

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



**FOR THE YEARS ENDED JUNE 30, 2014 AND 2013
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)**

TABLE OF CONTENTS

	Page
Independent Auditor's Report.....	1
Management’s Discussion and Analysis.....	5
Basic Fund Financial Statements	
Statement of Net Position	9
Statement of Revenue, Expenses and Changes in Net Position.....	10
Statement of Cash Flows	11
Notes to Financial Statements.....	13



INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the business-type activities of the City of 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, 2014 and 2013, and the related statement of revenues, expenses and changes in nets assets, statement of cash flows for the years then ended, and notes to the financial statements, which collectively comprise Silicon Valley Power's basic financial statements as listed in the Table of Contents..

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the 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 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 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.

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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 as of June 30, 2014 and 2013, and the changes in financial position and, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting Principles

Management adopted the provision of the following Governmental Accounting Standards Board Statement, which became effective during the year ended June 30, 2014 and had a material effect on the financial statements:

Statement 65 – *Items Previously Reported as Assets and Liabilities*. See Note 2B to the financial statements for relevant disclosures.

Management adopted the provisions of the following Governmental Accounting Standards Board Statements, which became effective during the year ended June 30, 2014 but had no material effects on the financial statements:

Statement 67 – *Financial Reporting for Pension Plans*. See Note 2B to the financial statements for relevant disclosures.

Statement 70 – *Accounting and Reporting for Nonexchange Financial Guarantees*. See Note 2B to the financial statements for relevant disclosures.

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 Management's Discussion and Analysis, 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, 2014 and 2013, 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 14, 2014, on our consideration of Silicon Valley Power'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 Silicon Valley Power's internal control over financial reporting and compliance.

Maze & Associates

Pleasant Hill, California
November 14, 2014

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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 7 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

FISCAL YEAR 2013-14 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).

Table 1
Net Position
June 30, 2014 and 2013
(in millions)

Description	2014	2013 ^(A)	Increase (Decrease)		2012
			Amount	%	
Cash and investments	\$ 277.1	\$ 246.0	\$ 31.1	12.6%	\$ 283.6
Other assets	104.7	103.1	1.6	1.6%	88.3
Capital assets	531.8	532.9	(1.1)	-0.2%	500.9
Total Assets	913.6	882.0	31.6	3.6%	877.6
Deferred Outflows of Resources:					
Deferred outflows on derivative instruments	10.2	10.6	(0.4)	-3.8%	14.9
Deferred outflow on refunding	7.2	7.8	(0.6)	-7.7%	-
Total Deferred Outflows of Resources	17.4	18.4	(1.0)	-5.4%	14.9
Long-term liabilities outstanding (including current portion)	237.4	214.6	22.8	10.6%	221.7
Other liabilities	30.2	31.2	(1.0)	-3.2%	28.0
Total Liabilities	267.6	245.8	21.8	8.9%	249.7
Deferred Inflows of Resources:					
Deferred inflow on refunding	0.5	0.6	(0.1)	-16.7%	-
Total Deferred Inflows of Resources	0.5	0.6	(0.1)	-16.7%	-
Net Position:					
Net investment in capital assets	334.2	351.7	(17.5)	-5.0%	318.5
Unrestricted	328.7	302.3	26.4	8.7%	324.3
Total Net Position	\$ 662.9	\$ 654.0	\$ 8.9	1.4%	\$ 642.8

^(A) Certain amounts in the prior year have been restated due to the implementation of GASB 65.

Table 2
Revenues, Expenses and Changes in Net Position
For the years ended June 30, 2014 and 2013
(in millions)

Description	2014	2013 ^(A)	Increase (Decrease)		2012
			Amount	%	
Revenues:					
Retail	\$ 309.2	\$ 298.8	\$ 10.4	3.5%	\$ 297.6
Wholesale	28.6	22.3	6.3	28.3%	29.1
Interest Revenue	1.7	2.7	(1.0)	-37.0%	4.8
Net increase (decrease) in fair value of investment	1.9	(3.8)	5.7	150.0%	(0.8)
Rents and royalties	2.7	2.9	(0.2)	-6.9%	2.6
Renewable energy credit	5.4	6.8	(1.4)	-20.6%	14.8
Other	22.6	20.4	2.2	10.8%	14.4
Total Revenues	372.1	350.1	22.0	6.3%	362.5
Expenses:					
Retail	319.7	295.8	23.9	8.1%	267.6
Wholesale	28.9	24.7	4.2	17.0%	32.1
Interest on long term debt	8.6	11.1	(2.5)	-22.5%	11.1
Other	5.6	5.1	0.5	9.8%	8.5
Total Expenses	362.8	336.7	26.1	7.8%	319.3
Increase (decrease) in net position before transfers	9.3	13.4	(4.1)	-30.6%	43.2
Transfers in (out)	(0.4)	(0.9)	0.5	55.6%	(0.3)
Increase (decrease) in net position	8.9	12.5	(3.6)	-28.8%	42.9
Net Position - July 1 as restated	654.0	641.5	12.5	1.9%	599.9
Net Position - June 30	\$ 662.9	\$ 654.0	\$ 8.9	1.4%	\$ 642.8

