

**CITY OF SANTA CLARA
ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
FINANCIAL STATEMENTS**



**FOR THE YEARS ENDED JUNE 30, 2016 AND 2015
CITY OF SANTA CLARA, CALIFORNIA
1500 WARBURTON AVENUE
SANTA CLARA, CA 95050-3796**

PREPARED BY DEPARTMENT OF FINANCE

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)**

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INDEPENDENT AUDITOR'S REPORT

To the Honorable Members of the City Council
City of Santa Clara, California

We have audited the accompanying financial statements of the Santa Clara Electrical Utility Enterprise Fund (Silicon Valley Power) of the City of Santa Clara, California, as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, as listed in the Table of Contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Silicon Valley Power of the City of Santa Clara as of June 30, 2016, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Management adopted the provisions of Governmental Accounting Standards Board Statement No. 72 – *Fair Value Measurement and Application*, which became effective during the year ended June 30, 2016 as discussed in Note 2S and 3E to the financial statements.

Management early-implemented the provisions of Governmental Accounting Standards Board Statement No. 82 – *An Amendment of GASB Statements No. 67, No. 68, and No. 73* during the year ended June 30, 2016 as noted in the Pension-Related Required Supplementary Information.

The emphasis of these matters does not constitute a modification to our opinions.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and other Required Supplementary Information as listed in the Table of Contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

As discussed in Note 2, the financial statements present only the Silicon Valley Power and do not purport to, and do not present fairly the financial position of the City of Santa Clara as of June 30, 2016 and 2015 the changes in its financial position, or, where applicable, its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 21, 2016, on our consideration of the City of Santa Clara's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Silicon Valley Power's internal control over financial reporting and compliance.

Maze & Associates

Pleasant Hill, California
November 21, 2016

MANAGEMENT’S DISCUSSION AND ANALYSIS

This section of the Silicon Valley Power (SVP) financial statements presents a narrative overview and analysis of the financial activities for the fiscal year. Please read this document in conjunction with the accompanying Basic Financial Statements.

SVP is a separate enterprise fund of the City of Santa Clara (the City), and was established to account for the electric power transactions of the City. SVP owns power generation facilities, has investments in joint ventures that produce electric power, and trades power on the open market. These efforts are directed toward ensuring its retail customers—the citizens, organizations and businesses of the City—have a reliable source of electric power at reasonable rates.

SVP has been affected by the deregulation of the electric power industry in California, as discussed in detail in Note 8 to its financial statements.

OVERVIEW OF SVP’S BASIC FINANCIAL STATEMENTS

The Basic Financial statements are in two parts:

1. Management’s Discussion and Analysis (this part),
2. The Basic Financial Statements, along with the Notes to these Financial Statements.

The Basic Financial Statements provide both a short-term and a long-term view of SVP’s financial activities and financial position.

The Financial Statements are comprised of the Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position, and the Statements of Cash Flows. The Statements of Net Position provide information about the financial position of SVP as a whole, including all its long-term liabilities on the full accrual basis. The Statements of Revenues, Expenses and Changes in Net Position provide information about all SVP’s revenues and all its expenses, also on the full accrual basis, with the emphasis on measuring net revenues or expenses of the program. The Statements of Cash Flows provide information about cash activities for the year.

During the fiscal year 2014-15, SVP implemented Governmental Accounting Standard Board Statement (GASB) No. 68 and 71 for pension accounting and financial reporting. As a result, SVP recorded a net pension liability of \$74.5 million. Additional information can be found in Note 7 to financial statements. During the fiscal year 2015-16, SVP implemented GASB Statement No. 72, Fair Value Measurement and Application and it has no fiscal impact to SVP.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

FISCAL YEAR 2015-16 FINANCIAL HIGHLIGHTS

The following is summarized financial information from the Statements of Net Position (Table 1) and the Statements of Revenues, Expenses and Changes in Net Position (Table 2).

Please note that financial information in the following tables for the prior fiscal year ended June 30, 2014 was not adjusted for implementation of GASB Statements 68 and 71 because not all of the information was available to adjust prior year amounts.

Table 1
Net Position
June 30, 2016 and 2015
(in millions)

| <u>Description</u> | <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | | <u>2014</u> |
|---|-----------------|-----------------|----------------------------|---------------|-----------------|
| | | | <u>Amount</u> | <u>%</u> | |
| Cash and investments | \$ 227.3 | \$ 238.6 | \$ (11.3) | -4.7% | \$ 277.1 |
| Other assets | 129.7 | 122.3 | 7.4 | 6.1% | 104.7 |
| Capital assets | 578.4 | 559.6 | 18.8 | 3.4% | 531.8 |
| Total Assets | <u>935.4</u> | <u>920.5</u> | <u>14.9</u> | <u>1.6%</u> | <u>913.6</u> |
| Deferred Outflows of Resources: | | | | | |
| Deferred outflows on derivative instruments | 10.3 | 9.2 | 1.1 | 12.0% | 10.2 |
| Deferred outflows on refunding | 6.2 | 6.7 | (0.5) | -7.5% | 7.2 |
| Deferred outflows on pension related items | 6.5 | 5.4 | 1.1 | 20.4% | - |
| Total Deferred Outflows of Resources | <u>23.0</u> | <u>21.3</u> | <u>1.7</u> | <u>8.0%</u> | <u>17.4</u> |
| Long-term liabilities outstanding | | | | | |
| (including current portion) | 217.7 | 226.8 | (9.1) | -4.0% | 237.4 |
| Net pension liabilities | 74.5 | 69.1 | 5.4 | 7.8% | - |
| Other liabilities | 42.8 | 44.3 | (1.5) | -3.4% | 30.2 |
| Total Liabilities | <u>335.0</u> | <u>340.2</u> | <u>(5.2)</u> | <u>-1.5%</u> | <u>267.6</u> |
| Deferred Inflows of Resources: | | | | | |
| Deferred inflows on derivative instruments | - | 0.7 | (0.7) | -100.0% | - |
| Deferred inflows on refunding | 0.5 | 0.5 | - | 0.0% | 0.5 |
| Deferred inflows on pension related items | 3.6 | 9.8 | (6.2) | -63.3% | - |
| Total Deferred Inflows of Resources | <u>4.1</u> | <u>11.0</u> | <u>(6.9)</u> | <u>-62.7%</u> | <u>0.5</u> |
| Net Position: | | | | | |
| Net investment in capital assets | 384.0 | 356.1 | 27.9 | 7.8% | 334.2 |
| Unrestricted | 235.3 | 234.5 | 0.8 | 0.3% | 328.7 |
| Total Net Position | <u>\$ 619.3</u> | <u>\$ 590.6</u> | <u>\$ 28.7</u> | <u>4.9%</u> | <u>\$ 662.9</u> |

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Table 2
Revenues, Expenses and Changes in Net Position
For the years ended June 30, 2016 and 2015
(in millions)

| <u>Description</u> | <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | | <u>2014</u> |
|--|-----------------|-----------------|----------------------------|-------------|-----------------|
| | | | <u>Amount</u> | <u>%</u> | |
| Revenues: | | | | | |
| Retail | \$ 371.8 | \$ 332.9 | \$ 38.9 | 11.7% | \$ 309.2 |
| Wholesale | 17.3 | 27.3 | (10.0) | -36.6% | 28.6 |
| Interest Revenue | 2.2 | 1.6 | 0.6 | 37.5% | 1.7 |
| | | | | | |
| Net increase (decrease) in fair value of investment | 0.9 | 0.4 | 0.5 | 125.0% | 1.9 |
| Rents and royalties | 4.0 | 3.5 | 0.5 | 14.3% | 2.7 |
| Renewable energy credit | 3.9 | 2.1 | 1.8 | 85.7% | 5.4 |
| Other | 15.5 | 16.0 | (0.5) | -3.1% | 22.6 |
| | | | | | |
| Total Revenues | <u>415.6</u> | <u>383.8</u> | <u>31.8</u> | <u>8.3%</u> | <u>372.1</u> |
| Expenses: | | | | | |
| Retail | 348.4 | 330.7 | 17.7 | 5.4% | 319.7 |
| Wholesale | 21.7 | 32.6 | (10.9) | -33.4% | 28.9 |
| Interest on long term debt | 8.8 | 9.0 | (0.2) | -2.2% | 8.6 |
| Other | 7.3 | 9.5 | (2.2) | -23.2% | 5.6 |
| | | | | | |
| Total Expenses | <u>386.2</u> | <u>381.8</u> | <u>4.4</u> | <u>1.2%</u> | <u>362.8</u> |
| | | | | | |
| Increase (decrease) in net position before transfers | 29.4 | 2.0 | 27.4 | 1370.0% | 9.3 |
| Transfers in (out) | (0.7) | (0.5) | (0.2) | -40.0% | (0.4) |
| | | | | | |
| Increase (decrease) in net position | 28.7 | 1.5 | 27.2 | 1813.3% | 8.9 |
| | | | | | |
| Net Position - July 1 as adjusted ⁽¹⁾ | <u>590.6</u> | <u>589.1</u> | <u>1.5</u> | <u>0.3%</u> | <u>654.0</u> |
| | | | | | |
| Net Position - June 30 | <u>\$ 619.3</u> | <u>\$ 590.6</u> | <u>\$ 28.7</u> | <u>4.9%</u> | <u>\$ 662.9</u> |

⁽¹⁾ Amount for July 1, 2014 has been adjusted due to the implementation of GASB Statement No. 65.

SVP retail operating revenues were \$371.8 million in fiscal year 2015-16, \$332.9 million in fiscal year 2014-15, and \$309.2 million in fiscal year 2013-14, reflecting increases of approximately 11.7% and 7.7% from fiscal years 2014-15 and 2013-14, respectively. The main reason for the increase in fiscal year 2015-16 was due to a rate increase of 2% effective January 1, 2016, and consumption increase in commercial and industrial sectors.

Retail operating expenses were \$348.4 million in fiscal year 2015-16, \$330.7 million in fiscal year 2014-15, and \$319.7 million in fiscal year 2013-14, an increase of \$17.7 million or 5.4% and an increase of \$11.0 million or 3.4% from fiscal years 2014-15 and 2013-14, respectively. The retail operating expenses for fiscal year 2015-16 were higher primarily due to increases in the cost of purchased power of \$18.4 million, and offsetting with decreases in operation costs of \$0.6 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Revenues from wholesale power sales were \$17.3 million in fiscal year 2015-16, \$27.3 million in fiscal year 2014-15, and \$28.6 million in fiscal year 2013-14. Concurrently, the cost of wholesale power purchases was \$21.7 million in fiscal year 2015-16, \$32.6 million in fiscal year 2014-15, and \$28.9 million in fiscal year 2013-14. The decrease in wholesale power purchases was due to the return to near normal hydroelectric production and additional production from specified power purchase agreements reducing the need for general wholesale power purchases.

Interest income was \$2.2 million in fiscal year 2015-16, \$1.6 million in fiscal year 2014-15, and \$1.7 million in fiscal year 2013-14. The increase in the current fiscal year was primarily the result of higher interest rate in the market. Interest expense was \$8.8 million in fiscal year 2015-16, \$9.0 million in fiscal year 2014-15, and \$8.6 million in fiscal year 2013-14. Annual interest expense varies based on existing debt service amortization schedules for outstanding utility bonds.

The Electric Utility Fund had a net position of \$619.3 million at June 30, 2016, an increase of \$28.7 million from the prior fiscal year. Of this amount, \$27.9 million was an increase in net investment in capital assets and \$0.8 million was an increase of unrestricted net position. The adjusted net position at July 1, 2014 of \$589.1 million reflected a decrease of \$73.8 million as a result of implementation of GASB Statement No.68. At June 30, 2015, the Electric Utility Fund had a net position of \$590.6 million, a decrease of \$72.3 million from fiscal year 2013-14.

CAPITAL ASSETS

At the end of fiscal year 2015-16, SVP had \$578.4 million, net of depreciation, invested in capital assets, with a significant amount in power generation facilities and the remainder in transmission and distribution assets. At June 30, 2016, SVP had various projects completed or under construction. In fiscal year 2015-16, the Capital Improvement Projects Budget included appropriations for significant investments in substation improvements in the coming years.

Further detail may be found in Note 4 to the financial statements.

DEBT ADMINISTRATION

Each of SVP's debt issues is discussed in detail in Note 5 to the financial statements. At June 30, 2016, SVP's debt is comprised of three issues of Revenue Bonds and one loan agreement with carrying balances of \$217.7 million at that date. These Bonds are secured by electric revenues earned by SVP, and mature in fiscal years through 2033.

