

EAST BAY MUNICIPAL UTILITY DISTRICT
BASIC UNAUDITED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016

Third quarter report which provides a continuing view of the District's financial position

**PREPARED BY THE
FINANCE DEPARTMENT**

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**EAST BAY MUNICIPAL UTILITY DISTRICT
BASIC UNAUDITED FINANCIAL STATEMENTS
For the Nine Months Ended March 31, 2016**

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**EAST BAY MUNICIPAL UTILITY DISTRICT
BASIC UNAUDITED FINANCIAL STATEMENTS
For the Third Quarter Ended March 31, 2016**

Management's Discussion and Analysis (MDA) of Financial Condition and Results of Operations

Forward Looking Statements

This section presents management's analysis of the East Bay Municipal Utility District's (the District) financial condition and activities as of March 31, 2016. This information should be read in conjunction with the unaudited financial statements for the nine months ended March 31, 2016. The information in this MDA is presented under the following headings:

- Organization and Business
- The Basic Unaudited Financial Statements
- Financial Analysis – Water System
- Financial Analysis – Wastewater System
- Request for Information

ORGANIZATION AND BUSINESS

The District provides water and wastewater services to industrial, commercial, residential and public authority users. The Water System collects, transmits, treats, and distributes high-quality water to approximately 60% (332 square miles) of the developed area within Alameda and Contra Costa counties of California and serves a population of about 1.4 million. The Wastewater System intercepts and treats wastewater from residences and industries within an 88 square mile service area including the communities of Alameda, Albany, Berkeley, Emeryville, Oakland, Piedmont, and the Stege Sanitary District and serves a population of about 680,000. The District recovers cost of service primarily through user fees.

THE BASIC UNAUDITED FINANCIAL STATEMENTS

The District's basic unaudited financial statements are comprised of three components: Management Discussion and Analysis, Fund Financial Statements, and Notes to Basic Financial Statements. This quarterly financial report excludes the District's Fiduciary Fund that consists of the Pension and other Employee Benefit Trusts. The Fiduciary Fund is reported on an annual basis only and is included in the most recent Annual Audited Financial Reports for the year ended June 30, 2015, which is posted on the District website <http://www.ebmud.com>.

FINANCIAL ANALYSIS – WATER SYSTEM

Net Position

The Water System's net position increased by \$57.2 million or 6% during the nine months ended March 31, 2016. Current and other assets increased by \$6.5 million. Capital assets increased by \$75.9 million or 2%. Changes in deferred outflow and inflow of resources primarily reflect changes in the market value of interest rate SWAP agreements (see Note 6D). By far the largest portion of the Water System's net position, 82% or \$899.8 million, represents its investment in capital assets necessary to provide services. Components of the net position are shown in Table 1.

Table 1

Water System

Net Position

March 31, 2016 and June 30, 2015

(In thousands)

	March 31, 2016	June 30, 2015	Variance	%
Current and other assets	\$772,930	\$766,463	\$6,467	1%
Capital assets	3,760,394	3,684,449	75,945	2%
Deferred outflow of resources	102,760	92,534	10,226	11%
Total assets and deferred outflow	4,636,084	4,543,446	92,638	2%
Current and other liabilities	607,914	570,939	36,975	6%
Long-term liabilities	2,811,286	2,823,075	(11,789)	(0)%
Deferred inflow of resources	122,194	111,968	10,226	9%
Total liabilities and deferred inflow	3,541,394	3,505,982	35,412	1%
Net position:				
Net investment in capital assets	899,824	812,113	87,711	11%
Restricted	272,130	275,923	(3,793)	(1)%
Unrestricted	(77,264)	(50,572)	(26,692)	53%
Total net position	\$1,094,690	\$1,037,464	\$57,226	6%

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Results of Operation

For the nine months ended March 31, 2016, the Water System's change in net position increased by \$40.0 million as compared to the same period of the previous fiscal year. This increase was due to an increase in operating revenue and a decrease in non-operating net expense offset by an increase in operating expense and a decrease in capital contribution. Total operating revenue increased by \$40.6 million or 15% primarily due to an additional \$37.7 million drought surcharge, an 8% water rate increase offset by a 14.9% decrease in billed water consumption in the current year. Total operating expense increased by \$30.0 million primarily due to an increase in raw water expenses of \$23.2 million drought management expenses to purchase additional drought water supply and additional expenses incurred to treat local reservoir water. Net non-operating expense decreased by \$34.5 million primarily due to a \$37.0 million reduction of bond interest and expenses compared to a non-recurring \$32.2 million in interest expenses paid for advance refunding in March 2015. Capital contributions decreased by \$5.1 million as a result of a decrease of \$18.3 million in seismic improvement offset by an \$10.4 million increase in system capacity charges and an increase of \$1.9 million in grants and other reimbursements in the current fiscal year compared to the prior year, as discussed on page 6.

Table 2

Water System

Changes in Net Position

For the Nine Months Ended March 31, 2016 and 2015
(In thousands)

	March 31, 2016	March 31, 2015	Variance	%
Operating revenue:				
Water	\$317,027	\$276,541	\$40,486	15%
Power	1,684	1,574	110	7%
Total operating revenues	318,711	278,115	40,596	15%
Operating expense:				
Raw water	53,997	29,412	24,585	84%
Water treatment and distribution	76,073	73,394	2,679	4%
Recreation areas, net	4,029	4,052	(23)	(1)%
Customer accounting and collecting	12,136	12,226	(90)	(1)%
Financial and risk management	13,688	12,360	1,328	11%
Facilities management	5,816	6,036	(220)	(4)%
General administration	28,333	28,752	(419)	(1)%
Depreciation on utility plant and vehicle	72,155	69,997	2,158	3%
Total operating expense	266,227	236,229	29,998	13%
Net operating income	52,484	41,886	10,598	25%
Nonoperating income (expense):				
Investment income	1,497	3,173	(1,676)	(53)%
Taxes and subventions	19,601	18,922	679	4%
Interest, amortization and bond expenses, net	(69,475)	(106,413)	36,938	(35)%
Increase (decrease) of equity in JPA partnership fund	(3,040)	(3,062)	22	100%
Other income	10,168	11,675	(1,507)	(13)%
Total nonoperating income (expense), net	(41,249)	(75,705)	34,456	(46)%
Income before capital contributions	11,235	(33,819)	45,054	(133)%
Capital contributions	45,991	51,058	(5,067)	(10)%
Change in net position	57,226	17,239	39,987	232%
Total net position – beginning	1,037,464	1,363,331	(325,867)	(24)%
Prior period adjustment per implementation GASB 68	-	(401,602)	401,602	(100)%
Total net position – ending	\$1,094,690	\$978,968	\$115,722	12%

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Liquidity

As of March 31, 2016, total combined current and non-current cash and investments increased by \$126.6 million or 37% compared to the same period of the previous fiscal year. Net increase (decrease) in cash and cash equivalents decreased by \$78.7 million compared to the prior year. This was primarily due to an increase of \$17.1 million from operating activities, increase of \$25.1 million from capital and related financing activities and a decrease of \$121.6 million from the reallocation of investments between short-term and long-term. Net increase (decrease) in non-current investments increased by \$120.0 million also primarily due to reallocation of investments between short-term and long-term.

Water System				
Cash Flows				
For the Nine Months Ended March 31, 2016 and 2015				
(In thousands)				
	March 31, 2016	March 31, 2015	Variance	%
Cash and cash equivalents:				
Beginning of year	\$348,722	\$175,941	\$172,781	98%
Net cash provided by operating activities	138,183	121,077	17,106	14%
Net cash provided by financing activities	19,601	18,922	679	4%
Net cash provided by (used in) capital and related financing activities	(163,944)	(188,997)	25,053	(13)%
Net cash provided by (used in) investing activities	(120,834)	737	(121,571)	(16,495)%
Net increase (decrease) in cash and cash equivalents	(126,994)	(48,261)	(78,733)	163%
End of period	<u>\$221,728</u>	<u>\$127,680</u>	<u>\$94,048</u>	74%
Non-current investments:				
Beginning of year	128,945	216,170	(87,225)	(40)%
Net increase (decrease) in non-current investments	122,222	2,463	119,759	4,862%
End of period	<u>251,167</u>	<u>218,633</u>	<u>32,534</u>	15%
Total cash and investments	<u>\$472,895</u>	<u>\$346,313</u>	<u>\$126,582</u>	37%

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Cash and Investments by Fund

Total cash and investments available for operating and capital activities are reported in current and non-current assets as unrestricted and restricted funds. Table 4 shows the composition of the Water System's cash and investments as of March 31, 2016 and June 30, 2015. Total cash and investments decreased by \$4.8 million or 1% during the nine months ended March 31, 2016. Significant activities included use of \$9.2 million in capital reserves to fund capital projects and equipment, and reserve of an additional \$4.7 million in funds received for construction.

Table 4
Water System
Cash and Investments by Fund
March 31, 2016 and June 30, 2015
(In thousands)

	March 31, 2016	June 30, 2015	Variance	%
Unrestricted cash and investments				
Operating reserves:				
Rate stabilization fund	\$95,000	\$95,000	-	0%
Working capital	62,100	61,700	400	1%
Self-insurance reserves	5,000	5,000	-	0%
Workers' compensation reserves	3,200	3,200	-	0%
Total operating reserves	165,300	164,900	400	0%
Capital reserves:				
Reserved for capital projects	251,701	262,074	(10,373)	(4)%
Vehicle replacement Fund	6,956	7,600	(644)	(8)%
Equipment replacement fund	2,020	157	1,863	1,187%
Total capital reserves	260,677	269,831	(9,154)	(3)%
Total unrestricted cash and investments	425,977	434,731	(8,754)	(2)%
Restricted Cash and Investments				
Bond interest and redemption fund	32	796	(764)	(96)%
Debt service reserve fund	12,698	12,672	26	0%
Funds received for construction	31,447	26,709	4,738	18%
FERC partnership fund	2,206	2,225	(19)	(1)%
Monetary reserve	535	534	1	0%
Total restricted cash and investments	46,918	42,936	3,982	9%
Total Cash and Investments	\$472,895	\$477,667	(\$4,772)	(1)%

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Capital Contributions

Capital contributions primarily consist of System Capacity Charges (SCC) and Seismic Improvement Program (SIP) surcharges. Additionally, the District receives contributions when the District's facilities need to be relocated during construction projects. The District also receives state and federal grants to fund capital projects.

