Northern California Gas Authority No. 1

Financial Statements
as of December 31, 2019 and 2018
and
Report of
Independent Auditors

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of Northern California Gas Authority No. 1, a component unit of Sacramento Municipal Utility District, as of and for the years ended December 31, 2019 and 2018, and the related notes to the financial statements, which collectively comprise Northern California Gas Authority No. 1's basic financial statements as listed in the table of contents.

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 Northern California Gas Authority No. 1's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Northern California Gas Authority No. 1's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Northern California Gas Authority No. 1 as of December 31, 2019 and 2018, and the respective changes in financial position and cash flows thereof 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 basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic 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 basic financial statements, and other knowledge we obtained during our audit of the basic 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 21, 2020

NORTHERN CALIFORNIA GAS AUTHORITY No. 1
MANAGEMENT'S DISCUSSION AND ANALYSIS - UNAUDITED
For the years ended December 31, 2019 and 2018

Using this Financial Report

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

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

Overview of the Financial Statements

The following discussion and analysis of the financial performance of the Agency provides an overview of the financial activities for the years ended December 31, 2019 and 2018. This discussion and analysis should be read in conjunction with the Agency's financial statements and accompanying notes, which follow this section.

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

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

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

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

Nature of Operations

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

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

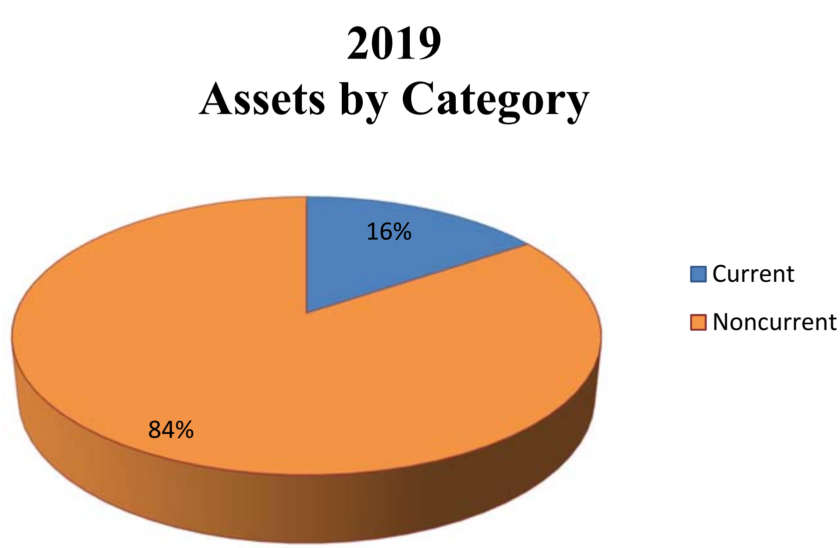
The Agency's Commission is comprised of SMUD's Board of Directors. The Agency is a separate legal entity; however, due to the extent of its operational and financial relationship with SMUD, it is included in the financial statements of SMUD.

FINANCIAL POSITION

Statements of Net Position Summary
(Dollars in thousands)

	December 31,			Change			
	2019	2018	2017	2019 vs. 2018		2018 vs. 2017	
Assets							
Current assets	$ 33,422	$ 50,818	$ 59,786	$ (17,396)	-34.2%	$ (8,968)	-15.0%
Noncurrent assets	180,564	198,303	223,372	(17,739)	-8.9%	(25,069)	-11.2%
Total assets	$ 213,986	$ 249,121	$ 283,158	$ (35,135)	-14.1%	$ (34,037)	-12.0%
Liabilities							
Long-term debt - net	$ 181,935	$ 198,610	$ 233,170	$ (16,675)	-8.4%	$ (34,560)	-14.8%
Current liabilities	21,937	39,433	37,328	(17,496)	-44.4%	2,105	5.6%
Total liabilities	203,872	238,043	270,498	(34,171)	-14.4%	(32,455)	-12.0%
Net position							
Restricted	8,053	16,842	15,216	(8,789)	-52.2%	1,626	10.7%
Unrestricted	2,061	(5,764)	(2,556)	7,825	135.8%	(3,208)	-125.5%
Total net position	10,114	11,078	12,660	(964)	-8.7%	(1,582)	-12.5%
Total liabilities and net position	$ 213,986	$ 249,121	$ 283,158	$ (35,135)	-14.1%	$ (34,037)	-12.0%

