento Municipal Utility District (SMUD) and the Modesto Irrigation District (collectively, Members). The Agency owns and operates the Cosumnes Power Plant Project (Project) and related facilities for electric power generation. The Project, which began commercial operations in 2006, is comprised of a 539 megawatt (MW) natural gas-fired combined cycle generation plant.

SMUD purchases all of the electricity produced by the Project pursuant to the Power Purchase Agreement (PPA) between SMUD and the Agency. The Agency has no employees and is obligated to reimburse SMUD for the actual costs of providing general and administrative services, water, fuel costs, and other costs paid by SMUD on the Agency's behalf.

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 consolidated financial statements of SMUD.

Financial & Operational Highlights

In 2018, the Agency's plant operator, Ethos Energy Power Plant Services, LLC, continued to perform quarterly off line gas turbine water washes and inspections as part of standard maintenance protocols. These outages and inspections have been an integral part of the Agency's successful performance, which for 2018 included an Institute of Electrical and Electronics Engineers (IEEE) Availability rating of 80.37 percent, an IEEE Reliability rating of 98.80 percent and an overall capacity factor of 78.10 percent.

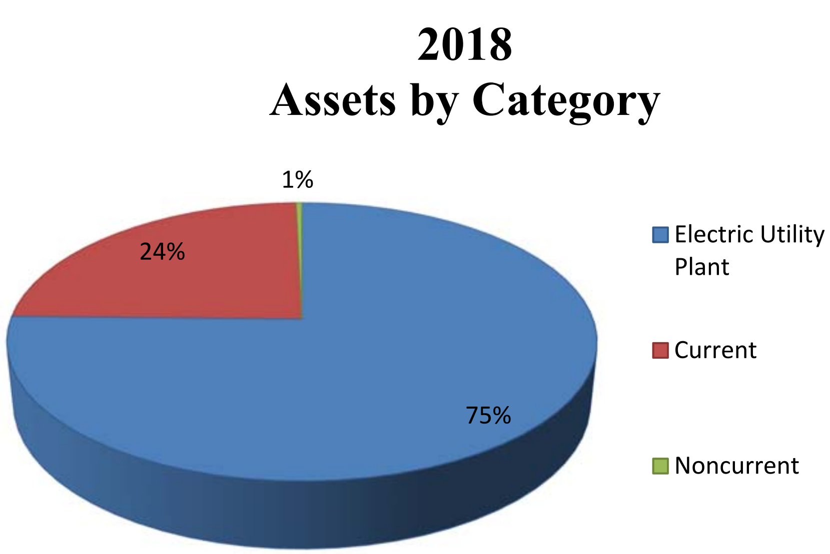
The plant completed the Advanced Gas Path (AGP) capital improvement project in 2018 for Combustion Turbine Generator (CTG) 3 for $17.0 million and the Steam Turbine Major Overhaul for $8.0 million during the cold iron outage in the second quarter of 2018.

FINANCIAL POSITION

Statements of Net Position Summary
(Dollars in thousands)

	December 31, 2018	December 31, 2017	December 31, 2016	Change 2018 vs. 2017		Change 2017 vs. 2016	
Assets							
Electric utility plant - net	$ 230,315	$ 219,260	$ 234,671	$ 11,055	5.0%	$ (15,411)	-6.6%
Current assets	74,372	51,238	63,780	23,134	45.2%	(12,542)	-19.7%
Noncurrent assets	1,103	1,209	1,308	(106)	-8.8%	(99)	-7.6%
Total assets	305,790	271,707	299,759	34,083	12.5%	(28,052)	-9.4%
Deferred outflows of resources	2,593	3,031	3,528	(438)	-14.5%	(497)	-14.1%
Total assets and deferred outflows of resources	$ 308,383	$ 274,738	$ 303,287	$ 33,645	12.2%	$ (28,549)	-9.4%
Liabilities							
Long-term debt - net	$ 138,049	$ 152,830	$ 170,479	$ (14,781)	-9.7%	$ (17,649)	-10.4%
Current liabilities	84,439	42,418	61,612	42,021	99.1%	(19,194)	-31.2%
Total liabilities	222,488	195,248	232,091	27,240	14.0%	(36,843)	-15.9%
Net position							
Net investment in capital assets	83,154	55,321	43,819	27,833	50.3%	11,502	26.2%
Restricted	5,852	7,070	11,950	(1,218)	-17.2%	(4,880)	-40.8%
Unrestricted	(3,111)	17,099	15,427	(20,210)	-118.2%	1,672	10.8%
Total net position	85,895	79,490	71,196	6,405	8.1%	8,294	11.6%
Total liabilities and net position	$ 308,383	$ 274,738	$ 303,287	$ 33,645	12.2%	$ (28,549)	-9.4%