^(A) Certain amounts in the prior year have been restated due to the implementation of GASB 65.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

SVP retail operating revenues were \$309.2 million in fiscal year 2013-14, \$298.8 million in fiscal year 2012-13, and \$297.6 million in fiscal year 2011-12, reflecting increases of approximately 3.5% and 0.4% from fiscal years 2012-13 and 2011-12, respectively. The main reason for the increase in fiscal year 2013-14 was due to a rate increase of 5%.

Retail operating expenses were \$319.7 million in fiscal year 2013-14, \$295.8 million in fiscal year 2012-13, and \$267.6 million in fiscal year 2011-12, an increase of \$23.9 million or 8.1% and an increase of \$28.2 million or 10.5% from fiscal years 2012-13 and 2011-12, respectively. The retail operating expenses for fiscal year 2013-14 were higher primarily due to increases in the cost of purchased power (\$18.8 million), operation costs (\$5.3 million), and depreciation expense (\$0.5 million), partially offset by a decrease in the cost of maintenance.

Revenues from wholesale power sales were \$28.6 million in fiscal year 2013-14, \$22.3 million in fiscal year 2012-13, and \$29.1 million in fiscal year 2011-12. Concurrently, the cost of wholesale power purchases was \$28.9 million in fiscal year 2013-14, \$24.7 million in fiscal year 2012-13, and \$32.1 million in fiscal year 2011-12. The wholesale power market has stabilized in recent years compared to the peak year of the power crisis experienced by California in 2001, resulting in a lower level of wholesale power transactions.

Interest income was \$1.7 million in fiscal year 2013-14, \$2.7 million in fiscal year 2012-13, and \$4.8 million in fiscal year 2011-12. The decrease in the current fiscal year was primarily due to a lower interest rate environment resulting from Federal Reserve actions to stabilize the economy. Interest expense was \$8.6 million in fiscal year 2013-14, and \$11.1 million in fiscal year 2012-13 and 2011-12. The decrease in interest expenses was due to the interest savings of \$2.5 million from refunding of the Series 2003A Revenue Bonds.

The Electric Utility Fund had a net position of \$662.9 million at June 30, 2014, an increase of \$8.9 million from the prior fiscal year. Of this amount, \$334.2 million was net investment in capital assets; \$328.7 million was unrestricted. Due to adoption of GASB 65, the net impact of this change in accounting principle is \$1.3 million. The restated Net Position as of July 1, 2013 is \$654.0 million. At June 30, 2013, the Electric Utility Fund had a net position of \$655.3 million, an increase of \$12.5 million from fiscal year 2011-12.

CAPITAL ASSETS

At the end of fiscal year 2013-14, SVP had \$531.8 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, 2014, SVP had various projects completed or under construction. In fiscal year 2013-14, 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

DEBT ADMINISTRATION

Each of SVP's debt issues is discussed in detail in Note 5 to the financial statements. At June 30, 2014, SVP's debt is comprised of three issues of Revenue Bonds with carrying balances of \$227.2 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, 2014.

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, 2014 and 2013**

ASSETS	2014	2013
Current Assets:		
Pooled cash and investments (Note 3)	\$ 254,864,491	\$ 228,127,987
Investments with fiscal agent (Note 3)	7,875,869	3,733,523
Receivables (net of allowances)		
Accounts	41,657,901	43,793,384
Interest	342,463	501,496
Due from the City of Santa Clara (Note 2E)	2,321,989	2,132,363
Inventory of materials and supplies and prepaid (Note 2F)	13,390,012	13,575,657
Total Current Assets	320,452,725	291,864,410
Noncurrent Assets:		
Capital assets (Note 4)		
Land	14,379,593	14,379,593
Construction in progress	27,066,703	22,907,498
Buildings, improvements and infrastructure	837,264,421	823,646,406
Equipment	10,603,625	10,859,821
Accumulated depreciation	(357,484,354)	(338,908,599)
Total Capital assets (Net of accumulated depreciation)	531,829,988	532,884,719
Other Noncurrent Assets:		
Investments in joint ventures (Note 6)	39,300,858	35,086,342
Investments with fiscal agent (Note 3)	14,420,703	14,178,392
Deposits (Note 3)	7,593,487	7,968,435
Advance to the City of Santa Clara	30,811	45,525
Total Other Noncurrent Assets	61,345,859	57,278,694
Total Noncurrent Assets	593,175,847	590,163,413
Total Assets	913,628,572	882,027,823
DEFERRED OUTFLOWS OF RESOURCES		
Accumulated decrease in fair value of hedging instruments (Note 5G)	10,225,092	10,590,344
Deferred outflow on refunding	7,239,973	7,775,234
Total Deferred Outflows of Resources	17,465,065	18,365,578
LIABILITIES		
Current Liabilities:		
Accrued liabilities	23,572,143	22,718,189
Interest payable	2,914,191	2,177,213
Accrued compensated absences	437,872	403,352
Unearned Revenue	833,841	514,757
Current portion of long-term debt (Note 5)	6,490,000	3,550,000
Current portion derivative financial instruments (Note 5G)	577,814	217,870
Total Current Liabilities	34,825,861	29,581,381
Noncurrent Liabilities:		
Long-term derivative financial instruments (Note 5G)	9,647,278	10,372,474
Long-term portion accrued compensated absences	2,481,276	2,588,079
Long-term debt (Note 5)	220,672,726	203,295,303
Total Noncurrent Liabilities	232,801,280	216,255,856
Total Liabilities	267,627,141	245,837,237
DEFERRED INFLOWS OF RESOURCES		
Deferred inflow on refunding	565,320	605,700
Total Deferred Inflows of Resources	565,320	605,700
NET POSITION		
Net investment in capital assets	334,203,807	351,726,565
Unrestricted net position	328,697,369	302,223,899
Total Net Position	\$ 662,901,176	\$ 653,950,464

