SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
TABLE OF CONTENTS

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of Sacramento Municipal Utility District Financing Authority which comprise the Statements of Net Position as of December 31, 2016 and 2015, and the related Statements of Revenues, Expenses and Changes in Net Position, and Statements of Cash Flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sacramento Municipal Utility District Financing Authority at December 31, 2016 and 2015, 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.

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

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 17, 2017

SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
(UNAUDITED)

Using this Financial Report

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

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

Overview of the Financial Statements

The following discussion and analysis of the financial performance of the Agency provides an overview of the financial activities for the years ended December 31, 2016 and 2015. This discussion and analysis should be read in conjunction with the Agency's financial statements and accompanying notes, which follow this section.

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

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

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

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

Nature of Operations

The Agency is a joint powers authority formed by the Sacramento Municipal Utility District (SMUD) and the Modesto Irrigation District. The Agency owns and operates the Cosumnes Power Plant Project (Project) and related facilities for electric power generation. The Project, which began commercial operations in 2006, is comprised of a 501 megawatt natural gas-fired combined cycle generation plant.

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

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

Financial & Operational Highlights

In 2016, the Agency's plant operator, Ethos Energy Power Plant Services, LLC, continued to perform quarterly off line gas turbine water washes and inspections as part of standard maintenance protocols. These outages and inspections have been an integral part of the Agency's successful performance, which for 2016 included an Institute of Electrical and Electronics Engineers (IEEE) Availability rating of 95.4 percent, an IEEE Reliability rating of 100 percent and an overall capacity factor of 90.1 percent.

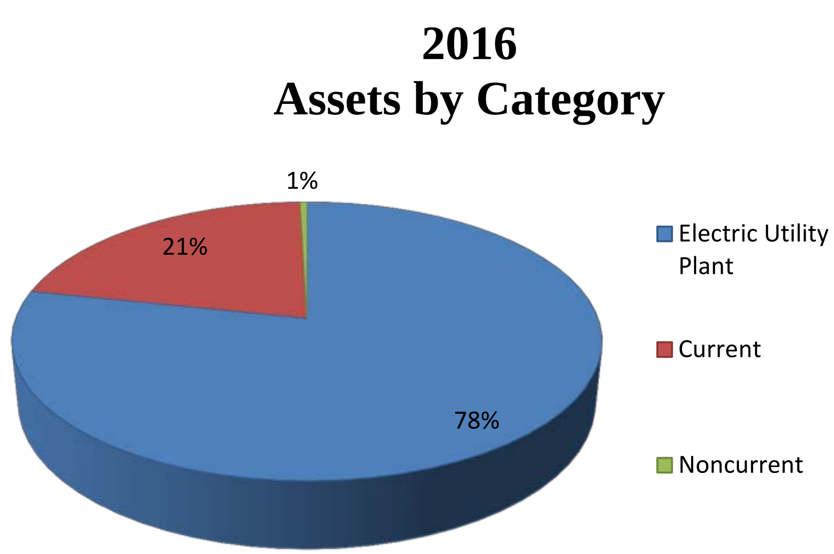
The following maintenance and capital improvement projects were completed throughout the year, as well as during the cold iron outage in March and April: Combustion Turbine Generator (CTG) 2 hot section inspection, Closed Cooling Water Pressure Relief Valve (PRV) Drain Header, Transformer Dissolved Gas Analysis (DGA) Monitors, Pump House Upgrade, Closed Cooling Water Motor Upgrades, H2 Analyzer Upgrade, Awning and Concrete, Air Inlet Filter Replacement, High Energy Piping Program, Zero Liquid Discharge system maintenance and high voltage relay protection maintenance and testing. The costs of the capital improvement projects totaled $6.8 million and $1.1 million for maintenance projects. Immediately following the CTG 2 hot section inspection, the unit experienced a high exhaust gas temperature spread. A few fuel nozzles along with the cross fire tube were replaced and the unit was returned to service. Root cause analysis is still underway. The Agency successfully completed all work planned for the year and on budget.

