A large, semi-transparent circular graphic of an electric vehicle charging station is centered on the page. The station is white and has a charging cable plugged into it. The background of the entire page is a circular aerial photograph showing a mix of greenery, buildings, a highway interchange, and several wind turbines under a clear blue sky. The bottom of the page features a light gray, stylized map of a city grid.

ELECTRIC SOLUTIONS | 2018 SMUD Annual Report

SMUD OVERVIEW



1.5
million

Service Area Population

Record Peak Demand

3,299

megawatts on

JULY 2006

S	M	T	W	T	F	S
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31					



Employees
(year end)

2,278

Authorized Budget

\$1.7 billion

Customer Contracts
(year end)

635,137

Credit Rating



AA

Standard & Poor's

Aa3

Moody's

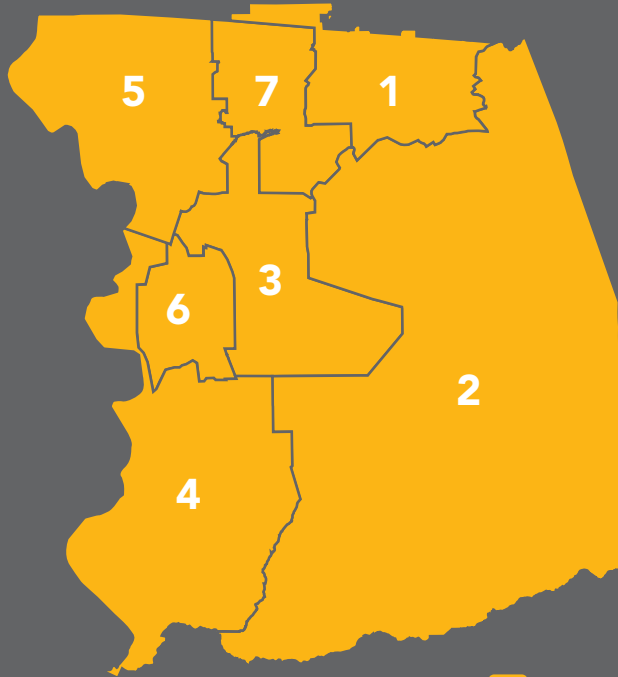
AA

Fitch



SMUD OVERVIEW

SMUD Service Area and Board Member Wards



The Sacramento Municipal Utility District generates, transmits and distributes electricity to a 900-square-mile territory that includes California's capital city, Sacramento County, and small portions of Placer and Yolo counties. As a publicly owned utility, SMUD is governed by a seven-member Board of Directors elected by the voters to staggered four-year terms. The SMUD Board of Directors determines policy and appoints the chief executive officer/general manager, who is responsible for SMUD's day-to-day operations.

SMUD BOARD OF DIRECTORS

Brandon Rose
Ward 1

Nancy Bui-Thompson
Ward 2

Gregg Fishman (*President 2018*)
Ward 3

Genevieve Shiroma
(*Rosanna Herber was elected in 2018*)
Ward 4

Rob Kerth (*Vice President 2019*)
Ward 5

Dave Tamayo
(*Vice President 2018, President 2019*)
Ward 6

Bill Slaton
(*Heidi Sanborn was elected in 2018*)
Ward 7

EXECUTIVE MANAGEMENT

Arlen Orchard
CEO & General Manager

Laura Lewis
Chief Legal Officer

Jennifer Davidson
Chief Financial Officer

Paul Lau
*Chief Grid Strategy
& Operations Officer*

Gary King
Chief Workforce Officer

Frankie McDermott
Chief Energy Delivery Officer

Nicole Howard
Chief Customer Officer

Stephen Clemons
Chief Information Officer

“ CEO LETTER



Each year brings its own opportunities and challenges, but I’m confident in saying that 2018 will go down as a watershed year for SMUD. Without losing sight of the daily basics, we devoted much of our effort in 2018 to an issue of great importance – not just to SMUD and our customers but to the health and prosperity of the entire Sacramento region.

I’m referring specifically to the SMUD Board’s passage in October of an Integrated Resource Plan (IRP) that puts us on path to reach a greenhouse gas emission target of net zero by 2040. In the past, these resource plans

focused largely on the capacity and energy needed to meet customer demand. SMUD’s current IRP takes a much bolder approach by maximizing local investment, supporting local economic development and innovation, reaching disadvantaged communities, improving air quality, and lowering the region’s carbon footprint.

We’re not taking this bold approach because the state told us to. In fact, our goals are more ambitious than the state’s. We’re doing it because it’s the right thing to do – for our customers, for our community, and for our grandchildren and their children.

A key component of SMUD's IRP is a \$1.7 billion investment over the next 20 years in the electrification of buildings and transportation. We initiated several first-in-the-nation partnerships with homebuilders to incentivize the construction of all-electric homes. SMUD has spent more than \$20 million in the last five years supporting electric transportation, an investment that will grow significantly in the next few years.

AS CALIFORNIA'S RELIANCE ON CARBON-BASED FUELS DECREASES EACH YEAR, INCREASED BUILDING AND TRANSPORTATION ELECTRIFICATION WILL REDUCE GREENHOUSE GAS EMISSIONS, IMPROVE AIR QUALITY AND ADVANCE ECONOMIC DEVELOPMENT ACROSS THE REGION. IT'S WHY THE THEME OF THIS REPORT IS "ELECTRIC SOLUTIONS."

As I mentioned at the beginning, SMUD remains focused on getting the basics right each day. This means meeting our customers' expectations for safe, reliable, affordable and environmentally responsible energy. We did just that in 2018 while finishing the year in a strong financial position.

SMUD's net income in 2018 was \$209.1 million, approximately \$80 million higher than planned. We exceeded our goal for fixed charge ratio and ended the year with sizable balances in our rate stabilization and hydro rate stabilization funds. We achieved major milestones in our strategy to develop new sources of revenue in 2018. SMUD's first two Community Choice Aggregator customers, Valley Clean Energy in Yolo County and East Bay Community Energy in Alameda County, became operational in 2018.

In 2018, we began implementing two of the most significant rate overhauls in SMUD's seven-decade history. We began the transition of all residential customers to Time-of-Day Rates and rolled out our new Energy Assistance Program Rate for low-income customers. Time-of-Day Rates give customers the opportunity to manage their bills by shifting usage to lower-cost time periods. The overhaul of our low-income assistance rate ensures that SMUD assists the customers who need it the most.

Support for low-income communities is part of a broader strategy to holistically align our rates and programs to help our disadvantaged communities. We've developed a Sustainable Communities strategy that combines SMUD's efforts with those of our regional partners to make life better for all Sacramentans.

Our rates remain among the lowest in California – 36 percent lower than neighboring PG&E's as of March 2019 – and we met our reliability targets for frequency and duration of outages. While SMUD's service territory did not experience any of the wildfires that ravaged the state in 2018, we enhanced our fire prevention and mitigation efforts in El Dorado County, where our Upper American River Project provides our customers with carbon-free hydroelectricity. SMUD is preparing a Wildfire Mitigation Plan in compliance with Senate Bill 901 and anticipates releasing a draft for public comment in 2019.

By 2020, we expect digital channels to be the primary way customers do business with SMUD. We delivered several enhancements in 2018 that support our digital-first strategy, the most noteworthy being the launch of a SMUD App that features usage, bill pay and outage functionalities.

We made significant progress on the “value for what you pay” metric adopted by the SMUD Board and continue to meet customer satisfaction targets. We strengthened our connection to the community by providing more than \$425,000 in Shine neighborhood awards, and our employees personally donated almost \$500,000 to non-profits in 2018 through the SMUD Cares charitable giving program.

I encourage you to read more about the Electric Solutions we're developing across the board.

Sincerely,



Arlen Orchard
SMUD CEO & General Manager





YEAR IN REVIEW

STRONG FINANCIAL FOOTING

SMUD ended 2018 in a strong financial position. Net income was \$209.1 million, approximately \$80 million higher than planned. Repurchasing the third phase of the Solano Wind Farm resulted in a favorable adjustment of \$46.7 million.

SMUD ended the year with an unrestricted cash and investment balance of \$478.3 million along with a Rate Stabilization Fund balance of \$32.6 million and a Hydro Rate Stabilization Fund balance of \$64.1 million. In June 2018, SMUD made an additional \$50 million contribution to help reduce its unfunded CalPERS pension liability.

The full, audited financial report begins on page 25 of this report.

SMUD customers continue to pay significantly less for electricity than most Californians. In early 2019, SMUD’s average residential rates were approximately 36 percent lower than neighboring PG&E’s.

Comparison of electric bills based on 750 kWh electric usage

Utility	Average Monthly Bill	% SMUD below Utility
SMUD	\$113.79	
PG&E	\$178.11	36.1%
Roseville	\$113.74	0.0%
Turlock	\$114.74	0.8%
Modesto	\$133.92	15.0%
LADWP	\$150.04	24.2%
SCE	\$154.10	26.2%
SDG&E	\$217.36	47.7%

as of March 1, 2019



TIME-OF-DAY RATES

SMUD began transitioning its residential customers to a new Time-of-Day (TOD) rate structure in October 2018. The transition was completed in May 2019.

With TOD rates, customers will see much lower rates for the eight non-summer months as well as on weekends and holidays the entire year. Rates will be higher during the peak summer hours (Monday through Friday, 5 to 8 p.m.) when it costs the most to provide electricity.

SMUD is the first large California utility to make TOD rates standard for all residential customers, though other utilities are laying the same groundwork and will follow suit soon.

TOD rates better align rates with the cost of providing electricity, send more accurate price signals to customers, and give them the opportunity to better manage their electricity bills by shifting usage to lower-cost time periods.

SMUD's commercial customers have been on TOD rates for several years.

As 2019 began, the transition to residential TOD rates was proceeding smoothly, with approximately 185,000 customers having made the switch. To prepare our customers for the biggest rate redesign in SMUD's history, we developed a comprehensive marketing, education and outreach campaign. The goal is to make sure customers are aware of the change, learn how it might impact them, and give them easy-to-use tools that help them make decisions for their individual circumstances and needs.

Prior to the transition, the SMUD Board approved investments of more than \$10 million in programs and services for disadvantaged communities to assist low-income customers in making the transition to TOD rates.



EAPR

Support for low-income communities is an important part of SMUD's broader strategy to align its rates and programs to benefit disadvantaged communities. SMUD offers the Energy Assistance Program Rate (EAPR). Customers with the lowest household incomes, based on the federal poverty level, receive the largest discounts on their monthly bills.

In addition to the rate discount, EAPR pilot programs benefitted 6,124 low-income households in 2018, a significant increase from 3,468 households assisted in 2017. The 2018 efforts included:

- 32 solar installations coupled with energy efficiency products;
- 579 deep home retrofits;
- 3,462 bundled energy efficiency products for apartment tenants and single-family residents;
- 919 energy efficiency products for mobile home and master meter mobile home tenants; and
- More than 1,100 weatherization installations.

SEED

The Supplier Education and Economic Development program, better known as SEED, offers incentives for local small businesses to participate in SMUD's competitive bid process. SMUD's goal is to award 20 percent of all contracts to certified small businesses.

In 2018, 30 percent of the contracts awarded went to SEED-qualified small businesses, for a total amount of \$109 million. More than \$20 million of the contracting work on the rehabilitation of the SMUD Headquarters building (pictured below) was committed to SEED businesses.

To further support job creation and economic development across the Sacramento region, SMUD also deposited \$15 million in three banks to provide for local lending.



SUSTAINABLE COMMUNITIES INITIATIVE

The SMUD Board's mission is to enhance the quality of life for our customers and community. The Sustainable Communities initiative that SMUD will continue rolling out in 2019 focuses on the further development of economically and environmentally sustainable neighborhoods throughout the region.

Studies have shown – and our eyes can see – that significant social, economic and environmental disparities exist in the greater Sacramento region. These inequities are holding the entire region back from realizing its full potential.

The goal of Sustainable Communities effort is to advance prosperity of everyone in the Sacramento region. This includes focusing on healthy neighborhood environments, improved education outcomes, job creation, access to transportation, and strengthening partnerships with civic networks and institutions.

Whether it be offering financial assistance through our Powering Futures scholarship program or supporting community development through our Shine neighborhood awards, SMUD is already doing a lot of good things. It's something we've done for more than 70 years.

At the same time, we've come to understand that not all of our customers and communities have benefitted equally from having SMUD be their community-owned utility. We also understand that we can't eliminate these inequities by ourselves. By leveraging external partnerships, we can maximize our collective impact to help those most in need and ensure that all of our customers and communities share in the region's bright future.



GREENENERGY®

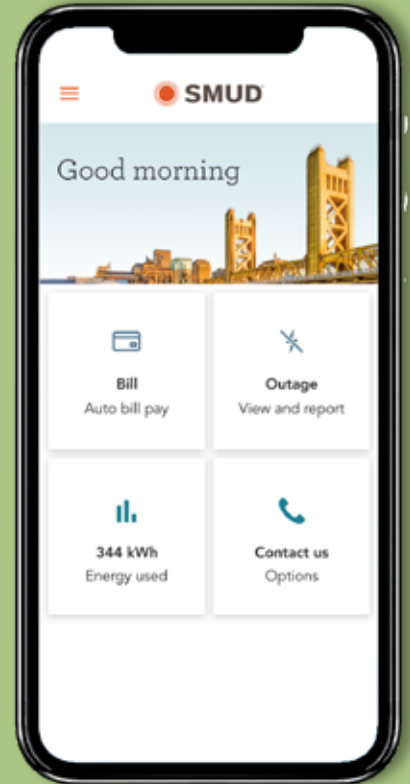
SMUD's Greenergy program grew 19 percent in 2018, ending the year with approximately 71,000 participants. The nationally recognized program allows customers to select carbon-free energy for either 100 percent or 50 percent of their electricity use for an extra fee each month.

SMUD APP

The new SMUD App hit the virtual shelves of Apple App and Google Play Stores in 2018, giving customers an opportunity to connect and engage with SMUD whenever and wherever they want.

It's part of SMUD's digital-first strategy – the recognition that by 2020, digital channels will be the primary way customers do business with their community-owned utility.

With the SMUD App, residential customers have the power to manage their accounts with single sign-on access. Once logged in, customers can review current and past bills, make or schedule payments, view and report past bills, make or schedule payments, view and report outages, see their monthly energy usage, and more.



SMUD JOINS GROWING CCA MARKET

SMUD's first two CCA (Community Choice Aggregator) customers became operational in 2018. Valley Clean Energy in Yolo County and East Bay Community Energy in Alameda County contracted with SMUD to develop and maintain various services for each community-owned electricity provider.

In California, communities can come together to choose to be the energy supplier, or CCA, within an investor-owned utility's service territory. SMUD currently provides call center, data management and other services to Valley Clean Energy and East Bay Community Energy.

The trend toward CCAs is driven by a number of factors, including a desire for community control over energy supply decisions and a cleaner, more sustainable power mix. SMUD's mission aligns with the CCA model of local control, renewable energy, greenhouse gas reduction, customer choice and price stability.



MOVING IN A CLEANER, MORE SUSTAINABLE DIRECTION

In 2018, California legislators enacted some of the most ambitious clean energy and carbon reduction goals in the world. The state's utilities must have 60 percent of their power mix come from renewable resources by 2030, and by 2045, all retail electricity sold must be met by carbon-free resources.

With its Integrated Resource Plan (IRP) developed in 2018, SMUD is committed to moving further and faster than the state. In the near term, SMUD's Board of Directors set a greenhouse gas (GHG) goal of 60 percent below 1990 emissions by 2030. The longer-term goal for SMUD is to achieve a net-zero GHG position in 2040.

By focusing on local investments in renewable energy and building and transportation electrification, SMUD's IRP looks to achieve a 64-percent reduction in the Sacramento region's GHG emissions by 2040.

Utilities are required to submit an IRP to the California Energy Commission in early 2019, outlining their investment priorities through 2040.

A key component in SMUD's IRP is a \$1.7 billion investment over 20 years in the electrification of buildings and transportation. As California's reliance on carbon-based fuels decreases each year, increased electrification will reduce GHG emissions, improve air quality and spur economic development across the Sacramento region.





SMUD is partnering with developers in the region to create new all-electric single- and multi-family housing developments. Together with an all-electric smart home program incentivizing retrofits of existing homes, SMUD is boosting Sacramento's all-electric housing stock. (For more on SMUD's electric transportation efforts, see pages 15-18.)

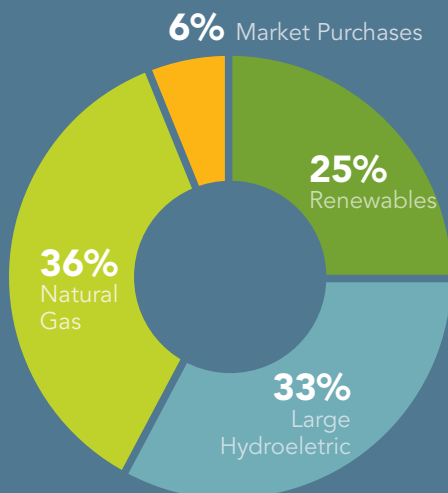
While cutting GHG emissions is a major goal of the IRP, so is ensuring reliable electricity for our customers. Based on today's technologies, the

IRP recognizes that at least through 2040, the Sacramento region will need a certain amount of gas generation for reliability purposes. SMUD will find offsetting reductions through electrification to ensure that our carbon footprint is net zero by 2040 – five years ahead of what the state is planning to do.

SMUD has laid out a bold vision for the Sacramento region's energy future, one which will leave a lasting footprint for decades to come.



SMUD RESOURCE CHART FOR 2017



AS SMUD'S POWER MIX INCORPORATES MORE CLEAN ENERGY SOURCES, THE ELECTRIFICATION OF THE TRANSPORTATION AND BUILDING SECTORS WILL HAVE AN INCREASINGLY POSITIVE EFFECT ON LOCAL AIR QUALITY.

(2018 figures not available; includes all renewables purchased for SMUD's Renewable Portfolio Standard and voluntary green programs.)



ELECTRIC TRANSPORTATION KEY TO A CLEANER TOMORROW

The increased electrification of the transportation sector is a key component of SMUD's Integrated Resource Plan to create a more sustainable future.

SMUD has supported electric transportation since the early 1990s for a variety of reasons, the foremost being air quality benefits. Greenhouse gas emissions from an electric vehicle (EV) are typically 70 percent lower than gasoline combustion engines.

With SMUD's power supply at more than 50 percent carbon-free and headed to 75 percent by 2030, the difference will become even more pronounced.

The number of electric vehicles on the Sacramento region's roads passed 10,000 for the first time in 2018. SMUD also helped lay the groundwork for Sacramento being designated the first "Green City" by Electrify America, a Volkswagen subsidiary.







Sacramento is home to the first electric school buses in the nation. With support from SMUD's Transportation Electrification Initiative, Twin Rivers School District's fleet now includes 16 electric school buses.

Electrify America committed \$44 million in funding to the capital region, approximately 35 percent of which will be devoted to making electric transportation more accessible in low-income communities.

The "Green City" designation builds on work already being done to connect Sacramento's low-income communities to green technologies and accessible transportation options.

Furthering its reputation as a national leader, SMUD received a federal patent in 2018 for an improved method for detecting an electric-vehicle charger at a customer's residence. The new technology will help SMUD market the benefits of off-peak charging to EV owners.



**SMUD IS TAKING A LEADERSHIP
ROLE IN A GROUNDBREAKING
INITIATIVE TO MAKE
SACRAMENTO A HUB FOR
ELECTRIC TRANSPORTATION
RESEARCH AND DEVELOPMENT.**

The California Mobility Center is a public-private consortium of partners representing energy, technology, automobile manufacturers, government agencies and venture capital.

The Center's mission is to fund, test and commercialize advances in mobility technologies, including electric vehicles, autonomous transportation, battery storage, shared mobility solutions, and public transit. The Center will also be a national hub for testing and validating new policies, regulations and business models.

SMUD commissioned a feasibility study done by PEM Motion, a German company that runs a successful mobility innovation hub out of Aachen University. Entertech Capital is helping design the consortium model that will make the Mobility Center financially self sustaining within a short period of time.

Joining SMUD on the Mobility Center's advisory group are the City of Sacramento, Sacramento State, UC Davis, Los Rios Community College District, Valley Vision, and the Greater Sacramento Economic Council.

California is the epicenter of climate change policies in the world, and Sacramento, as the state capital, is uniquely positioned to leverage cutting-edge public policy, electric transportation expertise and university research.



Shine

Building on the success of the previous year, SMUD awarded more than \$425,000 to local non-profits through our Shine Community Development Awards program in 2018.

In 2017, in conjunction with SMUD's 70th anniversary, SMUD launched the Shine program to help enhance and revitalize local neighborhoods. In 2018, nearly 80 organizations presented applications for projects ranging from education to neighborhood revitalization to energy efficiency. Staff applied a four-stage review process. This extensive screening process enabled SMUD to select 21 recipients for Shine awards.

While SMUD considers a broad range of potential projects for Shine funding, preference is given to organizations and projects in the following areas:

- Neighborhood revitalization or clean-up;
- STEM (science, technology, engineering and mathematics) education;
- Environmental, energy efficiency, energy conservation or greenhouse gas reduction; and
- General beautification.



One of the Shine awards went to Girl Scouts Heart of California for its STEM Center.

THE FOLLOWING 21 ORGANIZATIONS WERE SELECTED FOR SHINE AWARDS FROM A STRONG POOL OF 78 APPLICANTS IN 2018:

- 80 Watt District Property & Business Improvement District / Watt Avenue Partnership
- Alchemist Community Development Corporation
- Cordova Lancers, Leaders & Legends
- Del Paso Boulevard Partnership Foundation
- Fair Oaks Park Foundation
- FosterHope Sacramento
- Franklin Neighborhood Development Corporation
- Freedom Through Education
- Girls Scouts Heart of Central California
- Girls Self-Esteem Program
- Improve Your Tomorrow
- La Familia Counseling Center
- Los Rios Colleges Foundation
- Midtown Sacramento PBID Corp
- Parent Teacher Home Visits
- Pioneer Congregational United Church of Christ
- ReIMAGINE Mack Road Foundation
- Roberts Family Development Center
- Sacramento Neighborhood Housing Services, Inc./NeighborWorks
- San Juan Unified School District
- Sierra Nevada Journeys



While SMUD employees have long shown a commitment to their community, they went above and beyond in their 2018 actions. The SMUD Cares campaign raised almost \$500,000 for local non-profits and volunteered more than 18,400 hours in the community in 2018.

Additionally, SMUD employees also donated aid kits to those affected by the devastating Camp Fire in Butte County. Earlier in the summer, SMUD sent two line crews north to assist Redding Electric Utility's rebuilding efforts following the Carr Fire. Earlier in the year, SMUD line crews and support personnel helped restore power to approximately 2,000 Puerto Rico residents suffering from the effects of Hurricane Maria.





RELIABILITY

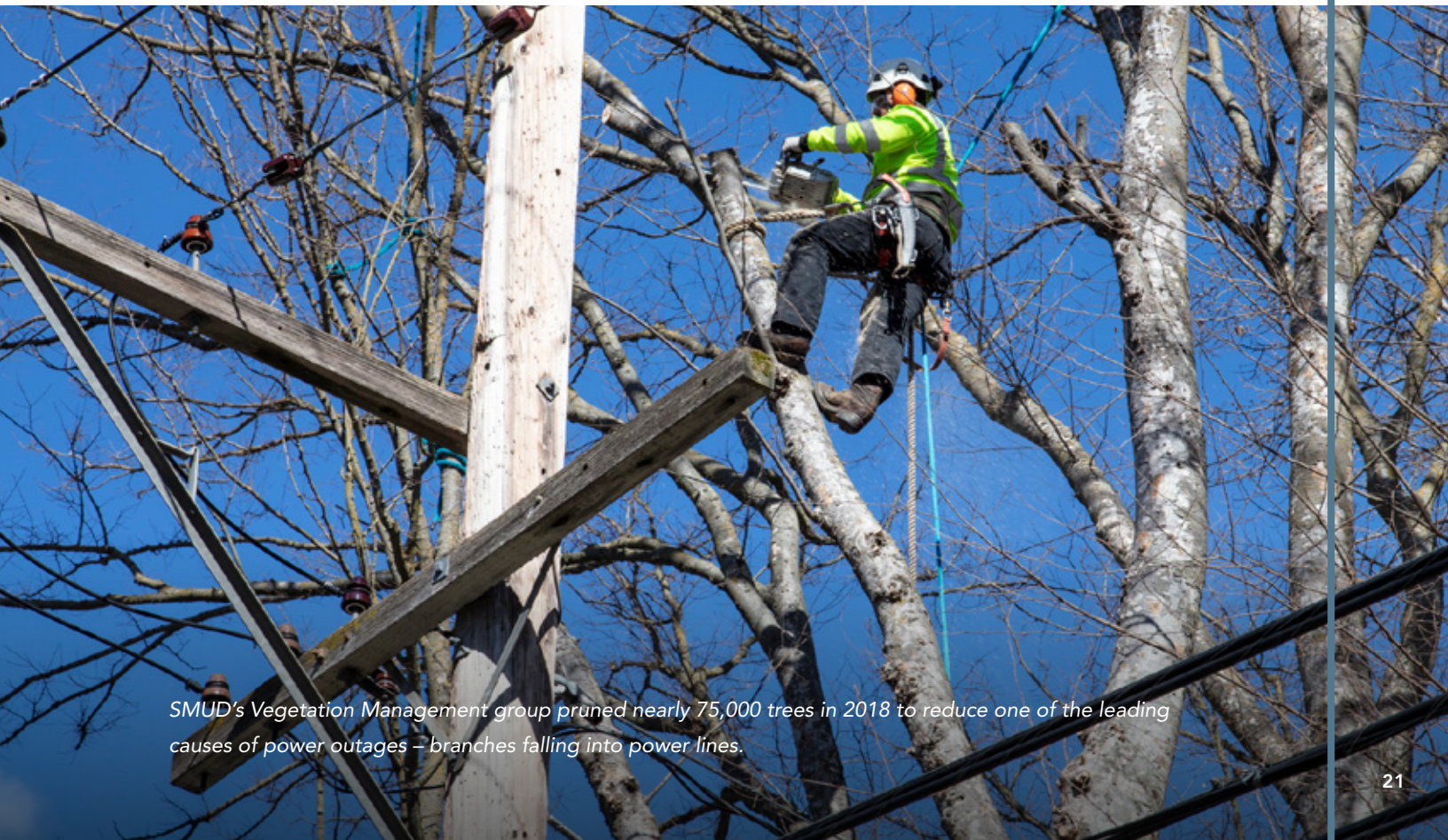
Providing reliable electric service to all of our customers is one of SMUD's core values. The frequency and duration of outages is one of the most important factors on how customers and regulators judge SMUD.

After a couple of challenging years, due in part to an increased number of cars crashing into utility poles, SMUD delivered greatly improved reliability in 2018.

The two ways SMUD measures distribution system reliability are through SAIDI (System

Average Interruption Duration Index) and SAIFI (System Average Interruption Frequency Index). SAIDI indicates the average outage duration for customers in a given year. SAIFI indicates how many outages, on average, our customers experience in a year.