ECONOMIC OUTLOOK AND MAJOR INITIATIVES

The economy of the City and its major initiatives for the coming year are discussed in detail in the Letter of Transmittal Section of the City's Comprehensive Annual Financial Report for the year ended June 30, 2016.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

CONTACTING SVP'S FINANCIAL MANAGEMENT

These Basic Financial Statements are intended to provide citizens, taxpayers, investors, and creditors with a general overview of the SVP's finances. Questions about these Statements should be directed to the City Finance Department, at 1500 Warburton Avenue, Santa Clara, CA 95050-3796.

CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
STATEMENTS OF NET POSITION
June 30, 2016 and 2015

| ASSETS | 2016 | 2015 |
|---|----------------------|----------------------|
| Current Assets: | | |
| Pooled cash and investments (Note 3) | \$ 227,274,391 | \$ 238,643,608 |
| Investments with fiscal agent (Note 3) | 8,698,139 | 8,869,238 |
| Receivables (net of allowances) | | |
| Accounts | 52,698,378 | 42,937,502 |
| Interest | 442,802 | 274,555 |
| Due from the City of Santa Clara (Note 2E) | 1,728,545 | 1,889,167 |
| Inventory of materials and supplies and prepaid (Note 2F) | 9,604,143 | 12,441,972 |
| Derivative Instrument (Note 5F) | - | 666,648 |
| Total Current Assets | <u>300,446,398</u> | <u>305,722,690</u> |
| Noncurrent Assets: | | |
| Capital assets (Note 4) | | |
| Land | 22,872,234 | 22,872,234 |
| Construction in progress | 70,812,122 | 41,224,610 |
| Buildings, improvements and infrastructure | 870,752,284 | 861,953,802 |
| Equipment | 9,694,142 | 10,416,267 |
| Accumulated depreciation | <u>(395,742,785)</u> | <u>(376,833,487)</u> |
| Total Capital assets (Net of accumulated depreciation) | <u>578,387,997</u> | <u>559,633,426</u> |
| Other Noncurrent Assets: | | |
| Investments in joint ventures (Note 6) | 35,318,623 | 34,581,763 |
| Investments with fiscal agent (Note 3) | 14,667,026 | 14,420,513 |
| Deposits (Note 3) | 6,560,076 | 6,157,601 |
| Advance to the City of Santa Clara | 2,314 | 16,437 |
| Total Other Noncurrent Assets | <u>56,548,039</u> | <u>55,176,314</u> |
| Total Noncurrent Assets | <u>634,936,036</u> | <u>614,809,740</u> |
| Total Assets | <u>935,382,434</u> | <u>920,532,430</u> |
| DEFERRED OUTFLOWS OF RESOURCES | | |
| Accumulated decrease in fair value of hedging instruments (Note 5F) | 10,366,115 | 9,234,917 |
| Deferred outflow on refunding of debts | 6,169,451 | 6,704,712 |
| Deferred outflows on pension related items (Note7) | <u>6,509,168</u> | <u>5,335,643</u> |
| Total Deferred Outflows of Resources | <u>23,044,734</u> | <u>21,275,272</u> |

See accompanying notes to financial statements

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
STATEMENTS OF NET POSITION
June 30, 2016 and 2015**

| LIABILITIES | 2016 | 2015 |
|--|-----------------------|-----------------------|
| Current Liabilities: | | |
| Accrued liabilities | 25,566,102 | 28,054,585 |
| Interest payable | 2,755,916 | 2,826,132 |
| Accrued compensated absences | 336,358 | 362,159 |
| Unearned Revenue | 504,706 | 854,187 |
| Current portion of long-term debt (Note 5) | 7,640,000 | 7,280,000 |
| Current portion derivative financial instruments (Note 5F) | - | 68,400 |
| Total Current Liabilities | <u>36,803,082</u> | <u>39,445,463</u> |
| Noncurrent Liabilities: | | |
| Long-term derivative financial instruments (Note 5F) | 10,366,115 | 9,166,517 |
| Long-term portion accrued compensated absences | 3,198,115 | 2,966,506 |
| Net pension liability (Note 7) | 74,516,387 | 69,068,338 |
| Long-term debt (Note 5) | 210,078,572 | 219,548,285 |
| Total Noncurrent Liabilities | <u>298,159,189</u> | <u>300,749,646</u> |
| Total Liabilities | <u>334,962,271</u> | <u>340,195,109</u> |
| DEFERRED INFLOWS OF RESOURCES | | |
| Accumulated increase in fair value of hedging instruments (Note 5F) | - | 666,648 |
| Deferred inflow on refunding of debts | 484,560 | 524,940 |
| Deferred inflows pension related items (Note 7) | 3,646,392 | 9,837,338 |
| Total Deferred Inflows of Resources | <u>4,130,952</u> | <u>11,028,926</u> |
| NET POSITION | | |
| Net investment in capital assets | 384,034,590 | 356,094,892 |
| Unrestricted net position | 235,299,355 | 234,488,775 |
| Total Net Position | <u>\$ 619,333,945</u> | <u>\$ 590,583,667</u> |

See accompanying notes to financial statements

CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
For the years ended June 30, 2016 and 2015

| | <u>2016</u> | <u>2015</u> |
|--|-----------------------|-----------------------|
| Operating Revenues: | | |
| Residential sales | \$ 27,789,440 | \$ 27,138,612 |
| Commercial sales | 15,408,652 | 13,783,286 |
| Industrial sales | 321,490,938 | 277,079,287 |
| Other operating revenues | 7,111,891 | 14,936,437 |
| Total Operating Revenues | <u>371,800,921</u> | <u>332,937,622</u> |
| | | |
| Operating Expenses: | | |
| Operations | 63,708,168 | 64,317,852 |
| Maintenance | 12,348,271 | 12,232,136 |
| Purchased power | 252,395,569 | 234,022,872 |
| Amortization | - | 139,366 |
| Depreciation | 19,956,266 | 20,023,306 |
| Total Operating Expenses | <u>348,408,274</u> | <u>330,735,532</u> |
| | | |
| Operating Income | <u>23,392,647</u> | <u>2,202,090</u> |
| | | |
| Nonoperating Revenues (Expenses): | | |
| Interest revenue | 2,230,745 | 1,623,008 |
| Net changes in the fair value of investments | 907,131 | 420,573 |
| Interest expense | (8,819,064) | (9,094,230) |
| Renewable energy credits | 3,879,397 | 2,128,628 |
| Wholesale resources sales (Note 8) | 17,278,778 | 27,300,976 |
| Wholesale resources purchases (Note 8) | (21,682,117) | (32,635,438) |
| Equity in income (losses) of joint ventures | 736,860 | (4,719,095) |
| Rents and royalties | 3,966,868 | 3,455,122 |
| Mandated program receipts and other revenues | 14,778,112 | 16,035,553 |
| Gain on retirement of assets | (9,887) | 63,905 |
| Mandated program disbursements and other expenses | (7,182,521) | (4,765,651) |
| Total Nonoperating Revenues, net | <u>6,084,302</u> | <u>(186,649)</u> |
| | | |
| Income Before Transfers | 29,476,949 | 2,015,441 |
| | | |
| Transfers to the City of Santa Clara | <u>(726,671)</u> | <u>(549,651)</u> |
| | | |
| Net Income | 28,750,278 | 1,465,790 |
| | | |
| Net Position, Beginning of Year, as adjusted (Note 2R) | <u>590,583,667</u> | <u>589,117,877</u> |
| | | |
| Net Position, End of Year | <u>\$ 619,333,945</u> | <u>\$ 590,583,667</u> |

See accompanying notes to financial statements

CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
STATEMENTS OF CASH FLOWS
For the years ended June 30, 2016 and 2015

| | <u>2016</u> | <u>2015</u> |
|---|-----------------------|-----------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Receipts from customers | \$ 362,271,774 | \$ 331,209,832 |
| Payments to suppliers | (301,106,218) | (281,899,243) |
| Payments to employees for salaries and benefits | (28,171,117) | (26,516,166) |
| Rents and royalties received | 3,673,301 | 3,496,887 |
| Other receipts | 6,969,125 | 11,221,281 |
| Net Cash from Operating Activities | <u>43,636,865</u> | <u>37,512,591</u> |
| CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES | | |
| Wholesale resources sales | 17,278,778 | 27,300,976 |
| Wholesale resources purchases | (21,682,117) | (32,635,438) |
| Renewable energy credits | 3,879,397 | 2,128,628 |
| Increase (decrease) in due from other funds | 174,745 | 447,196 |
| Wholesale trading escrow | 1,308,933 | 1,335,886 |
| Transfers (out) | (726,671) | (549,651) |
| Cash Flows from Noncapital Financing Activities | <u>233,065</u> | <u>(1,972,403)</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | |
| Acquisition and construction of capital assets, net | (40,898,984) | (44,066,254) |
| Proceeds from retirement of assets | - | 63,905 |
| Proceeds from debt issuance | - | 6,000,000 |
| Principal payments on debt | (8,958,030) | (6,485,000) |
| Interest paid on debt | (6,564,938) | (8,492,033) |
| Cash Flows from Capital and Related Financing Activities | <u>(56,421,952)</u> | <u>(52,979,382)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Interest and dividends | 351,090 | 1,790,916 |
| Net increase in the fair value of investments | 907,131 | 420,573 |
| Payments made by fiscal agent | 12,921,685 | 12,204,910 |
| Deposits made with fiscal agent | (12,997,101) | (13,198,088) |
| Cash Flows from Investing Activities | <u>1,182,805</u> | <u>1,218,311</u> |
| Net Increase (Decrease) in Cash and Cash Equivalents | (11,369,217) | (16,220,883) |
| Cash and cash equivalent at Beginning of Period | <u>238,643,608</u> | <u>254,864,491</u> |
| Cash and cash equivalent at End of Period | <u>\$ 227,274,391</u> | <u>\$ 238,643,608</u> |

See accompanying notes to financial statements

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
STATEMENTS OF CASH FLOWS
For the years ended June 30, 2016 and 2015**

| | <u>2016</u> | <u>2015</u> |
|---|----------------------|-----------------------|
| Reconciliation of Operating Gain(Loss) to Net Cash | | |
| Provided (Used) by Operating activities: | | |
| Operating income | \$ 23,392,647 | \$ 2,202,090 |
| Adjustments to reconcile operating income to net cash | | |
| provided (used) by operating activities: | | |
| (Decrease) Increase in due to retirement system | (1,916,422) | (213,266.00) |
| Amortization | - | 139,366 |
| Depreciation | 19,956,266 | 20,023,306 |
| Change in assets and liabilities: | | |
| Receivable, net | (9,760,876) | (1,279,601) |
| Inventory | 2,837,829 | 808,673 |
| Accrued liabilities | (2,291,365) | 677,136 |
| Compensated absences | 205,808 | 409,517 |
| Unearned revenues | (349,481) | 20,346 |
| Other receipts | 18,744,980 | 19,490,675 |
| Other expenses | <u>(7,182,521)</u> | <u>(4,765,651)</u> |
| Net Cash Provided by Operating Activities | <u>\$ 43,636,865</u> | <u>\$ 37,512,591</u> |
| NONCASH TRANSACTIONS: | | |
| Joint Ventures | | |
| Nonoperating Income (Expense) | <u>\$ 736,860</u> | <u>\$ (4,719,095)</u> |

See accompanying notes to financial statements

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 1 – DEFINITION OF THE REPORTING ENTITY

The City of Santa Clara (the City), California's Electric Utility Enterprise Fund, which began operating as Silicon Valley Power (SVP) in 1999, commenced operations over 100 years ago in 1896. Originally, SVP constructed a lighting plant consisting of forty-six 2000 candlepower direct current lamps and a dynamo (a type of electric generator) which entered into service in October 1896. In late 1903, SVP invested \$5,000 to convert the system to alternating current and abandoned the small generating plant. Wholesale power was purchased from United Gas and Electric Company of San Jose.

Between 1903 and 1965, SVP purchased all of its electric power requirements from investor-owned utilities. In 1965, it received an allocation of power from the Federal Central Valley Project and began to diversify its resources. SVP became a charter member of the Northern California Power Agency (NCPA) in June 1968. Throughout the 1970's, SVP and NCPA worked on behalf of all municipal electric utilities in Northern California to gain access to wholesale transmission markets and to jointly develop cost-effective electric generation resources.

In 1980, SVP became a generating utility for the first time in 73 years with the start of operations of the 6-Megawatt Cogen No. 1 power plant. In 1983, the 110 Megawatt NCPA Geothermal Project, the first municipally owned and operated geothermal power plant in the United States, entered service with SVP as lead partner holding a 55% participation share. Subsequently, SVP participated in further jointly owned power generation projects including hydroelectric, natural gas and coal fired generation. In 2005, SVP placed the 147 Megawatt Don Von Raesfeld Power Plant into service.