FINANCIAL POSITION

Statements of Net Position Summary
(Dollars in thousands)

	December 31,			Change			
	2016	2015	2014	2016 vs. 2015		2015 vs. 2014	
Assets							
Electric utility plant - net	$ 234,671	$ 244,251	$ 253,204	$ (9,580)	-3.9%	$ (8,953)	-3.5%
Restricted assets	-0-	-0-	69,887	-0-	0.0%	(69,887)	-100.0%
Current assets	63,780	57,170	49,463	6,610	11.6%	7,707	15.6%
Noncurrent assets	1,308	1,414	3,468	(106)	-7.5%	(2,054)	-59.2%
Total assets	299,759	302,835	376,022	(3,076)	-1.0%	(73,187)	-19.5%
Deferred outflows of resources	3,528	4,098	-0-	(570)	-13.9%	4,098	100.0%
Total assets and deferred outflows of resources	303,287	306,933	376,022	(3,646)	-1.2%	(69,089)	-18.4%
Liabilities							
Long-term debt - net	$ 170,479	$ 198,415	$ 228,928	$ (27,936)	-14.1%	$ (30,513)	-13.3%
Current liabilities	61,612	56,362	42,791	5,250	9.3%	13,571	31.7%
Total liabilities	232,091	254,777	271,719	(22,686)	-8.9%	(16,942)	-6.2%
Net position							
Net investment in capital assets	43,819	27,139	25,008	16,680	61.5%	2,131	8.5%
Restricted	11,950	12,274	64,143	(324)	-2.6%	(51,869)	-80.9%
Unrestricted	15,427	12,743	15,152	2,684	21.1%	(2,409)	-15.9%
Total net position	71,196	52,156	104,303	19,040	36.5%	(52,147)	-50.0%
Total liabilities and net position	$ 303,287	$ 306,933	$ 376,022	$ (3,646)	-1.2%	$ (69,089)	-18.4%

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



2016 Compared to 2015

ASSETS & DEFERRED OUTFLOWS OF RESOURCES

- The Agency's main asset is its investment in the Project, which comprises $234.7 million in Electric Utility Plant, net of Accumulated Depreciation at December 31, 2016. The Electric Utility Plant - net decreased due to $16.4 million depreciation expense for the year, partially offset by $7.1 million of additions. The additions included the CTG2 and CTG3 overhaul, Transformer DGA Monitors, H2 Analyzer upgrade, Awning and Concrete, Closed Cooling Water Motor upgrades, and PRV Drain Header. Electric Utility Plant assets make up about 78 percent of the Agency's assets.

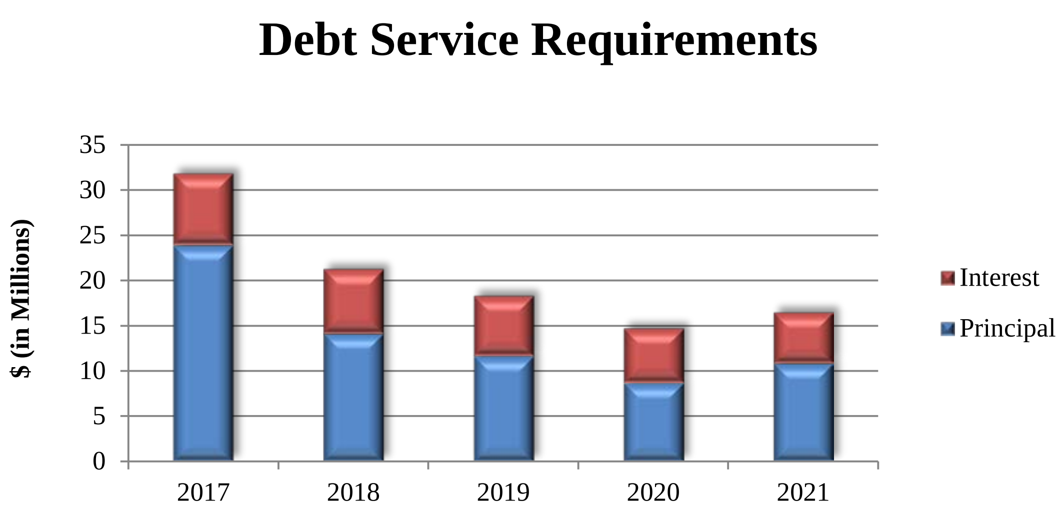
- Current Assets increased primarily due to higher Receivable from SMUD for the fuel portion of the PPA billings in November and December 2016, Materials and supplies for the replenishment of inventory used in 2015, and Unrestricted cash as part of normal operations, partially offset by lower Restricted cash as a result of the 2015 bond refunding.

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

LIABILITIES & NET POSITION

- Long-Term Debt - net decreased primarily due $22.8 million of the scheduled principal payments for 2016. At December 31, 2016, the Agency had bonds outstanding of $170.5 million with maturities through 2030. The Agency's Bonds are rated "AA-" by Standard and Poor's and Fitch.

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



- Current Liabilities increased primarily due to higher fuel billings from SMUD for November and December 2016, and higher current portion of the long-term debt, partially offset by lower accrued interest and accounts payable for operator reimbursable expenses and capital projects at December 31, 2016.

