NORTHERN CALIFORNIA GAS AUTHORITY No. 1
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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Northern California Gas Authority No. 1
Sacramento, California

Report on the Financial Statements

We have audited the accompanying financial statements of Northern California Gas Authority No. 1 which comprise the Statements of Net Position as of December 31, 2017 and 2016, and the related Statements of Revenues, Expenses and Changes in Net Position, and Statements of Cash Flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control over financial reporting relevant to the Northern California Gas Authority No. 1's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Northern California Gas Authority No. 1's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Northern California Gas Authority No. 1 at December 31, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

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INTERNATIONAL

Other Matter

Required Supplementary Information

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

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
February 16, 2018

NORTHERN CALIFORNIA GAS AUTHORITY No. 1
MANAGEMENT'S DISCUSSION AND ANALYSIS
(UNAUDITED)

Using this Financial Report

This annual financial report for Northern California Gas Authority No. 1 (Agency) consists of management's discussion and analysis and the financial statements, including notes to the financial statements. The basic Financial Statements consist of the Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position and the Statements of Cash Flows.

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

Overview of the Financial Statements

The following discussion and analysis of the financial performance of the Agency provides an overview of the financial activities for the years ended December 31, 2017 and 2016. This discussion and analysis should be read in conjunction with the Agency's financial statements and accompanying notes, which follow this section.

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

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

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

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

Nature of Operations

The Agency is a joint powers authority (JPA) formed by the Sacramento Municipal Utility District (SMUD) and the Sacramento Municipal Utility District Financing Authority (SFA) in 2007. SFA is a JPA formed by SMUD and the Modesto Irrigation District. The Agency was formed for the purpose of prepaying for a fixed quantity supply of natural gas to be delivered over a twenty-year period by Morgan Stanley Capital Group, Inc. (MSCG) under a Prepaid Gas Purchase and Sale Agreement (Prepaid Gas Supply) between the Agency and MSCG. The Agency then sells the natural gas to SMUD. The Agency issued bonds in May 2007, and commenced gas sales in June 2007.

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

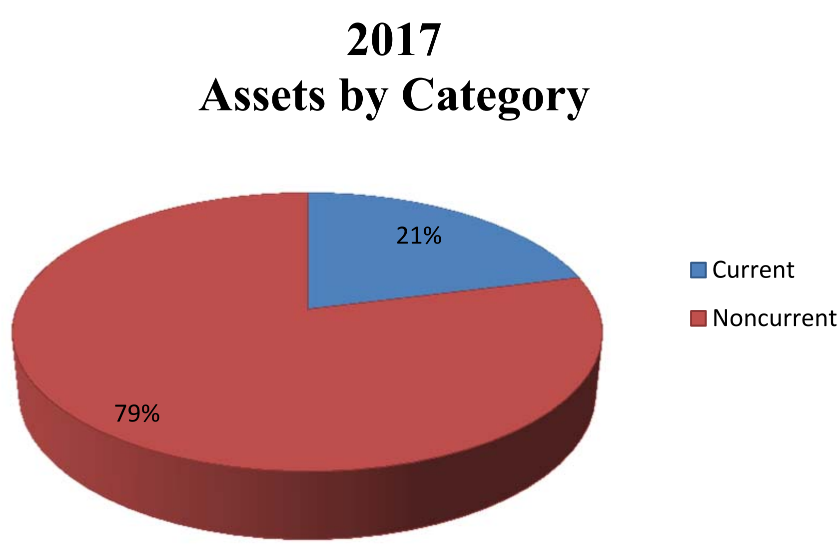
The Agency's Commission is comprised of SMUD's Board of Directors. The Agency is a separate legal entity; however, due to the extent of its operational and financial relationship with SMUD, it is included in the consolidated financial statements of SMUD.