The Water System's SCC consists of charges collected from all applicants who request a new water service connection or a larger water meter size, and varies depending on geographic region. The SCC pays for the applicant's share of the capital facilities, including those that serve the entire water system such as the aqueducts and raw water facilities, regional facilities such as treatment plants and distribution facilities, and future water supply upgrades needed to meet long-term increases in water demand created by new customers. The portion of the SCC that pays for the future water supply is restricted and the remainder is unrestricted.

The Seismic Improvement Program (SIP) surcharge was implemented in 1994 to fund the District's SIP. The object of the program was to ensure that water service would be available after a seismic event to meet fire safety needs and to provide continued service to residential, commercial and industrial customers. The charge was anticipated to be in place through February 2025, but as a result of lower than expected construction costs, lower than expected financing costs, and higher revenues than anticipated, by the end of fiscal year 2015 the District has collected sufficient funds from the SIP surcharge to cover project costs. Accordingly, fiscal year 2015 was the last year that the District levied the seismic surcharge. No seismic surcharge revenues are being budgeted for FY16 or FY17.

For the nine months ended March 31, 2016, capital contributions decreased \$5.1 million or 10% as compared to the same period of the previous fiscal year. System capacity charges increased by \$10.4 million was due to rising development activities as the housing industry continues to rebound from the most recent recession. Grants and other reimbursements increased by \$1.9 million due to \$3.6 additional mitigation fees received offset by a decrease of \$1.7 million received from Federal and State grants. Table 5 shows the Water System's capital contributions received for the nine months ended March 31, 2016 and 2015:

Table 5

Water System

Capital Contributions

For the Nine Months Ended March 31, 2016 and 2015

	(In thousands)			
	March 31,	March 31,		
	2016	2015	Variance	%
System capacity charges	\$31,546	\$21,122	\$10,424	49%
Earned contributions on construction	10,460	9,566	894	9%
Seismic improvement surcharge	32	18,310	(18,278)	(100)%
Grants and other reimbursements	3,953	2,060	1,893	92%
Total capital contributions	<u>\$45,991</u>	<u>\$51,058</u>	<u>(5,067)</u>	(10)%

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Capital Assets

The Water System had \$3.8 billion (net of accumulated depreciation) invested in a broad range of utility capital assets as of March 31, 2016. The investment in capital assets includes land, buildings, improvements, water treatment plants, aqueducts, water transmission and distribution mains, water storage facilities, pump stations, water recycling facilities, machinery and equipment.

Table 6
Water System
Capital Assets, Net of Depreciation
March 31, 2016 and June 30, 2015
(In thousands)

	March 31, 2016	June 30, 2015	Variance	%
Structures, buildings, and equipment (net)	\$3,332,400	\$3,316,559	\$15,841	0%
Land and rights-of-way	58,748	58,445	303	1%
Construction work in progress	369,246	309,445	59,801	19%
Totals	<u>\$3,760,394</u>	<u>\$3,684,449</u>	<u>\$75,945</u>	2%

Debt Administration

As of March 31, 2016, the Water System had total long-term debt outstanding of \$2.9 billion (net of unamortized costs).

Table 7
Water System
Long -Term Debt
(Net of Unamortized Costs)
March 31, 2016 and June 30, 2015
(In thousands)

	March 31, 2016	June 30, 2015	Amount	%
Revenue bonds	\$2,486,756	\$2,497,539	(\$10,783)	(0)%
Commercial paper	359,800	359,800	-	0%
Loans	14,013	14,996	(983)	(7)%
Totals	<u>\$2,860,569</u>	<u>\$2,872,335</u>	<u>(\$11,766)</u>	(0)%

It is the policy of the District to maintain a reasonable balance between debt and current revenue financing of capital projects. The following targets provide the framework for financing capital projects:

Debt Service Coverage Ratio: Maintain an annual revenue bond debt coverage ratio of at least 1.6 times coverage.

Debt-Funded Capital Spending: Limit debt-funded capital to no more than 65% of the total capital program over each five-year planning period.

Commercial Paper/Variable Rate Debt (unhedged): Limit to 25% of outstanding long-term debt.

Revenue-supported debt authorization for the District can be approved by the District's Board of Directors, subject to a referendum process. At March 31, 2016, the Water System had \$995.3 million in authorized but unissued revenue bonds.

The Water System's debt ratings as of March 31, 2016 are outlined in Table 8.

Table 8
Water System
Credit Ratings
March 31, 2016

District debt by type	Rating by		
	Standard & Poor's	Moody's Investors Service	Fitch
Fixed Rate Revenue Bonds	AAA	Aa1	AA+
Variable Rate Revenue Bonds			
Long-term Underlying Rating	AAA	Aa1	—
Short-term Rating	A-1+	VMIG-1	—
Extendable Commercial Paper	A-1+	P-1	F1+
Commercial Paper Notes	A-1+	P-1	—

FINANCIAL ANALYSIS – WASTEWATER SYSTEM

Net Position

The Wastewater System's net position increased by \$16.9 million or 7% during the nine months ended March 31, 2016. Current and other assets increased by \$16.5 million or 16%. Capital assets increased by \$9.6 million. By far the largest portion of the Wastewater System's net position, 97% or \$246.3 million, represents its investment in capital assets necessary to provide services. Components of the net position are shown in Table 9.

Table 9

Wastewater System

Net Position

March 31, 2016 and June 30, 2015

(In thousands)

	March 31, 2016	June 30, 2015	Variance	%
Current and other assets	\$116,770	\$100,314	\$16,456	16%
Capital assets	691,155	681,585	9,570	1%
Deferred outflow of resources	11,962	11,962	-	0%
Total assets and deferred outflow	819,887	793,861	26,026	3%
Current and other liabilities	117,134	106,431	10,703	10%
Long-term liabilities	431,859	433,384	(1,525)	(0)%
Deferred inflow of resources	17,859	17,859	-	0%
Total liabilities and deferred inflow	566,852	557,674	9,178	2%
Net position:				
Net investment in capital assets	246,296	235,202	11,094	5%
Restricted	3,821	87	3,734	4,292%
Unrestricted	2,918	898	2,020	225%
Total net position	\$253,035	\$236,187	\$16,848	7%

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Results of Operation

For the nine months ended March 31, 2016, the Wastewater System's change in net position increased by \$9.9 million compared to the same period of the prior year. Total operating revenue remained stable compare to the same period of the prior year. Total operating expense decreased \$1.0 million or 2% compared to the same period of the prior year due to decreases in depreciation on utility plant and vehicle expenses. Total net non-operating expense decreased by \$7.3 million primarily due to decreased interest and bond expenses compared to a non-recurring \$5.9 million in interest expenses paid for advance refunding in March 2015. Capital contributions increased by \$0.6 million compare to the same period of the prior year, as discussed on page 13.

Table 10

Wastewater System

Changes in Net Position

For the Nine Months Ended March 31, 2016 and 2015

	(In thousands)			
	March 31,	March 31,		
	2016	2015	Variance	%
Operating revenue:				
Sewer	\$58,428	\$57,579	\$849	1%
Power	826	583	243	42%
Wet weather facilities charges	16,125	16,125	-	0%
Total operating revenue	75,379	74,287	1,092	1%
Operating expense:				
Sewer lines and pumps	10,293	10,098	195	2%
Sewer treatment plant operations	23,792	22,948	844	4%
Customer accounting and collecting	1,888	1,910	(22)	(1)%
Financial and risk management	376	510	(134)	(26)%
General administration	5,351	5,715	(364)	(6)%
Depreciation on utility plant and vehicle	16,625	18,119	(1,494)	(8)%
Total operating expense	58,325	59,300	(975)	(2)%
Net operating income	17,054	14,987	2,067	14%
Nonoperating income (expense):				
Investment income	244	234	10	4%
Taxes and subventions	6,482	6,496	(14)	(0)%
Interest, amortization and bond expenses, net	(12,383)	(20,464)	8,081	(39)%
Other income	2,635	3,460	(825)	(24)%
Total nonoperating income (expense), net	(3,022)	(10,274)	7,252	(71)%
Income before contributions	14,032	4,713	9,319	198%
Capital contributions	2,816	2,197	619	28%
Change in net position	16,848	6,910	9,938	144%
Total net position – beginning	236,187	300,351	(64,164)	(21)%
Prior period adjustment per implementation GASB68	-	(75,644)	75,644	(100)%
Total net position – ending	\$253,035	\$231,617	\$21,418	9%

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Liquidity

As of March 31, 2016, the total combined current and non-current cash and investments decreased by \$3.5 million or 4% compared to the same date of the previous fiscal year. For the nine months ended March 31, 2016, net increase (decrease) in cash and cash equivalents increased by \$3.3 million compared to the same period of the prior year. This was primarily due to a increase of \$2.6 million from the reallocation of investments between short-term and long-term. Net increase (decrease) in non-current investments increased by \$2.6 million, primarily due to the aforementioned reallocation of investments between short-term and long-term.