2015 Compared to 2014

ASSETS & DEFERRED OUTFLOWS OF RESOURCES

- The Agency's main asset is its investment in the Project, which comprises $244.3 million in Electric Utility Plant, net of Accumulated Depreciation at December 31, 2015. The Electric Utility Plant - net decreased due to $16.6 million depreciation expense for the year, partially offset by $7.6 million of addition for the CTG3 overhaul inspections.

- Restricted Assets decreased due to the release of the Agency's various restricted funds as a result of the bond refunding and the new PPA with SMUD, and higher Distribution to Member.

- Current Assets increased primarily due to a higher debt service fund and a higher Receivable from SMUD for the fuel portion of the PPA billings in November and December 2015.

- Noncurrent Assets decreased primarily due to the write off of the prepaid insurance for the refunding of the 2006 Bonds.

- Deferred Outflows of Resources increased due to the unamortized loss upon issuance of the 2015 Bonds.

LIABILITIES & NET POSITION

- Long-Term Debt - net decreased primarily due to the refunding of the Agency bonds of $233.2 million with maturities through 2030. The 2015 Bonds are backed by SMUD credit instead of bond insurance due to the new PPA.

- Current Liabilities increased primarily due to a higher current portion of the long-term debt and higher fuel billings from SMUD for November and December 2015, partially offset by lower accrued interest and accounts payable for operator reimbursable and capital projects at December 31, 2015.

RESULTS OF OPERATIONS

Summary of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

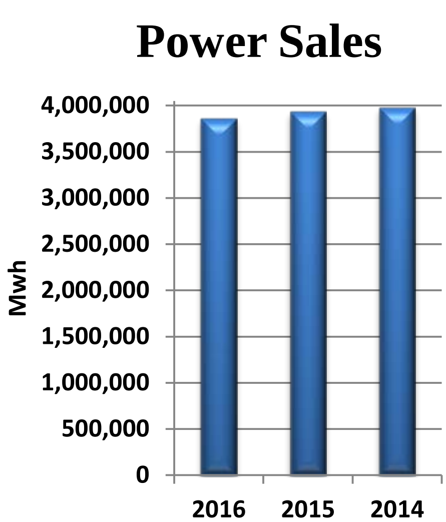
	December 31,			Change			
	2016	2015	2014	2016 vs. 2015		2015 vs. 2014	
Operating revenues	$ 210,631	$ 214,565	$ 231,388	$ (3,934)	-1.8%	$ (16,823)	-7.3%
Operating expenses	(196,942)	(195,615)	(206,429)	(1,327)	-0.7%	10,814	5.2%
Operating income	13,689	18,950	24,959	(5,261)	-27.8%	(6,009)	-24.1%
Interest income	38	183	151	(145)	-79.2%	32	21.2%
Interest on debt	(4,670)	(9,280)	(10,895)	4,610	49.7%	1,615	14.8%
Other income	9,983	-0-	-0-	9,983	100.0%	-0-	0.0%
Change in net position before distributions	19,040	9,853	14,215	9,187	93.2%	(4,362)	-30.7%
Distributions to Member	-0-	(62,000)	(4,500)	62,000	100.0%	(57,500)	-1277.8%
Change in net position	19,040	(52,147)	9,715	71,187	136.5%	(61,862)	-636.8%
Net position - beginning of year	52,156	104,303	94,588	(52,147)	-50.0%	9,715	10.3%
Net position - end of year	$ 71,196	$ 52,156	$ 104,303	$ 19,040	36.5%	$ (52,147)	-50.0%