FINANCIAL POSITION

Statements of Net Position Summary
(Dollars in thousands)

	December 31,			Change			
	2017	2016	2015	2017 vs. 2016		2016 vs. 2015	
Assets							
Current assets	$ 59,786	$ 55,348	$ 51,507	$ 4,438	8.0%	$ 3,841	7.5%
Noncurrent assets	223,372	258,079	289,108	(34,707)	-13.4%	(31,029)	-10.7%
Total assets	$ 283,158	$ 313,427	$ 340,615	$ (30,269)	-9.7%	$ (27,188)	-8.0%
Liabilities							
Long-term debt - net	$ 233,170	$ 264,475	$ 292,870	$ (31,305)	-11.8%	$ (28,395)	-9.7%
Current liabilities	37,328	35,279	33,524	2,049	5.8%	1,755	5.2%
Total liabilities	270,498	299,754	326,394	(29,256)	-9.8%	(26,640)	-8.2%
Net position							
Restricted	15,216	13,769	12,486	1,447	10.5%	1,283	10.3%
Unrestricted	(2,556)	(96)	1,735	(2,460)	-2562.5%	(1,831)	-105.5%
Total net position	12,660	13,673	14,221	(1,013)	-7.4%	(548)	-3.9%
Total liabilities and net position	$ 283,158	$ 313,427	$ 340,615	$ (30,269)	-9.7%	$ (27,188)	-8.0%

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



2017 Compared to 2016

ASSETS

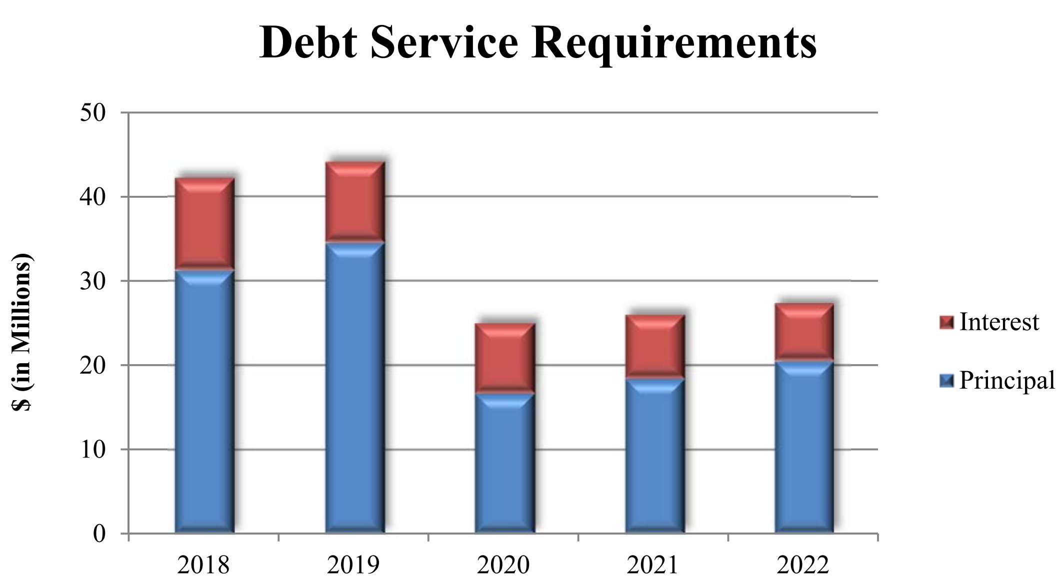
- Current Assets increased primarily due to higher current portion of the Prepaid Gas Supply.

- The Agency's main asset is its Prepaid Gas Supply, of which, the noncurrent portion was $222.3 million at December 31, 2017. Noncurrent Assets decreased due to the amortization of the Prepaid Gas Supply for gas delivered in 2017. The Prepaid gas supply (current and noncurrent portion) was about 79 percent of the Agency's assets at December 31, 2017.

LIABILITIES & NET POSITION

- Long-Term Debt - net decreased primarily due to $28.4 million of the scheduled principal payments for 2017. At December 31, 2017, the Agency had bonds outstanding of $264.5 million with maturities through 2027. At December 31, 2017, the 2007 Agency Bonds are rated "BBB+" by Standard & Poor's, "A" by Fitch and "A3" by Moody's. The Agency's bonds are tied to MSCG's credit rating.