Table 11

Wastewater System

Cash Flows

For the Nine Months Ended March 31, 2016 and 2015

(In thousands)

	March 31, 2016	March 31, 2015	Variance	%
Cash and cash equivalents:				
Beginning of year	\$67,109	\$71,576	(\$4,467)	(6)%
Net cash provided by operating activities	31,121	28,416	2,705	10%
Net cash provided by financing activities	6,482	6,496	(14)	(0)%
Net cash provided by (used in) capital and related financing activities	(33,293)	(31,387)	(1,906)	6%
Net cash provided by (used in) investing activities	(6,823)	(9,385)	2,562	(27)%
Net increase (decrease) in cash and cash equivalents	(2,513)	(5,860)	3,347	(57)%
End of period	<u>\$64,596</u>	<u>\$65,716</u>	<u>(\$1,120)</u>	(2)%
Non-current investments:				
Beginning of year	24,737	24,548	189	1%
Net increase (decrease) in non-current investments	7,034	9,619	(2,585)	(27)%
End of period	<u>31,771</u>	<u>34,167</u>	<u>(2,396)</u>	(7)%
Total cash and investments	<u>\$96,367</u>	<u>\$99,883</u>	<u>(\$3,516)</u>	(4)%

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Cash and Investments by Fund

Total cash and investments available for operating and capital activities are reported in current and non-current assets as unrestricted and restricted funds. Table 12 shows the composition of the Wastewater System's cash and investments as of March 31, 2016 and June 30, 2015. Significant activity was Wastewater System reserved an additional \$3.7 million in bond interest and redemption fund to pay for upcoming debt service payment.

Table 12

Wastewater System

Cash and Investments by Fund

March 31, 2016 and June 30, 2015

(In thousands)

	March 31, 2016	June 30, 2015	Variance	%
Unrestricted cash and investments				
Operating reserves:				
Rate stabilization fund	\$24,090	\$24,090	-	0%
Working capital	16,400	15,800	600	4%
Self-insurance reserves	1,700	1,700	-	0%
Workers' compensation reserves	600	600	-	0%
Total operating reserves	42,790	42,190	600	1%
Capital reserves:				
Reserved for capital projects	29,042	30,239	(1,197)	(4)%
Reserve funded CIP	14,511	14,472	39	0%
Equipment replacement fund	6,203	4,858	1,345	28%
Total capital reserves	49,756	49,569	187	0%
Total unrestricted cash and investments	92,546	91,759	787	1%
Restricted Cash and Investments				
Bond interest and redemption fund	3,821	87	3,734	4,292%
Total restricted cash and investments	3,821	87	3,734	4,292%
Total Cash and Investments	\$96,367	\$91,846	\$4,521	5%

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Capital Contributions

Capital contributions primarily consist of System Capacity Charges (SCC). Additionally, the District receives contributions when the District's facilities need to be relocated during construction projects. The District also receives state and federal grants to fund capital projects. The Wastewater System's Capacity Fee is treated as unrestricted funds and pays for the share of Wastewater facilities attributed to new customers. For the nine months ended March 31, 2016, Earned contributions on construction increased by \$0.7 million as compared to the same period of the previous fiscal year was due to reimbursement received for facility relocation. Table 13 shows the Wastewater System's capital contributions received for the nine months ended March 31, 2016 and 2015:

Table 13

Wastewater System

Capital Contributions

For the Nine Months Ended March 31, 2016 and 2015

(In thousands)

	March 31, 2016	March 31, 2015	Variance	%
System capacity charges	\$1,930	\$2,016	(\$86)	(4)%
Earned contributions on construction	747	-	747	100%
Grants and other reimbursements	139	181	(42)	(23)%
Total capital contributions	<u>\$2,816</u>	<u>\$2,197</u>	<u>\$619</u>	28%

Capital Assets

The Wastewater System had \$691.1 million (net of accumulated depreciation) invested in a broad range of utility capital assets as of March 31, 2016. The investment in capital assets includes land, buildings, improvements, wastewater and wet weather treatment facilities, machinery and equipment.

Table 14

Wastewater System

Capital Assets, Net of Depreciation

March 31, 2016 and June 30, 2015

(In thousands)

	December 31, 2015	June 30, 2015	Variance	%
Structures, buildings, and equipment (net)	\$591,316	\$595,549	(\$4,233)	(1)%
Land and rights-of-way	21,106	21,017	89	0%
Construction work in progress	78,733	65,019	13,714	21%
Totals	<u>\$691,155</u>	<u>\$681,585</u>	<u>\$9,570</u>	1%

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Debt Administration

As of March 31, 2016, the Wastewater System had total long-term debt outstanding of \$444.9 million (net of unamortized costs).

Table 15
Wastewater System
Long -Term Debt
(Net of Unamortized Costs)
March 31, 2016 and June 30, 2015

(In thousands)

	March 31, 2016	June 30, 2015	Amount	%
General obligation bonds	\$11,234	\$11,500	(\$266)	(2)%
Revenue bonds	418,625	419,884	(1,259)	(0)%
Commercial paper	15,000	15,000	-	0%
Totals	<u>\$444,859</u>	<u>\$446,384</u>	<u>(\$1,525)</u>	(0)%

It is the policy of the District to maintain a reasonable balance between debt and current revenue financing of capital projects. The following targets provide the framework for financing capital projects:

Debt Service Coverage Ratio: Maintain an annual revenue bond debt coverage ratio of at least 1.6 times coverage.

Debt-Funded Capital Spending: Limit debt-funded capital to no more than 65% of the total capital program over each five-year planning period.

Commercial Paper/Variable Rate Debt (unhedged): Limit to 25% of outstanding long-term debt.

Revenue-supported debt authorization for the District can be approved by the District's Board of Directors, subject to a referendum process. At March 31, 2016, the Wastewater System had \$204.4 million in authorized but unissued revenue bonds.

The Wastewater System's debt ratings as of March 31, 2016 are outlined in Table 16.

Table 16
Wastewater System
Credit Ratings
March 31, 2016

District debt by type	Rating by		
	Standard & Poor's	Moody's Investors Service	Fitch
General Obligation Bonds	AAA	Aa1	—
Fixed Rate Revenue Bonds	AAA	Aa2	AA+
Extendable Commercial Paper	A-1+	P-1	F1+

REQUEST FOR INFORMATION

If you have any questions about this report or need additional information, please visit our website at <http://www.ebmud.com> or contact: the Controller, Accounting Division, P.O. Box 24055, M/S 402, Oakland, CA 94623-1055.

EAST BAY MUNICIPAL UTILITY DISTRICT
BALANCE SHEETS
MARCH 31, 2016 AND JUNE 30, 2015
(DOLLARS IN THOUSANDS)

	Water System		Wastewater System		Totals	
	March 31, 2016	June 30, 2015	March 31, 2016	June 30, 2015	March 31, 2016	June 30, 2015
Current assets:						
Cash and cash equivalents (Note 2)	\$179,810	\$310,786	\$60,775	\$67,022	\$240,585	\$377,808
Investments (Note 2)	246,167	123,945	31,771	24,737	277,938	148,682
Receivables:						
Customer	42,202	37,241	6,225	5,674	48,427	42,915
Interest and other	13,067	2,845	13,890	2,447	26,957	5,292
Materials and supplies	7,238	7,317	-	-	7,238	7,317
Prepaid Insurance	282	1,127	-	-	282	1,127
Total current assets	<u>488,766</u>	<u>483,261</u>	<u>112,661</u>	<u>99,880</u>	<u>601,427</u>	<u>583,141</u>
Noncurrent assets:						
Restricted cash and investments (Note 2):						
Cash and cash equivalents	41,918	37,936	3,821	87	45,739	38,023
Investments	5,000	5,000	-	-	5,000	5,000
Total restricted cash and investments	<u>46,918</u>	<u>42,936</u>	<u>3,821</u>	<u>87</u>	<u>50,739</u>	<u>43,023</u>
Other assets:						
Equity in JPA partnership fund (Note 2I)	237,009	240,049	-	-	237,009	240,049
Other	237	217	288	347	525	564
Total other assets	<u>237,246</u>	<u>240,266</u>	<u>288</u>	<u>347</u>	<u>237,534</u>	<u>240,613</u>
Capital assets (Note 3):						
Structures, buildings, and equipment	5,007,170	4,919,404	1,004,055	991,663	6,011,225	5,911,067
Less accumulated depreciation	(1,674,770)	(1,602,845)	(412,739)	(396,114)	(2,087,509)	(1,998,959)
Subtotal	<u>3,332,400</u>	<u>3,316,559</u>	<u>591,316</u>	<u>595,549</u>	<u>3,923,716</u>	<u>3,912,108</u>
Land and rights-of-way	58,748	58,445	21,106	21,017	79,854	79,462
Construction in progress	369,246	309,445	78,733	65,019	447,979	374,464
Total capital assets, net	<u>3,760,394</u>	<u>3,684,449</u>	<u>691,155</u>	<u>681,585</u>	<u>4,451,549</u>	<u>4,366,034</u>
Total noncurrent assets	<u>4,044,558</u>	<u>3,967,651</u>	<u>695,264</u>	<u>682,019</u>	<u>4,739,822</u>	<u>4,649,670</u>
Total assets	<u>4,533,324</u>	<u>4,450,912</u>	<u>807,925</u>	<u>781,899</u>	<u>5,341,249</u>	<u>5,232,811</u>
Deferred outflows of resources:						
Accumulated decrease in fair value of hedging derivatives (Note 6)	33,711	23,485	-	-	33,711	23,485
Pension related (Note 8)	69,049	69,049	11,962	11,962	81,011	81,011
Total deferred outflows	<u>102,760</u>	<u>92,534</u>	<u>11,962</u>	<u>11,962</u>	<u>114,722</u>	<u>104,496</u>
Total assets and deferred outflows	<u>\$4,636,084</u>	<u>\$4,543,446</u>	<u>\$819,887</u>	<u>\$793,861</u>	<u>\$5,455,971</u>	<u>\$5,337,307</u>