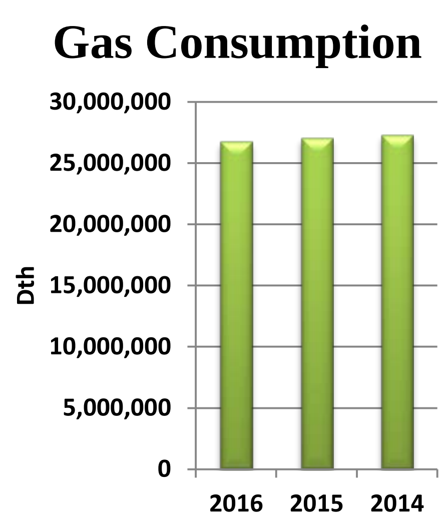
2016 Compared to 2015

OPERATING REVENUES

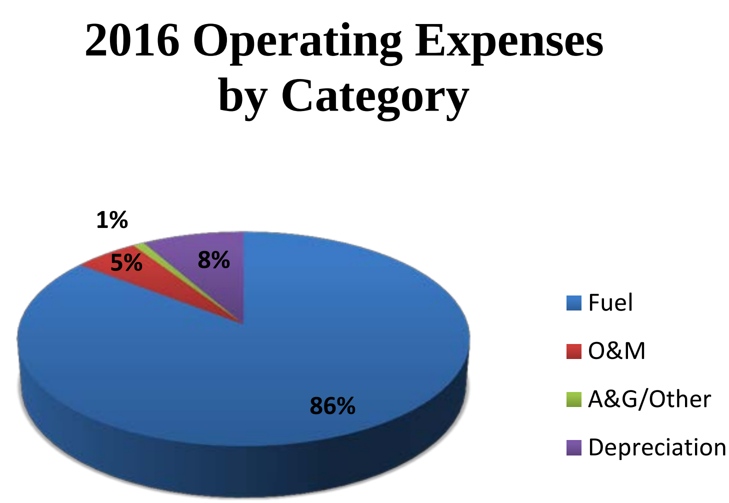
Operating Revenues decreased primarily due to lower Power sales to Member in 2016. The Agency's power sales are determined monthly, based on a formula defined in the PPA, which is driven by the Agency's actual cost of operations including debt service. In 2016, less revenue was needed due to the pass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

The following charts show power sales and gas consumption in 2016, 2015, and 2014:





OPERATING EXPENSES



The following table summarizes Operating Expenses 2016, 2015, and 2014 (dollars in thousands):

	December 31,			Change			
	2016	2015	2014	2016 vs. 2015		2015 vs. 2014	
Operating Expenses							
Fuel	$ 168,389	$ 164,107	$ 175,097	$ 4,282	2.6%	$ (10,990)	-6.3%
Operations and Maintenance	10,380	12,366	11,378	(1,986)	-16.1%	988	8.7%
Administrative & general and Other	1,779	2,580	2,083	(801)	-31.0%	497	23.9%
Depreciation	16,394	16,562	17,871	(168)	-1.0%	(1,309)	-7.3%
Total operating expenses	$ 196,942	$ 195,615	$ 206,429	$ 1,327	0.7%	$ (10,814)	-5.2%

- Fuel expense increased due to higher fuel cost of $5.9 million, partially offset by lower fuel volume of $1.6 million.
- Operations and Maintenance decreased primary due to lower operator base fee and reimbursable expenses.
- Administrative and general and Other expenses decreased primarily due to the write off of the prepaid bond insurance as a result of the refunding in 2015.

INTEREST ON DEBT

Interest on debt decreased due to a lower debt principal as a result of the bond refunding.

OTHER INCOME

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

DISTRIBUTIONS TO MEMBER

Distributions to SMUD are optional and based on excess funds collected through the billings for debt service and operating costs as compared to projected cash requirements, and may vary significantly from year to year. There was no distribution to member in 2016.

2015 Compared to 2014

RESULTS OF OPERATIONS

- Operating Revenues decreased primarily due to lower Power sales to Member. Power sales to Members cover operating costs, including debt service. In 2015, power sales was lower primarily due to lower prices of natural gas and lower fuel volume, and a change to how the overhaul costs are reimbursed.

- Fuel expense decreased due to lower fuel cost of $9.2 million and lower fuel volume of $1.8 million.

- Administrative and general and Other expenses increased primarily due to the write off of the prepaid insurance due to the bond refunding and the bond issuance costs for the 2015 Bonds.

INTEREST ON DEBT

Interest on debt decreased due to a lower debt principal as a result of the bond refunding.

DISTRIBUTIONS TO MEMBER

Distributions to SMUD are optional and based on excess funds collected through the billings for debt service and operating costs as compared to projected cash requirements, and may vary significantly from year to year. Distributions to Member increased due to a $62.0 million distribution to SMUD due to the release of the restricted funds resulting from the bond refunding.

SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
STATEMENTS OF NET POSITION

	December 31, 2016	December 31, 2015
ASSETS		
ELECTRIC UTILITY PLANT		
Plant in service	$ 427,450,986	$ 420,305,482
Less accumulated depreciation	(193,482,504)	(177,088,145)
Plant in service - net	233,968,482	243,217,337
Construction work in progress	702,114	1,033,283
Total electric utility plant - net	234,670,596	244,250,620
RESTRICTED ASSETS		
Debt service funds	15,903,801	17,106,475
Less current portion	-15,903,801	-17,106,475
Total restricted assets	-0-	-0-
CURRENT ASSETS		
Cash and cash equivalents:		
Unrestricted cash and cash equivalents	6,800,344	4,591,082
Restricted cash and cash equivalents	15,903,801	17,106,475
Receivables:		
Power sales to Member	39,025,176	34,505,444
Accrued interest and other	10,681	6,801
Materials and supplies	1,705,563	616,027
Prepayments	230,463	239,886
Regulatory costs recovered within one year	104,416	104,416
Total current assets	63,780,444	57,170,131
NONCURRENT ASSETS		
Regulatory costs for future recovery	1,305,198	1,409,614
Other	2,989	4,394
Total noncurrent assets	1,308,187	1,414,008
TOTAL ASSETS	299,759,227	302,834,759
DEFERRED OUTFLOWS OF RESOURCES		
Unamortized bond losses	3,528,228	4,098,499
TOTAL DEFERRED OUTFLOWS OF RESOURCES	3,528,228	4,098,499
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	$ 303,287,455	$ 306,933,258