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



- Current Liabilities increased primarily due to higher current portion of the long-term debt due within one year, partially offset by lower credit support obligation to a collateral deposit from MSCG and accounts payable for the net settlement of the interest rate swap due to the counterparty.

2016 Compared to 2015

ASSETS

- Current Assets increased primarily due to higher current portion of the Prepaid Gas Supply.

- The Agency's main asset is its Prepaid Gas Supply, of which, the noncurrent portion was $256.9 million at December 31, 2016. Noncurrent Assets decreased due to the amortization of the Prepaid Gas Supply for gas delivered in 2016.

LIABILITIES & NET POSITION

- Long-Term Debt - net decreased primarily due to $25.9 million of the scheduled principal payments for 2016. At December 31, 2016, the Agency had bonds outstanding of $292.9 million with maturities through 2027.

- Current Liabilities increased primarily due to higher current portion of the long-term debt due within one year, partially offset by lower credit support obligation to a collateral deposit from MSCG, and accounts payable for the net settlement of the interest rate swap due to the counterparty.

RESULTS OF OPERATIONS

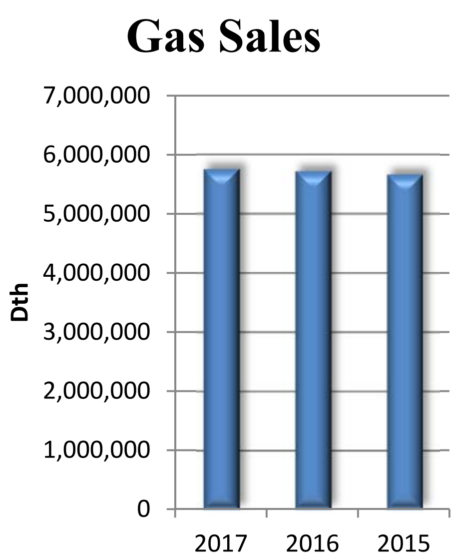
Summary of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

	December 31,			Change			
	2017	2016	2015	2017 vs. 2016		2016 vs. 2015	
Operating revenues	$ 41,895	$ 40,338	$ 38,871	$ 1,557	3.9%	$ 1,467	3.8%
Operating expenses	(31,083)	(27,943)	(25,106)	(3,140)	-11.2%	(2,837)	-11.3%
Operating income	10,812	12,395	13,765	(1,583)	-12.8%	(1,370)	-10.0%
Interest and other income	785	707	649	78	11.0%	58	8.9%
Interest on debt	(11,870)	(12,973)	(13,981)	1,103	8.5%	1,008	7.2%
Change in net position before distributions and contributions	(273)	129	433	(402)	-311.6%	(304)	-70.2%
Distributions to Member	(809)	(748)	(698)	(61)	-8.2%	(50)	-7.2%
Member contributions	69	71	102	(2)	-2.8%	(31)	-30.4%
Change in net position	(1,013)	(548)	(163)	(465)	-84.9%	(385)	-236.2%
Net position - beginning of year	13,673	14,221	14,384	(548)	-3.9%	(163)	-1.1%
Net position - end of year	$ 12,660	$ 13,673	$ 14,221	$ (1,013)	-7.4%	$ (548)	-3.9%

2017 Compared to 2016

The following chart shows gas sales in 2017, 2016 and 2015:



- Operating Revenue increased primarily due to higher gas sales to Member as a result of higher price index.
- Operating Expense increased due to higher amortization of the Prepaid Gas Supply.
- Interest expense decreased primarily due to lower bonds outstanding.
- Distributions to SMUD are based on interest earnings on the Debt Service fund not otherwise needed for another purpose, as specified in the indenture of trust. In 2017, the Agency distributed $0.8 million to SMUD.

2016 Compared to 2015

- Operating Revenue increased primarily due to higher swap revenues as a result of higher net swap price, partially offset by the lower gas sales to Member due to lower index prices.

- Operating Expense increased due to higher amortization of the Prepaid Gas Supply.

- Interest expense decreased primarily due to lower bonds outstanding.

- The Agency distributed $0.7 million to SMUD in 2016.