SMUD's numbers were excellent in 2018 - 45 minutes for SAIDI, 0.93 for SAIFI. Both figures are better than SMUD Board's aggressive reliability goals. The SAIDI figure was SMUD's lowest since 2006, and SAIFI figure was the best since 2013.



SMUD's Vegetation Management group pruned nearly 75,000 trees in 2018 to reduce one of the leading causes of power outages – branches falling into power lines.



The improved figures were attributable to a variety of factors, including:

- The installation of more remotely operable switches on the 69kV system;
- Two rounds of vegetation patrols on all of the 69kV circuits targeting trees located outside SMUD's rights of way;
- The use of LIDAR technology in our vegetation management efforts;
- The installation of pole barrier systems, relocation of poles and installation of new visibility strips, reducing the impact from car pole accidents;

- Infrared inspections of bulk transmission substations; and
- The installation of animal guarding at three substations most susceptible to animal-related outages.

SMUD is replacing Substation A at 16th and H Streets with what will be known as Substation G. The new substation will accommodate the future load growth we're anticipating in downtown Sacramento.

SMUD purchased land for a new substation in Elk Grove in 2006. The recession delayed its construction, but Elk Grove is booming again, and the Franklin Bulk Substation will meet the increased energy demands of the south county area.

SMUD REPLACED MORE THAN 370,000 FEET OF UNDERGROUND CABLE IN 2018. THE NUMBER OF CABLE FAULTS IN 2018 WAS 516 AS COMPARED TO 641 IN 2017.





2018 Financial Statements

5 YEAR SUMMARY (Unaudited)

Operating Statistics (i)	2018	2017	2016	2015	2014
Customer contracts at year-end	635,137	628,952	626,460	621,990	618,895
kWh Sales (thousands)					
Sales to customers -					
Residential	4,515,031	4,957,240	4,670,304	4,654,571	4,639,175
Commercial, industrial & other	5,718,480	5,819,110	5,750,831	5,819,228	5,858,785
Subtotal	10,233,511	10,776,350	10,421,135	10,473,799	10,497,960
Sales of surplus power	1,516,289	1,788,719	1,826,687	1,677,566	1,906,263
Total	11,749,800	12,565,069	12,247,822	12,151,365	12,404,223
Revenues (thousands of dollars)					
Sales to customers -					
Residential	\$ 642,789	\$ 689,806	\$ 645,430	\$ 621,830	\$ 594,644
Commercial, industrial & other	760,565	771,763	743,377	733,778	711,208
Subtotal	1,403,354	1,461,569	1,388,807	1,355,608	1,305,852
Sales of surplus power	59,599	59,787	62,382	55,189	84,158
Sales of surplus gas	93,194	84,751	25,708	26,863	82,104
Total (ii)	\$ 1,556,147	\$ 1,606,107	\$ 1,476,897	\$ 1,437,660	\$ 1,472,114
Average kWh sales per residential customer	8,101	8,969	8,495	8,522	8,545
Average revenue per residential kWh sold (cents)	14.43	14.05	13.90	13.48	12.92
Power supply (thousands of kWh)					
Hydroelectric	1,261,998	2,462,002	1,904,442	497,766	765,190
Cogeneration	5,312,495	4,612,178	5,816,886	6,146,848	5,919,981
Windpower	514,667	200,411	212,466	212,782	211,359
Photovoltaic	270	269	292	102	5
Purchases	5,078,432	5,757,332	4,798,517	5,746,573	5,963,656
Peak demand - MW	2,944	3,157	2,972	2,956	3,003
Employees at year-end	2,278	2,293	2,219	2,121	2,071
Financial Statistics (thousands of dollars)					
Operating revenues	\$ 1,595,455	\$ 1,559,336	\$ 1,494,833	\$ 1,478,748	\$ 1,529,344
Operating expenses -					
Purchased and interchanged power	294,116	283,693	243,031	288,835	316,082
Operation and maintenance	839,438	851,894	800,556	785,707	813,581
Depreciation and amortization	196,920	194,925	184,043	188,928	184,810
Regulatory amounts collected in rates	22,894	12,253	12,127	7,299	5,401
Total operating expenses	1,353,368	1,342,765	1,239,757	1,270,769	1,319,874
Operating income	242,087	216,571	255,076	207,979	209,470
Other income	57,329	58,573	43,077	35,040	79,125
Income before interest charges	299,416	275,144	298,153	243,019	288,595
Interest charges	90,278	97,251	102,895	112,942	121,931
Change in net position	\$ 209,138	\$ 177,893	\$ 195,258	\$ 130,077	\$ 166,664
Funds available for debt service	\$ 435,629	\$ 534,151	\$ 507,318	\$ 452,029	\$ 476,757
Debt service (iii)	\$ 205,405	\$ 235,076	\$ 234,300	\$ 243,341	\$ 248,868
Fixed charge coverage ratio	2.12	2.27	2.17	1.86	1.92
Electric utility plant - net	\$ 3,516,573	\$ 3,353,775	\$ 3,344,860	\$ 3,323,900	\$ 3,331,965
Capitalization					
Long-term debt	\$ 2,783,617	\$ 2,474,215	\$ 2,665,235	\$ 2,826,180	\$ 3,052,131
Net position	\$ 1,720,954	\$ 1,511,816	\$ 1,333,923	\$ 1,138,665	\$ 1,013,369

i Financial information is consolidated.

ii Prior to the net deferral/transfer of revenues to/from the Rate Stabilization Fund and net deferral/recognition of Public Good, Senate Bill I, and Assembly Bill 32 revenues.

iii Includes SMUD and component unit bond debt service (excluding Northern California Gas Authority No. 1 and Northern California Energy Authority), SMUD's portion of Transmission Agency of Northern California's debt service, and expenses related to interest rate swaps and commercial paper.

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Sacramento Municipal Utility District | 2018 Annual Report

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

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

Management's Responsibility for the Financial Statements

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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's preparation and fair presentation of the consolidated 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'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 consolidated financial statements.

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

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INDEPENDENT AUDITORS' REPORT *continued*

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sacramento Municipal Utility District and its blended component units at December 31, 2018 and 2017, and the respective changes in their financial position and their cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 3 to the financial statements, the Sacramento Municipal Utility District has adopted the provisions of Governmental Accounting Standards Board Statement No. 75 – *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* effective January 1, 2017. Accordingly, the accounting changes have been retroactively applied to prior periods presented. Our opinion is not modified with respect to this matter.

Other Matter

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Funding Progress information as listed in the table of contents be presented to supplement the consolidated financial statements. Such information, although not a part of the consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the consolidated 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 consolidated financial statements, and other knowledge we obtained during our audit of the consolidated 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we will also issue a report on our consideration of Sacramento Municipal Utility District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Sacramento Municipal Utility District's internal control over financial reporting and compliance.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
February 15, 2019

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 (SMUD) consists of management's discussion and analysis and the consolidated financial statements, including notes to consolidated financial statements. The Consolidated Financial Statements consist of the Statements of Net Position, the Statements of Revenue, Expenses and Changes in Net Position and the Statements of Cash Flows.

SMUD maintains its accounting records in accordance with Generally Accepted Accounting Principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB). SMUD's accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission (FERC), except as it relates to accounting for contributions of utility property in aid of construction.

Overview of the Financial Statements

The following discussion and analysis of the financial performance of SMUD 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 consolidated financial statements and accompanying notes, which follow this section.

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

The Consolidated Statements of Revenues, Expenses and Changes in Net Position report all of SMUD's revenues and expenses for the periods shown.

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

Nature of Operations

Under provisions of California's Municipal Utility District Act, the citizens of Sacramento voted in 1923 to form their own electric utility – SMUD. The independently run community-owned utility began operations on December 31, 1946 and is not subject to regulation or oversight by the California Public Utilities Commission. It is now the sixth largest community-owned electric utility in the nation.

Governed by an elected board of directors (Board), SMUD has the rights and powers to fix rates and charges for commodities and services it furnishes, incur indebtedness, and issue bonds or other obligations. SMUD is responsible for the acquisition, generation, transmission and distribution of electric power to its service area with a population of approximately 1.5 million – most of Sacramento County and small adjoining portions of Placer and

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

For the Years Ended December 31, 2018 and 2017

Yolo Counties. Its purpose is to enhance the quality of life for its customers and community through creative energy solutions. The Board has independent authority to set SMUD's rates and charges. Changes in rates require a public hearing and formal action by the Board. In July 2015, the Board approved a 2.5 percent rate increase for both 2016 and 2017 to allow for additional investments in technology and infrastructure and declared its intent to make time-of-day (TOD) rates the default rate for residential customers in 2018. In July 2017, the Board approved a 1 percent rate increase in both 2018 and 2019 for commercial customers and a 1.5 percent rate increase in 2018 for residential customers and approved the TOD rate as the standard rate for residential customers in 2019. In 2018, SMUD began rolling out the transition to TOD rates, as well as changes to its Energy Assistance Program Rate (EAPR), which supports low-income customers. TOD rates better align with the cost of providing electricity, send more accurate price signals to customers, and give customers the opportunity to better manage their electricity bills by shifting usage to lower-cost time periods. Changes to EAPR help ensure SMUD provides the greatest support to customers most in need, to save energy and money through a combination of rate design, energy-efficiency investments, pilot programs and education. The 2018 Rate Action also changed the Economic development rate and Rule 16 fees, which will help spur regional economic development, support job creation, and provide incentives to businesses located in disadvantaged communities. Even with these increases, SMUD's rates continue to remain amongst the lowest in the state. In 2018, the average system rate was 33 percent below the average rate of the nearest investor owned utility.

SMUD's vision is to be the trusted partner with its customers and the community, providing innovative solutions to ensure energy affordability and reliability, improve the environment, reduce the region's carbon footprint, and enhance the vitality of the community. SMUD's business strategy focuses on serving its customers in a progressive, forward looking manner, addressing current regulatory and legislative issues and potential competitive forces. This includes ensuring financial stability by establishing rates that provide acceptable cash coverage of all fixed charges on a consolidated basis, taking into consideration the impact of capital expenditures and other factors on cash flow.

Financial & Operational Highlights

In 2018, SMUD updated its 5-Year Strategic plan to ensure work is aligned with fulfilling the Board's Strategic Directions and customers' expectations for safe, reliable, affordable and environmentally responsible energy, while adapting to a rapidly changing industry, technology advances and growing customer expectations. The Board adopted aggressive carbon reduction goals as part of the new Integrated Resource Plan. The plan sets a greenhouse gas (GHG) target of net zero by 2040, which SMUD will achieve through a commitment to procuring local renewable energy whenever feasible, and significant investment in electrification of the local building and transportation sectors. Together, these efforts are expected to reduce GHG emissions in the Sacramento region by 64%, delivering significant benefits to the community and regional economy. SMUD continued to maintain its strong bond ratings of AA by two of the three major rating agencies and has consistently exceeded the Board's policy for a minimum fixed charge coverage ratio of 1.50 times of annual budgets for the last ten years. In addition, approximately 30% of contract dollars were awarded to small, local businesses and \$15.0 million was deposited in local community banks as a participant in the new Responsible Investments for a Stronger Economy (RISE) program.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

For the Years Ended December 31, 2018 and 2017

SMUD received two industry awards for the EAPR restructure in 2018 and was also recognized by its residential customers as the top California utility by J.D. Power and was ranked second highest in the West region for commercial customers. SMUD received an industry community service award for several of its significant campaigns: SMUD Cares, 70 Years Bright, Shine Awards, and Powering Futures Scholarships. SMUD continued its partnership with Habitat for Humanity by completing rooftop repairs for solar installations, as well as installed solar kits on tiny homes. Building electrification programs resulted in a partnership with D.R. Horton to build more than 100 new all-electric homes. Its 28-year partnership with the Sacramento Tree Foundation resulted in an additional 10,000 trees planted in 2018. The Large Commercial SolarShares® program increased to about 150 MW, making it one of the largest programs of its kind in the nation. This program also received a 2018 Green California Summit Leadership award. Through its economic development program, SMUD played a key role in the attraction, retention and expansion of several companies in its service territory which led to the creation of over 2,700 jobs.

In July 2014, FERC issued a fifty year license for the Upper American River Project (UARP) which consists of three relatively large storage reservoirs and eight powerhouses containing eleven turbines. The UARP is one of SMUD's lowest cost power sources. In addition to providing clean hydroelectric power and operational flexibility, it provides habitat for fish and wildlife and a variety of recreational opportunities, including camping, fishing, boating, hiking, horseback riding, mountain biking, and cross-country skiing. The combined capacity of the UARP is approximately 673 MW and represents about 15 percent of SMUD's average annual retail energy requirements. SMUD's other power generation facilities include a 3 MW of solar photovoltaic installations, a 102 MW Solano Wind Project, and five local gas-fired power plants with total capacity of approximately 1,012 MW. Also, in April 2018, SMUD exercised its option to repurchase the Solano Wind Phase 3 plant consisting of 128 MW. In addition, SMUD has entered into several power purchase agreements to help meet its remaining power requirements.

As part of the hydro relicensing process, SMUD entered into long-term contracts to provide certain services to four different government agencies – U.S. Department of Interior Bureau of Land Management, U.S. Department of Agriculture Forest Service, El Dorado County, and the California Department of Parks and Recreation. At December 31, 2018 and 2017, the liability for these contract payments was \$58.8 million and \$57.8 million, respectively.

As of September 2018, SMUD's total reservoir storage in the UARP was about 67 percent of capacity, approximately 1% below the historical average for this date. SMUD manages its reservoirs to maximize water storage going into the summer season and thereby preserving generating capacity during SMUD's high load months. Although reservoir levels in the UARP are only slightly below historical averages, there remains the potential for wide swings in precipitation from year to year and dry conditions could return again in any year. In years with below average rainfall, SMUD may have to generate or purchase replacement energy at additional cost. A Hydro Rate Stabilization Fund (HRSF) was established to help absorb higher energy costs when hydroelectric production is down and to serve as a buffer against unexpected financial developments. In April 2018, \$1.7 million was transferred into the HRSF due to above average precipitation. The balance in the HRSF at December 31, 2018 and 2017 was \$64.1 million and \$62.4 million, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

For the Years Ended December 31, 2018 and 2017

SMUD also has a long-term agreement with the Western Area Power Administration (WAPA) to purchase power generated by the Central Valley Project, a series of federal hydroelectric facilities operated by the U.S. Bureau of Reclamation. SMUD uses a Rate Stabilization Fund (RSF) to offset any excess or deficits in WAPA energy deliveries. Due to deficits in deliveries by WAPA, \$4.9 million was transferred from the RSF in 2018 and excess deliveries in 2017 resulted in a \$12.3 million transfer to the RSF in 2017. At December 31, 2018 and 2017, the balance of the RSF was \$32.6 million and \$37.5 million, respectively.

Decommissioning

SMUD has made significant progress toward completing the Decommissioning Plan for its Rancho Seco nuclear facility, which was shut down in 1989. The plan consists of two phases that allow SMUD to terminate its possession-only license. Phase I of the decommissioning was completed at the end of 2008. Phase II consists of a storage period for the Class B and Class C radioactive waste overseen by the existing facility staff, followed by shipment of the waste for disposal, and then complete termination of the possession-only license. SMUD also established and funded an external decommissioning trust fund as part of its assurance to the Nuclear Regulatory Commission (NRC) to pay for the cost of decommissioning. Shipment of the previously stored Class B and Class C radioactive waste was completed in November 2014 to a low-level radioactive waste facility located in Andrews, Texas. The remaining Phase II decommissioning activities required for termination of the possession-only license commenced in 2015. In September 2017, SMUD formally requested the termination of the possession-only license and termination of the possession-only license was completed in 2018. The Accrued Decommissioning balance in the Consolidated Statements of Net Position includes \$156.5 million and \$149.8 million for costs related to Rancho Seco as of December 31, 2018 and 2017, respectively.

As part of the Decommissioning Plan, the nuclear fuel and Greater Than Class C (GTCC) radioactive waste is being stored in a dry storage facility constructed by SMUD and licensed separately by the NRC. The U.S. Department of Energy (DOE), under the Nuclear Waste Policy Act of 1982, was responsible for permanent disposal of used nuclear fuel and GTCC radioactive waste and SMUD contracted with the DOE for removal and disposal of that waste. The DOE has yet to fulfill its contractual obligation to provide a permanent waste disposal site. SMUD has filed a series of successful lawsuits against the federal government for recovery of the past spent fuel costs, with recoveries to date in excess of \$104.0 million. SMUD will continue to pursue cost recovery claims until the DOE fulfills its obligation.

Employee Relations and Benefits

Effective January 2018, SMUD began operating under a new four-year memorandum of understanding (MOU) with both of its collective bargaining units, the International Brotherhood of Electrical Workers Local Union 1245 and the Organization of SMUD Employees. Both contracts contain a no-strike/no-lockout clause effective during the life of the agreements.

SMUD participates in the California Public Employees' Retirement System (PERS), an agent multiple-employer public employee defined benefit pension plan. In 2015, SMUD implemented GASB Statement of Governmental

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

For the Years Ended December 31, 2018 and 2017

Accounting Standards (SGAS) No. 68, *“Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27,”* and in 2017, SGAS No. 73, *“Accounting and Financial Reporting for Pensions and Related Assets that are not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68”*. The primary objective of these standards is to improve accounting and financial reporting by state and local governments for pensions. SMUD is required to report the Net Pension Liability (NPL), which is the difference between the actuarial present value of projected pension benefit payments attributable to employees' past service and the pension plan's fiduciary net position, in its Consolidated Statements of Net Position. At December 31, 2018 and 2017, the NPL was \$454.0 million and \$565.8 million, respectively. SMUD elected to follow accounting for regulated operations under GASB SGAS No. 62, *“Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,”* (GASB No. 62) and recorded a regulatory asset as of December 31, 2014, in the amount of \$425.7 million to account for the net effect of required prior period adjustments to recognize the NPL. Amortization of the regulatory asset began in 2018 over a period of 25 years.

SMUD provides postemployment healthcare benefits (OPEB) to all employees who retire from SMUD and their dependents, in accordance with SMUD policy and MOUs. These benefits are funded through the PERS California Employer's Retiree Benefit Trust, an agent multiple-employer plan. In 2018, SMUD implemented SGAS No. 75 *“Accounting and Financial Reporting for Postemployment Benefits Other than Pensions”* (GASB No. 75). The primary objective of GASB No. 75 is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions. SMUD is required to report the Net OPEB Liability (NOL), which is the difference between the actuarial present value of projected OPEB benefit payments attributable to employee's past service and the OPEB plan's fiduciary net position, in its Consolidated Statements of Net Position. At December 31, 2018 and 2017, the NOL was \$22.1 million and \$100.9 million, respectively. SMUD elected to follow accounting for regulated operations under GASB No. 62 and recorded a regulatory asset as of December 31, 2017, in the amount of \$319.3 million to account for the net effect of required prior period adjustments to recognize the NOL. Amortization of the regulatory asset will begin in 2020 over a period of 25 years.

Developments in the Energy Market

New developments in the energy market at both the federal and state level kept SMUD on high alert as it continued to monitor and address the potential impacts on the organization. Legislation at the federal level include policies on cyber security, regulations related to transmission access, the North American Electric Reliability Corporation reliability standards, anti-market manipulation rules, and greenhouse gas emissions. Legislation at the state level includes bills that provide for GHG standards and greater investment in energy efficiency, mandate rooftop solar, renewable portfolio standards, and ongoing regulatory proceedings related to Sacramento - San Joaquin River Bay - Delta processes.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

For the Years Ended December 31, 2018 and 2017

Significant Accounting Policies

In accordance with GASB No. 62, the Board has taken regulatory actions for ratemaking that result in the deferral of expense and revenue recognition. These actions result in regulatory assets and liabilities. SMUD has regulatory assets that cover costs related to decommissioning, derivative financial instruments, debt issuance costs, pension costs, and OPEB costs. As of December 31, 2018 and 2017, total regulatory assets were \$886.3 million and \$893.5 million, respectively. SMUD also has regulatory credits that cover costs related to contributions in aid of construction, the RSF and HRSF, EAPR reserves, SB-1, grant revenues, and Transmission Agency of Northern California operations costs. As of December 31, 2018 and 2017, total regulatory credits were \$442.7 million and \$445.7 million, respectively.

FINANCIAL POSITION

Condensed Consolidated Statements of Net Position	December 31,		
	2018	2017 (Restated)	2016
	(millions of dollars)		
Assets			
Electric Utility Plant - net	\$ 3,517	\$ 3,354	\$ 3,345
Restricted and Designated Assets	120	121	57
Current Assets	954	1,200	1,084
Noncurrent Assets	1,697	1,205	1,188
Total Assets	6,288	5,880	5,674
Deferred Outflows of Resources	227	291	279
Total Assets and Deferred Outflows of Resources	\$ 6,515	\$ 6,171	\$ 5,953
Liabilities			
Long-Term Debt - net	\$ 2,639	\$ 2,342	\$ 2,504
Current Liabilities	768	607	630
Noncurrent Liabilities	803	996	840
Total Liabilities	4,210	3,945	3,974
Deferred Inflows of Resources	584	714	645
Net Position			
Net Investment in Capital Assets	1,276	1,011	816
Restricted	87	59	77
Unrestricted	358	442	441
Total Net Position	1,721	1,512	1,334
Total Liabilities, Deferred Inflows of Resources, and Net Position	\$ 6,515	\$ 6,171	\$ 5,953

MANAGEMENT’S DISCUSSION AND ANALYSIS (Unaudited)

For the Years Ended December 31, 2018 and 2017

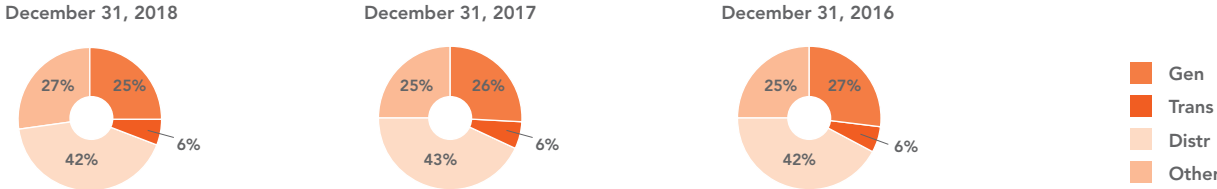
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

Electric Utility Plant - net

2018 compared to 2017 As of December 31, 2018, SMUD has invested approximately \$3,517.0 million in electric utility plant assets and construction work in progress (CWIP) net of accumulated depreciation. Electric Utility Plant - net makes up about 54 percent of SMUD’s Total Assets and Deferred Outflows of Resources, which is unchanged compared to 2017. In 2018, SMUD capitalized approximately \$237.7 million of additions to electric utility plant in the Consolidated Statements of Net Position. The additions were primarily due to distribution line work, major overhauls in the Joint Power Authorities (JPAs), investments in software and hardware and purchases related to the replacement of bulk substations. These additions were offset by the retirement of communication equipment, distribution assets, fleet equipment, software and hardware equipment, and JPA assets.

2017 compared to 2016 As of December 31, 2017, SMUD has invested approximately \$3,354.0 million in electric utility plant assets and construction work in progress (CWIP) net of accumulated depreciation. Electric Utility Plant - net makes up about 55 percent of SMUD’s Total Assets and Deferred Outflows of Resources, which is similar to 2016. In 2017, SMUD capitalized approximately \$147.2 million of additions to electric utility plant in the Consolidated Statements of Net Position. The additions were primarily due to distribution line work, major overhauls in the Joint Power Authorities (JPAs), investments in software and hardware and purchases related to the replacement of bulk substations. These additions were offset by the retirement of communication equipment, distribution assets, and software and hardware equipment.

The following charts show the breakdown of Electric Utility Plant - net by major plant category – Generation (Gen), Transmission (Trans), Distribution (Distr), and Other:



Restricted and Designated Assets

2018 compared to 2017 SMUD’s restricted and designated assets are comprised of debt service reserves, nuclear decommissioning trust funds, rate stabilization fund, and other third party agreements or Board actions, less the current portion. These assets decreased \$1.0 million during 2018. The decrease was due to an increase of \$31.5 million in the current portion, offset by an increase of \$30.2 million in revenue bond, debt service and construction reserves.

2017 compared to 2016 SMUD’s restricted and designated assets are comprised of debt service reserves, nuclear decommissioning trust funds, rate stabilization fund, and other third party agreements or Board actions, less the current portion. These assets increased \$64.4 million during 2017. The increase was due to a net transfer of \$64.7 million to the RSF (including the HRSF) as a result of higher precipitation and higher energy deliveries from WAPA, and a decrease of \$22.0 million in current portion, offset by a decrease of \$22.2 million in the revenue bond and debt service reserves.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

For the Years Ended December 31, 2018 and 2017

Current Assets

2018 compared to 2017 Total current assets decreased \$245.4 million in 2018. Restricted and designated cash and cash equivalents decreased \$157.8 million. Prepayments and other decreased by \$129.0 million mainly due to the repurchase of the Solano Wind Phase 3 plant in April 2018. These decreases were offset by a total increase of restricted and designated investments, wholesale and other receivables, inventories, and prepaid gas of \$62.0 million.

2017 compared to 2016 Total current assets increased \$115.6 million in 2017. Prepayments and other increased by \$123.0 million. SMUD submitted its notice of intent to exercise the option to buy back the Solano Wind Phase 3 plant and recorded the prepayment for purchased power as current. Unrestricted cash and cash equivalents and regulatory costs to be recovered within one year increased \$27.0 million. These increases were offset by a total decrease of restricted and designated cash and cash equivalents and restricted and designated investments of \$35.1 million.

Noncurrent Assets

2018 compared to 2017 Total noncurrent assets increased \$492.5 million. Prepaid gas increased by \$498.8 million mainly due to a new prepaid gas contract. This increase was offset by decreases in regulatory costs for future recovery and hedging derivative instruments of \$15.1 million.

2017 compared to 2016 Total noncurrent assets increased \$16.4 million. Regulatory costs for future recovery increased by \$306.6 million mainly due to the recording of the regulatory asset related to implementation of GASB No. 75 in the amount of \$319.3 million. Prepaid power and capacity decreased by \$128.6 million partially due to the prepayment for purchased power for Solano recorded as current (see Current Assets). Prepayments and other decreased by \$126.4 million mainly due to the removal of the OPEB asset due to implementation of GASB No. 75. In addition, prepaid gas and hedging derivative instruments decreased by \$36.6 million.

Deferred Outflows of Resources

2018 compared to 2017 Total deferred outflows of resources decreased by \$64.1 million due to a decrease in deferred pension outflows of \$40.0 million and a decrease in the value of hedging derivative instruments and amortization of bond losses of \$27.4 million.

