
Northern California Energy Authority

Report of Independent Auditors

as of December 31, 2018



GREEN ENERGY



ENERGY STORAGE



SOLAR ENERGY



WIND ENERGY

NCEA

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 which comprise the Statement of Net Position as of December 31, 2018, and the related Statement of Revenues, Expenses and Changes in Net Position, and Statement of Cash Flows one month 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 audit. We conducted our audit 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 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 the 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 at December 31, 2018, and the changes in its financial position and its cash flows for the one month 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

**NORTHERN CALIFORNIA ENERGY AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS - UNAUDITED
For the Month Ended December 31, 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 Statement of Net Position, the Statement of Revenues, Expenses and Changes in Net Position and the Statement 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 one month ended December 31, 2018. This discussion and analysis should be read in conjunction with the Agency's financial statements and accompanying notes, which follow this section.

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

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

The Statement 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. 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 will commence 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.

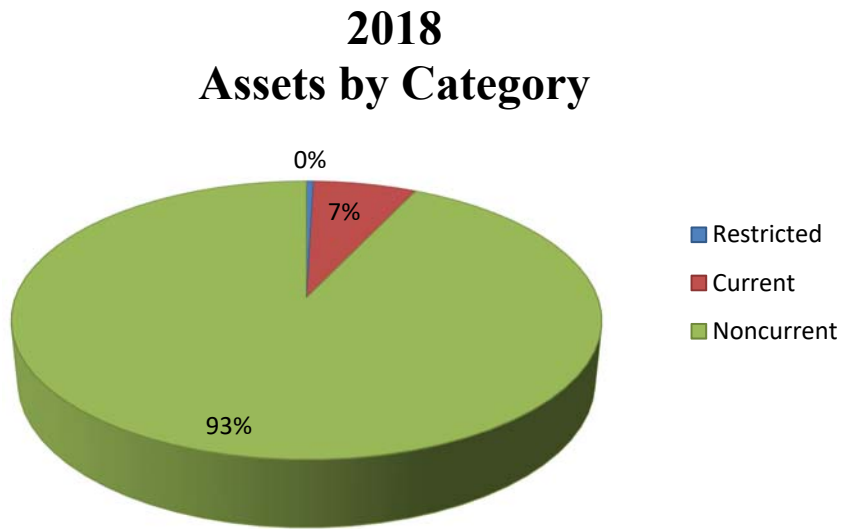
The Agency's Commission is comprised of SMUD's Board of Directors. The Agency is a separate legal entity; however, due to the extent of its operational and financial relationship with SMUD, it is included in the consolidated financial statements of SMUD.

FINANCIAL POSITION

Statement of Net Position Summary
(Dollars in thousands)

	<u>December 31,</u> <u>2018</u>
Assets	
Restricted assets	\$ 2,478
Current assets	37,479
Noncurrent assets	523,786
Total assets	<u>\$ 563,743</u>
Liabilities	
Long-term debt - net	\$ 566,893
Current liabilities	1,449
Total liabilities	<u>568,342</u>
Net position	
Unrestricted	<u>(4,599)</u>
Total net position	<u>(4,599)</u>
 Total liabilities and net position	 <u>\$ 563,743</u>