NORTHERN CALIFORNIA GAS AUTHORITY No. 1
STATEMENTS OF NET POSITION

	December 31, 2017	December 31, 2016
ASSETS		
RESTRICTED ASSETS		
Debt service fund	$ 18,032,562	$ 16,876,219
Other restricted funds	3,206,630	3,777,633
Less current portion	(21,239,192)	(20,653,078)
Total restricted assets	-0-	774
CURRENT ASSETS		
Cash and cash equivalents:		
Restricted cash and cash equivalents	21,239,192	20,653,078
Receivables:		
Gas sales to Member	481,862	693,374
Accrued interest and other	3,358,025	2,971,838
Prepaid gas supply	34,586,730	30,908,611
Other prepayments	15,630	15,630
Regulatory costs to be recovered within one year	104,796	104,796
Total current assets	59,786,235	55,347,327
NONCURRENT ASSETS		
Prepaid gas supply	222,348,517	256,935,247
Regulatory costs for future recovery	890,771	995,567
Prepaid bond insurance costs	132,858	148,488
Total noncurrent assets	223,372,146	258,079,302
TOTAL ASSETS	$ 283,158,381	$ 313,427,403
LIABILITIES AND NET POSITION		
LONG-TERM DEBT - net	$ 233,170,000	$ 264,475,000
CURRENT LIABILITIES		
Accounts payable	1,758,119	2,184,089
Credit support for collateral obligation	3,203,932	3,776,859
Long-term debt due within one year	31,305,000	28,395,000
Accrued interest	1,061,287	923,668
Total current liabilities	37,328,338	35,279,616
TOTAL LIABILITIES	270,498,338	299,754,616
NET POSITION		
Restricted	15,215,854	13,769,236
Unrestricted	(2,555,811)	(96,449)
TOTAL NET POSITION	12,660,043	13,672,787
COMMITMENTS AND CONTINGENCIES (Notes 6 and 7)		
TOTAL LIABILITIES AND NET POSITION	$ 283,158,381	$ 313,427,403

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

NORTHERN CALIFORNIA GAS AUTHORITY No. 1

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	Years Ended December 31, 2017	Years Ended December 31, 2016
OPERATING REVENUES		
Gas sales to Member	$ 6,570,887	$ 4,956,882
Gas swap settlement, net	35,323,763	35,381,239
Total operating revenues	41,894,650	40,338,121
OPERATING EXPENSES		
Prepaid gas amortization	30,908,611	27,767,785
Administrative and general	69,224	71,008
Regulatory amounts collected in rates	104,796	104,796
Total operating expenses	31,082,631	27,943,589
OPERATING INCOME	10,812,019	12,394,532
NON-OPERATING REVENUES (EXPENSES)		
Interest and other income	785,252	706,866
Interest on debt	(11,869,952)	(12,973,192)
Total non-operating expenses	(11,084,700)	(12,266,326)
CHANGE IN NET POSITION BEFORE DISTRIBUTIONS AND CONTRIBUTIONS	(272,681)	128,206
Distributions to Member	(809,287)	(747,890)
Member contributions	69,224	71,008
CHANGE IN NET POSITION	(1,012,744)	(548,676)
NET POSITION - BEGINNING OF YEAR	13,672,787	14,221,463
NET POSITION - END OF YEAR	$ 12,660,043	$ 13,672,787