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



2019 Compared to 2018

ASSETS

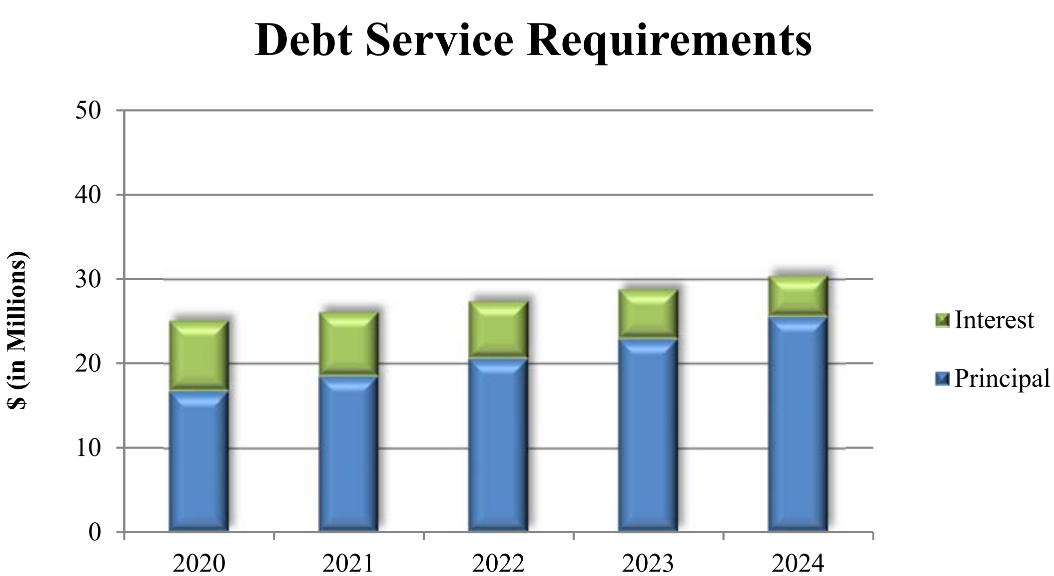
- Current Assets decreased due to lower Restricted cash for lower debt service, Accrued interest and other as a result of lower gas volume, and current portion of the Prepaid Gas Supply.

- The Agency's main asset is its Prepaid Gas Supply, of which, the noncurrent portion was $179.8 million at December 31, 2019. Noncurrent Assets decreased due to the amortization of the Prepaid Gas Supply for gas delivered in 2019. The Prepaid gas supply (current and noncurrent portion) was about 92 percent of the Agency's assets at December 31, 2019.

LIABILITIES & NET POSITION

- Long-Term Debt - net decreased primarily due to $34.6 million of the scheduled principal payments for 2019. At December 31, 2019, the Agency had bonds outstanding of $198.6 million with maturities through 2027. At December 31, 2019, the 2007 Agency Bonds are rated "A+" by Standard & Poor's. The Agency's bonds are tied to MSCG's credit rating.

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



- Current Liabilities decreased primarily due to lower current portion of the long-term debt, partially offset by higher credit support obligation to a collateral deposit from MSCG.

2018 Compared to 2017

ASSETS

- Current Assets decreased primarily due to lower current portion of the Prepaid Gas Supply.

- The Agency's main asset is its Prepaid Gas Supply, of which, the noncurrent portion was $197.4 million at December 31, 2018. Noncurrent Assets decreased due to the amortization of the Prepaid Gas Supply for gas delivered in 2018.

LIABILITIES & NET POSITION

- Long-Term Debt - net decreased primarily due to $31.3 million of the scheduled principal payments for 2018. At December 31, 2018, the Agency had bonds outstanding of $233.2 million with maturities through 2027.