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, 2014 and 2013**

	<u>2014</u>	<u>2013</u>
Operating Revenues:		
Residential sales	\$ 25,653,078	\$ 23,473,671
Commercial sales	13,769,571	15,579,375
Industrial sales	267,168,684	257,117,571
Other operating revenues	2,577,835	2,580,708
Total Operating Revenues	<u>309,169,168</u>	<u>298,751,325</u>
Operating Expenses:		
Operations	58,545,982	53,295,667
Maintenance	11,752,656	12,148,289
Purchased power	229,689,839	210,927,716
Amortization	168,425	371,802
Depreciation	19,559,451	19,030,402
Total Operating Expenses	<u>319,716,353</u>	<u>295,773,876</u>
Operating Income	(10,547,185)	2,977,449
Nonoperating Revenues (Expenses):		
Interest revenue	1,675,741	2,710,253
Net changes in the fair value of investments	1,914,604	(3,853,023)
Interest expense	(8,604,831)	(11,074,673)
Renewable energy credits	5,448,910	6,825,701
Wholesale resources sales (Note 7)	28,621,758	22,295,534
Wholesale resources purchases (Note 7)	(28,871,121)	(24,716,822)
Equity in income (losses) of joint ventures	4,214,516	6,111,186
Rents and royalties	2,712,453	2,932,611
Mandated program receipts and other revenues	18,327,017	14,239,851
Loss on retirement of assets	-	(1,196)
Mandated program disbursements and other expenses	(5,556,334)	(5,092,643)
Total Nonoperating Revenues, net	<u>19,882,713</u>	<u>10,376,779</u>
Income Before Transfers	<u>9,335,528</u>	<u>13,354,228</u>
Transfers to the City of Santa Clara	<u>(384,816)</u>	<u>(850,981)</u>
Net Income	8,950,712	12,503,247
Net Position, Beginning of Year, as Restated (Note 2B)	<u>653,950,464</u>	<u>641,447,217</u>
Net Position, End of Year	<u>\$ 662,901,176</u>	<u>\$ 653,950,464</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, 2014 and 2013**

	<u>2014</u>	<u>2013</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	\$ 309,472,428	\$ 292,367,595
Payments to suppliers	(272,787,831)	(259,282,309)
Payments to employees	(23,727,202)	(21,372,491)
Rents and royalties received	3,420,000	3,194,654
Other receipts	12,917,584	10,307,253
Net Cash from Operating Activities	<u>29,294,979</u>	<u>25,214,702</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Wholesale resources sales	28,621,758	22,295,534
Wholesale resources purchases	(28,871,121)	(24,716,822)
Renewable energy credits	5,448,910	6,825,701
Increase (decrease) in due from other funds	(174,912)	(70,307)
Wholesale trading escrow	(190,559)	(339,918)
Transfers (out)	(384,816)	(850,981)
Cash Flows from Noncapital Financing Activities	<u>4,449,260</u>	<u>3,143,207</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets, net	(19,926,645)	(47,320,521)
Proceeds from debt issuance	24,435,000	-
Principal payments on debt	(3,550,000)	(19,265,000)
Interest paid on debt	(7,896,328)	(3,759,343)
Cash Flows from Capital and Related Financing Activities	<u>(6,937,973)</u>	<u>(70,344,864)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest and dividends	2,400,280	8,183,909
Net increase (decrease) in the fair value of investments	1,914,604	(3,853,023)
Payments made by fiscal agent	8,597,404	13,483,893
Deposits made with fiscal agent	(12,982,050)	(7,934,703)
Cash Flows from Investing Activities	<u>(69,762)</u>	<u>9,880,076</u>
Net Increase (Decrease) in Cash and Cash Equivalents	26,736,504	(32,106,879)
Cash and cash equivalent at Beginning of Period	<u>228,127,987</u>	<u>260,234,866</u>
Cash and cash equivalent at End of Period	<u>\$ 254,864,491</u>	<u>\$ 228,127,987</u>
Reconciliation of Operating Gain(Loss) to Net Cash Provided (Used) by		
Operating activities:		
Operating income	\$ (10,547,185)	\$ 2,977,449
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Amortization	168,425	371,802
Depreciation	19,559,451	19,030,402
Change in assets and liabilities:		
Receivable, net	2,135,483	(10,450,020)
Inventory	17,219	(5,930,670)
Accrued liabilities	2,231,649	6,951,504
Compensated absences	(72,283)	(78,312)
Unearned revenues	319,084	262,728
Other receipts	21,039,470	17,172,462
Other expenses	(5,556,334)	(5,092,643)
Net Cash Provided by Operating Activities	<u>\$ 29,294,979</u>	<u>\$ 25,214,702</u>
NONCASH TRANSACTIONS:		
Joint Ventures		
Nonoperating Income (Expense)	<u>\$ 4,214,516</u>	<u>\$ 6,111,186</u>