(Continued)

UNAUDITED

EAST BAY MUNICIPAL UTILITY DISTRICT
BALANCE SHEETS
MARCH 31, 2016 AND JUNE 30, 2015
(DOLLARS IN THOUSANDS)

	Water System		Wastewater System		Totals	
	March 31, 2016	June 30, 2015	March 31, 2016	June 30, 2015	March 31, 2016	June 30, 2015
Current liabilities:						
Current maturities of long-term debt and Commercial Paper (Note 5 & 6)	\$49,283	\$49,260	\$13,000	\$13,000	\$62,283	\$62,260
Accounts payable and accrued expenses (Note 4)	65,698	69,218	7,896	9,119	73,594	78,337
Current reserve for claims (Note 9)	7,814	7,814	900	900	8,714	8,714
Accrued interest	38,060	9,279	6,785	1,757	44,845	11,036
Total current liabilities	160,855	135,571	28,581	24,776	189,436	160,347
Noncurrent liabilities:						
Advances for construction	11,796	7,061	-	-	11,796	7,061
OPEB liabilities (Note 8)	20,034	20,034	3,617	3,617	23,651	23,651
Reserve for claims (Note 9)	29,184	29,184	5,601	5,601	34,785	34,785
Net pension liability (Note 8)	364,956	364,956	66,363	66,363	431,319	431,319
Other liabilities	21,089	14,133	12,972	6,074	34,061	20,207
Long-term liabilities, net of current maturities (Note 5 & 6)	2,811,286	2,823,075	431,859	433,384	3,243,145	3,256,459
Total noncurrent liabilities	3,258,345	3,258,443	520,412	515,039	3,778,757	3,773,482
Total liabilities	3,419,200	3,394,014	548,993	539,815	3,968,193	3,933,829
Deferred inflows of resources						
Derivative instrument (Note 6)	33,711	23,485	-	-	33,711	23,485
Pension related (Note 8)	88,483	88,483	17,859	17,859	106,342	106,342
Total deferred inflows	122,194	111,968	17,859	17,859	140,053	129,827
Total liabilities and deferred inflows	3,541,394	3,505,982	566,852	557,674	4,108,246	4,063,656
Net position (Note 7):						
Net investment in capital assets	899,824	812,113	246,296	235,202	1,146,120	1,047,315
Restricted for construction (Note 1G)	19,651	19,647	-	-	19,651	19,647
Restricted for debt service (Note 1G)	12,729	13,468	3,821	87	16,550	13,555
Restricted for JPA	237,009	240,049	-	-	237,009	240,049
Restricted - other (Note 1G)	2,741	2,759	-	-	2,741	2,759
Unrestricted	(77,264)	(50,572)	2,918	898	(74,346)	(49,674)
Total net position	1,094,690	1,037,464	253,035	236,187	1,347,725	1,273,651
Total liabilities, deferred inflows and net position	\$4,636,084	\$4,543,446	\$819,887	\$793,861	\$5,455,971	\$5,337,307

See accompanying notes to financial statements

UNAUDITED

EAST BAY MUNICIPAL UTILITY DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE NINE MONTHS ENDED MARCH 31, 2016 AND 2015
(DOLLARS IN THOUSANDS)

	Water System		Wastewater System		Total	
	March 31, 2016	March 31, 2015	March 31, 2016	March 31, 2015	March 31, 2016	March 31, 2015
Operating revenue:						
Water	\$317,027	\$276,541	-	-	\$317,027	\$276,541
Sewer	-	-	\$58,428	\$57,579	58,428	57,579
Power	1,684	1,574	826	583	2,510	2,157
Wet weather facilities charges	-	-	16,125	16,125	16,125	16,125
Total operating revenue	<u>318,711</u>	<u>278,115</u>	<u>75,379</u>	<u>74,287</u>	<u>394,090</u>	<u>352,402</u>
Operating expense:						
Raw water	53,997	29,412	-	-	53,997	29,412
Water treatment and distribution	76,073	73,394	-	-	76,073	73,394
Recreation areas, net	4,029	4,052	-	-	4,029	4,052
Sewer lines and pumping	-	-	10,293	10,098	10,293	10,098
Sewer treatment plant operations	-	-	23,792	22,948	23,792	22,948
Customer accounting and collecting	12,136	12,226	1,888	1,910	14,024	14,136
Financial and risk management	13,688	12,360	376	510	14,064	12,870
Facilities management	5,816	6,036	-	-	5,816	6,036
General administration	28,333	28,752	5,351	5,715	33,684	34,467
Depreciation on utility plant and vehicle	72,155	69,997	16,625	18,119	88,780	88,116
Total operating expense	<u>266,227</u>	<u>236,229</u>	<u>58,325</u>	<u>59,300</u>	<u>324,552</u>	<u>295,529</u>
Net operating income	<u>52,484</u>	<u>41,886</u>	<u>17,054</u>	<u>14,987</u>	<u>69,538</u>	<u>56,873</u>
Nonoperating income (expense):						
Investment income	1,497	3,173	244	234	1,741	3,407
Taxes and subventions	19,601	18,922	6,482	6,496	26,083	25,418
Interest and amortization of bond expenses, net of capitalized interest of \$7,176 and \$6,311 for the Water System and \$1,247 and \$1,288 for the Wastewater System in 2016 and 2015, respectively	(69,475)	(106,413)	(12,383)	(20,464)	(81,858)	(126,877)
Increase (decrease) of equity in JPA partnership fund	(3,040)	(3,062)	-	-	(3,040)	(3,062)
Other income	10,168	11,675	2,635	3,460	12,803	15,135
Total nonoperating income (expense), net	<u>(41,249)</u>	<u>(75,705)</u>	<u>(3,022)</u>	<u>(10,274)</u>	<u>(44,271)</u>	<u>(85,979)</u>
Income (loss) before capital contributions	11,235	(33,819)	14,032	4,713	25,267	(29,106)
Capital contributions	45,991	51,058	2,816	2,197	48,807	53,255
Change in net position	57,226	17,239	16,848	6,910	74,074	24,149
Total net position - beginning	1,037,464	1,363,331	236,187	300,351	1,273,651	1,663,682
Prior period adjustment per implementation of GASB 68 (Note 1Q)	-	(401,602)	-	(75,644)	-	(477,246)
Total net position - ending	<u>\$1,094,690</u>	<u>\$978,968</u>	<u>\$253,035</u>	<u>\$231,617</u>	<u>\$1,347,725</u>	<u>\$1,210,585</u>

See accompanying notes to financial statements

UNAUDITED

EAST BAY MUNICIPAL UTILITY DISTRICT
STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED MARCH 31, 2016 AND 2015
(DOLLARS IN THOUSANDS)

	Water System		Wastewater System		Total	
	March 31, 2016	March 31, 2015	March 31, 2016	March 31, 2015	March 31, 2016	March 31, 2015
Cash flows from operating activities						
Cash received from customers	\$313,750	\$277,908	\$74,828	\$72,968	\$388,578	\$350,876
Cash received from other income	10,168	11,675	2,635	3,460	12,803	15,135
Cash payments for judgments and claims	(5,795)	(4,474)	(122)	(190)	(5,917)	(4,664)
Cash payments to suppliers for goods and services	(50,615)	(40,172)	(24,246)	(25,845)	(74,861)	(66,017)
Cash payments to employees for services	(129,325)	(123,860)	(21,974)	(21,977)	(151,299)	(145,837)
Net cash provided by operating activities	<u>138,183</u>	<u>121,077</u>	<u>31,121</u>	<u>28,416</u>	<u>169,304</u>	<u>149,493</u>
Cash flows from noncapital financing activities:						
Tax receipts	<u>19,601</u>	<u>18,922</u>	<u>6,482</u>	<u>6,496</u>	<u>26,083</u>	<u>25,418</u>
Net cash provided by financing activities	<u>19,601</u>	<u>18,922</u>	<u>6,482</u>	<u>6,496</u>	<u>26,083</u>	<u>25,418</u>
Capital and related financing activities:						
Capital contributions	45,991	51,058	2,816	2,197	48,807	53,255
Proceeds from advances for construction	4,735	(1,646)	-	-	4,735	(1,646)
Proceeds from sale of capital assets	598	2,695	42	-	640	2,695
Net proceeds and premiums from sale of bonds	-	543,905	-	208,103	0	752,008
Acquisition and construction of capital assets	(162,808)	(162,846)	(27,271)	(21,210)	(190,079)	(184,056)
Principal retirement on long-term debt and commercial paper	(11,766)	(520,269)	(1,525)	(185,835)	(13,291)	(706,104)
Amount paid to refunding bond escrow agent	-	(15,301)	-	(17,310)	0	(32,611)
Costs and discounts from issuance on long-term debt	-	(1,505)	-	(1,127)	0	(2,632)
Interest paid on long-term debt	(40,694)	(85,088)	(7,355)	(16,205)	(48,049)	(101,293)
Net cash provided by (used in) capital and related financing activities	<u>(163,944)</u>	<u>(188,997)</u>	<u>(33,293)</u>	<u>(31,387)</u>	<u>(197,237)</u>	<u>(220,384)</u>
Cash flows from investing activities:						
Proceeds from securities	212,467	260,551	17,392	14,095	229,859	274,646
Expenditures from purchases of securities	(334,689)	(263,014)	(24,426)	(23,714)	(359,115)	(286,728)
Interest received on investments	<u>1,388</u>	<u>3,200</u>	<u>211</u>	<u>234</u>	<u>1,599</u>	<u>3,434</u>
Net cash provided by (used in) investing activities	<u>(120,834)</u>	<u>737</u>	<u>(6,823)</u>	<u>(9,385)</u>	<u>(127,657)</u>	<u>(8,648)</u>
Net increase (decrease) in cash and cash equivalents	<u>(126,994)</u>	<u>(48,261)</u>	<u>(2,513)</u>	<u>(5,860)</u>	<u>(129,507)</u>	<u>(54,121)</u>
Cash and cash equivalents:						
Beginning of year	<u>348,722</u>	<u>175,941</u>	<u>67,109</u>	<u>71,576</u>	<u>415,831</u>	<u>247,517</u>
End of period	<u>\$221,728</u>	<u>\$127,680</u>	<u>\$64,596</u>	<u>\$65,716</u>	<u>\$286,324</u>	<u>\$193,396</u>