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

NORTHERN CALIFORNIA GAS AUTHORITY No. 1
STATEMENTS OF CASH FLOWS

	December 31, 2017	December 31, 2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from gas sales to Member	$ 6,782,399	$ 4,831,916
Receipts from others	34,964,523	35,388,709
Receipts/payments for credit support collateral	(572,927)	(451,283)
Net cash provided by operating activities	41,173,995	39,769,342
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Repayment of bonds	(28,395,000)	(25,925,000)
Interest payments on long-term debt	(12,142,673)	(13,220,829)
Distributions to Member	(809,287)	(747,890)
Net cash used in noncapital financing activities	(41,346,960)	(39,893,719)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	758,305	692,870
Net cash provided by investing activities	758,305	692,870
Net increase in cash and cash equivalents	585,340	568,493
Cash and cash equivalents - beginning of the year	20,653,852	20,085,359
Cash and cash equivalents - end of the year	$ 21,239,192	$ 20,653,852
CASH AND CASH EQUIVALENTS INCLUDED IN:		
Restricted cash and cash equivalents	$ 21,239,192	$ 20,653,078
Other restricted funds (a component of the total of $3,777,633 at December 31, 2016)	-0-	774
Cash and cash equivalents - end of the year	$ 21,239,192	$ 20,653,852
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	$ 10,812,019	$ 12,394,532
Adjustments to reconcile operating income to net cash provided by operating activities:		
Amortization of prepaid gas supply	30,908,611	27,767,785
Regulatory amortization	104,796	104,796
Receipts (payments) for credit support collateral	(572,927)	(451,283)
Changes in operating assets and liabilities:		
Receivables	(147,728)	(117,496)
Payables and accruals	69,224	71,008
Net cash provided by operating activities	$ 41,173,995	$ 39,769,342
SUPPLEMENTAL DISCLOSURE OF NONCASH AND RELATED FINANCING ACTIVITIES		
Amortization of debt related costs	$ (15,630)	$ (15,630)
Contributions from Member	69,224	71,008

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

NORTHERN CALIFORNIA GAS AUTHORITY No. 1
NOTES TO FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND OPERATIONS

The Northern California Gas Authority No. 1 (Agency) is a joint powers authority (JPA) formed by the Sacramento Municipal Utility District (SMUD) and the Sacramento Municipal Utility District Financing Authority (SFA) pursuant to the California Government Code (collectively, Members). SFA itself is a JPA formed by SMUD and the Modesto Irrigation District. The purpose of the Agency is to prepay for a supply of a fixed quantity of natural gas to be delivered over a twenty-year period (Gas Project) by Morgan Stanley Capital Group, Inc. (MSCG) under a Prepaid Gas Purchase and Sale Agreement (Prepaid Agreement) between the Agency and MSCG. The Prepaid Agreement terminates on May 31, 2027. MSCG is obligated to make payments to the Agency for any shortfall of gas not delivered or taken under the Prepaid Agreement for any reason, including force majeure.

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

The Agency has no employees. The Gas Project is operated by SMUD's staff. SMUD is obligated to contribute to the Agency the actual costs of providing administrative and general services. SMUD contributed \$0.1 million both in 2017 and 2016 for administrative and general services provided to the Agency by SMUD.

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

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting. The accounting records of the Agency are maintained in accordance with Generally Accepted Accounting Principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB). The Agency's accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission. The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Natural gas sale revenues and purchase costs that are directly related to delivery of natural gas are reported as operating revenues and expenses. All other revenues and expenses are reported as non-operating revenues and expenses.

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

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

Credit and Market Risk. The Agency entered into a guaranteed investment contract (see Note 3) in 2007 and is exposed to credit risk related to nonperformance by its investment provider. This contract requires the investment provider to post collateral if their credit ratings fall below agreed upon levels. At December 31, 2017 and 2016, the Agency held $3.2 million and $3.8 million on deposit by the investment provider, respectively. The amount is recorded as current restricted asset with an associated current liability.

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

Receivable from Member. The Agency records as a Receivable from Member the amounts due from SMUD for the purchase of natural gas from the Gas Project.

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

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

Prepaid Bond Insurance Costs. The Agency recorded a prepaid asset for the prepaid bond insurance portion of unamortized debt issuance costs of previously issued bonds of the Agency. The prepaid bond insurance costs will be amortized using the straight line method over the remaining life of the associated bonds and recorded in Interest on Debt in the Statements of Revenues, Expenses and Changes in Net Position.

Derivative Financial Instruments. The Agency enters into derivative financial instruments (interest rate swap and natural gas commodity price swap agreements) to manage its exposure to interest rate risk and market volatility of natural gas commodity prices. The Agency does not enter into these agreements for trading purposes. Due to the termination provisions of these agreements, they have no fair value, and therefore, there is no mark-to-market and the Agency does not record these derivative financial instruments on its Statement of Net Position. The Agency is exposed to the risk of early termination of the Prepaid Agreement if the counterparties default or if the swap agreements are terminated.