See accompanying notes to financial statements

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**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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 8,041 streetlights and serves approximately 53,157 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, 2014 and 2013**

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, 2014, SVP implemented the following GASB Statements:

The GASB issued Statement No. 65 "Items Previously Reported as Assets and Liabilities". The objective of the statement is to establish accounting and financial reporting standards that reclassifies, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This statement becomes effective for periods beginning after December 15, 2012. This standard was adopted for fiscal year ended June 30, 2014. On July 1, 2012, SVP wrote off debt issuance cost in the amount of \$1,363,730. As a result, the beginning net position, as restated, was \$653,950,464.

The GASB issued Statement No. 66 "Technical Corrections-2012-An Amendment of GASB Statements No. 10 and No. 62." which resolves conflicts from Statement No. 54 "Fund Balance Reporting and Governmental Fund Type Definitions" and Statement No. 62 "Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements". This statement becomes effective for periods beginning after December 15, 2012. This standard was adopted for fiscal year ended June 30, 2014. The adoption of this standard does not have an impact to SVP's financial statement.

The GASB issued Statement No. 67 "Financial Reporting For Pension Plans-An Amendment of GASB Statement No. 25." which will revise existing guidelines for the financial reports of most pension plans. This statement becomes effective for periods beginning after June 15, 2013. This standard was adopted for fiscal year ended June 30, 2014. The adoption of this standard does not have an impact to SVP's financial statement.

The GASB issued Statement No. 70 "Accounting and Financial Reporting for Nonexchange Financial Guarantees." The objective of this statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. This statement becomes effective for periods beginning after June 15, 2013. This standard was adopted for fiscal year ended June 30, 2014. The adoption of this standard does not have an impact to the SVP's financial statement.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

The GASB issued Statement No. 68 "Accounting and Financial Reporting For Pension Plans-An Amendment of GASB Statement No. 27." which will revise and establish new financial reporting requirements for most governments that provide their employees with pension benefits. This statement becomes effective for periods beginning after June 15, 2014. SVP is currently evaluating the impact on the financial statements.

The GASB issued Statement No. 69 "Government Combinations and Disposals of Government Operations." This statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. This statement becomes effective for periods beginning after December 15, 2013. SVP is currently evaluating the impact on the financial statements.

The GASB issued Statement No. 71 "Pension Transition for Contributions Made Subsequent to the Measurement Date-An Amendment of GASB Statement No. 68." The objective of this statement is to address an issue regarding application of the transition provisions of Statement No. 68. This statement becomes effective for periods beginning after June 15, 2014. 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

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 other funds of the City of Santa Clara” on the accompanying statement of net position.

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 \$1,000 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

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

asset is ready for its intended use. There was no interest capitalized for the fiscal year ended June 30, 2014.

H. Joint Ventures

SVP participates in several joint ventures, and in accordance with GASB Statement No. 14, The Financial Reporting Entity, investments in these joint ventures are accounted for using the equity method, 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.

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

I. Compensated Absences

Vested or accumulated vacation leave and benefits are recorded as an expense and liability as the benefits accrue to the employees. Vacation pay accruals generally do not exceed the amount earned for one year, however, an employee may accumulate vacation pay earned, but not for more than two years.

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).

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

K. Electric Power Purchased

SVP purchases power from various suppliers and agencies (including joint powers agencies) for resale to its customers (see Note 8). 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 7).