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

RESULTS OF OPERATIONS

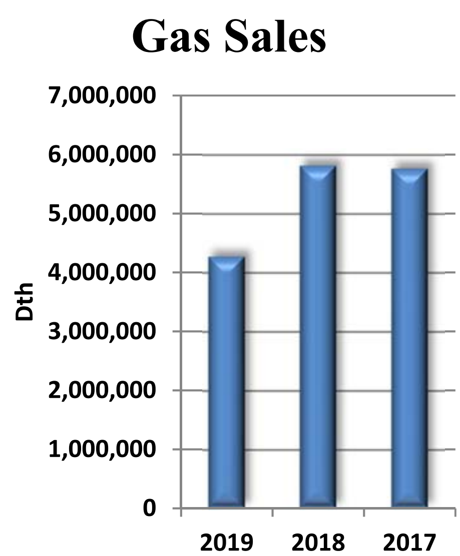
Summary of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

	December 31,			Change			
	2019	2018	2017	2019 vs. 2018		2018 vs. 2017	
Operating revenues	$ 33,472	$ 43,760	$ 41,895	$ (10,288)	-23.5%	$ 1,865	4.5%
Operating expenses	(25,133)	(34,761)	(31,083)	9,628	27.7%	(3,678)	-11.8%
Operating income	8,339	8,999	10,812	(660)	-7.3%	(1,813)	-16.8%
Interest and other income	850	876	785	(26)	-3.0%	91	11.6%
Interest on debt	(9,280)	(10,645)	(11,870)	1,365	12.8%	1,225	10.3%
Change in net position before distributions and contributions	(91)	(770)	(273)	679	88.2%	(497)	-182.1%
Distributions to Member	(953)	(881)	(809)	(72)	-8.2%	(72)	-8.9%
Member contributions	80	69	69	11	15.9%	-0-	0.0%
Change in net position	(964)	(1,582)	(1,013)	618	39.1%	(569)	-56.2%
Net position - beginning of year	11,078	12,660	13,673	(1,582)	-12.5%	(1,013)	-7.4%
Net position - end of year	$ 10,114	$ 11,078	$ 12,660	$ (964)	-8.7%	$ (1,582)	-12.5%

2019 Compared to 2018

The following chart shows gas sales in 2019, 2018 and 2017:



- Operating Revenue decreased due to lower Gas swap settlement and Gas sales to Member as a result of lower gas volume.

- Operating Expense decreased due to lower amortization of the Prepaid Gas Supply.

- Interest expense decreased primarily due to lower bonds outstanding.

- Distributions to SMUD are based on interest earnings on the Debt Service fund not otherwise needed for another purpose, as specified in the indenture of trust. In 2019, the Agency distributed $0.9 million to SMUD.

2018 Compared to 2017

- Operating Revenue increased due to higher Gas swap settlement, partially offset by lower gas sales to Member as a result of lower gas price index.

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

- Interest expense decreased primarily due to lower bonds outstanding.

- The Agency distributed $0.9 million to SMUD in 2018.

NORTHERN CALIFORNIA GAS AUTHORITY No. 1
STATEMENTS OF NET POSITION

	December 31, 2019	December 31, 2018
ASSETS		
RESTRICTED ASSETS		
Debt service fund	$ 10,189,434	$ 19,336,565
Other restricted funds	3,125,785	2,378,910
Less current portion	(13,315,219)	(21,715,475)
Total restricted assets	-0-	-0-
CURRENT ASSETS		
Restricted cash and cash equivalents	13,315,219	21,715,475
Receivables:		
Gas sales to Member	374,608	499,172
Accrued interest and other	1,993,049	3,534,399
Prepaid gas supply	17,618,858	24,948,582
Other prepayments	15,630	15,630
Regulatory costs to be recovered within one year	104,796	104,796
Total current assets	33,422,160	50,818,054
NONCURRENT ASSETS		
Prepaid gas supply	179,781,077	197,399,935
Regulatory costs for future recovery	681,179	785,975
Prepaid bond insurance costs	101,598	117,228
Total noncurrent assets	180,563,854	198,303,138
TOTAL ASSETS	$ 213,986,014	$ 249,121,192
LIABILITIES AND NET POSITION		
LONG-TERM DEBT - net	$ 181,935,000	$ 198,610,000
CURRENT LIABILITIES		
Accounts payable	1,072,714	1,136,297
Credit support for collateral obligation	3,124,864	2,378,131
Long-term debt due within one year	16,675,000	34,560,000
Accrued interest	1,064,330	1,358,789
Total current liabilities	21,936,908	39,433,217
TOTAL LIABILITIES	203,871,908	238,043,217
NET POSITION		
Restricted	8,053,311	16,842,258
Unrestricted	2,060,795	(5,764,283)
TOTAL NET POSITION	10,114,106	11,077,975
COMMITMENTS AND CONTINGENCIES (Notes 6 and 7)		
TOTAL LIABILITIES AND NET POSITION	$ 213,986,014	$ 249,121,192