2017 compared to 2016 Total deferred outflows of resources increased \$12.0 million due to an increase of \$26.8 million in deferred pension outflows and the recording of \$11.9 million in deferred OPEB outflows as a result of implementation of GASB No. 75, offset by a \$26.7 million decrease in the value of hedging derivative instruments and amortization of bond losses.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

For the Years Ended December 31, 2018 and 2017

LIABILITIES AND DEFERRED INFLOWS OF RESOURCES

Long-Term Debt - net

2018 compared to 2017 In July 2018, SMUD issued \$165.5 million of 2018 Series F Revenue Refunding Bonds. The purpose of this transaction was to refund the fixed rate debt associated with 2008 Series U bonds. Proceeds from the 2018 Series F bonds, in addition to \$7.5 million of proceeds from terminating the Wells Fargo and Bank of America variable-to-fixed interest rate swaps and \$5.0 million from funds on hand defeased all the outstanding Series 2008 U bonds, totaling \$204.2 million. Bonds were defeased through a legal defeasance, and accordingly, the liability for the defeased bonds has been removed from Long-Term Debt - net in the Consolidated Statements of Net Position. The refunding resulted in the recognition of a deferred accounting gain of \$0.2 million, which is being amortized over the life of the refunding issue. The termination payments of the interest rate swaps are being amortized over the life of the refunding issue. The 2018 refunding reduced future aggregate debt service payments by \$42.6 million and resulted in a total economic gain of \$39.1 million, which is the difference between the present value of the old and new debt service payments.

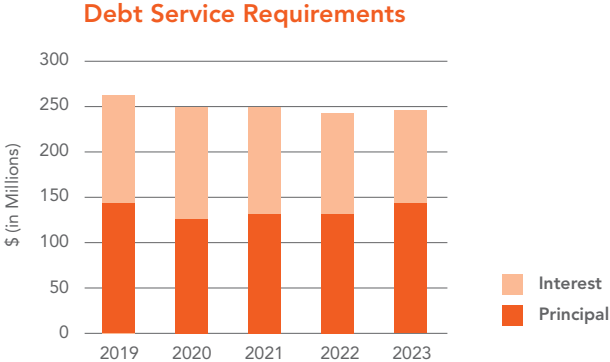
NCEA issued \$539.6 million of 2018 Commodity Supply Revenue Bonds in December 2018 maturing in June 2049, with mandatory tender purchase in June 2024. The 2018 Commodity Supply Revenue Bonds have fixed interest rates of 4.0 percent to 5.0 percent. The proceeds of the offering were used to finance the prepayment of a thirty-year commodity contract. NCEA is obligated to pay the debt service on the bonds. SMUD's obligation is limited to the purchase and payment for the commodity tendered for delivery by NCEA.

2017 compared to 2016 In December 2017, SMUD issued \$202.5 million of 2017 Series E Electric Revenue Refunding Bonds. The purpose of this transaction was to refund variable rate debt with fixed rate debt to reduce the risk of increased interest rates. Proceeds from the 2017 Series Bonds, in addition to \$13.0 million of funds on hand, were used to defease \$26.1 million of a portion of the Series 2016 N bonds, \$26.1 million of a portion of the Series 2016 O bonds, \$120.0 million of all of the outstanding 2016 Series P bonds, and \$77.9 million of all of the outstanding Series 2016 Q bonds. A total of \$250.1 million bonds were defeased through a legal defeasance, and accordingly, the liability for the defeased bonds has been removed from long-term debt - net in the Consolidated Statements of Net Position. The refunding resulted in the recognition of a deferred accounting loss of \$5.5 million, which is being amortized over the life of the refunding issue. Based on an assumed LIBOR rate of 1.7 percent for the life of the debt, the 2017 refunding increased future aggregate debt service payments by \$0.6 million and resulted in a total economic loss of \$1.4 million, which is the difference between the present value of the old and new debt service payments.

MANAGEMENT’S DISCUSSION AND ANALYSIS (Unaudited)

For the Years Ended December 31, 2018 and 2017

The following table shows SMUD’s future debt service requirements through 2023 as of December 31, 2018:



As of December 31, 2018, SMUD’s bonds had an underlying rating of “AA” from Standard & Poor’s, “AA” from Fitch, and “Aa3” from Moody’s. Some of SMUD’s bonds are insured and are rated by the rating agencies at the higher of the insurer’s rating or SMUD’s underlying rating.

Current Liabilities

2018 compared to 2017 Total current liabilities increased \$160.7 million during 2018. The increase was mainly due to increases in commercial paper, accounts and purchased power payables, and long-term debt due within one year of \$171.0 million, offset by a decrease in customer deposits of \$17.2 million.

2017 compared to 2016 Total current liabilities decreased \$22.4 million during 2017. The decrease was mainly due to decreases in long-term debt due within one year, interest payable and investment and hedging derivative instruments maturing within one year of \$35.2 million, offset by an increase in accounts payable of \$11.2 million.

Noncurrent Liabilities

2018 compared to 2017 Total noncurrent liabilities decreased \$191.8 million during 2018. The decrease was mainly due to a \$111.8 million decrease in the net pension liability and a \$78.8 million decrease in the net OPEB liability.

2017 compared to 2016 Total noncurrent liabilities increased \$154.9 million during 2017. The increase was mainly due to the recording of the net OPEB liability of \$100.9 million as a result of implementing GASB No. 75 and a \$66.6 million increase in the net pension liability, offset by a total decrease of \$16.5 million in investment and hedging derivative instruments.

Deferred Inflows of Resources

2018 compared to 2017 Total deferred inflows of resources decreased \$130.2 million. Financing obligation and other decreased by \$201.3 million mainly due to the repurchase of the Solano Wind Phase 3 plant. This decrease was offset by an increase in deferred OPEB inflows of \$50.4 million and deferred pension inflows of \$29.8 million.

2017 compared to 2016 Total deferred inflows of resources increased \$69.8 million. Regulatory credits increased \$75.4 million due to a total of \$64.7 million transfer to the rate stabilization funds as a result of higher precipitation and higher energy deliveries from WAPA and a \$10.1 increase of SB-1. This increase was offset by a reduction of \$10.9 million for Solano Wind Phase 3 plant.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

For the Years Ended December 31, 2018 and 2017

RESULTS OF OPERATIONS**Condensed Consolidated Statements of Revenues, Expenses and Changes in Net Position**

	2017	December 31, 2017 (Restated)	2016
		(millions of dollars)	
Operating revenues	\$ 1,595	\$ 1,559	\$ 1,495
Operating expenses	(1,353)	(1,343)	(1,240)
Operating income	242	216	255
Other revenues	57	59	43
Interest charges	(90)	(97)	(103)
Change in net position	209	178	195
Net position - beginning of year	1,512	1,334	1,139
Net position - end of year	<u>\$ 1,721</u>	<u>\$ 1,512</u>	<u>\$ 1,334</u>

Operating Revenues

2018 compared to 2017 Total operating revenues increased \$36.1 million in 2018. Rate stabilization transfers increased by \$67.9 million. In 2018, SMUD transferred \$4.9 million from the RSF, while \$1.7 million was transferred to the HRSF. In 2017, \$52.4 million was transferred to the HRSF and \$12.3 million was transferred to the RSF.

Wholesale revenues are comprised of both surplus gas and energy sales which are part of the operational strategy in managing fuel and energy costs. In 2018, surplus gas sales were higher than 2017 by \$8.4 million due to higher gas prices and an increase in the volume of gas sold. Energy sales were slightly lower in 2018 by \$0.2 million as compared to 2017 due to higher prices and lower energy sales.

Senate Bill - 1 and public good deferral revenue increased by \$16.4 million due to funds being spent on solar initiatives and energy efficiency programs for EAPR customers.

These increases to operating revenues were offset by a decrease in retail sales of \$63.1 million due to lower demand.

2017 compared to 2016 Total operating revenues increased \$64.5 million in 2017. An increase of \$69.3 million from retail sales includes the 2.5 percent rate increase that went into effect January 1, 2017. As of December 31, 2017, the number of customers increased to 628,952 at a slightly higher average revenue per kilowatt hour as compared to the end of 2016.

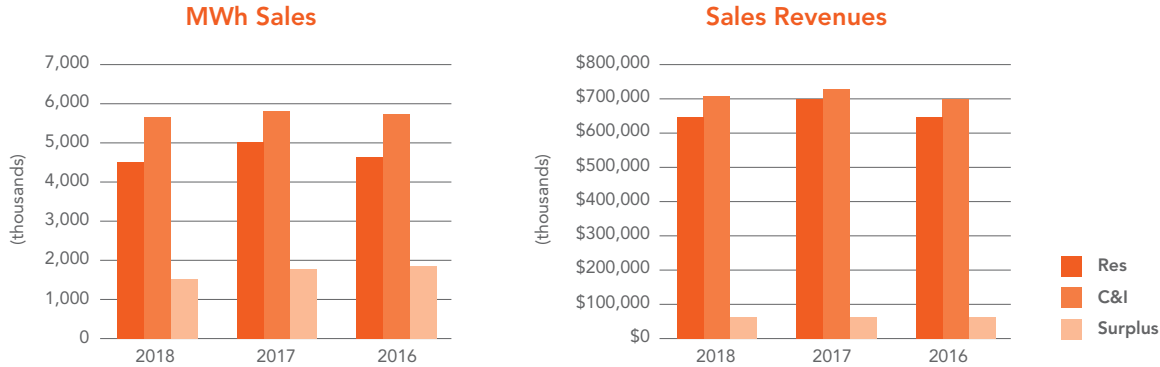
In 2017, SMUD transferred \$52.4 million to the HRSF and \$12.3 million to the RSF. In 2016, \$10.0 million was transferred to the HRSF, while \$5.1 million was transferred from the RSF.

Wholesale revenues are comprised of both surplus gas and energy sales which are part of the operational strategy in managing fuel and energy costs. In 2017, surplus gas sales were higher than 2016 by \$59.0 million due to higher gas prices and an increase in the volume of gas sold. Energy sales were lower in 2017 by \$2.6 million as compared to 2016 due to lower prices and lower energy sales.

MANAGEMENT’S DISCUSSION AND ANALYSIS (Unaudited)

For the Years Ended December 31, 2018 and 2017

The following charts show the megawatt hour (MWh) sales, and sales revenue for the past three years by surplus energy sales (Surplus), commercial and industrial (C&I) and residential (Res) customers:

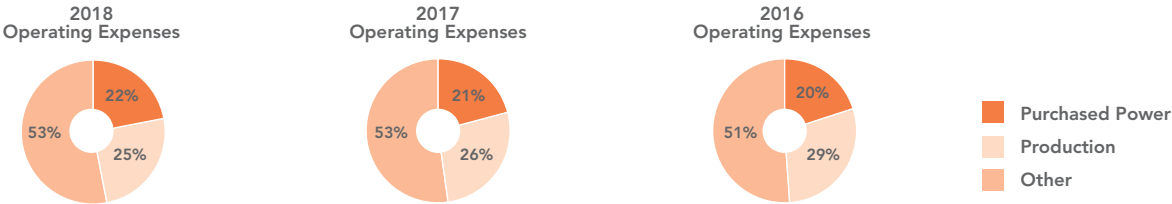


Operating Expenses

2018 compared to 2017 Total operating expenses increased \$10.6 million compared to 2017. Regulatory deferrals collected in rates increased by \$10.6 million mainly due to the amortization of the regulatory asset for pension costs related to implementation of GASB No. 68.

2017 compared to 2016 Total operating expenses increased \$103.0 million compared to 2016. Administrative, general and customer increased \$47.0 million. Operations which includes purchased power, production, transmission and distribution, and depletion, increased by \$35.3 million mainly due to higher purchased power volumes. Maintenance increased by \$15.8 million.

The following charts show the breakdown of operating expenses:



Other Revenues

2018 compared to 2017 Total other revenues were \$1.2 million lower in 2018. In 2018, an arbitration award was paid in the amount of \$17.8 million, whereas in 2017, \$27.1 million was received from the Rancho Seco judgement. Other revenue included a gain of \$46.7 million from the repurchase of the Solano Wind Phase 3 plant. In addition, net fee-based expense increased by \$8.2 million, offset by lower investment expense of \$8.0 million.

2017 compared to 2016 Total other revenues were \$15.5 million higher in 2017, which was partially attributable to the difference of \$9.2 million received for the judgment for Rancho Seco nuclear waste disposal litigation in 2017 and the PG&E refund received in 2016, and \$6.7 million of higher interest and lower ineffective gas and interest rate swaps.

CONSOLIDATED STATEMENTS OF NET POSITION

Assets	December 31,	
	2018	2017 (Restated)
	(thousands of dollars)	
Electric Utility Plant		
Plant in service	\$ 6,029,451	\$ 5,914,377
Less accumulated depreciation and depletion	<u>(2,941,127)</u>	<u>(2,841,294)</u>
Plant in service - net	3,088,324	3,073,083
Construction work in progress	<u>428,249</u>	<u>280,692</u>
Total electric utility plant - net	<u>3,516,573</u>	<u>3,353,775</u>
Restricted and Designated Assets		
Revenue bond and debt service reserves	123,509	93,322
Nuclear decommissioning trust fund	8,566	8,411
Rate stabilization fund	96,694	99,899
Other funds	13,533	10,235
Less current portion	<u>(122,210)</u>	<u>(90,757)</u>
Total restricted and designated assets	<u>120,092</u>	<u>121,110</u>
Current Assets		
Unrestricted cash and cash equivalents	211,252	227,657
Unrestricted investments	267,027	424,759
Restricted and designated cash and cash equivalents	38,003	38,262
Restricted and designated investments	84,207	52,495
Receivables - net:		
Retail customers	157,436	162,192
Wholesale and other	48,368	37,346
Regulatory costs to be recovered within one year	19,240	20,178
Investment derivative instruments maturing within one year	20	1
Hedging derivative instruments maturing within one year	4,524	2,868
Inventories	68,969	58,135
Prepaid gas to be delivered within one year	43,062	34,587
Prepayments and other	<u>12,762</u>	<u>141,759</u>
Total current assets	<u>954,870</u>	<u>1,200,239</u>
Noncurrent Assets		
Regulatory costs for future recovery	886,276	893,526
Prepaid gas	721,186	222,348
Prepaid power and capacity	1,003	1,211
Hedging derivative instruments	10,480	18,359
Energy efficiency loans - net	23,867	21,817
Credit support collateral deposits	5,900	1,500
Due from affiliated entity	25,311	22,406
Prepayments and other	<u>22,856</u>	<u>23,254</u>
Total noncurrent assets	<u>1,696,879</u>	<u>1,204,421</u>
Total Assets	<u>6,288,414</u>	<u>5,879,545</u>
Deferred Outflows of Resources		
Accumulated decrease in fair value of hedging derivatives	85,769	105,645
Deferred pension outflows	103,031	143,034
Deferred other postemployment benefits outflows	15,330	11,937
Unamortized bond losses	<u>22,997</u>	<u>30,584</u>
Total Deferred Outflows of Resources	<u>227,127</u>	<u>291,200</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 6,515,541</u>	<u>\$ 6,170,745</u>

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

CONSOLIDATED STATEMENTS OF NET POSITION

Liabilities	December 31,	
	2018	2017 (Restated)
	(thousands of dollars)	
Long-Term Debt - net	<u>\$ 2,638,732</u>	<u>\$ 2,341,775</u>
Current Liabilities		
Commercial paper notes	288,750	200,000
Accounts payable	146,803	83,991
Purchased power payable	27,408	19,968
Credit support collateral obligation	2,488	3,364
Long-term debt due within one year	144,885	132,440
Accrued decommissioning	5,562	5,775
Interest payable	35,803	33,147
Accrued salaries and compensated absences	42,960	38,551
Investment derivative instruments maturing within one year	1,743	2,833
Hedging derivative instruments maturing within one year	29,085	27,500
Customer deposits and other	42,517	59,710
Total current liabilities	<u>768,004</u>	<u>607,279</u>
Noncurrent Liabilities		
Net pension liability	454,044	565,800
Net other postemployment benefits liability	22,066	100,866
Accrued decommissioning	164,276	156,431
Investment derivative instruments	15,328	11,697
Hedging derivative instruments	56,684	78,145
Self insurance and other	91,292	82,543
Total noncurrent liabilities	<u>803,690</u>	<u>995,482</u>
Total Liabilities	<u>4,210,426</u>	<u>3,944,536</u>
Deferred Inflows of Resources		
Accumulated increase in fair value of hedging derivatives	15,004	21,227
Regulatory credits	442,718	445,657
Deferred pension inflows	62,766	32,921
Deferred other postemployment benefits inflows	55,024	4,632
Financing obligation and other	8,649	209,956
Total Deferred Inflows of Resources	<u>584,161</u>	<u>714,393</u>
Net Position		
Net investment in capital assets	1,275,517	1,011,029
Restricted:		
Revenue bond and debt service	76,193	51,833
Other funds	11,155	7,031
Unrestricted	358,089	441,923
Total Net Position	<u>1,720,954</u>	<u>1,511,816</u>
Commitments, Claims and Contingencies (Notes 17 and 18)		
Total Liabilities, Deferred Inflows of Resources, and Net Position	<u>\$ 6,515,541</u>	<u>\$ 6,170,745</u>

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

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	Year Ended December 31,	
	2018	2017 (Restated)
	(thousands of dollars)	
Operating Revenues		
Residential	\$ 642,789	\$ 689,806
Commercial and industrial	711,484	727,574
Street lighting and other	49,081	44,189
Wholesale	152,793	144,538
Senate Bill - 1 revenue deferral	2,754	(10,124)
AB-32 revenue	29,810	28,097
Public good deferral	3,540	-0-
Rate stabilization fund transfers	3,204	(64,744)
Total operating revenues	<u>1,595,455</u>	<u>1,559,336</u>
Operating Expenses		
Operations:		
Purchased power	294,116	283,693
Production	333,504	346,523
Transmission and distribution	83,326	78,922
Administrative, general and customer	237,511	238,608
Public good	55,269	59,081
Maintenance	122,787	120,759
Depreciation	196,920	194,925
Depletion	7,041	8,001
Regulatory amounts collected in rates	22,894	12,253
Total operating expenses	<u>1,353,368</u>	<u>1,342,765</u>
Operating Income	<u>242,087</u>	<u>216,571</u>
Non-Operating Revenues and Expenses		
Other revenues and (expenses):		
Interest income	14,945	11,848
Investment expense	(1,542)	(9,589)
Other income - net	43,926	56,314
Total other revenues and (expenses)	<u>57,329</u>	<u>58,573</u>
Interest charges:		
Interest on debt	94,902	100,485
Allowance for funds used during construction	(4,624)	(3,234)
Total interest charges	<u>90,278</u>	<u>97,251</u>
Total non-operating revenues and (expenses)	<u>(32,949)</u>	<u>(38,678)</u>
Change in Net Position	209,138	177,893
Net Position - Beginning of Year	<u>1,511,816</u>	<u>1,333,923</u>
Net Position - End of Year	<u>\$ 1,720,954</u>	<u>\$ 1,511,816</u>

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,	
	2018	2017
	(thousands of dollars)	
Cash Flows From Operating Activities		
Receipts from customers	\$ 1,403,217	\$ 1,458,707
Receipts from surplus power sales	59,732	60,592
Receipts from surplus gas sales	86,157	83,571
Receipts from steam sales	4,317	5,109
Other receipts	29,104	60,081
Payments for credit support collateral	(5,276)	(573)
(Issuance) repayment of energy efficiency loans to customers - net	(1,980)	2,659
Payments to employees - payroll and other	(358,591)	(287,607)
Payments for wholesale power	(286,577)	(284,960)
Payments for gas purchases	(155,087)	(194,675)
Payments to vendors/others	(369,049)	(372,033)
Payments for decommissioning	(5,448)	(7,055)
Net cash provided by operating activities	<u>400,519</u>	<u>523,816</u>
Cash Flows From Noncapital Financing Activities		
Proceeds from bond issuance, net of premium	567,063	-0-
Repayment of debt	(31,305)	(28,395)
Prepaid gas supply expenditures	(541,900)	-0-
Receipts from federal and state grants	16,714	9,832
Interest on debt	(10,953)	(12,143)
Net cash used in noncapital financing activities	<u>(381)</u>	<u>(30,706)</u>
Cash Flows From Capital and Related Financing Activities		
Construction expenditures	(341,047)	(217,042)
Proceeds from land sales	113	-0-
Contributions in aid of construction	16,927	13,183
Net proceeds from bond issues	199,285	237,082
Repayments and refundings of debt	(421,434)	(382,290)
Issuance of commercial paper	88,750	-0-
Interest on debt	(99,795)	(100,821)
Net cash used in capital and related financing activities	<u>(557,201)</u>	<u>(449,888)</u>
Cash Flows From Investing Activities		
Sales and maturities of securities	263,745	316,145
Purchases of securities	(141,413)	(347,049)
Interest and dividends received	15,107	11,204
Investment revenue/expenses - net	(1,560)	(9,607)
Net cash provided by (used in) investing activities	<u>135,879</u>	<u>(29,307)</u>
Net increase (decrease) in cash and cash equivalents	(21,184)	13,915
Cash and cash equivalents at the beginning of the year	<u>276,687</u>	<u>262,772</u>
Cash and cash equivalents at the end of the year	<u>\$ 255,503</u>	<u>\$ 276,687</u>
Cash and cash equivalents included in:		
Unrestricted cash and cash equivalents	\$ 211,252	\$ 227,657
Restricted and designated cash and cash equivalents	38,003	38,262
Restricted and designated assets (a component of the total of \$120,092 and \$121,110 at December 31, 2018 and 2017, respectively)	6,248	10,768
Cash and cash equivalents at the end of the year	<u>\$ 255,503</u>	<u>\$ 276,687</u>

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

A reconciliation of the consolidated statements of cash flows operating activities to operating income as follows:

	Year Ended December 31,	
	2018	2017 (Restated)
	(thousands of dollars)	
Operating income	\$ 242,087	\$ 216,571
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	196,920	194,925
Depletion	7,041	8,001
Regulatory amortization	22,894	12,253
Amortization of advance capacity and other	2,446	(1,427)
Amortization of prepaid gas supply	34,587	30,909
Revenue (recognized from) deferred to regulatory credits - net	(9,498)	74,868
Other (receipts) payments - net	(20,014)	31,346
Changes in operating assets, deferred outflows, liabilities and deferred inflows:		
Receivables - retail customers, wholesale and other	(11,838)	6,099
Regulatory costs for future recovery	-0-	(319,329)
Inventories, prepayments and other	(10,964)	125,881
Credit support collateral deposits	(4,400)	-0-
Deferred pension outflows	40,003	(26,781)
Deferred other postemployment benefits outflows	(3,393)	(11,937)
Payables and accruals	31,291	10,261
Credit support collateral obligation	(876)	(573)
Decommissioning	(5,448)	(7,055)
Net pension liability	(111,756)	66,572
Net other postemployment benefits liability	(78,800)	100,866
Deferred pension inflows	29,845	7,734
Deferred other postemployment benefits inflows	50,392	4,632
Net cash provided by operating activities	<u>\$ 400,519</u>	<u>\$ 523,816</u>

The supplemental disclosure of noncash financing and investing activities is as follows:

	Year Ended December 31,	
	2018	2017
	(thousands of dollars)	
Amortization of debt related (expenses) and premiums - net	\$ 18,602	\$ 9,813
Gain on debt extinguishment and refundings	236	-0-
Unrealized holding loss	(186)	(2,033)
Change in valuation of derivative financial instruments	11,131	13,245
Amortization of revenue for assets contributed in aid of construction	16,531	19,437
Allowance for funds used during construction	4,624	3,234
Construction expenditures included in accounts payable	69,639	22,199
Gain on repurchase of Solano Wind Phase 3 plant	46,712	-0-
Losses on retirements - net	(15,817)	-0-
Write-off inventory	(552)	-0-

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

NOTE 1. ORGANIZATION

The Sacramento Municipal Utility District (SMUD) was formed and operates under the State of California Municipal Utility District Act (Act). The Act gives SMUD the rights and powers to fix rates and charges for commodities or services it furnishes, and to incur indebtedness and issue bonds or other obligations. As a community-owned utility, SMUD is not subject to regulation or oversight by the California Public Utilities Commission.

SMUD is responsible for the acquisition, generation, transmission, and distribution of electric power to its service area, which includes most of Sacramento County and small adjoining portions of Placer and Yolo Counties. The Board of Directors (Board) determines SMUD's rates.

SMUD is exempt from payment of federal and state income taxes and, under most circumstances, real and personal property taxes. SMUD is not exempt from real and personal property taxes on assets it holds outside of its service territory. In addition, SMUD is responsible for the payment of a portion of the property taxes associated with its real property in California that lies outside of its service area.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting. SMUD's accounting records are maintained in accordance with Generally Accepted Accounting Principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB). SMUD's accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission (FERC), except as it relates to the accounting for contributions of utility property in aid of construction. SMUD's Consolidated 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 the related cash flows. Electric revenues and costs that are directly related to the acquisition, generation, transmission, and distribution of electricity 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 and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Financial Reporting Entity. These Consolidated Financial Statements include SMUD and its component units. Although the component units are legally separate from SMUD, they are blended into and reported as part of SMUD because of the extent of their operational and financial relationships with SMUD. All significant inter-component transactions have been eliminated in consolidation.

Component Units. The component units include the Central Valley Financing Authority (CVFA), the Sacramento Cogeneration Authority (SCA), the Sacramento Municipal Utility District Financing Authority (SFA), the Sacramento Power Authority (SPA), the Northern California Gas Authority No. 1 (NCGA), and the Northern California Energy Authority (NCEA). The primary purpose of CVFA, SCA, SFA and SPA is to own and operate electric utility plants that supply power to SMUD. The primary purpose of NCGA is to prepay for natural gas to sell the natural gas to SMUD. The primary purpose of NCEA is to prepay for commodities in the form of natural gas and electricity and to sell the commodities to SMUD. SMUD's Board comprises the Commissions that govern these entities (see Note 6).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Plant in Service. Capital assets are generally defined by SMUD as tangible assets with an initial, individual cost of more than three thousand dollars and an estimated useful life in excess of two years. The cost of additions to Plant in Service and replacement property units is capitalized. Repair and maintenance costs are charged to expense when incurred. When SMUD retires portions of its Utility Plant, retirements are recorded against Accumulated Depreciation and the retired portion of Utility Plant is removed from Plant in Service. The costs of removal and the related salvage value, if any, are charged or credited as appropriate to Accumulated Depreciation. SMUD generally computes depreciation on Plant in Service on a straight-line, service-life basis. The consolidated average annual composite depreciation rates for 2018 and 2017 were 3.4 percent and 3.5 percent, respectively. Depreciation is calculated using the following estimated lives:

Generation	5 to 80 years
Transmission and Distribution	7 to 50 years
Gas Pipeline	15 to 90 years
General	5 to 90 years

Investment in Joint Powers Authority (JPA). SMUD’s investment in the Transmission Agency of Northern California (TANC) is accounted for under the equity method of accounting and is reported as a component of Plant in Service. SMUD’s share of the TANC debt service costs and operations and maintenance expense, inclusive of depreciation, is included in Transmission and Distribution expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Position (see Note 5).

SMUD’s investment in the Balancing Authority of Northern California (BANC) is accounted for under the equity method of accounting. SMUD’s share of the BANC operations and maintenance expense is included in Transmission and Distribution expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Position (see Note 5).

Investment in Gas Properties. SMUD has an approximate 21 percent non-operating ownership interest in the Rosa Unit gas properties in New Mexico of which, SMUD’s portion of the extracted gas is transported for use in its component unit natural gas-fired power plants (see Note 6). SMUD uses the successful efforts method of accounting for its investment in gas producing properties. Costs to acquire mineral interests in gas properties, to drill and equip exploratory wells that find proved reserves, and to drill and equip development wells are capitalized as a component of Plant in Service in the Consolidated Statements of Net Position. Costs to drill exploratory wells that do not find proved reserves, geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed. SMUD has purchased proven reserves and has not participated in exploratory drilling. Capitalized costs of producing gas properties, after considering estimated residual salvage values, are depleted by the unit-of-production method based on the estimated future production of the proved developed producing wells. SMUD’s investment in gas properties is reported as a component of Plant in Service.