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

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

NOTE 3 – CASH AND INVESTMENTS

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

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, 2014 and 2013**

NOTE 3 – CASH AND INVESTMENTS (continued)

Authorized Investment Type	Maximum Maturity	Minimum Credit Quality	Maximum Percentage or Portfolio	Maximum Investment In One Issuer
U.S. Treasury Obligations	5 years	Top three ratings categories	None	None
U.S. Agency Securities ^(A)	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%

(A) 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 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

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 3 – CASH AND INVESTMENTS (continued)

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, the greater the sensitivity of its fair value to changes in market interest rates.

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.

	<u>Credit Rating</u>	<u>Carrying Amount</u>	<u>Maturity Date</u>
Investment held by fiscal agent:			
Deposits held by Fiscal Agent		\$ 326	
Mutual fund - Federated Prime	Aaam	7,740,358	12 months or less
Mutual fund - Dreyfus	Aaam	<u>14,555,888</u>	12 months or less
Total Investment held by fiscal agent		22,296,572	
Investments not rated:			
Pooled Cash and Investments		254,864,491	12 months or less
Deposits		<u>7,593,487</u>	12 months or less
Total Cash and Investments		<u>\$ 284,754,550</u>	

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 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.

Mutual funds are available for withdrawal on demand.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 3 – CASH AND INVESTMENTS (continued)

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.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 4 – CAPITAL ASSETS

A. Capital Assets Summary

	Balance				Balance
	June 30, 2013	Additions	Retirements	Transfers	June 30, 2014
Non Depreciable Assets:					
Land	\$ 14,379,593	\$ -	\$ -	\$ -	\$ 14,379,593
Construction In Progress	22,907,498	17,843,771	-	(13,684,566)	27,066,703
Total Non Depreciable Assets	<u>37,287,091</u>	<u>17,843,771</u>	<u>-</u>	<u>(13,684,566)</u>	<u>41,446,296</u>
Capital assets being depreciated:					
Buildings and Improvements	823,646,406	-	-	13,618,015	837,264,421
Machinery & Equipment	10,859,821	660,949	(983,696)	66,551	10,603,625
Total capital assets being depreciated	<u>834,506,227</u>	<u>660,949</u>	<u>(983,696)</u>	<u>13,684,566</u>	<u>847,868,046</u>
Less accumulated depreciation for:					
Buildings and Improvements	(330,691,923)	(18,728,826)	-	-	(349,420,749)
Machinery & Equipment	(8,216,676)	(830,625)	983,696	-	(8,063,605)
Total accumulated depreciation	<u>(338,908,599)</u>	<u>(19,559,451)</u>	<u>983,696</u>	<u>-</u>	<u>(357,484,354)</u>
Net Depreciable Assets	<u>495,597,628</u>	<u>(18,898,502)</u>	<u>-</u>	<u>13,684,566</u>	<u>490,383,692</u>
Enterprise Activity Capital Assets, Net	<u>\$ 532,884,719</u>	<u>\$ (1,054,731)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 531,829,988</u>

B. Construction in Progress

Construction in progress as of June 30, 2014 consisted of \$27,066,703 in Electric Projects.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 5 – LONG-TERM DEBT AND DERIVATIVE INSTRUMENTS

Changes in long-term debt for the year ended June 30, 2014, consisted of the following:

Type of Indebtedness	Issue Date	Final Maturity	Range of Interest Rates	Outstanding as of June 30, 2013	Debt Retired / Defeased	Additions and Amortization of Discounts	Outstanding as of June 30, 2014	Current Portion
Business Type Activity Debt								
Enterprise Long-term Debt								
Electric Utility:								
2008 Series B Subordinate Revenue Bonds	5/29/2008	7/1/2027	Adj.	\$ 79,190,000	\$ 3,550,000	\$ -	\$ 75,640,000	\$3,765,000
2011 Series A Refunding Revenue Bonds	3/22/2011	7/1/2032	5%-6%	54,830,000	-	-	54,830,000	-
2013 Series A Refunding Revenue Bonds	4/24/2013	7/1/2028	3%-5%	64,380,000	-	-	64,380,000	2,725,000
Unamortized Discount/Premium				8,445,303	-	567,577	7,877,726	-
Subtotal Electric Utility Revenue Bonds				<u>199,675,769</u>	<u>3,550,000</u>	<u>567,577</u>	<u>202,727,726</u>	<u>6,490,000</u>
Bank of America Loan Agreement	6/16/2014	7/1/2024	2.67%	-	-	24,435,000	24,435,000	-
Total Electric Utility Activities - Bonds and Loan Payable				<u>\$ 199,675,769</u>	<u>\$ 3,550,000</u>	<u>\$25,002,577</u>	<u>\$ 227,162,726</u>	<u>\$6,490,000</u>

A. Subordinated Electric Revenue Refunding Bonds, 2003 Series A

On October 9, 2003, SVP issued \$100 million of the Subordinated Electric Revenue Bonds, Series 2003A (Electric 2003A Bonds) to finance a portion of the Donald Von Raesfeld Power Plant. The Electric 2003A Bonds mature annually in serial amounts from July 1, 2005 to July 1, 2025 with the final Term Bond maturity of July 1, 2028 and bear coupon rates ranging from 2.50% to 5.25%. Debt service on the Electric 2003A Bonds is secured by a pledge of net revenues of the Electric Utility Enterprise Fund. The Electric 2003A Bonds were refunded on April 24, 2013 by the Electric 2013A Bonds described below and were redeemed in full on July 1, 2013. The difference between cash flow required to service the Electric 2003A Bonds and the Electric 2013A Bonds is \$17.0 million. The present value savings of the refunding at the effective interest rate is \$14.1 million.