Today, SVP has grown to approximately 8,103 streetlights and serves approximately 54,157 electric customers. As SVP looks to the future, it continues to be responsive to the electric market development by increasing its renewable power resources, reducing its greenhouse gas (GHG) footprint, and working with its customers to enhance the value they receive from municipal ownership of their electric utility.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

SVP's Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America. The Government Accounting Standards Board (GASB) is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the United States of America. The electric enterprise fund is included in the City's Comprehensive Annual Financial Report, and therefore, these financial statements do not purport to represent the financial position and changes in financial position of the City.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

B. Basis of Accounting

SVP reports its activities as a proprietary fund type (Enterprise Fund) which is maintained on the accrual basis of accounting wherein revenues are recognized in the accounting period in which they are earned regardless of whether they are received, and expenses are recognized in the period in which the related liabilities are incurred. Certain indirect costs are included in program expenses reported for individual functions and activities.

During the year ended June 30, 2016, SVP implemented the following GASB Statements:

The GASB issued Statement No. 72 *"Fair Value Measurement and Application."* The objective of this statement is to address accounting and financial reporting issues related to fair value measurements. This statement becomes effective for periods beginning after June 15, 2015. The adoption of this standard does not have an impact to SVP's financial statements.

The GASB issued Statement 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."* The objective of this statement is to address accounting and financial reporting issues related to pensions. This statement becomes effective for periods beginning after June 15, 2015. The adoption of this standard does not have an impact to SVP's financial statements.

The GASB issued Statement No. 76 *"The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments."* The objective of this statement is to modify the hierarchy of authoritative standards for accounting and reporting on governmental entities. This statement becomes effective for periods beginning after June 15, 2015. The adoption of this standard does not have an impact to SVP's financial statements.

The GASB issued Statement No. 79 *"Certain External Investment Pools and Pool Participants."* The objective of this statement is to address accounting and financial reporting for certain external investment pools and pool participants. This statement becomes effective for periods beginning after June 15, 2015. SVP has evaluated this pronouncement and noted it was not applicable to SVP since SVP is not electing to measure all its investments at amortized cost. The adoption of this standard does not have an impact to SVP's financial statements.

The GASB issued Statement No. 82 *"Pension Issues-An Amendment of GASB Statements No. 67, No. 68 and No. 73."* The objective of this statement is to address certain issues that have been raised with respect to Statement No. 67, *"Financial Reporting for Pension Plans"*, No. 68 *"Accounting and Financial Reporting For Pension Plans-An Amendment of GASB Statement No. 27."* 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*

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Statements 67 and 68.” This statement becomes effective for periods beginning after June 15, 2017. This standard was adopted for fiscal year ended June 30, 2016. The adoption of this standard does not have an impact to SVP’s financial statements.

SVP is analyzing the effects of the following pronouncements and plans to adopt them by the effective dates:

The GASB issued Statement No. 74 *“Financial Reporting for Postemployments Benefits Plans Other Than Pension Plans.”* The objective of this statement is to address the financial reports of defined benefits OPEB plans that are administered through trusts that meet specified criteria. This statement becomes effective for periods beginning after June 15, 2016. SVP is currently evaluating the impact on the financial statements.

The GASB issued Statement No. 75 *“Accounting and Financial Reporting for Postemployments Benefits Plans Other Than Pension Plans.”* The objective of this statement is to addresses reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. This statement becomes effective for periods beginning after June 15, 2017. SVP is currently evaluating the impact on the financial statements.

The GASB issued Statement No. 77 *“Tax Abatement Disclosures.”* The objective of this statement is to require governments that enter into tax abatement agreements to disclose specific information concerning the agreements. This statement becomes effective for periods beginning after December 15, 2015. SVP is currently evaluating the impact on the financial statements.

The GASB issued Statement No. 78 *“Pensions Provided Through Certain Multiple-Employer Defined Benefit Pension Plans.”* The objective of this statement is to address a practice issue regarding the scope and applicability of Statement No. 68 *“Accounting and Financial Reporting for Pensions.”* This statement becomes effective for periods beginning after December 15, 2015. SVP is currently evaluating the impact on the financial statements.

The GASB issued Statement No. 80 *“Blending Requirements for Certain Component Units-An Amendment of GASB Statement No. 14.”* The objective of this statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. This statement becomes effective for periods beginning after June 15, 2016. SVP is currently evaluating the impact on the financial statements.

The GASB issued Statement No. 81 *“Irrevocable Split-Interest Agreements.”* The objective of this statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which government is a beneficiary of the agreement. This statement becomes effective for periods

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

beginning after December 15, 2016. SVP is currently evaluating the impact on the financial statements.

C. Measurement Focus

Enterprise funds are accounted for on a cost of services or economic resources measurement focus, which means that all liabilities associated with the activity are included on their Statement of Net Position. Enterprise fund type operating statements present increases (revenues) and decreases (expenses) in total net position. Reported net position is segregated into three categories – net investment in capital assets, restricted, and unrestricted.

D. Cash and Investments

SVP's cash and investments pool is maintained by the City except for fiscal agent cash and investments.

While maintaining safety and liquidity, the City maximizes investment return by pooling its available cash for investment purposes. Unless there are specific legal or contractual requirements to do otherwise, interest earnings are apportioned among funds according to average monthly cash and investment balances. It is generally the City's intention to hold investments until maturity. City investments are stated at fair value (see Note 3).

Cash and cash equivalents for purposes of the statement of cash flows include pooled cash and investments and cash designated for construction. Transactions with City-wide cash management pools are similar to those with external investment pools; therefore, since pooled cash and investments have the same characteristics as demand deposits in that the City's individual funds and component units may withdraw additional monies at any time without prior notice or penalty, pooled cash and investments are considered essentially demand deposit accounts.

Cash and investments with fiscal agent, a bond reserve investment pool, and amounts classified as deposits are not considered cash and cash equivalents.

E. Due from City of Santa Clara

During the course of operations, transactions occur between SVP and the City for goods provided or services rendered. The related receivables, net, are classified as "Due from the City of Santa Clara" on the accompanying statement of net position.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

F. Inventory of Materials and Supplies

Inventory of materials and supplies is accounted for using the consumption method and is stated at average cost. Inventory consists of expendable supplies held for consumption by the electric utility.

G. Capital Assets

All capital assets with a value of \$5,000 or more with useful lives exceeding two years are capitalized. These assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Contributed capital assets are valued at their estimated fair value on the date contributed. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets (buildings and improvements: 20 to 50 years; and equipment: 3 to 25 years) and is charged as an expense against operations. Accumulated depreciation is reported on the statement of net position.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related capital assets.

Capital assets and the related obligations under lease/purchase agreements are capitalized and accounted for in accordance with Accounting Standards Codification (ASC) Topic 840. Interest is capitalized on construction in progress in accordance with ASC Topic 835, Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings, and Certain Gifts and Grants. Accordingly, interest capitalized is the total interest cost for the date of the borrowings net of any interest earned on temporary investments of the borrowed proceeds until the specified asset is ready for its intended use. There was no interest capitalized for the fiscal year ended June 30, 2016.

H. Joint Ventures

SVP participates in several joint ventures, and in accordance with GASB Statement No. 61, The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34, when appropriate. If SVP's equity in net losses of a joint venture exceeds its investments, use of the equity method is suspended except to the extent that SVP is obligated to provide further support or has guaranteed obligations of the joint venture.

SVP advances funds to certain of its joint ventures in the form of refundable advances, project advances, and operating and maintenance advances. Refundable advances accrue interest at rates stated in the related agreements. Operating, maintenance, and project advances are charged to operations when incurred.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Capitalized project costs are charged to operations in the event that a project is determined to be not economically feasible.

I. Compensated Absences

Amounts of vested or accumulated vacation leave and certain benefits that are not expected to be liquidated with expendable available financial resources are reported in the SVP financial statements as an expense and liability.

In accordance with the provisions of GASB Statement No. 16, Accounting for Compensated Absences, a liability for sick leave and benefits is accrued using the vesting method. The vesting method provides that a governmental entity estimate its accrued sick leave liability based on the sick leave accumulated at the statement of net position date by those employees who currently are eligible to receive termination payments as well as other employees who are expected to become eligible in the future to receive such payments. Estimated sick leave payments are recorded as an expense and liability by SVP.

J. Risk Management

SVP is covered under the City's self-insurance programs via Internal Service Funds. There are no significant reductions in insurance coverage from the prior year by major categories of risk and the amount of settlements did not exceed insurance coverage for the past three fiscal years. Additional information with respect to the City's self-insurance programs can be found in the City's Comprehensive Annual Financial Report (CAFR).

K. Electric Power Purchased

SVP purchases power from various suppliers and agencies (including joint powers agencies) for resale to its customers (see Note 9). SVP also engages in numerous wholesale power transactions with the objective of reducing its overall cost of purchased power. Gross wholesale power sales and wholesale power purchases are recorded as nonoperating revenue and expense, respectively (see Note 8).

L. Bond Discounts/Issuance Costs

Bond discounts are presented as a reduction of the face amount of bonds payable, whereas issuance costs are recognized in the current period.

M. Revenue Recognition

Operating revenues are recognized based on cycle billings periodically rendered to customers. Operating revenues for services provided, but not billed at the end of the fiscal year, are

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

recognized and accrued based on estimated consumption. Operating revenues primarily include the sales of electric power to residential, commercial, industrial, and municipal customers.

Non-operating revenues primarily represent wholesale resources sales, interest income, public benefit charge revenues, grants, rents, and other non-recurring miscellaneous income.

N. Taxes on Income

As an agency of the City, SVP falls under the review of the Internal Revenue Code Section 115 and corresponding California Revenue and Taxation Code provisions. As such, it is not subject to federal income or state franchise taxes.

O. Deferred Outflows/Inflows of Resources

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

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

P. Net Position and Fund Equity

SVP may fund certain programs with a combination of restricted and unrestricted net position. The policy is to first apply restricted net position followed by unrestricted net position if necessary.

Q. Use of Estimates

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 disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 3 – CASH AND INVESTMENTS

SVP's cash and investments pool is maintained by the City except for fiscal agent cash and investments. A full description of the City's cash and investment policy is in Note 7 of its Comprehensive Annual Financial Report (CAFR).

A. Investments Authorized by the California Government Code and the City's Investment Policy

The City's Investment Policy and the California Government Code allow the City to invest in certain types of investments, provided the credit ratings of the issuers are acceptable to the City. The table below also identifies certain provisions of the City's Investment Policy and the California Government Code that address interest rate risk, credit risk, and concentration of credit risk.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 3 – CASH AND INVESTMENTS (continued)

| <u>Authorized Investment Type</u> | <u>Maximum Maturity</u> | <u>Minimum Credit Quality</u> | <u>Maximum Percentage or Portfolio</u> | <u>Maximum Investment In One Issuer</u> |
|---|-----------------------------|---------------------------------------|--|---|
| U.S. Treasury Obligations | 5 years | Top three ratings categories | None | None |
| U.S. Agency Securities ⁽¹⁾ | 5 years | Top three ratings categories | None | None |
| Negotiable Certificates of Deposit | 5 years | N/A | 30% | None |
| Bankers Acceptances | 180 days | N/A | 40% | 30% |
| Commercial Paper | 270 days | A1 / P1 | 25% | 10% |
| California Local Agency Investment Fund | N/A | N/A | None | \$50M Per A/C |
| Repurchase Agreements | 1 year | N/A | None | None |
| Reverse Repurchase Agreements (requires City Council approval) | 92 days | N/A | None | None |
| Tax Exempt Municipal Bonds (for yield restriction purposes) | 5 years | N/A | None | None |
| Medium Term Corporate Notes | 5 years | Top three ratings categories | 15% | None |
| Mutual Funds | N/A | Top rating category | 20% | 10% |
| Investment Pools | N/A | Top rating category | 20% | 10% |

⁽¹⁾ Securities issued by the Federal Farm Credit Bank (FFCB), the Federal Home Loan Bank (FHLB), the Federal National Mortgage Association (FNMA), and the Federal Home Loan Mortgage Corporation (FHLMC).

B. Investments Authorized by Debt Agreements

The City invests bond proceeds restricted for construction in instruments that are stated in the Investment Policy and in various return-guaranteed investment agreements. These investments are invested in accordance with bond indentures and the maturities of each investment should not exceed the final maturity of each bond. Bond proceed investments are reported monthly to the City Council.

SVP also maintains 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

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 3 – CASH AND INVESTMENTS (continued)

pledged reserves to be used if the City fails to meet its obligations under these debt issues. The California Government Code 53601 (L) allows these funds to be invested in accordance with the statutory provisions governing the issuance of those bonds, indebtedness, other agreements, or certificates of participation in accordance with the ordinance, resolution, indenture, or agreement of the local agency providing for the issuance.

