**CENTRAL VALLEY FINANCING AUTHORITY**
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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Central Valley Financing Authority
Sacramento, California

**Report on the Financial Statements**

We have audited the accompanying financial statements of Central Valley Financing Authority 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 Central Valley Financing Authority's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Central Valley Financing Authority's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Central Valley Financing Authority 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.

***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

**CENTRAL VALLEY FINANCING AUTHORITY**
**MANAGEMENT'S DISCUSSION AND ANALYSIS**
**(UNAUDITED)**

**Using this Financial Report**

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

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

**Overview of the Financial Statements**

The following discussion and analysis of the financial performance of the Agency provides an overview of the financial activities for the years ended December 31, 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 and capital additions.

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

**Nature of Operations**

The Agency is a joint powers authority formed by the Sacramento Municipal Utility District (SMUD) and the Sacramento Regional County Sanitation District (SRCSD) in 1992. The Agency was formed for the purpose of owning and operating the Carson Cogeneration Project (Project) and related facilities for electric power generation. The Project, which began commercial operation in 1995, is comprised of a 65 megawatt (MW) natural gas-fired combined cycle plant and a 42 MW natural gas-fired simple cycle peaking plant.

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

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

**Financial & Operational Highlights**

In 2017, the Agency's operator, Ethos Energy Power Plant Services, LLC, continued implementation of a normal six-week cycle of gas turbine water washes and inspections as part of standard maintenance protocols. These outages and inspections have been an integral part of the Agency's successful performance, which for 2017 included an Institute of Electrical and Electronics Engineers (IEEE) Availability rating of 79.81 percent, an IEEE Reliability rating of 99.81 percent and a successful call-up ratio for the simple cycle unit of 100 percent with all 53 call-up attempts being successful.

In April 2017, the annual cold iron regulatory inspection and testing outage was performed on schedule. The simple cycle engine was removed for service bulletin repairs in October and will be returned to service in January 2018. Several minor forced outages related to control system malfunctions were found and corrected in a few hours over the course of the year.

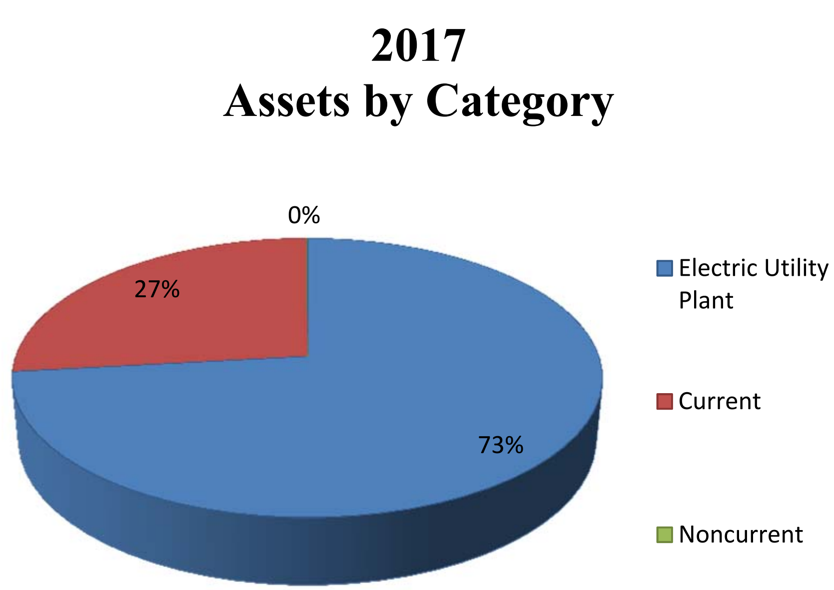
In October 2017, the Agency completed the Auxiliary Boiler project that would enable the plant to meet its steam host requirements while shutting down the combined cycle plant during uneconomical market conditions. As part of this project, the Agency also completed the process of electrifying the Glacier Ice Plant (Glacier). By transferring the energy supplied from the Agency to Glacier from steam to electricity, it allows the Auxiliary Boiler to meet the remaining steam requirements for SRCSD while the combined cycle plant is down. The total cost of the Auxiliary Boiler project was $9.1 million.