B. Electric Revenue Refunding Bonds, 2008 Series B

On May 29, 2008, SVP issued \$86.6 million of the Subordinated Electric Revenue Bonds, Series 2008B (Electric 2008B Bonds) to refinance \$80.53 million of the Electric 1998A Bonds on July 1, 2008. The Electric 2008B Bonds mature annually in serial amounts from July 1, 2009 to July 1, 2027. The Electric 2008B Bonds are multi-modal bonds that are authorized to be issued in variable mode. Initially, the Electric 2008B Bonds were issued in the Weekly Mode. Payment of the principal of and interest on, and purchase price of, the Electric 2008B Bonds are made from proceeds of draws on the Letter of Credit 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 re-designated from “Subordinated Electric Revenue Refunding Bonds” to “Electric Revenue Refunding Bonds” to

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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

reflect that all senior electric revenue bonds of SVP have 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. Debt service on the Electric 2008B Bonds is secured by a pledge of net revenues of the Electric Utility Enterprise Fund.

C. Electric Revenue Refunding Bonds, 2011 Series A

On March 22, 2011, SVP issued \$54.83 million of Electric Revenue Refunding Bonds, 2011 Series A (Electric 2011A Bonds) to refinance the \$49.66 million outstanding principal amount of the Electric 2008A Bonds. The Electric 2011A Bonds mature annually in serial amounts from July 1, 2028 to 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.

D. 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 refund and defease the City's outstanding Electric 2003A Bonds. The Electric 2013A Bonds mature annually in serial amounts from July 1, 2014 to 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.

E. Bank of America Loan Agreement

On March 16, 2014, the City/Silicon Valley Power (SVP) issued a Subordinated Electric Revenue Bond under a Loan Agreement with the Bank of America Preferred Funding Corporation to fund the acquisition and integration of a phase-shifting transformer and the acquisition of property. The loan is a tax-exempt multiple draw term loan, allowing SVP to draw funds corresponding to the need for funds. The first draw occurred on June 16, 2014 for approximately \$24.3 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 will occur in April 2015 for \$6 million to cover the construction and commissioning of the Phase Shifting Transformer. The loan terms allow the City to capitalize the interest for up to two years so that no payments are due until July 1, 2016. As the installation of the Phase Shifting Transformer is expected in December 2015, this allows the loan repayment schedule to coincide with the cost of savings from this installation, thereby avoiding any impact to the electric utility's bottom line. The loan carries an interest rate of 2.67% and the final payment is due on July 1, 2024.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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

F. Pledges of Future Electric Revenues

The pledge of future Electric Fund revenues ends upon repayment of the \$219 million in remaining debt service on the bonds which is scheduled to occur in fiscal year 2032-33. For fiscal year 2013-14, Electric Fund revenues including operating revenues and non-operating interest earnings amounted to \$306 million and operating costs including operating expenses, but not interest, depreciation or amortizations amounted to \$289 million. Net revenues available for debt service amounted to \$17 million which represented coverage ratio of 1.41 over the \$12.2 million in debt service.

G. 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, Santa Clara 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). Santa Clara’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 6/30/2014	City Pays Variable Rate on Bond 6/30/2014
2008 Series B	\$72,620	3.47%	Weekly Mode - 65% of LIBOR=0.09845%	Weekly Mode - SIFMA=0.06%

The swap is classified as a debt instrument and had negative fair values of \$9,647,278 as of June 30, 2014, and \$10,372,474 as of June 30, 2013, resulting in a deferred outflow change of \$725,196 from June 30, 2013. The swap is classified as a deferred outflow of resources and derivative financial instrument on the statement of net position. The fair values were based on

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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

mid-market levels as of the close of business date on June 30, 2014 and June 30, 2013, respectively. The values were estimated from proprietary models based upon well recognized financial principles and reasonable estimates about relevant future market conditions.

