

EAST BAY MUNICIPAL UTILITY DISTRICT
BASIC UNAUDITED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017

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

**PREPARED BY THE
FINANCE DEPARTMENT**

UNAUDITED

**EAST BAY MUNICIPAL UTILITY DISTRICT
BASIC UNAUDITED FINANCIAL STATEMENTS
For the Three Months Ended September 30, 2017**

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**EAST BAY MUNICIPAL UTILITY DISTRICT
BASIC UNAUDITED FINANCIAL STATEMENTS
For the Three Months Ended September 30, 2017**

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 September 30, 2017. This information should be read in conjunction with the unaudited financial statements for the three months ended September 30, 2017. 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 685,000. 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, 2017, 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 \$80.0 million or 6% during the three months ended September 30, 2017. Current and other assets increased by \$97.2 million or 11%. Capital assets increased by \$25.8 million or 1%. Changes in deferred outflows and inflows of resources primarily reflect changes in the market value of interest rate SWAP agreements (see Note 6E) and debt refunding. By far the largest portion of the Water System's net position, \$927.2 million or 70%, 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

September 30, 2017 and June 30, 2017

(In thousands)

	September 30, 2017	June 30, 2017	Variance	%
Current and other assets	\$954,937	\$857,733	\$97,204	11%
Capital assets	3,966,317	3,940,493	25,824	1%
Deferred outflows of resources	201,255	203,199	(1,944)	(1)%
Total assets and deferred outflows	<u>5,122,509</u>	<u>5,001,425</u>	<u>121,084</u>	2%
Current and other liabilities	797,139	751,005	46,134	6%
Long-term liabilities	2,980,212	2,985,760	(5,548)	(0)%
Deferred inflows of resources	25,953	25,497	456	2%
Total liabilities and deferred inflows	<u>3,803,304</u>	<u>3,762,262</u>	<u>41,042</u>	1%
Net position:				
Net investment in capital assets	927,180	895,807	31,373	4%
Restricted	258,912	259,869	(957)	(0)%
Unrestricted	133,113	83,487	49,626	59%
Total net position	<u><u>\$1,319,205</u></u>	<u><u>\$1,239,163</u></u>	<u><u>\$80,042</u></u>	6%

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Results of Operation

For the three months ended September 30, 2017, the Water System's change in net position increased by \$33.9 million as compared to the same period of the previous fiscal year. This increase was due to increases in operating revenue and capital contribution, and a decrease in operating expense, offset by an increase in net non-operating expense. Total operating revenue increased by \$18.0 million due to \$16.3 million increase in water revenue and \$1.7 million increase in power revenue. Water revenue increased by \$16.3 million or 13 % due to an 11.6% increase in billed water consumption, and a 9.25% water rate increase, offset by no drought surcharge received in the current fiscal year compared to \$5.6 million received in the same period of the prior year. The power revenue increase was due to release of excess water to generate more hydropower in the current year. Total operating expense decreased by \$2.4 million primarily due to a \$1.5 million decrease in general administration. Net non-operating expense increased by \$3.6 million due to a \$2.5 million increase in bond interest expense, and a \$3.3 million decrease in other income, offset by \$1.0 million increase in investment income and \$1.2 million increase in tax and subventions revenue. Capital contributions increased by \$17.3 million as a result of a \$17.1 million increase in system capacity charges in the current fiscal year compared to the same period of the prior year, as discussed on page 6.

Table 2

Water System

Changes in Net Position

For the Three Months Ended September 30, 2017 and 2016

(In thousands)

	September 30, 2017	September 30, 2016	Variance	%
Operating revenue:				
Water	\$142,553	\$126,281	\$16,272	13%
Power	2,565	908	1,657	182%
Total operating revenues	<u>145,118</u>	<u>127,189</u>	<u>17,929</u>	<u>14%</u>
Operating expense:				
Raw water	8,888	8,440	448	5%
Water treatment and distribution	26,427	25,852	575	2%
Recreation areas, net	1,200	1,503	(303)	(20)%
Customer accounting and collecting	3,400	3,837	(437)	(11)%
Financial and risk management	3,418	4,237	(819)	(19)%
Facilities management	1,479	1,613	(134)	(8)%
General administration	11,957	13,419	(1,462)	(11)%
Depreciation on utility plant and vehicle	25,790	26,016	(226)	(1)%
Total operating expense	<u>82,559</u>	<u>84,917</u>	<u>(2,358)</u>	<u>(3)%</u>
Net operating income	62,559	42,272	20,287	48%
Nonoperating income (expense):				
Investment income	1,712	679	1,033	152%
Taxes and subventions	7,500	6,277	1,223	19%
Interest, amortization and bond expenses, net	(25,909)	(23,377)	(2,532)	11%
Increase (decrease) of equity in JPA partnership fund	(1,016)	(1,014)	(2)	0%
Other income	2,380	5,720	(3,340)	(58)%
Total nonoperating income (expense), net	<u>(15,333)</u>	<u>(11,715)</u>	<u>(3,618)</u>	<u>31%</u>
Income before capital contributions	47,226	30,557	16,669	55%
Capital contributions	<u>32,816</u>	<u>15,566</u>	<u>17,250</u>	<u>111%</u>
Change in net position	80,042	46,123	33,919	74%
Total net position – beginning	<u>1,239,163</u>	<u>1,131,413</u>	<u>107,750</u>	<u>10%</u>
Total net position – ending	<u>\$1,319,205</u>	<u>\$1,177,536</u>	<u>\$141,669</u>	<u>12%</u>

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Liquidity

As of September 30, 2017, total combined current and non-current cash and investments increased by \$206.6 million compared to the same date of the previous fiscal year. Net increase (decrease) in cash and cash equivalents decreased by \$124.2 million compared to the prior year. This was primarily due to an increase of \$20.7 million from capital and related financing activities offset by a decrease of \$149.9 million from the reallocation of investments between short-term and long-term. Net increase (decrease) in non-current investments increased by \$150.0 million also primarily due to reallocation of investments between short-term and long-term.