## FINANCIAL POSITION

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

| | December 31, | | | Change | | | |
|---|---|---|---|---|---|---|---|
| | 2017 | 2016 | 2015 | 2017 vs. 2016 | | 2016 vs. 2015 | |
| Assets | | | | | | | |
| Electric utility plant - net | $ 50,685 | $ 51,674 | $ 53,394 | $ (989) | -1.9% | $ (1,720) | -3.2% |
| Current assets | 18,468 | 19,580 | 16,183 | (1,112) | -5.7% | 3,397 | 21.0% |
| Noncurrent assets | 54 | 88 | 123 | (34) | -38.6% | (35) | -28.5% |
| Total assets | 69,207 | 71,342 | 69,700 | (2,135) | -3.0% | 1,642 | 2.4% |
| Deferred outflows of resources | 289 | 505 | 775 | (216) | -42.8% | (270) | -34.8% |
| Total assets and deferred outflows of resources | $ 69,496 | $ 71,847 | $ 70,475 | $ (2,351) | -3.3% | $ 1,372 | 1.9% |
| Liabilities | | | | | | | |
| Long-term debt - net | $ 10,790 | $ 15,907 | $ 20,828 | $ (5,117) | -32.2% | $ (4,921) | -23.6% |
| Current liabilities | 11,459 | 13,321 | 10,680 | (1,862) | -14.0% | 2,641 | 24.7% |
| Noncurrent liabilities | 10,428 | 9,726 | 9,071 | 702 | 7.2% | 655 | 7.2% |
| Total liabilities | 32,677 | 38,954 | 40,579 | (6,277) | -16.1% | (1,625) | -4.0% |
| Net position | | | | | | | |
| Net investment in capital assets | 35,219 | 31,542 | 28,836 | 3,677 | 11.7% | 2,706 | 9.4% |
| Restricted | 2,482 | 2,365 | 2,253 | 117 | 4.9% | 112 | 5.0% |
| Unrestricted | (882) | (1,014) | (1,193) | 132 | 13.0% | 179 | 15.0% |
| Total net position | 36,819 | 32,893 | 29,896 | 3,926 | 11.9% | 2,997 | 10.0% |
| Total liabilities and net position | $ 69,496 | $ 71,847 | $ 70,475 | $ (2,351) | -3.3% | $ 1,372 | 1.9% |

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



**2017 Compared to 2016**

**ASSETS & DEFERRED OUTFLOWS OF RESOURCES**

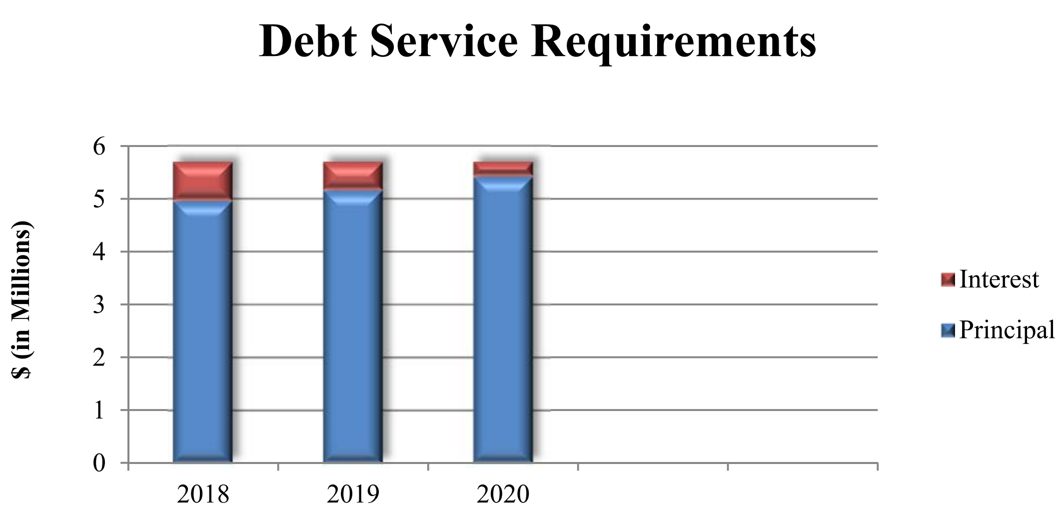
- The Agency's main asset is its investment in the Project, which comprises $50.7 million in Electric Utility Plant, net of Accumulated Depreciation at December 31, 2017. The Electric Utility Plant - net decreased due to $5.5 million depreciation expense for the year, partially offset by a $4.5 million addition for the Auxiliary Boiler project. Electric Utility Plant assets make up about 73 percent of the Agency's assets.

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

**LIABILITIES & NET POSITION**

- Long-Term Debt - net decreased primarily due to $4.7 million of the scheduled principal payments for 2017. At December 31, 2017, the Agency had bonds outstanding of $15.6 million with maturities through 2020. The Agency's Bonds are rated "AA" by Standard and Poor's and Fitch and "Aa3" by Moody's.

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




- Current Liabilities decreased primarily due to lower capital project billings from SMUD for November and December 2017, partially offset by higher current portion of long-term debt.

- Noncurrent Liabilities increased due to higher accretion of the Asset Retirement Obligation.

**2016 Compared to 2015**

**ASSETS & DEFERRED OUTFLOWS OF RESOURCES**

- The Agency's main asset is its investment in the Project, which comprises \$51.7 million in Electric Utility Plant, net of Accumulated Depreciation at December 31, 2016. The Electric Utility Plant - net decreased due to \$5.4 million depreciation expense for the year, partially offset by a \$3.7 million addition for the Auxiliary Boiler project.

- Current Assets increased primarily due to higher Receivable from SMUD for the capital project portion of the PPA billings in November and December 2016, and Unrestricted cash as part of normal operations.