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



2018 Compared to 2017

ASSETS & DEFERRED OUTFLOWS OF RESOURCES

- The Agency's main asset is its investment in the Project, which comprises $230.3 million in Electric Utility Plant, net of Accumulated Depreciation at December 31, 2018. The Electric Utility Plant - net increased primarily due to $46.2 million of additions, offset by $19.7 million net book value of assets retired and $15.5 depreciation expense for the year. The additions included the CTG3 and CTG2 AGP, Flex Software Upgrade, AGP, Controls GE System 1, Site Access, and Valve Access Platform. Electric Utility Plant assets make up about 75 percent of the Agency's assets.

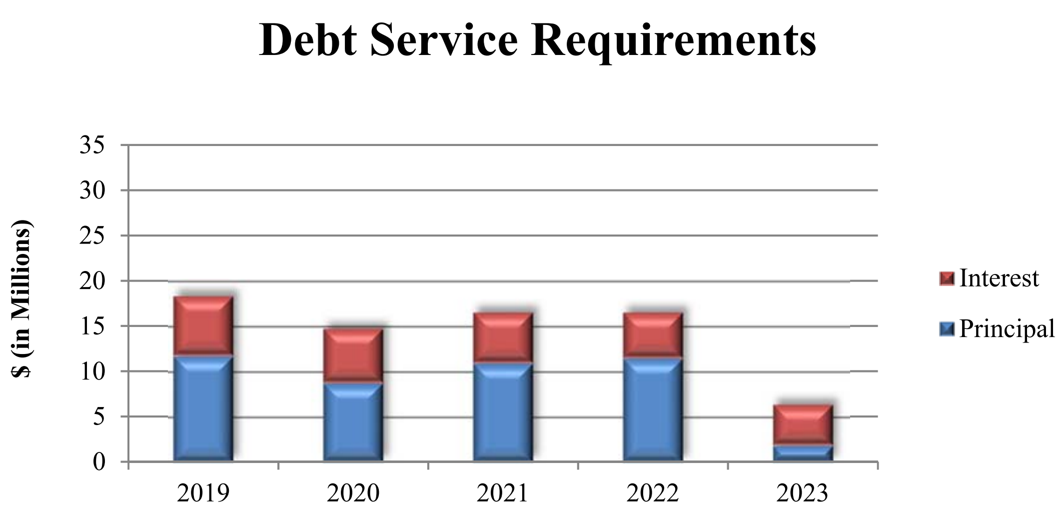
- Current Assets increased primarily due to higher Receivable from SMUD for the fuel portion of the PPA billings in November and December 2018, Prepayments for inventory, and Materials and supplies for the replenishments of inventory, partially offset by lower Restricted cash for debt service.

- Deferred Outflows of Resources decreased due to amortization of the loss on bond refunding.

LIABILITIES & NET POSITION

- Long-Term Debt - net decreased primarily due to $14.1 million of the scheduled principal payments for 2018. At December 31, 2018, the Agency had bonds outstanding of $132.5 million with maturities through 2030. The Agency's Bonds are rated "AA" by Standard and Poor's and Fitch.

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



- Current Liabilities increased primarily due to higher accounts payable for the AGP project and advance from SMUD to cover anticipated payments for the AGP project, partially offset by lower current portion of the long-term debt and accrued interest.

2017 Compared to 2016

ASSETS & DEFERRED OUTFLOWS OF RESOURCES

- The Agency's main asset is its investment in the Project, which comprises $219.3 million in Electric Utility Plant, net of Accumulated Depreciation at December 31, 2017. The Electric Utility Plant - net decreased due to $16.7 million depreciation expense for the year, partially offset by $1.2 million of additions. The additions included the CTG3 AGP, Steam Turbine Controls upgrade and UPH/UDH Redundant Highway hardware and software installation.

- Current Assets decreased primarily due to lower Receivable from SMUD for the fuel portion of the PPA billings in November and December 2017 and Restricted cash for debt service, partially offset by higher Unrestricted cash as part of normal operations.

- Deferred Outflows of Resources decreased due to amortization of the loss on bond refunding.

LIABILITIES & NET POSITION

- Long-Term Debt - net decreased primarily due $23.9 million of the scheduled principal payments for 2017. At December 31, 2017, the Agency had bonds outstanding of $146.6 million with maturities through 2030.

- Current Liabilities decreased primarily due to lower fuel billings offset by an advance for the AGP project from SMUD for November and December 2017, current portion of the long-term debt and accrued interest, partially offset by higher accounts payable for operator reimbursable and utilities costs at December 31, 2017.