Table 3

Water System
Cash Flows

For the Three Months Ended September 30, 2017 and 2016

(In thousands)

	September 30, 2017	September 30, 2016	Variance
Cash and cash equivalents:			
Beginning of year	\$224,866	\$158,595	\$66,271
Net cash provided by operating activities	68,893	65,122	3,771
Net cash provided by financing activities	7,500	6,277	1,223
Net cash provided by (used in) capital and related financing activities	(22,167)	(42,896)	20,729
Net cash provided by (used in) investing activities	(157,366)	(7,469)	(149,897)
Net increase (decrease) in cash and cash equivalents	(103,140)	21,034	(124,174)
End of period	<u>\$121,726</u>	<u>\$179,629</u>	<u>(\$57,903)</u>
Non-current investments:			
Beginning of year	342,054	227,546	114,508
Net increase (decrease) in non-current investments	158,094	8,118	149,976
End of period	<u>500,148</u>	<u>235,664</u>	<u>264,484</u>
Total cash and investments	<u>\$621,874</u>	<u>\$415,293</u>	<u>\$206,581</u>

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 September 30, 2017 and June 30, 2017. Total cash and investments increased by \$55.0 million during the three months ended September 30, 2017. Significant activities included increased reserves of \$3.5 million in working capital and \$51.6 million in capital reserves to fund capital spending.

Table 4

Water System

Cash and Investments by Fund

September 30, 2017 and June 30, 2017

(In thousands)

	September 30, 2017	June 30, 2017	Variance	%
Unrestricted cash and investments				
Operating reserves:				
Rate stabilization fund	\$95,000	\$95,000	-	0%
Working capital	69,100	65,600	3,500	5%
Self-insurance reserves	6,651	6,651	-	0%
Workers' compensation reserves	<u>7,066</u>	<u>7,066</u>	<u>-</u>	0%
Total operating reserves	<u>177,817</u>	<u>174,317</u>	<u>3,500</u>	2%
Capital reserves:				
Reserved for capital projects	383,471	334,746	48,725	15%
Vehicle replacement Fund	8,119	6,791	1,328	20%
Equipment replacement fund	<u>4,809</u>	<u>3,282</u>	<u>1,527</u>	47%
Total capital reserves	<u>396,399</u>	<u>344,819</u>	<u>51,580</u>	15%
Total unrestricted cash and investments	<u>574,216</u>	<u>519,136</u>	<u>55,080</u>	11%
Restricted Cash and Investments				
Bond interest and redemption fund	519	519	-	0%
Debt service reserve fund	3,628	3,620	8	0%
Funds received for construction	40,793	40,924	(131)	(0)%
FERC partnership fund	2,181	2,185	(4)	(0)%
Monetary reserve	<u>537</u>	<u>536</u>	<u>1</u>	0%
Total restricted cash and investments	<u>47,658</u>	<u>47,784</u>	<u>(126)</u>	(0)%
Total Cash and Investments	<u>\$621,874</u>	<u>\$566,920</u>	<u>\$54,954</u>	10%

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Capital Contributions

Capital contributions primarily consist of System Capacity Charges (SCC). Additionally, the District can receive 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.

For the three months ended September 30, 2017, capital contributions increased \$17.3 million or 111% as compared to the same period of the previous fiscal year. System capacity charges increased by \$17.1 million due to an increase in infill projects (multi-family dwelling and mixed used structures), particularly in the Oakland, Emeryville and Berkeley areas. Table 5 shows the Water System's capital contributions received for the three months ended September 30, 2017 and 2016:

Table 5

Water System

Capital Contributions

For the Three Months Ended September 30, 2017 and 2016

(In thousands)

	September 30, 2017	September 30, 2016	Variance	%
System capacity charges	\$29,721	\$12,631	\$17,090	135%
Earned contributions on construction	2,744	2,687	57	2%
Grants and other reimbursements	351	248	103	42%
Total capital contributions	<u>\$32,816</u>	<u>\$15,566</u>	<u>17,250</u>	111%

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Capital Assets

The Water System had \$4.0 billion (net of accumulated depreciation) invested in a broad range of utility capital assets as of September 30, 2017. 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

September 30, 2017 and June 30, 2017

(In thousands)

	September 30, 2017	June 30, 2017	Variance	%
Structures, buildings, and equipment (net)	\$3,463,781	\$3,470,628	(\$6,847)	(0)%
Land and rights-of-way	64,508	64,508	-	0%
Construction work in progress	438,028	405,357	32,671	8%
Totals	<u>\$3,966,317</u>	<u>\$3,940,493</u>	<u>25,824</u>	1%

Debt Administration

As of September 30, 2017, the Water System had total long-term debt outstanding of \$3.0 billion (net of unamortized costs).