(Continued)

UNAUDITED

EAST BAY MUNICIPAL UTILITY DISTRICT
STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED MARCH 31, 2016 AND 2015
(DOLLARS IN THOUSANDS)

	Water System		Wastewater System		Total	
	March 31, 2016	March 31, 2015	March 31, 2016	March 31, 2015	March 31, 2016	March 31, 2015
Reconciliation of net operating income to net cash provided by operating activities:						
Net operating income	\$52,484	\$41,886	\$17,054	\$14,987	\$69,538	\$56,873
Adjustments to reconcile net operating income to net cash provided by operating activities:						
Depreciation on utility plant and vehicle	72,155	69,997	16,625	18,119	88,780	88,116
Depreciation within recreation areas	916	1,075	-	-	916	1,075
Amortization	13,194	13,972	1,034	1,118	14,228	15,090
Other income	10,168	11,675	2,635	3,460	12,803	15,135
Changes in assets/liabilities:						
Materials and supplies	79	(1,248)	-	-	79	(1,248)
Prepaid insurance	845	850	-	-	845	850
Customer receivables	(4,961)	(207)	(551)	(1,319)	(5,512)	(1,526)
Other assets	(10,133)	(10,598)	(11,351)	(11,513)	(21,484)	(22,111)
Accounts payable and accrued expenses	3,436	(6,325)	5,675	3,564	9,111	(2,761)
Net cash provided by operating activities	<u>\$138,183</u>	<u>\$121,077</u>	<u>\$31,121</u>	<u>\$28,416</u>	<u>\$169,304</u>	<u>\$149,493</u>

See accompanying notes to financial statements

UNAUDITED

**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. *Description of the Primary Government*

The East Bay Municipal Utility District (the District or EBMUD) was formed in May 1923 under the provisions of the Municipal Utility District Act of 1921, as amended in 1941. The District is comprised of two financially independent entities: the Water System and the Wastewater System. These two entities are governed by the same elected seven-member Board of Directors which determines such matters as rates and charges for services, approval of contracts, and District policies. The Water System provides administrative and other support services to the Wastewater System. These costs are charged to the Wastewater System.

B. *Basis of Presentation*

The unaudited financial information for the nine months ended March 31, 2016 has been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and therefore does not contain all of the information and footnotes required by GAAP for annual financial statements. The financial statements should be read in conjunction with EBMUD's Annual Audited Financial Report for the year ended June 30, 2015 which is posted on our web site <http://www.ebmud.com>.

The accounts of the District are organized and operated on a fund basis. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, deferred outflows, liabilities, deferred inflows, net position, revenues, and expenses.

The basic financial statements include prior year comparative information. A complete presentation of the prior year information can be found in the District's Annual Audited Financial Reports for the year ended June 30, 2015.

The District reports the following major proprietary (enterprise) funds:

The **Water System** is engaged in the collection, transmission, and distribution of water to communities within Alameda and Contra Costa counties of California.

The **Wastewater System** is engaged in the interception and treatment of wastewater from residences and industries in the California communities of Alameda, Albany, Berkeley, Emeryville, Oakland, Piedmont, and the Stege Sanitary District.

In the opinion of EBMUD, the accompanying unaudited condensed financial statements contain all adjustments necessary for the fair presentation of the results for the nine months ended March 31, 2016. These adjustments consist only of normal recurring adjustments. The results for interim periods are not necessarily indicative of the results for any future periods.

Management's discussion and analysis (MD&A) precedes the Basic Unaudited Financial Statements and provides a narrative introduction, overview, and analysis of the basic financial statements. This Basic Unaudited Financial Statements and MD&A complement each other and should be read in conjunction with each other.

EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. Basis of Accounting

Proprietary funds distinguish *operating* revenues and expenses from *non-operating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the District are charges to customers for sales and services. The District also recognizes wet weather facilities charges as operating revenue. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

In addition, the accounting policies of the District conform to accounting policies generally accepted in the United States of America for water utilities. The accounts are maintained substantially in accordance with the Uniform System of Accounts for Water Utilities followed by investor-owned and major municipally-owned water utilities.

Balance Sheet – The balance sheet is designed to display the financial position of the District. The District's fund equity is reported as net position, which is broken down into three categories defined as follows:

- Net investment in capital assets – This component of net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets and related deferred inflows and outflows.
- Restricted – This component of net position consists of net position subject to constraints placed on its use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or law or regulations of other governments. It also pertains to constraints imposed by law or constitutional provisions or enabling legislation.
- Unrestricted – This component of net position consists of net position that does not meet the definition of "restricted" or "net investment in capital assets".

Statement of Revenues, Expenses, and Changes in Net Position – The statement of revenues, expenses, and changes in net position is the operating statement for proprietary funds. Revenues are reported by major source. This statement distinguishes between operating and non-operating revenues and expenses and presents a separate subtotal for operating revenues, operating expenses, and other income.

**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Use of Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

E. Capital Assets

Utility Plant – at Original Cost

The cost of additions to utility plant and replacement of retired units of property are capitalized. Cost includes material, direct labor and fringe benefits, transportation, and such indirect items as engineering, supervision, and interest on borrowed funds during construction, net of interest earned on unspent construction proceeds. Repairs, maintenance, and minor purchases of equipment are charged to expenses as incurred.

The depreciated cost of capital assets, plus removal costs, less salvage, is charged to expense upon retirement.

Water Supply Management Program

Costs incurred in this program are debt funded and capitalized in construction in progress. These costs are transferred to utility plant upon completion of the project and depreciated over their useful life. Debt service costs on the debt used to finance the program are recovered in future periods through connection fees and rates and charges for service to those benefiting from the program.

Preliminary Survey and Investigation Costs

The District capitalizes initial costs incurred to study and evaluate certain potential long-term capital projects. These costs are transferred to property, plant and equipment upon completion of the project and are depreciated over the life of the asset. In the event the project is abandoned, these costs are expensed.

Contract Water Rights

The District has contracted with the US Bureau of Reclamation for water deliveries from the Central Valley Project (CVP) through February 2046 (Long Term Renewal Contract), with the anticipation of subsequent renewals of 40 year terms. Payments under the contract include reimbursement based on the amounts of water delivered to EBMUD of Capital costs for CVP storage and conveyance facilities (EBMUD's current allocation is \$4,373) and the O&M Deficit (EBMUD's current balance is \$6,781). The Water Enterprise Fund capitalized the two components.

**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. Depreciation

Depreciation of capital assets is computed on a straight-line basis using the estimated service lives of the related assets (5 to 100 years).

G. Restricted and Unrestricted cash and investments

The District segregates cash and investments into funds that are “Restricted” and “Unrestricted.” Funds are “restricted” when limitations on use of the resources are imposed by creditors, grantors, contributors, laws or regulations of other governments, or imposed by law through constitutional provision or by enabling legislation. “Unrestricted” resources are committed by the Board of Directors through the passage of a resolution, or constrained for a specific purpose by committees or officials with authority delegated by the Board. The exception is the Reserve for Capital Projects which is anticipated but not committed or constrained to be used for the District’s capital improvement program.

Unrestricted cash and investments are further categorized into Operating and Capital Reserves:

Operating Reserves:

- Rate Stabilization Fund (RSF) reserve is established by Policy 4.02, as adopted by the Board of Directors in the bi-annual budget, to maintain at least 20% of projected annual water volume revenues for Water and at least 5% of annual operating and maintenance expenses for Wastewater. Funding of the RSF is consistent with the District’s Bond indentures. In fiscal year 2014, the District combined the Rate Stabilization Fund referenced in the Bond indentures and the Contingency and Rate Stabilization Reserve referenced in Policy 4.02 into a single Rate Stabilization Fund reserve to enhance transparency.
- Working Capital reserve is established by Policy 4.02, as adopted by the Board of Directors in the bi-annual budget, to maintain at least three times the District’s monthly net operating and maintenance expenses.
- Self-insurance reserve is established by Policy 4.02, as adopted by the Board of Directors in the bi-annual budget, to maintain 1.25 times the expected annual costs.
- Workers' compensation reserve is established by Policy 4.02, as adopted by the Board of Directors in the bi-annual budget, to maintain a level equal to the estimated future liability for workers’ compensation claims.

Capital Reserves:

- Reserve for Capital Projects comprises the resources available for cash funding of the District’s capital improvement program as projected in conjunction with the bi-annual budget.
- Reserve Funded CIP (Wastewater) balance is a specific designation [Board Motion 029-94] used to fund wet and dry weather eligible construction projects.
- Vehicle Replacement Fund [Board Motion 94-030] is financed by deposits based on internal user rate charges, and used to reimburse operational expenditures and vehicle replacement purchases.

UNAUDITED

**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- Equipment Replacement Fund was established by the District with the implementation of the Wastewater Capacity Fees effective July 1, 1984. The balance in this account represents funds set aside for future wastewater department equipment replacements.