**LIABILITIES & NET POSITION**

- Long-Term Debt - net decreased primarily due to \$4.5 million of the scheduled principal payments for 2016. At December 31, 2016, the Agency had bonds outstanding of \$20.3 million with maturities through 2020.

- Current Liabilities increased primarily due to higher capital project billings from SMUD for November and December 2016, and accounts payable for capital projects, digester gas owed to SRCSD, and gas turbine overhaul at December 31, 2016.

- Noncurrent Liabilities increased due to higher accretion of the Asset Retirement Obligation.

## RESULTS OF OPERATIONS

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

(Dollars in thousands)

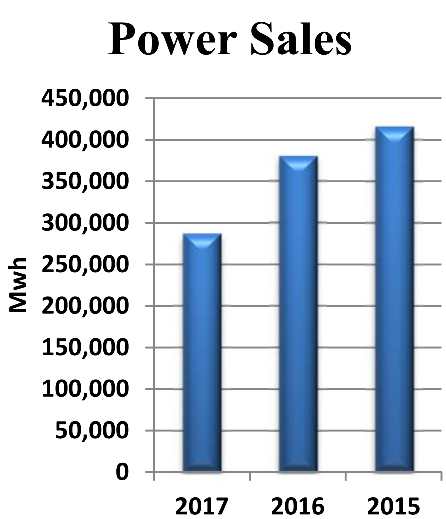
| | December 31, | | | Change | | | |
|---|---|---|---|---|---|---|---|
| | 2017 | 2016 | 2015 | 2017 vs. 2016 | | 2016 vs. 2015 | |
| Operating revenues | $ 32,007 | $ 35,854 | $ 35,390 | $ (3,847) | -10.7% | $ 464 | 1.3% |
| Operating expenses | (27,207) | (33,295) | (33,678) | 6,088 | 18.3% | 383 | 1.1% |
| Operating income | 4,800 | 2,559 | 1,712 | 2,241 | 87.6% | 847 | 49.5% |
| Interest income | 49 | 9 | 1 | 40 | 444.4% | 8 | 800.0% |
| Interest on debt | (924) | (1,169) | (1,401) | 245 | 21.0% | 232 | 16.6% |
| Other income | 1 | 1,598 | -0- | (1,597) | -99.9% | 1,598 | 100.0% |
| Change in net position | 3,926 | 2,997 | 312 | 929 | 31.0% | 2,685 | 860.6% |
| Net position - beginning of year | 32,893 | 29,896 | 29,584 | 2,997 | 10.0% | 312 | 1.1% |
| Net position - end of year | $ 36,819 | $ 32,893 | $ 29,896 | $ 3,926 | 11.9% | $ 2,997 | 10.0% |

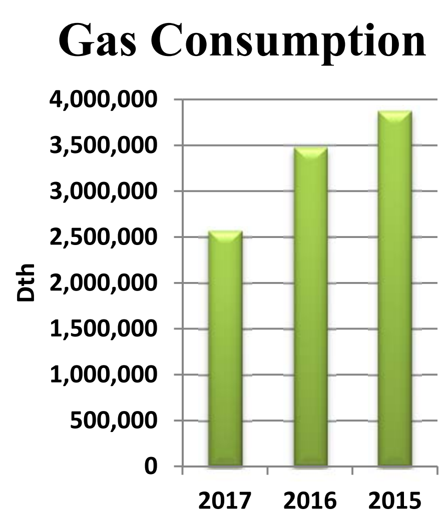
**2017 Compared to 2016**

## OPERATING REVENUES

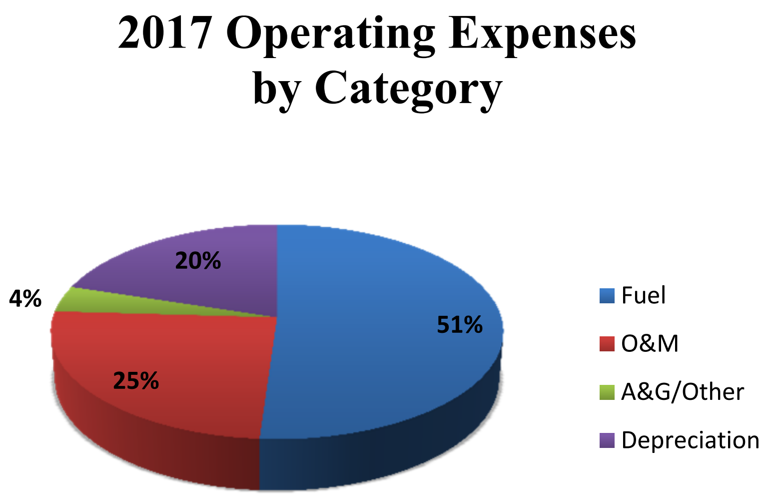
Operating Revenues decreased primarily due to lower Power sales to Member. The Agency's power sales are determined monthly, based on a formula defined in the PPA, which is driven by the Agency's actual cost of operations including debt service. In 2017, less revenue was needed due to lower fuel and maintenance costs, partially offset by the pass through of the California Public Utilities Commission (CPUC) mandated PG&E gas refund in 2016, and higher fixed and other costs.