Table 7

Water System

Long -Term Debt, Net of Unamortized Costs

September 30, 2017 and June 30, 2017

(In thousands)

	September 30, 2017	June 30, 2017	Amount	%
Revenue bonds	\$2,666,446	\$2,671,994	(\$5,548)	(0)%
Commercial paper	359,800	359,800	-	0%
Loans	12,892	12,892	-	0%
Totals	<u>\$3,039,138</u>	<u>\$3,044,686</u>	<u>(5,548)</u>	(0)%

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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 service coverage ratio of at least 1.6 times.

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 September 30, 2017, the Water System had \$764.2 million in authorized but unissued revenue bonds.

The Water System’s debt ratings as of September 30, 2017 are outlined in Table 8.

Table 8
Water System
Credit Ratings
September 30, 2017

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	—
Commercial Paper Notes	A-1+	P-1	—

FINANCIAL ANALYSIS – WASTEWATER SYSTEM

Net Position

The Wastewater System’s net position increased by \$13.3 million or 5% during the three months ended September 30, 2017. Current and other assets increased by \$36.1 million or 33%. Capital assets increased by \$0.9 million. By far the largest portion of the Wastewater System’s net position, 90% or \$272.2 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

September 30, 2017 and June 30, 2017

(In thousands)

	September 30, 2017	June 30, 2017	Variance	%
Current and other assets	\$146,215	\$110,096	\$36,119	33%
Capital assets	711,669	710,744	925	0%
Deferred outflows of resources	27,392	27,704	(312)	(1)%
Total assets and deferred outflows	<u>885,276</u>	<u>848,544</u>	<u>36,732</u>	4%
Current and other liabilities	153,705	129,308	24,397	19%
Long-term liabilities	425,876	426,877	(1,001)	(0)%
Deferred inflows of resources	3,139	3,139	-	0%
Total liabilities and deferred inflows	<u>582,720</u>	<u>559,324</u>	<u>23,396</u>	4%
Net position:				
Net investment in capital assets	272,244	270,317	1,927	1%
Restricted	71	18	53	294%
Unrestricted	<u>30,241</u>	<u>18,885</u>	<u>11,356</u>	60%
Total net position	<u><u>\$302,556</u></u>	<u><u>\$289,220</u></u>	<u><u>\$13,336</u></u>	5%

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Results of Operation

For the three months ended September 30, 2017, the Wastewater System's change in net position increased by \$5.5 million compared to the same period of the prior year. This increase was due to an increase in operating revenue and an increase in capital contribution. Total operating revenue increased by \$2.1 million or 8% primarily due to a 5% wastewater rate increase. Capital contributions increased by \$2.7 million compared to the prior year, as discussed on page 13.

Table 10

Wastewater System

Changes in Net Position

For the Three Months Ended September 30, 2017 and 2016

(In thousands)

	September 30, 2017	September 30, 2016	Variance	%
Operating revenue:				
Sewer	\$21,969	\$20,208	\$1,761	9%
Power	224	124	100	81%
Wet weather facilities charges	6,003	5,725	278	5%
Total operating revenue	<u>28,196</u>	<u>26,057</u>	<u>2,139</u>	8%
Operating expense:				
Sewer lines and pumps	3,121	3,059	62	2%
Sewer treatment plant operations	6,825	7,160	(335)	(5)%
Customer accounting and collecting	640	611	29	5%
Financial and risk management	120	208	(88)	(42)%
General administration	2,708	2,687	21	1%
Depreciation on utility plant and vehicle	5,656	5,502	154	3%
Total operating expense	<u>19,070</u>	<u>19,227</u>	<u>(157)</u>	(1)%
Net operating income	9,126	6,830	2,296	34%
Nonoperating income (expense):				
Investment income	274	162	112	69%
Taxes and subventions	1,510	1,858	(348)	(19)%
Interest, amortization and bond expenses, net	(4,307)	(3,957)	(350)	9%
Other income	2,107	1,087	1,020	94%
Total nonoperating income (expense), net	<u>(416)</u>	<u>(850)</u>	<u>434</u>	(51)%
Income before contributions	8,710	5,980	2,730	46%
Capital contributions	<u>4,626</u>	<u>1,886</u>	<u>2,740</u>	145%
Change in net position	13,336	7,866	5,470	70%
Total net position – beginning	<u>289,220</u>	<u>260,887</u>	<u>28,333</u>	11%
Total net position – ending	<u><u>\$302,556</u></u>	<u><u>\$268,753</u></u>	<u><u>\$33,803</u></u>	13%

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Liquidity

As of September 30, 2017, the total combined current and non-current cash and investments increased by \$23.3 million compared to the same date in the previous fiscal year. For the three months ended September 30, 2017, net increase (decrease) in cash and cash equivalents increased by \$17.1 million compared to the same period of the prior year. This was primarily due to an increase of \$7.2 million from capital and related financing activities and an increase of \$7.8 million from the reallocation of investments between short-term and long-term. Net increase (decrease) in non-current investments decreased by \$7.7 million also primarily due to reallocation of investments between short-term and long-term.