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

SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
STATEMENTS OF NET POSITION

	December 31, 2016		December 31, 2015	
LIABILITIES AND NET POSITION				
LONG-TERM DEBT - net	$	170,479,472	$	198,415,433
CURRENT LIABILITIES				
Accounts payable		2,511,156		2,930,008
Payable due to Member		31,247,176		25,805,044
Long-term debt due within one year		23,900,000		22,795,000
Accrued interest		3,953,800		4,832,245
Total current liabilities		61,612,132		56,362,297
TOTAL LIABILITIES		232,091,604		254,777,730
NET POSITION				
Net investment in capital assets		43,819,352		27,138,686
Restricted		11,950,001		12,274,230
Unrestricted		15,426,498		12,742,612
TOTAL NET POSITION		71,195,851		52,155,528
COMMITMENTS AND CONTINGENCIES (Notes 8 and 9)				
TOTAL LIABILITIES AND NET POSITION	$	303,287,455	$	306,933,258

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

	Years Ended December 31, 2016	Years Ended December 31, 2015
OPERATING REVENUES		
Power sales to Member	$ 210,631,351	$ 214,564,874
Total operating revenues	210,631,351	214,564,874
OPERATING EXPENSES		
Fuel	168,389,464	164,106,945
Operations	9,237,718	11,152,278
Maintenance	1,142,054	1,213,699
Administrative and general	1,673,762	2,475,631
Depreciation	16,394,359	16,561,810
Regulatory amounts collected in rates	104,416	104,416
Total operating expenses	196,941,773	195,614,779
OPERATING INCOME	13,689,578	18,950,095
NON-OPERATING REVENUES (EXPENSES)		
Interest income	37,467	183,099
Interest on debt	(4,669,860)	(9,280,861)
Other income	9,983,138	-0-
Total non-operating revenues (expenses)	5,350,745	(9,097,762)
CHANGE IN NET POSITION BEFORE DISTRIBUTIONS	19,040,323	9,852,333
Distributions to Member	-0-	(62,000,000)
CHANGE IN NET POSITION	19,040,323	(52,147,667)
NET POSITION - BEGINNING OF YEAR	52,155,528	104,303,195
NET POSITION - END OF YEAR	$ 71,195,851	$ 52,155,528

SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from power sales to Member	$ 206,111,619	$ 213,190,394
Payments to Member	(154,900,948)	(164,232,233)
Payments to vendors	(11,402,756)	(12,707,460)
Net cash provided by operating activities	39,807,915	36,250,701
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Distributions to Member	-0-	(62,000,000)
Net cash used in noncapital financing activities	-0-	(62,000,000)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITES		
Proceeds from bond issuances, including premium	-0-	223,707,599
Repayment and refundings of long-term debt	(22,795,000)	(243,155,363)
Construction expenditures	(7,025,919)	(7,386,970)
Interest payments on long-term debt	(9,013,995)	(10,459,504)
Net cash used in capital and related financing activities	(38,834,914)	(37,294,238)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of securities	-0-	14,648,635
Interest received	33,587	212,253
Net cash provided by investing activities	33,587	14,860,888
Net increase (decrease) in cash and cash equivalents	1,006,588	(48,182,649)
Cash and cash equivalents - beginning of the year	21,697,557	69,880,206
Cash and cash equivalents - end of the year	$ 22,704,145	$ 21,697,557
CASH AND CASH EQUIVALENTS INCLUDED IN:		
Unrestricted cash and cash equivalents	$ 6,800,344	$ 4,591,082
Restricted cash and cash equivalents	15,903,801	17,106,475
Cash and cash equivalents - end of the year	$ 22,704,145	$ 21,697,557

SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
	2016	2015
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	$ 13,689,578	$ 18,950,095
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	16,394,359	16,561,810
Regulatory amortization	104,416	104,416
Other income	9,983,138	-0-
Changes in operating assets and liabilities:		
Receivables	(4,519,732)	(1,374,480)
Other assets	(1,078,708)	561,678
Payables and accruals	5,234,864	1,447,182
Net cash provided by operating activities	$ 39,807,915	$ 36,250,701
SUPPLEMENTAL DISCLOSURE OF NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES		
Net amortization of debt related (expenses) and premiums	$ 3,465,690	$ 341,163