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



2018

ASSETS

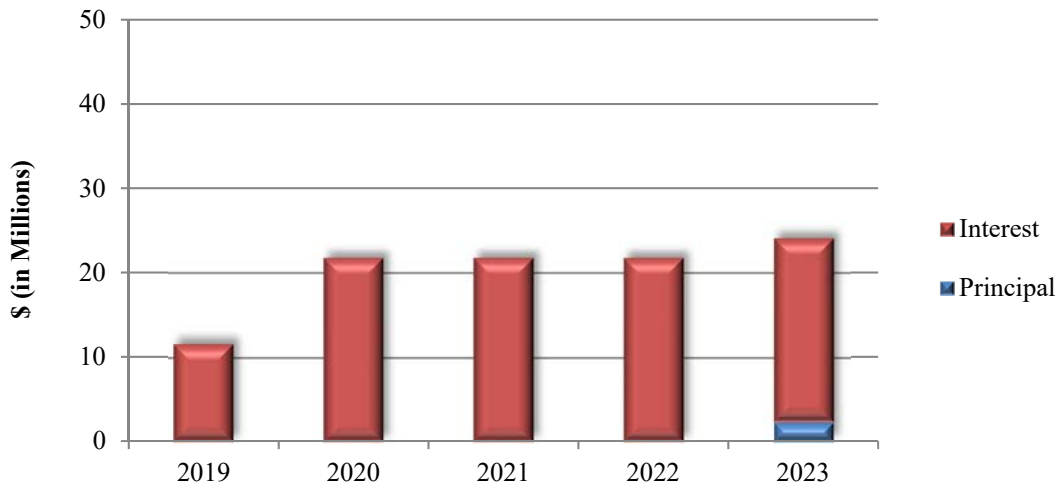
- Current Assets were \$37.5 million, primarily comprised of the current portion of the Prepaid Gas Supply, and the debt service fund balance as a result of issuance of \$539.6 million bonds in December 2018.
- The Agency’s main asset is its Prepaid Gas Supply, of which the noncurrent portion was \$523.8 million. The Prepaid Gas Supply (current and noncurrent portion) was about 96 percent of the Agency’s assets at December 31, 2018.

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. 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 is related to the accounts payable for the bond issuance costs and accrued interest.

2018

RESULTS OF OPERATIONS

Summary of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

	December 31, 2018
Operating revenues	\$ -0-
Operating expenses	4,045
Operating income	(4,045)
Interest on debt	(555)
Change in net position before contributions	(4,600)
Member contributions	1
Change in net position	(4,599)
Net position - beginning of year	-0-
Net position - end of year	<u>\$ (4,599)</u>

- Operating Expense were \$4.0 million, primarily comprised of bond issuance costs.
- SMUD made contributions to the Agency totaling \$1.5 thousand in 2018.

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

	December 31,
	2018
ASSETS	
RESTRICTED ASSETS	
Debt service funds	\$ 18,080,000
Other restricted funds	3,763,185
Less current portion	(19,364,705)
Total restricted assets	2,478,480
CURRENT ASSETS	
Restricted cash and cash equivalents	763,185
Restricted investments	18,601,520
Prepaid gas supply	18,113,819
Total current assets	37,478,524
NONCURRENT ASSETS	
Prepaid gas supply	523,786,181
Total noncurrent assets	523,786,181
TOTAL ASSETS	\$ 563,743,185
LIABILITIES AND NET POSITION	
LONG-TERM DEBT - net	
	\$ 566,893,224
CURRENT LIABILITIES	
Accounts payable	724,000
Accrued interest	725,095
Total current liabilities	1,449,095
TOTAL LIABILITIES	568,342,319
NET POSITION	
Unrestricted	(4,599,134)
TOTAL NET POSITION	(4,599,134)
COMMITMENTS AND CONTINGENCIES (Notes 6 and 7)	
TOTAL LIABILITIES AND NET POSITION	\$ 563,743,185

The accompanying notes are an integral part of this financial statement.

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

	One Month Ended December 31, <u>2018</u>
OPERATING REVENUES	
Gas sales to Member	\$ -0-
Total operating revenues	<u>-0-</u>
OPERATING EXPENSES	
Administrative and general	4,045,457
Total operating expenses	<u>4,045,457</u>
OPERATING LOSS	<u>(4,045,457)</u>
NON-OPERATING EXPENSES	
Interest on debt	(555,172)
Total non-operating expenses	<u>(555,172)</u>
CHANGE IN NET POSITION BEFORE CONTRIBUTIONS	<u>(4,600,629)</u>
Member contributions	1,495
CHANGE IN NET POSITION	<u>(4,599,134)</u>
NET POSITION - BEGINNING OF YEAR	<u>-0-</u>
NET POSITION - END OF YEAR	<u>\$ (4,599,134)</u>

The accompanying notes are an integral part of this financial statement.