Table 11

Wastewater System

Cash Flows

For the Three Months Ended September 30, 2017 and 2016

(In thousands)

	September 30, 2017	September 30, 2016	Variance
Cash and cash equivalents:			
Beginning of year	\$44,191	\$46,105	(\$1,914)
Net cash provided by operating activities	6,030	3,570	2,460
Net cash provided by financing activities	1,510	1,858	(348)
Net cash provided by (used in) capital and related financing activities	(2,917)	(10,127)	7,210
Net cash provided by (used in) investing activities	(2,394)	(10,188)	7,794
Net increase (decrease) in cash and cash equivalents	2,229	(14,887)	17,116
End of period	<u>\$46,420</u>	<u>\$31,218</u>	<u>\$15,202</u>
Non-current investments:			
Beginning of year	56,705	40,896	15,809
Net increase (decrease) in non-current investments	2,586	10,293	(7,707)
End of period	<u>59,291</u>	<u>51,189</u>	<u>8,102</u>
Total cash and investments	<u>\$105,711</u>	<u>\$82,407</u>	<u>\$23,304</u>

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 September 30, 2017 and June 30, 2017. Total cash and investments increased by \$4.8 million during the three months ended September 30, 2017. Activities included increased reserves of \$4.9 million in capital reserves to fund capital spending and decreased reserves of \$0.1 million in working capital.

Table 12

Wastewater System

Cash and Investments by Fund

September 30, 2017 and June 30, 2017

(In thousands)

	September 30, 2017	June 30, 2017	Variance	%
Unrestricted cash and investments				
Operating reserves:				
Rate stabilization fund	\$24,090	\$24,090	-	0%
Working capital	17,600	17,700	(100)	(1)%
Self-insurance reserves	1,267	1,267	-	0%
Workers' compensation reserves	1,346	1,346	-	0%
Total operating reserves	<u>44,303</u>	<u>44,403</u>	<u>(100)</u>	<u>(0)%</u>
Capital reserves:				
Reserved for capital projects	32,805	31,771	1,034	3%
Reserve funded CIP	14,680	14,642	38	0%
Equipment replacement fund	<u>13,852</u>	<u>10,062</u>	<u>3,790</u>	38%
Total capital reserves	<u>61,337</u>	<u>56,475</u>	<u>4,862</u>	9%
Total unrestricted cash and investments	<u>105,640</u>	<u>100,878</u>	<u>4,762</u>	5%
Restricted Cash and Investments				
Bond interest and redemption fund	<u>71</u>	<u>18</u>	<u>53</u>	294%
Total restricted cash and investments	<u>71</u>	<u>18</u>	<u>53</u>	294%
Total Cash and Investments	<u>\$105,711</u>	<u>\$100,896</u>	<u>\$4,815</u>	5%

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Capital Contributions

Capital contributions primarily consist of capacity fees. Additionally, the District can receive 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 fees are treated as unrestricted funds and pays for the share of Wastewater facilities attributed to new customers. For the three months ended September 30, 2017, capacity fees increased by \$2.7 million as compared to the same period of the previous fiscal year due to increased development activities. Table 13 shows the Wastewater System's capital contributions received for the three months ended September 30, 2017 and 2016:

Table 13

Wastewater System

Capital Contributions

For the Three Months Ended September 30, 2017 and 2016

(In thousands)

	September 30, 2017	September 30, 2016	Variance	%
Wastewater capacity fees	\$4,626	\$1,886	\$2,740	145%
Total capital contributions	\$4,626	\$1,886	\$2,740	145%

Capital Assets

The Wastewater System had \$711.7 million (net of accumulated depreciation) invested in a broad range of utility capital assets as of September 30, 2017. 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

September 30, 2017 and June 30, 2017

(In thousands)

	September 30, 2017	June 30, 2017	Variance	%
Structures, buildings, and equipment (net)	\$629,339	\$632,224	(\$2,885)	(0)%
Land and rights-of-way	21,285	21,285	-	0%
Construction work in progress	61,045	57,235	3,810	7%
Totals	\$711,669	\$710,744	\$925	0%

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Debt Administration

As of September 30, 2017, the Wastewater System had total long-term debt outstanding of \$439.4 million (net of unamortized costs).

Table 15
Wastewater System
Long -Term Debt, Net of Unamortized Costs
September 30, 2017 and June 30, 2017

(In thousands)

	September 30, 2017	June 30, 2017	Amount	%
General obligation bonds	\$3,577	\$3,602	(\$25)	(1)%
Revenue bonds	420,849	421,825	(976)	(0)%
Commercial paper	15,000	15,000	-	0%
Totals	<u>\$439,426</u>	<u>\$440,427</u>	<u>(\$1,001)</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 service coverage ratio of at least 1.6 times.

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 September 30, 2017, the Wastewater System had \$186 million in authorized but unissued revenue bonds.

The Wastewater System's debt ratings as of September 30, 2017 are outlined in Table 16.

Table 16
Wastewater System
Credit Ratings
September 30, 2017

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
SEPTEMBER 30, 2017 AND JUNE 30, 2017
(DOLLARS IN THOUSANDS)