C. Credit and Interest Rate Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligations to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization.

Interest rate risk is the risk that changes in market interest rate will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment is the greater the sensitivity of its fair value to changes in market interest rates to be.

Information about the sensitivity of the fair values of SVP’s investments to market interest rate fluctuations is provided by the following table that shows the distribution to SVP’s investment by maturity.

| | Credit Rating | Carrying Amount |
|---------------------------------------|--------------------------|----------------------------|
| Investment held by fiscal agent: | | |
| Deposits held by Fiscal Agent | | \$ 327 |
| Mutual fund - Federated Prime | Aaam | 8,354,400 |
| Mutual fund - Dreyfus | Aaam | 15,010,438 |
| Total Investment held by fiscal agent | | 23,365,165 |
| Investments not rated: | | |
| Pooled Cash and Investments | | 227,274,391 |
| Deposits | | 6,560,076 |
| Total Cash and Investments | | \$ 257,199,632 |

The City is a participant 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 City 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 is available for withdrawal on demand, and is based on the accounting records maintained by LAIF, which are recorded on an

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 3 – CASH AND INVESTMENTS (continued)

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, floating rate securities issued by federal agencies, government-sponsored enterprises, United States Treasury Notes and Bills, and corporations. See City's Comprehensive Annual Financial Report Note 7 to the financial statements for additional detail on fiscal year 2015-16 investment portfolio.

Mutual funds are available for withdrawal on demand.

D. Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the City 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. Under California Government Code Section 53651, depending on specific types of eligible securities, a bank must deposit eligible securities posted as collateral with its Agent having a fair value of 105% to 150% of the City's cash on deposit. All of the City's deposits are either insured by the Federal Depository Insurance Corporation (FDIC) or collateralized with pledged securities held in the trust department of the financial institutions.

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 City will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The City's Investment Policy limits its exposure to custodial credit risk by requiring that all security transactions entered into by the City, including collateral for repurchase agreements, be conducted on a delivery-versus-payment basis. Securities are to be held by a third party custodian.

E. Fair Value Hierarchy

The City adopted GASB Statement No. 72, Fair Value Measurement and Applications, which required governmental entities to measure investments at fair value in fiscal year 2015-16. The City categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation input used to measure the fair value of asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. See City's Comprehensive Annual Financial Report Note 7 to the financial statements for more detailed information.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 3 – CASH AND INVESTMENTS (continued)

| | <u>Fair Value Measurements Using</u> | | | | |
|--|--|---|--|--|------------------------------|
| | Investments and Derivative Instruments Measured at Fair Value 6/30/2016 | Quoted Prices in Active Markets for Identical Assets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 | Exempt ⁽¹⁾ |
| Investments by Fair Value Level | | | | | |
| Short Term Investments | | | | | |
| Federal Farm Credit Banks | \$ 53,960,142 | \$ - | \$ 53,960,142 | \$ - | - |
| Federal Home Loan Banks | 14,086,759 | - | 14,086,759 | - | - |
| Federal National Mortgage Association | 50,814,923 | - | 50,814,923 | - | - |
| Federal Home Loan Mortgage Corp | 28,031,094 | - | 28,031,094 | - | - |
| Mutual Fund - Fidelity Money Market | 13,434,940 | - | 13,434,940 | - | - |
| Total Short Term Investments | <u>160,327,858</u> | <u>-</u> | <u>160,327,858</u> | <u>-</u> | <u>-</u> |
| Debt Securities and Other | | | | | |
| Mutual Fund - Money Market Funds (Debt Fund) | 23,365,165 | - | - | - | 23,365,165 |
| Collateral Obligations (JP Morgan & Other) | 6,560,076 | - | - | - | 6,560,076 |
| Total Debt Securities and Other | <u>29,925,241</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>29,925,241</u> |
| Total Investment by Fair Value Level | <u>190,253,099</u> | <u>\$ -</u> | <u>\$ 160,327,858</u> | <u>\$ -</u> | <u>\$ 29,925,241</u> |
| Investments Measured at the Net Asset Value (NAV) | | | | | |
| State Investment Pool (LAIF) | 16,567,362 | | | | |
| Cash in Banks | <u>50,379,171</u> | | | | |
| Total Cash and Investment | <u>\$ 257,199,632</u> | | | | |
| Investments Derivative Instruments | | | | | |
| Interest rate swap | \$ 10,366,115 | \$ 10,366,115 | | | |
| Total Investment Derivative Instruments | <u>\$ 10,366,115</u> | <u>\$ 10,366,115</u> | | | |

⁽¹⁾ Accounts in exempt column are Money Market accounts which are exempt from GASB 72 fair value categorization

The City utilizes a third party pricing service to determine fair market prices for its individually held investments. Evaluations are based on market information available at the time and generated using proprietary evaluated pricing models and methodologies.

Derivative instruments classified as Level 2 on the fair value hierarchy are valued using the zero-coupon method. This method calculates the future net settlement payments required by the

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 3 – CASH AND INVESTMENTS (continued)

derivative, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the derivative. To measure non-performance risk for a derivative liability, the third party, HedgeStar, uses credit spreads implied by the credit rating for debt issues by entities with similar credit characteristics. This is the best method available under current market conditions since the City has no credit default swaps that actively trade in the marketplace. For a derivative asset, HedgeStar determines the adjustment for non-performance risk of counterparties by analyzing counterparty-specific credit default swaps, if available. If not available, HedgeStar uses credit default swaps in the market for entities of similar type and rating with information found in various public and private information services.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 4 – CAPITAL ASSETS

A. Capital Assets Summary

| | <u>Balance</u> <u>June 30, 2015</u> | <u>Additions</u> | <u>Retirements</u> | <u>Transfers</u> | <u>Balance</u> <u>June 30, 2016</u> |
|---|--|----------------------|--------------------|-----------------------|--|
| Non Depreciable Assets: | | | | | |
| Land | \$ 22,872,234 | \$ - | \$ - | \$ - | \$ 22,872,234 |
| Construction In Progress | 41,224,610 | 38,385,994 | - | (8,798,482) | 70,812,122 |
| Total Non Depreciable Assets | <u>64,096,844</u> | <u>38,385,994</u> | <u>-</u> | <u>(8,798,482)</u> | <u>93,684,356</u> |
| Capital assets being depreciated: | | | | | |
| Buildings and Improvements | 861,953,802 | 8,798,482 | - | | 870,752,284 |
| Machinery & Equipment | 10,416,267 | 334,730 | (1,056,855) | | 9,694,142 |
| Total capital assets being depreciated | <u>872,370,069</u> | <u>9,133,212</u> | <u>(1,056,855)</u> | <u>-</u> | <u>880,446,426</u> |
| Less accumulated depreciation for: | | | | | |
| Buildings and Improvements | (368,598,429) | (19,338,512) | | - | (387,936,941) |
| Machinery & Equipment | (8,235,058) | (617,754) | 1,046,968 | - | (7,805,844) |
| Total accumulated depreciation | <u>(376,833,487)</u> | <u>(19,956,266)</u> | <u>1,046,968</u> | <u>-</u> | <u>(395,742,785)</u> |
| Net Depreciable Assets | <u>495,536,582</u> | <u>(10,823,054)</u> | <u>(9,887)</u> | <u>-</u> | <u>484,703,641</u> |
| Enterprise Activity Capital Assets, Net | <u>\$ 559,633,426</u> | <u>\$ 27,562,940</u> | <u>\$ (9,887)</u> | <u>\$ (8,798,482)</u> | <u>\$ 578,387,997</u> |

B. Construction in Progress

Construction in progress as of June 30, 2016 consisted of the following in Electric Projects.

| <u>Enterprise Fund Projects</u> | <u>Authorized</u> | <u>Expended</u> | <u>Commitments</u> |
|---------------------------------|-------------------|-----------------|--------------------|
| Electric Projects | \$ 115,895,254 | \$ 70,812,122 | \$ 45,083,132 |

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 5 – LONG-TERM DEBT AND DERIVATIVE INSTRUMENTS

Changes in long-term debt for the year ended June 30, 2016, consisted of the following:

| Type of Indebtedness Rate, Issue Date and Maturity | Outstanding as of June 30, 2015 | Debt Retired / Defeased | Additions and Amortization of Discounts | Outstanding as of June 30, 2016 | Current Portion |
|--|--|--|--|--|----------------------------|
| 2008 Series B Subordinate Revenue Bonds, Adjustable rate, 05/29/08-07/01/27 | \$ 71,880,000 | \$ 3,975,000 | \$ - | \$ 67,905,000 | \$ 4,200,000 |
| 2011 Series A Refunding Revenue Bonds, 5%-6% 03/22/11-07/01/32 | 54,830,000 | - | - | 54,830,000 | - |
| 2013 Series A Refunding Revenue Bonds 3%-5%, 04/24/13-07/01/28 | 61,655,000 | 3,305,000 | - | 58,350,000 | 3,440,000 |
| Unamortized Discount/Premium | 7,310,149 | - | 567,577 | 6,742,572 | |
| Subtotal Electric Utility Revenue Bonds | 195,675,149 | 7,280,000 | 567,577 | 187,827,572 | 7,640,000 |
| Bank of America Loan Agreement 2.67%, 06/16/14-07/01/2024 | 31,153,136 | 1,678,030 | 415,894 | 29,891,000 | - |
| Total Electric Utility Activities - Bonds and Loan Payable | \$ 226,828,285 | \$ 8,958,030 | \$ 983,471 | \$ 217,718,572 | \$ 7,640,000 |

A. Electric Revenue Refunding Bonds, 2008 Series B

On May 29, 2008, SVP issued \$86.6 million of Variable Rate Demand Subordinated Electric Revenue Bonds, Series 2008B (Electric 2008B Bonds) to refinance \$80.53 million of Electric 1998A Bonds on July 1, 2008. The Electric 2008B Bonds mature annually beginning July 1, 2009 through July 1, 2027. The Electric 2008B Bonds are variable-rate, multi-modal bonds that were initially issued in the weekly mode. Payment of principal and interest on the Electric 2008B Bonds was originally made from proceeds of draws on a Letter of Credit originally provided by Dexia Credit Local. On May 11, 2011, the Letter of Credit provided by Dexia was replaced by a Letter of Credit provided by Bank of America, N.A. In connection therewith, the name of the bonds was changed from “Subordinated Electric Revenue Refunding Bonds” to “Electric Revenue Refunding Bonds” to reflect that all senior electric revenue bonds of Silicon Valley Power had been retired. On November 1, 2012, the Letter of Credit provided by Bank of America, N.A. was replaced by a Letter of Credit provided by The Bank of Tokyo-Mitsubishi UFJ, Ltd with expiration date of October 30, 2018. The Electric 2008B Bonds are in a weekly mode and debt service is secured by a pledge of net revenues of the Electric Utility Enterprise Fund.

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(SILICON VALLEY POWER)
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NOTE 5 – LONG-TERM DEBT AND DERIVATIVE INSTRUMENTS (continued)

B. Electric Revenue Refunding Bonds, 2011 Series A

On March 22, 2011, SVP issued \$54.83 million of Electric Revenue Refunding Bonds, Series 2011A (Electric 2011A Bonds) to refinance \$49.66 million outstanding principal amount of Electric 2008A Bonds. The Electric 2011A Bonds mature annually beginning on July 1, 2028 through July 1, 2032 and bear coupon rates ranging from 5.00% to 6.00%. Debt service on the Electric 2011A Bonds is secured by a pledge of net revenues of the Electric Utility Enterprise Fund.

C. Electric Revenue Refunding Bonds, 2013 Series A

On April 24, 2013, SVP issued \$64.38 million of the Electric Revenue Bonds, Series 2013A (Electric 2013A Bonds), to provide funds, together with other available moneys, to refinance outstanding Electric 2003A Bonds. The Electric 2013A Bonds mature annually beginning on July 1, 2014 through July 1, 2028 and bear coupon rates ranging from 3.00% to 5.00%. Debt service on the Electric 2013A Bonds is secured by a pledge of net revenues of the Electric Utility Enterprise Fund.

D. Bank of America Loan Agreement, Series 2014

On June 16, 2014, Silicon Valley Power (SVP) entered into a Tax-Exempt Multiple Draw Term Loan with the Bank of America Preferred Funding Corporation (the “Electric 2014 Loan Agreement”) to fund the phase-shifting transformer project and the acquisition of property for future utility use. The loan is a tax-exempt multiple draw term loan that allows SVP to draw funds as needed. The first draw occurred on June 16, 2014 for approximately \$24.4 million, which includes \$15.8 million for the Phase Shifting Transformer engineering, equipment purchase, and initial construction activities and \$8.5 million for the land purchase. The second draw occurred on April 15, 2015 for \$6.0 million to cover the construction and commissioning of the Phase Shifting Transformer. The loan terms allow the City to capitalize interest for up to two years in amount of \$1,134,031 with the initial loan payment due July 1, 2016. The loan carries an interest rate of 2.67% and the final payment is due on July 1, 2024. Debt service on the Electric 2014 Loan Agreement is secured by a pledge of net revenues of the Electric Utility Enterprise Fund on a basis subordinate to the outstanding Electric Revenue Bonds.