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, 2014, 65% of weighted average on weekly mode LIBOR was 0.09845% and the SIFMA rate was 0.06%. Using rates as of June 30, 2014, 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	Total
	Principal	Interest	Swaps, Net	
2015	\$ 3,760,000	\$ 45,384	\$ 2,550,240	\$ 6,355,624
2016	3,975,000	43,128	2,423,470	6,441,598
2017	4,200,000	40,743	2,289,451	6,530,194
2018	4,440,000	38,223	2,147,846	6,626,069
2019	4,685,000	35,559	1,998,149	6,718,708
2020-2024	27,550,000	132,414	7,440,674	35,123,088
2025-2029	27,030,000	41,283	2,319,795	29,391,078
	<u>\$ 75,640,000</u>	<u>\$ 376,734</u>	<u>\$ 21,169,625</u>	<u>\$ 97,186,359</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
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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 the following future derivative instruments outstanding at June 30, 2014 with Bache Commodities to hedge cash flows on CAISO NP15 power purchases:

Objective	Notional Amount (MWh)		Effective Date	Maturity Date	Average Price	Classification	Fair Value		Change in Fair Value	
	Long	Short					Amount	Classification	Amount	
Hedge cash flows on NP15 power purchases	246,400	-	Various	Jul-14 to Sep-14	\$56.50	Derivative Instrument	\$ 108,384	Deferred inflow	\$ 108,384	
Hedge cash flows on NP15 power purchases	123,200	-	Various	Oct-14 to Dec-14	53.50	Derivative Instrument	(203,040)	Deferred outflow	(203,040)	
Hedge cash flows on NP15 power purchases	244,000	-	Various	Jul-14 to Sep-14	44.38	Derivative Instrument	(300,200)	Deferred outflow	(300,200)	
Hedge cash flows on NP15 power purchases	97,700	-	Various	Oct-14 to Dec-14	46.13	Derivative Instrument	(182,958)	Deferred outflow	(182,958)	
							<u>\$ (577,814)</u>		<u>\$ (577,814)</u>	

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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

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, 2014, SVP was exposed to credit risk because certain open derivative contracts were in asset positions. However, should interest rates change and the fair market value of the swap become negative, the City would not be exposed to credit risk in the amount of the fair market values. The swap and open contract counterparties were rated A and BBB, respectively, by S&P at June 30, 2014.

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, Pierce, Fenner & Smith, Inc. and Bache Commodities, the trading accounts are prefunded by SVP. If the account value falls below zero, margin calls are invoked. At June 30, 2014 SVP had posted collateral of \$4,132,508 on the interest rate swap and \$3,460,979 was deposited with Merrill Lynch, Pierce, Fenner & Smith, Inc., CAISO and Bache Commodities for wholesale trading. At June 30, 2014, no margin calls were paid to Bache Commodities on the outstanding future derivative instruments.

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, 2014 SVP had various derivative instrument purchase contracts with Bache Commodities.

Termination Risk

The swap may be terminated by the City at any time. If the swap is terminated, the City 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 Santa Clara would be payable from net revenues of the electric system subordinate to Santa Clara'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 the City. 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

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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

exposed to risk because the commodity purchase price being hedged is different from the price on settlement.

H. 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.

I. Repayment Requirements

As of June 30, 2014, the debt service requirements to maturity for SVP’s long-term debt are as follows:

Year Ending	Long-term Debt		
	Future Debt Service Requirements		
June 30	Principal ⁽¹⁾	Interest ⁽²⁾	Total
2015	\$ 6,485,000	\$ 5,730,290	\$ 12,215,290
2016	7,280,000	5,621,059	12,901,059
2017	9,318,031	6,321,466	15,639,497
2018	11,416,000	6,128,041	17,544,041
2019	11,897,000	5,868,855	17,765,855
2019-2024	68,128,000	24,765,011	92,893,011
2025-2029	62,150,000	17,355,960	79,505,960
2030-2033	49,745,000	5,601,972	55,346,972
	<u>\$ 226,419,031</u>	<u>\$ 77,392,654</u>	<u>\$ 303,811,685</u>

(1) The second draw down loan in the amount of \$6,000,000 on April 15, 2015 and the capitalized interest loan of \$1,134,031 on January 1, 2015, July 1, 2015 and January 1, 2016 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, 2014.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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

Reconciliation of Long-term Debt:

Principal Outstanding As Of 6-30-2014	\$ 219,285,000
Unamortized Discount/Premium - Electric Revenue Bonds	<u>7,877,726</u>
Total Long-term Debt	<u>\$ 227,162,726</u>

J. Defeasances

There is no defeased debt for the SVP as of June 30, 2014.

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).