	Water System		Wastewater System		Totals	
	September 30, 2017	June 30, 2017	September 30, 2017	June 30, 2017	September 30, 2017	June 30, 2017
Current assets:						
Cash and cash equivalents (Note 2)	\$74,403	\$177,417	\$46,349	\$44,173	\$120,752	\$221,590
Investments (Note 2)	499,813	341,719	59,291	56,705	559,104	398,424
Receivables:						
Customer	54,885	42,259	6,600	6,021	61,485	48,280
Interest and other	35,746	4,513	33,628	2,904	69,374	7,417
Materials and supplies	8,748	9,246	-	-	8,748	9,246
Prepaid Insurance	791	1,054	-	-	791	1,054
Total current assets	674,386	576,208	145,868	109,803	820,254	686,011
Noncurrent assets:						
Restricted cash and investments (Note 2):						
Cash and cash equivalents	47,323	47,449	71	18	47,394	47,467
Investments	335	335	-	-	335	335
Total restricted cash and investments	47,658	47,784	71	18	47,729	47,802
Other assets:						
Equity in JPA partnership fund (Note 2J)	232,193	233,210	-	-	232,193	233,210
Other	700	531	276	275	976	806
Total other assets	232,893	233,741	276	275	233,169	234,016
Capital assets (Note 3):						
Structures, buildings, and equipment	5,282,916	5,264,539	1,076,265	1,073,495	6,359,181	6,338,034
Less accumulated depreciation	(1,819,135)	(1,793,911)	(446,926)	(441,271)	(2,266,061)	(2,235,182)
Subtotal	3,463,781	3,470,628	629,339	632,224	4,093,120	4,102,852
Land and rights-of-way	64,508	64,508	21,285	21,285	85,793	85,793
Construction in progress	438,028	405,357	61,045	57,235	499,073	462,592
Total capital assets, net	3,966,317	3,940,493	711,669	710,744	4,677,986	4,651,237
Total noncurrent assets	4,246,868	4,222,018	712,016	711,037	4,958,884	4,933,055
Total assets	4,921,254	4,798,226	857,884	820,840	5,779,138	5,619,066
Deferred outflows of resources:						
Accumulated decrease in fair value of hedging derivatives (Note 6)	25,233	24,777	-	-	25,233	24,777
Debt refundings related	32,401	34,801	3,129	3,441	35,530	38,242
Pension related (Note 8)	143,621	143,621	24,263	24,263	167,884	167,884
Total deferred outflows	201,255	203,199	27,392	27,704	228,647	230,903
Total assets and deferred outflows	\$5,122,509	\$5,001,425	\$885,276	\$848,544	\$6,007,785	\$5,849,969

(Continued)

UNAUDITED

EAST BAY MUNICIPAL UTILITY DISTRICT
BALANCE SHEETS
SEPTEMBER 30, 2017 AND JUNE 30, 2017
(DOLLARS IN THOUSANDS)

	Water System		Wastewater System		Totals	
	September 30, 2017	June 30, 2017	September 30, 2017	June 30, 2017	September 30, 2017	June 30, 2017
Current liabilities:						
Current maturities of long-term debt and Commercial Paper (Note 5 & 6)	\$58,926	\$58,926	\$13,550	\$13,550	\$72,476	\$72,476
Accounts payable and accrued expenses (Note 4)	63,159	68,852	6,204	9,342	69,363	78,194
Current reserve for claims (Note 9)	9,341	9,341	755	755	10,096	10,096
Accrued interest	38,786	9,063	6,381	1,521	45,167	10,584
Total current liabilities	170,212	146,182	26,890	25,168	197,102	171,350
Noncurrent liabilities:						
Advances for construction	20,940	21,125	-	-	20,940	21,125
OPEB liabilities (Note 8)	23,019	23,019	4,131	4,131	27,150	27,150
Reserve for claims (Note 9)	33,036	33,036	4,322	4,322	37,358	37,358
Net pension liability (Note 8)	514,809	514,809	89,283	89,283	604,092	604,092
Other liabilities	35,123	12,834	29,079	6,404	64,202	19,238
Long-term liabilities, net of current maturities (Note 5 & 6)	2,980,212	2,985,760	425,876	426,877	3,406,088	3,412,637
Total noncurrent liabilities	3,607,139	3,590,583	552,691	531,017	4,159,830	4,121,600
Total liabilities	3,777,351	3,736,765	579,581	556,185	4,356,932	4,292,950
Deferred inflows of resources						
Derivative instrument (Note 6)	25,233	24,777	-	-	25,233	24,777
Pension related (Note 8)	720	720	3,139	3,139	3,859	3,859
Total deferred inflows	25,953	25,497	3,139	3,139	29,092	28,636
Total liabilities and deferred inflows	3,803,304	3,762,262	582,720	559,324	4,386,024	4,321,586
Net position (Note 7):						
Net investment in capital assets	927,180	895,807	272,244	270,317	1,199,424	1,166,124
Restricted for construction (Note 1G)	19,853	19,799	-	-	19,853	19,799
Restricted for debt service (Note 1G)	4,147	4,139	71	18	4,218	4,157
Restricted for JPA	232,193	233,210	-	-	232,193	233,210
Restricted - other (Note 1G)	2,719	2,721	-	-	2,719	2,721
Unrestricted	133,113	83,487	30,241	18,885	163,354	102,372
Total net position	1,319,205	1,239,163	302,556	289,220	1,621,761	1,528,383
Total liabilities, deferred inflows and net position	\$5,122,509	\$5,001,425	\$885,276	\$848,544	\$6,007,785	\$5,849,969

See accompanying notes to financial statements

UNAUDITED

EAST BAY MUNICIPAL UTILITY DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016
(DOLLARS IN THOUSANDS)