The following charts show power sales and gas consumption in 2017, 2016, and 2015:



## OPERATING EXPENSES




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

| | December 31, | | | Change | | | |
|---|---|---|---|---|---|---|---|
| | 2017 | 2016 | 2015 | 2017 vs. 2016 | | 2016 vs. 2015 | |
| **Operating Expenses** | | | | | | | |
| Fuel | $ 13,897 | $ 18,626 | $ 19,856 | $ (4,729) | -25.4% | $ (1,230) | -6.2% |
| Operations and Maintenance | 6,758 | 8,211 | 7,347 | (1,453) | -17.7% | 864 | 11.8% |
| Administrative & general and Other | 1,072 | 1,072 | 1,106 | -0- | 0.0% | (34) | -3.1% |
| Depreciation | 5,480 | 5,386 | 5,369 | 94 | 1.7% | 17 | 0.3% |
| Total operating expenses | $ 27,207 | $ 33,295 | $ 33,678 | $ (6,088) | -18.3% | $ (383) | -1.1% |

- Fuel expense decreased due to lower fuel volume of $4.4 million, cost of $0.1 million and digester gas for resale $0.2 million.

- Operations and Maintenance expense decreased primarily due to lower gas turbine overhaul of $2.2 million, partially offset by higher miscellaneous operating costs of $0.7 million as a result of the Glacier electrification project.

## OTHER INCOME

Other income decreased due to the CPUC mandated PG&E gas refund received in 2016.

**2016 Compared to 2015**

**RESULTS OF OPERATIONS**

- Operating Revenues increased primarily due to higher Power Sales to Member as a result of higher capital project and maintenance costs, partially offset by lower fuel cost and the pass through of the CPUC mandated PG&E gas refund.

- Fuel expense decreased due to lower fuel volume of $1.4 million and cost of $0.1 million, partially offset by higher digester gas for resale $0.3 million.

- Operations and Maintenance expense increased primarily due to the gas turbine overhaul of $1.5 million, partially offset by lower operator reimbursable costs of $0.6 million.

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

## CENTRAL VALLEY FINANCING AUTHORITY
## STATEMENTS OF NET POSITION

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| **ASSETS** | | |
| **ELECTRIC UTILITY PLANT** | | |
| Plant in service | $ 155,434,931 | $ 146,650,739 |
| Less accumulated depreciation | (104,924,438) | (99,543,937) |
| Plant in service - net | 50,510,493 | 47,106,802 |
| Construction work in progress | 173,991 | 4,566,995 |
| Total electric utility plant - net | 50,684,484 | 51,673,797 |
| **RESTRICTED ASSETS** | | |
| Debt service funds | 2,853,331 | 2,854,081 |
| Less current portion | (2,853,331) | (2,854,081) |
| Total restricted assets | -0- | -0- |
| **CURRENT ASSETS** | | |
| Cash and cash equivalents: | | |
| Unrestricted cash and cash equivalents | 5,912,426 | 4,056,536 |
| Restricted cash and cash equivalents | 2,853,331 | 2,854,081 |
| Receivables: | | |
| Power sales to Member | 6,966,444 | 9,847,130 |
| Steam sales | 466,020 | 483,625 |
| Accrued interest and other | 16,007 | 4,154 |
| Materials and supplies | 2,075,195 | 2,145,939 |
| Prepayments | 144,352 | 153,747 |
| Regulatory costs to be recovered within one year | 34,689 | 34,689 |
| Total current assets | 18,468,464 | 19,579,901 |
| **NONCURRENT ASSETS** | | |
| Regulatory costs for future recovery | 52,034 | 86,723 |
| Other | 2,109 | 1,406 |
| Total noncurrent assets | 54,143 | 88,129 |
| TOTAL ASSETS | 69,207,091 | 71,341,827 |
| **DEFERRED OUTFLOWS OF RESOURCES** | | |
| Unamortized bond losses | 289,319 | 505,071 |
| TOTAL DEFERRED OUTFLOWS OF RESOURCES | 289,319 | 505,071 |
| TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES | $ 69,496,410 | $ 71,846,898 |