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

	NCPA	TANC	MSR PPA	MSR EA
Date of latest audited financial statement	6/30/2013	6/30/2013	12/31/2013	12/31/2013
Participant's address	651 Commerce Dr. Roseville, CA 95678	P.O. Box 15129 Sacramento, CA 95851	P.O. Box 4060 Modesto, CA 95352	P.O. Box 4060 Modesto, CA 95352

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

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, 2013:

	NCPA				TANC	MSR EA	MSR PPA
	Geothermal	Hydroelectric	Combustion Turbine	Lodi Energy Center			
Participation percentage	44.39%	37.02%	41.67%	25.75%	20.96%	33.40%	35.00%
Investment		\$36,126,824			\$ 3,174,034	\$ -	\$ -
Method of accounting		Equity			Equity	Suspended	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 fourteen 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 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

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

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

NCPA owns Geothermal Plants completed in 1988, in the Sonoma/Lake County area of California. Santa Clara has 44% of the production of the plants. These 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 five 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 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, Santa Clara entered into an agreement with NCPA for a 25.75% interest in 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 late 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,

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

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, 2013, the most recent data available, TANC's investment in the Project was \$506.9 million, less accumulated depreciation and amortization of \$213.7 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 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.

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, 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.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

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, 2013, the date of the latest available audited financial statements, SVP’s unrecognized share of member’s deficit of MSR PPA was \$30.9 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, 2013, 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 is also a participant in the Southwest Transmission Project, a 500-kilovolt alternating current transmission project between Central Arizona and Southern California that provides a firm transmission path for the electric power from the San Juan Plant to the MSR 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, MSR 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 Iberdrola 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%

On December 9, 2009, MSR PPA entered into a series of agreements with Iberdrola 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 firmed, shaped, and delivered to the California-Oregon Border (COB) for a twenty-year period.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

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%.

The City'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, 2013, the date of the latest available audited financial statements, the City's unrecognized share of member's deficit of MSR EA was \$44.3 million. Under the joint exercise of power agreement, which formed MSR EA, the City 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, 2013, the City 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, 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, 2013, 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, 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.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 6 – PARTICIPATION IN JOINT VENTURES (continued)

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, 2013 as follows:

Agreements	Total Debt	Silicon Valley Power's Debt Share	Silicon Valley Power's Contingent Liability
NCPA 06/30/13	\$ 850,850,000	31.89%	\$ 271,350,649
TANC 06/30/13	343,195,000	20.96%	71,940,671
MSR PPA 12/31/13	290,330,000	35.00%	101,615,500
MSR EA 12/31/13	901,620,000	55.48%	500,200,000
TOTAL	<u>\$ 2,385,995,000</u>		<u>\$ 945,106,820</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, 2013 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%	29.7824%
TANC - CA-OR Transmission Project (COTP)	May-2024	20.4745%	20.9620%
MSR PPA -San Juan Plant	July-2022	35.0000%	35.0000%

** The SVP's debt service share in NLEC on issue one is 46.1588%, on issue two is 0%.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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, 2013 is as follows:

Fiscal Year	NGP	NHP	NLEC	COTP	MSR PPA	Total
2014	\$ 2,131,625	\$ 15,034,308	\$ 7,714,210	\$ 8,888,500	\$ 13,418,300	\$ 47,186,943
2015	2,263,406	14,575,614	7,713,818	8,888,585	14,120,400	47,561,823
2016	2,267,016	14,582,142	7,715,155	8,960,672	13,265,700	46,790,685
2017	2,267,879	14,600,914	7,715,876	8,167,346	12,915,700	45,667,715
2018	2,268,241	14,300,656	7,715,539	8,166,685	12,778,850	45,229,971
2019-2023	11,374,190	70,515,851	38,575,283	40,821,421	59,379,950	220,666,695
2024-2028	3,247,454	54,227,603	38,589,013	6,388,853	-	102,452,923
2029-2033	-	40,921,388	38,619,608	-	-	79,540,996
2034-2038	-	-	38,618,066	-	-	38,618,066
2039-2042	-	-	22,527,488	-	-	22,527,488
Total	<u>\$ 25,819,811</u>	<u>\$ 238,758,476</u>	<u>\$ 215,504,056</u>	<u>\$ 90,282,062</u>	<u>\$ 125,878,900</u>	<u>\$ 696,243,305</u>

NOTE 7 – 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

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

**NOTE 7 – RESTRUCTURING OF THE CALIFORNIA ELECTRIC INDUSTRY
(continued)**

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.

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

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

**NOTE 7 – RESTRUCTURING OF THE CALIFORNIA ELECTRIC INDUSTRY
(continued)**

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 \$28.9 million and \$28.6 million, respectively, for fiscal year ended June 30, 2014, 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 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.

**CITY OF SANTA CLARA ELECTRIC UTILITY ENTERPRISE FUND
(SILICON VALLEY POWER)
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 8 – 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:

Supplier	Power Purchased	% of the Total Purchased Power
M-S-R Public Power Agency	\$ 57,002,457	26.94%
NCPA	\$ 68,894,871	32.56%
TANC	\$ 12,515,335	5.91%
CAISO	\$ 29,669,302	14.02%

NOTE 9 – 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:

	Authorized	Expended Through June 30, 2014	Remaining Commitments
Electric Projects	\$ 83,757,553	\$ 27,066,703	\$ 56,690,850

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