	Water System		Wastewater System		Total	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Operating revenue:						
Water	\$142,553	\$126,281	-	-	\$142,553	\$126,281
Sewer	-	-	\$21,969	\$20,208	21,969	20,208
Power	2,565	908	224	124	2,789	1,032
Wet weather facilities charges	-	-	6,003	5,725	6,003	5,725
Total operating revenue	<u>145,118</u>	<u>127,189</u>	<u>28,196</u>	<u>26,057</u>	<u>173,314</u>	<u>153,246</u>
Operating expense:						
Raw water	8,888	8,440	-	-	8,888	8,440
Water treatment and distribution	26,427	25,852	-	-	26,427	25,852
Recreation areas, net	1,200	1,503	-	-	1,200	1,503
Sewer lines and pumping	-	-	3,121	3,059	3,121	3,059
Sewer treatment plant operations	-	-	6,825	7,160	6,825	7,160
Customer accounting and collecting	3,400	3,837	640	611	4,040	4,448
Financial and risk management	3,418	4,237	120	208	3,538	4,445
Facilities management	1,479	1,613	-	-	1,479	1,613
General administration	11,957	13,419	2,708	2,687	14,665	16,106
Depreciation on utility plant and vehicle	25,790	26,016	5,656	5,502	31,446	31,518
Total operating expense	<u>82,559</u>	<u>84,917</u>	<u>19,070</u>	<u>19,227</u>	<u>101,629</u>	<u>104,144</u>
Net operating income	<u>62,559</u>	<u>42,272</u>	<u>9,126</u>	<u>6,830</u>	<u>71,685</u>	<u>49,102</u>
Nonoperating income (expense):						
Investment income	1,712	679	274	162	1,986	841
Taxes and subventions	7,500	6,277	1,510	1,858	9,010	8,135
Interest and amortization of bond expenses, net of capitalized interest of \$2,435 and \$2,310 for the Water System and \$221 and \$519 for the Wastewater System in 2017 and 2016, respectively	(25,909)	(23,377)	(4,307)	(3,957)	(30,216)	(27,334)
Increase (decrease) of equity in JPA partnership fund	(1,016)	(1,014)	-	-	(1,016)	(1,014)
Other income	2,380	5,720	2,107	1,087	4,487	6,807
Total nonoperating income (expense), net	<u>(15,333)</u>	<u>(11,715)</u>	<u>(416)</u>	<u>(850)</u>	<u>(15,749)</u>	<u>(12,565)</u>
Income (loss) before capital contributions	47,226	30,557	8,710	5,980	55,936	36,537
Capital contributions	32,816	15,566	4,626	1,886	37,442	17,452
Change in net position	80,042	46,123	13,336	7,866	93,378	53,989
Total net position - beginning	<u>1,239,163</u>	<u>1,131,413</u>	<u>289,220</u>	<u>260,887</u>	<u>1,528,383</u>	<u>1,392,300</u>
Total net position - ending	<u>\$1,319,205</u>	<u>\$1,177,536</u>	<u>\$302,556</u>	<u>\$268,753</u>	<u>\$1,621,761</u>	<u>\$1,446,289</u>

See accompanying notes to financial statements

UNAUDITED

EAST BAY MUNICIPAL UTILITY DISTRICT
STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016
(DOLLARS IN THOUSANDS)

	Water System		Wastewater System		Total	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Cash flows from operating activities						
Cash received from customers	\$132,492	\$129,253	\$27,617	\$26,212	\$160,109	\$155,465
Cash received from other income	2,380	5,720	2,107	1,087	4,487	6,807
Cash payments for judgments and claims	(1,126)	(2,098)	(53)	(131)	(1,179)	(2,229)
Cash payments to suppliers for goods and services	(21,533)	(13,281)	(16,598)	(14,829)	(38,131)	(28,110)
Cash payments to employees for services	(43,320)	(54,472)	(7,043)	(8,769)	(50,363)	(63,241)
Net cash provided by operating activities	<u>68,893</u>	<u>65,122</u>	<u>6,030</u>	<u>3,570</u>	<u>74,923</u>	<u>68,692</u>
Cash flows from noncapital financing activities:						
Tax receipts	<u>7,500</u>	<u>6,277</u>	<u>1,510</u>	<u>1,858</u>	<u>9,010</u>	<u>8,135</u>
Net cash provided by financing activities	<u>7,500</u>	<u>6,277</u>	<u>1,510</u>	<u>1,858</u>	<u>9,010</u>	<u>8,135</u>
Capital and related financing activities:						
Capital contributions	32,816	15,566	4,626	1,886	37,442	17,452
Proceeds from advances for construction	(185)	561	-	-	(185)	561
Proceeds from sale of capital assets	211	343	-	-	211	343
Acquisition and construction of capital assets	(55,675)	(60,720)	(7,407)	(12,506)	(63,082)	(73,226)
Principal retirement on long-term debt and commercial paper	(3,148)	(3,417)	(689)	(446)	(3,837)	(3,863)
Interest paid on long-term debt	3,814	4,771	553	939	4,367	5,710
Net cash provided by (used in) capital and related financing activities	<u>(22,167)</u>	<u>(42,896)</u>	<u>(2,917)</u>	<u>(10,127)</u>	<u>(25,084)</u>	<u>(53,023)</u>
Cash flows from investing activities:						
Proceeds from securities	72,642	107,289	14,020	14,293	86,662	121,582
Expenditures from purchases of securities	(230,737)	(115,408)	(16,605)	(24,586)	(247,342)	(139,994)
Interest received on investments	729	650	191	105	920	755
Net cash provided by (used in) investing activities	<u>(157,366)</u>	<u>(7,469)</u>	<u>(2,394)</u>	<u>(10,188)</u>	<u>(159,760)</u>	<u>(17,657)</u>
Net increase (decrease) in cash and cash equivalents	(103,140)	21,034	2,229	(14,887)	(100,911)	6,147
Cash and cash equivalents:						
Beginning of year	<u>224,866</u>	<u>158,595</u>	<u>44,191</u>	<u>46,105</u>	<u>269,057</u>	<u>204,700</u>
End of period	<u>\$121,726</u>	<u>\$179,629</u>	<u>\$46,420</u>	<u>\$31,218</u>	<u>\$168,146</u>	<u>\$210,847</u>