E. Pledges of Future Electric Revenues

The pledge of future Electric Fund revenues ends upon repayment of the \$211.0 million in remaining debt service on the bonds which is scheduled to occur in fiscal year 2032-33. For fiscal year 2015-16, Electric Fund revenues including operating revenues and non-operating interest earnings amounted to \$359.1 million and operating costs including operating expenses, but not interest, depreciation or amortizations amounted to \$316.6 million. Net revenues

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NOTE 5 – LONG-TERM DEBT AND DERIVATIVE INSTRUMENTS (continued)

available for debt service amounted to \$42.5 million which represented coverage ratio of 2.38 over the \$17.8 million in debt service.

F. Derivative Instruments

In fiscal year 2009-10, SVP implemented GASB Statement No. 53, which addresses recognition, measurement and disclosures related to derivative instruments to determine whether they meet the definition of derivative instruments, and if so, whether they effectively hedge the expected cash flows associated with the interest rate and energy exposures. Under hedge accounting, the increase (decrease) in the fair value of a hedge is reported as a deferred cash flow hedge on the statement of net position. For the reporting period, all of SVP’s derivatives meet the hedge effectiveness tests under GASB Statement No. 53.

Interest Rate Swap Agreements-2008 Series B Bonds

Pursuant to the Interest Rate Hedging Policy adopted by the City Council in 2006, as a means to lower borrowing costs, the City has a variable-to-fixed interest rate Swap Agreement with JPMorgan Chase related to the Electric 2008 Series B bonds. Under the Swap Agreement, SVP is obligated to make payments to the Swap Provider calculated on the basis of a fixed rate of 3.47% and receives from the Swap Provider payments equal to 65% of the one month London InterBank Offering Rate (LIBOR). SVP’s obligation to make any net regularly scheduled payments due to the Swap Provider under the Swap Agreement is payable from net revenues of the electric system on a parity with its other outstanding electric bonds. The effective date of the swap was May 29, 2008 and the scheduled termination date is July 1, 2027.

| | Notional Amount (000's) | City Pays Fixed Rate to Counterparty | City Receives Floating Rate From Counterparty 6/30/2016 | City Pays Variable Rate on Bond 6/30/2016 |
|---------------|-------------------------------|--|---|---|
| 2008 Series B | \$65,030 | 3.47% | Weekly Mode - 65% of LIBOR=0.29446% | Weekly Mode - SIFMA=0.41% |

The swap is classified as a debt instrument and had negative fair values of \$10,366,115 including accrued interest as of June 30, 2016, and \$9,166,517 as of June 30, 2015, resulting in a deferred outflow change of \$1,199,598 from June 30, 2015. The swap is classified as a deferred outflow of resources and derivative financial instrument on the statement of net position. The fair values of the derivative were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the derivative, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. The standard applied to the valuation of the derivative is fair value as defined in GASB Statement No. 72. Fair value is the price that would be received to sell the asset (exit price) or transfer a liability in a

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NOTE 5 – LONG-TERM DEBT AND DERIVATIVE INSTRUMENTS (continued)

hypothetical transaction under orderly market conditions between informed market participants on the valuation date. As of June 30, 2016, the fair value of the interest rate swap of \$10,199,760 along with accrued interest of \$166,355 are classified in level 2 of the fair value hierarchy.

Rollover Risk

SVP is exposed to rollover risk on hedging derivative instruments that are hedges of debt because SVP can terminate the interest rate swap prior to the maturity of the bond. The risk if the swap is terminated will be to re-expose SVP to the risks being hedged by the interest rate swap. SVP currently has no plans to terminate the swap prior to maturity in 2027.

Interest Rate/Basis Risk

SVP is exposed to interest rate risk on its swap agreement. SVP's net payment on the swap increases as the LIBOR swap index decreases. With respect to basis risk, under the swap, the City receives 65% of LIBOR and pays the Securities Industry and Financial Markets Association (SIFMA) rate to bondholders of the City's 2008B bonds. The basis risk is the difference between the two rates. As of June 30, 2016, 65% of the weighted average on weekly mode LIBOR was 0.29446% and the SIFMA rate was 0.41%. Using rates as of June 30, 2016, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their term, were as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

| Year Ending June 30 | Variable-Rate Bond | | Interest Rate Swaps, Net | Total |
|--------------------------------|---------------------------|---------------------|-------------------------------------|----------------------|
| | Principal | Interest | | |
| 2017 | 4,200,000 | 278,411 | 2,156,350 | 6,634,761 |
| 2018 | 4,440,000 | 261,191 | 2,022,978 | 6,724,169 |
| 2019 | 4,685,000 | 242,987 | 1,881,984 | 6,809,971 |
| 2020 | 4,945,000 | 223,778 | 1,733,210 | 6,901,988 |
| 2021 | 5,215,000 | 203,504 | 1,576,179 | 6,994,683 |
| 2022-2026 | 30,405,000 | 672,872 | 5,211,537 | 36,289,409 |
| 2027-2028 | 14,015,000 | 86,777 | 672,103 | 14,773,880 |
| | <u>\$ 67,905,000</u> | <u>\$ 1,969,520</u> | <u>\$ 15,254,341</u> | <u>\$ 85,128,861</u> |

Compliance

Various debt agreements governing the Enterprise Funds' revenue bonds contain a number of covenants, including those that require the City to maintain and preserve the respective enterprise in good repair and working order, to maintain certain levels of insurance and to fix and collect rates, fees and charges so as to maintain certain debt coverage ratios. The City is in compliance

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
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For the years ended June 30, 2016 and 2015

NOTE 5 – LONG-TERM DEBT AND DERIVATIVE INSTRUMENTS (continued)

with these specific covenants and all other material covenants governing the particular revenue bond issues. No event of default as defined in the bond indentures has occurred or is occurring.

Notional Amounts and Fair Values

SVP maintains a Market Risk Management Policy, which among other things, sets forth the guidelines for the purchase and sale of certain financial instruments defined as hedge instruments in support of market power purchase transactions. The primary goal of these guidelines is to provide a framework for the operation of an energy price hedging program to better manage SVP's risk exposure in order to stabilize pricing and costs for the benefit of SVP and its customers.

Consistent with hedge accounting treatment meeting effectiveness tests, changes in fair value are reported as deferred flows of resources on the statement of net position until the contract expiration that occurs in conjunction with the hedged expected energy purchase transaction. When hedging contracts expire, at the time the purchase transactions occur, the deferred balance is recorded as a component of Purchased Power. For energy derivatives, fair values are estimated by comparing contract prices to forward market prices quoted by third party market participants.

SVP had no future derivative instruments outstanding at June 30, 2016.

Credit Risk

Credit risk is the risk of loss due to a counterparty defaulting on its obligations. SVP is exposed to credit risk if hedging instruments are in asset positions. As of June 30, 2016, SVP was not exposed to credit risk because there were no open derivative contracts, and the fair market value of the swap was negative. The swap and open contract counterparties were rated A and BBB-, respectively, by S&P at June 30, 2016.

SVP's policy for requiring collateral on hedging instruments varies based on individual contracts and counterparty credit ratings. Under the interest rate swap agreement, collateral is required based on the counterparty rating and dollar threshold on the mark-to-market value of the swap. Under the trading agreements with Merrill Lynch, Bache Commodities, SG America Securities, and Archer Daniels Midland Company, the trading accounts are prefunded by SVP. If the account value falls below zero, margin calls are invoked. At June 30, 2016, SVP had posted collateral of \$5,743,916 on the interest rate swap and \$816,160 was deposited with Merrill Lynch, CAISO, Bache Commodities, and Archer Daniels Midland Company for wholesale trading. At June 30, 2016, no margin calls were paid to Bache Commodities on the outstanding future derivative instruments.

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NOTE 5 – LONG-TERM DEBT AND DERIVATIVE INSTRUMENTS (continued)

It is also SVP's policy to negotiate netting arrangements whenever it has entered into more than one derivative instrument transaction with a counterparty. Under the terms of these arrangements, should one party become insolvent or otherwise default on its obligations, the non-defaulting party may accelerate and terminate all outstanding transactions and net their fair values so that a single amount will be owed by (or to) the non-defaulting party. At June 30, 2016 SVP had various derivative instrument purchase contracts with Bache Commodities.

Termination Risk

The swap may be terminated by SVP at any time. If the swap is terminated, SVP may be required to make a termination payment to the Swap Provider if the swap had a negative fair market value. The cost to terminate would be the fair value of the swap at the time of termination. Any such termination payment owed by SVP would be payable from net revenues of the electric system subordinate to SVP's outstanding electric revenue bonds. If the swap had a positive fair market value, the Swap Provider would be required to make a termination payment to SVP. Futures contracts are traded over the counter and have no termination risks.

Price Risk

With respect to price risk under these future contracts, SVP receives the CAISO NP15 average daily rate at settlement and pays the fixed contracted rate entered into on the trade date. SVP is exposed to risk because the commodity purchase price being hedged is different from the price on settlement.

G. Other

Various debt agreements governing SVP's revenue bonds contain a number of covenants including those that require SVP to maintain and preserve the enterprise in good repair and working order, to maintain certain levels of insurance, and to fix and collect rates, fees, and charges so as to maintain certain debt coverage ratios. SVP is in compliance with these specific covenants and all other material covenants governing the particular revenue bond issues. No event of default as defined in the bond indentures has occurred or was occurring as of the date of this report.

H. Repayment Requirements

As of June 30, 2016, the debt service requirements to maturity for SVP's long-term debt are as follows:

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(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 5 – LONG-TERM DEBT AND DERIVATIVE INSTRUMENTS (continued)

| Year Ending | Long-term Debt Future Debt Service Requirements | | |
|-------------|--|-------------------------|-----------------------|
| | Principal ⁽¹⁾ | Interest ⁽²⁾ | Total |
| June 30 | | | |
| 2017 | \$7,640,000 | \$6,137,687 | \$ 13,777,687 |
| 2018 | 11,416,000 | 6,351,008 | 17,767,008 |
| 2019 | 11,897,000 | 6,076,283 | 17,973,283 |
| 2020 | 12,440,000 | 5,771,846 | 18,211,846 |
| 2021 | 13,011,000 | 5,453,946 | 18,464,946 |
| 2022-2026 | 69,877,000 | 22,157,122 | 92,034,122 |
| 2027-2031 | 58,465,000 | 13,908,967 | 72,373,967 |
| 2032-2033 | 26,230,000 | 1,444,294 | 27,674,294 |
| | <u>\$ 210,976,000</u> | <u>\$ 67,301,153</u> | <u>\$ 278,277,153</u> |

⁽¹⁾ The second Bank of America, Series 2014 loan draw in the amount of \$6,000,000 on April 15, 2015 and capitalized interest of \$718,136 and \$415,895 in 2014-15 and 2015-16 are included in the principal of future debt service requirements.

⁽²⁾ Interest on the 2008 Series B Bonds is estimated using current rate at June 30, 2016.

Reconciliation of Long-term Debt:

| | |
|---|-----------------------|
| Principal Outstanding As Of June 30, 2016 | \$ 210,976,000 |
| Unamortized Discount/Premium - Electric Revenue Bonds | 6,742,572 |
| Total Long-term Debt | <u>\$ 217,718,572</u> |

I. Defeasances

There is no defeased debt for the SVP as of June 30, 2016.

NOTE 6 – PARTICIPATION IN JOINT VENTURES

A. Investment in Joint Ventures

SVP (through the City) participates in significant joint ventures: Northern California Power Agency (NCPA), Transmission Agency of Northern California (TANC), M-S-R Public Power Agency (MSR PPA), M-S-R Energy Authority (MSR EA).