Restricted and Designated Assets. Cash, cash equivalents, and investments, which are restricted by regulation or under terms of certain agreements for payments to third parties are included as restricted assets. Restricted assets include Revenue bond and debt service reserves, Nuclear decommissioning trust fund, and \$12.9 million and \$9.6 million of Other funds as of December 31, 2018 and 2017, respectively. Board actions limiting the use of such funds are included as designated assets. Designated assets include the Rate stabilization fund and \$0.6 million of Other funds as of December 31, 2018 and 2017. When SMUD restricts or designates funds for a specific purpose, and restricted and designated and unrestricted resources are available for use, it is SMUD’s policy to use restricted and designated resources first, then unrestricted resources as they are needed.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Restricted Bond Funds. SMUD's Indenture Agreements (Indenture) requires the maintenance of minimum levels of reserves for debt service on the 1997 Series K Bonds.

Nuclear Decommissioning Trust Fund. SMUD made annual contributions to its Nuclear Decommissioning Trust Fund (Trust Fund) through 2008 to cover the cost of its primary decommissioning activities associated with the Rancho Seco facility. Primary decommissioning excludes activities associated with the spent fuel storage facility after 2008 and most non-radiological decommissioning tasks. Interest earnings on the Trust Fund assets are recorded as Interest Income and are accumulated in the Trust Fund.

Accrued Decommissioning. SMUD accrues decommissioning costs related to Utility Plant when an obligation to decommission facilities is legally required. Adjustments are made to such liabilities based on estimates in accordance with FASB ASC 410, "*Asset Retirement and Environmental Obligations*" (FASB ASC 410). For active plants, such costs are included in the Utility Plant's cost and as a component of Operating Expense over the Utility Plant's life. Expenditures for decommissioning activities are recorded as reductions to Accrued Decommissioning liability. Changes in the Rancho Seco decommissioning liability estimates arising from inflation, annual accretion, and other changes to the cost assumptions are recorded to Accrued Decommissioning with a corresponding adjustment to the related regulatory deferral. The current portion of the Accrued Decommissioning liability represents SMUD's estimate of actual expenditures in the next year, as set forth in the annual budget.

SMUD has identified potential retirement obligations related to certain generation, distribution and transmission facilities. SMUD's non-perpetual leased land rights generally are renewed continuously because SMUD intends to utilize these facilities indefinitely. Since the timing and extent of any potential asset retirements are unknown, the fair value of any obligations associated with these facilities cannot be reasonably estimated. Accordingly, a liability has not been recorded.

At December 31, 2018 and 2017, SMUD's Accrued Decommissioning balance in the Consolidated Statements of Net Position relating to Rancho Seco was \$156.5 million and \$149.8 million, respectively (see Note 13). The Accrued Decommissioning balance in the Consolidated Statements of Net Position relating to other electricity generation and gas production facilities totaled \$13.3 million and \$12.4 million as of December 31, 2018 and 2017, respectively.

Cash and Cash Equivalents. Cash and cash equivalents include all debt instruments purchased with an original maturity of 90 days or less, deposits held at financial institutions, 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.

Investments. SMUD's investments are reported at fair value in accordance with Statement of Governmental Accounting Standards (SGAS) No. 72, "*Fair Value Measurement and Application*" (see Note 12). Realized and unrealized gains and losses are included in Other Income - Net in the Consolidated Statements of Revenues, Expenses and Changes in Net Position. Premiums and discounts on zero coupon bonds are amortized using the effective interest method. Premiums and discounts on other securities are amortized using the straight-line method, which approximates the effective interest method.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Electric Operating Revenues. Electric revenues are billed on the basis of monthly cycle bills and are recorded as revenue when the electricity is delivered. SMUD records an estimate for unbilled revenues earned from the dates its retail customers were last billed to the end of the month. At December 31, 2018 and 2017, unbilled revenues were \$69.4 million and \$72.6 million, respectively.

Purchased Power Expenses. A portion of SMUD's power needs are provided through power purchase agreements (PPA). Expenses from such agreements, along with associated transmission costs paid to other utilities, are charged to Purchased Power expense on the Consolidated Statements of Revenues, Expenses and Changes in Net Position in the period the power is received. The costs or credits, associated with energy swap agreements (gas and electric) or other arrangements that affect the net cost of Purchased Power are recognized in the period in which the underlying power delivery occurs. Contract termination payments and adjustments to prior billings are included in Purchased Power expense once the payments or adjustments can be reasonably estimated.

Advanced Capacity Payments. Some long-term agreements to purchase energy or capacity from other providers call for up-front payment. Such costs are generally recorded as an asset and amortized over the length of the contract.

Credit and Market Risk. SMUD enters into forward purchase and sales commitments for physical delivery of gas and electricity with utilities and power marketers. SMUD is exposed to credit risk related to nonperformance by its wholesale counterparties under the terms of these contractual agreements. In order to limit the risk of counterparty default, SMUD has a wholesale counterparty risk policy which includes using the credit agency ratings of SMUD's counterparties and other credit services, credit enhancements for counterparties that do not meet an acceptable risk level, and the use of standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty. SMUD is also subject to similar requirements for many of its gas and power purchase agreements. SMUD uses a combination of cash and securities to satisfy its collateral requirements to counterparties. SMUD's component units, NCGA and NCEA, entered into guaranteed investment contracts and is exposed to credit risk related to nonperformance by its investment provider. For NCGA, the investment provider provides collateral if their credit ratings fall below agreed upon levels. At December 31, 2018 and 2017, respectively, SMUD held \$2.5 million and \$3.4 million on deposit by counterparties and an investment provider. The amount is recorded as unrestricted cash and current restricted cash with an associated current liability. At December 31, 2018 and 2017, SMUD posted cash collateral of \$5.9 million and \$1.5 million with counterparties, respectively.

Accounts Receivable and Allowance for Doubtful Accounts. Accounts Receivable is recorded at the invoiced amount and does not bear interest, except for accounts related to energy efficiency loans. SMUD recognizes an estimate of uncollectible accounts for its receivables related to electric service, energy efficiency loans, and other non-electric billings, based upon its historical experience with collections and current energy market conditions. For large wholesale receivable balances, SMUD determines its bad debt reserves based on the specific credit issues for each account. SMUD records bad debts for its estimated uncollectible accounts related to electric service as a reduction to the related operating revenues in the Consolidated Statements of Revenues, Expenses and Changes in Net Position. SMUD records bad debts for its estimated uncollectible accounts related to energy efficiency loans and other non-electric billings in Administrative, General and Customer expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

The summarized activity of the changes in the allowance for doubtful accounts during 2018 and 2017 is presented below:

	Balance at beginning of Year	Additions	(Write-offs) and Recoveries	Balance at end of Year
	(thousands of dollars)			
Other Non-Electric:				
December 31, 2018	\$ 1,524	\$ 779	\$ (794)	\$ 1,509
December 31, 2017	\$ 831	\$ 1,326	\$ (633)	\$ 1,524
Retail Customers:				
December 31, 2018	\$ 3,172	\$ 8,916	\$ (6,083)	\$ 6,005
December 31, 2017	\$ 2,397	\$ 6,760	\$ (5,985)	\$ 3,172
Energy Efficiency Loans:				
December 31, 2018	\$ 677	\$ (444)	\$ 404	\$ 637
December 31, 2017	\$ 804	\$ (675)	\$ 548	\$ 677

Regulatory Deferrals. The Board has the authority to establish the level of rates charged for all SMUD services. As a regulated entity, SMUD's financial statements are prepared in accordance with SGAS Statement No. 62, *"Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,"* which requires that the effects of the ratemaking process be recorded in the financial statements. Accordingly, certain expenses and credits, normally reflected in Change in Net Position as incurred, are recognized when included in rates and recovered from or refunded to customers. SMUD records various regulatory assets and credits to reflect ratemaking actions of the Board (see Note 8).

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

Compensated Absences. SMUD accrues vacation leave and compensatory time when employees earn the rights to the benefits. SMUD does not record sick leave as a liability until it is taken by the employee, since there are no cash payments made for sick leave when employees terminate or retire. At December 31, 2018 and 2017, the total estimated liability for vacation and other compensated absences was \$27.2 million and \$26.0 million, respectively.

Public Good. Public Good expenses consist of non-capital expenditures for energy efficiency programs, low income subsidies, renewable energy resources and technologies, and research and development.

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

Gains/Losses on Bond Defeasances or Extinguishments. Gains and losses resulting from bond defeasances or extinguishments that were not financed with the issuance of new debt are included as a component of Interest on Debt in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Allowance for Funds Used During Construction (AFUDC). SMUD capitalizes, as an additional cost of Construction Work In Progress (CWIP), AFUDC, which represents the cost of borrowed funds used for such purposes. The amount capitalized is determined by a formula prescribed by FERC. The AFUDC rate for 2018 and 2017 was 2.3 percent and 2.4 percent of eligible CWIP, respectively.

Derivative Financial Instruments. SMUD records derivative financial instruments (interest rate swap and gas price swap agreements, certain wholesale sales agreements, certain power purchase agreements and option agreements) at fair value on its Consolidated Statements of Net Position. SMUD does not enter into agreements for speculative purposes. Fair value is estimated by comparing contract prices to forward market prices quoted by third party market participants and/or provided in relevant industry publications. SMUD is exposed to risk of nonperformance if the counterparties default or if the swap agreements are terminated. SMUD reports derivative financial instruments with remaining maturities of one year or less and the portion of long-term contracts with scheduled transactions over the next twelve months as current on the Consolidated Statements of Net Position (see Note 9).

Interest Rate Swap Agreements. SMUD enters into interest rate swap agreements to modify the effective interest rates on outstanding debt (see Notes 9 and 10).

Gas and Electricity Price Swap and Option Agreements. SMUD uses forward contracts to hedge the impact of market volatility on gas commodity prices for its natural gas-fueled power plants and for energy prices on purchased power for SMUD's retail load (see Note 9).

Solano Wind Sale and Purchase. SMUD entered into an agreement to sell the Solano Wind Phase 3 plant in December 2011 with a corresponding Power Purchase Agreement for all output of the plant. The plant began commercial operation in April 2012 and SMUD received all output generated. Under the terms of the various agreements, SMUD had the option to buy the plant back upon the sixth, eighth, or fifteenth anniversary of the commercial operation date or the end of the delivery term. In October 2017, SMUD submitted its notice of intent to exercise this option upon the sixth anniversary of commercial operation date which was in April 2018. At December 31, 2017, SMUD recorded the prepayment for purchase power as Prepayments and Other under Current Assets. In April 2018, SMUD purchased the plant back and recorded the gain on purchase of \$46.7 million as Other Income – Net in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

Precipitation Hedge Agreements. SMUD enters into non-exchange traded precipitation hedge agreements to hedge the cost of replacement power caused by low precipitation years (Precipitation Agreements). SMUD records the intrinsic value of the Precipitation Agreements as Prepayments and Other under Current Assets on the Consolidated Statements of Net Position. Settlement of the Precipitation Agreements is not performed until the end of the period covered (water year ended September 30). The intrinsic value of a Precipitation Agreement is the difference between the expected results from a monthly allocation of the cumulative rainfall amounts, in an average rainfall year, and the actual rainfall during the same period.

Insurance Programs. SMUD records liabilities for unpaid claims at their present value when they are probable in occurrence and the amount can be reasonably estimated. SMUD records a liability for unpaid claims associated with general, auto, workers' compensation, and short-term and long-term disability based upon estimates derived by SMUD's claims administrator or SMUD staff. The liability comprises the present value of the claims outstanding, and includes an amount for claim events incurred but not reported based upon SMUD's experience (see Note 16).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Pollution Remediation. SGAS No. 49, *“Accounting and Financial Reporting for Pollution Remediation Obligations,”* (GASB No. 49) requires that a liability be recognized for expected outlays for remediating existing pollution when certain triggering events occur. SMUD recorded a pollution remediation obligation for its North City Substation, which was built on a former landfill, for the former Community Linen Rental Services Property, and obligations for land sites, including one where it will be building a substation (see Note 18). At December 31, 2018 and 2017, the total pollution remediation liability was \$17.3 million and \$33.6 million, respectively, and recorded as either Current Liabilities, Customer Deposits and Other or Noncurrent Liabilities, Self Insurance and Other in the Consolidated Statements of Net Position. Costs were estimated using the expected cash flow technique prescribed under GASB No. 49, including only amounts that are reasonably estimable.

Hydro License. SMUD owns and operates the Upper American River Hydroelectric Project (UARP). The original license to construct and operate the UARP was issued in 1957 by FERC. Effective July 1, 2014, SMUD received a 50-year hydro license. As part of the hydro licensing process, SMUD entered into four contracts with government agencies whereby SMUD makes annual payments to them for various services for the term of the license. At December 31, 2018 and 2017, the liability for these contract payments was \$58.8 and \$57.8 million, respectively, and recorded as either Current Liabilities, Customer Deposits and Other or Noncurrent Liabilities, Self Insurance and Other in the Consolidated Statements of Net Position (see Note 17).

Assembly Bill 32. California Assembly Bill 32 (AB-32) was an effort by the State of California to set a greenhouse gas (GHG) emissions reduction goal into law, and initially was set through 2020. In 2015, the state established a 2030 goal for GHG emissions at 40% below 1990 levels, and in July of 2017 AB-398 was approved by the Governor. Central to these initiatives is the Cap and Trade program, which covers major sources of GHG emissions in the State including power plants; AB-398 extended Cap and Trade through 2030. The Cap and Trade program includes an enforceable emissions cap that will decline over time. The State distributes allowances, which are tradable permits, equal to the emissions allowed under the cap. Sources under the cap are required to surrender allowances and offsets equal to their emissions at the end of each compliance period. SMUD is subject to AB-32 and participated in the program auctions in 2017 and 2018. In a normal water year, SMUD expects its free allocation of allowances from the Air Resources Board to cover its compliance costs associated with electricity delivered to its retail customers. SMUD expects to recover compliance costs associated with wholesale power sales costs through its wholesale power sales revenues. SMUD continues to monitor new legislation and proposed programs that could impact AB-32 and its subsequent extensions.

Net Pension Liability (NPL). SMUD implemented SGAS No. 73, *“Accounting and Financial Reporting for Pensions and Related Assets that are not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68,”* (GASB No. 73) in 2017 and SGAS No. 68, *“Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27,”* (GASB No. 68) in 2015. The NPL is the difference between the actuarial present value of projected pension benefit payments attributable to employees’ past service and the pension plan’s fiduciary net position. At December 31, 2018 and 2017, the NPL was \$454.0 million and \$565.8 million, respectively (see Note 14).

Net Other Postemployment Benefit (OPEB) Liability (NOL). SMUD implemented SGAS No. 75, *“Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions,”* (GASB No. 75) in 2018 (see Note 3). The NOL is the difference between the actuarial present value of projected OPEB benefit payments attributable to employee’s past service and the OPEB plan’s fiduciary net position. At December 31, 2018 and 2017, the NOL was \$22.1 million and \$100.9 million, respectively (see Note 15).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Net Position. SMUD 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, or 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.”

Contributions in Aid of Construction (CIAC). SMUD records CIAC from customer contributions, primarily relating to expansions to SMUD’s distribution facilities, as Other Income - Net in the Consolidated Statements of Revenues, Expenses and Changes in Net Position. Contributions of capital are valued at acquisition value. For ratemaking purposes, the Board does not recognize such revenues when received; rather, CIAC is included in revenues as such costs are amortized over the estimated useful lives of the related distribution facilities.

Revenues and Expenses. SMUD distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with SMUD’s principal ongoing operations. The principal operating revenues of SMUD are charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as Non-Operating Revenues and Expenses.

Grants. SMUD receives grant proceeds from federal and state assisted programs for its projects which include, but are not limited to, advanced and renewable technologies, electric transportation, and energy efficiency. SMUD also periodically receives grant proceeds from federal or state assistance programs as partial reimbursements for costs it has incurred as a result of natural disasters, such as storm or fire damages. When applicable, these programs may be subject to financial and compliance audits pursuant to regulatory requirements. SMUD considers the possibility of any material disallowances to be remote. During 2018, SMUD recorded \$4.6 million of grant proceeds and recognized \$3.5 million as a component of Other Income - Net, in the Consolidated Statements of Revenues, Expenses and Changes in Net Position, and \$1.2 million as a Regulatory Credit. During 2017, SMUD recorded \$4.9 million of grant proceeds and recognized \$3.0 million as a component of Other Income - Net, in the Consolidated Statements of Revenues, Expenses and Changes in Net Position, and \$1.9 million as a Regulatory Credit (see Note 8).

In 2010, SMUD issued taxable Build America Bonds. SMUD receives an interest subsidy from the federal government equal to 35 percent of the interest paid (see Note 10). SMUD received reduced subsidy payments in 2018 and 2017 due to budget sequestration by the federal government. SMUD recognized \$9.2 million and \$9.1 million in revenues in 2018 and 2017, respectively, for its Build America Bonds, as a component of Other Income - Net, in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Customer Sales and Excise Taxes. SMUD is required by various governmental authorities, including states and municipalities, to collect and remit taxes on certain customer sales. Such taxes are presented on a net basis and excluded from revenues and expenses in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

Rancho Seco Litigation. In June 1983, SMUD and the U.S. Department of Energy (DOE) entered into a contract whereby the DOE would build a repository for the acceptance and disposal of SMUD's spent nuclear fuel (SNF) and/or high-level radioactive waste (HLW). SMUD paid the DOE a total of approximately \$40.0 million in fees under the contract, thus satisfying its obligation of performance under the contract. The DOE did not build a repository and therefore breached its obligation under the contract to commence acceptance of SNF and HLW by January 31, 1998. As a result, SMUD incurred costs to design, license, and fabricate its own on-site storage facility for the long term dry storage of its spent fuel at Rancho Seco. In June 2015, SMUD filed a suit against DOE which covered the costs incurred from 2010 through June 2015. In June 2017, SMUD received an award for \$28.9 million from the U.S. Court of Claims of which \$27.1 million was recorded as Other Income - Net in the Consolidated Statements of Revenues, Expenses and Changes in Net Position and \$1.7 million was recorded as CIAC since a portion of the award constituted a reimbursement for the cost of capital assets.

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

Reclassifications. Certain amounts in the 2017 Consolidated Financial Statements have been reclassified in order to conform to the 2018 presentation.

Recent Accounting Pronouncements. In November 2016, GASB issued SGAS No. 83, "*Certain Asset Retirement Obligations*" (GASB No. 83). An Asset Retirement Obligation (ARO) is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this statement. GASB No. 83 establishes the criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. Recognition occurs when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates the government to perform the asset retirement activities. GASB No. 83 requires the measurement of the ARO be based on the probability weighted best estimate of the current value of outlays expected to be incurred, and adjusted for general inflation or deflation at least annually. It requires a government to evaluate all relevant factors at least annually to determine whether the effects of one or more of the factors are expected to significantly change the estimated asset retirement outlays. The ARO should only be remeasured when the result of the evaluation indicates a significant change in the estimated outlays. GASB No. 83 also requires disclosures of descriptive information about the nature of a government's AROs including the methods and assumptions used for the estimates of the liabilities, the estimated remaining useful life of the associated tangible capital assets, how any funding and assurance requirements are being met, and the amount of any assets restricted for payment of the AROs (if not separately displayed in the financial statements). If a liability for an ARO (or portions thereof) has been incurred by a government but is not yet recognized because it is not reasonably estimable, the government should disclose that fact and the reasons therefor. This statement is effective for SMUD in 2019. SMUD is currently assessing the financial statement impact of adopting this statement. SMUD currently records AROs following the FASB guidance (see **Accrued Decommissioning** under Note 2).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

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 SMUD in 2019. SMUD 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 SMUD in 2018. SMUD 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 SMUD in 2018. SMUD 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

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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 SMUD in 2020. SMUD 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 SMUD in 2019. SMUD 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 SMUD in 2020. SMUD has assessed the financial statement impact of adopting the new statement and its impact is not material. SMUD will discontinue capitalizing interest costs in 2020 when GASB 89 is implemented.

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 SMUD in 2019. SMUD is currently assessing the financial statement impact of adopting this statement, but does not expect it to be material.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

NOTE 3. ACCOUNTING CHANGE

In June 2015, GASB issued SGAS No. 75, “*Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*” (GASB No. 75). This Statement replaces the requirements of SGAS No. 45, “*Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*,” as amended, and SGAS No. 57, “*OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*.” For defined benefit other postemployment benefits (OPEB), GASB No. 75 identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed. In addition, this statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria.

SMUD implemented GASB No. 75 in 2018 for OPEB that is provided to its employees. The implementation impacted the Consolidated Statements of Net Position when the net OPEB liability and corresponding deferred outflows and deferred inflows of resources were recorded. The implementation also impacted the Consolidated Statements of Revenues, Expenses and Changes in Net Position as OPEB expense was also recorded (see Note 15 and the Required Supplementary Information).

SMUD has restated amounts of the affected balances within the financial statements for the period ended December 31, 2017, as follows:

CONSOLIDATED STATEMENT OF NET POSITION

	December 31,	
	2017 (Restated)	2017
	(thousands of dollars)	
Noncurrent Assets		
Regulatory costs for future recovery	\$ 893,526	\$ 574,197
Prepayments and other	23,254	252,483
Deferred Outflows of Resources		
Deferred other postemployment benefits outflows	11,937	-0-
Noncurrent Liabilities		
Net other postemployment benefits liability	100,866	-0-
Deferred Inflows of Resources		
Deferred other postemployment benefits inflows	4,632	-0-
Net Position		
Net investment in capital assets	1,011,029	979,724
Unrestricted	441,923	476,689

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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CONSOLIDATED STATEMENT OF REVENUE, EXPENSES AND CHANGES IN NET POSITION

	December 31,	
	2017 (Restated)	2017
	(thousands of dollars)	
Operating Expenses		
Administrative, general and customer	\$ 238,608	\$ 235,147
Change in Net Position	177,893	181,354

NOTE 4. UTILITY PLANT

The summarized activity of SMUD's Utility Plant during 2018 is presented below:

	Balance January 1, 2018	Additions	Transfers and Disposals	Balance December 31, 2018
	(thousands of dollars)			
Nondepreciable Utility Plant:				
Land and land rights	\$ 138,147	\$ 1,506	\$ (28)	\$ 139,625
CWIP	280,692	380,877	(233,320)	428,249
Total nondepreciable utility plant	<u>418,839</u>	<u>382,383</u>	<u>(233,348)</u>	<u>567,874</u>
Depreciable Utility Plant:				
Generation	1,695,217	29,208	(90,094)	1,634,331
Transmission	310,195	27,287	(1,075)	336,407
Distribution	2,246,154	101,195	(9,865)	2,337,484
Investment in gas properties	206,617	7	-0-	206,624
Investment in JPAs	15,210	3,802	-0-	19,012
Intangibles	413,245	18,854	(5,832)	426,267
General	889,592	57,371	(17,262)	929,701
	<u>5,776,230</u>	<u>237,724</u>	<u>(124,128)</u>	<u>5,889,826</u>
Less: accumulated depreciation and depletion	(2,834,954)	(201,880)	102,360	(2,934,474)
Less: accumulated amortization on JPAs	(6,340)	(313)	-0-	(6,653)
	<u>(2,841,294)</u>	<u>(202,193)</u>	<u>102,360</u>	<u>(2,941,127)</u>
Total depreciable plant	2,934,936	35,531	(21,768)	2,948,699
Total Utility Plant - net	<u>\$ 3,353,775</u>	<u>\$ 417,914</u>	<u>\$ (255,116)</u>	<u>\$ 3,516,573</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

The summarized activity of SMUD's Utility Plant during 2017 is presented below:

	Balance January 1, 2017	Additions	Transfers and Disposals	Balance December 31, 2017
(thousands of dollars)				
Nondepreciable Utility Plant:				
Land and land rights	\$ 135,340	\$ 2,822	\$ (15)	\$ 138,147
CWIP	216,081	209,506	(144,895)	280,692
Total nondepreciable utility plant	<u>351,421</u>	<u>212,328</u>	<u>(144,910)</u>	<u>418,839</u>
Depreciable Utility Plant:				
Generation	1,669,687	28,730	(3,200)	1,695,217
Transmission	305,426	3,505	1,264	310,195
Distribution	2,179,486	75,318	(8,650)	2,246,154
Investment in gas properties	206,621	-0-	(4)	206,617
Investment in JPAs	15,649	-0-	(439)	15,210
Intangibles	388,049	25,913	(717)	413,245
General	881,095	13,759	(5,262)	889,592
	<u>5,646,013</u>	<u>147,225</u>	<u>(17,008)</u>	<u>5,776,230</u>
Less: accumulated depreciation and depletion	(2,646,547)	(204,603)	16,196	(2,834,954)
Less: accumulated amortization on JPAs	(6,027)	(313)	-0-	(6,340)
	<u>(2,652,574)</u>	<u>(204,916)</u>	<u>16,196</u>	<u>(2,841,294)</u>
Total depreciable plant	<u>2,993,439</u>	<u>(57,691)</u>	<u>(812)</u>	<u>2,934,936</u>
Total Utility Plant - net	<u>\$ 3,344,860</u>	<u>\$ 154,637</u>	<u>\$ (145,722)</u>	<u>\$ 3,353,775</u>

NOTE 5. INVESTMENT IN JOINT POWERS AUTHORITY

TANC. SMUD and fourteen other California municipal utilities are members of TANC, a JPA. TANC, along with the other California municipal utilities, own and operate the California-Oregon Transmission Project (COTP), a 500-kilovolt transmission line between central California and southern Oregon. SMUD is obligated to pay approximately 39 percent of TANC's COTP debt service and operations costs in exchange for entitlement to approximately 536 megawatts (MW) of TANC's 1,390 MW transfer capability. Additionally, SMUD has a 48 MW share of TANC's 300 MW firm, bi-directional transmission over Pacific Gas and Electric Company's (PG&E) system between PG&E's Tesla and Midway substations (SOT). The total entitlement shares for the COTP and SOT described above include the long-term agreements listed below.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

In 2009, SMUD entered into a 15-year long-term layoff agreement with TANC and certain members, expiring January 31, 2024. This agreement provides for the assignment of all rights and obligations of the City of Palo Alto and the City of Roseville related to their COTP and SOT entitlements. This agreement increased SMUD's COTP entitlement by 36 MW and SOT entitlement by 2 MW. Effective July 1, 2014, an amendment provides for the return to the City of Roseville of all rights and obligations related to the COTP entitlements, which decreased SMUD's COTP entitlement by 13 MW.

Effective July 1, 2014, SMUD entered into a 25-year long-term layoff agreement with TANC and certain members that provides for the assignment of all rights and obligations of Northern California Power Agency and partial rights and obligations of the City of Santa Clara related to their COTP entitlements. This agreement increased SMUD's COTP entitlements by 130 MW.