RESULTS OF OPERATIONS

Summary of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

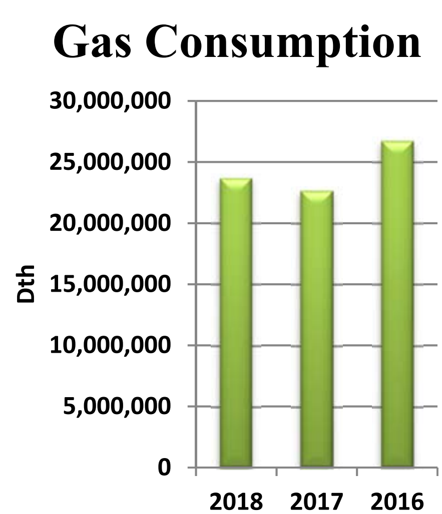
	December 31,			Change			
	2018	2017	2016	2018 vs. 2017		2017 vs. 2016	
Operating revenues	$ 154,235	$ 163,942	$ 210,631	$ (9,707)	-5.9%	$ (46,689)	-22.2%
Operating expenses	(131,133)	(151,250)	(196,942)	20,117	13.3%	45,692	23.2%
Operating income	23,102	12,692	13,689	10,410	82.0%	(997)	-7.3%
Interest income	302	139	38	163	117.3%	101	265.8%
Interest on debt	(4,269)	(4,537)	(4,670)	268	5.9%	133	2.8%
Other income (expense)	(12,730)	-0-	9,983	(12,730)	-100.0%	(9,983)	-100.0%
Change in net position	6,405	8,294	19,040	(1,889)	-22.8%	(10,746)	-56.4%
Net position - beginning of year	79,490	71,196	52,156	8,294	11.6%	19,040	36.5%
Net position - end of year	$ 85,895	$ 79,490	$ 71,196	$ 6,405	8.1%	$ 8,294	11.6%

2018 Compared to 2017

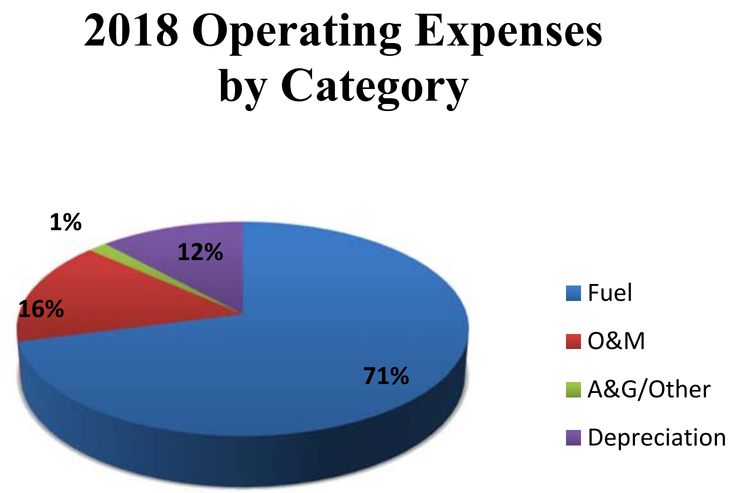
OPERATING REVENUES

Operating Revenues decreased primarily due to lower Power sales to Member in 2018. The Agency's power sales are determined monthly, based on a formula defined in the PPA, which is driven by the Agency's actual cost of operations including debt service. In 2018, less revenue was needed due to lower fuel and financial payment, partially offset by higher capital, overhaul, and operator costs.

The following charts show power sales and gas consumption in 2018, 2017, and 2016:



OPERATING EXPENSES



The following table summarizes Operating Expenses for the years ended December 31 (dollars in thousands):

	December 31,			Change			
	2018	2017	2016	2018 vs. 2017		2017 vs. 2016	
Operating Expenses							
Fuel	$ 93,008	$ 120,433	$ 168,389	$ (27,425)	-22.8%	$ (47,956)	-28.5%
Operations and Maintenance	20,548	12,321	10,380	8,227	66.8%	1,941	18.7%
Administrative & general and Other	2,088	1,837	1,779	251	13.7%	58	3.3%
Depreciation	15,489	16,659	16,394	(1,170)	-7.0%	265	1.6%
Total operating expenses	$ 131,133	$ 151,250	$ 196,942	$ (20,117)	-13.3%	$ (45,692)	-23.2%

- Fuel expense decreased due to lower fuel cost of $32.7 million, partially offset by higher fuel volume of $5.3 million.
- Operations and Maintenance expense increased primarily due to the steam turbine overhaul.
- Depreciation expense decreased due to the retirement of CTG assets.