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

	One Month Ended December 31, <u>2018</u>
CASH FLOWS FROM OPERATING ACTIVITIES	
Payments to vendors	\$ (3,319,962)
Net cash used in operating activities	<u>(3,319,962)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Proceeds from bond issuance, net of premium	567,063,147
Prepaid gas supply expenditures	(541,900,000)
Net cash provided by noncapital financing activities	<u>25,163,147</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of investments	(21,080,000)
Net cash used in investing activities	<u>(21,080,000)</u>
Net increase in cash and cash equivalents	763,185
Cash and cash equivalents - beginning of year	-0-
Cash and cash equivalents - end of the year	<u>\$ 763,185</u>
CASH AND CASH EQUIVALENTS INCLUDED IN:	
Restricted cash and cash equivalents	\$ 763,185
Cash and cash equivalents - end of the year	<u>\$ 763,185</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES	
Operating loss	\$ (4,045,457)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Changes in operating assets and liabilities:	
Payables and accruals	725,495
Net cash used in operating activities	<u>\$ (3,319,962)</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH AND RELATED FINANCING ACTIVITIES	
Amortization of debt related premiums	\$ 169,923
Contributions from Member	1,495

The accompanying notes are an integral part of this financial statement.

NORTHERN CALIFORNIA ENERGY AUTHORITY
NOTES TO FINANCIAL STATEMENTS
As of and for the Month Ended December 31, 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 \$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 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. 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.

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 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 "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.

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

Member Contributions. Amounts contributed by SMUD for the actual costs of providing administrative and general services 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 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 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. 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 policy for custodial credit risk. At December 31, 2018, the Agency had money market funds of \$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, 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. At December 31, 2018, \$18.6 million of the Agency's investments have maturities between one to five years and \$2.5 million had maturities of one year or less.

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 schedule presents credit risk by type of security held at December 31, 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, <u>2018</u>
Cash and Cash Equivalents:		
Money market funds	AAAm	\$ <u>763,185</u>
Total cash and cash equivalents		763,185
Investments:		
Guaranteed investment contracts	BBB+	<u>21,080,000</u>
Total investments		<u>21,080,000</u>
Total cash, cash equivalents, and investments		<u>\$ 21,843,185</u>

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

	December 31, 2018
	<u>2018</u>
Cash, cash equivalents, and investments:	
Debt service funds:	
Debt service fund	\$ 14,080,000
Debt service reserve fund	<u>4,000,000</u>
Total debt service funds	<u>18,080,000</u>
Other restricted funds:	
Working capital fund	3,000,000
Acquisition fund	<u>763,185</u>
Total other restricted funds	<u>3,763,185</u>
Total cash, cash equivalents, and investments	<u>\$ 21,843,185</u>

NOTE 4. PREPAID GAS SUPPLY

The Agency's prepaid gas supply is presented below:

	December 31, 2018
	<u>2018</u>
Prepaid gas supply	\$ 541,900,000
Less: amounts due within one year	<u>(18,113,819)</u>
Total prepaid gas supply - noncurrent portion	<u>\$ 523,756,181</u>

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

	December 1, 2018		Additions		Amortization		December 31, 2018
	<u>2018</u>		<u>Additions</u>		<u>Amortization</u>		<u>2018</u>
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 2049. 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, 2018
	<u>2018</u>
2018 Commodity supply revenue bonds, fixed rates 4.00% - 5.00%, 2019-2049	\$ 539,615,000
Unamortized premiums	27,278,224
Less: amounts due within one year	<u>-0-</u>
Total long-term debt - net	<u>\$ 566,893,224</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, 2018:

Year	Principal	Interest	Total
2019	\$ -0-	\$ 11,601,520	\$ 11,601,520
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	537,295,000	21,636,850	558,931,850
Total	<u>\$ 539,615,000</u>	<u>\$ 120,249,770</u>	<u>\$ 659,864,770</u>

Interest includes interest requirements for fixed rate debt at their stated rates.

The Agency had pledged future net revenues to repay \$539.6 million at December 31, 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 was \$659.9 million at December 31, 2018. 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.

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, 2018 was 120,776,000 million mmbtu and 9,917,329 MWh. Presently, the Commodity Swap Agreement is an average of 18,425 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.