The long-term debt of TANC, which totals \$200.3 million (unaudited) at December 31, 2018, is collateralized by a pledge and assignment of net revenues of TANC supported by take or pay commitments of SMUD and other members. Should other members default on their obligations to TANC, SMUD would be required to make additional payments to cover a portion of such defaulted payments, up to 25 percent of its current obligation. SMUD recorded transmission expenses related to TANC of \$18.4 million and \$14.6 million in 2018 and 2017, respectively.

Summary financial information for TANC is presented below:

	December 31,	
	2018 (Unaudited)	2017 (Unaudited)
	(thousands of dollars)	
Total Assets	\$ 351,219	\$ 341,672
Total Deferred Outflows of Resources	1,956	2,922
Total Assets and Deferred Outflows of Resources	<u>\$ 353,175</u>	<u>\$ 344,594</u>
Total Liabilities	\$ 329,023	\$ 330,927
Total Net Position	<u>24,152</u>	<u>13,667</u>
Total Liabilities and Net Position	<u>\$ 353,175</u>	<u>\$ 344,594</u>
Changes in Net Position for the Six Months Ended December 31	<u>\$ (63)</u>	<u>\$ (424)</u>

Copies of the TANC annual financial reports may be obtained from SMUD at P.O. Box 15830, Sacramento, California 95852 or online at www.tanc.us.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

BANC. SMUD, City of Redding, City of Roseville, Modesto Irrigation District (MID), City of Shasta Lake, and Trinity Public Utilities District are members of BANC, a JPA formed in 2009. In 2011, operational control of Balancing Authority Area (BAA) operations was transferred from SMUD to BANC. BANC performs FERC approved BAA reliability functions that are managed by North American Electric Reliability Corporation (NERC), nationally, and by Western Electricity Coordinating Council functions in the west. SMUD recorded expenses related to BANC of \$2.9 million in 2018 and \$2.4 million in 2017.

Summary financial information for BANC is presented below:

	December 31,	
	2018	2017
	(Audited)	(Audited)
	(thousands of dollars)	
Total Assets	\$ 3,994	\$ 2,092
Total Liabilities	\$ 3,994	\$ 2,092
Total Net Position	-0-	-0-
Total Liabilities and Net Position	\$ 3,994	\$ 2,092
Changes in Net Position for the Year Ended December 31	\$ -0-	\$ -0-

Copies of the BANC annual financial reports may be obtained from SMUD at P.O. Box 15830, Sacramento, California 95852.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

NOTE 6. COMPONENT UNITS

CVFA Carson Cogeneration Project. CVFA is a JPA formed by SMUD and the Sacramento Regional County Sanitation District. CVFA operates the Carson Project, a 65 MW (net) natural gas-fired cogeneration facility and a 42 MW (net) natural gas-fired simple cycle peaking plant. The revenue stream to pay the CVFA bonds' debt service is provided by a "take-or-pay" power purchase agreement between SMUD and CVFA.

SCA Procter & Gamble Cogeneration Project. SCA is a JPA formed by SMUD and the SFA. SCA operates the Procter & Gamble Project, a 136 MW (net) natural gas-fired cogeneration facility and a 50 MW (net) natural gas-fired simple cycle peaking plant. The revenue stream to pay the SCA bonds' debt service is provided by a "take-or-pay" power purchase agreement between SMUD and SCA.

SFA Cosumnes Power Plant Project. SFA is a JPA formed by SMUD and MID. SFA operates the Cosumnes Power Plant Project, a 539 MW (net) natural gas-fired, combined cycle facility. The revenue stream to pay the SFA bonds' debt service is provided by a "take-or-pay" power purchase agreement between SMUD and SFA.

SPA Campbell Soup Cogeneration Project. SPA is a JPA formed by SMUD and the SFA. SPA operates the Campbell Soup Project, a 160 MW (net) natural gas-fired cogeneration facility, and the McClellan Project, a 72 MW (net) natural gas-fired simple cycle peaking plant.

NCGA. NCGA is a JPA formed by SMUD and the SFA. NCGA has a prepaid gas contract with Morgan Stanley Capital Group (MSCG) expiring in 2027, which is financed primarily by NCGA revenue bonds. SMUD has contracted with NCGA to purchase all the gas delivered by MSCG to NCGA, based on market prices. NCGA is obligated to pay the principal and interest on the bonds. Neither SMUD nor SFA is obligated to make debt service payments on the bonds. NCGA can terminate the prepaid gas contract under certain circumstances, including a failure by MSCG to meet its gas delivery obligation to NCGA or a drop in MSCG's credit rating below a specified level. If this occurs, MSCG will be required to make a termination payment to NCGA based on the unamortized prepayment proceeds received by MSCG.

NCEA. NCEA is a JPA formed by SMUD and the SFA. NCEA has a prepaid natural gas and electricity (commodity) contract with J. Aron & Company LLC (J. Aron) expiring in 2049, which is financed primarily by NCEA revenue bonds. SMUD has contracted with NCEA to purchase all the commodity delivered by J. Aron to NCEA, based on market prices. NCEA is obligated to pay the principal and interest on the bonds. Neither SMUD nor SFA is obligated to make debt service payments on the bonds. NCEA can terminate the prepaid commodity contract under certain circumstances, including a failure by J. Aron to meet its commodity delivery obligation to NCEA. If this occurs, J. Aron will be required to make a termination payment to NCEA based on the unamortized prepayment proceeds received by J. Aron.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

The summarized activity of SMUD's component units for 2018 is presented below:

CONDENSED STATEMENTS OF NET POSITION

December 31, 2018

(thousands of dollars)

	CVFA	SCA	SFA	SPA	NCGA	NCEA
Assets						
Electric Utility Plant - net	\$ 44,240	\$ 64,171	\$ 230,315	\$ 59,643	\$ -0-	\$ -0-
Restricted Assets	-0-	-0-	-0-	-0-	-0-	2,478
Current Assets	19,595	30,453	74,372	20,356	50,818	37,479
Noncurrent Assets	19	61	1,103	2	198,303	523,786
Total Assets	63,854	94,685	305,790	80,001	249,121	563,743
Deferred Outflows of Resources	131	283	2,593	-0-	-0-	-0-
Total Assets and Deferred Outflows of Resources	\$ 63,985	\$ 94,968	\$ 308,383	\$ 80,001	\$ 249,121	\$ 563,743
Liabilities						
Long-Term Debt - net	\$ 5,515	\$ 13,250	\$ 138,049	\$ -0-	\$ 198,610	\$ 566,893
Current Liabilities	10,365	12,735	84,439	6,708	39,433	1,449
Noncurrent Liabilities	11,181	-0-	-0-	-0-	-0-	-0-
Total Liabilities	27,061	25,985	222,488	6,708	238,043	568,342
Net Position	36,924	68,983	85,895	73,293	11,078	(4,599)
Total Liabilities and Net Position	\$ 63,985	\$ 94,968	\$ 308,383	\$ 80,001	\$ 249,121	\$ 563,743

CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

December 31, 2018

(thousands of dollars)

	CVFA	SCA	SFA	SPA	NCGA	NCEA
Operating Revenues	\$ 27,276	\$ 52,109	\$ 154,235	\$ 36,421	\$ 43,760	\$ -0-
Operating Expenses	27,820	47,031	131,133	39,549	34,761	4,045
Operating Income (Loss)	(544)	5,078	23,102	(3,128)	8,999	(4,045)
Non-Operating Revenues and Expenses						
Other Revenues (Expenses)	1,340	1,347	(12,427)	109	876	-0-
Interest Charges and Other	(691)	(1,096)	(4,270)	-0-	(10,645)	(555)
Change in Net Position Before Distributions and Contributions	105	5,329	6,405	(3,019)	(770)	(4,600)
Distribution to Member	-0-	(10,000)	-0-	-0-	(881)	-0-
Member Contributions and Adjustments	-0-	-0-	-0-	-0-	69	1
Change in Net Position	105	(4,671)	6,405	(3,019)	(1,582)	(4,599)
Net Position – Beginning of Year	36,819	73,654	79,490	76,312	12,660	-0-
Net Position – End of Year	\$ 36,924	\$ 68,983	\$ 85,895	\$ 73,293	\$ 11,078	\$ (4,599)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

CONDENSED STATEMENTS OF CASH FLOWS

December 31, 2018

(thousands of dollars)

	CVFA	SCA	SFA	SPA	NCGA	NCEA
Net Cash Provided by (Used in)						
Operating Activities	\$ 6,134	\$ 14,388	\$ 37,216	\$ 3,664	\$ 42,770	\$ (3,320)
Net Cash Provided by (Used in)						
Noncapital Financing Activities	-0-	(10,000)	-0-	-0-	(43,140)	25,163
Net Cash Used in Capital Financing						
Activities	(5,867)	(7,401)	(38,231)	(2,024)	-0-	-0-
Net Cash Provided by (Used in)						
Investing Activities	107	256	243	94	846	(21,080)
Net Increase (Decrease) in Cash and						
Cash Equivalents	374	(2,757)	(772)	1,734	476	763
Cash and Cash Equivalents at the						
Beginning of the Year	8,765	20,350	24,809	7,197	21,239	-0-
Cash and Cash Equivalents at the						
End of the Year	<u>\$ 9,139</u>	<u>\$ 17,593</u>	<u>\$ 24,037</u>	<u>\$ 8,931</u>	<u>\$ 21,715</u>	<u>\$ 763</u>

The summarized activity of SMUD's component units for 2017 is presented below:

CONDENSED STATEMENTS OF NET POSITION

December 31, 2017

(thousands of dollars)

	CVFA	SCA	SFA	SPA	NCGA
Assets					
Electric Utility Plant - net	\$ 50,685	\$ 72,074	\$ 219,260	\$ 65,055	\$ -0-
Current Assets	18,468	35,485	51,238	19,295	59,786
Noncurrent Assets	54	101	1,209	2	223,372
Total Assets	69,207	107,660	271,707	84,352	283,158
Deferred Outflows of Resources	289	495	3,031	-0-	-0-
Total Assets and Deferred Outflows of					
Resources	<u>\$ 69,496</u>	<u>\$ 108,155</u>	<u>\$ 274,738</u>	<u>\$ 84,352</u>	<u>\$ 283,158</u>
Liabilities					
Long-Term Debt - net	\$ 10,790	\$ 19,518	\$ 152,830	\$ -0-	\$ 233,170
Current Liabilities	11,459	14,983	42,418	8,040	37,328
Noncurrent Liabilities	10,428	-0-	-0-	-0-	-0-
Total Liabilities	32,677	34,501	195,248	8,040	270,498
Net Position	36,819	73,654	79,490	76,312	12,660
Total Liabilities and Net Position	<u>\$ 69,496</u>	<u>\$ 108,155</u>	<u>\$ 274,738</u>	<u>\$ 84,352</u>	<u>\$ 283,158</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	December 31, 2017				
	(thousands of dollars)				
	CVFA	SCA	SFA	SPA	NCGA
Operating Revenues	\$ 32,007	\$ 51,777	\$ 163,942	\$ 31,959	\$ 41,895
Operating Expenses	27,207	45,471	151,250	37,809	31,083
Operating Income (Loss)	4,800	6,306	12,692	(5,850)	10,812
Non-Operating Revenues and Expenses					
Other Revenues	50	146	140	44	785
Interest Charges and Other	(924)	(1,365)	(4,538)	-0-	(11,870)
Change in Net Position Before Distributions and Contributions	3,926	5,087	8,294	(5,806)	(273)
Distribution to Member	-0-	-0-	-0-	-0-	(809)
Member Contributions and Adjustments	-0-	-0-	-0-	-0-	69
Change in Net Position	3,926	5,087	8,294	(5,806)	(1,013)
Net Position – Beginning of Year	32,893	68,567	71,196	82,118	13,673
Net Position – End of Year	<u>\$ 36,819</u>	<u>\$ 73,654</u>	<u>\$ 79,490</u>	<u>\$ 76,312</u>	<u>\$ 12,660</u>

CONDENSED STATEMENTS OF CASH FLOWS

	December 31, 2017				
	(thousands of dollars)				
	CVFA	SCA	SFA	SPA	NCGA
Net Cash Provided by Operating Activities	\$ 12,357	\$ 11,998	\$ 35,590	\$ 1,722	\$ 41,174
Net Cash Used in Noncapital Financing Activities	-0-	-0-	-0-	-0-	(41,347)
Net Cash Used in Capital Financing Activities	(10,539)	(7,956)	(33,607)	(353)	-0-
Net Cash Provided by Investing Activities	37	111	122	33	758
Net Increase in Cash and Cash Equivalents	1,855	4,153	2,105	1,402	585
Cash and Cash Equivalents at the Beginning of the Year	6,910	16,197	22,704	5,795	20,654
Cash and Cash Equivalents at the End of the Year	<u>\$ 8,765</u>	<u>\$ 20,350</u>	<u>\$ 24,809</u>	<u>\$ 7,197</u>	<u>\$ 21,239</u>

As described in Note 2, all of the activities and balances of the component units are blended into and reported as part of SMUD because of the extent of their operational and financial relationships with SMUD. Copies of CVFA's, SCA's, SFA's, SPA's, NCGA's and NCEA's annual financial reports may be obtained from their Executive Office at P.O. Box 15830, Sacramento, California 95852 or online at www.smud.org.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

NOTE 7. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash Equivalents and Investments. SMUD’s investment policy is governed by the California State and Municipal Codes and its Indenture, which allow SMUD’s 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. SMUD’s investment policy 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 this risk, SMUD 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, with the exception of NCEA. NCEA 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 rated as “BBB+”.

Custodial Credit Risk. This is the risk that, in the event of the failure of a depository financial institution or counterparty to a transaction, SMUD’s deposits and investments may not be returned or SMUD will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of another party. SMUD does not have a deposit policy for custodial credit risk.

As of December 31, 2018 and 2017, \$15.3 million and \$18.3 million in deposits were uninsured, respectively. The bank balance is also, per a depository pledge agreement between SMUD and SMUD’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. SMUD had money market funds of \$92.3 million and \$117.7 million which were uninsured at December 31, 2018 and 2017, respectively. SMUD’s investments and money market funds are held in SMUD’s name.

Concentration of Credit Risk. This is the risk of loss attributed to the magnitude of an entity’s investment in a single issuer. SMUD places no limit on the amounts invested in any one issuer for repurchase agreements and federal agency securities.

The following are the concentrations of risk greater than five percent in either year:

Investment Type:	December 31,	
	2018	2017
Federal Home Loan Banks	15%	20%
Freddie Mac	7%	13%
Federal Farm Credit Bank	13%	13%
Corporate Note – Berkshire Hathaway	5%	5%
Corporate Note – Wells Fargo Bank	4%	5%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Interest Rate Risk. This is the risk of loss due to the fair value of an investment declining due to interest rates rising. Though SMUD has restrictions as to the maturities of some of the investments, it does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. SMUD is exposed to interest rate risk on its interest rate swaps (see Note 9).

The following schedules indicate the credit and interest rate risk at December 31, 2018 and 2017. The credit ratings listed are from Standard & Poor's (S&P) or Moody's. (N/A is defined as not applicable to the rating disclosure requirements.)

At December 31, 2018, SMUD's cash, cash equivalents, and investments consist of the following:

Description	Credit Rating	Remaining Maturities (in years)			Total Fair Value
		Less Than 1	1-5	More Than 5	
(thousands of dollars)					
Cash and Cash Equivalents:					
Cash	N/A	\$ 6,683	\$ -0-	\$ -0-	\$ 6,683
LAIF	Not Rated	88,401	-0-	-0-	88,401
Money Market Funds	AAAm	92,343	-0-	-0-	92,343
Deposit at Notice	N/A	26,572	-0-	-0-	26,572
Commercial Paper	A-1	16,626	-0-	-0-	16,626
Fannie Mae	N/A	9,944	-0-	-0-	9,944
Federal Home Loan Bank	N/A	14,934	-0-	-0-	14,934
Total cash and cash equivalents		255,503	-0-	-0-	255,503
Investments:					
Fannie Mae	AA+	9,538	-0-	-0-	9,538
Federal Farm Credit Bank	AA+	44,572	23,717	-0-	68,289
Federal Home Loan Bank	AA+	62,075	2,517	-0-	64,592
Freddie Mac	AA+	10,226	24,662	-0-	34,888
U.S. Treasury Obligations	AA+	43,735	123,684	-0-	167,419
Corporate Notes	AAA/AA/AA-/A+	79,442	4,953	-0-	84,395
Municipal Bonds	AA-	-0-	14,877	-0-	14,877
Guaranteed Investment Contracts	BBB+	18,602	2,478	-0-	21,080
Total investments		268,190	196,888	-0-	465,078
Total cash, cash equivalents, and investments		\$ 523,693	\$ 196,888	\$ -0-	\$ 720,581

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

At December 31, 2017, SMUD's cash, cash equivalents, and investments consist of the following:

Description	Credit Rating	Remaining Maturities (in years)			Total Fair Value
		Less Than 1	1-5	More Than 5	
(thousands of dollars)					
Cash and Cash Equivalents:					
Cash	N/A	\$ 16,738	\$ -0-	\$ -0-	\$ 16,738
LAIF	Not Rated	119,832	-0-	-0-	119,832
Money Market Funds	AAAm	117,727	-0-	-0-	117,727
Deposit at Notice	N/A	4,545	-0-	-0-	4,545
Commercial Paper	A-1	17,845	-0-	-0-	17,845
Total cash and cash equivalents		276,687	-0-	-0-	276,687
Investments:					
Fannie Mae	AA+	-0-	19,497	-0-	19,497
Federal Farm Credit Bank	AA+	-0-	68,266	-0-	68,266
Federal Home Loan Bank	AA+	-0-	103,430	-0-	103,430
Freddie Mac	AA+/A-1+	9,890	59,608	-0-	69,498
Financing Corp FICO	N/A	-0-	12,777	-0-	12,777
U.S. Treasury Obligations	AA+	-0-	163,120	-0-	163,120
Corporate Notes	AAA/AA/AA-/A+/A	-0-	106,170	-0-	106,170
Municipal Bonds	AA-	-0-	15,073	-0-	15,073
Commercial Paper	A-1+/A-1	29,765	-0-	-0-	29,765
Total investments		39,655	547,941	-0-	587,596
Total cash, cash equivalents, and investments		\$ 316,342	\$ 547,941	\$ -0-	\$ 864,283

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

	December 31,	
	2018	2017
(thousands of dollars)		
Cash, Cash Equivalents, and Investments:		
Revenue bond reserve and debt service funds:		
Revenue bond reserve fund	\$ 5,617	\$ 6,432
Debt service fund	64,951	51,841
Component unit bond reserve and debt service funds	52,941	35,049
Total revenue bond reserve and debt service funds	123,509	93,322
Nuclear decommissioning trust fund	8,566	8,411
Rate stabilization fund	96,694	99,899
Component unit other restricted funds	6,142	3,207
Escrow fund	6,737	6,374
Other restricted funds	654	654
Unrestricted funds	478,279	652,416
Total cash, cash equivalents, and investments	\$ 720,581	\$ 864,283

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

NOTE 8. REGULATORY DEFERRALS

The Board has taken various regulatory actions that result in differences between the recognition of revenues and expenses for ratemaking purposes and their treatment under generally accepted accounting principles for non-regulated entities (see Note 2). These actions result in regulatory assets and deferred inflow of resources, which are summarized in the tables below. Changes to these balances, and their inclusion in rates, occur only at the direction of the Board.

Regulatory Assets (Costs)

Decommissioning. SMUD's regulatory asset relating to the unfunded portion of its decommissioning liability is being collected through interest earnings on the Trust Fund. Nuclear fuel storage costs and non-radiological decommissioning costs have been collected in rates since 2009.

Derivative Financial Instruments. SMUD's regulatory costs and/or credits relating to investment derivative instruments are intended to defer the net difference between the fair value of derivative instruments and their cost basis, if any. Investment derivative instruments are reflected in rates at contract cost and as such, the balance is charged or credited into rates as the related asset or deferred inflow of resource is utilized (see Note 9).

Debt Issuance Costs. SMUD established a regulatory asset for costs incurred in connection with the issuance of debt obligations, principally underwriter fees and legal costs. The regulatory asset is amortized through 2018 for the portion related to SMUD's debt issuance costs and over the life of the bonds for the portion related to the component units' debt issuance costs. Debt issuance costs after December 31, 2013 are expensed.

Pension. SMUD established a regulatory asset for pension costs related to the implementation of GASB No. 68 which requires SMUD to record a net pension liability. The regulatory asset is being amortized over a period of 25 years starting in 2018.

OPEB. SMUD established a regulatory asset for OPEB costs related to the implementation of GASB No. 75 which requires SMUD to record a net OPEB liability. The regulatory asset will be amortized over a period of 25 years starting in 2020.

SMUD's total regulatory costs for future recovery are presented below:

	December 31,	
	2018	2017 (Restated)
	(thousands of dollars)	
Regulatory Costs:		
Decommissioning	\$ 158,239	\$ 151,640
Derivative financial instruments	17,052	14,529
Debt issuance costs	2,243	2,526
Pension	408,653	425,680
OPEB	319,329	319,329
Total regulatory costs	<u>905,516</u>	<u>913,704</u>
Less: regulatory costs to be recovered within one year	(19,240)	(20,178)
Total regulatory costs for future recovery - net	<u>\$ 886,276</u>	<u>\$ 893,526</u>

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Regulatory Credits

CIAC. In 2018 and 2017, SMUD added CIAC totaling \$19.0 million and \$14.6 million, respectively, to Regulatory Credits in the Consolidated Statements of Net Position and recorded \$12.3 million and \$11.9 million of amortization, respectively, to Other Income - Net in the Consolidated Statements of Revenues, Expenses and Changes in Net Position. SMUD's regulatory credit relating to CIAC is intended to offset the revenue and expense associated with this accounting treatment. Thus, this regulatory credit is being amortized into rates over the depreciable lives of the related assets in order to offset the earnings effect of these non-exchange transactions.

Rate Stabilization. SMUD's regulatory credit relating to Rate Stabilization is intended to defer the need for future rate increases when costs exceed existing rates. At the direction of the Board, amounts may be either transferred into this fund (which reduces revenues), or amounts are transferred out of this fund (which increases revenues). The Board authorizes Rate Stabilization Fund (RSF) transfers on an event driven basis. In 2018, \$4.9 million was transferred to revenue from the RSF as a result of lower than budgeted energy deliveries from Western Area Power Administration (Western). In 2017, \$12.3 million was transferred from revenue to the RSF as a result of higher than budgeted energy deliveries from Western.

Hydro Rate Stabilization. The Hydro Rate Stabilization Fund (HRSF) was established through the Hydro Generation Adjustment (HGA) mechanism, which helps manage volatility in energy costs. The HGA mechanism applies a formula based on precipitation and wholesale electricity prices to calculate needed withdrawals from or deposits to the HRSF. The maximum balance of the HRSF is 6 percent of the budgeted retail revenue and the maximum annual transfer in or out of the HRSF is 4 percent of budgeted retail revenue. If the HRSF is depleted, SMUD will apply a hydro rate surcharge to customers' bills up to 4 percent. When the HRSF reaches the 6 percent cap, the Board may authorize a hydro rebate to customers or direct the funds for another purpose. In 2018 and 2017, \$1.7 million and \$52.4 million, respectively, was transferred from revenue to the HRSF as a result of high precipitation.

Energy Assistance Program Rate (EAPR). In 2016, the Board authorized SMUD to transfer \$10.0 million of revenue to a regulatory credit related to EAPR. This regulatory credit is intended to offset future expenditures for energy efficiency programs for EAPR customers from the period 2018-2020. In 2018, \$3.5 million was spent on energy efficiency programs for EAPR customers.

Senate Bill 1. SMUD implemented a per kilowatt hour solar surcharge, effective January 1, 2008 in order to fund investments in solar required by Senate Bill 1 (SB-1). The difference between the surcharge revenues received and the funds spent on solar initiatives will be recognized or deferred into future years. SMUD has spent less than it collected in SB-1 revenues and has recorded a regulatory credit. Collection of the solar surcharge ended in December 2017 when total collections reached \$130.0 million.

Grant Revenues. In 2009, SMUD was awarded several large grants under the ARRA, which provided significant reimbursements for capital expenditures. In 2010, the Board authorized the deferral of grant income for capital expenditures as regulatory liabilities. Thus, this regulatory credit will be deferred to match the depreciable lives of the related capital assets in order to offset the earnings effect of these non-exchange transactions.

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TANC Operations Costs. SMUD’s regulatory asset relating to deferred TANC costs comprises the difference between its cash payments made to TANC and its share of TANC’s accrual-based costs of operations. This regulatory asset is being collected in rates over the life of TANC’s assets during the period that cash payments to TANC exceed TANC’s accrual-based costs. SMUD’s cash payments to TANC exceeded TANC’s accrual-based costs and SMUD has recorded a regulatory credit.

SMUD’s total regulatory credits for future revenue recognition are presented below:

	December 31,	
	2018	2017
	(thousands of dollars)	
Regulatory Credits:		
CIAC	\$ 260,999	\$ 254,328
Rate stabilization	32,641	37,509
Hydro rate stabilization	64,054	62,390
EAPR	6,460	10,000
Senate Bill 1	9,294	12,049
Grant revenues	43,959	46,975
TANC operations costs	25,311	22,406
Total regulatory credits	<u>\$ 442,718</u>	<u>\$ 445,657</u>

NOTE 9. DERIVATIVE FINANCIAL INSTRUMENTS

To help provide stable electric rates and to meet the forecasted power needs of its retail customers reliably, SMUD enters into various physical and financial fixed price purchase contracts for electricity and natural gas. These fixed price contracts and swap agreements are intended to hedge the exposure due to highly volatile commodity prices. SMUD also enters into interest rate swap agreements to reduce interest rate risk. SMUD utilizes these derivative financial instruments to mitigate its exposure to certain market risks associated with ongoing operations. SMUD has established policies set by an executive committee for the use of derivative financial instruments for trading purposes. These contracts are evaluated pursuant to SGAS No. 53, “*Accounting and Financial Reporting for Derivative Instruments*,” (GASB No. 53) to determine whether they meet the definition of derivative instruments, and if so, whether they effectively hedge the expected cash flows associated with interest rate and commodity price risk exposures.

SMUD applies hedge accounting for derivatives that are deemed effective hedges. Under hedge accounting, the increase or (decrease) in the fair value of a hedge is reported as a Deferred Inflow or Deferred Outflow on the Consolidated Statements of Net Position. Derivatives that do not meet the effectiveness tests are deferred for ratemaking purposes as regulatory assets or liabilities on the Consolidated Statements of Net Position (see Note 8).

During 2018 and 2017, SMUD executed numerous new gas and power related purchase agreements, some of which are recorded as hedging or investment derivatives and are therefore included in the following table. All hedging or investment derivatives are recorded at fair value on the Consolidated Statements of Net Position.

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For electricity and gas derivatives, fair values are estimated by comparing contract prices to forward market prices quoted by an independent external pricing service. When external quoted market prices are not available for derivative contracts, SMUD uses an internally developed valuation model utilizing short term observable inputs. For interest rate derivatives, SMUD calculates the fair value by discounting the expected cash flows at their corresponding zero coupon rate.