OTHER EXPENSE

Other expense increased primarily due to the loss on retirement of CTG assets of $19.7 million, partially offset by salvage value $7.5 million.

2017 Compared to 2016

RESULTS OF OPERATIONS

- Operating Revenues decreased primarily due to lower Power sales to Member as a result of lower fuel, capital, debt service and other costs, partially offset by the pass through of the California Public Utilities Commission (CPUC) mandated PG&E gas refund in 2016 and higher maintenance cost.

- Fuel expense decreased due to lower fuel volume of $25.2 million and cost of $22.8 million.

- Operations and Maintenance expense increased primarily due to higher HRSG and various maintenance project costs.

- Other income decreased due to the CPUC mandated PG&E gas refund.

SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
STATEMENTS OF NET POSITION

	December 31,	
	2018	2017
ASSETS		
ELECTRIC UTILITY PLANT		
Plant in service	$ 355,888,891	$ 428,034,898
Less accumulated depreciation	(156,222,818)	(209,888,743)
Plant in service - net	199,666,073	218,146,155
Construction work in progress	30,648,861	1,113,812
Total electric utility plant - net	230,314,934	219,259,967
RESTRICTED ASSETS		
Debt service funds	9,165,000	10,665,300
Less current portion	(9,165,000)	(10,665,300)
Total restricted assets	-0-	-0-
CURRENT ASSETS		
Cash and cash equivalents:		
Unrestricted cash and cash equivalents	14,871,833	14,144,113
Restricted cash and cash equivalents	9,165,000	10,665,300
Receivables:		
Power sales to Member	46,286,317	24,300,015
Accrued interest and other	87,737	28,336
Materials and supplies	2,625,047	1,754,386
Prepayments	1,231,741	241,042
Regulatory costs recovered within one year	104,416	104,416
Total current assets	74,372,091	51,237,608
NONCURRENT ASSETS		
Regulatory costs for future recovery	1,096,366	1,200,782
Other	7,031	8,437
Total noncurrent assets	1,103,397	1,209,219
TOTAL ASSETS	305,790,422	271,706,794
DEFERRED OUTFLOWS OF RESOURCES		
Unamortized bond losses	2,593,160	3,030,991
TOTAL DEFERRED OUTFLOWS OF RESOURCES	2,593,160	3,030,991
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	$ 308,383,582	$ 274,737,785

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

SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
STATEMENTS OF NET POSITION

	December 31, 2018	December 31, 2017
LIABILITIES AND NET POSITION		
LONG-TERM DEBT - net	$ 138,049,455	$ 152,830,450
CURRENT LIABILITIES		
Accounts payable	27,410,791	3,118,948
Payable due to Member	42,010,749	21,563,247
Long-term debt due within one year	11,705,000	14,140,000
Accrued interest	3,312,500	3,595,300
Total current liabilities	84,439,040	42,417,495
TOTAL LIABILITIES	222,488,495	195,247,945
NET POSITION		
Net investment in capital assets	83,153,639	55,320,508
Restricted	5,852,500	7,070,000
Unrestricted	(3,111,052)	17,099,332
TOTAL NET POSITION	85,895,087	79,489,840
COMMITMENTS AND CONTINGENCIES (Notes 8 and 9)		
TOTAL LIABILITIES AND NET POSITION	$ 308,383,582	$ 274,737,785

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

SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	Years Ended December 31, 2018	2017
OPERATING REVENUES		
Power sales to Member	$ 154,234,674	$ 163,941,902
Total operating revenues	154,234,674	163,941,902
OPERATING EXPENSES		
Fuel	93,007,465	120,432,935
Operations	9,020,424	9,383,794
Maintenance	11,527,698	2,937,213
Administrative and general	1,982,990	1,733,251
Depreciation	15,489,297	16,658,714
Regulatory amounts collected in rates	104,416	104,416
Total operating expenses	131,132,290	151,250,323
OPERATING INCOME	23,102,384	12,691,579
NON-OPERATING REVENUES (EXPENSES)		
Interest income	302,334	139,725
Interest on debt	(4,269,636)	(4,537,315)
Other expenses - net	(12,729,835)	-0-
Total non-operating revenues (expenses)	(16,697,137)	(4,397,590)
CHANGE IN NET POSITION	6,405,247	8,293,989
NET POSITION - BEGINNING OF YEAR	79,489,840	71,195,851
NET POSITION - END OF YEAR	$ 85,895,087	$ 79,489,840