Interest Rate Swap Agreements. The Agency enters into interest rate swap agreements to modify the effective interest rates on outstanding debt. Interest expense is reported net of the swap payments received or paid as a component of Interest on Debt in the Statement of Revenues, Expenses and Changes in Net Position.

Natural Gas Commodity Price Swap Agreement. The Agency uses a forward contract to hedge the impact of market volatility on natural gas commodity prices on its natural gas sales to SMUD. Net swap payments received or paid are reported as a component of Operating Revenues in the Statement of Revenues, Expenses and Changes in Net Position.

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

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

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

Operating Expenses. Operating expenses include the cost of sales and services, administrative expenses and amortization on Prepaid Gas Supply assets and Regulatory Costs for Future Recovery and are recorded when incurred.

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

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

Subsequent Events. Subsequent events for the Agency have been evaluated through February 16, 2018, which is the date that the financial statements were available to be issued.

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

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

In May 2017, GASB issued SGAS No. 86, "***Certain Debt Extinguishment Issues***" (GASB No. 86). The primary objective of this statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources (resources other than the proceeds of refunding debt) are placed in an irrevocable trust for the sole purpose of extinguishing debt. GASB No. 86 also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. This statement is effective for the Agency in 2018. The Agency is currently assessing the financial statement impact of adopting this statement.

In June 2017, GASB issued SGAS No. 87, "***Leases***" (GASB No. 87). The objective of this statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. GASB No. 87 requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under GASB No. 87, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources. The lease liability should be measured at the present value of payments expected to be made during the lease term. As payments are made the lease liability is reduced and an outflow of resources (interest expense) is recognized for the interest on the liability. The lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset. The lease receivable should be measured at the present value of the lease payments expected to be received during the lease term. Any payments received are first allocated to accrued interest receivable and then to lease receivable. The deferred inflow of resources should be recognized as inflows of resources (revenue) in a systematic and rational manner over the term of the lease. The lessor should not derecognize the asset underlying the lease. A lease is defined as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under the leases guidance, unless specifically excluded in this statement. The lease term is defined as the period during which a lessee has a noncancellable right to use an underlying asset, plus the following periods, if applicable. A short-term lease is defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources (expenses) or inflows of resources (revenues), respectively, based on the payment provisions of the lease contract. This statement is effective for the Agency in 2020. The Agency is currently assessing the financial statement impact of adopting this statement.

NOTE 3. CASH, CASH EQUIVALENTS, AND INVESTMENTS

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

Credit Risk. This is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. To mitigate the risk, the Agency limits investments to those rated, at a minimum, "A-1" or equivalent for short-term investments and "A" or equivalent for medium-term corporate notes by a nationally recognized rating agency.

Custodial Credit Risk. This is the risk that in the event of the failure of a depository financial institution or counterparty to a transaction, the Agency's deposits may not be returned or the Agency will not be able to recover the value of its deposits, investments or securities that are in the possession of another party. The Agency does not have a deposit policy for custodial credit risk. At December 31, 2017 and 2016, the Agency had money market funds of $3.4 million and $4.0 million which were uninsured, respectively. At December 31, 2017 and 2016, $0.2 million of the money market funds were held in trust for the benefit of the Agency, and $3.2 million and $3.8 million represent amounts held by the Agency as a collateral deposit by an investment provider, respectively.

Concentration of Credit Risk. This is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. The Agency places no limit on the amounts invested in any one issuer for federal agency securities. To limit the Agency's credit risk for commercial paper purchased under the Debt Service Fund Agreement, the aggregate maturity amount invested in any combination of one issuer, affiliate of issuer, or backed by any one credit support, cannot exceed $30.0 million. The Agency has concentrations of risk greater than five percent invested in Chesham Finance of 100 percent at December 31, 2017 and 2016.

Interest Rate Risk. This is the risk that investments are exposed to fair value losses arising from increasing interest rates. Though the Agency has restrictions as to the maturities of some of the investments, it does not have a formal policy for interest rate risk. At December 31, 2017 and 2016, all of the Agency's investments had maturities of one year or less.