The following is a summary of the fair value, changes in fair value and notional amounts of derivative instruments, grouped by trading strategy, outstanding at December 31, 2018 (amounts in thousands; gains shown as positive amounts, losses as negative):

	2018 Changes in Fair Value		Fair Value at December 31, 2018		Notional
	Current Amount	Noncurrent Amount	Current Amount	Noncurrent Amount	
Cash Flow Hedges:					
(thousands of dollars)					
(thousands of Dekatherms (Dth))					
Asset: Investment Derivative Instruments					
Gas – Commodity	\$ 20	\$ -0-	\$ 20	\$ -0-	78 Dth
Gas – Storage	(1)	-0-	-0-	-0-	
Total Investment					
Derivative Instruments	\$ 19	\$ -0-	\$ 20	\$ -0-	
Asset: Hedging Derivative Instruments					
Gas – Basis	\$ (265)	\$ -0-	\$ -0-	\$ -0-	
Gas – Commodity	(64)	(228)	462	-0-	1,768 Dth
Gas – Storage	235	-0-	237	-0-	683 Dth
Gas – Transportation	2,545	-0-	2,597	-0-	10,333 Dth
Interest Rate	(795)	(7,651)	1,228	10,480	\$103,455
Total Hedging					
Derivative Instruments	\$ 1,656	\$ (7,879)	\$ 4,524	\$ 10,480	
Liability: Investment Derivative Instruments					
Gas – Commodity	\$ (268)	\$ 4,703	\$ 1,368	\$ 8,603	10,890 Dth
Interest Rate	(822)	(1,072)	375	6,725	\$90,950
Total Investment					
Derivative Instruments	\$ (1,090)	\$ 3,631	\$ 1,743	\$ 15,328	
Liability: Hedging Derivative Instruments					
Gas – Basis	\$ 3,651	\$ -0-	\$ 3,651	\$ -0-	7,300 Dth
Gas – Commodity	(2,217)	(21,461)	25,002	56,684	66,890 Dth
Gas – Storage	189	-0-	391	-0-	1,295 Dth
Gas – Transportation	(38)	-0-	41	-0-	155 Dth
Total Hedging					
Derivative Instruments	\$ 1,585	\$ (21,461)	\$ 29,085	\$ 56,684	

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The following is a summary of the fair value, changes in fair value and notional amounts of derivative instruments, grouped by trading strategy, outstanding at December 31, 2017 (amounts in thousands; gains shown as positive amounts, losses as negative):

	2017 Changes in Fair Value		Fair Value at December 31, 2017		Notional
	Current Amount	Noncurrent Amount	Current Amount	Noncurrent Amount	
Cash Flow Hedges:					
(thousands of dollars)					
(thousands of Dekatherms (Dth))					
Asset: Investment Derivative Instruments					
Gas – Commodity	\$ (401)	\$ (175)	\$ -0-	\$ -0-	
Gas – Storage	1	-0-	1	-0-	78 Dth
Gas – Transportation	(19)	-0-	-0-	-0-	
Total Investment					
Derivative Instruments	\$ (419)	\$ (175)	\$ 1	\$ -0-	
Asset: Hedging Derivative Instruments					
Gas – Basis	\$ 265	\$ -0-	\$ 265	\$ -0-	3,960 Dth
Gas – Commodity	(307)	(394)	526	228	9,258 Dth
Gas – Storage	(341)	-0-	2	-0-	78 Dth
Gas – Transportation	5	-0-	52	-0-	2,290 Dth
Interest Rate	(4,635)	(1,636)	2,023	18,131	\$317,785
Total Hedging					
Derivative Instruments	\$ (5,013)	\$ (2,030)	\$ 2,868	\$ 18,359	
Liability: Investment Derivative Instruments					
Gas – Basis	\$ (34)	\$ -0-	\$ -0-	\$ -0-	
Gas – Commodity	(623)	2,645	1,636	3,900	7,833 Dth
Gas – Transportation	(30)	-0-	-0-	-0-	
Interest Rate	(3,001)	(589)	1,197	7,797	\$122,115
Total Investment					
Derivative Instruments	\$ (3,688)	\$ 2,056	\$ 2,833	\$ 11,697	
Liability: Hedging Derivative Instruments					
Gas – Basis	\$ (515)	\$ -0-	\$ -0-	\$ -0-	
Gas – Commodity	(168)	(18,516)	27,219	78,145	91,660 Dth
Gas – Storage	11	-0-	202	-0-	2,590 Dth
Gas – Transportation	(62)	-0-	79	-0-	4,563 Dth
Total Hedging					
Derivative Instruments	\$ (734)	\$ (18,516)	\$ 27,500	\$ 78,145	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Objectives and Terms of Hedging Derivative Instruments. The objectives and terms of SMUD's hedging derivative instruments that were outstanding at December 31, 2018 are summarized in the table below. The table is aggregated by the trading strategy. Credit ratings of SMUD's counterparties can be found in the table under Credit Risk. Details of SMUD's interest rate derivative instruments can be found in Note 10.

	Notional Amount Dth	Beginning Date	Ending Date	Minimum Price/Dth	Maximum Price/Dth
Gas – Basis	7,300	01/01/19	12/31/19	\$ (1.44)	\$ (1.43)
Gas – Commodity	68,658	01/01/08	12/31/22	2.61	7.17
Gas – Storage	1,978	01/01/19	12/31/19	.24	1.60
Gas – Transportation	10,488	01/01/19	12/31/19	(.62)	.97

The objectives and terms of SMUD's hedging derivative instruments that were outstanding at December 31, 2017 are summarized in the table below. The table is aggregated by the trading strategy.

	Notional Amount Dth	Beginning Date	Ending Date	Minimum Price/Dth	Maximum Price/Dth
Gas – Basis	3,960	01/01/18	12/31/18	\$ (1.56)	\$ (1.42)
Gas – Commodity	100,918	01/01/08	12/31/22	2.61	7.17
Gas – Storage	2,668	01/01/18	03/31/18	(.26)	.25
Gas – Transportation	6,853	01/01/18	12/31/18	(.42)	(.20)

SMUD hedges its interest rate exposure with swaps. One swap is used to convert some of the interest expense associated with fixed rate bonds to a variable rate interest expense. SMUD also has a swap that is designed to partially fix the interest expense associated with commercial paper (see Note 11).

SMUD hedges its power and natural gas costs so that it can offer predictable rates to its retail electric customers and support its credit rating. SMUD maintains a risk management program to control the price, credit, and operational risks arising from its power and natural gas market activities. Under the program, authorized SMUD employees assemble a portfolio of swaps, futures, and forward contracts over time with the goal of making SMUD's purchased power and fuel budget more predictable.

The hedged risks include those related to interest rate and commodity price fluctuations associated with certain forecasted transactions, including interest rate risk on long-term debt, and forward purchases of gas and electricity to meet load.

Derivatives Not Designated as Hedging Instruments

Gas and Electric Contracts. SMUD utilizes certain gas swap and electric swap agreements under GASB No. 53 not designated as hedging derivative instruments to mitigate exposure to changes in the market price of natural gas and electricity. The fair value of each agreement, excluding the actual settlements to be paid or received as of the end of the period, is recorded on the Consolidated Statements of Net Position in either Current or Noncurrent Assets, Investment Derivative Instruments if in an asset position or Current or Noncurrent Liabilities, Investment Derivative Instruments if in a liability position. An offsetting amount is included in Current or Noncurrent Regulatory Costs or Regulatory Credits for future recovery in the Consolidated Statements of Net Position. The actual settlement payable is recorded in Accounts Payable on

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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the Consolidated Statements of Net Position, and the actual settlement receivable is recorded in Receivables - Net: Wholesale and Other on the Consolidated Statements of Net Position. The payments and receipts of the actual settlement are recorded as Investment Expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

Interest Rate Contracts. SMUD utilizes certain interest rate swap agreements not designated as hedging derivative instruments under GASB No. 53 to mitigate exposure to fluctuations in interest rates. The fair value of each agreement, excluding the balance of interest to be paid or received as of the end of the period, is recorded on the Consolidated Statements of Net Position in either Current or Noncurrent Assets, Investment Derivative Instruments if in an asset position or Current or Noncurrent Liabilities, Investment Derivative Instruments if in a liability position. An offsetting amount is included in Current or Noncurrent Regulatory Costs or Deferred Outflows or Inflows of Resources in the Consolidated Statements of Net Position. The interest receivable is recorded in Receivables - Net: Wholesale and Other on the Consolidated Statements of Net Position and the accrued interest is recorded in Interest Payable on the Consolidated Statements of Net Position. The payments or receipts of the actual settlement are recorded as Investment Expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

The Board has deferred recognition of the effects of reporting the fair value of Investment Derivative Instruments for ratemaking purposes, and maintains regulatory accounts to defer the accounting impact of these accounting adjustments (see Note 8). Fair values may have changed significantly since December 31, 2018.

Basis Risk. This is the risk that arises when a hedged item and a derivative that is attempting to hedge that item are based on different indices. SMUD is exposed to basis risk when it hedges its natural gas purchases, which are priced at various locations, and with NYMEX futures contracts, which settle based on the price at Henry Hub, Louisiana. SMUD enters into basis swaps to hedge against this risk.

Termination Risk. This is the risk that a derivative will terminate prior to its scheduled maturity due to a contractual event. Contractual events include bankruptcy, illegality, default, credit events upon merger, and other events. One aspect of termination risk is that SMUD would lose the hedging benefit of a derivative that becomes subject to a termination event. Another aspect of termination risk is that, if at the time of termination the mark to market value of the derivative was a liability to SMUD, SMUD could be required to pay that amount to the counterparty. Termination risk is associated with all of SMUD's derivatives up to the fair value amounts.

Credit Risk. This is the risk of loss resulting when the counterparty is unable or unwilling to fulfill its present and future financial obligations. SMUD can be exposed to significant counterparty credit risk on all derivative instruments. SMUD seeks to minimize credit risk by transacting with creditworthy counterparties. SMUD has established and maintained strict counterparty credit guidelines. SMUD continuously monitors counterparty credit risk and utilizes numerous counterparties to diversify the exposure to potential defaults. Under certain conditions as outlined in SMUD's credit risk management policy, SMUD may require additional credit support under its trading agreements.

Some of SMUD's derivative master agreements contain credit contingent provisions that enable SMUD to maintain unsecured credit as a result of positive investment quality credit ratings from each of the major credit rating agencies. If SMUD's credit rating were to be downgraded, there could be a step-down in SMUD's unsecured credit thresholds, and SMUD's counterparties would require additional collateral. If SMUD's credit rating were to decrease below investment grade, SMUD's unsecured credit thresholds would be reduced to zero, and counterparties to the derivative instruments would demand ongoing full collateralization on derivative instruments in net out of the money positions (see Note 2).

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The counterparties' credit ratings at December 31, 2018 and 2017 are shown in the table below. The credit ratings listed are from S&P or Moody's.

	December 31,	
	2018	2017
Counterparty Gas Contracts:		
Bank of Montreal	A+	A+
Barclays Bank PLC	A	A-
Cargill Inc.	N/A	A
Citigroup Inc.	BBB+	BBB+
EDF Trading Group	BBB	BBB
J.P. Morgan Ventures Energy Corp.	A-	A-
Merrill Lynch	A-	BBB+
Morgan Stanley Capital Group, Inc.	BBB+	BBB+
Shell Trading Market Risk	A	A
Interest Rate Contracts:		
Goldman Sachs Capital Markets, L.P.	AA-	BBB+
Goldman Sachs Mitsui Marine Derivative Products, L.P.	N/A	AA-
Morgan Stanley Capital Services, Inc.	A+	BBB+
Wells Fargo & Company	N/A	AA-
Bank of America Corporation	N/A	A+

NOTE 10. LONG-TERM DEBT

SMUD's total long-term debt is presented below:

	December 31,	
	2018	2017
	(thousands of dollars)	
Electric revenue bonds, 2.0%-6.32%, 2019-2041	\$ 1,673,590	\$ 1,783,660
Subordinated electric revenue bonds, index rates	-0-	88,750
Total electric revenue bonds	1,673,590	1,872,410
Component unit project revenue bonds, 5.0%-5.25%, 2019-2030	130,750	186,890
Gas and Commodity supply revenue bonds, index rates and 4.0%-5.0%, 2019-2049	804,090	264,475
Total long-term debt outstanding	2,608,430	2,323,775
Bond premiums - net	175,187	150,440
Total long-term debt	2,783,617	2,474,215
Less: amounts due within one year	(144,885)	(132,440)
Total long-term debt - net	<u>\$ 2,638,732</u>	<u>\$ 2,341,775</u>

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The summarized activity of SMUD's long-term debt during 2018 is presented below:

	December 31, 2017	Additions	Payments or Amortization	December 31, 2018	Amounts Due Within One Year
	(thousands of dollars)				
Electric revenue bonds	\$ 1,783,660	\$ 165,515	\$ (275,585)	\$ 1,673,590	\$ 87,425
Subordinate electric revenue bonds	88,750	-0-	(88,750)	-0-	-0-
Component unit project revenue bonds	186,890	-0-	(24,835)	162,055	22,900
Gas and Commodity supply revenue bonds	264,475	539,615	(31,305)	772,785	34,560
Total	2,323,775	705,130	(420,475)	2,608,430	\$ 144,885
Unamortized premiums - net	150,440	53,682	(28,935)	175,187	
Total long-term debt	<u>\$ 2,474,215</u>	<u>\$ 758,812</u>	<u>\$ (449,410)</u>	<u>\$ 2,783,617</u>	

The summarized activity of SMUD's long-term debt during 2017 is presented below:

	December 31, 2016	Additions	Payments or Amortization	December 31, 2017	Amounts Due Within One Year
	(thousands of dollars)				
Electric revenue bonds	\$ 1,676,315	\$ 202,500	\$ (95,155)	\$ 1,783,660	\$ 76,300
Subordinate electric revenue bonds	341,850	-0-	(253,100)	88,750	-0-
Component unit project revenue bonds	220,925	-0-	(34,035)	186,890	24,835
Gas supply prepayment bonds	292,870	-0-	(28,395)	264,475	31,305
Total	2,531,960	202,500	(410,685)	2,323,775	\$ 132,440
Unamortized premiums - net	133,275	34,582	(17,417)	150,440	
Total long-term debt	<u>\$ 2,665,235</u>	<u>\$ 237,082</u>	<u>\$ (428,102)</u>	<u>\$ 2,474,215</u>	

At December 31, 2018 scheduled annual principal maturities and interest are as follows:

	Principal	Interest	Total
	(thousands of dollars)		
2019	144,885	119,063	263,948
2020	130,025	121,704	251,729
2021	134,030	115,178	249,208
2022	135,115	108,672	243,787
2023	143,515	102,017	245,532
2024 – 2028 (combined)	1,228,575	321,808	1,550,383
2029 – 2033 (combined)	318,815	161,087	479,902
2034 – 2038 (combined)	308,605	50,494	359,099
2039 – 2041 (combined)	64,865	6,627	71,492
Total requirements	<u>\$ 2,608,430</u>	<u>\$ 1,106,650</u>	<u>\$ 3,715,080</u>

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Interest in the preceding table includes interest requirements for fixed rate debt at their stated rates, variable rate debt covered by interest rate swaps at their fixed rate, and variable rate debt not covered by interest rate swaps using the debt interest rate of 70 percent of 1 month London Interbank Offered Rate (LIBOR) plus a fixed fee. The LIBOR rate is based on the rate in effect at December 31, 2018 for the issues.

The following bonds have been issued and are outstanding at December 31, 2018:

Date	Issue	Final Maturity	Interest Rate	Original Amount	Outstanding Amount
(thousands of dollars)					
Electric Revenue Bonds					
06/15/1997	1997 Series K Bonds	07/01/2024	5.25% - 5.9%	\$ 131,030	\$ 103,455
05/15/2009	2009 Series V Bonds	05/15/2036	6.322%	200,000	200,000
07/29/2010	2010 Series W Bonds	05/15/2036	6.156%	250,000	250,000
10/04/2011	2011 Series X Bonds	08/15/2028	1.5% - 5.0%	325,550	210,825
05/31/2012	2012 Series Y Bonds	08/15/2033	3.0% - 5.0%	196,945	180,395
05/21/2013	2013 Series A Bonds	08/15/2041	3.75% - 5.0%	132,020	132,020
05/21/2013	2013 Series B Bonds	08/15/2033	3.0% - 5.0%	118,615	93,975
07/14/2016	2016 Series D Bonds	08/15/2028	2.0% - 5.0%	149,890	149,890
12/14/2017	2017 Series E Bonds	08/15/2028	5.0%	202,500	187,515
07/12/2018	2018 Series F Bonds	08/15/2028	5.0%	165,515	165,515
JPA Revenue Bonds					
08/19/2009	2009 CVFA Bonds	07/01/2020	2.25% - 5.25%	\$ 48,920	\$ 10,590
08/19/2009	2009 SCA Bonds	07/01/2021	4.0% - 5.25%	57,530	18,965
06/03/2015	2015 SFA Bonds	07/01/2030	2.0% - 5.0%	193,335	132,500
05/31/2007	2007B NCGA#1 Bonds	07/01/2027	Index Rate	668,470	233,170
12/19/2018	2018 NCEA Bonds	07/01/2049	4.0% - 5.0%	539,615	539,615

2018 Commodity Supply Revenue Bonds. NCEA issued \$539.6 million of 2018 Commodity Supply Revenue Bonds in December 2018 maturing in June 2049, with mandatory tender purchase in June 2024. The 2018 Commodity Supply Revenue Bonds have fixed interest rates of 4.0 percent to 5.0 percent. The proceeds of the offering were used to finance the prepayment of a thirty-year commodity contract. As discussed in Note 6, NCEA is obligated to pay the debt service on the bonds. SMUD's obligation is limited to the purchase and payment for the commodity tendered for delivery by NCEA.

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2018 Bond Refunding. In July 2018, SMUD issued \$165.5 million of 2018 Series F Revenue Refunding Bonds. The purpose of this transaction was to refund the fixed rate debt associated with 2008 Series U bonds. Proceeds from the 2018 Series F bonds, in addition to \$7.5 million of proceeds from terminating the Wells Fargo and Bank of America variable-to-fixed interest rate swaps and \$5.0 million from funds on hand defeased all the outstanding Series 2008 U bonds. A total of \$199.3 million of bonds were defeased through a legal defeasance, and accordingly, the liability for the defeased bonds has been removed from Long-Term Debt - net in the Consolidated Statements of Net Position. The refunding resulted in the recognition of a deferred accounting gain of \$0.2 million, which is being amortized over the life of the refunding issue. The termination payments of the interest rate swaps are being amortized over the life of the refunding issue. The 2018 refunding reduced future aggregate debt service payments by \$42.6 million and resulted in a total economic gain of \$39.1 million, which is the difference between the present value of the old and new debt service payments.

2017 Bond Refunding. In December 2017, SMUD issued \$202.5 million of 2017 Series E Electric Revenue Refunding Bonds. The purpose of this transaction was to refund variable rate debt with fixed rate debt to reduce the risk of increased interest rates. Proceeds from the 2017 Series Bonds, in addition to \$13.0 million of funds on hand, were used to defease \$26.1 million of a portion of the Series 2016 N bonds, \$26.1 million of a portion of the Series 2016 O bonds, \$120.0 million of all of the outstanding 2016 Series P bonds, and \$77.9 million of all of the outstanding Series 2016 Q bonds. A total of \$250.1 million bonds were defeased through a legal defeasance, and accordingly, the liability for the defeased bonds has been removed from Long-Term Debt - net in the Consolidated Statements of Net Position. The refunding resulted in the recognition of a deferred accounting loss of \$5.5 million, which is being amortized over the life of the refunding issue. Based on an assumed LIBOR rate of 1.7 percent for the life of the debt, the 2017 refunding increased future aggregate debt service payments by \$0.6 million and resulted in a total economic loss of \$1.4 million, which is the difference between the present value of the old and new debt service payments.

Interest Rate Swap Agreements. A summary of SMUD's two interest rate swap agreements as of December 31, 2018 are as follows. The credit ratings listed are from S&P.

	Notional Amount (thousands)	SMUD Pays	Fixed Rate	Floating Rate	Termination Date	Counterparty Credit Rating
\$	103,455	Variable	5.168%	SIFMA	07/01/24	AA-
	90,950	Fixed	2.894%	63% of LIBOR	08/15/28	A+

A summary of SMUD's five interest rate swap agreements as of December 31, 2017 are as follows:

	Notional Amount (thousands)	SMUD Pays	Fixed Rate	Floating Rate	Termination Date	Counterparty Credit Rating
\$	117,625	Variable	5.154%	SIFMA	07/01/24	BBB+
	26,015	Fixed	4.345%	70% of LIBOR	08/15/18	AA-
	96,100	Fixed	2.894%	63% of LIBOR	08/15/28	BBB+
	79,714	Fixed	1.172%	67% of LIBOR	08/15/28	AA-
	120,446	Fixed	1.113%	67% of LIBOR	08/15/28	A+

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At December 31, 2018 and 2017, SMUD had a fixed-to-variable interest rate swap agreement with a notional amount of \$103.5 million and \$117.6 million, respectively, which is equivalent to the principal amount of SMUD's 1997 Series K Electric Revenue Bonds. Under this swap agreement, SMUD pays a variable rate equivalent to the Securities Industry and Financial Markets Association (SIFMA) Index (1.71 percent at December 31, 2018 and 2017) and receives fixed rate payments of 5.168 percent and 5.154 percent as of December 31, 2018 and 2017, respectively. In connection with the swap agreement, SMUD has a put option agreement, also with a notional amount of \$103.5 million and \$117.6 million as of December 31, 2018 and 2017, respectively, which gives the counterparty the right to sell to SMUD, at par, either the 1997 Series K Bonds, or a portfolio of securities sufficient to defease the 1997 Series K Bonds. SMUD receives fixed rate payments of 0.162 percent and 0.268 percent as of December 31, 2018 and 2017, respectively, in connection with the put option agreement. The exercise of the option terminates the swap at no cost to SMUD. The term of both the swap and the put is equal to the maturity of the 1997 Series K Bonds.

At December 31, 2018, SMUD had one variable-to-fixed interest rate swap agreement with a notional amount of \$91.0 million and at December 31, 2017, SMUD had two variable-to-fixed interest rate swap agreements with a notional amount of \$122.1 million. These swaps were originally entered into for the purpose of fixing the effective interest rate associated with certain of its subordinated bonds that were refunded during 2008. The notional values of the swaps are amortized over the life of the swap agreements. SMUD can terminate the swap agreements at any time, with payment or receipt of the fair market value of the swap as of the date of termination. The obligations of SMUD under the swap agreement are not secured by a pledge of revenues of SMUD's electric system or any other property of SMUD.

Additionally, at December 31, 2017, SMUD had variable-to-fixed interest rate swap agreements with Wells Fargo and Bank of America with a combined notional amount of \$200.2 million. These interest rate swaps were entered into for the purpose of fixing the effective interest rate associated with subordinated bonds that were expected to be issued in July of 2018. The swaps were not effective until July 2018. The notional values of the two swaps are amortized over the life of their respective swap agreements. In 2018, SMUD terminated both interest rate swap agreements (see 2018 Bond Refunding).

Component Unit Interest Rate Swap Agreements. NCGA had two interest rate swap agreements as of December 31, 2018, which are summarized as follows. The credit ratings listed are from S&P.

	Notional Amount (thousands)	NCGA Pays	Fixed Rate	Floating Rate	Termination Date	Credit Support Provider Credit Rating
\$	34,560	Fixed	4.144%	67% of LIBOR +.63%	07/01/19	A+
	198,610	Fixed	4.304%	67% of LIBOR +.72%	07/01/27	A+

NCGA had two interest rate swap agreements as of December 31, 2017, which are summarized as follows:

	Notional Amount (thousands)	NCGA Pays	Fixed Rate	Floating Rate	Termination Date	Credit Support Provider Credit Rating
\$	65,865	Fixed	4.144%	67% of LIBOR +.63%	07/01/19	BBB+
	198,610	Fixed	4.304%	67% of LIBOR +.72%	07/01/27	BBB+

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At December 31, 2018 and 2017, NCGA had two variable-to-fixed interest rate swap agreements with a counterparty for the purpose of fixing the effective interest rate associated with the 2007 Series B Bonds. NCGA pays the counterparty a fixed rate on the notional amount and receives a floating rate equal to 67 percent of the three month LIBOR (2.8 percent and 1.69 percent at December 31, 2018 and 2017, respectively) plus an interest rate spread, as specified in each swap agreement. The total notional amount of the two swaps at December 31, 2018 and 2017 were \$233.2 million and \$264.5 million, respectively, and were equivalent to the outstanding principal balance on the NCGA Bonds. The swaps are amortized over the life of their respective swap agreements in a manner corresponding to the principal repayment schedule of the NCGA Bonds. Early termination of the swaps would occur upon termination of the prepaid agreement for any reason. Upon early termination, the swaps would have no value to either party.

Subordinated Electric Revenue Bonds. Payment of and interest on the Subordinated Electric Revenue Bonds is subordinate to the payment of the principal and interest on SMUD's Electric Revenue Bonds. On June 29, 2018, SMUD expanded its commercial paper capacity by \$88.8 million and concurrently defeased all the outstanding \$44.4 million 2016 Series N and \$44.1 million of 2016 Series O, leaving \$0.3 million outstanding. The remaining outstanding balance of \$0.3 million was defeased in September 2018 with proceeds from commercial paper.

Component Unit Bonds. The component units of SMUD have each issued bonds to finance their respective projects. The revenue stream to pay CVFA, SCA, and SFA bonds' debt service is provided by "take-or-pay" power purchase agreements, and is therefore not dependent on the successful operation of the projects. SMUD guarantees to make payments sufficient to pay principal and interest and all other payments required to be made under the CVFA's, SCA's, and SFA's indenture of trust. CVFA, SCA, and SFA are not required to repay SMUD for any amounts paid under this guarantee. The revenue stream to pay NCGA and NCEA bonds' debt service is provided by "take-and-pay" purchase agreements. Therefore, principal and interest associated with these bonds are paid solely from the revenues and receipts collected in connection with the operation of the project. Most operating revenues earned by NCGA and NCEA are collected from SMUD in connection with the sale of gas or electricity to SMUD. The ability for NCGA and NCEA to service debt is dependent on various parties (particularly MSCG, as gas supplier for NCGA and J. Aron, as commodity supplier for NCEA) meeting their contractual obligations.

Callable Bonds. SMUD has \$450.0 million of Electric Revenue Bonds that are currently callable, \$450.0 million of which are fixed rate Build America Bonds debt. SMUD also has \$531.3 million of bonds that become callable from 2019 through 2026, and these bonds can be called until maturity.

Collateral. The principal and interest on SMUD's bonds are payable exclusively from, and are collateralized by a pledge of, the net revenues of SMUD's electric system. Neither the credit nor the taxing power of SMUD is pledged to the payment of the bonds and the general fund of SMUD is not liable for the payment thereof.

Covenants. SMUD's bond resolutions contain various covenants that include requirements to maintain minimum debt service coverage ratios, certain other financial ratios, stipulated minimum funding of revenue bond reserves, and various other requirements including a rate covenant to raise rates to maintain minimum debt service coverage.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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SMUD has pledged future net electric revenues, component unit net project revenues, and net gas supply prepayment revenues to repay, in electric revenue, component unit project revenue, and gas supply prepayment revenue bonds issued from 1997 through 2018. Proceeds from the bonds provided financing for various capital improvement projects, component unit capital projects, and the prepayments of a twenty-year supply of natural gas and a thirty-year supply of commodity. The bonds are payable solely from the net revenues generated by SMUD's electrical sales, component unit project revenues, and gas supply prepayment revenues and are payable through 2041 at December 31, 2018.