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

SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from power sales to Member	$ 149,875,872	$ 178,667,063
Payments to Member	(92,656,564)	(132,409,488)
Payments to vendors	(22,503,064)	(10,667,285)
Net cash provided by operating activities	34,716,244	35,590,290
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITES		
Construction expenditures	(16,901,157)	(1,799,492)
Salvage on retirement of plant	2,500,000	-0-
Repayment of long-term debt	(14,140,000)	(23,900,000)
Interest payments on long-term debt	(7,190,600)	(7,907,600)
Net cash used in capital and related financing activities	(35,731,757)	(33,607,092)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	242,933	122,070
Net cash provided by investing activities	242,933	122,070
Net (decrease) increase in cash and cash equivalents	(772,580)	2,105,268
Cash and cash equivalents - beginning of the year	24,809,413	22,704,145
Cash and cash equivalents - end of the year	$ 24,036,833	$ 24,809,413
CASH AND CASH EQUIVALENTS INCLUDED IN:		
Unrestricted cash and cash equivalents	$ 14,871,833	$ 14,144,113
Restricted cash and cash equivalents	9,165,000	10,665,300
Cash and cash equivalents - end of the year	$ 24,036,833	$ 24,809,413

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

SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2018	2017
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	$ 23,102,384	$ 12,691,579
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	15,489,297	16,658,714
Regulatory amortization	104,416	104,416
Changes in operating assets and liabilities:		
Receivables	(4,358,802)	14,425,161
Other assets	(2,412,423)	(64,850)
Payables and accruals	2,791,372	(8,524,730)
Net cash provided by operating activities	$ 34,716,244	$ 35,290,290
SUPPLEMENTAL DISCLOSURE OF NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES		
Net amortization of debt related (expenses) and premiums	$ 2,638,164	$ 3,011,785
Loss on asset retirements	(14,677,366)	-0-
Write off of inventory	(552,469)	-0-

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

NOTE 1. ORGANIZATION AND OPERATIONS

The Sacramento Municipal Utility District Financing Authority (Agency) is a joint powers authority (JPA) formed by the Sacramento Municipal Utility District (SMUD) and the Modesto Irrigation District (MID) pursuant to the California Government Code (collectively, Members). The purpose of the Agency is to own and operate the Cosumnes Power Plant Project (Project) and related facilities for electric power generation. The Project, which began commercial operations in February 2006, is comprised of a 539 megawatt natural gas-fired combined cycle generation plant. The Project is situated on approximately 38 acres adjacent to SMUD's decommissioned nuclear power plant. The land is owned by SMUD and leased to the Agency.

The Agency has no employees. The Project is operated by Ethos Energy Power Plant Services, LLC (Ethos) under the terms of the Operations and Maintenance Agreement.

In June 2015, the Agency entered into a new Power Purchase Agreement (PPA) with SMUD. Pursuant to the new PPA, SMUD purchases, on a "take-or-pay" basis, all capacity, energy and environmental attributes of the Project. The Agency is obligated to reimburse SMUD for the actual costs of providing general and administrative services, fuel costs, and other costs paid by SMUD on the Agency's behalf. The Agency was charged $95.3 million in 2018 and $122.3 million in 2017 for general and administrative services, water, fuel costs, and other costs paid by SMUD on the Agency's behalf.

SMUD is entitled to all rights and property of the Project in the event of termination of the JPA agreement. MID has no obligation to make contributions or advances to the Agency. 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. Project revenues and the subsequent payments of principal and interest related to the Agency's long-term debt are not dependent upon the continued successful operation of the Project. SMUD is required to make payments in an amount sufficient to pay principal and interest and all other payments required to be made under the Indenture of Trust (Indenture), dated June 1, 2015. Neither MID nor SMUD has any obligation or liability to the Agency beyond that specifically provided for in the JPA agreement or the Project agreements.

The Agency's Commission is comprised of SMUD's Board of Directors. The Agency is a separate legal entity; however, it is included in the consolidated 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. Electric revenues and costs that are directly related to generation of electricity and steam 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.

Plant in Service. The Agency generally computes depreciation on Electric Utility Plant on a straight-line basis using five years for software and the remaining life of the JPA for all other capital assets. The costs of replacement units are capitalized. Major overhaul parts are depreciated over their estimated useful lives, ranging from 4 to 24 years. Repair and maintenance costs are charged to expense. When the Agency retires portions of its Electric Utility Plant, retirements are recorded against Accumulated Depreciation and the retired portion of Electric Utility Plant is removed from Plant in Service. Capital assets are generally defined by the Agency as tangible assets with an initial, individual cost of more than five thousand dollars and an estimated useful life in excess of two years.

Restricted Assets. The Agency's restricted assets are comprised of cash, which is limited for specific purposes pursuant to the 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 the Local Agency Investment Fund (LAIF), and money market funds. LAIF has an equity interest in the State of California (State) Pooled Money Investment Account (PMIA). PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments.