Debt Service Fund Agreement. The Agency has entered into a synthetic guaranteed investment contract, in the form of a forward supply agreement, in which it has agreed to purchase securities with the debt service deposit amounts for a guaranteed fixed rate of return of 5.148 percent. The agreement terminates on June 30, 2027.

The following schedules present credit risk by type of security held at December 31, 2017 and 2016. The credit ratings listed are from S&P.

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

	Credit Rating	December 31, 2017	December 31, 2016
Cash and Cash Equivalents:			
Money market funds	AAAm	$ 3,394,505	$ 3,954,183
Commercial paper - Chesham Finance	A-1	17,844,687	16,699,669
Total cash and cash equivalents		$ 21,239,192	$ 20,653,852

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

	December 31, 2017	December 31, 2016
Cash and Cash Equivalents:		
Debt service fund	$ 18,032,562	$ 16,876,219
Other restricted funds:		
Collateral for credit support	3,203,932	3,776,859
Revenue fund	2,698	774
Total other restricted funds	3,206,630	3,777,633
Total cash and cash equivalents	$ 21,239,192	$ 20,653,852

NOTE 4. PREPAID GAS SUPPLY

The Agency's prepaid gas supply is presented below:

	December 31, 2017	December 31, 2016
Prepaid gas supply	$ 255,074,364	$ 285,694,149
Prepaid gas supply revenue	1,860,883	2,149,709
Total prepaid gas supply	256,935,247	287,843,858
Less: amounts due within one year	(34,586,730)	(30,908,611)
Total prepaid gas supply - noncurrent portion	$ 222,348,517	$ 256,935,247

The following summarizes prepaid gas supply activity for the year ended December 31, 2017:

	December 31, 2016	Terminations	Amortization	December 31, 2017
Prepaid gas supply	$ 285,694,149	$ -0-	$ (30,619,785)	$ 255,074,364
Prepaid gas supply revenue	2,149,709	-0-	(288,826)	1,860,883
Total prepaid gas supply	$ 287,843,858	$ -0-	$ (30,908,611)	$ 256,935,247

The following summarizes prepaid gas supply activity for the year ended December 31, 2016:

	December 31, 2015	Terminations	Amortization	December 31, 2016
Prepaid gas supply	$ 313,190,414	$ -0-	$ (27,496,265)	$ 285,694,149
Prepaid gas supply revenue	2,421,229	-0-	(271,520)	2,149,709
Total prepaid gas supply	$ 315,611,643	$ -0-	$ (27,767,785)	$ 287,843,858

The prepaid gas supply is the discounted NPV of the fixed monthly natural gas prices per million British Thermal Units (mmbtu) as specified in, and over the remaining term of, the Prepaid Agreement. The prepaid gas supply revenue is the discounted NPV of $0.07 per mmbtu over the remaining term of the Prepaid Agreement.

NOTE 5. LONG-TERM DEBT

The Agency issued $668.5 million of 2007 Series B Gas project revenue bonds in May 2007 (Bonds) with variable interest rates, maturing July 2027.

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

	December 31, 2017	December 31, 2016
2007 Series B Gas project revenue bonds, variable rates, 2018-2027	$ 264,475,000	$ 292,870,000
Less: amounts due within one year	(31,305,000)	(28,395,000)
Total long-term debt - net	$ 233,170,000	$ 264,475,000

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

	December 31, 2016	Additions	Payments/ Amortizations	December 31, 2017
2007 Gas project revenue bonds	$ 292,870,000	$ -0-	$ (28,395,000)	$ 264,475,000
Total long-term debt	$ 292,870,000	$ -0-	$ (28,395,000)	$ 264,475,000

The following summarizes long-term debt activity for the year ended December 31, 2016:

	December 31, 2015	Additions	Payments/ Amortizations	December 31, 2016
2007 Gas project revenue bonds	$ 318,795,000	$ -0-	$ (25,925,000)	$ 292,870,000
Total long-term debt	$ 318,795,000	$ -0-	$ (25,925,000)	$ 292,870,000