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

NORTHERN CALIFORNIA GAS AUTHORITY No. 1
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	Years Ended December 31, 2019	Years Ended December 31, 2018
OPERATING REVENUES		
Gas sales to Member	$ 2,227,519	$ 2,775,121
Gas swap settlement, net	31,244,270	40,984,418
Total operating revenues	33,471,789	43,759,539
OPERATING EXPENSES		
Prepaid gas amortization	24,948,582	34,586,730
Administrative and general	80,112	69,385
Regulatory amounts collected in rates	104,796	104,796
Total operating expenses	25,133,490	34,760,911
OPERATING INCOME	8,338,299	8,998,628
NON-OPERATING REVENUES (EXPENSES)		
Interest income	850,433	875,925
Interest on debt	(9,279,888)	(10,644,611)
Total non-operating revenues (expenses)	(8,429,455)	(9,768,686)
CHANGE IN NET POSITION BEFORE DISTRIBUTIONS AND CONTRIBUTIONS	(91,156)	(770,058)
Distributions to Member	(952,825)	(881,395)
Member contributions	80,112	69,385
CHANGE IN NET POSITION	(963,869)	(1,582,068)
NET POSITION - BEGINNING OF YEAR	11,077,975	12,660,043
NET POSITION - END OF YEAR	$ 10,114,106	$ 11,077,975

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

NORTHERN CALIFORNIA GAS AUTHORITY No. 1
STATEMENTS OF CASH FLOWS

	December 31, 2019	December 31, 2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from gas sales to Member	$ 2,352,083	$ 2,757,811
Receipts from others	32,849,373	40,837,605
Receipts/payments for credit support collateral	746,733	(825,801)
Net cash provided by operating activities	35,948,189	42,769,615
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Repayment of bonds	(34,560,000)	(31,305,000)
Interest payments on long-term debt	(9,622,300)	(10,953,301)
Distributions to Member	(952,825)	(881,395)
Net cash used in noncapital financing activities	(45,135,125)	(43,139,696)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	786,680	846,364
Net cash provided by investing activities	786,680	846,364
Net (decrease) increase in cash and cash equivalents	(8,400,256)	476,283
Cash and cash equivalents - beginning of the year	21,715,475	21,239,192
Cash and cash equivalents - end of the year	$ 13,315,219	$ 21,715,475
CASH AND CASH EQUIVALENTS INCLUDED IN:		
Restricted cash and cash equivalents	$ 13,315,219	$ 21,715,475
Cash and cash equivalents - end of the year	$ 13,315,219	$ 21,715,475
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	$ 8,338,299	$ 8,998,628
Adjustments to reconcile operating income to net cash provided by operating activities:		
Amortization of prepaid gas supply	24,948,582	34,586,730
Regulatory amortization	104,796	104,796
Receipts (payments) for credit support collateral	746,733	(825,801)
Changes in operating assets and liabilities:		
Receivables	1,729,667	(164,123)
Payables and accruals	80,112	69,385
Net cash provided by operating activities	$ 35,948,189	$ 42,769,615
SUPPLEMENTAL DISCLOSURE OF NONCASH RELATED FINANCING ACTIVITIES		
Amortization of debt related premiums	$ (15,630)	$ (15,630)
Contributions from Member	80,112	69,385

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

NORTHERN CALIFORNIA GAS AUTHORITY No. 1
NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended December 31, 2019 and 2018

NOTE 1. ORGANIZATION AND OPERATIONS

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

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

The Agency has no employees. The Gas Project is operated by SMUD’s staff. SMUD is obligated to contribute to the Agency the actual costs of providing administrative and general services. SMUD contributed $0.1 million both in 2019 and 2018 for administrative and general services provided to the Agency by SMUD.