Receivable from Member. The Agency records as a Receivable from Member the amounts due from SMUD for the purchase of power generated by the Project.

Materials and Supplies. Materials and supplies are stated at average cost, which approximates the first-in, first-out method.

Regulatory Deferrals. As a regulated entity, the Agency's financial statements are prepared in accordance with GASB Statement No. 62, ***"Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,"*** which require that the effects of the rate making process be recorded in the financial statements. Accordingly, certain expenses and credits normally reflected in the Change in Net Position as incurred, are recognized when included in rates and recovered from, or refunded to, SMUD through the PPA agreement. The Agency records regulatory assets and credits to reflect rate-making actions of the Commission. The account includes the unamortized debt issuance costs of previously issued bonds of the Agency. The regulatory asset is amortized using the straight line method over the remaining life of the associated bonds and recorded in Regulatory Amounts Collected in Rates in the Statements of Revenues, Expenses and Changes in Net Position.

Gains and Losses on Bond Refundings. Gains and losses resulting from bond refundings are included in Deferred Outflows and Deferred Inflows of Resources and amortized as a part of Interest on Debt, over the shorter of the life of the refunded debt or the new debt using the effective interest method, in the Statements of Revenues, Expenses and Changes in Net Position.

Payable to Member. The Agency records as a Payable to Member the amounts due to SMUD for general and administrative services, water, fuel costs, and other costs paid by SMUD on the Agency's behalf.

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

- Net investment in capital assets - This component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding debt balances, net of unamortized debt expenses. Deferred inflows and outflows of resources that are attributable to the acquisition, construction or improvement of those assets or related debt are also included.
- 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, above), grants or laws and regulations of other governments, by law through constitutional provisions or enabling legislation, or by the Board. 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 "Net investment in capital assets" or "Restricted."

Power Sales to Member. Power sales to Member are recorded as revenues when the electricity is delivered.

Operating Expenses. Operating expenses include the cost of sales and services, administrative expenses and depreciation on capital assets and are recorded when incurred.

Other Expenses - net. Amounts recorded for the write-off of the remaining net book value of the Combustion Turbine Generator parts partially offset by salvage value.

Distributions to Member. Amounts paid to SMUD from surplus funds are recorded as Distributions to Member.

Member Contributions. Amounts contributed by SMUD are recorded as Member Contributions.

Subsequent Events. Subsequent events for the Agency have been evaluated through February 15, 2019, which is the date that the financial statements were available to be issued.

Recent Accounting Pronouncements. In January 2017, GASB issued 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 is currently assessing the financial statement impact of adopting this statement.

In March 2017, GASB issued SGAS No. 85, ***"Omnibus 2017"*** (GASB No. 85). GASB No. 85 addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits). This statement is effective for the Agency in 2018. The Agency has assessed the financial statement impact of adopting the new statement, and its impact is not material.

In May 2017, GASB issued SGAS No. 86, ***"Certain Debt Extinguishment Issues"*** (GASB No. 86). The primary objective of this statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources (resources other than the proceeds of refunding debt) are placed in an irrevocable trust for the sole purpose of extinguishing debt. GASB No. 86 also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. This statement is effective for the Agency in 2018. The Agency has assessed the financial statement impact of adopting the new statement, and its impact is not material.

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 is currently assessing the note disclosure impact of adopting this statement.

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 its impact is not material.

In August 2018, GASB issued SGAS No. 90, ***"Majority Equity Interests"*** (GASB No. 90). The objectives of this statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and 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 is currently assessing the financial statement impact of adopting this statement but does not expect it to be material.

NOTE 3. ELECTRIC UTILITY PLANT

The Agency had the following electric utility plant activity during 2018:

	Balance December 31, 2017	Additions	Adjustments/ Transfers/ Disposals	Balance December 31, 2018
Nondepreciable utility plant:				
Construction work in progress	$ 1,113,812	$ 46,221,630	$ (16,686,581)	$ 30,648,861
Total nondepreciable utility plant	1,113,812	46,221,630	(16,686,581)	30,648,861
Depreciable utility plant:				
Generation	428,034,898	16,686,581	(88,832,588)	355,888,891
Less: accumulated depreciation	(209,888,743)	(15,489,297)	69,155,222	(156,222,818)
Total electric utility plant - net	$ 219,259,967	$ 47,418,914	$ (36,363,947)	$ 230,314,934

The Agency had the following electric utility plant activity during 2017:

	Balance December 31, 2016	Additions	Adjustments/ Transfers/ Disposals	Balance December 31, 2017
Nondepreciable utility plant:				
Construction work in progress	$ 702,114	$ 1,248,084	$ (836,386)	$ 1,113,812
Total nondepreciable utility plant	702,114	1,248,084	(836,386)	1,113,812
Depreciable utility plant:				
Generation	427,450,986	836,388	(252,476)	428,034,898
Less: accumulated depreciation	(193,482,504)	(16,658,715)	252,476	(209,888,743)
Total electric utility plant - net	$ 234,670,596	$ (14,574,243)	$ (836,386)	$ 219,259,967

NOTE 4. 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 the 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; LAIF; 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 a minimum, "A-1" or equivalent for short-term investments and "A" or equivalent for medium-term corporate notes by a nationally recognized rating agency.