GASB Statement No. 48, "*Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*," disclosures for pledged revenues are as follows:

	December 31, 2018	December 31, 2017
	(thousands of dollars)	
Pledged future revenues	\$ 2,608,430	\$ 2,323,775
Principal and interest payments for the year ended	\$ 243,188	\$ 273,549
Total net revenues for the year ended	\$ 692,339	\$ 786,647
Total remaining principal and interest to be paid	\$ 3,715,080	\$ 3,459,445
Annual principal and interest payments as a percent of net revenues For the year ended	35%	35%

NOTE 11. COMMERCIAL PAPER NOTES

SMUD issues Commercial Paper Notes (Notes) to finance or reimburse capital expenditures. At December 31, 2018 and 2017, Notes outstanding totaled \$288.8 and \$200.0 million, respectively. The average interest rate for the Notes outstanding at December 31, 2018 and 2017 was 1.74 percent and 1.03 percent and the average term was 53 days and 80 days, respectively. SMUD has a \$295.9 million in letter of credit agreements (LOCs). The LOCs are calculated as the sum of the maximum principal amount of the Notes plus interest thereon at a maximum rate of ten percent per annum for a period of 90 days calculated on the basis of a year of 365 days and the actual number of days elapsed. There have not been any term advances under the LOCs.

The summarized activity of SMUD's Notes during 2018 and 2017 is presented below:

	Balance at Beginning of Year	Additions	Reductions	Balance at End of Year
	(thousands of dollars)			
December 31, 2018	\$ 200,000	\$ 88,750	\$ -0-	\$ 288,750
December 31, 2017	\$ 200,000	\$ -0-	\$ -0-	\$ 200,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 12. FAIR VALUE MEASUREMENT

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). SMUD 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 SMUD'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 as follows:

- 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.
- U.S. Government Agency Obligations – uses a market based approach which considers yield, price of comparable securities, coupon rate, maturity, credit quality and dealer-provided prices.
- U.S. Treasury Obligations – uses a market approach based on institutional bond quotes. Evaluations are based on various market and industry inputs.
- Corporate Notes – uses a market based approach. Evaluations are based on various market and industry inputs.
- Municipal Bonds – uses a market approach based on institutional bond quotes. Evaluations are based on various market and industry inputs.
- Investment Derivative Instruments:
 - Interest rate swap agreements – uses the present value technique. The fair value of the interest rate swap agreements are calculated by discounting the expected cash flows at their corresponding zero coupon rate. The cash flows are estimated based on a 1-month LIBOR forward curve from Bloomberg, and assuming SIFMA is equal to 70 percent of 1-month LIBOR.
 - Gas related agreements – uses the market approach based on monthly quoted prices from an independent external pricing service. The fair values for natural gas and electricity derivative financial instruments are calculated based on prevailing market quotes in active markets (i.e., Henry Hub and So Cal) where identical contracts are available.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The following tables identify the level within the fair value hierarchy that SMUD's financial assets and liabilities were 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. SMUD'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	At fair value as of December 31, 2018		
	Level 1	Level 2	Total
	(thousands of dollars)		
Investments, including cash and cash equivalents:			
LAIF	\$ -0-	\$ 88,401	\$ 88,401
U.S. Government Agency Obligations	-0-	157,469	157,469
U.S. Treasury Obligations	167,419	-0-	167,419
Corporate Notes	-0-	84,395	84,395
Municipal Bonds	-0-	14,877	14,877
Total Investments, including cash and cash equivalents	<u>\$ 167,419</u>	<u>\$ 345,142</u>	<u>\$ 512,561</u>
Investment Derivative Instrument Assets:			
Gas related agreements	\$ 20	\$ -0-	\$ 20
Total Investment Derivative Instrument Assets	<u>\$ 20</u>	<u>\$ -0-</u>	<u>\$ 20</u>
Hedging Derivative Instrument Assets:			
Gas related agreements	\$ 3,296	\$ -0-	\$ 3,296
Interest rate swap agreements	-0-	11,708	11,708
Total Hedging Derivative Instrument Assets	<u>\$ 3,296</u>	<u>\$ 11,708</u>	<u>\$ 15,004</u>
Investment Derivative Instrument Liabilities:			
Gas related agreements	\$ 9,971	\$ -0-	\$ 9,971
Interest rate swap agreements	-0-	7,100	7,100
Total Investment Derivative Instrument Liabilities	<u>\$ 9,971</u>	<u>\$ 7,100</u>	<u>\$ 17,071</u>
Hedging Derivative Instrument Liabilities:			
Gas related agreements	\$ 85,769	\$ -0-	\$ 85,769
Total Hedging Derivative Instrument Liabilities	<u>\$ 85,769</u>	<u>\$ -0-</u>	<u>\$ 85,769</u>

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Recurring Fair Value Measures	At fair value as of December 31, 2017		
	Level 1	Level 2	Total
	(thousands of dollars)		
Investments, including cash and cash equivalents:			
LAIF	\$ -0-	\$ 119,832	\$ 119,832
U.S. Government Agency Obligations	-0-	263,578	263,578
U.S. Treasury Obligations	163,120	-0-	163,120
Corporate Notes	-0-	106,170	106,170
Municipal Bonds	-0-	15,073	15,073
Total Investments, including cash and cash equivalents	<u>\$ 163,120</u>	<u>\$ 504,653</u>	<u>\$ 667,773</u>
Investment Derivative Instrument Assets:			
Gas related agreements	\$ 1	\$ -0-	\$ 1
Total Investment Derivative Instrument Assets	<u>\$ 1</u>	<u>\$ -0-</u>	<u>\$ 1</u>
Hedging Derivative Instrument Assets:			
Gas related agreements	\$ 1,073	\$ -0-	\$ 1,073
Interest rate swap agreements	-0-	20,154	20,154
Total Hedging Derivative Instrument Assets	<u>\$ 1,073</u>	<u>\$ 20,154</u>	<u>\$ 21,227</u>
Investment Derivative Instrument Liabilities:			
Gas related agreements	\$ 5,536	\$ -0-	\$ 5,536
Interest rate swap agreements	-0-	8,994	8,994
Total Investment Derivative Instrument Liabilities	<u>\$ 5,536</u>	<u>\$ 8,994</u>	<u>\$ 14,530</u>
Hedging Derivative Instrument Liabilities:			
Gas related agreements	\$ 105,645	\$ -0-	\$ 105,645
Total Hedging Derivative Instrument Liabilities	<u>\$ 105,645</u>	<u>\$ -0-</u>	<u>\$ 105,645</u>

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NOTE 13. RANCHO SECO DECOMMISSIONING LIABILITY

Background. With the completion of nuclear decommissioning of the former 913 MW nuclear power plant, and the subsequent termination of the 10 CFR 50 license by the Nuclear Regulatory Commission (NRC) effective August 31, 2018, all remaining Rancho Seco decommissioning liability relates to the Independent Spent Fuel Storage Installation (ISFSI) licensed under 10 CFR Part 72. Nuclear decommissioning is the process of safely removing nuclear facilities from service and reducing residual radioactivity to a level that permits termination of the NRC licenses and release of the property for unrestricted use. Final decommissioning of the ISFSI will occur after the spent nuclear fuel (SNF) and Greater Than Class C (GTCC) radioactive waste are removed from the site and SMUD demonstrates that the site is suitable for release in accordance with release criteria specified in 10 CFR 20, Subpart E and an approved License Termination Plan.

The DOE, under the Nuclear Waste Policy Act (NWPA) of 1982 as amended, is responsible for permanent disposal of spent nuclear fuel and GTCC radioactive waste, which are currently stored in the Part 72 licensed ISFSI. SMUD has a contract with the DOE for the removal and disposal of SNF and GTCC waste. All SMUD's SNF and GTCC waste are currently stored in sealed canisters in the ISFSI. However, the date when DOE will remove the fuel and GTCC waste is uncertain. In 2010, the DOE formally withdrew the application for licensing of Yucca Mountain as a high-level waste repository. While the court ordered reinstatement of NRC license review activities of Yucca Mountain have yielded generally positive results, Yucca Mountain remains speculative as a disposal option for SMUD's used nuclear fuel. The DOE also announced in January 2010 the creation of a Blue-Ribbon Commission to study alternatives for developing a repository for the nation's used nuclear fuel. The Commission provided a final report on alternatives in January 2012. The DOE evaluated the recommendations and published the report "Strategy for the Management and Disposal of Used Nuclear Fuel and High-Level Radioactive Waste" in January 2013.

The next phase of the process will be for Congress and the President of the United States to consider the recommendations and enact legislation to implement the recommendations. At this time, two license applications have been submitted to the NRC for the construction and operation of Consolidated Interim Storage Facility(s) that would store SNF and GTCC waste on an interim basis. These applications are currently under review by the NRC. Should the NRC license one or both facilities, Congress will have to modify the NWPA to allow for its use. In May 2018, the U.S. House of Representatives passed H.R. 3053 – the Nuclear Waste Policy Amendments Act, which was co-sponsored by Representative Doris Matsui and 109 other members of Congress. This bill includes a provision to allow a Consolidated Interim Storage Facility to store fuel from permanently shut down sites like Rancho Seco. As of the end of 2018, the U.S. Senate has not acted on the bill. Passage of this legislation would be a significant step towards removal of the used nuclear fuel from the Rancho Seco facility. Until then, SMUD is committed to the safe and secure storage of its SNF and GTCC waste under its Part 72 license until DOE fulfills its obligation to dispose of this material in accordance with NWPA. In support of this commitment, SMUD submitted its ISFSI license renewal application to the NRC in March of 2018. Once approved, the ISFSI would be allowed to continue the safe and secure storage of SMUD's SNF and GTCC.

Asset Retirement Obligations (ARO). These financial statements reflect SMUD's current estimate of its obligation for the cost of decommissioning (including the cost of managing the Storage Facility until it can be decommissioned) under the requirements of FASB ASC 410, based on studies completed each year. Each year, SMUD evaluates the estimate of costs of decommissioning and there was an increase in costs in the 2018 study. The ARO estimate assumes all spent nuclear fuel will be removed from the site by 2035.

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Rancho Seco’s ARO is presented below:

	December 31,	
	2018	2017
	(thousands of dollars)	
Active decommissioning	\$ 15,506	\$ 14,559
Spent fuel management	141,009	135,221
Total ARO	<u>156,515</u>	<u>149,780</u>
Less: current portion	<u>(5,562)</u>	<u>(5,775)</u>
Total non-current portion of ARO	<u>\$ 150,953</u>	<u>\$ 144,005</u>

The summarized activity of the Rancho Seco ARO during 2018 and 2017 are presented below. The annual adjustments include a savings computed as the difference between the fair value of the obligation as if the decommissioning activities were performed by a third party and the amount actually incurred by SMUD performing the decommissioning activities.

	December 31,	
	2018	2017
	(thousands of dollars)	
ARO at beginning of year	\$ 149,780	\$ 147,970
Accretion	7,591	7,521
Expenditures	(5,448)	(7,439)
Change in study	7,975	2,969
Annual adjustments	<u>(3,383)</u>	<u>(1,241)</u>
ARO at end of year	<u>\$ 156,515</u>	<u>\$ 149,780</u>

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NOTE 14. PENSION PLANS

Summary of Significant Accounting Policies. For purposes of measuring net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the pension plans and additions to/deductions from the Plan’s fiduciary net position have been determined on the same basis as they are reported by the California Public Employees’ Retirement System (PERS) Financial Office. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms. Investments are reported at fair value.

Plan Description and Benefits Provided. SMUD participates in PERS, an agent multiple-employer public employee defined benefit pension plan (PERS Plan). PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State. Benefit provisions and all other requirements are established by State statute and SMUD policies. The pension plan provides retirement benefits, survivor benefits, and death and disability benefits based upon employee’s years of credited service, age, and final compensation. A full description of the pension plan regarding number of employees covered, benefit provision, assumptions (for funding, but not accounting purposes), and membership information are included in the annual actuarial valuation reports as of June 30, 2017 and June 30, 2016.

SMUD also provides a supplemental benefit in lieu of PERS’ Single Highest Year (SHY) for certain represented employees hired before January 1, 2013. For these employees, if the present value of pension allowance under the PERS Plan with the employer paid member contributions (EPMC) benefit enhancement program is less than the present value of what the employee would have received under the PERS Plan benefit with SHY earnings but no EPMC, SMUD pays a lump sum equivalent to the difference. There are no assets accumulated in a trust for SHY. SMUD implemented GASB No. 73 to record SHY in 2017.

GASB No. 68 and GASB No. 73 require that the reported results must pertain to liability and asset information within certain defined timeframes. The following timeframes are used for the year ended:

PERS Plan	December 31,	
	2018	2017
Valuation date	June 30, 2017	June 30, 2016
Measurement date	June 30, 2018	June 30, 2017

SHY	December 31,	
	2018	2017
Valuation date and Measurement date	June 30, 2018	June 30, 2017

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Employees Covered by Benefit Terms. The following employees were covered by the benefit terms for the year ended:

PERS Plan	December 31,	
	2018	2017
Inactive employees or beneficiaries currently receiving benefit payments	2,865	2,777
Inactive employees entitled to but not yet receiving benefit payments	919	921
Active employees	<u>2,169</u>	<u>2,125</u>
Total employees covered by benefit terms	<u><u>5,953</u></u>	<u><u>5,823</u></u>

SHY	December 31,	
	2017	2016
Inactive employees or beneficiaries currently receiving benefit payments	-0-	-0-
Inactive employees entitled to but not yet receiving benefit payments	1	-0-
Active employees	<u>231</u>	<u>276</u>
Total employees covered by benefit terms	<u><u>232</u></u>	<u><u>276</u></u>

Contributions. Section 20814(c) of the California Public Employees' Retirement Law requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. The total plan contributions are determined through PERS' annual actuarial valuation process. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The employer is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. For the PERS fiscal years ended June 30, 2018 and 2017, the average active employee contribution rate is 6.8 percent and 6.9 percent of annual pay, respectively. For the PERS fiscal year ended June 30, 2018, the employer's contribution rate is 7.7 percent of annual payroll plus \$22.3 million for the unfunded accrued liability contribution. For the PERS fiscal year ended June 30, 2017, the employer's contribution rate is 16.0 percent of annual payroll. Employer contribution rates may change if plan contracts are amended. For the fiscal years ended June 30, 2018 and 2017, SMUD made contributions recognized by the PERS Plan in the amount of \$90.1 million and \$32.4 million, respectively.

Net Pension Liability (NPL). SMUD's NPL at December 31, 2018 and 2017 was measured at June 30, 2018 and 2017, respectively. The total pension liability used to calculate the NPL was determined by actuarial valuations as of June 30, 2017 and 2016 rolled forward using generally accepted actuarial procedures to the June 30, 2018 and 2017 measurement dates for the PERS Plan and actuarial valuations as of June 30, 2018 and 2017 for SHY.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Actuarial Methods and Assumptions. The actuarial methods and assumptions used for the December 31, 2018 and December 31, 2017 total pension liabilities are as follows for the PERS Plan:

Actuarial Cost Method	Entry age normal
Discount Rate	7.15%
Inflation	2.5% (2018), 2.75% (2017)
Salary Increases	Varies by entry age and service
Mortality Rate Table	The mortality table used was developed based on PERS' specific data. For 2018, the table includes 15 years of mortality improvements using the Society of Actuaries Scale 90% of scale MP 2016 (2017 experience study). For 2017, the table includes 20 years of mortality improvements using Society of Actuaries Scale BB (2014 experience study).
Post Retirement Benefit Increase	For 2018, contract COLA up to 2.0% until Purchase Power Protection Allowance Floor on Purchasing Power applies, 2.5% thereafter. For 2017, contract COLA up to 2.75% until Purchase Power Protection Allowance Floor on Purchasing Power applies, 2.75% thereafter.

The actuarial methods and assumptions used for the December 31, 2018 and December 31, 2017 total pension liabilities are as follows for SHY:

Actuarial Cost Method	Entry age normal
Discount Rate	Bond Buyer 20 Index – 3.87% (2018), 3.58% (2017)
Inflation	2.75%
Salary Increases	Aggregate - 3.00%; merit - PERS 1997-2015 Experience Study (2018), PERS 1997-2011 Experience Study (2017)
Mortality, Retirement, Disability, Termination	PERS 1997-2015 Experience Study (2018), PERS 1997-2011 Experience Study (2017)
Mortality Improvement	Mortality projected 15 years with 90% of Scale MP-2016 (2018) Mortality projected 20 years with Scale BB (2017)

Discount Rates. For the PERS Plan, the discount rate used to measure the total pension liability for the years ended December 31, 2018 and 2017 was 7.15 percent for both years. For the year ended December 31, 2018, the projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current member contribution rates and that contributions from employers will be made at statutorily required rates, actuarially determined. Based on those assumptions, the PERS Plan was projected to be available to make all projected future benefit payments of current plan members. The long-term expected discount rate of return on plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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For the year ended December 31, 2017, to determine whether the municipal bond rate should be used in the calculation of a discount rate for each plan, PERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. The tests revealed the assets would not run out. Therefore, the discount rates used for the valuations are appropriate and the use of the municipal bond rate calculation is not deemed necessary. The long-term expected discount rates are applied to all plans in the Public Employees Retirement Fund. The cash flows used in the testing were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. Using historical returns of all the funds' asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach.

The expected real rates of return by asset class used for December 31, 2018 are as follows:

Asset Class	Current Target Allocation	Real Return Years 1-10	Real Return Years 11+
Global Equity	50.0%	4.80%	5.98%
Global Fixed Income	28.0%	1.00%	2.62%
Inflation Assets	0%	0.77%	1.81%
Private Equity	8.0%	6.30%	7.23%
Real Estate	13.0%	3.75%	4.93%
Liquidity	1.0%	0%	(0.92%)

The expected real rates of return by asset class used for December 31, 2017 are as follows:

Asset Class	Current Target Allocation	Real Return Years 1-10	Real Return Years 11+
Global Equity	47.0%	4.90%	5.38%
Global Fixed Income	19.0%	.80%	2.27%
Inflation Sensitive	6.0%	.60%	1.39%
Private Equity	12.0%	6.60%	6.63%
Real Estate	11.0%	2.80%	5.21%
Infrastructure and Forestland	3.0%	3.90%	5.36%
Liquidity	2.0%	(2.20%)	(2.70%)

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Changes in the NPL. The following table shows the changes in NPL recognized over the year ended December 31, 2018:

	Total Pension Liability (a)	Increase (Decrease) Plan Fiduciary Net Position (b)	Net Pension Liability (a) - (b)
		(thousands of dollars)	
Balances at January 1, 2018	\$ 2,220,196	\$ 1,654,396	\$ 565,800
Changes recognized for the measurement period:			
Service cost	36,245	-0-	36,245
Interest	151,548	-0-	151,548
Changes in assumptions	(61,661)	-0-	(61,661)
Differences between expected and actual experience	346	-0-	346
Contributions – employer	-0-	90,141	(90,141)
Contributions – employee	-0-	16,832	(16,832)
Net investment income	-0-	138,739	(138,739)
Benefit payments	(111,763)	(111,763)	-0-
Administrative expense	-0-	(7,474)	7,474
Other	-0-	(4)	4
Net changes	14,715	126,471	(111,756)
Balances at December 31, 2018	\$ 2,234,911	\$ 1,780,867	\$ 454,044

The following table shows the changes in NPL recognized over the year ended December 31, 2017:

	Total Pension Liability (a)	Increase (Decrease) Plan Fiduciary Net Position (b)	Net Pension Liability (a) - (b)
		(thousands of dollars)	
Balances at January 1, 2017	\$ 2,040,497	\$ 1,541,269	\$ 499,228
Changes recognized for the measurement period:			
Service cost	35,340	-0-	35,340
Interest	150,312	-0-	150,312
Changes in assumptions	122,216	-0-	122,216
Differences between expected and actual experience	(30,190)	-0-	(30,190)
Contributions – employer	-0-	32,389	(32,389)
Contributions – employee	-0-	15,845	(15,845)
Net investment income	-0-	171,596	(171,596)
Benefit payments	(104,428)	(104,428)	-0-
Administrative expense	-0-	(2,275)	2,275
GASB No. 73 implementation adjustment	6,449	-0-	6,449
Net changes	179,699	113,127	66,572
Balances at December 31, 2017	\$ 2,220,196	\$ 1,654,396	\$ 565,800

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Sensitivity of the NPL to Changes in the Discount Rate. The following presents the NPL of the Plan as of the measurement date, calculated using the current discount rate, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current discount rate:

PERS Plan	1% Decrease (6.15%)	Current Discount Rate (7.15%)	1% Increase (8.15%)
		(thousands of dollars)	
Plan's NPL, December 31, 2018	\$ 737,102	\$ 449,456	\$ 210,375
Plan's NPL, December 31, 2017	855,323	560,599	316,456

SHY	1% Decrease (2.87%)	Current Discount Rate (3.87%)	1% Increase (4.87%)
		(thousands of dollars)	
Plan's NPL, December 31, 2018	\$ 5,572	\$ 4,588	\$ 3,808

	1% Decrease (2.58%)	Current Discount Rate (3.58%)	1% Increase (4.58%)
		(thousands of dollars)	
Plan's NPL, December 31, 2017	\$ 6,373	\$ 5,201	\$ 4,280

Pension Plan Fiduciary Net Position. Detailed information about the PERS Plan's fiduciary net position is available in the separately issued PERS Plan financial statements. This report, the audited financial statements, and other reports can be obtained at the PERS' website at www.calpers.ca.gov.

Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions. For the year ended December 31, 2018 and 2017, SMUD recognized pension expense of \$56.2 million and \$78.5 million, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

At December 31, 2018 and 2017, SMUD reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	December 31,	
	2018	2017
	(thousands of dollars)	
Deferred outflows of resources:		
Changes of assumptions	\$ 57,325	\$ 90,688
Differences between expected and actual experience	961	-0-
Differences between projected and actual earnings on pension plan investments	6,184	21,648
Employer's contributions to the Plan subsequent to the measurement of total pension liability	38,561	30,698
Total deferred outflows of resources	<u>\$ 103,031</u>	<u>\$ 143,034</u>
Deferred inflows of resources:		
Changes of assumptions	\$ (46,528)	\$ (5,636)
Differences between expected and actual experience	(16,238)	(27,285)
Total deferred inflows of resources	<u>\$ (62,766)</u>	<u>\$ (32,921)</u>

Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended December 31:

2019	\$ 30,722
2020	7,312
2021	(31,045)
2022	(4,381)
2023	(158)
Thereafter	(746)

Other Plans. SMUD provides its employees with two cash deferred compensation plans: one pursuant to Internal Revenue Code (IRC) Section 401(k) (401(k) Plan) and one pursuant to IRC Section 457 (457 Plan) (collectively, the Plans). The Plans are contributory plans in which SMUD's employees contribute the funds. Each of SMUD's eligible full-time or permanent part-time employees may participate in either or both Plans, and amounts contributed are vested immediately. Such funds are held by a Trustee in trust for the employees upon retirement from SMUD service and, accordingly, are not subject to the general claims of SMUD's creditors. SMUD is responsible for ensuring compliance with IRC requirements concerning the Plans and has the fiduciary duty of reasonable care in the selection of investment alternatives, but neither SMUD, nor its Board or officers have any liability for market variations in the Plans' asset values. SMUD employees are responsible for determining how their funds are to be invested and pay all ongoing fees related to the Plans. The Plans are currently not subject to discrimination testing, nor the requirements of the Employee Retirement Income Security Act of 1974. SMUD employees participating in the Plans are allowed to contribute a portion of their gross income not to exceed the annual dollar limits prescribed by the IRC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

SMUD makes annual contributions to the 401(k) Plan on behalf of certain employees pursuant to a memorandum of understanding with both of its collective bargaining units. SMUD also matches non-represented employee contributions to the 401(k) Plan up to a set amount. SMUD made contributions into the 401(k) Plan of \$4.9 million in 2018 and \$4.4 million in 2017. SMUD does not match employee contributions, nor make contributions on behalf of its employees to the 457 Plan. Participating employees made contributions into both Plans totaling \$23.8 million in 2018 and \$21.3 million in 2017.

NOTE 15. OTHER POSTEMPLOYMENT BENEFITS

Summary of Significant Accounting Policies. For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the OPEB plan and additions to/deductions from the OPEB plan’s fiduciary net position have been determined on the same basis as they are reported by the California Employers Retiree Benefit Trust (CERBT). For this purpose, SMUD recognizes benefit payments when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Plan Description and Benefits Provided. SMUD is a member of CERBT. The CERBT Fund is an IRC Section 115 Trust set up for the purpose of receiving employer contributions to prefund OPEB for retirees and their beneficiaries. CERBT is an agent multiple-employer defined benefit OPEB plan (OPEB Plan) administered by PERS. The OPEB Plan provides medical, dental and long-term disability benefits for retirees and their beneficiaries, in accordance with SMUD policy and negotiated agreements with employee representation groups. The benefit, benefit levels, retiree contributions and employer contributions are governed by SMUD and can be amended by SMUD through its personnel manual and union contracts. Any changes to these benefits would be approved by SMUD’s Board and unions.

Employees Covered by Benefit Terms. The following employees were covered by the benefit terms:

	December 31,	
	2018	2017
Inactive employees or beneficiaries currently receiving benefit payments	2,197	2,152
Inactive employees entitled to but not yet receiving benefit payments	41	47
Active employees	2,178	2,077
Total employees covered by benefit terms	4,416	4,276

Contributions. OPEB contributions are elective and not required. SMUD contributes the full actuarially determined rate. SMUD may also elect to put additional contributions into the OPEB Plan. For the OPEB Plan’s fiscal years ended June 30, 2018 and 2017, SMUD made contributions recognized by the OPEB Plan in the amounts of \$34.2 million and \$114.6 million, respectively.