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

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

Credit and Market Risk. The Agency entered into a synthetic guaranteed investment contract (see Note 3) in 2007 and is exposed to credit risk related to nonperformance by its investment provider. This contract requires the investment provider to post collateral if their credit ratings fall below agreed upon levels. The amount is recorded as current restricted asset with an associated current liability on the Statements of Net Position.

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

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

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

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

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

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

Gas Swap Agreement. The Agency uses forward contracts to hedge the impact of market volatility on gas commodity prices for its GSC.

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

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

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

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

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

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

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

Subsequent Events. Subsequent events for the Agency have been evaluated through February 21, 2020, which is the date that the financial statements were available to be issued.

Recent Accounting Pronouncements. In January 2017, GASB issued Statement of Governmental Accounting Standards (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 has assessed the financial statement impact of adopting the new statement, and the Agency has no fiduciary activities to report.

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

In March 2018, GASB issued SGAS No. 88, ***"Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements"*** (GASB No. 88). The primary objective of this statement is to improve the information that is disclosed in notes to financial statements related to debt, including direct borrowings and direct placements. GASB No. 88 also clarifies which liabilities should be included when disclosing information related to debt. This statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. GASB No. 88 also requires additional information related to debt be disclosed, including unused lines of credits; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. This statement also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt. This statement is effective for the Agency in 2019. The Agency included additional note disclosures related to debt in Note 5.

In June 2018, GASB issued SGAS No. 89, ***"Accounting for Interest Cost Incurred before the End of a Construction Period"*** (GASB No. 89). The objectives of this statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. GASB No. 89 establishes accounting requirements for interest cost incurred before the end of a construction period. This statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity. The GASB has allowed that provided the criteria for regulated operations are met and the entity has elected regulatory accounting, qualifying interest cost may be capitalized as a regulatory asset. This statement is effective for the Agency in 2020. The Agency has assessed the financial statement impact of adopting the new statement, and since the Agency has no borrowings for construction, this statement has no impact on the Agency.

In August 2018, GASB issued SGAS No. 90, ***"Majority Equity Interests"*** (GASB No. 90). The objectives of this statement are (1) to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and (2) to improve the relevance of financial statement information for certain component units. GASB No. 90 defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method. For all other holdings of a majority equity interest, a government should report the legally separate organization as a component unit. The government should report an asset related to the majority equity interest using the equity method. This statement is effective for the Agency in 2019. The Agency has assessed the financial statement impact of adopting the new statement, and since the Agency does not have majority equity interests in any legally separate organizations, this statement has no impact on the Agency.

In May 2019, GASB issued SGAS No. 91, ***"Conduit Debt Obligations"*** (GASB No. 91). The objectives of this statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. A conduit debt obligation is defined as a debt instrument having all of the following characteristics: (a) there are at least three parties involved: (1) an issuer, (2) a third-party obligor, and (3) a debt holder or a debt trustee; (b) the issuer and the third-party obligor are not within the same financial reporting entity; (c) the debt obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer; (d) the third-party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance; and (e) the third-party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments). All conduit debt obligations involve the issuer making a limited commitment. Some issuers extend additional commitments or voluntary commitments to support debt service in the event the third party is, or will be, unable to do so. An issuer should not recognize a conduit debt obligation as a liability, however, an issuer should recognize a liability associated with an additional commitment or a voluntary commitment to support debt service if certain recognition criteria are met. This statement is effective for the Agency in 2021. The Agency is currently assessing the financial statement impact of adopting this statement.

NOTE 3. CASH, CASH EQUIVALENTS, AND INVESTMENTS

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

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

Custodial Credit Risk. This is the risk that in the event of the failure of a depository financial institution or counterparty to a transaction, the Agency's deposits may not be returned or the Agency will not be able to recover the value of its deposits, investments or securities that are in the possession of another party. The Agency does not have a deposit or investment policy for custodial credit risk. At December 31, 2019 and 2018, the Agency had money market funds of $5.4 million and $5.1 million which were uninsured, respectively. At December 31, 2019 and 2018, $2.3 million and $2.7 million of the money market funds were held in trust for the benefit of the Agency respectively, and $3.1 million and $2.4 million represent amounts held by the Agency as a collateral deposit by an investment provider, respectively.