(Continued)

UNAUDITED

EAST BAY MUNICIPAL UTILITY DISTRICT
STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016
(DOLLARS IN THOUSANDS)

	Water System		Wastewater System		Total	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Reconciliation of net operating income to net cash provided by operating activities:						
Net operating income	\$62,559	\$42,272	\$9,126	\$6,830	\$71,685	\$49,102
Adjustments to reconcile net operating income to net cash provided by operating activities:						
Depreciation on utility plant and vehicle	25,790	26,016	5,656	5,502	31,446	31,518
Depreciation within recreation areas	375	311	-	-	375	311
Amortization	3,477	4,122	825	424	4,302	4,546
Other income	2,380	5,720	2,107	1,087	4,487	6,807
Changes in assets/liabilities:						
Materials and supplies	498	723	-	-	498	723
Prepaid insurance	263	275	-	-	263	275
Customer receivables	(12,626)	2,064	(579)	155	(13,205)	2,219
Other assets	(30,419)	(26,630)	(30,642)	(30,171)	(61,061)	(56,801)
Accounts payable and accrued expenses	16,596	10,249	19,537	19,743	36,133	29,992
	<u>\$68,893</u>	<u>\$65,122</u>	<u>\$6,030</u>	<u>\$3,570</u>	<u>\$74,923</u>	<u>\$68,692</u>
Net cash provided by operating activities						

See accompanying notes to financial statements

**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017
(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 three months ended September 30, 2017 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, 2017 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, 2017.

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 three months ended September 30, 2017. 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 THREE MONTHS ENDED SEPTEMBER 30, 2017
(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 THREE MONTHS ENDED SEPTEMBER 30, 2017
(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 during construction based on the interest rate on outstanding debt of the system in the prior fiscal year as allowed by GASB 76. 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 \$3,100) 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 THREE MONTHS ENDED SEPTEMBER 30, 2017
(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 biennial 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 biennial 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 biennial budget, to maintain a level based on the Actuarial Self-Insured Retention (SIR) funding recommendation for the following year’s discounted loss and allocated loss adjustment expenses (ALAE) funding guidelines. Reserve amount should be calculated at a high (85%) confidence level. If an actuarial study is not available before close of the prior fiscal year end, the reserve shall equal 1.15 times the prior year reserve.
- Workers' compensation reserve is established by Policy 4.02, as adopted by the Board of Directors in the biennial budget, to maintain a level based on the Actuarial SIR funding recommendation for the following year’s discounted loss and ALAE funding guidelines. Reserve amount should be calculated at a high (85%) confidence level. If an actuarial study is not available before close of the prior fiscal year end, the reserve shall equal 1.15 times the prior year reserve.

UNAUDITED

EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017
(Dollars in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 biennial budget.
- Reserve Funded CIP (Wastewater) balance is a specific designation [Board Motion No. 029-94] used to fund wet and dry weather eligible construction projects.
- Vehicle Replacement Fund [Board Motion No. 030-94] is financed by deposits based on internal user rate charges, and used to reimburse operational expenditures and vehicle replacement purchases.
- 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.
- 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.
- 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.
- 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.

**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017
(Dollars in thousands)**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- 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.
- 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 to provide operating support to the 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.
- 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.

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.

EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017
(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 September 30, 2017 and June 30, 2017, 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
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017
(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. Implementation of Governmental Accounting Standards Board (GASB) Pronouncements

GASB Statement No. 74 – The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. This statement required additional footnote disclosures as noted in Note 8G and additional tables in the required supplemental information.

GASB Statement No. 82 - The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, Financial Reporting for Pension Plans, No. 68, Accounting and Financial Reporting for Pensions, and No. 73, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. This Statement had no effect on the financial statements.

Q. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The District categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The fair value hierarchy categorizes the inputs to valuation techniques used to measure fair value into three levels based on the extent to which inputs used in measuring fair value are observable in the market.

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 inputs are inputs – other than quoted prices included within level 1 – that are observable for an asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for an asset or liability.

If the fair value of an asset or liability is measured using inputs from more than one level of the fair value hierarchy, the measurement is considered to be based on the lowest priority level input that is significant to the entire measurement.

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**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017
(Dollars in thousands)**

NOTE 2 - CASH AND INVESTMENTS

A. Classification

Reconciliations of cash and investments reported on the financial statements as of September 30, 2017, are as follows:

<i>District Enterprise Funds:</i>	Water System	Wastewater System	Total
Cash and investments included in current assets	\$574,216	\$105,640	\$679,856
Cash and investments included in restricted assets	47,658	71	47,729
Total District cash and investments	621,874	105,711	727,585
Less non-current investments	(500,148)	(59,291)	(559,439)
District cash and cash equivalents	<u>\$121,726</u>	<u>\$46,420</u>	<u>\$168,146</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/Fund
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% \$65,000	40% in each Agency
State of California Local Agency Investment Fund (LAIF Pool)	N/A	N/A	per account	N/A
California Asset Management Program (CAMP)	N/A	AAAm	20%	N/A
Money Market Mutual Funds	N/A	AAAm	20%	5%
Certificates of Time Deposit	1 Year	AA-	20%	\$250
Negotiable Certificates of Deposit	5 Years	AA-	20%	\$250
Commercial Paper	270 Days	A-1+, P1 or F1+	20%	10%
Medium Term Corporate Notes	5 Years	AA- and A	30%	10%
Repurchase Agreements	270 Days	N/A	20%	N/A
Municipal Bonds	5 Years	AA- and A	40%	20%