Restricted funds include the following:

- Debt Funded Construction funds are the proceeds of bond or commercial paper issues that are restricted for use on eligible projects in the District's capital program. The current balance is \$0 for Water and Wastewater.
- Capitalized Interest fund is restricted by the District's bond indenture for the purpose of defraying a specific bond issue's debt service payments for a specified period. The current balance is \$0 for Water and Wastewater.
- Bond Interest and Redemption fund is required, under the District's bond indentures, in order for the District to transfer funds to the Trustee for the payment of principal and interest on the outstanding bonds one business day prior to the date such payment is due. The District uses the Bond Interest and Redemption Fund to segregate funds accumulated for such payments. In addition, under certain of the interest rate swap agreements related to the District's outstanding bonds, the District is required to post collateral to the swap counterparty to the extent that the District's total exposure for termination payments under the swap agreement exceeds the threshold amount specified in the applicable swap agreement. The District also uses the Bond Interest and Redemption Fund to segregate District funds held by the applicable custodian to satisfy this collateral posting obligation. As of March 31, 2016 and June 30, 2015, respectively, the balances were \$32 and \$796 for Water, and \$3,821 and \$87 for Wastewater.
- Debt Service Reserve fund is created and required to be maintained at a specified level in connection with certain series of the District's outstanding bonds. Amounts in a Bond Reserve Fund may only be used (a) for the payment of principal of and interest on the related series of bonds in the event the District fails to transfer the required payment from the related system Revenue Fund (the respective designated part of the General Fund) (b) for the payment of redemption of all of the related series of bonds then outstanding or (c) for the payment of the final principal and interest payments on the related series of bonds. As of March 31, 2016 and June 30, 2015, respectively, the balances were \$12,698 and \$12,672 for Water, and \$0 for Wastewater.
- Funds received for construction reflect advances received from applicants for work to be performed by the District and the unspent future water supply component of system capacity charges. This fund is used for the construction of major facilities, applicant requested services, and the design and construction of water supply improvement program projects. The balance as of March 31, 2016 was \$31,447 for Water (\$19,143 for Future Water Supply projects, \$12,304 for Applicant Work) and \$0 for Wastewater. The balance as of June 30, 2015 was \$26,709 for Water (\$19,087 for Future Water Supply projects, \$7,622 for Applicant Work) and \$0 for Wastewater.

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EAST BAY MUNICIPAL UTILITY DISTRICT
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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- FERC partnership fund of \$2 million was established January 11, 1999, in compliance with Federal Energy Regulatory Commission (FERC) order which brought resolution to its Mokelumne River Proceeding. The District manages the fund and income derived from investing the funds provides operating support to Joint Settlement Agreement with US Fish and Wildlife and California Fish and Game to protect the Mokelumne River Ecosystem from Pardee Reservoir to the Delta. The principal and any unused earnings shall remain the property of the District and will revert to the District upon expiration of the agreement in March 2031 or upon withdrawal of any party to the agreement. As of March 31, 2016 and June 30, 2015, respectively, the balances were \$2,206 and \$2,225 for Water.
- Monetary Reserve represents money on deposit in the name of the District with the Automated Power Exchange Inc. (APX) in accordance with the terms and conditions of the Automated Power Exchange Inc. California Master Service Agreement of July 15, 1999, entered between the District and APX for the sale and purchase of electric power. The funds held on deposit shall be withdrawn by the Depository and Clearing Agent in the event that sufficient funds are not deposited in the District settlement account to cover power exchange transactions. As of March 31, 2016 and June 30, 2015, respectively, the balances were \$535 and \$534 for Water.

H. Deferred Amount on Bond Refunding

Gains and losses incurred in connection with debt refunding transactions are deferred and amortized over the shorter of the life of the refunded debt or the new debt.

I. Cash and Cash Equivalents

For purposes of the statement of cash flows, the District considers all highly liquid investments with original maturities of three months or less at the date of purchase to be cash equivalents.

J. District Investments

Investments are stated at fair value. Included in investment income (loss) is the net change in the fair value of investments, which consists of the realized gains or losses and the unrealized appreciation (depreciation) of those investments.

Measurement of the fair value of investments is based upon quoted market prices, if available. The estimated fair value of investments that have no quoted market price is determined based on equivalent yields for such securities or for securities of comparable maturity, quality, and type as obtained from market makers.

Each of the financial instruments invested in by the District represents a potential concentration of credit risk. However, as the portfolio and the components of the various instruments are diversified, and issuers of securities are dispersed throughout many industries and geographic locations, the concentrations of credit risk are limited.

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**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

K. Material and Supplies

Material and supplies inventories are valued at cost, which approximates market, using the average-cost method.

L. Compensated Absences

Compensated absences as of March 31, 2016 and June 30, 2015, respectively, are included on the balance sheet in accounts payable and accrued expenses. In previous years, trends have shown that the District employees utilize the accruals annually, therefore, amounts payable are accrued and reported as a current liability on the financial statements only.

M. Revenue

Water billings include charges for water flow, elevation, and a monthly meter charge. Customer water meters are read on a cyclical basis throughout a monthly or bimonthly period. Bills are rendered and revenue is recognized in the period that meters are read.

Wastewater treatment billings are a combination of flow, strength charges, and a monthly service charge. Customer bills are rendered on a cyclical basis throughout a monthly or bimonthly period, and revenue is recognized in the period in which bills are rendered.

Wet weather facilities charges are designed to finance the operating and capital costs related to wet weather sewage flows and are billed annually on the property tax bill.

N. Interest Rate Swap

The District entered into interest rate swap agreements to modify interest rates on some outstanding debt.

In June 2008, GASB issued Statement No. 53, Accounting and Financial Reporting for Derivative Instruments (GASB 53). The statement specifically requires governments to measure and report most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The requirement of reporting the derivative instruments at fair value on the face of the basic financial statements gives the users of those statements a clearer look into the risks their governments are sometimes exposed to when they enter into these transactions and how those risks are managed. The statement also addresses hedge accounting requirements and improves disclosures, providing a summary of the government's derivative instrument activity, its objectives for entering into derivative instruments, and their significant terms and risks. The District implemented GASB 53 in fiscal 2010.

O. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position or balance sheet will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position or fund balance that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then.

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EAST BAY MUNICIPAL UTILITY DISTRICT
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(Dollars in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In addition to liabilities, the statement of financial position or balance sheet will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position or fund balance that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time.

P. Reclassification

For the nine months ended March 31, 2016 and 2015, certain classifications have been changed to improve financial statement presentation. For comparative purposes, prior year balances have been reclassified to conform with the fiscal year 2015 and 2014 presentations.

Q. Implementation of Governmental Accounting Standards Board (GASB) Pronouncements

GASB Statement No. 68 – In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*. The requirements of this Statement will improve the decision-usefulness of information in employer and governmental nonemployer contributing entity financial reports and will enhance its value for assessing accountability and interperiod equity by requiring recognition of the entire net pension liability and a more comprehensive measure of pension expense. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014, therefore, the District implemented this Statement in fiscal year ending June 30, 2015, which required a restatement to the District's financial statements. The financial statements for fiscal year ended June 30, 2014 could not be restated as the information required to do so was not readily available. See Note 8 for additional information.

GASB Statement No. 70 – In 2013, the GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Finance Guarantees*. This Statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more than likely than not the government will be required to make a payment on that guarantee. The provisions of this Statement are effective for reporting periods beginning after June 15, 2013, therefore, the District implemented this statement for fiscal year ended June 30, 2015, and had no impact on the financial statements.

GASB Statement No. 71 – In 2014, the GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*. The requirements of this Statement will eliminate the source of a potential significant understatement of restated beginning net position and expense in the first year of implementation of Statement 68 in the accrual-basis financial statements of employers and non-employer contributing entities. This benefit will be achieved without the imposition of significant additional costs. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014, therefore, the District implemented this Statement in fiscal year ending June 30, 2015, along with GASB 68 as discussed above.

EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)

NOTE 2 - CASH AND INVESTMENTS

A. Classification

Reconciliations of cash and investments reported on the financial statements as of March 31, 2016, are as follows:

<i>District Enterprise Funds:</i>	Water System	Wastewater System	Total
Cash and investments included in current assets	\$425,977	\$92,546	\$518,523
Cash and investments included in restricted assets	46,918	3,821	50,739
Total District cash and investments	472,895	96,367	569,262
Less non-current investments	(251,167)	(31,771)	(282,938)
District cash and cash equivalents	<u>\$221,728</u>	<u>\$64,596</u>	<u>\$286,324</u>

B. District Investments Authorized by the California Government Code and the District's Investment Policy

The District's Investment Policy and the California Government Code allow the District to invest in the following, provided the credit ratings of the issuers are acceptable to the District; and approved percentages and maturities are not exceeded. The table below also identifies certain provisions of the California Government Code, or the District's Investment Policy where the District's Investment Policy is more restrictive and provides information as to the limitations as they relate to interest rate risk, credit risk and concentration risk.

Authorized Investment Type	Maximum Maturity	Minimum Credit Quality	Maximum in Portfolio	Maximum Investment In One Issuer
Repurchase Agreements	270 Days	N/A	20%	10%
State of California Local Agency Investment Fund (LAIF Pool)	Upon Demand	N/A	\$65,000 per account	N/A
U.S. Treasury Bonds, Notes and Bills	5 Years	N/A	up to 100%	N/A
U.S. Government Agency and U.S. Government-Sponsored Enterprise Obligation	5 Years	N/A	up to 100%	40% in each Agency
Bankers' Acceptances	180 Days	N/A	40%	10%
Commercial Paper	270 Days	A1, P1, or F1	25%	10%
Negotiable Certificates of Deposit	5 Years	AA	30%	10%
Time Certificates of Deposits - Banks or Savings and Loans	5 Years	N/A	30%	10%
Medium Term Corporate Notes	5 Years	AA	30%	10%
Money Market Mutual Funds	N/A	AAA	40%	10%
Municipal Bonds	5 Years	AA	40%	10%
California Asset Management Program (CAMP)	Upon Demand	Highest Rating	10%	10%

The District does not enter into reverse repurchase agreements.