Concentration of Credit Risk. This is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. The Agency places no limit on the amounts invested in any one issuer for federal agency securities. To limit the Agency's credit risk for commercial paper purchased under the Debt Service Fund Agreement, the aggregate maturity amount invested in any combination of one issuer, affiliate of issuer, or backed by any one credit support, cannot exceed $30.0 million. The Agency has concentrations of risk greater than five percent invested in Chesham Finance of 100 percent at December 31, 2019 and 2018.

Interest Rate Risk. This is the risk that investments are exposed to fair value losses arising from increasing interest rates. Though the Agency has restrictions as to the maturities of some of the investments, it does not have a formal policy for interest rate risk. At December 31, 2019 and 2018, all of the Agency's investments had maturities of one year or less.

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

The following schedules present credit risk by type of security held at December 31, 2019 and 2018. The credit ratings listed are from Standard & Poor's (S&P).

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

	Credit Rating	December 31, 2019	December 31, 2018
Cash and Cash Equivalents:			
Money market funds	AAAm	$ 5,374,882	$ 5,088,917
Commercial paper - Chesham Finance	A-1	7,940,337	16,626,558
Total cash and cash equivalents		$ 13,315,219	$ 21,715,475

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

	December 31,	
	2019	2018
Cash and Cash Equivalents:		
Debt service fund	$ 10,189,434	$ 19,336,565
Other restricted funds:		
Collateral for credit support	3,124,864	2,378,131
Revenue fund	921	779
Total other restricted funds	3,125,785	2,378,910
Total cash and cash equivalents	$ 13,315,219	$ 21,715,475

NOTE 4. PREPAID GAS SUPPLY

The Agency's prepaid gas supply is presented below:

	December 31,	
	2019	2018
Prepaid gas supply	$ 196,065,052	$ 220,796,428
Prepaid gas supply revenue	1,334,883	1,552,089
Total prepaid gas supply	197,399,935	222,348,517
Less: amounts due within one year	(17,618,858)	(24,948,582)
Total prepaid gas supply - noncurrent portion	$ 179,781,077	$ 197,399,935

The following summarizes prepaid gas supply activity for the year ended December 31, 2019:

	January 1, 2019	Terminations	Amortization	December 31, 2019
Prepaid gas supply	$ 220,796,428	$ -0-	$ (24,731,376)	$ 196,065,052
Prepaid gas supply revenue	1,552,089	-0-	(217,206)	1,334,883
Total prepaid gas supply	$ 222,348,517	$ -0-	$ (24,948,582)	$ 197,399,935

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

	January 1, 2018	Terminations	Amortization	December 31, 2018
Prepaid gas supply	$ 255,074,364	$ -0-	$ (34,277,936)	$ 220,796,428
Prepaid gas supply revenue	1,860,883	-0-	(308,794)	1,552,089
Total prepaid gas supply	$ 256,935,247	$ -0-	$ (34,586,730)	$ 222,348,517

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

NOTE 5. LONG-TERM DEBT

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

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

	December 31, 2019	December 31, 2018
2007 Series B Gas project revenue bonds, variable rates, 2020-2027	$ 198,610,000	$ 233,170,000
Less: amounts due within one year	(16,675,000)	(34,560,000)
Total long-term debt - net	$ 181,935,000	$ 198,610,000

The following summarizes long-term debt activity for the year ended December 31, 2019:

	January 1, 2019	Additions	Payments/ Amortizations	December 31, 2019
2007 Gas project revenue bonds	$ 233,170,000	$ -0-	$ (34,560,000)	$ 198,610,000
Total long-term debt	$ 233,170,000	$ -0-	$ (34,560,000)	$ 198,610,000

The following summarizes long-term debt activity for the year ended December 31, 2018:

	January 1, 2018	Additions	Payments/ Amortizations	December 31, 2018
2007 Gas project revenue bonds	$ 264,475,000	$ -0-	$ (31,305,000)	$ 233,170,000
Total long-term debt	$ 264,475,000	$ -0-	$ (31,305,000)	$ 233,170,000

The annual debt service requirements to maturity for the Bonds are as follows at December 31, 2019:

Year	Principal	Interest	Total
2020	$ 16,675,000	$ 8,368,752	$ 25,043,752
2021	18,450,000	7,631,960	26,081,960
2022	20,550,000	6,815,276	27,365,276
2023	22,865,000	5,905,895	28,770,895
2024	25,530,000	4,893,110	30,423,110
2025-2027 (combined)	94,540,000	7,401,805	101,941,805
Total	$ 198,610,000	$ 41,016,798	$ 239,626,798

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

The Agency had pledged future net revenues to repay $198.6 million and $233.2 million at December 31, 2019 and 2018, respectively, for Bonds issued in May 2007. Proceeds from the Bonds were used to purchase the Gas Project from MSCG at a price of $754.1 million with the remaining amounts used to fund the appropriate accounts for the Agency. The Bonds, payable through 2027, are secured solely by a pledge of and lien on the trust estate under the Indenture which includes bond proceeds, rights under the GSC, revenues, any termination payment and any investment income. Annual principal and interest payments on the Bonds are expected to require approximately 100 percent of the Agency's net revenues. The total principal and interest remaining to be paid on the Bonds was $239.6 million and $283.8 million at December 31, 2019 and 2018, respectively. Debt service payments on the Bonds are made quarterly on January 1, April 1, July 1 and October 1.

Principal and interest paid was $44.2 million and $42.3 million for 2019 and 2018, respectively. Total gross revenues were $34.3 million and $44.6 million for 2019 and 2018, respectively.

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

Terms of Debt Indenture. The debt indenture contains a provision that in an event of default, the holders of the majority of the debt outstanding are entitled to declare the outstanding amounts due immediately.

Interest Rate Swap Agreements - 2007 Series B Bonds. The following summarizes the Agency's swap agreement at December 31, 2019:

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

The following summarizes the Agency's two swap agreements at December 31, 2018:

Notional Amount	Agency Pays	Fixed Rate	Floating Rate	Termination Date	Credit Support Provider Credit Rating (S&P)
$ 34,560,000	Fixed	4.144%	67% of LIBOR +.63%	07/01/19	A+
198,610,000	Fixed	4.304%	67% of LIBOR +.72%	07/01/27	A+

At December 31, 2019 and 2018, the Agency had variable-to-fixed interest rate swap agreements with a counterparty. The Agency pays the counterparty a fixed rate on the notional amount and receives a floating rate equal to 67 percent of the three month London Interbank Offered Rates (LIBOR) (1.9 percent and 2.8 percent at December 31, 2019 and 2018, respectively) plus an interest rate spread, as specified in each swap agreement. The total notional amounts of the swaps at December 31, 2019 and 2018 were $198.6 million and $233.2 million, respectively, and were equivalent to the outstanding principal balance on the Agency's Bonds. The swaps are amortized over the life of their respective swap agreements in a manner corresponding to the principal repayment schedule of the Bonds. Early termination of the swaps would occur upon termination of the Prepaid Agreement for any reason. Upon early termination, the swaps would have no value to either party.

Variable Rate 2007 Series B Bonds. The Agency's variable rate Bonds bear interest at a quarterly rate of 2.0 percent at December 31,2019.

NOTE 6. COMMITMENTS

Natural Gas Commodity Price Swap Agreement. The Agency has entered into a floating-to-fixed natural gas commodity price swap agreement (Gas Swap Agreement) with a counterparty for the purpose of fixing the variable price on the Agency's natural gas sales to SMUD under the GSC. The Agency pays an index-based natural gas price over the twenty-year period and receives a fixed natural gas price as specified in the Gas Swap Agreement, for notional quantities of natural gas at a pricing point corresponding to the daily contract quantity and the delivery point under the Prepaid Agreement. The Gas Swap Agreement terminates on May 31, 2027. The total notional amount of the Gas Swap Agreement remaining at December 31, 2019 was 23.5 million mmbtu. Presently, the Gas Swap Agreement is 8,678 mmbtu per calendar day, and this amount will change on June 1 of each remaining year of the Gas Swap Agreement and will range from 8,678 to 8,675 mmbtu per calendar day. Early termination of the Gas Swap Agreement would occur upon termination of the Prepaid Agreement for any reason whatsoever. Upon early termination, the Gas Swap Agreement would have no value to either party.

NOTE 7. CONTINGENCIES

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

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