SACRAMENTO MUNICIPAL UTILITY DISTRICT FINANCING AUTHORITY
NOTES TO FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND OPERATIONS

The Sacramento Municipal Utility District Financing Authority (Agency) is a joint powers authority (JPA) formed by the Sacramento Municipal Utility District (SMUD) and the Modesto Irrigation District (MID) pursuant to the California Government Code. The purpose of the Agency is to own and operate the Cosumnes Power Plant Project (Project) and related facilities for electric power generation. The Project, which began commercial operations in February 2006, is comprised of a 501 megawatt natural gas-fired combined cycle generation plant. The Project is situated on approximately 38 acres adjacent to SMUD's decommissioned nuclear power plant. The land is owned by SMUD and leased to the Agency.

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

In June 2015, the Agency entered into a new Power Purchase Agreement (PPA) with SMUD. Pursuant to the new PPA, SMUD purchases, on a "take-or-pay" basis, all capacity, energy and environmental attributes of the Project. The Agency is obligated to reimburse SMUD for the actual costs of providing general and administrative services, fuel costs, and other costs paid by SMUD on the Agency's behalf. The Agency was charged $160.1 million in 2016 and $166.1 million in 2015 for general and administrative services, water, fuel costs, and other costs paid by SMUD on the Agency's behalf.

SMUD is entitled to all rights and property of the Project in the event of termination of the JPA agreement. MID has no obligation to make contributions or advances to the Agency. The JPA agreement will remain in effect until terminated by a supplemental written agreement of the parties; provided, that in no event shall the JPA agreement terminate while any contracts between the Agency and either of the parties or other parties are in effect, or while any bonds or notes of the Agency are outstanding. Project revenues and the subsequent payments of principal and interest related to the Agency's long-term debt are not dependent upon the continued successful operation of the Project. SMUD is required to make payments in an amount sufficient to pay principal and interest and all other payments required to be made under the Indenture of Trust (Indenture), dated June 1, 2015. Neither MID nor SMUD has any obligation or liability to the Agency beyond that specifically provided for in the JPA agreement or the Project agreements.

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting. The accounting records of the Agency are maintained in accordance with Generally Accepted Accounting Principles (GAAP) 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. Overhaul parts are depreciated over their estimated useful lives, ranging from 2.25 to 18 years. The remaining balance of the Electric Utility Plant is depreciated over the estimated useful life of 30 years. The costs of replacement units are 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 $50.0 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.

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 Bonds in the Statements of Revenues, Expenses and Changes in Net Position. In June 2015, the Agency refunded the 2006 Series bonds and the related prepaid bond insurance costs were written off.

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

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

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

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

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

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

Other 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 $10.0 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 17, 2017, which is the date that the financial statements were available to be issued.

Reclassifications. Certain amounts in 2015 financial statements have been reclassified in order to conform to the 2016 presentation.

Recent Accounting Pronouncements. In February 2015, GASB issued SGAS No. 72, ***"Fair Value Measurement and Application"*** (GASB No. 72). GASB No. 72 addresses accounting and financial reporting issues related to fair value measurements. This statement requires investments to be measured at fair value. An investment is defined as a security or other asset that (a) a government holds primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (described as an exit price) in an orderly transaction between market participants at the measurement date. This statement requires valuation techniques that are appropriate in the circumstances and for which sufficient data are available to be used to measure fair value. The valuation techniques should be consistent with one or more of the following approaches: the market approach, the cost approach, or the income approach. This statement establishes a hierarchy of inputs to the valuation techniques used to measure fair value. The hierarchy has three levels. 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 within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs reflecting the Agency's own assumptions developed from the best information available in the circumstances. A fair value takes into account the highest and best use for a nonfinancial asset. This statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, valuation techniques and changes in valuation techniques, and for nonrecurring fair value measurements, the reason(s) for the measurement. This statement is effective for the Agency in 2016. The Agency implemented GASB No. 72, prospectively, for investments that are measured at fair value on a recurring basis (see Note 7).

In June 2015, GASB issued SGAS No. 76, ***"The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments"*** (GASB No. 76). GASB No. 76 established the hierarchy of GAAP for state and local governments. This statement supersedes SGAS No. 55, ***"The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments."*** The GAAP hierarchy sets forth what constitutes GAAP for all state and local governmental entities. It establishes the order of priority of pronouncements and other sources of accounting and financial reporting guidance that a governmental entity should apply. Category A is comprised of GASB statements. Category B includes GASB Technical Bulletins, GASB Implementation Guides, and literature of the AICPA cleared by the GASB. This statement is effective for the Agency in 2016. The Agency has assessed the financial statement impact of adopting the new statement, and its impact is not material.