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**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)**

NOTE 2 - CASH AND INVESTMENTS (Continued)

C. District Investments Authorized by Debt Agreements

The District must maintain required amounts of cash and investments with trustees or fiscal agents under the terms of certain debt issues. These funds are unexpended bond proceeds or are pledged reserves to be used if the District fails to meet its obligations under these debt issues. The California Government Code requires these funds to be invested in accordance with District resolutions, bond indentures or State statutes. The table below identifies the investment types that are authorized for investments held by fiscal agents. The table also identifies certain provisions of these debt agreements:

Authorized Investment Type	Minimum Credit Quality
Repurchase Agreements	Top Four Short Term Rating Category
U.S. Treasury Bonds, Notes and Bills	N/A
U.S. Government Agency and U.S. Government-Sponsored Enterprise Obligation	N/A
State Obligations	Not lower than the District's bond rating
Commercial Paper	Top Rating Category
Negotiable Certificates of Deposit	FDIC insured or collateralised
Time Certificates of Deposits - Banks or Savings and Loans	FDIC insured or collateralised
Corporate Notes and Bonds	Not lower than District's bond rating
Variable Rate Obligations	Not lower than District's bond rating
Cash Sweep Agreements	Top Rating Category
Guaranteed Investment Contract	Not lower than District's bond rating
Shares of Beneficial Interest	Top Rating Category

D. Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the market value of an investment. Normally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. The District generally manages its interest rate risk by holding the investment to maturity.

Information about the sensitivity of the market values of the District's investments (including investments held by bond trustees) to market interest rate fluctuations is provided as part of the annual financial report.

The District participates in the Local Agency Investment Fund (LAIF) that is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. The District reports its investment in LAIF at the fair value amount provided by LAIF, which is the same as the value of the pool share. The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis. Included in LAIF's investment portfolio are collateralized mortgage obligations, mortgage-backed securities, other asset-backed securities, loans to certain state funds, and floating rate securities issued by federal agencies, government-sponsored enterprises, United States Treasury Notes and Bills, and corporations.

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**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)**

NOTE 2 - CASH AND INVESTMENTS (Continued)

E. Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical credit rating organization. This information is presented annually on EBMUD's Comprehensive Annual Financial Report.

F. Concentration Risk

Significant District investments in the securities of any individual issuers, other than U. S. Treasury securities, LAIF, and mutual funds are presented in the annual audited financial statements.

G. Foreign Currency Risk

Foreign currency risk, the risk that changes in foreign exchange rates will adversely affect the fair values of an investment or deposit, is presented in the annual audited financial statements.

H. Custodial Credit Risk

Custodial credit risk for *cash on deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, the District will not be able to recover the value of its investment or collateral securities that are in the possession of another party.

California Law requires banks and savings and loan institutions to pledge government securities with a market value of 110% of the District's cash on deposit, or first trust deed mortgage notes with a market value of 150% of the deposit, as collateral for these deposits. Under California Law this collateral is held in a separate investment pool by another institution in the District's name and places the District ahead of general creditors of the institution.

The District invests in individual investments and in investment pools. Individual investments are evidenced by specific identifiable *securities instruments*, or by an electronic entry registering the owner in the records of the institution issuing the security, called the *book entry* system. In order to increase security, the District employs the Trust Department of a bank or trustee as the custodian of certain District managed investments, regardless of their form.

I. Joint Powers Authority

DRSD/EBMUD Regional Water Authority - On June 28, 1995, the Dublin San Ramon Service District (DSRSD) and East Bay Municipal Utility District (District) entered into a Joint Powers Agreement (JPA) and established the DSRSD/EBMUD Recycled Water Authority (DERWA) with the purpose of creating a recycled water program in the San Ramon and Livermore-Amador Valleys. The JPA governing body is not substantially the same as the District and its independent Board consists of two directors each from the DSRSD and District. The JPA books and records are being maintained separately from DSRSD and the District. The DSRSD and District made member contributions to fund the JPA start-up and continue to fund capital projects at the request of the JPA

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**EAST BAY MUNICIPAL UTILITY DISTRICT
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NOTE 2 - CASH AND INVESTMENTS (Continued)

on an as needed basis. Although DERWA has a significant relationship with the District, DERWA does not provide services solely to the District, and therefore is not considered a component unit of the District.

Freeport Regional Water Authority - The Freeport Regional Water Project (FRWP) is a regional water supply project undertaken by the District in partnership with the Sacramento County Water Agency (SCWA). In February 2002, with the support of the United States Bureau of Reclamation, the District and SCWA formed the Freeport Regional Water Authority (FRWA) under a joint powers agreement to develop the FRWP. The FRWP provides the permanent infrastructure to allow the District to receive water deliveries pursuant to the Long-Term Renewal Central Valley Project Contract at a new point of diversion along the Sacramento River. In addition to providing the District up to 100 MGD of supplemental water in dry years, the FRWP can provide up to 85 MGD to SCWA in all years. The District's share of the facilities is recorded as Investment in JPA and is presented on the balance sheet. To increase the District's reserve of water supply due to the recent drought, the District activated the pumping of water from the Sacramento River via the Freeport facility during Fiscal Year 2015.

NOTE 3 – CAPITAL ASSETS

A. Summary

The District capitalizes all assets with a historical cost of at least \$5 and a useful life of at least five years. Contributed property is recorded at estimated fair market value at the date of donation.

The purpose of depreciation is to spread the cost of capital assets equitably among all customers over the life of these assets, so that each customer's bill includes a pro rata share of the cost of these assets. The amount charged to depreciation expense each year represents that year's pro rata share of depreciable capital assets.

Depreciation of all capital assets in service, excluding land, is charged as an expense against operations each year and the total amount of depreciation taken over the years, called accumulated depreciation, is reported on the balance sheet as a reduction in the book value of the capital assets.

Capital assets are depreciated using the straight line method of depreciation, which means the cost of the asset is divided by its expected useful life in years and the result is charged to expense each year until the asset is fully depreciated. The District has assigned the useful lives listed below to capital assets:

Utility plant:	Years
Source of supply	25-100
Raw water transmission and storage	20-100
Interception and outfall	60-75
Pumping	25-75
Treatment	20-75
Distribution	25-75
Power Generation	25-75
Equipment	5-20
Plant Structures	25-75
Other	5-40

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EAST BAY MUNICIPAL UTILITY DISTRICT
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NOTE 4 – ACCOUNTS PAYABLE & ACCRUED EXPENSES

Accounts payable and accrued expenses at March 31, 2016 and June 30, 2015 consist of:

	Water System		Wastewater System		Total	
	March 31	June 30	March 31	June 30	March 31	June 30,
	2016	2015	2016	2015	2016	2015
Accounts payable	\$12,460	\$22,743	\$2,981	\$3,845	\$15,441	\$26,588
Accrued salaries	(38)	3,982	(21)	683	(59)	4,665
Accrued compensated absences	27,137	26,424	4,275	4,178	31,412	30,602
Other	26,139	16,069	661	413	26,800	16,482
Total	<u>\$65,698</u>	<u>\$69,218</u>	<u>\$7,896</u>	<u>\$9,119</u>	<u>\$73,594</u>	<u>\$78,337</u>

NOTE 5 – COMMERCIAL PAPER NOTES

The District's Board of Directors has authorized the issuance of short-term indebtedness of the District in a maximum principal amount of up to the lesser of either the average of the total annual revenue for the three preceding years or 25% of the District's total outstanding bonds. Under this authority the District has established two commercial paper programs: an extendable commercial paper program and a traditional commercial paper program. In December 2015, the District had determined an aggregate of \$522 million to be authorized for these programs. The proceeds from the issuance of commercial paper under these programs are restricted as to use. Under the programs, which must be authorized by the Board of Directors every seven years by resolution subject to the right of referendum, the Water System or the Wastewater System may issue commercial paper and bank notes at prevailing interest rates for periods of not more than 270 days from the date of issuance. The programs were last authorized on April 28, 2015.

The District initially established its extendable commercial paper program in March 2009. Under the extendable commercial paper program, no liquidity support agreement with a commercial bank is needed. Instead, the District limits the term of the extendable commercial paper to 120 days, and the investor agrees to extend the maturity of their investment by 150 days at a higher interest rate in the event of a failed remarketing, giving the District sufficient time to find a replacement investor or refund the extendable commercial paper with a different form of debt to repay the investor.

As of March 31, 2016, \$0 million in Water Series and \$15.0 million in Wastewater Series extendable commercial paper notes were outstanding under this program. The Water Series included terms of 68 to 120 days and interest rates ranging from 0.07% to 0.16% as of June 30, 2015. The Wastewater Series included the term of 78 days and an interest rate of 0.09% as of March 31, 2016, and the term of 91 days and an interest rate of 0.07% as of June 30, 2015.

The District established its current traditional commercial paper program in December 2015. As of March 31, 2016, \$359.8 million in Water Series and \$0 in Wastewater Series commercial paper notes were outstanding under this program. The Water Series commercial paper notes included terms of 30 to 102 days and interest rates ranging from 0.03% to 0.23% as of March 31, 2016.

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**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)**

NOTE 5 – COMMERCIAL PAPER NOTES (Continued)

To provide liquidity for the Water Series notes issued under the traditional commercial paper program, the District maintains two liquidity support facilities with commercial banks: a standby letter of credit in the amount of \$200,000,000 and a revolving credit agreement in the amount of \$160,000,000. Borrowings by the Water System for commercial paper notes and bank notes under the traditional commercial paper program cannot exceed the aggregate amount available under these agreements. Drawings under the liquidity support facilities are restricted to pay principal on maturing Water Series commercial paper notes. There were no borrowings under the liquidity support facilities as of March 31, 2016. The liquidity support facilities expire on December 1, 2020 and November 30, 2018, respectively, and are subject to extension at the request of the District upon agreement by the issuing bank.