The annual debt service requirements to maturity for the Bonds are as follows at December 31, 2017:

Year	Principal	Interest	Total
2018	$ 31,305,000	$ 10,953,300	$ 42,258,300
2019	34,560,000	9,622,299	44,182,299
2020	16,675,000	8,368,752	25,043,752
2021	18,450,000	7,631,960	26,081,960
2022	20,550,000	6,815,276	27,365,276
2023-2027(combined)	142,935,000	18,200,810	161,135,810
Total	$ 264,475,000	$ 61,592,397	$ 326,067,397

Interest includes interest requirements for fixed rate debt at their stated rates and variable rate debt covered by interest rate swaps at their fixed swap rate.

The Agency had pledged future net revenues to repay $264.5 million and $292.9 million at December 31, 2017 and 2016, respectively, for Bonds issued in May 2007. Proceeds from the Bonds were used to purchase the Gas Project from MSCG at a price of $754.1 million with the remaining amounts used to fund the appropriate accounts for the Agency. The Bonds, payable through 2027, are secured solely by a pledge of and lien on the trust estate under the Indenture which includes bond proceeds, rights under the GSC, revenues, any termination payment and any investment income. Annual principal and interest payments on the Bonds are expected to require approximately 100 percent of the Agency's net revenues. The total principal and interest remaining to be paid on the Bonds was $326.1 million and $366.6 million at December 31, 2017 and 2016, respectively. Debt service payments on the Bonds are made quarterly on January 1, April 1, July 1 and October 1.

Principal and interest paid was $40.5 million and $39.1 million for 2017 and 2016, respectively. Total gross revenues were $42.7 million and $41.0 million for 2017 and 2016, respectively.

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

Interest Rate Swap Agreements - 2007 Series B Bonds. A summary of the Agency's two swap agreements are as follows:

Notional Amount	Agency Pays	Fixed Rate	Floating Rate	Termination Date	Credit Support Provider Credit Rating (S&P)
$ 65,865,000	Fixed	4.144%	67% of LIBOR +.63%	07/01/19	BBB+
198,610,000	Fixed	4.304%	67% of LIBOR +.72%	07/01/27	BBB+

At December 31, 2017, the Agency had three variable-to-fixed interest rate swap agreements with a counterparty. The Agency pays the counterparty a fixed rate on the notional amount and receives a floating rate equal to 67 percent of the three month London Interbank Offered Rates (LIBOR) (1.69 percent at December 31, 2017) plus an interest rate spread, as specified in each swap agreement. The total notional amount of the two swaps at December 31, 2017 was $264.5 million and was equivalent to the outstanding principal balance on the Agency's Bonds. The swaps are amortized over the life of their respective swap agreements in a manner corresponding to the principal repayment schedule of the 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.

Variable Rate 2007 Series B Bonds. The Agency's variable rate Bonds bear interest at quarterly rates, ranging from 1.77 percent to 1.86 percent at December 31, 2017.

NOTE 6. COMMITMENTS

Natural Gas Commodity Price Swap Agreement. The Agency has entered into a floating-to-fixed natural gas commodity price swap agreement (Gas Swap Agreement) with a counterparty for the purpose of fixing the variable price on the Agency's natural gas sales to SMUD under the GSC. The Agency pays an index-based natural gas price over the twenty-year period and receives a fixed natural gas price as specified in the Gas Swap Agreement, for notional quantities of natural gas at a pricing point corresponding to the daily contract quantity and the delivery point under the Prepaid Agreement. The Gas Swap Agreement terminates on May 31, 2027. The total notional amount of the Gas Swap Agreement remaining at December 31, 2017 was 33.6 million mmbtu. Presently, the Gas Swap Agreement is 15,845 mmbtu per calendar day, and this amount will change on June 1 of each remaining year of the Gas Swap Agreement and will range from 8,673 to 15,992 mmbtu per calendar day. Early termination of the Gas Swap Agreement would occur upon termination of the Prepaid Agreement for any reason whatsoever. Upon early termination, the Gas Swap Agreement would have no value to either party.

NOTE 7. CONTINGENCIES

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

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