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NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

The separately issued financial statements of these joint ventures (as noted below) are available on request.

| | Date of latest audited financial statement | Joint venture's address |
|---------|---|--------------------------------------|
| NCPA | 6/30/2015 | 651 Commerce Dr. Roseville, CA 95678 |
| TANC | 6/30/2015 | P.O. Box 15129 Sacramento, CA 95851 |
| MSR EA | 12/31/2015 | P.O. Box 4060 Modesto, CA 95352 |
| MSR PPA | 12/31/2015 | P.O. Box 4060 Modesto, CA 95352 |

As described in paragraph (D) below, the carrying value of SVP's investment in MSR PPA is \$0. SVP's financial statements reflect the following investments in joint ventures as of June 30, 2015:

| | Participating percentage | Investment | Method of accounting |
|--------------------|-----------------------------|--------------|----------------------|
| NCPA | | | |
| Geothermal | 44.39% | \$33,856,612 | Equity |
| Hydroelectric | 37.02% | | |
| Combustion Turbine | 41.67% | | |
| Lodi Energy Center | 25.75% | | |
| TANC | 9.72% | 1,462,011 | Equity |
| MSR EA | 33.40% | - | Suspended |
| MSR PPA | 35.00% | - | Suspended |

B. Northern California Power Agency (NCPA)

NCPA was formed in 1968 as a joint powers agency in the State of California. Its membership consists of fifteen public agencies. NCPA is generally empowered to purchase, generate, transmit, distribute and sell electrical energy. Members participate in the projects of NCPA on an elective basis. Therefore, the participation percentage varies for each project in which it participates.

A Commission comprised of one representative from each joint venture member governs NCPA. The Commission is responsible for the general management of the affairs, property, and business of NCPA. Under the direction of the General Manager, the staff of NCPA is responsible for

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NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

providing various administrative, operating and planning services for NCPA and its associated power corporations.

Project Financing and Construction

NCPA's project construction and development programs have been individually financed by project revenue bonds collateralized by NCPA's assignment of all payments, revenues and proceeds associated with its interest in each project. Each project participant has agreed to pay its proportionate share of debt service and other costs of the related project, notwithstanding the suspension, interruption, interference, reduction or curtailment of output from the project for any reason. Certain of the revenue bonds are additionally supported by municipal bond insurance credit enhancements.

Hydroelectric Project

NCPA contracted to finance, manage, construct, and operate Hydroelectric Project Number One for the licensed owner, Calaveras County Water District (CCWD). In exchange, NCPA has the right to the electric output of the project for 50 years from February 1982. NCPA also has an option to purchase power from the project in excess of the CCWD's requirements for the subsequent 50 years, subject to regulatory approval.

Geothermal Project

The NCPA Geothermal Plants have historically experienced greater than anticipated declines in steam production from the existing geothermal wells. Although initially operated as baseload generation projects at full capability (238MW), NCPA changed its steam field production from baseload to load-following and reduced average annual steam production. Along with other steam field operators in the area, the Agency began implementing various operating strategies to further reduce the rate of decline in steam production. The Agency has modified both steam turbine units and the associated steam collection system to enable generation with lower pressure steam at higher mass-flow rates to optimize the utilization of the available steam resource.

Based upon current operation protocols and forecasted operations, NCPA expects average annual generation and peak capacity to decrease further, reaching approximately 60 MWG by the year 2036.

Combustion Turbine Project No. 1

NCPA owns three dual (natural gas and fuel oil) combustion turbine units, each of which is nominally rated at 25 MW, which are collectively known as the Combustion Turbine Project No. 1. These units were completed in 1986 and are designed to provide peak power and reserve requirements and emergency support. Each purchaser is responsible under its power sales

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NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

contract for paying entitlement share in Combustion Turbine Project No. 1 of all NCPA's costs of such project.

Lodi Energy Center

On May 24, 2010, SVP entered into an agreement with NCPA for a 25.75% interest in the the Lodi Energy Center, a 280 MW combined cycle natural gas fired power plant, located in Lodi, California. The project received approval from the California Energy Commission in April 2010 and was placed into operation in November 2012.

C. Transmission Agency of Northern California (TANC)

TANC was organized under the California Government Code pursuant to a joint powers agreement entered into by 15 Northern California utilities. The purpose of TANC is to provide electric transmission or other facilities for the use of its members through its authority to plan, acquire, construct, finance, operate and maintain facilities for electric power transmission. The joint powers agreement provides that the costs of TANC's activities can be financed or recovered through assessment of its members or from user charges through transmission contracts with its members. Each TANC member has agreed to pay a pro-rata share of the costs to operate TANC and for payment of debt service, and has the right to participate in future project agreements.

The joint powers agreement remains in effect until all debt obligations and interest thereon have been paid, unless otherwise extended by the members.

California-Oregon Transmission Project

TANC is a participant and also the Project Manager of the California-Oregon Transmission Project (Project), a 340 mile long, 500 kilovolt alternating current transmission project between Southern Oregon and Central California. As Project Manager, TANC is responsible for the overall direction and coordination of all Project operations and maintenance, additions and betterments, and for general and administrative support.

The Project was declared commercially operable on March 24, 1993, with a rated transfer capability of 1,600 megawatts and provides a third transmission path between the electric systems of the Pacific Northwest and those in California. The Project has successfully met and completed all major environmental requirements. As of June 30, 2015, the most recent data available, TANC's investment in the Project was \$510.4 million, less accumulated depreciation and amortization of \$239.4 million.

In connection with its participation in the Project, TANC has an entitlement balance of the Project's transfer capability of approximately 1,362 megawatts and is obligated to pay an average of approximately 80 percent of the operating costs associated with the Project. TANC

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NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

incurred and initially capitalized all costs for project construction since they were expected to be recovered through reimbursement from Project participants and from the successful operations of the Project transmission lines. The Project agreement among the participating members provides that each member agrees to make payments, from its revenues, to TANC for project costs incurred and for payment of debt service.

SVP has historically been obligated to pay 20.47% of TANC's COTP operating and maintenance expenses and 20.70% of TANC's COTP debt service and 22.16% of the Vernon acquisition debt. SVP has also been entitled to 20.4745% of TANC's share of COTP transfer capability (approximately 278 MW net of third party layoffs of TANC) on an unconditional take-or-pay basis. Starting on July 1, 2014, SVP laid-off 147 MWs of this entitlement to other TANC members under a 25 year agreement. During the term of this agreement the parties taking on the entitlement will pay all associated debt service, operations and maintenance costs, and all administrative and general costs. SVP's portion of the operating and maintenance expenses and the COTP debt service is 10.003 %.

D. M-S-R Public Power Agency (MSR PPA)

MSR PPA is a joint power agency formed in 1980 by the Modesto Irrigation District, the City of Santa Clara, and the City of Redding, California, to develop or acquire and manage electric power resources for the benefit of the members. The personnel of its members and contract professional staff perform the administrative and management functions of MSR PPA. The member's income and expenses sharing ratio is as follows: Modesto Irrigation District – 50 percent, City of Santa Clara – 35 percent, and City of Redding – 15 percent.

SVP's equity in MSR PPA's net losses exceeds its investments and, therefore, the equity method of accounting for the investment has been suspended. As of December 31, 2015, the date of the latest available audited financial statements, SVP's unrecognized share of member's deficit of MSR PPA was \$16.9 million. Under the joint exercise of power agreement, which formed MSR PPA, SVP is responsible for funding up to 35 percent of MSR PPA's operating cost, to the extent such funding is necessary. During the year ended June 30, 2015, SVP made no contributions to fund its share of operating deficits. If there were such contributions, they would be included in the Electric Utility Enterprise Fund expenses.

MSR PPA's principal activity is a 28.8 percent ownership interest in a 507-megawatt unit of a coal-fired electricity generating plant located in New Mexico (San Juan Plant). The acquisition of such ownership interest was funded through the issuance of revenue bonds, secured by a pledge and assignment of the net electric revenues of MSR PPA and supported by take-or-pay commitments of the equity participants. MSR PPA was also a participant in the Southwest Transmission Project, a 500-kilovolt alternating current transmission project between Central Arizona and Southern California that provided a firm transmission path for the electric power

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NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

from the San Juan Plant to the M-S-R PPA members. The Southwest Transmission Project was completed and placed in service in April 1996.

In accordance with an agreement with the Tucson Electric Power Company (TEP), MSR PPA has the right to certain levels of power transmission without charge and without transmission losses between the San Juan Plant in New Mexico and Palo Verde, Arizona through 2025. These rights are being utilized in connection with the delivery of power from the San Juan Plant to the members or to third party purchasers.

On June 1, 2005, M-S-R PPA entered into a series of agreements with PPM Energy (as amended in October 2005 and restated effective February 1, 2006; PPM Energy is now Avangrid Renewable Holdings, Inc.) to purchase wind power energy from Big Horn I with nominal installed capacity of approximately 199.5 MW and an expected annual capacity factor of about 35%, as firmed, shaped, and delivered to the California-Oregon Border for a twenty-year period. The deliveries for the wind power began in 2006. The participation in this project is as follows:

| | |
|-----------------------------|-------|
| Modesto Irrigation District | 12.5% |
| City of Santa Clara | 52.5% |
| City of Redding | 35.0% |

M-S-R PPA San Juan

M-S-R PPA has negotiated with the other joint owners of San Juan Unit 4 and entered into a series of agreement wherein M-S-R PPA will divest itself of its Ownership Interest at or around the end of 2017. On July 22, 2015, through Resolution 2015-02, the M-S-R PPA approved the San Juan Restructuring Agreements, made a determination that these agreements were exempt from CEQA review, approved the Restructuring Agreements and accepted the Consultant's Report finding that entering the Restructuring Agreements does not impair the ability of the Agency to comply with the Indenture. These agreements became effective January 31, 2016.

M-S-R PPA Southwest Transmission Project

M-S-R PPA has also developed and issued a Request for Proposals for the Southwest Transmission Project. It received proposals from four qualified entities for purchase of the SWTP and concluded the proposal made by LADWP to acquire M-S-R PPA's interests in the SWTP through SCPPA for a sum of \$60 million offered the greatest potential value to the Agency and its Members. LADWP proposed that the transaction be structured so that SCPPA will purchase the SWTP and LADWP, as the sole SCPPA participant in such project enter into a long-term Transmission Services Agreement to secure SCPPA's financing. LADWP's commitments will provide the security for Revenue Bonds to be sold by SCPPA to finance their

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NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

purchase of the SWTP. The sale closed May 25, 2016. M-S-R PPA Members currently use more economic alternative delivery means for San Juan Project energy.

On December 9, 2009, MSR PPA entered into a series of agreements with Avangrid Renewables Inc. to purchase additional wind power energy from the same site, called Big Horn II, with a nominal installed capacity of 50 MW and an expected capacity factor of about 35%, as firm, shaped, and delivered to the California-Oregon Border (COB) for a twenty-year period. Deliveries of energy under this project began on November 1, 2010. The participation in this project is as follows: Modesto Irrigation District – 65%; City of Santa Clara – 35%.

E. M-S-R Energy Authority (M-S-R EA)

MSR EA is a joint power agency formed in 2008 by the Modesto Irrigation District, the City of Santa Clara, and the City of Redding, California, to develop or acquire and manage natural gas resources for the benefit of the members. The personnel of its members and contract professional staff perform the administrative and management functions of MSR EA. Each member's income and expense sharing ratio is as follows: Modesto Irrigation District – 33.3%; City of Santa Clara – 33.4%; and City of Redding – 33.3%.

SVP's equity in MSR EA's net losses exceeds its investment and, therefore, the equity method of accounting for the investment has been suspended. As of December 31, 2015, the date of the latest available audited financial statements, SVP's unrecognized share of member's deficit of MSR EA was \$27.2 million. Under the joint exercise of power agreement, which formed MSR EA, SVP is responsible for funding up to 33.4% of MSR EA's operating cost, to the extent such funding is necessary. During the year ended June 30, 2015, SVP made no contributions to fund its share of operating deficits. If there were such contributions, they would be included in the Electric Utility Enterprise Fund expenses.

In 2009, the City of Santa Clara, along with the Cities of Modesto and Redding participated in the M-S-R Energy Authority Gas Prepay Project. The Gas Prepay Project provides the City, through a Gas Supply Agreement with M-S-R EA dated September 10, 2009, a secure and long-term supply of natural gas of 7,500 MM Btu (Million British thermal unit) daily or 2,730,500 MM Btu annually through December 31, 2012, and 12,500 MM Btu daily, or 4,562,500 MM Btu annually thereafter until September 30, 2039. The agreement provides this supply at a discounted price below the spot market price (the Pacific Gas & Electric City gate index) over the next 30 years. As of December 31, 2015, bonds issued by MSR EA to finance the City's share of the Gas Prepay Project were outstanding in the principal amount of \$500,200,000. These bonds were initially sold on August 27, 2009. Under the Gas Supply Agreement, MSR EA will bill the City for actual quantities of natural gas delivered each month on a "take-and-pay" basis. MSR EA has contracted with Citigroup Energy, Inc. ("CEI") to use the proceeds of the Gas Prepay bond issue to prepay CEI for natural gas. CEI has guaranteed repayment of the bonds,

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NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

and responsibility for bond repayment is non-recourse to the City. Moreover, any default by the other Gas Prepay Project participants is also non-recourse to the City.