There were no unused proceeds of commercial paper notes as of March 31, 2016. It is the District's practice to use the commercial paper programs as a portion of the District's long-term variable rate debt exposure.

NOTE 6 – LONG-TERM DEBT

A. Composition and Changes

The District generally incurs long-term debt to finance projects or purchase assets which will have useful lives equal to or greater than the related debt. The District's debt issues and transactions for the year ending June 30, 2015 are presented in the annual audited financial statements.

B. Description of the District's Long-Term Debt Issues

General obligation and revenue bonds are generally callable at future dates. The general obligation bonds are repaid from property taxes levied on property within the District.

Revenue-supported debt can be authorized by the District's Board of Directors, subject to a referendum process.

The net revenues of the Water System are pledged toward the repayment of the Water Revenue Bonds and the State Water Resources Control Board Parity Loans of the Water System. The net revenues of the Wastewater System are pledged toward the repayment of the Wastewater Revenue Bonds of the Wastewater System.

The District is subject to certain revenue bond covenants on outstanding debt which require the setting of rates and charges to yield net revenues of the respective Water System or Wastewater System, as applicable, equal to at least 110% of the current annual debt service requirements for all revenue bonds and other parity obligations of the respective Water System or Wastewater System. The District has designated \$119.1 million (\$95.0 million for the Water System and \$24.1 million for the Wastewater System) of operating reserves as a rate stabilization fund, which is available to satisfy the coverage requirements for debt service in future years. There have never been any draws for this purpose.

**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)**

NOTE 6 – LONG-TERM DEBT (Continued)

C. Variable Rate Debt

The District has a number of bond issues with variable interest rates. The Water Series 2008A Bonds are subject to purchase on the demand of the holder with seven days prior notice at a price equal to the principal plus accrued interest. The remarketing agent is authorized to use its best efforts to sell the repurchased bonds at a price equal to 100 percent of the principal amount by adjusting the interest rate. In the event that they not sold, under Standby Bond Purchase Agreements (SBPAs) issued by banks for the above variable rate debt issues, the trustee or the remarketing agent is entitled to draw an amount sufficient to pay the purchase price of delivered bonds. The District is required to pay an annual commitment fee to the banks issuing SBPAs. Expiration dates of these SBPAs are presented below by debt issue. In addition, the remarketing agent receives an annual fee of seven basis points of the outstanding principal amount of the bonds.

Issue	SBPA Expiration Date	Interest Rate	Swap Rate
Water System Revenue Subordinated Bonds:			
Series 2008A-1	12/9/2016	Reset Weekly	See below
Series 2008A-2	7/2/2018	Reset Weekly	See below
Series 2008A-3	7/2/2018	Reset Weekly	See below
Series 2008A-4	12/9/2016	Reset Weekly	See below

D. Interest Rate Swap Agreements

The District has entered into a number of matched interest rate swap contracts with providers in which the District contracted to pay a fixed rate on the nominal amount of outstanding bonds, in exchange for a floating rate payment, set monthly on the first day of each calendar month for its LIBOR based swaps. The combination of variable rate bonds and a floating-rate swap creates synthetic fixed-rate debt for the District. The synthetic fixed rate on the bonds protects the District against increases in short-term interest rates. The terms, fair value, and credit risk of each of the swap agreements are discussed below.

Term and credit risks. The terms and credit ratings of the outstanding swaps, as of March 31, 2016, are included below. The District's swap agreements contain scheduled reductions to outstanding notional amounts that are expected to follow scheduled reductions in the associated bonds.

Related Bond Issue	Notional Amount	Effective Date	Counterparty	Counterparty Credit Ratings (Moody's/ S&P)	Issuer Pays	Issuer Receives	Maturity/ Termination Date
2008A Water System Refunding Bonds	37,240	6/2/2005	JP Morgan Chase & Co.	Aa3/A+	3.115%	62.3% of 30-day LIBOR	6/1/2038
2008A Water System Refunding Bonds	37,240	6/1/2011	Bank of America National Assoc.	A1/A	3.115%	62.3% of 30-day LIBOR	6/1/2038
2008A Water System Refunding Bonds	16,195	6/1/2012	Merrill Lynch Capital Services	Baa1/BBB+	3.115%	62.3% of 30-day LIBOR	6/1/2038
2008A Water System Refunding Bonds	14,575	9/25/2008	The Bank of New York Mellon	Aa2/AA-	3.115%	62.3% of 30-day LIBOR	6/1/2038

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NOTE 6 – LONG-TERM DEBT (Continued)

The effect of these transactions is structured to result in the approximate equivalent of the District paying a fixed rate on the bonds, since the inflow of payments from the LIBOR based swaps are anticipated to approximate the outflow of payments on the variable rate bonds. Only the net difference in the amount owed to and received from the swap providers is made under the swap contracts.

Fair value. The fair value of the swaps takes into consideration the prevailing interest rate environment, the specific terms and conditions of a given transaction and any upfront payments that may have been received. The fair value was estimated using the zero-coupon discounting method. This method calculates the future payments required by the swap, assuming that the current forward rates implied by the LIBOR swap yield curve are the market's best estimate of future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for a hypothetical zero-coupon rate bond due on the date of each future net settlement on the swaps. The fair value of the swaps at March 31, 2016, is included below:

<u>Related Bond Issuance</u>	<u>Fair Value</u>
2008A Water System Refunding Bonds	(33,711)

Credit risk. As of March 31, 2016, the District was not exposed to credit risk on its outstanding swaps because the swaps had a negative fair value of \$33.7 million. The District faces a maximum possible loss equivalent to the swaps' fair value. However, if interest rates increase and the fair value of the swaps were to become positive, the District would be exposed to credit risk.

The District will be exposed to interest rate risk only if the counterparty to the swap defaults or if the swap is terminated. The swap agreements contain provisions that determine if and when the District or the counterparty must provide collateral. The agreements require full collateralization of the fair value of the swap should the counterparty's credit rating fall below a certain threshold. As of March 31, 2016, the District was not required to provide collateral to any swap counterparty.

Basis risk. Basis risk is the risk that the interest rate paid by the District on underlying variable rate bonds to bondholders temporarily differs from the variable swap rate received from the applicable counterparty. The District is exposed to basis risk as the District receives payments based on LIBOR rates to offset the actual variable interest rate the District pays on its bonds. The District is exposed to basis risk should the floating rate that it receives on a swap be less than the actual variable rate the District pays on the bonds. Depending on the magnitude and duration of any basis risk shortfall, the expected cost of the basis risk may vary. As of March 31, 2016, the District has a basis difference on its swaps of a positive 16 basis points (the District receives more from its swap floating rate payment than it pays out on its variable rate debt).

Termination risk. The District or the counterparty may terminate if the other party fails to perform under the terms of the SWAP contract. The District will be exposed to variable rates if the providers to the swap contracts default or if the swap contracts are terminated as it will lose the hedge provided by the SWAP. A termination of the swap contracts may also result in the District's making or receiving a termination payment based on market interest rates at the time of the termination. If at the time of termination the swap has a negative fair value, the District would be liable to the counterparty for a payment equal to the swap's fair value.

UNAUDITED

**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)**

NOTE 7 – NET POSITION

Net Position is the excess of all the District's assets and deferred outflows over all its liabilities and deferred inflows, regardless of fund. Net Position is divided into three captions. These captions apply only to Net Position and are described below:

Net Investment in Capital Assets describes the portion of Net Position which is represented by the current net book value of the District's capital assets, less the outstanding balance of any debt issued to finance these assets and any related deferred outflows and inflows.

Restricted describes the portion of Net Position which is restricted as to use by the terms and conditions of agreements with outside parties, governmental regulations, laws, or other restrictions which the District cannot unilaterally alter. These principally include developer fees received for use on capital projects, funds restricted for debt service and fees charged for the provision of future water resources.

Unrestricted describes the portion of Net Position which is not restricted to use.

NOTE 8 – EMPLOYEES' RETIREMENT PLAN

Net OPEB (Other Pension Employee Benefits) obligation, Net Pension liability (i.e., the Plan's liability determined in accordance with GASB No. 68 less the fiduciary net position) and pension related deferred inflows and outflows of resources are calculated and revised annually.

NOTE 9 – RISK MANAGEMENT

The District has purchased commercial insurance for general, property, public officials' liability and workers' compensation.

The District's liability, property, and workers' compensation risks are insured by commercial insurance carriers, all of which are subject to the District's self-insurance retentions, which vary by type of coverage as shown below:

Coverage	Policy Limit	Self-insurance retention
Workers' Compensation	Statutory Limit	\$5,000
All risk property (except flood)	\$200,000	500
Flood	25,000	1,500
Liability	90,000	10,000 Water/ 10,000 Wastewater
Crime	10,000	25
Boiler and Machinery	10,000	25
Pardee and Camanche Dams	10,000	50
Main Wastewater Treatment Plant	10,000	50

Settled claims have not exceeded the District's policy limits in any of the past five fiscal years. Reserve for claims balance is calculated and revised annually.

UNAUDITED

EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MARCH 31, 2016
(Dollars in thousands)

NOTE 10 - CONTINGENT LIABILITIES

The District is a defendant in a number of lawsuits which have arisen in the normal course of business. The ultimate outcome of these matters is not presently determinable. In the opinion of the District, these actions when finally adjudicated will not have a material adverse effect on the financial position of the District.

NOTE 11 – CONTROLS & PROCEDURES

The management of EBMUD is responsible for establishing and maintaining adequate internal controls to assure that EBMUD's operations are effective and efficient, applicable laws and regulations are followed, and financial reports are reliable. The internal controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost of control should not exceed the benefits likely to be derived, and that cost-benefit analyses require estimates and judgments by management.