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

**CENTRAL VALLEY FINANCING AUTHORITY**
**STATEMENTS OF NET POSITION**

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| **LIABILITIES AND NET POSITION** | | |
| **LONG-TERM DEBT - net** | $ 10,789,921 | $ 15,906,523 |
| **CURRENT LIABILITIES** | | |
| Accounts payable | 2,780,585 | 2,708,375 |
| Payable due to Member | 3,342,817 | 5,393,703 |
| Long-term debt due within one year | 4,965,000 | 4,730,000 |
| Accrued interest | 370,831 | 489,081 |
| Total current liabilities | 11,459,233 | 13,321,159 |
| **NONCURRENT LIABILITIES** | | |
| Accrued decommissioning | 10,427,998 | 9,725,796 |
| Total noncurrent liabilities | 10,427,998 | 9,725,796 |
| TOTAL LIABILITIES | 32,677,152 | 38,953,478 |
| **NET POSITION** | | |
| Net investment in capital assets | 35,218,882 | 31,542,345 |
| Restricted | 2,482,500 | 2,365,000 |
| Unrestricted | (882,124) | (1,013,925) |
| TOTAL NET POSITION | 36,819,258 | 32,893,420 |
| **COMMITMENTS AND CONTINGENCIES (Notes 9 and 10)** | | |
| TOTAL LIABILITIES AND NET POSITION | $ 69,496,410 | $ 71,846,898 |

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

## CENTRAL VALLEY FINANCING AUTHORITY
## STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

| | Years Ended December 31, 2017 | 2016 |
|---|---|---|
| **OPERATING REVENUES** | | |
| Power sales to Member | $ 29,808,433 | $ 33,593,974 |
| Gas sales to Member | 1,586,798 | 1,641,705 |
| Steam sales | 459,085 | 566,258 |
| Other | 152,982 | 51,749 |
| Total operating revenues | 32,007,298 | 35,853,686 |
| **OPERATING EXPENSES** | | |
| Fuel | 13,897,397 | 18,626,050 |
| Operations | 5,269,830 | 4,532,876 |
| Maintenance | 1,487,722 | 3,677,642 |
| Administrative and general | 1,037,239 | 1,037,570 |
| Depreciation | 5,480,501 | 5,385,908 |
| Regulatory amounts collected in rates | 34,689 | 34,689 |
| Total operating expenses | 27,207,378 | 33,294,735 |
| **OPERATING INCOME** | 4,799,920 | 2,558,951 |
| **NON-OPERATING REVENUES (EXPENSES)** | | |
| Interest income | 48,559 | 9,137 |
| Interest on debt | (924,063) | (1,168,862) |
| Other income | 1,422 | 1,598,391 |
| Total non-operating revenues (expenses) | (874,082) | 438,666 |
| CHANGE IN NET POSITION | 3,925,838 | 2,997,617 |
| NET POSITION - BEGINNING OF YEAR | 32,893,420 | 29,895,803 |
| NET POSITION - END OF YEAR | $ 36,819,258 | $ 32,893,420 |

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

**CENTRAL VALLEY FINANCING AUTHORITY**
**STATEMENTS OF CASH FLOWS**

| | Years Ended December 31, | |
|---|---|---|
| | 2017 | 2016 |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Receipts from power sales to Member | $ 34,275,917 | $ 32,466,866 |
| Receipts from steam sales | 476,690 | 550,152 |
| Other receipts | 152,982 | 51,749 |
| Payments to Member | (17,408,428) | (16,240,017) |
| Payments to vendors | (5,139,764) | (7,330,838) |
| Net cash provided by operating activities | 12,357,397 | 9,497,912 |
| **CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITES** | | |
| Repayment of long-term debt | (4,730,000) | (4,505,000) |
| Construction expenditures | (4,830,800) | (3,256,748) |
| Interest payments on long-term debt | (978,163) | (1,203,414) |
| Net cash used in capital and related financing activities | (10,538,963) | (8,965,162) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Interest received | 36,706 | 5,346 |
| Net cash provided by investing activities | 36,706 | 5,346 |
| Net increase in cash and cash equivalents | 1,855,140 | 538,096 |
| Cash and cash equivalents - beginning of the year | 6,910,617 | 6,372,521 |
| Cash and cash equivalents - end of the year | $ 8,765,757 | $ 6,910,617 |
| **CASH AND CASH EQUIVALENTS INCLUDED IN:** | | |
| Unrestricted cash and cash equivalents | $ 5,912,426 | $ 4,056,536 |
| Restricted cash and cash equivalents | 2,853,331 | 2,854,081 |
| Cash and cash equivalents - end of the year | $ 8,765,757 | $ 6,910,617 |

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

**CENTRAL VALLEY FINANCING AUTHORITY**
**STATEMENTS OF CASH FLOWS**

| | | Years Ended December 31, | | |
|---|---|---|---|---|
| | | 2017 | | 2016 |
| **RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES** | | | | |
| Operating income | $ | 4,799,920 | $ | 2,558,951 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | | | |
| Depreciation | | 5,480,501 | | 5,385,908 |
| Regulatory amortization | | 34,689 | | 34,689 |
| Other income | | 1,422 | | 1,598,391 |
| Accretion | | 702,202 | | 654,918 |
| Changes in operating assets and liabilities: | | | | |
| Receivables | | 2,898,291 | | (2,784,919) |
| Other assets | | 79,436 | | (70,210) |
| Payables and accruals | | (1,639,064) | | 2,120,184 |
| Net cash provided by operating activities | $ | 12,357,397 | $ | 9,497,912 |
| **SUPPLEMENTAL DISCLOSURE OF NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES** | | | | |
| Net amortization of debt related (expenses) and premiums | $ | (64,150) | $ | (78,074) |