F. Contingent Liability

Under the terms of the various joint venture agreements, SVP is contingently liable for a portion of the long-term debt of the entities under take-or-pay agreements, letters of credit, guarantees or other similar agreements.

Based on the most recent audited financial statements of the individual joint ventures, SVP was contingently liable for long-term debt as of June 30, 2015 as follows:

| Agreements | Total Debt | Silicon Valley Power's Debt Share | Silicon Valley Power's Contingent Liability |
|------------------|-------------------------|--------------------------------------|--|
| NCPA 06/30/15 | \$ 852,551,000 | 32.32% | \$ 275,559,000 |
| TANC 06/30/15 | 283,950,000 | 9.81% | 27,863,000 |
| MSR PPA 12/31/15 | 234,335,000 | 35.00% | 82,017,000 |
| MSR EA 12/31/15 | 901,620,000 | 55.48% | 500,200,000 |
| TOTAL | <u>\$ 2,272,456,000</u> | | <u>\$ 885,639,000</u> |

In addition, SVP would be, under certain conditions, liable to pay a portion of costs associated with the operations of the entities. Under certain circumstances, such as default or bankruptcy of the other participants, SVP may also be liable to pay a portion of the debt of these joint ventures on behalf of those participants and seek reimbursement from those participants.

Take-or-Pay commitments expire upon final maturity of outstanding debt for each project. Final fiscal year debt expirations as of June 30, 2015 are as follows:

| Project | Debt Expiration | Entitlement Share % | Debt Service Share % |
|--|-----------------|------------------------|-------------------------|
| NCPA - Geothermal Project (NGP) | July-2024 | 44.3905% | 44.3905% |
| NCPA - Hydroelectric Project (NHP) | July-2032 | 37.0200% | 37.0200% |
| NCPA - Lodi Energy Center (NLEC) | June-2040 | 25.7500% | 29.9159% |
| TANC - CA-OR Transmission Project (COTP) | May-2024 | 9.7226% | 9.8126% |
| MSR PPA -San Juan Plant | July-2022 | 35.0000% | 35.0000% |

** The SVP's debt service share in NLEC on issue one is 30.056%, on issue two is 0%.

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For the years ended June 30, 2016 and 2015

NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

A summary of SVP’s “Take-or-Pay” contracts and related projects and its contingent liability for the debt service including principal and interest payments at June 30, 2015 is as follows:

| Fiscal Year | NGP | NHP | NLEC | COTP | MSR PPA | Total |
|-------------|----------------------|-----------------------|-----------------------|----------------------|----------------------|-----------------------|
| 2016 | \$ 2,267,016 | \$ 14,582,142 | \$ 7,715,155 | \$ 5,103,705 | \$ 13,389,600 | \$ 43,057,618 |
| 2017 | 2,267,879 | 14,600,914 | 7,715,876 | 3,656,160 | 13,038,900 | 41,279,729 |
| 2018 | 2,268,241 | 14,300,656 | 7,715,539 | 3,655,953 | 12,902,400 | 40,842,789 |
| 2019 | 2,270,099 | 14,302,720 | 7,714,299 | 3,655,857 | 12,687,500 | 40,630,475 |
| 2020 | 2,271,098 | 14,066,048 | 7,715,751 | 3,655,298 | 12,688,550 | 40,396,745 |
| 2021-2025 | 10,080,447 | 72,648,439 | 38,573,119 | 13,836,914 | 34,361,950 | 169,500,869 |
| 2026-2030 | - | 39,531,862 | 38,608,043 | - | - | 78,139,905 |
| 2031-2035 | - | 25,115,773 | 38,621,389 | - | - | 63,737,162 |
| 2036-2040 | - | - | 38,616,265 | - | - | 38,616,265 |
| 2041 | - | - | 7,080,592 | - | - | 7,080,592 |
| Total | <u>\$ 21,424,780</u> | <u>\$ 209,148,554</u> | <u>\$ 200,076,028</u> | <u>\$ 33,563,887</u> | <u>\$ 99,068,900</u> | <u>\$ 563,282,149</u> |

NOTE 7 – RETIREMENT PLAN – DEFINED BENEFIT PENSION PLAN

For purposes of measuring the net pension liability and deferred outflows/inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Plan and additions to/deductions from the Plan’s fiduciary net position have been determined on the same basis as they are reported by the CalPERS Financial Office. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms. Investments are reported at fair value.

A. General Information about the Pension Plan

Plan Descriptions

All qualified regular and probationary employees are required to participate in the City’s Miscellaneous Agent Multiple-Employer defined benefit plan administrated by the California Public Employees’ Retirement System (CalPERS), which acts as a common investment and administrative agent for its participating member employers. Benefit provisions under the Plans are established by State statute and City resolution. CalPERS issues publicly available reports that include a full description of the pension plans regarding benefit provisions, assumptions and membership information and can be found on the CalPERS website.

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NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 7 – RETIREMENT PLAN – DEFINED BENEFIT PENSION PLAN (continued)

Benefits Provided

CalPERS provides service retirement and disability benefits, annual cost of living adjustments, and death benefits to plan members, who must be public employees or beneficiaries. Benefits are based on years of credited service, equal to one year of full time employment. Members with five years of total service are eligible to retire at age 50 with statutorily reduced benefits. All members are eligible for non-duty disability benefits after 5 years of service. The pre-retirement death benefit is the Optional Settlement 2W Death Benefit. The cost of living adjustments for each plan are applied as specified by the Public Employees’ Retirement Law.

The Plan’s provisions and benefits in effect at June 30, 2015, are summarized as follows:

| | Miscellaneous | |
|---|-----------------------------|--------------------------------|
| | Prior to January 1, 2013 | On or after January 1, 2013 |
| Hire date | | |
| Benefit formula | 2.7% @ 55 | 2% @ 62 |
| Benefit vesting schedule | 5 years service | 5 years service |
| Benefit payments | monthly for life | monthly for life |
| Retirement age | 50 | 50 |
| Monthly benefits, as a % of eligible compensation | 2.70% | 2.00% |
| Required employee contribution rates | 8% | 6.25% |
| Required employer contribution rates | 29.562% | 29.562% |

Contributions

Section 20814(c) of the California Public Employees’ Retirement Law requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. Funding contributions for both Plans are determined annually on an actuarial basis as of June 30 by CalPERS. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. SVP is required to contribute the difference between the actuarially determined rate and the contribution rate of employees.

The contributions to the Plan were as follows:

| | Miscellaneous Tier I | |
|--------------------------|----------------------|---------------|
| | June 30, 2016 | June 30, 2015 |
| Contributions - employer | \$6,484,674 | \$5,335,643 |

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 7 – RETIREMENT PLAN – DEFINED BENEFIT PENSION PLAN (continued)

B. Net Pension Liability, Pension Expenses and Deferred Outflows/Inflows of Resources Related to Pensions

SVP reported a net pension liability for its proportionate share of the net pension liability of the Plan as follows:

| | Proportionate Share of Net Pension Liability | |
|-----------------------------|--|---------------|
| | June 30, 2016 | June 30, 2015 |
| Miscellaneous | \$ 74,516,387 | \$ 69,068,338 |
| Total Net Pension Liability | \$ 74,516,387 | \$ 69,068,338 |

SVP’s net pension liability for the Plan is measured as the proportionate share of the net pension liability. The net pension liability of the Plan is measured as of June 30, 2015, and the total pension liability for the Plan used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2014 rolled forward to June 30, 2015 using standard update procedures. SVP’s proportion of the net pension liability was based on a projection of SVP’s long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. SVP’s proportionate share of the net pension liability for the Plan as of June 30, 2014 and 2015 was as follows:

| | Miscellaneous |
|------------------------------|---------------|
| Proportion - June 30, 2014 | 34.97% |
| Proportion - June 30, 2015 | 34.97% |
| Change - Increase (Decrease) | 0.00% |

For the year ended June 30, 2016, SVP recognized pension expense of \$4,696,771. At June 30, 2016, SVP reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

Miscellaneous Plan:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|--|-----------------------------------|----------------------------------|
| Pension contributions subsequent to measurement date | \$ 6,484,674 | \$ - |
| Differences between expected and actual experience | 24,494 | - |
| Changes in assumptions | - | (2,300,492) |
| Net differences between projected and actual earnings on plan investments | 6,032,104 | (7,378,003) |
| Total | \$ 12,541,272 | \$ (9,678,495) |

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
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For the years ended June 30, 2016 and 2015

NOTE 7 – RETIREMENT PLAN – DEFINED BENEFIT PENSION PLAN (continued)

\$6,484,674 reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows:

| Fiscal Year Ended June 30 | Annual Amortization |
|------------------------------|------------------------|
| 2016 | \$ (2,215,751) |
| 2017 | (1,962,863) |
| 2018 | (951,308) |
| 2019 | 1,508,025 |

C. Actuarial Assumptions

For the measurement period ended June 30, 2015, the total pension liability was determined by rolling forward the June 30, 2014 total pension liability. The June 30, 2016 total pension liability was based on the following actuarial methods and assumptions:

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
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NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 7 – RETIREMENT PLAN – DEFINED BENEFIT PENSION PLAN (continued)

| | Miscellaneous | |
|----------------------------------|--|---------------------|
| Valuation Date | | June 30, 2014 |
| Measurement Date | | June 30, 2015 |
| Actuarial Cost Method | Entry-Age Normal Cost Method | |
| Actuarial Assumptions: | | |
| Discount Rate | | 7.65% |
| Inflation | | 2.75% |
| Payroll Growth | | 3.0% |
| Projected Salary Increase | Varies by Entry-Age and Service | |
| Investment Rate of Return | | 7.5% ⁽¹⁾ |
| Post Retirement Benefit Increase | Contract COLA up to 2.75% until Purchasing Power Protection applies, 2.75% thereafter | |
| Mortality | Derived using CalPERS' Membership Data for all Funds ⁽²⁾ | |

⁽¹⁾ Net of pension plan investment and administrative expenses, including inflation.

⁽²⁾ The mortality table used was developed based on CalPERS' specific data. The table includes 5 years of mortality improvements using Society of Actuaries Scale AA. For more details on this table, please refer to the CalPERS 2014 experience study report available on CalPERS website.

All other actuarial assumptions used in the June 30, 2014 valuation were based on the results of a January 2015 actuarial experience study for the period 1997 to 2011, including updates to salary increase, mortality and retirement rates. Further details of the Experience Study can be found on the CalPERS website under Forms and Publications.

Change of Assumptions

GASB 68, paragraph 68 states that the long-term expected rate of return should be determined net of pension plan investment expense, but without reduction for pension plan administrative expense. The discount of 7.50 percent used for the June 30, 2014 measurement date was net of administrative expenses. The discount rate of 7.65 percent used for the June 30, 2015 measurement date is without reduction of pension plan administrative expense. All other assumptions for the June 30, 2015 measurement date were the same as those used for the June 30, 2014 measurement date.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
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NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 7 – RETIREMENT PLAN – DEFINED BENEFIT PENSION PLAN (continued)

Discount Rate

The discount rate used to measure the total pension liability was 7.65% for the Plan. To determine whether the municipal bond rate should be used in the calculation of a discount rate for each plan, CalPERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. Based on the testing, none of the tested plans run out of assets. Therefore, the current 7.65% discount rate is adequate and the use of the municipal bond rate calculation is not necessary. The long term expected discount rate of 7.65% will be applied to all plans in the Public Employees Retirement Fund (PERF). The stress test results are presented in a detailed report that can be obtained from the CalPERS website.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Such cash flows were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years.

Using historical returns of all the funds' asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

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For the years ended June 30, 2016 and 2015

NOTE 7 – RETIREMENT PLAN – DEFINED BENEFIT PENSION PLAN (continued)

The table below reflects the long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. These geometric rates of return are net of administrative expenses.

| Asset Class | New Strategic Allocation | Real Return Years 1 - 10(a) | Real Return Years 11+(b) |
|-------------------------------|--------------------------------|--------------------------------|-----------------------------|
| Global Equity | 51.0% | 5.25% | 5.71% |
| Global Fixed Income | 19.0% | 0.99% | 2.43% |
| Inflation Sensitive | 6.0% | 0.45% | 3.36% |
| Private Equity | 10.0% | 6.83% | 6.95% |
| Real Estate | 10.0% | 4.50% | 5.13% |
| Infrastructure and Forestland | 2.0% | 4.50% | 5.09% |
| Liquidity | 2.0% | -0.55% | -1.05% |
| Total | <u>100%</u> | | |

(a) An expected inflation of 2.5% used for this period.

(b) An expected inflation of 3.0% used for this period.