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 collateral securities that are in the possession of another party. The Agency does not have a deposit policy for custodial credit risk.

At December 31, 2018 and 2017, $1.3 million and $7.2 million of the Agency's cash balances were uninsured, respectively. The bank balance is also, per a depository pledge agreement between the Agency and the Agency's bank, collateralized at 135 percent and 134 percent of the collective funds on deposit (increased by the amount of accrued but uncredited interest, reduced by deposits covered by Federal Deposit Insurance Corporation) at December 31, 2018 and 2017, respectively. At December 31, 2018 and 2017, the Agency had money market funds of $9.2 million and $10.7 million which were uninsured, respectively. The Agency's money market funds are 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 had no investments at December 31, 2018 and 2017.

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 at December 31, 2018 and 2017.

The following schedules present credit risk by type of security held at December 31, 2018 and 2017. The credit ratings listed are from Standard & Poor's. N/A is defined as not applicable to the rating disclosure requirements.

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

	Credit Rating	December 31, 2018	December 31, 2017
Cash and Cash Equivalents:			
Deposits	N/A	$ 1,535,529	$ 7,420,461
LAIF	Not Rated	13,336,304	6,723,652
Money market funds	AAAm	9,165,000	10,665,300
Total cash and cash equivalents		$ 24,036,833	$ 24,809,413

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

	December 31, 2018	December 31, 2017
Cash and Cash Equivalents:		
Debt service funds	$ 9,165,000	$ 10,665,300
Unrestricted funds	14,871,833	14,144,113
Total cash and cash equivalents	$ 24,036,833	$ 24,809,413

NOTE 5. LONG-TERM DEBT

The Agency issued $193.3 million of 2015 project revenue bonds in June 2015 with interest rates ranging from 2.0 percent to 5.0 percent, maturing July 2030.

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

	December 31, 2018	December 31, 2017
2015 Cosumnes project revenue refunding bonds, fixed rates 5.00%, 2019-2030	$ 132,500,000	$ 146,640,000
Unamortized premium - net	17,254,455	20,330,450
Total long-term debt	149,754,455	166,970,450
Less: amounts due within one year	(11,705,000)	(14,140,000)
Total long-term debt - net	$ 138,049,455	$ 152,830,450

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

	December 31, 2017	Additions	Refunding, Payments or Amortization	December 31, 2018
Cosumnes project revenue bonds	$ 146,640,000	$ -0-	$ (14,140,000)	$ 132,500,000
Unamortized premiums - net	20,330,450	-0-	(3,075,995)	17,254,455
Total long-term debt	$ 166,970,450	$ -0-	$ (17,215,995)	$ 149,754,455

The following summarizes activity in long-term debt for the year ended December 31, 2017:

	December 31, 2016	Additions	Refunding, Payments or Amortization	December 31, 2017
Cosumnes project revenue bonds	$ 170,540,000	$ -0-	$ (23,900,000)	$ 146,640,000
Unamortized premiums - net	23,839,472	-0-	(3,509,022)	20,330,450
Total long-term debt	$ 194,379,472	$ -0-	$ (27,409,022)	$ 166,970,450

The annual debt service requirements to maturity for Bonds are as follows at December 31, 2018:

Year	Principal	Interest	Total
2019	$ 11,705,000	$ 6,625,000	$ 18,330,000
2020	8,710,000	6,039,750	14,749,750
2021	10,900,000	5,604,250	16,504,250
2022	11,450,000	5,059,250	16,509,250
2023	1,845,000	4,486,750	6,331,750
2024-2028 (combined)	66,895,000	15,192,750	82,087,750
2029-2030 (combined)	20,995,000	1,326,500	22,321,500
Total	$ 132,500,000	$ 44,334,250	$ 176,834,250