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 THREE MONTHS ENDED SEPTEMBER 30, 2017
(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 (up to 3 years)	Top Short-Term Rating Category
Corporate Bonds (longer than 3 years)	Not lower than District's bond rating
Variable Rate Obligations	Top Short-Term Rating Category
Cash Sweep Agreements	Top Rating Category
Guaranteed Investment Contract	Not lower than District's bond rating
Shares of Beneficial Interest	Top Rating Category

D. Fair Value Hierarchy

The District categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure fair value of the assets. Level 1 inputs are quoted prices in an active market for identical assets; Level 2 inputs are significant other observable inputs; and Level 3 inputs are significant unobservable inputs. This information is presented in the annual audited financial statements.

E. 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.

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EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017
(Dollars in thousands)

NOTE 2 - CASH AND INVESTMENTS (Continued)

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.

F. 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 in the annual audited financial statements.

G. 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.

H. 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.

I. 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.

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**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017
(Dollars in thousands)**

NOTE 2 - CASH AND INVESTMENTS (Continued)

J. 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 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 three years. Contributed capital assets are valued at their estimated acquisition value on the date contributed.

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:

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**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017
(Dollars in thousands)**

NOTE 3 – CAPITAL ASSETS (Continued)

Utility plant:	<u>Years</u>
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

NOTE 4 – ACCOUNTS PAYABLE & ACCRUED EXPENSES

Accounts payable and accrued expenses at September 30, 2017 and June 30, 2017 consist of:

	<u>Water System</u>		<u>Wastewater System</u>		<u>Total</u>	
	<u>September 30</u>	<u>June 30</u>	<u>September 30</u>	<u>June 30</u>	<u>September 30</u>	<u>June 30,</u>
	<u>2017</u>	<u>2017</u>	<u>2017</u>	<u>2017</u>	<u>2017</u>	<u>2017</u>
Accounts payable	\$6,896	\$19,340	\$1,364	\$4,365	\$8,260	\$23,705
Accrued salaries	14	2,360	(3)	394	11	2,754
Accrued compensated absences	26,008	26,545	4,175	4,130	30,183	30,675
Other	<u>30,241</u>	<u>20,607</u>	<u>668</u>	<u>453</u>	<u>30,909</u>	<u>21,060</u>
Total	<u>\$63,159</u>	<u>\$68,852</u>	<u>\$6,204</u>	<u>\$9,342</u>	<u>\$69,363</u>	<u>\$78,194</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. 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.

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EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017
(Dollars in thousands)

NOTE 5 – COMMERCIAL PAPER NOTES (Continued)

As of September 30, 2017, \$0 million in Water Series and \$15.0 million in Wastewater Series extendable commercial paper notes were outstanding under this program. The Wastewater Series included the term of 92 days and an interest rate of 0.88% as of September 30, 2017, and the term of 61 days and an interest rate of 0.91% as of June 30, 2017.

The District established its current traditional commercial paper program in December 2015. As of September 30, 2017, \$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 the terms of 27 to 98 days and interest rates ranging from 0.80% to 0.94% as of September 30, 2017, and the terms of 30 to 123 days and interest rates ranging from 0.78% to 0.97% as of June 30, 2017.

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 September 30, 2017. 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 September 30, 2017. 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, 2017 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.

**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017
(Dollars in thousands)**

NOTE 6 – LONG-TERM DEBT (Continued)

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.

C. Prior-Year Defeasances

In prior years, the District defeased certain debt issues by placing proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the refunded bonds. Accordingly, the trust account assets and the liability for the defeased debt are not included in the District's financial statements. On September 30, 2017, \$355 million of the bonds outstanding are considered defeased.

D. 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 are 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	Standby Purchase Agreement Terms		
	Expiration Date	Interest Rate	Swap Rate
Water System Revenue Subordinated Bonds:			
Series 2008A-1	12/9/2019	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	12/9/2019	Reset Weekly	See below

E. 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.

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**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
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NOTE 6 – LONG-TERM DEBT (Continued)

Term and credit risks. The terms and credit ratings of the outstanding swaps, as of September 30, 2017, 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	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

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 September 30, 2017, is included below:

<u>Related Bond Issuance</u>	<u>Fair Value</u>
2008A Water System Refunding Bonds	(25,233)

Credit risk. As of September 30, 2017, the District was not exposed to credit risk on its outstanding swaps because the swaps had a negative fair value of \$25.2 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 September 30, 2017, the District was not required to provide collateral to any swap counterparty.

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EAST BAY MUNICIPAL UTILITY DISTRICT
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(Dollars in thousands)

NOTE 6 – LONG-TERM DEBT (Continued)

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 September 30, 2017, the District has a basis difference on its swaps of a negative 2 basis points (the District receives less 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.

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), net OPEB liability (The Plan's liability determined according to GASB 74) and pension related deferred inflows and outflows of resources are calculated and revised annually.

**EAST BAY MUNICIPAL UTILITY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017
(Dollars in thousands)**

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	25,000	25
Pardee and Camanche Dams	25,000	25
Main Wastewater Treatment Plant	25,000	25

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.

NOTE 10 - CONTINGENT LIABILITIES

The District is a defendant in a number of lawsuits which have arisen in the normal course of business including challenges over certain rates and charges. 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.