NOTE 3. ELECTRIC UTILITY PLANT

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	$ 1,033,283	$ 6,814,335	$ (7,145,504)	$ 702,114
Total nondepreciable utility plant	1,033,283	6,814,335	(7,145,504)	702,114
Depreciable utility plant:				
Generation	420,305,482	7,145,504	-0-	427,450,986
Less: accumulated depreciation	(177,088,145)	(16,394,359)	-0-	(193,482,504)
Total utility plant - net	$ 244,250,620	$ (2,434,520)	$ (7,145,504)	$ 234,670,596

The Agency had the following electric utility plant activity during 2015:

	Balance December 31, 2014	Additions	Adjustments/ Transfers/ Disposals	Balance December 31, 2015
Nondepreciable utility plant:				
Construction work in progress	$ 1,697,601	$ 7,608,915	$ (8,273,233)	$ 1,033,283
Total nondepreciable utility plant	1,697,601	7,608,915	(8,273,233)	1,033,283
Depreciable utility plant:				
Generation	412,032,249	8,273,233	-0-	420,305,482
Less: accumulated depreciation	(160,526,335)	(16,561,810)	-0-	(177,088,145)
Total utility plant - net	$ 253,203,515	$ (679,662)	$ (8,273,233)	$ 244,250,620

NOTE 4. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash Equivalents and Investments. The Agency's investments are governed by the California Government and Public Utilities 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 rated in the top two rating agency categories; bankers' acceptances; certificates of deposit; repurchase and reverse repurchase agreements; mortgage backed bond and collateralized mortgage obligations; LAIF; money market funds; certain investment agreements; and other short term investments rated at least P-1 or A-1 by Moody's and Standard & Poor's (S&P), respectively. The California Government Code 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 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, 2016 and 2015, $1.4 million and $2.2 million of the Agency's cash balances were uninsured, respectively. The bank balance is also, per a depository pledge agreement between the Agency and the Agency's bank, collateralized at 122 percent and 117 percent of the collective funds on deposit (increased by the amount of accrued but uncredited interest) at December 31, 2016 and 2015, respectively. At December 31, 2016 and 2015, the Agency had money market mutual funds of $15.9 million and $17.1 million which were uninsured, respectively. The Agency's money market mutual 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 did not have concentrations of risk greater than five percent at December 31, 2016 and 2015.

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, 2016 and 2015.

The following schedules present credit risk by type of security held at December 31, 2016 and 2015. 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, 2016	December 31, 2015
Cash and Cash Equivalents:			
Deposits	N/A	$ 1,619,844	$ 2,446,146
LAIF	Not Rated	5,180,500	2,144,936
Money market mutual funds	AAAm	15,903,801	17,106,475
Total cash and cash equivalents		$ 22,704,145	$ 21,697,557

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

	December 31, 2016	December 31, 2015
Cash and Cash Equivalents:		
Debt service funds	$ 15,903,801	$ 17,106,475
Unrestricted funds	6,800,344	4,591,082
Total cash and cash equivalents	$ 22,704,145	$ 21,697,557

NOTE 5. LONG-TERM DEBT

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

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

	December 31, 2016	December 31, 2015
2015 Cosumnes project revenue refunding bonds, fixed rates 3.00% - 5.00%, 2017-2030	$ 170,540,000	$ 193,335,000
Unamortized premium - net	23,839,472	27,875,433
Total long-term debt	194,379,472	221,210,433
Less: amounts due within one year	(23,900,000)	(22,795,000)
Total long-term debt - net	$ 170,479,472	$ 198,415,433

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
Cosumnes project revenue bonds	$ 193,335,000	$ -0-	$ (22,795,000)	$ 170,540,000
Unamortized premiums - net	27,875,433	-0-	(4,035,961)	23,839,472
Total long-term debt	$ 221,210,433	$ -0-	$ (26,830,961)	$ 194,379,472

The following summarizes activity in long-term debt for the year ended December 31, 2015:

	December 31, 2014	Additions	Refunding, Payments or Amortization	December 31, 2015
Cosumnes project revenue bonds	$ 233,155,000	$ 193,335,000	$ (233,155,000)	$ 193,335,000
Unamortized premiums - net	5,828,314	30,372,599	(8,325,480)	27,875,433
Total long-term debt	$ 238,983,314	$ 223,707,599	$ (241,480,480)	$ 221,210,433

Revenue Bond Refunding. In June 2015, the Agency issued $193.3 million of 2015 Series Cosumnes Project Revenue Refunding Bonds (Bonds). Proceeds from the 2015 Series Bonds and $24.8 million of available funds were used to refund $233.2 million of the outstanding 2006 Series Bonds through a legal defeasance, and accordingly, the liability for the defeased bonds has been removed from Long-term Debt in the Statements of Net Position. The refunding resulted in the recognition of a deferred accounting loss of $4.4 million, which is being amortized over the life of the refunding issue, and a current period loss of $0.03 million which is included in Interest on Debt in the Statement of Revenues, Expenses and

Changes in Net Assets. The 2015 refunding reduced future aggregate debt service payments by $46.7 million, and resulted in a total economic gain of $35.5 million, which is the difference between the present value of the old and new debt service payments.