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

## CENTRAL VALLEY FINANCING AUTHORITY
## NOTES TO FINANCIAL STATEMENTS

### NOTE 1. ORGANIZATION AND OPERATIONS

The Central Valley Financing Authority (Agency) is a joint powers authority (JPA) formed by the Sacramento Municipal Utility District (SMUD) and the Sacramento Regional County Sanitation District (SRCSD) pursuant to the California Government Code. The purpose of the Agency is to own and operate the Carson Cogeneration Project (Project) and related facilities for electric power generation. The Project, which began commercial operations in 1995, is comprised of a 65 megawatt (MW) natural gas-fired combined cycle cogeneration facility and a 42 MW natural gas-fired simple cycle peaking plant. The Project is situated on approximately ten acres adjacent to SRCSD's sewage treatment plant. The land is owned by SRCSD and leased to the Agency.

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

Pursuant to the Power Purchase Agreement (PPA), SMUD purchases, on a "take-or-pay" basis, all capacity, energy and environmental attributes of the Project. The Agency is obligated to reimburse SMUD for the actual costs of providing general and administrative services, fuel costs, and other costs paid by SMUD on the Agency's behalf. The Agency was charged $17.4 million in 2017 and $17.5 million in 2016 for general and administrative services, fuel costs, and other costs paid by SMUD on the Agency's behalf.

The Agency provides steam to SRCSD's adjacent sewage treatment plant pursuant to the Long-Term Commodity Agreement. The Agency also provides steam and electricity for the refrigeration process of the Glacier Ice facility pursuant to the Thermal Energy Sales Agreement. The primary fuel for the Project is a mixture of natural gas and digester gas from SRCSD's sewage treatment plant. Presently, digester gas represents four percent of the fuel used by the Project and the remaining amount is sold to SMUD.

SMUD is entitled to all rights and property in the Project in the event of termination of the JPA agreement. SRCSD has no obligation to make contributions or advances to the Agency. The JPA agreement will remain in effect until terminated by a supplemental written agreement of the parties; provided, that in no event shall the JPA agreement terminate while any contracts between the Agency and either of the parties or other parties are in effect, or while any bonds or notes of the Agency are outstanding. Project revenues and the subsequent payments of principal and interest related to the Agency's long-term debt are not dependent upon the continued successful operation of the Project. SMUD is required to make payments in an amount sufficient to pay principal and interest and all other payments required to be made under the Indenture of Trust (Indenture), dated August 1, 2009. Neither SRCSD nor SMUD has any obligation or liability to the Agency beyond that specifically provided for in the JPA agreement or the Project agreements.

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

## NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

**Plant in Service.** The Agency provides for depreciation on the historical cost of Plant in Service on a straight-line basis over an estimated useful life of 30 years. The cost of replacement units is capitalized. Repair and maintenance costs are charged to expense. When the Agency retires portions of its Electric Utility Plant, retirements are recorded against Accumulated Depreciation and the retired portion of Electric Utility Plant is removed from Plant in Service. Capital assets are generally defined by the Agency as tangible assets with an initial, individual cost of more than three thousand dollars and an estimated useful life in excess of two years.

**Restricted Assets.** The Agency's restricted assets are comprised of cash, which is limited for specific purposes pursuant to the Indenture requirements. The Indenture specifies the flow of cash into the various Agency funds and dictates when they may become unrestricted.

**Cash and Cash Equivalents.** Cash and cash equivalents include all debt instruments purchased with an original maturity of 90 days or less and all investments in the Local Agency Investment Fund (LAIF), and money market funds. LAIF has an equity interest in the State of California (State) Pooled Money Investment Account (PMIA). PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The Agency's deposits with LAIF comprise cash representing demand deposits up to a $65.0 million maximum and cash equivalents representing amounts which may be withdrawn once per month after a thirty-day period.

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

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

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

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

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

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

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

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

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

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

**Other Income.** In June 2016, SMUD received a $17.9 million refund from PG&E in association with the PG&E 2010 natural gas transmission pipeline explosion in San Bruno. The California Public Utilities Commission imposed a penalty on PG&E requiring them to provide a one-time bill credit to natural gas customers on their June 2016 bills based on usage for a prescribed time period. SMUD recorded the $17.9 million refund as Other Income, and the allocable portion was passed through to the Agency. The Agency recorded $1.6 million related to the refund as Other Income in the Statements of Revenues, Expenses and Changes in Net Position.

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

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

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

**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 re-measured 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 the Agency in 2019. The Agency is currently assessing the financial statement impact of adopting this statement. The Agency currently records AROs following the FASB guidance (see **Accrued Decommissioning** under Note 3).