Sensitivity of the Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents SVP's proportionate share of the net pension liability for the Plan, calculated using the discount rate for the Plan, as well as what SVP's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower or 1-percentage point higher than the current rate:

| | <u>Miscellaneous</u> |
|-----------------------|----------------------|
| 1% Decrease | 6.65% |
| Net Pension Liability | \$ 101,343,010 |
| Current Discount Rate | 7.65% |
| Net Pension Liability | \$ 74,516,387 |
| 1% Increase | 8.65% |
| Net Pension Liability | \$ 52,126,205 |

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 7 – RETIREMENT PLAN – DEFINED BENEFIT PENSION PLAN (continued)

Pension Plan Fiduciary Net Position

Detailed information about each pension plan's fiduciary net position is available in the separately issued CalPERS financial reports.

NOTE 8 – RESTRUCTURING OF THE CALIFORNIA ELECTRIC INDUSTRY

A. Long-term Power Purchase Contracts

SVP purchases wholesale electric power from various participants of the Western Systems Power Pool (WSPP), NCPA, MSR Public Power Agency (Note 6), Western Area Power Administration, and other sources to supply the power requirements of Silicon Valley Power's electric utility customers. SVP actively manages the financial risks inherent in these long-term contracts, including the risks arising from the changing spot market prices that move above and below the contract prices and from contract disputes that may arise from time to time. The cost of power is included in enterprise fund materials, services and supplies expense.

B. Restructuring of the California Electric Industry

Deregulation Legislation and Direct Access

The passage of AB1890 in 1998 triggered fundamental changes in the structure of the electric industry in California. The essential feature of AB1890 was to allow individual consumers the opportunity to buy energy directly from power producers and marketers, rather than from their local investor-owned utility. This was called direct access. Generally, AB1890 provided for creation of the California Power Exchange (Cal PX), which was to be a clearinghouse for energy transactions among investor-owned utilities, independent generators and power marketers, who in turn would serve direct access customers. AB1890 also created the California Independent System Operator (CAISO), which was to manage the state's bulk transmission grid. In addition, investor-owned utilities were encouraged to sell a substantial portion of their generating facilities to third parties, which they did. AB1890 further provided for a four-year freeze of investor-owned utility rates and recovery by investor and publicly owned utilities during this four-year period of so-called "stranded costs" arising from what were thought at the time to be uncompetitive generation investments. AB1890 also encouraged, but did not require, municipal utilities to establish direct access programs.

In 1999, the City Council adopted a direct access program that provided for a stranded cost charge, or Competition Transition Charge, subject to legal validation of the City's and SVP's right to collect such a charge. That validation was secured in 2000, and SVP's direct access program was to commence in April 2001.

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(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

**NOTE 8 – RESTRUCTURING OF THE CALIFORNIA ELECTRIC INDUSTRY
(continued)**

However, in 2000 and 2001, the price of electricity at the Cal PX became extremely high, and investor-owned utilities were unable to pay for the energy that they needed from the Cal PX. These conditions caused the passage of AB1X by the California legislature, pursuant to which investor-owned utilities' energy procurement function was assigned to the California Department of Water Resources. AB1X also suspended direct access for investor-owned utilities, essentially until 2013. In 2009, SB695 added Section 365.1 to the Public Utilities Code, which allowed limited reinstatement of direct access for certain customers of investor-owned utilities. Except for this change, Section 365.1 continues the suspension of direct access until the Legislature, by statute, repeals the suspension or otherwise authorizes direct transactions. No such statute has occurred. Based on this development, SVP has deferred implementation of its direct access program.

Other Effects of Restructuring

The restructuring of the electric industry has created a substantially changed market for electricity. Compared to the prior market structure, this market has exhibited increased uncertainty and volatility. In anticipation of this restructured market, SVP developed a strategic plan to guide its electric utility's transition efforts into the new environment. As part of the Strategic Plan, the Rate Stabilization Fund (previously called Cost Reduction Fund) was established to protect ratepayers from rate volatility in future years due to revenue shortfalls or unexpected costs.

The strategic plan is a multi-pronged strategic initiative to address electric generation, transmission and distribution business issues given both the initially anticipated operating environment, and the operating environment that has actually evolved. The City's management believes that the strategic plan has been an effective tool for the electric utility as it has transitioned into the new environment.

Energy Wholesale Trading and Risk Management

SVP participates in the wholesale gas and power market and the California Independent System Operator's centralized market. SVP engages in the trading of commodity forward contracts (gas and electric energy contracts). Activities during the fiscal year were substantially considered hedging transactions and, as such, have been accounted for using the settlement method of accounting. Accordingly, related gross purchases and sales totaling \$21.7 million and \$17.3 million, respectively, for fiscal year ended June 30, 2016, have been separately reported on the statement of revenues, expenses and changes in net position.

The restructured electric wholesale market exposes SVP to various risks including market, credit and operational risks. Active and effective management of these risks associated with the power

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
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NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

**NOTE 8 – RESTRUCTURING OF THE CALIFORNIA ELECTRIC INDUSTRY
(continued)**

trading activity is critical to its continued success and contribution to the entire utility. A Risk Management Committee, separate from the units that create the risk exposures, overseen by a Risk Oversight Committee that reports ultimately to the City Council, administers and monitors compliance with the risk policies and procedures on a regular basis. The City and SVP believe that it has the resource commitment, and effective policies and procedures, and is continuing to improve the control structure and oversight for evaluating and controlling the market and credit risks to which it is exposed.

Credit Arrangements

The City maintains credit policies, procedures, and systems for SVP that help mitigate credit risk and minimize overall credit risk exposure. The policies include transacting only with investment grade counterparties, evaluating of potential counterparties’ financial condition and assigning credit limits as applicable. These credit limits are established based on risk and return considerations under terms customarily available in the industry. Additionally, The City is a signatory to the WSPP netting agreement supplement and otherwise, enters into master netting arrangements whenever possible and, where appropriate, obtains collateral prior to trade execution. Master netting agreements incorporate rights of setoff that provide for the net settlement of subject contracts with the same counterparty in the event of default.

NOTE 9 – MAJOR SUPPLIERS

SVP purchases wholesale electric energy through its participation in the NCPA and M-S-R Public Power Agency joint powers agencies, from the Western Area Power Administration, from the market via the California Independent System Operator (CAISO), and from other sources to supply its retail electric utility customers. Additionally, SVP purchases transmission services through its participation in the TANC and from the CAISO.

The purchases of energy and transmission services that represent 5% or more of the total purchased power costs are shown in the table below:

| <u>Supplier</u> | <u>Power Purchased</u> | <u>% of the Total Purchased Power</u> |
|-------------------------------|------------------------|---|
| NCPA | \$ 92,463,695 | 32.19% |
| M-S-R Public Power Agency | 54,527,102 | 18.98% |
| EDF Trading North America LLC | 30,563,550 | 10.64% |
| Tri-Dam Project | 25,236,507 | 8.79% |
| CAISO | 15,223,685 | 5.30% |

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS**

For the years ended June 30, 2016 and 2015

NOTE 10 – COMMITMENTS AND CONTINGENCIES

Commitments and contingencies, undeterminable in amount, include normal recurring pending claims and litigation. In the opinion of management, based upon discussion with legal counsel, there is no pending litigation, which is likely to have a material adverse effect on the financial position of the fund.

SVP has future commitments under construction projects as follows:

| | <u>Authorized</u> | <u>Expended Through June 30, 2016</u> | <u>Remaining Commitments</u> |
|-------------------|-----------------------|---|----------------------------------|
| Electric Projects | <u>\$ 115,895,254</u> | <u>\$ 70,812,122</u> | <u>\$ 45,083,132</u> |

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)**

REQUIRED SUPPLEMENTARY INFORMATION

For the years ended June 30, 2016 and 2015

This part of the City of Santa Clara Electric Utility Enterprise Fund Financial Statements provides detailed information to better understand the data presented within the financial statements and note disclosures.

SCHEDULE OF CHANGES IN THE NET PENSION LIABILITY AND RELATED RATIOS

Discloses the changes and components of the net pension liability and related ratios, including the pension plan's fiduciary net position as a percentage of the total pension liability, and the net pension liability as a percentage of covered-employee payroll.

SCHEDULE OF CONTRIBUTIONS

Contains information of the employer's contractually required contribution rates, contributions to the pension plan and related ratios.

Schedule of Changes in the Net Pension Liability and Related Ratios
City of Santa Clara Electric Enterprise Fund Miscellaneous Plan,
a Cost-Sharing Defined Benefit Pension Plan
Last Ten Fiscal Years for the Measurement Periods Ended June 30⁽¹⁾

| | Fiscal Year Ending | |
|--|------------------------------|------------------------------|
| | 2015 | 2014 |
| Total Pension Liability | | |
| Service cost | \$ 3,465,325 | \$ 3,617,908 |
| Interest | 15,651,016 | 15,026,265 |
| Changes in benefits | - | - |
| Differences between expected and actual experience | 38,102 | - |
| Changes of assumptions | (3,578,542) | - |
| Benefit payments, including refunds of employee contributions | <u>(11,140,846)</u> | <u>(10,437,547)</u> |
| Net change in total pension liability | 4,435,055 | 8,206,626 |
| Total pension liability - beginning | <u>211,966,647</u> | <u>203,760,021</u> |
| Total pension liability - ending | <u>\$ 216,401,702</u> | <u>\$ 211,966,647</u> |
| Plan Fiduciary Net Position | | |
| Contributions - employer | 5,464,162 | 5,206,247 |
| Contributions - employee | 1,663,100 | 1,902,198 |
| Net investment income | 3,160,547 | 21,456,937 |
| Benefit payments, including refunds of employee contributions | (11,140,843) | (10,437,547) |
| Administrative expenses | (159,831) | - |
| Plan to plan resource movement | <u>(129)</u> | <u>-</u> |
| Net change in plan fiduciary net position | (1,012,994) | 18,127,835 |
| Plan fiduciary net position - beginning | <u>142,898,309</u> | <u>124,770,474</u> |
| Plan fiduciary net position - ending | <u>\$ 141,885,315</u> | <u>\$ 142,898,309</u> |
| Net Pension Liability - ending | <u>\$ 74,516,387</u> | <u>\$ 69,068,338</u> |
| Plan fiduciary net position as a percentage of the total pension liability | 65.6% | 67.4% |
| Covered payroll | \$ 20,050,479 | \$ 20,000,599 |
| Net Pension Liability as percentage of covered payroll | 371.64% | 345.33% |
| Notes to Schedule: | | |

⁽¹⁾ Fiscal year 2014-15 was the first year of implementation, therefore only two years are shown.

Benefit changes: The figures above do not include any liability impact that may have resulted from plan changes which occurred after June 30, 2014.

Changes in assumptions: The discount rate was changed from 7.5 percent (net of administrative expense) to 7.65 percent.

Schedule of Plan Contributions
City of Santa Clara Electric Enterprise Fund Miscellaneous Plan,
a Cost-Sharing Defined Benefit Pension Plan
Last Ten Fiscal Years⁽¹⁾

| | Fiscal Year Ending | |
|---|----------------------|----------------------|
| | <u>June 30, 2016</u> | <u>June 30, 2015</u> |
| Actuarially determined contribution | \$ 6,484,674 | \$ 5,335,643 |
| Contributions in relation to the actuarially determined contributions | <u>(6,484,674)</u> | <u>(5,335,643)</u> |
| Contribution deficiency (excess) | <u>\$ -</u> | <u>\$ -</u> |
| Covered payroll | \$ 21,661,244 | \$ 20,050,479 |
| Contributions as a percentage of covered payroll | 29.94% | 26.61% |
| Notes to Schedule | | |
| Valuation date | 6/30/2013 | 6/30/2012 |

Methods and assumptions used to determine contribution rates:

| | |
|-------------------------------|---|
| Actuarial cost method | Entry age |
| Amortization method | Level percentage of payroll, closed |
| Remaining amortization period | 28 years as of valuation date |
| Asset valuation method | 5-year smoothed market |
| Inflation | 2.75% |
| Salary increases | 3.20% to 12.20% depending on age, service and type of employment |
| Investment rate of return | 7.50%, net of pension plan Investment and administrative expenses; includes inflation |
| Retirement age | 67 yrs. Misc. |
| Mortality ⁽²⁾ | Derived using CalPERS' Membership Data for all Funds |

⁽¹⁾ Fiscal year 2014-15 was the 1st year of implementation, therefore only one year is shown.

⁽²⁾ The probabilities of mortality are based on the 2010 CalPERS Experience Study for the period from 1997 to 2007. Pre-retirement and Post-retirement mortality rates include 5 years of projected mortality improvement using Scale AA published by the Society of Actuaries.

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