The annual debt service requirements to maturity for Bonds are as follows at December 31, 2016:

Year	Principal	Interest	Total
2017	$ 23,900,000	$ 7,907,600	$ 31,807,600
2018	14,140,000	7,190,600	21,330,600
2019	11,705,000	6,625,000	18,330,000
2020	8,710,000	6,039,750	14,749,750
2021	10,900,000	5,604,250	16,504,250
2022-2026 (combined)	54,310,000	20,704,500	75,014,500
2027-2030 (combined)	46,875,000	5,360,750	52,235,750
Total	$ 170,540,000	$ 59,432,450	$ 229,972,450

Proceeds from the 2015 Series Bonds were used to refund previously issued 2006 Bonds that provided financing for the Project. The 2015 Series Bonds, payable through 2030, are secured solely by a pledge of and lien on the trust estate under the Indenture which includes revenues from the PPA and investment income from funds established under the Indenture. The Agency has pledged future net revenues to repay $170.5 million for 2015 Series Bonds at December 31, 2016 and $193.3 million at December 31, 2015. Annual principal and interest payments on the 2015 Series Bonds required approximately 15.1 and 4.9 percent of the Agency's net revenues for 2016 and 2015, respectively. The total principal and interest remaining to be paid on the 2015 Series Bonds is $230.0 million and $261.8 million at December 31, 2016 and 2015, respectively. Debt service payments are made semi-annually on January 1 and July 1. Principal and interest paid was $31.8 million and $10.5 million for 2016 and 2015, respectively. Total gross revenues were $210.7 million and $214.7 million for 2016 and 2015, respectively.

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

NOTE 6. INSURANCE PROGRAMS

The Agency purchases commercial property and casualty insurance coverage at levels consistent with coverages on similar facilities. The policies' deductible dollar amounts vary depending on the type of coverage. The Agency has additional insurance coverage in excess of the requirements of the Indenture. 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, $1.0 million for property claims, and up to $50.0 million for earthquakes. No claims have exceeded the limits of property or liability insurance in any of the past three years. There were no significant reductions in coverage compared to the prior year.

NOTE 7. FAIR VALUE MEASUREMENTS

Effective January 1, 2016, the Agency adopted GASB No. 72 as discussed in Note 2. GASB No. 72 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The Agency utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique.

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

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

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

- LAIF - uses the fair value of the pool's share price multiplied by the number of shares held. This pool can include a variety of investments such as U.S. government securities, federal agency securities, negotiable certificates of deposit, bankers' acceptances, commercial paper, corporate bonds, bank notes, and other investments. The fair values of the securities are generally based on quoted market prices.
- Money market mutual funds - uses a net asset value. Money market mutual funds may include several different underlying short term obligations, including corporates, U.S. Treasuries, U.S. Government Agency Obligations, and municipal securities. Certain investments within the fund may be deemed unobservable and not considered to be in an active market.

The following table identifies the level within the fair value hierarchy that the Agency's financial assets and are accounted for on a recurring basis as of December 31, 2016 and 2015, 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,	
	2016	2015
Investments reported as Cash and Cash Equivalents:		
LAIF	$ 5,180,500	$ 2,144,936
Money market mutual funds	15,903,801	17,106,475
Total fair value investments	$ 21,084,301	$ 19,251,411

NOTE 8. COMMITMENTS

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

Operation and Maintenance Agreement. Ethos serves as the Project Operator and is responsible for the primary operation, repair, overhaul and maintenance services of the Project. The Agency pays for such services according to the terms of this agreement and provides, at no cost to Ethos, fuel, water, and power not already provided for in other agreements. At December 31, 2016, the minimum annual commitment to Ethos under this agreement was approximately $3.7 million.

Ground Lease Agreement. The Agency leases land from SMUD under the ground lease agreement expiring December 2040. At December 31, 2016, the Agency's annual minimum lease payment was approximately $0.1 million.

Water Supply Agreement. Pursuant to the Water Supply Agreement, SMUD supplies water to the Agency. The Agency pays for the actual water supply, storage, and transportation costs for 30 years following Acceptance, which means that the Water Supply Agreement will be in effect through September 2039.

NOTE 9. CONTINGENCIES

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