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 non-cancellable 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. ACCRUED DECOMMISSIONING

**Asset Retirement Obligation.** The Agency accounts for AROs associated with tangible long-lived assets at fair value in the period in which the liability is incurred and is capitalized as part of the related long-lived asset and depreciated over the asset's useful life.

The Agency has identified potential retirement obligations related to the Project's facilities. The Agency has no other potential AROs that represent material obligations.

A summary of the Agency's decommissioning obligation is presented below:

| | |
|---|---|
| Accrued decommissioning, December 31, 2015 | $ 9,070,878 |
| Accretion | 654,918 |
| Accrued decommissioning, December 31, 2016 | 9,725,796 |
| Accretion | 702,202 |
| Accrued decommissioning, December 31, 2017 | $ 10,427,998 |

Amounts recorded under FASB ASC 410, "*Asset Retirement and Environmental Obligations*," are subject to various assumptions and determinations, such as determining whether an obligation exists to remove assets, estimating the fair value of the costs of removal and estimating when final removal will occur. Changes that may arise over time with regard to these assumptions and determinations will change amounts recorded for AROs.

## NOTE 4. ELECTRIC UTILITY PLANT

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

| | Balance December 31, 2016 | Additions | Adjustments Transfers/ Disposals | Balance December 31, 2017 |
|---|---|---|---|---|
| Nondepreciable utility plant: | | | | |
| Construction work in progress | $ 4,566,995 | $ 4,491,188 | $ (8,884,192) | $ 173,991 |
| Total nondepreciable utility plant | 4,566,995 | 4,491,188 | (8,884,192) | 173,991 |
| Depreciable utility plant: | | | | |
| Generation | 146,650,739 | 8,884,192 | (100,000) | 155,434,931 |
| Less: accumulated depreciation | (99,543,937) | (5,480,501) | 100,000 | (104,924,438) |
| Total utility plant - net | $ 51,673,797 | $ 7,894,879 | $ (8,884,192) | $ 50,684,484 |

The Agency had the following electric utility plant activity during 2016:

| | Balance December 31, 2015 | Additions | Adjustments Transfers/ Disposals | Balance December 31, 2016 |
|---|---|---|---|---|
| Nondepreciable utility plant: | | | | |
| Construction work in progress | $ 901,884 | $ 3,665,111 | $ -0- | $ 4,566,995 |
| Total nondepreciable utility plant | 901,884 | 3,665,111 | -0- | 4,566,995 |
| Depreciable utility plant: | | | | |
| Generation | 146,650,739 | -0- | -0- | 146,650,739 |
| Less: accumulated depreciation | (94,158,029) | (5,385,908) | -0- | (99,543,937) |
| Total utility plant - net | $ 53,394,594 | $ (1,720,797) | $ -0- | $ 51,673,797 |

## NOTE 5. 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 collateral securities that are in the possession of another party. The Agency does not have a deposit policy for custodial credit risk.

At December 31, 2017 and 2016, $1.0 million and $0.5 million of the Agency's bank balances were uninsured, respectively. The bank balance is also, per a depository pledge agreement between the Agency and the Agency's bank, collateralized at 134 percent and 122 percent of the collective funds on deposit (increased by the amount of accrued but uncredited interest, reduced by deposits covered by FDIC) at December 31, 2017 and 2016, respectively. The Agency had money market funds of $2.9 million which were uninsured at December 31, 2017 and 2016. The Agency's money market funds are held in trust for the benefit of the Agency.

**Concentration of Credit Risk.** This is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. The Agency places no limit on the amounts invested in any one issuer for federal agency securities. The Agency had no investments at December 31, 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. The Agency had no investments at December 31, 2017 and 2016.

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. N/A is defined as not applicable to the rating disclosure requirements.

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

| | Credit Rating | December 31, 2017 | December 31, 2016 |
|---|---|---|---|
| Cash and Cash Equivalents: | | | |
| Deposits | N/A | $ 1,230,346 | $ 794,875 |
| LAIF | Not Rated | 4,682,080 | 3,261,661 |
| Money Market Funds | AAAm | 2,853,331 | 2,854,081 |
| Total cash and cash equivalents | | $ 8,765,757 | $ 6,910,617 |

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 | $ 2,853,331 | $ 2,854,081 |
| Unrestricted funds | 5,912,426 | 4,056,536 |
| Total cash and cash equivalents | $ 8,765,757 | $ 6,910,617 |

## NOTE 6. LONG-TERM DEBT

The Agency issued $48.9 million of 2009 Series Cogeneration project revenue bonds (Bonds) in August 2009 with interest rates ranging from 2.25 percent to 5.25 percent, maturing July 2020.