Net OPEB Liability (NOL). SMUD’s NOL at December 31, 2018 and 2017 was measured as of June 30, 2018 and 2017, respectively, and the total OPEB liability used to calculate the NOL was determined by actuarial valuations as of those dates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Actuarial Methods and Assumptions. The actuarial methods and assumptions used for the December 31, 2018 and December 31, 2017 total OPEB liabilities are as follows:

Discount Rate	6.75%
Inflation	2.75%
Salary Increases	Aggregate - 3.0%; merit - PERS 1997-2015 Experience Study (2018), PERS 1997-2011 Experience Study (2017)
Mortality, Retirement, Disability, Termination	PERS 1997-2015 Experience Study (2018), PERS 1997-2011 Experience Study (2017)
Mortality Improvement	Mortality projected fully generational with Scale MP-17 (2018), MP-16 (2017)
Healthcare Cost Trend Rates	Non-medicare: 7.5% for 2020, decreasing to an ultimate rate of 4.0% in 2076 and later years (2018); 7.5% for 2019, decreasing to an ultimate rate of 4.0% in 2076 and later years (2017) Medicare: 6.5% for 2020, decreasing to an ultimate rate of 4.0% in 2076 and later years (2018); 6.5% for 2019, decreasing to an ultimate rate of 4.0% in 2076 and later years (2017)

Discount Rates. For the OPEB Plan, the discount rate used to measure the total OPEB liability for the years ended December 31, 2018 and 2017 was 6.75 percent for both years. The projection of cash flows used to determine the discount rate assumed that contributions from SMUD will be made at rates equal to the actuarially determined contribution rates. Based on those assumptions, the OPEB Plan's fiduciary net position was projected to be available to make all projected OPEB payments for current active and inactive employees. Therefore, the long-term expected rate of return on the OPEB Plan's investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

The expected real rates of return by asset class used and presented as geometric means for December 31, 2018 and December 31, 2017 are as follows:

Asset Class	Target Allocation CERBT Strategy 1	Expected Real Rate of Return
Global Equity	57%	4.82%
Fixed Income	27%	1.47%
TIPS	5%	1.29%
Commodity	3%	0.84%
REITS	8%	3.76%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Changes in the NOL. The following table shows the changes in NOL recognized over the year ended December 31, 2018:

	Total OPEB Liability (a)	Increase (Decrease) Plan Fiduciary Net Position (b)	Net OPEB Liability (a) - (b)
		(thousands of dollars)	
Balances at January 1, 2018	\$ 442,414	\$ 341,548	\$ 100,866
Changes recognized for the measurement period:			
Service cost	9,263	-0-	9,263
Interest	29,656	-0-	29,656
Changes in assumptions	3,105	-0-	3,105
Differences between expected and actual experience	(59,921)	-0-	(59,921)
Contributions - employer	-0-	34,243	(34,243)
Net investment income	-0-	27,295	(27,295)
Benefit payments	(24,672)	(24,672)	-0-
Administrative expense	-0-	(635)	635
Net changes	(42,569)	36,231	(78,800)
Balances at December 31, 2018	\$ 399,845	\$ 377,779	\$ 22,066

The following table shows the changes in NPL recognized over the year ended December 31, 2017:

	Total OPEB Liability (a)	Increase (Decrease) Plan Fiduciary Net Position (b)	Net OPEB Liability (a) - (b)
		(thousands of dollars)	
Balances at January 1, 2017	\$ 426,937	\$ 225,186	\$ 201,751
Changes recognized for the measurement period:			
Service cost	8,993	-0-	8,993
Interest	28,676	-0-	28,676
Contributions - employer	-0-	114,573	(114,573)
Net investment income	-0-	24,104	(24,104)
Benefit payments	(22,192)	(22,192)	-0-
Administrative expense	-0-	(123)	123
Net changes	15,477	116,362	(100,885)
Balances at December 31, 2017	\$ 442,414	\$ 341,548	\$ 100,866

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Sensitivity of the NOL to Changes in the Discount Rate. The following presents the NOL of SMUD as of the measurement date, calculated using the current discount rate, as well as what the NOL would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current discount rate:

	1% Decrease (5.75%)	Current Discount Rate (6.75%)	1% Increase (7.75%)
	(thousands of dollars)		
NOL, December 31, 2018	\$ 71,629	\$ 22,066	\$ (19,135)
NOL, December 31, 2017	157,146	\$ 100,866	54,233

Sensitivity of the NOL to Changes in the Healthcare Cost Trend Rates. The following presents the NOL of SMUD as of the measurement date, calculated using the current healthcare cost trend rate, as well as what the NOL would be if it were calculated using a healthcare cost trend rate that is 1 percentage-point lower or 1 percentage-point higher than the current healthcare trend rate (see assumptions above for healthcare trend rate):

	1% Decrease	Current Healthcare Trend Rate	1% Increase
	(thousands of dollars)		
NOL, December 31, 2018	\$ (22,822)	\$ 22,066	\$ 76,918
NOL, December 31, 2017	50,699	\$ 100,866	162,085

OPEB Plan Fiduciary Net Position. Detailed information about the OPEB Plan's fiduciary net position is available in the separately issued OPEB Plan's report. This report can be obtained at the PERS' website at www.calpers.ca.gov.

OPEB Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB. For the years ended December 31, 2018 and 2017, SMUD recognized OPEB expense of \$3.3 million and \$18.3 million, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

At December 31, 2018 and 2017, SMUD reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	December 31,	
	2018	2017
	(thousands of dollars)	
Deferred outflows of resources:		
Changes of assumptions	\$ 2,508	\$ -0-
Employer's contributions to the OPEB Plan subsequent to the measurement of total OPEB liability	12,822	11,937
Total deferred outflows of resources	<u>\$ 15,330</u>	<u>\$ 11,937</u>
Deferred inflows of resources:		
Differences between expected and actual experience	\$ (48,398)	\$ -0-
Differences between projected and actual earnings on OPEB plan investments	(6,626)	(4,632)
Total deferred inflows of resources	<u>\$ (55,024)</u>	<u>\$ (4,632)</u>

Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in OPEB expense as follows:

Year ended December 31:	
2019	\$ (12,872)
2020	(12,872)
2021	(12,872)
2022	(11,714)
2023	(2,186)
Thereafter	-0-

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

NOTE 16. INSURANCE PROGRAMS AND CLAIMS

SMUD is exposed to various risks of loss related to torts, theft of and destruction to assets, errors and omissions, cyber activities, natural disasters, employee injuries and illnesses, and others. SMUD carries commercial insurance coverage to cover most claims in excess of specific dollar thresholds, which range from \$5.0 thousand to \$2.5 million per claim with general liability coverage limits of \$100.0 million, and wildfire liability coverage limits of \$300.0 million. SMUD's property insurance coverage is based on the replacement value of the asset. There have been no significant reductions in insurance coverage, and in some cases, certain coverages increased. In 2018, 2017 and 2016, the insurance policies in effect have adequately covered all settlements of the claims against SMUD. No claims have exceeded the limits of property or liability insurance in any of the past three years.

The claims liability is included as a component of Self Insurance and Other in the Consolidated Statements of Net Position.

SMUD's total claims liability, comprising claims received and claims incurred but not reported, at December 31, 2018, 2017 and 2016 is presented below:

	2018	2017	2016
		(thousands of dollars)	
Workers' compensation claims	\$ 10,993	\$ 9,823	\$ 10,820
General and auto claims	3,523	1,941	2,227
Short and long-term disability claims	153	113	212
Claims liability	<u>\$ 14,669</u>	<u>\$ 11,877</u>	<u>\$ 13,259</u>

Changes in SMUD's total claims liability during 2018, 2017 and 2016 are presented below:

	2018	2017	2016
		(thousands of dollars)	
Claims liability, beginning of year	\$ 11,877	\$ 13,259	\$ 12,024
Add: provision for claims, current year	2,601	1,840	2,304
Increase in provision for claims in prior years	10,450	1,595	5,638
Less: payments on claims attributable to current and prior years	(10,259)	(4,817)	(6,707)
Claims liability, end of year	<u>\$ 14,669</u>	<u>\$ 11,877</u>	<u>\$ 13,259</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

NOTE 17. COMMITMENTS

Electric Power and Gas Supply Purchase Agreements. SMUD has numerous power purchase agreements with other power producers to purchase capacity, transmission, and associated energy to supply a portion of its load requirements. SMUD has minimum take-or-pay commitments for energy on some contracts. SMUD has numerous long-term natural gas supply, gas transportation and gas storage agreements with Canadian and U.S. companies to supply a portion of the consumption needs of SMUD's natural gas-fired power plants, which expire through 2040.

At December 31, 2018, the approximate minimum obligations for the "take-or-pay" contracts over the next five years are as follows:

	Electric	Gas
	(thousands of dollars)	
2019	\$ 78,420	\$ 12,572
2020	47,527	13,223
2021	31,598	13,349
2022	31,994	13,537
2023	32,397	13,634

At December 31, 2018, the approximate minimum obligations for the remaining contracts, assuming the energy or gas is delivered over the next five years, are as follows:

	Electric	Gas
	(thousands of dollars)	
2019	\$ 204,727	\$ 111,925
2020	207,074	93,643
2021	206,047	84,842
2022	146,754	80,568
2023	147,848	80,753

Contractual Commitments beyond 2023 - Electricity. Several of SMUD's purchase power and transmission contracts extend beyond the five-year summary presented above. These contracts expire between 2024 and 2044 and provide for power under various terms and conditions. SMUD estimates its annual minimum commitments under the take-or-pay contracts ranges between \$32.8 million in 2024 and \$7.7 million in 2033. SMUD estimates its annual minimum commitments under the remaining contracts, assuming the energy is delivered, ranges between \$145.6 million in 2024 and \$17.2 million in 2044. SMUD's largest purchase power source (in volume) is the Western Base Resource contract, whereby SMUD receives 25.5 percent of the amount of energy made available by Western, which equals an equal share of their revenue requirement. The Western contract expires on December 31, 2024.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Contractual Commitments beyond 2023 - Gas. Several of SMUD's natural gas supply, gas transportation and gas storage contracts extend beyond the five-year summary presented above. These contracts expire between 2024 and 2040 and provide for transportation and storage under various terms and conditions. SMUD estimates its annual minimum commitments under the take-or-pay contracts ranges between \$13.8 million in 2024 and \$8.1 million in 2040. SMUD estimates its annual minimum commitments under the remaining contracts, assuming the gas is delivered, ranges between \$44.2 million in 2024 and \$14.4 million in 2040.

Gas Price Swap Agreements. SMUD has entered into numerous variable to fixed rate swaps with notional amounts totaling 99,157,500 Dths for the purpose of fixing the rate on SMUD's natural gas purchases for its gas-fueled power plants and gas indexed electric contracts. These gas price swap agreements result in SMUD paying fixed rates ranging from \$2.61 to \$7.17 per Dth. The swap agreements expire periodically from January 2019 through December 2022.

Gas Transport Capacity Agreements. SMUD has numerous long-term natural gas transport capacity agreements with Canadian and U.S. companies to transport natural gas to SMUD's natural gas-fired power plants from the supply basins in Alberta to the California-Oregon border and from supply basins in the southwest and Rocky Mountains to the Southern California border. These gas transport capacity agreements provide for the delivery of gas into SMUD-owned pipeline capacity within California. The gas transport capacity agreements provide SMUD with 58,300 Dth per day (Dth/d) of natural gas pipeline capacity from the North, including the Canadian Basins through 2021 and 51,300 Dth/d from the Southwest or Rocky Mountain Basins through at least 2019.

Gas Storage Agreements. SMUD also has an agreement for the storage of up to 2.0 million Dth of natural gas at regional facilities through March 2020, dropping to 1.0 million Dth through March 2023.

Hydro License Agreements. SMUD has a hydro license for a term of 50 years effective July 1, 2014 (see Note 2). SMUD entered into four contracts with government agencies whereby SMUD makes annual payments to them for various services for the term of the license. Each contract is adjusted annually by an inflation index. The present value of the sum of the annual payments is \$58.8 million at December 31, 2018.

Construction Contracts. SMUD has entered into various construction contracts for the renovation of the Headquarters building, a new substation, an upgrade of combustion turbines at the SFA plant, and a new powerhouse and road improvement project in the UARP. As of December 31, 2018, the not-to-exceed price for these contracts totaled \$128.3 million. The remaining contract obligations for these contracts as of December 31, 2018 was \$56.1 million.

NOTE 18. CLAIMS AND CONTINGENCIES

FERC Administrative Proceedings. SMUD is involved in a number of FERC administrative proceedings related to the operation of wholesale energy markets, regional transmission planning, gas transportation, and the development of NERC reliability standards. While these proceedings are complex and numerous, they generally fall into the following categories: (i) filings initiated by the California Independent System Operator Corporation (CAISO) (or other market participants) to adopt/modify the CAISO Tariff and/or establish market design and behavior rules; (ii) filings initiated by existing transmission owners (i.e. PG&E and the other Investor Owned Utilities) to pass through costs to their existing wholesale transmission customers; (iii) filings initiated by FERC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

on market participants to establish market design and behavior rules or to complain about or investigate market behavior by certain market participants; (iv) filings initiated by transmission owners under their transmission owner tariffs for the purpose of establishing a regional transmission planning process; (v) filings initiated by providers of firm gas transportation services under the Natural Gas Act; and (vi) filings initiated by NERC to develop reliability standards applicable to owners, users, and operators of the bulk electric system. In addition, SMUD is an active participant in other FERC administrative proceedings, including those related to reliability and cybersecurity standards, variable resource integration, and transmission planning and cost allocation. SMUD's management believes that the ultimate resolution of these matters will not have a material adverse effect on SMUD's financial position, liquidity or results of operations.

Construction Matters. SMUD contracts with various firms to design and construct facilities for SMUD. Currently, SMUD is party to various claims, legal actions and complaints relating to such construction projects. SMUD's management believes that the ultimate resolution of these matters will not have a material adverse effect on SMUD's financial position, liquidity or results of operations.

Environmental Matters. SMUD was one of many potentially responsible parties that had been named in a number of actions relating to environmental claims and/or complaints. SMUD has resolved these environmental claims and/or complaints and entered into settlement agreements and/or consent orders. These settlement agreements and consent orders have statutory reopener provisions which allow regulatory agencies to seek additional funds for environmental remediation under certain limited circumstances. While SMUD believes it is unlikely that any of the prior settlements or consent orders will be reopened, the possibility exists. If any of the settlements or consent orders were to be reopened, SMUD management does not believe that the outcome will have a material adverse impact on SMUD's financial position, liquidity or results of operations.

North City Environmental Remediation. In 1950, SMUD purchased property (North City Site) from the City of Sacramento and the Western Railroad Company. Portions of the North City Site prior to the sale had been operated as a municipal landfill by the City of Sacramento. SMUD currently operates a bulk substation on the North City Site and plans to decommission the facility in the next few years. SMUD intends to assure compliance with State standards at closed landfill sites and is in the process of determining the appropriate remediation for the North City Site. In 2009, SMUD established a regulatory asset to defer recognition of the expense related to the investigation, design and remediation necessary for the North City Site, and recorded a liability for the full \$12.0 million estimated for the project. In 2012, the regulatory asset was fully amortized. As the owner of the North City Site, SMUD will play the principal role in the remediation selection and activities. SMUD has estimated the total exposure for closing the site at as high as \$12.0 million based on initial tests and studies of the site and approve and implemented cap designs for nearby former landfill areas. Costs could exceed that amount based on the need to design around transmission-related infrastructure improvements. SMUD's management does not believe this will occur. Even if remediation costs associated with the North City Site were to increase, SMUD management believes that any increased costs will not have a material adverse impact on SMUD's financial position, liquidity or results of operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended December 31, 2018 and 2017

Station E Site Remediation. In October 2013, SMUD purchased property for development of a new substation to replace the North City Substation (“Station E”). Initial development of the site in 2016 uncovered solid waste in quantities not indicated by pre-purchase due diligence. SMUD thereafter worked with the Sacramento County Environmental Management Division, the local enforcement agency for the California Department of Resources Recycling and Recovery to obtain approval of soil handling and land use plans for development of the site, which approval was given in the third quarter of 2017. SMUD substantially implemented the plans in 2018, including installing a cover, grading, drainage, maintenance and landfill gas control measures at the site. SMUD filed a lawsuit to recover remediation costs from a prior owner of the site, Union Pacific Railroad. Ultimate financial responsibility for the closure activities has not been determined, though SMUD management believes that any increased costs ultimately borne by SMUD will not have a material adverse impact on SMUD’s financial position, liquidity or results of operations.

Patua Acquisition Company, LLC. On April 16, 2010, SMUD entered into a 23-year PPA with Patua Project, LLC. The fifth amendment to the PPA was signed on November 30, 2016, with the new project owner, Patua Acquisition Company, LLC (Patua). The PPA requires Patua to provide a warranty for the annual amount of energy and green attributes produced and delivered to SMUD. If Patua fails to meet the warranty for two consecutive years, it triggers SMUD’s right to reduce the Guaranteed Capacity and Transmission Capacity Requirement as defined in the PPA.

On February 16, 2017, SMUD sent Patua a Notice of Failure to Meet Annual Performance Guarantee, Reduction of Phase 1 Guaranteed Capacity Resizing, and Reduction of Transmission Capacity Requirement pursuant to the terms of the PPA. Patua disagreed with the reductions and on June 9, 2017, after meetings with SMUD staff, sent a letter requesting a meeting with a senior officer to work towards a resolution in accordance with the dispute resolution provisions of the PPA. A meeting of the senior officers occurred. Staff continues to work through the issue with Patua. However, SMUD management does not believe that the outcome will have a material adverse impact on SMUD’s financial position, liquidity or results of operations.

Other Matters. Currently, SMUD is party to various claims, legal actions and complaints relating to its operations, including but not limited to: property damage and personal injury, contract disputes, torts, and employment matters. SMUD’s management believes that the ultimate resolution of these matters will not have a material adverse effect on SMUD’s financial position, liquidity or results of operations.

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

For the Years Ended December 31, 2018 and 2017

**Schedule of Changes in Net Pension Liability and Related Ratios
During the Measurement Period**

PERS Plan. The schedule of changes in NPL and related ratios is presented below for the years for which SMUD has available data. SMUD will add to this schedule each year and when it reaches 10 years it will contain the last 10 years data which will then be updated each year going forward.

	December 31,				
	2018	2017	2016	2015	2014
	(thousands of dollars)				
Total pension liability:					
Service cost	\$ 36,029	\$ 35,040	\$ 29,044	\$ 27,991	\$ 28,170
Interest	151,354	150,119	147,497	142,468	137,546
Changes of assumptions	(61,585)	123,043	-0-	(34,228)	-0-
Differences between expected and actual experience	1,293	(29,276)	(8,357)	(10,613)	-0-
Benefit payments, including refunds of employee contributions	(111,763)	(104,428)	(99,155)	(94,636)	(90,175)
Net change in total pension liability	15,328	174,498	69,029	30,982	75,541
Total pension liability, beginning of year	2,214,995	2,040,497	1,971,468	1,940,486	1,864,945
Total pension liability, end of year (a)	<u>\$ 2,230,323</u>	<u>\$ 2,214,995</u>	<u>\$ 2,040,497</u>	<u>\$ 1,971,468</u>	<u>\$ 1,940,486</u>
Plan fiduciary net position:					
Contributions - employer	\$ 90,141	\$ 32,389	\$ 27,645	\$ 22,499	\$ 21,511
Contributions - employee	16,832	15,845	15,271	14,503	15,346
Net investment income	138,739	171,596	8,316	35,797	245,659
Benefit payments, including refunds of employee contributions	(111,763)	(104,428)	(99,155)	(94,636)	(90,175)
Administrative expense	(7,474)	(2,275)	(969)	(1,795)	(2,028)
Other	(4)	-0-	34	(25)	-0-
Net change in plan fiduciary net position	126,471	113,127	(48,858)	(23,657)	190,313
Plan fiduciary net position, beginning of year	1,654,396	1,541,269	1,590,127	1,613,784	1,423,471
Plan fiduciary net position, end of year (b)	<u>\$ 1,780,867</u>	<u>\$ 1,654,396</u>	<u>\$ 1,541,269</u>	<u>\$ 1,590,127</u>	<u>\$ 1,613,784</u>
Net pension liability, ending (a) - (b)	<u>\$ 449,456</u>	<u>\$ 560,599</u>	<u>\$ 499,228</u>	<u>\$ 381,341</u>	<u>\$ 326,702</u>
Plan fiduciary net position as a percentage of the total pension liability	79.8%	74.7%	75.5%	80.7%	83.2%
Covered payroll	\$ 235,902	\$ 223,685	\$ 207,119	\$ 197,481	\$ 191,439
Net pension liability as a percentage of covered payroll	190.5%	250.6%	241.0%	193.1%	170.7%

Notes to Schedule

Benefit Changes: The figures above do not include any liability impact that may have resulted from plan changes which occurred after the June 30, 2017 valuation date. This applies for voluntary benefit changes as well as any offers of two years additional service credit.

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

For the Years Ended December 31, 2018 and 2017

Changes in Assumptions: In 2018, demographic assumptions and inflation rate were changed in accordance to the PERS Experience and Study and Review of Actuarial Assumptions December 2017. There were no changes in the discount rate. In 2017, the accounting discount rate reduced from 7.65 percent to 7.15 percent. In 2016, there were no changes. In 2015, amounts reported reflect an adjustment of the discount rate from 7.5 percent (net of administrative expense) to 7.65 percent (without a reduction for pension plan administrative expense). In 2014, amounts reported were based on the 7.5 percent discount rate.

Schedule of Changes in Net Pension Liability and Related Ratios During the Measurement Period

SHY. The schedule of changes in NPL and related ratios is presented below for the years for which SMUD has available data. SMUD will add to this schedule each year and when it reaches 10 years it will contain the last 10 years data which will then be updated each year going forward.

	2018	December 31, 2017	2016
	(thousands of dollars)		
Total pension liability:			
Service cost	\$ 216	\$ 300	\$ 218
Interest	194	193	195
Changes of assumptions	(76)	(827)	1,118
Differences between expected and actual experience	(947)	(914)	-0-
Net change in total pension liability	(613)	(1,248)	1,531
Total pension liability, beginning of year	5,201	6,449	4,918
Total pension liability, end of year	<u>\$ 4,588</u>	<u>\$ 5,201</u>	<u>\$ 6,449</u>
Covered payroll	\$ 20,466	\$ 21,743	\$ 21,748
Net pension liability as a percentage of covered payroll	22.4%	23.9%	29.7%

Notes to Schedule

Benefit Changes: There were no changes to benefits.

Changes in Assumptions: In 2018, the accounting discount rate increased from 3.58 percent to 3.87 percent. In 2017, the accounting discount rate increased from 2.85 percent to 3.58 percent.

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

For the Years Ended December 31, 2018 and 2017

Schedule of Plan Contributions for Pension

PERS Plan. The schedule of pension contributions is presented below for the years for which SMUD has available data. SMUD will add to this schedule each year and when it reaches 10 years it will contain the last 10 years data which will then be updated each year going forward.

	2018	2017	December 31,		
			2016	2015	2014
	(thousands of dollars)				
Actuarially determined contribution	\$ 40,142	\$ 32,389	\$ 27,645	\$ 22,499	\$ 21,511
Contributions in relation to the actuarially determined contribution	<u>(90,142)</u>	<u>(32,389)</u>	<u>(27,645)</u>	<u>(22,499)</u>	<u>(21,511)</u>
Contribution deficiency (excess)	<u>\$ (50,000)</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>
Covered payroll	\$ 248,590	\$ 236,219	\$ 222,133	\$ 213,627	\$ 195,394
Contributions as a percentage of covered payroll	36.3%	13.7%	12.5%	10.5%	11.0%

Notes to Schedule

The actuarial methods and assumptions used to set the actuarially determined contributions for the year ended December 31, 2018 was derived from the June 30, 2015 funding valuation report.

Actuarial cost method	Entry age normal
Amortization method/period	For details, see June 30, 2015 Funding Valuation Report
Asset valuation method	Market value of assets. For details, see June 30, 2015 Funding Valuation Report
Inflation	2.75%
Salary increases	Varies by entry age and service
Payroll growth	3.0%
Investment rate of return	7.5% Net of pension plan investment and administrative expenses; includes inflation
Retirement age	The probabilities of retirement are based on the 2014 PERS Experience Study for the period from 1997 to 2011
Mortality	The probabilities of mortality are based on the 2014 PERS Experience Study for the period from 1997 to 2011. Pre-retirement and post-retirement mortality rates include 20 years of projected mortality improvement using Scale BB published by the Society of Actuaries.

Prior to 2017, the retirement age and mortality assumptions were based on the 2010 PERS Experience Study for the period from 1997 to 2007. In addition, the mortality assumption for pre-retirement and post-retirement rates included 5 years of projected mortality improvement using Scale AA published by the Society of Actuaries.

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

For the Years Ended December 31, 2018 and 2017

**Schedule of Changes in Net OPEB Liability and Related Ratios
During the Measurement Period**

OPEB. The schedule of changes in NOL and related ratios is presented below for the years for which SMUD has available data. SMUD will add to this schedule each year and when it reaches 10 years it will contain the last 10 years data which will then be updated each year going forward.

	December 31,	
	2018	2017
	(thousands of dollars)	
Total OPEB liability:		
Service cost	\$ 9,263	\$ 8,993
Interest	29,656	28,676
Changes of assumptions	3,105	-0-
Differences between expected and actual experience	(59,921)	-0-
Benefit payments, including refunds of employee contributions	(24,672)	(22,192)
Net change in total OPEB liability	(42,569)	15,477
Total OPEB liability, beginning of year	442,414	426,937
Total OPEB liability, end of year (a)	<u>\$ 399,845</u>	<u>\$ 442,414</u>
Plan fiduciary net position:		
Contributions - employer	\$ 34,243	\$ 114,573
Net investment income	27,295	24,104
Benefit payments, including refunds of employee contributions	(24,672)	(22,192)
Administrative expense	(635)	(123)
Net change in plan fiduciary net position	36,231	116,362
Plan fiduciary net position, beginning of year	341,548	225,186
Plan fiduciary net position, end of year (b)	<u>\$ 377,779</u>	<u>\$ 341,548</u>
Net OPEB liability, ending (a) - (b)	<u>\$ 22,066</u>	<u>\$ 100,866</u>
Plan fiduciary net position as a percentage of the total OPEB liability	94.5%	77.2%
Covered payroll	\$ 269,753	\$ 252,211
Net OPEB liability as a percentage of covered payroll	8.2%	40.0%

Notes to Schedule

Benefit Changes: The figures above do not include any liability impact that may have resulted from plan changes which occurred after the June 30, 2018 valuation date.

Changes in Assumptions: In 2018, there were no changes in the discount rate.

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

For the Years Ended December 31, 2018 and 2017

Schedule of Plan Contributions for OPEB

OPEB Plan. The schedule of OPEB contributions is presented below for the years for which SMUD has available data. SMUD will add to this schedule each year and when it reaches 10 years it will contain the last 10 years data which will then be updated each year going forward.

	December 31,	
	2018	2017
	(thousands of dollars)	
Actuarially determined contribution	\$ 15,366	\$ 16,472
Contributions in relation to the actuarially determined contribution	<u>(35,128)</u>	<u>(116,181)</u>
Contribution deficiency (excess)	<u>\$ (19,762)</u>	<u>\$ (99,709)</u>
Covered payroll	\$ 277,193	\$ 260,210
Contributions as a percentage of covered payroll	12.7%	44.6%

Notes to Schedule

The actuarial methods and assumptions used to set the actuarially determined contributions for the year ended December 31, 2018 was derived from the June 30, 2017 funding valuation report.

Actuarial cost method	Entry age normal
Amortization method	Level percent of pay
Amortization period	28-year fixed period for 2018
Inflation	2.75%
Discount rate	6.75%
Medical trend	Non-medicare: 7.5% for 2019, decreasing to an ultimate rate of 4.0% in 2076 and later years Medicare: 6.5% for 2019, decreasing to an ultimate rate of 4.0% in 2076 and later years
Mortality	PERS 1997-2011 experience study
Mortality improvement	Mortality projected fully generational with Scale MP-16

In 2017, the amortization period was for a 29-year fixed period. The inflation rate was 3.0% and the discount rate was 7.25%. The mortality projected fully generational with Scale MP-14, modified to converge in 2022.

A graphic consisting of a solid orange triangle pointing downwards, containing the text "ELECTRIC SOLUTIONS" in white, uppercase, sans-serif font.

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