Proceeds from the 2015 Series Bonds were used to refund previously issued 2006 Bonds that provided financing for the Project. The 2015 Series Bonds, payable through 2030, are secured solely by a pledge of and lien on the trust estate under the Indenture which includes revenues from the PPA and investment income from funds established under the Indenture. The Agency has pledged future net revenues to repay $132.5 million for 2015 Series Bonds at December 31, 2018 and $146.6 million at December 31, 2017. Annual principal and interest payments on the 2015 Series Bonds required approximately 13.8 percent and 19.4 percent of the Agency's net revenues for 2018 and 2017, respectively. The total principal and interest remaining to be paid on the 2015 Series Bonds is $176.8 million and $198.2 million at December 31, 2018 and 2017, respectively. Debt service payments are made semi-annually on January 1 and July 1. Principal and interest paid was $21.3 million and $31.8 million for 2018 and 2017, respectively. Total gross revenues were $154.4 million and $164.0 million for 2018 and 2017, respectively.

The payments of principal and interest related to the Agency's long-term debt are not dependent upon the continued successful operation of the Project. SMUD guarantees to make payments in an amount sufficient to pay principal and interest and all other payments required to be made under the Indenture, under a "take-or-pay" contract. The Agency is not required to repay SMUD for any amounts paid under this guarantee.

NOTE 6. INSURANCE PROGRAMS

The Agency purchases commercial property and casualty insurance coverage at levels consistent with coverages on similar facilities. The policies' deductible dollar amounts vary depending on the type of coverage. Excess liability coverage for most claims against the Agency is $100.0 million. Generally, the maximum risk that the Agency would be exposed to is limited to $0.3 million for most casualty claims, $1.0 million for property claims, and up to $50.0 million for earthquakes. No claims have exceeded the limits of property or liability insurance in any of the past three years. There were no significant reductions in coverage compared to the prior year.

NOTE 7. FAIR VALUE MEASUREMENTS

SGAS No. 72, ***"Fair Value Measurement and Application"*** (GASB No. 72), defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The Agency utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique.

GASB No. 72 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy defined by GASB No. 72 are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for an asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs that reflect the Agency's own assumptions about factors that market participants would use in pricing the asset or liability.

The valuation methods of the fair value measurements are disclosed below. All of the Agency's investments are valued using Level 2 inputs.

- LAIF - uses the fair value of the pool's share price multiplied by the number of shares held. This pool can include a variety of investments such as U.S. government securities, federal agency securities, negotiable certificates of deposit, bankers' acceptances, commercial paper, corporate bonds, bank notes, and other investments. The fair values of the securities are generally based on quoted and/or observable market prices.

The following table identifies the level within the fair value hierarchy that the Agency's financial assets and are accounted for on a recurring basis as of December 31, 2018 and 2017, respectively. As required by GASB No. 72, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Agency's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of the fair value of liabilities and their placement within the fair value hierarchy levels.

Recurring Fair Value Measures (Level 2)

	December 31,	
	2018	2017
Investments reported as Cash and Cash Equivalents:		
LAIF	$ 13,336,304	$ 6,723,652
Total fair value investments	$ 13,336,304	$ 6,723,652

NOTE 8. COMMITMENTS

Natural Gas Interconnection and Supply Agreement. Pursuant to the Natural Gas Interconnection and Supply Agreement, SMUD supplies all of the natural gas requirements of the Project. The Agency pays for the actual supply, storage and transportation costs for the fuel supplied to the Project as specified in this agreement for 30 years following Acceptance, which means that the Natural Gas Interconnection and Supply Agreement will be in effect through September 2039.

Operation and Maintenance Agreement. Ethos serves as the Project Operator and is responsible for the primary operation,
repair, overhaul and maintenance services of the Project. The Agency pays for such services according to the terms of this agreement and provides, at no cost to Ethos, fuel, water, and power not already provided for in other agreements. At December 31, 2018, the minimum annual commitment to Ethos under this agreement was approximately $3.9 million.

Ground Lease Agreement. The Agency leases land from SMUD under the Ground Lease Agreement expiring December 2040. The minimum lease payment increases by three percent annually and the rate is renegotiated based on the average Consumer Price Index every five years. At December 31, 2018, the Agency's annual minimum lease payment was approximately $0.2 million.

Water Supply Agreement. Pursuant to the Water Supply Agreement, SMUD supplies water to the Agency. The Agency is obligated to pay for the actual water supply, storage, and transportation costs for 30 years through September 2039.

Advanced Gas Path and DLN 2.6+ Combustion System Purchase Agreement. The Agency, through Ethos, signed a three year contract with General Electric International, Inc. to procure parts and the accompanying software for the upgrade of the plant's Combustion Turbine Generators for $35.6 million. At December 31, 2018, $23.7 million remains available on this contract.

NOTE 9. CONTINGENCIES

General Contingencies. 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.