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

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| 2009 Cogeneration project revenue bonds, 4.0% - 5.25%, 2018-2020 | $ 15,555,000 | $ 20,285,000 |
| Unamortized premiums - net | 199,921 | 351,523 |
| Total long-term debt | 15,754,921 | 20,636,523 |
| Less: amounts due within one year | (4,965,000) | (4,730,000) |
| Total long-term debt - net | $ 10,789,921 | $ 15,906,523 |

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

| | December 31, 2016 | Additions | Refunding, Payments or Amortization | December 31, 2017 |
|---|---|---|---|---|
| Cogeneration project revenue bonds | $ 20,285,000 | $ -0- | $ (4,730,000) | $ 15,555,000 |
| Unamortized premiums - net | 351,523 | -0- | (151,602) | 199,921 |
| Total long-term debt | $ 20,636,523 | $ -0- | $ (4,881,602) | $ 15,754,921 |

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

| | December 31, 2015 | Additions | Refunding, Payments or Amortization | December 31, 2016 |
|---|---|---|---|---|
| Cogeneration project revenue bonds | $ 24,790,000 | $ -0- | $ (4,505,000) | $ 20,285,000 |
| Unamortized premiums - net | 543,039 | -0- | (191,516) | 351,523 |
| Total long-term debt | $ 25,333,039 | $ -0- | $ (4,696,516) | $ 20,636,523 |

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

| Year | Principal | Interest | Total |
|---|---|---|---|
| 2018 | $ 4,965,000 | $ 741,663 | $ 5,706,663 |
| 2019 | 5,165,000 | 543,063 | 5,708,063 |
| 2020 | 5,425,000 | 284,812 | 5,709,812 |
| Total | $ 15,555,000 | $ 1,569,538 | $ 17,124,538 |

Proceeds from the 2009 Series Bonds were used to refund previously issued bonds that provided financing for the Project. The 2009 Series Bonds, payable through 2020, are secured solely by a pledge of and lien on the trust estate under the Indenture which includes revenues from the PPA and investment income from funds established under the Indenture. The Agency had pledged future net revenues to repay $15.6 million for 2009 Series Bonds at December 31, 2017 and $20.3 million at December 31, 2016. Annual principal and interest payments on the 2009 Series Bonds required approximately 19.1 and 17.0 percent of the Agency's net revenues for 2017 and 2016, respectively. The total principal and interest remaining to be paid on the 2009 Series Bonds is $17.1 million and $22.8 million at December 31, 2017 and 2016, respectively. Debt service payments are made semi-annually on January 1 and July 1. Principal and interest paid was $5.7 million for both 2017 and 2016. Total gross revenues were $29.8 million and $33.6 million for 2017 and 2016, respectively.

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

**NOTE 7. INSURANCE PROGRAMS**

The Agency purchases commercial property and casualty insurance coverage at levels consistent with coverages on similar facilities. The policies' deductible dollar amounts vary depending on the type of coverage. Excess liability coverage for most claims against the Agency is $140.0 million. Generally, the maximum risk that the Agency would be exposed to is limited to $0.3 million for most casualty claims, $0.5 million for property claims, and $25.0 million for earthquakes. No claims have exceeded the limits of property or liability insurance in any of the past three years. There were no significant reductions in coverage compared to the prior year.

**NOTE 8. FAIR VALUE MEASUREMENTS**

Effective January 1, 2016, the Agency adopted GASB No. 72, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The Agency utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique.

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

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

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

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

The following table identifies the level within the fair value hierarchy that the Agency's financial assets are accounted for on a recurring basis as of December 31, 2017 and 2016, respectively. As required by GASB No. 72, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Agency's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value of liabilities and their placement within the fair value hierarchy levels.

Recurring Fair Value Measures (Level 2)

| | December 31, | |
|---|---|---|
| | 2017 | 2016 |
| Investments reported as Cash and Cash Equivalents: | | |
| LAIF | $ 4,682,080 | $ 3,261,661 |
| Total fair value investments | $ 4,682,080 | $ 3,261,661 |

## NOTE 9. COMMITMENTS

**Commodity Agreement.** The Agency provides SRCSD's sewage treatment plant with all of the steam required for its operation and emergency power should the outside power supply become disrupted. The Agency also purchases a minimum of 90 percent of the digester gas made available to the Project by the sewage treatment plant, provided the gas meets standards set forth in this agreement, as amended, which expires in October 2025.

**Natural Gas Interconnection and Supply Agreement.** Pursuant to the Natural Gas Interconnection and Supply Agreement, SMUD supplies all of the natural gas requirements of the Project. The Agency pays for the actual supply, storage and transportation costs for the fuel supplied to the Project as specified in this agreement through October 2025.

**Operation and Maintenance Agreement.** Ethos serves as the Project Operator and is responsible for the primary operation, repair, overhaul and maintenance services of the Project. The Agency pays for such services according to the terms of this agreement and provides, at no cost to Ethos, fuel, water, and power not already provided for in other agreements. At December 31, 2017, the minimum annual commitment to Ethos under this agreement was approximately $1.8 million.

**Ground Lease Agreement.** The Agency leases land from SRCSD under the ground lease agreement expiring October 2025. The minimum lease payment increases by the escalation in SRCSD's average electric power cost. At December 31, 2017, the Agency's annual minimum lease payment was approximately $0.2 million.

## NOTE 10. CONTINGENCIES

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